WACHOVIA
ECONOMICS GROUP

SPECIAL COMMENTARY

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Housing Chartbook: April 2009

Mark Vitner, Senior Economist
mark.vitner@wachovia.com
704-383-5635
Adam G. York, Economist
adam.york@wachovia.com
704-715-9660

Closing in on a Bottom in 2009

Signs are beginning to emerge that suggest sales of new and existing homes are moving toward a bottom. Actual sales figures took a positive turn in February and mortgage applications for the purchase of a home have increased in recent weeks as mortgage rates have tumbled. We expect sales to bottom this summer and look for some modest improvement during the second half of the year. Such a turn of events would be consistent with past recessions, which saw home sales turn around approximately six months before the broader economy did.

Home sales have turned up around the country, particularly in the hardest hit markets, where short sales and foreclosure sales account for a large proportion of transactions. The National Association of Realtors (NAR) estimates that distressed sales have accounted for 45 percent of existing home sales in recent months, which is one reason why prices have fallen so sharply. The combination of falling home prices and lower mortgage rates has made home ownership much more affordable. The NAR Housing Affordability Index has surged more than 50 points over the past 6 months and is at an all-time high.

Home sales bottoming out does not mean sales are about to turn decisively higher. While housing affordability has improved and investor sales (to investors rather than speculators) have increased, we doubt home sales will turn up in a decisive way until employment conditions improve. Our latest forecast has the unemployment rate rising through the middle of next year. As a result, we do not see any real strength returning to the housing market until late next year or in 2011.

New home construction is in virtual free fall and we expect housing starts to contract a bit further as builders continue to work off excess inventories. The continued slide in residential construction reflects extremely tight credit conditions and builders' desire to bring inventories back in line with sales. Residential construction outlays are expected to have declined at a pace of at least 35 percent or more in the first quarter and are expected to fall at a 25 percent pace in the current quarter.

The plunge in homebuilding has brought the pace of single-family starts roughly in line with new home sales, which is something that has not happened in the history of these two series. While this might seem intuitively odd, new home sales include a narrower definition of transactions than housing starts by excluding houses built for rent, owner-built homes and houses that are built by a general contractor on the owner's land. In contrast, all of these are included in single-family starts.

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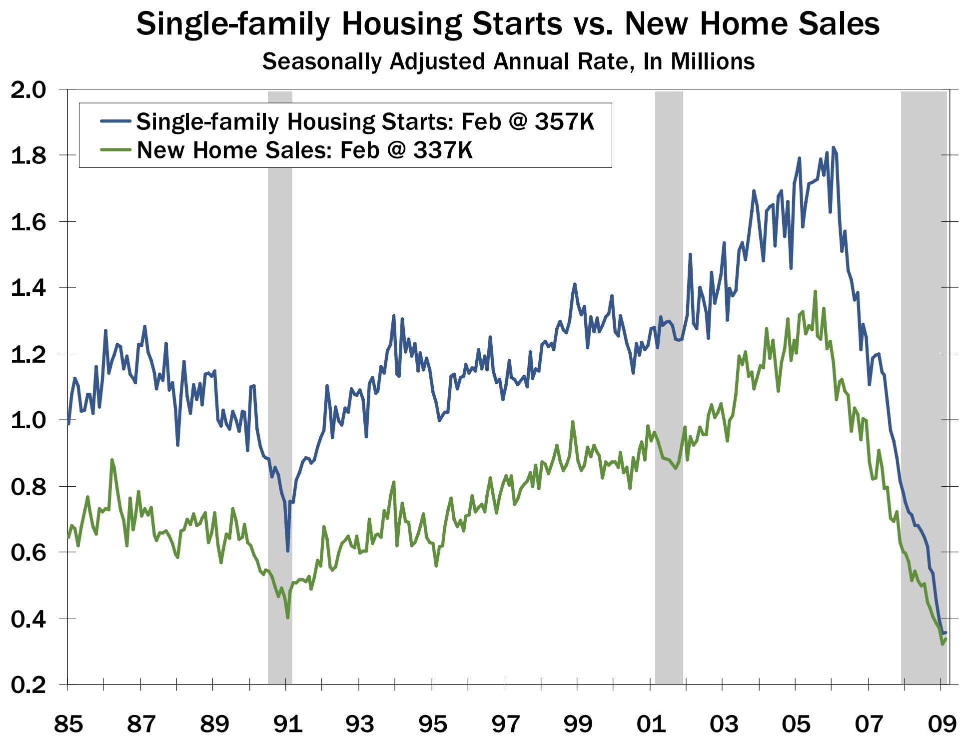


Source: U.S. Department of Commerce and Wachovia

The sharper than usual decline in single-family starts relative to home sales drives home how different this boom and bust are from what we have seen in the past. Even using the most conservative assumptions, single-family starts are now running below replacement demand, as they should. The number of vacant homes for sale or for rent is still running around two million units above what is considered normal.

Housing inventories actually increased late last year, with most of the increase in vacant homes for rent. The supply of rental properties is being bolstered by conversions of condominiums into rental units. The same thing is happening to many single-family residences that were initially purchased by speculators hoping to make a quick profit. Now those properties are being bought at greatly discounted prices through foreclosure sales and are being offered for rent.

