

Economics Group**Special Commentary**

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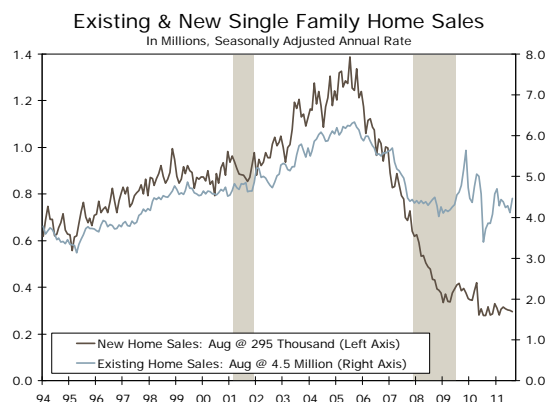
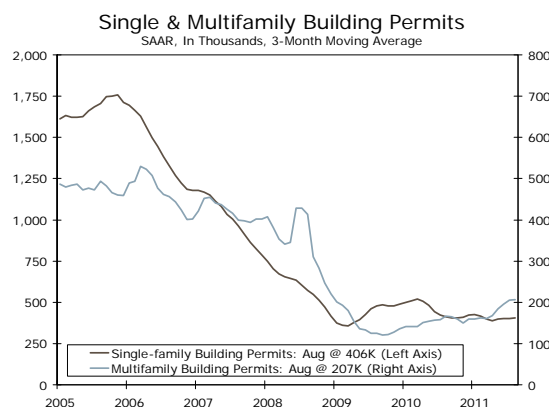
Joe Seydl, Economic Analyst

joseph.seydl@wellsfargo.com • (704) 715-1488**Housing Chartbook: September 2011****How Sturdy Is the Floor?**

While we will likely have to endure a few more months of price declines, a definitive bottom in home sales and new home construction appears to have taken hold. Sales of new homes appear to have bottomed at around a 300,000-unit pace, and existing home sales have perked up a bit as lenders have become a bit more aggressive in terms of clearing out foreclosures in many parts of the country. We expect home prices to decline a bit further, as foreclosures and distressed transactions account for a larger proportion of overall sales later this year and in early 2012. However, a bottom in home prices is within sight.

Given the severity of the recent financial market volatility in Europe and the United States, home sales have held up better than what many would have expected. While new home sales have fallen for four straight months, sales are down by just a cumulative 6.7 percent since April. Existing home sales have actually picked up to nearly a 4.5 million-unit pace, which is 5.4 percent above the pace of sales witnessed this past spring. New home construction is also holding near current levels. Housing starts fell nearly 5.0 percent in August to a 571,000-unit pace, but building permits rose 3.2 percent during the month and are up 7.8 percent on a year-ago basis. The resilience of new home sales and new home construction in the face of global financial instability is largely due to the historic slide in activity that has occurred over the past five years. Sales and new home construction are already so low that they are unlikely to fall significantly further unless the U.S. economy dips into an actual recession or the credit market freezes up. Unfortunately, there is not much risk of a breakout to the upside either; not at least until the mountain of foreclosures and pending foreclosures is cleared, appraisals normalize and lending standards ease up.

Given the severity of the recent financial market volatility in Europe and in the United States, home sales have held up better than what many would have been expected.

Figure 1**Figure 2**

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

While there is still a great work to be done, we are seeing some modest progress being made at clearing out the shadow inventory of homes on the market. CoreLogic's most recent negative equity data for the second quarter indicated that the percentage of homeowners that owe more on

Together we'll go far

Some modest progress is being made at clearing out the shadow inventory of homes on the market.

their mortgage than their home is worth fell 0.2 percentage points to 22.5 percent. While this is only a very slight reduction in negative equity, on a regional basis, many of the areas where the housing bust has been most acute saw larger reductions in negative equity during the second quarter. Nevada, Arizona, Florida, Michigan and California collectively saw their average negative equity share decline from 41 percent to 38 percent. CoreLogic also reports that the nationwide shadow inventory of homes declined by 600,000 units from July 2010 to 1.6 million units, or a roughly a five months' supply of homes waiting to enter the foreclosure process. There are still plenty of problems further back in the pipeline, however. Lender Processing Services data report that, as of August, nearly 1.9 million mortgages were 90 or more days delinquent, which is roughly unchanged from the July data.

There was also some good news on the policy front. At its two-day meeting last week, the FOMC decided to implement "Operation Twist," which calls for the Fed to sell \$400 billion worth of its short-term Treasury holdings and buy an equal amount of longer-term Treasury securities with maturities ranging from 6 years to 30 years. The market expected this move, but the Fed took an additional step by announcing that it would also reinvest the proceeds from its agency debt and MBS holdings back into agency bonds and MBS, instead of into Treasury securities. The objective is to reduce spreads between MBS and Treasuries—spreads that have widened in recent months—and thereby make mortgages even more affordable.

The Fed's decision to reinvest in agency bonds and MBS is likely to help at the margin.

The Fed's decision to reinvest in agency bonds and MBS is likely to help at the margin. The interest rate for a 30-year fixed mortgage hit an all-time record low level at around 4.0 percent following the Fed's move on September 21, which caused refinancing activity to pick up a bit. However, mortgage purchase applications have benefited less, as would-be buyers continue to grapple with sluggish job and income growth and uncertainty about the broader macro environment. Moreover, qualifying for a mortgage is more difficult today, and many would-be sellers have been put off recently by overly conservative appraisals. Plans to buy a home remain near all-time lows and an unusually large proportion of home sales are currently cash deals.

Figure 3

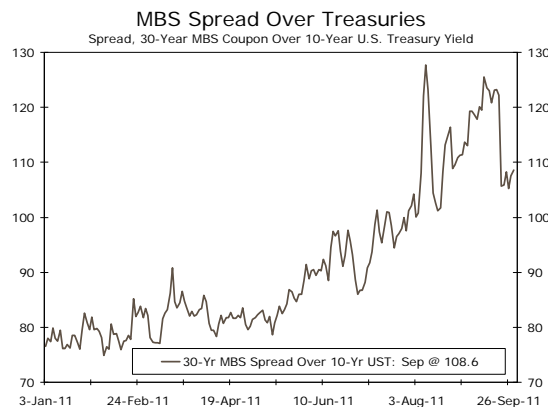
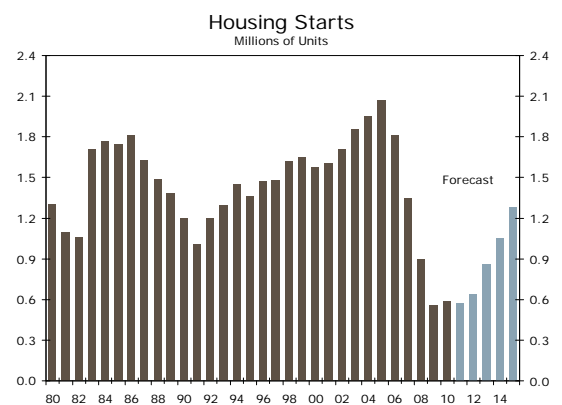


Figure 4



Source: U.S. Dept. of Commerce, Federal Reserve Board, Bloomberg LP and Wells Fargo Securities, LLC

While home sales are showing signs of bottoming, housing still faces a long and arduous road to recovery.

