A Need, A Want, A Leveraged Asset: Four Years After the Great Recession

Housing Washington 2013
Spokane, Washington
October 8, 2013
John W. Mitchell

Housing Excitement

- Long Lasting Asset–Providing a Stream of Services
- Needs Long Term Financing–What Form will this take?
- Asset at the Vortex of The Great Recession
- Record Housing Affordability in 2012
- 53% Increase in Real House Prices between 1996 and 2006 followed by a 28 percent decline between 2006–2011 (Glaeser)
- Tax Favored
- A Different World than A Decade Ago

- Objective: Economic Context –Risks, Issues

- Edward Glaeser: ***A Nation of Gamblers: Real Estate Speculation and American History*** (2013)
- "America has always been a nation of real estate speculators." Examples going back to the 1700s
- Optimistic Expectations Crucial–Booms End when they Fail to Materialize

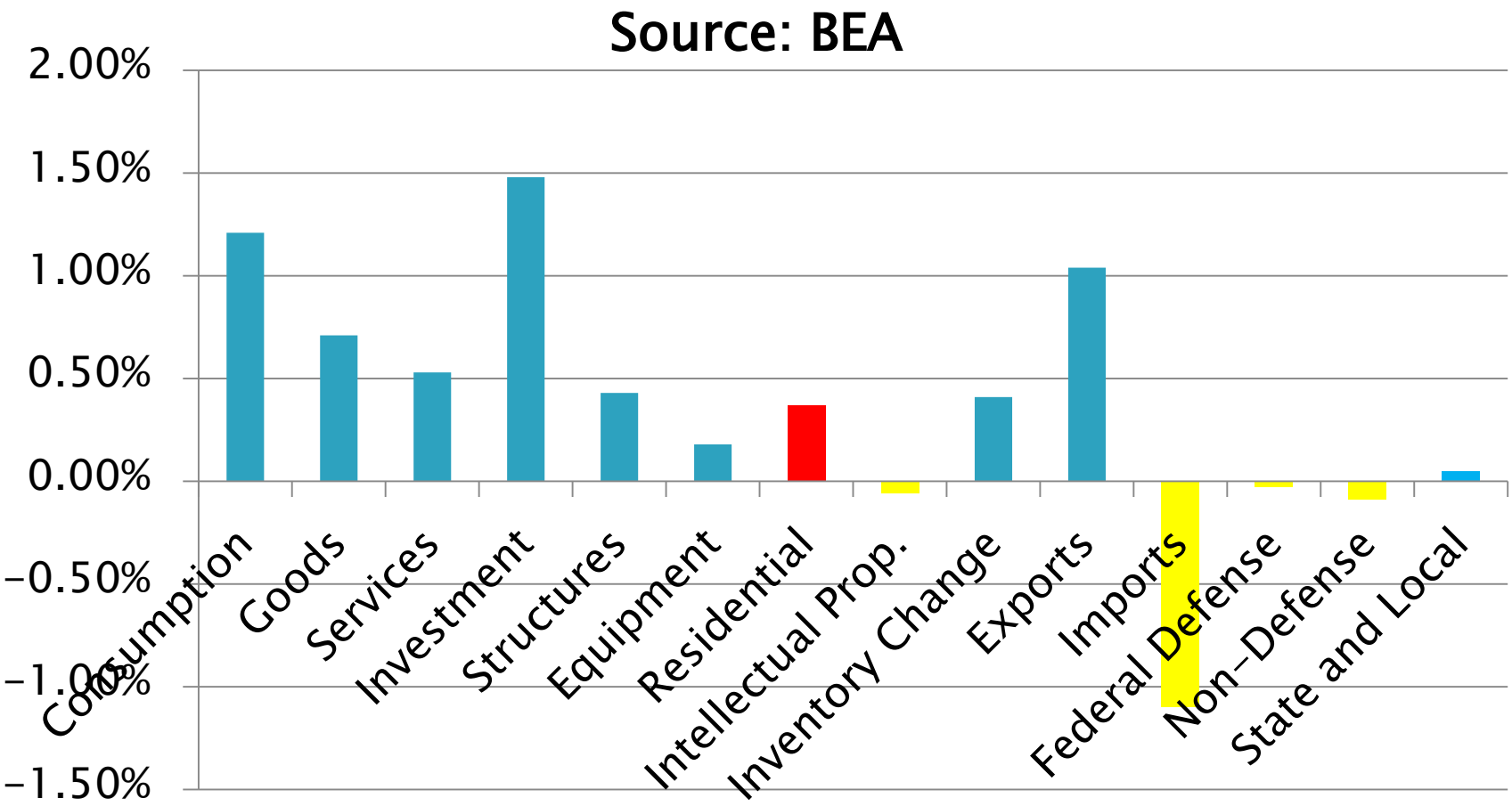
October, 2013

- 5th Year of Upturn–Half Speed Experience
- 1.92 Million Jobs Below Most Recent Peak
- New Fiscal Year–No Budget/Debt Ceiling–Shutdown
- Confidence Inspiring NOT
- 8 Days into Exchanges
- Washington One of the Strongest Performing States
- Net Worth at Nominal Highs–Up $1.3 Trillion in Q2
- Largest Municipal Bankruptcy in US History
- Monetary Policy Uncertainty–New Cast Coming
- Minimal Inflationary Pressure

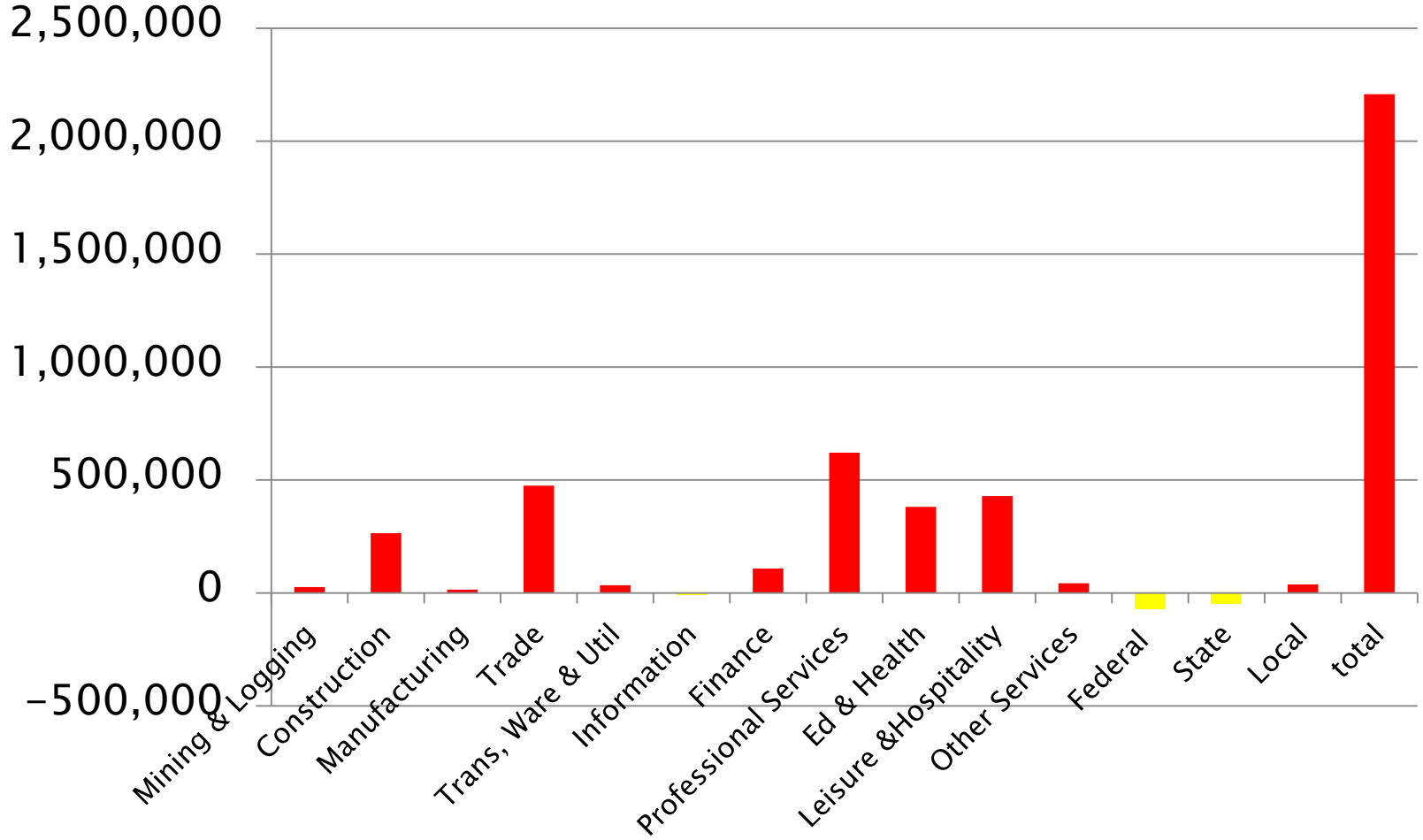
Revised Real GDP Commerce Department (SAAR,%)

