

STEEL PRICES FEBRUARY 2004

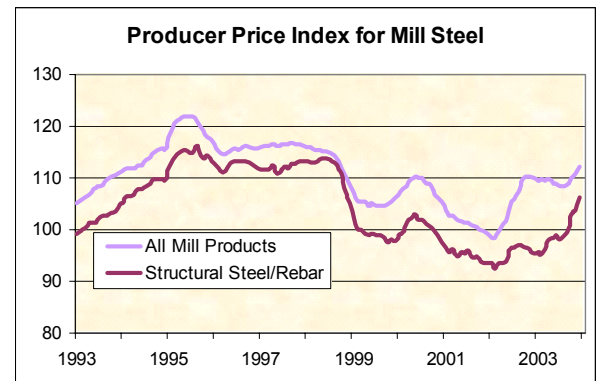
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In the past few weeks the rapid rise of raw steel prices has caused a great deal of concern in the construction industry. Global carbon steel prices have risen about 22% in the past year¹; some steel types have seen larger increases in the range of 30 – 40% worldwide. Further increases are anticipated over the next three to six months, with estimates as high as a cumulative 50% increase. While these increases are dramatic, and unprecedented in their speed, the impact on construction costs overall is likely to be fairly small. Raw steel contributes between 5% and 17% of the cost of steel in construction, and 2.5% of the total cost of a new building. The increase resulting from the rapid rise in steel prices is therefore only 1 to 1.5% of the total construction cost.

Overview

Increased demand for steel, especially in China has resulted in a scarcity of raw materials, driving up the price and leading to a rapidly shrinking pool of available resources. Mills are currently working at close to maximum capacity, and coal, ore and scrap metal are in short supply. Higher freight charges, due in part to the increased demand by China, have also contributed to the rise in price. Some companies have indicated that they will begin including surcharges on all shipments, starting this quarter, which they say are to cover the added costs from freight charges as well as the higher prices for raw materials and scrap. While some consumers are balking at the additional fees, the high demand and low supply in the market may leave them no choice but to comply.

In the United States steel prices are further aggravated by the weakening dollar, which has reduced the ability for consumers to afford the more expensive imports, putting more pressure on local suppliers. However, US steel producers are competing for the same rapidly dwindling supply of scrap and other raw materials as non-US companies, leading to more pressure on overall price of steel. This situation is compounded by the fact that the United State's depressed economy has led to consolidation and an overall decline in the capacity of the US steel industry to produce to the current demand. The recent removal of the steel tariffs did not drop steel prices appreciably, mainly due to the fact that demand and supply had a far greater impact on price for raw materials and finished products than the tariffs ever did.



While these increases in price have been particularly sharp in the past year, it is important to note that raw steel prices fluctuate like any other commodity, as illustrated in the graph above, and that the overall steel price index has still not returned to the highs seen in the mid 90's. What makes these recent spikes in price stand out more is how quickly and how steep the rise has been in such a short period of time.²

Impact on Cost

The increase in price for steel is greatly dependant on the type of steel material considered; those products that are more dependant on the high-demand scrap materials will have a higher price impact as a result. For example, materials costs for reinforcing steel have risen by about 70% in the last year. However, this translates into only a 9% increase in overall cost of the reinforcing steel when installed. In comparison, materials costs for structural steel have risen by only about 33% in the past year, yet materials account for only about 17% of the total cost of the structural steel. Steel is also found throughout buildings in miscellaneous metal fabrications, metal studs, and in ducts and pipe work. Total impact on cost for these systems due to elevated prices for raw materials has been very small.

The impact of these increases in steel prices on construction costs is still fairly small. Installed costs for reinforcing steel have increased approximately 10%, and structural steel approximately 7%. On the overall construction cost, the impact is much smaller.

¹CRU Steel Price Index (<http://www.steelweek.com>)

²Bureau of Labor Statistics (<http://www.bls.gov/data/home.htm>) – Producer Price Index Commodity Data

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Average overall cost impacts for major categories of steel product are shown below for concrete frame and steel frame buildings:

	Concrete Frame	Steel Frame
Reinforcing steel	0.80 %	0.15 %
Structural steel & metal deck	—	0.55 %
Miscellaneous metals	0.08 %	0.08 %
Metal studs	0.10 %	0.10 %
HVAC	0.07 %	0.07 %
Total Cost Impact	1.05 %	0.95 %

While the total cost increases resulting from the steel products themselves may not have a significant impact on construction budgets, one possibility for greater impact can be seen in construction project schedules. As demand increases and supplies shrink, some projects have faced delays in receiving needed materials. This can have a significant impact not only on budget, but also on the ability for projects to be completed in a timely and efficient fashion.

Conclusion

The current high demand for scrap material, iron and coal is likely to outpace supply for the next six months, and prices can be expected to remain at these inflated levels, or even continue to rise in the short term. A moderate fall in prices is expected in the second half of 2004, although prices are likely to remain elevated in the long term.

While the steep increase in the price of steel is certainly expected to have a significant impact on some industries, the impact on the construction industry as a whole is not as significant a concern. We expect that the higher steel prices will only add about 1 – 1.5% to total construction cost, which falls well within the 4 – 7% increase in cost of construction anticipated for 2004³.

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³ 2004 Market Escalation Report, Davis Langdon Adamson