Construction will remain constrained until inventories move back toward their historical norms. Once again, we believe this will be late next year at the earliest. In addition to the oversupply of properties, household formations have slowed as more people are choosing to remain in school, stay at home with their parents or other relatives or live with roommates. Household formations tend to pick up about a year after employment begins to rise, which means we may not see a material improvement in household formations until the middle of 2011.

While the news on the housing sector is no longer uniformly negative, we still believe home sales and residential construction face a long road to recovery. Housing remains in oversupply and prices will continue to fall until supply and demand are back in balance. We expect both sales and starts to bottom by the middle of this year but do not expect to see a strong recovery take hold until late next year or 2011.

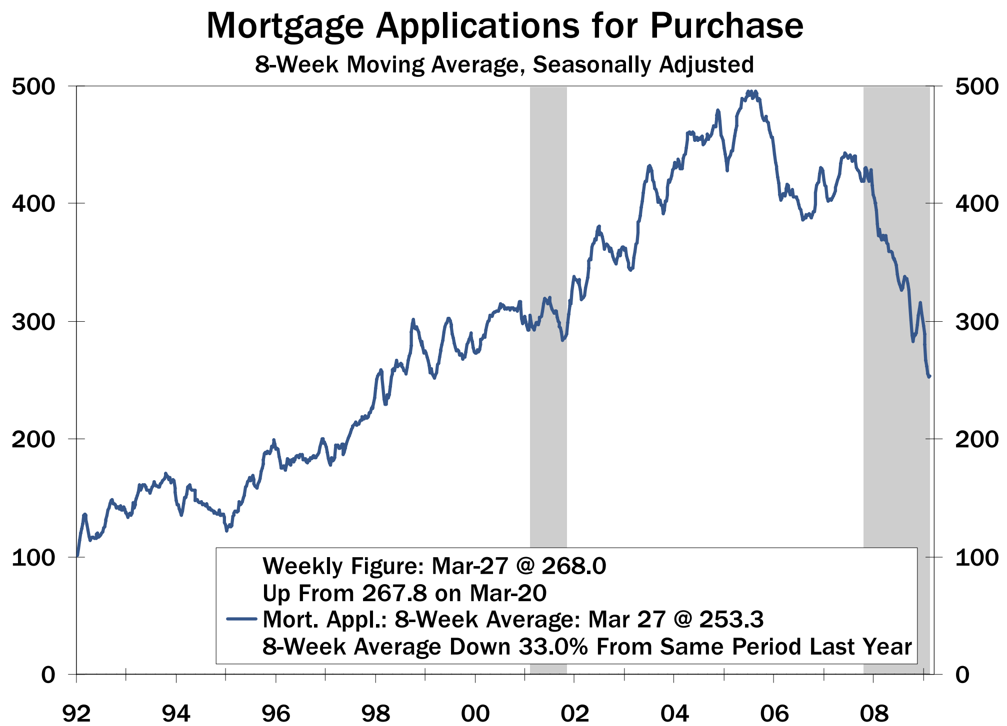
National Economic & Financial Outlook

	Actual				Forecast	
	2005	2006	2007	2008	2009	2010
Real GDP, percent change	2.9	2.8	2.0	1.1	-2.9	0.8
Nonfarm Employment, percent change	1.7	1.8	1.1	-0.4	-4.0	-1.4
Unemployment Rate	5.1	4.6	4.6	5.8	9.2	10.6
Home Construction						
Total Housing Starts, in thousands	2072.9	1811.9	1340.7	903.4	510.0	740.0
Single-Family Starts, in thousands	1718.5	1473.6	1034.0	617.1	350.0	510.0
Multi-Family Starts, in thousands	354.4	338.3	306.7	286.3	160.0	230.0
Home Sales						
New Home Sales, Single-Family, in thousands	1278.9	1049.3	768.0	482.3	360.0	400.0
Total Existing Home Sales, in thousands	7075.7	6517.6	5673.8	4893.8	4400.0	4625.0
Existing Single-Family Home Sales, in thousands	6180.8	5711.7	4960.0	4340.8	3925.0	4100.0
Existing Condominium & Townhouse Sales, in thousands	894.8	805.9	713.8	553.0	475.0	525.0
Home Prices						
Median New Home, $ Thousands	234.2	243.1	243.7	230.2	198.0	195.0
Percent Change	7.5	3.8	0.3	-5.5	-14.0	-1.5
Median Existing Home, $ Thousands	217.5	221.9	215.5	195.8	166.2	163.5
Percent Change	12.8	2.0	-2.9	-9.2	-15.1	-1.6
FHFA (OFHEO) Home Price Index, Percent Change	11.6	7.7	2.4	-2.6	-8.5	-3.0
Case-Shiller C-10 Home Price Index, Percent Change	16.9	7.4	-4.4	-16.7	-13.5	-3.0
Interest Rates - Annual Averages						
Prime Rate	6.19	7.96	8.05	5.08	3.25	3.35
Ten-Year Treasury Note	4.29	4.80	4.63	3.66	2.80	3.40
Conventional 30-Year Fixed Rate, Commitment Rate	5.87	6.41	6.34	6.04	4.85	5.10
One-Year ARM, Effective Rate, Commitment Rate	4.49	5.54	5.56	5.18	4.90	5.00

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

I. Mortgage Applications

Figure 1



Applications Get Help from Lower Rates

Mortgage applications, especially those for refinancing, continue to get considerable help from lower mortgage rates. With the Fed actively purchasing mortgage-backed securities as well as Treasury notes, interest rates have plummeted over the past few weeks. Refinancing applications have been volatile but in general are moving higher. Still, credit availability remains a major concern. Borrowers who have limited equity or poor credit still face an uphill battle in securing a refinancing. Dedicated government programs and bank staffs are attempting to assist borrowers that are delinquent or at risk, but these are taking time to work through the system.

