June 14, 2013

Economics Group

Special Commentary

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Housing Chartbook: May 2013

Separating the Fluff from the Fundamentals

We have consistently maintained a cautious view on the housing recovery, even as home prices have raced upward. Our caution stems from our focus on the underlying fundamentals for housing demand, which have improved much less than prices. We remain skeptical of the sustainability of recent price gains, as they are against relatively weak year-ago numbers and have been helped along by an influx of investor purchases. Demand for mortgages for the purchase of a home is improving but much more modestly than prices, and that improvement will be tested by the recent rise in mortgage rates. The homeownership rate also continues to decline, as foreclosures reduce the number of potential homeowners and a large proportion of millennials, many of which are saddled with significant student loan debt, delay forming families and rent for longer periods of time. Ultimately, a sustainable recovery in housing will require more homeowners, which implies a steady or rising homeownership rate. We are not there yet.

We remain skeptical of the sustainability of recent price gains.

Real GDP growth has averaged just a 2.1 percent pace since the recession ended four years ago, and our forecast calls for growth to gradually ramp up to just under a 2.5 percent pace over the next couple of years. Growth along such modest lines is unlikely to produce a change in homeownership trends. Moreover, while economic growth is too weak to promote significant gains in homeownership, conditions are strong enough to nudge the Fed toward winding down, or tapering, its securities purchases, which has already sent long-term interest rates higher.

The larger role that investors are playing makes even a modest rise in interest rates more troublesome because the spread between returns on owning rental properties and lower-risk investments narrows. The good news, however, is that the fundamentals are improving. There is more to the housing recovery than just the spike in home prices. Significant progress has been made at reducing the backlog of foreclosed properties, and the pipeline of future foreclosures has also slowed considerably. Fewer mortgages are also underwater, which is allowing more homeowners to put their homes on the market, helping revive the trade-up market.

Figure 1

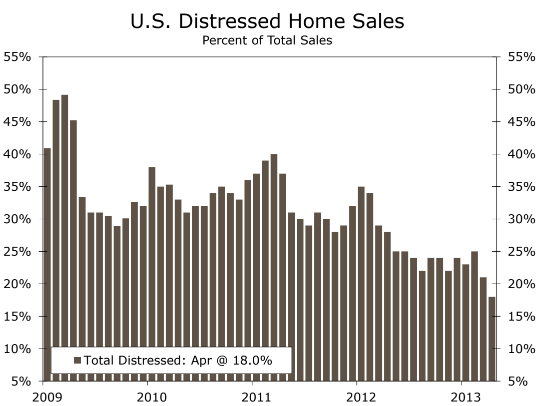
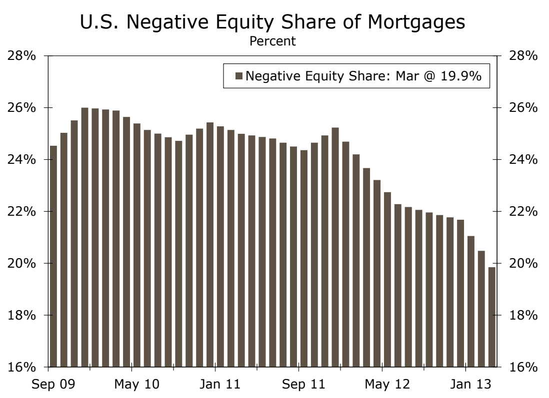


Figure 2



Source: National Association of Realtors, CoreLogic and Wells Fargo Securities, LLC

Together we'll go far

This report is available on wellsfargo.com/economics and on Bloomberg WFRE

Fundamental, Albeit Incremental, Improvement Across the Board

The recent acceleration in job growth has further raised expectations that the recovery is gaining momentum and raising hopes for larger gains in home sales and new home construction. Our employment outlook has increased modestly, reflecting the addition of an average of 189,200 jobs per month so far this year. While we have become more constructive on the employment outlook, we remain concerned about the quality of jobs, which has been heavily weighted toward lower-paying occupations. The initially reported jobs data are often misleading, however, and tend to miss shifts in underlying momentum. That momentum now appears to be to the upside, given recent upbeat reports on consumer confidence, weekly first-time unemployment claims, hiring surveys and anecdotal reports from realtors, builders and closing attorneys. So the employment numbers may actually be better than they currently appear. We are not simply acquiescing to the recent tide of good news but rather sticking with our previous forecast, which might otherwise have been downgraded given the relatively soft numbers on home sales and housing starts that were evident even before the recent jump in mortgage rates.

Momentum now appears to be to the upside.

Due to the much larger-than-usual decline in housing activity during the recession, seasonal adjustment has tended to exaggerate some of the swings in sales and new construction during the recovery. We feel that the best gauge to assess the housing market is to look at the year-to-year change of the non-seasonally adjusted year-to-date data. Through the first four months of this year, existing home sales have totaled 1.44 million homes and are running 4.8 percent above their year-ago pace. Sales of single-family homes are up 8.8 percent, while sales of condos and co-ops are up 18.0 percent. Data on prices and homes are a bit more difficult to interpret because there have been far fewer distressed transactions this year, which has biased the numbers to the upside. Inventories have been exceptionally low and have only recently given signs of improving. At the current sales pace, there is just a 5.2-month supply of homes on the market, which is down from 6.6 months one year ago.

Tight inventories of new and existing homes set the stage for even stronger gains in new home construction later this year.

Sales of new single-family homes through the first four months of this year are running 26.8 percent ahead of their year-ago pace, with the strongest gains coming in the West. Inventories of new homes also remain exceptionally lean at around a 4-month supply. Tight inventories of new and existing homes set the stage for even stronger gains in new home construction later this year. Single-family starts are running closely in line with sales, with starts through April rising 26.9 percent from their year-ago pace. Single-family permits are running a bit stronger than starts and are up 27.9 percent ahead of their year-ago pace, suggesting that starts will rebound in the coming months. Multifamily starts are up more solidly, climbing 33.6 percent from their year-ago pace during the first four months of the year. Our forecast assumes some additional improvement in new home sales and new single-family home construction, reflecting stronger job and income growth and a modest increase in mortgage rates. Rising mortgage rates should not present a major impediment to the housing recovery unless rates rise much more than we currently expect.

Figure 3

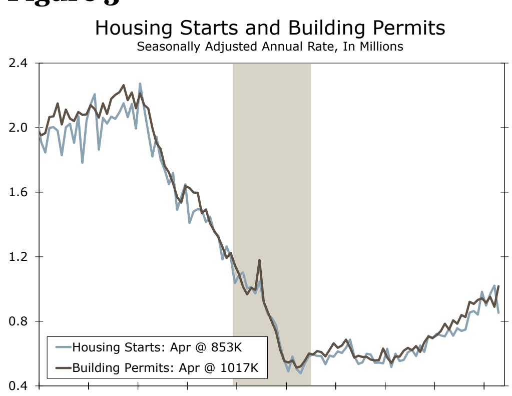
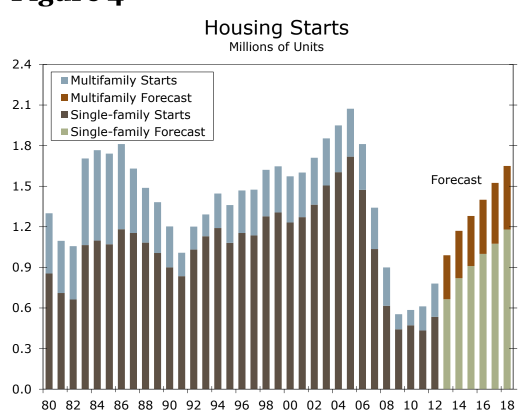


