

# Economics Group

## Special Commentary

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## Housing Chartbook: March 2012

### Spring Came Early for the Housing Market

Some of the optimism surrounding the unfolding recovery in the housing market took a hit this past month, as most of the February data came in below expectations. Sales of new homes fell 1.6 percent in February, and January's sales were revised significantly lower. Sales of existing homes also declined, falling 0.9 percent, and pending home sales fell 0.5 percent, suggesting that a rebound in March was not all that likely. New home construction also slipped, falling 1.1 percent in February. Fortunately, permits remained robust, climbing 5.1 percent on an overall basis and 4.9 percent for single-family units. The latest data on home prices also came in a little better than expected, and the survey data from the NAHB/Wells Fargo Homebuilders Survey as well as anecdotal reports from builders and realtors all suggest better days are ahead for the industry.

*Anecdotal reports from builders and realtors all suggest better days are ahead for the industry.*

Drawing definitive conclusions from the winter housing data is perilous. The winter months account for the smallest proportion of the year's housing activity, and unseasonably mild weather during the winter months can cause the data to bounce around quite a bit from month to month. The March and April data are much more important, and all indications suggest that the key spring selling season has gotten off to a solid start. From an analytical standpoint, we believe that the homebuilders' survey data and the housing related question in the consumer confidence survey are the best indicators of the state of housing market right now. Both increased significantly in March and tend to match up well with what we are hearing from builders, lenders, appraisers and realtors. One of the most common refrains we have heard over the past few months is that "it feels like spring." Well the weather has been spring-like across much of the country, and those milder temperatures have encouraged more buyers to get out and look for bargains. Ironically, one of the biggest problems has been that there is not all that much inventory on the market right now, aside from foreclosures and short sales. Moreover, many foreclosed properties have been sitting idle and deteriorating in limbo for a number of years. For buyers not interested in dealing with all those issues, the choices for new and existing product are limited.

*Many foreclosed properties have been sitting idle and deteriorating in limbo for a number of years.*

Figure 1

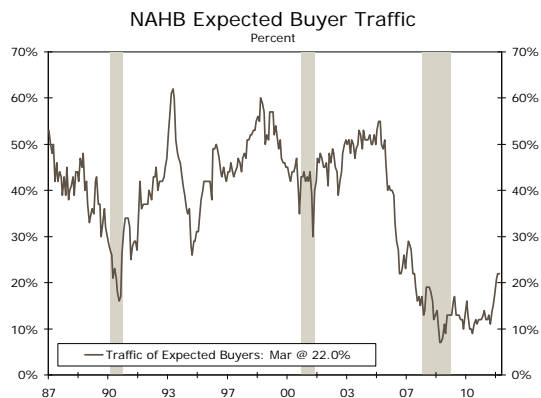
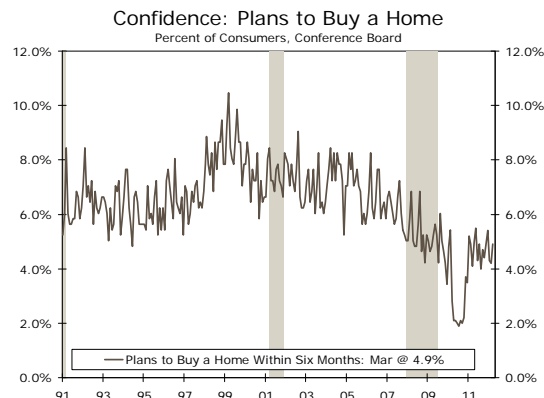


Figure 2



Source: NAHB, The Conference Board and Wells Fargo Securities, LLC

Together we'll go far



***There is no single policy or program that can meaningfully speed up the recovery.***

One of the themes we have often repeated in our outlook is that the housing recovery will take considerable time to unfold.<sup>1</sup> There is no single policy or program that can meaningfully speed up the process, as the remaining obstacles to a full-fledged, self-sustaining recovery are many and varied. Some of the greatest improvement in recent months has come in markets where overbuilding and speculation were the greatest, most notably Florida, Arizona and, to a lesser extent, Nevada. Prices have fallen so sharply in Florida, Arizona and Nevada that many traditional retiree buyers do not have to wait until they can sell their home in the Northeast or the Midwest before purchasing a home in the sunshine. Many of these buyers tend to transition to these states anyway, spending more time there until they eventually relocate permanently.

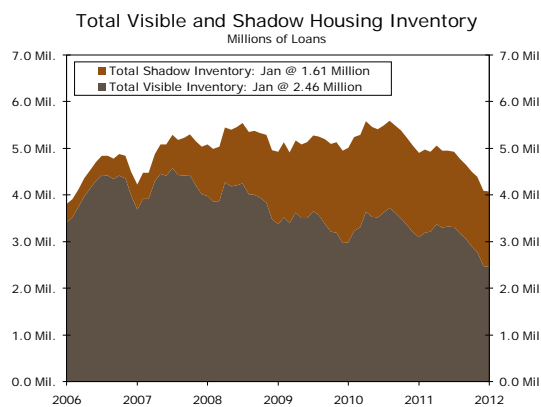
Economic policy is also playing a role in the turnaround in the Sun Belt. The latest iteration of the Home Affordable Refinance Plan has allowed many homeowners that owe more on their homes than they are currently worth to refinance at today's significantly lower interest rates, which should help shore up household finances in many of the states where housing values rose and subsequently fell the most. With more households on a solid financial footing, worries about an onslaught of foreclosure sales, driven almost exclusively by extrapolations of the large number of homeowners that are in a negative equity position, should subside. Once appraisers and lenders become comfortable with the amount of homes and the quality of those homes that are likely to come onto the market over the next few years, appraisals and mortgage underwriting standards should loosen up a bit.

***We have nudged our forecast for home sales and new home construction slightly higher.***

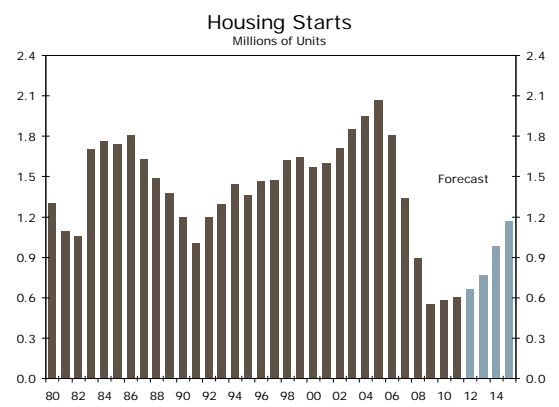
We have nudged our forecast for home sales and new home construction slightly higher, as the spring selling season appears to have gotten off to a strong start. While employment conditions have clearly improved and consumer confidence and spending have risen, we remain concerned about the lack of real after-tax income growth. That said, the anecdotal evidence is hard to dismiss. Most builders and realtors report significant gains in buyer interest and sales. Moreover, the gains are organic rather than incentive induced. Unfortunately, conservative appraisals and tight mortgage underwriting continue to undermine a large number of deals. We suspect that the undertow from these two hindrances will subside over the course of this year, as the fog surrounding shadow inventories lightens up a bit and more lenders come back to the market.

New home sales are expected to increase 12 percent in 2012 and rise nearly twice as fast in 2013. With inventories of new homes at all-time lows, those gains should produce sizeable gains in single-family starts. Apartment construction should increase much more significantly this year, helping drive multifamily starts up nearly 30 percent. We expect home prices to definitively bottom by the middle of this year, as the backlog of foreclosures finally begins clear. For properties not in foreclosure, prices have probably already bottomed, but should remain relatively low nonetheless given the competition and perceived competition from foreclosures.

**Figure 3**



**Figure 4**



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

<sup>1</sup> See, "Vacancies and The Housing Recovery: We Still Have Quite a Way to Go," which is available at: [www.wellsfargo.com/economics](http://www.wellsfargo.com/economics).

