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THIS MONTH

IN CONSTRUCTION SUPPLY

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A handwritten signature in black ink, appearing to read 'Greg Brooks'.

Greg Brooks, editor | 303 845 4880 | Greg@cs24.us

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THIS MONTH

IN CONSTRUCTION SUPPLY

JUL 2010

STALKED BY SHADOW INVENTORY



By Greg Brooks. Getting sore from all this bouncing along the bottom? You're not alone and it's not over yet. It wouldn't be so bad if the numbers just rose and fell each month. Some people think we need drama, though.

For example, the [Washington Post](#) declared that June retail sales "flopped" even though they fell just 0.5%. 2Q GDP grew 2.4% and the [L.A. Times](#) headline read, "Steep decline in GDP growth raises alarms." Steep? Only because 1Q

GDP was revised *up* a full point, from 2.7% to 3.7%. The Times may be alarmed; [Wall Street](#) and [economists](#) weren't.

[MarketWatch](#) apparently misplaced its thesaurus: "Consumer sentiment plummeted in early July." Not to be left out, though, MW noted that "the drop of 9.5 points compares with the drop of 9.7 points following the terror attacks of September 11, 2001."

It does. It also compares with the 9.4 point drop in February 2004 and the 12.2 point drop in September 2005, when nothing happened.

In housing, [NPR](#) reported that annualized existing home sales "slumped" 5%. True, but actual sales rose 7.2% — the best June since 2007. It just wasn't enough to boost the seasonally-adjusted number.

The [Wall Street Journal](#) said annualized new home sales "surged" 23.6% in June. Also true, except May was the worst month since Census began tracking in 1963; June was the second-worst.

In the four quarters since GDP stopped falling, the economy has grown half as much as it did in the four quarters following the 1981-82 recession. But on the downslope, GDP fell twice as far in this recession. Like Mark Twain's talk-

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ing dog, the remarkable thing isn't how well the recovery is proceeding so much as that it's proceeding at all.

But at this point no one cares. All we want to know is when it'll be over.

That's easy. Nearly a quarter of the 8.5 million jobs lost since 2007 were construction jobs that pay well and can't be outsourced. The recession will be over when housing recovers.

So what's holding us back? Nothing but a few million foreclosures.

Shadow inventory is the bogeyman of the day: bank-owned foreclosures (REOs) past, present, and future, that haven't yet been put up for sale. The fear is that REOs will delay a housing recovery until 2013 or even later.

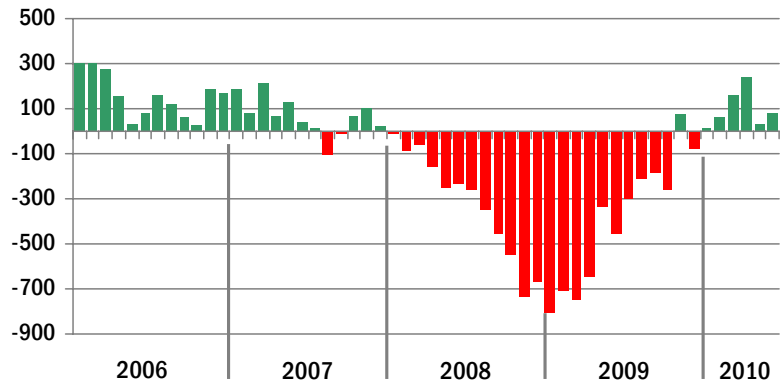
Estimates range from 1.7 million (CoreLogic) to 8 million (Morgan Stanley), which tells you something right off the bat – no one knows. Morgan Stanley counts everything in the foreclosure pipeline plus delinquencies not yet in default, and even current loans it expects to go bad someday.

Whatever the real number is, it is big. Delinquencies and foreclosures are both at record levels; [LPS Applied Analytics](#) (CS24.us sign-in req'd) puts the combined total at 13.2%, or about 7.2 million.

