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**WELLS
FARGO** SECURITIES

Economics Group

Special Commentary

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Housing Chartbook: August 2009

Finally, We Are Seeing Some Positive Signs

Recent months have seen a modest improvement in home sales, residential construction and home prices. While activity is far from robust, the improvement is consistent across most geographic areas and is backed up with anecdotal reports from builders and realtors. The source of the improvement is some lessening of the credit headwinds from last fall's collapse in the financial markets as well as two key policy moves by the Administration and the Federal Reserve.

Credit conditions tightened abruptly amidst the onset of the financial crisis late last year, making it extremely difficult for builders and developers to secure construction and development loans. Conditions eased slightly earlier this year, and single-family home starts rose for four consecutive months from their severely depressed levels of January and February. Nonetheless, despite the increase, construction of single-family homes remains severely depressed and on track to post its lowest annual total since records began being kept in the 1960s.

Home sales have also risen off their earlier lows, reflecting some improvement in mortgage lending. The Federal Reserve announced a plan late last year to purchase \$1.2 trillion in mortgage-backed securities, effectively buying down mortgage rates. The program was very successful at the start of the year, almost instantaneously bringing mortgage spreads back to their historical norms relative to the 10-Year Treasury note. Treasury yields also declined, as the Fed bought large quantities of Treasury securities. By late January, conforming 30-year mortgages could be had at just 4.50 percent.

Home sales are also getting a boost from the \$8,000 tax credit for first-time homebuyers. The credit is due to expire near the end of the year, but the looming end of the program could depress sales well before then as purchases must be completed by November 30. Builders are lobbying Congress and the Administration to extend and expand the program, but large and growing budget deficits make an extension far from a sure thing. In the near term, the approaching end of the first-time homebuyer tax credit will likely boost sales late this summer, which is typically when sales tend to wind down.

While it is encouraging to see some improvement in sales and new construction, it is also somewhat worrisome that sales have risen so little given the enormous amount of stimulus that has been put in place. In the past, housing has helped lead the economy out of recession, as sharply lower interest rates brought buyers back into the market. It is doubtful that mortgage rates will revisit the lows seen earlier this year, and even those exceptionally low rates produced only a minor ripple of sales. There is also very little pent-up demand for homes in the economy today. Nearly everyone who wanted to buy a home and could afford to do so purchased during the boom years. Moreover, much to everyone's consternation today, lots of people who wanted to buy a home and could not afford to do so, bought one too.

Together we'll go far



The lack of pent up demand means there are very few levers policymakers can pull in order to jump-start demand. Even if the first-time homebuyer tax credit is extended, its benefits are likely to be fleeting, and the program could effectively rob the system of sales in future years. Sales and new construction are much more likely to slowly grind higher over the next few years. As a result, it will likely take quite some time to clear the tremendous oversupply of homes on the market.

The oversupply of housing will likely put further pressure on prices and rents. Home prices have firmed up in a number of widely followed home price indices, including the Case-Shiller index. The increases may simply reflect the impact from foreclosure moratoria, which reduced the volume of foreclosure sales late this spring and early this summer. With fewer bargain-priced foreclosure sales in the mix, the median price of an existing home has perked a bit, and this improvement has bled through to other price measures.

Unfortunately, mortgage delinquency rates and foreclosures are still rising, particularly in areas where home prices surged during the bubble years and in markets where construction ran well ahead of demand. Most of the run-up in delinquency rates and foreclosures that has occurred so far has been due to the poor underwriting done around the peak of the housing boom. As a result, a large proportion of foreclosures is occurring in just a handful of states, namely California, Arizona, Nevada, and Florida. A larger part of credit problems going forward are likely to arise from deteriorating employment conditions, which means delinquency rates and foreclosures are likely to rise much more in the Southeast, Midwest and Pacific Northwest. All these areas have seen the unemployment rate rise dramatically over the past year, while wages and salaries have stumbled.

Our updated forecast has home sales and housing construction slowly grinding higher over the next 18 months. We assume the \$8,000 tax credit for first-time homebuyers is extended through 2010 but that its impact wanes as fewer buyers are able to take advantage of the program. The gradual improvement in underlying economic conditions that we are projecting for 2010 should also help sales to pick up even though mortgage rates are expected to rise nearly half a percentage point from current levels.

We expect home prices to resume their slide later this year, as more foreclosures work their way to market. We calculate the housing market is still oversupplied by just under two million units. While underlying demand should gradually improve, unemployment is expected to remain high through the next few years, which will likely serve to reduce household formations. The oversupply of housing will likely also put additional downward pressure on rents, making rental apartments a more attractive option versus home ownership. The weak rental market and oversupply of condominiums will likely also keep a tight lid on multi-family unit starts, although we see some improvement from today's unusually depressed levels.

Figure 1

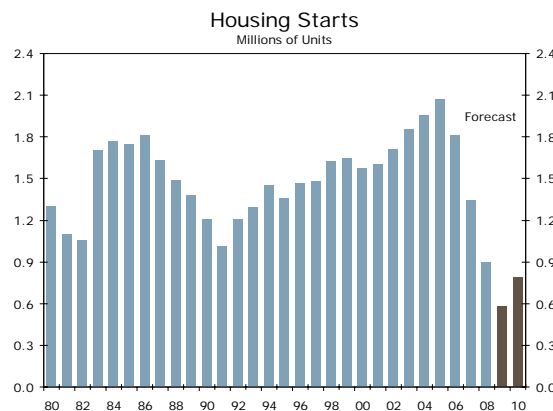
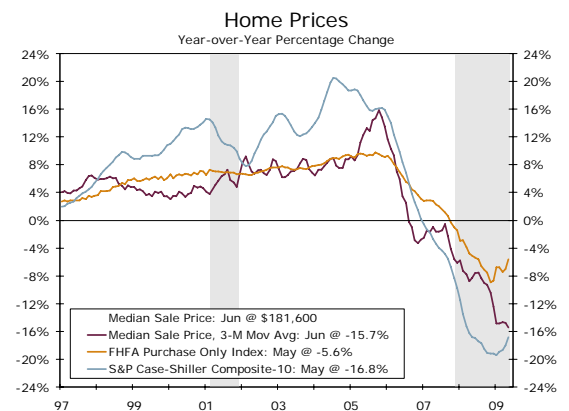


