



23 July 2015



SENT TO LSU AGCENTER/LOUISIANA FOREST PRODUCTS DEVELOPMENT CENTER - FOREST SECTOR / FORESTY PRODUCTS INTEREST GROUP

To all:

Housing continues to struggle with total starts up 10%, but this was due to the 44% surge in the volatile multi family sector. Single family starts were down 1%. Good news is that total was up 26% over last year - SF up 15% and MF up 60%. Also, permits were up significantly this month. The trend to multi family continues to be the main story and I have included some slides offering some rationale for these trends. The job market is improving, but many jobs are lower paying with few benefits. Particularly difficult for younger people with education debt being a drag. There are jobs out there, but there seems to be a "skill set" problem - many applicants don't have the required skills for available jobs. The world economy is slowing, particularly China and Europe, but commodity dependent countries like Australia and Canada are also experiencing difficulties. E.g., Canada just lowered its bank rate to 0.5%, the 2nd reduction this year. I've mentioned this in previous notes, that maybe we just have too much of most products/services. That is why inflation is subdued in most parts of the world despite record low interest rates. Maybe we have a demand problem and low interest rates are not the best solution.

The U.S. economy is improving, but the strong dollar is hurting exports. Latest forecasts show U.S. GDP to grow about 2.5% this year - not really that great considering we're in the 6 or 7th year of a recovery. Will be interesting to see what happens when the FED starts raising rates later this year.

Anyway, enough from me - hope you enjoy the attached slides. If any questions, send me a note and I'll try to better explain myself.

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Housing comments – July, 2015

- *May starts increased 9.8 % (to 1.174 million, annual rate) from revised May numbers - single family fell 1.0% to 0.691 million (SAAR). Multifamily was the reason total starts were up as multi family was up 29% to 489,000 (SAAR)*
- Multi family continues to be the driver (42% of total in June) – rental prices still increasing – single family sales remain weak and this has big impact on wood product prices. This trend will probably continue for some time.
- Economic issues - slowing world economy(China GDP slowest in past 6 years); sub par domestic job market; sluggish income growth; continuing tight domestic credit environment . **And increasing global political risk - causes uncertainty – less investment – slower growth**
- Job market is improving , albeit slowly, and wage gains are starting to pick up, however, the real unemployment rate remains high at 10.8%. This equates to about 16 million people who are either unemployed, stopped looking, or working part time because they can't find full time jobs. This “slack” in the job market will keep wage gains modest for some time.
The manufacturing sector (good paying jobs with benefits) use to be 23% of the workforce, but today it is down to 13% as the service sector now employs the bulk of Americans. Problem is that half of service sector jobs created today are low paying with few benefits (health care, pensions, etc.).
- This won't change as the economy has evolved into a service economy with some high paying high tech jobs in the IT field, health care, etc, but most are lower paying jobs in the retail sector. To change this, we need to invest in infrastructure – R&D, education, highways, airports, communications, That is the key to higher paying jobs, productivity, competitiveness, GDP, and, yes, housing starts!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!! Productivity fell at a 3.1% (annual rate) in the 1st qtr as businesses reduced investment spending.

Rental demand versus single family housing ---

There are growing indications that rental demand may continue to increase for some time – a recent study by the Urban Institute suggests it may continue for another decade or two

(<http://www.wsj.com/articles/new-housing-crisis-looms-as-fewer-renters-can-afford-to-own-1433698639>)

Why - - demographics; growing minority population; student debt; weak income growth; E.g., Minorities (nonwhite) will make up 75% of net household growth over the next 10 years, and 85% during 2020- 2030 (see next slide). They are less likely to own homes (lower incomes is main reason) so home ownership continues to fall toward 60% by 2030. During this time, rental demand will increase dramatically. Although this is just one study, it provides food for thought. One potential question with the study, however, is other studies show that although immigrants, for example, rent initially, but, over time they purchase homes at a rate equal to or higher than native born Americans. Why – people come to the U.S. to improve quality of life, and for most, this means homeownership. This suggests that the U.S. has to find solutions to immigration issues like “illegal immigrants” while encouraging legal immigration. This country was founded by immigrants seeking a better life, and they are key to our future. **And, incomes for all Minorities has to improve if home ownership is to return to “good old days”**

(http://www.engineeredwood.org/Data/sites/3/documents/EngWoodJournal/EWJ_Spring2010.pdf)

Anyway, this has potential implications for home ownership; single family construction; and demand for wood products – lots of variables and scenarios.

Key findings and numbers from recent Urban Institute study On Home Ownership (<http://www.wsj.com/articles/new-housing-crisis-looms-as-fewer-renters-can-afford-to-own-1433698639>)

Key findings(Laurie Goodman, et.al.)

- (1) For next 15 years, new renters will outpace new homeowners
- (2) Headship rate, (rate at which people create new households) is declining
- (3) Majority of new households (HH) formed between 2010 – 2030 will be nonwhite
- 43% Hispanic and only 18% white
- (4) Majority of new homeowners will be nonwhite
- (5) Number of senior HH to expand dramatically from 2010 – 2030

Key numbers (Laurie Goodman, et.al.)

- (1) Between 2010 – 2030, there will be 22 million new HH – 13 million will rent and 9 million (4 million fewer) will buy
- (2) By 2030, the homeownership rate will drop from 65.1 % to 61.3%
- (3) Of the 11.6 million net new HH formed between 2010 – 2020, 77% will be nonwhite and 88% of new HH will be nonwhite.

My “two cents worth”

- (1) Minorities salary is considerably less
- (2) They are less able to purchase homes
- (3) We need to deal with this issue if housing is to get back on track
- (4) We better start building more rental units or rent prices will become too high for many people – already, high rents prevent potential home buyers from saving enough for a down payment for a house

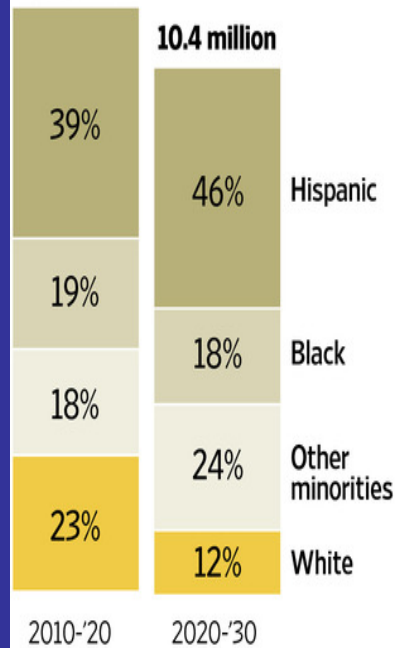
Urban Institute study – demographics, growing minority population, weak income growth, and student debt combine to drive homeownership lower!! That means fewer single family starts and stronger rental demand - - - A trend that could last for another two decades according to the Urban Institute

Home Builders

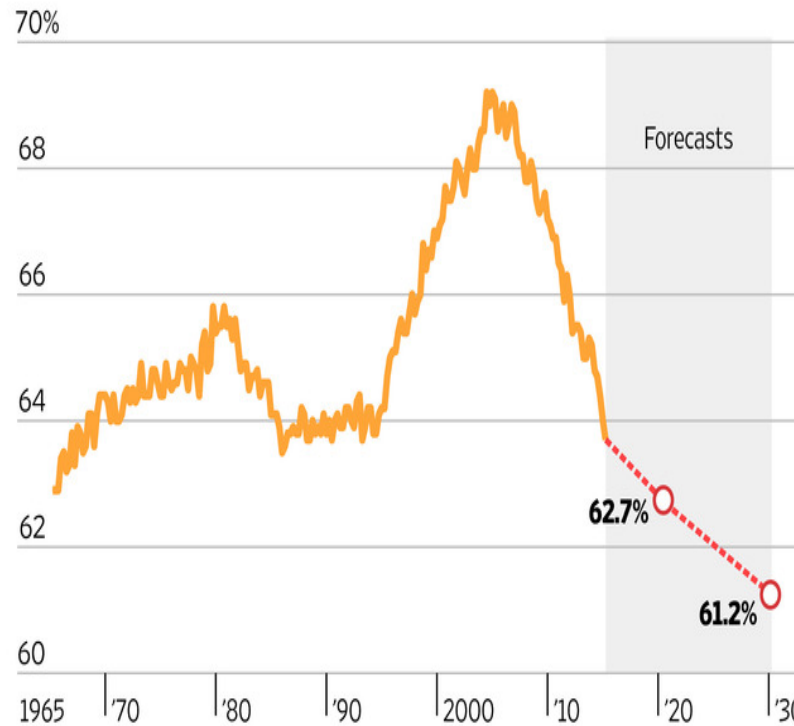
Minorities, who will account for more household-formation growth...

Net new households

11.6 million households

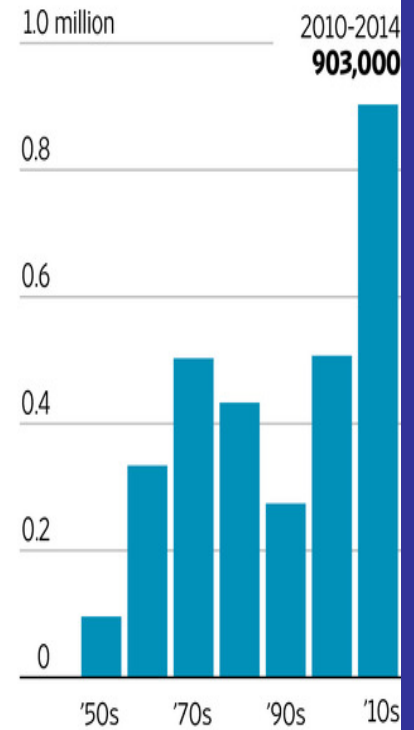


...are less likely to own homes, which will drag down the U.S. homeownership rate...



...as rental growth surges.

Average annual net growth in renter households



Sources: Urban Institute (household formation, homeownership rate forecasts); Commerce Department (homeownership rate); Harvard Joint Center for Housing Studies (renting households)

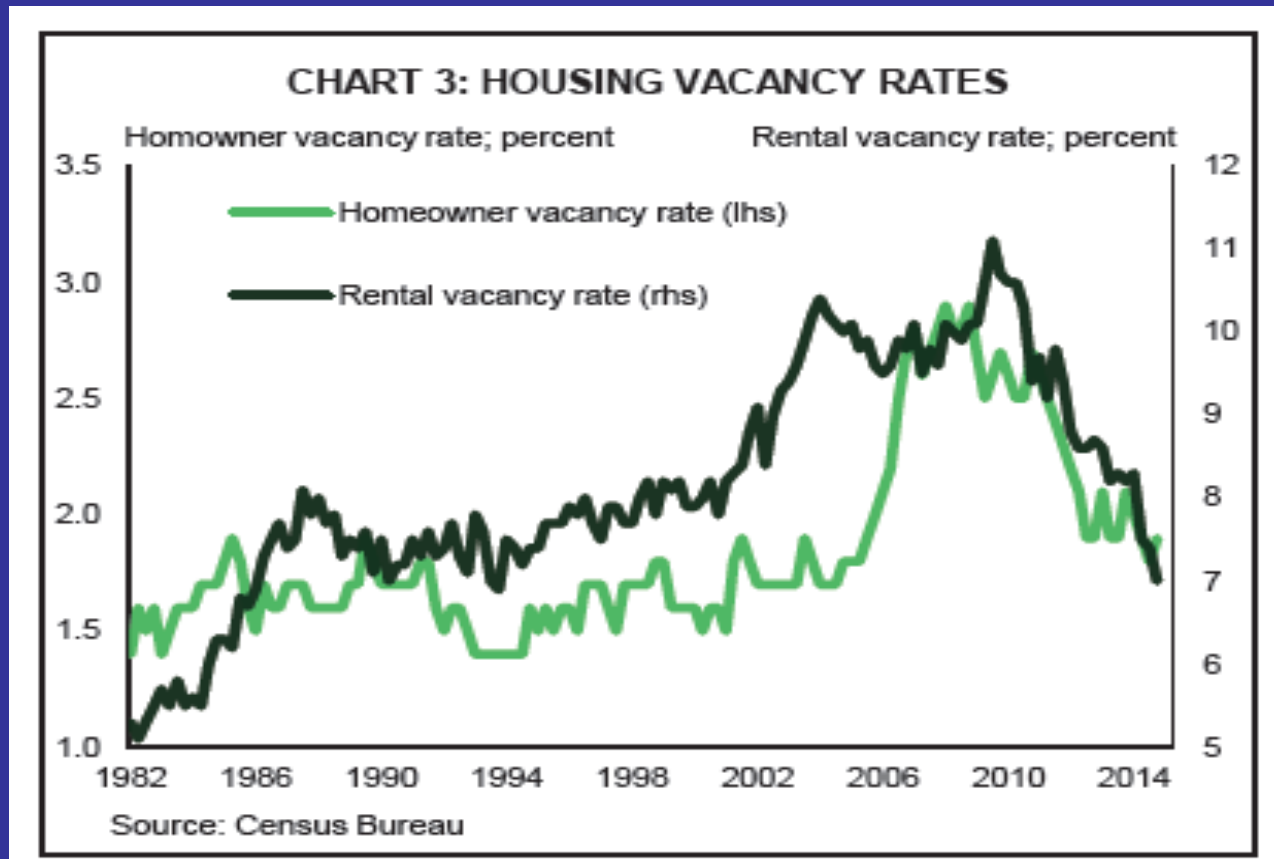
THE WALL STREET JOURNAL.

Source: (<http://www.wsj.com/articles/new-housing-crisis-looms-as-fewer-renters-can-afford-to-own-1433698639>)

Falling rental vacancy rates will drive rental prices higher And this will drive multi family construction – Economics 101

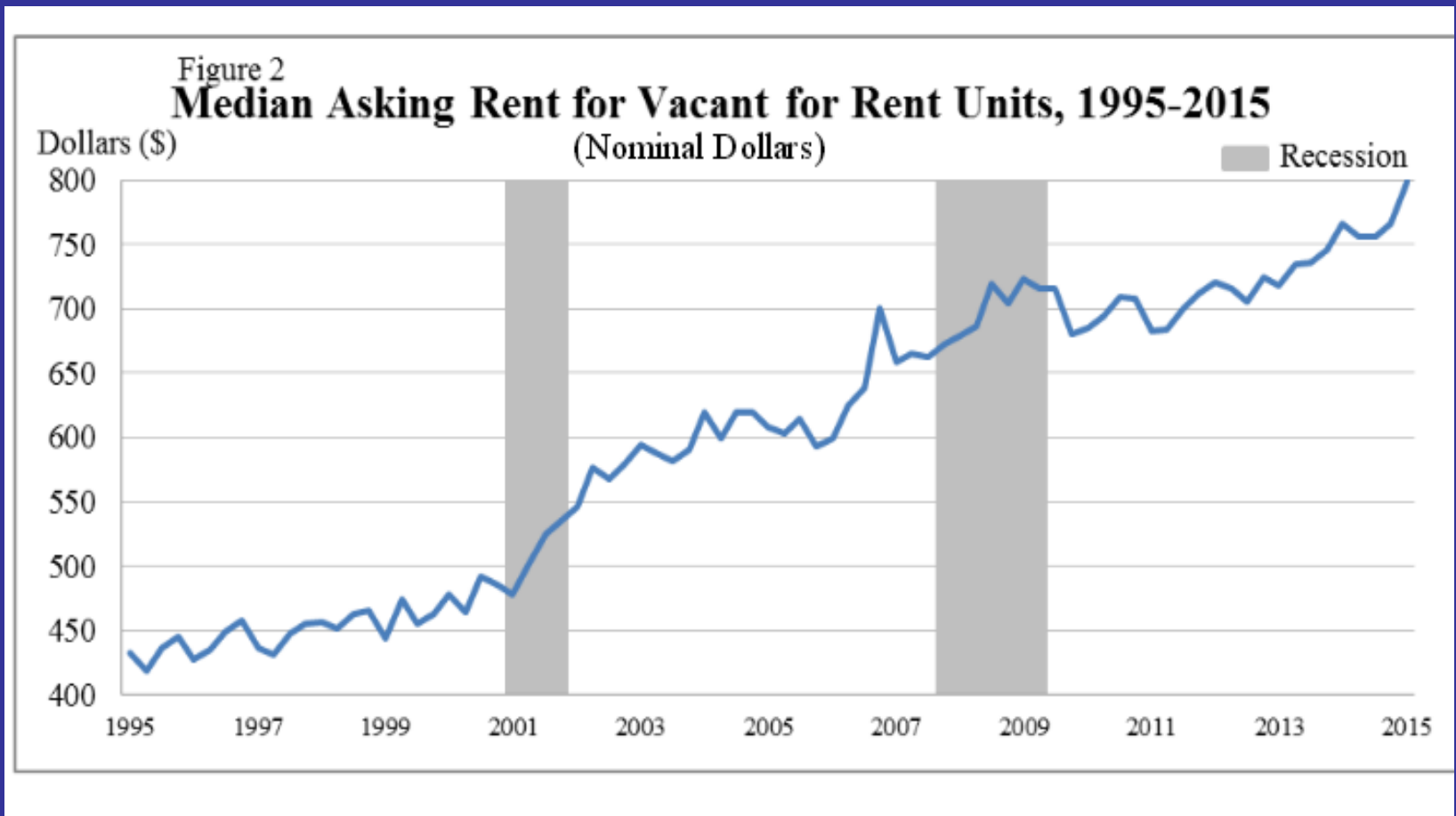
But, this could make homeownership more challenging as potential buyers have more difficulty saving for a down payment as rising rents gobble up more disposable income

