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OUTLOOK
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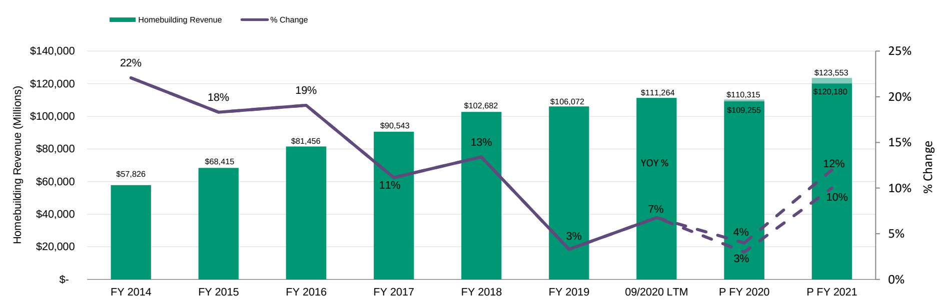
Homebuilding – US

Outlook to positive with robust new orders, backlogs to produce solid revenue growth

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

» **We changed our Homebuilding outlook to positive because we expect solid demand that emerged in the sector during third quarter of 2020 to continue during 2021.** This should result in solid revenue growth and robust profitability for US homebuilders. The positive outlook reflects our expectations of revenue growth for the rated homebuilder group in the range of 10% to 12% in 2021, along with gross margin in the range of 20% to 21%, in line with a positive sector outlook parameters (see Exhibits 1 & 2). Housing is expected to continue to vastly outperform the broader economy. US GDP is forecast to grow 4.2% in 2021 and 3.9% in 2022, according to Moody's Macroeconomic Board, following a decline of 3.6% this year.

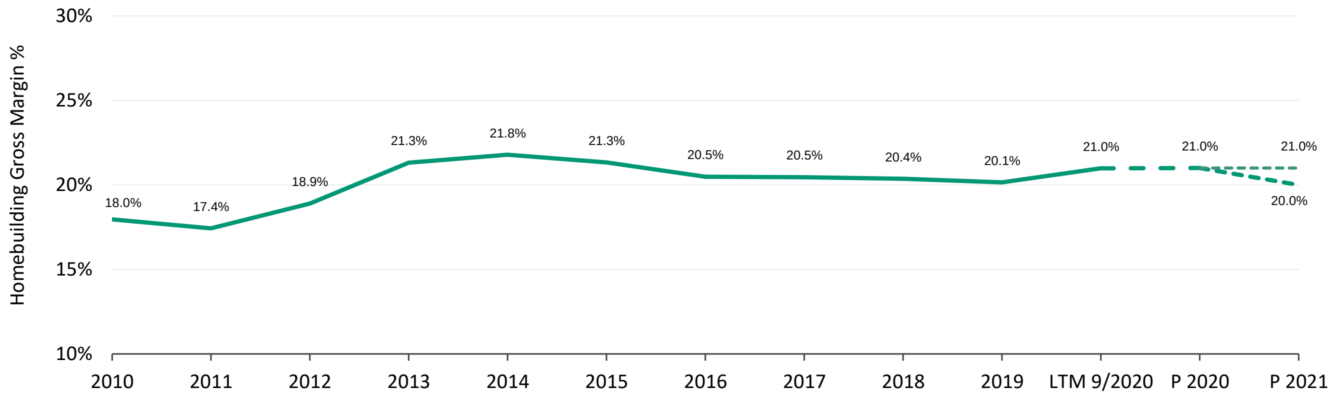
Exhibit 1
Homebuilder revenue forecast to grow 10% to 12% in 2021



Aggregate revenue of 22 rated homebuilders
Source: Moody's Financial Metrics™, Moody's Projections

Exhibit 2

Homebuilding gross margin to be in the range of 20% to 21% in 2021



Aggregate gross margin of rated homebuilders

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

» **Homebuilding benefits from solid underlying fundamentals, which we expect to persist.** Inventories of new and existing homes are low, as a result of strong demand and construction constraints during 2020. As of October 2020, new home supply stood at an all-time low of 3.3 months (see Exhibit 3). These supply constraints support homebuilders' pricing power, which bodes well for their gross margins. Record low interest rates (see Exhibit 4), which are likely to remain low for the next three to five years, will continue to drive demand and support affordability. Favorable demographics will also play a role, with one-quarter of the US population being Millennials, many of whom are at or approaching their peak home-buying years. We expect this group, the most numerous US generation, to drive an increasing portion of demand for first-time and entry-level homes over the next few years. Additionally, housing starts and new home sales remain at or below long-term averages and are far from their peaks, indicating a lack of excess supply in the market and room to grow, especially given population growth.

