

Economics Group

Special Commentary

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Housing Chartbook: February 2016

Another Year of This Most Unusual Housing Recovery

The housing market ended 2015 on a fairly solid note, with some modest improvement evident in most measures of housing demand, home prices and new home construction. The overall pace of growth, however, particularly in the single-family market remains disappointing. Sales remain a shadow of what was previously thought to be the norm. Housing turnover also remains far lower than it has in the past, which has left many markets stuck in place and unable to generate the self-reinforcing momentum that has been such an important part of past housing recoveries. We remain optimistic about the prospects for home sales and new home construction in 2016 and 2017, but have scaled back our expectations, as the broader economic expansion is beginning to show its age and the recent volatility in global financial markets will likely cause some potential buyers to put off home buying decisions even further.

We remain optimistic about the prospects for home sales and new home construction in 2016 and 2017.

While the cumulative recovery in home sales and new home construction relative to previous business cycles is disappointing, a great deal of progress has been made in recent years. The proportion of homeowners that are delinquent on their mortgage or facing foreclosure has continued to trend lower (Figure 1) and are now at levels where it no longer presents a significant headwind. The slide in the homeownership rate also appears to have finally ended, with two consecutive quarters of slight gains (Figure 2). Even with this improvement, the hangover from the housing bust has left the marketplace with a significant number of hurdles. A large proportion of homeowners remain in a negative equity or near negative equity position. Moreover, many more homeowners have less equity than they would like at this time in their life, which is weighing on trade-up and downsizing decisions. The influx of investor buyers that flooded the market near the nadir of the housing bust pushed home prices sharply higher ahead of household income, which has severely curtailed affordability for first-time home buyers.

Figure 1

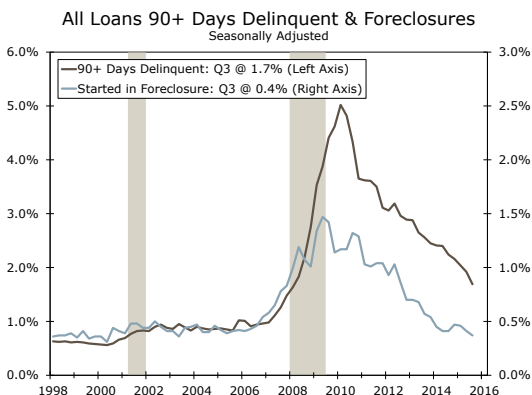
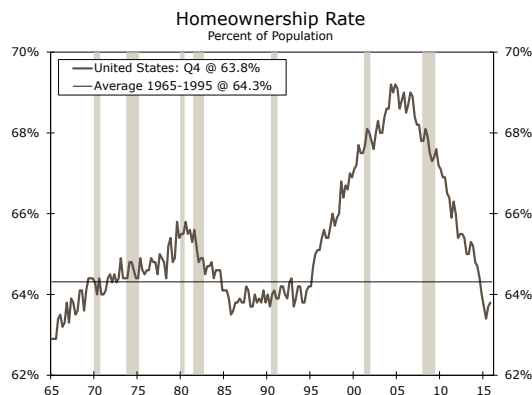


Figure 2



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



We expect the pace of residential investment to pick up slightly in 2016.

Housing Remains a Bright Spot for the Economy

For all the disappointing numbers that we have seen in recent months, housing still remains a notable bright spot for the economy. Residential investment grew at an 8.1 percent annual rate during the fourth quarter and contributed 0.3 percentage points to economic growth both in the fourth quarter of last year and in 2015 as a whole. We expect the pace of residential investment to pick up slightly in 2016, as single-family housing accounts for a slightly larger proportion of overall starts and spending on renovations and upgrades continues to grow solidly. We have scaled back our expectations for 2016, however, reflecting our forecast for slower overall economic growth and surprisingly soft readings on most housing indicators during the fall of last year. The slowdown in the energy sector, particularly in Houston—the nation’s top homebuilding market—will also limit the extent of any improvement in 2016. Sales and starts appear to be headed higher nationally, however, and even most of Texas appears to be holding up well.

Two themes that we have repeatedly highlighted in our monthly housing updates—affordability and rising construction costs—will continue to impede the housing market in 2016. Home prices have been rising faster than had been widely expected throughout most of this recovery. Earlier price spikes were largely driven by swings in investor buying, which quickly took many bargain-priced homes off the market. Price appreciation has been supported more recently by an influx of foreign buyers, particularly in gateway markets like southern California, Seattle, New York City and Miami. Demand from foreign buyers has cooled considerably in recent months, however, as the dollar has surged against most key currencies and new regulations governing third-party purchases have been enacted. We expect home price appreciation to moderate in 2016, but home price appreciation should still outpace income growth in most markets.

Affordability should get some support from low mortgage rates.

Affordability should get some support from low mortgage rates. The global economic slowdown and adoption of negative policy rates in Japan suggest that interest rates will likely be lower than they were expected to be at the start of the year. Lower mortgage rates may motivate some potential buyers that have been reluctant to part with homes financed near the low in mortgage rates. Refinancing activity should also improve modestly, as households that could not refinance earlier because their mortgages were underwater are now back in a positive position. Given that mortgage rates were already low and have been low for quite some time, we do not see a slower trajectory for interest rate increases to be a game changer for the housing sector but rather supporting influence for the housing market.

New home sales are expected to climb 11.8 percent in 2016. Sales will benefit from increases in supply. Builders are ramping up development, with large tract development making a comeback in many of the faster growing markets in the South and West, as is evidenced by the rising inventory of homes under construction and not yet started. We are looking for single-family starts to rise about 9 percent in 2016 and multifamily starts will likely rise 6 percent (Figure 4).

Figure 3

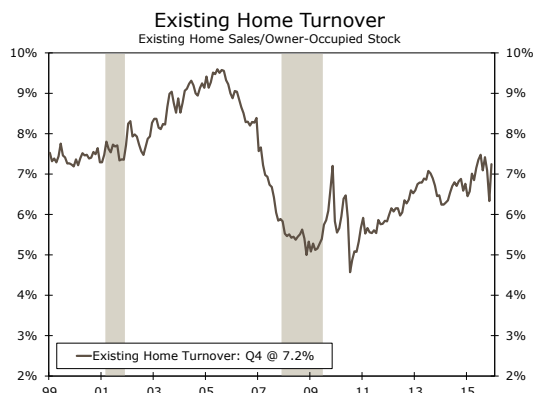
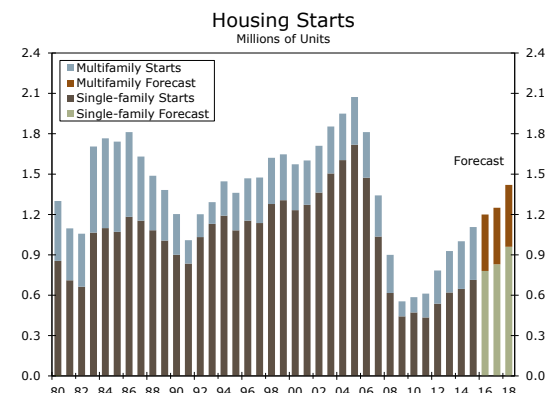