Figure 2



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

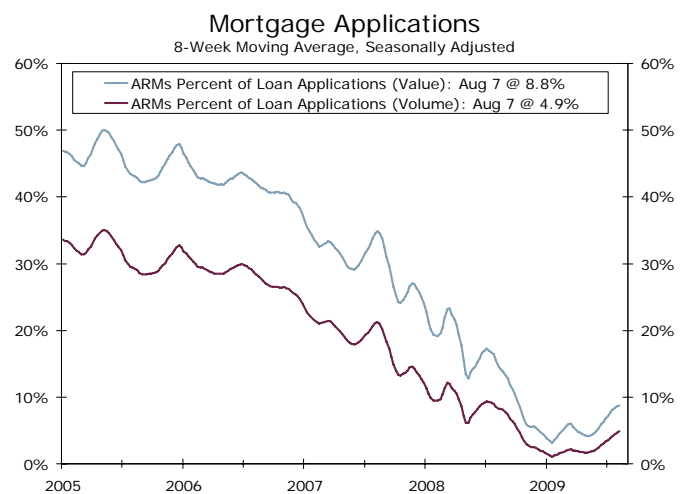
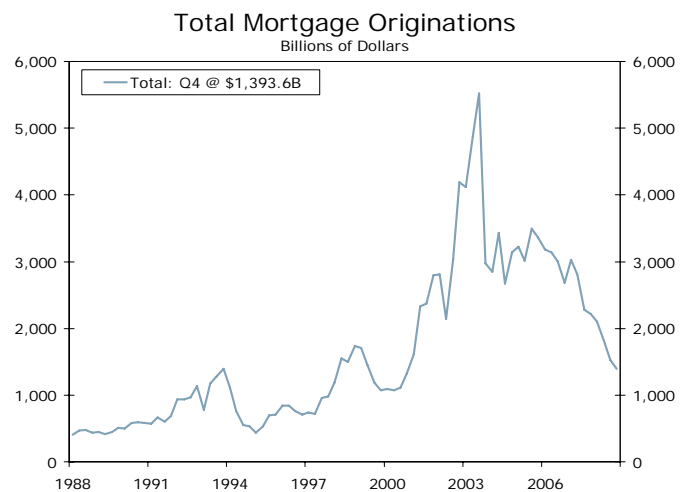
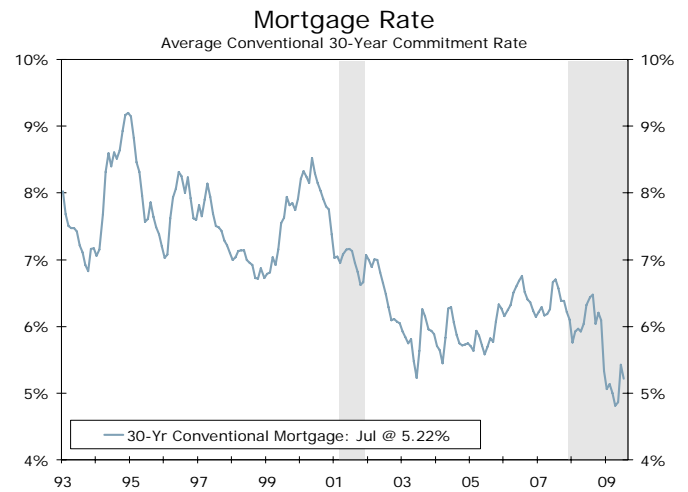
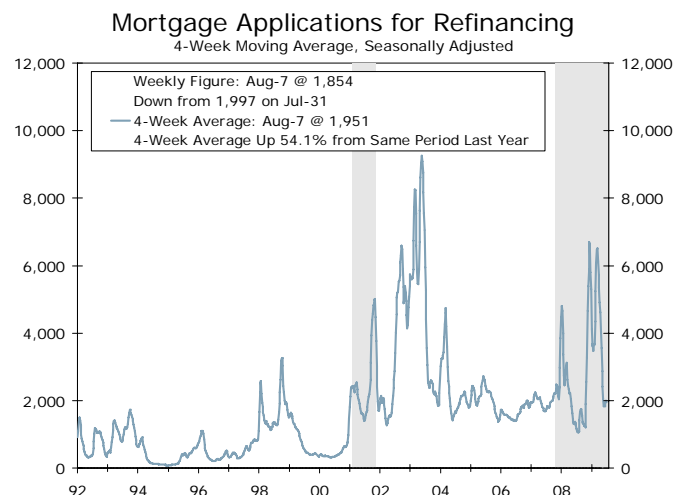
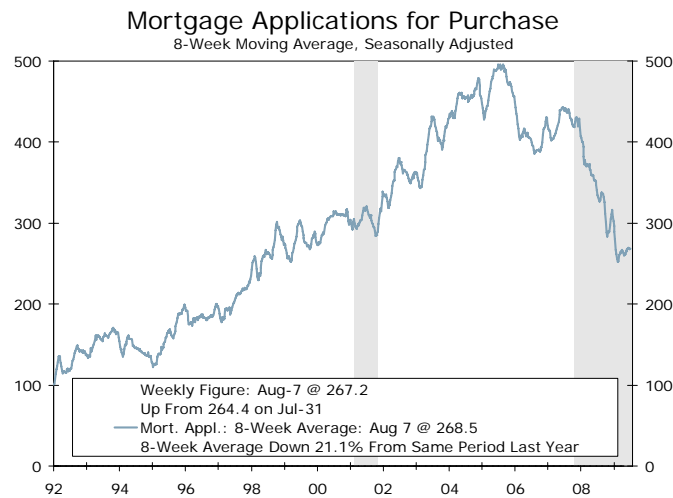
National Economic & Financial Outlook

	Actual			Forecast		
	2005	2006	2007	2008	2009	2010
Real GDP, percent change	3.1	2.7	2.1	0.4	-2.5	2.1
Nonfarm Employment, percent change	1.7	1.8	1.1	-0.4	-4.0	-1.3
Unemployment Rate	5.1	4.6	4.6	5.8	9.2	10.1
Home Construction						
Total Housing Starts, in thousands	2072.9	1811.9	1341.8	900.3	580.0	790.0
Single-Family Starts, in thousands	1718.5	1473.6	1035.8	615.8	440.0	590.0
Multi-Family Starts, in thousands	354.4	338.3	306.1	284.5	140.0	200.0
Home Sales						
New Home Sales, Single-Family, in thousands	1278.9	1049.3	768.7	481.3	390.0	460.0
Total Existing Home Sales, in thousands	7074.8	6482.9	5652.8	4913.0	4800.0	5200.0
Existing Single-Family Home Sales, in thousands	6180.0	5677.0	4939.0	4358.0	4300.0	4660.0
Existing Condominium & Townhouse Sales, in thousands	894.8	805.9	713.8	555.0	500.0	540.0
Home Prices						
Median New Home, \$ Thousands	234.2	243.1	247.9	232.1	206.5	198.5
Percent Change	7.5	3.8	2.0	-6.4	-11.0	-3.9
Median Existing Home, \$ Thousands	217.5	221.9	217.9	196.6	170.4	162.5
Percent Change	12.8	2.0	-1.8	-9.8	-13.4	-4.6
FHFA (OFHEO) Home Price Index, Percent Change	11.5	7.5	2.2	-2.5	-4.6	-0.6
Case-Shiller C-10 Home Price Index, Percent Change	16.9	7.4	-4.4	-16.7	-15.4	-3.0
Interest Rates - Annual Averages						
Prime Rate	6.19	7.96	8.05	5.08	3.25	3.75
Ten-Year Treasury Note	4.29	4.80	4.63	3.66	3.80	4.20
Conventional 30-Year Fixed Rate, Commitment Rate	5.87	6.41	6.34	6.04	5.40	5.80
One-Year ARM, Effective Rate, Commitment Rate	4.49	5.54	5.56	5.18	4.90	5.20

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

Mortgages

- After dropping precipitously earlier this year, mortgage rates have bounced back above 5 percent. The increase reflects higher Treasury yields. Spreads have remained close to their historical norms ever since the Fed announced their massive purchases of mortgage-backed securities last winter. Higher mortgage rates have caused home affordability to decline slightly, but affordability remains high and is not the issue today.
- Mortgage origination volumes continue to decline, reflecting the relatively low levels of home sales and lack of cash-out refinancings.
- Home sales have perked up a bit recently, and this should translate into at least a slight pickup in mortgage applications and volumes this fall.

