

June 2012 Housing Commentary



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Executive Summary

This review regards June 2012s housing data and macro factors influencing the United States housing market. This report includes data for new home starts, new and existing sales, building permits, housing completions, and construction spending. Also included are comments concerning existing home sales; delinquencies, foreclosures, and distressed homes; pricing; housing economic outlook; housing demographics; and conclusions.

June housing data indicated an increase in overall single- and multi-family housing starts. New and existing home sales indicated sharp decreases; housing completions and residential construction spending indicated modest increases; and building permits decreased month-over-month.

Existing home sales are still “bottom-bouncing” and the number of available existing homes decreased slightly from May. Existing home prices posted a monthly increase of 7.9% and the Case-Shiller® indices reported increasing prices for the second month in a row. Private investors still remain key purchasers of foreclosures, bank-owned (REO) homes, and existing and new home sales in June.

Lastly, many economic indicators appear to be trending downwards in both the United States, Europe, and China. The Eurozone crisis is still with us and likely will be for sometime to come. As for China, while the Chinese economy does not affect the U.S. housing market directly – the indirect impact is considerable: U.S. treasury purchases, lumber and log exports; etc. We are pleased to be able to share a report by Simon Hunt Strategic Services about China. Mr. Hunt and his team are well-respected international analysts on China.

June 2012 Housing Commentary

Opening Comments

United States and global economic concerns still pose threats to a robust housing recovery

- Government debt: federal, state, and local → problematic
- Personal debt → Americans still continue to deleverage
- European sovereign debt and banking crisis still looms as challenging even with the latest proposed “solution”

“We are watching our inventories closely and trying not to get too far ahead because we are concerned about disappointing employment figures and lack of construction growth in the U.S.”¹

- - Matt Missad, CEO, Universal Forest Products

New Housing Starts

Commentary on Starts

June 2012: Total starts → Improvement

760,000 starts, a seasonally adjusted annual rate (SAAR):
6.9% above the revised May estimate of 711,000

From May 2011 to May 2012 – an increase of 23.6%

Total starts have increased 59% from 2009s all-time low
but are 63% below the recent high in 2005

New Housing Starts

June 2012: Single-Family (SF) Starts

539,000 starts (SAAR): an increase of 4.7% from the revised May estimate of 515,000

From June 2011 to June 2012 – an increase of 21.7%

SF Starts:

Fourth consecutive monthly gain

Increasing – albeit slowly

New Housing Starts

June 2012 Multi-Family (MF) Starts:

213,000 starts (SAAR): 5+ MF units: increased 17.0%
from a revised May estimate of 182,000

From June 2011 to June 2012 – an increase of 29.1%

8,000 starts (SAAR): 2-4 MF unit estimate for June

MF Starts:

MF starts are still volatile

“Built For Rent” Housing: 2011

A number of articles have been written on the increasing number of renters in the U.S. A question arose about the quantity of new SF houses that were being built for rental purposes. Below is a DOC estimate for 2011; also note these data include permits, starts, and completions – we are learning the nuances of this database.

Type	Number
Built for sale/sold	492,583
Contractor-built	133,461
Owner-built	109,333
<u>Built for rent</u>	<u>50,246</u>
2011 estimate	785,623

The US DOC classifies all new houses into one of four categories:

- (1) houses built for sale: the house and land are sold as a package (whether sold or not);
- (2) contractor-built houses: landowner hires a general contractor to build the house;
- (3) owner-built houses: landowner builds the house him/herself or acts as the general contractor;
- (4) houses built for rent: and

Each category includes SF houses started, completed, and/or sold and houses authorized but not started, under construction, or for sale at the end of the year.

Each record contains a sampling weight that indicates how many houses a sampled house represents. Tabulated totals from the files will not exactly match published estimates, primarily because the files were produced at different times. The files do not provide accurate tabulations of total units authorized by permits for a number of reasons.

New Housing Permits

June Building Permits: Privately-Owned Housing:
755,000 units (SAAR)

3.7% below the revised May rate of 784,000 (SAAR)

19.3% above the June 2011 estimate of 633,000 (SAAR)

SF authorizations

493,000 (SAAR): 0.6% below the revised May figure of 475,000

MF authorizations

5 units or more: 241,000 (SAAR) in June

2-4 units: 21,000 (SAAR) in June

Housing Completions

June Completions – Privately-Owned Housing:
622,000 units (SAAR)

2.6% above the revised May rate of 606,000 (SAAR)

7.2% above the May 2011 estimate of 580,000 (SAAR)

SF completions

470,000: 1.3% above the May estimate of 464,000 (SAAR)

MF completions

134,000: 21.8% above the May estimate of 126,000 (SAAR)

New Single-Family House Sales

June 2012 – New SF House Sales:
350,000 units (SAAR)

8.4% below the revised May rate of 382,000 (SAAR)
15.1% above the June 2011 estimate of 304,000 (SAAR)

Median new house sale price in June: \$232,600

Average June house sale price: \$273,900

- Median sales price decreased 1.9% month-over-month

“Don't let the volatility in prices fool you. Yes, prices are increasing in some markets, but in the longer term it has to come back to incomes, and unless incomes are increasing, price increases are not sustainable.”²

- - Sam Khater, Senior Economist, CoreLogic

New Single-Family House Sales

Estimate of new homes available for sale at June's end:
144,000 (SAAR)

This represents a supply of 4.9 months at the current sales rate*

“How can it possibly be that the housing market is showing a durable recovery when it is still taking a median of eight months for the builders to find a buyer upon completion of the unit? Up until April 2008 – in the midst of the Great Recession – a number this high was unheard-of, having happened but once previously and that was the peak of the previous housing market meltdown in June 1991.”³ - - David Rosenberg, Chief Economist, Gluskin Sheff



June Existing House Sales

National Association of Realtors (NAR) June 2012 sales data:

4.37 million (SAAR): A decrease of 5.4% from
an upwardly revised 4.62 million in May

Existing housing inventory decreased 3.2% to 2.39 million homes →
a 6.6-month supply at the current sales pace

Listed inventory is 24.4% below June 2011

\$189,400 median existing-house price, an increase of 7.9% from June 2011⁴

“June data indicates that home closings of all types are likely to show a decline by as much as 9% from the same month a year ago. So is the housing market recovery derailed? ...many existing home owners are still too far under water to consider selling. The result is very low inventory of both new and resale homes. Fewer homes to sell means fewer sales when compared to prior months when more inventory was available. Pricing data illustrates this reality.”⁵

- - Jonathan Dienhart and Ken Lee, *Housing Intelligence*

June Existing House Sales

June 2012 Existing Sales Data:

Distressed houses: 25% of sales - -
(13% foreclosures and 12% short-sales)

Distressed house sales: a decrease from 28% in May
and 30% in June 2011

All-cash sales: increased to 29% (28% in May)

Investors account for the bulk of cash purchases: 19%;
17% in May and 19% in May 2011

First-time buyers: decreased to 32% from 34% in May and
increased year-over-year: 31% in May 2011⁴

“The housing market improvement has gotten as good as it can without more improvement in the labor market. I don't see it worsening unless the economy goes back into a recession, but I think it's more a case of stagnating.”²

- - Steve Blitz, Chief Economist, ITG Investment Research

June 2012 Construction Spending

Private Construction: \$265.6 billion (SAAR)

0.7% above the revised May estimate of \$262.1 billion (SAAR)

June SF construction: \$125.9 billion (SAAR)

June 2011 SF construction: \$106.1 billion (SAAR)

June MF construction: \$21.7 billion (SAAR)

June 2011 MF construction: \$14.6 billion (SAAR)

June Improvement^A construction: \$118.0 billion (SAAR)

June 2011 Improvement^A construction: \$116.2 billion (SAAR)

^A The US DOC does not report improvements directly, this is an estimation.

June 2012 Construction Spending

“Residential building, at \$163.7 billion (annual rate), increased 1% in June compared to May. The upward push was provided by multifamily housing, which increased 5% in June on top of its 30% surge in May. Single family housing in June was unchanged from May, essentially stabilizing after registering gains during the first five months of 2012. The June pace for both sides of the housing market were considerably above their respective monthly averages during 2011, with multifamily housing up 45% and single family housing up 26% on this basis.

