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Dave Stark

The torrid sales pace set in the first half of 2013 continued unabated in the 3rd quarter, with sales for the combined Dane, Sauk and Columbia County market up 28.7% over the same period in 2012. As has been the norm this year, Dane County led the way with a 31.4% increase over 2012, while Sauk and Columbia Counties were up 18% and 15% respectively. This is roughly equal to the increases we saw last quarter for Dane and Sauk, and represents a solid improvement for Columbia. For the year, Dane County is up 31.3%, followed by Sauk at 18.3% and Columbia at 6.7%. With three quarters now safely in the bank, we remain on pace for what could be

the 3rd best year on record. The question now before us is whether the pace will continue through 4th quarter and into next year, or if the explosion of pent-up demand we witnessed in 2013 will prove to be an aberration.

While it's still early in the 4th quarter as we write this edition, and the data is nowhere near conclusive, there does appear to be at least anecdotal evidence that the underlying pace of activity has slowed a bit since Labor Day. Some of this is seasonal, of course, and the 4th quarter is normally the least active quarter of the year as far as new offers to purchase are concerned. But last year at this time, things were getting more active, unusually so for October, and we took that as a harbinger of things to come in 2013 (we were certainly right about that). This year, it seems to be slowing as we go through the fall, and it's entirely

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
3rd Quarter Closings	1820	1386	1118	533	405	283	2353	1791	1401
Year-to-Date Closings	4669	3680	2959	1375	966	747	6044	4646	3706
Active Inventory	2031	2338	2797	829	1069	1345	2860	3407	4142
Months of Inventory	4.3	6.4	9.4	6.1	11.1	17.8	4.7	7.4	11.8
3 Month Median	230,750	219,250	220,000	157,500	147,900	163,250	216,000	203,750	209,800
12 Month Median	225,000	217,500	220,000	150,125	145,000	154,000	210,000	203,477	208,000

SAUK COUNTY

	Single Family			Condominiums			Total Residential		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
3rd Quarter Closings	215	185	174	41	32	20	256	217	194
Year-to-Date Closings	563	469	414	77	72	55	640	541	469
Active Inventory	635	613	702	140	134	182	775	747	884
Months of Inventory	10.8	12.4	15.7	17.7	19.6	31.2	11.6	13.3	17.5
3 Month Median	151,000	133,500	129,450	185,000	141,000	156,200	154,750	133,500	129,900
12 Month Median	145,000	135,000	129,000	149,900	136,000	144,500	145,050	135,000	130,000

COLUMBIA COUNTY

	Single Family			Condominiums			Total Residential		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
3rd Quarter Closings	192	168	133	20	16	4	212	184	137
Year-to-Date Closings	477	446	361	50	48	20	527	494	381
Active Inventory	527	529	615	58	76	113	585	605	728
Months of Inventory	10.2	11.3	16.1	11.4	15.7	56.5	10.3	11.7	18.1
3 Month Median	155,200	138,250	130,000	114,950	147,000	98,250	153,250	138,800	137,750
12 Month Median	134,250	128,000	130,000	114,900	101,075	132,750	130,500	127,250	130,000

* Closed sales reported to the SCW MLS between 7/1/13 and 9/30/13. Data for all years pulled between the 12th & 16th of the month following the end of quarter. "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.

MARKET OBSERVATIONS

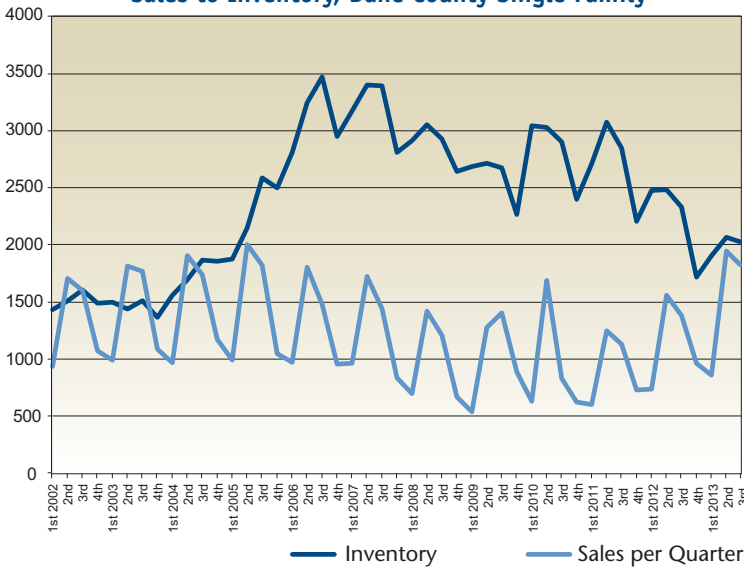
possible that the 4th quarter of 2013 will underperform relative to 2012, the first time that will have happened in more than two years. Given the usual quiet pace of the 4th quarter, this doesn't trouble us. What matters for consumers is what the supply and demand conditions will look like next year when the spring market heats up again.

