CHAPTER 1

AMERICAN HISTORY

THE EVOLUTION AND MIGRATION OF SECOND HOME INVESTMENTS

On a beautiful autumn day in the Valley of the Sun, the evocative name for the Phoenix metropolitan area, I drove the 20 miles from my house in Mesa to the Arizona Biltmore Resort & Spa in central Phoenix for a mortgage technology conference. Many of the people attending the conference had arrived from cold weather locations and for the two days in Arizona, they thought they were in paradise. I was coming to the conference to interview one of the presenters for a business magazine, but I stayed on through the handsome luncheon. When the folks at my table learned I was a local, they asked a few questions about the surrounding area, just in case they had time to do some local exploring.

I suppose because I was partial to the building, I gave them this small bit of introduction, telling them that if they just stepped out of the conference center and looked up at the top of the hill just in front of them, they would see a large white building. While it is now called the Mansion Club, it was originally a second home of chewing gum magnate, William Wrigley Jr. Actually, it was one of five Wrigley homes, but this one was built as a 50th wedding anniversary gift for Wrigley's wife, Ada.

Now this was a true second home, or vacation home, as defined by standards of American life from the mid-nineteenth century through the early part of the twentieth century. Whereas in Europe and elsewhere around the world, royalty of one sort or another generally boasted of other homes, either in the countryside or on the coast; in the United States, the great second homes were constructed by and for the emperors of business and their families. Thus arose Newport, Rhode Island, the greatest second home market in the United States during the Gilded Age (from 1865 to 1901), where the great financiers and industrialists built their summer mansions. Many of these can still be visited, such as The Breakers, a 70-room summer residence built by Cornelius Vanderbilt II, at a cost of a then wildly extravagant $7 million.

Newport wasn't the only famous colony for the wealthy. Between the middle of the 1800s and the start of World War I, Long Branch, New Jersey, attracted not only the rich, but the famous as well. Jay Gould, infamous stock manipulator and railroad magnate built four cottages in this coastal community, while George F. Baker, banking chieftain, constructed two. Also regular vacationers in Long Branch were two of the most famous actors of their time, Edwin Booth and Oliver Dowd Byron.[1]

By the early twentieth century, a number of smaller second home markets for the less-than-incredibly wealthy began to develop in places such as Lake George, New York. Elsewhere, the American Southwest opened up to travelers and artistic types with the inclination to visit or live close to wide vistas of mountainous desert regions. Santa Fe and Taos, New Mexico, attracted the likes of everyone from writer D.H. Lawrence to artist Georgia O'Keefe, the latter of whom visited seasonally starting around 1930 before moving there as a permanent resident.

Nevertheless, because of two world wars and an economic depression sandwiched between, the business of second homes continued to be the business of industrial and financial barons through most of the twentieth century.

Phoenix, the capital of Arizona, was still a relatively small city (its population didn't exceed 50,000 until after World War II), but it, too, was beginning to attract seasonal visitors. The Biltmore, then simply the Arizona Biltmore Hotel, opened in February 1929. The Wrigley Mansion, originally known as La Colina Solana (sunny hill), was finished in 1931. It boasted 16,850 square feet of living space, 24 rooms, and 12 bathrooms. With all that, it was the smallest of the Wrigley homes and only used sparingly, maybe four to eight weeks of the year.

The area around the Wrigley home and Biltmore Hotel was sparsely populated and guests still felt the sense of nature, untamed desert, and Wild West. Today, the Mansion Club and Biltmore sit in the very heart of Phoenix, which by itself, boasts a population of more than 1 million.

Phoenix's astronomical growth really began after World War II, and the cities comprising the Valley of the Sun, including Scottsdale, Mesa, Tempe, Glendale, and a few others, all grew up together. With population expansion in the 1950s and 1960s, the first large wave of seasonal visitors started arriving, northerners who rented or built a wide variety of residential structures, from mobile homes to small, single-family residences. This was a market for the middle class from cold climates, including Canada.

Phoenix mirrored other warm weather locations, attracting a small, but growing number of middle-class families that came south for the sun and started buying homes to be used occasionally.

In the United States, second homes as a middle-class phenomenon was a post-World War II development, when a strong economy, a greater amount of excess family capital, entrepreneurial real estate development, and the creation of new roadways and airplane travel all helped redefine vacation travel.

