

October 2012 Housing Commentary



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Executive Summary

October housing data revealed continued healing in the housing market, albeit incrementally. Even so, many industry gurus and the main stream media continue to proclaim that housing is “full steam” ahead. As written in past issues, we have our concerns and doubts. We get an eerie feeling that one or more of the economic macro factors are going to hinder the healing process.

This report covers housing data, demographics, and macro factors influencing the United States housing market. October’s housing data indicated an increase in total starts, including multi-family starts. Total building permits and new house sales decreased month-over-month. Private construction spending and housing completions increased month-over-month

Existing house sales increased with prices declining again; new house sales and prices declined month-over-month. The number of available existing and new houses available for sale decreased; with that stated, in the judicial states there a large quantity of distressed homes that will be put on the market sometime in the future. Private investors remain key purchasers of existing, foreclosed, and bank-owned (REO) homes. The Case-Shiller® indices, and other private indices, reported house values increased as well.

Lastly, household formations increased – which could bode well for housing – people have to live somewhere. Freddie Mac’s Multifamily Research unit projects information on the housing market for the next five years, including new single-family construction. In three different economic scenarios, multifamily housing is forecast to remain strong – new single-family construction is not projected to return to historic norms until 2017, even in the best economic scenario.

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October 2012 Housing Commentary

Opening Comments

Western world economic conditions remain unchanged

- Americans are still “leveraging” up → increasing personal debt
Revolving debt increased 6.2% and non-revolving debt decreased by 6.9% in August (both at a seasonally adjusted annual rate). Student debt is nearly 20% (\$0.52 trillion) of Federal debt holdings (funded liabilities)
- Government debt: Federal, state, and local increasing → very problematic
- Europe → Greece received new aid and Spain continues to struggle – along with Portugal, Italy, and Britain, and also including France

“The only uncertainty that’s been clarified is who’s going to be President and the members of Congress. That level of uncertainty is behind us, but I do think this fiscal cliff, not knowing how it’s going to be resolved or when it’s going to be resolved ... it’s front and center. I do think that will have an impact on consumer spending.”¹

- - Robert Niblock , Chief Executive Officer, Lowes

October 2012 Housing Scorecard

	M/M	Y/Y
Housing Starts ^A	Δ3.6%	Δ41.9%
Housing Permits ^A	▽2.7%	Δ29.8%
Housing Completions ^A	Δ14.5%	Δ33.6%
New Single-Family House Sales ^A	▽0.3%	Δ17.2%
Existing House Sales ^B	Δ2.1%	Δ10.9%
Remodeling Permits ^C	▽12.0%	▽5.0%
Private Construction Spending ^A	Δ1.3%	Δ20.9%

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

New Housing Starts

	Total Starts*	Single-Family Starts	Multi-Family 2-4 unit Starts	Multi-Family 5 or more unit Starts
October	894,000	594,000	15,000	285,000
September	863,000	595,000	9,000	259,000
2011	630,000	439,000	16,000	175,000
M/M change	+3.6%	-0.2%	+66.7%	+10.0%
Y/Y change	+41.9%	+35.3%	-6.2%	+62.9%

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

October 2012: Total starts → Spiked upward

.Is the housing market ready to return to historic norms?

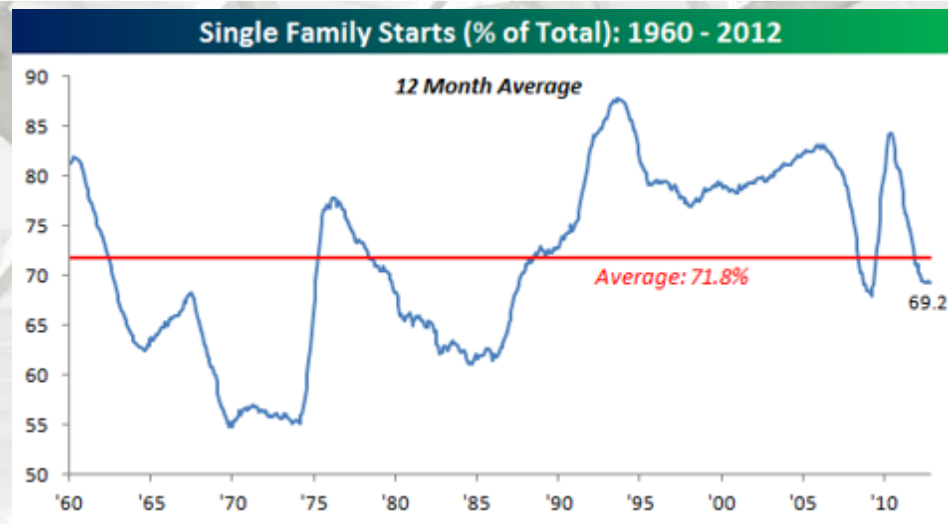
“I still don’t see a lot of jobs being created. And I also see the fact that there are potential layoffs in a number of industries, especially the defense industry.”²

- - Donald Tomnitz, Chief Executive Officer, D.R. Horton Homes

New Housing Starts

Single Family Housing Starts as a Percent of Total Starts

“In spite of the October’s report, one complaint regarding the report was that multi-family units made up an increasingly large share of total starts. In the October report, single family units dropped to 66.4% of total starts, bringing the 12-month average down to 69.2%. The small share of single family starts even prompted Goldman Sachs to lower GDP forecasts for the fourth quarter. While single family housing unit starts are more beneficial to the economy than multi-family units, the current breakdown between single and multi-family unit starts is not way out of line with the historical range.

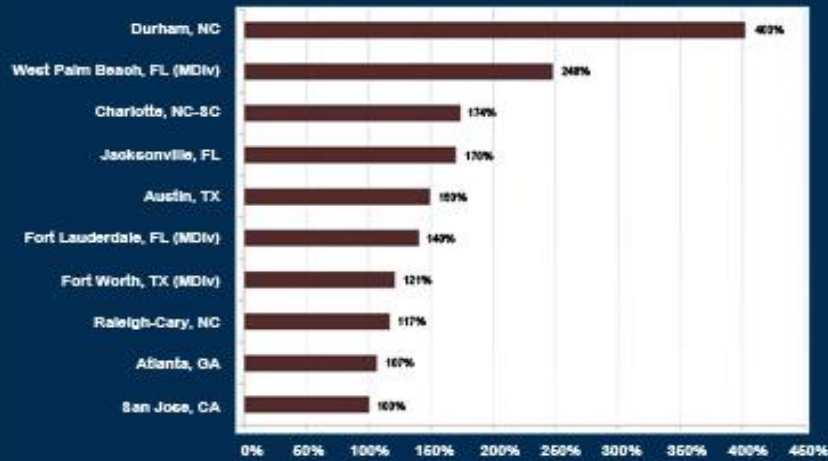


As shown in the chart, the average level going back to 1960 has been 71.8%. Although the current level of 69.2% is only modestly below average, the share of single family units has widely fluctuated over time. Going back to just 1990, the current level is on the low side of the range. From 1960 to 1990, though, single family units as a share of total starts was typically much lower.”³

-- Bespoke Investment Group

New Housing Starts

Multifamily Permit Increase - 2012 vs. 2011

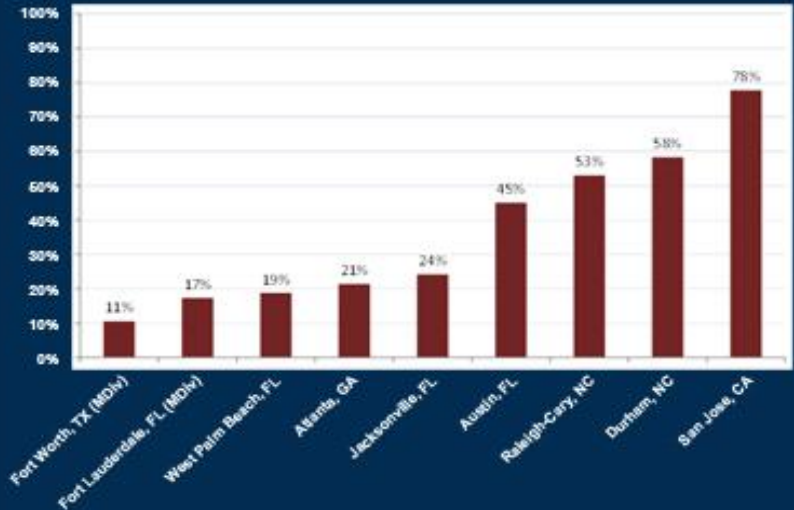


The above MSAs experienced the largest net gain in permits from 2012 vs. 2011.

SOURCE: John Burns Real Estate Consulting, 2012

*Multifamily permit issuance includes apartments and for-sale condominiums, but apartment construction comprises the majority of multifamily permit issuance.

2012 Multifamily Permit Issuance as a % of Peak



SOURCE: John Burns Real Estate Consulting, 2012

*Multifamily permit issuance includes apartments and for-sale condominiums, but apartment construction comprises the majority of multifamily permit issuance.

Apartment Construction Booming!

“... 44 metro areas which will double their multifamily construction this year. Among the major markets, the growth is staggering. Despite the boom, many of these markets are far from their peak levels of construction, and we think further increases can easily be absorbed in a growing economy. There is now more multifamily construction than single-family construction in 36 of the 183 MSAs we forecast. The surge in multifamily construction has extended beyond the coastal markets to such inland areas The growth in multifamily construction is contributing to rising labor and materials costs for builders of all homes. At some point, the multifamily market is likely to get overbuilt too, which always seems to coincide with a recession. Right now, the outlook for the apartment market looks bright.”⁴

-- Lesley Deutch, Vice President, John Burns Real Estate Consulting LLC

New Housing Permits and Completions

	Total Permits*	Single-Family Permits	Multi-Family 2-4 unit Permits	Multi-Family 5 or more unit Permits
October	866,000	562,000	24,000	280,000
September	890,000	550,000	27,000	313,000
2011	667,000	444,000	24,000	199,000
M/M change	-2.7%	+2.2%	-11.1%	-10.5%
Y/Y change	+29.8%	+26.6%	0.0%	+40.7%
	Total Completions*	Single-Family Completions	Multi-Family 2-4 unit Completions	Multi-Family 5 or more unit Completions
October	772,000	542,000	4,000	226,000
September	674,000	524,000	5,000	145,000
2011	578,000	445,000	7,000	126,000
M/M change	+14.5%	+3.4%	-20.0%	+55.9%
Y/Y change	+33.6%	+21.8%	-42.8%	+79.4%

New and Existing House Sales

	New Single-Family Sales*	Median Price	Month's Supply	Existing House Sales ⁵ *	Median Price ⁵	Month's Supply ⁵
October	368,000	\$237,700	4.8	4,790,000	\$178,600	5.4
September	369,000	\$248,000	4.7	4,690,000	\$178,300	5.6
2011	314,000	\$224,800	6.1	4,320,000	\$233,100	7.6
M/M change	-0.3%	-3.2%	+2.1%	+2.1%	-0.5%	-3.6%
Y/Y change	+17.2%	+6.7%	-21.3%	+10.9%	+11.0%	-28.9%

* All sales data are SAAR

Commentary on Housing Sales

New single-family house sales -- a substantial downward revision from
September's first reporting of 389,000 units

Existing house sales -- a slight increase from September

“Overall sales volumes remain low with distressed transactions at historic highs. Over the prior 12 months there were 4.07 million total transactions: REOs = 16.1% (656k) and short-sales = 16.2% (661k) for about 1.31 million distressed sales. For comparison, there were 8.2 million sales from November 2004 to November 2005, with 226,000 distressed sales – 2.75%.”⁶

- - Lender Processing Services

Existing House Sales

National Association of Realtors (NAR)⁸

October 2012 sales data:

Distressed houses: 24% of sales –
(12% foreclosures and 12% short-sales)

Distressed house sales: 24% in September
and 28% in October 2011

All-cash sales: increased to 29% – 28% in August

Investors are still purchasing a substantial portion of “all cash” sale houses – 20%;
18% in September 2012 and 18% in October 2011

First-time buyers: decreased to 31% from 32% in September 2012
and were 34% in October 2011⁵

New and Existing House Sales

More and more are asking, if this is a robust recovery –

Where Are The First-time Homebuyers?