While home sales are showing signs of bottoming, housing still faces a long and arduous road to recovery. Home prices are likely to come under additional pressure this fall and winter as more foreclosures come on the market during the seasonally slow sales period. Appraisals are likely to remain conservative for at least the next year, or until the mountain of foreclosures hanging over the market finally clears. Many would-be buyers are also frozen in place by the inability to quickly sell their current home and trade up to a newer home or relocate to another part of the country. The ongoing financial crisis in Europe and frustratingly sluggish growth in the United States will also continue to give buyers pause. We are looking for only a modest rise in new home sales and single-family construction in 2012, but we look for prices to find a bottom by the middle of that year. The return to a "normal" housing market, where supply and demand are in balance and prices are rising 2 percent to 3 percent a year, is still, unfortunately, years away.

National Housing Outlook

	2008	2009	Forecast		
			2010	2011	2012
Real GDP, percent change	-0.4	-3.6	3.0	1.6	1.3
Nonfarm Employment, percent change	-0.6	-4.4	-0.7	0.9	0.6
Unemployment Rate	5.8	9.3	9.6	9.1	9.5
Home Construction					
Total Housing Starts, in thousands	900.0	554.3	585.4	575.0	640.0
Single-Family Starts, in thousands	616.3	442.3	471.5	420.0	445.0
Multi-Family Starts, in thousands	283.7	112.0	113.9	155.0	195.0
Home Sales					
New Home Sales, Single-Family, in thousands	482.2	373.9	321.7	303.0	330.0
Total Existing Home Sales, in thousands	4892.0	5148.5	4917.0	4970.0	5170.0
Existing Single-Family Home Sales, in thousands	4336.7	4559.2	4310.8	4380.0	4560.0
Existing Condominium & Townhouse Sales, in thousands	555.3	589.3	606.2	590.0	610.0
Home Prices					
Median New Home, \$ Thousands	232.1	216.7	222.6	220.7	222.0
Percent Change	-4.8	-6.6	2.7	-0.9	0.6
Median Existing Home, \$ Thousands	198.1	172.5	172.7	165.0	166.0
Percent Change	-9.2	-12.9	0.1	-4.5	0.6
FHFA (OFHEO) Home Price Index (Purch Only), Pct Chg	-6.1	-4.6	-2.9	-4.4	0.1
Case-Shiller C-10 Home Price Index, Percent Change	-16.7	-12.9	2.2	-3.5	0.2
Interest Rates - Annual Averages					
Prime Rate	4.88	3.25	3.25	3.25	3.25
Ten-Year Treasury Note	3.66	3.26	3.22	2.50	2.08
Conventional 30-Year Fixed Rate, Commitment Rate	6.04	5.04	4.69	4.24	3.90
One-Year ARM, Effective Rate, Commitment Rate	5.18	4.71	3.78	3.00	3.10

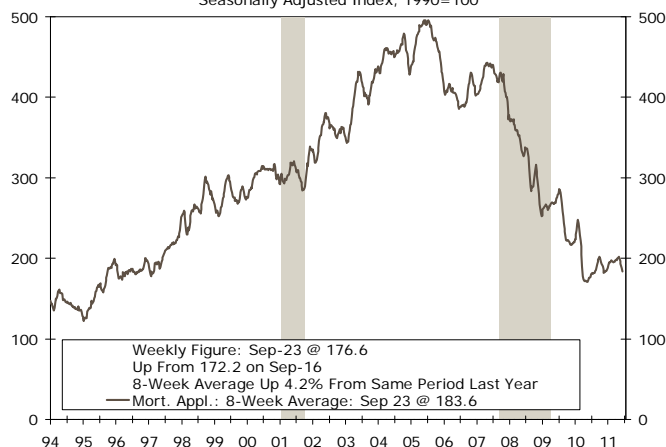
Forecast as of: September 29, 2011

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

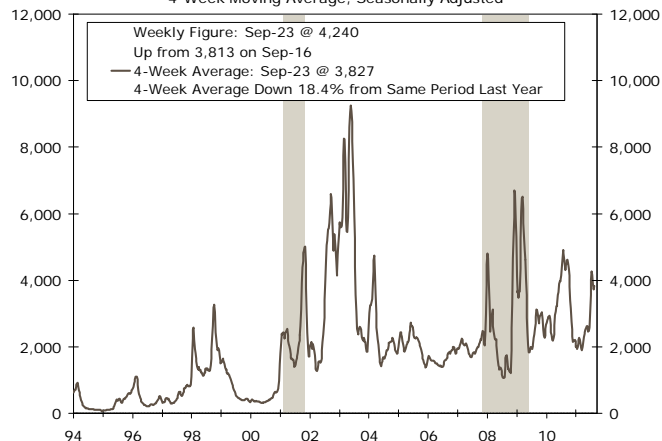
Mortgages

- Mortgage rates have fallen 25 bps since the start of the month on the back of deteriorating economic data and the Federal Reserve's decision to implement "Operation Twist." At close to 4.0 percent, the 30-year fixed rate mortgage is currently at an all-time record low.
- Mortgage refinancing activity has picked up a bit as rates have plummeted; mortgage applications for refinancing are up 40 percent since July. Applications for purchase continue to stagnate, however, apparently not benefitting much from lower mortgage rates.
- Mortgage rates will likely remain low, but broader uncertainty about the U.S. recovery and structural problems in the labor market will continue to restrain home buying.

Mortgage Applications for Purchase
Seasonally Adjusted Index, 1990=100



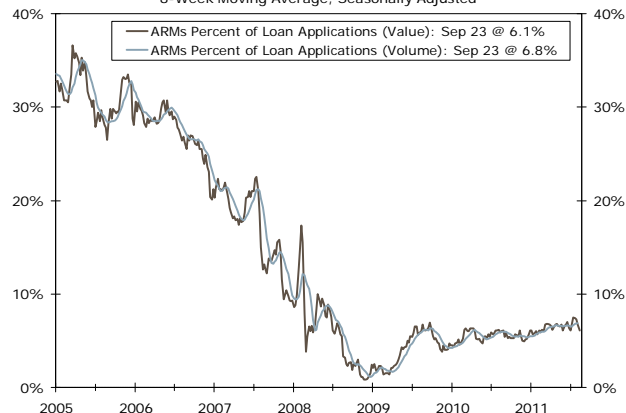
Mortgage Applications for Refinancing
4-Week Moving Average, Seasonally Adjusted



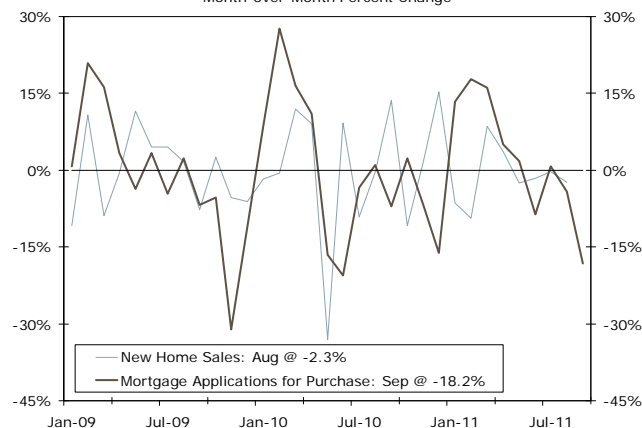
Conventional 30-Year Mortgage Rate
Percent, FHLMC Fixed-Rate Mortgage



