



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

2007 FIRST QUARTER

First Quarter | Vol. 2 Issue 1 | 2007



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So far, 2007 seems to be unfolding pretty much to form. In our last newsletter (4th Quarter 2006), we predicted that closings reported in the first quarter of 2007 would run slightly behind closings for the first quarter of 2006. As of mid April 2007, sales reported to the South Central Wisconsin MLS for the first quarter trail last year by 8%. This probably overstates the drop, since stragglers will continue to report closings for the next few months. It wouldn't surprise us if another 100 or so sales will be on the books when we look back next year. **Nonetheless, there are a number of very positive, and underreported, trends at work behind those numbers that bear analyzing.**

Inventories: In the chart below, you see that inventories have risen slightly from the same period a year ago, although not nearly as much as they did the year before that. However, if you compare both inventories and the pace of sales to 3 months ago, you'll see that the number of days of inventory on the market have actually fallen for both single family homes and condos (see chart, p.2). Condo inventory on the MLS hasn't grown at all since the 4th quarter, although

it remains stubbornly high. Building permits are down even further this year than they were last year, which will continue to hasten the fall in inventories.

New Construction vs. Resale Housing: For all of 2006, single family sales fell 7.8% for the entire South Central Wisconsin market, and 11.1% for Dane County. However, if you break those sales up into new and used, you see a different picture. **Single family resales were down only 5.5% for the entire market, and 6.2% in Dane County.** New construction, by contrast, was down 20.1% for the entire market, and 27.2% for Dane County. For the first quarter of 2007, resales are down only 1.4% for the entire market, and are actually up 1.5% in Dane County. New construction sales, however, were down 30% in Dane County for the first quarter of 2007 compared to a year ago.

There is always a 30 to 60 day lag between offers and closings, so the numbers you're seeing for the first quarter reflect activity from the holidays and January/February, always the slowest time of the year for offers. So far, offers have tracked pretty closely with a year ago, which is good news, because the first half of last year wasn't that bad. If we have a "normal" second half of 2007, we should have a much better year than last.

DANE COUNTY									
	Single Family			Condominiums			Total Residential		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
1st Quarter Sales*	916	970	984	251	354	312	1,167	1,324	1,295
Active Inventory	2,875	2,637	1,688	2,425	2,147	1,135	5,300	4,629	2,823
Inventory Days	201	190	109	618	423	231	290	252	138
Average Price	\$256,156	\$260,632	\$245,678	\$201,604	\$220,150	\$184,452	\$244,450	\$249,713	\$230,891

SAUK COUNTY									
	Single Family			Condominiums			Total Residential		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
1st Quarter Sales*	124	108	109	21	22	12	145	130	121
Active Inventory	546	504	367	224	239	156	770	743	523
Inventory Days	282	298	215	682	695	831	340	365	276
Average Price	\$164,973	\$178,605	\$171,812	\$141,038	\$248,752	\$208,263	\$161,507	\$190,384	\$175,426

COLUMBIA COUNTY									
	Single Family			Condominiums			Total Residential		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
1st Quarter Sales*	100	129	101	10	13	19	110	142	120
Active Inventory	502	439	312	177	88	98	679	527	410
Inventory Days	321	218	198	1,132	433	330	395	237	218
Average Price	\$166,194	\$190,821	\$174,145	\$175,161	\$232,193	\$174,664	\$167,047	\$194,739	\$174,227

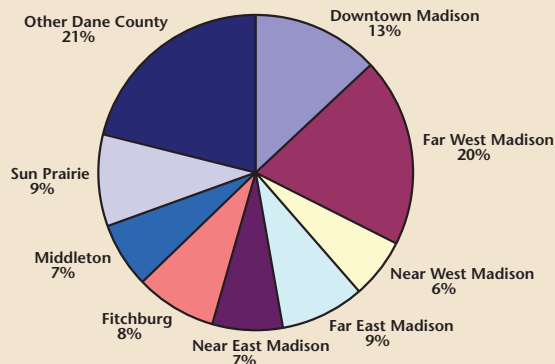
* Closed sales reported to the SCW MLS between 01-01-07 and 03-31-07. "Inventory Days" represents the number of days it would take to sell the entire active inventory at the pace of sales for the most recent quarter represented, adjusted to account for seasonal variations.

MARKET OBSERVATIONS

WHAT'S REALLY GOING ON WITH CONDOS

Clearly, the number of condominiums available has grown considerably in the last few years, and as the statistics in this newsletter show, there are more days of condo inventory on the market than is true for single family homes. However, many observers incorrectly perceive that this is a "downtown" phenomenon, reacting to the number of expensive high rise condo projects there.

