

Economics Group

Special Commentary

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Housing Chartbook: October 2009

Housing Still Faces Significant Hurdles in Coming Months

A small but steady improvement in new home sales and single-family home construction, combined with reports that home prices are actually rising in many markets, has raised hopes that the housing market has finally bottomed. Much of the good news we have seen in the housing sector has been the result of some sort of temporary government action, such as the \$8,000 tax credit for first-time homebuyers and the efforts by various governments, agencies and financial institutions to stem the tide of mortgage foreclosures. Lenders have also held some foreclosed properties off the market, which has resulted in fewer foreclosure sales and higher average and median sales prices.

While the numbers look a little better, the fundamentals for the housing sector remain extremely challenging. The overall market still remains oversupplied by close to two million units and potential buyers are being held back by concerns about employment and income prospects. Demand is not likely to pick up until the unemployment rate stops rising, which will be around the middle of next year at the earliest. Credit remains harder to qualify for, and appraisals are much more conservative today, to say the least. None of this is likely to change until the broader economy strengthens, which we believe will be in the second half of next year.

The number one immediate worry is what happens to housing demand once the first-time homebuyer tax credit expires. To qualify for the tax credit, buyers must close on their purchase by November 30. As most homes take more than 90 days to build, housing starts have already likely seen all of the lift they will get from the tax credit. New home sales may see some residual strength in September, as activity did not seem to fall off nearly as much as it usually does that month. Existing home sales, which are counted at the time of closing, should get a lift right through November, which is normally a very weak month for home sales. Existing sales could very easily spike on a seasonally adjusted basis, as buyers pull closings forward to take advantage of the tax credit. That would set things up for a huge payback in December and early 2010.

The number one immediate worry is what happens to housing demand once the first-time homebuyer tax credit expires.

There is a great deal of discussion under way to expand and extend the first-time homebuyer tax credit. While the program is politically popular and Congress has the ability to react quickly when motivated properly, there is a good chance the program will not be extended immediately and may not be extended at all. Even if the program were to be extended, we believe the results would be less than expected. Employment conditions are considerably weaker today than they were when the tax incentives were enacted, and many of the most likely buyers targeted have already taken advantage of the program. There is also the moral dilemma of possibly weakening any other type of future stimulus. The two key elements of stimulus programs are that the stimulus itself is targeted and temporary. Once programs start being extended, future stimulus moves may not attract as many takers as it would have in the past.

In the end, we do not see the extension of the first-time homebuyer tax credit as influencing the ultimate timing of a sustainable recovery in the housing market. The demand for new and existing homes will not pick up on a sustainable basis until job and employment conditions improve.

Together we'll go far



While this may technically begin to happen as soon as the middle of next year, we do not believe employment conditions will improve enough to generate a strong and sustainable recovery in home sales until spring 2011. There are simply too many households experiencing extreme financial stress to allow the conditions necessary for a stronger recovery to take hold. We expect the unemployment rate to rise to around 10.5 percent by about the middle of next year. But even that number understates the stress many households are experiencing. Many of the unemployed have been without a job for six months or more, which means their household finances will need considerable time to heal, which will restrain household growth and mobility.

Home sales are expected to decline slightly late this year and in early 2010, reflecting a modest payback following the expiration of the first-time homebuyer tax credit. Sales are then expected to rebound to their preexisting run rate by spring. If the tax credit is extended, the decline would likely be moderated somewhat and the rebound might be slightly more pronounced. We look for a more substantial improvement in sales to take place in 2011 and for sales momentum to gradually build up during that year.

Prices for existing homes are expected to decline further during the coming year, but there are a number of cross currents that may lead to seemingly contradictory price movements. The expiration of the first-time homebuyer tax credit will reduce the share of lower priced homes in the monthly sales figures, which should result in higher average and median sales prices. We also expect to see some modest improvement in the sales of higher-priced homes, reflecting the bounce back in the equity markets and more attractive financing options on jumbo loans. An increase in the sales of higher-priced homes would also push up the average and median prices. These gains, however, should be at least partially offset by a rising volume of foreclosure sales.

Foreclosure sales should pick back up during the coming year. A large proportion of the mortgage modifications that have been made in recent years have become delinquent in a relatively short period of time. The likely culprit is the unusually large number of people out of work for six months or more and the large number of folks working fewer hours and receiving less pay, commissions and bonuses.

The repeat sales index, particularly the Case-Shiller, should see slightly larger price declines, particularly once the sales of higher-priced homes increase. The higher end of the market has been moribund for the past year, and price discovery will not occur until a significant number of transactions take place. We still see housing prices bottoming out in nearly every price measure during the coming year, and the major home price indices should post modest gains in 2011.

Figure 1

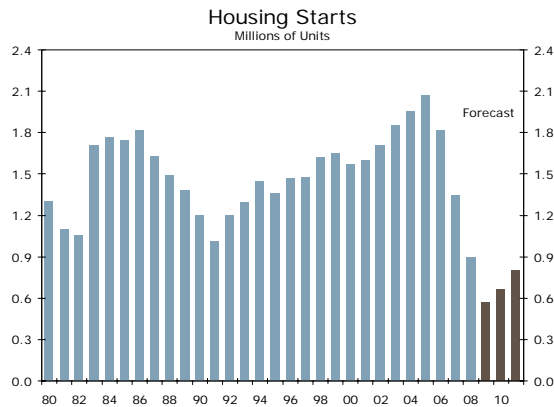
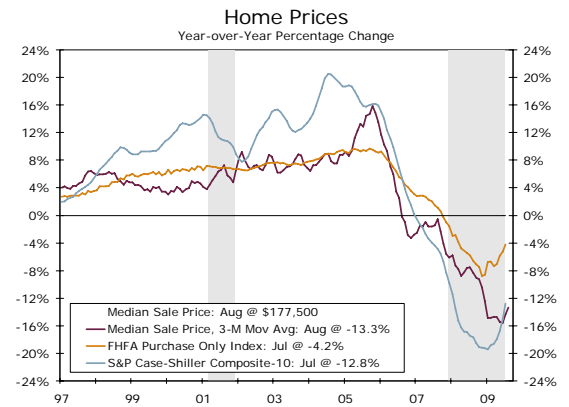


