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OUTLOOK
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Homebuilding – US

Outlook negative on economic slowdown from coronavirus, rising unemployment

Contacts

Natalia Gluschuk +1.212.553.4121
AVP-Analyst
natalia.gluschuk@moodys.com

Dean Diaz +1.212.553.4332
Associate Managing Director
dean.diaz@moodys.com

Lana Kulikova +1.212.553.1034
Associate Analyst
lana.kulikova@moodys.com

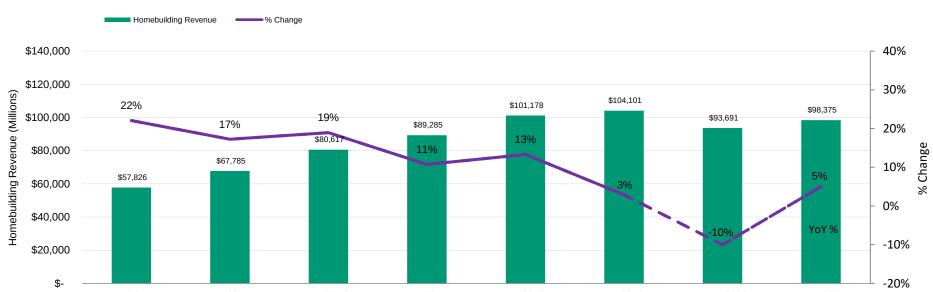
Griselda Bisono +1.212.553.4985
VP-Senior Analyst
griselda.bisono@moodys.com

Our outlook for the US Homebuilding Industry is negative. This outlook reflects our expectations for the fundamental business conditions in the industry over the next 12 to 18 months.

» **Our negative outlook for US homebuilding reflects the expectation of a slowdown in home sales during the coronavirus outbreak.** Homebuilders' 2020 results will be dampened by a meaningful slowdown in home selling during the second quarter 2020, with an improved, but still weaker environment, in Q3 and Q4 2020 — compared to 2019. This is reflective of Moody's Macroeconomic forecast for real GDP in the US to decline 2.0% in 2020, composed of a 4.3% decline in Q2 with improvement in the second half, once fiscal and monetary stimulus efforts take hold.

» **Given the likely near-term pause in the US economy, we forecast homebuilders' revenue will decline by 10% or more in 2020** (see Exhibit 1)**.** We also expect industry gross margins will weaken to 19% (see Exhibit 2). These figures compare to a 3% growth in aggregate revenue and a 20% average gross margin generated by US homebuilders in 2019.

Exhibit 1
Homebuilding revenue to decline by 10% or more in 2020

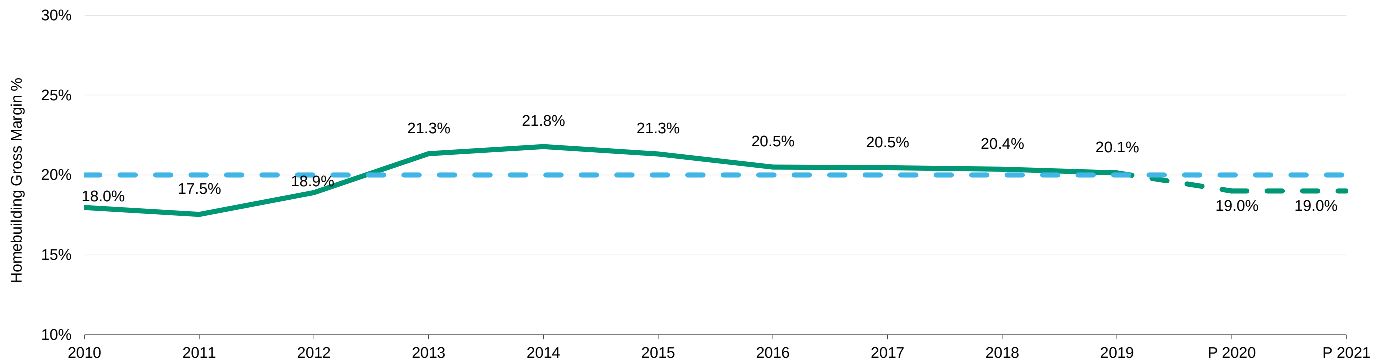


Aggregate revenue of rated homebuilders
Source: Moody's Financial Metrics™, Moody's Projections

