National Housing & Rehabilitation Association

Summer Institute

July 18-21, 2018 Martha's Vineyard, MA

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Economic Update

NH&RA Summer Institute
Martha's Vineyard, MA
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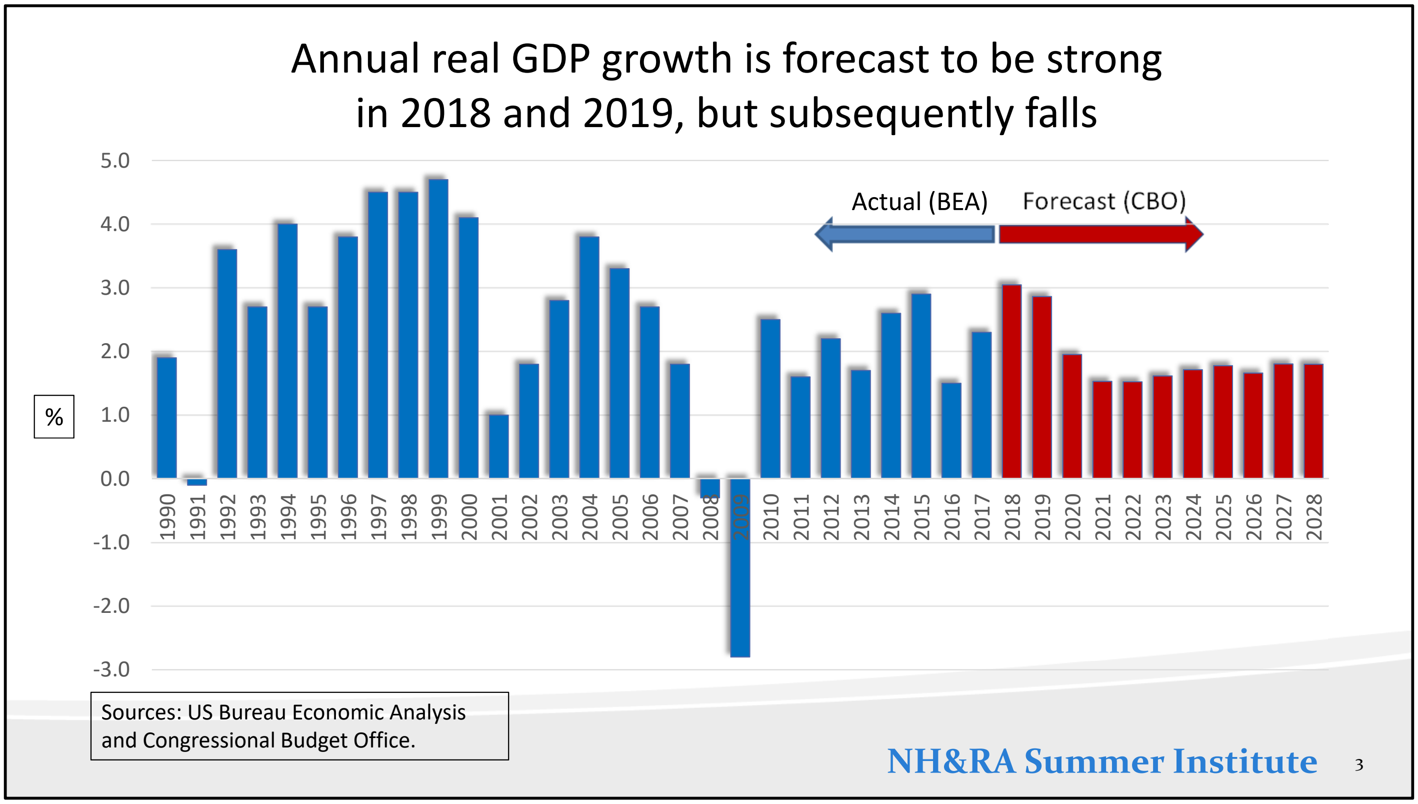
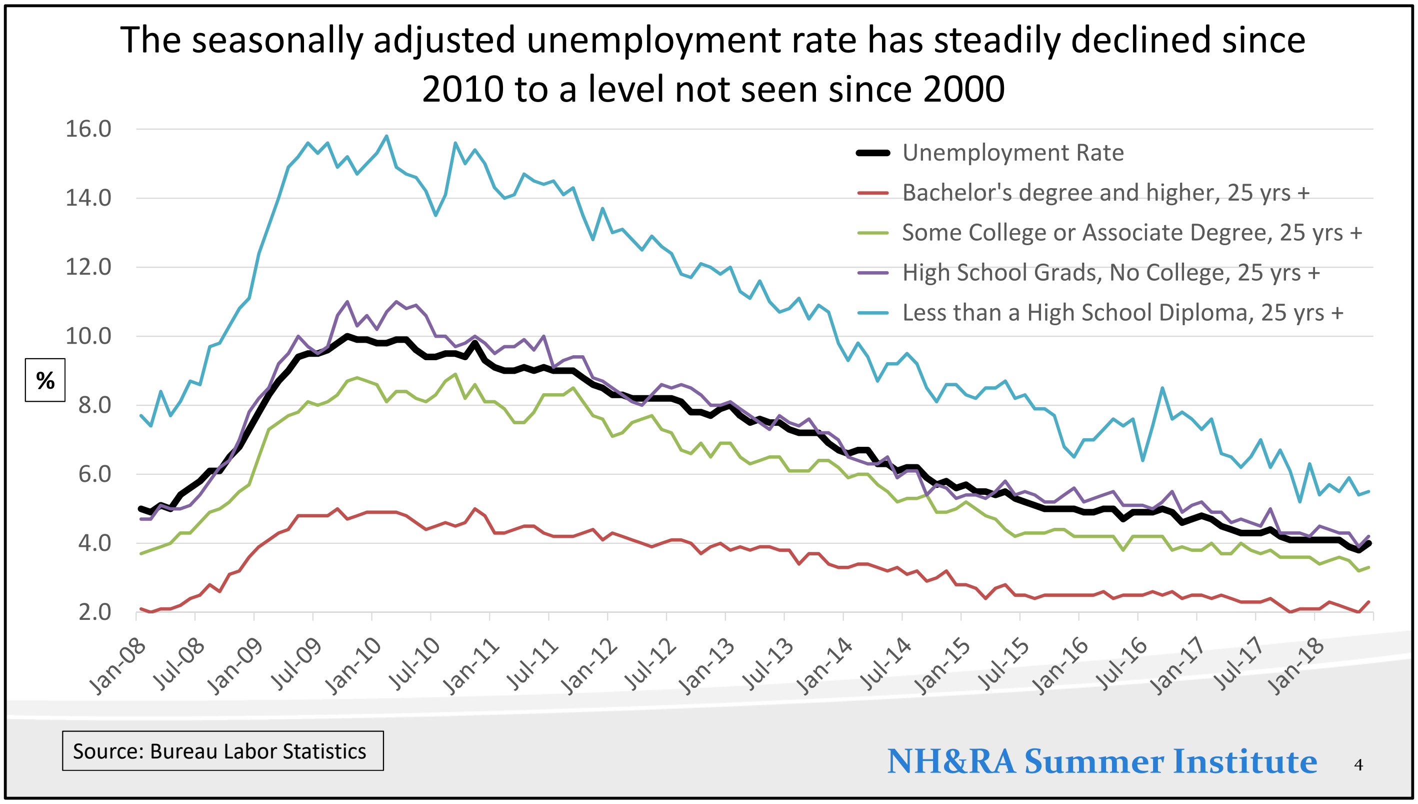
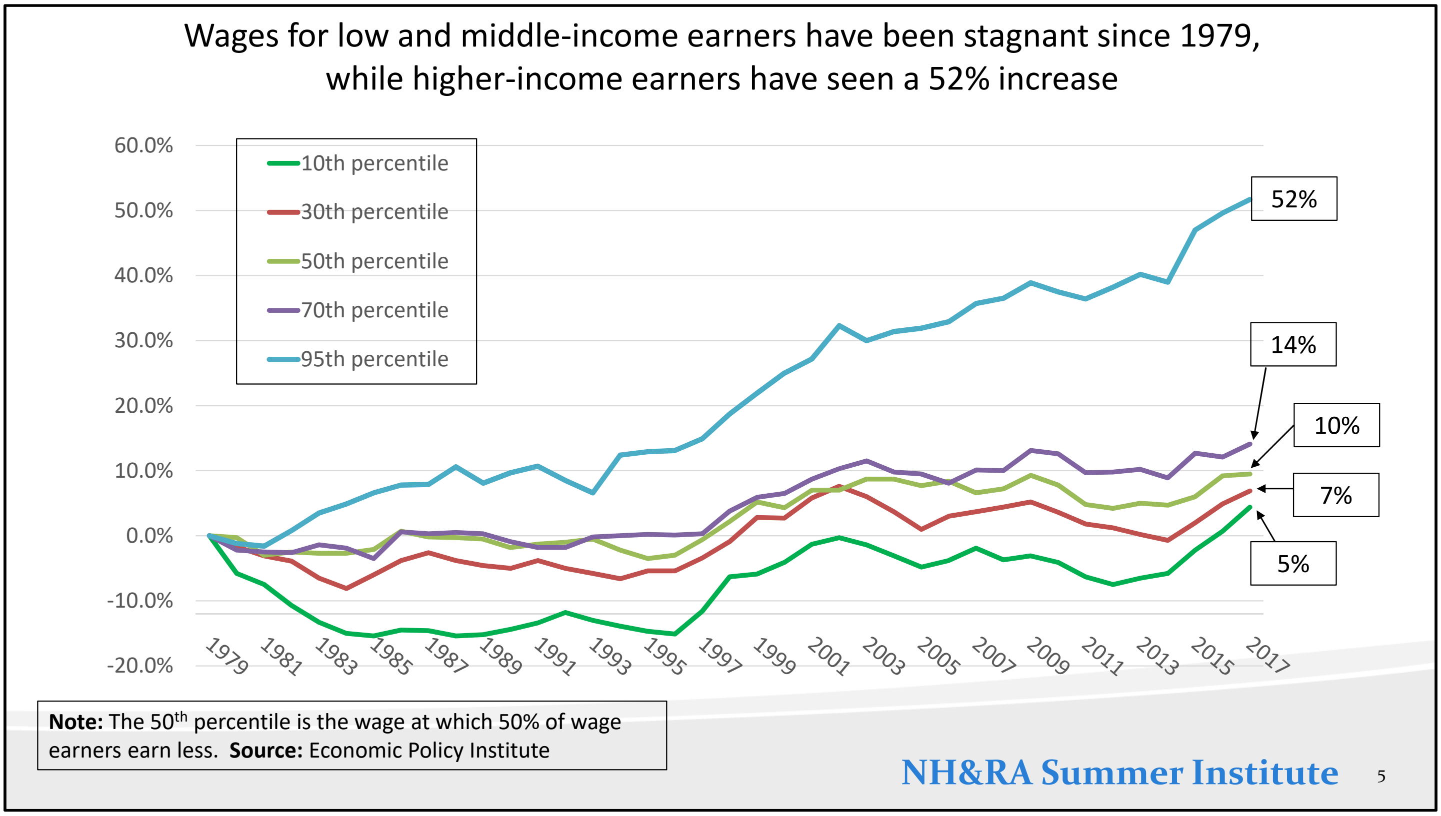


