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SSA Special Update: April 2004

STEEL PRICES INFLICT UNEXPECTED PAIN ON SELF STORAGE INDUSTRY

“Ouch!” That’s what some Self Storage Association members say when they hear the word “steel” these days. Steel prices rose exponentially in recent months, hobbling some members’ projects and introducing intensely frustrating uncertainty into their near-term planning.

“I’m in shock over it,” says the association’s president, Nancy Gunning, president of Chesapeake Resources, Inc. “Our economy is tough enough out there without us having this.”

The rapid run-up in prices caught industry veterans by surprise. Rick Dodge, vice president of sales and marketing at Rib Roof Metal Systems in Tennessee, recalls that such massive increases had not been included in projections.

“In February, when we did this year’s first trade show, I didn’t really truly believe it would be unprecedented like it is,” says Dodge. “When you get an eight to 10 percent increase you can live with it, but when you start getting 37-plus percent increases over two weeks--a lot of us didn’t see that coming. We hadn’t yet seen March and April’s big 60 to 70 percent numbers.”

Others point to even higher hikes, in some cases between 80 and 100 percent. Members’ shock at suddenly skyrocketing steel prices is accompanied by the fear that

this vital ingredient of most self storage facility construction will be unavailable at any price. That combination amounts to the perfect storm for members with projects under development.

“I have projects with people on them and they don’t have any steel,” observes John Wilson, president of Construction Processes International, Inc., a Houston-based general contractor. “People are canceling jobs. Manufacturers can’t deliver jobs. It’s really a terrible thing, and it’s impacting small business people in the country.”

The American Iron & Steel Institute (AISI) reports that as of April 10, 2004, domestic raw steel production was 2,007,000 net tons, a slight increase from the 1,943,000 tons produced a year ago in the week ending April 10, 2003. U.S. steel production was running at 90.1 percent in the week ending April 10, 2004, compared to 83.9 percent in the same period the year before.

AISI says adjusted year-to-date production through April 10, 2004 was 28,733,000 tons, a one percent increase over the 28,449,000 tons during the same period last year. Year-to-date capacity—or what AISI terms the industry’s “capability utilization rate”—through April 10, 2004 was 89.3 percent, compared with last year’s 85.1 percent for the same period.

AISI reported April 13, 2004 that for the first two months of 2004, U.S. steel mills shipped 18,225,000 net tons. That represents a 10.8 percent increase from the 16,451,000 net tons shipped during the same period in 2003, according to AISI.

The International Trade Administration's latest stats report that cold-rolled steel imports dipped recently. "February 2004 imports of cold-rolled steel decreased 3.0 percent compared to January 2004 levels and decreased 30.0 percent compared to February 2003 levels. January to February 2004 imports of cold-rolled steel decreased 34.5 percent compared to the same period last year."

What Happened?

How did this worst case scenario become reality for the self storage industry? A variety of factors contributed to the pain.

The "Reader's Digest" version goes something like this. The People's Republic of China has become the world's biggest steel consumer, out-running its own steel production capacity. U.S. steel producers--weakened by years of industry consolidation, bankruptcies, and battles for survival--have not been able to keep up with demand. A limp U.S. dollar has tilted the playing field against U.S. steel consumers. Coke supply problems that hinder steel production, plus increasing energy and shipping costs, round out the list.

"You're dealing with a dynamic out there that's multifaceted," explains Dave Cook, CEO of Tech-Fast Metal Systems. "There's no single cause for the cost to spike up as suddenly and as much as it did. It's truly an example of world dynamics."

Caesar Wright, president of Mako Steel, Inc., points to China as the main factor. "The tariffs (on foreign steel) were lifted in December 2003, and we thought it would keep our U.S. companies honest and drive

prices down a bit--but then China exploded with growth."

Not everyone accepts the standard explanations, though. Emotions are obviously running high among members who find themselves caught in the market's pressure points. Comparisons with OPEC-controlled oil prices can be heard from some who believe steel producers are grinning ear-to-ear while squeezing customers for every dollar the market will bear.