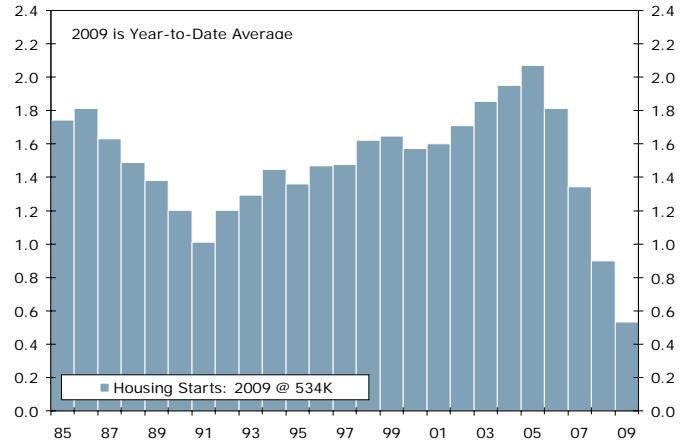


Source: Moody's Economy.com, Mortgage Bankers Association, NAR and Wells Fargo Securities, LLC

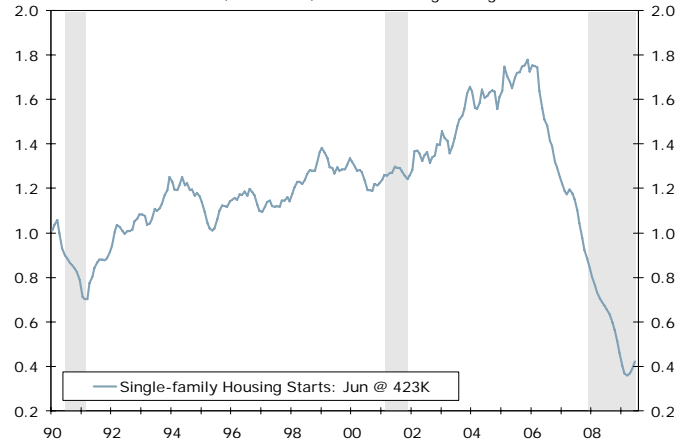
Single-Family Construction

- Single-family home construction bottomed in the first half of the year and has made small but steady gains since then. While sales are rising, they remain low and are likely being helped by the \$8,000 first-time home buyer tax credit.
- Single-family home building permits and starts both showed clear signs of bottoming earlier this year and should continue to gradually grind higher.
- Completions hit modern-era lows earlier this year and will likely remain near current levels.
- Builder sentiment has risen off the lows hit earlier this year and likely reflects success at clearing inventory.

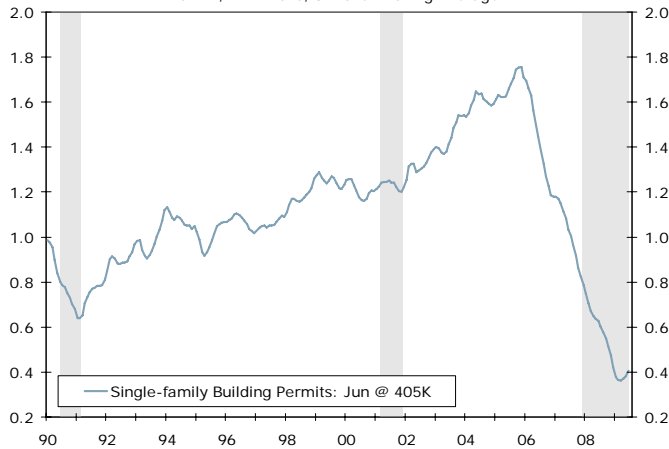
Housing Starts
 In Millions



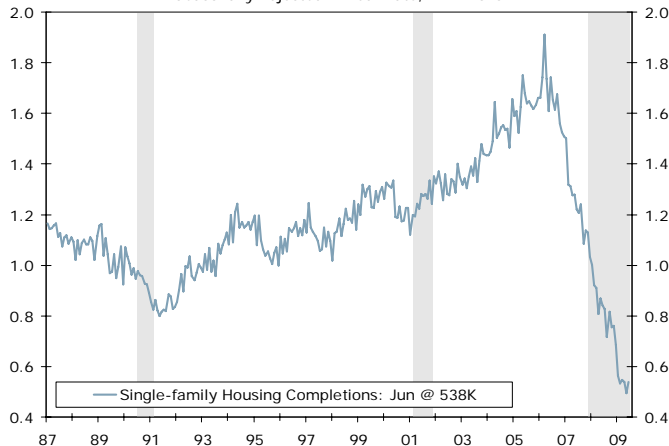
Single-family Housing Starts
 SAAR, In Millions, 3-Month Moving Average



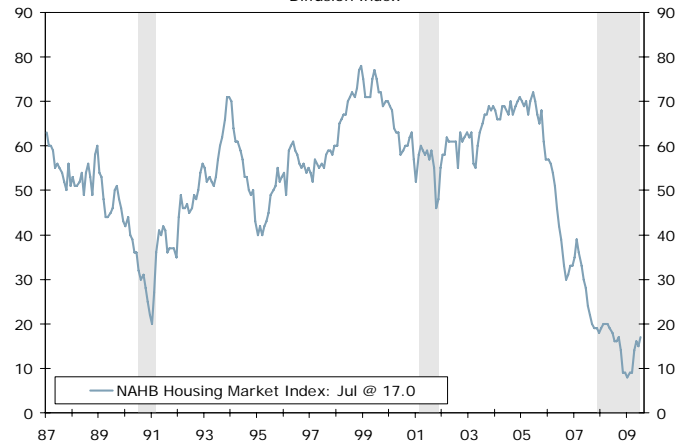
Single-family Building Permits
 SAAR, In Millions, 3-Month Moving Average



