

## Economics Group

### Special Commentary

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# Housing Data Wrap-Up: October 2010

## Home Sales and New Home Construction Face a Tough Second Half

We have once again scaled back our expectations for the housing recovery and now expect housing starts to rise 30 percent in 2011. Our forecast has been scaled back slightly due to the recent increased scrutiny of the foreclosure process. We believe the foreclosure process will be slowed modestly during the latter part of 2010, which will push out the bottoming in home prices expected to occur early next year. The lack of price discovery means a true recovery in home construction will begin a little later than it would otherwise, which means starts will likely come in a little lower than we had earlier projected for 2011. We still see a genuine recovery in home sales and new construction beginning to take hold next year, however, and we look for activity to gradually build momentum through 2012.

By genuine recovery we mean a recovery driven by the underlying fundamentals as opposed to temporary government stimulus. We were never huge fans of the extension of homebuyer tax credits. The program effectively pulled demand forward and caused prices to temporarily rebound. Now that the tax credits have ended we are seeing a payback with reduced purchases and declining home prices. Foreclosures, short sales and bank sales have now taken center stage and builders have pulled back on new projects until the tide of foreclosures passes, which will give them a better idea of how many homes they can sell and at what price they can sell them.

As always, there are a few exceptions. A small number of builders have chosen to take on the foreclosures and build houses offering more amenities at a better price or superior location to what is available on the resale market or from foreclosures. The opportunities are scarce, however, and the absolute level of new home construction remains exceptionally low. While housing starts rose in September, the increase was largely a statistical fluke. Starts are so low and they did not fall as much as they normally do from August to September, leading to a small seasonally-adjusted increase. Building permits were essentially unchanged during the month and have been running well below starts for the past six months, suggesting home construction will likely remain near its current levels for at least the next several months.

**Table 1**

### Recent Housing Data

	Release	Consensus	Actual	Prior	Revised	Next Release
NAHB Sentiment Index	October	14	16	13	n/a	Nov-16
Housing Starts, Thousands of Units	September	580K	610K	598K	608K	Nov-17
Housing Permits	September	575K	539K	569K	571K	Nov-17
Existing Home Sales, Millions of Homes	August	4.10M	4.13M	3.83M	3.84M	Oct-25
Percent Change	August	7.1%	7.6%	-27.2%	-27.0%	Oct-25
New Home Sales, Thousands of Units	August	295K	288K	276K	288K	Oct-27
Percent Change	August	6.9%	0.0%	-12.4%	-7.7%	Oct-27
S&P Case/Shiller Composite-20	July	3.10%	3.18%	4.23%	4.21%	Oct-26

Source: Bloomberg LP, National Association of Realtors and U.S. Department of Commerce and Wells Fargo Securities, LLC

This report is available on [wellsfargo.com/research](http://wellsfargo.com/research) and on Bloomberg WFEC

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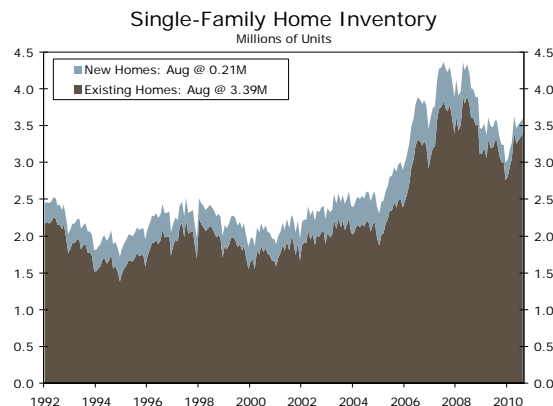
The demand for housing is ultimately determined by the underlying growth in the broader economy. The two most important variables are job and income growth, which we expect will be modestly stronger during the coming year. Home construction will continue to be held back by the oversupply of homes available for sale or for rent, which we estimate is around 1.9 million units. Moreover, a steady stream of foreclosures is expected to keep the inventory of unsold homes elevated for at least the next two years as there are currently more than 2.0 million homes in the process of foreclosure and another 2.0 million plus with mortgages 90 days or more past due. All of these homes will not necessarily come back on the market, but enough will to keep pressure on prices for at least the next six to nine months. We estimate home prices will fall an additional five to eight percent by the middle of 2011.