	Q3 12	Q4 12	Q1 13	Q2 13
GDP	2.8	.1	1.1	2.5
Consumption	1.7	1.7	2.3	1.8
Equipment	-3.9	8.9	1.6	3.3
Intellectual Property	*2.8*	*5.7*	*3.7*	*-1.5*
Non-Res Structures	5.9	17.6	-25.7	17.6
Residential	14.1	19.8	12.5	14.2
Federal	8.9	-13.9	-8.4	-1.6
State and Local	-.2	-1	-1.3	.4
Exports	.4	1.1	-1.3	8
Imports	.5	-3.1	.6	6.9

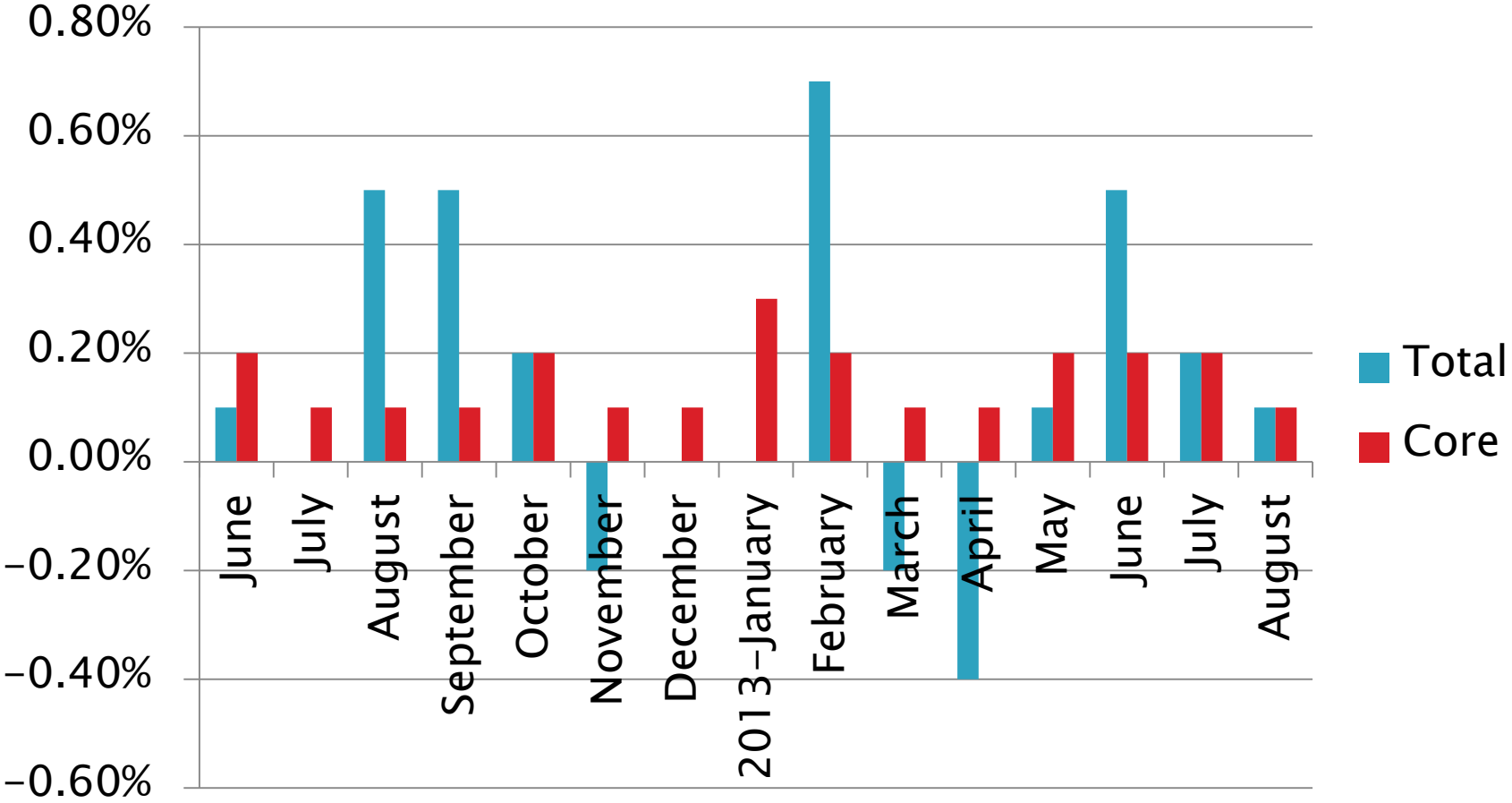
Contributions to GDP Growth Q2 2013



Annual Job Change August, 2012-August, 2013 (1.7%)



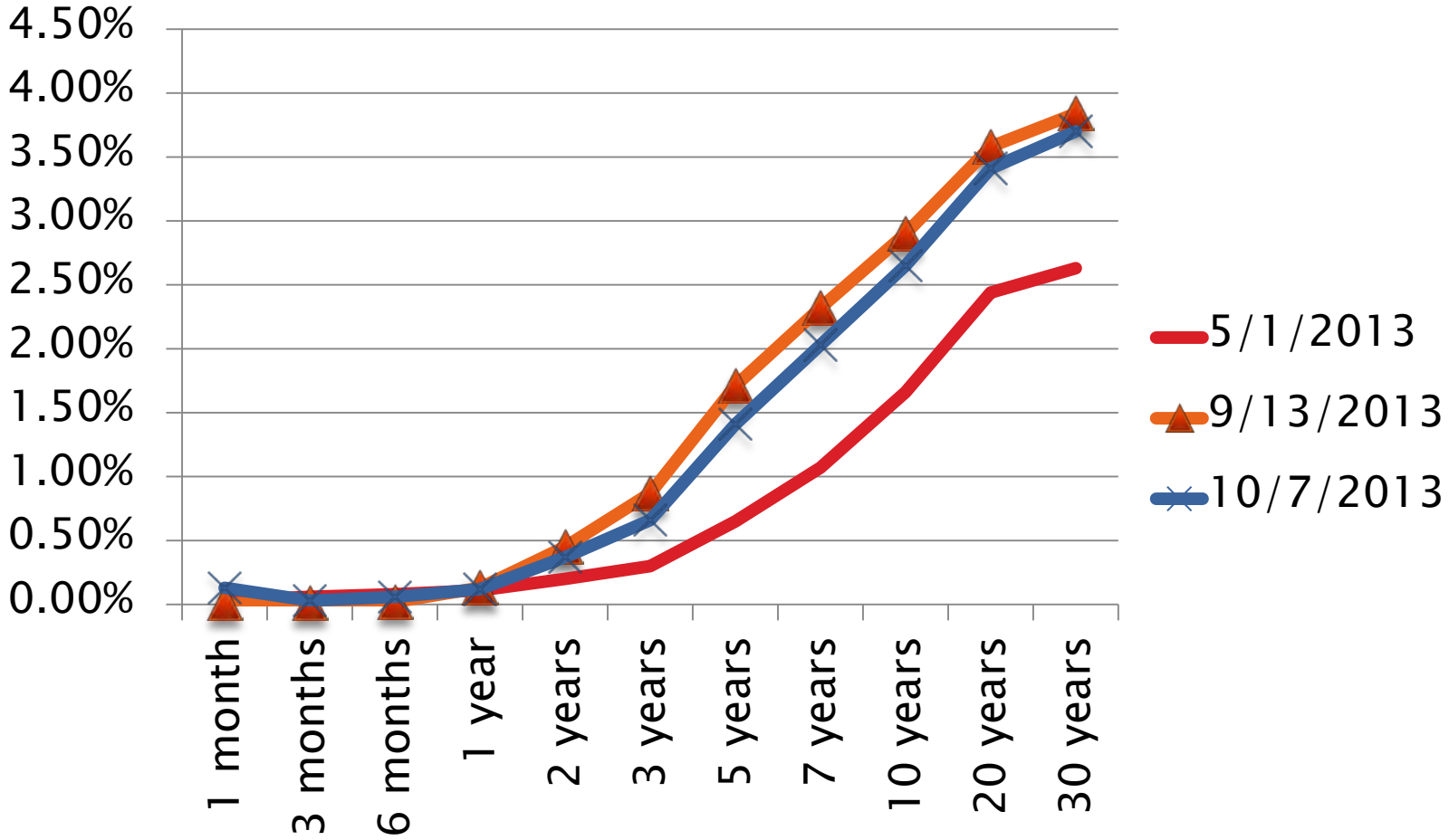
Inflation August, 2012 to August, 2013 Total 1.5%, Core 1.8% Source: BLS



Inflation

- Below the Fed's Target
- Employment Cost Index June 2013-Private Sector 1.9% Wages and Benefits Public Sector 1.8% Wages 1% and Benefits 3.3%
- Unit Labor Costs-Business Sector Q2 1.6%
- Core PC Deflator up 1.2% August to August

Interest Rates
Source: US Treasury



Rates

- “Never in recent economic history have interest rates been so low for so many for so long.” Economist 4/6/13
- What changed since May 1, 2013?
- Conventional Mortgage Week Ending 10/4 4.22% in the Week Ending 5/3 3.35%

Prospects

- Consensus Moving from 1.6% in 2013 to 2.6% in 2014
- Fed 2013 GDP 2-2.3% and 2.9-3.1% in 2014
- Inflation Staying Below 2% Through 2014
- Federal Funds Rate Target 0-.25% until 2015
- Long Rates Already Moved
- What do the numbers imply?

