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REAL ESTATE MARKET SOURCE

OF SOUTH CENTRAL WISCONSIN

RELEASED NOVEMBER 2011

THIRD QUARTER 2011 | VOL. 6 ISSUE 3

Dave Stark

Alright…that's better. Having suffered statistically for most of a year in the wake of the Federal tax credit expiration, we now, finally, get to enjoy the return swing of the pendulum. For the 3rd quarter of 2011, total residential sales in the combined Dane, Sauk and Columbia County market rose 30% over the same period a year ago. Single family sales rose an even stronger 35%, while condo sales rose by about 10%. Interestingly, sales in Sauk and Columbia Counties even surpassed the tax credit fueled pace set in the third quarter of 2009, while sales in Dane County did not quite reach that level. However, sales in all three counties were not far off the pace set in the third quarter of 2008, which was just before things really fell apart in September of that year. This is encouraging, signaling that the market is finally returning to a sustainable, organically driven pace.

We see strong evidence of this in the nature of the buyers in the market now. Two years ago, when the tax credit was in effect, buyers were largely "deal" oriented. Many buyers were looking to take advantage of the credit, so their motivation was more financial than lifestyle. They looked at numerous houses before making a commitment, and were willing to walk away if the deal wasn't exactly what they were looking for. By contrast, today's buyers are traditionally motivated buyers simply looking for a good place to live. They're looking at fewer houses on average before making a decision, as evidenced by the chart on the next page showing the number of showings per offer over the last couple years. When they find what

DANE COUNTY

	Single Family			Condominiums			Total Residential		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
3rd Quarter Closings	1,118	824	1409	283	253	422	1,401	1,077	1,831
Year-to-Date Closings	2,959	3,136	3,274	747	984	944	3,706	4,120	4,218
Active Inventory	2,797	2,910	2,682	1,345	1,536	1,877	4,142	4,446	4,559
Months of Inventory	9.4	8.6	8.0	17.8	14.0	19.8	11.8	9.9	10.6
3 Month Median	$220,000	$233,483	$221,500	$163,250	$160,372	$148,000	$202,250	$220,000	$209,700
12 Month Median	$220,000	$220,000	$220,000	$154,000	$150,000	$153,000	$208,000	$202,400	$207,000

SAUK COUNTY

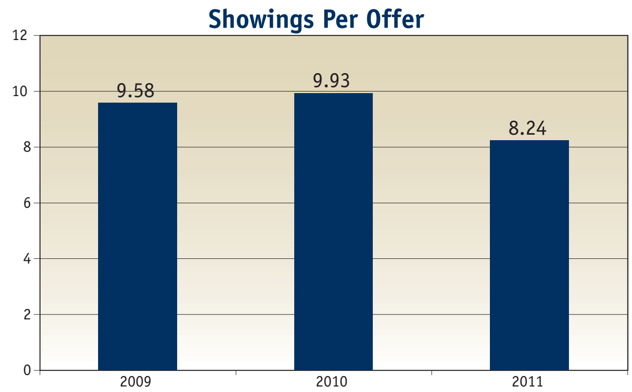
	Single Family			Condominiums			Total Residential		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
3rd Quarter Closings	174	130	163	20	14	11	194	144	174
Year-to-Date Closings	414	366	391	55	47	29	469	413	420
Active Inventory	702	694	701	182	215	228	884	909	929
Months of Inventory	15.7	16.7	17.6	31.2	44.5	57.0	17.5	19.6	21.2
3 Month Median	$129,450	$148,000	$140,000	$156,200	$128,400	$158,000	$129,900	$149,500	$139,950
12 Month Median	$129,000	$136,750	$140,000	$144,500	$163,930	$154,950	$130,000	$140,000	$140,000

COLUMBIA COUNTY

	Single Family			Condominiums			Total Residential		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
3rd Quarter Closings	133	98	128	4	13	11	137	111	139
Year-to-Date Closings	361	351	350	20	27	30	381	378	380
Active Inventory	615	644	660	113	119	128	728	763	788
Months of Inventory	16.1	14.8	19.4	56.5	38.6	38.4	18.1	16.4	21.1
3 Month Median	$130,000	$157,500	$150,000	$98,250	$87,500	$132,000	$137,750	$152,000	$150,500
12 Month Median	$130,000	$143,450	$145,000	$132,750	$118,000	$165,250	$130,000	$140,000	$146,000

* Closed sales reported to the SCW MLS between 7/1/11 and 9/30/11. Data for all years pulled between the 12th & 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 12 months.

