

# Economics Group

## Special Commentary

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# Housing Chartbook: March 2016

## Restrained Optimism Heading into the Spring Home Buying Season

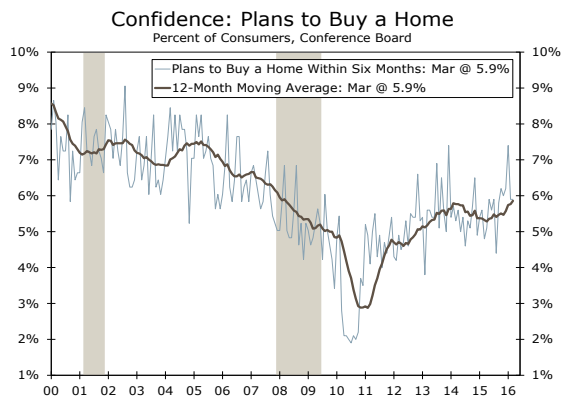
Federal Reserve Board Chair Janet Yellen’s dovish comments to the New York Economics Club in late March added to home builders’ and realtors’ quiet sense of optimism headed into the crucial spring season. Yellen’s speech suggested that the Federal Reserve would be more cautious in raising interest rates this year and also hinted that interest rates would not rise as much as previously thought over the course of the business cycle. Mild winter weather, a rebounding stock market and slowly, but steadily, improving household finances are additional positive influences that could lead to upside surprises in home sales and new home construction.

While the stars appear to be moving into alignment for more tangible improvement in the housing sector, the hard data remain mixed. Buyers’ attitudes dipped in February, which may have been linked to persistent start-of-the-year selloff in the stock market, which bottomed that month. The Consumer Confidence Index rebounded in March, but plans to buy a home, which fell sharply in February, was unchanged at 5.9 percent, which is still a respectable level and within its average for the past 12 months (Figure 1). Actual data on sales and single-family construction have been somewhat more positive. New home sales rebounded solidly in February and January’s decline was not nearly as severe as first reported. Residential construction has also picked up. Starts of single-family homes rose 7.2 percent in February to an 822,000-unit annual pace, which marks a high for this cycle. Starts through the first two months of 2016 are up 21.7 percent from their year-ago level, helped a great deal by this year’s unseasonably moderate winter weather.

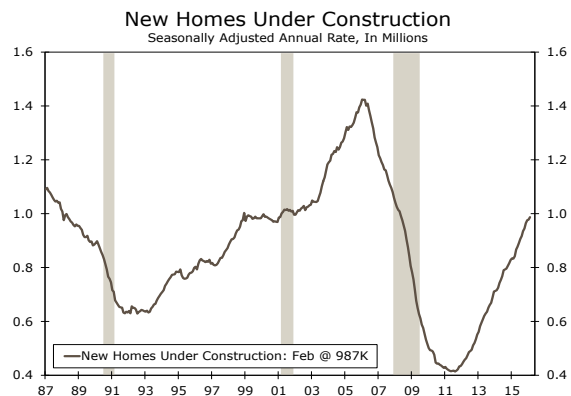
*The stars appear to be moving into alignment for more tangible improvement in the housing sector.*

The recent gains in new home construction could prove beneficial by providing more completed inventory this spring. Buyer traffic has fallen off recently, likely due to the lack of homes for sale. Single-family completions have been trailing sales, which has kept completed inventories unusually lean. The number of homes under construction is rising, however (Figure 2).

**Figure 1**



**Figure 2**



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

Together we'll go far



*Persistently strong demand for apartments has been one of the hallmarks of this expansion.*

### Momentum Appears to Be Swinging Back to Single-Family Homes

Persistently strong demand for apartments has been one of the hallmarks of this expansion. Demand for apartments has proved to be much stronger for much longer than just about anyone expected. Growth has been driven by the emergence of Millennials into the workforce, many of which began their careers in a sluggish job market and carrying a great deal of student loan debt. Apartment demand has also been fueled by displaced homeowners, who lost homes to foreclosure or short sales. The number of rental households has increased by 8.6 million from 2005 to 2015 largely mirroring the decline in the homeownership rate.

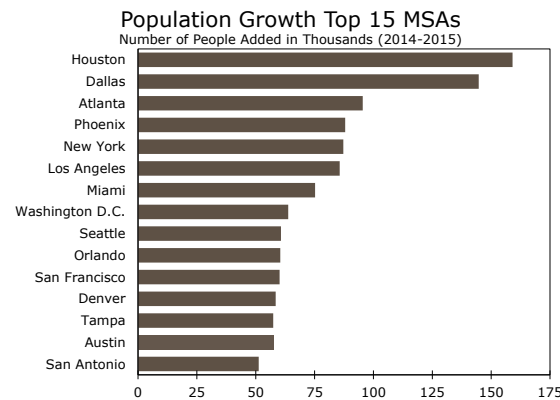
The growth in rental households has spurred a boom in the apartment market, particularly in rapidly growing urban areas that are attracting scores of Millennials. A large proportion of this new construction has been focused on higher-end apartments, which has pushed average rents up much faster than incomes in recent years. Apartment rents in metropolitan areas with the fastest growing populations, including New York, Los Angeles, Miami and San Francisco (Figure 3), are now running up against severe affordability constraints, which is pushing some renters further out into suburbs and making homeownership a more viable option in many markets.

*Affordability has been pushed beyond the reach of many renters and homebuyers.*

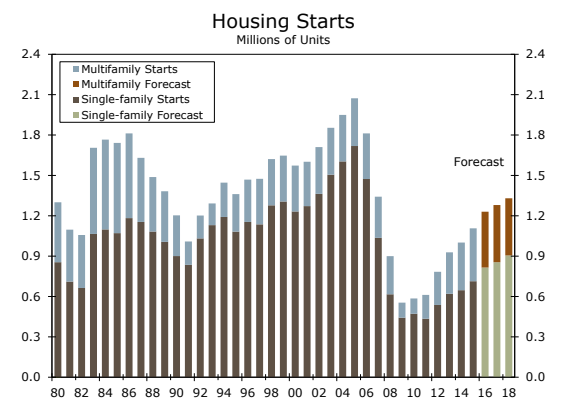
A surge in deliveries of new apartments appears to be offering some near-term relief in some markets, but we believe we are now at a key inflection point where demand will likely shift back toward more suburban development for both apartments and single-family homes. The return of the affordability migration is apparent in the most recent U.S. Census Bureau data, which show rapid population growth returning to the more affordable suburban-oriented metropolitan areas in the South and West. This does not mean the end of the move back to the cities, which is apparent across the country. The magnitude of that move has been so large, however, that it has pushed affordability beyond the reach of many renters and homebuyers. Supply of available homes for sale is also scarce closer to the city center, which has led to a boom in tear-downs. The National Association of Home Builders estimates that tear-downs, where an older structure was torn down to build a new home, accounted for 7 percent of single-family starts in 2015.

