

Putting hammer to Nail: an overview of Residential building in metro Denver

FOR: BUILDER REALTY COUNCIL

BY: TED LEIGHTY, COLORADO ASSOCIATION OF
HOME BUILDERS

APRIL 20, 2021



overview



CURRENT HOUSING
MARKET



CONSTRUCTION
COST DRIVERS



PUBLIC POLICY
CHALLENGES

Current Market: Challenges Ahead

- Pandemic unknowns – will cases spike again?
- Economic uncertainty – future layoffs
- High unemployment and fragile consumer confidence
- Mortgage forbearance – a possible spike in foreclosures
- Managing customer expectations with increased backlog
- Price appreciation puts homes out of reach given area household incomes
- Have we borrowed demand from the future?
- Tight lot supplies and gapping out – slowing releases
- Market competition increases
- Managing cost increases and trades
- Increased entitlement timelines at local jurisdictions

Source: Zonda

Denver Market – What We Have Going For Us

- Record low interest rates
- Record low RESALE Inventory
- Healthy price appreciation and equity
- Strong Pre-Covid economy that appears to be stabilizing
- Steady business expansion
- In-migration
- Stable rental market
- Substantial pent up demand – riding the wave
- If pandemic shut-down occurs again, builders know how to shift operations quickly
- Strong demographics
- New communities opening up with more affordable product
- Low NEW Home inventory
- Mindshare of buyers shifting to NEW homes
- New home design trends to accommodate shifting buyer preferences during pandemic
- Interest in BFR product is growing
- Consumer confidence
- Healthy sales backlog
- Flight from urban core (+ for suburban builders)

Cost Drivers

The Four L's:

- Land
- Lumber (Materials)
- Labor
- Loans

Regulations

- Land Use/zoning
- Entitlement process
- Government exactions
 - Impact fees
 - Tap Fees
 - Permits

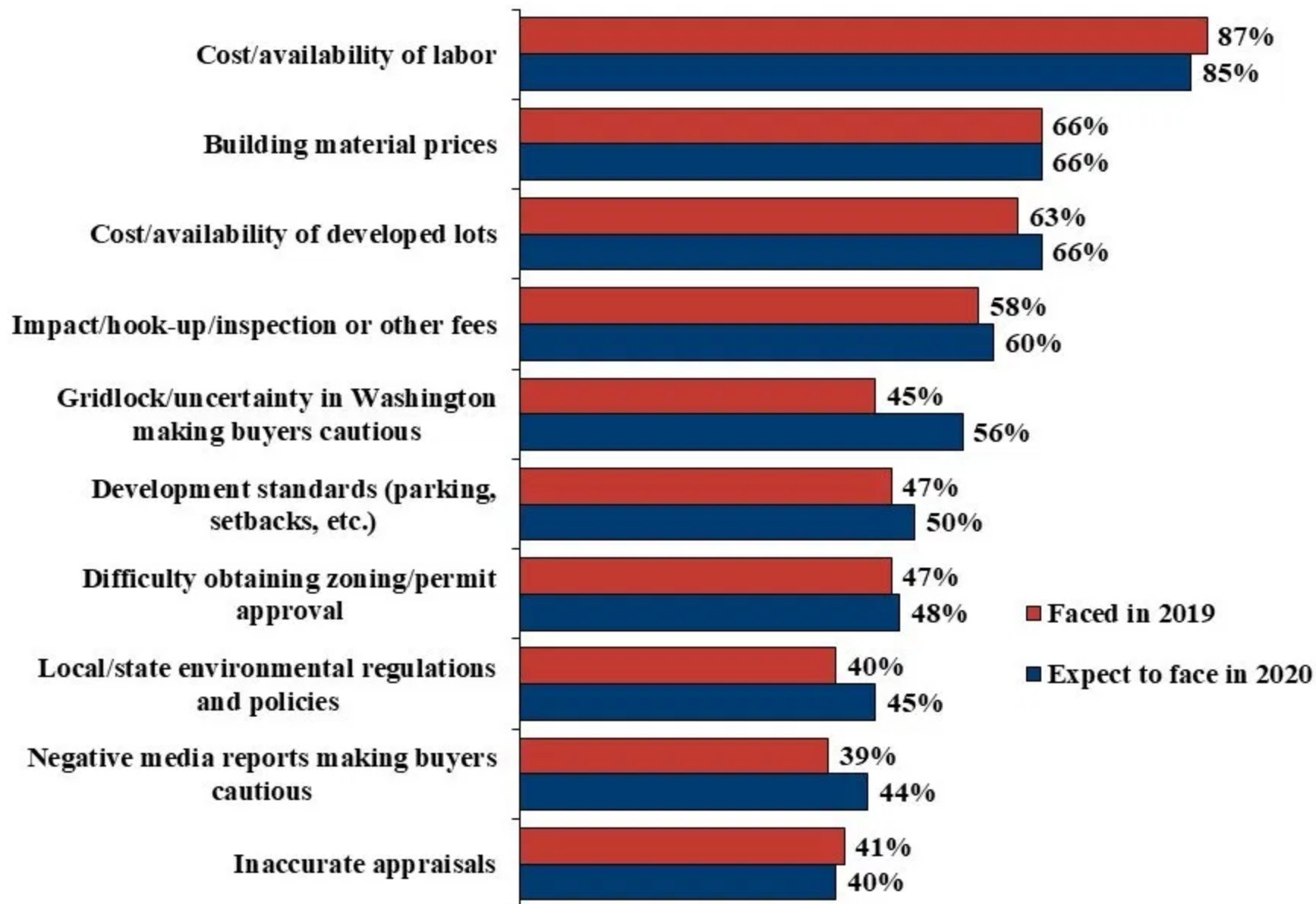
Cost Drivers

NAHB's most recent Construction Cost Survey (conducted in September of 2019) indicates:

