

Economics Group

Special Commentary

Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277
Charlie Dougherty, Economist
charles.dougherty@wellsfargo.com • (704) 410-6542

Housing Chartbook: August 2020

How Long Can Home Sales Outrun the Dampening Effects of COVID?

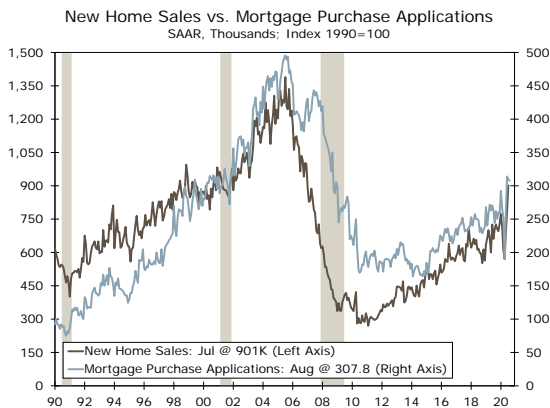
Home sales have generally blown past expectations this summer, as buyers made up for purchases put off earlier this spring and a significant number of higher-income renters chose to buy homes. Sales of existing homes posted a record gain in July, spiking 24.7% to a 5.86 million-unit pace. New homes rocketed up 13.9% in July to a 901,000 unit pace, the strongest since 2006. The jump in sales has pulled inventories lower, setting the stage for more home building.

The swing in home sales is reminiscent of what we saw at the early stage of the housing boom after the September 11 attacks. That event sparked a nesting instinct, which saw people spend more time at home. Similarly, the COVID-19 pandemic resulted in people spending more time at home, prompting a shift toward homeownership as well as increased spending for additions and renovations. One important difference, however, is that the current environment is far more bifurcated than what we saw nearly 20 years ago. Most of the improvement has occurred at the upper-end of the housing market, reflecting the resilience of jobs in financial, professional and technical services. While this improvement is real, parts of the housing market are clearly struggling. Freddie Mac reported the share of seriously delinquent single-family home mortgages—meaning three or more skipped payments or already in foreclosure—rose 0.61 percentage points to 3.12% in the second quarter, the highest level since February 2013.

The bifurcation of the workforce explains a lot about how home sales can surge with the unemployment rate exceptionally high.

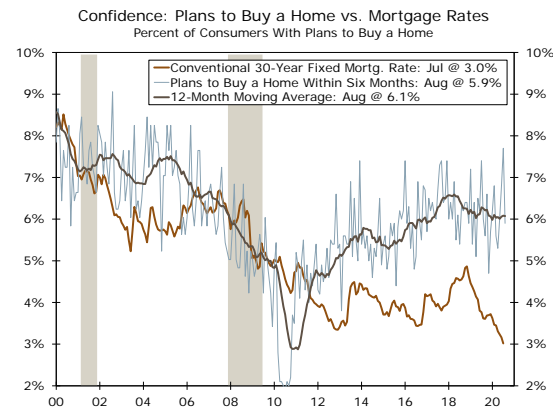
The recent rise in home sales has provided a much needed lift to realtors, mortgage lenders and homebuilders. Lumber prices have also increased and investment is flowing to restart sawmills and lumber yards. In addition, the floor covering business is ramping up, with producers of carpets, hardwood and laminate flooring all seeing an influx of new investment. Producers of cabinets, wallboard, furniture, home furnishings and household appliances are also getting a boost. While we expect sales to remain strong, we feel the initial bounce back from pandemic lows has nearly run its course. Of most concern is that a large proportion of workers are still very concerned about their employment prospects. Those concerns have weighed on consumer confidence, which fell 6.9 points in August, and contributed to a decline in home buying plans. Buying plans do not show anywhere near the improvement home sales have, particularly given the drop in mortgage rates.

Figure 1



Source: U.S. Departments of Labor & Commerce, NAR, MBA and Wells Fargo Securities

Figure 2



Together we'll go far



COVID Will Limit Future Gains but Housing is Clearly Headed Higher

The August pullback in consumer confidence exposes the limits of how much the housing market can strengthen without significantly more progress at containing and minimizing the threat from COVID-19. Economic activity has pulled back the most for undertakings that require significant social interaction. Restaurant dining, bars, various forms of entertainment, retailing, certain aspects of healthcare, education and personal services have been most heavily impacted. Combined these industries account for roughly 60% of the jobs lost in this recession. Many of these jobs are relatively low paying, which means earlier stimulus and relief payments—much of which has expired—offset a fairly large share of foregone earnings. Employment in higher paying industries, such as professional services, financial services and many aspects of the tech sector, has fared considerably better. A larger proportion of these workers also have the ability to work remotely.

The bifurcation of the workforce explains a lot about how home sales can surge while unemployment remains exceptionally high. A disproportionate share of those out of work tend to be younger and renters, while a larger proportion of the workers faring the best through this ordeal tend to be older and are more likely to be home buyers. The split is evident in the latest Consumer Confidence data. Overall confidence fell 6.9 points to 84.8 in August, with most of the drop coming from consumers' assessment of current economic conditions. The split between income cohorts is even more telling. Upper middle and upper income households are notably more upbeat about the economy's prospects than middle and lower income households.

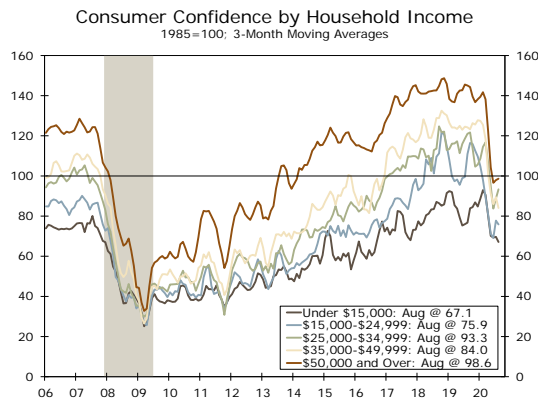
The split in consumer confidence is reinforced by research from the Opportunity Insights Economic Tracker that shows employment among households earnings \$60,000 a year has nearly fully recovered, while employment among workers earning \$27,000 a year or less remains 15.7% below its prepandemic level. Given the split, job losses are a greater issue for missed rent payments and mortgage delinquencies than they are for home sales. For upper middle and middle income households, the current environment, with near record low mortgage rates and a soaring stock market, are an usually opportune time to buy a home. Combined, however, the split suggests the pool of potential homebuyers is not as deep as it would be in a more typical economic recovery.

We have updated our forecast to incorporate our latest macroeconomic outlook as well as the recent data on home sales and home prices. With the recent bounce back, new and existing home sales are clearly going to be much stronger than earlier forecasted, even assuming most of the bounce back is behind us. We now expect new home sales to rise 8.5% this year to 740,000 homes. With new home sales moderating and inventories exceptionally low, we have penciled in a modest 2.7% gain for 2021. New home construction is clearly set to ramp up, particularly in the South and more affordable parts of the West, which are seeing an influx of home buyers from higher costs major metro areas in the Northeast and along the West Coast. Home sales are also being sustained by the growing cohort of Millennials reaching their late thirties, which is a time when lifetime milestones, such as marriage and raising children, tend to increase.

The bifurcation of the workforce explains a lot about how home sales can surge with the unemployment rate exceptionally high.

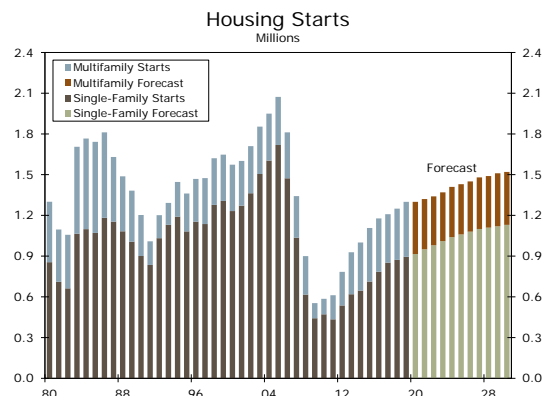
We now expect new home sales to rise 8.5% this year to 740,000 homes.

