

# Housing comments – August 14, 2012

Housing starts will be released this Thursday, August 16

(<http://www.census.gov/construction/nrc/pdf/newresconst.pdf> )

- Still lots of headwinds to deal with:
  - economy is still a mess, but, it's getting better, albeit slowly
  - government debt issues – all levels of government – exacerbates the job problem – this will get worse before it gets better
  - Problems in Europe are getting worse – 2/3<sup>rd</sup> Europe in recession
  - This will impact USA – Europe is our largest trading partner and our banks are linked to theirs. Would mean lower exports and even tighter credit
- **Improving signs:** . Demand/ supply balance in getting better. Supply due to continuing foreclosures is slowing while demand for new homes is starting to pick up.
- **Housing's main problem - - Weak domestic economy made worse by slowing world economy**

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

But, bottom line is that housing can't recover  
without a stronger economy ( i.e., jobs)  
Also – need better access to credit

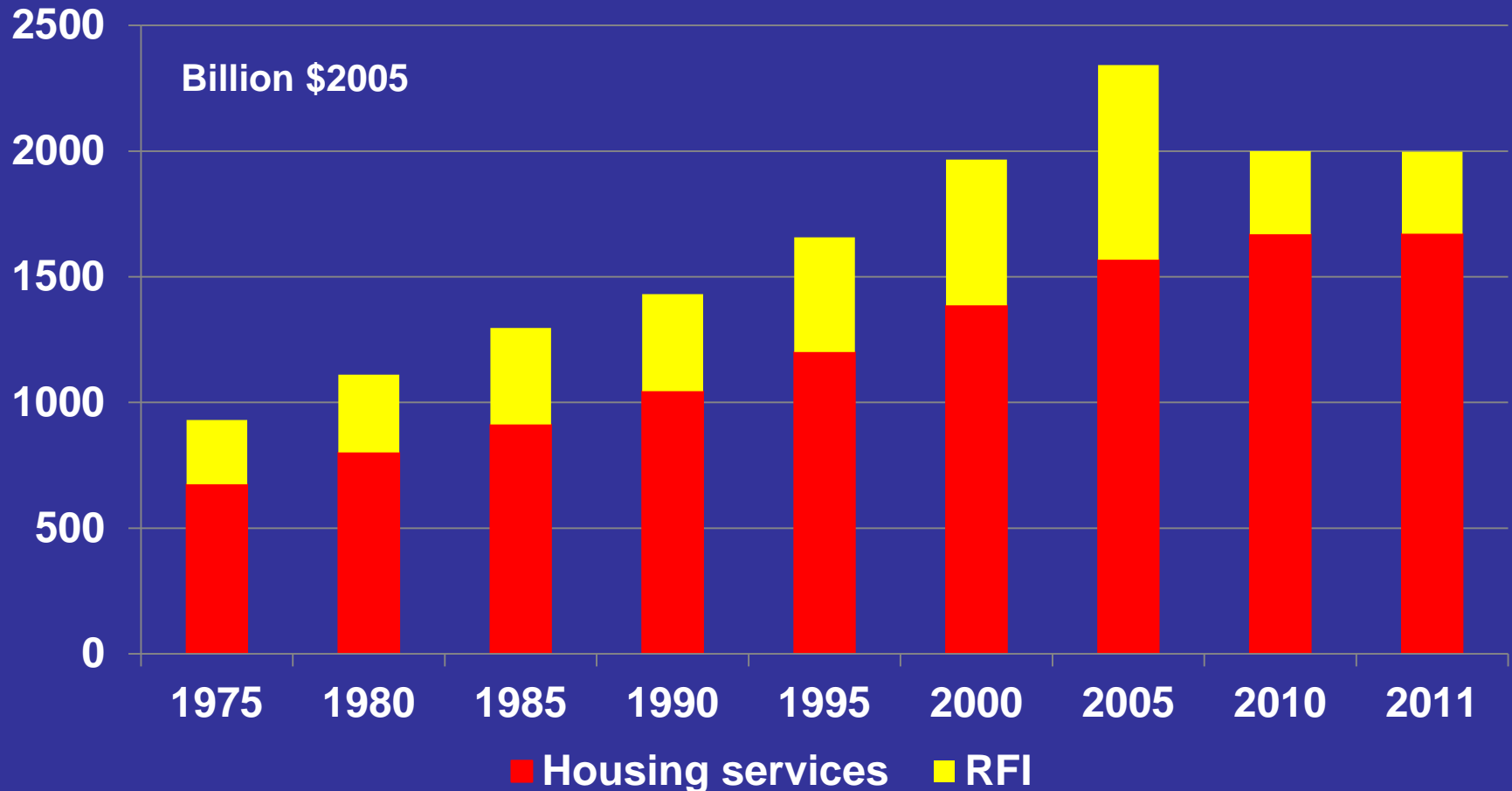
A real corundum, but the solution is clear – fix  
the economy (and instill confidence)

- 1 – we need more investment and consumption
- 2 – but, that requires confidence by business  
and “joe sixpack”
- 3 – that’s missing today
- 4 – we need leadership and cooperation  
(bipartisanship) from our elected  
officials – otherwise, weak recovery continues  
indefinitely

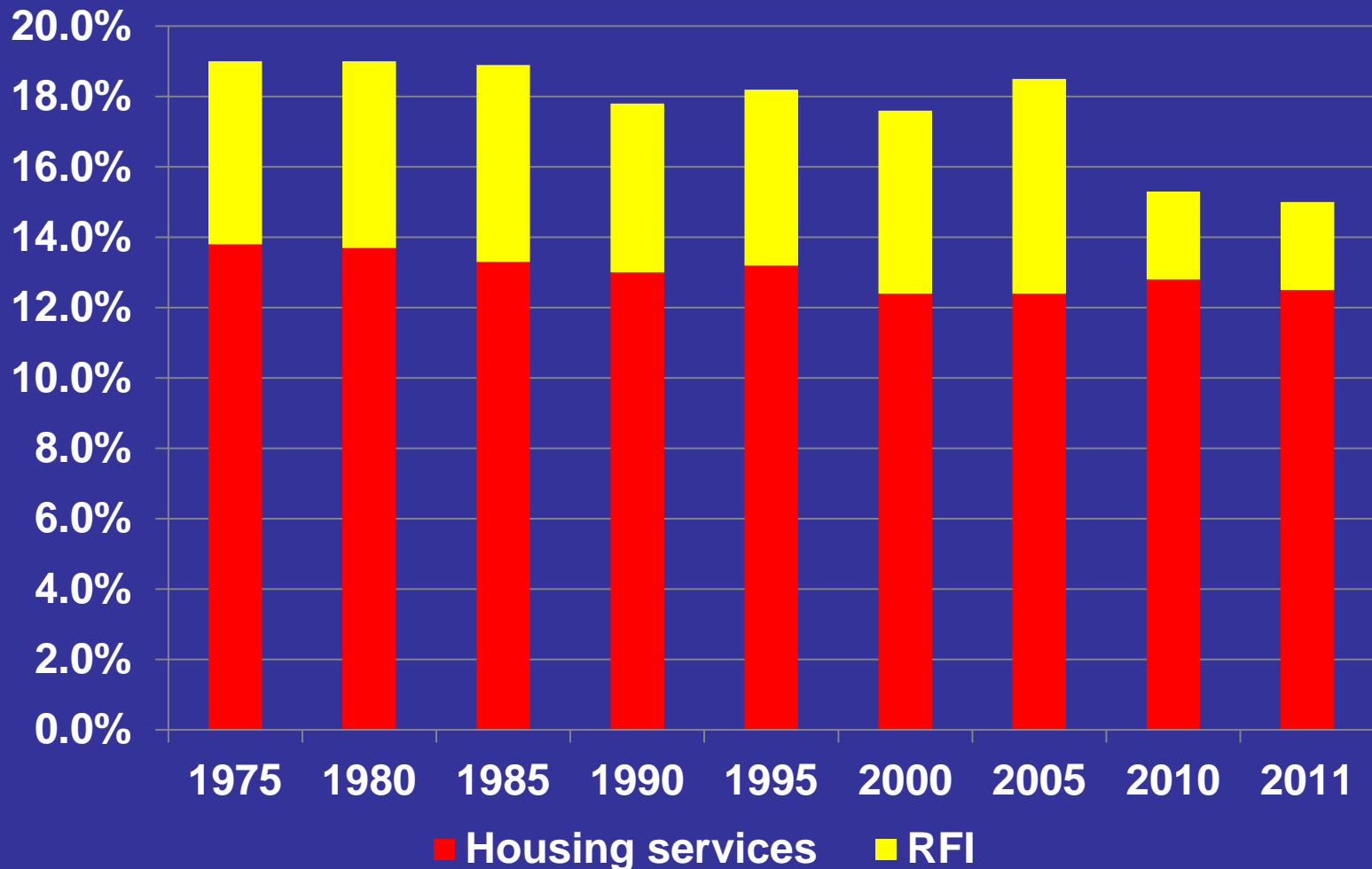
# The potential - - Housing's contribution to GDP

**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's contribution to GDP (%) – housing is extremely important to the economy – in a good year, it is Almost one fifth or 20% of the economy



Source: NAHB

## Examples of jobs & economic benefits of new home construction

For each new SF home built  
3 jobs are created  
\$90,000 in tax revenues is generated

Impact of improved market - -

2011 , housing starts = 609,000

long term trend = 1.7 - 1.8 million

gap = 1 million

filling the gap would create 3 million jobs

Source: NAHB

# Key problem in economy - - weak income growth in USA over past two decades.

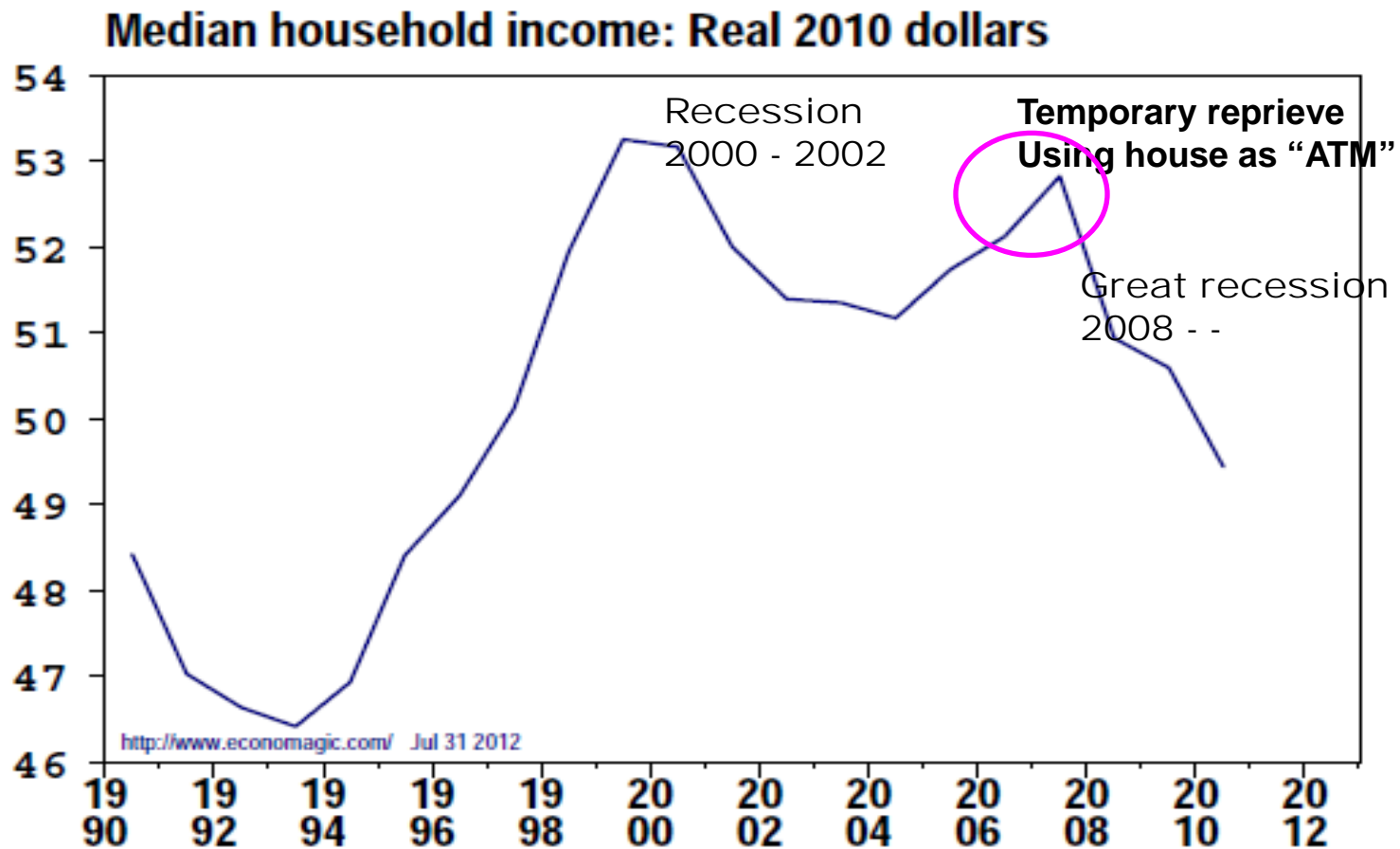
- (1) little growth in “standard of living”
- (2) ability to buy homes is weak despite very “affordable housing” using traditional metrics such as record low interest rates and house prices . In fact, interest rates have never been lower.
- (3) Income growth can be restored only when we become more globally competitive
  - > that means we have to invest more and consume less for at least a decade or more
  - > otherwise, the economy and housing will remain weak and we will join Japan ( and much of Europe) In a “lost decade”
  - > *we need to deal with massive Income/wealth concentration (see next page)*

