

September 2014 Housing Commentary



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September 2014 Housing Scorecard

	M/M	Y/Y
Housing Starts ^A	△ 6.3%	△ 17.8%
Single-Family Starts ^A	△ 1.1%	△ 11.0%
Housing Permits ^A	△ 1.5%	△ 2.5%
Housing Completions ^A	△ 8.6%	△ 31.3%
New Single-Family House Sales ^A	△ 0.2%	△ 17.0%
Existing House Sales ^B	△ 2.4%	▽ 1.7%
Private Residential Construction Spending ^A	△ 0.4%	△ 0.7%
Single-Family Construction Spending ^A	△ 1.1%	△ 9.8%

M/M = month-over-month; Y/Y = year-over-year

New Housing Starts

	Total Starts*	Single-Family Starts	Multi-Family 2-4 unit Starts	Multi-Family 5 or more unit Starts
September	1,017,000	646,000	18,000	353,000
August	957,000	639,000	9,000	298,000
2013	863,000	582,000	10,000	271,000
M/M change	6.3%	1.1%	100.0%	18.5%
Y/Y change	17.8%	11.0%	80.0%	30.3%

* All start data are presented at a seasonally adjusted annual rate (SAAR)

New Housing Permits and Completions

	Total Permits*	Single-Family Permits	Multi-Family 2-4 unit Permits	Multi-Family 5 or more unit Permits
September	1,018,000	624,000	25,000	369,000
August	1,003,000	627,000	31,000	345,000
2013	993,000	617,000	29,000	347,000
M/M change	1.5%	-0.5%	-19.4%	7.0%
Y/Y change	2.5%	1.1%	-13.8%	6.3%

	Total Completions*	Single-Family Completions	Multi-Family 2-4 unit Completions	Multi-Family 5 or more unit Completions
September	999,000	624,000	7,000	368,000
August	920,000	618,000	9,000	292,000
2013	761,000	563,000	8,000	190,000
M/M change	8.6%	1.0%	-22.2%	26.0%
Y/Y change	31.3%	10.8%	-12.5%	93.7%

New and Existing House Sales

	New Single-Family Sales*	Median Price	Month's Supply	Existing House Sales ^{B*}	Median Price ^B	Month's Supply ^B
September	467,000	259,000	5.3	5,170,000	\$209,700	5.3
August	466,000	286,800	5.3	5,050,000	\$219,800	5.5
2013	399,000	269,800	5.5	5,260,000	\$238,300	5.0
M/M change	0.2%	-9.6%	0.0	2.4%	-4.5%	-3.6%
Y/Y change	17.0%	-4.0%	-3.6%	-1.7%	5.6%	6.0%

* All sales data are SAAR

Existing House Sales

National Association of Realtors (NAR®)^B

September 2014 sales data: 5.17 million houses sold (SAAR)

August 2014: 5.05 million (SAAR) and September 2013: 5.26 million (SAAR)

Distressed house sales: 10% of sales –
(7% foreclosures and 3% short-sales);

8% in August and 14% in September 2013.

All-cash sales: increased to 24%; 23% in August.

Investors are still purchasing a substantial portion of
“all cash” sale houses – 14%, and
12% in August 2014 and 19% in September 2013;

Sixty-three percent of investors paid cash in September.

First-time buyers: increased to 29% (29% in August 2014)
and were 28% in September 2013 (32%: September 2012)

September 2014 Construction Spending

September 2014 Private Residential Construction: \$349.07 billion (SAAR)

0.4% more than the revised August estimate of \$347.75 billion (SAAR)
0.7% greater than the September 2013 estimate of \$346.55 billion (SAAR)

September SF construction: \$192.51 billion (SAAR)
1.1% more than August: \$190.43 billion (SAAR)
9.8% greater than September 2013: \$175.40 billion (SAAR)

September MF construction: \$43.30 billion (SAAR)
-1.0% less than August: \$43.75 billion (SAAR)
25.7% greater than September 2013: \$34.44 billion (SAAR)

September Improvement^C construction: \$113.26 billion (SAAR)
-0.3% less than August: \$113.57 billion (SAAR)
-17.1% less than September 2013: \$136.70 billion (SAAR)

^C The US DOC does not report improvements directly, this is an estimation. All data is SAAR and is reported in nominal US\$.

Conclusions

September data holds positive news. However, it is only one month of data. Currently, there is much month-to-month volatility in the data, which is expected in multifamily reporting, but not for other sectors. For instance, currently single family housing starts and single family new house sales data were volatile with lots of revisions from the previous months, which is not typical.

What does this volatility represent? Patience and ardent attention to the data over the next few months will tell.

As written in previous months, the near-term outlook on the U.S. housing market remains unchanged – there are potentially several negative macro-factors for a robust housing recovery (based on historical long-term averages). Once the economy improves, we should expect to see housing improve as well.

Why?

- 1) Lack-luster household formation,
- 2) a lack of well-paying jobs being created,
- 3) a sluggish economy,
- 4) declining real median annual household incomes ,
- 5) strict home loan lending standards,
- 6) new banking regulations, and
- 7) global uncertainty?

August 2014

EU Housing Scorecard

		M/M	Y/Y
Production in Construction^A	EU 28	▲ 0.5% ^s	▼ 0.8% ^s
	EU 18	▲ 1.5% ^s	▼ 0.3% ^s
	Germany	▼ 2.0%	▼ 2.6%
	France	▲ 2.4%	▲ 2.8%
	UK	▼ 3.2% ^p	▼ 2.5% ^p
	Spain	▲ 2.1% ^{ps}	▲ 18.0% ^p
Building permits (m² floor) ^A	EU 28	-.-	-.-
	EU 18	▼ 3.2% ⁽⁰⁷⁾	▼ 8.0 ⁽⁰⁷⁾
	Germany	▼ 1.7% ^s	▼ 2.6%
	France	▼ 3.4% ^s	▼ 2.0%
	UK	-.-	-.-
	Spain	▼ 12.6 ^{s(07)}	▼ 5.7% ^{e(07)}

M/M = month-over-month; Y/Y = year-over-year

Source: Eurostat (http://epp.eurostat.ec.europa.eu/portal/page/portal/short_term_business_statistics/data/main_tables),

^A see http://epp.eurostat.ec.europa.eu/portal/page/portal/short_term_business_statistics/introduction/sts_in_brief

^e estimate, ^s Eurostat estimate, ^p provisional, -. no data available, ⁽⁰⁷⁾ July data

Housing comments – September, 2014 data

- *September was decent month for housing – up 18% Year over year*
- Housing getting better, but multi family is the driver so far – rental demand is strong! **Single family sales of new homes remains weak!**
- Housing's issues - slowing world economy; weak domestic job market; sluggish income growth; tight credit environment continues – Europe is in a recession, and facing disinflation with growing deflation concerns.
- *Main problem (short term) continues to be the job market. Unemployment rate keeps coming down, but often this is due to people leaving the workforce. It is taking longer to find a job (employers are getting pickier); labor force participation rate keeps falling (will lead to labor shortages in the future); and many jobs (30%) are temporary with low pay, no benefits, etc.*
- **Another problem, longer term, is the aging population – I've included a few slides suggesting that the solution is Immigration reform. Without it, we're going to see serious labor shortages (skilled labor particularly), and enormous problems with entitlement programs like SSI and Medicare . If we don't deal with these issues, (and better debt management) housing won't come close to returning to the "good old days!"**
- **My best guess re: housing is that it will be 2016 or later before we get back to 1.5 million starts. Don't expect too much from the Congress or the Administration over the next two years. More gridlock and less concerted effort to solve serious problems facing the country . Lots of politicking, but no problem solving.**
- **RE: the economy and interest rates – I believe the FED will keep interest rates low for some time (another two years?). Why – the economy is being propped up by monetary policy, and there is little evidence it can move forward without the stimulus. I hope I'm wrong, but I don't think so.**

Here are some good references from NAHB on Impact Of Housing on the Economy

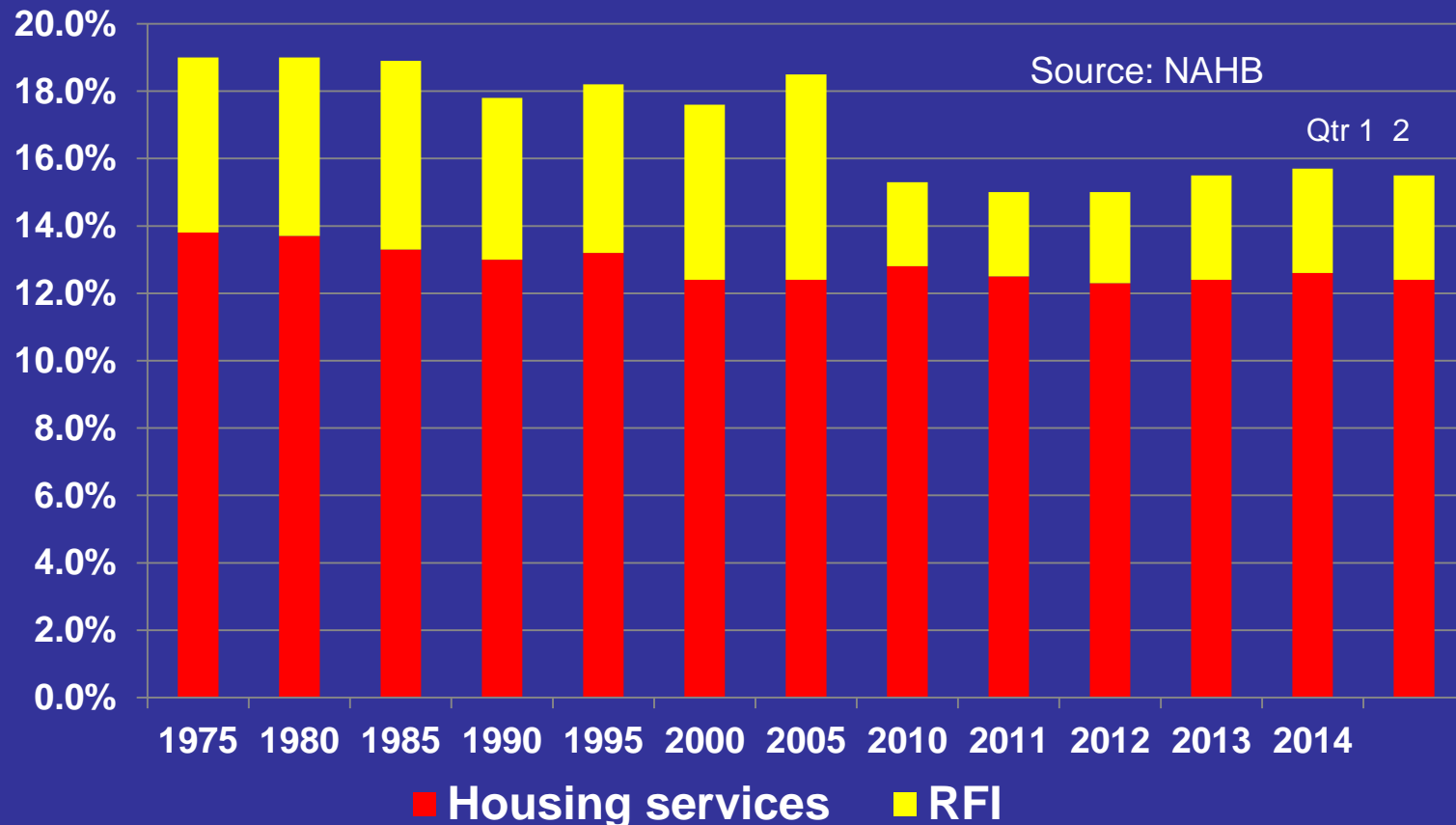
Gives you some appreciation why housing is so important to the economy, and why one can't move forward without the other!

