

# Is Inventory Tight Again?

Stay patient for the turnaround.

By G.U. Krueger

**W**ith the new housing market showing some “green shoots,” the sentiment arises that if housing inventory only was tight again, maybe financing would return to the cash-starved building industry. Or that those hedge funds would finally bite. And pension funds might actually come out of their hiding places. Clearly, housing business fortunes have a lot riding on this story; they always have, especially in California and other high-priced markets in the nation.

So what’s the narrative to make the case for tight housing inventory? For traditionally supply-challenged states like California, the long-term case is crystal clear: housing production is at historical lows, running at a 32,000 annualized rate in April of this year. If this goes on much longer, California will eventually face another housing shortage (once those pesky foreclosures have waned). Even “Uber Bears” like Beacon Economics or The UCLA Anderson Forecast are now worrying about this scenario.

The only problem with this long view is that it is, by definition — darn it — long, maybe too long for investors, who have to ponder alternative investment opportunities. Wouldn’t it be great if we had a short-term narrative of tight inventory — and some evidence! For example, there is “inventory is tight” chatter again pointing to declining new home inventory in various markets throughout the U.S. For example, in Southern California’s Riverside County, according to Hanley Wood Market Intelligence there were just 800 units of new home inventory — or barely eight weeks of supply at the end of April 2009. Thus, the implication is that in eight weeks or so we

are going to be whole again.

However, new home inventory is only a small part of the story. By April 2009, there were an additional 1,159 homes under construction in Riverside County and lots earmarked for future construction, another 21,000 units — a number which has been dropping but is still large. This future supply is significant because it is a type of pent-up supply which can be easily activated. Consequently, total buildable lot supply reached 25,000 units in April 2000, a 60-month supply at current sales rates — not quite as tight as local pundits are proclaiming.

Ironically, this hasty focus on new home inventories misses a critical point that would serve to advance its case. For example, by observing only the level of unsold homes,

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all sub markets in Riverside County look practically equal. However, if one looks at the broader buildable lot category, there

is a lot more differentiation. For example, the Northwest Riverside sub market had 18 months of total unsold lots and home inventory. This is actually stable already since historically new home prices stabilize in the range between 15 and 20 months of buildable lots. Interestingly, South Riverside, with its 28 months of buildable lots, was still oversupplied but looked better than some more interior markets which maintain from 50 to 160 months of buildable lots. Thus, looking at the larger supply number may actually yield more concrete strategic market insights than the simple “inventory is tight” story.

More of these sub market asymmetries can be found throughout California and the rest of the country. In our own research, we have discovered them to show up in the Carolinas,

(such as Charlotte) and in Florida (such as in Tampa). Even in Arizona, Nevada, and the DC area, one can detect sharp differences in inventory by sub market.

So what can we glean from these differences? It is probably a safe bet that the sub markets closest to supply stability will be the early winners in the recovery. A major condition for this, however, is that resale markets stabilize first and that foreclosures get burned off. We know from recent experience that supply and demand in new home markets tend to improve once their resale markets turn. But this could still take time.

So, forget these short-term “inventory is tight” narratives. Their horizon is too short and the Wall Street guys don’t buy it anyways. There won’t be an instant recovery, although it may be brewing already. Patience, grasshoppers, looking for those green shoots — they will eventually come, but not at the time of your choosing!

People assume that a few “green shoots” in the housing market and declining home inventory means a new housing shortage.

Total inventory is much more than that, including homes under construction and remaining un-built lots in open projects.

Although the total supply number may be discouraging, it yields more differentiation among inventory status, which is more valuable strategically.



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