We have slightly increased our forecast for new home sales and residential construction, given the more positive outlook for mortgage rates and stronger construction data. Lean inventories and declining affordability will keep sales in check, but that situation seems to be improving. Job growth has also gotten off to a strong start and the early-year worries that the global economic slowdown might pull the U.S. into recession have subsided. We are still looking for a modest recovery in new home sales and single-family construction, but now look for both new home sales and new home construction to rise a stronger 14.0 percent in 2016 (Figure 4). Price appreciation is still likely to moderate this year. The bounce back in home prices is bringing out more sellers, which should move the existing market closer into balance. In addition, foreign buyers are pulling back from overheated gateway markets, most notably New York and Miami, while a rising share of domestic buyers are seeking more affordable options in lower priced suburban markets.

**Figure 3**



**Figure 4**



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

National Housing Outlook

	2009	2010	2011	2012	2013	2014	2015	Forecast	
								2016	2017
Real GDP, Percent Change	-2.8	2.5	1.6	2.3	2.2	2.4	2.4	1.9	2.3
Nonfarm Employment, Percent Change	-4.3	-0.7	1.2	1.7	1.6	1.9	2.1	1.8	1.5
Unemployment Rate	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	553.9	586.9	608.8	780.6	924.9	1,003.3	1,111.8	1,230.0	1,280.0
Single-Family Starts, in Thousands	445.0	471.1	430.5	535.3	617.7	647.9	714.5	815.0	855.0
Multifamily Starts, in Thousands	108.9	115.8	178.3	245.3	307.2	355.4	397.3	415.0	425.0
Home Sales									
New Home Sales, Single-Family, in Thousands	374.0	321.0	305.0	369.0	429.0	439.0	501.0	570.0	620.0
Total Existing Home Sales, in Thousands	4,340.0	4,190.0	4,260.0	4,660.0	5,090.0	4,940.0	5,250.0	5,480.0	5,600.0
Existing Single-Family Home Sales, in Thousands	3,870.0	3,708.0	3,787.0	4,128.0	4,484.0	4,344.0	4,646.0	4,870.0	4,980.0
Existing Condominium & Townhouse Sales, in Thousands	464.0	474.0	477.0	528.0	603.0	591.0	608.0	610.0	620.0
Home Prices									
Median New Home, \$ Thousands	216.7	221.8	227.2	245.2	268.9	282.8	296.2	308.0	320.0
Percent Change	-6.6	2.4	2.4	7.9	9.7	5.2	4.7	4.0	3.9
Median Existing Home, \$ Thousands	172.5	172.9	166.1	176.8	197.1	208.3	222.4	231.4	241.1
Percent Change	-12.9	0.2	-3.9	6.4	11.5	5.7	6.8	4.0	4.2
FHFA Purchase Only Index, Percent Change	-5.8	-3.0	-4.1	3.1	7.4	5.5	5.6	4.8	4.5
Case-Shiller C-10 Home Price Index, Percent Change	-12.9	2.1	-3.5	0.3	11.7	7.9	4.7	4.5	4.4
Interest Rates - Annual Averages									
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.27	3.75	4.63
Ten-Year Treasury Note	3.26	3.22	2.78	1.80	2.35	2.54	2.14	2.05	2.41
Conventional 30-Year Fixed Rate, Commitment Rate	5.04	4.69	4.46	3.66	3.98	4.17	3.85	3.99	4.29
One-Year ARM, Effective Rate, Commitment Rate	4.71	3.79	3.03	2.69	2.61	2.44	2.53	2.80	3.00

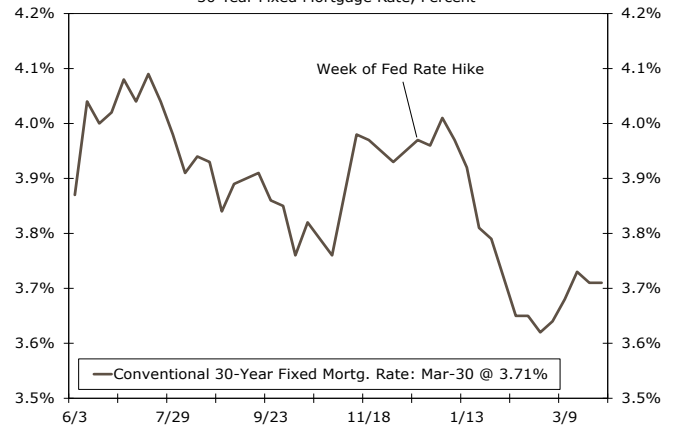
Forecast as of: March 31, 2016

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

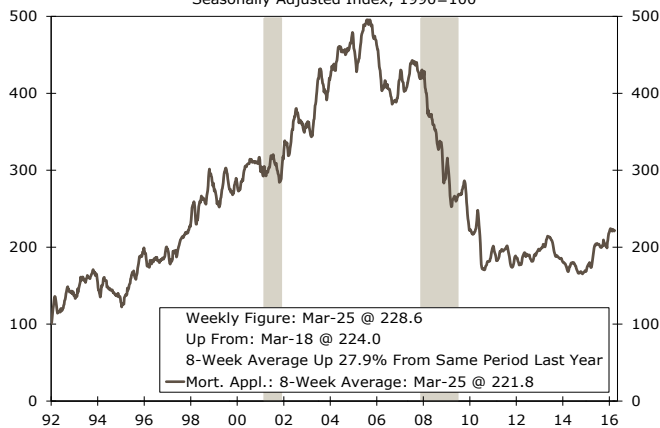
## Mortgages

- Mortgage rates have fallen slightly since the start of the year, as both financial market and FOMC expectations for future rate hikes have been scaled back. While low mortgage rates remain a positive for homebuyers, they have provided just about all the boost to housing affordability and home sales that we can reasonably expect.
- Mortgage rates are likely to rise gradually over the next few years. We expect the 30-year conventional fixed mortgage rate to remain below 4.0 percent for the majority of 2016 and reach about 4.4 percent by year-end 2017. With incomes growing only ever so slightly, even a modest rise in mortgage rates will reduce affordability. Absent a repeat of the taper tantrum spike, however, mortgage rates should generally be supportive to the housing market.

