



Quarterly Updates and Estimates

Special Report - The El Paso County Housing Market

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New Residential Building Permit Update

Compared to 2001, year-to-date new single-family residential building permit activity for 2002 is down 11.91%. This is a markedly better performance than the ~20% decline the Forum projected for 2002 during its October 2001 Annual Report. Allowing for town homes and all categories of multi-family housing, year to date, total new residential building permits are down 8.89% compared to 2001. Strong gains among the town home, duplex and condominium sectors contributed to this unanticipated strength. This strength might lead to a misleading comparison with 2001. For example, 2001 had the second highest number of single family permits ever issued in El Paso County. Table 1 summarizes activity through July for 2002, 2001 and an average for 1998-2001. Annualized projections for permits are presented based on data through July for 2002, 2001 and the average of 1998-2001.

Table 1 – New Residential Building Permit Activities in El Paso County

Year to Date Building Permits to July							
	Single Family	Town Home	Duplex	Condominium	3 & 4 Family	5 Family or More	All Residential Permits
For 2002	2,877	282	13	134	36	817	4,159
For 2001	3,177	174	15	126	35	708	4,235
For 98-01 Avg.	2,805	147	12	114	32	534	3,643

Annualized Building Permit Projections Based on Year to Date through July							
	Single Family	Town Home	Duplex	Condominium	3 & 4 Family	5 Family or More	All Residential Permits
2002	4,254	417	19	198	53	1,208	6,150
2001	4,829	269	9	118	65	1,459	6,750
98-01 Avg.	4,148	217	18	168	47	789	5,387

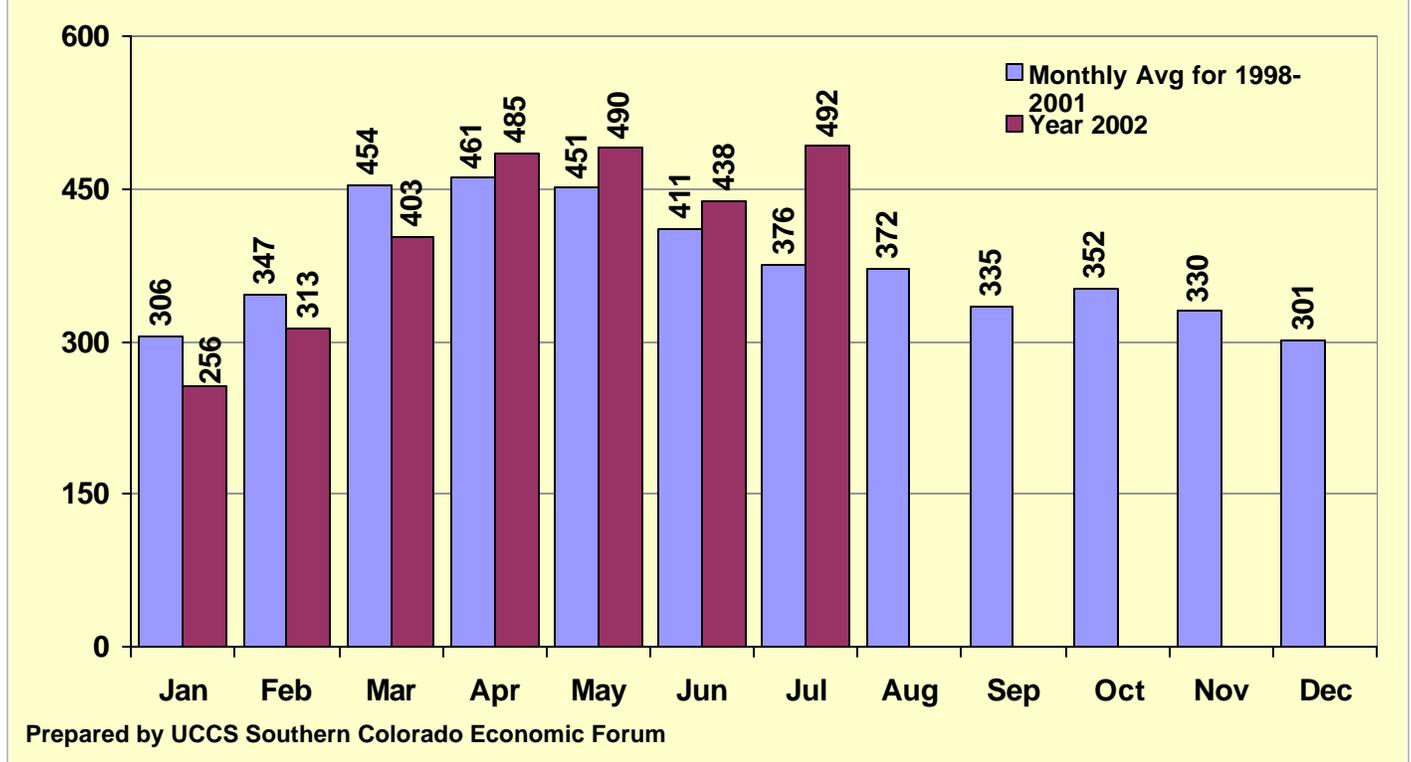
Permit Activity in 2002 Compared to Reference Periods January to July							
	Single Family	Town Home	Duplex	Condominium	3 & 4 Family	5 Family or More	All Residential Permits
2002 vs. 2001	-11.91%	54.95%	116.67%	67.50%	-18.18%	-17.22%	-8.89%
2002 vs. 98-01 Avg.	2.57%	91.84%	8.33%	18.06%	12.50%	53.14%	14.16%