“Despite the recent positive signs in the housing market, one key group has not yet returned. ...the closely watched S&P/Case-Shiller index report on Tuesday noted home prices over the summer posted its biggest percentage gain in more than two years. This is good news, but a crucial segment is missing out on better days: First-time homebuyers.”⁷

-- Nin-Hai Tseng, Writer, *Fortune*

First-time Buyers Continue To Fade

“With record low interest rates and affordable prices, this was to be the year of the first-time home buyer. Instead, first-timers’ market share has fallen from 39% of existing home sales last year to 31% in October. What happened? First-time buyers normally account for 40% of all sales, have now tied the record low of 28% of January 2011... .”⁸

-- Steve Cook, Executive Vice President, Reecon Advisors

The Vanishing First-time Homebuyer

“It was only a matter of time before the market learned the true fate of the young, first-time homebuyer who may have a solid credit history and a good job, but lacks a 20% down payment. The reality is they are disappearing before our very eyes.”⁹

-- Kerri Ann Panchuk, Reporter, *HousingWire*

Sources:⁷http://finance.fortune.cnn.com/2012/11/27/first-time-homebuyers-housing-market/?iid=SF_F_River; 11/27/12;

⁸www.realestateeconomywatch.com/2012/11/where-did-the-first-time-buyers-go; 11/20/12;

⁹www.housingwire.com/rewired/vanishing-first-time-homebuyer; 11/26/12

Existing and New Housing Sales

Challenges in Housing and Mortgage Markets

“The growing demand for homes has been underpinned by record levels of affordability, the result of historically low mortgage rates and house prices that are 30% or more below their peaks in many areas. To be sure, the housing sector is far from being out of the woods. Construction activity, sales, and prices remain much lower than they were before the crisis. About 20% of mortgage borrowers remain underwater -- that is, they owe more than their homes are worth. Despite marked improvements in overall credit quality, 7% of mortgages are either more than 90 days overdue or in the process of foreclosure. And, although the number of homes in foreclosure has edged down since cresting in 2010, that number remains in excess of 2 million, three times the historical norm. Meanwhile, the national homeownership rate has slipped nearly 4 percentage points from its 2004 high of 69%, and it now stands at a 15-year low. So, although there are good reasons to be encouraged by the recent direction of the housing market, we should not be satisfied with the progress we have seen so far.”¹⁰

-- Dr. Ben Bernanke, Chairman, The Federal Reserve Bank

Big Money Bets on a Housing Rebound

“A flurry of private-equity giants and hedge funds have spent billions of dollars to buy thousands of foreclosed SF homes. They are purchasing them on the cheap through bank auctions, multiple listing services, short-sales, and bulk purchases from local investors in need of cash, with plans to fix up the properties, rent them out and watch their values soar as the industry rebounds. They have raised as much as \$8 billion to invest... . Some firms involved:

The Blackstone Group...has spent more than \$1 billion to buy 6,500 single-family homes so far this year.

The Colony Capital Group... has bought 4,000.

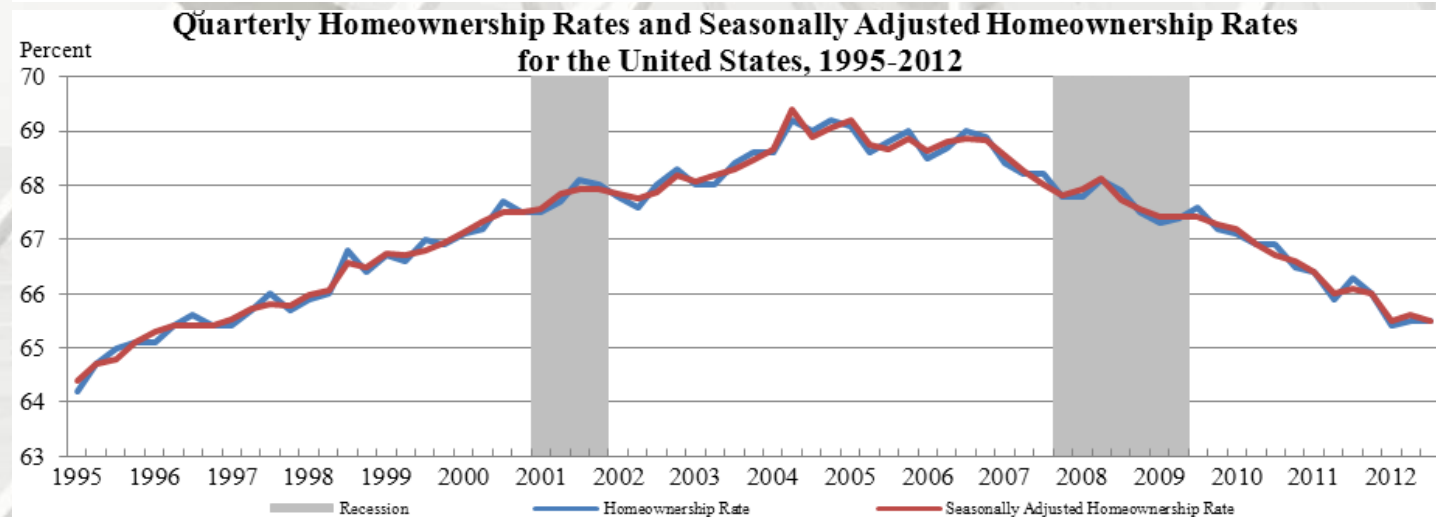
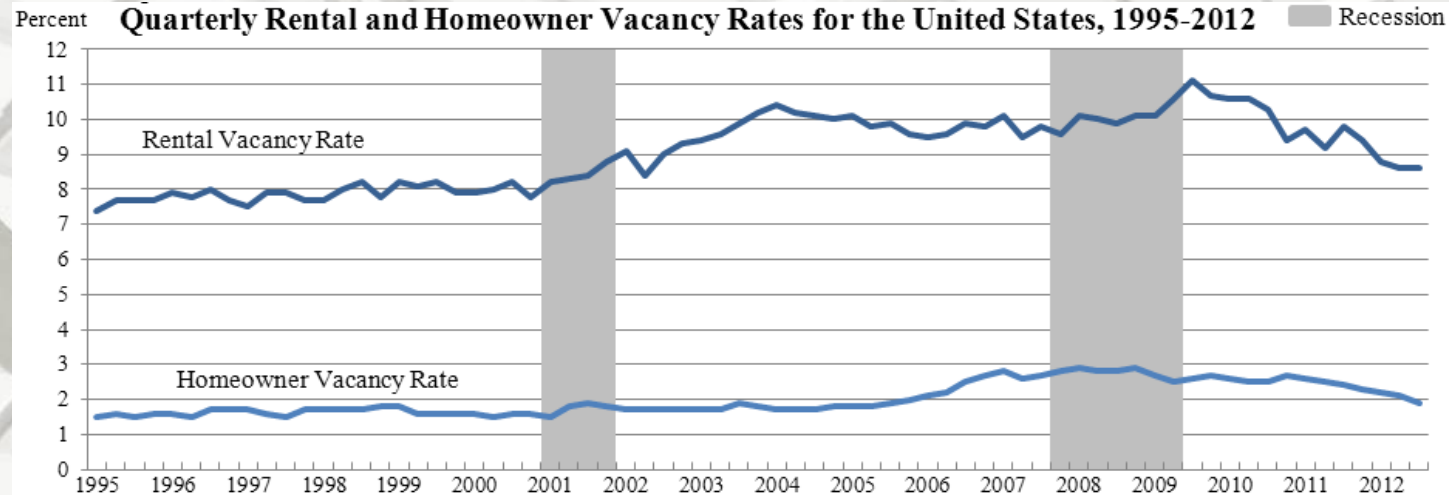
Two Harbors had acquired 2,200 houses.

Sylvan Road Capital owns between 200 and 500 homes in the Atlanta area and has a \$20 million commitment from Carlyle Group CG for additional purchases.”¹¹

Source: ¹⁰www.federalreserve.gov/newsevents/speech/bernanke20121115a.htm; 11/15/12;

¹¹www.nytimes.com/2012/12/09/business/financiers-bet-on-rental-housing.html?pagewanted=2&_r=1&ref=business; 12/8/12

Vacancies and Homeownership



National vacancy rates in the 3rd quarter 2012 were 8.6% for rental housing and 1.9% for homeowner housing. Both the rates were lower than the 3rd quarter 2011 rate, and lower than last quarter (2.1%).

The homeownership rate of 65.5% was **lower** than the 3rd quarter 2011 rate (66.3%) and about the same as the rate last quarter.

October 2012 Construction Spending

Private Construction: \$294.24 billion (SAAR)

3.0% above the revised September estimate of \$285.66 billion (SAAR)

20.7% above the September 2011 estimate of \$243.66 billion (SAAR)

October SF construction: \$141.28 billion (SAAR)

28.9% above October 2011: \$109.54 billion (SAAR)

October MF construction: \$23.83 billion (SAAR)

53.2% above October 2011: \$15.56 billion (SAAR)

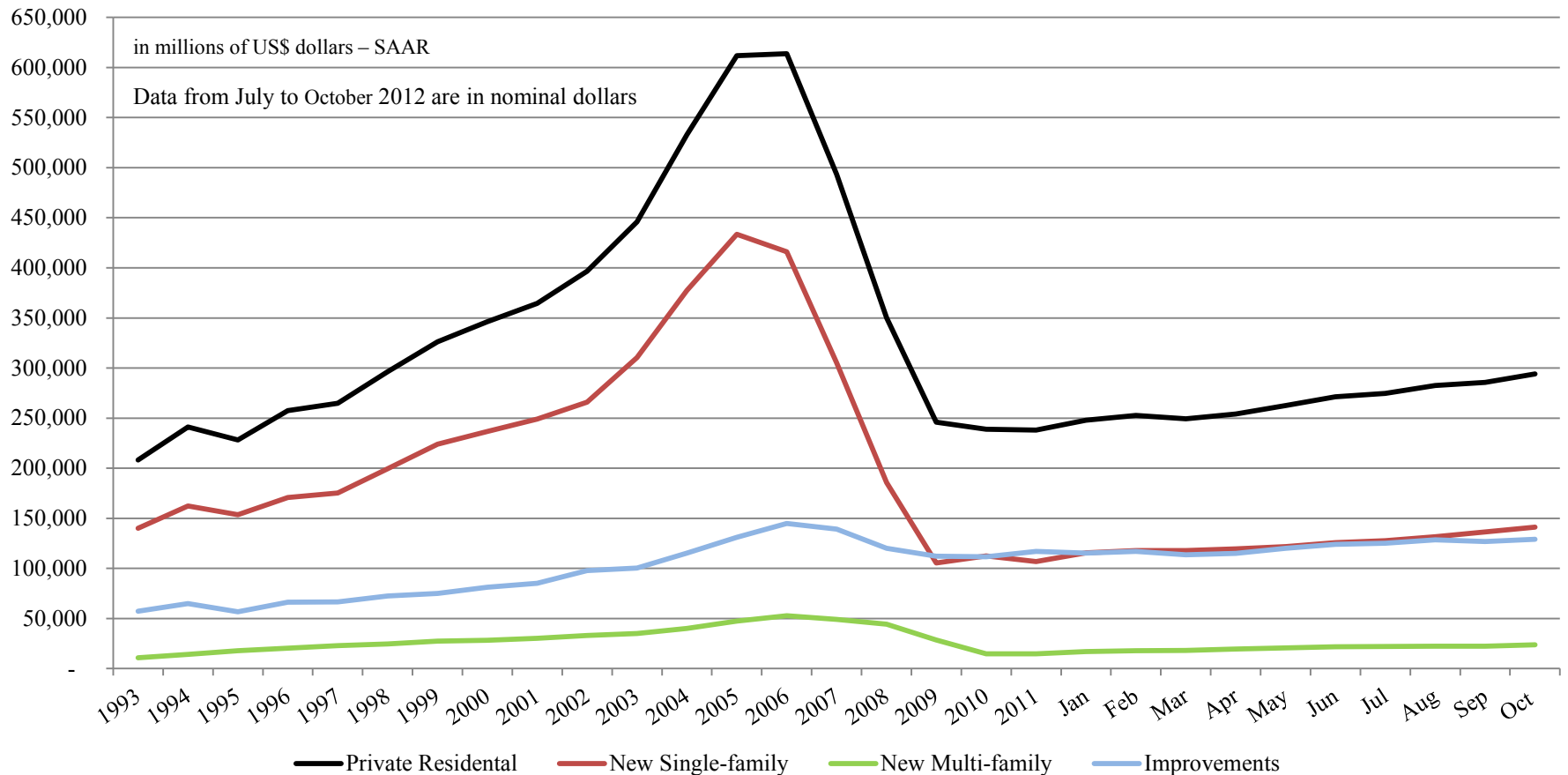
October Improvement^A construction: \$129.13 billion (SAAR)

26.4% above October 2011: \$102.16 billion (SAAR)

Private residential construction spending increased slightly from September, but one important thing to keep in mind – these numbers are reported in nominal dollars and not adjusted for inflation.

