MORNING BRIEFING
August 4, 2021

There Is No Place Like Home

Check out the accompanying chart collection.

(1) Hot in Atlanta. (2) Housing market is a mess. (3) Best cure for high home prices. (4) Would-be homebuyers bummed out and priced out. (5) New and existing home sales cool off. (6) Double-digit gains in home prices. (7) Housing inventories bottoming? (8) Falling vacancies for rental housing pushing up rents. (9) Evictions set to cause more turmoil in rental markets. (10) Homebuilding is in fits and starts. (11) Permits down sharply. (12) Materials costs and labor availability remain troublesome for homebuilders. (13) Assessing the outlook for S&P 500 Homebuilding.

US Housing I: Home Prices Rising. Melissa reports that her neighborhood in suburban Atlanta is hot. It's always hot there this time of year weatherwise, but the mercury has soared in the housing market too: Home prices are up 25% y/y owing to demand for bigger homes, with backyards for the kids, resulting from the pandemic. Boosting prices is also a shortage of both existing and new homes for sale.

Melissa's Baby Boom neighbors considered selling their home, downsizing, and moving closer to their grandkids. But they haven't been able to find a smaller home at a reasonable price. Even finding affordable rentals on their fixed income has been difficult, as folks making similar moves have driven up rental prices.

The national housing market has been a frantic and tumultuous mess since the end of last year's lockdowns. However, it may be starting to calm down. That's partly because the best cure for high home prices and a shortage of housing inventory may be record-high home prices.

Recent home price appreciation has incentivized some homeowners to sell to capitalize on their gains, which has increased the supply of available homes. Meanwhile, aggressive competition for homes and rising prices are bumming out many would-be homebuyers, dampening the intense pandemic-induced demand for homes that drove prices up. "[T]he affordability [of homes] is squeezing some of the buyers out of the market," said Lawrence Yun, the National Association of Realtors' chief economist. "Homebuyers qualify for a mortgage based on their income, but with prices rising 20% or higher, it is simply pricing them out," reported a July 12 CNN *article*.

Consider the following:

(1) *Home sales.* In June, new US home sales unexpectedly fell as many would-be buyers stepped out of the market due to a lack of affordable homes (*Fig. 1*). The number of new homes sold during June dropped to 676,000 units, saar, from a post-pandemic peak of 993,000 units at the start of this year.

Total existing home sales and sales of existing single-family homes ticked up ever so slightly during June to 5.9 and 5.1 million units, saar, respectively, but remained significantly below their recent post-pandemic onset peaks of 6.7 million and 6.0 million, respectively, during October (*Fig. 2*).

(2) *New and existing home prices.* Both new and existing home prices have been rising since the market bottomed at the start of 2012, and the gains have accelerated over the past year as Covid-19 has prompted cramped urban dwellers to move into larger suburban homes. The 12-month moving average of the median price of existing single-family homes rose 16.5% y/y during June to $326,300, with new home prices also rising at a double-digit rate, of 10.0% y/y, during June (*Fig. 3*).

(3) *Housing inventories.* As a result of the pandemic, housing inventories have been extremely tight in both the new and existing markets. However, that's changing in residential markets given new dynamics. High prices are inducing some homeowners to put their homes on the market and some homebuilders to build more. But at the same time, many would-be buyers are now backing off from their search because of a lack of affordable homes.

New homes for sale rose to 353,000 units, sa, during June, the highest since the end of 2008 (*Fig. 4*). And the ratio of new homes for sale to new homes sold, an indicator of months' supply, rose to 6.3 during June up from the record low of 3.5 from August through October (*Fig. 5*). A similar dynamic is showing up in existing home inventories (*Fig. 6* and *Fig. 7*).

(4) *Traffic & mortgages.* Meanwhile, traffic of prospective new home buyers declined in July, falling from last November's record high (*Fig. 8*). Record-low mortgage rates may be helping the refi market, but evidently not low enough to offset the rise in home prices. The four-week seasonally adjusted average of mortgage applications on new purchases fell during the week of July 23 along with single-family home sales (*Fig. 9* and *Fig. 10*).

US Housing II: Rents Rising. The demand for affordable housing is pushing up rents. Nationally, during Q2, the median monthly rent for vacant units held at Q1's record high of over $1,200 (*Fig. 11*). Tenant rents also were partly responsible for the higher yearly percent change in the Consumer Price Index during June (*Fig. 12*).

