Parliment Building Products, Inc.
You Can Rely On Us

THE PARLIMENT PAGES

October, 2017

THE WRATH OF MOTHER NATURE –

We typically write this newsletter over a period of a couple of weeks. No particular reason other than that is just the way it happens. So, when I started writing several weeks ago, Harvey had just hit and I composed much of the body talking about the impact of Harvey on our industry. Well, as you know Irma screamed her way through the Caribbean and up the spine of Florida. And if that wasn't enough, Maria just devastated other parts of the Caribbean, especially the heavily populated island of Puerto Rico.

These were not just regular hurricanes but were instead major destructive storms, the likes of which have never been seen. I am personally closely associated with the British Virgin Islands and in particular the small island of Virgin Gorda. It has taken several weeks for communication to be restored enough to just get the basic information out. The destruction in Texas, Florida and throughout the Caribbean is becoming known. However, what is hard to see is the terror surrounding the events and the unbelievable aftermath, physically, emotionally and financially.

Stories of my personal friends huddled in an interior bathroom, wrapping towels around the door handle and holding on for all of their might for 6 straight hours, as their house literally disintegrates around them. Much of this newsletter will be dedicated to the aftermath of these storms and the profound impact they will have on our industry, both in the short-term and the long-term.

OVERALL ECONOMIC IMPACT – SHORT TERM -

Before we address our industry specific issues, it is interesting to first look at how these storms are likely to impact our overall economy. The broad, general view is that it will hurt the fourth quarter, perhaps as much as a 1% reduction in growth. For an already anemic economy, this looks bad and seems somewhat unbelievable. However, most of the real economic damage was done in Houston.

The major cities of Houston, Dallas, Austin and San Antonio are economic powerhouses. Those Texas cities account for over 17% of our national economic growth. Houston alone is the biggest contributor, at almost 7%, which is substantially bigger than even New York or Los Angeles. Combine these Texas cities with Miami and we find that over 20% of the national economic growth comes from those 5 cities. Take those cities off line for a month, and you can see the impact that will have.

OVERALL ECONOMIC IMPACT – LONGER TERM –

The good news is the rebuilding of those areas will juice the economy significantly in 2018. There are estimates that it could add at least 1% growth for the next 6 quarters. No single market or activity comes close to having that big of an impact.

Many are asking where the money for this massive rebuilding will come from. It appears that the majority of damage done in Texas was due to rising water. As many of you know, standard homeowner's policies do not cover rising water. Typically, that is covered with the federally funded flood insurance programs. Therefore, it is likely that a huge portion of the private property loss will not be covered by any insurance. Low cost government loans will probably be put in place to help close that gap. As we all know, dealing with the Federal bureaucracy is not something that happens quickly. Therefore, much of the Texas rebuilding will stretch out over a long period of time.

THE FLORIDA VERSION OF IRMA -

Irma hit Southwest Florida as a major storm and marched up the west coast before moving inland. In addition, it was geographically a very large storm wherein virtually the entire state experienced strong winds and flooding. Parts of some of the cities were devastated by rising waters and power was out, at one point, to over 13 million people. Three days later, that number was still over 4 million.

However, when all is said and done, there was not a lot of structural damage compared to the expectation from a major storm. In talking this over with several contractors, it is the growing belief that the super tough Dade County building code (which is used in many parts of the State) has resulted in stronger hurricane proof structures. Many of us can remember back prior to these tough building codes to hurricane Andrew and the devastation that storm caused.

IRMA AND MARIA TEAR THROUGH THE CARIBBEAN -

Both Puerto Rico and US Virgin Islands are USA territories and were close to functionally bankrupt before the storms. It will be a political hot potato in Washington as to how funding will flow to rebuild these two territories. It will take significant resources for the rebuilding to occur.

MATERIAL SHORTAGES AT THE MANUFACTURING LEVEL -

We have stated over and over the snail-like progress that is being made to bring production levels up at the manufacturing end. Domestically, so much manufacturing was shuttered or moved overseas, and bringing it back is difficult because of upgraded zoning and code requirements, lack of personnel and a certain wariness towards investment.

Internationally, in some areas the situation is even worse. For years, much of the building material production was done in China. Severe pollution, failing companies, internal demand for product, and escalating labor costs have severely impacted China's exportation of materials. We are feeling the pinch on a daily basis. Until very recently, it was customary for our importers to guarantee prices for at least a week and often more. Now, price guarantees are only good for two days and in some cases, the guarantee is off the table the minute you hang up the phone.

Raw materials are becoming more problematic as many of the mines in Australia that produced the iron ore for China and other Asian countries have been closed. Scrap steel prices are rising and are not expected to reverse downward at any time in the foreseeable future.

Estimates out of Houston say that somewhere between 600,000 and 800,000 vehicles have been destroyed by the flooding. That number will most assuredly go up substantially when the toll is measured in Florida and Puerto Rico. Those vehicles will need to be replaced and the corresponding bump in automobile manufacturing will swallow up even more of the steel and plastics capacity.

To add to the equation, Houston was a major port of entry for massive amounts of imported steel. While the port facilities will be operational quickly, most people are forgetting the huge amounts of inventory on the docks that was flooded and possibly salt water contaminated. In most instances, that inventory will have to be taken out of the supply chain.