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

Construction Spending



Improvement and new SF house construction spending has been roughly equivalent since 2009. Historically, this has not been the case. A future indicator of a robust SF construction market would indicate a widening divergence between the two. However, this future spread may not be as wide as between the years 1993 and 2009 due to an increase in aging homes and an aging population, and decreased SF construction. This would indicate more money being spent on improvements; and in the latter, more owners will be staying put (and possibly spending more on “aging in place” improvements).

October 2012 Construction Spending

October Construction **Drops** 14 Percent

“The value of new construction starts **retreated** 14% in October to \$434.9 billion (SAAR)... . The 4% pickup for total construction on an unadjusted basis during the first ten months of 2012 was the result of increases for two of the three main construction groups. Residential building advanced 28%, with year-to-date gains of 27% for single-family housing and 30% for multi-family housing. Nonbuilding construction grew 3% year-to-date... .

Nonresidential building continued to be the one major construction group to register a year-to-date **decline**, falling 14%. The nonresidential building decline was due to this behavior by segment – commercial building, up 2%; institutional building, down 15%; and manufacturing building, down 47%. On a square footage basis, nonresidential building in the first ten months of 2012 was up 1% compared to a year ago.

Nonresidential building, at \$131.6 billion (SAAR), **decreased** 4% in October. The manufacturing plant category plunged 73%, continuing to pull back from the improved activity that was reported earlier in 2012. Warehouse construction also **weakened** substantially in October, falling 33%. Office construction in October slipped 3%... .

“As the result of the uncertainty created by the looming fiscal cliff, manufacturers have increasingly held back on investment as 2012 has progressed.”¹²

- - Robert Murray, Vice President, Economic Affairs, McGraw-Hill Construction

October 2012 Construction Spending

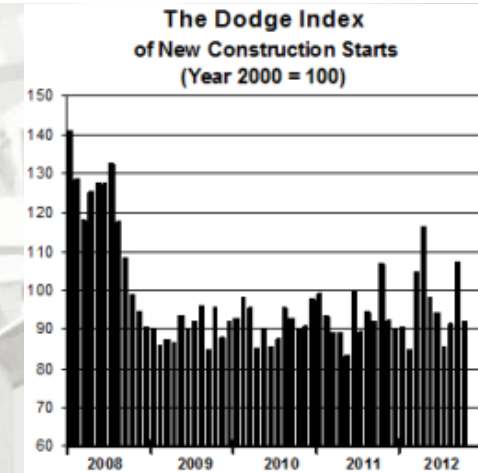
“**Residential building** in October **dropped** 2% to \$169.9 billion (SAAR). The downward pull came from multifamily housing, which **retreated** 7% from September. During 2012, multifamily housing has fluctuated around an upward trend, and the pace for multi-family housing in October was still 23% above the level reported at the start of the year.

Single-family housing in October was unchanged from September, maintaining the enhanced activity that's been established over the course of 2012. The October single-family amount was up 25% from the level reported at the start of the year, and this project type had earlier shown gains in seven out of the nine preceding months.

During the January-October period of 2012, the regional pattern for single-family housing showed the largest increase in the West, up 39%; followed by the Midwest, up 28%; the South Atlantic, up 26%; the South Central, up 22%; and the Northeast, up 14%.¹²

- Robert Murray, Vice President, Economic Affairs, McGraw-Hill Construction

October 2012 Construction Starts



MONTHLY SUMMARY OF CONSTRUCTION STARTS Prepared by McGraw-Hill Construction Research & Analytics

MONTHLY CONSTRUCTION STARTS Seasonally Adjusted Annual Rates, In Millions of Dollars			
	October 2012	September 2012	% Change
Nonresidential Building	\$131,595	\$137,740	-4
Residential Building	169,920	172,724	-2
Nonbuilding Construction	133,378	196,989	-32
TOTAL Construction	\$434,893	\$507,453	-14

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

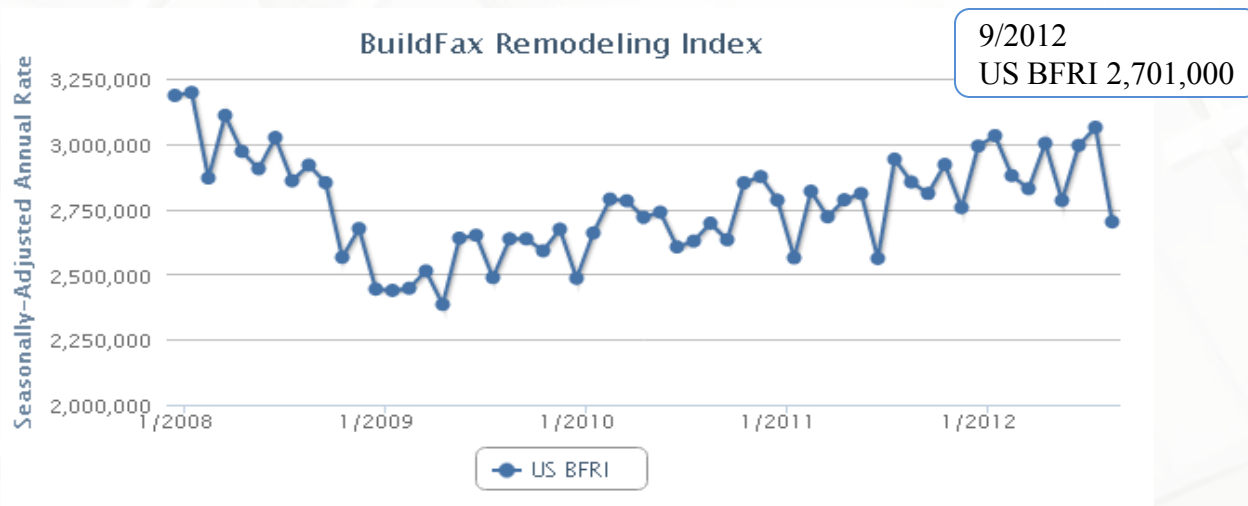
October 2012.....92
September 2012.....107

YEAR-TO-DATE CONSTRUCTION STARTS Unadjusted Totals, In Millions of Dollars			
	10 Mos. 2012	10 Mos. 2011	% Change
Nonresidential Building	\$122,861	\$142,283	-14
Residential Building	134,422	105,327	+28
Nonbuilding Construction	133,094	128,775	+3
TOTAL Construction	\$390,377	\$376,385	+4

Residential Remodeling August 2012

September Residential Remodeling Permits: 2,701,000 (SAAR)

12% **below** the revised August estimate of 3,063,000 and
5% **below** August 2011's 2,854,000 permits



“Northeast, 647,000 (**down** 17% from August and down 3% from September 2011); South, 1,121,000 (**down** 12% from August and up 12% from September 2011); Midwest, 474,000 (**down** 12% from August and down 24% from September 2011); West, 727,000 (**down** 10% from August and **down** 10% from September 2011)” – all SAAR.

“September was a rough month for residential remodeling, but early returns from October appear to show an unusual jump, so we may just be seeing a significant percentage of deferred jobs.”¹³

- - Joe Emison, Vice President-R&D, BuildFax

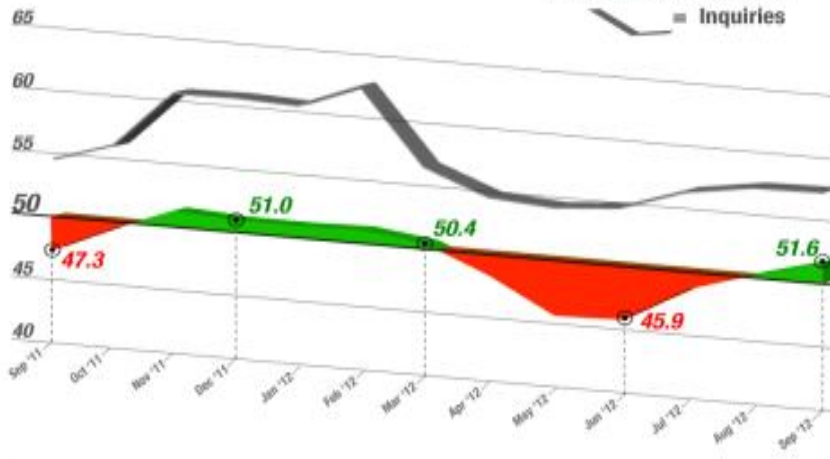
Architectural Billing Indicators

NATIONAL

More Firms Report **Improving** Business Conditions in September
Inquiries Remain **Above 55**

Graphs represent data from September 2011–September 2012

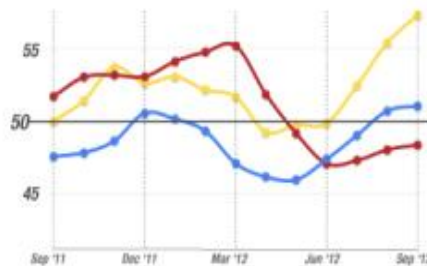
Above 50 = Below 50 =
50 = No change from previous period
= Inquiries



SECTOR

Commercial/Industrial Firms Still
Reporting **Weakness**

Graph represents data from September 2011–September 2012 across the three sectors. 50 represents the diffusion center. A score of 50 equals no change from the previous month. Above 50 shows increase; Below 50 shows decrease. 3-month moving average.



Commercial/Industrial: 48.4



Institutional: 51.0



Residential: 57.3

ABI Reflects Strongest Billings in Nearly Two Years

“Architecture firms reported an improvement in business conditions for the second consecutive month in September, as the Architecture Billings Index climbed to a score of 51.6, reflecting the strongest growth in nearly two years. With the general economy continuing to show signs of improvement, there is hope for a more sustained period of recovery for the profession. Inquiries into new work remained strong this month, and fewer firms reported a decline in the value of new design contracts.

However, architecture firm billings are not improving in all regions of the country. Just like last month, firms in the South and West regions are reporting growth, while firms in the Northeast and Midwest are reporting **weaker** firm billings. After nearly 5 years of declining billings, firms in the West not only reported billings growth for the second month in a row in September, but also had the highest score of all four regions.

