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A YEAR OF EXTREMES

Three months ago, when struggling to find a way to describe our local real estate market, we ran through a list of adjectives: Active? Crazy? Nuts? Ultimately, we settled on *wild*. But, we also described it as "a year of extremes." Three months later, nothing much has changed. If anything, the condition of the market has become even *more* extreme. The forces that have been at work for a few years now—declining inventories, rising demand, low interest rates—are unabated. As we move further into uncharted territory, the nature of the challenge is becoming clearer. As we gain more understanding, perhaps we can start to find solutions.

REAL ESTATE MARKET SOURCE
OF SOUTH CENTRAL WISCONSIN

IT'S NO SECRET that low inventories are at the heart of the challenge. They've been declining steadily for the last five years and the trend hasn't stopped.

For this reason, the market has become more and more strained as time's gone by. This has led to some unusual volatility in the normal seasonal sales pattern. A normal season has February as the start of activity; March-May as the busiest months; June-August as active months; September as the beginning of the slowdown.

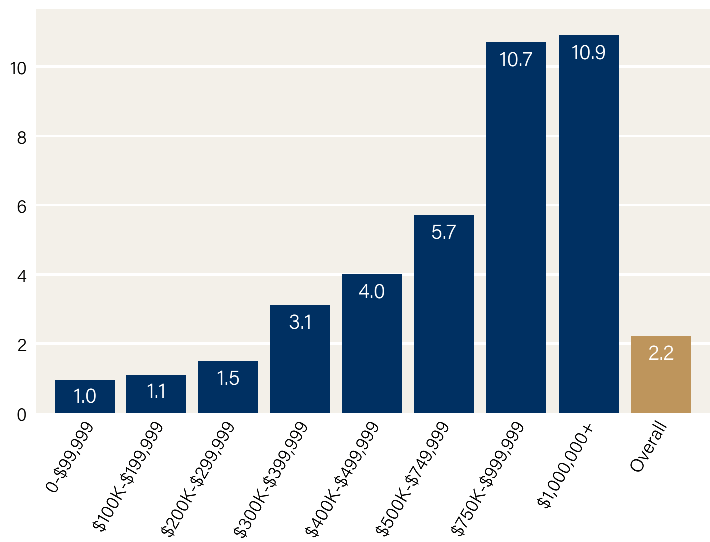
This year, we've had months where home closings have been unusually low (February, May, July), and some that have been unusually high (April, August, September). Offers were flying in the door in April, became sluggish in June and July, and now seem to be picking up again. Home showings, which are normally on a steady downward path this time of year, have actually been rising week over week since before Labor Day. Currently, fall showings are as high as we've seen since we started tracking in 2008. At the end of the second quarter, sales were running slightly behind last year. Now, with a hot September, they're slightly ahead.

So, what are the patterns that are becoming clearer? What can be done about them? What do they mean for our clients as we move into the winter? Let's explore.

MARKET MISMATCH

For a couple years now, the dominant narrative has been "inventories are low." And they are. But there's more to the story. In Dane County, there is a growing mismatch between supply and demand *by price range.* For more than a year, Dane County has been operating with roughly two months of inventory.[†] This is well below the six months commonly thought to represent a "balanced" market where neither buyers nor sellers have a distinct negotiating advantage. When we analyze months of inventory by price range, an interesting pattern emerges.

DANE COUNTY MONTHS OF INVENTORY[†]



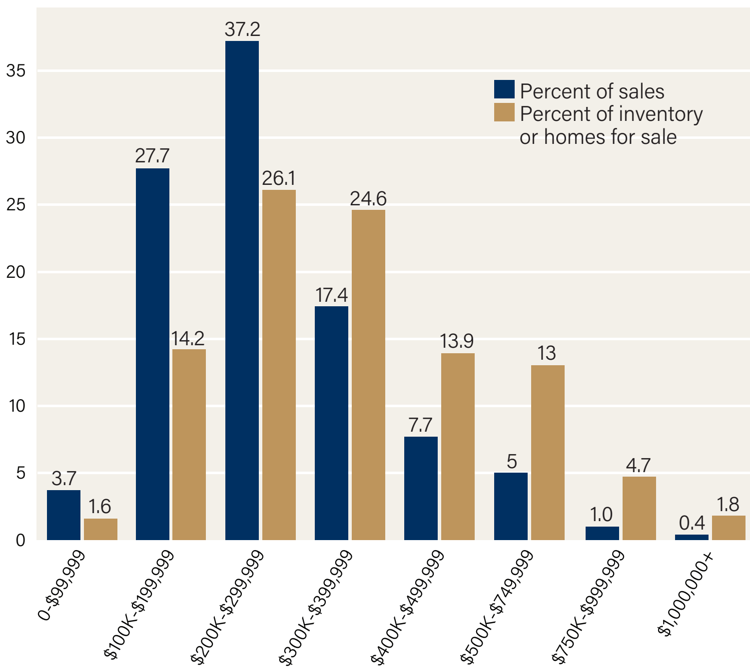
Inventories below $300K are very lean. Between $300K-$750K, supplies range from roughly three to six months. (Still lean, but not as severe.) Over $750K, we have almost a year's worth. Refer to the chart on page two to understand how this equates to a low inventory overall.

