January 2012 Housing Notes

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Commentary on Housing: Overview

U.S. Housing
- New housing starts and permits
- New housing completions and sales
- Existing home sales and Case-Shiller Indices
- Foreclosures and Distressed homes
- FHA Enterprise/REO Asset Disposition

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Executive Summary

This summary reviews January's housing data and is intended to provide a wide-ranging perspective on the current conditions of the United States housing market. This commentary reports on the housing market and includes data for new home starts and sales, building permits, housing completions, and construction spending. Also included are comments concerning existing home sales, distressed homes, student debt, housing trends, money velocity, Enterprise/REO Asset Disposition, new home construction developments, pricing news and housing affordability, a missing demographic, and conclusions.

January's data indicated a small increase in housing starts. Multi-family starts, still volatile, are the driver for much of the overall housing increase. New home sales were down slightly from January as were starts. Permits increased very slightly, housing completions decreased, and residential construction spending increased.

Existing home sales are still ‘muddling along’; the quantity of available existing homes is declining, and the least since 2005. United States existing home prices are still declining year-over-year. Private investors are the main purchasers of foreclosure, real estate owned, and existing and new home sales.

In the future, student loan debt may be a stumbling block for home purchases. While the United States monetary base is increasing rapidly, according to the Federal Bank of Saint Louis, the money multiplier effects are anemic. The result is less money circulating and loaned for construction and homes.

Many variables are used in projecting housing, the most important factor is ‘Jobs’; until there is a substantial recovery in job creation and calling laid-off employees back to work, housing probably will remain in the doldrums.

Lastly, the Grecian debt saga continues in conjunction with the European Central Bank expanding its loan portfolio. This has stabilized the European banking system, but at what cost?
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Commentary on Housing

Opening Comments

- New home starts → no improvement
  - Jan 2011 to Jan 2012 starts averaged about 618,000 (SAAR)
  - Single-family starts decreased from December 2011

- Multi-family starts → still the driver for housing starts, in spite of volatility:
  - 5+ multi-family starts decreased year-over-year

Yet,

- In January, total multi-family starts increased from December

Source: U.S. Department of Commerce-NAICS 23, Construction
Commentary on Housing

Opening Comments

• New home sales → still bottom bouncing

• Existing home sales indicate a nascent increase → though statistically insignificant

• Shadow inventory and distressed home numbers → still elevated

• Renters → is the U.S. becoming a “Renter Nation”?

Source: U.S. Department of Commerce-NAICS 23, Construction; NAR®; CoreLogic
Commentary on Housing

Opening Comments

Economic deterrents to a meaningful recovery are unchanged

• Federal and State governments’ debt → still increasing
• Personal debt → fell 1.1% to US $11.53 trillion
• Student loan debt → still increasing
• European sovereign debt crisis → wait and see
• European bank debt crisis → stable? and highly-leveraged
• China → several analysts suggest a soft landing
New Housing Starts

Single-Family Starts Commentary

2012: Single-family (SF) starts → struggling along:

508,000 starts: down 1.0% from a downwardly revised December estimate of 513,000

From January 2011 to January 2012 – an increase of 16.2%

SF Starts:

4th consecutive year of historically low-start levels → still no relief in sight for hardwood and softwood sales

Source: U.S. Department of Commerce-NAICS 23, Construction
New Housing Starts

Multi-Family Starts Commentary

January 2012, Multi-family (MF) starts – Volatile and increasing:

175,000 starts (5+ units): up 14.4% from a downwardly revised December estimate of 153,000

From Jan 2011 to Jan 2012 – a decrease of 6.4%

16,000: 2-4 unit estimate for January

“On an absolute basis, the apartment industry is looking forward to a strong three- to five-year upcycle”¹ - Matt Slepin

“Renter Nation” will be discussed later in the commentary

Source: U.S. Department of Commerce-NAICS 23, Construction;
¹www.multihousingnews.com/in-focus/multifamily-outlook-for-2012-the-bar-has-been-raised-2/1004048396.html
Average monthly starts: January 2000 to January 2012

