May 2014 Housing Commentary

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May 2014
Housing Scorecard

	M/M	Y/Y
Housing Starts[A]	▽ 6.5%	△ 9.4%
Single-Family Starts[A]	▽ 5.9%	△ 4.7%
Housing Permits[A]	▽ 6.4%	▽ 1.9%
Housing Completions[A]	△ 6.8%	△24.8%
New Single-Family House Sales[A]	△18.6%	△16.9%
Existing House Sales[B]	△ 4.9%	▽ 5.0%
Private Residential Construction Spending[A]	▽ 1.5%	△ 7.5%
Single-Family Construction Spending[A]	▽ 1.4%	△10.9%

M/M = month-over-month; Y/Y = year-over-year

Source: [A]U.S. Department of Commerce-Construction ; [B] National Association of Realtors® (NAR®)

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New Housing Starts

	Total Starts*	Single-Family Starts	Multi-Family 2-4 unit Starts	Multi-Family 5 or more unit Starts
May	1,001,000	625,000	10,000	366,000
April	1,071,000	664,000	8,000	399,000
2013	915,000	597,000	11,000	311,000
M/M change	-6.5%	-5.9%	25.0%	-8.3%
Y/Y change	9.4%	4.7%	-9.1%	17.7%

* All start data are presented at a seasonally adjusted annual rate (SAAR)

Source: U.S. Department of Commerce-Construction: www.census.gov/construction/nrc/pdf/newresconst.pdf

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New Housing Permits and Completions

	Total Permits*	Single-Family Permits	Multi-Family 2-4 unit Permits	Multi-Family 5 or more unit Permits
May	991,000	619,000	25,000	347,000
April	1,059,000	597,000	26,000	436,000
2013	1,010,000	624,000	29,000	282,000
M/M change	-6.4%	3.7%	-3.8%	-20.4%
Y/Y change	-1.9%	-0.8%	-13.8%	-2.8%

	Total Completions*	Single-Family Completions	Multi-Family 2-4 unit Completions	Multi-Family 5 or more unit Completions
May	897,000	618,000	10,000	269,000
April	840,000	605,000	4,000	231,000
2013	719,000	560,000	10,000	149,000
M/M change	6.8%	2.1%	150.0%	16.5%
Y/Y change	24.7%	10.4%	0%	80.5%

Source: U.S. Department of Commerce-Construction: www.census.gov/construction/nrc/pdf/newresconst.pdf

* All data are SAAR

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New and Existing House Sales

	New Single-Family Sales*	Median Price	Month's Supply	Existing House Sales [B*]	Median Price [B]	Month's Supply [B]
May	504,000	282,000	4.5	4,890,000	$213,400	5.6
April	425,000	275,800	5.3	4,660,000	$201,700	5.7
2013	431,000	263,700	5.0	5,150,000	$203,100	5.0
M/M change	18.6%	2.2%	-15.1%	4.9%	5.8%	1.7%
Y/Y change	16.9%	6.9%	-10.0%	-5.0%	5.0%	12.0%

* All sales data are SAAR

Source: U.S. Department of Commerce-Construction: www.census.gov/construction/nrs/pdf/newressales.pdf;
[B] NAR® www.realtor.org/topics/existing-home-sales; 6/22/14

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Existing House Sales

National Association of Realtors (NAR®)[B]
May 2014 sales data:

Distressed house sales: 11% of sales –

(8% foreclosures and 3% short-sales)

Distressed house sales: 15% in April
and 18% in May 2013

All-cash sales: no change – 32%; 32% in April

Investors are still purchasing a substantial portion of
"all cash" sale houses – 16%;
18% in April 2014 and 18% in May 2013

First-time buyers: decreased to 27% (29% in April 2013)
and were 29% in May 2013

Source: [B] NAR® www.realtor.org/topics/existing-home-sales; 6/22/14

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May 2014 Construction Spending

May 2014 Private Construction: $354.77 billion (SAAR)

-1.48% less than the revised April estimate of $360.09 billion (SAAR)
7.49% greater than the May 2013 estimate of $330.04 billion (SAAR)

May SF construction: $187.55 billion (SAAR)
-1.3% less than April: $190.17 billion (SAAR)
10.8% more than May 2013: $169.19 billion (SAAR)

May MF construction: $40.45 billion (SAAR)
-0.6% less than April: $40.69 billion (SAAR)
30.6% more than May 2013: $30.96 billion (SAAR)

May Improvement[C] construction: $126.77 billion (SAAR)
-1.9% less than April: $129.24 billion (SAAR)
-2.4% less than May 2013: $129.89 billion (SAAR)

The US DOC does not report improvements directly, this is an estimation. All data is SAAR and is reported in nominal US$.

Source: [C] U.S. Department of Commerce-C30 Construction: www.census.gov/construction/c30/pdf/privsa.pdf

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Conclusions

May was “mixed bag” for housing: A blowout number for new house sales (keep an eye out for adjustments in future months) and existing sales were up-n-down. Single-family and remodeling expenditures declined month-over-month – with remodeling decreasing year-over-year as well. Permit data was not encouraging – both month-over-month and year-over-year permit issues were negative. Housing completions increased substantially – will new house sales absorb these completions?

As in previous months, the near-term outlook on the U.S. housing market remains unchanged. There are potentially several negative macro-factors or headwinds at this point in time for a robust housing recovery (based on historical long-term averages).

Why?

1) Lack-luster household formation,
2) a lack of well-paying jobs being created,
3) a sluggish economy,
4) declining real median annual household incomes,
5) strict home loan lending standards,
6) new banking regulations, and
7) global uncertainty?

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April 2014
EU Housing Scorecard

		M/M	Y/Y
Production in Construction^{A}	EU 28	△ 0.6%^{s}	△ 7.2%^{s}
	EU 18	△ 0.8%^{s}	△ 8.0%^{s}
	Germany	▽ -1.2%	△ 2.9%
	France	△ 0.2%	△ 1.1%
	UK	△ 1.1%^{p}	△ 5.0%^{p}
	Spain	△ 5.0%^{sp}	△ 55.4%^{p}
Building permits (m² floor)^{A}	EU 28	-.-	-.-
	EU 18	▽ -0.0$^{(02)}$	▽ -13.5$^{(02)}$
	Germany	▽ -3.3%$^{s(04)}$	▽ -8.0%$^{(04)}$
	France	▽ -10.6%$^{s(05)}$	▽ -20.5%$^{s(05)}$
	UK	-.-	-.-
	Spain	▽ -11.7$^{s(02)}$	▽ -5.5%$^{e(03)}$

M/M = month-over-month; Y/Y = year-over-year

Source: Eurostat (http://epp.eurostat.ec.europa.eu/portal/page/portal/short_term_business_statistics/data/main_tables), ^{A} see following slide
^{e} estimate, ^{s} Eurostat estimate, ^{p} provisional, $^{-.-}$ no data available, $^{(02)}$ February data, $^{(03)}$ March data, , $^{(05)}$ May data)

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April 2014
Legend - EU Housing Scorecard

Production in construction

The production in construction shows the output and activity of the construction sector. It measures changes in the volume of output on a monthly basis. Construction includes building construction and civil engineering. The construction sector in total corresponds to the NACE Rev. 2 section F but the split between building construction and civil engineering is based on the Classification of types of Construction (CC1, CC2). Production in construction is compiled as a "fixed base year Laspeyres type volume-index". The current base year is 2010 (Index 2010 = 100). The index is presented in calendar and seasonally adjusted form. Growth rates with respect to the previous month (M/M-1) are calculated from calendar and seasonally adjusted figures while growth rates with respect to the same month of the previous year (M/M-12) are calculated from calendar adjusted figures.

Building permits - monthly data - m2 of the useful floor area

The objective of the building permit index is to show the future development of construction activity in terms of per square meter of useful floor. The current base year is 2010 (Index 2010 = 100). The index is presented in seasonally adjusted form. Growth rates with respect to the previous month (M/M-1) are calculated from seasonally adjusted figures while growth rates with respect to the same month of the previous year (M/M-12) are calculated from raw data.

Source: Eurostat (http://epp.eurostat.ec.europa.eu/portal/page/portal/short_term_business_statistics/data/main_tables)

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Housing comments – May, 2014

Economy – short term (next 2-3 years):

- government debt – all levels of government – exacerbates the job problem

- European economy getting better (slowly) – some deflation risk ; China is slowing too as they focus on domestic economy versus exports (1st qtr 2014 GDP was 7.4%, slowest in 18 years)

- Housing's issues - slowing world economy; weak job market; sluggish income growth; tight credit environment

- This is not your typical housing recovery – 1st time buyers are absent while investors and cash sales are much higher percentage – this will create problems going forward.

(1) lost "follow-through" with delayed 1st time purchasers (i.e., move up purchases at later date).

(2) also, as interest rates rise, investor activity will wane.

Economy – longer term (next 4 - 8 years) – slower growth (<3% ?) due to demographics

- that means housing starts may not return to "trend" (1.5 – 1.6 million/year) unless we get some help from favorable immigration policies – aging population spends less, buys fewer houses, consumes less, …. Similar situation in Europe

We'll discuss this issue in more detail in a future housing note.

The return of 1st time buyers is the key to any sustainable recovery in housing! That depends on a stronger job recovery. Right now, prospects are not good. Student debt is serious problem for many young people so they are putting off forming households

Here is good article discussing impact on housing.

http://www.td.com/document/PDF/economics/special/USStudentLoansHomeownership.pdf

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The weak economy has impacted housing in many ways – here are some major ones:

A. Lackluster job creation has resulted in household(HH) formation off by 50%. In fact, some estimates have formations (cumulative) off by 2 million since 2008.
HH formations are the key to any housing recovery as they account for two thirds of housing demand.
B. There is a growing trend to multi family versus single family due in large part to weak economy. Many 1st time buyers can't get a mortgage so they rent.
C. The market is skewed to cash sales due in large part to the tight credit environment. This isn't typical and won't lead to a return to normal housing demand.
D. The job market has returned to the 2008 pre recessionlevel, but 7.5 million have entered the workforce since then – the market has not been able to absorb them. A key reason why income growth has not advanced and the economy flounders
E. Household formations are the key to any sustainable housing recovery – that won't happen without solid recovery in jobs allowing young people to form households again.

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Housing, Economy, and wood products

Here is good article on housing's impact on the economy – why the economy is having problems moving forward.
NYT http://www.nytimes.com/2014/04/27/upshot/the-housing-market-is-still-holding-back-the-economy-heres-why.html?ref=business&_r=1

Here is the dilemma – housing contributes about 4% directly to GDP and another 12 – 15% indirectly, for a total of 16 – 19%. The key to housing's recovery is good paying jobs with benefits. That means we need a stronger economy. But, with housing and related activities contributing only 15% to GDP, that won't happen. The old "chicken and egg" dilemma. What is the solution? I've read that U.S. businesses have about 2 trillion Dollars stashed on their balance sheets (much of it offshore). If they were to invest that in plant, equipment, job training, technology, R&D, etc., that would create jobs and some momentum for the economy. What is holding them back? Uncertainty is key reason (and the corporate tax code). We need 'Washington" to provide leadership in where the country is headed and how to get there – we need to remove some of the uncertainty. And, they need to convince businesses (and the public) that their vision (to fix the economy) is realistic and they have a viable strategy for achievement. A tall order and I know I have oversimplified things. But, the current mix of politicians in Washington can't agree on a unified strategy to move the country forward. Consequently, housing, the economy, and hence, the wood products industry, will continue to "underachieve".

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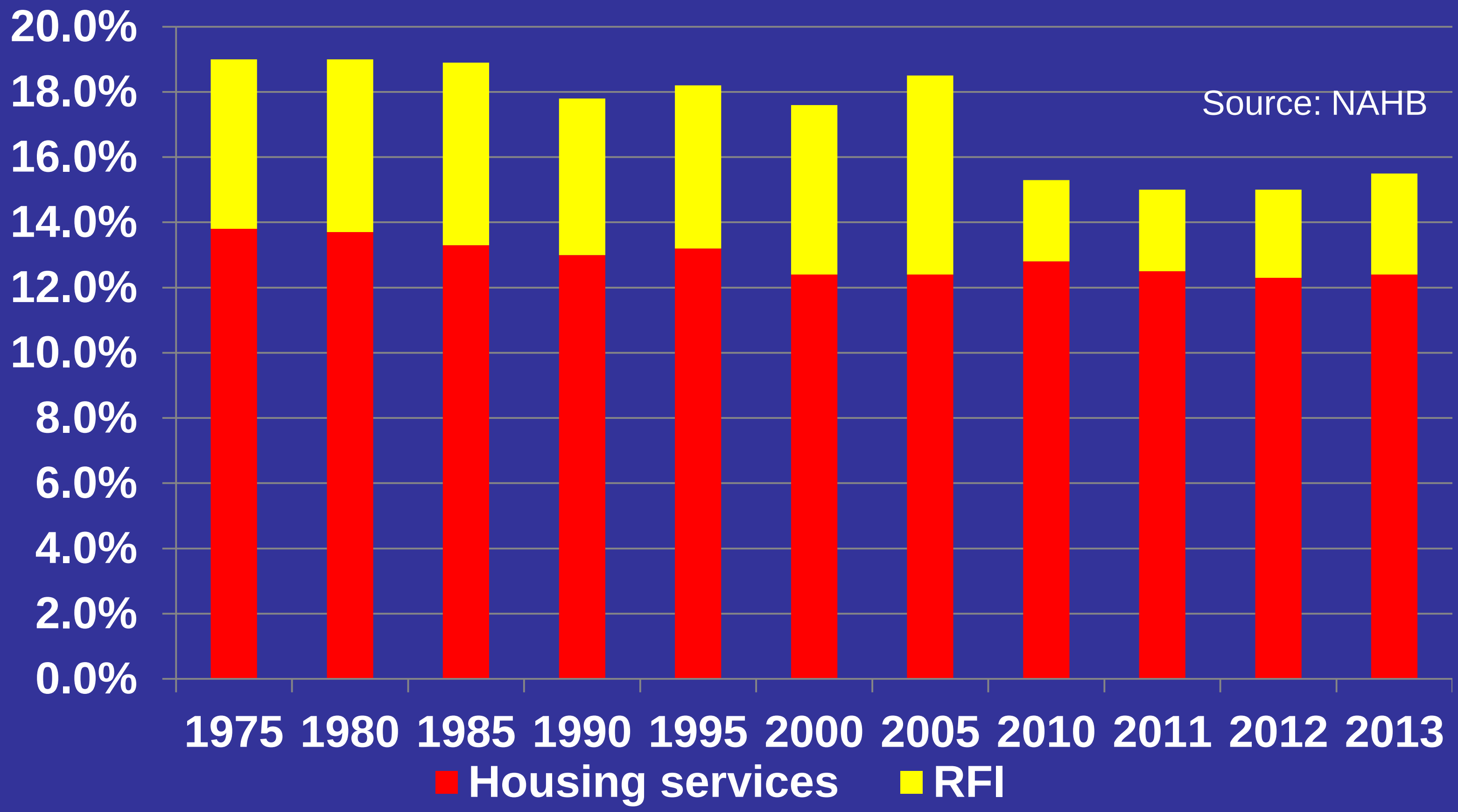
Housing's contribution to GDP (%) – historically, it is almost 20% of the economy when you include housing services and fixed investment, but today it is down to 15%. In reality, housing's contribution to the economy is even more important when you include purchased furniture, landscaping, maintenance, etc.

