Even as the overall real estate market suffers, many luxury second-home markets continue to attract affluent buyers.

BY ELIZABETH HARRIS

Luxury REAL ESTATE INVESTMENT

WHEN PETER FORSCH SET A DEADLINE of early January to accept offers on the first 25 condominiums at the Club at Spanish Peaks in Montana, he wondered if the national real estate malaise would restrain buyers. During the residential property boom in 2004 and 2005, Forsch, the development's president, and residents alike celebrated frenzied demand and rising home values. But in 2006, sales of cabins and homesites at the 3,500-acre ski and golf resort tapered off. » Forsch anticipated that buyers would still covet condos in the lodge, where the club planned no more than 49 units; he presumed the limited number would heighten demand. Their location, too, near the 18th hole of the Tom Weiskopf-designed golf course and a high-speed quad lift, seemed ideal. Forsch was right. On January 10, buyers snapped up all 25 units in one day, generating $50 million in sales." Given the quirkiness and the softness of the market, we wondered—although we were confident we had the right product at the right time," he says. "But the only way to test that is to really put it out there."

The broad real estate market continued to suffer in the second half of 2006, with the median home sales price slipping

TOP VIEW

AS THE OVERALL real estate market has swooned, some high-end second-home markets have bucked this trend. Unusual vacation homes located in markets where growth is limited are behaving differently than real estate in most other classes, and continue to attract interest from enough buyers to keep values growing. Most of these home shoppers tend to be more concerned with lifestyle options than investment value, while speculators are being driven from the marketplace. Alternately, owners of even top-tier homes in areas saturated with them are suffering weakened demand.

up to 3.5 percent nationwide. But not all properties are languishing. Second-home real estate in places such as the Club at Spanish Peaks continues to perform well, enticing buyers who fuel rising property values. Certain vacation-oriented communities seem to share characteristics—exclusivity and limited supply—that have shielded them from the general real estate downturn. Today smart buyers of second homes (and third, fourth and fifth residences) are shopping carefully for these attributes.

Natural Selection

Admittedly, measuring the performance of the second-home market requires at least some divination. No one seems sure of even how many second homes exist in the United States. Conflicting studies put the number of second homes as a percentage of all homes at anywhere from less than 10 percent to a high of 30 percent. The National Association of Realtors tracks average home sales, but does not specifically identify luxury vacation properties in its data. Finding comprehensive statistics on high-end vacation properties priced at $3 million and above presents an even greater challenge. But canvassing real estate agents, developers and recent investors suggests that buyers of such homes are still acquiring them at a healthy rate, and are focused more on lifestyle issues than market vagaries.

These types of buyers enjoy greater immunity from the rise in 30-year mortgage rates, which climbed from 5 percent to higher than 6 percent from 2005 to 2006. Overall, most vacation-home investors do not finance their purchases with mortgage debt, according to a 2006 study sponsored by the Research Institute for Housing America, a Washington, D.C.—based nonprofit. Second-home mortgages comprise only about 4 percent of all mortgage activity, according to the study. And those individuals planning to pay cash for a multimillion-dollar second—or third or fourth—home by and large say that their decision requires little more than cursory financial calculations. Certainly no buyers at this level invest recklessly, but, for many, purchasing a beach house or mountain retreat may entail finding a property that suits the tastes of an entire multigenerational family rather than trying to time the bottom of a local real estate market.

When John Robbins, co-owner of Concord, N.C.—based Greathorn Properties, signed a contract for one of the units at the Lodge at Spanish Peaks in January—a four-bedroom condominium for $2.9 million—he remained unfazed about purchasing during a national lull in real estate sales. Robbins and his wife, Holly, sought a fourth home where they could bring their daughters, who are in high school and college, for ski vacations and summer breaks. "My family has an interest in luxury and a lot of amenities at your fingertips," he says. "This selection for us is a personal one and a long-term one."

The Robbins family, who reside in Concord most of the year and own a summer home in northern Ontario, watched the cooling real estate sector carefully. But they believe that Spanish Peaks offers a unique property—one that will hold their interest. The family members intend to vacation there for years to come, a plan that will protect them from any short-term volatility in value.

As a buyer and a seller, Robbins experiences both sides of the luxury real estate market. He and his business partner are building on two homesites at the Yellowstone Club in Montana, along with a number of others, including one at Spanish Peaks. Greathorn recently completed framing one 6,000-square-foot home. Robbins will watch the market to determine a price, but he reports stable prices at Yellowstone in the range of $1,100 to $1,250 per square foot.

"Despite the apparent softness of the domestic primary-home market, the high-end, second-home market remains strong and less affected in locations like Yellowstone Club," says Beau Blixseth, the company's vice president of special projects. Blixseth is responsible for overseeing the planning and construction of the Pinnacle at Yellowstone Club, a $155 million dollar home designed by Bozeman, Mont—based Locati Architects.