Figure 3



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

Figure 4



National Housing Outlook

	2013	2014	2015	2016	2017	2018	2019	Forecast	
								2020	2021
Real GDP, Percent Change	1.8	2.5	2.9	1.6	2.4	2.9	2.3	-4.9	3.8
Residential Investment, Percent Change	12.4	3.8	10.2	6.5	3.5	-1.5	-1.5	-0.2	5.2
Nonfarm Payroll Change (Avg. Monthly)	192	250	227	195	176	193	178	-826	238
Unemployment Rate	7.4	6.2	5.3	4.9	4.3	3.9	3.7	8.7	6.9
Home Construction									
Total Housing Starts, in Thousands	924.9	1,003.3	1,111.9	1,173.7	1,202.9	1,249.9	1,290.0	1,300.0	1,320.0
Single-Family Starts, in Thousands	617.7	647.8	714.6	781.5	848.9	875.8	887.7	915.0	950.0
Multifamily Starts, in Thousands	307.2	355.5	397.3	392.2	354.0	374.2	402.3	385.0	370.0
Home Sales									
New & Existing Home Sales, in Thousands	5,516.0	5,374.0	5,755.0	6,013.0	6,124.0	5,960.0	6,026.0	5,750.0	6,150.0
New Home Sales, Single-Family, in Thousands	429.0	439.0	501.0	561.0	613.0	617.0	682.0	740.0	760.0
Total Existing Home Sales, in Thousands	5,087.0	4,935.0	5,254.0	5,452.0	5,511.0	5,343.0	5,344.0	5,010.0	5,390.0
Existing Single-Family Home Sales, in Thousands	4,484.0	4,344.0	4,646.0	4,838.0	4,892.0	4,742.0	4,765.0	4,435.0	4,800.0
Existing Condominium & Co-op, in Thousands	603.0	591.0	608.0	614.0	619.0	601.0	579.0	575.0	590.0
Manufactured Homes									
Total Shipments, in Thousands	60.2	64.3	70.5	81.1	92.9	96.6	94.6	94.2	96.8
Percent Change	9.7	6.8	9.7	15.0	14.5	3.9	-2.0	-0.5	2.8
Home Prices									
Median New Home, \$ Thousands	268.9	288.5	294.2	307.8	323.1	326.4	321.5	327.5	335.0
Percent Change	9.7	7.3	2.0	4.6	5.0	1.0	-1.5	1.9	2.3
Median Existing Home, \$ Thousands	197.1	208.3	222.4	233.8	247.2	259.3	271.9	289.5	304.0
Percent Change	11.5	5.7	6.8	5.1	5.7	4.9	4.9	6.5	5.0
FHFA Purchase Only Index, Percent Change	7.0	5.0	5.3	5.8	6.4	6.5	5.3	5.7	5.8
S&P Case-Shiller C-10 Home Price Index, Percent Change	11.7	7.9	4.6	4.5	5.3	5.4	2.3	2.4	2.6
Interest Rates - Annual Averages									
Federal Funds Target Rate	0.25	0.25	0.27	0.52	1.13	1.96	2.25	0.25	0.25
Prime Rate	3.25	3.25	3.27	3.52	4.13	4.96	5.25	3.25	3.25
10-Year Treasury Note	2.35	2.54	2.14	1.84	2.33	2.91	2.14	0.95	1.23
Conventional 30-Year Fixed Rate, Commitment Rate	3.98	4.17	3.85	3.65	3.99	4.54	3.94	3.30	3.10

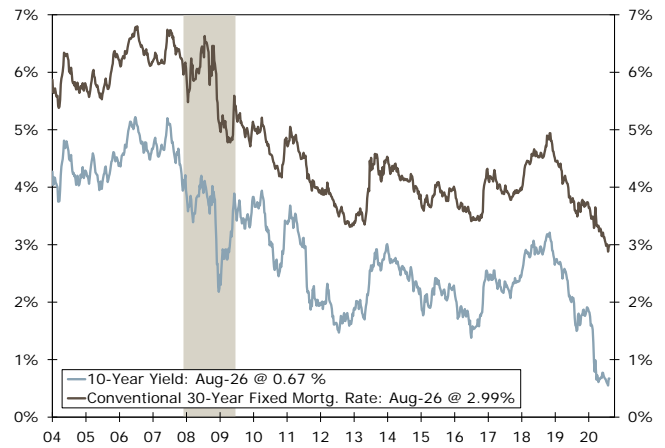
Forecast as of: August 27, 2020

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

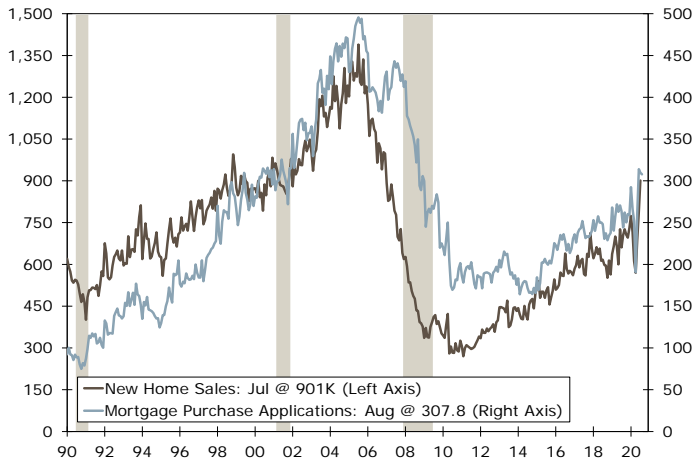
Mortgages

- Mortgage rates remain historically low, averaging 2.96% in August. Lower rates should further bolster home sales. Purchase applications were up 33.1% year-over-year for the week ending August 21.
- Applications for refinancing are up 34.5%. Mortgage lenders, still constrained by this past spring's surge in refinancing requests, may struggle to handle another wave of applications.
- Refinancing may become more expensive. The FHFA announced a price adjustment (0.5% of the total loan amount) for refinancing beginning in September. Underwriting also remains relatively tight, with higher FICO score borrowers accounting for a larger share of recent originations. The split also matches our belief that a large part of the recent improvement in home sales has been driven by upper income buyers.

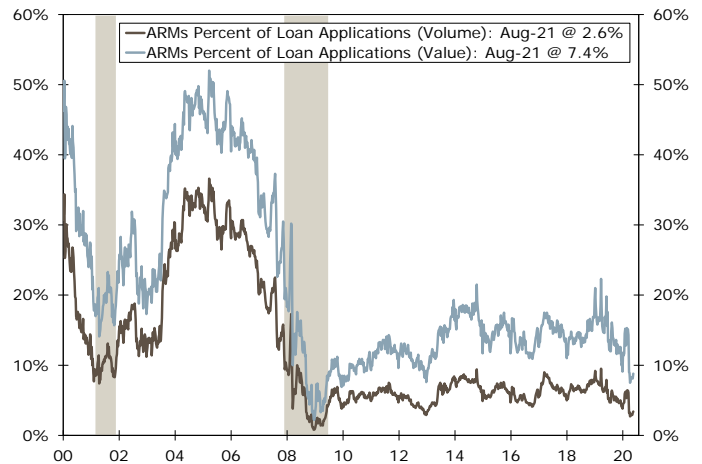
Conventional Mortgage Rate vs. 10-Year Treasury Yield



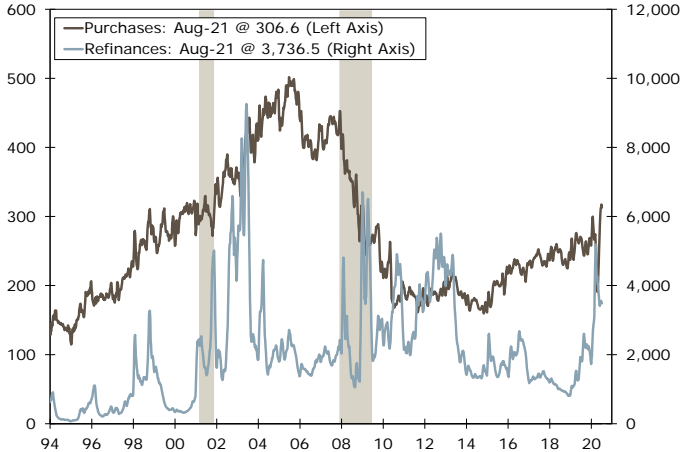
New Home Sales vs. Mortgage Purchase Applications
 SAAR, Thousands; Index 1990=100



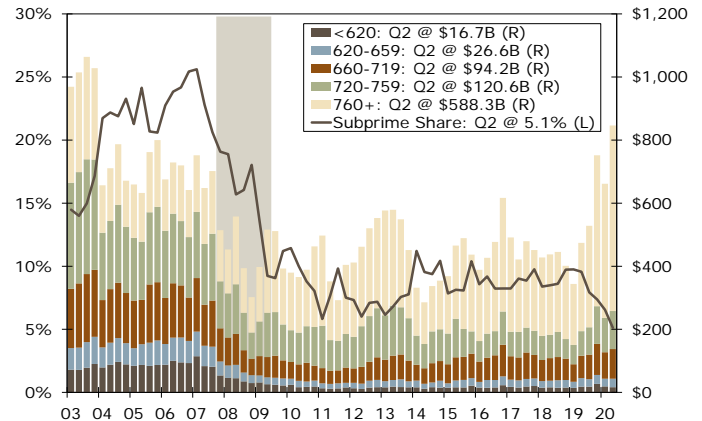
Adjustable Rate Mortgage Applications



Mortgage Applications
 Index 1990=100, 4-Week Moving Average



Mortgage Origination by Credit Score
 Billions of Dollars

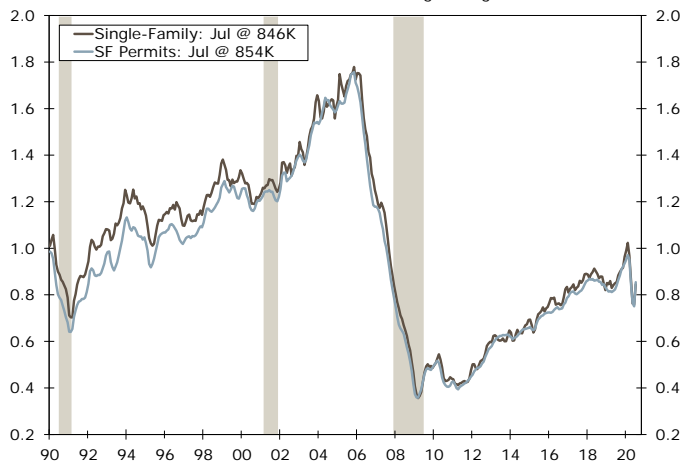


Source: MBA, FHLMC, Federal Reserve System, U.S. Dept. of Commerce and Wells Fargo Securities