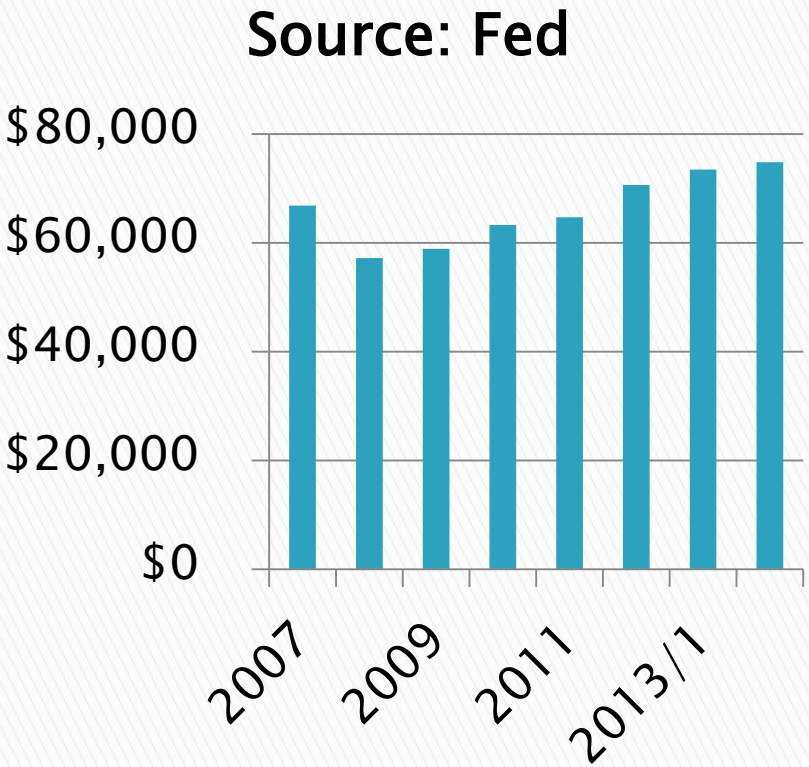
- Fiscal Policy
- FEAR of Monetary Shifts
- Real Wealth Loss
- Global Shocks
- Uncertainty
- Diminished Confidence
- Quelled Animal Spirits
- Aging Population

Headwinds

- Rising Income and Employment
- Housing Upturn
- Stock and House Prices
- Balance Sheet Health
- Monetary Policy
- Diminished Drag–State and Local Sectors
- Hydraulic Fracking
- Credit Standards Easing
- Europe/China Stabilizing

Tailwinds

Net Worth of Households and Non-Profits

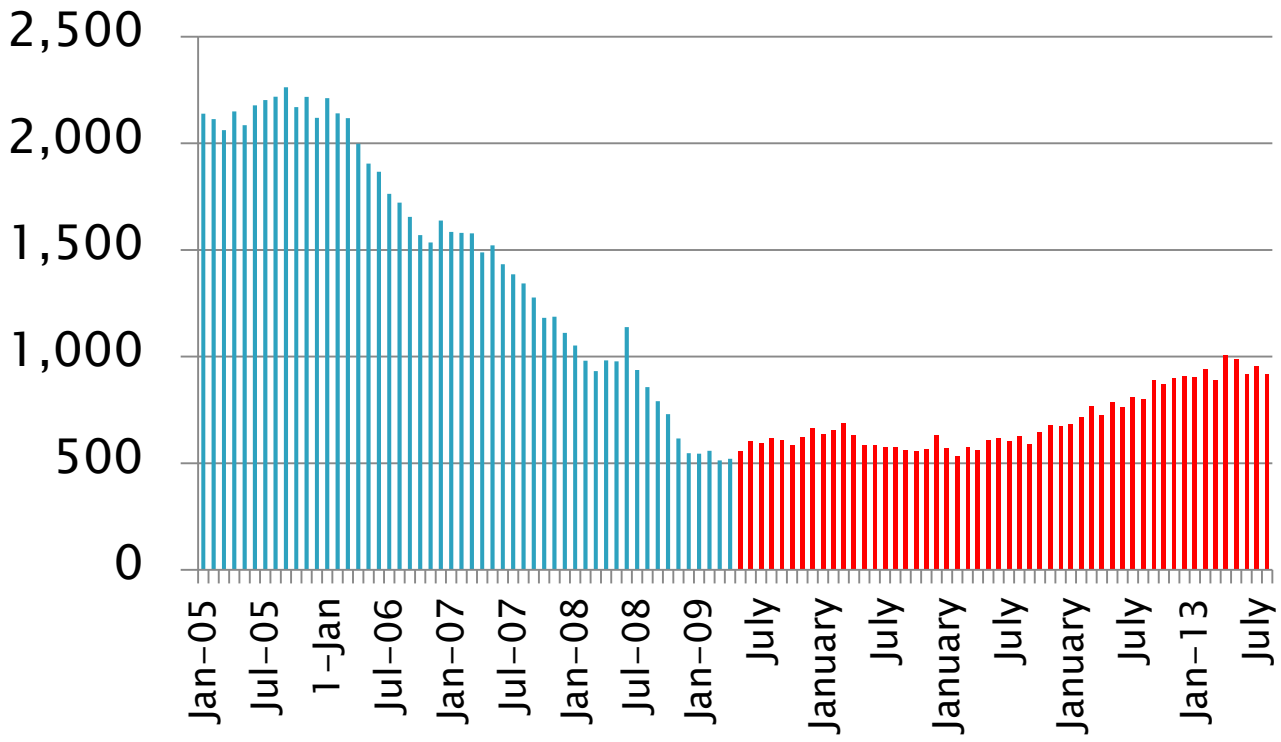


- Q2 45% of Gains from Real Estate 16.8% from Equities and Mutual Funds (Fed)
- As of Q1 adjusted for inflation and household numbers about 63% of Wealth Loss Recovered

