

'Perfect Storm' Of Construction Cost Spikes Wreaking Havoc On Contractors, Developers

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The cost of construction materials — things like lumber, steel, wood paneling, flooring and joint compound — has collectively risen close to 13% over the last year, the largest annual spike since 2008.

The ripple effects for the real estate industry from such a sudden cost increase are vast: Projects are getting delayed and development timelines are lengthening, and developers are considering strategy shifts to avoid using the material most in demand, lumber. Ultimately, the costs will lead to higher rents and higher prices for real estate.

Housing prices increased 12% in February alone, according to [S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index](#), the largest single-month gain in 15 years after an 11% increase in January.

The industry periodically experiences waves of price spikes of [construction materials](#) for various reasons, but experts say this time it's different, because there is no clear vision as to when prices may moderate again. That is changing the way developers and general contractors are conducting their business.

“It's like this perfect storm of how to sabotage a recovery,” said Scott Hudson, the vice president of preconstruction with [Batson-Cook Construction](#) in Florida. “I've been doing this for 27 years, and it's very strange.”

[Lumber](#) prices reached a record price of \$1,400 per thousand board feet this week, rising 57% since January and more than 325% since last year, [according](#)

[to Market Insider](#). Last year, many lumber mills were forced to shutter during national lockdown measures and are [now struggling to catch up with demand](#). “It’s not a switch you can turn back on,” [Joy Construction](#) principal [Eli Weiss](#) said. “So you’re sort of seeing the impact of having to warm up the car.”

At the same time, a population stuck at home focused on remodeling, which elevated demand for lumber. That has now led to a shortage as the world emerges from the coronavirus pandemic and construction — especially of single-family houses — has soared.

Skyrocketing lumber costs are only one factor in the price shock. The pandemic [caused a blockage in major U.S. ports](#), which has prevented suppliers from importing key construction materials, experts say. The deadly ice storm that swept through Texas in February [shuttered petroleum and petroleum-product processing plants](#), denting the U.S. supply of plastics used in construction, as well as joint compound.

In March alone, year-over-year price changes ranged from a significant uptick to a seismic spike: diesel fuel rose 79.5%, lumber and plywood rose 62.9%, iron and steel scrap rose nearly 60%, copper scraps rose nearly 63%, copper and brass mill products rose 44.2%, the cost for prefabricated metal buildings jumped 21.8% and plastic construction products rose 10.4%, [according to the Bureau of Labor Statistics’ producer price index](#), compiled by the [Associated General Contractors of America](#).

“It’s a competition in which [product] is going to go up the most in any given week,” AGC Chief Economist [Ken Simonson](#) said.

AGC [issued a first-quarter inflation alert](#) on the overall construction cost increases, calling on Congress and the [Biden administration](#) to eliminate [tariffs](#) and quotas to help kick up supply in the market that mills and factories are struggling to refill.

While the price spikes in construction materials are on par so far with 2008, Simonson said the ramifications of this year’s increases are much more severe.

“By December 2008, the year-over-year change was down to 2.8%, and it turned negative for most of the following year. This time, there is widespread expectation that many material prices will remain at or above current levels for many months, if not longer,” Simonson said.

Generally, prices for materials are pre-negotiated by general contractors with their subcontractors ahead of time, meaning large spikes could have dire consequences, AGC warned.

“Given that materials often represent half or more of the cost of a contract, such an increase could easily wipe out the profit from a project and create severe financial hardship for the contractor,” he said.

For years before the pandemic, labor costs had unrelentingly driven yearly construction cost increases, but construction materials have outpaced the still-rising cost of labor. [In a recent report, JLL](#) projected labor costs to rise by 2% to 5% this year.

[Alex Elkin](#), who runs New York development and construction firm [Eastbound Construction](#), said the supply shortage in construction materials wouldn't have been as big a problem had overall construction not bounced back since the pandemic. Now he's seeing price spikes for material like glass and ductwork.

“There was no way to handicap how this was going to go because this was unlike anything else,” Elkin said. “This was a pandemic that was going on for months and months, and nobody knew what was going on until the vaccine became a reality. [Prices] will lighten up as manufacturers catch up, but it might still take another two to three months. But it's at unsustainable levels right now.”

The decline in overall new commercial construction is helping to moderate some of the cost impacts at this point. Batson-Cook's Hudson said quotes made on potential commercial jobs in the first quarter were down 30% from the prior year. But not all commercial construction is down: Multifamily is showing growth this year, [according to the U.S. Census Bureau](#).

Batson-Cook also has increased the number of weeks for planning and hiring of subcontractors to prepare for a project, from 14 to 20 weeks, Hudson said.

“There's a lot of angst in the industry,” he said. “Because what comes next?”

The biggest impact thus far has been on homebuilders, who heavily rely on lumber. [Lennar Corp.](#) co-CEO Jon Jaffe [recently told investors](#) that lumber was already adding a cost of \$2,300 per home in the first quarter, with the

expectation that that price will rise to upward of \$5K per home by the end of the second quarter.

"And then in Q3 and Q4, we'll see a repeat of that pattern as lumber prices moved higher in the recent months before what we hope will be an expected leveling off," Jaffe said.

This is causing sticker shock in the price of housing in general. [Greg Otto](#), a project executive with Los Angeles prefabrication builder [Clark Pacific](#), said [during a Bisnow digital summit](#) last week that housing prices in the Southeast were already on the rise because of population growth. Construction material prices are now adding to the sticker shock.

"That shock, you put those things together and you could have, effectively, the nuclear effect that you have in the Bay Area," Otto said in an interview. "If you increase demand and then you put sticker shock around it because commodity prices inflate it, one plus the other, it's not an additive problem, it's a multiplication problem."

Atlanta-based [Selig Development](#) Chief Operating and Development Officer [Steve Baile](#) told *Bisnow* the lumber price spike is especially painful for multifamily developers looking to do stick-built garden apartments.

The firm has a number of apartment projects in its pipeline in Metro Atlanta, and it is hopeful prices will moderate again in the near future. If not, Selig could push back the start of some of its projects or consider material alternatives, Baile said.

"It may slow some of the decision-making down a little bit, but inevitably it won't stop us, unless there continues to be escalation at the rate we've seen so far," Baile said. "I have a feeling it can't stay that high. And if it does, it's going to kill a lot of people's projects."

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