ECONOMIC UPDATE

REGIONS

January 19, 2017

December Residential Construction: Plenty Of Questions To Be Answered In 2017

- Total housing starts rose to an annualized rate of 1.226 million units; total housing permits fell to an annualized rate of 1.210 million units.
- Single family starts fell to 795,000 units while single family permits rose to 817,000 units (annualized rates).
- Multi-family starts rose to 431,000 units and multi-family permits fell to 393,000 units (annualized rates).

Total housing starts rose to an annualized rate of 1.226 million units in December, short of our above-consensus forecast of 1.282 million units, with single family starts falling and multi-family starts bouncing back from an oddly large decline in November. Total housing permits were roughly unchanged, with an annualized rate of 1.210 million units permitted, a bit shy of our forecast of 1.243 million units.

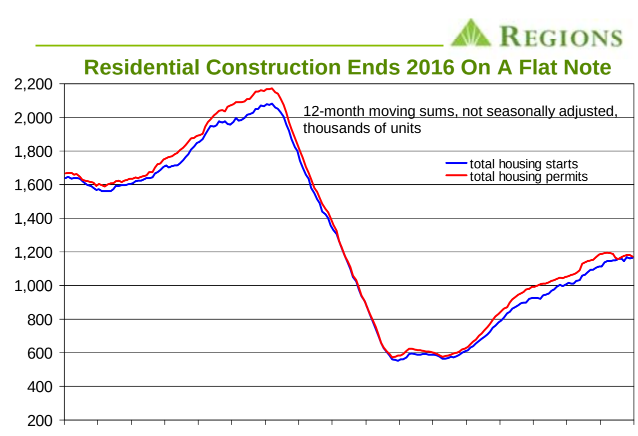
As our regular readers know, we attach little value in the headline numbers on the residential construction reports and instead focus on the trends in the not seasonally adjusted data. In December, there were 83,100 total housing starts, below our forecast of 89,700 units. This puts total housing starts at 1,166,300 units for 2016 as a whole, up 4.9 percent from the 1,111,900 units started in 2015. The 780,900 single family starts in 2016 reflect an increase of 9.3 percent over 2015's total, while multi-family starts slipped 3.0 percent to 385,400 units. As for housing permits, there were 90,000 units permitted in December, slightly lower than our forecast for 93,100 units. For 2016 as a whole, total housing permits fell 0.9 percent from 2015's total, but this is the result of a 12.6 percent decline in multi-family permits offsetting a 7.3 percent increase in single family permits.

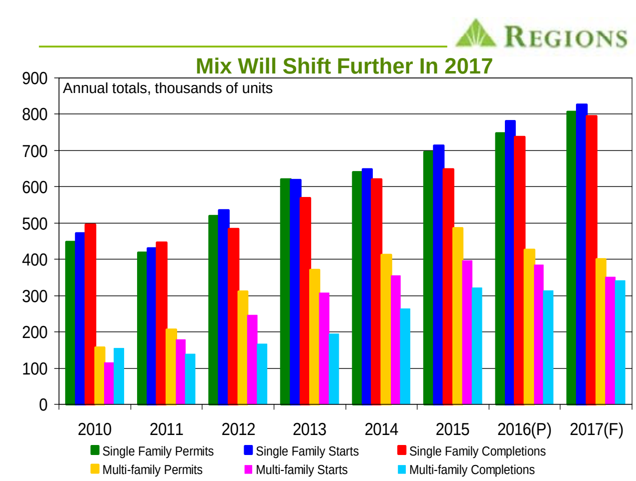
Regionally, both single family permits and starts rose in each of the four broad Census regions in 2016, with the Midwest and Northeast logging double-digit gains in starts. The Midwest and West saw increases in multi-family permits and starts in 2016, while the Northeast and South saw declines in multi-family permits and starts. In the Northeast, the decline in multi-family activity is largely a function of tax incentives in New York that led to a spurt of multi-family development in 2015.

As seen in the first chart below, residential construction activity flattened out over the latter months of 2016. To some extent, this reflects a shift in the underlying dynamics – multi-family activity has passed its cyclical peak while single family activity continues to push higher though remaining far below levels that would be deemed "normal" though, admittedly, one has to have a long memory to recall what that looks like. For those who don't, single family starts of around 1.250 million units would constitute a "normal" year in a fully healthy housing market, and it will be some time yet before we're even close.

As seen in the second chart below, 2016 was the first post-recession year in which multi-family permits and starts declined from the prior year. We expect further declines in 2017, but at this point we're unclear on how significant of a decline we will see. Our uncertainty largely stems from the curiously slow pace of completions, as seen in the chart below. We have for some time now argued multi-family starts had gotten well ahead of themselves, an argument that has been routinely "countered" with angry lectures about how we "don't understand demand." We actually do, and we've actually argued there was healthy demand for multi-family housing, simply not to the extent reflected in multi-family construction. As a result, we've argued that as more and more of these multi-family units come on line, the demand simply won't be there and that will turn up in actual rents being lower than levels at which many of these properties were underwritten. Against this backdrop, developers have seemingly tapped the brakes on the pace of construction, to the point that as 2016 came to a close there were over 600,000 multi-family units under construction, a level that has prevailed for the past several months but previously had not been seen since 1974. Should the pace of completions pick up at some point in 2017, then we will likely see permits and starts fall more rapidly than we now expect.

In the single family segment of the market, our main question for 2017 is how much further mortgage interest rates will rise and how much of an impact that will have on demand, which see as being healthy. It is worth noting that over the last two momths of 2016 the unadusted data show larger than normal declines in single family starts and permits, some of which could be due to the post-election bounce in mortgage rates. So, as can be said in many other instances, if nothing else 2017 should be an interesting year for the housing market.





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