CBRE

Chicago Office Construction Cost Trends

Increasingly Expensive to Build

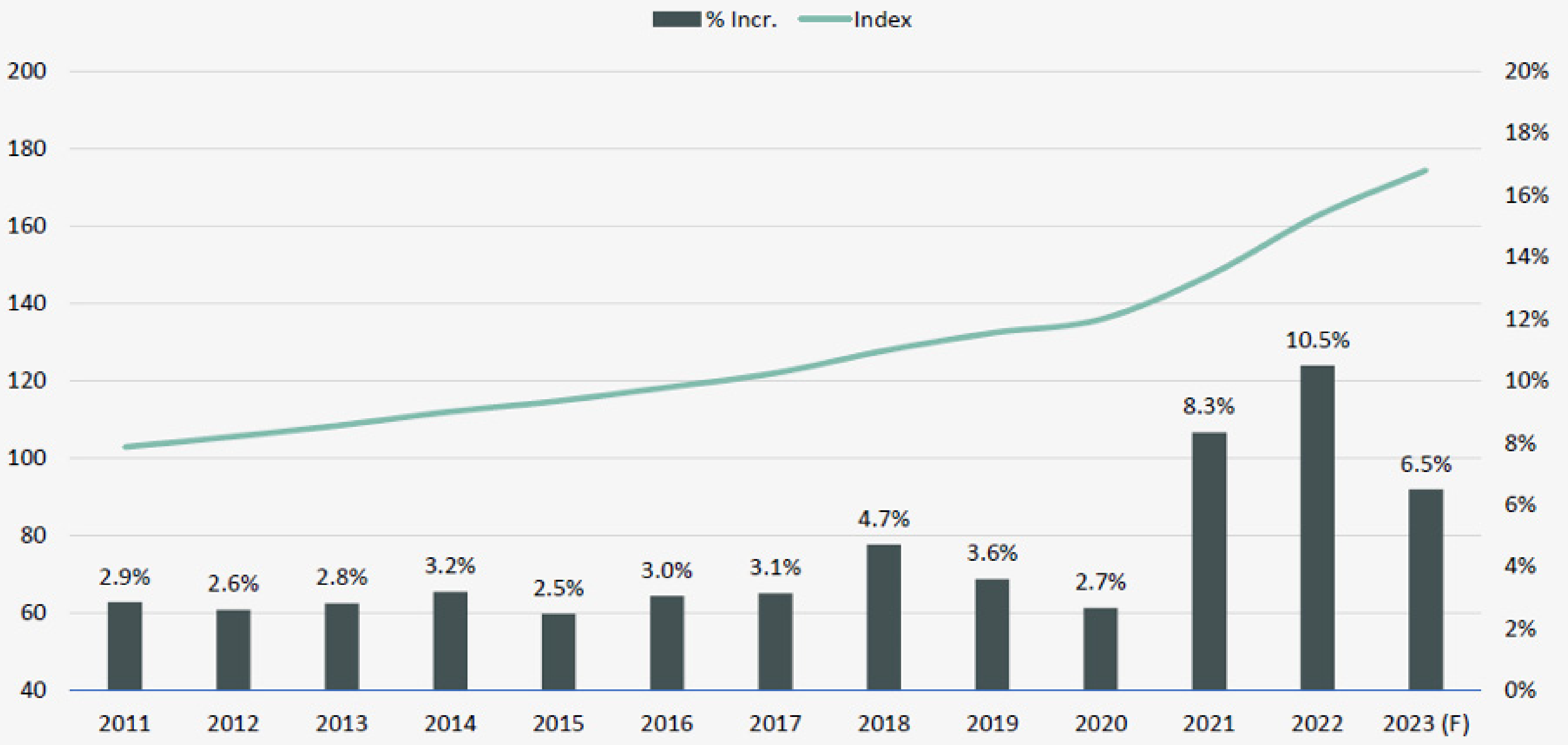
Construction cost escalation continued in 2023, and clients are finding was to be more efficient with space.

In the Chicago market, new leasing square footage is down compared to last year. However, the decrease in leasing volume this year will likely lead to less construction demand next year and a tightening in the market, resulting in a short-term reduction of total construction cost.

This report incorporates data from 70 projects spanning Q4 2022 to Q3 2023 provided to CBRE Project Management by seven Chicago-based interiors contractors. When possible, this year's data is compared to last year's initial report. Year-over-year, the average project size within the data set has remained consistent. Note that only hard construction cost is evaluated in this analysis; soft cost, furniture, fixtures and equipment, AV, security, and technology are not included.