"The reality is nothing changed," says Wilson. "They're blaming it on China...and its GNP isn't even the size of California's. Sure, a lot of things are being manufactured over there, but those are things that are not manufactured here now. I think the problem is created to drive the price up. You're talking about one of the world's most basic commodities."

AISI acknowledged in an April 14, 2004, statement that prices are up dramatically, noting: "The newly competitive steelmakers have started to benefit as U.S. steel prices have surged more than 30 percent in some grades since the beginning of the year on strong global demand. Cheap imports, once the scourge of the industry, have been prevented by a weakening dollar and high freight rates."

Global Perspective

International trade and metal industry analysts, however, suggest that the severe discomfort being experienced by some companies has been years in the making. Moreover, steel isn't the only commodity affected; copper, silver, cotton and other raw materials are similarly being consumed—largely by China—at record levels.

"Three great transformations are occurring," says Charlie Blum, president of Washington, D.C.-based International Advisory Services

Group, Ltd., long standing observers of metals industries, particularly steel.

First, the world market for metals has shifted to Asia. While China is by far the largest consumer now, India and southeast Asian nations like Vietnam should not be ignored.

Second, producers' excess of steel making capacity has been replaced by a shortage of steel making inputs. "The equipment's still there, you just can't run it," observes Blum.

Third, the buyer's market for steel has become a seller's market. "It probably won't go back for a good long time," predicts Blum, "so people need to evaluate everything if they want to survive."

China's demand for steel didn't arise overnight. However, Blum says, China tends to buy its steel in bulk—which has a big effect on supply. "Their needs are taking another quantum leap every year," he notes.

Enormous pent up demand for material goods throughout Asia drives much of this growth. As Blum puts it, "The bulk of mankind wants more stuff." That means every country is in a bidding war for the raw materials needed to make all those goods.

Years of pent up demand will not likely be satisfied in the short term. Pat Mears, an analyst specializing in China and trade issues at the National Association of Manufacturers in Washington, D.C., notes that China is intent on increasing its industrial base significantly over the next five to 10 years.

"It won't be a steady uphill climb," Mears says, but they will certainly continue to grow. "China is trying to bring a huge population into the middle class." She also agrees that India is poised to be a significant player in world trade.

Got Coke?

The coke problem has complicated the

picture, as well, although it doesn't always get the credit—or blame—that it's due. (Coke is a coal product used by some steel producers to keep blast furnaces hot.) It, too, is a multi-faceted, global challenge.

"The Chinese have put on what amounts to a quota through a licensing system," explains Blum. "It's a legitimate policy issue. The Europeans have threatened to go to the (World Trade Organization), but the U.S. government has not made that an issue."

Beyond China's coke manipulation, though, a shortage has resulted from a combination of market choices and mining disasters. Blum says the U.S. and Europe took production down "based on the presumption that you could buy it from China. But China needs the coke now, so it's not available from them."

He also cites a fire in a West Virginia mine that was a leading supplier, a mining accident in Australia, and another one in China. "You put these things together and it became impossible to find coke."

"So What?"

Of course, understanding the dynamics of a train derailment is little comfort for passengers on a careening train. Firms, like self storage developers, that depend on affordable steel to stay in business are deeply worried.

U.S. steel makers, observes Gunning, "are shipping to China, but what about the good ol' USA? Are 41 of the 47 steel companies bankrupt? In the short run it's a major, major problem—not just for the storage industry: auto makers, structural, anything (that uses steel)."

As Rick Dodge notes, steel is purchased months in advance, based on prices quoted at that time. "When surcharges become price increases, all of a sudden projected costs go out of control," he says. "People will feel the effects of this. Cars will cost more. Houses

will cost more. It hits everybody somewhere along the line.”

What does a builder do when faced with enormous supply side increases? “I’ve had fantastic feedback from most of my clientele, but not from others,” says Mako’s Wright. “As a whole it’s a very, very serious concern. For the first time in many years steel companies are able to dictate the price to the fabricators we buy from.”

Market Forces at Work

Others say that while the pain is real and serious, it’s an unfortunate but necessary byproduct of the laws of supply and demand. Companies with solid projects in good markets will, they say, ride through the tough times and could even emerge strengthened.