New residential permit activity for 2002 is higher in every housing category compared to year to date average for 1998-2001. If it were not for a comparison with 2001, residential permit activity for 2002 would be considered very strong. Single-family monthly permit comparisons for 2002 with respective monthly average permits over years 1998-2001 are summarized in Figure 1.

The relation between new single-family permits for 2002 and the average number of permits per month for years 1998-2001 is illustrated in Figure 2. The first quarter of 2002 was still in a recovery mode. Permit activity was below “typical” monthly activity based on 1998-2001 averages. The second quarter of 2002 exceeded the past “typical.” By July 2002, not only were permits significantly higher than is normal for July, it also reversed the seasonal pattern we expect – one in which we normally observe a decline in permits. The number of permits in July 2002 was 492, the most in any month of 2002. July 2002 was 31% above the average of 376 units for July in years 1998-2001. Were too many single-family permits taken out in July 2002?

Fig. 1 - Monthly Single Family Permits for 2002 Compared to Monthly Averages for 1998-2001

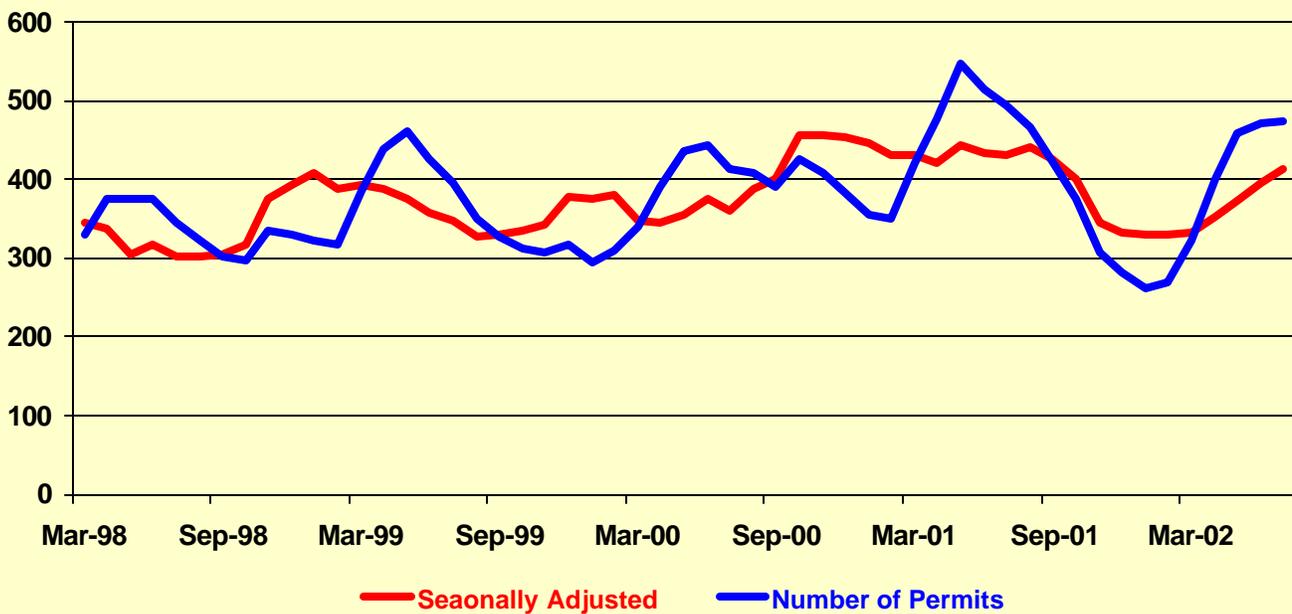




2002 Single Family Developments

Single-family building permit trends, actual and seasonally adjusted, are plotted in Figure 2. The seasonal adjustment process corrects for peaks and troughs in permit activities that are regular and recurring such as seasonal changes in temperature. Figure 2 suggests building permit activity bottomed out in December 2001 – January 2002. Activity in the last several months has been significantly higher than the seasonally corrected numbers would have led us to expect based on trend lines that were emerging from the low point of December 2001. The actual number of permits seems to have peaked recently and appears to be reflective of an observed pattern in the month-to-month data in Figure 1.

**Fig. 2 - El Paso County Single-Family Permits
March 1998 through July 2002
(3 Month Moving Avg)**



Prepared by UCCS Southern Colorado Economic Forum

Driving Forces Behind Residential Permit Levels

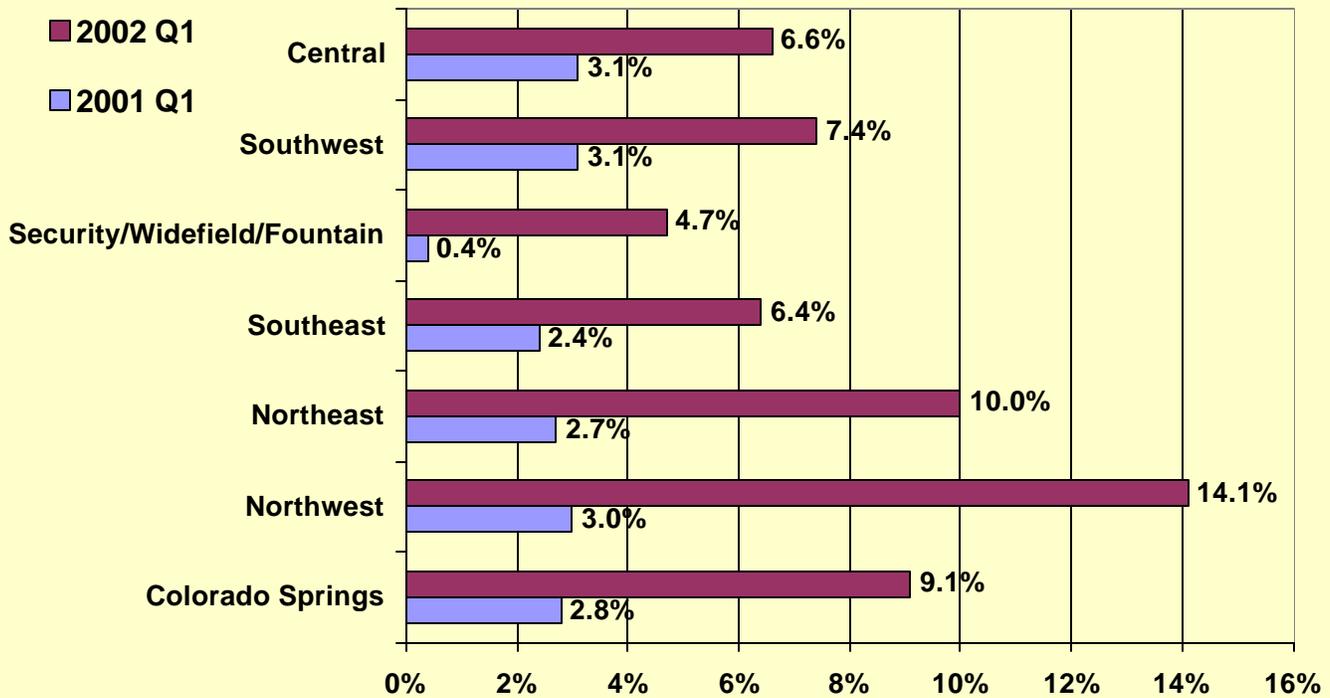
Two reasons help explain the higher than expected residential building permit activity. First, mortgage rates are extremely attractive. Second, we had stronger than normal growth in population, especially net in-migration.