Figure 2



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

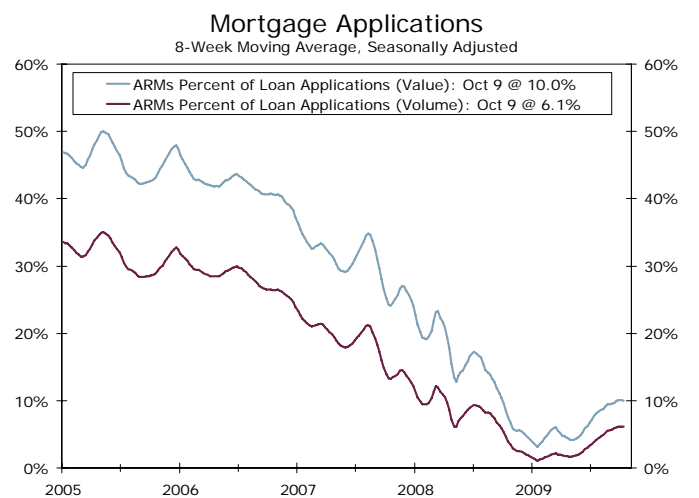
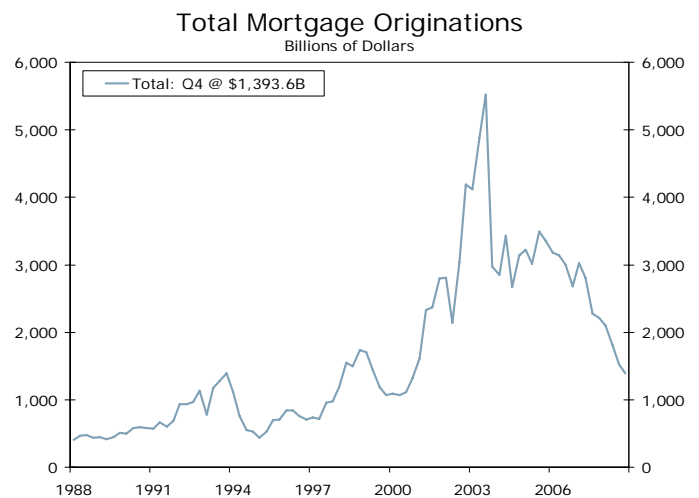
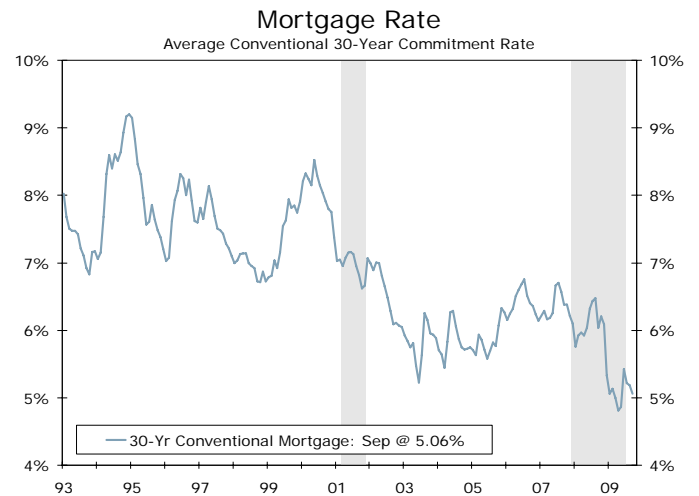
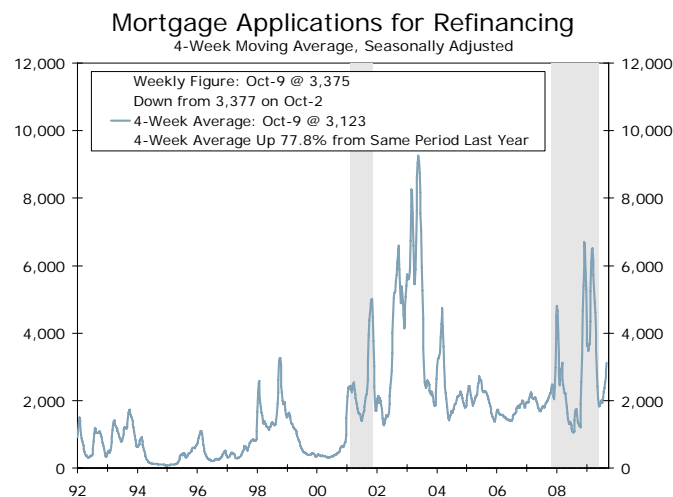
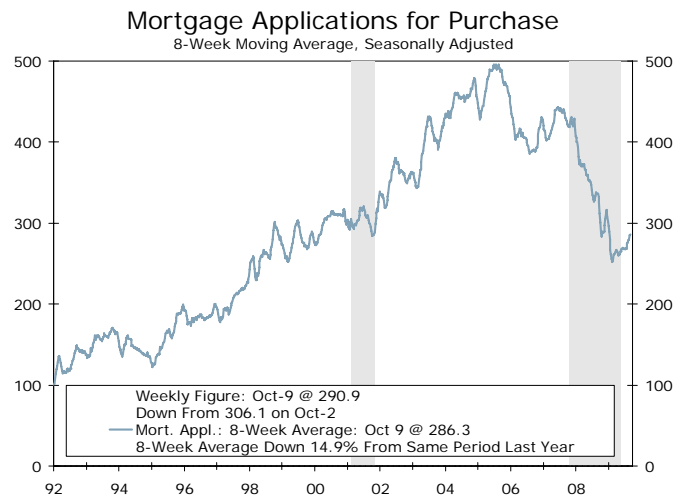
National Economic & Financial Outlook

	Actual			Forecast			
	2005	2006	2007	2008	2009	2010	2011
Real GDP, percent change	3.1	2.7	2.1	0.4	-2.4	2.4	2.2
Nonfarm Employment, percent change	1.7	1.8	1.1	-0.4	-3.8	-1.6	0.9
Unemployment Rate	5.1	4.6	4.6	5.8	9.2	10.4	9.9
Home Construction							
Total Housing Starts, in thousands	2072.9	1811.9	1341.8	900.3	570.0	660.0	800.0
Single-Family Starts, in thousands	1718.5	1473.6	1035.8	615.8	430.0	510.0	620.0
Multi-Family Starts, in thousands	354.4	338.3	306.1	284.5	140.0	150.0	180.0
Home Sales							
New Home Sales, Single-Family, in thousands	1278.9	1049.3	768.7	481.3	390.0	450.0	540.0
Total Existing Home Sales, in thousands	7075.7	6517.6	5673.8	4893.8	4942.5	5230.0	5670.0
Existing Single-Family Home Sales, in thousands	6180.8	5711.7	4960.0	4340.8	4380.0	4600.0	5000.0
Existing Condominium & Townhouse Sales, in thousands	894.8	805.9	713.8	553.0	562.5	630.0	670.0
Home Prices							
Median New Home, \$ Thousands	234.2	243.1	243.7	230.4	206.4	207.3	212.1
Percent Change	7.5	3.8	0.3	-5.5	-10.4	0.5	2.3
Median Existing Home, \$ Thousands	217.5	221.9	215.5	195.8	174.0	171.0	174.2
Percent Change	12.8	2.0	-2.9	-9.2	-11.1	-1.7	1.9
FHFA (OFHEO) Home Price Index, Percent Change	11.4	7.4	2.0	-2.6	-3.8	-0.4	1.1
Case-Shiller C-10 Home Price Index, Percent Change	16.9	7.4	-4.4	-16.7	-14.8	-2.1	1.8
Interest Rates - Annual Averages							
Prime Rate	6.19	7.96	8.05	5.08	3.25	3.50	5.50
Ten-Year Treasury Note	4.29	4.80	4.63	3.66	3.20	3.70	4.20
Conventional 30-Year Fixed Rate, Commitment Rate	5.87	6.41	6.34	6.04	5.10	5.30	5.80
One-Year ARM, Effective Rate, Commitment Rate	4.49	5.54	5.56	5.18	4.80	5.00	5.60

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

Mortgages

- Mortgage applications have increased in recent weeks, as a renewed slide in rates has led to a slight pickup in refinancing. Purchase applications have also risen and are likely still benefitting from the looming deadline for the first-time homebuyer tax credit.
- Rising mortgage applications are not translating into the same increase in originations they did in the past. Sales are clustered toward the lower end of the price spectrum, and lower home values are reducing loan sizes on refinancings.
- Adjustable rate products have started to make a slow reentry in the marketplace. Although the crisis has taken activity to near zero, as rates rise over the next few years, the attractiveness of these products should make a return.