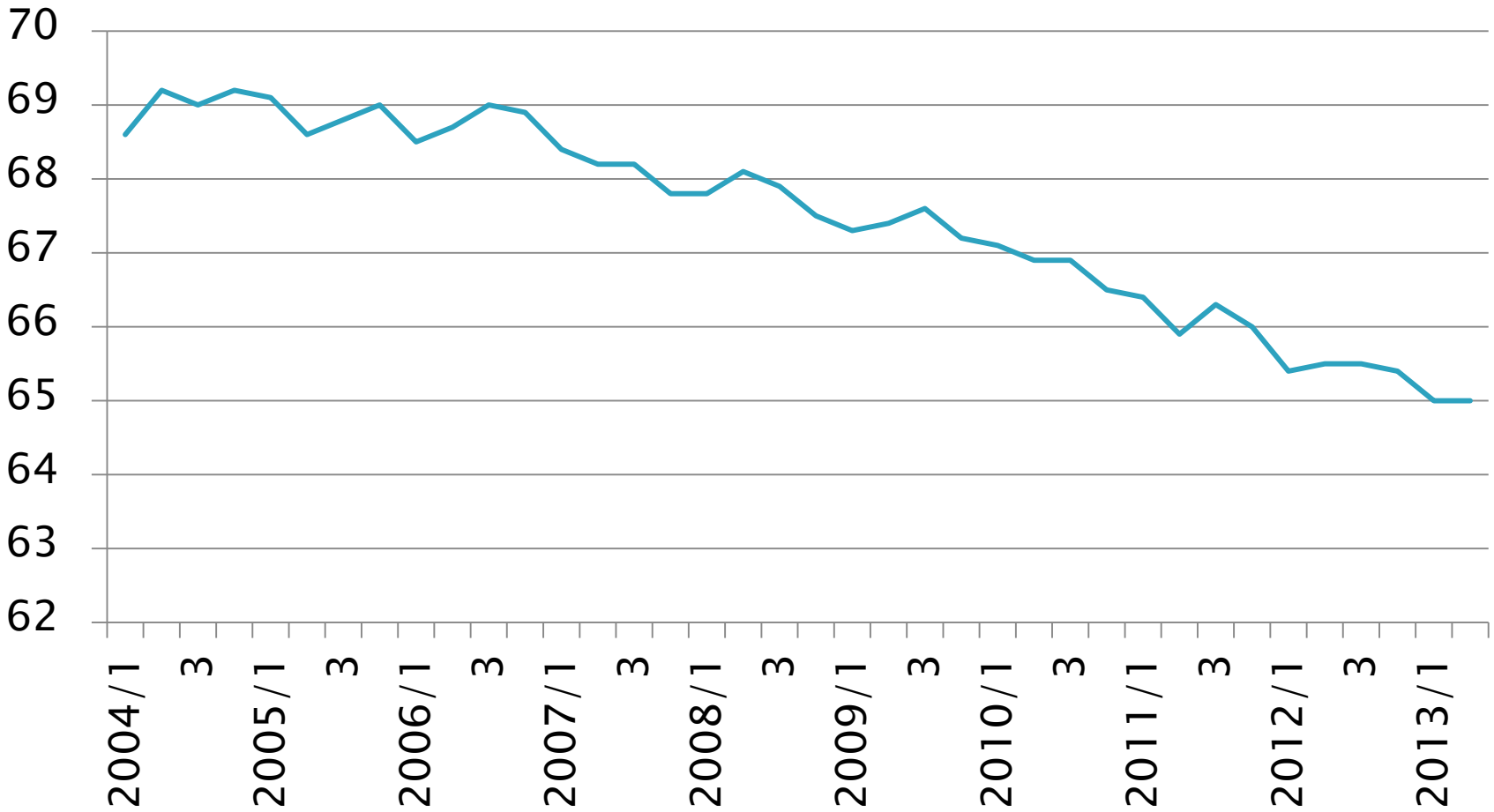
(Billions) $74.8 Trillion in Q2

Center for Household Financial Stability Q1

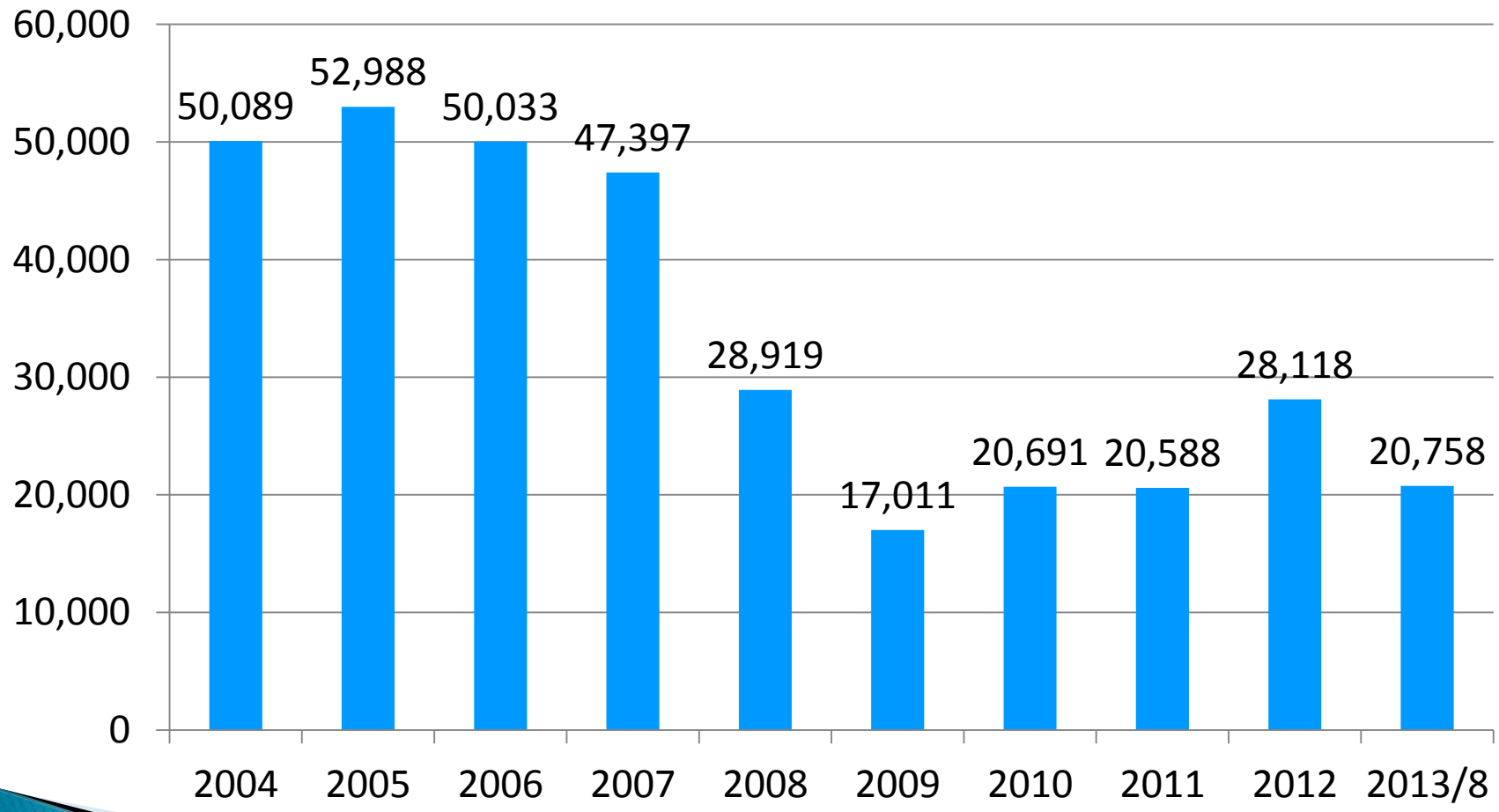
Residential Permits (SAAR) Census Bureau 2005-2013
Up 21.2% to August 2013



