



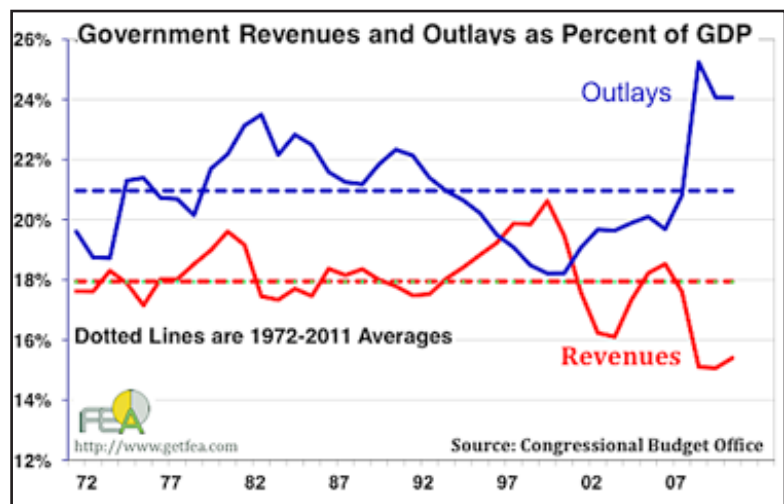
MADISON'S TIMBER PREVIEW

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Forest industry analysts Forest Economic Advisors (FEA) out of Boston, MA, last week held a webinar, "Exploring the Risks that Could Derail the Long-Awaited Housing Recovery". This is the same outfit that earlier this year made a very good presentation of US demographics and a projection of its affects on US home building to 2020 at the Western Wood Products Association annual convention. *Madison's* was very interested to hear what they have come up with in their projections for US home building. Unfortunately its not all pretty, which is pretty much a given:

- Housing and panel forecasts from Craig Adair at APA - The Engineered Wood Association, using nine different forecasting organizations. There's a very broad consensus that we're going to see housing improve from to about 750,000 starts this year and about 900,000 next year.
- Despite coming in at the low end of these estimates FEA does have an optimistic assessment. But a lot of that is based upon the presumption that: 1) we're not going to get another recession; 2) while we're not going to have spectacular economic growth going forward, we're going to have decent economic growth.
- The number one proximate risk, starting with economic risk, is an unruly Euro meltdown. This has cascading effects through the European banking system. It's a return of a financial crisis.
- Oil prices are a persistent risk. There were significant increases in oil prices on a percentage basis prior to each of the last two recessions. We've had persistent upward pressure in oil prices due to developments overseas, particularly in China. We're looking at persistent upper pressure on demand coupled with very tight supply.
- In the US, no matter who's elected, taxes are going to go up and spending is going to have to go down.
- There are those who say we're going to get a rise in interest rates because of the deficit and the debt, and a concurrent crash in the dollar. This so far hasn't happened.
- Each single family new home sale corresponds to about two housing starts within the next six months down the road. If we



assume a 68 per cent single-family share (see table), which is slightly lower than we've had the last few years, that brings us up to 822,000 housing starts annualized. This is insane and we currently are under building. We need to get more homes sales to reach our housing forecast, or else we're going to build inventory.

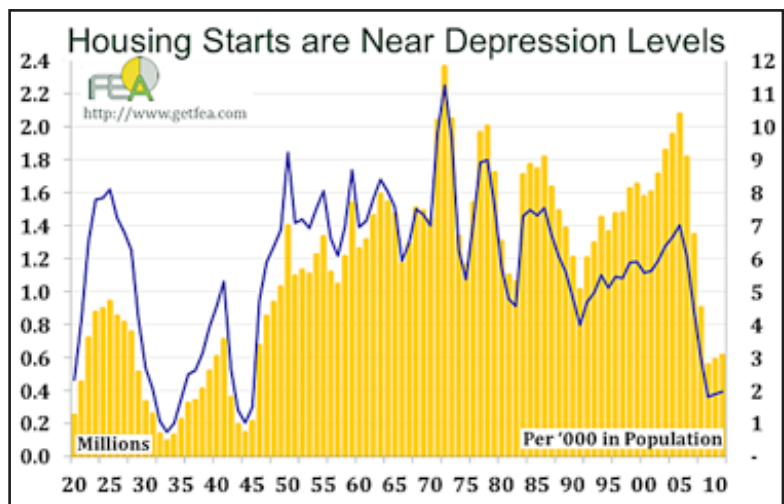
- House prices have just started to stabilize, and we view this as a seminal moment in the housing

New Single-Family Home Sales		358
Owner Build Share	http://www.getfea.com	33.7%
Single-Family Starts Needed To Replenish Sales		540
Not all Starts Completed		96.5%
Single-Family Starts Needed To Replenish Sales		559
Single-Family Share		68.0%
Total Housing Starts Needed To Keep Inventories Flat		822

recovery, it's one of the reasons why we're optimistic. Because the decline in home prices was hurting the confidence of buyers.

- In terms of student loan debt, we do expect increased debt loads to trim the headship rate for folks in that key 25-34 age bracket. And we built that into our forecast, lower headship rates for these folks.

- The orange bar shows housing starts, and the blue line shows housing starts per thousand population. We assume that that blue line returns to about five, which is actually pretty conservative. We project that using the census base-line projection for the next 15 years, we would get an average of 166,000 housing starts. Which is slightly above our estimate of underlying demand. During great depression and WW II we averaged 2.8 houses per thousand people.



The upshot of this bar chart is that [home sales] would have to stay really bad for a very long time to map the scenario that we had from 1930 to 1945.

- Since our long-term metrics have returned to long-term trend, the most likely scenario going forward is: housing recovery supported by stable home prices; employment growth; and, the continual sucking up of excess overhang of existing homes. The main risk of the forecast is macro economic in nature.

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