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.

**November 2013**

![Graph: Traditional Home - Median Sale Price](image)

From October to November the market indicators for the Twin Cities housing market continue to exhibit the normal seasonal pattern that we expect to see as we move into the early winter season. As expected the number of closed sales, pending sales, and the number of new listings sales were down sharply from October 2013 levels. The bright spot in the data is the relatively low number of distressed sales (foreclosures and short sales) that continue to remain well below last year’s level. At 21.9%, the percentage of distressed sales remains well below the mid-30s percentages seen last fall and winter. The median price of a traditional (non-distressed) home sale in November 2013 decreased slightly, giving up October’s gain, moving from $218,750 back to $217,000. The average median price of a non-distressed home is 2.8% higher than the $211,075 reported in November 2012. This remains 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

<table>
<thead>
<tr>
<th>UST Residential Real Estate Indexes</th>
<th>November 2012</th>
<th>October 2013</th>
<th>November 2013</th>
<th>Year to Year Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional Sale Index</td>
<td>996</td>
<td>1,057</td>
<td>1,035</td>
<td>3.92%</td>
</tr>
<tr>
<td>Short Sale Index</td>
<td>794</td>
<td>879</td>
<td>880</td>
<td>10.83%</td>
</tr>
<tr>
<td>Foreclosure Sale Index</td>
<td>701</td>
<td>763</td>
<td>748</td>
<td>6.70%</td>
</tr>
</tbody>
</table>

**UST Residential Real Estate Indexes**

- Traditional Sale Index
- Short Sale Index
- Foreclosure Sale Index
**Inventory**

The inventory of homes for sale continues to be very low by historical standards. At the end of November there were only 14,165 homes listed for sale, 5.5% lower than the 14,990 that were available at the same time in 2012. At current levels there will continue to be unmet demand as more buyers are chasing fewer homes for sale, creating upward pressure on sale prices. Although the negative equity situation (home owners who are “underwater”) continues to improve, the relatively low number of homes on the market will persist through the first half of 2014 but will improve during the second half of the year as rising prices improve more home owner’s equity situations.

**New Home Construction**

Through the 3rd quarter of 2013 there had been 5,240 new single family home starts in the Twin Cities metro area. That is 46% ahead of the 3,573 starts compared to last year’s level. Despite the significant gains realized in 2013 this total is only 36% of the number of pre-crash starts. Look for new home construction to make additional major gains in 2014 as conditions will be very favorable for new single family home construction.

**The UST Indices**

The UST Traditional Sale Composite Index continued to decrease in November, moving from 1,057 in October to 1,035 in November. Despite the monthly decrease, the index remains 3.9% above the level recorded in the previous year.

The UST Residential Real Estate Short Sale Composite Market Health Index was 880 in November, virtually unchanged from the 879 recorded in October and an 11% increase compared to one year ago.

The foreclosure market’s health as represented by the UST Residential Real Estate Foreclosure Composite Index decreased in November, moving from 764 in October to 750 in November, a decrease of 1.8%. The index is up 6.9% compared to November 2012.
The Stage is Set for a Good Year in the Housing Market in 2014

Home ownership is and will continue to be very affordable in Minnesota. Minneapolis / St. Paul is one of the most affordable housing markets in the nation. According to Trulia, it is 46% cheaper to buy then to rent in Minneapolis / St. Paul. This comparison is calculated for an average family that will not move for 7 years that would have a 20% down payment factoring in all of the costs for both options at current market conditions. In comparison the national average is 35% in favor of buying.

The economic fundamentals that are important to the health of the housing market are improving. The important ones to watch for are:

- Low unemployment – In Minnesota the unemployment rate is now 4.8%, the lowest since December 2007. In Minneapolis / St. Paul, the news is even better, the rate is 4.1%, the lowest rate observed in the 50 largest metropolitan areas in the nation.

- Job creation is improving, from October of 2012 to October of 2013 slightly over 50,000 new jobs were created in Minnesota, about 34,000 of those were in the Twin Cities metro area.

- More new jobs and higher employment rates lead to increased household formation. Household formation in Minnesota increased in 2013 and will accelerate in 2014. This is important because household formation is an important driver of the need for more new homes.