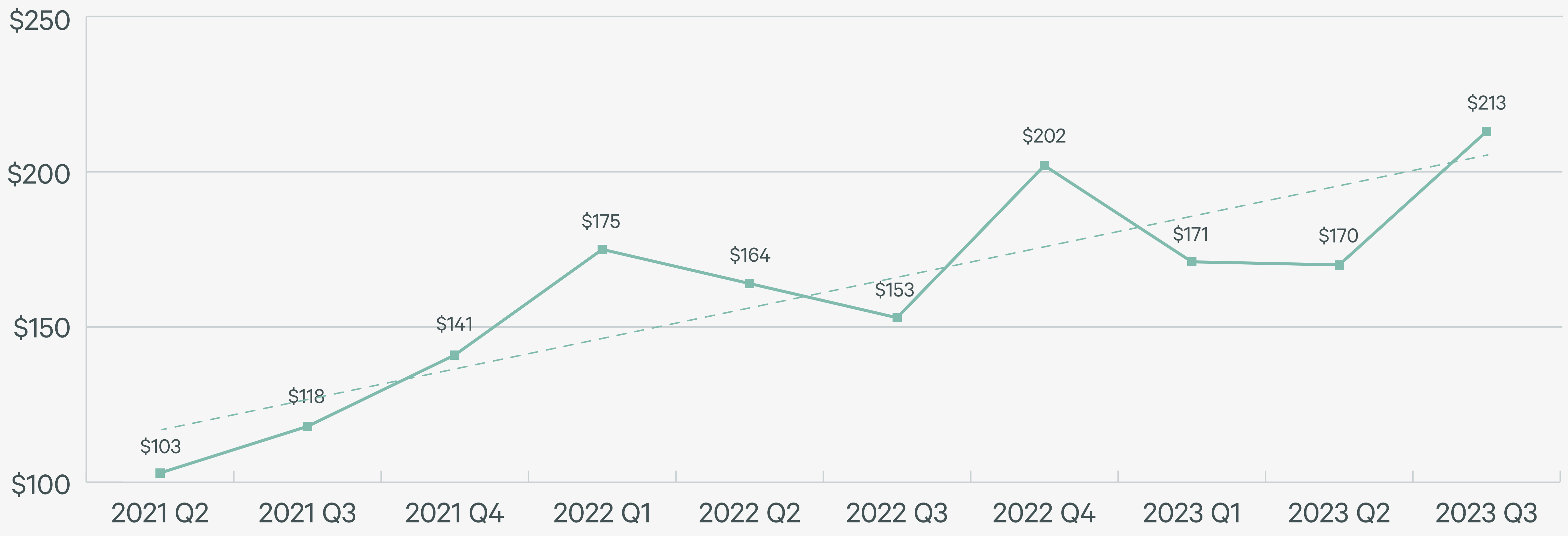
Intended to educate stakeholders and help guide expectations, this report provides a slice of overall Chicago office construction activity meant to illustrate trends but not capture the whole picture.

CBRE Construction Cost Index and Cost Escalation Per Year



Source: CBRE Cost Consultancy
Note: (F) is for forecasted values

Construction Cost PSF Over Time (Chicago PJM data based on purchase date)



Includes new construction and renovation projects

Construction Cost Escalation Is Easing

Construction escalation refers to a rise in the price of construction commodities or services due to a combination of inflation, supply/demand, and other effects such as environmental changes. On a national level, CBRE Cost Consultancy is predicting a 6.5% year-over-year escalation in national construction costs for 2023.

For the data collected for this report, year-over-year construction costs are significantly higher than the same point last year, but about 6% above the peak in Q4, in line with national predictions.

CBRE expects escalation to return to historical norms by the end of 2024 (3-6% is the 10-year average). However, the decline of this rate is dependent upon both the Federal Reserve Bank interest rate changes and the construction market supply and demand cycles.

Takeaways

— Construction cost escalation will return to historical norms in 2024

— Construction costs are not expected to decrease long-term

Managing Client Expectations Is Vital

Managing client expectations is more important than ever in the current market. In the case study to the right, this financial services company constructed similar sized office space in the same building 2.5 years apart and saw a 25% increase in cost per square foot, much higher than the average escalation.

There were a few factors at play, including significant material and labor cost escalation over the past few years. The initial office space was purchased in the first year of the pandemic when the construction market was tight, leading to aggressive subcontractor bidding. The subsequent project in May 2023 was procured when the market was active, so subcontractor pricing was no longer discounted.

Takeaways

— Market changes occur rapidly

— Expectations set with a client one year may not be the reality another year

Case Study

Location	Chicago, IL	
Building	Trophy / Class A	
Sector	Financial Services	
Type	First Generation	
Purchase Date	December 2020	May 2023
Size (RSF)	189,000	189,426
Construction Cost/RSF	$170.32	$215.04