Homeownership Rate % Census



Residential Permits 2004 to 2013
Washington (Up 36.6% in 2012)
Source: Census



FHFA Q2 2013 House Price Index Metro Areas All Transactions

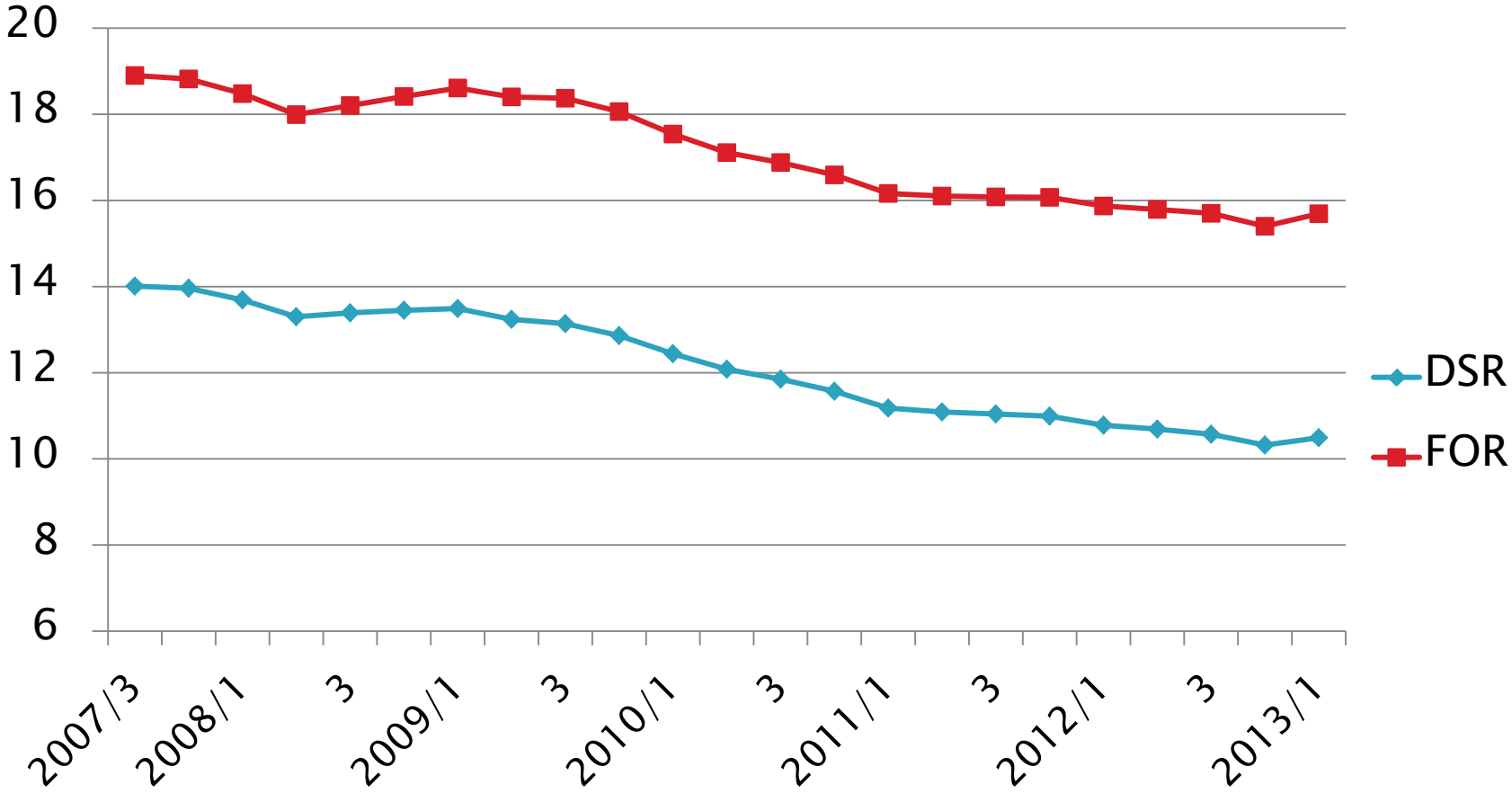
	1 Year %	5 Years %
Bellingham	3.41%	-12.96%
Bremerton	1.12%	-22.92%
Kennewick	1.44%	5.26%
Longview	2.42%	-23.80%
Mount Vernon	-.39%	-24.26%
Olympia	-.24%	-21.87%
Seattle	8.26%	-17.66%

Spokane	1.43%	-17.29%
Tacoma	3.43%	-27.18%
Wenatchee	1.69%	-16.66%
Yakima	.41%	-6.37%

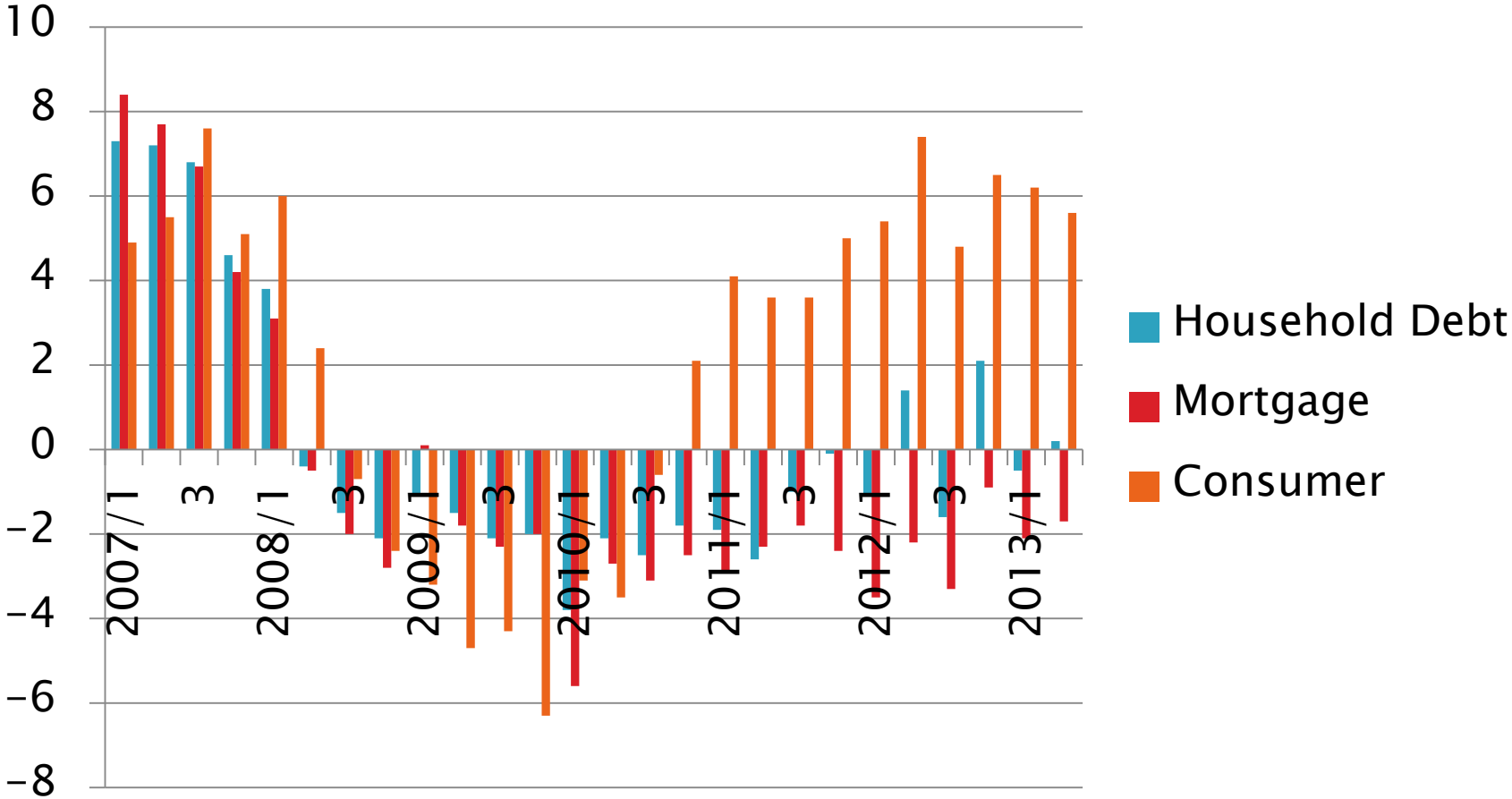
Source: FHFA

- Affordability Down from Record Levels in July NAR 157.8 in 2012 was 193.9-Pre Boom Decade 134
- Washington Affordability Index Q2 166.6 WCRER
- Rising Rates and Prices Not Likely to Stop Rebound-Might Think of this as a Return to Normalcy
- 10% of Washington Homeowners with Mortgages Underwater
- In Q2 2.5 Million Homeowners Moved to Positive Equity
- Tighter Credit Standards
- Deferred Household Formation During Recession
- Rising Employment
- The Dynamic Has Changed-Rising Rates and Prices

