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For perhaps the first time in the 12-year history of the *Market Source Newsletter*, we're a bit unsure of what to say that hasn't already been said. The reason?

As we look at the state of the south central Wisconsin real estate market, particularly in Dane County, the situation we find ourselves in at the end of the third quarter is virtually identical to the situation one year ago. Total residential sales, both for the quarter and year-to-date, have been almost exactly the same for each of the last three years. Mortgage rates? Still low. Inventory of homes for sale? Still low (even slightly lower than a year ago).

REAL ESTATE MARKET SOURCE
OF SOUTH CENTRAL WISCONSIN

NEW LISTINGS? ABOUT THE SAME AS A YEAR AGO (earlier hopes that they were finally increasing did not materialize). Prices? Up, again (about seven percent year-over-year in Dane County). New construction? Still not enough to satisfy overall demand.

So, here we are. Not stuck, really, as that would imply things are bad. Far from it. While overall sales are not yet increasing year-over-year, they've settled in at a brisk and healthy pace. What's frustrating—if that's the right word—is that we can't help feeling it could be even *better*. Better, if we could just find enough homes to sell to satisfy our region's growing demand. And growing it certainly is. Steve Steinhoff, Deputy Director of the Capital Area Regional Planning Commission, reported in a recent talk that our region is growing at a rate of about 80,000 people every 12 years. That's enough new people to fill Camp Randall Stadium. And it's now well understood that many of those new arrivals in the Greater Madison area are Millennials—the largest age cohort in the nation's history.

According to Zillow Group, Millennials nationwide now make up 42 percent of all homebuyers, and 71 percent of all first-time homebuyers. (So much for the theory that Millennials will never be home owners, a theory we've never subscribed to anyway.) These Millennial buyers are looking for homes primarily in the $200K to $350K range, which unfortunately is below the range where builders in our market can help fill the inventory gap (a fact we've discussed in a number of previous editions of the newsletter).

Where does this leave us, and what can we expect going forward? Do we have any further insight into the causes of our low inventories? Will we break out of the current situation any time soon? And if not, how do we manage it?

Baby Boomers • Born 1946-1964
53% of Home Owners
2nd Largest Generation

Millennials • Born 1977-1995✦
42% of Home Buyers
Largest Generation

THE GENERATION GAP

We've speculated, along with many others, about the root causes of today's housing shortages. A lack of new construction has been the most frequently mentioned culprit. There's no doubt it's going to have to be a part of the solution. But there's another theory we've heard recently that rings true to us.

Up until the Millennials came along, the Baby Boomers were by far the largest generation in our history. They're also the longest lived. Most important for this discussion, Baby Boomers are also the generation staying in their homes the longest. According to an August 8th *Bloomberg* article by Prashant Gopal, "People 55 and older own 53 percent of U.S. owner-occupied houses, the biggest share since the government started collecting data in 1900, according to real estate website Trulia. That's up from 43 percent a decade ago."

Baby Boomers, in general, are healthier and more active than previous generations were at the same age. As a result, a growing number of them are choosing to 'age in place.' In other words, Baby Boomers are not selling their houses after retirement as quickly as previous generations. This contributes to the housing shortage we're experiencing all over the country, including here.

There's a wonderful irony in this, one that should remind all of us to take the predictions of pundits and prognosticators with a huge grain of salt (including those from yours truly). Back around the beginning of the 21st Century, a number of articles forecasted an impending housing bust. The reason? Baby Boomers, it was assumed, would begin to retire and start putting their homes on the market, downsizing or moving to retirement homes. A housing glut was predicted that would decimate home values.

In fact, what we have is the exact opposite. Boomers in greater numbers are simply choosing to stay where they are, hogging the supply of housing already built. Add in the fact that the Millennial generation is even bigger, and now entering prime home-buying age, and we have the perfect ingredients for a housing shortage.

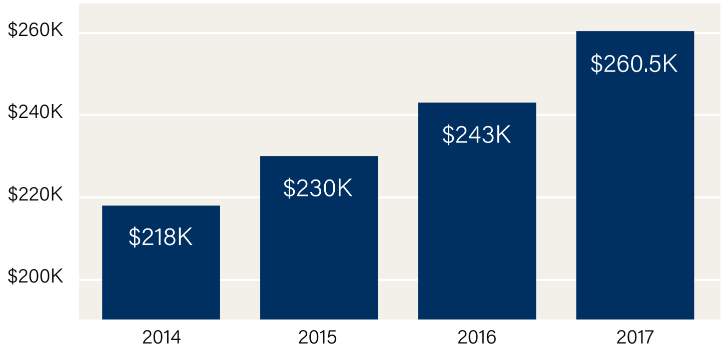
It's not just that simple, of course, and the obstacles we've outlined in previous editions that discourage new construction are still playing a role.