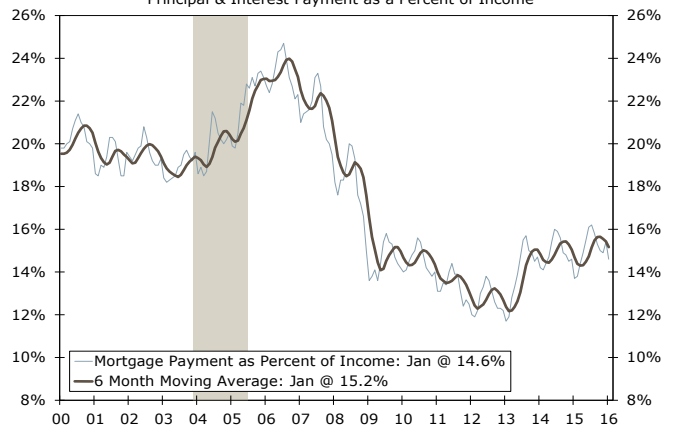
Conventional Mortgage Rate  
 30-Year Fixed Mortgage Rate, Percent



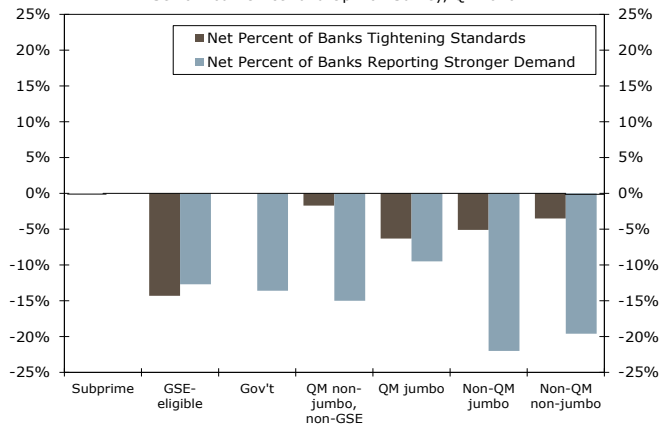
Mortgage Applications for Purchase  
 Seasonally Adjusted Index, 1990=100



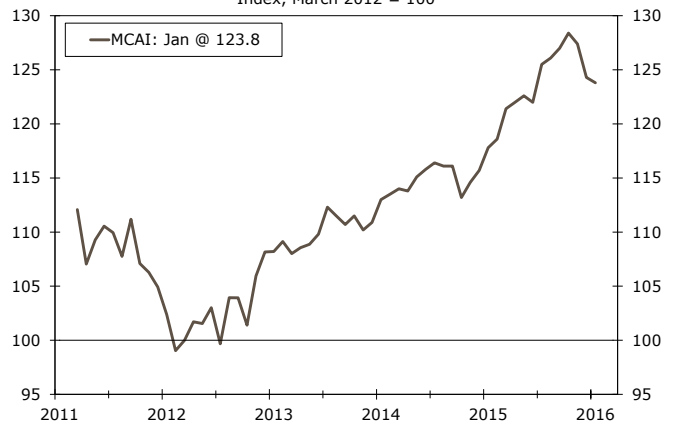
Mortgage Payment  
 Principal & Interest Payment as a Percent of Income



Mortgage Supply and Demand  
 Senior Loan Officer and Opinion Survey, Q1 2016



MBA Mortgage Credit Availability Index  
 Index, March 2012 = 100

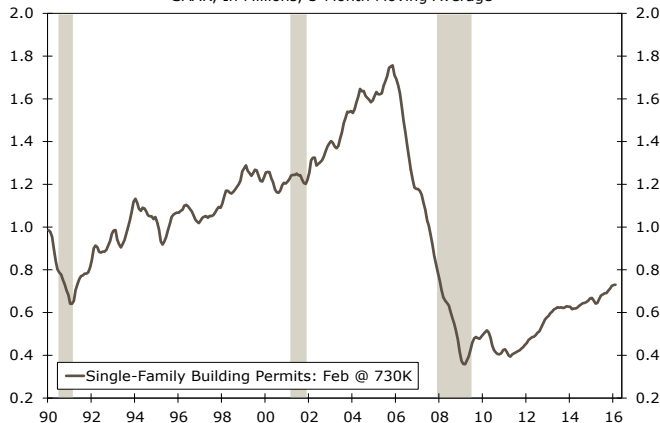


Source: Mortgage Bankers Association, FHLMC, NAR, Federal Reserve Board and Wells Fargo Securities, LLC

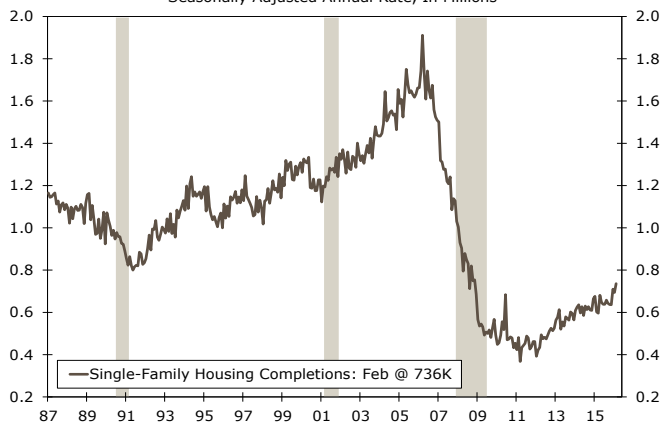
## Single-Family Construction

- On the heels of back-to-back monthly declines, single-family housing starts rose to an annual rate of 822,000 units in February, marking the series' highest pace since November 2007. The bulk of the improvement was seen in the West, which saw a 24.8 percent rise in single-family starts. The West's large gain is encouraging, as the region has been struggling with supply shortages in booming job markets along the coast. The rise in single-family starts may provide a much-needed lift to inventory ahead of the spring selling season.
- Home builder sentiment has moderated in recent months, as a reduced outlook for future sales has weighed on builder optimism. That said, the index remains well above the 50 demarcation line, signaling steady gains in the single-family market.

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



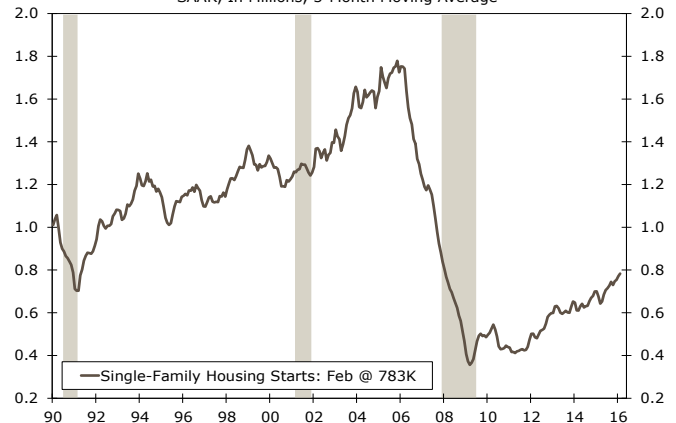
Single-Family Housing Completions  
 Seasonally Adjusted Annual Rate, In Millions



