By Tim Grogan with Bruce Buckley

Costs: Shaken, Not Stirred

Materials prices tied to the housing market bounce back, while other prices remain flat

If secret agent 007 were your estimator, he would be ordering his costs the same way as his martini—shaken, not stirred. That is pretty much what happened with inflation this quarter. Materials with a high-end use in housing were shaken as producers took full advantage of a modest rebound in residential construction to lift prices up from historic low levels.

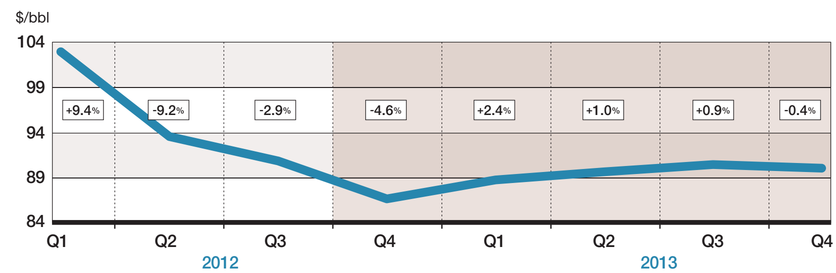
The Bureau of Labor Statistics' producer price index for July showed year-to-year increases of 16% for plywood and 15% for gypsum wallboard. The PPI for softwood lumber declined 4.3% for the month, bringing the year-to-year increase for that index down to 6% in July from 11% in June.

On the other hand, prices for materials with a high-end use in the non-residential buildings and public-works markets barely stirred. The PPI in July showed year-to-year increases of just 0.2% for fabricated steel, 0.4% for cement, 1.6% for PVC products and 1.7% for ready-mix concrete. The PPI for asphalt paving responded to a decline in oil prices by falling to 5% in July from a year-to-year high of 11% last March. The PPI for aluminum and copper products remained well below 2011's level.

In the end, overall construction inflation was not stirred, either. This quarter, the annual escalation rate for seven major general-purpose construction cost indexes averaged 2.5%, which was down from the 2.9% averaged by the same group of indexes last quarter.

Specialty cost indexes compiled by the U.S. Commerce Dept. show industry inflation ranging from 1% to 3.5%. Despite materials price increases for gypsum wallboard, plywood and lumber, Commerce's cost index for new housing in July was up just 1% for the year. The index for office-building construction measured a 2.5% annual increase in costs, while indexes for new school construction and warehouses both posted annual gains of 3.5%.

Crude Oil Prices Stabilize



SOURCE: IHS GLOBAL INSIGHT. U.S. WEST TEXAS INTERMEDIATE CRUDE OIL SPUT PRICE.

"Don't believe the hype on material price increases. Overall, we are seeing only modest increases with no strong or sustainable movement," says Charlie McCarren, construction materials analyst with IHS Global Insight, Washington, D.C. "One thing about a weak recovery is that it does not put much pressure on prices."

Global Insight predicts that relatively weak oil prices will help keep a cap on construction inflation through 2013. "Our medium outlook for oil is to see prices come down a bit," says McCarren (see chart, above).

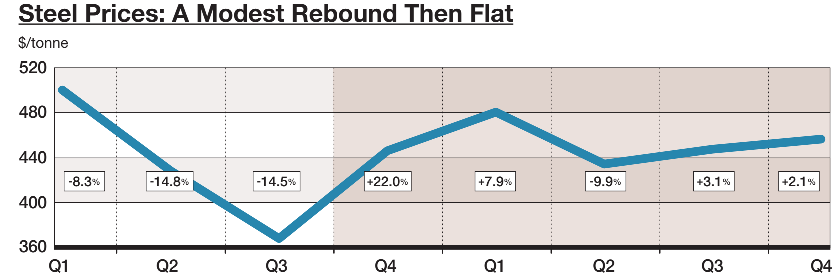
"Overall, material prices are only up about 1% from a year ago," says Mary Wallers, who compiles the Sierra West cost indexes. "It is put-in-place costs where we are seeing some pressure as subcontractors start to add back to their margins," she says.

"The U.S. steel market saw a fairly strong price increase earlier in the year, but that is starting to come down," says John Anton, steel analyst for Global Insight. "The China market is so overproduced that higher prices would just be an open invitation for imports," he says.

"We have not seen any uptick in civil material prices," says Dan Frondorf, central Plains regional governor for the American Society of Professional Estimators. "Things have been flat, and I expect them to stay that way."