Firms with a residential specialization recorded their highest scores in nearly seven years, as the demand for rental housing is increasing, interest rates continue to fall, and the mortgage crisis recedes further into the background. Commercial buildings are overbuilt in many areas, and firms specializing in that sector may still see some softness until they are filled.”¹⁴

- - Jennifer Riskus, Manager of Economic Research, The American Institute of Architects

Source: ¹⁴www.aia.org/practicing/AIAB096284; 11/20/12

Housing Market 47% Back to “Normal”

Housing Market Recovery Accelerating

“In October 2012, all three housing measures improved: construction starts increased again, existing-home sales rose, and the delinquency + foreclosure rate dropped considerably. Even though construction and sales declined month-over-month in the Northeast region, stronger activity in the rest of the country outweighed the impact of Hurricane Sandy.

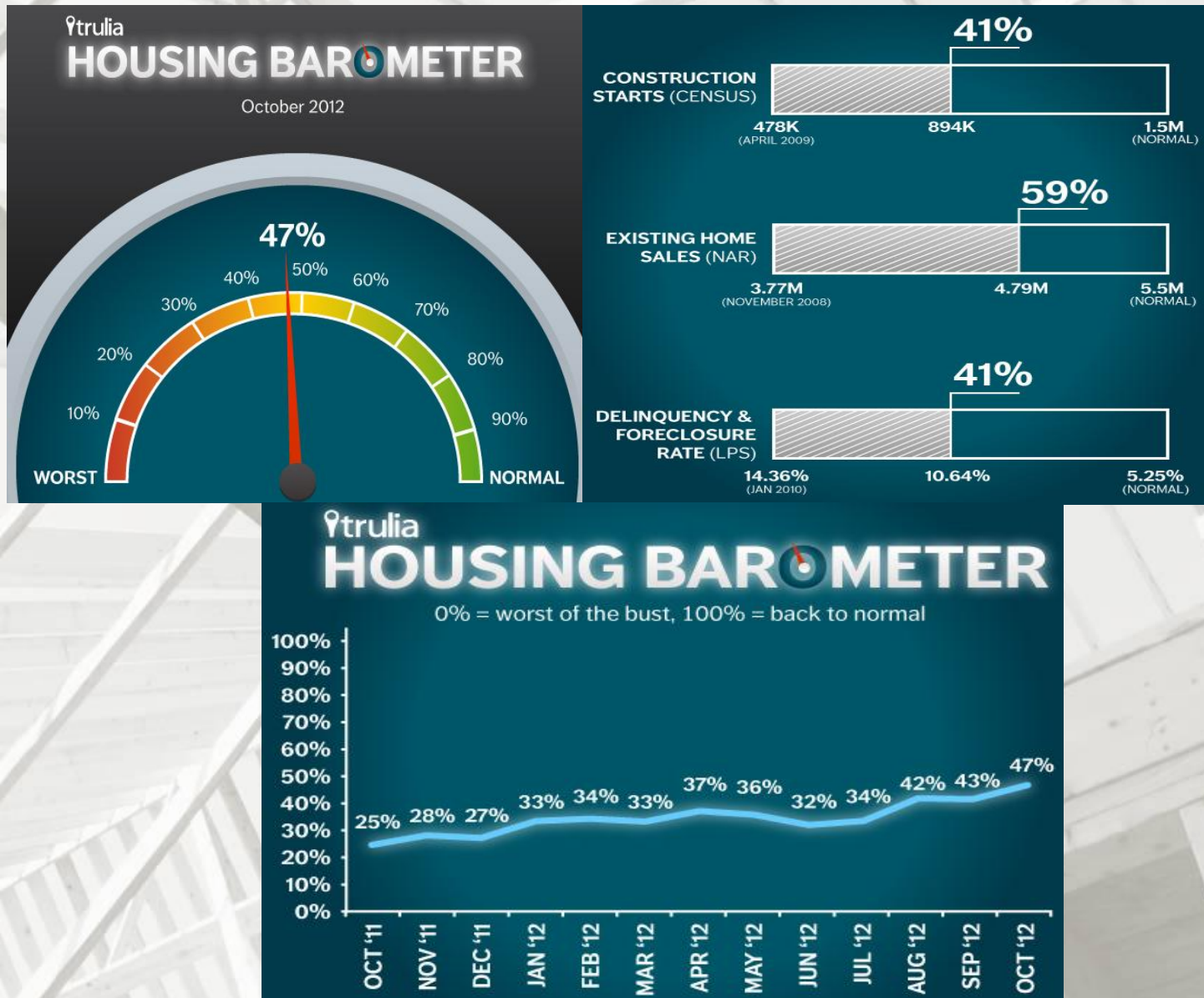
Construction starts rose from last month’s high. Starts in October were at an 894,000 annualized rate, up 4% month-over-month after a big jump in September and up 42% year-over-year. Nationally, construction starts are 41% of the way back to normal.

Existing-home sales recovered in October. After slipping in September, existing home sales rose 2% month-over-month to 4.79 million in October and are now just a bit below their post-crisis high of 4.83 million in August. Sales are 59% back to normal—more than halfway.

The delinquency + foreclosure rate dropped to a post-crisis low. In October, 10.64% of mortgages were delinquent or in foreclosure, down sharply from 11.27% in September and from 11.88% in October 2011. The combined delinquency + foreclosure rate is at its lowest level in four years and is 41% back to normal.”¹⁵

- - Jed Kolko, Chief Economist, Trulia Housing Research

Housing Market 47% Back to “Normal”



Shiller, Gross, and Jurow Speak on Housing



Robert Shiller

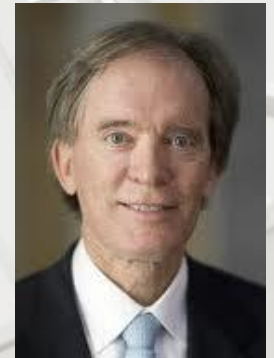
Case-Shiller Indices® and Professor of Economics, Yale University

Why I'm Doubting the Housing Recovery

Bill Gross

Managing Director and Co-CIO, PIMCO

We're Hopeful on U.S. Housing



Keith Jurow

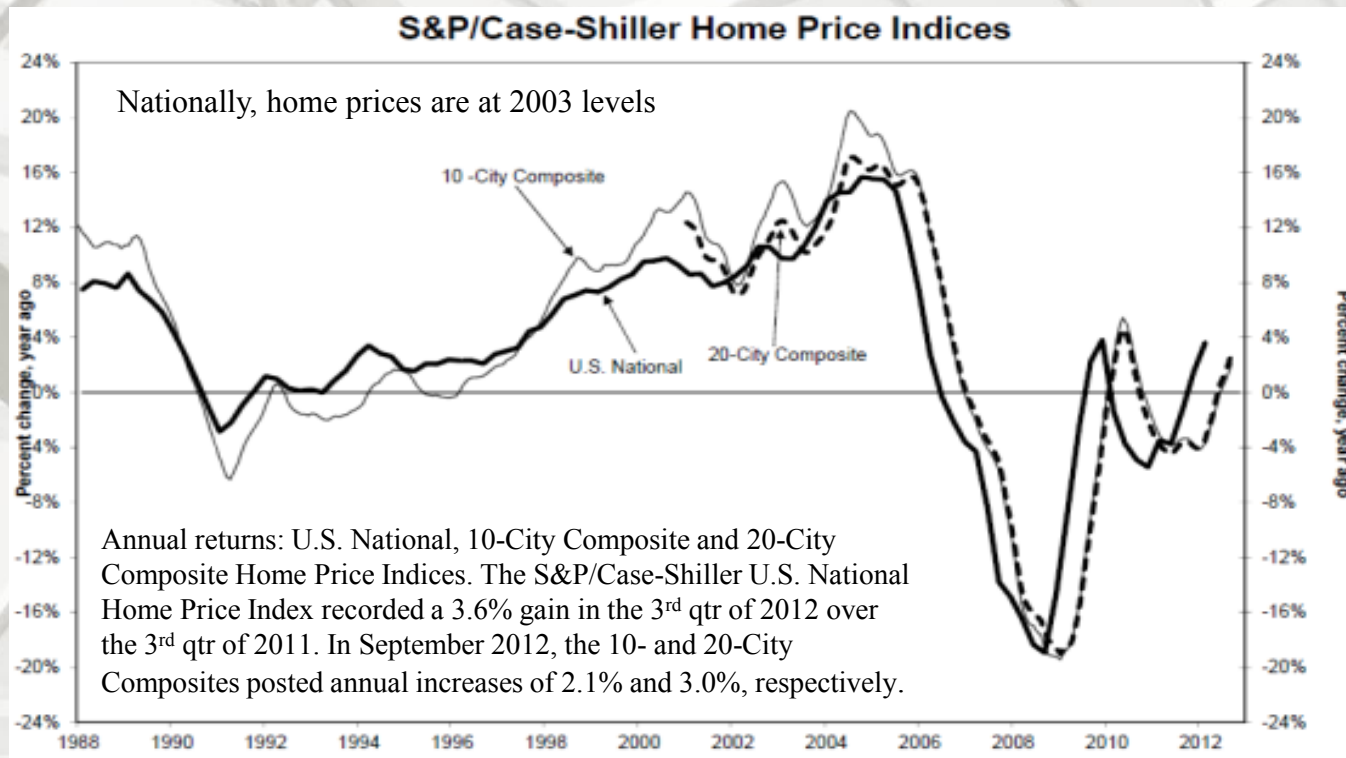
Economics Journalist, Minyanville

House Prices Are Nowhere Near A Bottom



Double click on the photo for the link

S&P/Case-Shiller August Home Price Indices



“Home prices rose in the 3rd qtr, marking the 6th consecutive month of increasing prices. In September’s report all 3 headline composites and 17 of the 20 cities gained over their levels of a year ago. M/M, 13 cities and both Composites posted positive monthly gains. The National Composite increased by 3.6% from the same qtr in 2011 and by 2.2% from the 2nd qtr of 2012. The 10- and 20-City Composites have posted positive annual returns for 4 consecutive months with a +2.1% and +3.0% annual change in September, respectively. M/M, both Composites have recorded increases for 6 consecutive months, with the most recent monthly gain being +0.3% for each Composite.

We are entering the seasonally weak part of the year. The headline figures, which are not seasonally adjusted, showed five cities with lower prices in September versus only one in August; in the seasonally adjusted data the pattern was reversed: one city fell in September versus two in August. Despite the seasons, housing continues to improve. With six months of consistently rising home prices, it is safe to say that we are now in the midst of a recovery in the housing market.”¹⁶

- - David Blitzer, Chairman of the Index Committee at S&P Dow Jones Indices

October 2012 Home Prices

	U.S.	M/M Change
CoreLogic® HPI	146.36	+6.3%
Clear Capital HDI™		+1.0%
LPS®	\$205	+0.1%
Federal Housing Finance Agency HPI	191.1	+1.1%
FNC RPI™	138.11	0.0
Zillow®	\$153,800	+1.1%

“While the housing market is now a significant contributing factor to economic growth, it will take much more time before the housing market sees a full recovery. Short- to medium-term factors driving this recovery are fueled by an investor-based demand for rental properties, combined with rising home prices and a decline in the number of under-equited households. A full housing recovery will be driven by a healthier economy, fundamental gains in income growth and consumption, and an ongoing increase in home prices.”¹⁷

- - Mark Fleming, Chief Economist, CoreLogic

“The past year has seen consistent price increases, but a number of factors continue to affect the recovery in home prices such as stagnant income growth, high unemployment levels, lingering uncertainty about the macro economy, and the large number of homes in the foreclosure pipeline.”¹⁸

- - Andrew Leventis, Principal Economist, Federal Housing Finance Agency

Source: ¹⁷www.corelogic.com/about-us/researchtrends/asset_upload_file817_16690.pdf; October 2 2012;

¹⁸www.fhfa.gov/webfiles/24676/2012Q3HPI.pdf; 11/27/12

www.zillow.com/blog/research/2012/10/22/u-s-home-values-post-big-gains-but-recovery-is-uneven-among-markets, 10/22/ 2012;

www.clearcapital.com/user_data/userfiles/file/ClearCapitalHDIMarketReport_Dec_2012_v1.pdf?v=1; 11/10/12