The good news is that delinquencies have been falling in 2010. Even so, [RealtyTrac](#) expects over 3,000,000 properties to receive foreclosure filings in 2010, about 10% above last year.

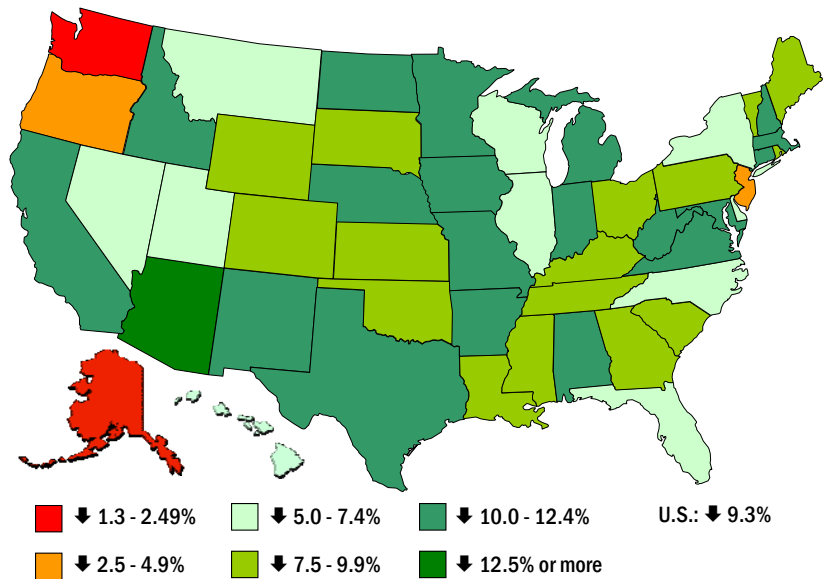
RealtyTrac also says that'll translate into 1,000,000 repossessions, but that ratio is probably higher this year than it will be going forward. Between foreclosure moratoriums, HAMP, and processing delays, the average lag time

Private sector net job gains/losses by month, Jan 2006 - Jun 2010 (000). Bureau of Labor Statistics



6-month change in percentage of non-current loans (delinquent + in foreclosure), June 2010.

LPS Applied Analytics



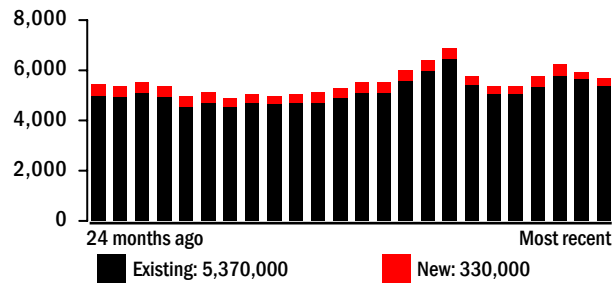
from initial default to repossession rose from 251 days in January 2008 to 461 days in June 2010. One reason the foreclosure numbers are so high now is that banks are working off a backlog.

One big worry is that REOs will push home prices down further, triggering a new wave of strategic defaults by homeowners who can make their payments but

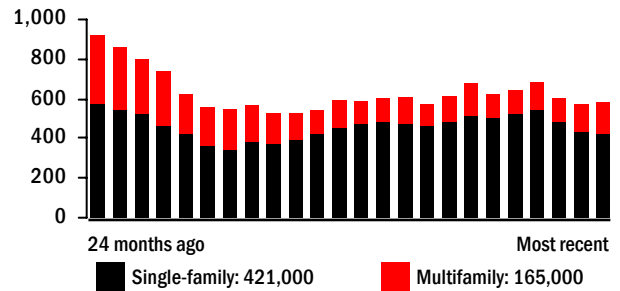
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VITAL STATISTICS

