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LEGAL ALERT

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Beware Project Impacts Due to Rising Material Costs and Long Lead Times

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Steeply rising material prices and unexpected shortages for certain material deliveries are wreaking havoc on the construction industry. A recent article from the Associated General Contractors of America illustrates the threat these rising material prices can pose to contractors. Other projects have been impacted by unexpected shortages—and corresponding delayed deliveries—of certain items, notably steel joists. Contractors should watch changing material costs and delivery dates and communicate this information to both current and prospective clients as soon as possible. It is also important review contracts for terms related to material cost escalations and delivery delays in order to prepare for these issues.

The AGC article notes that the cost of contractor's material purchases for nonresidential construction rose nearly 13% from April 2020 to February 2021. Bid prices remained relatively stable in that same time period, however, rising only 0.5%. The increasing material costs are particularly severe for contractors working with copper and steel. In the same time frame, the Producer Price Index (PPI) for copper and brass mill shapes rose 37% while the PPI for steel mill products rose 20%. Furthermore, the benchmark price for hot-rolled steel this quarter hit its highest price in the last 13 years. For a contractor or subcontractor that submits a fixed-price bid but doesn't purchase materials until several months later, these cost increases may cause substantial impacts to project budgets. These increases could eliminate a contractor's profit from a project and create severe financial hardship.

Many contractors are also facing supply issues caused by the COVID-19 pandemic, shipping delays due to recent events in the Suez Canal and ongoing delays at major California ports, and unexpected shortages caused by certain companies cornering the market for particular items. According to the Census Bureau, unfilled orders for steel in the last quarter were at the highest level in five years. At the same time, steel inventories were at a three-and-a-half-year low. Notably, a certain major online retailer recently purchased all steel joists available in the US through late 2021. These factors have led to long delivery delays that, for many if not most contractors, were unexpected and unforeseen when bids were submitted and schedules were finalized. Current conditions in the industry show that this problem is not likely to end soon.

WHAT CAN YOU DO?

In light of these problems, contractors should review their contracts for provisions relating to material cost escalation adjustments and delays due to unanticipated and uncontrollable material deliveries. A material escalation clause will shift the risk from the contractor or supplier of goods and services back to upstream parties and provide a clear mechanism for addressing these issues, rather than requiring the parties to go through a lengthy claim process before reaching resolution. Every material escalation clause is different and must be evaluated on its own terms, but there are often similar features in such clauses. For instance, these clauses are often "cost-based" or "index-based." A cost-based clause compares actual incurred cost with the bid cost, and enables the contractor/supplier to receive payment for extra costs incurred. An index-based clause tracks and adjusts prices based on existing material price indexes and PPIs published by the Bureau of Labor Statistics. These terms can enable contractors to build smaller contingencies into their bids while providing the owner the ability to share in any savings should the price of materials begin to drop. Delay provisions should be evaluated to determine whether delays due to material deliveries are excusable and/or compensable.

If your contract does not contain a material escalation clause or a delay provision that encompasses material-delivery delays, also evaluate whether the contract has a force majeure clause. In some contracts, the force majeure clause is written broadly enough that it may apply to delays or added costs caused by unforeseen and uncontrollable market factors such as material-cost escalations and delivery delays. Upstream parties may push back on whether market factors truly represent force majeure events, though, and force the parties to engage in a claims process.

Regardless of whether or how your contract handles material-cost escalations and delivery delays, monitoring actual costs and schedule versus the original estimate and schedule is crucial in managing these issues. Keeping track of progress can help identify potential issues early and may avoid job loss or stoppage. Furthermore, contractors should always proactively raise these issues with upstream parties as soon as the issues arise in order to avoid any risk of waived claims. If the project is still in the bidding phase, contractors should also discuss the concern of material price escalation and delivery delays when negotiating the contract and schedule. Again, it is critical to be proactive. By getting ahead of price escalation and delivery delays before they happen, or at least promptly communicating and addressing them once they do, contractors can save a lot of headache for themselves and their projects.

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