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Dave Stark

It's been a long time coming, but for the first time since 2006, we have a significant increase in the number of homes sold in South Central Wisconsin. For all residential sales in the combined Dane, Sauk and Columbia markets, sales were up 11.8% in the third quarter compared to 2008. For the year they're still down 3.3%. But think for a minute about how slow the first quarter of this year was, and you realize how much the market has turned around in the past 6 months. And, as the TV pitchman likes to say, "but wait, it gets better!" Preliminary indications are that offer activity was up in the neighborhood of 45% in September over last year, and October is off to a similarly strong start. If these trends hold throughout the rest of this year, there's a good chance we'll fill in the entire hole created in the first quarter and perhaps finish with a year over year sales gain.

While some might be tempted to start pulling the champagne corks over this news, it's important to put in perspective. For starters, this says as much about how weak last year was in the second half of the year than how healthy this year is. And the trend of increasing activity in the lower price ranges, while the upper end stagnates, is continuing. Some have suggested that the spike in activity is a direct result of first time buyers trying to get their purchases done in time to take advantage of the first time home buyer tax credit, which is set to expire on November 30, 2009. Extending that line of thought, still others have suggested that the credit is stealing buyers from next year, and that we'll see a significant slowdown shortly.

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
3rd Quarter Closings	1,409	1,212	1,369	422	415	483	1,831	1,627	1,852
Year-to-Date Closings	3,274	3,337	4,003	944	1,087	1,431	4,218	4,424	5,434
Active Inventory	2,682	2,935	3,018	1,877	2,099	2,234	4,559	5,034	5,252
Months of Inventory	6.9	8.8	8.1	16.2	18.4	17.0	9.1	11.3	10.4
3 Month Median	$221,500	$235,000	$243,000	$148,000	$168,075	$162,500	$209,700	$217,000	$222,000
12 Month Median	$220,000	$230,000	$231,900	$153,000	$169,575	$167,000	$207,000	$215,000	$217,500

SAUK COUNTY

	Single Family			Condominiums			Total Residential		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
3rd Quarter Closings	163	149	185	11	11	37	174	160	222
Year-to-Date Closings	391	369	495	29	44	83	420	413	578
Active Inventory	701	691	600	228	209	252	929	900	852
Months of Inventory	15.7	16.9	11.9	75.5	69.2	25.0	19.5	20.5	14.1
3 Month Median	$140,000	$150,000	$168,000	$128,400	$158,000	$158,000	$139,950	$151,450	$164,750
12 Month Median	$140,000	$155,000	$160,000	$154,950	$167,933	$138,500	$140,000	$157,500	$158,000

COLUMBIA COUNTY

	Single Family			Condominiums			Total Residential		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
3rd Quarter Closings	128	119	179	11	12	19	139	131	198
Year-to-Date Closings	350	322	502	30	28	60	380	350	562
Active Inventory	660	671	591	128	175	175	788	846	766
Months of Inventory	18.8	20.6	12.1	42.4	53.2	33.8	20.7	23.5	14.2
3 Month Median	$150,000	$156,500	$174,750	$132,000	$176,000	$145,000	$150,500	$160,000	$174,500
12 Month Median	$145,000	$156,500	$165,000	$165,250	$152,500	$182,750	$146,000	$156,500	$165,000

* Closed sales reported to the SCW MLS between 07/01/09 and 09/30/09. Data for all years pulled between the 15th & 21st of the month following the end of 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 quarter represented, adjusted to account for seasonal variations.

MARKET OBSERVATIONS

While all those concerns have, or may have, some merit, there are plenty of things to like about the current state of our market, and we think that on balance, the good news outweighs the concerns. Whatever the reason, up is up, and that brings with it other benefits. With rising sales, inventories are steadily falling, laying the groundwork for recovery in demand and in price increases. Sales in the lower end of the market ultimately release buyers to move up, so eventually the upper price tiers will see some improvement. We have little doubt that the tax credit played a role in stimulating some buyers to buy now, and contributed to the downward price skew. But it also served to give people a reason to buy, and in so doing helped reduce the fear of real estate that had been planted in so many people's minds. The extra sales also helped lower inventories. And who knows how many foreclosures were averted because a house was able to sell now, before the bank had to take it back.

We'll examine these facets of the market in a little more detail below. We'll also try to put the current level of activity into a larger perspective, and in so doing make some preliminary predictions about what consumers should expect going forward. For now, we think the best part of all this is that there's some energy in the market again, rather than the fear induced gloom of a year ago. That's something to celebrate.