Figure 4



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

National Housing Outlook

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|------------------------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Real GDP, percent change | -0.3 | -2.8 | 2.5 | 1.6 | 2.3 | 2.2 | 2.4 | 2.4 | 1.9 | 2.4 |
| Nonfarm Employment, percent change | -0.6 | -4.3 | -0.7 | 1.2 | 1.7 | 1.7 | 1.9 | 2.1 | 1.8 | 1.5 |
| Unemployment Rate | 5.8 | 9.3 | 9.6 | 8.9 | 8.1 | 7.4 | 6.2 | 5.3 | 4.7 | 4.5 |
| Home Construction | | | | | | | | | | |
| Total Housing Starts, in thousands | 905.5 | 553.9 | 586.9 | 608.8 | 780.6 | 924.9 | 1003.3 | 1111.2 | 1,200.0 | 1,250.0 |
| Single-Family Starts, in thousands | 622.0 | 445.0 | 471.1 | 430.5 | 535.3 | 617.7 | 647.9 | 715.3 | 780.0 | 830.0 |
| Multifamily Starts, in thousands | 283.5 | 108.9 | 115.8 | 178.3 | 245.3 | 307.2 | 355.4 | 395.9 | 420.0 | 420.0 |
| Home Sales | | | | | | | | | | |
| New Home Sales, Single-Family, in thousands | 485.0 | 374.0 | 321.0 | 305.0 | 369.0 | 429.0 | 437.0 | 501.0 | 560.0 | 620.0 |
| Total Existing Home Sales, in thousands | 4,110.0 | 4,340.0 | 4,190.0 | 4,260.0 | 4,660.0 | 5,090.0 | 4,940.0 | 5,260.0 | 5,500.0 | 5,625.0 |
| Existing Single-Family Home Sales, in thousands | 3,660.0 | 3,870.0 | 3,708.0 | 3,787.0 | 4,128.0 | 4,484.0 | 4,344.0 | 4,648.0 | 4,870.0 | 4,980.0 |
| Existing Condominium & Townhouse Sales, in thousands | 450.0 | 464.0 | 474.0 | 477.0 | 528.0 | 603.0 | 591.0 | 608.0 | 630.0 | 645.0 |
| Home Prices | | | | | | | | | | |
| Median New Home, \$ Thousands | 232.1 | 216.7 | 221.8 | 227.2 | 245.2 | 268.9 | 282.8 | 293.6 | 304.8 | 316.4 |
| Percent Change | -6.4 | -6.6 | 2.4 | 2.4 | 7.9 | 9.7 | 5.2 | 3.8 | 3.8 | 3.8 |
| Median Existing Home, \$ Thousands | 198.1 | 172.5 | 172.9 | 166.1 | 176.8 | 197.1 | 208.3 | 223.9 | 231.4 | 241.1 |
| Percent Change | -9.5 | -12.9 | 0.2 | -3.9 | 6.4 | 11.5 | 5.7 | 7.5 | 3.3 | 4.2 |
| FHFA (OFHEO) Home Price Index (Purch Only), Pct Chg | -8.0 | -5.8 | -3.0 | -4.1 | 3.2 | 7.4 | 5.5 | 5.7 | 4.8 | 4.5 |
| Case-Shiller C-10 Home Price Index, Percent Change | -16.7 | -12.9 | 2.1 | -3.5 | 0.3 | 11.7 | 7.9 | 4.7 | 4.5 | 4.4 |
| Interest Rates - Annual Averages | | | | | | | | | | |
| Prime Rate | 4.88 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 | 3.26 | 3.88 | 4.88 |
| Ten-Year Treasury Note | 3.66 | 3.26 | 3.22 | 2.78 | 1.80 | 2.35 | 2.54 | 2.14 | 2.41 | 2.68 |
| Conventional 30-Year Fixed Rate, Commitment Rate | 6.04 | 5.04 | 4.69 | 4.46 | 3.66 | 3.98 | 4.17 | 3.85 | 4.13 | 4.34 |
| One-Year ARM, Effective Rate, Commitment Rate | 5.18 | 4.71 | 3.79 | 3.03 | 2.69 | 2.61 | 2.44 | 2.52 | 2.90 | 3.30 |

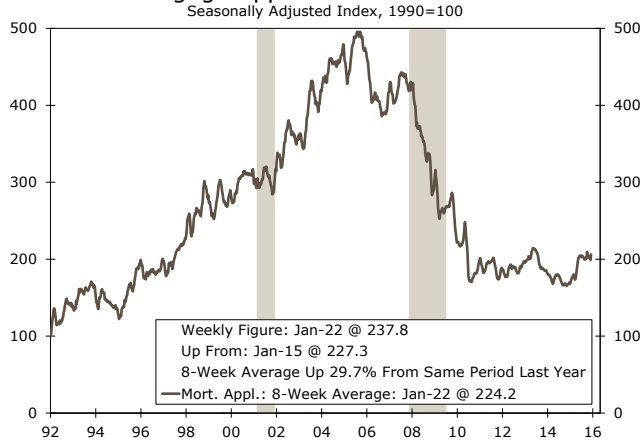
Forecast as of: February 1, 2016

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

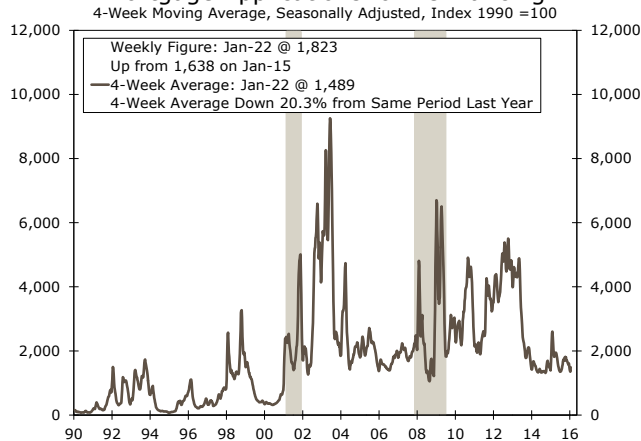
Mortgages

- Mortgage purchase applications have continued to trend upward and application activity remains near post-recession highs. Refinancing activity has slowed, as the Federal Reserve has widely been expected to continue to raise short-term interest rates. The global slowdown and recent financial market turmoil will likely cause folks to reassess their expectations for interest rates. We expect mortgage rates to continue to rise as Fed policy moves toward normalization. Our outlook calls for a modest pickup in mortgage rates, however.
- The Mortgage Credit Availability Index, which uses credit score, loan type, and loan-to-value ratio, fell in both November and December. The overall index remains at a level consistent with ample credit availability but the slide is notable.

