10 March 2015

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Attached, please find the monthly housing report based on January's data.

The housing report is a free service of Virginia Tech and is intended to help you gauge future business activity. All past housing reports are archived at: **http://woodproducts.sbio.vt.edu/housing-report/**.

Please let us know if you have any questions.

Respectfully,

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January 2015 Housing Commentary

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January 2015
Housing Scorecard

	M/M	Y/Y
Housing Starts[A]	▽ 2.0%	△18.7%
Single-Family Starts[A]	▽ 6.7%	△16.3%
Housing Permits[A]	▽ 0.7%	△ 8.1%
Housing Completions[A]	△ 1.3%	△ 9.4%
New Single-Family House Sales[A]	▽ 0.2%	△ 5.3%
Existing House Sales[B]	▽ 4.9%	△ 3.2%
Private Residential Construction Spending[A]	△ 0.6%	▽ 3.4%
Single-Family Construction Spending[A]	△ 0.6%	△ 9.7%

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

Source: [A]U.S. Department of Commerce-Construction ; [B] National Association of Realtors® (NAR®)

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New Housing Starts

	Total Starts*	Single-Family Starts	Multi-Family 2-4 unit Starts	Multi-Family 5 or more unit Starts
January	1,065,000	678,000	6,000	381,000
December	1,087,000	727,000	20,000	340,000
2014	897,000	583,000	8,000	306,000
M/M change	-2.0%	-6.7%	-70.0%	12.1%
Y/Y change	18.7%	16.3%	-25.0%	24.5%

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

Source: U.S. Department of Commerce-Construction: www.census.gov/construction/nrc/pdf/newresconst.pdf

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New Housing Permits and Completions

	Total Permits*	Single-Family Permits	Multi-Family 2-4 unit Permits	Multi-Family 5 or more unit Permits
January	1,053,000	654,000	27,000	372,000
December	1,060,000	675,000	25,000	360,000
2014	974,000	618,000	29,000	327,000
M/M change	-0.7%	-3.1%	8.0%	3.3%
Y/Y change	8.1%	5.8%	-6.9%	13.8%

	Total Completions*	Single-Family Completions	Multi-Family 2-4 unit Completions	Multi-Family 5 or more unit Completions
January	930,000	649,000	7,000	274,000
December	918,000	664,000	6,000	248,000
2014	850,000	609,000	14,000	227,000
M/M change	1.3%	-2.3%	16.7%	10.5%
Y/Y change	9.4%	6.6%	-50.0%	20.7%

Source: U.S. Department of Commerce-Construction: www.census.gov/construction/nrc/pdf/newresconst.pdf

* All data are SAAR

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New and Existing House Sales

	New Single-Family Sales*	Median Price	Month's Supply	Existing House Sales [B*]	Median Price [B]	Month's Supply [B]
January	481,000	294,300	5.4	4,820,000	$199,600	4.7
December	482,000	302,100	5.4	5,070,000	$208,200	4.4
2014	457,000	269,800	5.0	4,670,000	$187,900	4.8
M/M change	-0.2%	-2.6%	--	-4.9%	-4.1%	-13.7%
Y/Y change	5.3%	9.1%	8.0%	3.2%	6.2%	-4.3%

* All sales data are SAAR

Source: U.S. Department of Commerce-Construction: www.census.gov/construction/nrs/pdf/newressales.pdf;
[B] NAR® www.realtor.org/topics/existing-home-sales; 2/23/15

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Existing House Sales

National Association of Realtors (NAR®)[B]

January 2015 sales data: 4.82 million houses sold (SAAR)

Distressed house sales: 11% of sales –
(8% foreclosures and 3% short-sales);

11% in December and 15% in January 2014.

All-cash sales: increased to 27%; 26% in December 2014 and 33% in January 2014

Investors are still purchasing a substantial portion of "all cash" sale houses – 17% in January 2015, 17% in December 2014 and 20% in January 2014.

67% of investors paid cash in January.

First-time buyers: 28% (29% in December 2014) and were 26% in January 2014

Source: [B] NAR® www.realtor.org/topics/existing-home-sales; 2/23/15

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January 2015 Construction Spending

January 2015 Private Residential Construction:
$351.72 billion (SAAR)

0.6% more than the revised December estimate of $349.45 billion (SAAR)
-3.4% less than the January 2014 estimate of $364.08 billion (SAAR)

January SF construction: $204.89 billion (SAAR)
0.6% more than December: $203.68 billion (SAAR)
9.7% greater than January 2014: $186.85 billion (SAAR)

January MF construction: $48.75 billion (SAAR)
1.9% more than December: $47.83 billion (SAAR)
29.8% greater than January 2014: $37.56 billion (SAAR)

January Improvement[C] construction: $98.08 billion (SAAR)
-0.5% less than December: $97.95 billion (SAAR)
-29.8% less than January 2014: $139.67 billion (SAAR)

[C] The US DOC does not report improvements directly, this is an estimation. All data is SAAR and is reported in nominal US$.

Source: U.S. Department of Commerce-C30 Construction: www.census.gov/construction/c30/pdf/privsa.pdf

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Conclusions

January housing data was mixed – as to be expected for a winter month. The most troubling component is remodeling or improvement spending. While it is not reported directly, it is interpolated. And since January of 2014, improvement spending has decreased each month. Year-over-Year, remodeling expenditures have declined by nearly 30 percent. For most data reported, we must remind ourselves we are well below historical averages in most of these categories.

Housing, obviously, reacts to the overall economy; when the economy improves, we should expect to see most housing sectors improve as well. As written in previous months, the near-term outlook on the U.S. housing market remains unchanged – there are potentially several negative macro-factors or headwinds at this point in time for a robust housing recovery (based on historical long-term averages).
Why?

1) Lack-luster household formation,
2) A constrained quantity of well-paying jobs being created,
3) a sluggish economy,
4) declining real median annual household incomes ,
5) strict home loan lending standards, and
6) global uncertainty

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December 2014
EU Housing Scorecard

		M/M	Y/Y
Production in Construction[A]	EU 28	▽ 0.5%[s]	▽ 0.5%[s]
	EU 18	▽ 0.8%[s]	▽ 3.5%[s]
	Germany	▽ 2.9%	▽ 4.7%
	France	△ 0.4%	▽ 7.5%
	UK	△ 0.4%[p]	△ 4.7%[p]
	Spain	▽ 0.9%[ps]	△ 1.9%[p]
Building permits (m^2 floor)[A]	EU 28	-.-	-.-
	EU 18	△ 1.9%[(10)]	▽ 1.6[(10)]
	Germany	▽ 4.4%[s(11)]	△ 2.0%[(11)]
	France	△ 9.2%[s]	▽ 10.0%
	UK	-.-	-.-
	Spain	△ 19.9[s(10)]	▽ 37.1%[e(10)]

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

Source: Eurostat (http://epp.eurostat.ec.europa.eu/portal/page/portal/short_term_business_statistics/data/main_tables),
[A] see http://epp.eurostat.ec.europa.eu/portal/page/portal/short_term_business_statistics/introduction/sts_in_brief
[e] estimate, [s] Eurostat estimate, [p] provisional, '-.-' no data available, [(10)] October data

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Housing comments – February , 2015

- *December starts fell 2.0% (to 1.065 million, annual rate) from previous month, with single family coming in at 678,000 (SAAR) – another weak month.*
- Multi family continues to be the driver – rental prices are increasing – single family sales remain weak and this has big impact on wood prices. This may not change for some time due to "two tiered economy".
- Economic issues - slowing world economy; sub par domestic job market; sluggish income growth; continuing tight domestic credit environment ; recession in Europe and facing growing deflation concerns.
- *Main problem (short term) continues to be the job market. Unemployment rate keeps coming down, but \often this is due to people leaving the workforce. Longer term – makeup of U.S. economy is changing and this is impacting spending patterns and housing choices.*
- RE: the economy and interest rates – I believe the FED will keep interest rates low for some time. Yes, the FED will start increasing rates in 2015, but I don't think rates will move up very quickly. The stronger dollar will impact rate decisions!

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“Musical chairs and currency devaluations –

Today, we’re seeing various countries (Europe, Japan, and the latest, Canada) lowering interest rates to weaken their currencies to spur export and general economic growth. Consequently, U.S. dollar strengthens, and when we raise rates, the dollar will strengthen even more (it gained 15% against our trading partners in 2014). There is a growing concern in some countries (Europe, Japan) with outright deflation (i.e., 1930’s). In others , with disinflation – slower price increases -- U.S., Canada, China,…… Falling energy prices are a factor. This creates problems with debtor countries (all of the above except China) as it’s much easier to repay debt in an inflationary environment. Problem is that all of us can’t deflate our currencies! So, we get a ‘race to the bottom”, and play “musical chairs” hoping we’re not left “standing when the music stops”. In the past, the U.S. could play the role of the world’s economic engine – today, we’re just not economically strong enough. E.g., Our debt situation is growing more serious as public debt To GDP ratio exceeds 70% - as interest rates rise, debt servicing costs become a serious burden forcing tough spending decisions.

The answer to weak growth isn’t currency devaluation – it’s growing demand for products, services, etc. That means investment, product development – this requires research, infrastructure spending , tax reform, better education. Massive government spending isn’t the answer – a supportive government has a key role in the job creation process, but it is a supporting role. Good government can help create an environment that encourages innovation, job creation, etc., but the private sector creates products and services and therefore jobs, in any vibrant economy. Just look to Europe to see what happens when government gets too big – stagnation, unemployment, etc.
Will be interesting to see how currency devaluations impact the U.S. recovery/ growth, and any impact on The FED’s decision re: interest rate increases.

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Two tiered economy* – where the U.S. is headed, and what It could mean for consumption patterns and demand for housing

See interesting article in WSJ - "Two tiered economy reshapes the marketplace" WSJ January 25, 2015, Page A1.
(http://www.wsj.com/articles/how-a-two-tier-economy-is-reshaping-the-u-s-marketplace-1422502201?KEYWORDS=two+tiered+economy+reshapes)

Following are some slides from that article that suggests the U.S. economy is evolving into a 'two tiered economy" – the well off and the not so well off. We have discussed this before in our housing notes –
.e.g. Stagnant household incomes; more people underemployed; low income jobs with few benefits; ……

The bottom line is that consumption patterns are changing as well as demand for shelter. We may not see a return to the 'good old days" for housing? We may see continuing demand for larger, more expensive single family homes, but, total demand will remain below trend (1.5 million) as rental demand remains strong.