Figure 2

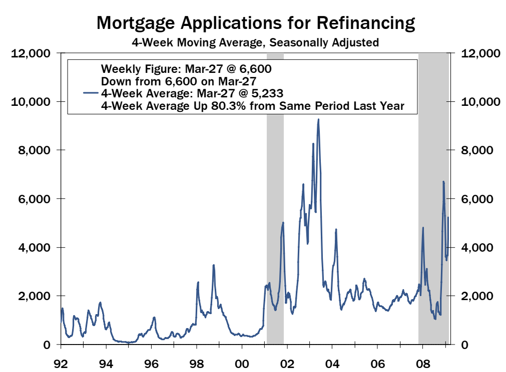
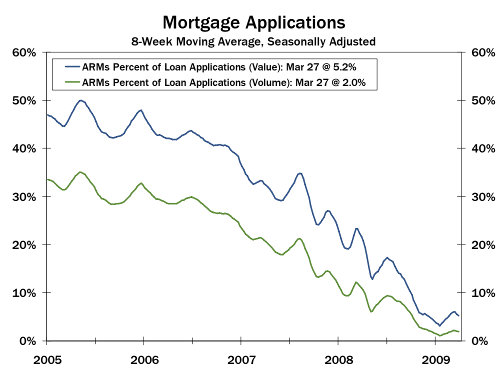


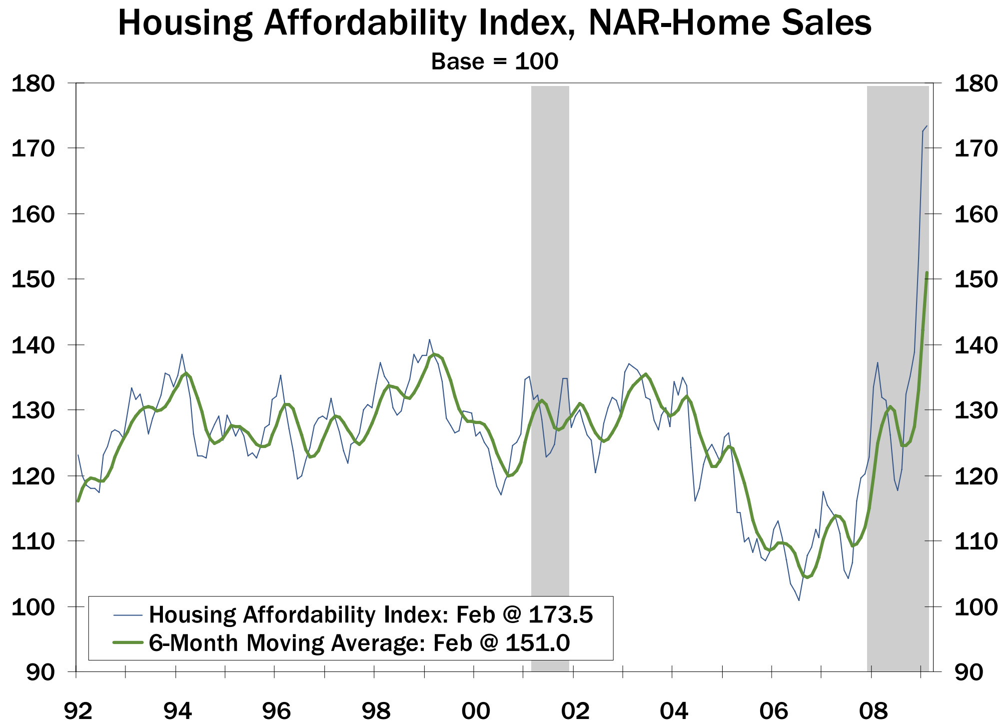
Figure 3



Source: Mortgage Bankers Association and Wachovia

II. Mortgage Rates & Affordability

Figure 4



Affordability Soars, Does it Matter?

Affordability measures continued to soar through the first few months of 2009, but our concerns about the relevance of the data remain. Clearly, the relevance of this key measure has been diminished by several key factors. Median home prices are being pushed sharply lower by distressed sales, which may be overstating the extent of price declines. Moreover, tighter credit standards and rising unemployment mean fewer consumers have access to today's low mortgage rates. So, while affordability may be improving, buyers are not likely to return to the market in a major way until overall economic growth improves.

