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Economics Group

Special Commentary

Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277
Charles Dougherty, Economist
charles.dougherty@wellsfargo.com • (704) 410-6542
Nicole Cervi, Economic Analyst
nicole.cervi@wellsfargo.com • (704) 410-3059

Five Questions for Housing in 2021

Housing Flipped the Script on COVID in 2020. What Will Happen in 2021?

The pandemic wreaked havoc on most of the economy in 2020, with the notable exception of housing. The onset of lockdowns as well as the rise of remote work and remote schooling flipped the script on COVID by strengthening demand for single-family homes, townhomes and suburban apartments. Pandemic-driven job losses, however, also led to a spike in the number of people behind on mortgage and rent payments. Moreover, many homeowners have taken advantage of expanded forbearance options to put off mortgage payments. With vaccines now rolling out, questions are arising as to how long lasting these shifts will be. We address a few of these questions in this report and provide our insights into where we believe housing is headed in 2021.

One of the most frequent questions we get is what is the risk that the red-hot housing market will turn into a bubble?

Most of the housing bubble worries stem from the resurgence in home prices. The median price of an existing single-family home has surged 15.1% over the past year. The price spike, however, is the result of the sudden increased demand for housing rather than increased speculation. The pandemic has unleashed some unusual supply and demand dynamics. The surge in remote work and remote learning combined with the increased proportion of time that people are spending at home has set off a race for more living space. More apartment renters are looking to buy and more homeowners are looking to enhance their current homes or buy larger homes. This change in preferences results in an outward shift in housing demand that by itself drives home prices higher.

More apartment renters are looking to buy and more homeowners are looking to enhance their current homes or buy larger homes.

The supply of housing has also been disrupted. While more people want to buy homes, fewer want to sell them. The supply curve has shifted inward and the inventory of homes for sale has fallen to an all-time low. Folks that were thinking about downsizing are now holding onto their current homes because they need them for workspace or to house their adult children returning from school or urban apartments. Rather than selling, many homeowners are investing in upgrades, increasing demand for remodelers and driving up sales at home improvement centers.

Figure 1

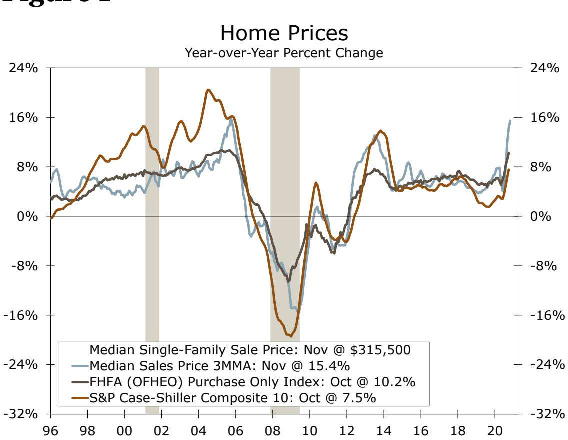
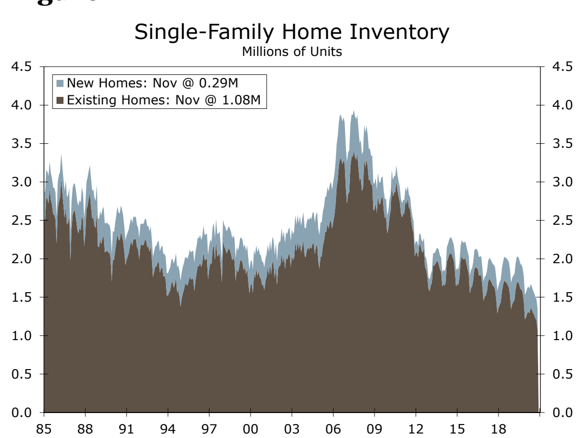


Figure 2



Source: U.S. Department of Commerce, FHFA, S&P CoreLogic Case-Shiller and Wells Fargo Securities

The CARES Act provided some short-term relief to struggling homeowners.