Figure 4



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

National Housing Outlook

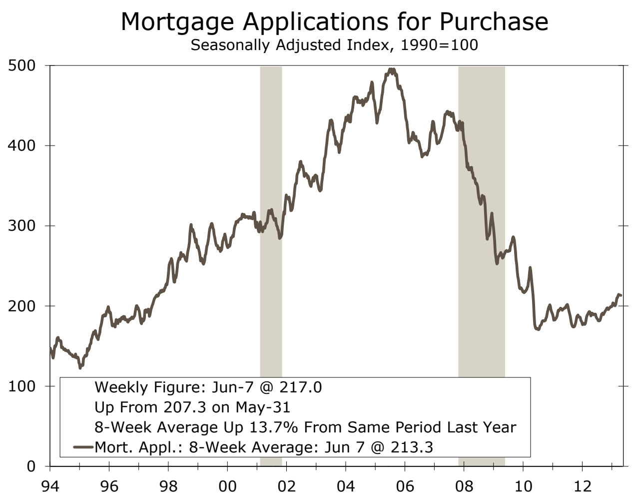
						Forecast	
	2008	2009	2010	2011	2012	2013	2014
Real GDP, percent change	-0.3	-3.1	2.4	1.8	2.2	1.8	2.1
Nonfarm Employment, percent change	-0.6	-4.4	-0.7	1.2	1.7	1.7	1.8
Unemployment Rate	5.8	9.3	9.6	8.9	8.1	7.6	7.3
Home Construction							
Total Housing Starts, in thousands	905.5	553.9	586.9	608.8	780.6	990.0	1,170.0
Single-Family Starts, in thousands	622.0	445.0	471.1	430.5	535.3	665.0	820.0
Multifamily Starts, in thousands	283.5	108.9	115.8	178.3	245.3	325.0	350.0
Home Sales							
New Home Sales, Single-Family, in thousands	485.0	374.0	323.0	306.0	367.0	470.0	550.0
Total Existing Home Sales, in thousands	4,110.0	4,340.0	4,190.0	4,260.0	4,650.0	4,990.0	5,200.0
Existing Single-Family Home Sales, in thousands	3,660.0	3,870.0	3,708.0	3,787.0	4,127.0	4,440.0	4,640.0
Existing Condominium & Townhouse Sales, in thousands	450.0	464.0	474.0	477.0	528.0	550.0	560.0
Home Prices							
Median New Home, $ Thousands	232.1	216.7	221.8	227.2	243.6	265.0	270.0
Percent Change	-6.4	-6.6	2.4	2.4	7.2	8.8	1.9
Median Existing Home, $ Thousands	198.1	172.5	172.9	166.1	176.6	186.0	190.0
Percent Change	-9.5	-12.9	0.2	-3.9	6.3	5.3	2.2
FHFA (OFHEO) Home Price Index (Purch Only), Pct Chg	-7.7	-5.5	-3.0	-4.2	3.5	6.4	2.7
Case-Shiller C-10 Home Price Index, Percent Change	-16.7	-12.9	2.1	-3.5	0.3	6.3	2.7
Interest Rates - Annual Averages							
Prime Rate	4.88	3.25	3.25	3.25	3.25	3.25	3.25
Ten-Year Treasury Note	3.66	3.26	3.22	2.78	1.80	2.18	2.53
Conventional 30-Year Fixed Rate, Commitment Rate	6.04	5.04	4.69	4.46	3.66	3.93	4.30
One-Year ARM, Effective Rate, Commitment Rate	5.18	4.71	3.78	3.00	2.70	2.80	3.10

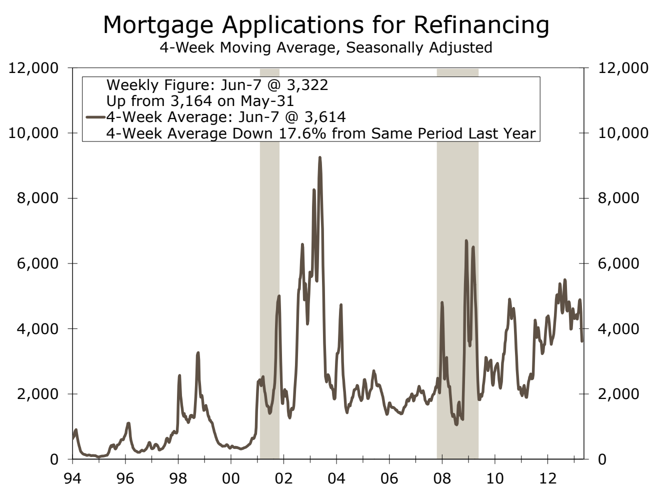
Forecast as of: June 14, 2013

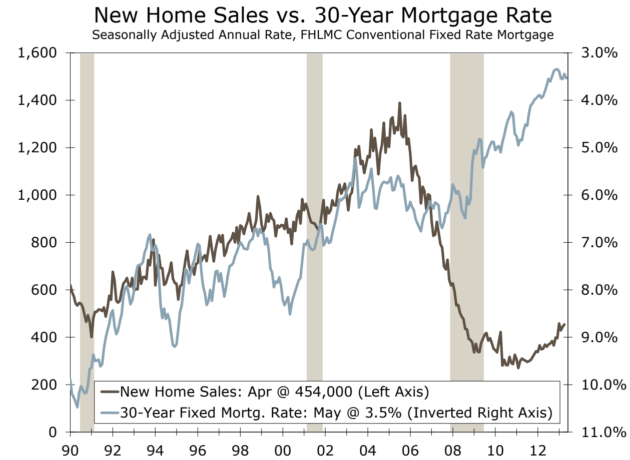
Source: Federal Reserve Board, FHFA, MBA, NAR, S&P, U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities, LLC

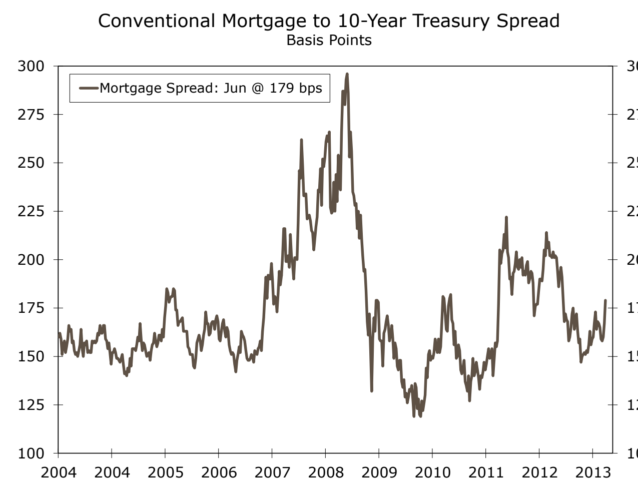
Mortgages

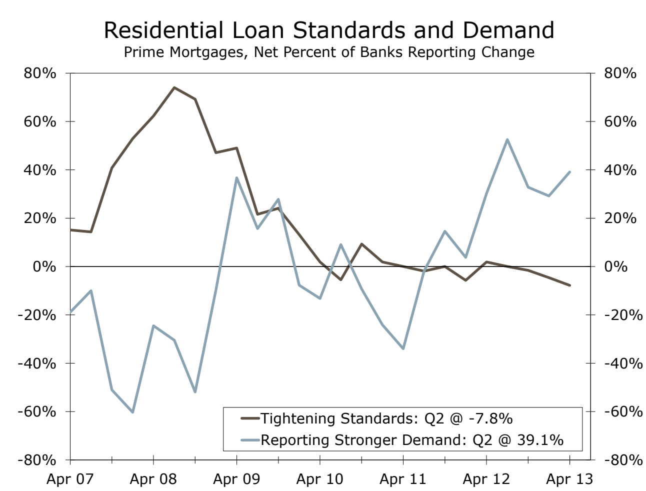
- Over the past five weeks, the 30-year mortgage rate increased nearly 50 basis points and is quickly approaching 4 percent. With mortgage rates inching higher, refinance activity has fallen sharply. The four-week moving average dropped nearly 23 percent in the past three weeks. Purchase activity, however, has held up relatively well.
- Higher mortgage rates make it tougher for first-time homebuyers and renters to enter the housing market. In fact, research done by the National Association of Realtors show that even a simple 20 basis point increase from a mortgage rate of 3.8 percent to 4 percent would prevent nearly 500,000 renter-households from qualifying for a mortgage. A rate increase to 5 percent would cause nearly 2 million fewer potential renter-households from qualifying for a mortgage.