For an interesting discussion of “The 1 Percent’s Problem”. See Joseph Stiglitz’s ( Nobel Prize Economics) article in Vanity Fair (<http://www.vanityfair.com/politics/2012/05/joseph-stiglitz-the-price-on-inequality> ). For Those so inclined, read his book “The Price of Inequality”. In Essence, the theme is that the growing concentration of Wealth/income in the USA is bad for the U.S. economy. E.g., Using “total net worth”, the top 1% have 35% while the bottom 80% have 15%; using ‘financial wealth”, the top 1% have 43% While the bottom 80% have 7%. Compared with rest of the world, And using the “Gini coefficient” as the metric, the USA is 77 out Of 144 in the world – i.e., we are one of the worst of the Industrialized countries.

Implications are that this leads to social unrest; reduction in productivity growth; lower overall GDP growth; ..... In essence, as people lose faith in their ability/opportunity To better themselves ( the tables are stacked against us), the entire Country loses as standard of living falls. See Wikipedia for a brief Explanation of definition, causes, implications, measurement, etc. of inequality ([http://en.wikipedia.org/wiki/Income\\_inequality\\_in\\_the\\_United\\_States#Gini\\_index](http://en.wikipedia.org/wiki/Income_inequality_in_the_United_States#Gini_index) )

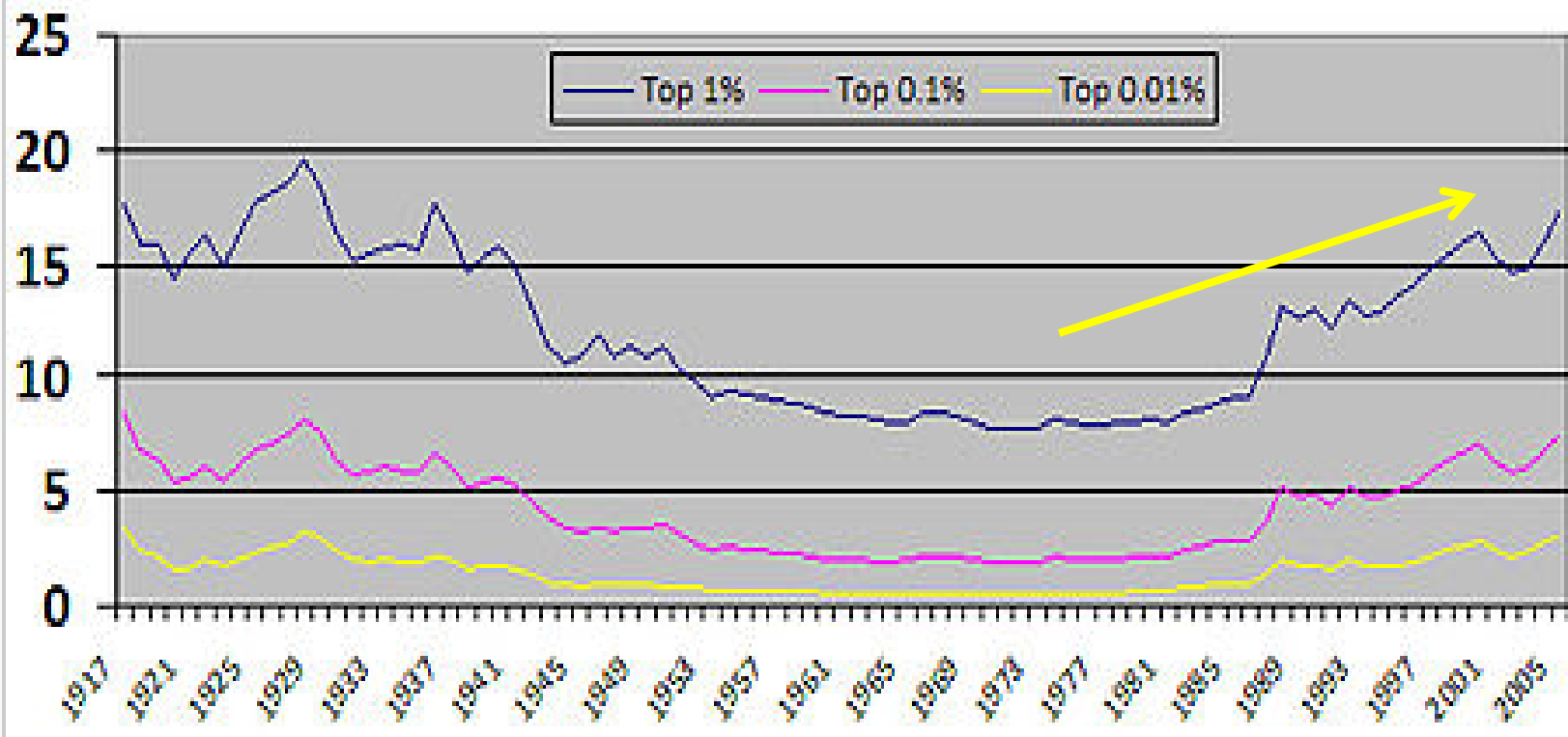
What happened in 1998 – 2000 to send us in a downward Spiral??? – recession; repeal of Glass Steagall; globalization; loss of mfg jobs; two wars; .... Maybe we're not as competitive as before??

(\$1000)





Share of pre tax household income by top 1%, 0.1%, and .01% - my opinion, very bad trend over past three decades



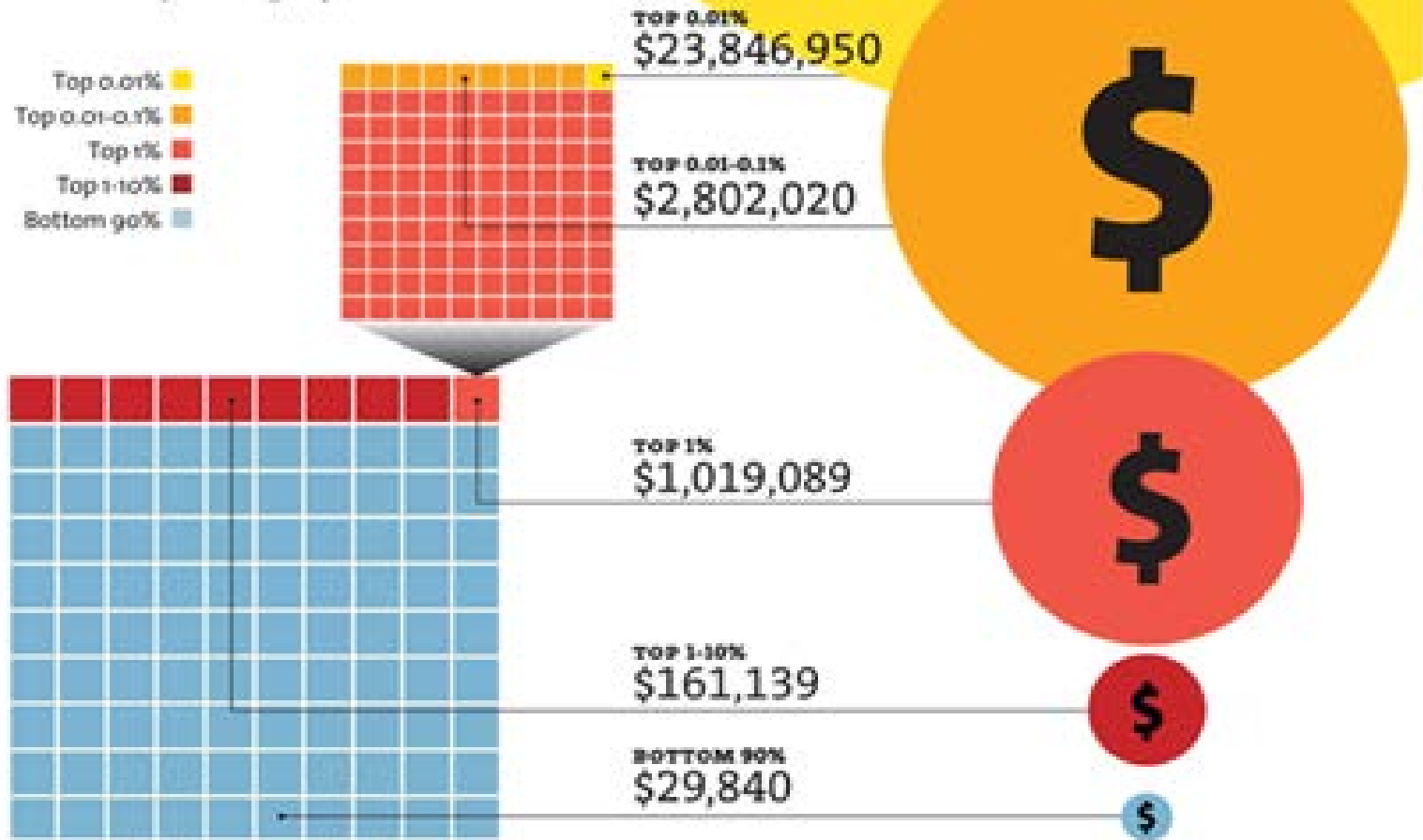
Share of pre-tax household income received by the top 1 percent, top 0.1 percent and top 0.01 percent, between 1917 and 2005. <sup>[26][27]</sup>

# Average family income – bottom 90% is <\$30K While top 1% make \$1 million

## AVERAGE INCOME PER FAMILY

Distributed by income group

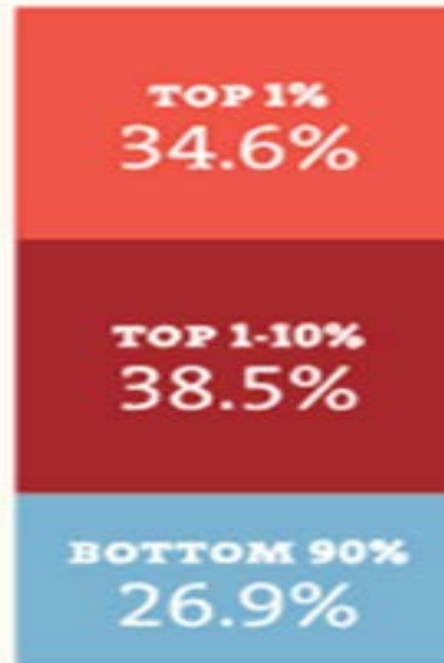
- Top 0.01% ■
- Top 0.01-0.1% ■
- Top 1% ■
- Top 1-10% ■
- Bottom 90% ■



2010 data. Includes capital gains. Source: Emmanuel Saez, University of California-Berkeley