- (1) Impact of Homebuilding and Remodeling on the U.S. Economy (May 2014, Paul Emrath)
- (2) Housing's contribution to GDP (NAHB staff)
(http://www.nahb.org/reference_list.aspx?sectionID=784)

Housing's contribution to GDP (%) – historically, it is almost 20% of the economy when you include housing services and fixed investment, but today it is down to 15%. In reality, it is even more important when you include purchased furniture, landscaping, general maintenance, etc. key reason why the economic recovery remains muted

Housing services = gross rents paid by renters (include utilities) + owner's imputed rent (how much It would cost to rent owner occupied homes) + utility payments

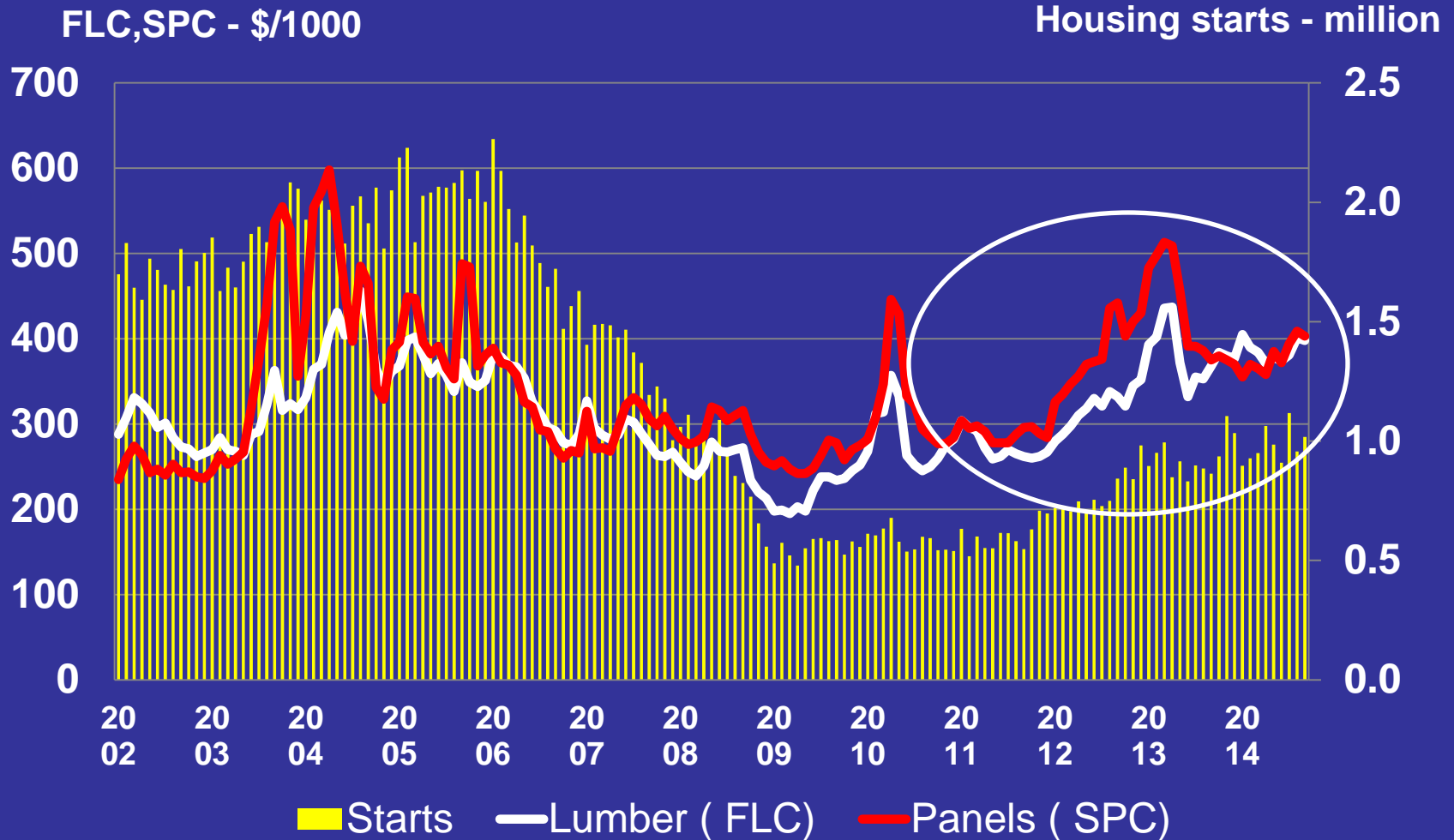
RFI (residential investment) = construction of new SF and multifamily structures, remodeling, manufactured homes , plus broker's fees



Housing starts and wood product prices – Economics 101

75% of structural wood products go to housing (new construction plus remodeling)

50% or more of hardwoods go to housing related activities. By the way, main reason wood prices have gone up is better demand/supply balance – reduced production! Key to being profitable is lowering your costs. Being a price taker in commodity markets, lower costs is best strategy!

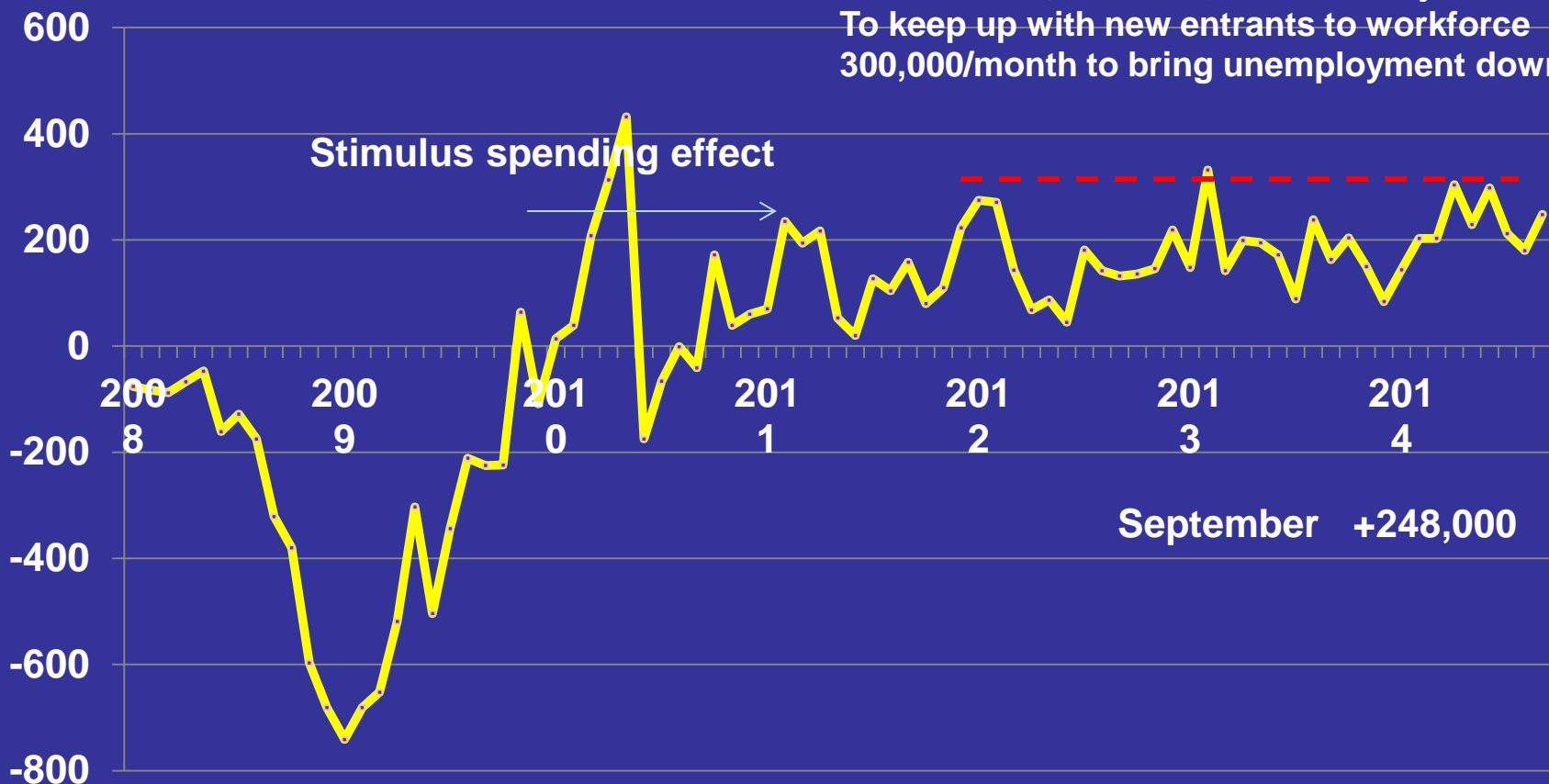


Sources: Prices – Random Lengths (<http://www.randomlengths.com/>); starts (Bureau of Census (<http://www.census.gov/construction/nrc/>))

Employment situation - our biggest problem - it's getting better, but the jobs recovery remains weak by past standards, and many jobs (e.g., temporary ones) Don't include health care or retirement benefits – those kinds of jobs don't encourage people to buy houses

Net change in non farm payrolls – monthly, thousands

**We need 100,000 – 150,000 net new jobs/month
To keep up with new entrants to workforce
300,000/month to bring unemployment down**

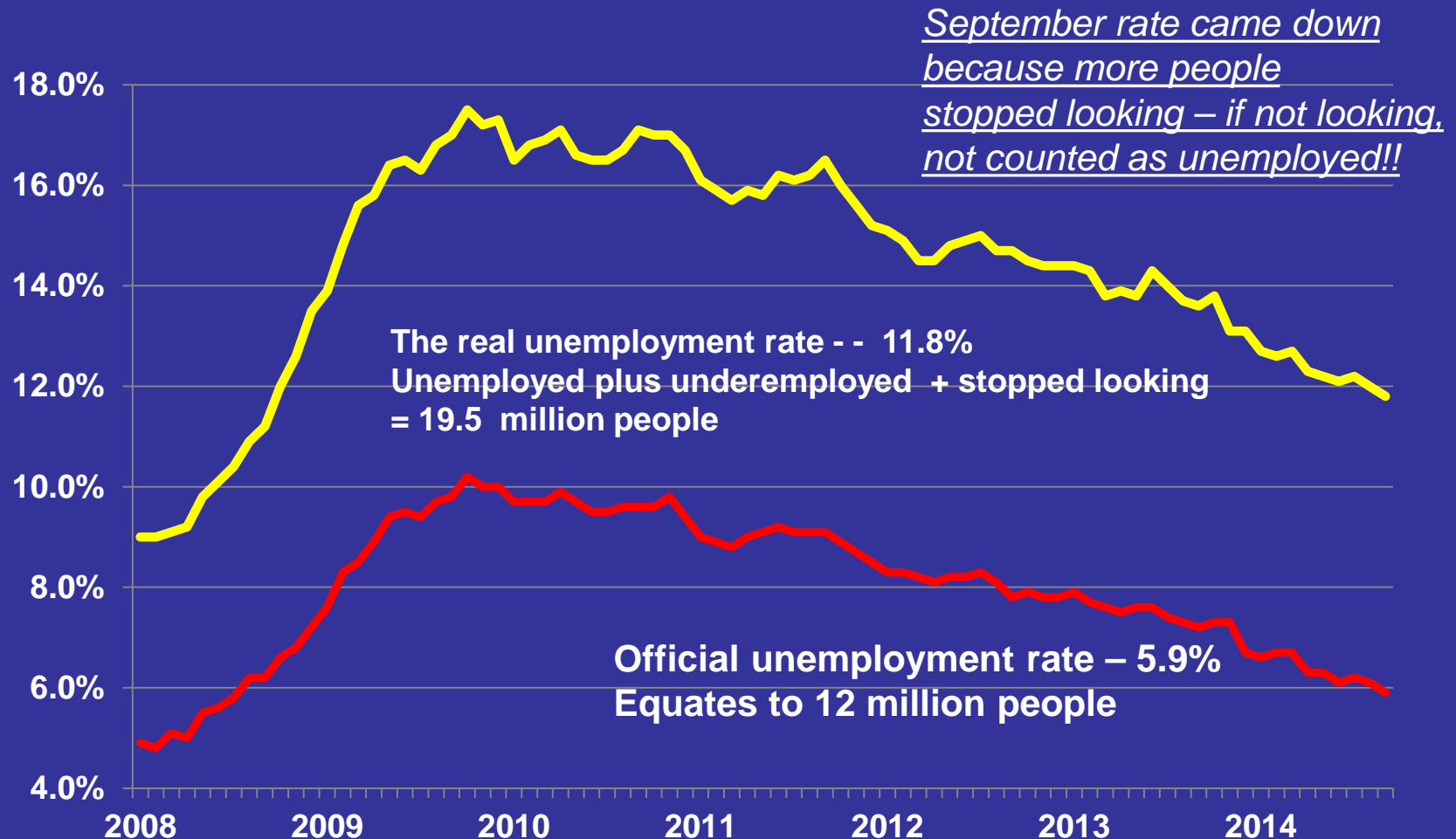


Source: U.S. BLS (www.bls.gov)

Unemployment rate keeps coming down – but, for wrong reasons

1. Many jobs are temporary with few benefits; 2. many have left the work force (and are no longer counted as unemployed)

There are about 20 million people either unemployed, underemployed, or stopped looking for work – **they are not buying houses



Source - - BLS: <http://www.bls.gov/news.release/pdf/empsit.pdf>; <http://data.bls.gov/cgi-bin/surveymost?ln>

Latest employment situation showed unemployment dropping to 5.9%, but, this is misleading. Slide below compares December 2007 (the last “normal year”) with today’s numbers. E.g. look at the 1st line --- total net jobs created in past 7 years was a meager 300,000, not nearly enough to absorb the 8 million or so adults that entered the labor force over that time period. Key reason the rate has come down is because many have left the labor force, not due to job creation!