Taking a peek at popular second home locations around the country, we find the middle class heading to Cape Cod beginning in the 1960s. As *The Boston Globe* noted, "During the 1960s, 1970s, and early 1980s, the Cape was a retreat for a middle class who could afford the modestly priced vacation homes being developed then."[2]

Down in South Carolina, the development of Hilton Head Island really got started in 1956 when two things happened: The James F. Byrnes Bridge was constructed, opening the island to direct automobile traffic from the mainland; and Charles Fraser bought his father's interest in Hilton Head Company and began developing it into Sea Pines Plantation. By 1958, the first deed to a lot in Sea Pines was signed. Beachfronts initially sold for $5,350, but it didn't take long for demand and appreciation to set in; four years later beachfronts were selling for $9,600. Part of the reason for the bigger price tag was that the island's first golf course, Ocean Course, opened in 1959.

It wasn't only beach areas that began attracting the middle class for seasonal residency; skiing had just begun to catch on in the United

States before World War II, but the war threw ski development plans into a hiatus. Finally, at the end of the 1940s, some of the country's major ski resorts began to take shape. As an example, the Aspen Skiing Corporation was founded in 1946, and the Aspen, Colorado, area very quickly caught on with skiers. Just 12 years later, the popularity of skiing was growing so quickly, Aspen opened two more ski areas, Buttermilk and Aspen Highlands. Expansion continued with the opening of Snowmass in 1969.

Vail, Aspen's big competitor for the high-end skier and cross-state rival, is a younger development. Construction on its ski resort didn't start until 1962 and the town itself wasn't incorporated until 1966. Interestingly, in 2006, the *Vail Daily* newspaper ran a story about the local residential market and it began by featuring Gary Lebo, the owner of a company called Alpenglow Property Management. A key point in Gary's career history was that he began in the 1970s by selling second homes.

The event that really put skiing on the map for most Americans was the Winter Olympics of 1960, which took place at Squaw Valley in the Lake Tahoe region, which sits on the border of California and Nevada in the Sierra Nevadas.

For the first half of the twentieth century, development around Lake Tahoe consisted of a few vacation homes, but the Olympics, and most importantly, completion of the interstate highway through the region in preparation for the Olympics, opened up Tahoe to development. Here's the telling statistic: Over the 20-year period from 1960 to 1980, the permanent resident population increased from 10,000 to 50,000, while the seasonal population jumped from 10,000 to 90,000.

When I moved to Mesa, a suburb of Phoenix, in 1976, there was already in my town a large swath of RV parks, residential developments, and over-55 communities that catered to the seasonal visitor. The word "snowbird," to connote residents of cold weather climes who traveled south for the winter months, was already used extensively. In my early years in Mesa, it used to amuse me to identify license plates from the various states of the union and provinces of Canada. At the end of my first year in Arizona, I had developed a theory that east of Chicago, snowbirds migrated to Florida, but from the Windy City west, they came to Arizona. (Mesa is the spring training home of the Chicago Cubs—an underappreciated rationale for second home selection is where the home baseball team goes for spring training.)

While the sunshine, beach, and ski second home markets for the middle class began to build in the 1960s, '70s, and '80s, it should be noted for as long as there has been a United States, there has always been a fairly low-end, niche market in this sector for hunters and fishermen, who often owned cabins, camps, lodges, or other rudimentary structures that were used almost exclusively for these outdoor activities. As William Faulkner wrote about the annual hunting trip in mythical Yoknapatawpha County in *Go Down, Moses:* "It had already begun on that day when he first wrote his age in two ciphers and his cousin McCaslin brought him for the first time to the camp, the big woods, to earn for himself the name and state of hunter provided he in his turn was humble and enduring enough."

This part of the market still exists; some of it has gone upscale, and depending on where the cabin is located, consistent appreciation has been a side benefit to the good hunt.

The 1990s

Consistent appreciation, a traditional hallmark of most second home markets, ended in the 1990s. Instead, the value of vacation homes began to accelerate dramatically. The reason for this was due to a confluence of factors: financial, economic, and demographic.

In 2004, I wrote one of the first major articles on the vast appreciation being experienced in second home venues for *Barron's* magazine. At the time, markets were peaking. Within a year, prices would begin to plateau, finally dropping into a slight decline by 2006.