The bottom line is quite simple. A limited and diminishing manufacturing capacity is about to be hit with a freight train of extraordinary demand.

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MATERIAL SHORTAGES AT THE DISTRIBUTOR LEVEL -

We have spoken about upcoming material shortages in our prior newsletters. Prior to the storms, we were experiencing some of the shortages that we had predicted. Longer lead times and product rationing on some products was already starting to take place.

We expect the situation to become severe. However, before we get into detail on that, there is another aspect that needs to be considered. Read on…

LABOR -

Materials comprise less than 20% of the cost of a house. The balance is the real estate and labor, with labor being the vast majority of that balance. Builders and building supply people have been complaining about the shortage of skilled labor for some time. In our last quarter, we discussed that in detail. Many builders have complained that they can't meet customer demand because of that shortage.

The situation is about to get much worse. First, everyone with a pick-up truck will suddenly become contractors. Some of our customers will lose their very best people as they venture out on their own. So, today's great employee will be tomorrow's low priced competitor.

The vast scope of work needed will overwhelm the present labor pool. Maybe some will come into the market from out-of-state. However, many of those remember the crash and vowed to never again get back into this cyclical industry. Again, the bottom line is there will be a severe shortage of labor which will constrain building activities.

"Carpet baggers" will disrupt the normal sales process and builders will just be faced with another convoluted set of problems.

BACK TO MATERIAL SHORTAGES AT THE DISTRIBUTION LEVEL -

Let's set the scenario. Beginning sometime in the latter part of the 4th quarter or sooner, we will start to see a dramatic increase in demand for product. Finished housing inventories are low with a high demand to build those levels back up. Builders will be frustrated because they have customers demanding work and the builders won't have product or labor. This is the time to "make hay" and the "tools" just are not going to be there. This could be a very frustrating time for your customers. This also could be the time for you to help your customers in a way that will leave them forever in your debt.

There are two strategies that we believe will be necessary for the next 12 – 18 months. The first is to assure yourself of supply of inventory. Quotas, allocations, and rationing will take place. Several of the larger national distributors are bound by contract to supply the big box retailers. They will have to meet off that demand before they will have product available for the independents. This is where loyalty pays. Just a few days ago, we received a call from someone who had never purchased from us. They were requesting a whole truckload of coil roof nails. These will definitely be on allocation and this guy knew that. He was hoping to build his inventory before the crunch hits.

Obviously, we chose not to do business with him. While we hope allocation, rationing and quotas will not happen, we must be prepared. Our policy is quite simple. The most loyal customers will always be taken care of first. We suggest you do the same with your customers. Prepare them for product shortages and let them know that you will be there for them.

The second strategy is to recognize the shortage of labor. What can you do to take some of the labor intensity out of your customer's daily lives? In addition, look closely at your inventory. There are a multitude of new products continually introduced that are designed to cut back on labor hours. Do you have those products in stock? And more importantly, have you educated your customers on which products to buy and how they can save that precious labor hour. In times like these, the cost of the product will pale in comparison with the associated labor cost.

HOME CONSTRUCTION TRENDS –

In several previous issues, we have discussed the impact of demographics on the housing industry. We have all heard the terms "baby boomers," "gen Xer's," and others including "millennials." It was the baby boomer generation that drove the economic expansion of our country over the past 35 years. That generation is now past their prime spending and is not a significant factor in future growth. There was about a 15-year gap between the boomers and the millennials. Interestingly, the millennials have almost twice the population of the boomers. Theoretically, it would be easy to assume that the size of that cohort alone would drive our economy and especially the housing industry. It hasn't yet. Over 80% of the millennials said they would prefer to own over rent. If you did the math, it would result in annual single family starts of about 1.1 million per year instead of the 600,000 we seem to be stuck on. What's the problem?

The median income of the millennials is about $65k per year. The average cash on hand for a down payment is $6,200. This income and down payment would barely support the purchase of a $200,000 house. However, the median price for new home construction right now is $306,000 which is way out of reach for the average millennial. Why don't the builders see this and come to market with a house that would attract that huge segment of the population?

They do recognize it, but they just can't build a house in that price range. In 2011 the average cost of a house was $261,000. Of that, about $67,000 went into land, improvements and regulation. Currently land, improvements and regulation are now bumping against almost $90,000 or about a 30% increase in just 5 years.

During this same period, construction costs have also risen from an average of about $80 per foot to $103 per foot. And based upon what you read earlier, that cost is likely to increase even more. Because of the strength of the market, builders have also increased their margins from about 6% to over 9%. All of these together contribute to a price tag that is simply unaffordable to a huge segment of the willing Buyer's market. It's not even close as the average cost for a new home was $348,000. Less than 100,000 homes in the $200,000 price range have been built in the last 18 months.

The lack of this huge population cohort not buying homes has a significant impact not only on the housing industry but also the economy in general. Furniture and accessory sales suffer. Mortgage lending is down which slows the velocity of money. Fewer people are employed in the industry. All told, housing construction typically accounts for around 10% of the economic growth. However, today that contribution towards growth is a little over 5%.

I believe the big question is whether this is a fundamental change in our culture and economy where single family ownership will just not be the reality for many as it once was.

HERE AT PARLIMENT –

On September 3rd, Parliment celebrated 15 years in business. We would like to thank each and every one of you that has been a part of our success. We look forward to a long prosperous future with all of you.

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