University of St. Thomas

Minneapolis St. Paul Residential Real Estate Index

June 2013

University of St. Thomas Minnesota

Real Estate
UST Opus College of Business

Welcome to the latest edition of the UST Minneapolis St. Paul Residential Real Estate Index.

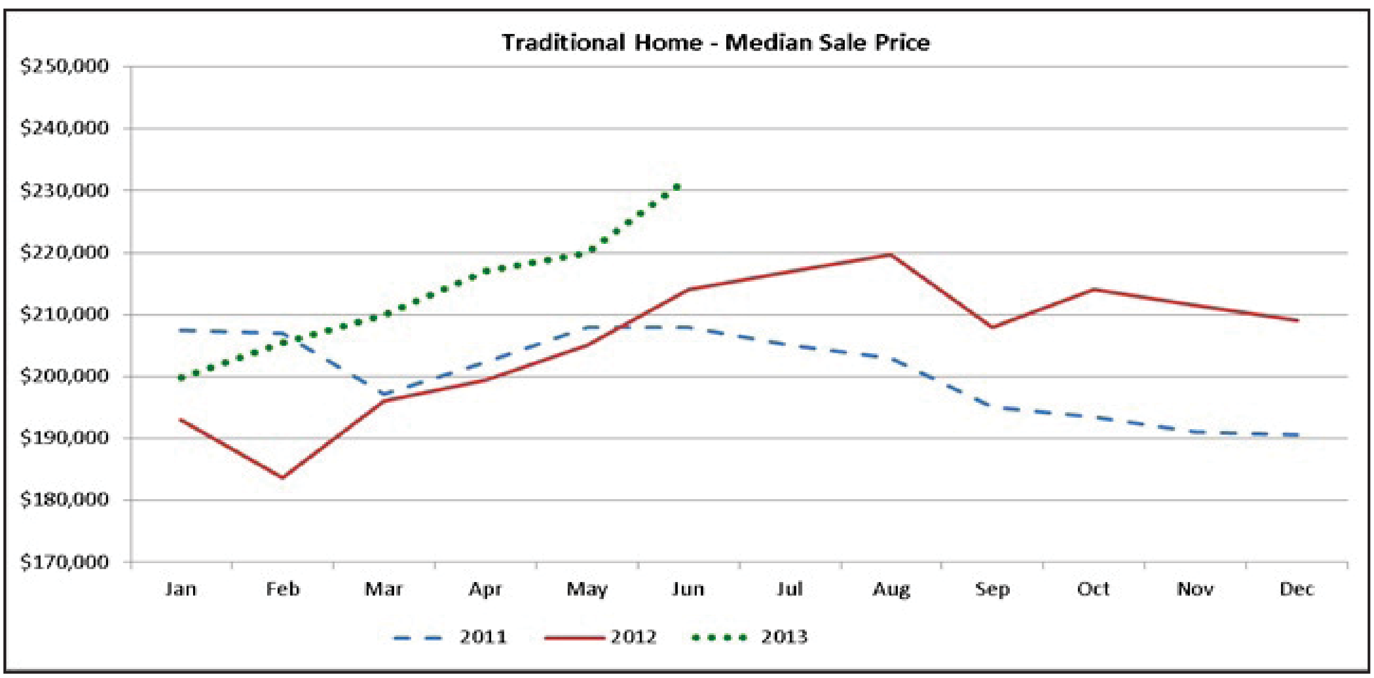
The University of St Thomas Residential Real Estate Index has been developed by the Shenehon Center for Real Estate at the University of St. Thomas Opus College of Business to correct the overstatement of housing price decline reported by the S&P Case-Shiller Price Index for the Minneapolis–St. Paul metropolitan area. Rather than a single index or price representative of all homes, the UST Residential Real Estate Index includes the price of homes in three sub-markets: traditional sales, short sales and foreclosure sales as well as a nine variable composite index for measuring market health for each category based on a three-month moving average.