Flight to Quality – First Generation vs. Renovation

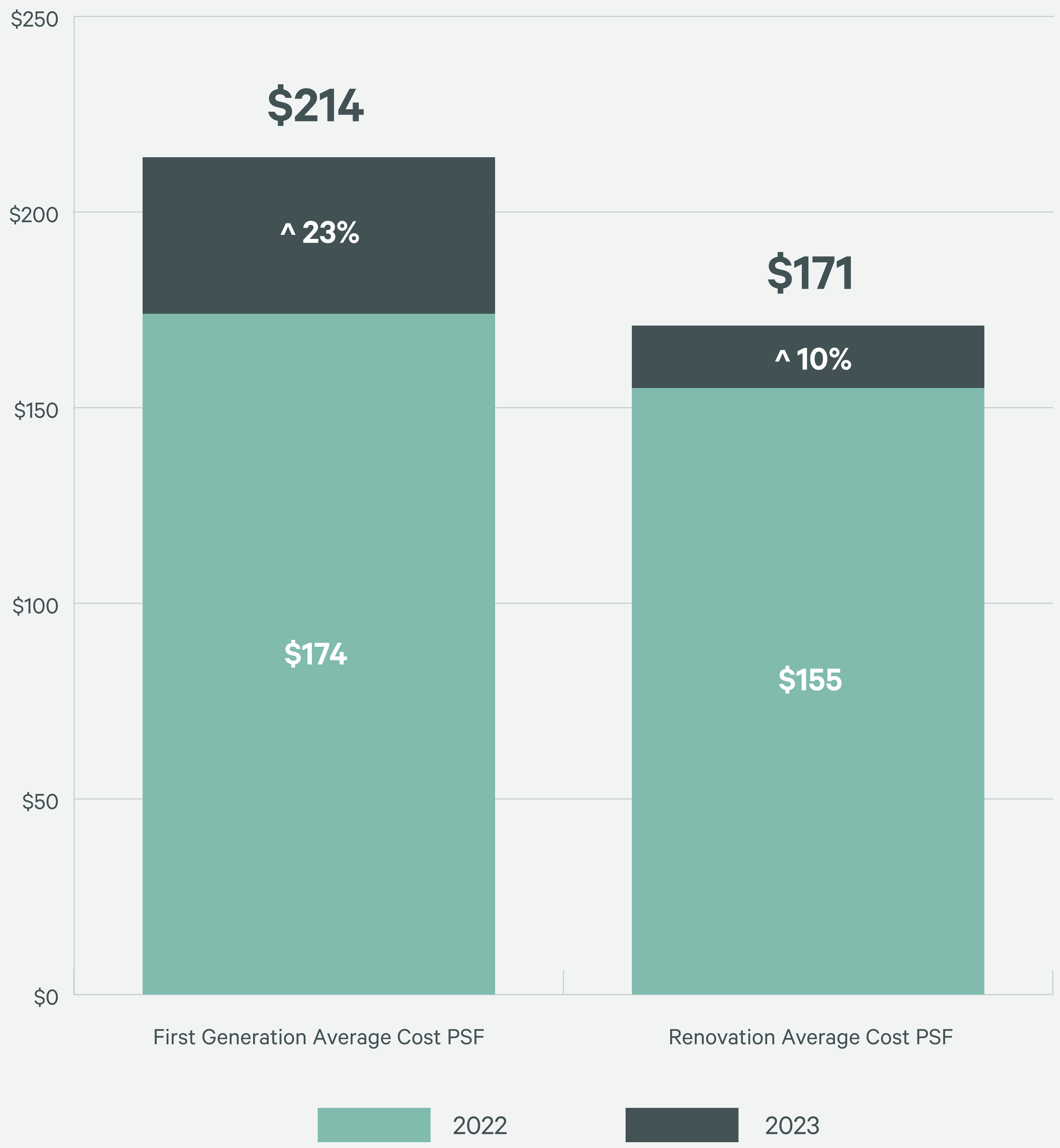
Construction costs for first generation spaces increased 23% from 2022, according to our data set. Cost escalation is part of the increase, but another contributing factor may be flight to quality.

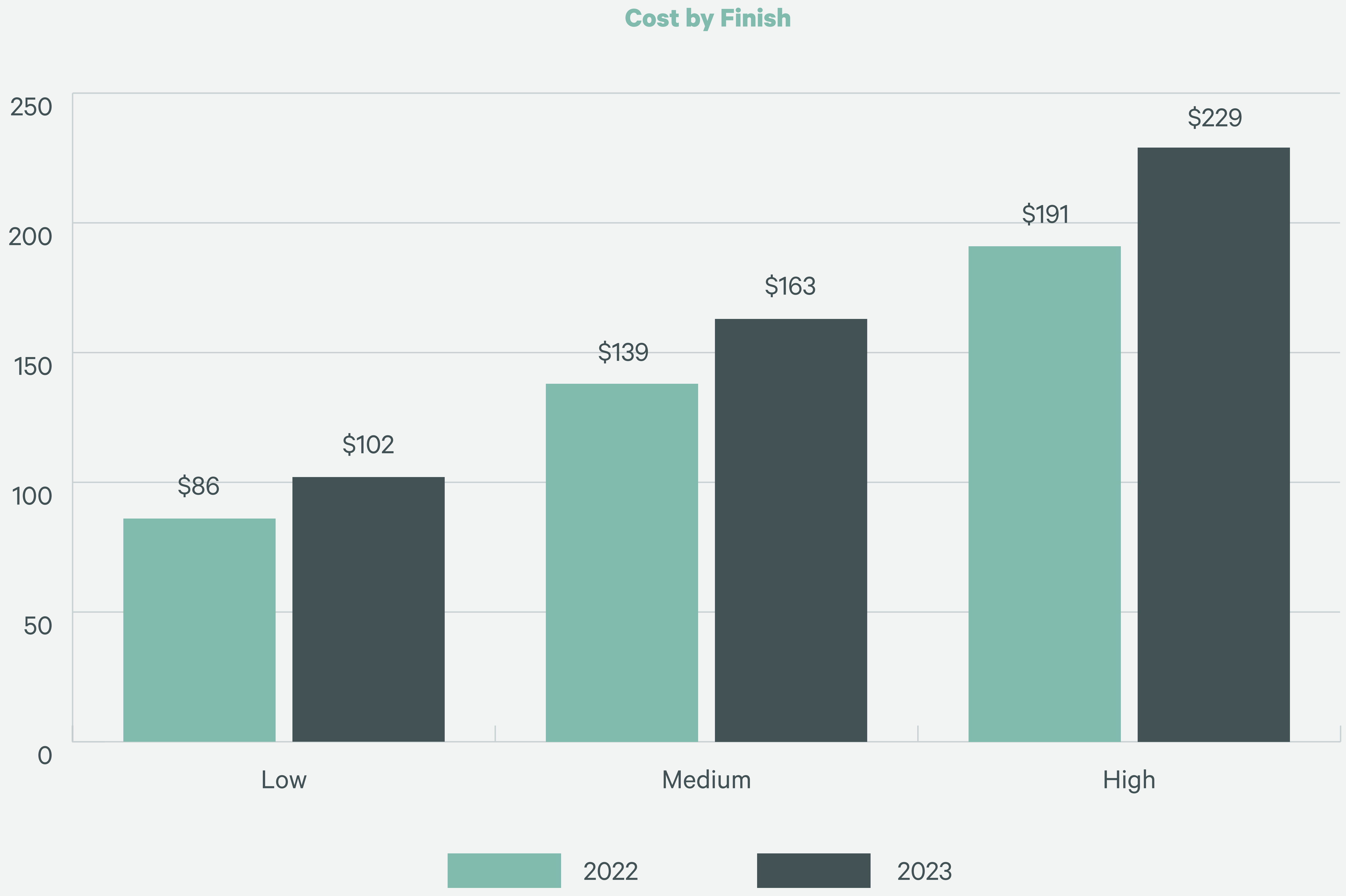
We are seeing financial sector clients take advantage of first generation spaces at a higher level. Financial tenants accounted for 14% of first generation spaces in our 2022 report and account for almost 44% in this report.