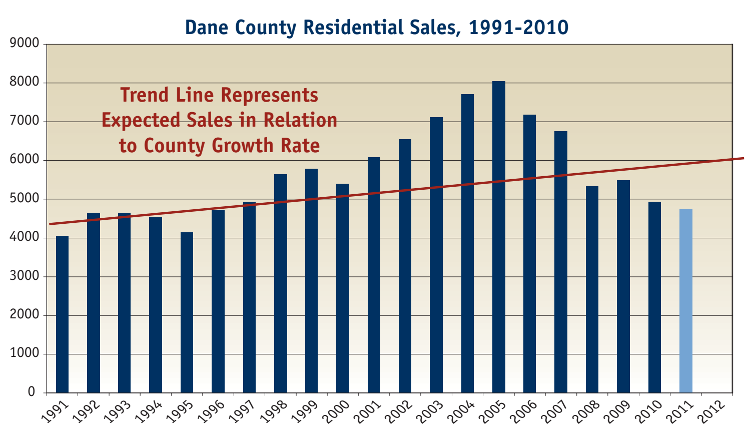
they want, they buy it. Indications are that on a seasonally adjusted basis, September will be among the strongest months for offers to purchase so far this year. Assuming this trend continues into next spring, we should see a much stronger start to the year in 2012.



For the year to date, sales are still down 7.3% from last year. We expect that gap to continue to close in the fourth quarter, and it's possible we'll match last year's total when all is said and done. However, the pace of sales in 2011, seasonally adjusted, has been remarkably steady all year, and if we stay at the same pace in the 4th quarter, we'll finish the year down about 5% overall. When you consider that we were down 21% for the year just three months ago, that's quite an improvement.

So, have we finally turned the corner? Is the long awaited recovery to the housing market finally at hand? Absent another big shock to our economic system, which is certainly possible but also becoming less and less likely, we think the answer is "yes." That said, it's important to understand that recovery is a process, not an event, and the process is going to take some time. It's also important to understand what full recovery will really look like, because we all got accustomed to some very unrealistic market conditions in the first half of the last decade, and it's safe to assume (and in fact desirable) that those conditions will never occur again.

From 2001 to 2007, Dane County averaged 7,058 sales per year. Since then, we've averaged 5,125. So, the last four years have averaged about 27% below the pace we became accustomed to during the first 7 years of the new millennium. Compared to what we were used to, the market now seems slow to many. But is it really that slow? We addressed this topic in the last issue of the Market Source, and it bears revisiting. We republish below a chart showing Dane County sales from 1991 to the present, including our estimate of about 4,750 for 2011. The trend line estimates the expected level of sales if they had increased at the average pace of population growth for the county overall, about 1.5% per year. By that logic, expected "normal" sales levels for Dane County should be in the 5500-6000 sales per year range. If that's right, then "normal" is somewhere in the neighborhood of 15-25% above the pace we expect for 2011. Clearly, the pace we enjoyed from 2001-2007 was well above trend, and we undoubtedly pulled some of today's sales forward into those years. But looked at this way, we're not as far from "normal" as many people probably believe, at least in terms of the number of annual transactions.