- On average, 61% (up 5% from 2017) of the final sales price goes to construction costs, 18% to finished lot costs, and 9% to builder profit

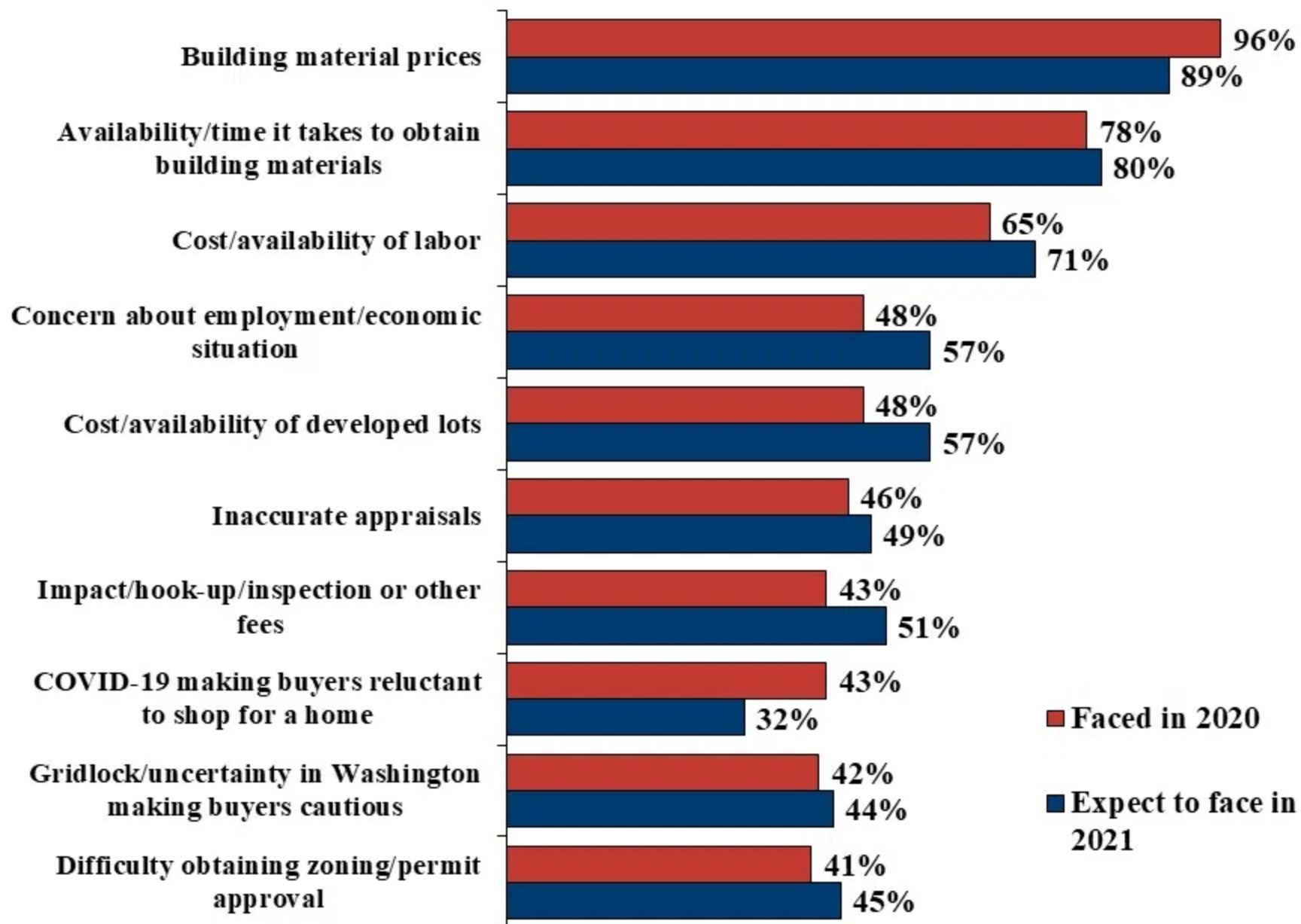
- Source: NAHB

Top 10 Significant Problems Faced in 2019 and Expect to Face in 2020



Source: HMI Special Survey, NAHB EcHp.

Top 10 Significant Problems Faced in 2020 and Expect to Face in 2021



Source: HMI Special Survey, NAHB EchP.

Cost Drivers

Land (Lot cost): 18.5% of the cost of constructing a new single-family home

- 57% of builders believe cost and availability of lots will be an issue in 2021
- Currently we are under-supplied
- When the supply of land is constrained, the cost of developable lots increases.
- Fewer land developers/production builders have become their own developers.