According to Blixseth, the upswing and downturn of local economies has less effect on the prospective Yellowstone Club buyer because there is more demand than product.

"Buyers will pay more for their secondary residence because they spend more quality time in it," Blixseth adds. "In the primary residence, work and school take up most of the day and families often only spend their time together in the evening. In a secondary home, the quality time with family can be a 24-hour experience. All of these reasons combined make for a strong, high-end second-home market."

Limited supply helps explain continued interest in such communities. William Wheaton, a professor in the Massachusetts Institute of Technology's economics department and director of research at the school's Center for Real Estate, studies ski resorts and second-home communities. He sees a positive correlation between price strength and supply constraints. The reverse also holds true: Those who purchase more common ski condos in areas where developers can build more will likely see values barely keep pace with inflation, according to Wheaton. "Most second-home com-

Assessing Your Exposure

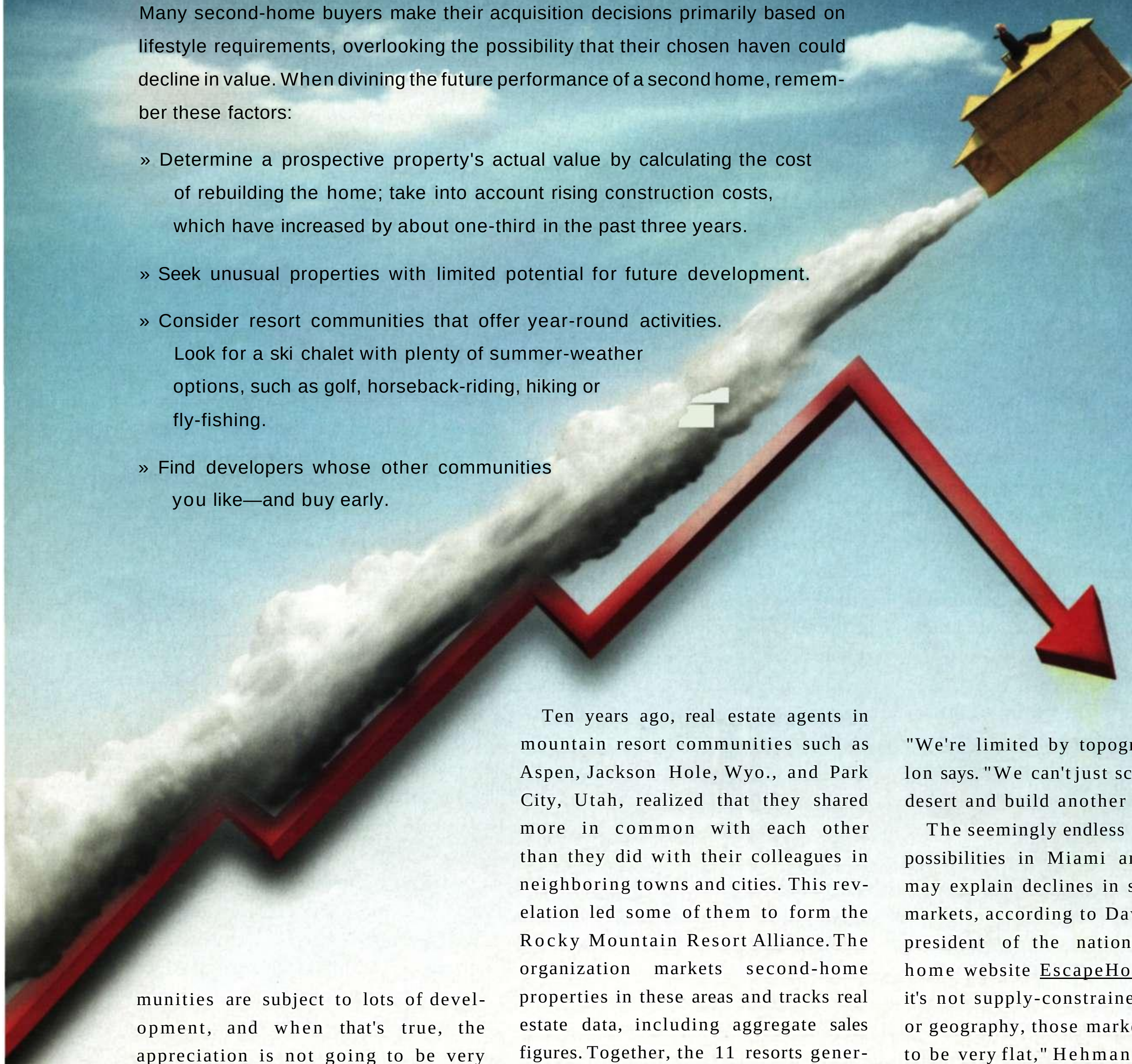
Many second-home buyers make their acquisition decisions primarily based on lifestyle requirements, overlooking the possibility that their chosen haven could decline in value. When divining the future performance of a second home, remember these factors:

» Determine a prospective property's actual value by calculating the cost of rebuilding the home; take into account rising construction costs, which have increased by about one-third in the past three years.

