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May New Home Sales: Sales Soar As Buyers Outpace Builders

- > New home sales rose to an annualized rate of 504,000 units in May from a (revised) sales pace of 425,000 units in April.
- > Months supply of inventory stands at 4.5 months; the median new home sale price rose by 6.9 percent on a year-over-year basis.

Totally did not see that coming. Okay, that wasn't our actual reaction when the new home sales data came across the wire, but it is the printable version of our reaction. New home sales are reported to have risen to an annual rate of 504,000 units in May, ahead of our expectations and those of everyone else as the high estimate in *Bloomberg's* survey was 462,000 units. The 18.6 percent increase in sales from April was the largest monthly increase since January 1992 and the annualized sales rate is the highest of any month since May 2008. Sales rose in each of the four broad Census regions with the West and Midwest logging the largest increases. At \$282,000 the median new home sales price stands 6.9 percent above the median price posted in May 2013.

The sales figures for May seem at odds with data on permits, starts, and inventories. We and other analysts have pointed to low inventories as acting as a restraint on new home sales over the past several months, and we have been concerned over the lack of a meaningful pick up in the pace of single family permits and starts. Also, as not all single family units constructed are intended for the sales market, the May sales data seem even more out of line. How we reconcile this seeming inconsistency is by pointing out that 36.7 percent of all sales in May were sales of units on which construction has not yet started. The Census Bureau defines a home as being for sale when a permit is issued in permit-issuing places or when work has begun, but no sales contract signed, in nonpermit-issuing places. In the Census data sales can occur before construction has begun, during the construction period, or after construction has been completed. The high share of sales accounted for by units not yet under construction is an indication of tight inventory conditions even though the absolute level of market activity is still low, and over the past six months completed units have accounted for less than one-third of all new home sales.

Focusing on "physical" homes for sale, i.e., either under construction or completed, the inventory story becomes even more compelling – while off their historical lows of recent years, physical inventories of homes for sale remain exceptionally lean. This reflects the ongoing constraints on lots, labor, and materials that have plagued builders for some time now. Starts of single family units intended for sale have been running ahead of sales over the past several months but only just, meaning inventory constraints will ease, but only slightly, over coming months. That sales have been running ahead of completions goes to a point made earlier – units under construction or not yet started are accounting for a higher than normal share of sales.

Lean inventories mean builders are wielding a greater degree of pricing power, but there are also demand side factors at play as well. One interesting trend has been the rising share of new home sales accounted for by homes priced at or above \$300,000 which in May were 44 percent of all sales. In the early phases of the recovery builders had to contend with competition from lower priced existing homes, particularly what were large inventories of distressed properties. With distress inventories having been pared down so sharply, builders have had more latitude to raise prices. At the same time, however, in a still stringent mortgage credit environment, younger and first-time buyers account for a smaller share of total home purchases while those buyers with the financial wherewithal to meet higher underwriting standards and down payment requirements are increasingly driving new home sales. Without a greater presence of first-time buyers to fuel continued move-up trades, it is an open question as to how long this situation can persist but for now builders will take full advantage.

The May new home sales figures likely overstate the degree of improvement in the single family segment of the housing market. Even so, with inventories remaining at such lean levels, a sustained increase in demand for new homes suggests a meaningful increase in single family construction over coming months.