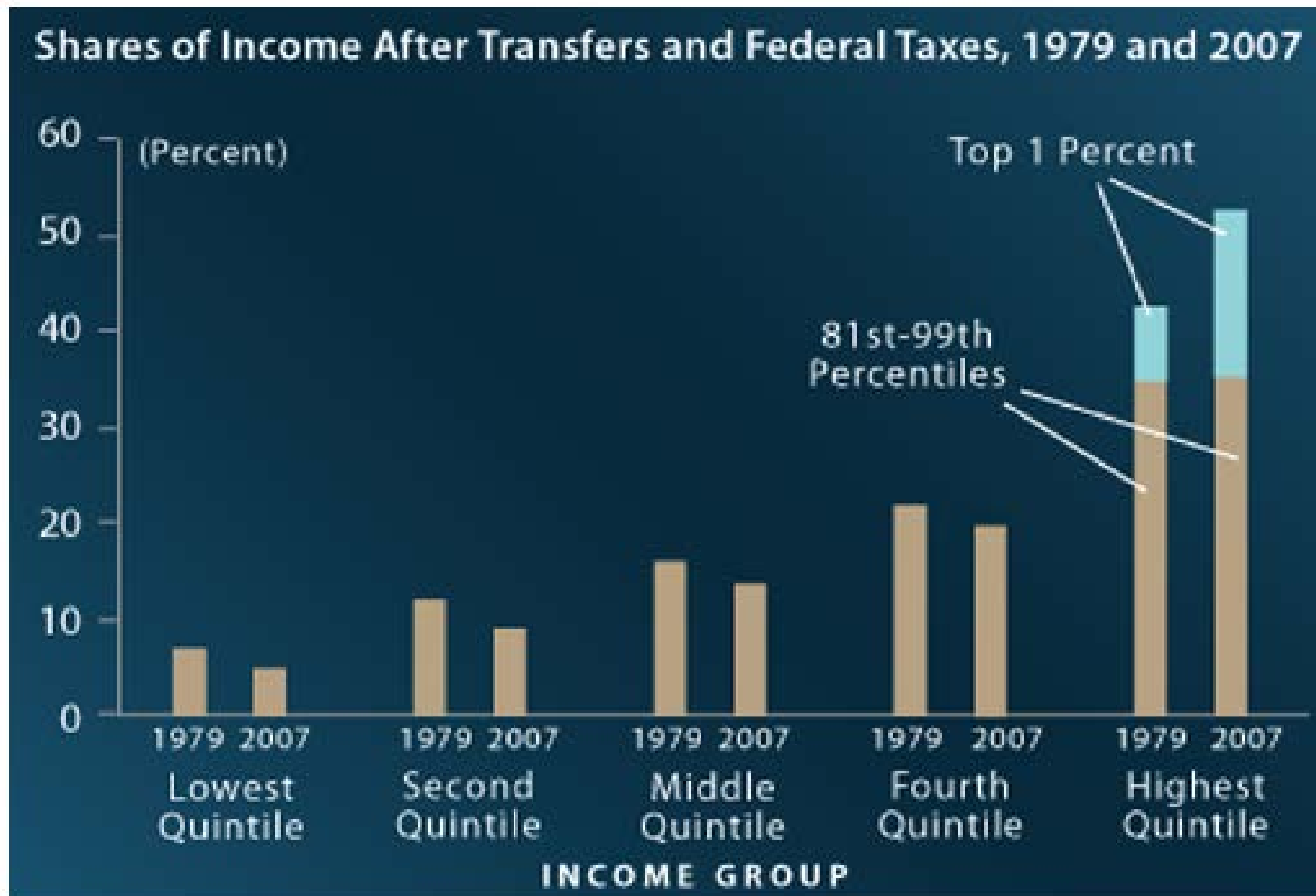
Richest 10% control 65% of American net worth - -  
I'm not a genius, but there is something  
very wrong with that much concentration.

The richest 10%  
controls 2/3 of  
Americans'  
net worth:



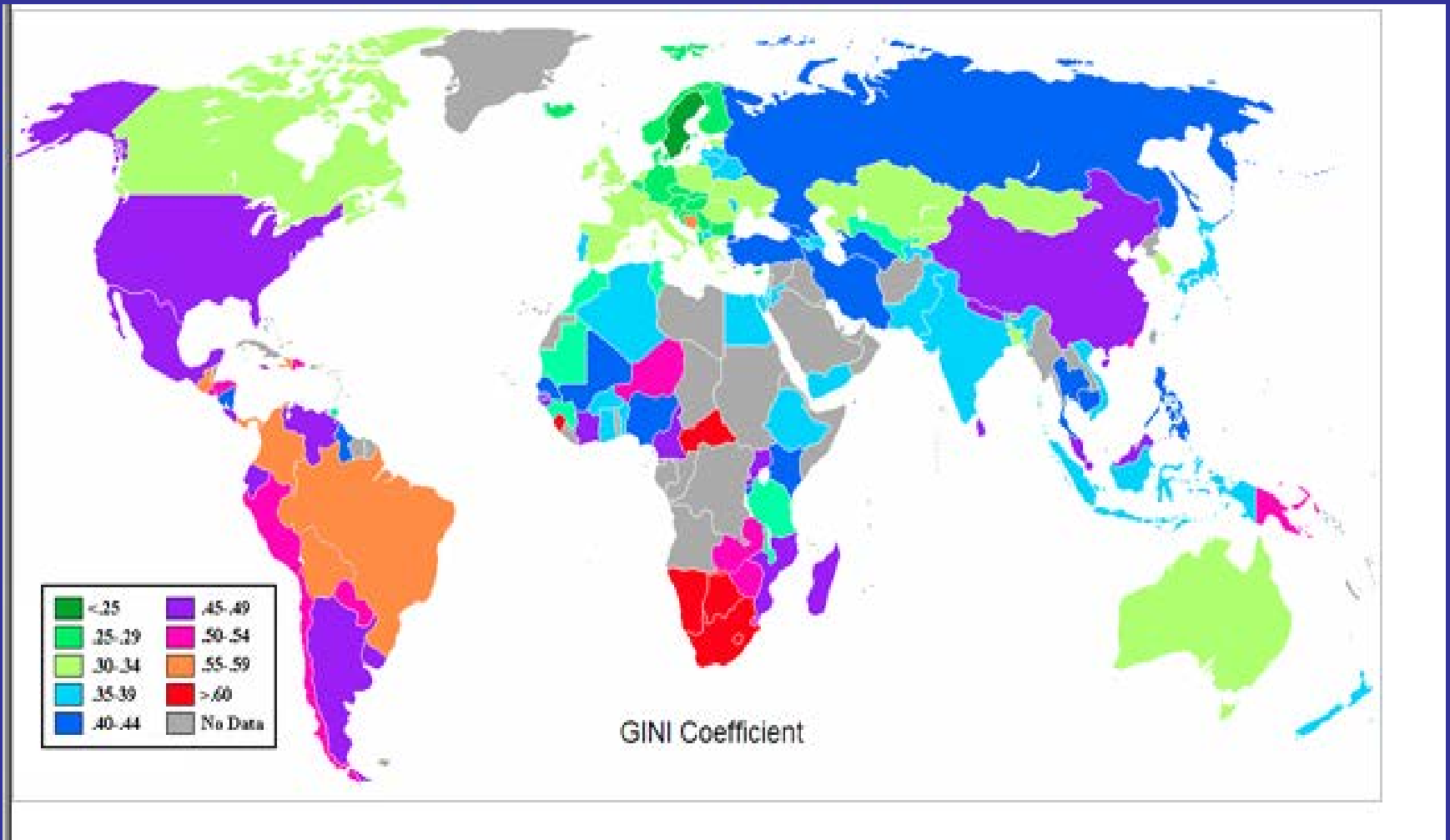
2007 data. Includes  
home equity. Sources:  
Edward Wolff, Bard  
College; Federal  
Reserve

Income distribution by Quintiles ( 20%) - - highest  
Quartile ( top 20%) only group to see increase in past 30 years



Source; CBO (<http://www.cbo.gov/publication/42729> )

Income inequality measure – Gini coefficient\*  
Ranges from 0 ( everyone has same income) to 1.0  
(one person has all the income) - - USA not doing so well –  
no better than China



\* A Gini coefficient of zero expresses perfect equality where all values are the same (for example, where everyone has an exactly equal income). A Gini coefficient of one (100 on the percentile scale) expresses maximal inequality among values (for example where only one person has all the income

Bottom Line – Income inequality problem  
Is getting worse – we need to fix it or  
USA will continue to see regression in  
Standard of living – that means demand  
For housing will fall. What made USA great  
Was it provided a realistic opportunity for  
The majority of its' citizens to “achieve  
The American dream”. Over the past three  
Decades that opportunity has been diminished  
Significantly.

There is plenty of blame to go around, both  
Republicans and Democrats. This is important  
Because when people believe in the ‘dream’,  
They work hard to achieve the ‘dream’.  
Productivity goes up; work ethic improves; ....  
GDP increases and the entire country benefits!!!

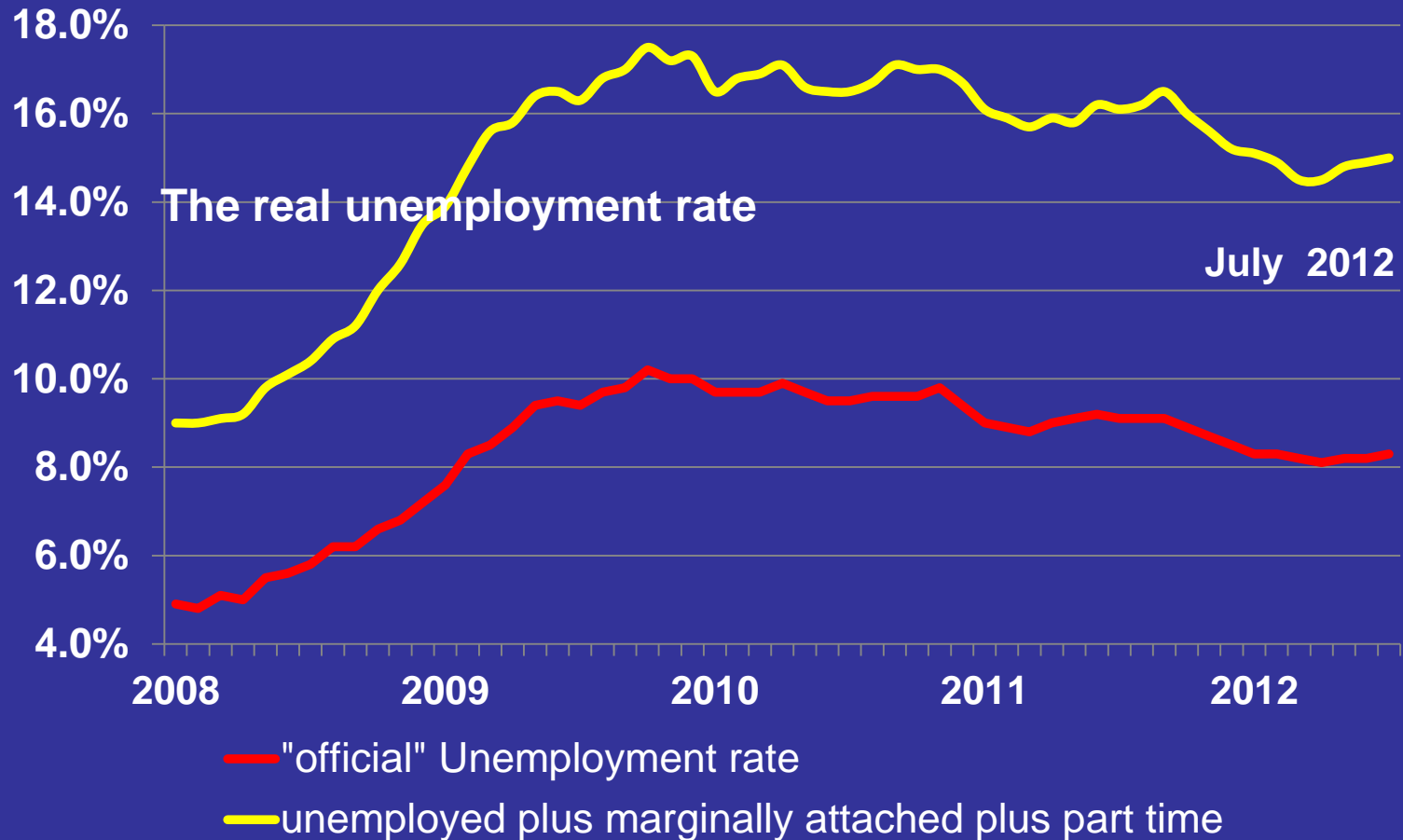
**Employment situation - Still our biggest problem - it's getting better, but the jobs recovery remains weak by past standards. The sad Fact is that there are many jobs available that aren't being filled Because people don't have the required skills.**

Net change in non farm payrolls – monthly, thousands



Source: U.S. BLS ( [www.bls.gov](http://www.bls.gov) )

