Housing in pictures: slicing starts

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Challenges for multifamily construction

The recent housing data have been disappointing. Housing starts have declined in four of the first five months of the year, leaving starts on track to be down 13% over 1H, assuming a conservative estimate for June. The weakness is concentrated in the multifamily sector where starts have tumbled since the end of last year. The outlook for single family starts looks more promising. We are acknowledging the weak start to the year, leading us to revise down our forecast for housing starts this year to 1.2 million (from 1.25 million) and next year to 1.3 million (from 1.325 million). Within the components, we are looking for single family starts to be up 7% this year to 840,000 while multifamily are down 8% to 360,000.

What has happened? One possibility is that the warm winter weather pulled forward activity into the end of last year, depressing sales and starts in late winter/early spring. We saw some evidence of this with very strong activity in October, kicking off the winter season. Another theory is that homebuyers are in "wait and see" mode, which is a mentality we have seen from businesses and consumers since the beginning of the year. Looming policy changes from Washington and volatility in mortgage rates may have left potential homebuyers on the sidelines and homebuilders cautious. A third theory is that the softness in housing construction is due to the frictions in the market, which include a shortage of labor. In other words, there is sufficient interest for housing, but insufficient supply. We will be getting May new and existing home sales this week which will be a good indication of underlying demand – thus far, sales are up very slightly from the end of last year.

In addition to the forecast changes, we take a look at the ability and willingness of the Millennial generation to buy a home, which is an important aspect of forecasting future home sales and starts. We find that Millennials can generally afford to buy a home – in terms of making the monthly payments. We believe the delay in homeownership is due to tighter credit standards and lifestyle changes, including delayed marriage and children. We do not expect these factors to change in the medium term, keeping the homeownership rate low for young adults.

Table 1: Summary of housing forecasts

	Quarterly								Annual average		
	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	2016	2017	2018
Existing home sales (000s, saar)	5357	5477	5380	5547	5620	5594	5635	5669	5440	5630	5750
New home sales (000s, saar)	526	562	588	568	616	587	620	639	561	615	670
Housing starts (000s, saar)	1153	1158	1150	1248	1238	1118	1190	1255	1177	1200	1300
S&P Case-Shiller prices (% yoy)	5.2	5.0	5.1	5.6	5.6	6.0	5.7	4.1	5.2	5.3	3.0

Source: BofA Merrill Lynch Global Research, Census Bureau, National Association of Realtors, S&P Case-Shiller; Note: S&P Case-Shiller prices are annual average, 4Q/4Q change are in the quarterly table. Shaded regions represent BofA Merrill Lynch Global Research forecasts.

Refer to important disclosures on page 6 to 7.

Revision to housing starts

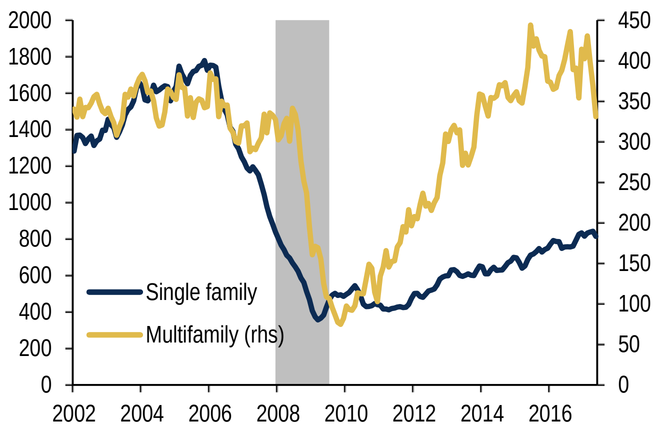
Table 2: Volatile housing starts (% change)

	Total		Single		Multifamily	
	1H (June/Dec)	2H (Dec/June)	1H	2H	1H	2H
2010	-7.7%	0.6%	-8.1%	-3.6%	-6.2%	20.9%
2011	12.8%	14.1%	1.4%	20.0%	57.3%	-0.6%
2012	9.1%	28.9%	0.4%	17.4%	35.5%	54.9%
2013	-12.7%	18.5%	-1.6%	7.9%	-31.6%	44.5%
2014	-8.1%	16.5%	-8.1%	20.3%	-8.1%	9.5%
2015	11.1%	-5.2%	-3.9%	10.1%	41.2%	-26.2%
2016	4.6%	6.6%	0.8%	4.9%	12.3%	9.5%
2017F	-12.8%	14.8%	-3.7%	15.6%	-28.7%	13.1%