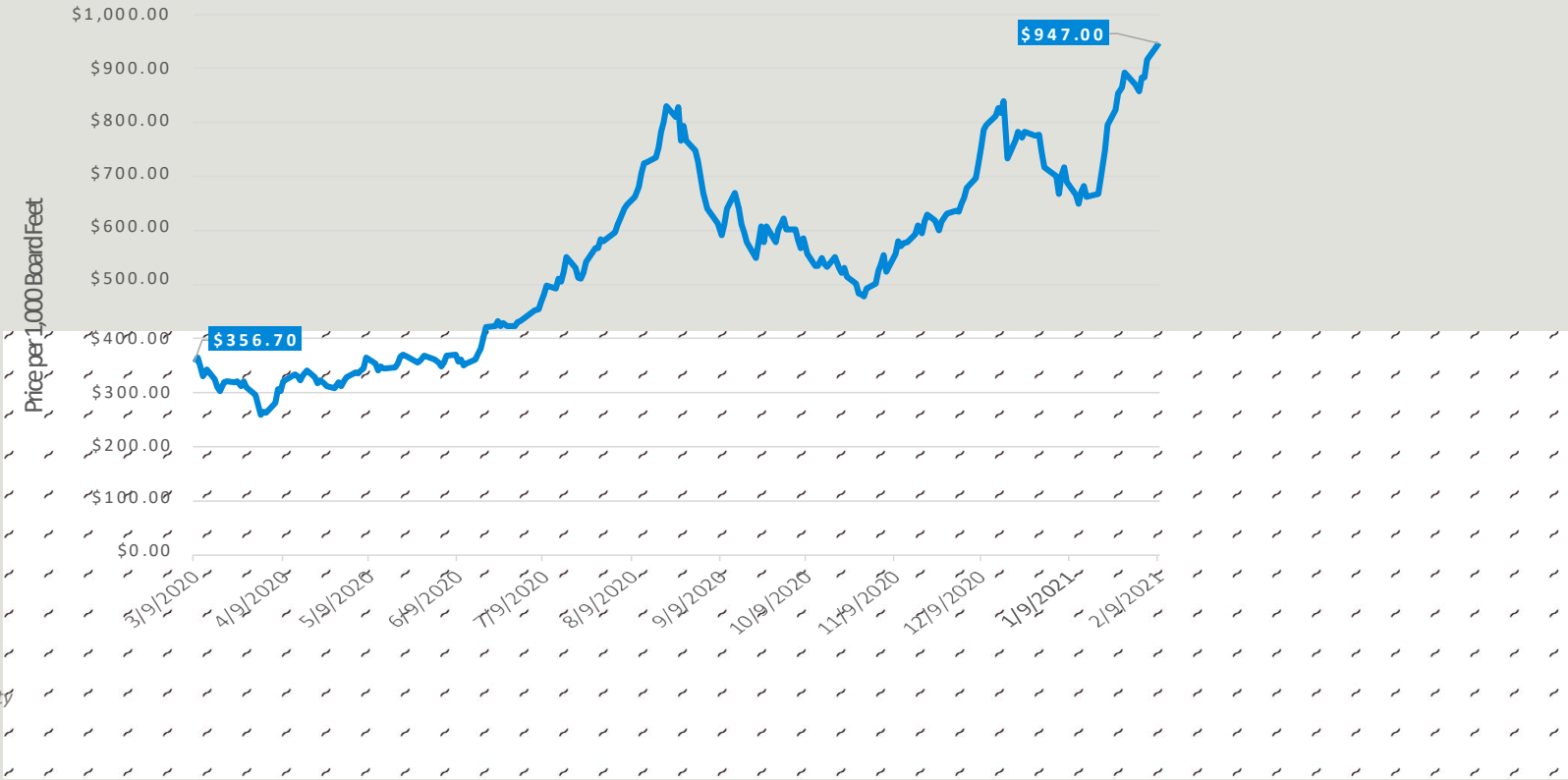
Cost Drivers

Lumber/Materials:

- Lumber prices skyrocketed over 180% since last spring
- Causing the average price of new single-family home to increase by \$24,000

Source: NAHB/Random Lengths Framing Lumber Composite

Strong Housing Market & Limited Production Capacity Driving Lumber Prices Higher. Up 35% Since Jan 4th. Expected Through 2021.



Source: Nasdaq Market Activity

Cost Drivers

Labor: 21% of the cost of constructing a new single-family home

Colorado has low unemployment, population growth rate, and a shortage of skilled construction labor. Basically, the state needs more homes to be built, but doesn't have the workers to do so.

The Denver Post reports that Colorado is facing a labor shortage that will become worse over the years, expanding to 96,000 vacant construction jobs by 2025, a 38 percent increase from today.

- Source: Denver Post

Cost drivers

Labor:

- The National Association of Home Builders and Wells Fargo Housing Market Index survey of home builders' indicates...
- In the Mountain West Region 76% of builders believe the cost and availability of labor will be a significant problem in 2021, the highest of any region.
- The effects of the scarcity and higher cost of workers are clear. NAHB data indicates longer build times, more delays, and higher costs for workers and subcontractors.