**Multi family permits reached 592,000
In May – the highest in 25 years!!!!**

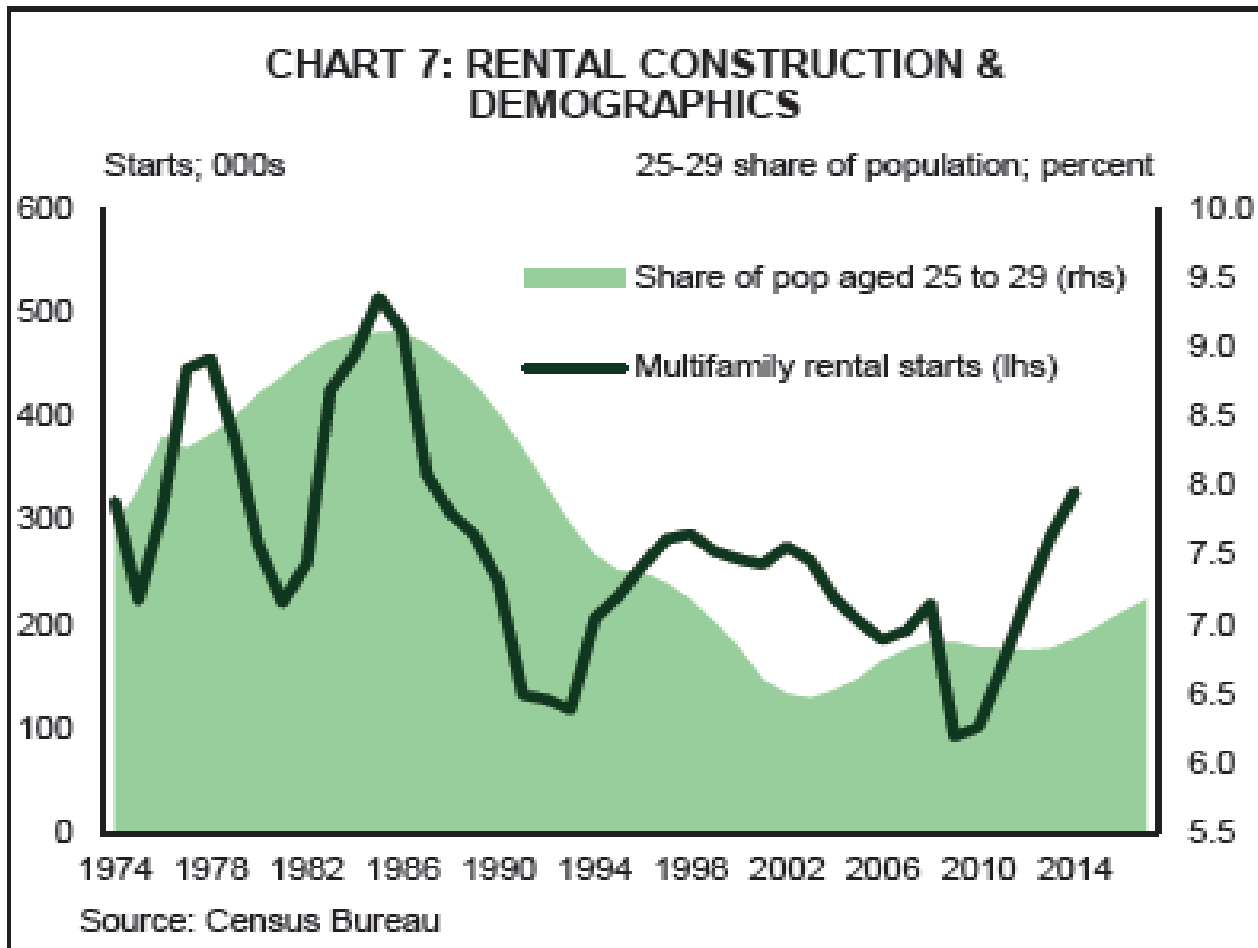


Increasing rents may slow housing starts - -

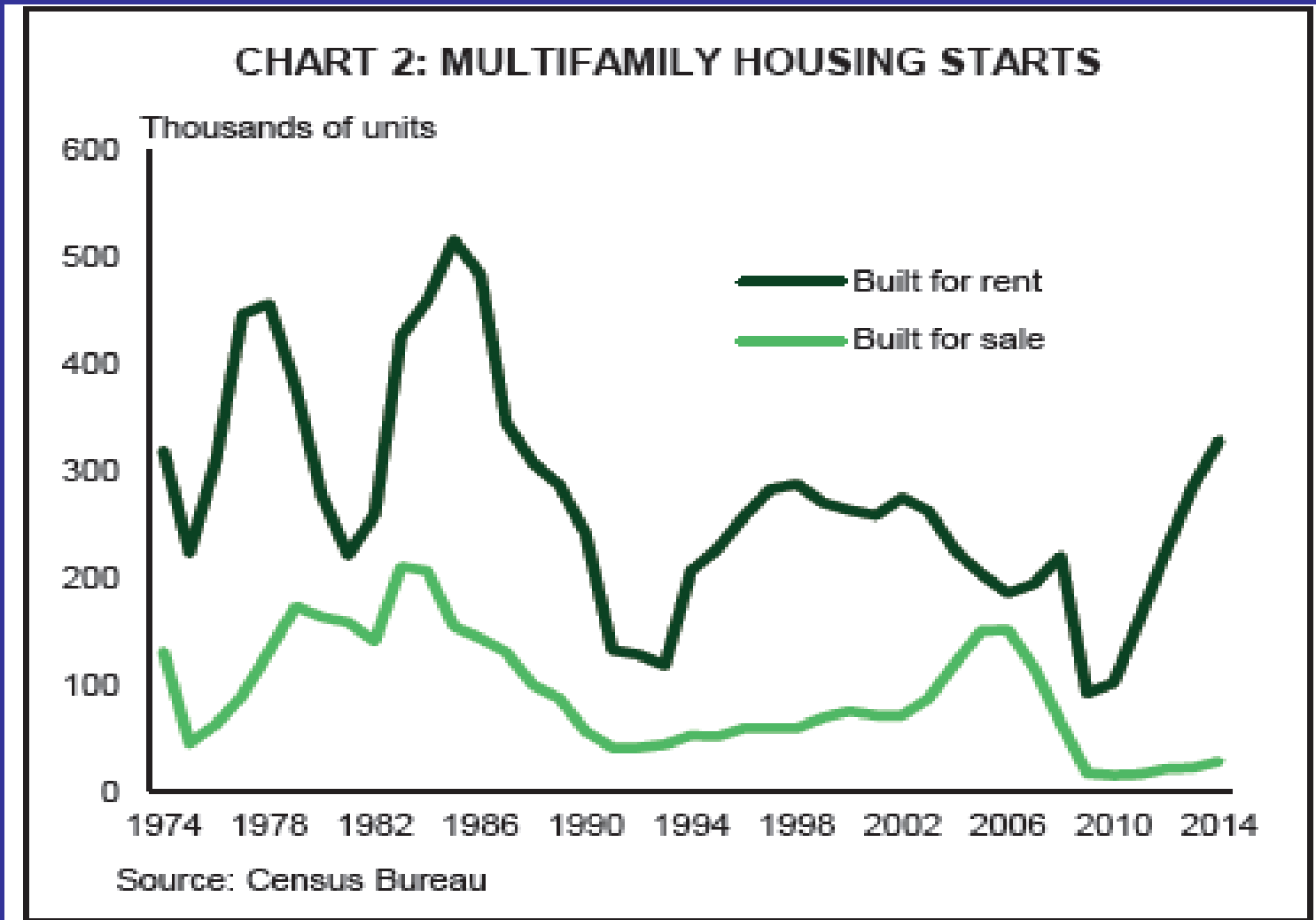
makes it more difficult for renters to save for down payment for house purchase



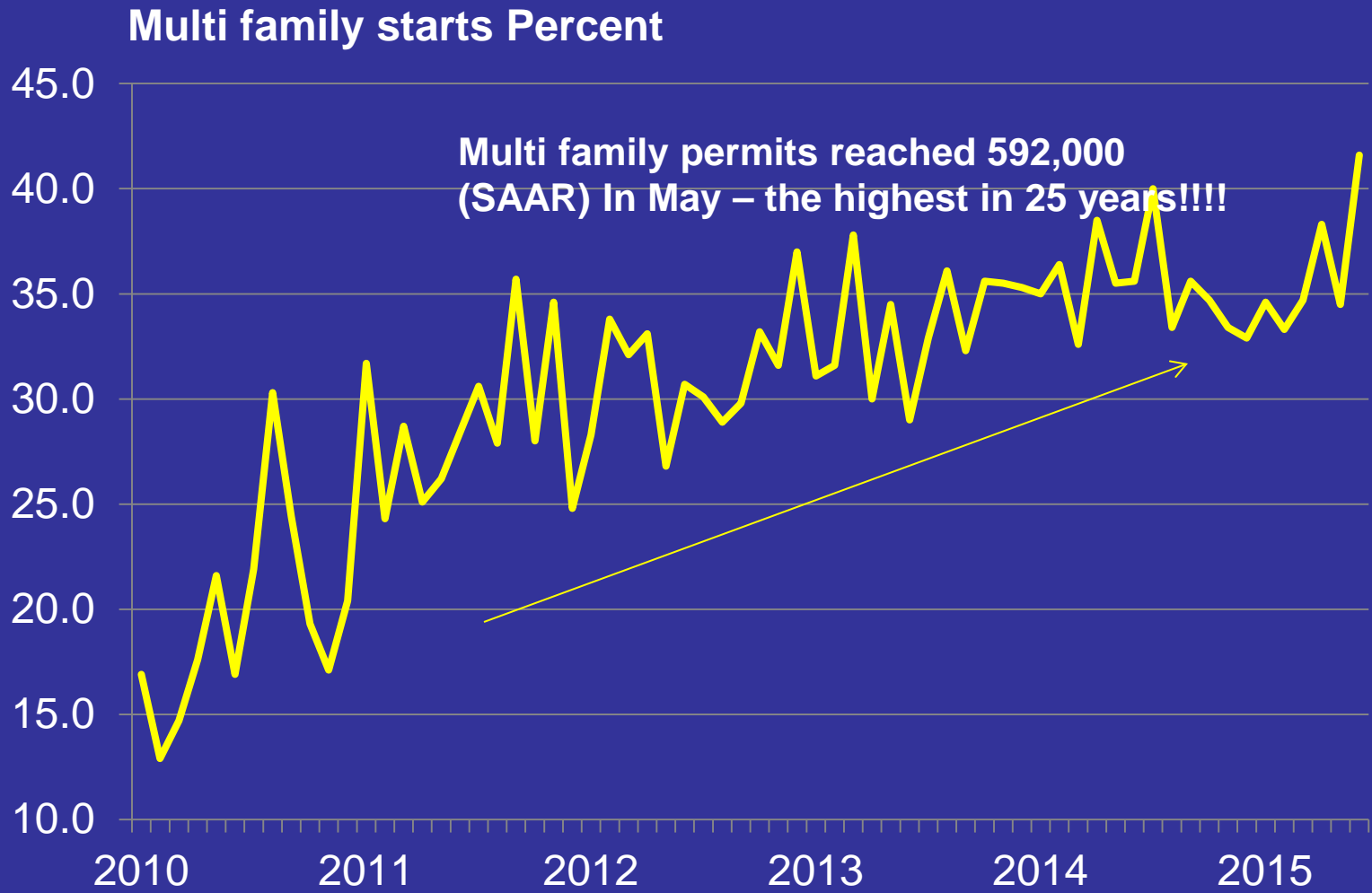
Many young people can't find good jobs – so, they rent instead of Buying a house



The bulk of multi family housing are rental units



Multi family share of housing starts – upward trend
Should continue for some time???



Higher prices don't necessarily mean the Market is good which is what economic theory would suggest.

Housing inventory – short supply is driving up prices! – In addition, builders are Building bigger houses to accommodate “well healed customers” which is driving new home prices higher. Existing home sales reflect similar trends.

One more issue impacting housing – with starts remaining weak, we will See a continuing shortage of inventory, and that means higher prices. Many Builders just don't see enough traffic supporting an increase in starts. In the Resale market, many people can't list their homes due to foreclosure issues, Underwater mortgages, Job problems, credit issues, etc.

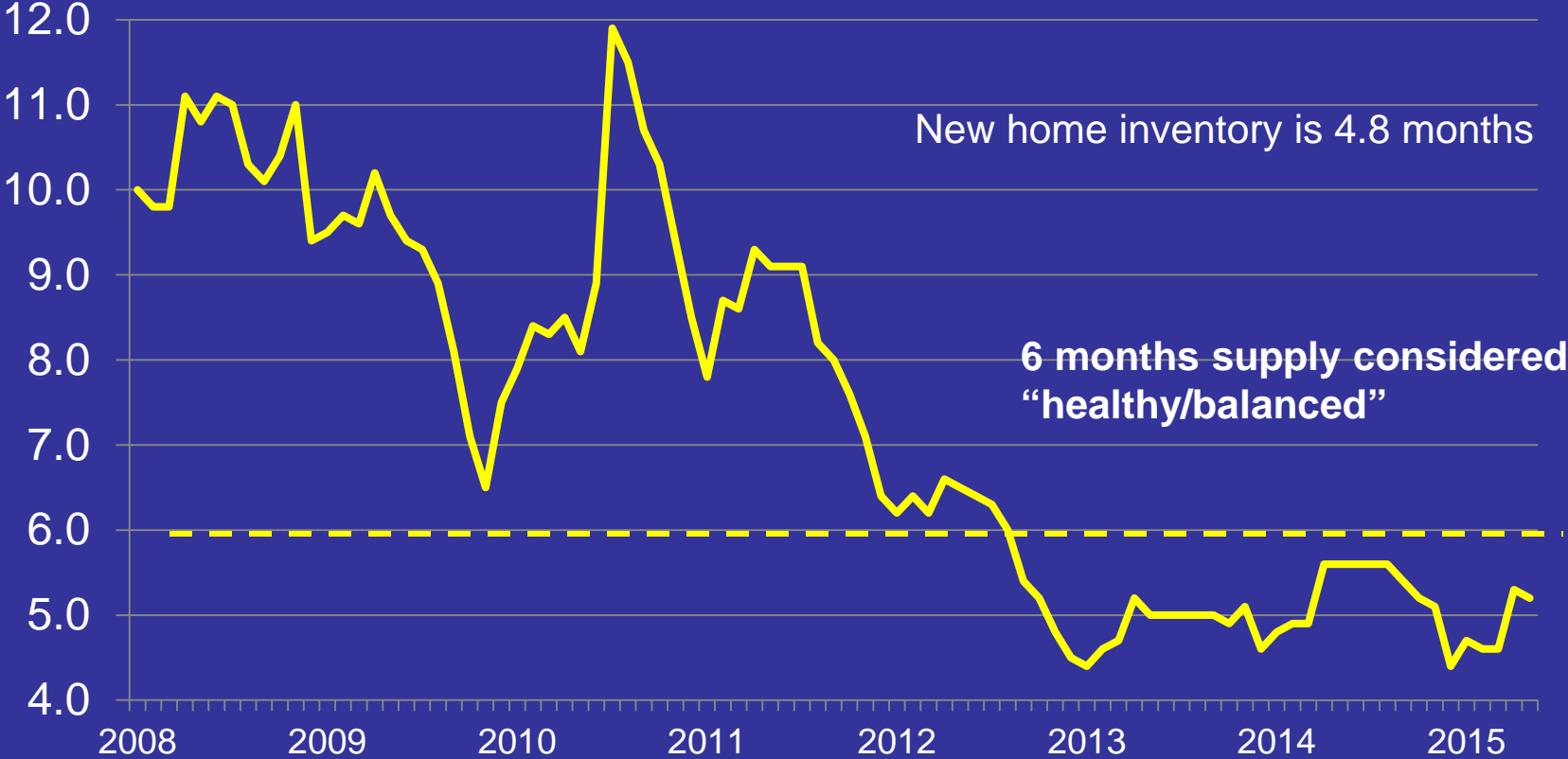
Current inventory is 4.6 months for new homes and 5.3 months for existing homes – six months supply is considered a ‘healthy market’

Another good article on current housing situation re: dilemma for 1st time Buyers. Limited choices; higher prices; weak income growth; weak New home construction; --- short supply drives prices higher putting more 1st time buyers out of the market. **I've said this before – return of 1st time Buyers is needed before housing returns to “normal”!**

(<http://finance.yahoo.com/news/first-time-buyers-face-hurdles-101147166.html>)

