Housing Developments Episode 3

Jerry Howard: Hi, I'm Jerry Howard the chief executive officer of the National Association of Home Builders.

Paul Lopez: And I am *not* Jim Tobin Chief lobbyist for the National Association of Home Builders.

JH: No, you're, I would say you're much better looking, but that would be a stretch too.

PL: Wow!

JH: Joining me today is Paul Lopez who's the head of our public affairs group whose substituting for Jim who is on a well-deserved vacation golfing in Ireland. I can say this for certain that the golf courses in Ireland will never be the same.

[Intro Music]

PL: He also is taking his family there as well. Let's be fair there.

JH: Yeah, but he's golfing for a week, which means that most of the fairways in Ireland will become just gigantic sand traps. If you've seen Jim Tobin play golf, you'll know what I'm talking about.

PL: That's pretty funny.

JH: But anyway Paul. Thanks. Thanks for joining me here today.

PL: Happy to be here.

JH: Paul yeah, I actually have to give all credit the idea for these podcasts came from Paul. He has been dutifully coaching Jim and I for the last three episodes. And so now it'll be interesting to see how he does behind the microphone himself. But why don't you tell me a little bit about what you and your team do not just for NAHB, but for the average listener for the average Builder out there in the field, how can the public affairs group do something that relates directly to their business?

PL: Well, basically any information that we send out to the press and to the members and to the public come through my shop. So, if you heard about NAHB, it's because we were part of it.

JH: Thank you. That's really true. He's laughing because I put him on the spot. We did not rehearse that question. That's the kind of guy I am.

PL: Let's talk about let's talk about you Jerry your favorite –

JH: Enough about you, Paul.

PL: Let's talk about your favorite topic: you. You just came out from meeting with Mark Calabria. He just got sworn in. How was that?

JH: Mark did get sworn in today, it was interesting. It was a fairly large gathering, a lot of people representing the Housing Industry were all present. I had opportunity to talk to Secretary Carson for a few minutes, which is always interesting. I talked to Brian Montgomery, the acting Deputy Secretary and a full-time FHA commissioner, talked to him a little bit.

PL: Let me walk you back. I think a lot of our listeners may not know who Mark Calabria is. So, who is Mark and why would why should we care?

JH: Oh, Mark Calabria is a former NAHB economist, believe it or not, who was sworn in today as the regulator for Fannie Mae and Freddie Mac, the head of FHFA, the Federal Housing Finance Administration. So, Mark will be intricately involved in regulating what the Government-Sponsored Enterprises can do and I think more importantly from our members perspective, Mark will be leading the charge in defining what their roles will be going forward.

PL: Now and we feel good about his is nomination. Right?

JH: Well, we feel good about it because we know Mark really well and make no mistake about it, the people out there listening, Mark Calabria is a Libertarian. He would like to see as little government involvement in the mortgage markets as possible. Having said that, he's also a very bright guy who realizes that Fannie Mae and Freddie Mac are deeply ingrained in our Housing Finance system that to the point where you can't just privatize them and send them away. Mark knows he can't do that. He will be looking to potentially shrink their footprint as much as possible. But at the same time, during his confirmation hearings, for example, NAHB planted a question up there asking Mark about the potential role of the GSEs in in the A D&C arena and Mark didn't shut that down. In fact, he said that there probably is a role. So, I think that you've got a guy there who is very bright, who has very firm and strong philosophical beliefs but is also pragmatic enough to know that he now moves markets with everything he says and does and understands the weight of that responsibility.

PL: Do you think this is the year that GSE reform finally gets done?

JH: I think you're going to see a lot get done administratively Paul. I think the window for doing anything legislatively is narrowly closing. But I think what they're doing is set in this stage either for next year or more importantly for the next after the next election.

PL: Speaking of the administration. You also met with Secretary Acosta recently, didn't you?

JH: I did I met with Secretary Acosta. Actually just a few moments ago I left his office. Ed Brady who is the president of HBI, the Home Builders Institute and I went over there, it was a privilege for me to introduce Ed to the Secretary because HBI is, you know, and some of our listeners know, is very involved in Workforce Development, and in fact at one point was the single largest Job Corps contractor. So, Ed and the secretary talked a lot about Job Corps as you might imagine in a conservative Administration, the secretary has some ideas that are novel in the way he wants to reform Job Corps, but Ed did a tremendous job in in asserting HBI into that process and assuring the Secretary that HBI wants to play a productive role in that process. And then the Secretary and I talked about a couple other issues not the least of which is the is the rule that precludes teenagers from using power equipment. So that we could train somebody in HBI but they can't get a job then using power tools.

PL: Really?