» Seek unusual properties with limited potential for future development.

» Consider resort communities that offer year-round activities. Look for a ski chalet with plenty of summer-weather options, such as golf, horseback-riding, hiking or fly-fishing.

» Find developers whose other communities you like—and buy early.



C.J. BURTON

munities are subject to lots of development, and when that's true, the appreciation is not going to be very great," he explains.

This theory may account for the softening market in second-home communities in Florida—even at the high end. For example, home sales of properties priced at $1 million and higher in Naples fell nearly 40 percent in 2006, according to Multiple Listing Service data for the area. In luxury real estate circles, this notion is becoming axiomatic: Rare properties will command greater demand.

Ten years ago, real estate agents in mountain resort communities such as Aspen, Jackson Hole, Wyo., and Park City, Utah, realized that they shared more in common with each other than they did with their colleagues in neighboring towns and cities. This revelation led some of them to form the Rocky Mountain Resort Alliance. The organization markets second-home properties in these areas and tracks real estate data, including aggregate sales figures. Together, the 11 resorts generated a record $11.4 billion in sales in 2005. And, while 2006 sales fell, the alliance remained strong at $10.3 billion. Steamboat Springs, Colo., topped its $605 million in sales in 2005 by about $70 million, while resorts in Summit County, Colo., (including Copper Mountain and Breckenridge) surpassed their $1.1 billion in sales in 2005 by more than $200 million in 2006, according to Dennis Hanlon, president and founder of the alliance.

"We're limited by topography," Hanlon says. "We can't just scrape into the desert and build another tract house."

The seemingly endless development possibilities in Miami and Las Vegas may explain declines in sales in those markets, according to David Hehman, president of the national vacation-home website EscapeHomes.com. "If it's not supply-constrained by politics or geography, those markets are going to be very flat," Hehman says.

Hesitant Hunters

For Horsham, Pa.—based Toll Brothers, one of the nation's largest homebuilders, whose properties range from upper-middle-class developments to high-end vacation homes, the slowdown prompted the cancellation of 37 percent of all contracts for the quarter ending last October 31, nearly twice the number compared to the same period in 2005. The value of new sales contracts signed totaled $4.15 billion, or 5,812 homes, in fiscal 2006, a 41 percent decrease from 2005. Toll Brothers' stock fell from a high of about $55 a share in 2005 to roughly $33 at the beginning of 2007. CEO Robert Toll attributes some of the decline to market psychology—a general belief that real estate is sinking. The reality is that right now, few investors favor housing, he says. "Nobody wants to be labeled as the dope who bought in a falling market."

Realtor Jonah Wilson, of Sotheby's International Realty in Los Angeles, watched some buyers delay second-home purchases in 2006 because they feared they would overpay should the market continue to soften. Wilson, who helps celebrities such as Courtney Cox and David Arquette scout properties in locales from Beverly Hills to Malibu, grew up amid star culture as the son of Beach Boy Carl Wilson, and later worked as tour manager for his cousins' band, Wilson Phillips. Even though many luxury properties now take longer to sell—he estimates they spend 60 or 90 days on the market compared to 30 days in 2005—prices for the best properties remain resilient. Wilson sees continued strength among expensive properties. "It's such a specialized part of the market," he says.

At the beginning of this year, Wilson started hearing from the buyers who had stayed on the sidelines in 2006. They had waited for a significant decline in second-home prices among the more desirable properties—but the drop never came. "Buyers who hung out all last year are saying, 'Let's find something,'" Wilson says. "They see it hasn't been a huge, drastic change."

David and Rebecca Shopay understand the temptation to delay a purchase. "You don't like to think you're buying into a really, really weak market," David notes. But the couple say the home they selected at the Cliffs at Walnut Cove near Asheville, N.C., suits their interests, and they believe it will hold its value. The Shopays, whose primary home is in Marco Island, Fla., wanted a summer retreat. David retired about a year ago after selling his home-security company, Vanguard Security, to Tri-S Security. An avid golfer who now coproduces DVDs featuring the late golf legend Ben Hogan, David liked the Jack Nicklaus—designed links at the Cliffs. Rebecca, who enjoys hiking, also desired a location with extensive trails. So they signed a contract on a $2.6 million new home on the course's first hole last November. Six people they know also bought in the area.

The Shopays, who envision living at the Cliffs six months each year and do not deem their home an investment property, believe they made the right decision. "You're buying a really good quality product in a gorgeous place," Rebecca says. "We felt like it was worth the chance."