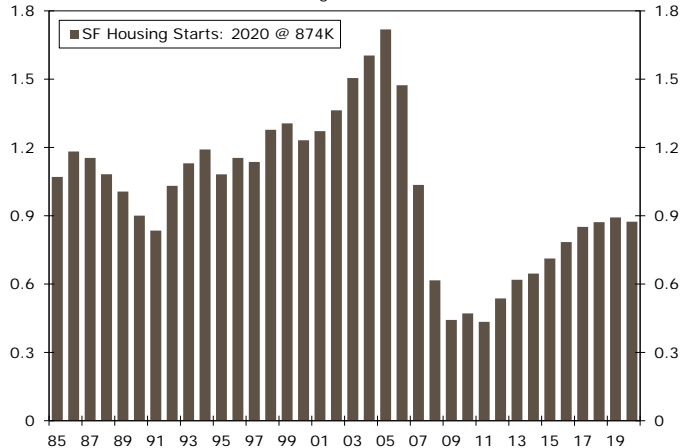
Single-Family Construction

- The rebound in home-buying has boosted builder confidence and led to a ramp-up in new construction. Single-family starts rose 8.2% in July and permits jumped 17.0%. Year-over-year, starts are up 7.4%.
- The COVID-19 crisis may indirectly be a boon for home builders. Weary from the lockdowns and lack of open urban amenities, many apartment dwellers now appear to be pursuing homeownership, often in the suburbs or parts of the South and West where new homes are more affordable.
- Starts and permits are likely headed higher in coming months. The ramp up, however, may be constrained by shortages of building materials and skilled labor. These bottlenecks have emerged due to prior shutdowns and the resurgence in COVID-19 cases.

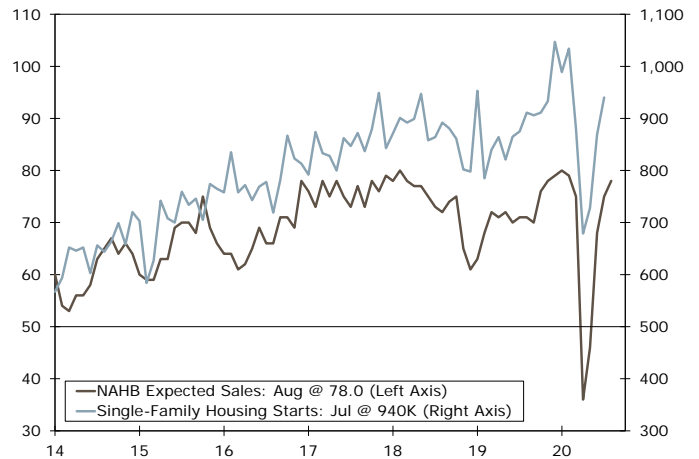
Single-Family Housing Starts vs. Building Permits
 SAAR, Millions, 3-Month Moving Average



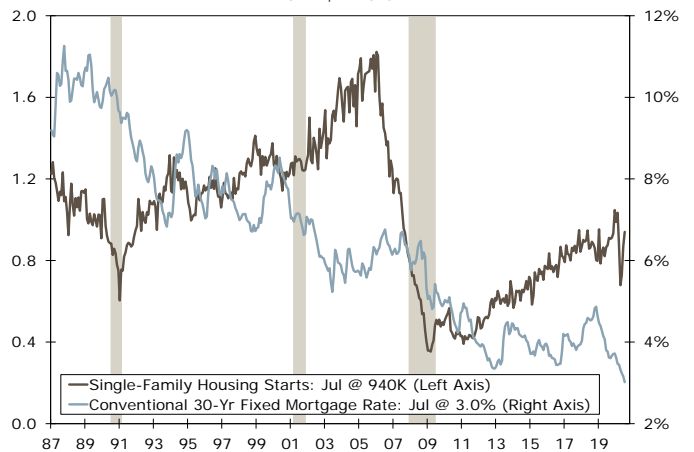
Single-Family Housing Starts
 Annual Average of SAAR, Millions



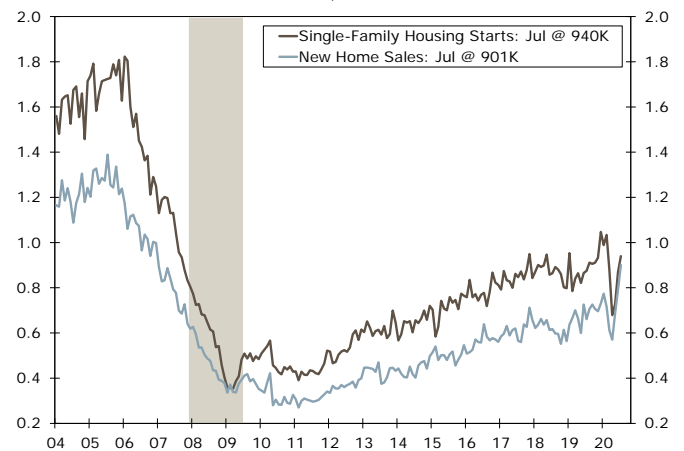
NAHB Expected Single-Family Home Sales vs. SF Starts
 Index: SAAR, Thousands



Single-Family Housing Starts vs. Mortgage Rate
 SAAR, Millions



Single-family Housing Starts vs. New Home Sales
 SAAR, Millions

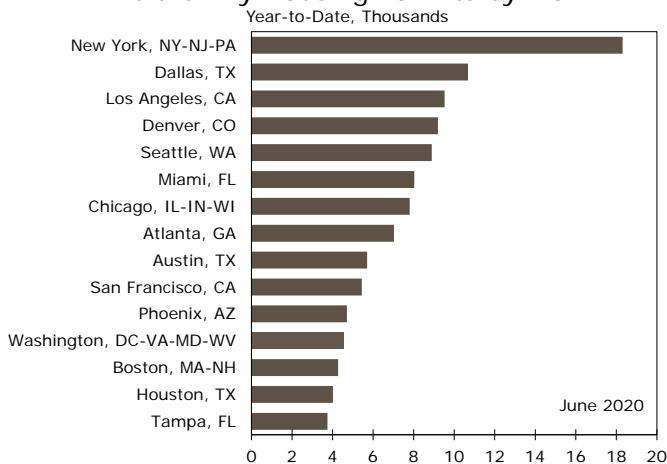


Source: U.S. Department of Commerce, National Association of Home Builders and Wells Fargo Securities

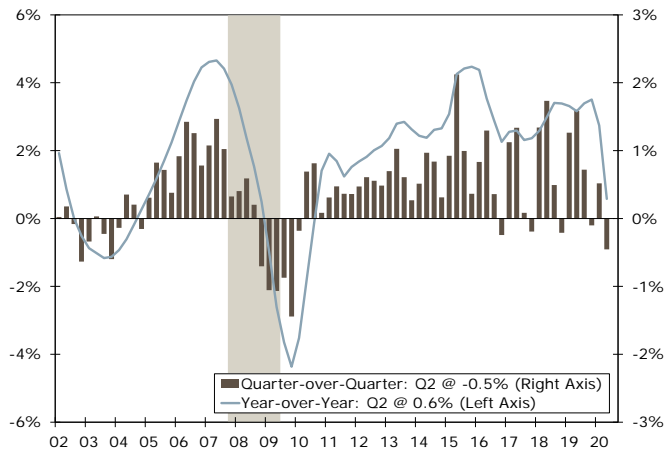
Multifamily Construction

- Multifamily construction is rebounding somewhat stronger than had been expected. New starts jumped 58.4% in July to a 556,000-unit pace. While that spike follows a lull during the lockdown period, multifamily starts through the first seven months of 2020 are running 14.6% ahead of their year-ago pace.
- Permits rose 22.5% in July, which makes sense given the big rise in starts. Most projects are started the same month a permit is pulled. On a year-to-date basis, permits are running 4.2% below its year-ago pace. We expect starts to slow in coming months.
- With the shine of urban living wearing off, activity appears to be picking up in many suburban markets in the Sunbelt. Credit underwriting for new projects has tightened, particularly in higher cost urban areas.

