MARKET SOURCE NEWSLETTER

Written by President David Stark

WE APPEAR TO BE IN THE EARLY STAGES of what might be the most consequential shift in the housing market since 2012. In response to post-pandemic inflationary pressures, the Federal Reserve has declared an all out war on rising prices and has begun a series of monetary tightening moves that have sent mortgage rates from the low 3% range at the beginning of the year to over 6% a few weeks ago (closer to 5.5% as of this writing). Media reports have led many to the conclusion that rising mortgage rates are doing harm to the housing market. Our view is that higher rates are actually a long term positive, finally allowing the market to embark on a period of normalization and healing, perhaps ending over a decade of imbalanced shortages, price increases, and frustration for many buyers.

While a changing environment can be confusing, it also presents great opportunity for both buyers and sellers. In this edition, we will walk you through the changes that are now underway, to give you an understanding of the forces at work, and ultimately to help you make decisions that lead to a successful outcome.

MORTGAGE RATES

We probably need to start here, since rising mortgage rates have been driving most of the media coverage, and most of the angst, around housing in the last couple months. In the nearby chart, you can see the course of 30-year mortgage rates since 2000, including the most recent rise the most recent rise in the last three months, along with the drop in the last few weeks added in red. There are a number of very important things to note about this chart.

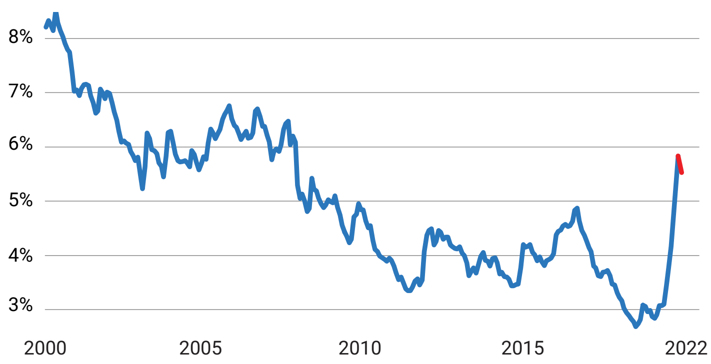
First, note how low 30-year rates were by historical standards for the last two years. Not even during the 2007-2011 recession did we see mortgage rates this low. It is our view, like many others in the real estate industry, that rates during 2020 and 2021 were kept too low for too long. With supply and demand so far out of balance, prices could only go up, and low rates helped give buyers purchasing power they would not have had otherwise. The key takeaway here is today's rates are not too high. Yesterday's rates were too low.

The next thing to note is how quickly rates rose once the Fed decided to act. To some extent, it was the suddenness of the move, as much as the move itself that unnerved many buyers. However, we believe that it's more important how high rates ultimately go than how fast they go there. How high the rates go depends to some extent on the course of inflation over the next few months, and also whether we enter a recession or not. The Fed has only indirect control over long term interest rates, like those on 30-year mortgages. Market forces are more important, and as of this writing, long term bond prices seem to be responding more to recession fears than inflation fears. Long term rates tend to fall during recessions, and mortgage rates are showing resistance to rising higher than 6% even in this inflationary environment.

Third, notice that rates nearly reached 5% in 2019, before they were driven back down in the pandemic panic. The move was much more gradual then, and went largely unnoticed. This strongly suggests that had the Fed not intervened in early 2020, mortgage rates would still be about where they are right now.

Taking all this together, we believe that today's mortgage rates, rather than being too high, are about where they should have been all along. Assuming a long term inflation rate of 2-3%, a 30-year mortgage rate of 5-6% is about where the market would put it, absent unusual Fed intervention. While they could go higher for a while in the near term, we think rates will settle in the mid 5% range for the long term.

30 YEAR MORTGAGE RATES



Source: Freddie Mac

PRICES

The current narrative around housing now is that rising rates, coupled with the price increases of the last two years, have made housing unaffordable. This is another myth that needs to be dispelled, at least for the South Central Wisconsin market.

