Housing comments – March, 2013

Still lots of headwinds to deal with:

- economy is getting better, albeit very slowly
- government debt issues – all levels of government – exacerbates the job problem
- Much of Europe in recession – major banking problems – Cyprus is latest
- This will impact USA – Europe is our largest trading partner and our banks are linked to theirs.
- Housing's main problems - Weak domestic economy made worse by slowing world economy; weak job market; poor income growth; high debt levels; and tight credit environment

- Demand (not enough), Debt and uncertainty are some of serious problems that are impacting the economy.
- **Job creation is key to better demand!!! – this requires better vision from "Washington"**

Background:

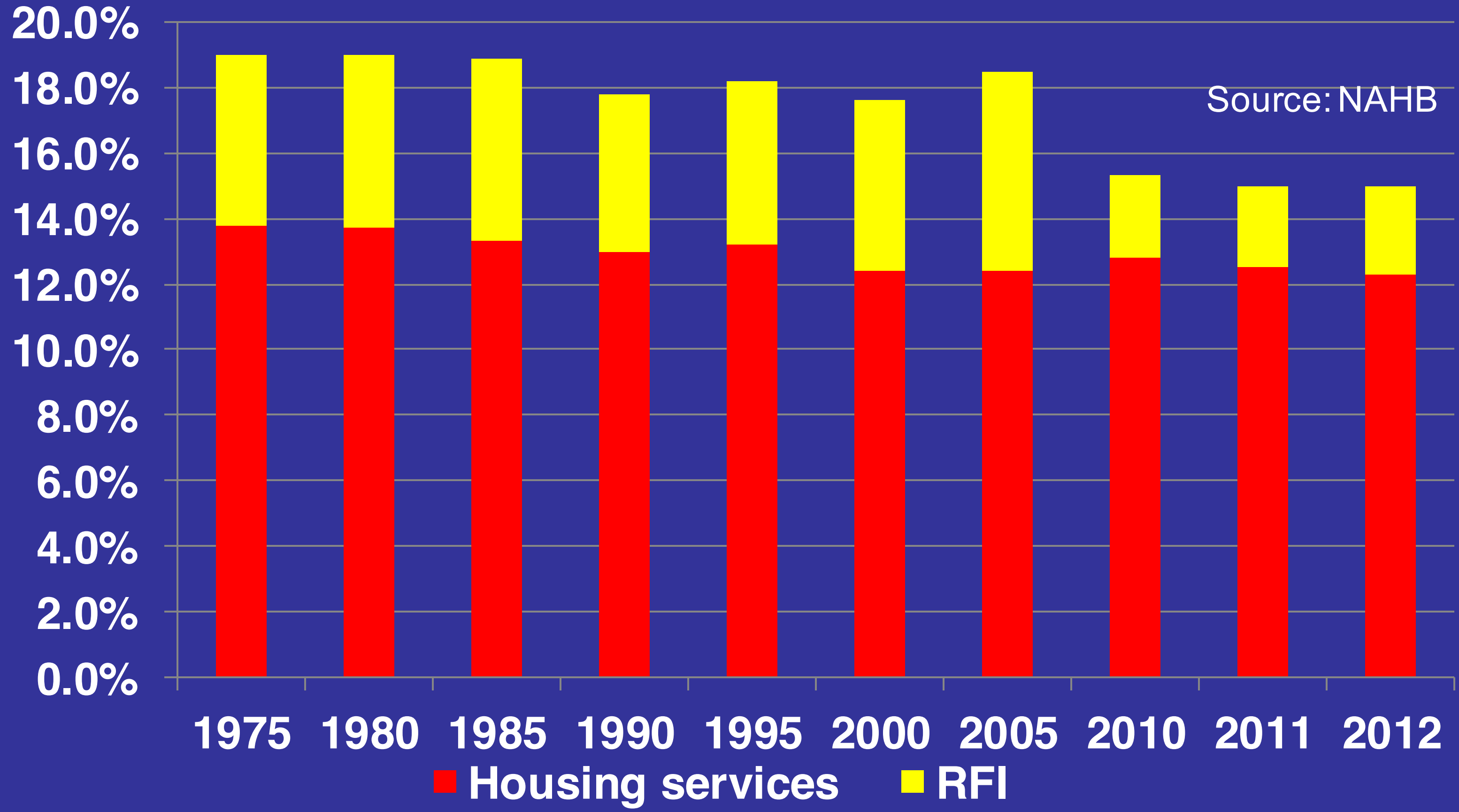
Housing Markets are getting better –
Have we turned the corner? – Probably, but the climb back will remain muted until we see economic growth of 3% or more for an extended period of time!!! That probably won't happen for another until 2014 or 2015?

Today, there is lots of slack in the economy – i.e., there is a gap between what the economy can produce and demand for goods and services. As long as that continues, wage and income growth will remain weak, and the economy will limp along.

So, how do we get 3% GDP growth? We need demand – that means job creation – that means "Washington" has to get its' "collective act together" and show much needed leadership. As of March 2013, I don't see nearly enough "leadership" from our elected officials – we need cooperation to deal with thorny issues like debt, entitlement reform, taxes, ….. So far, very little progress. All the while, our debt situation keeps getting worse – sometime in the future we will need to pay those debts off and when interest rates rise (and they will), just paying the interest will take a much bigger share of our GDP.

Housing's contribution to GDP (%) – housing is extremely important to the economy – in a good year, it is Almost one fifth or 20% of the economy, but with the housing collapse, it is down to 15% - key reason why the economic recovery remains muted

Housing services = gross rents paid by renters (incl utilities) + owner's imputed rent (how much It would cost to rent owner occupied homes) plus utility payments
RFI (residential investment) = construction of new SF and multifamily structures, remodeling, manufactured homes , plus broker's fees

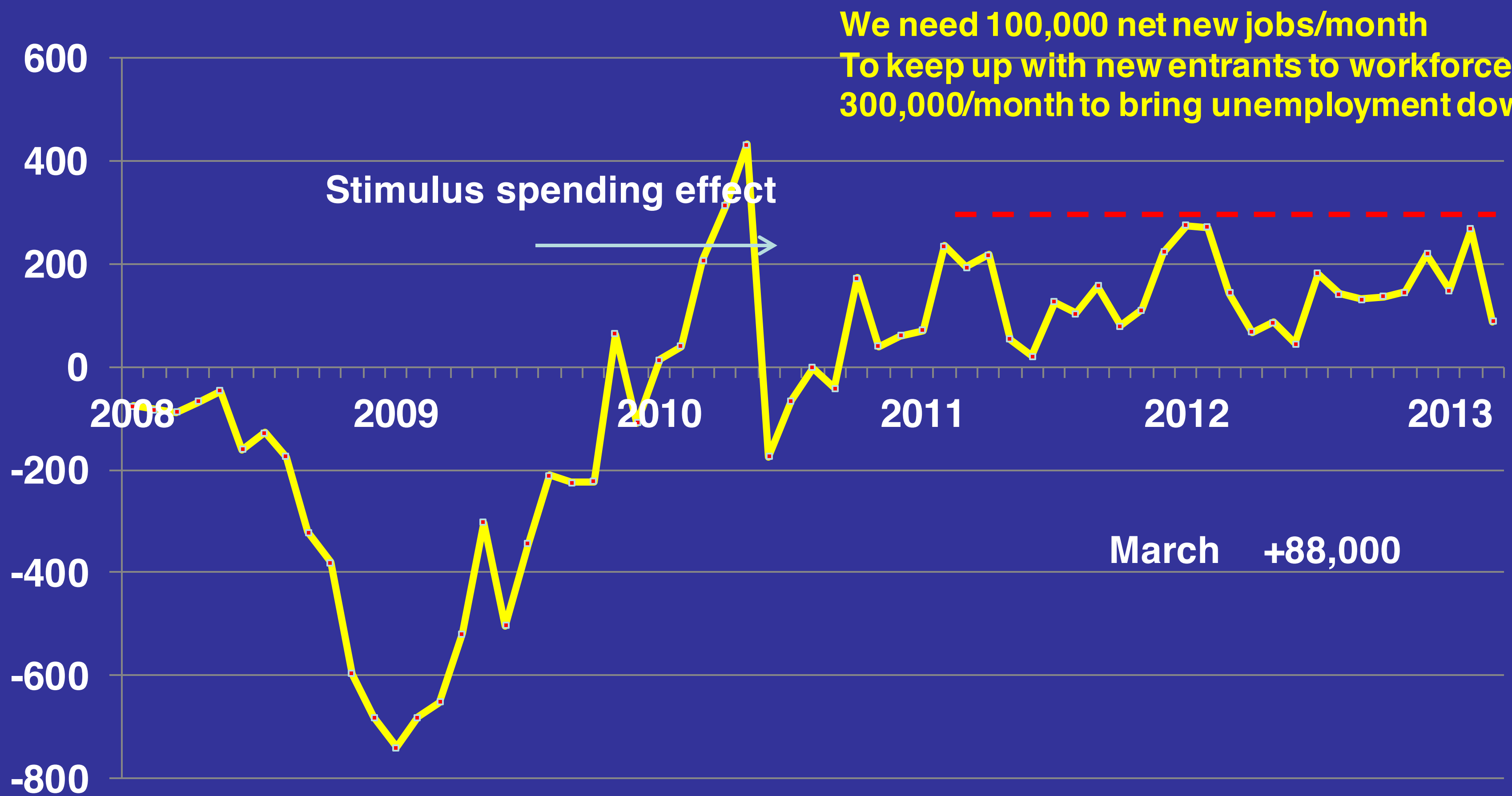


Economic growth is challenging without the help of a healthy housing market

I keep repeating this slide, but there is no way housing can return to "normal" (~ 1.5million starts) without a robust economy and the economy can't get "revved up" without a healthy housing market

Employment situation - our biggest problem - it's getting better, but the jobs recovery remains weak by past standards, and many jobs Don't include health care or retirement benefits (because they are Often part time jobs) – those kinds of jobs don't encourage people to buy houses

