

The MasterWerks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.

MEASURED
ADVICE.

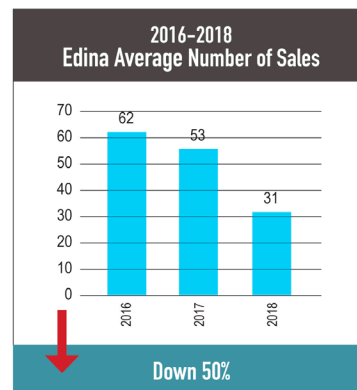
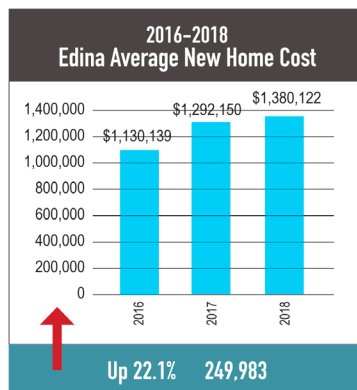
RIISING NEW CONSTRUCTION COSTS SHIFT MARKET TO TRANSFORMATION AND REMODELING

Fasten your seat belts. Here's a high-speed account of what has happened to housing prices in Edina over the past decade and how price migration has affected the behavior of many builders and buyers, with overall consequences for the market.

THE BACK STORY

Following the 2008 crash, housing prices in many cities stagnated. Construction costs stayed relatively flat, too. Edina, however, experienced a quicker recovery, with sales picking up in 2010-2011. As demand accelerated, site prices increased, while construction costs remained relatively stable. From 2016-2018, the average cost of a new home in Edina rose 22.1% — from \$1,130,139 to \$1,380,122—an actual increase of \$244,983 in just two years!

But here's the kicker: In the same period, reported new home sales declined 50% — falling from 62 to 31. And that trend has continued. So what's going on?



Average new home costs have risen 22.1% over the past two years, while number of sales have fallen by 50%. Detailed statistics can be reviewed at end of post.

The MasterWorks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

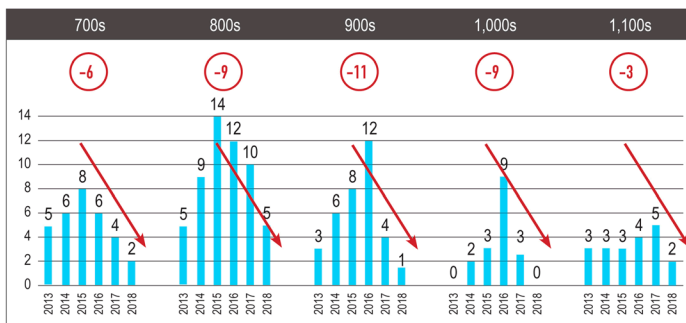
THOUGHTFUL
ANALYSIS.

MEASURED
ADVICE.

Basically, increasing demand sparked a flow of speculative builders into Edina. Initially, they built homes in lower-price categories of \$600K-\$1M. As development demand increased, so did pressure on prices. The builders also began building in higher-priced categories. Examining the 2016-2018 numbers, we see that while site costs flattened out in this period, rising just 2.1%, building costs actually increased 31.7% or \$235,772 on average. The spike was due to numerous factors: the quantity of building, material price increases, shortage of skilled labor, lumber tariffs, as well as regulatory mandated costs and fees.

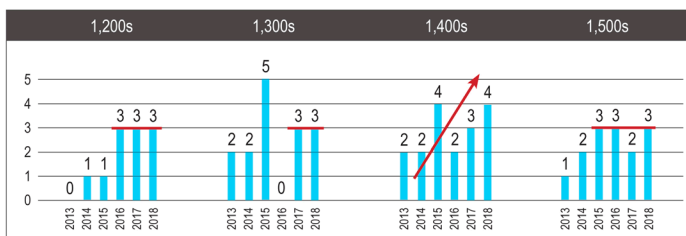
As a result, prices have shot to levels that are severely restricting and retarding the growth of sales of new houses, primarily in the \$700K-1,199M range, while those from \$1,200-1,599 have remained flat (see previous post on \$1M+ homes) Clearly, the market is running out of buyers. As of this posting, Edina has 47 new houses for sale with an average price of \$1,619,735, with just five pending that average \$1,508,275. That's less than 10% of the total. Even in well-heeled Edina, \$1,600,000 is rarified air, indeed.

2013-2018 Number of New Home Sales \$700,000-1,100,000 Categories



Numbers of new home sales in the \$700K-1,199M range have fallen 79.2% from their peaks, while those in the \$1,200-1,599M range have generally not increased.

2013-2018 Number of New Home Sales \$1,200,000-1,500,000 Categories



The MasterWerks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.

MEASURED
ADVICE.

