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RELEASED FEBRUARY 2008

FOURTH QUARTER 2007 | VOL. 2 ISSUE 4

2007: The Year in Review



Dave Stark

One year ago, we looked back on 2006 and described it as "strange." If 2006 was strange, then 2007 was downright bizarre. As we reported last quarter, what started out as a promising if unspectacular year turned into a melodrama when the nation's credit system suddenly went into cardiac arrest. Needless to say, the result was a disappointing finish to the year. For the combined Dane, Sauk, and Columbia County market, single family and condo sales were off 12% in the fourth quarter compared to 2006. For the year, we were only off 6%, reflecting the promise the market was showing before August. The hope going into 2007 was that the second half would surpass the weak second half of 2006, sowing the seeds for a strong 2008. The issues in the credit markets,

and the accompanying media hoopla, put a damper on that. (See below for more on this topic.)

As our readers know, adjustable rate loans made in the past couple years will be resetting throughout 2008, so we are likely to continue to read about delinquencies, foreclosures, and problems in the credit system. But this is starting to become old news to many, and we're hopeful that most of the big bombs have already exploded. Politicians and Federal Reserve officials are busily coming up with "rescue plans," and although it remains to be seen how effective they will be, they probably won't hurt in the short run, unless they spook people yet again into thinking things are worse than they really are. So what does the coming year have in store? While the events of the last four months drive home the danger inherent in making predictions, we think it's best to look to fundamentals for evidence of what's going to happen, sooner

continued on page 2

DANE COUNTY

| | Single Family | | | Condominiums | | | Total Residential | | |
|----------------------|---------------|-----------|-----------|--------------|-----------|-----------|-------------------|-----------|-----------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| 4th Quarter Closings | 820 | 903 | 1,044 | 251 | 281 | 383 | 1,071 | 1,184 | 1,427 |
| Year-to-Date | 4,923 | 5,133 | 5,827 | 1,750 | 1,931 | 2,154 | 6,673 | 7,064 | 7,981 |
| Average Sales Price | \$278,488 | \$269,433 | \$259,760 | \$206,633 | \$196,769 | \$184,347 | \$261,948 | \$249,647 | \$239,343 |
| Active Inventory | 2,531 | 2,624 | 2,318 | 2,059 | 2,424 | 1,695 | 4,590 | 5,048 | 4,013 |
| Mos. of Inventory | 7.9 | 7.5 | 5.7 | 21.1 | 22.1 | 11.3 | 11.0 | 10.9 | 7.2 |

SAUK COUNTY

| | Single Family | | | Condominiums | | | Total Residential | | |
|----------------------|---------------|-----------|-----------|--------------|-----------|-----------|-------------------|-----------|-----------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| 4th Quarter Closings | 105 | 129 | 147 | 20 | 25 | 22 | 125 | 154 | 169 |
| Year-to-Date | 599 | 639 | 655 | 103 | 131 | 110 | 702 | 770 | 765 |
| Average Sales Price | \$180,384 | \$182,714 | \$176,158 | \$248,419 | \$214,917 | \$181,323 | \$191,269 | \$188,212 | \$176,899 |
| Active Inventory | 540 | 526 | 455 | 224 | 208 | 179 | 764 | 732 | 632 |
| Mos. of Inventory | 13.2 | 10.5 | 7.9 | 28.8 | 21.3 | 20.8 | 15.7 | 12.2 | 9.6 |

COLUMBIA COUNTY

| | Single Family | | | Condominiums | | | Total Residential | | |
|----------------------|---------------|-----------|-----------|--------------|-----------|-----------|-------------------|-----------|-----------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| 4th Quarter Closings | 106 | 138 | 149 | 10 | 17 | 13 | 116 | 155 | 162 |
| Year-to-Date | 607 | 666 | 728 | 70 | 86 | 77 | 677 | 752 | 805 |
| Average Sales Price | \$166,376 | \$183,422 | \$170,187 | \$168,780 | \$202,270 | \$179,138 | \$166,583 | \$185,606 | \$171,039 |
| Active Inventory | 488 | 463 | 379 | 184 | 114 | 110 | 672 | 577 | 489 |
| Mos. of Inventory | 11.8 | 8.6 | 6.5 | 47.3 | 17.2 | 21.7 | 14.9 | 9.5 | 7.7 |

* Closed sales reported to the SCW MLS between 10-01-07 and 12-31-07. "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 quarter represented, adjusted to account for seasonal variations.

