

Building Material Price Trends

Q2 2021

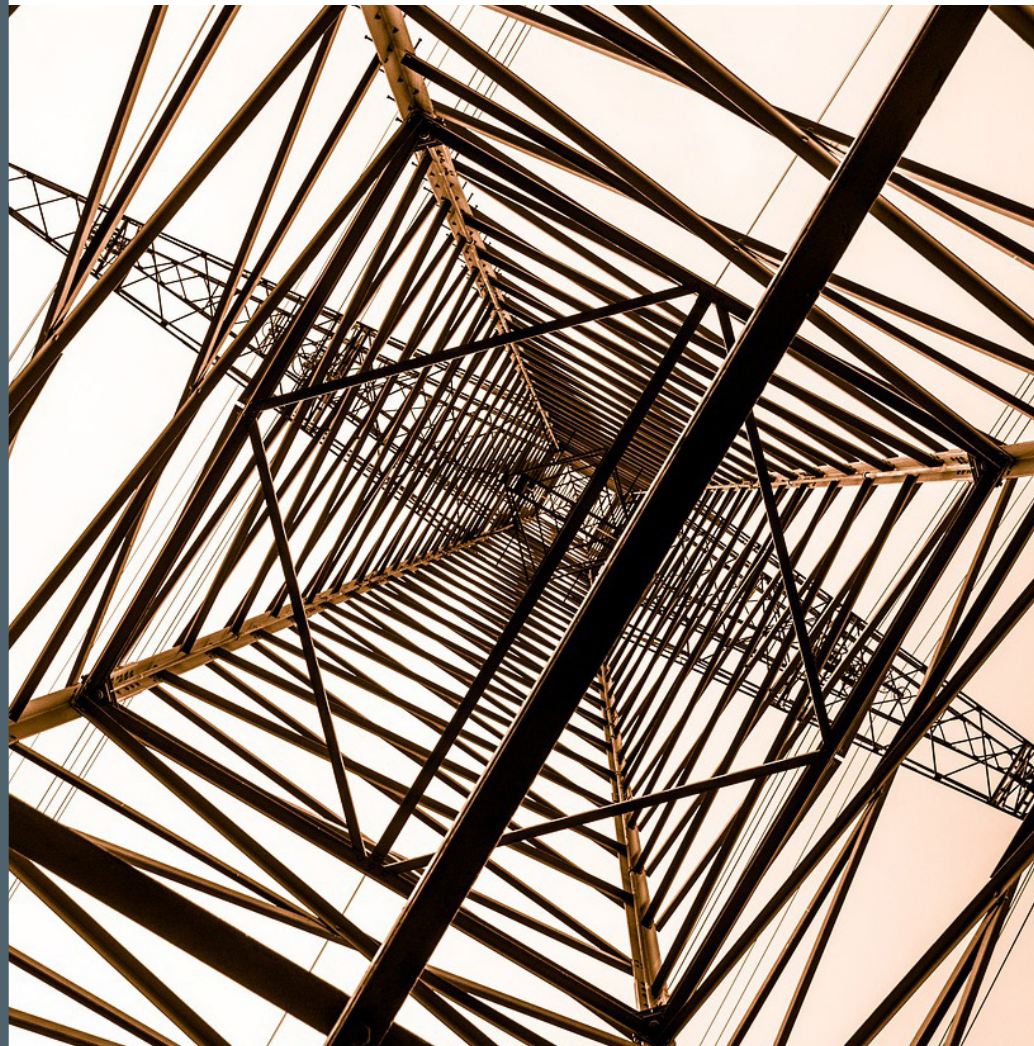
BRIEFING NOTE

April 2021

The US economy continues to recover from the historic 2020 pandemic-plunge, with the strength of the rebound depending on a number of factors, including the expansion of the vaccination program and the effectiveness of the \$1.9 trillion fiscal aid program to support labor markets, business confidence and consumer spending.

Construction activity ramped up since the second half of 2020 as lockdowns were lifted, and has been firm so far this year. However, market trends point to another eventful year for the industry.

In particular, the construction supply chain is facing significant building material price increases and price volatility, which is impacting project costs, schedules and cash flows of clients, contractors and sub-contractors.



Global Commodity PRICE TRENDS

Commodity prices have collectively seen significant increases in recent months. The WTI benchmark oil price climbed to \$62.6/ bbl in March 2021, reaching levels last seen in early 2019. The rise in copper prices has been even more substantial. Global copper prices passed the \$9,000/ ton mark in March, rising 15% so far this year and up 75% compared to a year ago (chart 1). Current copper prices are the highest in a decade, impacting the cost of many construction materials, most notably MEP products.