Invitation Homes, the largest US single-family landlord, raised rents in Q2 by 8% nationwide amid strong demand for suburban rentals, *reported* Bloomberg. On new leases, rents rose by nearly 24% in Phoenix and more than 22% in Las Vegas, the highest increases out of the 16 markets in which the company operates.

During Q2, renter vacancy rates fell to just 6.2%, the lowest since Q2-2020 and a near-record low (*Fig. 13*). Invitation Homes reported an average occupancy rate of 98% for Q2, reported Bloomberg. The percent of households renting rather than owning a home remained on a steep ascent during Q2 (*Fig. 14*).

US Housing III: Tenants Facing Eviction. Vacancy rates may be low partly because of the federal moratorium on evictions. Implemented last August on executive order by President Donald Trump, the moratorium prohibited evictions for tenants who fell behind on rent. About 8.2 million adults were behind on their rent or mortgage as of July 5 and have low confidence they can pay on time next month, a Census Bureau survey showed, according to a July 30 *WSJ* *article*. Federal recovery funds sent to state and local authorities intended as aid for struggling tenants and landlords reportedly has failed to make it into the appropriate hands, the article said.

Originally set to expire on December 31, 2020, the moratorium was extended by Congress until late January, and the Centers for Disease Control and Prevention (CDC) further extended the order three times. In June, the Supreme Court ruled that the moratorium was beyond the scope of the CDC's authority, but allowed it to be in place through July in any case. In a statement on Friday, President Joe Biden said that state and local governments had legal authority to do their own moratoriums, reported the *WSJ*.

More than 3.6 million Americans are at risk of eviction, *reported* CNBC on Sunday. Nationally, about 16% of adult renters live in households that are behind on rent payments, reported a separate *WSJ* *article*, noting that renters in southern states appear the most vulnerable, as the region has the most landlord-friendly laws countrywide. Rents in Atlanta increased 12.7% during the past year, exceeding the national average of 10.3%, according to listings website Apartment List. Rents in some Atlanta suburbs have risen more than 20%

during that period.

For homeowners, however, "[t]he departments of Housing and Urban Development, Agriculture and Veterans Affairs extended their foreclosure-related eviction moratoriums through the end of September on households living in federally insured, single-family homes late Friday, after Biden had asked them to do so," CNBC said.

Late breaking news: The *WSJ* *reported* late yesterday that the Biden administration is expected to announce a new federal moratorium on evictions. The action is expected to buy states and localities more time to distribute about $47 billion in rental assistance designed to help tenants harmed by the pandemic who have fallen behind on their rent. As of June 30, just $3 billion of that money had reached tenants and landlords.

US Housing IV: Builders Building More Slowly. Building affordable homes was a challenge long before the pandemic. Making matters worse, pandemic-induced supply-chain problems have caused a rise in materials prices, further exacerbating the affordability challenge for builders and buyers.

Melissa reports that in her suburban Atlanta area, some local homebuilders visibly have paused residential projects mid-build. Homebuilders may be on the road to restarting, some indications suggest, but that road may be awfully bumpy, especially as building permits are falling. Consider the following:

(1) *Housing starts.* "Despite rising costs and limited availability of key materials and labor, the nation's home builders exceeded expectations and found ways to break ground on the third-most new homes in a single month since 2006," *said* Zillow Senior Economist Matthew Speakman.

Indeed, single-family housing starts rose 6.3% in June m/m. However, all year the series has been volatile within a range near the average of historical norms. Could June be the start of an actual uptrend? Maybe, but challenges remain for homebuilders, chief among them the recent dip in demand and high costs to build (as discussed below).

Interestingly, multifamily starts edged up in June and look to be gaining more momentum than single-family builds. That jibes with the situation in the rental market, where demand is high and vacancies are low, for now (*Fig. 15*).

(2) *Permits.* Permits are the big "but" when it comes to housing starts. The indicator of

future months' building activity fell dramatically during June for both single and multifamily homes to a total 1.59 million units, saar, from a recent high of 1.88 during January (*Fig. 16*). It is "a clear signal that difficulties persist, and that construction activity could be even higher given a bit more long-term certainty and an easing of critical supply chain volatility," Zillow's Speakman added. Completions also fell in June (*Fig. 17*).