- one of the key reasons why the economic recovery remains muted

Housing services = gross rents paid by renters (include utilities) + owner's imputed rent (how much It would cost to rent owner occupied homes) + utility payments

RFI (residential investment) = construction of new SF and multifamily structures, remodeling, manufactured homes , plus broker's fees



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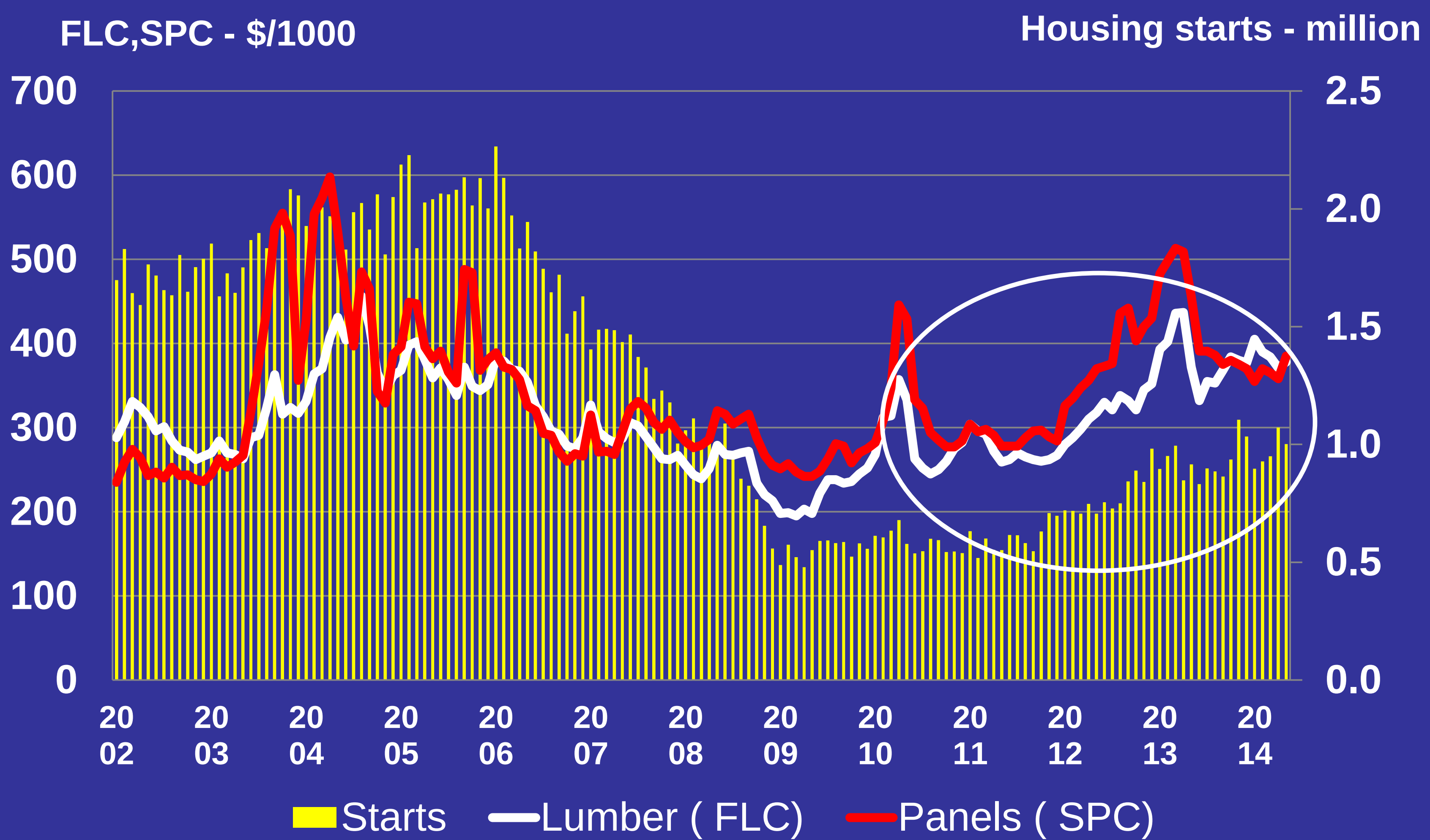
Housing starts and wood product prices – Economics 101

75% of structural wood products go to housing (new construction plus remodeling)
50% or more of hardwoods go to housing related activities.



Sources: Prices – Random Lengths (http://www.randomlengths.com/); starts (Bureau of Census (http://www.census.gov/construction/nrc/)

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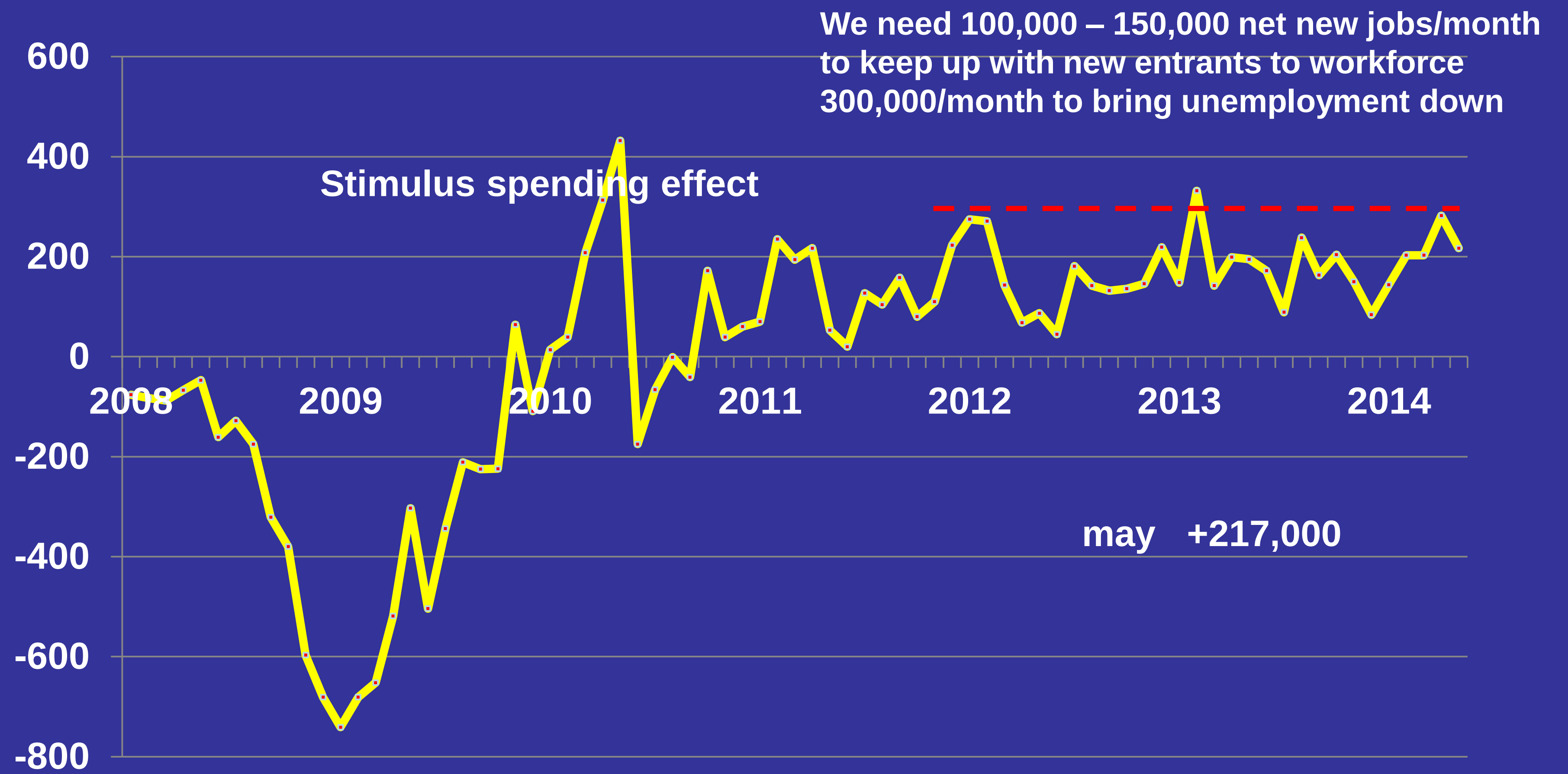
Employment situation - our biggest problem - it's getting better, but the jobs recovery remains weak by past standards, and many jobs (e.g., temporary ones) don't include health care or retirement benefits – those kinds of jobs don't encourage people to buy houses

Net change in non farm payrolls – monthly, thousands



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

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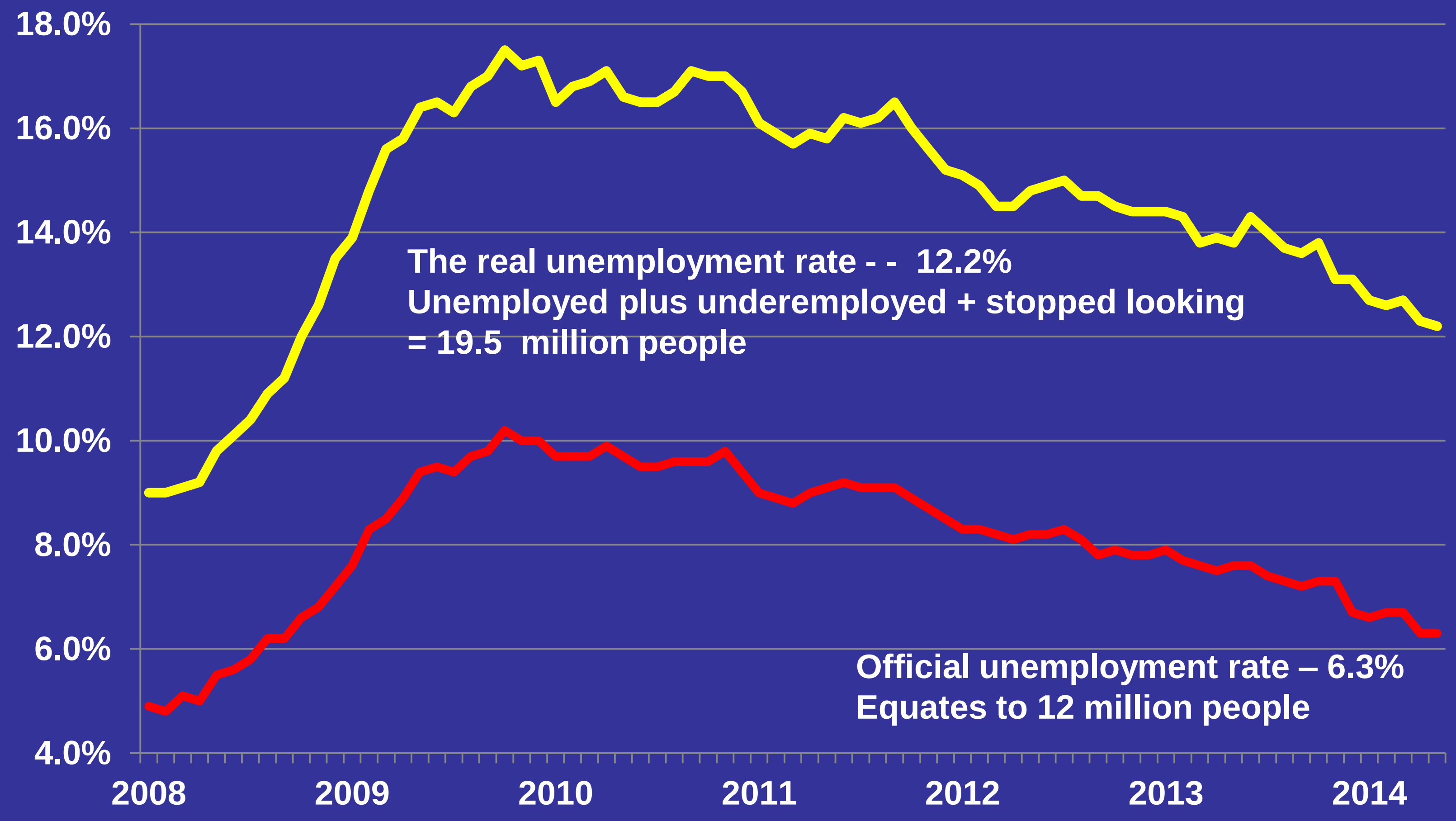
Unemployment keeps coming down – but, the quality of many jobs being created is not so good!!