How can we have most price ranges with three months of inventory (or more) and yet have an overall inventory of barely two months?

The answer lies in the relationship between the numbers of sellers and buyers in each price range. To paint this picture, we will compare the number of sales during the first nine months of the year to the inventory currently available (as of roughly October 10). What we found is a compelling story that explains the intense competition for homes in the meat of our market—around the $243K median.[‡] The numbers show why most of the buyers are fighting over very few of the houses. Look closely at the graph on the next page.

Nearly *70 percent* of our sales in Dane County are under $300K. Yet, only about *40 percent* of the homes for sale are in this same price range. When you apply the actual numbers, the discrepancy is even more apparent. So far this year, 4,443 homes have sold that were $300K or below. As of this newsletter, there were only 664 homes—single family and condo—on the market in this price range.

DANE COUNTY SALES VS. HOMES AVAILABLE



Nearly 70 percent of home sales are under $300K, while only a little over 40 percent of homes available are in the same price range. In this area of intense competition, well over a third of all sales are in a narrow band between $200K-$300K.

Now take a look at the right side of the graph. We have 60 percent of our inventory over $300K. However, this price range only makes up 30 percent of the buyers. Which raises another interesting question: how can there be so many more homes for sale in the higher price ranges? Where are the move-up buyers?

We've been giving this quite a bit of thought. While the evidence is somewhat anecdotal, there are a couple explanations that fit our experience. First, as we've mentioned in previous editions of this newsletter, our region is growing rapidly. The main driver of that growth is the younger Millennial generation, many whom are first-time buyers (go to starkhomes.com to read our discussion of this phenomenon in our Fall 2015 issue). Most first-time buyers are buying moderately-priced starter homes, in the busy range. Second, and just as interesting, it appears that many sellers of larger homes are buying *down*, not up, in price range. We're seeing retiring baby boomers buying condos downtown, or smaller houses with less maintenance. The pressure on the middle of the market is coming from both above and below. What's the answer?

BUILDING BLUES

The obvious answer, it seems, is new construction. With so much demand and so little supply, you'd think builders would be running to fill the gap. Talking to many builders, they'd plainly love to. Unfortunately, it's not that simple.

Clearly, new construction continues to lag historic norms as shown on the chart on page three. This is not specific to just our region. Nationally, new construction has been running at about 75 percent of normal, and many markets report similar shortages.

What's holding builders back? There are many factors. In no particular order, builders cite a lack of skilled workers (too many left the trades during the recession) and a shortage of developable land. Additionally, builders struggle with high regulatory costs and risk aversion on the part of banks when it comes to both land development and spec lending. (Spec lending is helping a builder to build a house before a buyer is found).

Condos have also been stagnant. There have been few, if any, major condo projects since the recession. This is due to the problems outlined above, with lenders often requiring 50 percent of units to be pre-sold before construction can begin. This is a hurdle most developers won't attempt to clear.

However, the biggest problem builders face is the same supply/demand imbalance as the market overall. Their problem is that it's virtually impossible to build a home in Dane County today for under $300K (including land), where most of the demand is. All the reasons above apply, with land costs being most often cited. With few ready-to-build lots available under $100K

ADVICE FOR BUYERS

We understand the frustration many of you felt last spring when it seemed that making home offers was futile. There's only so much rejection one can take. So, you took the summer off, spent some time on the lakes, and now you're back. It's a good strategy, and it should pay off. With fewer buyers in the market, those of you who are here are being pickier. That's fine, but from a pricing perspective, if you don't buy in the next three to four months, you're going to be back in the spring market again. Beware that prices might start to be bid up further. Plus, we haven't mentioned that the Federal Reserve is signaling another interest rate increase, possibly in December. This might not have much near-term effect, but it's always wise to remember that today's rates will someday disappear. In other words, we're solidly in a market where your total cost of ownership will probably never be cheaper. There's no such thing as a perfect house. If you can get 80-90 percent of what you want – grab it.

