

Housing comments –August , 2013

Still lots of headwinds to deal with:

- economy is getting better, albeit very slowly
- government debt issues – all levels of government – exacerbates the job problem
- Much of Europe in recession , but getting better – China is slowing too
- Housing's main problems - Weak domestic economy made worse by slowing world economy; weak job market; weak income growth; high debt levels; and tight credit environment

- Demand , Debt and uncertainty are some of serious problems that are impacting the economy – but, getting better
- Three major concerns going forward –
 - (1) can the economy (and housing) stand on its own (without Fed stimulus) ???
 - (2) Uncertainty is key reason holding back job creating investments . Ex., impact of health care legislation; Dodd/Frank; dysfunctional “Washington”;
 - (3) Will rising rates derail the housing market?
- Longer term – what will be the mix of single family versus multi family?
- Will people continue to live in the suburbs?
- What happens to house size?

Some questions going forward:

(1) Sustainable housing recovery?

(2) Economy – Inflation; deflation; or disinflation?

**Hyper Inflation from running the printing presses
for past 3 – 5 years**

Deflation – 1930's – weak demand

Disinflation – slower rate of inflation

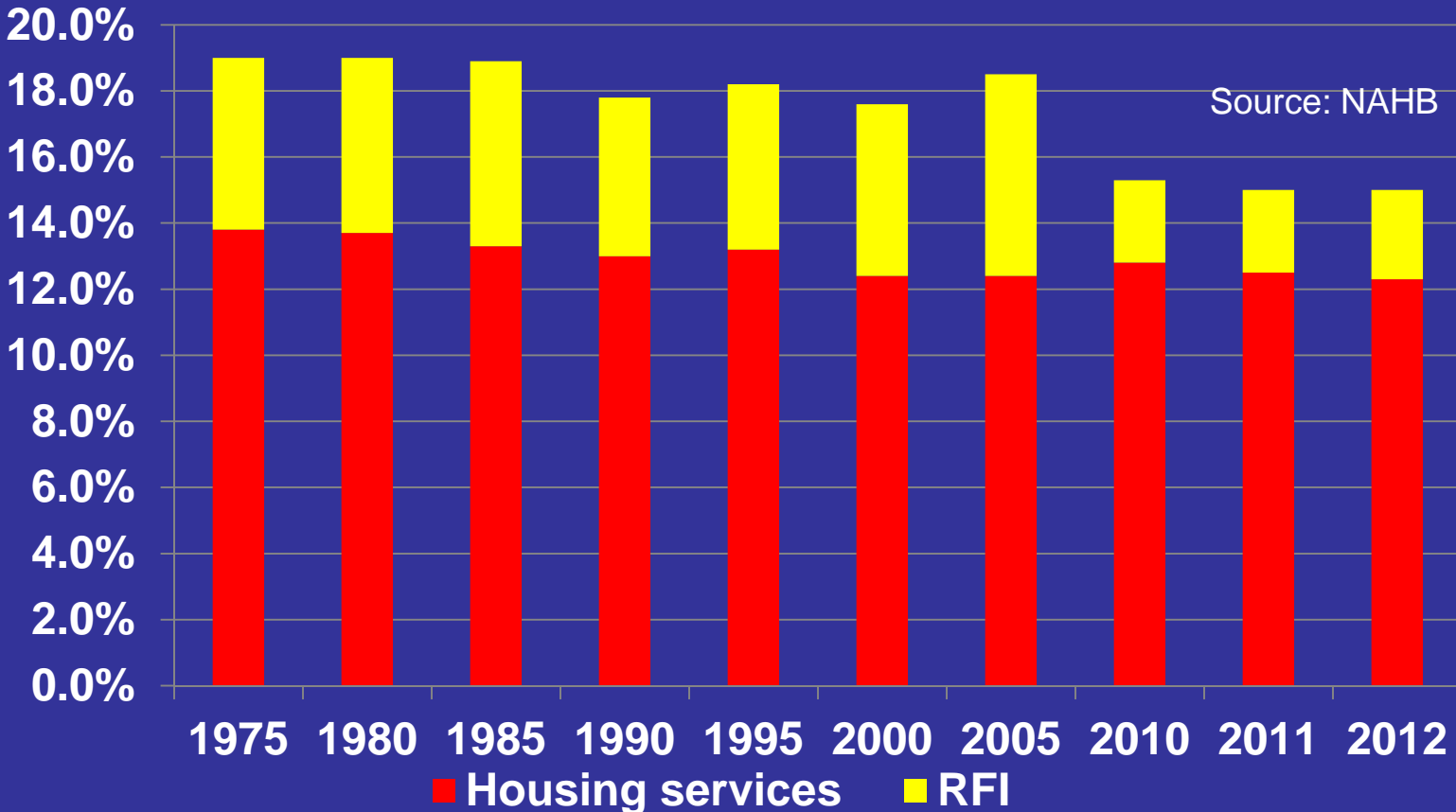
**(3) What kind of housing market will we get? My guess
is more multi family; smaller single family homes;
and more people (young people and retired) will
choose to live in the city (e. g., suburb living not as
popular anymore).**

Housing, Economy, and wood products

They are “joined at the hip”

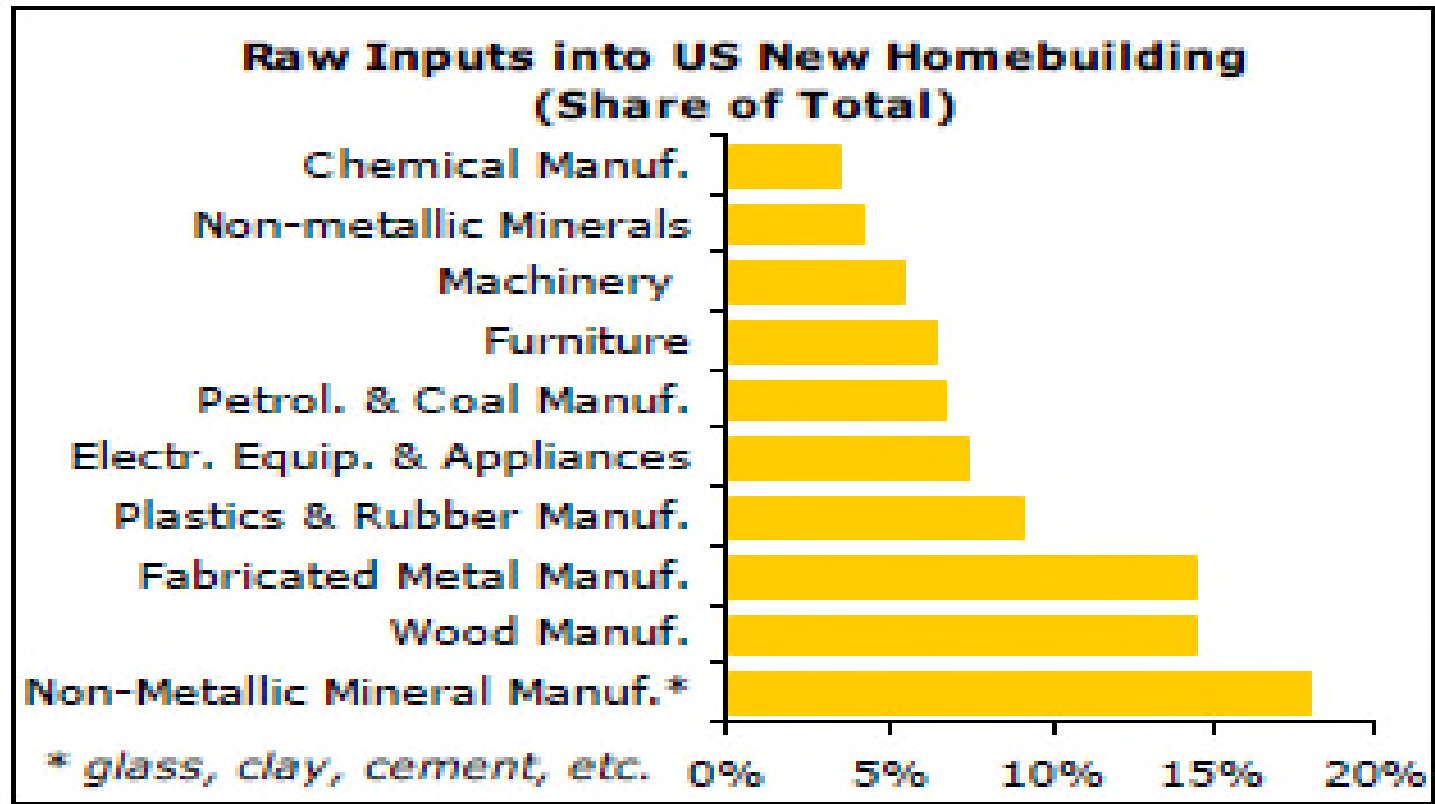
Housing's contribution to GDP (%) – historically, it is almost 20% of the economy when you include housing services and fixed investment, but today it is down to 15%. In reality, it is even more important when you include purchased furniture, landscaping, general maintenance, etc. key reason why the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

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



Housing is important to wood products, but other Products benefit too

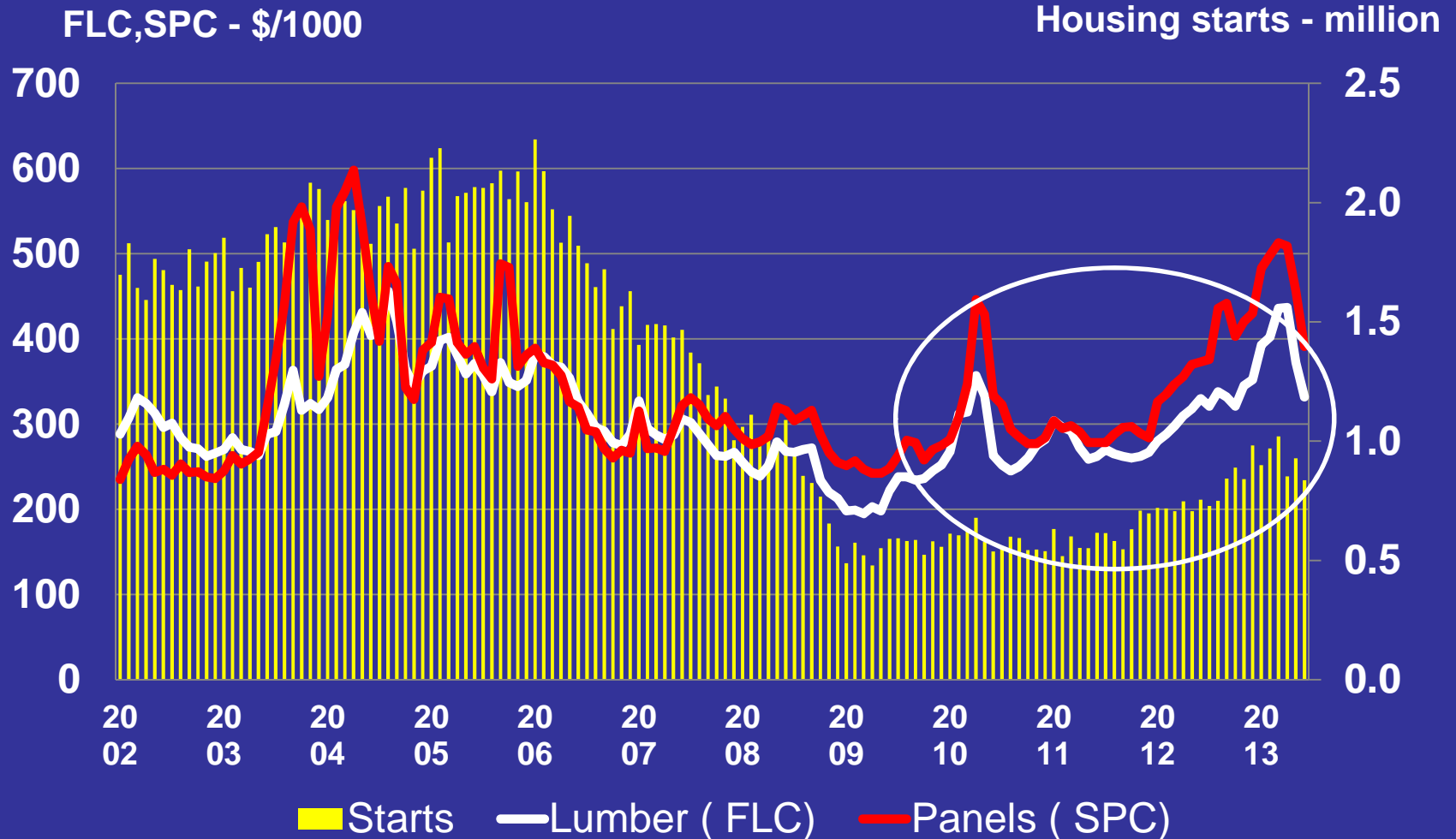
US Homebuilding: Not Just Lumber



Source: US Bureau of Economic Analysis, CIBC

Housing starts and wood product prices – Economics 101

Following housing bust in 2008, wood prices fell and production capacity was reduced. So, when housing starts increased, there was an imbalance between demand and supply of wood products. The price mechanism brings demand and supply into balance. Initially, prices fell almost 50% - this instigated production cutbacks of 50% or more - then, as housing begins to turn around, prices increase - this encourages production increases for wood products - and the cycle starts over.