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



NAHB/Wells Fargo Housing Market Index
 Diffusion Index

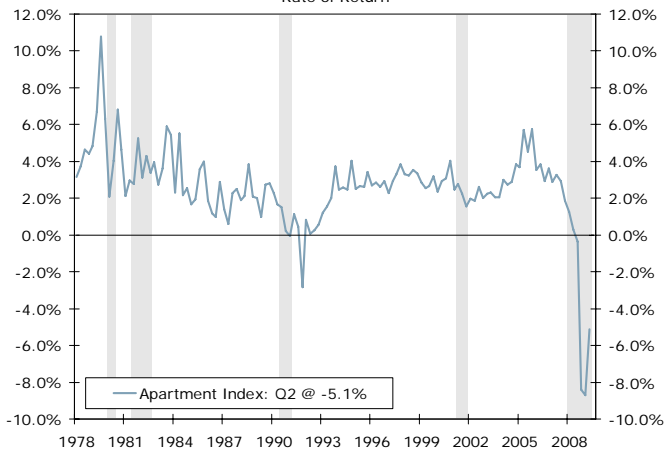


Source: NAHB, U.S. Department of Commerce and Wells Fargo Securities, LLC

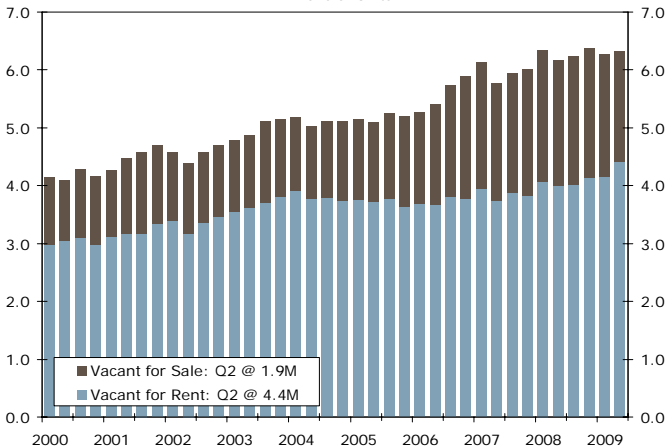
Multi-Family Home Construction

- Multi-family home construction activity has been far more volatile, but it may have bottomed when activity dropped below an annual 100,000 unit pace in April. With apartment and condominium construction near all-time lows, much of the recent construction activity likely reflects student housing and affordability housing projects.
- Apartment market conditions remain extremely stressed, with markets generally oversupplied and facing competition from condominiums and for-sale housing currently being offered for rent.
- Sales activity is improving slightly. Debt and equity financing is still tough to secure, but conditions are a little better than they were at the start of the year.

NCREIF Apartment Property Index
Rate of Return

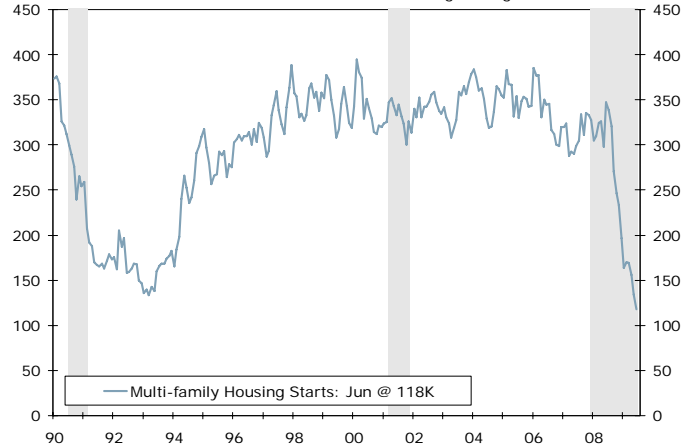


Housing Vacancies
Millions of Units



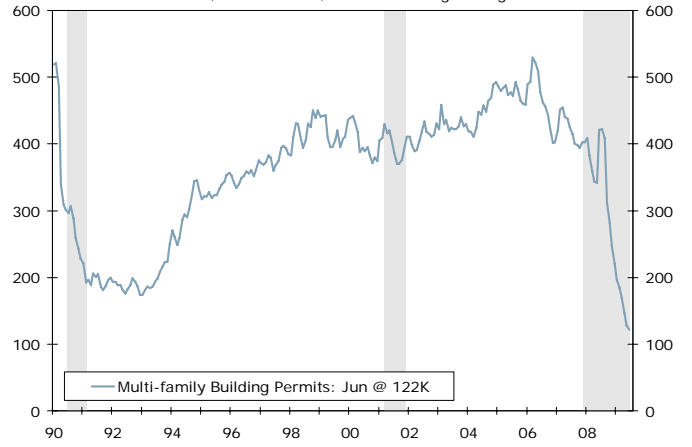
Multi-family Housing Starts

SAAR, In Thousands, 3-Month Moving Average



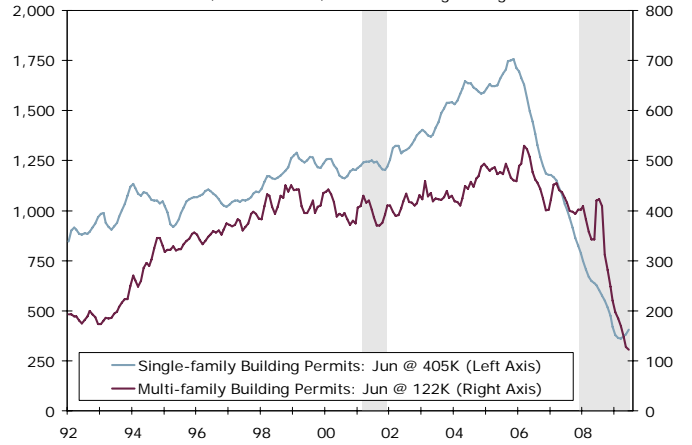
Multi-family Building Permits

SAAR, In Thousands, 3-Month Moving Average



Single & Multi-family Building Permits

SAAR, In Thousands, 3-Month Moving Average

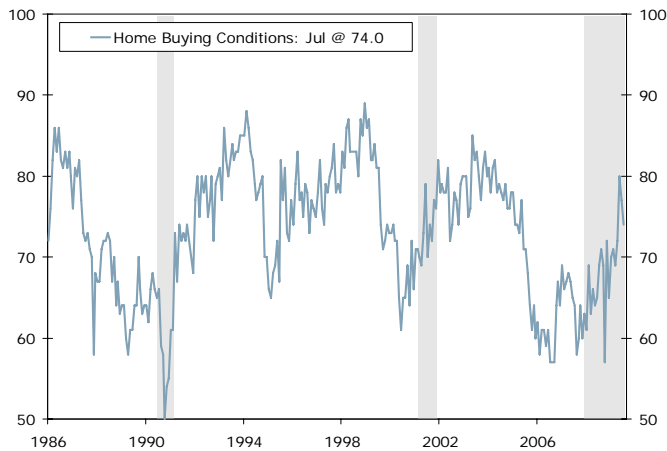


Source: NCREIF, U.S. Department of Commerce
and Wells Fargo Securities, LLC

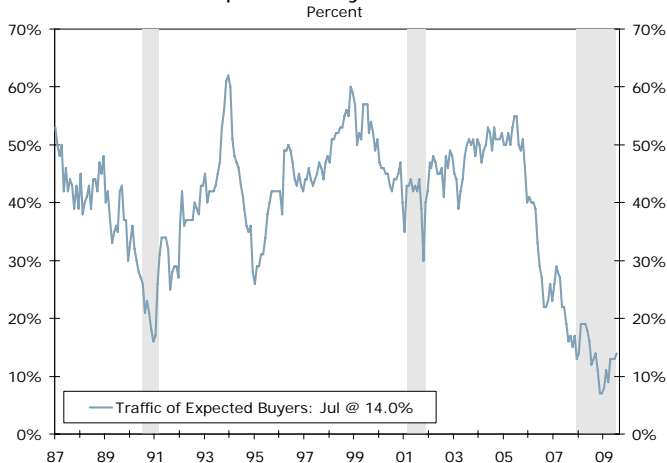
Buying Conditions

- If you are employed, feel secure in your job, and have the income to qualify, now is a great time to buy a home. Mortgage rates are relatively low, and home prices have fallen across much of the country, particularly in markets where prices had risen the most. Unfortunately, high unemployment is preventing many potential homebuyers from taking advantage of today's improved buying conditions.
- Buyer traffic has not improved anywhere near as much as buying conditions have, but traffic has clearly moved off its lows and matches up well with the recent uptick in sales.
- Lending standards remain relatively tight, particularly in areas where home prices are still falling significantly.