(3) *Input prices.* Nevertheless, starts that were stopped could get restarted, as some, but not all, prices of commodities important to the housing industry recently have come down from record highs. Since reaching their recent off-the-charts record-breaking high on May 7, lumber futures have plunged 62%, but they remain higher than most of their pre-pandemic peaks (*Fig. 18*). Hot rolled steel prices do not yet seem to have peaked, soaring to a recent record at the end of July from early-2020 lows (*Fig. 19*). At the same time, the 200-day moving average of the copper futures price also has soared (*Fig. 20*).

Speakman noted: "While lumber prices have fallen back to earth after the prolonged surge that began last spring, disruptions are now pushing up prices of other key building materials including steel, concrete and lighting, and making other important supplies very difficult to come by."

(4) *Labor costs.* Many builders cite problems related to a continued shortage of available workers. That's most likely why the yearly percent change in average hourly earnings for all construction workers rose 3.9% during June (*Fig. 21*). Keep in mind that the yearly rate has been distorted by its "base effect" and therefore hard to measure. But real average hourly earnings for both all construction workers and those just in production and nonsupervisory roles have climbed dramatically since 2012 as well (*Fig. 22* and *Fig. 23*). The cost of labor represents about 30%-40% of the cost of a typical new home, according to the Home Builders Institute.

US Housing V: More Upside for Homebuilders? Construction and housing stocks have had a pretty good year. The iShares US Home Construction ETF has risen 28.5% ytd as of the August 2 close, compared to a 16.8% rise in the S&P 500. Investors slightly pulled back last month on the concerns about rising costs but regained confidence in July.

The S&P 500 Homebuilding stock price index is up 35.1% ytd, surpassing the previous cyclical high during July 2005 (*Fig. 24*).The industry's forward operating earnings per share recently hit a new high, furthering its vertical ascent (*Fig. 25*). But while analysts' earnings growth forecasts for 2021 have risen to 60.8% as of the July 22 week, forecasts for 2022 have moderated since earlier this year to 9.7%. The industry's forward P/E of 8.0 remains within its trading range over the past five years (*Fig. 26*).

If demand for homes is dwindling at current price levels while input costs are elevated, what positives are investors hanging onto? Over the longer term, generational trends suggest to us that the most bullish opportunities can be found in apartment developers. Over the medium term, we are watching for any lasting negative outcomes for rentals from both rising rents and the looming eviction cliff. But if employment resolves as the US economic recovery continues unfazed by the latest evolutions of the virus, as we expect, then let the multifamily-unit building commence! Let's look at the industry dynamics that investors in the housing space may be weighing at this point:

(1) *If supply-chain issues go poof, will stocks go up?* Analysts may be anticipating that forward earnings for homebuilders could only go up from here, assuming that commodities prices decline once supply bottlenecks are resolved and that builders take that benefit to their margins rather than passing it along to buyers in lower selling costs, as the July 14 *WSJ* *indicated* is likely.

Because apartment developers order wood by the boxcar all at once, many multifamily projects were tabled as the price of lumber soared, explained a market analyst for the *WSJ*. Many multifamily builders have been "barreling back into the market" as the price of lumber has retreated.

(2) *Will Millennials suddenly embrace the American Dream?* What about the new demand from would-be Millennial homebuyers that single-family homebuilders have been dreaming of? Millennial demand started to show signs of growth during the pandemic, as many of those who could afford to do so moved out of city apartments and into suburban homes.

But now that the cohort has witnessed two major crises that induced wild home price swings—the Great Financial Crisis of 2008 and the Great Virus Crisis—renting for life may look like their best option. Many have lots of student loan debt and not much wealth or income. Many of those who finally have saved a down payment now find themselves priced out of this pandemic-distorted housing market, at an age when their parents already owned starter homes—as a July 11 *Associated Press* article explored.

Some would-be Millennial homebuyers could still be waiting on the sidelines for home prices to come back to Earth. Some may turn to their Baby Boomer parents for financial help to purchase a home. But a big problem is that starter homes are in short supply, largely because of zoning laws for smaller lots, said Robert Robert Dietz, chief economist for the

National Association of Home Builders (NAHB), *according* to MSN.

Nevertheless, Millennials need a place to live, and if renting is it, then multifamily building may be a good bet for investors. New household formation is driving demand for rental apartments, *suggested* yesterday's WSJ. "You've had young professionals who were living with parents being called back to their employer or who feel more secure and now they're going to rent," an analyst said.