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

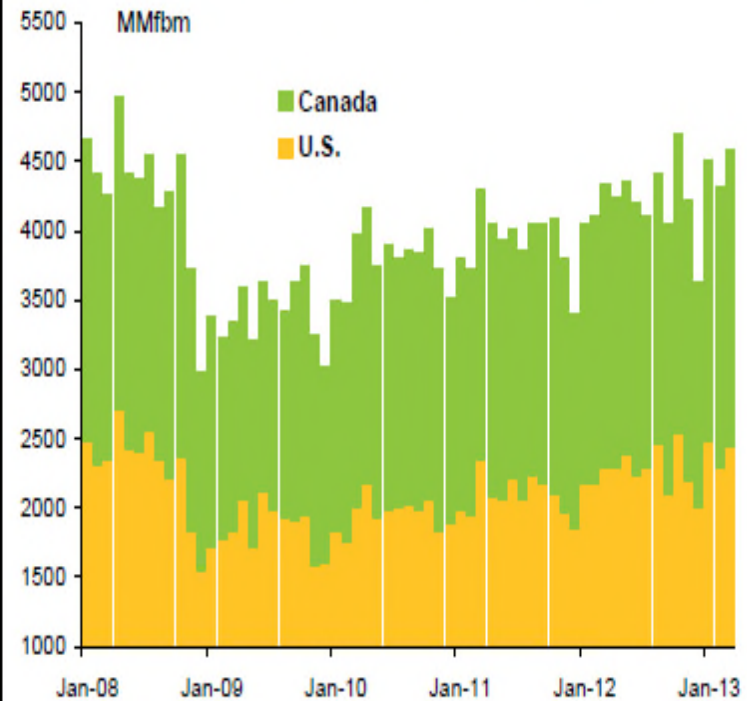
North American Lumber Shipments and Production

NORTH AMERICAN LUMBER SHIPMENTS



Source: Forest Economics Advisors, International Wood Markets Group, TD Securities

NORTH AMERICAN LUMBER PRODUCTION



Source: Random Lengths, Forest Economic Advisors, TD Securities

British Columbia's Lumber Supply projected to fall 40% (Impact of Mountain Pine Beetle Infestations)

| | <u>AAC</u> | <u>Lumber production</u> |
|-------------|----------------|----------------------------------|
| 2005 | 68 MMCM | 15 BBF |
| 2013 | 59 MMCM | |
| 2018 | 40 MMCM | 9 BBF - - <u>40% drop</u> |

BC's share of NA production ~ 20- 25%

A 40% drop in BC ~ 8 – 10% drop in NA production

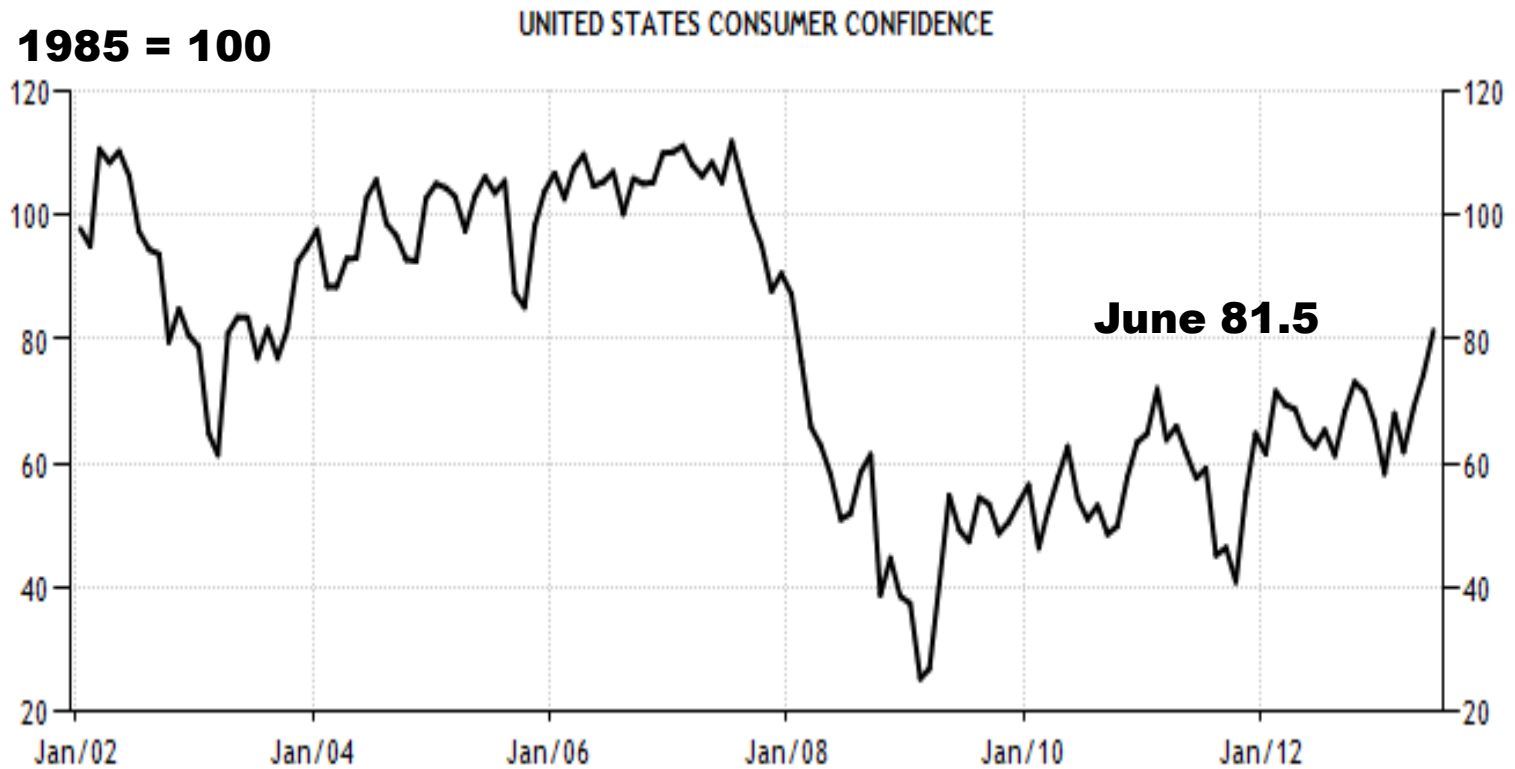
This has to impact lumber pricing

Wood product pricing should be solid for the next two years or so due to - -

- (1) improving domestic housing market and export**
- (2) demand for wood products outstrips supply as previous production cutbacks catch up with demand**
- (3) structural products (framing lumber, OSB, plywood), and hardwood based products like furniture, kitchen cabinets, flooring, all benefit from residential construction including new construction plus remodeling.**

Consumer Confidence at 5 year high – good news

As consumer spending is 70% of the economy



SOURCE: WWW.TRADINGECONOMICS.COM | THE CONFERENCE BOARD

Source: (<http://www.tradingeconomics.com/united-states/consumer-confidence>)

Although confidence is up, Wages continue a disturbing Downward trend

Stagnant wages

● Real median household income



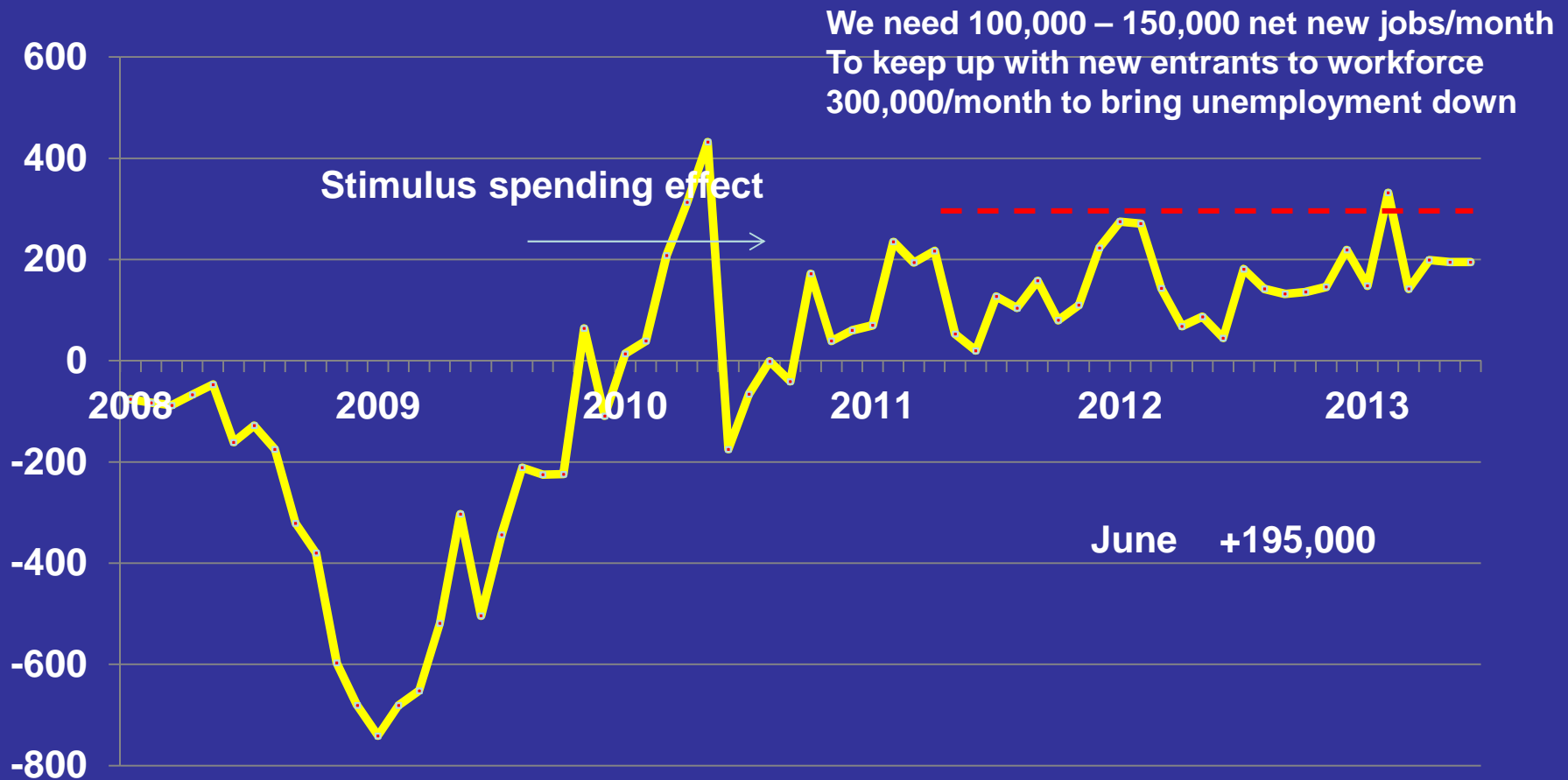
Source : Sentier Research

Employment situation - our biggest problem - it's getting better, but the jobs recovery remains weak by past standards, and many jobs

Don't include health care or retirement benefits (because they are

Often part time jobs) – those kinds of jobs don't encourage people to buy houses

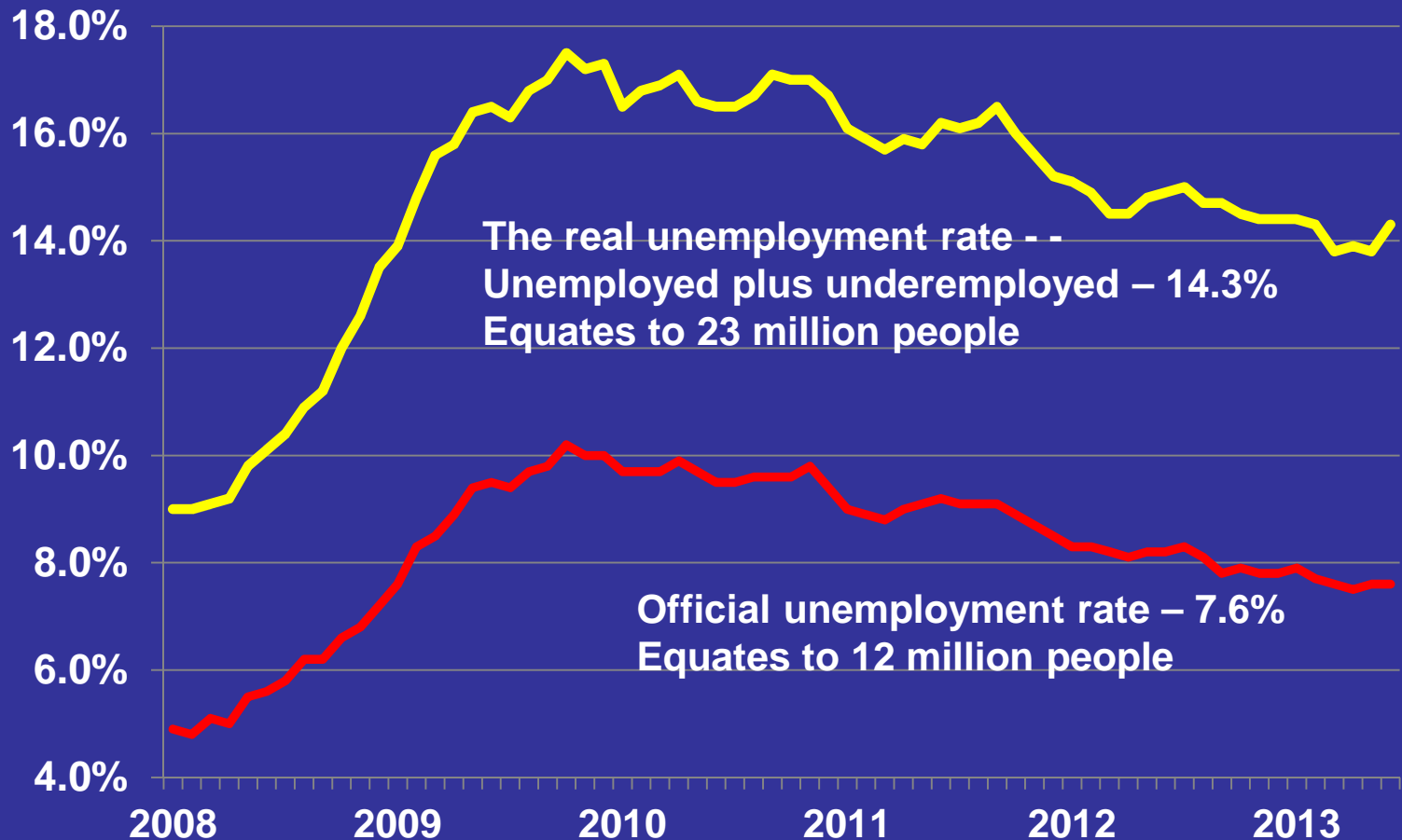
Net change in non farm payrolls – monthly, thousands



