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.

**January 2014**

![Traditional Home - Median Sale Price](chart)

**Existing Homes**

In January of 2014 the housing market continues to follow the normal seasonal pattern producing the results that would be expected in mid-winter. The good news is that median sale price of all categories of homes continues to remain above previous the year’s levels. The median sale price of a traditional home was $212,500 compared with $199,900 a year ago (see the chart above). Sales volume, new listings, and pending sales were all victims of the polar vortex and the extremely cold weather as they recorded levels below what occurred in January 2013. A low inventory of homes available for sale continues to be an issue. In January of 2014 there were 11,843 homes for sale compared to 13,070 in January of 2013. As would be expected the months supply fell to 2.7 and the number of days on the market fell from 106 in January of 2013 to 93 this month. The percentage of distressed sales spiked up to 29% in January after three previous months in the 20% - 22% range, however, that is still a large improvement over the 42.2% that was observed in Jan 2013. Most of the January numbers were adversely affected by the extremely cold weather. Expect the February results to be depressed in a similar manner by the colder than average weather. The January data and the likelihood of subdued results in February should not be interpreted as an indicator of a long term weakness in the Twin Cities housing market. The underlying fundamentals of the local economy and the arrival of the spring – summer selling season will show the true long term strength of the market as 2014 will be another year of solid gains for the Twin Cities housing market.
New Home Construction

The number of building permits issued for single family homes in January indicate that new home construction is off to a good start in 2014 after making solid gains in 2013. Despite the bad weather the number of permits for new single family homes issued in January was 15% ahead of the number recorded at the same time last year and the dollar value was 22% higher than last year. Look for a flurry of housing starts as the weather improves and builders whose production was delayed by snow and cold weather scramble to build homes in time for the spring and summer selling season.

There is good reason to believe that this trend will accelerate during the year. The key driver for new residential construction is household formation. Household formation is largely driven by jobs, as a result jobs are the key driver for new residential construction. In 2013 Minneapolis / St. Paul area added approximately 33,000 new jobs. These new jobs coupled with a chronic shortage of existing homes for sale will continue to drive demand for new home construction.

There is another reason to be optimistic about the need for new housing. There is a demographic trend that is changing the ratio between total jobs and households. In the decade from 1994 through 2003 the Bureau of Labor Statistics (BLS) reported the number of people “55 and over” and “not in the labor force” increased by 4.3 million. Between January 2004 and February 2013, the BLS reports the number of people over 55 and not in the labor force increased by 8.1 million. That means more older people are leaving the labor force.

According to the Census Bureau older people tend to live in smaller households and this has pushed down the overall household size, even with some people doubling up. The overall mean household size in America is 2.55, but that falls to 2.29 for householders in the 55 to 59 age group, and 2.07 in the 60 to 64 age group, 1.91 in the 65 to 74 age group, and to 1.60 for those 75 and older.

This increase in the number of retired Americans with smaller household sizes means the relationship between jobs and households has changed over time. Models of the relationship of number of households to jobs need to be modified to reflect the changing demographics. This is another reason why the United States including Minnesota will continue to need more housing.

The UST Indices

The UST Traditional Sale Composite Index continued to decrease in January, moving from 1,035 in December to 1,023 in January. 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 January, up 10 points from the 880 recorded in December 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 January, moving from 750 in December to 732 in January, a decrease of 1.8%. The index is up 5.2% compared to January 2013.

<table>
<thead>
<tr>
<th>UST Residential Real Estate Indexes</th>
<th>January 2013</th>
<th>December 2013</th>
<th>January 2014</th>
<th>Year to Year Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional Sale Index</td>
<td>973</td>
<td>1022</td>
<td>1006</td>
<td>3.39%</td>
</tr>
<tr>
<td>Short Sale Index</td>
<td>782</td>
<td>883</td>
<td>860</td>
<td>9.97%</td>
</tr>
<tr>
<td>Foreclosure Sale Index</td>
<td>694</td>
<td>731</td>
<td>726</td>
<td>4.61%</td>
</tr>
</tbody>
</table>
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.
## January 2014 UST Index Data

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>Traditional</td>
<td>$199,900</td>
<td>$213,250</td>
<td>$212,500</td>
<td>-0.35%</td>
<td>6.30%</td>
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<tr>
<td>Short Sale</td>
<td>$125,000</td>
<td>$149,000</td>
<td>$139,400</td>
<td>-6.44%</td>
<td>11.52%</td>
</tr>
<tr>
<td>Foreclosed</td>
<td>$124,000</td>
<td>$127,500</td>
<td>$130,250</td>
<td>2.16%</td>
<td>5.04%</td>
</tr>
</tbody>
</table>

| 2. Closed Sales      | 2,908        | 3,457         | 2,566        | -25.77%          | -11.76%        |
| Traditional          | 1,680        | 2,670         | 1,802        | -32.51%          | 7.26%          |
| Short Sale           | 300          | 192           | 138          | -28.13%          | -54.00%        |
| Foreclosed           | 928          | 593           | 617          | 4.05%            | -33.51%        |

| 3. % Distressed Sales| 42.23%       | 22.71%        | 29.42%       | 29.57%           | -30.32%        |

| 4. Days on Market    | 106          | 86            | 93           | 8.14%            | -12.26%        |

| 5. Month’s Supply    | 3.2          | 2.8           | 2.7          | -3.57%           | -15.63%        |

| 6. New Listings      | 4,799        | 2,677         | 4,246        | 58.61%           | -11.52%        |

| 7. Pending Sales     | 3,352        | 2,768         | 2,801        | 1.19%            | -16.44%        |

| 8. Homes for Sale    | 13,070       | 12,158        | 11,843       | -2.59%           | -9.39%         |

| 9. % of Original Price| 93.50%       | 94.70%        | 93.50%       | -1.27%           | 0.00%          |

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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 1%. Short sales and foreclosure sales had price decreases of 9.8% and 15.9% 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.