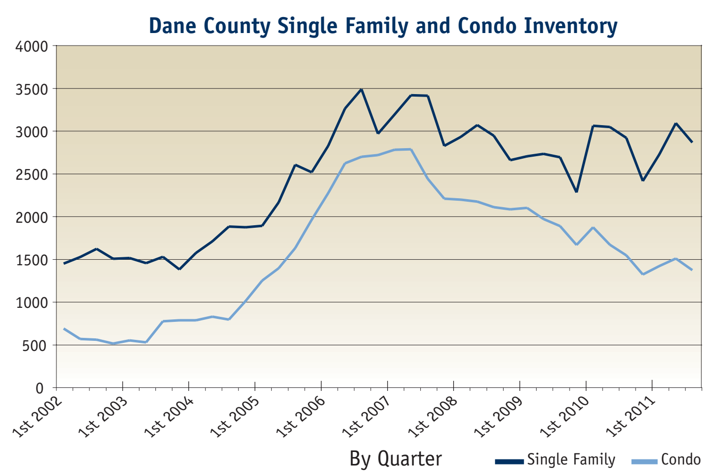


Our good friend Steve Murray of Real Trends, probably the most knowledgeable observer of the national residential brokerage business working today, confirms this analysis for the nation as a whole. He predicts total housing sales in the US for 2011 will be about 5 million. He pegs "normal", based on historic home sale patterns in relation to the total number of households, to be in the neighborhood of 6 million per year, roughly 20% above today's rate. He also predicts that sales will increase about 2-5% per year (variable by market) until normal is reached, and then will level off at about a 1.5% per year growth rate thereafter. He guesses it will take roughly 3 to 5 years, again varying widely by market, for the country to finally return to normal overall.

As we've argued consistently in these pages, we're very lucky to be in South Central Wisconsin, where our experience was far less dire than in many parts of the country, most notably California, Nevada, Arizona, and Florida. It's reasonable to expect that we will be among the markets that return to equilibrium more quickly, particularly with our low unemployment rate, stable employment base, and one of the fastest overall growth rates of any market in the Midwest. Even with all those positives, many still feel as though the market is compromised. Why should that be? The answer, we think, is simple: we continue to carry an unusually high inventory of homes actively for sale. And until that inventory is reduced, it will continue to be a challenge for sellers to know that they can sell their homes for a reasonable price in a predictable time frame. Let's analyze that inventory a little bit, and see if we can't gain some understanding of what it will take to get it reduced.

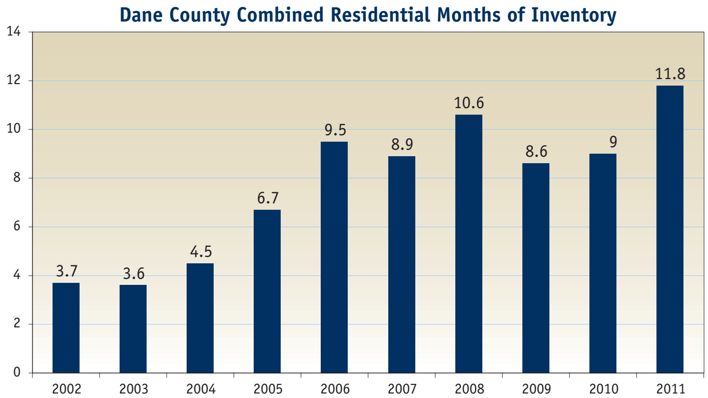
INVENTORIES

The chart below tracks Dane County inventory levels for single family homes and condos going back to 2002. Starting in 2004 and accelerating through 2007, inventories really jumped. While single family inventories have bounced around a bit since then, they've essentially been stuck in a range between 2500 and 3000 since 2008. Condo inventories have shown more steady improvement, but this may be somewhat misleading, since most new condo inventory was new development, and developers have since either held back much of what they originally planned, or rented it out. Single family, by contrast, is made up mainly of individual owners trying to move on with their lives.



The next chart gives some more insight into why the market still feels slow. It shows how many months it would take to sell the current inventory given the pace of sales over the most recent 12 months. At 11.8 months, inventories are they highest they've been relative to sales since the recession started. 6 months of inventory is traditionally considered "balanced." To get there, we'll need about a 20% increase in sales and a 20% decrease in inventories.

