University of St. Thomas
Minneapolis St. Paul
Residential Real Estate Index
December 2013
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.

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

December 2013

Existing Homes

As 2013 drew to a close the data from December continued to follow the pattern that is typical for the Minneapolis / St. Paul housing market in the late fall and winter. Median sale prices, sales volume, new listings, and pending sales were all down while the number of days on the market were up. See the summary chart for the actual statistics. There were several things that were noteworthy in the December numbers. Median sale prices for all types of homes continues to remain above previous year levels (see chart above). This is a continuation of a trend that began in February 2012. The median sale price of a traditional, non-distressed home was $214,000. That is down 1.6% from November but 2.4% above December 2012. The other noteworthy item is that the overall number of homes for sale was 11,797, the lowest level seen in over 10 years. That low number has resulted in a 2.7 month supply of homes available for sale which is also at a 10+ year low. It is also encouraging to see the percentage of distressed sales remain in the low 20% range since in previous years that number tends to spike up considerably during the winter months.

<table>
<thead>
<tr>
<th>UST Residential Real Estate Indexes</th>
<th>December 2012</th>
<th>November 2013</th>
<th>December 2013</th>
<th>Year to Year Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional Sale Index</td>
<td>992</td>
<td>1,035</td>
<td>1,023</td>
<td>3.13%</td>
</tr>
<tr>
<td>Short Sale Index</td>
<td>792</td>
<td>886</td>
<td>890</td>
<td>12.37%</td>
</tr>
<tr>
<td>Foreclosure Sale Index</td>
<td>695</td>
<td>748</td>
<td>732</td>
<td>5.32%</td>
</tr>
</tbody>
</table>

December 2013
New Home Constructions

As reported by Keystone Report, in 2013 there were a total of 5,110 permits issued for new single family homes in the Twin Cities metro area. That is a 25.9% increase over the 4,058 that were issued in 2012. Although it is early, the numbers for January also look encouraging. Through the middle of the month the number of single family permits issued is 22% ahead of the number recorded at the same time last year and the dollar value is 32% higher than last year. Even with that being the current situation, there will be some headwinds for builders next year. A continuation of a shortage of finished lots will result in higher land prices as well as a shortage of skilled labor available in some areas of construction. However, overall, 2014 should be another very good year for home builders. The chronic shortage of existing homes for sale and a generally improving economy along with increasing sale prices should propel the number of single family permits to increase another 25 – 30% in 2014.

The UST Indices

The UST Traditional Sale Composite Index continued to decrease in December, moving from 1,035 in November to 1,023 in December. Despite the monthly decrease, the index remains 3.1% above the level recorded in the previous year.

The UST Residential Real Estate Short Sale Composite Market Health Index was 890 in December, up 10 points from the 880 recorded in November and a 12.7% increase compared to one year ago.

The foreclosure market's health as represented by the UST Residential Real Estate Foreclosure Composite Index decreased in December, moving from 750 in November to 732 in December, a decrease of 1.8%. The index is up 5.2% compared to December 2012.

Minneapolis / St. Paul Residential Housing Composite Indices

For comparison purposes, the S&P Case Shiller Index was scaled on this chart so that both the Case Shiller Minneapolis Index and the UST Minneapolis/St. Paul Residential Real Estate Index both start at 1000 in January of 2005.
What to Look for in 2014 – A Maturing Recovery

The housing market recovery in the Twin Cities is about to enter its third year. The previous two years have seen double digit gains in median sale prices and a healthy increase in sales activity and new construction. The percentage of distressed sales has declined from the mid-50% range to the low-20% range as the foreclosure crises continues to recede. We have seen the housing market swing from being a buyer’s market two years ago to a seller’s market with the inventory of homes for sale decreasing to ever lower levels.

What about 2014? In 2014 look for a continuation of the housing recovery, but it will be a maturing recovery. Median prices will continue to increase but at a lower rate. Traditional non-distressed prices should increase 4% - 6% and distressed sale prices will increase 7% to 9% leading to an overall increase 5% - 7% for the year. Increasing sale prices will bring more homes on to the market as more home owners are no longer underwater and equity positions continue to improve. The balance between buyers and sellers should approach a more normal proportion during the second half of 2014. The percent of distressed sales should be near 10% by year end as the number of foreclosures will continue to decline.