Figure 5

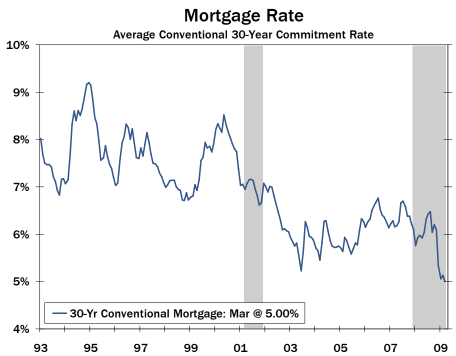
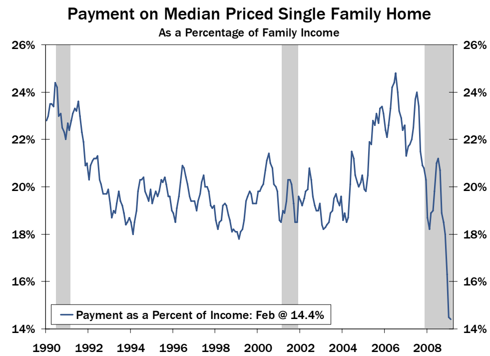


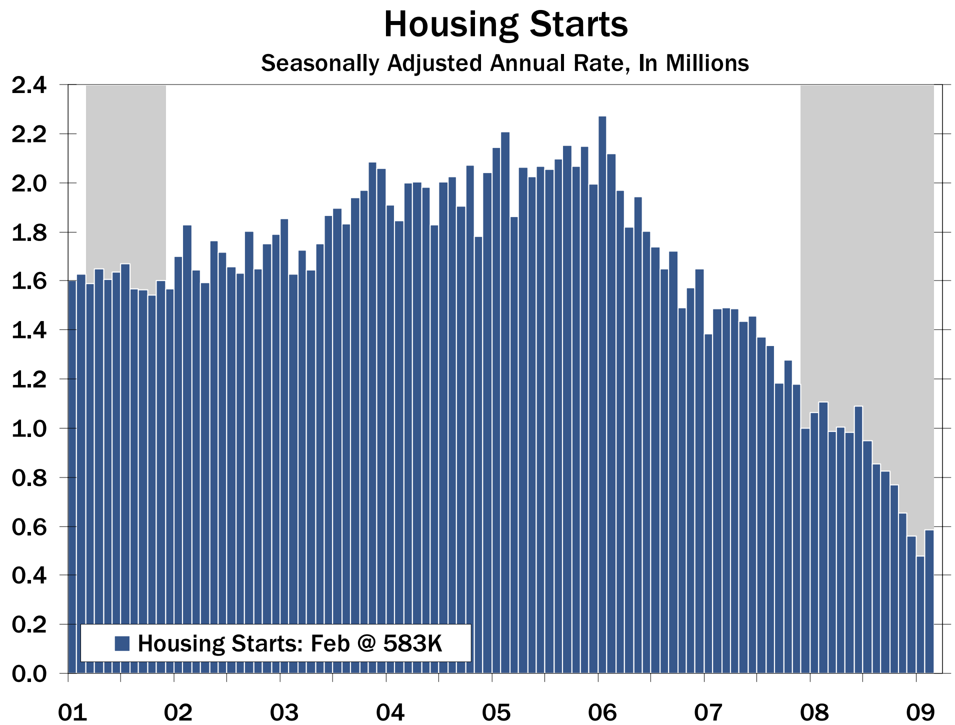
Figure 6



Source: Freddie Mac, National Association of Realtors, and Wachovia

III. Housing Starts

Figure 7



With Winter Comes Volatility

Housing starts made a large and unexpected jump higher in February, and while any good news is welcome in housing, we do not expect the gains to hold through spring. Winter always introduces considerable volatility for housing data and this may simply be a one-month aberration. While it is premature to call an absolute trough, a bottom is closer. Starts may hover near the half-million unit pace during the first half of this year, but should begin to slowly climb during the second half. We are probably two years away from seeing starts back above one million units, however, as we continue to struggle with excess inventory and a deep recession.

Figure 8

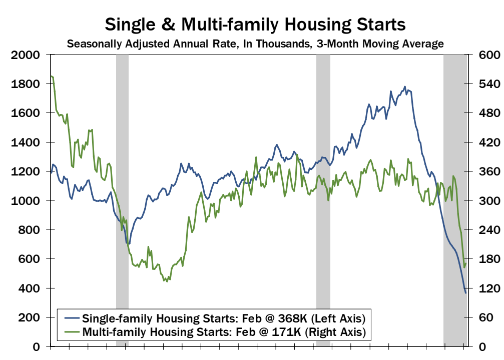
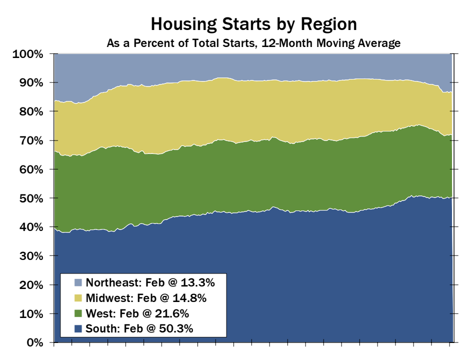