The supply of housing is being constrained by other factors as well. The CARES Act provided some short-term relief to struggling homeowners. The expansion of mortgage forbearance allowed homeowners to delay monthly payments by making one-time payments, paying back over time, modifying the loan or tacking the payment on to the end of the loan, effectively extending the term of the loan. One byproduct has been fewer foreclosures. Black Knight Financial, a leading provider of mortgage analytics, shows the number of properties in foreclosure pre-sale inventory fell to just 176,000 in November from 248,000 last November. Since distressed sales are typically done at a discount, the lack of foreclosures tends to exaggerate the year-over-year rise in home prices. The shift in preferences to larger homes and lack of foreclosures is one reason that average and median home prices have increased much more than prices in repeat-sales indices, such as the S&P CoreLogic Case-Shiller and FHFA Home Price Index.

Perhaps the greatest difference with what was seen in the bubble years is the greater discipline on the part of lenders. Mortgage underwriting tightened at the onset of the pandemic and remains fairly tight today. The average FICO score for conventional mortgages originated for the purchase of a home was 758 in November, according to Ellie Mae. Fewer than 10% of mortgages were originated by buyers with FICO scores of 655 or less. For refis, the average FICO score was 765 and cash-out refinancing's are nowhere near as prevalent as they were in the bubble years. Homeowners also have substantially more equity in the homes today. Federal Reserve data show single-family home equity at record $20.4 trillion, or nearly two-thirds of single-family housing values. Moreover, with lower mortgage rates, many homeowners have been able to refinance their mortgages at lower rates, reducing their monthly payments and enhancing their creditworthiness.

Another repeated concern is what happens when forbearance ends? Will there be a surge in foreclosures? And if so, how will that impact the broader housing market?

Problem loans are not nearly as concentrated as they were during the bubble years.

Foreclosures will increase once moratoriums end, but we doubt that we will see a surge in foreclosures once forbearance programs end. Forbearance has proven remarkably successful. The share of mortgages in forbearance, tracked by the Mortgage Bankers Association, surged in April and May but has been generally edging lower since June, with many of the borrowers exiting forbearance either making their mortgage payments or modifying their mortgages. Data from Black Knight Financial shows the number of properties that are delinquent but not in foreclosure has risen 81% to 3,381,000. Of this total 2.2 million loans are seriously delinquent, meaning 90 days or more past due. While these numbers are problematic, they include mortgages in forbearance, many of which will effectively see their maturity extended, with little negative impact to the homeowner. To the extent that foreclosures increase, and they will, we do not expect them to weigh too heavily over the market. Problem loans are not nearly as concentrated as they were during the bubble years and the housing market is currently undersupplied. There may be some issues in slow growing states that have taken major hits, like Mississippi and Louisiana. States that are heavily dependent on tourism are also struggling a bit more, most notably Nevada and Hawaii.

Figure 3

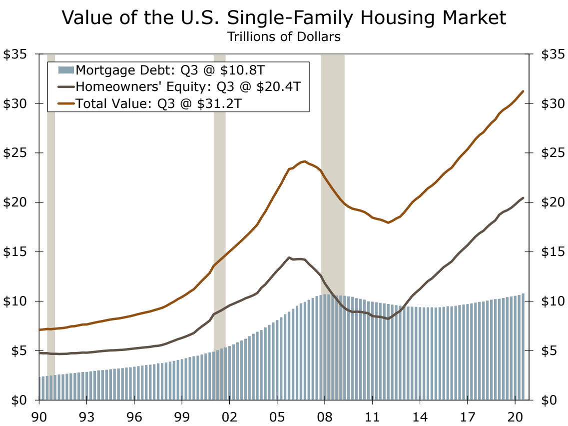
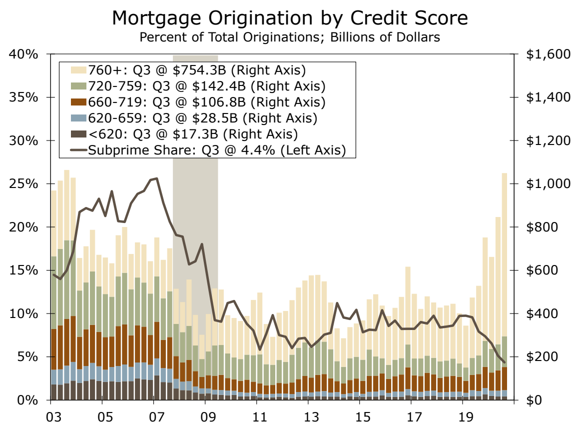


