Multifamily Market Commentary – March 2017

Multifamily Construction Costs Still Escalating

Last year, approximately 343,000 apartment rental units were delivered nationwide. The number of deliveries is expected to increase this year as nearly 404,000 apartment rental units are underway and expected for delivery in 2017. Alongside the increased level of new multifamily construction, costs have also been rising. According to RSMeans data, used with permission from Gordian, the average cost nationwide of constructing a new multifamily building consisting of between 8 and 24 stories was approximately $31.5 million in 2016, compared to $29.9 million in 2015 and up more than 10 percent compared to 2014’s cost of $28.5 million.

In fact, the cost of construction for all types of new multifamily buildings has increased every year over the past four years, as illustrated in the tables below. And 2017 is not expected to be any different, with the cost estimated to be approximately $33.7 million for an 8 to 24 story building, a nearly 20 percent increase in just a few years.

Big Differences in Costs

There are two primary categories of sub-costs that factor into the construction of a new multifamily building: Hard costs, which include the actual building materials, equipment, and other supplies; and soft costs, which include engineering and architectural costs, labor costs, and other miscellaneous fees. Increases in both of these categories have contributed to overall construction costs, which also vary widely by metro. Unsurprisingly, costs in major gateway metros, such as New York City, Boston, Los Angeles, and Washington, D.C., are considerably higher on average than compared to other metros.

Costs Up for All Building Types

For buildings made from different variations of concrete, from 2014 through 2016, costs have ranged from $3.3 million for 1-to-3 story buildings all the way to $33.7 million for 8-to-24 story buildings. As expected, construction costs for 8-to-24 story buildings have the highest costs. As seen below, total construction costs for these taller buildings started at $28.2 million in 2013 and are projected to escalate to $33.7 million in 2017. The cost per square foot also started at $194.60 in 2013 and expanded 20 percent in 2017 to $233.

The chart on the following page illustrates how construction costs have increased since 2013. For 1-to-3 story buildings, overall construction costs rose by approximately $1.0 million from 2013 to 2017 (forecast), representing a 30 percent increase. The nominal increase in expected construction costs of 4-to-7 story buildings over the same time period is slightly higher, up $1.4 million to $11.5 million, an increase of 14 percent.
Hard Construction Costs vs. Soft Construction Costs

RSMeans data breaks down hard costs into six different categories:

- Substructure
- Shell
- Interiors
- Services
- Equipment
- Furnishings

The substructure category involves foundations, walls, and the more structural elements of construction. The shell category includes flooring, window construction, and roof construction. On a national level, the shell category equates to approximately 20 percent of total multifamily construction costs in 8-to-24 story buildings. Interiors include partitions, doors, finishes, and stairs. Services includes elevators, plumbing, energy supply, and piping. Equipment and furnishings consist of architectural equipment and furnishings that are part of the finished building. The Services category is actually the most expensive in multifamily construction, as seen in the chart on the next page, accounting for nearly 29 percent of total project costs in 8-to-24 story buildings.

The soft costs portion of multifamily construction are consolidated into a single category. According to RSMeans data, soft costs include contractor fees, architectural fees, and, occasionally, user fees. Nationwide, in 8-to-24 story buildings, contractor fees account for approximately 25 percent of the total multifamily construction costs. The chart shows the average hard costs in blue, soft costs in orange, and total construction costs in gray, for new apartment construction of 8-to-24 story buildings during 2016.
Construction Costs Top Out in Top Metros

As seen in the following chart, the three most expensive metros for all three categories of multifamily construction are New York City, San Francisco, and Boston. Even with all the construction taking place in the nation’s capital, Washington, D.C. remains a bargain at less than—albeit slightly—the national cost of constructing new apartment buildings. This is likely the reason that multifamily construction took off in the nation’s capital: increased net migration, job growth, rising renter population, all coupled with relatively cheaper construction costs.

The data also explains the increase in Class A rental properties in high-cost metros such as New York City and San Francisco. With such high construction costs, even with local tax subsidies it is likely that only these type of more expensive properties will “pencil out” for most developers.

Note: Furnishings are included in Equipment.

Source: RSMeans
Expect Construction Costs to Keep Rising

Of the 343,000 new apartments delivered in 2016, approximately 79,000 were delivered in New York City, Washington, D.C., Boston, Los Angeles, and San Francisco combined. In 2017, the number of new apartments delivered to these metros is expected to increase to 81,000. A large percentage of the nation’s new multifamily rental supply is being delivered to a few metro areas, and it appears that much of the construction is in the Class A tier.

Although we expect the new supply being delivered in most of these metros over the next 12-to-24 months will outpace demand, actual construction costs are not expected to moderate. Land costs are the only variable that may decline, if developers back off from new acquisitions, but many other costs, including lumber, concrete, and steel, are not dependent upon rental supply and demand. Fees could decrease if municipalities see a fall-off in permits, but it would likely take a prolonged decline for any action to be taken. More likely, costs will remain elevated, as projected, but the pace of development will slow starting in late 2018.

Francisco Nicco-Annan
Multifamily Economist

Multifamily Economics and Market Research
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