May 2013 - The Road Ahead

Median Prices and Inventory of Homes for Sale

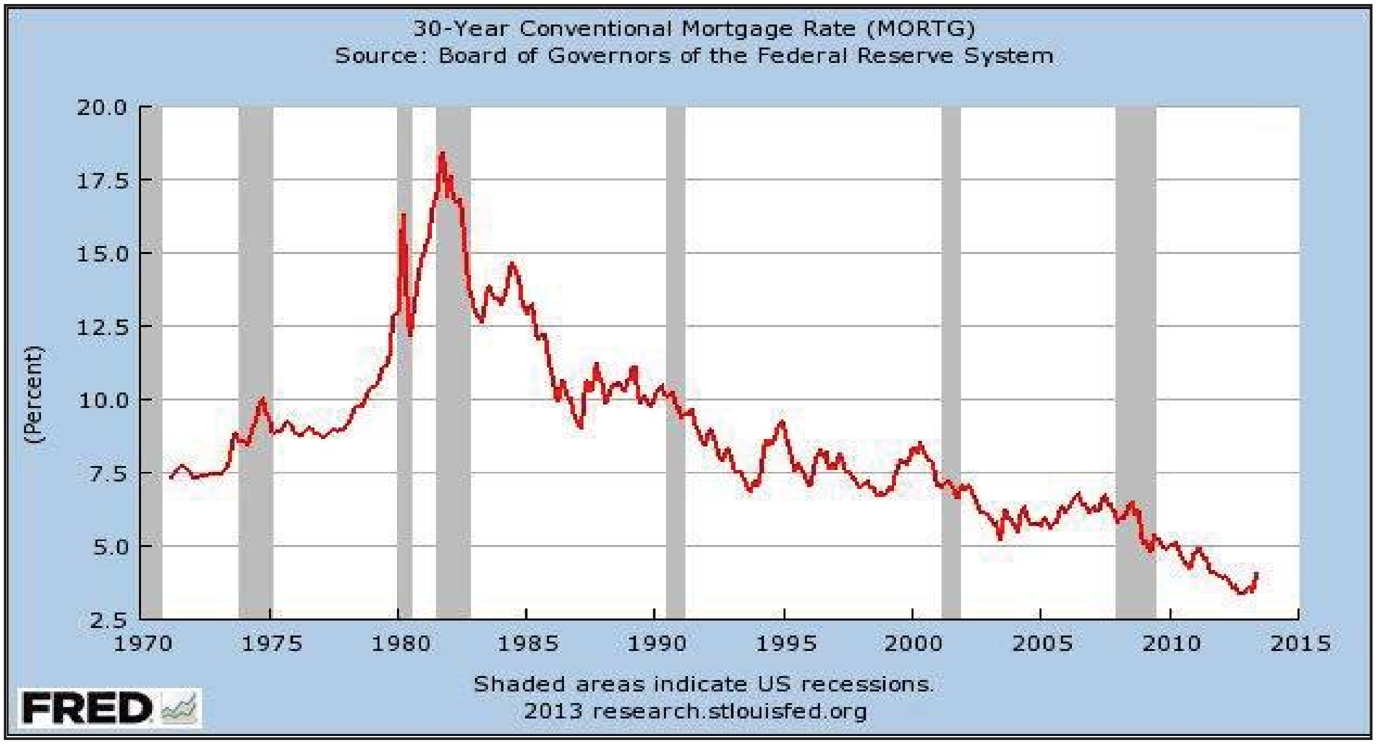
During the month of June median sale prices for all categories of homes continued their upward trend for the fifth consecutive month, increasing 5.4% from May to June. The median price of a traditional (non-distressed) home sale in June 2013 was $232,000, an increase of 8.7% over the $213,500 reported in June 2012. At $232,000 the median sale price of a traditional, non-distressed home is only 3.3% less than the all-time high of $239,900 recorded in June 2006. In June 2013 the volume of closed sales was 5,565, up 2.1% from the 5,449 recorded in May and 13.6% higher than the 5,160 recorded in June 2012. The proportion of distressed sales continues to decline. In June of 2013 only 22% of the closed sales were distressed. That is the lowest percentage of distressed sales we have seen since January 2008.