*Wealthy households advancing while middle income and lower income people struggle."

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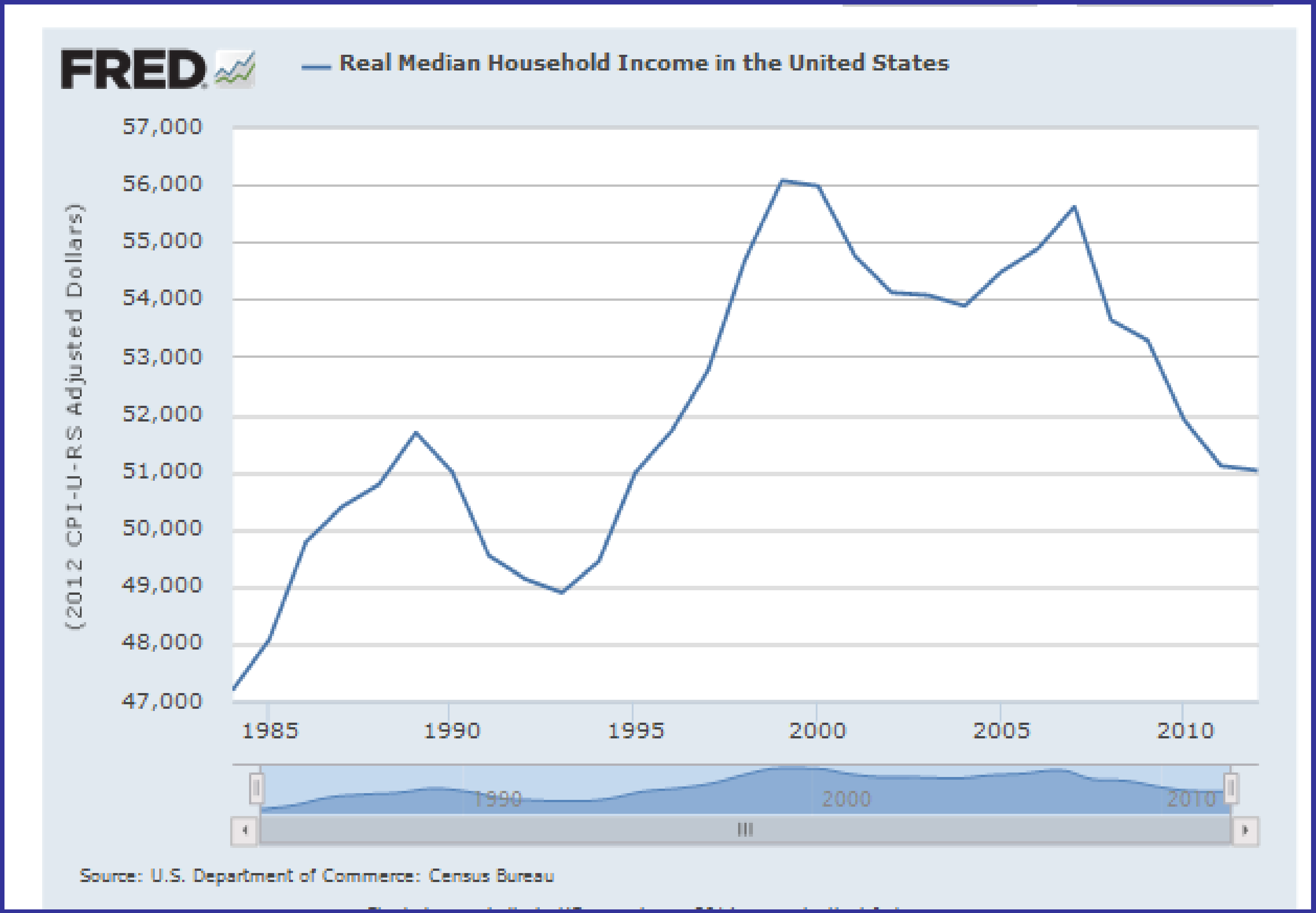
1st, just a reminder what has happened to incomes over the past twenty years --- real incomes have been shrinking for the past 20 years



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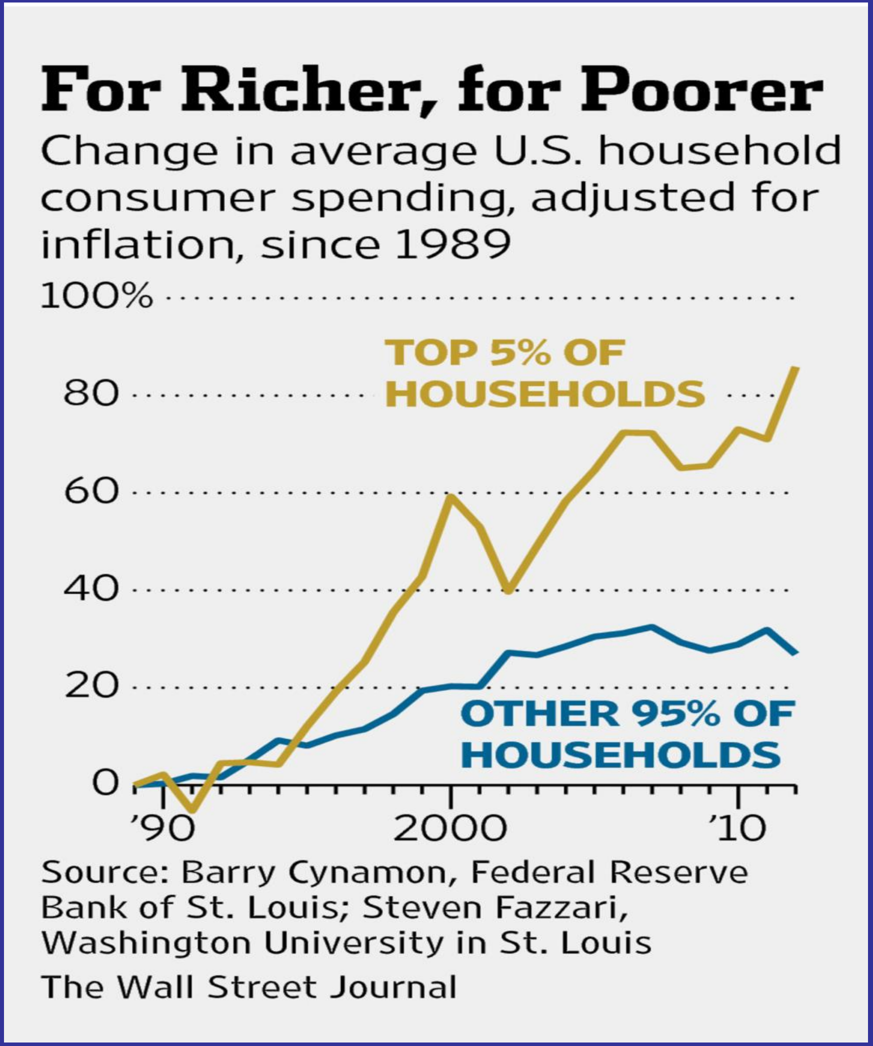
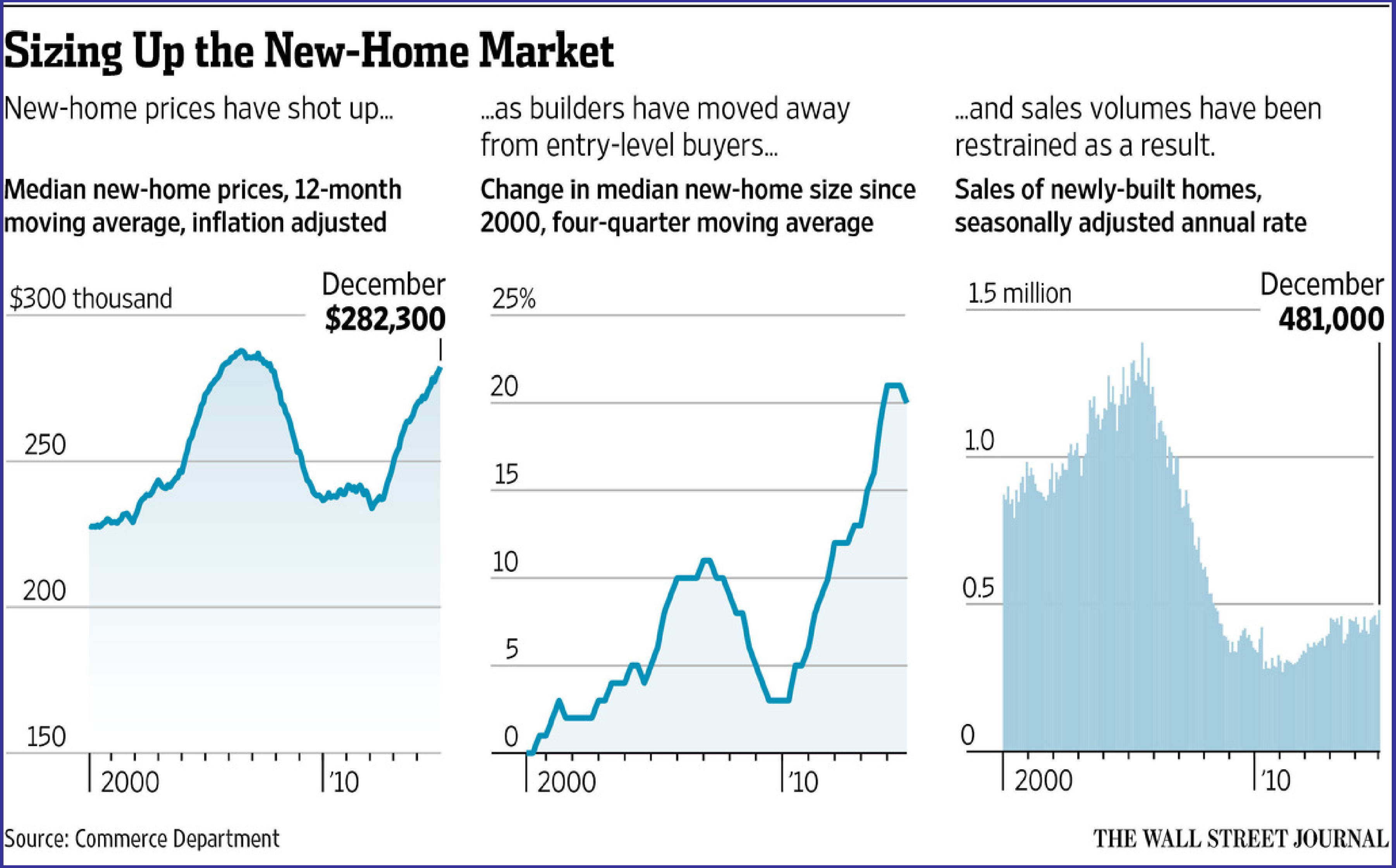
Consumer spending trends reflect changing income patterns of U.S. population - therefore, many businesses are reorienting to serve higher income buyers. E.g., luxury retail sales, hotels, cars doing well, even premium beer sales are booming, but rest of economy not doing as well