At current interest rates, a typical entry-level, new home can be purchased and carried for approximately \$1,000 – \$1,300 a month, including insurance and taxes. Both interest and property taxes are deductible on a person’s Federal 1040, Schedule A. If it is assumed the homeowner is in a 20% marginal Federal Income Tax rate, the after tax cost of home ownership, excluding maintenance, is approximately \$800 - \$1,000 a month. This is very similar to average rents in the northeast, northwest and southwest regions of the county and is often less than the rent for larger apartment units in these regions. Additional factors such as life-style, appreciation in value, size of house vs. apartment, maintenance and other considerations also influence the home ownership decision. Holding these considerations constant, home ownership, especially for homes in the \$140,000 to \$175,000 range, can be less expensive than renting. This is a key factor of increased home ownership in the region.

Population for the period April 2000 to July 2001 increased approximately 13,000 people. Natural population increase was approximately 5,500. El Paso County experienced a net in-migration of approximately 7,500 people. Given an average household size of approximately 2.5 people, the increase in population translates into an expected demand of an additional 5,200 housing units - single family homes and/or apartments. During this period, a total of 8,770 housing units were “permitted.” This suggests vacancies should have increased by approximately 3,570 units. In addition, 6,838 new residential housing units have been permitted between August 1, 2001 and July 31, 2002. Is supply beginning to exceed demand?

Fig. 3 - Colorado Springs Apartment Vacancy Rates



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Vacancy Analysis

Figure 3 illustrates apartment vacancies in the first quarters of 2001 and 2002. Vacancies for 2002/Q1 were estimated to be 9.1% compared to 2.8% in 2001/Q1. Sub-market vacancies were estimated to be as high as 14.1% (Northwest) to 4.7% (Security/Widefield).

In April of 2000, the Census reported a vacancy rate of 4.94%. The apartment survey for 2001/Q1 reported a vacancy rate of 4.4%, an immaterial difference. Given the number of residential building permits that have been let, it is estimated that the County has approximately 218,000 housing units. Applying the Census observed 43.7% of vacant units as being available for rent, it is believed there are approximately 8,700 vacant (and available for rent) housing units in the county. Given historical average vacancy rates, there are approximately 3,700 “excess” vacancies in El Paso County at this time.

Single Family Construction Issues

Three factors will likely impact single-family residential construction over the next 18 to 30 months.