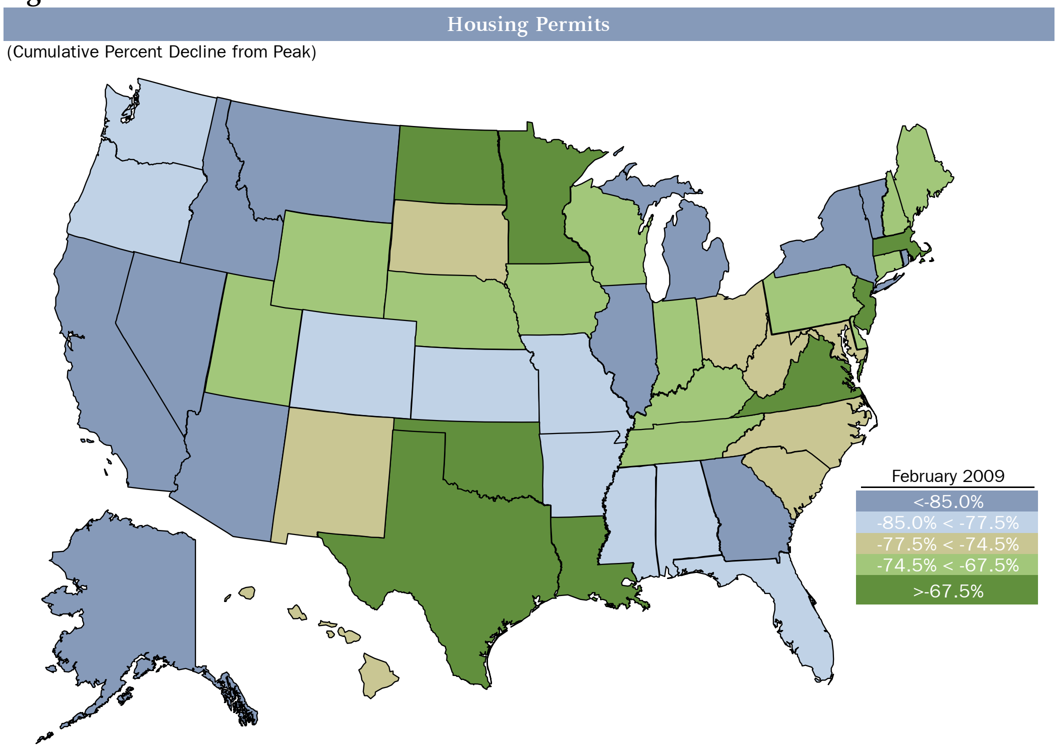
Figure 9



Source: U.S. Department of Commerce and Wachovia

IV. Housing Permits

Figure 10



Permits Hit Hard by Market Troubles, but Showing Signs of Stability

The steady declines we have seen in permits over the past several years appear to have stalled. While we have seen several similar periods over the past couple of years, most recently in summer 2008, there is at least some hope that this one may prove to be the actual trough. We are forming a bottom at extremely low levels that will prove very challenging to the nation's builders. Many are capital constrained. Unfortunately, even if we level out and hold this range, we are not looking for any near-term pick-up. Building activity will most likely remain depressed for some time to come as we work through the massive inventory overhang and builders work to strengthen their balance sheets.

Figure 11

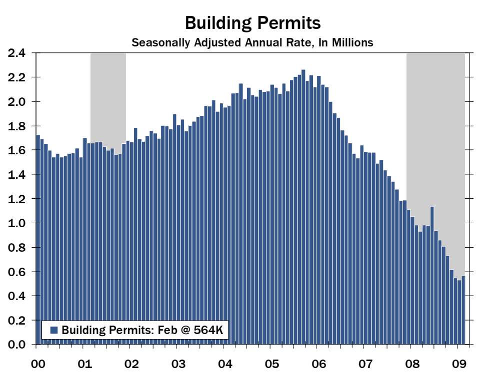
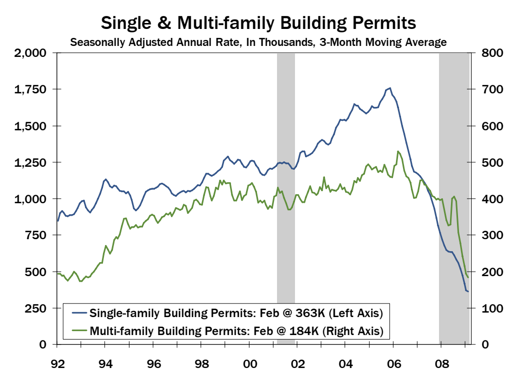