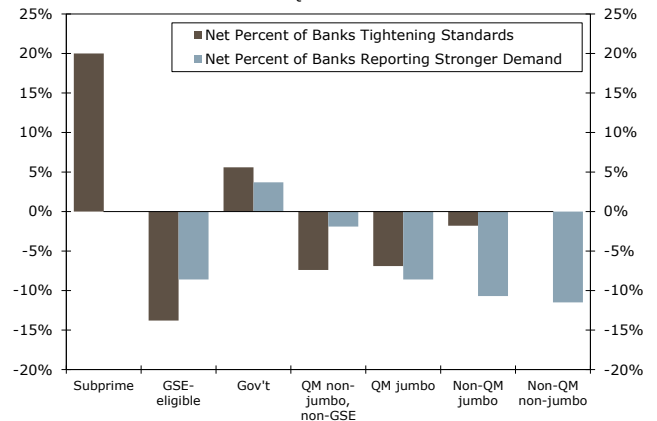
Mortgage Applications for Purchase



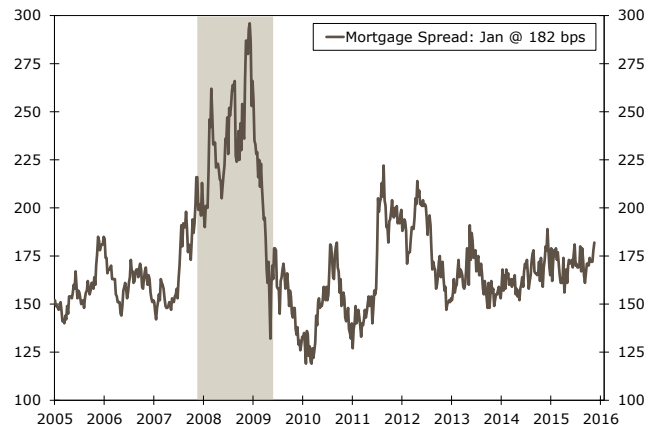
Mortgage Applications for Refinancing



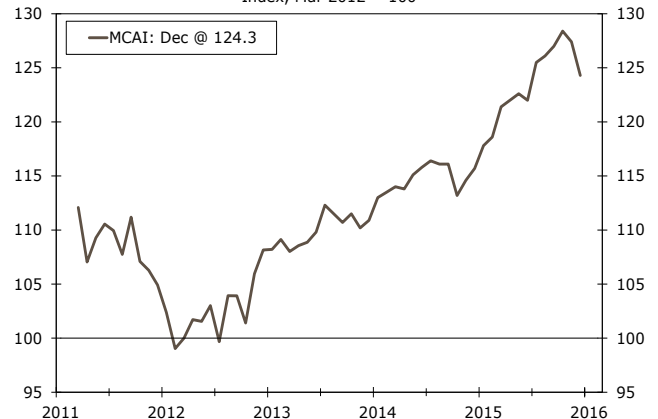
Mortgage Supply and Demand
Q4 2015



Conventional Mortgage to 10-Year Treasury Spread
Basis Points



MBA Mortgage Credit Availability Index
Index, Mar 2012 = 100

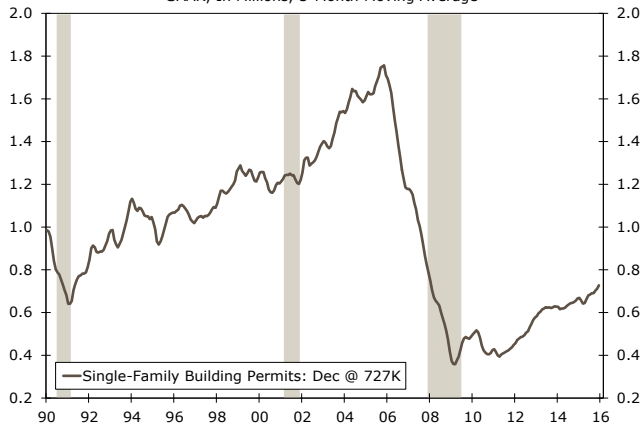


Source: Mortgage Bankers Association, FHLMC
U.S. Dept. of Commerce, Federal Reserve Board and
Wells Fargo Securities, LLC

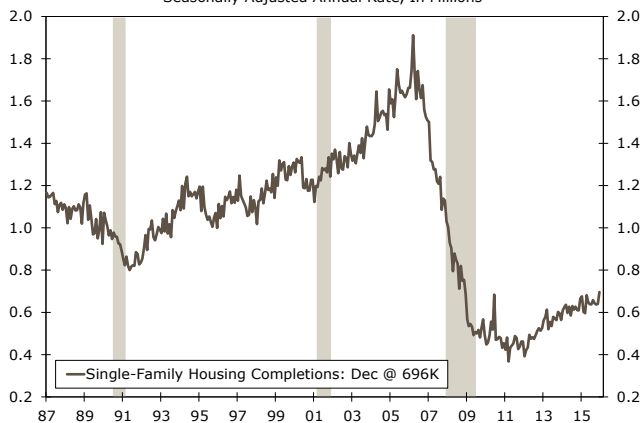
Single-Family Construction

- Single-family starts ended the year on a weak note, falling unexpectedly in December. The drop was somewhat surprising given December's unseasonably warm weather and large seasonally adjusted rise in construction employment. Permits, which are less volatile than starts, rose during the last three months of 2015. Even with these gains, however, permits are running below starts, which may lead to some additional weak readings at the beginning of this year.
- Homebuilder sentiment has also fallen off its earlier highs. The slide may reflect difficulties in securing affordable lots, workers and materials by smaller builders. Sales at larger national builders continue to grow fairly solidly.

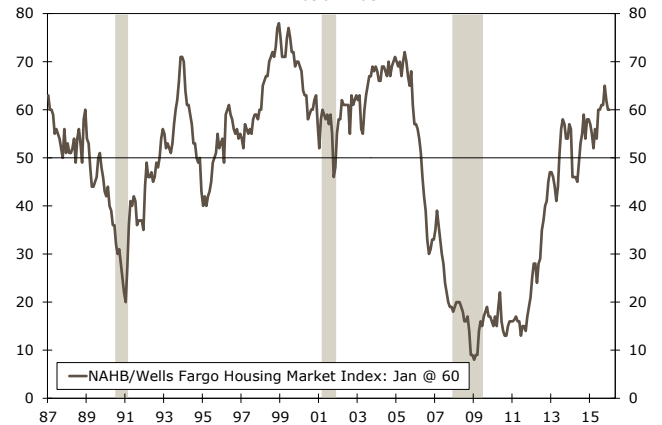
Single-Family Building Permits
SAAR, In Millions, 3-Month Moving Average