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or later. And on that score, our market appears headed inexorably back toward balance.

Although there are many variables influencing the performance of the market, four are particularly important: inventories, prices, interest rates, and employment. In our market, all four are flashing positive signals. Inventories are slowly falling, housing prices are steadily rising, interest rates are falling, and the employment picture in our market remains rosy. We'll discuss all four of these variables in more detail in this issue, along with a few others. And for better or worse, we'll once again make our fearless prediction for activity in the upcoming year.

Even before that, however, we'd like to share what we think is an important thought on the (crisis, meltdown, recession, bursting bubble, take your pick of catastrophic labels) that has dominated media attention for the past four months. As very interested observers watching events unfold, we've concluded that there's a critical distinction to be made about the real nature of the "bubble."

Bubble? What Bubble? For a couple years now, we've been bombarded with stories about the "real estate bubble." The events of the past 18 months have been presented as evidence that the housing market is in disarray. But if you read the stories carefully, you might have noticed a subtle but important nuance.

As we reported in our 3rd Quarter 2006 issue, an asset "bubble" has been defined as "a market in which the value of the key asset is inflated based on speculation and psychology." In other words, the trading price of the asset becomes disconnected from the true economic value of the asset. Since markets always work in the long run, true bubbles eventually burst, bringing prices back in line with fundamentals. And sure enough, our readers know that in many real estate markets around the country, this is just what happened. **But it hasn't happened here, nor has it in most parts of the country. Where, really, is the bubble?**

If you read our previous issue, you learned about the "sub-prime meltdown" that sent all of us into a tailspin last August. If you carefully read the news stories since then, you noticed that most were not really about real estate. They were about banks. Some of the biggest players in the national financial industry (Citigroup, Merrill Lynch, Bank of America, Morgan Stanley, Countrywide, Wells Fargo, the list goes on) reported huge "write-downs" in their profits. Write-downs? Bursting bubble? As the smoke clears, it appears that the asset class experiencing a bubble is not just, or even primarily, real estate. **In most markets, including ours, real estate prices have not strayed far from their fundamental value. The real bubble, the big one that's really causing problems, is in the credit system, specifically the sub-prime loan packages that are still on the books of many financial institutions. That's where the big losses are being taken.**

Of course, these events have indeed had a substantial impact on real estate markets. Our readers are aware that in many states, particularly California, Arizona, Nevada, and Florida, the credit bubble did lead to a real estate bubble, as speculators pumped easy money into real estate, driving prices up more quickly than the fundamentals warranted. Prices in those markets are now coming back to earth, leading to the story line that there is a "real estate problem." But that problem is very localized to those markets that fell victim to speculative fever. We were not one of those markets, and that's why our prices are not falling. To be sure, we are not unaffected either, as the pace of sales in our market has slowed, driven largely by the negative psychology these stories have created. And foreclosures have climbed in our market too, although no where near the pace of the bubble markets, nor are they adding to our inventory in any significant way. But the crucial distinction is that this is not some fundamental problem with real estate as an asset class. **If you don't live in one of the "bubble**