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

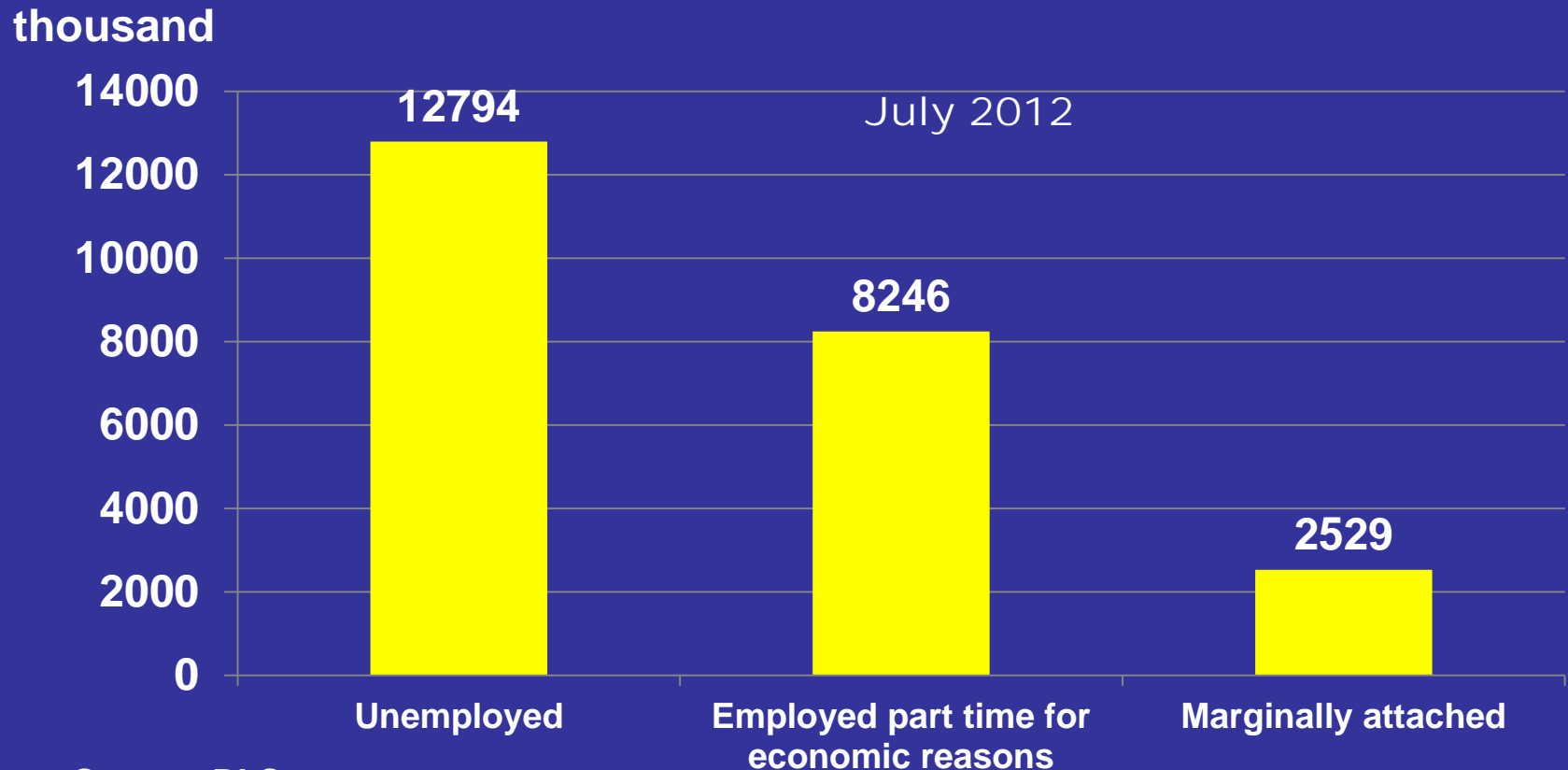




Unemployed plus people working part time for economic  
Reasons plus people marginally attached\* = 23,569,000

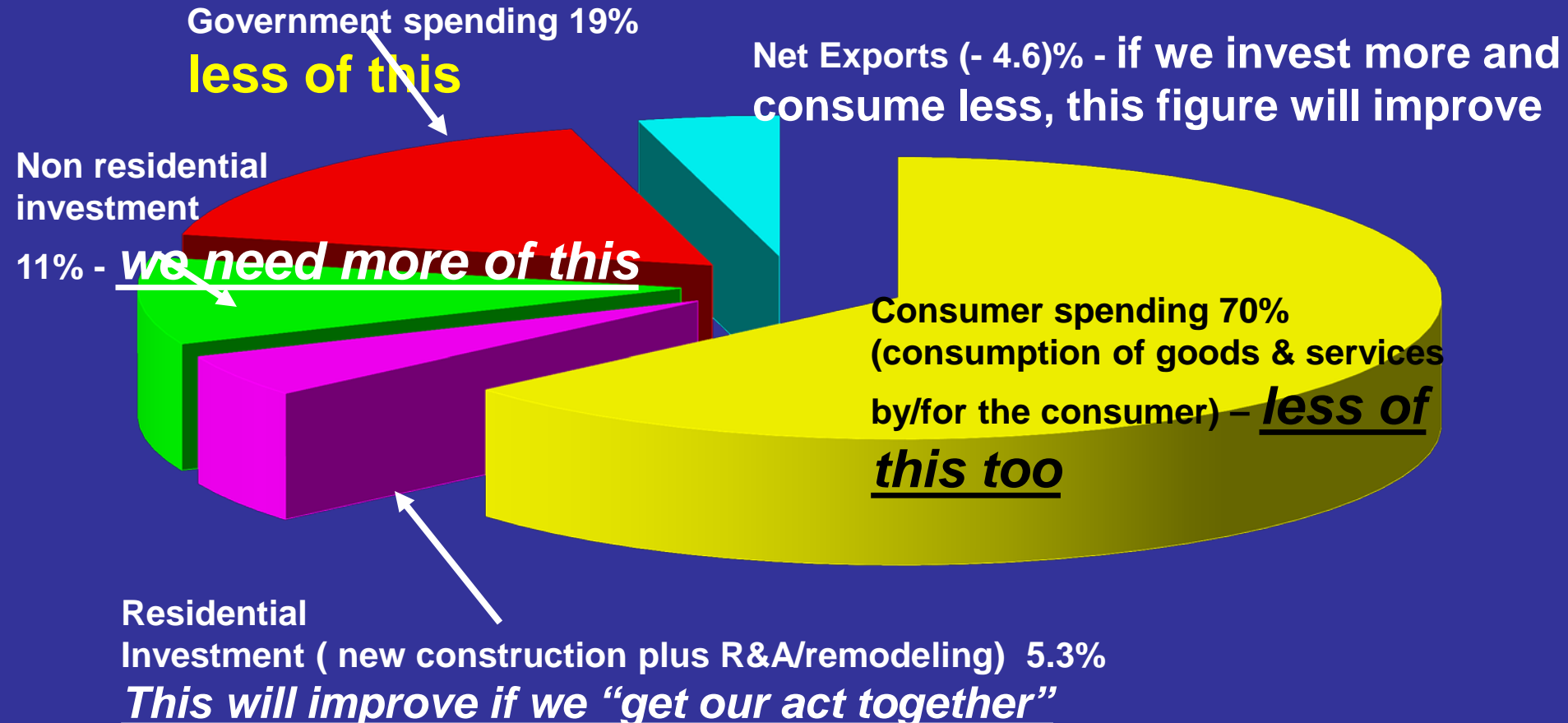
This = 15 % of the civilian labor force -

- Marginally attached - people who have stopped looking either because they're discouraged or other reasons ( therefore, they are not included in the employment/unemployment stats)

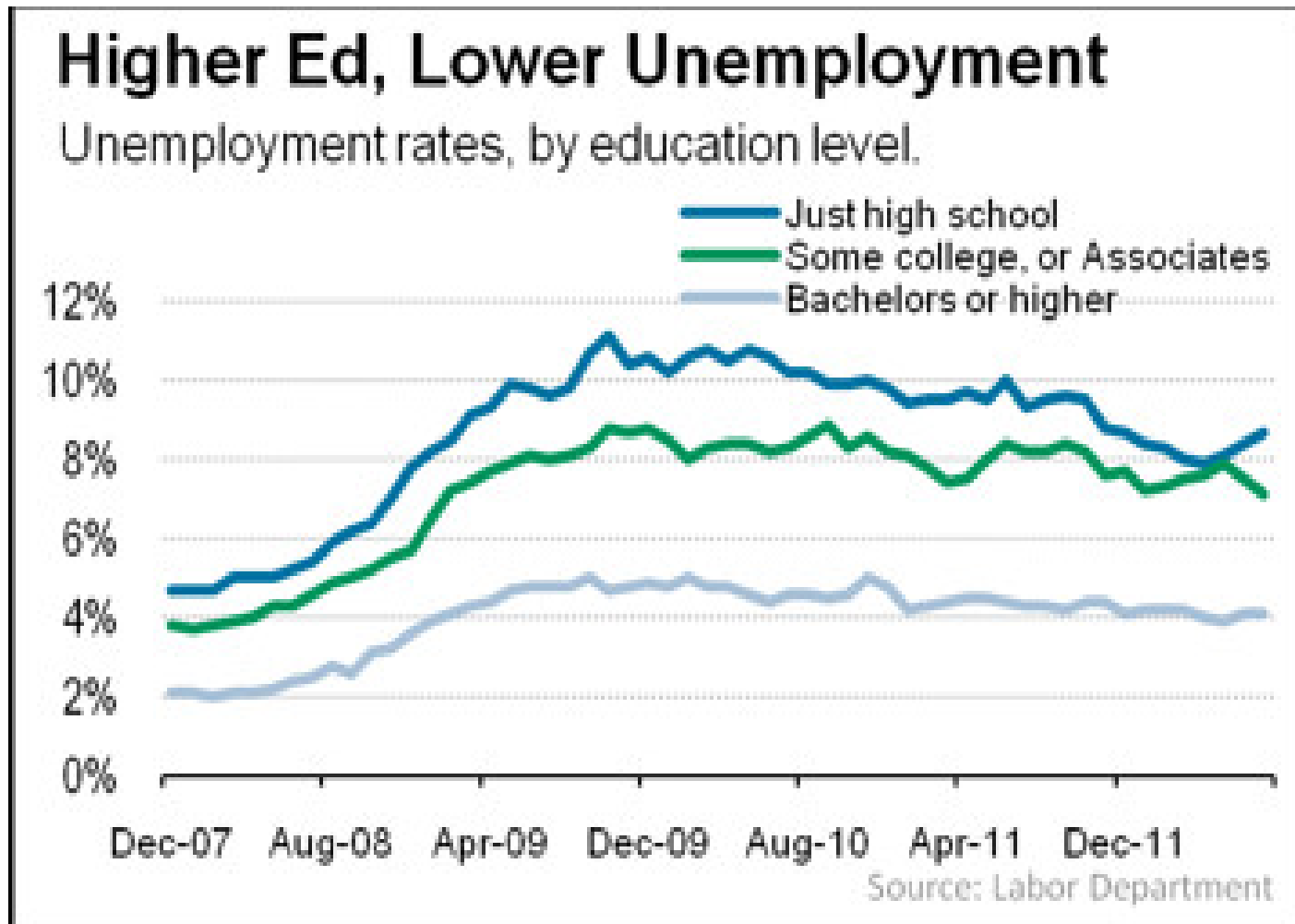


## U.S. Economy 2000 – 2010

this type of economy not sustainable – insufficient investment in infrastructure, R&D, education makes us less competitive and this leads to reduced standard of living and less housing demand



# One Key to Job Growth - - Invest in education



# Recent Housing statistics

Still mired in a "depression" at ~ 516,000 Single family starts (annual Rate) – until jobs improve substantially.

