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Are We Building Enough?

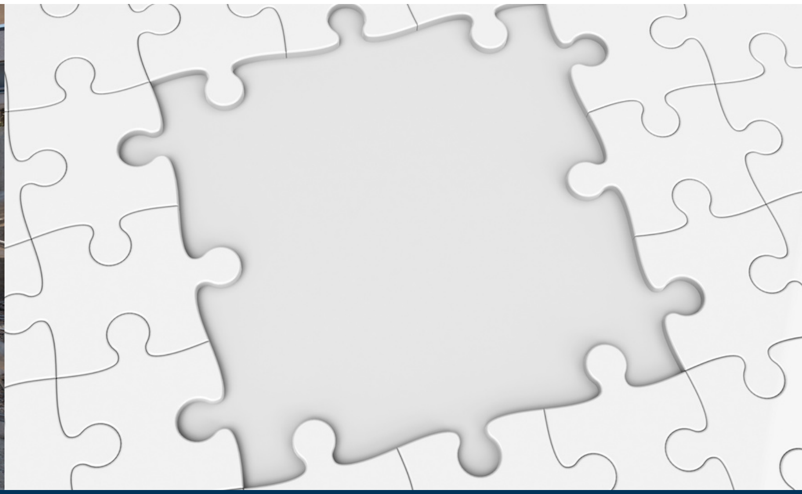
by **Stevan Novakovic**
Economist

Citrus Tower in Clermont

ARE WE BUILDING ENOUGH?

Over a year ago, Farm Credit of Central Florida published a state-level real estate review and, in so doing, echoed lyrics from crooner Tracey Lawrence. Somehow his music continues to ring true, but instead of “Time Marches On” (which it still does), more fitting for this update might be “If the World Had a Front Porch.” Why? Well, because in today’s write-up the central point is that many Americans do not have a porch, more specifically a house at all, and it is not getting much easier to find one. While this piece is intended to follow the most recent post a few weeks ago, the scope is to zoom out to a higher level view looking all the way back to before the “Great Recession,” and then consider the past's implications for today. While the words “Covid,” “pandemic,” and “coronavirus” are all too frequently repeated, we (unfortunately) cannot dispense with them in this briefing.

For those who spend significant quantities of time in central Florida, it is evident that a lot of building is in process. Between the numerous neighborhoods viewable from the interstate or the turnpike, the actual roads themselves, or new multi-story glass behemoths in downtown Tampa or Orlando, construction is impossible to miss. The national story, however, is vastly different, obfuscated for those of us constantly surrounded by rapid change in the fastest-growing state in the country. In order to clear this up, let’s look at some data visualizations.



1,620,000

The number of housing units FreddieMac estimates need to be built annually to meet replenishment.

-17%

The gap between total units completed in the US for 2021 and what FreddieMac estimates is needed to keep up with population growth.

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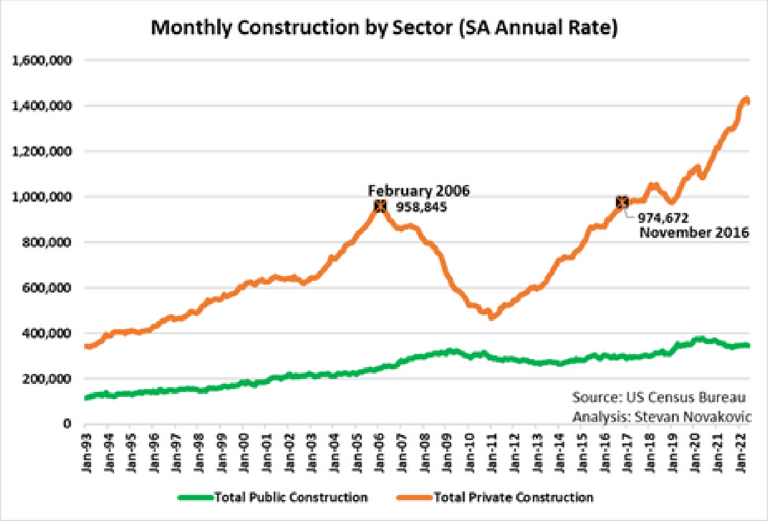
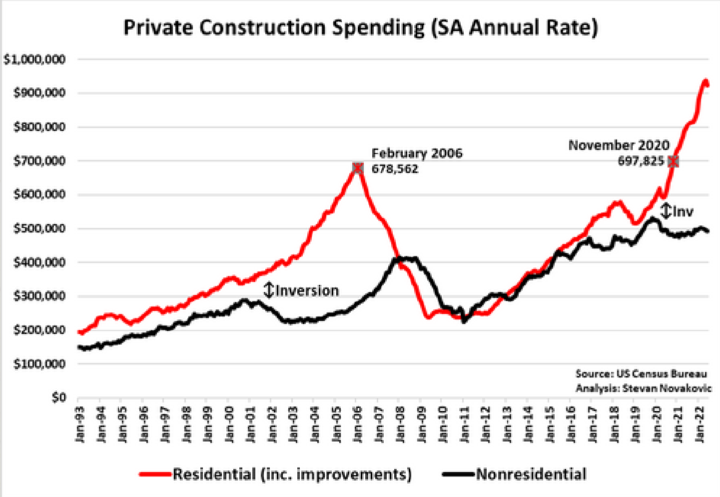