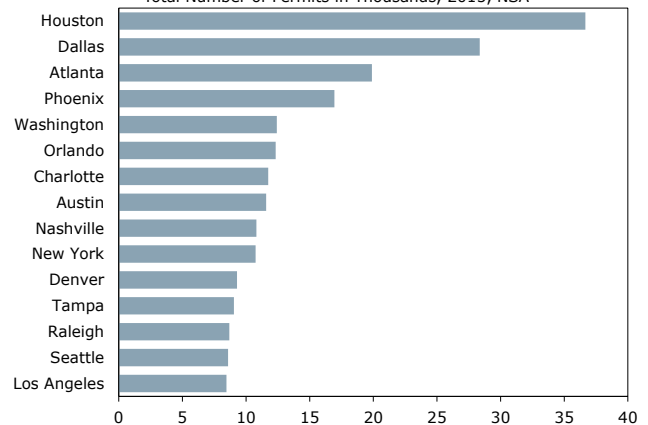
NAHB/Wells Fargo Housing Market Index  
 Diffusion Index



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



Single-Family Housing Permits by MSA  
 Total Number of Permits in Thousands, 2015, NSA

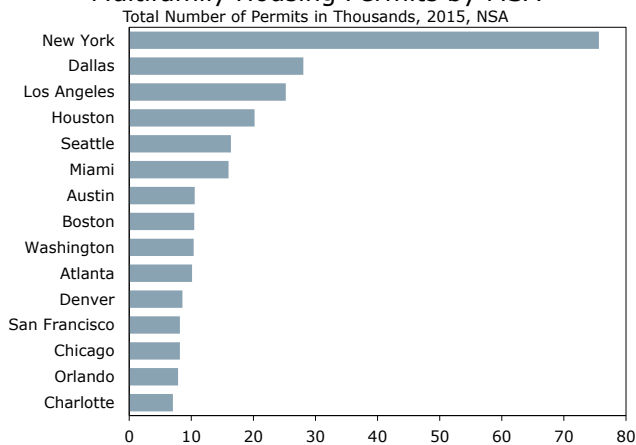


Source: U.S. Department of Commerce, NAHB and Wells Fargo Securities, LLC

## Multifamily Construction

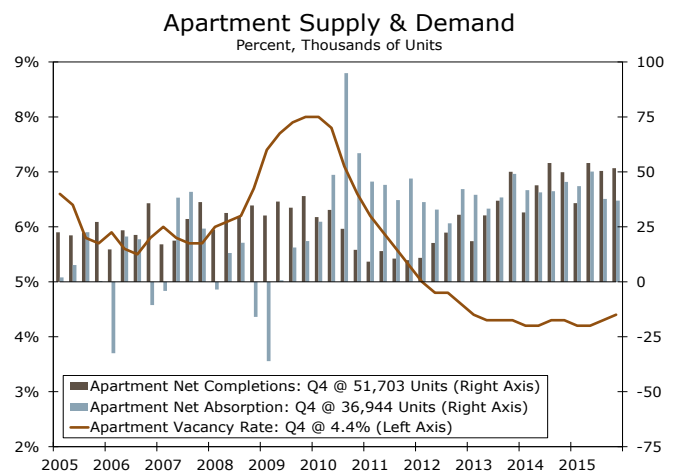
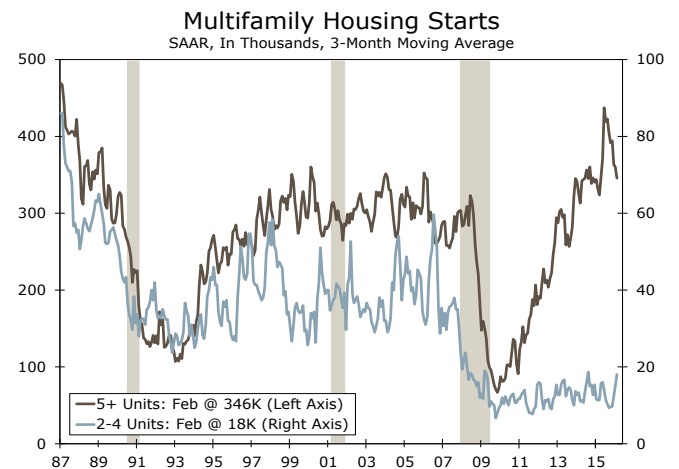
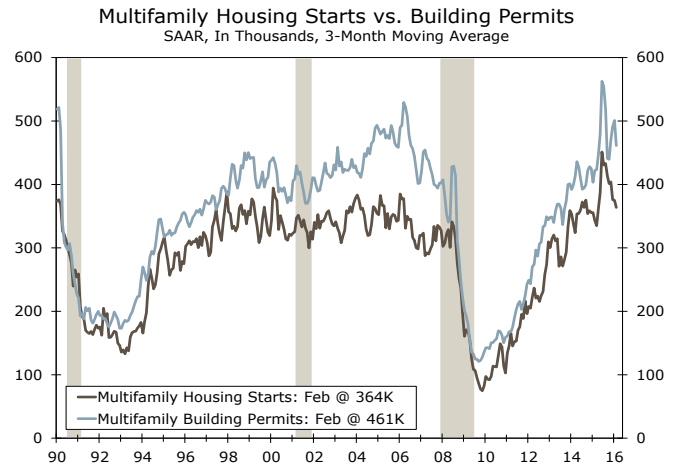
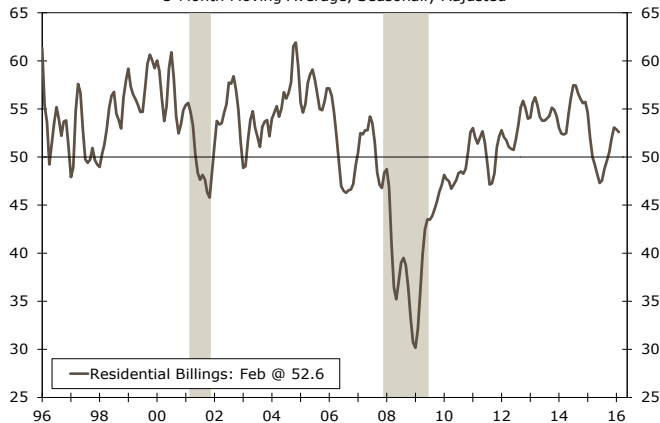
- The pace of multifamily construction has come down as an onslaught of new apartments has hit the market. Both multifamily starts and permits have shown signs of moderation in recent months. Multifamily starts rose a modest 0.8 percent in February, following a sharp 9.5 percent drop in January. Permits continue to run significantly ahead of starts, however, suggesting further gains are in the offing.
- After reporting negative readings for a majority of 2015, the residential architecture billings index, a leading indicator of construction activity, has trended higher in recent months. Improved labor market conditions paired with the growing appeal for urban living will likely continue to support demand in 2016.