National Housing Outlook

	2008	2009	2010	2011	Forecast	
					2012	2013
Real GDP, percent change	-0.4	-3.6	3.0	1.7	2.2	2.2
Nonfarm Employment, percent change	-0.6	-4.4	-0.7	1.2	1.4	1.2
Unemployment Rate	5.8	9.3	9.6	9.0	8.4	8.3
Home Construction						
Total Housing Starts, in thousands	905.5	553.9	586.9	608.8	710.0	820.0
Single-Family Starts, in thousands	622.0	445.0	471.2	430.6	480.0	550.0
Multi-Family Starts, in thousands	283.5	108.9	115.7	178.2	230.0	270.0
Home Sales						
New Home Sales, Single-Family, in thousands	485.0	374.0	323.0	304.0	340.0	420.0
Total Existing Home Sales, in thousands	4913.0	4340.0	4190.0	4260.0	4500.0	4650.0
Existing Single-Family Home Sales, in thousands	4350.0	3870.0	3708.0	3786.0	4000.0	4125.0
Existing Condominium & Townhouse Sales, in thousands	563.0	464.0	474.0	477.0	500.0	525.0
Home Prices						
Median New Home, \$ Thousands	232.1	216.7	221.8	225.8	218.0	220.0
Percent Change	-6.4	-6.6	2.4	1.8	-3.5	0.9
Median Existing Home, \$ Thousands	198.1	172.5	172.9	166.1	164.0	165.0
Percent Change	-9.5	-12.9	0.2	-3.9	-1.3	0.6
FHFA (OFHEO) Home Price Index (Purch Only), Pct Chg	-7.5	-5.3	-3.0	-4.3	-0.8	0.9
Case-Shiller C-10 Home Price Index, Percent Change	-16.7	-12.9	2.1	-3.4	-1.7	0.2
Interest Rates - Annual Averages						
Prime Rate	4.88	3.25	3.25	3.25	3.25	3.25
Ten-Year Treasury Note	3.66	3.26	3.22	2.78	2.34	2.73
Conventional 30-Year Fixed Rate, Commitment Rate	6.04	5.04	4.69	4.46	4.00	4.35
One-Year ARM, Effective Rate, Commitment Rate	5.18	4.71	3.78	3.00	3.10	3.20

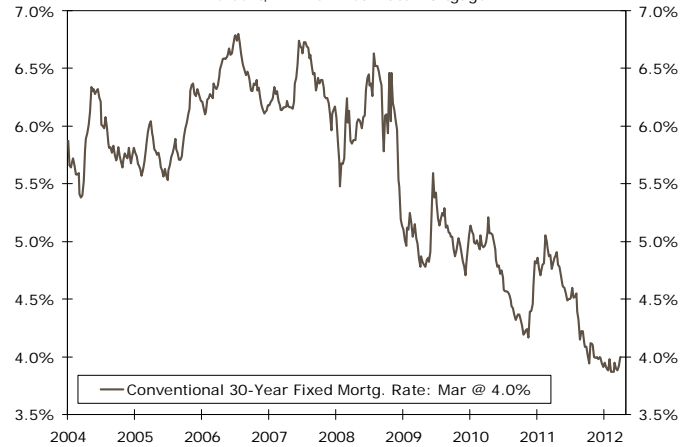
Forecast as of: April 2, 2012

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

- Reflecting the recent spike in Treasury yields, mortgage rates have moved up over the past few weeks. The rate on a 30-year fixed mortgage has risen 13 bps since the beginning of February to around 4.0 percent. While this move is noticeable, it is important to remember that mortgage rates remain extremely low relative to historical trends. Unless mortgage rates continue to trend higher and approach the 4.5 percent to 5.0 percent range, the recent spike probably will not have much of an effect on refinancing and purchasing activity.
- The mortgage-rate spread over the 10-year Treasury yield has fallen nearly 20 bps to 176 bps since the beginning of March. This may partly reflect the more competitive lending atmosphere that we have seen in recent months. However, the mortgage spread usually rises during the spring home buying months, so this trend may soon reverse itself.

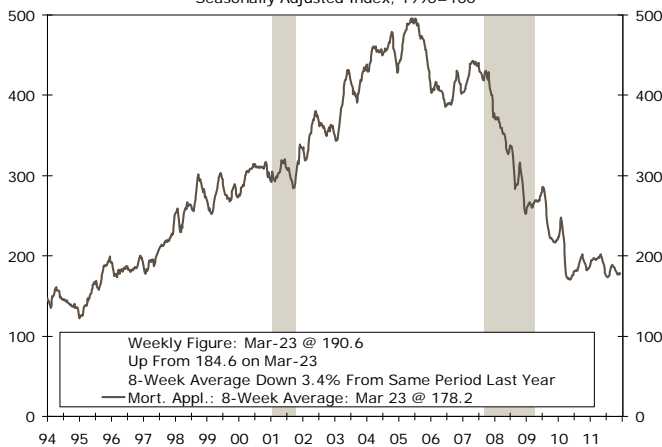
Conventional 30-Year Mortgage Rate  
 Percent, FHLMC Fixed-Rate Mortgage



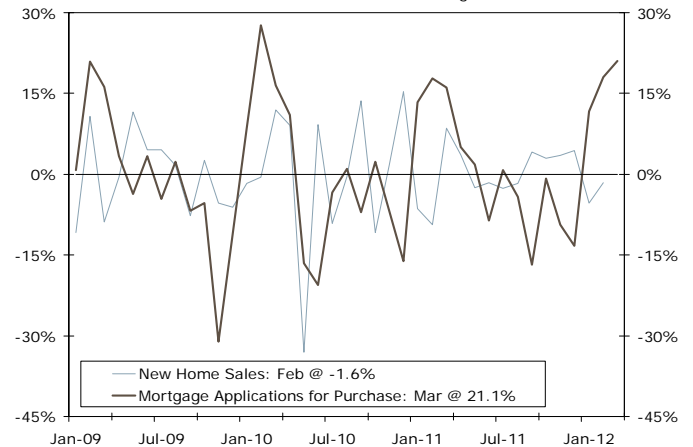
Conventional Mortgage to 10-Year Treasury Spread  
 Basis Points



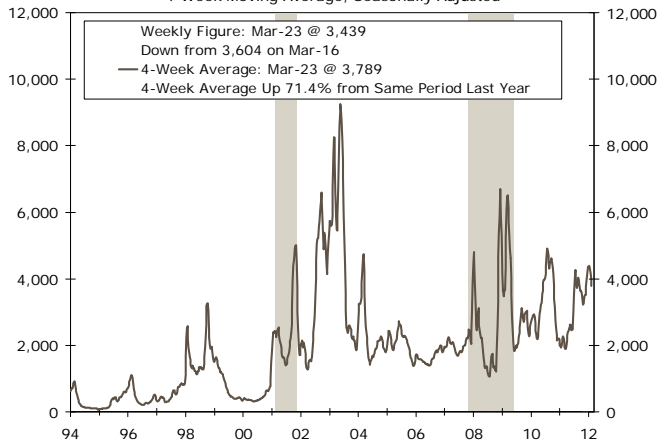
Mortgage Applications for Purchase  
 Seasonally Adjusted Index, 1990=100



New Home Sales vs. Mortgage Applications  
 Month-over-Month Percent Change



Mortgage Applications for Refinancing  
 4-Week Moving Average, Seasonally Adjusted

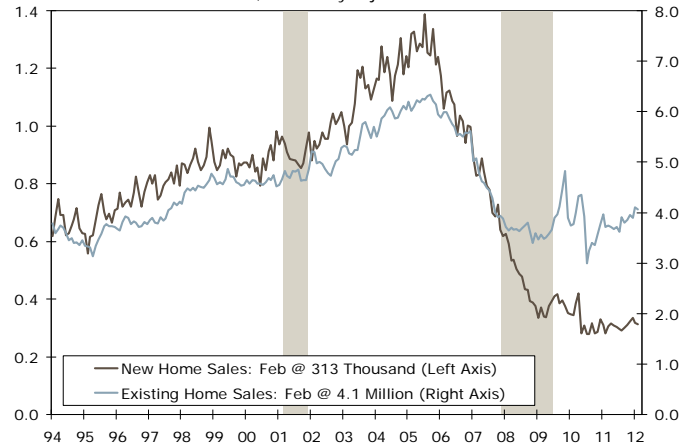


Source: Mortgage Bankers Association, FHLMC, U.S. Department of Commerce and Wells Fargo Securities, LLC

