

ECONOMIC UPDATE



REGIONS

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August Residential Construction: Eye-Popping Headline Numbers Cover Worrisome Details

- › Total housing starts rose to an annualized rate of 1.364 million units; total housing permits rose to an annualized rate of 1.419 million units
- › Single family starts rose to 919,000 units and single family permits rose to 866,000 units (annualized rates)
- › Multi-family starts rose to 445,000 units and multi-family permits rose to 553,000 units (annualized rates)

We're not normally ones to look a gift horse in the mouth, at least when that comes in the form of data points that come in much stronger than expected. But, while both housing permits and housing starts in the month of August blew by expectations, we're more puzzled than pleased given the split between single family and multi-family activity. Total housing starts jumped to an annualized rate of 1.364 million units in August, topping our above-consensus forecast of 1.282 million units, with total housing permits spiking to an annualized rate of 1.419 million units, trouncing even the most optimistic (1.340 million) of forecasts. August's jump in housing starts came off of an upward revision to July starts, with the preliminary estimate of 1.191 million units revised up to 1.215 million (annualized rates). With both permits and starts, however, the biggest driver of the August increase was the multi-family segment, and it is the multi-family segment that accounts for the upward revision to the initial July estimates. The old adage holds that when you find you've dug yourself into a hole, the thing to do is stop digging, but when it comes to multi-family construction, when you've built yourself into a supply glut the thing to do, apparently, is to keep on building.

On a not seasonally adjusted basis, there were a total of 121,100 units started in August, above our forecast of 115,300 units. The 82,500 single family starts were right in line with our forecast of 82,800 starts, but the 38,500 multi-family units started easily topped our forecast of 32,500 units. Single family starts fell in each of the four broad Census regions in August, but this is in line with typical seasonal patterns in which single family starts decline in the month of August, and in each region single family starts have rebounded smartly from the steep declines triggered by the affordability shock of late-2018. As of August, the running 12-month total of not seasonally adjusted single family starts stood at 859,100 units. This is still below where that total stood prior to the steep decline in starts late last year and which ran into the early months of 2019, but those declines will weigh on the trending data into early next year. Additionally, even with favorable mortgage interest rates and elevated builder sentiment, the reality is that single family

construction remains held down by limitations, often in the form of higher regulatory hurdles in many markets, on buildable lots, and this will continue to act as a drag on the rate of growth in single family activity. Additionally, labor supply constraints are more of a hinderance in the single family segment of the market, which is more labor intensive than is multi-family construction.

On a not seasonally adjusted basis, 127,000 new housing units were permitted in August, well ahead of our forecast of 116,700 units. The 78,100 single family permits issued fell short of our forecast of 79,900 units, but the 48,900 multi-family units permitted made a mockery of our forecast of 36,800 units. While multi-family permit issuance was abnormally high in the Midwest and Northeast regions, the 22,300 multi-family permits issued in the South region in August is the highest monthly total since March 2006. If you don't recall, that coincided with the height of the frenzied pace of condominium construction. Indeed, we've been asked more and more of late whether the elevated number of multi-family permits and starts over recent months reflects a shift towards condo construction, which would seem plausible given where interest rates are and given the constraints on single family construction. Alas, as we illustrate in the chart below, condo construction has yet to show any meaningful signs of picking up, and we see this as unlikely to change any time soon, with the combination of long memories and liability issues for contractors shaping our views.

Two things stand out to us in terms of multi-family. One is that the ratio of starts to permits remains atypically low, which begs the question of why pull the permits. The other thing that stands out is the magnitude of the pipeline of multi-family units under construction which, as of August, stands at 627,000 units, the highest number since October 1974 (no, that isn't a typo). This number has consistently been over 600,000 units for over three years now, reflecting abnormally low numbers of completions. At some point, something has to give in the multi-family segment, but what and when that will be has yet to be determined.