Source: WSJ: http://www.wsj.com/articles/how-a-two-tier-economy-is-reshaping-the-u-s-marketplace-1422502201?KEYWORDS=two+tiered+economy+reshapes

Also means Shifting makeup for single family housing demand resulting in bigger and More expensive houses with lower entry level demand
--- bottom line --- fewer housing starts/sales (and demand for wood)



Source: WSJ (http://www.wsj.com/articles/how-a-two-tier-economy-is-reshaping-the-u-s-marketplace-1422502201?KEYWORDS=two+tiered+economy+reshapes)

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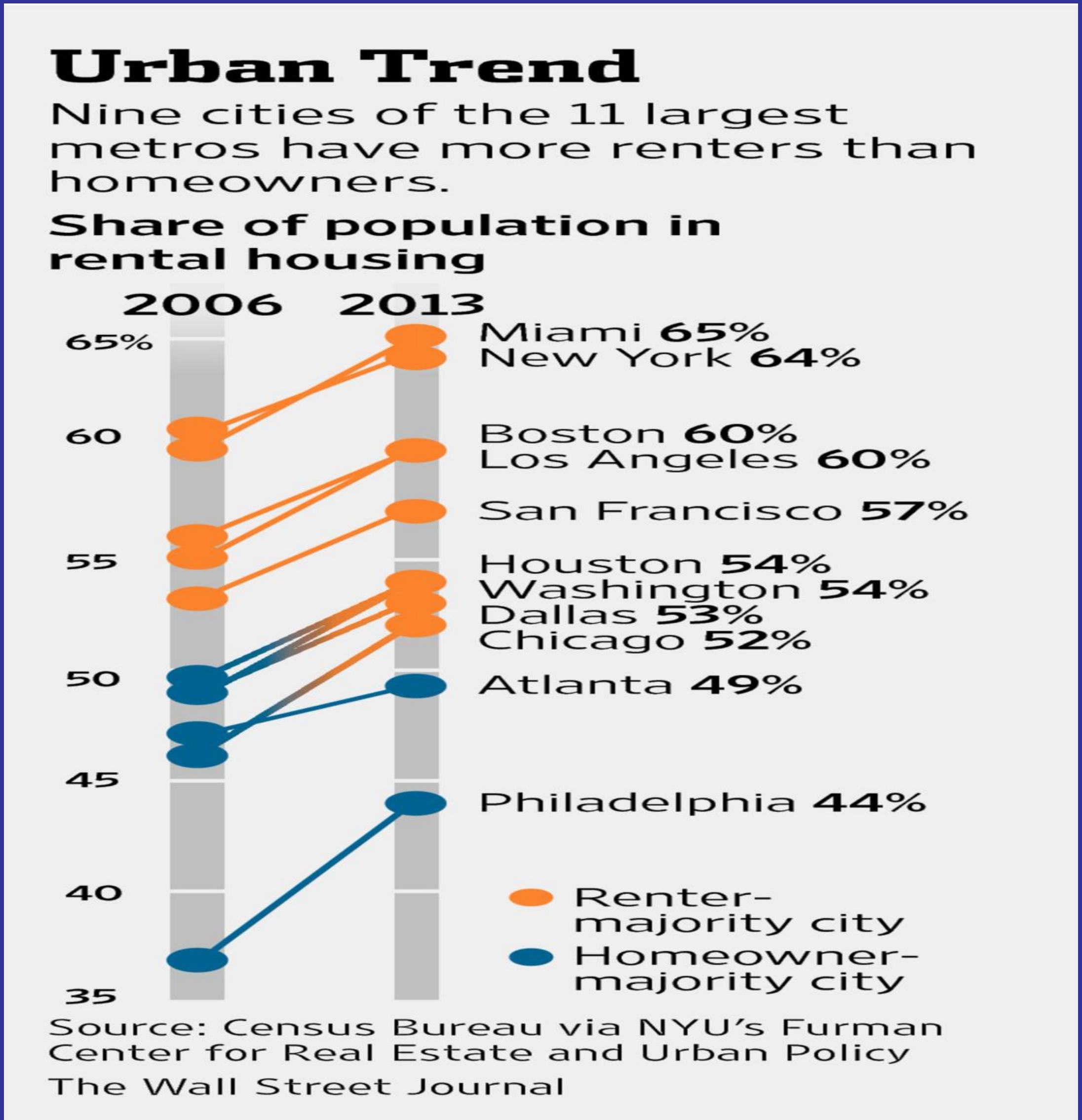
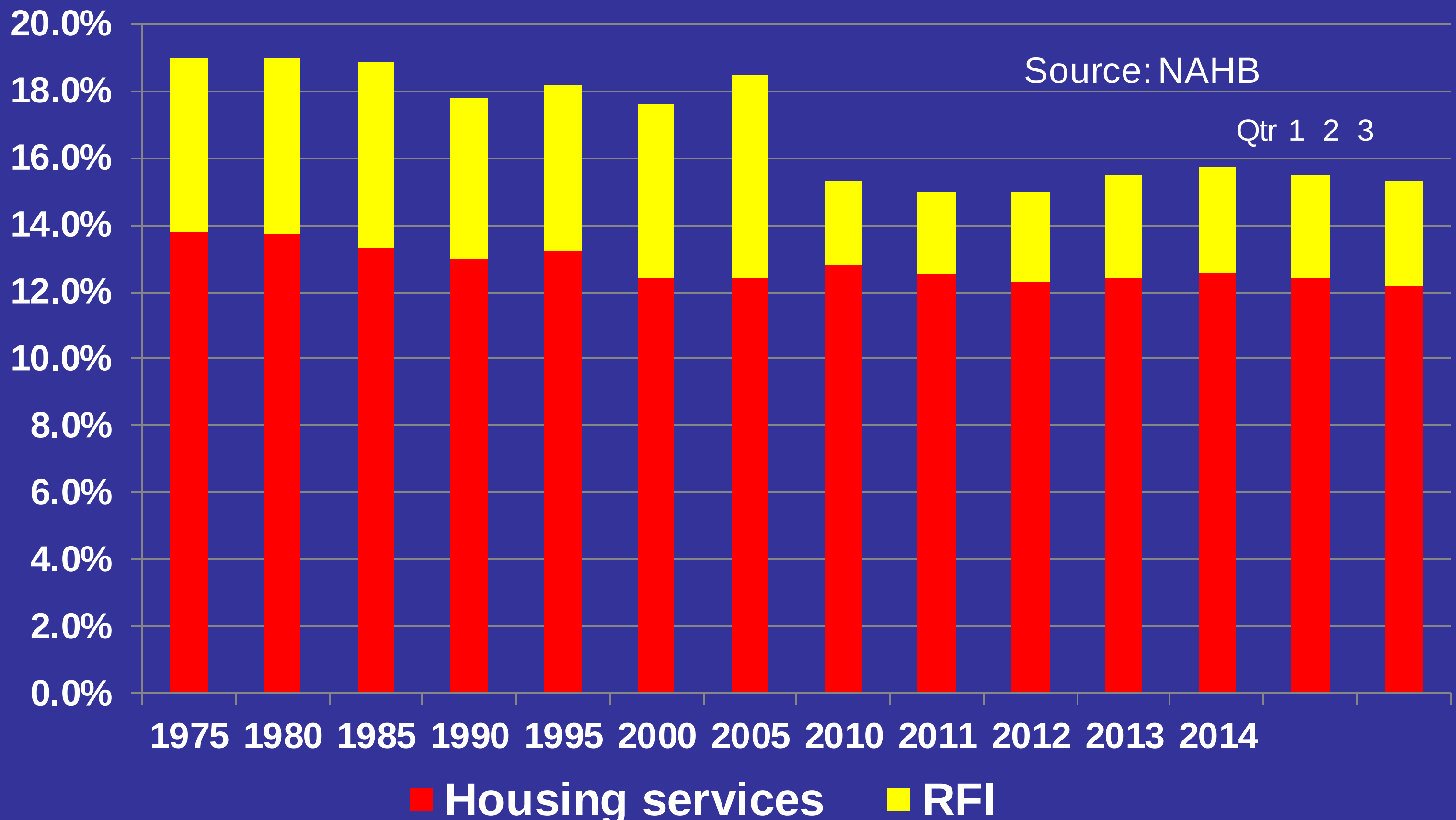
Another result --- Rental demand keeps increasing



Source: WSJ (http://www.wsj.com/articles/renters-are-majority-in-big-u-s-cities-1423432009?KEYWORDS=shift+to+renting)

This will impact the U.S. economy because Housing's contribution to GDP (%) is huge – 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 (include utilities) + owner's imputed rent (how much It would cost to rent owner occupied homes) + utility payments
RFI (residential investment) = construction of new SF and multifamily structures, remodeling, manufactured homes , plus broker's fees