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

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

**There are about 23 million people either unemployed, underemployed, or stopped looking – they are not buying houses

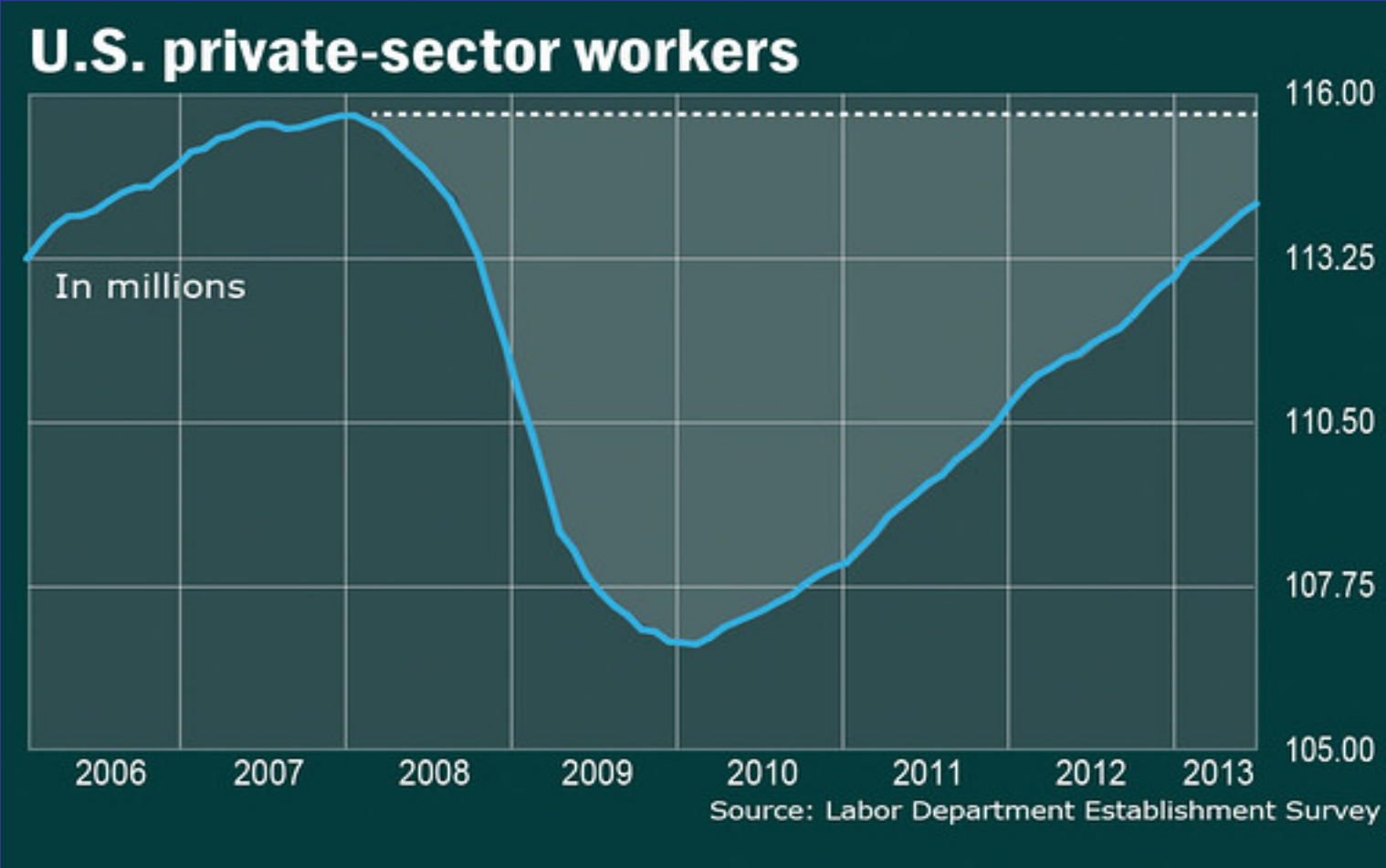


Jobs growth

In thousands, seasonally adjusted



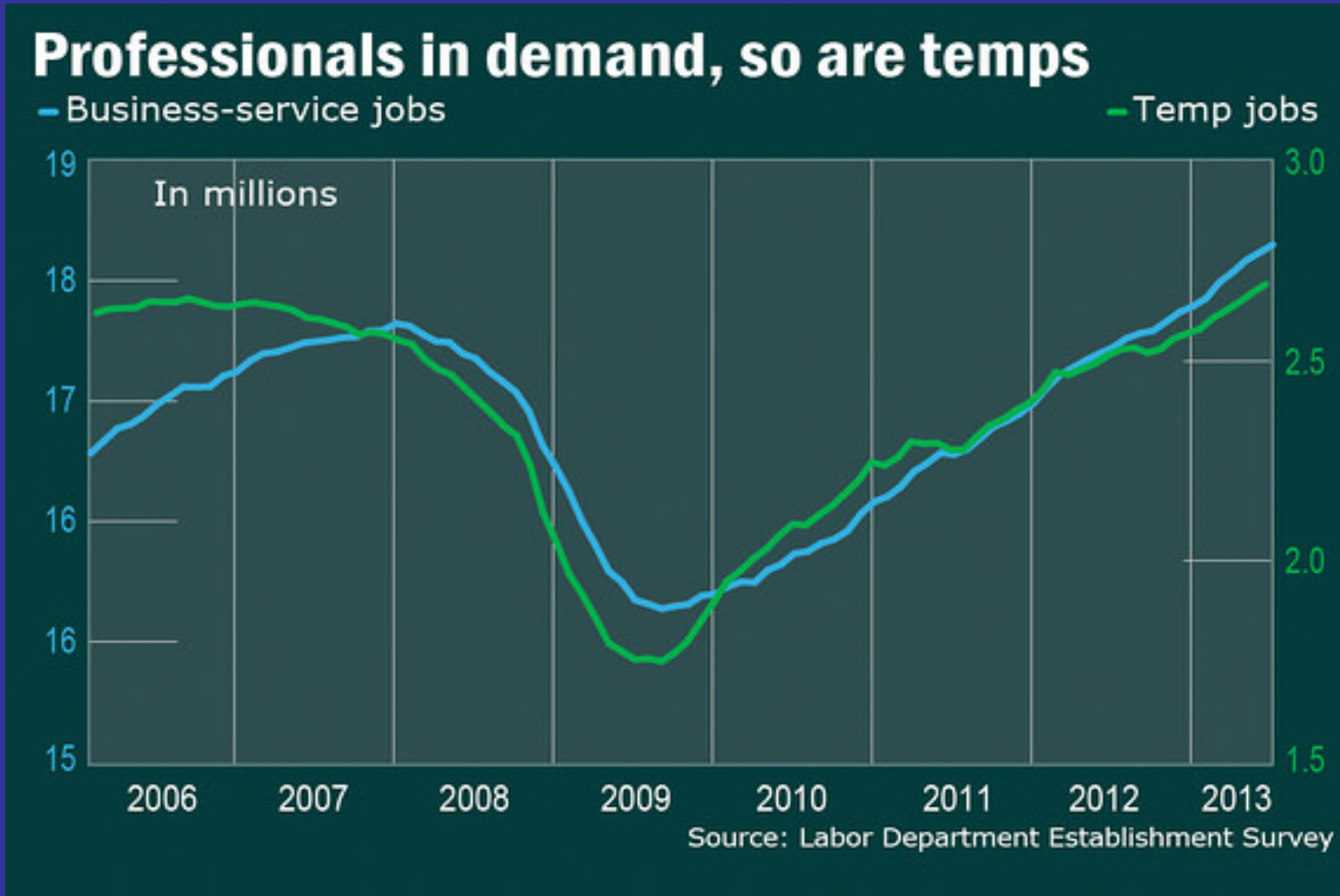
Employment - - We're still 2.5 million below pre recession levels



Source: marketwatch : (<http://www.marketwatch.com/Story/story/print?guid=5C9788D6-FB68-11E2-A97E-002128040CF6>)

Where the growth is - -

30% of jobs created in past 5 years are “temporary jobs”

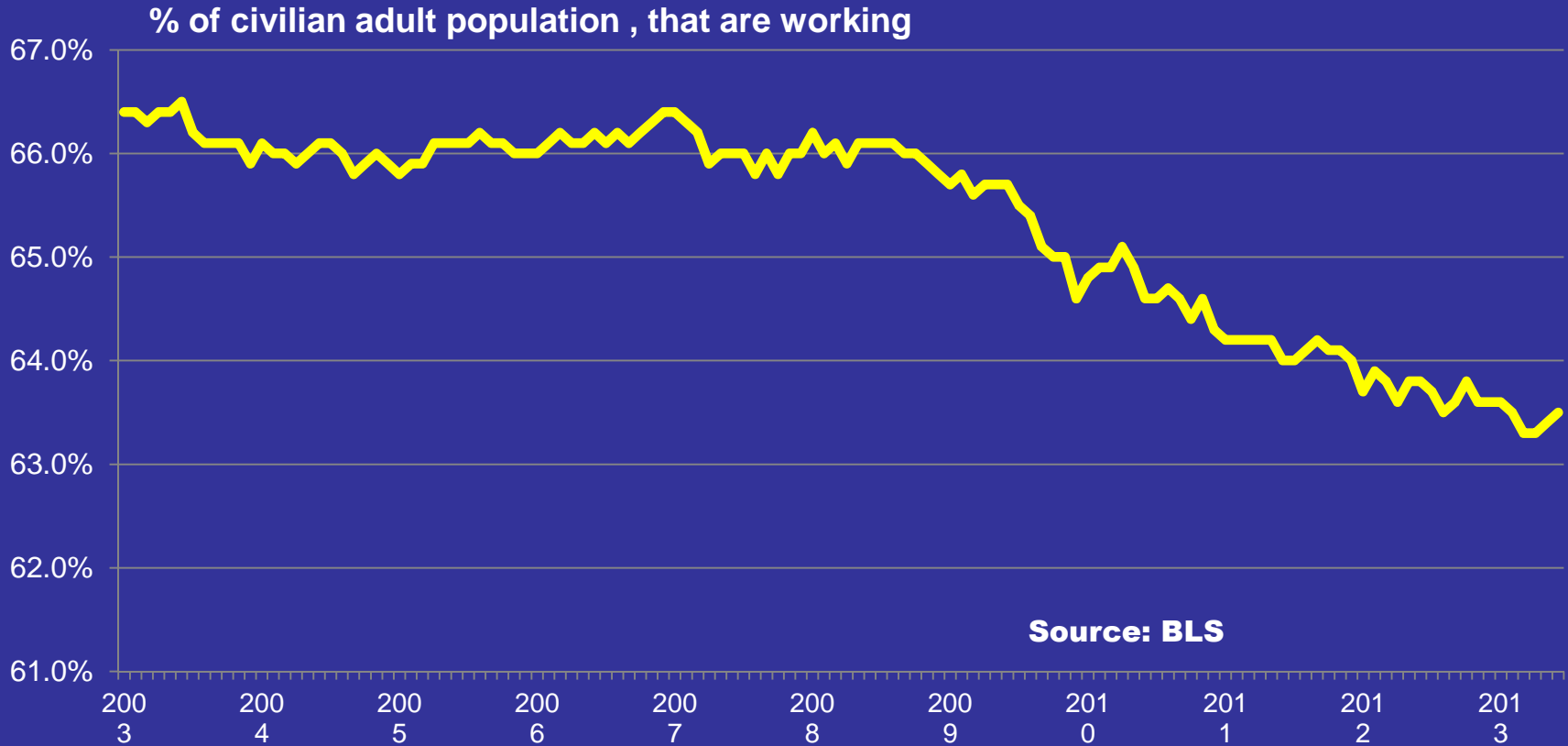


Source: marketwatch : (<http://www.marketwatch.com/Story/story/print?guid=5C9788D6-FB68-11E2-A97E-002128040CF6>)

Other economic issues –

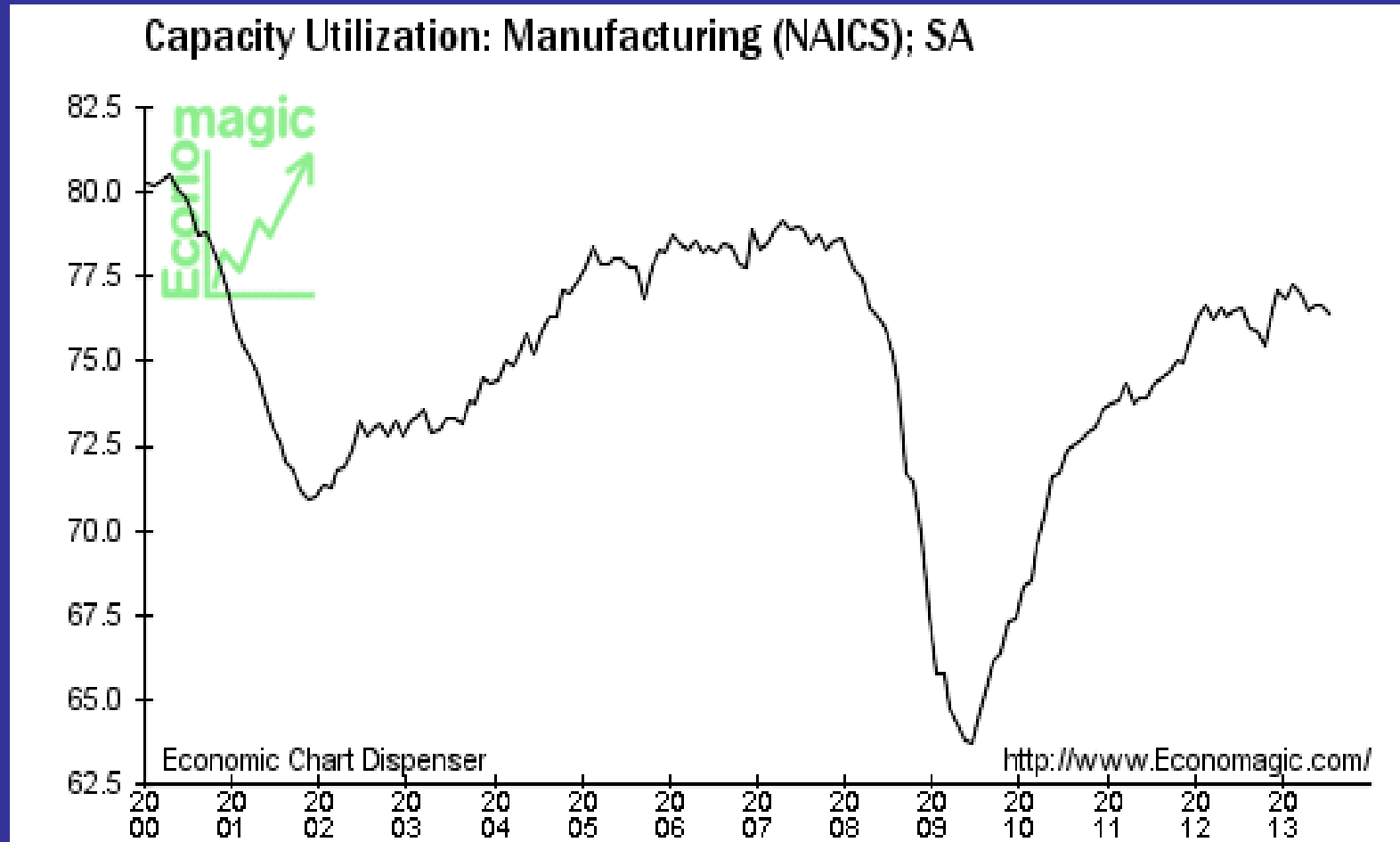
- **The workforce is shrinking and Labor force participation rate is lowest since WWII
Some implications – more problems funding social programs**
- **Capacity utilization remains below 80% - that means firms won't invest and that means weak job growth (and weak income growth)**
- **Inflation not a problem yet**
- **Going forward, unemployment will be a huge drag on the federal (and other government levels) budgets – implications for taxes, spending, domestic programs, and job creation**
- **Major questions going forward are inflation, disinflation, deflation, or continued weak growth (disinflation is weakening inflation (i.e., today) whereas deflation is general fall in prices (i.e., 1930's). My guess is continuing weak growth (less than 3% GDP) with moderate pick up in inflation . There are too many headwinds for stronger growth, and deflation is just too ugly to contemplate.**

Labor force participation rate is shrinking - Major problems for social programs with our aging population – fewer people paying taxes, but more people collecting SSI, Medicare, etc.