To try to assess that, we'll examine the major drivers of market conditions: inventories, prices, interest rates, and demand. When those elements are in balance, sellers can sell in a reasonable time, buyers can find what they're looking for, and afford to buy it. That's what defines a healthy market, not just the pace of sales.

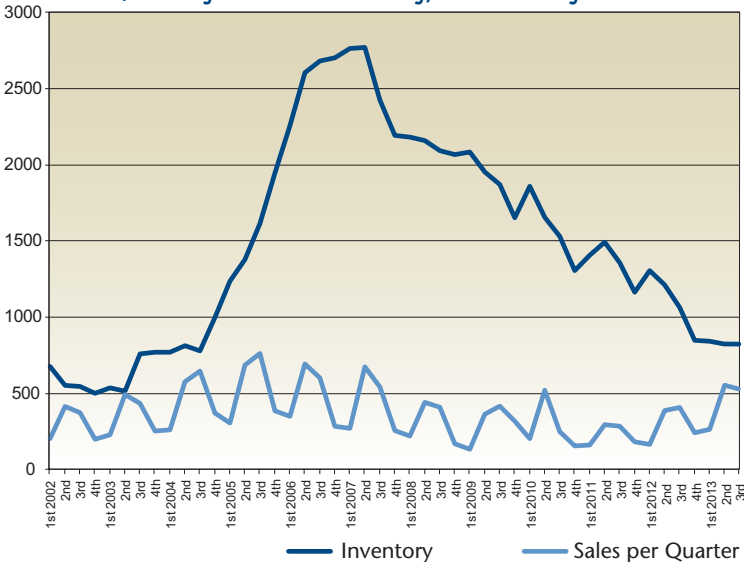
INVENTORIES

We'll start with inventories, since that's where it begins for the consumer. A year ago, we saw a sudden, dramatic, and somewhat unexpected decrease in the level of active inventory, especially in Dane County. Combined Dane County inventories fell from 3,407 at the end of the 3rd quarter, to 2,598 at the end of the 4th, a 24% drop in the space of three months. Months of inventory fell from 7.4 months in early October to 5.3 months by the first of the year. Sauk and Columbia also saw improvement, but not as dramatic

Sales to Inventory, Dane County Single Family



Quarterly Sales to Inventory, Dane County Condos



(more on that below). This, probably more than any other factor, was the driver of the surge in 2013. The period from 2007-2011 was defined by bloated inventories, which removed any sense of urgency for buyers, and led to soft prices. Once those inventories disappeared, buyers started competing again to get the best properties, and the rush was on.

Notice the two charts, (lower left) comparing quarterly inventory levels to sales for single family homes and condos. While not quite back to the relationship we saw in 2002-2004, it's getting close. We could once again see single family sales exceeding available inventory in the 2nd and 3rd quarters of next year, and condo inventories seem to be leveling off again at more reasonable levels after a colossal increase starting in 2004. When supply and demand are balanced like this, the market is usually very functional.

Heading into 2014, be aware that inventories have not increased at all during the course of this year. Combined inventories are still well under 3000 in Dane County, and faster absorption rates have pushed months of inventory down to 4.7 months. It will probably fall further going into next year. We expect heavy bidding for desirable homes again this spring.

DISTRESSED PROPERTIES

The anomaly that plagued us throughout the downturn was the glut of "distressed properties", properties that were either owned by the bank through foreclosure and heading that way, or "under water," meaning the owner owed more on the mortgage than the home could be sold for, resulting in a "short sale." While our experience was nothing like other areas of the country, we had our share. This is important because it was a major factor causing bloated inventories. Too many homes were on the market because they had to be, not because they wanted to be. With today's tougher (some would say simply more rational) underwriting standards, defaults and foreclosures have returned to more normal levels, leading in turn to lower inventories. However, the process of working through this inventory has been slower in Sauk and Columbia Counties than it has been in Dane.

