

Builder Roundtable

1Q14 forecast and discussion

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2013 Was a Good Year!

- Near record year for Austin home resales. Better for builders
- 2013 was the year Austinites felt and saw the recovery
- Austin economy is in expansion mode, rather than recovery
- More demand than inventory in most channels
- Austin is one of nations top job markets
- Austin residential investment properties 95+% occupancy with continued rental income increases. Commercial, retail, industrial at 90+% occupancy
- Austin has enjoyed double-digit growth in GDP, jobs, population and birthrate since 2007
- Milken Institute named Austin top performing metro 2013
- Austin leads nation in economic and job growth – *Forbes*
- Austin is No. 1 on list of the Cities Creating the Most Middle Class Jobs – *Forbes*



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Where are we in the cycle?

- **US – Stabilization** – The Federal Reserve lowers rates, then gradually allows increase, as housing and job growth historically follow. When the rates are at zero, the Federal reserve uses other means, such as quantitative easing (QE) to encourage growth. Mildly effective. As Fed reduce stimulus, rates should rise
- **Texas – Recovery/Expansion** – Supply / demand is in balance, and home / land value appreciation meets or beats inflation
- **Austin – Expansion** – Economic housing formation as well as other real estate channel demand exceeds supply. Housing and real estate appreciation stronger
- **Houston – Expansion** – Economic housing formation as well as other real estate channel demand exceeds supply. Housing and real estate appreciation stronger
- **San Antonio – Recovery** – Demand has picked up, putting pressure on supply
- **Dallas/Fort Worth – Recovery** – Demand has picked up, putting pressure on supply

All of this is caused by dynamic job growth in Texas.



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2014 key strengths

- American economy improving. Slow national recovery
- Texas economy strong. Seven other states to prerecession numbers
- Energy and new technology have put US on top of oil/gas producers
Texas energy businesses lead nation
- Federal Reserve begins slowing tapering
- Mortgage and interest rates historically low
 - Mortgage interest rates in the 4-percent range were unheard of until 2010, and rates in the 5-percent range were unknown prior to 2003
 - 1970s, rates hovered in the 7-percent range and spiked up above 9 percent in late 1975, late 1976 and most of 1978
 - In the early 1980s, mortgage interest rates brushed the stratospheric highs of 18 percent and even 19 percent
 - During the 1990s, mortgage interest rates ranged from around 7 percent to roughly 9 percent. They held at less than 9 percent in 2000, less than 8 percent in 2001 and less than 7 percent in 2003
- 6+ years of economic negativity, replaced by positive outlook
- Consumers and businesses spending
- Texas sustains economic growth through year into 2015
- Low inventory – better than the alternative
- Resale / new homes sales continue positive appreciation / sales
- Other real estate channels strong though 2014
- Sustained GDP growth (below average)



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2014 key strengths

- Continued low inflation
- Job creation. More people are working, more jobs created
- On average in the past 12 months employer payrolls have increased 182,000 a month, almost exactly the rate of gain we saw in 2012. All the gains took place in the private sector. Government employment fell slightly over the year
- Interest rates will continue at low levels but gradual increase to low 5's. Consumers continue to watch Federal Reserve
- Americans have credit capacity again, but lenders slow to lend
- Mortgage rates still low. What's the mortgage market going to look like post Dodd-Frank, post QE taper?
- Regulatory uncertainty & political risk continue to fuel business indecision
- National rebound started in 2011, slow progress 2012, 1st 8 months 2013
 - Austin and other major Texas metros rebound started in 2Q2010
 - Regional real estate and economy show strength 2013, continue through 2014
 - Slow improvement nationally from worst economy in 60+ years



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2014 economic forecast

- Employment – Nationally very slow recovering
 - Unemployment – US 6.7% (U6 13.9) / Texas 6.0% / Austin 4.5%
 - Austin has 3rd lowest unemployment of top 50 large US metros (over a million)
 - Austin and Texas have been lower than the national avg. the last 84 months (7+ years)
 - 11.8 million Americans remain unemployed. In Texas there are 776,119 without jobs, in Central Texas with an estimated 50,572 workers looking for work
- Home, car and retail sales have improved dramatically
- Real estate construction stronger across all channels nationally, Texas leading
- Interest rates have stayed low through most of 2013, improving economy should cause rates to rise in 2014
- 5+ years of household formation pent up demand
- Corporate earnings continue to improve
- Housing and real estate slowly stabilizing, putting more people to work

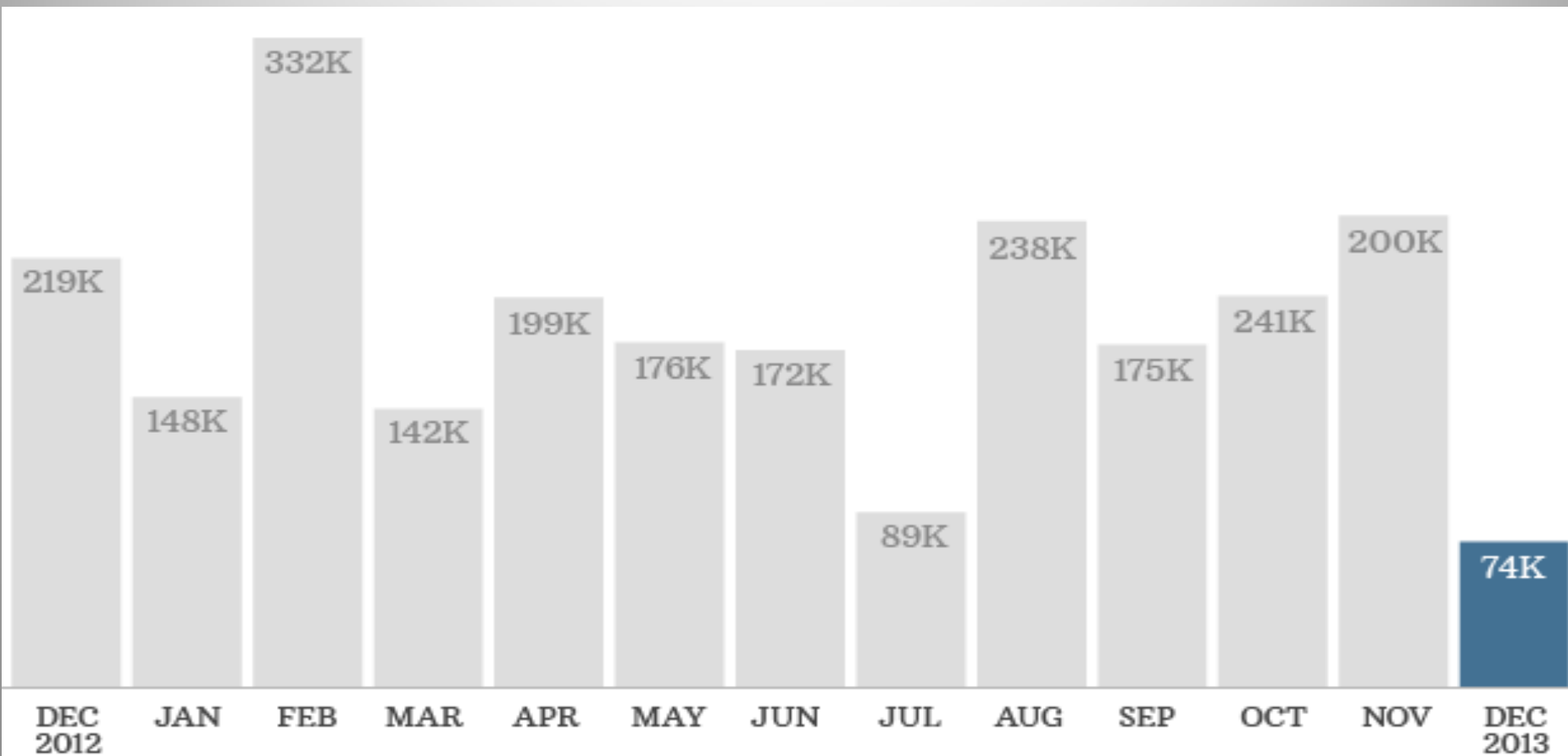
Projections for the next couple of years indicate substantive national growth still challenged. Texas growth strong in 2014, continuing through 2015