Price migration into these higher categories has had severe consequences for lower-priced new construction, sharply curtailing the supply. Since the household income of buyers has not increased at the same pace as housing prices, many of them are literally priced out—unable to afford the larger prices and down payments and bigger monthly payments that include mortgage, taxes, and insurance. Because of these factors, new home sales in the \$720K-\$1,199M price range have fallen by 79.2%. The factors outlined here also affect all other dimensions of construction, such as transformations and remodeling; only the size and scope differ. The cost drivers remain the same, often leading to sticker shock even for small remodels.

While the numbers we're quoting are germane to Edina, they also apply to other locations. The only difference is how fast prices have risen, in terms of each city's actual post-2008 recovery. The metro area's northern suburbs operate at lower price points, were slower to recover, and are still experiencing the tail end of the boom.

These two homes, built by the same builder in the same neighborhood, show how the cost of building has increased substantially in only two years. Rising costs increased the down payment requirement by \$37,597.00 and the monthly payment by \$937.46. This requires higher property tax and insurance payments and considerably more income to qualify for the loan.

Two Very Similar Homes With Greatly Differing Building Costs and Mortgage Payments



Square Footage	4,349
Bedrooms	5
Bathrooms	5
Garage	3
Date Closed	7/15/16
Sold Price	\$1,011,015
Site Cost	\$ 291,900
Building Cost	\$ 719,115
Building Cost/sq ft	\$ 165.35
20% Down Payment	\$ 202,203
Mortgage 3.5% for 30 years	\$ 808,812
Principal & Interest	\$ 3,684.13



Square Footage	4,346
Bedrooms	5
Bathrooms	5
Garage	3
Date Closed	8/27/18
Sold Price	\$1,199,000
Site Cost	\$ 325,000
Building Cost	\$ 874,000
Building Cost/sq ft	\$ 201.10
20% Down Payment	\$ 239,800
Mortgage 4% for 30 years	\$ 959,200
Principal & Interest	\$ 4,621.59

Increase
of 18.6%
or
\$187,985

Increase
of 25.4%
or
\$937.46

The MasterWerks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.
MEASURED
ADVICE.

COPING MECHANISMS OF AVERAGE BUYERS: SHIFT TO TRANSFORMATION AND REMODELING

In response to this price migration, many would-be buyers seeking to upgrade are forced to stay put and remodel as their only viable alternative. They see this as a more affordable option and a way to leverage their existing housing investment. But they may actually be opening a different can of worms, in terms of outdated assumptions, costs, and potential payback. It's much trickier to enhance value through remodeling than with new construction.

Many homeowners quickly discover that they can't achieve a solid rendition of their dream kitchen or bathroom for the price they assumed. Proceeding without sound strategic advice, they are drawn to the allure of contractor advisory services, where they find builder-remodelers who are only too happy to focus solely on installing new cabinetry, floors, counters and appliances. This symptomatic approach to remodeling typically ignores holistic issues with overall design and spatial compatibility, in order to keep costs down, as well as bigger deficiencies affecting heating, ventilation and air conditioning (HVAC), electrical, plumbing, insulation, and windows. It's like applying a band-aid to a wound, when what's needed is surgery.

Remodeling that's done in this ill-informed way—without proper planning and foresight—is actually much more expensive in the long run, with higher probability of loss for mistakes and lower potential resale returns.

The MasterWerks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.
MEASURED
ADVICE.

COPING MECHANISMS OF AVERAGE BUILDERS: MEET REMODELING DEMAND BY SKIMPING ON QUALITY

Whether they build new or remodel—and remodeling is gaining traction as an alternative way to make sales—”builders gotta build.” To cope with construction price increases, they typically try to find ways to cut their costs. Thus, we see much promotion of trendy open designs that are less labor-intensive and use cheaper materials. Builders market more transitional or soft contemporary design, eliminating and minimizing details such as cabinetry and trim, while increasing the overall square footage with lower-cost 2x6 framing and sheetrock, persuading buyers to think they are getting more bang for their buck.

Builders are aided and assisted in this by the design industry, which also feels the financial pressure to cut costs. Both converge in selling “clean and simple” to consumers who don’t perceive the underlying rationale. Meanwhile, home improvement shows—and the age-old desire to keep up with the Joneses—reinforce the trend.

The MasterWerks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.
MEASURED
ADVICE.

GOOD NEWS FOR SAVVY HOMEOWNERS

Despite the roiling seas of price migration, the news is good for homeowners who made shrewd new home purchases before the jump in prices. The rise in new home prices has provided relief from flat equity scenarios, when these houses were competing directly against more current new construction. Now the best of them—built with competitive features and amenities—are seeing significant gains in appreciation, since from the point of view of buyers, they represent desirable alternatives to more expensive new construction or poorly remodeled older homes.

