University of St. Thomas

Minneapolis St. Paul Residential Real Estate Index

October 2013

UNIVERSITY of ST. THOMAS MINNESOTA

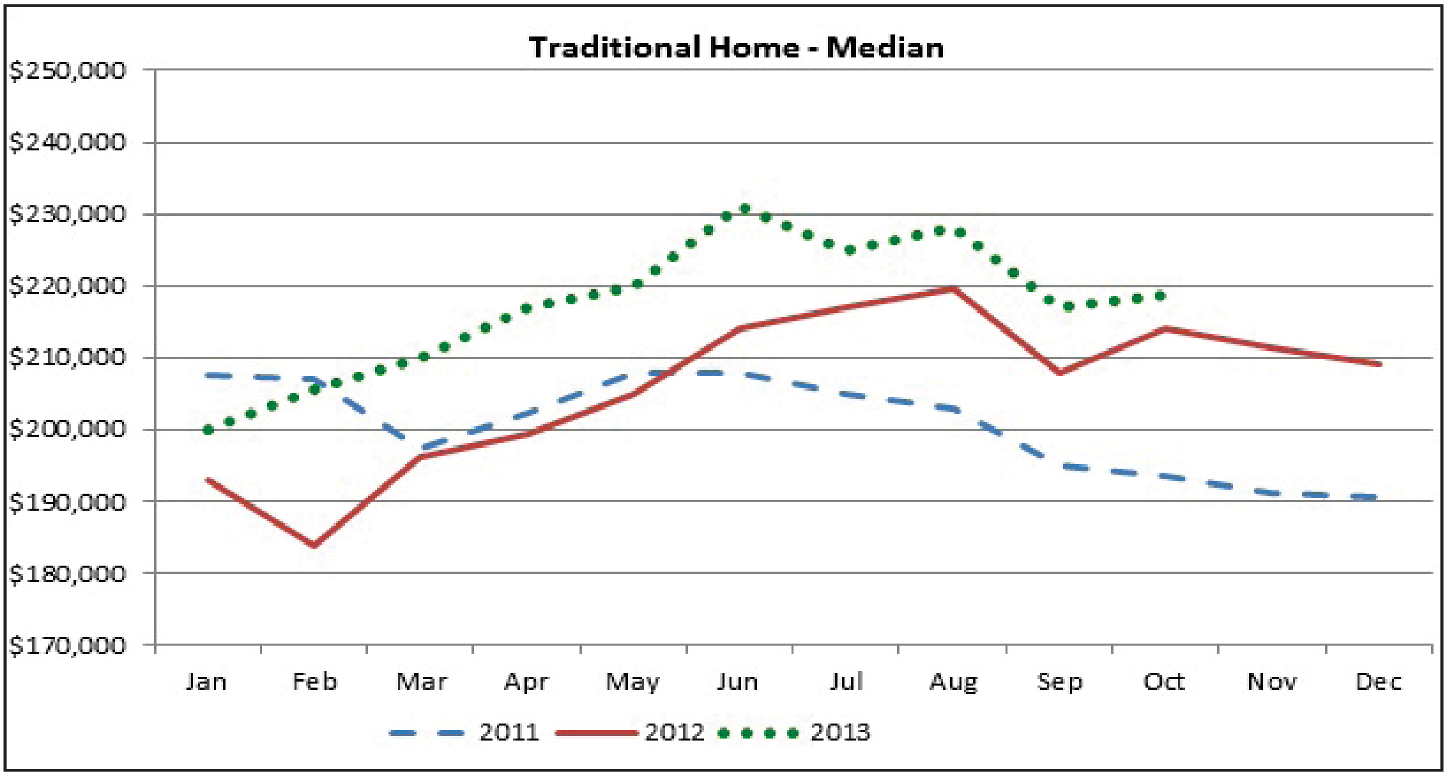
Real Estate

UST OPUS COLLEGE OF BUSINESS

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

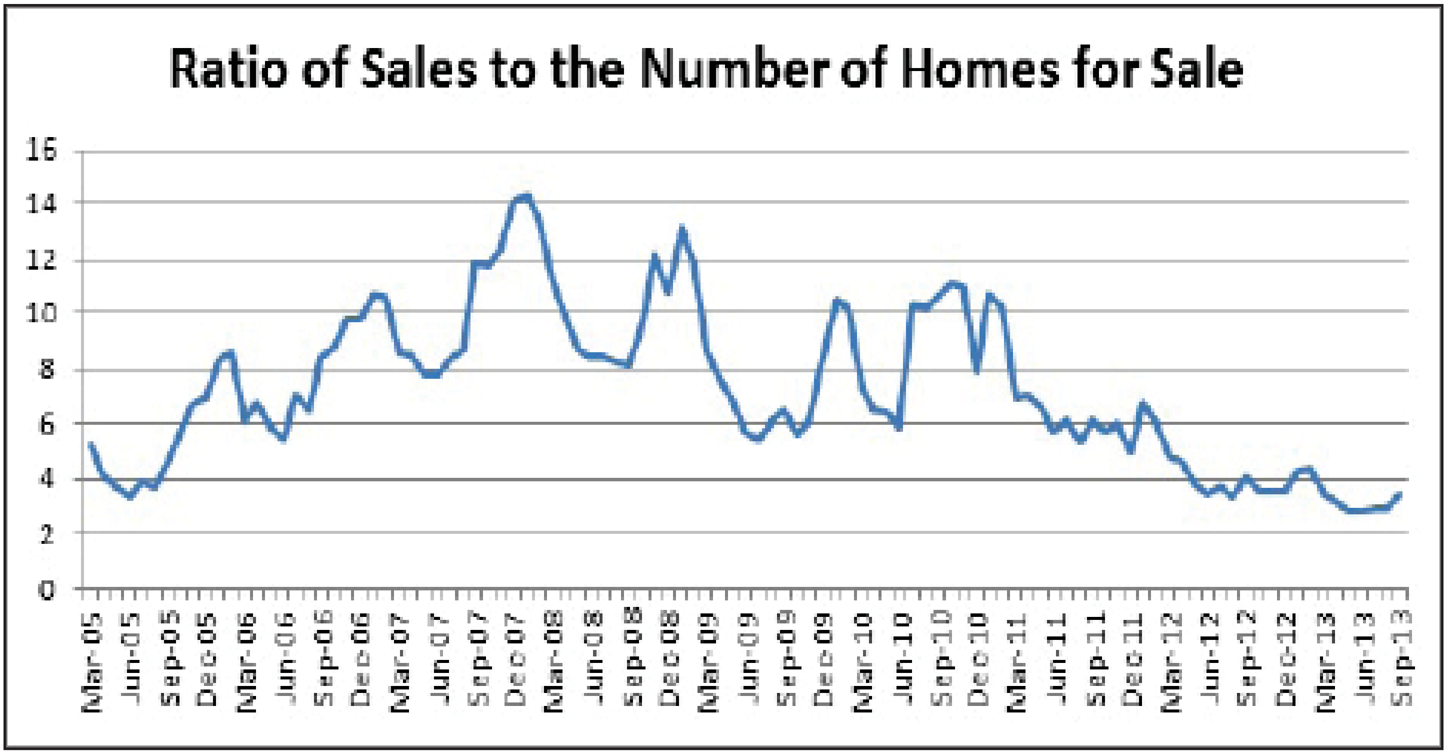
The University of St Thomas Residential Real Estate Index has been developed by the Shenehon Center for Real Estate at the University of St. Thomas Opus College of Business to correct the overstatement of housing price decline reported by the S&P Case-Shiller Price Index for the Minneapolis–St. Paul 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.

October 2013



From September to October all of the market indicators for the Twin Cities housing market continue to exhibit the normal seasonal pattern that we expect to see in the fall. Median sale prices and pending sales were essentially unchanged between September and October. The number of closed sales and the number of new listings sales were both down slightly from September 2013 levels. What remains important is that compared to a year ago these indicators continue to show a healthy year-over-year increase. The exception to this trend is the number of distressed sales (foreclosures and short sales) remains well below last year's level which is a sign of continued improving market health. The median price of a traditional (non-distressed) home sale in October 2013 increased slightly from the previous month moving from $217,000 to $218,750. The average median price of a non-distressed home is 2% higher than the $214,350 reported in October 2012. This is consistent with our earlier predictions that the annual rate of increase in the sale price of traditional homes is expected to moderate from the double digit gains seen earlier this year and remain in the 3% to 5% range for the remainder of 2013 through the 1st quarter of 2014. The percentage of distressed sales remained at 22% in October. Look for this percentage to remain low in the first quarter of 2014 as the number of newly foreclosed properties declines and the number of non-distressed homes on the market begins to increase.