JH: Yeah, and in fact the Secretary pointed out to Ed and to me that it goes farther than that: 16 and 17 year-olds are not allowed to deliver pizza anymore under federal law because driving the car’s a hazardous equipment nor are they allowed - and this will be interesting - to adjust hospital beds. So the traditional candy stripers that we knew when we were kids –

PL: Right.

JH: …can't adjust the hospital beds of patients or if they're working as part of a training program to do emergency EMS training. They can't adjust hospital beds up or down to help the patients get into them. Now, it seems like we've gotten a little carried away with some of our laws in that regard. I got to tell you.

PL: And that's one of the things that NAHB is known for, right? Going in there making sure that we start removing some of these regulations…

JH: Exactly. And so we were talking about power tools. The Department of Labor is going to start with some of these other more actually ludicrous laws that are on the books and go from there, but we had a good meeting with the Secretary talking about some of the other regulations that we're dealing with and in fact the secretary expressed an interest in coming to speak to NAHB sometime in the future.

PL: This was in Ohio where you guys met?

JH: No, I was right here in his office this morning.

PL: I thought you were in Ohio recently.

JH: I was in Iowa.

PL: Iowa.

JH: See, Paul’s from the West Coast, ladies and gentlemen. To him, there's a West Coast and East coast and the rest are flyovers. So, builders from Iowa and Ohio: He just got you confused. And that ain't right.

PL: My apologies, I misspoke. How was Iowa?

JH: I wonder if Jim Tobin would have gotten that confused?

PL: Easily so.

JH: Iowa was great, we went out there and had breakfast with the Executive Officers from the Ohio Association. Then we went up and met with the Governor and the Lieutenant Governor talking, not only about Workforce Development, but the provision of affordable housing in Iowa and I've got to tell you Governor Reynolds and her team couldn't have been more hospitable. But more importantly they could not have been more up to speed on the issues which impact our Builders.

PL: Do they have an affordability problem?

JH: They certainly do, particularly in rural Iowa. The provision of affordable housing in rural, Iowa, it's gotten to be a real problem, but the Governor is out in front of it trying to tackle it and I got to say that the HBA out there, the state HBA, and the locals have a tremendous relationship with the people in their state capital and they really represent exactly what our Builders are in their state and to do a terrific job.

PL: Excellent. Now, I also have some other good news, is that the HMI came out this week and it looks like it ticked up a little bit again up to another point. I think to 63. Now our members are telling us that they're seeing the want, the demand for housing, but that affordability going back to what you were just talking about is the key problem that they're seeing across the country. I mean, do you see that kind of continuing throughout the rest of the year?

JH: Well, first of all, let me comment. Although I haven't gotten a chance to review the data on the HMI not surprised that we took up a little bit at the end of March the beginning or the end of it April beginning of May. I am surprised that housing affordability hasn't taken a greater toll on the HMI because as I travel around the country Builders everywhere from Iowa to Ohio, and from Maine to Minnesota, Maine's in the East Coast, Paul, Minnesota dead center, north –

PL: Good tip.

JH: Builders talk about what's going on with the problem is and it's all housing affordability. As you know Chairman Ugalde has made housing affordability the number one issue for NAHB this year, and I got to tell you I think that Governor's whether they're Republican or Democrat are very quick to sign on with us and say we have to do something to help people be able to afford either the rents or the mortgages for an average house.

PL: Speaking about economics our Guest this week is our very own Robert Dietz, and he's going to be talking to us a little bit about what's going on with economics. And what he sees in his forecasts for 2019 and Beyond.

JH: First of all, let me congratulate you for securing Rob as a speaker. Rob spends more time on the road probably than anybody at any NAHB except for me. He's always gone somewhere. So, when we do see him, it's really a thrill for all of us. So, for the listeners to be able to hear Rob's forecast I think is a great coup and a great opportunity. And I'm joking Rob does travel a lot on our behalf. He's very well respected not only out in the country, but more importantly here in Washington on Capitol Hill and in the Administration Rob is acknowledged as the foremost housing Economist in America, and we're very, very proud of that fact.

PL: So with that let's bring him on. All right, Rob. Thanks for coming.

Rob Dietz: Glad I could join you guys.

PL: So recently you spoke to our Board in regards to what you see housing is going to look like in the next year or two. Can you tell us what you told them?

RD: Sure, so the forecast actually for housing and the overall economy is actually improved a lot over the last few months. The big reason for that is the Federal Reserve which had adopted a really aggressive, hawkish view of the economy going into 2019 they expected for example to raise interest rates for times this year. They've backed off of that and in part some of that was due to looking at what are called the soft indicators of the economy including the housing market index that we do with Wells Fargo, which is our Builder confidence measure and what it what it showed last fall was a fairly substantial drop in single-family Builder confidence with respect to going into 2019. Well now things have improved. But the Federal Reserve is adopted this more dovish position. I think there's a general expectation, now that the Fed is not going to raise interest rates in 2019. And so we're going from what we were categorizing at least at the Builder Show as a bumpy landing for the economy with maybe the prospects of a growth recession. We're now looking at more of a kind of soft landing with modest growth rates for single-family construction and apartment construction, but the big challenge of course remains housing affordability.