### Multifamily Housing Permits by MSA



### Residential Architecture Billings

3-Month Moving Average, Seasonally Adjusted

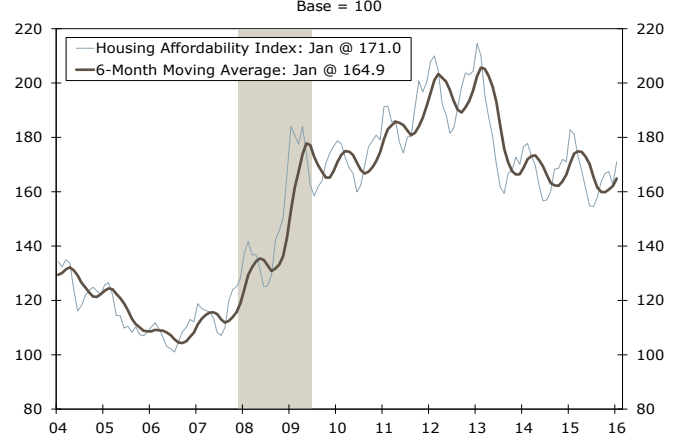


Source: U.S. Dept. of Commerce, Reis, Inc., American Institute of Architects and Wells Fargo Securities, LLC

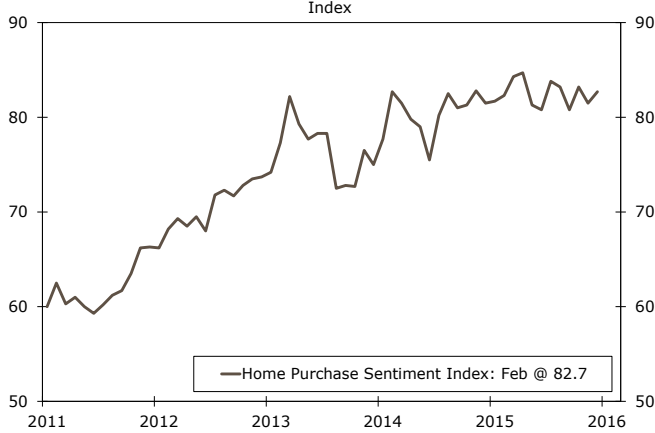
## Buying Conditions

- Buying conditions have been mixed ahead of the key spring home buying season. Inventory remains incredibly tight and affordability has come down. Housing affordability, as measured by the National Association of Realtors, has moderated over the past year, as steadily rising home prices continue to outpace income growth. While lower affordability is taking a toll on all buyers, first-time homebuyers face the greatest hurdles.
- Higher home prices are beginning to bring out more sellers. The proportion of homeowners that believe it is now a good time to sell a house has risen steadily, although it did dip in February, possibly reflecting the early year sell-off in the stock market.

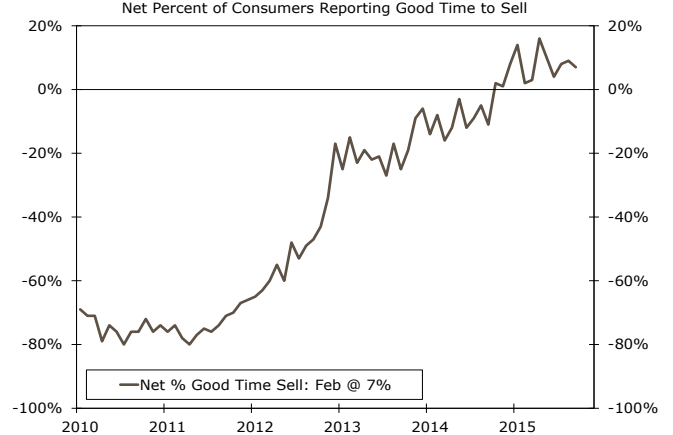
Housing Affordability, NAR-Home Sales



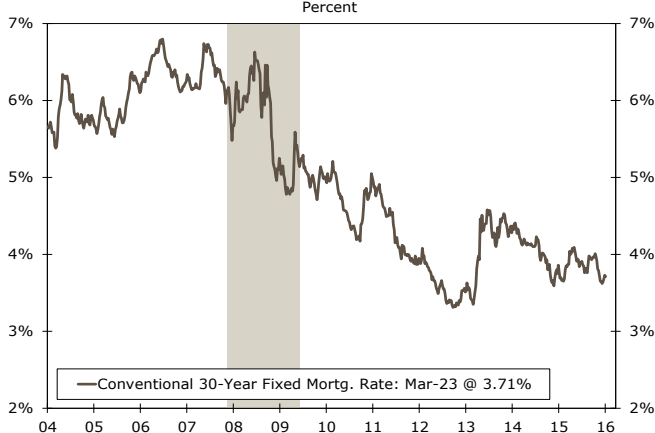
Home Purchase Sentiment Index



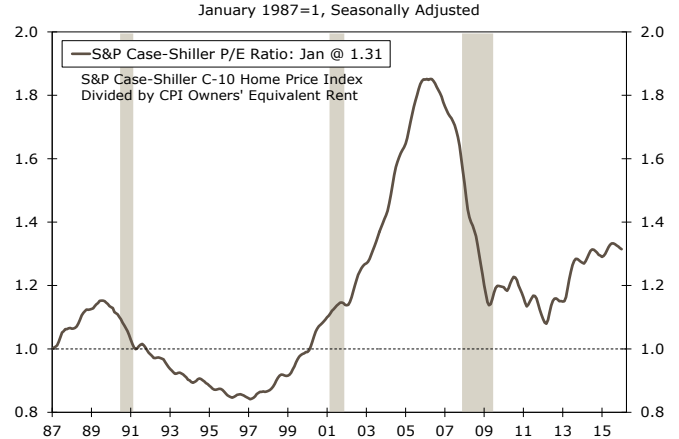
Good Time to Sell A House



Conventional Mortgage Rate



S&P Case-Shiller Home Price Index P/E Ratio



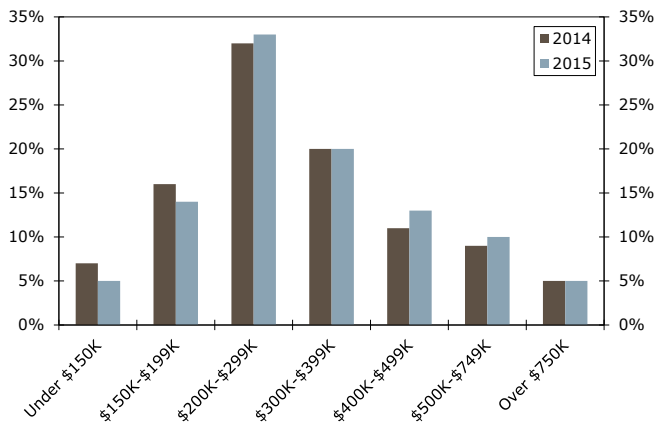
Source: Fannie Mae, S&P, Conference Board, NAR, FHLMC and Wells Fargo Securities, LLC