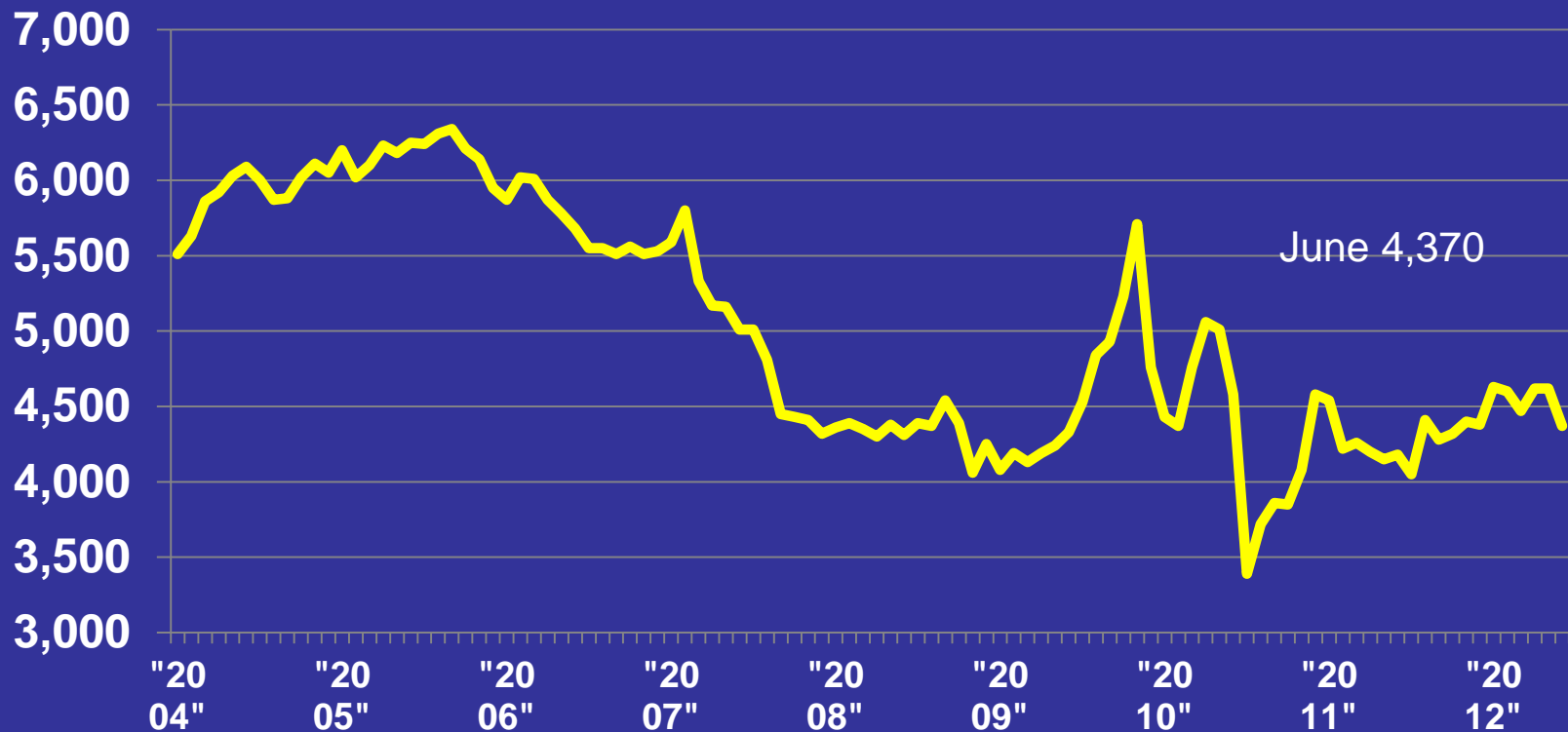
## Single family starts, Thousand units, SAAR



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

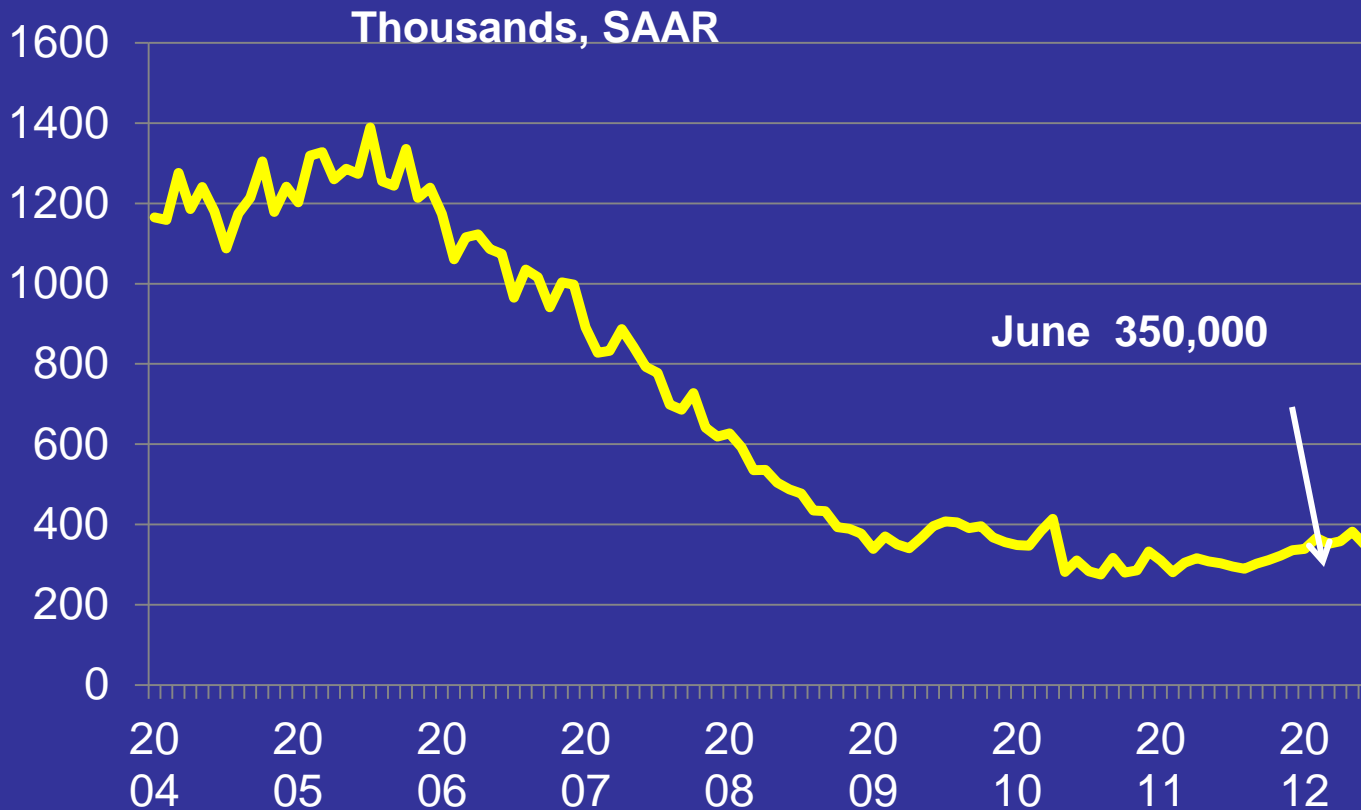
**Resale market still weak, but getting better – many sales remain "distressed" ( roughly, 35% of 2011 sales were distressed and sold at 30% plus discount)**

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



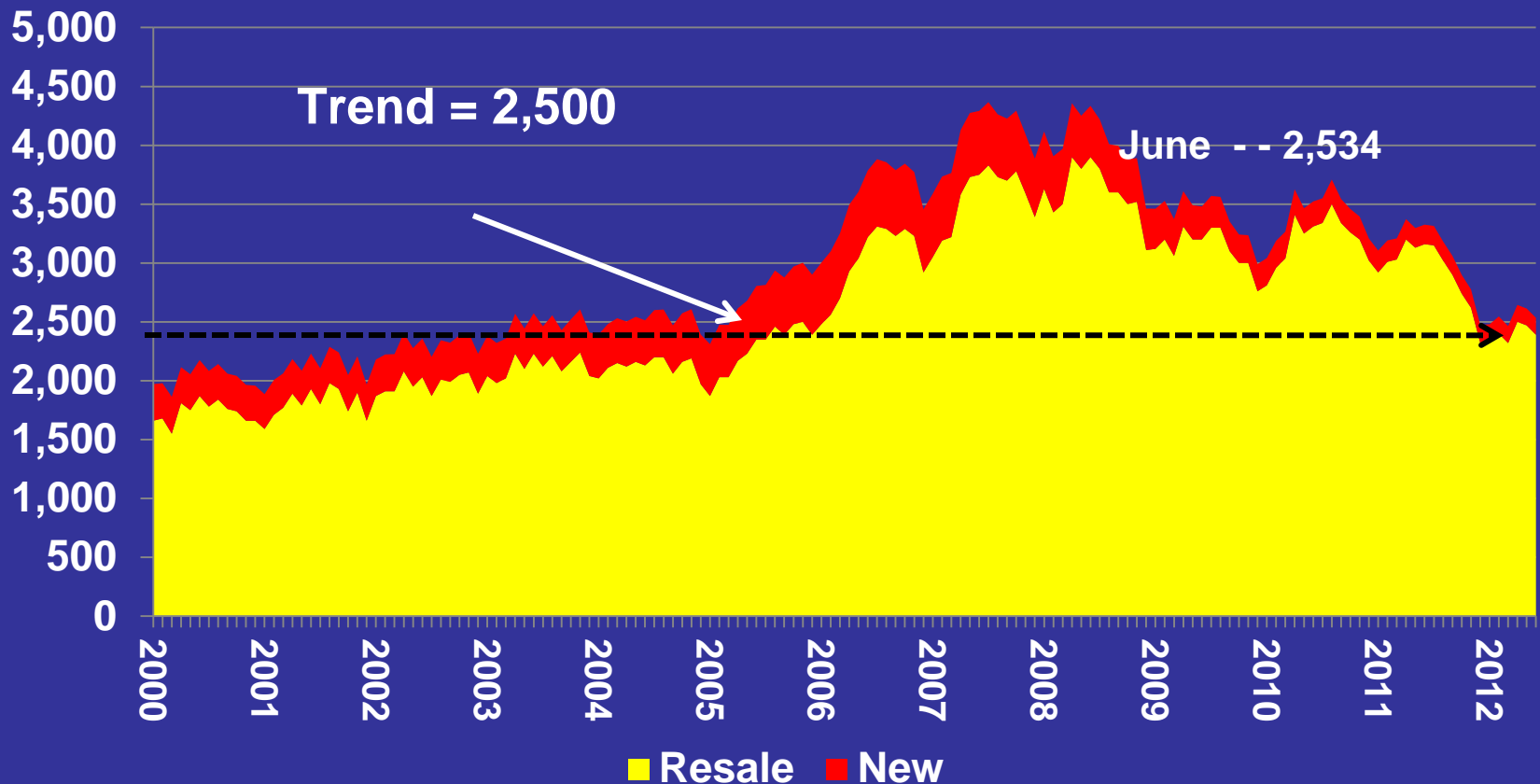
Source: NAR (<http://www.realtor.org/research> )

**New Home sales continue to languish –  
can't compete with distressed resale prices – this trend will continue  
until foreclosures are brought under control – jobs ( good jobs) are the  
key**



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

# Some good news - Single family (incl condos) Housing Inventory "listed inventory" back to normal



Source: U.S. Census (<http://www.census.gov/hhes/www/housing/hvs/hvs.html> )



## Recent Forecasts – The Economy and Housing

Deleveraging will slow growth for some time  
In USA and Europe

Much of Europe already in recession – Qtr 2, 2012  
getting worse as German economy sputters

