

U.S. Homebuilding

What You Need to Know About the Atlanta Housing Market

Equities

Americas
Home Construction

Susan Maklari

Analyst

susan.maklari@ubs.com

+1-212-713 7971

Taking the Pulse of Local Market Conditions

In order to gauge current conditions in the housing market, we regularly host a series of 30-minute conference calls with local market experts. This week we'll be speaking with Eugene James, Director of the Nashville and Atlanta markets for Metrostudy, to receive an update on the status of this area.

In Line with Regional Trends, Volume Gains Persist in Atlanta

[The Southeast continues to be an area of particular strength](#) for the housing market. In line with these trends, the improvement in demand Atlanta experienced last year has continued into 2016. We'd note starts have outpaced closings, driven by detached activity increasing 16% year over year for the trailing four quarters ending 4Q15. Further, attached starts were up nearly 10% over the same period, though this is a less significant segment of the Atlanta market, representing ~15% of the total. [On prior calls](#), our expert has discussed construction activity slowly expanding to more peripheral locations, allowing builders to better target first time and entry level buyers. This trend is in line with our belief that housing broadly remains in a period of transition, where volume growth will accelerate while pricing power is more limited. We expect this theme to persist for the next few years, as conditions return to more normalized levels.

Move to the Periphery Expected to Continue

As of the end of 4Q15, Atlanta had 110,000 vacant developed lots, most of which are located in more outlying locations, where demand is beginning to materialize among entry level buyers. The existence of these lots offers builders room to expand at lower price points in future years. Further, from a demand standpoint, we look for the apartment market to be a source of incremental activity as rents rise. We'd note rental rates were up ~10% year over year last year, outpacing new home prices.

Valuation: Our PTs are Based on a 50/50 Blended 2017E P/E & P/BV

Our price targets are based on a blended valuation using an average of 8x our 2017E EPS and 1.3x our 2017E BVs. The stocks trade at 8.6x our 2017E EPS and 1x our 2017E BVs. Our top picks in the group are TOL, LEN and PHM.

Figure 1: Conference Call Information

Date	Time	Market	Speaker	Dial-In Number	Dial-In Passcode	Replay Number	Replay Passcode
5/5/2016	11:30am ET	Atlanta	Eugene James, Director, Nashville and Atlanta Markets	800-675-6207	21810937	800-633-8284	21810937

Source: UBS

U.S. Homebuilding

UBS Research THESIS MAP MOST FAVORED

LEAST FAVORED

Toll Brothers, Lennar, Pulte

Meritage, KB Home

PIVOTAL QUESTIONS

Q: How much will new home sales rise in 2016?

We look for 10-15% growth this year—with greater likelihood it will be at the lower end of this range—given constraints around land and the availability of labor as well as the macro environment.

Q: Will the rate of home price appreciation slow?

We look for prices to rise in the mid-single-digit range, reflecting: 1) positioning of new communities to better target entry level and first time buyers as well as volume gains; 2) difficult comparisons, as limited inventory allowed for greater levels of appreciation earlier in the recovery; and 3) increased activity in more moderately priced areas.

Q: Will the multiple compression witnessed year-to-date remain a factor in the stocks?

Yes, as we go further in time through the broader cycle, we look for this to persist. As would be expected, historically, as the rate of unit growth decelerates and volumes approach peak levels, multiples trend lower.

WHAT'S PRICED IN?

Current valuations are pricing in moderating growth as we approach peak levels of activity:

As we enter the fifth year of the recovery—and with visibility remaining limited and greater risks to macro growth—concerns around moderating rates of unit expansion have risen. This has been furthered as the builders increasingly reduce their risk appetites as it relates to land investments and, in exchange, are accepting lower margins and returns. Based on current levels, we believe the stocks are pricing in growth of new home sales of ~10% for 2016.

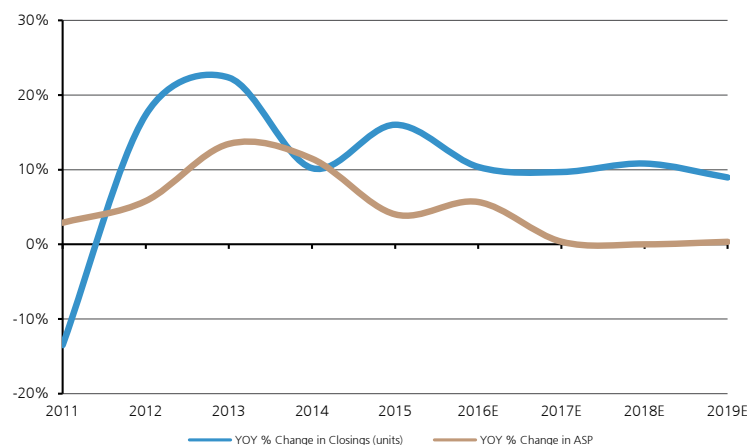
UBS VIEW

Greater participation among entry level and first time buyers will drive further gains: We expect activity in the housing market will continue to expand as the entry level and first time buyer segments gradually re-emerge, a trend that is likely to play out over the next 18-24 months, giving us confidence in our longer-term view.