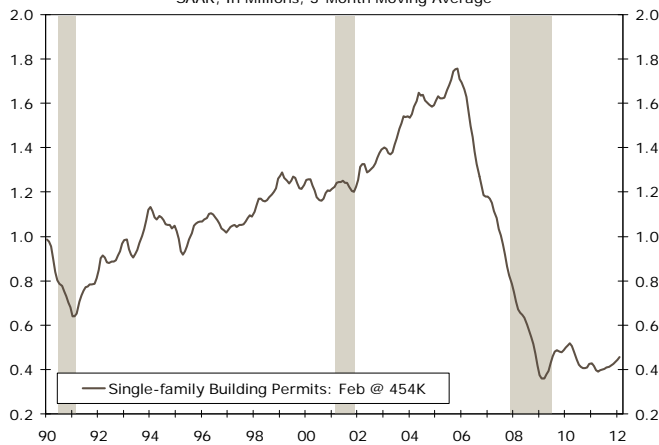
## Single-Family Construction

- Single-family construction put in place has shown consistent increases over the past eight months and has finally emerged from negative territory on a year-ago basis. While the improvement in single-family building likely signals the early stages of stabilization, any enthusiasm should be tempered as the gains are coming off an incredibly low base.
- Single-family starts are also displaying a somewhat similar trend. While starts pulled back in February, breaking a consistent chain of increases over the past four months, the underlying trend is still improving. Moreover, forward-looking single-family permits have risen in each of the past five months and are up 23.6 percent on a year-ago basis.
- While builder sentiment was unchanged in March, it remains at its highest level since June 2007.

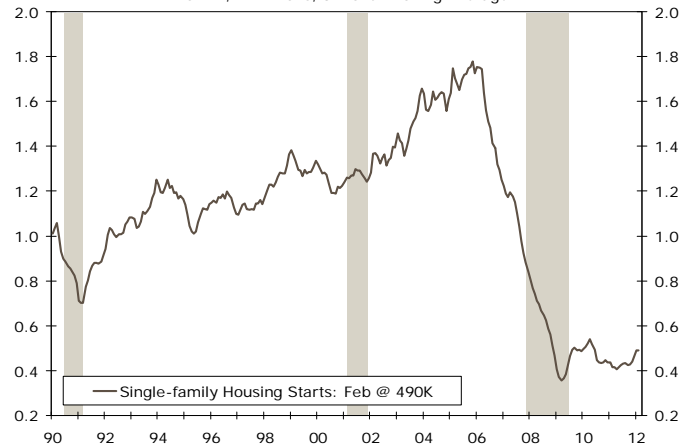
Existing & New Single-Family Home Sales  
 In Millions, Seasonally Adjusted Annual Rate



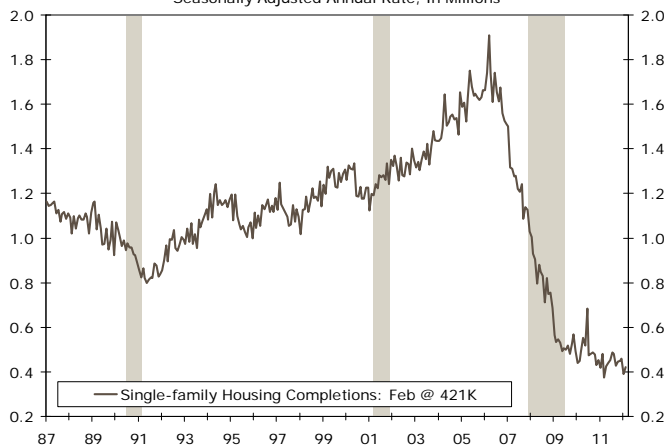
Single-Family Building Permits  
 SAAR, In Millions, 3-Month Moving Average



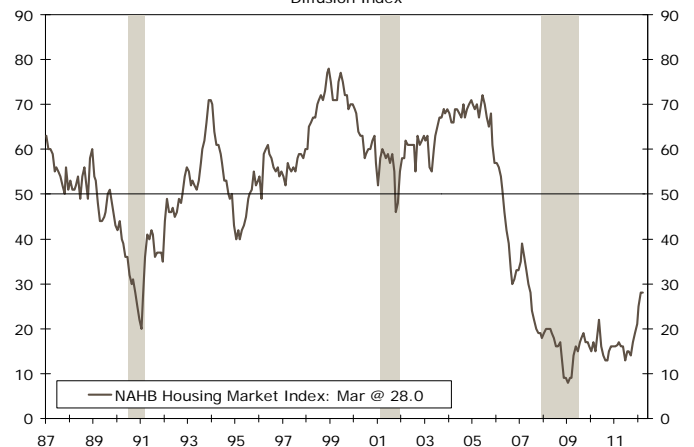
Single-Family Housing Starts  
 SAAR, In Millions, 3-Month Moving Average



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



NAHB/Wells Fargo Housing Market Index  
 Diffusion Index

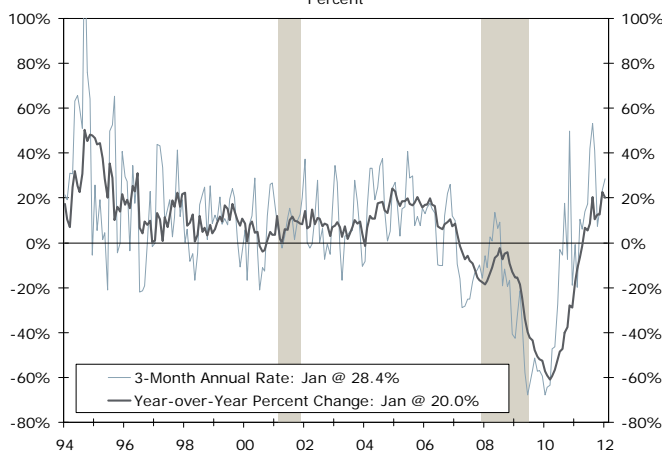


Source: National Association of Home Builders (NAHB), U.S. Dept. of Commerce, NAR and Wells Fargo Securities, LLC

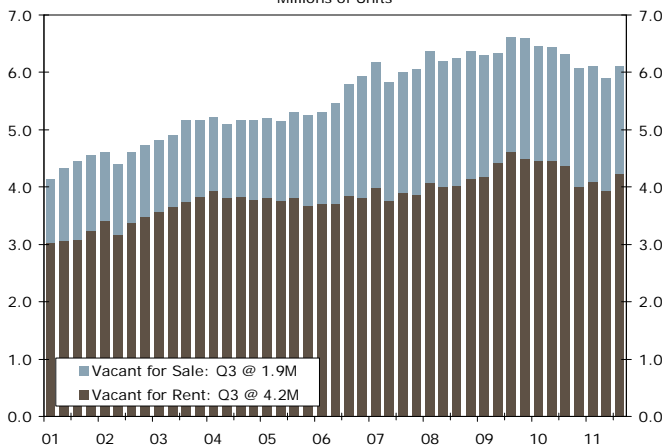
## Multifamily Construction

- Multifamily starts are up a solid 85.4 percent on a year-ago basis. The upward momentum in multifamily construction continues to illustrate the solid recovery in the apartment market. Apartment demand continues to benefit from the housing slump and modestly increasing household formation. This improvement has helped to drive the apartment vacancy rate down to 5.2 percent in the fourth quarter from a high of 8.0 percent in early 2010. Apartment fundamentals continue to improve, with effective rent growth now positive for eight-consecutive quarters, and net absorption still far outpacing completions. With supply constrained, rent will continue to increase for at least the next couple of years, as builders catch up with the growing demand. That said, multifamily permits are up 61.2 percent on a year-ago basis, and we continue to expect further gains in the coming quarters.