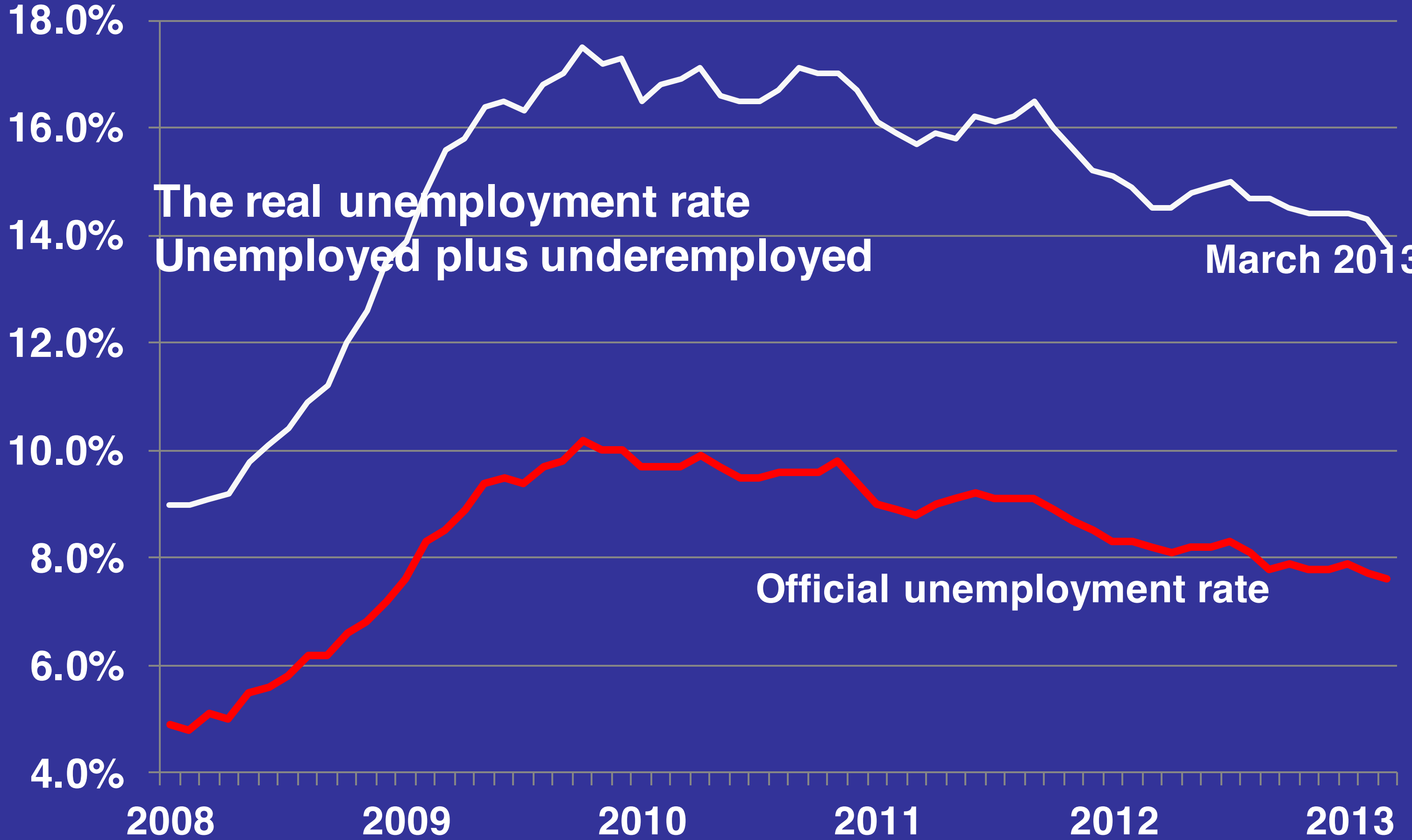
Net change in non farm payrolls – monthly, thousands



Source: U.S. BLS (www.bls.gov)

Unemployment remains high and will remain relatively high for several years – **but, it's getting better "slowly"**

There are about 21 million people either unemployed , underemployed, or stopped Looking – **they are not buying houses



Source - - BLS: http://www.bls.gov/news.release/pdf/empsit.pdf; http://data.bls.gov/cgi-bin/surveymost?ln

Other employment issues –

- **Labor force participation rate, lowest since WWII implications – more problems funding entitlement programs**

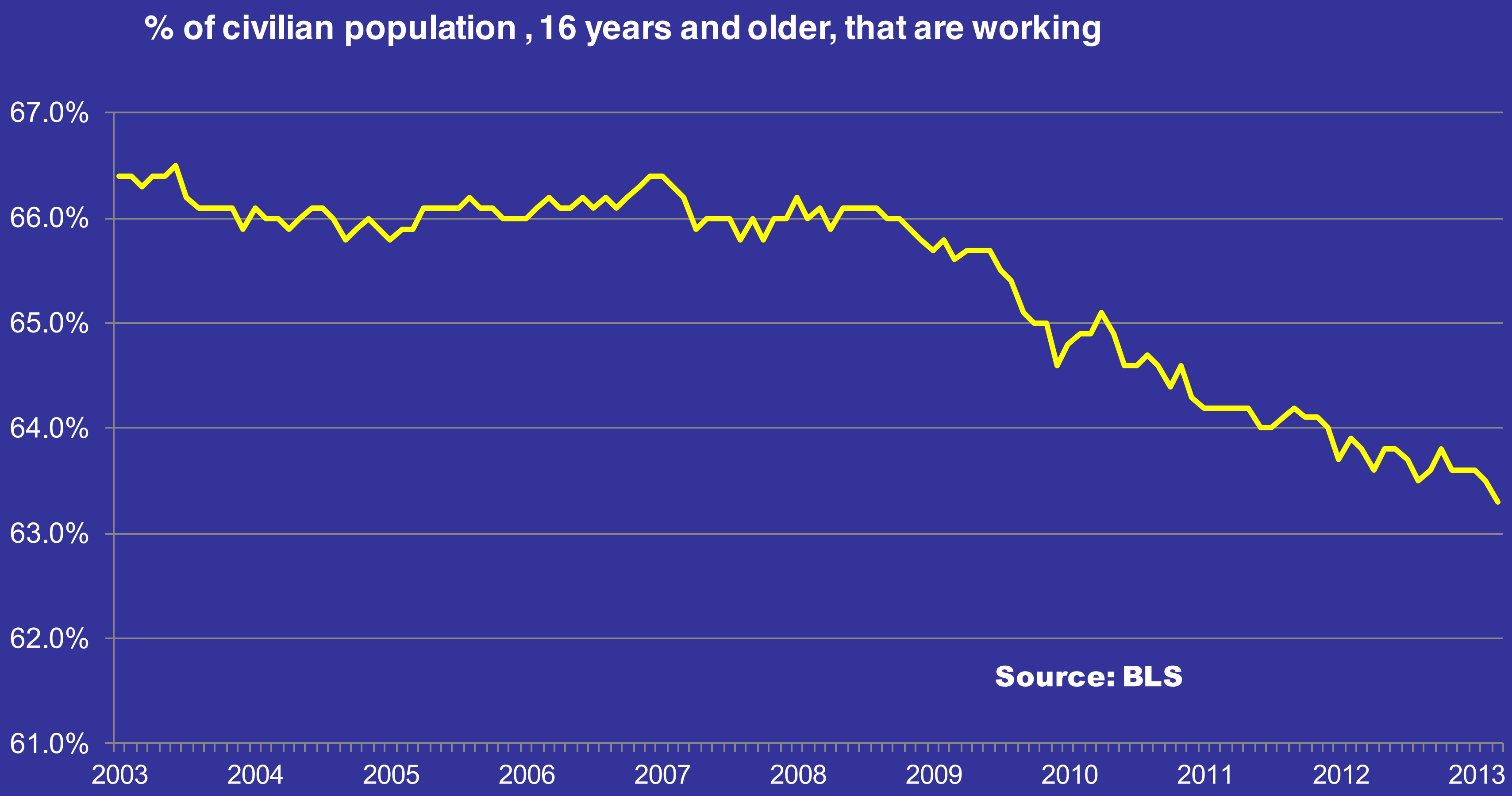
- **42% of U.S. households with the head of HH <65 (excl. SSI), are receiving government aid – food stamps, Medicaid; disability; housing allowance; UI; etc. This is unprecedented and suggests that our employment problems are more serious than the monthly UI numbers suggest. Also indicates serious personal problems related to unemployment. Why job creation should be number one priority!!!**

  (http://online.wsj.com/article/SB10001424127887323511804578298151374531578.html?mod=WSJ_WSJ_US_News_3)

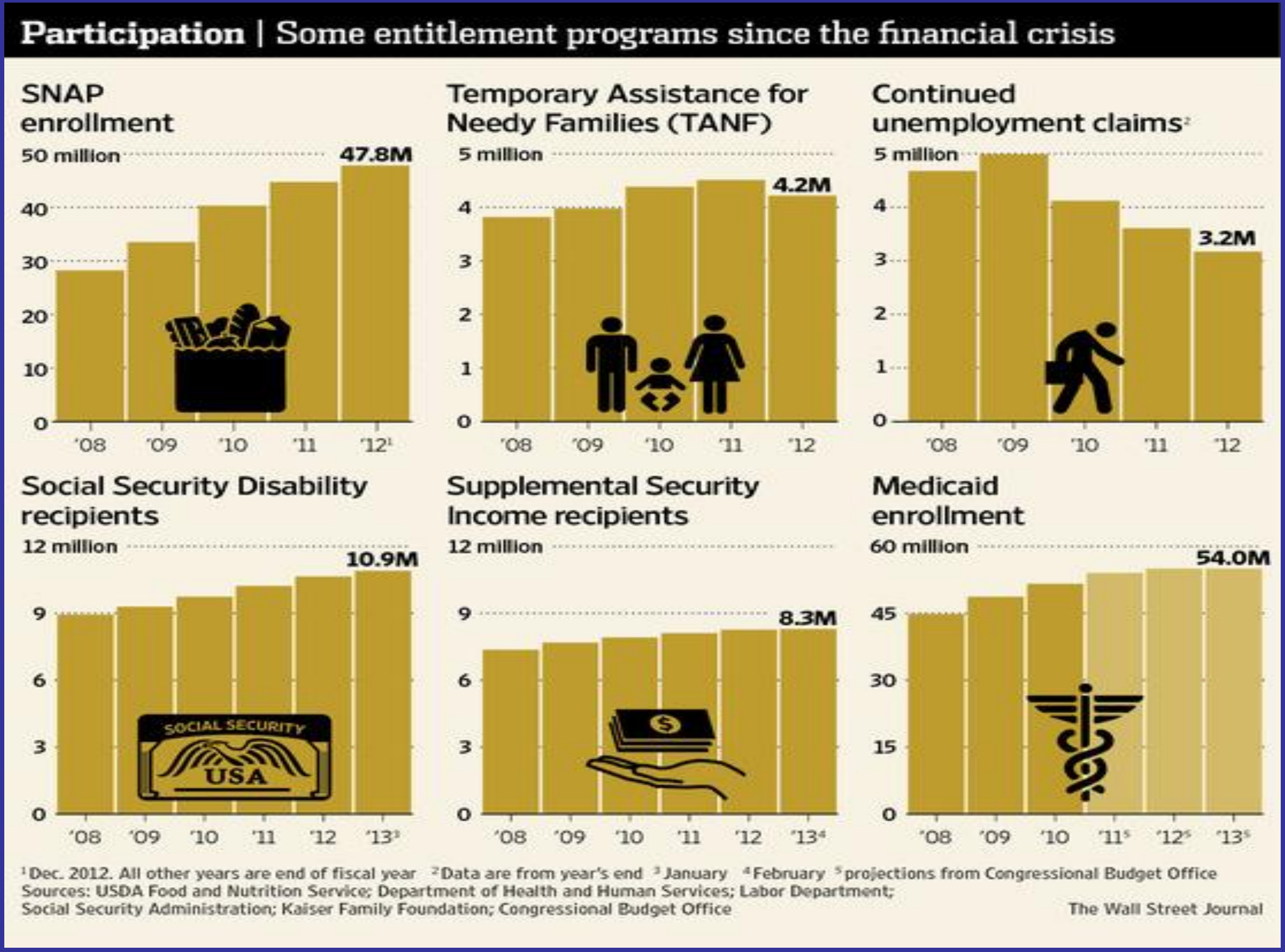
- **Going forward, this will be a huge drag on the federal (and other government levels) budgets – implications for taxes, spending, domestic programs, and job creation**

Labor force participation rate - -

Major Problems for entitlement programs – fewer people Paying taxes, but more people collecting SSI, Medicare, etc.

