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High demand, low inventory, low interest rates and rising prices. Really, what else needs to be said?

Happy days are here again! It certainly feels that way. There's no doubt the momentum we were feeling at the end of last year has carried over into 2015.

In our last edition of *Market Source Newsletter*, we predicted that 2015 had a chance to be one of the best years for the housing market in Dane County history. With one quarter in the books, we've seen nothing to dissuade us from that view. The biggest challenge of the spring and summer season will be managing sellers' temptations to overprice in a hot market.

Let's start our analysis by comparing the numbers to this time last year:

- **High Demand:** Residential sales in the combined Dane, Sauk and Columbia County market are up a healthy 13.7 percent and up more than 15 percent in Dane County alone.
- **Low Inventory:** Homes on the market continue to decline, down almost 23 percent in Dane County and 15 percent in Sauk and Columbia counties.
- **Low Interest Rates:** Rates are still at record lows, currently sitting at 3.77 percent compared to 4.34 percent last spring.
- **Rising Prices:** Home prices gained strength with the Dane County 12-month median‡ up nearly five percent. The three-month median rose nine percent.

Can we expect this good news to continue into 2015?

In this second quarter edition, we'll analyze key variables to help you navigate the waters ahead.

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2015	2014	2013	2015	2014	2013	2015	2014	2013
1st Quarter Closings*	989	841	863	254	235	269	1243	1076	1132
Year-to-Date Closings	989	841	863	254	235	269	1243	1076	1132
Active Inventory	1430	1773	1911	476	694	847	1906	2467	2758
Months of Inventory†	3.1	3.7	4.8	3.5	5.1	7.6	3.2	4	5.4
12-Month Median‡	$240,000	$227,950	$218,700	$155,000	$153,500	$143,625	$223,400	$213,000	$203,500

SAUK COUNTY

	Single Family			Condominiums			Total Residential		
	2015	2014	2013	2015	2014	2013	2015	2014	2013
1st Quarter Closings*	108	97	123	14	16	12	122	113	135
Year-to-Date Closings	108	97	123	14	16	12	122	113	135
Active Inventory	468	557	570	120	149	141	588	706	711
Months of Inventory†	8.2	9.5	11	10.8	17.7	19.7	8.6	10.6	12.1
12-Month Median‡	$150,000	$140,950	$137,000	$140,000	$146,900	$133,500	$148,500	$143,000	$136,750

COLUMBIA COUNTY

	Single Family			Condominiums			Total Residential		
	2015	2014	2013	2015	2014	2013	2015	2014	2013
1st Quarter Closings*	110	112	94	13	8	10	123	120	104
Year-to-Date Closings	110	112	94	13	8	10	123	120	104
Active Inventory	385	436	486	48	62	61	433	498	547
Months of Inventory†	7.2	8.2	10.1	9.8	13.1	11.4	7.4	8.6	10.2
12-Month Median‡	$150,000	$136,400	$128,000	$138,000	$134,250	$126,500	$149,000	$134,250	$126,500

*Sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates between 1/1/15 and 3/31/15. Data for all years is pulled between the 9th-10th 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. 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.

INTEREST RATES–THE WILD CARD

Interest rates represent the most obvious wild card as we see the market continue its upward trajectory. The Federal Reserve has surprised many observers by refusing to raise its Fed Funds rate–the next step in "normalizing" interest rate policy. In 2013, it looked as though rates were about to start rising when the Fed announced its intention to scale back its quantitative easing program. They did rise, briefly. But, after a few months of rates around 4.5 percent, they fell back below four, and that's where they remain. Rates have defied years of predictions that they must rise.

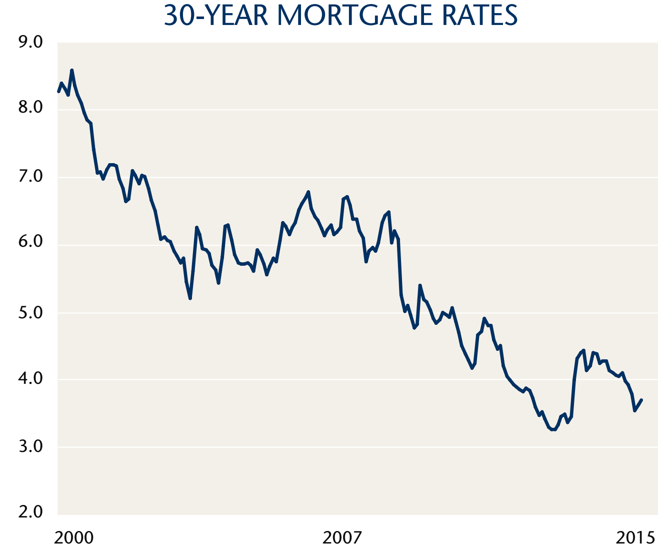
Now, it appears the rate shoe is about to drop. This time for real… well, probably. The Fed changed its language last month, removing the word "patient" in regard to their approach to raising rates. They stated that they will monitor conditions closely, and will not make a move until they believe conditions warrant. They also refused to commit to regular rate hikes, preferring to move only as quickly as the economy can handle. Perhaps just as importantly, the Fed lowered its interest rate forecast for the end of 2015 and beyond.

