THE PARLIMENT PAGES

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NEXT YEAR WILL BE THE YEAR –

As you know, Parliment is located in Jacksonville, which is also the home of the NFL Jaguars. According to the coaches of the 3 wins and 13 losses team, this was a rebuilding year and the foundations are in place for next year. On the surface all indicators point to that very fact. The team is young, has talent and a coach that everyone believes in. The problem is that we, the fans, have heard that same line at this time of the year for the past 8 years. For 8 years, the Jags have had a young team, full of talent with a good coach. And yet, every year ends up being the same or worse than the previous year. It's like the team is stuck in slow curing concrete and just can't get out of the mess.

Seriously, can you think of a better analogy to describe our industry? Every year, the hopes are there that the turnaround is right around the corner. All of the indicators are in place - low interest rates, low ownership absorption, low builder inventories, stable pricing, aggressive mortgage lending and many more. And yet despite these facts, we once again end up with what feels like a losing season.

Will 2015 be the year? Read on and let's see what we think.

EXACTLY HOW DID 2014 FARE?

We predicted that 2014 would have an 8%-10% increase over 2013 bringing total housing starts to somewhere in the 950,000 range. The good news is that we were spot on to that exact number. However, the not so good news was that the number was heavily skewed towards multi-family instead of the more profitable and higher cost single family. Like the Jags, this puzzled the analysts throughout the year. The economy was showing signs of a rebound, interest rates remain low, mortgage lending is more lenient and building costs have remained fairly stable.

As we have mentioned in the past, we spend a lot of time researching from multiple sources. We try to find as much diversification in opinion as possible to make sure we are not overlooking an opinion that may sway our thinking. One of our sources is the Dent Research Company headed by the well-known and controversial economist, Harry Dent. Dent made his mark in the early 80's when he began advocating the effects of demographics on the market. Simply put, he concludes that spending patterns vary according to age. For instance diapers are mostly sold to people in their late 20's, while vacation homes and motor homes are sold to people in their 50's. He also found that the largest age cohort that bought Harley Davidson motorcycles was 48 – 54, as men passed through their second childhood and identity crisis.

With this background information, he was then able to overlay the age cohorts as they moved through their cycles and accordingly was able to accurately predict spending patterns and those patterns that effect the overall economy.

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Dent actually predicted a downturn in housing as early as 2005. However, his downturn was not due to an economic crash but rather from his study that showed the aging population just was not going to be buying larger homes. In fact, there are 10,000 people a day retiring and a large portion of them are looking to downsize and wouldn't even dream of buying something bigger. Harry has steadfastly maintained his position and does not believe housing will recover substantially until 2025 when the echo boomers reach the age of larger trade-up home purchasing. We are coming to believe that Harry may have it right.

In our previous newsletter we discussed the effect of student loans on the housing industry. In our opinion, there is no question that the abundance of student loans has removed a large section of the house buying public from the market. If you put this together with Harry's thinking, we believe the two are the primary reasons for the stagnation in the market and the large population living in multi-family facilities.

LET'S DIVE A LITTLE DEEPER INTO THE HUMAN MIND –

The home ownership percentages have dropped to the lowest level in over 25 years, more than 15% lower than the peak. There is no question that the student debt situation has impacted the first time homebuyers and that has contributed significantly to this decrease in ownership percentage. However, there is another statistic that, we believe, hurts our industry even greater. The age cohort of 35-44 has virtually stopped buying trade-up homes. Traditionally, it was the construction of these larger homes that drove much of the economics of the industry.

There are a multiple of psychological reasons behind this stalled market. Most homebuyers, big or small, have refinanced mortgages. Psychologically, a refinance transaction pretty much commits the owner to staying in the property for a few more years. Puzzling, this psychology remains in place despite the fact that the homeowner could get almost the same rate on a new purchase. The continuing uncertainty of the economy and a total lack of confidence in the nation's leadership have added to this hesitancy. Additionally, many of these buyers purchased their first homes at the peak and suffered dramatic losses. Even though much of the loss has been recouped, the memory of the loss still lingers. No longer do buyers look at real estate as a sound investment.

One would hope that as the 18 – 35 age cohort moves into this category, trade-ups would start to take place. However, this age of the millennial, is not likely to rescue the industry anytime soon. In addition to crushing student debt, that millennial group has a vastly different outlook on life. They are truly the mobile and technology generation who do not see planting roots. Jobs, living conditions and recreation are all transitory with this generation and they feel no desire to be tied down to a fixed piece of real estate.

