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Greg Brooks, editor | 303 845 4880

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THISMONTH
IN CONSTRUCTION SUPPLY
JUL 2011

# CREDIT WHERE CREDIT IS DUE

By Greg Brooks. "Dear MasterCard: This letter is to inform you that my wife and I charged more to our credit card last month than we can afford. We're negotiating cuts to the family budget, but neither of us trusts the other to curb future spending if we raise our debt ceiling to pay this bill. We will pay the bill if and when we reach an agreement. In the meantime, we do not expect to incur penalties or higher interest rates since we have always paid our bills on time in the past (except that one month in 1979 when my pen ran out of ink). Sincerely, Greg & Paula Brooks."

Think it'll fly? Unless something happens fast, we're about to find out.

According to the latest Gallup poll, 42% of Americans oppose raising the U.S. debt ceiling versus only 22% in favor. When asked why, virtually everyone who's opposed said they're opposed because they want to reduce the deficit.

Trouble is, the debt ceiling isn't about future spending. Yes, it's being used as a bargaining chip. But the purpose of raising the limit is to meet commitments that have already been made.

What happens if we don't? Some think it'd be good for our financial credibility. Their argument is that not paying our bills would prove we're serious about reducing our debt (i.e., paying our bills). Seems less than airtight to me.

Others say that, by prioritizing, we could make our creditor's interest payments and maintain some programs without raising the debt ceiling. That's true; you can even do your own prioritizing with Bloomberg's interactive calculator.

But here's the catch: On August 3rd, we'll have $172.4 billion to pay $306.7

billion in bills that have come due. You can't suck $134.3 billion out of the economy all at once without an impact. The best estimates are that [GDP would fall 5% to 10%]. For comparison, GDP declined 4% in 2008-09.

That's why [business groups] ranging from the U.S. Chamber of Commerce to the Business Roundtable and the National Association of Manufacturers, plus Wall Street and both liberal and [conservative economists] around the world are begging Congress to get a deal done. Never mind the direct impact, they say; if we spook investors enough, we could trigger another global financial meltdown.

It's easy to talk about what *could* happen. Here's what did happen:

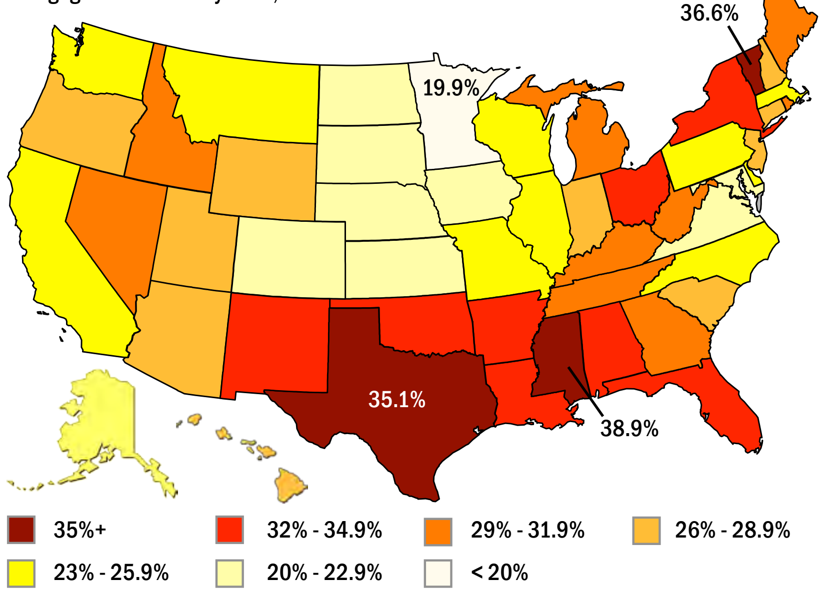
In 1979, [Congress played debt ceiling chicken] up to the last minute like they are today. When the limit was finally raised, the Treasury Department's check-writing machinery broke down so checks were a few days late. It still spooked the market enough to drive T-bill rates up 60 basis points (0.6%).

The rule of thumb is that a 0.5% increase in T-bill rates translates into a 0.71% increase in mortgage rates. [According to NAHB], each 0.25% hike in mortgage rates prices 1.2 million potential buyers out of the housing market.