Mortgage Applications
8-Week Moving Average, Seasonally Adjusted



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

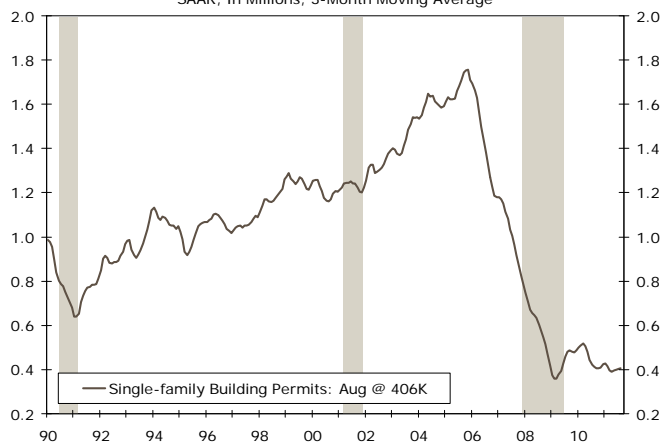


Source: Mortgage Bankers Association, FHLMC, U.S. Department of Commerce and Wells Fargo Securities, LLC

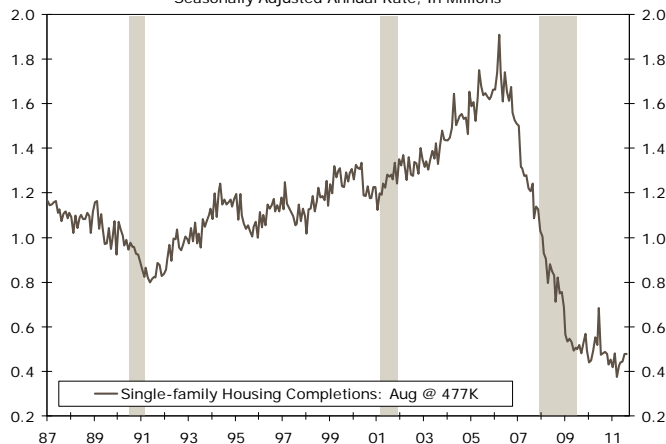
Single-Family Construction

- Single-family housing starts have remained stubbornly around a 400,000-unit pace since peaking in April 2010, when the homebuyer tax credit expired. Residential construction will likely not show any meaningful increase until the amount of distressed transactions moderates and the oversupply of existing homes is cleared.
- Builder sentiment also remains stuck in neutral. The NAHB/Wells Fargo Housing Market Index has remained near historic lows for nearly four years as builders have little incentive to compete with discounted existing home prices.
- Permits, however, have shown some improvement in the past two months, suggesting activity could be poised for modest gains in the coming months.

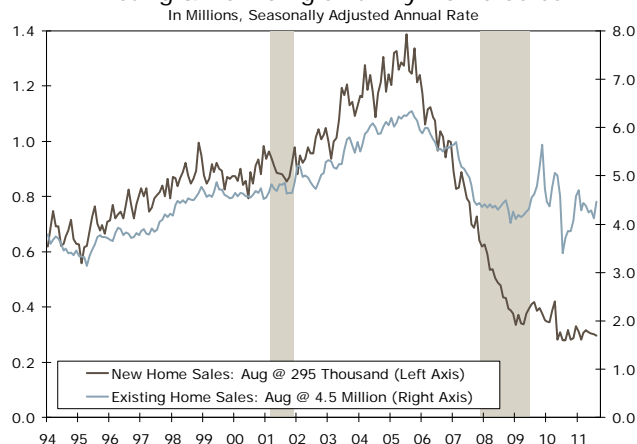
Single-Family Building Permits
SAAR, In Millions, 3-Month Moving Average



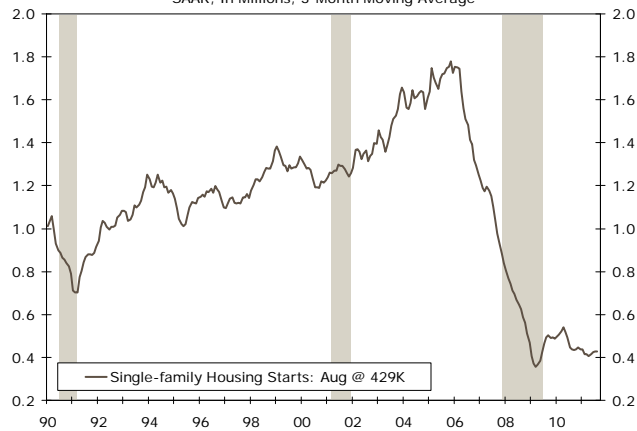
Single-Family Housing Completions
Seasonally Adjusted Annual Rate, In Millions



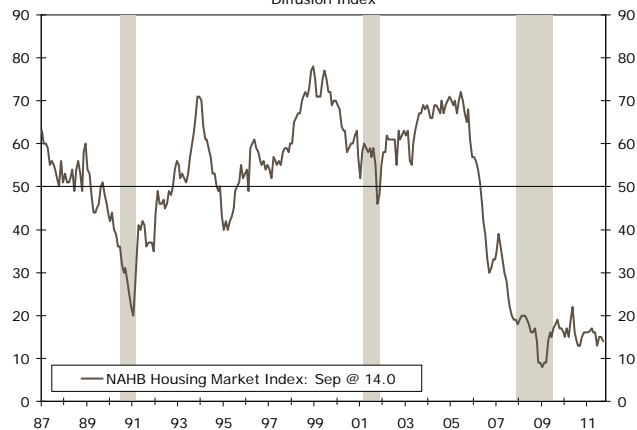
Existing & New Single Family Home Sales



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



NAHB/Wells Fargo Housing Market Index
Diffusion Index

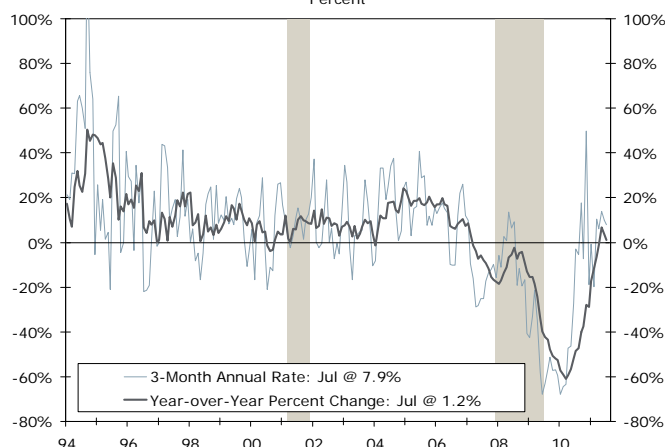


Source: National Association of Home Builders (NAHB), U.S. Dept. of Commerce, NAR and Wells Fargo Securities, LLC

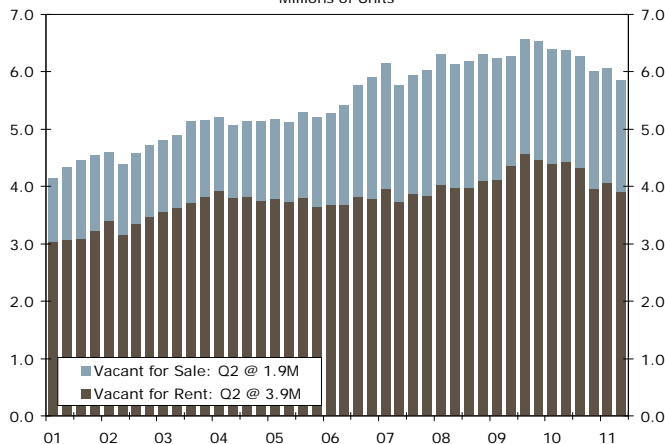
Multifamily Construction

- Multifamily construction remains a bright spot. On a year-ago basis, multifamily starts are up nearly 50 percent, as apartment demand continues to benefit from the ongoing struggles in the housing market as well as a modest rebound in household formation.
- For a variety of reasons, consumers are showing an increased preference for rental housing. Demand for apartments has outpaced supply for the past five quarters, helping cut the apartment vacancy rate to 5.9 percent. Rents have increased across most major markets, which is driving further development.
- Multifamily permits have risen 21.8 percent over the past year and are currently running 34 percent ahead of starts. As a result, multifamily construction should rise further.