My favorite location in the story was Nantucket, Massachusetts, which was, and still is, a playground for the corporate elite, the twenty-first century's equivalent of Newport in the Gilded Age. Before he moved his primary residence to the federal prison system, Dennis Kozlowski of Tyco International summered on Nantucket, rubbing shoulders with Lou Gerstner (IBM), Jack Welch (General Electric), Lawrence Bossidy (United Technologies), and many others. Gerstner had paid $12 million for 1.6 acres on Nantucket.

Well, when Corporate America wants in, that can only mean one thing: Prices are going to skyrocket and Nantucket experienced its own little bubble. Along the harbor, home values in Brant Point and Monomoy were appreciating at a sizzling 10 to 12 percent a month when I wrote my story. Even in the less ritzy mid-island section, homes values jumped about 40 percent annually.

The National Association of Realtors (NAR) first surveyed the second home market in 1989. At the time, it reported there were 288,000 sales of second homes in the country and the median price was $99,200. Ten years later, sales volume had risen to 377,000 and the median price jumped to $127,800.

By 2005, the NAR would report that 12.2 percent of all homes bought that year were vacation residences. Investment home sales were also very high, and the NAR lumped both categories together, reporting 3.34 million second home sales that year, up 16 percent from the year before. Separating out just vacation homes, sales were a record 1.02 million, up 16.9 percent from the previous year's 872,000 sales figure and a long way from 377,000 sales in 1999.

According to the *Christian Science Monitor,* the number of secondary residences steadily climbed in the last decade of the twentieth century, from 5.5 million in 1990 to 6.4 million in 2000, and by 2010, the newspaper predicts sales will reach 9.8 million.[3]

The question is: Why was there so much sudden interest in second homes on the part of the American middle class? The answer begins with demographics. Like many post-World War II phenomena, this one is being driven by the 80 million strong baby boomers.

In the year 2000, the leading edge of baby boomers began to hit 55 years of age. This is not only the optimum time in life when people become interested in second homes, says David Lereah, chief economist of the NAR, but they are at the peak of their earnings. Indeed, at 55 years, some baby boomers in the upper middle-class range are already retired or planning to retire within five to seven years. Real estate is now a key feature in retirement planning, either because of the possibility of retirement in warmer environs or avoiding the cold winters by spending part of the year in those warmer places.

"Vacation home sales will remain strong for the foreseeable future given the fact that baby boomers are favorably positioned in terms of affordability, as well as being at the stage in life when people are most interested in making that kind of lifestyle purchase," says Lereah.[4]

It's not only earnings power that is driving the second home decisions of the baby boomers but their inheritance potential as well. The parents of the baby boomers, who beginning in the 1950s overcame economic barriers to storm into the middle class or better, often amassed considerable assets, which they passed on to their children. As a means of diversifying their assets, financially astute baby boomers have used that inherited capital to invest in real estate, often the second home.

The single largest transfer of wealth in U.S. history is occurring with the baby boomer generation, notes David Hehman, president of EscapeHomes.com. “Baby boomers are inheriting a lot of money from their parents. They are prioritizing their lifestyle and recreational interests and what follows is a second home purchase.”

The baby boomers have been lucky in regard to the second home markets because both government-induced and free market turns have been in their favor.

The first boom for the second home market occurred in 1997 when tax law changes allowed most sellers to exclude up to $500,000 in capital gains from taxation (for a couple who lived in a home for two out of the five previous years). The tax change allowed people to make decisions based on needs and desires rather than simply trying to avoid a tax hit. Under the old law, the incentive was to always buy a more expensive home to avoid a tax penalty. Now people could trade down to a smaller, luxury condo and then go out and purchase a second home.

The second boom occurred after the year 2000, when the Alan Greenspan-led Federal Reserve pursued a low interest rate policy, with the rates falling to as low as 1 percent for federal funds in 2003, which was a benchmark not seen since the Eisenhower administration in the 1950s.

With a recession on the horizon following the collapse of the stock market at the close the of previous decade, Greenspan quickly pushed for lower interest rates. By 2001, the effect on just one sector of the economy, housing, was like a lightning bolt. The low interest rates gave (by keeping monthly payments down) first-time home buyers entry into the market, induced many existing homeowners to trade up to bigger homes, and made the acquisition of a second home a possibility. By 2001, newspapers such as *USA Today,* were reporting that the low rates stoked the housing market so strongly, they kept the nation out of a recession.

