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REAL ESTATE MARKET SOURCE

O F S O U T H C E N T R A L W I S C O N S I N

Second Quarter | Vol. 1 Issue 2 | 2006

SECOND QUARTER, 2006



Dave Stark

The chickens came home to roost a little bit in the second quarter of 2006, as sales of both single family homes and condominiums were down in all markets and price ranges when compared to the same period last year. However, if we look at the full year thus far, we see that the pace of sales is still roughly the same as it was two years ago in 2004. Overall residential sales were down 9.3% for the full MLS, and down 12.1% in Dane County. Inventories have continued to rise as well. The problem, particularly for sellers, remains the same; **inventories are double what they were two years ago, and 50% to 70% higher than last year.**

Days of inventory remain much the same as they were after the first quarter. However, it's interesting to note that the number of days of active inventory rose very little from 2004 to 2005, then nearly doubled between 2005 and 2006. Even though inventories started rising last year, the rising pace of sales kept average selling times and absorption rates fairly

level. This year, even the relatively modest downturn in sales has caused inventories to really back up.

There are a number of factors at work here, some we can control, some we can't. Interest rates remain close to the levels of 3 months ago, despite continued Fed tightening. The media environment remains negative (see p. 3), leaving many people that I talk to with the impression that the market is "slow." Prices continue to creep up, but only by about the 4% we predicted, and this seems to be due to a greater slowdown in the lower price ranges more than a true indicator of appreciation (See p. 2). Despite all this, there's enough activity and the rate environment is favorable enough, that smart buyers and sellers can make this market work for them rather than against them if they make good decisions about the variables they can control (see Seller and Buyer Strategies, p.3).

From our perspective, this market is not "slow," but it has clearly changed in character over the last two years. The first half of this decade was a strong "seller's" market, probably the strongest we've ever seen, or will ever see. Interest rates had been

so high in the 80's and early 90's, and came down so far, that a boom in housing was inevitable. That pace couldn't keep up forever. Rates are still low, but prices have risen to soak up the extra purchasing power that low rates gave to buyers, as we would expect. The market is now searching for a new equilibrium, and equilibrium feels "slow" compared to the accelerated pace of the past few years.

Overall, our market remains healthy and robust, but it's no longer frantic and overheated. We believe that inventories will gradually fall as construction moderates (see p. 2). With the spring market now behind us, sellers should re-examine the market over the past two or three months, as well as the existing inventory, and adjust accordingly if they haven't yet been successful. Buyers, on the other hand, should get out there, as the selection is as good as it's been for quite a while.

We hope you enjoy this newsletter, and we welcome your feedback to help us make it even better! Feel free to email us at Feedback@StarkHomes.com

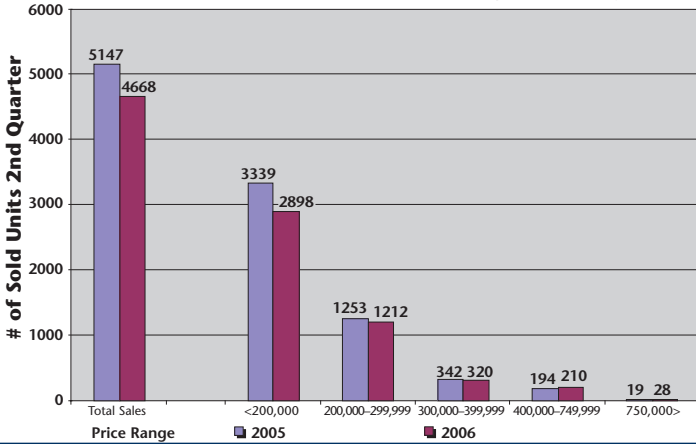
	FULL MLS								
	Single Family			Condominiums			Total Residential		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
2nd Quarter Sales*	3,811	4,296	3,906	857	851	712	4,668	5,147	4,618
YTD	6,086	6,472	5,959	1,335	1,247	1,045	7,421	7,719	7,004
Average Price	\$202,051	\$195,748	\$186,131	\$188,501	\$175,096	\$166,783	\$198,571	\$188,179	\$179,621
Active Inventory	7,596	5,453	4,556	3,041	1,759	1,208	10,637	7,212	5,764
Inventory Days	223	142	131	398	232	190	255	157	140