EVIDENCE

UBS Evidence Lab suggests intent to buy, especially among millennials, is improving: Our [US Housing Intentions Survey](#) has shown an increase among millennials looking to buy a home, with 27% of this cohort intending to purchase in the next 3 months, up from 24% a year ago. Further, reflecting their confidence in the continuation of the recovery, the public builders have increasingly allocated capital to share repurchases, especially for equities that have lagged the broader rebound in the group.

We expect volume growth will exceed pricing as we move further in the recovery



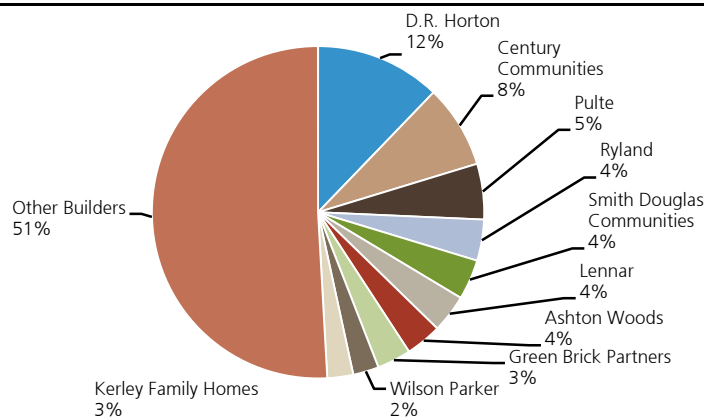
Source: Company reports and UBS estimates

Atlanta: A Closer Look

Builder Presence

With approximately 12,100 new homes closed in 2014 (based on data collected by Metrostudy and reported as part of Builder Magazine's "Local Leaders" series), the Atlanta/Sandy Springs/Roswell metropolitan area ranked as the 3rd largest housing market in the country. In terms of share held by the top builders, this MSA is more fragmented relative to other major markets. In each of the 50 largest housing markets in the US, the top ten builders were responsible for approximately two-thirds of new home closings in 2014, which compares to 49% in Atlanta.

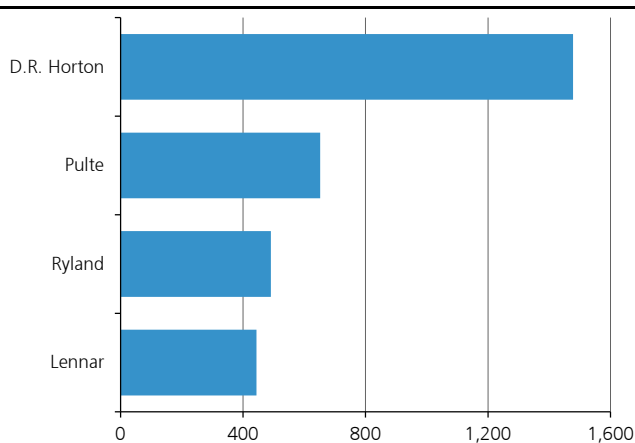
Figure 2: Share of 2014 Atlanta Area Closings, by Builder



Source: Builder Magazine (Metrostudy)

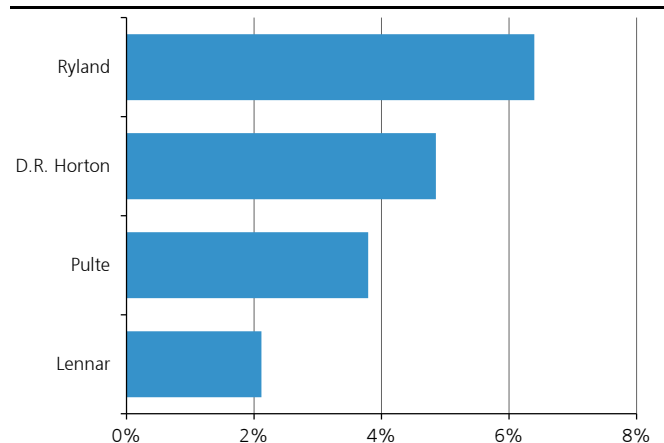
For companies in our coverage universe, D.R. Horton closed the largest number of homes in Atlanta in 2014. However, relative to total company closings, Atlanta was a more important market for Ryland (now part of CalAtlantic following the merger of equals with Standard Pacific).

Figure 3: 2014 Atlanta Area Closings



Source: Builder Magazine (Metrostudy)

Figure 4: 2014 Atlanta Share of Total Company Closings

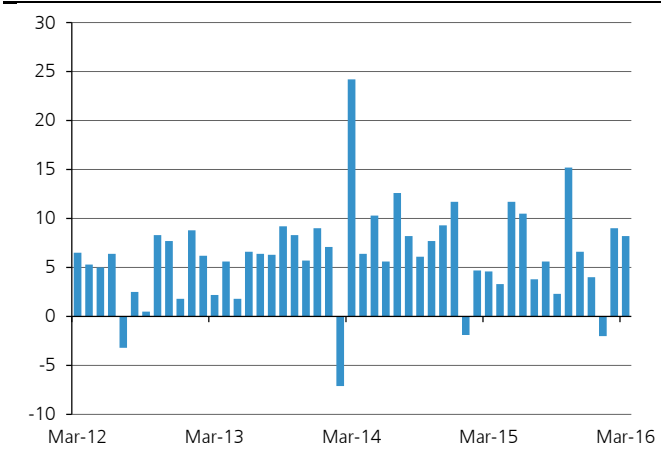


Note: Calendar year closings obtained from Builder Magazine. UBS divides these closings by closings per company reports for the four fiscal quarters most closely coinciding with the 2014 calendar year.
Source: Builder Magazine (Metrostudy) and company reports