A survey by Centex Destination Properties reported in June 2004 that 25 percent of affluent households expressed an interest in second home ownership over the next two years. The respondents had a median age of 45 years, 78 percent were married, and 87 percent already owned their own homes. The most desirable locations sought by respondents were those offering year-round temperate climates, with the top five most popular destinations being: Naples/Marco Island, Florida; southern New Jersey and Delaware coasts; the Florida Keys; the South Carolina coast; and Maui.[5]

Investment sectors often experience a kind of hysteria that is often labeled a "bubble." The genesis of these bubbles is usually the result of the bursting of some previous bubble. For example, an exuberant real estate market in the 1980s collapsed at the end of the decade, which left many investors, who remained whole, looking for places to park capital. Eventually, in the 1990s, this money began to flow into the stock market, in particular to the innovative and often revolutionizing technology companies that seemed to be like starbursts in the new economy. At the start of the next decade, the technology bubble burst, flattening the effervescent stock market. It was time for free investment capital to find a new home, and it was once again real estate that was back on everyone's tip list. However, whereas the boom in the 1980s was led by commercial real estate, at the turn of the new millennium, it was residential.

The low interest rate environment combined with this massive flow of investment capital into real estate inflated a new housing bubble, which itself began to collapse around 2006.

While it lasted, the movement of free investment capital absolutely stoked the second home market already benefiting from demographics and government economic policies.

With all that demand, prices rose accordingly. The median price of a vacation home in 2005 hit $204,100, up 7.4 percent from the year before and a considerable improvement over the $127,800 in 1999. These numbers temper the fact that in most of the country's most desirable second homes markets, there was probably little to be had for under $350,000 at best, and one would have to go to seven figures to get into Aspen, Colorado; Sea Island, Georgia; or Palm Beach, Florida.

After the turn of the millennium, the vacation home market, particularly the condominium sector, got juiced. The rapid appreciation began to attract not just soon-to-be retirees, but investors, people who had no intention of living in their secondary homes, and their shady counterparts, speculators. The difference in the two is simply a matter of "hold." Investors get in for the long run, but speculators want to turn properties as quickly as possible; in effect, they want to flip the real estate.

Beginning in the 1990s, investor activity in secondary homes became so strong that the NAR had to recognize it as a subset of the second home market. Indeed, while second homes as a percentage of total home sales rose 40 percent, so did the percentage as investments. In 2005, 27.7 percent of all home purchases were investments (up from 23 percent in 2004), reported the NAR. That number easily swamped the percentage that was bought as vacation homes: 12.2 percent in 2005.

"Vacation homes once constituted the majority of second home purchases, but the soaring real estate market has attracted more Americans to real estate investing," observed NAR's Lereah.[6]

Perhaps no sector of the second home market attracted more speculation than condominiums.

In November 2006, a small blurb of a news story about condos appeared in the *Wall Street Journal.* The story related how six luxury condo developers building in South Florida, including Donald Trump and Related Group (Time-Warner Center in New York) executives, hosted a cocktail party in Manhattan for prospective buyers. The story quoted one developer, who was selling units for as much as $6 million as saying, "For people who have that kind of money, it's not an investment. It's a lifestyle."[7]

Obviously, there are condominium units being marketed for seven figures, but generally, condos sell for less than single-family homes. They are also easier to rent and more subject to flipping. As a result, condo markets often exhibit a lot more price movement, going up and, unfortunately, going down.

In that same *Wall Street Journal* story, one broker was quoted as saying, "It's a known fact the [condo] market is in a downturn."[8]

Back in 2005, I did a story for the Urban Land Institute's *Multifamily Trends* magazine about what I saw as a condo bubble that was ripe for bursting, which turned out to be accurate. At the time, I quoted two economists. Celia Chen, director of housing economics at Economy.com, told me, "Condo prices tend to be more volatile than prices for single-family homes. They go up higher and they fall down further." Echoing those sentiments, David Stiff, a senior economist with Fiserv CSW, added, "There is usually more fluff in the condo market because people are trying to speculate on new development. Speculators target condos simply because they are easier to construct and cheaper to flip."