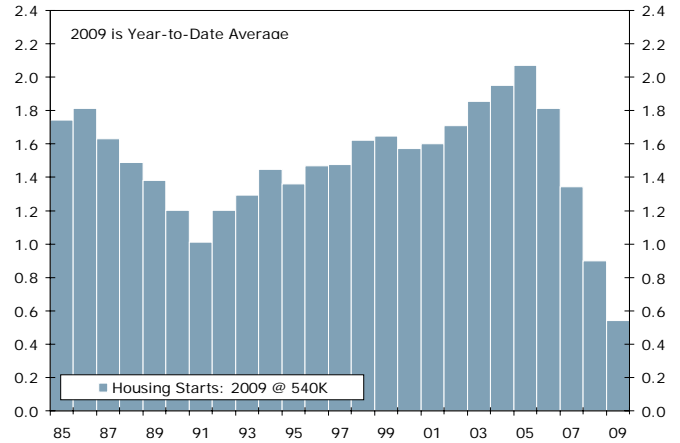


Source: Moody's Economy.com, Mortgage Bankers Association, NAR and Wells Fargo Securities, LLC

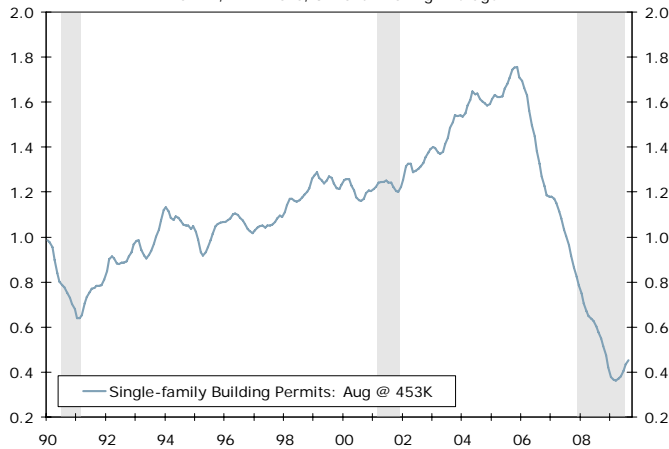
Single-Family Construction

- Single-family permits and starts appear to have bottomed earlier this year and should continue to gradually grind higher. We may see a temporary stall late this year, however, as the first-time homebuyer credit comes to an end. Some sales have undoubtedly been pulled forward, resulting in at least a modest payback.
- Completions have continued to decline as the pipeline of activity has evaporated. The drop in completions will help alleviate the overhang of new housing inventory in the medium term.
- Aggressive price cuts along with the \$8,000 first-time homebuyer tax credit have finally put an end to the long slide in builder sentiment. We are still at extremely low levels, however, and builders remain exceptionally cautious.

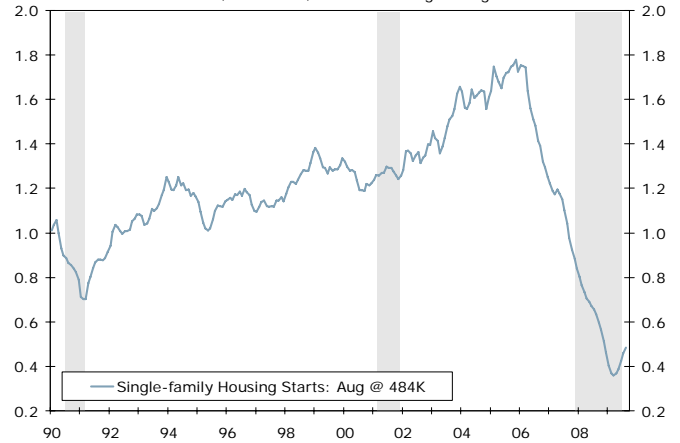
Housing Starts
 In Millions



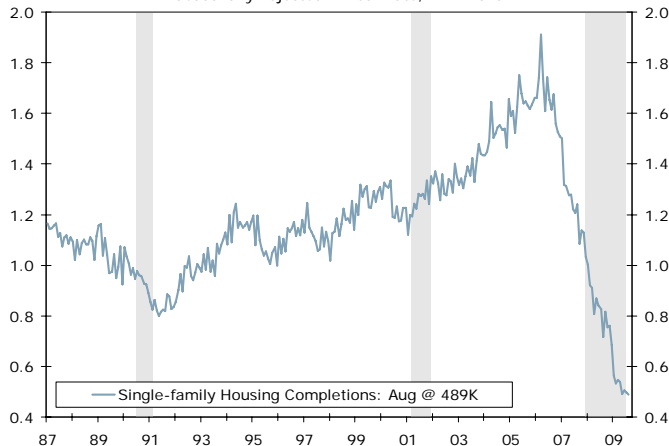
Single-family Building Permits
 SAAR, In Millions, 3-Month Moving Average



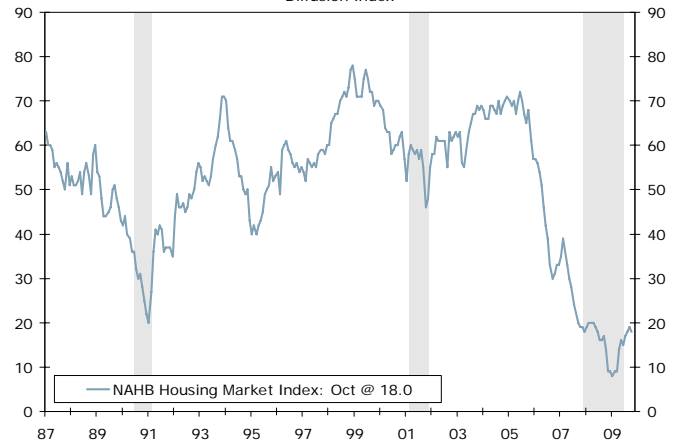
Single-family Housing Starts
 SAAR, In Millions, 3-Month Moving Average