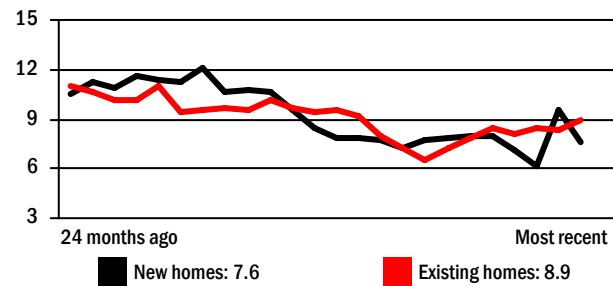
ANNUALIZED HOME SALES (000)



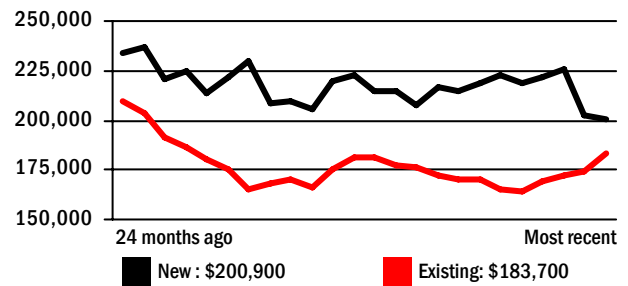
ANNUALIZED BUILDING PERMITS (000)



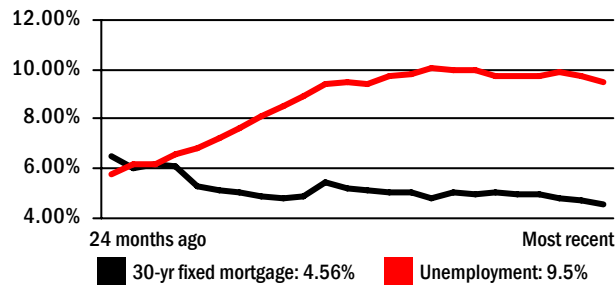
MONTHS' UNSOLD INVENTORY



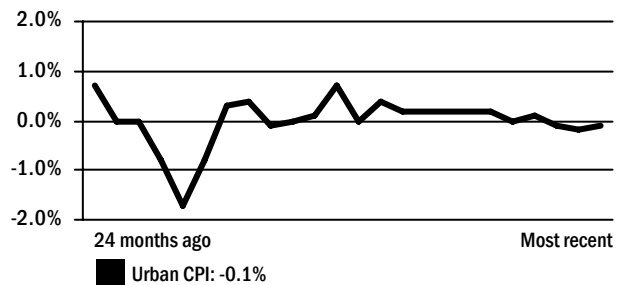
MEDIAN HOME PRICES



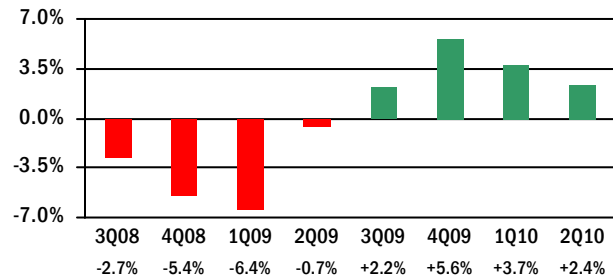
MORTGAGE & UNEMPLOYMENT RATES



INFLATION RATE



GDP CHANGE VS. PREVIOUS QUARTER



[Download current spreadsheet at CS24.us](http://CS24.us)

Sources: U.S. Census Bureau, National Association of Realtors, Freddie Mac, U.S. Bureau of Economic Analysis, U.S. Department of Labor. Data compiled by



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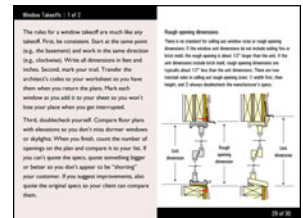
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owe more than their homes are worth. It's an easy thing to worry about because no one knows how big a factor strategic defaults really are.

But strategic defaults require two conditions: 1) extreme price declines and 2) little or no equity to lose. During the bubble, most high-LTV prime loans were made in grossly overpriced markets in California, Nevada, Arizona, and Florida, which account for nearly half of all foreclosures.