	Percent Distressed Sales		
	Bank Owned	Short Sale	Total Distressed
Dane	6.65%	1.49%	8.11%
Sauk	17.81%	3.13%	20.78%
Columbia	21.82%	1.90%	23.72%

The chart above shows the percentage of sales this year that have been distressed in each of the three counties. This goes a long way in explaining why inventories in the outer counties have remained higher, and therefore their recoveries slower. The recovery in our region has been an "inside out" recovery, with the City of Madison leading the way, and then spreading to outlying communities as the year went on. The good news is that Sauk and Columbia are still improving, and we look for better things for them in 2014 as well.

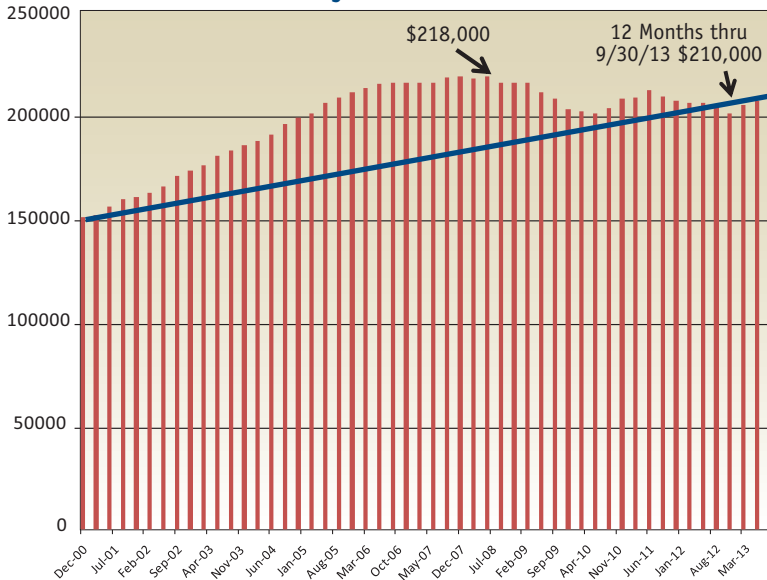
PRICES

When supply is low and demand is high, prices generally go up. Though moderate, we've started to see some upward movement, particularly in the most recent quarter. The 12 month median for combined single family and condo sales in Dane County is up 3.2% from a year ago, a very reasonable and sustainable pace.

The nearby chart shows the progress of Dane County's 12 month median since 2000. It's very encouraging to note that during that nearly 13 years, our median price has risen at an average rate of 2.65% a year over the entire period. That's very close to the underlying inflation rate, and a very healthy pace; not too hot, not too cold. Dane's relatively low percentage

of distressed sales has further contributed to its stability. We look for more of the same next year.

Dane County 12 Month Median Price



Oddly, 12 month medians are up 7.4% from last year in Sauk County, and 2.6% in Columbia. Note that medians tend to be more volatile in smaller markets with fewer sales, magnifying the effect of changes in the mix of properties in the data. That said, the higher number of distressed sales in Sauk and Columbia may also play a role. Bank owned properties often sell at an average discount of roughly 30% to fundamental value, according to national statistics. For that reason, high numbers of distressed property sales tend to depress measured median prices. Conversely, they also cause medians to increase when the number of bank owned property sales falls. The result is that reductions in the percentage of distressed sales in a median can create a false signal for price increases. This could be affecting Sauk County's median right now, and we'll watch for more evidence of this effect going forward. One way or another, a reduction in distressed sales will be very positive for Sauk County, and we hope it won't be too long before Columbia County follows suit.

INTEREST RATES

This may be the biggest wild card we face. As we wrote last quarter, the Federal Reserve signaled in June that they were preparing to "taper" their purchases

of government bonds and mortgage backed securities, in response to the improving economy (please go to www.starkhomes.com to see last quarter's issue of the Market Source Newsletter for a full discussion of the Fed and mortgage rates). The markets reacted, and mortgage rates rose by nearly a percentage point, to 4.75% or so. Then, in September, the Fed threw the markets a big curve ball, deciding NOT to taper after all. In response, the 30 year rate has settled back down, and now sits at roughly 4.25%. But where will it go from here?

Despite uncertainty about the timing of movements in rates, there is one thing you can take to the bank, as it were: interest rates WILL go up eventually. Even with current modest increases, rates remain well below historic norms, due entirely to Fed intervention, not normal market forces. Given the historic relationship between inflation and interest rates (again see the August 2013 Market Source), a 30 year rate somewhere in the range of 5.5% to 6.5% is a near certainty, eventually. We don't know when this will happen, but it probably won't happen until the Fed starts tapering for real. Until then, enjoy today's rates, and take advantage of them. They won't last forever.