Single-family Housing Completions
 Seasonally Adjusted Annual Rate, In Millions



NAHB/Wells Fargo Housing Market Index
 Diffusion Index

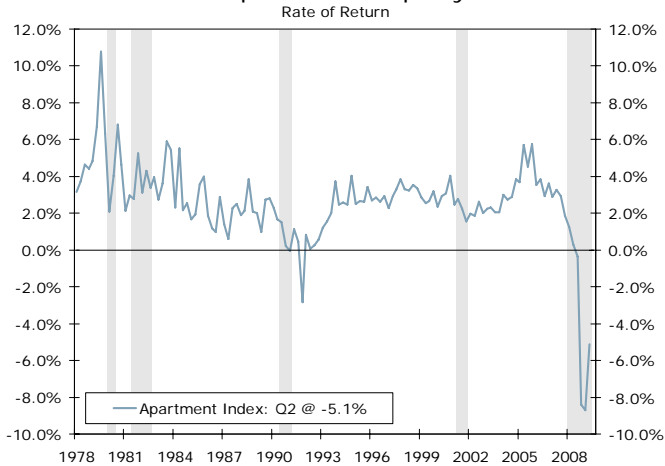


Source: NAHB, U.S. Department of Commerce and Wells Fargo Securities, LLC

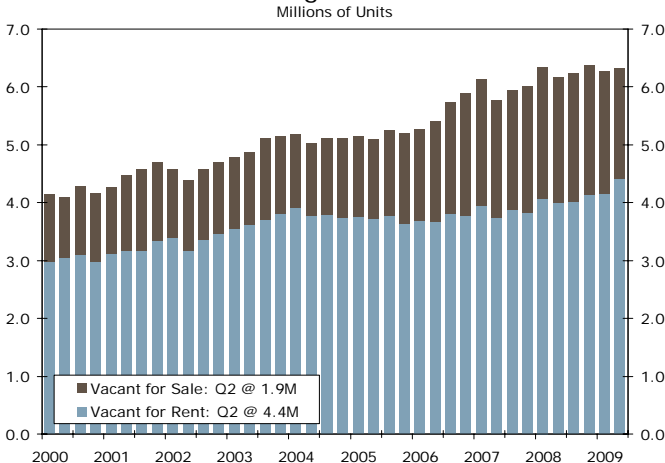
Multi-Family Home Construction

- Multi-family activity continues to be more volatile, but still remains near last spring's all-time lows. Multi-family starts have not gotten the same boost characteristic of single-family homes. Condominiums, which were heavily marketed to young, single households, is where homeownership has retreated the most.
- The apartment market is generally oversupplied and facing stiff competition from condominiums, and for-sale housing now being offered for rent. Meanwhile, debt and equity financing for new projects is still exceptionally tough to secure.
- Student housing, retirement communities and assisted living centers are providing some sense of support for multi-family construction.