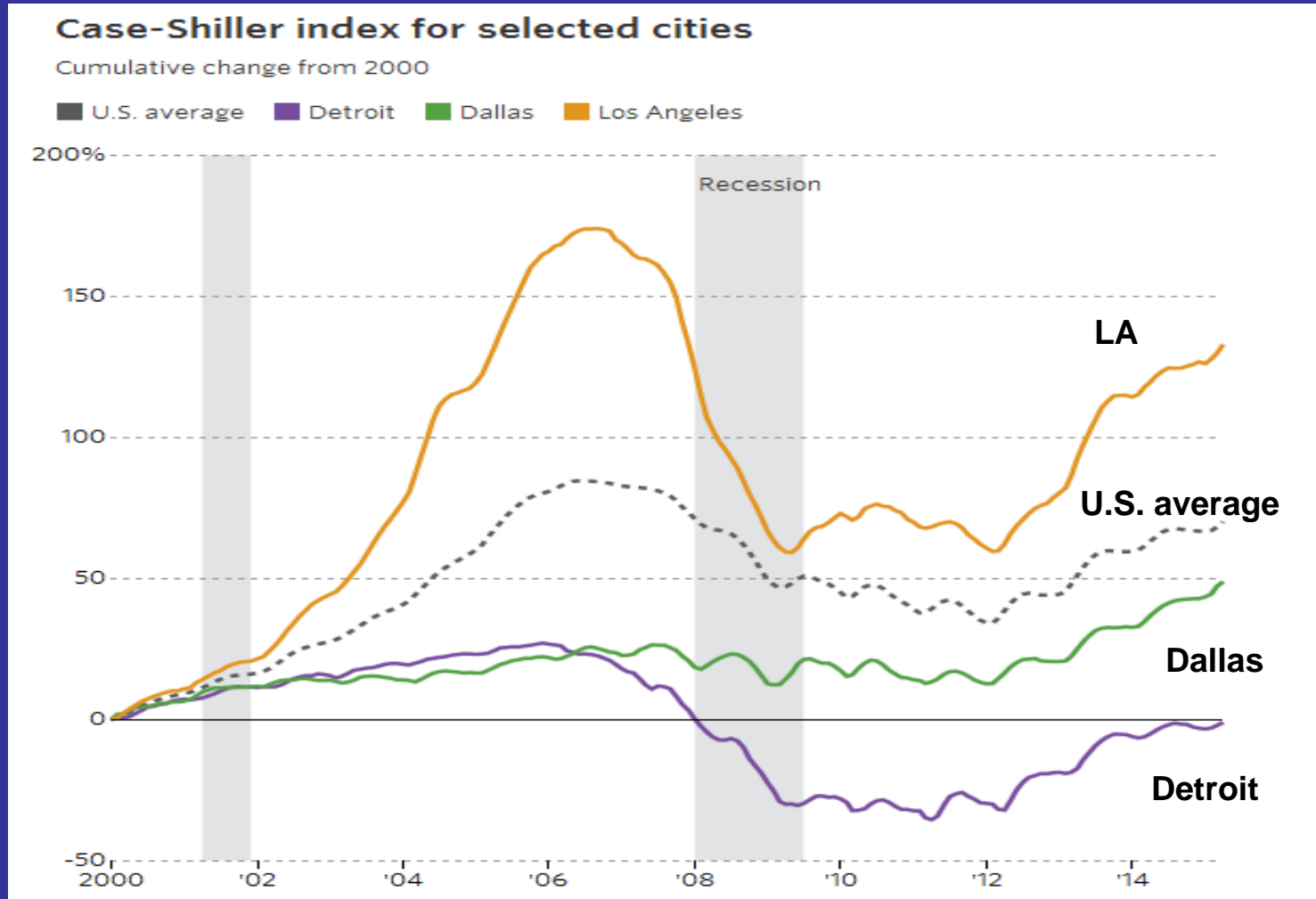
Existing home inventory at 5.1 months – it's improving, But, short supply still driving drives prices higher

Months supply, single family



Existing homes - Price increases are moderating, but still up substantially since the housing collapse in 2008

Case – Shiller Price Index Cumulative change since 2000 (%)

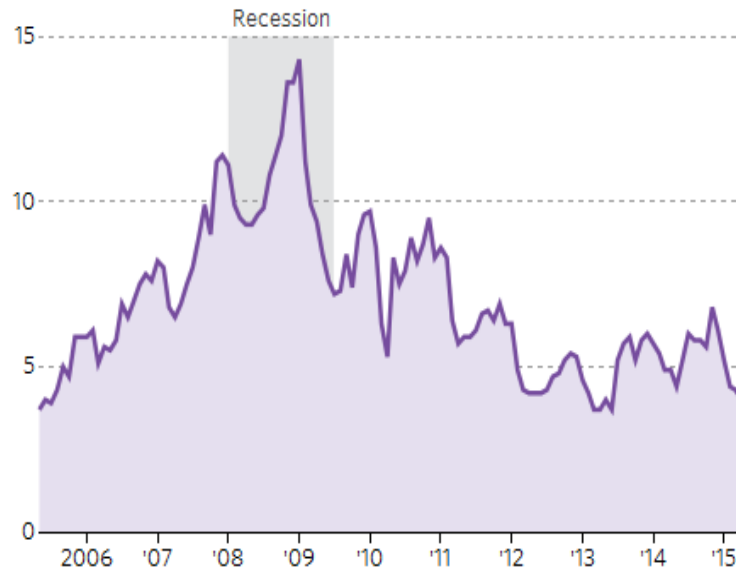


Weak New home supply drives prices higher

Months' supply

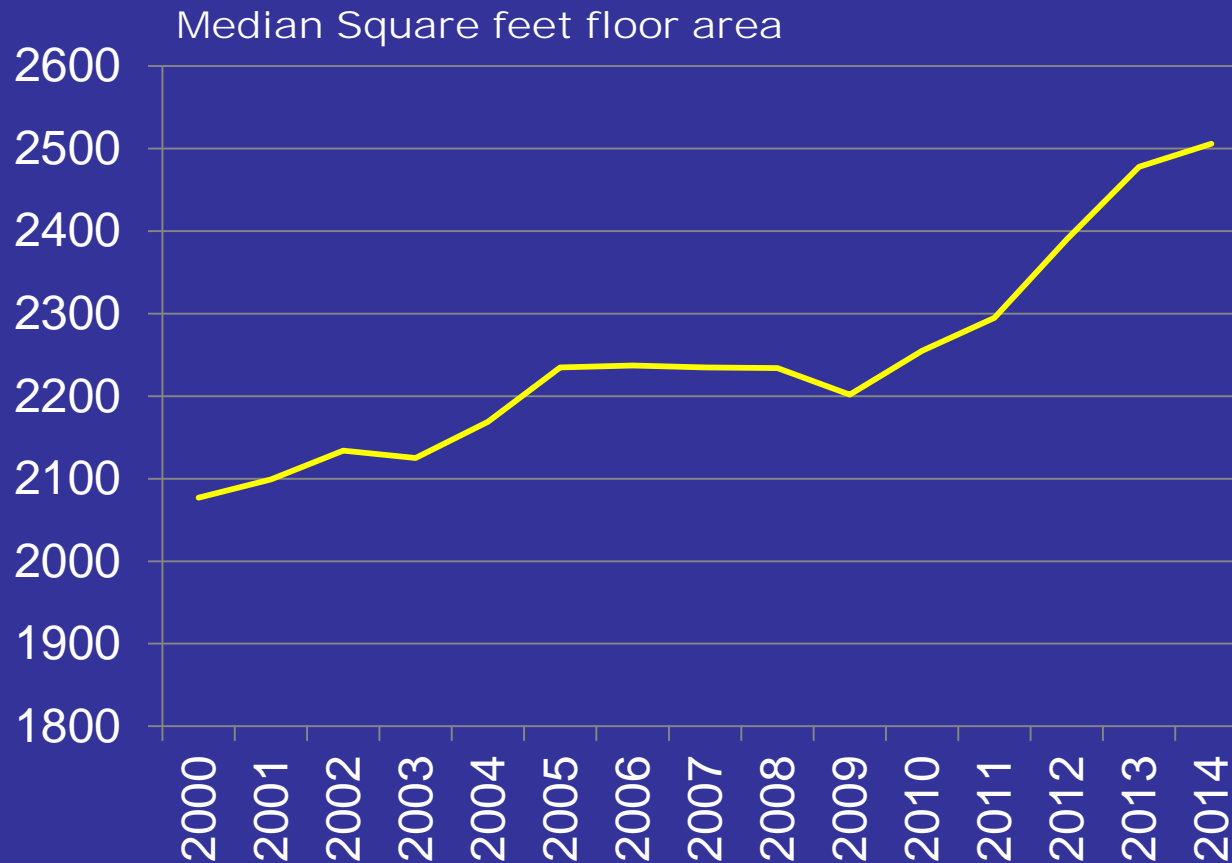
The amount of time it would take, in months, to sell the stock of newly-built homes available for sale at the current sales pace. The National Association of Realtors considers a six-month supply to be a balanced market.

Months' supply of newly-built homes for the past 10 years

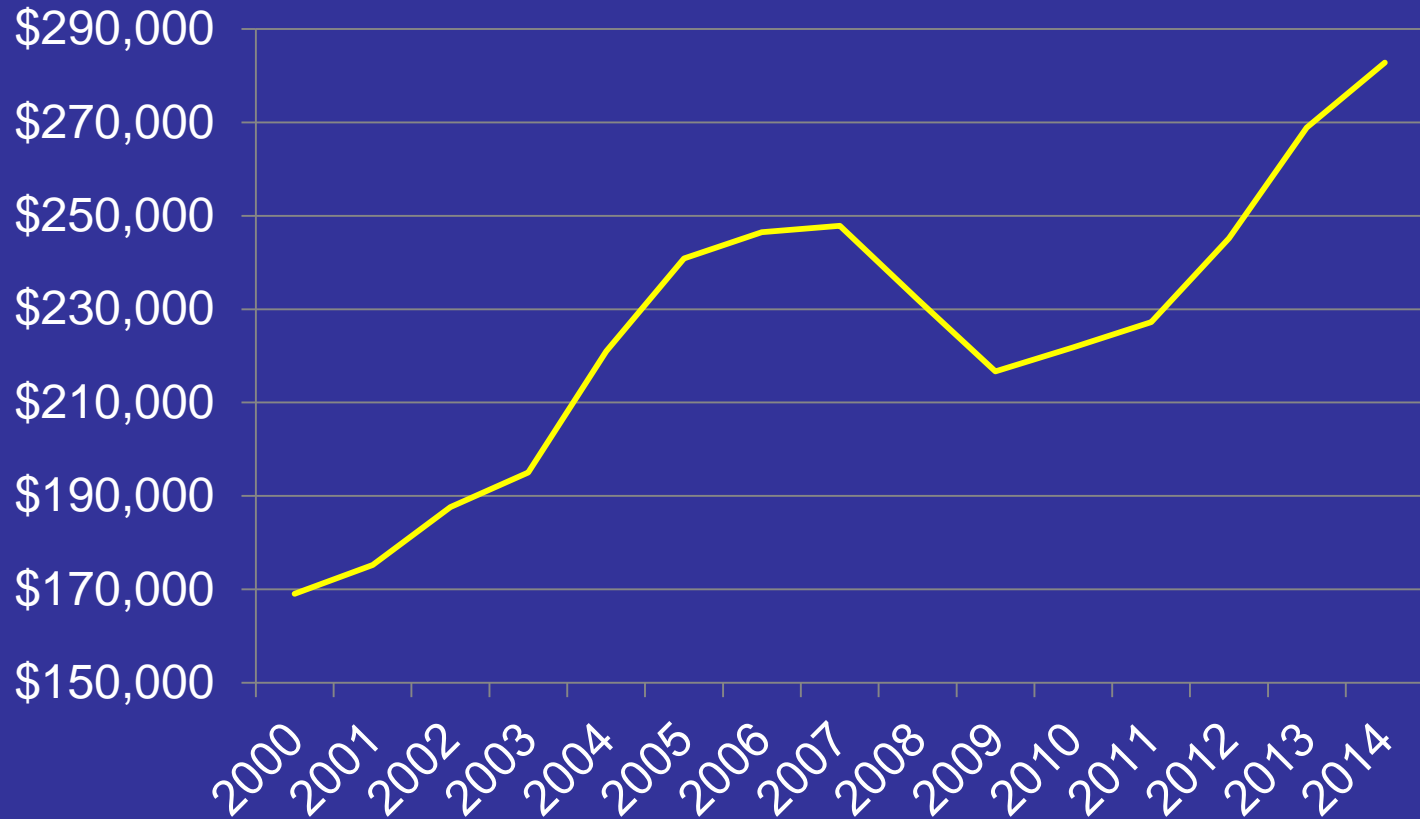


Sources: Commerce Department via the Federal Reserve Bank of St. Louis (new homes sold, housing starts), National Association of Realtors via the Federal Reserve Bank of St. Louis (existing homes sold, months' supply), S&P Dow Jones Indices (Case-Shiller index)

Size of New Homes sold has increased dramatically
In past 6 years as builders cater to “well healed”
Buyers as many 1st time buyers are missing



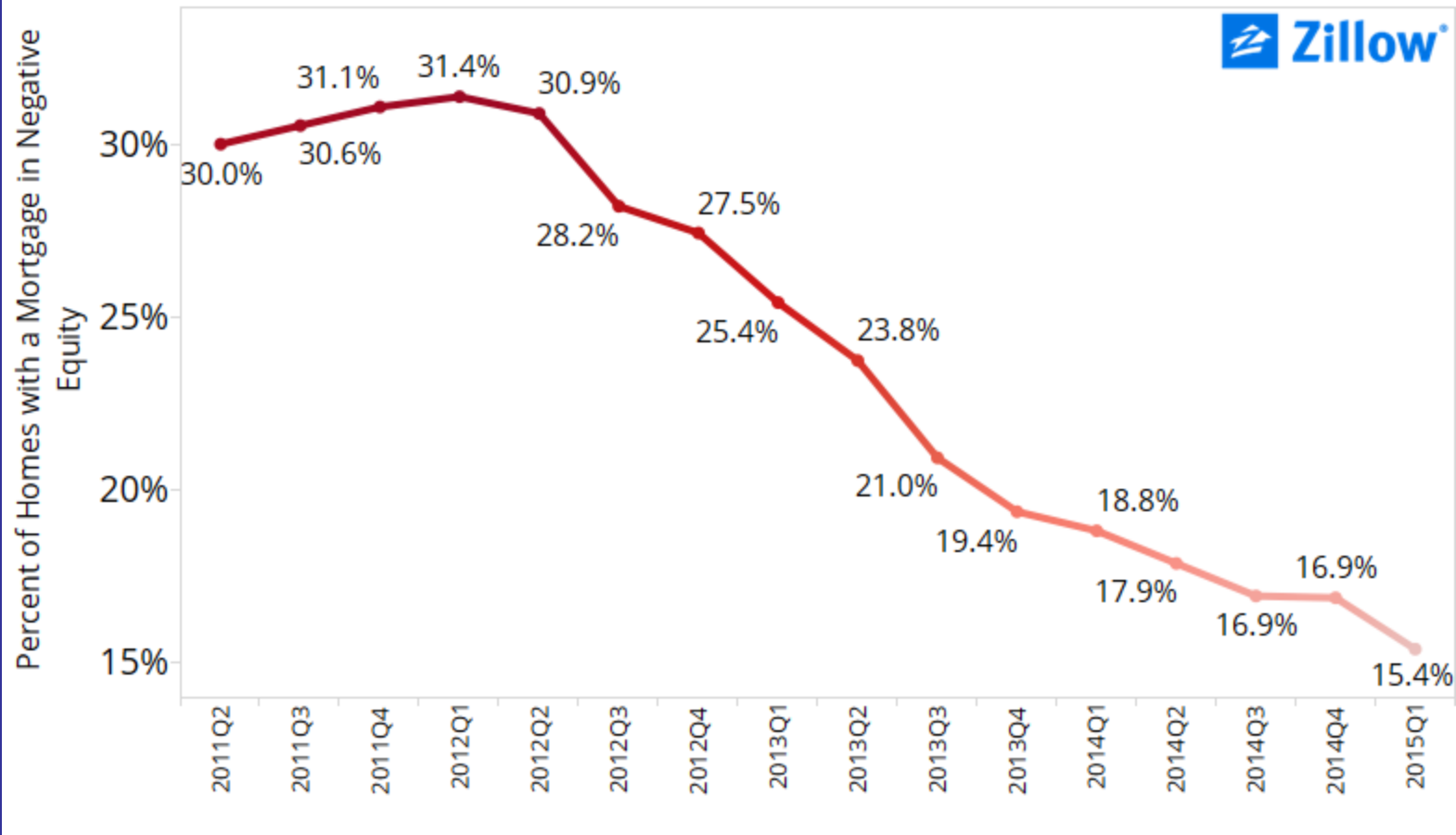
Median price of new homes has increased dramatically



(<https://www.census.gov/construction/chars/sold.html>)

Underwater mortgages still a problem: remain historically high at 15.4% (8 million) in 1st Qtr 2015. Healthy market is 1 – 2% underwater. Problem is that 15 - 20% of the market becomes “non – tradable” according to Stan Humphries at Zillow, and this will continue to slow the Housing recovery