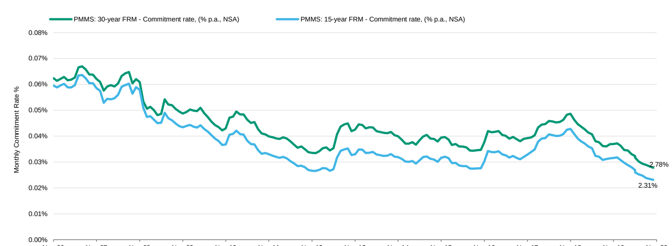
Exhibit 3

Record low supply of new homes on the market

Source: U.S. Census Bureau, Moody's Analytics

Exhibit 4

Low interest rates support affordability and encourage demand



Source: Freddie Mac: Primary Mortgage Market Survey, Moody's Analytics

» **Demand fueled by an increased emphasis on a home, and its intangible and nonmonetary value, amid the pandemic.** Large swaths of the US population are now spending significantly more time in their homes. As a result of the new realities of virtual living, people are putting increasing value on factors such as the safety features of a home, the ability to socially distance, outdoor space, the benefits of extra space and ability to reconfigure and customize space for work or study.

- **Remote work will continue to encourage home ownership in areas further from city centers and employment locations for years.** We believe this will continue to be the case when COVID-19 is no longer a pressing risk. Good productivity and output measures during the challenges of a pandemic are likely to mean increased remote work in the future, with companies increasingly accepting it as part of how they conduct business. Availability of remote work is also likely to remain a contributor to migration from urban areas to the suburbs, in addition to moving away from densely populated areas due to health concerns created by the pandemic.
- **Strong new orders, robust backlogs through second half of 2020 will drive revenue growth in 2021.** Following temporary weakness during Q2, US homebuilders experienced a strong recovery in new orders during H2 2020, with new order units up about 50% on average in Q3 versus a year ago (see Exhibit 5). Also, homebuilding backlogs (both units and value) were up nearly 40% on average at Q3 2020 compared with a year ago (see Exhibit 6). With demand continuing to be solid so far in Q4, homebuilders will enter 2021 in a position of strength.

Exhibit 5
Very strong new order bookings in Q3 and into Q4 will result in solid 2021 revenue generation
Quarterly new order growth year-over-year

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Median	12%	5%	2%	-11%	-2%	7%	23%	35%	22%	0%	50%
Average	14%	11%	7%	-9%	-1%	11%	23%	39%	17%	1%	53%

Metrics are based on the majority of issuers in the rated homebuilding peer group and reflect calendar quarter end or the quarter nearing the calendar quarter end for comparability.
Source: Earning releases, 10Qs, 10Ks, Moody's Investors Service

Exhibit 6
Homebuilding backlog values were up nearly 40% on average at Q3 2020
Backlog value growth year over year

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Median	17%	12%	-3%	-6%	-11%	-9%	1%	8%	10%	12%	37%
Average	23%	15%	5%	-2%	-12%	-8%	0%	10%	11%	11%	39%

Metrics are based on the majority of issuers in the rated homebuilding peer group and reflect calendar quarter end or the quarter nearing the calendar quarter end for comparability.
Source: Earning releases, 10Qs, 10Ks, Moody's Investors Service

- **Production constraints likely in 2021.** Homebuilders' business activity in 2020 was affected by: delayed construction and lower home starts because of business closures and government imposed lockdowns in Q2; reductions and delays in land spend; modest challenges in available supply of materials; and delays with municipal approvals. A short supply of developed lots, extended permitting processes, and availability of building materials and labor, will likely continue to restrain revenue growth and keep construction times extended to a degree in 2021. However, builders are now more accustomed to operating in such an environment, have adjusted accordingly and reengaged land engines.
- **There are numerous macroeconomic and sector-specific risks that could change the direction and magnitude of business activity.** Unemployment in the US is forecast by Moody's Macroeconomic Board to remain elevated, with gradual moderation to 6.0% by the end of 2021, and 5.5% by the end of 2022. The high jobless rate is among the key risks for the housing sector. Forbearance on mortgage payments for existing homeowners, set to expire in March 2021, could cause a rise in defaults and foreclosures, therefore increasing existing home inventory and putting downward pressure on prices. Surges in COVID-19 infections across the country and potential renewed lockdowns could also hurt the economy, in addition to the expiration of stimulus funds. COVID-19 related uncertainties continue to hurt consumer confidence, which could spill over to demand for homes, leading buyers to cancel existing contracts.
- **What could change our outlook?** We could change our homebuilding sector outlook to stable if we expect industry revenue in a range of negative 10% to positive 10% and gross margin within a range of 15% to 20%. We could change our outlook to negative if industry revenue is expected to decline by more than 10%, gross margins fall below 15%, and if risks related to economic recovery or COVID-19 containment rise.

Rating outlook

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.

Moody's related publications

Nonfinancial Companies – North America: 2021 Outlook, December 2020

Global Macro Outlook 2021-22: Nascent economic rebound takes hold globally but recovery will remain fragile, November 2020

Homebuilding – US: Outlook to stable on solid demand, supportive demographics, low interest rates, offset by high unemployment, September 2020

Housing – US: Urban markets will recover after pandemic as Americans' housing decisions evolve, August 2020

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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