Source: U.S. Department of Commerce-NAICS 23, Construction.
Housing Permits Commentary

January building permits – privately-owned housing:
676,000 units (SAAR)

0.7% above the revised December rate of 671,000
19.9% above the January 2011 estimate of 568,000

SF authorizations
445,000: 1.1% above the revised December figure of 441,000

MF authorizations
5 units or more – 208,000 in January: 1.0% above December

Source: U.S. Department of Commerce-NAICS 23, Construction
January completions – privately-owned: 530,000 units (SAAR)

-12.0% below the downwardly revised December rate of 602,000
4.1% above the January 2011 estimate of 509,000

SF completions
389,000: -14.9% below the downwardly revised December figure of 457,000

MF completions
5 units or more: 136,000 in January

Source: U.S. Department of Commerce-NAICS 23, Construction
January Private Construction: $253.6 million (SAAR)

1.8% above the revised December estimate of $249.2 million

January SF construction: $113,940 million
December 2011 SF construction: $111,205 million

January MF construction: $16,205 million
December 2011 MF construction: $16,069 million

Source: U.S. Department of Commerce-NAICS 23, Construction
New Single-Family Home Sales Commentary

January 2011 new SF home sales: 321,000 (SAAR)
-0.9% below the revised December rate of 324,000
3.5% above the January 2011 estimate of 310,000

Unfortunately, new home sales are still fragile and at a historically low-level of activity

Both new home sales and starts are languishing

Source: U.S. Department of Commerce-NAICS 23, Construction
New Home Sales Commentary

Median new home price in January: $217,100
Average January sale price: $261,600
Estimate of new homes for sale at January’s end: 158,100 (SAAR)
5.6 months inventory (median)
Number of new homes on the market → again, the lowest in 47 years

Source: U.S. Department of Commerce-NAICS 23, Construction
National Association of Realtors (NAR) January 2011 sales data:

4.57 million (SAAR) from a downwardly revised 4.38 mil in December
An increase of 4.3%

Total housing inventory fell 0.4% to 2.31 million existing homes → a 6.1-month supply at the current sales pace (6.4 in December)

January contract cancellations: 33% vs. 9% in January 2011

Source: NAR® – February 2012
January Existing Sales Commentary

$154,700 median existing-home price, down -2.0% from January 2011

Distressed homes: 35% of sales - - (22% foreclosures and 13% short-sales) up from 32% in December and 37% in January 2011

All-cash sales: unchanged at 31% (32% in January 2011)

Investors account for the majority of cash purchases: 23% of homes; up from 21% in December and (23% Jan 2011)

First-time buyers: 33% from 31% in December vs. 29% from January 2011

Source: NAR® – February 2012
Commentary on Housing

Household Formations, Starts, Existing and New Home Sales: 2000 to 2012

Source: U.S. Department of Commerce-NAICS 23, Construction and NAR®
Home Price Indices Commentary

Standard & Poor’s/Case-Shiller Home Price Indices

“All Three Home Price Composites End 2011 at New Lows”

National composite index fell -3.8% in 4th quarter 2011, down -4.0% vs. the 4th quarter of 2010

10- & 20-City Composites combined fell by -1.1% in December over November

10-City Composite: -3.9% versus December 2010
20-City Composite: -4.0% versus December 2010

Data were worse than the -3.8% combined annual rates from November 2011

“While we thought we saw some signs of stabilization in the middle of 2011, it appears that neither the economy nor consumer confidence was strong enough to move the market in a positive direction as the year ended.” - - David Blitzer, Chairman of the Index Committee at S&P Indices

Source: ^Case-Shiller® and Case-Shiller Indexes® and Fiserv – February 28 2012
In Q4 2011, average US home prices → late 2002 levels and the index level reached a new low for 2011 (down -4.0% vs. 4th quarter 2010 )