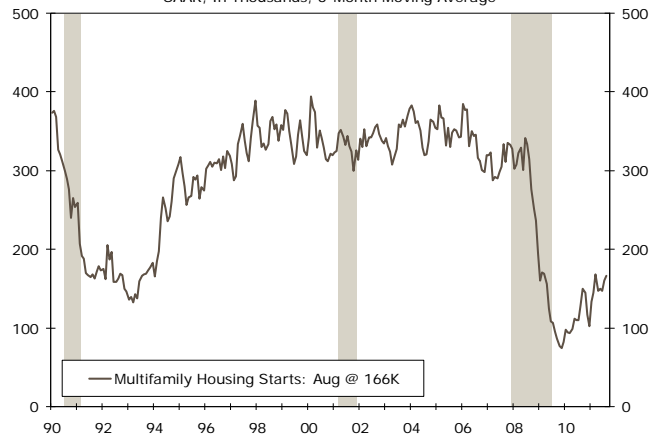
Private Multifamily Construction Spending
Percent



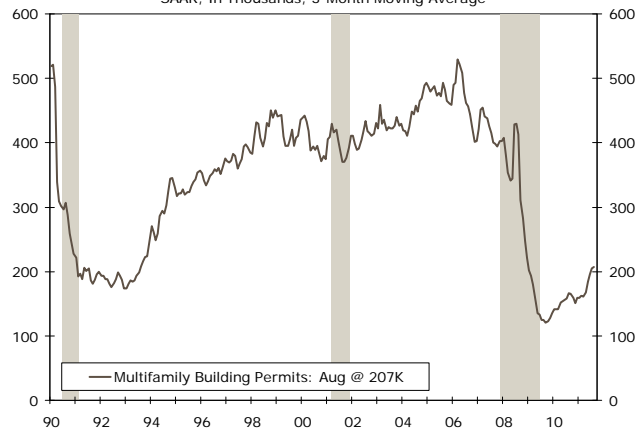
Housing Vacancies
Millions of Units



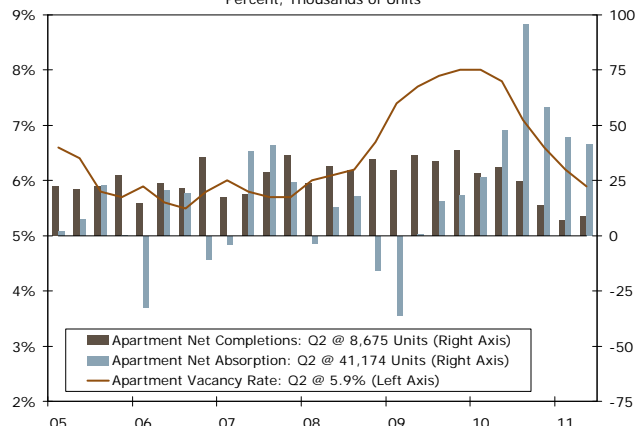
Multifamily Housing Starts
SAAR, In Thousands, 3-Month Moving Average



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



Apartment Supply & Demand
Percent, Thousands of Units

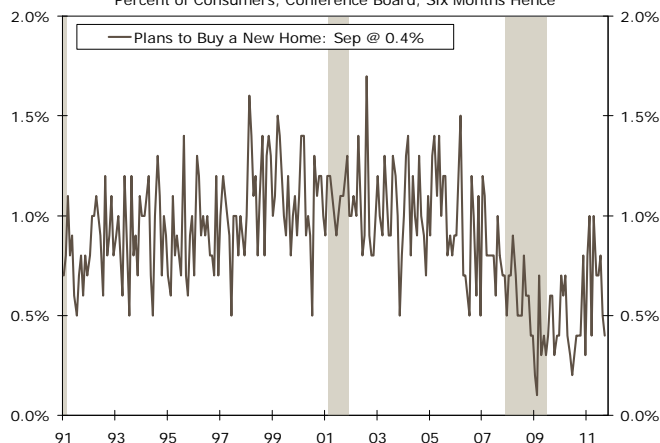


Source: U.S. Department of Commerce, REIS Inc.
and Wells Fargo Securities, LLC

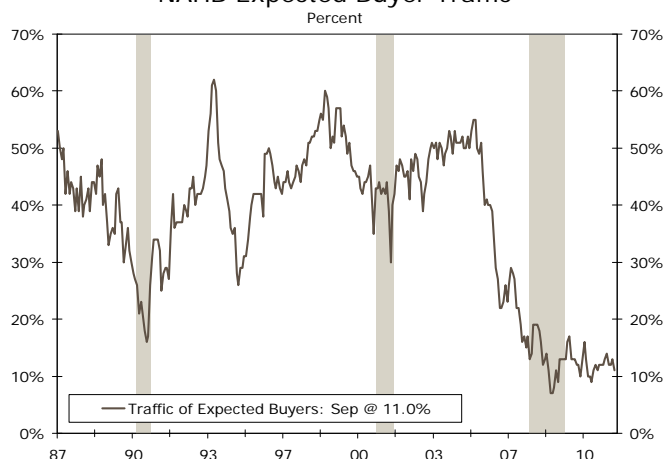
Buying Conditions

- The disconnect between extremely favorable buying conditions and the dearth of buying activity remains firmly in place. With the rate on a 30-year fixed mortgage falling to around 4.0 percent, affordability remains near all-time highs. Buyers are likely to remain on the sidelines, however, until concerns about job security and income growth subside.
- The latest consumer confidence data show that plans to buy a new home have suffered the most. September's consumer confidence report showed that just 0.4 percent of respondents are planning to buy a new home in the next six months.
- The expected buyer component of the Wells Fargo/NAHB Housing Market Index also declined two percentage points in September to 11.0 percent, falling to its lowest level since December 2010.

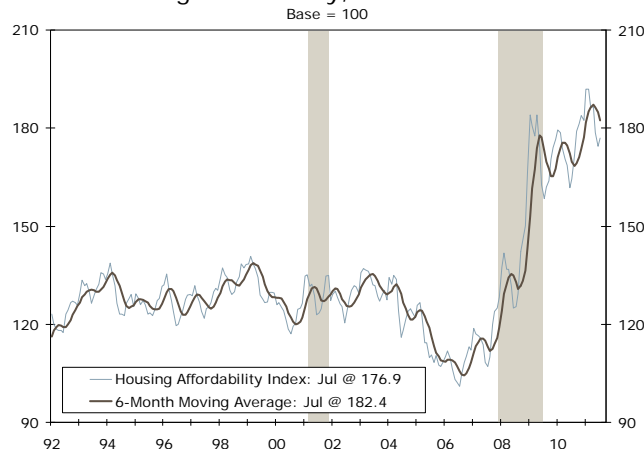
Confidence: Plans to Buy a New Home
Percent of Consumers, Conference Board, Six Months Hence



