

Economics Group

Special Commentary

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Housing Chartbook: July 2010

Housing Falters after the Tax Credit Expires

The response to the ending of tax credits for first-time homebuyers and some trade-up purchases was fast and furious. New home sales plunged immediately following the April 30 deadline to put home purchases under contract. Existing home sales were expected to hold up for another couple of months, but posted a surprising 2.2 percent drop in May, as a large number of pending purchases had trouble clearing newly implemented credit and appraisal guidelines. Problems with the National Flood Insurance Program also added to closing delays. As a result, Congress extended the deadline to close on purchases already under contract to Sept. 30. The delay should prove fortuitous to homebuyers, as mortgage rates have fallen sharply in recent weeks.

Now that the tax credit is behind us, we can refocus our analysis on the underlying fundamentals of the housing market, which have improved modestly over the past year. One area where conditions have clearly improved is on the supply side, where the inventory of completed homes for sale has fallen to its lowest level in six years. The reduced supply of new homes for sale is one of the steps necessary to bring the market into balance. There is still a tremendous supply of existing homes on the market and a more-difficult-to-quantify shadow inventory of homes either in foreclosure or homes where the borrower is seriously delinquent. The largest concentration of these homes are in states where the housing bubble inflated the most, including Florida, Nevada, Arizona and California. Other problem states include Illinois, New Jersey, Michigan and Georgia. We expect to see more of these homes come on the market during the second half of this year, as foreclosure activity increases and banks dispose of more properties.

The reduced supply of new homes for sale is one of the steps necessary to bring the market into balance.

Figure 1

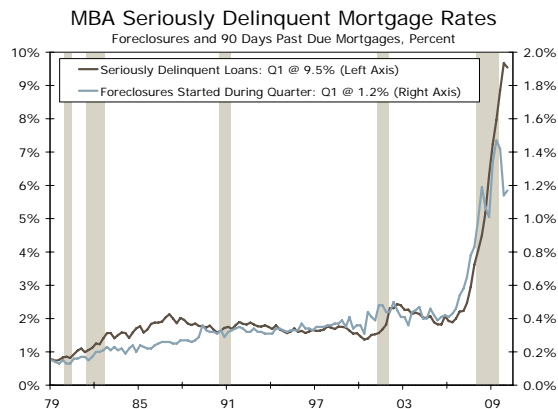
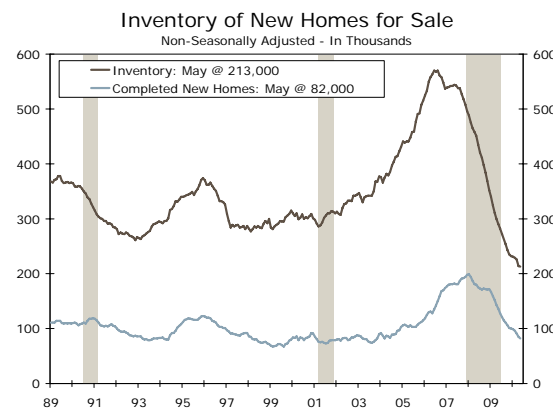
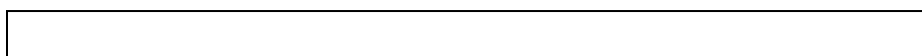


Figure 2



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



With distressed sales likely counting for a larger proportion of home sales during the second half of this year, we will probably see some renewed pressure on home prices. We expect to see a slide in home prices across most of the major price measures and look for the S&P Case-Shiller Index to decline between 4 percent and 6 percent from current levels by the end of this year. Declines in the National Association of Realtors and the Federal Housing Finance Agency price measure will be less severe, with drops in the 2 percent range. New home prices will also likely fall, as builders strive to compete with the onslaught of foreclosures. The larger drop in the S&P Case Shiller Index is due to the higher number of troubled nontraditional mortgages, which were particularly popular in parts of the country where housing activity and prices increased the most.

With distressed sales likely counting for a larger proportion of home sales during the second half of this year, we will likely see some renewed pressure on home prices.

Demand for both new and existing homes was likely pulled forward with the tax credits. As a result, sales and new home construction will likely slip a bit further in coming months. Mortgage applications for the purchase of a home provided a strong indication of how big a payback we would see in new home sales in May. The surprise in the decline in sales occurred all in one month. Mortgage purchase applications fell even further in June, suggesting sales likely fell an additional 6 percent to 8 percent that month.

Declines in home sales mean housing starts will likely fall further over the summer. We look for starts to average just a 524,000-unit pace in the third quarter and to total just 580,000 units for all of 2010. Builders have been extremely cautious over the past year and have built relatively few speculation homes. There has been a great deal of energy placed in reducing inventories and strengthening their balance sheets. Some analysts look at the low current levels of inventories and are building in a quick recovery in new home construction. We doubt building activity will pick up ahead of demand, however, as many builders are having trouble securing financing, particularly from community banks. We do expect activity to pick up this fall and are reasonably optimistic about 2011, but the recovery will be slow.

Longer term, there are questions about just how strong demand for new homes will be. The previous cycle saw the homeownership rate surge to 69 percent around the middle of the decade. The homeownership rate has since slipped around two percentage points to 67.2 percent, and most of the analysts that follow the housing market expect it to fall further in coming years. We agree with this assessment but do not see the homeownership rate falling back to the lower levels seen in the mid-1980s to mid-1990s. Much of the decline in homeownership has occurred among the young, while gains among other age cohorts and demographics appear to be holding up relatively well. We see the overall homeownership rate sliding to around 66 percent over the next few years, as tighter underwriting standards prevent more households from purchasing a home.

Figure 3

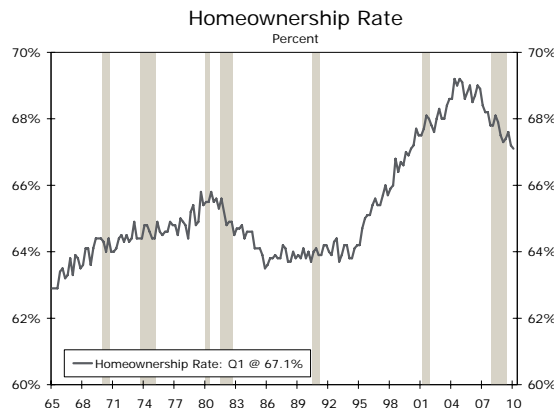
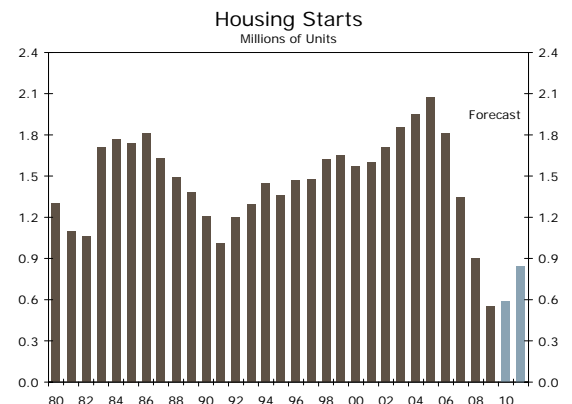