Source: Case-Shiller® and Case-Shiller Indexes® and Fiserv - February 28 2012
Federal Housing Finance Agency

“U.S. House Prices Fell 0.1 Percent in Fourth Quarter 2011”

National composite fell -0.1% in 4th quarter 2011, down -2.4% vs. the 4th quarter of 2010

The House Price Index, SAAR and purchase-only, rose in the 4th quarter in 27 states and the District of Columbia

Of the 9 Census Divisions, the West South Central Division had the strongest prices in Q4 2011 with a 1.1% price increase. The Middle Atlantic Division was weakest and prices fell 1.2%.

“While FHFA’s national index shows a 2 percentage point price decline over the latest 4 quarters, 12 states and the District of Columbia posted price increases. When coupled with the fact that about half of all U.S. states saw price increases in the latest quarter, this growth adds to mounting evidence that real estate markets are seeing at least some signs of life” - - Andrew Leventis, FHFA Principal Economist
House prices are returning to more affordable levels but they may need to decrease more (discussed further in an upcoming slide).

In Q4 2011, average U.S. home prices → at March 2004 levels.

Existing Homes

Segmentation of America's 131.8 million homes - Joe Weisenthal

Source: 4www.businessinsider.com/a-quick-breakdown-of-americas-1318-million-homes-2012-2#ixzz1nDf6PJHO
Shadow Inventory, Delinquencies, and Foreclosures

Lender Processing Services\(^5\) reported a total of 12.13% of homes are delinquent or in foreclosures:

- 2.23 million loans < 90 days delinquent
- 1.77 million loans 90+ days delinquent
- 2.08 million loans in foreclosure process

Standard & Poor's\(^3\) reports that as of December 2011, Shadow Inventory was $371 billion, the lowest since October 2008. They estimate that it will take 47-months to clear the national shadow inventory.

Differences in liquidation rates between judicial and non-judicial states are creating a large and growing difference in regional estimates of the months-to-clear.

Four of the top 20 metropolitan areas recorded declines in months-to-clear during the quarter, while 16 reported increases.

Source: \(^5\)Lender Processing Services February 16, 2012; \(^3\)Standard & Poor's March 5, 2012
Commentary on Housing

Distressed Sales and Housing Prices

“Across the 50 largest metropolitan statistical areas … existing home prices fell about -1%

When distressed sales are included … existing home prices declined nearly -3%

The percentage of distressed existing U.S. home sales in 2011 … about 35%

From 2009-2010 & 2010-2011, a slowdown (occurred) in the percentage of distressed sales and a moderation in price declines…

could be a hopeful sign for homeowners and policymakers concerned about the detrimental effects of distressed sales on non-distressed property values.” - - Daniel Hartley, Research Economist, Federal Reserve Bank of Cleveland

Source: www.clevelandfed.org/research/trends/2012/0312/01regact.cfm – February 24 2012
4th quarter 2011: Bank-owned (REO) or other homes in the foreclosure process - 24% of all home sales. Down slightly from 2010: foreclosures 26% of sales.

204,080 distressed properties bought in the 4th quarter, down 2% from Q4 2010. For 2011, foreclosure-related sales down 2% year-over year to 907,138: 23% of all home sales.
2011 completed foreclosures: 830,000. 1.1 million in 2010 and from the start of the financial crisis in September 2008 → 3.2 million completed foreclosures. Nationally, 1.4 million homes (3.4%) of all homes with a mortgage were in the foreclosure inventory as of December 2011. Source: CoreLogic® – February 8, 2012
Commentary on Housing - FHA Enterprise-REO Asset Disposition

Purpose: Disposition of foreclosed properties: real estate owned (REO)

Who: FHA and qualified Management and Marketing partners – a joint venture

Strategy:
- Transaction structure (rentals; rent-to-own or direct sales; demolition)
- Geographic targeting of sales
- Available and low-cost financing

Inman News⁶: Fannie Mae, the FHA, and Freddie Mac currently have 250,000 foreclosed homes that may expand to 1.4 million REOs.

