# Building Products market update

## Industry Consulting Team | Q3 2022

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### Highlights

- Builders are cautious as residential activity slows
- Improving supply chain delays
- Slower price inflation
- Non-residential backlog remains strong
- Inflation Reduction Act passed

**Figure 3: Housing Market Index** (1)

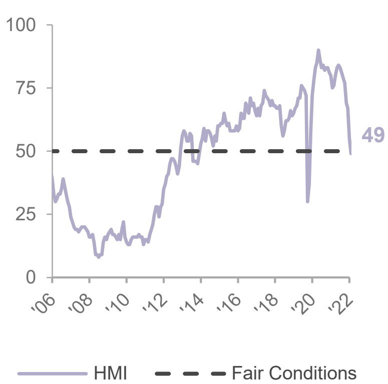
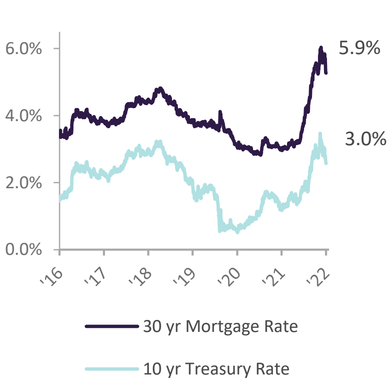



**Figure 4: 30 year Mortgage & 10 year Treasury**




**Strong earnings season, but residential activity is slowing:** Residential new construction and R&R pace is cooling off, but construction backlogs and housing shortages should limit the downside of this cycle. The industry does not expect a bubble to burst like it did from 2007-2009. 2Q22 earnings for most building product manufacturers and distributors generally included better than expected results due to higher pricing and flat-ish volume growth over the last 6 months. Early cracks in forward views based on expectations of decelerating business and inventory destocking were reported. The watch now begins to see how severe a downturn is coming, but the answer will not be found until 2023. Further, most companies have improved balance sheets over the last two years leaving them in a strong position to weather the changing environment.

**Figure 1: U.S. New Single-Family Homes for Sale (in thousands)**

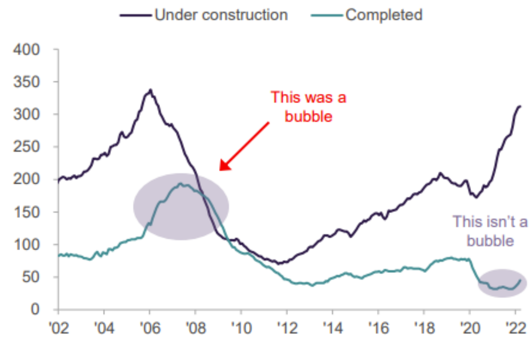
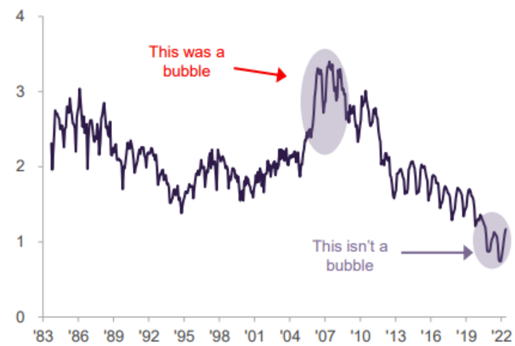



**Figure 2: Inventory of Existing Single-Family Homes for Sale (units in millions)**

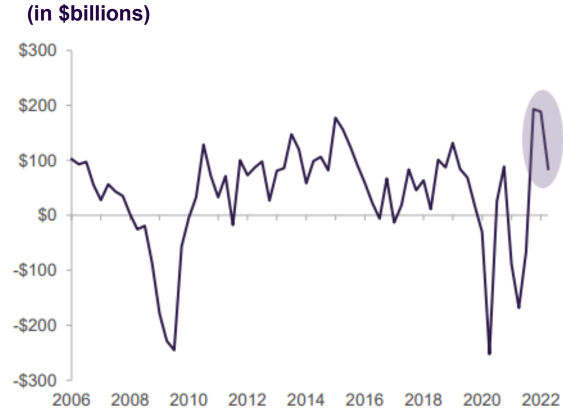



**Single-family and multifamily starts:** Slowing starts and sales are a symptom of coming off of the super-charged pandemic-influenced housing boom and now we should be settling into a pace that is more in line with historical norms. July housing starts slowed to an annualized basis of 1.446MM which was well below the consensus of 1.543MM and down 9.9% year-over-year. The majority of the decline was due to single-family starts being down 18.8% year over year which was partially offset by a 15.9% increase in MF starts. The latest NAHB forecast calls for over 1MM single-family starts and 510K MF starts in 2024.

One unique strength compared to previous cycles is that the millennial home buyer group continues to age into their prime home-buying years. This constant inflow of home buyers makes it unlikely that homebuilders can catch up production to meet the housing shortage anytime soon. Additionally, the inability of homebuilders to fully meet housing demand ends up being a nice tailwind for continued MF development.

**Inventory:** Inventory management strategies for distributors is mixed right now. Some distributors are starting to de-stock shelves in an attempt to keep sales-to-inventory ratios in check. Others are still stocking up on certain high-value SKUs predicting that supply chain delays will continue to linger. Q3 and Q4 will test both of these strategies as demand winds start to shift. Per July's Contractor and Builder Survey, the largest product delays are appliances, doors, certain lumber products, flooring, and paint. The largest price increases last month were cabinets, roofing, plumbing, and then insulation.