Figure 4



Source: Federal Reserve Board, Federal Reserve Bank of New York and Wells Fargo Securities

The pandemic also upended the resurgence in many urban areas and some of the larger and most dense areas have seen significant population outflows. The shift has raised questions on whether the urban renaissance is over and what that would mean for the apartment market?

The move back to the nation's center cities was one of the more heartening trends to take hold in the aftermath of the housing bust. The shift began in San Francisco when Yelp and Twitter announced they would locate in the South of Market district of downtown San Francisco. Tech companies had previously preferred to locate in suburban locations along the San Francisco Peninsula or in Silicon Valley. Like many trends that begin in the West, the move back to the cities spread across the nation and gained momentum over the course of the decade, with urban areas outgrowing suburban areas during the first half of the decade.

Urban areas outgrew suburban areas during the first half of the decade.

The move back into the cities not only fueled demand for apartments but also ushered in a renaissance in dining and entertainment. Sports facilities moved back into the city and often were surrounded with apartments, offices, restaurants, bars, breweries and other entertainment venues. As warehouses and other buildings were repurposed and revitalized, property values shot up and soon the majority of new apartment development shifted toward luxury lifestyle apartments. As many long-time residents were priced out, a backlash against gentrification took hold. Once again, this backlash began in San Francisco and quickly spread. The second half of the decade saw urban population growth moderate, with the suburbs outpacing the center cities again.

Affordability has been a persistent challenge for the apartment market. Harvard's Joint Center for Housing Studies noted that roughly 25% of apartment renters were severely rent burdened throughout much of the past decade, meaning housing costs consumed more than half their household income and another 10% of renters were moderately rent burdened, meaning 30% to 50% of income was devoted to housing costs. The problem was most acute in Southern California and South Florida. Burdens were lower in Manhattan and San Francisco because incomes were so high there. Higher-income households accounted for the bulk of the growth in renter households this past decade, particularly urban renters. This helps explain why high-end lifestyle apartment development accounted for over half of new apartment construction right up until the pandemic.

Higher-income households accounted for the bulk of the growth in renter households this past decade.

When the COVID lockdowns hit and remote work took off, restaurants, bars and entertainment venues largely emptied out. The value renters placed on proximity to these amenities quickly evaporated and renters fled higher-cost areas, often moving back in with relatives or renting lower cost apartments in near-in or distant suburbs. As the out-migration from higher-cost, densely-populated urban centers, such as Manhattan and San Francisco, significantly accelerated, demand cooled substantially in most major urban apartment markets. A handful of metros, most notably Raleigh, Charlotte and Dallas, have held up better than most, but even in these markets demand has shifted toward lower-cost suburban areas, which are now outperforming urban areas.

Figure 5

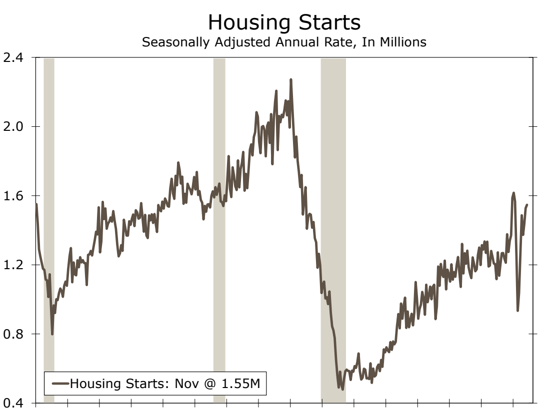
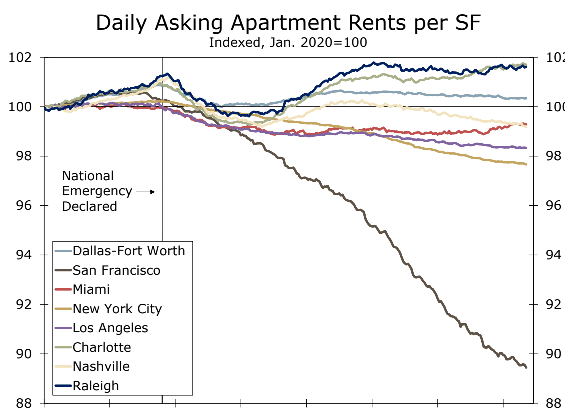