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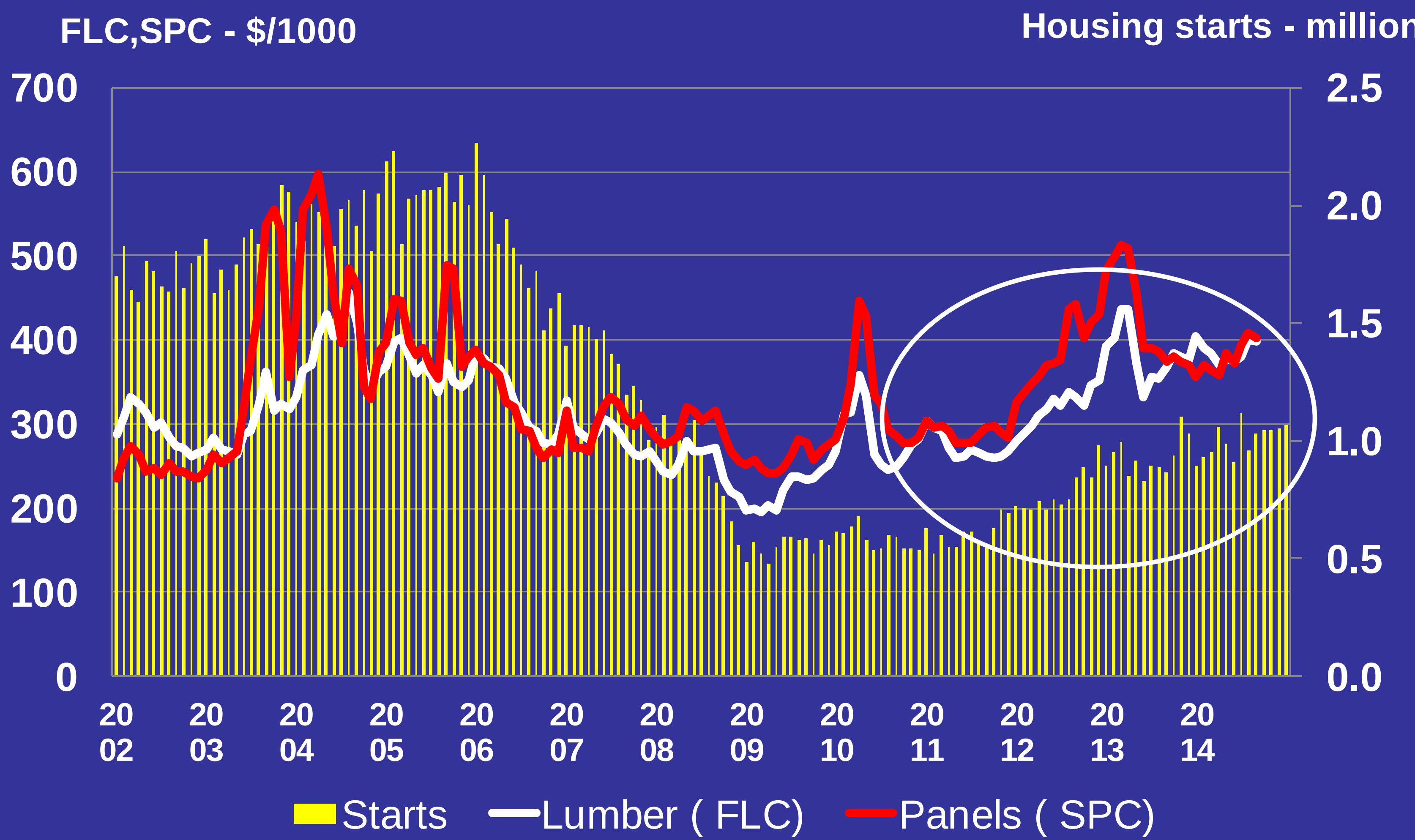
Housing starts and wood product prices – Economics 101

75% of structural wood products go to housing (new construction plus remodeling)
50% or more of hardwoods go to housing related activities.



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

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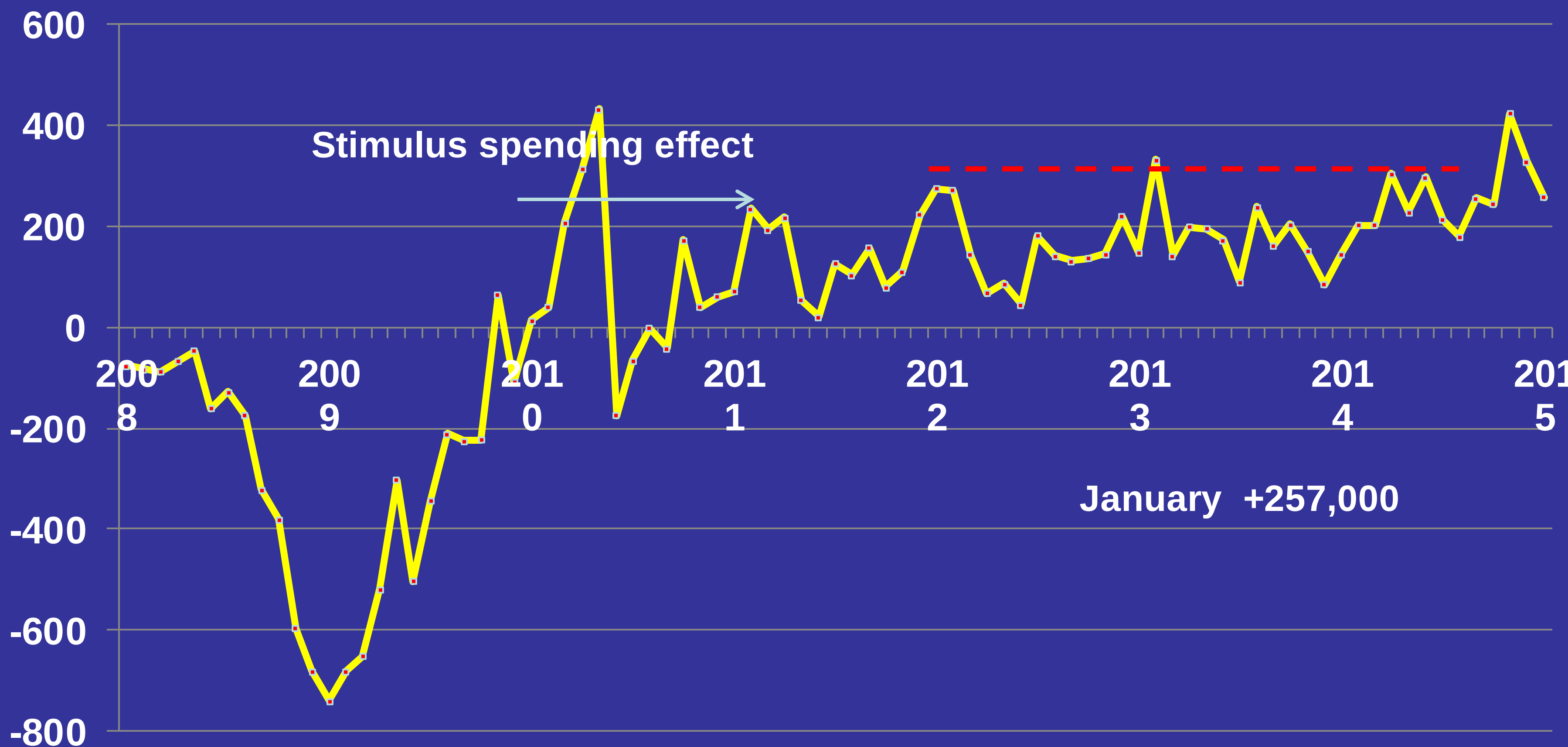
Employment situation - our biggest problem - it's getting better, but quality Jobs remain scarce, and inflation adjusted wage growth has been weak for Almost two decades.

Net change in non farm payrolls – monthly, thousands



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

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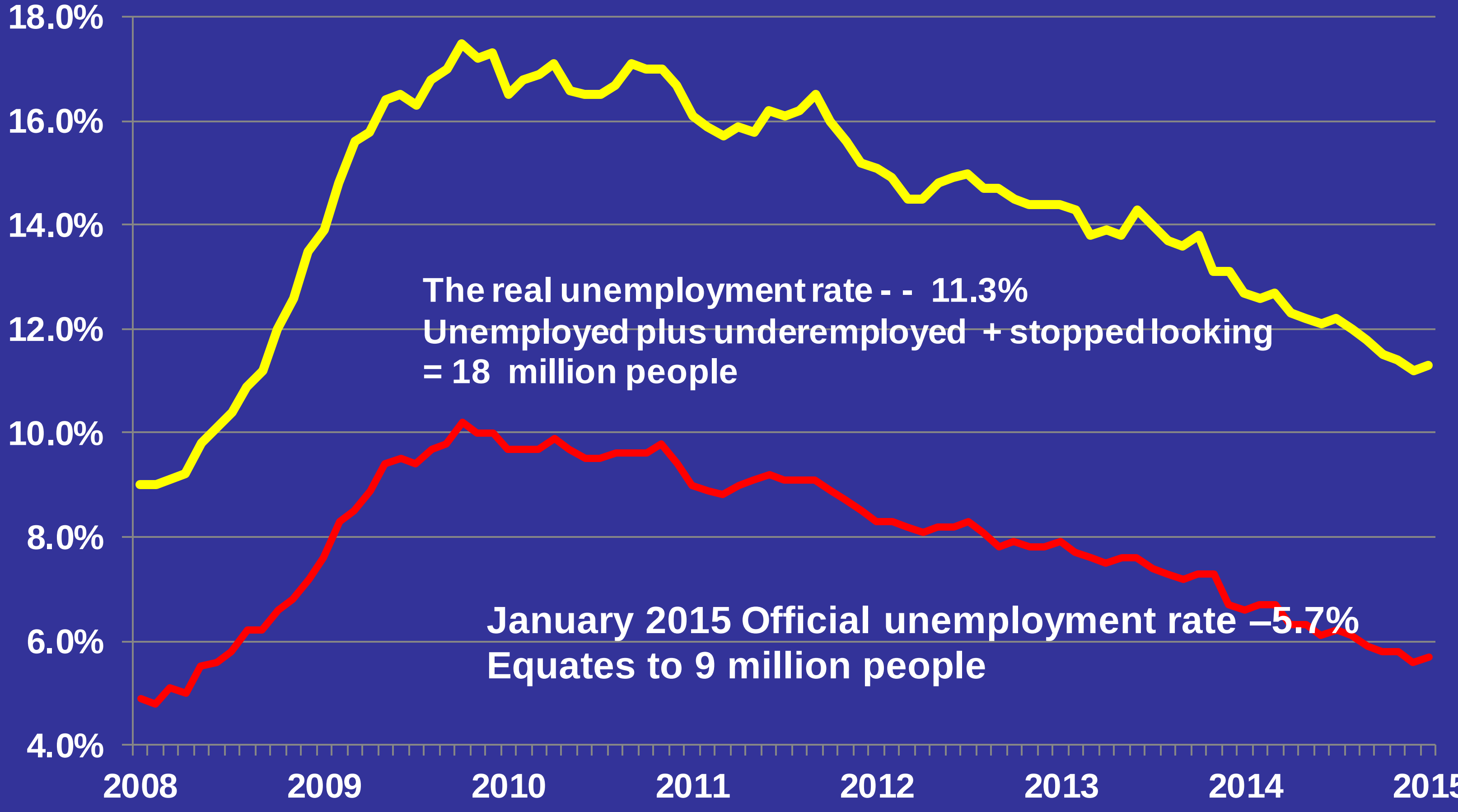
Unemployment rate keeps coming down – but, nearly 7 million remain "underemployed" – working part time, but want full time jobs

**There are about 18 million people either unemployed, underemployed, or stopped looking...



Source - - BLS: http://www.bls.gov/news.release/pdf/empsit.pdf; http://data.bls.gov/cgi-bin/surveymost?ln

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Yes, unemployment rate is now below 6%, but income growth is missing (yes, it is starting to pick up, but very slowly). E.g., inflation adjusted income today is the same as it was twenty years ago. I.e., there has been no improvement in median family income over the past two decades. That's why many people believe we are still in a recession, and consumer confidence remains relatively weak.