	DANE COUNTY								
	Single Family			Condominiums			Total Residential		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
2nd Quarter Sales*	1,706	1,983	1,893	646	692	582	2,352	2,675	2,475
YTD	2,636	2,963	2,853	997	1,003	848	3,633	3,966	3,701
Average Price	\$262,865	\$252,647	\$237,105	\$188,085	\$180,345	\$172,769	\$243,828	\$232,258	\$219,586
Active Inventory	2,871	1,831	1,474	2,281	1,207	744	5,152	3,038	2,218
Inventory Days	189	104	87	396	196	143	246	127	100

* Closed sales reported to the SCW MLS between 04-01-06 and 06-30-06. "Inventory Days" represents the number of days it would take to sell the entire active inventory at the pace of sales for the most recent quarter represented, adjusted to account for seasonal variations.

MARKET OBSERVATIONS

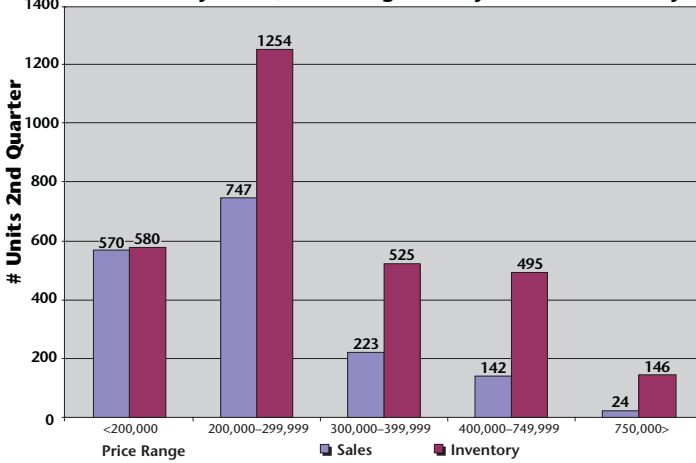
Full MLS Total 2nd Quarter Sales by Price Range



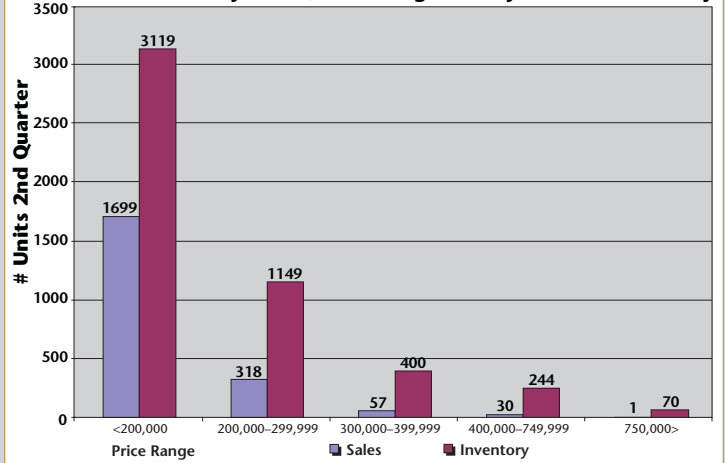
Price Paradox

For the full MLS, residential sales, including condos, were down 9.3% in the second quarter, but are down only 3.9% for the year. Oddly, the falloff is greatest in the under \$200,000 price range, where demand is the highest. Sales under \$200,000 were down 13.2%, while sales over \$400,000 were up almost 12%. This was true both inside and outside Dane County, unlike the first quarter of 2006, when sales under \$200,000 were up slightly outside Dane County. The fact that sales fell so sharply outside Dane County, particularly in the lower price ranges, may indicate that higher gas prices are starting to take a toll. It also may be that the rise in interest rates, though very modest, is scaring away some first time homebuyers, which would be a shame given the opportunities this market still affords them. Nonetheless, there were still more sales overall in the first half of 2006 than there were in the first half of 2004, which at the time was a record year.