The recent foreclosure crisis, which has led some lenders and servicers to temporarily suspend foreclosure actions, threatens to lengthen the recovery process. An interruption in foreclosures and increased uncertainty about the foreclosure process could stretch out the recovery timetable and cause home sales to slow even further. Not only would it take longer to clear out the mountain of foreclosed properties, but it would also create more uncertainty about home prices, potentially leading to even more conservative appraisals and even tighter underwriting standards. Tougher appraisals and tight underwriting standards are already offsetting much of the benefit from record low mortgage rates and are a big reason why mortgage purchase applications have risen so little in recent weeks.

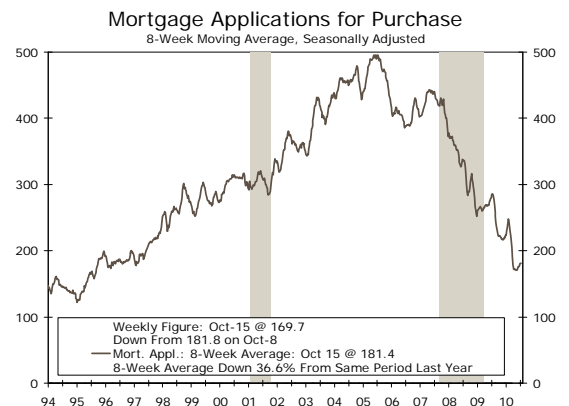
While foreclosures are expected to keep the inventory of homes available for sale elevated, home sales and new home construction will begin to recover well before the last foreclosure is sold. Much of the inventory of foreclosed homes and seriously delinquent home mortgages are concentrated in a handful of states, with Florida, Arizona, Nevada, California, Georgia, Illinois and Michigan heading the list of most troubled markets. Housing markets will likely take longer to recover in these states and prices will likely fall a bit further than in the rest of the country.

We continue to project a modest recovery in home sales and new home construction during the coming years. While real GDP growth is expected to slow in 2011, private final demand is actually expected to strengthen and private sector job growth should pick up. Sales of new single-family homes are expected to rise 29 percent next year, helping boost single-family housing starts nearly 30 percent. Apartment construction is also expected to strengthen modestly, lifting housing starts to 770,000 for all of 2011. That would still leave housing starts at their third lowest level in the modern era. Construction is expected to finally move back above 1.0 million units in 2012, but only barely so. By contrast, a “normal” year for housing would see around 1.45 million housing starts. We do not expect to hit that level until 2014 at the earliest.