Figure 4



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

National Housing Outlook

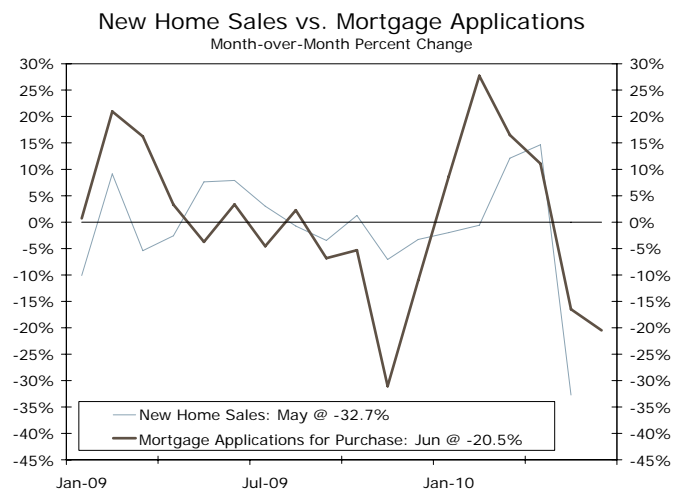
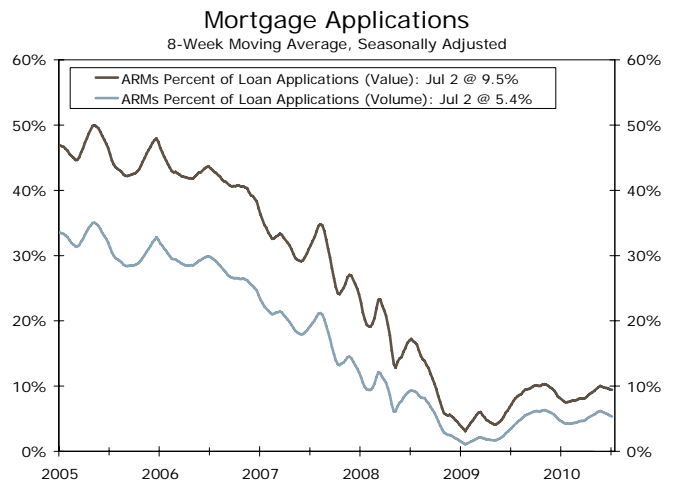
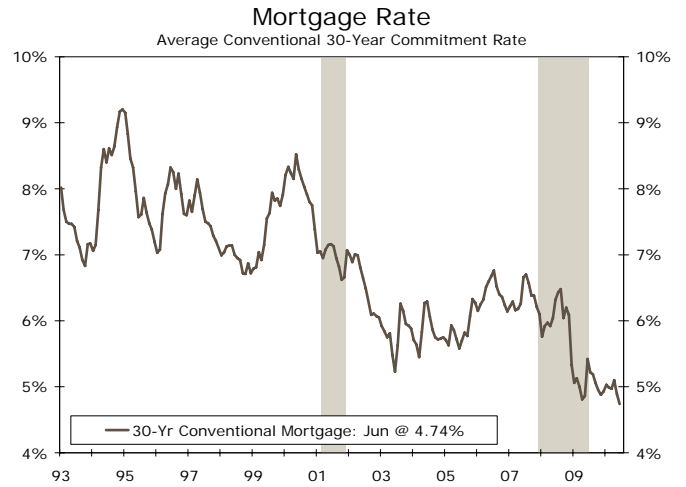
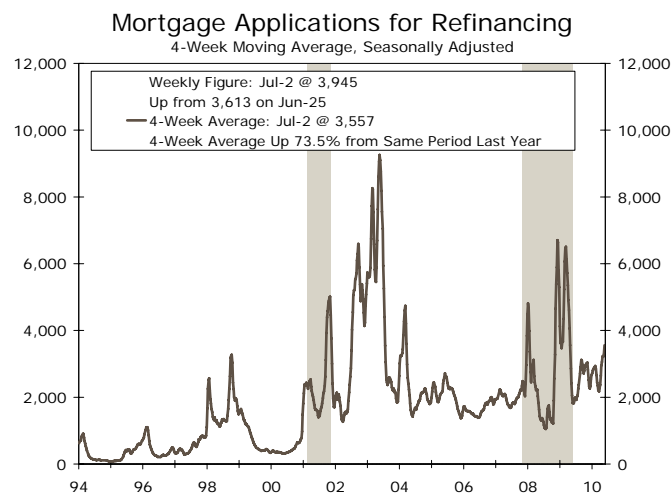
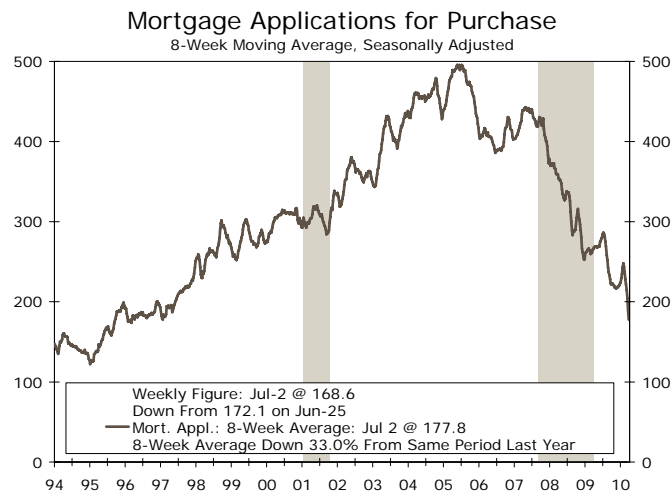
	Forecast				
	2007	2008	2009	2010	2011
Real GDP, percent change	2.1	0.4	-2.4	2.9	2.3
Nonfarm Employment, percent change	1.1	-0.6	-4.3	-0.5	1.1
Unemployment Rate	4.6	5.8	9.3	9.7	9.6
Home Construction					
Total Housing Starts, in thousands	1341.8	900.0	554.3	584.4	845.0
Single-Family Starts, in thousands	1035.8	616.3	442.3	484.4	620.0
Multi-Family Starts, in thousands	306.1	283.7	112.0	100.0	225.0
Home Sales					
New Home Sales, Single-Family, in thousands	768.7	482.2	373.9	370.0	480.0
Total Existing Home Sales, in thousands	5674.7	4892.0	5157.9	4981.0	5678.0
Existing Single-Family Home Sales, in thousands	4959.2	4337.5	4566.7	4358.4	4939.9
Existing Condominium & Townhouse Sales, in thousands	715.5	554.5	591.3	622.6	738.1
Home Prices					
Median New Home, \$ Thousands	243.7	230.4	214.5	205.4	211.2
Percent Change	0.3	-5.5	-6.9	-4.2	2.8
Median Existing Home, \$ Thousands	215.5	195.8	172.5	170.2	173.0
Percent Change	-2.9	-9.2	-11.9	-1.4	1.7
FHFA (OFHEO) Home Price Index, Percent Change	1.8	-3.0	-4.0	-1.3	1.4
Case-Shiller C-10 Home Price Index, Percent Change	-4.4	-16.7	-12.9	-2.0	1.6
Interest Rates - Annual Averages					
Prime Rate	8.05	5.08	3.25	3.30	3.40
Ten-Year Treasury Note	4.63	3.66	3.26	3.25	3.60
Conventional 30-Year Fixed Rate, Commitment Rate	6.34	6.04	5.04	4.86	5.20
One-Year ARM, Effective Rate, Commitment Rate	5.56	5.18	4.71	4.15	4.30

