

**Economics Group**

Special Commentary

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**Housing Chartbook: August 2017**

**The Housing Market Remains Woefully Out of Balance**

The housing recovery remains woefully out of balance, with far too few homes available for sale in parts of the country where population and employment are growing rapidly. The mismatch between supply and demand has sent home prices soaring in many parts of the West and South, which has reduced affordability and set off alarm bells about another possible housing bubble. While some markets are seeing price gains reminiscent of the height of the housing bubble, most markets are not. The Case-Shiller national home price index has risen 5.6 percent over the past year, which is close to the pace maintained the past four years. Moreover, there are still many housing markets that are languishing throughout the country, particularly in large parts of the South, Midwest and the Northeast. The split is also apparent between many suburban and exurban markets, which have been slower to recover, and many urban markets and areas close to key employment centers, which have seen home prices recover much more rapidly.

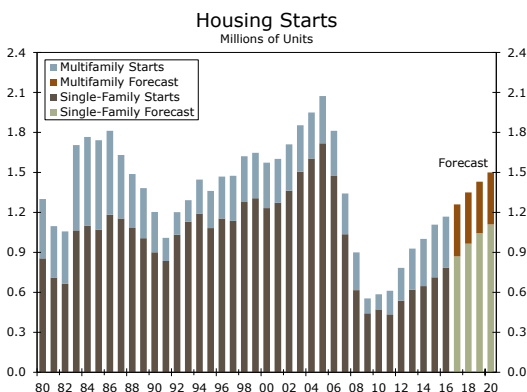
*Mismatch between supply and demand has sent home prices soaring in many parts of the West and South.*

Homeowners in parts of the country where home prices have been slower to recover have been unable to sell their homes and relocate to more vibrant job markets. As a result, the share of the population moving from one state to another has fallen to its lowest level since World War II. Young persons are less impacted by this trend and continue to migrate to where they believe the greatest opportunities are. The wave of relocating millennials has set off an apartment boom, primarily in rapidly growing Sun Belt cities and parts of the West, many of which are seeing a renaissance in their urban centers, where neighborhoods have often been dramatically gentrified.

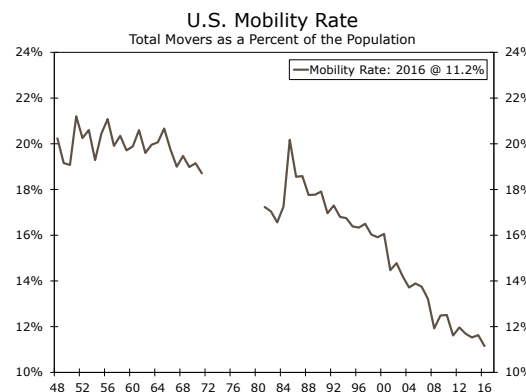
The geographic mismatch is just one way housing is out of balance. There is also far less turnover in existing homes today than there has been historically, particularly at the lower price points needed to pull first-time buyers back into the market. The lack of lower-priced homes is a consequence of the housing bust. Many of the homes lost to foreclosure were bought by investors and converted to rentals. This trend was particularly prevalent in rapidly growing Sun Belt areas.

*The lack of lower-priced homes is a consequence of the housing bust.*

**Figure 1**



**Figure 2**



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

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Together we'll go far



*There is also far less housing turnover at higher price points.*

### Demographics Headwinds Are Taking Longer to Dissipate

The lack of turnover is also a problem at higher price points, which is inhibiting trade-ups. Part of the problem in the trade-up market is that there are so few homes available for sale in the nation's stronger economies that many potential home buyers are choosing to stay put, further compounding the lack of inventory. The inclination to stay put has likely been reinforced by the persistence of low mortgage rates that have allowed homeowners to refinance at incredibly low interest rates and quickly build equity. For many homeowners, refinancing their home has provided their biggest financial windfall in recent years, and they are unwilling to put their current lower housing costs at risk to trade up for another home at what looks like the top of the market in many parts of the country.

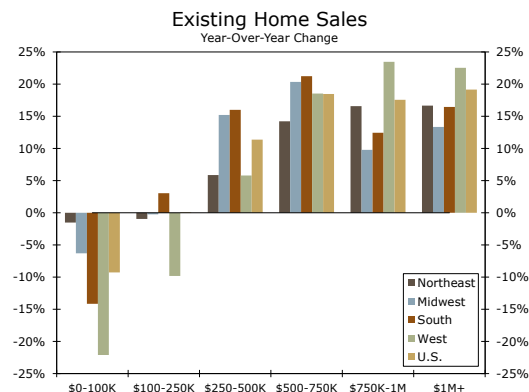
There have been some signs that this logjam is beginning to break. There has been a slight uptick in the corporate relocation market, with businesses and workers leaving higher costs markets like California, New Jersey and Connecticut for lower costs areas like Texas, Florida, Georgia and the Carolinas. Baby Boomers are also retiring in increasing numbers, boosting demand for homes in retiree-driven markets like Florida, Arizona, Nevada and South Carolina. In many cases, retirees are buying homes without selling their current residence. This is not that unusual, as younger-retirees tend to gradually transition to full-time living in retiree areas and may choose to hold onto their current home to maintain ties with family. There has been a rise in the number of vacant homes held off the market and more homes are also likely been rented.

We are also seeing some positive trends in the first-time home buyer market. Millennials are aging up and the leading edge of this cohort is now reaching their peak family formation years. While Millennials face more obstacles than previous generations, such as larger student loan debts and generally tighter mortgage qualification requirements, their sheer numbers are pushing first-time home buying higher. The rising number of first-time buyers is a big reason why the median price of a new home has fallen over the past year, as homebuilders are increasingly finding ways to bring more affordable homes to market. The median price of a new home has fallen 3.4 percent over the past year to \$310,800, as a larger share of new home sales in recent months has been for homes priced under \$300,000. Even with the drop, new homes still sell at a huge premium to existing homes. The large relative price gap is creating an opportunity for builders able to ramp up production of lower-priced homes.

*We have slightly scaled back our forecast homes sales and new home construction.*

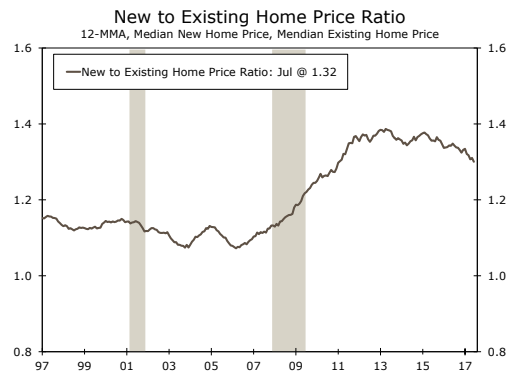
With half the year in the books, we have slightly scaled back our forecasts for homes sales and new home construction. While demand remains solid, diminishing affordability amid a general lack of homes available for sale appear to be problems with no quick or easy solutions. New home sales remain on pace to rise 10.5 percent this year to 620,000 homes. Sales should rise an additional 9.7 percent in 2018. Existing home sales should rise 2.5 percent this year, as tight supplies continue to push prices up faster than incomes.

