

Foreclosures: How do they affect YOU?

P.S. for LAND SPECULATORS: Is residential home ownership still a smart investment?

By Heather Skyler

IB doesn't want to be a part of the "doom and gloom" media blitz that most mortgage lenders and realtors refer to, but when the number of foreclosures in Dane County shoots from 84 to 440 during the same six-month period (comparing 2006 and 2007, January to June), the numbers are sending up smoking S-O-S signals.

Dane County foreclosures hit a record high in August with 103, and while they're down a bit for September (at 74), that's still more than triple the amount (22) of foreclosures in September of 2006.

Readers who make their own mortgage payments on time and have nothing to do with subprime lenders may feel protected from this crisis, but in actuality, everyone

who owns a home stands to be affected in some way.

We went in search of what the housing market crunch means for Dane County, in terms of buying or selling a home. Also, we wanted to know what type of portfolio makes sense – stocks or real estate? the lottery? – in today's investment market.

GREENSPAN IN MADISON?

Well, not exactly Alan Greenspan, but **Morris Davis**, the UW's new associate professor of real estate and urban land economics. He used to advise Greenspan on housing markets when he worked at the Federal Reserve.

He's now been in Madison a year.

When asked his prediction of when the housing slump might end, he said, "History would dictate that we have a ways to go. We're looking at three more bad years, I think; then another three of tepid but slow growth – and we may not get another boom.

"When house prices rise, they tend to rise for awhile, and when they fall, they tend to keep falling, and in a somewhat predictable manner.

"It's really created a puzzle for economists: 'What kind of world do we live in where prices have these predictable patterns– and does this world make sense? Is it rational?' At the end of the day, though, prices tend to fall for awhile."

INTERVIEWEES



Sara Alvarado
Keller Williams
The Alvarado Group



John Bottensek
Beacon Financial



Morris Davis
UW-Madison



Mark Hanson
City of Madison



Jim Wilson
Associated Bank



HOW THE MESS BEGAN

The term “subprime” refers to the credit status of the borrower as less than ideal – not to the interest rate on the loan itself.

Davis explained that there are two main reasons why we’re seeing so many defaults on loans and foreclosures right now: underwriting standards changed, so even more people were eligible for subprime mortgages, and home ownership is a stated policy goal.

“The idea that we’re extending credit to people with bad credit is still a stated goal,” he said. “However, for mortgages to be successful and for the person not to default, prices need to continue to rise.”

John C. Bottensek, president of Beacon Financial explained, “A lot of mortgages done in the past four to five years never should have been originated in the first place. However, when you’re a lender and you have an individual who has a very low threshold for qualifying but they *are* eligible, you have to give them the loan under federal law.

“So, the market (in its greed) provided funding for homes that shouldn’t have been bought in the first place.

“That said, the three biggest reasons for foreclosures are still catastrophic illness, job loss and divorce.”

Bottensek also thought it pertinent to compare the number of foreclosures to the number of homes purchased during a given year. “Six out of 1,000 homes are foreclosures. When you look at the increased rates of home ownership [during the boom], it makes sense there would be more foreclosures.”

THE HOUSING LADDER

The idea of the housing ladder is that house prices at the lower end affect housing prices all the way up the ladder to the upper end. Davis explained it this way: “Suppose every house needs a 20% down payment. If you have \$20,000, you can afford a \$100,000 house.

“If you own a small house and are thinking about trading up, you use any capital gains from that sale as your down payment. If the capital gains drop from \$20,000 to \$15,000, now the buyer can only afford a \$75,000 house. So to the extent that the prices of smaller houses

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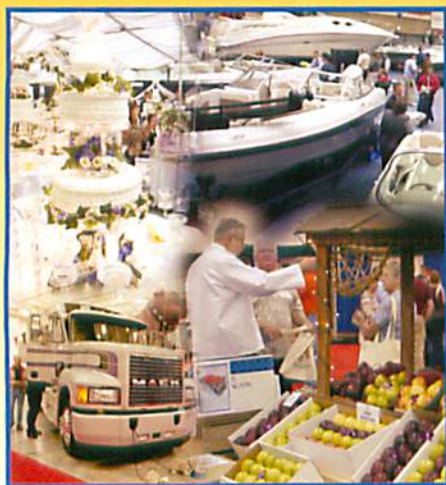
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fall, the larger house prices fall too.