One of the simplest gauges of the building industry is total dollars spent on construction. Public (government) investment over the last 30 years has remained relatively stable, growing at a compounded annual rate of about 3.9% since 1993. Private construction, on the other hand, has experienced significantly more volatility, leading to multiple upswings and downswings, most notably after the housing bubble burst in the mid-2000s. The impact was so severe that it took the nation nearly eleven years for spending levels to reach the pinnacle experienced in February 2006. While total private spending has ramped up noticeably since the beginning of the pandemic, this dollar amount is clouded by massively inflated input costs and includes all private construction spending from homes to apartments to warehouses to malls to restaurants and everything in-between. To get a clearer picture then, let's further dissect the numbers.



Private construction is divided into two categories, residential and nonresidential, which can then be bifurcated into smaller subsets such as homes, apartments, shopping centers, auto repair, and dozens more. For the most part, residential and nonresidential spending move in tandem, that is, except, when housing starts to boom, leading to the opposite effect. Historically, as profit margins in the housing sector rapidly outpace other categories, a divergence occurs. In the case of the Great Recession, this was a lead indicator, and if not for the shale boom which more than doubled spending in energy, the separation would have been much larger. The mini-inversion in 2017, while housing remained on trend, was due to a marked reduction in electricity spending. Since the beginning of the pandemic, residential and non-residential spending have again parted ways, with the lodging, office, and chemical categories the most negatively impacted. Flourishing warehouse and commercial growth, however, muted what could have been a much larger inversion. While the first chart on this page shows that private spending (overall) took nearly eleven years to reach housing boom levels, we can see now that the residential sector specifically took almost fourteen years to rebound. Though numerous imbalances contributed to the delay of the recovery (regional appetites, overbuilding, etc.), the construction industry was debilitated by the crash. Remaining survivors, shellshocked, limited speculative builds as risk management took center stage and developmental models were reformed.

2.1M

Peak housing completion total in US history which occurred in 1973.

3.9%

Annual growth rate for US public spending on construction in total dollar value over the last 30 years.

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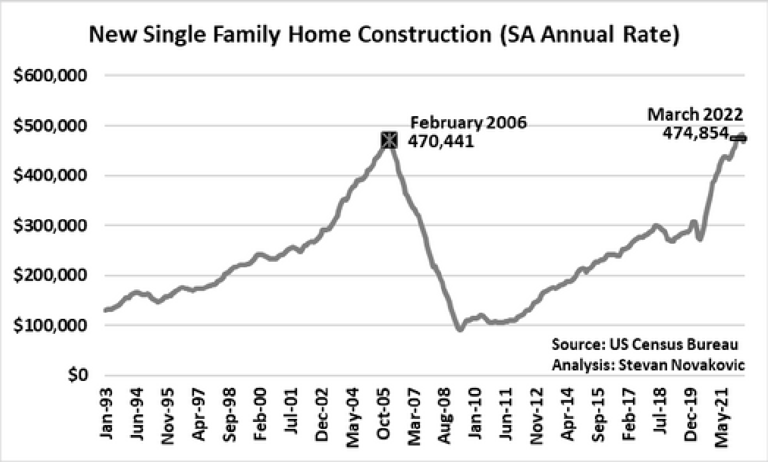
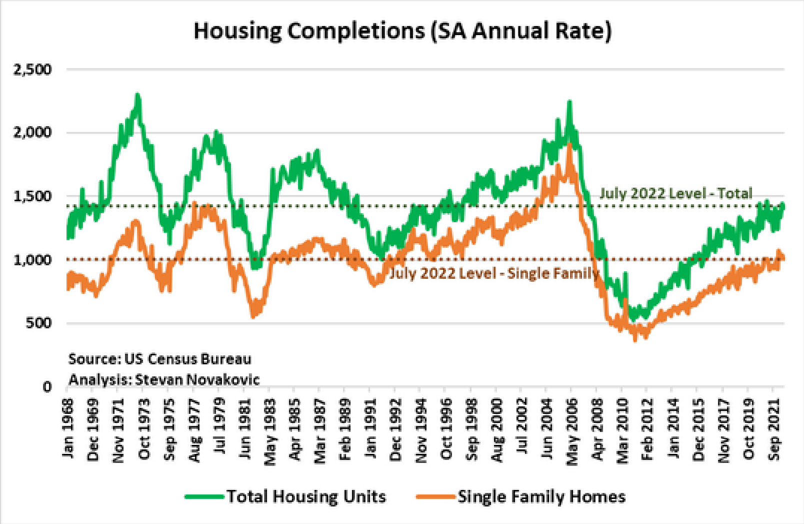
Honing in yet once more sheds additional light on why acquiring housing has been so difficult: domestic construction spending did not eclipse the 2006 peak until March 2022, more than sixteen years later and amidst record inflation and supply chain bottlenecks. Even if we allow the assertion made by some that overbuilding occurred in the mid-2000s, the US population has risen by around 33 million individuals since that time period. Of course, construction in dollar amount is not a foolproof metric for expanding home availability, but it does closely align with housing completions.