SOLID INFORMATION PROVIDES THE GROUNDWORK FOR GOOD DECISION MAKING

In summary, as more buyers find themselves without the option of newly built homes in the \$700K-\$1,199M+ range, due to escalating land prices and construction costs, they are forced to reconsider other smart ways to improve existing homes. While many of the principles behind this approach are not dissimilar from those of new construction, there are important differences.

Since affordability is a primary factor for many, we will focus a number of our upcoming posts on specific issues affecting remodeling and transformation, with smart approaches to meeting those complex challenges. Stay tuned.

The MasterWerks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.

MEASURED
ADVICE.

Smart New Home Buyers Gain Equity

Morningside



Purchased 7/16 \$972,000

Square Footage 3,869
Bedrooms 5
Bathrooms 5
Garage 3

Sold 2/18 \$1,119,000

Gain 19 mo \$147,000

Fairfax



Purchased 7/15 \$985,000

Square Footage 4,340
Bedrooms 5
Bathrooms 4
Garage 2

Sold 8/18 \$1,130,000

Gain 37 mo \$145,000

Grove



Purchased 4/14 \$949,000

Square Footage 4,168
Bedrooms 5
Bathrooms 5
Garage 3

Sold 7/18 \$1,183,735

Gain 51 mo \$234,735

Those who purchased astutely in the last few years saw their property values rise when they resold in 2018. They are profiting from rising construction costs and experiencing significant gains.

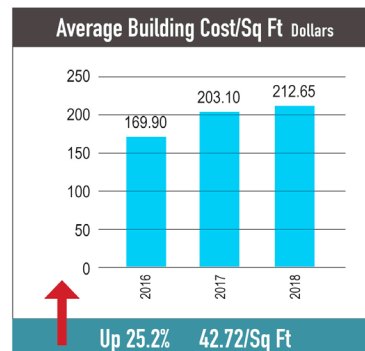
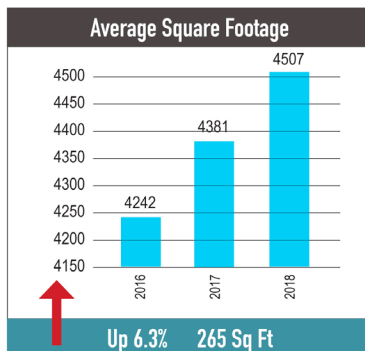
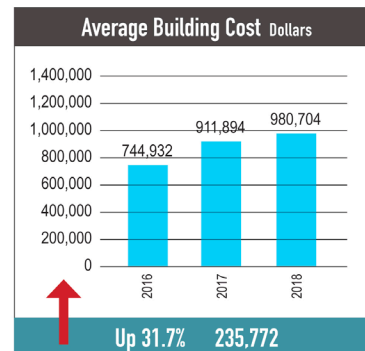
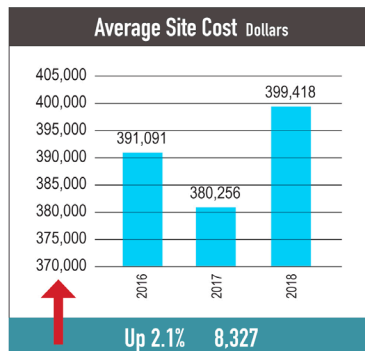
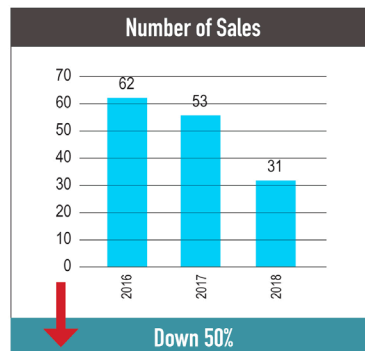
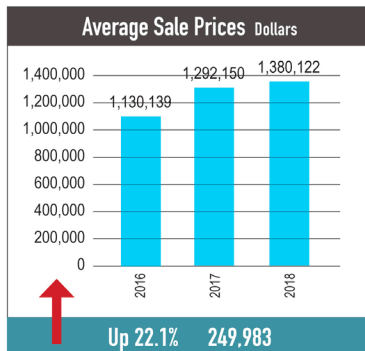
The MasterWorks Perspective

INFORMED OBSERVATIONS ON CURRENT HOUSING CHALLENGES AND OPPORTUNITIES • OCTOBER 8, 2019

THOUGHTFUL
ANALYSIS.

MEASURED
ADVICE.

2016-2018 Edina New Home Construction Statistics



These graphs show a radical rise in prices for houses sold between 2016-2018, due to various factors discussed in this Perspective post. Of particular note are the 31.7% rise in building cost, the 25.2% increase in building cost per square foot, and the 6.3% gain in average square footage. These increased costs are the primary reason for the major shift occurring in revitalization strategies.

SEE MORE PERSPECTIVE ARTICLES



MASTERWORKSLLC.COM