Historically, the premium for first generation space has been approximately $15 PSF, but that amount is increasing. A major component of the premium is mechanical and electrical infrastructure that must be installed new by the first tenant, but could be reused in a second generation space. Driven by efficiency enhancement, these systems have become more sophisticated and more costly, adding a greater burden to the tenant in first generation space. This is apparent in most of the new buildings in Fulton Market, which utilize variable refrigerant flow (VRF) and dedicated outdoor air systems (DOAS).

Takeaways

- First generation premium is increasing
- Tenants are trading quantity for quality





No Matter the Finish, Everything Is More Expensive

Many factors contribute to the cost differentials between the finish level classes. Drivers include:

— Space layout (open vs. enclosed)

— Standard vs. customized design

— Basic vs. enhanced infrastructure

— Finish quality

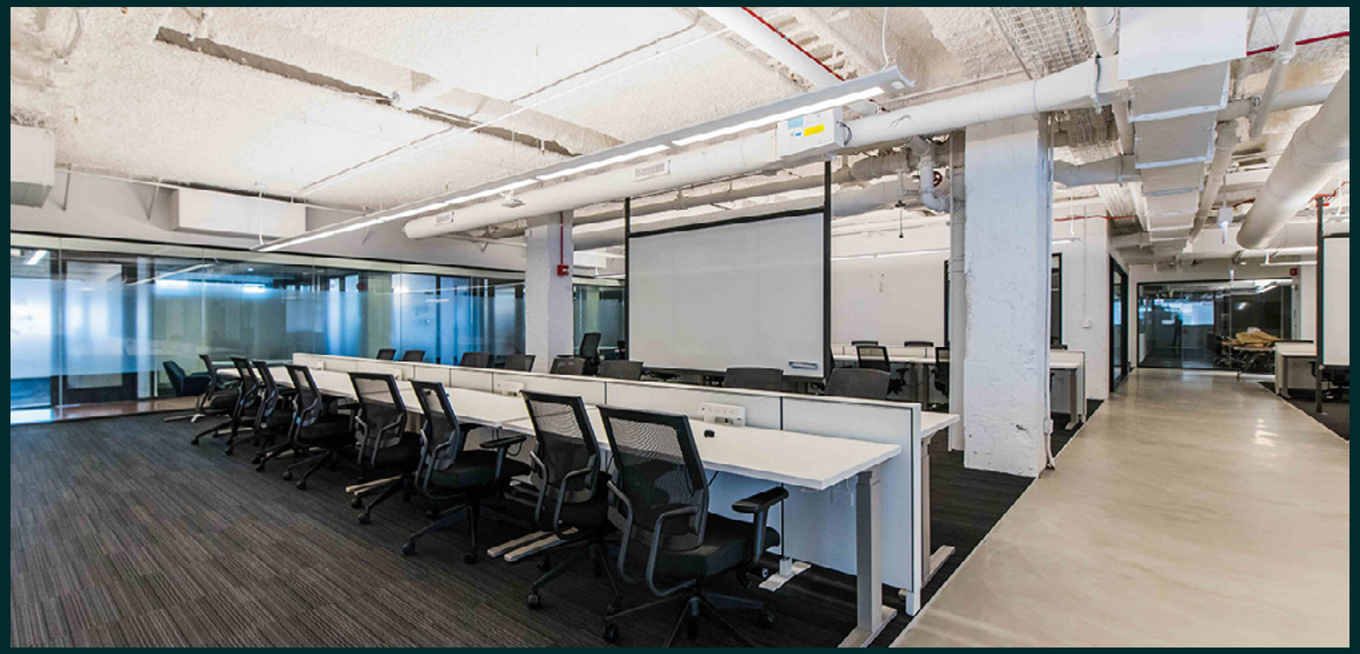
— Specialty space (amenity/conferencing)

