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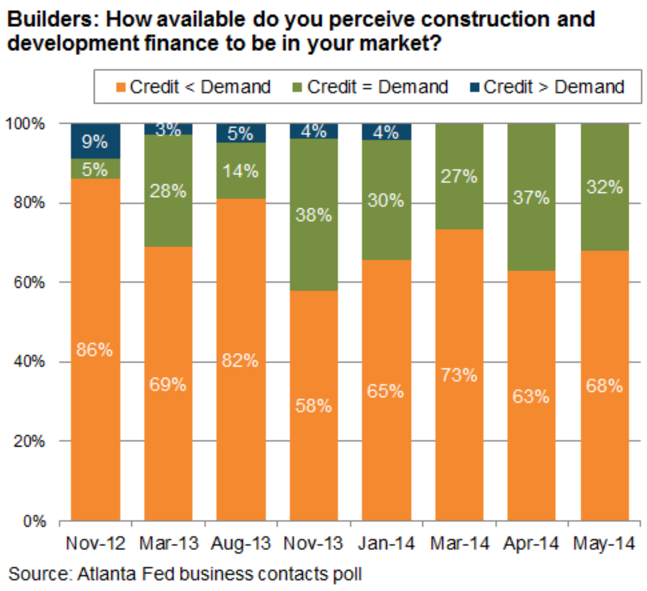
Signs Point to Slow but Steady Construction Growth

After bottoming out in early 2011 and following an upward trend for two years, national new house sales on a seasonally adjusted basis have been essentially flat since January 2013 and are at a pace about half that of 2000–01. Over the past month, speeches by Fed Chair Janet Yellen and Reserve Bank presidents John Williams, William Dudley, and Charles Plosser have included references to a slowing housing sector in the face of strong fundamentals as a source of economic uncertainty. They mentioned many reasons for the slow pace of housing´s recovery, including difficulties in increasing housing supply (that is, construction).

In the Southeast, we hear from our housing contacts that it remains difficult to acquire construction financing and that funding of land acquisition and development projects is extremely difficult. In the most recent Southeast Housing Market Poll, most builders continued to report that the amount of available construction and development finance fell short of demand (see the chart). Concern regarding the lack of readily available construction financing is not unique to the Southeast and may be part of the reason for the recent slowing in the housing sector. Fortunately, it appears that construction financing may in fact be getting a bit more accessible.



A key input to construction is the availability of financing. We explored construction lending trends in a few of our posts last year (here and here). The most recent bank lending data indicate several reasons to believe that banks continue to return to construction and development as a line of business.

Aggregate bank construction and development lending remains well below its 2008 peak (see the table). That said, more than half of the banks with a construction business line are expanding their single-family residential construction lending. Interestingly, the median March 2013 year-over-year growth rate in residential construction lending was positive, yet aggregate 1–4 family construction loans fell from March 2012 to March 2013, which means that lots of smaller lenders were growing. The good news is that the March level of 1–4 family construction loans increased in 2014 for the first time since the recession ended.

	Total			Residential 1–4 family construction loans			Other construction, all land development and other land		
March 31 as of	Percentage of banks reporting YoY positive growth	Median growth rate	Total outstanding ($ billions)	Percentage of banks reporting YoY positive growth	Median growth rate	Total outstanding ($ billions)	Percentage of banks reporting YoY positive growth	Median growth rate	Total outstanding ($ billions)
2005	70.6%	28.6%	358.2						
2006	73.8%	32.6%	485.3						
2007	67.4%	19.8%	581.0						
2008	61.9%	11.8%	631.0						
2009	44.5%	-4.4%	566.1						
2010	30.5%	17.1%	417.5			87.8			329.7
2011	30.5%	16.4%	294.0	34.3%	-21.5%	55.5	32.2%	-13.9%	238.4
2012	35.6%	12.0%	228.2	42.7%	-9.2%	43.5	33.1%	-12.3%	184.7
2013	45.4%	-3.2%	201.7	52.8%	4.2%	40.7	40.0%	-6.9%	160.8
2014	53.8%	4.2%	214.4	60.1%	17.8%	45.7	47.1%	-2.4%	168.6

Source: Bank call reports

Although banks appear to be lending for residential construction (the "vertical" part of homebuilding), we cannot say the same for lot development (the "horizontal" portion). The data is a bit less clear on this front because lending for raw land and land development is lumped together with loans for all construction that is not for 1–4 family structures. Aggregate lending for "other construction, all land development and other land" increased year over year, but the median growth rate was negative. That is, more banks are pulling back from this activity than are growing, but the ones that are growing are the ones with larger volumes. Considering that lenders have viewed multifamily construction favorably, it is more likely that the growth in lending is attributable to multifamily loans rather than to lot acquisition and development.

The Fed presidents I mentioned in the first paragraph were optimistic about housing in large part because population growth and household formation both point to an inevitable increase in housing demand. The evidence from bank construction lending supports this idea that growth will continue, but it also suggests that the recovery will continue at its slow and steady pace.

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