However, bidding remains brutal, and some subcontractors are taking some dangerous shortcuts in their bids, says

Steel Prices: A Modest Rebound Then Flat



SOURCE: IHS GLOBAL INSIGHT. STEEL BILLETS SPOT PRICE—LME.

2.5% **BUILDING INFLATION** averaged annual increase in July for seven general-purpose cost indexes tracked by ENR.

BUILDERS' CONSTRUCTION COST INDEXES

NAME, AREA AND TYPE	JULY 2011	OCT. 2011	JAN. 2012	APRIL 2012	JULY 2012	% CHANGE QRT.	% CHANGE YEAR
GENERAL-PURPOSE COST INDEXES:							
ENR 20-CITY: CONSTRUCTION COST[1]	845.32	851.54	854.24	863.27	867.98	+0.6	+2.7
ENR 20-CITY: BUILDING COST[1]	751.04	755.55	757.83	762.28	767.30	+0.7	+2.2
BUREC: GENERAL BUILDINGS[2]	324.00	326.00	327.00	332.00	332.00	0.0	+2.5
FM GLOBAL: INDUSTRIAL[3]	284.00	na	286.00	na	293.00	+1.2	+3.2
SIERRA WEST: LSI MATERIALS/LABOR[1]	849.21	868.65	866.26	872.40	872.46p	0.0	+3.6
MEANS: CONSTRUCTION COST[4]	191.20	192.70	194.00	194.00	194.60	+0.3	+1.8
ECC, EDWARTOSKI COST CONSULTING[5]	166.41	167.13	167.70	168.70	169.06	+0.2	+1.6
SELLING PRICES INDEXES—BUILDING:							
SIERRA WEST: LSI SUBCONTRACTOR[1]	922.16	927.38	927.42	938.22	947.28p	+1.5	+3.6
TURNER: GENERAL BUILDING[1]	814.00	818.00	821.00	826.00	832.00	+0.7	+2.2
RIDER LEVETT BUCKNALL[6]	144.53	145.29	145.73	146.35	146.67	+0.2	+1.5
SPECIAL-PURPOSE BUILDING COST INDEXES:							
U.S. COMMERCE: ONE -FAMILY HOUSE[7]	97.20	97.80	96.80	97.40	98.20	+0.8	+1.0
U.S. COMMERCE: NEW WAREHOUSES[7]	126.90	128.90	129.60	130.80	131.30	+0.4	+3.5
U.S. COMMERCE: NEW SCHOOL BUILDINGS[7]	135.50	138.00	138.90	140.00	140.20	+0.1	+3.5
U.S. COMMERCE: NEW OFFICE BUILDINGS[7]	115.10	116.50	117.50	118.00	118.00	0.0	+2.5
POWERADVOCATE: POWERPLANT[8]	180.42	181.93	182.23	182.81	182.87	0.0	+1.4

[1]BASE: 1967=100; [2]BASE: 1977=100; [3]BASE: 1980=100; [4]BASE: 1993=100; [5]FORMERLY SMITH GROUP, 1992=100; [6]BASE: APRIL 1993 =100; [7]BASE: 1992=100; [8]POWERPLANT FOR A 550-MW COMBINED-CYCLE FACILITY. P=PRELIMINARY REPRESENTS JUNE FOR SIERRA WEST DATA.

