

B.C.'S CONSTRUCTION INFLATION

After the green light, a new challenge for Alcan

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VANCOUVER, TORONTO -- **Rio Tinto Alcan** is eyeing an even heftier price tag for the \$2-billion (U.S.) modernization of its antiquated Kitimat aluminum smelter, as it aims to cope with the cost echoes of B.C.'s construction boom.

On Tuesday, the company received approval for a long-term electricity sales contract with B.C. Hydro, the last of three conditions it had set out for proceeding with the Kitimat project.

That approval in hand, it is now taking a fresh look at the capital costs of the project.

"We feel fairly certain that the cost will go up," said Rio Tinto spokeswoman Colleen Nyce.

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The costs of major construction projects in British Columbia have been surging by double digits annually through much of this decade, as expansion in the natural resources sectors, a residential construction boom and infrastructure needed for the 2010 Games have heated up competition - particularly for skilled hands.

For Rio Tinto, labour cost is the largest area of uncertainty.

"The big unknown for us is the labour factor," Ms. Nyce said.

As it recalculates the price tag of its often-delayed expansion, the company is weighing the combined effect of the B.C. construction boom, competition from other megaprojects around the globe, and the surging Canadian dollar.

The company has satisfied other conditions for going forward with the upgrade. In addition to approval of its deal with B.C. Hydro, it reached a deal with its unions for labour peace past the startup date of the project and assurances on environmental assessment from the B.C. government.

Rio Tinto Alcan is far from alone in facing the big question of escalating capital costs in British Columbia, including more expensive steel and concrete. Residential and commercial builders have been forced to put their projects on hold, said Stuart MacKay of MMK Consulting Inc.

"There is a lot of demand out there that has been deferred because of the hot construction market," Mr. MacKay said. "People who would like to undertake projects but because of the cost impacts and labour availability have deferred projects that they would otherwise have taken on," he said.

So far, there's no talk of shelving Kitimat. Rather, the project will be brought before the Rio Tinto board in April. That gives the Canadian arm just eight weeks to update, and most likely redraft, cost estimates for the expansion. If the board gives its approval, construction would start later this year, with production from the new facility beginning in 2012.

Ms. Nyce said the company had already taken some steps to contain costs, including signing contracts for some of the specialized equipment needed to build a smelter. But some inflation of the 18-month-old price tag will be unavoidable. During that time, the cost of steel and concrete has been on the rise. And the Canadian dollar has surged, making wage bills more pricey in U.S. currency.

Weighed against those costs are the benefits that Kitimat will confer: an efficient modern plant that already taps into the surging Asian market for aluminum. "It will become one of the three largest aluminum smelters in North America and one of Rio Tinto's largest wholly owned smelters once the technology is completed," Rio Tinto Alcan spokesman Stefano Bertolli said.

Kitimat is a key operation in Rio Tinto's plans to target increasing demand for aluminum from Chinese and other Asian customers. Almost all of the facility's aluminum production - 95 per cent - is destined for customers on the Pacific Rim, including China. The remaining 5 per cent goes to the United States.

China is currently a net exporter of aluminum. But Rio Tinto chief executive officer Tom Albanese is betting that China's booming economy, combined with a lack of access to cheap electricity needed to produce aluminum, will reverse the equation. That belief was a key driver in justifying the U.K. mining giant's \$38-billion takeover of Alcan.

The expanded smelter would also cut Kitimat's greenhouse gas emissions by roughly one third, potentially reducing the company's domestic exposure to any new regulations.

The Kitimat project also has a substantial edge in operating costs, because of the associated Kemano hydro power station. Electricity accounts for roughly a third of the cost of producing aluminum. The deal approved this week by the utilities commission is slightly less favourable; Alcan won't receive \$111-million in one-time payments from B.C. Hydro that would have been used to help fund the expansion.

RIO TINTO PLC (RTP)

Close: \$383.89 (U.S.), up \$6.68

By the numbers

9%

Average annual increase in

Canadian non-residential

construction costs between

2003 and 2006

1.9%

Average annual increase between 1992 and 2003

\$17.3-billion

Capital cost of major projects

under construction in B.C. in 2001

\$53.3-billion

Capital cost of major projects

under construction in B.C. in late 2007

Source: Statistics Canada,

Government of B.C.

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