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High Lumber Prices Threaten Housing Market

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By LIAM PLEVEN And LESTER ALDRICH



Bloomberg News

Wood headed for the door-manufacturing facility at Sierra Pacific Industries Inc. in Anderson, Calif. Lumber futures are up 32% this year.

The long-ailing U.S. housing market is facing a new headwind—a jump in the cost of lumber.



Lumber prices have climbed 32% on the futures market this year, a sudden and unexpected surge that could raise construction costs or force builders to swallow an added expense.

"That's the last thing we need right now," Stephen Melman, director of economic services at the National Association of Home Builders, said of the recent price hike.

Lumber's price rise contrasts with a decline in most other commodities, such as fossil fuels and industrial metals. Those are dragging due to fears of weaker demand amid a fragile recovery from the financial crisis.

But lumber prices shot up because of a shortage of supply. When the housing market cratered, mills in the U.S. and Canada slashed production; output plummeted about 45% between 2005 and 2009, according to Random Lengths,

an industry data provider.

Wholesalers shrank their own inventories and had little incentive to build them back up last year. Housing is the largest single source of demand for lumber, and new-home sales fell 7.6% in December from the prior month, to 342,000 units.

So when builders began their annual re-stocking for the spring construction season, there was little slack in the supply chain, causing a squeeze on prices. Some firms also stepped up speculative construction in the hope that an expiring federal tax credit would boost the market.

"Any increase in demand is going to allow the mills to raise their prices," said Gary Vitale, president of the North American Wholesale Lumber Association.

On Jan. 5, lumber buyers got an added incentive to lock in shipments. Canfor Corp., a major Vancouver-based lumber producer, announced a temporary but indefinite closure of one mill that took 255 million board feet out of production, on an annualized basis—equivalent to roughly half-a-percent of total output from the U.S. and Canada in 2009.

The day after Canfor's announcement, lumber futures at the Chicago Mercantile Exchange closed up 5%. Prices kept rising that month and hit a peak for the year of \$279 per thousand board feet on Feb. 4, according to Thomson Reuters. Prices settled Friday at \$270.90.

Industry insiders described a buying frenzy somewhat detached from actual economic activity.

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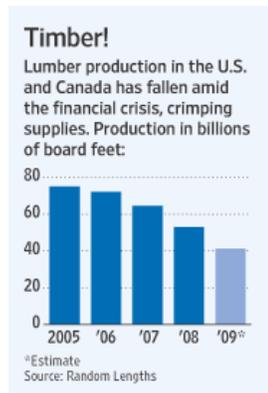
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"It's a bit of a herd mentality" in which people conclude, "If someone's gonna buy, I better buy, too," said Jamie Greenough, a broker and analyst at Global Futures Corp. in Vancouver.

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Home builders are wrestling with the consequences. Steve Petruska, chief operating officer of [Pulte Homes Inc.](#), told investors on Feb. 9 that the nation's largest home builder is responding to the price hike by trying to hold down labor costs. He predicted the situation "isn't going to be so bad."

But the January price increase was welcome news for [Weyerhaeuser](#), the forest-products giant, which reported a \$175 million fourth-quarter net loss on Feb. 5. Tom Gideon, a high-ranking executive, told investors the firm was "pleasantly surprised."



It is difficult to gauge how much the recent price increase would affect the price of a home, because various factors affect the bottom line. At the peak price for the year in early February, the rise would have added about \$1,000 to the price of a typical new home, said Henry Spelter, U.S. Forest Service economist.

Mr. Melman, of the home builders' group, said the impact on a more expensive house could be greater. "Builders don't have a lot of inventory sitting around," he said. "So when the price goes up, it really does go up, and that could have an immediate impact."

The supply crunch is striking because, just a few years ago, the North American lumber industry was able to supply enough wood to start more than two million homes

a year. That was nearly four times the pace of home starts in December.

The ongoing recession will keep production light, said Matt Layman, publisher of Layman's Lumber Guide in Belmont, N.C., who called this the only sustained supply-driven rally he has seen in 30 years of trading lumber.

Mills lost too much money in the lean years before finally cutting shifts and idling plants, and they don't have the necessary capital to restart shuttered operations now, Mr. Layman said.

The industry is also waiting to see whether lumber demand is actually rebounding, beyond the annual re-stocking. Dan Fulton, chief executive officer of Weyerhaeuser, told investors on Feb. 5 that it was "too early to tell."

The expiring tax credit may have boosted home builders' annual effort to fill their lumber stocks before the onset of spring makes building more practical. The measure was initially set to expire on Nov. 30, but it was extended and now offers first-time buyers an \$8,000 tax credit if they sign by April 30 and close by June 30.

If the home builders' wager on the tax credit doesn't pay off, and home sales remain tepid, lumber prices could suffer. "The sustainability of this rally is in question, because the amount of true demand is not clear," said Joshua Zaret, an analyst at Longbow Research.

And Mr. Petruska, of Pulte Homes, said the company wasn't locking in prices for future delivery, a move which could backfire if prices fall again.

"Obviously, in this demand environment, that's very risky," he said.

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