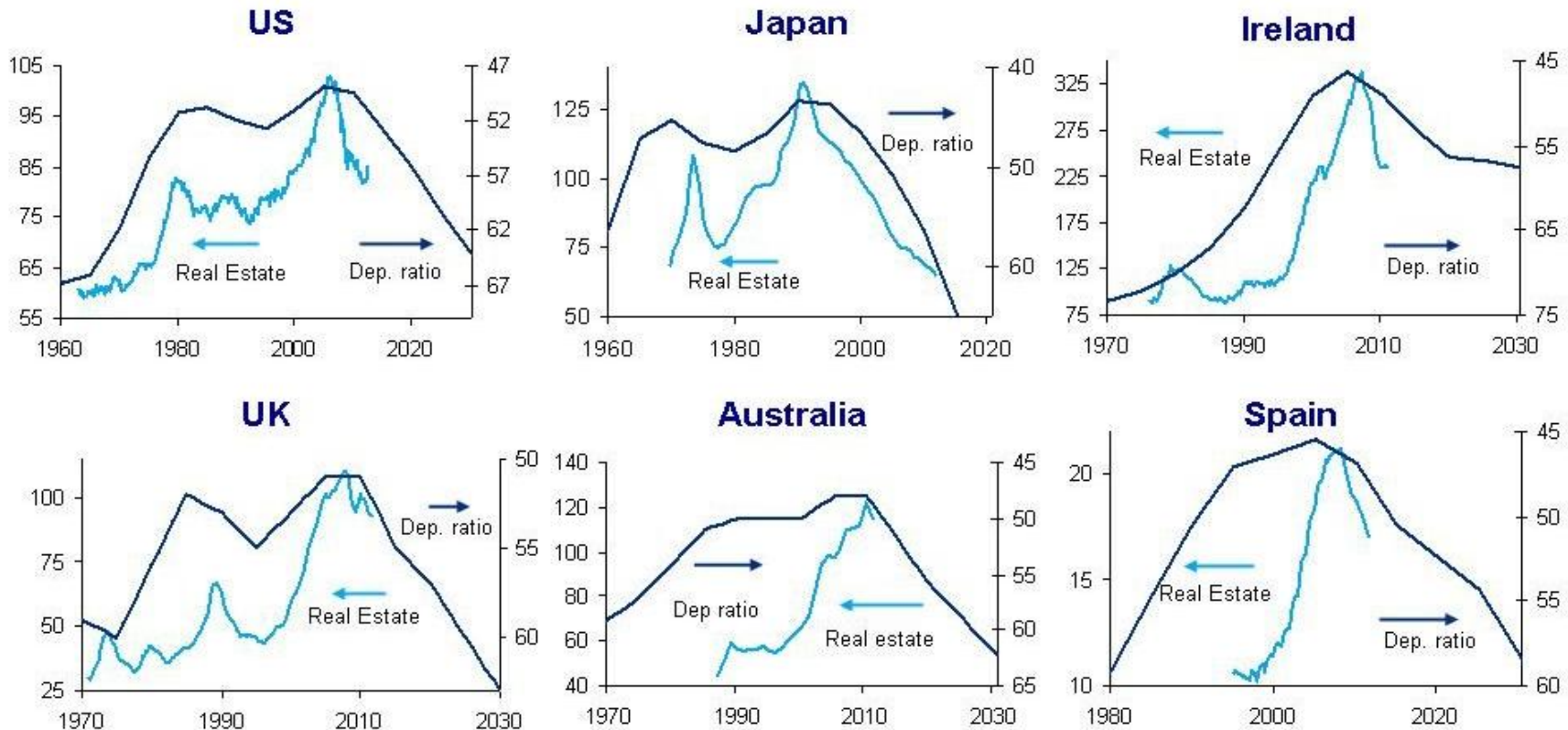
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www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/MortgageMonitor/201210MortgageMonitor/MortgageMonitorOct2012.pdf; 12/4/12

U.S. and World Housing Prices

Estate in Need of Maintenance – Is Recent Weakness Just a Blackspot, or Blight?

Last year's canes seldom bear fruit: *Real house price indices vs. dependency ratios*



Source: UN Population Database, US Census Bureau, Japan Real Estate Research Institute, UK FT House Price Index, Swiss National Bank. See *Ageing and asset prices*, E. Takats, BIS, and *Population Ageing, Macroeconomic Crisis and Policy Challenges*, K. Nishimura, BoJ.

“It's what I like to call “the most depressing slide I've ever created.” In almost every country you look at, the peak in real estate prices has coincided – give or take literally a couple of years – with the peak in the inverse dependency ratio (the proportion of population of working age relative to old and young). In the past, we all levered up, bought a big house, enjoyed capital gains tax-free, lived in the thing, and then, when the kids grew up and left home, we sold it to someone in our children's generation. Unfortunately, that doesn't work so well when there start to be more pensioners than workers.”¹⁹

- - Matt King, Global Head of Credit Strategy, Citi Bank

Delinquencies, Foreclosures, Negative Equity, and Shadow Inventory

October 2012

	Delinquent	Foreclosure	Negative Equity	Shadow Inventory
CoreLogic ^{®D}	2.7 million	58,000 foreclosures 1.3 million	10.8 million	1.5 million
LPS ^{®E}	3.5 million	203,000 starts 2.03 million	-	1.8 million
RealtyTrac ^{®F}	-	89,209 starts 186,455 notices	+12 million	-
Zillow ^{®G}	-	5.57 per 10,000 homes	+14 million	-

Each firm has different estimating methods – thus the discrepancy in the data.

Delinquencies, Foreclosures, Negative Equity, and Shadow Inventory

October Commentary

“Negative equity is impacting the real estate market. In total, underwater homeowners owe \$1.02 trillion more than their homes’ worth. More than 42% of underwater homeowners (11.9% of all homeowners with a mortgage), owe 20% or less than their home is worth. On average, U.S. homeowners in negative equity owe \$73,163 more than what their house is worth or 42.5% more.”²⁰

-- Daren Blomquist, Vice President, RealtyTrac

“As a result of completed foreclosures and alternative disposition methods, the foreclosure inventory has declined by 9% year-to-date. This is good news for housing markets as we look forward to 2013.”²¹

-- Mark Fleming, Chief Economist, CoreLogic

However, Reworked Mortgage Delinquencies **Jumped** in October

Modified-Mortgage Defaults **Soar** 24% in Looming Housing Challenge

“We are now seeing a wave of re-defaults from the modifications over the last two years that failed,” the J.P. Morgan analysts said. “This wave should last through 2013.”²²

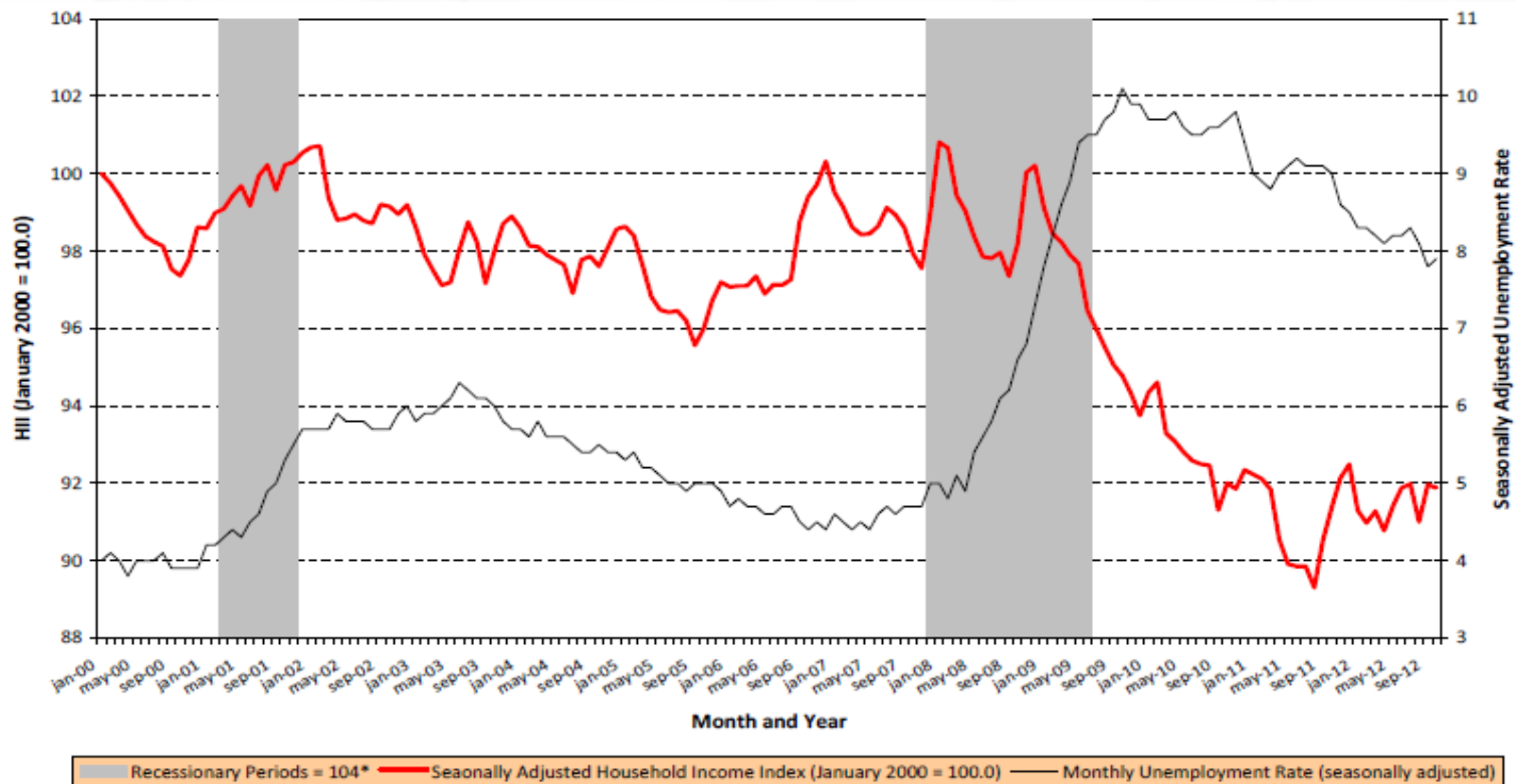
Source: ²⁰www2.marketwire.com/mw/frame_multimedia?prid=641471&attachid=1307869; 10/22/2012;

²¹www.corelogic.com/research/national-foreclosure-report-October-2012.pdf; 10/31/2012

²²www.bloomberg.com/news/2012-11-19/modified-mortgage-defaults-soar-24-in-looming-housing-challenge.html; 11/19/12