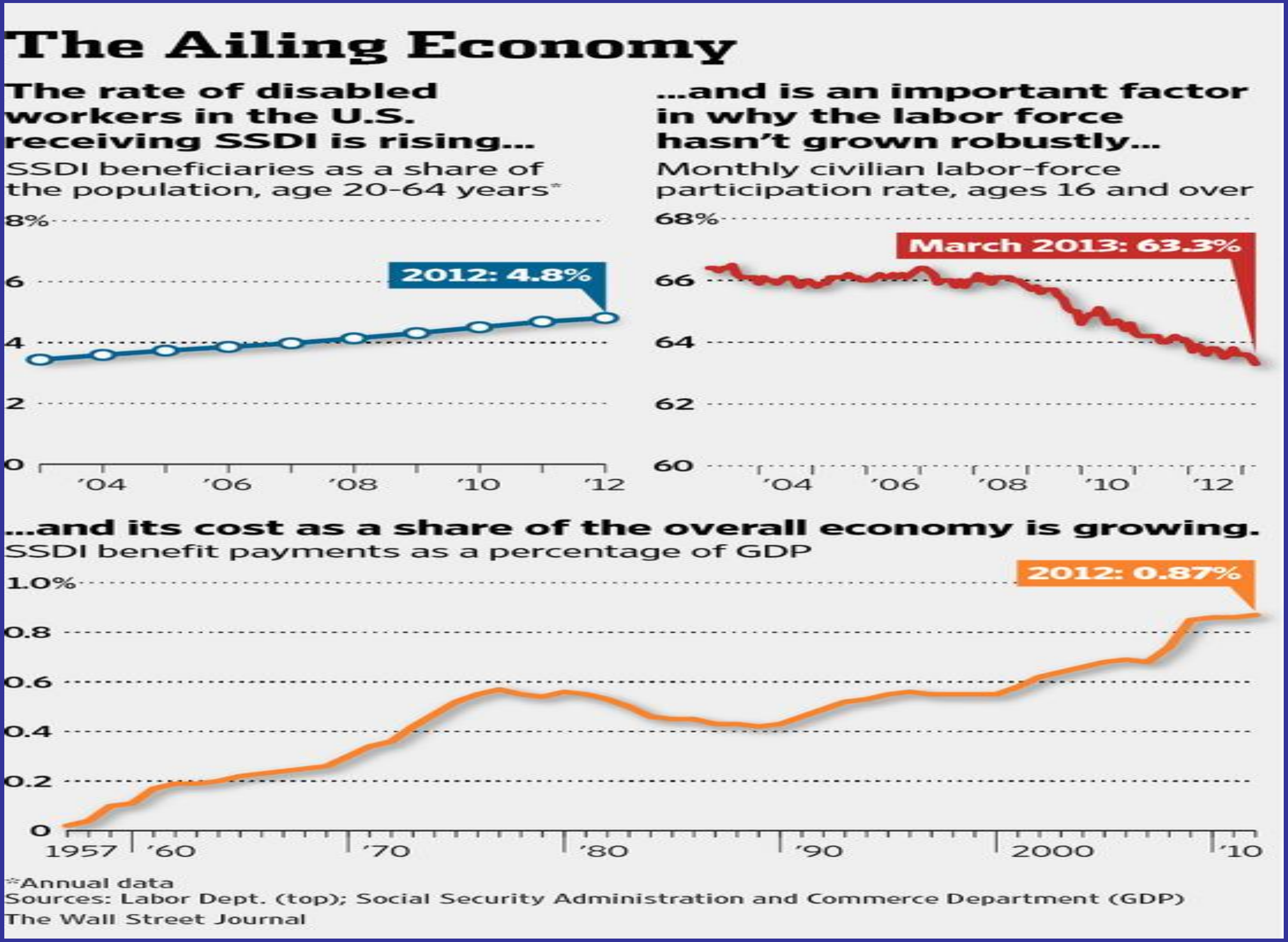


More than 120 million people on various assistance programs
This doesn't include "seniors" with SSI, Medicare – i.e., these are Working age people -



Source: WSJ, (http://online.wsj.com/article/SB10001424127887323699704578328601204933288.html?KEYWORDS=food+stamp+swells)

Since the recession, more people (net) have gone on disability than have joined the workforce – once on SSDI, less than 1% get off



Source: WSJ April 8, (http://online.wsj.com/article/SB10001424127887323511804578298151374531578.html?mod=WSJ_WSJ_US_News_3)

NAHB's latest Forecast (March 2013)

NAHB sees slow return to sustainable starts of 1.5 – 1.7 million in 2016 , 2017???

Housing and Interest Rate Forecast, 3/01/2013

	2008	2009	2010	2011	2012	2013	2014
Housing Activity (000)							
Total Housing Starts	**900**	**554**	**585**	**612**	**781**	**970**	**1,180**
Single Family	**616**	**442**	**471**	**434**	**534**	**658**	**848**
Multifamily	284	112	114	178	247	312	331
New Single Family Sales	482	374	321	307	366	449	615
Existing Single-Family Home Sales	3,655	3,868	3,705	3,793	4,130	4,505	4,726
Interest Rates							
Federal Funds Rate	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%
90 day T Bill Rate	1.39%	0.15%	0.14%	0.05%	0.09%	0.09%	0.14%
Treasury Yields:							
One Year Maturity	1.82%	0.47%	0.32%	0.18%	0.18%	0.17%	0.25%
Ten Year Maturity	3.67%	3.26%	3.21%	2.79%	1.80%	2.22%	2.91%
Freddie Mac Commitment Rates:							
Fixed Rate Mortgages	6.04%	5.04%	4.69%	4.46%	3.66%	3.72%	4.41%
ARMs	5.17%	4.71%	3.79%	3.04%	2.69%	2.57%	2.65%
Prime Rate	5.09%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%

Nat assoc. Realtor's latest Outlook

A bit more optimistic than NAHB for starts – they see recovery One year earlier (i.e., NAR starts in 2013 similar to NAHB Starts in 2014 – same story for resale market

Forecast Summary				
	2011	2012	2013	2014
Existing home sales	4260	4666	4996	5293
New SF home sales	306	367	540	724
Housing starts	**609**	**780**	**1127**	**1374**
Existing home prices	166000	176800	189000	197100
GDP growth	1.8	2.1	1.9	3
30 year mortgage	4.7	3.7	3.8	4.7
Source: NAR, April 2013				

(http://www.realtor.org/sites/default/files/reports/2012/embargoes/2012-09-phs/forecast-11-2012-us-economic-outlook-presentation-slides-10-25-2012.pdf)

Recent Housing statistics

Background:

Markets are getting better –
Have we turned the corner? – Probably, but
The climb back will remain muted
Until we see economic growth of 3% or
More for an extended period of time!!!

Starts are finally turning the corner??

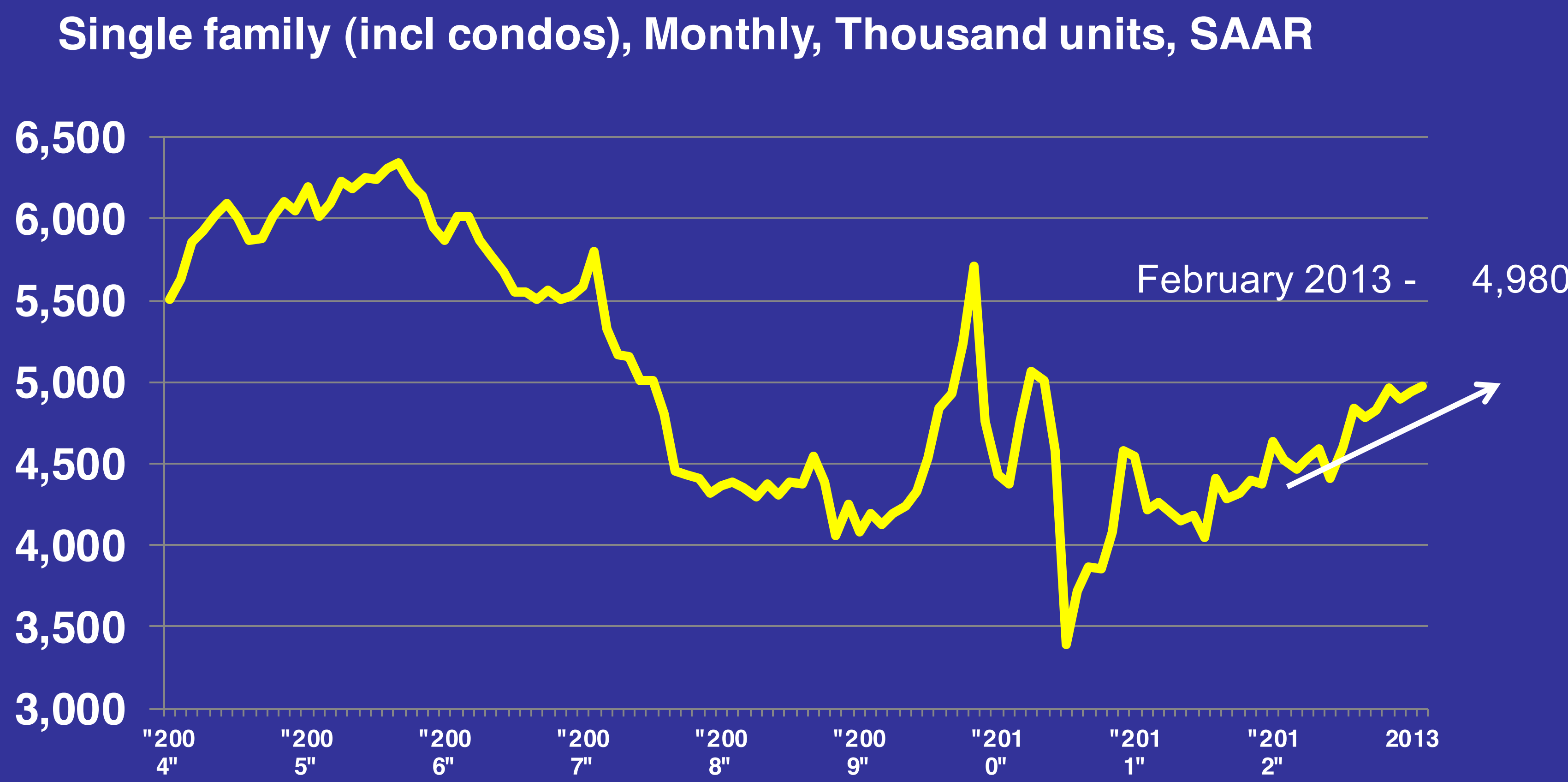
Problems going forward: distressed resales (i.e., foreclosures) and jobs. Rising prices will moderate the foreclosure problem while good paying jobs will create demand – this will take more time!!