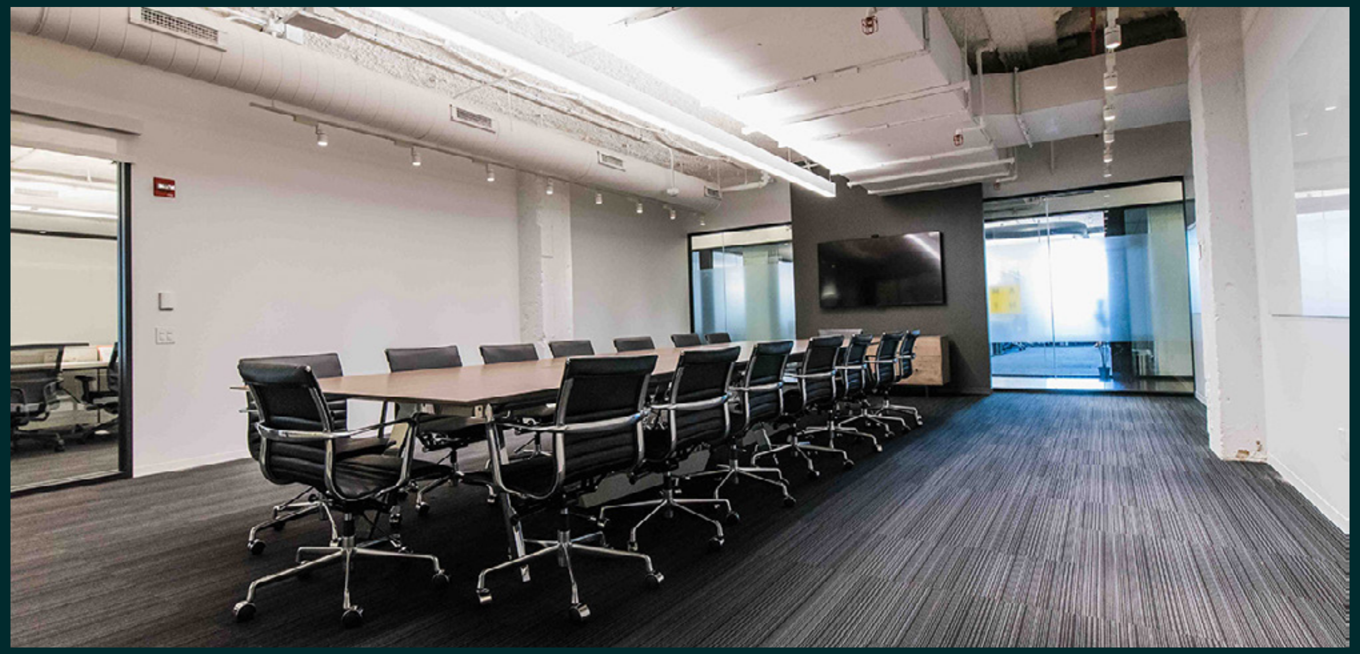
— Interconnecting stairs

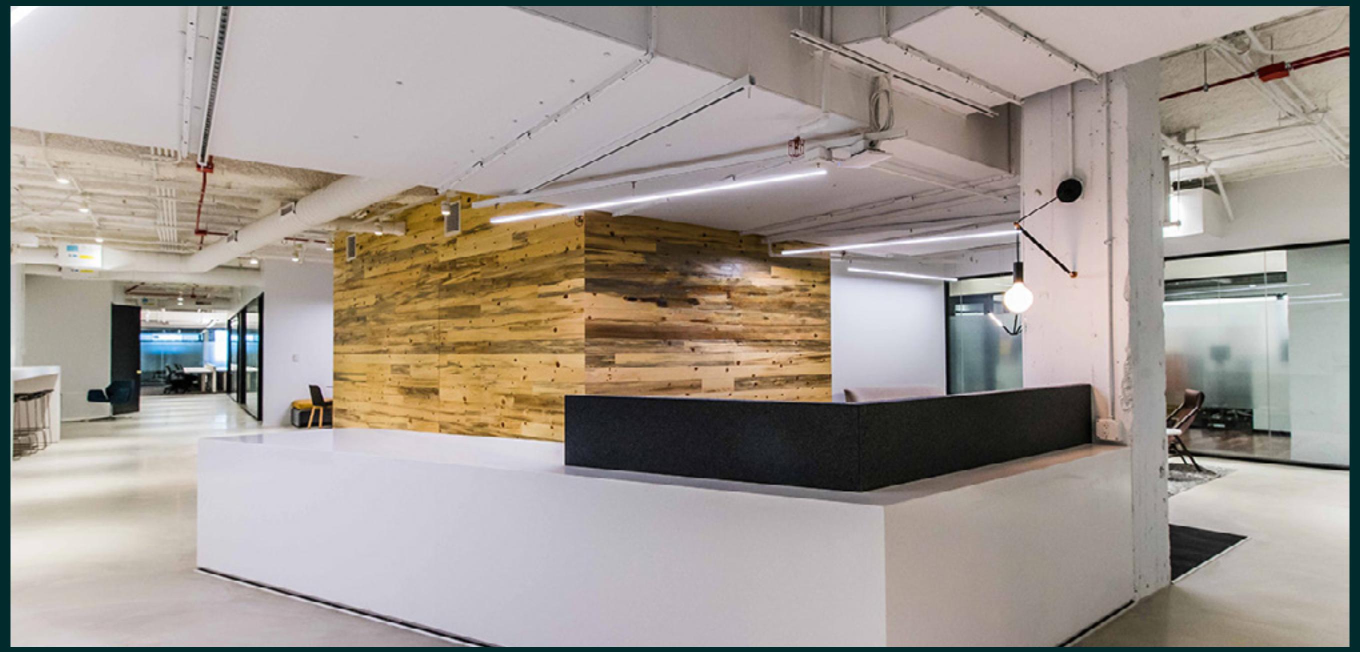
— Level of branding

Low Finish

A low level of finish includes the basics needed for a functional office at the most competitive price point. The space plan skews toward open (fewer enclosed rooms) with basic finishes and minimal customization, similar to a spec suite.