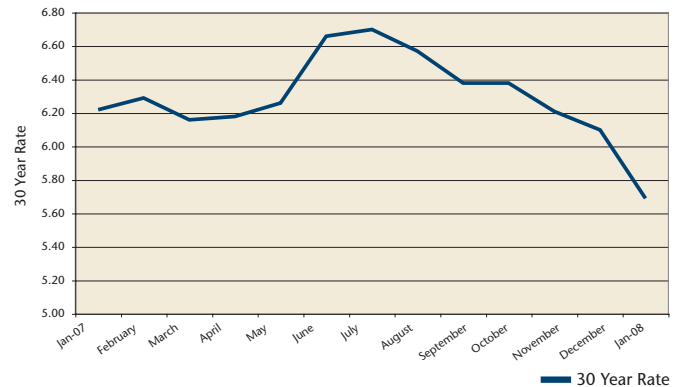
markets," which we don't, then your investment in real estate is safe. If you invested in sub-prime loan packages, well, that's another story!

2008: The Year Ahead

Here are our readings on the important variables that will drive our market in 2008. Assuming that there is not another credit bomb waiting to blow up, which seems unlikely at this point, then these are the signals that we think point to better times ahead.

Interest Rates. As we write this (January 22, 2008), the Federal Reserve has just cut both the Fed Funds and Discount Rates by a whopping 3/4 of one percent in a surprise move. Clearly, the credit market jitters we referenced above have gotten the Fed's attention. But even before this latest cut, 30 year and 15 year mortgage rates had fallen to very near their lows of three or four years ago, and about three quarters of a percent below their levels one year ago. It looks certain that the rate outlook will be very favorable into the spring market. **And contrary to some reports, financing is readily available from a variety of sources with excellent terms, including low down payments for credit worthy borrowers.**

Freddie Mac 30-Year Fixed Rate

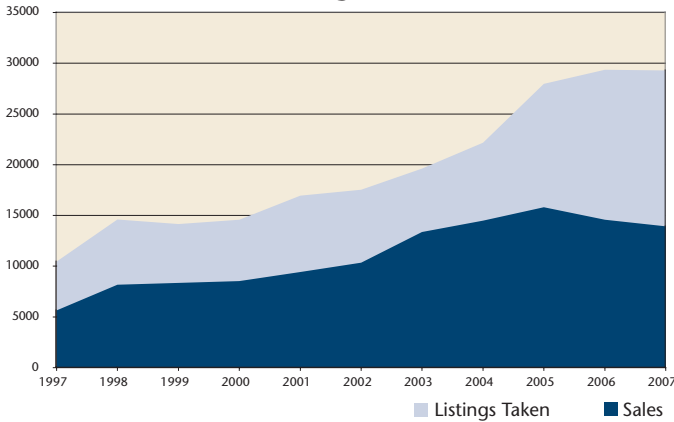


Inventories. Inventories have been steadily falling in real terms in Dane County, while rising slightly in Sauk and Columbia. Months of inventory have yet to fall because of the slow pace of sales in the fourth quarter. **But if low rates boost demand even a little bit, months of inventory could fall quickly in the second and third quarters.** Building activity is still subdued, and our agents are reporting that new construction still on the market is getting very low in most areas. It would not surprise us one bit to see us back in a balanced to mildly seller's market by mid-summer.

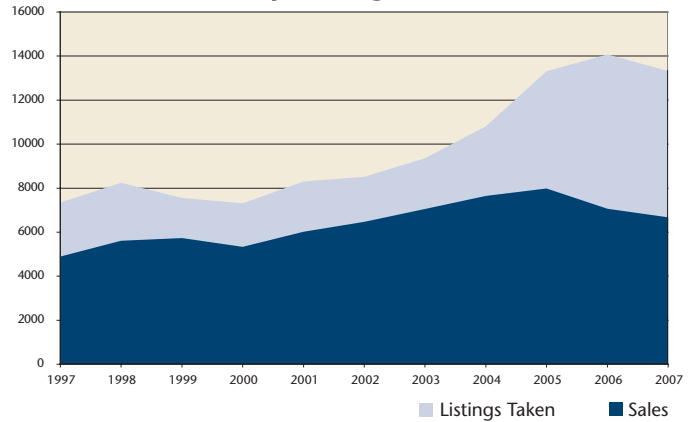
Prices. On average, prices continue to rise slowly in our market. OFHEO (The Office of Federal Housing Enterprise Oversight), which publishes the most reliable index of housing price changes, reported a 0.59% increase in the 3rd quarter of 2007 for the Madison MSA (the most recent quarter available at this writing), **and a 12 month increase of 2.58%.** The increase in the average price as reported by the South Central Wisconsin Multiple Listing Service is even higher, but average prices can be an unreliable gauge as they can be skewed by the mix of properties that happen to be sold in the period measured, particularly by a few large sales at the high end. (For this reason, we've started tracking median price changes in this issue's Trend Watch section on page 4, rather than averages, since this is a less volatile measure of price movements.) **No matter how you measure it, prices are not falling, and it's very unlikely they will. If the current recipe of low rates and falling inventories continues to cook, prices could easily start rising more rapidly by mid-year.**