Single family starts, Thousand units, SAAR

Source: Census (http://www.census.gov/const/www/newresconstindex.html)

Resale market getting better – however, in 2012, about 25% of sales were cash only, mostly by investors – these homes were then rented -

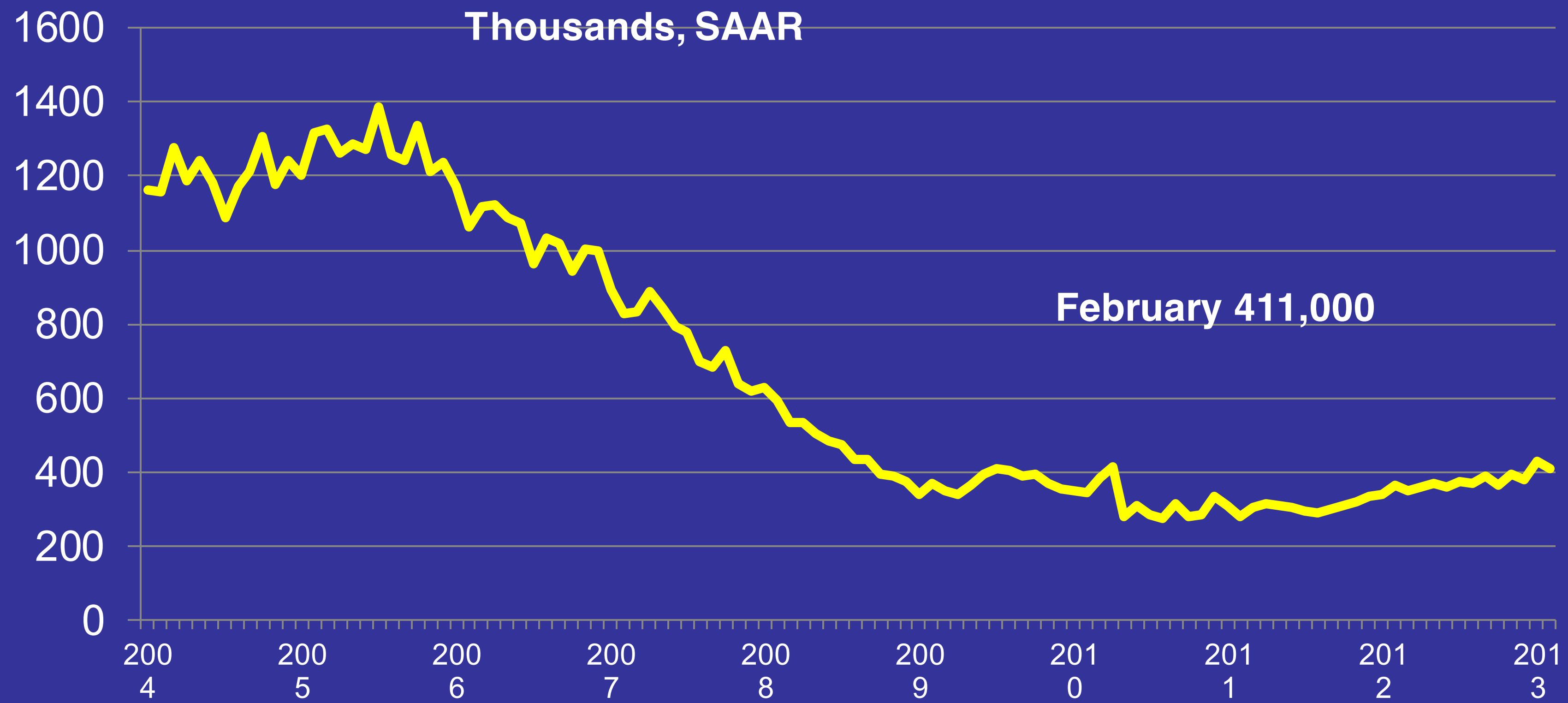
i.e., this is not your typical housing recovery



Source: NAR (http://www.realtor.org/research)

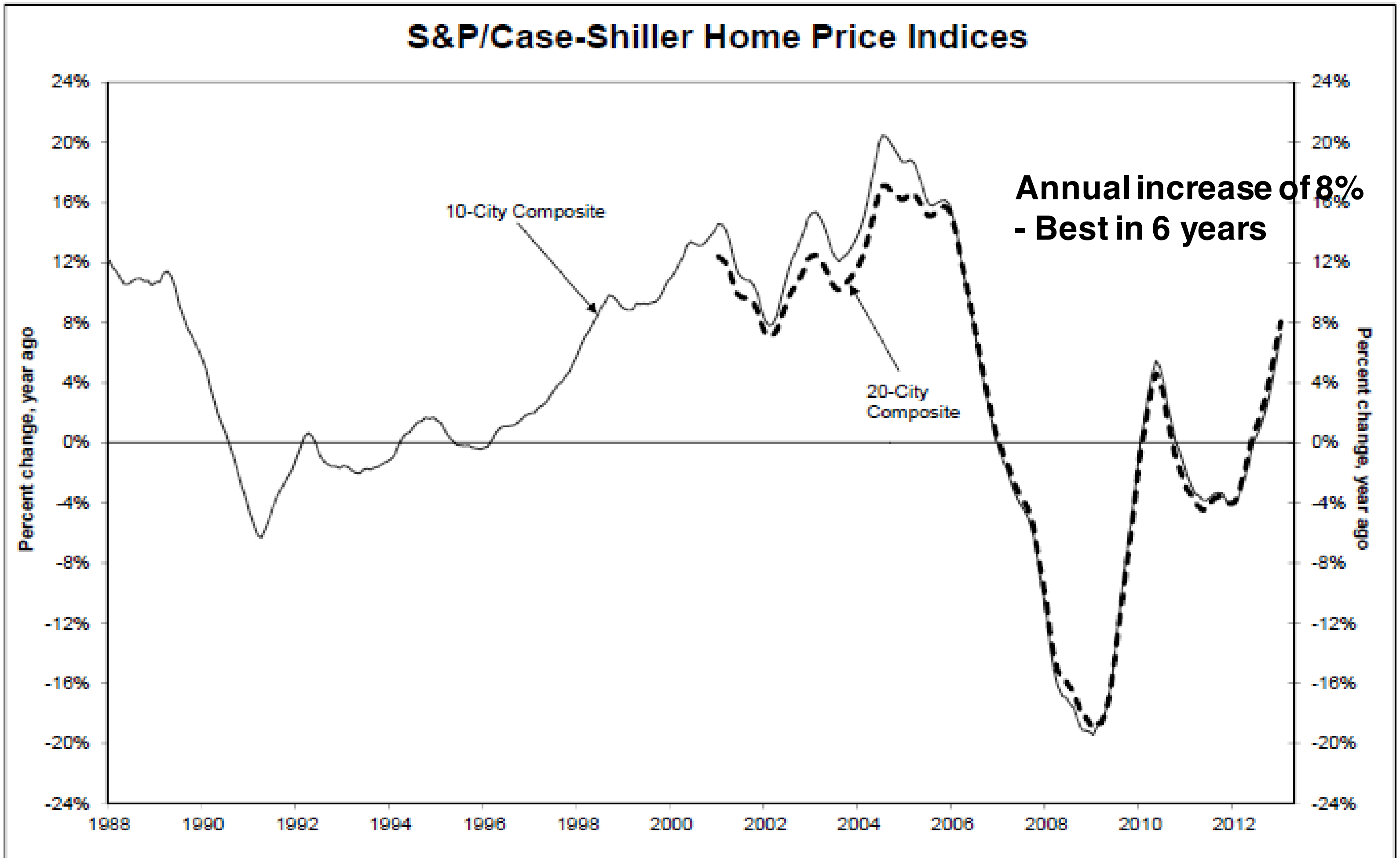
New Home sales is the key statistic to watch – Sales Drive starts – this drives demand for wood products!!!

Problem is price competition with resale homes, particularly distressed sales

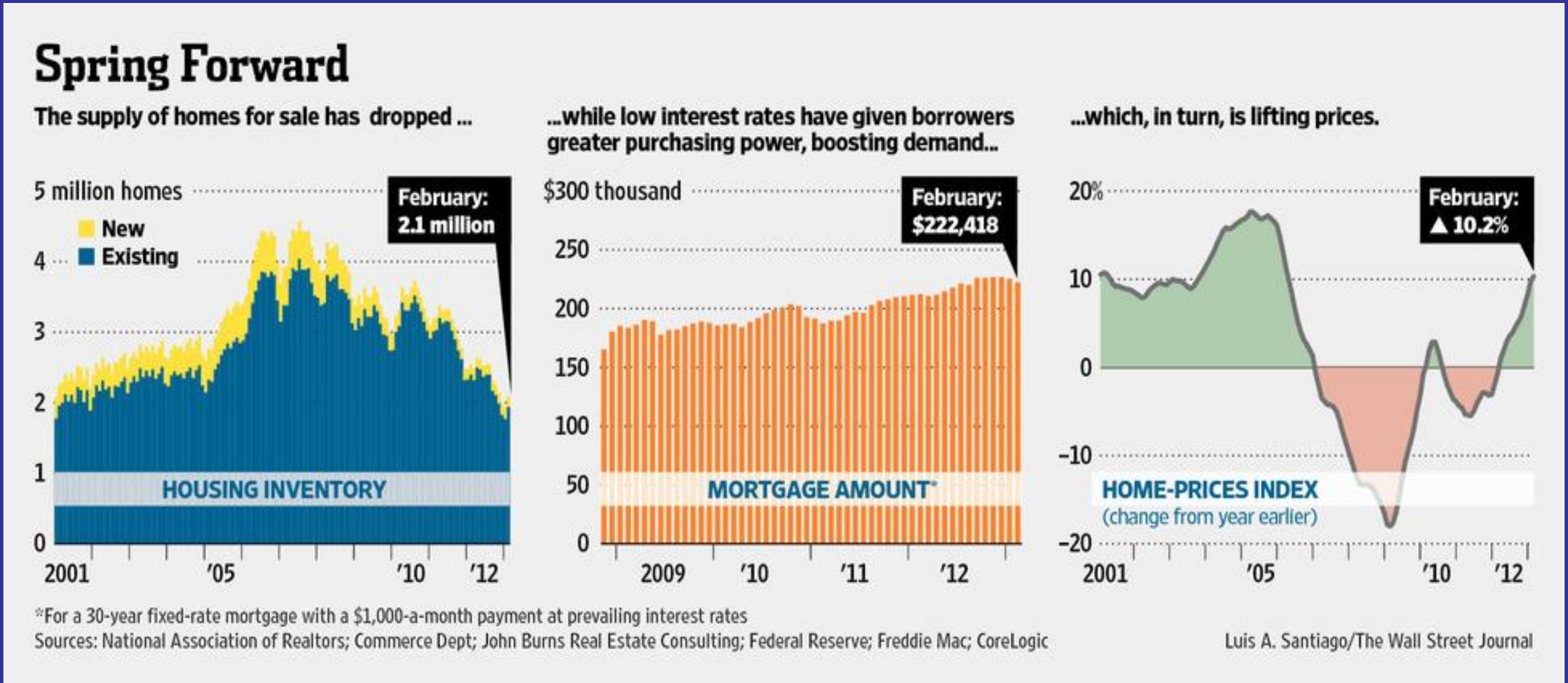


Source: Census (http://www.census.gov/const/www/newressalesindex.html)