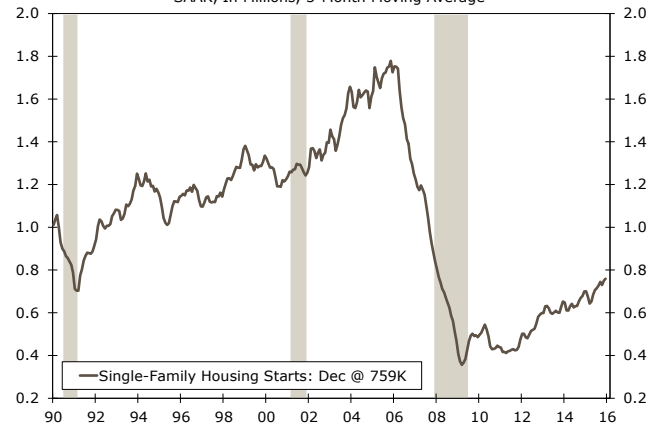
Single-Family Housing Completions
Seasonally Adjusted Annual Rate, In Millions



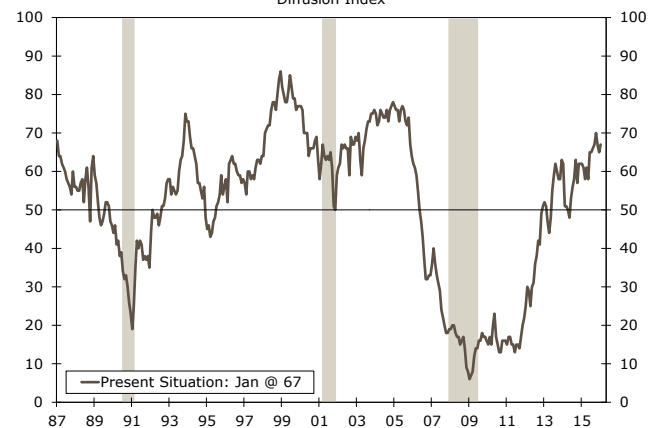
NAHB/Wells Fargo Housing Market Index
Diffusion Index



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



Present Single-Family Home Sales
Diffusion Index

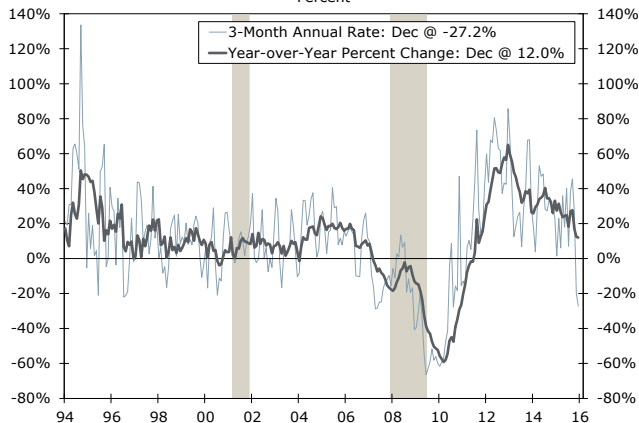


Source: U.S. Department of Commerce, NAHB and Wells Fargo Securities, LLC

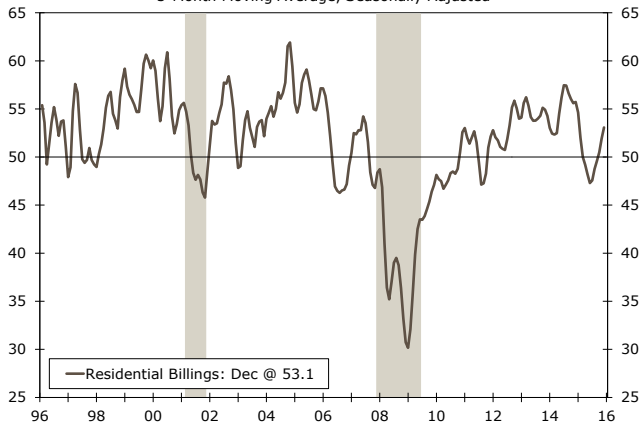
Multifamily Construction

- Multifamily starts have fallen sharply in recent months, but remain 5.6 percent above their year-ago level. Permits continue to run significantly ahead of starts, suggesting further gains are in the offing. Despite some moderation in demand, we expect multifamily starts to rise further in 2016, as capital is still flowing into apartment development.
- Residential architecture billings have perked back up after some earlier weakness. Favorable population trends and the still-high share of young adults living at home suggest there is significant pent-up demand. Improved labor market conditions should provide a catalyst for young adults to move out on their own, which will continue to fuel demand for rental units.

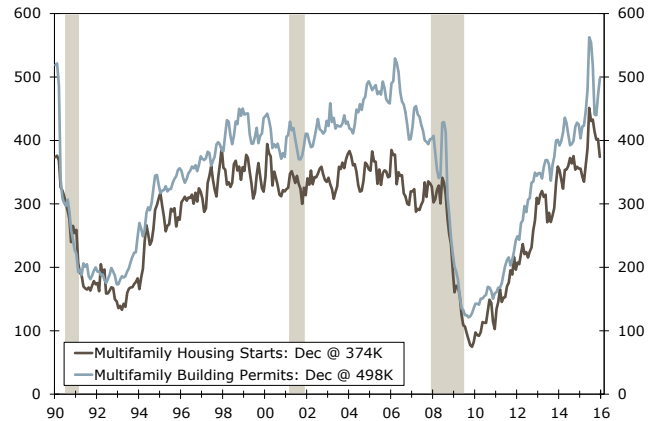
Private Multifamily Construction Spending
Percent



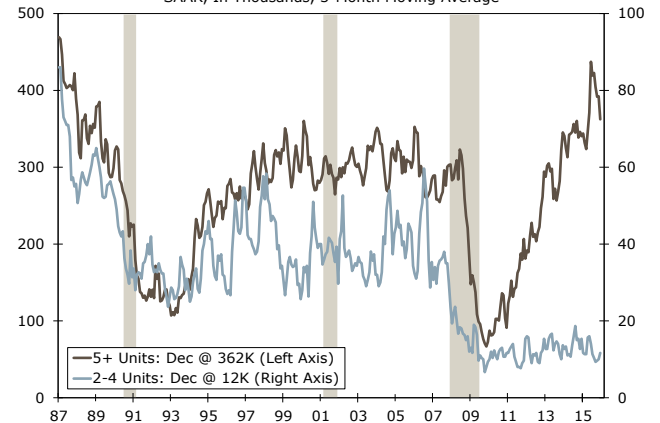
Residential Architecture Billings
3-Month Moving Average, Seasonally Adjusted



