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Boxed out: Supply chain, energy crises rock real estate

Climbing costs have landlords and developers feeling the squeeze — with winter looming

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(Photo-illustration by Paul Dilakian)

With huge heating bills looming, Valentina Gojcaj moved quickly to lock in energy rates and keep her tenants warm through the winter months.

The mere threat of rising demand amid a global energy crunch has landlords worried that the cost of heating oil could rise to a whopping $4 per gallon this winter, Gojcaj, who owns three buildings in the Bronx, said. She immediately began spot pricing, hoping to secure a low rate in advance.

“Each day it was like biting our fingers,” Gojcaj said.

The best she could do was $2.65 per gallon, or roughly $265,000 to heat the units in her portfolio through spring. Now she prays it will be enough to avoid buying more at higher rates in the dead of winter.

Real estate is feeling the ripple effects of global crises: climbing property-management bills are lightening landlords' wallets, while shipment delays, rising material costs and supply shortfalls are making it hard to finish projects, repairs and renovations on time.

To accommodate these disruptions, property managers are hunting for low oil prices before a winter hike, begging for more emergency assistance to help compensate for higher costs and seeking out alternative measures to save on energy use.

Meanwhile, developers are scrambling to score construction loans and building materials ahead of time and advising their partners to source alternative materials and reevaluate their cost models for projects.

Despite these attempts to be proactive, many in the industry are feeling powerless.

"I don't think there's really anything anyone can do regarding the energy problems we're having,'' said Matt Duthie, incoming chairman of the Building Owners & Managers Association of New York, an industry trade group. "I think it's just being aware that we're going to be at the mercy of utilities for a while."

Out of gas

Sourcing fuel to heat buildings has become both a gamble and a waiting game.

Crude oil and natural gas prices have skyrocketed, climbing to eight- and 12-year highs (https://therealdeal.com/2021/10/07/landlords-brace-for-winter-as-natural-gas-costs-soar/) , respectively, in October. Prices have since fluctuated, thanks to a warmer-than-usual autumn, though the cost of natural gas is still almost twice (https://markets.businessinsider.com/commodities/natural-gas-price) what it was last year.

Natural gas prices reached historic lows (https://www.eia.gov/todayinenergy/detail.php?id=46376) last year as offices, businesses and schools emptied by the pandemic lowered their thermostats. Some of that excess supply was depleted last winter when extreme weather roiled power grids in states such as Texas.

This year, relaxed lockdown policies, coupled with the hottest summer on record (https://www.noaa.gov/news/summer-2021-neck-and-neck-with-dust-bowl-summer-for-hottest-on-record) , drove up electricity usage across the country. Heightened demand for natural gas exports ultimately led to a deficit in storage.

As of October, storage levels were about 3 percent lower than their five-year average,

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according to the U.S. Energy Information Administration.

"Mild weather has limited natural gas consumption and helped bring our storage levels closer to average in recent weeks, but cold winter weather could continue to put upward pressure on prices," the agency said in November.

It’s an unwelcome change of pace for landlords like Gojcaj, who said she was fortunate to have had reasonable energy costs during the last three heating seasons. The rate she locked in this year was 2.5 times what she paid a year ago.

Nationwide, households that use propane can expect to spend 54 percent more, on average, to heat their homes this winter than last year, according to the EIA’s winter fuels outlook (https://www.eia.gov/outlooks/steo/report/WinterFuels.php) . Homes that use heating oil will see their bills jump 43 percent, compared to 30 percent for homes that use natural gas and 6 percent in homes heated with electricity.

With multifamily owners forking over more funds to keep buildings warm, tenants may bear the brunt of the uptick.

“The delays, the increases just don’t bode well for owners, and consequently, the tenants that are in these buildings,” Duthie said.