	Dec. 2007	Now	Change
Total number of jobs	146.3 million	146.6 million	300,000
Total number of unemployed	7.6 million	9.3 million	1.7 million
Unemployment rate	5.0%	5.9%	0.9 percentage points
U-6 unemployment rate (unemployed + underemployed)	8.8%	11.8%	3 points
Average hourly earnings, adjusted for inflation, 2014 dollars	\$24.33	\$24.53	20 cents
Employed part-time for economic reasons	4.6 million	7.1 million	2.5 million
Employed part-time for economic reasons, pctg. of the labor force	3.0%	4.6%	1.6 points
Labor force participation rate	66.0%	62.7%	-3.3 points

Another problem with today's economy – yes, unemployment rate is now below 6%, but income growth is missing. E.g., inflation adjusted income today is the same as it was twenty years ago. I.e., there has been no improvement in median family income over the past two decades. That's why many people believe we are still in a recession, and consumer confidence remains weak. **Just a reminder, consumer spending is 70% of the economy, and without real income growth, spending can't grow much.**

Real incomes have been shrinking for the past 20 years – this is a structural problem (long term) And not cyclical --- no quick fixes to this problem – Also, 15% of population live at or below the poverty level (\$24000 family of 4) – i.e., 45 million Americans - Canada’s entire population plus 12 million!

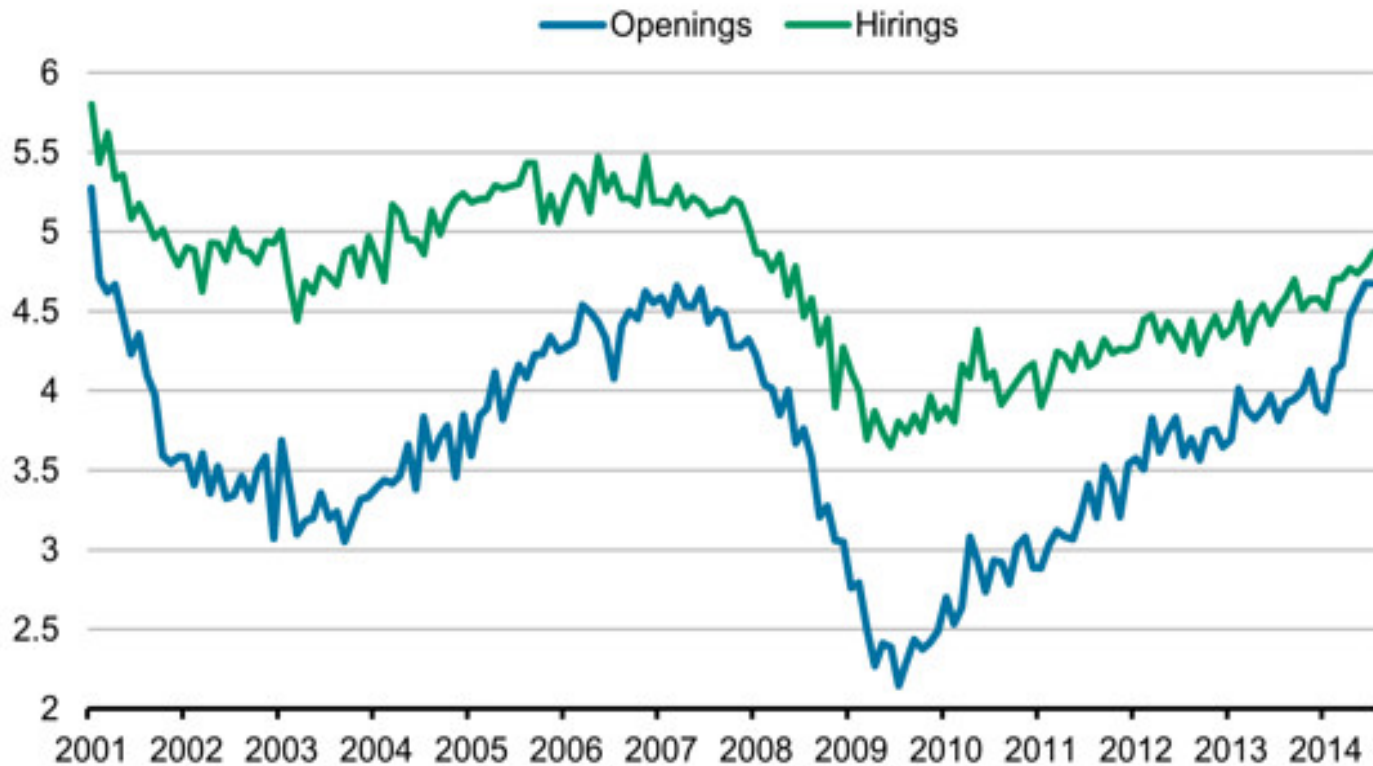


Source: U.S. Department of Commerce: Census Bureau

But, the labor market is improving, and we should be thankful for that.

Help Wanted

Job openings and hirings, seasonally adjusted, in millions



Source: Labor Department | WSJ.com

Another sign things are getting better

Hiring Headcount

Unemployed workers per job opening, seasonally adjusted



Source: Labor Department | WSJ.com

But, Labor force participation rate is shrinking –
this is not good!

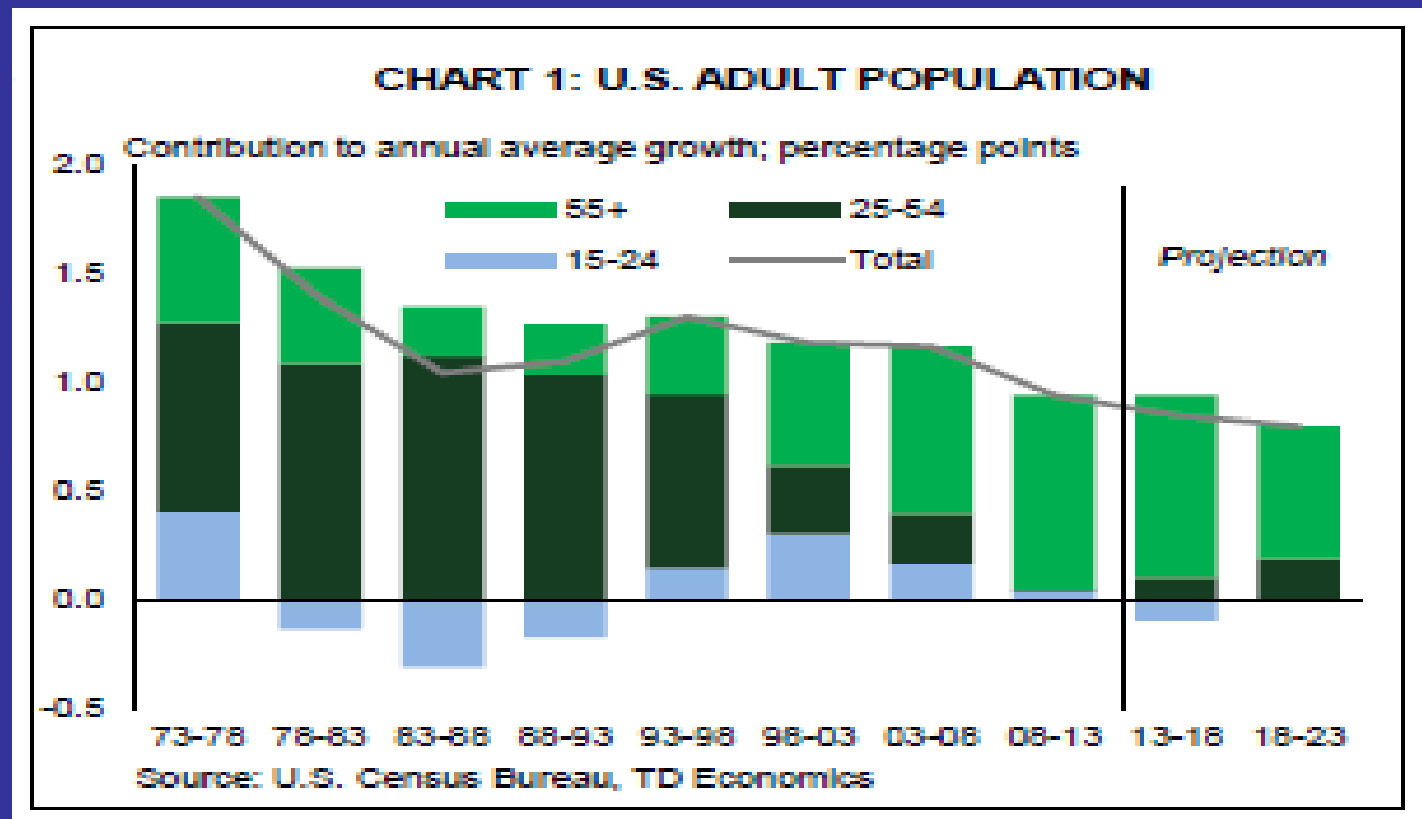
we will see more labor shortages in the future?

% of civilian adult population , that are working



Source: BLS

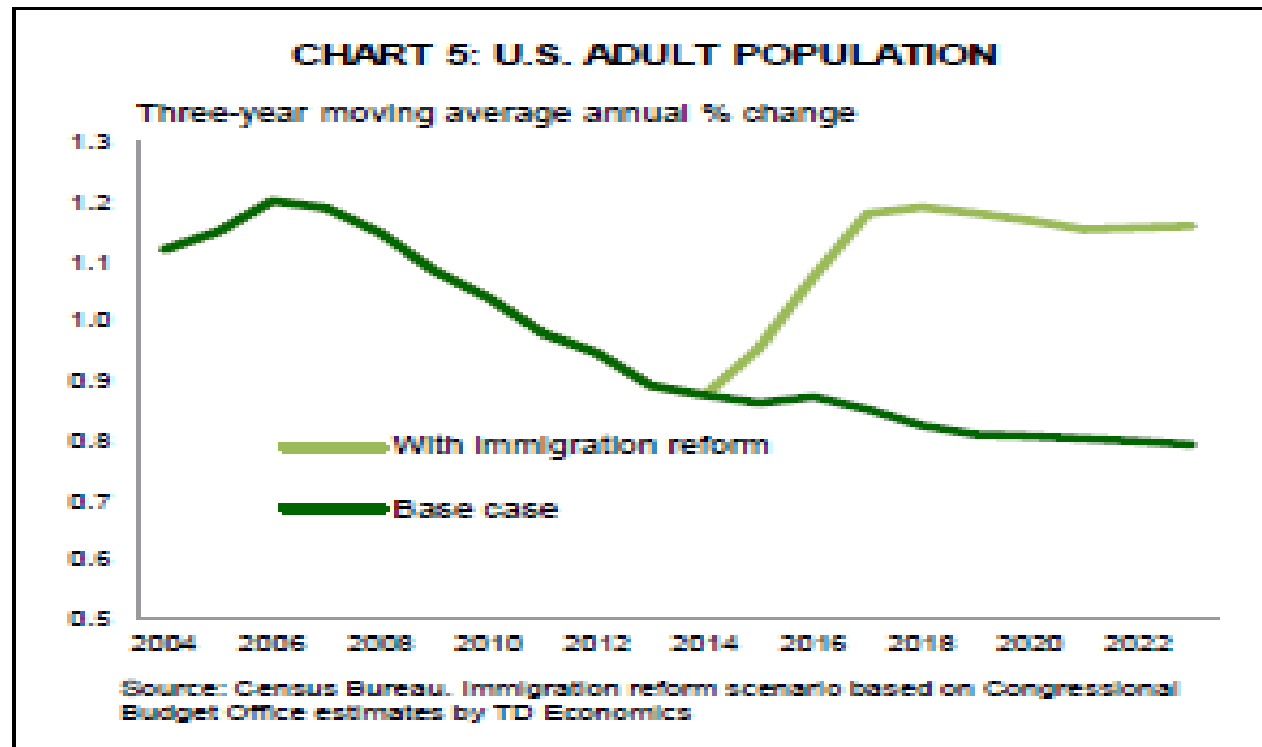
Projections show an aging population with the bulk of population growth in the 55+ age group – this suggests that labor shortages are going to be a serious problem in the future (and, by the way, a serious challenge for SSI and Medicare)



Source: TD Economics (http://www.td.com/document/PDF/economics/special/Recharging_the_US_Labor_Market.pdf)

The solution – immigration reform!