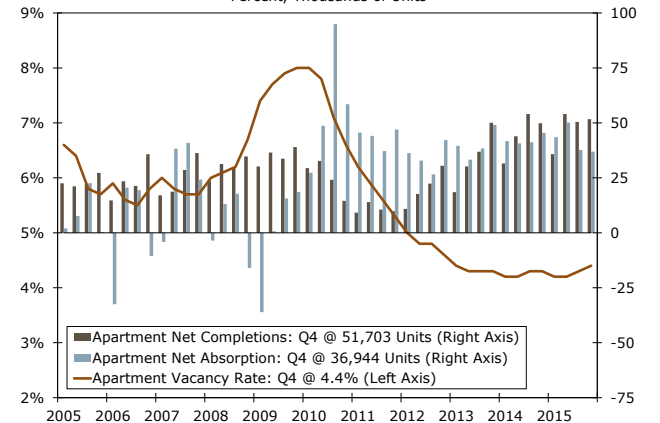
Multifamily Housing Starts vs. Building Permits
SAAR, In Thousands, 3-Month Moving Average



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



Apartment Supply & Demand
Percent, Thousands of Units

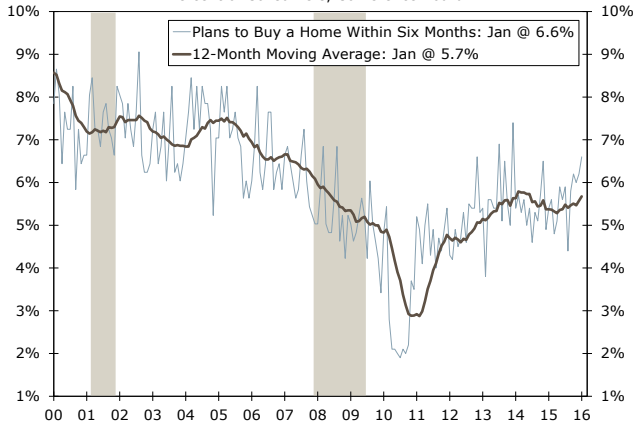


Source: U.S. Dept. of Commerce, REIS Inc. and Wells Fargo Securities, LLC

Buying Conditions

- Buying conditions remain relatively favorable, as strengthening fundamentals, including robust job growth and relatively low mortgage rates continue to support home buying.
- Affordability has become a major area of concern in many of the nation's largest urban centers, however. Home prices continue to rise at a much faster pace than incomes across most major metropolitan areas. The movement back into the cities has also resulted in the net removal of lower-priced housing and has been largely replaced with rental units or higher-priced homes.
- Buying plans increased in January, possibly reflecting lower mortgage rates. Affordability, credit restrictions and supply remain key stumbling blocks, however.

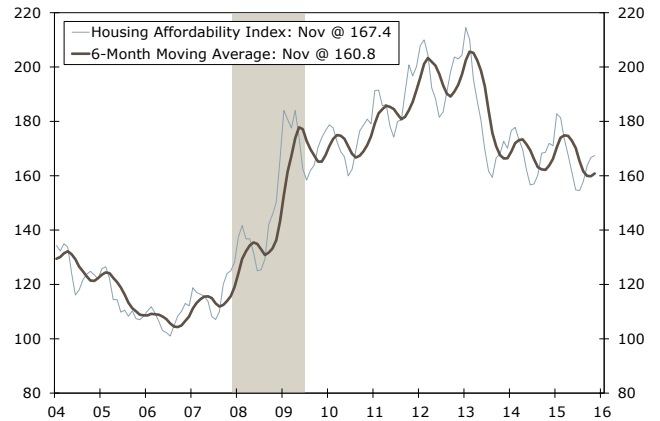
Confidence: Plans to Buy a Home
Percent of Consumers, Conference Board



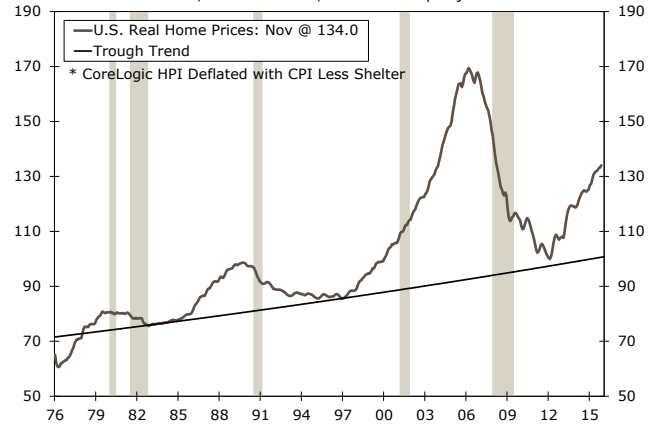
Conventional Mortgage Rate
Percent



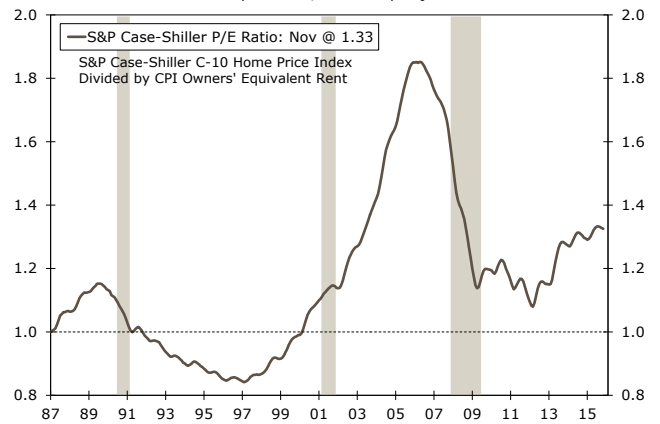
Housing Affordability, NAR-Home Sales
Base = 100



U.S. Real Home Prices
Index, Jan. 2000=100, Not Seasonally Adjusted



S&P Case-Shiller Home Price Index P/E Ratio
January 1987=1, Seasonally Adjusted

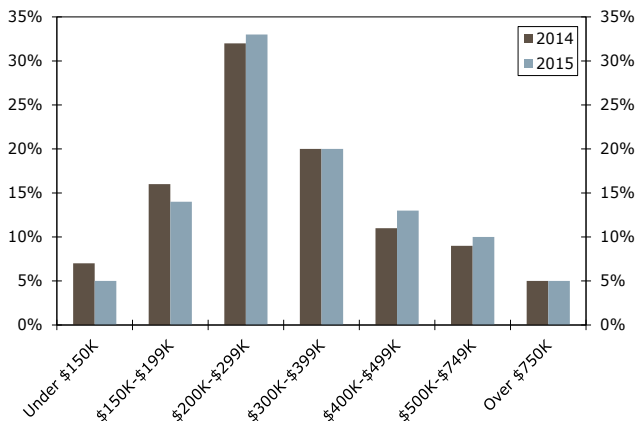


Source: CoreLogic, S&P, Conference Board, NAR, FHLMC and Wells Fargo Securities, LLC