- CBO released its forecast for GDP in April. Usually does so in Jan – delayed b/c fiscal changes (i.e., TCJA).
- Earlier (short-run) forecasts from OMB were a lot more optimistic than CBO.
- However, CBO's predictions for 2018 and 2019 (at approx. 3%) are now more optimistic – 2017 tax changes act on incentives to work, save and invest.
- In 2020 real growth starts to decrease. Why?
    - CBO predicts that large budget deficits reduce resources for private investment.
- In outer years (2023-2028), growth will be 1.7%. (OMB has it at 3.0%).
- **Deficits** from CBO: 2017 revenues were 17.3% of GDP, outlays 20.8%. Deficit of 3.5% ≈ $665 billion. Deficits predicted to grow to 4.9% in 2019-28.
- **Debt** held by public goes from 76% GDP (= $14.6 T) to 96% (= $28.7 T) in 2028.
    - Shouldn't we be fixing the deficit when there is full employment?
    - CBO long-term outlook: Payments on debt will be 6.3% of GDP in 2048.
        - Fed interest payments = Social Security budget at that point.
        - Federal spending would be 29% of GDP (not seen since WWII).
- One more aspect–**looming trade war**. Affects consumer and business confidence. Could reverse impacts of fiscal stimulus. Could trigger recession.

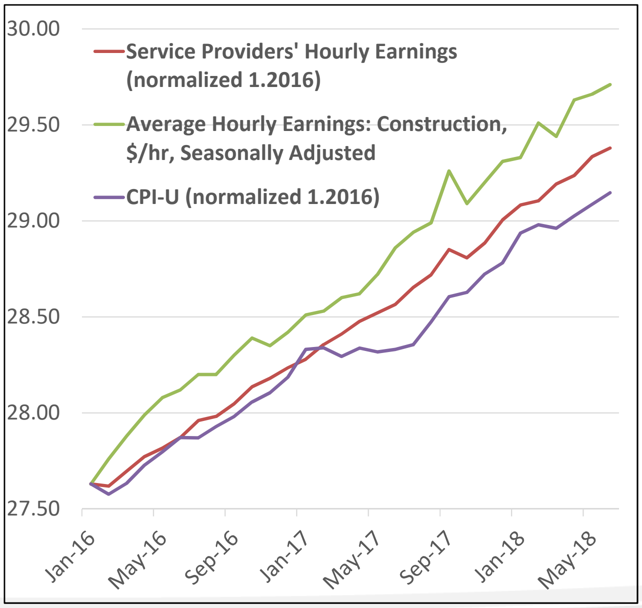


- The official unemployment rate, U-3, was 3.8% in May. Ticked up in June to 4%.
- 213k were jobs added to non-farm payrolls in June (214k avg over 6 months).
    - Construction employment continued to trend up in June (+13,000) and has increased by 282,000 over the year.
- Natural rate of UE is 5.2%. CBO predicts U-3 will fall to 3.8% this year and then 3.3% in 2020. Tight market.
- The broad measure, U-6, also low at 7.8%. U-6 includes marginally attached and part-time.
    - U-3 rate was 3.8-4.0% in 2000. At that time U-6 was 6.8-7.0%.
- **Issues**: Drill-down -- 2.3% in red. 5.5% in blue. Still room for improvement.
    - Improvement would give upward pressure on wages.
- Underemployment--Positions that do not utilize skills to their capacity.
    - Many explanations for these situations, but of interest in our context are geographical constraints.
    - For example, since it is often harder to move if one owns a home than if one rents, homeownership may contribute to underemployment.