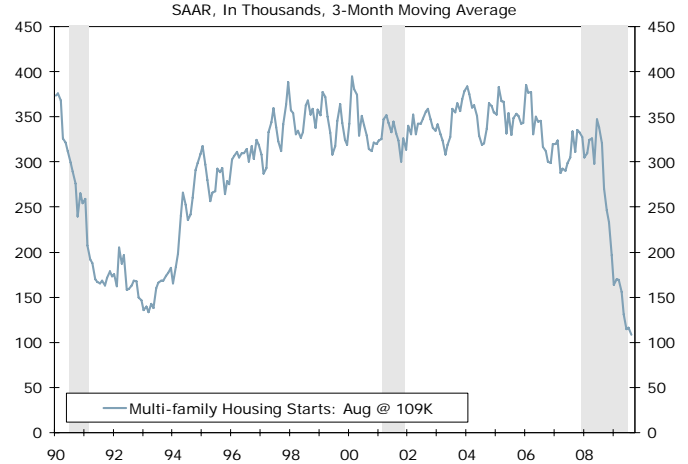
NCREIF Apartment Property Index



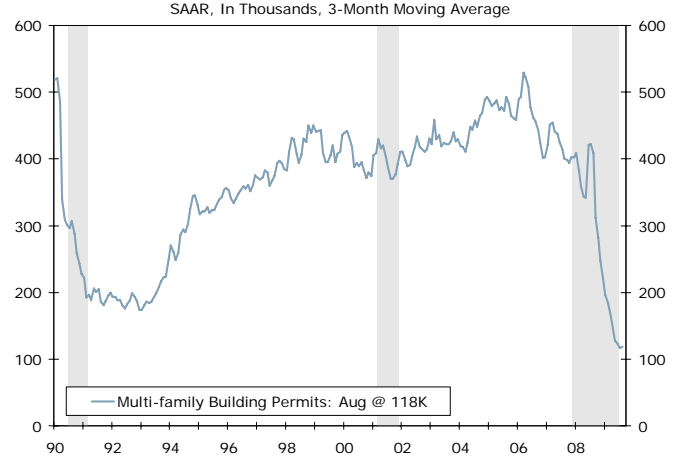
Housing Vacancies



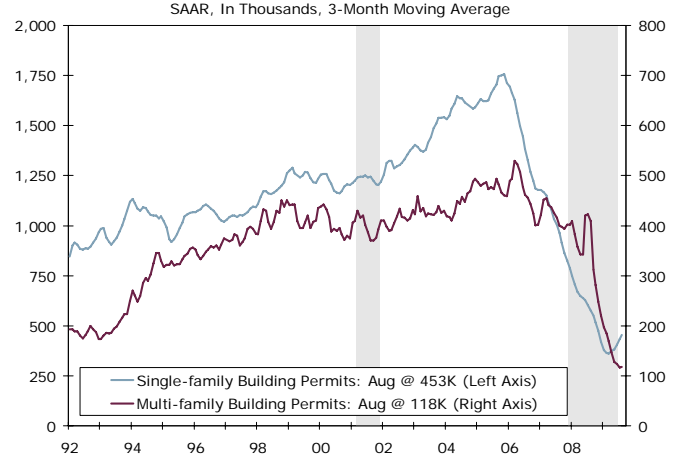
Multi-family Housing Starts



Multi-family Building Permits



Single & Multi-family Building Permits

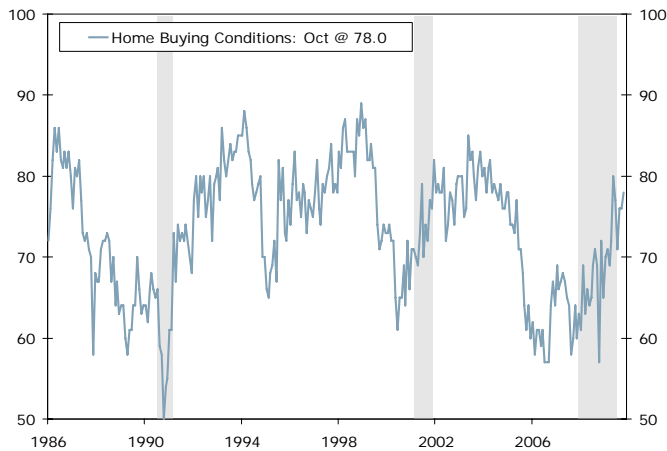


Source: NCREIF, U.S. Department of Commerce and Wells Fargo Securities, LLC

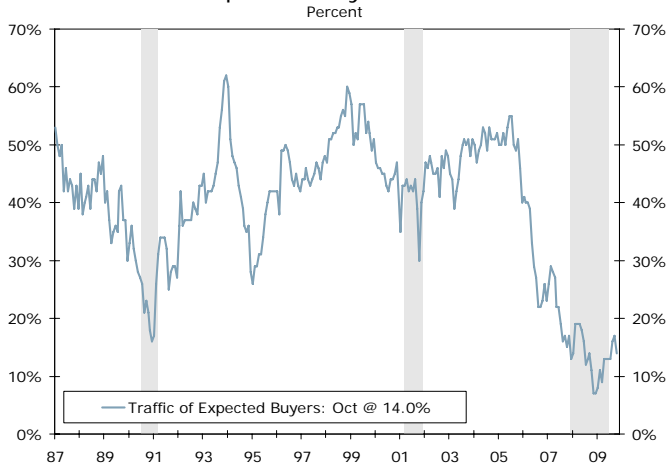
Buying Conditions

- If you are employed, feel secure in your job and have the income to qualify, now is a great time to buy a home. Mortgage rates are relatively low, and home prices have fallen across much of the country, particularly in markets where prices had previously risen the most.
- Buyer traffic has not improved anywhere near as much as buying conditions. Traffic is up off its lows and is likely contributing to the better sentiment among builders, though we have a long way to go from here.
- The first-time homebuyer tax credit is contributing to a better environment for buyers. With expiration looming, we expect to see some modest declines in coming months.

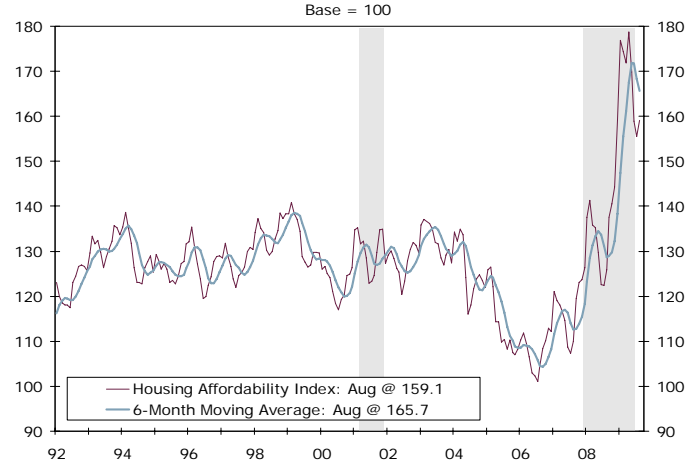
U. Michigan Sentiment Home Buying Conditions Index



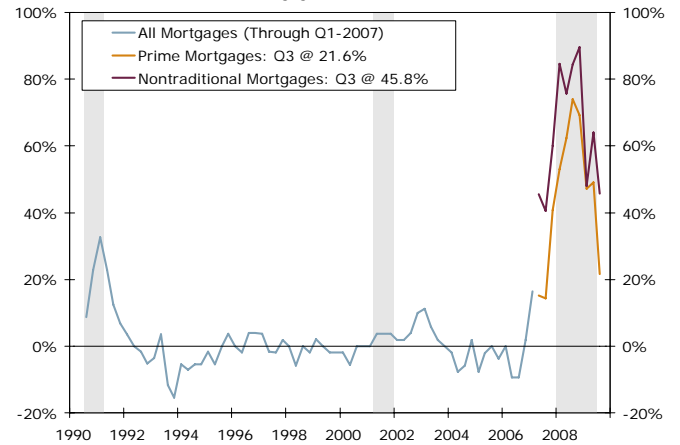
Expected Buyer Traffic Percent



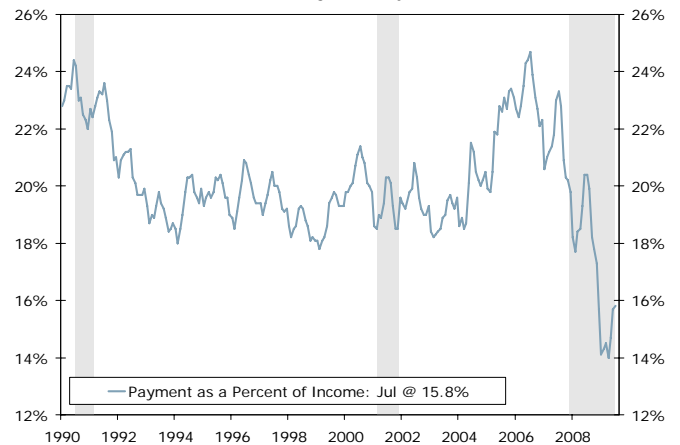
Housing Affordability, NAR-Home Sales



Net Percent of Banks Tightening Standards Mortgages for Individuals



Payment on Median Priced Single Family Home As a Percentage of Family Income

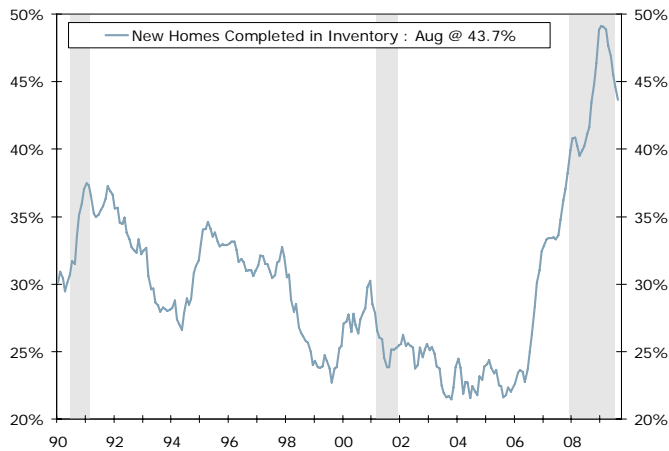


Source: Federal Reserve Board, MBA, NAHB, NAR, University of Michigan and Wells Fargo Securities, LLC

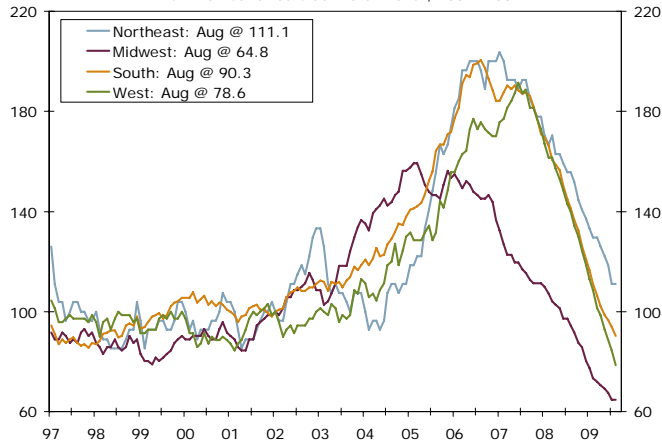
New Home Sales

- New home sales appear to have bottomed earlier this year but have since risen convincingly off of their lows. At least some of this improvement has to be attributed to the new homebuyer tax credit. But, with the credit set to expire, some retracement is likely.
- We do not expect a re-test of last year's lows. Sales are likely to stall, however, until the broader economy improves or a broader and more generous buyer incentive is enacted.
- Inventory levels have overshot their previous lows, and we expect tight conditions to prevail with little new activity in the pipeline. The low inventory levels are one reason that even the slight pickup in sales we have seen since February is boosting new construction.