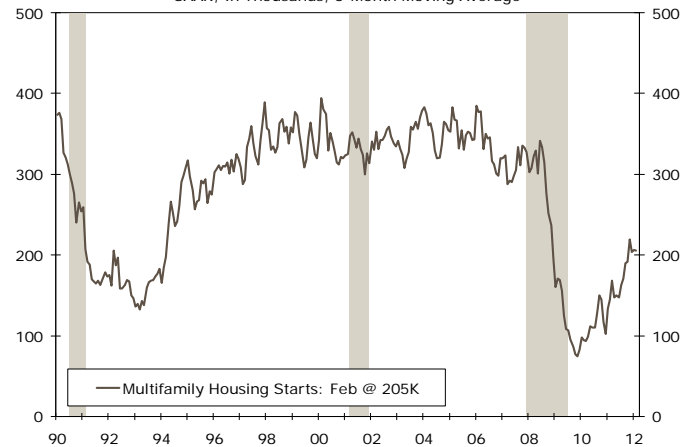
Private Multifamily Construction Spending



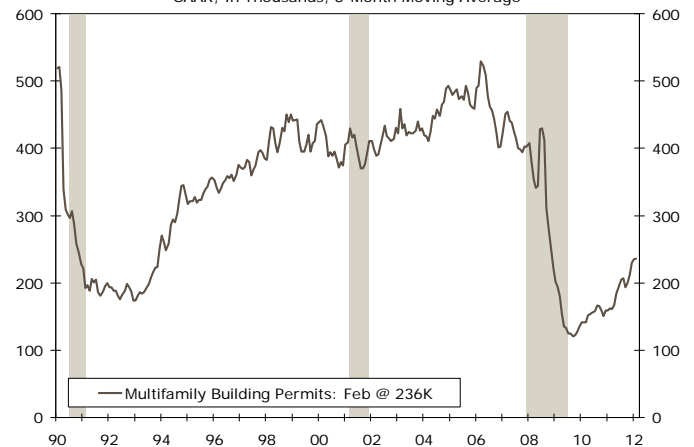
Housing Vacancies



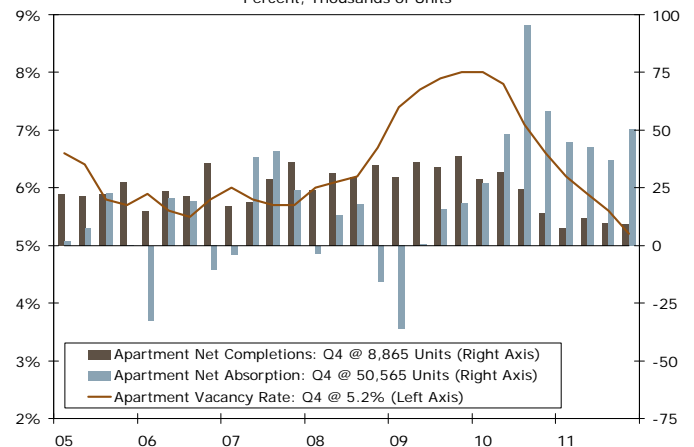
Multifamily Housing Starts



Multifamily Building Permits



Apartment Supply & Demand

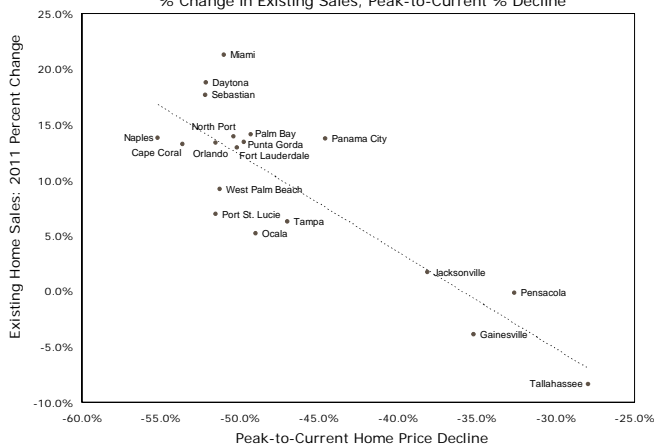


Source: U.S. Department of Commerce, REIS Inc. and Wells Fargo Securities, LLC

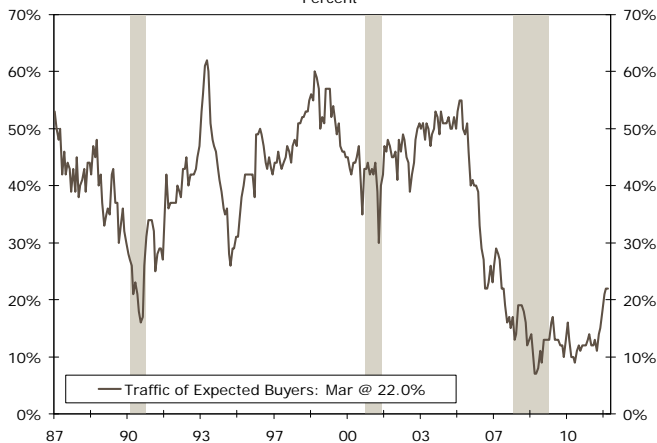
## Buying Conditions

- As we have noted previously, prices have fallen so far in many markets that affordability is at a record high. One market where this trend is particularly true is Florida. As the chart below shows, there is a direct relationship between sales activity in Florida and how far prices have fallen from their peak in the bubble years. Prices have likely overshot in many Florida markets, including Miami, Daytona and Naples, which has been driving sales as investors search for undervalued properties. While this trend has not necessarily been true for the nation as a whole, it has also been evident in other boom-and-bust states, such as Nevada, Arizona and California.
- Real home prices continue to fall and are now back down to 1999 levels. Price-to-rent ratios are also back down to 1999 levels. We are getting close to finding a bottom in national home prices.

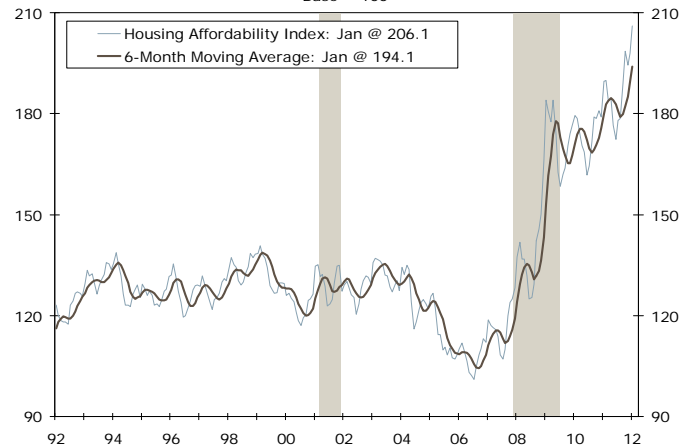
FL Home Price Declines vs. Sales Activity  
 % Change in Existing Sales, Peak-to-Current % Decline