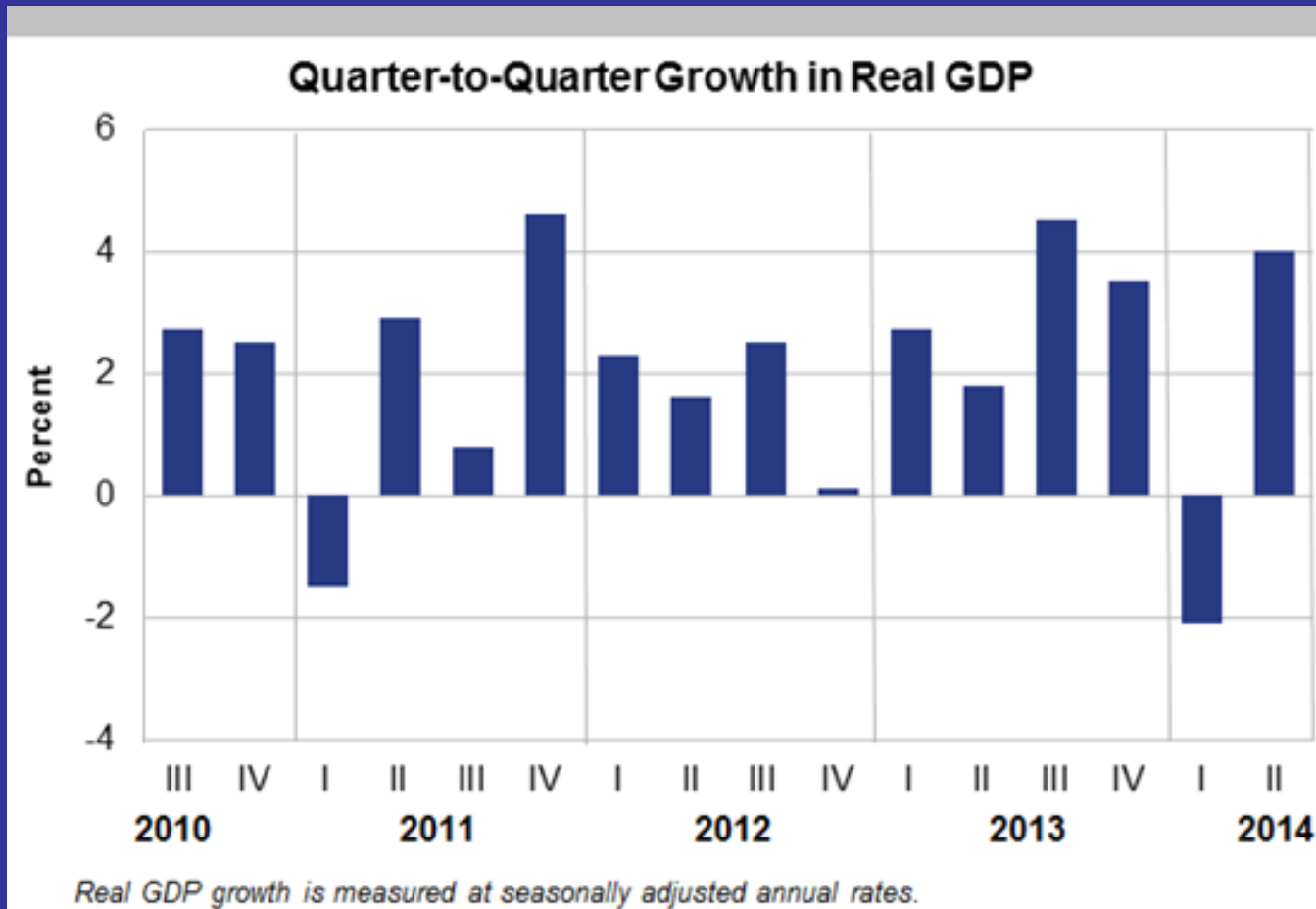
Here is excellent article from TD bank on how to “recharge the U.S. labor market” :
(http://www.td.com/document/PDF/economics/special/Recharging_the_US_Labor_Market.pdf)



Slowing population and labor force growth is a reality across America

Economic growth of 4.0% – 2nd qtr 2014 – good bounce from -2.9%
In 1st Qtr – will it continue through rest of 2014?

GDP for 2013 was 1.9% - nothing to write home about



Economic and Housing Outlook – downward revisions from August outlook – looks like 2016 is best bet for turnaround?

	NAR		NAHB		
	2014	2015	2014	2015	2016
GDP	2.1%	2.9%			
Housing starts(000)	1015	1283	1001	1239	1544
Single (SF)	649	860	643	875	1173
Multi (MF)	366	423	352	364	370
Resales* (000)	4938	5316	4340	4645	4695
SF Sales	459	613	446	597	839

*NAR resales include condos whereas NAHB excluded condos

Source: NAR (<http://www.realtor.org/research-and-statistics>)

Recent Housing statistics

Background:

Markets are getting better – maybe...

Have we turned the corner? – Probably, but...

The climb back will remain muted
until we see economic growth of 3% or
more for an extended period of time!

Starts are finally turning the corner, but growth is painfully slow
– multi family remains strong!

Single family starts, Thousand units, SAAR



Source: Census (<http://www.census.gov/const/www/newresconstindex.html>)

Resale market remains heavy in cash sales, many of whom are investors. Need more 1st time buyers to get sustainable (and healthy) recovery

Single family (incl condos), Monthly, Thousand units, SAAR



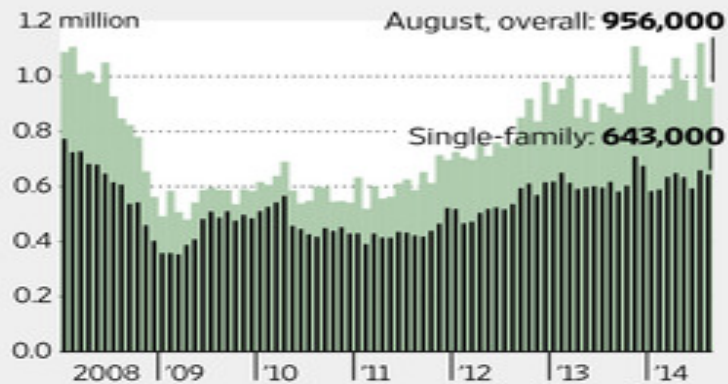
Source: NAR (<http://www.realtor.org/research>)

Things are improving, but to be honest, we're only back to where we were in 2008. And, the driver has been multi family – I'm not too impressed with this "recovery," but, at least we're "building some momentum"

Building Momentum

Housing starts fell sharply in August, but single-family construction remains steady and both housing starts and permits remain above their levels at the same time last year...

Housing starts, seasonally adjusted annual rate

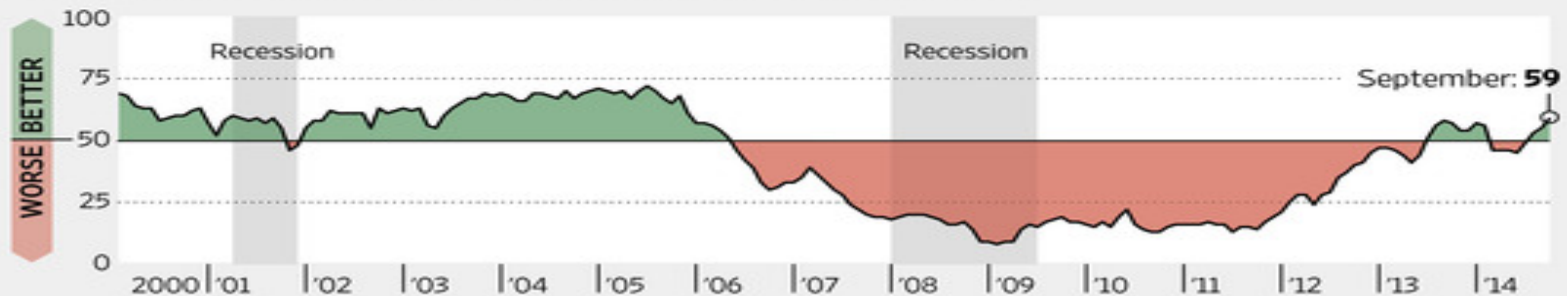


Change from previous year in seasonally adjusted annual rate, three-month moving average



...and builder confidence is as high as it's been since the end of the last housing boom.

Home builder outlook for the market for newly built, single-family homes



Sources: Commerce Department (starts and permits); National Association of Home Builders

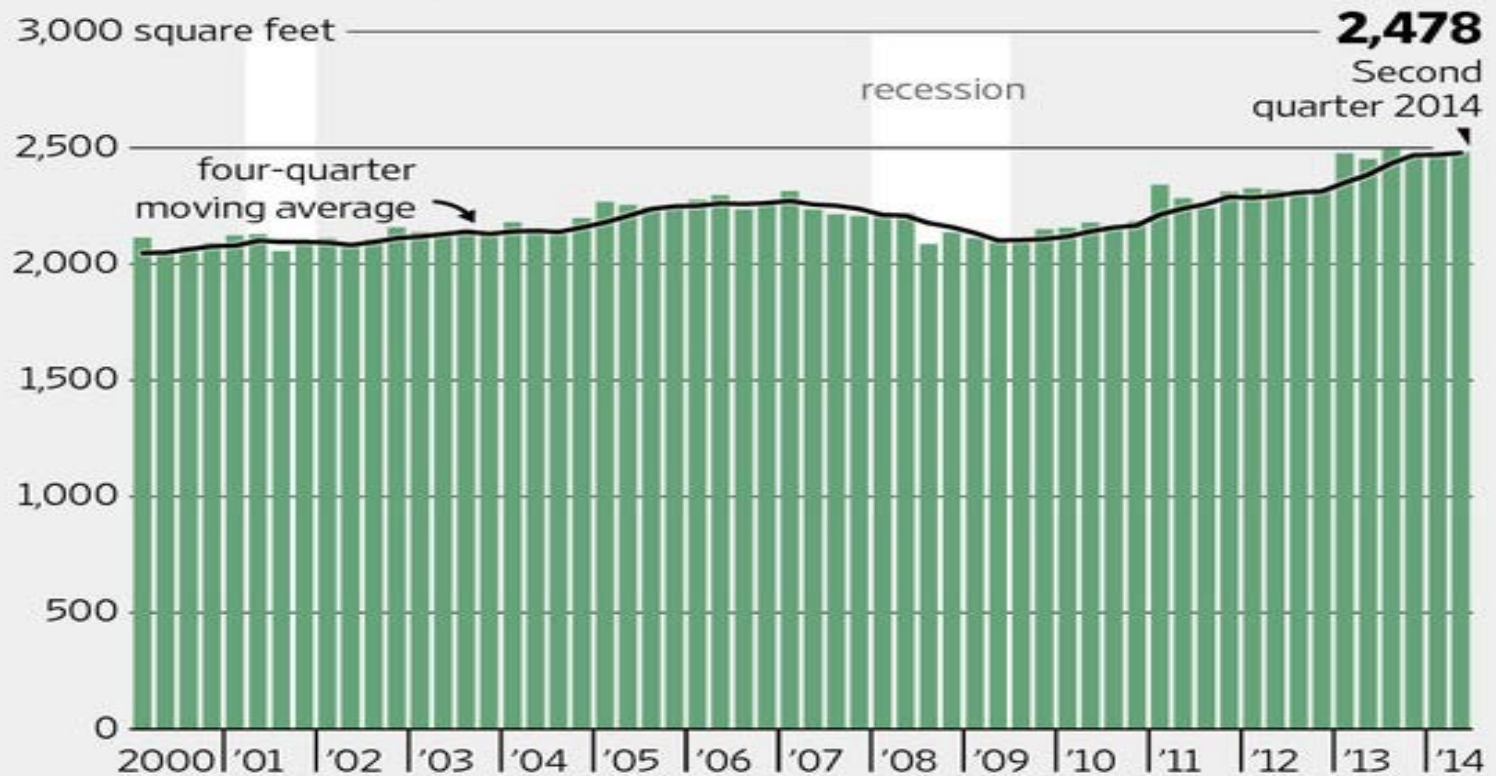
The Wall Street Journal

Another indication that 1st time buyers are absent from this market - -
“Dominated by better heeled , move – up buyers with capital and credit
to buy larger homes” – Kris Hudson, WSJ