**Figure 1**



**Figure 2**



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

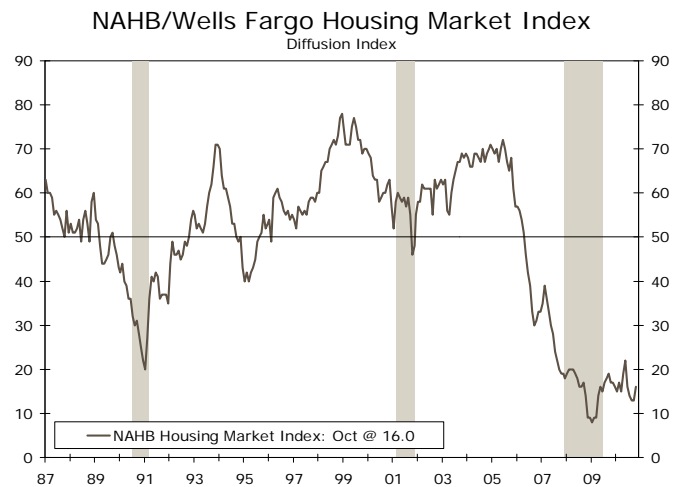
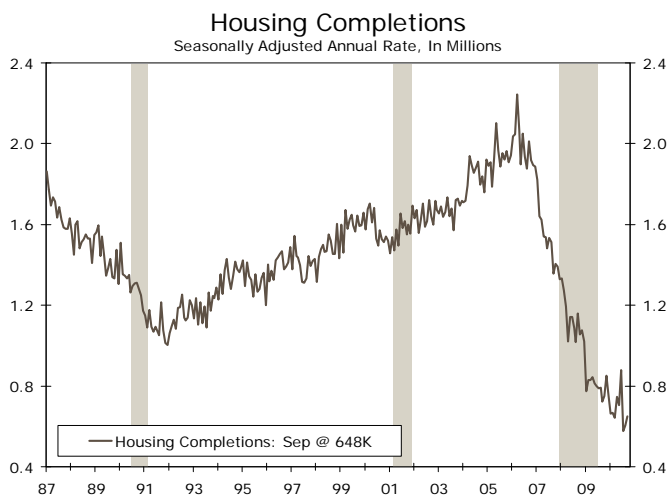
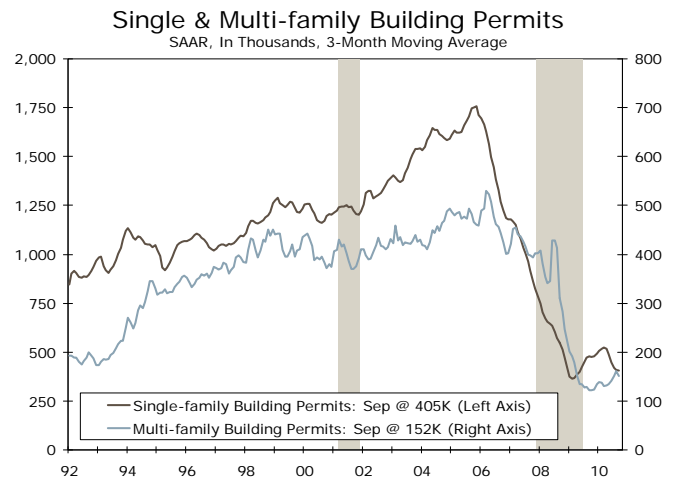
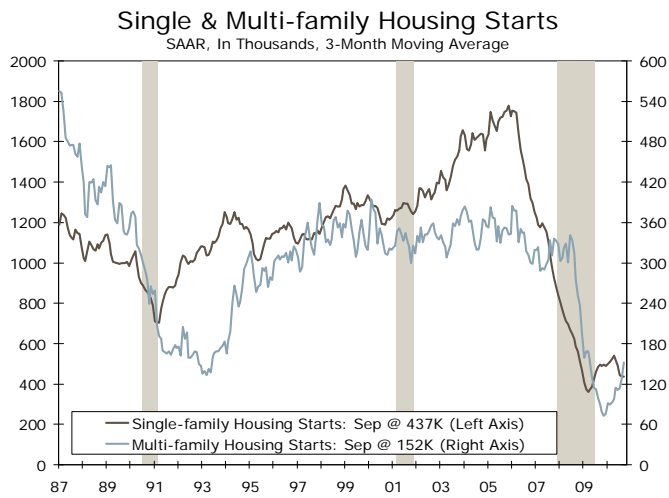
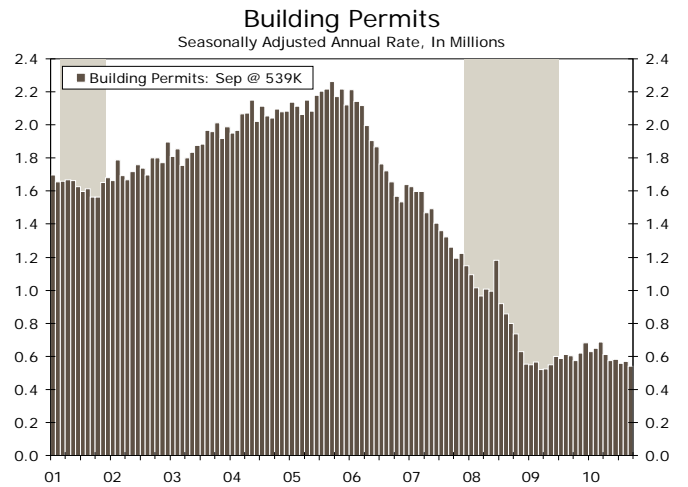
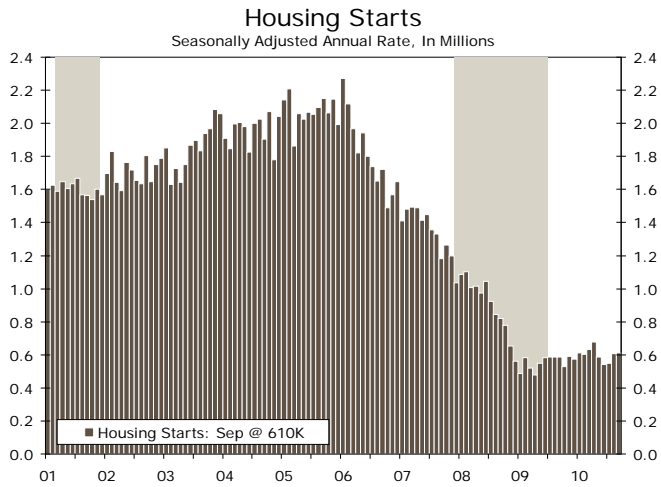
National Housing Outlook