INVENTORIES

Probably the best news from the standpoint of the overall health of the market is the improvement in active inventories. In Dane County, seasonally adjusted months of inventory in single family homes dropped from 8.8 months a year ago, and 8.1 months three months ago, to 6.9 months, the lowest it's been since the second quarter of 2007. If a balanced market is defined as 6 months of inventory, then Dane County is getting close in the single family sector. Furthermore, as you'll see in tables nearby, inventories under $300,000, which account for over 60% of the inventory and almost 80% of the sales, are well under 6 months of inventory already. Overall inventories are continuing their slow but steady decline in almost all sectors. Although condo inventories remain higher, they're still down from their peaks. Sauk and Columbia counties continue to show higher inventories overall, but even they showed movement in the right direction. Arguably the only fundamental problem in our market throughout the ordeal of the last three years has been the level of inventory, and that seems on its way to being corrected.

PRICES

The reason inventories are so important is that bringing them back down to balanced levels is the necessary prerequisite to stabilizing home prices, and ultimately getting new construction going again. The 12 month residential median fell again in Dane County to $207,000 from $210,000 last quarter and $215,000 a year ago. We continue to believe that this represents the continued skewing of activity to the lower end of the market, more than it does a fall in values overall. However, the somewhat distorted distribution of buying activity means that inventories, and therefore price pressures, are very different in different parts of the price spectrum. To understand this better, see the charts on this page comparing third quarter sales from last year to this year, the percentage of sales in each price range, and the active inventories and months of inventories in each price range. We published the same data for the second quarter in our last issue for Dane County, and this quarter we've added Sauk and Columbia County single family sales as well (there are too few condo sales in those counties to provide meaningful data).*

The figures continue to show greater activity in the lower price ranges than a year ago in all sectors. We're starting to see real shortages of good inventory in the lower price tiers, particularly in Dane County and Madison proper. The upper end, by contrast, almost always carries more inventory, and high end homes can be very distinctive, unique, and difficult to value. Sellers in those price ranges are advised to look carefully at the homes that have sold, compare their property as best they can, and price accordingly. The good news here is that the 11 single family sales over $700,000 in Dane County are more than double the pace from last quarter, and months of inventory are correspondingly half what they were three months ago.

Interestingly, Dane County's $207,000 12 month median price is roughly equal to the 12 month median at the end of the 3rd quarter of 2005, which was just about the exact peak for sales activity during the housing boom. With overall inventories coming steadily closer to balance, it's likely that we're near an equilibrium in prices, and if inventories continue to shrink, prices may soon start back up.

3rd QUARTER SALES BY PRICE - DANE COUNTY

SINGLE FAMILY	2008 Sales	% of Total	2009 Sales	% of Total	Current Inventory	Months of Inventory
< 200,000	390	31.8	531	37.7	739	4.2
200-300,000	501	40.9	573	40.7	924	4.8
300-400,000	188	15.3	176	12.5	441	7.5
400-500,000	66	5.4	60	4.3	166	8.3
500-700,000	57	4.7	58	4.2	215	11.1
> 700,000	24	2.0	11	0.8	195	53.2
Total	1,226	100.0	1,409	100.0	2,680	5.7

CONDO	2008 Sales	% of Total	2009 Sales	% of Total	Current Inventory	Months of Inventory
< 200,000	304	70.1	331	78.4	1,176	10.7
200-300,000	83	19.1	62	14.7	389	18.8
300-400,000	23	5.3	19	4.5	154	24.3
400-500,000	13	3.0	4	1.0	83	62.3
500-700,000	8	1.8	5	1.2	49	29.4
> 700,000	3	0.7	1	0.2	25	75.0
Total	434	100.0	422	100.0	1,875	13.3