Multifamily Housing Permits by MSA

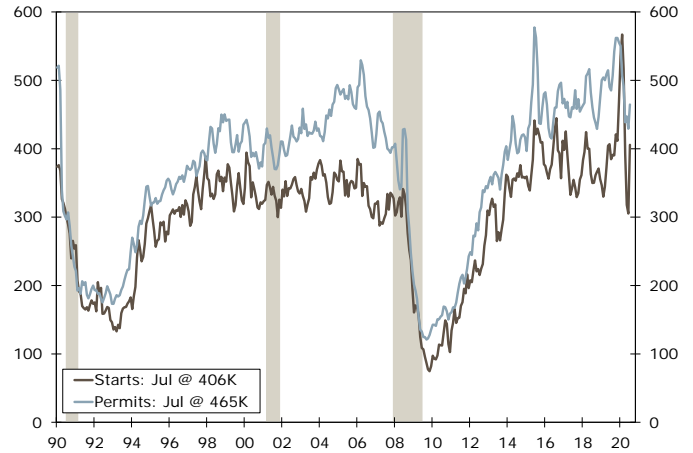


Apartment Effective Rent Growth



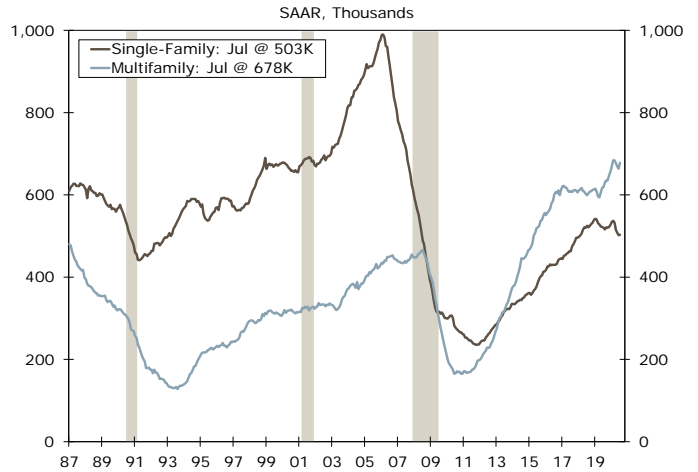
Multifamily Housing Starts vs. Building Permits

3-MMA of SAAR in Thousands



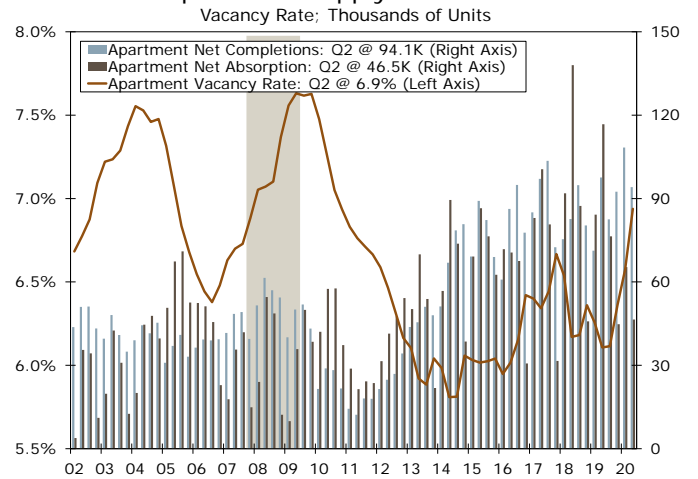
New Homes Under Construction

SAAR, Thousands



Apartment Supply & Demand

Vacancy Rate; Thousands of Units

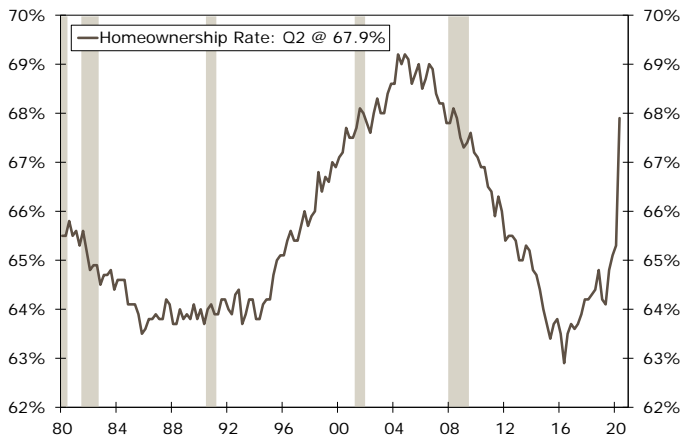


Source: U.S. Department of Commerce, CoStar, Inc. and Wells Fargo Securities

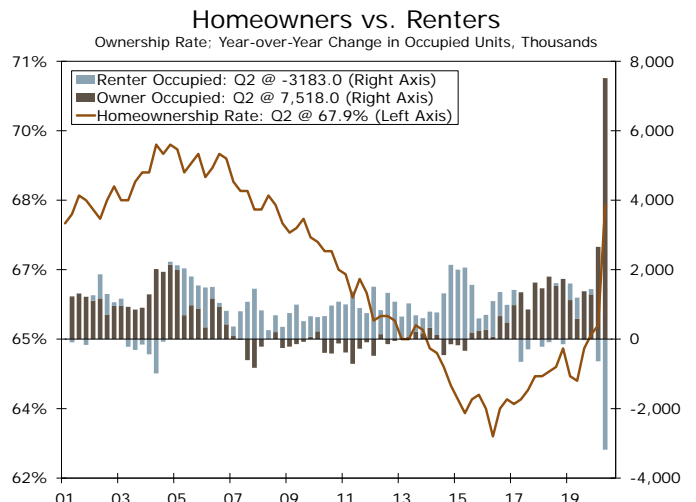
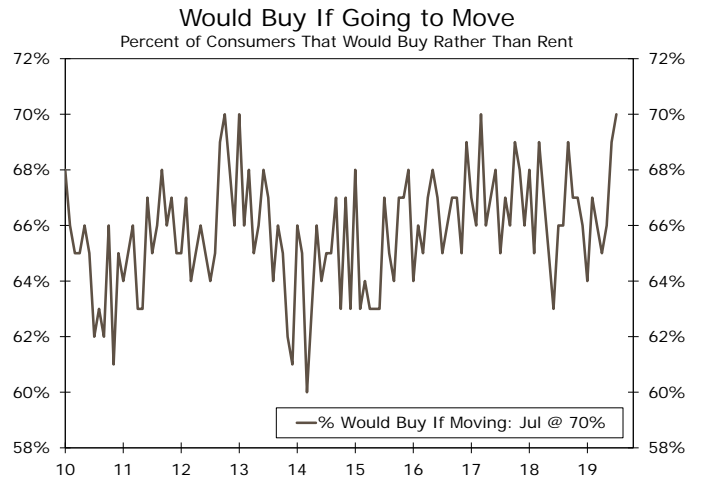
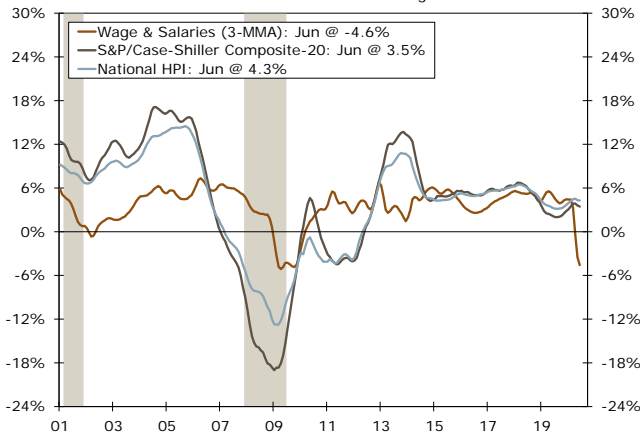
Buying Conditions

- Stimulus checks and more generous unemployment benefits at the onset of the COVID-19 crisis, helped many pay their rent or mortgage. A wave of delinquencies would have likely put more pressure on home prices and further tightened underwriting.
- Fannie Mae’s latest survey notes a big jump in the proportion of people stating they would buy rather than rent a home if they moved. Overall buying plans have improved less and even weakened in August.
- The homeownership rate surged to 67.9% in Q2, its highest level since 2008. The spike coincides with a decided shift toward home buying but overstates that shift. Census suspended in-person interviews due to COVID-19, and reported a sharply lower response rate. The sudden exodus of renters from high-cost cities also likely overwhelmed the seasonal factors.

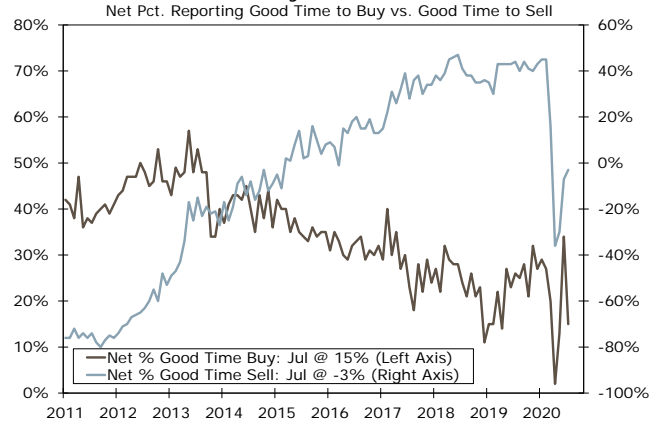
U.S. Homeownership Rate



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



Good Time to Buy vs. Good Time to Sell

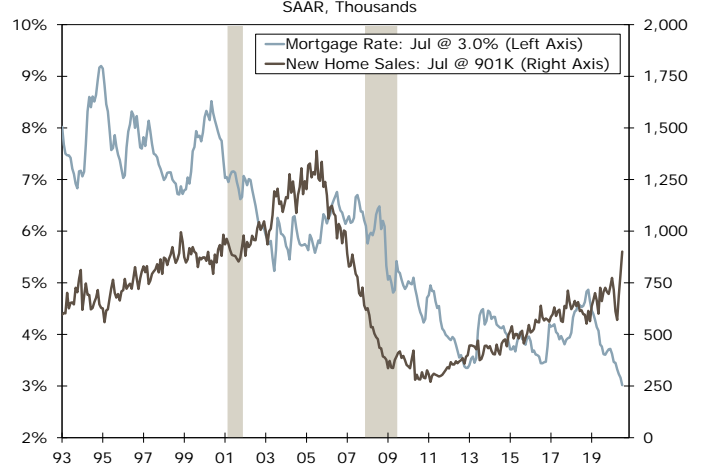


Source: University of Michigan, National Association of Realtors, The Conference Board, S&P, Fannie Mae, U.S. Dept. of Commerce and Wells Fargo Securities