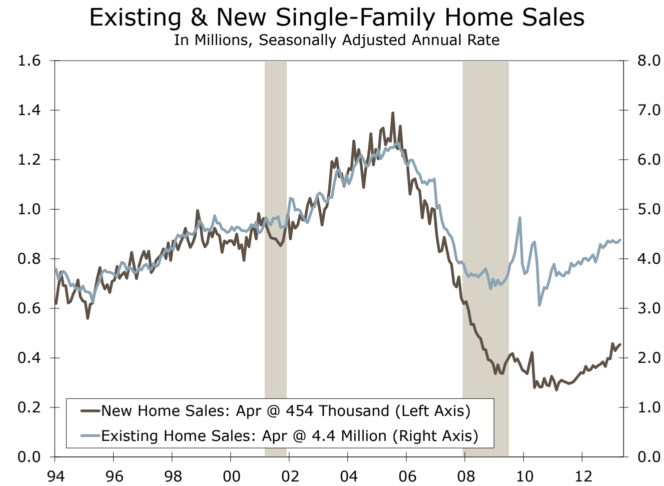


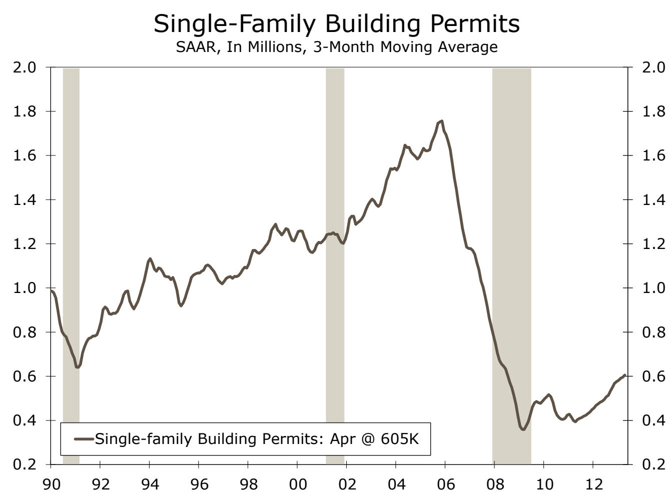


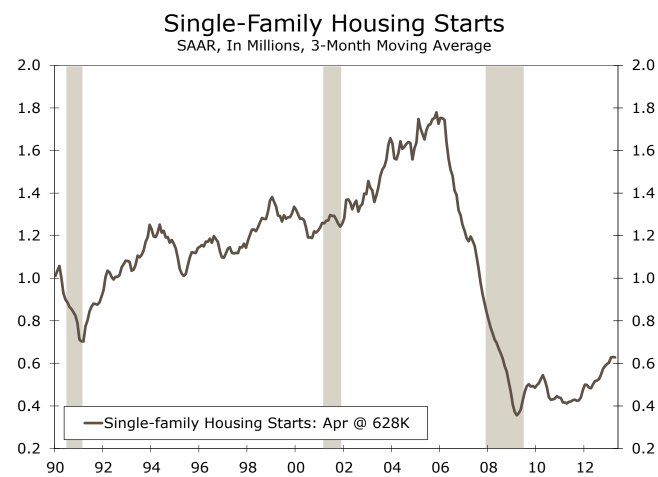
Source: Mortgage Bankers Association, FHLMC, U.S. Department of Commerce, Federal Reserve and Wells Fargo Securities, LLC

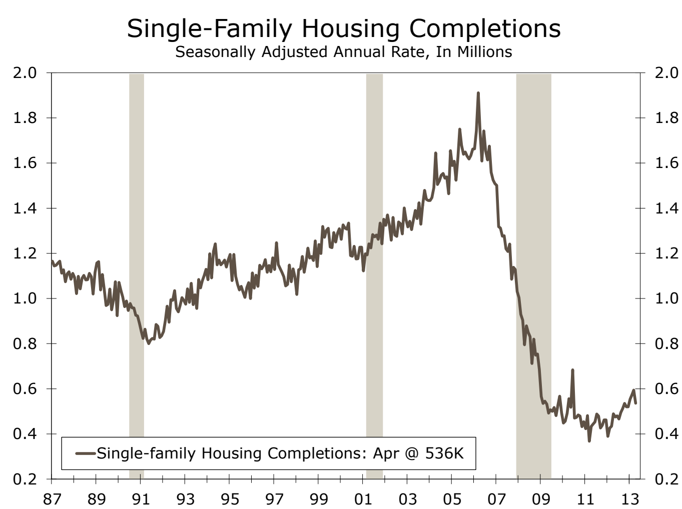
Single-Family Construction

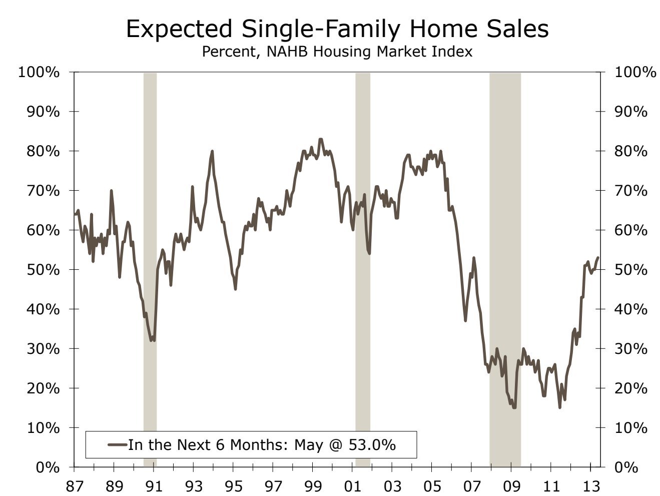
- Construction of single-family homes slowed in April despite large price gains reported nationwide. Single-family starts fell for the second consecutive month in April but remain up nearly 21 percent on a year-over-year basis. A moderate slowdown in starts was not entirely unexpected, as starts had been running ahead of permits.
- Permits data for April suggests that this slowdown is only temporary, as permits rose 3 percent to the highest level since May 2008. We should see these permits translate into higher starts numbers in the coming months.
- Builder confidence improved in May, but remains below the breakeven 50 level. Present sales and expectations for future sales both improved.









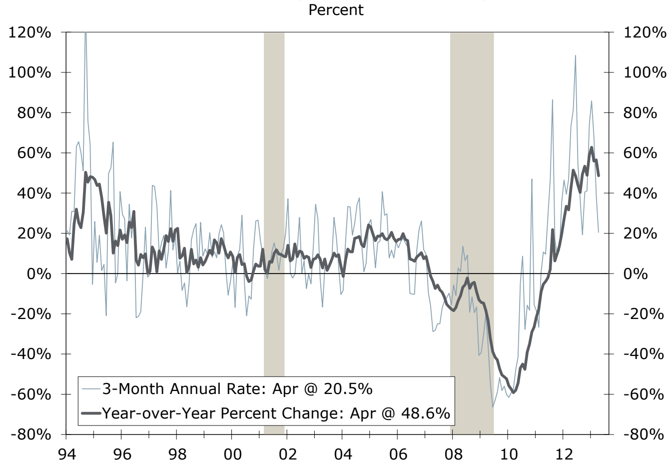


Source: U.S. Dept. of Commerce, National Association of Realtors, NAHB and Wells Fargo Securities, LLC

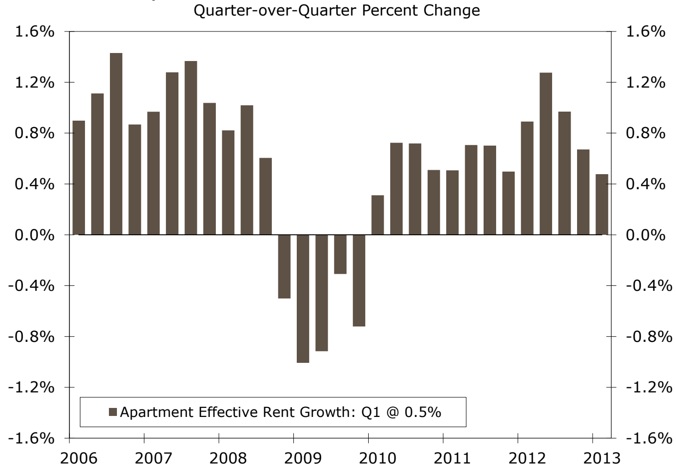
Multifamily Construction

- After surging more than 25 percent in March, multifamily starts declined nearly 40 percent in April. Some of this decline is likely some payback for the prior month's outsized gain, as this series commonly exhibits high volatility.
- In contrast, multifamily permits rose 34 percent, to the highest level in over 5 years. Thus, we suspect the brief slowdown in starts was a temporary blip likely to reverse itself in the coming months.
- Apartments continue to show profound strength in this recovery, although the rapid pace of this market is likely to normalize somewhat later on this year and into 2014. Vacancy rates are at record lows, allowing landlords to consistently raise prices without any slowdown in demand. As apartment prices continue to rise, renters will likely look to single-family homes, providing much needed support to this market.