PRICING PRESSURES

Probably the most tangible consequence of our low inventory market is the upward pressure it puts on prices. We discussed this question in some detail in our previous edition of the *Market Source Newsletter*. We continue to stand by our opinion that we are not yet in pricing territory that warrants concern for a market correction like we saw during the last recession. But that doesn't mean we aren't keeping our eyes on it.

Just as we saw last quarter, the Dane County 12-month median price† is up 2.2 percent over the past three months and almost 20 percent in the last three years. The average over the last 25 years has been more like four percent, which is pretty close to what we would consider 'normal' appreciation.

DANE COUNTY 12-MONTH MEDIAN PRICE



The Dane County 12-month median price† is up roughly seven percent since this time last year. It's up about 13 percent in the last two years, and almost 20 percent in the last three.

Of course, appreciation rates are never perfectly even from year to year. A few years above trend are not, in and of themselves, cause for concern. The fear some have is that prices will rise to an artificially high point and then fall as they did 10 years ago. There is no objective way to know when a market reaches artificial bubble territory. During the housing bust 10 years ago, a true bubble was created nationwide by an unsustainable and artificial flood of money washing over the market. When the flood receded, prices had to fall.

What we're experiencing now is sustainable, organic demand fueled by economic and population growth without adequate supply to satisfy it. As long as our region continues to grow, we should be able to support the price levels that supply and demand create, as well as absorb additional supply as it's brought to the market.

That doesn't mean price increases won't level off at times, or perhaps even fall slightly in the face of a severe recession. Those kinds of variations are normal in the short run. Real estate should always be viewed as a long-term investment. Perhaps our biggest worry is that if the current imbalance is not addressed, prices will eventually rise to the point where they become a real deterrent to our economic growth; where the average buyer can't afford to buy the average house. That would be a shame, and we hope our leaders are able to arrive at a policy mix that keeps it from happening.

THE PICKY BUYER?

In our last edition, we speculated that some buyers were withdrawing from the frenzy of the spring market, perhaps to reappear in late summer or fall. We continue to believe this is true. Our own internal numbers are running slightly ahead of last year for offers-to-purchase; we've been ahead every month since a lackluster April. It would seem that many buyers have taken our advice to remain in the game beyond the spring market.

As is often the case, however, we did see a bit of a lull right after Labor Day. September seemed to get off to a very slow start, and there was a point where we wondered if we might be writing about a declining market to finish the year. We also started to see something we haven't seen for a long time: the picky buyer. We heard a number of stories about buyers who made offers with somewhat of a take-it-or-leave-it attitude. Rather than playing the bidding war game, they were walking away if the first offer wasn't accepted. We were hearing far fewer instances of multiple buyers bidding up the price on new listings, and even heard some stories about sellers who were surprised when their home didn't fly off the shelf like most did in the spring.

As it turned out, it was short-lived. September ended with a flurry, and October is off to a very solid start. As we draft this edition in mid-October, we're starting to hear stories of multiple offers and bidding wars again. While it seemed there was a brief window where buyers could perhaps exert a little more control during negotiations, the October push has, for the moment, drawn that window closed. We remain in a very strong seller's market, and as long as homes remain scarce, buyers will be forced to compete.

WHERE DO WE GO FROM HERE?

It's been our experience that when we have a strong fall, a very busy spring awaits us. We have little doubt that 2018 will have the same low inventory and rising prices that buyers and sellers have been dealing with for the last three to five years. At this point, there are really only two solutions we can see. Either Baby Boomers need to start selling their houses, or we need to find a way to build more. The first will happen eventually, but it could take a while and is impossible to influence. The latter remains the most promising, but we're still not seeing enough new construction to satisfy demand.

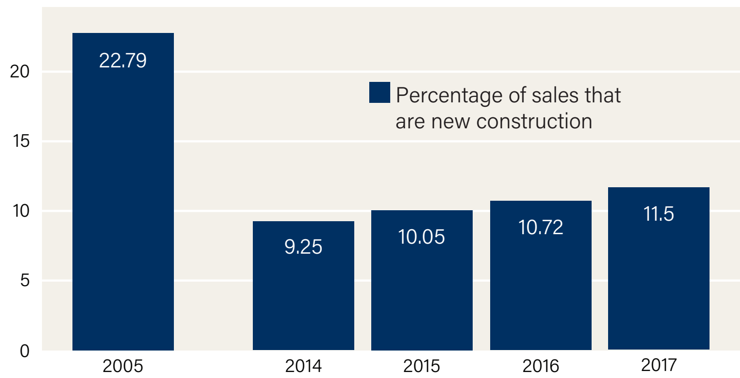
Often forgotten is the fact that from 2008 through 2011 or 2012, there was almost no new construction. Additionally, the recession had many Millennials living in their parents' basements, unable to buy homes. However, this did not reduce their desire to form households. Instead, the recession forced Millennials to wait, which built buying pressure under the real estate market like a dormant volcano. Now the Millennials are suddenly on the home-buying market, but we don't seem to have the capacity to overcome the backlog, with even more first-time buyers arriving every day.