	Forecast				
	2008	2009	2010	2011	2012
Real GDP, percent change	0.0	-2.6	2.7	2.1	3.0
Nonfarm Employment, percent change	-0.6	-4.3	-0.6	0.8	1.4
Unemployment Rate	5.8	9.3	9.7	9.7	9.0
Home Construction					
Total Housing Starts, in thousands	900.0	554.3	590.5	770.0	1040.0
Single-Family Starts, in thousands	616.3	442.3	490.5	640.0	857.5
Multi-Family Starts, in thousands	283.7	112.0	100.0	130.0	182.5
Home Sales					
New Home Sales, Single-Family, in thousands	482.2	373.9	365.0	470.0	630.0
Total Existing Home Sales, in thousands	4892.0	5157.9	4960.0	5125.0	5400.0
Existing Single-Family Home Sales, in thousands	4337.5	4566.7	4350.0	4450.0	4650.0
Existing Condominium & Townhouse Sales, in thousands	554.5	591.3	610.0	675.0	750.0
Home Prices					
Median New Home, \$ Thousands	230.4	214.5	205.4	211.2	217.5
Percent Change	-5.5	-6.9	-4.2	2.8	3.0
Median Existing Home, \$ Thousands	195.8	172.5	170.2	170.5	172.0
Percent Change	-9.2	-11.9	-1.4	0.2	0.9
FHFA (OFHEO) Home Price Index, Percent Change	-3.1	-4.0	-1.3	-0.2	1.0
Case-Shiller C-10 Home Price Index, Percent Change	-16.7	-12.9	-1.4	-0.5	1.8
Interest Rates - Annual Averages					
Prime Rate	5.08	3.25	3.25	3.25	3.50
Ten-Year Treasury Note	3.66	3.26	2.90	2.93	3.30
Conventional 30-Year Fixed Rate, Commitment Rate	6.04	5.04	4.43	4.33	4.89
One-Year ARM, Effective Rate, Commitment Rate	5.18	4.71	3.85	3.70	4.00

