

Optimal Building Levels

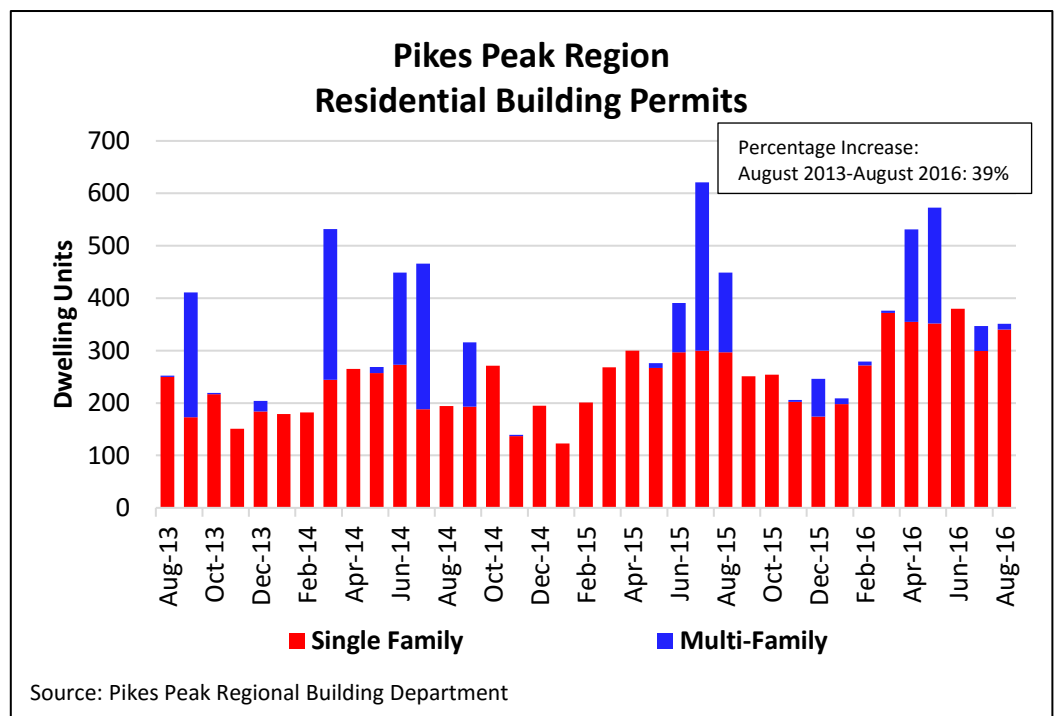
by Tatiana Bailey

Last month's By the Numbers talked about the robust, local, residential real estate market with a 95 percent increase in home sales from June 2012 to June 2016. Likewise, median home prices increased 9 percent from Q1 2015 to Q1 2016 in the Pikes Peak region, whereas they increased 6.3 percent in the U.S. during that same time period. The high in-migration rate into the state and the relative affordability of Colorado Springs (median price in Q2: \$259,300) compared to nearby Denver (\$394,400) and Boulder (\$549,600) will likely continue to highlight our region as a gem and a bargain in the milieu of frenetic growth, particularly in the northern part of the state. Our lower median age (33.8 years) than the U.S. (37.7 years) also bodes well for household formation, a major factor in home buying. All of these statistical determinants make it likely that home sales and appreciation rates will stay strong in our region into 2017. This is what the residential real estate market wants to hear, but cautious types speculate that there could be a housing bubble looming. This isn't likely, however. The much more stringent credit criteria for essentially all types of mortgage lending makes this improbable on the consumer side. On the producer side, lending criteria for development-based loans is also stringent

making overbuilding less likely. Today's housing high is not a house of cards driven by lax loan standards; it is driven primarily by new job creation and low interest rates, which is a much more favorable scenario.