At the six-month mark of 2012, residential building in dollar terms advanced 25% from the first half of 2011, with multifamily housing climbing 32% while single family housing grew 23%.

On the plus side, gains are being reported for several commercial building categories, and the strengthening trend for multifamily housing is now being joined by moderate growth for single family housing. On the negative side, such institutional project types as educational buildings and healthcare facilities continue to weaken, along with further declines for several public works categories.”⁶

- - Robert Murray, VP-Economic Affairs,
McGraw-Hill Construction

MONTHLY SUMMARY OF CONSTRUCTION STARTS

Prepared by McGraw-Hill Construction Research & Analytics

MONTHLY CONSTRUCTION STARTS Seasonally Adjusted Annual Rates, In Millions of Dollars

	<u>June 2012</u>	<u>May 2012</u>	<u>% Change</u>
Nonresidential Building	\$148,714	\$154,694	-4
Residential Building	163,717	161,633	+1
Nonbuilding Construction	<u>133,705</u>	<u>133,343</u>	<u>-0-</u>
TOTAL Construction	\$446,136	\$449,670	-1

THE DODGE INDEX (Year 2000=100, Seasonally Adjusted)

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YEAR-TO-DATE CONSTRUCTION STARTS Unadjusted Totals, In Millions of Dollars

	<u>6 Mos. 2012</u>	<u>6 Mos. 2011</u>	<u>% Change</u>
Nonresidential Building	\$69,383	\$82,793	-16
Residential Building	75,099	60,162	+25
Nonbuilding Construction	<u>80,473</u>	<u>72,447</u>	<u>+11</u>
TOTAL Construction	\$224,955	\$215,402	+4

Residential Remodeling May 2012

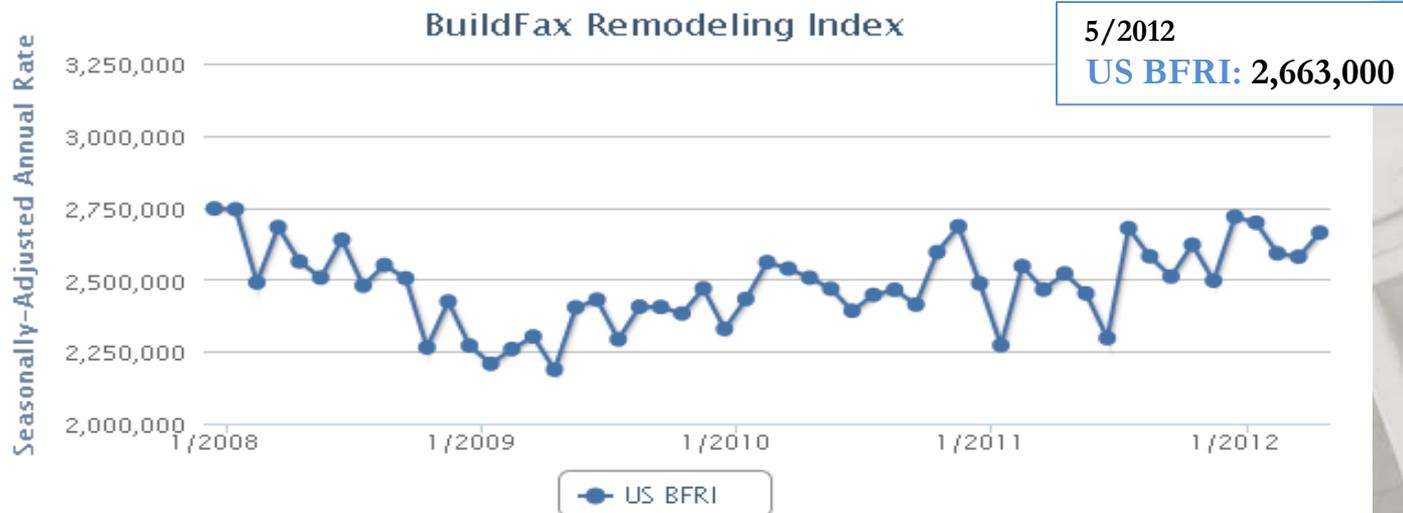
May's Residential Remodeling Permits: 2,663,000 (SAAR)

3% above the revised April estimate: 2,579,000 and is
6% above May 2011's 2,521,000 permits

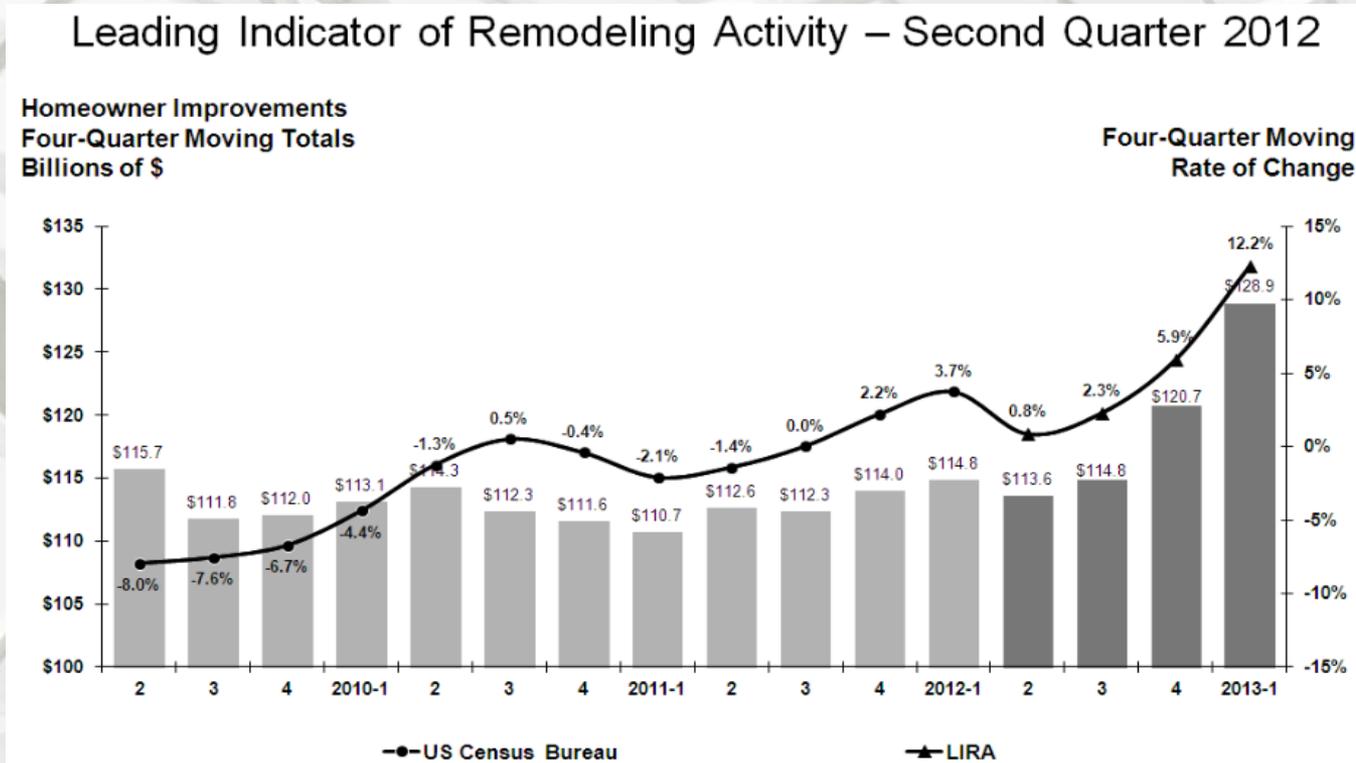
“Remodeling growth appears to be flattening out, although 2012 looks like it will still be significantly better than 2011.”⁷ - - Joe Emison, VP-R&D, BuildFax

Latest BFRI Release

BuildFax Remodeling Index



LIRA: Remodeling Activity Poised for Strong Growth



“Warm weather in the first quarter temporarily bumped up remodeling activity in many areas. By the end of the year, however, positive market fundamentals are expected to kick in, moving the industry out of this ebb and flow period and into a new growth phase. Home improvement activity has been bouncing around the bottom of this cycle for almost three years now, waiting for the industry to get some traction. Now, the combination of low financing costs, stronger consumer confidence, improving home sales, and the perception that home prices have stabilized in most markets across the country are encouraging owners to start working on the list of home improvement projects they have been putting off.”⁸

- - Eric Belsky, Managing Director and Kermit Baker, Director-Remodeling Futures Program,
Joint Center for Housing Studies of Harvard University

New Housing – A Land Shortage?