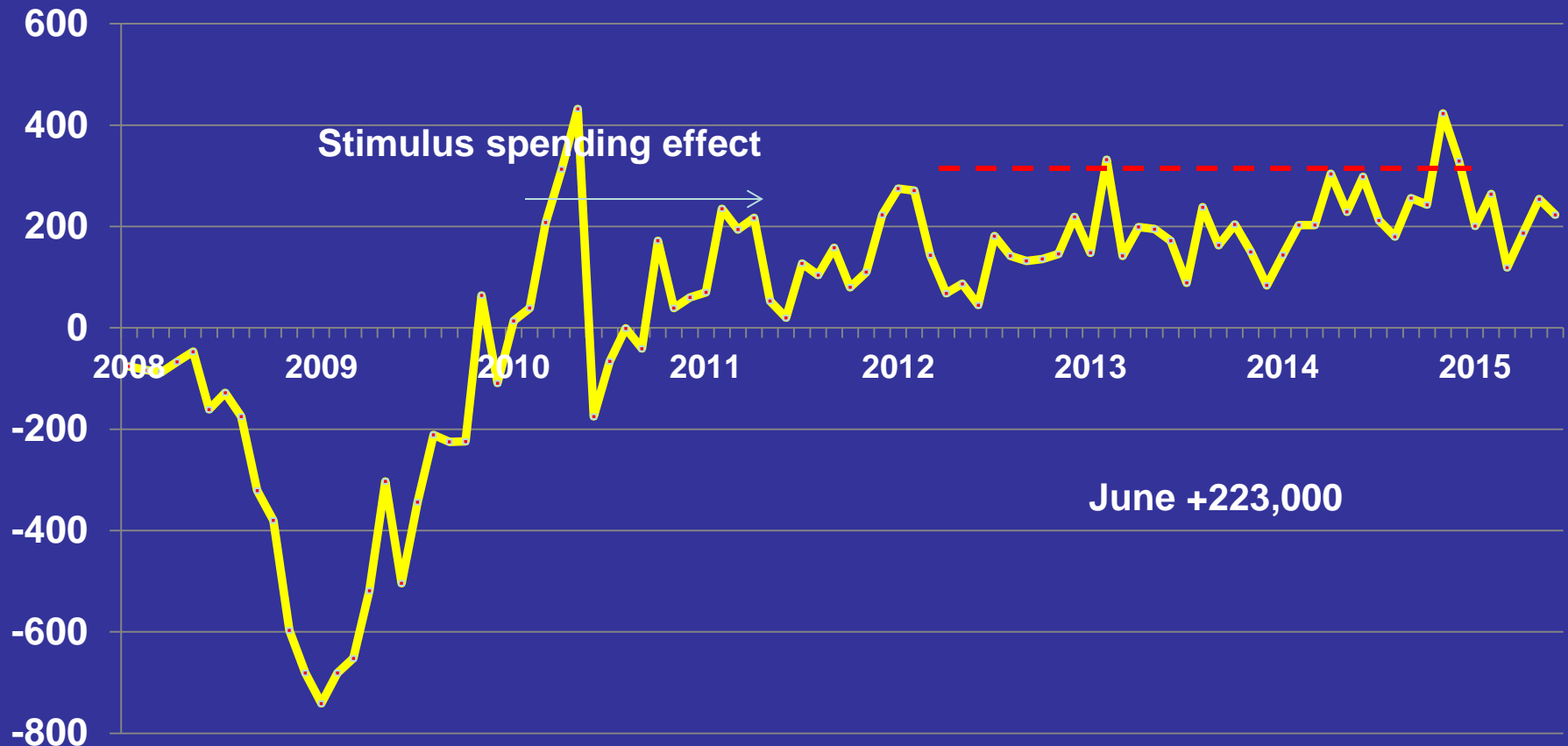
Figure 3: Negative Equity Time Series (United States)



Source: Zillow (<http://finance.yahoo.com/news/scariest-u-housing-chart-shows-040000853.html>)
(<http://www.zillow.com/research/negative-equity-2015-q1-9905/>)

Employment situation - our biggest problem - but, getting better with 223,000 jobs created in June

Net change in non farm payrolls – monthly, thousands

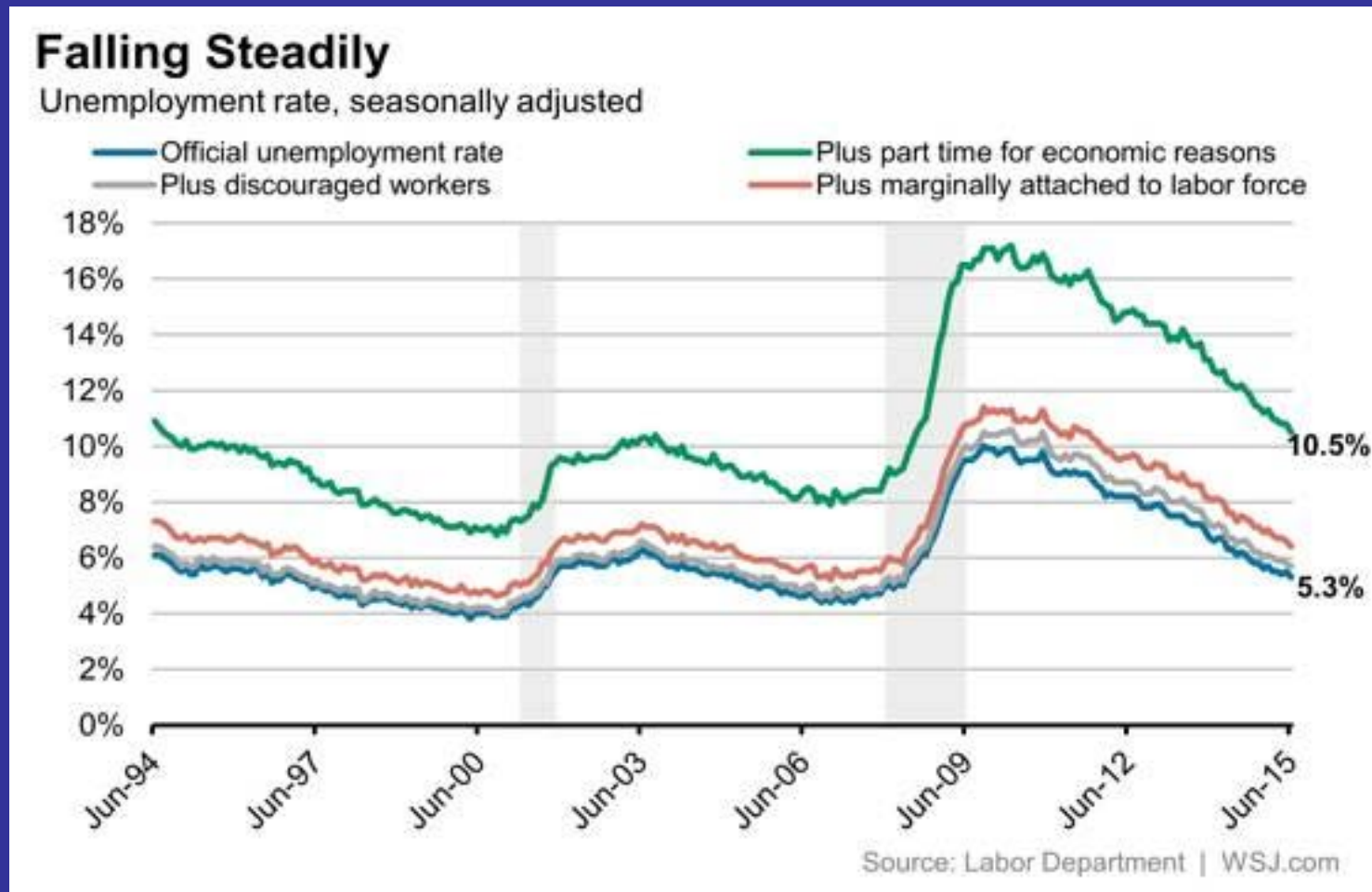


Unemployment rate keeps coming down – but, nearly 7 million remain “underemployed” – working part time, but want full time jobs

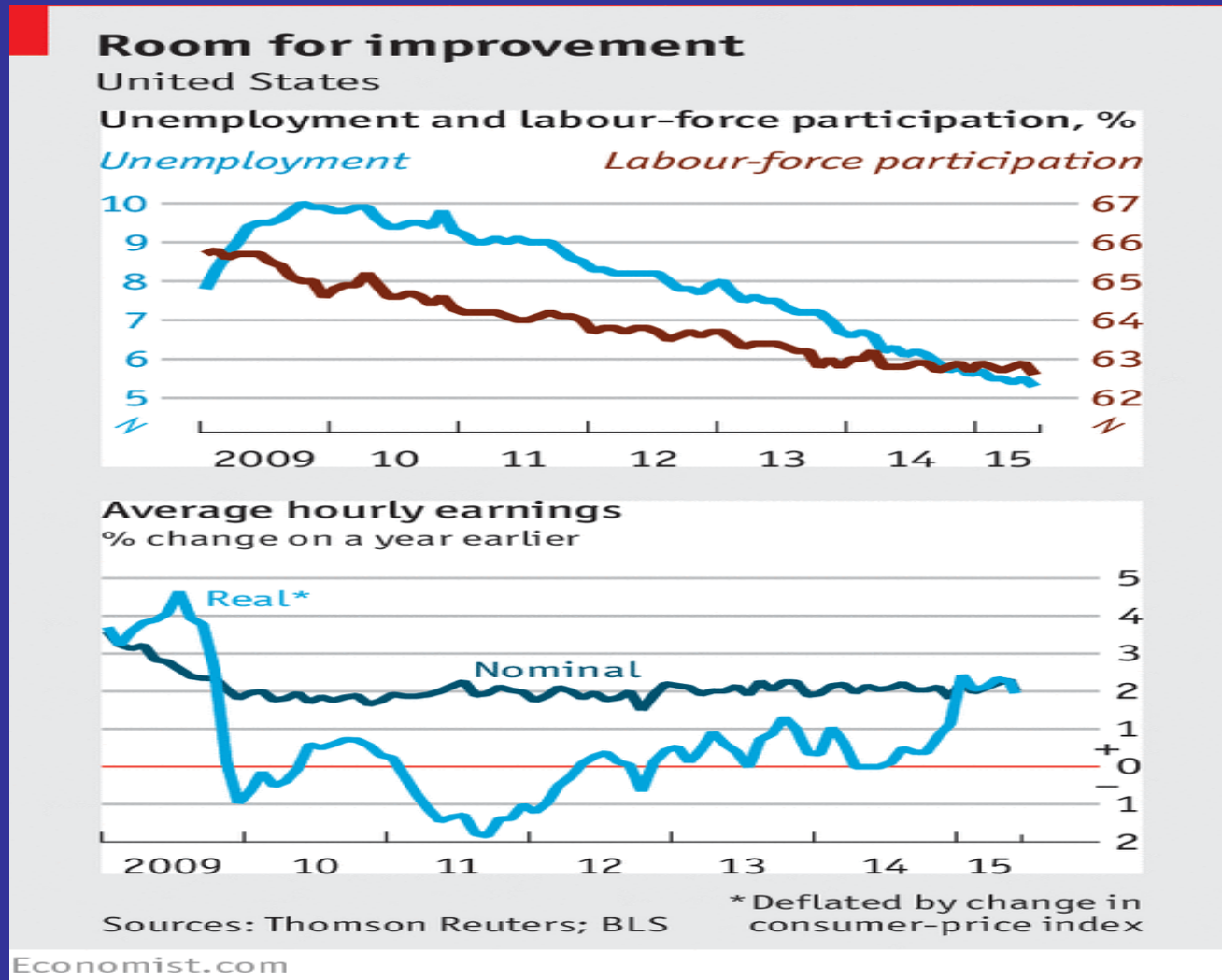
There are about 17 million people either unemployed, underemployed, or stopped Looking – **Key reason why wage increases are stagnant!!!



Closer look at “real unemployment rate” – things are Improving, but we really need stronger earnings growth



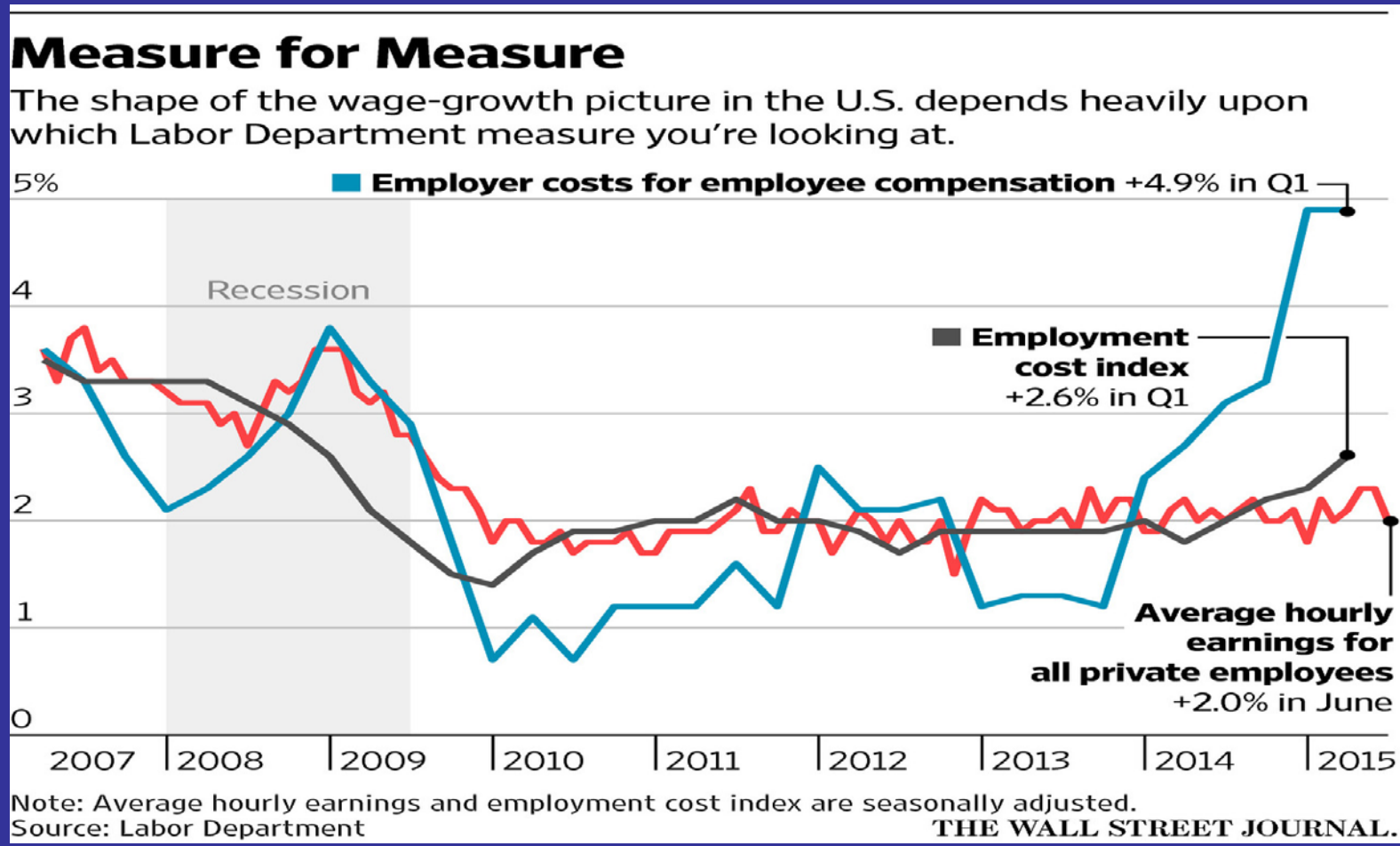
Labor market still having problems – unemployment rate
 Coming down, but many people dropping out of labor force
 And - - wages continue to languish (but there is more to this story - -
 See next several slides)



Wage growth has been weak or missing during past 8 years, but when you include benefits things look better

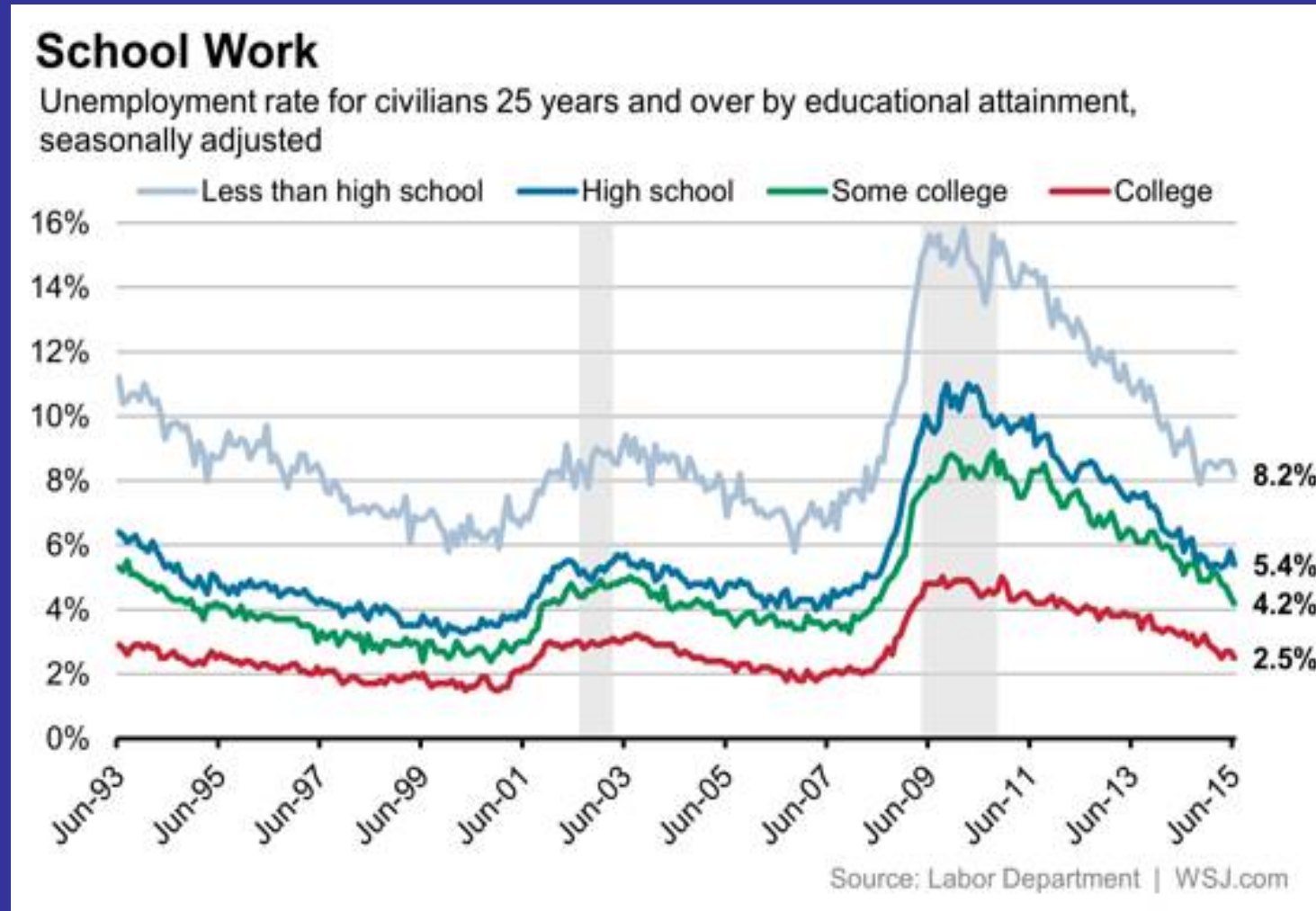
Both the ECI and ECEC include benefits with ECI controlling for differences in labor force Composition over time while the ECEC doesn't. Translation - the ECI is the best measure of broad based earnings over time while the ECEC suggests that high earning workers are doing well. Poor performance of hourly earnings suggests that many new jobs are low paying with little or no benefits.