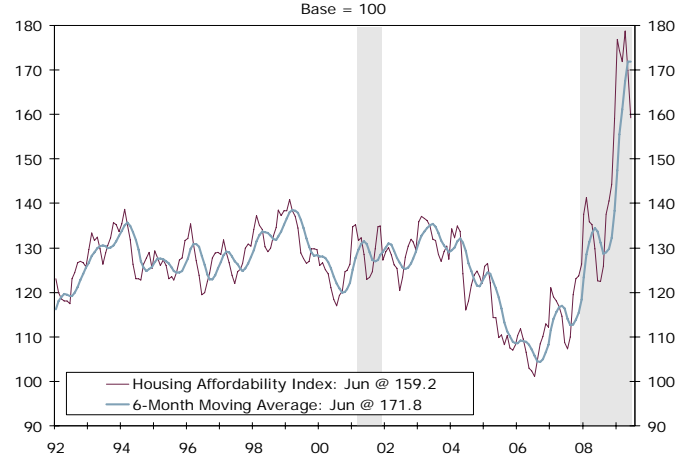
U. Michigan Sentiment Home Buying Conditions Index



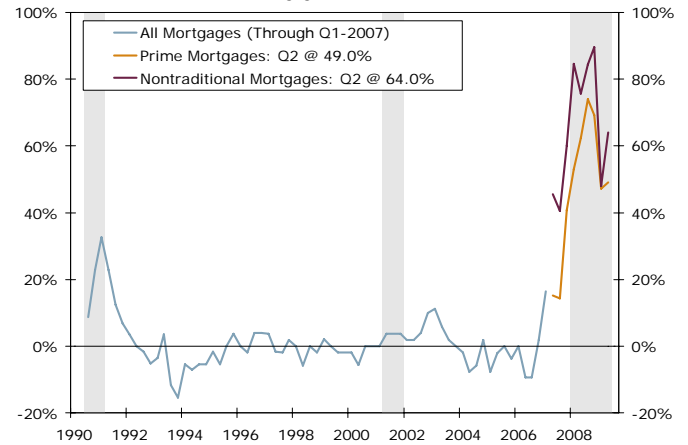
Expected Buyer Traffic Percent



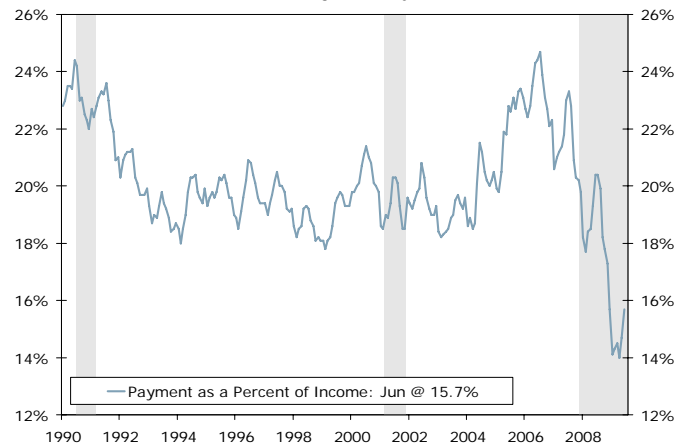
Housing Affordability, NAR-Home Sales



Net Percent of Banks Tightening Standards Mortgages for Individuals



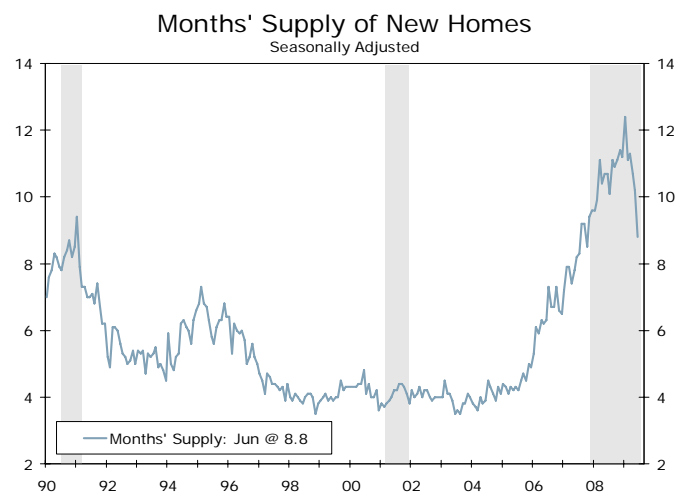
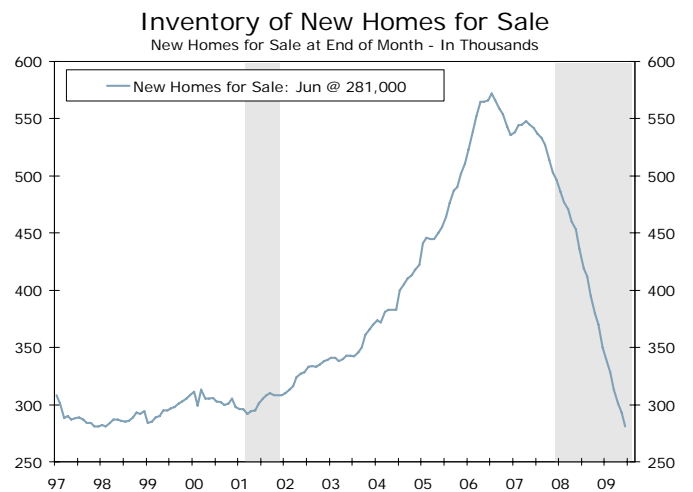
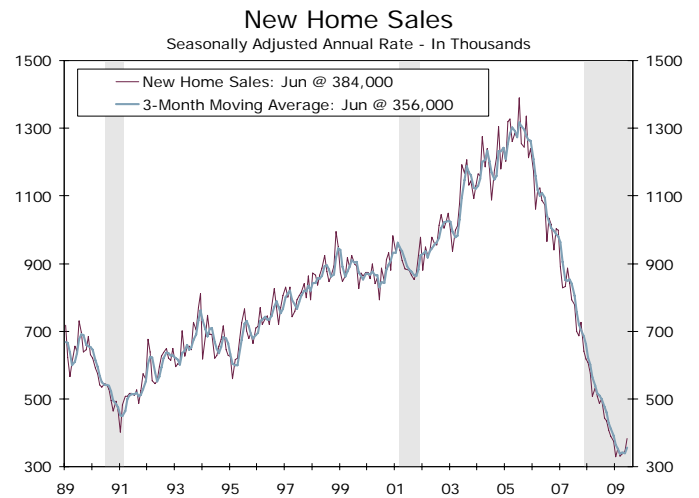
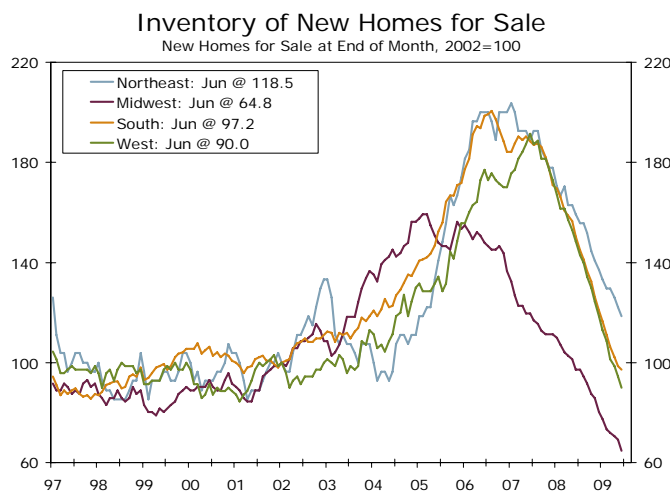
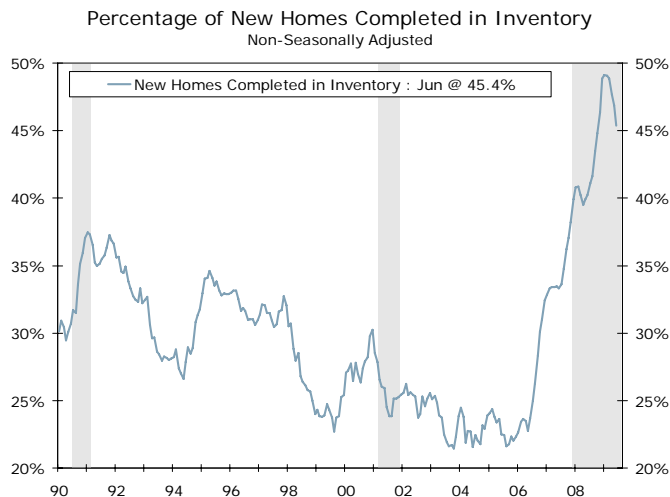
Payment on Median Priced Single Family Home As a Percentage of Family Income