Exhibit 2

Homebuilding gross margins to weaken to 19% in 2020

Margin forecast reflective of increasing incentives to encourage demand amid already weak pricing power and high costs



Aggregate gross margin of rated homebuilders

Source: Moody's Financial Metrics™, Moody's Projections

» **The spring selling season will be difficult.** During Q2 2020 homebuilders will face slowing new home orders and increasing cancellations of existing orders, both of which will result in weaker revenue later in the year. Homebuilders will likely need to offer greater incentives to close home sales, hurting their gross margins amid still-high input costs of land, labor and materials. Slowing sales will come as a result of employment weakening substantially. The US Department of Labor reported initial unemployment insurance claims rose by 3 million, to 3.28 million, for the week ended March 21. Unemployment claims rose as the industries most immediately and directly affected by the coronavirus cut staff. Also, stay-at-home orders across many states and municipalities, as well as increased homebuyer hesitancy, given the uncertain environment, will contribute to this weakness. Accommodative interest rates, that were lowered further by the Federal Reserve recently, will be helpful but will not offset weaker consumer sentiment.

» **Beyond the pandemic's shock, underlying homebuilding fundamentals are solid.** Lack of housing oversupply, low interest rates supporting affordability, and favorable demographics will result in pent-up demand once economic conditions stabilize in 2021 and employment figures improve. Moody's Macroeconomic Board forecasts real GDP in the US will recover, climbing 2.3% in 2021. We do not expect the depth and severity of the current slowdown to replicate the 2008 crisis for homebuilding, given the supportive underlying sector fundamentals.

» **Conservative balance sheets and curtailment of land purchases will help companies weather weak demand.** We believe most homebuilders will reduce land spend and lessen speculative home construction, thus boosting their near-term liquidity. Companies with an emphasis on land-light strategies will be less susceptible to land impairments. We expect large and broadly diversified homebuilders with strong balance sheets and liquidity profiles — such as NVR Inc. (Baa1 stable), D.R. Horton, Inc. (Baa2 stable), Lennar Corporation (Ba1 positive), PulteGroup, Inc. (Ba1 positive), Toll Brothers, Inc. (Ba1 positive) — to manage better through this period of weakness.

» **What could change our outlook?** We could change our homebuilding sector outlook back to stable from negative if our expectations for the industry revenue return to a range of negative 10% to positive 10%, while gross margin expectations remain within a range of 15% to 20%.

Industry outlooks reflect our view of fundamental business conditions for an industry over the next 12-18 months. Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

Coronavirus

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. We expect that credit quality around the world will continue to deteriorate, especially for those companies in the most vulnerable sectors that are most affected by prospectively reduced revenue, margins and disrupted supply chains. At this time, the sectors most exposed to the shock are those that are most sensitive to consumer demand and sentiment, including global passenger airlines, lodging and cruise, autos, as well as those in the oil & gas sector most negatively affected by the oil price shock. Lower-rated issuers are most vulnerable to these unprecedented operating conditions and to shifts in market sentiment that curtail credit availability. Moody's will take rating actions as warranted to reflect the breadth and severity of the shock, and the broad deterioration in credit quality that it has triggered.

For more information on research on and ratings affected by the coronavirus outbreak, please see: moodys.com/coronavirus.

Moody's related publications

» US – Homebuilding: Coronavirus related risks grow more acute if the economic fallout is deep and prolonged (March 19, 2020)

» Global Macro Outlook 2020-21 (March 25, 2020 Update) - The coronavirus will cause unprecedented shock to the global economy

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Contacts

Natalia Gluschuk +1.212.553.4121
AVP-Analyst
natalia.gluschuk@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454