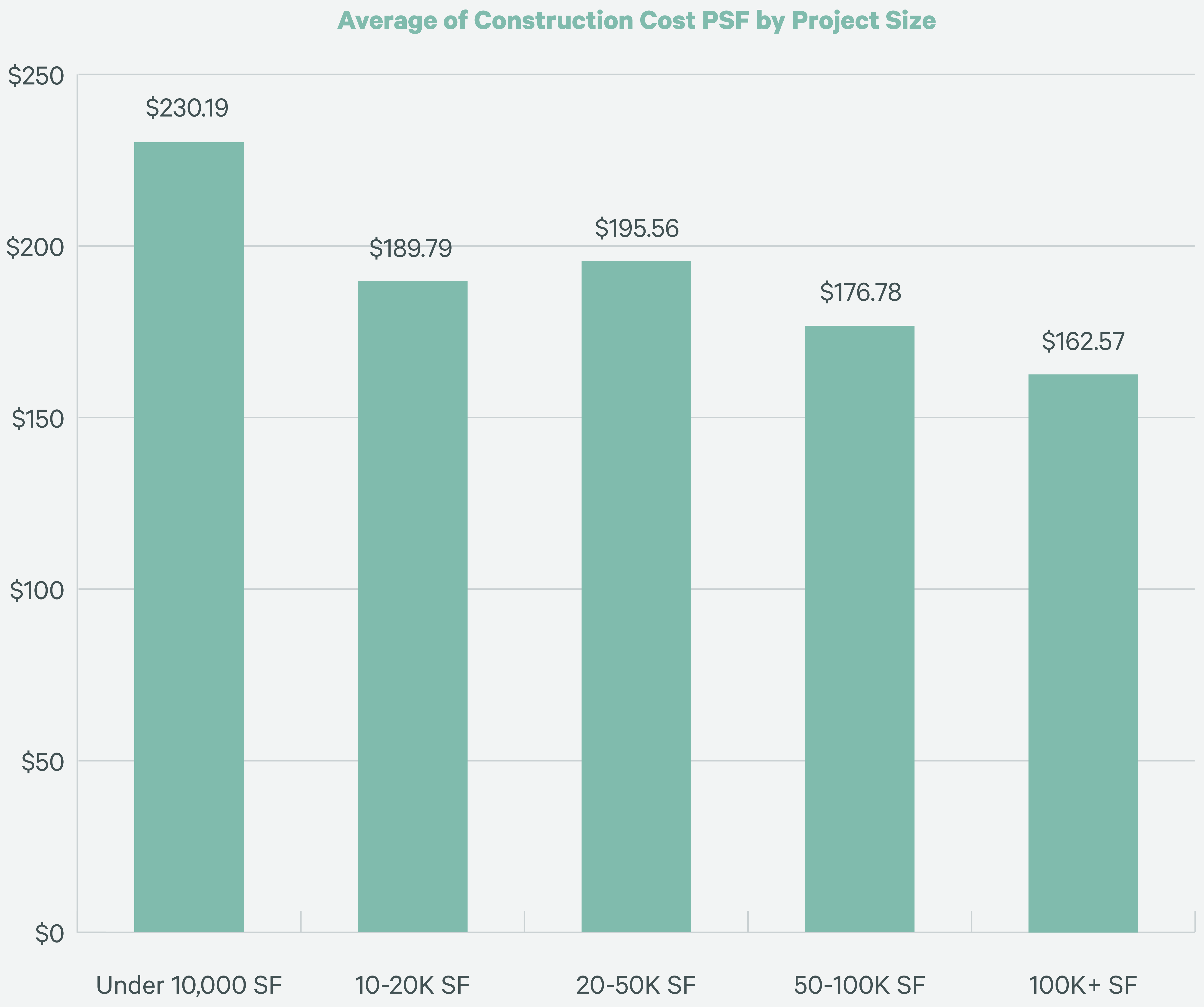


Medium Finish

A medium level includes some customization and enhancements, and moderate finish materials. The space plan includes more enclosed offices and collaborative space and may incorporate more custom design and light branding elements.

High Finish

A high level of finish includes all of the requirements in the medium level, with the highest level of customization and finish quality. The space may include enhanced MEP infrastructure (such as in a trading firm), enclosed offices with high acoustical requirements (such as a law firm), interconnecting stairs, amenity areas, high-end conference centers, and immersive branding



Economies of Scale Materialize Above 50,000 SF

As project size increases, average construction costs tend to decline. The average cost of a 100,000+ SF project is about 30% lower than projects under 10,000 SF and about 17% lower than 20,000-50,000 SF projects.

Fifty to 70% of hard construction costs are unseen infrastructure expenditures, such as mechanical, electrical, plumbing, or fire protection. Larger spaces spread these costs out with greater efficiency. Cost per square foot is an unreliable metric for projects under 10,000 SF.

Additionally, larger projects are in a better position to gain savings by reducing costs in the finish level category as finishes make up a more substantial portion of the overall budget.