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2013 ends with weakest job growth in years

National



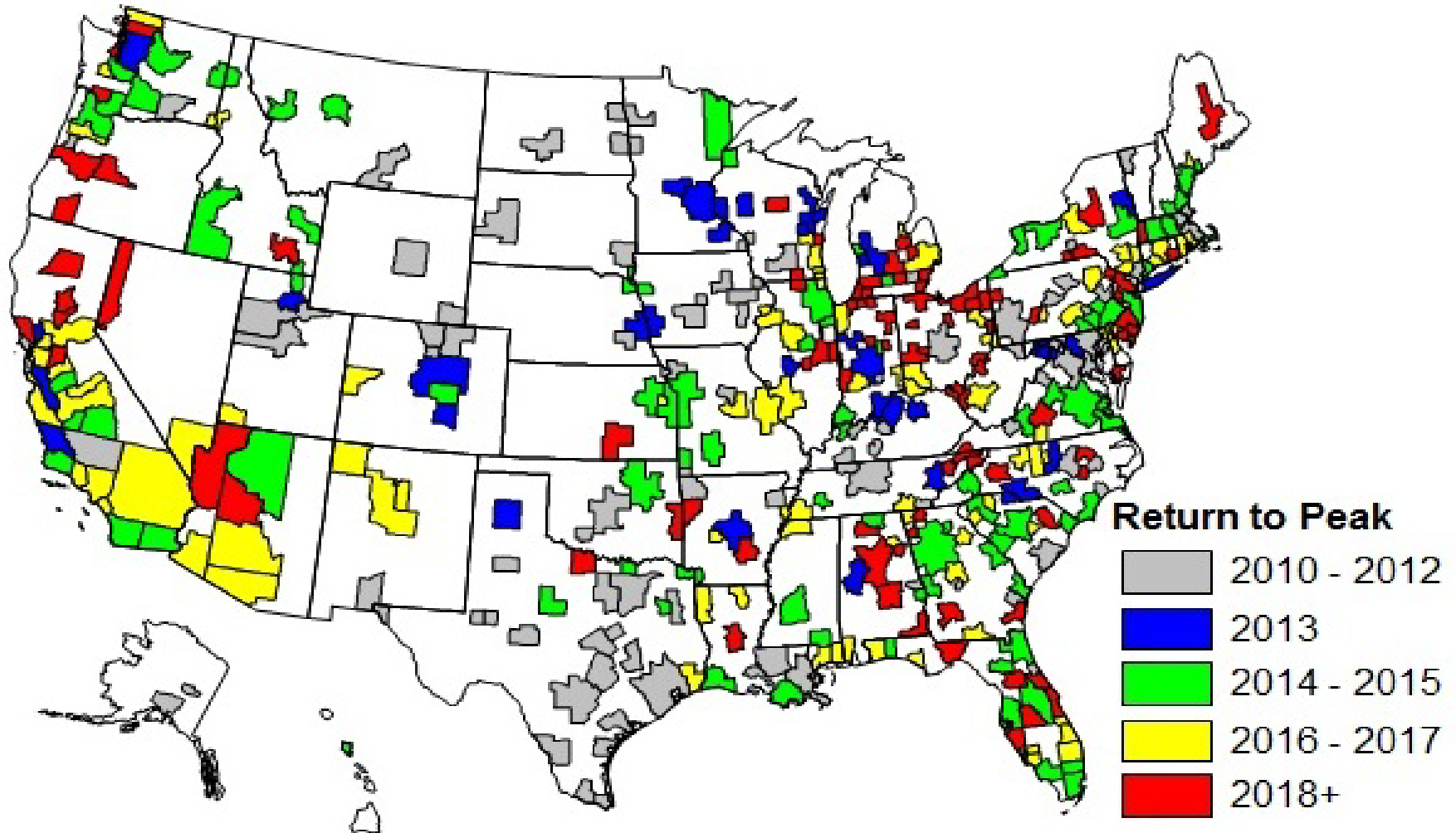
*NUMBERS ARE SEASONALLY ADJUSTED; SOURCE: BUREAU OF LABOR STATISTICS



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Where housing markets have recovered