> "The Federal Reserve announcement appears to suggest that when interest rates do finally start to go up, it will be slowly."

Why do we care and what does this mean for us?

Rather than wading into the technical weeds, let's simply say that this announcement may represent the very best of all worlds for real estate consumers. We've been saying for some time that interest rates would someday have to rise, we just didn't know when. Our major concern for the housing market was that a sharp, sudden increase in rates would dampen activity until people got adjusted to the new environment.

30-YEAR MORTGAGE RATES



Five for five. We've enjoyed at least five years of 30-year mortgage rates below five percent. Much of the last three years were below four percent.

What this announcement suggests is that when rates do finally start to go up, it will be slowly. Some analysts believe rates could start up as early as June, while others think the Fed will wait until September. Whenever it happens, if rate increases are slow and steady and spread over a few years, we have every chance to get through the transition with little, if any, damage to the housing market.

No matter what happens, take advantage of today's outstanding rates if you can.

HOME PRICES–TEMPTATIONS OF A HOT MARKET

With inventories this low, coupled with low mortgage rates, upward pressure on home prices is inevitable. The Dane County 12-month median[‡] rose moderately, but the larger increase in the most recent three-month median bears watching.

The high rate of increase in our current three-month median suggests that if continued for the balance of the year, 2015 could leave us with a larger price increase than we've seen in some time. We're not concerned about this, at least not yet. But, if we have a few consecutive years of 6-8 percent price growth, it could become a problem. The concern, of course, is that if prices rise too far, too fast, they will start to exceed the ability of the average buyer to afford them. If that happens, we could again face the risk that prices fall sometime in the future.

If we learned anything in the last recession, it's that price volatility is the absolute last thing we want to see.

So, while moderately rising prices are good for everyone, our hope is that increases will slow as the year moves on. Ironically, one of the primary drivers of price growth may also be part of the solution: interest rates. If rates do in fact go up slowly–as we discussed earlier–the effect may be to blunt price increases rather than to squelch activity. It's one of the reasons we're not put off by the prospect of slowly rising interest rates. It helps to keep prices in check.

It should also be noted that not all segments of the market are equally affected by inventory shortages. Below $400,000, inventories are very

DANE COUNTY SALES AND INVENTORY BY PRICE RANGE

	PERCENT OF HOMES SOLD IN 2014	PERCENT OF CURRENT INVENTORY	MONTHS OF INVENTORY[†]
$0-100K	2.0%	1.5%	2.4
$100-200K	29.5%	20.9%	2.2
$200-300K	38.4%	27.3%	2.2
$300-400K	16.4%	18.1%	3.4
$400-500K	8.0%	11.7%	4.6
$500-750K	4.7%	12.2%	8.1
$750-999K	0.9%	4.5%	16.3
$1M+	0.3%	3.6%	36.7
TOTAL	100	100	3.1

This chart compares 2014 sales to the current inventory in various Dane County single family price ranges. As you can see, some of the most popular ranges of 2014 have a much smaller inventory in 2015.

tight. Above $500,000, and especially above $750,000, supplies remain ample. This continues a pattern we observed a year ago–that it's normal for supplies to be greater in the higher price ranges. (Go to StarkHomes.com for a more detailed discussion of this phenomenon in the 2014 first quarter *Market Source Newsletter*).

The downside, of course, is that the temptation to overprice will likely be greatest at the lower end of the market–where demand is the highest. The upside is, if you're a "move-up buyer," supply and demand can work in your favor. You could possibly sell at a higher price while homes you wish to buy could be in a less competitive price range.