“A combination of factors is holding them back [home starts and sales]: mortgage credit remains tight, and many consumers are still spooked by instability in the global economy, particularly with Europe’s debt woes. But one factor in particular seems to be rearing its ugly head: the lack of profitable land.

The last four to five years have been slow for land developers, the companies that pave roads, lay pipe for sewer lines and handle the paperwork to lay out subdivisions. That’s because the housing bust seemed to prove that most parts of the suburbs – where most of the large tracts of land that builders like to build on are available – are overbuilt. That realization, along with the grim reality of the 2008 credit crunch, has kept banks from lending land developers the capital they need to invest in land and prepare it for builders.

“We’ve heard the builders moaning about the lack of land, lack of land. Now we’re starting to see that,” said John Burns, a prominent home-builder consultant. “The master planners are holding out for better prices, the farmers are holding out. The land sellers are all waiting for the market to come back. The result is the builders can’t find land at the prices they want.”

According to a recent study by Mr. Burns’s firm, only three of the 13 publicly traded builders have seen an annual increase in the number of new communities with homes for sale. And some of the largest builders have seen double-digit percentage declines in the number of new communities.”⁹

- - Robbie Whelan, *Wall Street J.*

S&P's Economic Outlook: U.S. Home Building Industry

“U.S. homebuilders continue to face headwinds as they recover from a very protracted downturn, but trends appear to be slowly improving. Standard & Poor's Ratings Services' base-case outlook for credit quality for the U.S. homebuilding sector in 2012 and 2013 is neutral. Our baseline economic forecast calls for a slow recovery, with real GDP growing about 2% in 2012 and 2013. Under this scenario, we expect demand for new single-family homes to improve over the balance of 2012 and 2013, resulting in low double-digit volume growth and modest price appreciation for most of the homebuilders that we rate.

Despite improving economic fundamentals that should bolster demand and pricing trends in the sector, homebuilders continue to face meaningful downside risks, including the following:

- A lack of available developed land in desirable submarkets, rising labor and material costs, and regulatory uncertainty surrounding many areas of housing finance in the U.S. could constrain upside revenue and EBITDA growth over the next 12 to 18 months.
- Consumers' willingness to commit to large-scale discretionary items such as SF homes could be derailed by a drop in consumer confidence, perhaps related to ongoing political tensions before the U.S. presidential election or due to new developments pertaining to the European debt crisis. Concerns regarding ongoing high unemployment, weak new job formation, and the potential for significant tax increases beginning in 2013 could also cause consumers to rein in spending.
- We currently believe the risk of a double-dip recession is at about 25% (up from 20% in June). We also believe that the impact of another downturn could be more severe than we previously thought. Specifically, total housing starts could drop in 2013 from their level in 2012, and home prices could fall an additional 10% from current levels.

The baseline forecast is the foundation on which we build our company-specific forecasts, which in turn inform our forward-looking ratings. Under the baseline scenario, we think homebuilders will realize moderate growth in sales volumes and relatively stable pricing trends. Capital market access will remain available to most issuers. Under these assumptions, the financial profiles for most of the companies that we rate will improve, and credit metrics will be more in line with similarly rated industrials.”¹⁰

- - Susan Madison, George Skoufis, and Matthew Lynam, Standard & Poors

S&P's Economic Outlook: U.S. Home Building Industry

Standard & Poor's Economic Outlook: U.S. Homebuilding Industry

Forecast/Scenarios*

	--Downside--		--Baseline--		--Upside--		Actual	Comment/outlook on baseline forecast	Baseline rating impact on U.S. homebuilding sector
	2012	2013	2012	2013	2012	2013			
Real GDP (% change)	1.2	(0.0)	2.0	2.0	2.5	3.9	1.7	Real GDP growth of 2% in 2012 while tepid, should provide support for modest growth in home sales over the next two years. Under our modest growth scenario, we expect interest rates to remain low, which should boost single-family home affordability.	Favorable
Consumer Sentiment	67.7	67.4	73.9	78.22	77.7	87.2	67.4	Stronger overall consumer confidence should help firm demand for high-ticket, discretionary purchases such as a new single-family home.	Favorable
Unemployment rate (%)	8.4	9.1	8.2	8.0	8.0	7.0	9.0	The slow growth recovery and likelihood that discouraged job seekers will re-enter the job market will likely keep the unemployment rate close to 8%.	Neutral
Real residential construction (% change)	6.6	(5.3)	11.3	11.3	14.1	27.7	(1.5)	Expectations for moderate yearly low double-digit improvement is in line with our expectation for growth in home deliveries (in units) over the next two years.	Favorable
30-yr fixed mortgage rate (%)	3.7	3.8	3.8	4.0	4.1	5.2	4.5	Mortgage affordability and availability remain critical supports to buyer demand. Although rates increase modestly under our baseline scenario, they remain near historic lows, making home ownership more attractive particularly as apartment rents rise.	Favorable
Existing single-family homes sales (mil. units)	4.00	4.02	4.14	4.45	4.26	4.78	3.80	Stronger existing home sales should improve homeowner mobility, creating improved demand across the price spectrum (including move-up demand for new single-family homes.)	Favorable
New-home sales(mil. units)	0.31	0.34	0.38	0.48	0.42	0.64	0.31	New home sales are poised to improve modestly this year and more significantly in 2013. Rated public builders should be well positioned to increase market share as demand strengthens, though they will continue to compete with existing /foreclosure inventory.	Favorable

*Economic scenarios are from "U.S. Economic Forecast: Aint' No Cure The Summertime Blues," published July 17, 2012, and "U.S. Risks To The Forecast: Lazy Hazy Crazy Days Of Summer," published June 25, 2012.

S&P's Economic Outlook: U.S. Home Building Industry

U.S. Homebuilders Summary Comparisons--First-Quarter 2012

Selected operating statistics and ratios

Company	NVR Inc.	MDC Holdings Inc.	Toll Brothers Inc.	Pulte Homes Inc.	Ryland Group Inc.	D.R. Horton Inc.	Lennar Corp.
Closings	1,924	619	671	3,117	815	4,240	2,472
Change from prior period (%)	17.7	11.7	13.5	(0.0)	18.5	20.6	29.9
New orders (No.)	3,157	1,063	1,290	4,991	1,328	5,899	2,999
Change from prior period (%)	31.38	50.78	46.76	14.87	37.47	19.34	33.53
Backlog (units)	4,909	1,487	2,403	5,798	1,994	6,189	2,696

Company	Meritage	Standard Pacific Corp.	KB Home	Shea Homes Inc.	M/I Beazer Homes USA Inc.	Hovnanian Enterprises Inc.
Closings	759	642	1,150	238	507	1,043
Change from prior period (%)	11.95	46.24	21.18	30.77	15.49	16.02
New orders (No.)	1,144	934	1,197	499	764	1,526
Change from prior period (%)	36.19	43.25	(8.1%)	44.22	16.82	45.89
Backlog (units)	1,300	973	2,203	722	933	1,921

Trulia's Housing Barometer: Tighter Inventory Complicates the Recovery¹¹

“In June 2012, construction starts improved, but existing home sales fell, and the delinquency plus foreclosure rate rose:

— **Construction starts jumped.** Starts rose in June to a 760,000 annualized rate, up 7% month-over-month and 24% year-over-year. Construction activity was especially strong in Texas and the Carolinas. Now, construction starts are 28% of the way back to normal (see Slide 25).