Source: NAHB

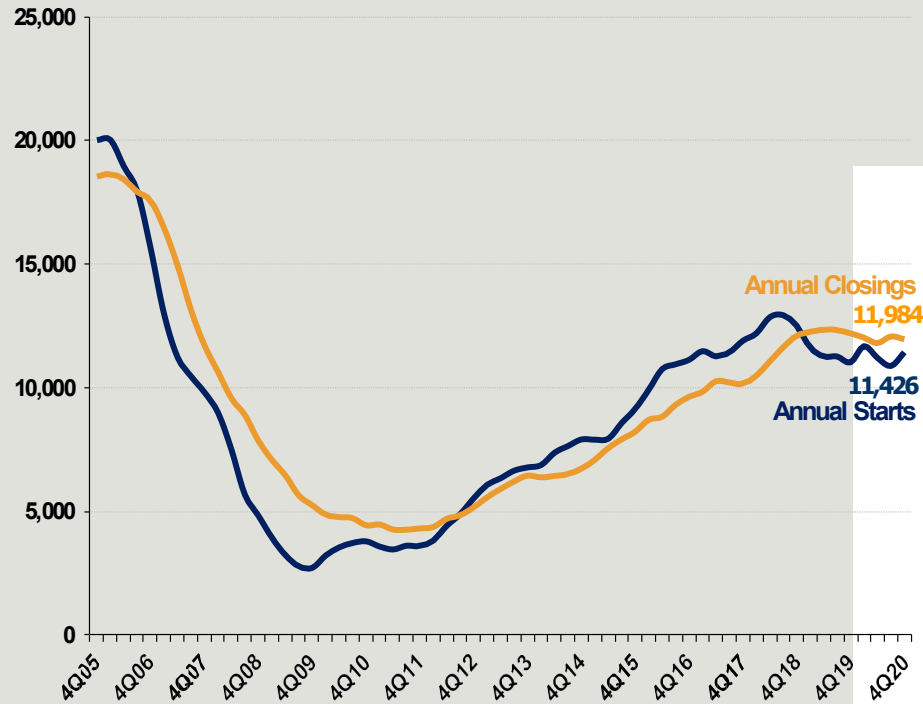
Cost Drivers

Loans (Capital)

- Construction financing is reportedly still available, but smaller builders do report capital issues, having to use non-conventional lenders at higher interest rates
- What isn't readily available is financing for land.
 - Hard money lenders willing to lend, but the costs are higher than capital from institutional lenders

Source: Denver Business Journal

Denver 8-County Metro Annual Starts & Closings



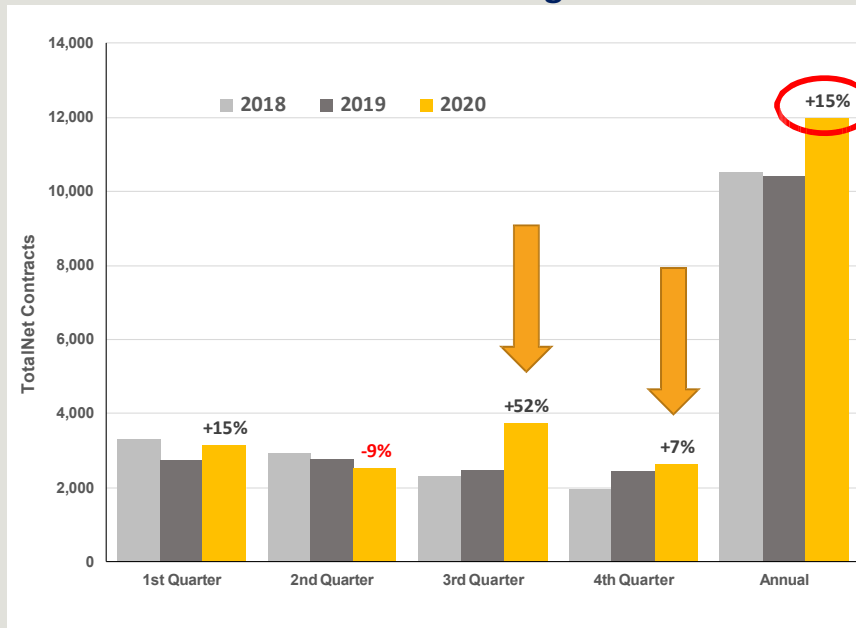
Source: Zonda

COPYRIGHT 2020

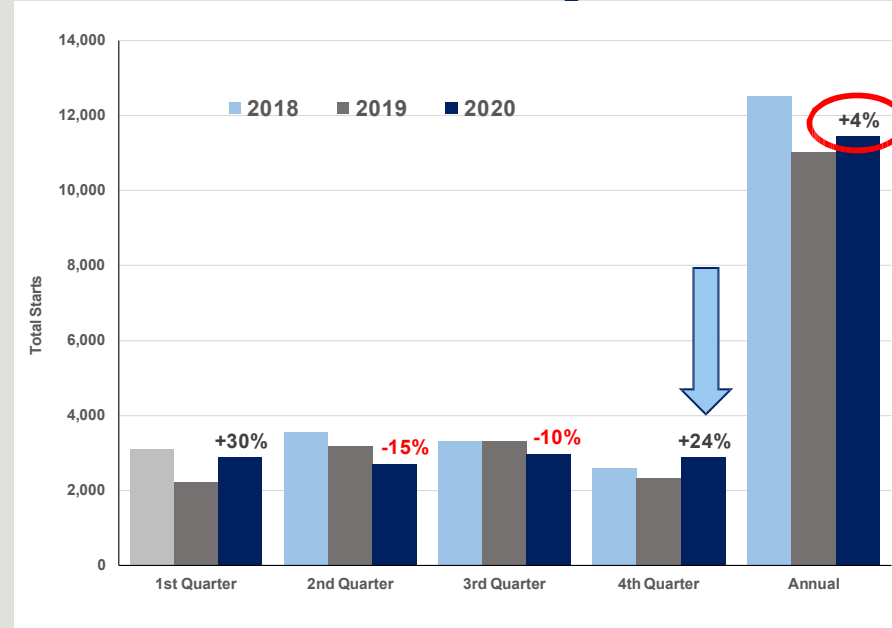
DENVER METRO		Type	4Q19	4Q20	% Change
Qtr Starts	Condominium		81	149	84.0%
	Townhome/Duplex		578	688	19.0%
	Detached		1,669	2,041	22.3%
	Total		2,328	2,878	23.6%
Annual Starts	Condominium		982	683	-30.4%
	Townhome/Duplex		2,672	2,709	1.4%
	Detached		7,367	8,034	9.1%
	Total		11,021	11,426	3.7%
Qtr Closings	Condominium		147	129	-12.2%
	Townhome/Duplex		632	678	7.3%
	Detached		1,999	1,856	-7.2%
	Total		2,778	2,663	-4.1%
Annual Closings	Condominium		993	709	-28.6%
	Townhome/Duplex		2,769	3,132	13.1%
	Detached		8,461	8,143	-3.8%
	Total		12,223	11,984	-2.0%