Forecast as of: July 8, 2010

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

Mortgages

- Mortgage purchase applications are now down 41 percent after peaking in late April as homebuyers rushed to meet the tax credit deadline. The pullback in purchase applications likely signals residential construction outlays will fall further this summer.
- Purchase applications have set a new cycle low but could be forming a trough. If so, this suggests at least a modest pick-up in sales and construction is imminent following a tax credit payback.
- Low mortgage rates continue to strengthen refinancing activity. On an eight-week trend basis, refinancing applications have been positive for each of the past seven weeks. Refinance applications have been positive for each of the past seven weeks. Refinance applications are now up 32.5 percent from their May 7 trough.

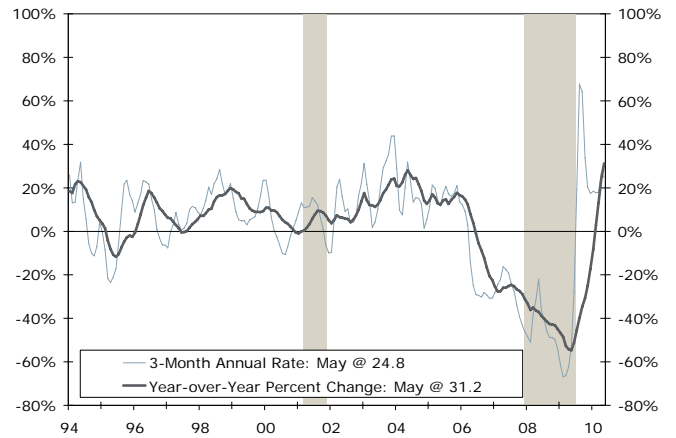


Source: Mortgage Bankers Association, FHLMC, U.S. Department of Commerce and Wells Fargo Securities, LLC

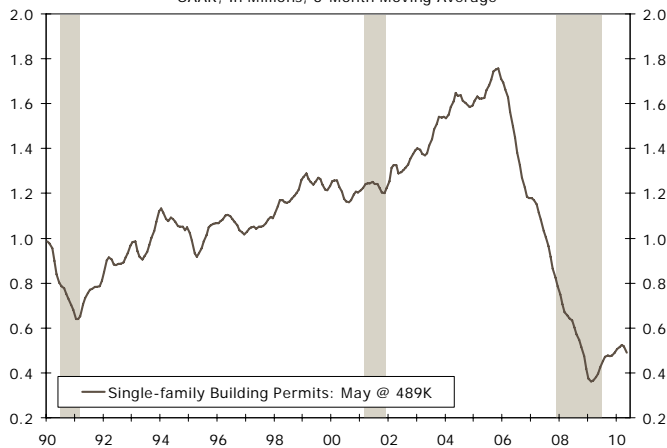
Single-Family Construction

- Single-family construction outlays have been in positive territory for nearly a year but will likely retrench following the expiration of the homebuyers' tax credit in the second quarter. We expect residential investment could fall around a 9 percent annual rate in the third quarter but should begin to rise modestly in subsequent quarters.
- Single-family permits have now declined in each of the past two months but are well above their historical low reached in early 2009. Homebuilders have likely gotten all the boost they are going to get from the tax incentive.
- Builder sentiment remains exceptionally low and is a clear warning sign that the recovery will be slow.

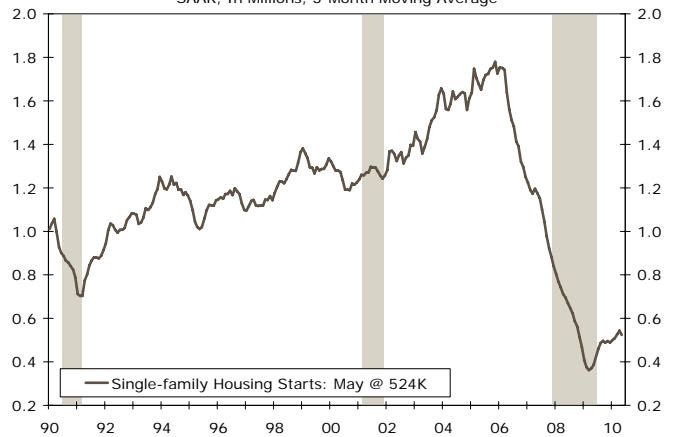
Private Single-family Construction Spending



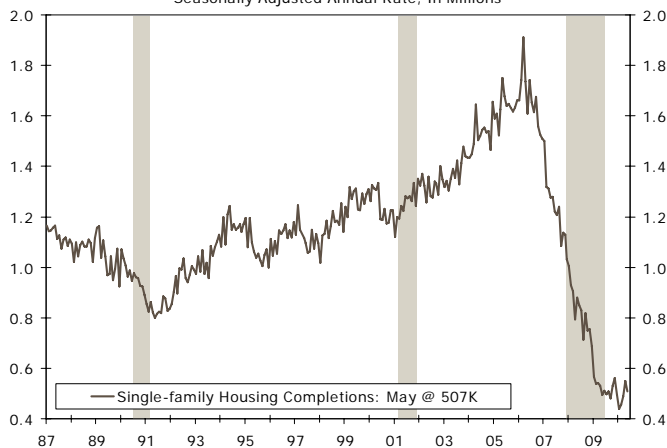
Single-family Building Permits
 SAAR, In Millions, 3-Month Moving Average



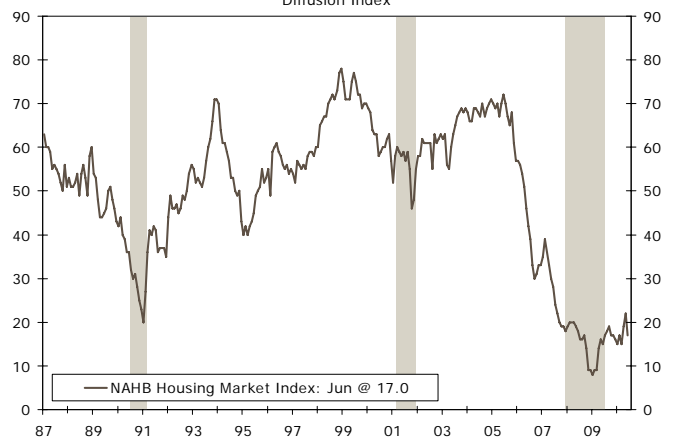
Single-family Housing Starts
 SAAR, In Millions, 3-Month Moving Average



