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September Residential Construction: More Than Florence Behind September Data?

- > Total housing starts fell to an annualized rate of 1.201 million units; total housing permits fell to an annualized rate of 1.241 million units
- > Single family starts fell to 871,000 units while single family permits rose to 851,000 units (annualized rates)
- > Multi-family starts fell to 330,000 units and multi-family permits fell to 390,000 units (annualized rates)

Total housing starts fell to an annualized rate of 1.201 million units in September, slightly lower than our below-consensus forecast of 1.208 million units, while total housing permits fell to an annualized rate of 1.241 million units, shy of our below-consensus forecast of 1.273 million units. Though Census offered no commentary on this topic, the September data for the South region were surely impacted by Hurricane Florence, and while we accounted for this in our forecasts of permits and starts, we cannot quantify the extent to which Florence held down residential construction activity. To us, however, the bigger question is what to make of the not seasonally adjusted data (a/k/a the data that actually matter), which show steep declines in both single family and multi-family housing permits in September. Answering this question in the single family segment will take time, so we're not quite ready to call the end of what has over the past few years been slow but steady growth in single family construction. While the multi-family data are inherently volatile from one month to the next, September's decline in permit issuance is in line with the downward trend seen over recent months, though the pace of this decline still seems far too slow to us given the magnitude of the backlog of units under construction.

On a not seasonally adjusted basis, there were 106,100 total housing starts in September, slightly below our forecast of 108,200 starts. Single family starts fell to 74,200 units. What stands out here is the decline in the South region, where the 36,000 single family starts is the lowest monthly total since February and well below the average of 44,000 starts per month over the prior five months. That the September starts number was also well below the recent run rate for single family permit issuance in the South region is also consistent with the premise that Hurricane Florence disrupted activity in the region in September. Though perhaps to a lesser degree, the October data will be impacted by Hurricane Michael, meaning it will be a few more months before we have a better sense of the underlying trends in construction activity in the South region. This is worth keeping in mind when you see the next "housing is done" headline – the South region accounts for over 50

percent of all single family permits and starts, so any disruptions in the data for this region will in turn make it more difficult to interpret the national data over coming months as well.

The not seasonally adjusted data show a total of 96,600 housing permits were issued in September, well below our forecast of 110,200 permits. There were sizeable declines in both single family and multi-family permits; the 64,700 single family permits issued marks the lowest monthly total since February. While the sharp decline in single family permits in the South region comes as no surprise, we'll note that there was also a sharp decline in the West region. Again, you cannot (well, okay, you can, but you shouldn't) draw any conclusions from a single data point, but it is worth noting that many of the major markets in the West region have seen a jump in listings of existing homes for sale which, if sustained, could dampen new single family construction given what in many of these same markets are elevated development costs.

One main housing market theme that, for better or worse, remains intact is the sizeable backlog of multi-family units under construction. With 607,000 units under construction, September marks the 27th consecutive month above the 600,000 unit mark. As we have been noting for some time now, one has to go back to the mid-1970s to see a backlog this large for this long. As our second chart below illustrates, this backlog is spread out across the four broad Census regions, and this stubbornly large backlog is why we've been looking for a faster pace of declines in multi-family permits and starts than we've thus far seen.

Higher mortgage rates and hurricane impacts notwithstanding, we expect the slow but steady growth in single family construction to continue over coming quarters. If we are correct, or, at least more so than we've been thus far, in our call on multi-family activity, this would mean total permits and total starts will be fairly range bound, which is why it pays to look beneath the headline numbers before drawing any conclusions about the health of the housing market.