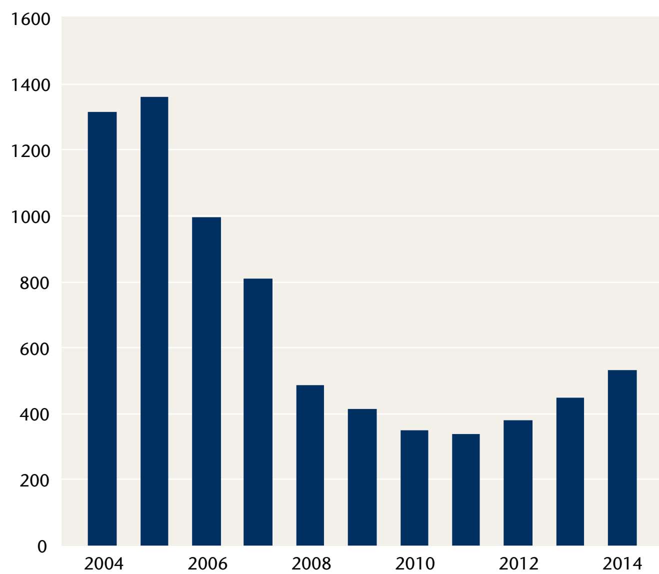
The bottom line is that moderately rising prices are good for the market. If interest rates rise slowly later this year, we could clock in with another 3-5 percent price increase for the balance of 2015. That would be perfect.

There is one other factor that can help keep prices in line: new construction.

DECONSTRUCTING THE ROLE OF NEW CONSTRUCTION

A year ago, we discussed the way new construction has lagged the recovery of the resale market. We saw an improvement in 2014, but we still appear to have a way to go. New construction was close to eight percent of total MLS sales last year–that's up from barely six percent in 2013. Better, yes, but still far below the roughly 17 percent we saw from 2003-2005.

DANE COUNTY NEW CONSTRUCTION SALES



Notice the continued moderate increase in the number of new homes sold through the MLS.

While it's still largely anecdotal, it looks as though 2015 could be the breakout year for new construction. One large builder we're affiliated with tells us they expect to double the number of new homes they sold last year. This coincides with the uptick in lot sale activity we have been experiencing. With fewer homes on the market, more and more buyers are turning to builders to get what they want. While we still aren't seeing a ton of speculative activity–new homes built without first having a buyer–we expect it will increase this year.

We sincerely hope this is the year new construction really kicks it up a notch. Our inventory has been so lean for so long that a real housing shortage could develop in a few years. Dane County is growing, and our housing stock needs to grow along with it. This could be the year it starts to happen.

With the building season just underway, the close watch on interest rates and home prices, we'll have plenty to discuss in next quarter's *Market Source Newsletter*. Until then, enjoy the summer!

ADVICE FOR BUYERS

For pretty much all of the first quarter, new listings flew off the shelves. Expect the same for the rest of the second quarter if not into the summer as well.

Here's how to improve your chances of success:

- **Be prepared.** Mentally and financially. Moving quickly is key in a competitive environment.
- **Get preapproved.** We once again strongly recommend a full preapproval from a reputable lender before you make your offer.
- **Be flexible.** Flexibility on closing dates and a minimum of extra contingencies are good strategies… if you can use them.
- **Forego perfection.** Even if you build it yourself, years from now there will be things you won't like. If a home has most of what's really important to you, jump on it.

If you're looking in the City of Madison or its immediate surroundings, expect some homes may be gone before you can even get to see them. Don't let that discourage you. Get prepared… then get out there!

ADVICE FOR SELLERS

If you blend optimism with realism, you should be fine. You may now have *some* pricing power, so erring a *little* on the high side might not hurt you as much as in years past. But we emphasize the word *"little"* for a reason. Avoid the temptation to overprice, as it can backfire on you in the end, especially with the appraisal. Here's why you shouldn't get carried away:

- **Current market conditions:** We're still seeing transactions hung up on appraisal issues. While appraisers do try to take current market conditions into account, they have to compare your house against recent sales of similar homes. You don't know how your neighbor's house will compare to yours or what other homes the appraisers will use.
- **Can't sell less for more.** Appraisers and lenders are now held to very strict standards in the aftermath of the financial crisis. Unless your buyer pays cash, their lender won't allow them to buy your home for more than its appraised value.

Most importantly, in today's internet age, buyers have all the pricing information they need at their fingertips. They generally know an overpriced home when they see one. As always, if you're not in line with the competition, you'll be passed over. Regardless of how hot the market is.