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US Housing

You have heard it before. "There are three kind of lies: lies, damned lies, and statistics." The quote is famously linked to Mark Twain, although Mark Twain, himself, attributed it to British Prime Minister Benjamin Disraeli.

Disparaging to those whose work is to develop and substantiate statistical facts, this comment is often used to cast doubt on an opponent's point of view when it is supported by statistics. It is a cheap but effective tactic. But mostly, this is a convenient saying to use when statistics do not align with our own realities.

There are plenty of uncertainties with housing market statistics when used to gauge demand for hardwood lumber. Frankly, these statistics can leave more questions than answers, even though residential construction is undeniably relevant to hardwood demand. Some of the more pressing questions about housing's effects on hardwoods will be highlighted later in this article. But for now, let's consider the facts.

First Things First

These are the ground rules for this discussion:

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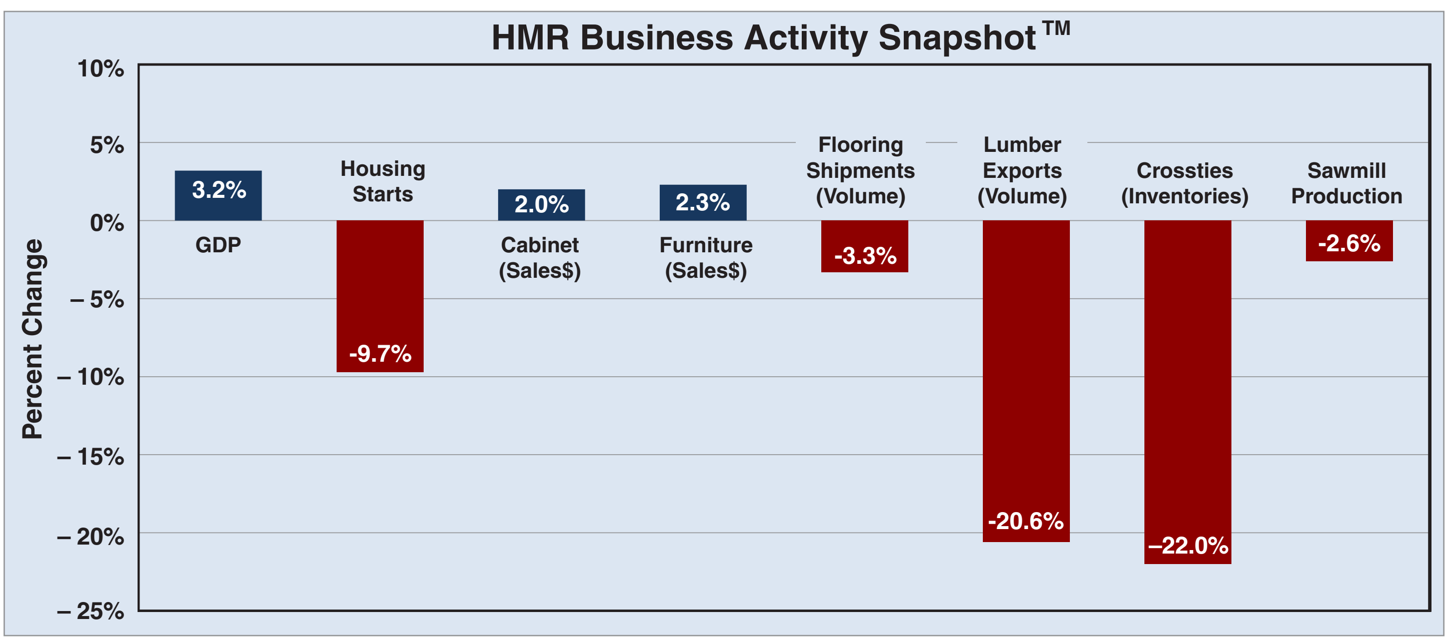
- Real average earnings for all US employees decreased 0.3% in March from February to $10.90 but were 1.3% higher than one year earlier.
- US manufacturing capacity utilization was 76.4% in March 2019, down from 76.5% in February but up from 76.3% in March 2018.
- Total US exports were $209.7B in February. Imports were $259.1B for a trade deficit of $49.4B.
- In the first quarter of 2019, China's retail sales advanced 8.3% year-over-year.
- China's GDP expanded 6.4% in Q1 2019 over Q1 2018.
- Cushing, OK WTI spot oil prices fell 1.1% between April 6, 2018 and April 5, 2019 but are up 32.7% since the first of the year.



GDP – Q1 2019, Advance est. **Housing Starts** – Y-T-D Mar. '19:'18, Unadj. **Cabinets** – '18:'17. **Furniture** – Y-T-D Feb. '19:'18, Unadj. **Flooring** – Y-T-D April '19:'18. **Exports** – Y-T-D Feb. '19:'18. **Crossties** – Y-T-D Mar. '19:'18. **Sawmill Production** – Y-T-D April '19:'18

1. Single-family construction has a greater impact on hardwood lumber demand than multi-family construction.
2. The size and cost of new single-family construction influence demand for hardwood lumber.
3. Remodeling of owner-occupied, single-family housing has a substantial impact on hardwood lumber demand that could rival and possibly exceed that from new single-family construction.
4. Housing statistics require a minimum of three consecutive months of expansion or contraction to determine a trend.
5. Housing statistics, like any statistics, need perspective. There are always reasons for the numbers, even if the reasons are not always evident.

(All of this can be debated and rationalized but at a different time and in a different article.)

> **"The fact that (single-family housing) starts are below a certain historical threshold is not the problem in itself. Rather, the signifigance of these numbers is that demand for housing in the US has not declined."**

New Construction

Construction of new single-family housing in the US is below its historical annual average rate of 1,016,300 units. Last year's starts were 14% under the average, making 2018 the 11th consecutive year in which single-family starts were below par.

In fact, underperformance these past years diluted the annual average rate to its present level. Making the calculations at the end of 2007 has the annual rate nearly 100,000 units higher. Compared to the average from 1959 through 2007, single-family housing starts in 2018 were more than 20% lower.

The fact that starts are below a certain historical threshold is not the problem in itself. Rather, the significance of these numbers is that demand for housing in the US has not declined.

It is true that the Great Recession changed the idea of the American Dream for certain people – some whom lost their homes in foreclosure, as well as children who witnessed their parents' despair and endured their own struggles from these experiences. This may have something to do with younger generations being slower to move into homeownership than previous generations. All of that said, experts tell us residential construction has left housing supplies about 2,000,000 units short of static demand.

Figure 1 shows single-family housing starts increased in each consecutive year from 2012 through 2018. Notably, this is the longest period of expansion on record (from 1959). However, the duration of increased housing construction is less impressive when considering the low number of units that were built.

After seven years of increased construction, the market is showing signs of a slowdown. **Figure 2** is a moving average of monthly permits, starts, and completions. Its value is to flatten out monthly volatility in the reporting process and/or numbers to show trends more clearly.

There are several things to note in this graph. One is the seasonality of construction processes and how the timing of peaks and low points differ for permits. Second is sustained growth; year-to-year, the peaks and troughs were higher than the previous year until Q1 2019.

So, single-family residential construction is apparently cooling off. But why is it cooling off? Is it because of disruptive weather patterns from late last fall throughout winter? Did the partial shutdown of the federal government have any influence? Was there something else?

Whatever the cause for this slowdown, there is a reported shortage of 2,000,000 units that the market must deal with. The problem cannot be resolved by slowing construction. More than a footnote, the general sentiment among housing market analysts is that 2019 will extend the streak of increased residential construction to eight years.