Just a reminder, consumer spending is 70% of the economy, and without real Income growth, spending can't grow very fast!

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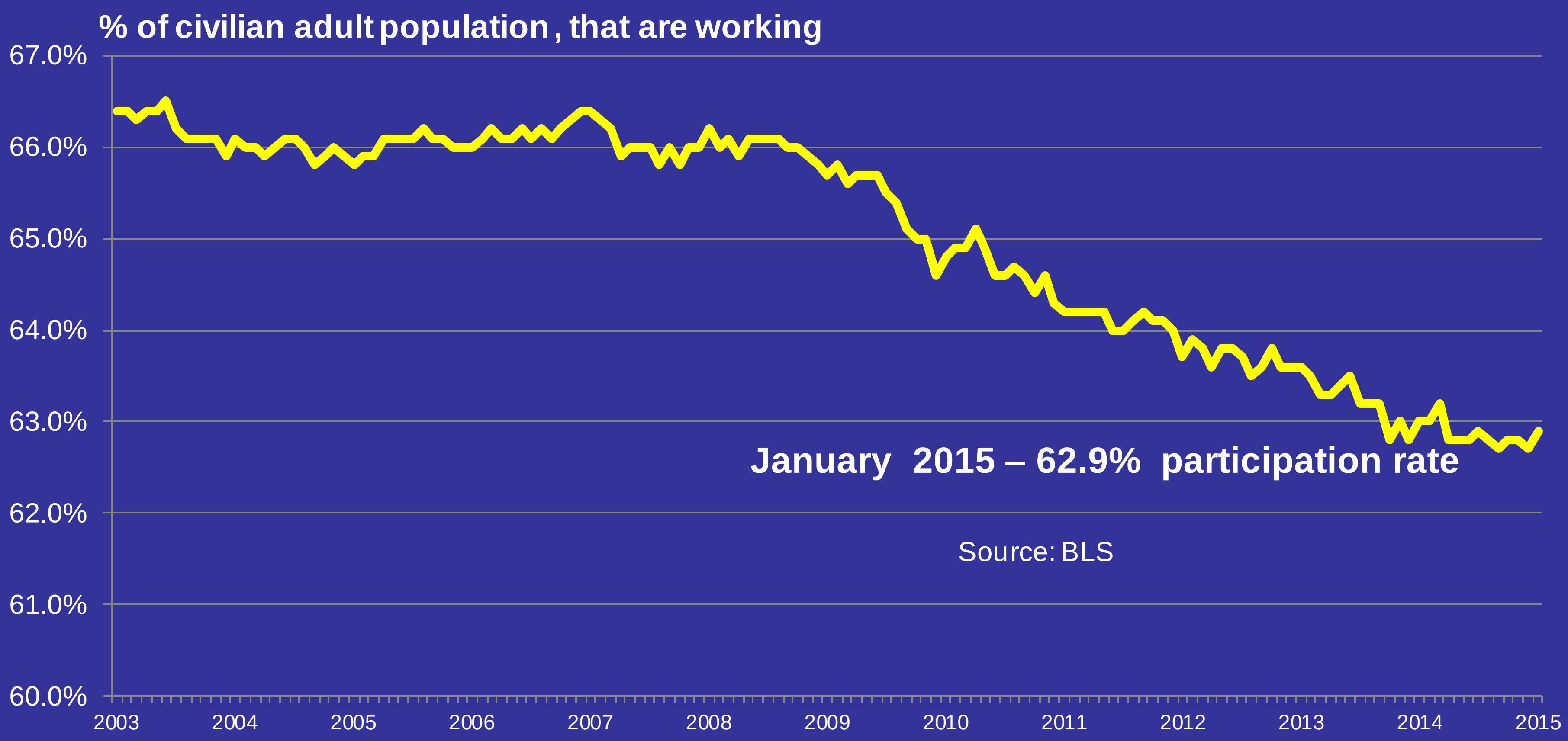
Labor force participation rate is shrinking – demographics is probably the main reason – we'll see skilled labor shortages increase over the next decade - we're already seeing construction related shortages with brick layers, masons, electricians, plumbers, etc. Solution – Revamp our education system (a 4 year degree isn't for everyone – 2 year community colleges, vocational schools, are better fit for many) and we could do a better job with immigration policies too.



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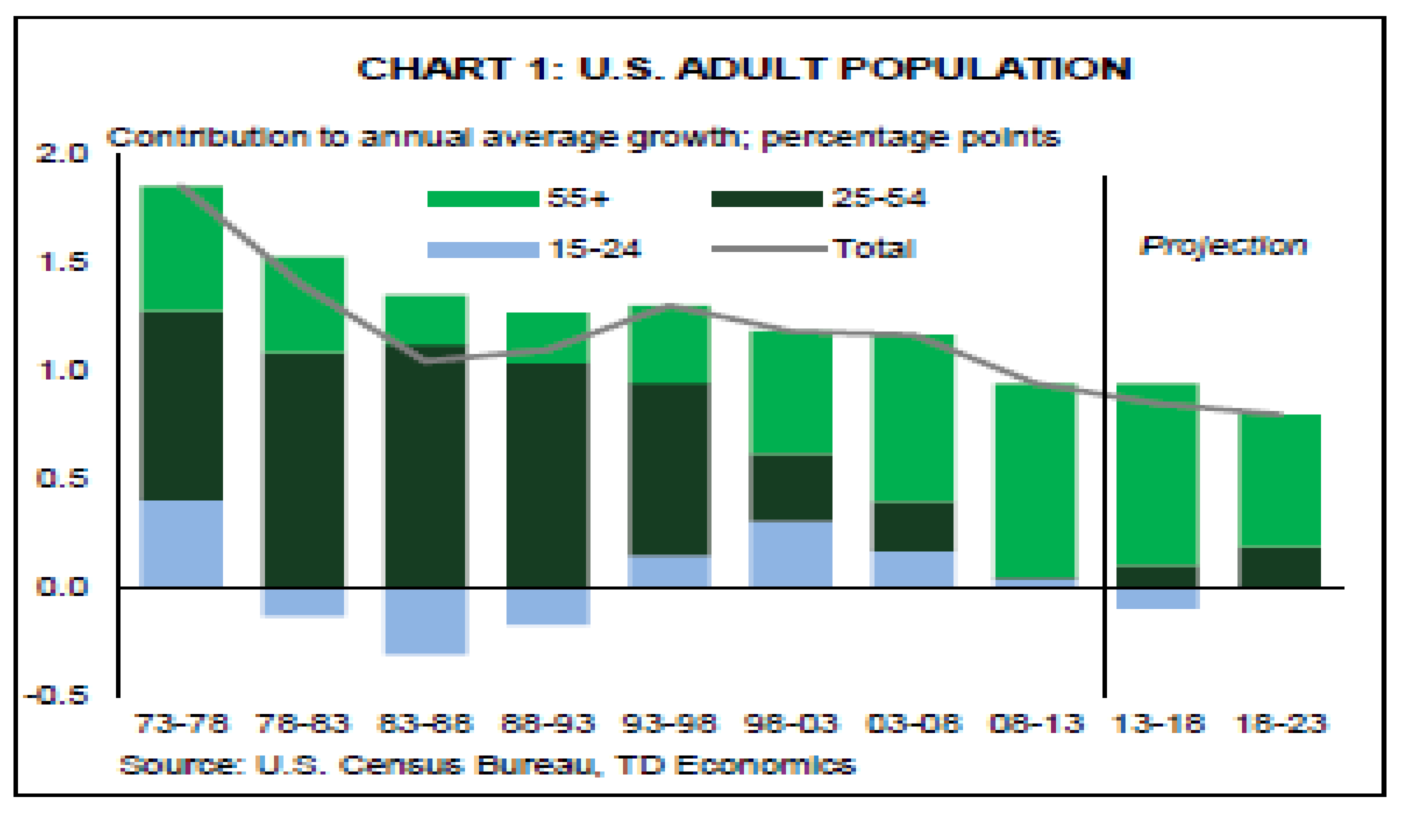
Demographics will be the big "game changer"

Projections show an aging population with the bulk of population growth in the 55+ age group – this suggests that labor shortages are going to be a very serious problem in the future! (and, by the way, a serious challenge for SSI and Medicare) – immigration reform is needed!



Source: TD Economics (http://www.td.com/document/PDF/economics/special/Recharging_the_US_Labor_Market.pdf)

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Economic growth of 5.0% – 3rd qtr 2014 – will it continue into 2015? My guess – no!
Impact of less FED stimulus still unknown . There are serious headwinds –
(1) Slowing world economy (European recession; weaker China growth)
(2) Stronger dollar will reduce exports and increase imports – negative impact on manufacturing jobs which is key to income growth in USA
(3) Political stalemate, terrorism, currency wars, growing national debt, ...

Source: BEA (http://www.bea.gov/newsreleases/national/gdp/gdp_glance.htm)

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Recent Housing statistics

<u>Background:</u>
Markets are getting better – yes, but ever so slowly!
The climb back will remain muted (my opinion)
until we see economic growth of 3% or
more (without FED stimulus) for an extended period of time!