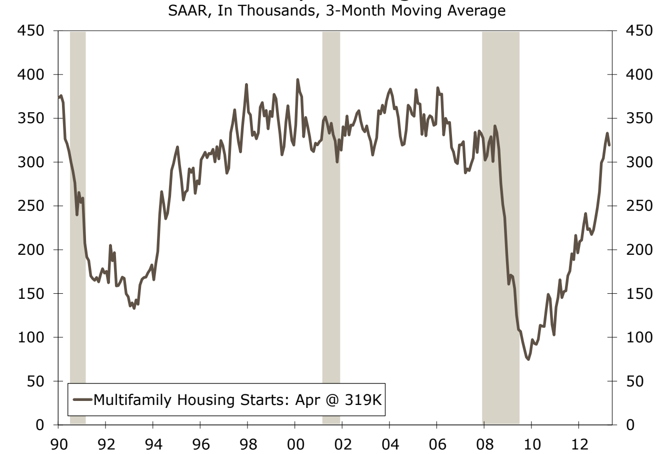
Private Multifamily Construction Spending
Percent



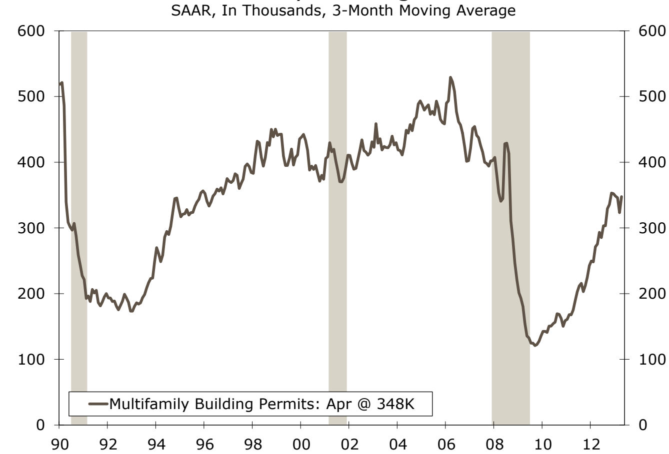
Apartment Effective Rent Growth
Quarter-over-Quarter Percent Change



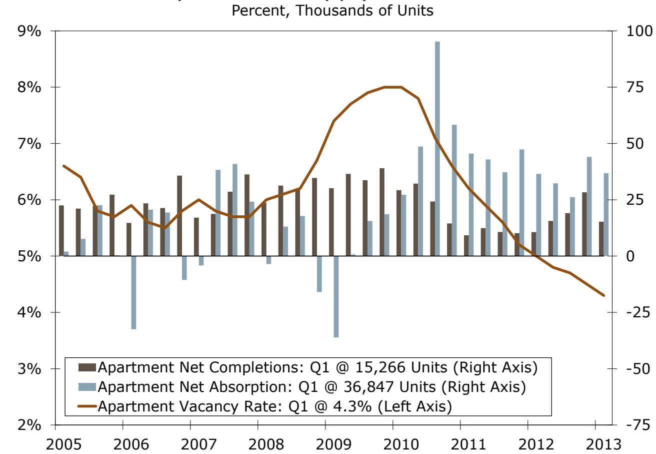
Multifamily Housing Starts
SAAR, In Thousands, 3-Month Moving Average



Multifamily Building Permits
SAAR, In Thousands, 3-Month Moving Average



Apartment Supply & Demand
Percent, Thousands of Units

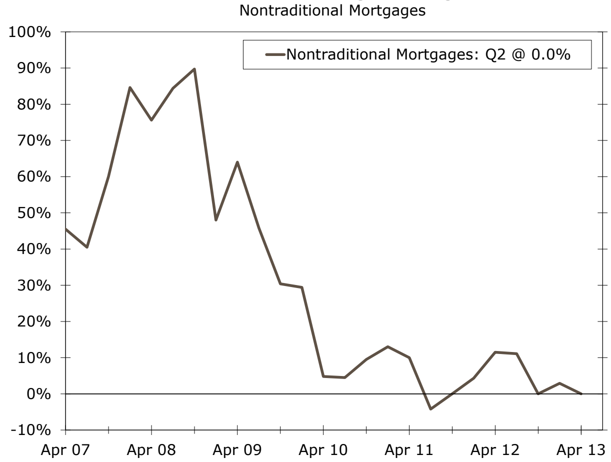


Source: U.S. Department of Commerce, REIS Inc. and Wells Fargo Securities, LLC

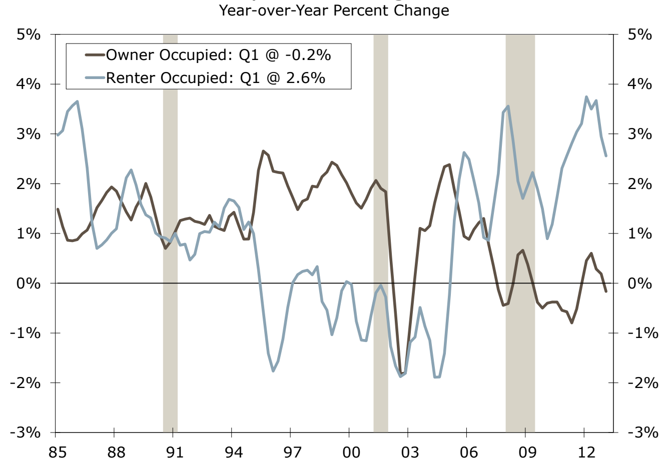
Buying Conditions

- Rising home prices and higher mortgage rates pulled the affordability index down to its lowest level in seven months in March. That said, repeat sales and median home prices remain below the pre-recession peak and interest rates are still at historic lows. While buying conditions remain favorable, much of the sales activity is being led by move-up buyers in the new home space who are seeking larger, more expensive properties.
- According to the latest Senior Loan Officer Survey, few banks reported any change in lending standards or demand for residential real estate. With lending standards still tight, first-time home buyers are being shut of the market. With first-time home buyers on the sidelines, the rental market continues to see solid gains. According to the National Association of Realtors, first-time homebuyers accounted for only 29 percent of sales in April, which remains below the average of 40 percent.