Sales Contracts Point to Strong Backlog Leading Into 2021

Zonda Net Sales – Strong 2nd Half of 2020

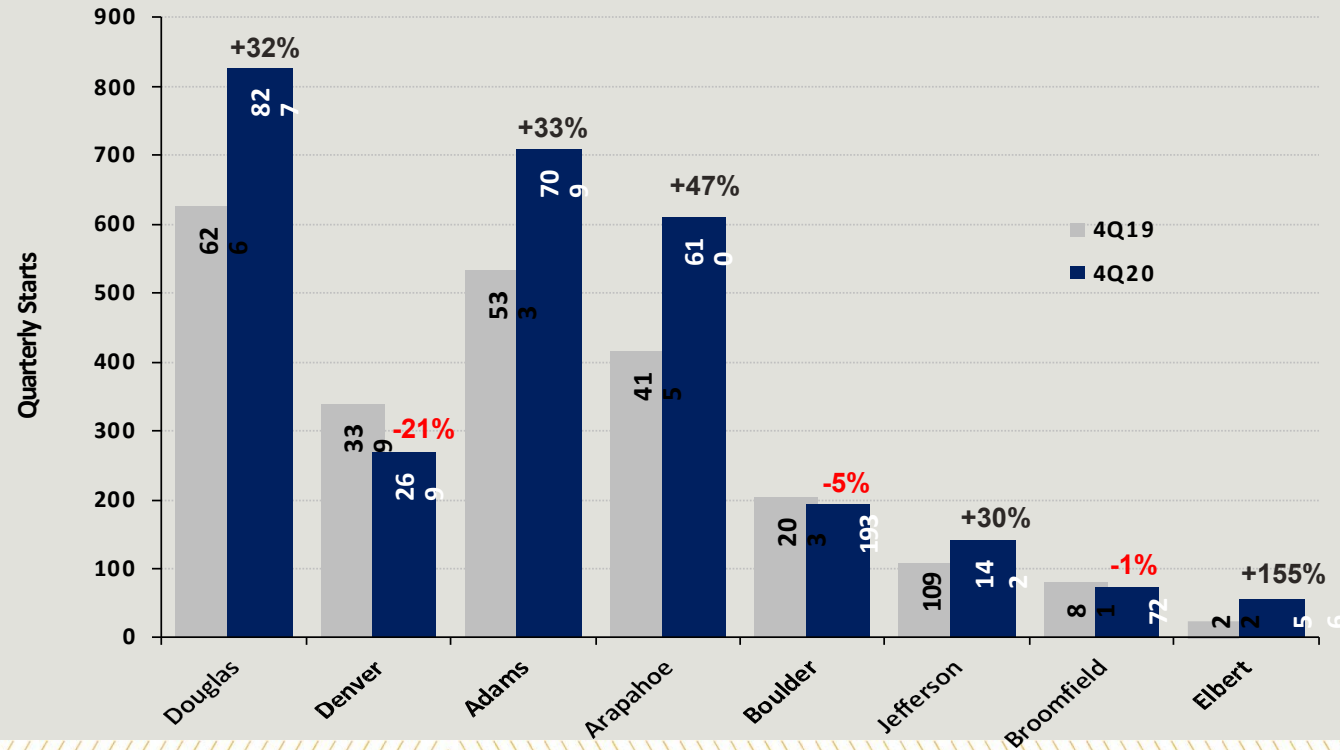


4Q Starts Reflect Strong Sales in 3Q20...