We are beginning to see the normal seasonal changes in the number of closed sales. The number of new listings and pending sales both declined slightly in June. Look for the number of closed sales to begin to level off as we move through summer and then start to decline in the 4th quarter of this year as we approach winter. The inventory of homes for sale continues to improve. It appears that the inventory of homes for sale bottomed out in January 2013 at 12,919. It has increased every month since then, ending June at 15,523 homes for sale. The ratio of closed sales to homes available for sale remains very low in June at only 2.8 homes available for sale for every home sold. Typically this ratio ranges from 6 to 8 in a balanced market. This low ratio indicates that the demand for homes remains strong and the inventory is still somewhat constrained. This is good news for sellers since it indicates that there will continue to be upward pressure on median sale prices for several months to come.



Interest Rates and Affordability

Should we be concerned that the recent rise in interest rates will derail the recovery in the housing market? Mortgage rates have recently increased about 1% and there is some concern about what the impact will be on home sales and prices. One thing that we need to keep in perspective is that while rates have increased they are still historically very low.



If rates increase slightly and it happens gradually it should not derail the housing recovery. As an example for a $200,000 30-year mortgage, a rate increase of ¼% will increase the monthly payment by $30.00 per month. As you can see in the chart below interest rates could increase moderately and a median priced home would still be affordable for a family that earns the median household income in Minneapolis / St. Paul.

Housing Affordability in Minneapolis / St. Paul				
Median Household Income (2012)	$61,412		Median Home Price (all categories)	$210,000
% of Income Recommended for Housing	28.00%		Down Payment Percent	10.00%
Annual Income Available for Housing	$17,795		Amount to Finance	$189,000
Monthly Income Available for Housing	$1,433		Term	30 Years
			Interest Rate	4.50%
			Payment (Principal & Interest)	$958
			Monthly Insurance	$100
			Monthly Property Taxes	$225
Monthly Income Available for Housing	**$1,433**		**Total Payment**	**$1,283**

For every ¼% increase in the mortgage interest rate, the monthly payment will increase by about $30.00

New Home Construction

The relatively low number of existing homes for sale continues to create opportunities for homebuilders who have been busy adding to the supply of homes for sale. According to the Keystone Report single family new construction permits are up by 29.7% year-to-date through the end of June. In June there were 478 new permits for single family homes issued. While the number of permits issued is running far behind the levels seen in 2005 and 2006 homebuilders in the Twin Cities are in the midst of a second year of steady growth.