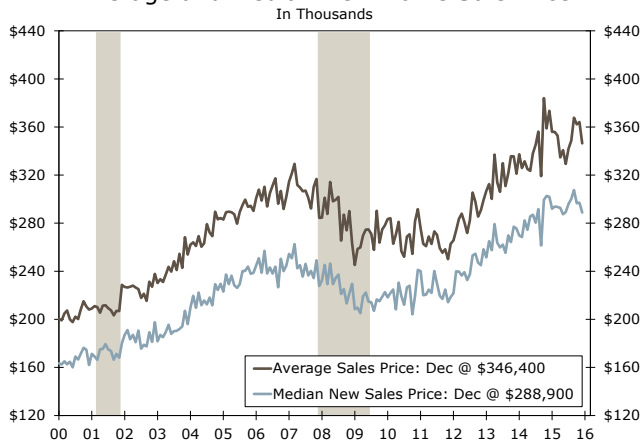
New Home Sales

- New home sales finished 2015 on a strong note, registering a seasonally adjusted annual rate of 544,000-units in December. During 2015 as a whole, there were 501,000 new homes sold, up 14.5 percent from the prior year. Despite the increase, the level of new home sales remains low by historical standards, which will make it relatively easy for sales to rise by double-digits again this year.
- Higher-priced homes accounted for a larger share of new homes sold in 2015. Homes above \$400,000 accounted for 28 percent of total sales, up from 21 percent in 2014. The rising proportion of higher-priced sales reflects strong demand for infill locations near the urban core of major metropolitan areas in the South and the West. Lower-priced suburban residential development has been lagging.

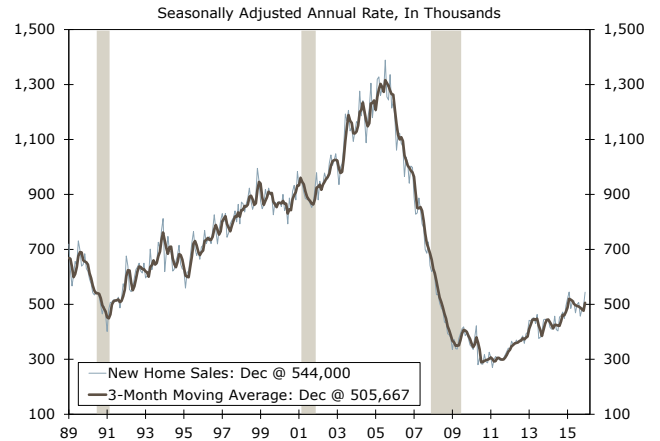
New Home Sales Price Distribution



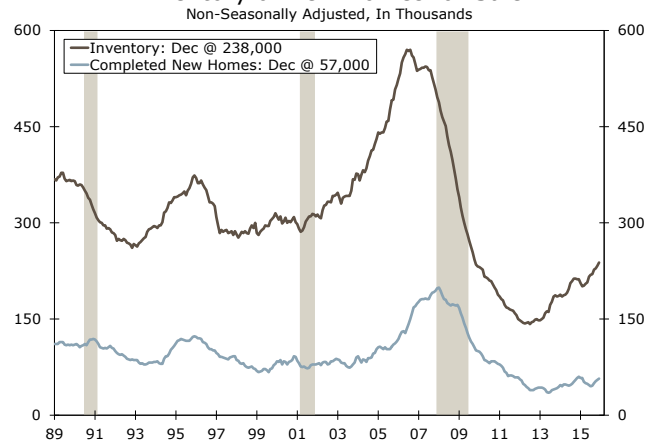
Average and Median New Home Sale Price



New Home Sales

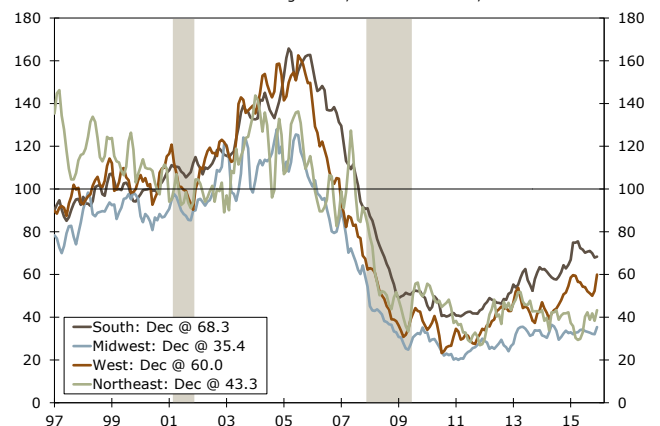


Inventory of New Homes for Sale



New Home Sales

New Homes Sold During Month, Index 2002=100, 3-MMA

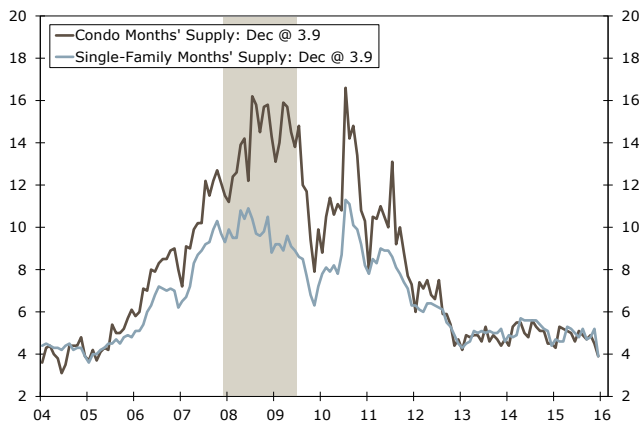


Source: U.S. Department of Commerce, and Wells Fargo Securities, LLC

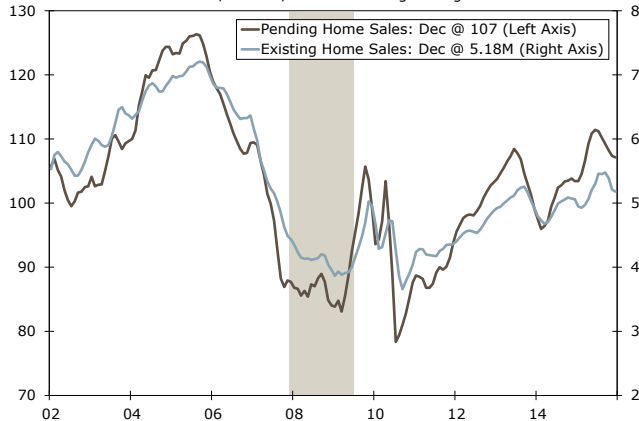
Existing Home Sales

- Existing home sales rebounded in December to a 5.46 million-unit annual pace after falling sharply in November. The late-year volatility was largely due to newly implemented regulations in the mortgage industry, which delayed closings this fall. According to the National Association of Realtors, 2015 marked the best year for existing home sales since 2006.
- Inventories remain exceptionally lean, as the number of available homes for sale fell 3.8 percent from its year-ago level. Scarce supply continues to drive home prices higher, creating additional challenges for first-time home buyers. This growing affordability hurdle paired with competition from investor-buyers and student loan debt, has prevented many first-time buyers from entering the market, despite young renters' increasing interest to own a home.