Source: BofA Merrill Lynch Global Research, Census Bureau

- Housing starts weakened through the first half of the year, falling nearly 13% from December to June, based on our estimates for June. The decline was concentrated in multifamily homes which tumbled nearly 30%.
- We expect a bounce in the second half of the year, offsetting the weak start to the year and leaving total starts of 1.2 million this year.
- This would not be unusual – we have seen these types of large swings in prior years. Our forecast of 1.2 million would leave total starts up only 2% this year, a slowdown from the 6% gain last year and 11% increase in 2015.

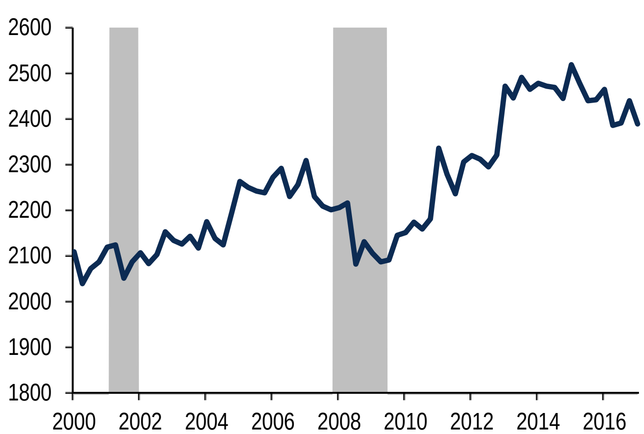
Chart 1: Plateauing multifamily, upward trending single family (000s saar, 3-mo moving average)



Source: Census Bureau

- Multifamily starts have seemingly plateaued since 2015, albeit in a choppy fashion. The most recent data shows a leg lower, but we expect to see a reversal of this drop given that permits have been a bit more stable.
- Single family starts were also weak, slipping 4% in the first half of the year. However, there were huge swings in single family starts data that could be partly due to seasonality issues – notably single family starts climbed higher in October as warm weather may have pulled forward activity from subsequent months.
- This chart show the painfully slow recovery in single family starts which has left the pace of construction notably below prior expansions.

Chart 2: Median square footage for single family starts

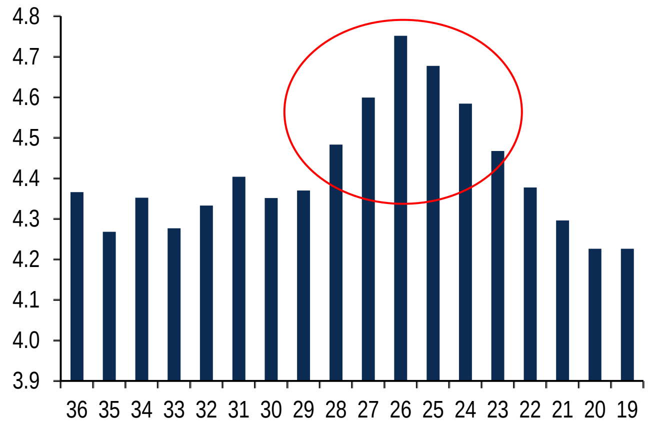


Source: Census Bureau

- The early stages of the housing recovery revealed that builders were inclined to construct larger properties. Indeed, the median square footage of single family properties continued to climb.
- Over the past few quarters, the median size has edged lower which could imply that builders are starting to consider building smaller and less expensive properties given demand from entry-level homebuyers.
- We would view a further decline in square footage to be an indication that volumes should pick up. There are only tentative signs thus far, however.