Employment. Total employment in Dane County increased steadily throughout 2007. According to the Wisconsin Department of Workforce Development, total employment in Dane County increased by roughly 10,000 jobs, from 284,874 at the end of 2006 to 294,488 in December of 2007.

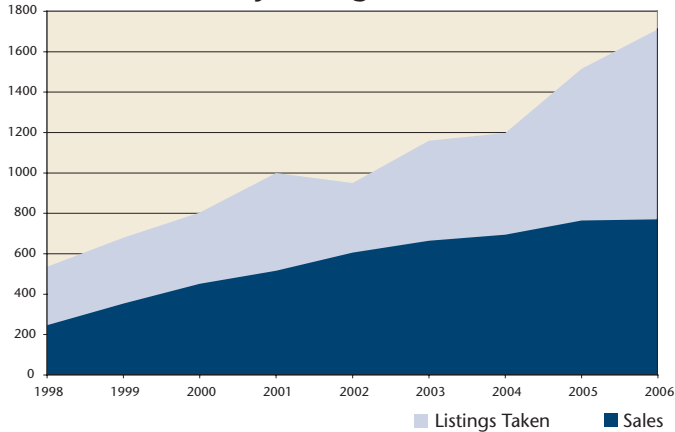
Full MLS Listings Taken and Sales



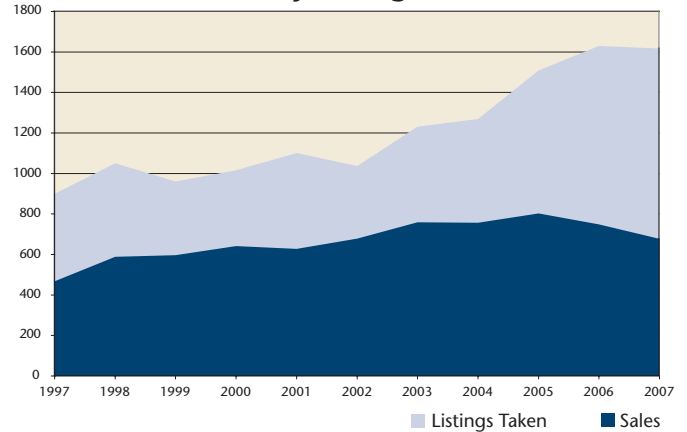
Dane County Listings Taken and Sales



Sauk County Listings Taken and Sales



Columbia County Listings Taken and Sales



The unemployment rate remains at a low 3.1%. We remain one of the fastest growing, most stable economies in the state, and one of the steadiest in the nation. As we reported a year ago, housing prices are influenced primarily by the interaction between employment growth and inventory size. Undoubtedly, our steady employment growth has helped sustain our real estate prices in the face of higher than normal inventories. We're starting to hear stories about "pent-up demand" in our market, also partly a function of this job growth. As inventories continue to fall, prices will start to rise faster, creating more energy and demand in the market.

