

Construction Cost Earthquake

April 2024

(SouthBuild (SB) is simply a nickname for ease of memory. SB is the teaming of an architect and a construction manager specializing in county level justice facilities—the SpiritArchitecture Group and Smith-Doyle Contractors, respectively. The team, in its 27th year, has contracted with over 100 counties in TN, AR, AL, MS, LA and OK, having been involved with more than \$500,000,000 worth of construction and more than 15,000 detention beds—most at the small and midsized county level.)

Construction Cost “Earthquake”. Construction cost increases observed by SB in the last four to five years have been unprecedented, primarily surfacing in the last two years. The rate of increase has been extraordinary—easily described as an “earthquake”.

As noted by Scott Rozanski, President of SpiritArchitecture, *“The long-term impact of the ‘seismic doubling inflation’ (on construction cost) to our clients will produce higher price increases per square foot than previous decades, even with relative low inflation rates.”*

Further addressed by Robert Barrett, President of Smith-Doyle, *“scarcity of quality trade contractors, material and labor shortages all combine to make an extremely unpredictable environment for estimating and budgeting projects.”*

These observations are similar to others involved in the construction industry such as:

- Thomas Schleifer, PhD, Construction Executive/Consultant
“We haven’t had to manage our business in an...environment that exceeded 5% [annual increases] for the last 32 years. That’s a professional lifetime for most construction executives.”¹
- Barry LePatner, founder of LePatner & Associates, Construction Advisors
“The construction industry has a shortfall of hundreds of thousands of workers in the U.S., as much as 500,000, according to some estimates.”²

Yesterday. The “seismic” cost increases substantively began with the COVID event in the spring of 2020, rippling through the United States (and worldwide) economy by affecting availability of goods and labor. This has reflected in construction cost increases seemingly erupting, beginning in 2021 and continuing through 2023. News stories about delivery congestion in U.S. ports

¹ Thomas Schleifer, 2022, *2022 Construction Inflation Alert*, Construction Financial Management Association, Page 1.

² Barry LePatner, 2024, *Construction Costs Continue to Rise in 2024*, Commercial Property Executive, Page 3.

began soon after the arrival of COVID in 2020³. Subsequently, labor shortages began to be seen in 2021 and 2022, sometimes referred to as the “Great Resignation”.⁴

As a result, at a planning level, per square foot construction costs have almost doubled⁵ in the last five years. Although particulars vary, “almost doubling” is a relatively accurate description from a planning perspective. Labor continues to be a major issue⁶ along with the availability of construction materials and goods—particularly electrical related items⁷, such as emergency generators.

Today. Recent data⁸ suggests prices are still rising, albeit possibly at a more ‘modest’ rate. Materials availability has stabilized for some items. This is due, in part, to slowing private sector [construction] starts⁹. However, Barry LePatner, founder of LePatner & Associates indicates “*We still have...uncertainty of the supply chain. There is not an assured supply chain yet like we had before 2020 when the pandemic started.*”

Further, labor shortages are anticipated to persist for the foreseeable future¹⁰. SB has been able to obtain trade bids for most areas of work; however, select areas such as Drywall installation remain difficult to secure—primarily due to labor issues. Addressing current labor shortages will require creativity in assembly of construction bid packages leading to adjustments in established standard approaches.

Tomorrow. Although too soon to know for certain, SB believes it has seen a flattening of the rate of increase—with some areas having decreased slightly from previous highs. This has been sporadically reflected in the price of lumber and other miscellaneous materials.

This is loosely corroborated by other construction professionals: Sarah Martin, Associate Director of Forecasting for Dodge Construction Network said, “*Generally speaking, we view the institutional factor as being a little less sensitive to the real time economic fluctuations*”.

³ Donna Littlejohn, 2020, *Coronavirus continues hit L.A., Long Beach ports hard halfway through 2020*, Daily Breeze, Page 1.

⁴ Stephanie Ferguson/Makinizi Hoover, 2024, *Understanding America's Labor Shortage: The Most Impacted Industries*, US Chamber of Commerce, Page 1.

⁵ Brooke Muckerman, 2024, *MSCS says costs of building new high schools in Frayser, Cordova have doubled. Here's why.*, Memphis Commercial Appeal, Page 1.

⁶ Andrew Volz, 2024, *Construction Costs Continue to Rise in 2024*, Commercial Property Executive, Page 3.

⁷ As observed by the SouthBuild Team in bids in 2023 where emergency generator prices almost tripled in some instances with delivery times extending beyond 18 months. (General Comment re electrical equipment: Andrew Volz, 2024, *Construction Costs Continue to Rise in 2024*, Commercial Property Executive, Page 3.)

⁸ Producers Price Index, 2024, *Producers Price Index by Commodity: Inputs to industries: Net Inputs to Construction Industries, Goods*, Page 1.

⁹ Gail Kalinoski, 2024, *Construction Costs Continue to Rise in 2024*, Commercial Property Executive, Page 2.

¹⁰ Nick Zoumas, 2024, *Construction Costs Continue to Rise in 2024*, Commercial Property Executive, Page 3.

“Despite less than stellar December (2023) and January (2024) statistics Martin and others still reasoned there are reasons to be optimistic, and that activity will start to pick up sooner than later, if only slightly.”¹¹

Also, recent reports suggest a moderation in cost escalation such as the Federal Reserve’s recent decision to not change their benchmark interest rate for the fifth straight time. Federal Reserve Chair Jerome Powell indicated *“the surprising pickup in inflation in January and February (2024) hadn’t fundamentally changed the Fed’s picture of the economy: The central bank still expects inflation to continue to cool, though more gradually than it thought three months ago.”*¹²

With county level justice construction usually related to “need” instead of “want”, delay simply leads to additional expense. Sometimes, as seen in the last two to three years, the additional expense has been extraordinary.

Navigating these times will demand flexibility and implementation of different approaches. For instance, key equipment, such as emergency generators continue to have long lead times and are still at a premium in availability and cost requiring advanced planning for long lead items.

Conclusion: Cautious Optimism? *“As we move into 2024 and beyond, it appears the headwinds are calming, and hopefully, we will continue to see a return to a more stable and predictable bidding environment,”* comments Scott Rozanski.

Hindsight shows the basic construction cost “earthquake” began in the Spring of 2020, filtering into 2021. Hindsight also shows how the impact continued to ripple through the U.S. economy and the level of impact—almost doubling construction costs in 2022 and 2023.

The SB Team believes the economy is now in a state of “recovery” from the “earthquake”—past tense. However, using seismic analogies further, “aftershocks” continue to be felt in the form secondary budgetary pressures where projects are forced to reduce scope or take monies from other planned expenditures.

Understanding the impact of design and construction decisions on construction costs will be more important than ever in these challenging times. Or, said more plainly, experience and expertise will be a key to “getting the most bang for the buck”.

Again, creativity in the design and delivery approach will be a necessity.

(for additional information contact Jim Langford at jimlangford@spiritarch.com)

¹¹ Gail Kalinoski, 2024, *Construction Costs Continue to Rise in 2024*, Commercial Property Executive, Page 5.

¹² Christopher Rugaber, 2024, *Federal Reserve still foresees 3 interest rate cuts this year despite bump in inflation*, Associated Press, Page 1.