— **Existing home sales fell sharply,** from 4.62 million in May to 4.37 million in June. Now, home sales are just 35% back to normal to from their worst point during the bust, down from 49% in May: they're now much closer to their low of November 2008 than to their pre-bubble normal level. That's a big slide. Tighter inventory, especially of distressed homes, held back sales.

— **The delinquency + foreclosure rose.** In June, 11.23% of mortgages were delinquent or in foreclosure, up from 11.08% in May (LPS revised its historical data, which changed our barometer measure slightly.) The delinquency + foreclosure rate is 34% back to normal (see Slide 25), down a bit from 36% in May.”

Trulia's Housing Barometer: Tighter Inventory Complicates the Recovery¹¹

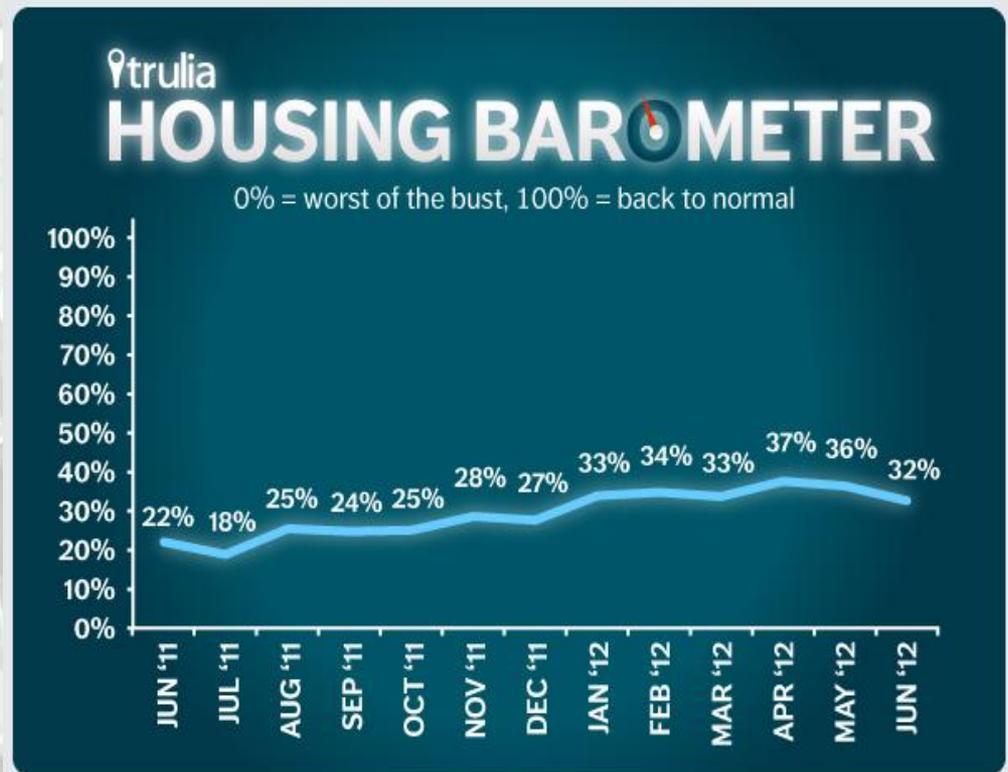
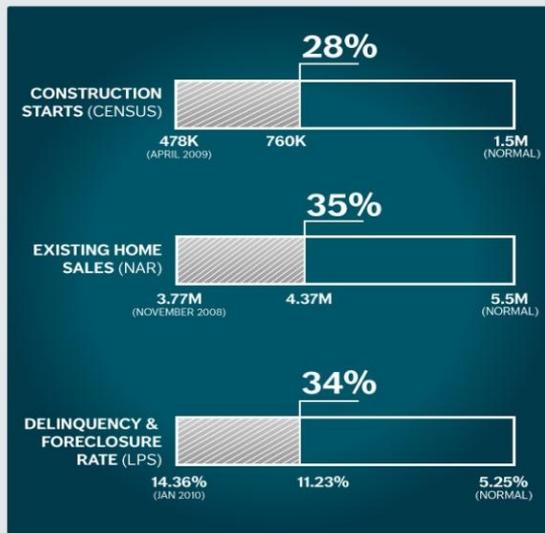
“Averaging these three back-to-normal percentages together, the market is now 32% of the way back to normal (see Slide 25) – the lowest level in 2012 but still well above June 2011, when the market was 22% back to normal.

Cause for concern? Depends who you are. We're farther from normal mostly because of the big drop in home sales, which was due to tightening inventory: fewer homes for sale means fewer sales. However, tighter inventory is part of the process of recovery.

In fact, inventory nationally is now near its long-term normal level – even though it is tight relative to several years of unusually high inventory. Tighter inventory is good news for sellers, who face less competition.

But it's bad news for buyers, who face fewer choices and higher prices. And, of course, tighter inventory and lower sales are bad news for many in the real estate industry who depend on sales. The housing barometer shows that the road to recovery is bumpy and uneven.”

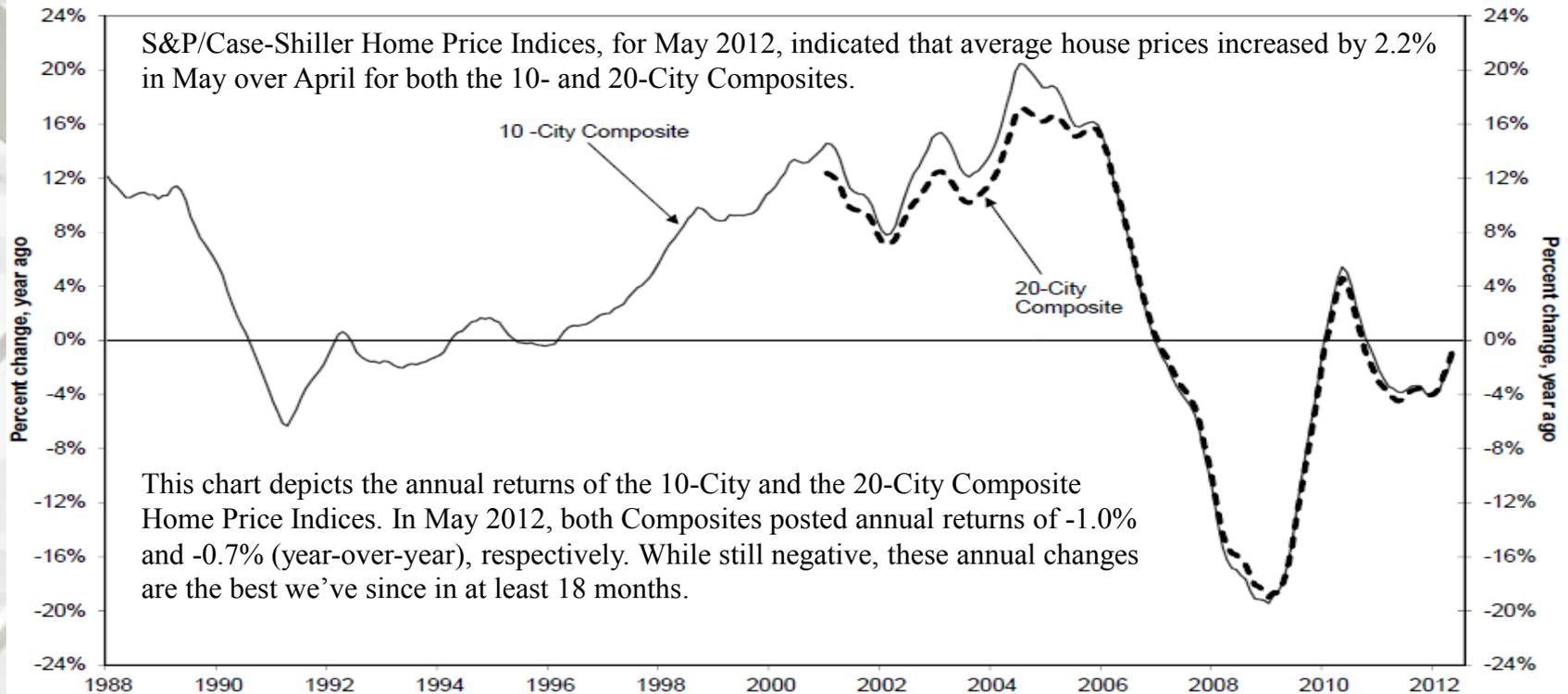
Trulia's Housing Barometer: Tighter Inventory Complicates the Recovery¹¹