NAHB Expected Buyer Traffic  
 Percent

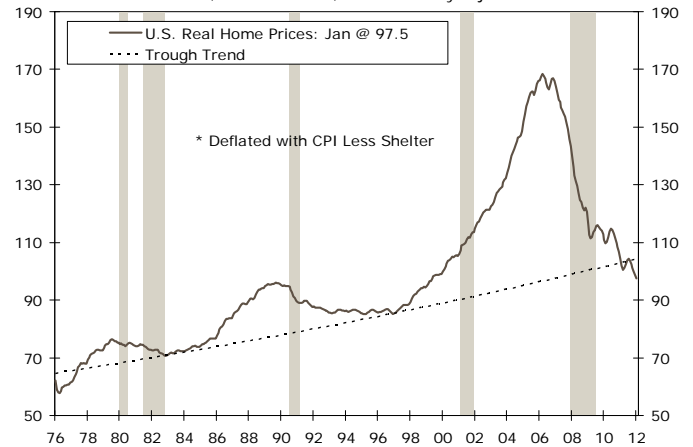


Housing Affordability, NAR-Home Sales  
 Base = 100



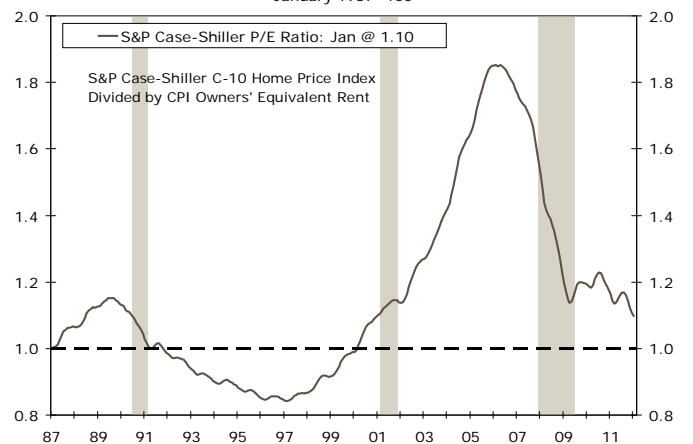
U.S. Real Home Prices

Index, Jan. 2000=100, Not Seasonally Adjusted



S&P Case-Shiller Home Price Index P/E Ratio

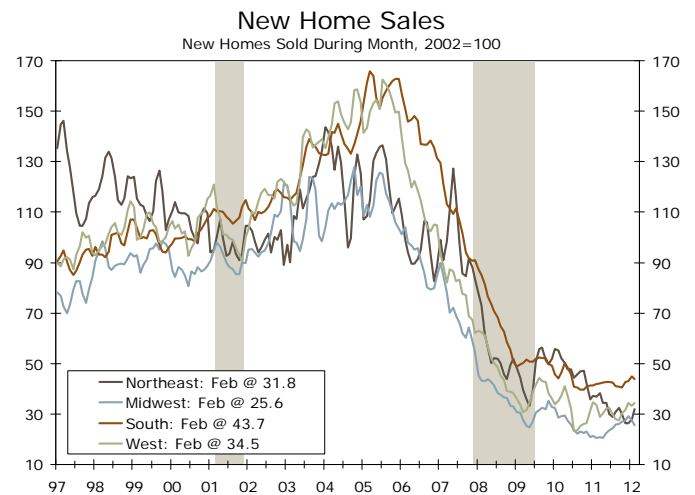
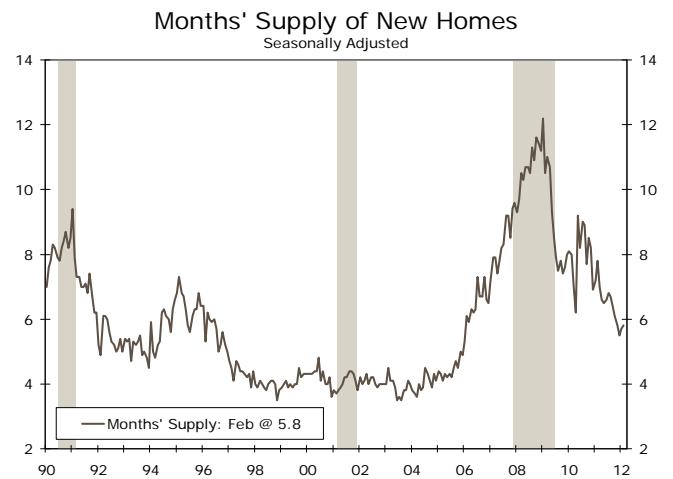
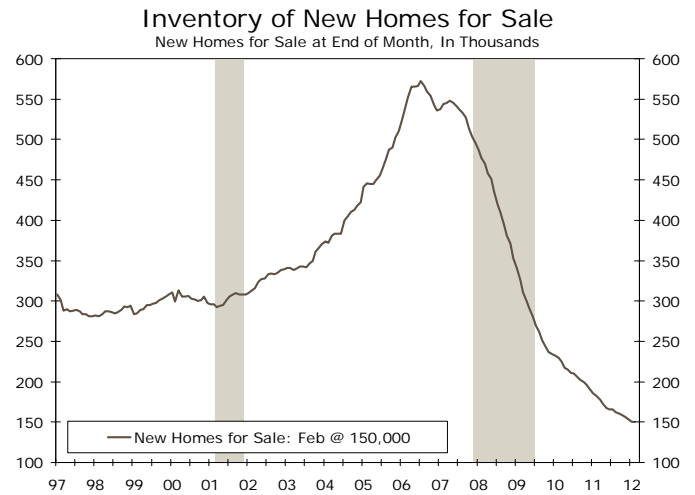
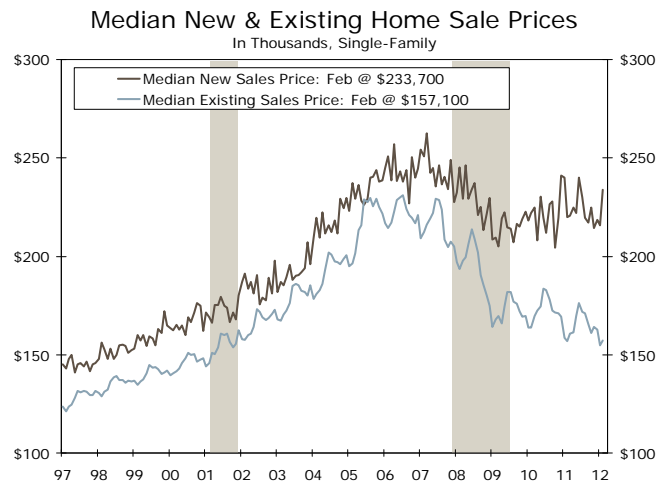
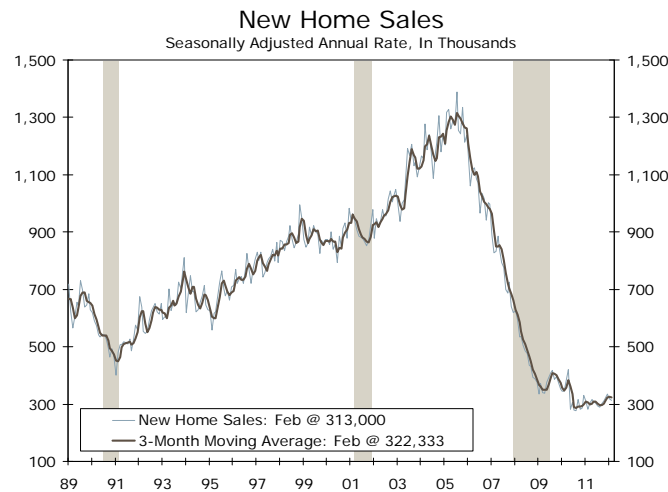
January 1987=100



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

## New Home Sales

- Construction of new homes continues to face tough competition from deeply discounted distressed properties. The gap between the median price of a new home and an existing home remains wide, at more than \$75,000. That said, the gap has narrowed somewhat over the past year, but remains well above its long-run trend of about \$18,000.
- The inventory of new homes for sale remains at a modern-era low, at 150,000 units. Of that, just 54,000 units are completed and vacant nationwide. The drop in inventories combined with stronger buyer traffic has helped boost builder confidence.
- While buyer traffic is improving, trade-up buyers are still relatively scarce, reflecting the problems that existing homeowners are having in selling their homes. Conditions should improve in 2012.

