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CHANGE IN THE AIR?

Something interesting is afoot. It may be too early to know exactly what it is, and the data is not yet clear. But there are straws in the wind suggesting the local real estate market may *finally* be starting a subtle shift. A shift that may eventually take us back to a more 'normal' balanced market.

Given that overall 2018 Dane County homes sales are within one percent of last year's pace, why would we think change is in the air? Let's start by looking at Dane County closings for the second quarter of this year. The number of homes sold is down five percent from last year, and down nine percent from two years ago.

REAL ESTATE MARKET SOURCE
OF SOUTH CENTRAL WISCONSIN

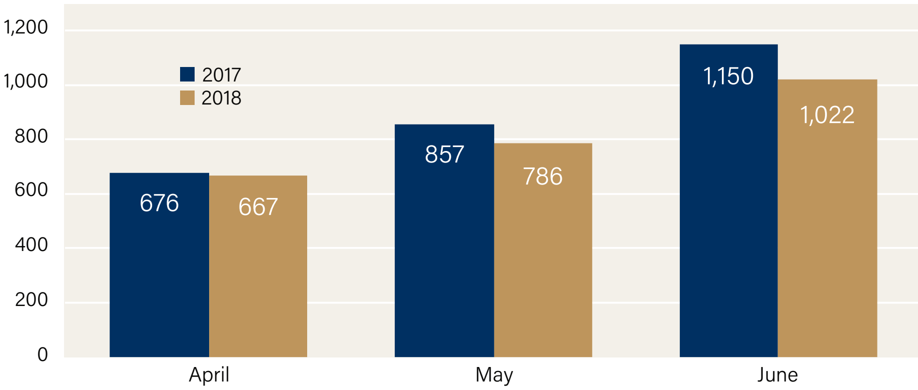
WHAT'S INTERESTING TO US is that almost the *entire decline* took place in May and June; normally among the biggest closing months of the year. May closings were down 8.3 percent from 2017. June closings were down 11.3 percent. From where we sit, July appears to be behind last year as well. Is this a catastrophic slowdown? *Absolutely not.* After three consecutive years of record-paced sales, a small pullback is nothing to fret over. But, it *is* a change nonetheless, and it's one worth watching as the year goes on.

There are other, more anecdotal indicators as well. Rather suddenly, our agents are reporting a decline of 'multiple-offer' situations—listings that received several competing offers within the first few days on the market. Through April and into May, we were continuing to experience intense competition for scarce inventory,† an ongoing pattern of the past three years. During these past three years, the intense competition had continued pretty much unabated beyond the traditionally-busy spring market, even stretching into the summer and fall.

That doesn't seem to be the case this year, as we get further into the summer. Yes, *some* homes are continuing to sell in a day or two. Yes, *some* homes are continuing to receive multiple offers. However, we are beginning to see less of this for the first time in three years. We're seeing some summer sales return to the more 'normal' seasonal pattern. (During a 'normal' summer home sale, the new listing comes on the market, has an open house or two with a handful of showings and then an offer is typically made within 30-60 days of the listing.) Will this return to 'normal' continue? We'll see.

Another straw: requests for open houses are suddenly common again. For the past three years, open houses were something of a rare bird. Oftentimes, when they were held, it was to 'unveil' a new listing. Offers were being collected from buyers and then presented to the sellers on the same night. The open houses were serving as mass showings. Now, open houses are becoming commonplace again and traffic at them has slowed a bit.

DANE COUNTY CLOSINGS IN THE SECOND QUARTER



Total Dane County homes sales for 2018 are nearly on pace with this time last year. However, second quarter sales are down five percent overall with the largest declines coming in May and June—typically the busiest closing months of the year.

What does this mean, and why is it happening? Honestly, it's too early to answer either of those questions with certainty. Activity always slows after Memorial Day, so some of the pullback is certainly seasonal. But we've become so accustomed to the frantic pace of the past few years that these subtle changes are noticeable to us. This *feels* different. We're writing this newsletter the week after the 4th of July, and it could easily pick up again before Labor Day. So we don't want to overreact, nor do we want to overstate the significance of what's happening. But our mission is to keep our readers informed so they can make the best decisions when buying or selling real estate. We'll share here what we think is going on, and you can discuss it further with your agent to be sure you're playing the market the right way.