PL: So when you say things are better what's your forecast in terms of growth?

RD: So we're looking at about a two percent growth rate on single family starts we think multifamily construction will be up just a little bit single family doing a little bit better these are reduced growth rates from what we've seen in recent years where for example single-family construction was near 10 percent growth rate in 2015 and 2016. So, the industry is slowing down in terms of its growth rate, but it should continue to expand and the reason why is that housing demand continues to grow. The demographics are really favorable for home building. The peak age of the Millennials is in their upper 20s, and they're moving into their 30s. The unemployment rate is low and we're finally starting to see fairly strong gains in income and wage growth. So, the demand side is good. The challenge is really the housing affordability considerations and we would be growing faster if we could tackle some of those housing affordability concerns and those come mostly in the form of higher construction costs. So, the industry has been dealing with a labor shortage for a while regulatory burdens have been growing and those factors increase the cost of construction particularly on the single-family side. And then limit the number of prospective home buyers. So, the homeownership rate is held a little bit lower than where it should be given the demographics. We're not building enough homes and just kind of put it into scale. We probably should be building about 1.1 million single family homes a year. This year we expect to build somewhere under 880,000. So, we're under buildings by several hundred thousand units, ultimately the people who pay for that are those renters that want to get into single-family homes and face really tight inventories in their markets both on the existing home sales side and the new construction side.

PL: Right. Now you travel across the country. I mean more than anyone. I think maybe Jerry beats you by a couple weeks a year. Are you hearing that same tone and same messaging from across the entire country in regards to what our members are telling you?

RD: The concern over housing affordability is almost universal. Every single market you go to basically says how you know the cost of development the cost of developing land the cost of complying with state, local and federal rules associated with building homes and developing land is have all gone up a lot over the last few years. And while we know that demand for single-family homes is out there, we just can't build exactly the price points that they need and that's the reason that the Federal Reserve's actions, for example, was really helpful because we were not only facing higher construction costs, but interest rates were also rising so that the combination of demand side, higher cost of servicing a mortgage, and then the higher cost of construction was really crowding out a lot of buyers. So, yeah, it's clearly worse in some parts of the country. I think everywhere kind of complains about it, right, coastal markets, high-cost markets, high-tax markets, are facing that housing affordability concern. A good example, for example, a lot of markets in California, only one out of ten home sales are affordable to a typical home buyer in those markets. Nationwide, it's right now about little under six out of ten home sales being affordable, but that challenge is growing and it's going to be a key advocacy issue going forward.

PL: So, what's the advice that you give are our members in regards to how to keep their business growing in this environment?

RD: So, you need to focus on the local data. You need to be cautious about cycles and you need to be sure about where that future demand pipeline is coming from. So, you know study your markets if you've got a market like markets in Florida, for example, their growing four times as fast as a nation as a whole. That demand is there it's just a question of are you building the right product?

PL: Right.

RD: In a lot of markets where population is either flat or even declining, you know, maybe tear down construction, maybe remodeling is really the market to be in; you want to be a little more cautious about owning and developing lots and places where there's a lot of job growth. The challenge is can you build entry-level single-family housing and you know, there's some examples of where it happens and it works, they're typically places where land is relatively cheap or where you can build more units with higher density and that would be places where the regulatory rules allow you to build single-family detached on smaller lots or townhouse construction, which last year grew by 14 percent which is real indication that in markets where you can build a single family product for sale that offers an ownership opportunity that products going to move provided the community will actually allow you the zone for it.

PL: Is it an impediment for construction loans?

RD: We're seeing construction loan growth slow. In fact, at the end of 2018 and the fourth quarter for the first time in almost five years the outstanding stock of A D&C loans decline and that was due to the fact that over 2018, the average interest rate on these kinds of loans increased somewhere between 50 and 75 basis points. So, where we've been talking a lot about the labor shortage, lumber cost and of these other supply-side headwinds. We always indicated that lending for builders was one of the constraining factors on housing affordability. At the end of 2018 that really moved up in terms of an issue that we need to look at and we'll be talking about it more in 2019.

PL: Is it too early to talk about whether the tax credit worked or not?

