MARKET SOURCE NEWSLETTER

Written by President David Stark

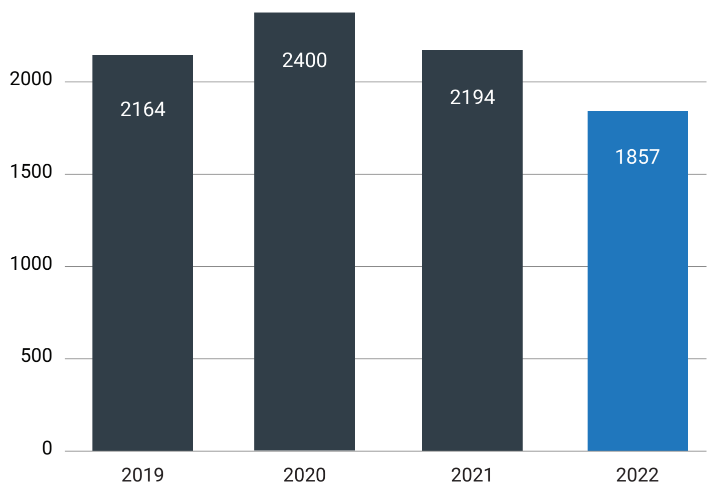
ON PAPER, IT APPEARED that the South Central Wisconsin housing market would look much the same in the spring of 2022 as it did in the spring of 2021. However, the threat of persistent inflation and the resulting rise in mortgage rates have caused this year to start out very differently than last year did. Some are even starting to ask if this is leading to a repeat of the Great Recession of 15 years ago. We think not, but it nonetheless remains critical to understand what today's influences are, and to avoid applying the wrong lessons to today's market. We'll walk you through the market as we see it today, in the hopes of giving you information that will help you make good decisions as you navigate your way.

THE STATE OF CURRENT INVENTORY

Any discussion of today's market must begin with inventory on hand. This is THE factor that is making today's market so different from any market we've experienced in the past. It's also important to understand that "inventory" is a snapshot number that literally changes minute to minute, and measures only the number of homes on the market and available to buy at any moment in time. It's what a buyer faces when they head out to look at homes on any given day. And as everyone knows by now, the number of homes available today is at record lows. At the moment we measured for this newsletter, there were 245 single family homes and 95 condominiums in "active" status on the MLS, meaning they were available and did not yet have an accepted offer. By comparison, in 2020, just before the pandemic, there were 810 single family homes and 230 condos at that point in time. In 2006, just before the Great Recession began, there were 2,624 single family homes on the market and 2,424 condos (let that sink in for a moment). We'll come back to this, but it is one of the fundamental differences between now and the Great Recession.

It is also important to remember that "inventory" is not the same as the number of homes that might be available over a given time frame. That is a function of the number of sellers who chose to list their homes for sale, and this is one of the first big differences between this year and last. As you can see in the nearby chart, new listings in 2022 are down 15.4% from the first three months of last year in Dane County, and down 17.1% in Sauk/Columbia. This means that so far in 2022, buyers have been presented with roughly 15% fewer houses to buy than they had a year ago. As a result, although closings were down only 4% in Dane County, accepted offers, most of which will close in the second quarter, are down 22% (closings in Sauk/Columbia are already down over 20%). This is not because of a lack of demand or desire to buy. It is entirely a result of too few listings coming on to the market.

DANE COUNTY FIRST QUARTER NEW LISTINGS



There is much debate about how we got to this point, and there is no one cause. It is important to remember that this is not simply a Wisconsin problem. Virtually every market in the country is struggling with the same thing. But we believe it's fair to say that the seeds were sown during the recession of 2007-2011. As we mentioned above, we were clearly over-built at that time, with more inventory than could be handled by organic demand. When the market turned in 2007, new construction came virtually to a halt, and strict financial constraints were put in place around both development and the buyer underwriting process. The restrictions on development were probably overdone, and many builders went out of business. As the economy picked up after the recession, new construction never recovered to a level sufficient to fill the gap created during the recession. When the Millennial generation started buying homes in large numbers, we were under-built, and remain that way today. With record home buying demand, we started inexorably drawing down the number of homes on the market day to day. The surge of home buying during the pandemic was the final nail.