Distribution of Condo Inventory in Dane County



As the accompanying charts illustrate, downtown condos are really a small part of the picture. **Downtown condos represent only 13% of the condo inventory in Dane County, and 25% of the inventory in Madison proper.** Of the 2425 condos on the market in Dane County at this writing, only 341 are "downtown." Another 322 are scattered through what I'd call the "Near" East and West sides, between Whitney Way on the West and Hwy 51 on the East (not including Downtown). But there are over twice that many (685) on the "Far" East and West Sides. Add in the condos being sold in Middleton, Fitchburg and Sun Prairie, and there are 1,276 condos for sale in what might be called the "fringe" of Madison, the areas where much of the new construction is happening.

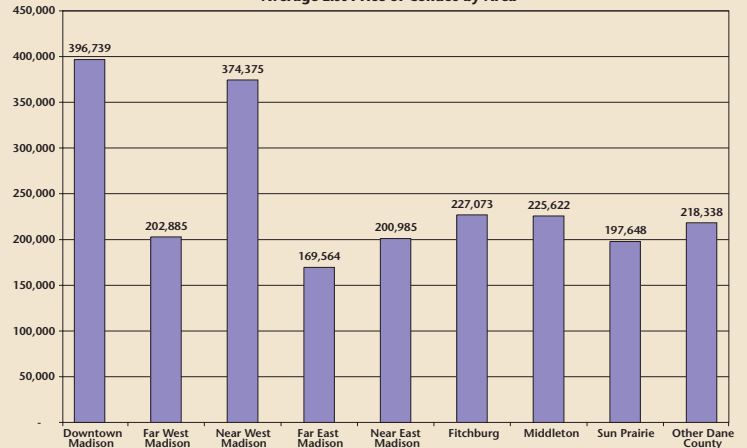
They're not all "expensive" either. Only 152 of the condos on the market today are listed for more than \$500,000. Over half (1310, or 54%) are listed for under \$200,000. 26.5% are listed between \$200,000 and \$300,000, and 24% are listed between \$300,000 and \$500,000. As the chart shows, the most expensive properties are indeed Downtown, but after that, condo inventory is very reasonably priced, and tends to get less expensive the farther out you go. Far West Madison in particular, with the largest inventory of any sub-area, has among the most reasonable prices.

FALLING PRICES?

We suspect you noticed that average prices reported from the MLS on page 1 were down in comparison to a year ago. Don't be misled; this is probably not an indication that prices in general are falling. Rather, it's an indication that there was more activity in the less expensive tiers of the market. For example, single family sales in Dane County were down 5.5% under \$200,000, but down 18.8% over \$500,000. The MLS also publishes a "median" price, which is the mid-point for all sales reported in the period. That was essentially flat in Dane County for single family and condos combined at \$214,000, compared to \$214,900 a year ago.

The best appreciation barometer is the quarterly report from OFHEO (Office of Federal Housing Enterprise Oversight), which tracks actual sales prices over time on the same property. For the 4th quarter 2006, they reported a 0.79% increase in prices in our market, and a 4.12% increase for the whole year. The First Quarter 2007 report will be out in a few weeks. It will be interesting to see what it says.

Average List Price of Condos by Area



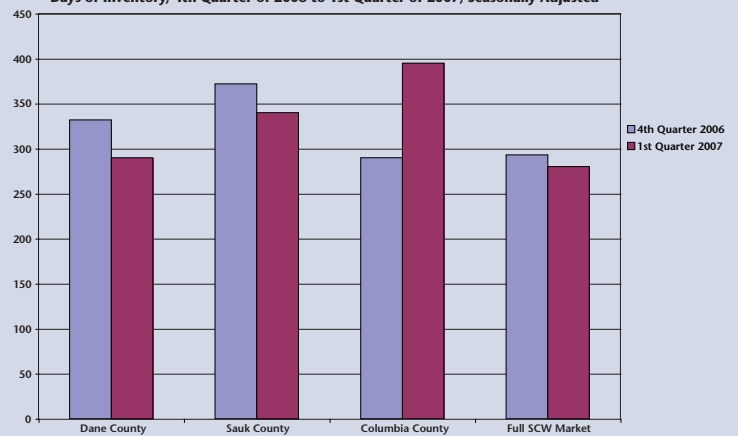
So what's really going on here? With land costs rising and the desire by regulators to increase density, condos have become the only way to create new inventory at affordable prices. They've also become an attractive option for many buyers who want the financial advantages of home ownership without some of the maintenance. Some of the least expensive inventory on the market has been created by condo conversions; there's a great deal of this on the Far East and West sides. **However, once a developer is committed, the whole project comes to the market, and it's not uncommon for it to take a few years for a project to sell out, even in the best of selling environments.**

