

The Rumbblings of Volatility

BY JOHN CROSS, P.E., LEED AP

Even as the economy remains unsettled, it appears construction pricing is beginning the return to more “normal” levels.

THE V-WORD IS BACK in our collective vocabulary. The stock market is volatile. Gas prices are volatile. And, if you believe what you hear on the street, steel prices are volatile. Or are they?

In recent months several AISC regional engineers have reported that project designers are showing some hesitancy to design in steel because steel prices are again “volatile.” They are hearing about increasing steel prices in the media and seeing increasing structural steel package prices. Yet at the same time, the prices publicly published by the producing mills on their websites have shown a decrease in the price per ton for structural steel.

What's Going on Here?

Like every other commodity material, structural steel has experienced periods of price volatility over the past eight years. Wood, copper, cement and petroleum-based products all have seen prices spike, then quickly fall back only to spike again. But over the past two years the typical mill price of a wide-flange structural section has stayed relatively constant.

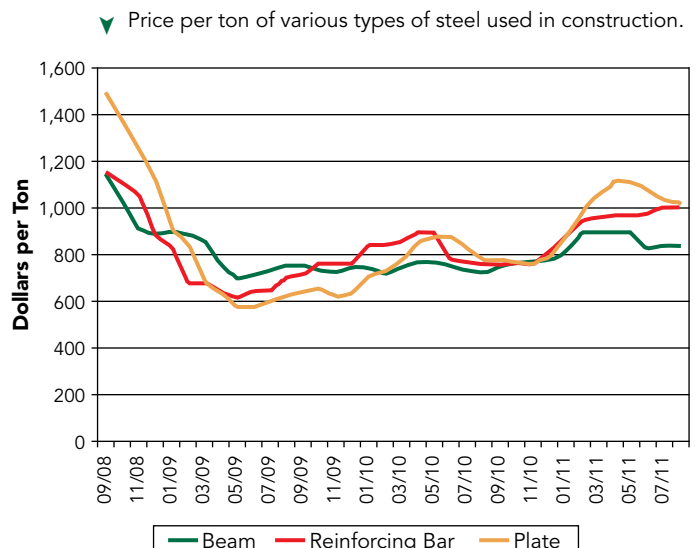


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Two Important Facts Are Being Forgotten

First, steel is not steel is not steel. Different steel products (plate, bars, sheet, coil, structural) exhibit different pricing behaviors. Of all the common types of steel products, structural steel has been the most stable over the past several years. There are several reasons for this including the balance of supply and demand, the use of electric arc furnaces for all hot-rolled structural shape production in the U.S., and supply chain considerations.

Second, material costs only account for roughly 30% of the overall cost of the steel package. The other 70% is a combination of fabrication and erection costs that transition the commodity of structural steel into the specialty product required for each individual building or industrial project. Historically based on U.S. Bureau of Labor Statistics data, an



increase in material costs would result in an increase in the overall cost of the steel package of about one-third the magnitude. For example, a 9% increase in the cost of structural steel sections would result in a 3% increase in the cost of the structural steel package.

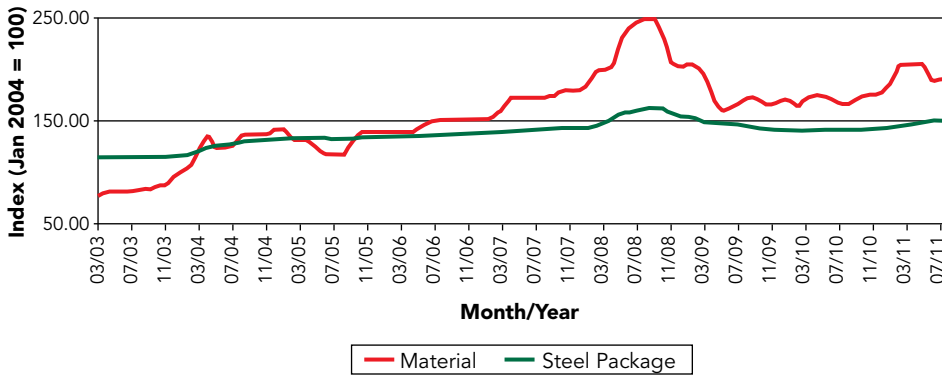
However, during the downturn in construction activity in 2008 and 2009 fabrication and erection prices experienced severe downward pressure falling even as material prices rose. Beginning in the fourth quarter of 2010 that trend began to correct itself with fabrication and erection costs moving upward and recovering a small portion of the margins lost in 2008 and 2009.

So what is really happening in the marketplace with structural steel prices? While some steel products are evidencing increased volatility, volatility of the type experienced in 2004 through 2008 has not reappeared in the structural steel market. Rather the increase in structural steel package costs is a function of a limited level of pricing normalcy returning to the marketplace.

For specialty contractors like steel fabricators and erectors, the return to more rational price levels is good news. However, all specialty contractors who depend on the purchase of commodity materials such as steel, cement, wood or copper need to be careful not to forget the lessons learned from 2004 through 2008 regarding how to manage volatility in material pricing. Clear contractual delineation of who holds the risk for volatility, pricing that includes a premium for holding that risk, acceleration of material orders to minimize the opportunity for volatility, compensation linked to the purchase and storage of materials as well as careful management of the supply chain are all critical considerations even in times of minimal volatility.

What does this mean for project owners and designers? The economic uncertainty of late summer may play havoc with construction demand and pricing levels, but it appears that construction prices in general and structural steel package prices in particular are beginning a return to more “normal” levels. While there may be a timing difference between material systems in terms of when this pricing recovery begins, the bottom line is that the cost level for all framing systems will maintain their relative positioning over the next several quarters. For project owners looking for the floor of the dip in construction costs, the time to move projects forward is now.

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◀ Material cost versus steel package index.