

2008 Housing Outlook

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Please see the disclosure appendix of this publication for certification and disclosure information.

Boom/Bust Hypothesis

We have examined the evidence for boom/bust cycles in past Webcasts. The evidence for boom/bust cycles is weak absent an economic shock.

Here, we regress one-year HPA as a function of five-year HPA (we know there is an endogeneity problem). The best fit produces an R2 of 0.02 and a correlation coefficient of -0.15.

This suggests some evidence of mean reversion but does not provide strong support for the boom/bust hypothesis.

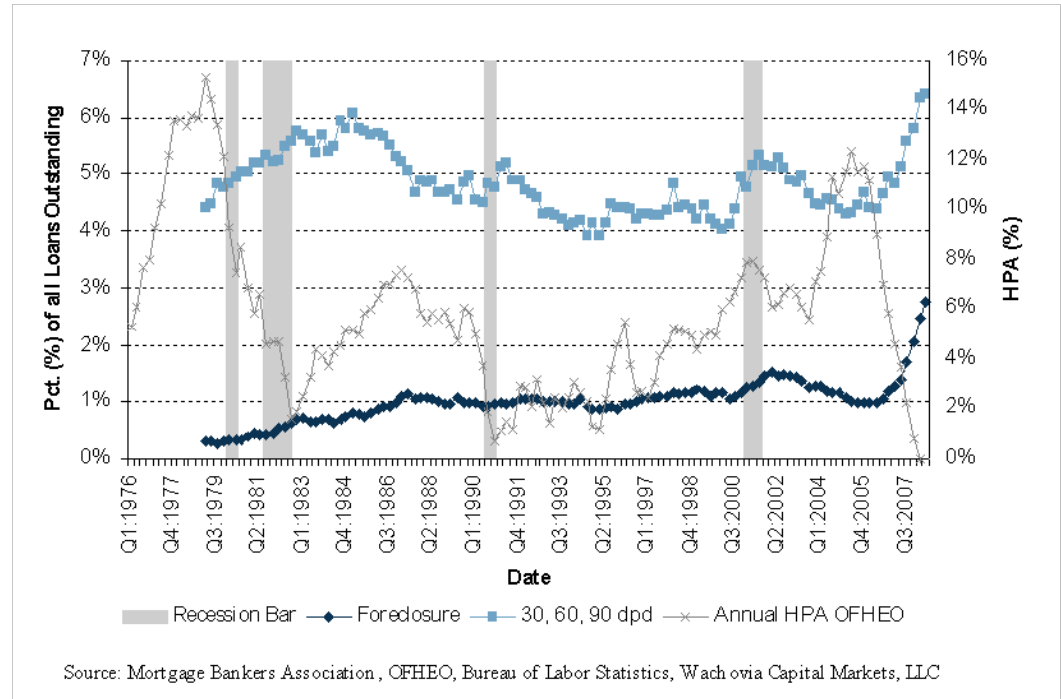


MBA Foreclosure and Delinquency Statistics

The Mortgage Bankers Association series goes back to Q1 1979 and covers the past three recessions. The exhibit shows that delinquency rates exceed by about 1% those recorded following the last recession Q1 1981 – Q3 1982.