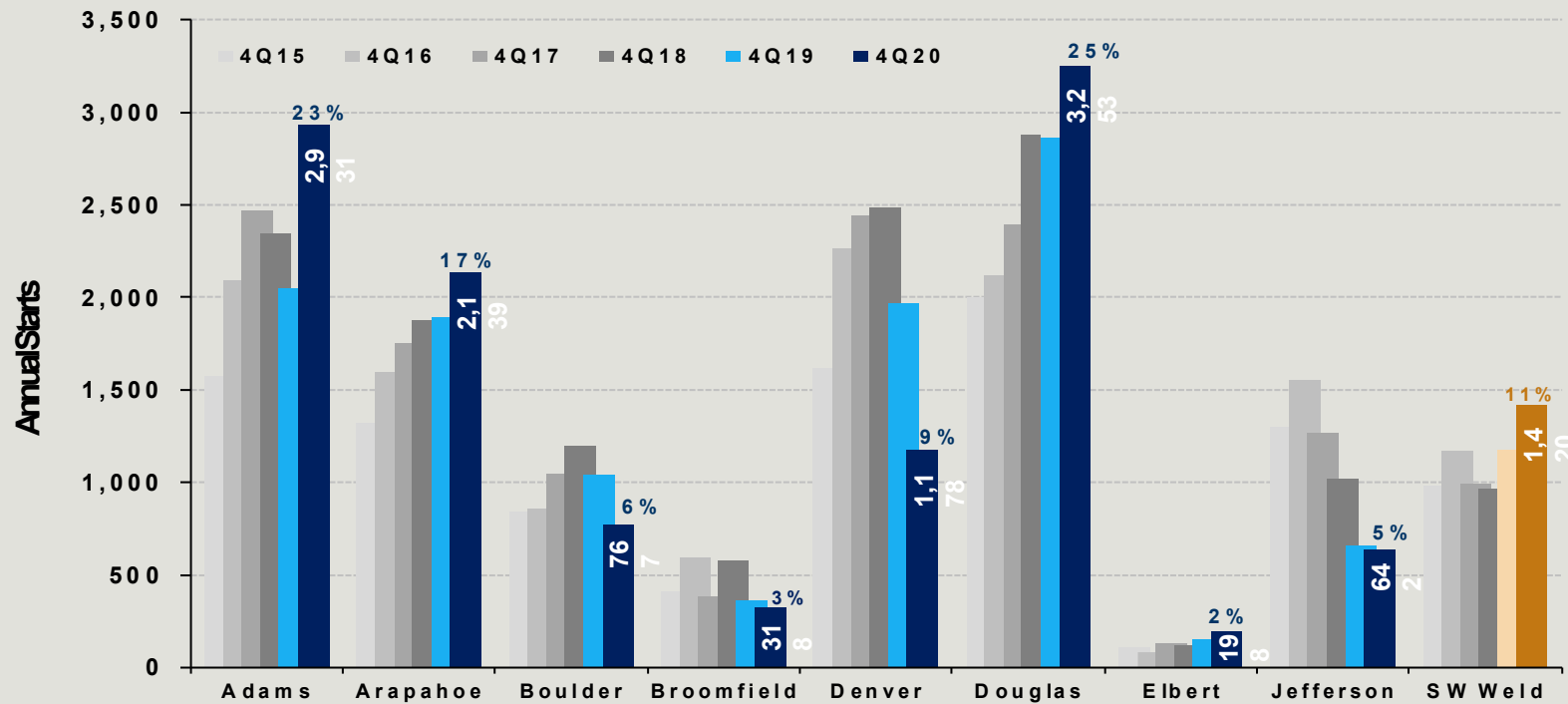
Source: Zonda

Denver Metro 4Q Starts YOY by County



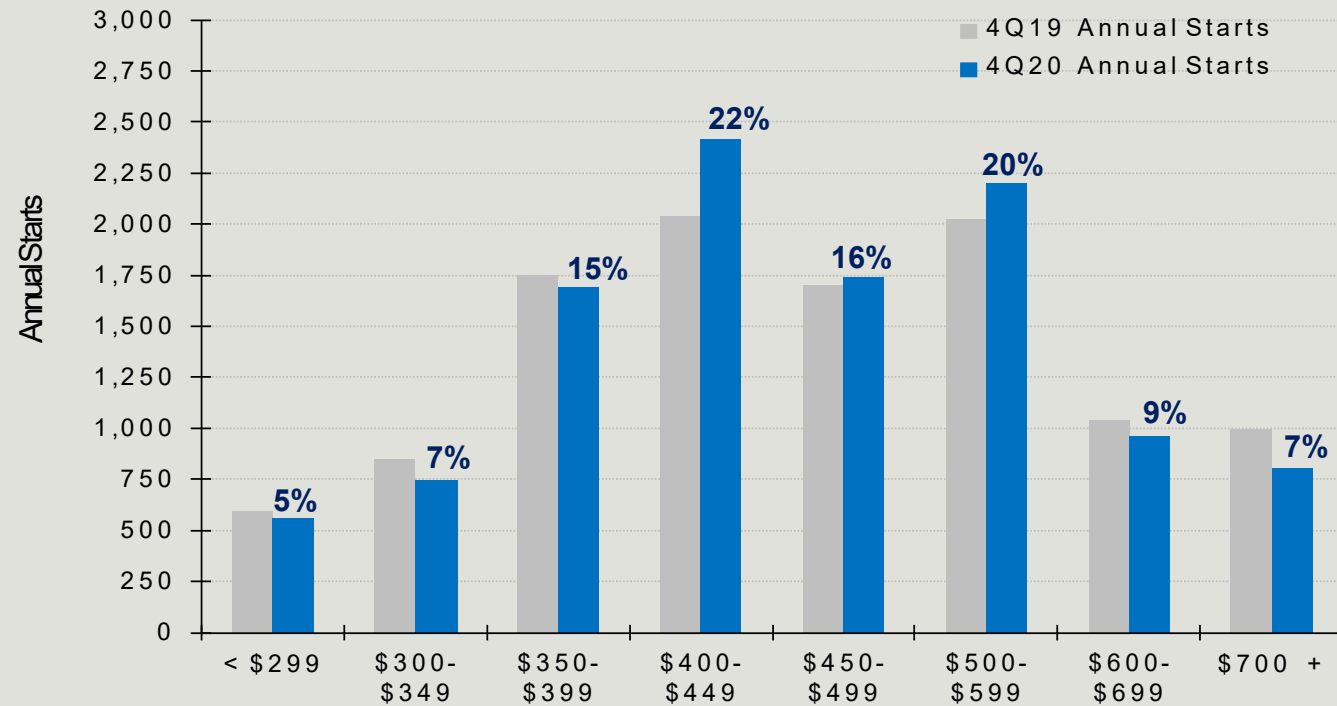
Source: Zonda

Denver Metro: Annual Starts Trend & Market Share by County



Source: Zonda

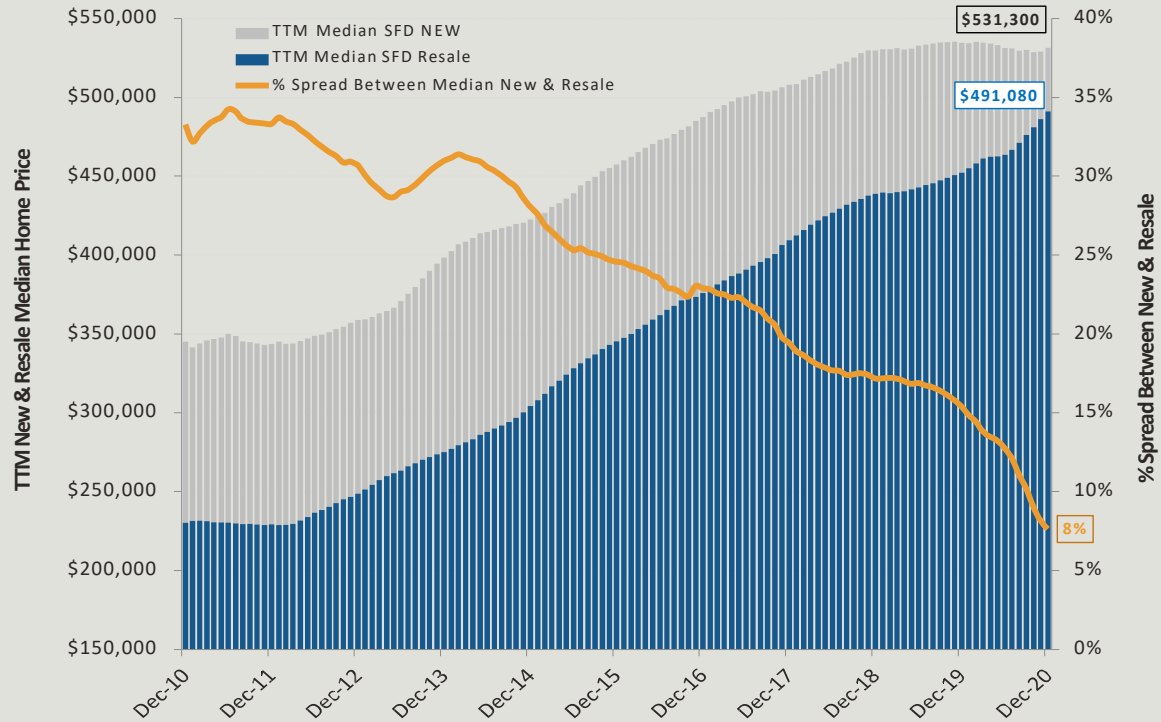
Denver: 2020 Annual Starts Market Share by Price (All Product)



- **under \$400k accounted for 27% of starts v. 29% in 2019**
- **\$400k to \$449K experienced the largest YOY growth = 19%**
- **\$600k + accounted for 16% of starts, down from 19% in 2019**

Source: Zonda

The Spread Between Median NEW and RESALE Home Prices Narrows



Source: Zonda

Denver Metro Scenario 1

2021 Scenario 1	
Health	<p>Positive cases and hospitalizations decline. No additional surges following holidays that would result in a return to 'stay-at-home orders'. Drop back to Levels Yellow (Concern) and/or Blue (Caution) for the majority of the Metro Area counties.</p> <p>Vaccine available by the end of January for Health Care workers and high-risk populations; general public by late Spring or early summer.</p>
Government	<p>Restaurants return to 50% capacity in the short term and expand to full capacity by summer.</p> <p>Large gathering events allowed in the second half of 2021 (i.e. churches, sports, concerts, etc.). K-12 children able to attend school in-person in the Spring.</p> <p>Daycares remain open.</p> <p>Colleges & Universities return to either hybrid or in-person learning for Spring & Summer Sessions. Fully in-person by Fall '21.</p> <p>Sessions. Governmental offices return to in-person permitting and inspections.</p>
Economy	<p>Additional federal stimulus prior to end of 2020; and subsequent packages in early 2021 are also passed by Congress. Unemployment rate drops back to below 6% by end of January and 5% by beginning of Summer.</p> <p>Initial unemployment claims drop to near-normal levels by end of 2021.</p> <p>Airline travel returns to at least 75% of normal by end of 2021.</p> <p>Stock market indices remains stable (+/- 3%) through first six months of the year.</p> <p>Retail spending remain at 100% or greater of 2020 levels.</p>