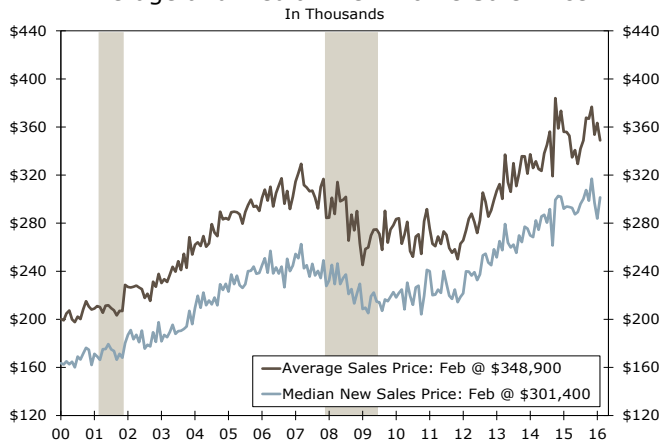
## New Home Sales

- New home sales bounced back in February to a 512,000 unit pace, after falling 7.0 percent in January. The West accounted for all of the increase. Rising new home sales in the West, a region which tends to have higher home prices, helped pull the median price up to \$301,400 in February. We expect new home sales to remain on an upward trend and post another low-double-digit gain this year.
- Low inventory levels continue to restrain sales. While the months' supply of new homes available for sale is a respectable 5.6 months, the inventory of completed new homes remains unusually tight. New completions are barely keeping pace with sales, although the number of homes under construction has risen sharply in recent months.

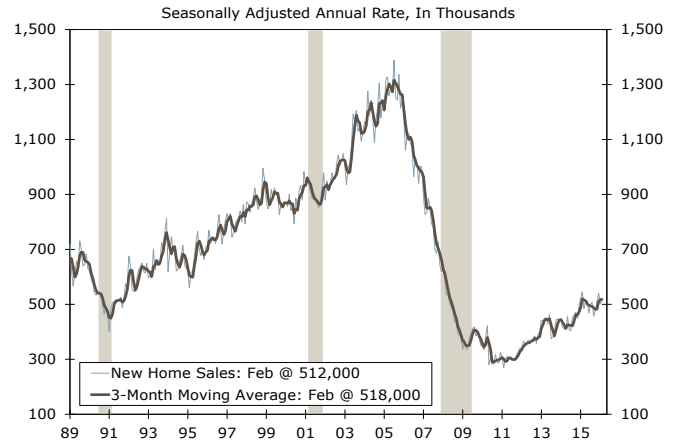
New Home Sales Price Distribution



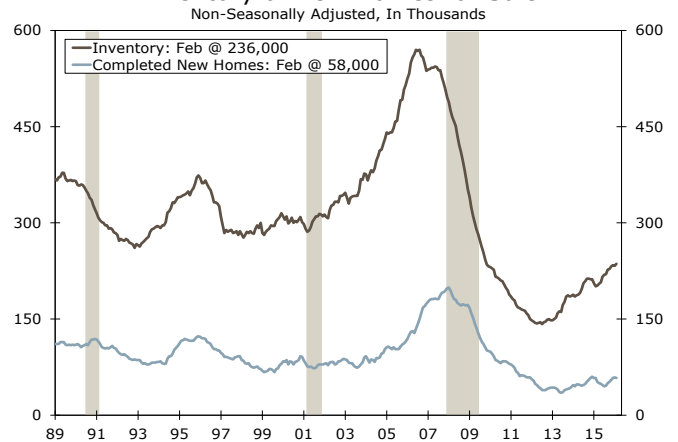
Average and Median New Home Sale Price



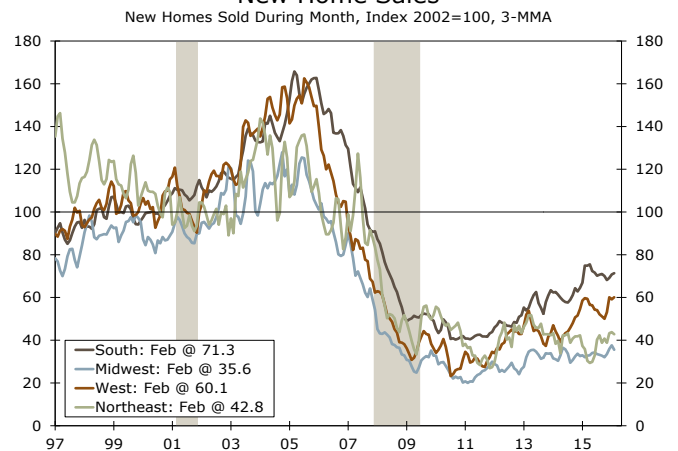
New Home Sales



Inventory of New Homes for Sale



New Home Sales



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



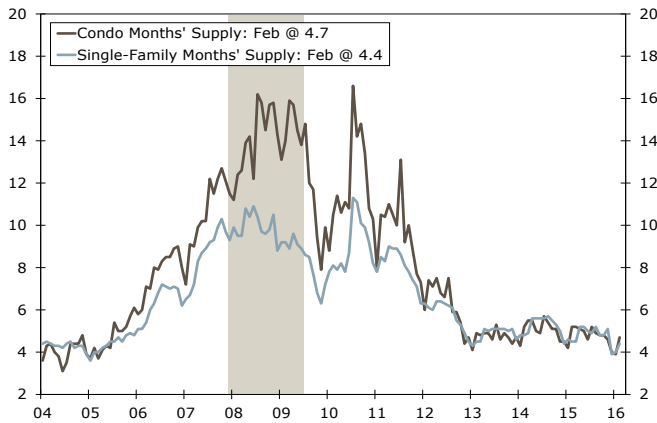
## Existing Home Sales

- Sales of previously owned homes fell 7.1 percent in February to a 5.08 million-unit rate, as low inventory levels and rising home prices continued to hold back overall sales. While total housing inventory ticked up over the month, the months' supply of existing single-family homes remains historically low at just 4.4 months.
- The share of first-time homebuyers fell back to around 30 percent, as supply shortages and higher prices continue to put off many potential buyers. Improvement in first-time buying has been sporadic. Many potential buyers lack the necessary down payment or are carrying too much debt to qualify for a mortgage. Stronger job growth should help but income needs to rise faster as well.