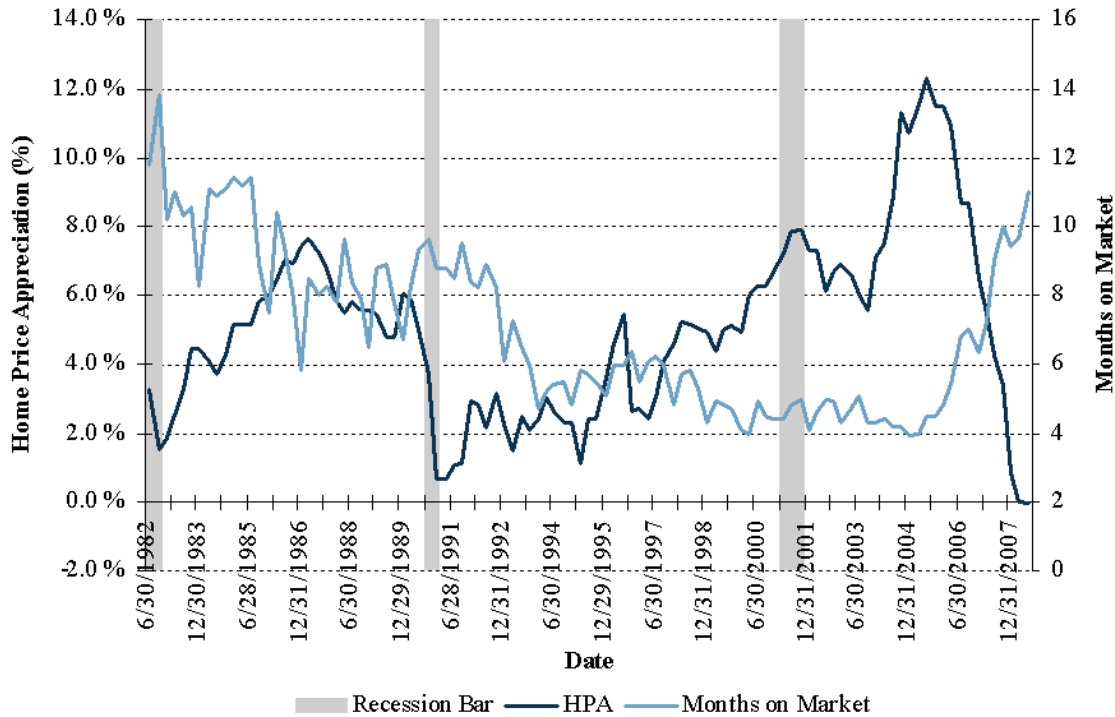
A closer look at the data shows that as delinquency rates increased foreclosure activity increased to around 1.0%. Furthermore, the foreclosure rate appears to have remained stuck around 1.0% through 2000.

Following the 2000 recession, the foreclosure rate increased to around 1.50% and then settled back to 1.0% before increasing.



Against the backdrop of history and considering we may already have mostly likely entered in recession, the current foreclosure statistics appear more or less in line with previous experience.

Months on Market and Home Price Appreciation



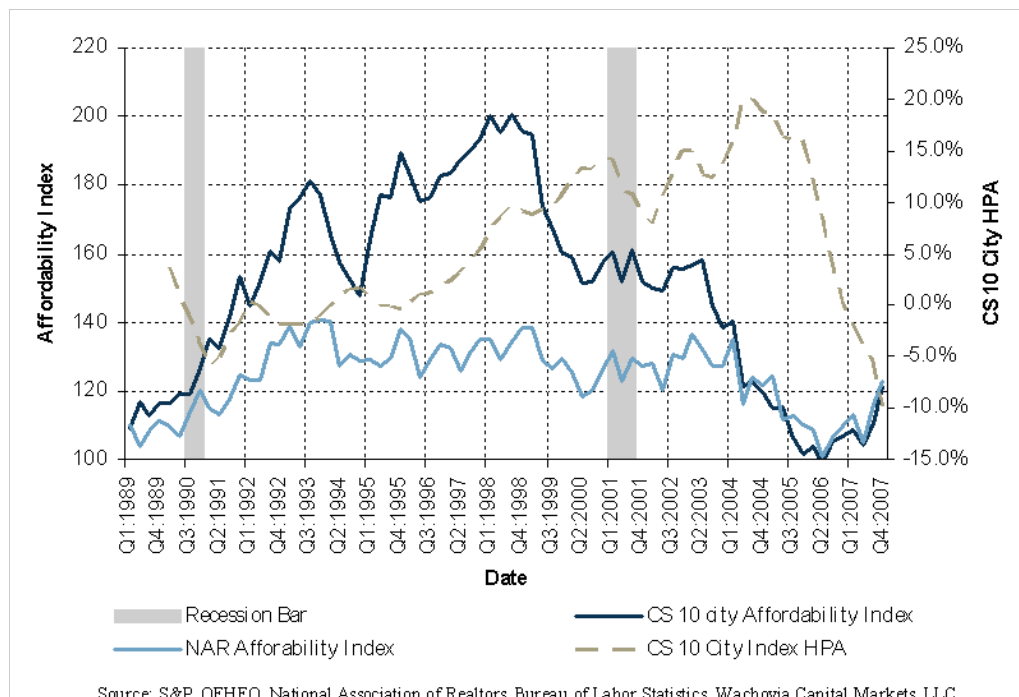
Source: OFHEO, National Association of Realtors, Wachovia Capital Markets, LLC

The conventional wisdom is that as months on market increase then prices must decrease. This is confirmed via simple linear regression (HPA as a function of months on market lagged one quarter).

The R2 is 0.17 and the correlation coefficient is -0.40. This supports the conventional wisdom, but the relationship is most likely weaker than most market participants believe.