Overall goals are to reduce inventory, stabilize prices, and provide affordable housing

Source: www.fhfa.gov/webfiles/22805/REORFISubmissions_112911.pdf; ⁶Inman News
Demographics – Renter Nation

“The housing collapse and 33% plunge in prices since 2006… favor renting over owning.

This will dominate the housing market for the next 4-5 years, and put additional pressure on a weak economy” — Gary A. Shilling

“Rent-buy ratio near 25-year average; recent increases in MF construction suggest increasing rents won’t shift the ratio to renting; home prices at 2001 levels – ‘both these trends argue that prices are not a deterrent to home buyers’…”

*i-rates at the lowest level most people can remember → the missing elements appear to be mortgage availability and consumer confidence (for home purchasing)” — David Blitzer

Using this chart as a guide, renting is/may be more preferable than purchasing a home.
Demographics – Renter Nation

Total Renter Households

Source: U.S. Census Bureau, John Burns Real Estate Consulting, Oct 2011

2000: 33.7 million
2005: 33.9 million
2010: 37.7 million
2015: 46.8 million

Increase:
- 112,000
- 3.8 million
- 9.1 million

Source: John Burns Real Estate Consulting, U.S. Building Market Intelligence™ - December 9, 2011
Demographics – Renter Nation

“If historical trends hold, the total homeownership rate will return to 64% by the 4th quarter of 2016;

…with continued average annual household growth…an additional 3.9 million new renters or 780,000 per year (by 2016)” - - Gary Shilling

Why renting is the ‘New Normal’ for the next few years – Dr. Shilling:

• “Financing and Refinancing woes
• Growing delinquencies
• Inventory count – inventory is subdued at the moment
• Federal programs to assist distressed owners – not working
• Federal Reserve quantitative easing – minimal, if any help at all
• In some states, judicial process still is playing out”

Rental starts primarily benefit softwood manufacturing – not so much a marketing opportunity for hardwood manufacturers.

Is Student Debt important?

“First-time homebuyers are typically an important source of incremental housing demand, so their smaller presence in the market affects house prices and construction quite broadly.” - Ben Bernanke, U.S. Federal Reserve Chairman

“Nine percent of 29-34 year-olds received a first-time mortgage between 2009 and 2011...17% 10-years earlier.”

John Rao, VP NACBA

“The only persons with potential consumer credit issues are the students and the government that sponsored those student loans.”

GaveKal (23 February 2012)
Demographics – Student Debt

Student loan debt → $865 billion\(^{10}\)

- Greater than all credit card debt outstanding
- Greater than all household debt except for mortgages
- Average debt at graduation → US$25,000

Source: \(^{10}\)John Burns Real Estate Consulting, U.S. Building Market Intelligence™ - December 9, 2011; GaveKal Ideas – February 23 2012
The Federal Reserve Bank of New York restates concerns about the growing debt load of college students and graduates; almost 27% of 37 million borrowers have past-due balances of 30 days or more; “In sum, student loan debt is not just a concern for the young,” the report said. “Parents and the federal government shoulder a substantial part of the postsecondary education bill.”

Trulia reports the average “ideal home size” declined to +/-2130 ft\(^2\) and an average new U.S. home was 2,169 ft\(^2\) in 2010. Peak: 2,277 ft\(^2\) in 2007.
Demographics – New Home Construction Developments

Is the McMansion Era Over?
Americans’ Ideal Home Size would be this large:

- 3,200 sq. ft.: 9%
- 2,600 - 3,200 sq. ft.: 9%
- 2,000 - 2,600 sq. ft.: 13%
- 1,400 - 2,000 sq. ft.: 27%
- 800 - 1,400 sq. ft.: 28%

Rick Palacios: “Since 2007, new SF sales of +$500,000 have been halved, from 13% to 6%. Sales of <$200,000 rose: 33% to 42%. Homes priced <$300,000 are about 75% of all new SF transactions. Price declines and a shift to smaller homes are drivers in this change, but consumer attitudes have shifted too.”