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



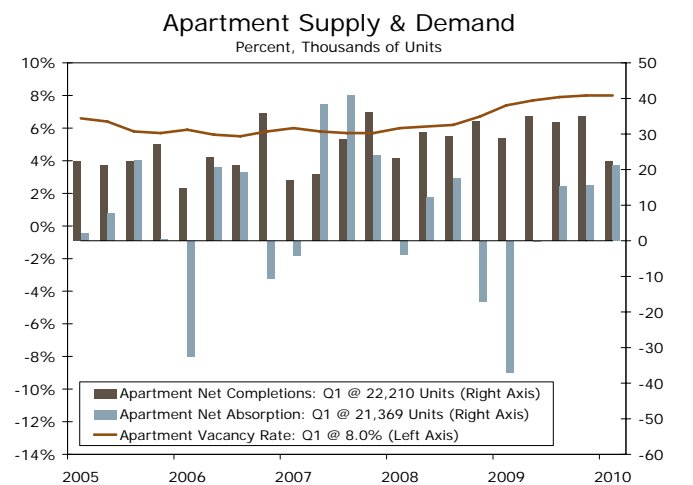
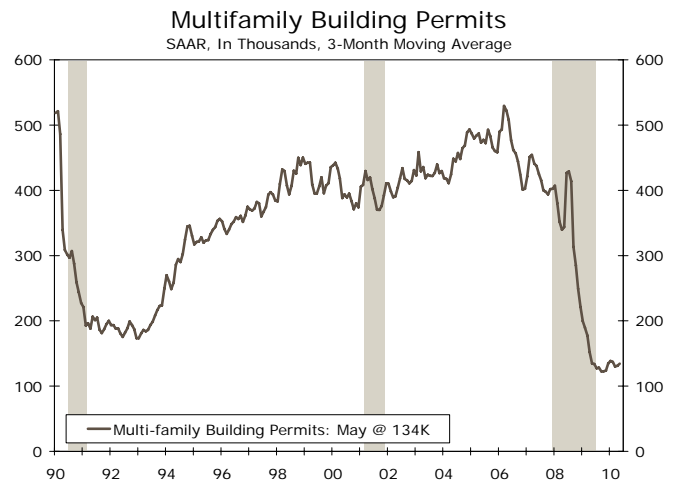
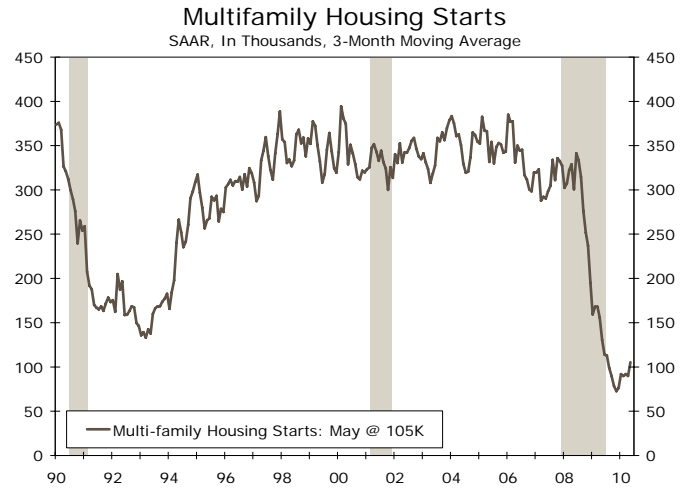
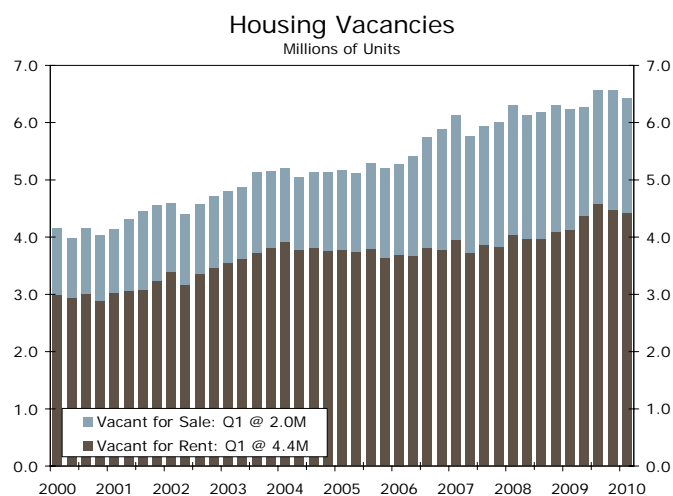
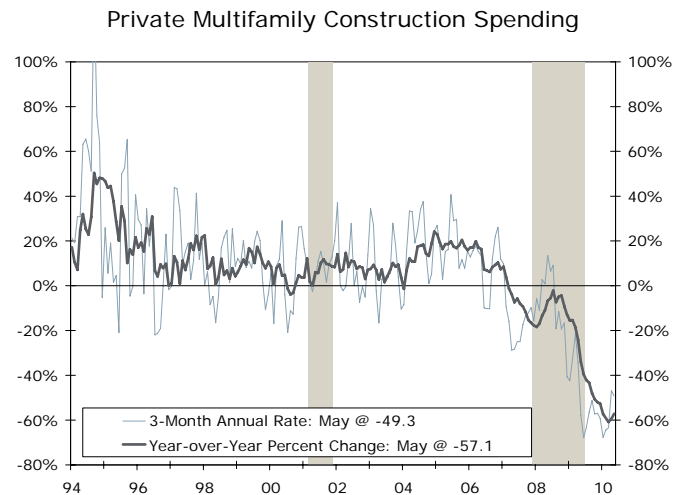
NAHB/Wells Fargo Housing Market Index
 Diffusion Index



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

Multifamily Construction

- Multifamily construction outlays peaked well before the onset of the recession and are now at their lowest level in almost 16 years. Declines have largely been due to competition from the oversupply of for-sale housing for rent.
- The expiration of the homebuyers' tax credit and better labor market conditions could help fuel multifamily demand.
- Apartment property fundamentals have already shown signs of stabilization. Apartment net absorption rose in each of the past three quarters, and effective rent growth posted a mild gain in the first quarter after five consecutive quarters of negative rent growth.