Inflation not a problem yet

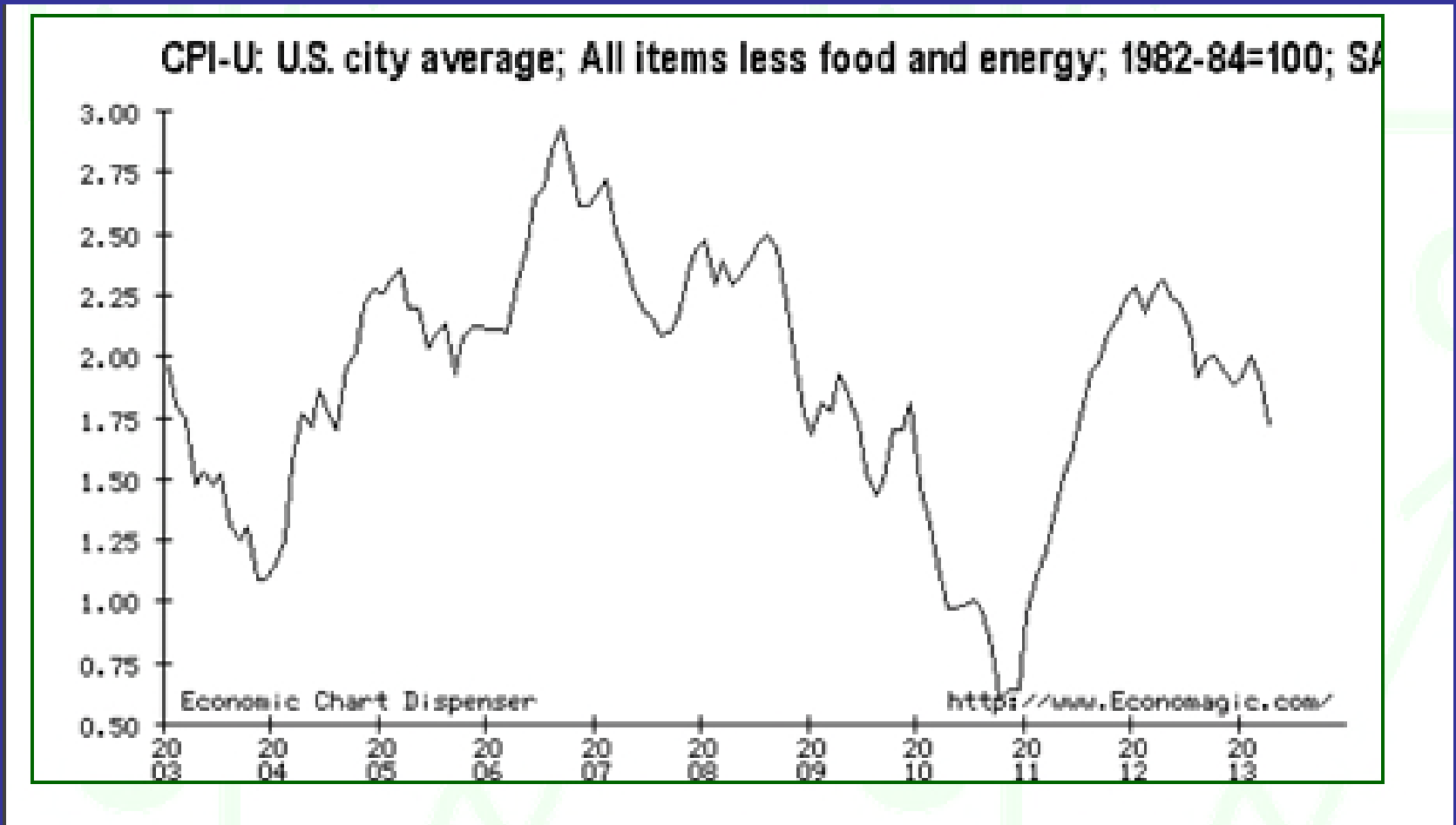
Manufacturing Excess Capacity: Until we get back to 80%, Firms won't invest in new capacity – that means weak income growth and continuing employment problems – but, it's getting Better!!



Inflation not a problem yet

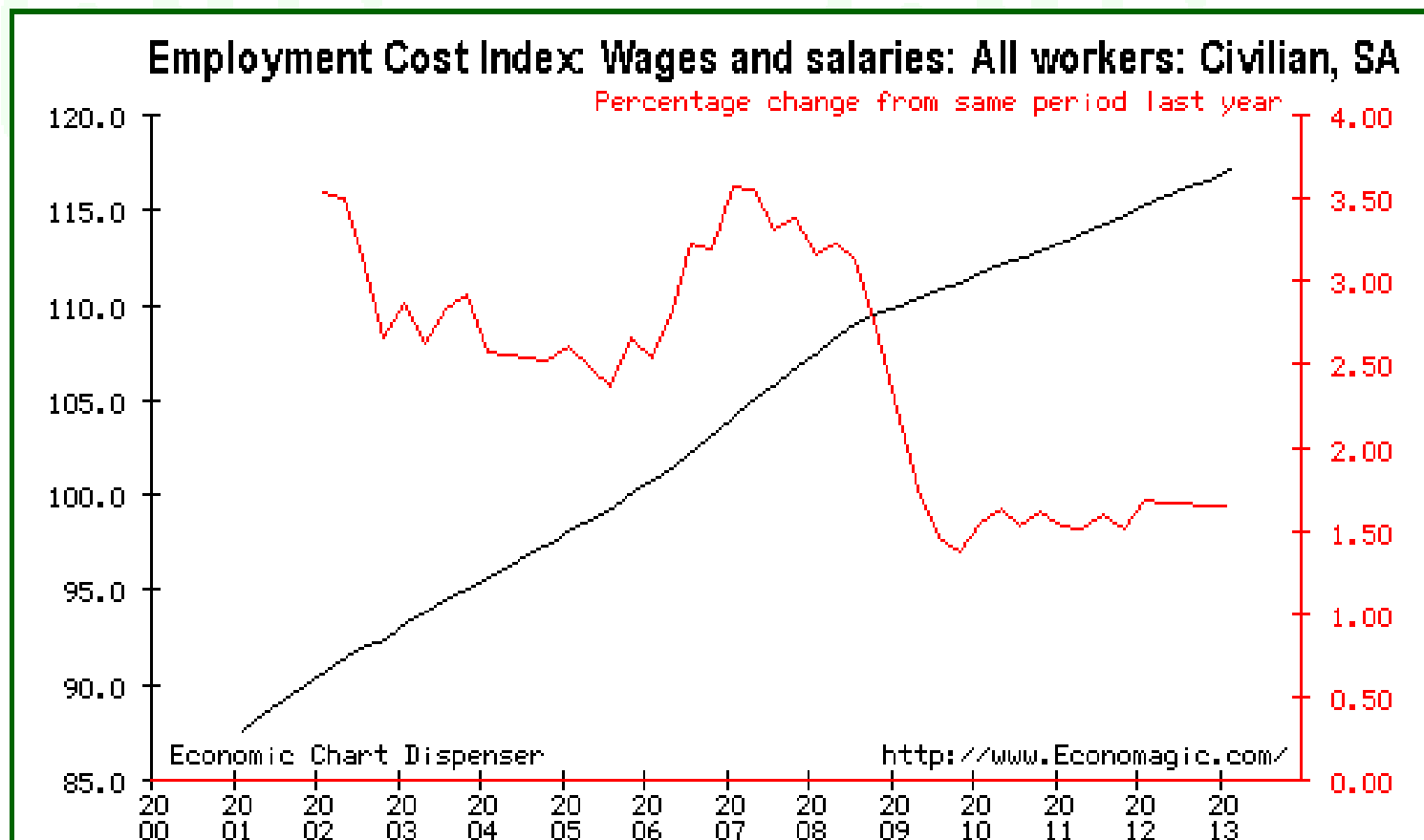


Core Inflation (year over year) not a problem either

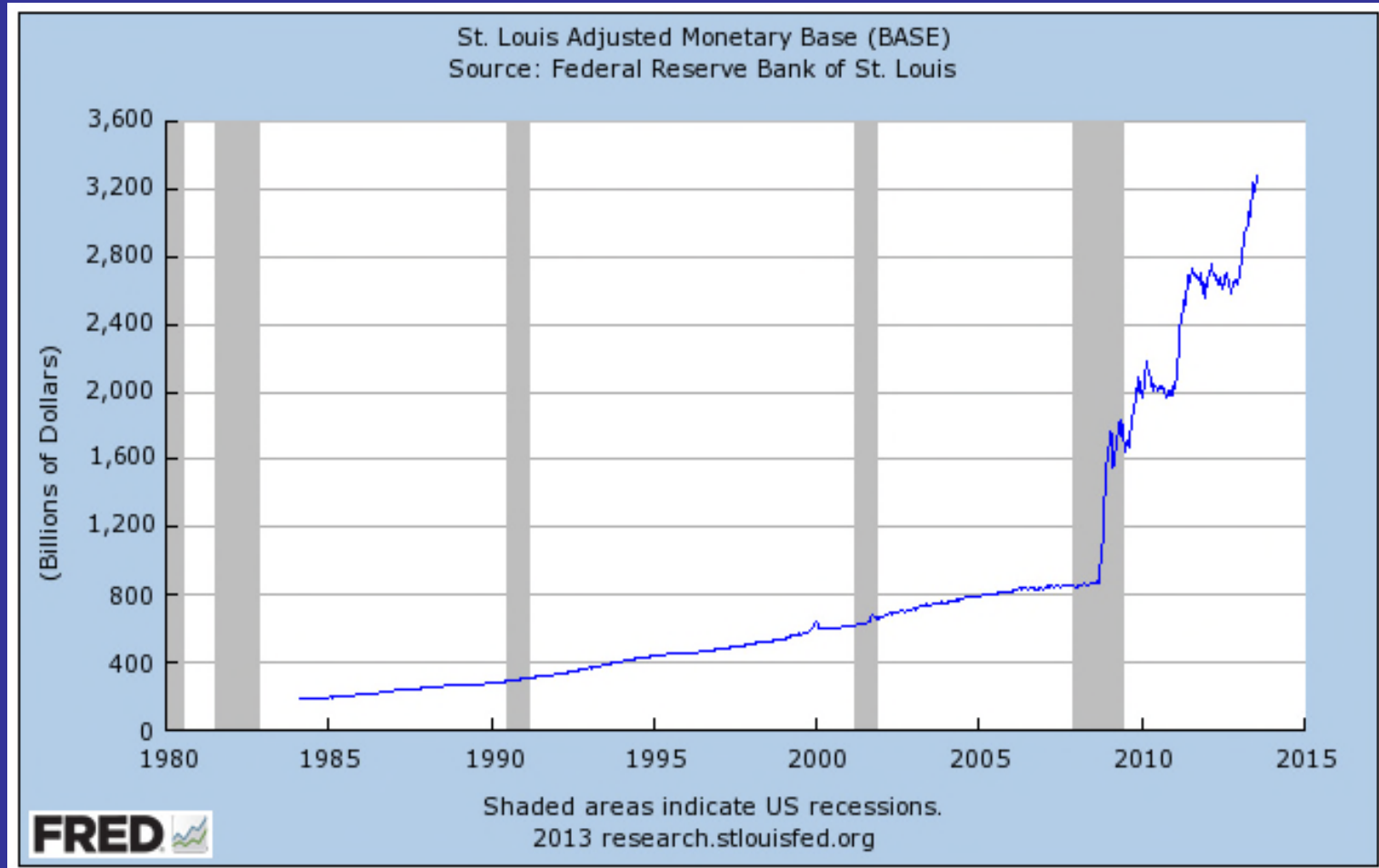


Source: Economagic (<http://www.economagic.com/em-cgi/daychart.exe/form>)