Economic Backdrop

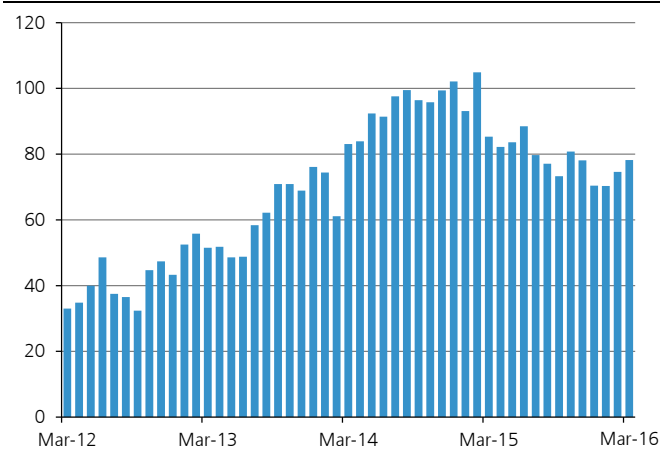
Although slightly slower than last year, employment growth in Atlanta has remained healthy to start 2016. Based on data published by the Bureau of Labor Statistics, employers in the Atlanta/Sandy Springs/Roswell MSA added 78,000 jobs annually as of March, down from an 85,000 gain for the same period in 2015.

Figure 5: Monthly Job Change (SA, '000s)



Source: Bureau of Labor Statistics

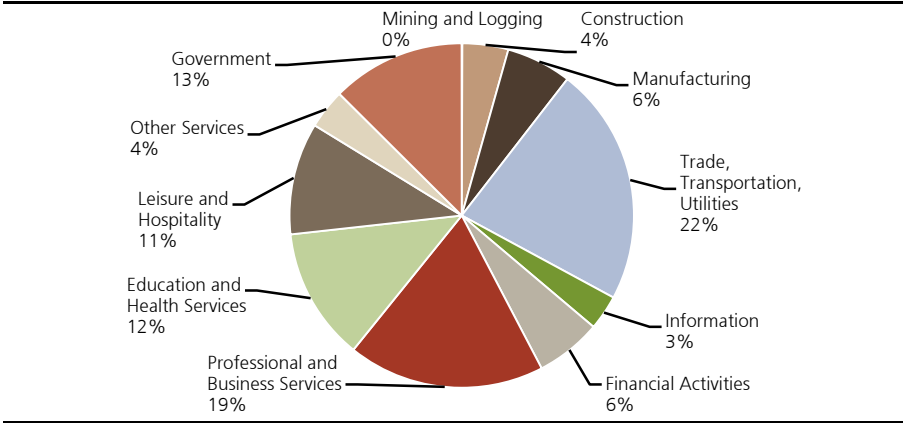
Figure 6: YOY Change in Employment (SA, '000s)



Source: Bureau of Labor Statistics

This represents employment growth of 3.1%, faster than the national average of 2%. Trade, Transportation & Utilities accounted for ~18,500 new jobs (+3% YOY), or about one-quarter of total additions, while Professional & Business Services added another ~14,000 positions (+3% YOY). In terms of percentage increase, construction was the fastest growing sector, adding ~8,500 jobs and increasing 8% year over year.

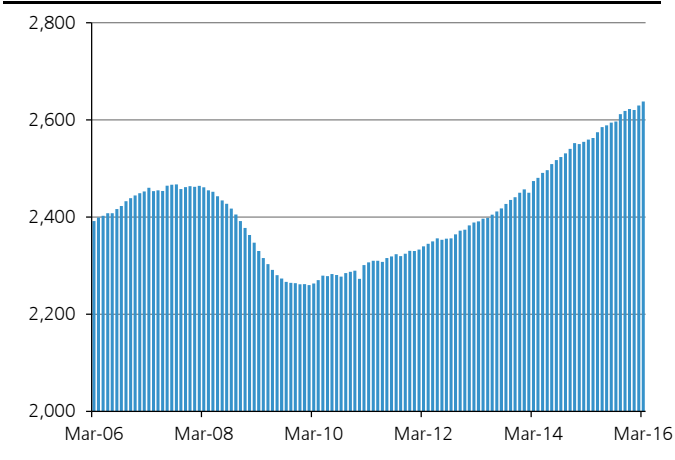
Figure 7: Share of Employment, by Sector, March 2016



Source: Bureau of Labor Statistics

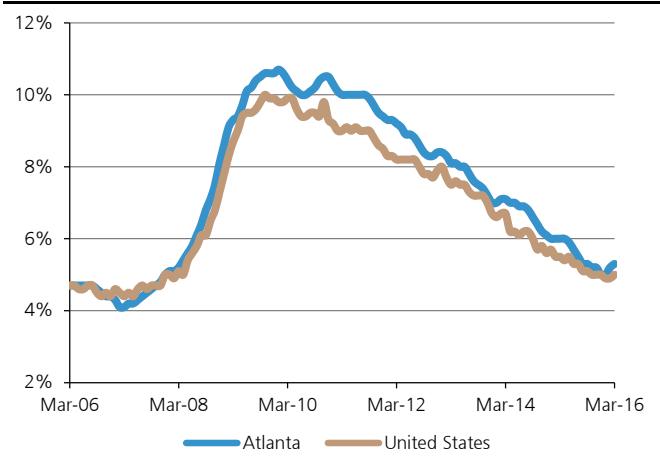
Although Atlanta has experienced strong job growth, which has lifted employment approximately 7% above its pre-recession peak, the unemployment rate here remains ahead of the national average.

