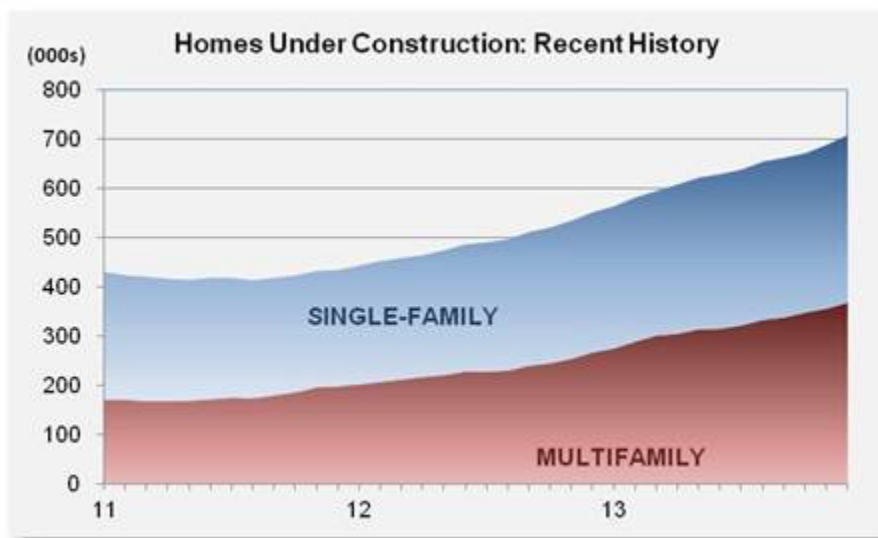


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Housing data for the end of 2013 cap off a year of post-recession growth. While construction activity remains below normal levels of production, the expansion experienced last year produced jobs and business growth. Yet headwinds remain in the form of rising materials costs and policy risk.

The Census Bureau/HUD December housing starts report revealed a solid finish for the end of the year. The pace of housing construction came in at an annualized rate of 999,000. This rate was almost 10% below an unusually strong level reported in November (1.107 million, which itself was revised up 1.6% from the already strong preliminary estimate). Despite the monthly decline, the December estimate marked the third strongest month of the year.

Totals for 2013 show significant gains for the year. The tally for total housing starts for the year (923,000) was an 18% improvement over 2012. Multifamily starts came in at 306,000, a 25% jump over the prior year. Single-family construction starts grew 15% to a total of 618,000.

The pattern of housing starts is consistent with trends suggested by the NAHB/Wells Fargo Housing Market Index (HMI). The January HMI dropped one point from downwardly revised December level to 56.



23 January 2014



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This marked the eighth consecutive month above 50, the point where more builders rate the market good rather than poor.

The December index, originally reported at 58, matched the recent high in August before the mortgage rate spike and the federal government shutdown softened buyer and builder confidence. The January level demonstrates builders' general positive attitude toward the current and future market but with some continued attention to the headwinds affecting the industry.

A long-term check on the state of the recovery in home building is a look at the number of homes being built. According to the Census Bureau, the count of homes under construction increased for the 28th consecutive month in December, from a seasonally adjusted 688,000 to 707,000. The continuous expansion of the stock of homes under construction is a useful reminder of the sustainability of the recovery in building.

New data for the third quarter of 2013 provide detail regarding the newly built single-family market. According to data from the Quarterly Starts and Completions by Purpose and Design, the size of a typical single-family continues to rise, increasing on a median basis from 2,446 square feet to 2,491 during the third quarter. The recent rise is explained by an atypical mix of buyers: fewer first-time buyers means meeting a proportionally greater demand for larger homes.

Other metrics are consistent with a recovery in traditional for-sale single-family home construction. The single-family built-for-rent share of the market (measured on a one-year moving average basis) fell to 4% for the third quarter, higher than the 2.8% historical average but lower than the 4.9% cycle high set earlier in 2013. The market share for the construction of townhomes also fell during the quarter, standing at 11.6% on a one-year moving average basis, down from 12.1% in the prior quarter. Additionally, the share of owner/contractor-built single-family homes declined to 21.9%. The shares of all three of these market segments fell as overall single-family starts expanded in 2013.

Multifamily data for the third quarter also show an increase in the average size of newly built units, rising to a median of 1,085 square feet. As the for-sale multifamily segment recovers, this number will continue to rise. One factor that may help support this movement is the ongoing rise in rents. According to December data from the Consumer Price Index, inflation-adjusted rents were up 0.2% month over month and 1.1% over the last year.

A useful gauge of the overall state of the housing recovery — and potential for growth — is the NAHB/First American Leading Markets Index (LMI). The number of markets reaching and exceeding their last normal level of economic and housing activity continues to advance, albeit slowly. The LMI contains 56 markets in which the index is at or above one, which means the last 12 months' average of single-family housing permits, home prices and employment levels are at or

above their last period of normalcy. The national index for January remained at .86, meaning that the U.S. market is only 86% of the way back to normal as evaluated on the basis of prices, jobs and building.

The headwinds for the industry as 2014 begins are the same challenges that were present for most of 2013. Increased demand for home construction has raised building material prices. Producer Price Index data



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indicate that softwood lumber prices rose during the second half of the year, with OSB prices also rising but at a slower pace. Gypsum prices ended 2013 up 16.6% over 2012.

Finding workers also remains a key concern. The latest BLS reports on job openings reveals that the open job rate (measured as a share of total employment) for construction (2.3%) is the highest since April 2007.

In policy news, minutes from the most recent Federal Open Market Committee – the Federal Reserve's monetary policymaking arm – reveal that the Fed believes that the strengthening economy justifies the reductions in its asset purchase program, commonly called Quantitative Easing (QE). The phasing out of QE will result in an increase in borrowing costs, including mortgage interest rates.

At the end of 2013, a number of housing and real estate-related tax policies expired. These include the energy tax credits for new home construction (45L) and existing home retrofits (25C), as well as the deduction for mortgage insurance and the 9% fixed rate for the Low-Income Housing Tax Credit. The fate of these now expired policies will depend on whether Congress pursues tax reform in early 2014.

Last, in analysis news, NAHB economists recently examined the cost of maintenance and repair for multifamily properties. For properties with five or more units, the average spending on maintenance and repair was \$50,802. For owner-occupied homes, NAHB used the American Housing Survey to chart the age of the housing stock. The 2011 data reveal a median age of 35 years, compared to 23 years of age in 1985. Finally, average and aggregate estimates of remodeling expenditures by state and county were published for NAHB Remodelers. The estimates suggest an average amount of \$1,400 of remodeling per owner-occupied home and \$1.9 million per ZIP code.

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Richard P. Vlosky, Ph.D.  
Director Louisiana Forest Products Development Center  
Crosby Land & Resources Endowed Professor of Forest Sector Business Development  
Room 227, School of Renewable Natural Resources  
Louisiana State University  
Baton Rouge, LA 70803  
Phone (office): (225) 578-4527  
Fax: (225) 578-4251  
Mobile Phone: (225) 223-1931