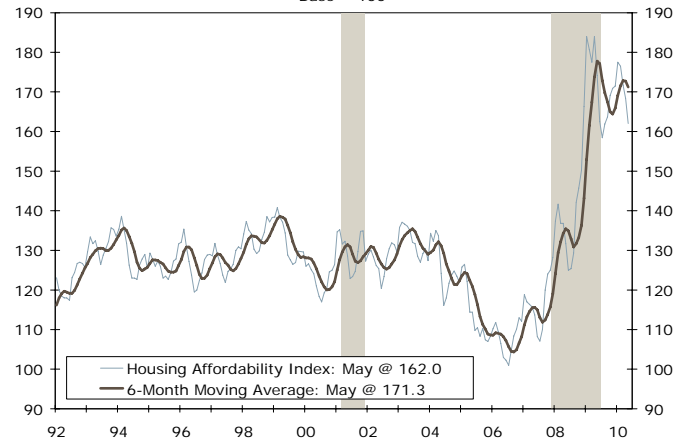


Source: U.S. Department of Commerce, REIS, Inc. and Wells Fargo Securities, LLC

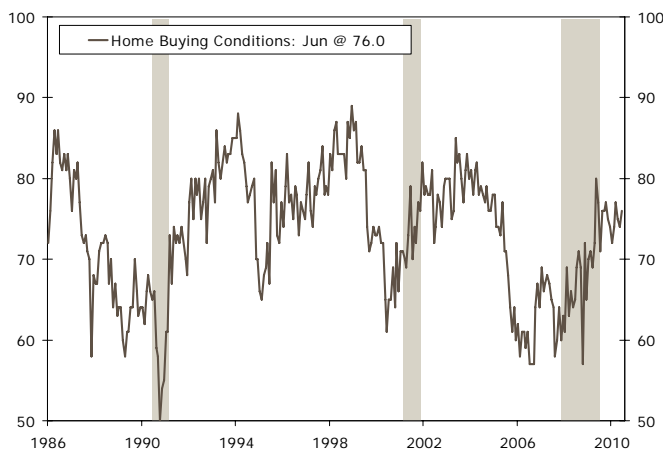
Buying Conditions

- Home-buying conditions remain favorable with mortgage rates at historic lows and prices now down 3.1 percent from a year ago. Obstacles still remain such as higher down payment requirements and tougher appraisal standards.
- While mortgage rates began drifting higher after the Federal Reserve's program to purchase mortgage-backed securities ended, uncertainty around sovereign risk in the euro area pulled the 10-year Treasury yield below 3 percent, which brought the 30-year mortgage rate down to 4.74 in June. We expect mortgage rates to remain at or below 5 percent through year-end.

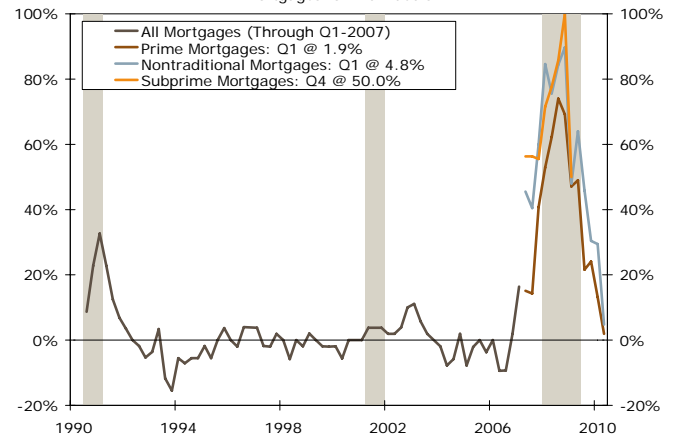
Housing Affordability, NAR-Home Sales
Base = 100



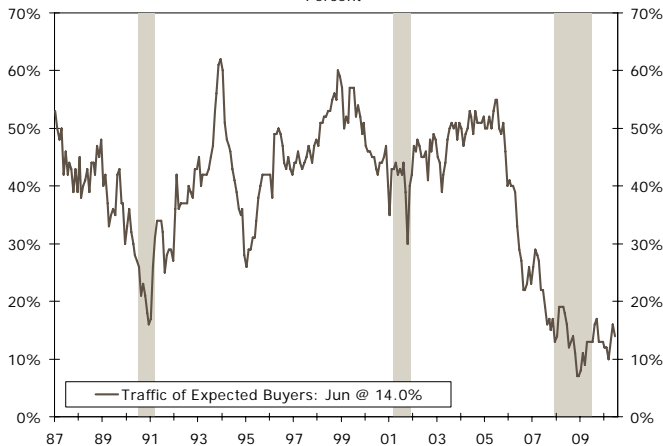
U. Michigan Sentiment Home Buying Conditions
Index



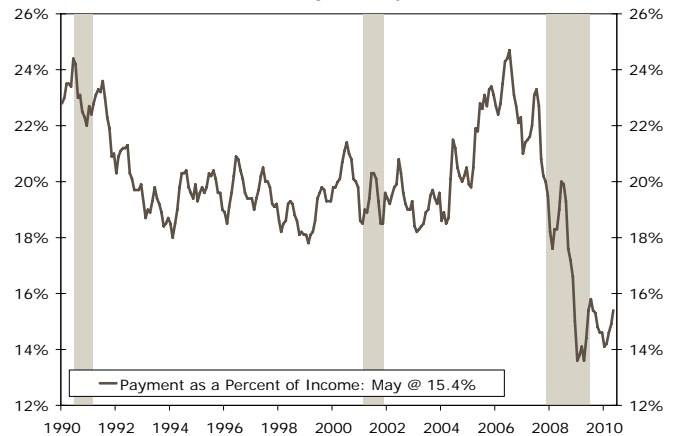
Net Percent of Banks Tightening Standards
Mortgages for Individuals