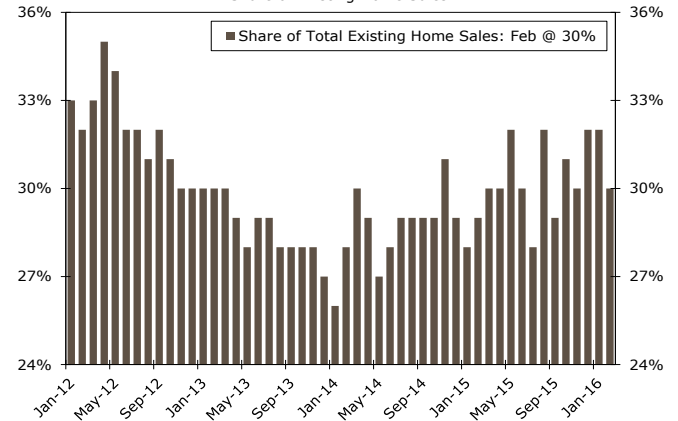
### Existing Home Sales



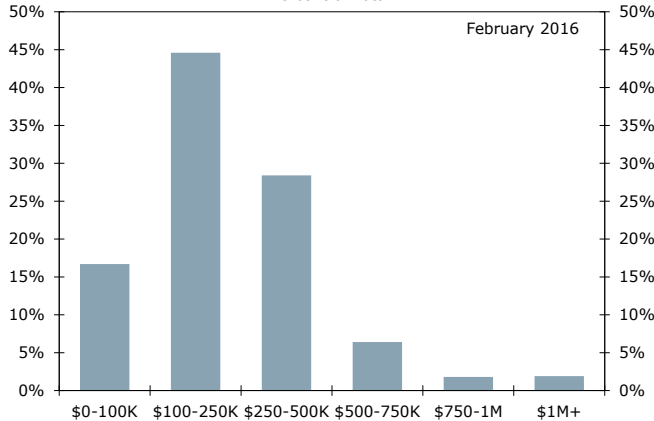
### Existing Home Supply



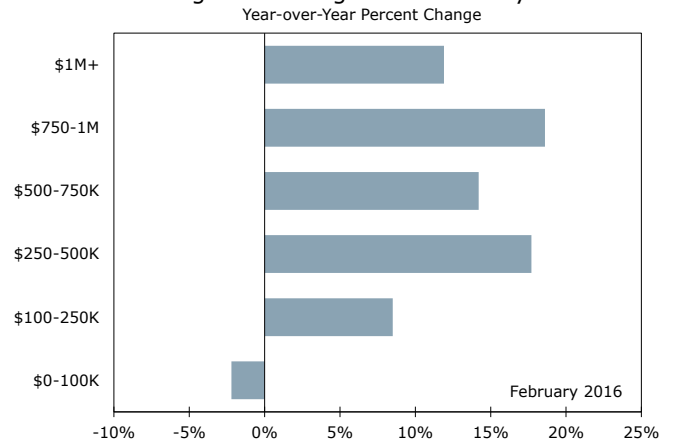
### First-Time Home Buyers



### Distribution of Existing Home Sales by Price



### Change in Existing Home Sales by Price

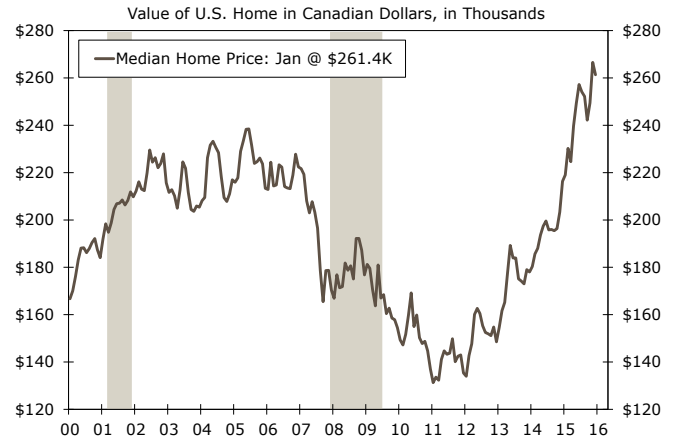


Source: National Association of Realtors and Wells Fargo Securities, LLC

## Home Prices

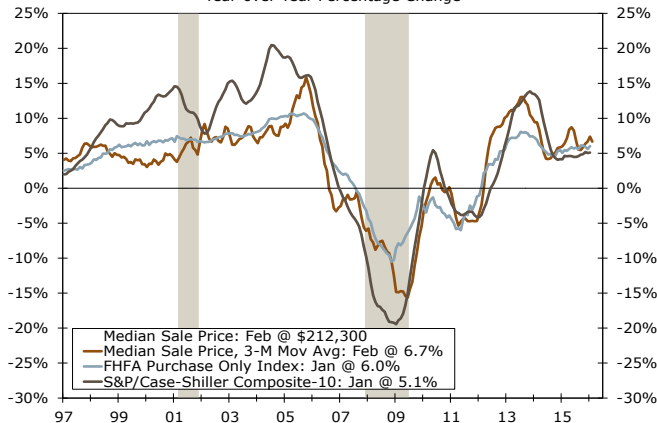
- Foreign home buying has put additional pressure on home prices in recent years, particularly in gateway markets, such as New York City, Miami and San Francisco. International buyer interest has cooled, however, as growth has slowed overseas. Weaker currencies in Canada, Russia, Brazil and China have also resulted in larger price increases for buyers from these countries.
- Inventory shortages continue to support home prices in many markets. With the inventory of both new and existing homes at historically low levels and high land and development costs, home prices should continue to outpace inflation and incomes. Rapidly growing land constrained areas, such as Portland, Seattle and San Francisco, face the greatest affordability challenges.