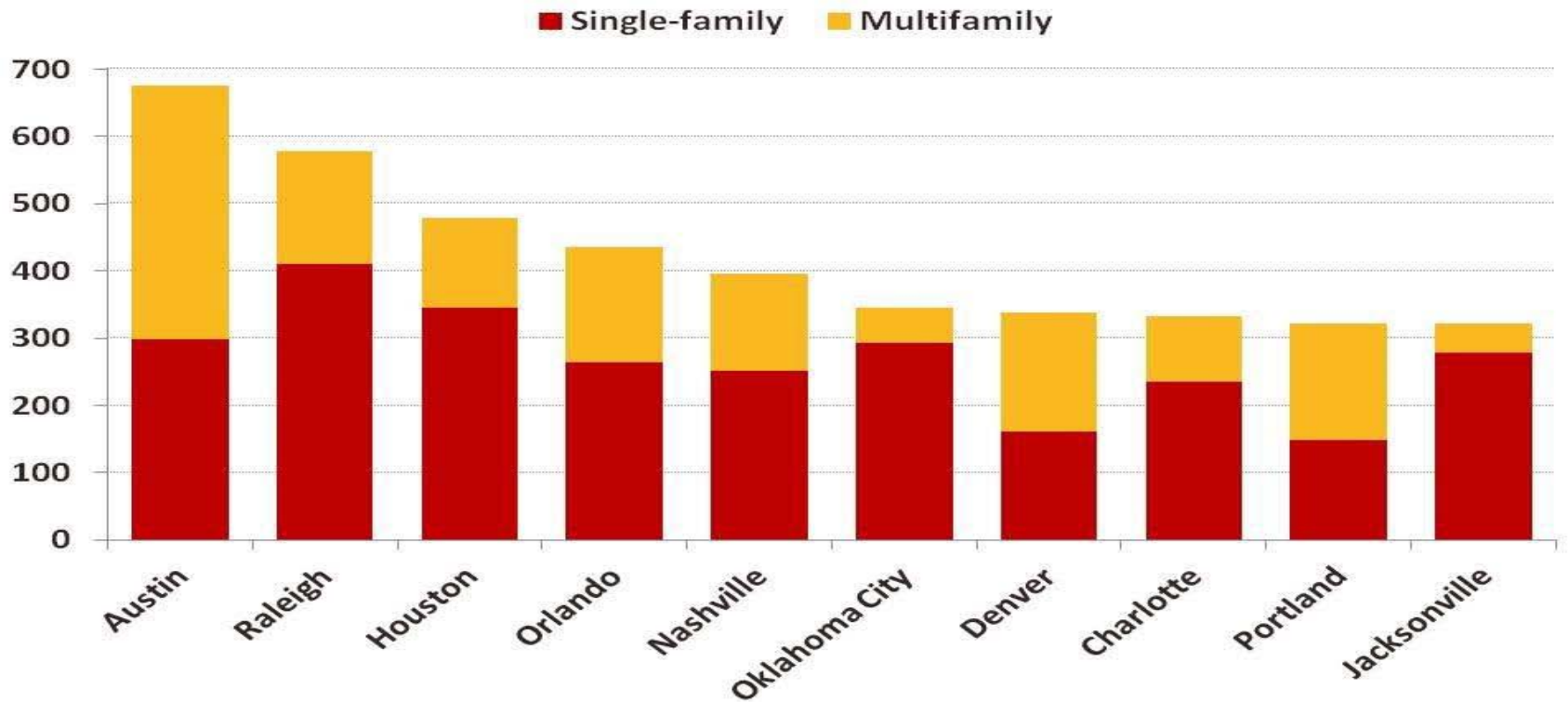


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Metro Comparison Housing

2013 Residential Permits per 100,000 Population
Best Performing Major Housing Markets by Per Capita Permitting Activity



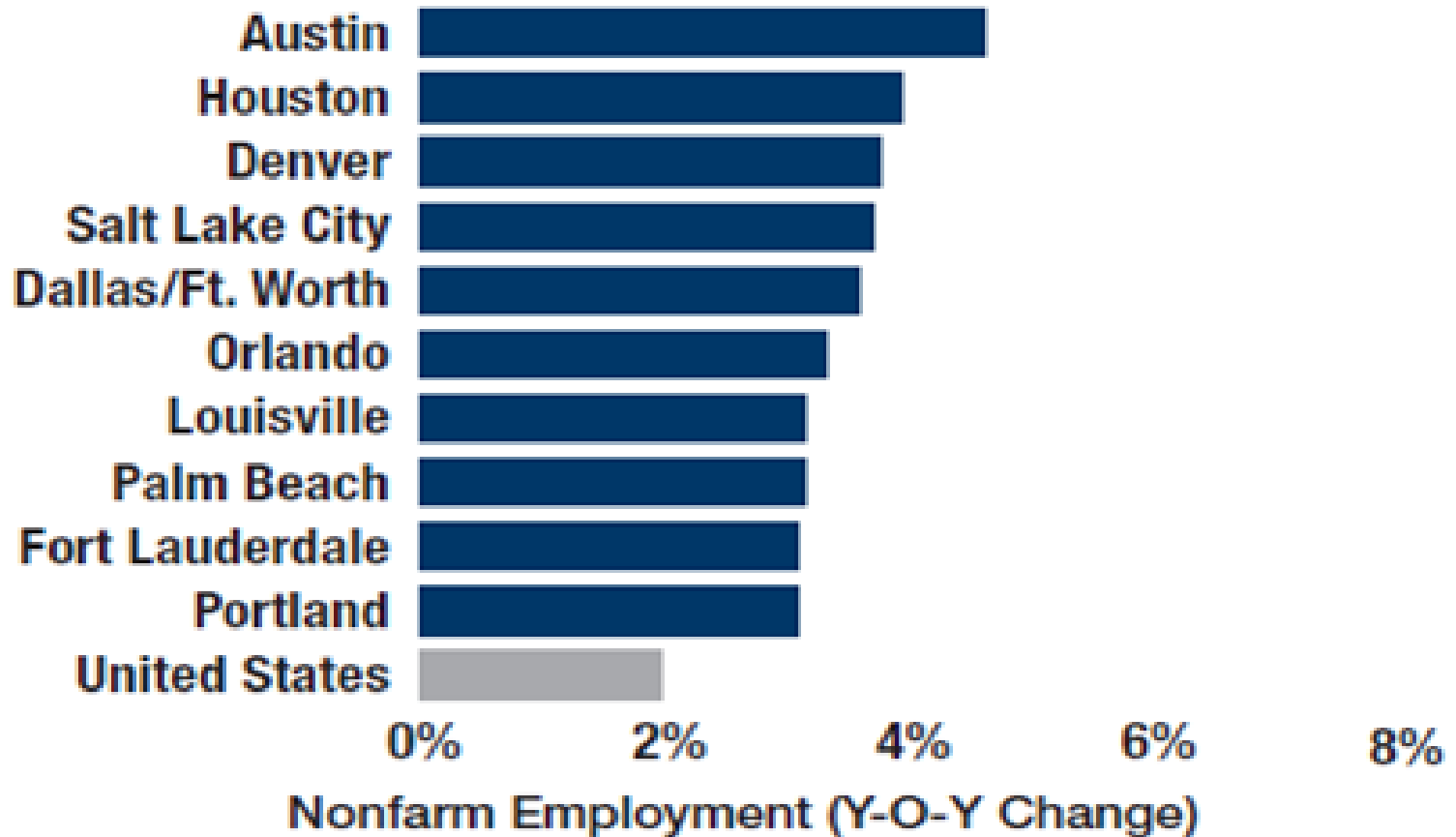
Source: U.S. Census Bureau.



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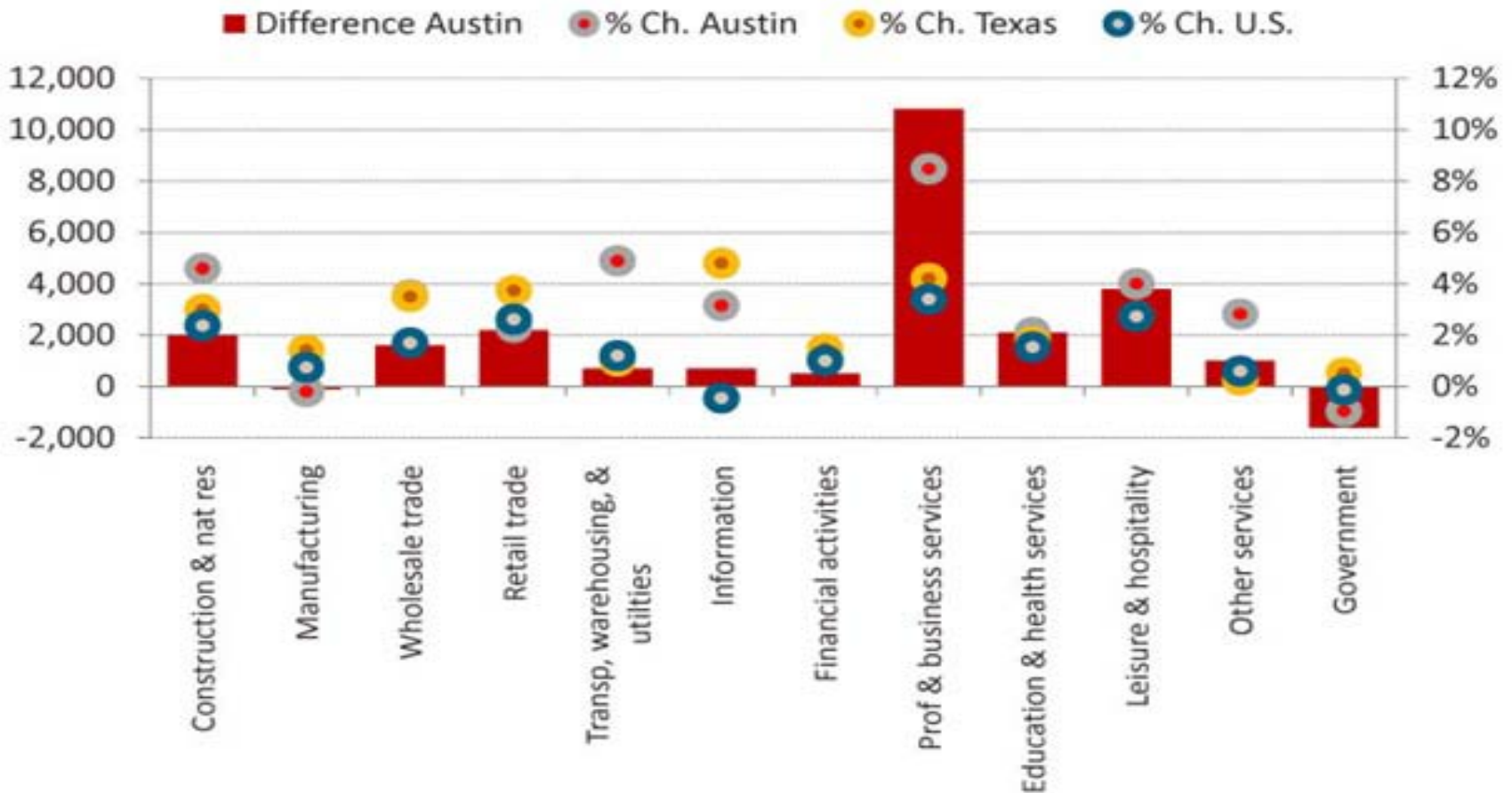
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Markets with the Highest Expected 2014 Employment Growth