Lifestyle Alternatives

Lingering worries over the real estate sector may fade in 2007 as developers and homeowners see signs of a more robust market. Toll noted improving statistics at the beginning of the year—even in troubled markets such as northern California and parts of Florida. Some private equity investors, too, see greater strength in luxury real estate. TriLyn and Investcorp recently raised $100 million in capital commitments for mezzanine financing that will focus on real estate investments. TriLyn founder and managing principal Mark Antoncic sees continued opportunity among high-end luxury properties. "The dynamics of that sector appear to be holding up," he says.

More importantly, the underpinnings for substantial growth in the luxury second-home market remain attractive. Toll says his company will expand its second-home communities with new projects planned for Las Vegas, Reno and Phoenix through 2009. He believes more and more affluent baby boomers will crave second homes. According to *American Demographics* magazine, second-home ownership among this group could grow from about 6.4 million units in 2000 to some 10 million in 2010.

Meanwhile, speculative interest from buyers seeking to flip houses for a quick profit has fallen, enhancing the long-term prospects for the high-end sector. Toll discourages the investor-buyer through contracts that require buyers to declare they are not speculators and promise that any profits from a short-term sale will revert to Toll. "We've seen this movie before," Toll says. "As an industry—and as a company—we were hurt in the recessions of 1988, '89, '90, and by the speculation that took place in 1986 and the early part of 1987."

But in some markets, speculator-owned properties continue to dominate. Investors accounted for as much as 64 percent of Myrtle Beach, 47 percent of Panama City, Fla., 46 percent of Naples and 40 percent of Vero Beach, Fla., real estate in 2005, according to Wellesley Mass.—based Local Market Monitor, a real estate research firm. Toll watched many speculators leave the market in 2006. At Spanish Peaks, Forsch also tries to dissuade speculators, and added a new stipulation to his contracts: The company reserves the right to buy a property back at the original sale price if an owner puts it on the market within 18 months of purchase. All buyers must also apply for club membership for each property they own. Full membership, which includes golf, costs a one-time fee of $85,000. Resident membership is $45,000.

"In 2004 and 2005, real estate was the darling of investments. It eclipsed the stock market, and people were moving into real estate," Forsch says. "There were a lot of projects people were buying as investments, and we were never crazy about that. What we're really trying to do is create a lifestyle."

But some buyers who made second-home purchases during the boom, based primarily on lifestyle options, have seen values appreciate in select areas. In December 2005, Domenick and Joann Galluzzo acquired a five-bedroom home in the Porches in Steamboat Springs for just under $1.6 million. Domenick, a retired attorney and former deputy chief state's attorney for Connecticut, estimates the property value has risen approximately 50 percent. And while the Galluzzos, whose primary residence is in Fairfield, Conn., watched other real estate markets decline, they were not concerned about buying in Steamboat.

"We were very fortunate," Domenick says. "It's been booming here in Steamboat."

The Galluzzos began vacationing in Steamboat in 1974, and since buying at the Porches, they have upped their time in Steamboat to more than six months out of the year; they ski selectively—in good weather and with few tourists. Their three children and eight grandchildren plan vacations there.

"We see our family more in Colorado than we do back East," he says, adding that in the summer, his grandchildren have learned to ride their bicycles and enjoy swimming in the river. "It's nice to have them," Galluzzo says. "And Steamboat is a gorgeous place. We came off of Rabbit Ears Pass in 1974, we looked down in the valley and we were just in awe of it."

Elizabeth Harris is a staff writer for **WORTH.**

Before You Buy

BURT SUGARMAN CONSIDERS THREE FACTORS before purchasing real estate in a resort: the quality of the operator; how much he and his family will enjoy the property; and his estimation of its future appreciation. In his experience, having bought and sold a number of such properties, most of the pleasure and potential profit hinge on who runs the show.

"If the clubs aren't operated correctly, your property isn't going to increase in value," he says.

Sugarman, a Beverly Hills businessman, recently bought a few oceanfront lots in the Los Angeles-based Discovery Land Company's new resort in Cabo San Lucas (a recent purchase since he last spoke with WORTH; see "The Private Resort Home Market," June 2005). He did so in large part after enjoying his experience as a homeowner in the company's Iron Horse development in Whitefish, Mont. At Iron Horse, he says an owner can count on Discovery's attention to detail, and recommends that buyers gauge whether management companies fulfill promises ranging from construction timelines to restaurant openings, and consider everything from how well they maintain greens on golf courses to how they greet you upon arrival.

Sugarman prefers resorts that protect wildlife and are environmentally sensitive. He also believes limited future development helps protect property values. "You don't want to have them triple the amount of lots all of a sudden," he says. *—EH*