In other words, if T-bill rates rise 0.6% this time around (could be more, could be less), 4.1 million home buyers would be priced out of the market. That's nearly 80% of the total homes sold in 2010.

The last thing the housing market needs right now is tighter credit.

**Mortgage denial rates by state, 2010.** Wall Street Journal



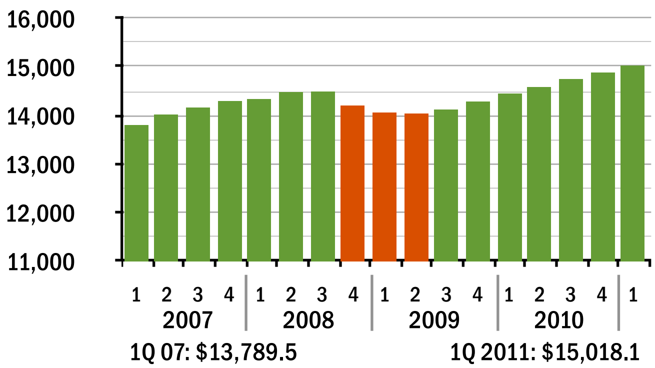

The [Wall Street Journal] says 26.8% of mortgage applicants were denied in 2010, versus 23.5% in 2009. Over the past six months, says [Pepperdine University], 63% of businesses larger than $25 million and 83% under $5 million were denied loans.

Part of the reason is lending standards are returning to historical norms. Part of it is that lenders are scared to death of any risk.

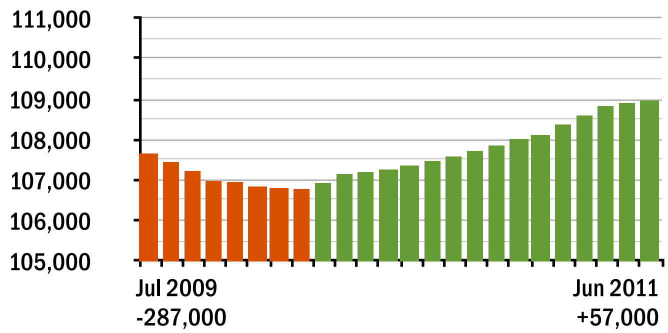
Part of it is that they still don't know where their balance sheets will land when this is over. Two years ago, lenders

# VITAL STATISTICS: U.S. ECONOMY

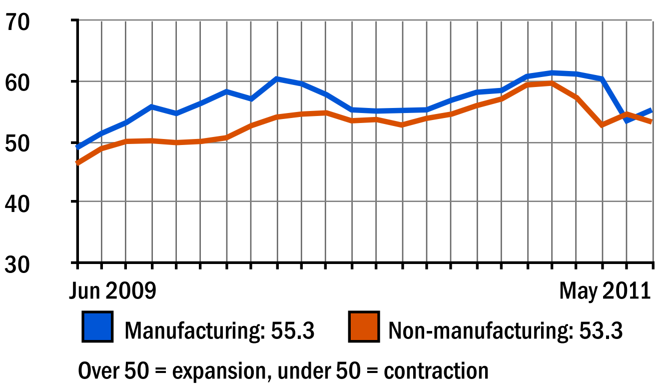
## GROSS DOMESTIC PRODUCT ($ BIL)