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New/Lost Jobs by Industry: Dec. 2012-Dec. 2013



Source: Texas Workforce Commission & U.S. Bureau of Labor Statistics, CES.



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The numbers...

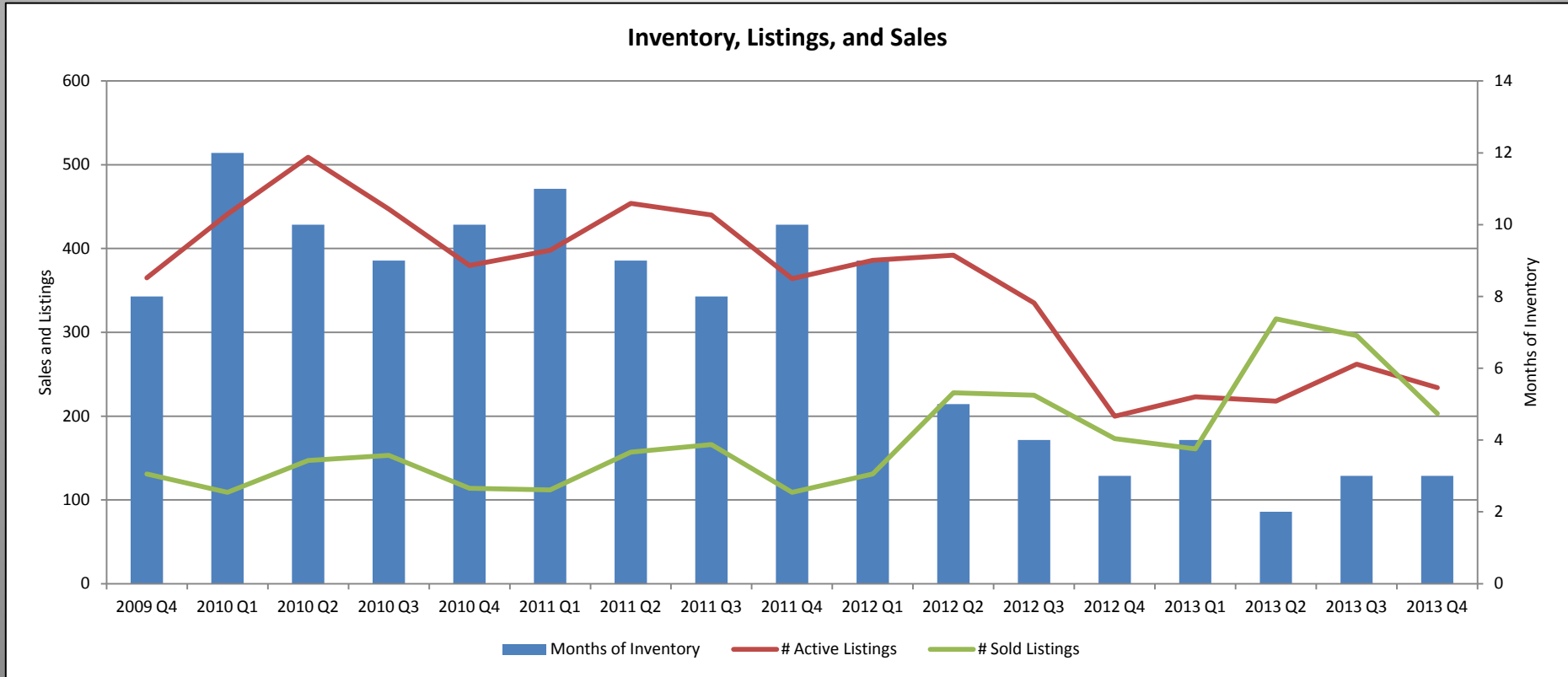
- **147,684 total rental units in Austin**
 - 95% occupancy = 7384 units available + 5880 units under construction to be completed 2014

Total of 13,264 rental units available in the next 12 months.
- **9,000 to 12,000 home starts this year**
 - For every 2 jobs / one home start
- **4,545 listings presently**
- **Total shelter 29,809 units available**
- **Total annual immigration 56,000+**



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Area Market Stats Q4-2013	Sq. Ft.	List Price	LP/Sqft	Sold Price	SP/Sqft	SP/LP	SP/OLP	DOM
Average	2,598	\$360,483	\$138	\$349,339	\$134	97%	0%	73
Median	2,542	\$340,000	\$130	\$330,000	\$127	97%	0%	46