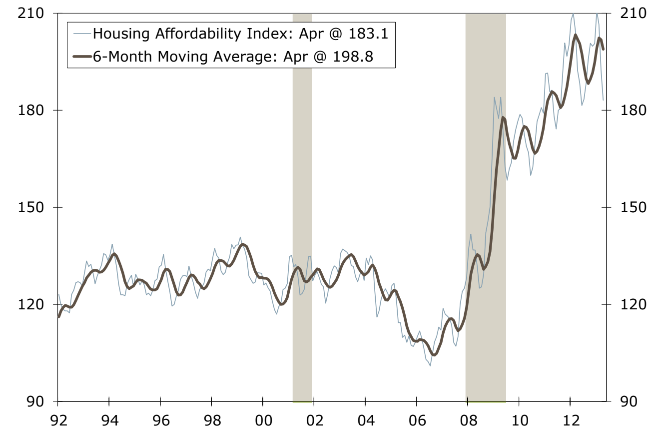
Net Percent of Banks Tightening Standards
Nontraditional Mortgages



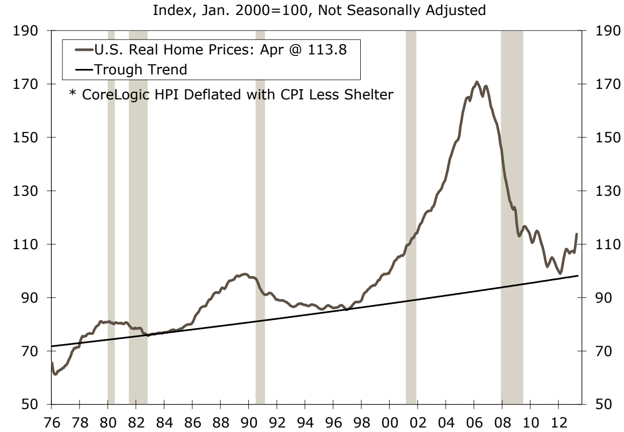
Occupied Housing Units
Year-over-Year Percent Change



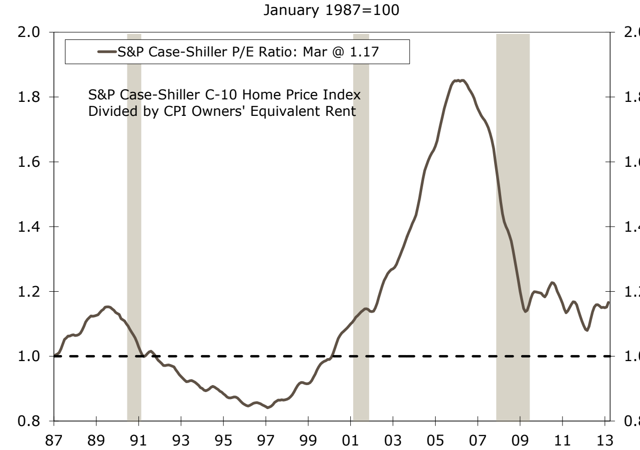
Housing Affordability, NAR-Home Sales
Base = 100



U.S. Real Home Prices
Index, Jan. 2000=100, Not Seasonally Adjusted



S&P Case-Shiller Home Price Index P/E Ratio
January 1987=100

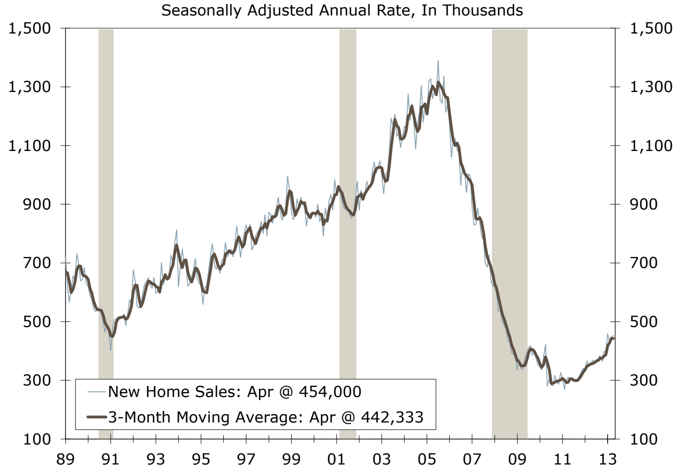


Source: CoreLogic, S&P, Federal Reserve, NAR, U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities, LLC

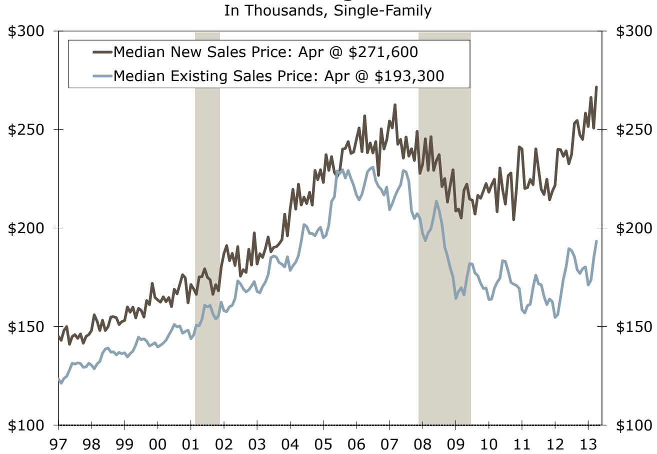
New Home Sales

- New home sales posted their second consecutive monthly gain in April, rising to a 454,000-unit annualized pace. The bulk of the rise was concentrated in the South and the West, which are also areas where we have seen some of the strongest recoveries. Sales in the South are now at their highest annualized pace since September 2008.
- Median and average new home prices rose solidly in April and are now at a record-high level. The jump in prices is mainly attributable to the increase in homes sold above $300,000. The number of homes sold below the $300,000-mark actually fell on the month. This occurrence highlights the inconsistency of this recovery, in which a portion of economic gains are concentrated at the high end, among wealthier individuals. Rising mortgage rates may change this mix and slow the rise in price measures.

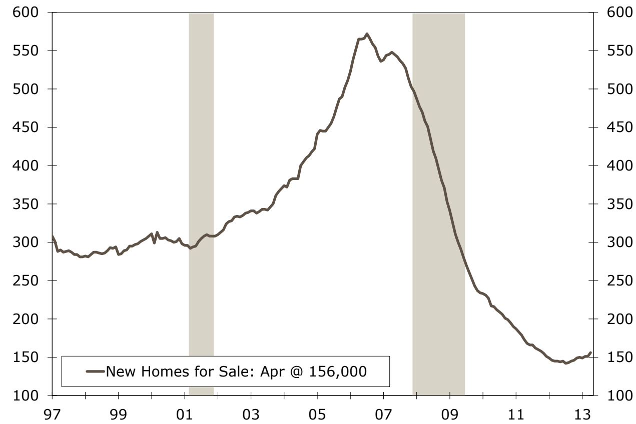
New Home Sales
Seasonally Adjusted Annual Rate, In Thousands



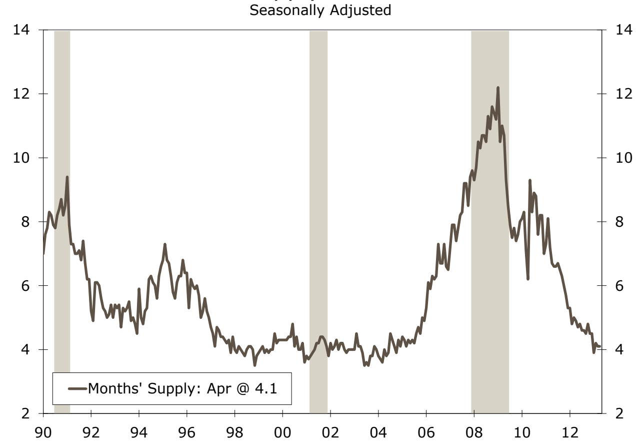
Median New & Existing Home Sale Prices
In Thousands, Single-Family



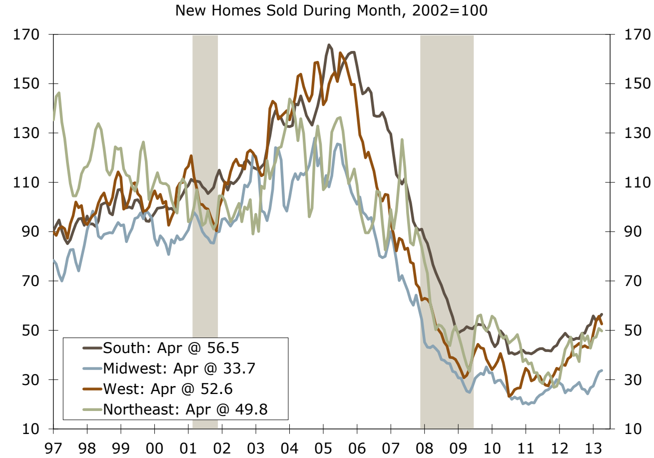
Inventory of New Homes for Sale
New Homes for Sale at End of Month, In Thousands