Key metric: Resale Home Prices are stabilizing – needed to stop foreclosures; enable people to sell homes and move to better jobs; apply for refinancing - - this will turn housing Market around along with improving economy



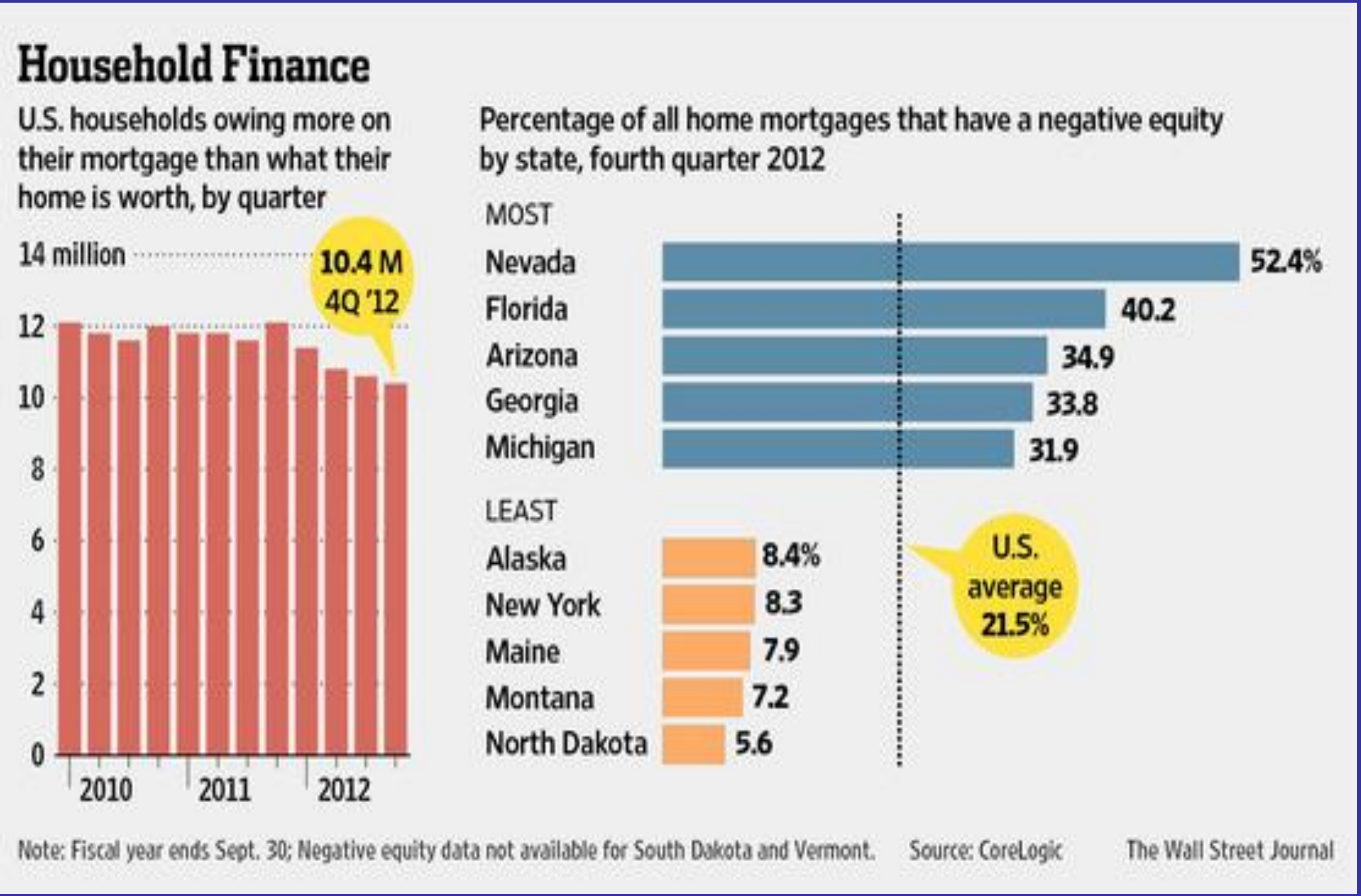
What's behind the price increases? – low inventories, pent up demand, low interest rates, tight credit standards Mean many owners postpone selling because they can't get a new mortgage



Source: WSJ April 7(http://online.wsj.com/article/SB10001424127887323916304578402831129812740.html?mod=WSJ_WSJ_US_News_6)

1.7 million Fewer underwater homeowners in 2012 vs 2011

Significance: as equity increases, people spend more; easier to refinance; Confidence increases; move to new jobs; Great for the economy



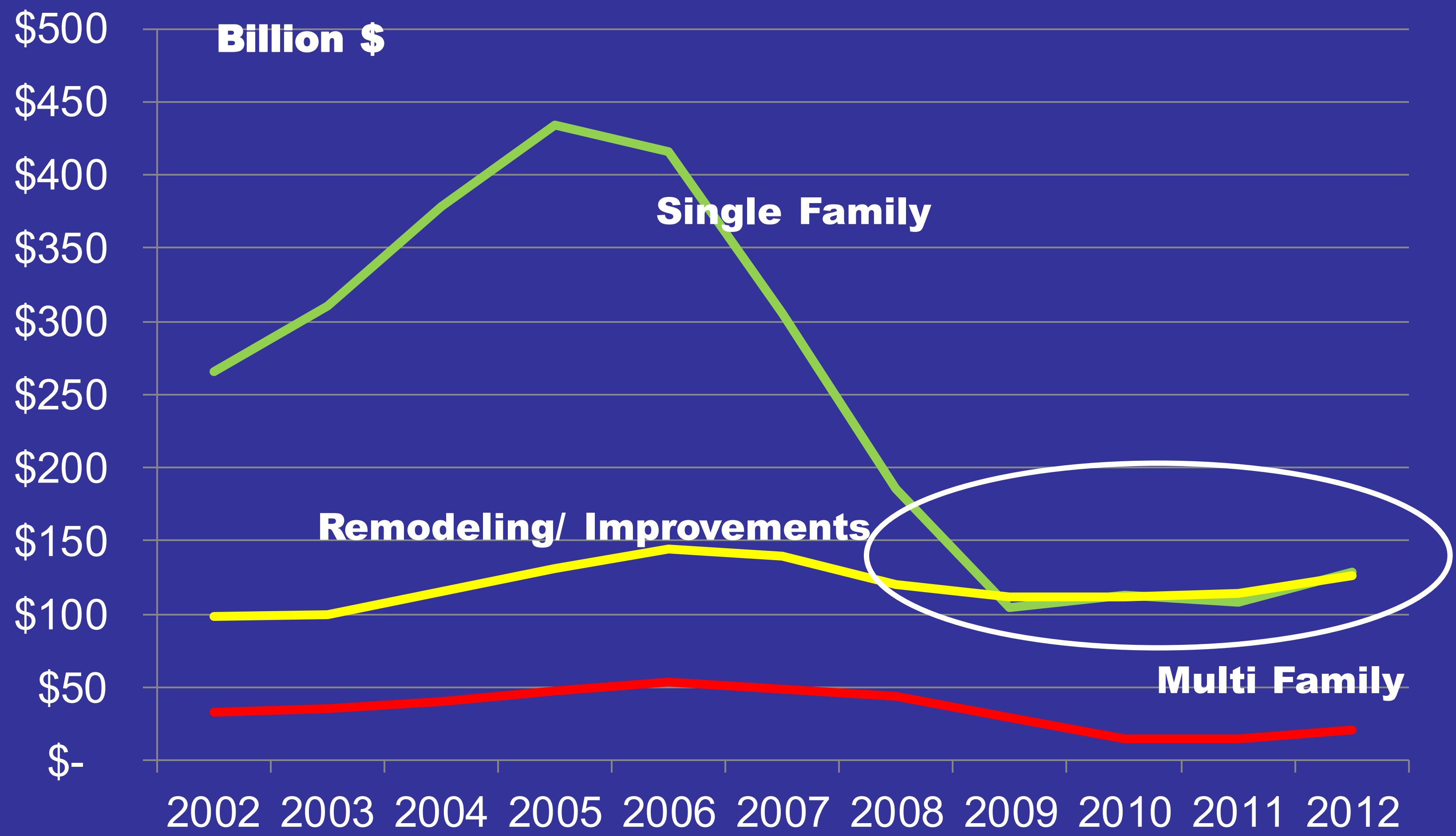
Source: WSJ, March 19, (http://online.wsj.com/article/SB10001424127887323639604578368640417427444.html?KEYWORDS=more+homeowners+dig+out)