Characteristics of New Single-Family Structures

There are four points to consider for this topic as it relates to hardwoods: The size of the houses being

Figure 1

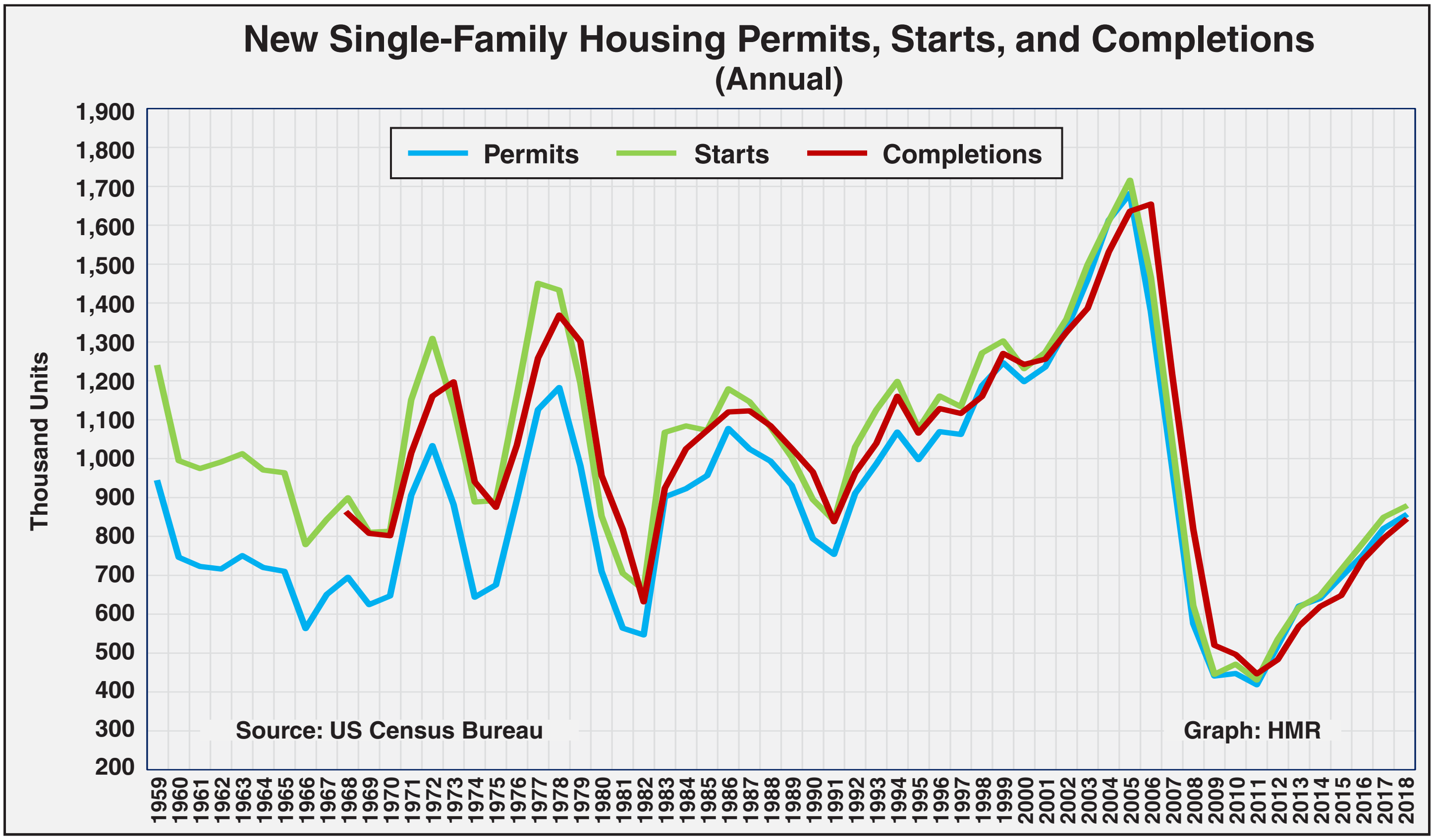
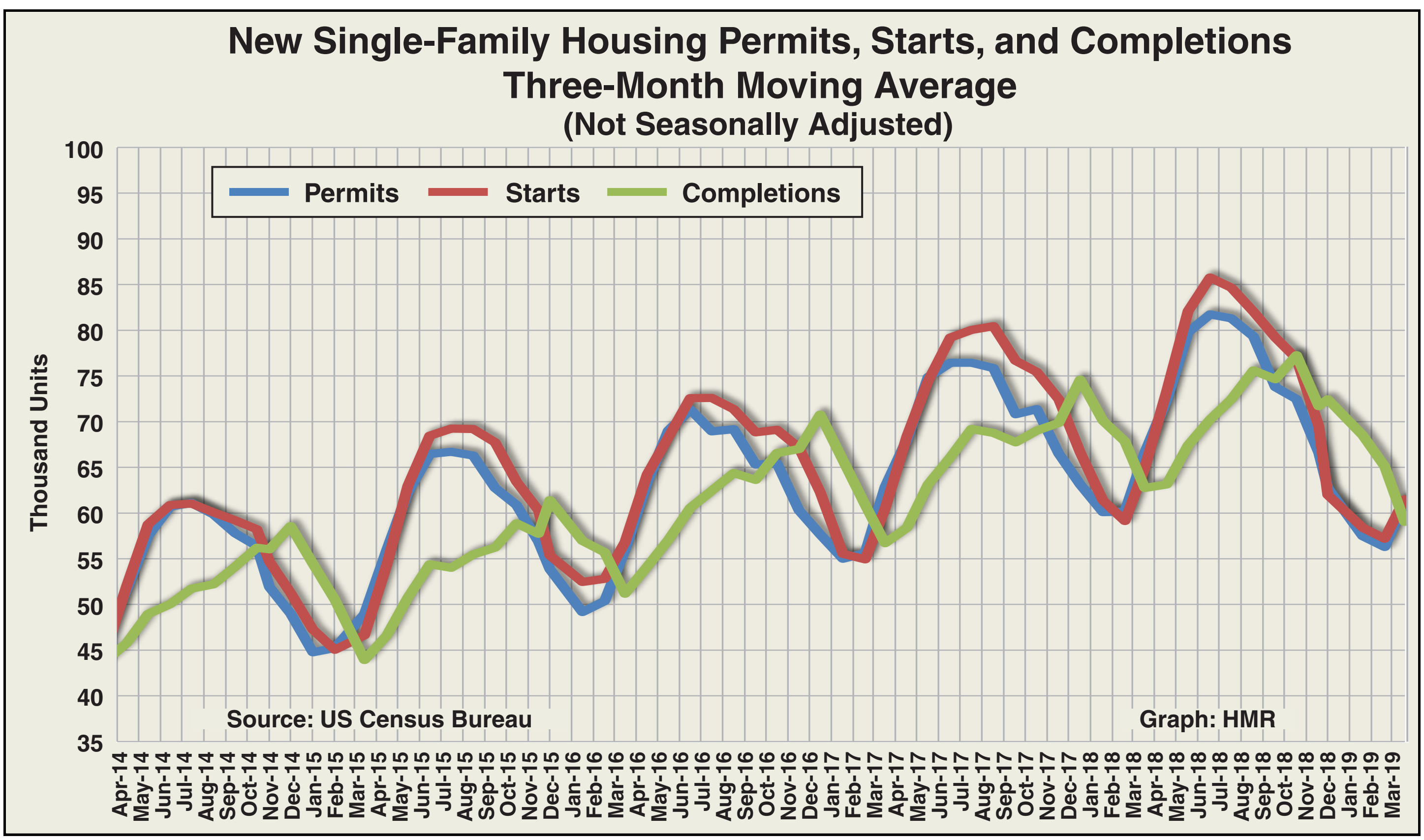


Figure 2



built. The location. The number of units constructed. The type of foundations.

Size, location, and number of units strongly influence the quantity and types of interior fittings, such as cabinets, mouldings, and millwork. There are significant variances between each of the four US regions identified by Census: the Northeast, Midwest, West, and South.

Separately but importantly, the foundation type can affect floor covering selections, in particular, engineered wood products over solid wood flooring products. **Figure 3** shows where market opportunities might be best or most vulnerable as influenced by foundation type.

Housing Supply

Any conversation about supply should begin with demand. The US homeownership rate at the end of 2018 was nearly a full percentage point below the historical average and far below the rates from 2005 through 2014, inclusive (**Figure 4**). Again, there are many opinions and probably a few good reasons that explain why homeownership is below average. But one of the most apparent reasons is supply, or in this case, the lack thereof.

