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### December Residential Construction: Plunge In Starts Doesn't Alter The Story Lines

- > Total housing starts fell to an annualized rate of 1.192 million units; total housing permits fell to an annualized rate of 1.302 million units.
- > Single family starts fell to 836,000 units while single family permits rose to 881,000 units (annualized rates).
- > Multi-family starts rose to 356,000 units and multi-family permits fell to 421,000 units (annualized rates).

Total housing starts fell to an annualized rate of 1.192 million units in December, well below the consensus forecast of 1.275 million units and even further below our forecast of 1.328 million units. In highly technical terms, we got our clock cleaned on this one. Total housing permits were basically flat at an annual rate of 1.302 million units in December compared to 1.303 million units in November. This was a bit above our forecast of 1.284 million units. The miss on the headline starts number is due to a sharp decline in single family starts, which fell from an annual rate of 948,000 units in November to a rate of 836,000 units in December.

Our forecast of headline, i.e., seasonally adjusted and annualized, housing starts was predicated on not seasonally adjusted starts holding up better than is typical for the month of December and a generous seasonal adjustment factor. While we were on the mark on the latter, the 80,300 not seasonally adjusted starts came in well below our forecast of 92,800. December saw only 54,300 single family starts, the fewest since January 2017. This likely reflects two things – first, winter weather likely held down starts in the Midwest and Northeast regions, where the sharp declines in single family starts were larger than it typical for the month of December; second, while atypically harsh winter weather likely contributed to the decline in single family starts in the South region, activity in this region is also realigning from the distortions caused by Hurricanes Harvey and Irma. The bottom line on starts is that even though the seasonal adjustment factor was as generous as our forecast anticipated, not even that could salvage our forecast from a much larger than expected decline in unadjusted single family starts. Our forecast for housing permits fared much better, with the 93,200 total starts just slightly ahead of our forecast of 92,800 units.

Though the December data are still subject to revision, as the data now stand there were 1.202 million total housing starts in 2017 (this is the sum of not seasonally adjusted starts for the year), with 848,300 single family starts and 353,700 multi-family starts. This reflects an 8.6

percent increase in single family starts and easily the highest annual total since 2007, while multi-family starts fell by 9.8 percent. There were 1.254 million total housing permits issued in 2017, of which 819,500 were single family permits (a 9.2 percent increase) and 434,800 were multi-family permits (a 4.6 percent decline). Residential construction in 2017 was in line with our below-consensus forecast; as our forecast anticipated, the composition of residential construction shifted more toward single family and away from multi-family activity, and we expect this shift will be more pronounced in 2018.

So, despite our "near miss" on the headline starts number for December, residential construction played out pretty much as we anticipated would be the case in 2017 and we've not changed our assessment of what we think will be the main themes of 2018. One of those themes will be the disposition of what remains a swollen pipeline of multi-family units under construction, with over 600,000 units awaiting their market debut. There has been some, let's say, curious, commentary around the multi-family segment of the market. Some seem fixated on the declines in permits and starts and on this basis proclaiming that new supply has been "choked off." This of course is ignoring the largest backlog of units under construction since the mid-1970s, which is the 300-pund gorilla, the elephant in the room, and the crazy uncle in the attic all rolled into one. Sure, you can ignore it, but you have to try really, really hard to ignore it. The pace at which this backlog clears will be one of the main housing market story lines to follow in 2018.

Another main story line will be the extent to which there are further increases in single family construction beyond those seen over the past few years. While we look for a double-digit increase in single family starts in 2018, that will still leave the single family segment of the market undersupplied relative to historical norms. Combined with what we expect to remain notably lean inventories of existing homes for sale, this will help sustain rapid house price appreciation, but higher mortgage rates will be an opposing force as 2018 wears on.