Source: ¹¹<http://trends.truliablog.com/2012/07/trulia-housing-barometer-tighter-inventory-complicates-the-recovery>; July 20, 2012

Standard & Poor's/Case-Shiller June Home Price Indices

S&P/Case-Shiller Home Price Indices

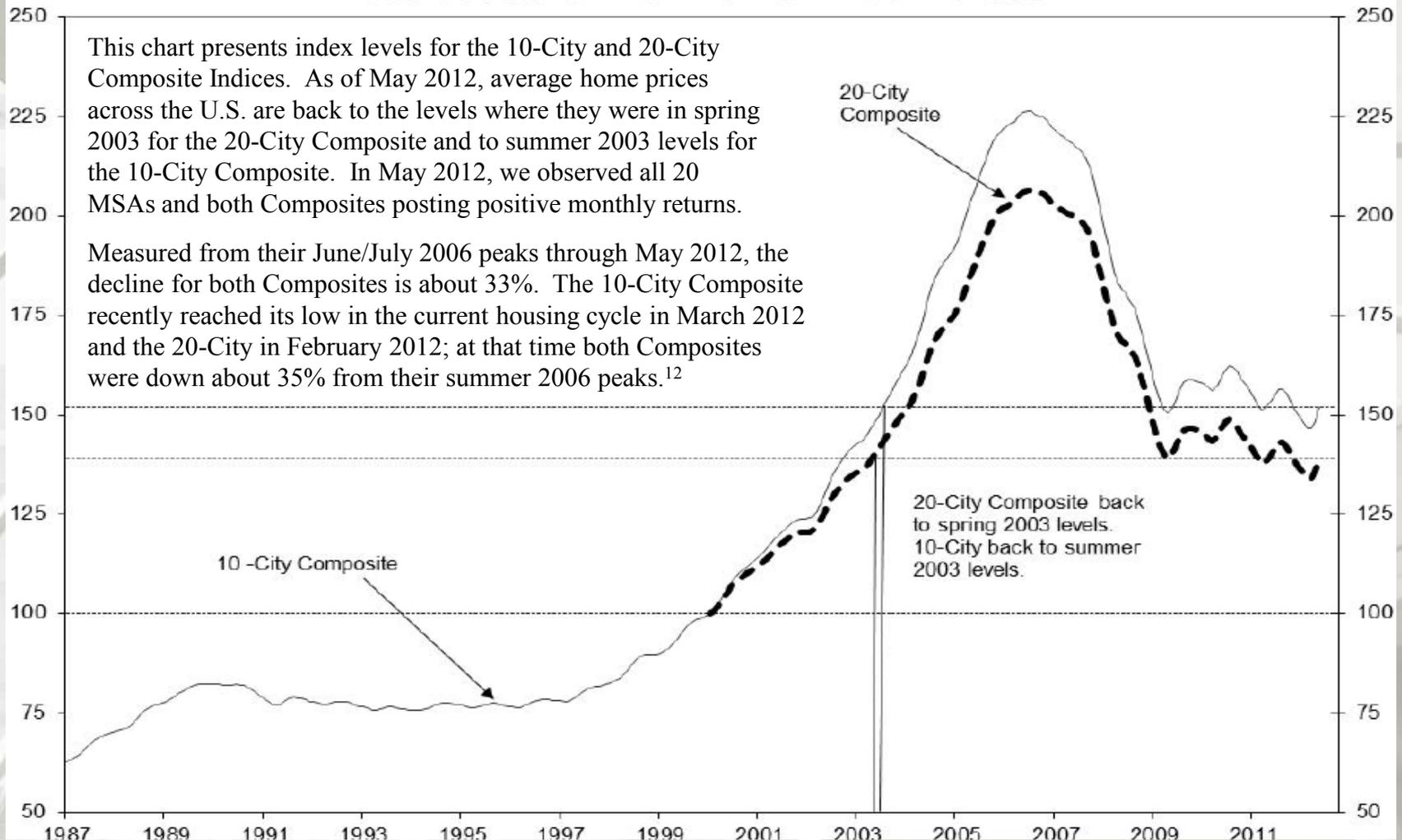


“With May’s data, we saw a continuing trend of rising home prices for the spring. On a monthly basis, all 20 cities and both Composites posted positive returns and 17 of those cities saw those rates of change increase compared to what was observed for April. Seventeen of the 20 cities and both Composites also saw improved annual rates of return. We have observed two consecutive months of increasing home prices and overall improvements in monthly and annual returns; however, we need to remember that spring and early summer are seasonally strong buying months so this trend must continue throughout the summer and into the fall.”¹² - - David Blitzer, Chairman of the Index Committee at S&P Dow Jones Indices

Source: ¹²Case-Shiller® and Case-Shiller Indexes® and Fiserv, July 31 2012

Standard & Poor's/Case-Shiller June Home Price Indices

S&P/Case-Shiller Home Price Indices



Shiller, Maitland, and Birnbaum Speak on Housing



Robert Shiller:
Case-Shiller Indices® and Professor of Economics, Yale U.
A Housing Bubble Could Be Forming in Some Areas
We suggest giving it a view and listen



Maureen Maitland
Vice President, S&P Dow Jones Indices
June Housing Prices

Josh Birnbaum
Chief Investment Officer
Tilden Park Capital Management LP
The Current State of Housing