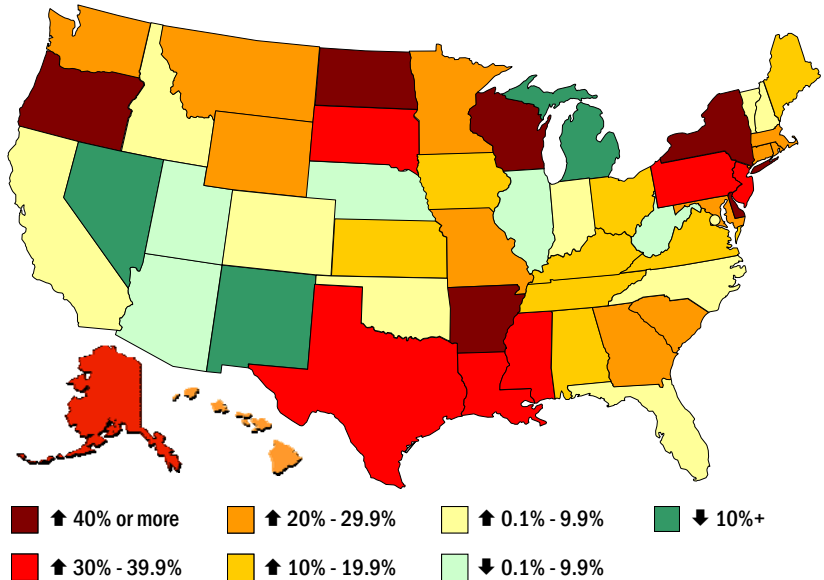
Prices in those four have already fallen so far that, as a multiple of median income, every one of them is at, near, or below their 1995 level. If you're down 40% and still making your payments, another 10% is unlikely to make you walk away.

That's not to say prices won't fall, especially in the 25 states where the price-to-income ratio is more than 20% above 1995 levels. But despite all the angst, it has no bearing on the housing recovery. Adjusted for inflation, home prices reached a peak in 1979 that wasn't reached again for over 20 years. No one noticed.

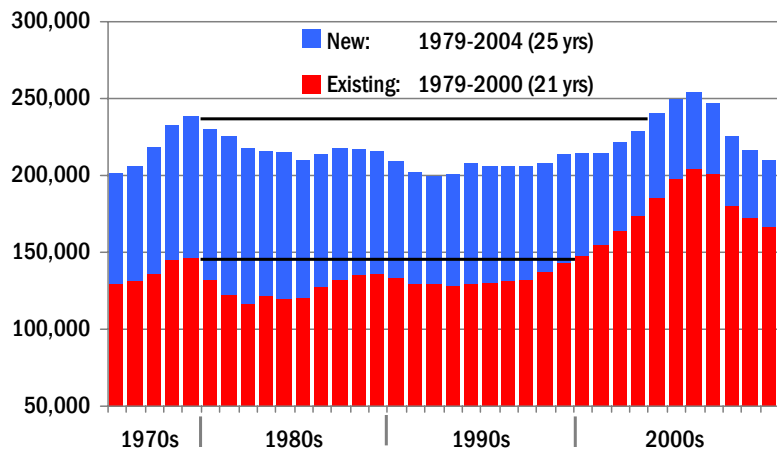
The problem with REOs is uncertainty. Buyers don't know how homes should be priced so they aren't buying. Banks don't know how big a hit their balance sheets will ultimately take, so they aren't lending. But whatever the final number is, it's not infinite; with 82% of the country fully-employed, chances are we're at the peak if not past it.

The fact is that we need this stage of the recovery in order to get to the next one. Will it take until 2013? It's possible but I wouldn't bet on it. I think banks are just as anxious to get back to business as you are. ☺

Change in median home price as a multiple of median household income, 1995 vs. 1Q 2010. Federal Housing Finance Agency



Median single-family home price, 1975 - 2009 (2010 dollars). Census Bureau



Greg Brooks, editor of THISMONTH, is a 41-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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