Some have suggested that our market is "over-condoed." If so, it's a short run condition. The current inventory will work itself down eventually, and demand for condos has been fairly steady. Our area continues to grow, and with it, demand for all types of housing will grow. Don't be surprised if a few years from now, people are complaining about a "shortage" of condos again in our market. The pendulum always keeps swinging. It's no different today.

FALLING INVENTORIES

When measuring inventory levels, it's useful to compare not just to the same time last year, but quarter to quarter. By that measure (other than Columbia County, which had a tough quarter), the days of inventory currently on the market for combined single family and condos have fallen over the last 3 months on a seasonally adjusted basis (about 21.3% of closings normally occur in the 4th quarter, while only 17.5% normally occur in the 1st quarter). Looked at this way, you can see why we're optimistic about inventory levels. Expect this trend to continue for the rest of 2007.

Days of Inventory, 4th Quarter of 2006 to 1st Quarter of 2007, Seasonally Adjusted



THE "CRISIS" IN SUB-PRIME LENDING

Just when the overblown talk of a real estate "bubble" had begun to subside, a new sensational story broke in March. The Mortgage Bankers Association issued its quarterly "National Delinquency Survey," citing a "record" increase in delinquencies and foreclosures, most notably in the "sub-prime ARM" category. While the issues raised by the report are real, and will have some effects on the real estate market in general, they are probably not as cataclysmic as immediate media reports would have you believe, and over the long run, the effects will be mostly positive.

First, what are we talking about when we discuss "sub-prime" loans? Simply put, sub-prime loans are loans made to borrowers with marginal credit scores. They are by their nature riskier than "prime" loans. Starting in 2004, sub-prime loans began to grow as a percentage of all loans, standing at about 13-14% today, taking market share from government loans (FHA and VA). "Prime" conventional loans also grew during this period, but not by as much. Often, sub-prime loans are "ARM's" (Adjustable Rate Mortgages), which feature lower initial interest rates, but adjust every 1 to 3 years. It's this upward adjustment that has thrown some borrowers into financial difficulty.

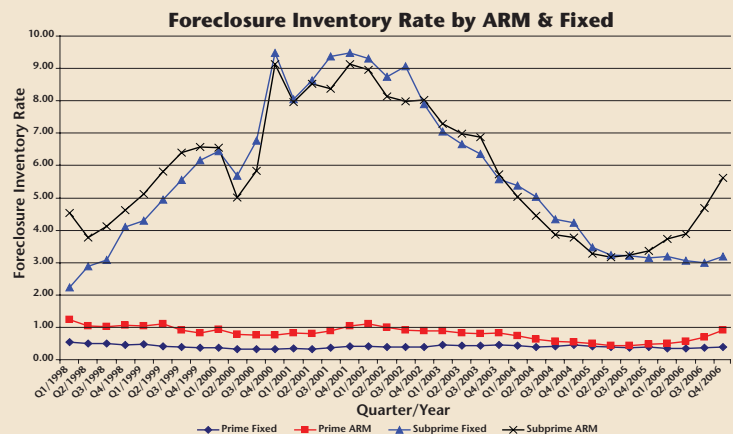
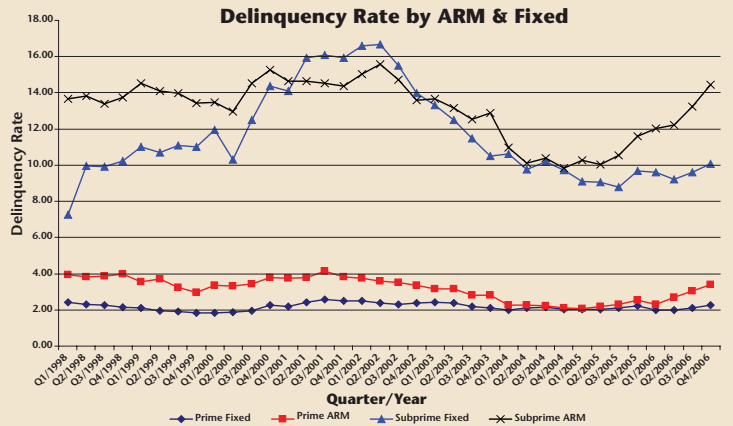
Because the housing market slowed in many markets in 2006, the media has spun this story as part of a continuing "crisis" in housing. And on the face of it, it's true that slowing appreciation rates have contributed to the difficulties in high appreciation markets (which our market is not). To the extent that interest rates have risen in the past 3 years, it has been the short term rates on which adustables are based that have gone up, causing further problems.