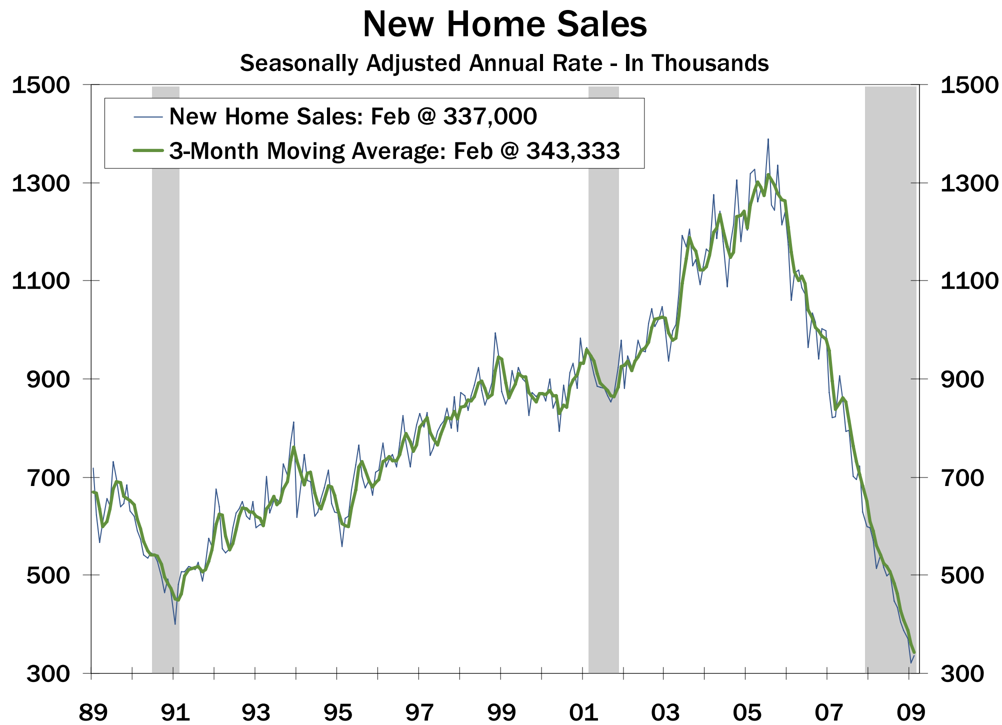
Figure 12



Source: U.S. Department of Commerce and Wachovia

V. New Homes

Figure 13



New Home Sales Remain Depressed

Sales of new homes will likely continue to struggle during the first half of 2009 as employment, economic concerns and mortgage market troubles, outweigh the improvements in overall affordability we have seen. Declines in completions and in general building activity mean less supply will be coming to the marketplace. Inventories may return to the "equilibrium" levels of the late 1990s by early this summer. There are a number of powerful incentives to purchase a new home in place today, including builder discounts, tax rebates for first-time home buyers and exceptionally low mortgage rates.

Figure 14

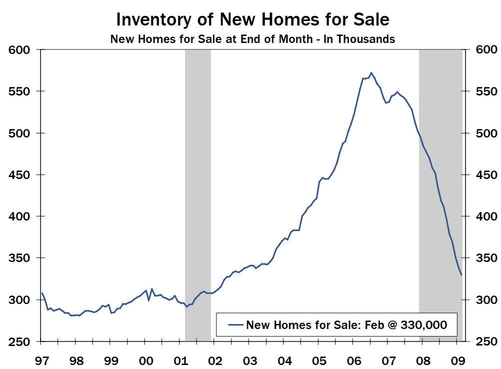
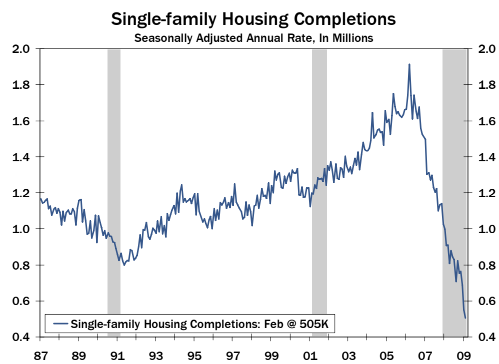