There are about 20 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

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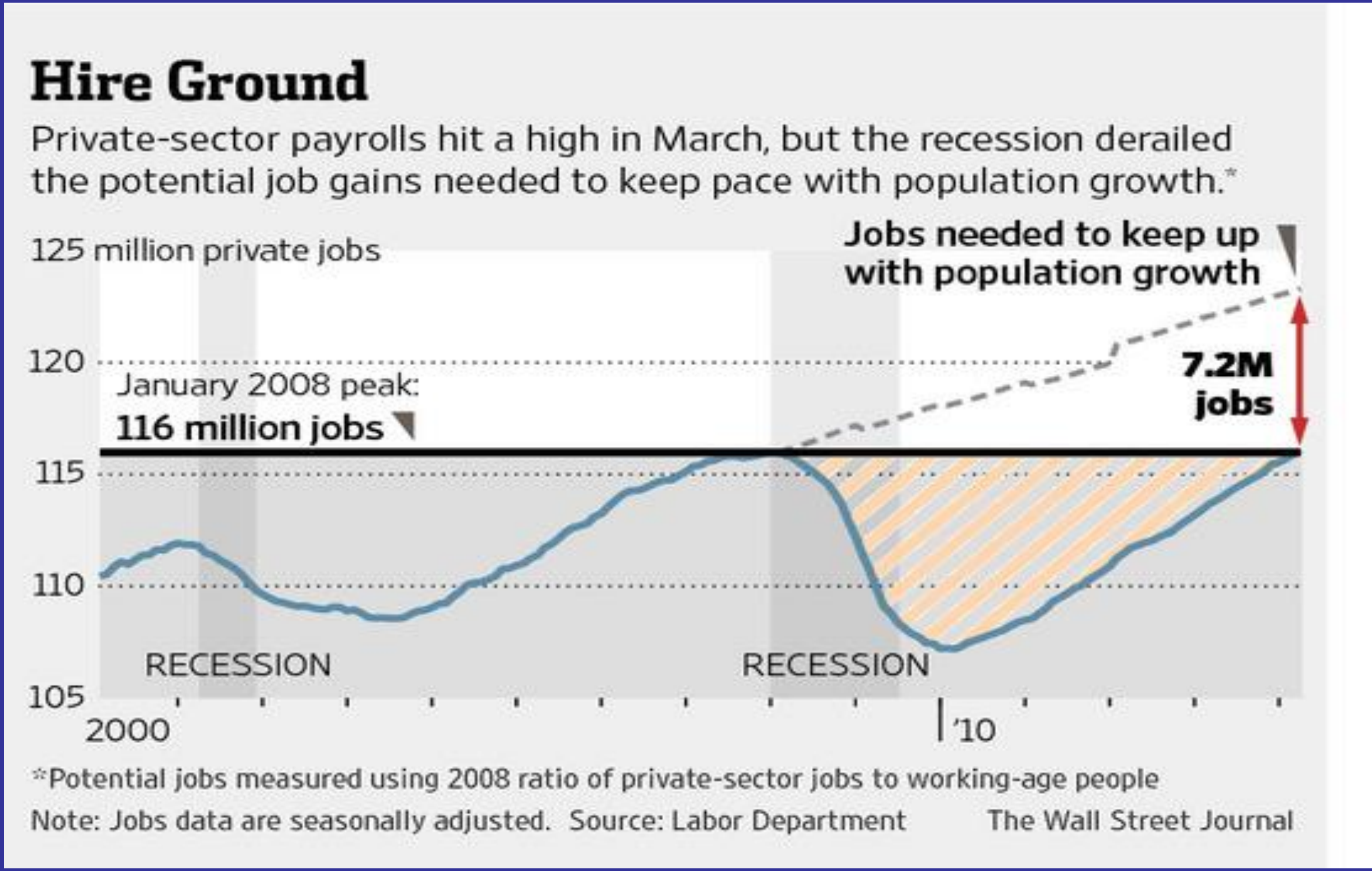
Private sector payrolls are back to where we were in January 2008 - but, we need 7.2 million more jobs just to keep pace with population growth – key reason why job market is soft!!!! (and real wage growth is nonexistent)



Source: WSJ (http://online.wsj.com/news/articles/SB10001424052702303987004579481141339889068?mod=WSJ_hp_LEFTWhatsNewsCollection&mg=reno64-wsj)

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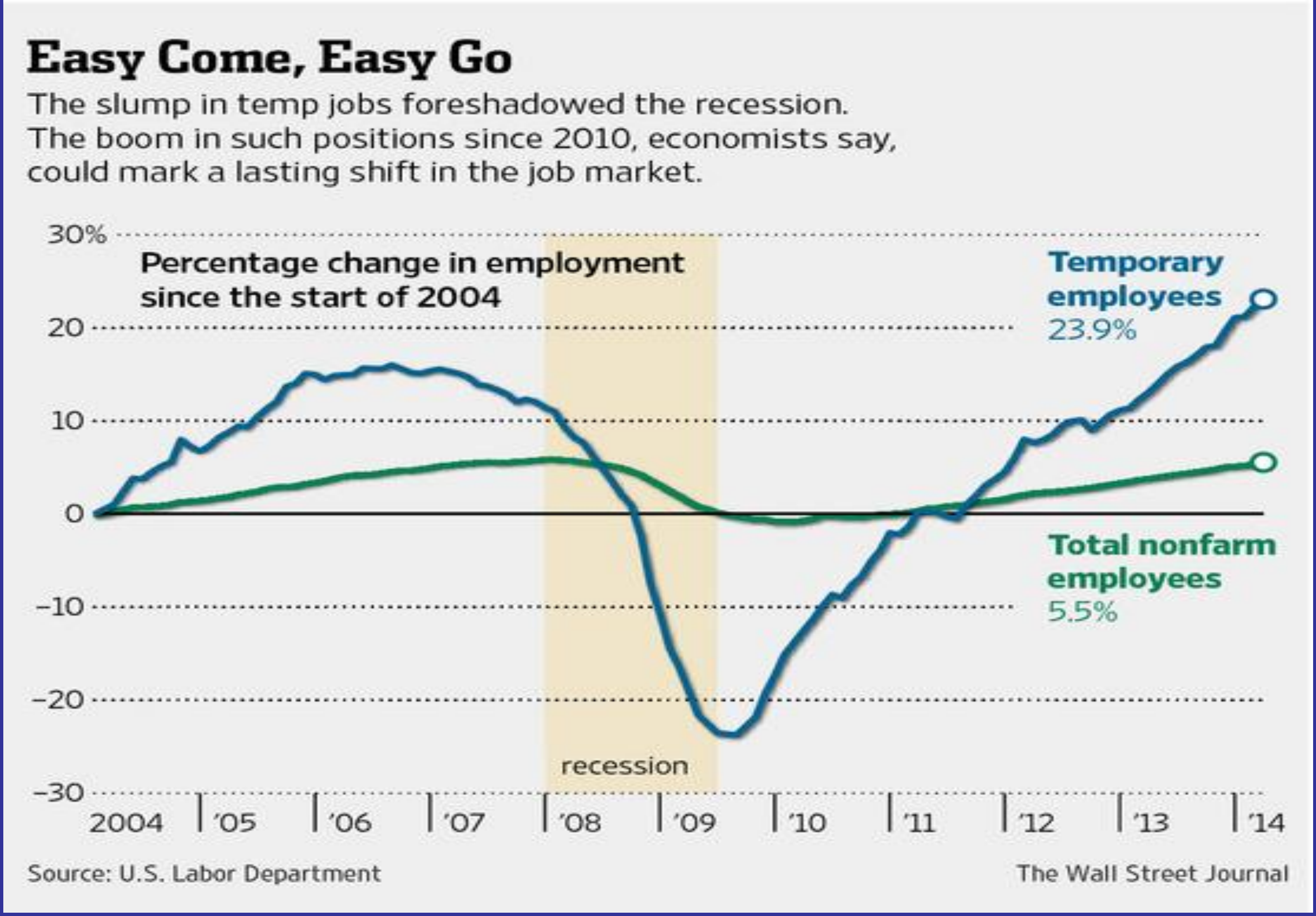
Temporary jobs keep increasing as firms cut expenses (D. Paletta/WSJ) – main reason income gain is weak



Source: WSJ (http://online.wsj.com/news/articles/SB10001424052702303910404579485303369082202?mg=reno64-wsj)

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Labor force participation rate is shrinking – this is not good!

Major problems for social programs with our aging population –
fewer people paying taxes, but more people collecting
SSI, Medicare, etc. Also, we will see more labor shortages in the future.

Source: BLS

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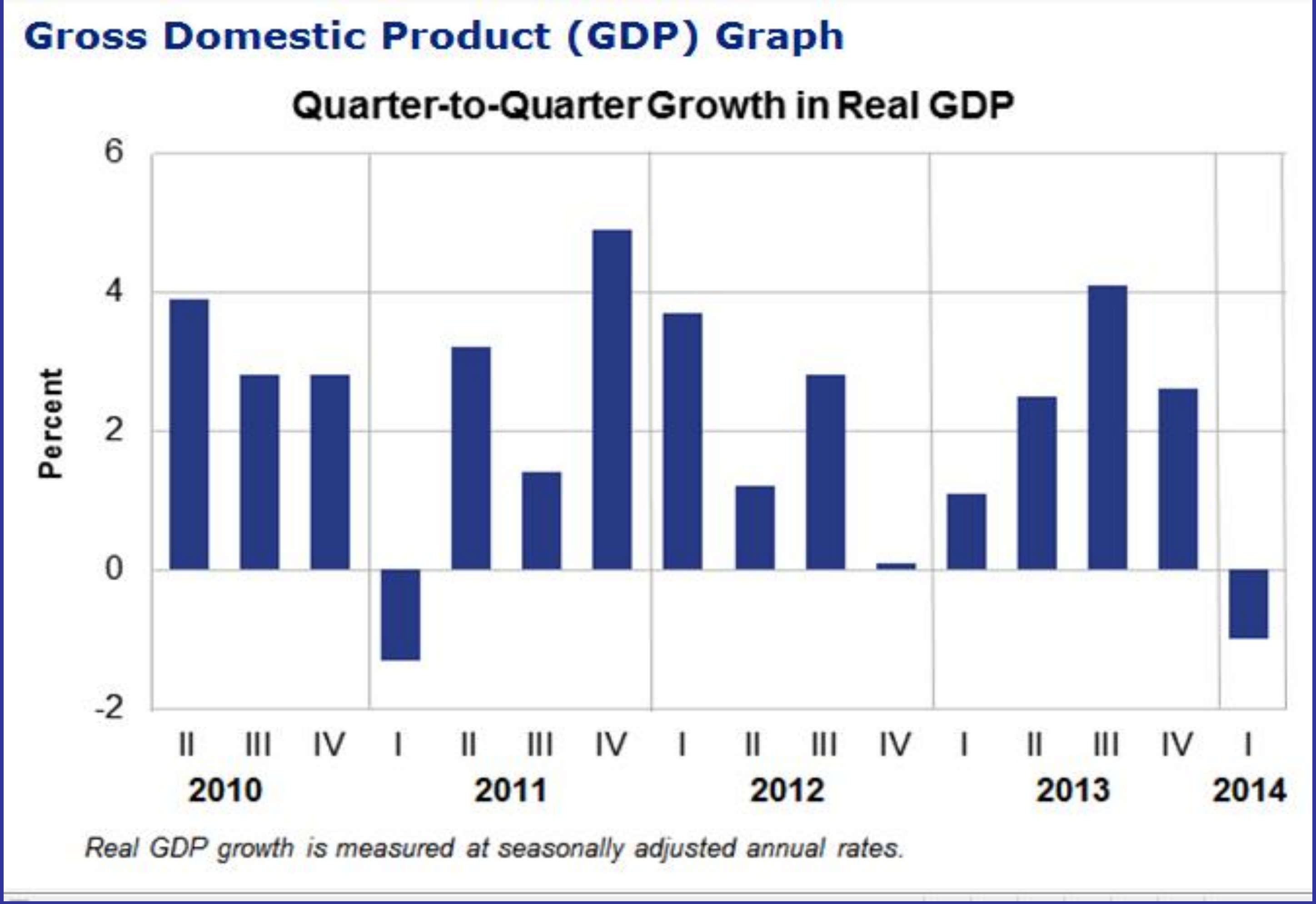
Economic growth (1.0%) - 1st qtr 2014 – weather related – but, weak considering we have had “free money” now for 5 years –
GDP for 2013 was 1.9% - nothing to write home about



Source: BEA (http://www.bea.gov/newsreleases/national/gdp/gdp_glance.htm)

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NAR's latest Economic and Housing Outlook – 2015 is the year for housing to return to "normal"

	2014	2015
GDP	2.3%	2.9%
Housing starts(000)	1016	1433
Single (SF)	734	1013
Multi (MF)	363	420
Resales (000)	4976	5257

My comments:
2014 - - looks OK except MF may be a bit higher and SF lower
2015 - - 2015 may be a bit too optimistic. For housing starts – may be closer to 1300.
Furthermore, for 2015, I would leave multi family(MF) at 35% – this would put MF at 455 and SF at 845 *(later in this note you will see some rationale for higher multi family numbers)*

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

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Recent Housing statistics

<u>Background:</u>
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!!!