3rd QUARTER SALES BY PRICE - SAUK COUNTY

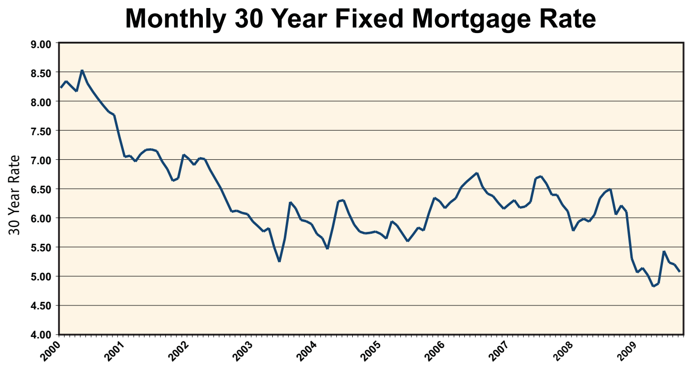
SINGLE FAMILY	2008 Sales	% of Total	2009 Sales	% of Total	Current Inventory	Months of Inventory
< 150,000	76	50.3	91	55.8	219	7.2
150-200,000	35	23.2	42	25.8	153	10.9
200-250,000	22	14.6	14	8.6	94	20.1
250-300,000	7	4.6	8	4.9	75	28.1
300-500,000	10	6.6	6	3.7	102	51.0
> 500,000	1	0.7	2	1.2	56	84.0
Total	151	100.0	163	100.0	699	12.9

3rd QUARTER SALES BY PRICE - COLUMBIA COUNTY

SINGLE FAMILY	2008 Sales	% of Total	2009 Sales	% of Total	Current Inventory	Months of Inventory
< 150,000	54	45.0	62	48.4	202	9.8
150-200,000	32	26.7	34	26.6	136	12.0
200-250,000	16	13.3	16	12.5	99	18.6
250-300,000	9	7.5	7	5.5	63	27.0
300-500,000	7	5.8	8	6.3	113	42.4
> 500,000	2	1.7	1	0.8	41	123.0
Total	120	100.0	128	100.0	654	15.3

**Readers may notice that the data in these tables, particularly months of inventory, differs slightly from the data on the summary table on the first page. This is because we seasonally adjust the months of inventory calculation on the first page, while we did not seasonally adjust the tables broken down by price. Since the third quarter is normally one of the busiest quarters of the year, seasonal adjusting will raise the months of inventory slightly.*

INTEREST RATES



Relatively little has been written or said about interest rates lately. With all the attention that's been paid to the first time home buyer tax credit this year, consumers might forget that we continue to enjoy the lowest mortgage rates we've ever seen. After peaking at about 5.59% in June, rates have fallen again, with the 30 year fixed rate hitting 4.87% during the week of October 8th, according to Freddie Mac's weekly mortgage survey. Even when the tax credit expires, buyers will miss a huge opportunity if they pass up buying with the current combination of low rates and favorable prices.

The question, of course, is how long this environment lasts. There is no doubt that the combination of immensely high federal spending and the accompanying deficits, along with all the money injected into the system by the Federal Reserve, create a risk for rising interest rates down the road. The Fed will have a very tricky dance ahead of it in order to withdraw all the liquidity it's pumped into the economy in the past year. If they don't pull some liquidity back, the result will be inflation, and inflation means higher interest rates. However, if they withdraw too fast, they run the risk of starving the economy of the cash it needs to grow, pushing rates up too high too fast, and throwing the country back into recession. For now, it's clear they want to keep interest rates as low as they can, in part to encourage home buying along with other big ticket items. Eventually, however, as the economy recovers, they will withdraw that support, and rates will rise. Just how much is anyone's guess. The National Association of Home Builders just released their forecast for rates, and they predict a 30 year rate of 5.44% next year and 5.74% in 2011. Given the enormous government red ink, we suspect something in the mid 6's is more likely. Assuming the housing market is on sound footing by then, that's still a very workable rate. Regardless, today's rates represent and opportunity not to be missed.

LOOKING FORWARD

Pundits commenting on the current economy fall into roughly two camps. One, which we'll call the "Green Shoots" camp, sees reasons for optimism everywhere, and are predicting a robust recovery. They feel we're at the bottom, the trend is up, and the recession is over. The Federal Reserve has said they believe the recession has officially ended, and the stock market's impressive gains this year are indicative of the Green Shoots mindset.

The other camp, which we'll call the "Doom and Gloomers," see a glass that's half empty. They point to the fact that while the number of jobless claims is getting smaller, people are still losing jobs, the unemployment rate will remain high, the dollar is weak, and while the stock market is up 50% from the bottom, it's still 30% below its old high. In other words, we still have a long way to go until we get back to where we were. The media loves story lines like this. Just today (October 20), the State Journal published a front page national article outlining all the reasons why today's high unemployment is the "new normal."

We think both camps somewhat miss the mark. Either could describe the current housing market in their terms. Clearly our market is improving, but it's nowhere near where it was. So is it good, or bad, and how much better will it get? We think the right question is, "how much better SHOULD it get?"