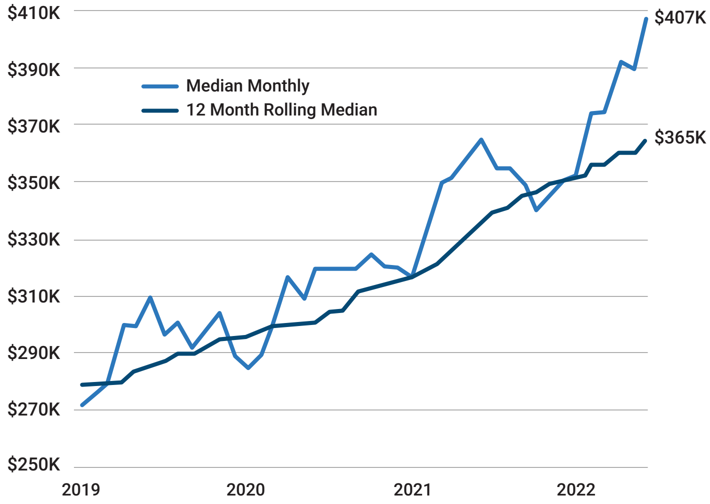
It is certainly true that rising rates will reduce the purchasing power of buyers who want or need to get a mortgage. It's also true that some buyers may decide that they don't like the choices they can afford at today's rates and prices, and those buyers will drop out of the market for the time being. It seems that has happened to some extent. While anecdotal, our agents have confirmed that in most cases, rather than getting 10 or 20 offers after two days of showings, it's more likely we get two to five. In fact, our analysis of the characteristics of offers that are accepted shows that about 30% of our offers are accepted without any competition at all.

However, while the competition may have thinned, we still have much more demand than supply. Our agents report that on the whole, not much has changed with rising mortgage rates. The remaining buyers seem undeterred, and competition, while somewhat reduced, is still brisk. If housing was unaffordable, we would not be seeing the competition we continue to see for the homes that become available. And because housing remains a fairly scarce resource in relation to demand, prices will not be falling anytime soon, regardless of rising mortgage rates.

In fact, we doubt prices will be falling any time in the foreseeable future. It's not just because inventories are low. Without getting too technical, home sellers normally are unwilling to accept less for their home than what they paid when they bought it unless they absolutely have to. One of the primary reasons housing prices fell during the last recession was because so many sellers found themselves in a "forced sale" situation, where their circumstances dictated that they had to sell to avoid foreclosure. Inventories were very high, and years of bad lending had left too many owners with homes they couldn't afford. We are in the opposite situation today, despite higher rates. Household balance sheets are in great shape, owners can afford their mortgages, and supply is very limited. There is no reason for mass forced selling. Inventory would have to rise to three or four times its current levels just to get us back to something approaching balance. And then, rather than lowering prices, sellers will simply wait for as long as they have to until a buyer is found that will pay a price the sellers are willing to accept. We've forgotten what that process feels like, but it's far more normal and healthy than the frenzy of the past few years.

While we don't see prices falling, rising mortgage rates will eventually take us back to the days when it takes 60-90 days or more to sell a house. In that type of market, prices generally rise at or slightly above the underlying rate of inflation. We're not there yet, but until then, the rate of increase will probably be reduced, or level off for a time. But a general price decrease is not in the cards, despite the increases of the last few years.

MONTHLY AND ANNUAL DANE COUNTY MEDIAN PRICE



IF YOU'RE BUYING

Don't believe the hype! Housing is not out of reach for most buyers. Rather, the field is finally clearing in such a way that for the first time in a few years, your chances of winning the home you want are improving. Unfortunately we're not quite to the point where you have the field all to yourself most of the time. But your odds have improved, and that's a good thing. Because the market is shifting, having the advice of a good buyer's agent is critical. We are still seeing overbids in 90% of cases, and you still need to be strategic about which contingencies you include in your offer. But the size of overbids is generally coming down (not always, every case is different!), so you have a better chance to pick your battles and how you want to fight them. Transitioning markets are always tricky, but with sound advice and patience you have a good chance to succeed. Waiting for rates or prices to fall is likely to be futile. Inventory is also rising seasonally, so you have more to pick from now than you did in the spring.

▶ SALES

Another misleading narrative is that rising rates are reducing the number of sales. Sales in fact are down in our market, with closings down 10.5% for the quarter and 8.3% for the year in Dane County, and down 20% in Sauk Columbia. But this has little to do with rising mortgage rates. It's all because of a lack of supply. The fact is that we have not had sufficient new listings for the last couple years to satisfy demand, and the sales pace was sustained by reducing inventory on hand. But now, the reservoir of inventory on hand has been drawn down to such an extent that we simply don't have enough to sell. We continue to sell virtually every listing we take, with few exceptions.