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

New Home Sales

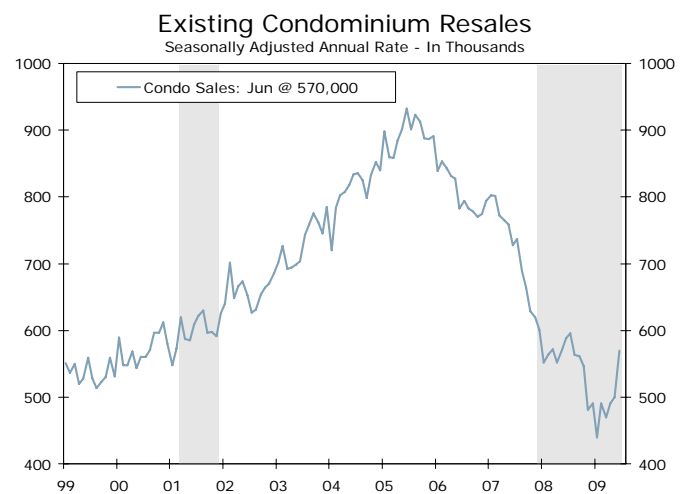
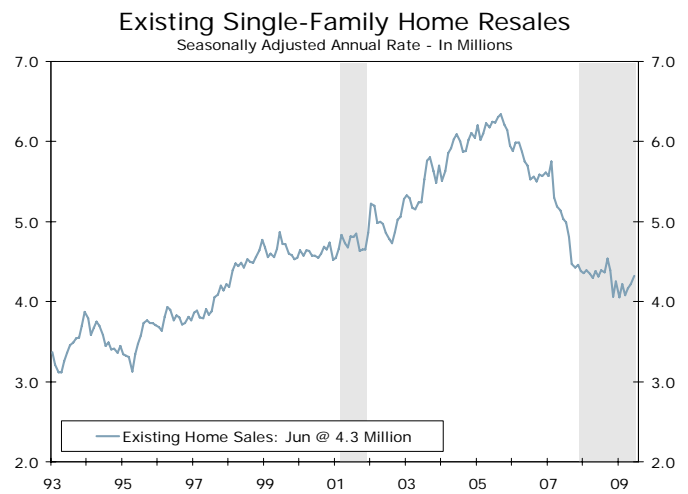
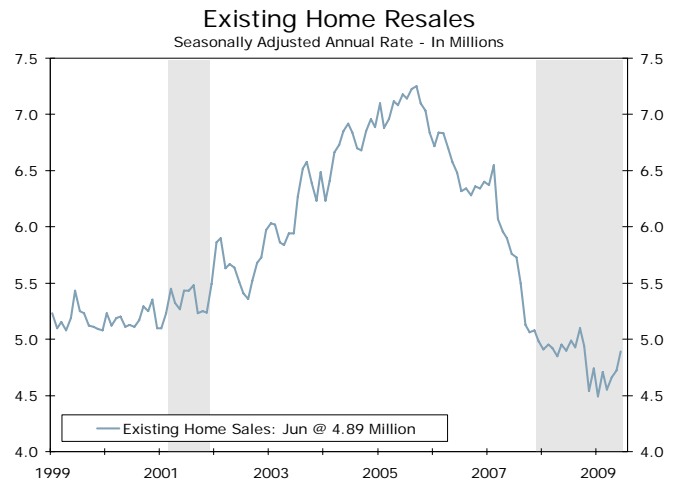
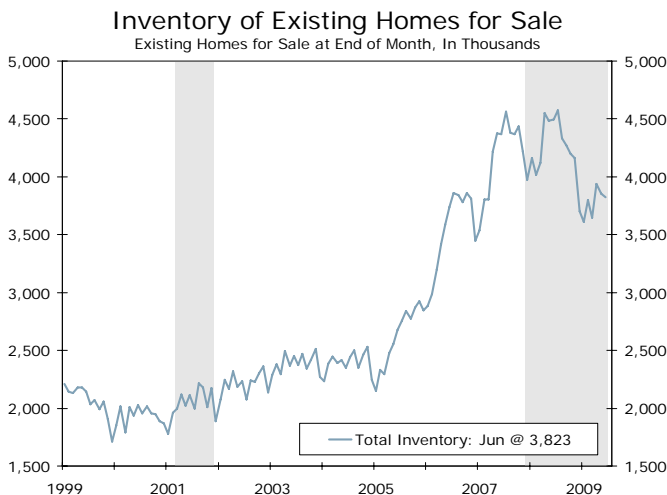
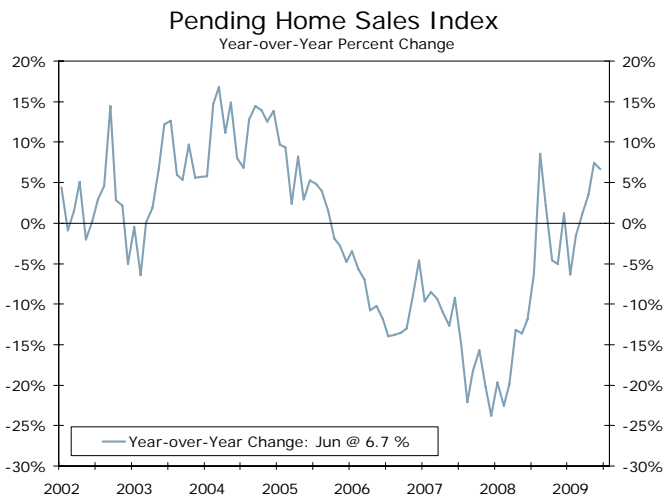
- Sales in the new home market appear to have bottomed earlier this year and have risen 16.7 percent since January. While builders will likely continue to face competition from the overhang of distressed properties, sales now appear to be on the upswing.
- Cancellation rates are reported to have declined significantly, which means a larger proportion of today's sales are actual transactions.
- Inventory levels have improved markedly over the course of the recession and are now below the levels maintained in the late 1990s. We would expect inventories to overshoot to the downside considering the dearth of new activity in the pipeline and lack of developer financing.