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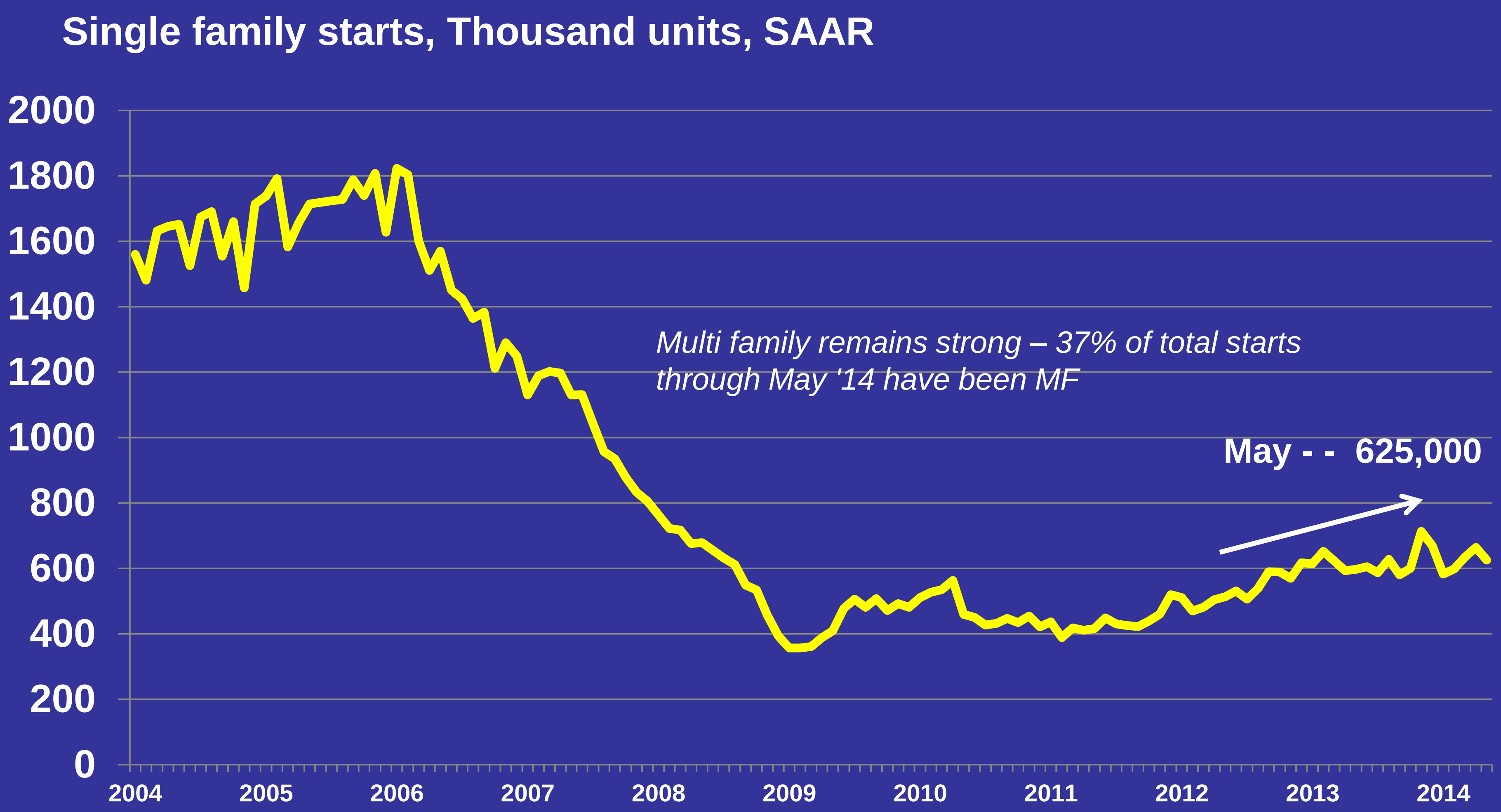
Starts are finally turning the corner, but growth is elusive



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

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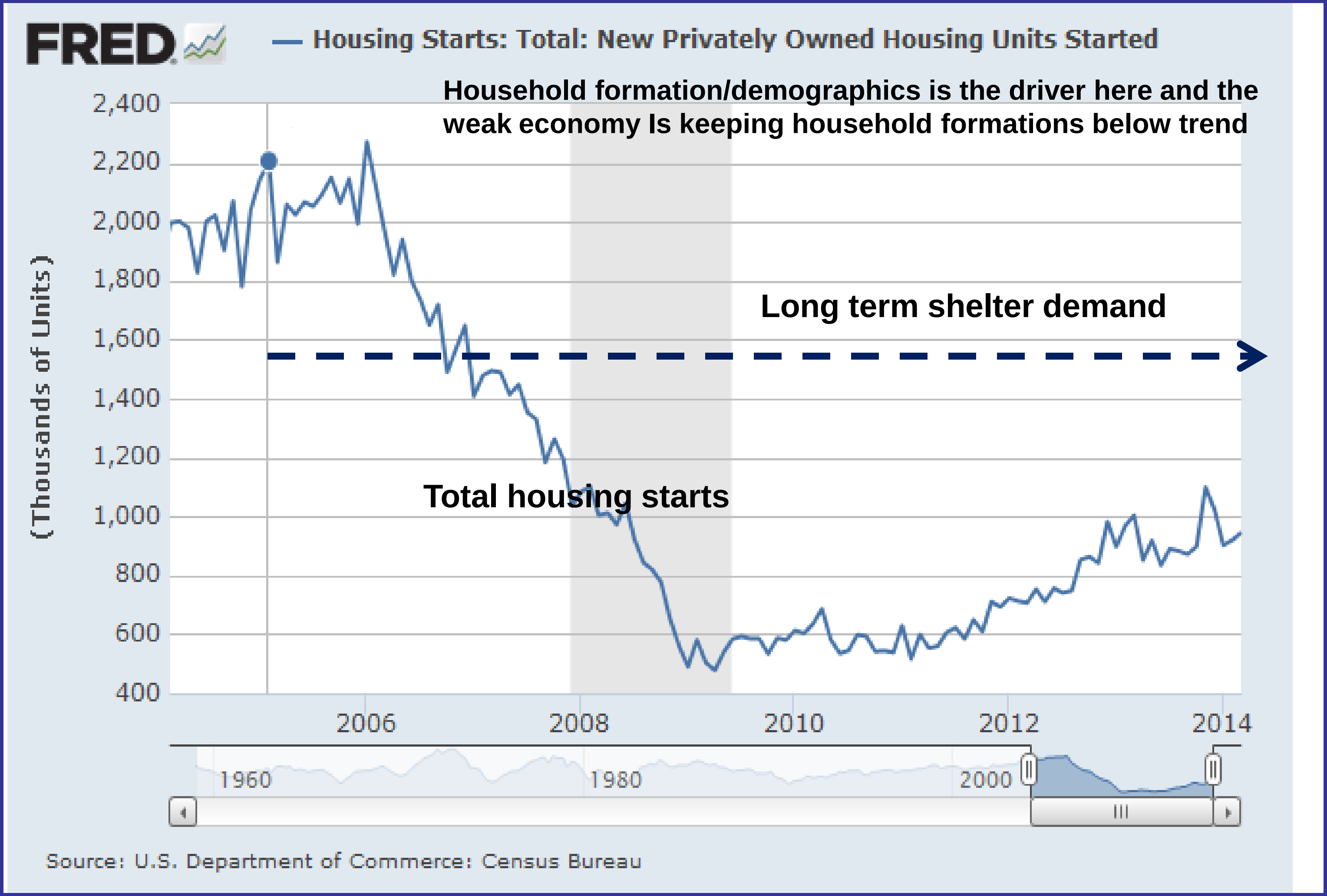
Long term shelter demand is estimated to be about 1.5 million annually
Based on demographics (65%), replacement demand (25%), and speculative demand including 2nd homes.(10%) - to date, the main drivers have been speculators/investors and people paying cash: e.g., in 1st qtr investors were 17% of existing home sales while cash sales were 43% of total purchases.



Source: Federal reserve bank of St. Louis (https://research.stlouisfed.org/fred2/categories/32302)

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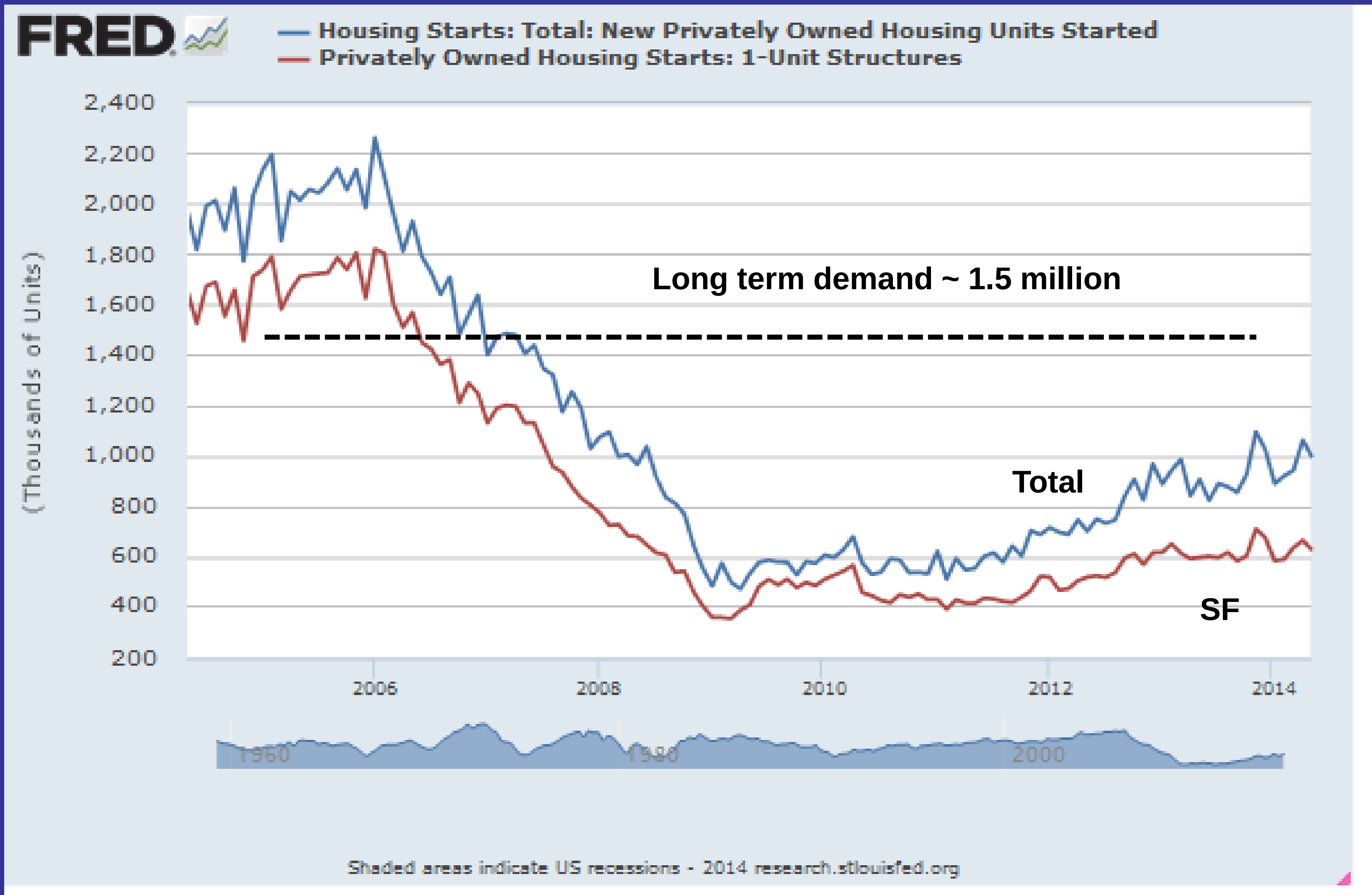
FRED
Housing Starts: Total: New Privately Owned Housing Units Started
Privately Owned Housing Starts: 1-Unit Structures
2,400
2,200
2,000
1,800
1,600
1,400
1,200
1,000
800
600
400
200
(Thousands of Units)
Long term demand ~ 1.5 million
Total
SF
2006
2008
2010
2012
2014
1960
1980
2000
Shaded areas indicate US recessions - 2014 research.stlouisfed.org

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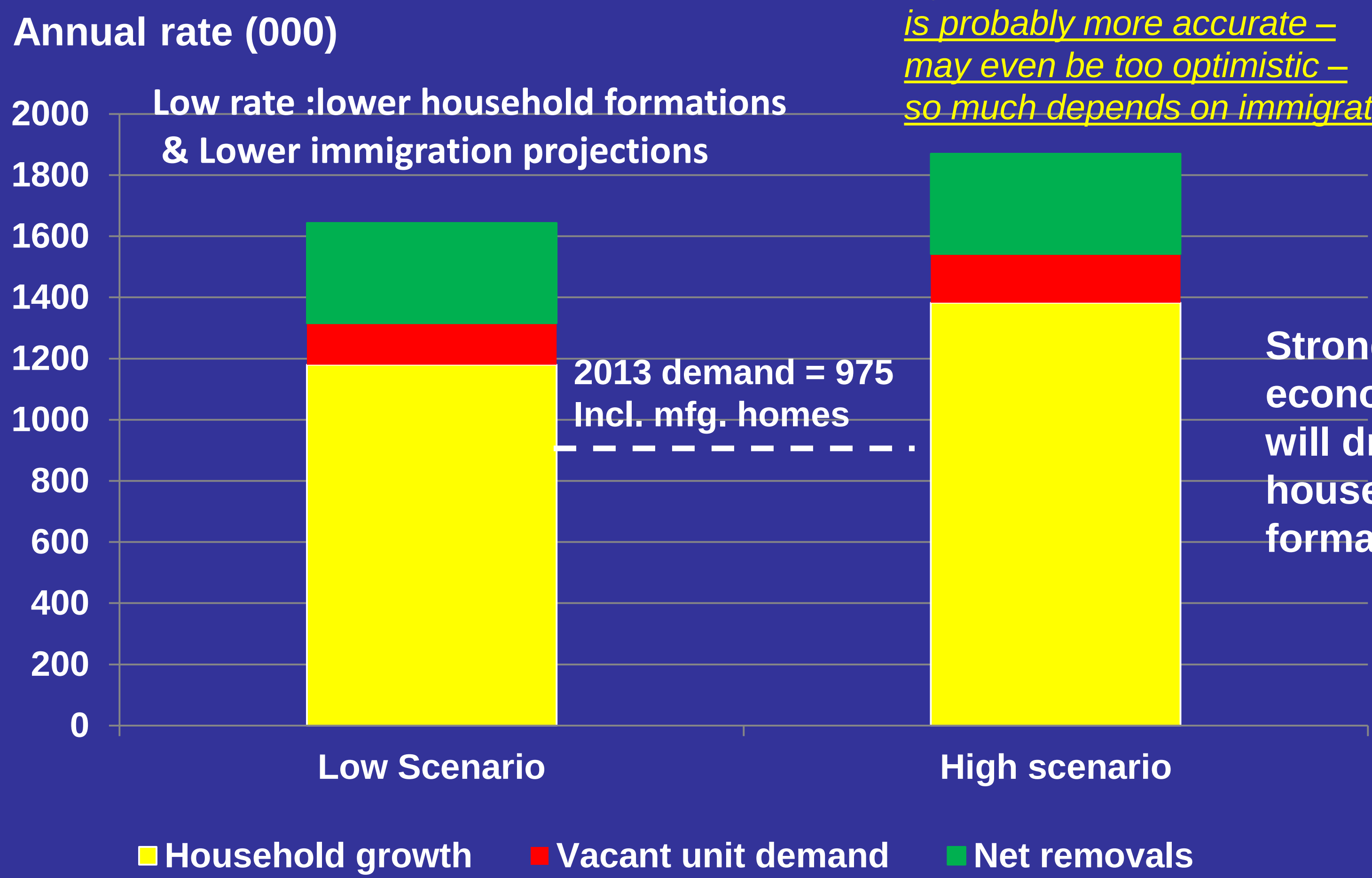
Harvard* Housing Demand Forecasts 2010 – 2020 (latest - September 2010)