UST Residential Real Estate Indexes	October 2012	September 2013	October 2013	Year to Year Change
Traditional Sale Index	1,012	1,090	1,070	5.73%
Short Sale Index	789	889	885	12.17%
Foreclosure Sale Index	703	791	775	10.24%



Inventory

The inventory of homes for sale continues to be very low by historical standards. At the end of October there were only 15,669 homes listed for sale which is 3% lower than the 16,154 that were available at the same time in 2012. In October there was a slight improvement in the ratio of the number of sales compared to the number of homes available for sale moving from 3.4 to 3.6 (see chart above); however, at current levels there will continue to be unmet demand creating upward pressure on sale prices. Historically the number of homes for sale peaks in mid-summer then declines through the fall, bottoming out in December. It appears that this year is following the same pattern and the inventory of homes for sale will remain near all-time low levels. One of the reasons that the inventory of homes available for sale remains persistently low is due to the fact that there are still a historically high number of homeowners that have negative equity or "effective negative equity." Effective negative equity is where the loan to value ratio on a home is more than 80% which makes it more difficult for the homeowner to come up with the down payment needed for the purchase of the next home. As long as interest rates remain steady these conditions indicate that the supply of homes will continue to be tight through the fall and winter into early spring.

	% of Owner Occupied Homes with a Mortgage in Negative Equity	Effective Negative Equity Rate	Percent by Which Underwater Home Owners are in Negative Equity
United States*	21.0%	39.2%	41.8%
Minneapolis / St. Paul*	21.1%	41.5%	35.3%

**Information from Zillow Negative Equity Report for the 3rd quarter*

New Home Construction

In October the pace of single family new construction permits issued compared to last year's levels began to slow down. For most of this year the number of permits issued has tracked about 30% ahead of last year's levels. In October the amount of increase has decreased to about 26% ahead of last year's levels. Through the end of October there have been approximately 4,300 permits issued for new single family homes in the Twin Cities compared to the 3,374 permits that had be issued at the same time in 2012.