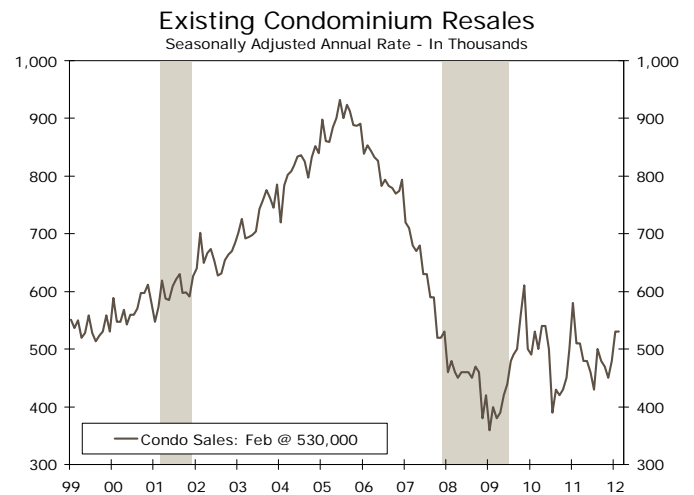
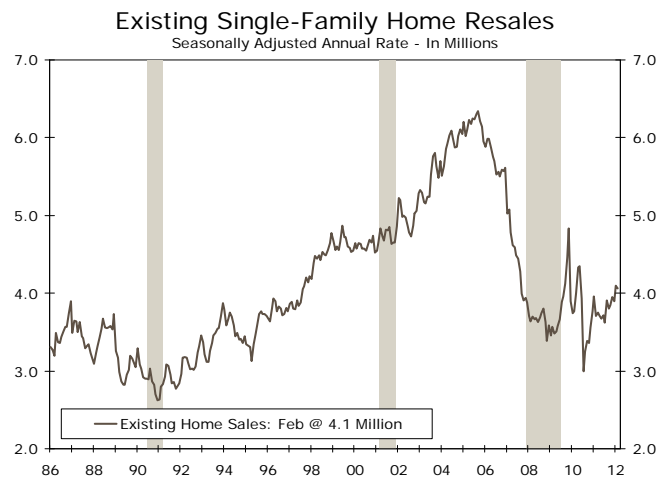
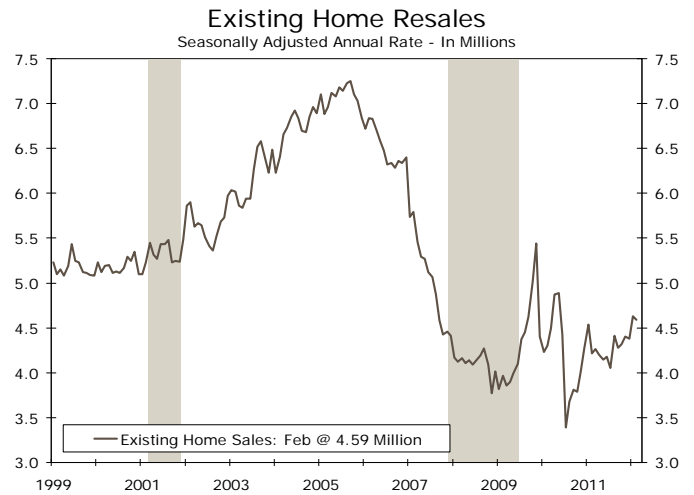
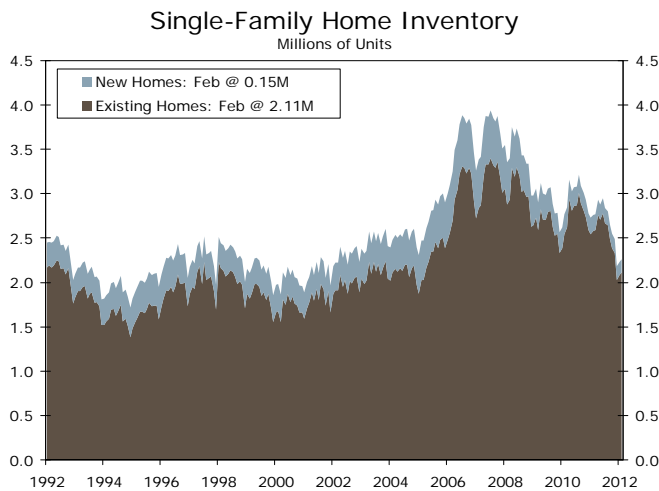
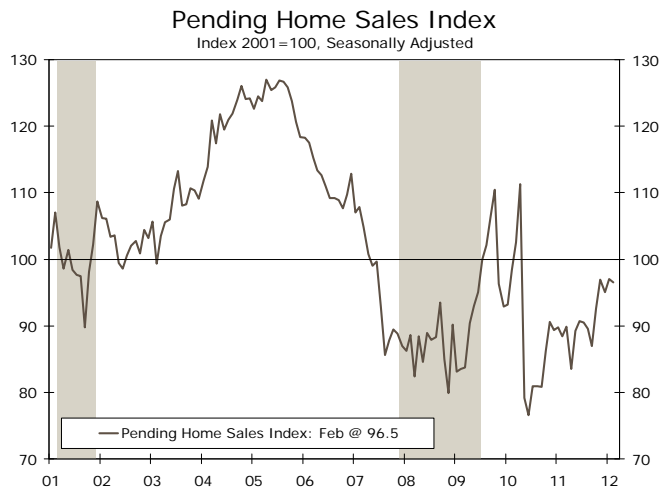


Source: U.S. Department of Commerce, NAR and Wells Fargo Securities, LLC



## Existing Home Sales

- Partly reflecting a payback from the gains in December and January due to the unseasonably warm weather, sales of existing homes fell 0.9 percent in February. The underlying trend remains positive, however, and we expect to see further improvements as the key spring home buying season kicks off. While we expect continued gains, we suspect that some sales were pulled forward due to the extremely early arrival of spring-like weather.
- Distressed transactions still make up a considerable portion of overall sales activity and will continue to pressure prices. On a positive note, all-cash sales remain solid, suggesting that investors continue to see buying opportunities. REO-to-rental programs may also soak up a portion of the estimated 300,000 excess vacant homeowner units.

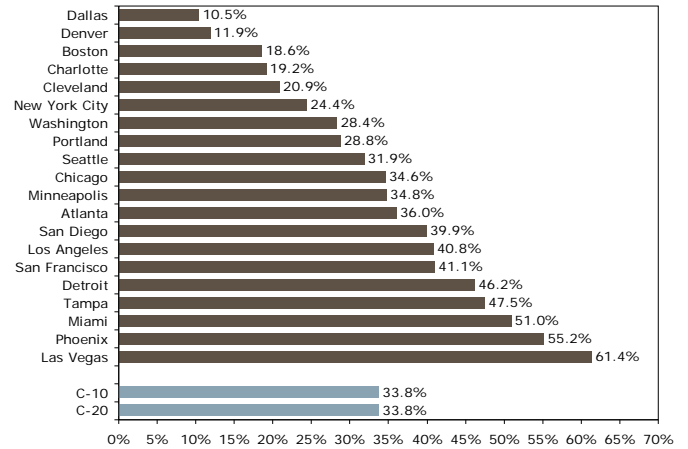


Source: National Assoc. of Realtors and Wells Fargo Securities, LLC

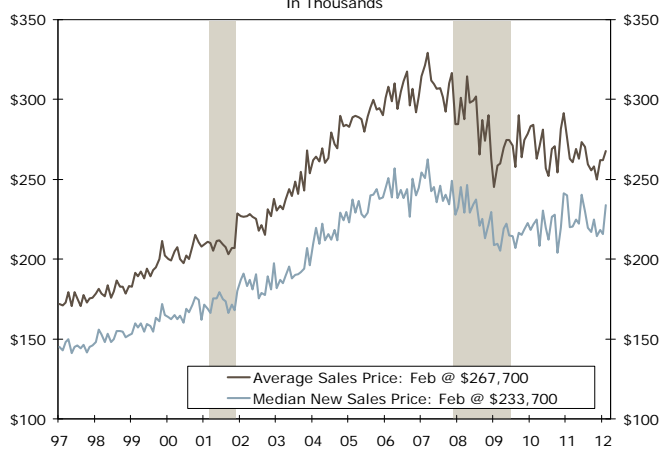
## Home Prices

- Home prices continue to come under pressure, but the pace of decline is moderating. According to CoreLogic, home prices including distressed sales declined 3.1 percent on a year-ago basis. Excluding distressed sales, however, home prices are just 0.9 percent below their year-ago level.
- Distressed transactions will continue to put pressure on home prices through at least the first half of 2012. The backlog of homes waiting to move through the foreclosure process, and fears about how big that number is now or eventually will be, continue to weigh on appraisals and mortgage underwriting. Moreover, many potential sellers are holding off on listing their homes for fear that competition foreclosures will make it more difficult for them to sell their homes.

