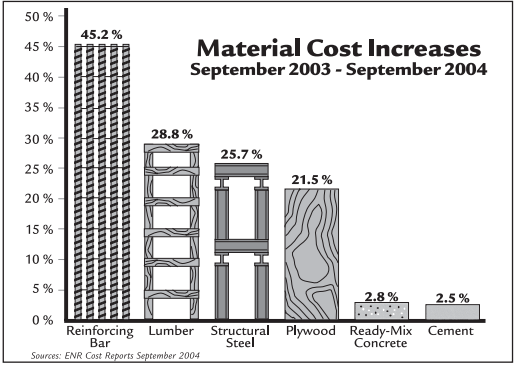




and many large infrastructure projects. Demand is also significantly higher in the US due to a rise in construction activity, related in part to new home construction. Some of the highest price increases have occurred with steel, lumber and plywood, while cement has been in short supply. The following graph shows the extent of construction material price inflation over the past twelve months:



This year, exceptionally high price increases of construction materials have caused serious problems for the construction industry. A major factor is the current economic and construction boom occurring in China. China is experiencing rapid growth and, with it, tremendous construction activity which is creating shortages in the US and throughout the world.

Background

Basic economics tell us that, in an open marketplace, prices will rise when demand increases or when supply decreases. Demand has been increasing exponentially in China due in part to a construction boom resulting from the country's economic revolution, preparations for the 2008 Olympic Games, construction of the Three Gorges Dam,

Steel

The construction industry has seen the demand for steel increase and the supply decrease simultaneously. While demand for steel has risen greatly, the shortage of coke, used in steel manufacturing, has reduced US steel production. Other factors such as high energy costs, high transportation costs resulting from increased fuel costs, the weak value of the US dollar, and the consolidation of steel



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manufacturers are all contributing to the increased steel prices. Delivery delays of imported steel have resulted from international shipping lanes being stretched to capacity. All types of steel have increased in price over the past twelve months. Reinforcing bar has risen by 45.2%, while structural steel has risen by 25.7%.

Lumber and Plywood

The prices for lumber and plywood have also risen dramatically over the past twelve months, mainly due to increased residential construction activity in the US. Low interest rates have spurred much of this new residential construction. Lumber has risen an average of 25.8% while plywood has risen an average of 21.5%. Since the start of this year’s hurricane season, repair and reconstruction work necessitated by hurricane and flood damage has further driven up lumber prices. These high prices will likely be sustained over the short term while the massive reconstruction efforts are progressing.

Cement

While cement prices have not risen as significantly as other materials’ prices, the shortage of cement has been a problem, particularly this past summer. Concrete mixing companies could not produce concrete fast enough to keep up with demand. The shortage led to countless project delays and disruptions.

China is currently consuming approximately 40% of the world’s cement supply. The country’s exceptionally high demand for concrete has allowed it to outbid US buyers on the world market, further reducing availability to the US.

Challenging Times for Contractors

Because most contracts are based on material prices estimated at the beginning of the project, the contractor can be adversely affected when material prices surge unexpectedly. Material prices can rise unexpectedly at any time, potentially wiping out profits or even driving the contractor into the red.

In addition to rising prices, another major problem is the delayed delivery of materials to contractors due to material shortages. Material delivery delays are generally beyond the control of the contractors, and they can delay the entire project. Such delays can put contractors at risk of liquidated damages due to missed project deadlines.

Possible Solutions

The following list highlights possible solutions to the increased material prices and material shortages dilemma:

- ◆ Incorporate price protection clauses into contracts (apply bid qualifications).
- ◆ Lock in on material prices.
- ◆ Buy materials early in the project to ensure availability.
- ◆ Delay the project until prices decrease.
- ◆ Work together with other builders and contractors to obtain group discounts on material purchases.
- ◆ Employ value engineering to help reduce costs.
- ◆ Renegotiate contracts to accommodate price increases and/or industry shortages.
- ◆ Purchase materials in bulk to receive discounts.
- ◆ Consider renovating an existing building as opposed to building a new structure.
- ◆ Maintain a good relationship with material suppliers.

Looking to the Near Future

Increased material costs may eventually cause a decrease in residential construction and are already increasing the price of new homes. This, in turn, could negatively impact new home sales, as home buyers are priced out of the market.

The market may, however, experience some relief in the near future. The following factors may alleviate the current situation:

- ◆ Rising interest rates may slow construction enough for cement and steel production to catch up, thus stabilizing prices and supplies.
- ◆ Construction rates will decrease as winter approaches.
- ◆ The measures being taken by the Chinese government may slow down its economic growth and in turn reduce some of the material price increases being experienced throughout the world.

Conclusion

Contractors must be careful to protect their own interests in a market that is shifting an increased amount of risk onto contractors. Protection from material price increases is just one of the considerations contractors must keep in mind. Owners must also be aware that current material shortages can delay projects and increase their costs.

About the Author:

Peter W. van der Schans is a project consultant with Interface Consulting International, Inc., who participates in construction claims, alternative dispute resolution, and litigation consulting. Mr. van der Schans provides assistance to contractors and owners involved in problem construction projects, as well as to attorneys and insurers when matters reach mediation, arbitration, and/or litigation. He specializes in analyzing the issues in disputes such as schedule delays and acceleration, cost overruns, and design and construction defects and in preparing and evaluating construction claims and damage assessments.

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