Figure 8: Total Nonfarm Employees, Atlanta (SA, '000s)



Source: Bureau of Labor Statistics

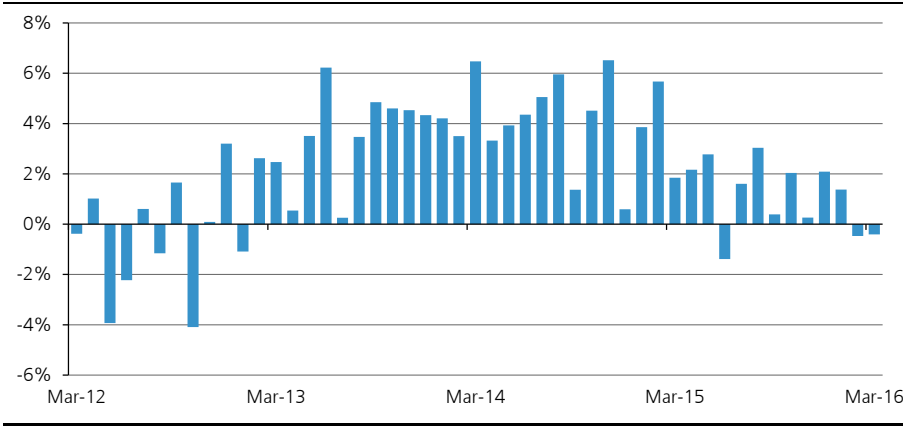
Figure 9: Unemployment Rate (SA)



Source: Bureau of Labor Statistics and Federal Reserve Bank of St. Louis

In term of wage growth, jobholders in Atlanta have seen comparable pay increases to those at the national level, with the average weekly earnings of a private employee rising at a compound annual rate of ~2% in the five years through March 2016.

Figure 10: Average Weekly Earnings, Private Employees, YOY % Change (NSA)



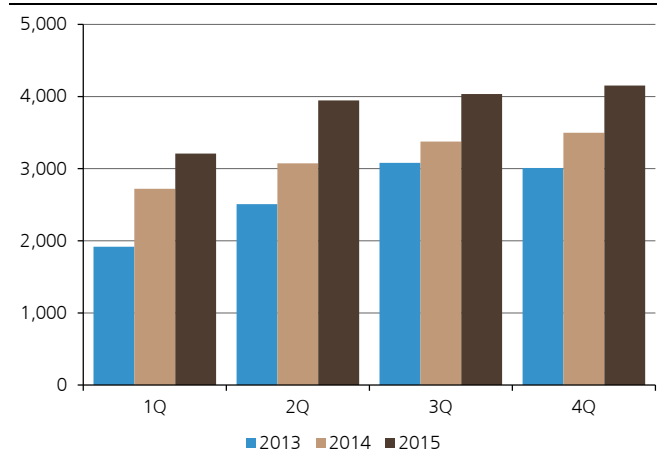
Source: Bureau of Labor Statistics

Housing Update

Volume

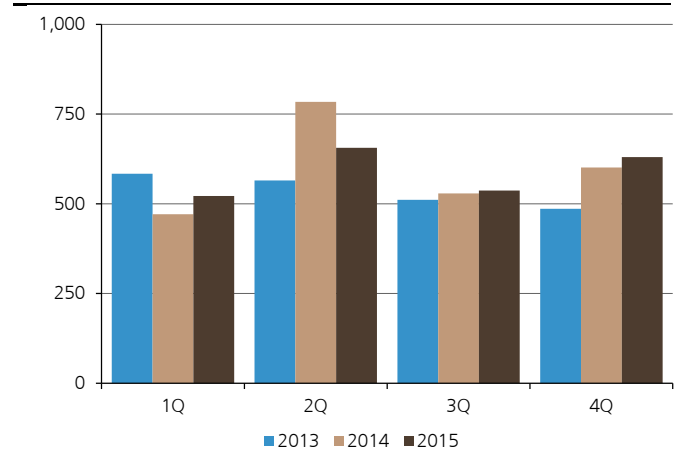
For the trailing four quarters ending 4Q15, closings of new detached homes in Atlanta rose 21% over the period ending 4Q14. In this area, attached dwellings represent approximately 15% of total closings, and declined 2% year over year.