Takeaways

— Cost per square foot is an unreliable metric for projects under 10,000 SF

Some Lead Times Still Problematic

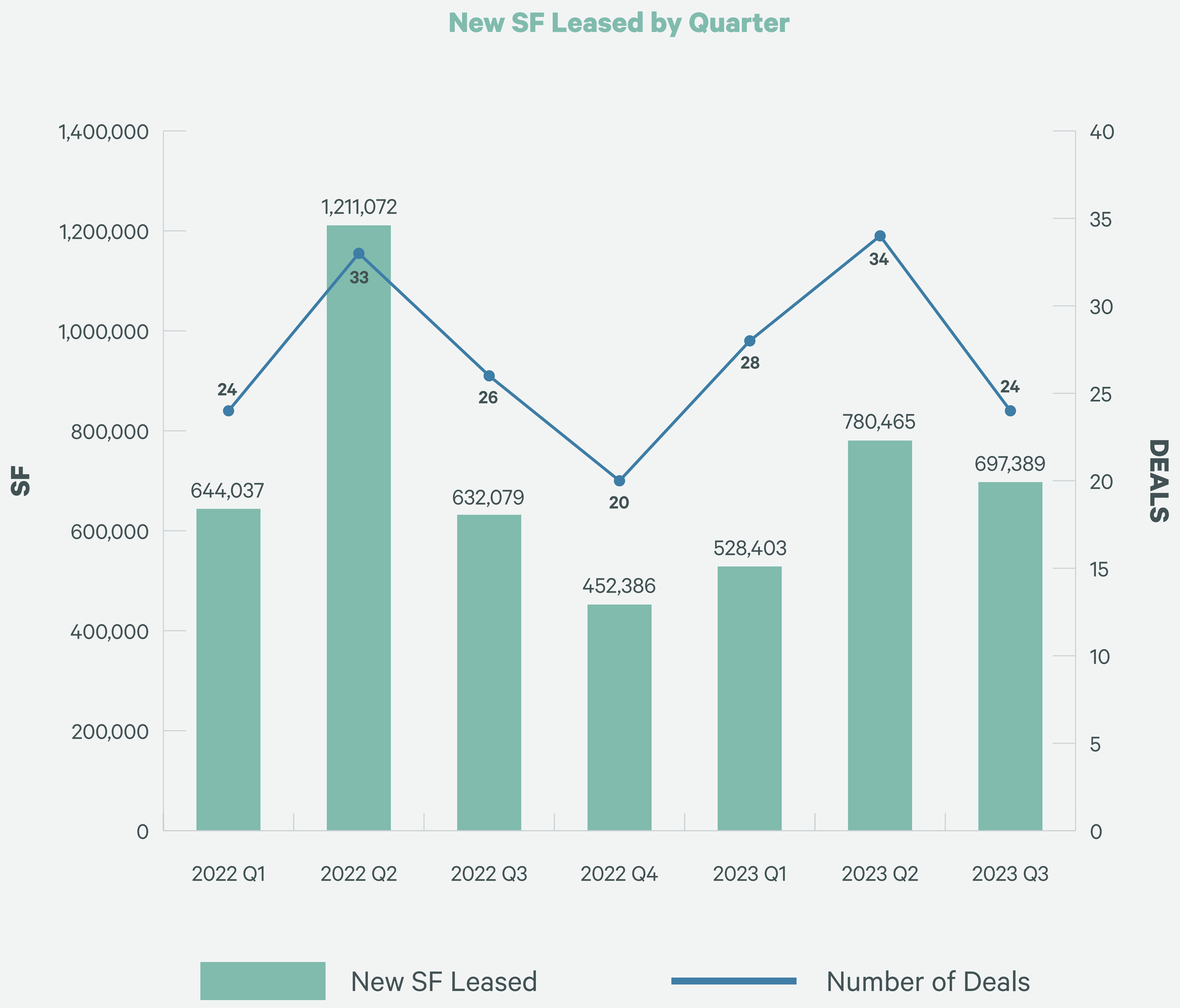
The lead time for some materials has shown improvement, while others remain stubbornly long. Lead times for drywall/metal studs, roofing materials, plumbing fixtures and equipment, aluminum storefront, and flooring materials have returned to their historical norms.

Electrical components, certain HVAC equipment, light fixtures and controls, wood doors, and hardware continue to have availability issues.

Takeaways

— Lead times are decreasing but not across the board

Trade Item / Material	Q3 2022 Lead Time	Q3 2023 Lead Time	Percent Change
Wood Doors	18-20 weeks	14-16 Weeks	-27%
Aluminum Storefront Glazing	30-36 weeks	10-12 Weeks	-200%
Drywall/Metal Studs	14-16 weeks	1-2 weeks	-900%
Carpet	10-12 weeks	6-10 Weeks	-38%
Plumbing Fixtures & Equipment	8-12 weeks	6-14 Weeks	+0%
HVAC AHUs & RTUs	36-52 weeks	5-42 Weeks	-91%
Electrical Panels, 120/208V	10-14 weeks	12-18 Weeks	+20%
Electrical Panels, 480V	27-40 weeks	12-18 Weeks	-123%
Lighting & Controls	16-20 weeks	10-16 Weeks	-38%



Average size of New Lease	41,411	32,640	33,254	28,540	23,227
	2019	2020	2021	2022	2023

Average New Lease Size Shrinking

Leasing volume for tenant fit-outs can be a precursor of what we will see in the construction market in six to nine months.

According to CBRE statistics, new leasing square footage is down almost 19% in the Chicago market in 2023 as compared to last year and down 44% from 2019. Not only are companies finding ways to be more efficient with space in response to the rise of working from home, but it is becoming more expensive to build.

Despite steadily increasing interest rates, the U.S. economy has remained surprisingly resilient. However, higher interest rates are historically deterrents to borrowing, and tighter lending standards from banks is making it harder for developers to secure funding, slowing construction.

The decrease in leasing volume this year will likely lead to less construction demand next year, and a tightening in the market. Even though inputs costs have not reduced (i.e., labor and material), clients will likely see a reduction in bid costs due to market competitiveness. This will result in a short term reduction of total construction cost.

Takeaways

— Deals are smaller and fewer

— Lower demand and tightening of construction market next year may lead to short-term reduction in construction costs

Construction Is Only Once Slice of the Pie

The hard construction costs noted in this report are just one part of total project expenditures for office build-outs. The total rough cost composition for a typical build-out is presented on the right.