Forecast as of: October 20, 2010

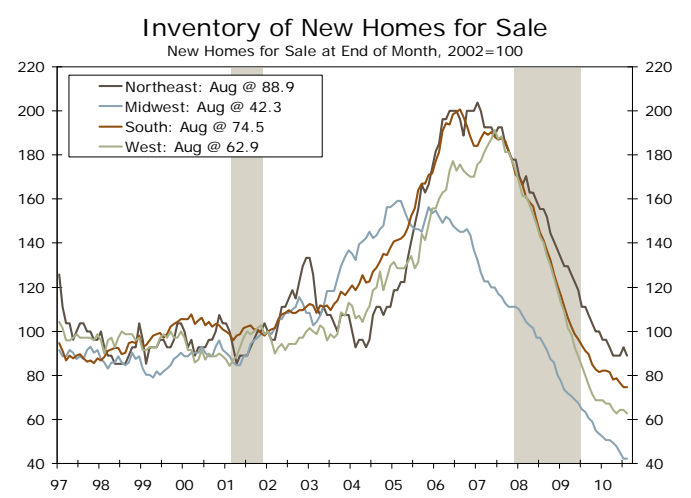
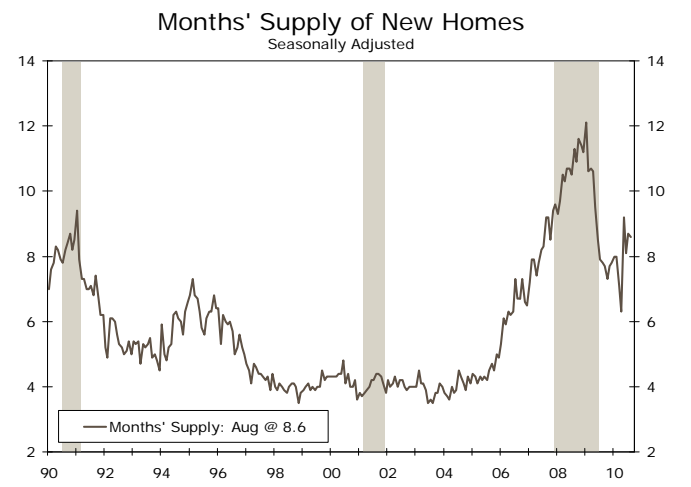
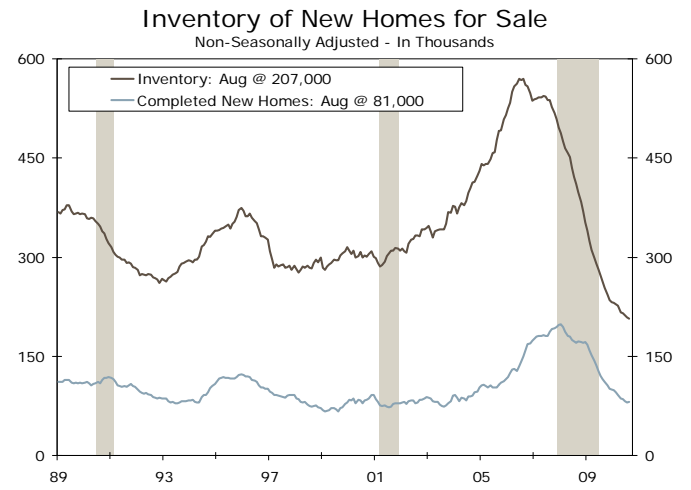
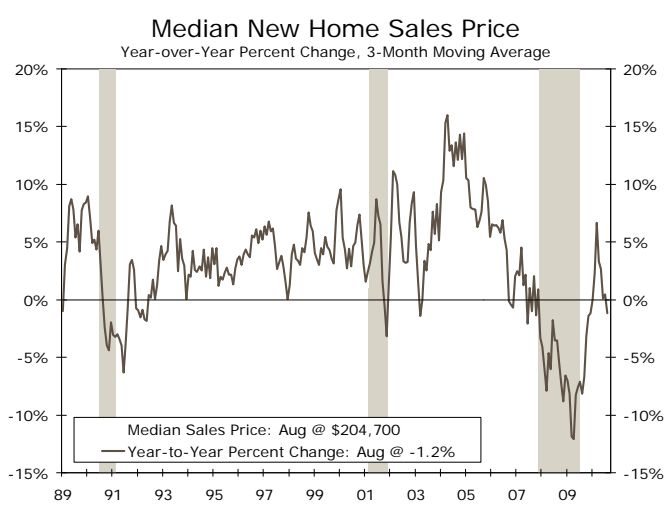