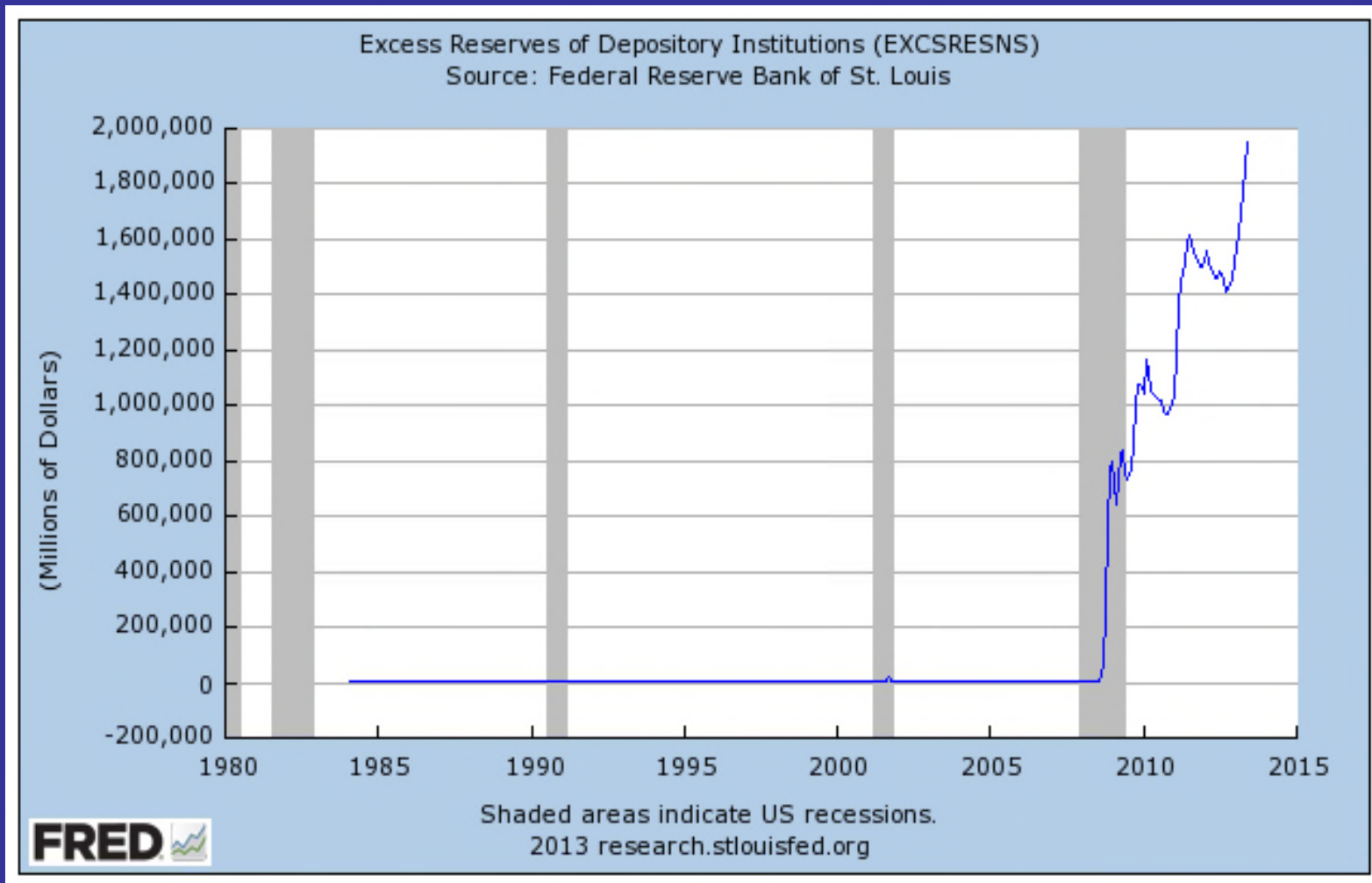
Wages are main source of inflation – this chart suggests that Inflation is not a problem yet! (focus on the red line) – believe It or not, some inflation is good – it suggests that demand is strong



QE1,2,3 – FED “money printing”



QE is not causing inflation because most of the \$ remain as Excess reserves with the banks – i.e., they are not lending The money!!!



Some additional housing headwinds

A. This economic recovery is much slower than Previous ones

Why

- (1) This recession was a financial recession**
- (2) Previous ones were typical economic recession (i.e., economy overheats, the Fed increases interest rates to cool things down,**
- (3) Financial recession are more serious and require more time to heal damaged credit, etc.**

B. And, mortgage rates are trending upward as the Fed pulls back on QE/money printing

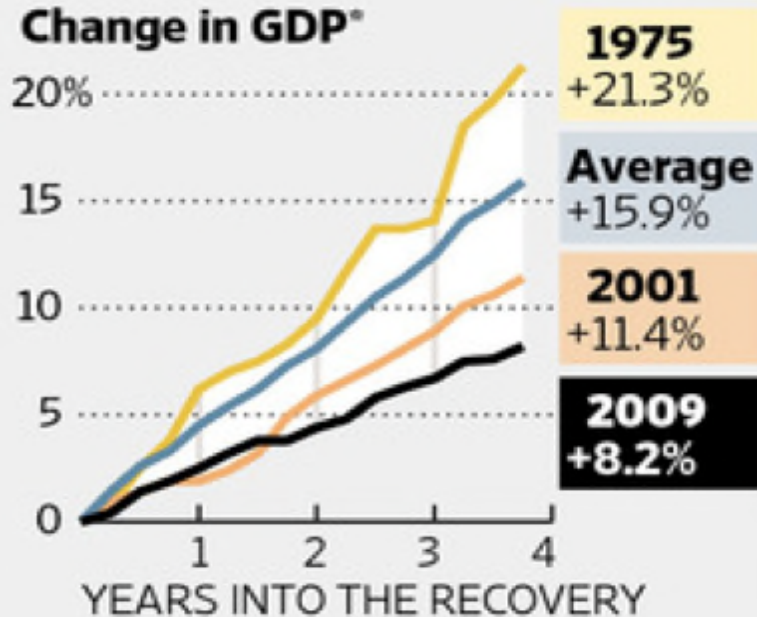
A comparison of GDP growth following recessions

Recovery from this recession much slower

Slow Climb

The economic rebound has been slower than the average between 1970 and 2008.

Change in GDP*



*GDP is annualized and adjusted for inflation and the seasons. Source: Commerce Dept.

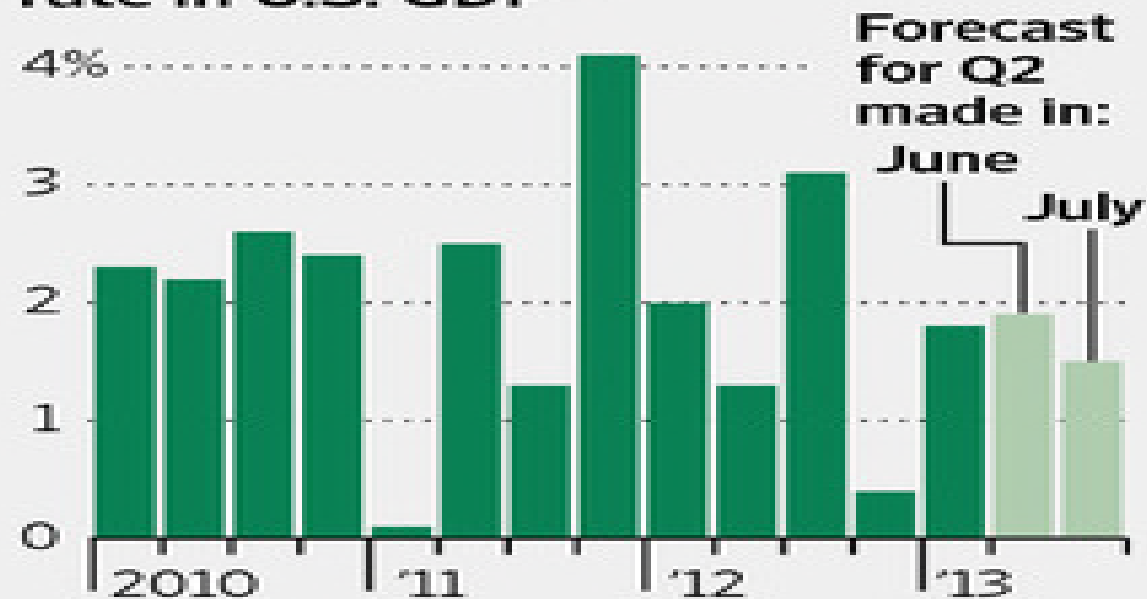
The Wall Street Journal

Source: Wall Street
Journal
(<http://online.wsj.com>)

And, Analysts continue to reduce outlooks for 2013

Lower Expectations

Quarterly change at an annual rate in U.S. GDP*



*Adjusted for inflation and the seasons

Source: Commerce Department (GDP);

WSJ survey of economists (forecasts)

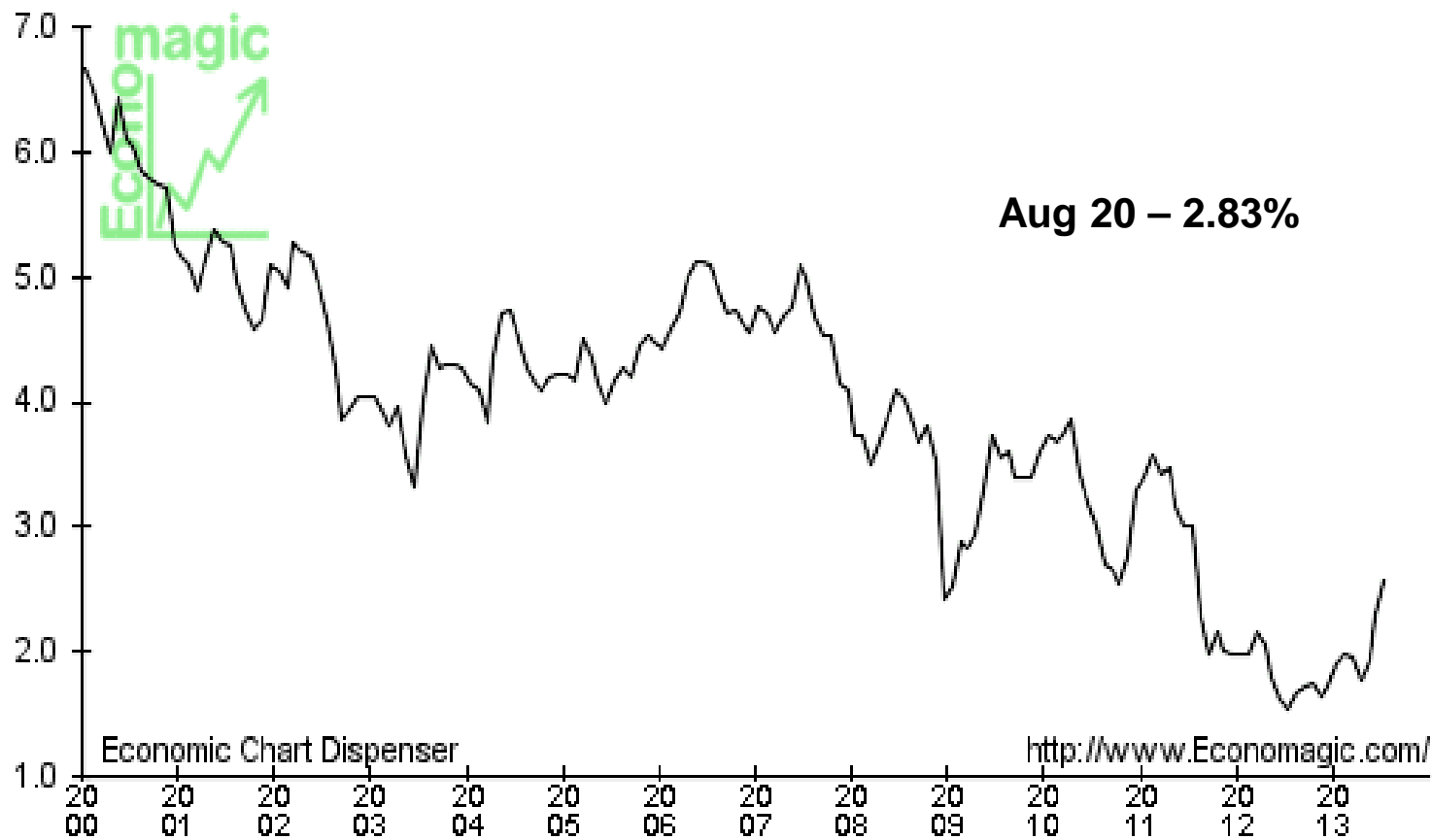
The Wall Street Journal

**Higher Mortgage rates on the way -
Actually good for housing – it forces many people
To “get off the fence” and , anyway, rates are still historically low.**



How long can we realistically expect 10 year rates To stay below 3%? c'mon!!

10-year Treasury Constant Maturity



Recent Housing statistics

Background:

Markets are getting better –

Have we turned the corner? – Probably, but

The climb back will remain muted

Until we see economic growth of 3% or

More for an extended period of time!!!

Starts are finally turning the corner??

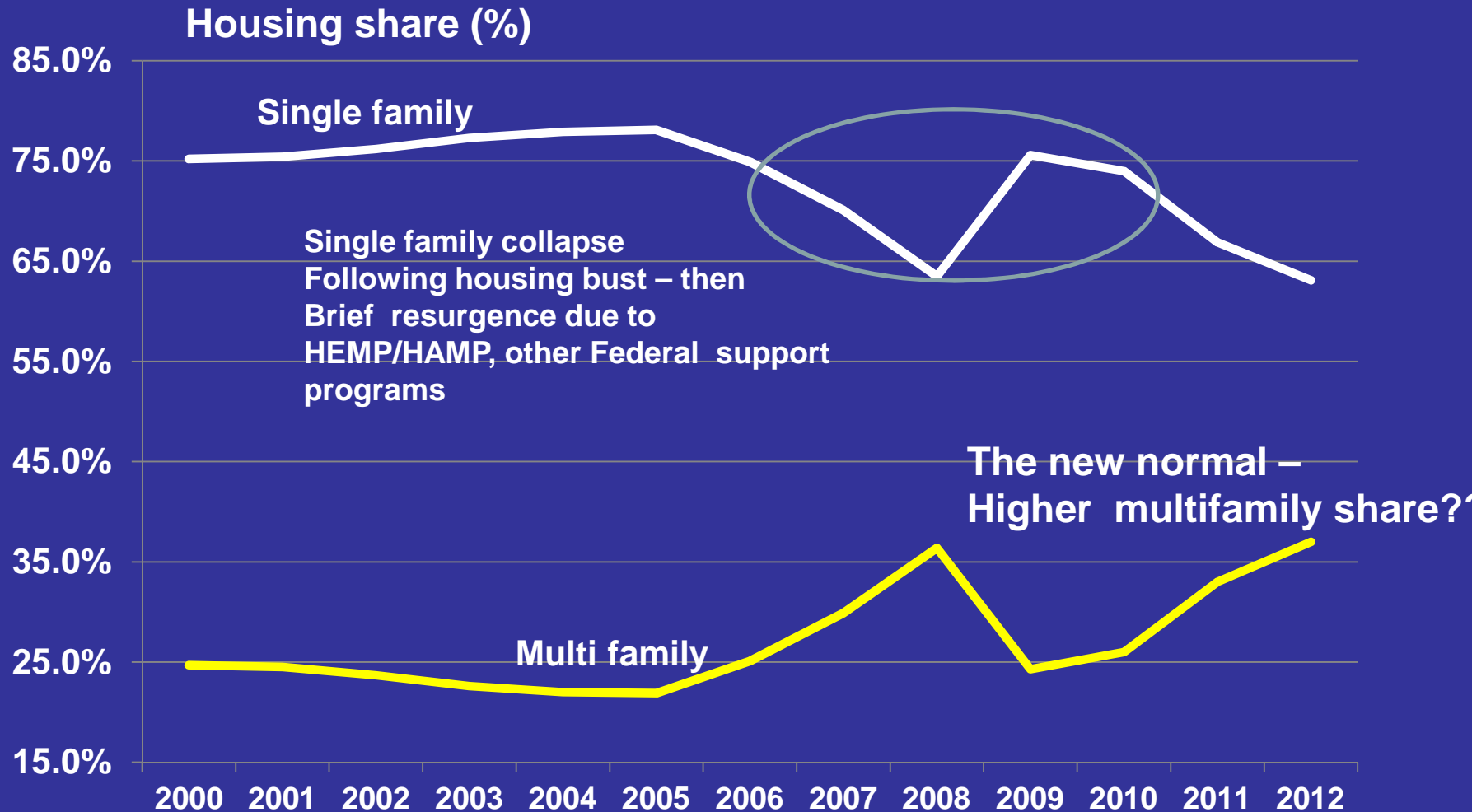
Problems going forward: distressed resales (i.e., foreclosures) and jobs. Rising prices will moderate the foreclosure problem while good paying jobs will create demand – this will take more time!!