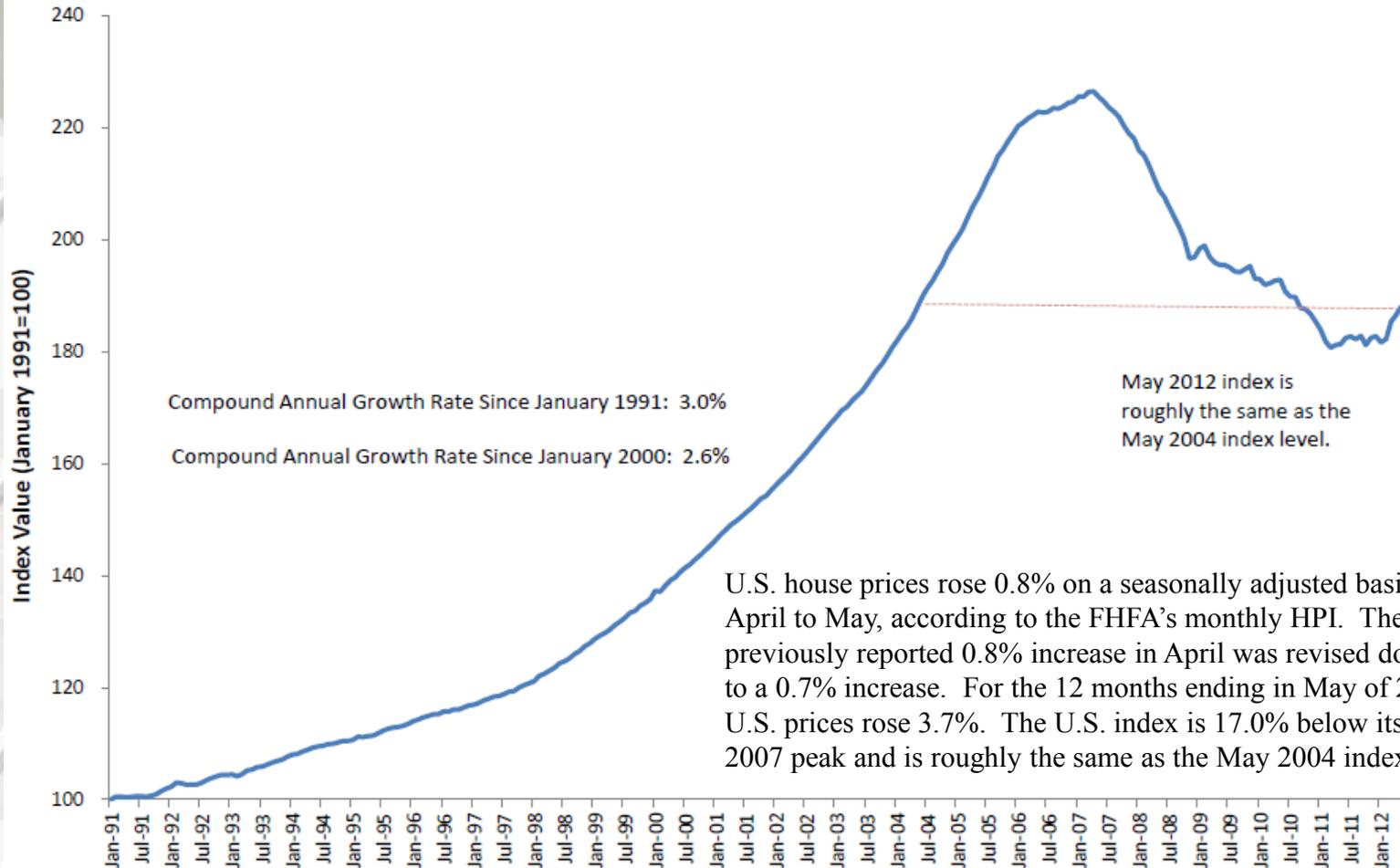


Click on the photo for video/audio link

Return TOC

FHFA Home Price Index

Figure 2: Monthly House Price Index for USA
Purchase-Only, Seasonally Adjusted Index, January 1991 - Present



U.S. house prices rose 0.8% on a seasonally adjusted basis from April to May, according to the FHFA's monthly HPI. The previously reported 0.8% increase in April was revised downward to a 0.7% increase. For the 12 months ending in May of 2012, U.S. prices rose 3.7%. The U.S. index is 17.0% below its April 2007 peak and is roughly the same as the May 2004 index level.¹³

Housing Prices

U.S. House Prices Should Generally Rise Going Forward, But Not Without Some Dips

- Recent upticks in housing prices indicate the beginning of a slow recovery for the U.S. housing market, though we expect additional drops in prices later this year with the addition of new distressed properties to the market.
- The price-to-rent ratio suggests that national home prices could drop an additional 3% to restore the long-term average relationship of the 1988-2004 period.
- In line with recent trends, we expect the summer season to bring some stability/growth to the housing market, albeit at a slow pace. Prices will improve overall this year, with a slow rise likely again next year.
- Despite the weak existing home sales data in June, home sales and prices have generally stabilized in recent months. However, regional variations exist with some regions recovering faster than others.
- At the current pace, the U.S. economy is growing too slowly to accelerate the housing market recovery. Key risk factors to U.S. housing include continuing weak macroeconomic conditions, lost net wealth, anemic employment growth, and soft wages, as well as the Euro debt crisis as related to banks' willingness and ability to lend.¹⁴

- - Erkan Erturk, Senior Director, Structured Finance, S&P Ratings Services

Delinquencies, Foreclosures, and Shadow Inventory

Delinquencies

Negative equity declined to 11.4 million (23.7%) of all borrowers in Q1 2012

Down from a revised estimate of 12.1 million or 25.2% in Q4 2011

+/- 2.8 mm homes (6.7% of all mortgaged homes) were at least 90-days past due (and in foreclosure or were Real Estate Owned (REO) as of May 2012

Compared to 3.1 mm (7.3%) in May 2011

2.3 million borrowers had less than 5% equity (AKA - near-negative equity)

“In the first quarter of 2012, rebounding home prices, a healthier balance of real estate supply and demand, and a slowing share of distressed sales activity helped to reduce the negative equity share. This is a meaningful improvement that is driven by quickly improving outlooks in some of the hardest hit markets. While the overall stagnating economic recovery will likely slow housing market recovery in the second half of this year, reducing the number of underwater households is an important step toward reducing future mortgage default risk.”¹⁵

- - Mark Fleming, Chief Economist, CoreLogic

Delinquencies, Foreclosures, and Shadow Inventory

Foreclosures

Midyear 2012 Foreclosure Market Report: 1,045,801 U.S. properties ...
with foreclosure filings or default notices, auction sale notices and bank repossessions

A 2% increase from the previous 6-months but still down 11%
from the first half of 2011

0.79% of all U.S. housing units (1 in 126) had at least one foreclosure filing
in the first 6-months of the year

“Additional scrutiny on how lenders and servicers process foreclosures, along with aggressive foreclosure prevention efforts by the federal government and several state governments, continue to keep a lid on the foreclosure problem at a national level. Still, foreclosure starts began boiling over in more markets in the first half of the year, particularly in the second quarter, when rising foreclosure starts spread from primarily judicial foreclosure states in the first quarter to more than half of all non-judicial foreclosure states in the second quarter.”¹⁶

- - Brandon Moore, CEO, RealtyTrac

Delinquencies, Foreclosures, and Shadow Inventory

Foreclosures

60,000 completed foreclosures in June 2012 vs. 80,000 in June 2011

+/- 1.4 million houses or 3.4% of all mortgaged houses were in the national foreclosure inventory as of June 2012

1.5 million or 3.5% in June 2011

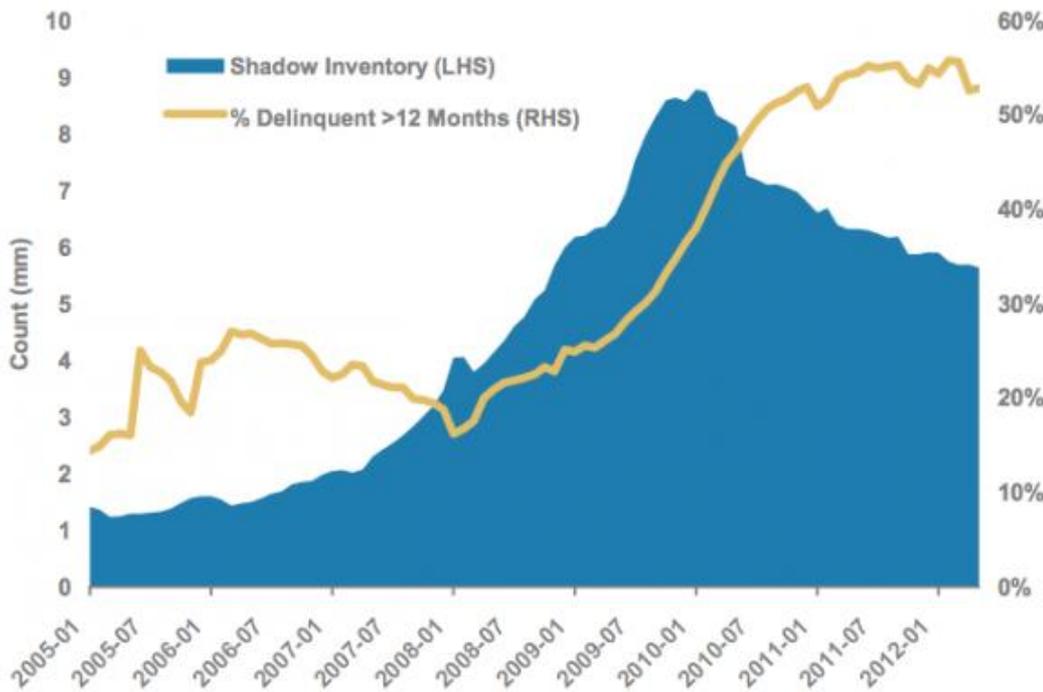
Month-over-month: foreclosure inventory unchanged from May 2012 to June 2012

“While completed foreclosures and real-estate owned (REO) sales virtually offset each other over the past four months, producing static levels of foreclosure inventory for most of this year, they are beginning to diverge again. Over the last two months REO sales declined while completed foreclosures leveled out. So we could see foreclosure inventory rising going forward.”¹⁷

- - Mark Fleming, Chief Economist, CoreLogic

Delinquencies, Foreclosures, and Shadow Inventory

Shadow Inventory Continues to Drop



Source: Lender Processing Services and Morgan Stanley

Shadow Inventory

5.65 million properties*

Inventory of homes likely to be sold after foreclosure has declined by 35% since 2010s peak

Compared to 3.1 mm (7.3%) in May 2011¹⁸

*Note: This is 3.7 times greater than CoreLogic's estimation

A Housing Recovery or Not?