Figure 6



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

We expect the move to lower-price markets to persist into the early years of the economic recovery. The majority of office work, however, will continue to be done in office buildings, particularly in creative industries where collaboration plays a critical role in driving innovation. San Francisco, Silicon Valley, Los Angeles and Manhattan no longer have a lock on the creative industries long centered in their areas, however. Several metro areas, most notably Austin, Dallas, Denver, Atlanta, Nashville, Raleigh, Charlotte and Miami, have developed substantial ecosystems and attained the critical mass of young talent needed to compete with these established globally-connected hubs for corporate headquarters, research facilities, movie, music and digital entertainment studios and other facilities. Several of these markets have also developed sizable startup communities. These factors, along with the increased ability to work remotely, suggest the shift away from high-cost gateway cites appears set to persist through the early years of the coming decade.

Apartment development will shift away from urban centers toward more affordable suburban areas.

We see the demand for apartments shifting toward these sizable mid-sized metro areas. Apartment development will shift away from urban centers toward more affordable near-in suburbs, suburban areas and even the exurbs. Smaller markets near high-cost metro areas will also see increased development. While vacancy rates will tick higher in 2021 and rents will decline, the apartment market is not as overbuilt as the topline fundamentals suggest. The mix of apartments was simply weighted too heavily toward high-end, urban, lifestyle apartments. Demand for more modestly priced apartments remains strong and development will shift toward markets that offer more opportunities for this type of development. We also believe that apartments with access to mass transit will also remain in high demand, despite the massive drop in mass transit use.

Will the surge in delinquent rents weigh on the economic recovery?

Following the unprecedented spike in initial unemployment claims at the start of the pandemic, there was a great deal of speculation about how many people would have trouble making timely rent payments. Many state and local governments quickly enacted eviction moratoriums, which alleviated some immediate fears about public welfare but amplified fears about landlords' capability to make their own financial commitments following a surge in missed rent payments. Forecasts of the potential shortfall in rent collections mounted much more quickly than actual data on rent collections. In short, a larger proportion of apartment renters have been able to make timely rental payments. This is not to say that there are no problems. A large percentage of renter households, particularly lower income households, report that they are behind in their rent.

Many of the early forecasts on rental delinquencies are based on data from the weekly Household Pulse Survey conducted by the Census Bureau. The survey asks renters what their level of confidence is that they will be able to make next month's rent payment. Respondents can answer no confidence, slight confidence, moderate confidence or high confidence. Fortunately, a relatively large proportion of renters have been able to make timely payments, even among those who stated they had no confidence or only slight confidence of their ability to pay next month's rent.

Figure 7

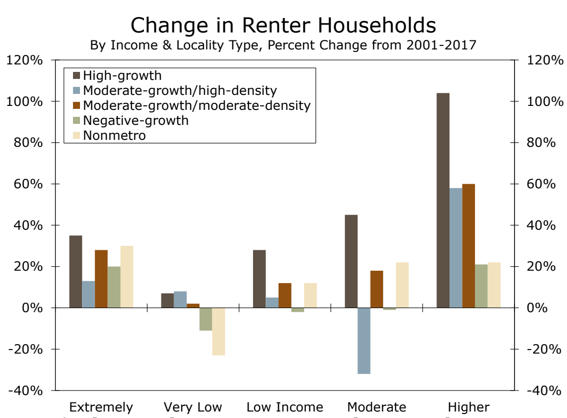
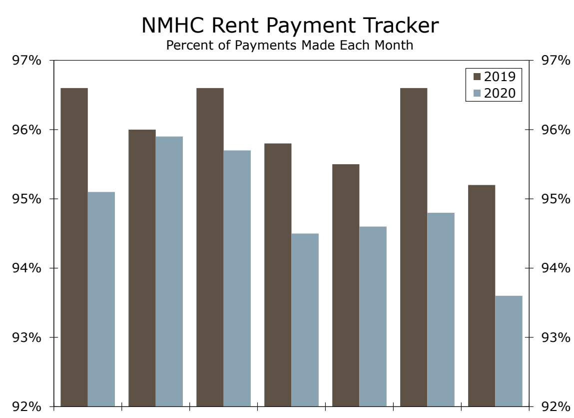