On the demand side, a rebound in global manufacturing activity, unprecedented state intervention and accommodating monetary policies, as well as a weaker US Dollar have all helped push up prices. Supply-chains are still feeling the repercussions of the pandemic-fallout in Spring 2020. Production capacity is reaching pre-pandemic levels, but some product markets are still dealing with disruptions which is impacting order backlogs, delivery times and prices. Conditions continue to improve, but these supply-side issues are likely to add to the volatility of the market this year.

The continuation of price increases will depend on how quickly supply-side bottlenecks are resolved. Overall available capacity in most industries is judged to be sufficient to meet projected demand in the near to medium term once operating rates improve. The IHS forecasts a stabilization in global commodity prices over the course of 2021 as supply and demand balance. It sees pricing risks on the downside pointing to a potential shift in investor sentiment, which could start a downward trend in prices.

US Building MATERIAL PRICES

Average local material prices have also recorded significant increases since the second half of last year, with the index for building material inputs to the construction industries now well above pre-pandemic crisis levels. In the three months to February, the index was up 4.9% year-on-year. Building materials are recording price rises across the board, but steel and lumber have by far seen the greatest price hikes since summer 2020 (chart 2).

Softwood lumber prices have been particularly volatile, with prices for the benchmark CME Random Length Lumber Futures ranging between \$260 and \$1,040 (per '000 sft) between March 2020 and March 2021 (chart 4). After an initial slowdown during the height of the pandemic, residential housing activity has been strong, fueling demand for lumber, which has led to scarcity, longer lead times and delivery delays, and mills taking advantage of market conditions raising prices. Some easing in the market can be expected, but prices are likely to stay high putting pressure on the cost of residential construction.

Other building materials, such as plastics products, gypsum and glass products have also seen price increases, but not to the extent of lumber and steel.

CHART 1: OIL AND COPPER PRICES

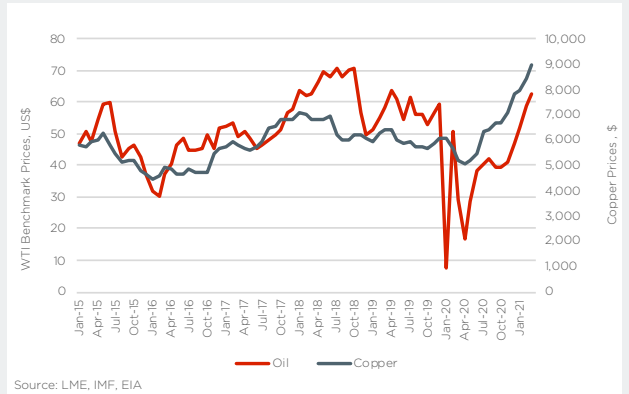


CHART 2: US BUILDING MATERIALS INFLATION

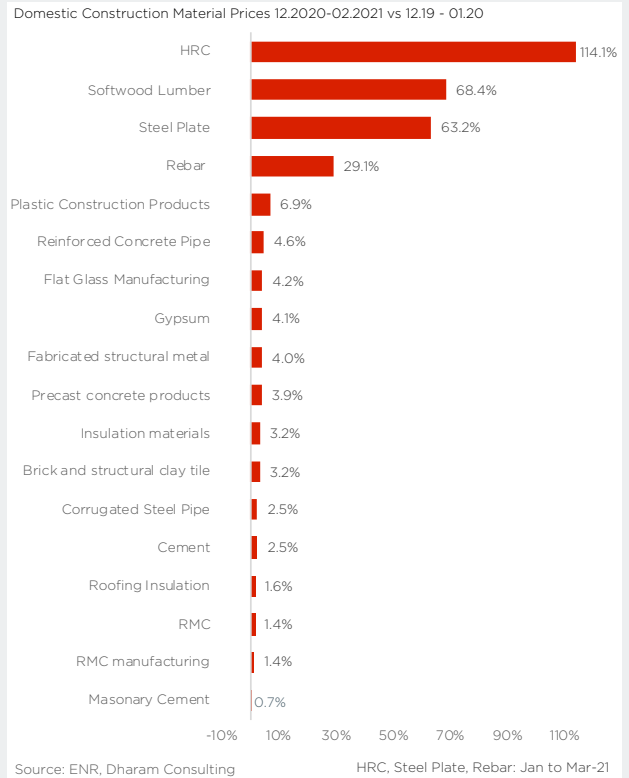


CHART 3: LUMBER PRICES



STEEL Prices

Current Trends

Steel prices for major product groups have rallied globally since Summer 2020, though the increase has been especially prominent in the US where mills have repeatedly pushed up prices over the past 9 months (chart 4).