Source: John Burns Real Estate Consulting, U.S. Building Market Intelligence™
Demographics – Pricing News & Home Affordability

In December 2011, median household income (inflation-adjusted) was $51,413 (US DOC).

According to Sentier Research (October 10, 2011), median household income was $49,909 in June 2011.

Even with home prices decreasing and housing affordability increasing – affordability will have to increase more for the ‘median’ American. Using the ‘old’ affordability formula, ‘capacity to borrow’ was limited to about 2.6X gross pay:

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<th>Existing median house price:</th>
<th>$154,700</th>
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<td>Median wage:</td>
<td>$51,413</td>
<td>3.01 &gt; 2.6</td>
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<td>$49,909</td>
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In all scenarios, existing and new home prices need to decrease further (or wages increase) to become more affordable.
According to GaveKal, if household leverage returns to the 1960-2000 trend (before the US household credit boom), the correction from the 2009s peak leverage is about 50% complete. The implication being that the average US consumer is still financially strapped. Combined with tighter lending practices and appraisals – home sales may remain constrained.

Source: GaveKal Ideas – February 23 2012
GaveKal: fewer workers and more retirees, difficult to project increasing household leverage. This has implications for the overall economy and housing as “…leveraging up is usually for people with rising incomes ahead, not for retirees.” In combination with the current employment situation, and younger adults strapped with student debt and limited job prospects, housing will be hard pressed to lead the US into a strong recovery. 

Source: GaveKal Ideas – Feb 23 2012
Don't Expect Consumer Spending to be the Engine of Economic Growth It Once Was

Consumer spending, the economy, and five-trends that will restrain a consumer spending comeback:

- Lower wealth
- Stagnant incomes
- Tight credit
- Fragile confidence
- Looming reversal of stimulus

In the past several decades baby-boomers were the peak-spending age group and currently Boomers are aging out of the ‘big spender’ years. Generation X is a smaller cohort, the group most damaged by recession, and the age class typically buying homes. This demographic shift indicates that consumer spending and home sales will be fragile for several years to come.

It is a financial fact, income - - adjusted for inflation - - must increase faster than inflation or sustained positive growth (real not nominal) consumer spending will not occur. This is important as consumer spending accounts for +/-73% of GDP. The missing demographic is Generation X and their spending like Boomers.
The Velocity of Money and the US Economy

The Velocity of Money and M1 are briefly discussed here as economic indicators. M1 is a measurement that quantifies the amount of money in circulation. The Velocity of Money or circulation, is the rate monies are spent in a discrete period of time. Generally, velocity is assumed to be the quantifiable economic activity associated with M1 and M2.

This is from Erik McCurdy of Prometheus Market Insight: “Since 2008, the M1 money supply has surged 60%, above the $2.2 trillion level in January. During this period, the velocity of M1 money plunged from 10.37 in late 2007 to 7.09 in late 2011 [nearly 30%].”

Why is this important?

“…velocity measures how fast money changes hands, providing a gauge of economic activity. In basic terms, when velocity declines sharply, even as supply is being introduced at an unprecedented rate, the implication is that the added liquidity is not engendering economic activity.”
U.S. Economic Indicators

M1 up 60% since ‘08

Source: seekingalpha.com/author/erik-mccurdy/instablog/3; Federal Reserve Bank of St. Louis
U.S. Economic Indicators

Velocity of M1 Money Stock (M1V)
Source: Federal Reserve Bank of St. Louis

M1 Velocity down 30% since ‘08

Shaded areas indicate US recessions.
2012 research.stlouisfed.org

Source: seekingalpha.com/author/erik-mccurdy/instablog/3; Federal Reserve Bank of St. Louis
M1 multiplier below 1.0 since ‘08