“Not everyone is down payment constrained. What matters is the very last person who buys that big house – because that person sets the price of all the big houses. That’s the way markets work. It’s not the average balance sheet that matters, but the person excluded who sets the price – the 101st buyer out of 100. Think of it like an auction. You pay a dollar more than the person who doesn’t get it. The same thing holds in principle for homes.”

Foreclosures work to lower the value of homes surrounding them, which is one reason why the large number of foreclosures are cause for worry.

Davis added, “The theory implies, and the data supports, that when house prices are in a downturn, it’s the upper end of the market that seems to be hit the hardest. All of us as homeowners will experience real losses to our portfolio.

“On the other hand,” he added, “we also had gains because people who didn’t previously have access to credit were able bid up prices of homes they couldn’t have afforded before. So in a sense, those of us who have been homeowners for a while are getting back. It’s a correction.”

ARE PRICES REALLY LOWER?

So, is the theory playing out yet in Madison? Are we seeing these lower home prices?

Mark Hanson, city tax assessor for the city of Madison, said in terms of assessments, the market did turn down this year. “There were an increased number of assessments that didn’t change (which is not typical), a minor amount of decreases, and increases on a much smaller scale.

“Looking ahead to 2008, it looks like we’re going to have more sales than last year coming in under assessment. The caveat there is, we don’t know if that is typical or whether a foreclosure or other factor is involved. Until we get out there and talk to the owners, we don’t really know what 2008 assessments are going to do. I’m guessing it might be similar to 2007 or even down a little bit more.”

Realtor Sara Alvarado, of the Alvarado Real Estate Group of Keller Williams, said, “Prices are lower than they have been. In the past two years, appreciation hasn’t had much of a jump. Madison experienced a really long, intense seller’s

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market and historically it swings back and forth. It doesn't really go up and down just between a seller's and a buyer's market. In some areas, like the near east and near west sides of Madison, we're still transitioning to a buyer's market.

"The last number we pulled showed we were 6.8% down in units and 6.5% down in volume [dollars], which means prices aren't dropping a lot. When you talk to a seller who could have sold their home for more two years ago, they think prices are dropping, but prices were ridiculous then – the market's normalizing now."

Sales reported by the South Central Wisconsin MLS show that housing prices are up from both 2005 and 2006, though not by much. According to that report, the average price for a Dane County home between January and August of 2005 was \$235,320; for 2006 the price was \$246,258; and for 2007 the price was \$248,179.

Alvarado explained, "Prices are not as high as they would have normally been based on what's happened in the past five or 10 years here in Madison, so it feels like prices are dropping, but they're really not. They probably will start to drop if we keep going down this road."

Bottensek said, "Because housing prices are a 'very localized phenomena, it gets to me when I see an article saying real estate has dropped 20%. But negative headlines get good press."

"In Madison, we've seen a slow down as far as activity, and we've seen a reduction in the transaction prices from the list prices, but the transaction prices overall haven't really changed. Maybe the problem is that the list price was too high to begin with, and those numbers have to come down. But I'm not seeing any deflation in the Dane County area. I'm not seeing any appreciation either."

"Volume has dropped off but we've had record sales for the past several years and things have to slow down at some point. The market gets saturated. The high end homes are generally the ones to get hit first and those will lose value the most rapidly. But the bread-and-butter house in Dane County in that \$175,000 to \$200,000 range, is doing fine. Mom and Dad and the kids still need a house to buy."

Davis added, "One thing I'm almost certain of is most – but not all – houses are

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taking longer to sell. I think that will eventually lead to a price decline. And in areas like Shorewood Hills and University Heights, I think prices are going to fall further than other areas of town. In boom-bust cycles, value is based primarily on location. The price of construction is flat, but the value of location is cyclical, so you should see bigger declines at the upper end."

GOOD TIME TO BUY?

Jim Wilson, regional director of mortgage lending for Associated Bank, thinks it's a great time to buy a house, especially if you're a first-time home buyer. "The inventory is so high, and the rates are so low. You hear in the media that it's an awful time to buy, but it's a fantastic time for the first time home owner. It might be bad if you've got a home you can't sell."

Bottensek agreed with this assessment, adding the caveat, "Of course, I have to be the pro-home ownership guy here."

Alvarado also cited the positives of buying: "There's more to look at now and you can take your time. If you've owned a home for a while and it has a lot of equity, selling and buying a new home will be kind of a wash. The owner might sell their home for less, but the house they buy will be less too."