The End of the Bust

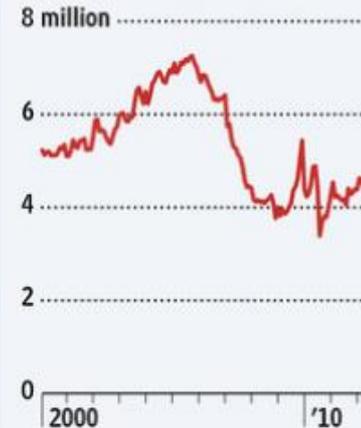
Home prices are inching up...

Case-Shiller 20-city and
Federal Housing Finance Agency
Purchase-Only indices
Change from the previous year



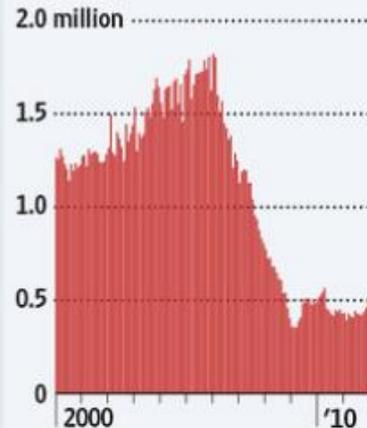
...and more homes are being sold.

Sales of existing
single-family homes
Seasonally adjusted annual rate



Housing starts are turning up...

Single-family home starts
Seasonally adjusted annual rate



...and home building is adding to
economic growth.

Contribution of home
building to GDP growth



Sources: S&P/Case-Shiller; FHFA; U.S. Department of Commerce via Federal Reserve Bank of St. Louis

The Wall Street Journal

“From here on, housing is unlikely to drag the U.S. economy down further. It will instead reflect the strength or weakness of the overall economy: The more jobs, the more confident Americans are about keeping their jobs, the more they are willing to buy houses. “Manufacturing had led growth and construction had lagged,” JPMorgan Chase economists said last week.” Now the roles are reversed: Manufacturing growth has slowed as private construction comes to life.”¹⁹

- - David Wessel, *Wall Street J.*

A Housing Recovery or Not?

“The worst U.S. housing crisis since the Great Depression has been declared over. But is it? What some of Wall Street's forecasts for a recovery may be underestimating are tectonic shifts in the U.S. economy that make the housing market a different place from a decade ago.

Record levels of student debt, 15-years of flat incomes and the fact that nearly half of homeowners are effectively stranded in their houses look likely to weigh on prices into the indefinite future.

Several housing experts have said the market is in danger of drifting for years. In a bleaker scenario, the fragile U.S. economic recovery could slip back into recession if Europe's crisis deepens or the political impasse in Washington triggers a new budget crisis, putting the housing market at risk again. ... Lennar's chief executive officer, Stuart Miller, told analysts in June that he was nervous about uttering the word recovery, “I don't think that there's reason for exuberance right now -- except for the fact that the beatings have stopped.”

“We've gone through half of a lost decade since the crisis started in 2007,” said Robert Shiller, co-founder of the Case-Shiller U.S. housing price index and an economics professor at Yale University. The so-called Lost Decade in Japan occurred after the speculative bubble in the 1980s, when abnormally low interest rates fueled soaring property values. The ensuing crash has continued to afflict the Japanese economy ever since. “It seems to me that a plausible forecast is, given our inability to do stimulus now, for Japan-like slow growth for the next five years in the economy. Therefore, if there is an increase in home prices, it's modest,” said Shiller.”²

- - Michelle Conlin and Leah Schnurr, Reuters

Demographics

WHERE DOES YOUR STATE RANK FOR FUTURE LIVABILITY?

To develop the rankings for future livability, Gallup ranked each of the nine regions below on 13 key metrics (1=best; 13=worst). Each metric was calculated, counted equally, and averaged to provide a final ranking of future livability.



Rank	Region	States	Average Rank
1	West North Central	Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska, Kansas	3.3
2	Mountain	Montana, Arizona, Colorado, Idaho, Wyoming, Utah, Nevada, New Mexico	3.5
3	Pacific	California, Oregon, Washington, Hawaii, Alaska	3.6
4	West South Central	Arkansas, Louisiana, Texas, Oklahoma	4.8
5	New England	Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut	5.0
6	South Atlantic	Maryland, Delaware, West Virginia, District of Columbia, Virginia, North Carolina, South Carolina, Georgia, Florida	5.5
7	East North Central	Ohio, Michigan, Indiana, Illinois, Wisconsin	5.6
8	Middle Atlantic	New York, New Jersey, Pennsylvania	5.8
9	East South Central	Kentucky, Tennessee, Alabama, Mississippi	7.2

Source: GALLUP

“If you want to find the U.S. states and regions with the brightest future, look west. Gallup analysis shows that the West North Central, Mountain, and Pacific regions are likely to be the best areas to live in 20 years, based on the strong economic, health, and community foundations they are building today.

For other areas of the U.S., though, the future is not so bright. The East South Central region, which includes Kentucky, Tennessee, Alabama, and Mississippi, trails on several critical metrics and performed worst overall of the nine regions. People in this region are the least likely to be employed in good jobs or to learn new and interesting things daily, and they have the lowest economic confidence. They are also the most likely nationwide to be obese, to smoke, and to lack a safe place to exercise. That's a killer combination, and it won't help this area build the productive, healthy society of the future.”²⁰

- - Dan Witters, Research Director,
Gallup-Healthways Well-Being Index

Demographics

There are more single-person households
in the U.S. than ever before

“Solo dwellers” spend more per person than the highest-spending families with children – a lot more.

“Solo dwellers” contribute an annual \$1.9 trillion to the economy...

spent more than \$34,000 per person in 2010 – about \$6,500 more than married individuals without kids

and \$11,500 more than the highest-spending families with children.

Singles also buy a whopping one-third of homes.

28% of all households currently consist of only one person

...more people are marrying later (half of women marry for the first time after age 27), relying on parental financial support past college, and delaying having children, there are few true indicators of adulthood.

Getting your own place is one of the last ones remaining.”²¹

- - Libby Kane, staff writer at LearnVest

Demographics

2010 Census: Households and Families

- Married couples account for fewer than half of households (48%).
- The number of nuclear families (married couples with children under age 18) fell by 1.2 million between 2000 and 2010, to 23.6 million households (20% of total households).
- People living alone are a larger share of households (27%) than nuclear families. They are the second most common household type after married couples without children under age 18 at home (28%).²¹

- - Libby Kane, staff writer at LearnVest

Demographics

2010 Census: Households and Families

- Unmarried partner households grew by 41% to 7.7 million (7% of total households).
- 10% of married couples have partners of a different race or Hispanic origin.
- Average household size fell, from 2.59 people in 2000 to 2.58 people in 2010.
- Multigenerational households (households with three or more generations of relatives) grew from 3.9 million to 5.1 million between 2000 and 2010 and account for 4% of households.²¹

- - Libby Kane, staff writer at LearnVest

China

Much has been written on China and there appears to be two “camps” regarding China’s GDP growth:

- 1) China Bears: who predict a hard-economic landing (GDP growth less than 3%) and the
- 2) China Bulls: who posit that China is currently experiencing a hiccup and that future growth will approach China’s past torrid pace (GDP growth greater than 6 to 7%).

We do not have a crystal ball; we know that coal supplies are increasing (in the ports) and that the pricing of “Dr. Copper” is tepid to declining; PMI, electrical consumption, and steel production are decreasing too. All are indicators of a slowing economy.

In the upcoming slides, a report on China's future growth is presented.

