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Behind the Numbers On New Home Sales

History, Effect On Economy, Contribution to GDP

September 6, 2012 by William L. Pittenger, MAI, SRA

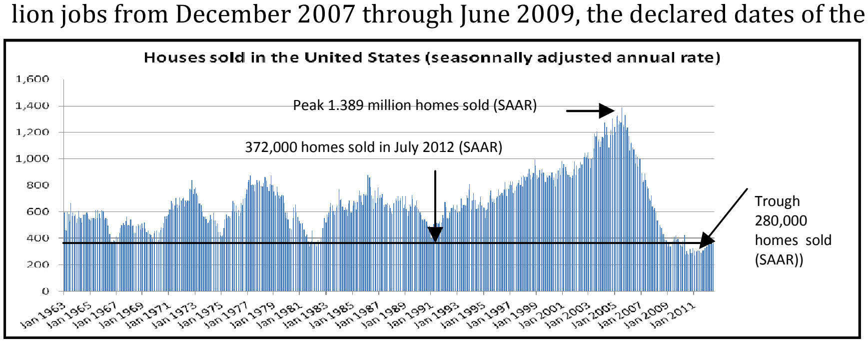
Recently in this space we reported on new home sales during July 2012. Sales totaled 372,000 at a seasonally adjusted annual rate. As new home construction is so important to the nation's economy, it seems as though the subject deserves a bit more than a passing glance.

During this real estate cycle we have witnessed both extremes of new home sale volume. From August 2002 through November 2006 the seasonally adjusted annual rate was greater than one -million. Sales performed in that fashion for all but five months during that lengthy period. The peak occurred in July 2005 with 1.389 million sales on an annualized basis. That rate of growth was clearly unsustainable and was fuelled for reasons other than real demand. Investors, speculators and flippers entered the market. Prices soared and much of the new development at that time was to satisfy faux demand without regard to real demand driven by need for housing. Indeed, during the "bubble era" somewhere between 25% and 40% more homes were built than there were people to occupy them either by purchase or rental. As early as 2002 and 2003 prices were increasing faster that incomes and it became apparent to anyone willing to pay attention that decline was inevitable. Nevertheless building went on.

The bubble finally burst in late 2006 and sales steadily declined until they reached a low of 280,000 (annualized) in May 2010. The peak to trough decline (1,389,000 to 280,000) was nearly 80%. Since then sales have bounced along the bottom in the 200,000 and 300,000 range finally reaching a new multi-year high of 372,000 in July. Still, that "new high" is rather dismal when one considers that these are annualized numbers for the entire United States. Indeed, 372,000 sales is roughly equivalent to total volume in 1966, some 46 years earlier, when population and other demographics were far different than they are today.

Under normal economic circumstances, construction has a widespread and positive effect on the broader economy. In 2006 for example, new home construction contributed $1.195 trillion, to the nation's GDP (8.9%). At the cyclical low point, housing was a drag on the economy. By 2011 new construction contributed less than 5% to GDP. These figures are direct spending on new home construction and do not include any multiplier effect.

Construction employment was severely affected during the downturn. The sector lost 1.5 million jobs from December 2007 through June 2009, the declared dates of the recession.



A long view of new homes sold by builders in the United States by month from January 1963 through July 2012. Horizontal line depicts sales at the July 2012 level of 372,000 (SAAR) as compared to historical levels.

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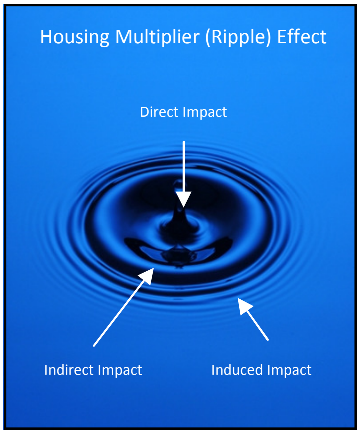
The decline was 19.8% and reduced construction employment to a level last seen in 1998. The majority of the losses occurred during the last nine months of the recession when employment declined by 1.0 million jobs. Employment continued to decline after the recession was declared ended in June 2009. Many workers who had lost jobs in the residential sector moved to the commercial sector but eventually lost those jobs too as both sectors slowed. By 2010, construction <u>un</u>employment exceeded 20%.



Different Data Different Perspectives. New home building permits, construction starts and new home sales are all measured monthly and each offers a different perspective of the all important housing sector. New home data tend to be forward looking, more so than existing home sales. That is largely because new home sales are counted when a contract is executed. With an existing residence, a sale is a closed transaction.

The data are also a good reflection of sentiment but among different groups and for different reasons. A new home sale is a good reflection of consumer confidence. New home construction starts however is more of a production number and perhaps a sign of builder confidence. Finally, building permits may be a reasonable sign of things to come.

Housing's multiplier (ripple) effect. A home purchase always has a ripple or "multiplier effect" in the economy. In other words, for each dollar that is spent, there is an additional amount spent over and above the initial investment that ripples through the economy. Multipliers take many forms but in housing, economists and policy analysts attempt to quantify three fundamental things: jobs, spending and tax revenues. These multiplier impacts tend to occur in two phases. The first is when the house is constructed and the second is throughout occupancy. While growth critics sometimes opine that housing doesn't pay its fair share, the reality is it almost always does, and then some except perhaps in times of severe recession.

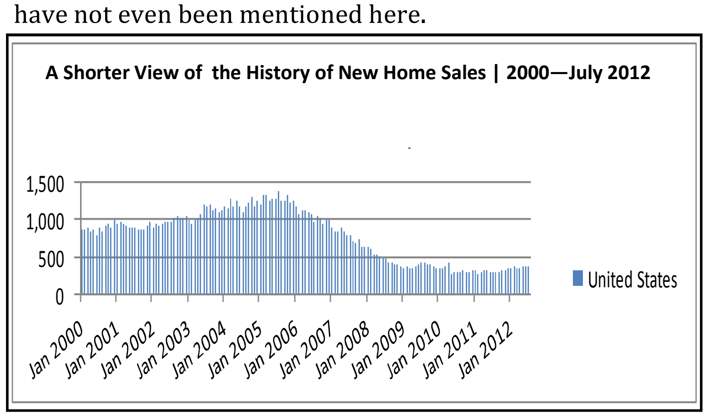
SOURCE: Bureau of Labor Statistics

An existing home sale produces a multiplier effect but certainly not as great as when a new home is constructed and sold. The first impacts in new home construction occur when the home is built. There is spending on the workers who build the homes as well as in the firms that support them. There are usually office staff, cost estimators, buyers accountants and more. This first layer of impact is typically referred to as *"direct impact."*

In addition to the direct impact of home construction, are the ripple effects; those that ripple through the local economy in some form or another. Generally two forms are measured. One is the *"indirect impact."* This is typically the jobs and spending created from businesses that are suppliers to the construction operation. This might include building supplies, architectural and engineering spending, cabinetry, flooring , decorating, financing and much more.

Finally there is "*induced impact"* when workers spend their wages in the local area such as at restaurants, retail, healthcare and other establishments. The induced spending tends to create additional new jobs at these consumer related businesses as well.

New home construction is extraordinarily important to the broader economy in many ways ranging from job creation, spending, tax revenue and potentially in many areas that have not even been mentioned here.



SOURCE: Census Bureau