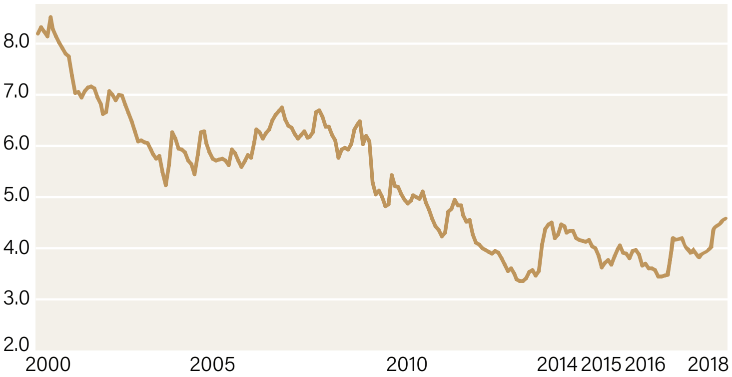
HOW MARKETS WORK

We have to start with simple market dynamics. We've said repeatedly in past issues that markets always return to equilibrium over time. We've had four straight years of continually dwindling inventory coupled with rising demand. The inevitable result: prices rise. And we've seen exactly that. Dane County's 12-month residential median price is up 6.3 percent from last year, and 13.5 percent from two years ago. At some point, a few buyers begin to be priced out, and overall demand is reduced.

This again raises the questions of whether our market is 'overpriced,' and if there's risk of a correction similar to the one we had 10 years ago. Our answer to both questions continues to be *no*. Remember, the housing crisis of 10 years ago was really a lending crisis, not a housing crisis. Prices were pushed to unsustainable levels by unsustainable lending practices, and the sharing of boatloads of bad mortgages throughout the global financial system. Massive numbers of defaults inevitably happened and the financial system contracted violently, pulling housing prices back down with it.

To the best of our knowledge, no such conditions exist today. It bears remembering that during the 2000's housing boom, inventory was high and new construction was robust. Free money was driving the market to overheat. Today's issues are driven by inventories that are too low, and new construction that's still not adequate to rebuild supply. It will probably take a few years for inventories to revert to a more normal four-to-six month supply. The continuation of low inventory will tend to build a floor under prices. The result will likely be prices increasing more slowly, or even moving sideways for a while, as demand tops out. We may be approaching that condition now, but there is nothing to suggest that massive defaults are in our future.

30-YEAR MORTGAGE RATES, 2000-2018



The 30-year rate is up six tenths of a percent since a year ago, and a full percentage point from two years ago. Most economists estimate the 'fair value' rate is somewhere near six percent. We're still well below that, so today's rates remain a bargain.

BUYER FATIGUE

Another factor may simply be frustration with the buying process. It's again anecdotal, but our agents have been confirming that many of their buyers—after losing out on multiple properties—simply decided to sign another lease and try again next year.

Our agents are also reporting growing numbers of buyers turning to new construction after failing to land a home. This is not only understandable, but probably a good thing in the long run. We need more homes in general, and the shortage is forcing buyers to build them themselves. While sales of newly built homes are often reflected in MLS statistics, some are not, particularly custom homes with smaller builders. This is probably contributing to the sense that there are fewer sales overall, when in fact more are going 'off book' and not showing up in the final numbers.

We have no doubt that we could have, and would have, sold more homes over the pasts few years if we had more homes to sell. Wisconsin continues to be a growing magnet for young professionals. They want to buy houses and start families. The urge to buy remains strong with these would-be buyers, and they'll be back soon, if they're not out building their dream home already. In the meantime, their pulling back may start to give inventories a chance to recover, and they'll have an easier time when they do reenter the market.

MORTGAGE RATES

We can't ignore the role that mortgage rates play in helping to shape demand. The 30-year rate is up about a half-a-percent since the beginning of the year, six-tenths of a percent since a year ago, and a full percentage point from two years ago. Everyone—including us—cried wolf on interest rates for years, knowing that someday they had to rise. It seems that day has finally arrived; and this time, it's for real. The Federal Reserve has been systematically raising rates for a couple of years now, and with today's very strong economy, this will in all likelihood continue.

We've spoken before about the 'one-percent/10-percent rule.' Simply put, every one-percent rise in the 30-year mortgage rate reduces the size of the mortgage a buyer can qualify for by roughly 10 percent. For example, at 3.5 percent, the payment on a $200K mortgage is $898 per month. At 4.5 percent, that same monthly payment will now service a $177K mortgage. As rates continue to rise, buyer purchasing power will fall.

While this may seem like bad news, we don't think it is. Or, at least we choose not to think of it that way. The fact is, rates did have to rise some day. They were held to artificially low levels by the Fed in response to the last recession. The market will be better off—and more stable—with rates set by the market, not engineered by the Fed. We have to go through the process, and that process seems to have begun. As long as the increases remain gradual, we don't expect major disruption to the market.

How high will mortgage rates go? Most economists estimate that 'fair value' for the 30-year rate is somewhere near six percent. We're still well below that, so today's rates remain a bargain. A glance at the historical mortgage rate chart reminds us that for much of the housing boom, rates were at—or well above—six percent. History already shows that we can have a healthy market at market rates; healthier, in fact. We just have to get there.