DEMAND

The ultimate outcome of this stew of forces will be the overall level of demand, and the number of sales we can expect, in 2014. Much can change between now and next spring, so any forecast today is preliminary. But based on the data we have, we think 2014 will be a good year, much better than 2008-2011, but possibly not quite up to the pace of 2013. Perhaps somewhere between 2012 and 2013 is a good guess. We've long estimated that a "normal" level of sales for Dane County is in the range of 6500 or so, compared to what will likely be over 7000 this year. If interest rates do indeed rise into next year, they could take a little steam out of the market, although when rates are rising, buyers often act more quickly to lock in a rate before they go even higher (we saw this happen in July after the June rate increase). Regardless of rate movements, inventories should remain lean, which will keep buyers on their toes and help maintain the momentum. And new construction is showing continued life, serving as an increasingly popular option for buyers who can't find what they're looking for on the resale market.

Up, down, or sideways, there's absolutely no reason to think 2014 won't be another solid year. Without the loony lending of 8-15 years ago, big price fluctuations and abnormal default rates are not in the cards. People will buy homes, live in them, and make mortgage payments they can afford. When they want to sell, they'll generally be able to do so, and those who have lived in their homes for a while will probably sell them for something more than they bought them for. That's how housing markets are supposed to work. If we can avoid yesterday's insanity, we should be able to enjoy it for years to come.

ADVICE FOR BUYERS AND SELLERS

BUYERS

You're in good place right now. Rates are low, and prices are moderate. The only real obstacle you have to deal with, depending on what you're looking for, is you may have some trouble finding it. Fall is generally a more relaxed time to buy, and next spring promises another surge, so buying this fall may be smart. Many buyers are having their Realtor scour the market for properties that may not yet be listed, and it's a good idea to have a trusted relationship with an agent who can call you right away when they find something new. Even now, good homes are selling quickly. Also, don't forget the rule of thumb that every 1% increase in the 30 year mortgage rate means you have 10% less buying power with the same monthly payment. We don't know how long today's rates will last, but they will go up eventually, so take advantage of them if you can.

SELLERS

It seems, at least for now, that the wave of demand we saw throughout the spring and summer has ended, and the market has a kind of "tired" feeling to it going into the fall and winter. That doesn't mean it's dead, but it's not the frenzy it was earlier. Some of this is seasonal, and it will certainly pick up again next spring. But if you really want to sell now, you'll need to be competitive, so talk to your agent about the current market dynamics in your neighborhood, and act accordingly. With less competition, buyers seem a little pickier, but that's just the way it is. The good news is that inventories are still very lean, so there's no reason you shouldn't have success, even this fall, if you're willing to meet the market on its own terms. It's also still a good idea to price your property to sell in the first 30 days if you can. If you've been on the market longer than that and aren't getting any activity, talk with your agent about what to do over the holidays, and try to present it in a fresh way after the first of the year if you haven't yet had success.

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TREND WATCH

Likely Direction Next Six Months

Number of Homes Sold (12 Months)

	Dane	Sauk	Columbia	
12 Months Ended 9/30/13	7303	802	681	→
12 Months Ended 6/30/13	6739	763	653	
12 Months Ended 9/30/12	5566	675	622	

Comment

What's this? A sideways arrow!
The market may have peaked.
We hope to repeat in 2014.

30 Year Mortgage Rates

September 2013	4.49%	Source: Freddie Mac
June 2013	4.07%	
September 2012	3.47%	



Steady increases expected over the next couple years. Not much movement until the Fed really starts tapering.

Median Sales Price – Single-Family & Condos (12 Months)

	Dane	Sauk	Columbia	
12 Months Ended 9/30/13	210,000	145,050	130,500	↑
12 Months Ended 6/30/13	205,900	138,000	127,000	
12 Months Ended 9/30/12	203,477	135,000	127,250	



Steady increases here too. 2-3% is a pretty normal rate going forward.

Inventories – Single Family & Condo

	Dane	Sauk	Columbia	
September 2013	2860	775	585	→
June 2013	2903	793	632	
September 2012	3407	747	605	

We don't want to go too much lower in Dane, but Sauk and Columbia still have some work to do.

New Listings – Single Family & Condo

	Dane	Sauk	Columbia	
3rd Quarter 2013	2439	386	327	→
3rd Quarter 2012	2213	301	279	
Year-to-Date 2013	8277	1200	1001	
Year-to-Date 2012	7593	1063	962	

Sales attracted listings this year. Expect more balance next year.

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