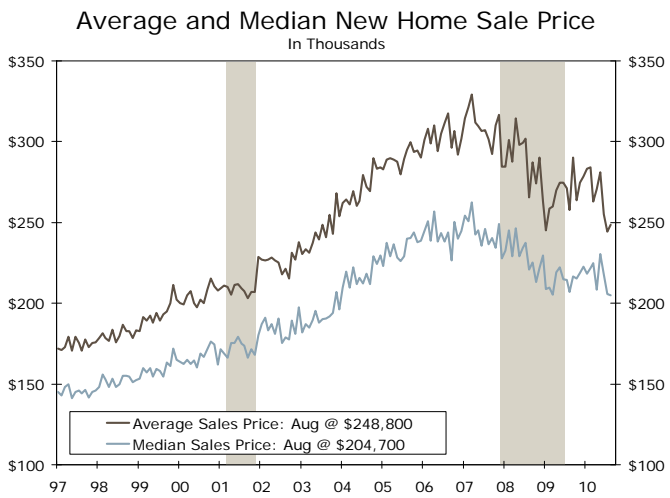
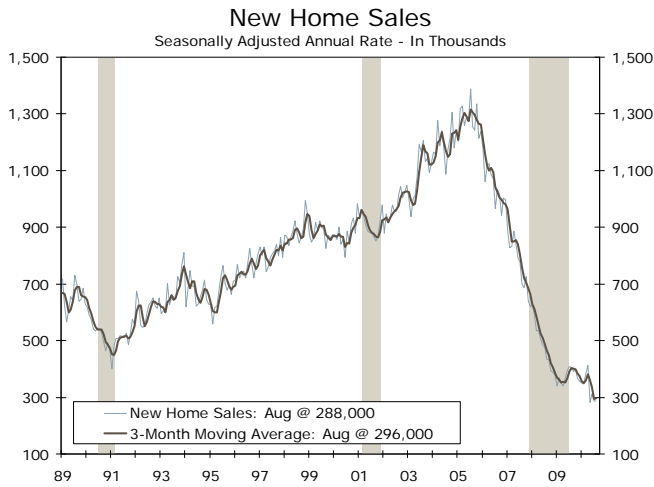
Source: Federal Reserve Board, FHFA, MBA, NAR, S&P Corp, U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities, LLC