Finally, financial problems at a few of the sub prime specialty companies that sprang up in the last couple years, and then got over extended in the current crunch, gave the media even more to feast on.

However, look at the accompanying charts, taken from a Power Point presentation by Doug Duncan, SVP and Chief Economist of the Mortgage Bankers Association, titled "We Call it Sub Prime for a Reason," dated March 16th, 2007. While the sub prime ARM delinquency and foreclosure rates have spiked up in the last year, they are still within the historical range for the type. They were higher 5-6 years ago. Furthermore, according to the MBA's press release for the most recent National Delinquency Survey, the delinquency rate for all loans stood at 4.95%, up only from 4.67% in the previous quarter, and up from 4.7% a year ago. So, while we don't want to minimize the impact this has on the families directly affected, in the big picture, the overall effect will be minimal, particularly in our market.

So what's good about this? We have believed for some time that the lending standards for sub-prime loans were becoming a little too lenient in the past few years. Most experts agree that it is in everyone's best interest to keep borrowers out of mortgages that they won't be able to afford. The industry is quickly tightening it's standards, so some buyers may have to lower their sights a little. If that results in fewer foreclosures, that's a good thing.

I'll close by quoting the MBA's Doug Duncan from the afore-mentioned press release: "The market is working, culling over-capacity from the industry... Far from being a problem, these clear and effective market signals and actions will help the market to more efficiently regain its equilibrium." Amen.



STRATEGIES FOR SELLERS AND BUYERS

SELLERS

It's been an up and down first quarter for you. Pressure from new construction is easing, and inventory is starting to fall in relation to demand. But the scales have yet to tip fully in your favor, so you've still got a lot of competition, and you still need to play it smart. Offer activity has been choppy so far this year. Just when things seem to be breaking open, a snowstorm hits, or a media storm hits (see Sub Prime above). Overall, however, activity is similar to last year, the spring market is here, and we don't expect to see the second half swoon we saw in 2006. **For now, we continue to recommend pricing and marketing your property with a keen eye on your competition.** That's always good advice. We don't see prices starting up again until next year, so play by today's rules. You're almost always money ahead if you can get the job done now.

BUYERS

Inventories are always at their highest around this time of year, as sellers take advantage of the spring market. But the "sold" signs are starting to go up faster this year, so we think the "glut" is coming down. **Days of inventory are steadily falling, and we're very close to "balance" in Dane County already. We think prices will start up more quickly next year, so getting in now is better than waiting.** Don't let the sub-prime stories scare you off. We're not going to see a rash of foreclosures in our market, given the strength of our economy and moderate appreciation rates, so inventories here will shrink, not grow. If you do take an ARM, however, be sure you understand its terms before you sign, and use a reputable local lender. Stay away from internet lenders; that's where many problems began.

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TREND WATCH

Number of homes sold (annualized)	Likely direction next 6 months			Comments
	Dane	Sauk	Columbia	
12 mo. ended, 03/31/07	6,987	790	720	↔ Probably one more flat quarter, then sales will start back up.
12 mo. ended, 12/31/06	7,137	776	752	
12 mo. ended, 03/31/06	8,014	776	832	
30 Year Mortgage Rates				
March 2007		6.29		↔ Continued stable and very affordable
December 2006		6.31		
March 2006		6.45		
Average Residential Price – Single-Family & Condos				
	Dane	Sauk	Columbia	↔ Don't let the drops fool you – there was more activity in the lower end of the market.
March 2007	\$244,450	\$161,507	\$167,047	
December 2006	\$249,647	\$188,212	\$185,606	
March 2006	\$246,714	\$190,384	\$194,739	
Building Permits – Dane County Single-Family				
	First Quarter			↓ It looks like its going to be a while before builders can get aggressive again.
2007	254			
2006	394			
2005	544			
Inventories – Residential & Condos				
	Dane	Sauk	Columbia	↓ It may not be evident until the 3rd Quarter, but they're starting to move toward balance.
March 2007	5,300	770	679	
December 2006	5,048	734	577	
March 2006	4,629	743	527	

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