Good News stories - -

(1) Remodeling share of private residential construction to increase

(1) Household formations are improving – but, depends on stronger economy

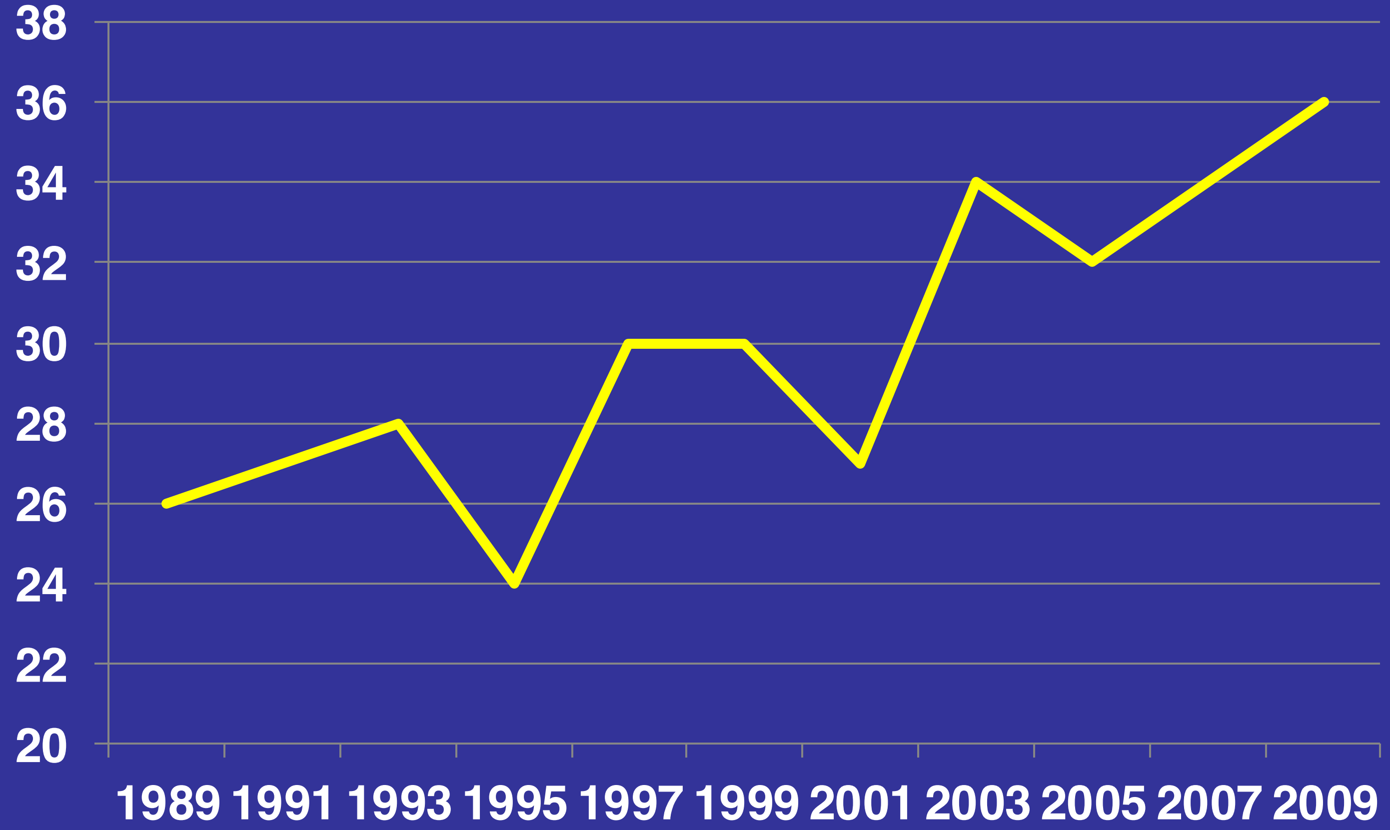
Construction Value Put In Place – remodeling Equals new SF construction for past four years



Source: Bureau of Census (http://www.census.gov/construction/c30/privpage.html)

Median Age of U.S. Housing Stock

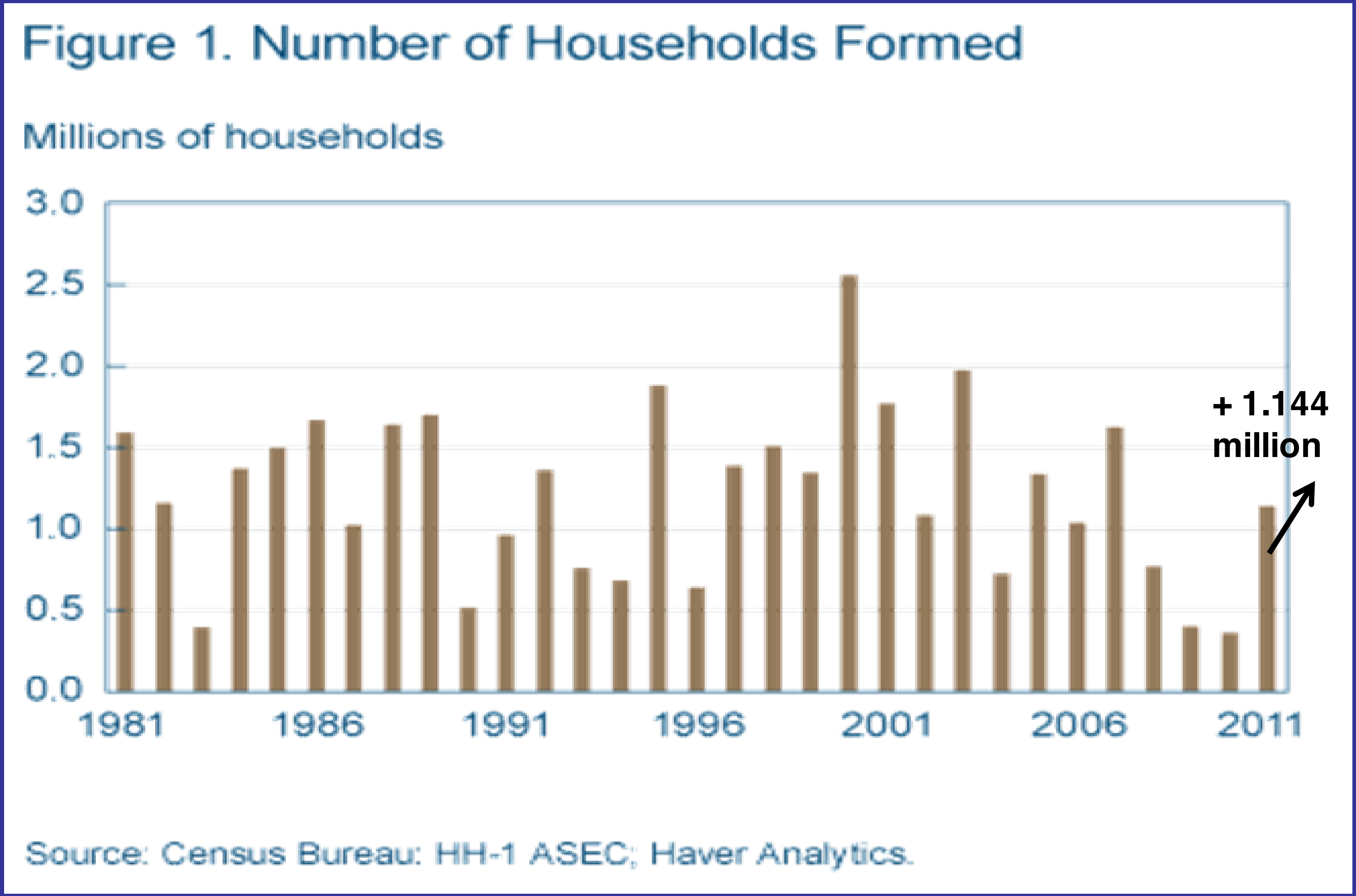
In 2009, half of U.S. homes were 36 years old or older. Good news for remodeling business – in fact, over time, we will emulate Europe where remodeling expenditures routinely exceed expenditures on new construction



Source: AHS (http://www.census.gov/hhes/www/housing/ahs/nationaldata.html)

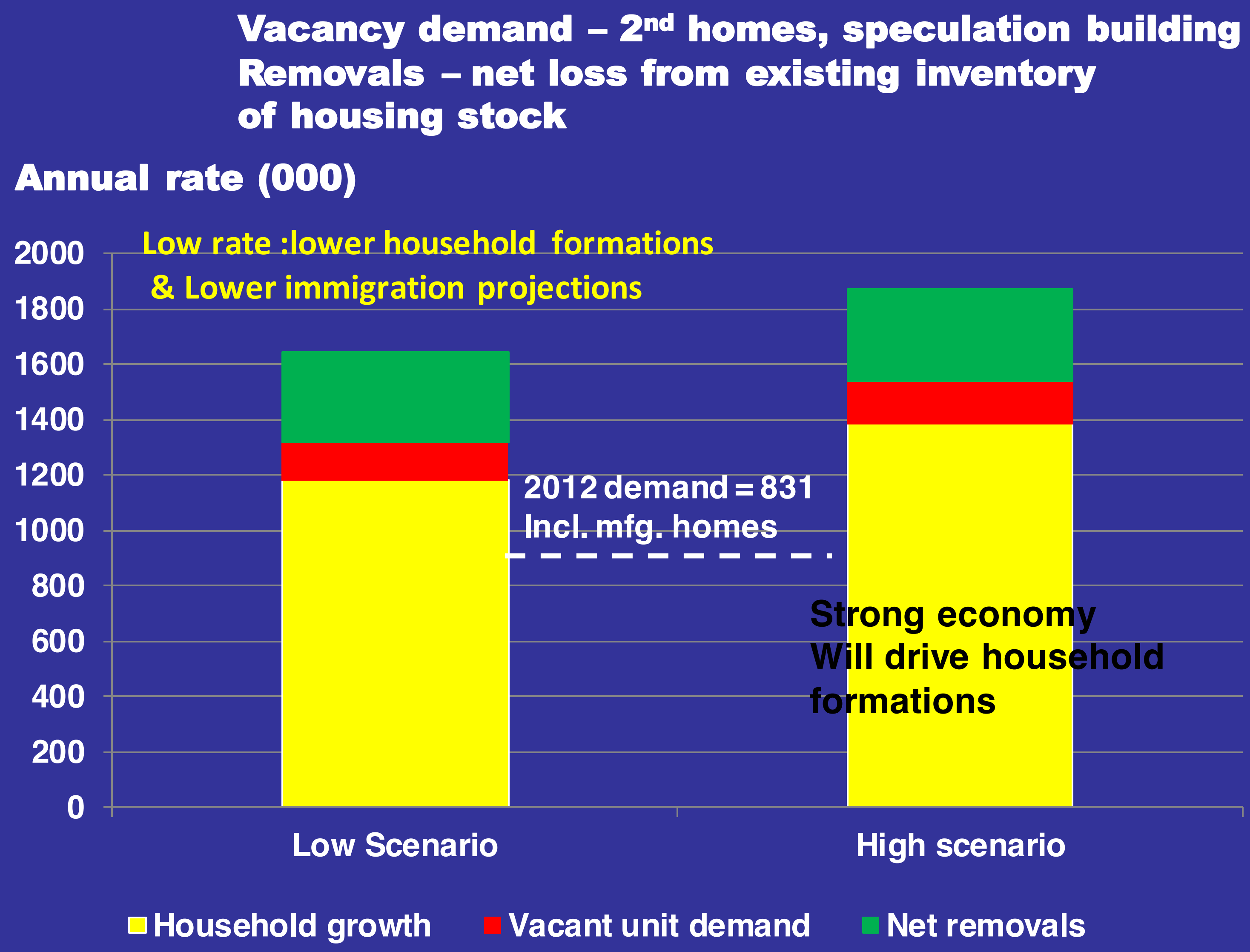
Household formation - Key to Housing Demand – Stronger economy will drive HH formations

Historically, household formations account for 65% of housing demand – Since 2007, they are half the historical rate – when the economy picks up, HH formations will go back to normal – again the key is the economy (jobs)