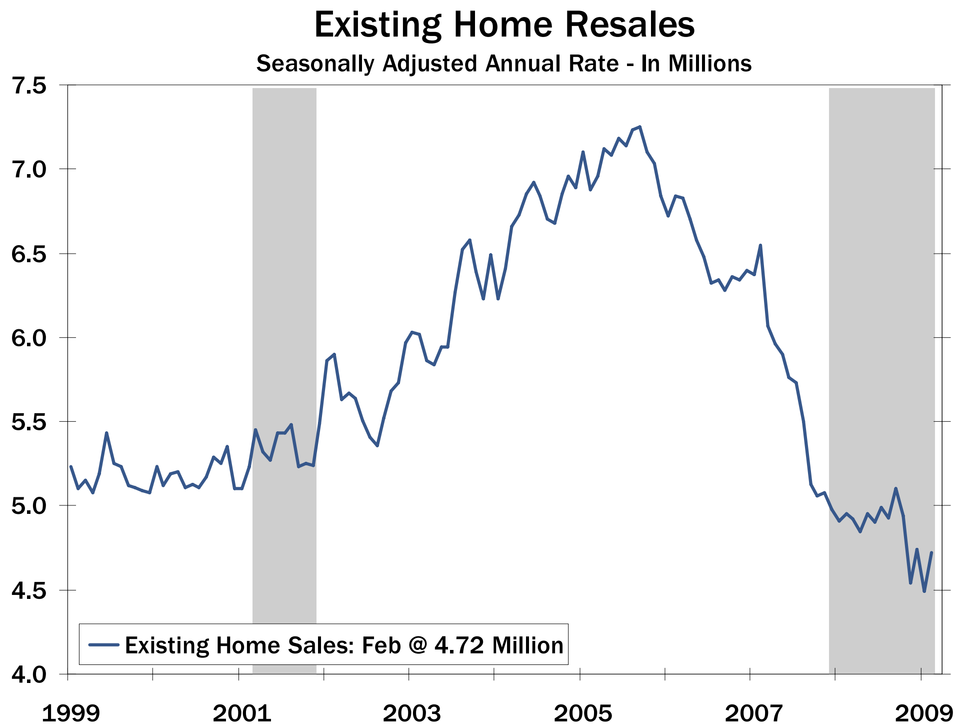
Figure 15



Source: U.S. Department of Commerce and Wachovia

VI. Existing Homes

Figure 16



Nearly Half of Existing Sales Still Distressed Properties

The National Association of Realtors estimates about 45 percent of recent sales activity nationwide was either distressed or foreclosure-related. With distressed sales accounting for such a large proportion of activity, we could actually see reported sales fall off sharply if efforts to modify existing mortgages gain traction in the next few months. Timing is difficult to estimate given the considerable lag of the data, but we would not be surprised to see sales move lower from here. We would not necessarily consider the declines to be a bad thing considering the source of the downturn. The moratoriums, however, may extend the recovery period.

Figure 17

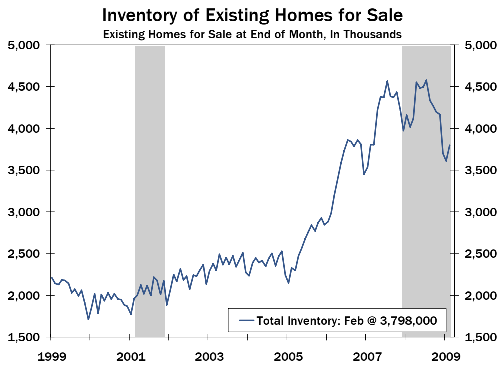
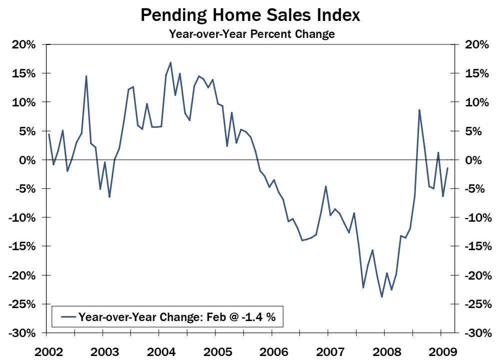


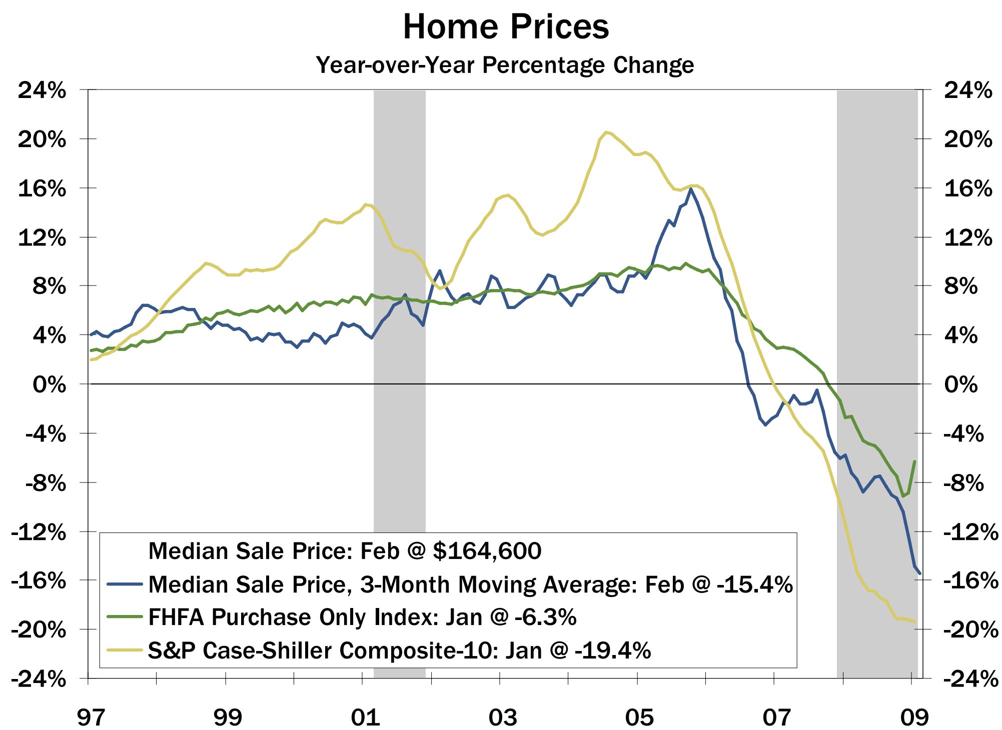
Figure 18



Source: National Association of Realtors and Wachovia

VII. Home Prices

Figure 19



Price Slide Continues

The slide in home prices has continued through the first part of the New Year. A surprising jump in the FHFA (OFHEO) index for the month of January raised some hope but we absolutely do not expect this jump to turn into a sustained increase. The pilling on of supply from builders, foreclosed properties and distressed sales will continue to pressure prices, but the gain may give some hope that the pace of decline will slow in the coming months. Though we do not expect to see housing prices bottom until the second half of this year or the first half of next year at the earliest; the worst of the decline is clearly behind us.