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

Existing Home Sales

- Existing home sales rose 3.6 percent in June, marking the third consecutive monthly gain. It appears that sales have firmly put in a bottom, and while they may not move sharply higher sales are unlikely to retest the lows.
- Foreclosure and distressed sales have also declined as a percentage of total transactions, suggesting the improvement we have witnessed is more sustainable than it would have been with more distressed activity.
- Pending home sales have also risen solidly. Unfortunately, not all pending transactions are making it to closing, and the NAR has specifically cited low appraisals as making it difficult for some deals to get done.

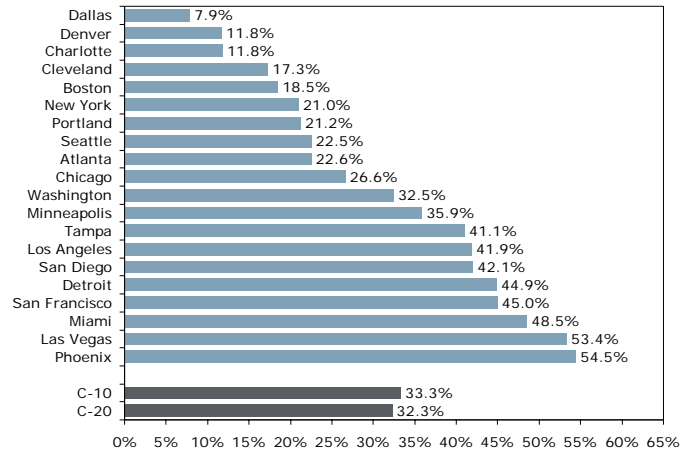


Source: National Association of Realtors and Wells Fargo Securities, LLC

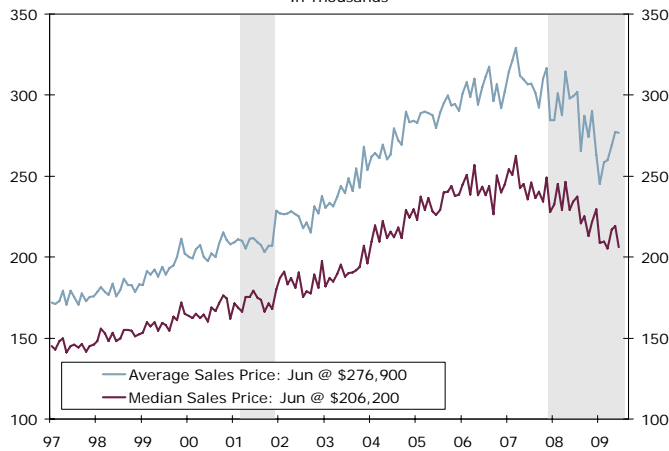
Home Prices

- Home prices still have some room to fall, in our view, but signs of an eventual stabilization are beginning to materialize. Prices have actually risen ever so slightly on a month-over-month basis in several of the widely followed price indices. We do not believe we have seen the last of the price declines, however. Foreclosure moratoria may have temporarily removed some lower-priced transactions from the market. Still, we believe the bulk of home price declines is behind us, and we expect an actual bottom to be hit next year.
- Many of the former bubble markets have seen significant drops, with both Las Vegas and Phoenix losing more than half their value according to the S&P Case-Shiller index.

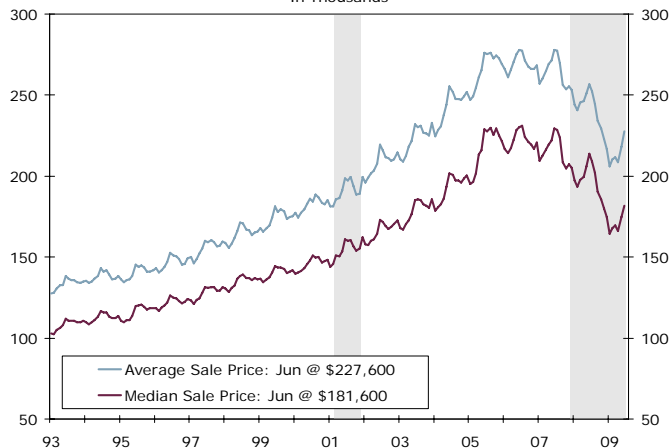
S&P Case-Shiller Home Prices
 Percent Decline from Local Market Peak



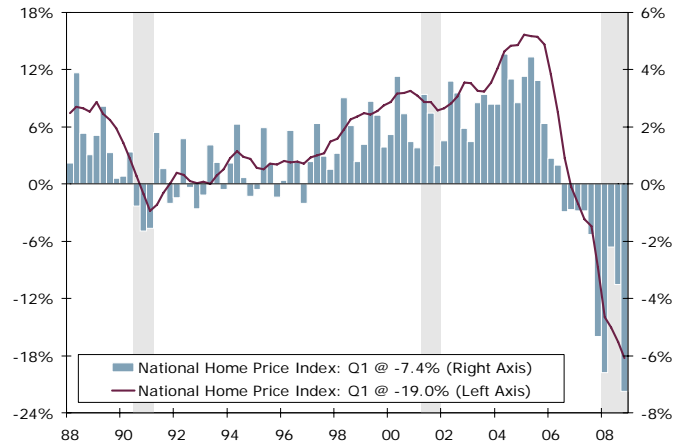
Average and Median New Home Sale Price
 In Thousands