Demographics and Economics

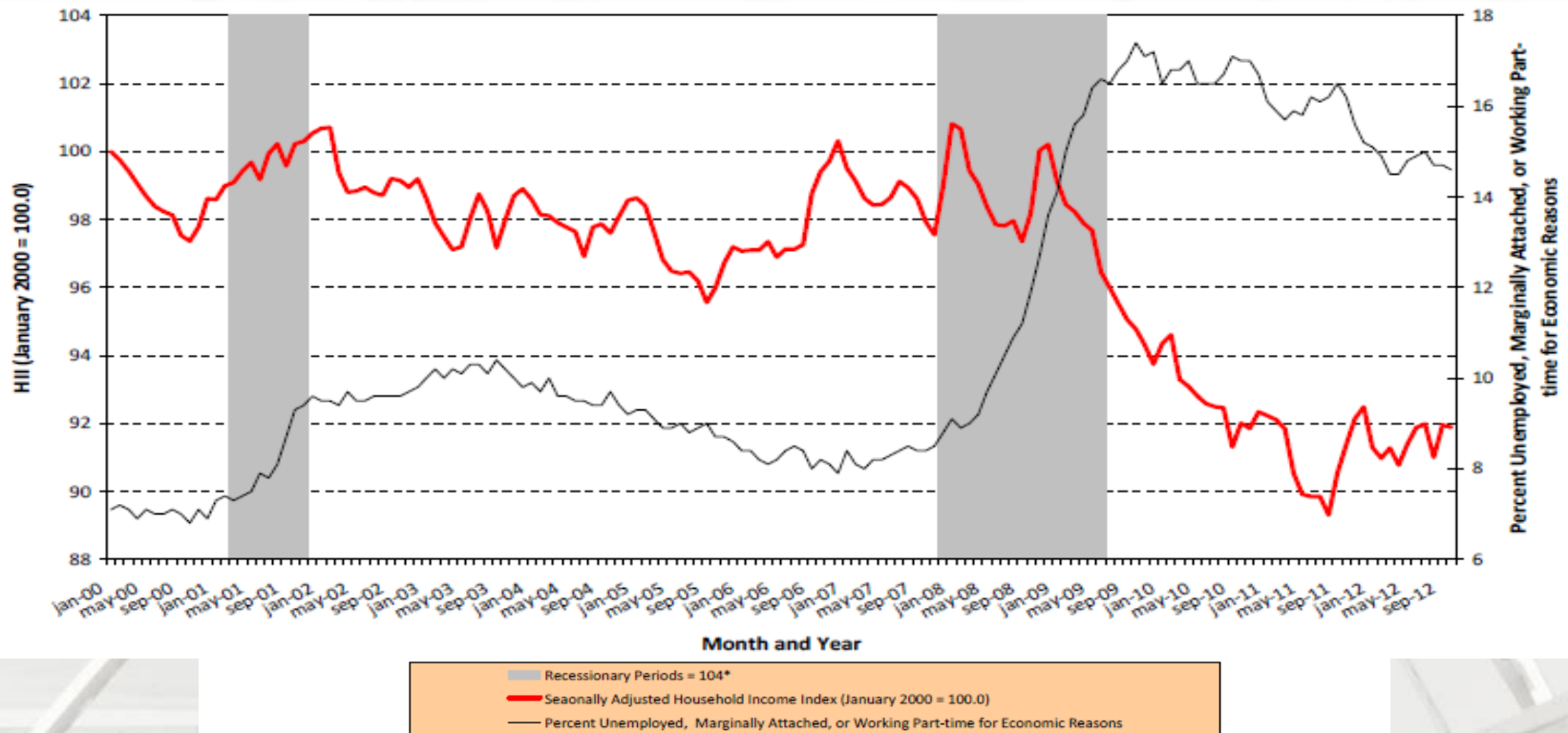
Median Household Income Index and Unemployment Rate by Month: Jan 2000 to Oct 2012



“The October level of real median annual household income is \$331 higher than January 2012 (\$51,047), reflecting an economy that continues to struggle. Even though we are technically in an economic recovery, real median annual household income has gained little traction. ... real median annual household income in October 2012 was \$51,378, statistically unchanged from the September 2012 median of \$51,418. The Household Income Index (HII) for October 2012 stood at 91.9, about the same level as September 2012 (92.0), but lower than the December 2011 reading of 92.5.”²³

- - Dr. Gordon Green, Sentier Research

Median Household Income Index, Percent Unemployed, Marginally attached or Working Part-time for Economic Reasons: January 2000 to October 2012



“October 2012 can be put into broader perspective by a comparison with previous levels of household income dating back to the start of the last decade. The October 2012 median annual household income of \$51,378 was 4.7% lower than the median of \$53,937 in June 2009, the end of the recent recession and beginning of the “economic recovery.” The October 2012 median was 7.2% lower than the median of \$55,356 in December 2007, the beginning month of the recession that occurred more than four years ago. And the October 2012 median was 8.1% lower than the median of \$55,914 in January 2000, the beginning of this statistical series.

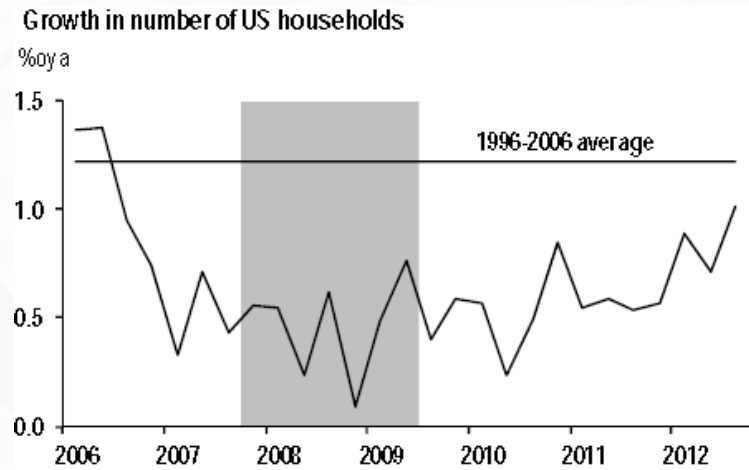
These comparisons demonstrate how significantly real median annual household income has fallen over the past decade, and how much ground needs to be recovered to return to income levels that existed more than ten years ago.”²³

- - Dr. Gordon Green, Sentier Research

Demographics

“More New Households Sprouting Up”

“Americans are setting up house at the fastest rate in more than six years, an indication that recession anxiety, which prompted adult children to move in with their parents and single people to postpone marriage, is starting to ease.



Source: SoberLook

The nation added 1.15 million households in the 12 months that ended in September, according to the most recent Census Bureau data. That is a significant rise from the past four years when an average of 650,000 households were formed annually. While what economists call “household formation” is running a little lower than the average 1.25 million added annually during the boom years, the latest data nevertheless represent an important shift.

“In the depths of the recession, three households would turn into one.... We've been waiting for this unbundling to happen,” said Ara Hovnanian, chief executive of Hovnanian Enterprises Inc., one of the nation's largest builders of single-family homes. “Demographics is destiny, in the end.”²⁴

- - Robbie Whelan, Reporter, *Wall Street Journal*

November 2012 U.S. Economic and Housing Market Outlook

“What a healthy housing market should look like will dismay those who keep comparing housing to what it was during its peak years. However, taking into account recent trends, key housing indicators and the shifting demographic patterns that will define a new and realistic trajectory toward a healthy housing market, the long-term prognosis is promising – just don't expect the housing market to wake up at 98.6 degrees tomorrow morning.”

-- Frank Nothaft, Vice President and Chief Economist, Freddie Mac

98.6 DEGREES

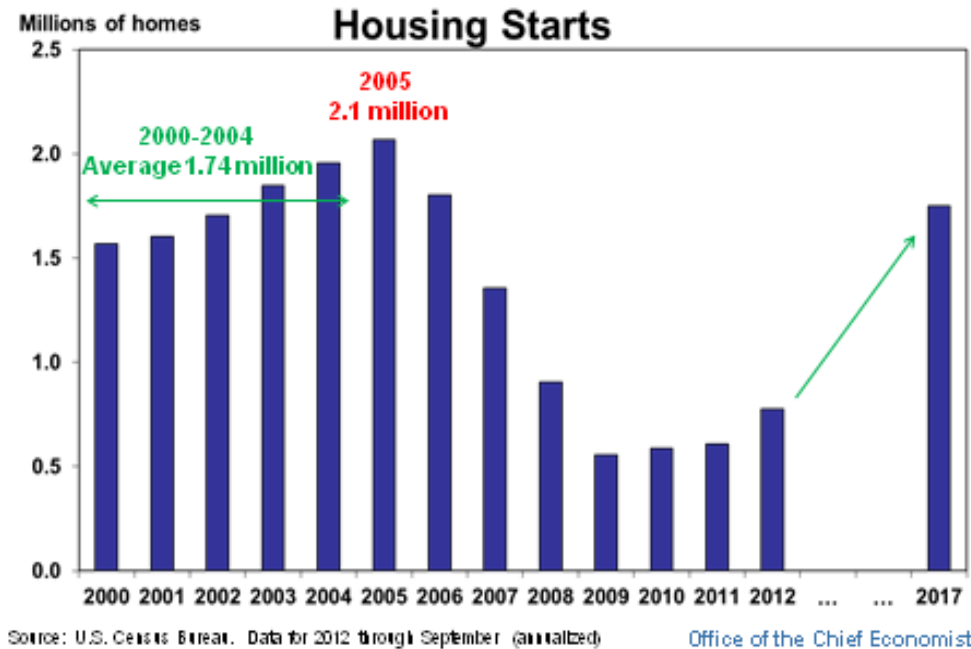
“The U.S. housing market is healing, but how will we know when it's actually “healthy”?

- Housing starts increasing to about 1.7 to 1.8 million dwellings per year compared with 2.1 million in 2005.
- Home sales increasing to about 5% of the housing stock, or about 6.5 to 7.0 million homes per year, compared with sales of 7% of the stock in 2005.
- U.S. house price appreciation rising gradually to about 3% per year compared to 11% of 2005.
- Vacancy rates easing further to about 1.7% on for-sale homes and 8% for rental homes, down from peaks of about 3% in 2008 and 11% in 2009, respectively.
- Serious delinquency rates nearing 2%, down from a peak of 9.5% in early 2010.”²⁵

Future Building



Healthy Housing Construction Has Annual Starts
Back to 1.7 to 1.8 Million by 2017

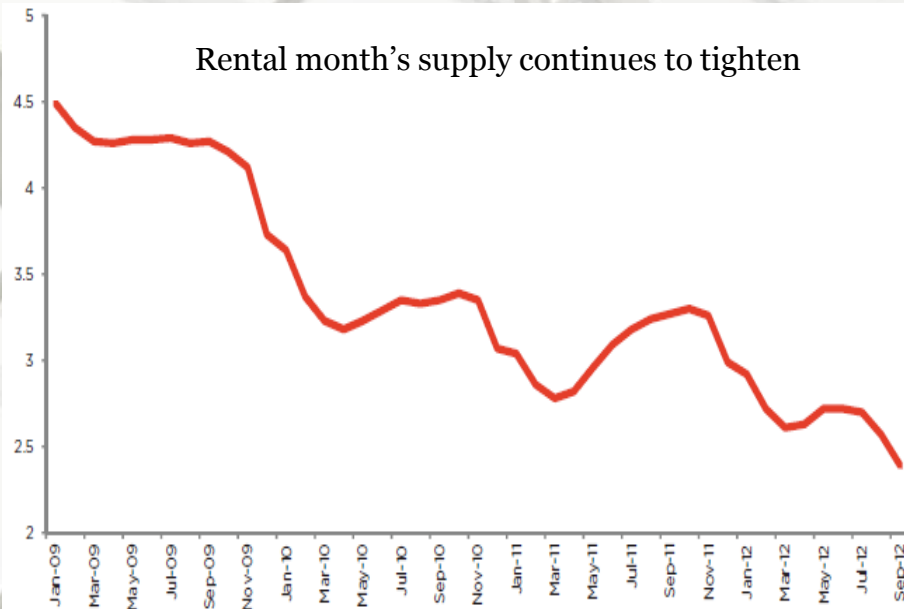


“To sum up: taking into account recent trends, key housing indicators and the shifting demographic patterns that will define a new and realistic trajectory toward a healthy housing market, the long-term prognosis is promising. In the immediate future, however, the market’s recovery will be tempered by continued high unemployment, modest income growth, and a subdued pace of household formations. In other words, the patient is on the way back to health, but don’t expect the housing market to wake up at 98.6 degrees tomorrow morning.”²⁵