Figure 5 establishes how much inventory of new single-family housing is available to buyers (note: government statistics on new home inventory include units that have not yet been started). **Figure 6** gives us a perspective of how supply matches up with demand by measuring demand as actual sales, not population demographics or projected new household formations. The National Association of Realtors® identifies six months inventory as the breaking point between a "buyer's market" and a "seller's market."

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Figure 3

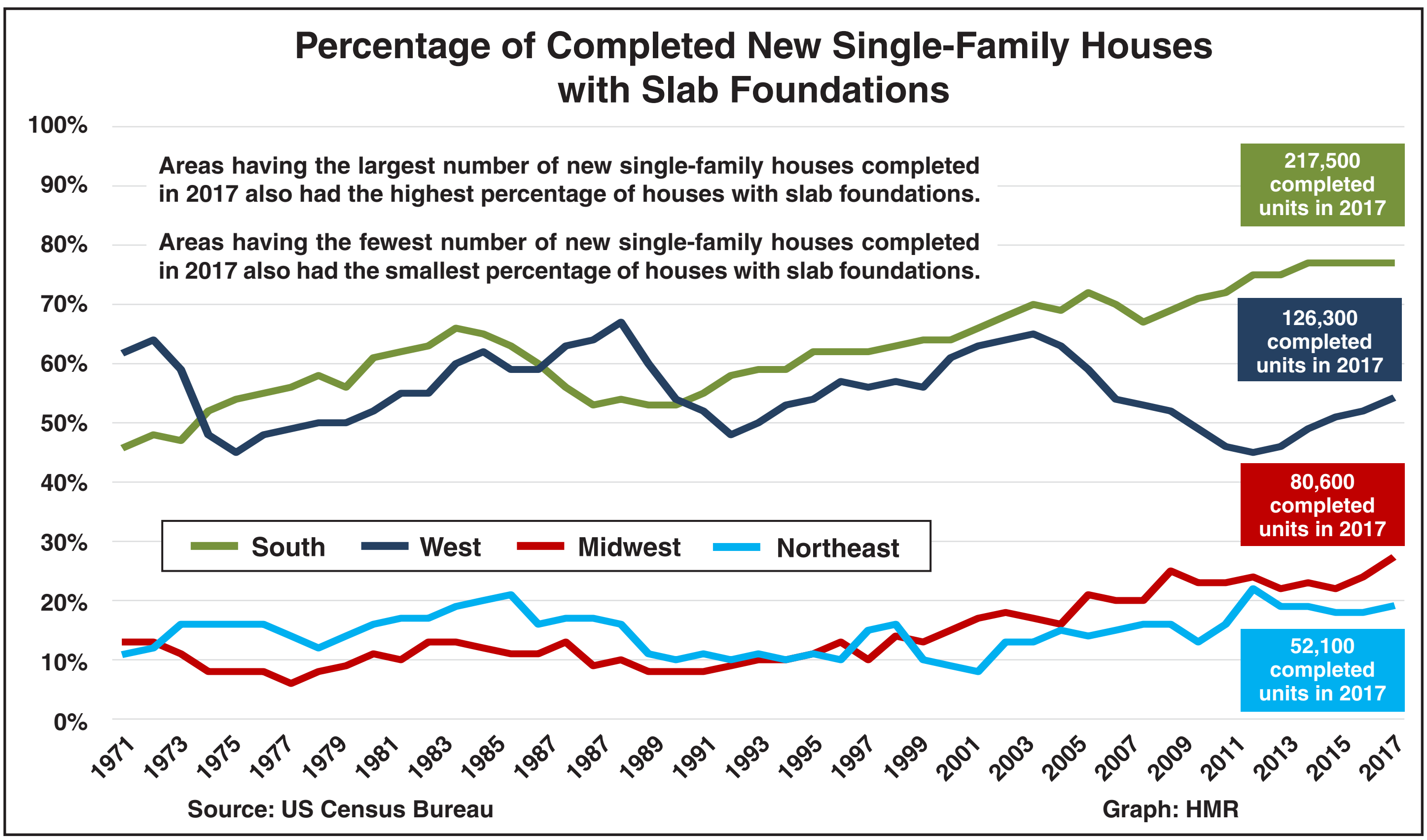


Figure 4

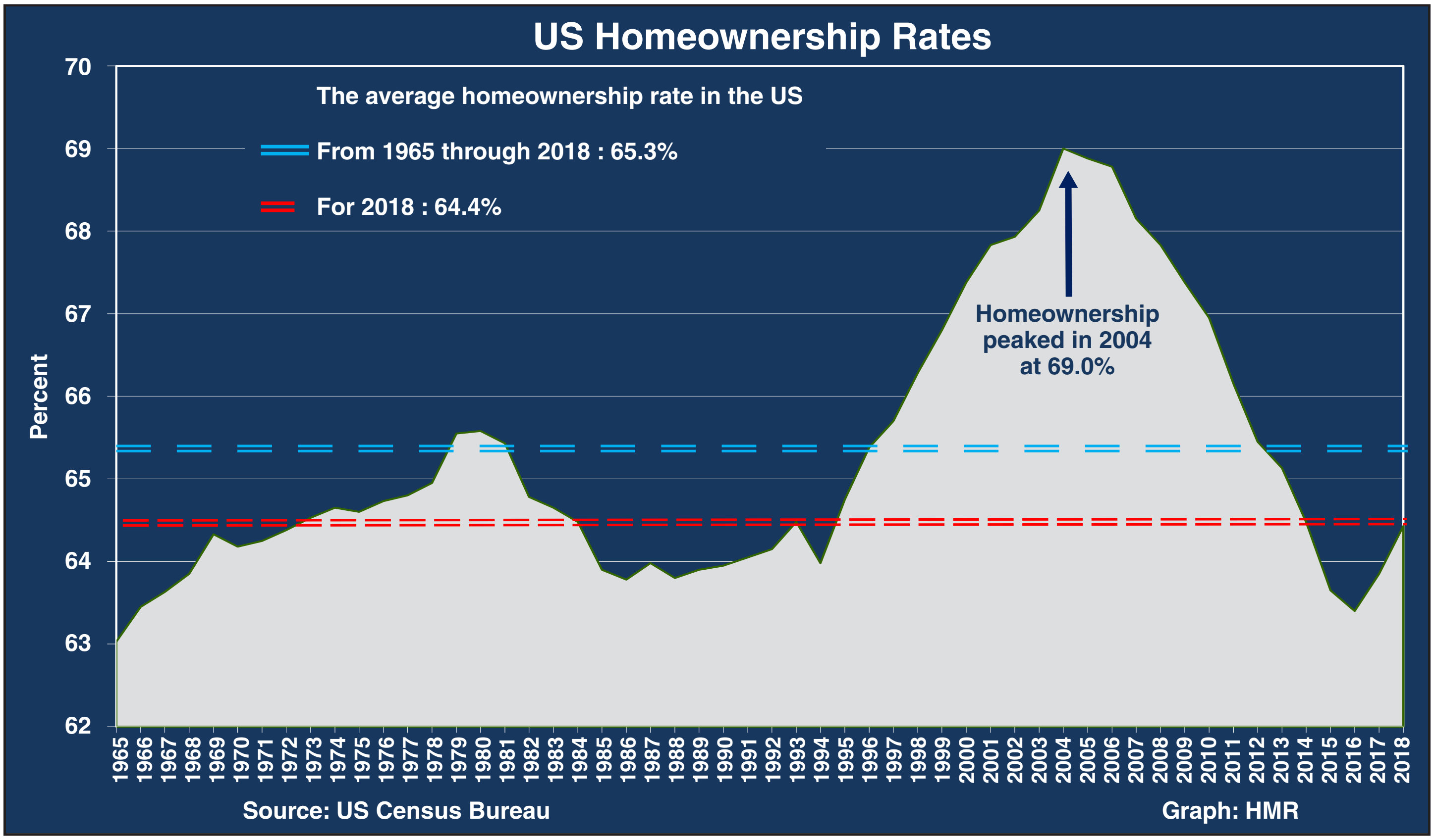
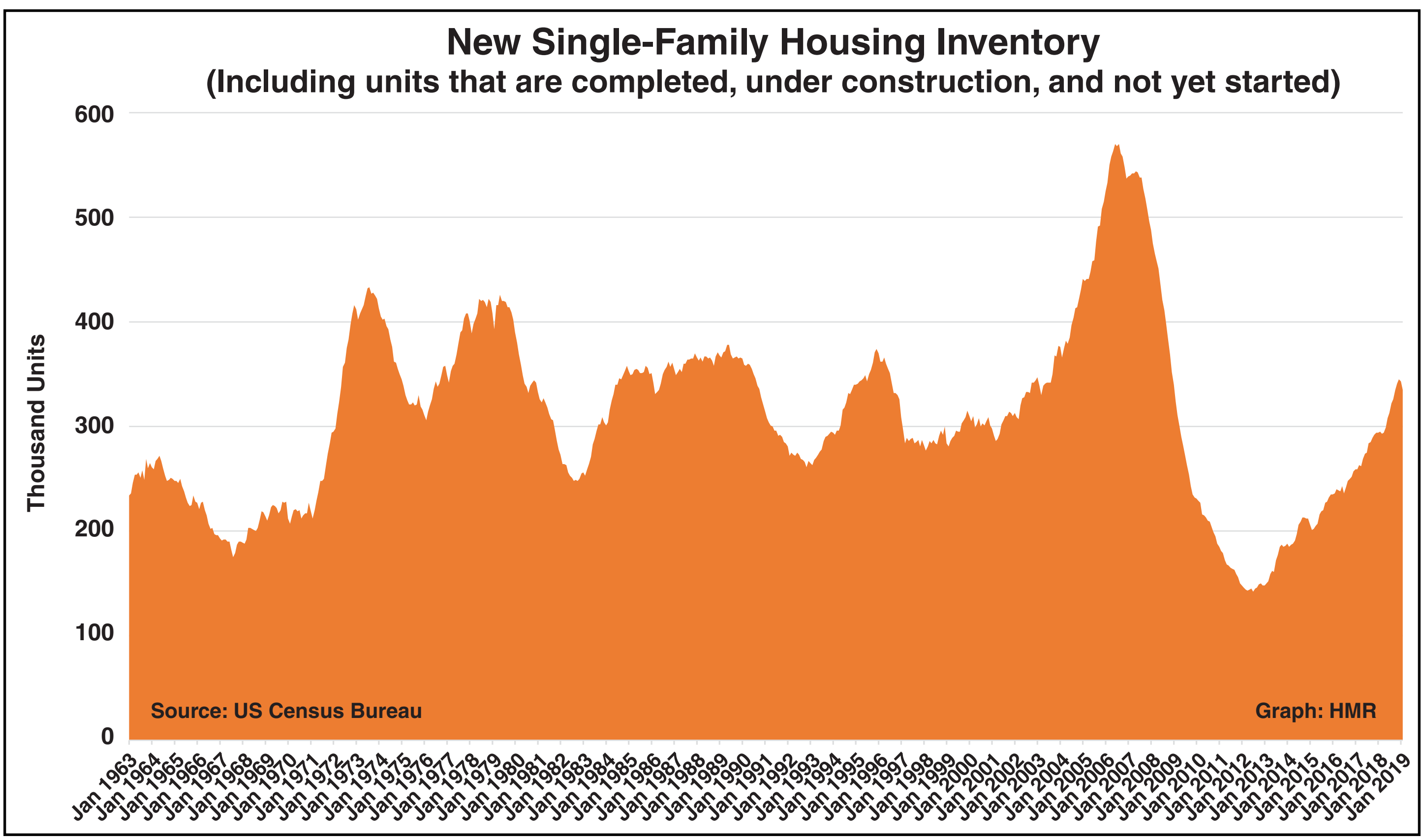