**Figure 3**



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

**Figure 4**



National Housing Outlook

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP, Percent Change	2.5	1.6	2.2	1.7	2.4	2.6	1.6	2.1	2.5
Residential Investment, Percent Change	-2.5	0.5	13.5	11.9	3.5	11.7	4.9	2.5	4.6
Nonfarm Payroll Change (Avg. Monthly)	88	174	179	192	250	226	187	164	140
Unemployment Rate	9.6	8.9	8.1	7.4	6.2	5.3	4.9	4.4	4.1
Home Construction									
Total Housing Starts, in Thousands	586.9	608.8	780.6	924.9	1,003.3	1,111.8	1,173.7	1,240.0	1,320.0
Single-Family Starts, in Thousands	471.1	430.5	535.3	617.7	647.9	714.5	781.5	860.0	930.0
Multifamily Starts, in Thousands	115.8	178.3	245.3	307.2	355.4	397.3	392.2	380.0	390.0
Home Sales									
New Home Sales, Single-Family, in Thousands	322.0	305.0	369.0	429.0	437.0	501.0	561.0	620.0	680.0
Total Existing Home Sales, in Thousands	4,190.0	4,260.0	4,660.0	5,090.0	4,940.0	5,250.0	5,450.0	5,580.0	5,720.0
Existing Single-Family Home Sales, in Thousands	3,708.0	3,787.0	4,128.0	4,484.0	4,344.0	4,646.0	4,838.0	4,960.0	5,090.0
Existing Condominium & Townhouse Sales, in Thousands	474.0	477.0	528.0	603.0	591.0	608.0	614.0	620.0	630.0
Home Prices									
Median New Home, \$ Thousands	221.8	227.2	245.2	268.9	282.8	296.4	316.2	325.0	335.2
Percent Change	2.4	2.4	7.9	9.7	5.2	4.8	6.7	2.8	3.1
Median Existing Home, \$ Thousands	172.9	166.1	176.8	197.1	208.3	222.4	233.8	247.9	262.3
Percent Change	0.2	-3.9	6.4	11.5	5.7	6.8	5.1	6.0	5.8
FHFA Purchase Only Index, Percent Change	-3.0	-4.1	3.0	7.3	5.3	5.6	6.1	6.4	6.0
S&P Case-Shiller C-10 Home Price Index, Percent Change	2.1	-3.5	0.3	11.7	7.9	4.6	4.5	5.5	5.4
Interest Rates - Annual Averages									
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.27	0.52	1.25	1.88
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.27	3.52	4.25	4.88
10-Year Treasury Note	3.22	2.78	1.80	2.35	2.54	2.14	1.84	2.42	2.71
Conventional 30-Year Fixed Rate, Commitment Rate	4.69	4.46	3.66	3.98	4.17	3.85	3.65	4.12	4.41

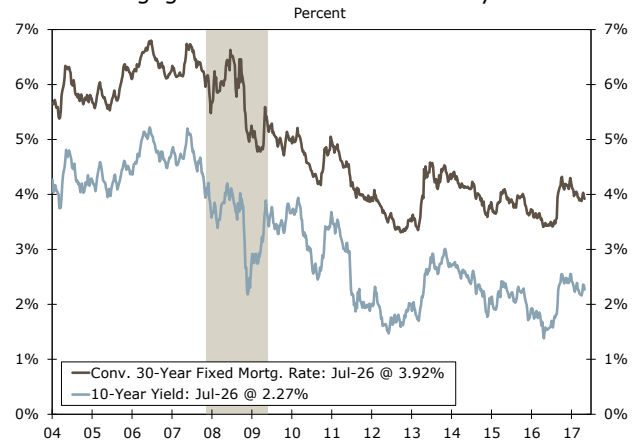
Forecast as of: August 2, 2017

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, FRB, FHFA, FHLMC, National Association of Realtors, S&P, Wells Fargo Securities

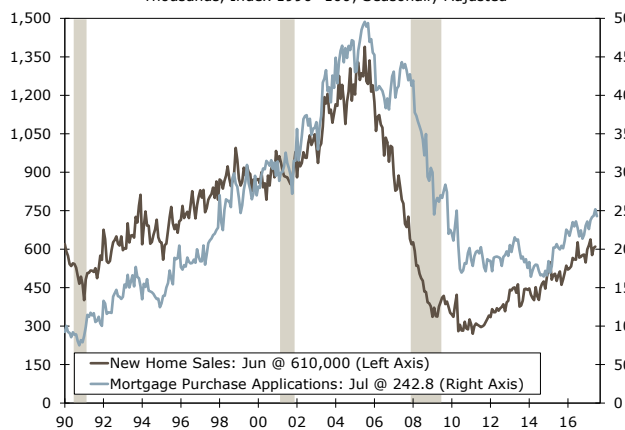
## Mortgages

- Mortgage rates dipped for the third week in a row to end the month at 3.92 percent. While down substantially from their post-election highs, mortgage rates remain about 35 bps above their level prior to the presidential election. As a result, the pull-back in rates has done more for lifting purchase applications than it has refinancings.
- Mortgage purchase applications have been gradually trending higher for the past few months, reflecting the modest uptrend in new home sales. After a bump following the surprise Brexit vote, refinancing applications have settled back down near their lows.