Percentage of New Homes Completed in Inventory
 Non-Seasonally Adjusted

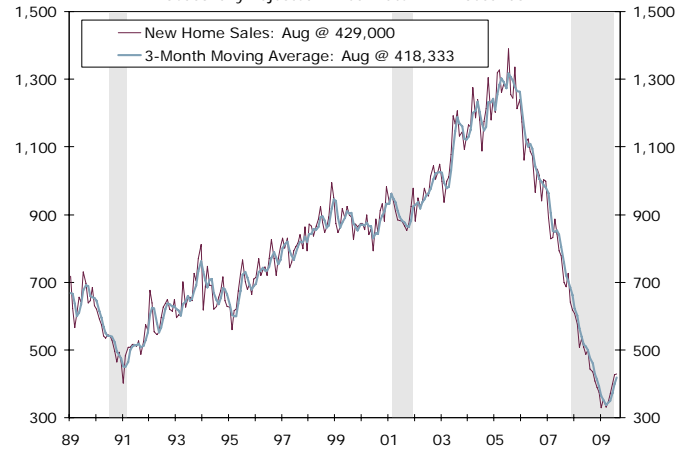


Inventory of New Homes for Sale
 New Homes for Sale at End of Month, 2002=100



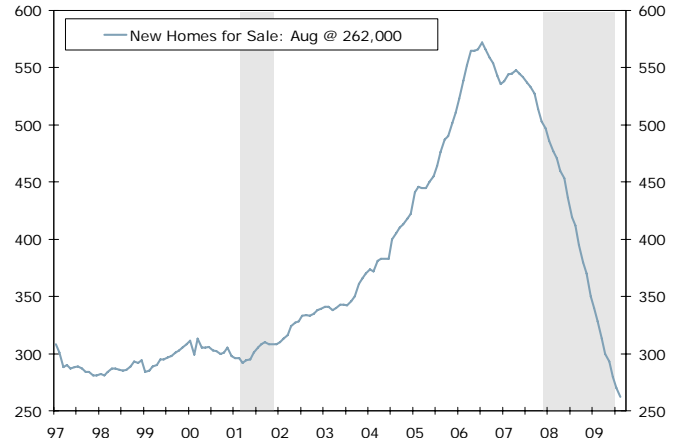
New Home Sales

Seasonally Adjusted Annual Rate - In Thousands



Inventory of New Homes for Sale

New Homes for Sale at End of Month - In Thousands



Months' Supply of New Homes

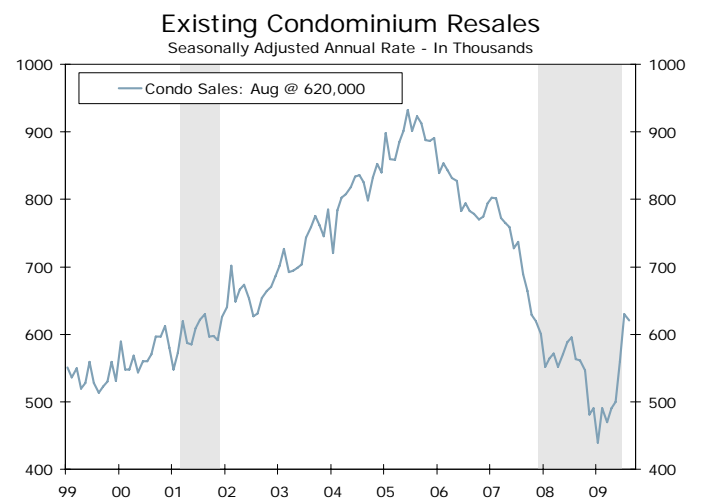
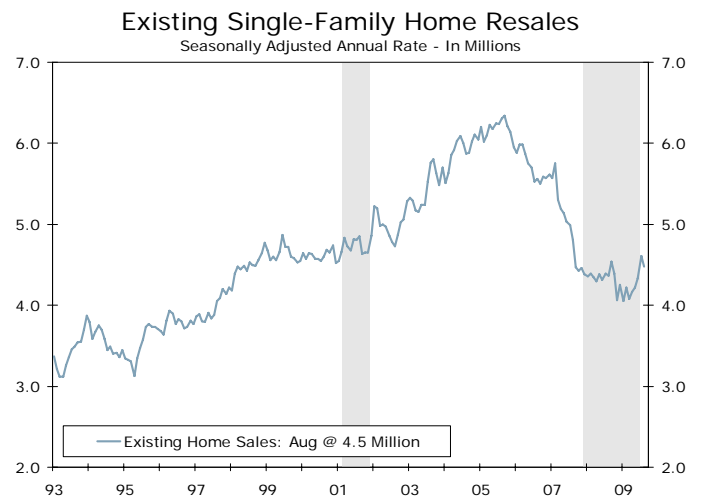
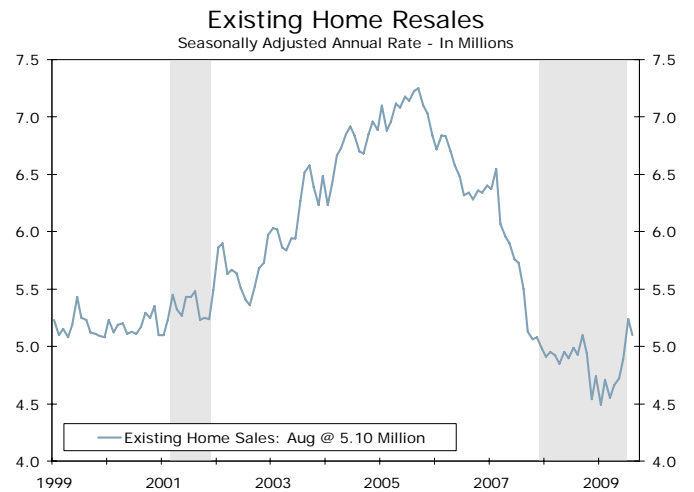
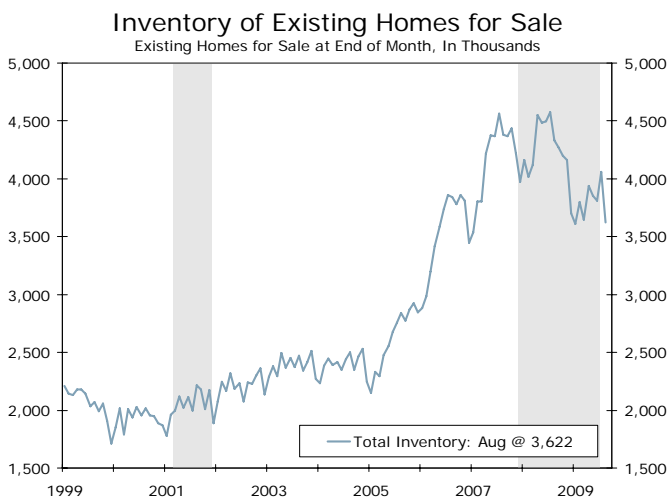
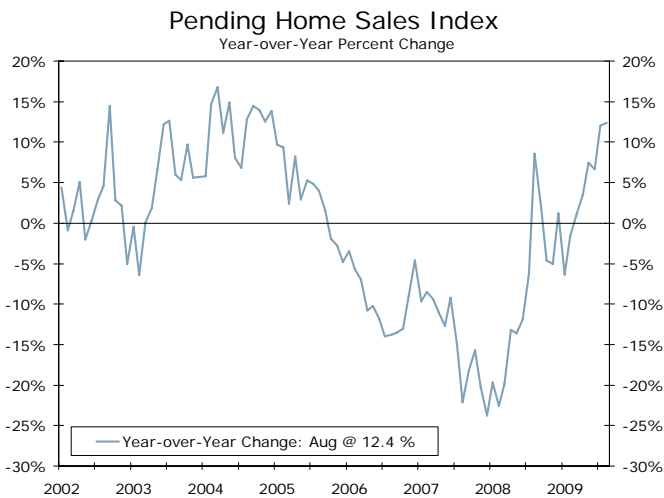
Seasonally Adjusted