Figure 11: New Detached Closings, Atlanta



Source: Metrostudy

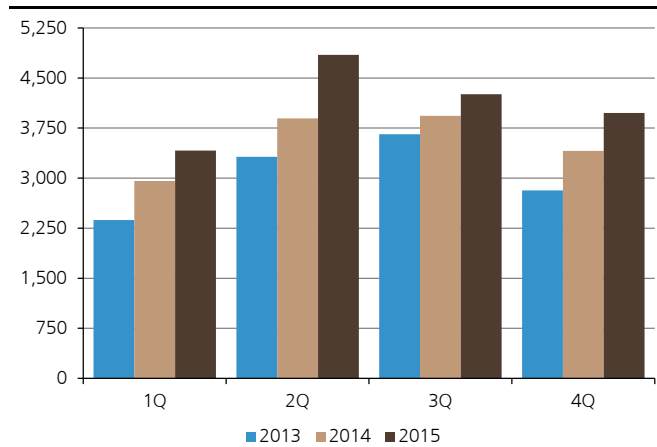
Figure 12: New Attached Closings, Atlanta



Source: Metrostudy

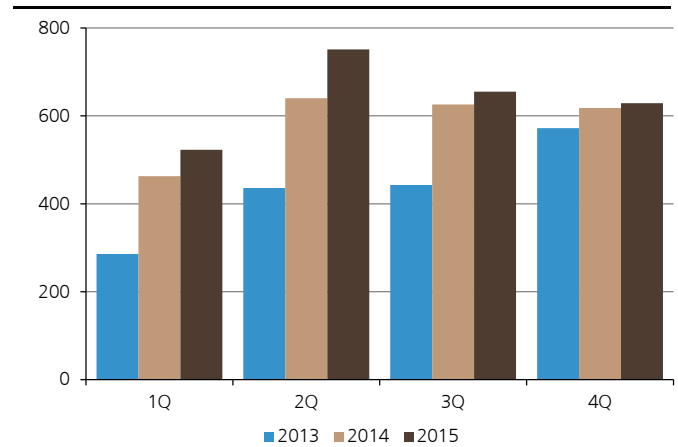
Starts continue to outpace closings, driven by detached activity increasing by 16% year over year for the trailing four quarters ending 4Q15. While attached starts were up 9% over the same period, like closings this is a less significant segment of the Atlanta housing market.

Figure 13: New Detached Starts, Atlanta



Source: Metrostudy

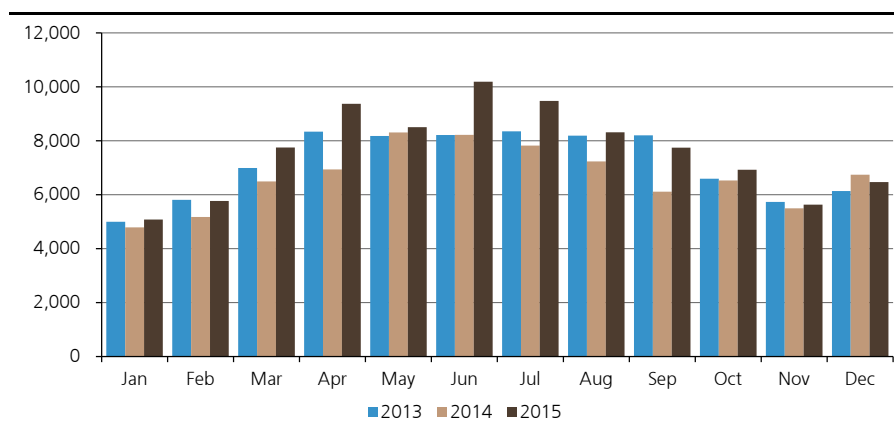
Figure 14: New Attached Starts, Atlanta



Source: Metrostudy

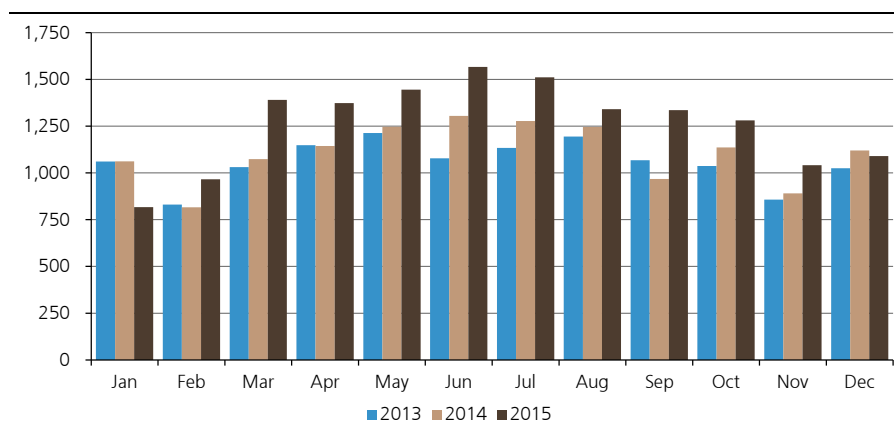
Total sales of existing homes were equally healthy as volume was up 14% for the trailing 12 months ended December 2015 versus 2014. Of this total, conventional sales rose 20%, while REOs fell 9%. Further, both detached and attached resales, including conventional and REO, increased 14%.