- - Frank Nothaft, Vice President and Chief Economist, Freddie Mac

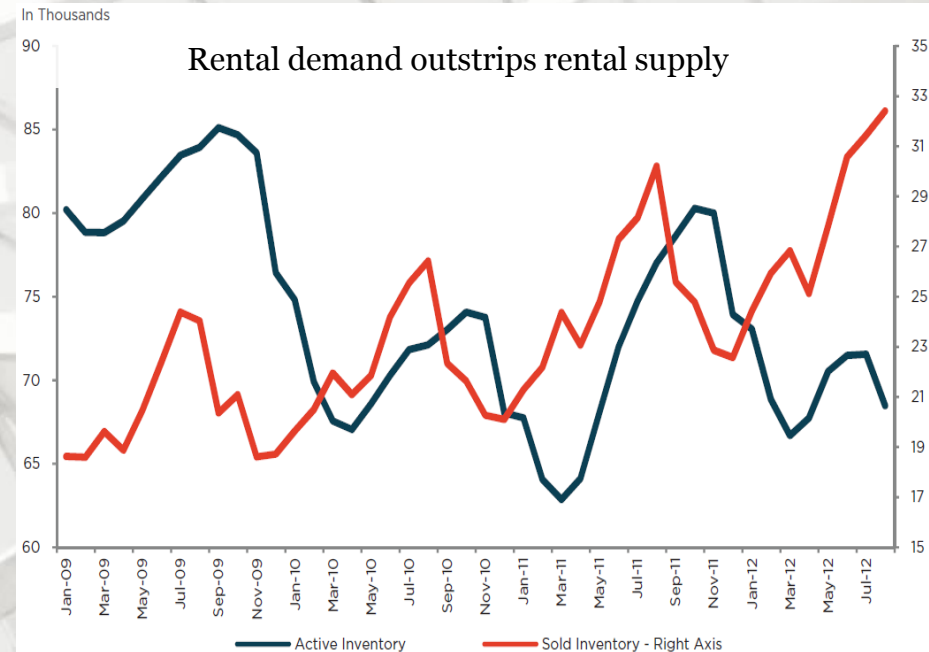
Renter Nation: Single-Family Rentals

Rental month's supply continues to tighten



Source: CoreLogic September 2012

Rental demand outstrips rental supply



Roll Tide, or The Rise of the SF Rental Market

“Nationally, rental leasing volumes were up every month during the last 2-years -- 1 million new renters were added in 2011. Traditionally, analysts have segmented the U.S. residential RE market into SF homes for sale (primarily owner occupiers) and MF rental. While SF rentals (SFR) have always been an important segment of the rental housing stock – 21 mm units (52% of the rental stock), about 1/3 of the 40 million households that rent live in SF units, and the lack of data on SFR properties has resulted in very little research or analytical understanding.

More than 80% SF rentals are owned by SF investors. In the last 2-years, an average of 42,000 rentals have been added monthly to the stock of rental homes. This is more than twice the average flow the country was experiencing prior to the housing recession. ...the negative correlation between rental inflows and SF home prices is evident given the recent increases in the Y/Y CoreLogic Home Price Index.”²⁶

-- Sam Khater, Senior Economist, and Thomas Vitlo, Research Analyst, CoreLogic

Future Building: Multi-Family

“Multifamily Market To Remain Strong Through 2015 With 1.7 Million New Renters”

“The research supports the optimism that currently pervades the multifamily market. It confirms that multifamily is a bright spot in the real estate market and the economy more broadly, and it will likely continue to shine for quite some time. The economic data indicates that current rental markets are very strong with low vacancy rates, rising rents and solid demographic trends. What this research demonstrates is that these conditions are likely to remain in place for several years to come.”²⁷

- - David Brickman, Senior Vice President, Freddie Mac Multifamily

Freddie Mac Multifamily Research Group Forecast Highlights:

- Recent declines in homeownership related to economic stress and high foreclosures in the single-family housing market have benefited the multifamily market.
- The homeownership rate will drop 1 to 2 percentage points if the current slow recovery continues.
- The single-family rental market, a growing and distinct market from multifamily, has expanded 16% (about 3 million units) since 2007.
- Multifamily market demand is expected to be strong through 2015 primarily due to demographic trends and a decreasing national homeownership rate.
- Rental demand will continue to grow faster than historical averages.
- Multifamily demand is likely to be 1.7 million new renter households between now and 2015 (slow growth prediction). If the economic recovery accelerates, demand will be in 1 million new renter range; and if no recovery, then in the 1.6 million range for new renters.²⁷

Future Building: Multi-Family

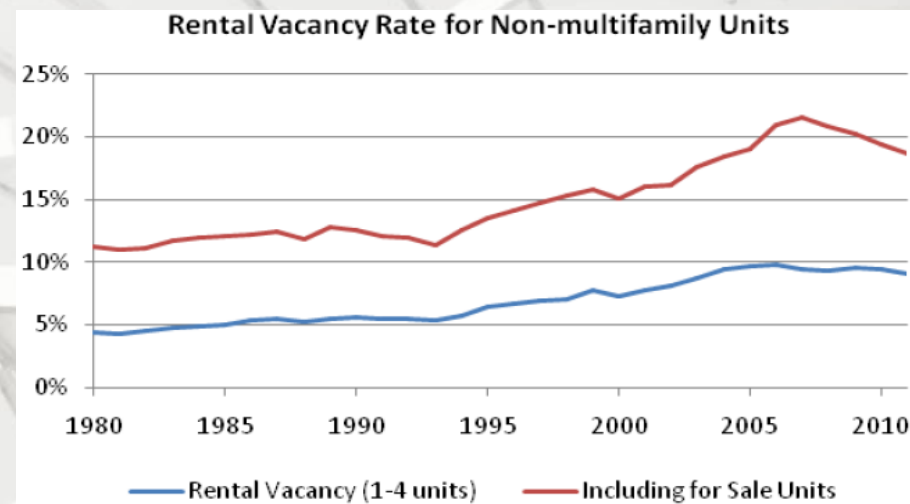
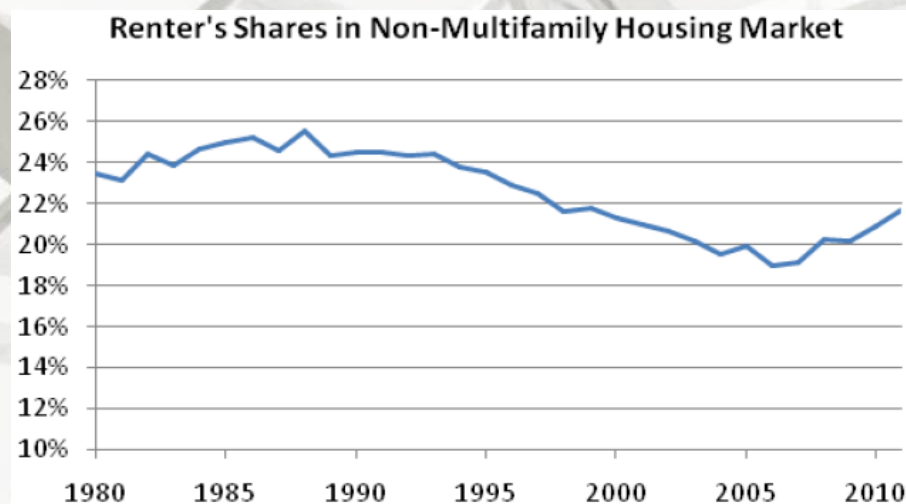
Freddie Mac Multifamily Research Group Demand Forecast:

- Recent declines in homeownership related to economic stress and high foreclosures in the single-family housing market have benefited the multifamily market.
- The homeownership rate will drop 1-2 percentage points if the current slow recovery continues.
- The single-family rental market, a growing and distinct market from multifamily, has expanded 16% (about 3 million units) since 2007.
- Multifamily market demand is expected to be strong through 2015 primarily due to demographic trends and shift in homeownership preference.

Test Scenarios

1. **Base Scenario:** given assumptions consistent with economic growth slightly slower than long run averages, multifamily demand is likely to be in the range of 1.7 million net new renter households between now and 2015.
2. **Accelerated Recovery Scenario:** if the economy recovers more quickly than expected – together with current homeownership affordability – multifamily rental demand will be healthy but more muted because of competition from the owner market. With relative strength in the economy, there are 1.0 million new multifamily renters over the same period.
3. **No Recovery Scenario:** in a stalled economy, households are more likely to choose to rent despite continued high ownership affordability, a scenario nearly as favorable to the multifamily market as our base scenario. The increase in multifamily renters is 1.6 million.²⁷

Future Building: Multi-Family



“...renters are becoming a bigger share of the residential housing market and the share of renters in residential homes is approaching levels that were typical in the 1980s and 1990s (Figure 1).

...renters generally make up more than 20% of the single-family space. This number dropped below 20% when the ownership market was at its peak. Since that time, the renter proportion of the residential market has been increasing towards historical norms (Figure 2).”²⁷

Future Building: Multi-Family

Demographic Trends

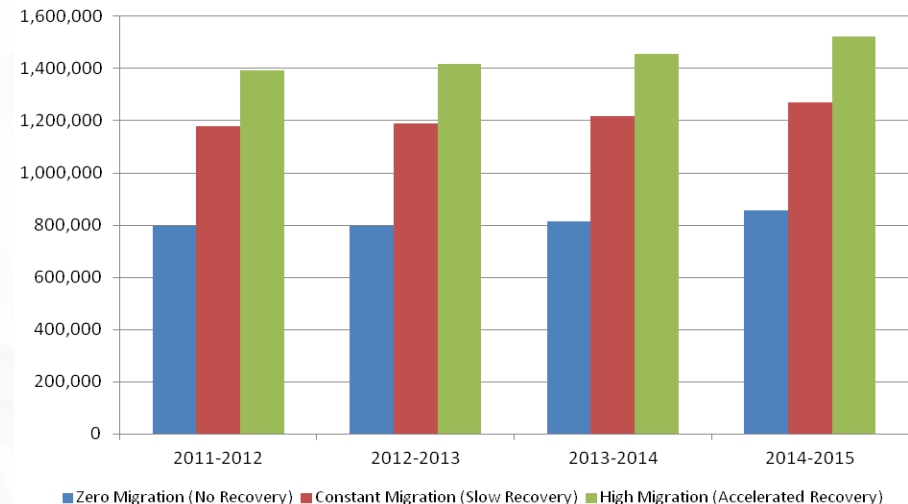
“A key driver of household formation and rental demand is demographic trends. U.S. population growth leads to an increase in the number of households. Reviewing data going back to World War II, the U.S. population average growth rate is 1.2% annually. During the last recession, population growth dropped to its lowest rate in five decades. However, the slowdown has not caused a contraction, just a slower rate of growth. The U.S. population still grew by 2.26 million in 2011 or 0.7% according to the U.S. Census.

International migration is a key element to overall population growth. Net migration is influenced by economic growth. Without a strong economy, immigration also slows dramatically.

Population Forecast

Forecast Scenarios	Population Increase 2011-2015
Zero International Migration	5.6M
Constant International Migration	10.6M
High International Migration	13.3M

Projected Increase of Households



In our slow recovery scenario assuming constant migration in population, we expect approximately 1.2 million new households annually from 2011 to 2015. In the accelerated growth scenario, the economy will grow at a healthy pace and young adults, as well as new immigrants, will form more households. This will contribute substantially to overall household formation and increase the demand for rental units.”²⁷

Future Building: Multi-Family

Housing Supply

“Housing supply relative to demand determines house price and rent levels, which impact homeownership and new development. In 2011, single-family builders delivered 455,000 new units, which is a fraction of the 1.7 million new units delivered in 2006. With some increase in the demand for housing, the number of vacant units declined despite a high number of distressed properties for sale. About 440,000 new 1-4 unit building permits were issued in 2011, which is far below the 30-year average of 1.0 million permits.

Multifamily development also dropped dramatically during the recession, but has since become the leading source of residential construction. New construction starts in the multifamily sector jumped 60% from 2010 to 2011. Even with the jump, starts are still below average over the last two decades, 260,000 units. Considering the lag between construction start and completion, delivery of new multifamily housing will remain at a relatively low level in the short-term.