**Figure 5: Change in Business Inventories (in $billions)**

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*(1) Indices are based on surveys that rate market conditions. An index number of 50 or higher indicates a higher share of participants view conditions as good rather than poor.*

*Sources: FRED, Bloomberg, IHS Markit, Brent, WTI, S&P Capital IQ, NAHB, U.S. Census Bureau, U.S. Dept. of Housing and Urban Development, Bankrate, Truist Advisory Services*

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**Product Highlight - Can structural concrete and mass timber products co-exist?** Absolutely. Structure concrete products have long dominated the large building world and continue to make significant improvements in product weight, install time, and aesthetics. Concrete remains the go-to for many architects, engineers, and contractors who have extensive experience with the products. However, their mass timber cousins Cross Laminate Timber (CLT) and Glue Laminated Timber (GLT) are gaining traction for buildings up to 20 stories. Unlike particle board products such as OSB and LVL, CLT and GLT are lumber based and are strong enough to carry long spans and support significant load allowing wood to compete head on with certain concrete and steel applications. Mass Timber products offer compelling advantages around the speed of installation, weight, and sound and they derive from a fully renewable resource. Looking forward, it is likely these two worlds co-exist where concrete and steel may provide the foundation and vertical structure, and then mass timber is used for floor panels, roofing panels, and even beams.

**Contractors:** The Contractors and Builder Survey results for July show that order activity is down, but backlogs are strong enough to get through 2022 and in some cases well into 2023. Forecasts for the second half of 2023 and 2024 largely depend on how well the Fed can manage a "soft landing" as they take on the fragile balance between inflation and interest rates. The supply chain is clearly loosening, but not likely to accelerate backlog conversion any time soon. Labor issues remain elevated setting a governor on productivity. Some good news is job openings finally came off peak levels indicating some short-term relief may be in sight.

**Positive Contractor Feedback:**

- Outlook improved from June as the market digests market disruptions and increased interest rates.
- Majority of contractors indicate slight, but manageable delays in supply chain

**Negative Contractor Feedback:**

- Contractors feel pullback in spending across all categories
- Cost of materials continues to increase, although at a more moderate pace

**Inflation Reduction Act:** Part of the Inflation Reduction Act includes expanded provisions for energy-related home improvement projects, such as tax credits for individuals and rebates for state-directed work to middle and lower income dwellings. The impact of the bill is not yet clear but the program could drive notable demand in residential HVAC and a modest assist in windows, exterior doors, and insulation sales. While there are positive spending components to this act, product-specific limitations and state-directed work will reduce the impact of the total spend potential. Additionally, parts of the act are vaguely described which will require more clarification to be released in future months.

**Figure 6: Construction Spending**

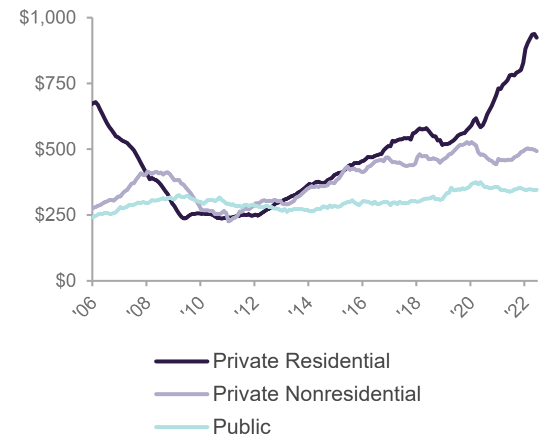



**Figure 7: Employment Trends**

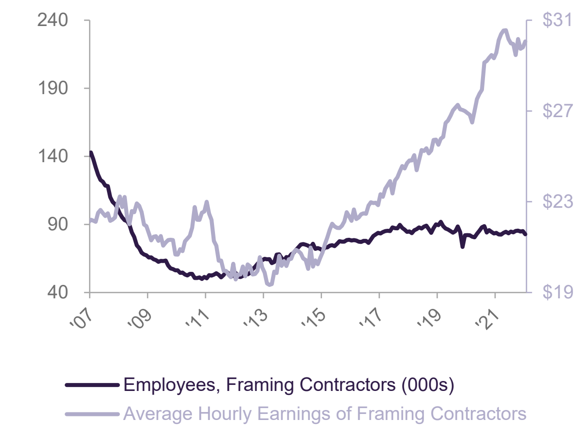
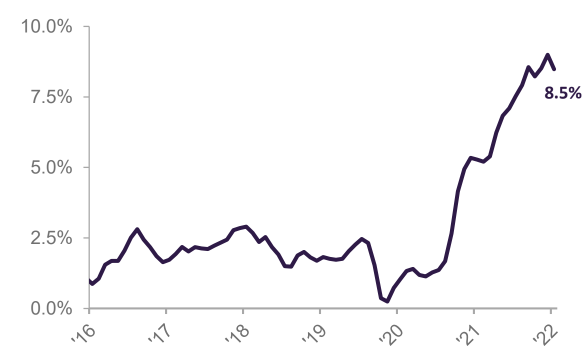



**Figure 8: Inflation**




Sources: FRED, Bloomberg, IHS Markit, Brent, WTI, S&P Capital IQ, NAHB, U.S. Census Bureau, U.S. Dept. of Housing and Urban Development, Bankrate, Truist Advisory Services