Financial challenges for millennials

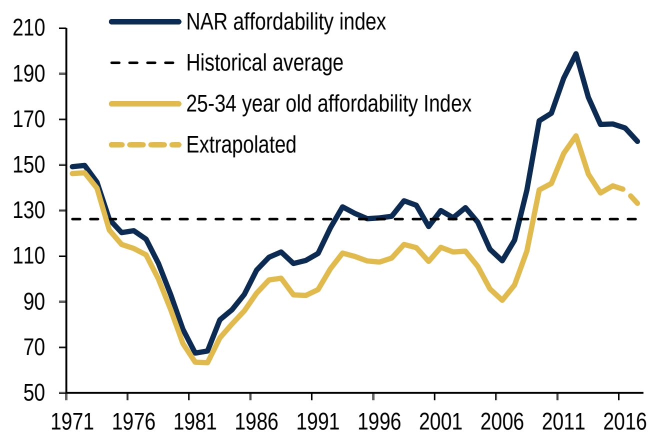
Chart 3: The Millennial generation by age (mns of individuals, Dec 2016)



Source: Census Bureau

- In order to understand the future of the housing stock, it helps to get a grasp on the growth in population, which is a function of immigration and the rate of births / deaths. Young adults are a particularly important demographic, given that they are the drivers of new household formation.
- There are currently 75 million individuals considered to be Millennials, making up the largest generation. The average age is 27.5, implying that there is a large cohort of young adults coming to age.
- In theory, this should underpin growth in homeownership. But, it is complicated — we have to understand the *ability* of Millennials to afford housing and the *desire* to become homeowners vs. renters.

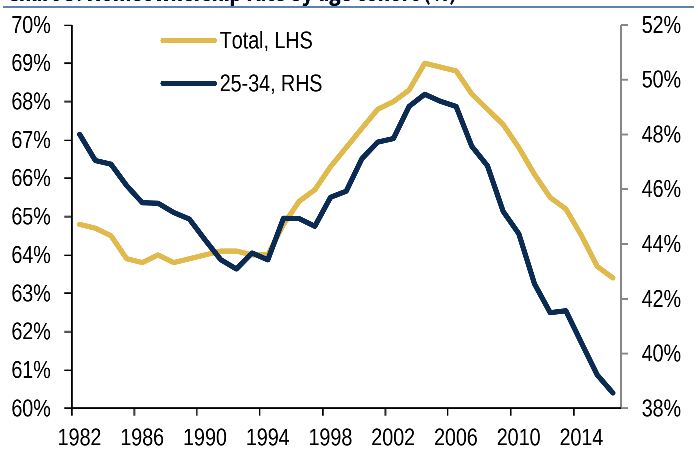
Chart 4: Housing affordability—more than meets the eye



Source: BofA Merrill Lynch Global Research, National Association of Realtors, Census Bureau

- The National Association of Realtors (NAR) produces a housing affordability index, which is a ratio between median family income and the qualifying income for a mortgage as a function of median existing single-family home prices and mortgage rates.
- Following this methodology, we compute an affordability measure for the 25-34 year old age cohort using median household income data from the Census Bureau. We find that housing is still affordable for young adults, although not to the extent it is for the overall population.
- However, a major assumption in the methodology is a 20% downpayment. This is a major hurdle for young adult first-time homebuyers. Plugging in a lower down payment of 5 or 10% and affordability looks much worse.

Chart 5: Homeownership rate by age cohort (%)



Source: Census Bureau

- The homeownership rate has tumbled at a faster rate for 25-34 year olds than for other generations which we do not think can be explained alone by affordability.
- Another challenge is the ability to take on a mortgage loan given high student debt. According to the NY Fed's credit panel, total outstanding student debt has reached $1.3 trillion, a substantial increase from the $260bn level in 2004.
- According to the NAR's Generational Report, nearly 50% of homebuyers under the age of 36 noted that student debt delayed their home purchase, making it harder to afford the downpayment. And, of course, there is the challenge from tighter credit standards which has made it more difficult to achieve homeownership.

