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BALANCING AN IMBALANCE

One year ago at this time, we looked at the state of the real estate market and struggled to come up with the right adjective to describe it. The one thing we knew for sure was that it was crazy. Well, it's still crazy. But, as we said three months ago, it's starting to become a familiar sort of crazy. Low inventories,† low mortgage rates, high sales and rising prices. The extreme is becoming the new normal. What more is there to say?

Quite a bit, actually. We've always resisted the idea of a "new normal." It implies that things have changed in fundamental ways that will never change back.

REAL ESTATE MARKET SOURCE
OF SOUTH CENTRAL WISCONSIN

MARKETS DON'T BEHAVE THAT WAY. They are always in the process of working their way back to the fundamentals. No matter how distorted they may be in the short run, we don't believe we are in some sort of new normal for the rest of time.

We do believe this market continues to be "out of balance" in terms of supply and demand. The effects of this imbalance are still causing ripple effects throughout the market for buyers, sellers, and professionals in the industry.

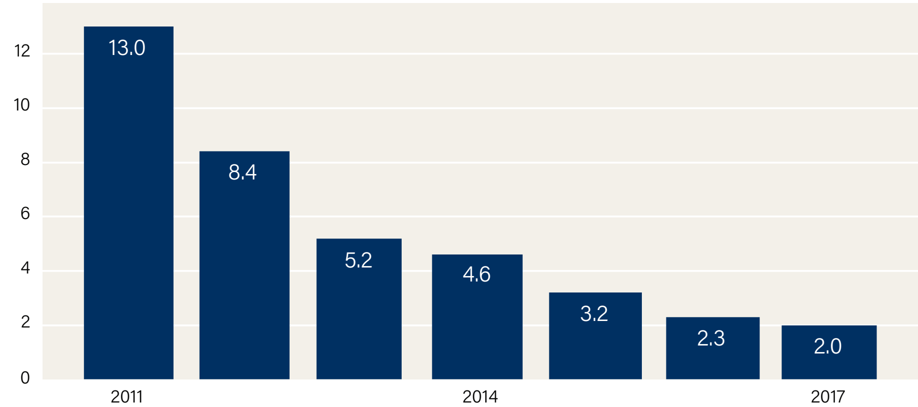
What those effects are, and how they are being dealt with, will be our subject for this quarter.

HOME SHORTAGE: TAKE 7

For our seventh straight edition, the story begins with home inventories and the lack thereof. Current inventories have fallen every year since the last year of the recession in 2011. This year is no exception. In fact, 2017 marks a Dane County record low for this time of year.

As a result, we had another spring market with exceptionally heavy bidding for desirable new listings. It has been common for sellers to receive eight to ten offers their first day on the market. Needless to say, the competition wore heavily on buyers and Realtors alike. It's even tough on sellers; sifting through that many offers, understanding them, and choosing one is not as easy as it might appear. Although, most will agree, it's a classic example of a good problem to have.

DANE COUNTY MONTHS OF INVENTORY IN JUNE



The end of June marks a Dane County record for the lowest months of inventory for this time of year. Inventories have continued to fall every year since 2011—the last year of the recession.

THE DOMINO EFFECT

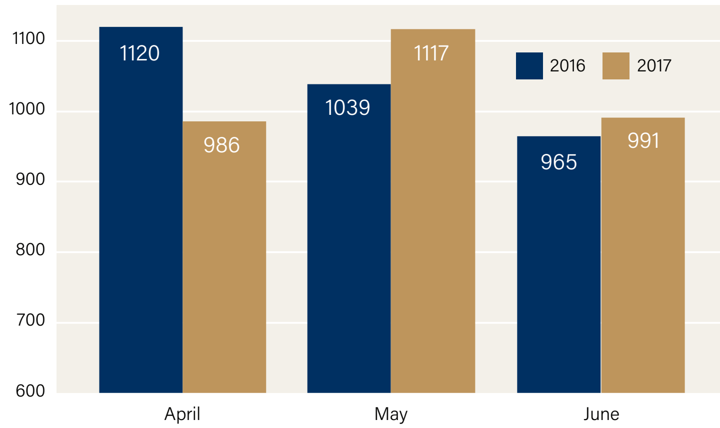
There is much debate in the industry as to whether the shortage of homes for sale is putting a crimp on overall sales. There is evidence that it might be. Sales for the first six months were down more than three percent in Dane County and more than four percent in Sauk and Columbia counties. Keep in mind, those numbers are compared to 2016 when residential sales set a new Dane County record. Also to note, this record was set during a similar period of scarce inventory.