NAHB Expected Buyer Traffic
Percent



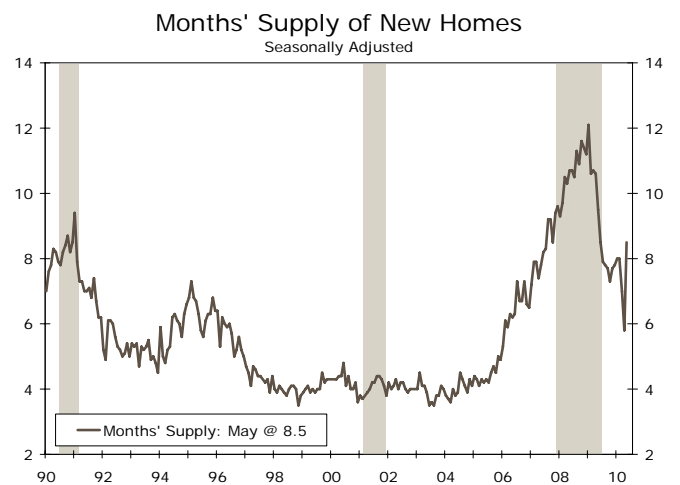
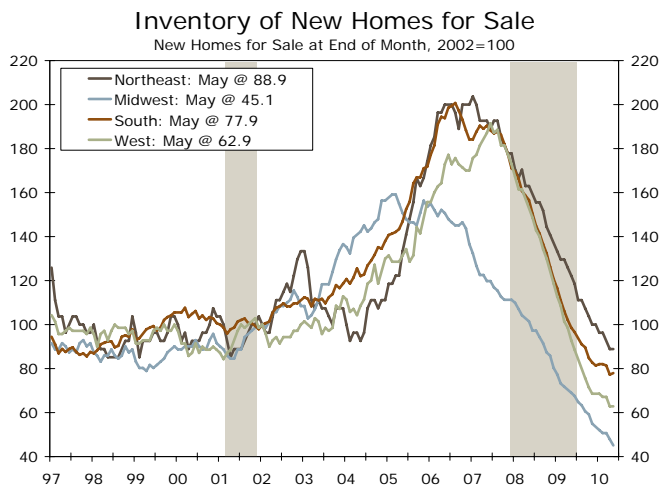
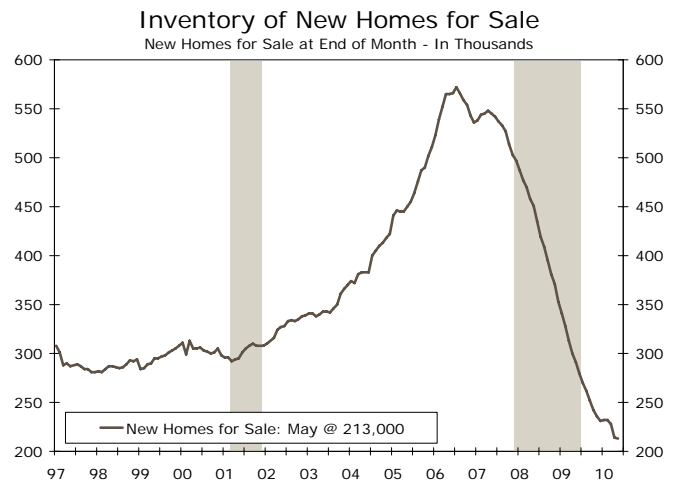
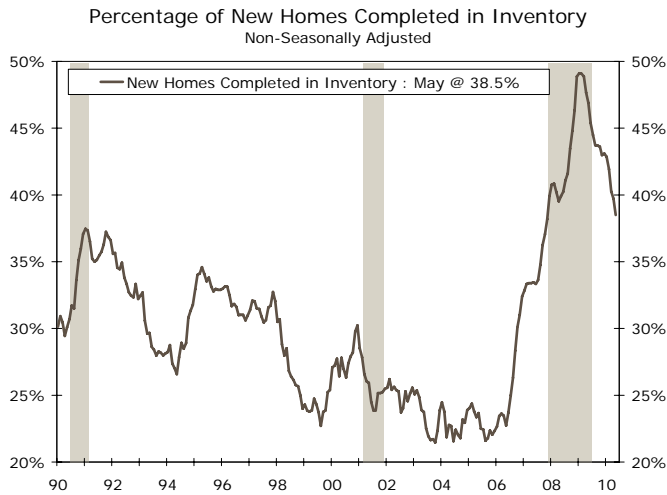
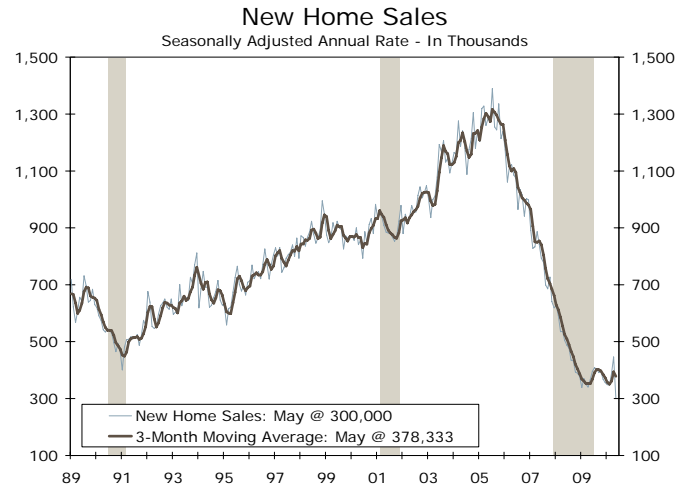
Payment on Median Priced Single-family Home
As a Percentage of Family Income



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

New Home Sales

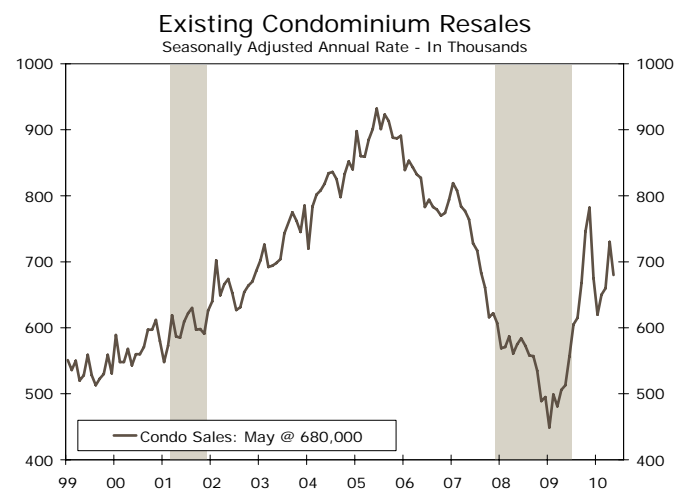
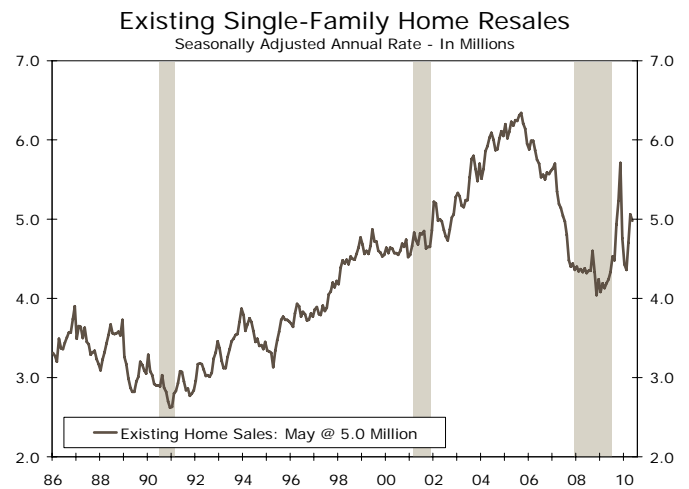
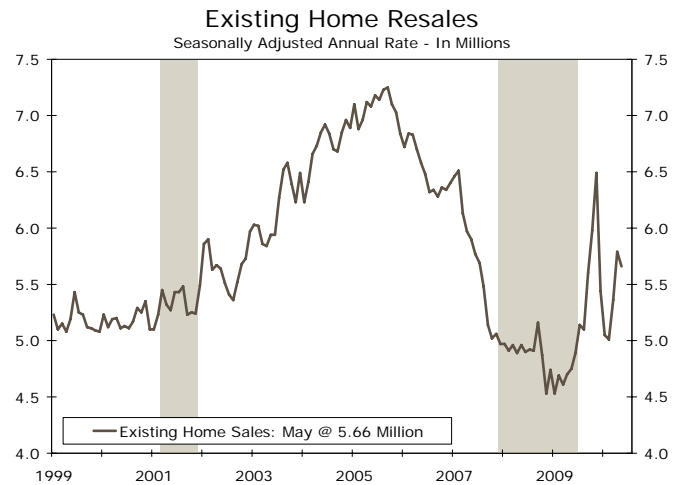
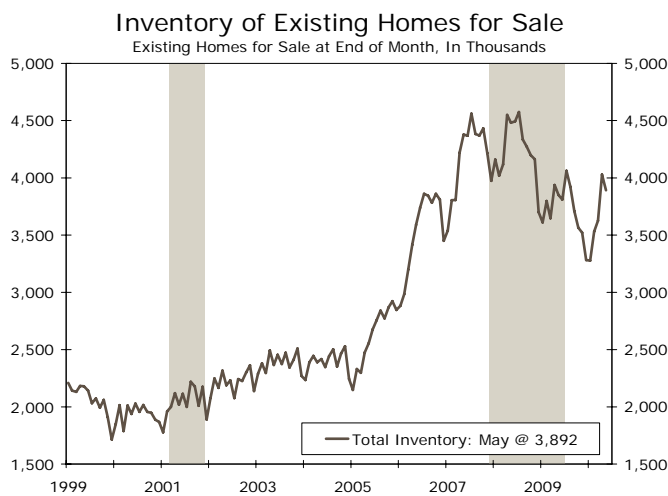
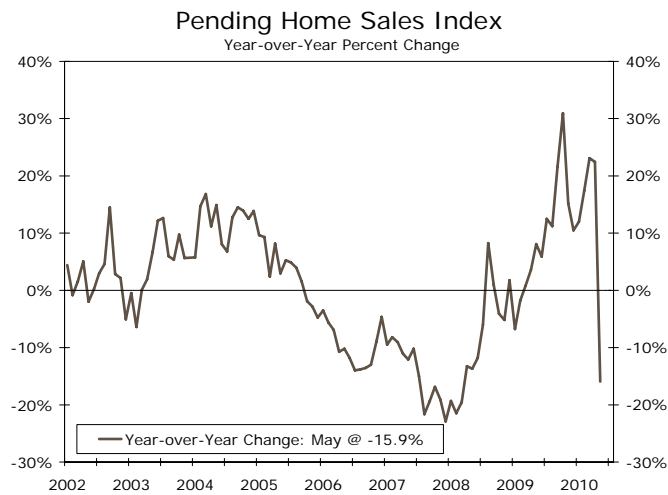
- Giving back much of their recent gains, new home sales dropped 32.7 percent in May to a 300,000-unit pace, the lowest level on record. The sharp decline is likely due to homebuyers rushing to meet the April 30 contract signing deadline for the tax credit. The seasonal adjustment process also likely exaggerated the slowdown.
- Inventories of homes for sale fell for the third consecutive month to 213,000 in May, its lowest level in nearly 40 years. The actual number of homes available for sale is now lower than any other recession since the series began in 1963. Due to the sharp decline in new home sales, months' supply is now 8.5 months.