- As we reach full employment, we should see pressure for wages to increase.
    - Wages up 2.7% in last year. We have not hit 3% since recession.
    - However, there are frictions: Labor markets are local and many jobs in today's economy require very specific skills.
- United Way ALICE (Asset Limited, Income Constrained, Employed): While 16 million households live in poverty, more than twice that number earn "less than what it takes to survive in the modern economy."
- Many social scientists believe the increasing inequality is due to poverty traps:
    - The probability for children to attain higher incomes than their parents has dropped dramatically (Chetty et al. "Fading American Dream).
        - 90% of children born in 1940 would earn more than their parents but 50% of children born in the 1980s can expect to.
        - The likelihood of successive generations improving their lot in life has diminished
    - Consensus: the way to overcome this trap is through education.

Average hourly earnings for construction workers have been rising faster than inflation



- In 2006, there were 7.7 million construction workers
- In 2010, this fell to 5.5 million
- As of 2018, it has increased to 7.2 million
- Demand for housing is at levels not seen in 20 years (Source: NAHB/Wells)
- There is a **shortage** of construction workers:
  - 2.5% of construction jobs remain unfilled
  - Construction wages are rising steadily and hit $29.71/hr. in June
- Questions:
  - Infrastructure program? Disaster recovery? Immigration policy?

Note: CPI-U is the consumer price index for all urban consumers. **Source**: Bureau Labor Statistics

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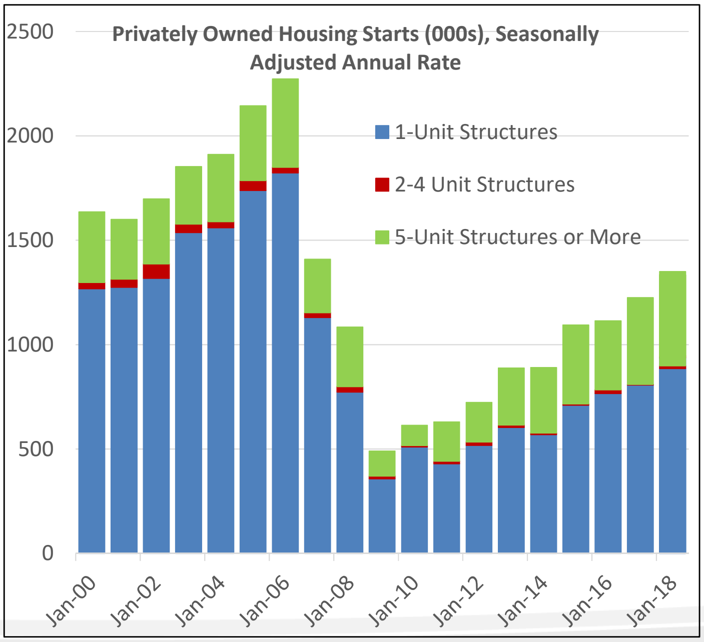
- **Housing Mkt Index:** Summarizes three aspects of housing demand: current mkt conditions for the sale of new homes, mkt conditions for the sale of new homes in the next 6 months, and the traffic of prospective new home buyers.
- **Foreign born workers** make up 17% of the overall workforce. Share of Hispanic workers among these is 48%.
  - Salaries lag those of comparable native workers ($715 vs. $860 median weekly wages).
  - Share of foreign born workers in construction is 37% (Source: Builder Online).

Given the shortage, how many units are being built?



- May starts: 1.35 million new units
  - Multifamily at 404,000
    - Average of 345,000 in 2017
  - This is 200,000 units below what is needed to satisfy demand (per NAR)
  - According to the Wall Street Journal, there is a national shortage of 7.3 mm units
- LIHTC:
  - 30% of multifamily starts in 2009-2011 (≈ 37k starts p.a.) (NAHB)
  - More recently, about 30k starts p.a. (≈ 8% multifamily total)