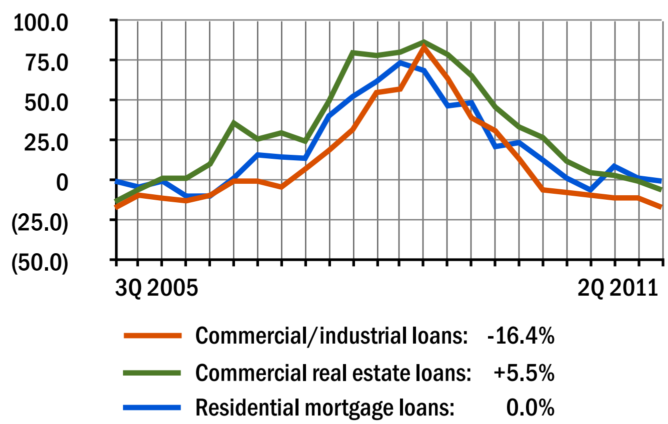

## PRIVATE-SECTOR EMPLOYMENT (000)




## ISM PURCHASING MANAGERS' INDEX



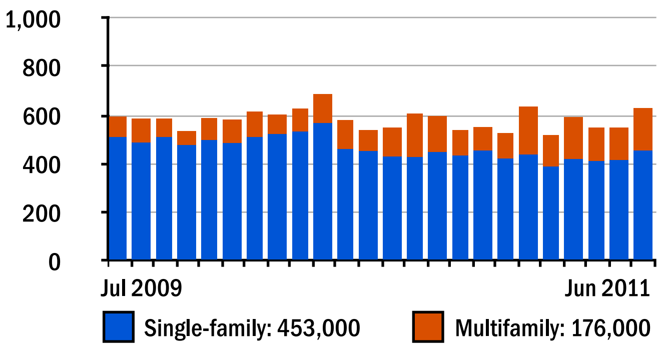

## % OF BANKS TIGHTENING LENDING STANDARDS



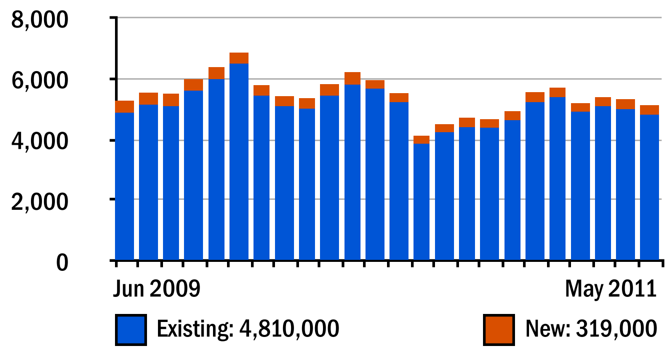

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Institute for Supply Management

# VITAL STATISTICS: HOUSING

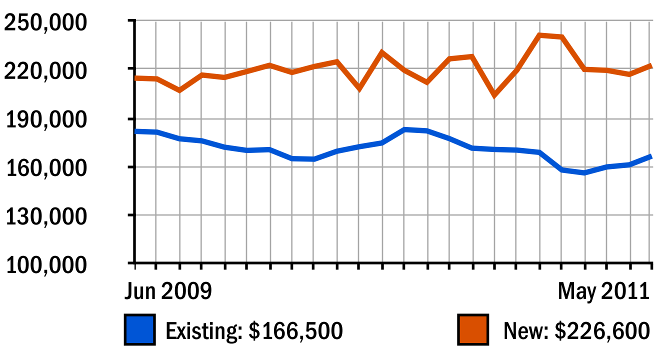
## ANNUALIZED HOUSING STARTS (000)