Months' Supply of New Homes
Seasonally Adjusted



New Home Sales
New Homes Sold During Month, 2002=100

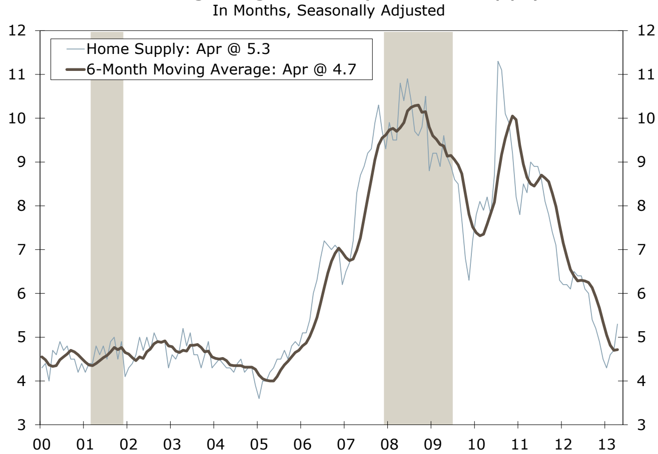


Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities, LLC

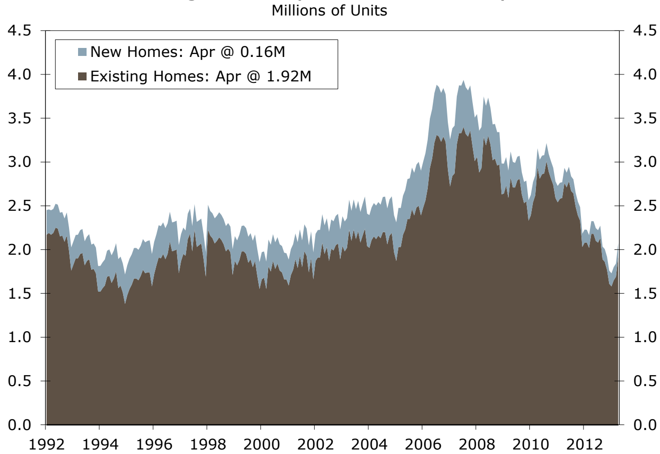
Existing Home Sales

- Existing home sales rose slightly in April to a 4.97 million-unit annualized pace, reflecting the moderate pace of improvement in the housing market recovery.
- The recovery has been uneven across the nation, as Sunbelt states, particularly in the South, have outperformed the nation. The South was the only region to report improved sales in April.
- Reflecting price appreciation and improved confidence, inventory levels jumped nearly 12 percent in April. Inventory levels bottomed at 1.77 million homes in January and have increased every month since then. This steady increase may partially reflect homeowners bringing their homes onto the market that had previously kept their homes off the market due to extraordinarily depressed prices.

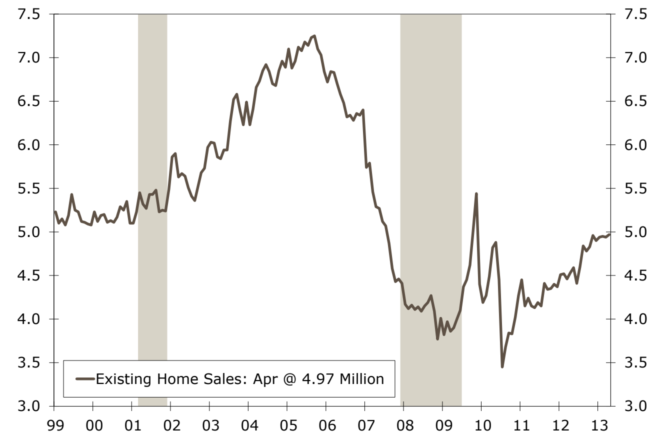
Existing Single-Family Home Supply
In Months, Seasonally Adjusted



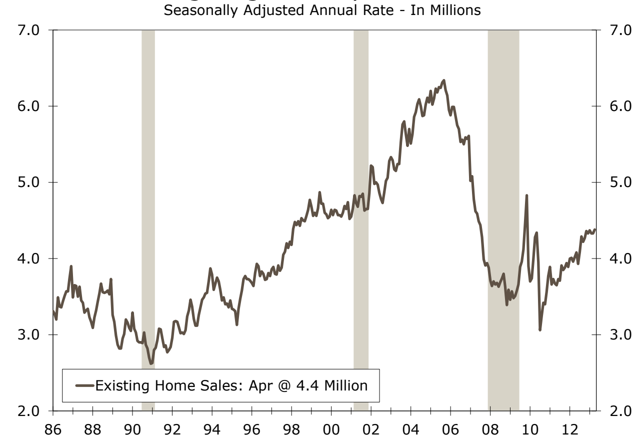
Single-Family Home Inventory
Millions of Units



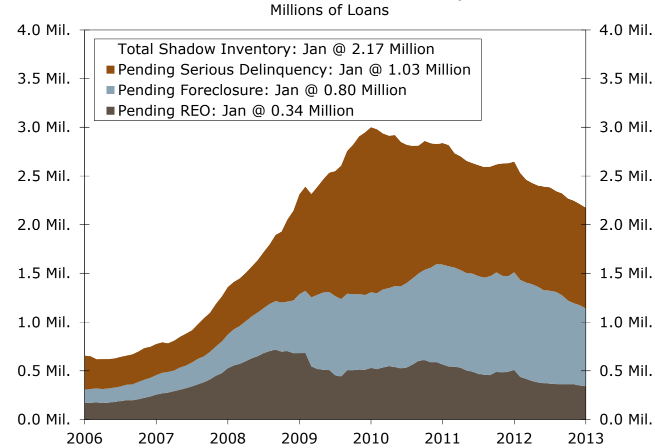
Existing Home Resales
Seasonally Adjusted Annual Rate - In Millions



Existing Single-Family Home Resales
Seasonally Adjusted Annual Rate - In Millions



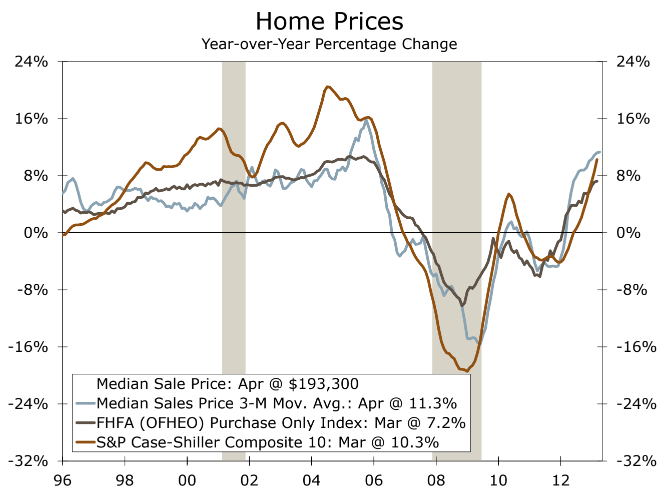
Total Shadow Inventory
Millions of Loans