(http://online.wsj.com/news/article_email/u-s-home-size-levels-off-for-now-at-least-1408476927-1MvQIAxMTA0MDIwMDEyNDAyWj)

Big Footprints

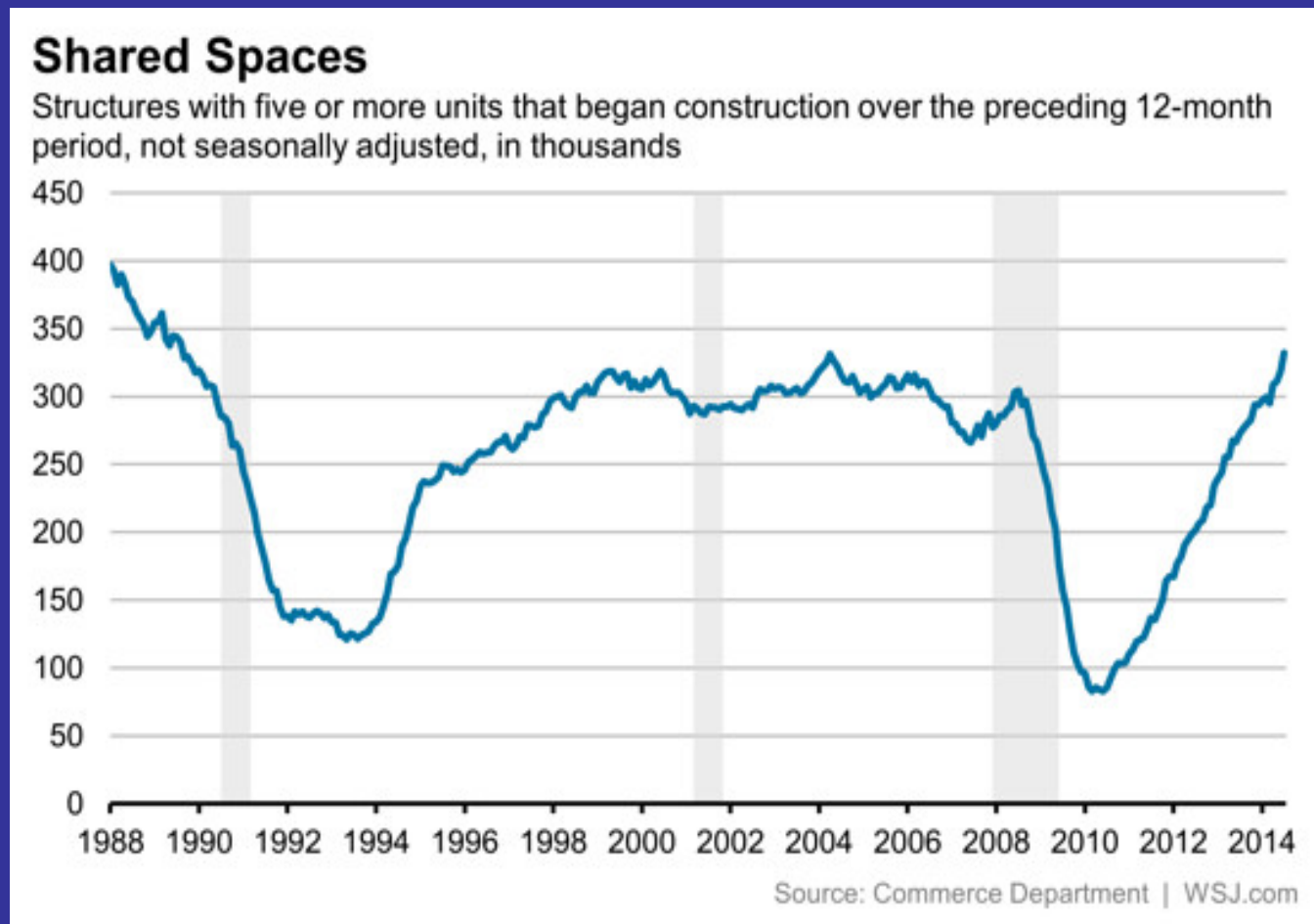
Median square footage of newly built U.S. single-family homes



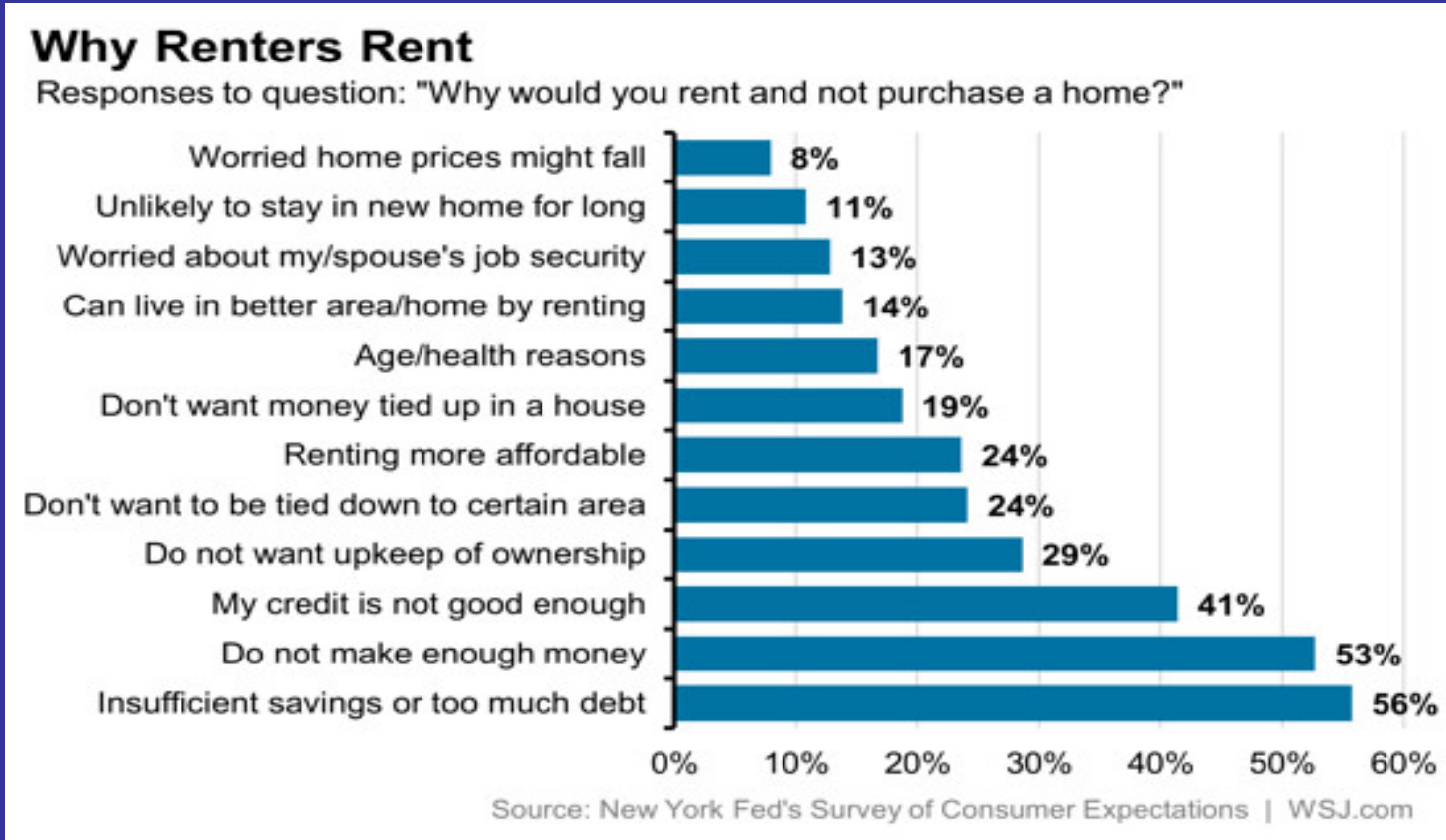
Source: Commerce Department via Moody's Analytics

The Wall Street Journal

Multi family continues to strengthen – this trend is expected to continue as mortgage applications for new single family homes continues to fall according to the Mortgage Bankers Association



Renting is popular because many can't afford to buy - it's that simple? Again, JOBS, JOBS...

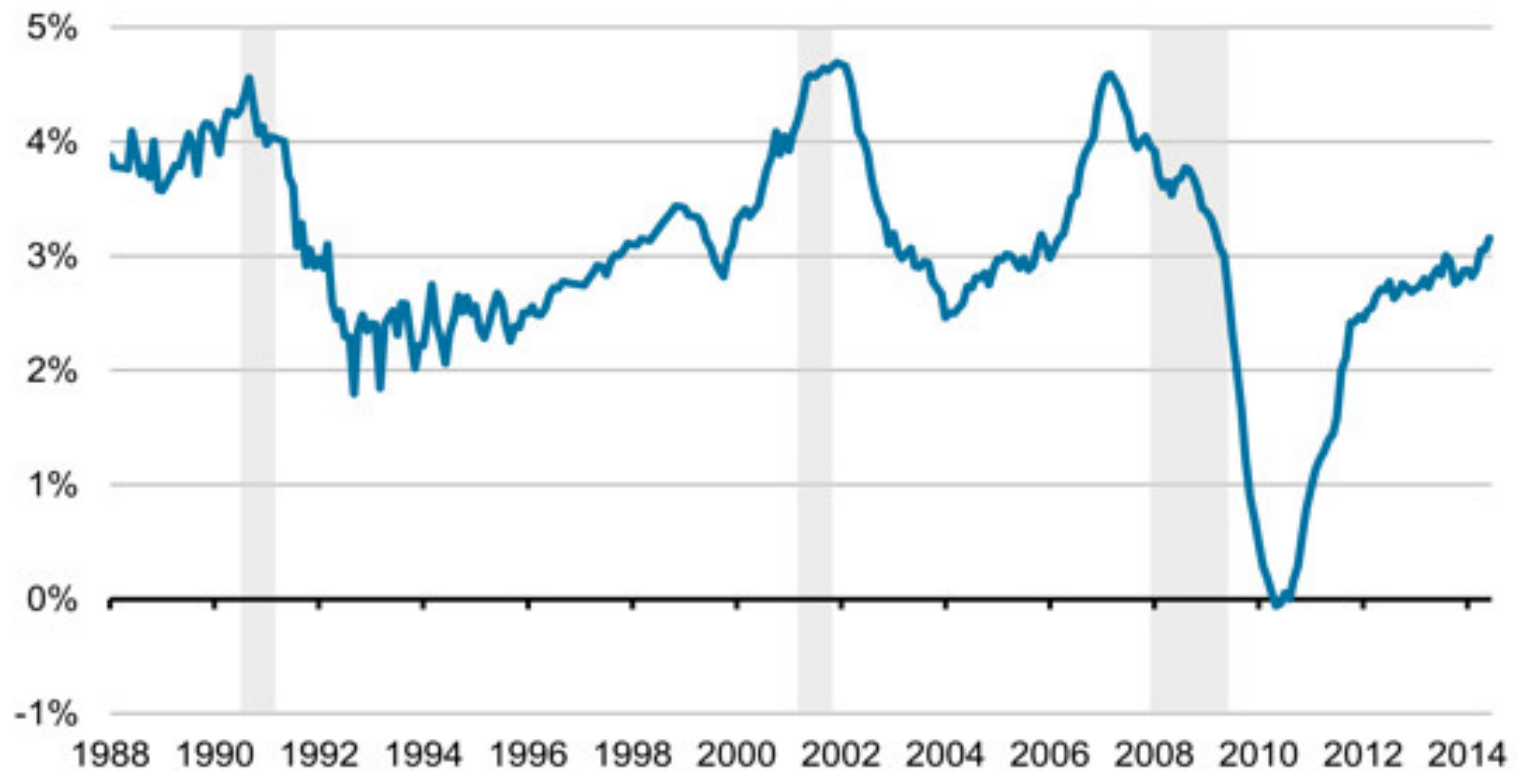


Source: WSJ (<http://blogs.wsj.com/economics/2014/09/08/why-more-renters-arent-buying-hint-weak-incomes-savings/?mod=marketbeat&mod=marketbeat>)

Rental prices keep increasing as demand outstrips supply
Rental construction strength will continue?