Dane County 2nd Quarter Single Family Sales vs. Inventory



Outside Dane County 2nd Quarter Single Family Sales vs. Inventory

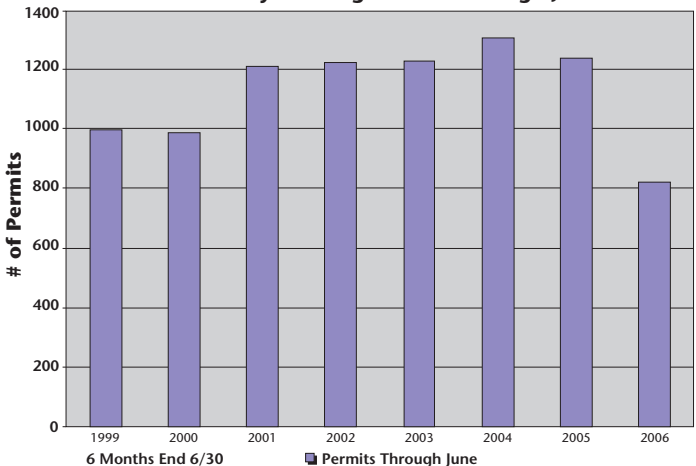


Where the Homes Are

Single family homes are still the backbone of our real estate economy, and the picture looks very different depending on where you are, and what price range you're in. Dane County has about 3 months of single family inventory (condos not included) under \$200,000, and about 6 months worth from \$200,000 – \$300,000. Outside Dane County, there are 3 times as many sales under \$200,000, but over 5 times as much inventory. In all other price ranges, Dane County has many more sales, and days of inventory are 2 to 3 times higher outside Dane County.

It's not surprising that prices are generally higher in Dane County. It's the hub of the market. But buyers who are willing to travel a bit have a wealth of options outside Dane County, in all price ranges. The same is true inside Dane County, but you'll pay about 30% more.

Dane County Building Permits Through June 30



Building Slowdown

Through June, there have been 822 single family building permits filed in Dane County, down 33.5% from last year. It's the lowest 6 month total in the last 8 years. There is no existing method to track new condo permits, which may be taking up some slack. Nonetheless, it seems clear that builders are pulling back in the face of high inventories. This is a natural cyclical response to current market conditions. It will ultimately lead to lower inventories, perhaps as soon as next year. Though sometimes more expensive initially, buying new construction has its advantages, including the latest building technology, updated amenities, new mechanicals, builder warranties, and the absence of any obsolescence or wear and tear. Plus, you often have more input into how the home is decorated, or you can build your own design. Once again, we urge buyers to take the long view when it comes to making a decision on buying new construction. Over a five to 10 year period, the price differential is probably negligible.

NEWS

Madison homes are 11.3% overpriced. (*Wisconsin State Journal*, June 15, 2006, citing a national study released by Global Insight and National City Corporation in Cleveland, OH.)

VIEWS

I've reviewed the methodology used by Global Insight, and while their methods are sound, the study makes for better headlines than a useful guide to buyers and sellers.

- The study uses "housing density" (number of households divided by land area in square miles) as a "proxy for scarcity of land," implying that more "dense" markets should have higher land costs.
- The study only uses 30 year fixed rate loans in conjunction with household income to determine statistically what buyers "should" be able to afford. Adjustable rate loans are not taken into account.
- The study states that their variables account for 77% of price fluctuations, leaving a great deal to other factors.

CONCLUSION

The study is completely statistical in nature, meaning the variables chosen determine what the result "should" be. Housing markets are open ended, complex, and subject to countless influences. Our guess, based on our feel for our market, is that price appreciation will slow over the next few years, but still be positive. The study results are an arbitrary snapshot of a moving target. We'll be less "overpriced" in future studies.

NEWS

Harvard's Joint Center for Housing Studies says that "...there may be bumps along the way, but the long-term health of the housing market is intact." ("Housing Boom 2.0," *CNNMoney.com*, June 13, 2006)

VIEWS

The Harvard study appears to be one of the most balanced and rational we've seen in a while, focusing on the long term, which is crucial to understanding real estate. According to the study, demographic changes make it likely that "The number of homes needed to meet demand in the next 10 years will likely exceed the 18.1 million units built from 1995 to 2004." Among the factors:

- **Booming Household Growth.** We'll add 1.37 million households this year.
- **Graying Boomers.** They're buying more second and vacation homes.
- **Changing Household Composition.** Smaller households, more single person households, more divorces, more adult children leaving the nest.
- **Minority Gains.** African American and Hispanic home ownership is on the rise.
- **Home Equity.** Equity accounted for 56% of total home value in 2004 (the most recent year available). 94% of owners have equity of 10% or more, 87% have 20% or more. Only 3% have less than 5% equity.
- **Government Influence.** "Government regulations, by limiting supply, also make it unlikely that housing prices will fall greatly. Land use restrictions, zoning laws and building codes make building housing difficult and expensive." Enough said.