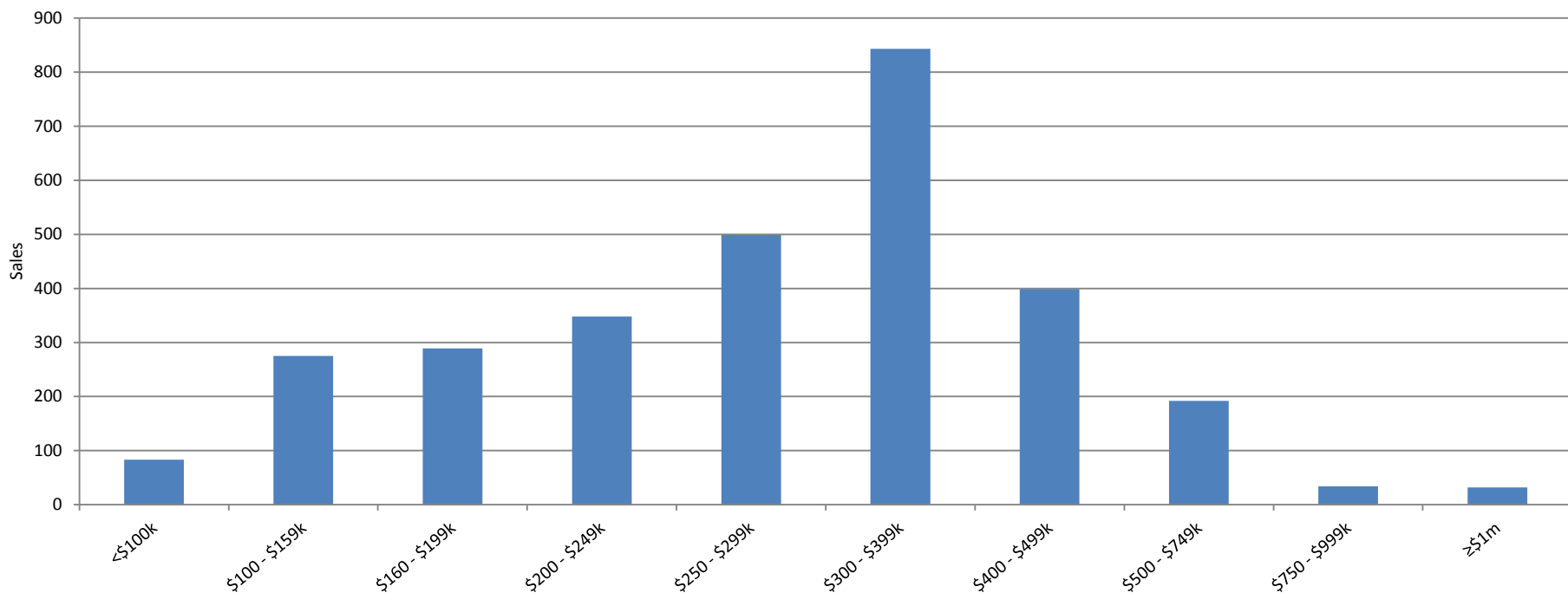


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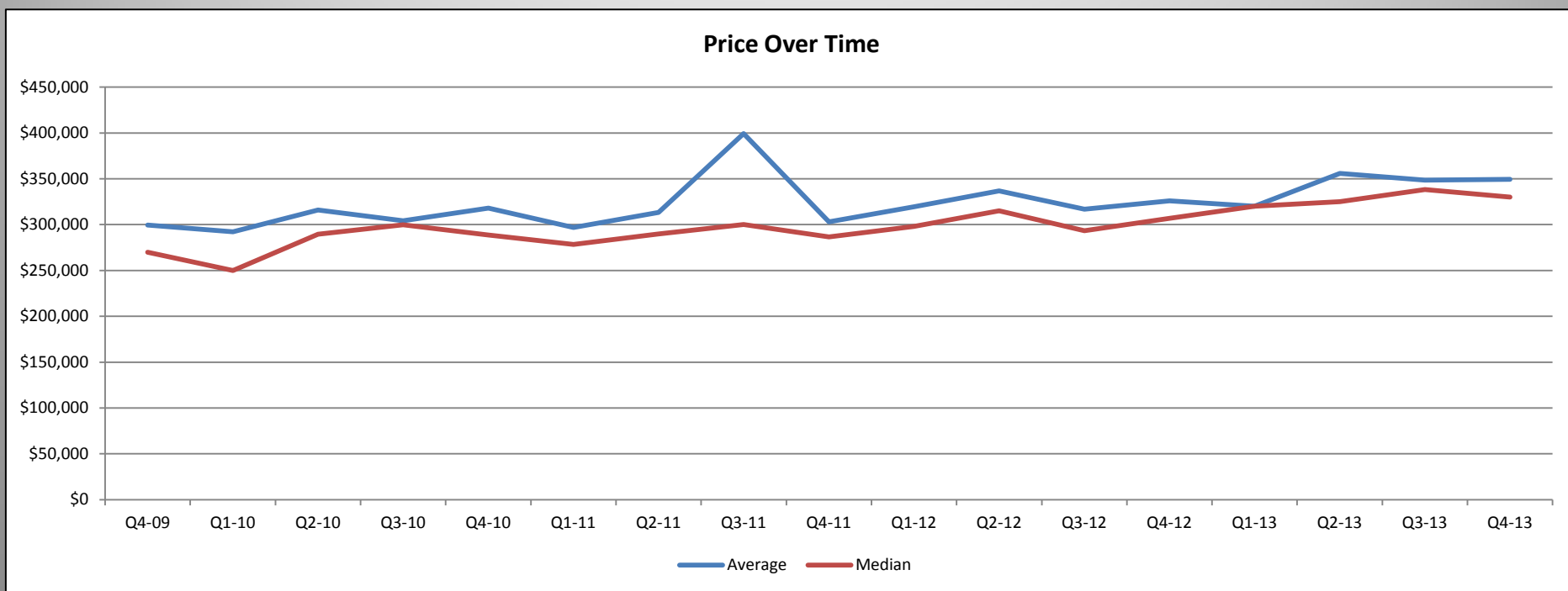
Sales by Price Range
4Q2009-4Q2013



