

Rising energy costs drive construction prices higher

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Construction costs for all building types continue to rise, and industry professionals say the major catalyst behind the escalation is the same one facing most Americans.

"It's the energy costs," says **Bob Greene**, vice president of construction for Worcester-based construction firm **Cutler Associates**. "A year ago, it would have been the steel going to China, but today it's definitely the energy costs."

Last year, when the topic of rising construction costs was discussed, China's building spree was invariably fingered as the culprit. The country's booming economy spurred an unprecedented residential and commercial building explosion, and demand for construction materials, particularly steel, drove up prices stateside.

That perception shifted last year in the wake of hurricanes Katrina, Rita and Wilma, and the ensuing damage was expected to increase the demand for building materials — a situation that has yet to materialize due to lagging reconstruction efforts. A recent report issued by **Associated General Contractors** Chief Economist **Ken Simonson** concluded that "rebuilding from hurricanes Katrina, Rita and Wilma is not likely to have much impact on national markets for materials or labor."

Steve Fox of Boston's **Corporate Project Partners** says there "were some costs associated with the initial impact of Katrina, but that has subsided. I don't think it's been significant."

The impact felt most by Massachusetts construction firms as a result of Katrina has largely been through the increases in energy prices. Oil and natural gas production from the Gulf

is still down about 15 percent, according to the AGC report. The price of diesel fuel used for heavy construction equipment and trucks rose 32.6 cents in New England from March of last year, according to the **U.S. Department of Energy**, and has led to hefty fuel surcharges for deliveries by materials suppliers.

Compounding the problem is that a tremendous amount of materials used in construction projects are derived from oil and natural gas. Such supplies as asphalt, roofing materials, insulation and PVC pipe, right down to the paint and carpet, are made from crude oil and gas. And concrete, cement and drywall are all energy-intensive to produce.

One local construction executive says concrete "was \$100 a (cubic) yard last year, now it's \$125," a jump he attributes directly to transportation and production fuel charges.

The AGC also reports that while steel prices have leveled off for now, copper and aluminum are high and continuing to rise. The price of copper ores alone rose 34.1 percent in 2005.

But despite the increase in fuel and materials costs, local construction companies say that the industry is in good shape.

"Improvements in the economy are spurring demand," says **Lori Coletti**, client services director for **Elaine Construction** in Newton. "The demand for labor is increasing, and there's a lot more momentum."

Elaine Construction specializes in tenant improvement work, which has a much shorter turnaround time for projects, so Coletti says that her firm

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is "not as concerned with spikes in inflation. We don't build in escalation factors (in contracts)."

Firms that manage larger projects with longer start-to-finish periods often build clauses into their bids to protect against surges in construction costs that can cut deeply into margins.

"There's a tremendous amount of volatility out there," says **David Shrestinian**, vice president of construction management services for **Bond Brothers**, a firm that has built a number of student residences for local schools, such as **Harvard** and **Brandeis**. "When we do pricing, we price at conceptual levels. We always tell clients that we need to carry an escalation factor in the budget."

As an example, Shrestinian says that a client that accepted a bid six months ago for a project that will begin in about 12 months has a contract that calls for a 6.75 percent annual escalation factor to offset expected increases in costs.

"It's a little bit of crystal-ball gazing," he says. "We really have to calculate what the right escalation factor is going to be."

Cutler Associates' Greene says that

his firm usually doesn't have mechanisms in place for cost escalations in their contracts. Greene says that by doing so they're able to issue early procurement packages for particularly volatile items. That was the case recently when they purchased a pre-cast concrete plank with a present cost of about \$1 million, for use in a residential project at the **University of New Hampshire**.

"That was the first procurement package that we issued before the site development, so we protected ourselves and the customer against the rising costs."

Since construction firms have little control over the wild fluctuations in the market, some firms try to combat cost inflation through communication and research.

"We're always talking to the subcontractor community to understand the trends of material and labor escalation," says **Jim Stukel**, vice president of **Shawmut Design and Construction's** corporate group.

Stukel says he expects material cost escalation this year to be about 10 percent, down from 15 percent in 2005. "I think it's getting better," he adds. "But the wild card is the cost of oil."