Bottom line - the labor force is shifting and education is Key to higher compensation



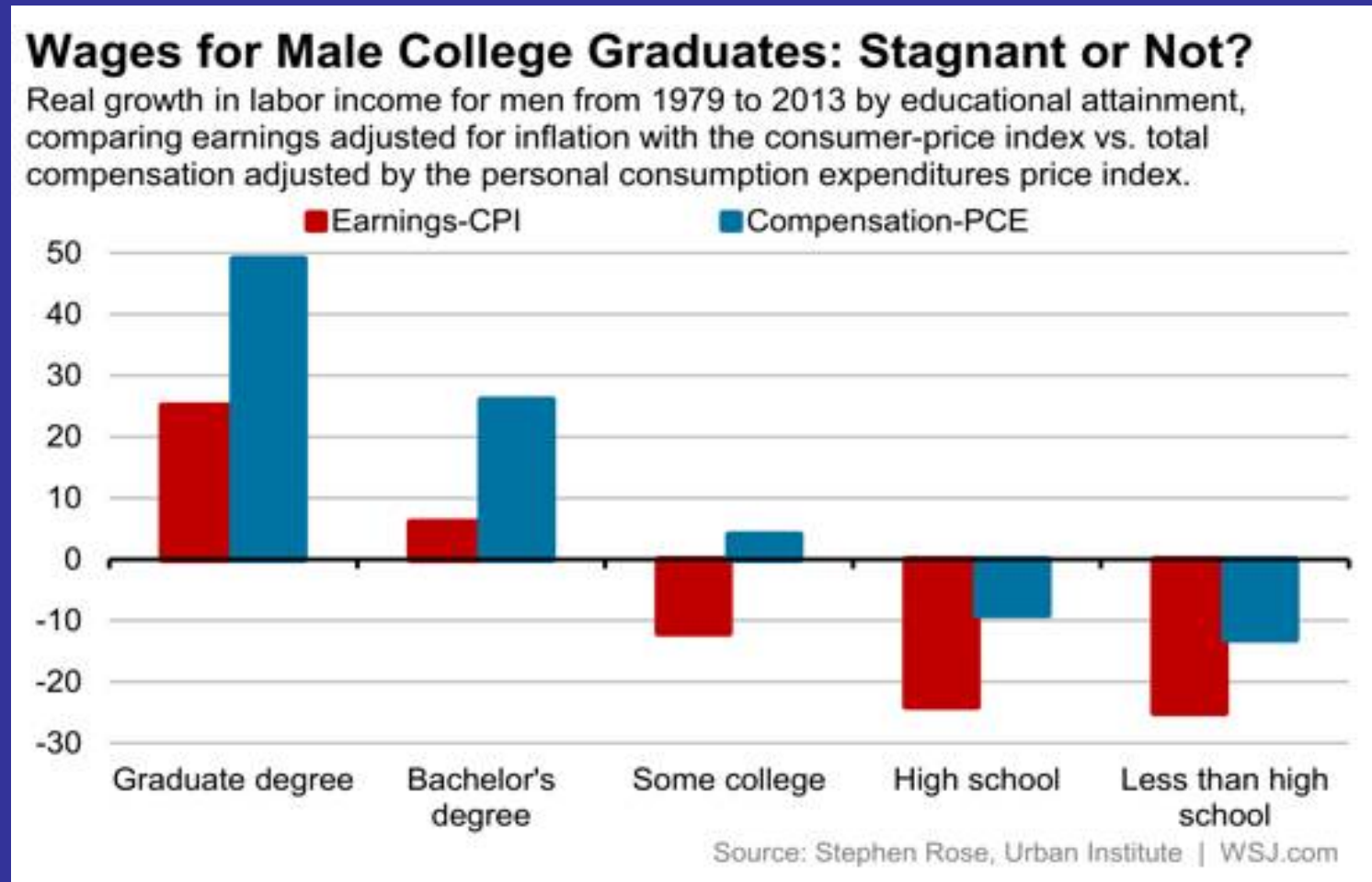
Source: WSJ (<http://www.wsj.com/articles/wage-measures-send-mixed-signals-1436132861>)

Good graphic showing that education improves
Your chances of staying out of the unemployment line

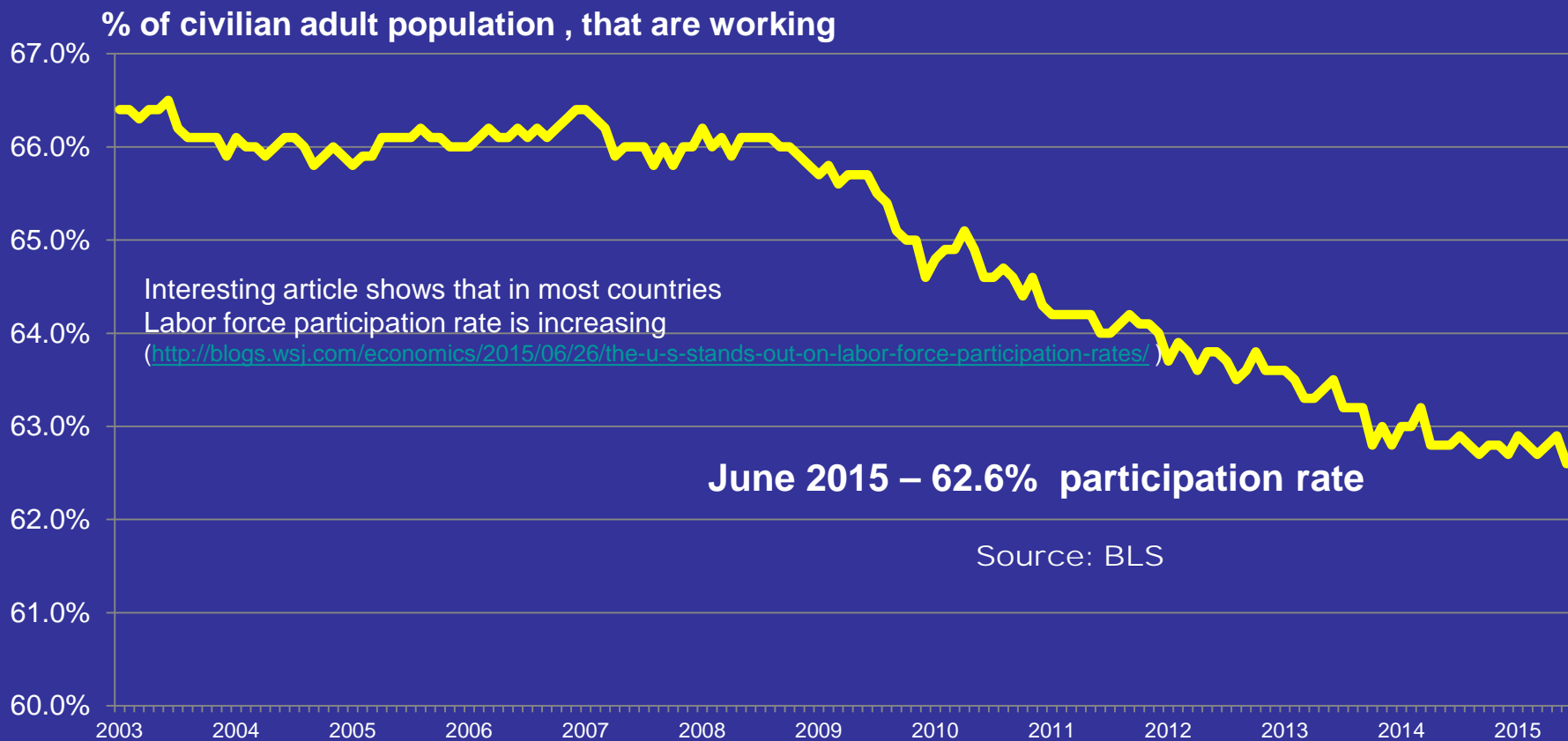


More evidence that education pays

Earnings vs Compensation - - compensation includes Benefits like employer paid health care, pensions, etc. while earnings are wages only. CPI and PCE are two indexes Used to adjust for inflation



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. One 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 they are much cheaper). Excellent article (<http://finance.yahoo.com/news/should-i-go-to-a-trade-school-162413337.html#>)



Economic growth negative 0.2% – 1st Qtr 2015 – Real GDP has averaged just 2.2% during the past 6 years

Weather; strong dollar; lower energy prices hurt oil producing states; ...

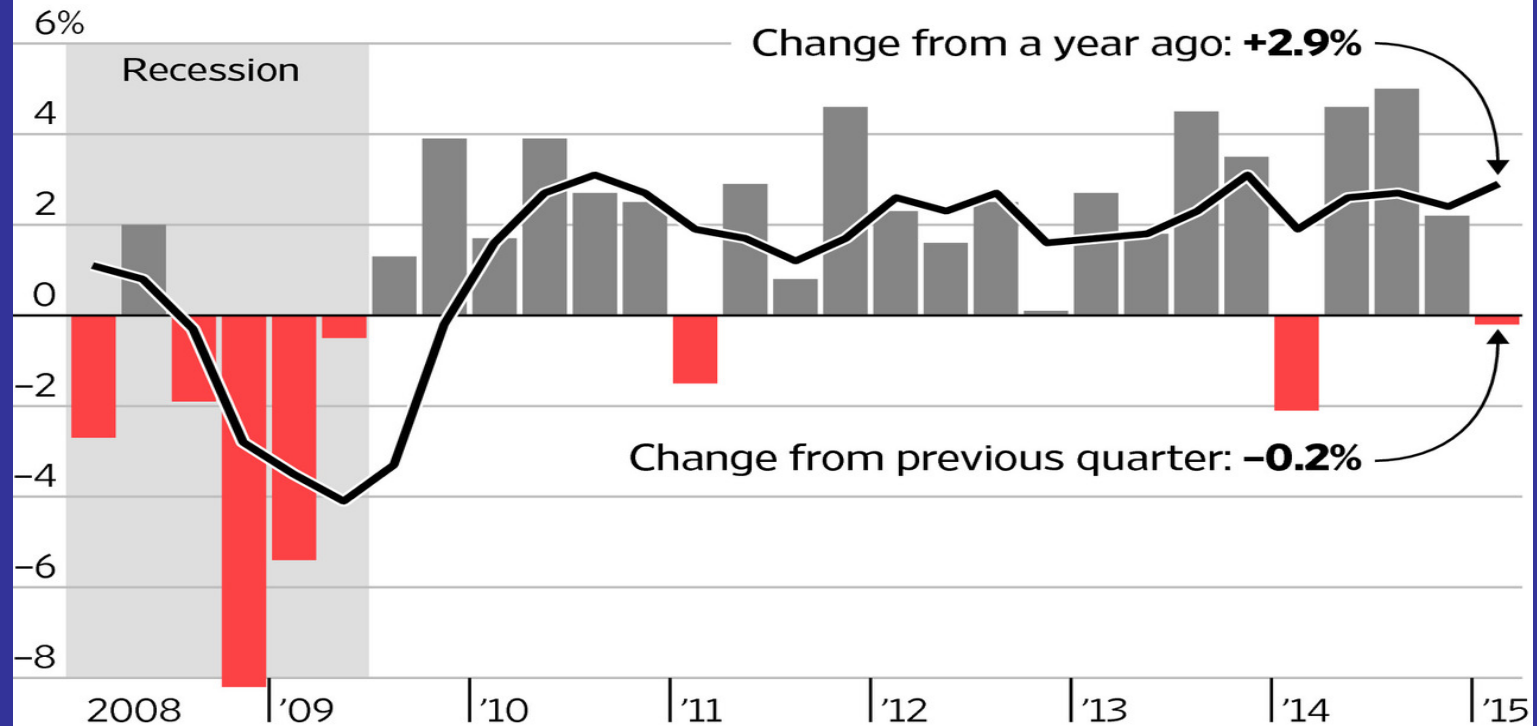
- (1) Slowing world economy (European recession; weaker China growth)
- (2) Stronger dollar will reduce exports and increase imports – negative impact on manufacturing jobs which is key to income growth in USA
- (3) Political stalemate, terrorism, currency wars, growing national debt, ...



The economy has grown at a lethargic rate of 2% since the recession Ended in June 2009 – weak business investment spending (R&D, machinery, Construction) and housing are two reasons.

Uneven Output

The expansion has failed to achieve a sustained acceleration in part because stretches of stronger economic growth have been interrupted by weak quarters. Change in U.S. gross domestic product:



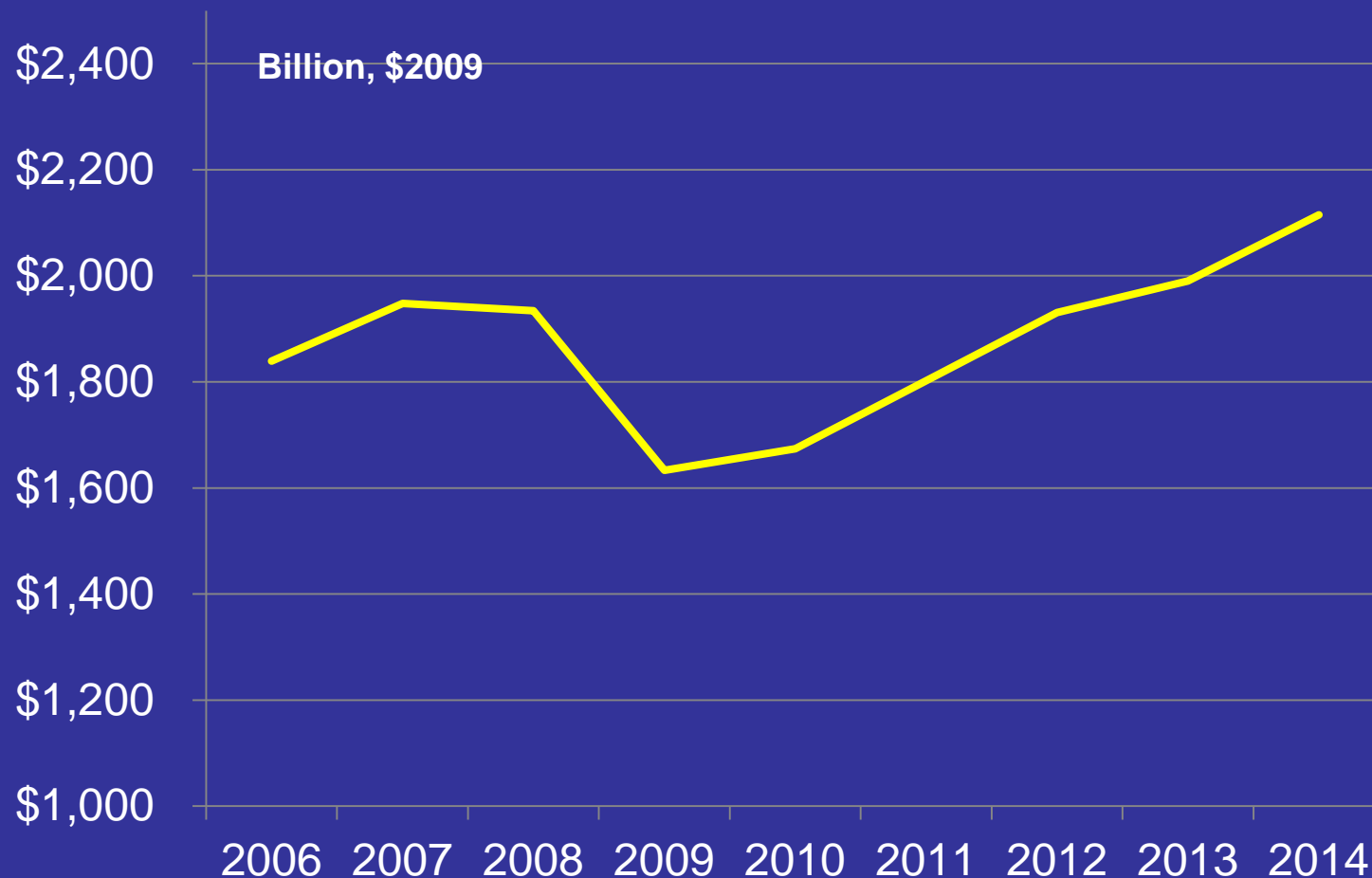
Note: Quarterly data are seasonally adjusted at annual rates

Source: Commerce Department

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Private Domestic investment barely above 2006 levels

