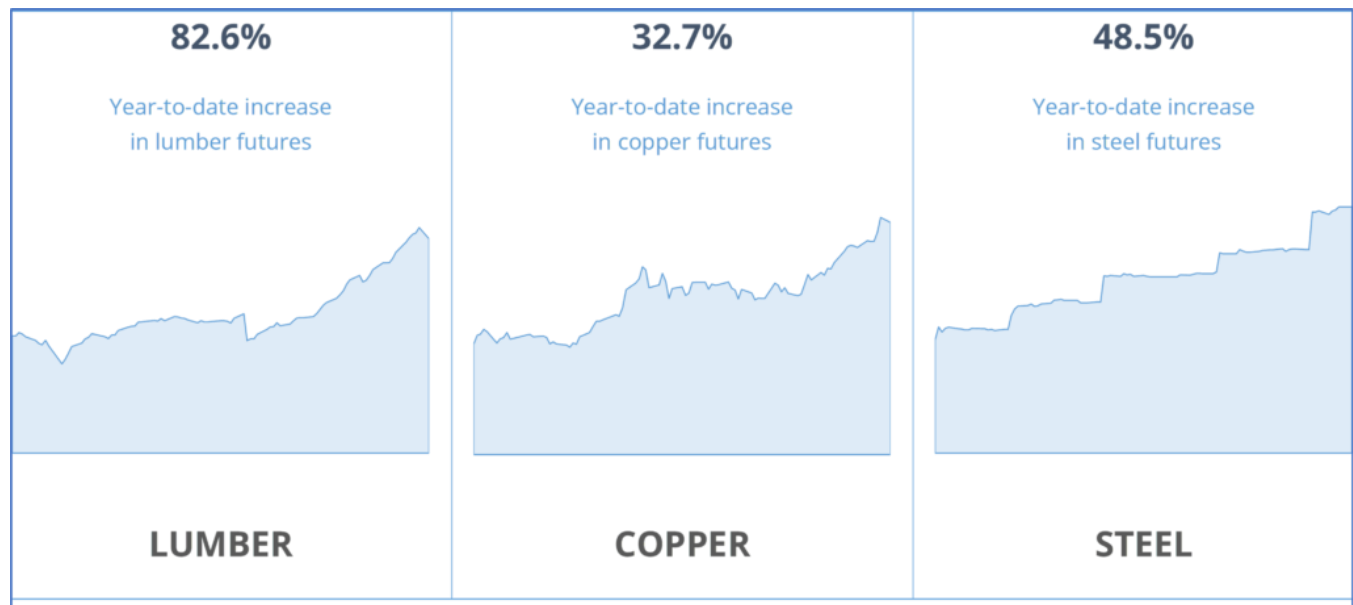




Housing Input Costs & Supply Chain Considerations

May 19, 2021

Material costs are becoming a 'fly in the ointment' for many housing developers/builders. Input costs such as lumber, steel and copper have all been steadily increasing in 2021 as demand for raw materials has elevated.



Source: Chicago Mercantile Exchange, Commodity Exchange, Inc.

According to the NAHB, the increase in lumber prices over the past twelve (12) months has added \$35,872 to the price of the average new single-family home, or approximately 10% of the median price of new home sales. In most markets, the demand for housing allows developers to pass along the added costs to the end buyer. Of course, the inelasticity of demand relative to changes in price has an upper bound. To the extent (i) material costs continue to rise and are not locked in upfront, and (ii) demand begins to wane such that cost increases may not be passed along to the buyer — developer margins will be compromised.

Often, experienced developers lock in the input costs early in the project life cycle. While input price is often locked in — delivery is not. As a result, supply chain disruption and material shortages have the potential to delay completion timelines. Interruptions tend to reduce developer profits to the extent they cannot be passed along to the end buyer (e.g. pre-sold deals). Given the quality of borrowers, project, and geographic locations of the Fund's portfolio, we do not anticipate any material degradation of performance as a result of the input costs or project delays.

THE PALISADES GROUP, LLC

Generally, developers/builders prefer to pre-sell properties whenever possible because doing so eliminates the post-completion marketing timeline and reduces the overall risk of the project. However, we are hearing from some developers that they are intentionally not pre-selling properties in order to avoid missing any appreciation in value that may arise during the build period.

The consensus seems to lean towards supply chain disruption being alleviated around the August/September timeframe. Given the demand for housing and structural deficit in available housing units, we currently anticipate (i) the rise in material costs will be absorbed by the market, and (ii) supply chain disruptions will cause only minor and temporary delays to project timelines. NOTE: as of this writing, lumber futures are off their high by 25%.