Source: Federal Reserve Bank of St. Louis

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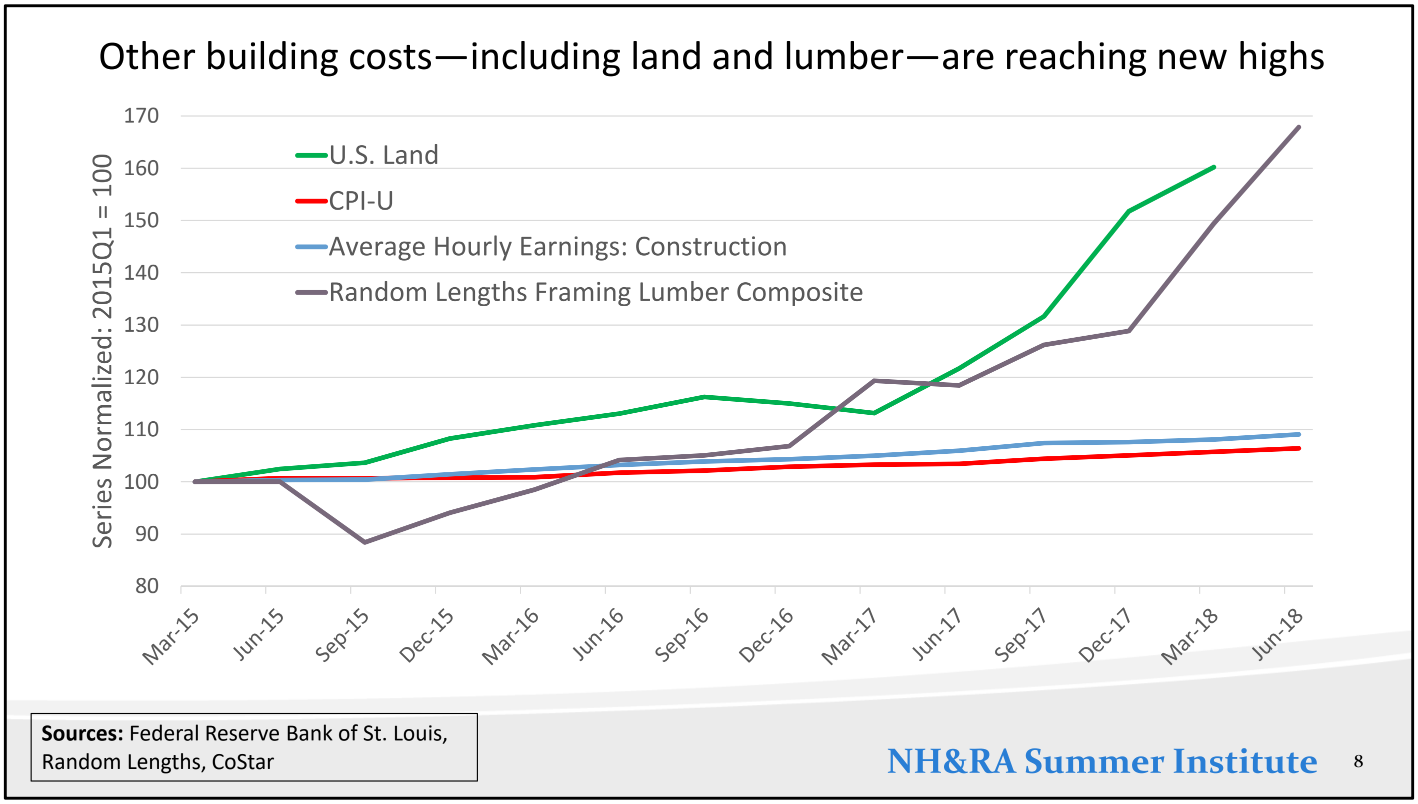
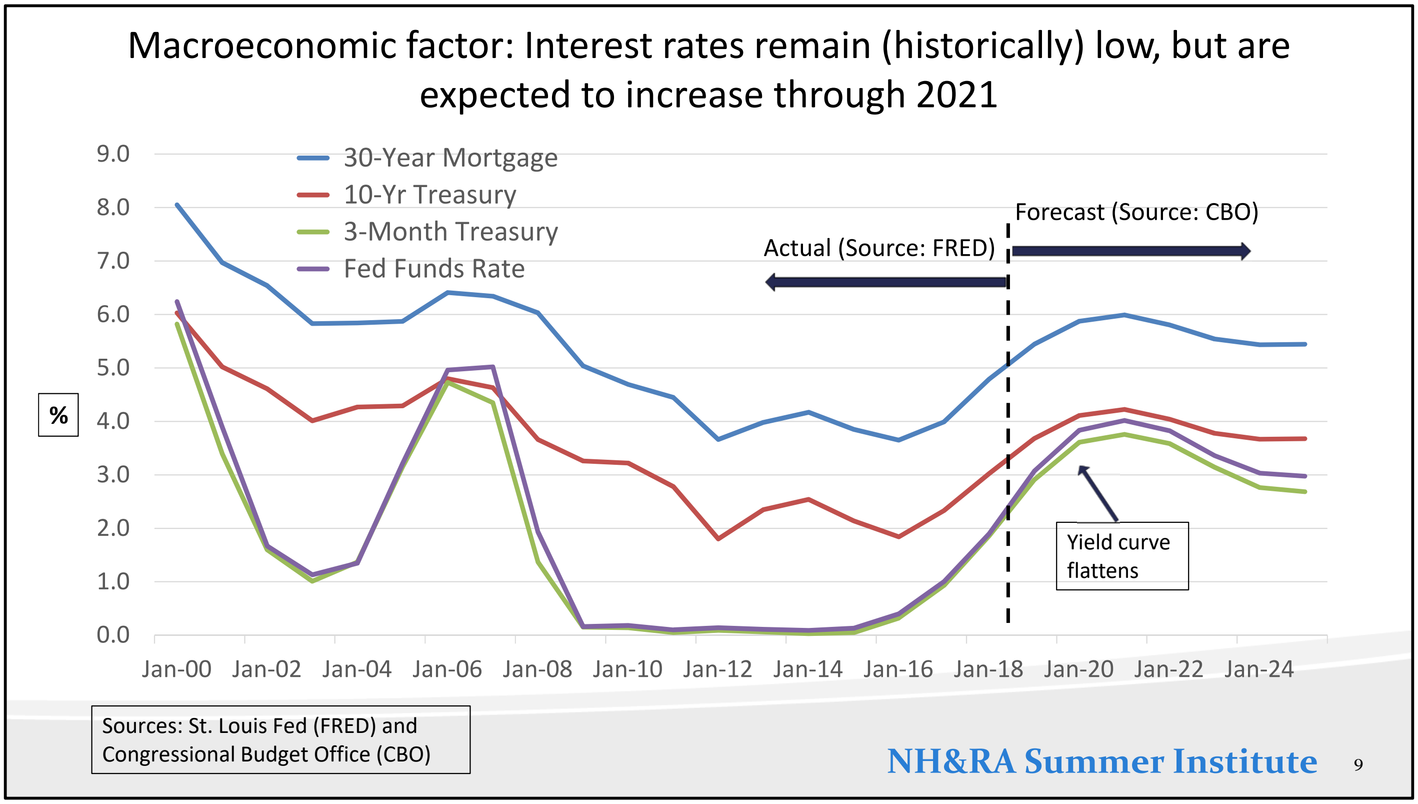
- Shortage of workers translates into shortage of units.
- LIHTC – note that this is starts (not rehabs).
  - Looking at the total numbers, in 2013 and 2014 there were approx. 100k units that were placed into service annually (NCSHA).
  - According to NAHB starts in 2011 and 2012 were approximately 35k.
  - Assuming a two year lag, we have approx a 35% new build rate.
- We will see that as construction costs increase, number of affordable units relative to allocations decreases.
- **Perspective:**
  - In San Francisco in 2000 it cost $265k per unit to build a 100-unit affordable housing building, accounting for inflation.
  - In 2016, a similar sized family building cost closer to $425k per unit, not taking into account other development costs (such as fees or the costs of capital) or changes in land values over this time period.