Debt Service and Financial Obligations Ratios
Source: Fed

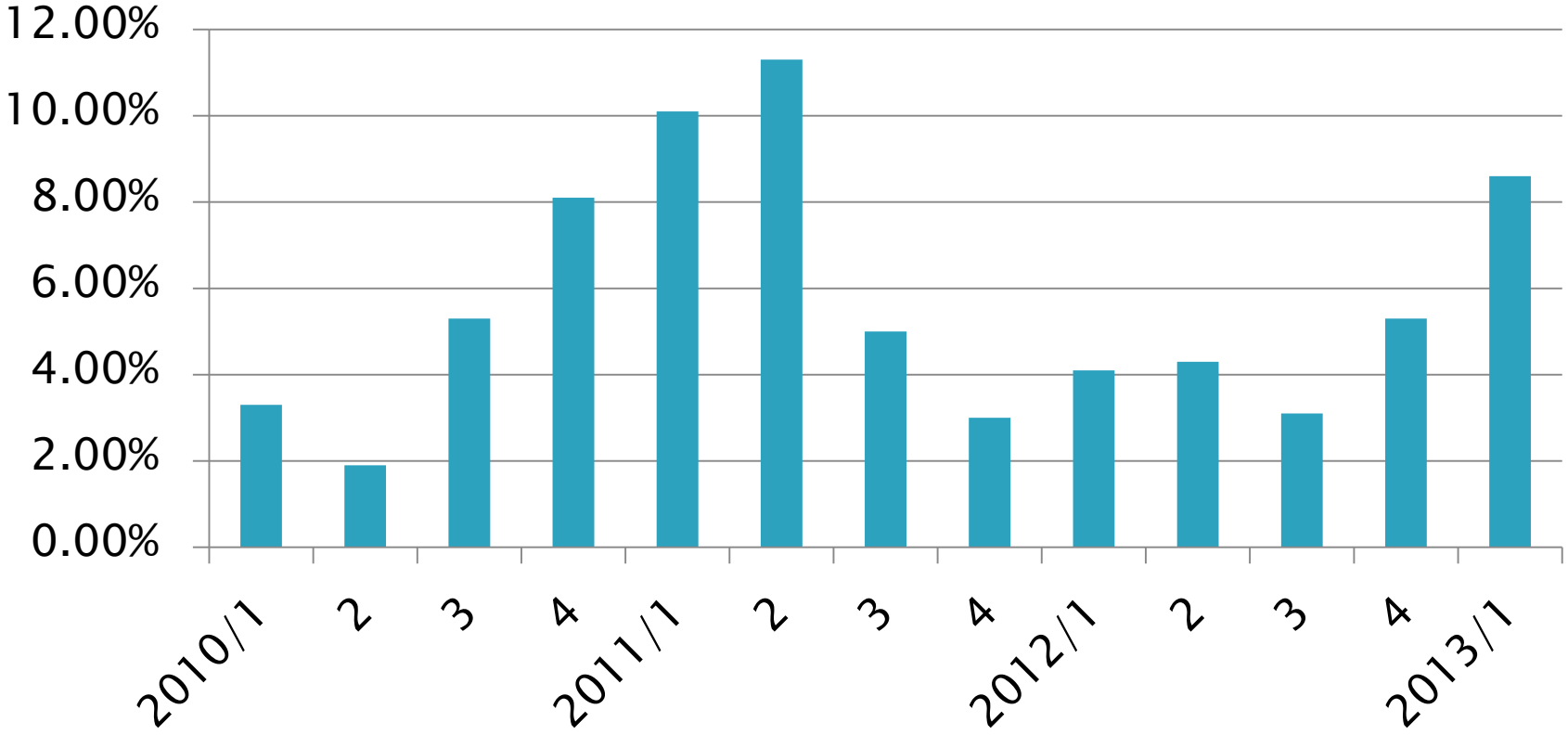


Debt Growth at SA Annual Rates
Source: Fed



Year Over Year Change in State Tax Revenues

Source: Rockefeller Institute

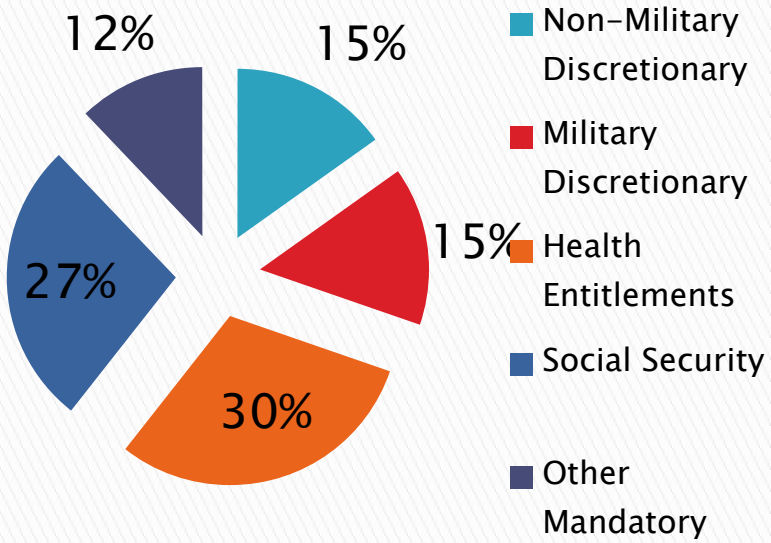


Fiscal Policy

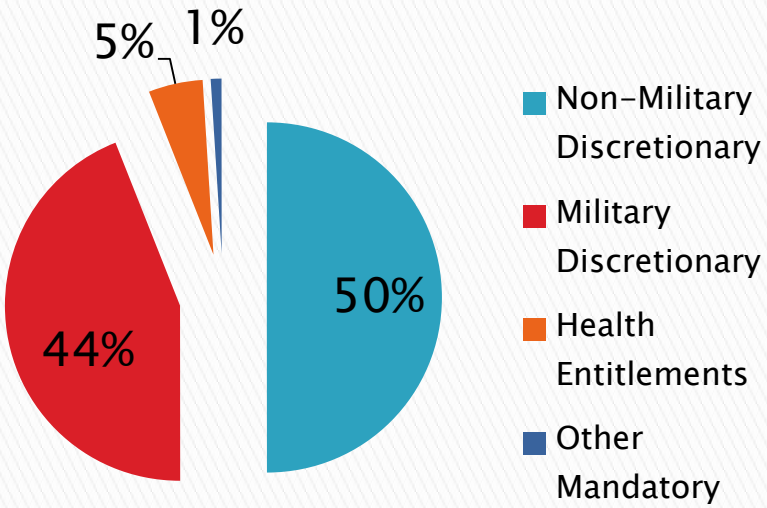
- Deficit Estimates Falling
- Another CBO Warning
- January Cliff–Payroll Tax Holiday Over, New Medicare Taxes, Some Tax Cuts Expired, Deduction Phase Out, Sequester Delayed and Implemented–A Current Drag
- Looming Debt Ceiling Issue Perhaps This Month as well as NO 2014 Budget and Shutdown

Another Approach
Sequester as a Preview

Spending 2014-2023



Cuts 2014-2023



CBO, Center on Budget and Priorities, Committee for Responsible Federal Budget NYT

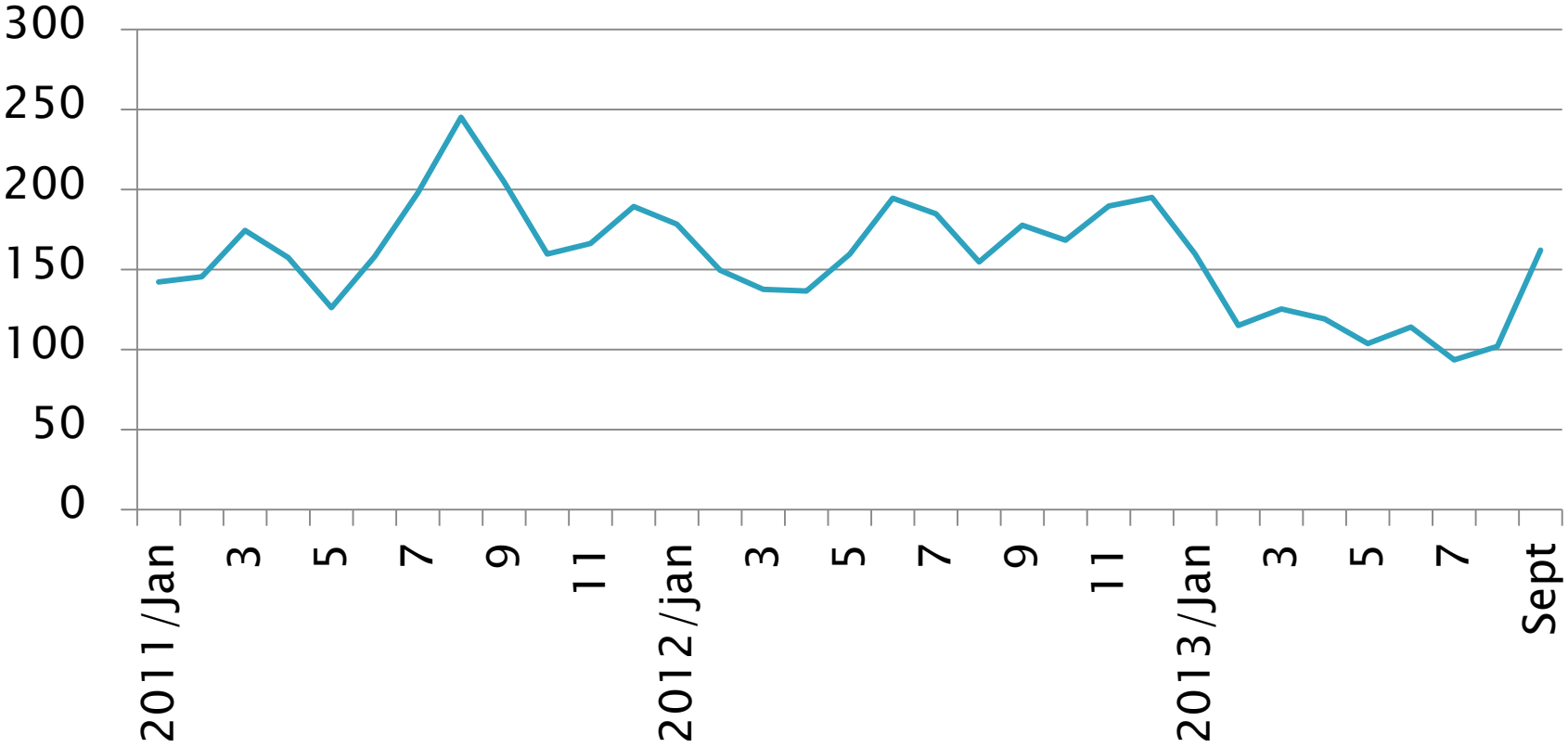
Appropriations, Control Act 2011, Fiscal Cliff and Sequesters