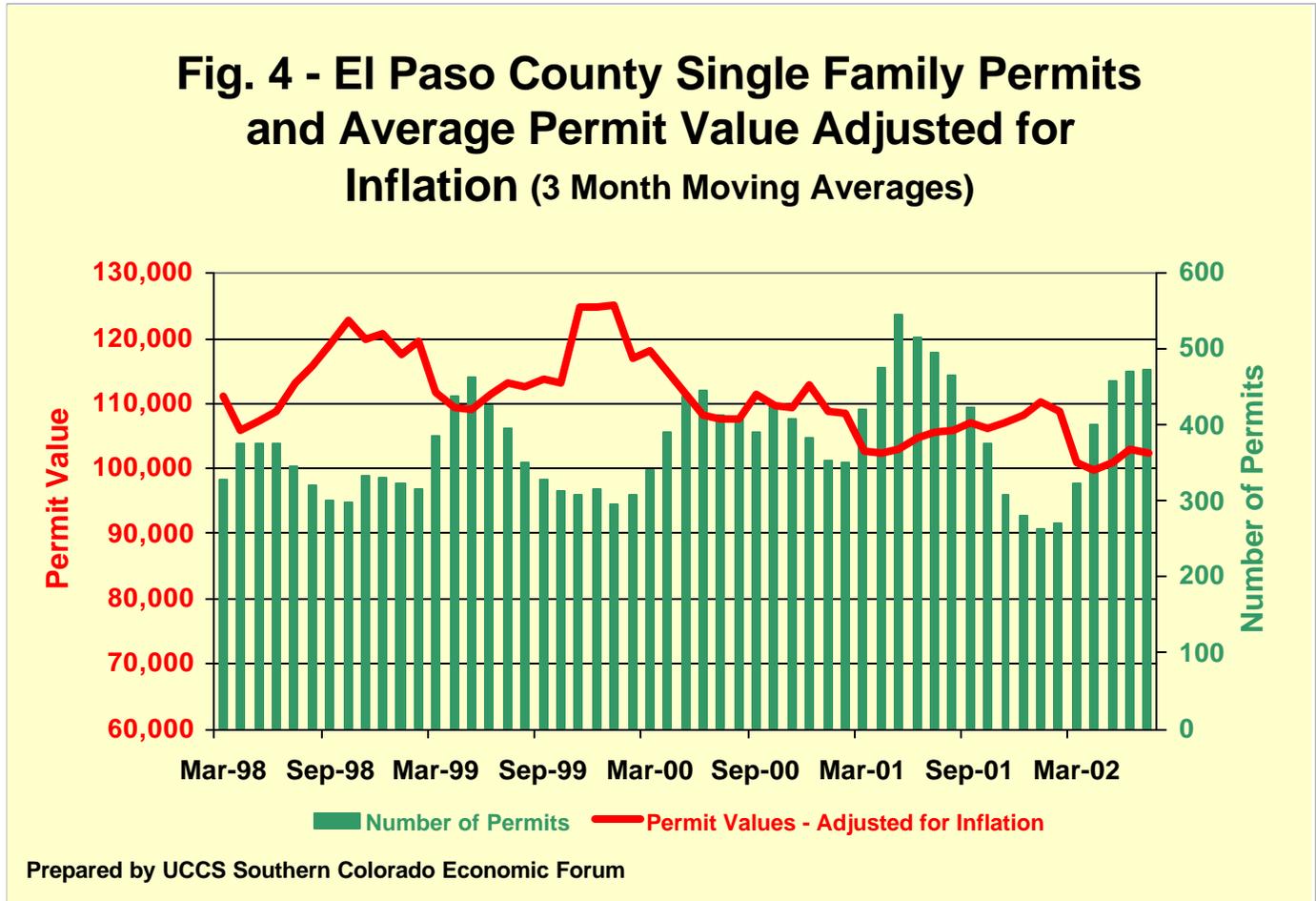
1. A 1% increase in mortgage rates will increase a typical monthly payment on an “entry-level” home by approximately \$125 a month. This may not be affordable for the “entry-level” homeowner. Alternatively, the price of an “entry-level” home would have to decrease by approximately \$18,000 to maintain the same payments as those at a 6.5% mortgage. Mortgage rates will increase to approximately 7.5% to 8.5%. “Entry level” permit activity will slow down.
2. Net in-migration, the most important component of new home construction in the county, will slow if the national and local economies do not improve. If residential construction continues at a pace of approximately 6,000 units for the next twelve months, this will bring a total of approximately 14,700 housing units available for occupancy. Allowing for normal vacancy rates in our area, we will have approximately 9,700 units that need to have families in them. Given an assumed 2.5 people per housing unit, our population will have to increase by approximately 24,250. This is not a realistic expectation.
3. Higher paying jobs have disappeared from the region by the thousands. The high-end housing market has slowed tremendously along with the loss of these well paying jobs. While the jobs are expected to return over time, it may two-to-three years before this happens. When the upper level housing market returns, builders will have to compete with the existing supply of unsold upper-end homes in the community that may have heavily discounted prices.