Sheet, tube and plate prices have seen the largest gains. Hot-rolled coil prices averaged \$582/ ton in pre-Covid-19 February 2020. After plunging to \$489 in April 2020, prices started to rise and stood at \$1,300/ ton in March 2021, and an all-time high. Tube prices have followed domestic HRC price increases, with mills having announced more than 10 price increases since late summer 2020. Similarly, steel plate prices increased by over 60% to \$1,200/ ton over the same period. Rebar prices also increased, though not to the same extent, rising from \$560/ ton in summer 2020 to over \$860 per ton in March 2021 (chart 5). The rise in semi-finished good prices has fed through to finished steel producer prices for product groups across the board.

Supply-side factors are the main reason for the rapid increase in prices. The large amount of steelmaking capacity idled during the heights of the pandemic could not be restarted quickly enough to meet the stronger-than-expected rebound in steel demand, leading to supply tightness in the market. Inventories were driven to low levels, as a lack of supply left service centers unable to restock, prompting prices to skyrocket. In addition, increases in input costs, such as scrap, as well as higher truck and rail transportation costs have pushed up prices for finished steel, such as steel pipe and tube, steel wire, hot rolled steel bars, plates and structural shapes.

Despite lower international prices, imports have not increased materially so far, as high import costs (tariffs and transportation) has deterred buyers. Should domestic prices continue to rise, imports may become increasingly attractive to U.S. buyers, even factoring in tariffs and transport costs.

On the back of firm demand, tight domestic supply and limited availability of imported material, delivery times have lengthened significantly. According to Farwest Steel Corporation, in March lead times for hot rolled sheet ranged between 9-12 weeks for delivery from the Midwest, while lead times for HSS tube ranged between 5-7 weeks, rebar 4-6 weeks and for beams 7-9 weeks.

Outlook

Until steel production increases significantly, inventories are restocked or demand softens, steel prices will remain high. Steel demand is set to strengthen further this year, albeit coming from a low level in 2020 as production levels are yet to make up the losses sustained during the first half of 2020. Overall, we do not see demand across a broad range of steel-consuming sectors increase excessively above pre-pandemic levels.

Steel mills have now restarted and US steel production and mill utilization at 75.3% in March 2021 is nearly at par with pre-pandemic levels of 77% on average in 2019.

Given current price levels, steel mills will have a strong financial incentive to continue to increase production so that we can expect a further increase in utilization rates.

This has prompted expectations that the market will soon reach a tipping point and prices will start to level out. Overall steel-making capacity – if online – is generally sufficient to meet demand however, views are currently divided whether prices will be maintained at this level or are going to start to retreat in the near term.

Whilst there are questions about the sustainability of the current high steel price levels, given the current lead times, limited inventory levels, and healthy underlying demand we share the view that the market will support high price levels for much of this year. Substantial capacity increases are likely to start easing some of the pressure, which could cause prices to start retreating before year-end.

Across the economy, sectors will continue to deal with the repercussions of the Covid-19 pandemic impacting demand and supply, as well as producers and consumers alike, which is likely to sustain pricing uncertainty and volatility in the construction market.

CHART 4: GLOBAL HOT-ROLLED COIL PRICES

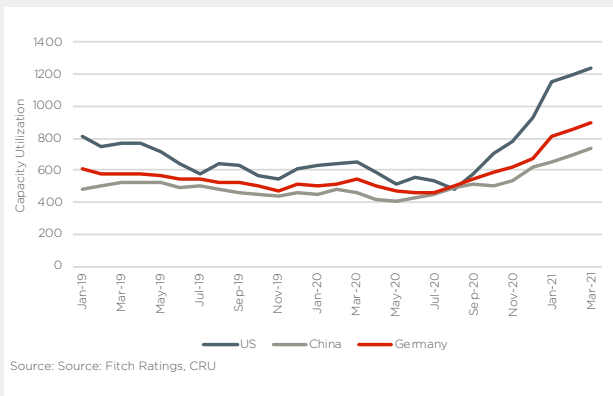
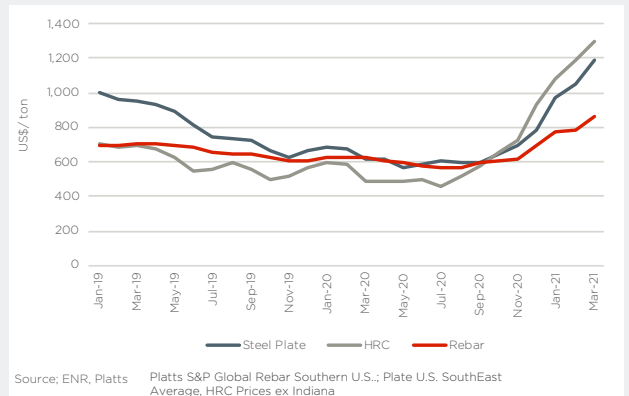


CHART 5: US DOMESTIC STEEL PRICES



Impact on Construction PROJECTS

Sharply higher prices coupled with long lead times for many steel products has created difficult market conditions across the construction supply chain, impacting project costs and supply chain relations.