How well will the housing market in the Twin Cities perform in 2014? What are the indicators of a healthy, growing housing market? There are several key economic measures to watch that will influence just how robust the recovery is in 2014. The first is the total employment in the Twin Cities area and the number of new jobs being created. In Minnesota employment has recovered to pre-recession levels. It is expected that there will be 30,000 to 40,000 new jobs created in the Twin Cities metro area in 2014. New jobs and increased total employment leads to increased household formation which is the primary driver of increased demand for housing. In 2013 household formation in Minnesota was 30,000 units, in 2014 it is expected to increase to 32,000 units, most of which will be in the Twin Cities. This increase, coupled with the historically low number of existing homes for sale, will mean that in the short-run there will be unmet demand for housing and that will continue to put upward pressure on sale prices. That will be good news for home builders and sellers. Mortgage interest rates are expected to increase modestly during 2014, however the increase will be gradual; and even after acknowledging increasing interest rates, the cost of mortgage money will still be historically very low so the increase should not be a major impact on housing. As such, credit should be readily available to qualified buyers. Look for the housing market to move more into a balanced situation during the second half of the year as 2014 shapes up to be another year of solid gains and a big step toward normality in the housing market.

![MN Household Formation, Housing Permits, & Construction](image_url)
## December 2013 UST Index Data

<table>
<thead>
<tr>
<th></th>
<th>December 2012</th>
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<th>Monthly % Change</th>
<th>Annual % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Median Sale Price</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Traditional</td>
<td>$209,000</td>
<td>$217,500</td>
<td>$214,000</td>
<td>-1.61%</td>
<td>2.39%</td>
</tr>
<tr>
<td>Short Sale</td>
<td>$133,250</td>
<td>$154,450</td>
<td>$154,125</td>
<td>-0.21%</td>
<td>15.67%</td>
</tr>
<tr>
<td>Foreclosed</td>
<td>$122,750</td>
<td>$133,426</td>
<td>$127,963</td>
<td>-4.09%</td>
<td>4.25%</td>
</tr>
<tr>
<td><strong>2. Closed Sales</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Traditional</td>
<td>3,516</td>
<td>3,853</td>
<td>3,424</td>
<td>-11.13%</td>
<td>-2.62%</td>
</tr>
<tr>
<td>Short Sale</td>
<td>2,142</td>
<td>2,999</td>
<td>2,644</td>
<td>-11.84%</td>
<td>23.44%</td>
</tr>
<tr>
<td>Foreclosed</td>
<td>436</td>
<td>194</td>
<td>188</td>
<td>-3.09%</td>
<td>-56.88%</td>
</tr>
<tr>
<td><strong>3. % Distressed Sales</strong></td>
<td>39.05%</td>
<td>21.91%</td>
<td>22.72%</td>
<td>3.73%</td>
<td>-41.81%</td>
</tr>
<tr>
<td><strong>4. Days on Market</strong></td>
<td>108</td>
<td>75</td>
<td>86</td>
<td>14.67%</td>
<td>-20.37%</td>
</tr>
<tr>
<td><strong>5. Month's Supply</strong></td>
<td>3.2</td>
<td>3.3</td>
<td>2.7</td>
<td>-18.18%</td>
<td>-15.63%</td>
</tr>
<tr>
<td><strong>6. New Listings</strong></td>
<td>2,855</td>
<td>3,901</td>
<td>2,676</td>
<td>-31.40%</td>
<td>-6.27%</td>
</tr>
<tr>
<td><strong>7. Pending Sales</strong></td>
<td>2,772</td>
<td>3,227</td>
<td>2,779</td>
<td>-13.88%</td>
<td>0.25%</td>
</tr>
<tr>
<td><strong>8. Homes for Sale</strong></td>
<td>13,013</td>
<td>14,540</td>
<td>11,797</td>
<td>-18.87%</td>
<td>-9.34%</td>
</tr>
<tr>
<td><strong>9. % of Original Price</strong></td>
<td>93.80%</td>
<td>95.40%</td>
<td>94.70%</td>
<td>-0.73%</td>
<td>0.96%</td>
</tr>
</tbody>
</table>

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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.
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 14.2%. Our analysis of traditional housing sales for the same period, with a three-month moving average, reveals a price decline of 3.1%. Short sales and foreclosure sales had price decreases of 10.1% and 14% respectively. The Case-Shiller Index also uses a three-month moving average.

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**About the Index**

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Herb is the director of the Shenehon Center for Real Estate and Master of Science degree in Real Estate at the University of St. Thomas Opus College of Business. His research specialties include housing studies, affordable housing and commercial market analysis. Herb received a Bachelor of Science degree in business from Colorado State University and an M.B.A. from the University of St. Thomas.

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Tom is an associate professor of Real Estate with the Department of Finance at the University of St. Thomas Opus College of Business. His research specialties include public utility valuation and real estate feasibility studies and investment analysis. He received a Bachelor of Science degree in natural resources from the University of Wisconsin and a Master of Science degree in Finance from the University of Wyoming. He received an M.B.A. and Ph.D in Urban Land Economics from the University of Wisconsin.

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December 2013
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.