Weak U.S. economy will continue to delay housing  
recovery

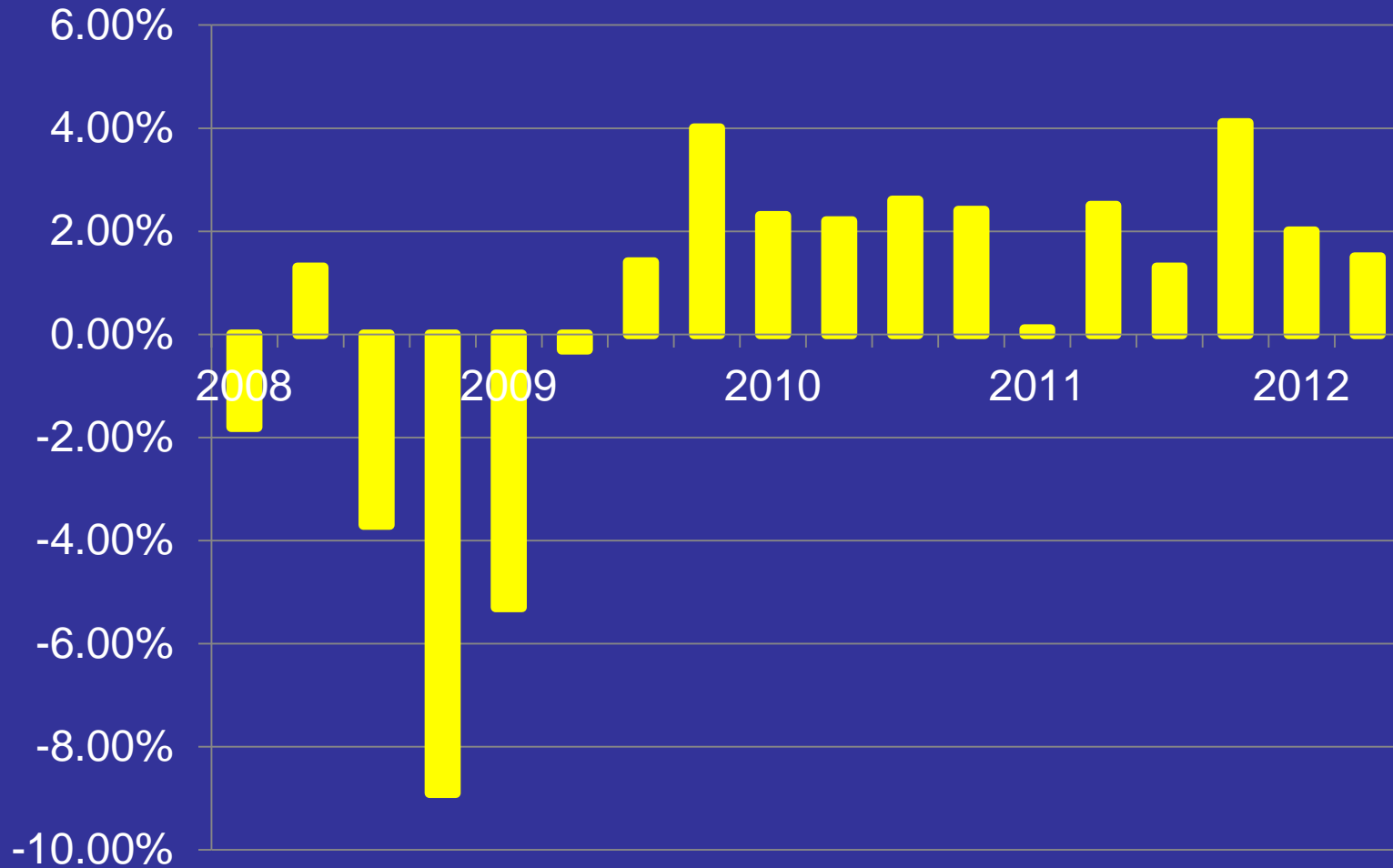
**Interconnected world – what happens in Europe will have a major impact on U.S. economy, and therefore U.S. housing – see interesting note below from TD Economics**

**( [http://www.td.com/document/PDF/economics/special/jm0512\\_greece\\_impact\\_on\\_us.pdf](http://www.td.com/document/PDF/economics/special/jm0512_greece_impact_on_us.pdf) )**

**Europe - - (1) Greece isn't the only country living beyond its means  
(2) Spain's problems are more similar to ours with banking troubles following housing bust  
(3) Italy – too much debt with debt/GDP ratio = 120%, and they have experienced weak growth for a decade**

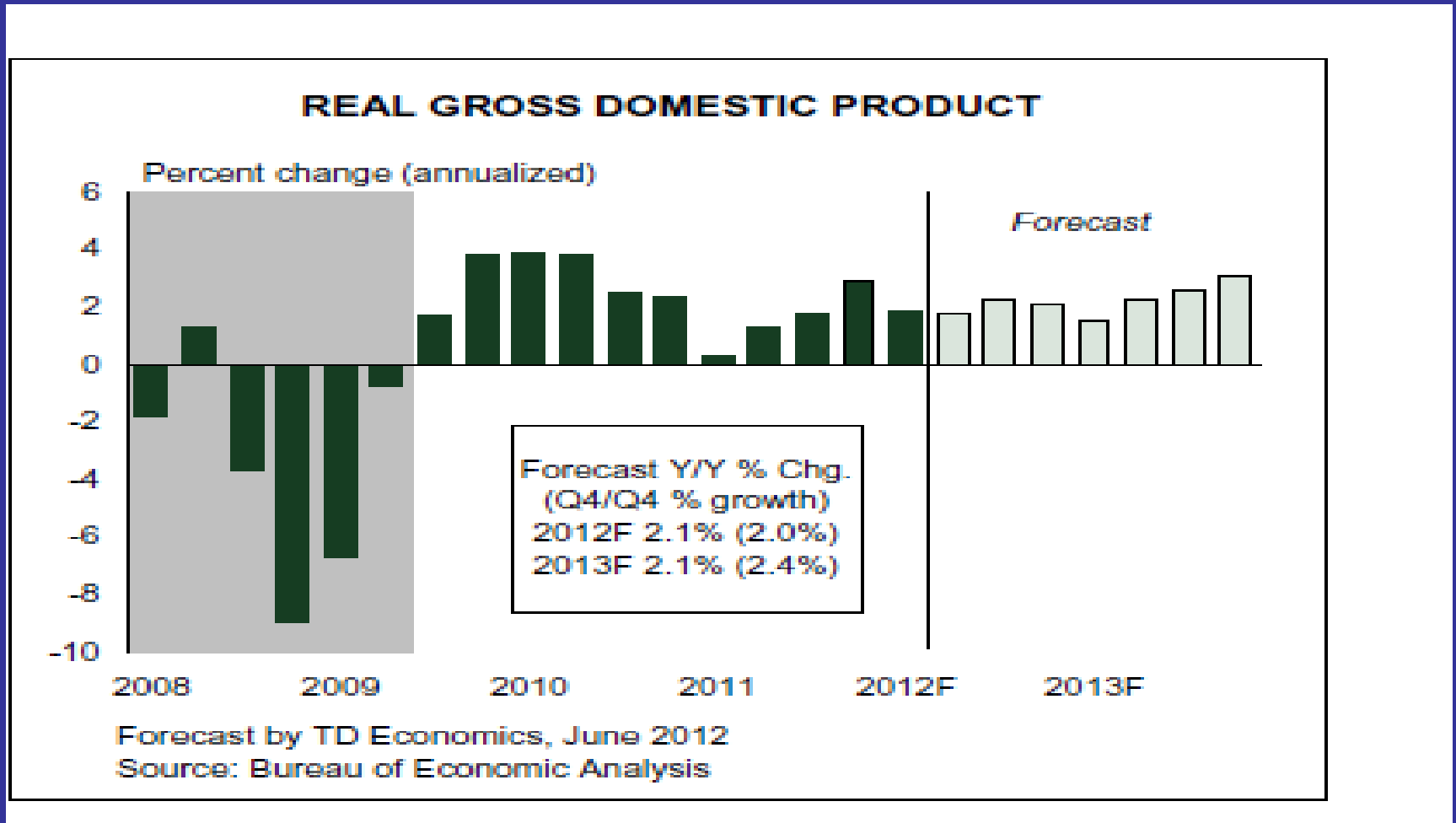
**Sooner or later, debts have to be repaid, and that means pain  
In the form of higher taxes and fewer government services – this  
Will slow world growth, particularly in North America and Europe**

## Real U.S. GDP Growth Losing Steam??



Source: BEA (<http://www.bea.gov/>)

# U.S. economy - - Slow growth for next 18 months?



Three time honored metrics ( house prices, price to rent ratios, and mortgage rates ) are telling us that housing demand should be great . Plus, demographics are favorable!!

So, why is housing still mired in a depression?

Hint – WEAK DEMAND ( need JOBS)

- (1) “Official” Unemployment is 8.3% ( 12.8 million), but when you add those underemployed for economic reasons or discouraged/not looking, we’re up to 15% or 23.6 million
- (2) The labor force participation rate ( civilian labor force divided by civilian population), we’re down to 63.7%, the lowest in recorded history. This will cause problems as “baby boomers” retire. **Solution – Smart Immigration!!!**
- (3) Income growth in past twenty years has been pathetic
- (4) Credit is still very tight and could get tighter if Europe’s problems get worse ( and things are getting worse in Europe)

But, things  
are getting better

# Some signs that housing is bottoming

## 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.

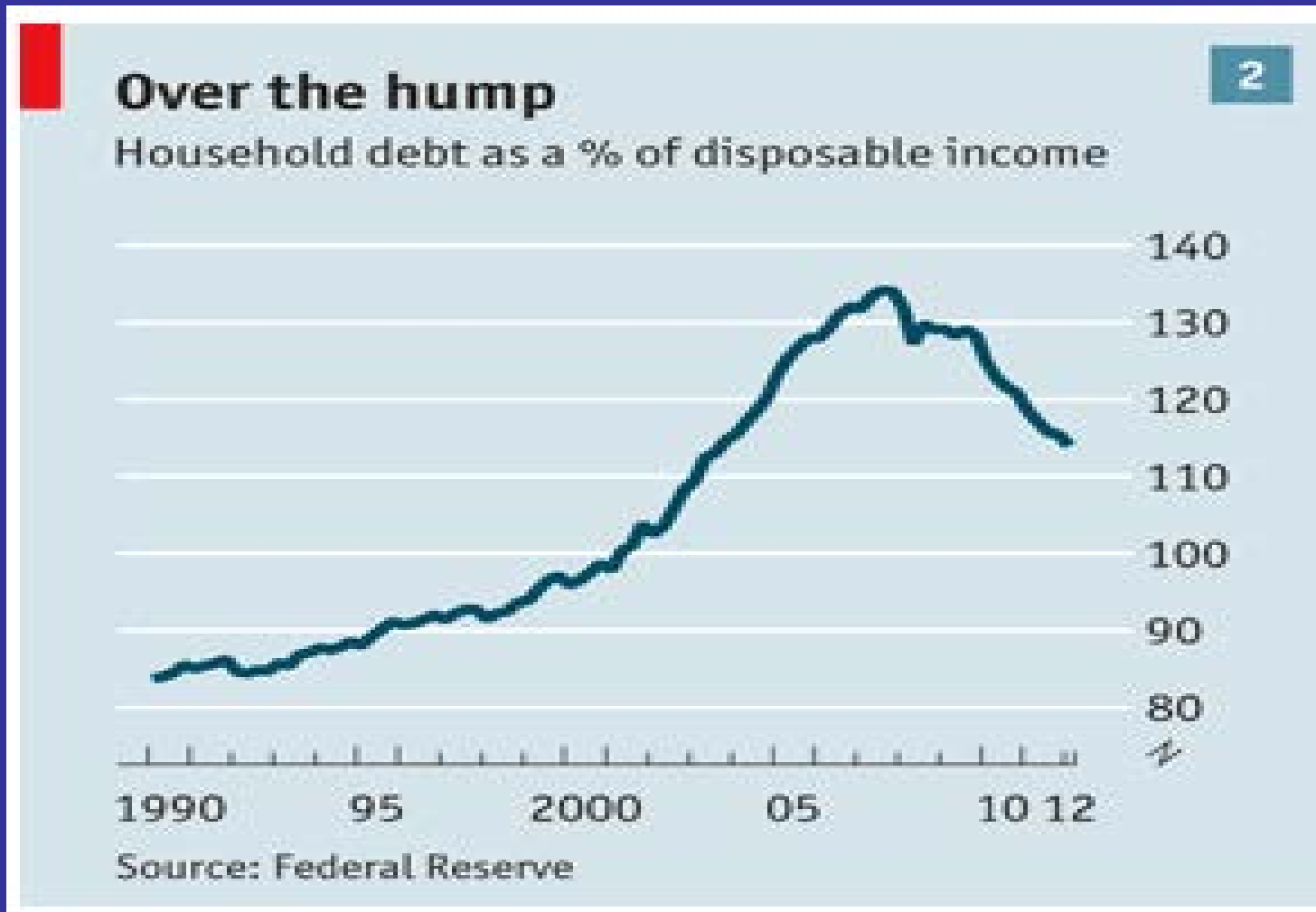
**Contribution of home building to GDP growth**