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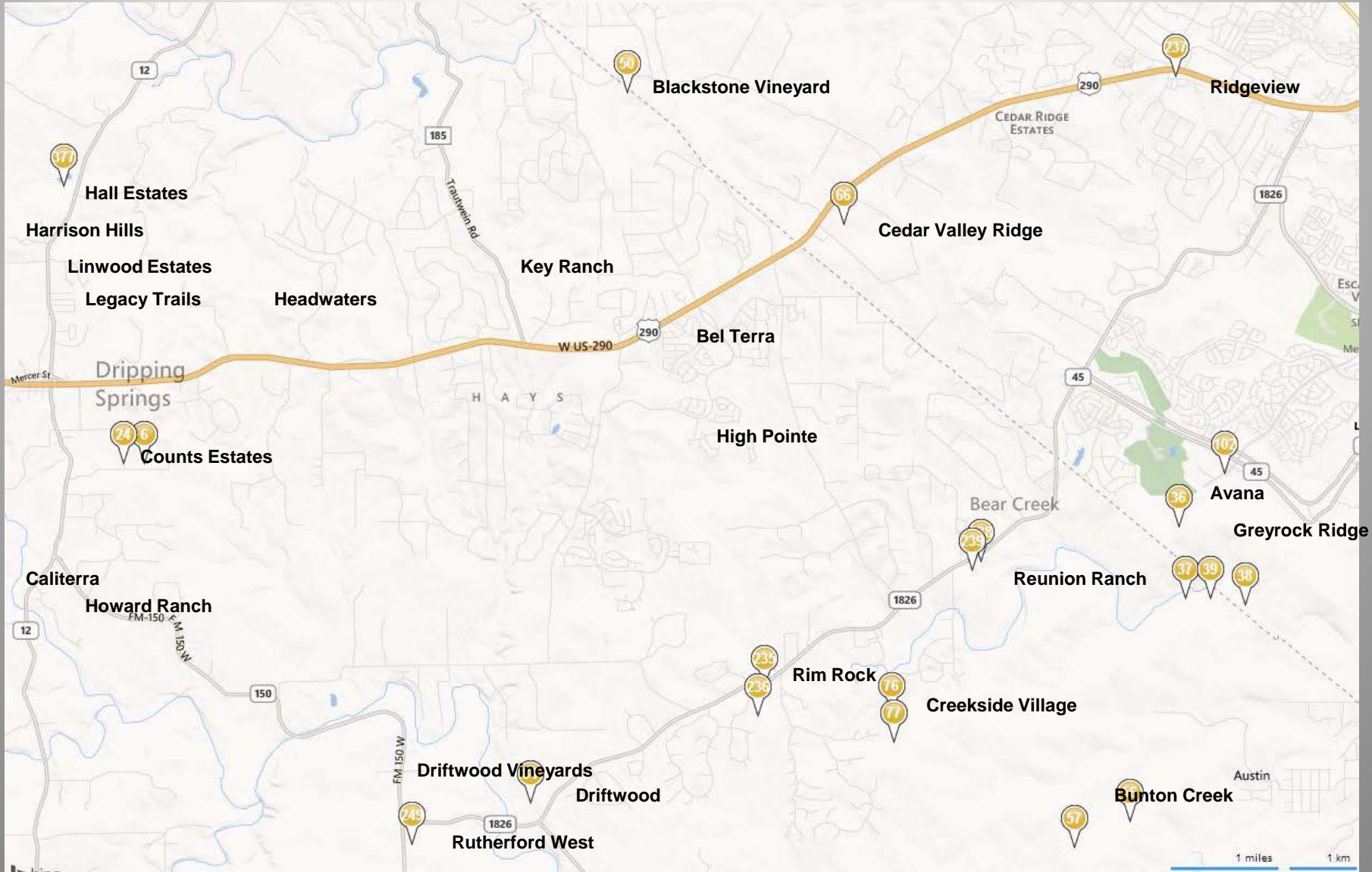
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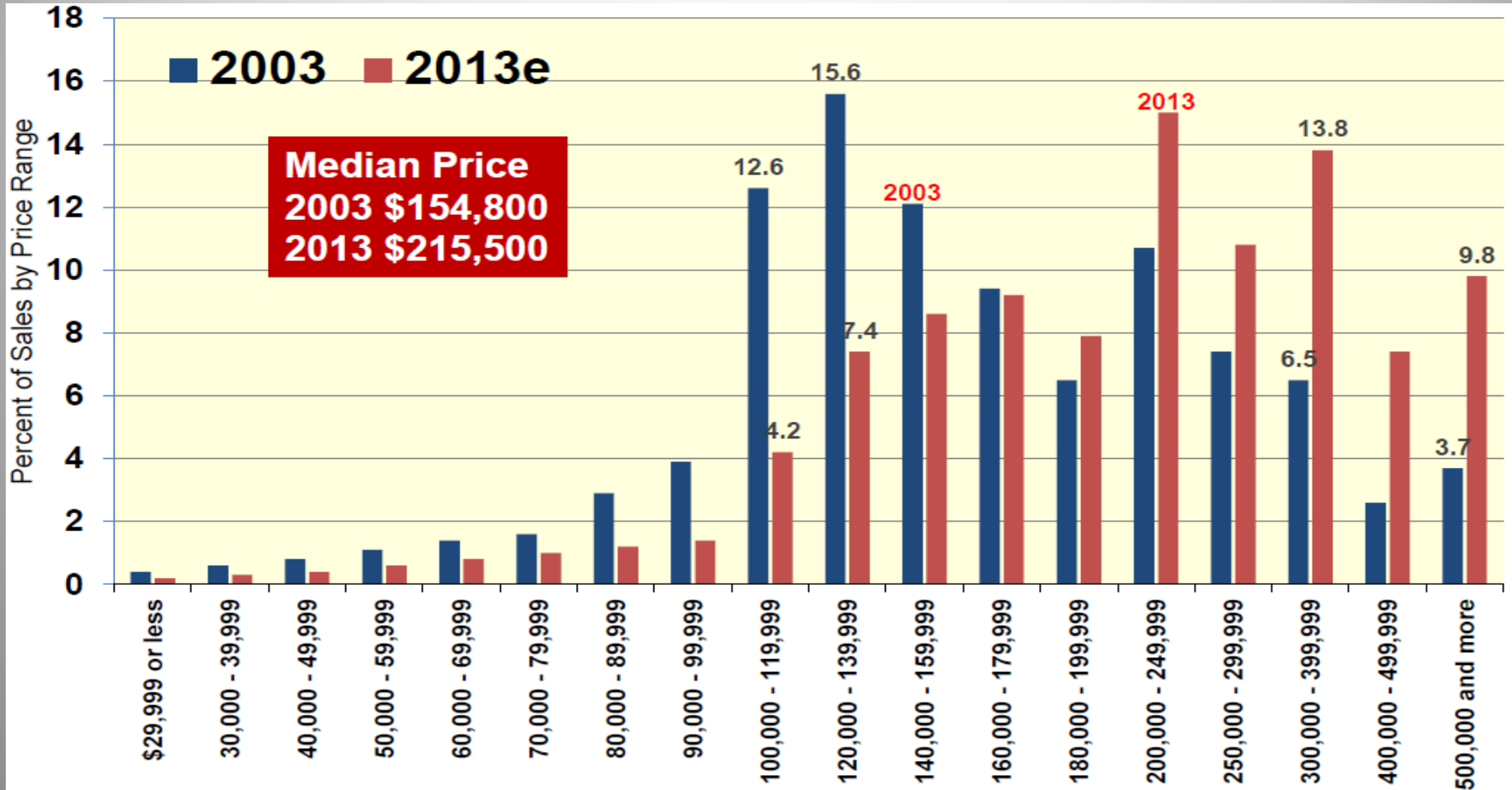
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Austin Sales Price Distribution

2003 - 2013



Source: ABOR; Real Estate Center at Texas A&M University

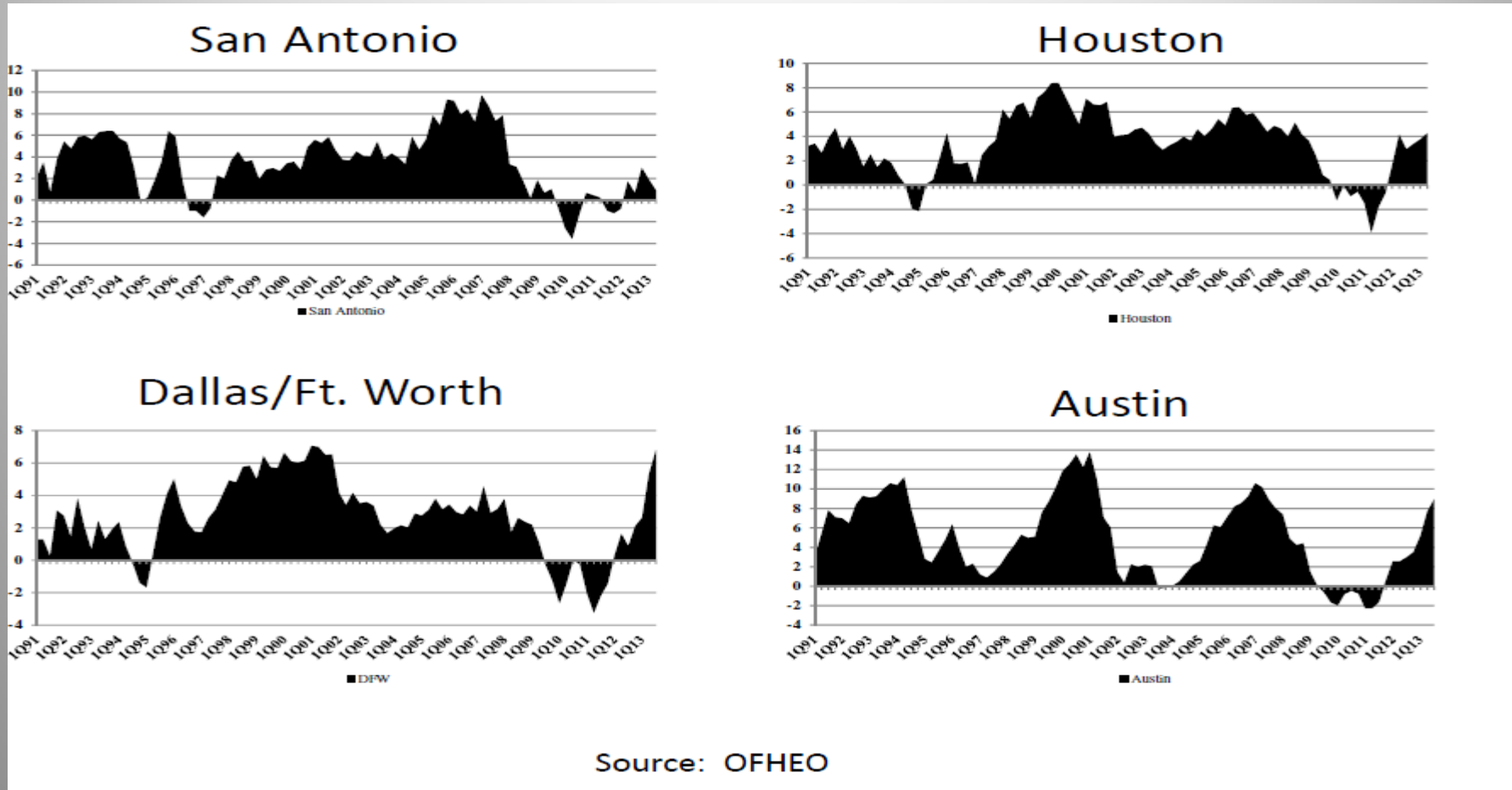
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House Price Appreciation