Assuming months on market, due to foreclosures, is closer to 20 months then, according to the model, annual HPA should be between -1.0% and -5.0%.

Affordability versus Home Price Appreciation



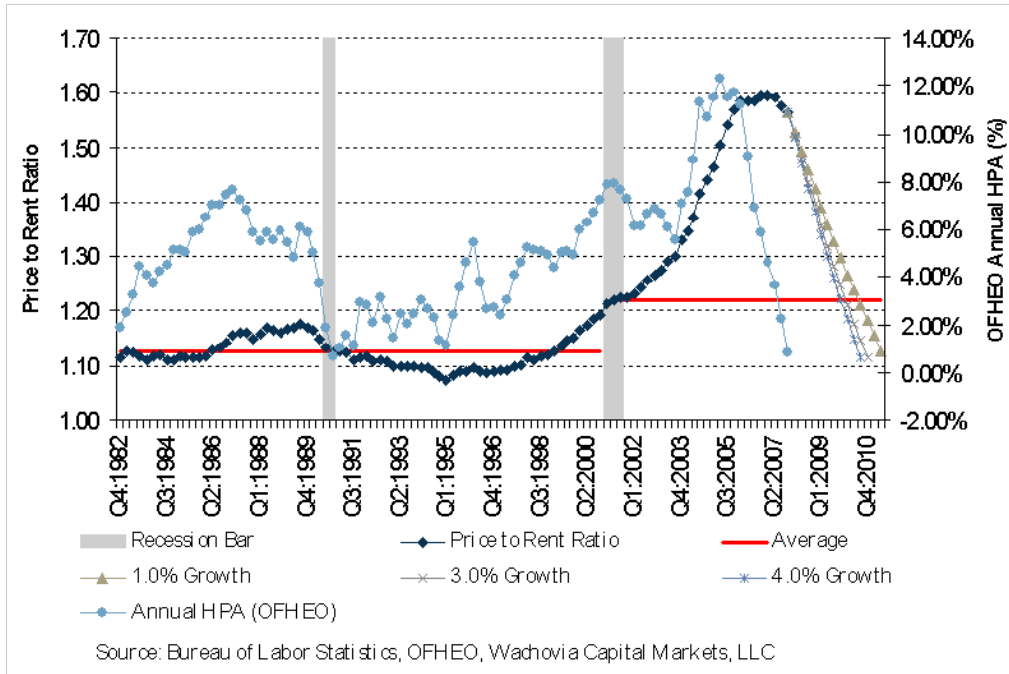
We compare affordability on a national scale comparing NAR affordability versus the Wachovia Capital Markets Affordability Index.

The Wachovia Capital Markets Affordability Index replaces the median home price with the CS 10 City Index.

The CS 10 City Index HPA uses the NAR median home price as of Q1 1989 and indexes that value to CS 10 city HPA rates.

Our analysis suggests a repeat sales index reading around 140 results in positive HPA in the Case Shiller 10 City Index. We computed the home price needed to bring the repeat sales affordability index to 140, requiring a 20% down payment and 25% front-end ratio. The implied home price is \$188,331. Currently, the affordability repeat sales index home price is \$216,200. This metric suggests a further decline of 12.8%.