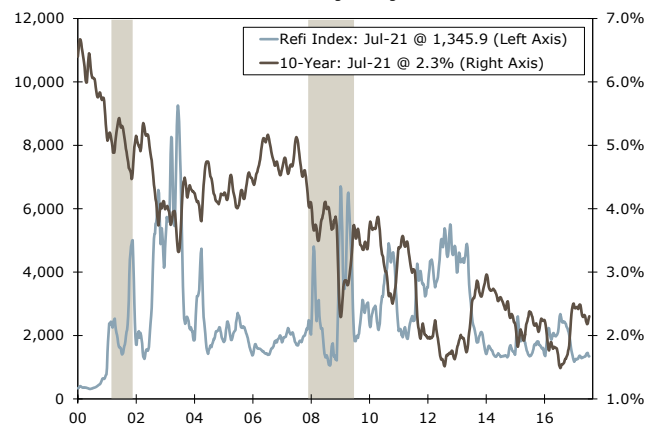
Mortgage Rate vs. 10-Year Treasury Yield



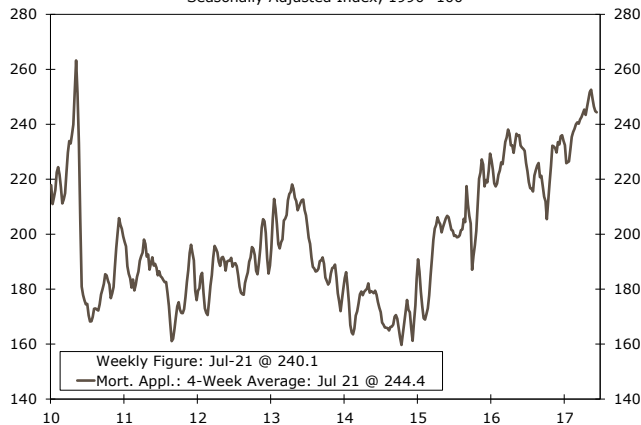
New Home Sales vs. Mortgage Purchase Applications



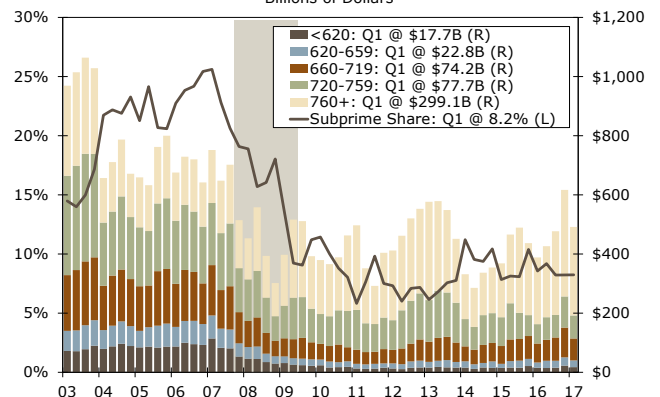
Mortgage Apps for Refi and 10-Year Treasury Yield



Mortgage Applications for Purchase Index



Mortgage Origination by Credit Score

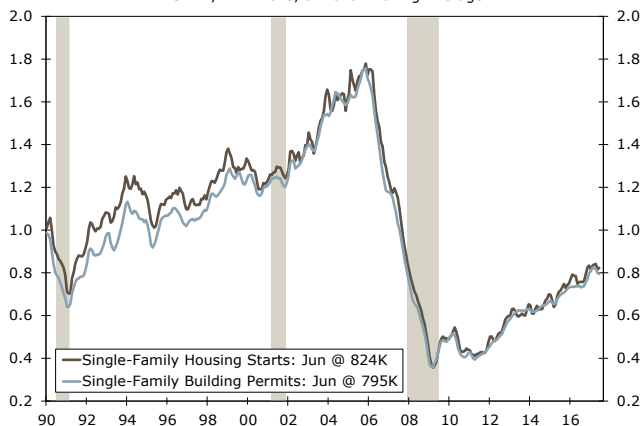


Source: MBA, FHLMC, Federal Reserve Board, U.S. Dept. of Commerce, FRBNY and Wells Fargo Securities

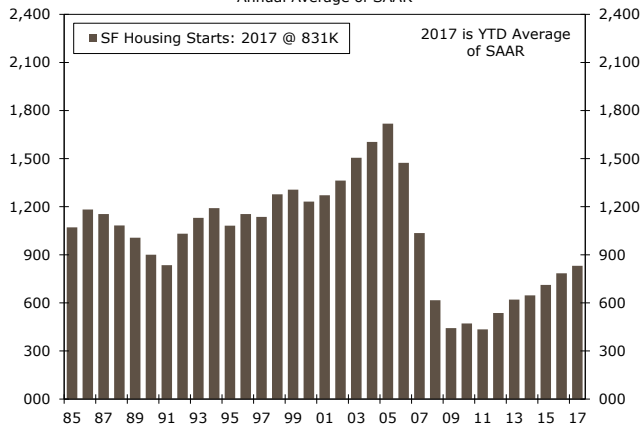
## Single-Family Construction

- Single-family housing starts rose 6.3 percent in June, driven primarily by solid gains in the supply-starved South and West. Starts rose 7.2 and 10.6 percent, respectively, in those regions. The rebound reflects some normalization in housing starts, which were buoyed earlier this year by unseasonably mild winter weather, which pulled strength forward from the spring.
- Single-family permits rose 4.1 percent in June, following three consecutive monthly declines. On a year-to-date basis, permits are running 7.4 percent ahead of their year-ago pace. But permits are also running slightly below the recent pace of starts, suggesting starts are unlikely to suddenly break out to the upside.

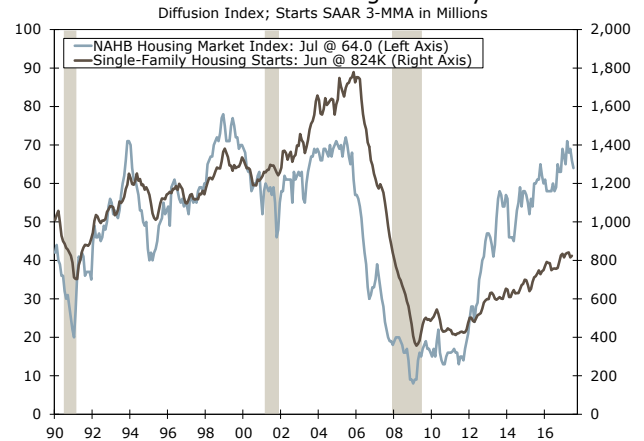
Single-Family Housing Starts vs. Building Permits  
SAAR, In Millions, 3-Month Moving Average



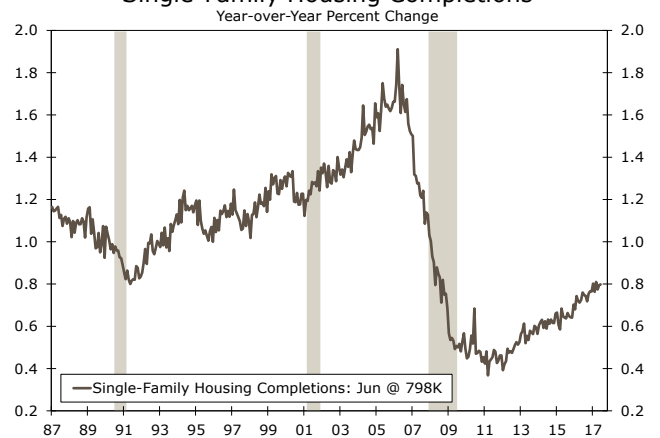
Single-Family Housing Starts  
Annual Average of SAAR