Interest rates are expected to remain relatively low in 2014 remaining at about 4.5% year for a 30 year mortgage. There is a possibility they may move up toward 5% during the second half of the year. The process of obtaining a mortgage and the availability of credit is also expected to improve somewhat in 2014.

Median sale prices will continue to increase in 2014, overall in the Twin Cities prices have increased 13% in the past year, the second consecutive year of double digit increases. Does this mean we headed for a housing bubble? The short answer is no. According to the Trulia Bubble Watch, Minneapolis St. Paul housing market is 12% undervalued relative to the underlying fundamentals. This number is arrived at by comparing today’s prices with historical prices, incomes and rents. A low supply of homes for sale, low interest rates, and improving economic conditions will continue to put upward pressure on median home sale prices. Look for a moderate overall increase of 4% - 6% next year. This rate of growth is healthy and sustainable as the Twin Cities housing market continues to recover.

The signs are all pointing in the right direction; job creation is up, household formation is up, interest rates are expected to remain low, the percentage of distressed sales continues to decline, the existing inventory of homes for sale will improve, and home prices will continue their recovery. The bottom line is that all of these things indicate that 2014 will be a definite step towards the full recovery of the Twin Cities housing market.
## Minneapolis St. Paul Residential Real Estate Index

**November 2013 UST Index Data**

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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Traditional</td>
<td>$211,075</td>
<td>$218,500</td>
<td>$217,000</td>
<td>-0.69%</td>
<td>2.81%</td>
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<tr>
<td>Short Sale</td>
<td>$130,000</td>
<td>$151,000</td>
<td>$150,000</td>
<td>-0.66%</td>
<td>15.38%</td>
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<tr>
<td>Foreclosed</td>
<td>$123,000</td>
<td>$128,850</td>
<td>$133,876</td>
<td>3.90%</td>
<td>8.84%</td>
</tr>
<tr>
<td>2. Closed Sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Traditional</td>
<td>3,994</td>
<td>4,572</td>
<td>3,787</td>
<td>-17.17%</td>
<td>-5.18%</td>
</tr>
<tr>
<td>Short Sale</td>
<td>2,574</td>
<td>3,588</td>
<td>2,959</td>
<td>-17.53%</td>
<td>14.96%</td>
</tr>
<tr>
<td>Foreclosed</td>
<td>978</td>
<td>752</td>
<td>643</td>
<td>-14.49%</td>
<td>-34.25%</td>
</tr>
<tr>
<td>3. % Distressed Sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>35.58%</td>
<td>21.54%</td>
<td>21.97%</td>
<td>1.98%</td>
<td>-38.25%</td>
</tr>
<tr>
<td>4. Days on Market</td>
<td>102</td>
<td>75</td>
<td>75</td>
<td>0.00%</td>
<td>-26.47%</td>
</tr>
<tr>
<td>5. Month’s Supply</td>
<td>3.6</td>
<td>3.6</td>
<td>3.2</td>
<td>-11.11%</td>
<td>-11.11%</td>
</tr>
<tr>
<td>6. New Listings</td>
<td>4,120</td>
<td>6,102</td>
<td>3,900</td>
<td>-36.09%</td>
<td>-5.34%</td>
</tr>
<tr>
<td>7. Pending Sales</td>
<td>3,482</td>
<td>4,300</td>
<td>3,224</td>
<td>-25.02%</td>
<td>-7.41%</td>
</tr>
<tr>
<td>8. Homes for Sale</td>
<td>14,990</td>
<td>15,860</td>
<td>14,165</td>
<td>-10.69%</td>
<td>-5.50%</td>
</tr>
<tr>
<td>9. % of Original Price</td>
<td>94.20%</td>
<td>95.80%</td>
<td>95.40%</td>
<td>-0.42%</td>
<td>1.27%</td>
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</tbody>
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**Real Estate at the Opus College of Business**

**Shenehon Center for Real Estate** [www.StThomas.edu/Shenehon](http://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](http://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](http://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.

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Minneapolis St. Paul Residential Real Estate 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 the 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 14.6%. Our analysis of traditional housing sales for the same period, with a three-month moving average, reveals a price decline of 4.3%. Short sales and foreclosure sales had price decreases of 9.9% and 12.6% respectively. The Case-Shiller Index also uses a three-month moving average.

About the Index

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About the Authors

November 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.