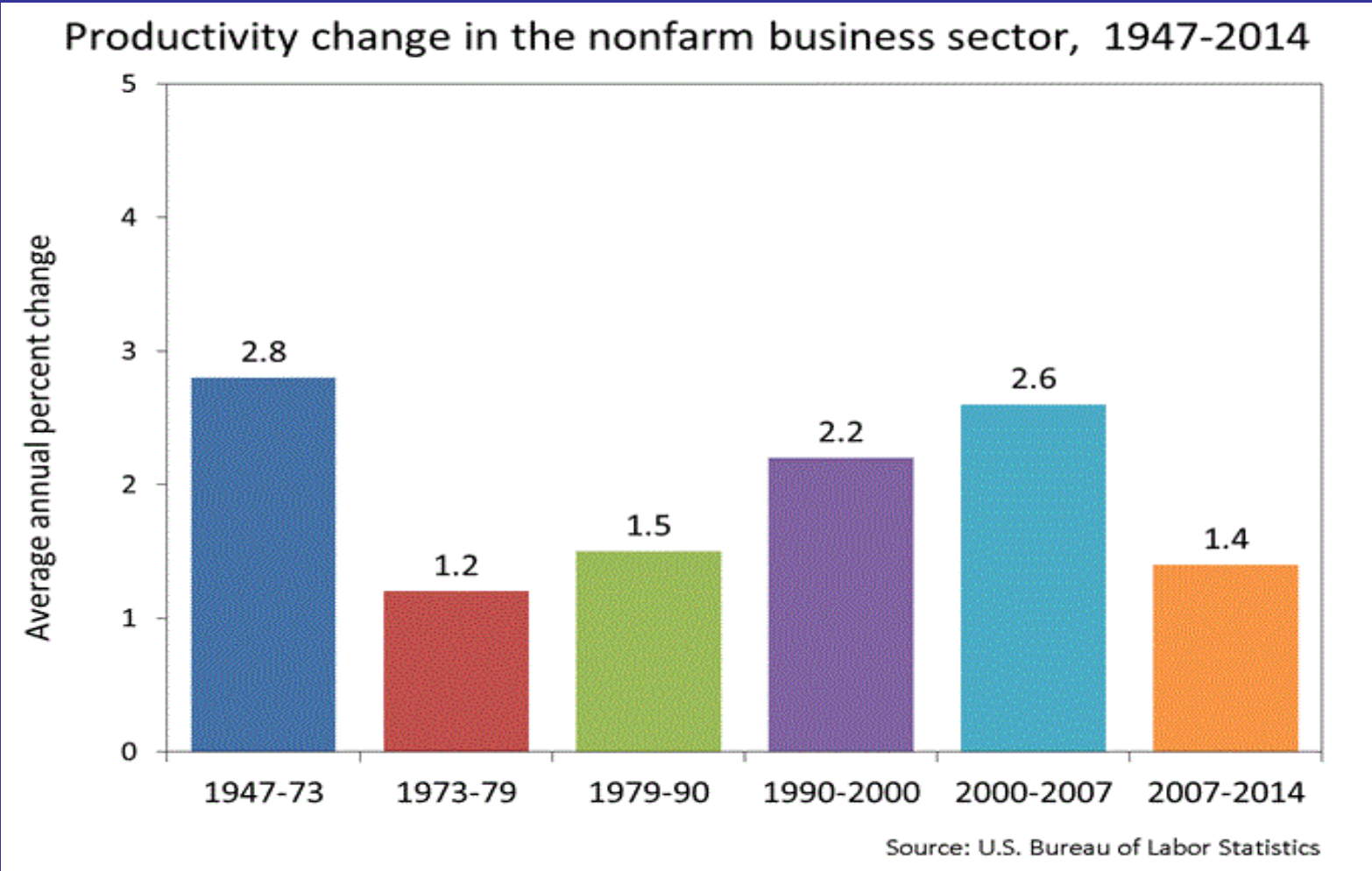
It's improving, but domestic and geopolitical concerns are creating Uncertainty which slows investment which slows productivity growth
And that translates to weaker GDP growth (and less demand for housing)



We need to invest more to become more competitive, create better paying jobs, and grow GDP

GDP derives from number of workers plus productivity (real GDP/worker) – (<http://marketrealist.com/2015/01/2-factors-drive-real-gdp-growth/>) -- with lower productivity , higher employment won't generate as much growth in GDP – this is why improving employment doesn't give us strong GDP growth .

Innovation and entrepreneurship is key to increasing productivity



Source: BLS (<http://www.bls.gov/lpc/prodybar.htm>)

More on productivity during the past 65 years – “to improve productivity, we Need to develop more innovative ways to produce products and services”

“Productivity, involves faster or cheaper ways to provide the same product or service, along with new products and services that accomplish a job more efficiently.

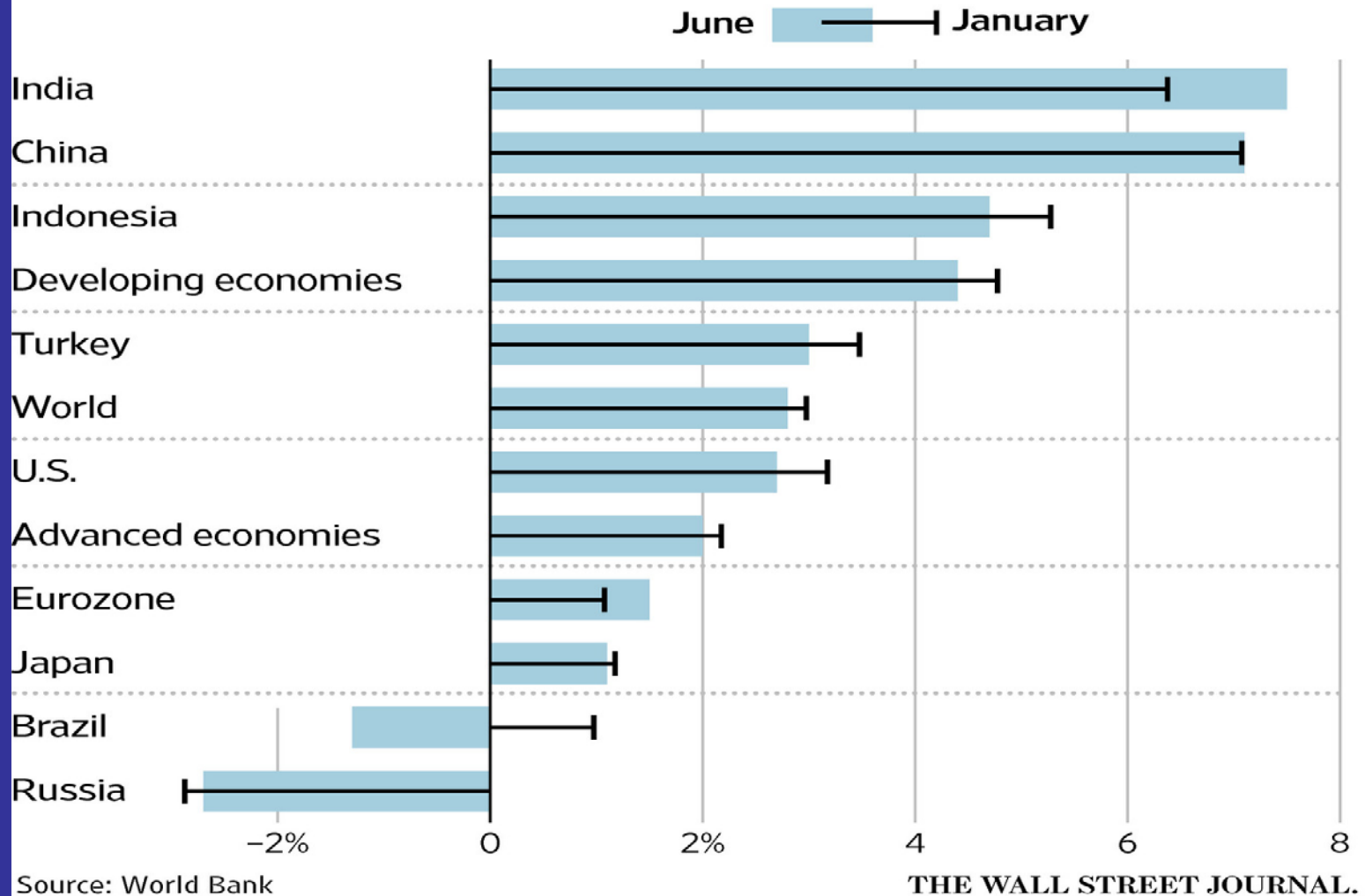
Breakthrough examples of such innovation include the telegraph, the automobile and the personal computer.” (Rick Newman – (<http://finance.yahoo.com/news/what-jeb-bush-is-getting-wrong-about-jobs-174544281.html>))

Decade	Average productivity gain per year
1950s	2.8%
1960s	2.8%
1970s	1.9%
1980s	1.5%
1990s	2.0%
2000s	2.6%
Since 2010	1.2%

World Bank forecast cuts world growth to 2.8% in 2015,
But expects 3.2% growth in 2016 (I don't believe it)

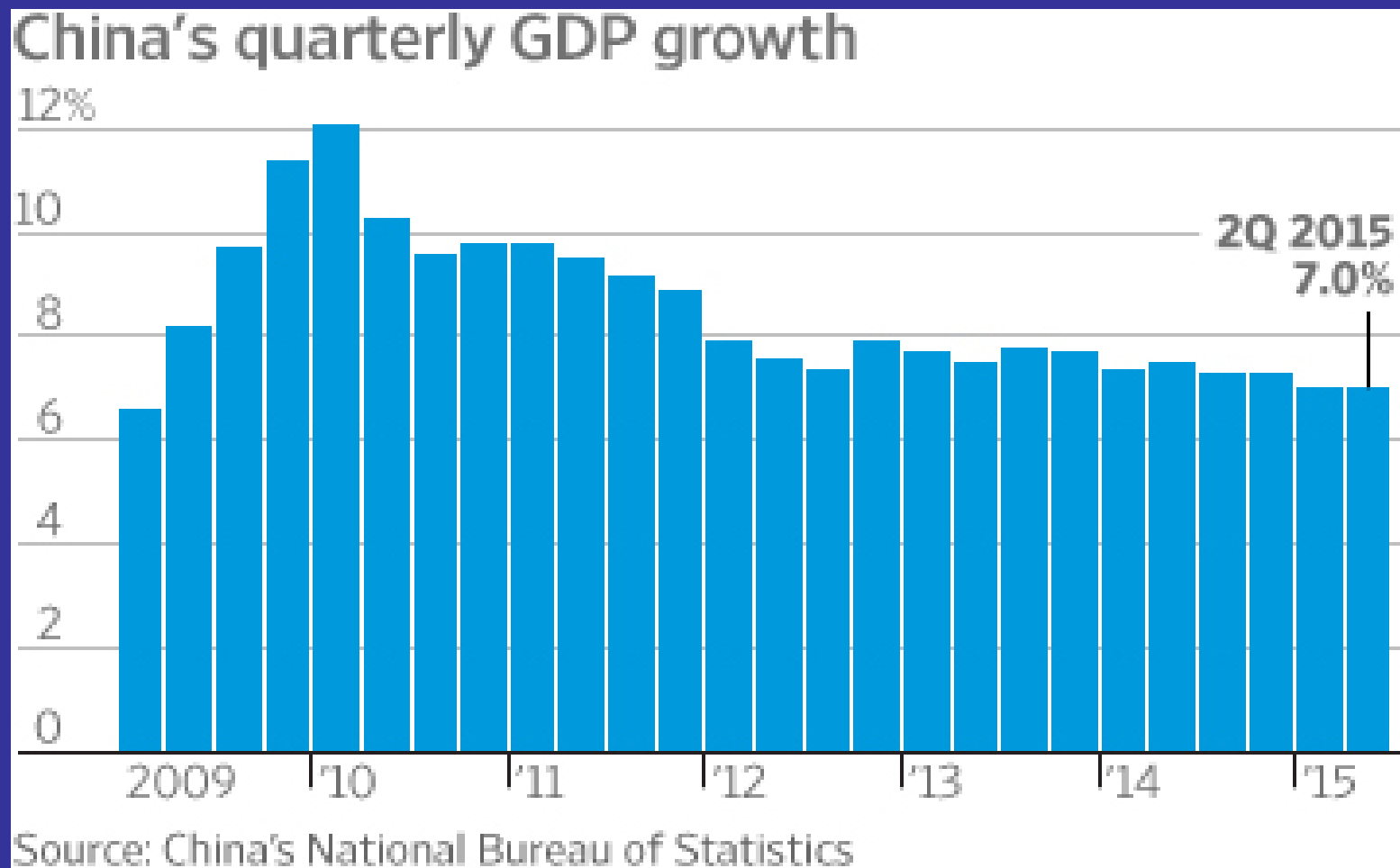
Downward Trend

2015 GDP growth forecasts from the World Bank



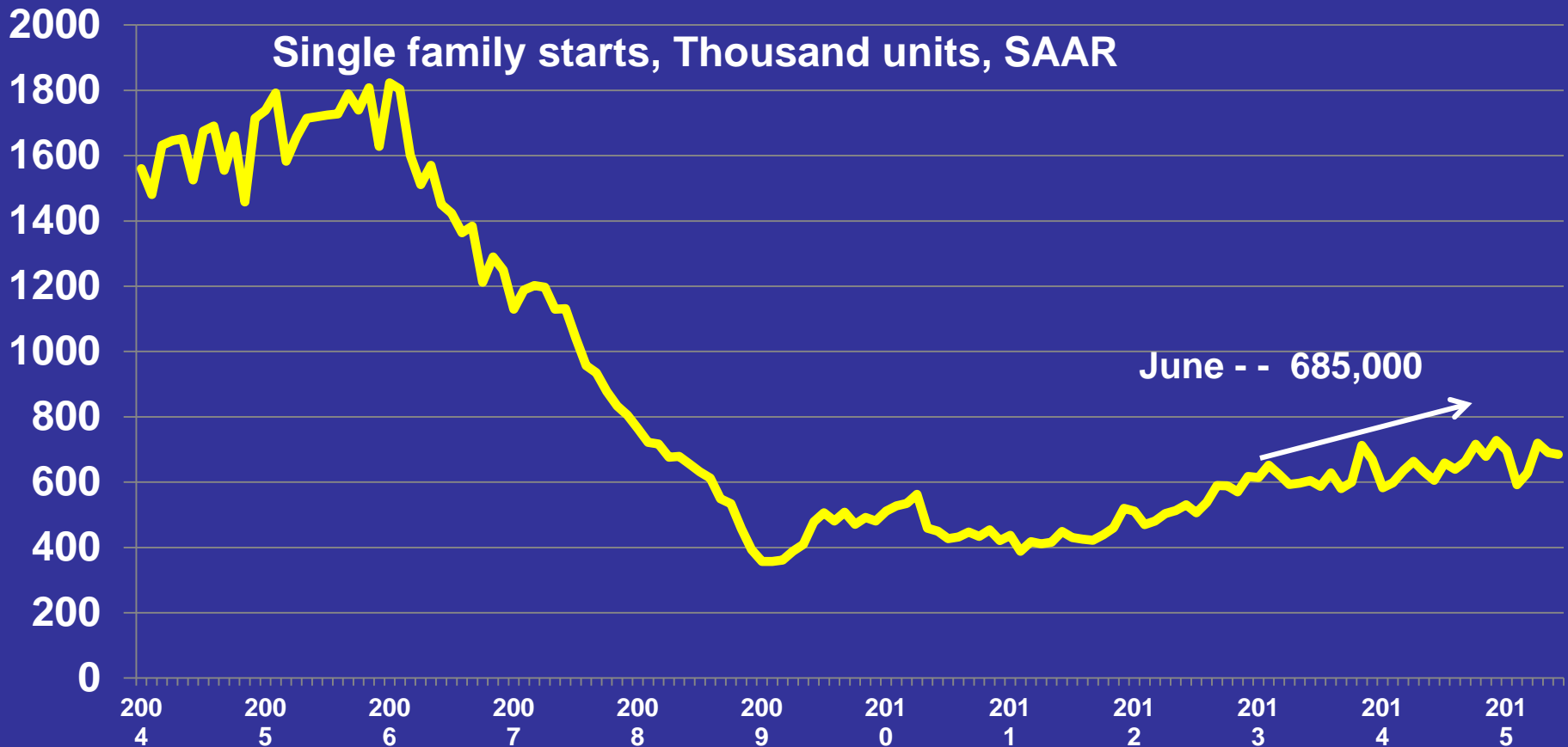
Source: World Bank (<http://www.wsj.com/articles/world-bank-cuts-2015-global-growth-forecast-to-2-8-1433966532>)

Although China's growth is slowing, it's still pretty good compared With Europe and the USA - this is key to world economy (China Is 2nd largest economy) and even more important for Commodity prices



Recent Housing statistics

Starts are inching forward – 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???? The FED has kept interest rates near zero for 6 years, but housing remains lethargic. Interest rates aren't the main problem



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

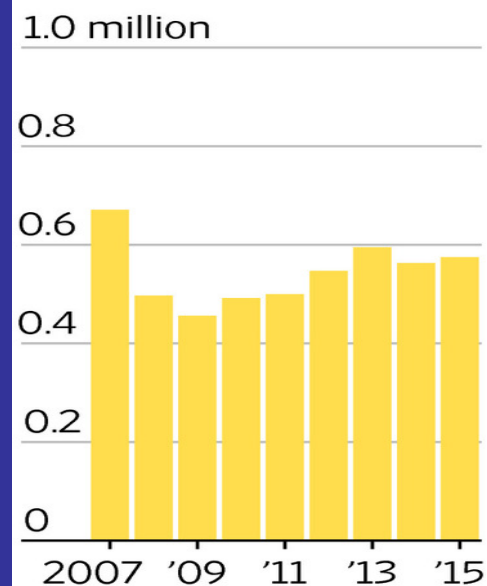
As the article indicates, Housing is doing best in places where the job market is healthiest. As always, jobs are the key metric to watch, and, a further reminder that Housing is a regional market.

Green Shoots

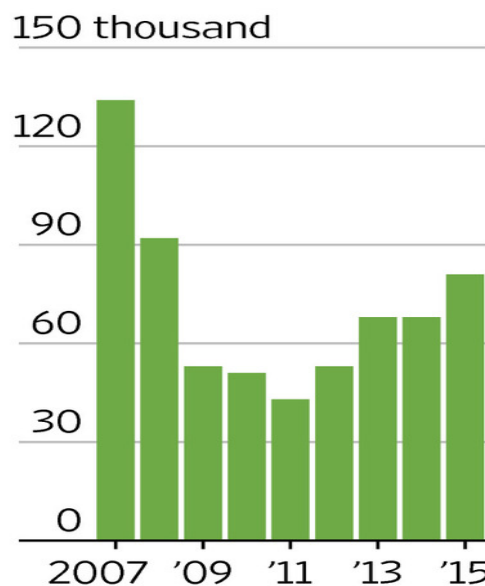
Home sales are up across the board for the first two months of 2015, compared to 2014's weaker start.