Lifestyles of young adults

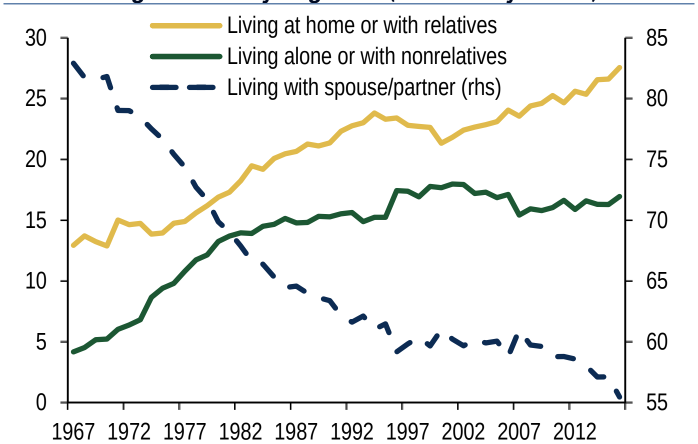
Table 3: Changes in the composition of consumer spending from 2004 to 2015 for 25-34 year olds (share of consumer basket, %)

	2004	2015	share
Owned shelter	11%	8%	-2.6%
Apparel	5%	4%	-1.4%
Transportation	20%	19%	-1.1%
Food at home	7%	7%	-0.6%
Furnishing	4%	3%	-0.3%
Entertainment	5%	5%	-0.2%
Food away from home	6%	6%	0.0%
Household operations	2%	3%	1.1%
Healthcare	4%	5%	1.8%
Renter shelter	9%	12%	3.2%

Source: Bureau of Labor Statistics Consumer Expenditure Survey

- In addition to financial difficulties as discussed earlier, we think the decline in young adult homeownership owes to lifestyle changes.
- Using data from the Consumer Expenditure Survey, we can look at the evolution of the consumer basket over time for those aged 24-35. Relative to the peak of the housing bubble in 2004, there has been a decline in the share of dollars spent on owned shelter and an increase in spending on renting. It also seems that this age group is spending more on healthcare and household operations.
- This has come at the expense of spending on apparel, transportation and groceries.

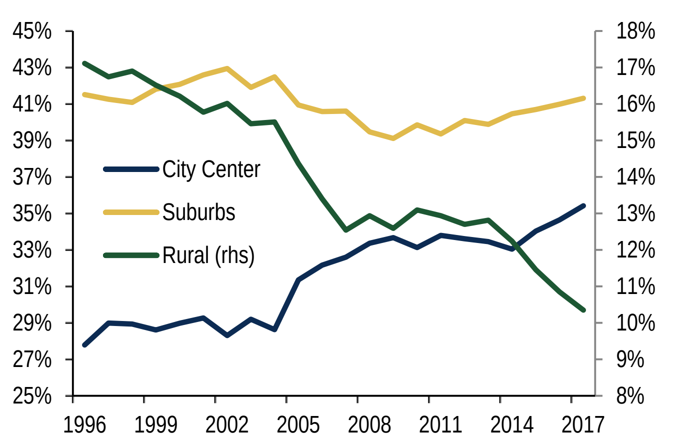
Chart 6: Living situation of young adults (% of 25-34 year olds)



Source: BofA Merrill Lynch Global Research, Census Bureau

- The change in spending patterns could reflect the fact that young adults are not only less likely to be homeowners, but they are less likely to be married or even live independently.
- Instead, this age group is living with parents or other relatives more than in the past. This adjustment in living arrangements has been ongoing for years but the Great Recession seemed to have speed up the trend. Today only 55% of those aged 25-34 live with a spouse/partner compared to over 80% in 1967.
- Life events such as getting married or having children are typical triggers to buying a home. The longer this age group lives with parents or independently, the more homeownership will be delayed.

Chart 7: Location of young adults (% of 25-34 year olds)



Note: data are as of January of each year

Source: BofA Merrill Lynch Global Research, Bureau of Labor Statistics , Current Population Survey

- We have also seen a shift toward urban centers and away from rural areas over the years. This goes hand-in-hand with a decline in homeownership for young adults.
- Interestingly the share of young adults living in the suburbs has been fairly steady at around 41%. Moreover, it appears that there is a flocking toward the major cities, specifically in the city centers which are close to transit, workplaces and restaurants.
- City centers typically have more rental properties than the suburbs. But we also see greater home sales close to city centers than in the past. According to BuildZoom, new home sales within 5 miles of the centers of the 10 most densely cities have exceeded 2000 levels but if you go another 10 miles out, sales are about 50% below 2000 levels.

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