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Rising construction costs nibble at federal infrastructure funds

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Add stress in the regional banking sector to the bevy of pressures facing the construction industry.

Small and medium banks are tapping the brakes on construction loans as they struggle to manage interest rate-related pressures that sparked some failures.

"It's surprising, the reach of those banks," said Julian Anderson, president of Rider Levett Bucknall North America, which this week released a pair of industry snapshots detailing construction costs and activity. "They do quite a lot of lending for construction and uncertainty for those banks means they are having to pull back on construction lending because they don't have the funds."

"We still have a construction cost inflation problem, it's just not as bad as its been the last couple years," said Julian Anderson, president of Rider Levett Bucknall North America. ***Rider Levett Bucknall***

Tightened lending standards, which have prompted some developers to pull out of projects, coupled with near-record inflation and unemployment come just as federal infrastructure funds are finally hitting the state and project level.

The 2021 Infrastructure Investment and Jobs Act and the 2022 Inflation Reduction Act together invested $1.25 trillion across the transportation, energy, water, and broadband sectors for the next five to 10 years, according to Brookings.

The federal funding marks a bright spot, RLB said, as it will cushion the construction industry if it tips into a recession as Anderson said many expect.

"The good news is if there's a slowdown in construction, the IIJA will help alleviate some of that distress," Anderson said.

The bad news is that inflation is eating away at those funds, Anderson said. Brookings, in a February report, noted that if inflation was 2.3% higher each year than expected, "it would effectively cause infrastructure industries to lose $137 billion in estimated buying power via federal spending." If inflation came in at

4.7% annually, "the federal government would effectively be spending as much on infrastructure in 2027 as it did in 2021 in constant dollars—hardly the massive leap Congress intended."

RLB's latest found that construction costs report noted the annual year-over-year inflation rate was 8.11%. That compares to a first-quarter increase of 5.4%, Anderson said.

"That's a better number," he said of the first quarter. "But it's compounding, so if you keep having these large increases year over year, it aggravates the cost problems," he said. "We still have a construction cost inflation problem, it's just not as bad as its been the last couple years."

The firm also tracks the number of fixed cranes on construction sites across 14 major North American cities on a biannual basis, and the latest report shows that crane activity nationally increased by 7% from the Q3 2022 report.

Of the 14 cities, eight have seen an increase in cranes, two a decrease and four remained flat. Chicago is down four cranes from the last report, to a total of 14, all of which are residential except for three cranes at the Obama Museum. New York City is also down, to 10 from 14, RLB said. Denver, Honolulu, Phoenix, Seattle and Las Vegas have all seen increases in cranes.