Climbing Back

Consumer price index, rent of primary residence, change from year earlier



Source: Labor Department | WSJ.com

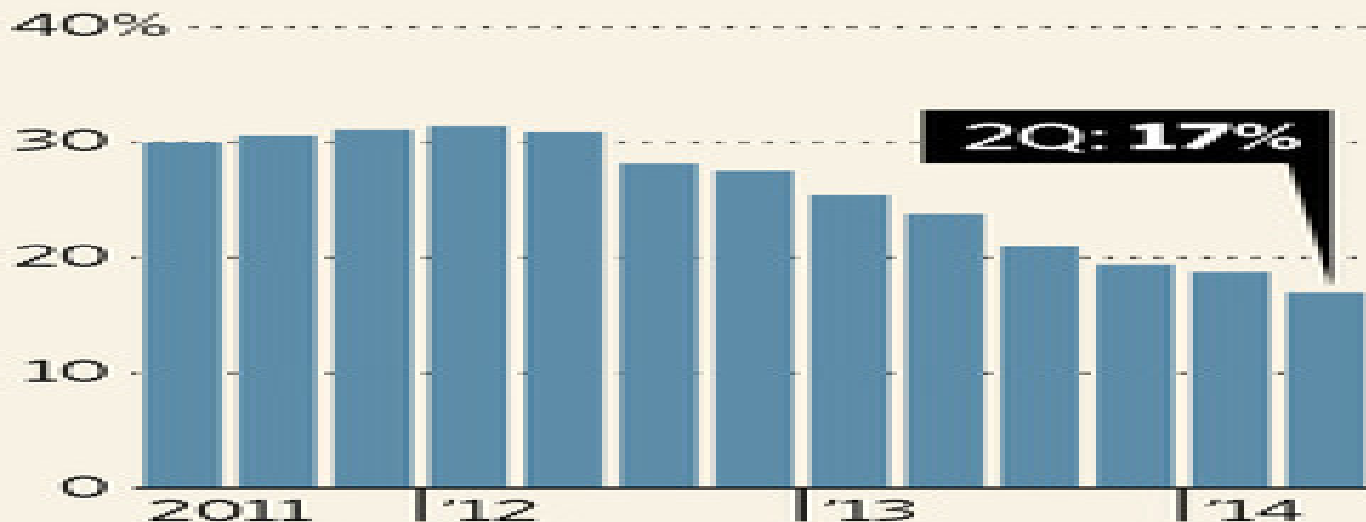
Long term shelter demand is estimated to be about 1.5 million annually, based on demographics (65%), replacement demand (25%), and speculative demand including 2nd homes (10%).
(to date, the main drivers have been speculators/investors and people paying cash: E.g., in 1st qtr investors were 17% of existing home sales while cash sales were 43% of total purchases)



Some good news – fewer underwater homes means more homes on the market, and this drives prices down –A GOOD THING – also facilitates moving to better Paying jobs (i.e., difficult to move when you're underwater)

Getting Above Water

Fewer borrowers owe more than their homes are worth. Percentage of homes underwater in the U.S.

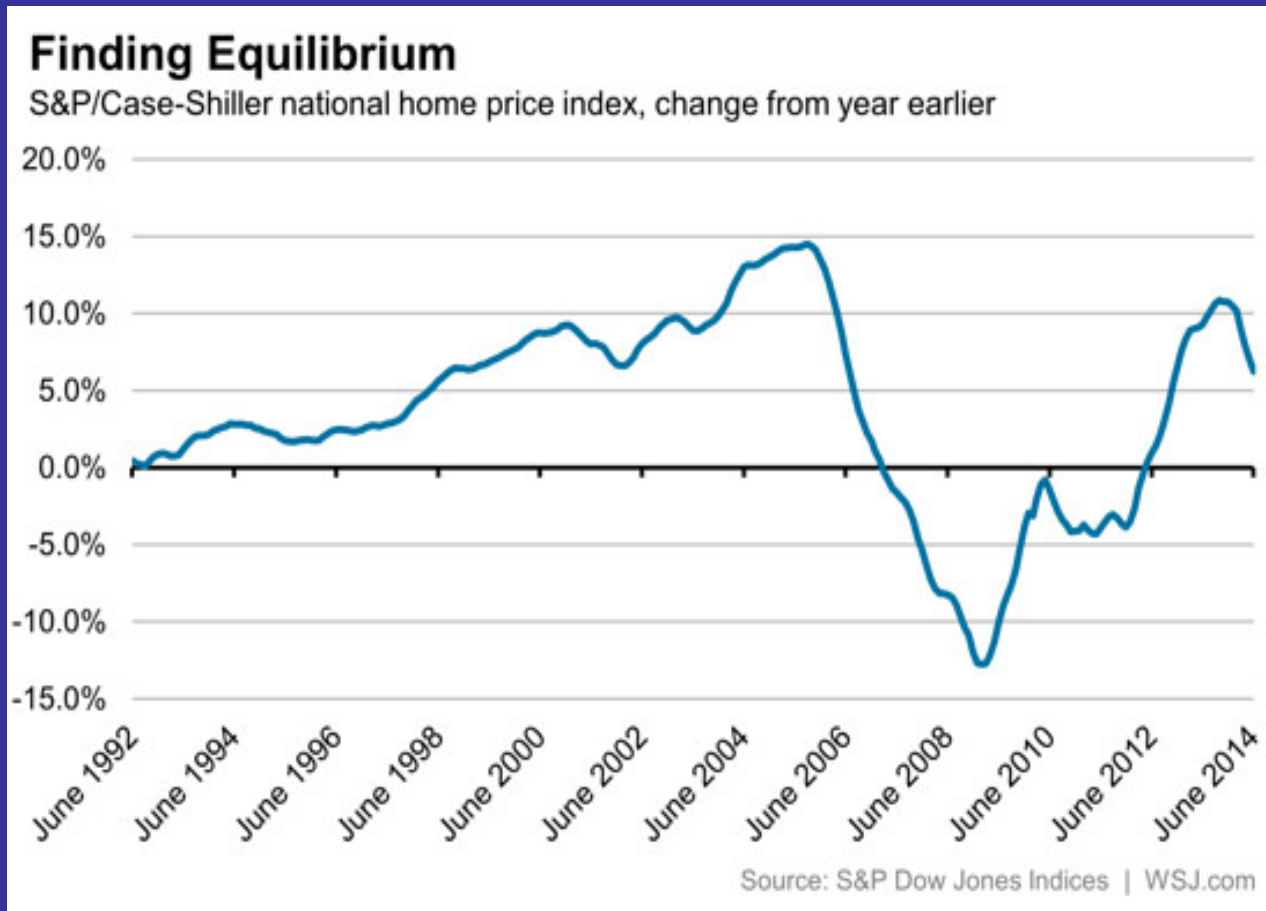


Note: Includes only homes that have a mortgage. Based on estimated home values.

Source: Zillow

The Wall Street Journal

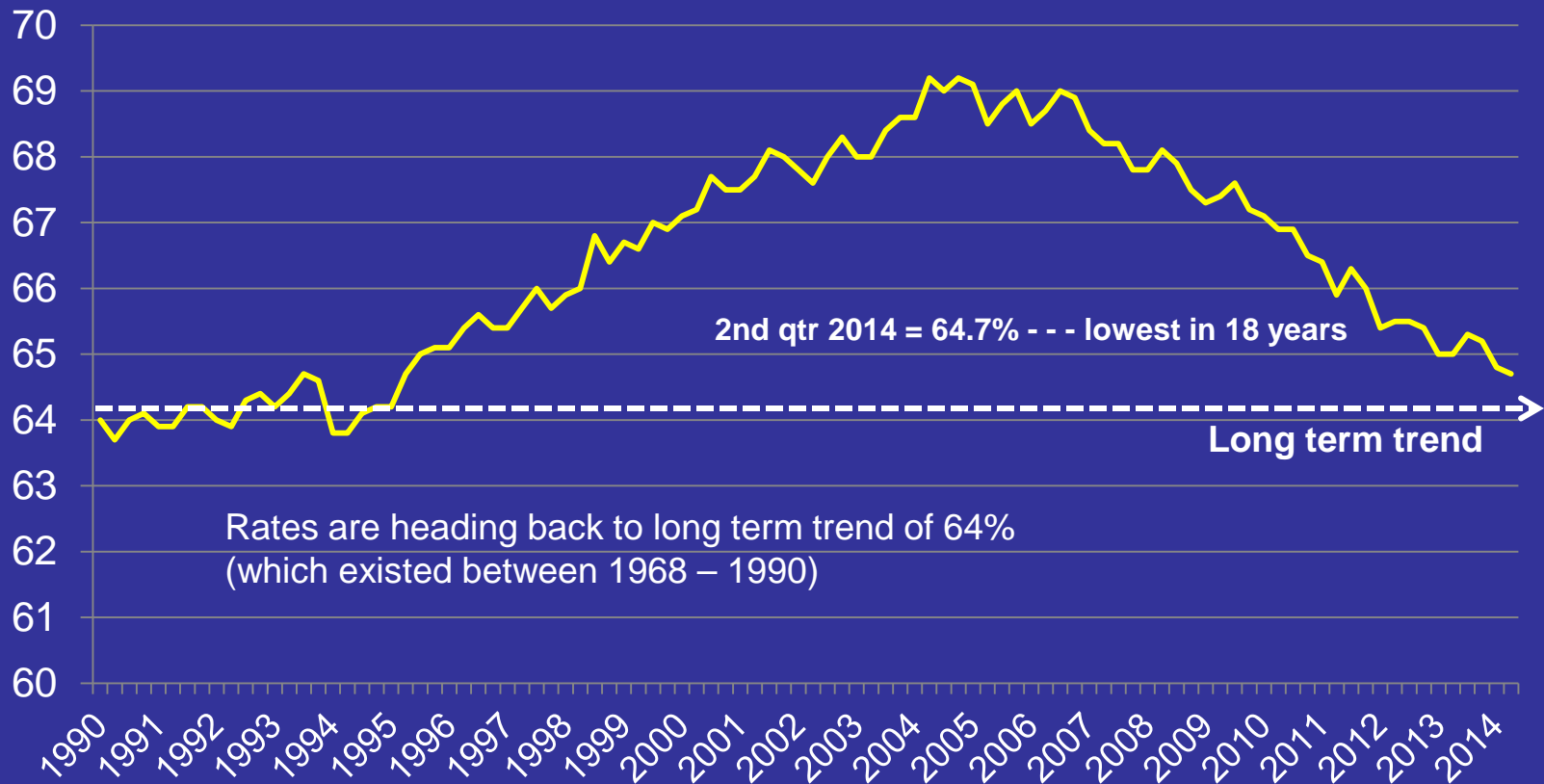
Indeed, Price increases are slowing as recent Case-Shiller data indicates



Impact of weak household formations - -

homeownership rates have been falling for the past seven years – when the economy gets back to normal, will people go back to single family or will we see more renting?
There will be impacts on wood products demand

Home Ownership(%)



Source: Census (<https://www.census.gov/housing/hvs/data/q413ind.html>)

Despite low mortgage rates, people are having problems buying a house because their real incomes have been shrinking for the past 20 years – this is a structural problem (long term) and not cyclical --- no quick fixes to this problem – Also, 15% of population live at or below the poverty level (\$24000 family of 4) – i.e., 45 million Americans - Canada's entire population plus 12 million



Source: U.S. Department of Commerce: Census Bureau

Real household incomes changed little in past 20 years

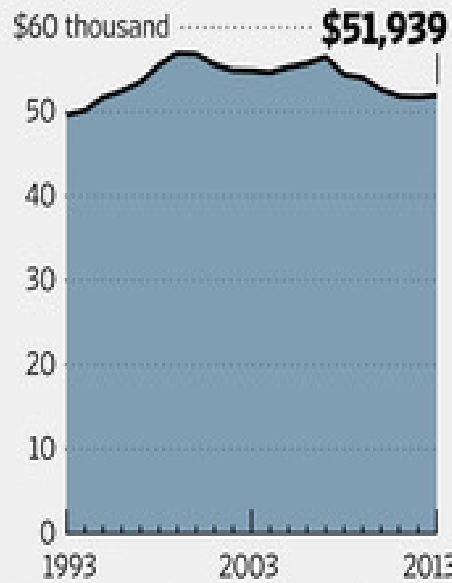
However, the same Census report show that incomes for 15-24 years olds increased 10.5% in the past year – this is good news for housing because these are 1st time buyers who have been absent in recent years!