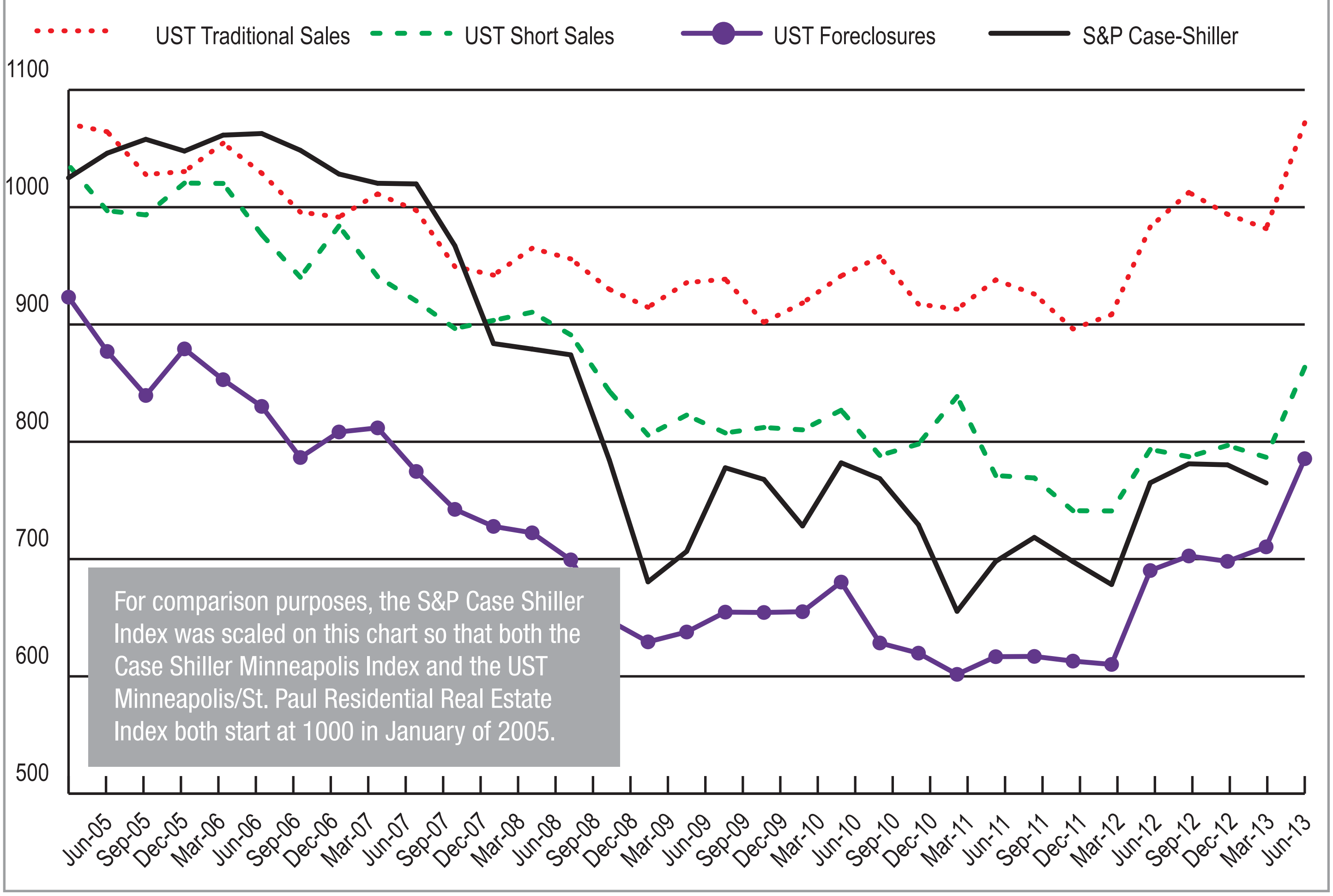
UST Residential Real Estate Indexes	June 2012	May 2013	June 2013	Year to Year Change
Traditional Sale Index	981	1041	1072	9.28%
Short Sale Index	793	837	864	8.95%
Foreclosure Sale Index	684	767	786	14.91%

The UST Traditional Sale Composite Index recorded its second consecutive 3% monthly increase in June, moving from 1,042 in April to 1,072. The increase is a reflection of the sustained recovery of traditional home median sale prices that began in March of this year, despite the fact that the index continues to be tempered by a relatively low number of homes available for sale. The index continues to remain well above the levels recorded in the previous year. June's Traditional Sale Composite Index of 1,072 is 9.3% higher than the 981 recorded in June 2012. The index is now only 1.4% less than the highest Traditional Sale Composite Index level recorded at 1,084 which occurred at the beginning of the "peak" of the housing market in late 2005.

The UST Residential Real Estate Short Sale Composite Market Health Index was 864 in June, an 8.9% increase compared to one year ago.