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

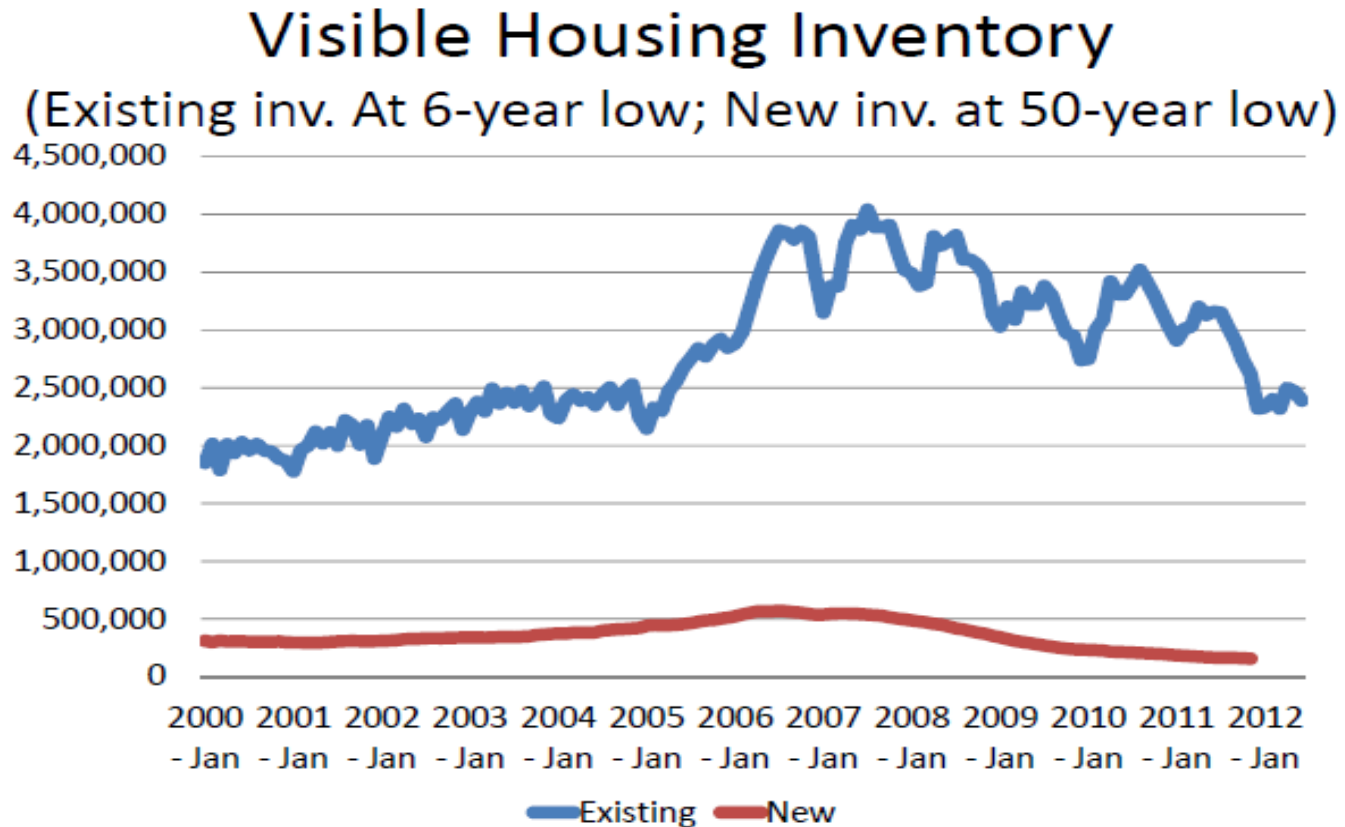
The Wall Street Journal

A Good Sign – paying off debt – once  
Deleveraging is achieved, consumers can spend and  
Buy houses again - - state government are doing the  
Same – the Feds need to take notice





Lower Inventory means builders will have to build More homes soon!!

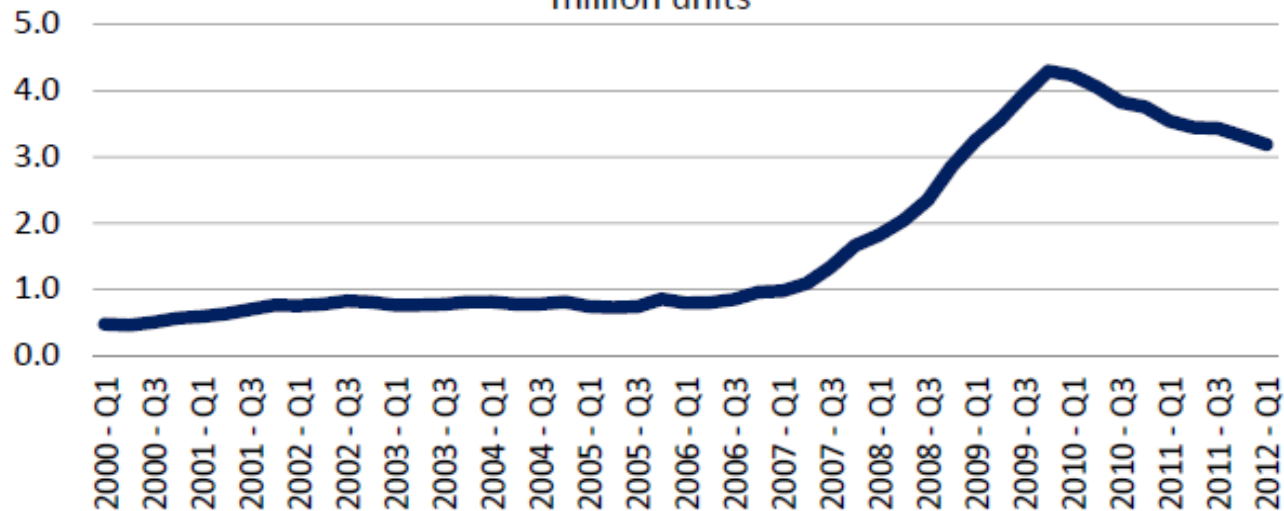


Source: NAR ( August 2012)

# Getting better

## Shadow Inventory

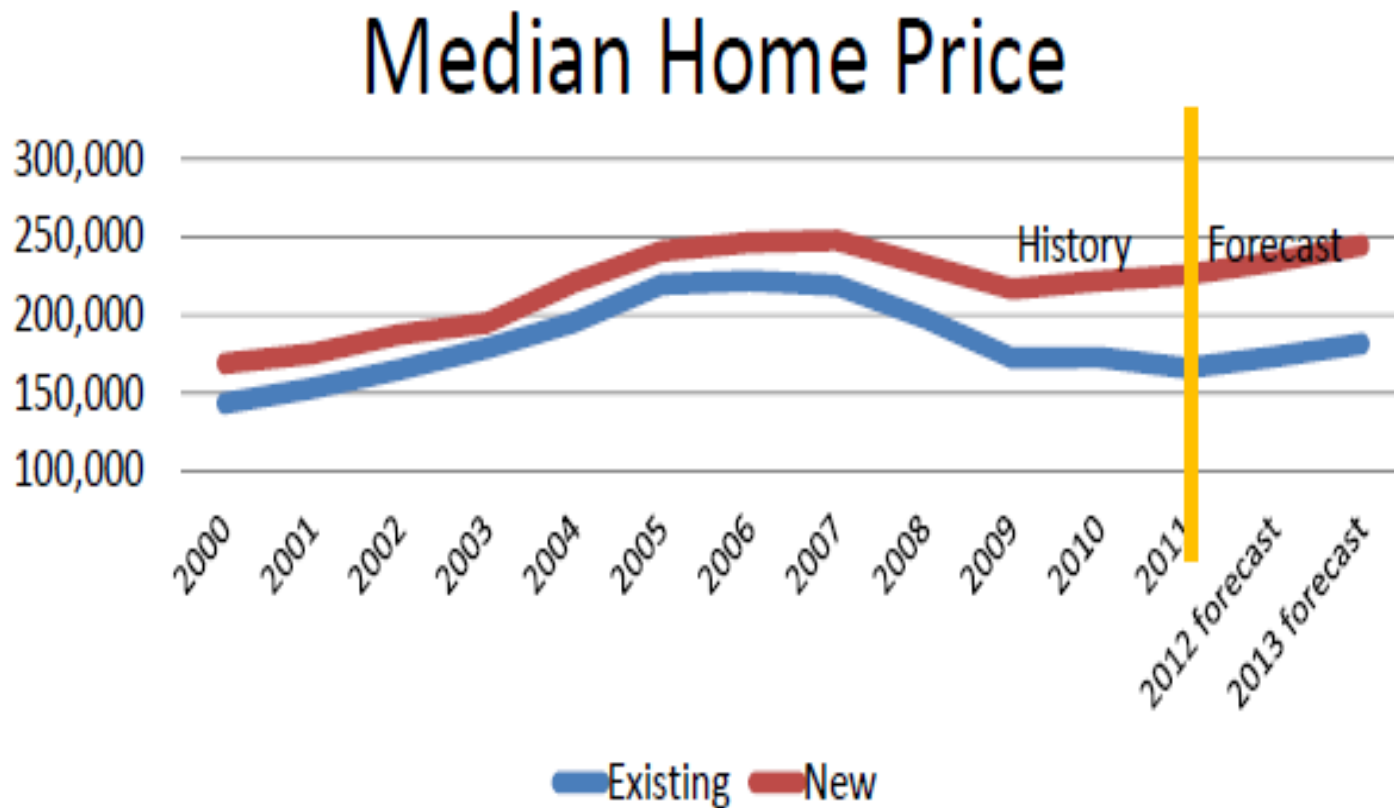
(Seriously delinquent mortgage + homes in foreclosure process)  
million units



**Shadow Inventory** can be defined as those distressed properties not yet on the market but will at some point appear given the serious delinquency situation.

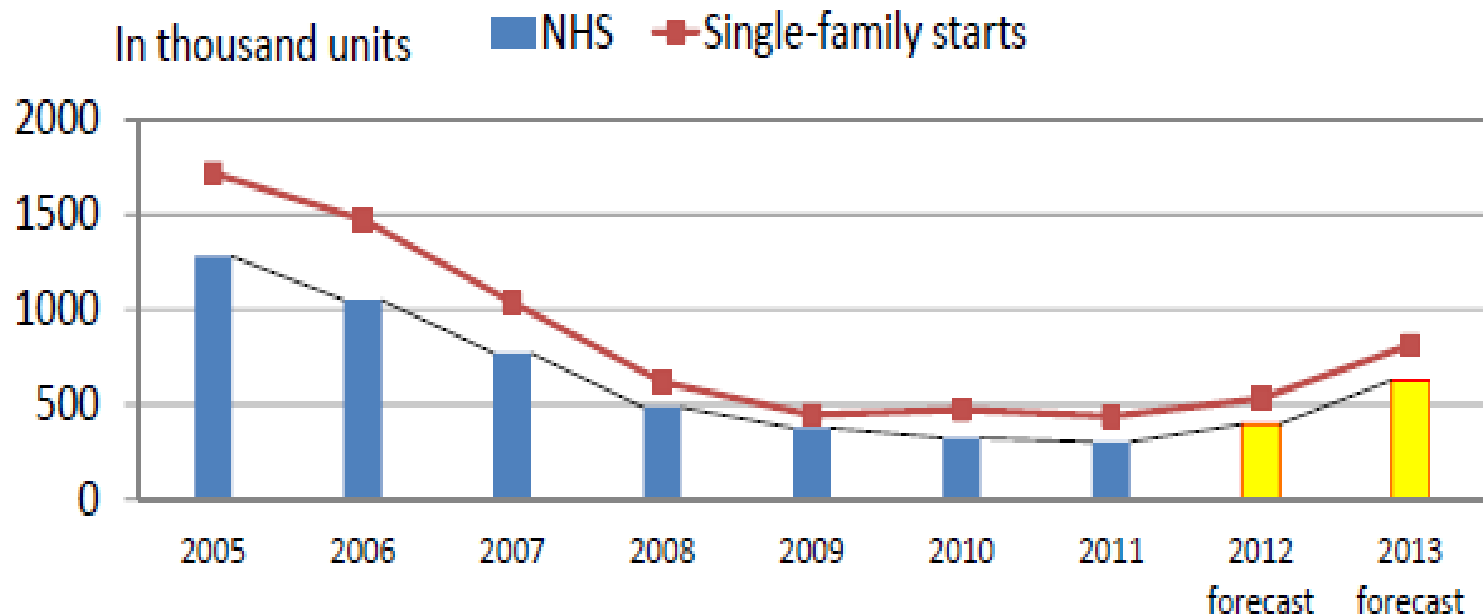
**Latest and Forecast:** Shadow inventory admittedly is still high, but it is about 1 million fewer than two years ago and is anticipated to steadily diminish over time. The falling share of distressed properties over time will lead to the median price of all homes that gets transacted to be higher.