We think the Doom and Gloomers are wrong in one very important respect: they equate where we were at the peak to where we "should be." We think the peak was too high and unsustainable. For the last five months of this year, we've averaged a seasonally adjusted pace of about 5700 transactions a year in Dane County. For the entire year to date, we're on a pace to have about 5550 transactions this year, which would exceed last year by about 4%. At the peak in 2005, we were over 8000. We think "normal," based on historic turnover rates and the size of our housing stock, is somewhere between 6000 and 7000 per year. If that's true, and if the current level of activity holds, we're not far from "normal" right now. Not a "new normal" but just plain old "normal."

The National Association of Home Builders recently forecast that existing single family sales nationally will total 4,452,000 this year, 4,900,000 next year (a 10% increase) and 6,025,000 in 2011. If we apply those percentages to our market, we would see 6100 transactions next year and 7500 in 2011. We think 6100 is right on for next year, but we think 7500 for 2011 is too high. The NAHB also forecast 30 year rates at 5.74% in 2011, which we think is too low. We see rates more like 6.5% in 2011, and 6500-6750 transactions. We think both numbers are healthy, and sustainable, with the promise of steady growth from there.

When all is said and done, no one knows what will happen next week, let alone two or more years from now. We think the right attitude is to accept the conditions we have right now, and look forward to steady growth from there. All markets search for equilibrium and a sustainable level of growth over the long run. But growth never happens in linear fashion. We overshoot and undershoot all the time. When we overshoot by a lot, as we did this decade, the correction can be painful. But eventually, normal growth always continues. So, if you're waiting for 2005 to return, in any facet of your economic life, we suggest you let it go. You probably never had what you thought you had. Rather, embrace today, and look forward with optimism.

ADVICE FOR BUYERS AND SELLERS

BUYERS

If you're looking under $200,000 in Dane County, particularly in the City of Madison, you're starting to face once again the type of market where your choices are going to be limited, and your best bet is to jump on the best option you can find, unless you're willing to be very, very patient. Even that strategy may backfire as pricing power will be moving back to sellers over the next 12 months. You can also lock in a great interest rate if you buy now. In the mid and upper price ranges, inventories are not as tight, but if present trends continue, that advantage will also disappear, probably by next spring. Remember, buying and holding for the long run is always the best advice.

SELLERS

As always, you are the reciprocal of the situation with buyers, and the playing field is no longer tilted as severely against you, particularly in the lower price ranges. That doesn't mean you can throw caution to the winds…the market remains competitive, and any willing buyer should be treated with respect. We're seeing properties that have been on the market a long time, generally properties where the seller simply won't face reality. They're usually in poor condition and overpriced. Don't be one of those sellers, if you want to succeed. We think that by next spring, all but the worst will have a good chance of success in a reasonable period of time. Waiting until then is not a bad strategy, particularly in the upper price ranges.

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TREND WATCH

Likely direction next 6 months

Number of homes sold (annualized)

	Dane	Sauk	Columbia	Direction	Comments
12 mo. ended, 9/30/09	5,094	521	445	↑	Finally a substantial uptick. 4th Quarter should blow last year out of the water.
12 mo. ended, 6/30/09	5,157	507	436		
12 mo. ended, 9/30/08	5,525	541	469		

30 Year Mortgage Rates

	Rate	Direction	Comments
September 2009	5.06%	↔	Back to the lowest rates in our lifetimes. It won't last more than a year.
June 2009	5.42%		
September 2008	6.04%		

Median Sales Price – Single-Family & Condos (12 Months)

	Dane	Sauk	Columbia	Direction	Comments
3rd Quarter 2009	$207,000	$140,000	$146,000	↔	Continued activity in lower price ranges pushing the median down.
2nd Quarter 2009	$210,000	$145,000	$149,500		
3rd Quarter 2008	$215,000	$157,500	$156,500		

Building Permits – Dane County Single-Family

	3rd Quarter	Year-to-Date	Direction	Comments
2009	174	453	↔	We look for improvement starting in 2010.
2008	180	560		
2007	261	893		

Inventories – Single Family & Condo

	Dane	Sauk	Columbia	Direction	Comments
September 2009	4,559	929	788	↓	Continued slow, steady improvement. A good 4th Quarter could put us in nice shape.
June 2009	4,731	963	842		
September 2008	5,034	900	846		

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