How long this process will take is anyone's guess. If our sales increase at 5% per year, it will take about 4 years to reach 6000 sales in Dane County. Accelerating sales will help reduce inventories, but it's hard to gauge how many new listings will come on the market as sales improve. Foreclosures are also a wild card, but new foreclosures have been falling in our market, which certainly helps. That said, we estimated in our last edition that "distressed" properties already on the market make up somewhere in the range of 20% of the current inventory, and there may be more already owned by banks that haven't hit the



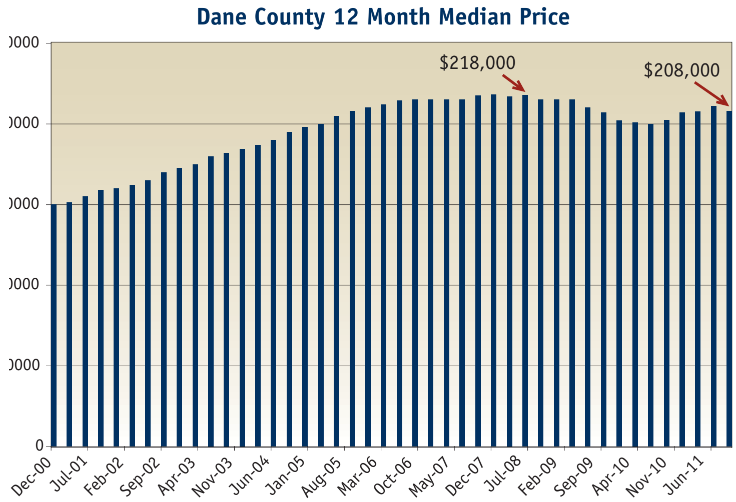
market yet. Furthermore, bank owned property often sells for far less than normal market value, distorting prices and contributing to the sense that the market is unhealthy. One way or another, getting the distressed inventory cleared through the market as quickly as possible would be a major step forward in returning to balance.

Where did all this inventory come from? We get asked this question a lot, and there's no easy answer. Overly aggressive building, particularly in condominiums, certainly played a role in the initial surge. But new construction has been down by 80% for four years now, so that's not today's source of new inventory. As mentioned earlier, distressed inventory is a significant culprit. The mystery here, though, is why we have much "distressed" inventory at all, given our employment picture. Estimates a few years ago put the number of "sub-prime" loans in our market at around 13% of the total during the boom years. We've certainly had some foreclosures as a result of the loose underwriting in the early 2000's. With roughly 5,750 homes for sale in the three county area, if 20% are distressed, that would be 1,150. In a market our size, it's no stretch to believe there were 1100 or more ill advised loans made in the boom years that are on the market now as foreclosures. It's a small part of our overall housing stock, but a big part of what's currently for sale.

Clearly, even a market like ours got ahead of itself in the first half of the last decade. It stands to reason that an elevated sales level 5-10 years ago leads to fewer sales today. The combination of a little too much inventory and a little weak demand leads to a market that still feels sluggish. Which leads to the final part of the supply/demand equation: prices.

PRICES

The chart in the next column tracks Dane County's 12 month median quarter by quarter since 2000. From 2000 to 2007, our median price increased an average of 5.5% per year, peaking at $218,000 at the end of 2007. We now stand at $208,000, meaning our prices have increased by an average of 3% per year over the last 11 years. This is exactly where we should be, since real estate prices track the rate of inflation over time. While 5.5% per year is a little higher than normal, it's not excessive, and largely explains why our prices have only fallen 4.6% from the peak. Fundamentally, our prices are right where they should be, and the only reason they're not going up now is the current, temporary imbalance in supply and demand.



One of the major influences holding back demand is the belief many buyers have that prices will fall further. With today's high inventories, they might. But buyers are playing a dangerous game by waiting for it to happen. Fundamentally, prices are great right now, and the only reason prices would fall further from here would be today's unusual and temporary dynamics. It will only take a small increase in demand and/or decrease in supply for the dynamic to reverse. There's no guarantee prices will fall at all, and if they do, it will be short lived and an overshoot on the low side. Demand appears already to have bottomed, and supply will improve over time. Plus, today's ultra-low interest rates create a once in a lifetime opportunity to lock in the lowest cost of ownership you're likely ever to get. In other words, if you're waiting for prices to fall, the window of time is small, and the benefit is also likely small or, if interest rates rise, non-existent. The conditions you're looking to take advantage of are here right now, today. There's no guarantee they'll still be here a year from now. It seems many of the buyers currently in the market understand this, and that's why they're acting now.