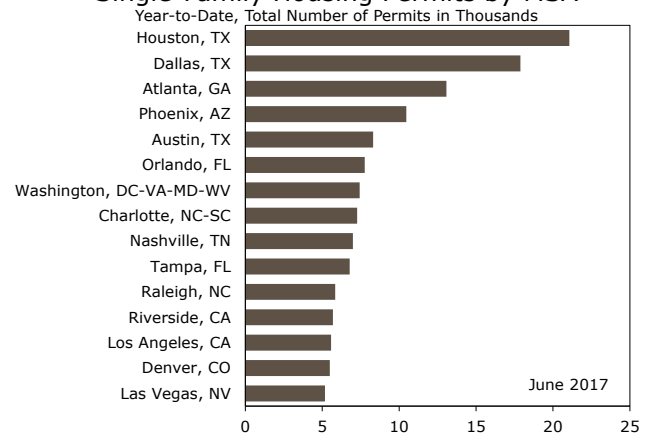
Builder Confidence & Single-Family Starts



Single-Family Housing Completions



Single-Family Housing Permits by MSA

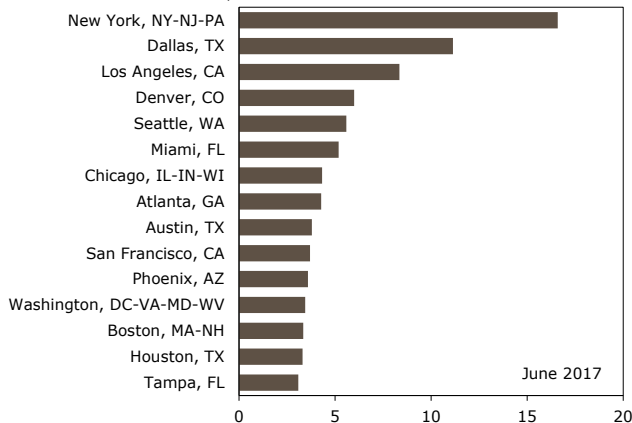


Source: U.S. Department of Commerce, National Association of Home Builders and Wells Fargo Securities

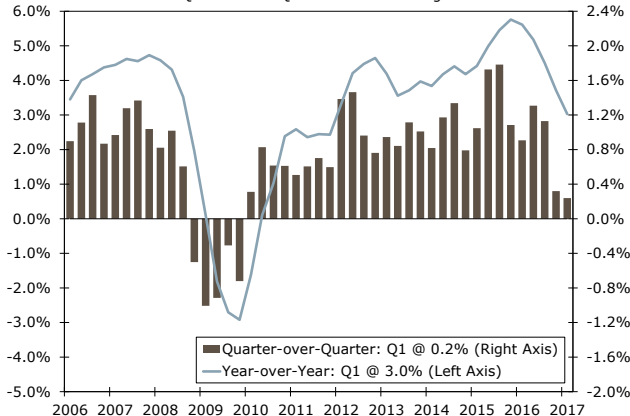
## Multifamily Construction

- Despite jumping 13 percent in June, multifamily housing starts and permits have both slowed significantly. The three-month moving average shows both series have clearly rolled over, possibly reflecting some tightening in credit.
- Multifamily effective rent growth has slowed to nearly a standstill, rising 0.2 percent over the quarter, the smallest quarterly gain since 2009. There has been a surge of apartment deliveries over the past few quarters in many of the fastest growing markets, leading to higher vacancy rates and increased leasing concessions. Demand for apartments remains strong, however, particularly in markets that have not yet seen a surge in new apartment development.

Multifamily Housing Permits by MSA  
Year-to-Date, Total Number of Permits in Thousands



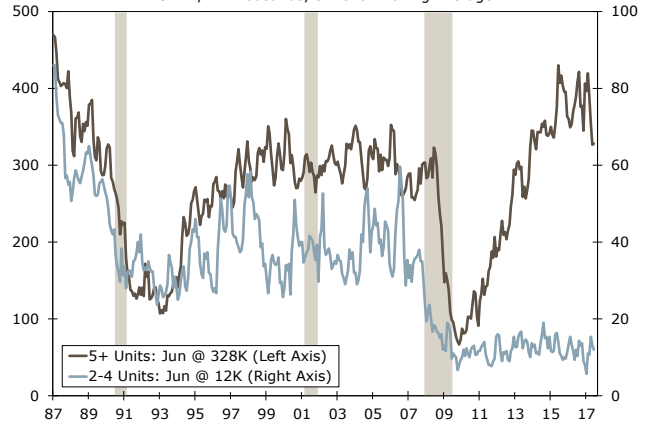
Apartment Effective Rent Growth  
Quarter-over-Quarter Percent Change



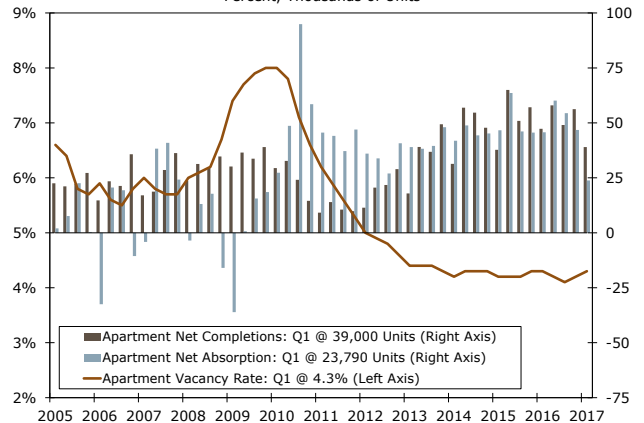
Multifamily Housing Starts vs. Building Permits  
SAAR, In Thousands, 3-Month Moving Average