Housing Bottom as prices trend upward  
( better demand supply balance)



Demand supply imbalance will drive new home sales and Single family starts in 2013 according to NAR – makes Sense to me too!!!

## New Home Sales



National assoc Realtors believes 2013 will be turnaround Year for housing – Why – Better Demand Supply Balance Makes good sense to me!!!!

## Forecast Summary

	2011 History	2012 Forecast	2013 Forecast
Existing Home Sales	4.26 million	4.6 million	5.0 million
New Home Sales	301,000	390,000	630,000
Housing Starts	611,000	770,000	1,150,000
Existing Home Price	\$166,100	\$173,000	\$182,000
GDP Growth	+1.7%	+2.0%	+2.9%
Payroll Job Gains	+1.7 million	+1.5 million	+2.3 million
Fed Funds Rate	0.1%	0.1%	0.1%
30-yr Mortgage	4.7%	3.8%	4.1%

## Future of housing looks good, but it is up to us!!!

Immigration plus household formation (HH)

Are the keys. In fact, in we add HH formation ( driven by population Growth ) Plus replacement demand plus 2<sup>nd</sup> homes, we will need about 1.5 to 1.7 million new homes per year – This year, ( 2012) we'll build about 700,000, so if you do the math, the future looks good for housing. ( the “pent up demand’ argument”)

But, there is one caveat – we need to fix the economy first!!!

Until we do that, people won't be able to afford the mortgage Payments ( Economics 101).

Oops – another caveat – what happens if past trends don't repeat?

- look at the homeownership slides – will Echo Boomers buys homes Like their parents did?

Another caveat – Hispanics and African Americans

represent about 25% of the Population today - in 30 years ( 2050) they

Will account for 40%. Yet, their median incomes are significantly less

Than non Hispanic white people. The government tried ( unsuccessfully) to

Bring these two groups into homeownership – maybe they need to rethink

This issue. Of course, this is a moral/political issue, but, if we could solve it,

Housing demand would boom again. – a no brainer!!

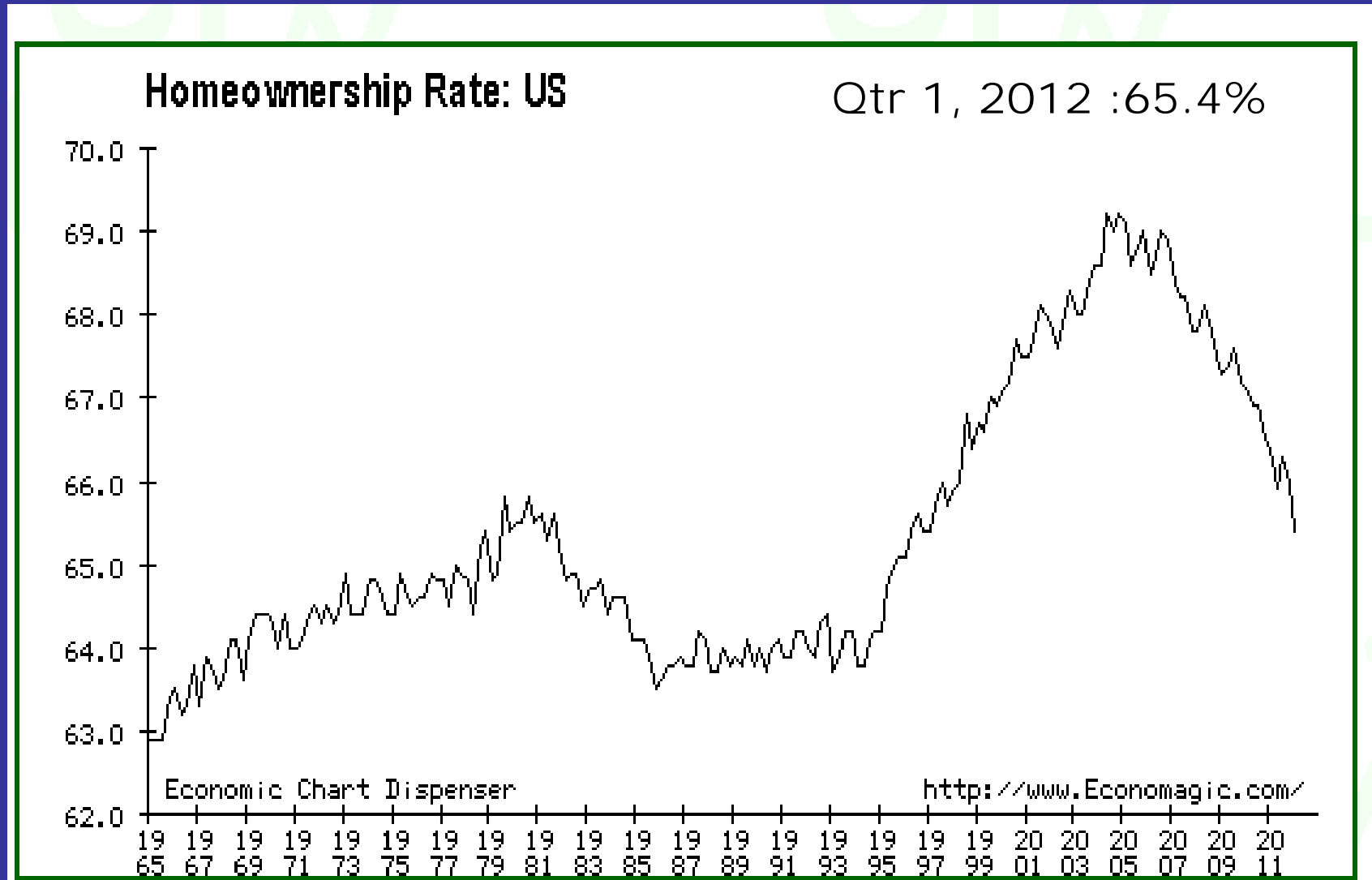
We all know that demographics is the key to housing  
But, we also know that there is no guarantee that the  
future will repeat itself

Translation – future homeownership patterns may be  
different from previous ones – two considerations:

- > largest cohort is “echo boomers’ – 75 million strong  
will they buy or rent?
- > federal government role – ownership reached almost  
70% due in large part to government influence – will  
the government reduce its footprint?

# Homeownership continues trending down – future depends on:

- (1) Federal government role – Fannie, Freddie, mortgage interest deduction, ....
- (2) Economy/jobs – again, government's impact via QE1, QE2, QE3??
- (3) Like it or not, the government plays large role with both

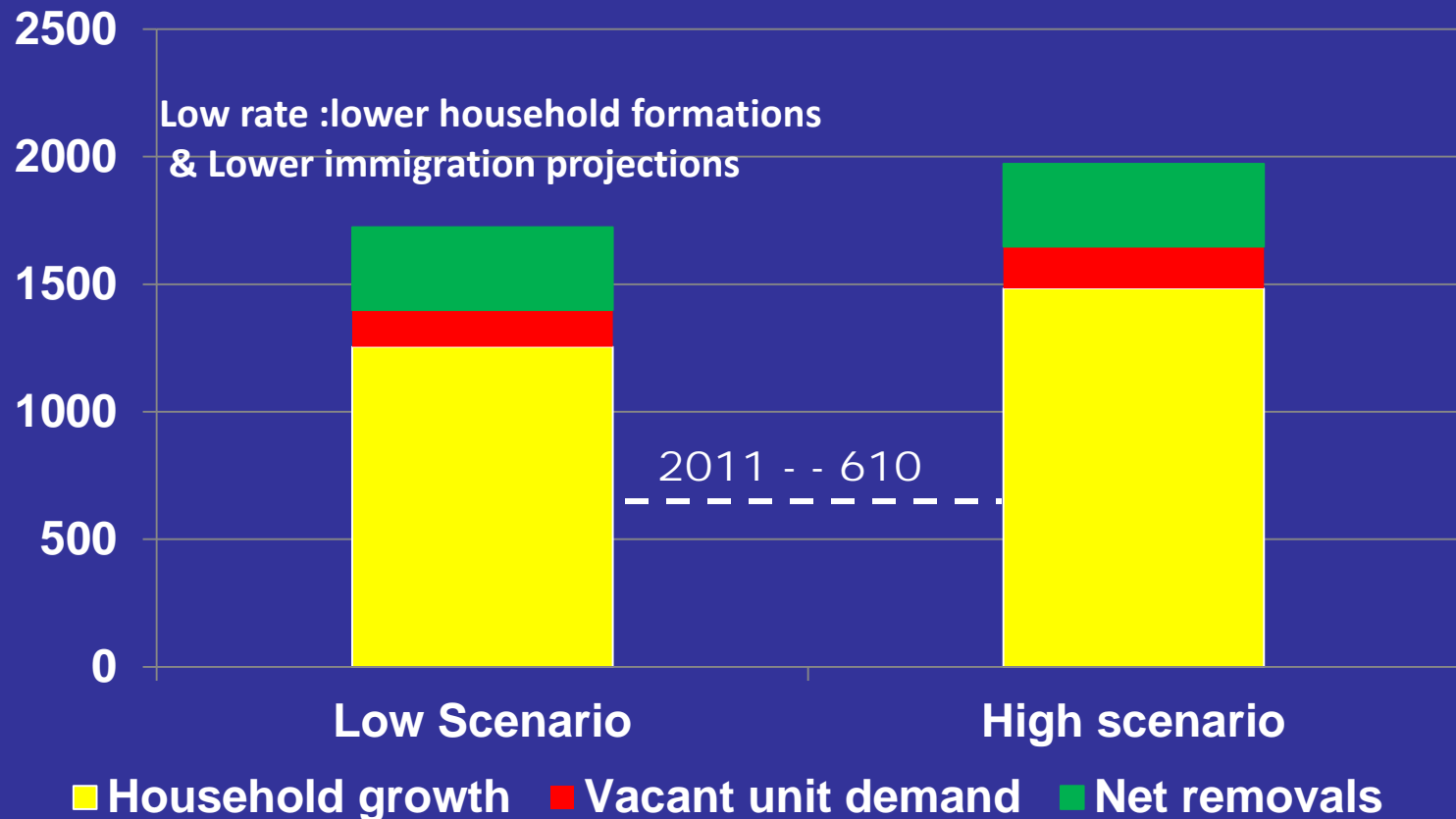




# Harvard\* Housing Demand Forecasts – strong fundamentals 2010 – 2020

Vacancy demand – 2<sup>nd</sup> homes, speculation building  
Removals – net loss from existing inventory  
of housing stock

Annual rate (000)



# U.S. population growth is projected to lead all other Geographic areas – good news for housing demand

(Annual growth rates)

	1971-1990	1991-2010	2011-2030	2010 population (million)
USA	1.0%	1.1%	0.8%	308
EU	0.4%	.03%	0.0%	501
B.R.I.C.	1.8%	1.1%	0.5%	2,844
Japan	0.9%	0.2%	-0.4%	128
Canada	1.2%	1.09%	0.6%	34
Mexico	2.4%	1.4%	0.8%	112
Africa	1.0%	0.3%	0.0%	1,028

Source: John Koskinen, Freddie Mac

## Some conclusions

- (1) The U.S. economy is facing strong headwinds and this suggests the recovery will remain muted for some time
- (2) Debt - - households plus government is high – deleveraging ( paying off debt) will impact consumer spending ( 70% of the economy) via higher taxes, job curtailments – result is weak income growth. Note the Wisconsin recall result; San Jose referendum ([http://www.nytimes.com/reuters/2012/06/02/business/02reuters-usa-california-pensions.html?\\_r=1&scp=1&sq=pension&st=nyt](http://www.nytimes.com/reuters/2012/06/02/business/02reuters-usa-california-pensions.html?_r=1&scp=1&sq=pension&st=nyt) ), etc.
- (3) The Fed has done about as much as it can – monetary stimulus - QE1 and 2/”printing money” to keep interest rates low – so far, the impact has been less than hoped for. Not sure they have many “bullets “ left.
- (4) Solutions
  - > Get our fiscal house in order without killing the economy
  - > Can be done, but means U.S. ( citizens and all levels of government) have to get back to basics – “living within our means” . Also, the Congress and administration need to do what they were elected to do – **make decisions for the good of the country!!** Probably good advice for a few other countries ( e.g., Germany/Euro)
- (5) If we do this, housing will come back because the fundamentals are sound – if we don't, housing will limp along for ??????