Housing	<p>Model homes remain open without any major restrictions.</p> <p>Resale market has at least 95% of 2020 sales levels and 100-125% of inventory levels. Resale inventory supplies remain low - below 2.0 months</p> <p>Mortgage rates remain below 3.5% for a 30-year term.</p> <p>Completed new home inventory remains at or below equilibrium of 1.5 to 2.0 months.</p> <p>New home start levels are >5% above 2020 levels.</p>
	<p><i>Public narrative regarding economic concerns significantly outweigh health fear concerns.</i></p>



Denver Metro Scenario 2

2021 Scenario 2	
Health	Positive cases and hospitalizations slow/plateau, but remain elevated to keep most counties in Levels Orange (High Risk), or Red (Severe Risk). Vaccine slow to reach general population by early summer and/or slow adoption by public.
Government	Large public gathering events remain limited, continuing restriction on attendance at concerts, sporting events and festivals through 2021. K-12 children attend school in the Spring, but with mix of districts using hybrid and virtual learning requiring at least one adult household member to be at home on some days. Restaurants remain open for in-person dining, but still only 50% capacity allowed.
Economy	Additional federal stimulus delayed at the end of 2020 and pushed until after January 20th inauguration of new administration and Congress. Job growth stagnates and the unemployment rate remains above 6% first 6-months of 2021. Airline travel remains 50% to 75% of normal levels throughout the year. Retail spending begins to slow, declines to 90% to 95% of 2020 levels. Stock market indices are more volatile (> 10% declines during the year).
Housing	Model homes remain open for normal visits (with minor inconveniences; i.e. face masks and physical distancing). Resale market has 85% to 95% of sales activity and 75-100% of inventory levels compared to 2020. Resale inventory supplies start to climb above 2.0 to 3.0 months, but remain historically low. Inefficiencies remain in new home construction: permitting, labor availability and supply chain. Completed new home inventory grows above 2.0months. New home start levels between -5% and +5% of 2020 levels. <i>Public narrative regarding economic concerns is balanced with health fear conversations.</i>