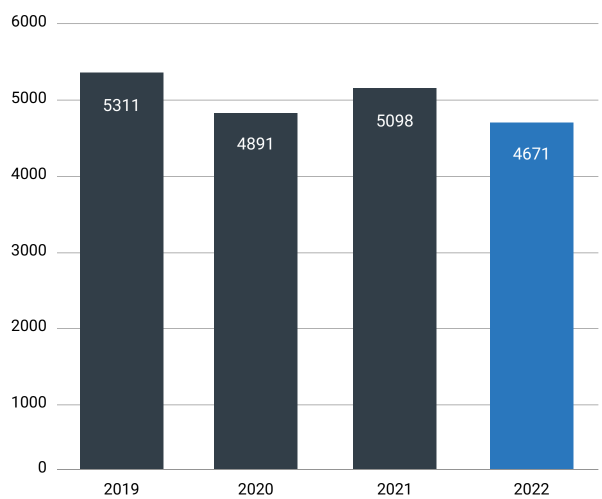
It may come as a surprise, but since rates have risen, accepted offer activity has actually improved a little bit. How can that be? Our theory is that with slightly fewer buyers competing for scarce housing, more of them are winning their bidding wars. And, when they do, many are in turn listing the houses they already own. In other words, rising rates are having the effect of starting to unlock the inventory that's been tied up with potential sellers who won't move until they can find a place to buy. We don't want to overstate this effect; the market remains very tight, and we don't think it will return to normal just for this reason. But with less artificial stimulus from low mortgage rates, we think the stage is set for a return to a more orderly housing market in the next few years.

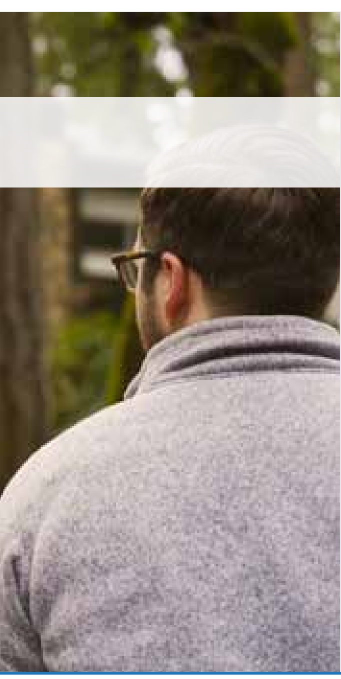
▶ THE BOTTOM LINE

The housing market is starting to transition to a new equilibrium. It's too early to say how long it will take to get there and exactly what it will look like. We certainly believe that higher inventories, perhaps three to four months' worth, will be a reality again within a few years. When that happens, price increases will moderate, and the process of buying and selling will become more orderly. The South Central Wisconsin region is the fastest growing in the state, and that growth will continue to support housing values, while stimulating increased demand for all types of housing. The positive long term future of the market is not in doubt. But transitions like this can be confusing, and it will take some time for the market to sort it all out.

In the meantime, if there is one point we would like to drive home to you, it is this: do not believe the narrative that rising mortgage rates are ruining the housing market. The truth is just the opposite. Today's rates are not only low by historical standards, they are about where they should have been all along. Furthermore, they're laying the groundwork for the return to a more normal and manageable housing market. If you're waiting for rates to fall, you're mistaken, and if for some reason they do fall in the future, you can always refinance. So don't stay out of the market because you think rates are high and housing is unaffordable. Housing is unlikely to be more affordable in the future. The market is simply starting the process of transitioning away from the chaos we've been struggling with. That's something we should all look forward to.

YEAR-TO-DATE NEW LISTINGS





IF YOU'RE SELLING

Deciding how to price your home will be a bit more difficult than it was during the spring. For the last few years, the best strategy was to price reasonably and let the bidding war drive the price up. But now that the competition isn't quite as fierce, you can't just assume that you'll be sifting through a pile of offers when the weekend is over. You might, but it's no longer the ironclad guarantee it once was. Remember that while there is still plenty of demand, rising mortgage rates have reduced the maximum amount some buyers can afford. So, the ceiling for overbids is generally lower, and fewer buyers will probably be bidding. As always, over pricing is a mistake. Rather, the goal is to find the sweet spot where you maximize interest. Where that is will vary from house to house, so advice from a good agent is critical. Also, remember that prices register their largest increases with offers negotiated in the second quarter of the year. That means recent comps will be a good indicator of what you can expect to get. Pay attention to the market. It will always tell you the truth.

Charts on page four represent sales reported to the South Central Wisconsin Multiple Listing Service (SCWMLS) with closing dates on or before June 30, 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. ©2022 Stark Company Realtors. ®All rights reserved. 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 7/12/22. This is not intended to solicit existing listings.

Stark

DANE COUNTY REAL ESTATE AT-A-GLANCE

Q2 2022 compared to Q2 2021

ACTIVE INVENTORY

679

↑ 23.90%

YEAR-TO-DATE CLOSINGS

3,576

↓ 8.26%

12 MONTH MEDIAN PRICE‡

$365K

↑ 8.95%

MONTHS OF INVENTORY†

1.0 mo

↑ 42.85%