Figure 15: Existing Home Sales, Detached, Atlanta



Note: Includes regular resale and REO closings.
Source: Metrostudy

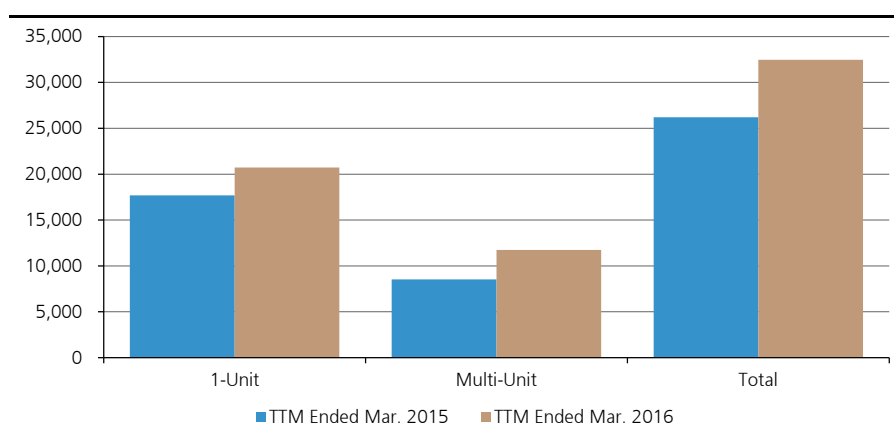
Figure 16: Existing Home Sales, Attached, Atlanta



Note: Includes regular resale and REO closings.
Source: Metrostudy

As it pertains specifically to the Atlanta/Sandy Springs/Roswell MSA, single-family permit issuances for the trailing 12 months ending March 2016 rose 17% over the same period for 2015. Further, multi-family permits, which make up roughly a third of all issuances, rose 38%.

Figure 17: Building Permits, Atlanta/Sandy Springs/Roswell (NSA)



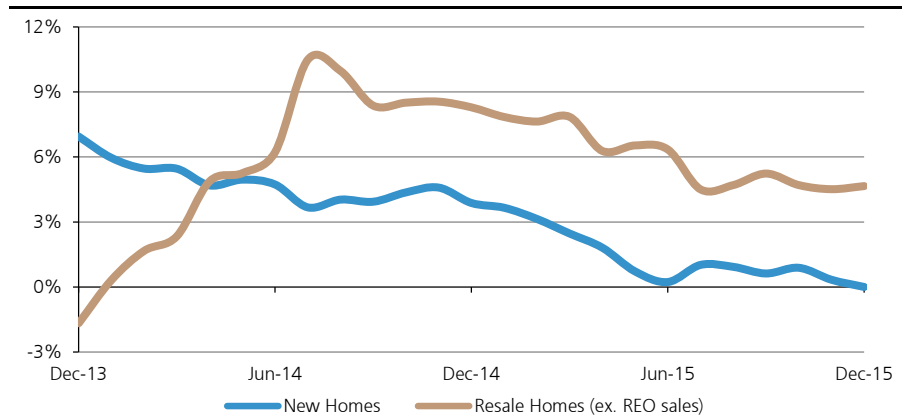
Source: US Census Bureau

Supply and Pricing

Total supply was up 14% year over year as of the end of 4Q15. This was driven by detached and attached product up 14% and 11% year over year, respectively. Currently, detached inventory represents approximately 80% of the available stock. Additionally, the supply of vacant developed lots stands at 67 months for detached housing. That said, the majority of these lots are located in less desirable submarkets.

Pricing of new detached homes has been fairly moderate over the past 2 years rising, on average, in the low-single-digit range on a year-over-year basis. Over that same time period, pricing in the detached resale market has been slightly more volatile, but appears to have settled into a similar range since the second half of last year.

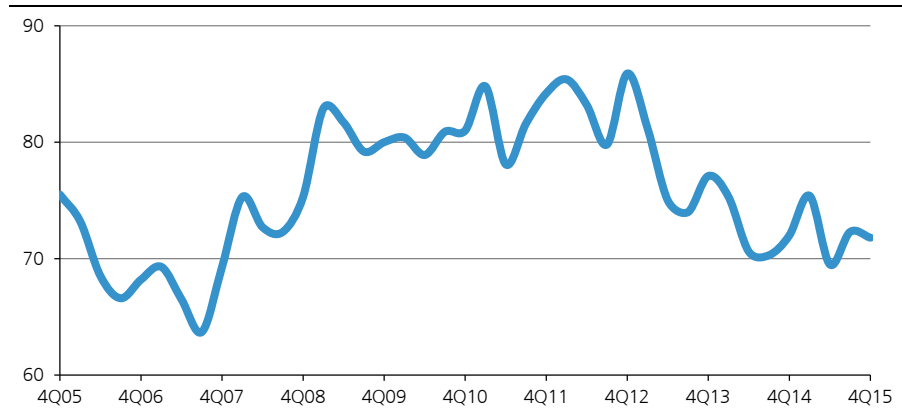
Figure 18: YOY % Change, Trailing 12 Months Average Median Prices, Detached Homes, Atlanta



Source: Metrostudy

Although it has deteriorated somewhat over the past 3 years, Atlanta remains relatively affordable given the more moderate price increases here compared to other markets. As a result, we will be interested to get an update on trends in the entry level and what builders are doing to attract this buyer.