Existing Home Supply
In Months, Seasonally Adjusted

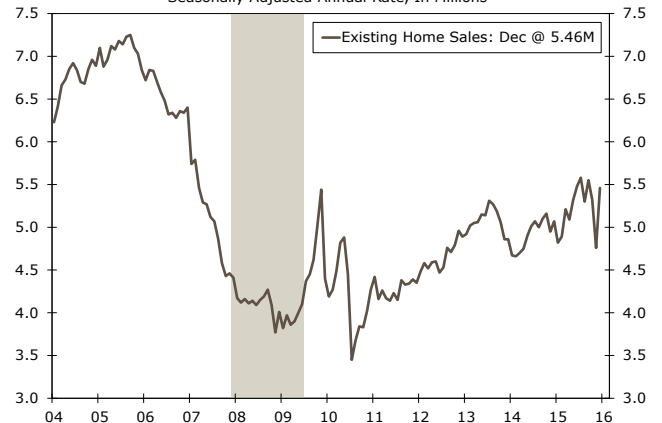


Pending vs. Existing Home Sales
Index, Millions, 3-Month Moving Average



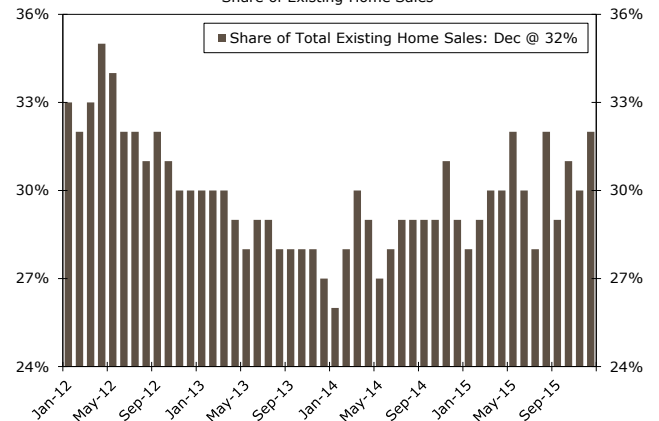
Existing Home Sales

Seasonally Adjusted Annual Rate, In Millions



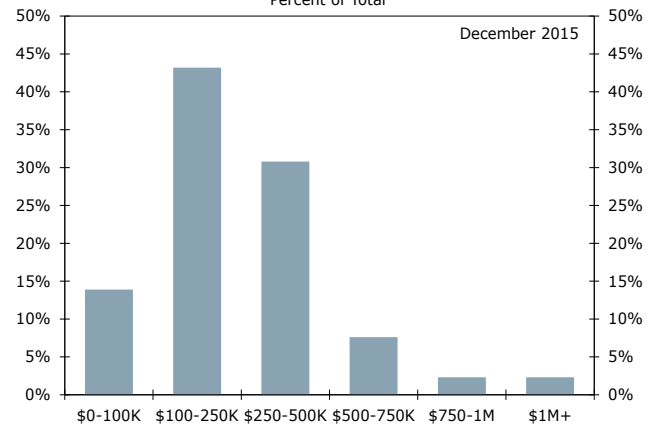
First-Time Home Buyers

Share of Existing Home Sales



Distribution of Existing Home Sales by Price

Percent of Total

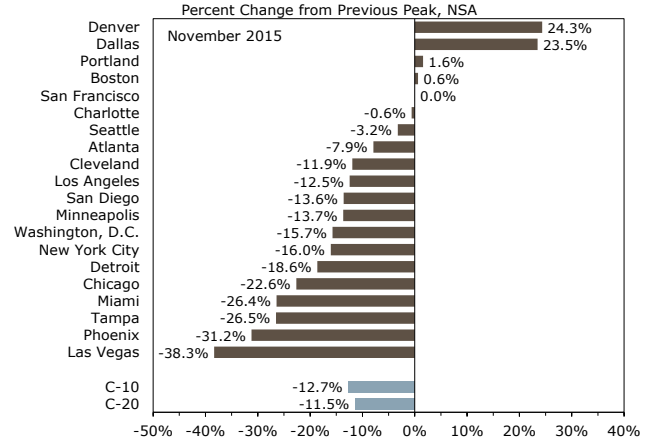


Source: National Association of Realtors and Wells Fargo Securities, LLC

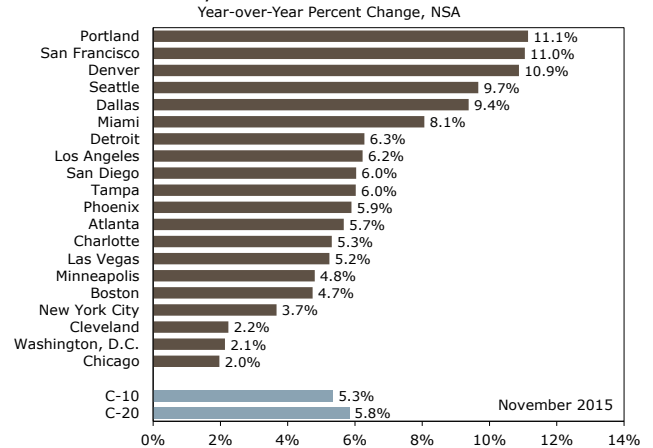
Home Prices

- Home price appreciation has been fairly steady in recent months, with most measures reporting a roughly five percent year-over-year increase. The S&P/Case-Shiller National Home Price Index (HPI) rose 5.3 percent year-to-year in November. Denver, Dallas, Portland and Boston reached new highs in 2015. Home prices in the majority of the nation's housing markets remain well below their previous peaks and the national HPI remains 4.8 percent below its pre-recession peak.
- Historically low inventory levels of new and existing homes have supported rising home prices over the year. We expect home price appreciation to decelerate modestly in 2016, as more supply gradually comes online and demand from foreign buyers cools off.

