THE PARLIMENT PAGES

January, 2013

OUR ANNUAL PREDICTIONS -

As is customary, the January issue of this newsletter is always the one where we go out on a limb and make our predictions for the upcoming year. It is always interesting for us to look back one year ago and see how close our predictions were. We were again pleasantly surprised when we saw that we were spot on for 2012. With this track record to maintain, the pressure is on for our look at 2013.

FIRST, SOME BACKGROUND –

For the past four years, housing predictions have had one false start after another. Countless authorities have predicted imminent recoveries only to be disappointed by the data of the following month. Finally, in the last quarter of 2012, we began to see some sustainability in the results. In the aftermath of the housing bubble burst, we saw starts plummet from 2.1 million per year to 350,000. We languished between there and 450,000 for the next three years. At the beginning of 2012, we began to see a steady rise, ending the year in the 700,000 annualized range. We think this number has now become a solid base from which growth can be predicted.

HOUSING STARTS IN 2013 –

Our prediction for 2013 is that there will be quarterly increases so that by the end of the year, we will have annualized housing starts in the 900,000 range. Thereafter, this number will increase between 8%-10% per year until we get to the true absorption number of about 1.1 million. This is the number that keeps getting bandied about as the real demand for new housing based upon demographic needs.

DEMOGRAPHICS VERSUS ECONOMICS –

Demographical experts have been screaming for years that there were not enough new homes built to handle the demographical growth and demand for housing. However, economic reality shot down the projections of this field of experts. Despite the need for homes, economic conditions just were not favorable to new home purchases. First, the unemployment and general economic decline severely impacted the desire of people to make a major investment in a home. Secondly, while interest rates were low, the ability to qualify for a loan became almost impossible and when one did qualify, there were requirements for large down payments.

THE GROWTH OF THE RENTAL MARKET –

As more and more would-be buyers faced economic uncertainty and tightening credit, they shied away from the new home purchase and instead opted for rentals. Rentals were in abundance because of the surge in construction of multi-family complexes and a growing number of foreclosed properties that were being bought by investors and converted to rentals.

Today, the vacancy rates are at an all time low and landlords are taking this condition as an opportunity to raise rents. In fact, in major markets, rents are now at an all time high with no sign of abatement.

3031 Westside Blvd. Jacksonville, Fl 32209
Ph# 904-387-8444 Toll Free – 866-387-7601 fax 904-387-8465
www.parlimentbuildingproducts.com

RENT OR BUY –

The cost of home ownership has decreased significantly from the bubble days. This cost decrease has come from a reduced per foot construction cost coupled with historically low interest rates. Average square footage of new home construction has also fallen for the first time in over 25 years. One of the major measurements of affordability has been the income to house price ratio. For 40 years the norm was 3.2. During the bubble years, that number rose dramatically to 4.7. Recent calculations show that we are back down to 3.4 and quickly approaching the norm. Combine all of this together and it becomes much more attractive to buy than rent. While credit qualification is still an issue, mortgage applications are up. The dream of home ownership for the 21 – 34 year old is back alive and will be the single biggest driving force in a housing recovery.

INTEREST RATES AND CREDIT –

The Federal Reserve has declared an open-ended pledge to buy mortgage backed securities. (For more on the Federal Reserve and the economic impact, refer to our sister newsletter, “The Blast.”) By taking these bonds off the open market, the Fed is able to artificially keep interest rates low. Their stated strategy is to buy enough bonds to insure low interest rates through 2014. Their belief is that these low rates will help the affordability of housing and will continue to feed the slow steady projected growth. Whether or not you agree with the political underpinnings of this philosophy, low interest rates are definitely good for housing and are certain to remain with us for some time.

Credit qualification continues to be an issue. The current political administration has tried numerous programs that have been designed to kick-start lending in housing or to help stem the tide of foreclosures that were dragging down new home demand. Not a single one of these programs have worked. While the theory of some of the programs makes sense, the bureaucratic implementation doomed the success of the programs before they ever got off the ground.

So, despite the government’s attempt to fix the situation, the free market is now starting to work like it always did. Banks have spent the last four years cleaning up their balance sheets. They have been allowed to do that at tremendous expense to the taxpayer. Nevertheless, much of the clean-up has been accomplished and now the banks are realizing that it is time to get back into the lending game. As more enter the game, the competition increases and with competition for mortgages, comes a lessening of the credit restrictions.

It is not like the old days, nor do we ever hope it will get there again. However, mortgages for good customers will become increasingly available and, like low interest rates, will feed our projected increase in new home construction.

So, for the first time in almost five years we have interest rates, credit availability, demographics and the economic advantages of buy vs. rent now all working in our favor. These are strong indicators that support future sustainable growth.

HOW IMPORTANT IS HOUSING? -

I have listened to numerous “talking heads” pontificate over and over why a housing recovery was necessary for a general economic recovery. Hearing it from so many sources led me to believe it was true. Finally, I found some information that sheds some light on this.

3031 Westside Blvd. Jacksonville, Fl 32209
Ph# 904-387-8444 Toll Free – 866-387-7601 fax 904-387-8465
www.parlimentbuildingproducts.com

The National Homebuilders Association conducted a study that showed a typical new construction home costing $320,000, provided over $200,000 of income to individuals, created three new jobs and generated over $20,000 of taxes, fees and permit costs. The additional expense of furnishing the home provided as much as another $30,000 in recurring income and $7,000 of annual property tax revenue. This is just for one house. All in all, housing accounts for a huge chunk of our Gross Domestic Product (GDP). While this illustrates the positive impact, you can also begin to understand how the housing collapse helped bring the overall economy to its knees.