Source: seekingalpha.com/author/erik-mccurdy/instablog/3; Federal Reserve Bank of St. Louis
U.S. Economic Indicators

*Velocity of Money 1900-2011*

Equation of Exchange: GDP(nominal) = M*V

**Annual**

- 1918 = 1.95
- avg. 1900 to present = 1.67
- 1928 = 1.5
- 1932 = 1.17
- 1997 = 2.12

Sources: Federal Reserve Board; Bureau of Economic Analysis; Bureau of the Census; Monetary Statistics of the United States. Through Q3 2011. Q3 2011; V = GDP/M, GDP (est. = 5%) = 15.1 tril, M2 = 9.6 tril, V = 1.57

Source: Hoisington Management Company, 3rd QTR 2011
“You can lead a horse to water, but you cannot make him drink. You can force money into the system in exchange for government bonds, its close money substitute; but you cannot make the money circulate against new goods and services.” - - Paul Samuelson, Economist and Nobel Laureate

“…the M1 money multiplier has remained well below the 1.0 level during the last three years.

The Federal Reserve can attempt to spur economic activity by introducing monetary stimuli, but they cannot force banks to increase their loan and investment activity. The velocity and multiplier data trends clearly demonstrate that the newly introduced M1 supply is simply remaining idle in places like bank reserves.”

Mr.'s McCurdy’s and Hoisington’s analysis may be one of the reasons why home lending is constrained - - thus, not solely due to tightening credit standards.
Eurozone Redux²

The Grecian saga drags on; the ISDA declared Greece’s bond swap a ‘Credit Event’ or technical default on March 9. Many banks could be negatively affected – including U.S. banks.

The European Central Bank’s (ECB) Long-Term Refinancing Operation (LTRO) has stabilized the banking system – for now.

On February 28, €529.53 billion (US$705.7 billion)¹⁴ was loaned to 800 banks and in December €489.19 billion (US$639.9 billion)¹⁴ was allocated to 523 institutions. Some of February’s loans were rolled over from December.

These loans were allocated to many banks who are on shaky financial ground and some of their assets are sovereign debt bonds. Many analysts are now delving into the repayment terms, which are not discussed here, but the repayment terms and amounts are quite staggering.

The ECB is now leveraged by about 36.6X¹⁴. As a note, Lehman Brothers was leveraged 30X at the time of their collapse. Of course, Lehman was not a central bank.

Europe still warrants discussion as the ramifications of default may have contagion effects on U.S. financial markets.  

Source: ¹⁴www.ecb.int
Conclusions

New home sales are still bottom-bouncing

New housing starts are driven by MF starts and some analysts believe this to be the trend for some years to come

- MF units are still the catalyst for overall starts
- SF starts are struggling

SF and MF permits increased slightly

SF completions decreased substantially from December to January
MF completions – no change from December

Construction spending increased slightly
Conclusions

Existing sales are ‘muddling along’ – even with low interest rates
Lowest quantity of available existing homes since ‘05 – a positive
Private investors are the primary purchasers of foreclosure, REO, existing, and new home sales
Even with increasing home affordability – prices need to decrease further to become more ‘affordable’ for the ‘median’ American
Student debt and employment are a looming detriment to home construction and home sales in the future
Shadow inventory, foreclosures, and distressed homes may start appearing on the market soon. There has been a lull, in relative terms, of this inventory on the market due to the “Robo Signing’ debacle. Several analysts believe this inventory will be entering the market shortly and throughout the upcoming year.
Conclusions

Recently several economic indicators have shown improvement and the majority can be used to project housing starts and sales. However, the one variable that is most crucial is Well Paying Jobs. When JOB creation numbers are greater than those laid off for the first time + new entrants + laid-off workers – that’s when we may see a housing recovery.

But from analysis – i.e., ‘looking under the hood’ – it still appears a meaningful housing recovery is several years in the future – and we hope it is not.
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