But there's more to it than new construction. Today's record demand and rising prices have not yet drawn sellers into the market. Baby Boomers, it seems, are not selling at the pace many predicted or that previous generations have. Many refinanced to lock in record low mortgage rates, and feel no incentive to sell. And many sellers have decided that in today's environment, they want to buy first, then sell. But until they find something to buy, their homes stay off the market. So the market, it seems, is literally strangling itself on the lack of inventory.

There is no easy way out of this dilemma. New construction is probably the only ultimate solution, but the combination of labor and materials shortages, coupled with land use regulation and expensive land, has made new construction an expensive option for many buyers. Builders are building as fast as they can, but so far it has been insufficient to meet demand. If supply can't respond quickly enough, can something be done about demand?

30 YEAR MORTGAGE RATES

Source: Freddie Mac

MORTGAGE RATES AND THE FED

It's no secret that mortgage rates have increased substantially since the first of the year. The current 30 year fixed rate stands at roughly 4.75%, up from about 3% only three months ago, and it may go higher. Truthfully, we support the increases. If you look at the nearby chart, you see that rates were at about this level only four years ago (how quickly we forget). While the current increase is dramatic in a short period of time, it so far seems to have done nothing to dampen demand, nor should it. What higher rates can and should do, is moderate price increases by limiting the size of the mortgage a buyer can afford. We've been hearing that some sellers fear that they've "missed" the window of opportunity now that rates are rising. At least at this writing, the window remains wide open. The question is, how high will rates go, and will the window ultimately close?

The Fed has made it clear they intend to fight inflation aggressively, but we hope they don't fall victim to the mistake of fighting the last war. Today is very different from the last inflationary episode we had in the 1970's, and nothing like the recession of 2007-11. The economic dislocations caused by the pandemic, and the (some

IF YOU'RE BUYING

If you're going to get into the game, you need to be ready to do what it takes to win. You will most likely pay more than the asking price, so know what your limits are. Get as strong a preapproval from a trusted lender as you possibly can. If you can safely make a "cash" offer (meaning no financing contingency), do so, as up to a third of offers so far this year have been "cash." Only about a quarter of accepted offers now contain inspection contingencies, and those that do often provide for the buyer to pay for repairs up to a certain amount. Many buyers are agreeing to bring extra cash to the closing table if the appraisal comes in lower than the sale price. Flexible closing dates are also popular with many sellers... who still need to find a place to live, or who are waiting to close on their new home. Perhaps most importantly, find a trusted buyer agent, and listen to their advice. They should know what it takes to win. It may not be the ideal way to buy, but it's unlikely housing will get any cheaper in the future. Approaching the market with persistence and patience is likely to be less expensive in the long run than sitting it out.

might say excessive) stimulus provided by the government to combat it, has kicked off an inflationary spiral with both supply and demand characteristics feeding it. The question now is just how aggressive the Fed will be. In order for supply to return to normal, demand needs to remain sufficient to draw it out. If the Fed overreacts, they could cause a recession that will slow or stop the growth in supply we need. So far, the Fed's comments have not brought clarity to the question.

From a strictly housing perspective, prices are rising now because of constricted supply, not excess demand. We need home builders to keep building and we need sellers to sell. Cutting demand off entirely, like The Fed tried to do in 1980, will not solve today's problem. It's true that mortgage rates have probably been kept too low for too long, so rising to a more sustainable market rate is desirable as a way to cool things off. A 30 year rate around 5-6% is workable for the long run, and neither buyers nor sellers should fear it. It will help keep price increases in check. But we need more housing, so we hope the markets respond with reasonable rates that allow builders to continue to build the housing we desperately need. Ultimately, housing has a supply problem, not a demand problem, and killing demand will be focusing on the wrong variable.

▶ PRICES, AND A BUBBLE?

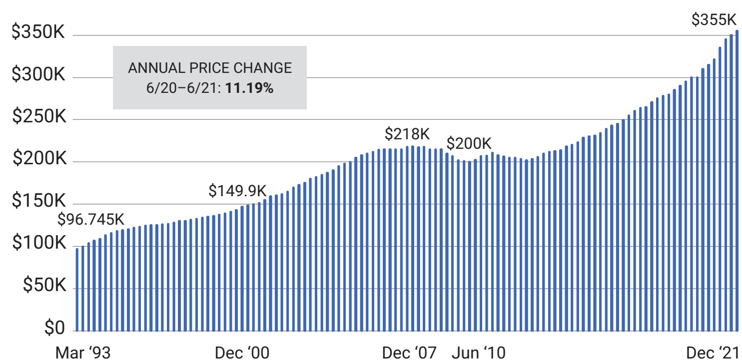
It is no secret that the supply-demand imbalance has caused prices to rise at the fastest rate since the 1970's. For the first three months of 2022, the median residential price is up roughly 10.5% from a year ago. The median was up 11% for all of 2021. Bidding wars remain the norm so far this year in Dane County, with 89% of properties selling for an average of 6-8% over list price. Sauk/Columbia prices are up a still brisk 6.2%.