Single family starts, Thousand units, SAAR

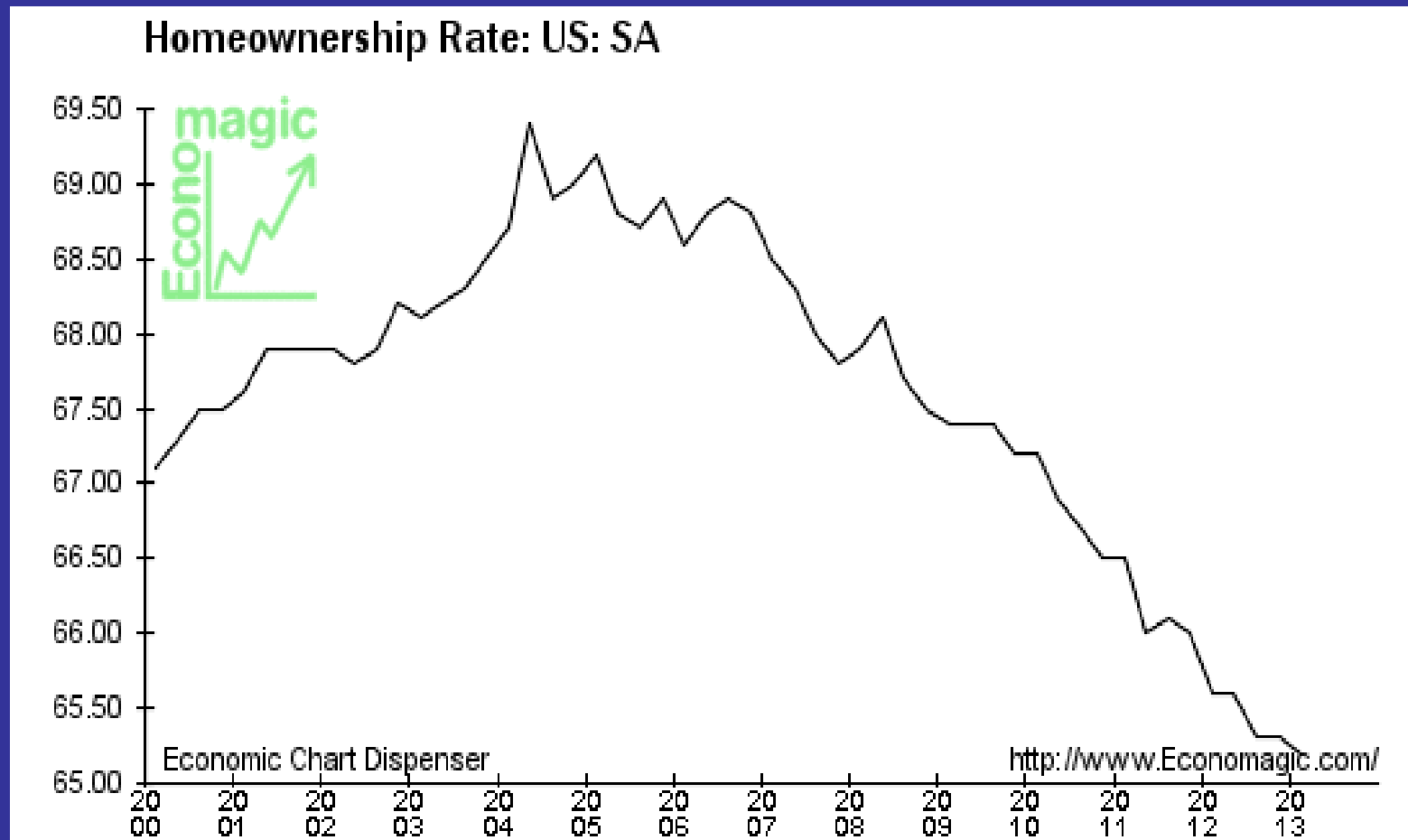


Source: Census (<http://www.census.gov/const/www/newresconstindex.html>)

Multi family share is increasing – will it continue? I believe it will!!



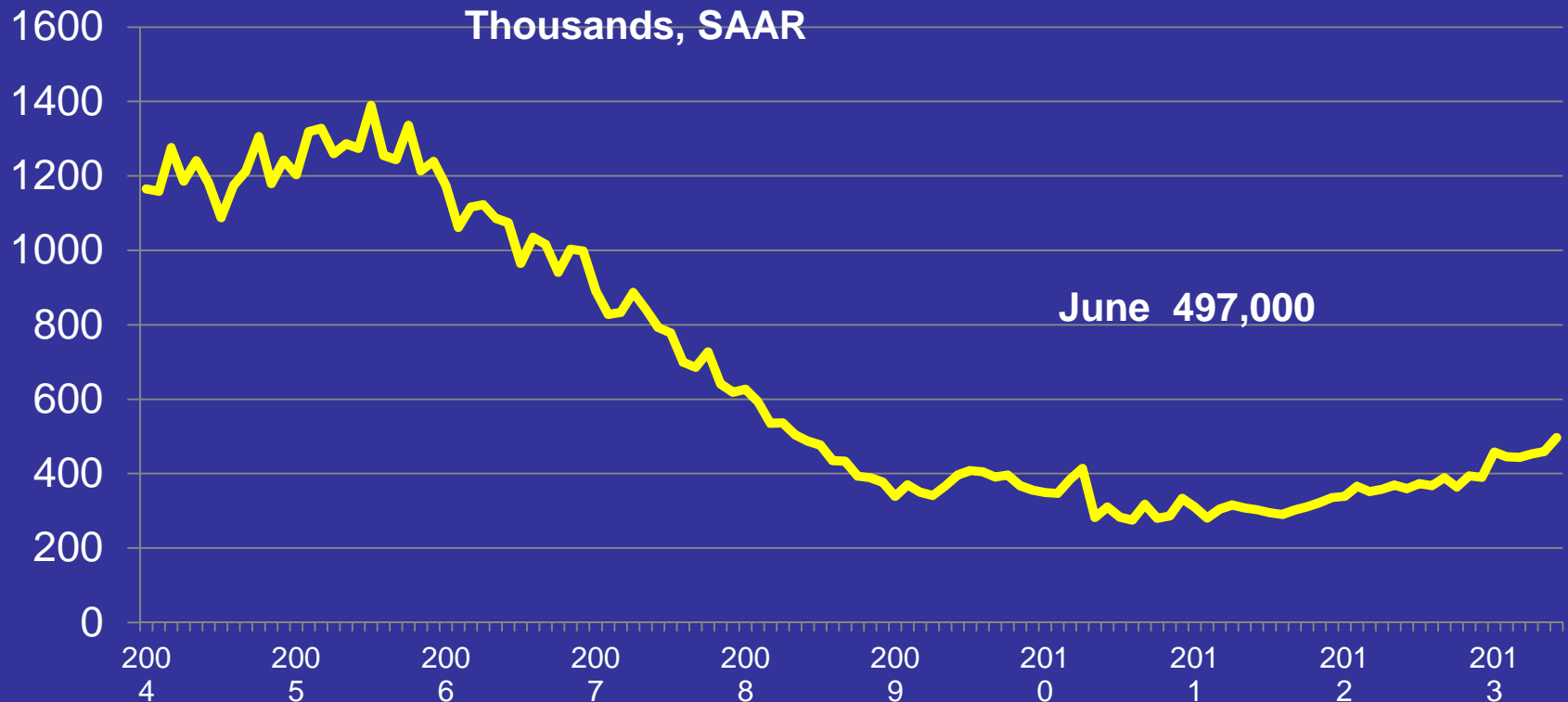
Homeownership rates have been falling for the past seven Years – big question – when the economy gets back to normal, Will people go back to single family or will we see more multi Family?? To date, the “recovery” has been mainly multifamily



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

New Single Family Home sales is the key statistic to watch – Sales drive housing starts – this drives demand for wood products!!!

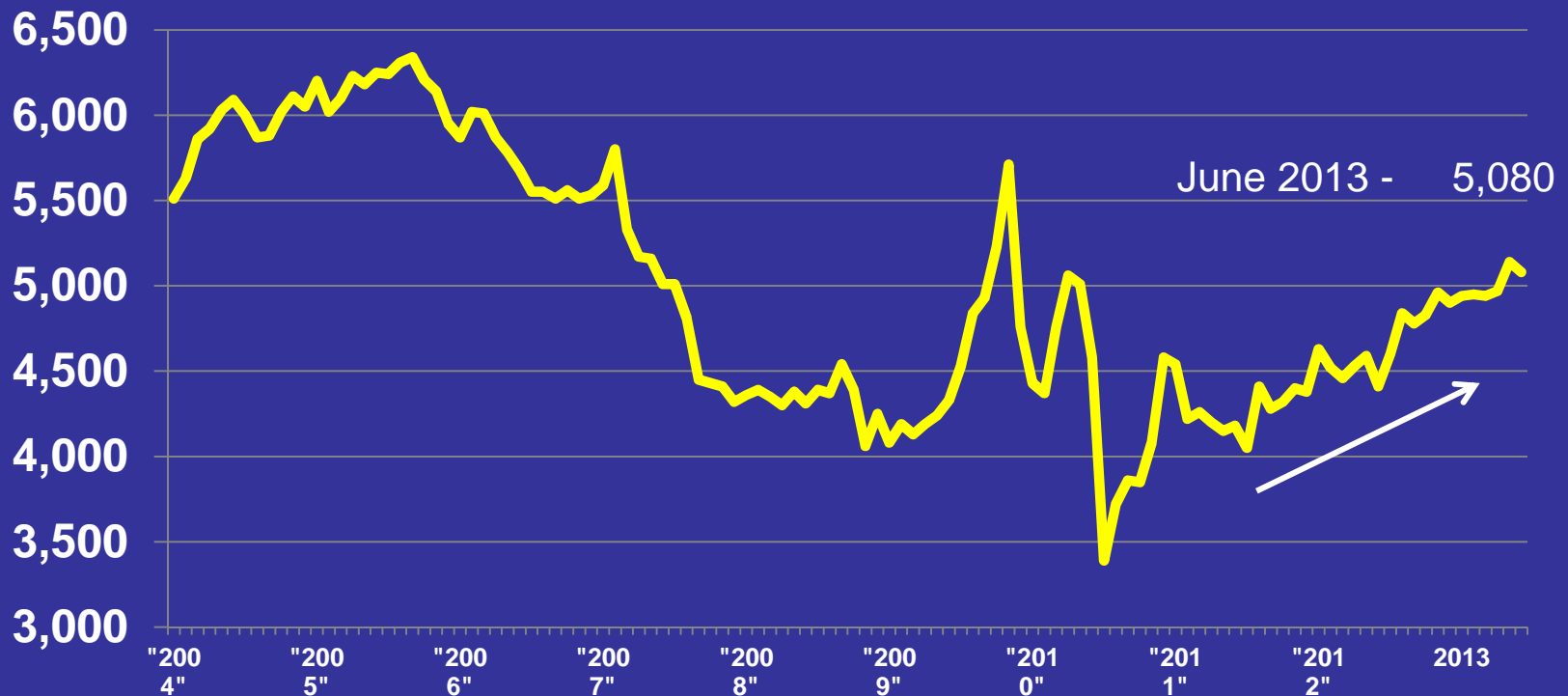
Problem is price competition with resale homes, particularly distressed sales



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

Resale market getting better – however, in 2012, about 25% of sales were cash only, mostly by investors – these homes were then rented -
i.e., this is not your typical housing recovery

Single family (incl condos), Monthly, Thousand units, SAAR



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

Some comments on recent house price increases - -

**Let's hope they keep increasing because higher prices
Will encourage builders to build more homes -**

- - in addition - -

(1) higher prices are needed to slow foreclosures;

**(2) enable people with negative equity to sell homes
and move to better jobs;**

(3) apply for refinancing - -

**(4) this will turn housing market around along with
improving economy**

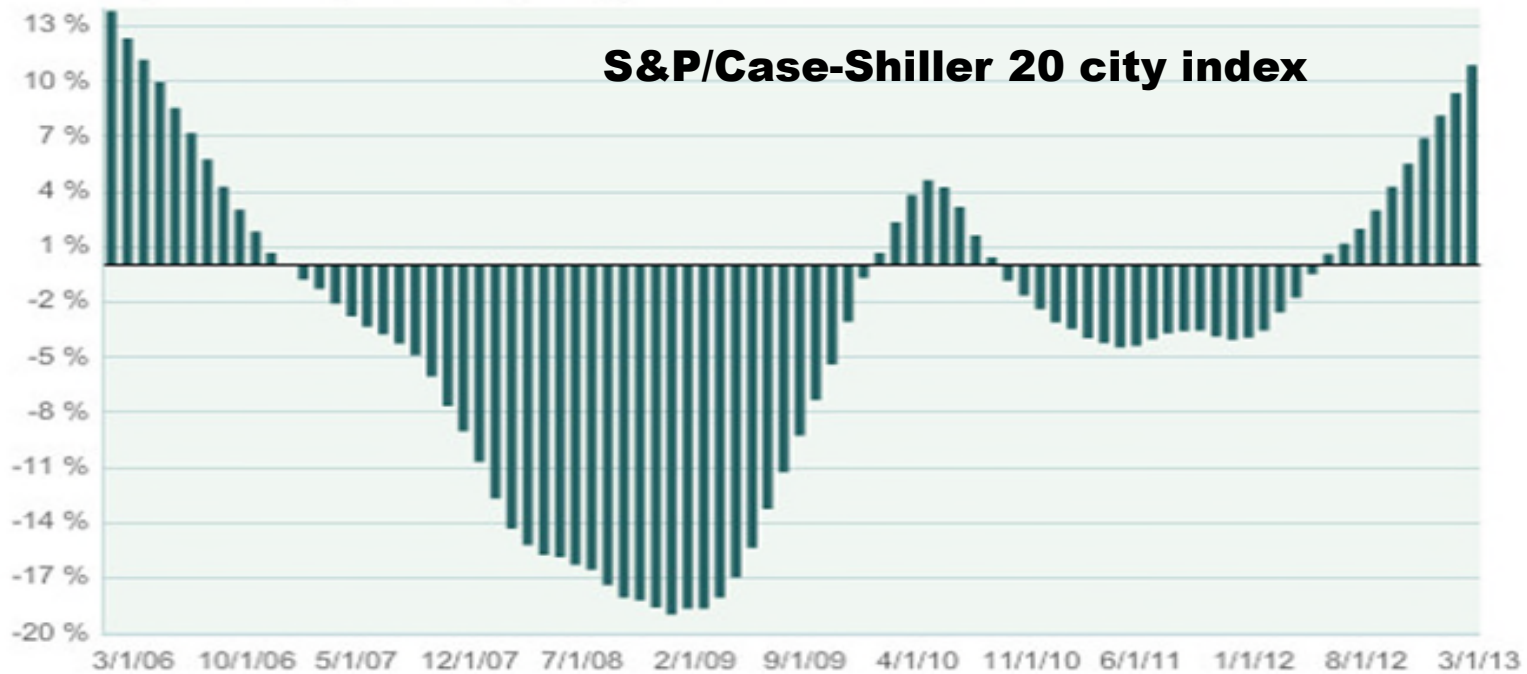
Price increase due in large part to weak supply, but, still good news –