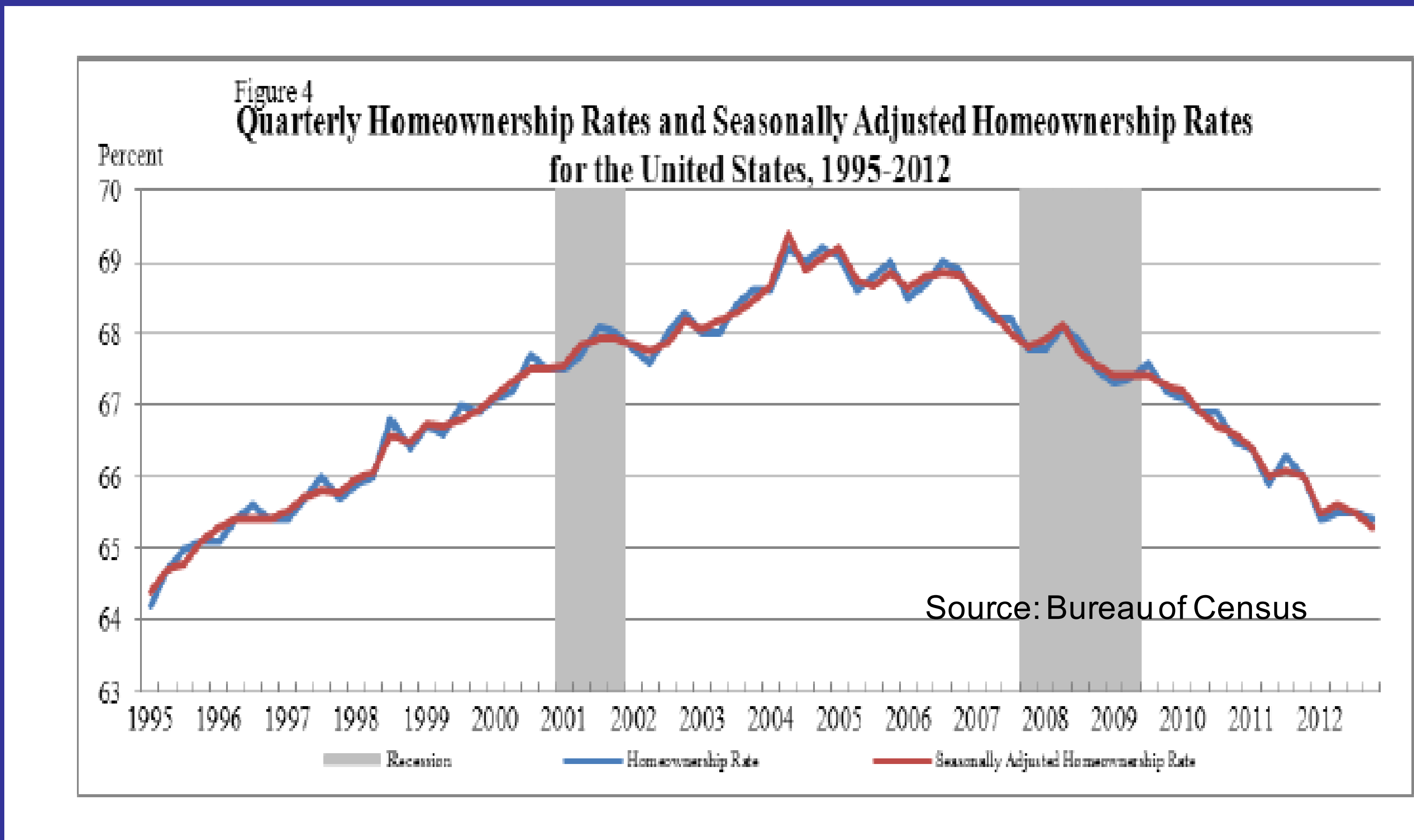
Source: (http://www.clevelandfed.org/research/Commentary/2012/2012-12.cfm)

Harvard* Housing Demand Forecasts 2010 – 2020 (latest - September 2010)



Source: HJCHS, W10-9 , amended (http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w10-9_masnick_mccue_belsky.pdf)

Homeownership rates have been falling for the past seven Years – lower homeownership means less demand for single family housing and increased numbers for multi family/rental housing - that means less demand for wood



Source: Census (http://www.census.gov/housing/hvs/files/qtr412/q412press.pdf)

But, Continuing Problems with Housing

(1) Tight Credit remains big problem and the Private sector has to return to the mortgage Market

Essentially, the housing finance market is broken and it needs To be fixed (i.e., private sector returns) before housing gets Back to normal!!! Today, "Washington" has too much Influence over housing markets.

(2) Debt and income growth remains a problem too

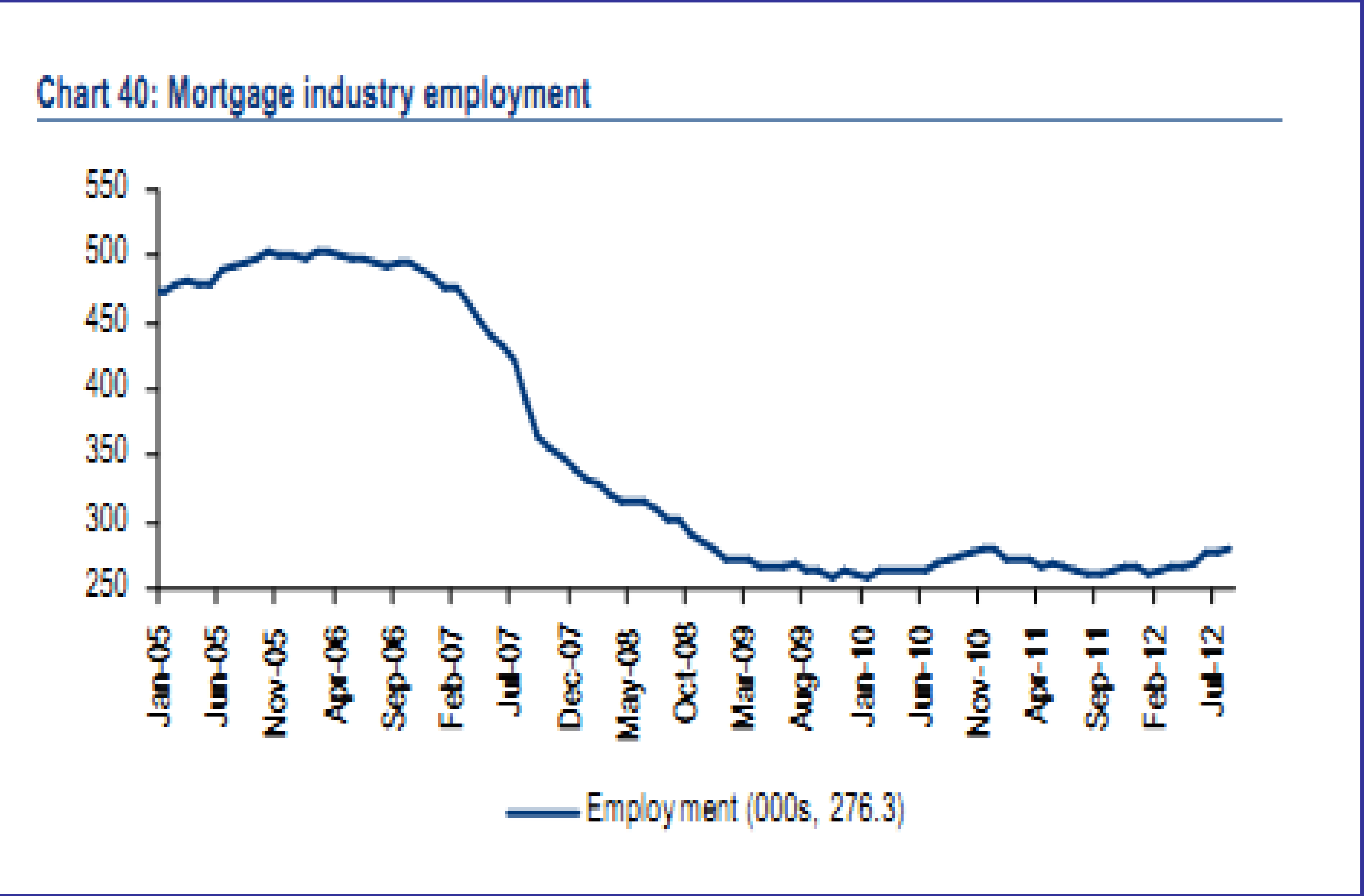
Difficult to buy a house if you can's make mortgage payments

Housing Finance market is Broken – future prospects are not good until federal "footprint" shrinks – i.e., private sector needs to return to mortgage market

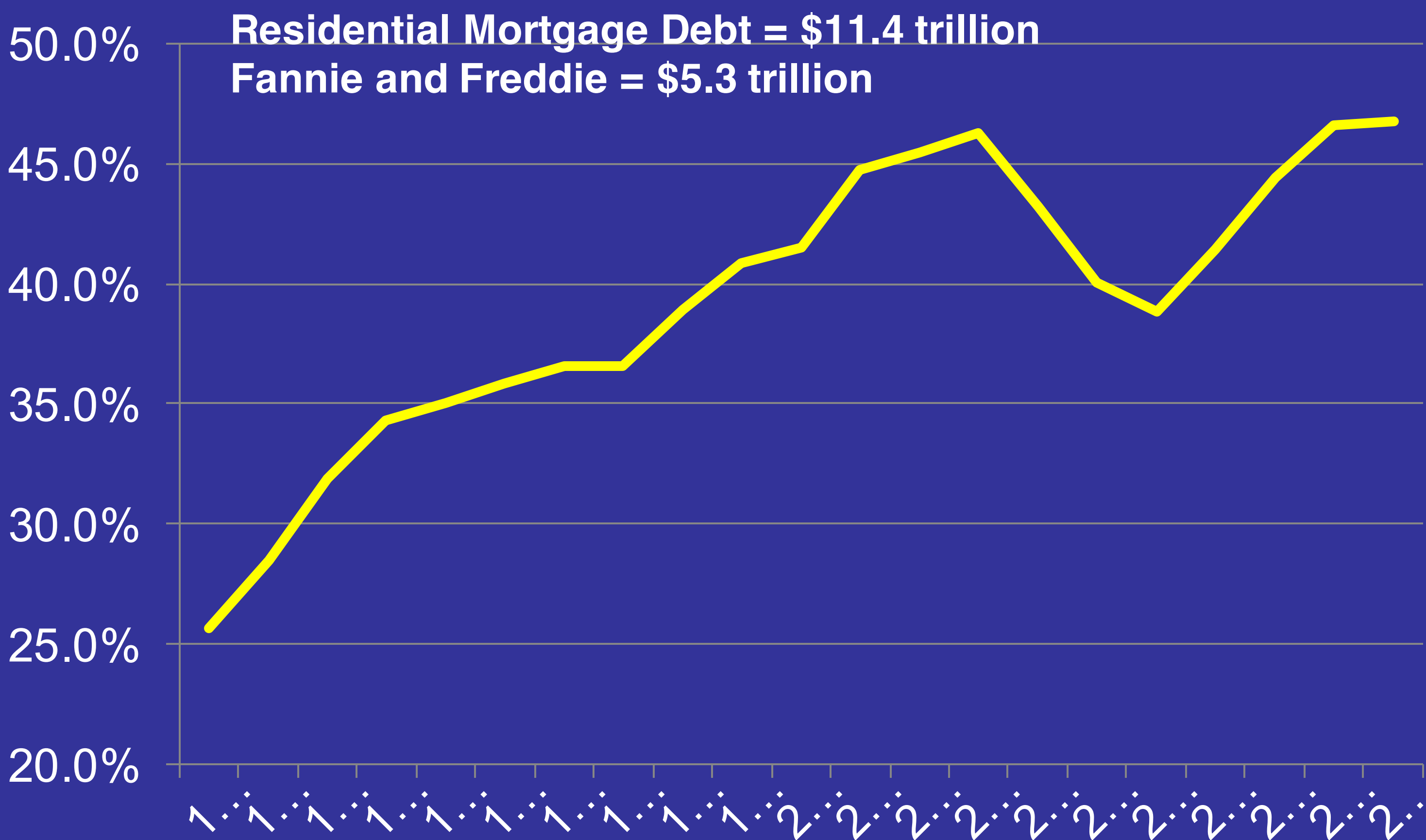
Bottom line - unless you have cash, you will have difficulty Buying a house

E.g, the Federal government is the mortgage market today Fannie, Freddie , and FHA issue, insure, hold 90% or more Of residential mortgages written in past 5 years. Fannie and Freddie are in conservatorship (fancy word for bankruptcy), And FHA announced on November 20 that they need taxpayer Assistance (i.e., their liabilities exceed their assets).