Figure 19: NAHB/Wells Fargo Housing Opportunity Index, Atlanta Area



Source: NAHB

Valuation Method and Risk Statement

The primary risk facing homebuilders, including KBH, LEN, MTH, PHM and TOL, currently is that the recent improvements experienced slow or reverse, driven by 1) a weaker macroeconomic backdrop and the related lower level of job creation or 2) the impact from recent increases in mortgage rates. Additional risks include increased costs for either land, labor or materials and the potential for the more limited availability of mortgage financing to negatively impact demand.

Our price targets for KBH, LEN, MTH, PHM and TOL are based on a blended valuation using an average of 8x our 2017E EPS and 1.3x our 2017E BVs.

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Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
KB Home ¹⁶	KBH.N	Sell	N/A	US\$13.39	03 May 2016
Lennar ^{7, 16}	LEN.N	Buy	N/A	US\$44.72	03 May 2016
Meritage Corporation ¹⁶	MTH.N	Sell	N/A	US\$33.45	03 May 2016
PulteGroup, Inc. ¹⁶	PHM.N	Buy	N/A	US\$18.20	03 May 2016
Toll Brothers ¹⁶	TOL.N	Buy	N/A	US\$26.94	03 May 2016

Source: UBS. All prices as of local market close.

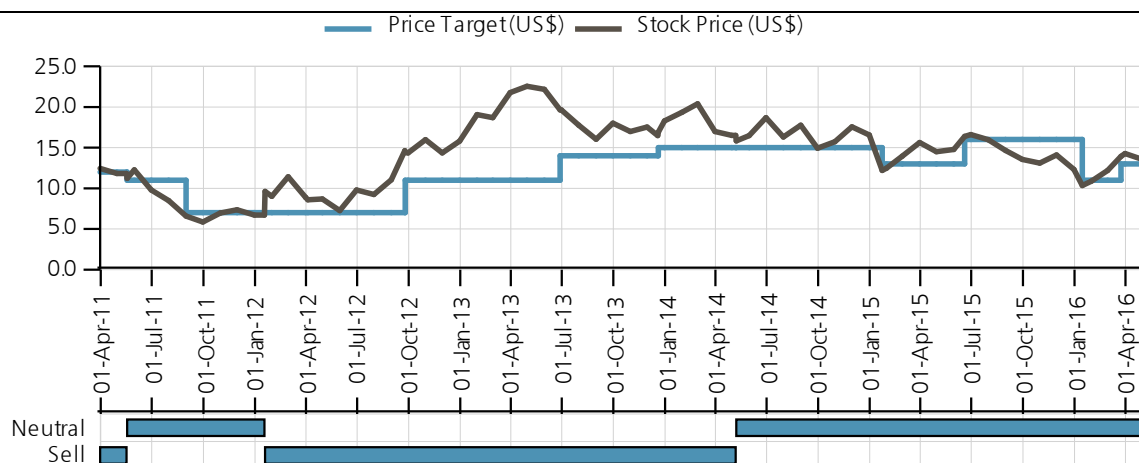
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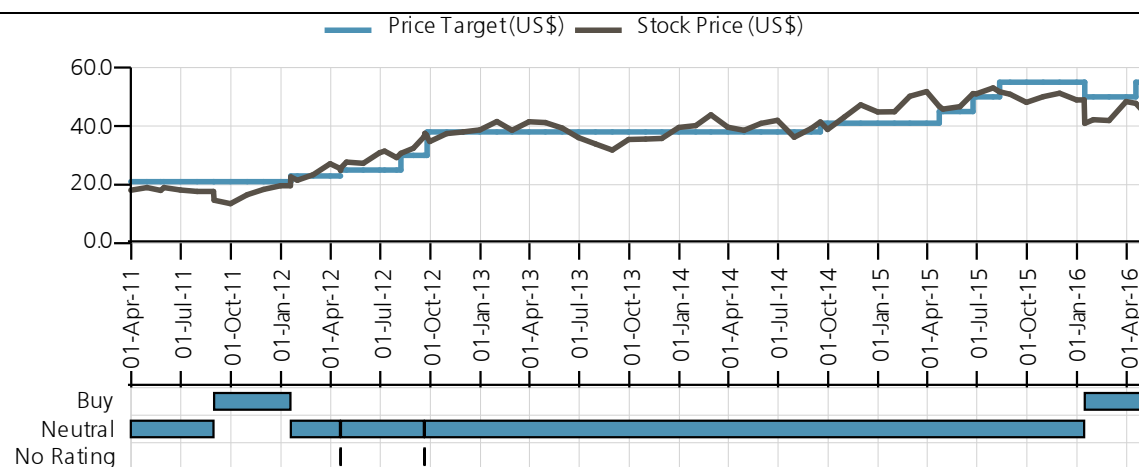
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KB Home (US\$)