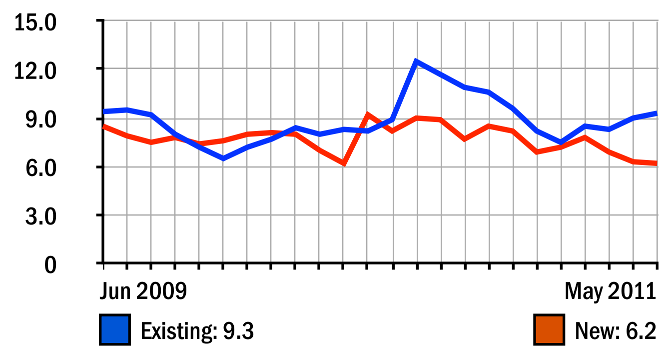

## ANNUALIZED HOME SALES (000)



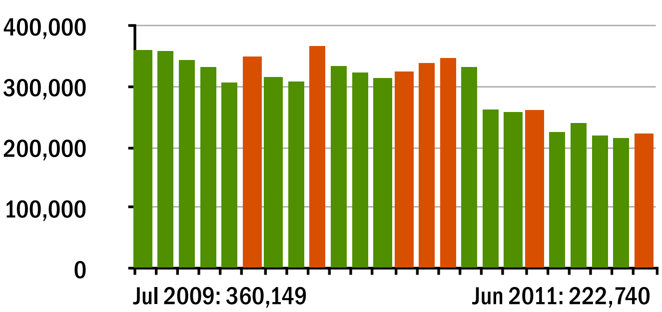

## MEDIAN HOME PRICES



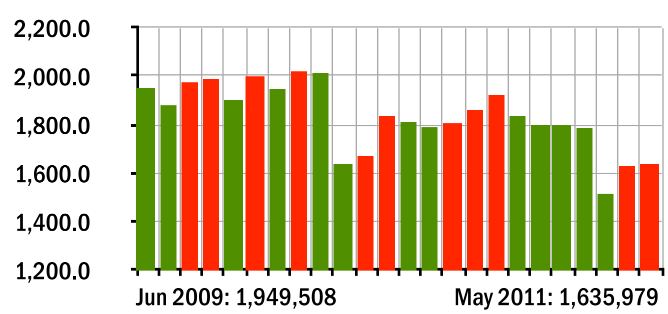

## UNSOLD INVENTORY (MONTHS)




## FORECLOSURES (000)




## 30-DAY DELINQUENCIES (000)




[Download current Econo-Matrix spreadsheet at CS24.us]

Sources: U.S. Census Bureau, National Association of Realtors, Freddie Mac, RealtyTrac, LPS Applied Analytics. EconoMatrix data compiled by:

LBMRESEARCH

were gung ho to repossess everything they could get their hands on. Dr. Phil would ask “How’s that working for you?” The answer today would be “Not so well.”

Turns out state attorneys general get snotty when you can’t prove you have a claim to a home you want to repossess. If you do get the home, municipalities get snotty when lawns aren’t mowed and taxes aren’t paid. To top it all off, it appears that vacant REOs grow mold faster than a Petri dish.

That’s why some lenders are quietly reducing the principal on underwater mortgages as much as 30%, YoY foreclosures are down 18%, and the average time from default to repossession has ballooned to nearly 600 days: Better to keep people in those homes – rent-free if necessary – than to watch your prize repossessions rot away.

This is not good news. Shadow inventory may disappear faster if REOs rot before they sell, but they could also take lenders down with them. As bad as the credit crunch is now, it may get worse before it gets better.

At the beginning of 2011, most analysts thought this was the year housing would start to recover. Not only are we not recovering, we’re on track to build fewer homes this year than in 2009, at the height of the crisis. We haven’t seen three back-to-back years below 1,000,000 starts since 1943-45, when housing was all but shut down due to the war.

In fact, housing starts today as a percentage of the population are just about exactly where they were from 1943-45. It truly is a war out there.

And there is yet another parallel: Prior to World War II, the typical builder built three to four homes per year with an in-house crew that did everything from foundation to finish. In 1950, tract home pioneer William Levitt built 30 homes per day with specialized subcontractors and prefab components. Levitt sold his homes – profitably – for nearly 30% less than the median price.

No one knows when housing will recover, but one thing you can take to the bank (assuming the bank is still there) is that affordability will be paramount when it does. If lending standards remain higher and home buyers remain poorer, price is the only way to take up the slack.

That means smaller, simpler homes and more multifamily, but there will also be pressure to find another 30% solution – either on the jobsite or, more likely, in the channel

Someone is going to make a lot of money in the next boom. TM

**Projected U.S. housing starts by date of forecast.** NAHB, Wells Fargo Securities, McGraw-Hill, John Burns Real Estate Consulting

| | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|
| John Burns | | | | |
| Mar 2011: | 628,000 | n/a | n/a | n/a |
| Current: | 486,200 | 602,400 | 756,500 | 886,200 |
| McGraw-Hill | | | | |
| Jan 2011: | 735,000 | n/a | n/a | n/a |
| Current: | 640,000 | 945,000 | n/a | n/a |
| NAHB | | | | |
| Feb 2011: | 673,000 | 986,000 | n/a | n/a |
| Current: | 597,000 | 800,000 | n/a | n/a |
| Wells Fargo | | | | |
| Mar 2011: | 620,000 | 830,000 | n/a | n/a |
| Current: | 590,000 | 760,000 | n/a | n/a |

Greg Brooks, editor of THIS MONTH, is a 43-year veteran of the construction supply business with 20 years’ experience in the field. Brooks is a former editor of ProSales, a steering committee member at the Harvard Joint Center for Housing Studies, and author of Scope of the LBM Industry, published by the National Lumber & Building Material Dealers Association.

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