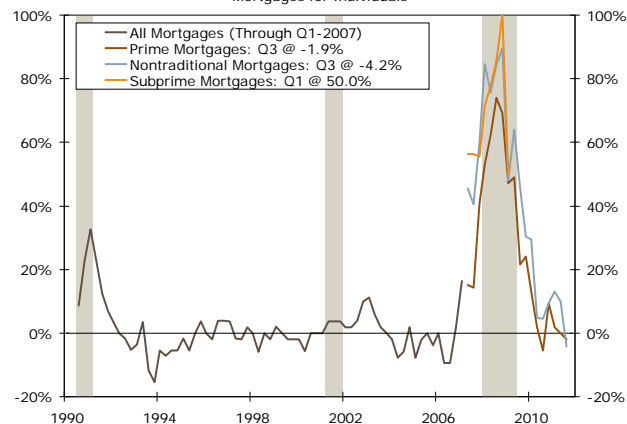
NAHB Expected Buyer Traffic



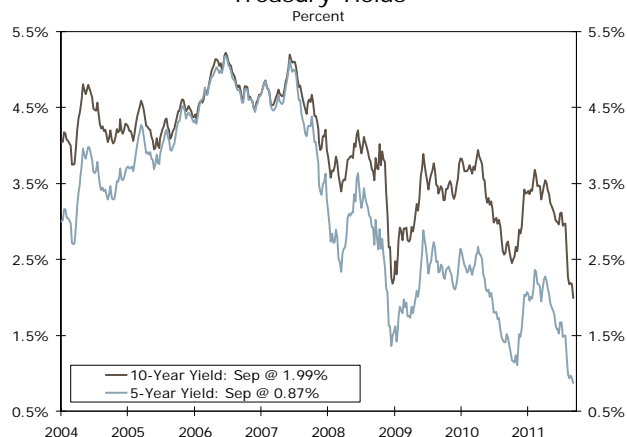
Housing Affordability, NAR-Home Sales



Net Percent of Banks Tightening Standards
Mortgages for Individuals



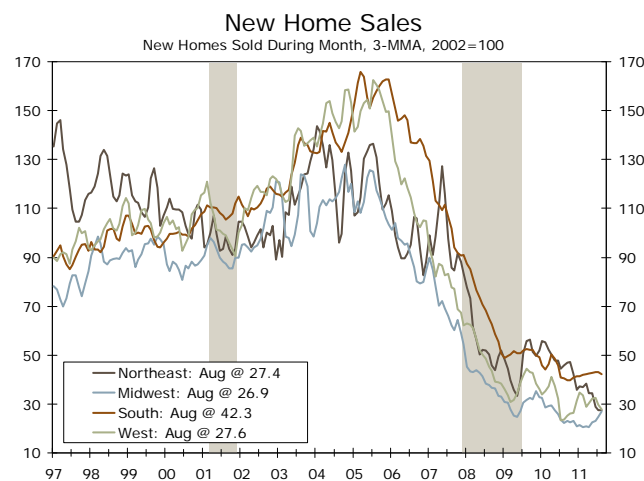
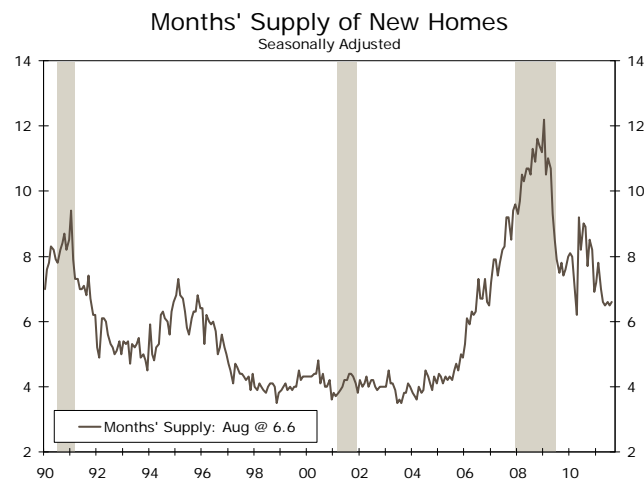
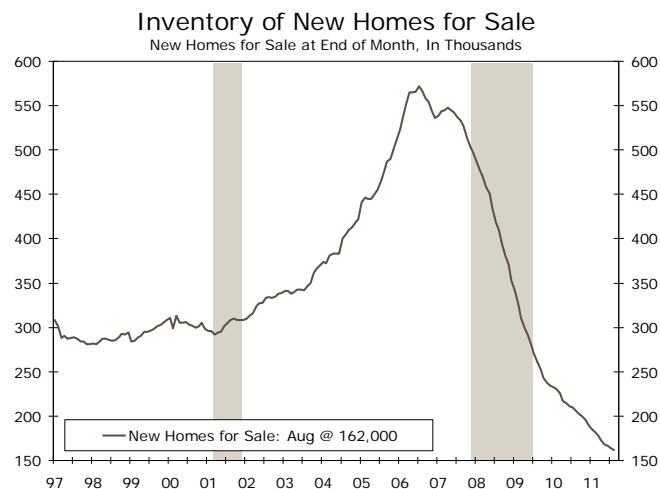
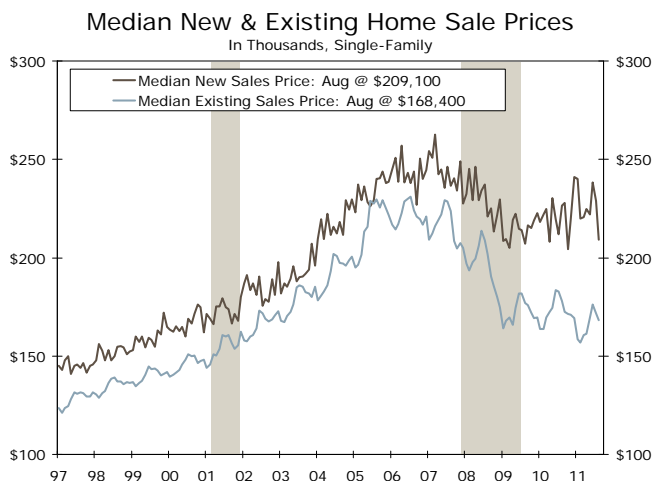
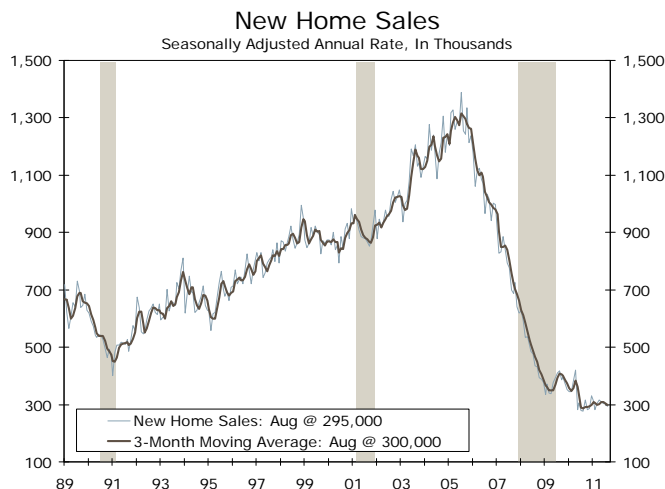
Treasury Yields



