THE ANALYST
MARYLAND CAPITAL MARKET OVERVIEW

Q2 2018

ECONOMIC INDICATORS MAY NOT FAVOR NEW DEVELOPMENT

Three events stood out to me in the previous quarter.

- The Federal Reserve has raised the federal funds rate from 1.75% to 2% - signals that more increases are to come
- Unemployment Rate was reported at 3.8%
- A looming trade war has been escalating across the world

The one thing I think that all three of these items will directly effect is construction costs. As the federal funds rate increases, construction loans that are often floating over LIBOR (London Inter-bank Offered Rate) will likely increase. This low of an unemployment rate means there is not an excess supply of labor ready to be hired for construction projects and wages are likely to rise. Construction wages have increased by about 3.5% year over year. The potential for a trade war or even tariffs on raw materials such as aluminum and steel will increase the costs of any new construction.

These three factors may adjust an investors eyes to high quality existing assets that don't require much capital improvement as opposed to ground up development that will require capitalized loans at now increased rates, labor that is increasing in cost and demand, and raw materials that may be subject to new tariffs.

This could explain some of what we are seeing in the market place. Cap rates are holding at all time lows despite increases in lending costs. The value of non-residential or civil construction starts from January – April in 2017 and January – April 2018 decreased by 27.2%.

With the economy continuing to grow, absorption potential is out there. Buying some vacancy in a quality building may be a successful strategy over the next few years as development will become more expensive. Also, a development project may not deliver for two plus years where there is significant uncertainty with the economy.

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