Vacancy demand – 2nd homes, speculative building
Removals – net loss from existing inventory of housing stock

My comment: Low scenario is probably more accurate – may even be too optimistic – so much depends on immigration



Strong economy will drive household formations

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

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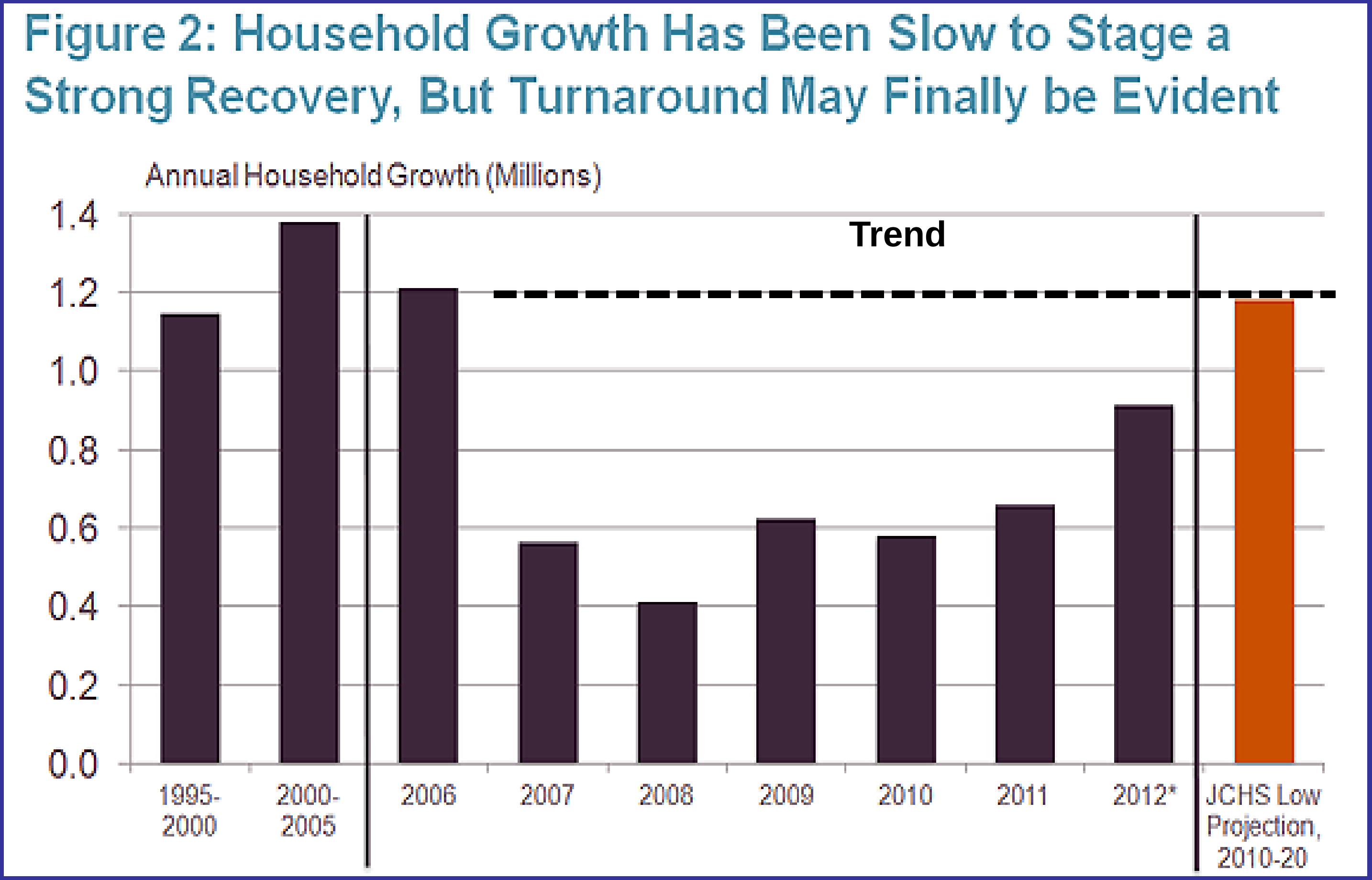
Recent Harvard study has household formations returning to trend of 1.2 million annually once the economy improves. During 2007 – 2012, the economy forced many young people to return home while many postponed getting married - - key reasons why HH formations fell dramatically



Source: HJCHS (http://housingperspectives.blogspot.com/2012/11/the-resurrection-of-household-growth.html)

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Estimate from Trulia on number of households that were not formed annually during 2008 – 2013 due to the economy – this suggests that when the economy picks up, this “pent up demand” will help drive demand for housing!

Year	# of “missing” households (cumulative) millions
2008	0.9
2009	1.8
2010	2.6
2011	2.6
2012	2.3
2013	2.4

Note: estimate takes into account changes in the age distribution of the population. See note at end of post.

Source: Trulia (http://www.trulia.com/trends/2013/07/kids-arent-moving-out-yet/)

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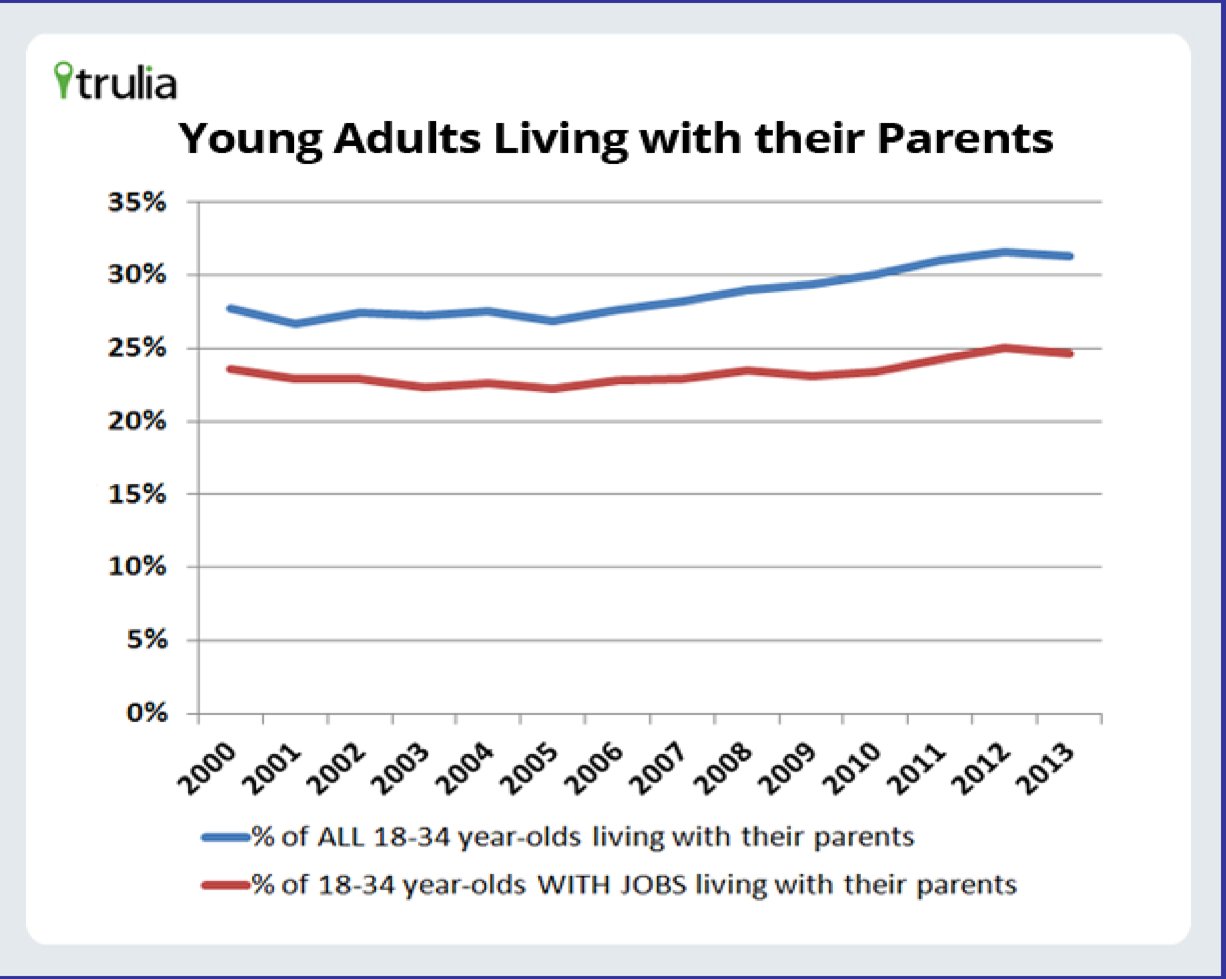
Key reason why household formations are weak many young people can't find jobs *(these are 1st time buyers and they hold the key to any housing recovery)*



Source: Trulia (http://www.trulia.com/trends/2013/07/kids-arent-moving-out-yet/)

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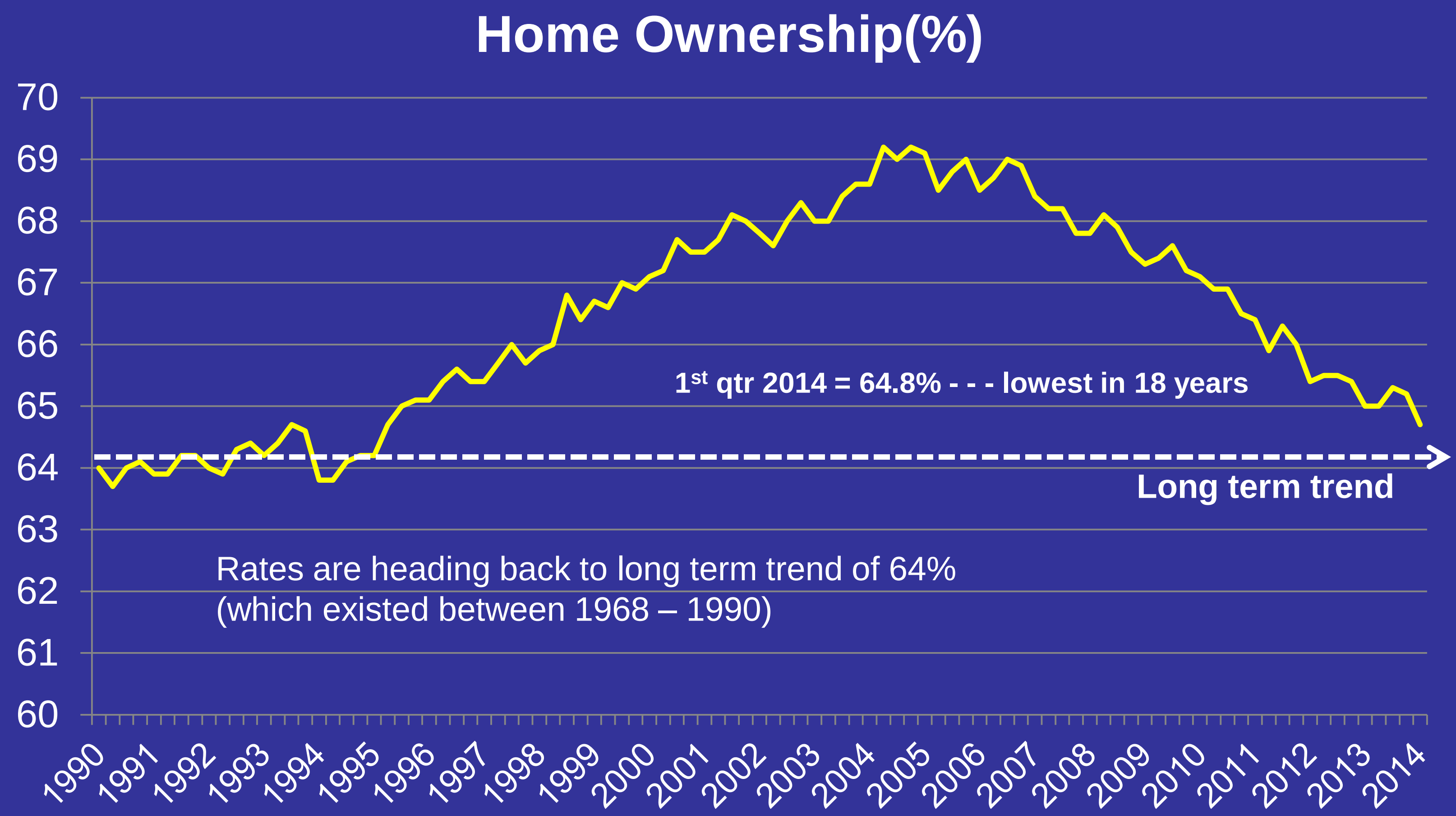
Impact of weak household formations - -
homeownership rates have been falling for the past seven years – when the economy gets back to normal,
will people go back to single family or will we see more renting?
There will be impacts on wood products demand