It will take time for single-family construction to catch up with the long run average of 1 million new units per year. For our forecasting and scenario analysis, we assume the following new single-family housing supply volumes from 2012 to 2015:

1. **No recovery scenario:** a constant 450,000 new single-family units.
2. **Slow recovery scenario:** new single-family units rising from the current level of 450,000 units to 750,000 units in 2015, with an average of 600,000 units per year from 2012 to 2015.
3. **Accelerated growth scenario:** new single-family units rising from the current level of 450,000 units to 1,000,000 units in 2015, with an average of 750,000 units per year from 2012 to 2015.”²⁷

Future Building: Multi-Family

Housing Affordability

“Generally, higher owner affordability pushes up homeownership and decreases demand in the rental market. However, the relationship between economic growth and affordability (and then the multifamily market) is complicated. An improving economy could cause increased house prices, a higher inflation rate, and higher mortgage rates – all of which then lower affordability in the owner market and lead to increased rental demand.

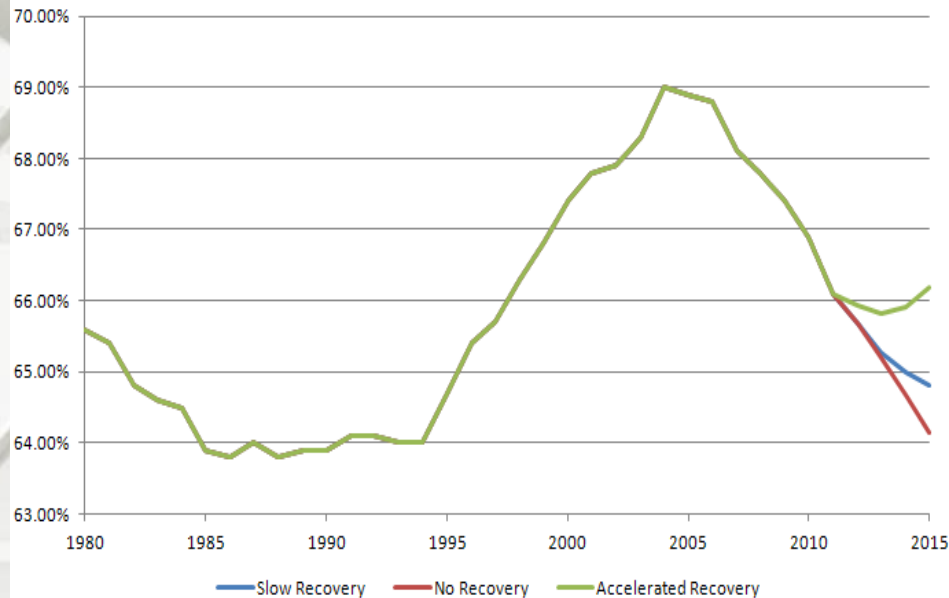
On the other hand, a deteriorating economy will likely increase affordability, but weakness in the economy can slow the decision to buy and, all else equal, increase rental demand. This is why it is important to consider this joint interaction between employment and affordability to provide a comprehensive view when analyzing the future rental market.

In our scenario analysis, we try to capture future housing affordability with assumptions regarding employment, mortgage rates, and household income:

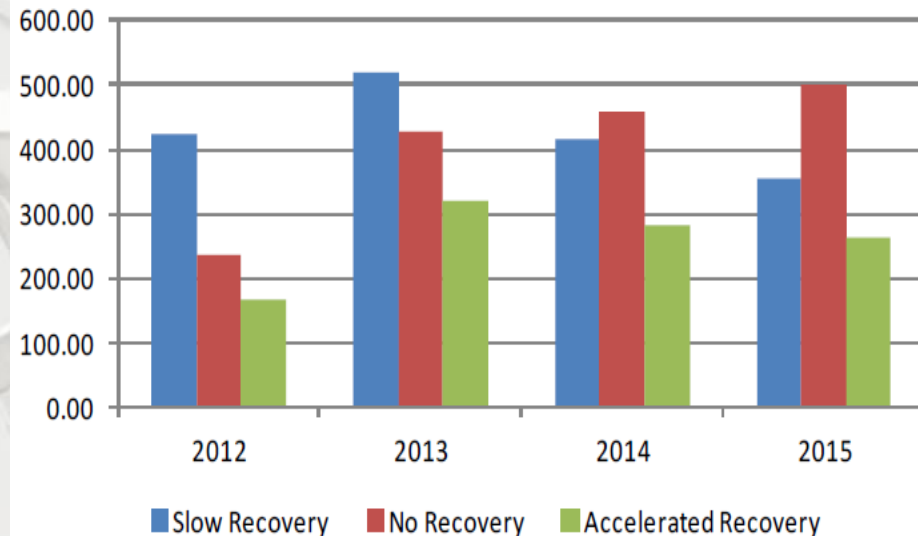
1. **No recovery scenario:** the unemployment rate stays at a high level of 8.3% and housing price does not increase. In this scenario there is no change in the mortgage rate from 2012 to 2015 and there is also no household income growth.
2. **Slow recovery scenario:** the unemployment rate gradually declines from 8.2% to 6.5% with a mortgage rate increase of 1.7% from 2012 to 2015. The single-family housing prices growth also gradually rises to 3% in 2015 with 1% annual household income growth.
3. **Accelerated growth scenario:** the unemployment rate declines rapidly from 8% in 2012 to 5.5% in 2015 with a higher mortgage rate growth of 2.7% during the same period. The house price growth rises to 4% in 2015 with a constant income growth of 3% per year.”²⁷

Future Building: Multi-Family

US Homeownership Rate



New Multifamily Demand
(in thousands unit)



U.S. Homeownership Rate and New Multifamily Demand

“Currently, most industry practitioners, including us, expect overall economic growth to be slower than the long-run average. Given this outlook, we forecast that the homeownership rate will continue to decline to around 65% level, which implies 3.1 million new families or more than half of total new households will move into rental units. Consequently, multifamily demand will be solid with a total of 1.7 million net new renters from 2011 to 2015.”²⁷

Future Building: Multi-Family

Household Distribution Increase by Scenario: 2012-2015

Scenarios	Increase of Homeowners	Increase of Single-Family Renters	Increase of Multifamily Renters
Base Scenario	1.7M	1.4M	1.7M
No Recovery	- 0.1M	1.7M	1.6M
Accelerated Recovery	4.0M	0.8M	1.0M

“In the relatively pessimistic scenario, homeownership will dip from 65.5% (2012 Q2) to 64.1% in 2015. The multifamily market will benefit from this trend despite continued economic stress and lower new household formation. In this scenario, the single-family rental sector is relatively competitive with the multifamily sector due to low house prices and the high foreclosure rate. Total new multifamily demand will still reach 1.6 million from 2011 to 2015.

If the overall economy strengthens quickly, a more optimistic scenario, there will be a rebound in home ownership. In 2015 it will rise to the 1999-2000 level. With expected high population growth, we foresee a modest increase of on average 250,000 units annually in multifamily renters. Unless there is a major jump in multifamily new construction, the multifamily market will still be balanced. However, the single-family rental market will see a significantly smaller increase of an estimated 800,000 households compared to 4 million growth in the ownership market.

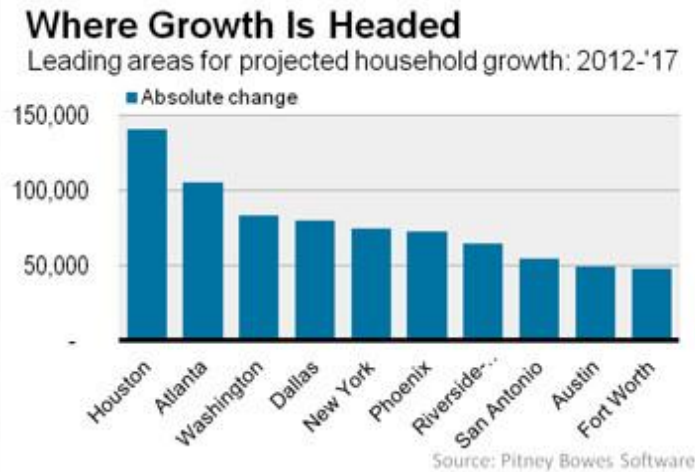
Summary

The analysis considers the impact of single-family rental units on the multifamily rental demand. Under three economic scenarios: slow growth, no growth, and accelerated growth we find the multifamily market will remain solid and healthy through at least 2015.”²⁷

Future Building

“Mapping Where to Build Next”

“Although construction of both homes and apartments is gaining steam, multifamily construction once again far outpaced single-family housing starts this month, in every U.S. region except California, where there are low inventories of single-family homes for sale. Builders are rushing to figure out where to place their chips when it comes to starting new communities and putting shovels in the ground.



Pitney Bowes found that while most of the top 20 places expected to grow fastest in the next five years are the same ones that grew the most last decade. Houston and Atlanta lead the list from both 2000 to 2010 and are expected to top it again for 2012 to 2017. Other areas set to continue seeing big gains are Dallas, Washington, Phoenix, Riverside-San Bernardino, Austin, Orlando, San Antonio and Charlotte. Just six of the top 50 projected growth markets are in the Northeast, the region that showed the weakest construction growth in the latest Census figures, while 16 of them are in the West, the region that has seen the most single-family construction growth. If projections like these are right, they could be a helpful road map for builders.”²⁸

- - Robbie Whelan, Reporter, *Wall Street Journal*

Conclusions

October housing construction data moderated, which typically begins this time of year. All of the major indicators: Permits, new and existing house sales, housing starts, and completions are at higher levels – nonetheless, they are substantially below long-term averages. The numbers of new and existing houses for sale continue to decline and are at historically low-levels. Interest rates are at historically low-levels – these also are a positives for the housing market.

The remodeling sector, even with September's permits decline, appears to be a promising and steadily increasing market. Many “Boomers” are concerned about their retirement as they have their children (some even with their parents) living with them. It is projected that many Boomers will not become “move-up” buyers and/or even may delay a move to a retirement home.²⁹ Potentially, these Boomers could opt to remodel their home to accommodate aging, or add “Granny” rooms, or bonus rooms for their children.³⁰

Apparently, first time buyers are a decreasing entity in home purchases – this possibly can be attributed to: 1) strict lending standards (and they are becoming more stern³¹) and 2) those burdened with student debt. We realize that the bulk of student debt is in the “less than \$25,000” category; but, if you are unemployed or underemployed, any debt can be perceived as a “millstone” around one's neck. Third, first time buyers are confronted with affordability and home ownership costs.³² There are some who disagree with these assessments, as the findings from a recent survey of Millennials indicated their desire to own a house.³³

Source: ²⁹<http://freddiemac.mediaroom.com/index.php?s=12329&item=135347>; 11/14/12;

³⁰www.nytimes.com/2012/11/30/us/building-homes-for-modern-multigenerational-families.html?hp; 11/29/12

³¹ www.housingwire.com/content/average-fico-ltvs-show-credit-may-be-harder-come; 11/20/12

³²www.mortgagenewsdaily.com/11152012_housing_insights.asp, 11/15/12;

³³www.newgeography.com/content/003259-millennials-ready-play-key-role-housing-market-recovery?; 11/26/2012

Conclusions

Freddie Mac projected multi-family starts under three different economic conditions – in all three analyses, multi-family housing is forecast to remain strong. They also projected single-family starts; even in the best economic scenario single-family housing is not expected to become robust until 2017. This coincides with private economists projections that we have reviewed. So, where are we?

From our viewpoint, the housing market is healing, but our near-term outlook on the U.S. housing market remains unchanged (again) – there remain too many potential negative macro-factors at this point in time for a robust housing recovery. Why?

- 1) Consumer confidence – decreased in the latest report,
- 2) a lack of well-paying jobs,
- 3) a sluggish economy
- 4) declining real median annual household incomes, and
- 5) strict home loan lending standards.

We could be completely wrong – there is the old adage, “Don’t fight the Fed.” Clearly, the Federal Reserve Bank is focusing on the housing market by providing ample liquidity via mortgage purchases and with ultra low interest rates. Until next month.

We wish you all Happy Holidays.

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