U.S. Median Home Price in Canadian Dollars



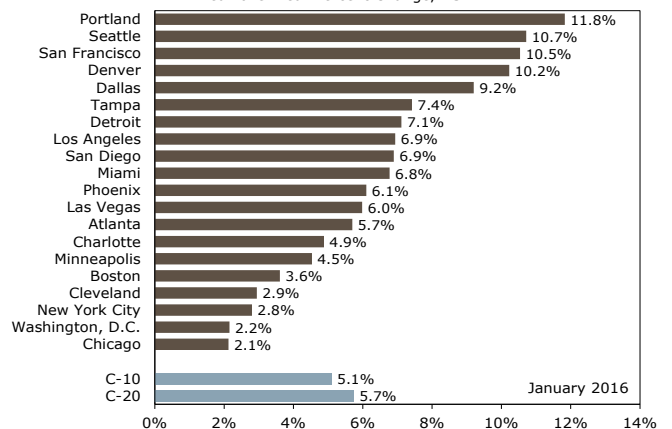
Home Prices

Year-over-Year Percentage Change



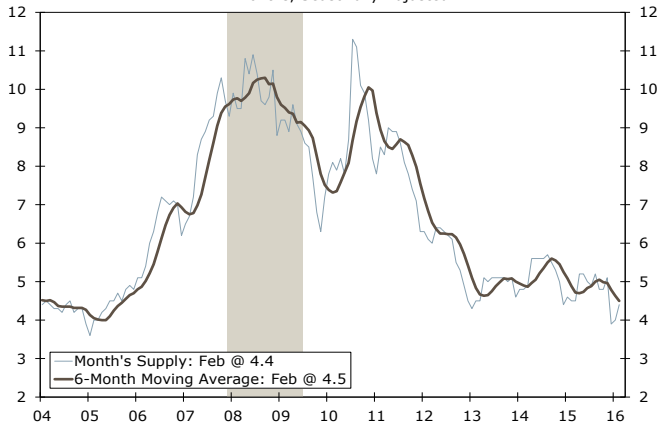
S&P/Case-Shiller Home Prices

Year-over-Year Percent Change, NSA



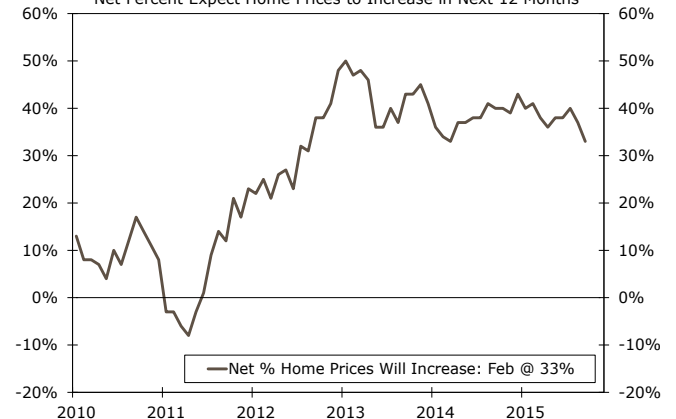
Inventory of Existing Single-Family Homes

In Months, Seasonally Adjusted



Expect Home Prices Will Increase

Net Percent Expect Home Prices to Increase in Next 12 Months

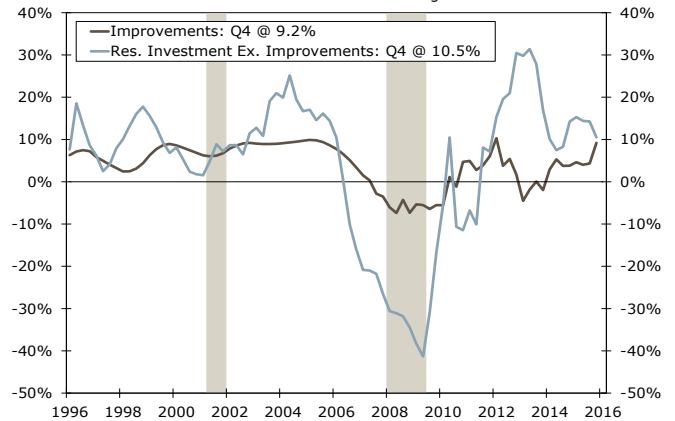


Source: NAR, S&P, FHFA, CoreLogic, Bloomberg LP, Fannie Mae and Wells Fargo Securities, LLC

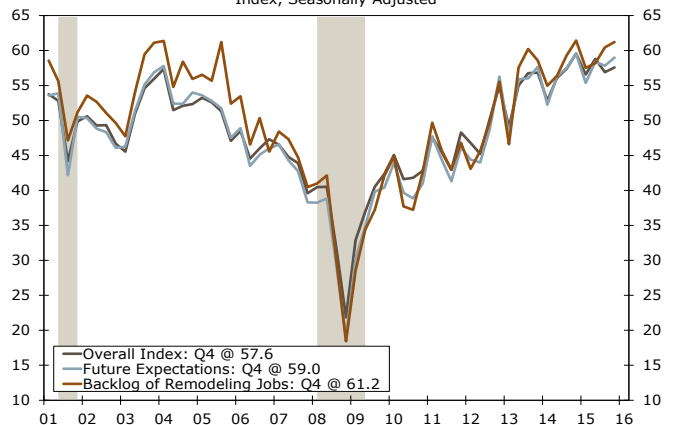
## Renovation and Remodeling

- Annual spending growth for home improvements is expected to accelerate in 2016, from 4.3 percent in the first quarter to 7.6 percent in the third quarter, according to the Joint Center for Housing Studies' (JCHS). The JCHS expects annual spending to surpass its 2006-prerecession peak in 2016.
- Rising home prices are encouraging more homeowners to spend more on upgrades and additions to their homes. Higher prices have also opened the door to more home equity borrowing, which is helping drive spending for upgrades and repairs. Longer term, aging baby boomers will likely spend more to retrofit their houses to accommodate their changing lifestyle.

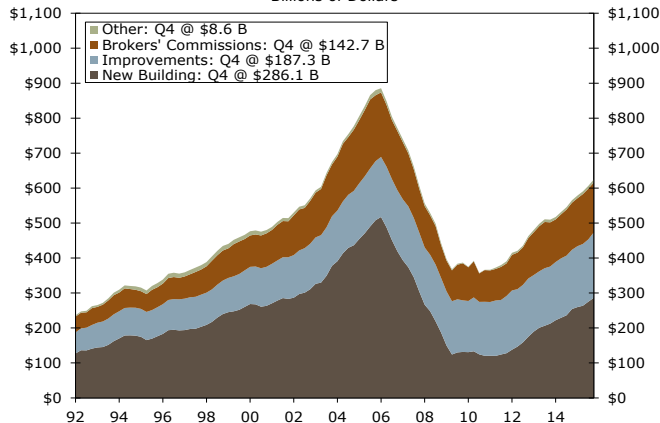
Residential Investment  
 Year-over-Year Percent Change



NAHB Remodeling Market Index  
 Index, Seasonally Adjusted

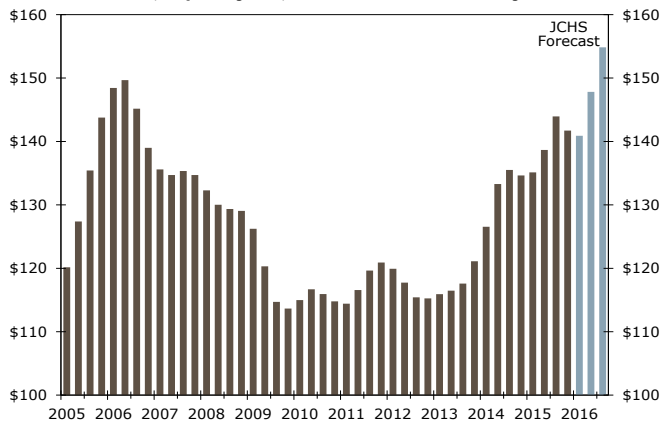


Residential Investment  
 Billions of Dollars

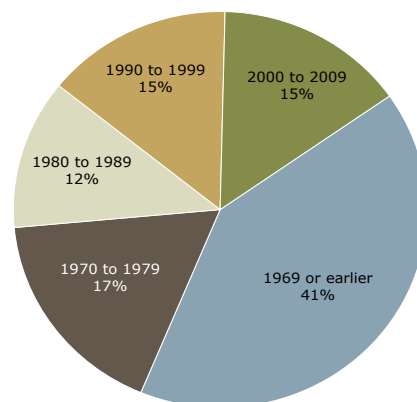


Leading Indicator of Remodeling Activity

In Billions, 4-Q Moving Total, Harvard Joint Center for Housing Studies



Share of Owner-Occupied Housing  
 Year Structure Built - 2013



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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