Tax Expenditures CBO 2013

Exclusions	
Employer Sponsored Health Ins.	$248 Billion
Pension Contributions/Earnings	$137
Capital Gains at Death	$43
Portion of SS and Rail Retirement	$33
Deductions	
State and Local Taxes	***$77***
Mortgage Interest	***$70***
Charitable Contributions	$39
Preferential Capital Gains and Dividends Rates	$161

Policy Uncertainty Index

Source: Baker, Bloom, Davis



Monetary Policy

" Economic policy mistakes were the primary cause of the Great Depression." Ben Bernanke

- Fed is Buying $45 Billion of Treasuries Per Month with Maturities from 4 Years to 30 Years and $40 Billion Mortgage-Backed Securities per month :Total $85 Billion Per Month
- Exceptionally low rates as long as *unemployment remains above 6.5% , inflation between one and two years ahead is projected to be no more than .5 point above the Committee's 2% longer run goal and long term inflation expectations continue to be well anchored. (12/12/12) , (1/30/2013) , (3/20/ 2013) (5/1/2013), (6/19/2013) , (7/31/2013) and (9/18/2013)*
- *"asset purchases are not a preset course" (9/18/2013)*
- *There are TWO aspects to Policy-Fed Funds Target and Long Term Asset Purchases*
- *In 2013 if Current Policy Continues Fed will buy about equivalent of ¾ of New Federal Borrowing*

- Tapering- When will this begin? Awaiting More Evidence!
- New Cast of Characters
- William McChesney Martin-Fed Chairman 1951-1970
- Independence ?
- Things that Go Down Can Go Up
- Generational Shock: 1981 the 10 Year was 13.92% in 2012 1.8%

Job Growth Update August 2013 Data–Year over Year Change–49 States Up

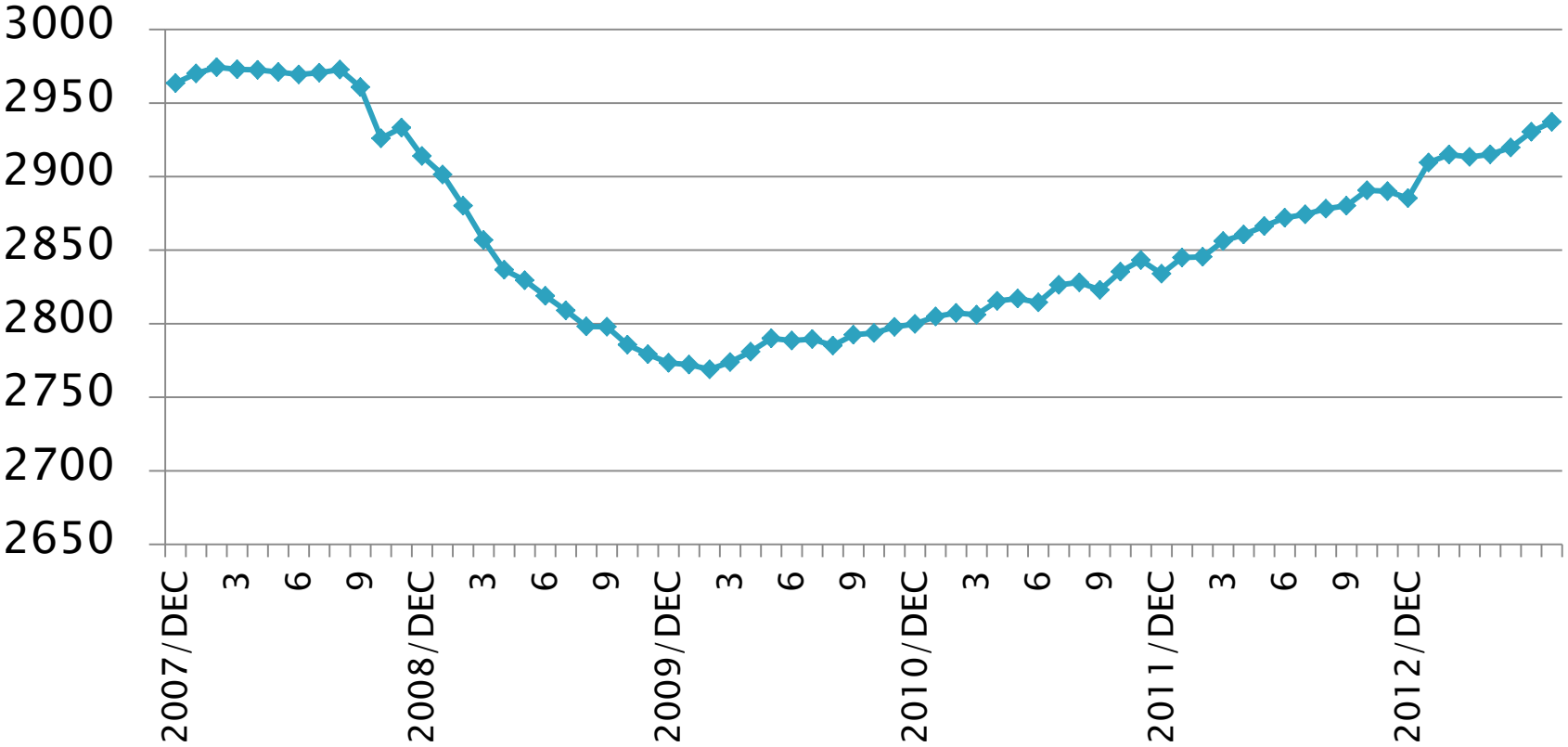
- **North Dakota 1**
- Utah 2
- Idaho 3
- Texas 4
- Minnesota 5
- Colorado 6
- ***Washington 7***
- Georgia 8
- New Jersey
- Arizona 10
- Nevada 11
- South Dakota
- Louisiana 13
- South Carolina 14
- Delaware 15
- Massachusetts 16
- Wisconsin 17
- Florida 18
- North Carolina 19
- Maryland 20
- Mississippi 21
- Michigan 22
- Oregon 23
- Indiana 24
- Montana 25
- Vermont 26
- California 27
- New York 28
- Tennessee 29
- Wyoming 30
- Nebraska 33
- Ohio 44
- West Virginia 45
- Rhode Island 46
- Hawaii 47
- Oklahoma 48
- Alabama 49
- **Alaska 50**