To offset her energy cost uptick, Gojcaj is banking on assistance from the state. But it’s a shaky foundation to lean on, with New York’s Emergency Rental Assistance Program short at least $3 billion (https://therealdeal.com/2021/09/21/new-yorks-rent-relief-fund-may-run-dry-monday/) . A separate fund released in October for property owners whose tenants did not apply for rent relief contains $125 million (https://therealdeal.com/2021/10/07/125m-for-landlords-with-deadbeat-tenants-now-up-for-grabs/) , a fraction of the shortfall, and priority will be given to landlords with 20 or fewer units.

“Release the funds so that landlords can pay for oil. Release the funds so that landlords can pay for their mortgage. We want to pay our supers,” Gojcaj said. “It’s heartbreaking.”

The Real Estate Board of New York said that it anticipated buildings would have higher costs this winter and would address any issues it received from its members in the coming months.

Caught in a bind, some property owners have resorted to other energy-saving measures, creating opportunities for certain businesses. Radiator Labs, for one, produces an insulated smart radiator cover designed to eliminate overheating in steam-heated buildings.

“The type of buildings we’re looking at are older buildings that are heated by radiators,” said Radiator Labs’ Matthew Isaacs. “In the multifamily space, the problem is more apparent because people live in these spaces. Management will hear about residents being uncomfortable, either overheated or underheated, much more often than in an office building.”

A broken chain

For some developers, like Slate Property Group's David Schwartz, most aspects of the global energy crisis have been on the back burner. Schwartz's portfolio includes buildings that run on electricity, natural gas and oil, and the back and forth has left him feeling jaded.

"Maybe it will be a really big thing to worry about, but a lot of us are having this 'wait and see' approach because, frankly, there's not much we can really do about it," Schwartz said.

He's more concerned about ongoing supply chain disruptions that have driven up construction costs (https://therealdeal.com/2021/08/10/rising-construction-costs-threaten-the-homebuilding-boom/) and slowed down production to the point that scheduling material shipments has become difficult.

A series of hitches led to the crisis: The pandemic crippled ports and factories at a time when consumers were ordering more stuff, leading to backlogs and bottlenecks.

Even as ports reopen, shortages in goods, employees, equipment and space have exacerbated the problems, leading to scheduling delays and higher freight rates.

The backups make it harder for developers like Schwartz to get their hands on items such as windows. It's hard to schedule shipping from one port to the next with items being delivered to unique locations that may or may not have the ships or containers needed to keep them moving.

Those disruptions add time and money to projects, which could ultimately hurt the most vulnerable tenants, Schwartz said.

"We already have so many people who can't afford their rent," he said. "If costs go up, it's going to drive rents up for new product, which is going to make the affordability crisis even worse and make it harder and more expensive to produce new affordable housing."

> **"Why should we put ourselves in a position where we're not going to have the funds to build jobs from the start?"** MARK BOYLE, TURNER CONSTRUCTION

It hasn't been easy for construction companies, either. Delays in procuring engineered wood, windows and garage doors are just a few of the disruptions that caused homebuilding giant Lennar to fall about 600 homes behind third-quarter projections that had already been lowered (https://therealdeal.com/2021/09/21/lennar-falls-short-on-home-deliveries-blames-supply-chain/) .

The crunch comes as builders are scrambling to keep up (https://therealdeal.com/2021/05/27/builders-fall-behind-on-construction-of-sold-homes/) with record demand (https://therealdeal.com/2021/04/15/us-needs-4m-homes-to-meet-demand-from-buyers/) for new homes. The shortage has helped drive home prices through the roof (https://therealdeal.com/2021/09/29/all-the-way-up-home-price-growth-broke-record-for-4th-straight-month-in-july/) in markets across the country.

A recent survey by the National Multifamily Housing Council found that things are worse now than earlier in the pandemic, with mounting pressure on construction materials and project pricing, said NMHC's Paula Cino.

"Early on, we could point to specific projects or production regions where there were delays. Now, we see volatility across the board," Cino said. "It's really damaging because it's unpredictable what products we're going to have a problem with next."