The United States has not approached anywhere near the home completion total of 2006 since, nor has it met the rate of *every year* between 1992 and 2006. Since 1971 the country has grown by greater than 50% in population terms, yet more single-family homes were built annually through the early ‘70s than today. But 2020 and 2021 were not “lowball” years: they accomplished the highest quantity of completions since 2008! Multiple industry and governmental organizations have submitted home-build goals to keep pace with population growth and attrition from deteriorated houses. FreddieMac estimates the country needs 1.62 million new housing units annually to keep pace and that in 2020 the US was 3.8million units short. Realtor.com suggests the shortage is around 5.2 million deficiencies. Coming in at the high end, the National Association of Realtors published a report in June 2021 asserting that the US then was lacking 6.8 million units. Regardless of which number one chooses, the totals are significant. How do we get back on track? Using the average of these three estimates we get a 5.3 million unit gap. In the United States, we completed 1.29 million units in 2020 and 1.34 million in 2021, 17% less than FreddieMac’s replacement rate.



CONCLUSION

To make up the housing deficit in five years, the country would need to build 2.68 million units per year, literally double what was completed in 2021. Such a feat, while not impossible, seems insurmountable. A more realistic goal, catching up in 10 years, would require 2.15 million units completed. This total (assuming historical growth patterns and attrition rates), would require building 60% more units than were completed in 2021 *every year for a decade* - a herculean task. Contextually, the American peak housing completion year was 1973 at 2.1 million, and even during the boom in 2006 the nation only finished 1.98 million units.

So, is there too much growth in the I-4 corridor? In Florida overall? Maybe. Well, probably. But, everyone, and their grandmother, and their uncle, wants to move to the Sunshine State. Satire? Perhaps, but hardly. Will housing prices retreat marginally due to fewer buyers and higher interest rates? Absolutely. The fundamental issue, however, is undersupply, exacerbated by imbalances. As we noted in the previous update, there are affordable houses all over the country, especially if one is willing to live in, for example, Scranton, PA, Memphis, TN, Dayton, OH, or Peoria, IL. Yet, even those cities have low inventory on the market. The fact is, there is a wide gap in housing stocks, with nowhere for millions of our friends to purchase. Back to Tracey: without achieving the American dream, without those philosophical front porches, how can folks treat neighbors like "next of kin?" Until builders and developers can crank out more completions, local governmental bodies can sign-off on increased permits, and logistical kinks can be straightened, the supply-side deficiency will continue to hoist the market.

ABOUT OUR ECONOMIST

STEVAN NOVAKOVIC

Stevan Novakovic holds an M.S. in Public Policy from Georgetown University with a focus in econometrics. Prior to joining Farm Credit of Central Florida he conducted economic research on agricultural commodities for IHS Market (previously Informa Economics Group), and spent time in hedging/risk management and as a commodities trader for Central States Enterprises, Inc. Stevan also earned an M.A. from Columbia University and undergraduate degrees from the Moore School of Business at the University of South Carolina, where he triple-majored in International Business, Global Supply Chain and Operations Management, and Finance.

ABOUT FARM CREDIT OF CENTRAL FLORIDA

Farm Credit of Central Florida is the local association for the region adjacent to the I-4 corridor and serves those in the following thirteen counties: Citrus, Hernando, Pasco, Pinellas, Hillsborough, Polk, Sumter, Lake, Osceola, Orange, Seminole, Volusia and Brevard. Farm Credit borrowers have long enjoyed the benefits of doing business with local offices, where people know their business, their community, and their market. We are headquartered in Lakeland and have brick and mortar locations in Apopka, Brooksville, and Plant City. Our affiliation is with AgFirst Farm Credit Bank in Columbia, South Carolina. Local service with national stability. We are Farm Credit.

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