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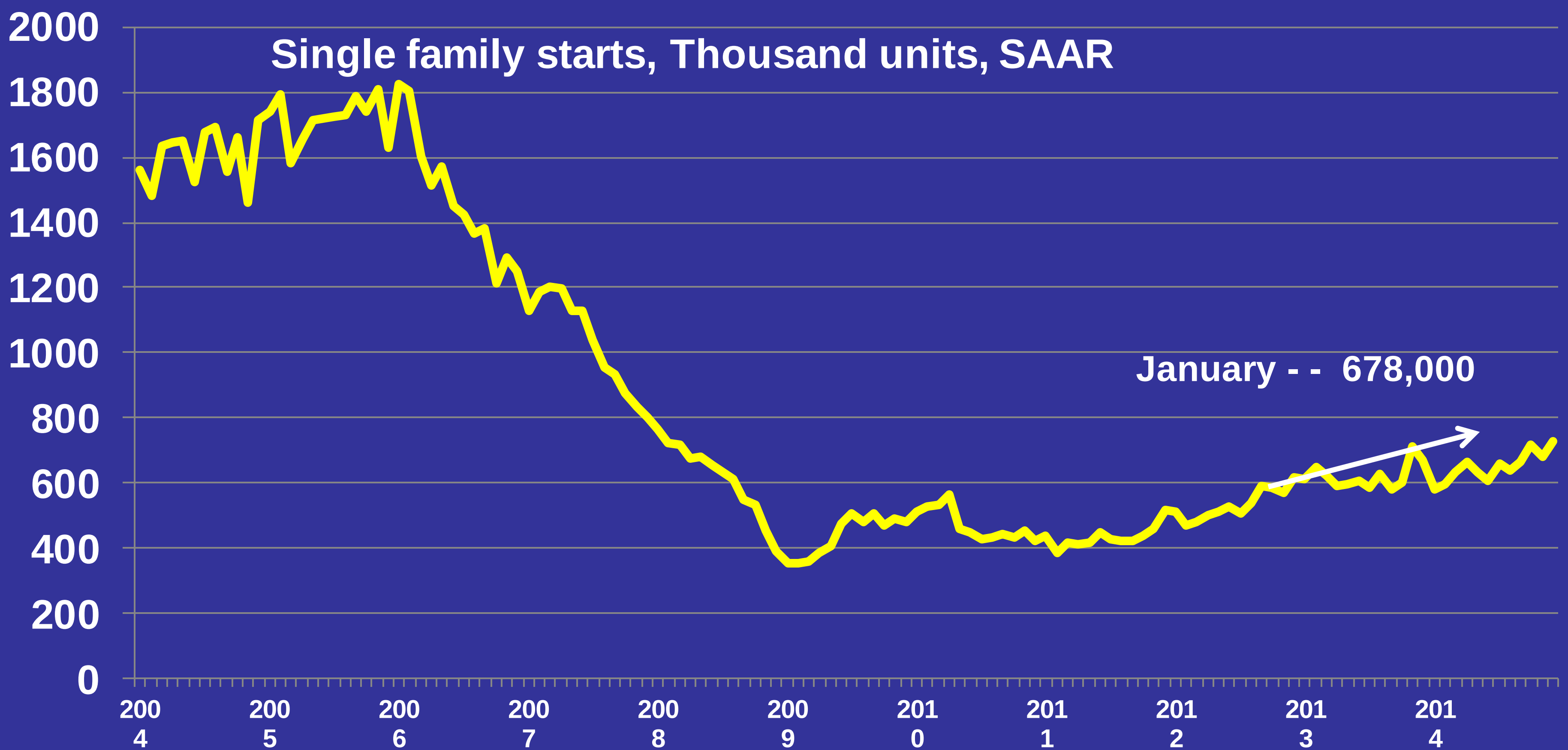
Starts are finally turning the corner, but growth is painfully slow – I'm concerned that the Feds will 'grease the wheels" again – e.g., Fannie and Freddie, FHA --- lowering down payment requirements and premiums on mortgage insurance, …. I guess they forgot what happened in 2008?



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

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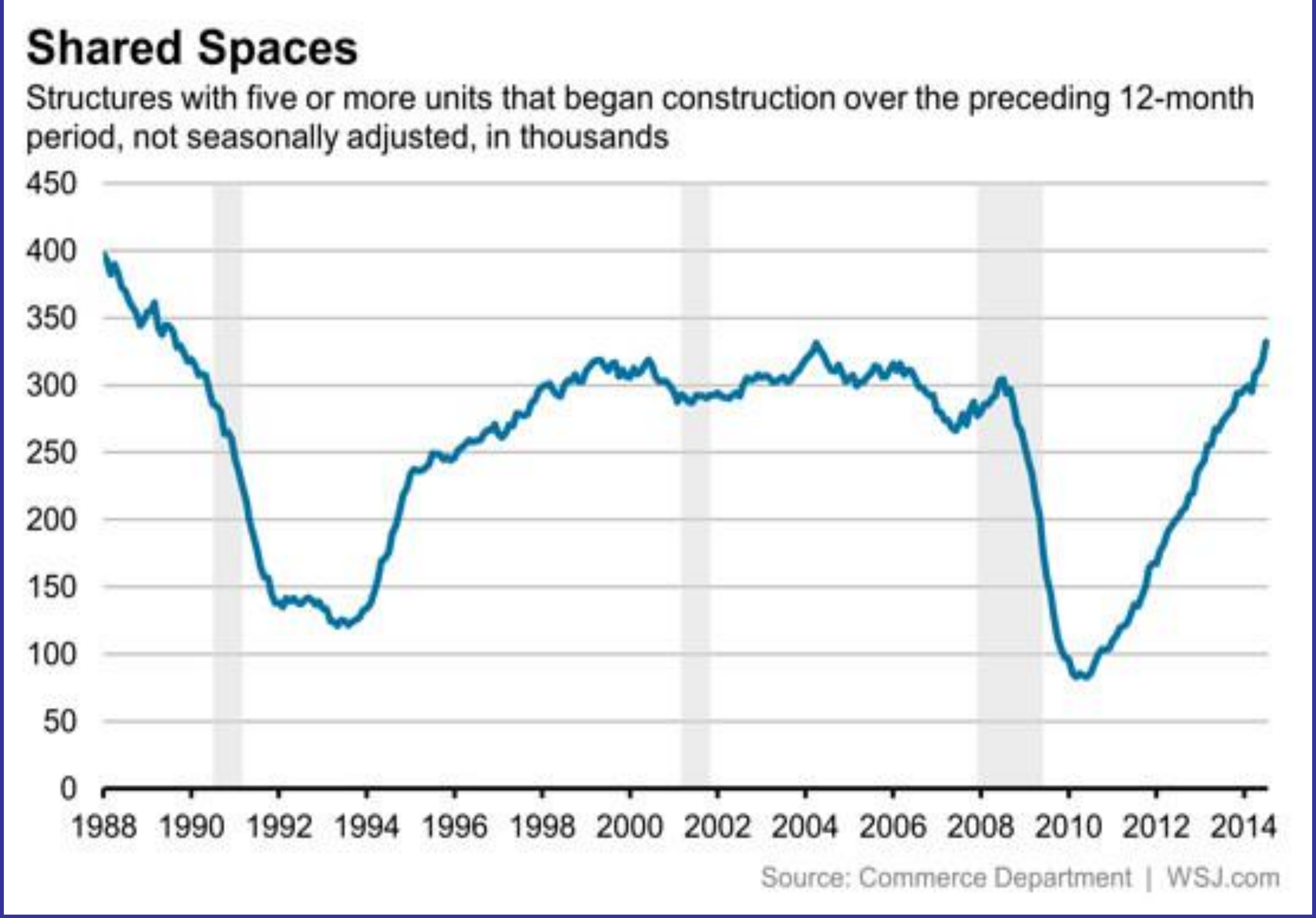
Multi family continues to strengthen – this trend should continue until the jobs picture improves and real incomes advance. Housing purchase depends on affordability (price, mortgage rates), and credit worthiness - mortgage rates are favorable, but too many Americans have poor credit (too much debt, low income, etc.) and, the lenders have tightened the rules. And, prices are on the rise!



Source: WSJ (http://blogs.wsj.com/economics/2014/08/19/with-rentals-in-fashion-apartment-construction-hits-25-year-high/?mod=WSJBlog&mod=marketbeat)

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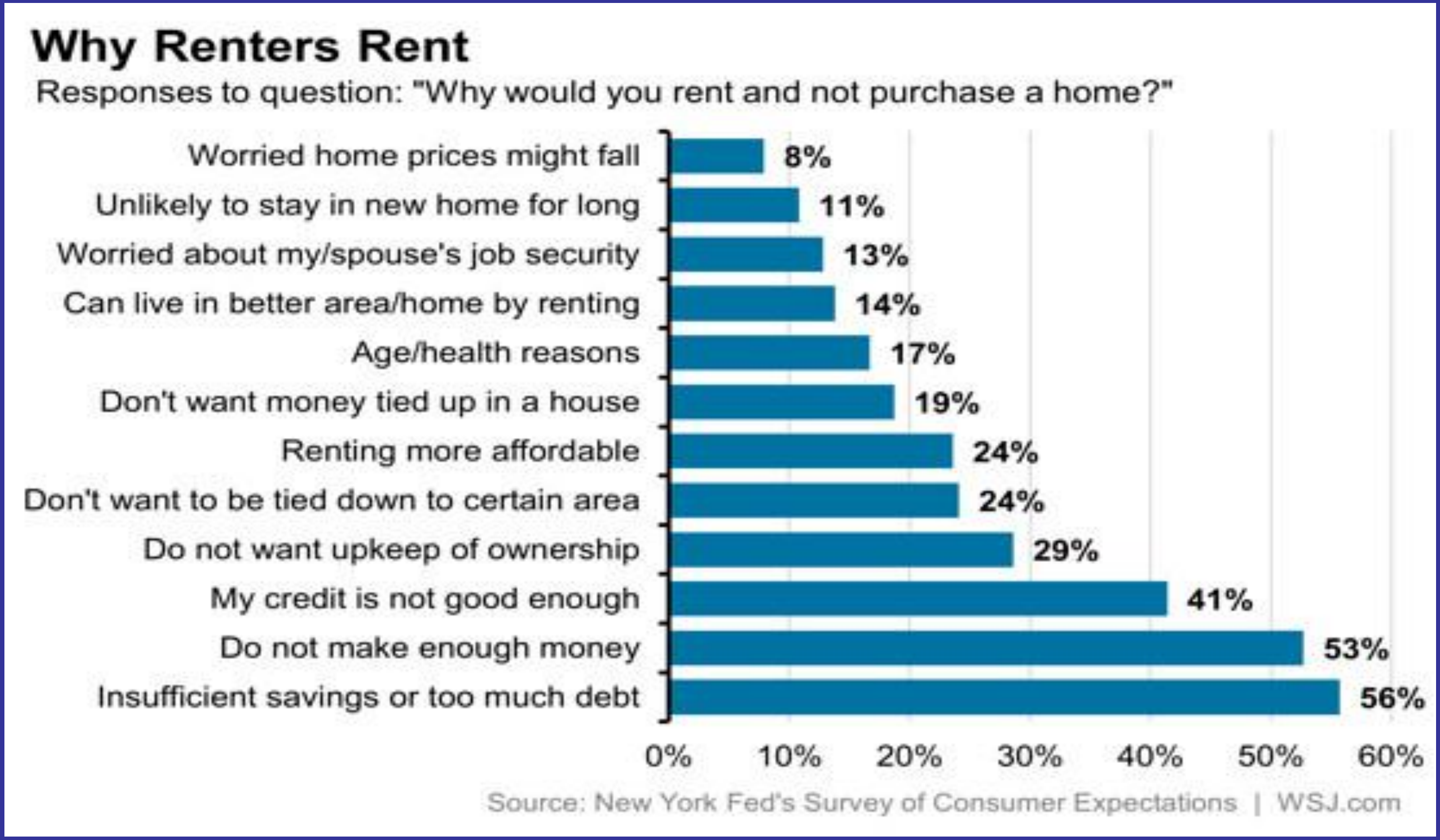
Renting is popular because many can't afford to buy - -
It's that simple?? Again, JOBS, JOBS...