The foreclosure market's health as represented by the UST Residential Real Estate Foreclosure Composite Index made another sizable gain in June, moving from 767 in May to 786 in June, an increase of 2.5%.The index is up 14.9% compared to June 2012 and continues to close the gap with the Traditional Sale Composite Index as the proportion of distressed transactions declines in the market.

Minneapolis / St. Paul Residential Housing Composite Indices



June 2013 UST Composite Index Data					
1. Median Sale Price	**June 2012**	**May 2013**	**June 2013**	**Monthly % Change**	**Annual % Change**
Traditional	$213,500	$220,000	$232,000	5.45%	8.67%
Short Sale	$127,000	$140,783	$145,000	3.00%	14.17%
Foreclosed	$124,000	$137,500	$145,000	5.45%	16.94%
2. Closed Sales	5,160	5,449	5,565	2.13%	7.85%
Traditional	3,378	3,989	4,325	8.42%	28.03%
Short Sale	495	374	335	-10.43%	-32.32%
Foreclosed	1,296	1,095	881	-19.54%	-32.02%
3. % Distressed Sales	34.71%	26.96%	21.85%	-18.95%	-37.05%
4. Days on Market	113	87	74	-14.94%	-34.51%
5. Month's Supply	4.8	3.5	3.5	0.00%	-27.08%
6. New Listings	6,358	8,324	7,628	-8.36%	19.97%
7. Pending Sales	4,748	5,790	5,355	-7.51%	12.78%
8. Homes for Sale	18,354	14,924	15,523	4.01%	-15.42%
9. % of Original Price	95.10%	96.90%	97.50%	0.62%	2.52%

Real Estate at the Opus College of Business

Shenehon Center for Real Estate www.StThomas.edu/Shenehon

The Shenehon Center for Real Estate serves as a resource to the commercial, industrial, residential and corporate segments of the real estate industry and the community to advance the public interest in real estate issues. For more than 15 years, the center has supported improvement in real estate leadership and management by creating and developing real estate leadership and management programs for undergraduate and graduate degree programs and professional development, providing a neutral forum to convene real estate professionals to share best practices, supporting and working with local real estate industry organizations, conducting real estate research, and developing mechanisms to transfer leading edge business practices to the real estate industry.

Master of Science Degree in Real Estate www.StThomas.edu/RealEstate

The Master of Science Degree in Real Estate is one of seven graduate business degree programs offered through the Opus College of Business. This part-time, evening program provides students with a comprehensive understanding of real estate financial and quantitative decision making processes, and advanced issues in valuation and land economics, knowledge of critical legal issues, and techniques for market and feasibility studies and real estate investment analysis. Students in the UST MSRE program come from a variety of different backgrounds including appraisal, brokerage, property management, finance, development, engineering, design, facilities management and corporate real estate. The program produces alumni with strong leadership abilities, aptitude for sound decision making, focus on ethics and social responsibility, and a solid network of real estate professionals.

Bachelor of Science Degree in Real Estate www.StThomas.edu/business/BSRealEstate

The Bachelor of Science Degree in Real Estate is one of 13 undergraduate concentration areas in the Opus College of Business. This four-year degree program provides students with a background in general business and real estate theory and practice. Students study the many factors involved in property assessment and sales, how they change and how these changes affect real estate and individuals. Recent graduates hold positions in the government, nonprofit, construction and private business sectors, including leadership positions in real estate brokerage, investment management, property management, appraisal, construction management, land-use planning and land development.

About the Index

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One of the problems with the S&P Case-Shiller Price Index is that the matched pairs selected to develop the index do not make a distinction between a traditional, normal market sale and a distressed (short or foreclosure) sale. A property purchased at the peak of the market in 2006 and then foreclosed in 2010 and subsequently sold by the lender is considered by the Case-Shiller Index as a "normal, arms-length," transaction. The UST Residential Real Estate Index does not consider the transaction to have occurred at "arms-length" because the seller (the bank as the lender) is not a typically motivated seller. In many cases foreclosed properties are sold at distressed, discount prices because the lender wishes to recover as much of their investment as possible and get the property off their books. Further foreclosed homes have often fallen into disrepair and require a significant amount of work to become habitable.