Income Statement

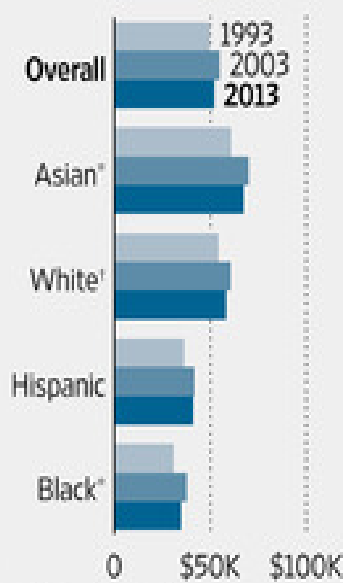
Income ticked up for the first time since the recession, but it remains far from its peak.

U.S. median household income, adjusted for inflation

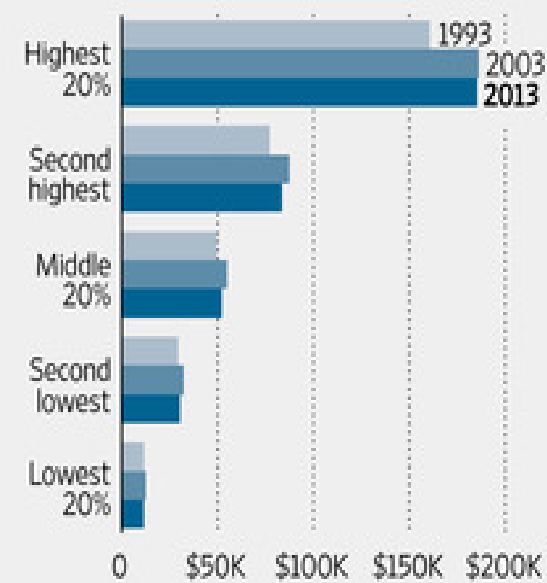
OVERALL



BY RACE, in thousands



BY INCOME QUINTILE, in thousands

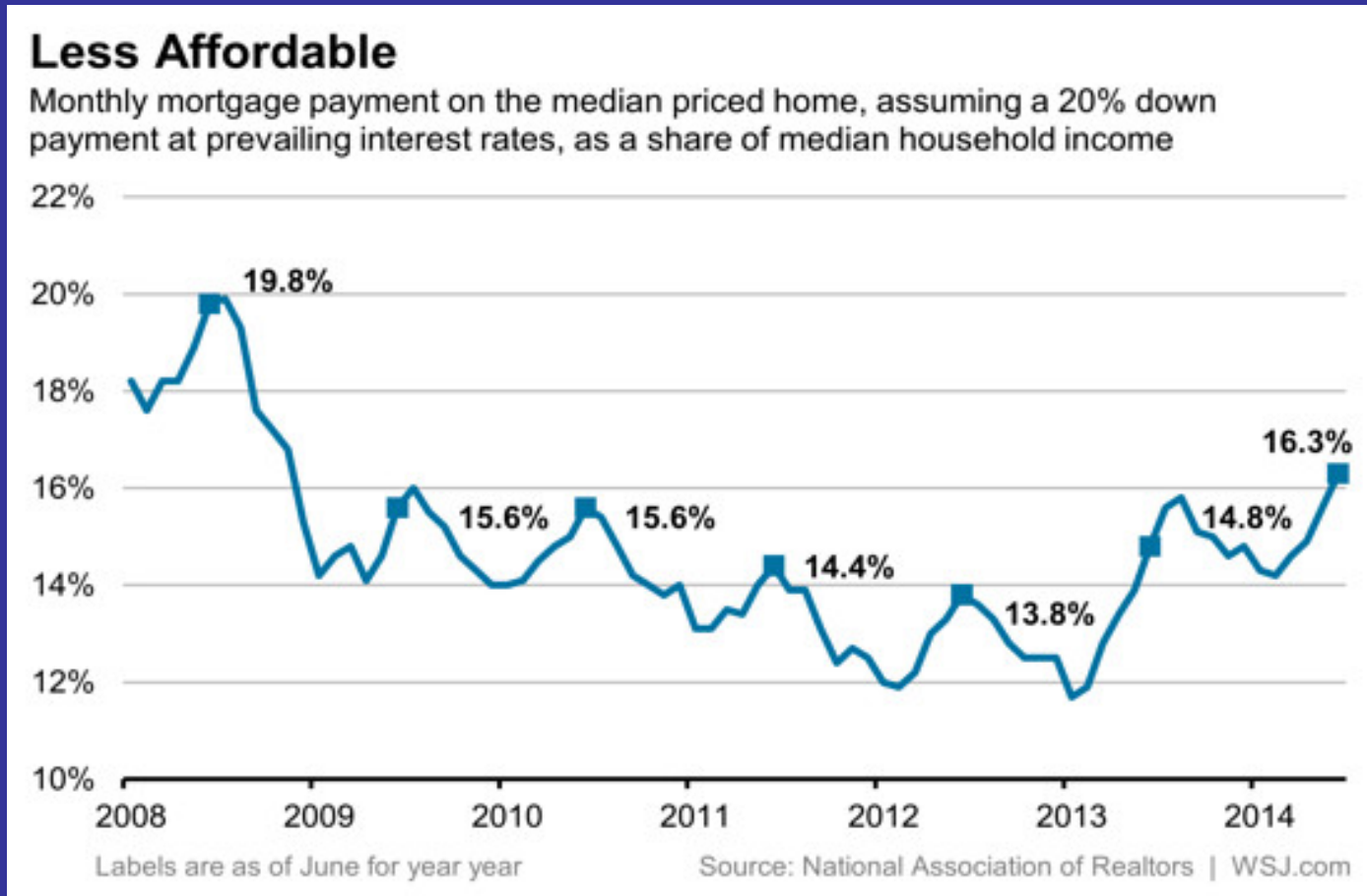


*Alone or in combination with any other race †non-Hispanic Source: Census Bureau

The Wall Street Journal

Another drag on the housing recovery – decreasing affordability

(it's actually worse – many people can't afford the 20% down payment and can't qualify for a loan with tighter credit restrictions, - we need lots of better paying jobs to get housing back on its feet)



Source: WSJ (<http://blogs.wsj.com/economics/2014/08/16/number-of-the-week-housing-affordability-hits-six-year-low/?mod=WSJBlog&mod=marketbeat>)

Real incomes are shrinking – why?

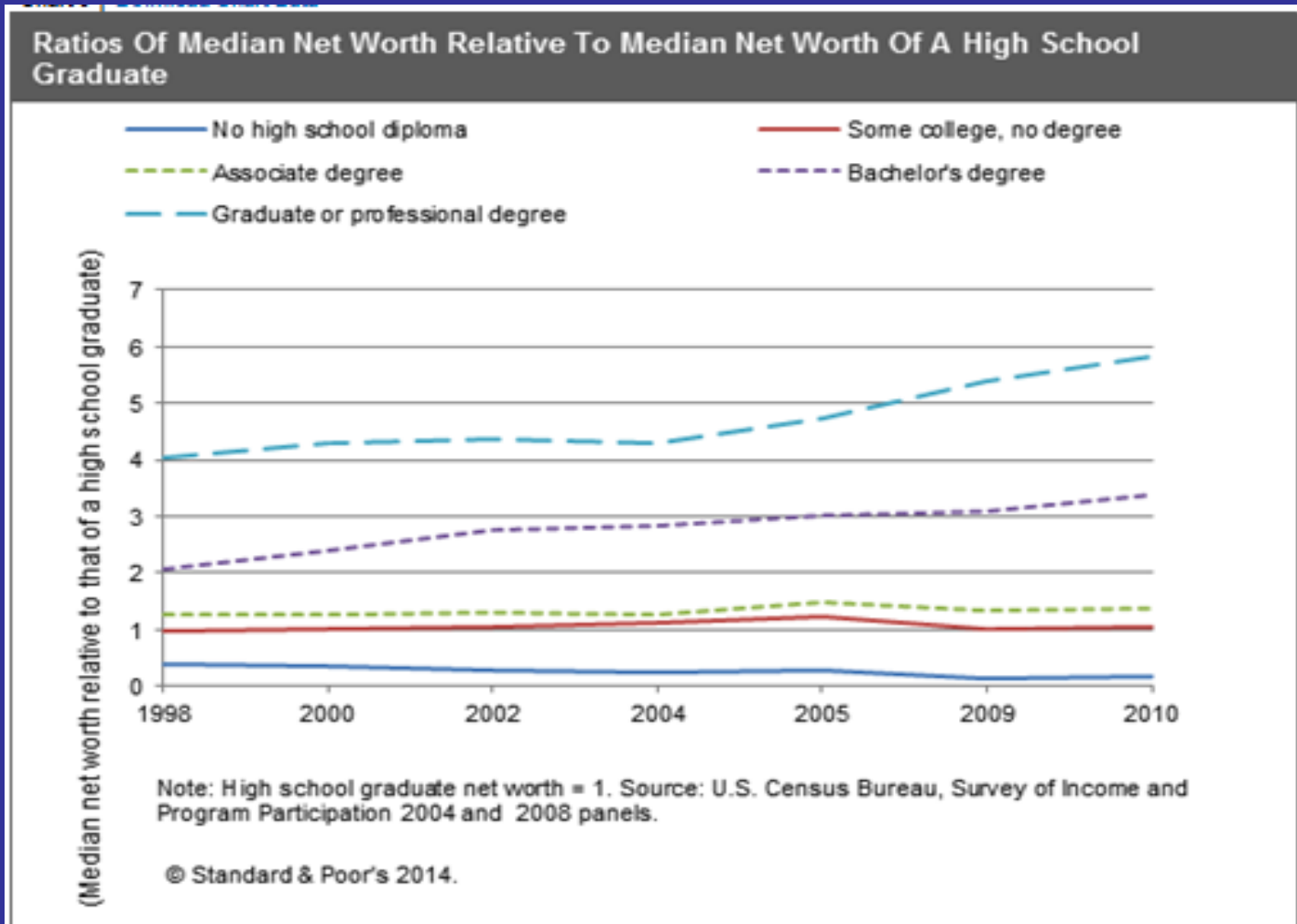
OK – we have discussed this before, but maybe it is time to revisit the issue of education – how it impacts standard of living, the economy, and demand for housing (and wood products)

PS. – a good friend pointed out that this isn't the only problem facing the economy – agreed – I'm hoping to point out a few other structural Issues in future housing notes.

The next few slides are from a recent study by Standard and Poor's, a reputable organization in my opinion. The title of the report “ How Increasing Income Inequality is dampening U.S. economic growth, And Possible ways to change the tide.”

