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August New Home Sales: Builder Backlogs Rise Even As Sales Fall

- > New home sales fell to an annual rate of 609,000 units in August from July's revised sales rate of 659,000 units.
- > Months supply of inventory stands at 4.6 months; the median new home sale price fell by 5.4 percent on a year-over-year basis.

After posting their best month since October 2007 new home sales retreated in August, with annualized sales of 609,000 units compared to July's upwardly revised sales rate of 659,000 units. With the slip in sales, the new home sales metric ticked up to 4.6 months, higher than 4.2 months in July but nonetheless still indicative of tight supplies. August's headline print was above the consensus estimate of 600,000 units and below our forecast of 622,000 units. We've repeatedly noted the headline new home sales number in any given month comes with several caveats, including a sizeable margin of error – for instance, Census is 90 percent confident annualized August sales came in between 463,449 and 754,551 units – and a high likelihood of significant revisions in subsequent months. As such, the underlying trends are far more important than the headline, and those trends continue to show steady, if halting, improvement in the pace of new home sales.

As our regular readers know, our preferred means of looking at the underlying trend in new home sales is to take the 12-month moving sum of not seasonally adjusted sales. In August, not seasonally adjusted sales fell to 50,000 units (our forecast was 52,000) from 57,000 units in July. This leaves the 12-month moving sum at 549,000 units, which is the highest such total since August 2008, when sales were beating a hasty retreat in the opposite direction. Unadjusted sales were unchanged between July and August in the Midwest, up slightly in the West, down slightly in the Northeast, and down sharply in the South region. Keep in mind, though, that new home sales are booked upon the signing of the sales contract, and it is likely at least part of the decline in the South reflects the severe weather that impacted the region. Overall, though, the not seasonally adjusted data are consistent with the theme of steady improvement in new home sales, and on a year-to-date basis through August unadjusted sales are running 13.6 percent ahead of 2015's pace.

As is the case in the existing homes segment of the market, lean inventories are acting as a meaningful drag on sales of new homes. One key difference, however, that mitigates the impact in the market for new homes is that new home sales can be booked at multiple stages in the construction cycle, i.e., before construction has started, while construction is underway, and after construction has been completed. One trend we have regularly pointed to is the elevated share of new home sales accounted for by units on which construction has not yet started. In August, these pre-construction sales accounted for 34 percent of all new home sales while completed homes accounted for 30 percent of all sales. Shortages of labor and, to a lesser extent, materials mean builders are facing rising backlogs of unfilled orders, a situation not likely to change as long as demand side fundamentals remain healthy and mortgage interest rates remain low. At the same time, what in many markets is a lengthier and costlier entitlement process will likely keep a lid on spec building, even for those builders who would otherwise have the time and resources to build spec homes.

Another trend we've been highlighting is the share of new home sales accounted for by homes priced at or above \$300,000. For some time now home sales have been atypically skewed towards the higher end of the price scale, which simply reflected how supply constrained builders were responding to underlying demand and credit conditions. We have, however, questioned how long this would continue, and we may have our answer. In August, homes priced at or above \$300,000 accounted for "only" 44 percent of all new home sales, higher than longer-term norms but the lowest share since February 2014. Our bottom chart shows six-month moving averages, an allowance for the high degree of monthly volatility, but one nonetheless gets the sense this trend is reversing, which again simply reflects builders taking advantage of greater demand for entry level homes and the lack of inventory of such homes in the existing homes segment of the market.

Our view on home sales has for some time now been that the demand side of the market is sound and the concerns are mainly on the supply side of the market. The August report on new home sales does nothing to alter our view.