(3) *Will Baby Boomers' lifestyle shifts boost multifamily demand?* Many Boomers are opting to age in place for now, but many may eventually need to move if their homes become too large to manage or if they need eldercare services. Downsizing Boomers may drive up demand for multifamily units, too, eventually, especially for those providing assisted living services. With anticipation, Alliance Residential Co. recently *broke ground* on an upscale Portland based 16-story senior living project.

Interestingly, multifamily construction sentiment reached its highest point in seven quarters in Q1-2021, especially reflecting strong demand for rental housing in the suburbs, according to results from the Multifamily Market Survey *released* by NAHB. NAHB now expects a gain in multifamily starts this year.

(4) *Will infrastructure legislation boost housing market?* President Biden's pending infrastructure agenda certainly should boost construction activity. However, the initial bipartisan infrastructure bill *proposed* this week is nowhere near $4 trillion in scope that Biden originally campaigned on. Rather, the text of the first bill allocates several billions of dollars to roads and bridges, public transit, expanded broadband access, and other such hard infrastructure.

But Democrats are hopeful that future legislation will include large investments in affordable "green" housing and eldercare housing.

Calendars

US: Wed: ADP Employment 700k, ISM NM-PMI 60.4, MBA Mortgage Applications, Crude Oil Inventories, Clarida. **Thurs:** Initial & Continuous Jobless Claims 384k/3.26, Trade Balance -$74.1b, Challenger Job Cuts, Natural Gas Storage, Waller. (Bloomberg estimates)

Global: **Wed:** Eurozone Retail Sales 1.7%m/m/4.5% y/y, Eurozone, Germany, and France C-PMIs 60.6/62.5/56.8, Eurozone, Germany, France, Italy, and Spain NM-PMIs 60.4/62.2/57.0/58.3/63.0, UK C-PMI & NM-PMI 57.7/57.8. **Thurs:** Germany Factory Orders 1.9%, France Industrial Production 0.6%, Japan Household Spending 2.1%m/m/0.1%y/y, BOE Interest Rate Decision 0.10%ECB Economic Bulletin, BOE Inflation Report, RBA Monetary Policy Statement, Lowe. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q2 Earnings Season Monitor (*link*): With over two-thirds of the S&P 500 companies finished reporting revenues and earnings for Q2-2021, revenues are beating the consensus forecast by a record-high 4.3%, and earnings have exceeded estimates by 17.0%. At the same point during the Q1 season, revenues were 3.8% above forecast and earnings beat by 23.3% in large part due to reversals of loan loss reserves at the banks. The S&P 500's earnings surprise also appears to have weakened substantially q/q excluding the Financials. The S&P 500's Q2 earnings surprise excluding Financials is 15.1% compared to 19.6% during Q1. For the 341 companies that have reported Q2 earnings through mid-day Tuesday, the aggregate y/y revenue and earnings growth rates and the percentage of companies reporting a positive revenue and earnings surprise have improved significantly from their Q1 measures due to the low base a year earlier when the US economy was shut down due to Covid-19. The current sample of Q2 reporters so far has a record-high y/y revenue gain of 28.0% and an earnings gain of 120.9%, surpassed only by Q4-2010's 211.1% rise. A whopping 88% of the Q2 reporters so far has reported a positive earnings surprise, with a tad lower 87% beating revenues forecasts. Slightly fewer companies have reported positive y/y earnings growth in Q2 (90%) than positive y/y revenue growth (91). These figures will change less markedly as more Q2-2021 results are reported in the coming weeks. The y/y growth rates will more than likely mark the peak of the recovery from the Covid-19 shutdown.

US Economic Indicators

Manufacturing Orders & Shipments (*link*): Factory orders in June advanced for the 13th time since bottoming last April, climbing to its highest level since July 2014. Billings advanced 1.5% in June and 39.8% during the 14 months through June. Factory shipments followed the same script, rising 1.6% and 31.1% over the comparable periods to its highest level since October 2018. Both motor vehicle orders and shipments have dropped year to date due to semiconductor shortages, though factory orders and shipments, excluding transportation, posted solid gains of 7.6% and 7.2% so far this year, rising to new record highs. Core capital goods orders and shipments continued to set new record highs yet again in June. Nondefense capital goods orders ex aircraft (a proxy for future business investment) has increased every month but one since bottoming last April, climbing 0.7% (vs 0.5% preliminary) in June and 27.4% over the period. Core capital goods shipments (used in calculating GDP) followed an identical pattern, advancing an unrevised 0.6% m/m and 24.1% over the comparable periods.

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