Price-to-Rent Ratio



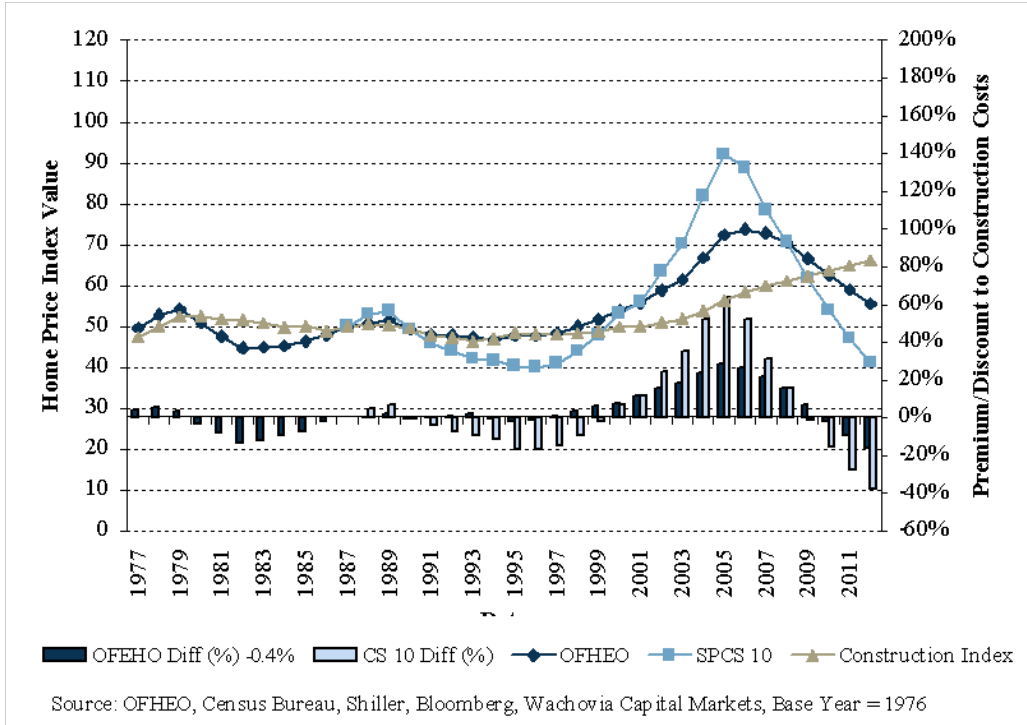
We examined the price-to-rent ratio by simulating rent increases and the commensurate HPA required, bringing the price-to-rent ratio back to its near-term historical average.

If the OFHEO index declines 8.0% per annum and owner's equivalent rent increases at 3.0% annually then the price-to-rent ratio normalizes in Q1 2010

This implies an 18.0% decline in the Case Shiller 10 City Index over the next two years.

The problem with arguing mean reversion to long-run historical average is that home prices are not a mean reverting process. Rather, they display persistence. Thus, given that home prices are part of the price-to-rent ratio, it is also only partially mean reverting.

Real Home Prices versus Real Construction Costs



For our analysis of existing home prices relative to construction costs, we use the Census Bureau Construction Price Index. This index overcomes, in our opinion, the weakness of other construction cost indexes based on only materials by including the cost of the lot acquired fee simple, as well as builder's profits.

The divergence from construction costs for each index (1976-2000) :

OFHEO: -18.0% to +12.0%

CS 10 City: -12.0% to +13.0%

We simulate the relationship to home prices assuming the premium for each index reaches it lows and incorporate a 2.0% annual increase in construction costs, a 3.0% annual inflation rate, a 3.0% annual decline in OFHEO and a 10.0% decline in the Case Shiller 10 City Index. Under these assumptions the OFHEO index would decline to around 316 and Case Shiller 10 City Index would decline to around 138.

Retracement Levels Using Construction Costs

Forecast Year	Nominal		Retracement from peak		Prem. To Const. Costs		Return to Year	
	OFHEO	CS 10	OFHEO	CS 10	OFHEO	CS10	OFHEO	CS 10
2008	378	181	-3.2%	-20.2%	15.6%	15.6%	Q2:2006	Q2:2004
2009	356	158	-9.1%	-30.2%	6.7%	-1.0%	Q3:2005	Q3:2003
2010	336	138	-14.5%	-39.0%	-1.5%	-15.2%	Q1:2005	Q3:2002
2011	316	121	-19.7%	-46.7%	-9.0%	-27.3%	Q3:2004	Q2:2001
2012	298	105	-24.6%	-53.5%	-16.0%	-37.7%	Q4:2003	Q3:2000

Source: Wachovia Capital Markets, LLC

Putting It All Together

	CS 10 Forecast	Retrac em ent from Peak	OFHEO Forecast	Retracem ent fr0m Peak	Prob.
Affordability Index	-12.80%	22.00%	-3.00%	-3.10%	45%
Owner's Equiv. Rent 3% Annual Increase	-15.00%	50.00%	-8.00%	21.00%	10%
Construction Cost Index	-10.00%	40.00%	-3.00%	24.00%	45%
Expected Retracement from Peak		32.90%		11.51%	
Peak Level		226.29		390.75	
Forecasted Level		151.84		345.79	
Current Level		196.06		390.20	
Q2:2009 Annual Decline		-18%		-9%	

Source: Wachovia Capital Markets, LLC

Each valuation metric affordability index, owner's equivalent rent, Construction Cost index suggest home price declines of varying amounts and time intervals.

To arrive at our forecast values we probability weight each outcome and select a horizon from peak to trough (16 quarters). Finally, we translate our target values for both the OFHEO and Case Shiller indexes into annualized values over the remaining horizon.

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Additional information is available on request.

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