What's Really Happening With New York City Construction Costs?

Over the past few years, I have been working to improve my understanding of the New York City land sales market and land sales business. Construction costs are clearly an aspect that has a profound impact on that market and business.

Two developers recently told me they priced construction jobs — jobs they had also priced about a year ago. The new quotes were 15 percent and 20 percent lower than the quotes received 12 months ago. This was surprising to me and made me think that, if this really was the case, it would have an immediate impact on land values. I spoke to a couple of other developers to get their opinions, and they were surprised as well. This prompted me to seek out a larger statistical sample to try to understand what was really going on here.

Robert Knakal.

I sent an email to all of the developers in our database asking for feedback on the direction of construction costs to try to get a consensus about what reality was. I received 87 responses, some of which were short and to the point while others were much more detailed. Here are the general themes that came out of this that address five major component issues: material costs, supply chain issues, the development pipeline, wages and profit margins.

On the material cost side, the consensus was that a few materials may have come down in price, such as lumber and steel, over the past 12 months, but these costs were relatively unchanged from 2019. The big drop in lumber prices appears to be due to the significant price spike during the pandemic. Generally, it was expected that the cost of materials would increase just 2 to 3 percent this year.

With regard to supply chain issues, it appears those issues have mostly abated and are not impacting the market at present. Some developers are ordering sooner in the development process than they have historically, but the consensus is that the impact is marginal and things should be completely back to normal by the end of 2023.

Regarding the pipeline of construction projects, there appears to be a big air bubble forming as the expiration of the Affordable Housing New York tax abatement program, known as 421a, has slowed land sales, particularly in the outer boroughs. Even those sites where owners rushed to get a footing in the ground by June 15 of last year, to vest their sites in the program, are experiencing issues. Many larger sites are not moving forward, as they may not be able to obtain their temporary certificates of occupancy (TCOs) by June 15, 2026, which is necessary for the site to receive the benefits of the 421a program.

The sites that are not impacted by the program's expiration — condo sites, particularly in prime Manhattan — have been impacted since early September by a rapidly changing financing market that has materially changed the construction loan market. The sites that have stalled are adding to this growing air bubble.

While there seems to be no downward pressure on wages, the slowdown in the pipeline is impacting the profit margins that contractors are expecting, although that dynamic differs from contractor to contractor depending on what their individual pipelines look like. For instance, demolition contractors were extraordinarily busy leading to the expiration of 421a as owners rushed to vest sites into the program. Today there is much less work to do, so they may be willing to take a smaller profit on jobs to keep workers working.

Probably the most impactful thing to watch relative to construction costs is how long we go without a tax abatement program. To get things moving, a three- or four-year extension of the June 2026 deadline to get a TCO would get about 15,000 units started within 30 days. The legislature getting 421a back on track would also deflate the air bubble.

A restoration of the major capital improvement (MCI) and individual apartment improvement (IAI) programs would also put thousands of contractors back to work renovating the tens of thousands of units sitting vacant due to the regulation changes implemented in June 2019. In the absence of these moves, work for contractors will grow more challenging.

Robert Knakal is chairman of New York investment sales at JLL.