Traditional sales of homes include those properties not subject to the threat of foreclosure or to a sales price which is less than the balance of the outstanding mortgage. Short sales are sales of homes sold for a price less than the outstanding mortgage balance and relieve the seller of the burden of continued payment for a home worth less than the outstanding debt. A short sale also eliminates the threat of future foreclosure. Foreclosure sales are sales of those properties whose owners have defaulted on their mortgage payment obligations and have lost their home to their lender. Title is held by the lender and the home is vacant.

Combining foreclosure and short sales of real estate with traditional property sales skews any single composite price index, such as the S&P Case-Shiller Index, and creates a downward bias when foreclosure sales and short sales represent a significant part of total housing sales. In a normal housing market less than 5% of properties sold would be classified as distressed. During last few years foreclosure and short sales have comprised between 35-60% of all housing sales. This unusually high disproportionality of distressed sales causes the reported decline in a single, overall housing price index to be overstated.

Analysis of these three submarkets for MSP Metro Area since 2005 has revealed that the S&P Case-Shiller Price Index has significantly overstated the price decline for the traditional housing market while understating the loss of value for homes subject to a foreclosure sale. Since the first quarter of 2005 Case-Shiller has reported an overall decline in market price of 21.8%. Our analysis of traditional housing sales for the same period, with a three-month moving average, reveals a price decline of 1.4%. Short sales and foreclosure sales had price decreases of 17.6% and 17.7% respectively. The Case-Shiller Index also uses a three-month moving average.

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June 2013

Why Another Real Estate Index?

How does the UST Residential Real Estate Index differ from the S&P Case-Shiller Price Index for the Twin Cities market?

The Case-Shiller Index is an aggregate price index only and is based on sales data from matched pairs of residential properties. Matched pair analysis compares the recent sale of a property with a previous sale at some point in the past. The difference in sale prices of the property over the time interval between sales is used to calculate the price change and the Case-Shiller Index for a particular month. As many matched pairs property sales as possible for the Twin Cities market are identified and used to calculate each month's index value.

The University of St Thomas Residential Real Estate Index for Minneapolis St. Paul metropolitan area has been developed by the Shenehon Center for Real Estate to provide a broad measure of the health and strength of the local residential housing market covering the 13 county Twin Cities metro area. The health of a housing market is more than just the current reported price for housing. Therefore the UST index incorporates other variables that together provide a better picture of the residential real estate market's health; it takes into account supply and demand factors that are indicators of market velocity and vitality, as well as their effect on housing prices.

The index is comprised of nine different elements that together reflect the residential real estate market health and include the following:

1. Selling prices for traditional, short and foreclosure sales;
2. Number of closed sales;
3. Proportion of traditional, short and foreclosed sales;
4. Time on the market;
5. Months' supply of homes for sale;
6. Number of pending sales;
7. Number of new listings;
8. Number of homes for sale; and
9. Sale price as a percentage of the asking price.

These factors are synthesized and used to calculate a numerical index reflecting overall health of the Twin Cities real estate housing market each month. Another element of the index is using a three month moving average for each of the variables. The use of a smoothing average eliminates many irregularities and distortions that can occur on a month to month basis. The UST Residential Real Estate Index reports a composite value for the total market—after accounting for distressed sales—as well as individual indices for traditional, short and foreclosed sales.

The baseline for the index is the three-month period January through March of 2005, which was assigned a value of 1000. The January through March 2005 period was selected because that was near the apex of the residential real estate housing market. Each month's index can be compared to the previous month, year or market peak to understand the relative strength, direction and momentum of the Twin Cities housing market.

The raw data we use in our research originates from the Northstar MLS in co-operation with the Minneapolis Area Association of Realtors.