Figure 5



The impacts from supply imbalances are well understood. We also understand that higher prices caused by these shortages are keeping many potential buyers from becoming homeowners. As a point of encouragement, there are over 500,000 new single-family houses under various stages of construction and almost another 100,000 units that have been permitted but not yet started (**Figure 7**). Are these houses included in the **Figure 5** inventory graphic? Most likely. But, they do represent positive response to the market's need for additional housing.

> **"Conditionally, the US housing markets seems much better than the rate of construction suggests. But even at ... the high percentage of houses priced above $300,000, demand for US hardwood lumber and hardwood products has not kept pace."**

Remodeling

It is important to know the US Census Bureau statistics for private investments in residential remodeling are limited to single-family, owner-occupied properties. This is an important distinction because of the purposes for the construction or the types of projects.

Some projects involve major repairs, due to wear that occurs over time. However, most projects are essentially upgrades or refreshing fashion to accommodate lifestyles. Such improvements often involve kitchen and bath renovations, which are areas in the house that typically have the greatest potential use for hardwood products.

Given the age of single-family housing in the US, remodeling activity should remain quite busy (**Figure 8**). The amount of money that has gone into refurbishing and upgrading housing certainly reflects the need and desire for owners to do so. Within a relatively short timeframe, annual remodeling expenditures on single-family, owner-occupied properties surpassed the $100B threshold to grow to more than $200B. For comparison, remodeling expenditures in February equaled $78 for every $100 of private investments spent on new single-family