“If it forces some projects to not get built, it’s probably a good thing,” says Tim Hobin, vice president of development at William Warren Group in southern California. “If you have a project that’s make or break based on the price of steel, it’s probably a project that shouldn’t be built anyway.”

In addition to winnowing weaker businesses from the field, the pricing and supply crisis could force some companies to exercise greater discipline in developing new self storage properties. And that would be healthy, says Mike Burnam, CEO of Columbia, Missouri-based StorageMart.

“A lot of people in this business, especially small operators, will look at new development on the cost per square foot without putting all their bids and estimates together,” he explains. “Instead of using rule of thumb, I hope they use specific bids before proceeding with any new development so they have specific cost estimates.”

Dave Cook encourages members to approach the challenges of the current market like any successful business would:

by dealing with reality, regardless of what’s causing problems. Every day you don’t build, you’re losing rent, he says.

“I believe you need to build the right product in the right location. If you’re sitting on property...what else are you going to do with that property? If you build retail, or an office building, the cost of materials is going up through the roof in the same way,” Cook notes. “Take a breath and deal with the situation like any business would.”

Survival Strategies

While self storage companies have little to no chance of influencing steel prices, observers say, some members have looked closely at measures to mitigate costs. The most often mentioned approach: Value engineering.

That typically means looking for efficiencies in the design and building process. Working closely with the architect, the engineer, and the general contractor can “shave a few dollars out of your costs,” notes Hobin.

Building the new economic reality into financial projections is prudent, as well. “Budget better with a little more flexibility, and do your homework on the project in the first place,” suggests Cook. “Look at the location.”

Some have explored the possibility of using materials other than steel, but none of the members interviewed for this article had decided to switch. Using a lighter gauge steel in order to lower the end user’s cost was mentioned, though. “I haven’t been hearing of a better mouse trap so far,” adds Cook, “and none of our clients have gone to other material.”

Cook says phasing the project is another option. Rather than building out all 100,000 square feet at a particular site, for example, going in with half of that will help to determine when or how much to build.

Simple honesty goes a long way, too. “We’ve been trying to be proactive with our clientele,” says Wright, “telling them that...there may be a shortage and to please bear with us. The word is out now that this is a crisis.”

Better Information Needed

Even though awareness of the problem is spreading, some have complained that the problem should have been caught—and acted upon—sooner.

“It’s really being ignored politically,” says Wilson. “Somebody should have stopped this.”

Dodge agrees. The government “should have looked at this six to eight weeks ago,” he says. “They allowed it to get out of hand. It’s legal extortion. This should have been handled differently, and I don’t know why it wasn’t. I got no response from e-mails to senators and Congressmen.”

Better information might have helped sound an alarm, some say.

“We have lousy data,” observes Blum. “It’s poor and slow. We could have seen it coming, but we didn’t. Everyone was focused on excess capacity and didn’t pay enough attention to input constraints.”

Dodge adds that the self storage industry has a problem being able to track what is constructed. To truly grasp the impact of the crisis on builders, he says, someone needs to know how much is being built.

“I know the impact on me and a few other vendors, but as far as the overall impact on the industry—no one can tell you that. We can’t even tell how much steel is supplied to the storage industry.”

What Happens Next?

Estimates about how long prices and supply will remain at such challenging levels vary significantly. Some think the worst of the problem will soon be past, perhaps within a few months. Others believe “short term” really means more like a year or two.

On the other hand, while prices may continue to fluctuate, or even moderate, over time, market conditions overseas would suggest continued upward movement. “This can’t be the peak,” says Blum, “because look at all the people in China and India who don’t have a car yet.”

If the current price and supply scenario is the leading edge of a larger market shift, the effects will be brutal, analysts say. And steel producers should be expected to test the value of their product in the global marketplace and adjust prices accordingly.

Self storage observers will likely also be watching other industries’ responses, most notably auto manufacturers, appliance makers and construction. General Motors sued two of its suppliers, even as it continued to buy steel from them.

Says Wright: “I’d like to be a fly on the wall in GM’s corporate office.”

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