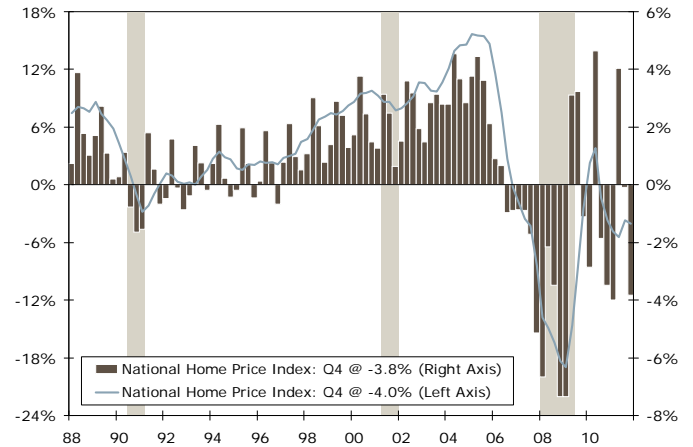
S&P Case-Shiller Home Prices  
 Percent Decline from Local Market Peak



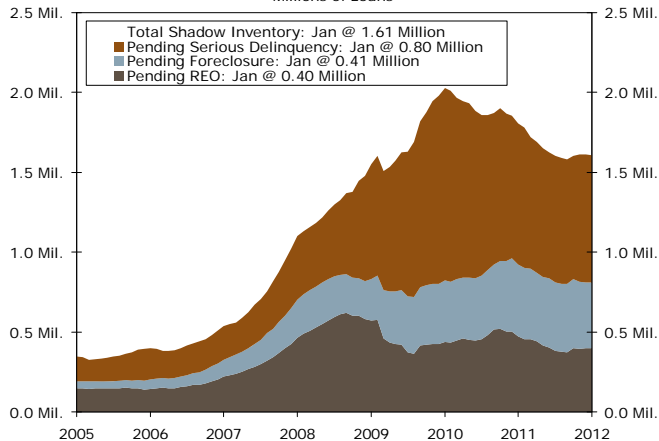
Average and Median New Home Sale Price  
 In Thousands



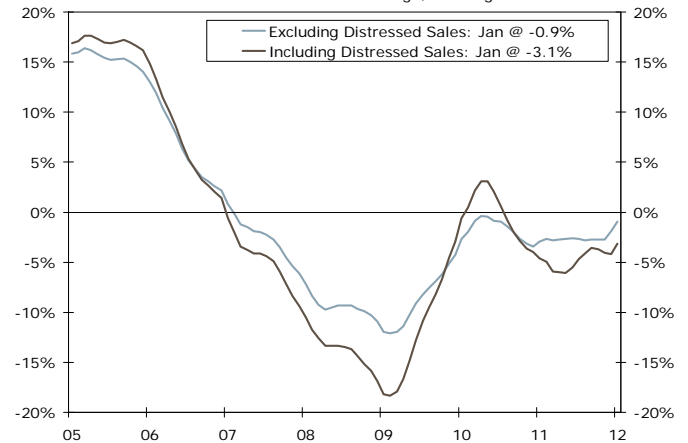
S&P Case-Shiller National Home Price Index, NSA  
 Bars = Q/Q % Change Line = Yr/Yr % Change



Total Shadow Inventory  
 Millions of Loans



Impact of Distressed Sales on Home Prices  
 Year-over-Year Percent Change, CoreLogic

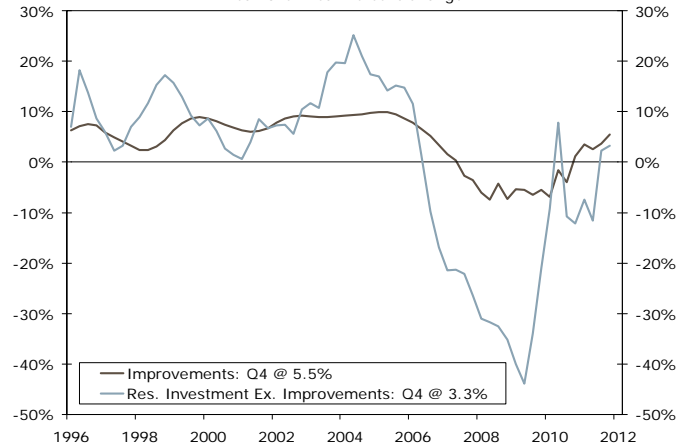


Source: CoreLogic, NAR, S&P Corp, U.S. Department of Commerce and Wells Fargo Securities, LLC

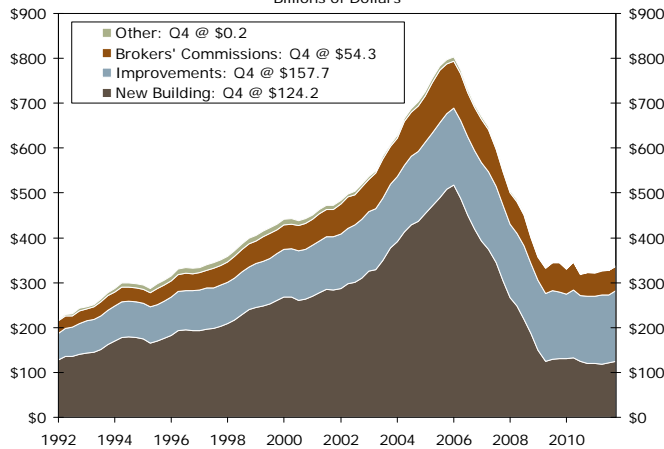
## Renovation & Remodeling

- Recent data for remodeling activity during the winter months reveal that the unseasonably warm winter had a noticeable positive effect. The BuildFax Remodeling Index (BFRI) increased 13 percent in January and was 11 percent higher than its level in January 2011. While remodeling activity remains below levels witnessed during the bubble years, when unsustainable equity extraction often found its way into home improvements, the BFRI is up 29 percent from its low back in May 2009.
- The imminent bottom in national home prices will likely be a boon for remodeling activity. Decisions to remodel are often a function of expected future home price movements. Even though remodeling activity has been robust in the current recovery, an end to the five-year slide in home prices will gradually induce homeowners to spend a bit more on remodeling and upgrade projects.

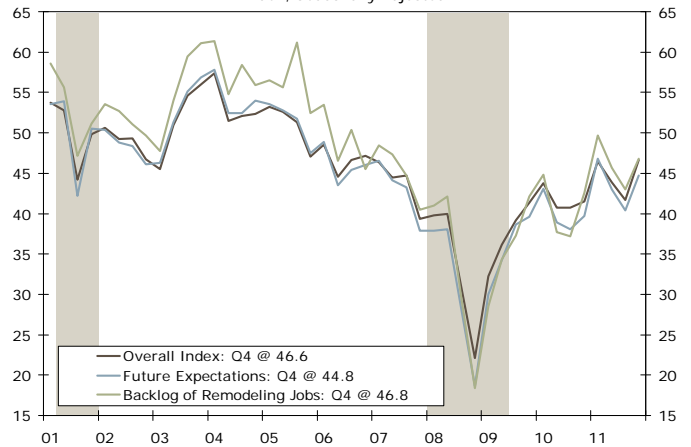
Residential Investment  
 Year-over-Year Percent Change



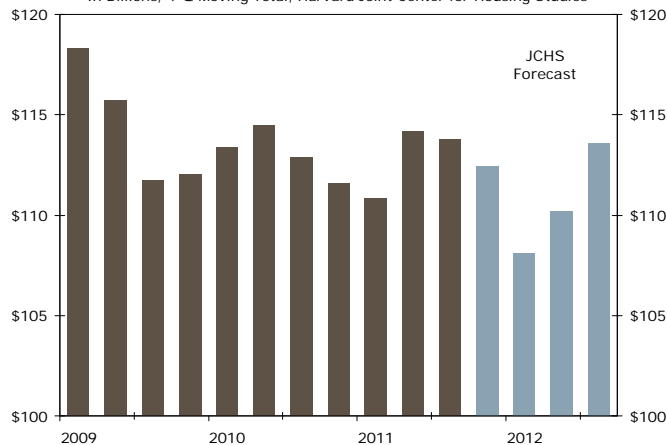
Residential Investment  
 Billions of Dollars