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

New Home Sales

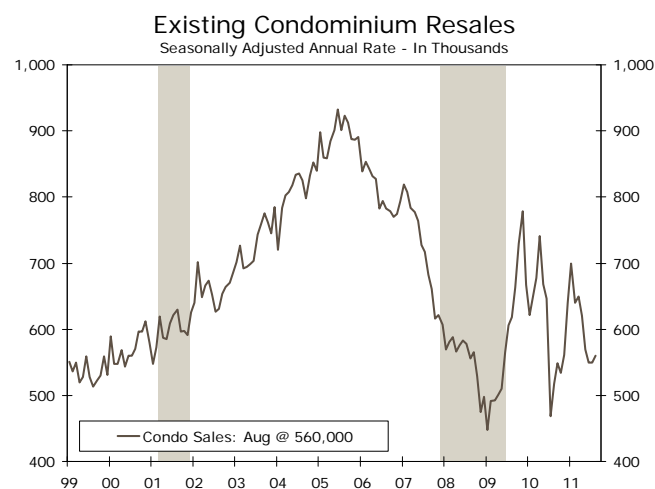
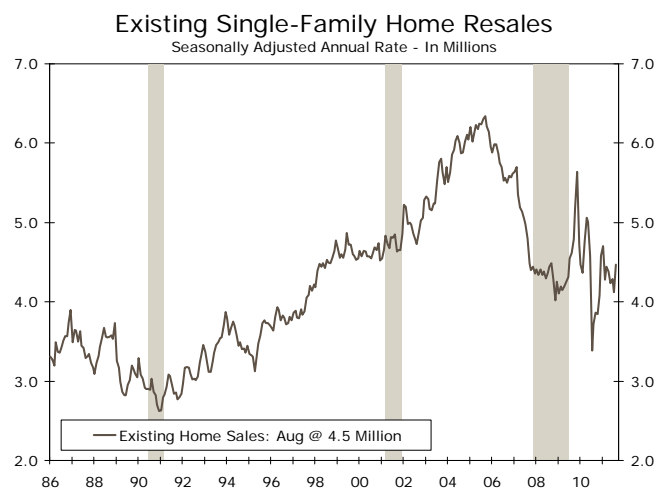
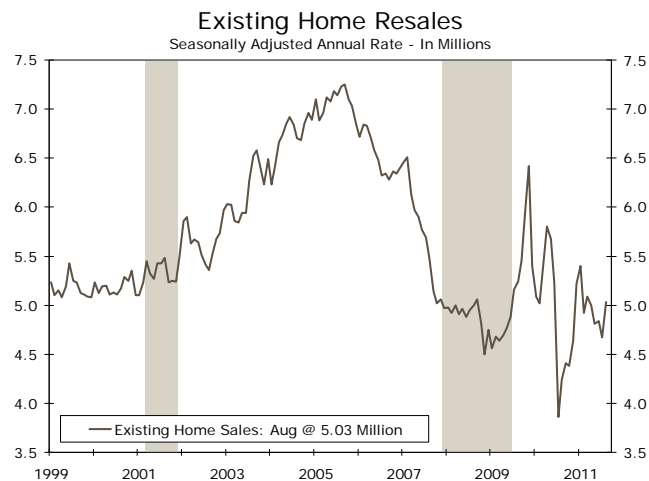
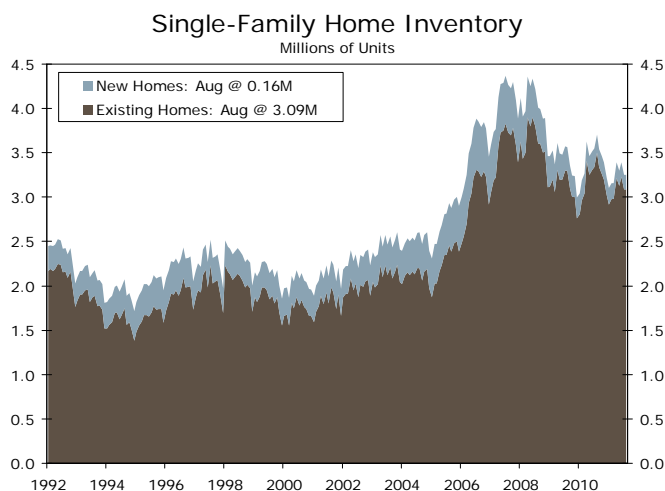
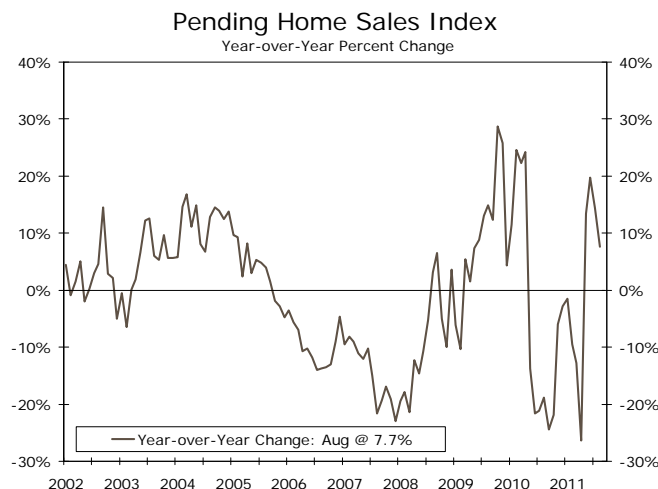
- Sales of new homes have shown little progress over the past year and have remained near historic lows, registering a meager 295,000-unit pace in August.
- Lackluster sales can partly be attributed to the gap in prices between an existing home and a new home—a gap now at \$57,450. With the premium for a new home at such an elevated level, builders are naturally reluctant to build many spec homes. The inventory of new homes fell to its lowest level on record of 162,000 in August.
- Both the median and average new home prices declined in August, as homes priced below \$200,000 accounted for the bulk of sales. Sales in this price range accounted for 47 percent of all sales in August up from 38 percent in July.



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

Existing Home Sales

- Sales of existing single-family homes are up 20.2 percent over the past three months. Much of the gain is due to investors scooping up distressed properties. All cash deals accounted for 29 percent of sales in August. Moreover, anecdotal reports suggest foreign buyers are becoming more active and have been buying discounted properties in long depressed markets, such as Florida and California.
- Reflecting tight credit underwriting and conservative appraisals, contract cancellations reached a record high of 18 percent in August.
- Low appraisals are keeping many would-be sellers on the sidelines. The inventory of single-family homes for sell fell to 3.09 million units in August and is now down 11.8 percent over the past year.

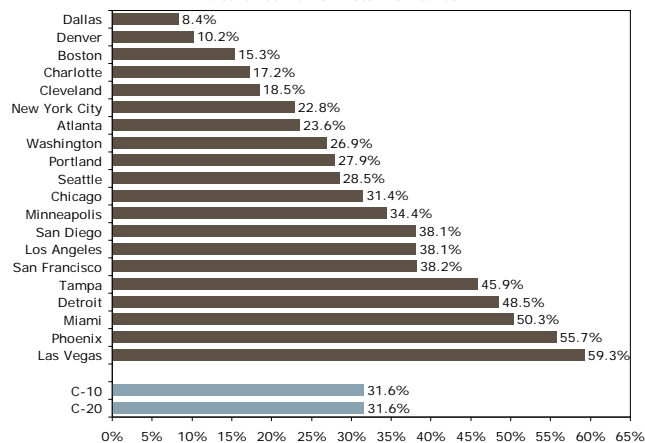


Source: National Assoc. of Realtors and Wells Fargo Securities, LLC

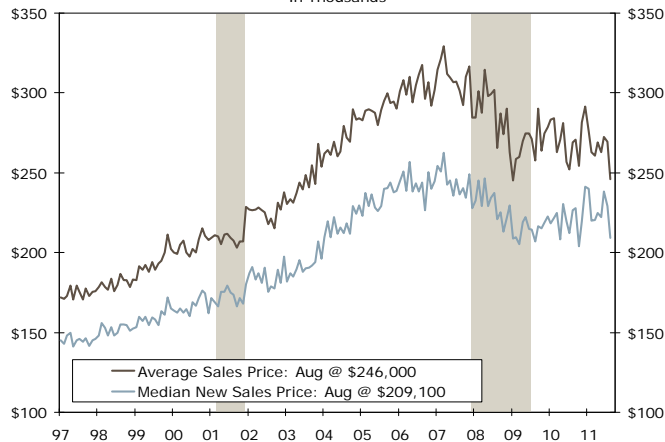
Home Prices

- According to CoreLogic, prices of single-family homes declined 5.2 percent on a year-ago basis. Excluding distressed properties, however, prices are down just 0.6 percent, and the trend has been improving. While nondistressed prices appear to be stabilizing, foreclosure, bank and short sales still account for 31 percent of all transactions, up from 29 percent in July. The foreclosure share should rise this fall and winter, pulling most of the widely followed price measures even lower.
- The shadow inventory of single-family homes fell to 1.6 million units in July from 1.9 million in June. Of the 1.6 million properties, nearly 50 percent are seriously delinquent and almost 30 percent are in some stage of foreclosure.

