**MEDIA: Television**

**STATION: CNBC**

**MARKET: National**

**DATE: 2023-10-17**

**TIME: 01:20 PM ET**

**PROGRAM: The Exchange**

**SUBJECT: Joe Ahlersmeyer - Homebuilders**

**PAGE COUNT: 4**

**KELLY EVANS, CNBC:**

Our next guest is staying positive on the builders into their earnings next week. Let's bring in Joe Ahlersmeyer. He's a research analyst in the home building space at Deutsche Bank. Joe, welcome. Let me just pick up first in kind of an unconventional place, which is do you expect any policy relief or help from Washington on mortgages or anything else for this industry?

**JOE AHLERSMEYER, DEUTSCHE BANK:**

Right. Great question. Thanks for having me back, Kelly. Nice to be here. First of all, I think it's very obvious to point to the spread versus the 10-year as a real problem and a big reason why the mortgage rate has gone higher. But you know, in recent months, we've actually seen the 10-year itself go much higher. So even if we had a more normal spread, which would come from less volatility in rates and perhaps more activity on the repurchase side from the Fed, you'd still be at something in the 6% range, which is a much higher rate than people are used to. So you will actually have to see the builders continuing to buy down rates. But you know, I hear you calling out or I hear you talking about Zelman calling out the margin hit. Margin is just one part of the equation, right? So it is going to help with volumes. It is going to hurt margins. It's likely going to hurt operating margins as well. But in terms of the actual earnings dollars that the builders are able to produce, that is what is going to drive book value higher. That's what the returns are going to be based on when people look to value these things. So seeing margins come down is not necessarily on its own a terrible thing.

**EVANS:**

Explain that again a little bit. And I know that- who is reporting next week? Who are going to be the main players that you're watching?

**AHLERSMEYER:**

Right. So last month, you had a couple builders report off cycle next week. We're going to get DR Horton. It's going to be- actually DR Horton's later in the year because of their fiscal year. They're going to be next month. But you're going to have Meritage, Pulte; they're going to be the ones that you're going to be looking at next week that are likely to talk about this. But the equation here, you said, sort of explain the dollars. You could sit on a home for three years and wait for somebody to pay as much as you're wanting to take for it and get a high margin. Or you can sell it at a lower margin today, redeploy it into land several more times between now and three years from now. And the builders are more concerned about generating those profit dollars than those returns, meaning the actual profit divided by the invested capital. They're not concerned so much about the gross margin that they'll get on a home. They could take 30% when times are good and pricing is good, or they'll take 20% when pricing is bad. And the good thing is when they underwrite land, they actually assume a very little price appreciation if any, and they assume a lower gross margin as a result. And they're really underwriting that to that return metric, not so much the gross margin metrics.

**EVANS:**

And that makes them a little bit more conservative. You know, interestingly enough, I've also heard plenty of people concerned that we're not going to see any new multi-family supply coming on. Once we get past this current glut, because the banks have really just pulled back, you know, they’re under pressure, capital is restrained. And maybe, you know, if you spin this story out two or three years, you will get continued demand coming from households who might see rents either start to go back up or not a lot of great options and kind of go back into the builder market, where at least they can do things on incentives that, you know, traditional realtors, I guess, cannot.

**AHLERSMEYER:**

Right. And when you think about what's happening over the last 18 months with rising rates attempting to bring inflation down, that is a demand side issue. That's bringing in demand so that you have less of it and less pressure upward on prices. What is actually more compelling as a solution on the housing side is increasing supply. And that's increasing supply, not only on the multi-family side, but also on the single-family side. And so while we also see deliveries of multi-family units extending beyond the weakness that you see here on the start side for multi-family, it is concerning that we're already seeing, I guess, a pullback on the number of starts on multi-family. Because again, building is good if you have a supply side constraint that we've had for so many years. And that's a big part of what has been pushing rents higher and pushing home prices higher is that supply constraint.

**EVANS:**

If you could only pick one home builder right now, which one would it be? And it's interesting to note that the year-to-date gains have really broadened where there are some stocks up 60 percent, some are up 20, you know, we're starting to see some more differentiation.

**AHLERSMEYER:**

For sure. And look, we're going to tell you it's DR Horton, and that is one of the most affordability focused buyers, meaning that their buyer really does depend on being able to make a payment work, not necessarily like at a Toll Brothers, where they have a tremendous amount of equity that they're bringing from their existing home and able to buy the home largely with balance sheet rather than income. So Horton, we still like them, though, because again, we cover builder stocks. We don't necessarily cover the housing market writ large. We're covering builder stocks. And we believe that Horton has the right mindset here, the production builder mindset. They're willing to take lower margins to push volumes. We expect to hear them talk about that at their fourth quarter call in November when they're giving potentially guidance for volumes into next year, their September fiscal year. We expect to hear them talk about growth. We expect to hear them talk about starting more homes than they're selling in the third and fourth quarter, building inventory and preparing for that volume growth next year. That's the type of thing that you won't see in the national housing data, like the NAHB index, like the Starts potentially, the Housing Starts from the census. Those are things that will cover every builder in the country. DR Horton is going to be a little bit different than that.

**EVANS:**

Alright, “Horton Hears a Who”, is all I can think. Very interesting, though. Glad you highlighted that. Joe, thanks so much for your time today. We'll check back in soon.

**AHLERSMEYER:**

Thanks, Kelly.

**EVANS:**

Joe Ahlersmeyer, from Deutsche Bank.