Mortgage industry employment down 50%



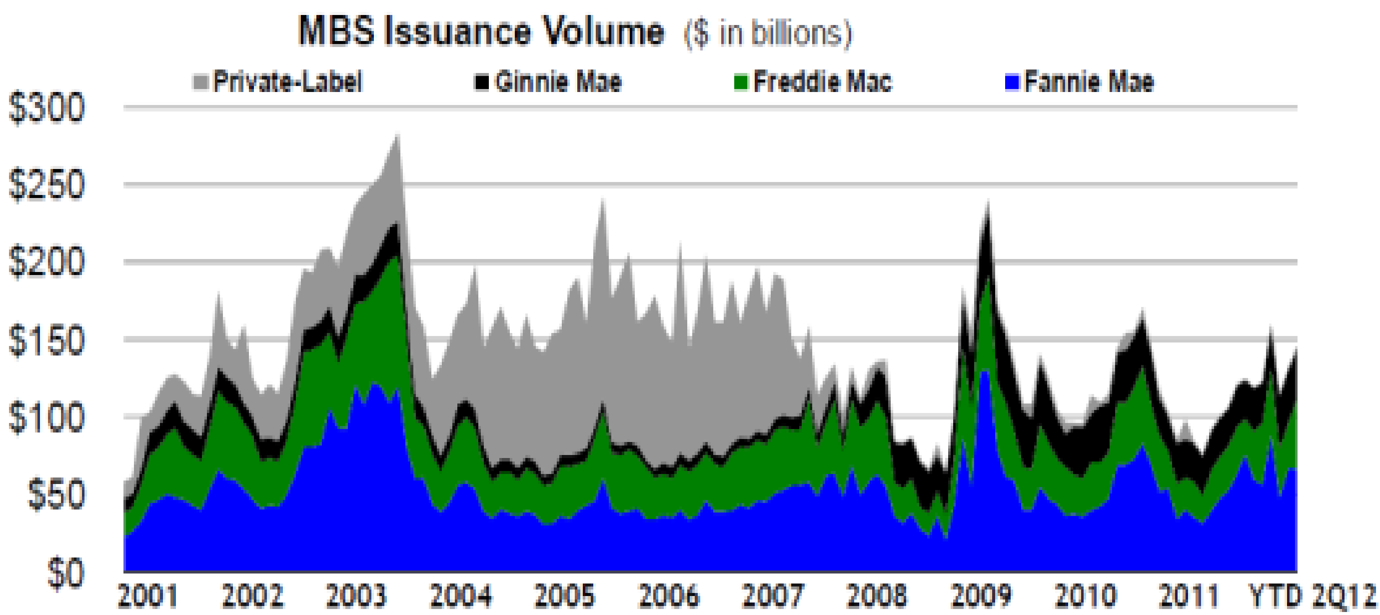
Combined Enterprise Share (Fannie and Freddie) of Residential Mortgage Market – Fannie and Freddie Are "in conservatorship" – How would you feel if your savings were in a bank that was insolvent?



Source: Federal Reserve

Federal Government and Mortgage backed Securities Market
They are basically "the only game in town" since 2008

Figure 1.2 Enterprises' Market Share – MBS Issuance Volume



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD 2Q12
Enterprises	67%	68%	70%	47%	41%	40%	58%	73%	72%	70%	73%	77%
Ginnie Mae	13%	9%	8%	7%	4%	4%	5%	22%	25%	26%	25%	23%
Total Agency	80%	77%	78%	54%	45%	44%	63%	95%	97%	96%	98%	100%

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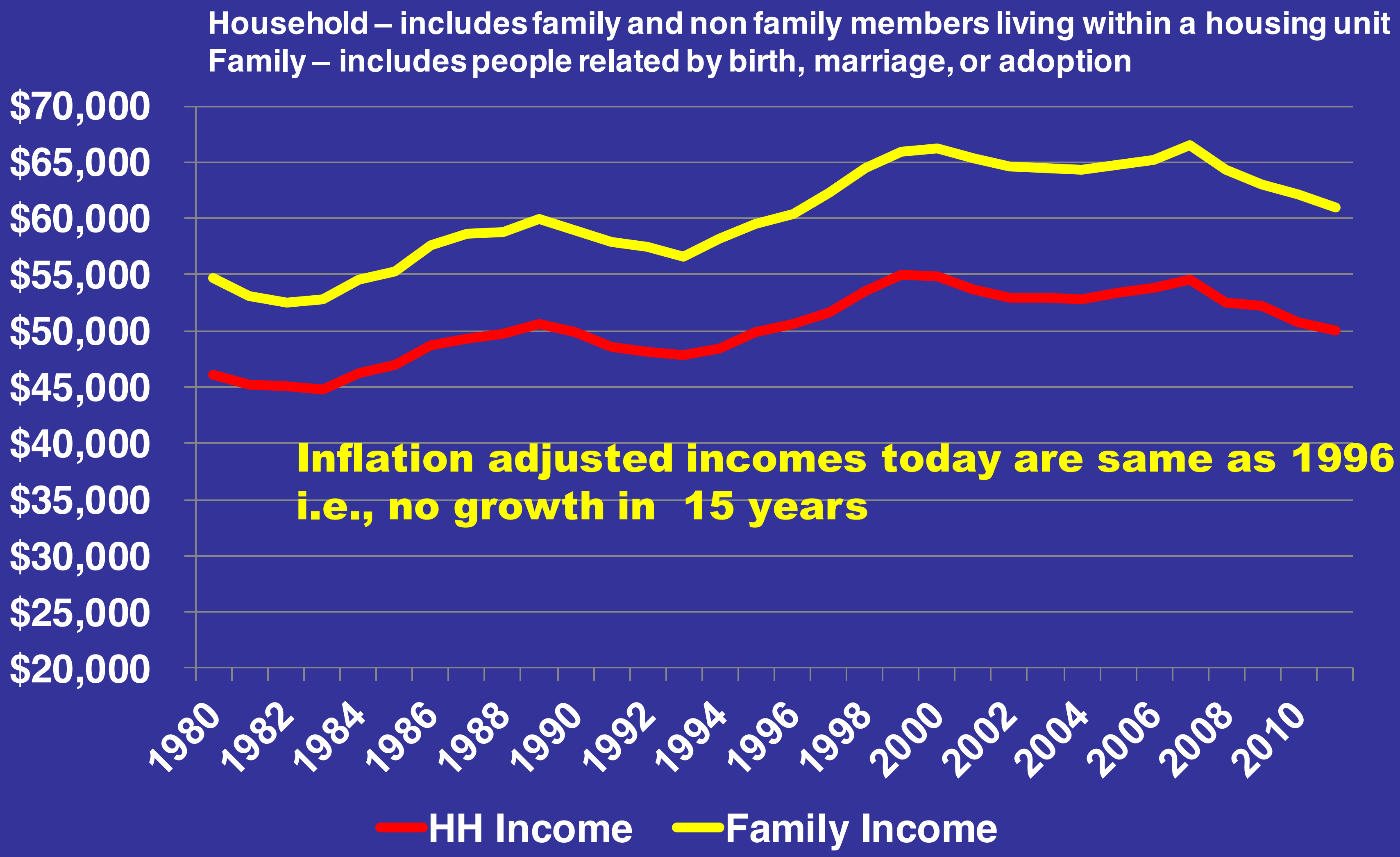
Debt , Wealth , and Income Problems

If housing (and standard of living) is to improve on sustainable basis,
Incomes will have to increase in real dollars

Median Annual Incomes in Inflation Adjusted $

We're keeping up with inflation, but that's it!!



Source: Current Population Survey (http://www.census.gov/hhes/www/income/data/historical/index.html)

Some conclusions – housing remains weak till economy fixed

(1) The main problem with the U.S. economy is "not enough demand"!!!

a. Debt - - households plus government is high – deleveraging (paying off debt) reduces consumer spending (70% of the economy) via higher taxes, job curtailments

b. Income growth – has been weak for 30 years

(2) Solution – increase demand – here's how we can do it

refocus our economy to invest more and consume less (for awhile) - - *the idea is to become more competitive internationally – this is best way to create jobs which are needed to create demand!!!!*

(3) The **Fed has done about as much as it can – monetary stimulus - QE1,2, 3 /"printing money" to keep interest rates low – so far, the impact has been less than hoped for.**

Hint – Interest rates are not the main problem

(4) Weak demand is the problem – the solution is job creation – how – make ourselves globally competitive – how – see item #2 above!!!!! Also have to revamp "assistance programs" like SSDI, extended UI, , etc.) so people are encouraged to rejoin the workforce

(5) Housing is getting better, but the recovery will remain slow by past comparisons – housing finance remains major problem

(6) “Washington” has to deal with the thorny issues - until they do, private sector will remain on the sidelines with their \$2 - \$3 trillion “stash”. That will delay investments needed for job creation.

Here is my guess at what will happen over the next 6 months:
- no decisive action (i.e., tax reform – broadening the tax base; hard look at entitlements; spending cuts ; etc.) – instead, they will “kick the can down the road” .
“Washington” will do nothing major until the bond markets force them to (raise interest rates, etc.) sometime in the future. Just look to Europe , most recently Cyprus, for a preview.

(7) End result – the economy avoids a recession, but only “limps along” in 2013 and housing recovery remains muted. This is sad because we could do a lot better. In the latest discussions with the President, Wall Street CEO’s (WSJ Nov 19) lamented that they can’t fill many jobs due to “skill set” mismatch. I.e., many jobs go unfilled because applicants don’t have necessary skills. Education in America needs an overhaul – we have lots of things that are good, but also lots of problems. If we don’t fix them, we will continue having problems competing and that means weak income growth and that translates to underperforming housing markets.