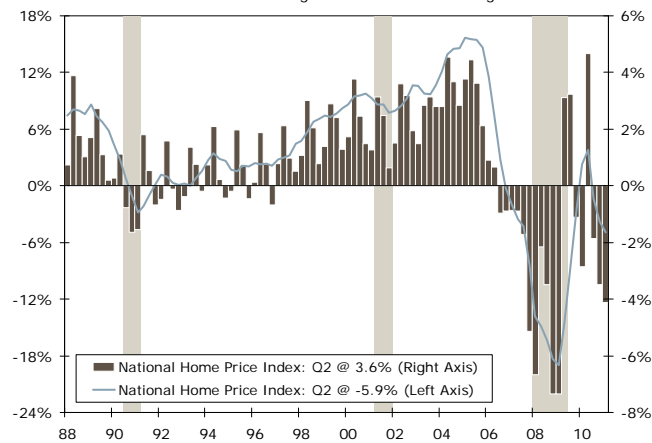
S&P Case-Shiller Home Prices
Percent Decline from Local Market Peak



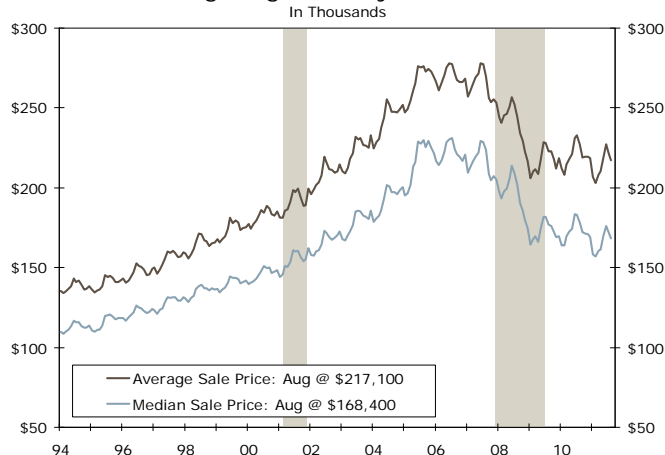
Average and Median New Home Sale Price
In Thousands



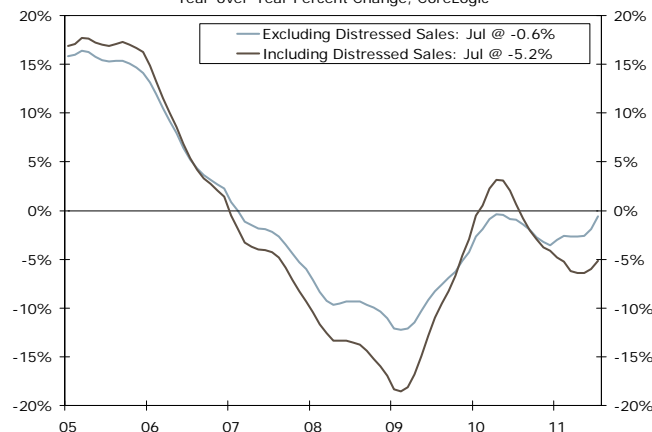
S&P Case-Shiller National Home Price Index, NSA
Bars = Q/Q % Change Line = Yr/Yr % Change



Existing Single-Family Home Prices
In Thousands



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

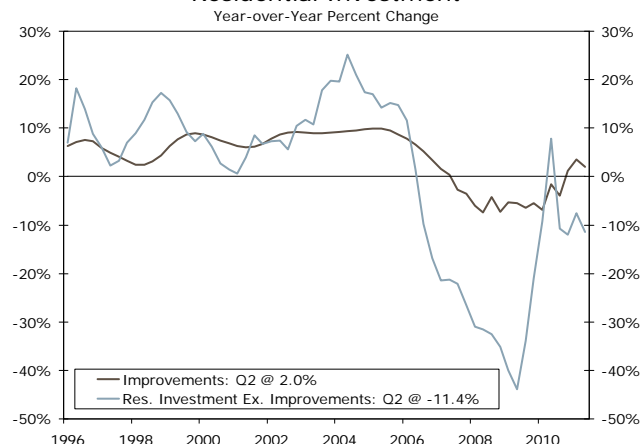


Source: CoreLogic, NAR, S&P Corp, U.S. Department of Commerce and Wells Fargo Securities, LLC

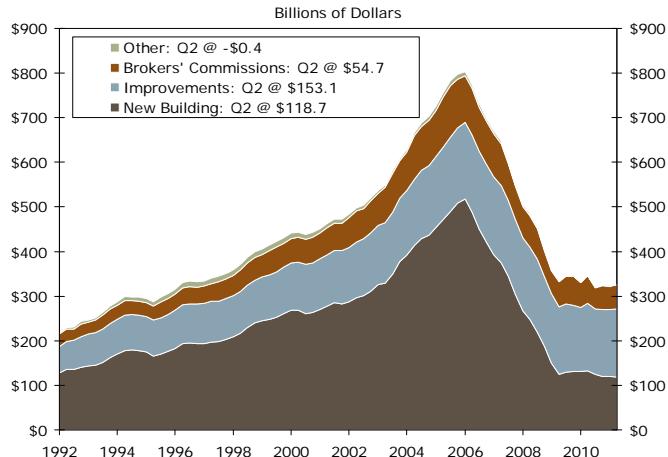
Renovation & Remodeling

- Home improvement activity continues to be a relative bright spot in an otherwise dismal housing market. On a year-over-year basis, spending on home improvements was up 21.8 percent in July.
- The Residential BuildFax Remodeling Index rose 24 percent year over year in July to 130.4, which is the highest level ever recorded. Regionally, the BuildFax index showed that remodeling activity picked up the most in the West and the Midwest, but fell slightly in the South and the Northeast. The Midwest is seeing a modest but broad-based recovery in all aspects of housing, benefitting from rebuilding.
- Tight credit conditions preventing buyers from purchasing new homes are likely driving the increased demand for remodeling activity.