Source: WSJ (http://blogs.wsj.com/economics/2014/09/08/why-more-renters-arent-buying-hint-weak-incomes-savings/?mod=marketbeat&mod=marketbeat)

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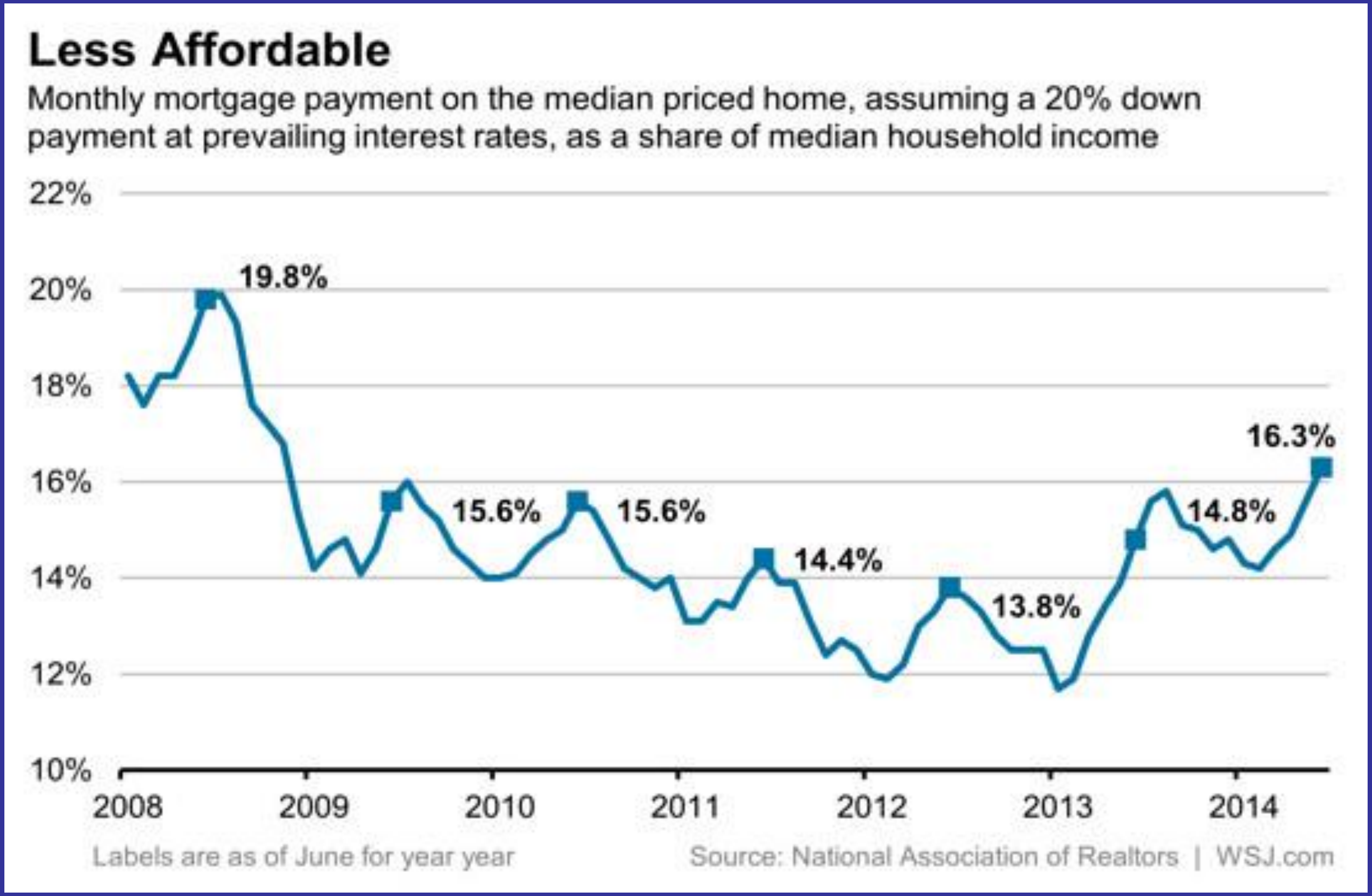
Another drag on the housing recovery – decreasing affordability

(it's actually worse – many people can't afford the 20% down payment, can't qualify for a loan with tighter credit restrictions, …. - - we need lots of better paying jobs to get housing back on its feet)



Source: WSJ (http://blogs.wsj.com/economics/2014/08/16/number-of-the-week-housing-affordability-hits-six-year-low/?mod=WSJBlog&mod=marketbeat)

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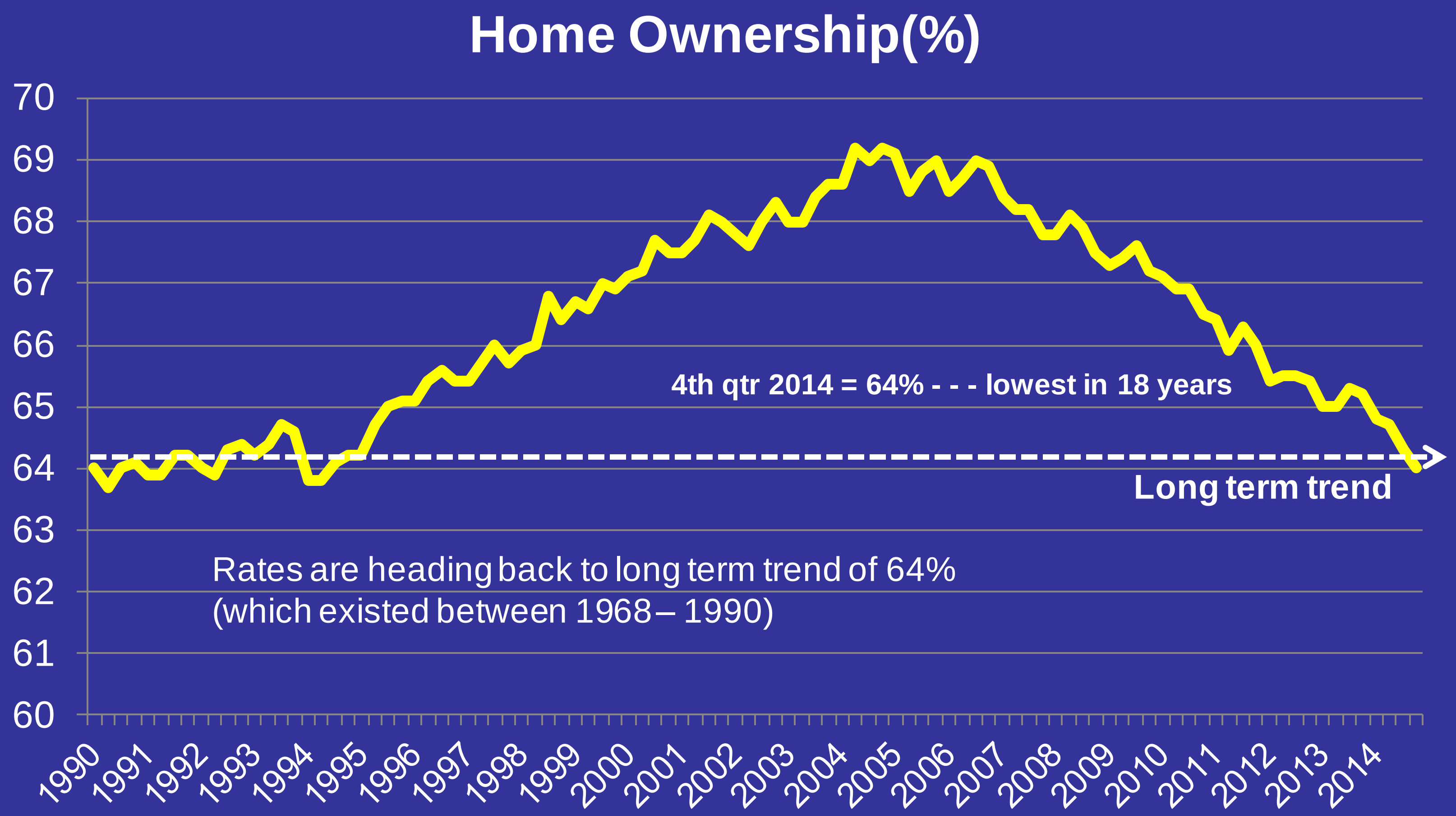
Impact of weak household formations - -
homeownership rates have been falling for the past nine years – when the economy gets back to normal, will people return to to single family or will we see more renting?
There will be impacts on wood products demand



Source: Census (https://www.census.gov/housing/hvs/data/q413ind.html)