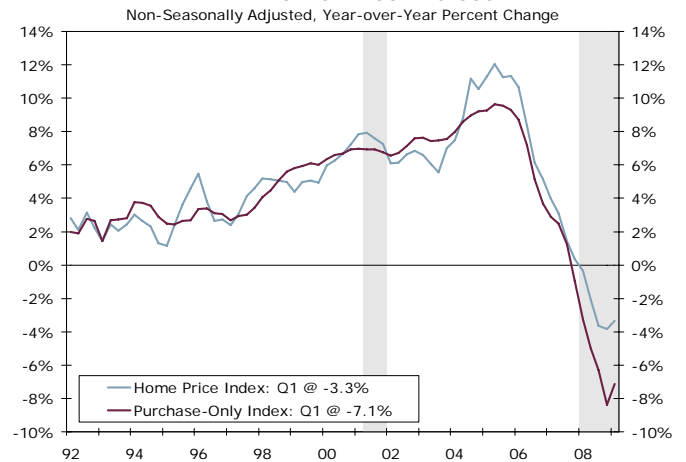
Existing Single-Family Home Prices
 In Thousands



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



FHFA Home Price Indices

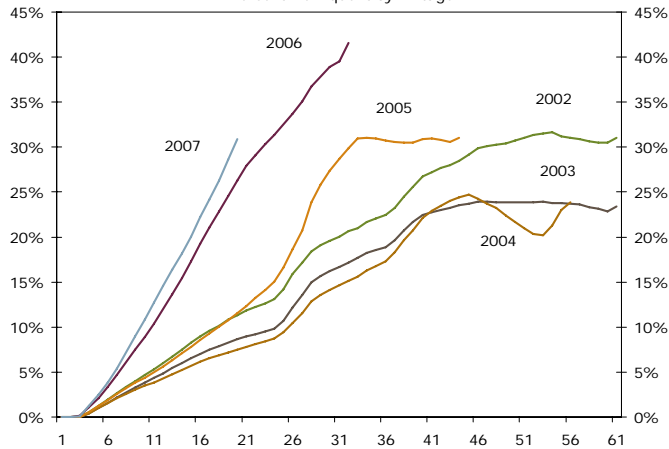


Source: FHFA, NAR, S&P Corp, U.S. Department of Commerce and Wells Fargo Securities, LLC

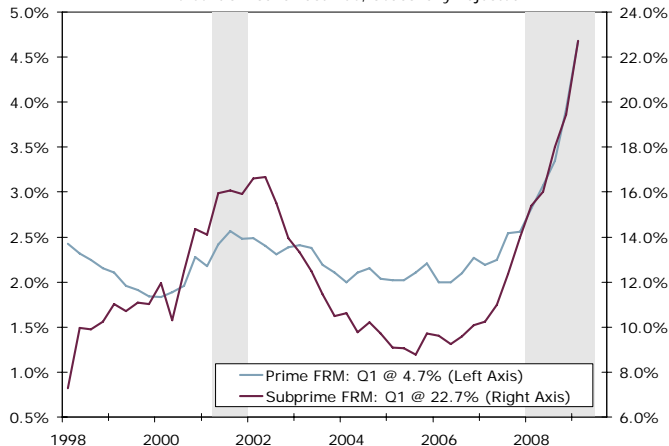
Credit Quality

- What seems to be an ever-rising tide of delinquencies is unlikely to abate this year. Rising unemployment and the payback from the loose lending near the peak of the housing bubble are responsible for much of the increase.
- The latest foreclosure numbers show that a disproportionate share of foreclosures continue to be in California, Florida, Arizona and Nevada, which is where the housing bubble inflation was the worst.
- Rising unemployment and sluggish income growth are becoming a larger issue for delinquencies, which are certain to rise further in coming months.

Subprime ARMs 60+ Delinquencies
Percent Delinquent by Vintage

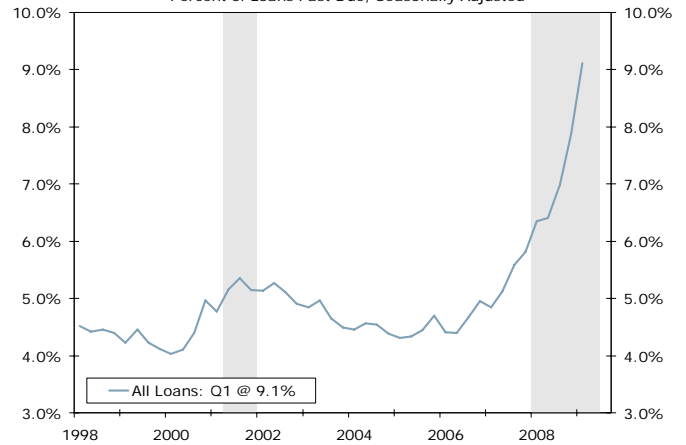


Fixed-Rate Mortgage Delinquency
Percent of Loans Past Due, Seasonally Adjusted



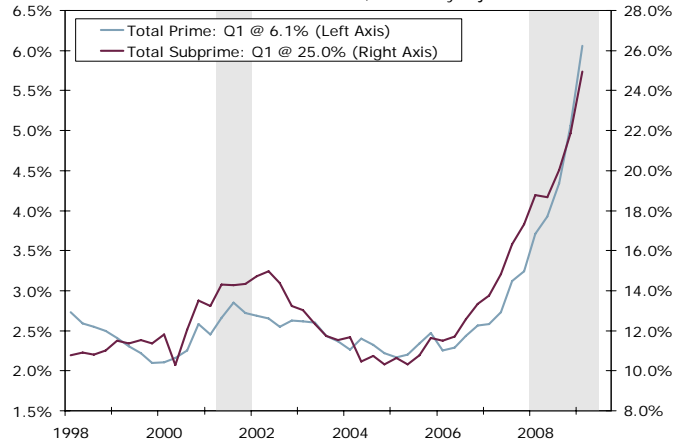
Mortgage Delinquency

Percent of Loans Past Due, Seasonally Adjusted



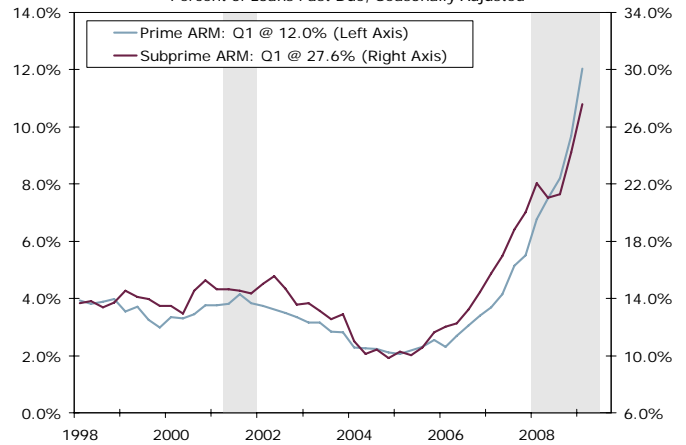
Conventional Mortgage Delinquency

Percent of Loans Past Due, Seasonally Adjusted



Adj. Rate Mortgage Loan Delinquency

Percent of Loans Past Due, Seasonally Adjusted



Source: Federal Reserve Board, MBA
and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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