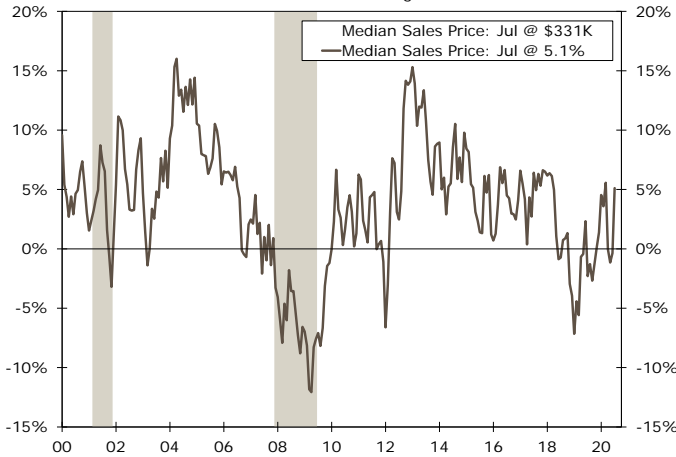
New Home Sales

- New home sales have rocketed higher over the past couple of months, surging 15.1% in June and 13.9% in July. The current 901,000-unit pace is the strongest since December 2006.
- The resurgence in home sales coincides with a sustained rise in mortgage applications. There appears to be a decided shift toward homeownership. New homes are a particularly good option for households looking for more space to accommodate remote work and tech gadgets.
- Inventories of new homes have been lean for some time and the recent jump in sales has cut them further. With more households in search of more living space and interest rates expected to remain low, residential development is increasing, particularly in the South and less expensive parts of the West.

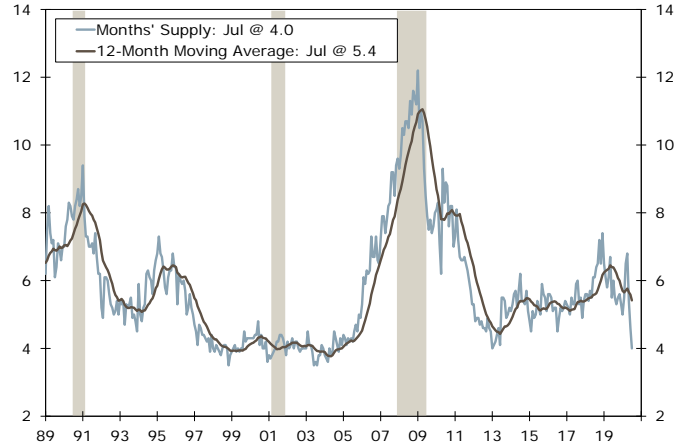
New Home Sales vs. Mortgage Rates



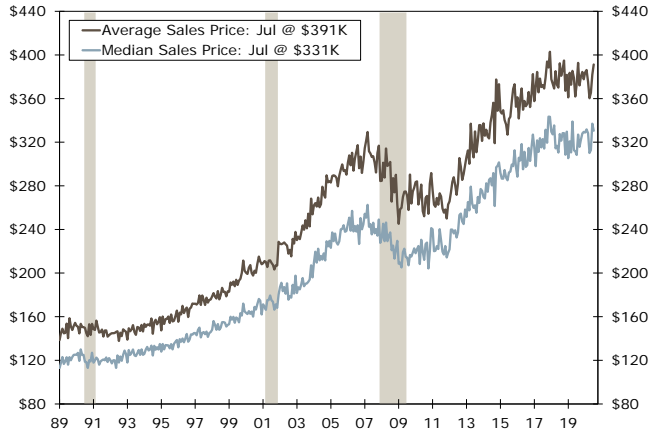
Median New Home Sales Price
 Year-over-Year Percent Change of 3-MMA



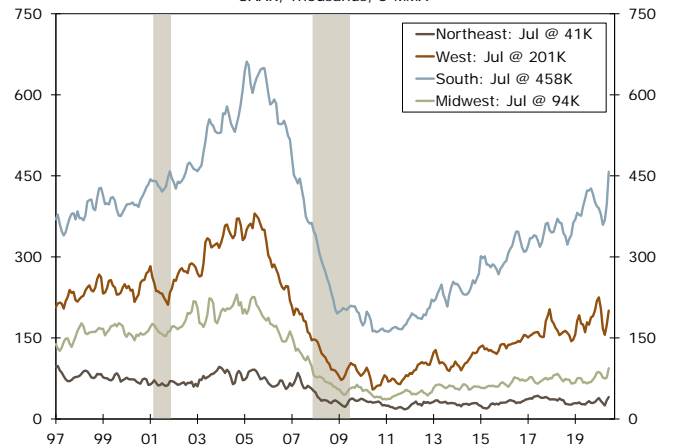
Inventory of New Homes for Sale
 Months of New Homes for Sale at Current Sales Rate



New Home Sale Price
 Thousands



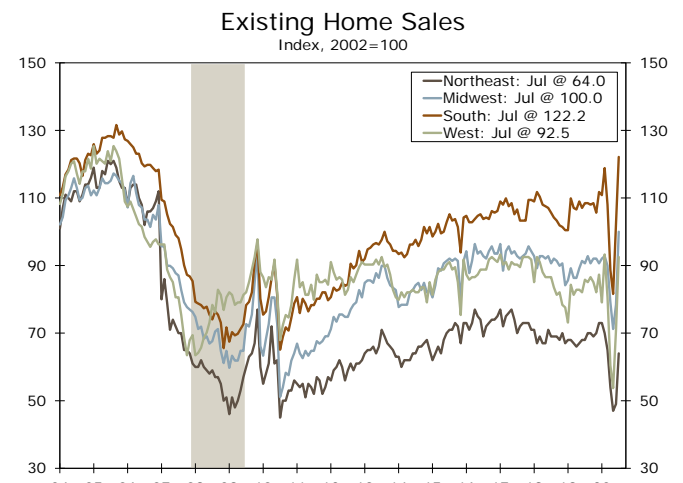
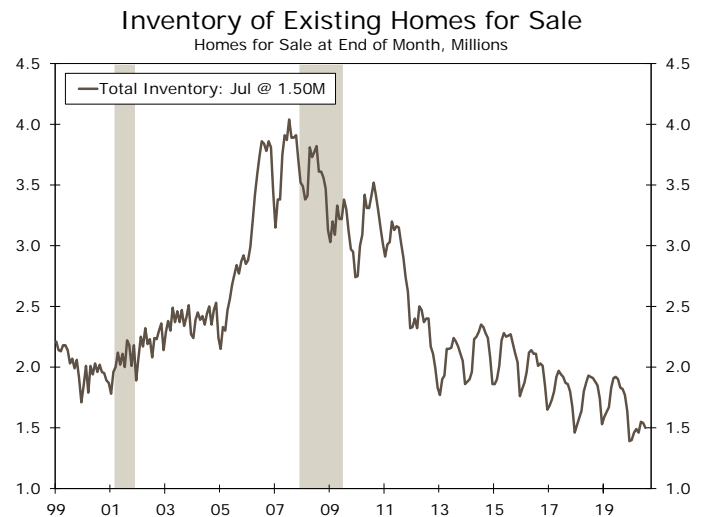
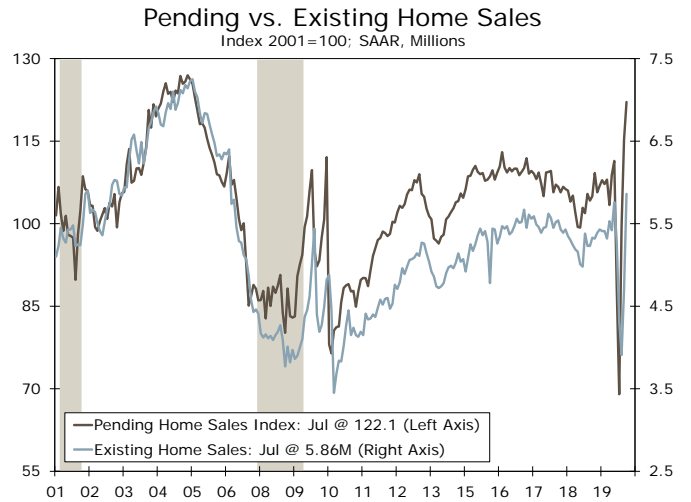
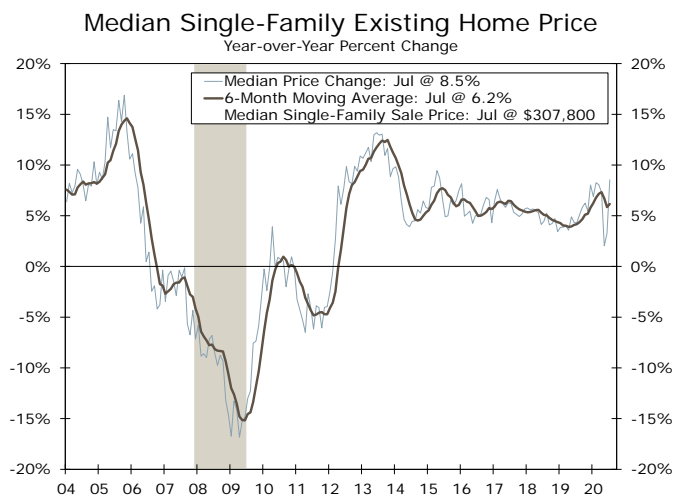
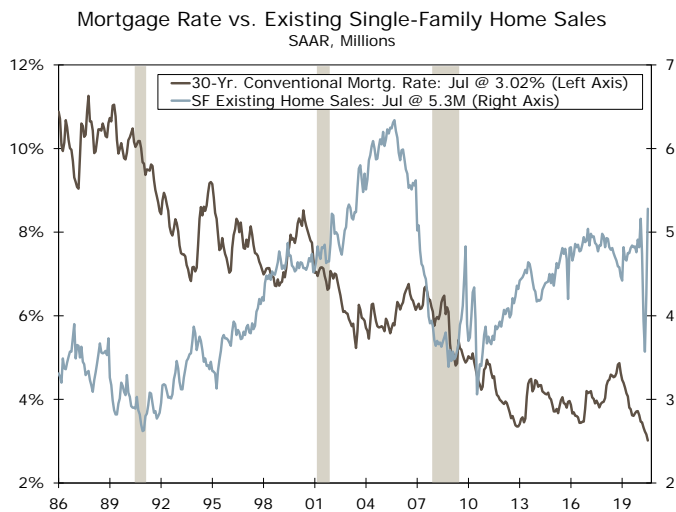
New Home Sales
 SAAR, Thousands, 3-MMA