Figure 8



Source: U.S. Government Accountability Office, NMHC and Wells Fargo Securities

The Census Bureau reports approximately 16.2% of the 44.7 million renter households were behind in their rent in early September, or some 7.24 million renters. While that percentage might fall over the course of the month, as some households make partial payments from week to week, a large proportion of those reporting they were behind in rent said they are not at all confident they will be able to make next month's rent, while 14.9% (1.08 million) and 30.5% (2.21 million) said eviction was either "very likely" or "somewhat likely" in the next two months, respectively.[1]

While the Census data are stark, they are hardly representative of the entire rental market. Just over 60% of renters that are behind in their rent live in single-family homes, duplexes, triplexes and quadplexes. These categories of homes account for about 55% of the stock of rental housing. The vast majority of these properties are owned by individual "mom-and-pop" investors. By contrast, the share of renters behind in their rent in professionally managed, multifamily properties is much smaller. The National Multifamily Housing Council (NMHC), which surveys 11.5 million professionally managed units, reports a much higher proportion of renters are paying their rent. The comparable numbers for the September Census data show 90.1% of professionally-managed apartment households made full or partial payments by September 20. The most recent data show some slippage, with 89.8% of rental households making full or partial payments.[2]

A disproportionate share of lower-income households rent from "mom-and-pops" and account for the bulk of rental delinquencies.

The split between "mom-and-pops" and professionally managed properties is an important distinction. A disproportionate share of lower-income households rent from "mom-and-pops" and account for the bulk of rental delinquencies. This is hardly surprising, as lockdowns have disproportionately impacted lower-income households. Workers employed in high-contact industries, including restaurants, bars, hotels, entertainment venues, hair salons and fitness studios, have endured a disproportionate share of job and income losses.

Given that the bulk of demand for professionally managed apartments comes from higher-income households, many of which can work remotely, the stronger performance from professionally-managed properties also makes a great deal of sense. While their future has been less negatively impacted, the attraction of the high-priced rental apartment is not what it was prior to the pandemic. Vacancy rates will likely rise a bit from current levels, particularly in markets that have lots of new apartments being completed. The ability to raise rents will likely be inhibited until nonfarm employment recovers more fully. Large, rapidly growing, dense, urban areas may be most impacted. This is where the bulk of apartment development occurred leading up to the pandemic. While higher-income renters accounted for a large proportion of the growth in these markets, recent evidence shows renters are pivoting toward suburban areas and less dense metro areas.

Figure 9

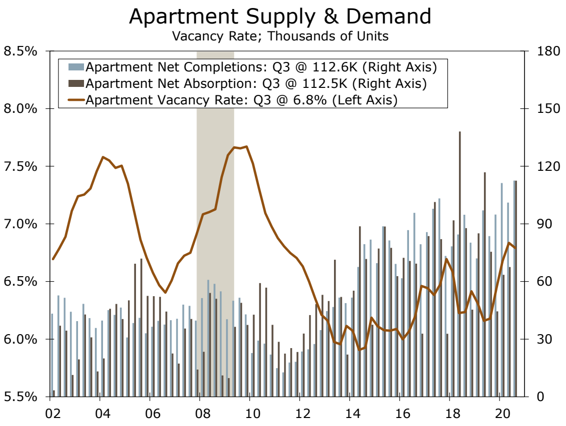
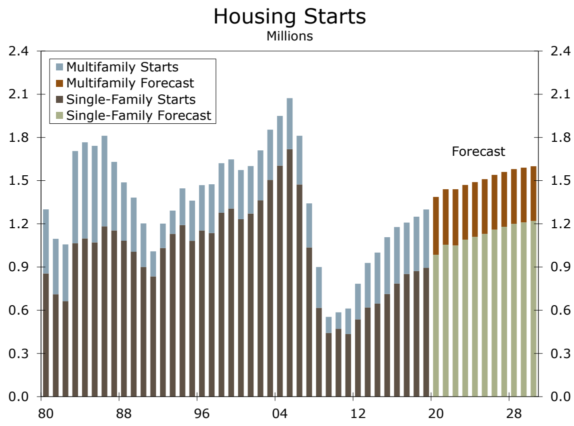