So, are we on our way? It looks like it. Lending conditions are still too tight, although the government recently announced a program that will significantly loosen the requirements for underwater homeowners to refinance, which could help with distressed inventory. But no matter what the government does, or the credit markets, it certainly feels as though the worst is behind us. Housing will recover, because it has to. Everyone needs a place to live, and demographers tell us that we'll have a housing shortage in a few years if building doesn't get re-started. After all the distortions of the past decade, the market is seeking a sustainable equilibrium, and probably the best medicine will be to simply let time heal the wounds. With patience and the right attitude, we're probably closer than we think.

ADVICE FOR BUYERS AND SELLERS

BUYERS

Re-read the section above on prices. There seems to be a clear understanding on the part of some that the time is now. If you've always wanted to own a home, the combination of price and interest rate is irresistible. If you're new to the market, this is a great time to go back and look at some homes that have been on the market for a while. There are some great values there. Homes new to the market get the most attention, so be ready to compete for the best ones. Financing remains a difficult process, but there are more options available than the conventional wisdom would lead you to believe. Particularly important: you don't have to have 20% down to buy. There are plenty of low downpayment options, including FHA, VA, and conventional loans with private mortgage insurance. But, you may have slightly tougher underwriting, and appraisals will be important. Professionals can help you navigate the process.

SELLERS

You remain on the tougher end of the supply/demand equation, and it will stay that way until inventories are reduced to normal levels. So your challenge, as it has been for the past four years, is to position yourself as attractively as possible, and try to get it sold in 30-60 days. That usually means a price that's not just competitive, but really gets a buyer's attention. We know that's not always easy to do, and if you currently owe more than the market will bear, it can be painful. It won't be like this forever, so if you can wait, wait. If you can't wait, the best advice is to do what you have to do and get it over with as quickly as possible. If you're buying again, you should be able to make it up to some extent on the other side. If you're not, remember there's a cost to holding on, so facing it and moving on is usually the best. Once the market has passed you over, it can be very difficult to regain attention.

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TREND WATCH

Likely direction next 6 months

Number of homes sold (12 Months)

		Dane	Sauk	Columbia	Direction	Comments
12 mo. ended,	9/30/11	4,496	608	483	↑	As expected, we're on our way back up. The trend should continue for the next year.
12 mo. ended,	6/30/11	4,161	556	454		
12 mo. ended,	9/30/10	5,339	559	555		

30 Year Mortgage Rates

			Direction	Comments
September	2011	4.11%	↔	The most incredible rates in a generation. The cost of ownership will never be lower.
June	2011	4.64%		
September	2010	4.35%		

Source: Freddie Mac

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

	Dane	Sauk	Columbia	Direction	Comments
12 mo. ended, 9/30/11	$208,000	$130,000	$130,000	↔	Still steady - up from a year ago in Dane. Clearing in Sauk and Columbia.
12 mo. ended, 6/30/11	$211,000	$138,000	$133,200		
12 mo. ended, 9/30/10	$202,400	$140,000	$140,000		

Building Permits – Dane County Single-Family

	3rd Quarter	Year-to-Date	Direction	Comments
2011	171	492	↔	We're stuck in a rut. Same old story - inventories have to fall for new construction to recover.
2010	163	498		
2009	173	454		

Source: MTD Marketing Services

Inventories – Single Family & Condo

		Dane	Sauk	Columbia	Direction	Comments
September	2011	4,142	884	728	↔	Some improvement but a long way to go. Still in a range we can't seem to fall below.
June	2011	4,515	908	825		
September	2010	4,446	909	763		

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