China

Mr. Simon Hunt, of Simon Hunt Strategic Services²², gave us permission to present excerpts from their February 2012 report – an assessment of China’ current and future growth.



ECONOMIC & COPPER ADVISORY SERVICES CHINA VISIT REPORT FEBRUARY 2012*

Their report is segmented into three sections:

1. The Transition Period 2012-2013
2. The Longer Term Outlook
3. Conclusions

*This document has been prepared with care. However, Simon Hunt (Strategic Services) Ltd. makes no warrant of any kind in regard to the contents and shall not be liable for incidental or consequential damages, financial or otherwise, arising out of the use of this document.

China

The Transition Period 2012-2013

Until the 18th National Congress meeting in October 2012, government policy will focus on “stability at all costs”.

...difficult decisions will be postponed with problems put in the back drawer

This includes:

- rolling over local government debt

- evolution of new faces at every level of government from central ministries, financial regulators, provincial and municipal leadership down through lower levels.

China

The Transition Period 2012-2013

2012 is a transition year for the Chinese government and the economy...
a transition from 10% plus growth to one that is lower but sustainable for the long-term.

The powers realise that to achieve that objective tough moves have now to be taken.

This means that any easing of monetary policy will be postponed for as long as possible...

in fact there won't be any general easing unless employment starts falling, just fine tuning.

China

The Transition Period 2012-2013

The reasoning is basically twofold:

to eradicate the speculative nature of so much of the economy and to restructure industry and manufacturing into larger but more competitive units.

The former implies a firmer hand on the monetary tiller in the process providing depositors at banks with positive returns on their savings.

The latter means that in key sectors, government wants to encourage the establishment of larger units so that they can reap the benefits of economies of scale.

The result will be corporate restructuring with weak units being allowed to go under and more non-performing loans.

The 12th Five-Year-Plan gives the game away with real GDP and industrial production targeted at 7% and 8% per year, respectively.

These are not forecasts of what might actually occur but signals that slower growth is acceptable.

China

The Transition Period 2012-2013

For 2012...What will drive policy are not falling GDP, exports or home prices, but employment.

So long as employment remains robust, there will be no overall stimulus, just fine tuning. Employment is especially robust in the services sector and in manufacturing and other businesses in the rural sector. Migrant workers are now better able to find jobs in smaller towns often adjacent to their family homes than in past years.

2013 and 2014 should be even more difficult years for China. They will be the first two years of the new leadership when difficult decisions will be taken, many held over from 2012.

These two years should coincide also with the emergence of the long period of rolling recessions in the rest of the world that we are forecasting. China's reported GDP should slow to around 5 to 7% in 2013 and 2014.

China

The Longer Term Outlook

...a GDP deflator [was developed] going back to 1990.

Between 1990 and 1999, China's GDP deflator averaged 10.7% a year and the country's real GDP was 7.8% a year.

Since then and including 2011, the GDP deflator averaged 9.7% a year but real GDP by only 4.3% a year.

The implications are interesting if not serious. The deflator data suggests that China's real inflation is rising by 61% every five years...

that is not sustainable and is one reason why government is keen to restructure how the country has financed growth.

China

The Longer Term Outlook

Fixed Asset Investment rose by an average of 21.5% in nominal terms over the past 11 years, accounting for 69.3% of GDP in 2010...

but in real terms (using the GDP deflator) it rose by 10.3% a year which is a far more realistic figure.

Retail sales which increased by an average of 14.2% in nominal terms only rose by an average of 4.8% a year in real terms.

Consumer spending, of which retail sales are an important constituent, has been the weak link in China's growth story at the expense of investment. This will change over the next five years.

China

The Longer Term Outlook

Housing prices have reached heights that make it difficult for ordinary people to acquire housing units. Government is prepared to see average home prices fall by 15-20% across the country.

They are confident in their ability to control the price decline in a measured way hence the People's Bank of China's move to help first time buyers. Whether they will is a different question.

There is a fundamental domestic reason for this change in tack: Demographics
Demographics have been a population dividend for growth; they are changing rapidly into a population penalty.

Population changes are the product of the country's past one-child policy.

What will emerge is 'baked in the cake' for the next 20-odd years even should the one-child policy be lifted.

China

The Longer Term Outlook

First, total population grew by an average of 0.5% a year over the last 10 years.

Over the coming five years to 2016, it will grow by just 0.1% a year and then it will start falling.

Second, the working age of the population, those between 15 and 65 years-old, rose by 84 million over the last 10 years...

but during the coming five years, again to 2016, it will actually fall by 5 million, with the decline rising to 29 million over the next five year period to 2021.

This means a change from an 84 million plus to a negative 34 million.

Third, over the past 10 years, the number of retirees rose by 38 million, or 38%, but they will rise by 150 million or 107% over the next 10 years.

Fourth, is the implication of these changing demographics on the country's ability to grow.

China

The Longer Term Outlook

Trend Growth Rate

The trend growth rate is an estimation of economic growth; not GDP, but similar. The trend growth rate can be calculated by:

(working age of the population - propensity to employ) x productivity;
productivity is forecast from the Education Index

in the five years 2012 to 2016, China's trend growth rate should be 7.5%
the next five year period, 2017 to 2021, it will slow to 5.1% a year
and thereafter to 3% a year

These estimates are so different from the usual 10% growth rate put about by analysts. Changes in China's fundamental ability to grow are recognised by the top policy advisors as well as Li Keqiang (who has a Ph.D. in economics), the likely successor to Premier Wen.

China

Conclusions

Growth will slow; that is inevitable.

But, China is prepared now to bear the pain of pricking its speculative bubbles over the coming three years or so to put the economy on a sustainable growth trajectory. It will be a difficult period with a recessionary feel to it. However, what should emerge will be a much stronger and stable economy and one that will be less dependent on the outside world for its resources. Metals intensity, for instance, whether steel or copper, will weaken and growth rates will fall.

For China, gone are the years when its demographics are a bonus for growth. They are fast becoming a penalty so much so that the country's trend growth rate will slip to 7.5% a year to 2016, 5% a year to 2021, followed by growth rates of under 4% a year.

China

Conclusions

China's leadership transits the economy from one based on exports and investment to one geared to consumption and the services sector so its focus will shift away from heavy industry to light industry

Ultimately, this means an economy that is less metals [and raw materials] intensive: China won't continue having the same appetite for imports of raw materials like iron ore and copper as in the past.

China will be led by a more charismatic and enlightened leadership than the current team at a time when most other countries will appear rudderless and mired in debt.

China is prepared to start bearing the pain now whilst most others are still content to “kick the can down the road”.

China

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Conclusions

New home and existing sales still are bottom bouncing – even with near record low interest rates. A continuing positive – we have the least quantity of available new and existing homes since 2005.

With that stated, there are those who assert that a housing shortage is hindering sales, particularly houses in the less than \$125,000 price category.

New housing starts are still being bolstered by multi-family, but single-family starts are improving; and:

- Single-family permits increased minimally and multi-family permits decreased sharply – historically multi-family permits and starts are volatile
- Both single-family and multi-family completions increased from May to June and year-over-year
- Construction spending increased very slightly

There are three primary factors impeding starts and sales: 1) Consumer confidence, 2) a lack of well-paying jobs, and 3) strict home loan lending standards (which may be tightened further).

Conclusions

The Eurozone crisis is quiet at the moment; again, we suggest keeping attuned to the happenings “across the pond.” The downside risk to the U.S. economy is substantial from both a consumer and business psychology perspective.

Now to China. China's growth is predicted to slow regardless of economic conditions – the pertinent question now is, will China be able to transform from a production economy to a consumer driven economy? Can or will the Chinese transition flawlessly from being big savers to big consumers? This is not a trivial matter, as up to this point-in-time, China's growth has largely been driven by state spending. The transition focal point is consumer spending, as pointed out by Mr. Hunt, as this spending will be a critical determinant for China's long-term growth prospects – and a consumer driven economy.

Our outlook on the U.S. housing market remains unchanged – there are too many negative macro factors at this point in time for a robust recovery. Thus, once again, “Muddling Along” appears to be the trajectory of U.S. housing.

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