INTEREST RATES AND MORTGAGES –

The common belief is that we will finally see the Federal Reserve put some pressure on raising interest rates. We believe that any rise in rates will really be quite insignificant. There are too many issues surrounding this and, in the end, we think most of the talk is just talk. Rates will continue to be at historic lows at least through 2015. This is good for two reasons. First, those obviously low rates improve affordability formulas. But even more significant could be the threat of rising rates that may get some people off the fence who will then make a home purchase in fear of missing out on the low rates.

Lending standards are once again changing as mortgage credit departments are lowering their requirements. As the refinancing phenomenon has pretty much worked itself to completion, mortgage companies will become increasingly competitive trying to get business. In the past couple of years, this has not really had much of a positive impact, however it is good to see that mortgage companies will at least not be a headwind going forward.

CONCLUSION –

We see the market remaining stable at the 2014 numbers. However, the good news is that we do see a slight shift from the multi-family numbers into the single family. In all, we believe the single-family starts will be in the 550,000 – 600,000 range while the multi-family drops from about 600,000 in 2014 to about 400,000 in 2015.

SO MUCH FOR THE BIG PICTURE –

This analysis of the national market provides a general environment under which local markets perform. To get a really good picture of what is going in your business, you need to look at more localized data. The good news is that we are still in the warm South and a good portion of our market is close to the oceans or in proximity of world class retirement communities. For instance, for years, Florida was gaining over 1,000 net new residents a day. As the crash took hold, that number reversed and we were losing about 1,000 net residents a day. Most of those that left were attached to the construction industry, which languished under the severe downturn.

Construction employment gains are now widespread through the Southeast. This is being driven somewhat by the modest rebound in home building. However, much of the gain is coming from industrial, commercial and infrastructure projects that are coming off the boards and are in the initial stages of commencement. We see especially strong growth occurring along the coastline and bordering the various interstate highways.

So, while the national market will continue to plow along at a snail's pace, we are optimistic that our markets will beat the national trends. We don't think it will be by any extravagant amount, but will more likely be about a 6%-8% growth from 2014.

MARKET CONSOLIDATION –

For the past couple of years we have been writing about the consolidation that is taking place throughout the entire distribution channel in our industry. Up to this point, most of that consolidation was happening in the manufacturing side. That continues to be hot and we expect there will be several more major acquisitions made in 2015, i.e. PrimeSource and Pro-Build. However, the biggest area of activity is now shifting to the dealer and the distribution levels. While much of this activity in the past was motivated by financial strategy, we believe most of the future activity is going to be demographically driven.

THE SCARY PICTURE OF BUSINESS OWNERSHIP –

Many businesses operate through the dealer/distribution sales model. Under this model, the distributor buys from the manufacturer and resells it to the dealer who in turn sells it to the "end user." These distributor/dealers are not one-man shops but typically will employ between a dozen and upwards to 100 employees. They are the backbone of our economy.

Demographics have played a nasty trick on these companies. The average age of the owner of these companies is presently sitting at 61+ years. Many of these owners are working with some of the same employees that they started with decades ago. As a result, we have an aging workforce who is looking more towards retirement than to building a business.

Many of these owners are also discovering that their exit plan strategies are somewhat limited. In the past, many of these businesses were passed on to the next family generation. However, more and more family members are choosing not to follow in their mother or father's footsteps. They sat on the sidelines and watched the struggles of the past few years. They experienced the dinner table conversations about bank debt, slow or no pay customers, disloyalty from major customers, and ridiculous regulations. So, when the parent asks the child, "do you want to take over the business" the answer, increasingly is, "no thank you."

With that option gone, these same owners are finding that you don't just put a "for sale" sign in front of your office. Few parties are interested and those that are, don't have any cash. Therefore, you are faced with selling to someone who has no idea what they are doing and you will only be paid out over a long period of time, if that person figures out how to be successful. This is not a particularly attractive alternative.

Several years ago, many of the "big boys" stepped in to do some roll-ups of large numbers of companies. Major outside private equity participated. True to form, this was done prior to the crash and virtually all of these roll-ups either failed totally or never came close to living up to their expectation. Additionally, the private equity guys took substantial losses and are not anxious to get back into that game. The big boys are probably not a factor for quite some time.

As a result, many dealers are now looking to sell to their competitors. This is always a troublesome transaction as you must open your books, your customer lists and a lot of your proprietary information to the guy you are competing with. However, in the end, you just may not have any other options. While these transactions are always quite tricky, we are seeing a dramatic increase in this activity and expect it will pick up exponentially over the next few years.

The art of exiting one's business is an extremely complex process that is full of inherent risks. For many owners, the value of their business represents the biggest portion of their wealth. The proper monetization of that value can take several years of careful planning and execution. Do not underestimate the steps necessary to make that transaction your most profitable sale of your career.