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

Existing Home Sales

- Existing home sales skyrocketed a record 24.7% in July, following a 20.2% rise in June. The current 5.86-million unit sales pace is the highest since November 2006. The 49.9% rise in the sales pace since May likely reflects some catchup from earlier this spring, when showings were severely limited.
- A lack of homes available for sale remains an impediment for continued gains at such a rapid pace. For-sale inventories fell 2.6% to 1.5-million units, which is 21.1% below its year-ago level.
- Existing home sales should remain strong but will not likely rise another 20% plus over the next couple of months. Low inventories and higher prices will limit sales in the near-term. Lower price sales are also being held back by rising mortgage delinquency rates due to the increased use of forbearance.

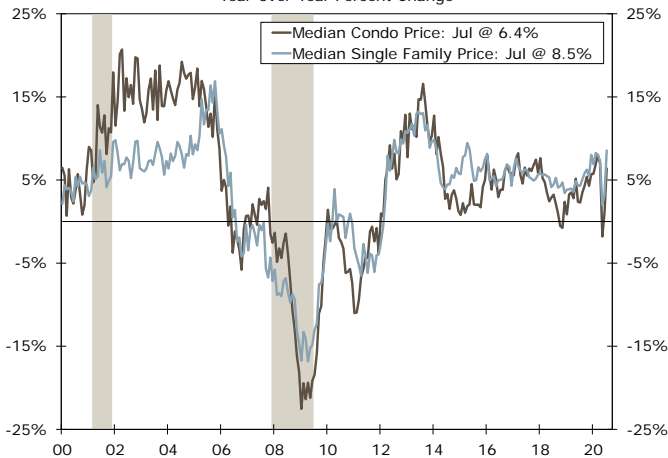


Source: National Association of Realtors, Freddie Mac and Wells Fargo Securities

Condos and Co-Ops

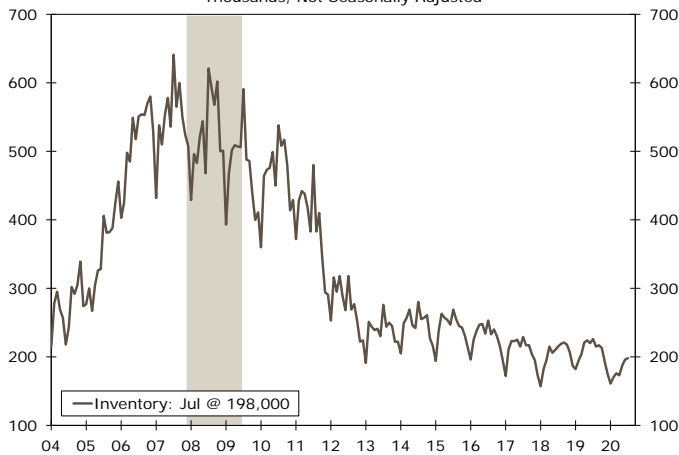
- Condo sales have roared back after hitting modern era lows a couple of months ago. Sales of existing condos and co-ops jumped 29.4% in June and a further 31.8% in July and now sit at 580,000-unit annual rate, which is just below their February high.
- Considering the most severe outbreaks of COVID-19 and social unrest have occurred in some of the largest condo markets—New York, Miami and Chicago—the volatility in sales is not surprising. We suspect seasonal factors exaggerated the improvement.
- Affordability may pull buyers into the condo market. Many older properties present a compelling value, particularly in parts of the South and West. Prices in the Northeast will likely remain under pressure, as outmigration from major cities accelerates and premiums for being near mass transit diminish.