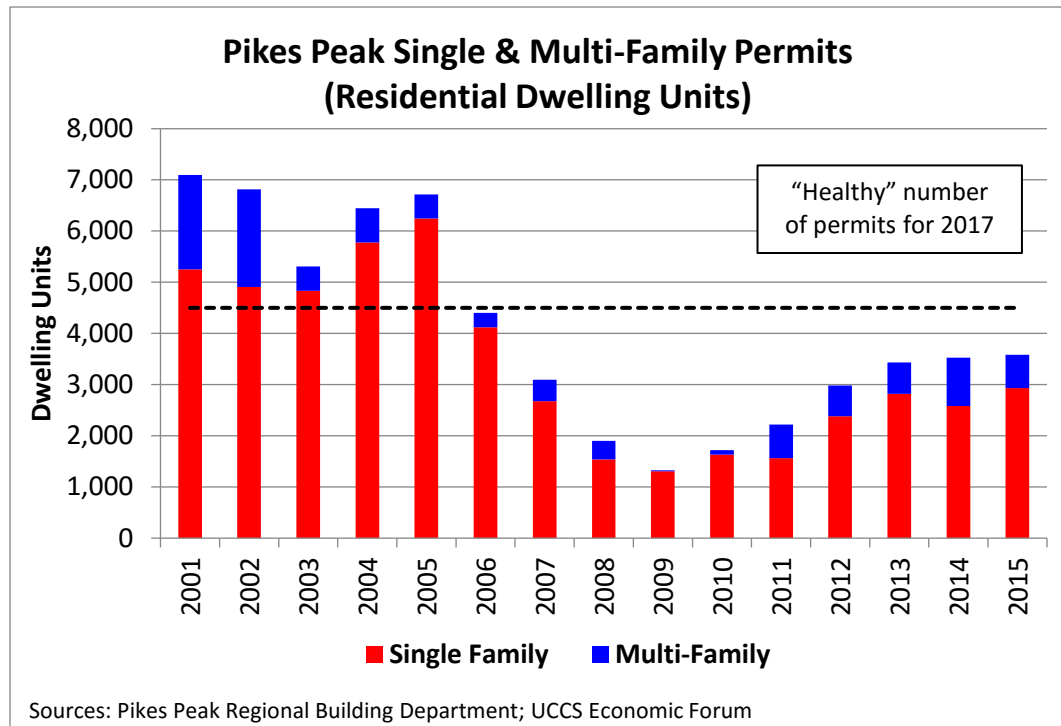
When we are in such a positive housing scenario and current inventory does not meet demand, as indicated by the meager 28 average days on market, the natural market

response is new construction. As the first graph shows, we've had a 39% increase in permits pulled from 2013 to 2016. When such growth is occurring, the building industry is euphoric and there is the positive externality of new employment related to construction with its own positive impact on local, economic activity in other industries (e.g. auto, retail). However, overzealous building is where some communities can get into trouble once there is an economic downturn. Existing inventory can quickly adjust prices once a recession hits; existing empty new neighborhoods just stay empty (or homes are sold at a significant loss bringing down all comparable property values). Given the high level of construction in



our region, and the perception of past, repeated episodes of overbuilding, it is perhaps not a bad time to examine the “optimal” level of building for our given demographics.

The second chart shows the permits pulled for single and multi-family construction going back to 2001. The dotted line shows the “healthy” number of permits for a population with our age distribution as projected by the Colorado State



Demographer’s Office. As illustrated, the number of permits for a population our size and with our age distribution is currently around 4,500. The bars above the dotted line demonstrate that our community did indeed have significant overbuilding in the early 2000’s. Conversely, the economic downturn and regulations such as Dodd-Frank reigned in building resulting in construction well below what is indicated by our population dynamic. This is part of the reason that building levels now are particularly robust; we are making up for lost time, the economy is still strong and the rate of population increase is still high (both in-migration and birth rates). At some point, either new home inventory will catch up to the optimal level, there will be an economic downturn, interest rates will increase or all of the above. This is all the more reason to use this data for future planning. It is important to track our demographic trends as well as the optimal building levels corresponding to those trends. Doing so gives our community well-informed parameters for growth. Right now that means (appropriate) enthusiastic building to meet demand. In the future, it could mean different things, but at least we would make informed decisions that keep our expanding community on a sustainable and healthy growth pattern.

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