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November Residential Construction: Headline Numbers Overstate The Case

- Total housing starts rose to an annualized rate of 1.297 million units; total housing permits fell to an annualized rate of 1.298 million units.
- Single family starts rose to 930,000 units while single family permits rose to 862,000 units (annualized rates).
- Multi-family starts fell to 367,000 units and multi-family permits fell to 436,000 units (annualized rates).

Total housing starts rose to an annualized rate of 1.297 million units, above the consensus forecast of 1.277 million units but shy of our forecast of 1.336 million units. There was, however, a sharp downward revision to October housing starts, now reported at an annual rate of 1.256 million units rather than the 1.290 million units initially reported, which mainly reflects a sharp downward revision to multi-family starts. Total housing permits fell to an annualized rate of 1.298 million units in November, with a slight increase in single family permits being offset by a decline in multi-family permits. In our weekly *Economic Preview* we noted our expectation that the report on November residential construction would be plagued by seasonal adjustment noise that would make the data look better than was actually the case. Our premise was correct, though the volume of noise was a bit lower than we anticipated. The broader point, however, is that the underlying trends in residential construction – a gradual increase in single family activity and gently declining multi-family activity – remain undisturbed by the noise.

As we routinely note, these trends are best seen in the not seasonally adjusted data, specifically the running 12-month sums of permits and starts. On a not seasonally adjusted basis, there were 98,400 total housing starts in November, shy of our forecast of 103,600 units. At 68,800 units, single family starts were in line with our forecast but the 30,500 multi-family starts fell short of our forecast. On a not seasonally adjusted basis, there were 96,500 total housing permits issued in November, with both single family permits (61,700 units) and multi-family permits (34,800 units) falling short of our forecasts (our forecast was for total permits of 107,100 units). Total starts were up in the West region in November and down in the other three broad Census regions, while total permits were down in each of the four broad regions.

As we noted in our *Preview*, with the onset of winter it is normal for builders to scale down construction activity in the month of November. What tend to be generous seasonal adjustment factors compensate for this typical seasonal slowdown, but if the magnitude of that slowdown

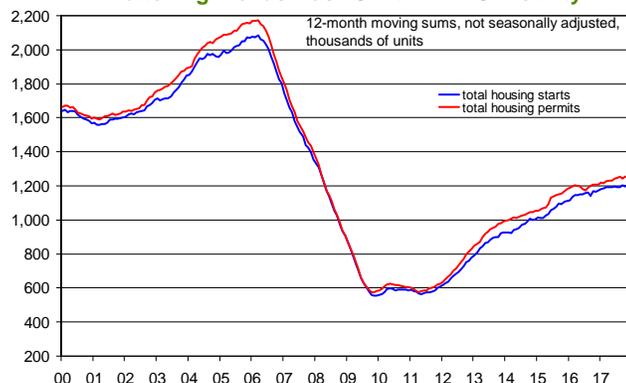
is smaller than normal, the seasonally adjusted data look more robust than is actually the case. This is one reason we stress the significance of the unadjusted data. November's unadjusted figures leave the running 12-month sum of not seasonally adjusted housing starts at 1.208 million units; the 845,000 single family starts over this span mark the highest 12-month total since May 2008. Over the past 12 months, there have been 1.255 million total housing permits issued, with the 818,200 single family permits the highest 12-month total since April 2008. The easing of multi-family activity can also be seen in the running 12-month totals, which as of November stand at 362,000 starts (down from 402,000 as of February) and 437,200 permits (down from 459,500 as of January).

As seen in our second chart below, however, what has been but a gradual pace of deceleration in multi-family permits and starts leaves us with the largest backlog of multi-family units under construction than at any point since the mid-1970s. Completions have been rising, but at a curiously slow pace that, even with a slowdown on the front end (i.e., permits and starts) still leaves the pipeline notably crowded. It is worth noting that banks have been tightening lending standards on multi-family loans over the past few quarters while also reporting waning demand for multi-family loans. The way to reconcile these seemingly conflicting trends is to note that private equity has rushed into any void left by commercial banks pulling in the reins on multi-family lending. We've been quite clear in our view that, yes, there is solid demand for multi-family rental units, just not nearly enough to absorb the supply in the pipeline. As more of these units come to market, however, there could be significant softening in effective apartment rents.

The story lines to watch in 2018 are whether the pace of single family starts will pick up – we think yes, but to a lesser degree than the consensus anticipates – and whether the pullback in multi-family permits and starts will be more pronounced – we think it will be. If we are correct, the top-line totals for permits and starts may not look all that different, but the mix of construction will be.



Flattening Trends Mask Shift In Mix Of Activity



Rising Completions Don't Make A Dent In Multi-Family Backlog