U.S. home-price growth fastest in nearly 7 years

By Ruth Mantell, MarketWatch

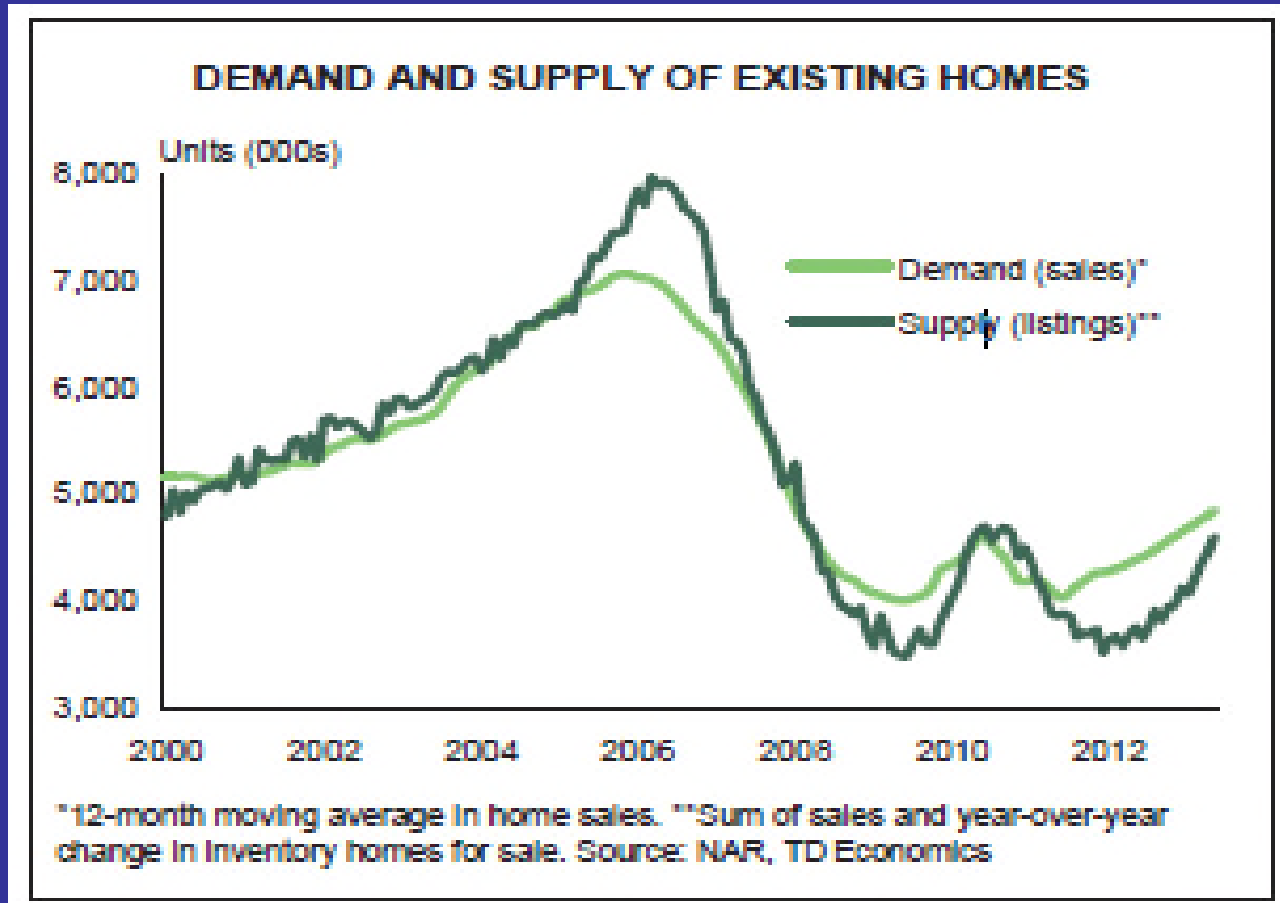
Annual home-price growth highest since 2006

■ Year-over-year home-price growth

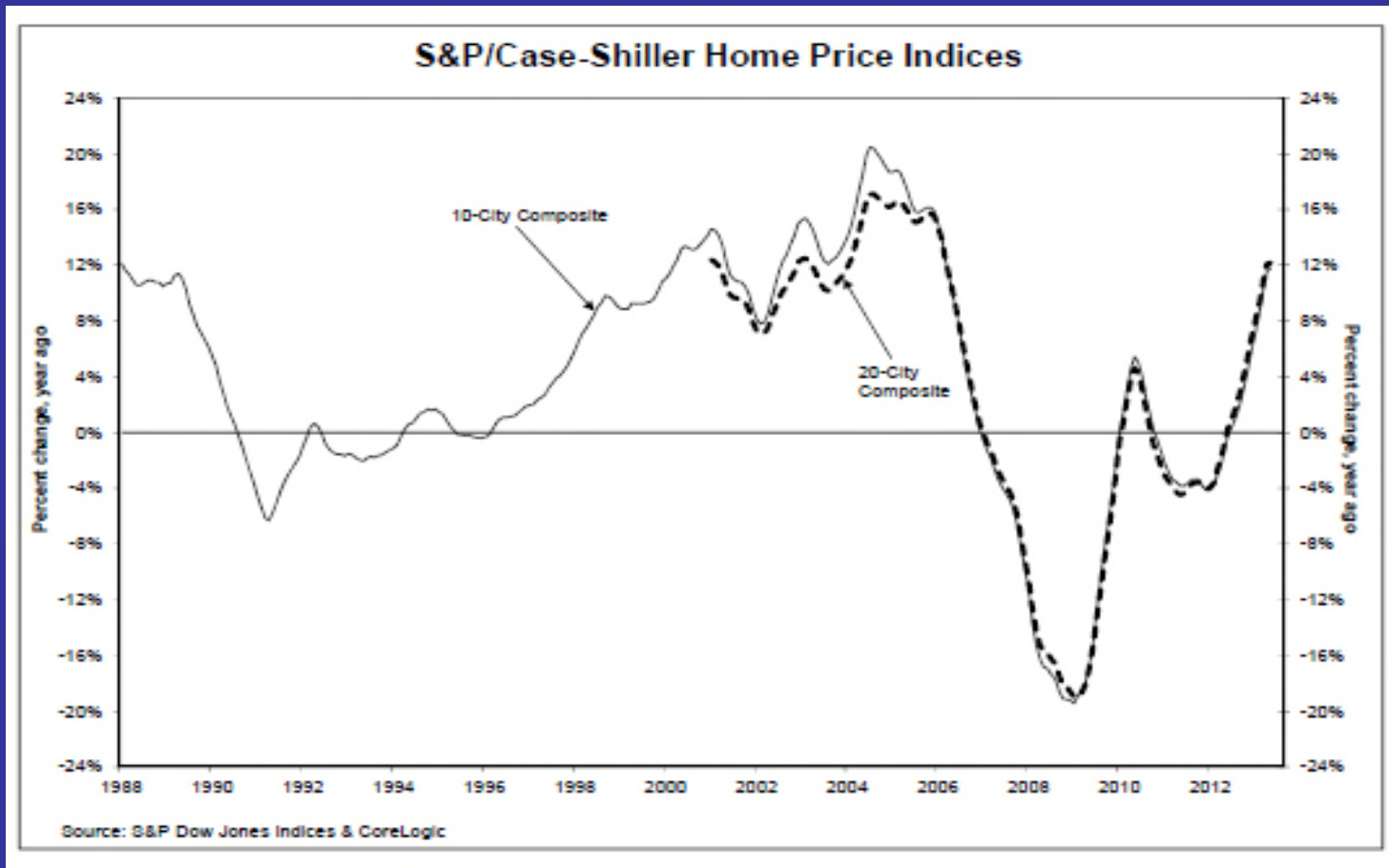


Source : S&P/Case-Shiller

When demand exceeds supply, price rises “Economics 101”



House prices up 12% year over year – Good news Because it will drive supply (housing starts) – Economics 101!!



**And, prices still undervalued compared with fundamentals
Like price/rent ratios; affordability; etc. - this is not a
bubble**

Home prices remain undervalued

■ Percent that home prices are undervalued (-) or overvalued (+)

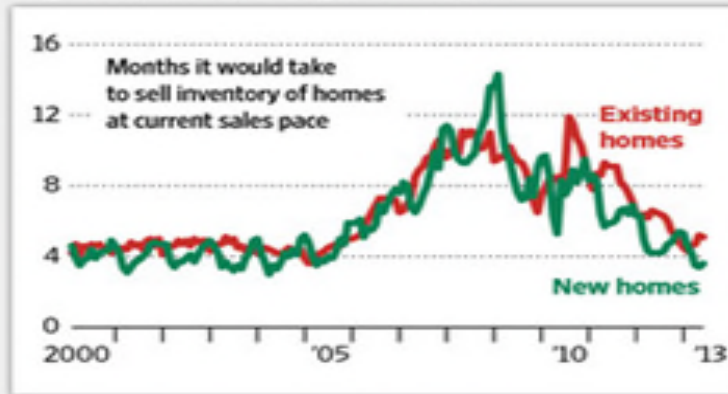


Source : Trulia

**Higher prices and rates won't stop the housing recovery - -
 Rates are still historically low and prices would have to increase
 Another 20% before housing would become unaffordable relative to
 historical levels**

Market Forces | Fear factors for those hunting for a home

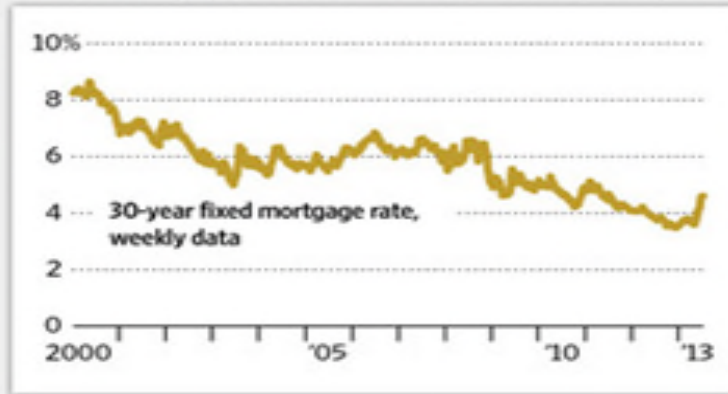
Big declines in housing inventory...



...have boosted home prices.



While mortgage rates are still low, the recent spike...



...could represent a payment shock for buyers.



Source: National Association of Realtors; Commerce Department; CoreLogic; Mortgage Bankers Association; Freddie Mac

The Wall Street Journal

Close

More comments re: recent house price increases

(1) Is it real and sustainable?

**Due in large part to demand/supply mismatch
(Mike Santoli/Daily Ticker, May 28)**

(a) Low inventories plus weak new home starts

(b) 25% of homeowners are still “underwater”

(c) 18% have little equity

i.e., 40% are “virtually trapped in their houses”

**(2) Are we setting ourselves up for another “bubble” – no,
we can’t be that dumb?**

**(3) Yes, it’s sustainable as long as the economy continues
to move forward!!!**

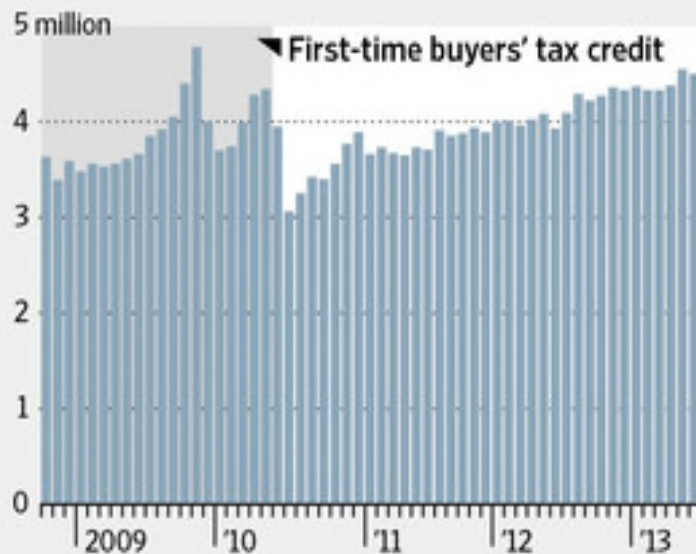
**(4) *Rising prices are a good thing (because it means
demand is improving)***

Problem with today's market – 1st time buyers share down To 30% from historical average of 40% - this problem “cascades” Over time (fewer 1st time buyers = delayed “move up” buyers, etc.)

Shrunken Share

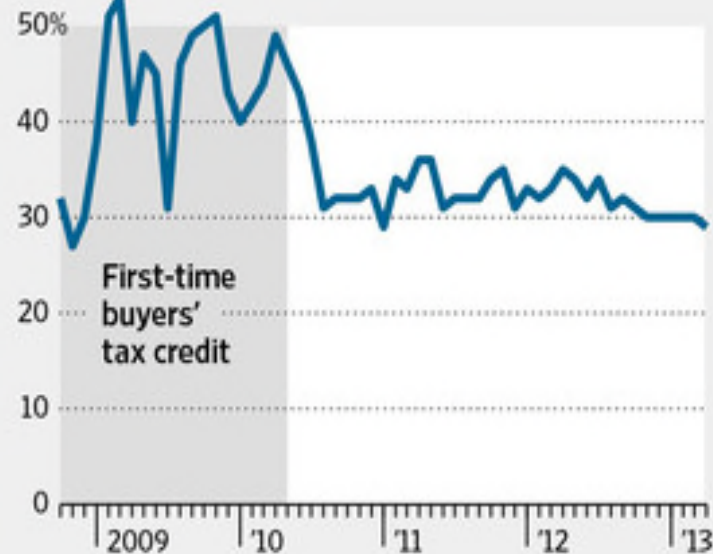
Sales of single-family homes have rebounded overall, despite a slip in June...