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

Existing Home Sales

- Existing home sales posted a surprising 2.2 percent decline in May. According to the National Association of Realtors, roughly 180,000 homebuyers who signed contracts could not close by the end of June due to delays in mortgage processing, which included tougher appraisals and higher financial hurdles. Potential sales were also deferred by an interruption in the National Flood Insurance Program (NFIP). The tax credit closing deadline and the NFIP reauthorization were extended to Sept. 30.
- First-time buyers accounted for 46 percent of total sales and distressed sales accounted for 31 percent of overall sales.

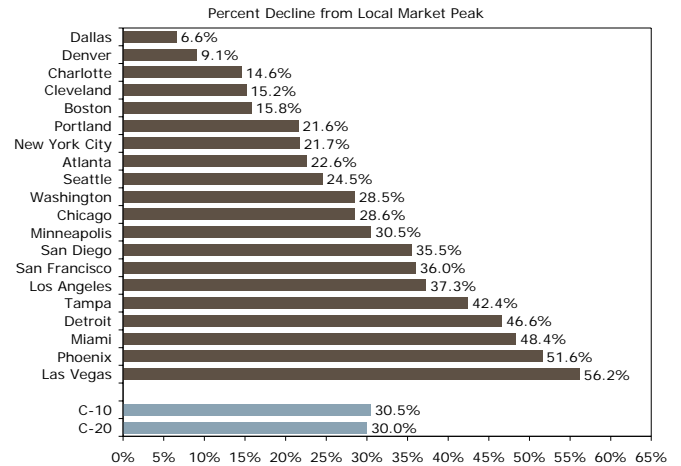


Source: National Association of Realtors and Wells Fargo Securities, LLC

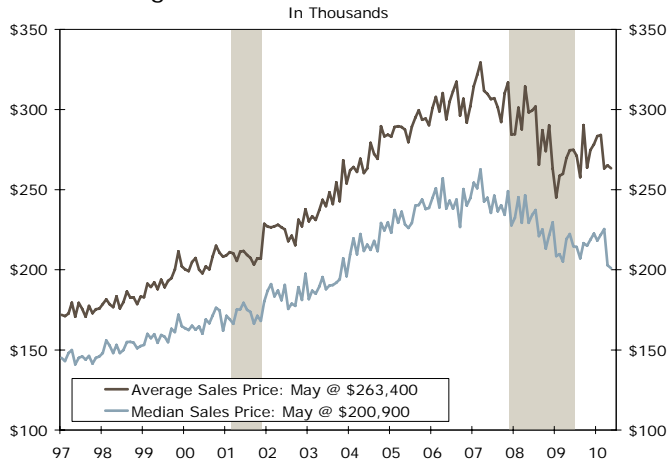
Home Prices

- Many of the closely followed home price indexes have posted monthly or quarterly increases suggesting the worst of the price declines are likely behind us. Recent gains, however, have been driven by a rise in sales volume fueled by the tax credit. A similar pattern occurred in October and November when the initial tax credit was scheduled to expire.
- Home prices will likely come under pressure in coming months as the effect of the tax credit fades and foreclosed properties and seriously delinquent mortgages still hang over the market.
- All real estate is local, and price declines will not be the same in all regions. States that experienced the housing boom and bust cycle will take longer to recover.