Housing market status through February of each year

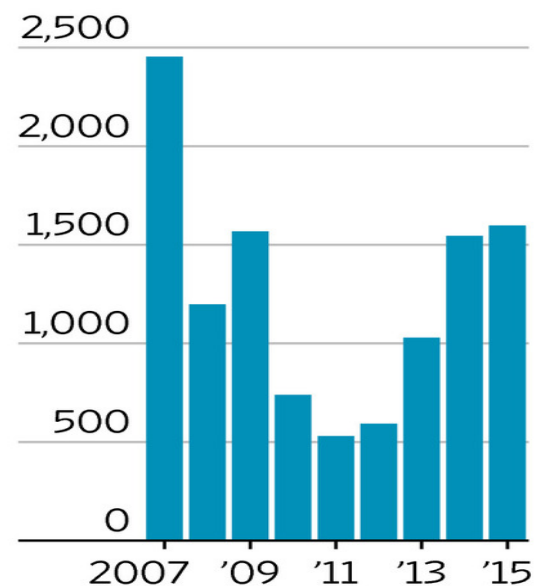
U.S. sales of existing single-family homes



U.S. sales of new single-family homes



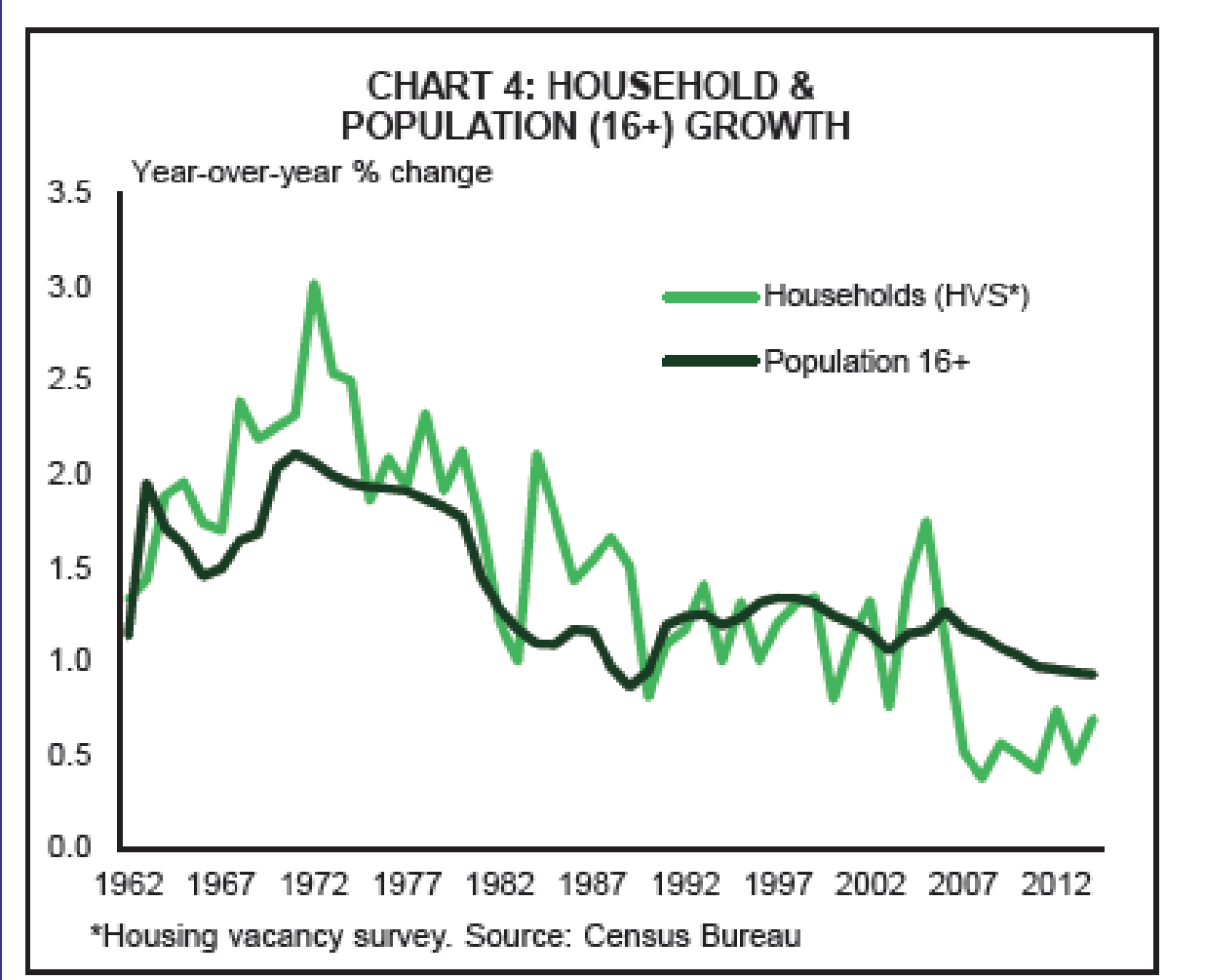
Housing permits issued in Jacksonville, Fla.



Sources: National Association of Realtors (existing); Commerce Department (new; Jacksonville, Fla.)

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Slower rate of household formation will constrain single family housing Starts



Impact of weak household formations - -

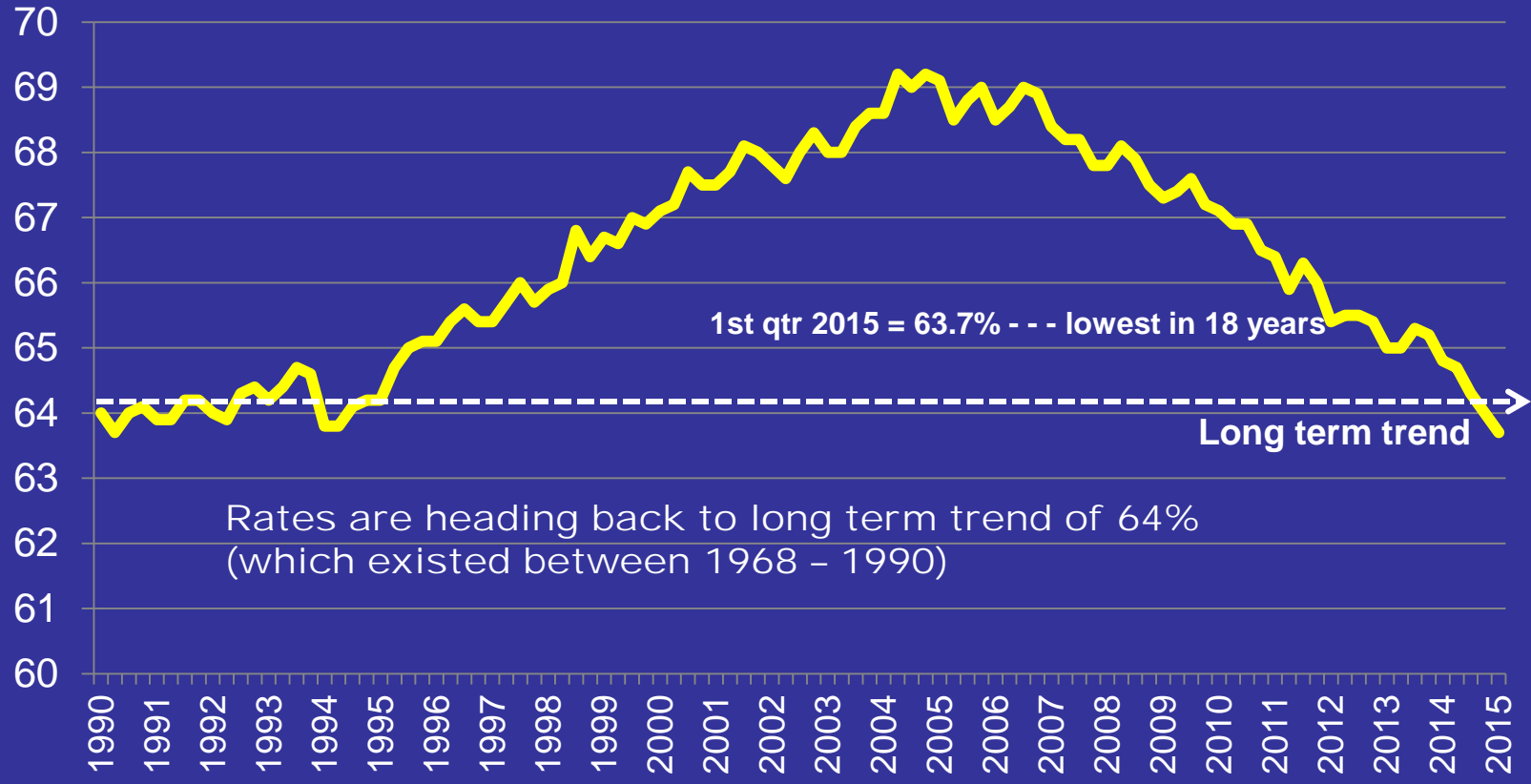
homeownership rates have been falling for the past ten

Years - when the economy gets back to normal,

Will people return to to single family or will renting remain in favor with many?

There will be impacts on wood products demand

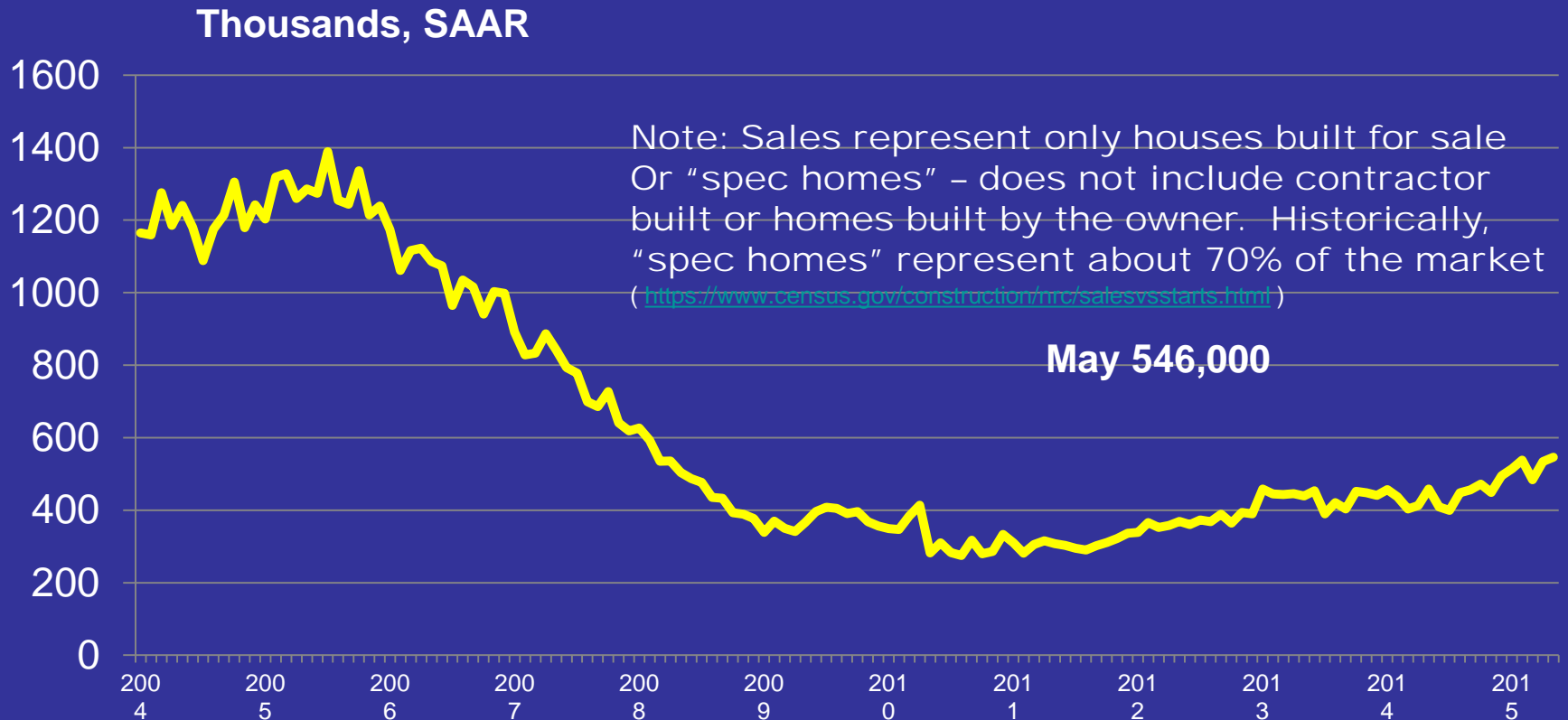
Home Ownership(%)



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

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

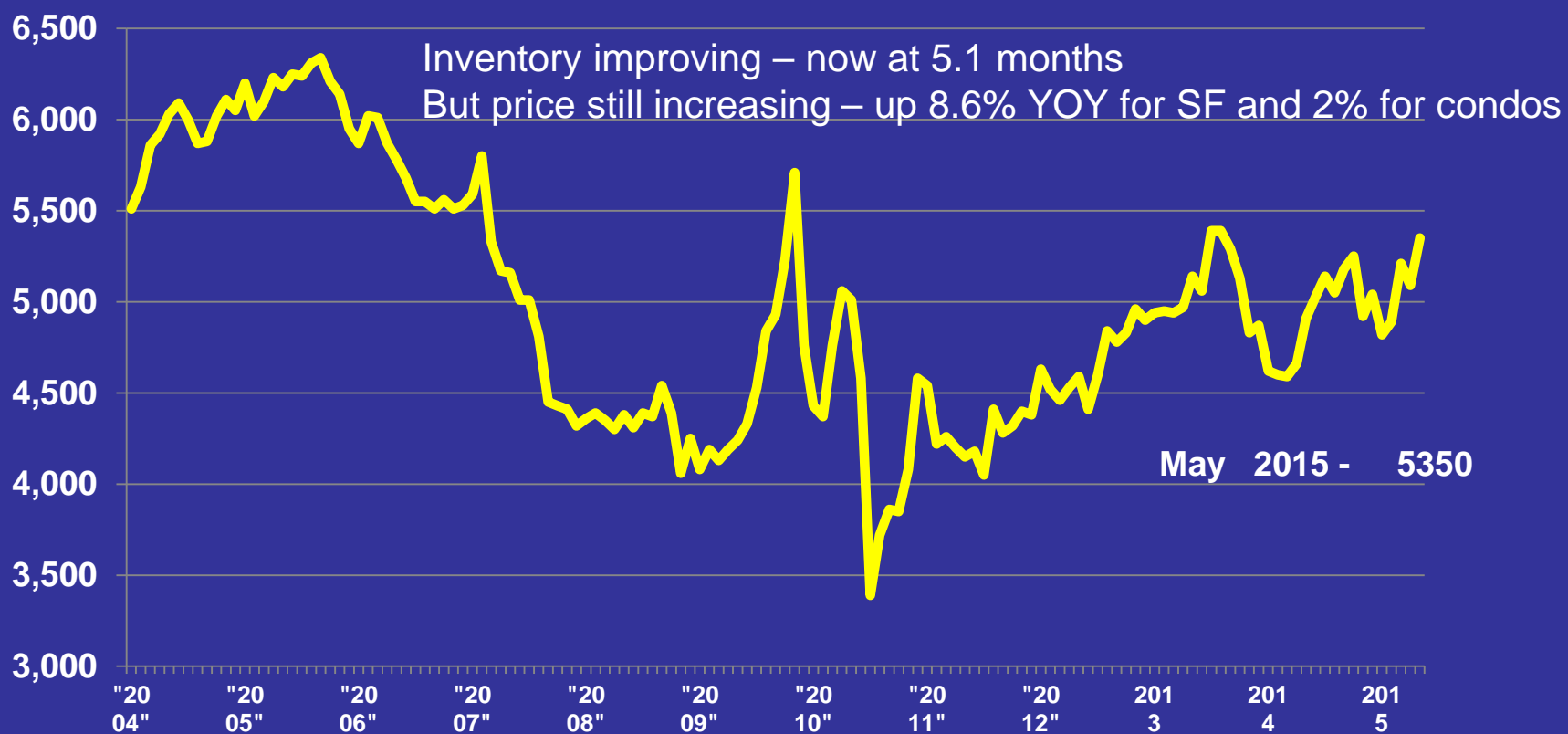
Supply still constrained at 4.5 months
And this drives prices higher



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

Resale market continues to improve, but still heavy to cash sales (24%) with 1st time buyers still below trend, but improving (traditionally they represent about 40 – 45% of market, but today they are at 32%). Another problem today is tight Supply (which drives prices), currently at 5.1 months. Healthy market is about 6 months supply.