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



Apartment Supply & Demand  
Percent, Thousands of Units

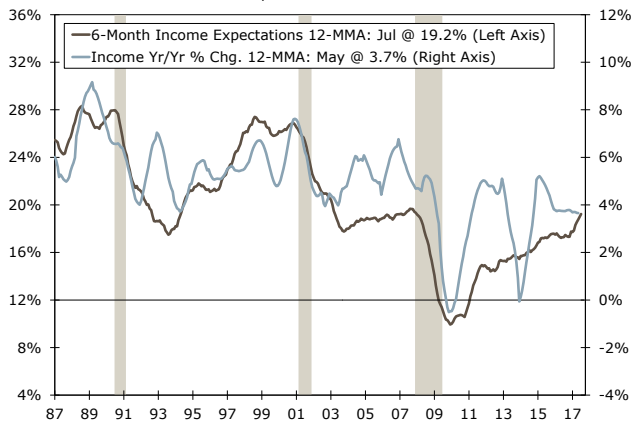


Source: U.S. Department of Commerce, Reis, Inc., and Wells Fargo Securities

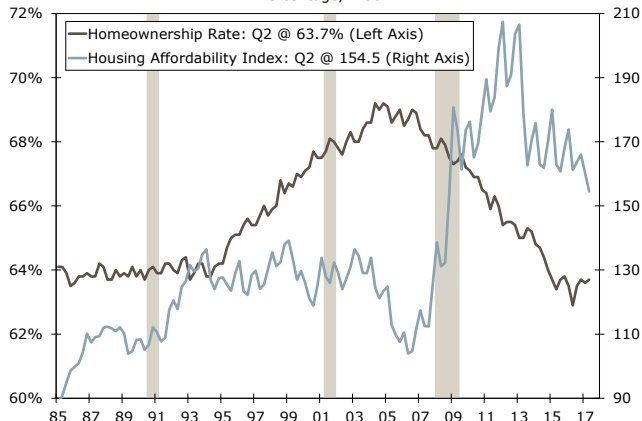
## Buying Conditions

- The current housing environment is imbalanced, with a shortage of homes available for sale keeping potential buyers and sellers on the sidelines and driving home prices higher. The West has been particularly hard hit, as construction has been unusually slow to ramp back up. Demand is not the issue. The Fannie Mae Home Purchase Sentiment Index rose to a post-recession high of 88.3 in June.
- The University of Michigan's measure of the proportion of consumers stating that now is a good time to buy a home continues to trend lower and is now even with the rising number stating that now is a good time to sell. Potential buyers have been put off by the general lack of inventory and rising home prices.

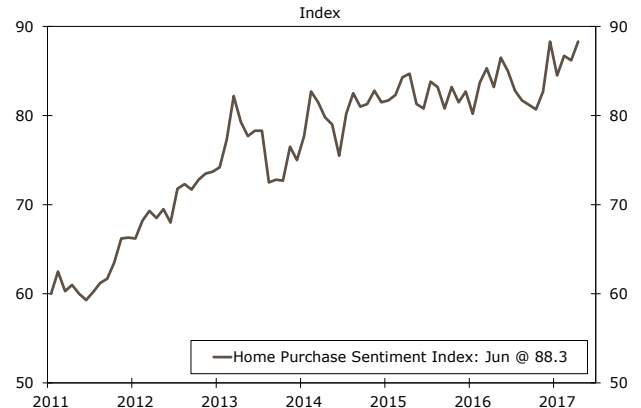
Consumer Confidence vs. Disposable Income  
Pct. Consumers That Expect Incomes to Increase Next 6 Months



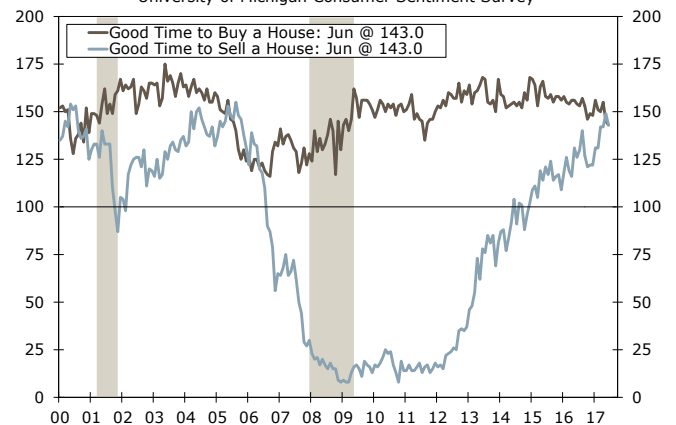
Homeownership vs. Housing Affordability  
Percentage, Index



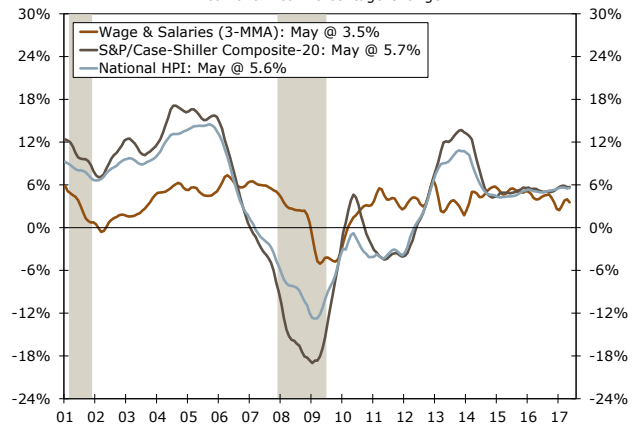
Home Purchase Sentiment Index



Good Time to Buy vs. Good Time to Sell  
University of Michigan Consumer Sentiment Survey



Home Prices vs. Wages and Salaries  
Year-over-Year Percentage Change

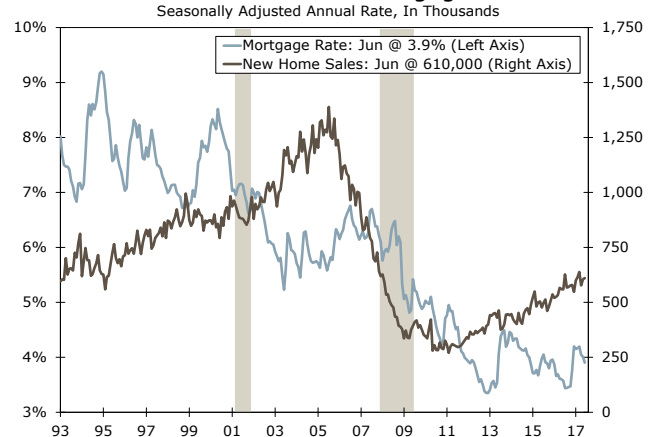


Source: University of Michigan, National Association of Realtors, The Conference Board, S&P, Fannie Mae, U.S. Dept. of Commerce and Wells Fargo Securities