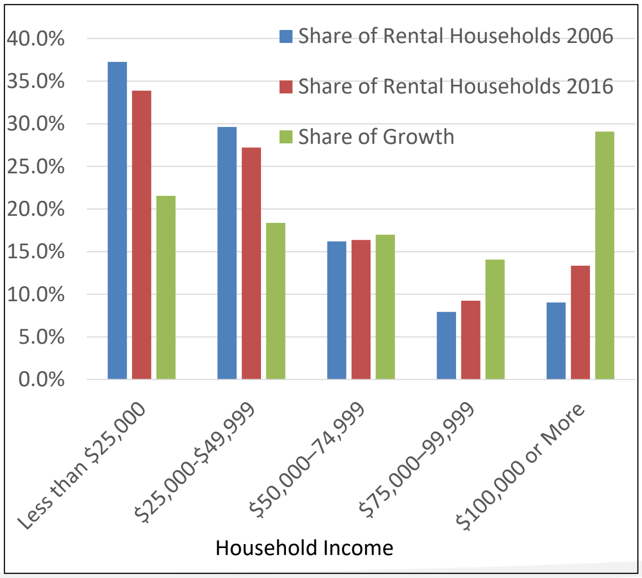


- According to RS Means, the cost of building a basic, 3-story apt building has increased by 8% from 2016-2017 alone.
- Vacant commercial land was up more than 80% in 2012-2017 (this is national, but is worrying is certain markets – is there a bubble or really high demand relative to inelastic supply?)
- **Lumber**: Tariffs on softwood Canadian lumber of almost 21% came after prices were up post the hurricanes in last 4 months of 2017.
  - Random Lengths framing lumber composite price for thousand board feet hit $502 in March and $564 in June (up from $398 a year earlier). Futures now reaching $600.
  - Lumber price increase since start 2017 has increased mkt value of SF unit by over $6000 and MF by $2400 (NAHB).
- **Regulatory Costs:** Big expense not on chart (at least directly), is the regulatory price increases. According to NAHB, these have gone up by 29% in the last 5 years.