A short-term reduction of total construction cost may be on the horizon as the decrease in Chicago's leasing volume in 2023 will likely lead to less construction demand in 2024 and a tightening in the market.

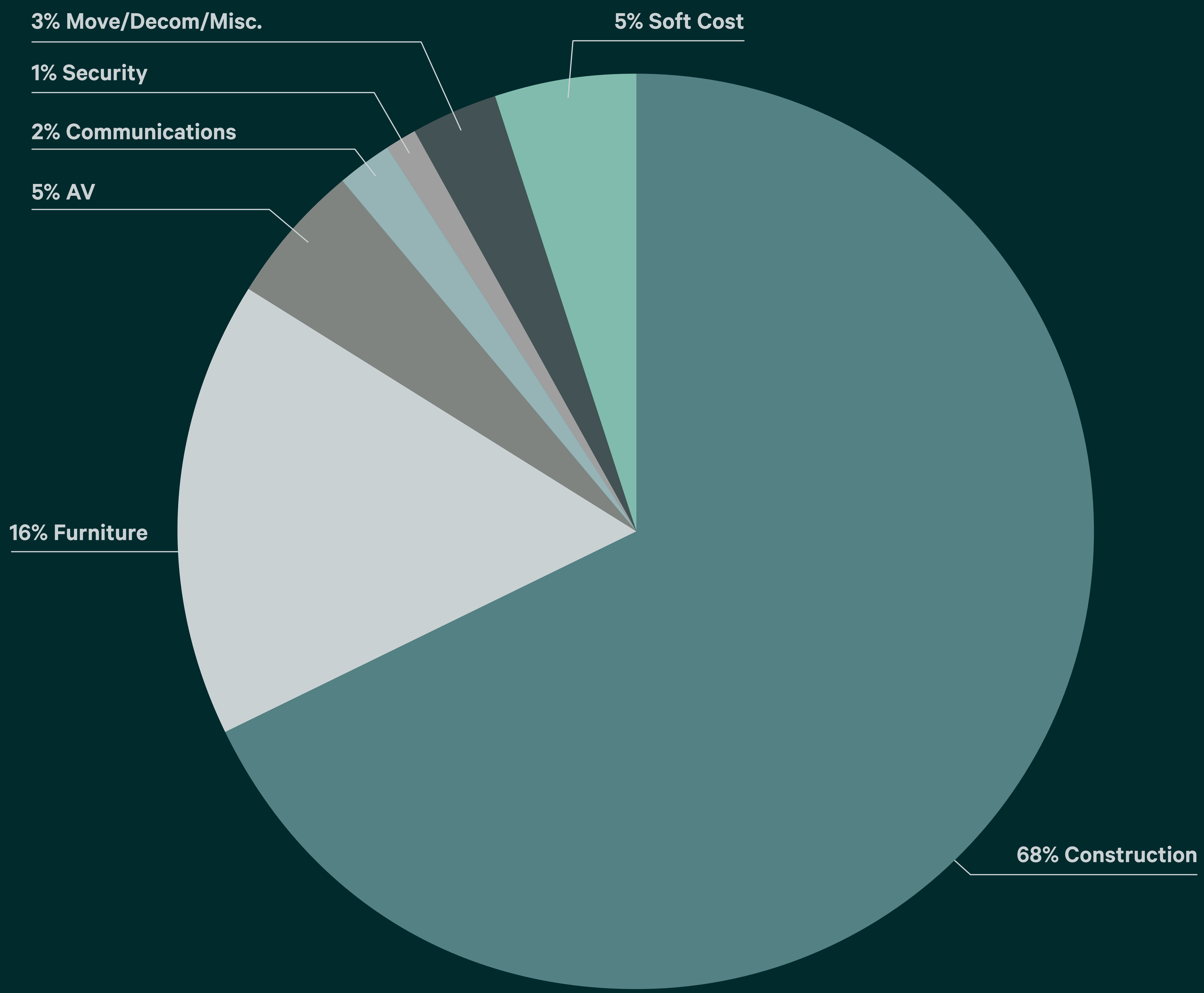
Additionally, the relative availability of skilled labor in the Chicago market is favorable as compared to other markets. While some markets are struggling to staff construction sites and are unable to keep up with demand, Chicago continues to maintain a healthy workforce.

CBRE expects escalation to return to historical norms by the end of 2024 (3-6% is the 10-year average). However, the decline of this rate is dependent upon both the Federal Reserve Bank interest rate changes and the construction market supply and demand cycles.

The best approach for clients executing an office build-out is to engage project management professionals as early on in the process as possible.

Reach out to the CBRE Project Management team to help plan and mitigate the risks.

Estimated Project Cost Composition



CBRE

Contact Us

Heidi McClenahan (She/Her)
Managing Director
CBRE | Project Management
321 N. Clark Street, Suite 3400 | Chicago, IL 60654
T +1 312 935 1429 | C +1 847 909 3883
heidi.mcclenahan@cbre.com

Steve Kiley (He/Him)
Director
CBRE | Project Management
321 N. Clark Street, Suite 3400 | Chicago, IL 60654
T +1 312 935 1942 | C +1 312 914 3946
steve.kiley@cbre.com

Michael Raleigh (He/Him)
Manager
CBRE | Research
321 N. Clark Street, Suite 3400 | Chicago, IL 60654
michael.raleigh@cbre.com

Source Acknowledgment:
BIG Construction, Clune Construction, Executive Construction, ICG, Leopardo Construction, Pepper Construction, Redmond Construction, Skender Construction, Skyline Construction.