In addition to huge direct impact on our economy, housing and construction in general is a key component in our employment situation. At the peak of the construction bubble, approximately 5.5% of our total workforce was in construction. Today, that number has dropped to the lowest level since 1946 and rests at a paltry 2.5%. An increase of 2% in employment would have a dramatic effect on our overall economy.

Housing is a major factor in personal income, capital goods spending, sales and property taxes, and overall job growth and employment. If the prognostication of a sustained growth in housing does take place, it will provide a great foundation for overall economic stability and maybe even some growth.

ON A MORE SOMBER NOTE –

While all of the analysts are looking forward with some degree of optimism, we cannot ignore an anchor that could still cancel out the growth. Historically, housing has never expanded when the national GDP growth is below 2.5. As this country moves closer to a socialistic form of enterprise, that rate of growth will become exceedingly difficult to achieve. We have not had that growth for over 4 years and the Federal Reserve believes we will be under that rate for all of 2013 and at least the first part of 2014.

In addition, we still have a crippling amount of foreclosures, troubled loans and upside down equities. Currently, out of the 78 million homes in this country, over 14 million of them are upside down in equity. If you were to remove the "free and clear" homes from the 78 million, you would find that upside down equity accounts for over 23% of all homes. Of the homeowners less than 40 years of age, over 48% of them are under water.

Will this negative equity and overall anemic economic growth change our predictions for new home construction? We do not believe it will in 2013. We believe there is enough impetus to carry our projected numbers through the year. However, unless the government gets out of the way and allows the free market to do its thing, we will probably face another downturn beginning in 2014. Current policies of increased taxes, more regulation and anti-business attitudes will create too much headwind for overall economic growth. Without economic growth, home values will not rise and the negative equity condition will persist.

PRODUCT AVAILABILITY AND PRICING –

We have discussed this in the past, but decided it needed a refresher as part of our prediction issue. The cost of producing construction materials is incredibly high. Hundreds of millions of dollars are required to capitalize and operate a steel mill that puts out rebar. A plant that produces roofing material can cost over $50 million. As a result of the downturn, a huge portion of manufacturing capacity was taken out. Plants were closed, scrapped and in some cases just bulldozed down. To open a new manufacturing facility or even reopen a facility that was closed, will take months and huge expenditures. With economic uncertainty still the prevalent thought, there are not a lot of business owners who are standing in line to make that type of investment. They will wait and see whether the recovery does, in fact, have sustainable legs.

This delay in creating capacity will undoubtedly result in product shortages. We see this happening in most all categories. We have seen very little excess capacity from our suppliers. They have reduced their manufacturing capacities to meet today's demand. No one is talking about expansion. When we ask them how they will handle any increase in demand, they pretty much tell us that they will increase prices until they are certain that the future demand will warrant capital investment in new facilities. You really can't blame them too much when you understand how big a bath so many of them had to take when the market collapsed.

If these shortages do happen and prices escalate, it will impact the affordability to some extent. Fortunately, building materials typically will only account for about 15%-18% of the total cost of a new home construction.

OUR RECOMMENDATION –

Inventory management will continue to be a major source of focus for our customers. You cannot afford to be out and you cannot afford to carry too much. If these projected shortages do start to take place, there will be no quicker way to lose a customer than not filling his order completely. As fragile as the business environment is today, no one can afford to lose a single customer.

One of the key measurements we use is "channel time." Quite simply this is the amount of time that it takes to get a product in the customer's hands once he has placed the order. Managing channel time is easy if you have unlimited funds and can carry excess inventory. Managing channel time becomes increasingly difficult when you are faced with product shortages and limitations on your investment in inventory stock levels.

We suggest you look carefully at channel time by asking yourself the following questions:

1. How effective of a job do my suppliers do at helping me manage my inventory levels
2. How often do they meet with me to discuss and examine inventory levels
3. If I need something that is not in my stock, how responsive are my suppliers
    a. How quickly do they respond to my request
    b. Do they have it in their inventory
    c. How quickly can they get it to me
    d. Can I buy it in small quantities
    e. If they don't have it, how quickly can they get it and turn it around into my hands
4. Do I know which suppliers I can trust to take care of me when shortages occur

EAST COAST DOCK STRIKE –

As we go to print, there is a pending dockworker's strike that could threaten all east coast shipping. We think it will probably settle without a work stoppage. However, if the strike does in fact, take place it will cause a huge disruption in the availability of products. Watch the news for the developments, and if the strike does take place, hit the panic button and stock up accordingly.

THE BLAST –

The purpose of this newsletter is to address issues that are specific to the building supply industry. We have been publishing the Parliment Pages for 10 years. We have an incredibly large readership that look to us for industry trends and predictions.

A year ago, it became apparent that there were many other issues that had either a direct or indirect impact on our industry. Many of those other factors were economic and geopolitical. We believed that this was not the proper publication to address some of these issues and instead started a new publication. This new newsletter is a monthly publication titled the Blast.

We closely follow the economic developments around the world. There is no doubt that we have become a world economy and having a better understanding of world economics will always lead us to make better strategic business decisions in our own little worlds.

The success of that newsletter has astounded me as there are currently over 1,000 readers of that publication. We live in increasingly difficult and unpredictable economic times and I strive very hard to bring perspective to these conditions so that we may all best prepare ourselves. If you would like a free subscription to this monthly publication, simply send me an email at jbleech@no-excuses.com