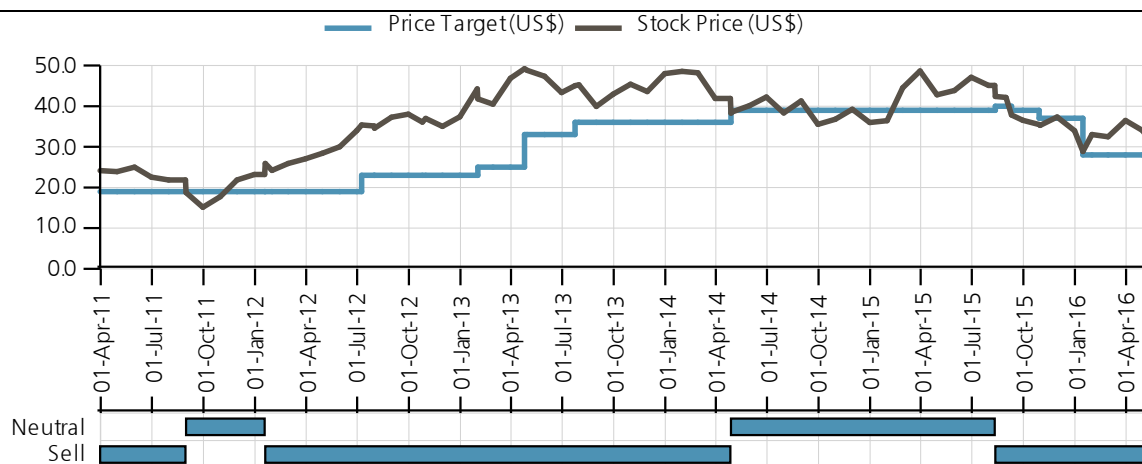
Source: UBS; as of 03 May 2016

Lennar (US\$)



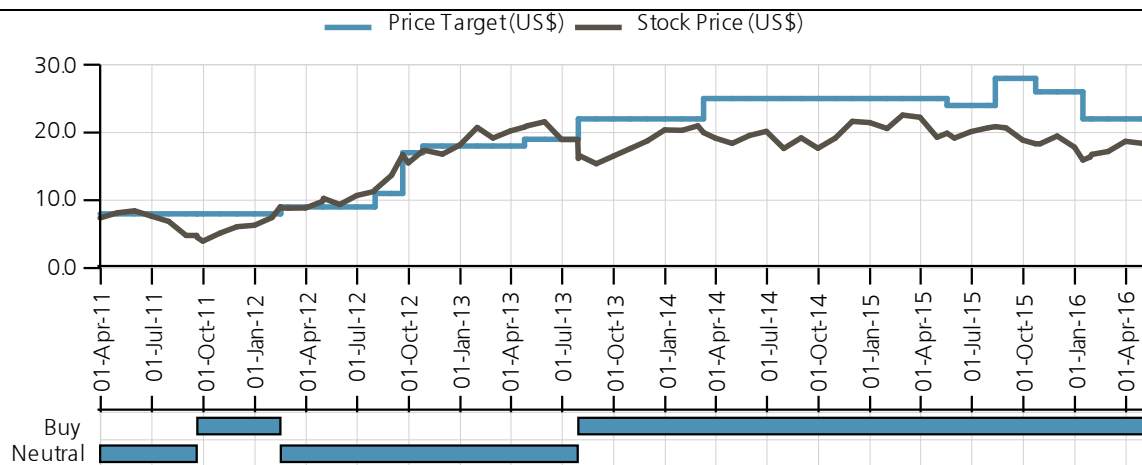
Source: UBS; as of 03 May 2016

Meritage Corporation (US\$)



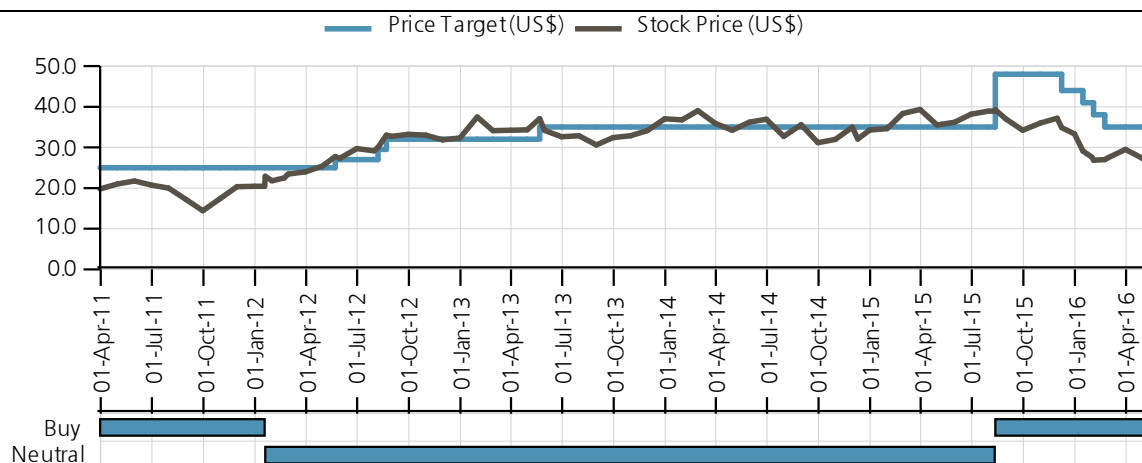
Source: UBS; as of 03 May 2016

PulteGroup, Inc. (US\$)



Source: UBS; as of 03 May 2016

Toll Brothers (US\$)



Source: UBS; as of 03 May 2016

Additional Prices: Beazer Homes, US\$7.71 (03 May 2016); D.R. Horton Inc., US\$29.99 (03 May 2016); CalAtlantic Group Inc, US\$31.93 (03 May 2016); Source: UBS. All prices as of local market close.

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