Critical components bought in bulk by the apartment industry, such as flooring and lighting fixtures, have been a major concern for the group's members, she added.

But perhaps one of the biggest struggles is a shortage of microchips. Turner Construction, one of New York City's largest general contractors (https://therealdeal.com/issues_articles/new-yorks-biggest-general-contractors-ranking/) , said that the shortage has caused delays in getting air handling units, emergency generators for hospitals, excavators and more.

"We now anticipate that we are going to have a shortage in excavation equipment coming in this next year because of not being able to get chips to operate our excavators, our dump trucks," said Mark Boyle, Turner's chief procurement officer. He expects higher excavation prices as a result.

The effects have been felt in the office sector, too, where investors are opting to repurpose office buildings in light of uncertainties surrounding the future of in-person work, said Ruth Colp-Haber, president of leasing brokerage Wharton Property Advisors.

Residential, health care and educational space is in higher demand, Colp-Haber explained, but repurposing office buildings for those uses typically requires construction, which faces mounting uncertainties surrounding timelines and costs.

It’s why Boyle has been talking to industry groups, contractors, developers, financial institutions — anyone he can reach — and advising them to reevaluate their cost models for future jobs.

Developers typically build a certain amount of escalation into their anticipated cost models, but the model they used over the past decade may not fit in with projects needed in the short term, Boyle said.

“We’re finally getting more of our developers and banks listening to us that this is an effect that we have to consider for the future,” Boyle said. “We’re dealing with it today, but why should we put ourselves in a position down the road where we’re not going to have the funds to build our jobs from the start?”

A collision course

Though the energy crisis and supply chain shortage are unique issues, Boyle views them as intertwined.

“The biggest cost of shipping, whether it’s ocean, air or inland is your fuel,” Boyle said. Even when lumber prices receded (https://therealdeal.com/2021/07/01/lumber-prices-are-splintering/) from historic highs over the summer (before rising (https://therealdeal.com/2021/10/01/lumber-prices-back-on-the-rise/) yet again in October), it remained a hassle to transport items in wooden crates from one place to another, Boyle said.

Soaring prices have truck stops limiting how much diesel fuel drivers can buy, the trucking industry publication Overdrive reported (https://www.overdriveonline.com/business/article/15281174/diesel-fuel-shortage-hits-truck-stops-across-america) in November.

Though President Joe Biden came to agreements with leaders at the nation’s ports allowing them to operate 24/7 to ease delays, Boyle is skeptical of that solution. He’s been advising architects and engineers to use multiple suppliers, plan for material use months in advance, and allow for substitutions.

"The biggest successes our members have had with dealing with these kinds of disruptions is just growing their suppliers and thinking outside the box about what alternatives — be it a specific material or design alternative — can overcome the current challenge," Cino added.

But there's no escaping the price surge. Members of the NMHC reported a 13 percent average increase in material costs, Cino said.

Some companies have been submitting requests for construction loans faster and making draw requests in an attempt to bulk up on construction materials, said Jay Neveloff, chair of the real estate department at the law firm Kramer Levin. But even that can become a challenge when warehouse space is running out (https://therealdeal.com/tristate/2021/11/05/no-vacancy-new-jersey-warehouse-space-effectively-sold-out/) .

He's had discussions with investor clients who have asked whether supply chain delays will trigger inflation as sellers and merchants respond to shortages by raising prices, whether or not they're justified.

"It's more of a macroeconomic concern," Neveloff said.

The Consumer Price Index soared 6.2 percent on an annual basis in October, the highest jump in 31 years. It was the fifth consecutive month in which the annual inflation rate was at least 5 percent. The category that saw the largest increase was fuel oil, up 59 percent year over year and 12.3 percent from September.

"As the cost of a project goes up or becomes unviable, the investment rent becomes less attractive," Cino said. "If our space becomes unattractive or the costs are too steep and uncertain, that capital and that investment looks elsewhere. It's a very real risk that we lose out on investment that is much needed in the apartment sector."

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