Sales of existing single-family homes, at a seasonally adjusted annual rate



...but the share of sales to first-time purchasers is shrinking.

Share of U.S. sales of previously owned homes to first-time buyers*

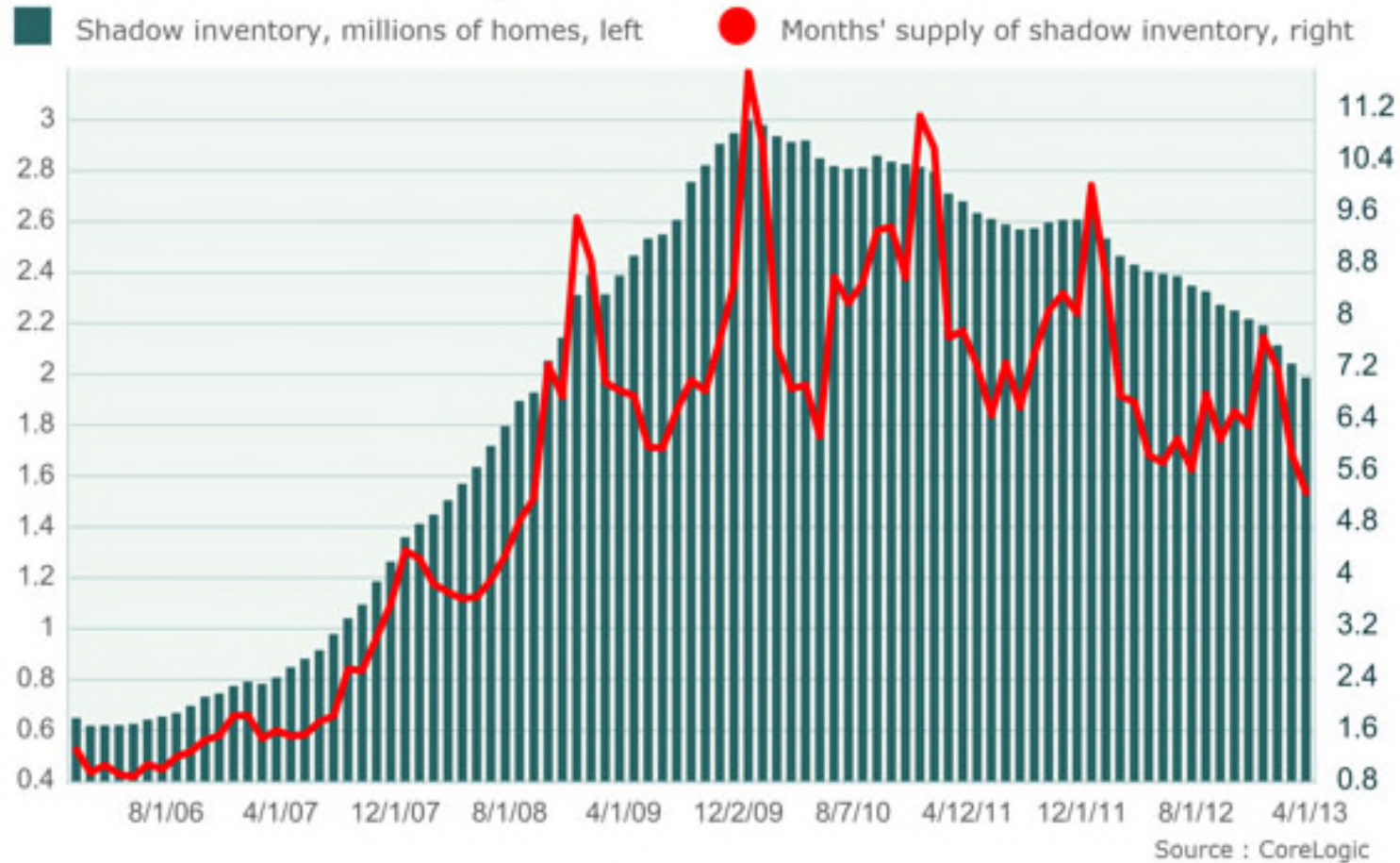


*Includes multifamily homes, such as condos and co-ops Source: National Association of Realtors

The Wall Street Journal

Shadow inventory coming down – a good sign

Shadow inventory of troubled homes



(<http://www.marketwatch.com/Story/story/print?guid=9E9C304A-EF17-11E2-922F-002128040CF6>)

Latest Housing Forecasts – and change from forecast Six months ago – multi family is leading the way

The Forecasts of the Analysts 2013 Housing Starts (thousands)

| | Single-Family | Multi-family | Total |
|--|---------------|--------------|------------|
| APA - The Engineered Wood Assn | 645 | 330 | 975 |
| Forest Economic Advisors | 639 | 332 | 971 |
| National Assn of Home Builders | 644 | 311 | 955 |
| Mortgage Bankers Assn | 635 | 325 | 959 |
| Fannie Mae | 659 | 318 | 977 |
| Average | 644 | 323 | 967 |
| % change from average of the analysts' projections for 2013 in January | +0.3 | +12.5 | +4.1 |

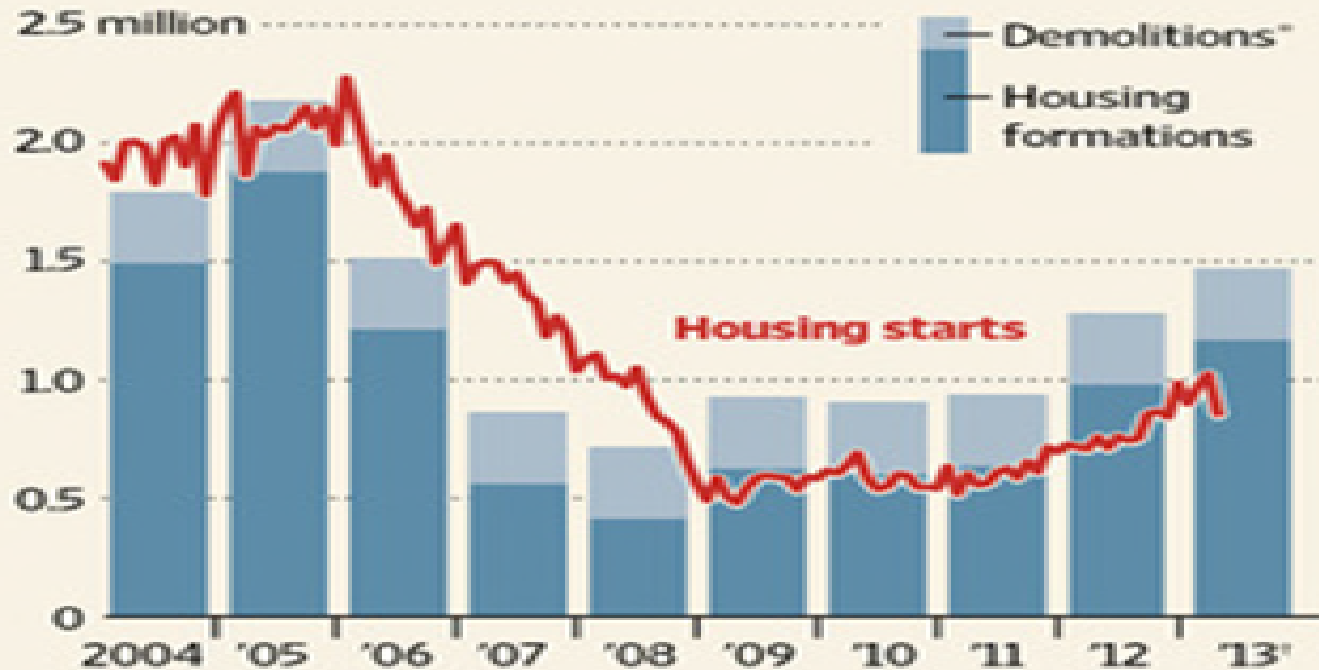
Good News - -

- (1) Household formations are key to the housing recovery
- - - there is a growing “pent up demand”**
- (2) Formations are improving – but, further improvement depends on a stronger economy**

**Good news is that household formations exceed starts - -
Plus, when you include demolitions, there is considerable
“pent up demand” for shelter – again, demand exceeds supply –
A good thing**

Market Measures

There are more households being set up than homes being built...



Household (HH) formations Shortfall*

Facts:

(1) 1995 - 2007: 1.5 million HH formed per year

2008 – 2010: 500,000 HH formed per year (1/3 of normal)

(2) During 1995 – 2007, population increased 2.9 million annually

2008 – 2010, the increase was 2.7 million annually

HH formation Shortfall(cumulative)*

2008 – 600,000

2009 – 1.7 million

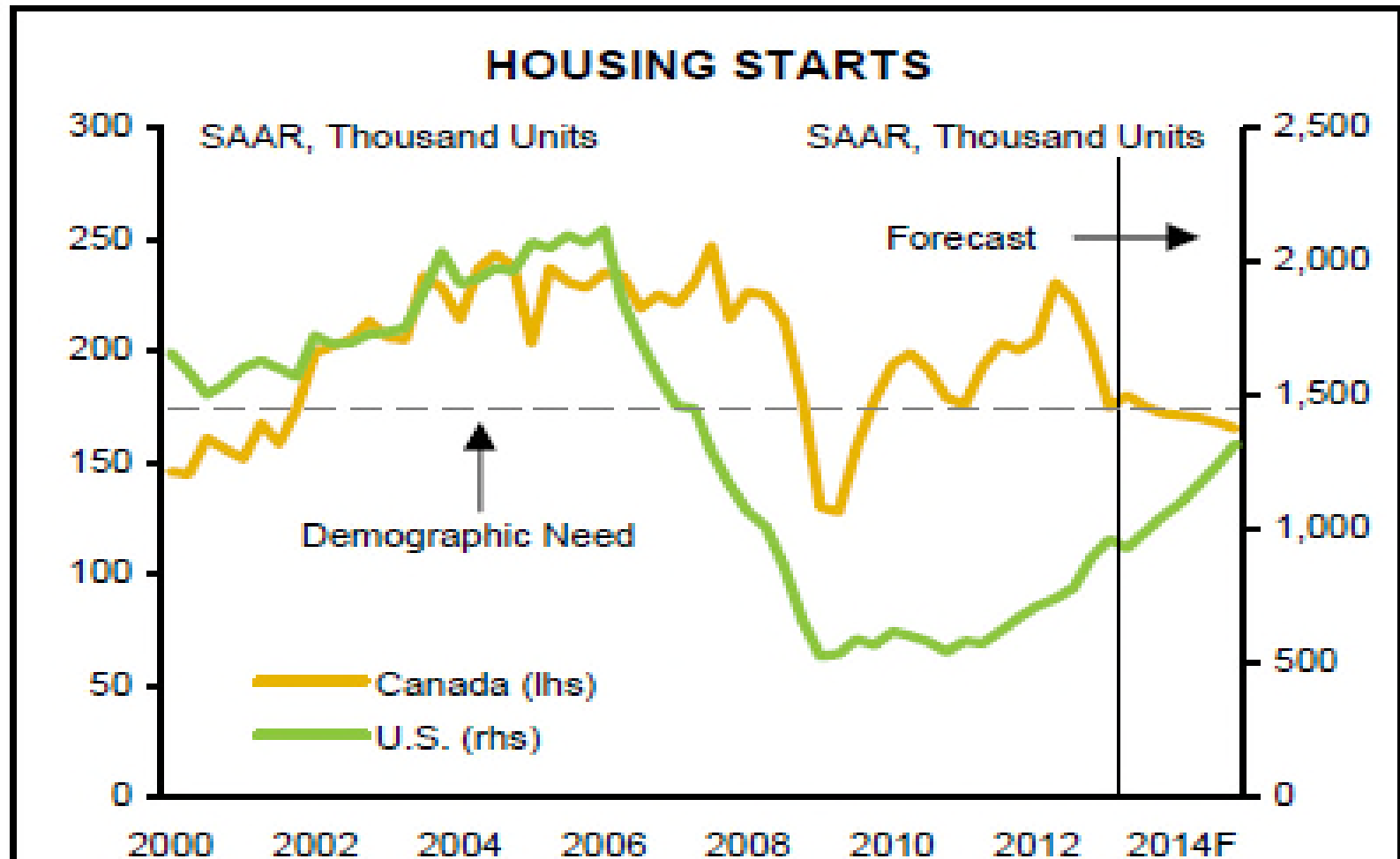
2010 – 2.5 million

2011 – 2.6 million - this is the shortfall

* Shortfall based on model developed by Tim Dunne of the Cleveland Fed

Based on historical relationship between economy, headship rates, population increase, Social norms, etc. (<http://www.clevelandfed.org/research/commentary/2012/2012-12.cfm>)

North American Housing outlook from TD Bank



Source: Haver Analytics; Forecast by TD Economics as at June 2013

**Bottom line – when economy returns to normal,
Demand for shelter will strengthen.**

**Question – what will the mix be between detached single
Family and multi family housing and what are the
Implication for the wood products industry? Also, implications
If house size gets smaller??**

**Most of you have seen this article by Craig Adair and
Myself and it is three years old, but there is some material
There that addresses the question posed above as it
Relates to the wood products industry**

(<http://www.nxtbook.com/nxtbooks/naylor/EWAB0110/index.php?startid=16#/16>)

Some conclusions – housing continues to improve – will Multifamily continue to gain share – will house size shrink?

- (1) Economy will muddle along until 2015? Depends on world economy, China, Europe, Question – can the economy “stand on its own”?**
- (2) What will housing look like in the future? My guess – smaller homes; higher percentage of renters; and more people moving back to the city**
- (3) We’re in “uncharted waters” territory right now (i.e., massive money printing) to date, it has helped prevent worsening of economy, but, certainly hasn’t had the impact the FED had hoped for (i.e., jump start the economy)**
- (4) Housing will continue to improve, albeit more slowly than hoped for**
- (5) Problems going forward are higher interest rates and continuing uncertainty. We have headwinds, but we’re making good progress**