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

Existing Home Sales

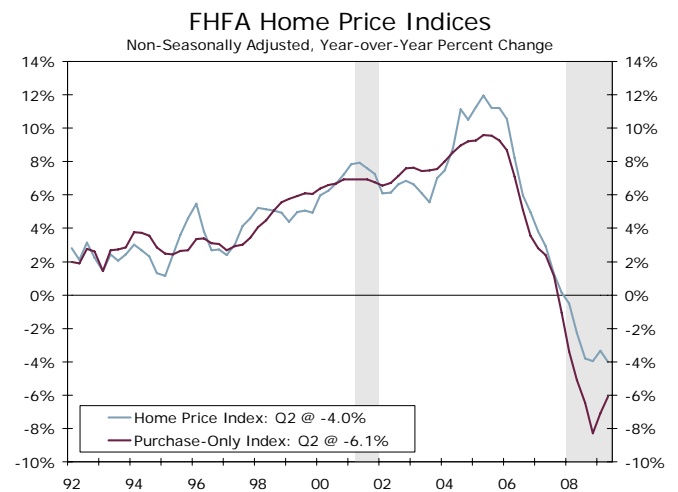
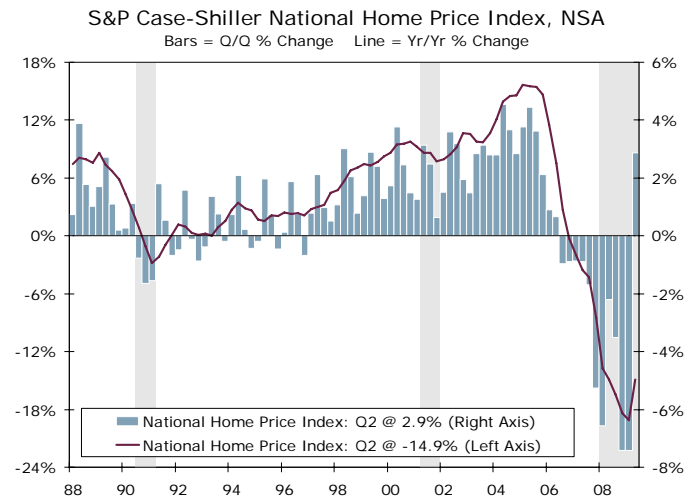
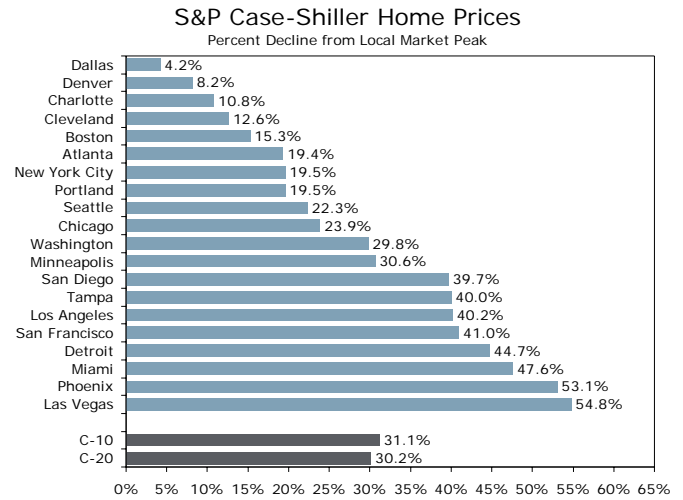
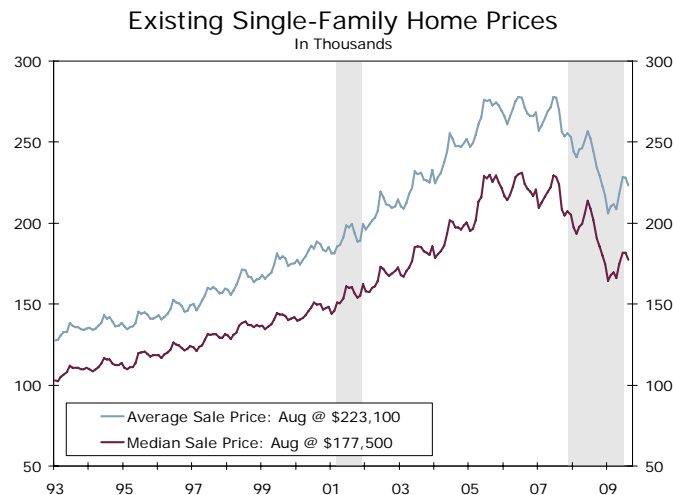
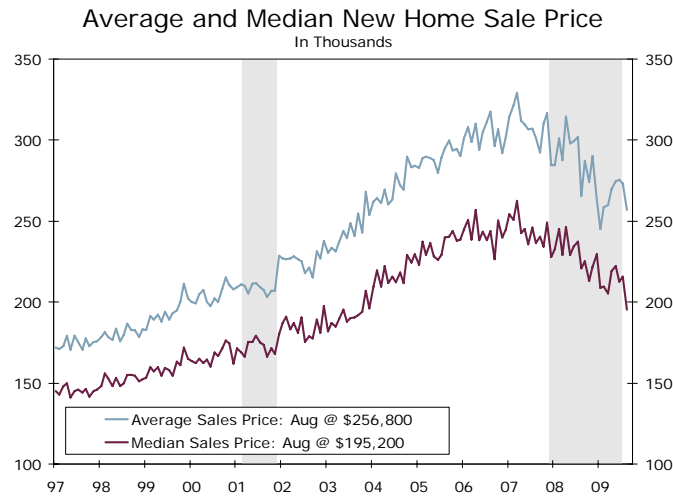
- Existing home sales have bounced back from the lows hit following last fall's financial crisis. The low levels of activity hit back then, when credit was exceptionally tight, will likely hold.
- Just as in the new home market, the pending expiration of the new homebuyer tax credit could make the sales data choppy in the coming months. Buyers will rush to close homes ahead of the deadline, pushing up sales temporarily. If the credit expires, look for a drop-off as sales activity that would have occurred late this year and into the next will have been pulled forward.
- Pending home sales continue to outperform closings. The NAR has repeatedly cited low appraisals as well as tough credit conditions as the causes for many deals not moving to closing.