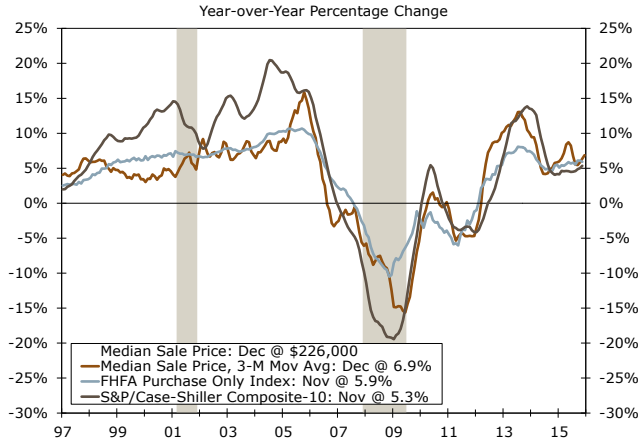
S&P/Case-Shiller Home Prices



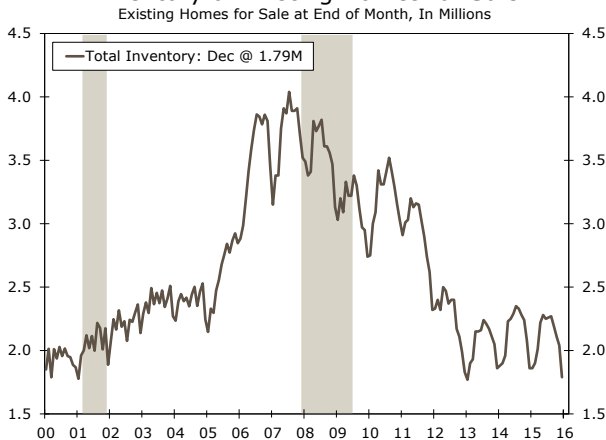
S&P/Case-Shiller Home Prices



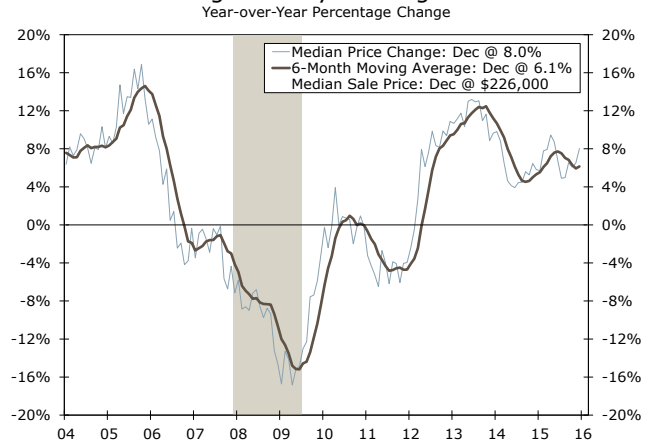
Home Prices



Inventory of Existing Homes for Sale



Median Single-Family Existing Home Price

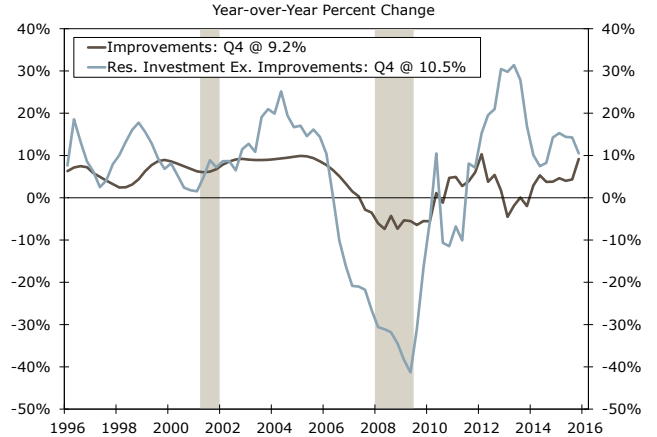


Source: NAR, S&P, FHFA, U.S. Department of Commerce and Wells Fargo Securities, LLC

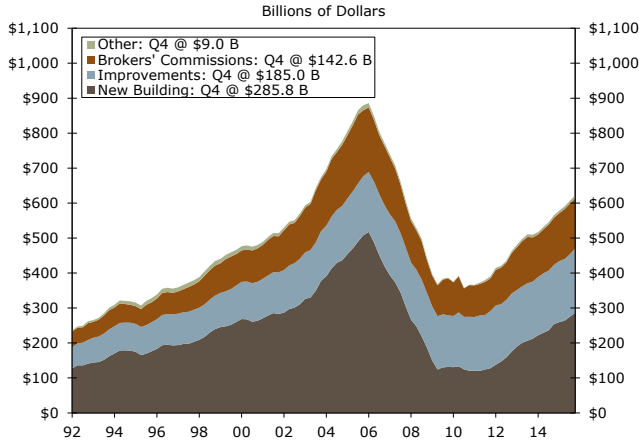
Renovation and Remodeling

- Home improvement spending capped the year on a positive note. Studies done by the Joint Center for Housing Studies (JCHS) show home improvement spending has picked up, as rising home prices have brought more homes to the market, resulting in increasing sales and a pickup in home improvement spending.
- Consistent with recent readings from the NAHB Remodeling Market Index, the JHCS's Leading Indicator of Remodeling Activity expects home improvement spending to see healthy gains in 2016. Revised data on renovations and improvements now show the pace of spending much more closely tracking the Remodeling Market Index.

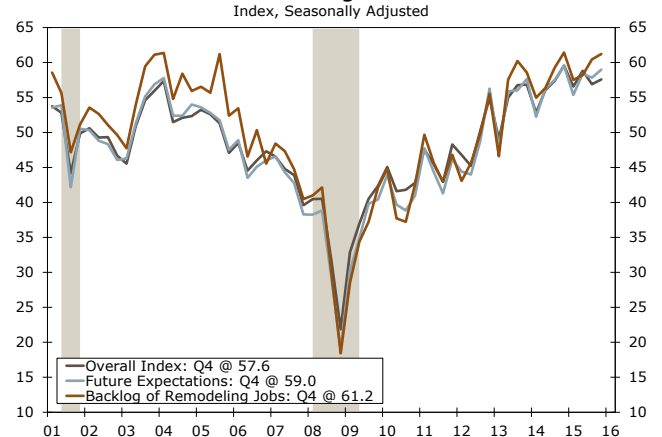
Residential Investment



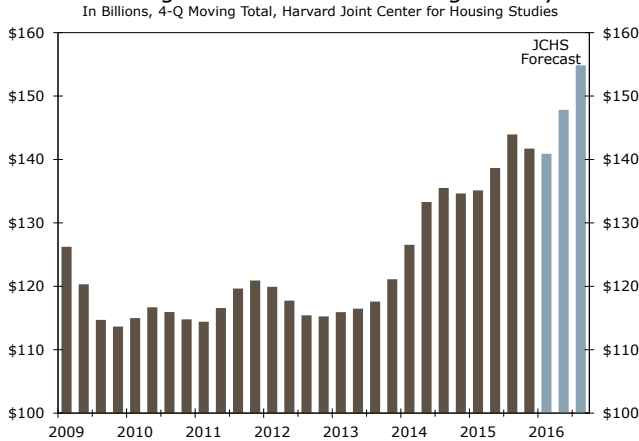
Residential Investment



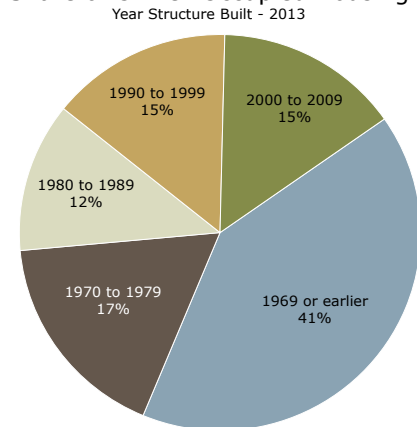
NAHB Remodeling Market Index



Leading Indicator of Remodeling Activity



Share of Owner-Occupied Housing



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

Wells Fargo Securities, LLC Economics Group

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