Figure 6

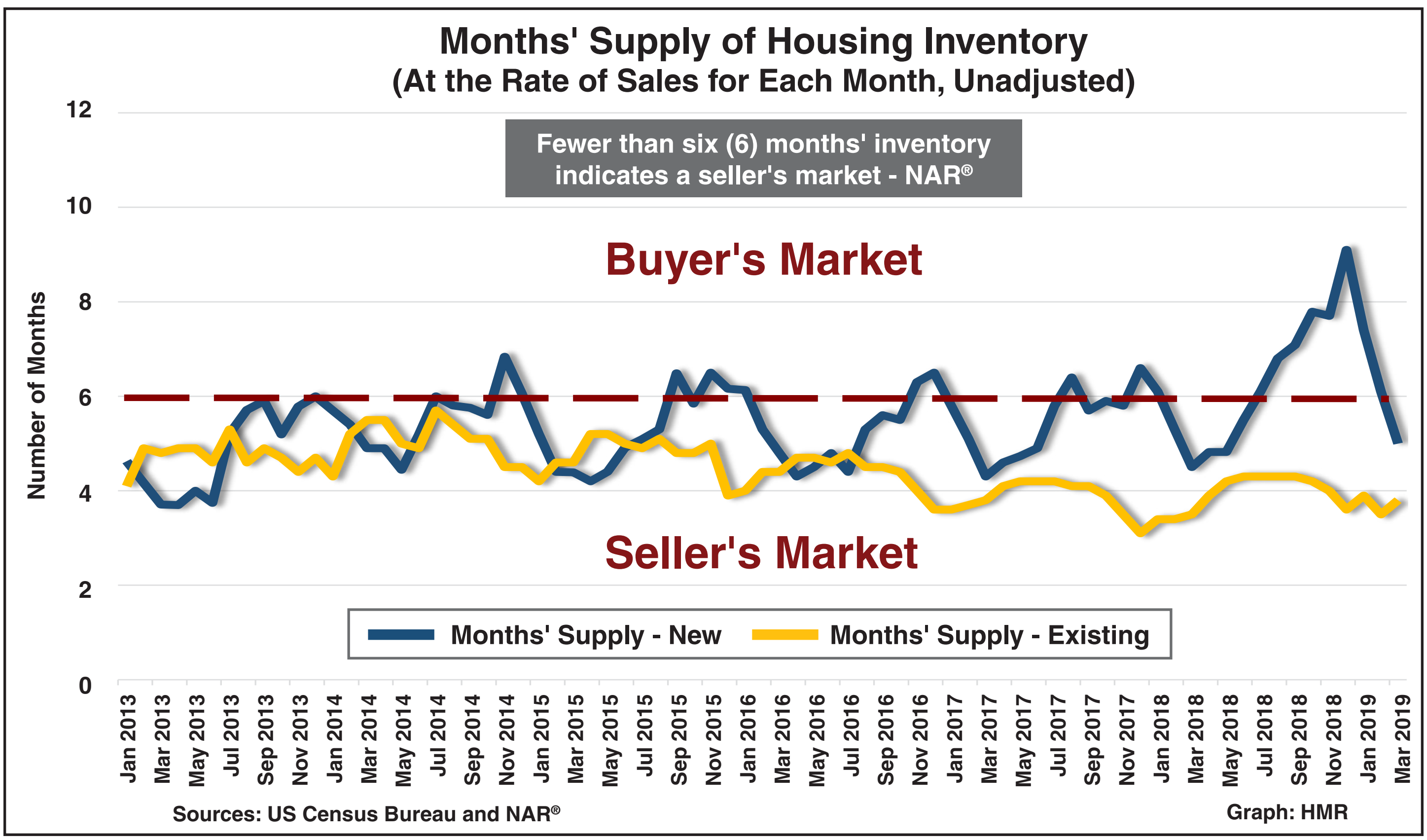


Figure 7

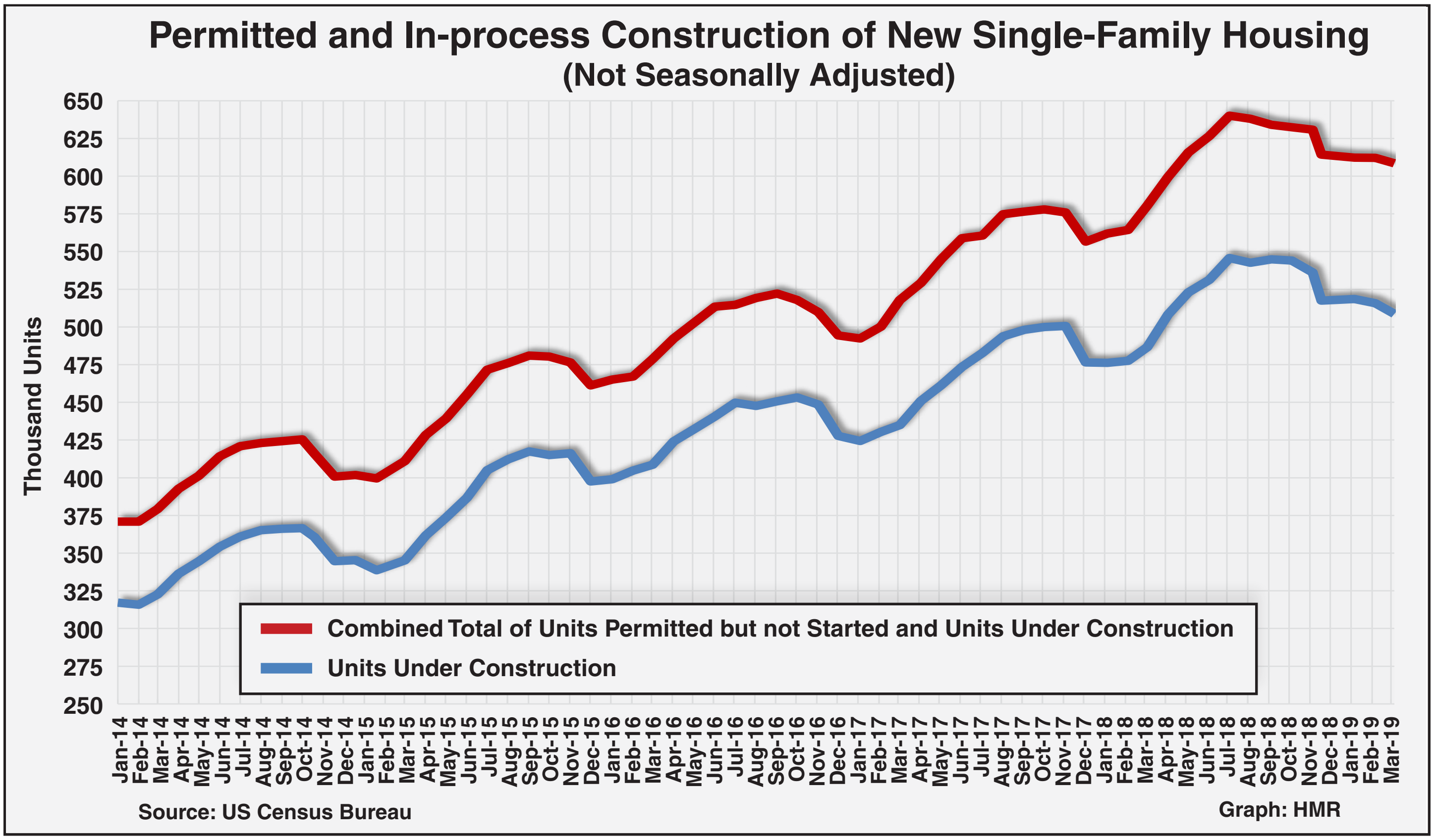


Figure 8

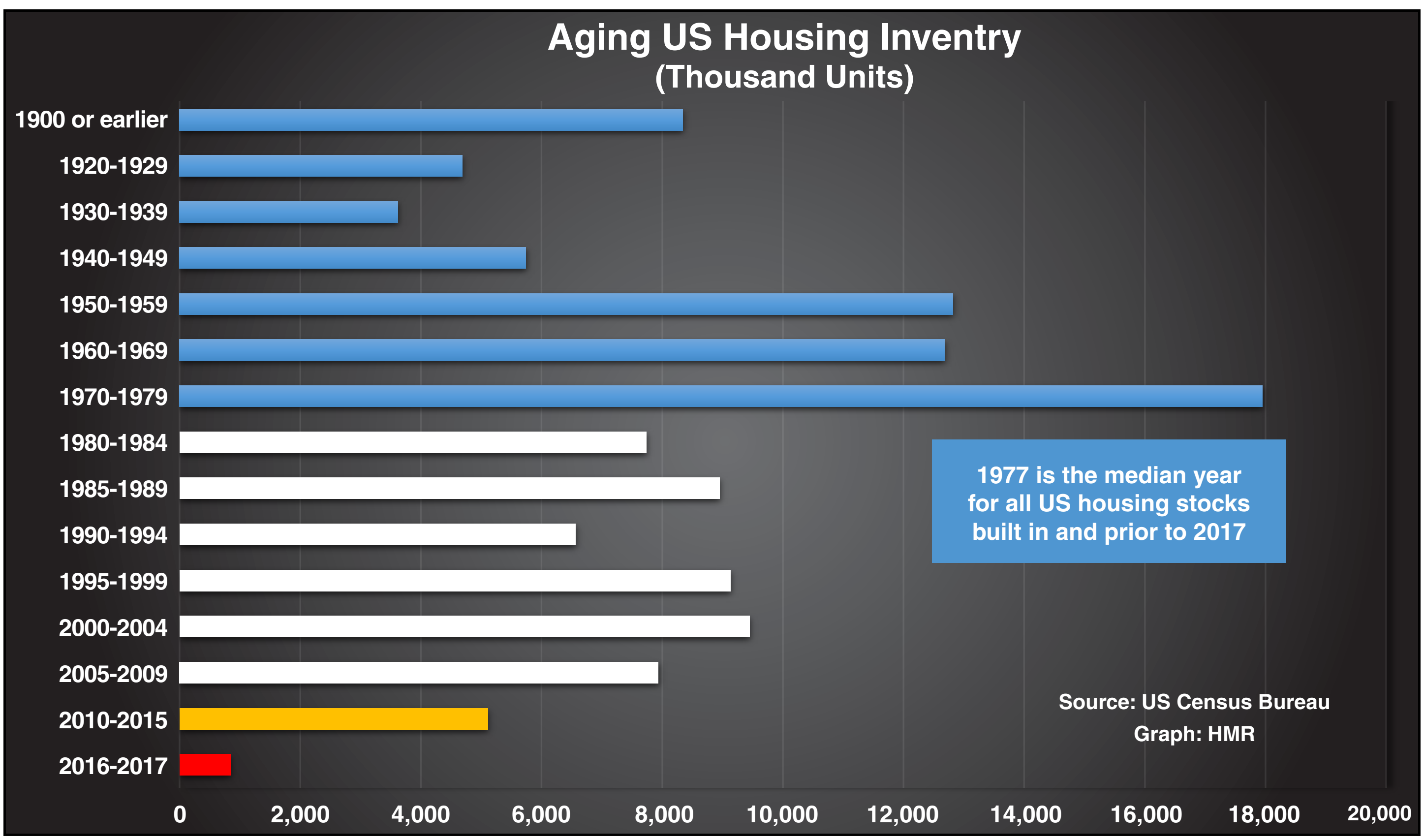


Figure 9

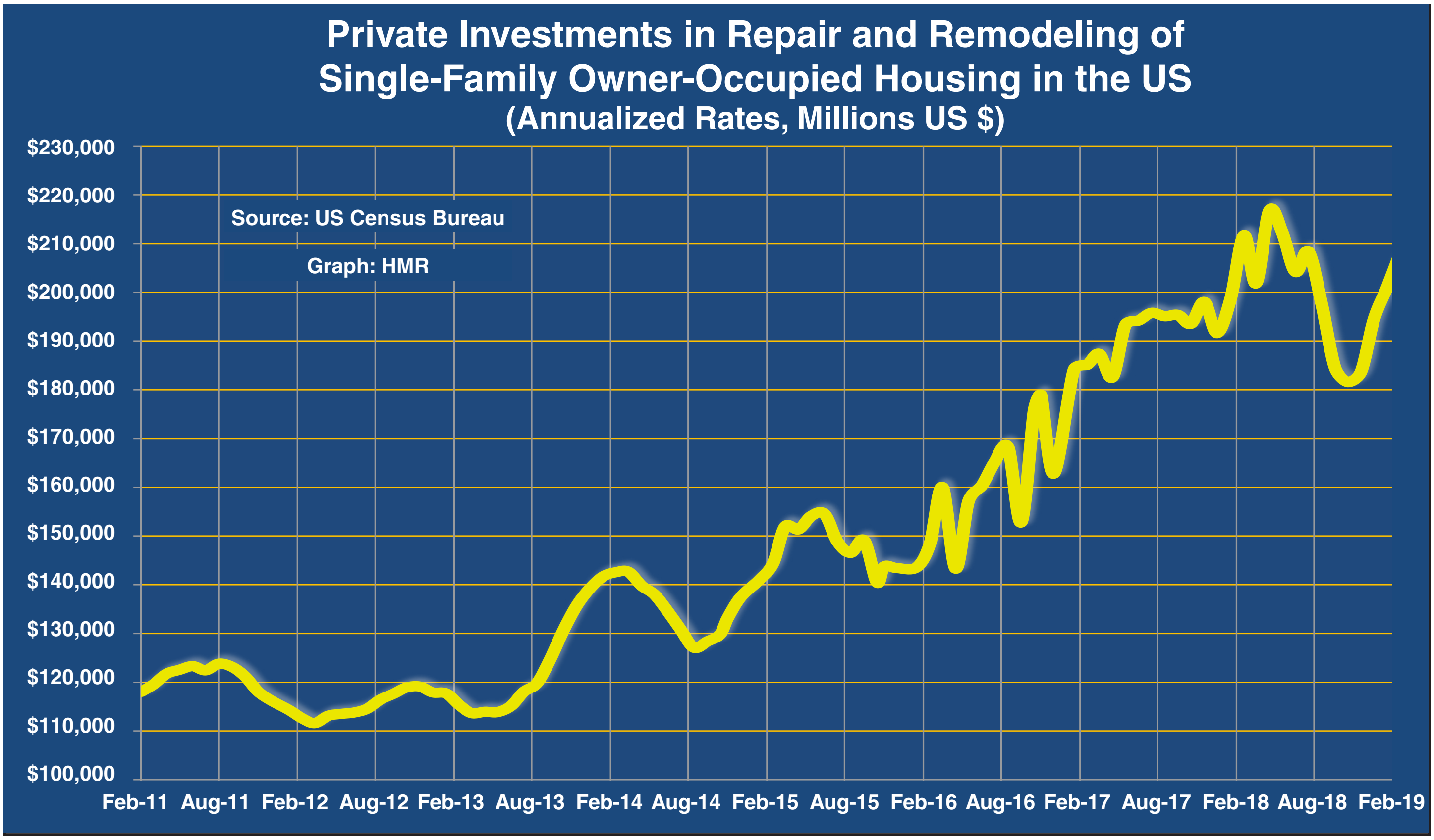


Figure 10

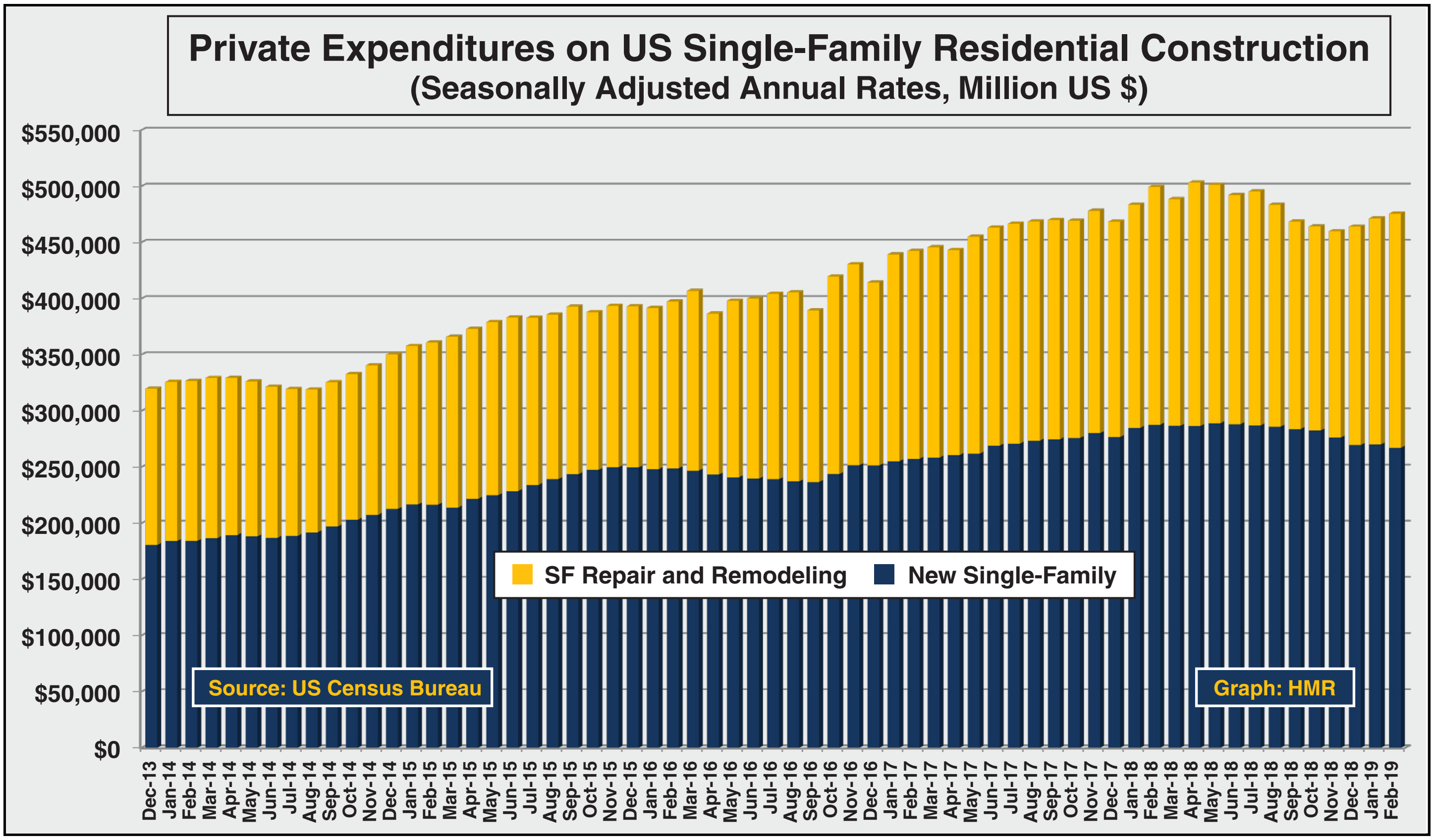


Figure 11

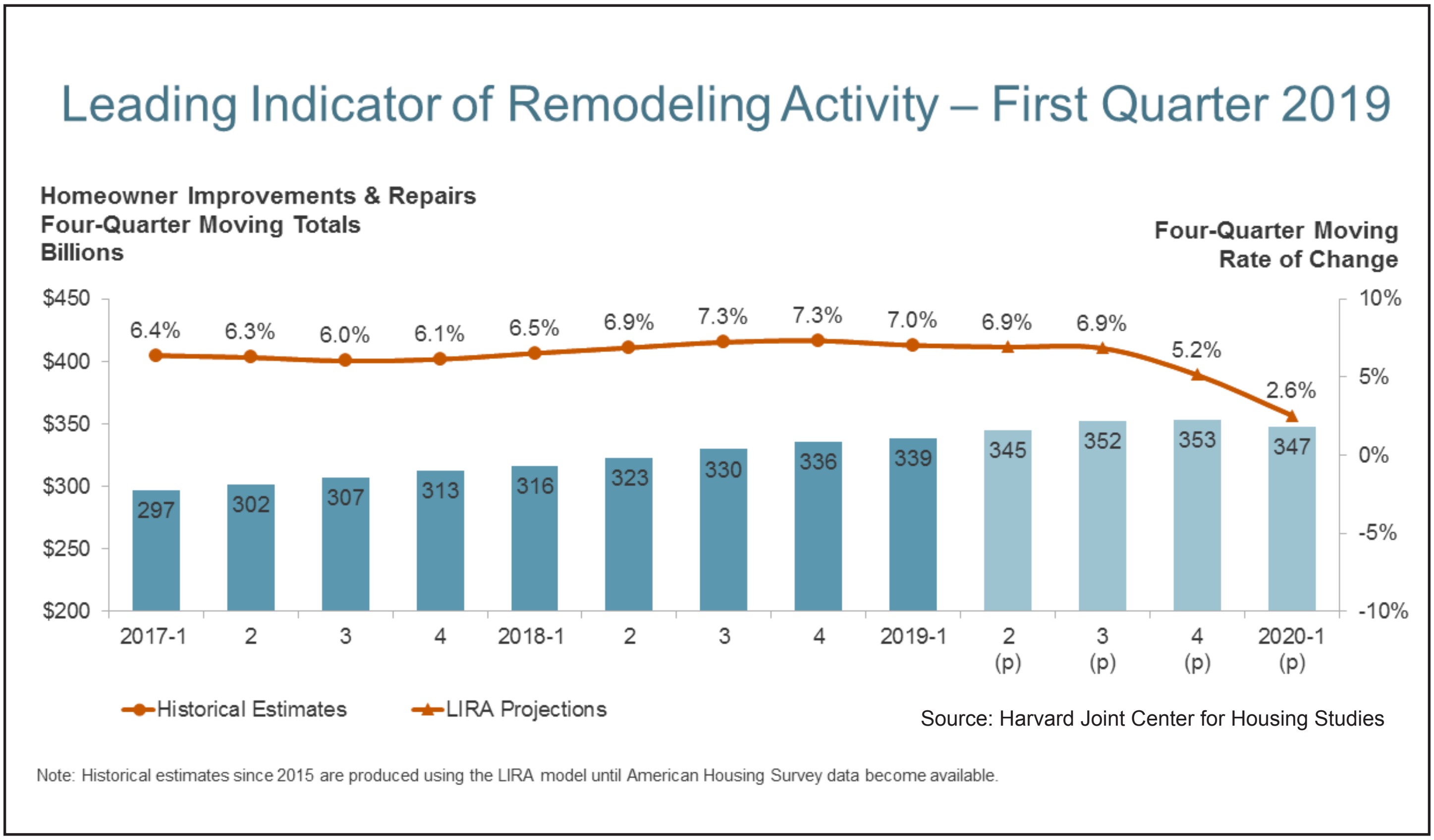
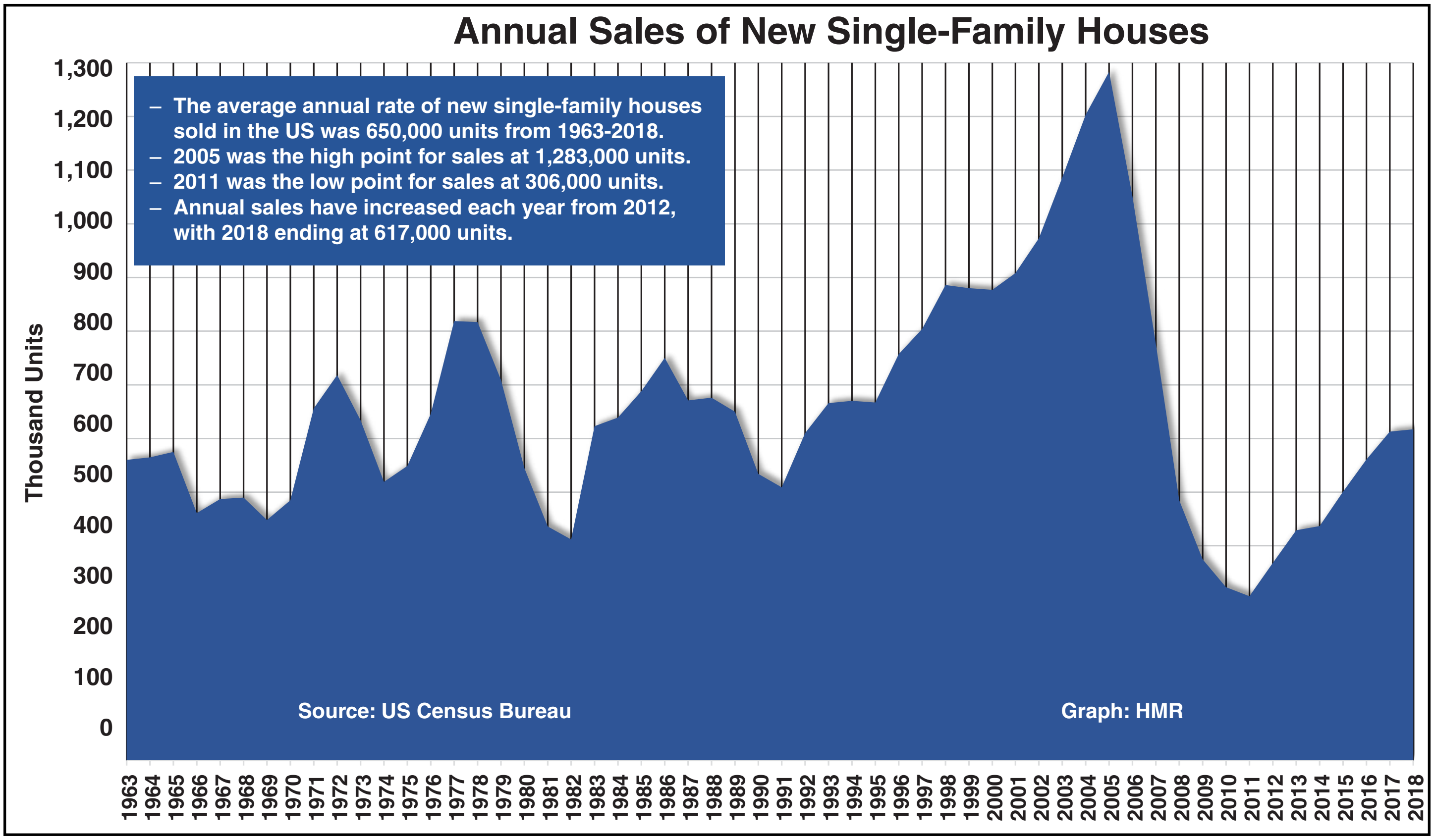


Figure 12



housing construction. (See **Figures 9** and **10**)

Each statistic that has been cited to this point is a measure of activity that has already occurred, meaning they all are lagging indicators. **Figure 11** is a leading indicator of remodeling activity, courtesy of the Harvard Joint Center for Housing Studies. Included in the components that make up the *Leading Indicator of Remodeling Activity* (LIRA) is the estimate of private expenditures on single-family, owner-occupied houses, listed above. However, the LIRA is inclusive of all homeowner remodeling expenditures, not just single-family or owner-occupied. More significant to this index are forward-reaching data used to construct forecasts of activity.