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

Home Prices

- Tentative signs that home prices have stopped falling may simply be too good to be true. Prices have in fact risen on a month-over-month basis in several of the widely followed price indices. We believe these price gains reflect the holding back of foreclosed properties from the market and a dearth of sales of higher-priced homes.
- While we expect home prices to decline further, we believe the bulk of the decline is behind us. The Case-Shiller 10-city index has declined a cumulative 32.3 percent since peaking in mid-2006. We expect the absolute bottom to be around mid-2010, with a cumulative loss of 36 percent.

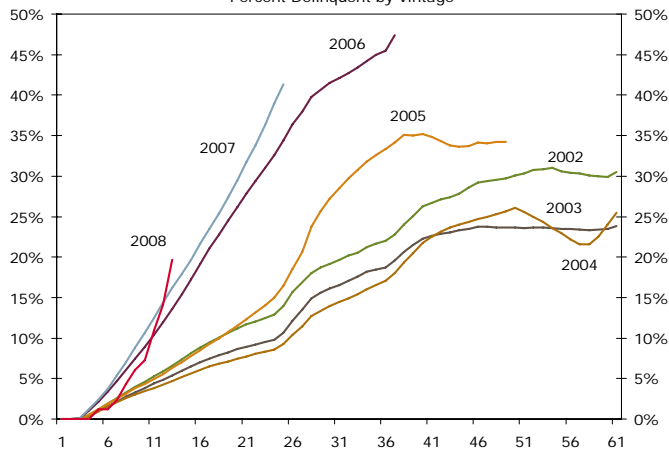


Source: FHFA, NAR, S&P Corp, U.S. Department of Commerce and Wells Fargo Securities, LLC

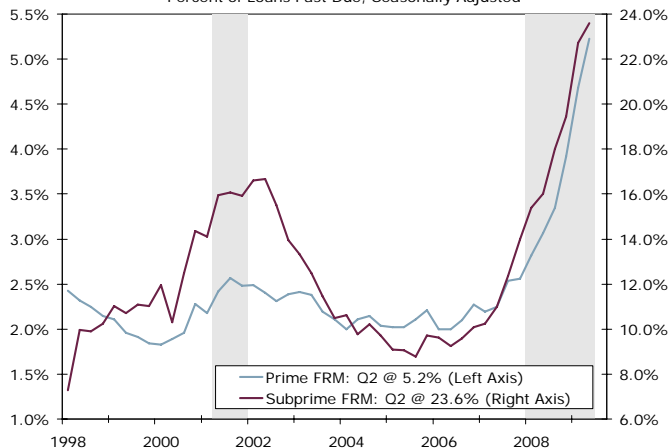
Credit Quality

- Credit quality continues to be a major concern in the mortgage space. Our chart on 60-day or more delinquency rates on subprime adjustable-rate mortgages by vintage year shows the steady deterioration in credit quality that occurred at and just after the peak in home sales in 2005.
- Delinquency rates on prime fixed-rate mortgages have become a larger issue more recently and likely reflect the prolonged weakness in the labor market, particularly the sharp reduction in hours worked and earnings as well as the high proportion of people that have been unemployed for six months or more.
- Delinquency rates on prime mortgages usually peak around the end of recession but are likely headed higher over the next few quarters.

Subprime ARMs 60+ Delinquencies
Percent Delinquent by Vintage

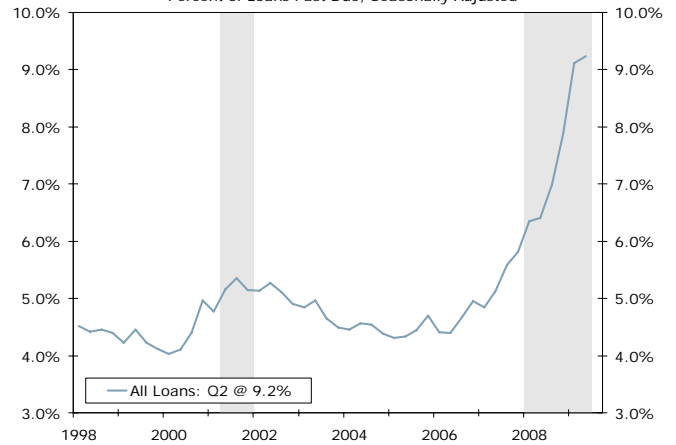


Fixed-Rate Mortgage Delinquency
Percent of Loans Past Due, Seasonally Adjusted



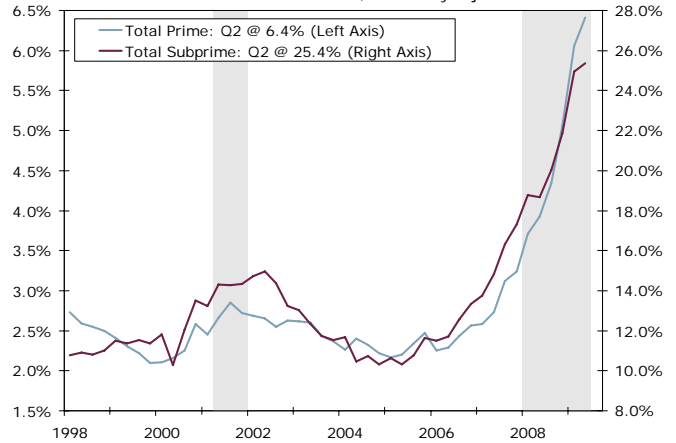
Mortgage Delinquency

Percent of Loans Past Due, Seasonally Adjusted



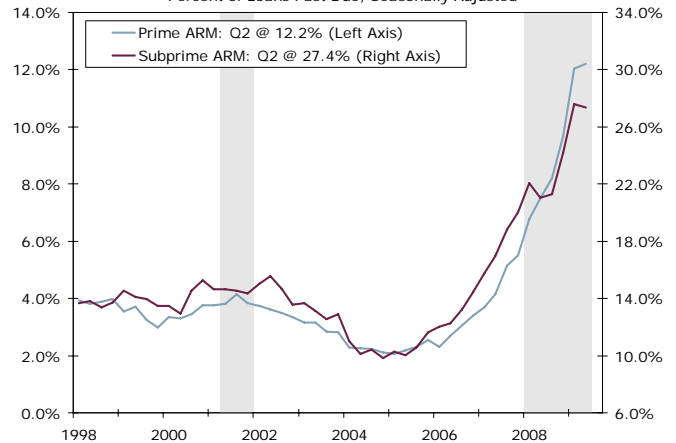
Conventional Mortgage Delinquency

Percent of Loans Past Due, Seasonally Adjusted



Adj. Rate Mortgage Loan Delinquency

Percent of Loans Past Due, Seasonally Adjusted



Source: Federal Reserve Board, MBA
and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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