Other Economic Factors. Oil prices, falling dollar, recession...goodness. While there's plenty of disagreement on how serious and chronic these problems are, there's no denying that we are in turbulent economic times. But there's an old saw in economics that has virtually always proved true: **housing often leads the country into recession, and also usually leads it out of one.** Our industry has paid a price in the past 18 months, and we

hope there isn't much new pain to be inflicted. Invariably, people flock to hard assets like real estate in turbulent times. It happened after the 2000 tech stock crash, and it looks like it's going to happen again as the effects of lower interest rates enter the economy through the housing market.

Our Fearless Prediction. We were off on how 2007 would end, but only because of the severe credit bust hitting the fan in August. Today, it's hard to see where new bad news for housing is going to come from. The "old" bad news will still be with us for a while, but its roots in the credit markets should keep interest rates low for most of the spring selling season. We think first quarter closings will still be soft based on the slow pace of fourth quarter 2007 offers, but then we think you'll see a noticeable turn-around. By the end of the year, sales will be up at least 5%, maybe more, close to or perhaps surpassing 2006. Inventories will be about 15% below current levels, and prices will be up 4% on average. The buyer's market is coming to an end.

STRATEGIES FOR SELLERS AND BUYERS

SELLERS

We wish we could say your troubles are behind you, but we're not quite there yet. Once inventories fall another 10 to 20%, which they should do over the course of this year, you'll be back in business. Unfortunately, they'll go up seasonally this spring before they fall again. Until they get back down, you still need to watch your competition closely and be as competitive as you can be. Be patient, but don't be greedy. **If you've been on the market a while, now is the time to get aggressive, but give buyers a new price to look at.** With any luck, this spring should be a little more fun.

BUYERS

The positive buying conditions you've been enjoying (and too many of you have been missing) are still with us, and if anything, are even a little better right now. Rates are back at record lows, and the inventory is still on the high side. However, the inventory of new spec homes is drying up quickly, and most new condo developments have been postponed, so new construction isn't piling on product any more. Are you more comfortable buying when prices are flat, or when they're rising quickly, in competition with lots of other buyers? **If you're buying for the long run, your window of opportunity is right now.**

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for all MLS listings

TREND WATCH

Likely direction next 6 months

Number of homes sold (annualized)

| | Dane | Sauk | Columbia |
|------------------------|-------|------|----------|
| 12 mo. ended, 12/31/07 | 6,673 | 702 | 677 |
| 12 mo. ended, 09/30/07 | 6,672 | 738 | 717 |
| 12 mo. ended, 12/31/06 | 7,064 | 770 | 752 |



Comments

Bold Prediction: we think we'll be ahead of 2007 by end of 3rd Quarter.

30 Year Mortgage Rates

| | |
|----------------|-------|
| December 2007 | 6.10% |
| September 2007 | 6.51% |
| December 2006 | 6.31% |



Already even lower in January. 15 year could go below 5%.

Median Sales Price – Single-Family & Condos

| | Dane | Sauk | Columbia |
|------------------|-----------|-----------|-----------|
| 4th Quarter 2007 | \$223,745 | \$165,000 | \$144,950 |
| 3rd Quarter 2007 | \$222,000 | \$162,000 | \$168,700 |
| 4th Quarter 2006 | \$220,000 | \$159,950 | \$173,000 |



We switched to median prices in this issue. Another slow, steady year, may pick up in second half.

Building Permits – Dane County Single-Family

| | Third Quarter | Year-to-Date |
|------|---------------|--------------|
| 2007 | 275 | 1,167 |
| 2006 | 271 | 1,389 |
| 2005 | 490 | 2,319 |



We think they've leveled off - may start to pick up in second half.

Inventories – Residential & Condos

| | Dane | Sauk | Columbia |
|----------------|-------|------|----------|
| December 2007 | 4,590 | 764 | 672 |
| September 2007 | 5,252 | 852 | 766 |
| September 2006 | 5,048 | 734 | 577 |



Falling already in Dane. The trend will steadily accelerate.

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