**Housing Starts**



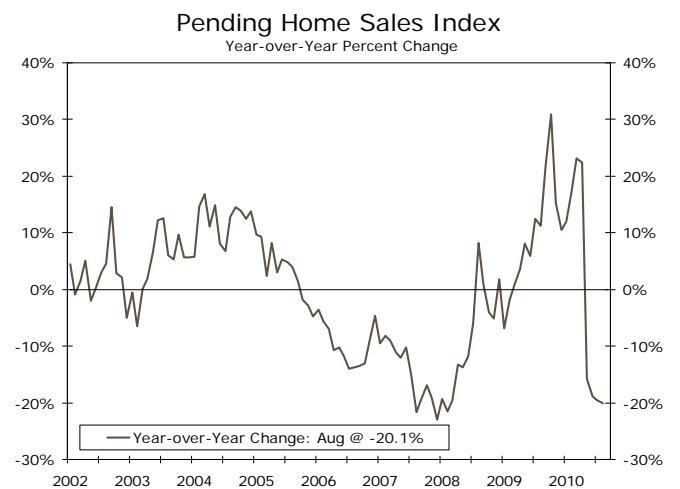
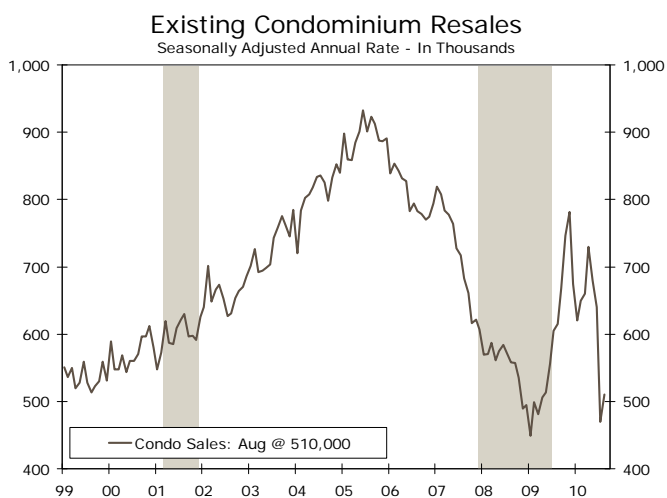
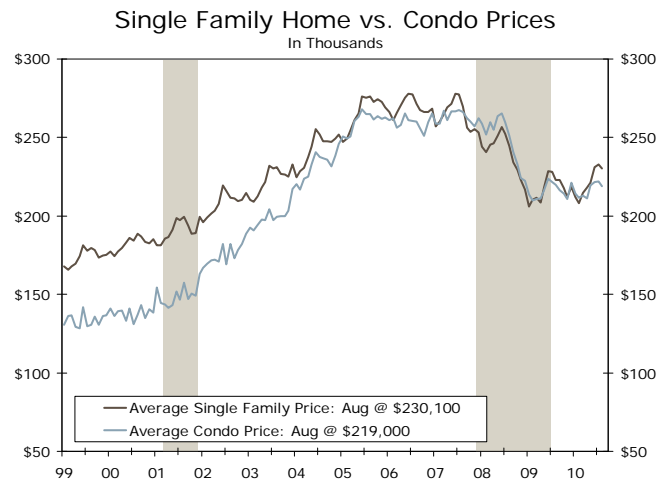
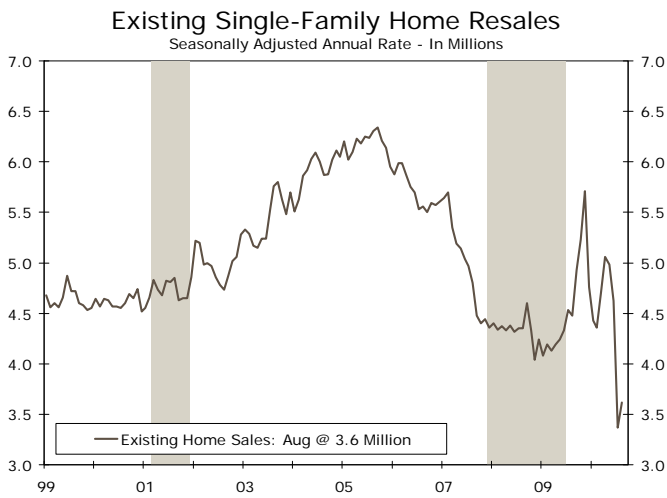
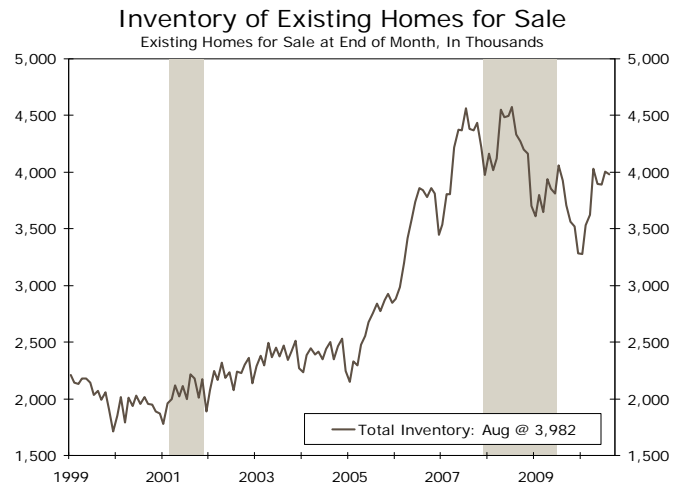
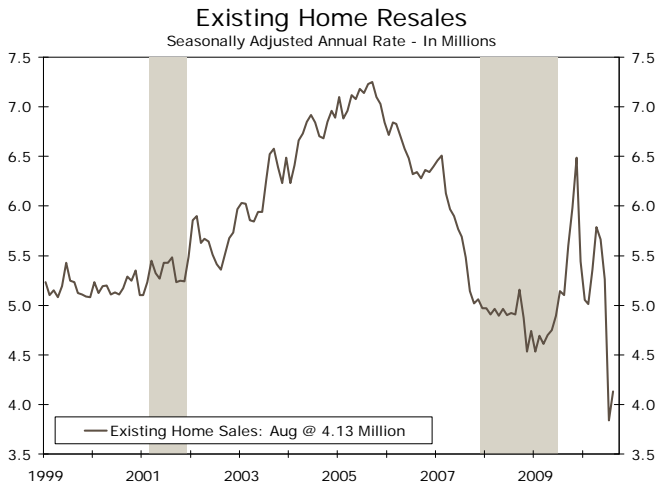
Source: NAHB, U.S. Department of Commerce and Wells Fargo Securities, LLC

**New Home Sales**



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

**Existing Home Sales**



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

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