Construction Cost and Bid Submission Prices

US building material price spikes are exerting significant upward pressure on construction cost. The ENR building material price index recorded a 4.6% year-on-year increase in the first quarter of 2021 (chart 6). Labor costs are relatively flat, with skilled labor and common labor recording a 1.6% and 0.8% increase, respectively in 1Q 2021 compared to a year earlier (chart 7).

Consequently, the rise in building costs is almost entirely driven by material prices, with the sub-index up 9.2% year-on-year over the same period. In March, the rate of price increase accelerated, with the index rising 2% compared to February and 11% year-on-year. The rise in steel prices (together with lumber) is the main driver behind the increase.

Construction starts dropped overall in 2020 and many projects that were expected to enter the bidding market were put on hold.

The bid environment was expected to firm up over the course of 2021 and so far, the rebound in projects being put onto the market has been stronger than we had anticipated in late 2020.

In fact, a strong bidding environment is already putting pressure on bid submission price inflation this year.

In this environment, contractors who have more choice of projects will seek to pass on the higher cost of material prices fully through the supply chain. Depending on the building type (and location), steel costs are a major component of building cost. We estimate that if fully passed down, the current rise in steel prices could add up to 2% to project bid submission prices in 2021 alone.

CHART 6: BUILDING COST INDEX

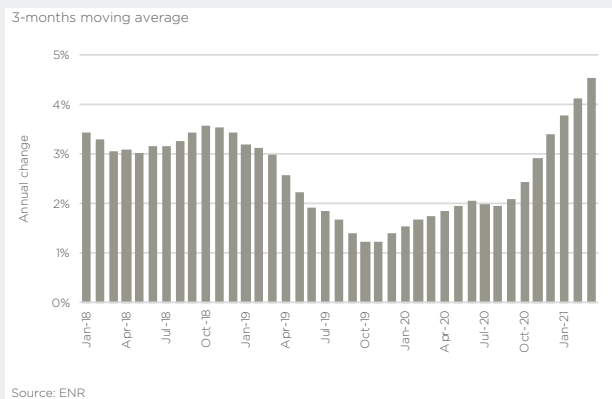
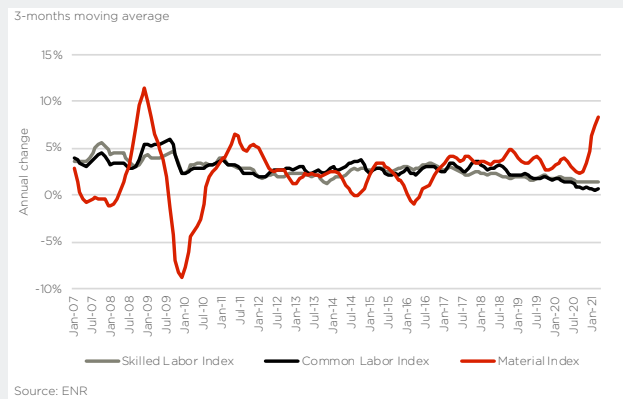


CHART 7: BUILDING COST INDEX



Availability

Extended lead times make on-time availability of steel products currently a major issue for many purchasers and projects. Material substitution is often a limited option. Given that near-term steel prices are expected to remain high, buyers may face difficulties in maintaining a wait-and-see approach and could be forced to lock in these higher prices for the remainder of the year in order to secure materials.

Construction activity

Higher steel prices at a time of generally rising materials costs and in combination with labor shortages could slow construction activity unless project financials can absorb these increases.

Contractual relations

Whilst contractors will seek to pass on the cost of material price increases to protect their cash-flows and margins, clients will want to protect themselves and their project financial viability. Clear contractual clauses around contingencies for material cost increases should be included upfront to reduce later disputes and achieve mutually beneficial outcomes.

Shorter bid times

In addition to raising prices, in busy local markets (sub)contractors are likely to shorten the time that their bids remain valid in anticipation of rising prices to mitigate their risk.

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Project benchmarking, market intelligence and data analytics support our services. We are a certified Minority Business Enterprise.

Our services are based upon strong relationships and trust, and our professional advice is grounded in a fundamental understanding of what matters to the project owner, architect and other stakeholders on a high-quality federal or publicly funded project, enabling our clients to deliver their vision.

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