Source: Census (https://www.census.gov/housing/hvs/data/q413ind.html)

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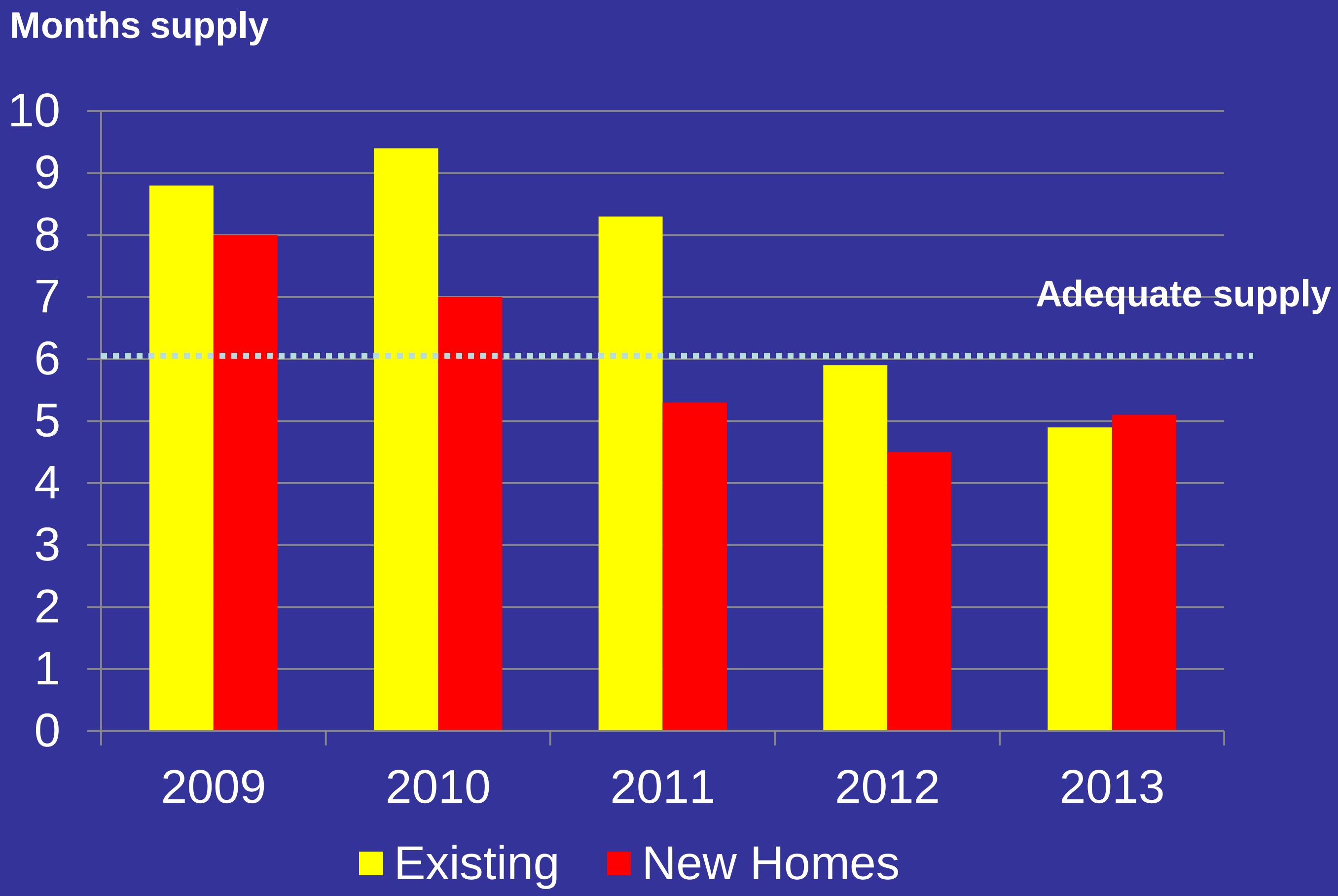
OK – you're reading about bidding wars in some locations and you think housing is starting to overheat? Don't believe it! (OK – some markets, but not the general housing market).

Historically, 6 months is the metric we use to determine adequate supply.
Low supply is key reason we are seeing "bidding wars" in some locations.
Unfortunately, it is not demand for housing by typical buyers that creates this situation.



Source" NAHB (http://www.nahb.org/fileUpload_details.aspx?contentID=55761)

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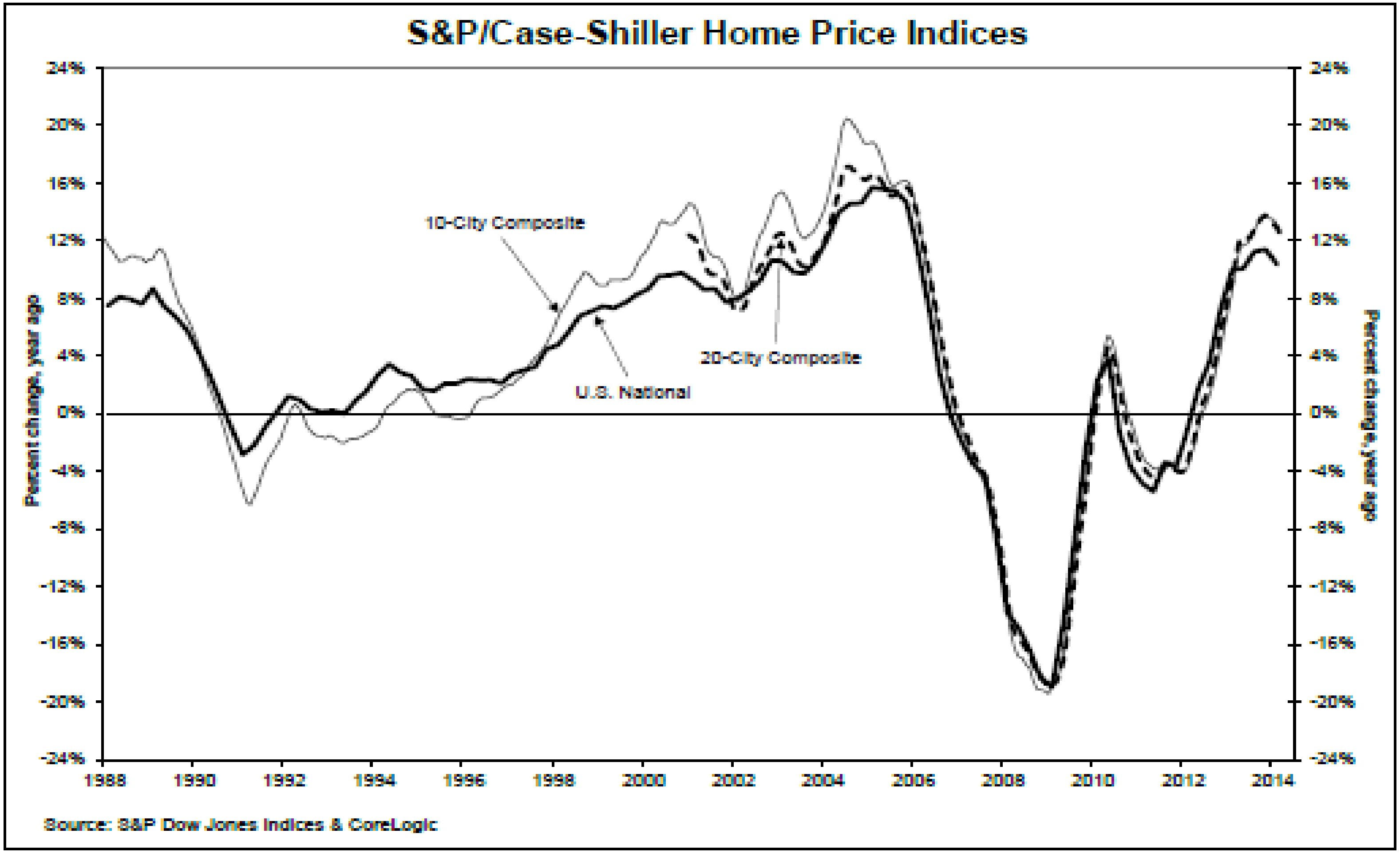
Yes, prices are up about 12%, annual basis, but I believe low supply is main reason



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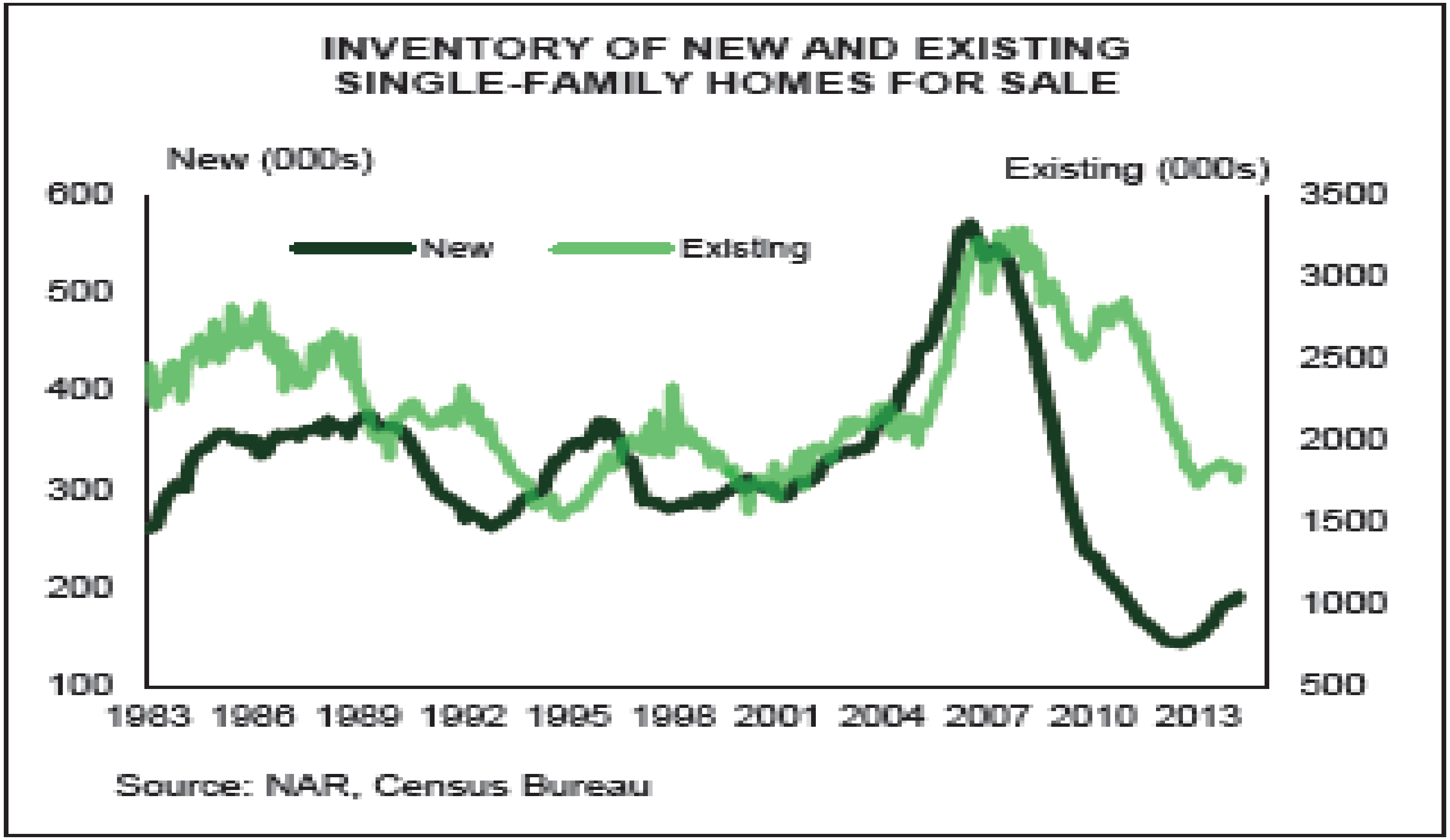
Low Inventories are key reason home prices are escalating so rapidly - historically, new home inventory is about 350,000 while existing home inventory is about 2,300,000. Today, existing inventory is 500,000 below trend while new homes are about 150,000 below trend



Source: TD Bank (http://www.td.com/document/PDF/economics/special/jm0516_USHousing.pdf)

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Following slides address some multi family issues