Median Condo & Single Family Home Price
 Year-over-Year Percent Change



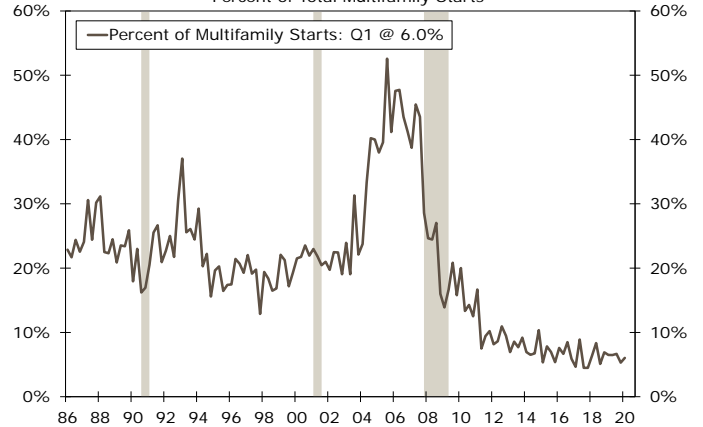
Condo Inventory

Thousands, Not Seasonally Adjusted



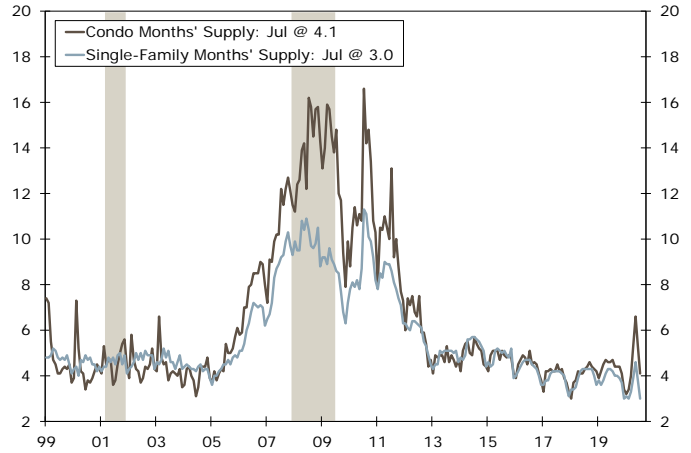
Multifamily Starts Intended for Sale

Percent of Total Multifamily Starts



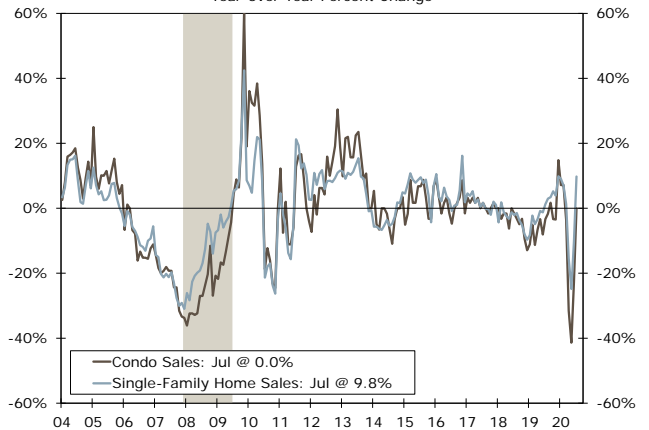
Existing Home Supply

Months



Single-Family Home Sales & Condo Sales

Year-over-Year Percent Change

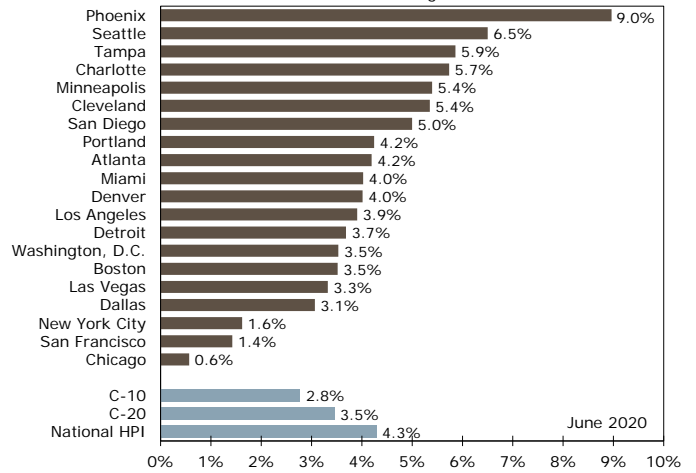


Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities

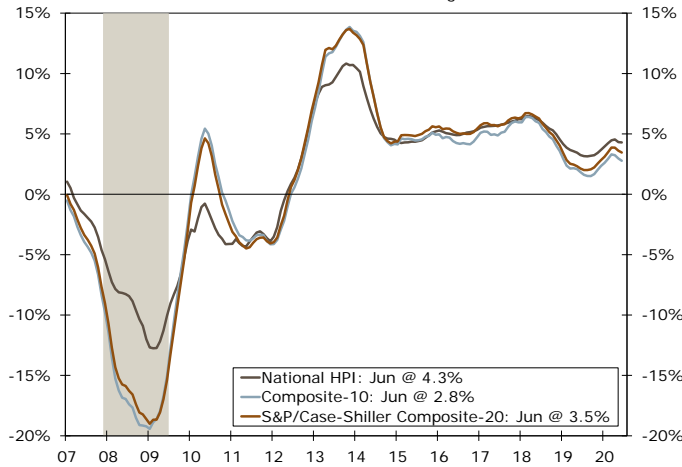
Home Prices

- Home prices have been bolstered by strong buyer demand. That said, we expect price appreciation to moderate this year. Like many parts of the economy we are seeing a high degree of bifurcation. There is growing preference to live just outside major cities or in walkable suburbs loaded with amenities. Rising construction costs, pulled up by surging lumber prices, will keep new home prices trending higher.
- The S&P CoreLogic Case-Shiller 20-City Home Price Index was unchanged in June and is up at just a 0.6% pace the past three months. That modest pace seems at odds with the recent surge in prices reported by Realtors and Census. Part of the split reflects a shift toward larger homes and intense bidding for the homes priced between \$200,000 and \$400,000, furthering both average and median home prices.

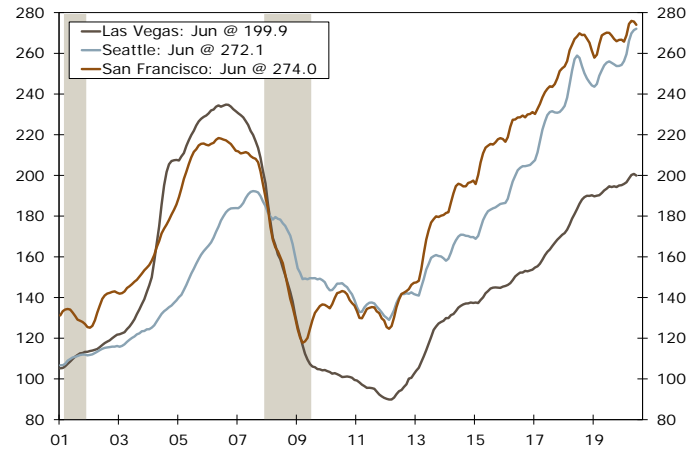
S&P CoreLogic Case-Shiller Home Prices
 Year-over-Year Percent Change, NSA



S&P CoreLogic Case-Shiller Home Price Index
 Year-over-Year Percent Change

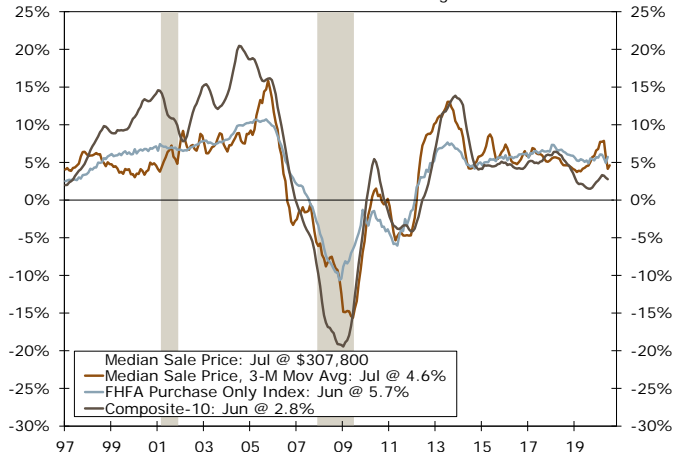


S&P CoreLogic Case-Shiller Home Price Index
 Index, January 2000=100



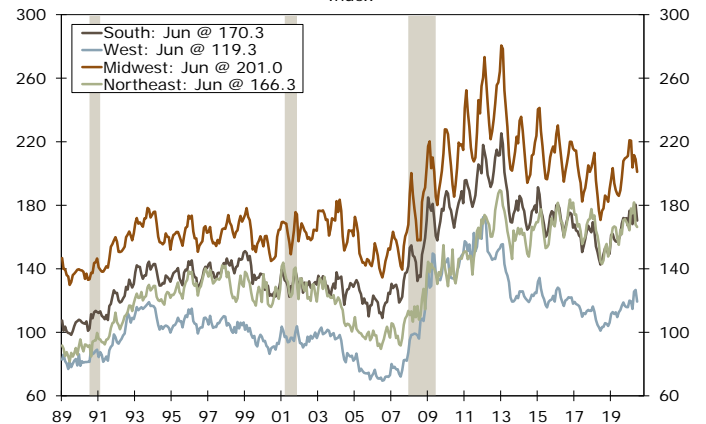
Home Prices

Year-over-Year Percent Change



Housing Affordability by Region

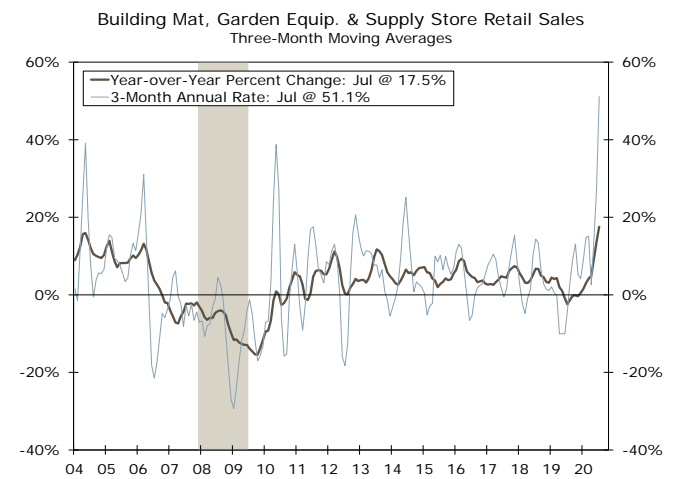
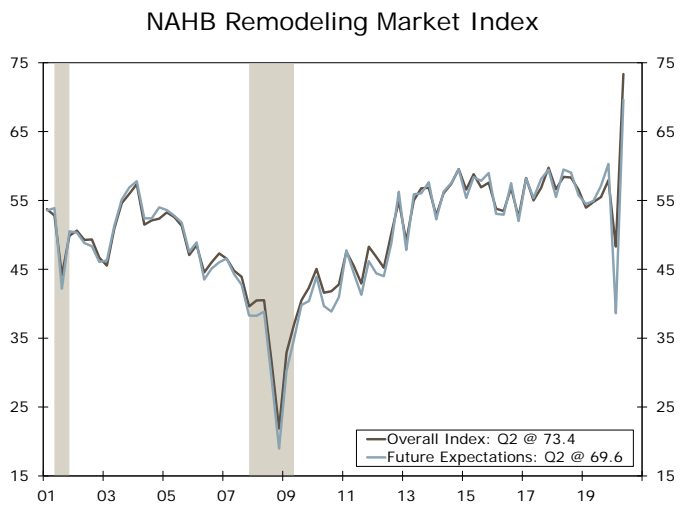
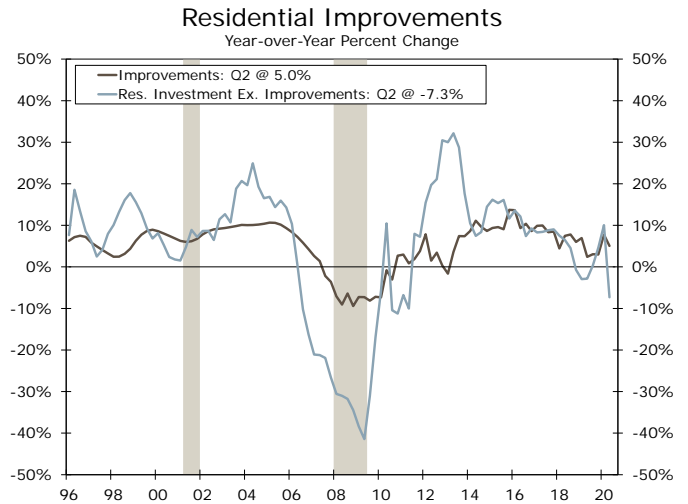
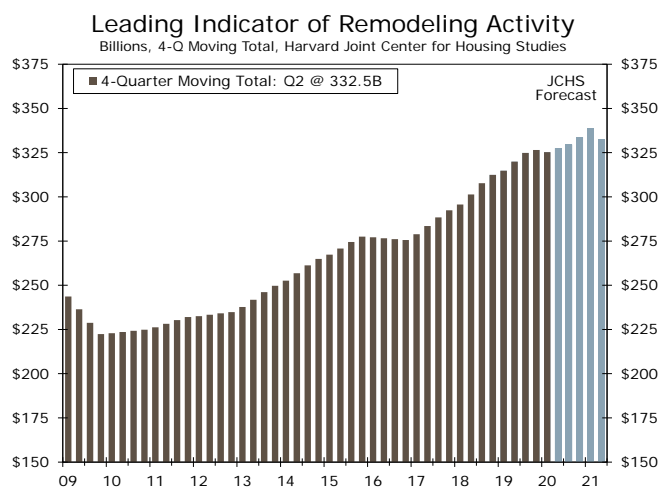
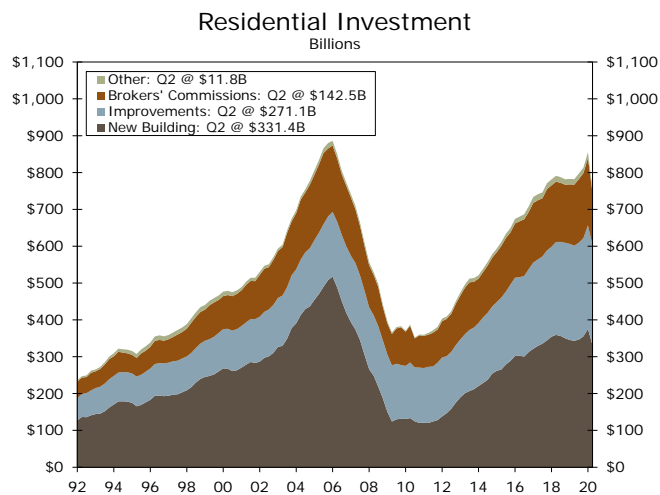
Index