Here we see the LIRA graphic (**Figure 11**) showing a moderate downturn in Q1 2019 remodeling expenditures from the previous quarter, followed by another moderate drop in Q2 and a sharper drop in Q4 2019. Activity in Q1 2020 is projected at a 2.6% rate of growth, which is the first time spending increases will fall below the historical average of 5.0% since 2013.

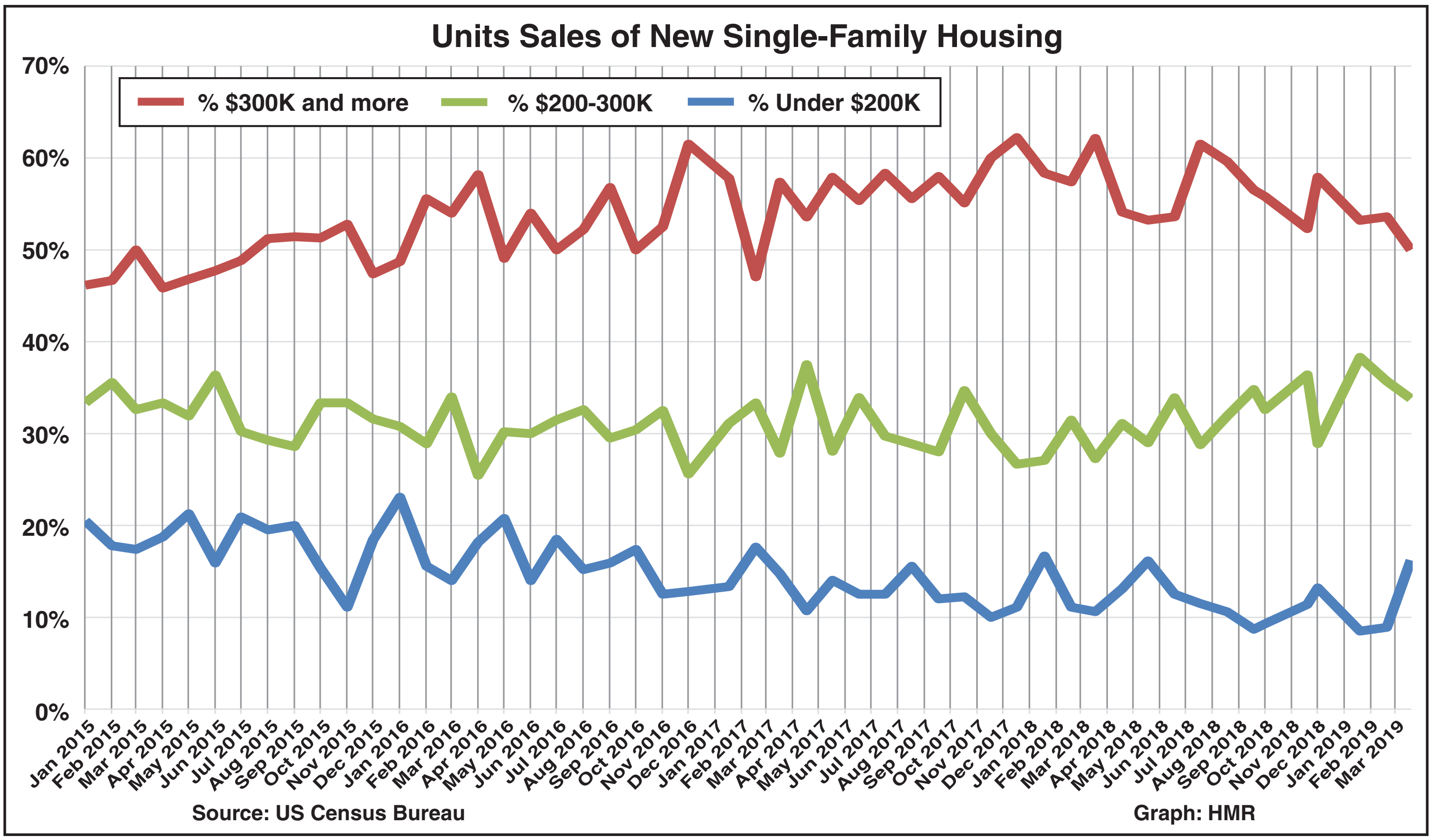
The thing about this and any other forecast is they are prone to change, and the reason they can change is because previously unknown circumstances often come into play.

No one knows this better than forecasters themselves. The following was taken from the Harvard Joint Center for Housing Studies website: "Cooling house price gains, home sales activity, and remodeling permitting are lowering our expectations for home improvement and repair spending this year and next," says Chris Herbert, managing director of the Joint Center for Housing Studies. "Yet, more favorable mortgage rates could still give a boost to home sales and refinancing this spring and summer, which could help buoy remodeling activity."

Sales and Sales Prices

Sales of new single-family houses are increasing, though not dramatically and are still far off the historic average. Sales totaled 617,000 units in 2018. The average annual rate of sales from 1963 forward is 650,000 units (1963 is the oldest available data). The **Figure**

Figure 13



12 graph image is very similar to that for construction, which is not surprising because they have a symbiotic relationship. Fundamentally, it is demand that drives supply. However, most information on US housing indicates supply is holding back sales … that construction has failed to compensate for years of subpar production.

Higher sales prices support the notion of supply strain, but there is more to escalated housing prices than that. Construction expenses have increased substantially from higher labor wage rates, permits, compliance with environmental regulations, and local ordinances. They all have added to the costs of land and site preparation before construction even starts.

More than half of new single-family houses sold are priced $300,000 and higher. Until March, houses sold for less than $200,000 hovered around 10% of all unit sales. **Figure 13** shows prices are beginning to moderate some, but there is not enough data to be certain new housing prices will be materially lower.

Should that be the case, the additional lower cost units will invite more new homebuyers into the marketplace. This will provide a much needed bottom-up push in sales for new and existing houses, which will likely stimulate remodeling activity all the more.

Facts Meet Reality

Conditionally, the US housing market seems much better than the rate of construction suggests. But even at the underperforming levels of building and the high percentage of houses priced above $300,000, demand for US hardwood lumber and hardwood products has not kept pace.

This raises three pressing questions:

1. Can we determine what housing construction really means in terms of exact demand for US hardwoods? … enough to use as a reliable leading indicator for business?
2. Why are US hardwood residential fittings and furnishings losing market share?
3. Are hardwood producing and consuming sectors willing to alter the direction of business to realize better, more profitable results?

Actually, only one of these is a pressing question.

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Import Newsletter™

Volume III – Issue 11 – November 2018

Current Trends

Market Commentary

Lead Story – Tariff Payments Climb 50%

US companies spent $4.4 billion on import tariff payments in September 2018, up from $2.9 billion in September 2017. This according to a study by the Trade Partnership, an anti-tariff consulting firm, on behalf of the Tariffs Hurt the Heartland campaign. The study also found that US exports of products subject to retaliatory tariffs by other countries were 26%, or $2.5 billion, lower this September than last. The Trump Administration has planned to raise tariffs on hardwood lumber and a host of other wood products imported from China from the current rate of 10% to as high as 25% on January 1, 2019.

The Harvard Joint Center for Housing Studies expects growth in US homeowner spending on improvements and repairs to reach 7.7% in 2018 and remain above 6% in 2019.

US imports of hardwood lumber from Russia are on pace to total 964,667 BF in 2018. Shipments averaged 2,324,206 BF annually during the preceding 10 years.

Market Overview

North American markets for tropical hardwood lumber performed well during the last 30 days, according to surveyed importers and distributors. Reports were decidedly more upbeat from contacts in the East than in the West, which was in sharp contrast to the previous two months. Several import sales operations have decent order files for the last six weeks of the year, while others expect business to be

continue

Quarterly US Imports of Sapele and African Mahogany Lumber

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