

Higher material costs hang over construction industry

Aleksandrs Rozens, Associated Press

NEW YORK — Prices for construction materials have been climbing because of demand from overseas and higher energy prices. Builders that in the past might have absorbed price increases are now passing those costs along to their commercial and residential customers.

"This year our clients foot the bill, but last year when they (steel prices) skyrocketed we footed the major portion of the bill because we were under contract," said Jonathan Drill, whose construction business is based in West Orange, N.J.

So far, it doesn't appear that higher prices have prompted the industry to put up fewer buildings. (**Related:** [Home sales down 2.8% in January](#))

"I have not seen a project killed. I have just seen aspects of the scope of the project scaled back," Drill said.

But the higher costs promise to ripple through the nation's economy because they will become an added burden for storeowners and businesses that rent space in new commercial buildings. Faced with higher rents from developers who paid more to put up their buildings, these businesses will end up charging their customers more for goods and services.

"There's no question. These costs have to get passed on," said John Cefaly, vice chairman of Cushman & Wakefield, a commercial real estate brokerage based in New York.

The higher building material prices have also pinched single-family home builders.

"We see it in lumber, concrete, insulation, drywall and vinyl," said Jason DeBoer, co-owner of DeBoer & Gabriel Builders, which specializes in single family home construction and remodeling. "Every week we see memos (from suppliers) of price increases of 5% to 10%."

The higher prices have made it tough for DeBoer's Burlington, N.C., company to stay on budget. At times, he absorbs the costs.

"When you set a price on the home its hard to stick to the price. Often the contractor or homeowner is the one who suffers through this," he said.

The run-up in construction costs is tied to a variety of factors. Higher crude oil prices have made the delivery of goods more expensive and, since oil is used to make plastic pipes and vinyl siding, they've also driven up the costs of those products. Steel and concrete have risen amid shortages created by strong demand from overseas markets, especially China.

In December, steel prices were up 4.2% from the previous year, while plastics were up 20.6%, according to the most recent data collected by Jim Haughey, director of economics at Reed Business Information. Cement was up 12.3% and gypsum wall board was up 15.3% from December 2004.

Haughey believes the higher material costs contributed to the increase in construction spending last year reported by the U.S. Commerce Department — it wasn't just that more projects were being built, it was also that they cost more. "Generally, the increase in various costs accounted for half of the rise in spending," he said.

Spending to construct homes, offices, highways and other building projects totaled a record \$1.12 trillion in 2005, up 8.9% from the previous record of nearly \$1.03 trillion in 2004, according to the Commerce Department.

"The price increases are widespread," said Stephen Hulston, regional manager at Howard S. Wright Construction. He said supply disruptions related to Hurricanes Rita and Katrina raised prices for PVC pipe, used by plumbers for water lines and electricians for wire conduits. PVC is a byproduct of natural gas.

Hulston, who is managing construction of luxury villas in the Catalina Mountains of Arizona, said last year's hurricanes also pushed up the cost of roof tiles and sheet rock used for walls in homes and office buildings.

Some builders have also had to pay surcharges to anyone delivering steel and concrete because of higher fuel costs, said Jeff Abramsky, an executive at Equis who advises banks on the construction of their retail branches.

But while costs are rising, Ambramsky's clients, so far, have not halted their plans. "These plans were put into effect long in advance, some two or three years in advance," he said.

At some office building projects, meanwhile, architects have been told to consider less expensive light fixtures or carpet when sketching out a building's interior design, Drill said. Some walls are being painted rather than decorated with more expensive fabric or vinyl coverings.

In New York, some developers may build smaller apartment units and sell them for the same price as larger apartments, according to Abram Shnay, a developer in the process of finishing an apartment project in Manhattan's trendy Tribeca neighborhood.

The higher construction costs have also been noticed by lenders financing building projects like David Keto, chief operating officer at AFL-CIO's Investment Trust, which is backing Shnay's project in Tribeca. "We are seeing budgets inch up all across the country," Keto said.

Rising costs make it harder to finance projects. Financiers like Keto follow a project's development from its inception to completion and budgets are subject to revision as a normal course. The rapid rise in construction material prices "makes it more challenging to underwrite (a loan for a building's construction)," Keto said.

The rise in building material prices also comes as borrowing costs are up due to a series of interest rate hikes by the Federal Reserve. Many construction loans are linked to prime rates and these have risen over 3 percentage points from June 2004.

Shnay acknowledged having reservations about starting a new project amid rising rates and materials prices.

He's not worried about breaking even on his current project — he's already sold 20% to 25% of the apartment units and a renowned architect's name, Phillip Johnson, adds cachet. But Shnay is hesitant about starting another project soon, as rising costs drive apartment prices higher, and possibly make them harder to sell.

"If there is a bubble I don't want to do another condo," he said.

Copyright 2006 The Associated Press. All rights reserved. This material may not be published, broadcast, rewritten or redistributed.

Find this article at:

http://www.usatoday.com/money/economy/housing/2006-02-28-building-costs_x.htm

Check the box to include the list of links referenced in the article.