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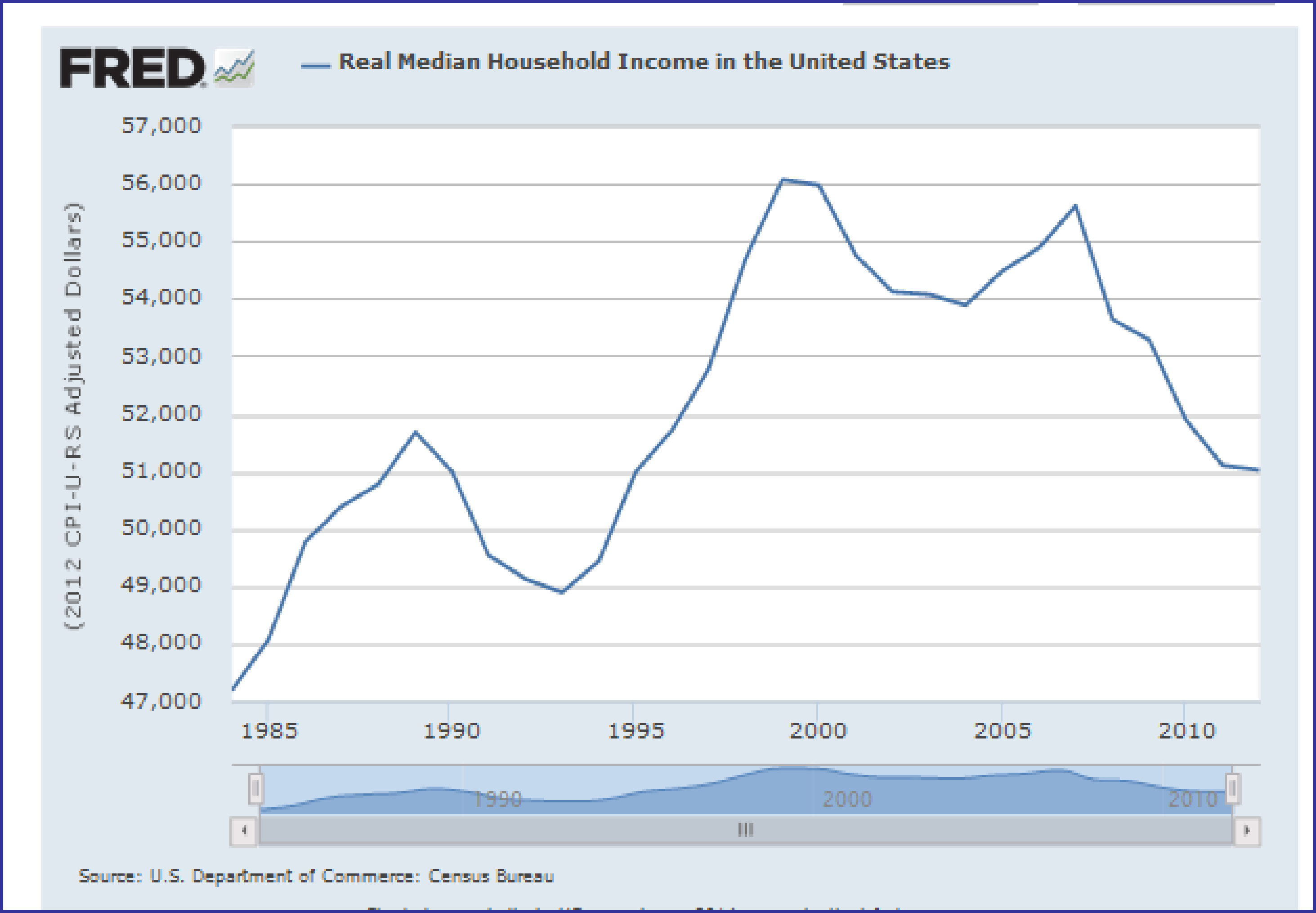
Despite low mortgage rates, people are having problems buying a house because their real incomes have been shrinking for the past 20 years – this is a structural problem (long term) and not cyclical



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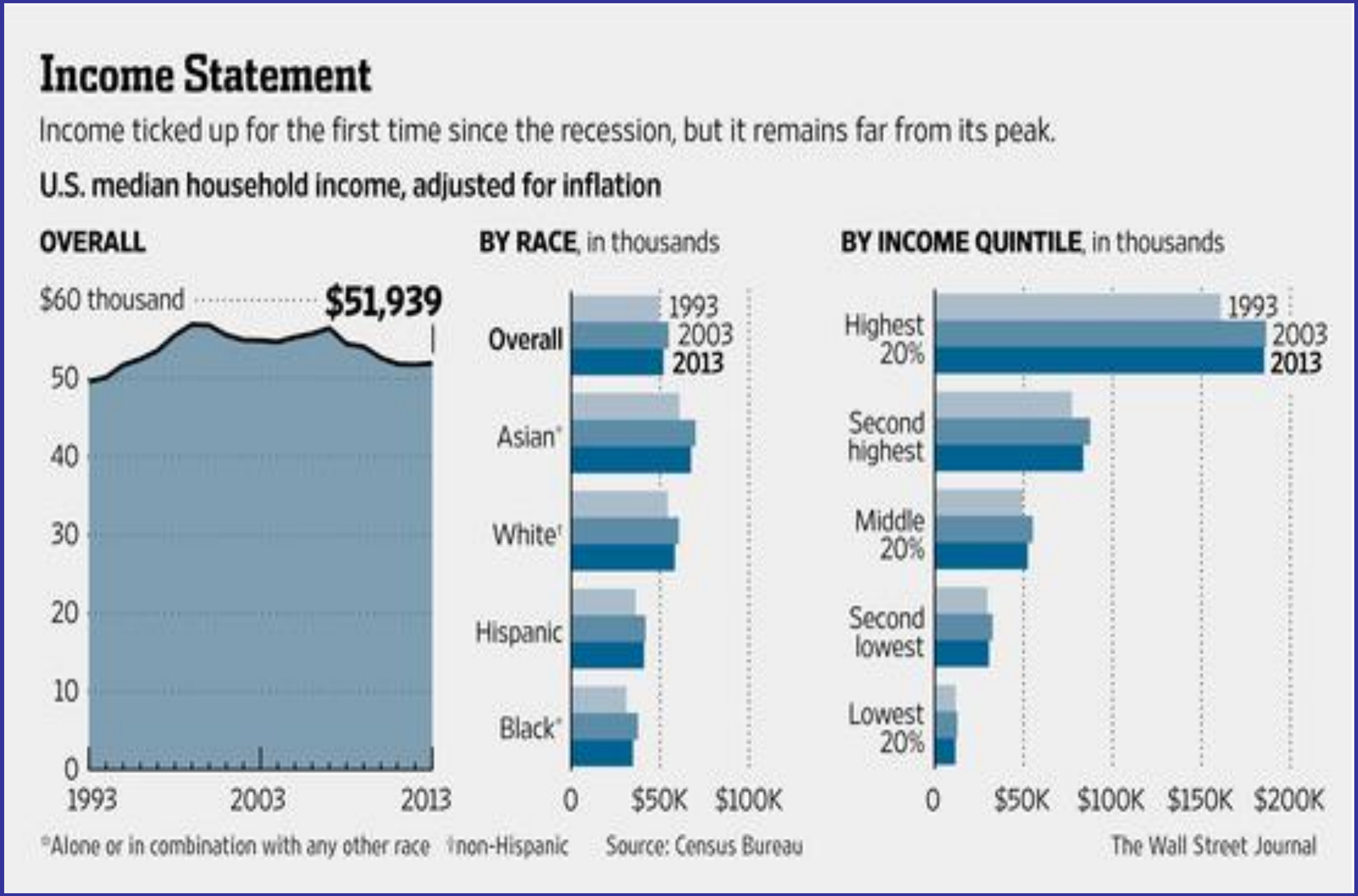
Real household incomes changed little in past 20 years

Source: WSJ (http://online.wsj.com/articles/income-data-show-a-lost-generation-finding-its-bearings-heard-on-the-street-1410892047)



Source: WSJ (http://online.wsj.com/articles/u-s-incomes-edge-higher-as-sluggish-recovery-persists-1410878730)

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

Not much improvement since 2009 – still off 70% from the peak – this metric is key to wood product markets!!

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

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Resale market continues to improve, but still heavy to cash sales with 1st time buyers still below trend (traditionally they represent about 40 – 45% of market, but today they are at 30%)

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

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

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Some conclusions – housing continues to improve albeit slowly

Short term:

(1) Economy will continue to improve -- **2015 may see 3% growth, but housing may not follow – looks like the "disconnect between the economy and housing will continue ("two tiered economy"?)**

(2) This is not a healthy housing market - 1st time buyers are absent and household formations are off 50% from trend – furthermore, many of sales are cash, many foreign buyers, etc. I.e., NOT SUSTAINABLE

(3) The key to a recovery in housing is the return of 1st time buyers, traditionally about 40- 45% of the market. Current market skewed to cash buyers and investors. 1st time buyers are mostly young people, **but they can't find good jobs**.

(4) Political discourse will continue to slow a truly strong economic and housing recovery – too much uncertainty re: Affordable Care Act/Obama care; immigration reform; interest rates; …….. Uncertainty will slow job creation, private sector investment, ….

(5) Growing problem in world economy is that USA is only major economy doing relatively well. Europe in recession; China slowing from previous highs (but still good); And we now have more countries devaluing their currencies to promote exports /economy. This will impact the U.S. recovery as a higher U.S. dollar dampens exports and weakens key manufacturing sector.

(6) One more comment on housing – usually, housing leads an economic recovery (after recessions) – but, this time it is not happening. A stronger economy will be needed to get the housing market back on track. That's hard to accomplish because housing is almost 20% of the economy (direct investment plus services, etc.).

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Longer term:

(1) Housing demand will hinge partly on the footprint of the Federal government – will they continue to promote housing to the degree they have in the past? Yes, the economy is important, but the politicians know how to "grease the wheels" Already, Fannie and Freddie are talking about less stringent lending rules.

(2) Labor participation rate keeps falling – this suggests that there will be future labor shortages. Furthermore, tax revenue will be impacted as more people collect from growing number of government programs while lower percentages pay taxes. Look for changes in tax code; consumption tax??; social security; Medicare/Medicaid; ….

(3) How will USA deal with aging demographics; crumbling infrastructure; out of control public debt; and, generally, decreasing global competitiveness!!!!! My thought – revamp the tax system to Discourage consumption (bring it in line with other countries); and invest more in our future!!! Otherwise, we will continue to "underperform", and housing and wood products will suffer. This will take a long term commitment from the country, politicians, voters, …… The U.S. consumption rate (% of GDP) is about 70% while our competitors , it is 60% or lower. Invest for the future – sounds simple, but requires some thinking that prevailed in this country following WWII. And, we have to get Medicare/Medicaid, and SSI on a sustainable basis.

(4) LEADERSIP IS important – politicians need to work on long term solutions

(5) To return to trend values – 1.5 – 1.6 million starts per year, the 1st time buyer has to return and this means real incomes for the middle class has to strengthen considerably – otherwise, The resulting "two tiered economy" could mean housing may not return to "the good old days"

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