To put into perspective how the low inventory affects sales, someone just recently summed it up; when 10 people make an offer on a property, nine end up losing. As many of those nine have yet to buy, those are nine sales that could have happened, but didn't, and therefore are not yet in final sales numbers.

Another question this raises is whether tight inventories are causing changes in buyer and seller behavior, and in the seasonal patterns we normally see. Again, there is evidence that it might be. For starters, our own in-house offers to purchase were up in June compared to last year. This is the second highest level—behind 2015—for any June on record since before the recession in 2007. If that strength continues into July, it might mean that some buyers who didn't win in the spring are still trying. It may even mean that some buyers chose to bypass the spring madness altogether and make summer offers instead.

There is also evidence that our summer buyers are being rewarded. While the number of overall new listings was down a bit for both the second quarter and year to date, new listings were *up* in both May and June. Interestingly, April is historically the biggest month of the year for both new listings and offers to purchase. This year, April was relatively weak for both. But May and June were another story; new listings and offers were both above the previous year and ahead of the normal pace.

DANE COUNTY LISTINGS BY MONTH



The tight inventories may be causing a shift in the seasonal buying and selling patterns we typically see. April is historically the biggest month of the year for both listings and offers to purchase, with May and June usually trending downward. We have a different story in 2017.

There is anecdotal evidence for this trend as well. A number of agents have reported that sellers, desiring to move in the summer, are now waiting until after school gets out to put their homes on the market. Traditionally, these types of sellers would list in the spring. Their reasoning is clear. In normal times, a seller would allow two to three months to get an offer. Moving in the summer would require a spring listing. Today, many sellers assume their home will sell in a day or two, or perhaps a couple weeks. So more are choosing to list after Memorial Day, anticipating a quick sale, yet retaining the ability to move comfortably in the summer. They're shortening the amount of time they're devoting to the home selling process.

To the extent this is true, buyers would be very well advised to stay in the game. While inventories are still slightly down from a year ago, the decline appears to be leveling off. If more sellers continue to list over the next few months, patient buyers will have more to pick from and less competition. This is how markets correct themselves. More sellers will continue to show up to take advantage of the seller's market, while buyers become more patient. While the days of tight inventories are certainly still with us, there's hope that the process of normalization has started.

PRICE COMPETITION

Inevitably, another way markets correct themselves is through pricing. We know that buyers have been forced to compete fiercely for available listings, and the main object of competition has been price. The data bears this out. Dane County's 12-month combined residential median price[‡] is up nearly seven percent from a year ago, and up more than two percent in just the last three months. Single-family homes alone are up more than seven percent from a year ago.

There are more stories than we could possibly print about the lengths buyers have gone to, but bids of $10,000 to $20,000 over the asking price have been common. Buyers are resorting to other strategies as well to win the battles. One of the most controversial has been the "escalator clause." This occurs when a buyer offers to pay a predetermined amount over the highest price the seller receives from someone else. Clearly, buyers are pulling out all the stops in a very heated market.

BURSTING BUBBLE CONCERNS

With all this going on, one of the most common questions we get asked is: *Are we returning to the bubble years of 2001-2005?* We've addressed this question before. But as the market has evolved, it bears revisiting.

The short answer is still "no," for a simple reason. The last bubble and crash were a result of widespread irresponsible lending practices—too much money was being given to buyers incapable of paying it back. No such reckless lending is taking place today.

Fifteen years ago, we had more inventory than we do today, and mortgage rates were considerably higher. Builders were building at a frantic rate, and speculators were buying homes and flipping them to take advantage of all the money being thrown at the system. The demand was artificial and could not absorb all the supply indefinitely. This eventually led to massive mortgage loan defaults, threatening the entire financial system.

Today's demand is very real with price increases being fueled by a shortage of supply all over the country. Households are forming at a rapid clip, but new construction continues to vastly lag the pace of household formation.

According to Real Trends, a highly respected national real estate consulting firm, nationwide households are growing at 1.3 million per year, and are expected to grow to two million per year as more Millennials enter the workforce. Yet, we're only building 1.1 million homes a year, and most of those are too expensive for first-time buyers. As a result, buyers are bidding prices up not because they're trying to score a speculative windfall, but because they need a place to live.