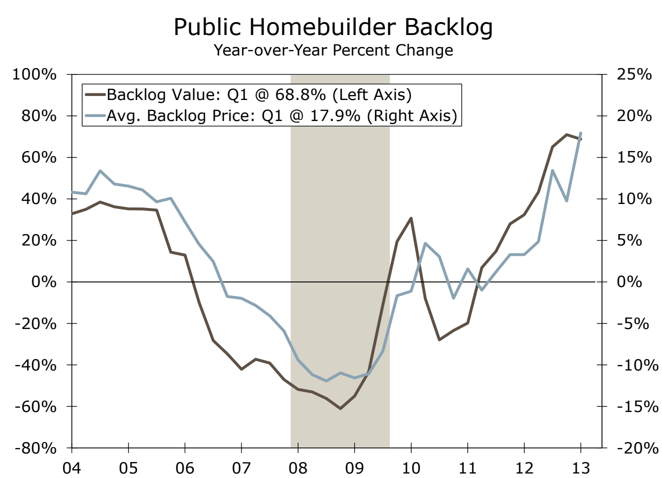


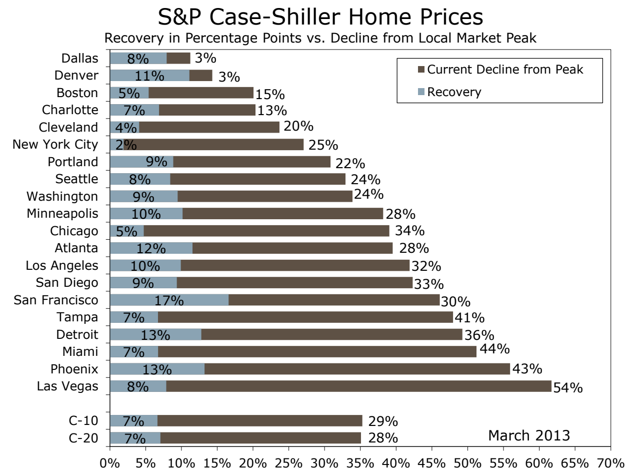
Source: National Association of Realtors, U.S. Department of Commerce, CoreLogic and Wells Fargo Securities, LLC

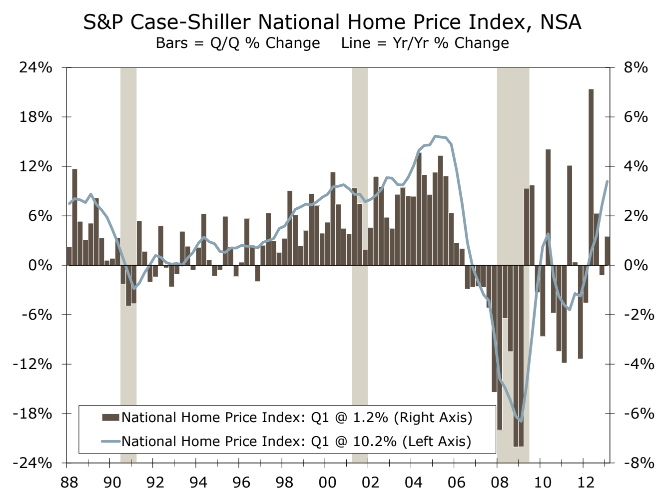
Home Prices

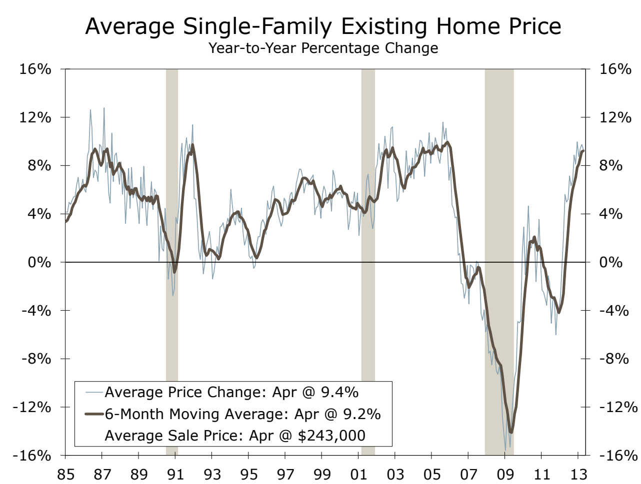
- The Fed's quantitative easing, limited inventory and increased demand continues to push up prices of new and existing homes. The changing mix of sales has also boosted prices, with foreclosures down 16 percent over the past year, according to Corelogic. Much of the remaining foreclosure backlog remains in hard hit markets, with Florida and California accounting for 25 percent of the total.
- Tight inventories have led to bidding wars for homes outside the foreclosure process while rising backlogs at homebuilders have restrained supply. According to Bloomberg, the backlog value rose to its highest level in over two years and the average price of a backlogged home at public builders is up 18 percent from last year. Increased construction and rising mortgages rates should ultimately curb those gains.







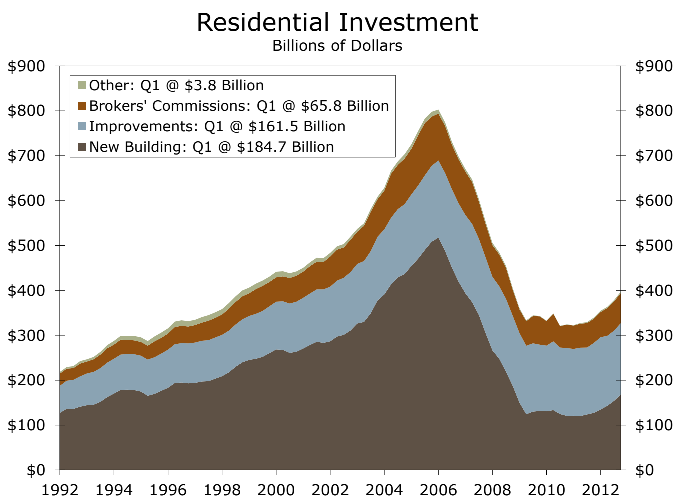


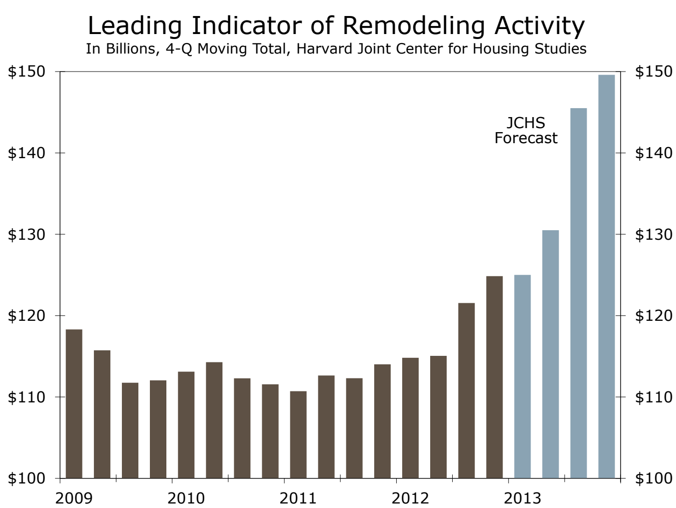


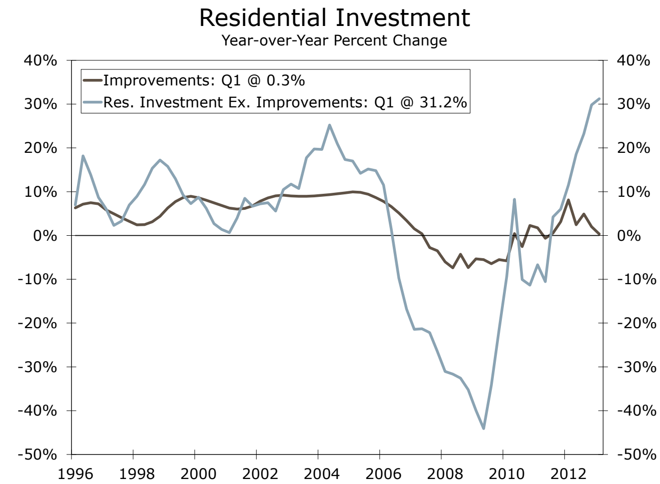
Source: CoreLogic, NAR, S&P, FHFA, U.S. Department of Commerce and Wells Fargo Securities, LLC