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



Housing Market breakdown - -

New home sales = 10 – 15% of housing market
Existing home sales = 85 – 90%

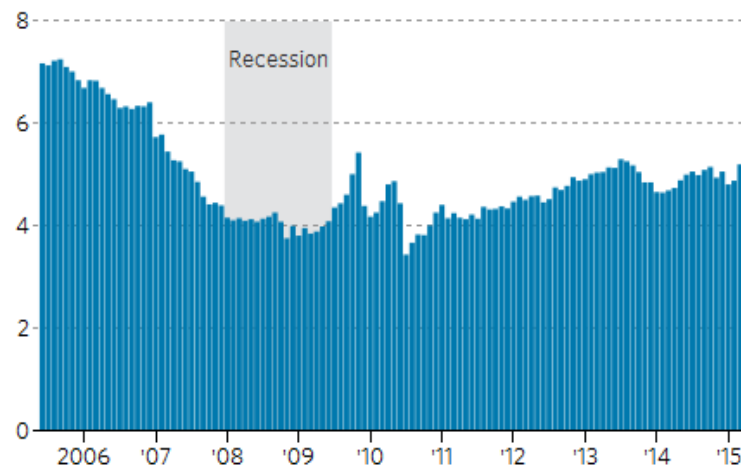
Home sales

Home sales offer the best gauge of housing demand at prevailing prices and interest rates. Sales of new homes tend to pack a bigger punch for overall economic growth, but they remain well below their pre-bubble levels.

All figures are seasonally adjusted at an annual rate

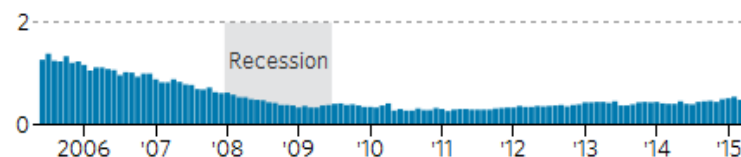
Existing home sales

Homes sold over the past 10 years, in millions



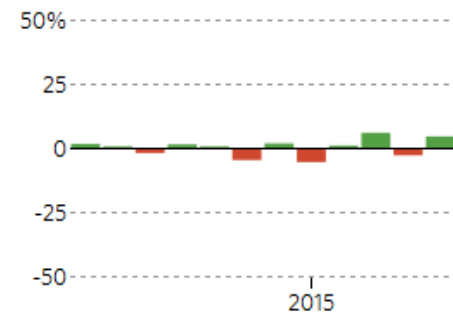
New home sales

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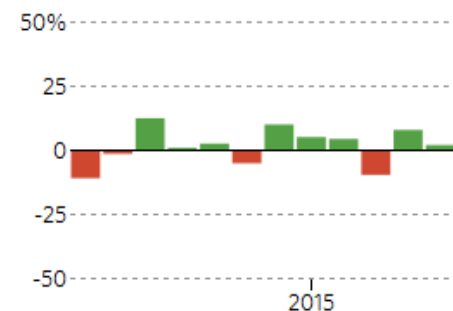
Existing home sales

Change from previous month



New home sales

Change from previous month

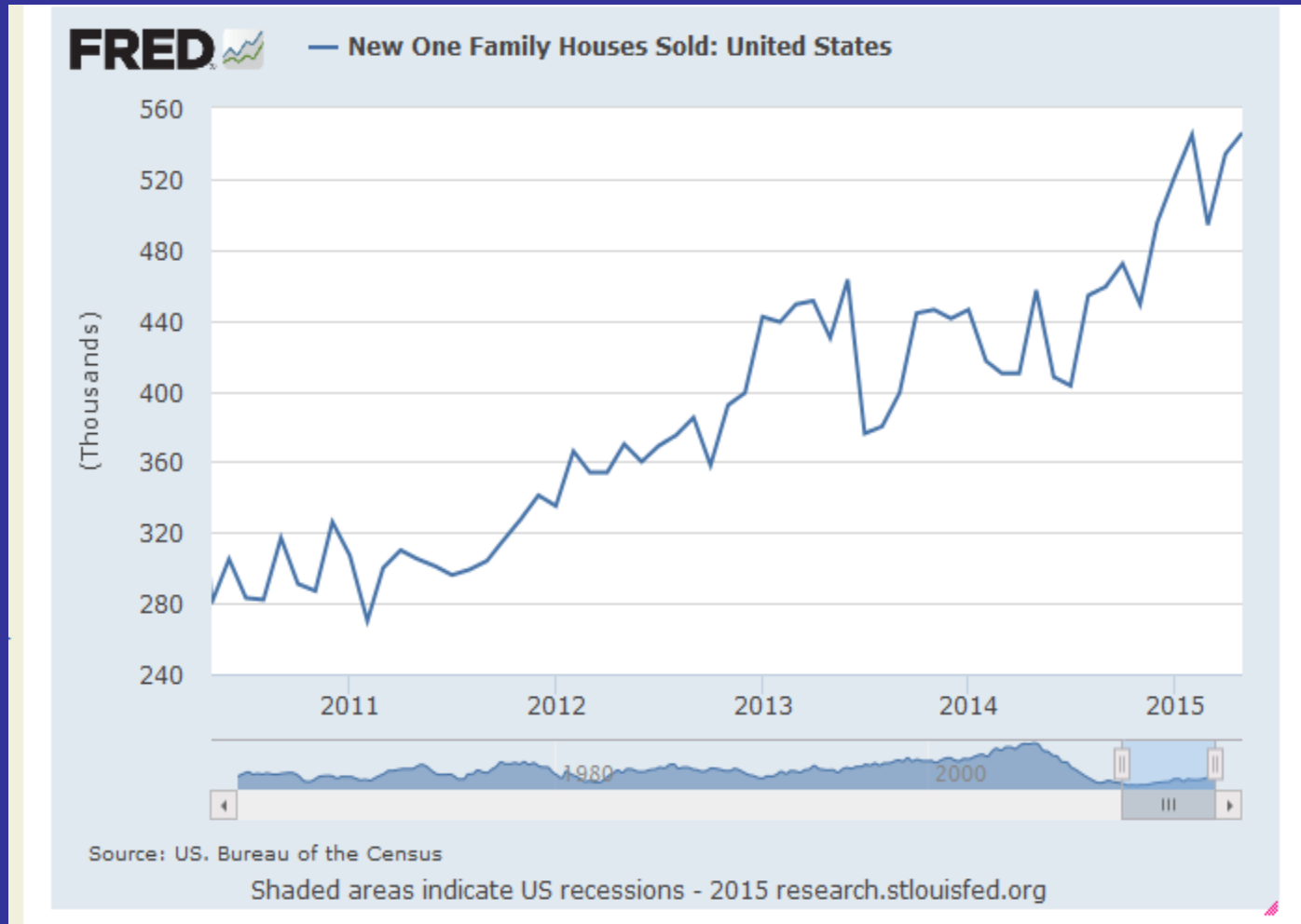


Some good news ----

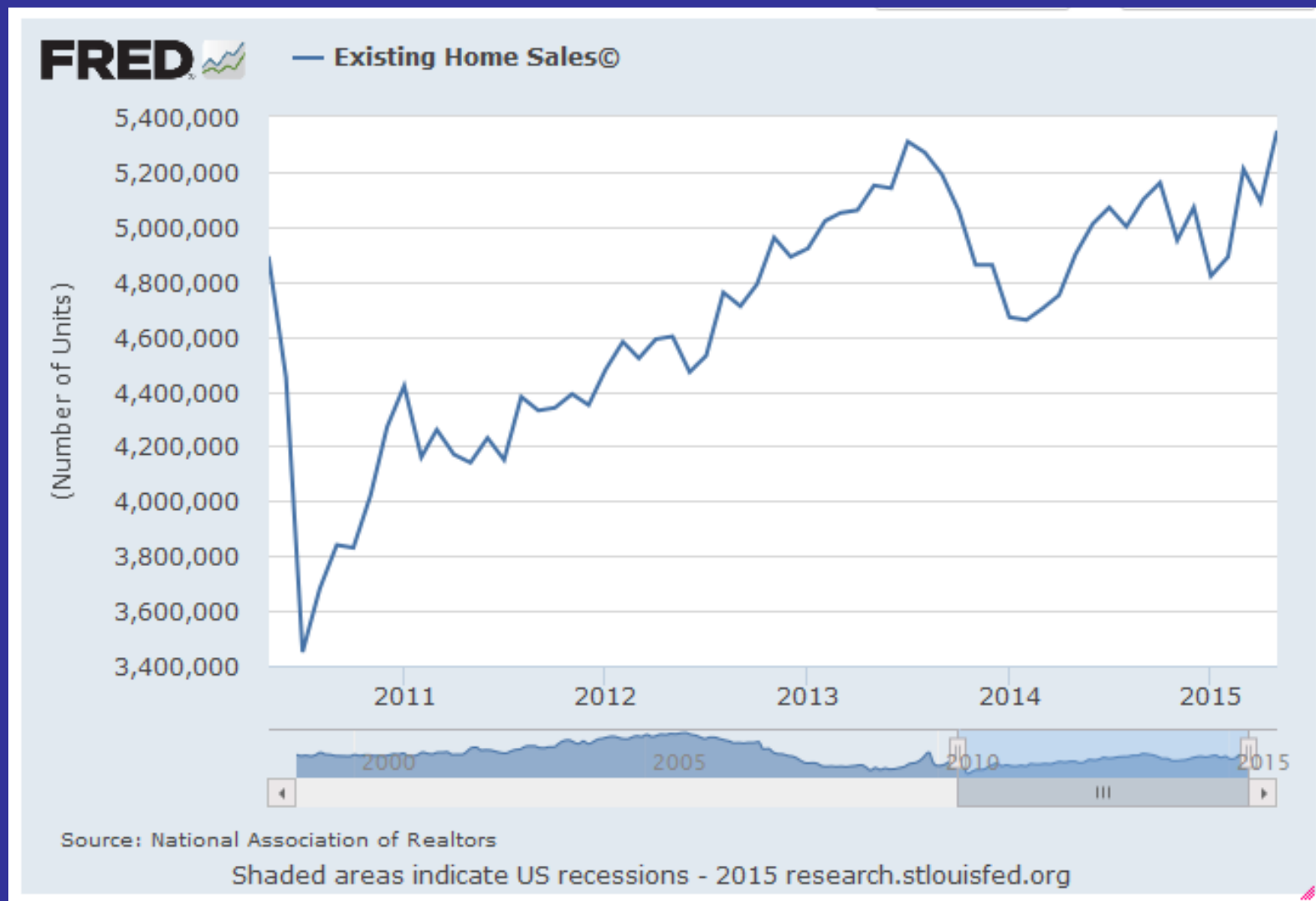
Following slides show that single family home sales are Getting Much better – in fact, together, new home sales plus Existing home sales are at highest level since June 2007
(<http://www.rbc.com/economics/daily-economic-update/Jun-23.html>)

Also, cash sales are falling – good news for 1st time buyers due to Less competition (for sales) and that means slower price increases Making houses more affordable

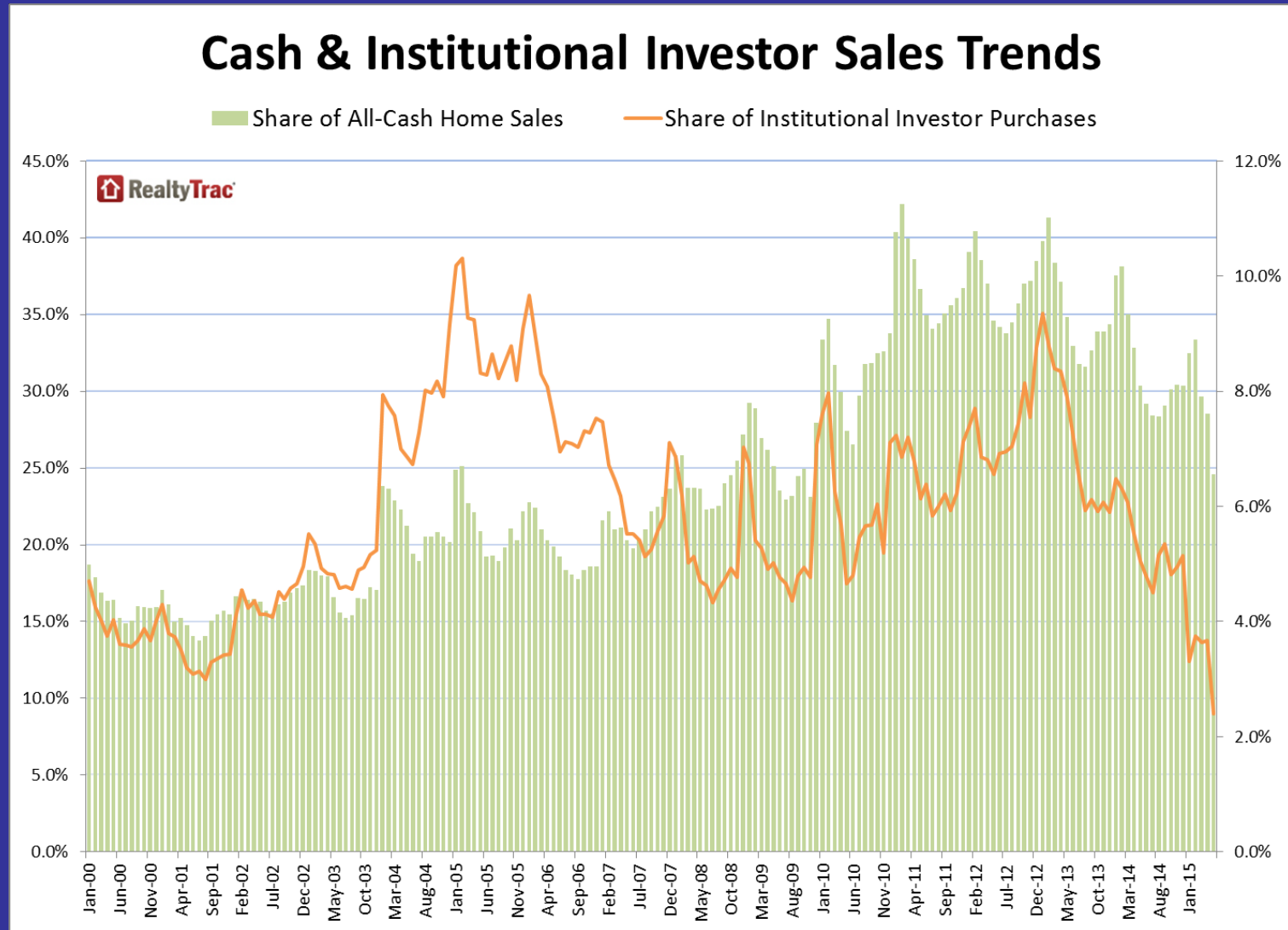
New single family home sales in May were at highest level since February 2008



Existing home sales – May sales rate is best in past 5.5 years



Cash sales back to trend values of 25% - good news for 1st time buyers - -
We need a return of 1st time buyers to get back to a more traditional
(and healthy) housing market (read excellent article by Realty Trac referenced below)



Source; Realty Trac (<http://www.realtytrac.com/news/foreclosure-trends/may-2015-u-s-home-foreclosure-sales-report/>)

Some conclusions – housing continues to improve albeit slowly

- (1) Economy will continue to improve slowly -- **2015 growth expected to be about 2.5% - however, looks like the "disconnect between the economy and housing will continue - strong dollar will be a drag (hurt exports)**
- (2) Still not a healthy housing market - 1st time buyers (32% today) are below trend (45%) and household formations are off 50% from trend –
- (3) The key to a recovery in housing is the return of 1st time buyers, traditionally about 40- 45% of the market. Current market still skewed to cash buyers and investors. 1st time buyers are mostly young people, **but they can't find good jobs**. Additionally, rising rents pose problems for home ownership - making it more difficult for renters to save for a down payment for home purchase.
- (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. Plus, additional concerns re: interest rates, world economy, terrorism, Uncertainty will slow job creation, private sector investment. E.g., capital spending lagging in this recovery
- (5) Productivity becoming a problem for U.S. economy – real GDP driven by population (number of workers) and real GDP/worker or productivity. During past 7 years, productivity has grown 1.7% annually whereas the average over previous 17 years was 2.4%. The recent drop is probably due to in large part to lack of investment by private sector. That won't change much until they get more confident about the future of the country. Political discord is a real drag on the economy whether you want to believe it or not – it creates uncertainty, and clouds decision making. Plus, these are difficult times geopolitically – Personally, I'm amazed that we do as well as we do.
- (6) World economy is slowing – China, particularly, but Europe also experiencing problems as well as the commodity countries like Australia and Canada

(6) Real GDP has averaged a weak 2.2% during the past 6 years – productivity is part of the **problem**, and poor **choices** by government politicians (Democrats and Republicans alike) haven't helped much. Recent article by Glenn Hubbard identifies tax and regulatory reform; better education policies; and trade as good places to start to get the economy back on a 4% growth path. Today, we are relying on the Fed and monetary policy to activate the economy, but that clearly isn't enough – better fiscal policy is much needed!!!
(<http://www.wsj.com/articles/how-the-u-s-can-return-to-4-growth-1434922625>)

Similar issues in Europe in addition to the EURO crisis

Longer term:

- (1) *makeup of U.S. economy is changing and this is impacting spending patterns and housing choices.***
- (2) *There are growing concerns that the job market is undergoing long term – structural – changes. Automation seems to be reducing job prospects for the middle class while creating jobs for the highly skilled and less skilled sectors . End result is stagnating family incomes that could translate to lower total housing demand with more emphasis on multi family/rental demand.***
- (3) *Education is more important today than ever before – don't forget two year programs; community Colleges; apprenticeships;... 4 year/University degree not always best option***
- (4) Currency devaluations are the preferred solution to “low inflation” concerns. Central banks in Europe and Japan are following the U.S. with quantitative easing/printing money, in order to spur demand by weakening their currencies. Good article in WSJ suggesting that the “low inflation world” is really a symptom of too much capacity relative to demand, and the solution isn't currency devaluation. Better solution may be developing technology to produce products that fulfill market place demands not being met by existing products (http://www.wsj.com/articles/global-glut-challenges-policy-makers-1429867807?mod=rss_markets_main)**
- (5) Eventually, Central banks will have to raise rates and nobody knows how the various economies will respond. We've never had so much liquidity in the system – it causes various types of bubbles (assets like houses, stocks, etc.), and a misallocation of resources. Interesting times ahead.**