Figure 20

S&P/Case-Shiller Single Family Home Resale Value

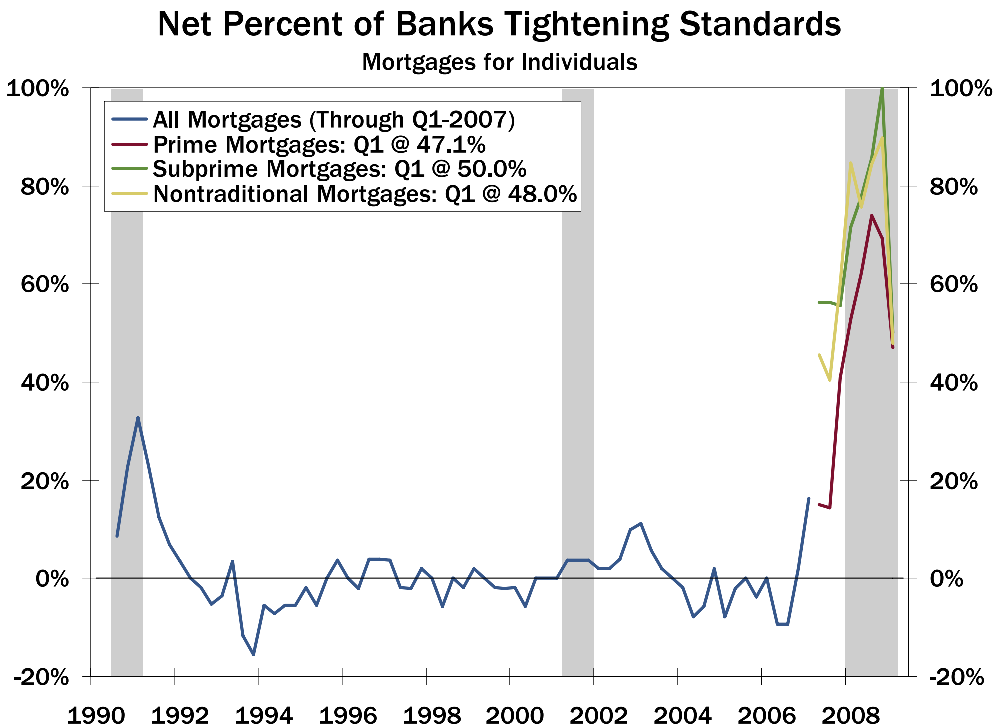
(January 2009)

MSA	Yr/Yr % Change	MSA	Yr/Yr % Change	MSA	Yr/Yr % Change
Dallas	-4.9%	Atlanta	-14.3%	San Diego	-24.9%
Denver	-5.1%	Seattle	-15.0%	Los Angeles	-25.8%
Cleveland	-5.2%	Chicago	-16.4%	Miami	-29.4%
Boston	-7.3%	Washington, DC	-19.3%	San Francisco	-32.4%
Charlotte	-8.2%	Minneapolis	-20.4%	Las Vegas	-32.5%
New York City	-9.6%	Detroit	-22.6%	Phoenix	-35.0%
Portland	-14.0%	Tampa	-23.3%		
U.S. - 10	-19.4%	U.S. - 20	-19.0%		

Source: FHFA, National Association of Realtors, S&P Corp. and Wachovia

VIII. Credit Conditions

Figure 21



Access to Credit Will Be a Problem for Months to Come

Credit standards remain exceptionally tight. Just about half of loan officers indicated they were tightening standards in the first quarter; this is on top of all the tightening that has already occurred. The continued caution by lenders is understandable given the continued rise in delinquency rates and foreclosures. Much of the earlier rise in foreclosures was due to lax underwriting of nontraditional mortgage products. More recently, rising unemployment has pushed up delinquency rates on conforming mortgages. With unemployment expected to continue rising well into 2010, delinquency rates are certain to rise even higher.

Figure 22

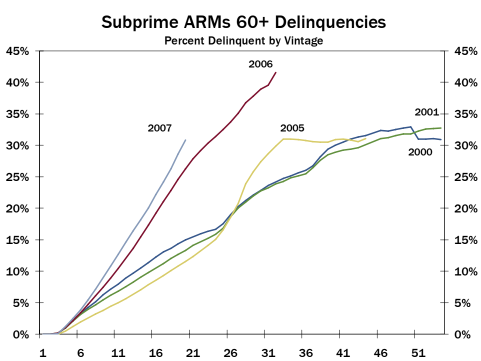
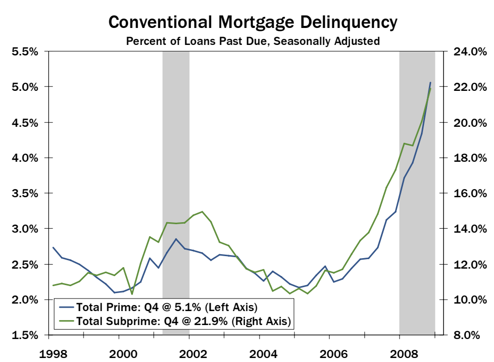


Figure 23



Source: Federal Reserve Board, Mortgage Bankers Association, Wachovia Securities and Wachovia

Wachovia Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wachovia.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economist	(704) 715-9660	adam.york@wachovia.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com

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