Construction Material Prices Starting To Cool, But Demand Concerns Are Creeping In

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After two years of volatility and historic increases, prices of construction materials have started to level off — although at much higher levels than before the pandemic.

But while prices have become more predictable, questions are starting to burble about whether demand can keep up. Total construction starts were up by 48% in July, according to Dodge Data & Analytics, but that was largely fueled by spikes in infrastructure and manufacturing — residential construction starts dropped, and the rate of commercial starts has slowed.

Builders and experts are expecting to see prices stabilize further, but are concerned that the still-high cost of building, coupled with the Federal Reserve's interest rate hikes could lead to canceled deals and further declines in demand.

"Cancellation rates are spiking up over the past few months, sales are declining and new housing starts are definitely cooling," said Matt Klinger, John Burns Real Estate Consulting's building products research manager. "The Federal Reserve rate hike is definitely having an effect on builder sentiment — and consumer sentiment. Homeowners are concerned about the general economy right now."

Overall construction material prices decreased by 2% from June to July this year, according to Associated Builders and Contractors data. But prices across the board are still higher than they were pre-pandemic, with steel and lumber products representing the biggest increases.

Prices for hot rolled steel bars, plates and structural shapes increased almost 29% from June to July this year, and by 83.5% from the same month last year, according to one analysis of the Bureau of Labor Statistics data. The cost of nails was up by nearly 55% from before the pandemic, power wire and cable by 74% and soft plywood products by 116.4%.

As many as three-quarters of developers were going over their construction budgets during the second quarter, a survey by research firm IDC found.

"Volatile materials are seeming to be less volatile, although their price points remain higher than history would suggest they should be or would be. We're still feeling the effects of supply chain, still some inflation is creeping in," Craig Williams, founder and CEO of Philadelphia-based builder and construction manager Pride Enterprises told *Bisnow*. "Things are starting to normalize, perhaps at a different level."

Both hardwood and softwood lumber prices are still up by over 50% compared to a year prior, but their prices are steadying — which could be a sign that other materials prices may do the same in the near future, Klinger said.

"Lumber is kind of the canary in the coal mine or that warning signal that we see," Klinger told *Bisnow*. "As builders work through their backlogs and complete homes under construction, I do see a scenario where products could follow suit and stabilize down the road."

The decline in lumber prices is symptomatic of which asset classes are beginning to see projects canceled or postponed, according to Associated General Contractors Chief Economist of America Ken Simonson.

"[Lumber prices] have come down sharply and they look like they're going to remain subdued for a while, because demand for housing construction is suddenly crumbling," Simonson told *Bisnow*.

Construction starts for single-family homes fell by nearly 10% from June to July, according to data released jointly by the U.S. Census Bureau and the U.S. Department of Housing and Urban Development. Permit approvals were also down by 1.3%, signaling that some developers may be stalling on plans amid the high cost of building.

Not all asset classes are suffering: Demand for industrial space has been pushing up rents for the past year, making building costs easier to swallow, industry insiders told an audience at a *Bisnow* event last October.

Glass prices — essential for industrial and office construction — are up almost 9% compared to a year ago, and almost 20% compared to pre-pandemic costs, according to Yield Pro's analysis of BLS data. **But the cost increases haven't dampened demand, with construction for industrial and warehouse properties pushing ahead at full steam, Zetlin & De Chiara LLP Managing Partner Michael Vardaro told *Bisnow*.**

"I think we've seen certain things in the housing sector that maybe don't translate exactly in the commercial and industrial sectors, because those sectors, we've seen continued interest and people are moving forward with projects," Vardaro said. "I won't say that everyone is not worried about the future, but they seem to be moving forward cautiously."

Confidence in the industrial sector is high because how people shop has changed since the pandemic began, with more people relying on internet shopping from big-box stores, Vardaro said.

Commercial building starts are 13% higher so far in 2022 than they were through July 2021, although in July, commercial building starts fell 11% year-over-year, according to Dodge. Manufacturing construction starts, even before Congress passed two laws that will funnel billions into the making of semiconductors, solar panels and electric vehicles, are up 189% in 2022 over last year.

In order to ensure they have enough material to meet the growing demand for large-scale projects — at a price they can lock in — builders and contractors are increasingly in the market for storage space for materials they buy before they need them.

But as supply chain issues persist — with importers clogging the U.S.' East Coast ports in an attempt to avoid materials long-delayed off-shore in California — costs could continue to climb. Increased costs are already being baked into budgets rather than being swallowed by builders, contractors or subcontractors who are interpreting the increases as permanent or at best unpredictable, Williams said.

"Once prices reach a certain level, they don't typically recede, things kind of establish a new new level," he said. "These have been extraordinary circumstances. I have no crystal ball. I can't tell you truly how this is going to shake out."

Prices could climb higher still, thanks to the Fed's back-to-back 0.75% interest rate hikes in June and July this year, a move that immediately had a chilling effect on homebuilders and prospective homebuyers alike, bringing loan costs up and making potential developments and purchases less affordable.

Now, almost a month after the most recent interest rate hike, slowing demand and cancellations have created circumstances for some builders to make headway with large backlogs on projects caused by materials shortages and supply chain difficulties. But Pride Enterprises' Williams told *Bisnow* that he is concerned about the consequences of continuing delays and even higher costs.

"I have a project that a client wanted delivered by Dec. 31," he said. But the project required a new air handler unit, which wasn't delivered until this month due to supply chain snags. "The client has a lot of heartburn about it. The deeper fallout is whether or not we retain this client. And that may be completely unfair."

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