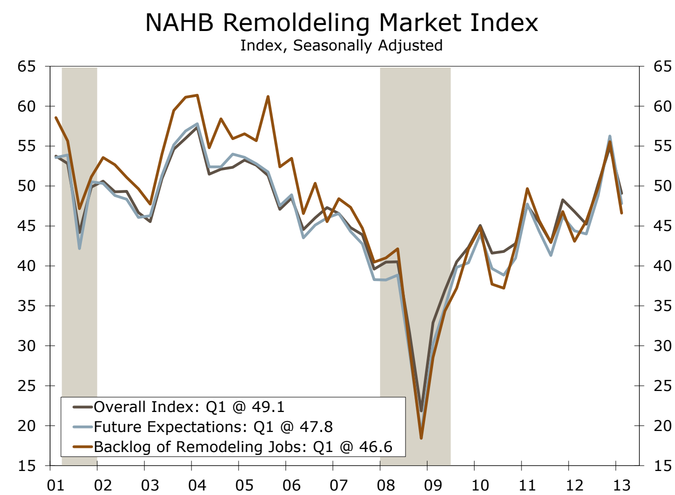
Renovation and Remodeling

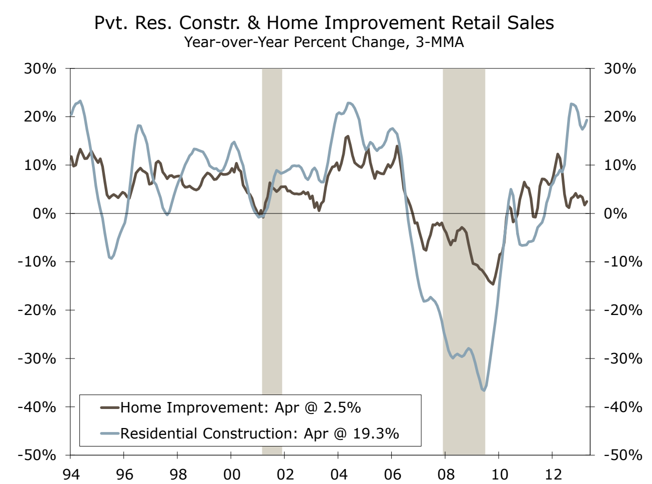
- Reflecting concerns about the rising costs of construction materials and labor, the Remodeling Market index (RMI) dipped just below the key threshold where more remodelers are reporting less market activity than more. Much of the weakness in the RMI was in the future market component suggesting home improvement spending could stall in the coming quarters.
- The Leading Indicator of Remodeling Activity (LIRA) suggests spending on home improvements is headed higher. Much of the upward momentum has been due to rising investor purchases of distressed properties, many of which are being converted into rental units. Rising home prices have also reduced the number of homeowners with negative equity, which had been a huge drag on remodeling activity.







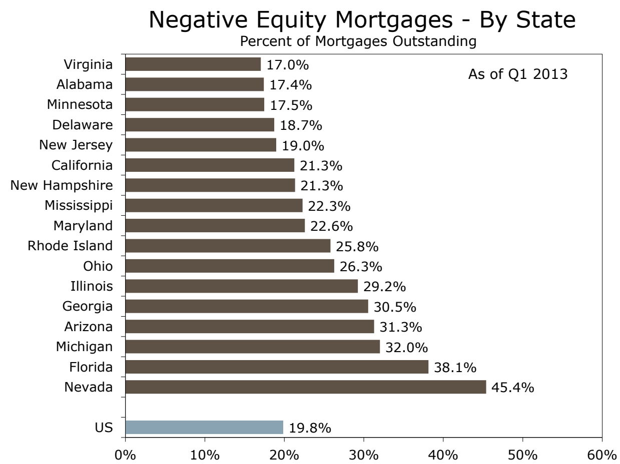


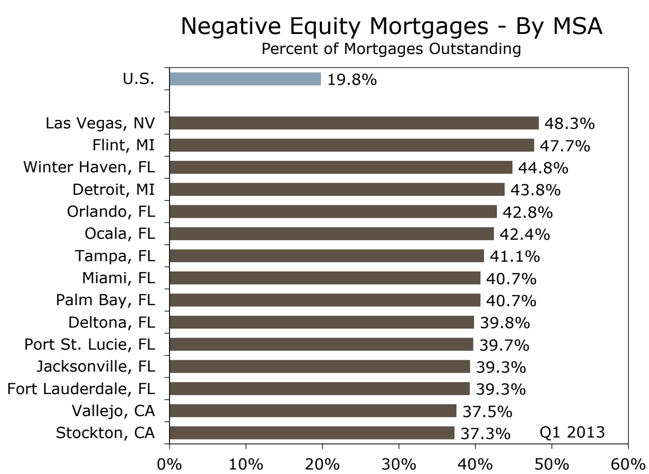


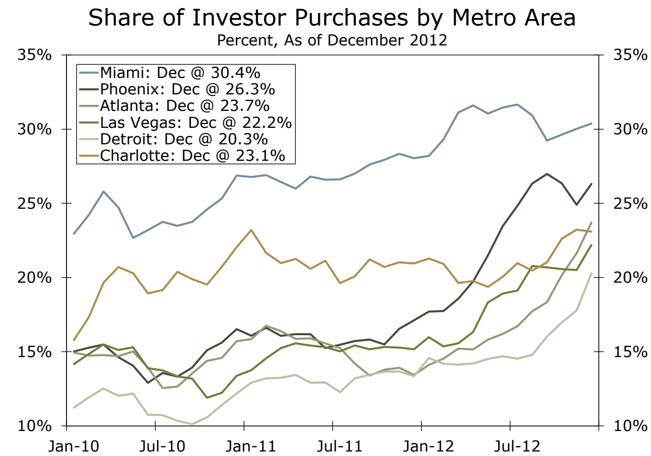
Source: Joint Center for Housing Studies, U.S. Department of Commerce, NAHB and Wells Fargo Securities, LLC

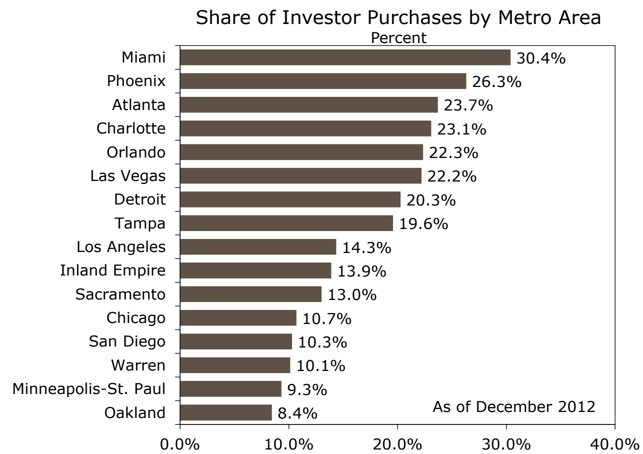
Regional Housing Trends

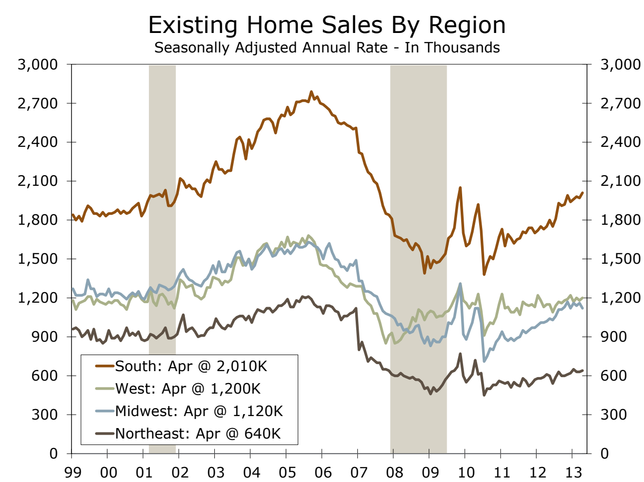
- Home prices have risen nationwide, with the West leading the way. In Western states including hard hit Nevada, California and Arizona, institutional buyers and limited inventory have helped boost prices. Existing median home prices in the West rose 17.5 percent in April, while other regions posted more modest gains. We suspect that price gains should slow as rising prices and higher mortgage rates calm the investor buying spree and more inventory comes on line.
- The South posted the largest regional gain in existing home sales, with sales up nearly 15 percent in April. Stronger population growth is helping fuel the rise. Residents continue to be attracted by low home prices. The median home price in the South is $168,700, compared to $245,100 in the Northeast.











Source: U.S. Department of Commerce, CoreLogic and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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