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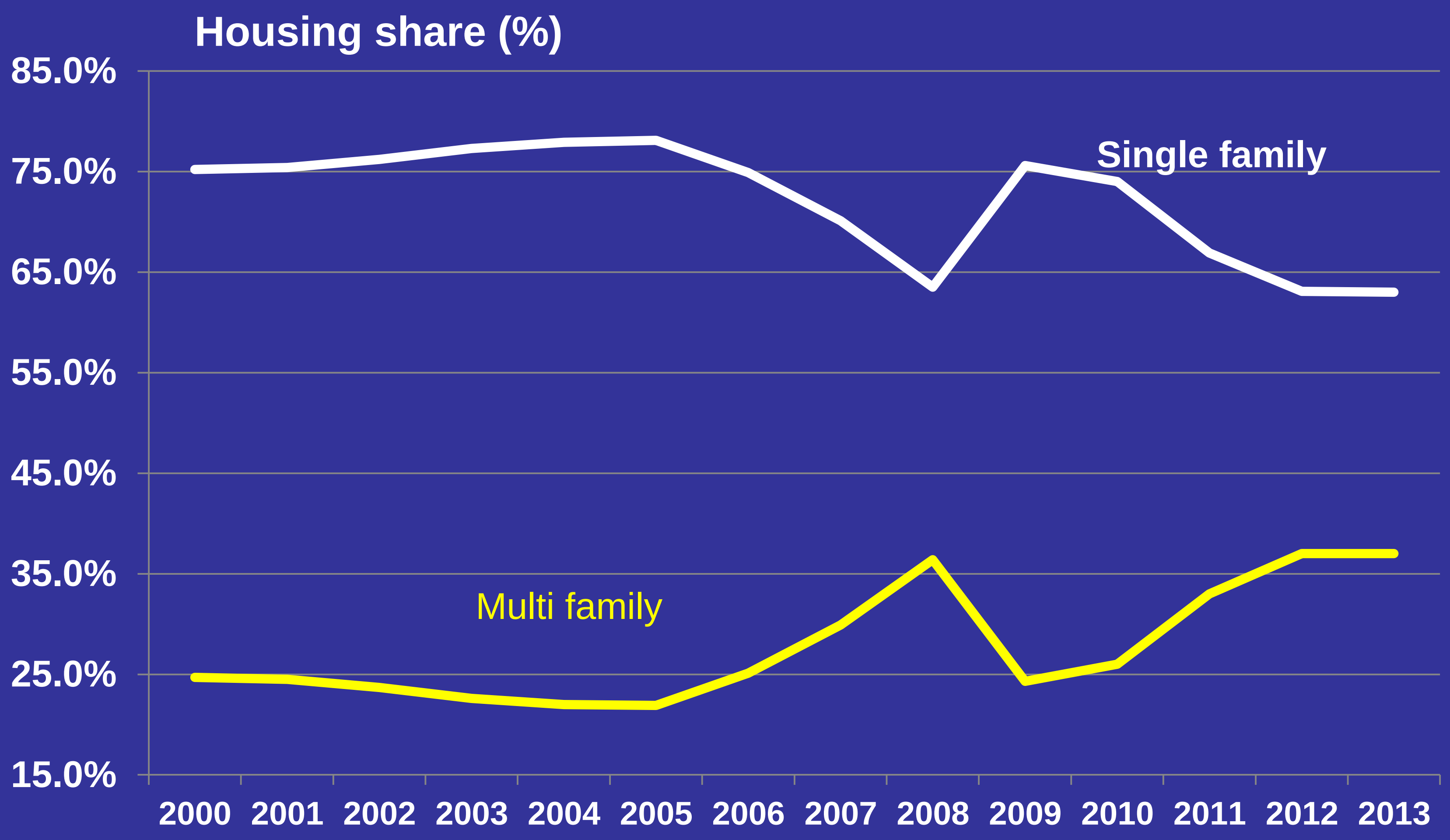
Multi family share is increasing – will it continue?

Yes – here are three drivers: financial/cost (tight credit and mortgage carrying cost big problem for buyers); social trends (suburban life losing its appeal to many Americans); and demographics (aging population is downsizing). In addition, many young people can't find good jobs so they rent.



Source: Census (http://www.census.gov/construction/nrc/)

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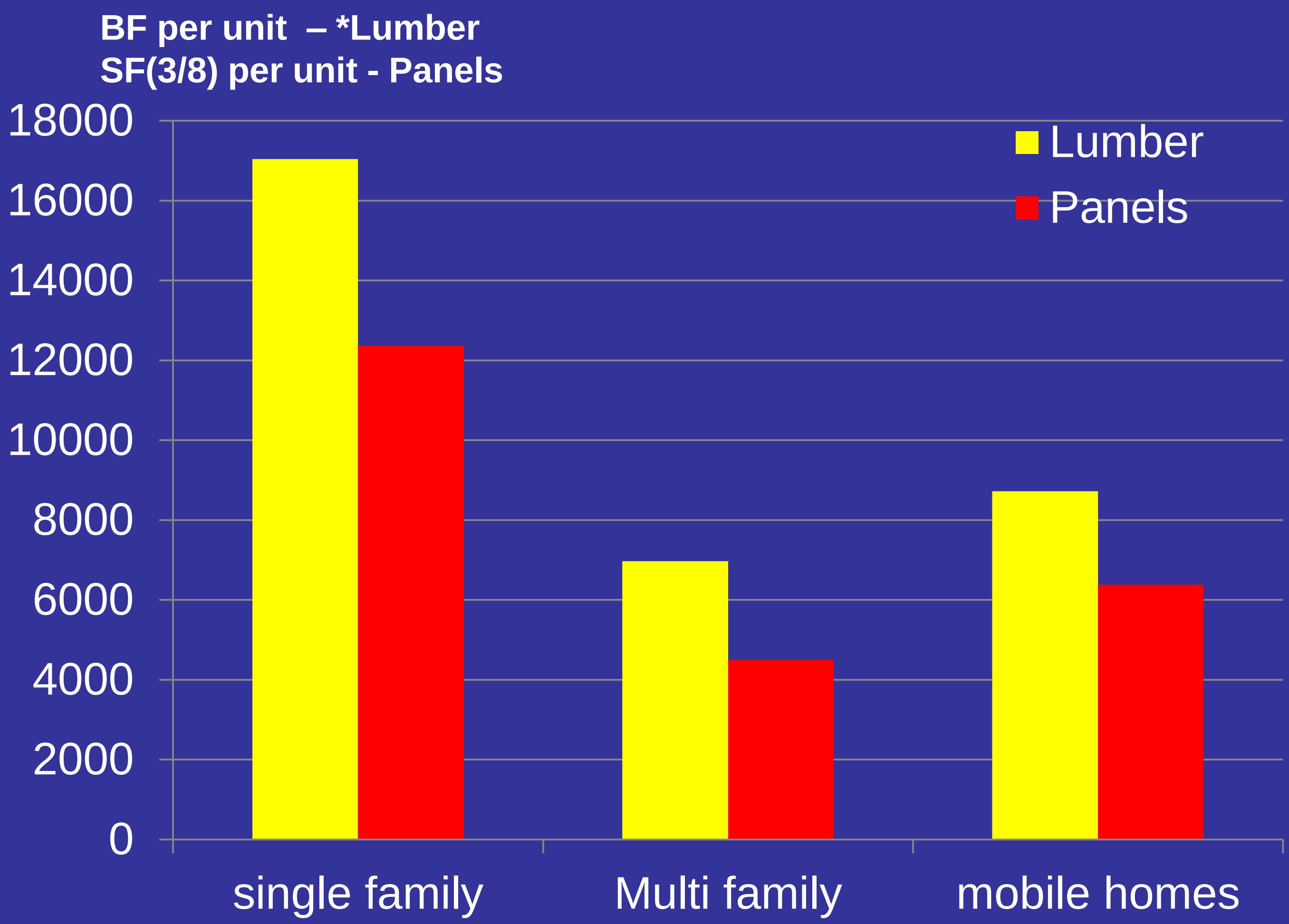
Wood Products Use per Unit



Source: Wood Products Council Table #7 and #13, ES4, 2006

(*Lumber includes BFE of engineered wood per unit)

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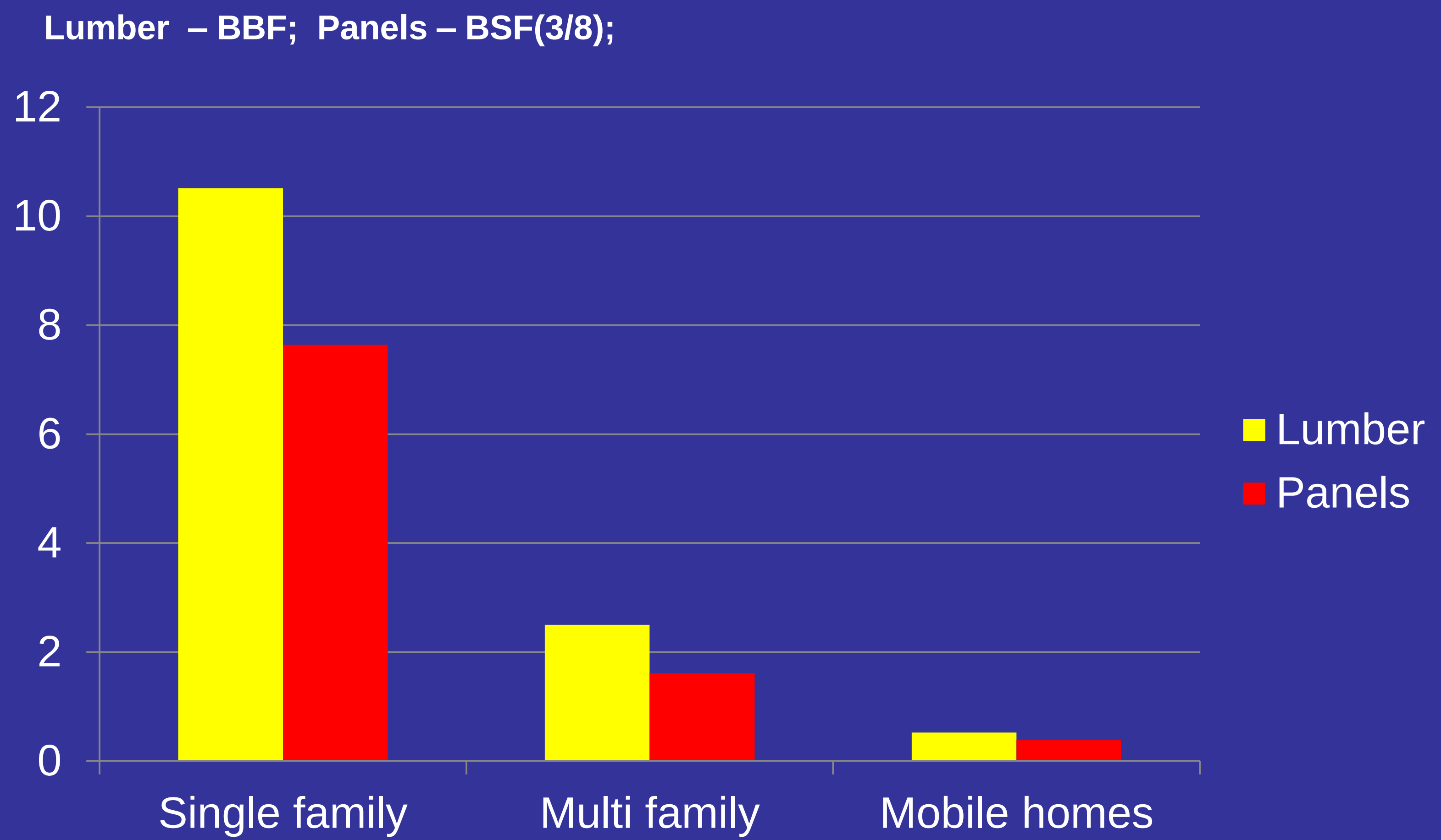
New residential markets – 2013 basis

Single family dominates – any switch to multifamily/rental has major impact on wood consumption



Source; WPC, Wood used in New Residential Construction, table #7, 2009

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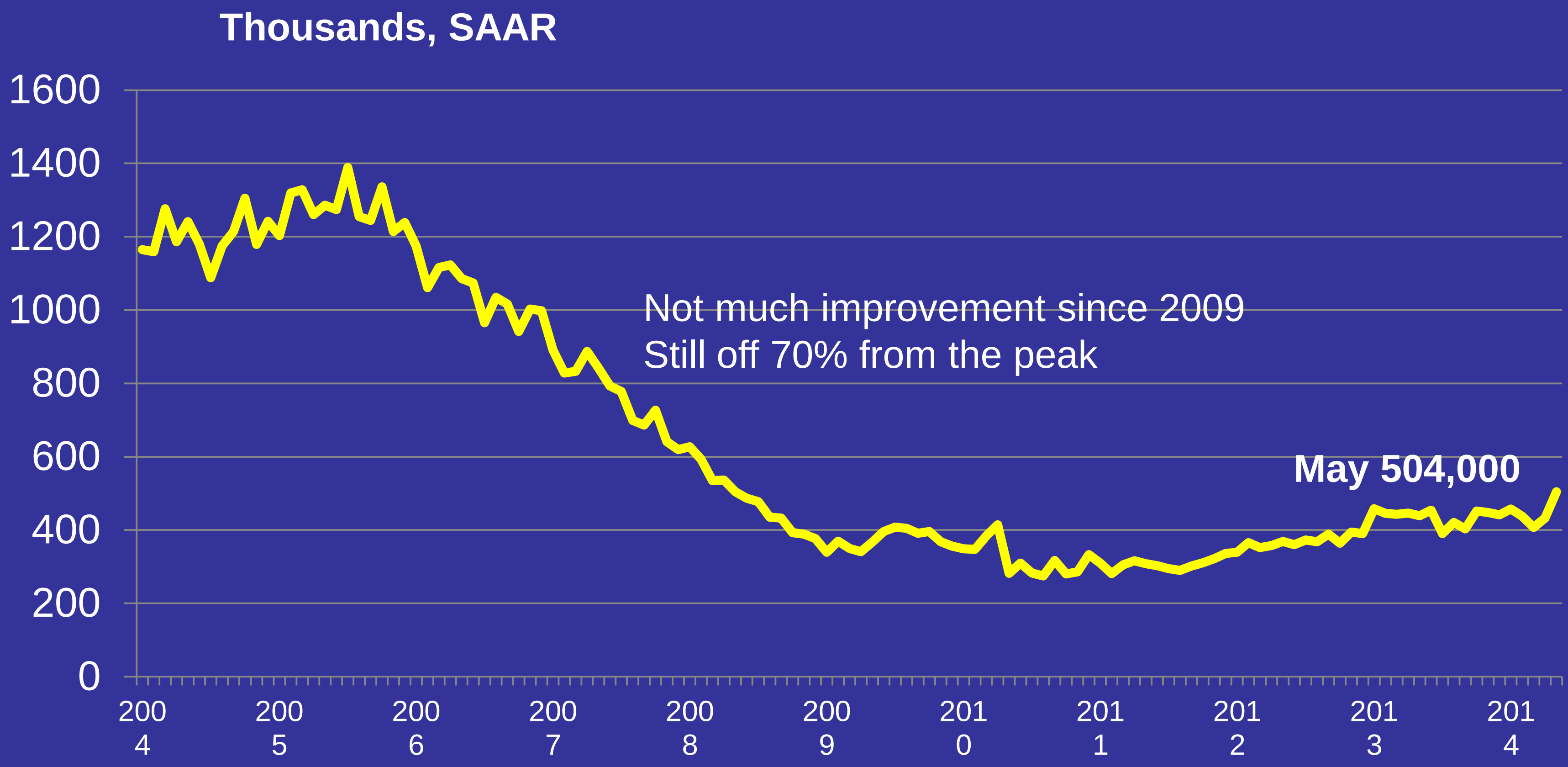
New Single Family Home sales is the key statistic to watch – Sales drive housing starts – this drives demand for wood products! All we can say so far is that sales have stabilized.