- Fed Chairman Powell’s message: optimism spurred by improved data in recent months, continued data dependence with a close watch on inflation.
- Two additional rate increases expected this year.
- New CBO forecasts have rates increasing quicker due to faster growth. This through 2021.
    - The yield curve is also expected to flatten (but not invert—that signals a recession)
- Previously, were flat after increase. Now, with increased deficits and slower economy, CBO forecasts that rates will decrease after the initial increases.
- Things to remember:
    - Rates are still low
    - The Fed has ≈ $4 trillion of securities on its balance sheet from QE. Starting to deleverage
    - Deficits will increase in the short run due to tax changes
    - As US debt increases, rates should increase.

Additional units are increasingly being built for higher end income renters:
This is in part due to rising development costs with land and construction costs increasing faster than inflation



Metropolitan Statistical Area	Share of Growth 2006-2016 (by Household Income)				
	Under $25,000	$25,000-$49,999	$50,000-$74,999	$75,000-$99,999	$100,000 or More
United States	22%	19%	18%	13%	29%
Atlanta	23%	19%	22%	15%	21%
Baltimore	22%	-5%	19%	10%	54%
Boston	13%	2%	7%	16%	61%
Chicago	21%	15%	15%	14%	35%
Las Vegas	41%	28%	11%	7%	13%
Los Angeles	27%	7%	15%	9%	42%
New York	9%	15%	1%	11%	65%
Philadelphia	22%	21%	11%	15%	30%
Pittsburgh	-60%	42%	42%	36%	40%
San Francisco	1%	-4%	0%	11%	93%
Seattle	2%	3%	18%	25%	51%
Washington, DC	22%	6%	10%	14%	48%

Source: JCHS

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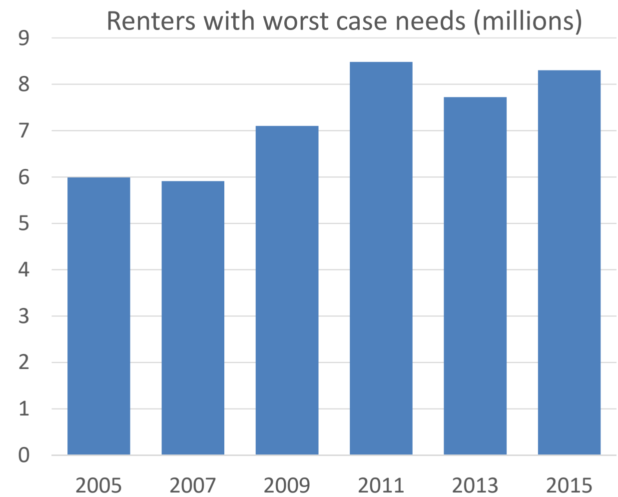
- Almost 30% of growth from wealthier households who could have possibly bought if they had wanted.
    - Represents almost 3 mm new renter households.
- 40% of new rentals in 2016 have rents greater than $1500/month (vs. 15% in 2001).
- New rentals for < $850/month fell from 42% to 18% over the same period (all in real $).

The availability of housing assistance continues to lag the growth of very low-income renters



Income Category	Rental Units per 100 Renters 2011	2013	2015
Extremely low-income renters (0-30% AMI)			
Affordable	58.2	65.3	66.0
Affordable and available	35.8	39.0	37.9
Very low-income renters (0-50% AMI)			
Affordable	92.4	97.2	92.9
Affordable and available	64.6	65.2	62.0

Note: Worst Case Needs: Renters with v. low incomes who don't receive govt housing assistance and who pay > ½ of their income for rent, live in severely inadequate conditions, or both.
Source: HUD Worst Case Needs 2017 Report to Congress.

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- **Graph**: In 2015 Worst Case Needs reached 8.3 mm.
  - Up 39% from 6.0 mm in 2005.
  - Between 2013-15, there were an additional 582,000 cases.
- The share of very low-income households receiving rental assistance fell from 28% to 25% between 2001 and 2015
- **Table**:
  - *Affordability* is 30% rent to income (is hypothetical in that it includes vacant and occupied stock).
  - *Availability* measures the extent to which affordable rental housing units are available to renters within a particular income range.
- Nationally, there are only 62 affordable and available units for every 100 VLI renters
- If we include "Adequate" (i.e., factoring in the physical condition of the apartments), there are only 54 affordable and available units for every 100 VLI renters and 33 for ELI renters.

Are we building enough LIHTC units to overcome this shortage?