Let's look at the math. So far in 2017, about 11 percent of single-family home sales in Dane County—or 567 homes—have been new construction. In 2005, the peak of the bubble, new construction sales were over 1,400. If our region is growing at between 6,000-7,000 people per year, with most of that growth in

Dane County, it seems clear that 500 or 600 new homes per year is not going to cut it. Remember, this is only single-family homes, and the MLS never captures *all* single-family new construction. And while very few condos have been built in the last 10 years, a great many new apartment buildings have relieved some of the pressure. Still, given the demand we do have for single-family homes, we need more. How we'll make that happen is a topic of ongoing debate.

While we trust a way to build more homes will be found, it won't arrive in time to ease the supply problem next year. Activity will diminish as 2017 winds down, so buyers who want to avoid the spring rush should stay active now. We'll discuss the detailed supply-and-demand picture as we head into 2018 in the next edition of our newsletter. In the meantime, we wish today's homebuyers happy hunting.

NEW CONSTRUCTION'S ROLE IN THE MARKET



In 2005, the last of the previous boom years, new construction was 23 percent of the sales reported to the MLS. During the last four years, it has only made up roughly 10 percent of single-family home sales.

ADVICE FOR BUYERS

If you've stayed active through summer and early fall, you've probably found it somewhat easier to navigate the market than in spring. You can perhaps afford to be a little pickier. But as always, don't outsmart yourself. It's still a seller's market, and most sellers don't have to capitulate to a lowball offer in order to sell. You can pass up some good values overplaying your hand, and if you don't buy this year, you'll be back in the spring market madness. Activity is still high for this time of year, and competition remains brisk for good new listings. But it's far less busy than it will be in March. If you can find something now, the process will be much easier.

ADVICE FOR SELLERS

You're still in the driver's seat, for sure. Despite the normal seasonal slowdown, there are enough buyers out there to maintain the likelihood of success before the holidays. In addition, the process will probably be much more pleasant than it would be with 10 buyers fighting over your home. We know that sounds like a great thing, but in reality, dealing with multiple offers can be very stressful. One or two buyers at a time is much easier. We don't expect prices overall to recede before next spring, so you're still fine. But don't be offended if you sell a little under your asking price. It's perfectly normal! It just doesn't seem that way anymore.

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
3rd Quarter Closings*	1851	1850	1811	569	556	504	2420	2406	2315
Year-to-Date Closings	4912	5027	4997	1422	1437	1330	6334	6464	6327
Active Inventory	1074	1256	1547	282	353	455	1356	1609	2002
Months of Inventory†	2.1	2.4	3.1	1.9	2.4	3.4	2.1	2.4	3.1
12-Month Median‡	279,900	260,000	246,000	182,650	165,400	155,900	260,500	243,000	230,000

SAUK & COLUMBIA COUNTIES

	Single Family			Condominiums			Total Residential		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
3rd Quarter Closings*	481	466	471	65	57	48	546	523	519
Year-to-Date Closings	1174	1223	1153	176	137	123	1350	1360	1276
Active Inventory	535	704	864	77	134	179	612	838	1043
Months of Inventory†	4.1	5.3	7	4.2	9.0	13.1	4.2	5.7	7.6
12-Month Median‡	175,000	168,250	158,000	150,000	152,500	142,700	172,000	165,900	155,500

✦According to The Center for Generational Kinetics. *Sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates between 7/1/17 and 9/30/17. †Months of Inventory represents the number of months it would take to sell the entire active inventory at the pace of sales for the most recent 12 months. A six-month inventory is considered balanced. ‡When all properties sold during the period are ranked in order of price, the median is the price of the home in the exact middle. The above sales figures herein are based on data supplied to the SCWMLS Corporation by its Participants. The MLS does not guarantee and is not responsible for its accuracy. Data maintained by the MLS does not reflect all real estate activity in the market. Data presented here was generated from the SCWMLS on or before 10/10/17. This is not intended to solicit existing listings.