PRIVATE WEALTH MANAGEMENT

CIBC Private Wealth Blog

Residential Housing Market Outlook Remains Positive

Bryan Reily

November 30, 2017

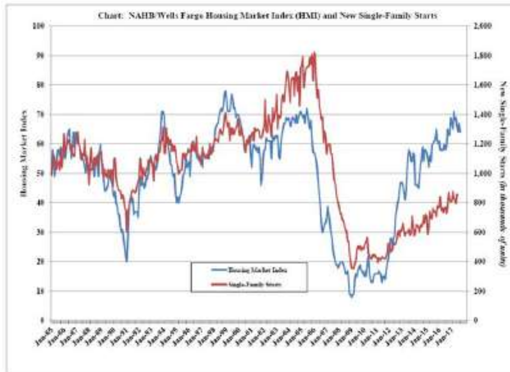
In "The Big Short," a film based on Michael Lewis' best-selling book about Wall Street's role in the credit and housing bubble collapse of the mid-2000s, there was a constant refrain: "But housing is always stable—people don't just not pay their mortgage—It will never collapse."

But collapse the housing market did. The spectacular meltdown led to the Great Recession and Financial Crisis of 2008. The residential housing market only began to recover from this debacle in 2011—well after the economy had begun to recover—and has been steadily rising since. Many market participants have questioned whether the continuing housing recovery is sustainable, and investors are understandably twitchy given the magnitude of the disaster leading up to 2008. However, housing market conditions are much different today and we believe the likelihood of severe disruption is low.

The 2008 crisis arose due to the collapse in the sub-prime lending market, and banks learned a hard lesson about lending standards. As a consequence, banks restrained lending and tightened standards as they began to recover from the financial crisis. Even prospective homebuyers with stable incomes and strong credit scores found it much harder to borrow to buy a home. These measures were a drag on the housing market recovery, and stagnant wages, job losses and lower levels of household formation also contributed to the recovery's slow start.

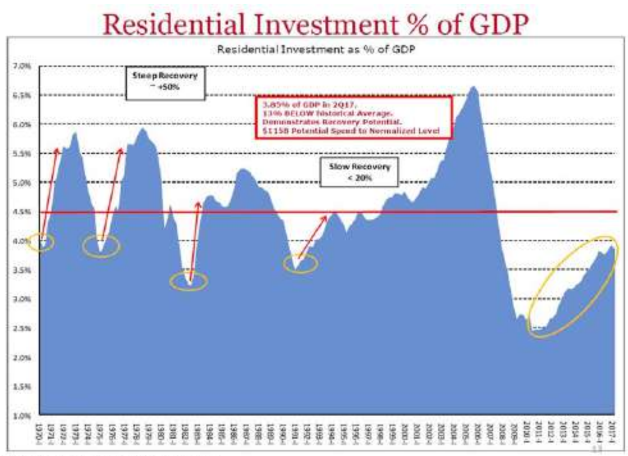
The current strength in the economy, accompanied by robust employment and job figures, as well as a moderate gain in wage levels, is contributing to the recovery in the housing market. In 2016 new household formation, an important factor influencing the strength of the housing market, witnessed the first uptick after a number of years in decline[1]. This year, housing demand has outstripped supply as labor constraints have held back building activity. However, homebuilder confidence continues to be strong on the back of demand, and the National Association of Home Builders (NAHB) has also forecast further gradual strengthening in the housing market[2].

PRIVATE WEALTH
MANAGEMENT



Source: Wells Fargo Securities, LLC, Census, NAHB

This fall's violent hurricane season has increased concerns about labor availability and building materials costs, and supply-side challenges are likely to continue as a drag on activity. However, with homebuilders unable to satisfy demand, we believe that the recovery cycle should be extended. Residential housing investment as a percentage of GDP also remains under the 50-year median, but with builders not adding to inventory faster, this doesn't present a problem in our view.



Source: Wells Fargo Securities, LLC, Commerce Department
As of October 2017.

On the credit side of the equation, we see that mortgage rates remain attractive, leading to increasing cash-out re-financings and home equity lines of credit. Nonetheless, the lessons from the sub-prime crisis are still reflected in credit terms, and we have no near-term concerns regarding any relaxation. Indeed, sub-prime auto lending, student loans, and credit card lending are much greater concerns for banks in the current climate.

In conclusion, our view is that the housing market should remain robust as long as the economy continues on its current positive track. Labor will remain a significant challenge in the housing construction sector, as across the economy employers are finding it more difficult to source skilled and trained workers given relatively full employment. This constraint may dampen supply. Meanwhile, indicators such as nonfarm payrolls, household debt service, attractive mortgage rates, improving mortgage availability, and firming house values should keep demand high.

For more on our views regarding the housing market, please speak with your CIBC Atlantic Trust wealth advisor.

Bryan Reilly is a senior investment analyst for CIBC Atlantic Trust Private Wealth Management's Proprietary Investment Team, responsible for researching the industrials and materials sectors. Additionally, he is a member of the Mid-Cap Growth Equity Team and the Asset Allocation Committee. Bryan also remains actively engaged as a member of CIBC Atlantic Trust's Multi-Manager Investment Program, where he is responsible for evaluating and selecting nonproprietary, long-only domestic and international equity managers across market capitalization and style categories.

[1, 2] Wells Fargo Monthly Housing Compendium, October 2017, page 16.