Units in Service

- From 1987 through 2016, 3.05 million units placed into service in 47,000 communities (Source: HUD)
- 2.46 million units remained in service (Source: 2017 Preservation Database)

+ New Units Added

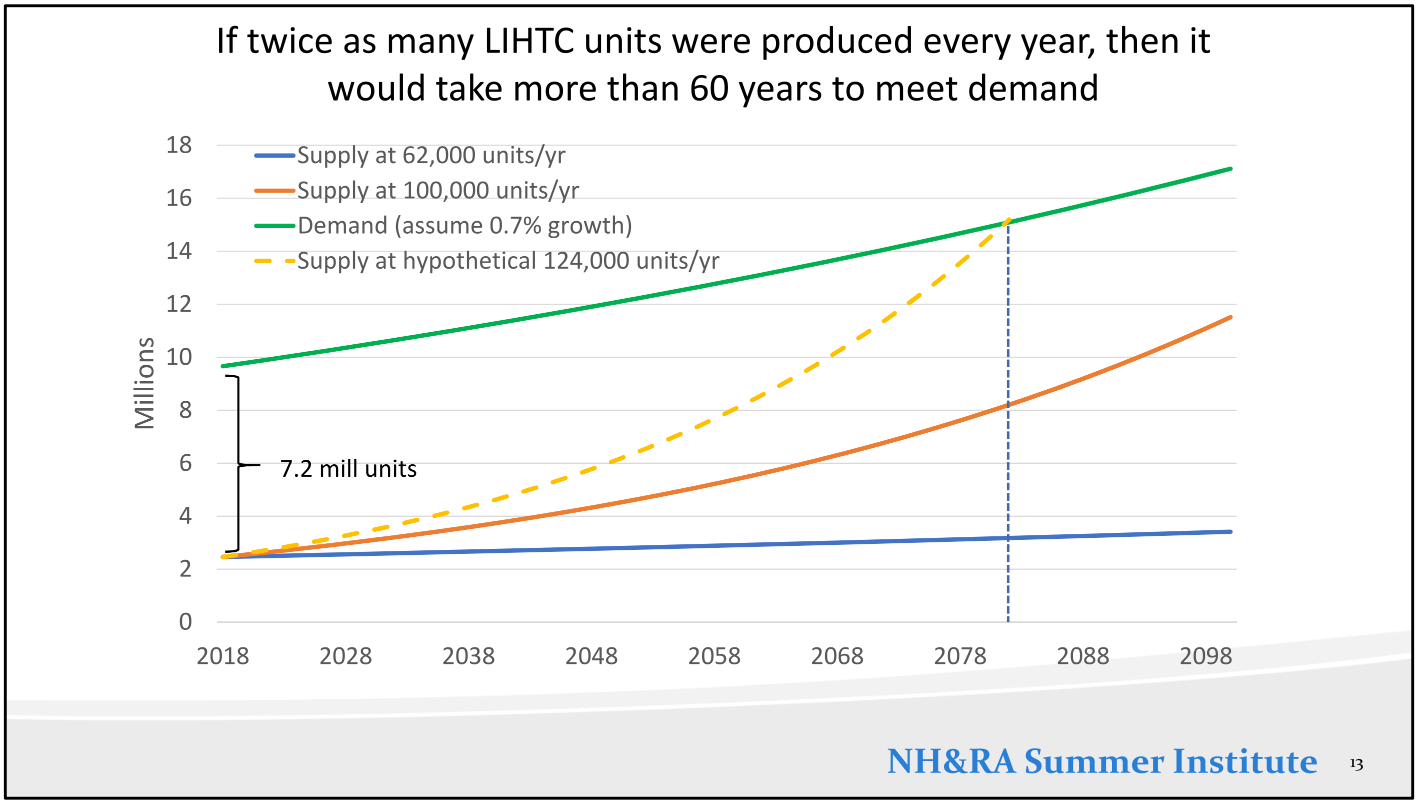
- From 1995 to 2016, an average of 109,000 units added each year
- This pace slowed down to 62,000 per year in 2013-2015 (Source: HUD)

− Units Exiting

- Between 2018 and 2022, 120,000 units per year have expiring affordability restrictions and are eligible to leave the program (Source: Fannie Mae)
- However, not all units will exit. Assume 53,000 units exit per annum (Source: JCHS 2018)

= Net Growth

- Assuming 62,000 units added and 53,000 units exit annually
- This gives an annual growth in units of 9,000 (= 0.4%)
- If 100,000 units added, annual growth will be 47,000 units (= 1.9%)



- The U.S. has a shortage of more than 7.2 million rental homes affordable and available to very low-income renter households (NLIHC 2018 GAP Report)
- If annual LIHTC unit net growth was 1.9% (i.e., 100,000 units added per annum), then it would take over 110 years to close the gap
- Even if LIHTC unit net growth was 2.9%, then it would take 60 years to meet the demand
- At the current 0.4% net growth, the shortage intensifies