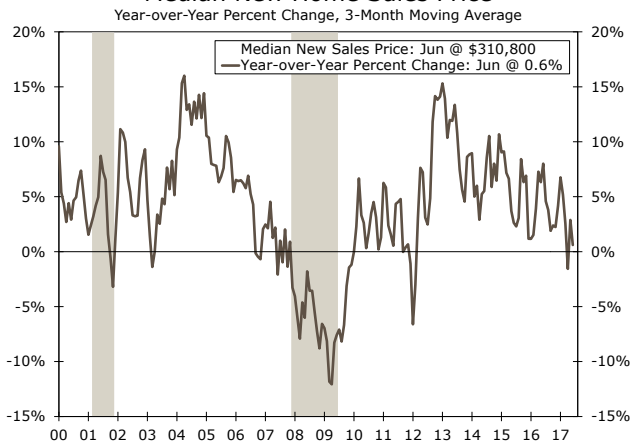
## New Home Sales

- New home sales inched up to a 610,000-unit pace in June. The West and Midwest led the way. Supply concerns have been the primary drag on new home sales. The recent momentum in the West is an encouraging sign, however, as completions have risen in this rapidly growing region, which is seeing increased development.
- Homebuilders have been ramping up construction of lower priced homes in an effort to attract more first-time buyers. The shifting price mix has pulled down the median price of a new home over the past year. Builders are increasingly looking to lower-priced suburban areas for lots, which is one reason so much of the recent gain in home sales has been for homes where construction has not yet begun.

New Home Sales vs. Mortgage Rates



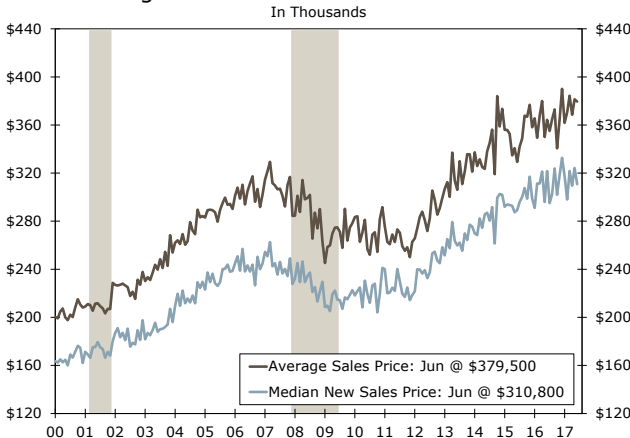
Median New Home Sales Price



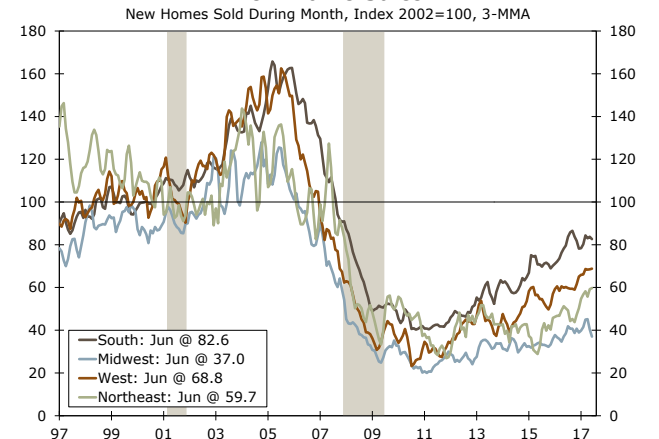
Months' Supply of New Homes



Average and Median New Home Sale Price



New Home Sales



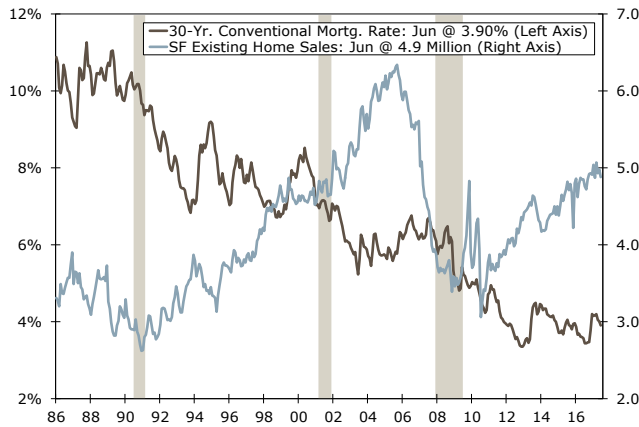
Source: U.S. Department of Commerce, FHLMC and Wells Fargo Securities



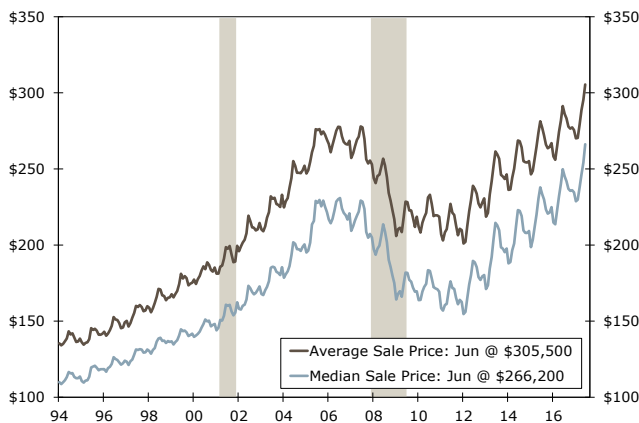
## Existing Home Sales

- Existing home sales fell for the second time in three months, declining by 1.8 percent to a 5.5 million-unit pace. The drop is most likely due to the lack of supply of homes available for sale. The inventory of existing homes for sale has declined year-to-year for the past 25 months. The lack of homes is particularly an issue in the South and West, which account for over half of the nation's existing home sales. This has pushed the median existing single-family home price to a record \$266,200 and pulled affordability lower.
- The lack of existing homes for sale is most apparent at the lower end of the price spectrum, which is where investor purchases of distressed properties have severely reduced inventories and profoundly lowered housing turnover. Home sales below \$100,000 fell 9.3 percent over the year.