(https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1351366&SctArtId=255732&from=CM&nsf_code=LIME&sourceObjectId=8741033&sourceRevId=1&fee_ind=N&exp_date=20240804-19:41:13)

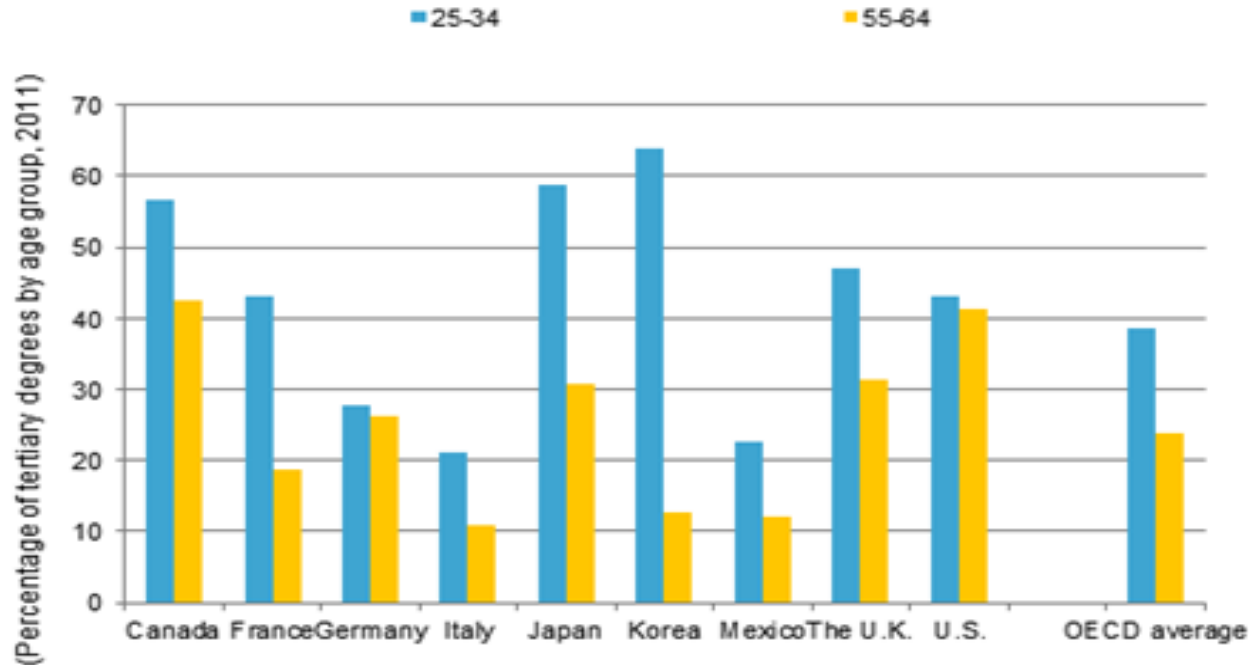
Education pays - a no brainer!! (study by Standard and Poor's)



If education pays, why is U.S. slipping behind?

Chart shows percentage of college degrees by age group - note the difference between young and old . e.g., in most countries, young people are better educated, but in U.S. , there is little difference
I don't know about you, but I would feel a lot better if the next generation was better educated than their parents.

U.S. Education Is Slipping Behind

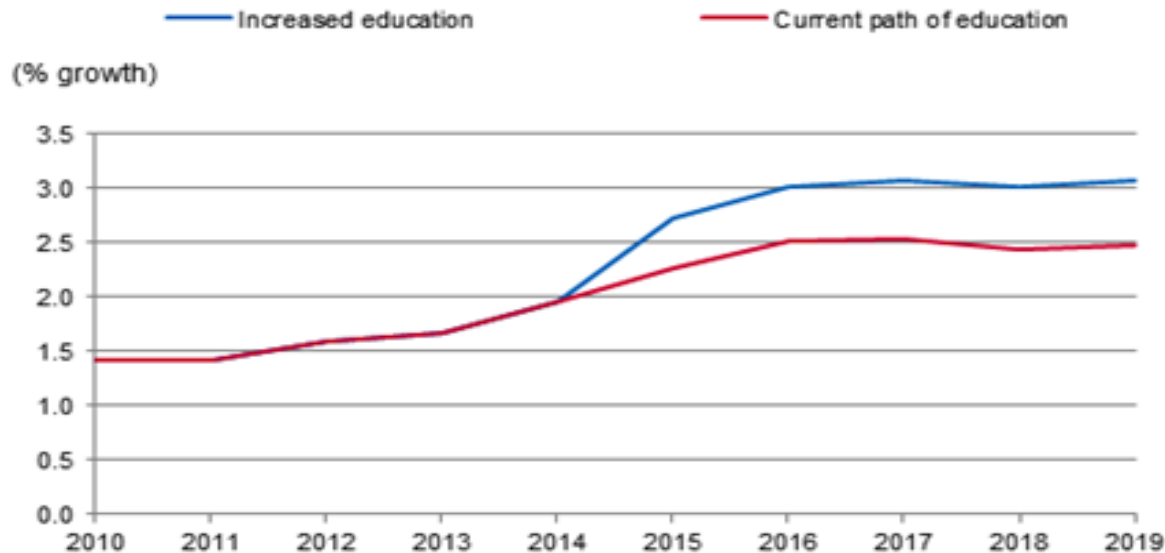


Source: The Organisation for Economic Co-operation and Development (OECD), "Education At A Glance 2013."

© Standard & Poor's 2014.

Education can improve our economy – again, why are we falling behind?

Education Improves U.S. Potential Growth



Sources: Barro, Robert and Jong-Wha Lee, "A New Data Set of Educational Attainment in the World, 1950-2010." *Journal of Development Economics*, vol. 104, pp.184-198; Oxford Economics; and Standard & Poor's Ratings Economics' Estimates.

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PS. A colleague suggested that better education alone won't fix the economy – I agree – we have additional structural problems

**What's the problem and how do we solve it?
(you have seen this movie before, but let's take another look)**

We consume too much and don't invest enough in our future – most of our competitors consume 60% or less of their economy – yet, we consume 70% or more. We need to consume less and invest more in education, infrastructure, R&D,

This is a legitimate strategy for improving our economy, and promoting more demand for housing, and wood products.

I know this is an oversimplification – but, one strategy is we need to change the tax laws to favor investment and discourage consumption (at least until we regain our global competitiveness). And, the government needs to be involved. By the way, this is what we did following WWII – after the war was over, the GI Bill encouraged soldiers to get an education, and other laws were enacted to encourage America to invest in its future (e.g., Eisenhower knew the importance of investing in a world class interstate highway system).

Bottom line – if we don't invest in our future, we won't have one!

**Some conclusions – housing continues to improve albeit slowly
Most forecasters now suggesting that 2016 will be “breakout year”?**

Short term:

- (1) Economy will muddle along until 2016 - i.e., **2015 still below trend**
- (2) This is still not a healthy housing market - 1st time buyers are absent and household formations are off 50% from trend – furthermore, many of sales are cash, many foreign buyers, etc. I.e., **NOT SUSTAINABLE**
- (3) The key to a recovery in housing is the return of 1st time buyers, traditionally about 40- 45% of the market. Current market skewed to cash buyers and investors. 1st time buyers are mostly young people, but they can't find jobs.
- (4) Political discourse will continue to slow a truly strong economic and housing recovery.

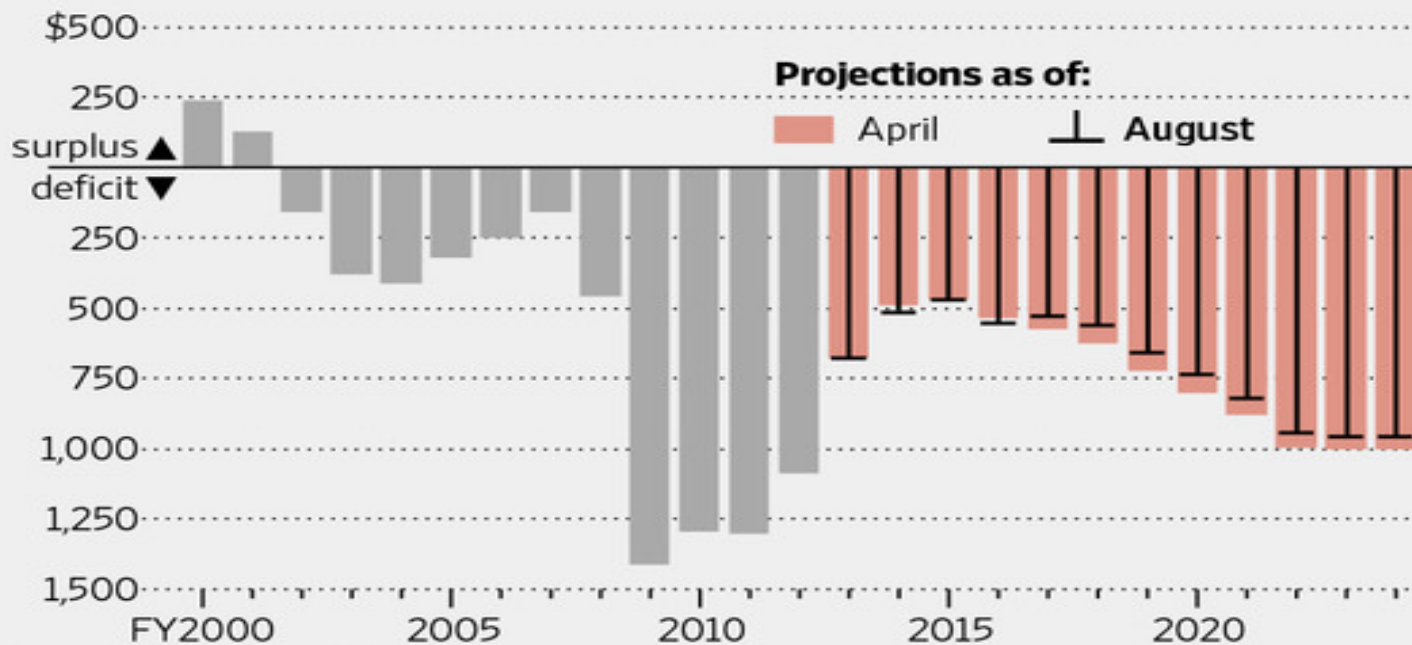
Longer term:

- (1) Housing demand will hinge partly on the footprint of the Federal government – will they continue to promote housing to the degree they have in the past? Yes, the economy is important, but the politicians know how to “grease the wheels”
- (2) Labor participation rate keeps falling – this suggests that there will be future labor shortages. Furthermore, tax revenue will be impacted as more people collect from growing number of government programs while fewer people pay taxes. Look for changes in tax code; consumption tax; social security; Medicare/Medicaid;
- (3) How will USA deal with aging demographics; crumbling infrastructure; out of control public debt; and, generally, decreasing global competitiveness! My thought – revamp the tax system to discourage consumption (bring it in line with other countries), and invest more in our future! Otherwise, we will continue to “underperform”, and housing and wood products will suffer. This will take a long term commitment from the country, politicians, voters, the U.S. consumption rate (% of GDP) is about 70% while our competitors consume 60% or lower. Invest for the future – sounds simple, but requires some thinking that prevailed in this country following WWII. **And, we have to get Medicare/Medicaid, and SSI on a sustainable basis (see next slide for information on federal debt because this makes debt reduction critical)**
- (4) LEADERSHIP is important – politicians need to work on long term solutions – And, more Americans need to get involved in the voting process – mid term turnout is less than 50%. If you don't vote, don't complain about the outcome and resulting poor legislation.

Smaller shortfall, but still lots of red ink – if this were a company, it would be bankrupt – Current federal tax receipts are \$2.976 trillion, spending is \$3.53 trillion (we borrow the difference). Medicare, Medicaid, plus SSI spending = \$1.75 trillion, or 60% of tax revenues. (50% of spending). This needs to change or SSI plus Medicare/Medicaid will gobble up 80% of the federal budget within 20 years. Of course, this won't happen – government will cut spending on R&D, education, health care, Medicare, SSI, Medicaid, to balance the budget. Yes, this is being cynical, but unfortunately realistic.

Smaller Projected Shortfall

Federal budget surplus/deficit, in billions



Note: Fiscal year ends Sept. 30.

Source: Congressional Budget Office

The Wall Street Journal

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