Because Davis believes the slump isn't over yet, he thinks it a poor time to buy, since prices will continue to get lower. However, his advice (if you do buy a home) is to plan on keeping it for at least five years if you want to recoup the money you put in. "You pay a sales tax on the transaction and there are all kinds of other fees. Also, if you use a real estate agent and a broker, there's more cost. You shouldn't ever buy a house if you expect to move in a year or two."

The realtor and lender who spoke to *IB* both considered five years a long holding period. Alvarado suggested three years – especially if you purchase a dated home and spend a little fixing it up.

Wilson was even more optimistic. "It all depends on the type of loan you take out. If there's no down payment and interest-only down, you need to be in that home for one to two years at least to break even with the realtor fees. If you put money down, say 10% – if you sold it in six months, you'd cover the fees."

INVESTMENT SUGGESTIONS

Is real estate a good investment in this market? Are stocks safer, considering many economists think the housing slump has just begun?

Bottensek said, "I'm kind of a purist in that I see housing as a shelter. If you start looking at it as a speculative venture, you can get in trouble. The underlying reason why people buy homes is because they need a place to live and they want safety and security. When you put the financial benefit ahead of the shelter benefit, people often make choices that aren't prudent."

Davis explained that people often think housing is a safe investment, but really it's not. "People saw spectacular returns on housing as an investment because they're leveraged returns. [The higher the proportion of debt, the more leverage. A leveraged venture entails more risk and more potential reward.]

"If you put \$20,000 down on a \$100,000 house and it goes up 20%, then you doubled your money. If the house goes down 2%, the owner loses everything. Once you start comparing the leveraged return of housing with unleveraged returns on stock, it's not clear stocks are that much less risky," Davis continued.

"People say housing is a safe asset because prices don't swing around, but buying a house with debt makes it riskier."

Bottensek suggested a method he recommends to clients in order to make housing a safer investment. "In the future, you can borrow against your equity and create arbitrage [the practice of taking advantage of a price differential between two or more markets].

"You borrow from entity A [your home] and lend to entity B for a higher percent [a mutual fund, perhaps]. That's how banks stay in business. People can do the same things with their money.

"Equity is not liquid and it's not protected from devaluation. It makes perfect sense to keep yourself leveraged on your home and build liquid assets inside funds." In other words, if the price of your house drops, you still have money making money elsewhere.

Wilson mused that real estate and stocks are both risky, adding, "If you buy a home, at least you've got something tangible. If that value goes down, you still have something."



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Introducing the 2007 Executive Team

Tomotherapy leadership takes *IN BUSINESS* magazine's top honor this year

By Heather Skyler

INTERVIEWEES



Jim Leonhart
WMBA



Peggy LesCrenier
Gammex RMI



Ed Neumueller
Standard Imaging



Paul Reckwerdt
Tomotherapy



Fred Robertson
Tomotherapy

When choosing our *IN BUSINESS* "Executive Team of the Year," several factors were taken into consideration. The key question *IB* arrived at, however, was this: What company is a great company in and of itself, *and* has had a visible impact on Dane County and enabled other businesses to ride on the coattails, so to speak, of its own success?

You've likely heard a lot about Tomotherapy in the last year, and with good reason. In May, the company went public, netting \$187 million in less than a week. This September, the company gained a foothold in the potentially lucrative Chinese market when it sold its first Hi-Art radiation therapy unit to PLA301,

one of China's largest hospitals.

Since its inception 10 years ago, Tomo has grown exponentially; there are now over 600 employees, offices in Madison and Belgium, and its machines are sold around the world.

This growth and success, in turn, has spurred the growth of other supporting companies. A more intangible, but very important result of Tomo's success has been the visibility and prestige the company has also given Madison and our region's business community.

Lastly, Tomo's technology is making major strides in helping cancer patients survive, and has helped people all over the world with its radiation therapy machine.

We decided it was appropriate to honor not one, but the two leaders of this business, CEO Fred Robertson, and president and co-founder Paul Reckwerdt, and share the secrets of how they work together. We also touched base with some of the local companies and area experts who have been along for the Tomo ride.

LEADERSHIP STYLES

You don't expect the member of one of the city's most high-powered executive teams to offer you a cup of tea—an espresso maybe? A shot of bourbon?—but that's what Paul Reckwerdt, president and co-founder of Tomotherapy likes to drink, and exactly what he offers guests to the