If more sellers continue to list over the next few months, patient buyers will have more to pick from and less competition. This is how markets correct themselves.

It appears that rising prices are starting to entice more sellers into the market, which is a good thing. We know that many builders and developers are trying to ramp up the pace, although labor shortages, land prices, regulatory costs, and cautious lending are making the process slower than we'd like. We're also hearing that some buyers are tiring of the rat race.

In our last issue, we advised buyers to look at older inventory, where more value might be found. All these trends, taken together, should start to moderate price increases as we go forward. So, we still don't think a 2008-style crash is in the cards. That said, six to seven percent increases are not sustainable over long periods of time either. Leaders both locally and nationally need to turn their attention to this problem, and remove whatever barriers they can to create more supply. If we don't, we're either going to run out of places for people to live or buyers will start to be priced out of the market. We're not there yet. We hope we can get it turned around before we do get there.

FINAL THOUGHTS

In Jim Collins' bestselling book *Good to Great*, he tells us about the "Stockdale Paradox." That when confronted with a difficult situation of unknown duration, you must "face the brutal facts" and accept them as truth. At the same time, Collins depicts how you must never waver in the belief that you *will* prevail.

We don't know how long current market conditions will last, but we are 100 percent certain that they will eventually return to a more normal state. A state when homes routinely take a month or two to attract an offer, and negotiations most often are conducted with one buyer at a time.

New construction *will* pick up, because the demand is there. Our region is growing rapidly, and we *will* have to find a way. Higher prices *will* attract more sellers and slow down some buyers, pushing us to a more normal balance.

Just like the heavily-tilted buyer's market of a few years ago, today's heavily-tilted seller's market cannot last forever; the laws of supply and demand won't allow it. As stressful as this market has been for everyone involved, it's important to remember that it's far better than the opposite, which we experienced in spades from 2007 to 2011.

Despite the challenges, houses are selling. So, let's all face the brutal facts and keep plugging away with the market we have. It's better than the alternative, and who knows what tomorrow's challenges will be.

ADVICE FOR BUYERS

We can't emphasize enough how important it is for you to stay in the game. As much as the playing field has been stacked against you—for a few years now—it's easier in the summer. There is more to pick from and less competition. New listings are still coming on the market; you haven't missed out. If you tried to buy multiple times this spring and never won, we understand fully how discouraging that can be. It's discouraging for us too. But it seems almost universal that when buyers finally do win, they're glad it worked out the way it did. They got the house they were meant to have. If you can still move—and still want to—get back out there. Your odds of success are improving.

ADVICE FOR SELLERS

As with buyers, there's still plenty of time to take advantage of this market, and we commend those of you who decided to wait until this summer to sell. It's helping all of us. Inevitably, however, it will be somewhat less active as the year moves on; you may not get multiple offers on the first day anymore. It might even take you a couple weeks to sell. We continue to advise prudent pricing, rather than reaching for the moon. The pattern we've explained in previous editions of this newsletter still holds; buyers continue to focus on new inventory, and if you stay on the market too long, it becomes increasingly difficult to sell, often resulting in a lower final selling price. But if you do it right, your odds of success remain very high.

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
2nd Quarter Closings*	2050	2111	2172	557	612	558	2607	2723	2730
Year-to-Date Closings	3029	3134	3209	843	880	830	3872	4014	4039
Active Inventory	1096	1184	1530	218	314	470	1314	1498	2000
Months of Inventory†	2.2	2.3	3.1	1.5	2.2	3.5	2.0	2.3	3.2
12-Month Median‡	274,101	256,000	245,000	178,000	160,750	155,000	255,000	238,882	228,700

SAUK & COLUMBIA COUNTIES

	Single Family			Condominiums			Total Residential		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
2nd Quarter Closings*	424	490	460	71	50	48	495	540	508
Year-to-Date Closings	686	755	679	109	76	75	795	831	754
Active Inventory	574	768	958	87	155	194	661	923	1152
Months of Inventory†	4.5	5.8	8.4	5.0	11.2	13.9	4.6	6.3	9.0
12-Month Median‡	171,000	165,000	155,000	148,000	149,350	135,000	168,000	164,000	152,500

*Sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates between 4/1/17 and 6/30/17. †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 7/15/17. This is not intended to solicit existing listings.