CONSTRUCTION MATERIALS PRICE MOVEMENT IN 2012

		JAN.	FEB.	MARCH	APRIL	MAY	JUNE	JULY
AGGREGATES	MONTHLY % CHG.	+0.4	+0.6	+0.8	+0.8	–0.3	0.0	–0.1
	Annual % Chg.	+1.1	+2.0	+2.9	+3.4	+2.9	+2.3	+2.0
ALUMINUM SHEET	MONTHLY % CHG.	–1.4	+1.8	+1.4	–0.7	–2.0	–0.6	–0.1
	ANNUAL % CHG.	–3.0	–1.7	–2.9	–6.6	–10.2	–10.9	–9.2
ASPHALT PAVING	MONTHLY % CHG.	+1.3	+2.2	+0.2	+1.4	0.0	+1.2	–0.6
	ANNUAL % CHG.	+9.8	+11.0	+11.0	+10.2	+6.2	+6.6	+5.2
CEMENT	MONTHLY % CHG.	+1.6	+0.2	–0.3	+1.7	+0.2	+0.4	–0.1
	ANNUAL % CHG.	–0.2	+0.2	–0.7	–0.4	+0.3	+1.3	+0.4
COPPER PIPE	MONTHLY % CHG.	–3.0	+5.9	+0.9	–2.0	–2.4	–4.2	+0.5
	ANNUAL % CHG.	–14.3	–12.5	–7.6	–11.9	–9.8	–13.9	–17.1
DIESEL FUEL	MONTHLY % CHG.	+3.5	+2.3	+4.6	–1.2	–3.6	–9.0	–0.3
	ANNUAL % CHG.	+19.3	+13.8	+7.0	+0.1	–0.2	–10.7	–9.3
DUCTILE IRON PIPE	MONTHLY % CHG.	+1.6	+0.8	0.0	+0.1	–0.2	–0.2	+1.2
	ANNUAL % CHG.	+6.2	+5.3	+5.3	+4.8	+4.4	+3.9	+4.6
FABRICATED STEEL	MONTHLY % CHG.	+0.4	+0.9	+0.9	+2.4	–0.3	+0.3	–4.2
	ANNUAL % CHG.	+3.4	+2.7	+3.3	+5.4	+5.0	+5.1	+0.2
GYPSUM PRODUCTS	MONTHLY % CHG.	+4.4	+5.9	+1.0	–1.4	+1.1	+0.8	+1.4
	ANNUAL % CHG.	+5.9	+15.0	+7.8	+10.7	+12.2	+11.8	+14.6
LUMBER, SOFTWOOD	MONTHLY % CHG.	+0.2	+2.1	+2.9	+1.1	+4.8	–0.3	–4.3
	ANNUAL % CHG.	–3.2	–1.2	+0.8	+3.0	+10.5	+11.0	+5.9
PLYWOOD	MONTHLY % CHG.	+1.6	+2.7	+2.8	+0.6	+1.3	+1.0	+0.4
	ANNUAL % CHG.	+1.0	+2.8	+6.2	+5.2	+12.2	+14.3	+16.1
PVC PRODUCTS	MONTHLY % CHG.	+0.9	+2.5	+0.3	+0.5	–0.7	–0.4	–0.1
	ANNUAL % CHG.	+4.4	+6.4	+6.0	+6.0	+3.6	+1.9	+1.6
READY-MIX CONCRETE	MONTHLY % CHG.	+0.7	+0.2	+0.4	–0.6	–0.7	+0.5	+0.4
	ANNUAL % CHG.	+1.1	+1.8	+2.2	+2.1	+1.1	+1.5	+1.9
SHEET METAL	MONTHLY % CHG.	0.0	–0.3	+0.1	+0.3	–0.4	–0.2	–0.2
	Annual % Chg.	+4.1	+3.1	+1.7	+0.1	–0.4	–1.0	–1.7

SOURCE: BUREAU OF LABOR STATISTICS

Frondorf. "I've seen some subs get into trouble because they have accelerated the production rates in their bids," he says. For example, on a job a sub used to estimate it could do at 600 sq ft a day, the sub now is doing at 750 sq ft a day. "On paper, you are 25% more productive, but in reality you are not going that fast," he says.

Another dangerous shortcut taken by some contractors in an effort to be more competitive is the exclusion in their estimates of equipment replacement costs, Frondorf observes. "Some subs are just putting in the fuel and maintenance for the equipment they own, but they are not creating a fund for when the time comes to replace that equipment," he says. "At some point they will be forced to rentals, and that's a cost you can't hide."

Moderate labor cost trends also have helped hold inflation down, but that may not last much longer. More craft labor is seeing increases in wages and fringes as fewer firms freeze compensation (see story, p 44). But studies suggest that demand for skilled workers could increase significantly in the coming years, possibly leading to cost escalations. By 2015, non-residential construction starts are predicted to increase 60%, to $260 billion, compared to a very depressed $163 billion in 2011, according to the most recent forecast update by McGraw-Hill Construction Analytics.

The Gulf Coast already is feeling the effect. The shale-oil and gas boom could lead to billions of dollars in petrochemical projects along the Gulf Coast in the coming years.

In August, the Greater Baton Rouge Industry Alliance's "Semi-Annual Contract Labor Forecast" reported that 3,000 additional regular maintenance workers were hired since 2011 to work in area plants, and that maintenance, turnaround or outage work and new project labor demand would peak at over 18,000 people in late 2013—a demand that has not been seen since 2008, according to GBRIA. The top industrial crafts in demand are pipefitters, welders, instrument and electrical technicians, boilermakers and scaffold builders, according to the report. ■