Figure 10



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

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[1] **"The Census Phase 2 Household Pulse Survey and Rental Housing During the Pandemic."** ***PD&R Edge*. September 28, 2020.**

[2] **"NMHC Rent Payment Tracker Finds 89.8 Percent of Apartment Households Paid Rent as of December 20."** ***National Multifamily Housing Council*. December 22, 2020.**

The hardships experienced by workers in high-contact occupations are considerable and relief programs such as the CARES Act provided significant help earlier in the year. Several important aspects of the CARES Act have expired, most notably expanded unemployment benefits. Many renters have had to subsequently borrow from relatives or take on credit card debt in order to try to remain current with their rent and other financial obligations. Others have moved in with friends or relatives. The recently enacted $900 billion relief package will provide some assistance to renters that are behind or having difficulty making their rent payments.

Even with additional assistance, renters and landlords will not be made whole by a longshot. A recent report from the Federal Reserve Bank of Philadelphia projects that, by the end of 2020, 1.34 million renter households, or about 4% of renter households, will owe $7.2 billion in back rent, or about $5,400 per household. The weakened financial position of renters and the slow and protracted recovery for high-contact parts of the economy means mom-and-pop rentals are likely to struggle in 2021, even with stronger overall economic growth. Given the rise in delinquent rent collections, owners of smaller rental properties will also face more pressure to sell their properties.[3]

After ramping up over the summer, home sales lost a little momentum toward the end of 2020. Where do you see the housing market in 2021 and what are some possible wildcards?

Home sales and new home construction should strengthen further in 2021.

Home sales and new home construction should strengthen further in 2021. We are looking for new home sales to rise 16% to 940,000 units, which would be the strongest year since 2006. Sales of existing single-family homes are expected to rise 4.0%, while sales of existing condominiums and co-ops should rise 2.6%. Sales would be even stronger if there were more homes available for sale. We expect the inventory situation to improve moderately in 2021, as the vaccine rollout should enable more people to put their homes up for sale and encourage folks that put off relocating, trading up or downsizing during the pandemic to go ahead and do so, resulting in more housing turnover. Foreclosure and distressed sales will also increase from their current low levels.

Single-family construction should build on this past year's strong momentum. After rising 11.0% in 2020, we look for single-family starts to rise 7.1% in 2021. The outlook for single-family construction has been clouded by concerns that some of the deluge in recent home buying has been due to a temporary, pandemic-driven effort to secure enough space to work remotely and accommodate children's education needs. Even if these influences decline, however, we suspect that stronger job and income growth, near record-low mortgage rates, positive demographic influences—such as more Millennials marrying and having children and more Baby Boomers retiring to the Sun Belt—as well as lessening fears about the pandemic should ease up mortgage underwriting and will send demand higher.

Affordability, or more aptly the lack of affordable homes, remains the biggest challenge for the housing market. We believe buyers will respond to this by shifting their attention to the suburbs and exurbs of their current market or relocating to more affordable second-tier large metro areas, such as Phoenix, Dallas and Atlanta, as well as rapidly growing larger metro areas such as Austin, Nashville, Tampa, Jacksonville, Charlotte and Raleigh. Recent data from Redfin and LinkedIn show a marked acceleration in relocations to these areas and home sales and new construction remains exceptionally strong in all of these areas. Growth is even more robust in many mid-sized and smaller markets, albeit starting from a smaller base, driven by both the need to find more affordable communities to live in and the greater ability to work remotely.