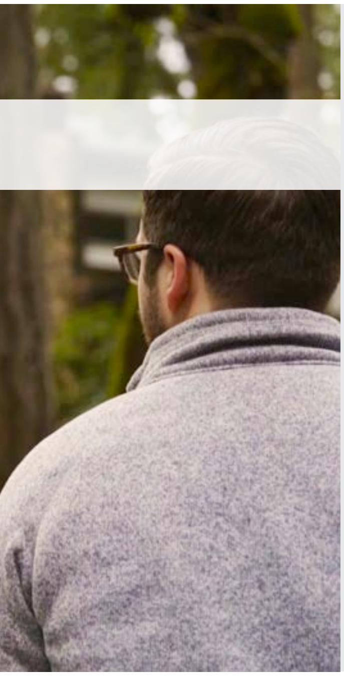
More so than last year, the media is filled with stories asking if we are in a housing bubble. While we certainly don't like to see prices increase this fast, we continue to believe that the answer to the bubble question is still "no."

The concern about a bubble is another example of re-fighting the last war. Remember, in 2006 inventories were 15 times higher than now. That bubble was created because lenders were passing out money in unlimited quantities without any regard for ability to repay. That is the very definition of artificial demand. Today's lenders are underwriting borrowers responsibly, and buyers are buying within their means with the intention of living in the home, not making a quick buck. But most importantly, when supply is this far behind demand, prices can only go up. The only parallel between now and 2006 is that prices are rising, but the reasons could not be more different. Unless and until inventories rise substantially, prices will be supported. Another simple way to think about it: housing has become a scarce resource. As long as it remains scarce, it will remain expensive.

It will take time and patience for the current housing situation to return to something resembling balance. Rising mortgage rates will help, as long as they don't rise too far. Housing construction of all types must continue, and we urge policy makers to find ways to reduce regulatory and financial barriers that make housing harder to produce affordably. But mostly, it will require giving markets the time they need to do their work. With patience and perseverance, this market too will pass.

DANE COUNTY MEDIAN PRICE





IF YOU'RE SELLING

You are at the center of the chicken and egg dilemma that is tying this market in knots. That said, it's logical to buy before you sell in this market, and we trust many of you will be showing up later after you find a house. But you need to succeed when you sell, so you still need to do it right. Pricing strategy is very important, and can vary with the price range and condition of your home. If you have any question about what your home might sell for, err on the lower side with your asking price. The price will probably be bid up anyway, and the more activity you attract, the better your final price is likely to be. We're hearing of more sellers worrying that rising mortgage rates might reduce what they can get for their home. They might, eventually, but so far demand seems unabated. But this is all the more reason to move sooner rather than later. We don't know where rates will end up, and it's possible they will rise high enough to really slow things down. We hope not, and don't think it's the most likely scenario. But the market is still in your favor, so moving now remains your best option if you can.

Charts on page four represent sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates on or before March 31, 2022. Data for all years was pulled between the 6th-10th of the month following the end of the 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. A six-month inventory is considered balanced. ‡When all properties sold during the period are ranked in order of price, the median is the price of the home in the exact middle. The above sales figures herein are based on data supplied to the SCWMLS Corporation by its Participants. The MLS does not guarantee and is not responsible for its accuracy. Data maintained by the MLS does not reflect all real estate activity in the market. Data presented here was generated from the SCWMLS on or before 4/10/22. This is not intended to solicit existing listings.

DANE COUNTY REAL ESTATE AT-A-GLANCE

Q1 2021 compared to Q1 2022

ACTIVE INVENTORY

340

7.85% ↓

YEAR-TO-DATE CLOSINGS

1,325

4.19% ↓

12 MONTH MEDIAN PRICE‡

$355K

10.59% ↑

MONTHS OF INVENTORY†

0.5 mo

No change