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

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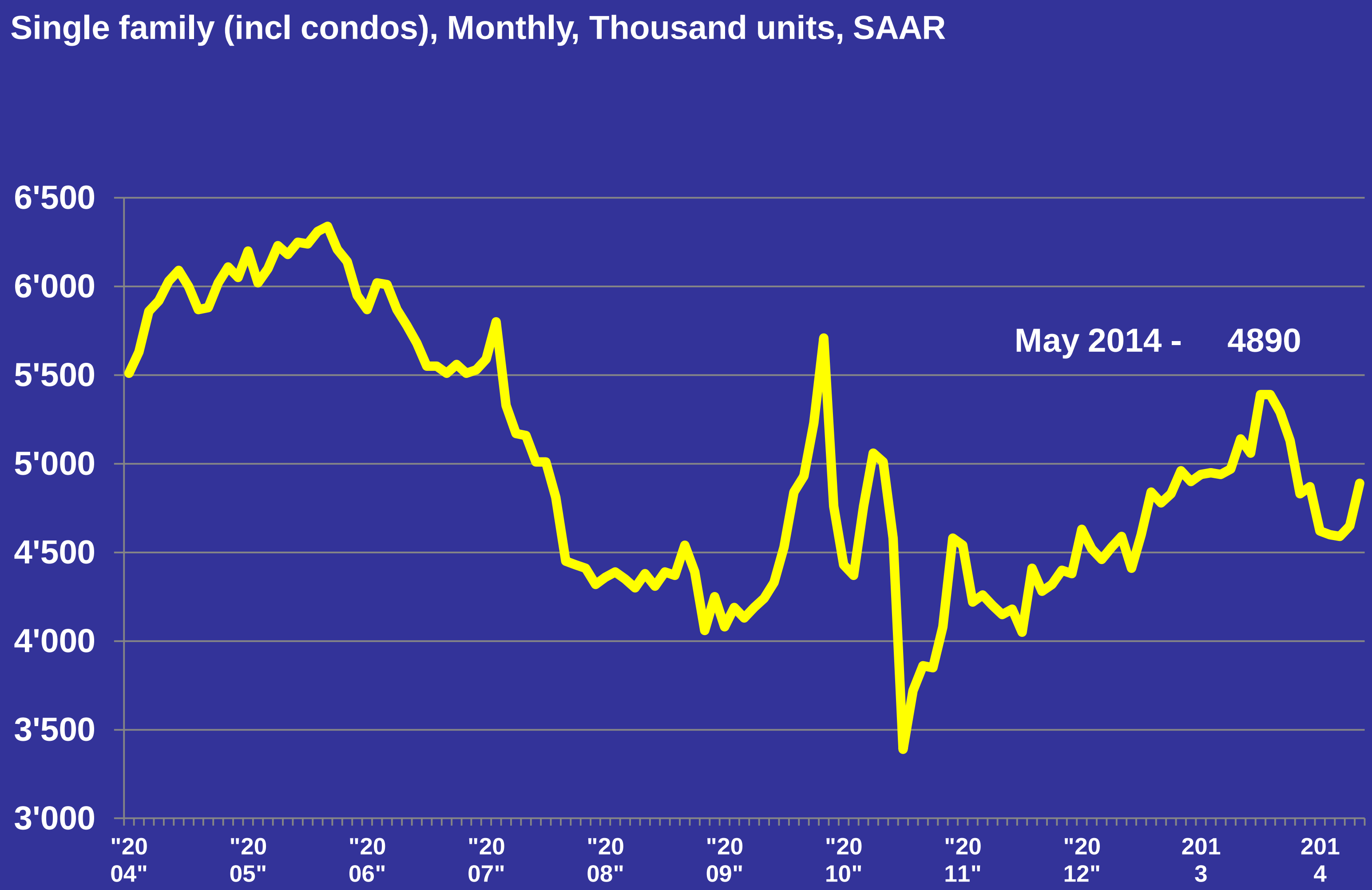
Resale market – higher prices and mortgages slow the rebound



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

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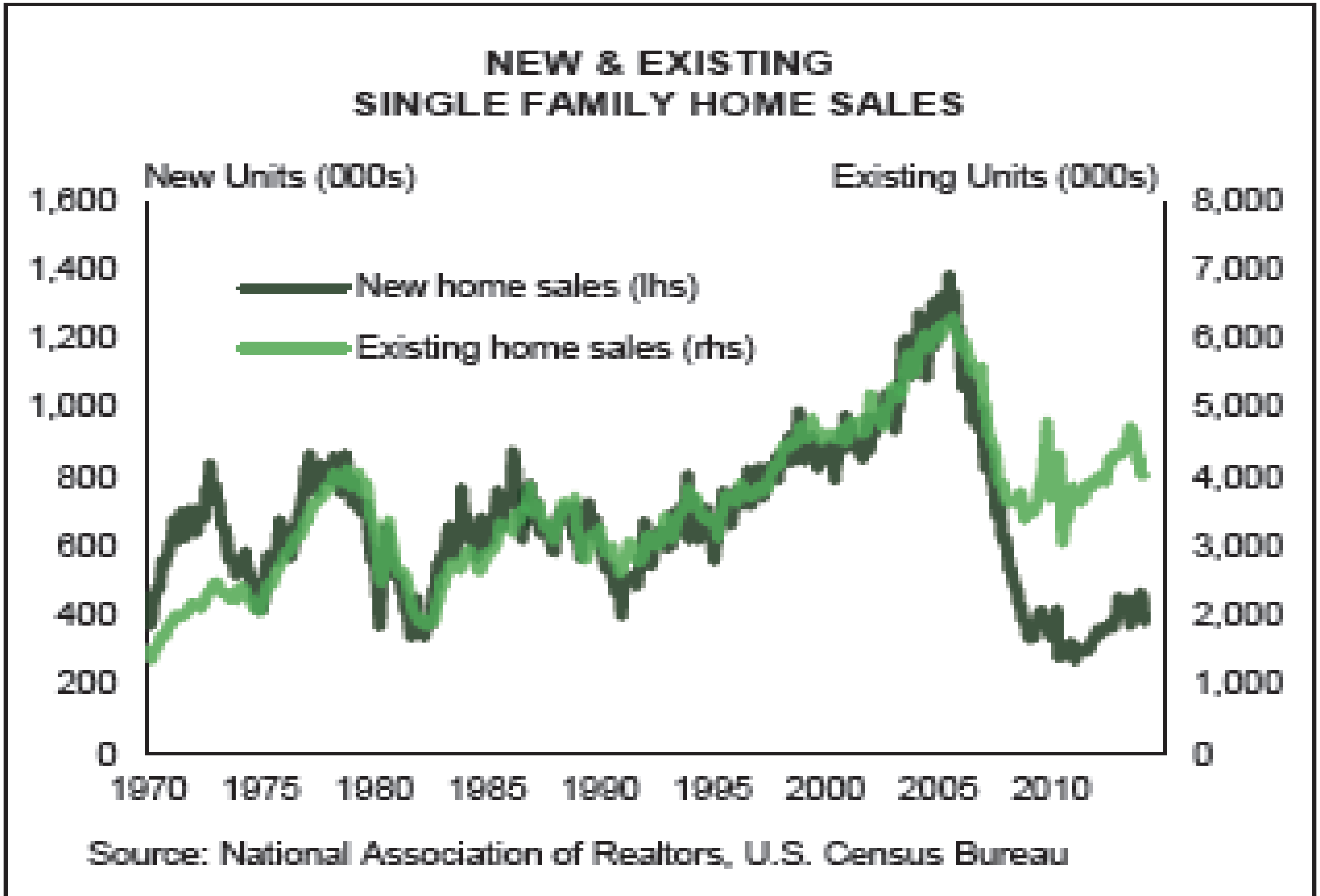
Existing home sales back to trend while new home sales still 300,000 below trend



Source: TD Bank (http://www.td.com/document/PDF/economics/special/jm0516_USHousing.pdf)

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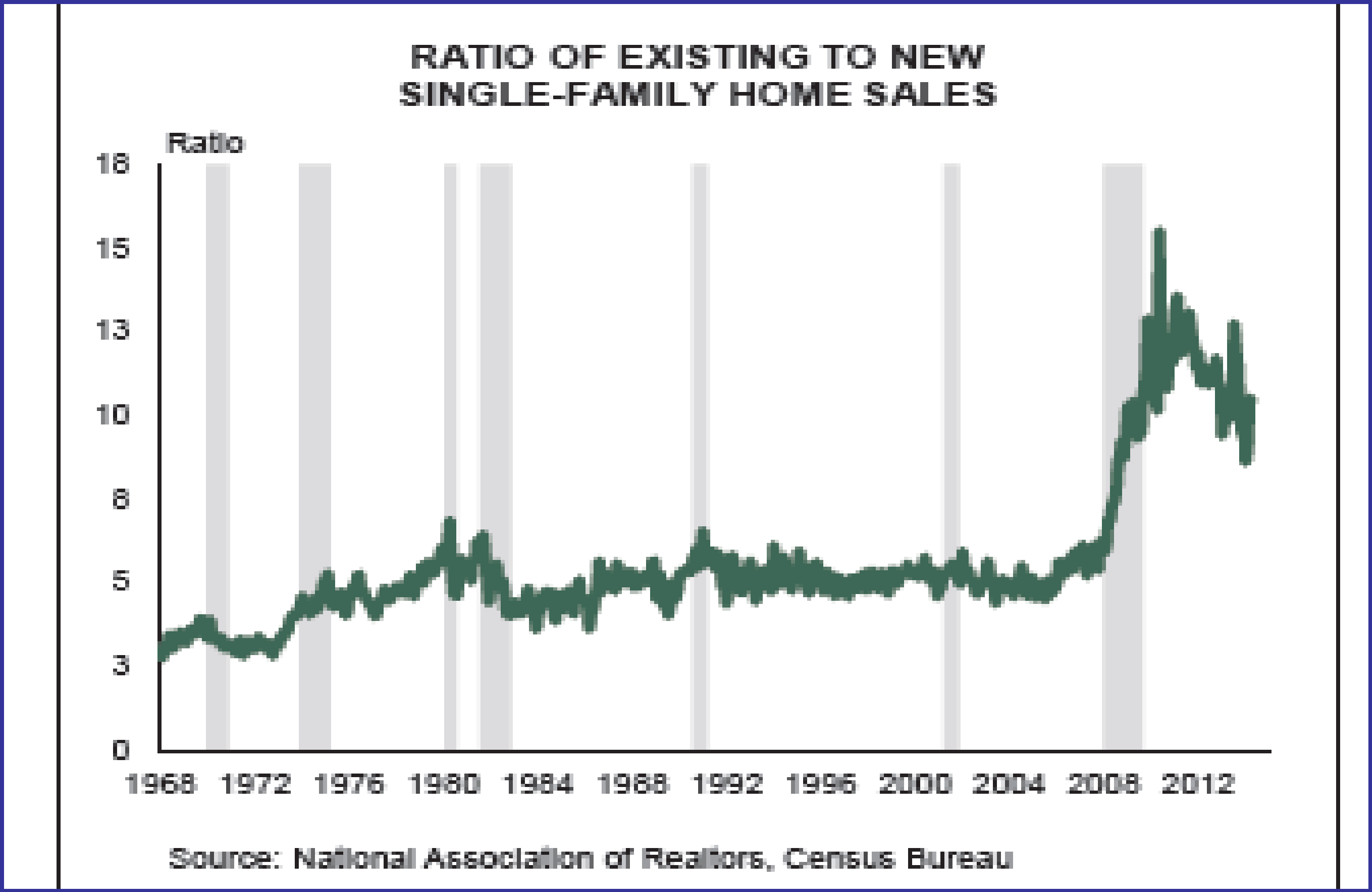
Problem for wood products industry – traditionally, new homes account for about 20% of the housing market, but today, they represent only 10%. Another reason why housing starts are still weak and lumber/panel sales are low!



Source: TD Bank (http://www.td.com/document/PDF/economics/special/jm0516_USHousing.pdf)

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Some conclusions – housing continues to improve albeit slowly

Short term:

(1) Economy will muddle along until 2015? Depends on world economy, China, Europe, ….. Question – can the economy "stand on its own" without QE?

(2) What will housing look like in the near future? My guess – renting continues to gain favor as more people move back to the city (due to demographic trends and changes in social values), and the economy keeps ownership elusive for many, especially young people.

(3) This has implications for demand for wood products in housing markets

(4) This is not a healthy housing market - 1st time buyers are absent and household formations are off 50% from trend

(5) The key to a recovery in housing is the return of 1st time buyers, traditionally about 40- 45% of the market. Current market skewed to cash buyers and investors. 1st time buyers are mostly young people, but they can't find jobs.

(6) To quote Irwin Kellner (Market Watch), "*Fiscal policy is frozen, and promises to stay that way, thanks to resurgence of Tea Party … spells more government gridlock .. Difficulties in producing a budget, more cuts in federal spending, …*" Economy may not reach 3% anytime soon?

Longer term:

(1) Housing demand will hinge on the footprint of the Federal government – will they continue to promote housing to the degree they have in the past? My guess is the federal government will slowly reduce its footprint and let the private sector play a larger role. Financing will be one of the 1st changes.

(2) Labor participation rate keeps falling – this suggests that there may be future labor shortages. Furthermore, tax revenue will be impacted as more people collect from growing number of government programs while fewer people pay taxes. Look for changes in tax code; consumption tax?; social security; Medicare/Medicaid; ….

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