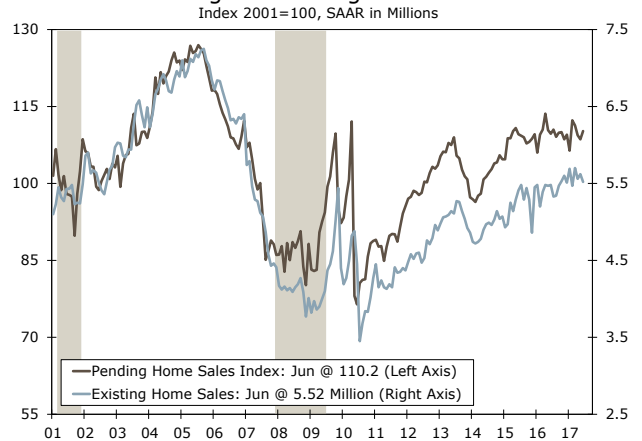
Existing Single Family Home Sales vs. Mortgage Rate  
Percent and SAAR in Millions



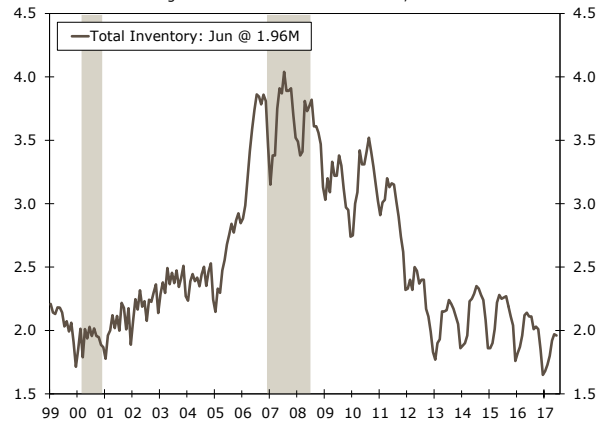
Existing Single-Family Home Prices  
In Thousands



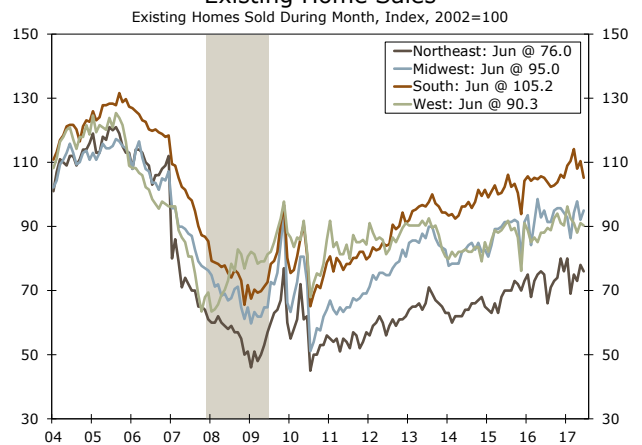
Pending vs. Existing Home Sales



Inventory of Existing Homes for Sale  
Existing Homes for Sale at End of Month, in Millions



Existing Home Sales

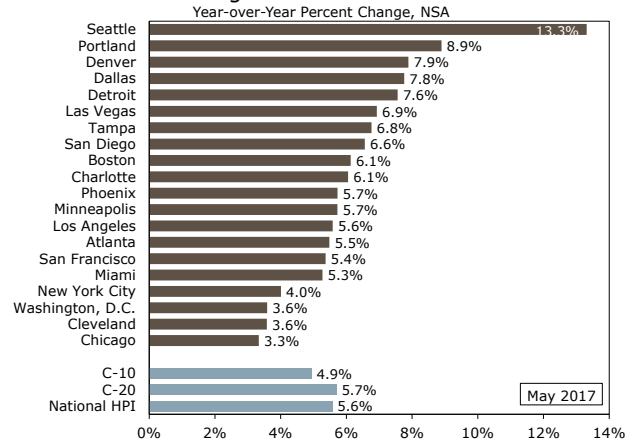


Source: National Association of Realtors, FHLMC and Wells Fargo Securities

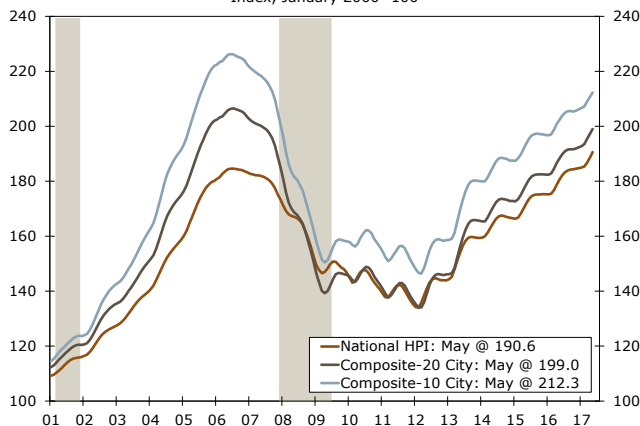
## Home Prices

- The S&P CoreLogic Case-Shiller Home Price Index rose 5.6 percent year-to-year in May. Prices are rising the fastest in the West, where population and employment are growing rapidly and homebuilding remains constrained.
- While prices are surging in the West, they are cooling off slightly in some larger metro areas, including New York, Chicago and Washington D.C. All of these markets are included in the 10-City HPI, which has underperformed the broader national and 20-City indices.
- Home prices in Denver and Dallas fell less than they did nationally during the housing bust and recovered much more rapidly, lifting home prices in both well past their previous highs.

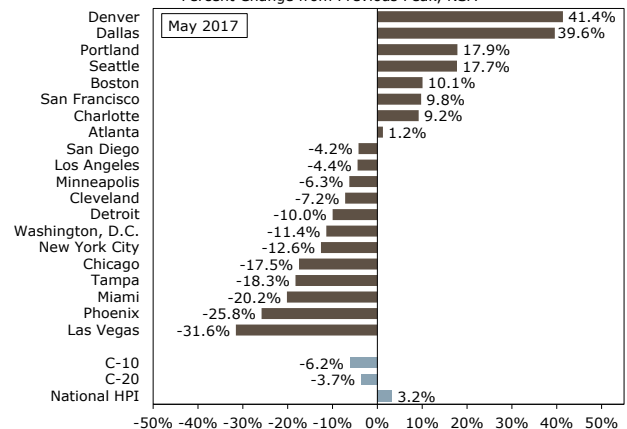
S&P CoreLogic Case-Shiller Home Prices



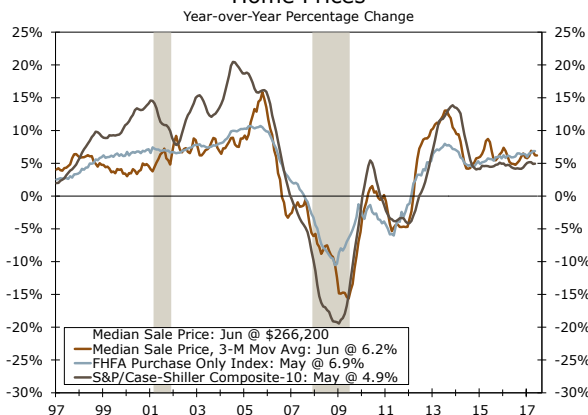
S&P CoreLogic CS Home Price Index  
Index, January 2000=100