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

Renovation and Remodeling

- Retail sales at building material stores have cooled off a bit but remain up 14.8% year-over-year. Overall residential improvement spending reportedly fell at a 13.5% annual rate in Q2. Spending is set to rebound in the current quarter.
- Residential remodeling payrolls added 52,700 jobs in May and June, partially recovering the 81,300 jobs lost during March and April. The swing highlights the improvement from the lows hit at the start of Q2.
- The NAHB Remodeling Index soared to 73.4 in Q2, the highest level on record. More time spent at home has spurred a boom in smaller renovation projects, such as home office or fitness room build outs. With unemployment still high, however, homeowners that feel less secure about their employment status are less inclined to splurge on home improvements.

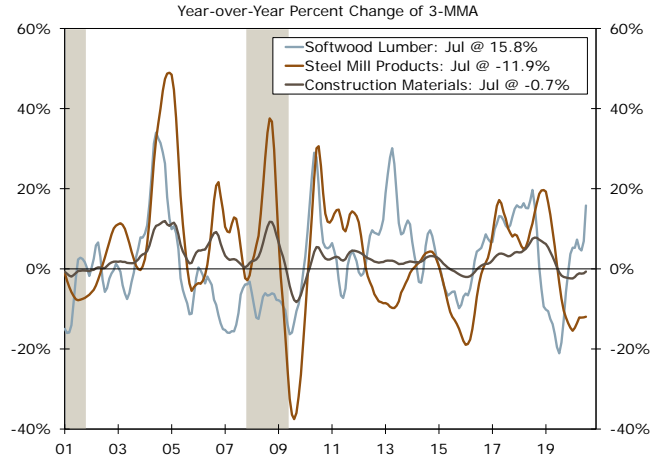


Source: Harvard Joint Center for Housing Studies, U.S. Dept. of Commerce, NAHB and Wells Fargo Securities

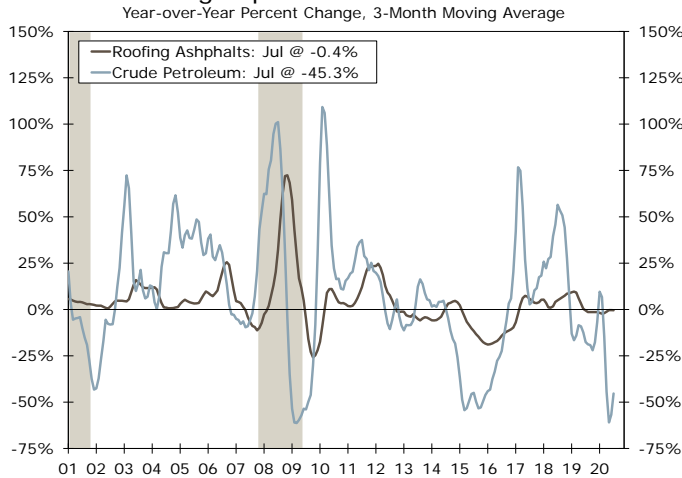
Construction Costs

- Languishing demand for building materials, owed to a drop-off in global economic activity, has pushed material prices lower. That said, the COVID-19 crisis appears to be having the opposite effect on lumber prices, which were up 26% year-over-year in July. During the lockdown, domestic lumber production was cut-back, and sawmills have had trouble keeping up with unexpectedly strong demand from builders.
- Framing lumber is a key input to residential construction, and a scarce supply threatens to delay new projects. Lumber also makes up over 17% of the total cost of building a new home, which may push new home prices higher.
- Inputs sourced globally, such as lighting fixtures, siding and flooring, are also in short supply, which has boosted prices and capital investment in the U.S.

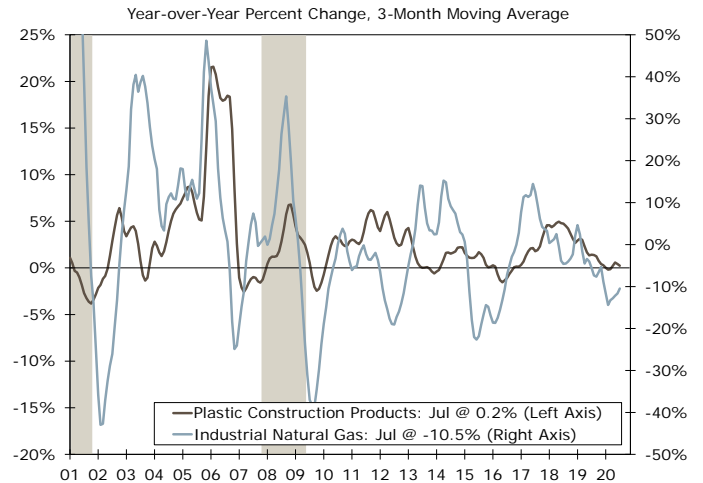
Construction, Lumber & Steel Prices



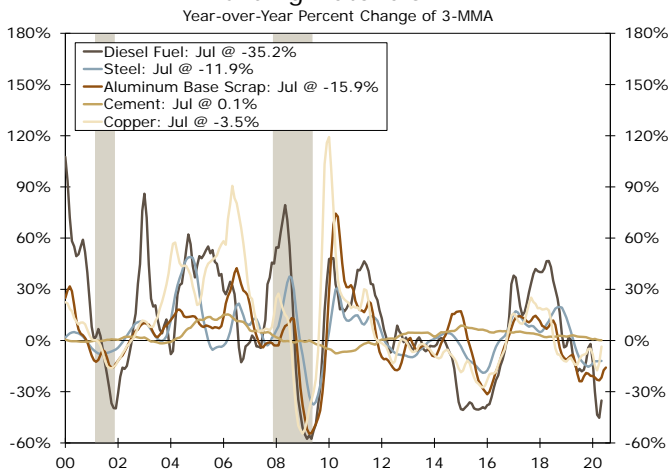
Roofing Asphalt vs. Crude Oil Prices



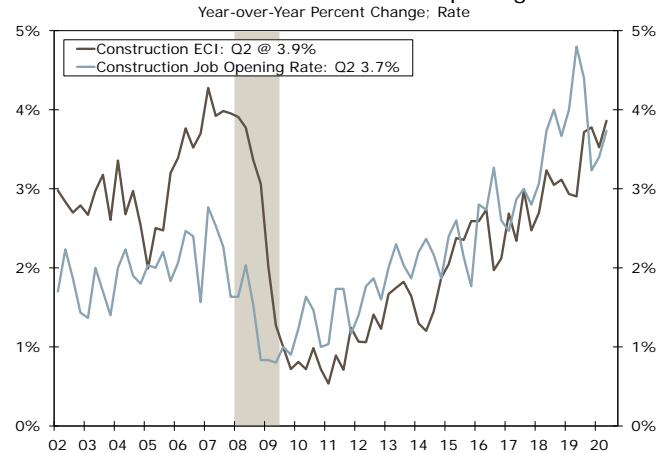
Plastic Constr. Products vs. Natural Gas Prices



Building Materials PPI



Construction ECI vs JOLTs Job Opening Rate



Source: U.S. Department of Labor, IHS Markit and Wells Fargo Securities

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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