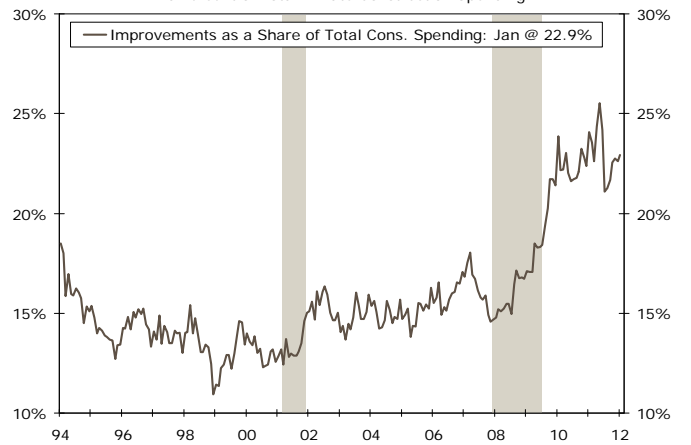
NAHB Remodeling Market Index  
 Index, Seasonally Adjusted



Leading Indicator of Remodeling Activity  
 In Billions, 4-Q Moving Total, Harvard Joint Center for Housing Studies



Improvements' Share of Total Cons. Spending  
 As Percent of Total Private Construction Spending

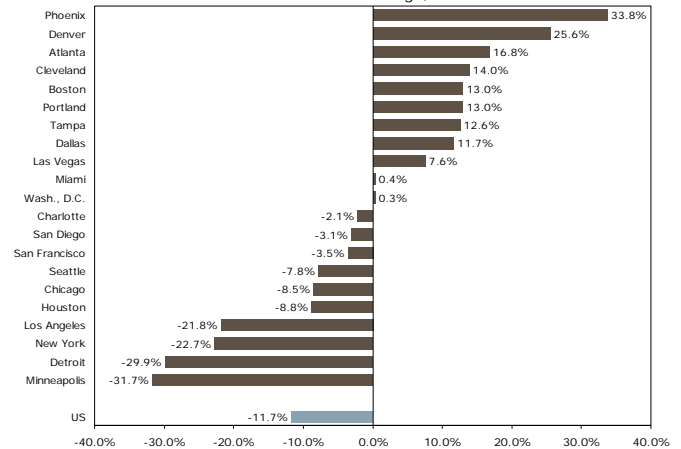


Source: Joint Center for Housing Studies, U.S. Department of Commerce and Wells Fargo Securities, LLC

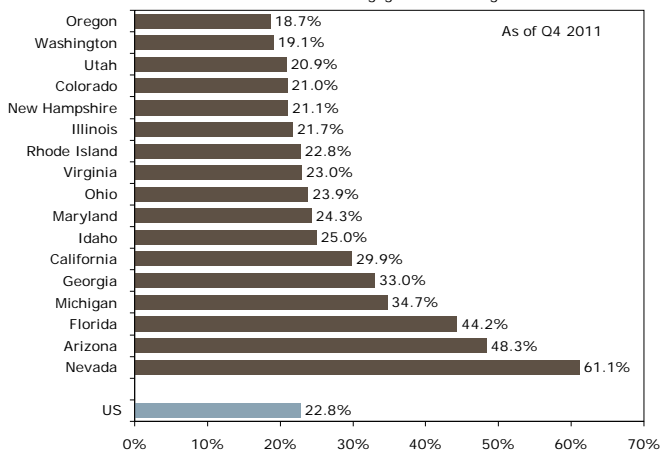
## Regional Housing Trends

- Existing home sales have picked up in a number of markets across the country. The chart to the right shows the year-over-year percentage change in existing home sales for 21 large markets. Over the past year, sales are up the most in Phoenix, in large part due to the large number of distressed sales in that metropolitan area. Sales are also up significantly in Denver, Atlanta, Cleveland and Boston. Sales are down the most in Minneapolis, Detroit, New York and Los Angeles.
- The second chart on the right shows the shadow inventory rate for the same 21 large markets. While sales are up significantly in Atlanta and Cleveland, each of these markets has a relatively high shadow inventory, suggesting that distressed sales will likely remain elevated. The highest levels of shadow inventory are in Miami, Tampa and Las Vegas.

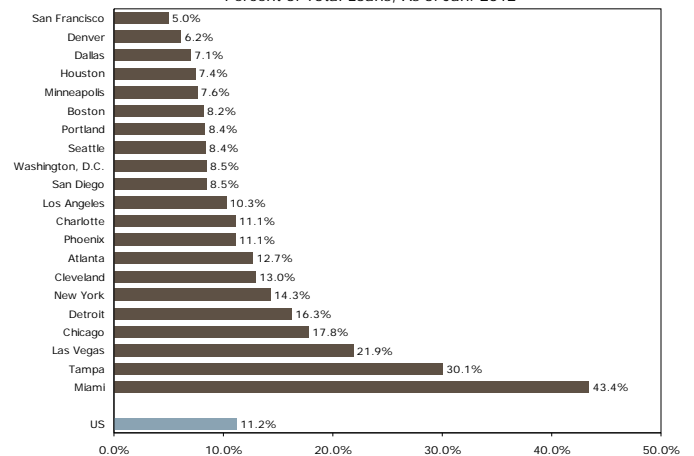
Existing Home Sales by Metro Area  
 Year-over-Year Percent Change, As of Jan. 2012



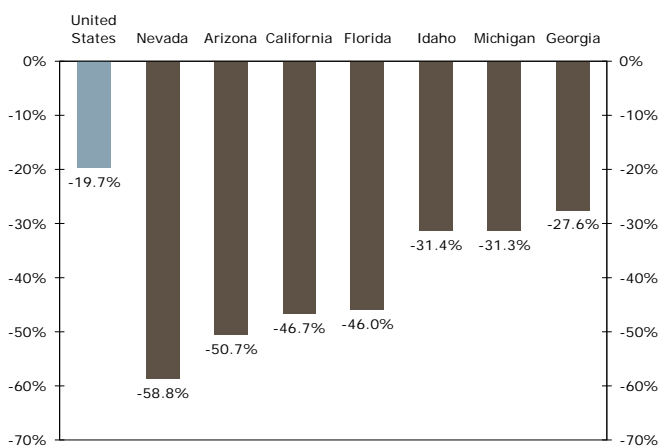
Negative Equity Mortgages - By State  
 Percent of Mortgages Outstanding



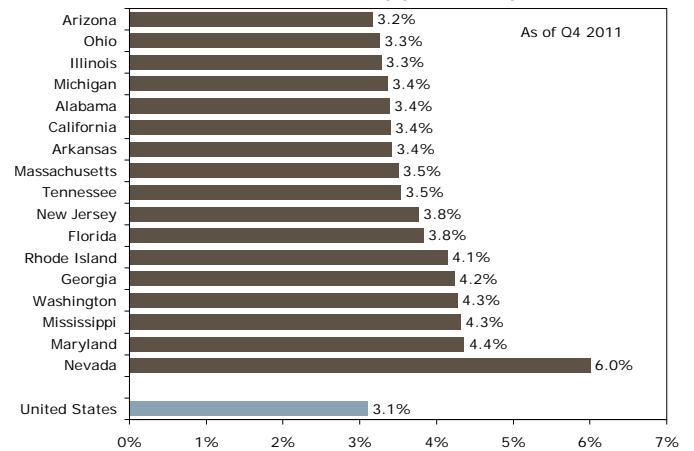
Shadow Inventory Rate by Metro Area  
 Percent of Total Loans, As of Jan. 2012



FHFA/OFHEO Home Price Index - By State  
 Percent Change, Peak to Trough



Mortgages 90+ Days Delinquent - By State  
 Percent of Mortgages Outstanding



Source: FHFA, CoreLogic, Mortgage Bankers Association, U.S. Department of Commerce and Wells Fargo Securities, LLC

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