Given these issues, it seems the residential construction industry will come under pressure over the next 12-18 months. The entry-level market will be constrained by rising mortgage rates. The upper-level market will be constrained by limited number of workers with well paying jobs who can afford the more expensive home but may prefer to buy an existing, resale home in the community. Population levels are expected to rise but not at levels necessary to reduce vacancy rates and produce demands for new housing units consistent with levels we have seen in the last several years.



Average Single Family Permit Value Trends

Figure 4 illustrates the single-family building pattern in El Paso County since 1998. The normal seasonal peaks and troughs are easily seen. More interesting is the apparent inverse relationship between the number of permits and the average permit value, adjusted for inflation. The exact reason for this is not known but may be caused by the timing of permit activity for “inventory” homes by builders. The distribution may also be skewed by the reduction in permits of high-end homes.



Tax Issues

If residential construction does slow in the coming months, construction employment will decrease. A temporary loss of these well paying jobs will reduce aggregate retail spending in the area. This will negatively impact municipal sales tax collections. If entry-level homebuyers continue to purchase new homes, they will have less discretionary income to spend on retail items. This will also negatively impact sales tax collections.



Moreover, the decline in the average permit value (real and nominal terms) will translate to lower property values. Given Gallagher amendment limitations and downward trend in the residential assessment rate, property tax dependent public entities will face financial constraints for several years to come.

Summary

The current vacancy rate along with the number of new residential housing units under construction this year combine for a likely and material surplus housing supply in the near future. Higher mortgage rates, losses in high-income jobs and a possible slow-down in population growth will possibly aggravate this situation for the next 12-18 months. Municipal tax revenues associated with residential construction are expected to take longer to recover. These concerns are not realities. If the area is successful at attracting strategic employers and if mortgage rates continue to be in the 6.25 to perhaps 7.0% range, housing activity could continue at its current levels. This will only happen with strong population increases. It is uncertain if the necessary increases in population will materialize to support residential construction at its current levels over the near future.

About the Forum

The Southern Colorado Economic Forum (SCEF) hosts its Annual Review and Forecast for the Colorado Springs economy in October. This year's Forum will be held in the Antler's Adams Mark Hotel on October 16, 2002 at 4:30-6:00pm. A reception follows from 6:00-7:00pm. Contact Judi Lakin for registration information at 262-3433.

SCEF sponsorship is available at a number of levels and benefits. Contact Richard Blair at (719) 262-3524 or Richard.Blair@cufund.colorado.edu for information about Sponsorship.

The Forum staff is also available for contract work and analysis on issues affecting the local economy and the firms in the economy. Examples of current and prior work included economic base analysis, population projections, survey analysis and labor force analysis. Contact Fred Crowley at (719) 262-3531 or fcrowley@uccs.edu for additional information.

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