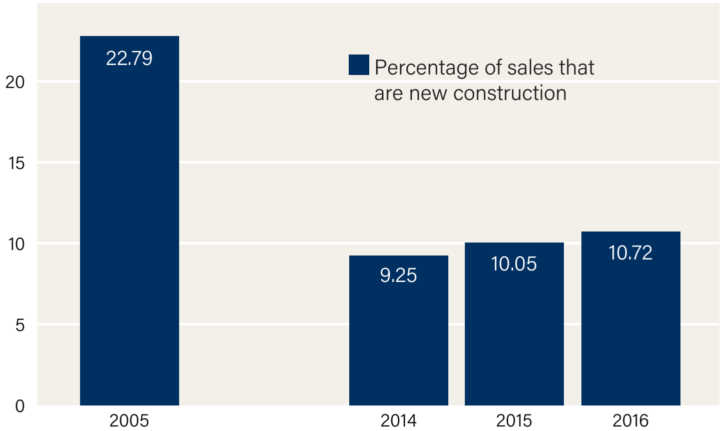
ADVICE FOR SELLERS

There's still action out there, so hang with it. Look closely at our study of supply and demand in various price points. If you're above $300K, and especially above $400K, you're in a very different market than the "average" market we so often talk about. Real estate is all about location, and the supply and demand dynamics are different in every neighborhood. Even the charts in this newsletter don't tell you everything you need to know. Also, the rule that you want your home sold in 30-60 days still applies, unless you're in the hyper-custom market over $750K. Buyers remain focused on "new" inventory, and new listings still get lots of attention. Some still sell very quickly. But activity will decline after your first few weeks on the market, and once the initial burst is over, your likely selling horizon lengthens considerably. If you've been on the market a long time, the market is telling you something. You should listen. And if all else fails, spring is not that far away.

in prime locations, it's almost impossible to build a home that will compete with existing housing under the magic $300K number. Interestingly, we hear that builders are having success with custom building in the middle and upper price ranges—sales which often don't appear in MLS statistics. That's good in the big picture, but doesn't help the median price inventory crunch. Plus, it siphons buyers from the existing housing market in the upper ranges—although this has always been the case over $750K.

There are no easy answers to this building dilemma. We're encouraged by the demand for new construction in the mid-price ranges ($300K-$500K), where inventories are still on the low side. Any addition to the overall supply is welcome. Condos have traditionally filled some of the void for less expensive housing, but it's a small portion of the market and can't fill the gap by itself. As memories of the last recession fade, we hope both lenders and regulators will take a slightly more permissive view of things and help finance the new housing units that all markets desperately need. Until then, our lean inventories are likely to remain.

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 three years, it has only made up roughly 10 percent of single-family home sales.

OUR CRYSTAL BALL

As we gain understanding of what's driving our market, it gets easier for us to advise our clients of what to do, and for them to make good decisions. We mentioned earlier that this year has been volatile and that showing and offer activity seems to be accelerating into the fall. While this is again anecdotal, our agents tell us many buyers, especially first-time buyers, who failed to get a home in the frenzy of the spring, are now back in the market trying to find something. It's a great strategy. We've also seen an ever-so-slight uptick in inventory lately, although still well below a year ago. It all points to another busy spring, with fierce competition and more than likely, rising prices.

Let's be clear: we far prefer these problems to those we had five to ten years ago. Every market has its challenges, and these are the ones we face today. But let's not have them obscure how good this market really is. We're again on pace for a potential record year for sales, and while prices are rising perhaps a bit faster than we'd like, we much prefer rising to falling. Our region is growing and economically dynamic. As we've counseled so many times before, it's always wise to take a long-term view when it comes to real estate. Given time, markets always work themselves out, and this will be no different. Supply and demand will find balance, and builders will find ways to meet the demand created by our growing number of households. It might be a few years before the days of multiple offers on new listings are behind us. But let's be grateful. On balance, it's a good problem to have.

DANE COUNTY									
	Single Family			Condominiums			Total Residential		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
3rd Quarter Closings*	1850	1811	1621	549	504	494	2399	2315	2115
Year-to-Date Closings	5027	4997	4267	1437	1330	1296	6464	6327	5563
Active Inventory	1256	1547	2033	353	455	592	1609	2002	2625
Months of Inventory†	2.4	3.1	4.6	2.4	3.4	4.4	2.4	3.1	4.6
12-Month Median‡	260,000	246,000	235,000	165,400	155,900	153,000	243,000	230,000	218,000

SAUK & COLUMBIA COUNTIES									
	Single Family			Condominiums			Total Residential		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
3rd Quarter Closings*	466	471	363	57	48	51	523	519	414
Year-to-Date Closings	1223	1153	996	137	123	148	1360	1276	1144
Active Inventory	704	864	1118	134	179	164	838	1043	1282
Months of Inventory†	5.3	7.0	10.3	9.0	13.1	11.1	5.7	7.6	10.4
12-Month Median‡	168,250	158,000	144,000	152,500	142,700	139,900	165,900	155,500	142,750

*Sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates between 7/1/16 and 9/30/16. Data for all years was pulled between the 7th-10th of the month following the end of the 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. 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 9/12/16. This is not intended to solicit existing listings.