The vaccines should gain the upper hand on the virus this spring and set the stage for a strong spring and summer.

The intensifying pandemic and ongoing rollout of vaccines remain the biggest wild cards for the housing outlook, as well as the overall economy. We suspect that rising infections and overwhelmed hospital systems will keep many potential buyers on the sidelines during the first few weeks of 2021. The vaccines should gain the upper hand on the virus by this spring and set the stage for a strong spring and summer selling season. Shortages of buildable lots, some key building materials and skilled workers will also remain a challenge for homebuilders, particularly tract builders targeting middle-income and lower-middle-income buyers.

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[3] **"Mounting Pressures on Mom-and-Pop Landlords Could Spell Trouble for the Affordable Rental Market."** ***Urban Institute*****. November 10, 2020.**

National Housing Outlook

								Forecast		
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP, Percent Change	1.8	2.5	2.9	1.6	2.4	2.9	2.3	-3.5	4.5	4.6
Residential Investment, Percent Change	12.4	3.8	10.2	6.5	3.5	-1.5	-1.5	5.1	12.5	7.4
Nonfarm Payroll Change (Avg. Monthly)	192	250	227	195	176	193	178	-781	446	248
Unemployment Rate	7.4	6.2	5.3	4.9	4.3	3.9	3.7	8.1	6.3	5.2
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	1,387.0	1,440.0	1,490.0
Single-Family Starts, in Thousands	617.7	647.8	714.6	781.5	848.9	875.8	887.7	985.3	1055.0	1100.0
Multifamily Starts, in Thousands	307.2	355.5	397.3	392.2	354.0	374.2	402.3	401.7	385.0	390.0
Home Sales										
New & Existing Home Sales, in Thousands	5,516	5,374	5,755	6,013	6,124	5,960	6,026	6,320	6,660	6,900
New Home Sales, Single-Family, in Thousands	429	439	501	561	613	617	682	810	940	1,020
Total Existing Home Sales, in Thousands	5,087	4,935	5,254	5,452	5,511	5,343	5,344	5,510	5,720	5,880
Existing Single-Family Home Sales, in Thousands	4,484	4,344	4,646	4,838	4,892	4,742	4,765	4,925	5,120	5,260
Existing Condominium & Co-op, in Thousands	603	591	608	614	619	601	579	585	600	620
Manufactured Homes										
Total Shipments, in Thousands	60.2	64.3	70.5	81.1	92.9	96.6	94.6	94.2	96.3	98.6
Percent Change	9.7	6.8	9.7	15.0	14.5	3.9	-2.0	-0.5	2.3	2.4
Home Prices										
Median New Home, $ Thousands	268.9	288.5	294.2	307.8	323.1	326.4	321.5	331.5	342.0	351.5
Percent Change	9.7	7.3	2.0	4.6	5.0	1.0	-1.5	3.1	3.2	2.8
Median Existing Home, $ Thousands	197.1	208.3	222.4	233.8	247.2	259.3	271.9	291.5	314.8	335.1
Percent Change	11.5	5.7	6.8	5.1	5.7	4.9	4.9	7.2	8.0	6.4
FHFA Purchase Only Index, Percent Change	7.0	5.0	5.3	5.8	6.4	6.5	5.3	5.7	5.8	5.4
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	2.8	3.5
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	0.25
Prime Rate	3.25	3.25	3.27	3.52	4.13	4.96	5.25	3.25	3.25	3.25
10-Year Treasury Note	2.35	2.54	2.14	1.84	2.33	2.91	2.14	0.74	1.24	1.58
Conventional 30-Year Fixed Rate, Commitment Rate	3.98	4.17	3.85	3.65	3.99	4.54	3.94	3.05	2.96	3.28

Forecast as of: December 29, 2020

Source: U.S. Department of Commerce, U.S. Department of Labor, FRB, FHFA, FHLMC, National Association of Realtors, S&P 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
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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