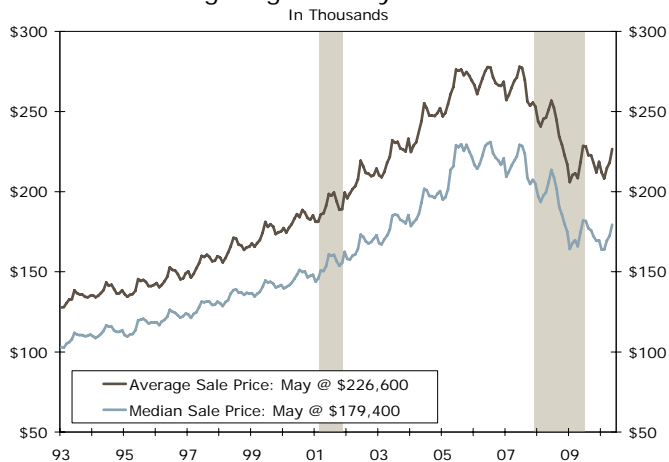
S&P Case-Shiller Home Prices



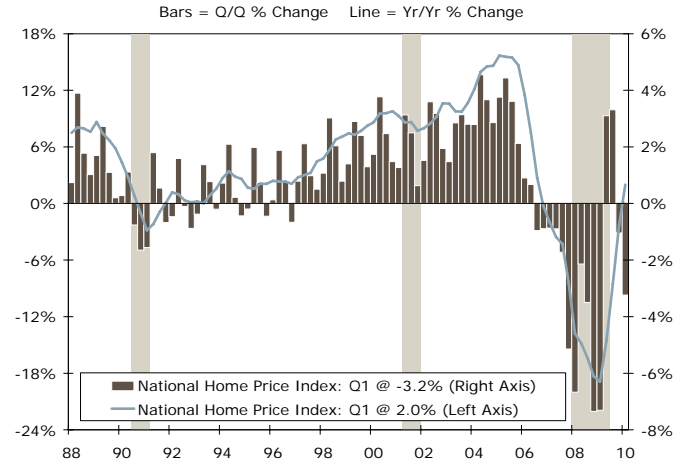
Average and Median New Home Sale Price



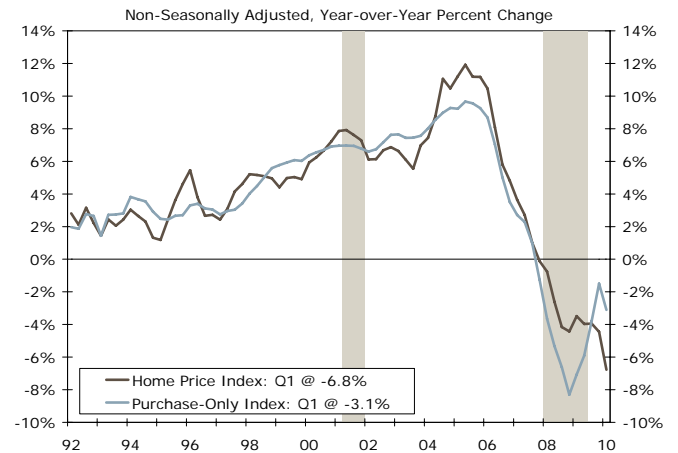
Existing Single-Family Home Prices



S&P Case-Shiller National Home Price Index, NSA



FHFA Home Price Indices

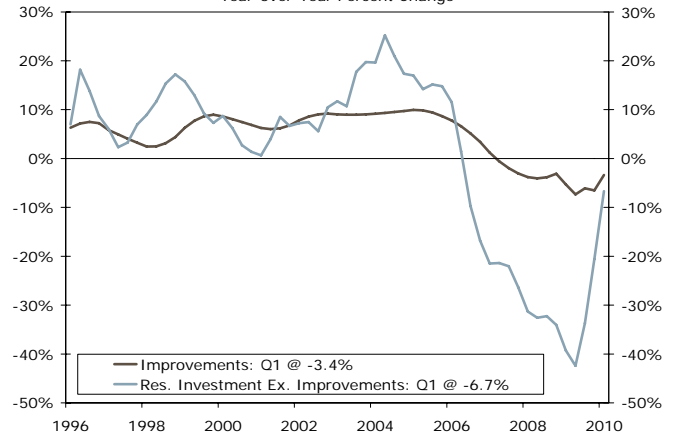


Source: FHFA, NAR, S&P Corp, U.S. Department of Commerce and Wells Fargo Securities, LLC

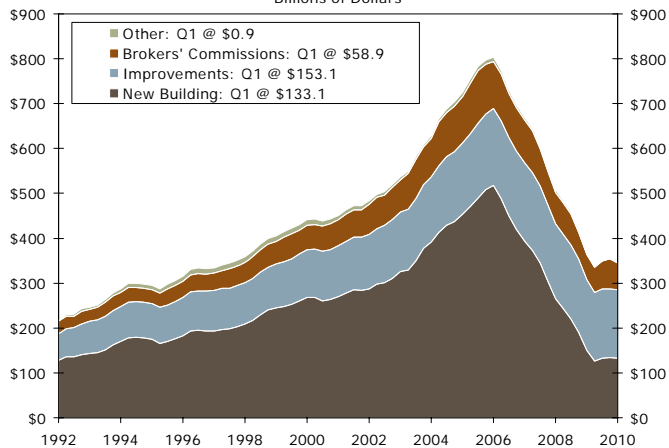
Renovation & Remodeling

- Home improvements bottomed in mid-2009 and are now up 26.6 percent. Recent gains are likely due to consumer energy tax incentives, such as cash for appliances and weatherization systems.
- The energy incentives are state administered and available on a first-come, first-served basis. Many states such as Florida have already depleted their funds well before the expiration date. Increases will likely not be sustainable as the rebates are available only through the end of the year.
- Another boon to improvements has been the surge of foreclosure sales that have produced a steady stream of homes in need of repair.

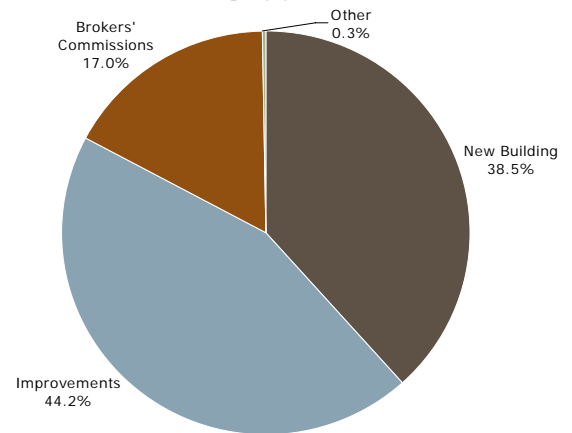
Residential Investment
Year-over-Year Percent Change



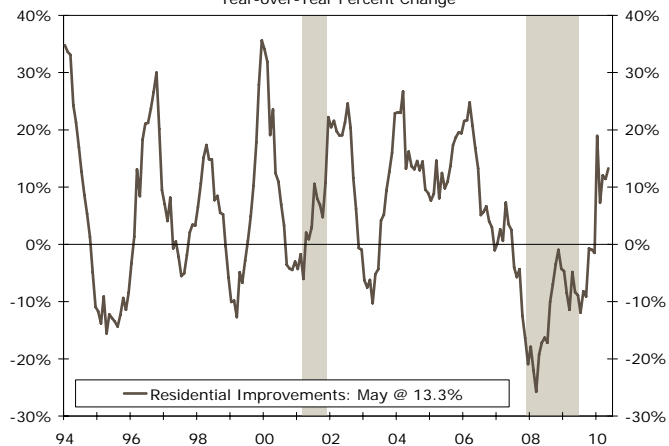
Residential Investment
Billions of Dollars



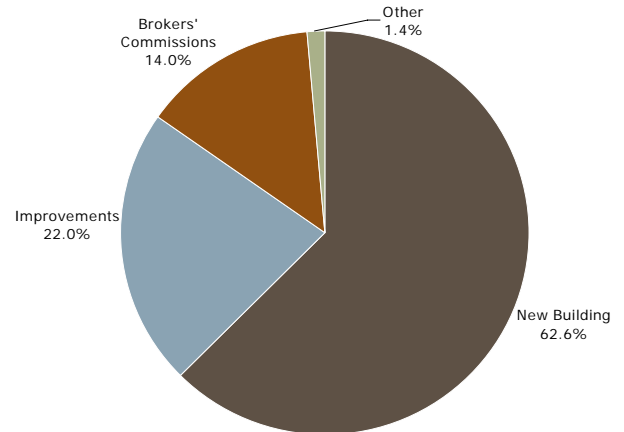
Residential Investment
Q1-2010



Residential Improvements
Year-over-Year Percent Change



Residential Investment
Q1-2005



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

Wells Fargo Securities, LLC Economics Group

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