Recent Washington Data

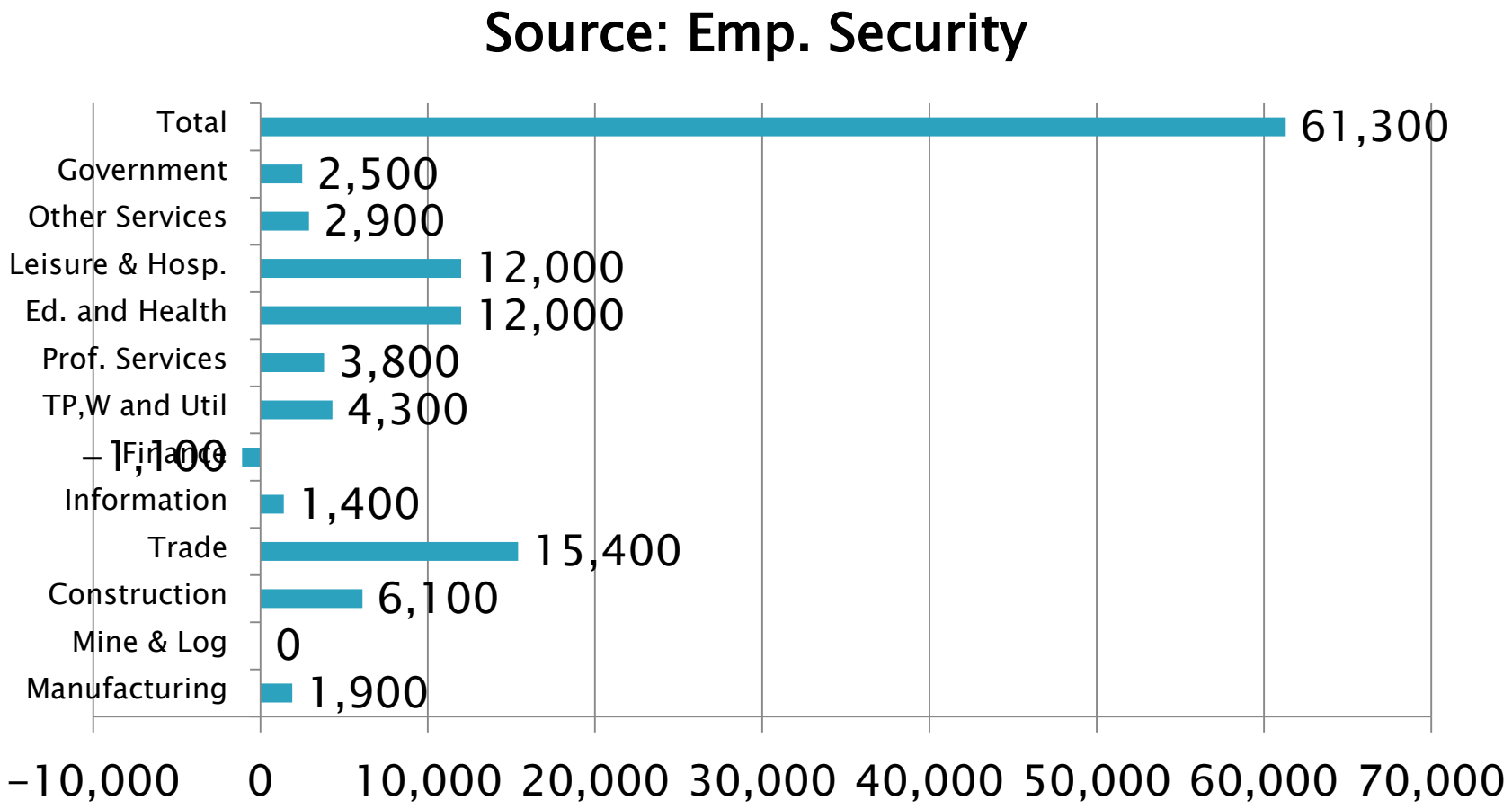
- Personal Income in Q2 up .9% after falling .9% in Q1 and increasing 2.7% in Q4 (Those Incentives Again!)
- Real GDP in 2012 in Washington 3.6%- 4th in the Nation
- Brookings Metro Monitor- Seattle-Tacoma-Bellevue 18th in the Top 100 Metros- Trough to Q1 2013

Washington Wage and Salary Employment (SA ,000)

Source: Emp. Security



Washington Job Growth Year to August 2013 (2.4%)



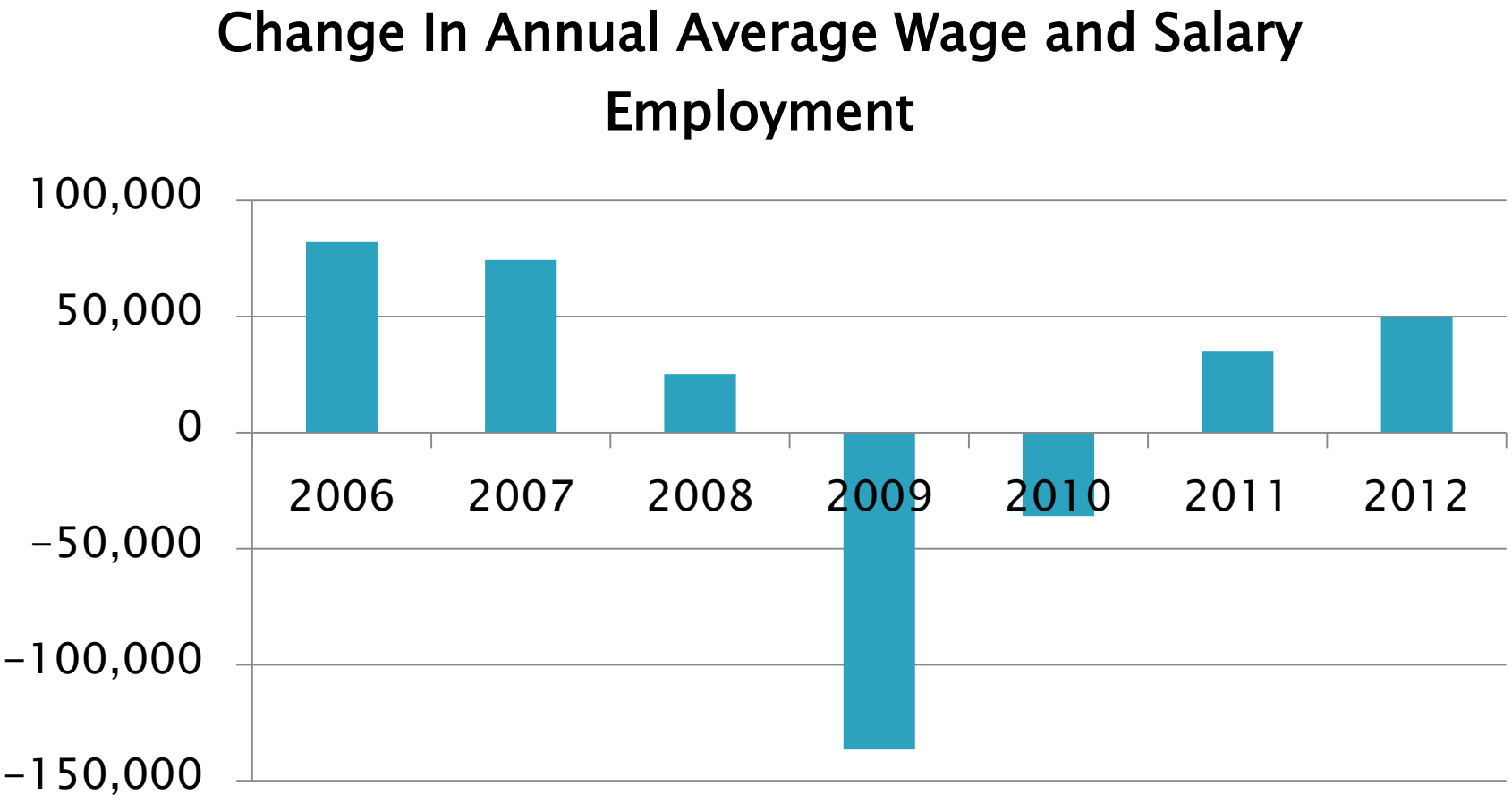
Job Growth Year to August 2013 Metro Areas

Bellingham	600	.8%
Bremerton	-1,100	-1.3%
Kennewick	-500	-.5%
Longview	-800	-2.2%
Mount Vernon	0	0
Olympia	100	.1%
Seattle	40,500	2.9%

Spokane	6,900	3.4%
Tacoma	5,000	1.9%
Wenatchee	200	.5%
Yakima	200	.3%%

Source: Employment Security

WASHINGTON
Source: Employment Security



Homo Economicus

- Economists Believe Incentives Matter
- How will individual decision makers act as we move through the rest of this year and into 2014 and what are the legacies of the Great Recession and in your case The Great Housing Convulsion?

Homeownership Rates 2007/4 and 2013/2 by Age

	Under 35	35-44	45-54	55-64	65 PLUS
2007/4	41%	67.2%	75.1%	80.4%	80.3%
2013/2	36.7%	60.3%	70.9%	76.7%	80.9%
Source: Census					

Renting- Buying-Financing

- Tighter Credit Standards
- The Young-Weak Income Growth, College Debt, Burden of the New Healthcare System
- A Generation Watched the Volatility
- Confidence
- Tax Preferences Still There: 73% of Mortgage Interest Value to top 20%: Simpson Bowles 12% non-refundable tax credit to all taxpayers-Mortgage Capped at $500,000-No Second Homes
- What will the Housing Finance System look like down the road?

Washington Spring 2013-Lowest Apartment Vacancy Rate in a Decade (WCRER)

The Background Experiments

- ACA to deal with the Access/ Equity Issue
- Part Time/Full Time
- Entrepreneurial Activity
- Mandate Behavior-Wither The Young?
- Link Between Employment and Insurance
- A New Shopping Experience?
- Pricing and Funds for Housing?
- Cost Pressures for Government Squeeze Other Spending? (Including Housing)

- What will tapering do to interest rates and when?

Before You Drift Off Tonight

- 36% of 18-31 Year Olds Live at Home up from 32% Pre Recession and 34% in 2009- Pew
- Median Weekly Earnings 20-24 Year Olds -6.9% 2007-12 16-19 Year Olds -4.6% Labor Dept.
- First Decade's Importance for Earnings
- Brookings Jobs Gap May 2013 Washington 266,000 Employment to Population Ratio 64.9 in 11/2007 now 60