RD: So, in terms of tax reform and its impact on housing, we're still looking at the data, there's clearly some parts of the country where housing demand fell back a little bit as people adopted to the new rules the state and local tax deduction cap of $10,000 is having an impact. I will point out and you don't see a lot of this in media interviews, but it's important to note, in places where that ten thousand dollar cap is in place a lot of those taxpayers got zero dollars state and local tax deductions previously because they were paying AMT. And one of the things that the tax reform bill did was, if you were used to be an AMT status, you're no longer going to be a 95% of AMT tax payers are now in the ordinary regular income tax. So, I think we got to look at the data clearly there are some markets that slow down. It's going to be a concern and those high costs markets, but there are also some upsides, namely that buyers are going to be able to save for a down payment faster because a double standard deduction and an income growth is accelerating as we go forward through the tax reform.

PL: Your long-term forecast basically shows more of the same rights kind of slow and steady all the way probably for the next 3-5 years. Is that a good thing or is that a bad thing?

RD: Well, it’s a bad thing if you want to grow your business more aggressively. I think it's a good thing that our forecast indicates that we don't see the market getting out ahead of itself that the builders are remaining cautious. They know what happened 10 to 15 years ago. So you don't see this kind of wild land market right now, but what you see is kind of a modest growth rate moving along with job growth and population growth and markets and there are a lot of sort of positive drivers for the market right now. We've got an aging housing stock. You've got again Millennials moving from their 20s and 30s, but then there's the challenge side: housing affordability going down due to the fact that we've been facing for a long time: labor shortages, volatility, and building material pricing and now it's a tighter financing market for businesses in terms of builders and land developer.

PL: Is labor still an issue in the marketplace?

RD: Labor's absolutely an issue. It’s one of the things I actually got a little bit wrong in 2018. I thought 2018 would be the year in which the labor shortage didn't get better, but would stop getting worse. And as we saw a little bit of slowing and labor market may be some of the data would indicate a little leveling off the labor shortage. That didn't happen. In fact right now, the industry is short about 300,000 construction workers challenging, you know, the industry the ability to expand due to lack of workers. So, it's not only a question of whether over the next five to ten years we can recruit additional workers into the industry, but they have to have the right skills because what you said in terms of the intensity of the labor shortage right now… skilled framers, skilled plumbers, electricians, that's not going to go away quickly. There's a lot of discussion, you'll see this if you attend conferences or sessions or trade shows a lot of discussion of the ability of robots to come in and replace individuals…

PL: Right.

RD: …that may happen at the margins. But you know, really what we need is increase worker productivity and that comes about by bringing people into the industry and training them and that's something that NAHB, local associations, Home Builders Institute, the National Housing Endowment, really going to focus on over the next 5-10 years.

PL: So building materials; also something that we need to look at. You know that lumber went crazy last year, has been down. Do you see any signs of any hot flashes in the market?

RD: So there's no signs right now that will see lumber accelerate like it did in 2018 and just as a reminder: I have, builders know this in their soul, but lumber prices at the middle of 2018 had gone up more than 60% since started 2017. It was adding easily eight to nine thousand dollars per price of a single-family home. We expect some gains in lumber prices in the spring particularly as the market goes from last fall when there were a lot of dampened expectations about the growth and building to the spring now where we expect these modest growth rates, that should increase the demand for lumber and push the pricing up. What we're concerned about over the next two to three years is the potential for his kind of volatility for these kinds of roller coaster rides and individual Building Material products –

PL: Right.

RD: And frankly the solution for that is to try to resolve some of the trade disputes that we've got some of the actions taken by the administration or clearly part of a negotiating strategy, but the sooner we can get a renewed softwood Lumber agreement with Canada, soon as we can resolve some steel and aluminum issues with China would help Remodeling and multi-family construction. The more certainty will have about building material pricing and it's that uncertainty right now that I think is responsible for kind of holding back some of that optimism among Builders.

PL: Is there one piece of advice that you always tell Builders moving forward as to you know, in terms of their business practices, like what they should be looking for or what advice you can give them in regards to not over building. I mean, when you're traveling what's the one core message that you want to convey to the builders?

RD: Cautious optimism. Be cautiously optimistic about the future that the demographics are really on our side, but you really have to watch the ability of the cost side to get ahead of itself. So you'll hear builders saying, “I could expand my business a little faster, but I don't know if I'm going to have those subcontracting crews to be able to come.” The other thing is from a strategic perspective what we see clearly in the data is the ability to grow the industry right now is concentrated at that entry level market and that's easy for an analyst to say Builder sort of laugh and say, yeah. Sure, I would love to be able to build a hundred-fifty-thousand, two hundred-thousand-dollar house, right? So, if you're in a market where you can do that in the jobs are growing, build away at the entry level, right? In other markets is going to be trying to find creative solutions in some cases. It means bending the cost curves and other places it means townhouse construction or other ways to add density, but that entry-level Market that's really where the market can grow over the next four to five years.

PL: Dr. Rob Dietz, thank you for joining us.

RD: Thank you.

JH: Thanks everybody for tuning in.

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