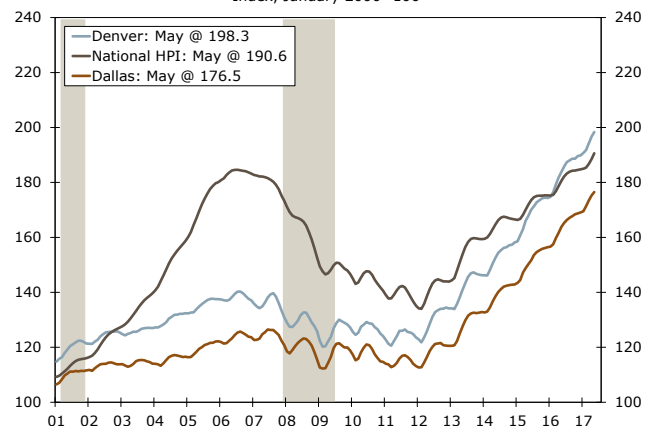
S&P CoreLogic Case-Shiller Home Prices  
Percent Change from Previous Peak, NSA



Home Prices



S&P CoreLogic Case-Shiller Home Price Index  
Index, January 2000=100

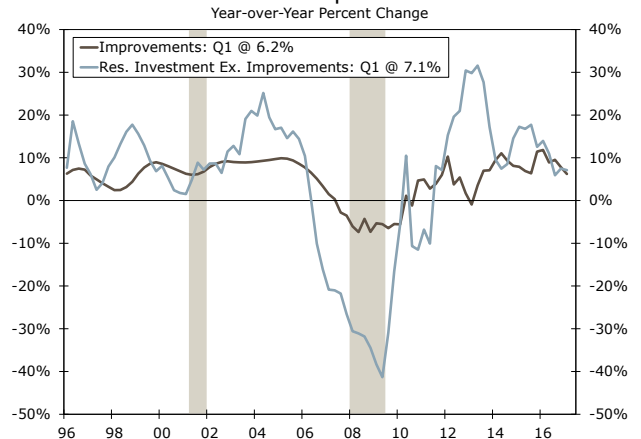


Source: National Association of Realtors, U.S. Dept. of Commerce, S&P, FHFA and Wells Fargo Securities

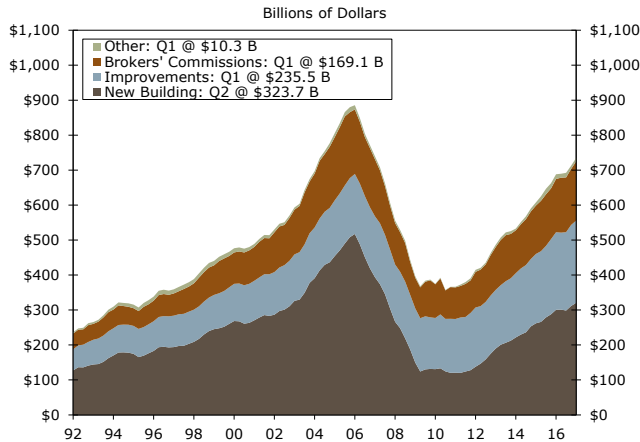
## Renovation and Remodeling

- Residential improvements spending rose less than initially thought, with spending rising 6.2 percent year-to-year in the first quarter. Earlier data had put the gain at 7.5 percent.
- Milder conditions this past winter pulled spending at home improvement centers forward into the first quarter and contributed to a slow start to the spring.
- The Harvard Joint Center for Housing Studies (JCHS) expects home improvement spending to continue to strengthen. With for-sale inventories unusually lean, more homeowners are opting to renovate their existing homes. Rising home values are also encouraging homeowners to enhance their current homes.

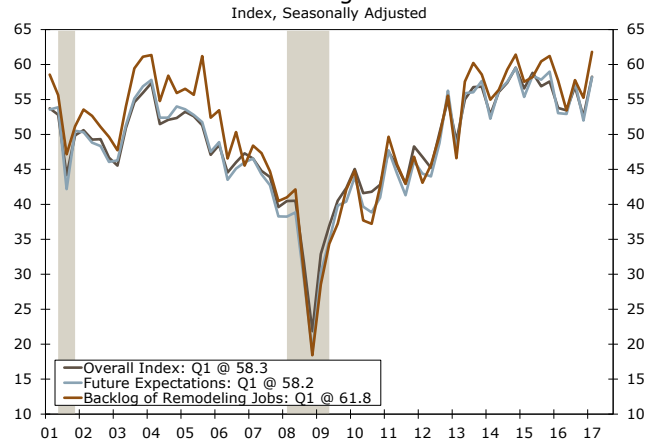
Residential Improvements



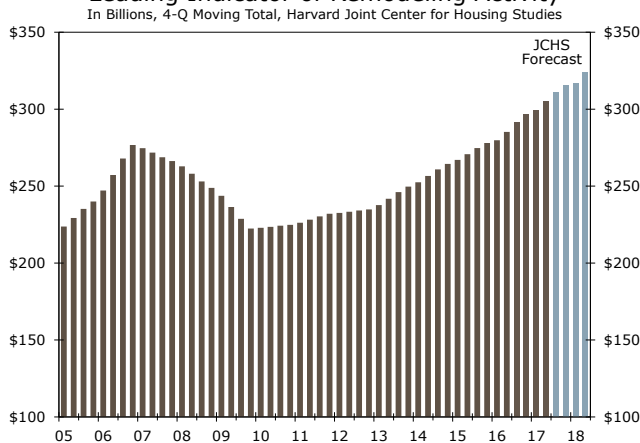
Residential Investment



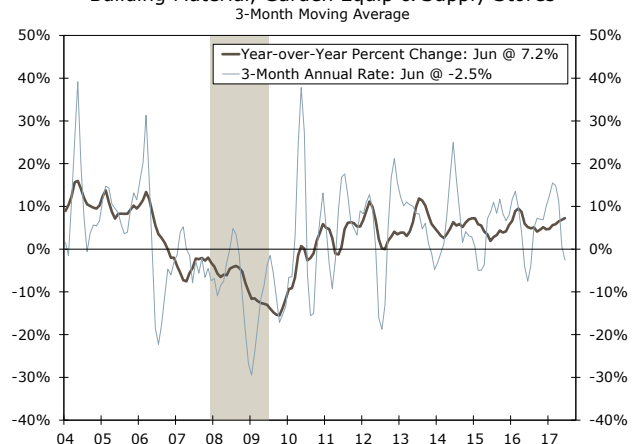
NAHB Remodeling Market Index



Leading Indicator of Remodeling Activity



Building Material, Garden Equip & Supply Stores



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

## Wells Fargo Securities Economics Group

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