Source: OFHEO



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2014-15 outlook for Texas economy

- **Downside risks:**
 - National (global) recession
 - National slow economic growth and recovery
 - Energy sector slower growth
 - Tech decline and new technology
- **Texas job growth continues to outpace national rate**
- **Energy industry slowing expansion**
- **State and local budget deficits and level spending**
- **Federal furloughs – defense, education, etc.**
- **Population growth continues even stronger with continued job creation**
 - The need for ‘tech’ workers in all metros, across the state
 - Continued immigration from California due to ‘business friendly’ / less tax burden environment
- **New construction rebound continues, but far from ‘recovered’**
- **Pent up demand for all channels of real estate driven by investment, affordability, low interest rates**



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National perspective

Mortgage qualification changes

- In wake of credit issues, mortgage originators raised the bar on the qualification process for those buyers that were on the peripheral. (Low doc / no doc / no credit score / no down payment, etc.)
- Sub – prime is non existent. Jumbo has eased up
 - No down payment loans with FICO scores <740 very difficult to obtain.
 - Modest down payment loans will not work without documentation.
- American Mortgage Bankers Association research indicates that latest changes in mortgage qualification standards will increase percentage of buyers unable to qualify.
 - Previously thought that 10% of buyers that purchased in 2006 would not qualify today



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QRM

What are the new rules?

QM loans cannot:

- Contain risky features, such as terms that exceed 30 years, interest-only payments or payments that are less than the full amount of interest so that the home loan debt grows each month.
- Carry more than 3% in upfront points and fees for loans above \$100,000.
- Push a borrower's total debt load above 43% of his or her monthly income, unless the loan is eligible to be backed by Fannie Mae or Freddie Mac, or a federal housing agency such as the FHA, or is made by a small lender that keeps the loan on its books.

Ability to repay standards QRM / ATR guidelines are as follows;

- Current or reasonably expected income or assets
- Current employment status
- Monthly payment on the covered transaction
- Monthly payment on any simultaneous loan
- Monthly payment for mortgage-related obligations
- Current debt obligations, alimony, and child support
- Monthly debt-to-income ratio or residual income
- Credit history



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Reasons mortgage rates will continue to rise

- **No more cheap money. Fed has announced the move to higher borrowing costs**
- **The End of Freddie and Fannie;**
 - Don't know what it will be, but every one wants a change
- **Inflation is on the march**
 - Mortgage rates have a direct correlation to demand.
 - As the economy improves, inflation will begin to set in naturally. To offset the risk of drastic rising inflation, the federal government (Federal Reserve) will be forced to raise their interest rates.
 - Supply and demand
 - Something's got to give and it doesn't look like it will be inflation.
- **History**
 - Interest rates have risen....however they are still at 60 year lows
 - 30 year mortgage rates have averaged 8.88 percent over time. They have been under 5 percent in just 41 of the 520 months on record or about 4+/-% of the time. Just a return to the lower 25th percentile of all time mortgage rates would see rates rise to 6.92%.
 - Interest rates are expected to go up! Not down!
 - For every point increase, there is a loss of 12% buying power



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How do you build confidence in the housing market?

- Realtors / mortgage professionals / Builders need to explain to buyers why the market has changed and now is the time to buy
- It would be helpful to see what the months inventory number looks like in their community and the city as a whole. Explain why prices are firm when monthly inventory drops below 6 months
- It would be helpful to show buyers the mortgage interest rate chart to help buyers to get a perspective of the current rates and affordability. Be sure to use more than 5 years of history
- Purpose of this is to **show them there never will be a better time to buy!**



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Conclusions

- **Austin and Texas Metros continue to grow in jobs and population**
 - How much more can it grow with constrained supply?
- **Years of pent up demand – 5+ years**
 - We are 2+ years into local recovery
- **Interest rates stay low through 2014, great time to buy**
 - Affordability; prices and interest rates. Rate increase will slow sales temporarily
 - QE3 and monetary policy changing. In healthy economy, rates should go up
- **Real estate to get stronger and hotter**
 - Under supply of homes. less downward price pressure
 - Not many 'A' opportunities left; housing, land, commercial. Where is the opportunity?
 - Rents are up, as are values. Bottom of market was 3 years ago
 - For qualified buyers, an ideal time to buy, selection and inventory a problem
 - Housing inventory looks like it bottomed in 2013
- **National housing market will remain slow and steady, local and regional continue to strengthen through 2014**
 - Homebuilding and Realtors more optimistic than previous 5+ years
 - Homebuilders constrained to respond
- **National and regional rental market will strengthen through mid 2014**
- **National economy slow improvement, Regionally and locally the economy should remain strong 2014/15**
- **Best Austin market in 35 years+**