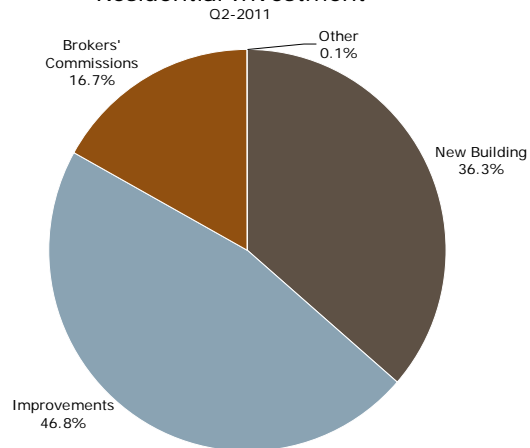
Residential Investment



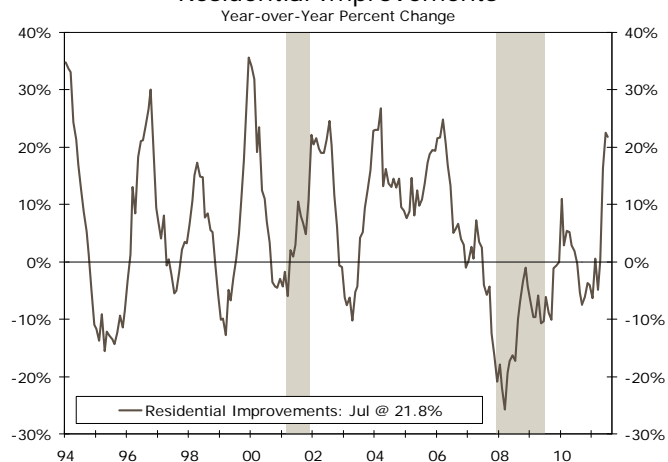
Residential Investment



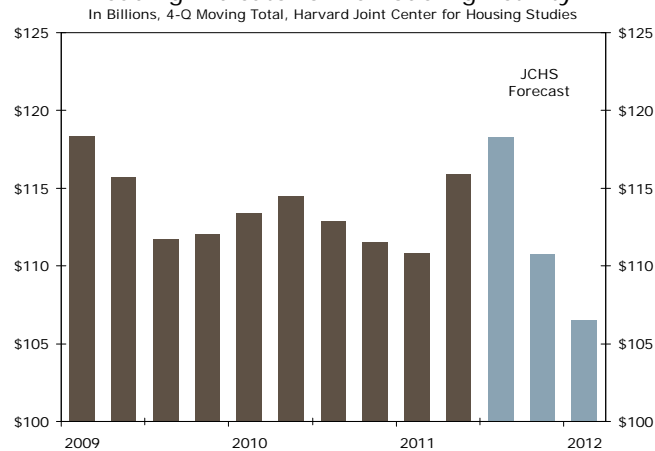
Residential Investment



Residential Improvements



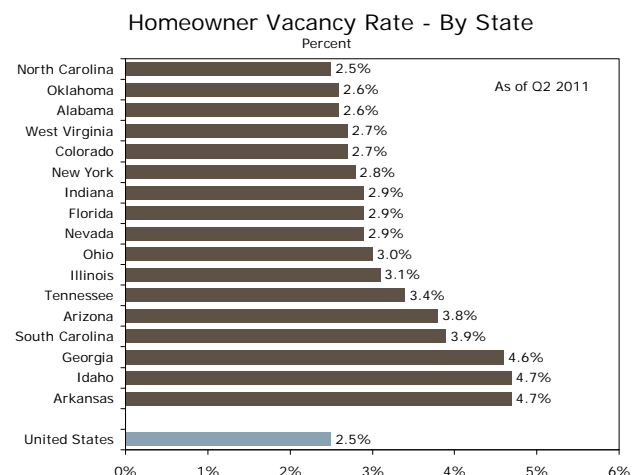
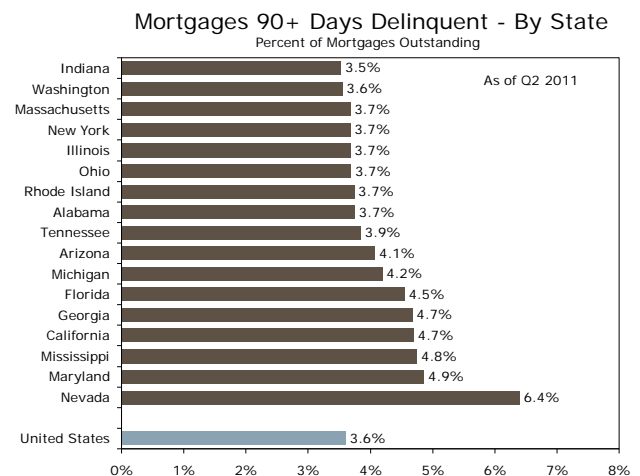
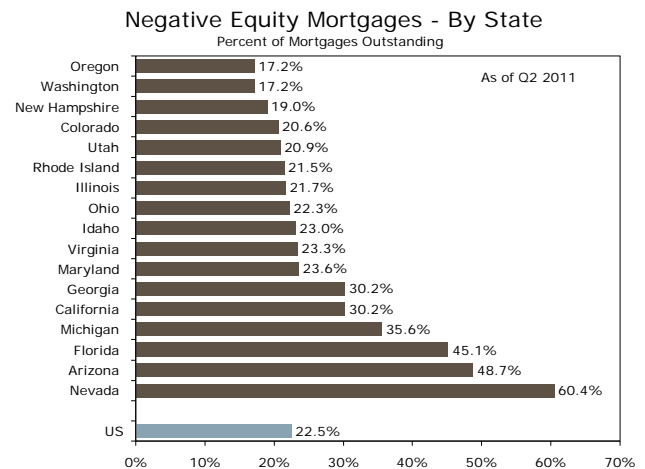
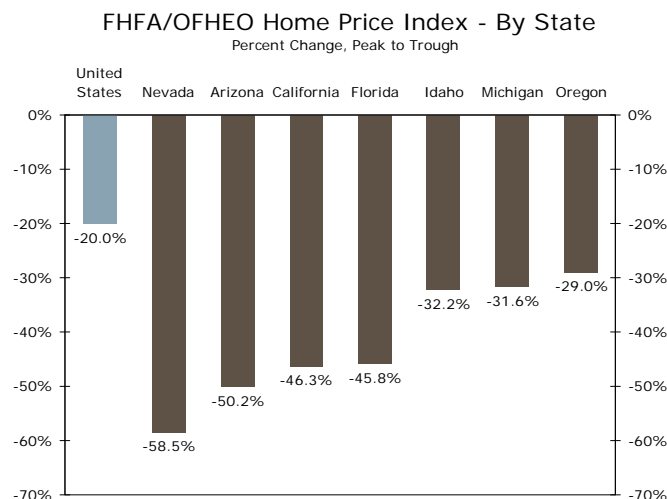
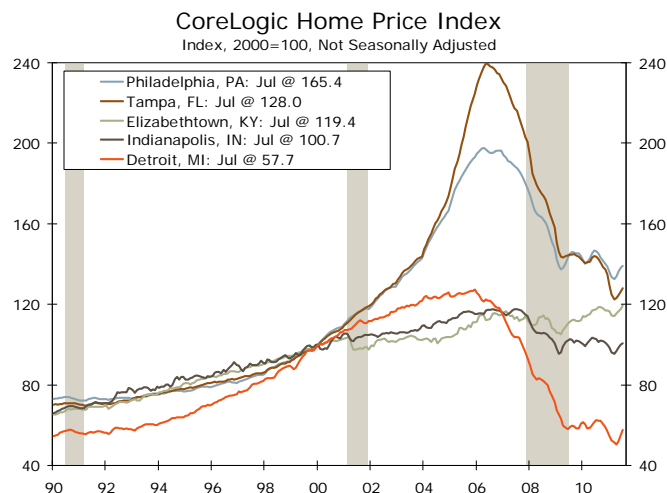
Leading Indicator of Remodeling Activity



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

Regional Housing Trends

- CoreLogic's negative equity data for Q2 showed a slight improvement in regional trends. The percentage of mortgages in a negative equity position fell in most of the areas that were hit the hardest by the housing collapse, including Nevada, Arizona, Florida, Michigan and California. Over the past year, the average negative equity share for these five states has declined from 41 percent to 38 percent.
- Home prices at the national level appear to be finding a floor, but, on a regional level, prices continue to behave very differently. Areas hosting major military facilities, such as Elizabethtown, Ky., have experienced impressive price resilience, while in wildly overbuilt markets, such as Tampa, distressed sales continue to drag price indices lower.



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

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