CONCLUSION

Demand is likely to continue to exceed supply over the long run, and most owners have plenty of equity at today's prices to withstand any downturn in the short run. Our relatively affordable housing and high quality of life makes our market attractive to many, and growth will surely continue. We need to keep making it easier to build the housing we need.

STRATEGIES FOR SELLERS AND BUYERS**SELLERS**

Our advice from 3 months ago is even more urgent today. This is not the market "try it" for a while to see if you can get top dollar, or more, particularly heading into the fall. Buyers often don't just "make an offer" to see if you'll take it. They usually buy the house down the street for the same price that is a better value. When you appear uncompetitive, you're signaling that you're either hoping to take advantage of someone, or that the negotiation will be difficult and uncertain. Buyers simply have too many choices in this market. You can also become "shopworn" fairly quickly, and we're finding those sellers are often getting less than they could have had they been competitive from the start. Don't cut corners in this market. Get good advice from a professional, get your house in top condition, and price it attractively right out of the gate. Your odds of selling are still excellent if you do it right.

BUYERS

If you haven't taken advantage of this market yet, you still have time. 30 year rates are still below 7%, and inventories remain ample. Some buyers seem to be afraid of "overpaying" in this market, which has led to contention in many negotiations. Stop worrying. Our market is not fundamentally overpriced, and prices are not poised to fall, even in the short run. Real estate should always be purchased with a long term view, and while we expect prices to be fairly level for the next year or two, there's no reason to fear a collapse. But the fact remains that you have plenty of options in every price range, which makes this the best time in the last 5 or 6 years to find the home you really want. We also reiterate our advice to look at properties that have been on the market a while. You won't have as much competition from other buyers, and you'll probably find some great homes where the seller had been unrealistic in the past but is now ready to work with you. At the same time, don't assume that every seller is ready to sell for a song. If they're priced competitively, they'll probably get what they're asking for. Be aggressive, but don't outsmart yourself.

REAL ESTATE MARKET SOURCE

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EAST

4509 Cottage Grove Road
Madison, WI 53716
608-221-4000

SUN PRAIRIE

1625 W. Main Street
Sun Prairie, WI 53590
608-837-7345

MIDDLETON

1818 Parmenter Street
Middleton, WI 53562
608-831-3234

COLUMBUS

111 South Ludington Street
Columbus, WI 53925
920-623-5500

STOUGHTON

1609 Hwy 51 & Hwy 138
Stoughton, WI 53589
608-873-8181

RELOCATION

2980 Arapaho Drive
Madison, WI 53719
800-779-4037



TREND WATCH

Likely direction next 6 months

Number of homes sold (annualized)*

	Full MLS	Dane Co.
2nd Quarter, 2006	15,593	7,628
1st Quarter, 2006	16,054	7,937
2nd Quarter, 2005	15,211	7,913

* Sales for 12 months ended 06/30/06

Comments

Dane County is a little soft, but we're not far off our records. The 3rd Quarter should be interesting.

30 Year Mortgage Rates

June, 2006	6.81
March, 2006	6.45
June, 2005	5.71

There seems to be resistance to going over 7%. The Fed is almost done.

Average Residential Price – Single-Family & Condos

	Full MLS	Dane Co.
June, 2006	198,571	243,828
March, 2006	194,923	246,714
June, 2005	188,179	232,258

Slight decrease in Dane County in 3 months, but still up 5% from last year. Lots of condo sales under 200,000 are pulling down the average.

Building Permits – Dane County Single-Family

	2nd Quarter	YTD
1st Quarter, 2006	429	822
1st Quarter, 2005	697	1236

Construction will probably be off for the rest of the year.

Inventories – Residential & Condos

	Full MLS	Dane Co.
2nd Quarter, 2006	10,637	5,152
1st Quarter, 2006	9,257	4,629
2nd Quarter, 2005	7,212	3,038

We were wrong last quarter, but I still think they'll start to fall.

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