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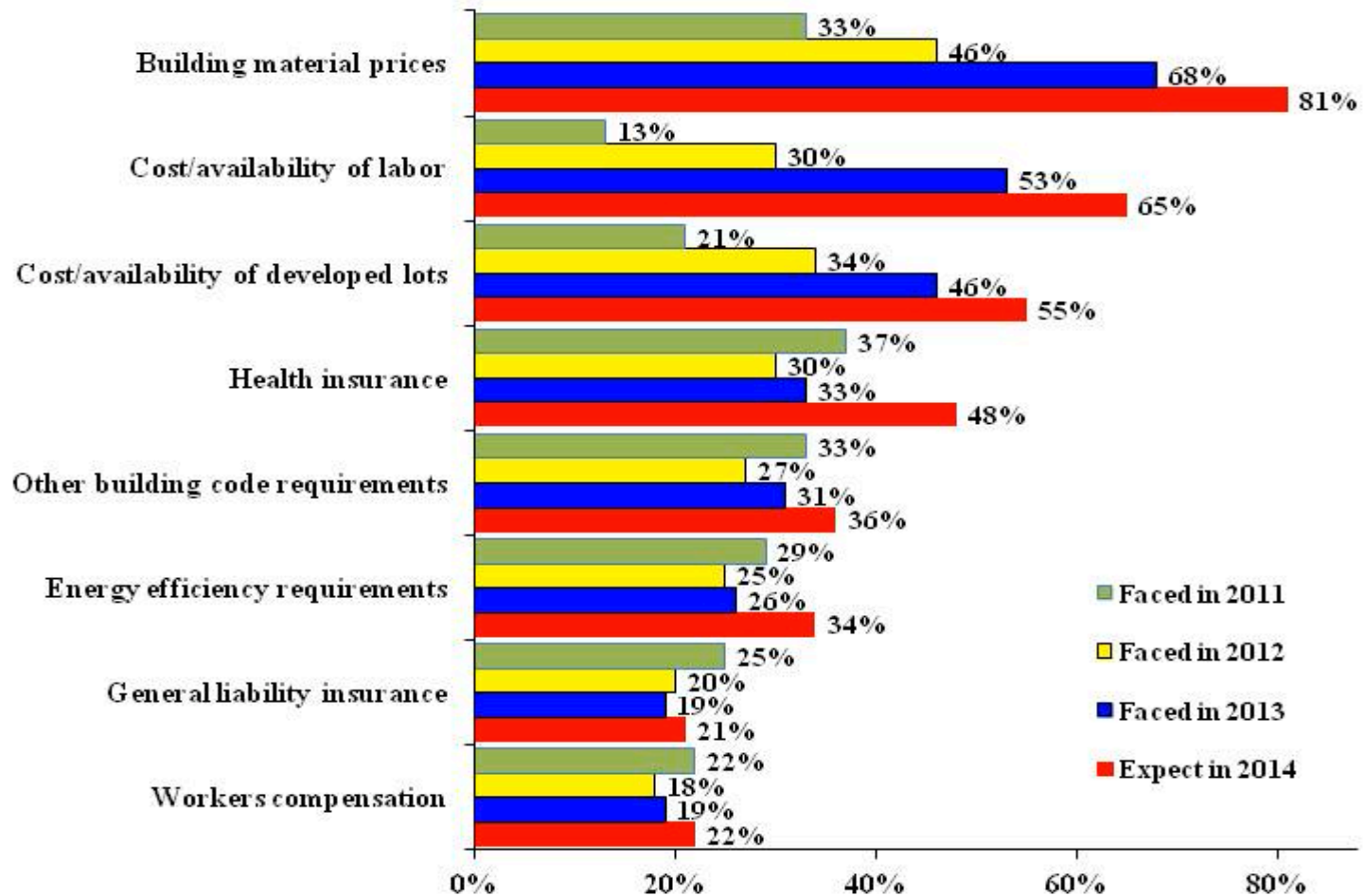
Why buy Austin today?

- Of all the markets, Austin has seen little to no price erosion over the past few years
- Hard costs for development and housing continue to rise at about 18% to 22%
- Austin and Texas are strong short and long term investments
- Barring a catastrophic event, values will continue to improve in Austin and other Texas Metros
- Investment income has continued to rise in Austin, and they have stabilized in the Texas Metros. As the national economy improves, Austin, etc. is at the top of most lists for relocation, corporate and personal.



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Chart: Most Significant Problems faced by builders - BUILDING COSTS

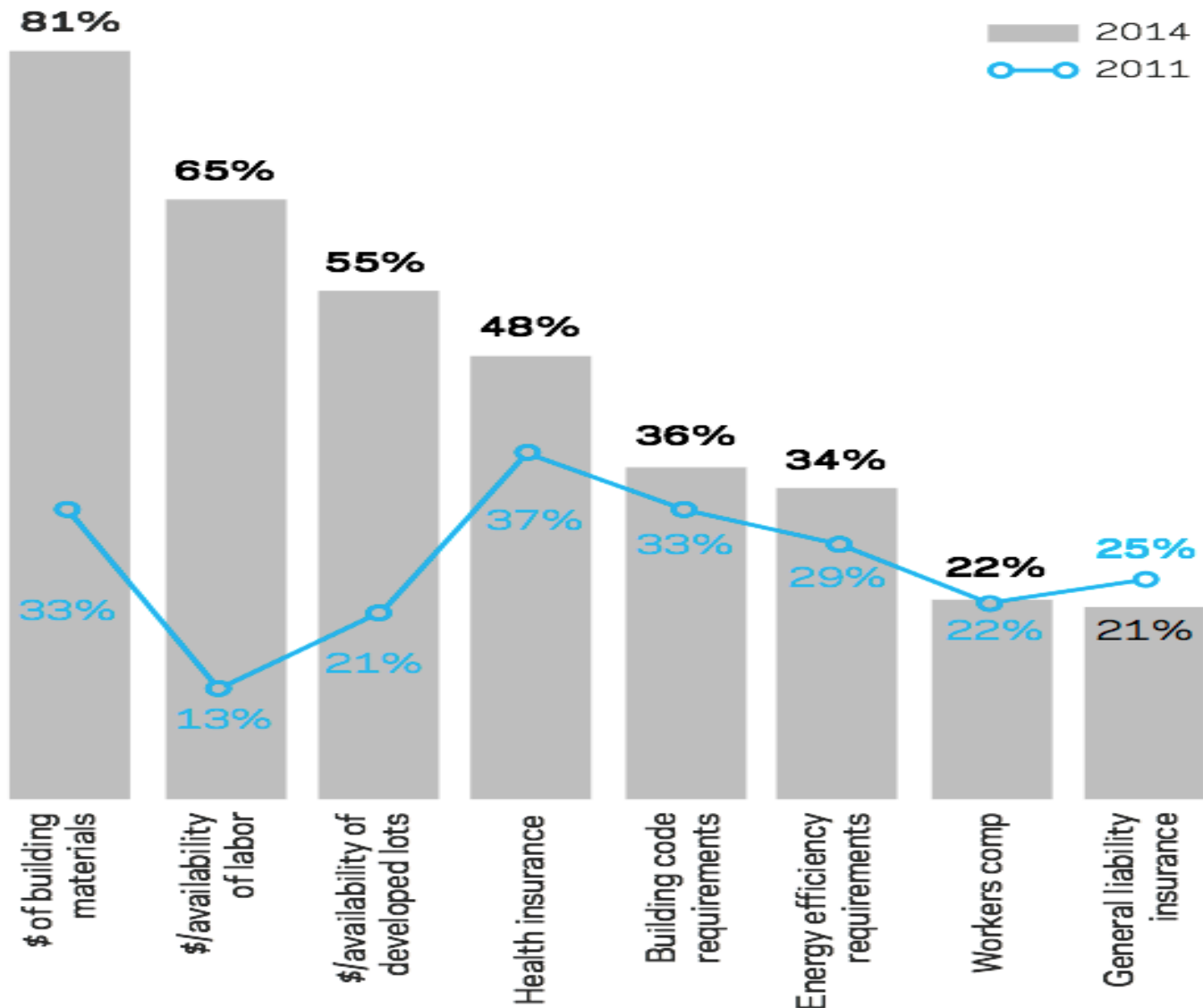


Source: HMI Survey, Jan. 2014, NAHB EcHp



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Thank you



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