ECONOMIC UPDATE

REGIONS

April 17, 2018

March Residential Construction: Multi-Family ~~Confuses~~ Beats To The Upside

- Total housing starts rose to an annualized rate of 1.319 million units; total housing permits rose to an annualized rate of 1.354 million units.
- Single family starts fell to 867,000 units while single family permits fell to 840,000 units (annualized rates).
- Multi-family starts rose to 452,000 units and multi-family permits rose to 514,000 units (annualized rates).

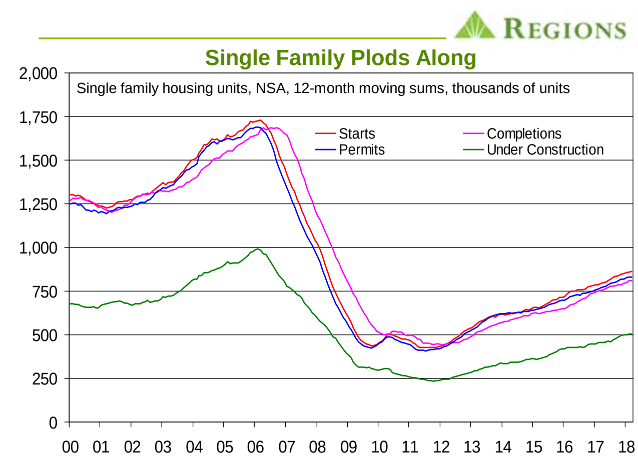
The headlines will say residential construction activity beat expectations quite easily in March, and there's no argument here. At 1.319 million units, total housing starts came in well ahead of the consensus forecast of 1.264 million units, and the 1.354 million total housing permits topped the consensus forecast of 1.330 million units. At the same time, there was a significant upward revision to the initial estimate of housing starts in February, now reported at 1.295 million units rather than the 1.236 million units originally reported (these are all seasonally adjusted annualized rates). Whether or not these beats are a good thing, however, is open to debate. As for us, we see a lot to not like in the data but, sure, whether this reflects us actually understanding the housing market or us being completely clueless about the housing market is open to debate. To be perfectly honest, the more data we see, at least in the multi-family segment of the market, the more we lean toward the latter explanation.

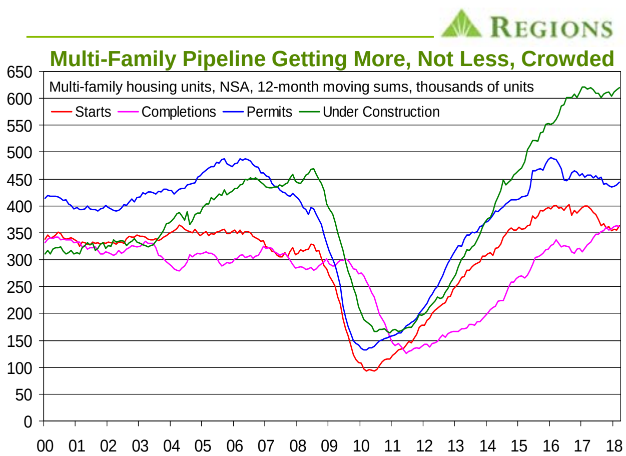
As always, we focus on the raw (or, not seasonally adjusted) data, which show that in March there were a total of 106,900 housing starts, ahead of our forecast of 101,800 units, and permits issued for 115,300 units, just ahead of our forecast of 113,600. For both permits and starts, our forecasts anticipated higher single family counts and lower multi-family counts than turned out to be the case. The sizeable upward revision to February starts stems from an upward revision to the unadjusted count of multi-family starts. As a side note, there is little evidence of weather having disrupted construction activity, as unadjusted starts were up in each of the four broad Census regions and the February/March percentage changes were in line with recent years.

Our misses on our forecasts of single family activity were slight, and on the whole single family activity over the past few years has been in line with our expectations. In other words, a slow and steady upward grind, as shown in our first chart below. As we routinely point out, the frustratingly slow pace of growth in single family activity is more a reflection of supply side, not demand side, constraints. There is demand for more, perhaps significantly more, single family housing than is now being produced but this imbalance figures to persist. Constraints such as shortages of lots, labor shortages, and regulatory restrictions don't figure to abate any time soon, and sharply higher prices for materials are altering the mix of the single family product being brought to market. This is a recipe for continued robust house price appreciation.

Those patterns are, and have for some time been, so obvious that even we can see them. The, for lack of a better term, logic in the multi-family segment of the market, however, has been and remains rather elusive. At least for us. In March, both multi-family starts and permits were far higher than our forecast anticipated and, as noted earlier, multi-family starts were much stronger in February than initially reported. Multi-family completions, however, increased only trivially in March, in keeping with a notably slow pace of multi-family completions over the course of the current cycle. As seen in our second chart below, this has led to a backlog of multi-family units under construction that is not only the largest in over 40 years but is getting larger, not smaller. As of March, there were 621,000 multi-family units under construction, with 610,000 of these units in structures with five or more units. Census data show that on average multi-family projects are taking over 13 months to complete once construction has started, a figure that has steadily risen over recent years. In part this reflects construction being more and more concentrated in urban core areas, meaning builders are building up and not out, which increases time to build. But, given rising vacancies and slipping rent growth, we can't help but wonder if builders are intentionally slow-walking projects in hopes of better timing the market. This, however, would imply a more pronounced pullback in multi-family permits and starts than has been actually seen to date.

Given the more or less binding constraints on single family activity, to us the main question in the housing market is whether and when we will see a more pronounced decline in multi-family activity. We have been expecting this for some time, and have been wrong. Whether we're stubborn or just clueless, however, we're not changing that call.





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