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June Residential Construction: "Shocking" Headline Number A Pointless Distraction

- > Total housing starts fell to an annualized rate of 1.173 million units; total housing permits fell to an annualized rate of 1.273 million units.
- > Single family starts fell to 858,000 units while single family permits rose to 850,000 units (annualized rates).
- > Multi-family starts fell to 315,000 units and multi-family permits fell to 423,000 units (annualized rates).

Total housing starts fell sharply in June, with the annualized rate of 1.173 million units well below even the lowest forecast, let alone our forecast of 1.303 million units. Housing permits also fell sharply, with the annual rate of 1.273 million units below our forecast of 1.294 million units, which was the lowest of any forecast. To be sure, the 12.2 percent decline in housing starts from May's (revised) rate of 1.337 million units was, well, "shocking" may be too strong of a word, but it's at least in the same neighborhood. That said, the real story in the data on residential construction is told, for anyone willing to listen, by the not seasonally adjusted data. Our quick summary of that story: the May data were notably strong, particularly in the Midwest region, and the June data reflect some payback; of more significance is that the underlying trends in the data have not changed, with single family activity grinding higher at a slow but steady pace and multi-family activity drifting lower at a pace nowhere near sufficient to clear a mammoth supply backlog.

The not seasonally adjusted data show total starts of 111,500 units in June, well below our forecast of 123,700 units, and total permits of 119,800 units, shy of our forecast of 124,800 units. The declines were most pronounced in the Midwest region, where total starts fell from 24,200 units in May – the highest monthly total since May 2007 – to 15,800 units in June, while total permits fell from 21,600 in May to 16,200 in June. Where our forecast went wrong here was anticipating the strength in single family activity seen in the Midwest in May would have more staying power than turned out to be the case. As we noted in our weekly *Economic Preview*, we thought the South region to pose the biggest challenge to our forecast of the June data given how notably strong activity in that region had been in the prior two months. Both permit issuance and construction starts jumped in the South in April and remained strong in May, with this strength highly concentrated in Florida. Our thought was that these were the first hints of the post-hurricane bounce in construction activity we had been watching for which, if this was indeed the case, suggests that at some point there will be payback in the form of decline in both permits and starts. The

alternative explanation would be that construction activity in the South has simply kicked into a higher gear. While both permits and starts did decline in June, those declines were very modest, though we think it too soon to come to any conclusions as to whether the higher level of activity seen over the past three months is transitory or lasting.

Time will tell but, as we routinely note, we think the best gauges of the underlying trends in the residential construction data are the running 12-month totals of permits, starts, and completions. Our charts below show these trends and illustrate our point in the value of looking at unadjusted data. Nationwide, over the past 12 months there have been 846,500 single family permits issued, 882,600 single family units started, and 826,400 single family units completed. To be sure, the past few months have been a bit choppy, but the long-running trend of slow but steady improvement remains intact, and we think this will remain the case.

The multi-family segment of the market, however, makes far less sense to us. In each of the four broad Census regions, the 12-month totals of both permits and starts are off what we think will be the cycle highs, but the pace of retreat from those highs remains curiously slow. We say that with an eye towards what remains the biggest backlog of multi-family units under construction since the mid-1970s. As of June, there were 608,300 multi-family units under construction, the 24th consecutive month in which this number has been above 600,000. We have never once doubted the strength of demand for multi-family (i.e., rental apartments) units, but that demand is simply not strong enough to absorb the number of units in the pipeline at the prices (rents) being asked as those units come on line. Sure, there is still ample funding, increasingly from non-bank lenders, to support development but the question, at least to us, is how long this can or will remain the case.

Sure, the headline number on the June report on residential construction is somewhat shocking. To us, however, that is nothing more than a pointless distraction away from the relevant trends in the data.