THE FUTURE

Real estate markets, like all markets, never stand still. They never stop at equilibrium, but they're always searching for it. They are never linear. They rise and fall. Speed up and slow down. Sometimes the causes are easy to see, sometimes mysterious. No matter how unbalanced a real estate market may become in the short run, they always head back to balance in the long run.

Since the end of the housing recession in 2012, our markets have been on a frantic pace of recovery. Pent up demand met with diminished supply, and the result has been intense competition and rising prices. We don't think this era is over, but our instincts tell us that it's starting to turn. So what does this mean? How will the reversion play out when it truly does happen?

Right now it looks like the balance of 2018 will be somewhat less active; sort of like 2014, when we saw a small pullback from an explosive 2013. We've had three consecutive near-record years, and the market is simply due to take a breather. We do not think this will express itself in falling prices; we're still in a seller's market and it will take a couple of years for that to change. Rather, we'll see a somewhat subdued pace of sales, allowing new construction and inventories in general to recover a bit. Price increases may slow, and might even move sideways. It's hard to see prices falling to any appreciable extent with supply still low and the economy continuing to grow.

Unless the slowdown is really severe, which it hasn't been so far, it will take a few years to get back to four to six months of inventory. We're already looking forward to next spring. Will the heavy competition and multiple offers be back? It's hard to say. Until then, perhaps buyers who can still move this year will have an easier time of it. Hey, you might be the only person negotiating with the seller to buy the house! Wouldn't that be nice?

As we've told our readers many times before, the beauty of real estate as an asset to own is not only its great fundamental utility (you get to live in it!), but its role as a very stable long-term store of value and wealth builder. If the correction is indeed getting underway, there is no need to wait for it to pass. Just the opposite, in fact. You can still expect three-to-four percent price appreciation over the long run, no matter when you buy. The process just might finally become easier again. And that, would be a very good thing.

ADVICE FOR BUYERS

It's not a buyer's market yet by any stretch, but the landscape does seem to be shifting. That means your strategy for making an offer may be a bit trickier than it's been for a while. Up to now, it's been bid fast, bid high, make your offer clean, and don't be disappointed if you lose. That's still good advice. But it's hard to know how much competition you'll have now, if any. If nothing else, it's time to dispense once and for all with the notion that the only houses worth looking at are those brand new to the market. Our guess is there will be more homes than in the past that take weeks to sell rather than days. Don't shy away from 'older' inventory. There's nothing wrong with it just because it didn't sell instantly. It also matters *where* it is. Some neighborhoods are still hotter than others. If you're looking at a brand new listing in a hot neighborhood, you might still see competition. Work with your agent to develop an offer strategy that works for your budget and the circumstances of the home you want to buy.

ADVICE FOR SELLERS

For the last year or so, sellers have been rewarded for reaching on price, especially during the spring market. This year in particular, sellers have been pricing aggressively. Even in the era of overbids, *on average*, homes are selling below that aggressive listing price. For example, the median Dane County residential *list* price is $289,900. On average, the median *sale* price is $271K, or 6.5 percent less. The median single-family home *list* price (no condos) has been a whopping $319,500. On average, the median *sale* price is only $290K, or nine percent lower than list price. In other words, sellers have been reaching higher and then forced to negotiate lower. If demand stays lukewarm through the summer and fall, we may start to see more listings expire without selling at all. The bottom line: it's time to start watching your competition closely, and pricing carefully. The days of being virtually guaranteed of success may be coming to an end. At least for the rest of 2018.

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
2nd Quarter Closings*	1917	2050	2111	553	557	612	2470	2607	2723
Year-to-Date Closings	2957	3029	3134	868	843	880	3825	3872	4014
Active Inventory	1021	1096	1184	245	218	314	1266	1314	1498
Months of Inventory†	2.0	2.2	2.3	1.6	1.5	2.2	1.9	2.0	2.3
12-Month Median‡	290,000	274,101	256,000	191,900	178,000	160,750	271,000	255,000	238,882

SAUK & COLUMBIA COUNTIES

	Single Family			Condominiums			Total Residential		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
2nd Quarter Closings*	473	424	490	65	71	50	538	495	540
Year-to-Date Closings	732	686	755	105	109	76	837	795	831
Active Inventory	463	574	768	75	87	155	538	661	923
Months of Inventory†	3.5	4.5	5.8	4.1	5.0	11.2	3.6	4.6	6.3
12-Month Median‡	190,000	171,000	165,000	165,000	148,000	149,350	188,000	168,000	164,000

*Sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates between 4/1/18 and 6/30/18. †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 7/11/18. This is not intended to solicit existing listings.