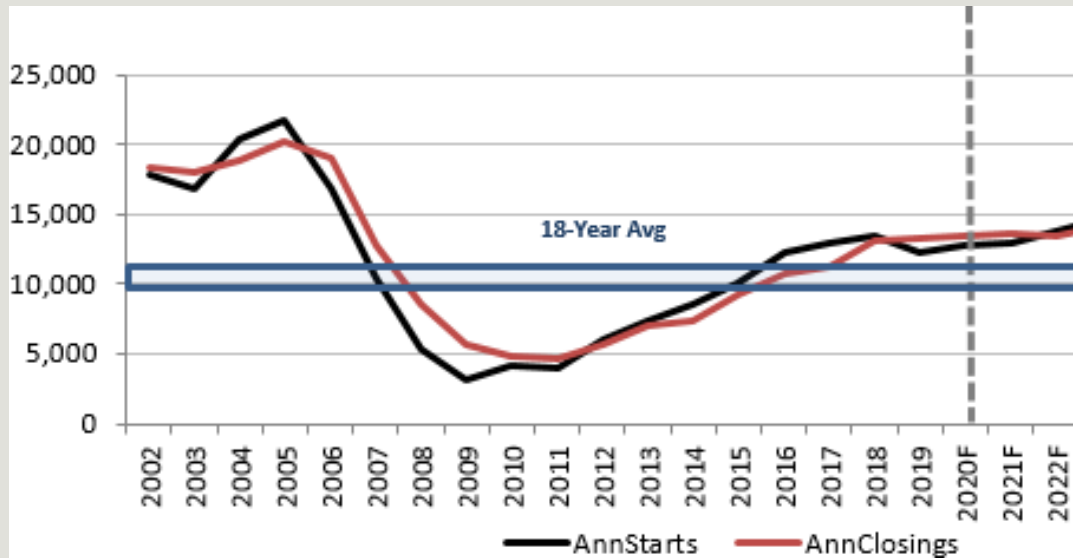


Denver Metro Scenario 3

2021 Scenario 3	
Health	Post holidays surge in cases & hospitalizations to stay at Level Red (Severe Risk) or elevate to Level Purple (Extreme Risk) with return to 'shut-at-home' orders. Vaccine deployment is delayed throughout the year and/or slow to adopt by public.
Government	K-12 schools and daycares forced to operate entirely virtually, likely requiring at least one adult household member to be at home full-time. Continued restrictions on large gathering events for the remainder of the year of 2020 Restaurants restricted to outdoor dining/takeout only because of restrictions under Red and Purple Levels.
Economy	Job growth declines and the unemployment rate stays above 7% for the remainder of 2021. Airline travel drops below 50% of normal for the year. Retail spending at less than 90% of 2020 levels Stock market indices experience sharp declines of greater than 20% (double dip recession; second black swan event - i.e. lower vaccine effectiveness) during 2021.
Housing	Model homes sales centers forced to close or operate by appointments only again. Resale market has less than 85% of sales activity and over 150% of inventory levels compared to 2020. Price depreciation in resale and new home markets. Notice of foreclosures become part of narrative. Resale inventory climbs above 4.0 months supply. New home start levels are > 5 % below 2020 levels.
	<i>Public narrative regarding health concerns significantly outweigh economic concerns.</i>



Denver Market: 2020-22 Housing Start Forecast – If Something Like Scenario One Plays Out



- Strong backlog carries into 2021 but pace of recent growth (2nd half of 2020) slows due to pricing, lots, economic uncertainty. Anticipate 0-10% increase.
- Anticipating steadier year in 2022 as lot availability widens, economy grows, and Covid fears diminish. 5-8% increase.
- If.....then back to 14,500+ starts at the end of 2022. Still only appx 75% back to peak in 2005!



Cost Drivers

Regulations

- Land use/zoning
- Entitlements
- Permits
- Tap and Impact Fees

Cost Drivers

Regulations:

- NAHB estimates, based on the latest data, that on average, regulations imposed by government at all levels account for 24.3 percent of the final price of a new single-family home built for sale. (32% for multi-family)
- Three-fifths of this—14.6 percent of the final house price—is due to a higher price for a finished lot resulting from regulations imposed during the lot's development.
- The other two-fifths—9.7 percent of the house price—is the result of costs incurred by the builder after purchasing the finished lot.
- The cost of regulation in the price of a new home is rising more than twice as fast as the average American's ability to pay for it.

- Source: NAHB

Public policy Challenges

Construction Litigation Reform

- Arbitration Policy Changes

Immigration

Workforce Development

Metro District Policy Changes

Impact Fees – vary widely in name and cost, not all our transparent, some lack a clear nexus to service

Inclusionary Zoning

Water resources/availability

Housing Growth Limitations

Policy solutions

Continue construction litigation reform?

- Defend against attempts to undo litigation reform via arbitration “reform”

Pass meaningful immigration reform

Fund, and partner with industry, on workforce development programs

Promote the sound use of metro districts as a way to build more affordable product

Don't increase impact fees and ensure there is a clear nexus between fee and service

Policy solutions

Don't pass transfer fees/taxes in the name of making housing more affordable

Create more water storage

Implement fallowing and leasing programs instead of "buy and dry"

Don't artificially restrict housing supply via arbitrarily limiting housing growth!



Questions?

THANK YOU FOR HAVING ME!