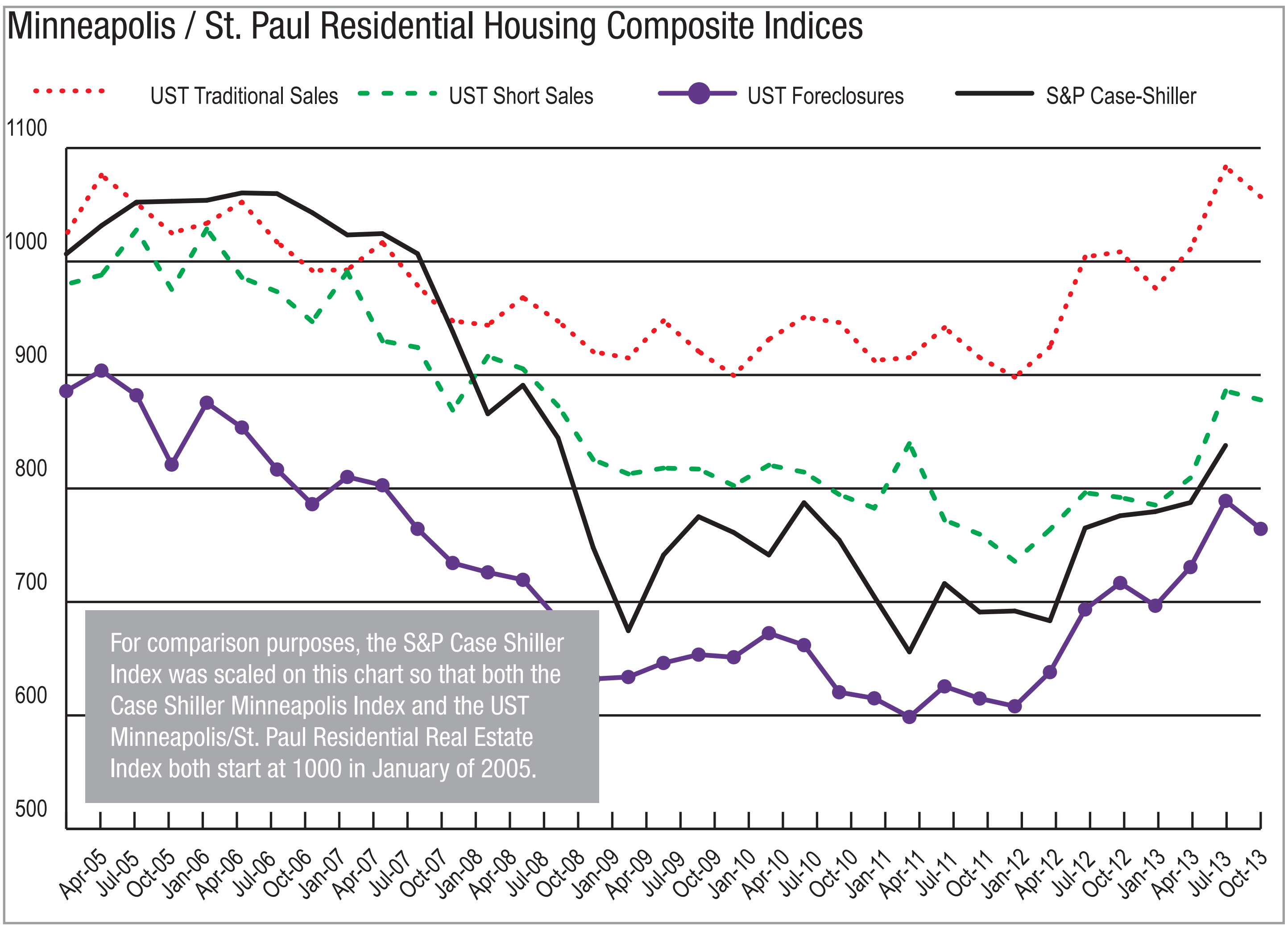
According to a recent Metrostudy report there are currently 22,446 vacant developed lots throughout the Twin Cities, representing a decline of 12% compared to last year. Of that number only 10,909 of these vacant developed lots are in the seven counties that make up the core of the metro, a decline of 18.1% compared to last year. The third quarter of 2013 represents the lowest supply number seen since early 2007. As home building activity continues to increase, more finished lots will be needed to meet expected demand. A shortage of finished lots will lead to higher land prices which is a concern because that has a negative effect on overall home affordability.

The UST Indices

The UST Traditional Sale Composite Index decreased again in October, moving from 1,070 in to 1,057 in October. Despite the monthly decrease the index remains 4.8%above the level recorded in the previous year.

The UST Residential Real Estate Short Sale Composite Market Health Index was 878 in October, a 10.9% increase compared to one year ago.

The foreclosure market's health as represented by the UST Residential Real Estate Foreclosure Composite Index decreased in October, moving from 775 in September to 764 in October, a decrease of 1.4%.The index is up 8.7% compared to October 2012.



October 2013 UST Index Data					
1. Median Sale Price	**October 2012**	**September 2013**	**October 2013**	**Monthly % Change**	**Annual % Change**
Traditional	$214,350	$217,000	$218,750	0.81%	2.05%
Short Sale	$131,000	$145,000	$150,000	3.45%	14.50%
Foreclosed	$122,250	$134,900	$129,600	-3.93%	6.01%
2. Closed Sales	4,413	4,797	4,527	-5.63%	2.58%
Traditional	2,853	3,725	3,546	-4.81%	24.29%
Short Sale	461	286	231	-19.23%	-49.89%
Foreclosed	1,099	766	747	-2.48%	-32.03%
3. % Distressed Sales	35.35%	21.93%	21.60%	-1.49%	-38.89%
4. Days on Market	103	71	75	5.63%	-27.18%
5. Month's Supply	4.0	3.7	3.5	-5.41%	-12.50%
6. New Listings	5,342	6,375	6,100	-4.31%	14.19%
7. Pending Sales	4,340	4,216	4,290	1.76%	-1.15%
8. Homes for Sale	16,154	16,366	15,669	-4.26%	-3.00%
9. % of Original Price	94.50%	96.40%	95.80%	-0.62%	1.38%

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

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.

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 15.3%. Our analysis of traditional housing sales for the same period, with a three-month moving average, reveals a price decline of 6.3%. Short sales and foreclosure sales had price decreases of 9.4% and 10.8% respectively. The Case-Shiller Index also uses a three-month moving average.

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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.