For a while, everyone was making money in real estate. In the summer of 2004, a close friend of my son and other members of his family took their place in line for the opening of sales at a condominium complex in Edgewater, New Jersey. After waiting on line through the night, the next morning, my son's friend and his family acquired a number of condos selling at just over $300,000. After a year, they were reselling the units at an average profit of $100,000 each.

In 2005, investment home prices jumped an amazing 24 percent over the year before to a median cost of $183,500. This spiral of inflation came to an end in 2006 with the collapse of the residential housing bubble, but the damage had already been done. Investment and vacation homes had leveled off at such a high plateau, buyers were already looking at the next frontier, cheaper real estate overseas.

Turn of the Century

Sometime at the end of the 1990s, I found myself, on separate trips, on the Mediterranean islands of Cyprus and Malta. As I journeyed around the respective islands I noticed some new home construction. Inquiring, I learned that they were retirement homes for British citizens. I wasn't sure if the British who were retiring to the Mediterranean were permanently leaving Manchester or London or Cornwall and heading south or simply coming down for the winter. Nevertheless, the explanation made sense because the British had a long history on both islands.

Middle-class Europeans, especially those from the cold countries, have a long history of owning second homes around the Mediterranean from Greece to Spain. In addition, certain European states have had a long colonial history, and a certain amount of second home movement occurs between the old colonial power and the modern, independent state that emerged from that legacy.

Around the turn of the twenty-first century, with the euro and British pound attaining a position of strength against the dollar, many Europeans took advantage of the difference to buy second home properties in the United States, especially in Florida. In the cold lands of Churchill, Manitoba, I was hiking into the tundra to spot polar bears with three Germans who had flown up from Naples, Florida, where one of them owned a vacation home. It was where they all came every winter, except for little adventures in North America, such as this one to Churchill.

Over in the United States, Americans never had a colonial legacy to explore, nor the inclination to even consider establishing a residence abroad, especially when there was such sunshine-dappled bounty within the country. When the American middle class began to dive into the world of second homes, it came south to places like Florida, South Carolina, Arizona, and California.

However, everything changed in the new century.

The last time the U.S. State Department did a survey of Americans living abroad was in 2000. At the time, the government concluded 4 million Americans were living outside the United States, but that included dual citizenship individuals and people who registered with a particular agency.

The next time the State Department does a similar survey won't be until 2010, and by then it will probably have to change its methodology because over this 10-year period, Americans have been buying vacation homes in random places around the world in greater numbers. Many of these individuals might live in their second homes for just three months of the year, so how would the government include those people in the survey?

In 2005, a United Features Syndicate survey quoted a Londoner who had a vacation home in Cape Town, South Africa, as saying, "You never used to hear an American accent in Cape Town. Now you hear it all the time. They're all over the place." Closer to home, the same story interviewed a director of sales for a gated community on Grand Bahama Island, who boasted that Americans were interested in the Bahamas because, "there are no property taxes, inheritance taxes, or capital gains taxes."[9]

The first rush of stories about Americans seeking vacation shelters in foreign ports occurred in 2005. The press often catches up to trends after the trend has already been established and is flourishing, and then numerous publications all begin to report different variations of the same story. So, if the press started to write about Americans buying vacation homes in 2005, the actual rush of home buying overseas probably first began in 2003 and 2004, which is significant because that's about the time when residential real estate in the United States began to plateau. National median existing single-family home prices finally peaked around the third quarter of 2005.

More importantly, for those interested in vacation homes, the price of residential property of any type along the ocean shore or in mountain resort areas, rose to a point where it was essentially out of reach of the American middle class. Just a decade earlier, a condo on the beach was a pricey consideration but certainly attainable for a family with excess capital. That wasn't the case by the new millennium. So Americans with a strong desire to have a sunshine-filled retirement or to spend three months of winter on the beach began to look at places around the globe where the dollar could buy a lot more than within the confines of the continental United States.

"Vacation home prices have gone through the roof," exclaims Jeffrey Hornberger, manager of international business development at NAR. "Appreciation in the last couple of years has been unprecedented. As a result, it has been very difficult to touch second home properties in the prime beach or mountain locations. They are out of reach for the typical, middle-class American. Whereas the previous generation could afford a condo on the beach, this generation cannot. That is why Americans began to look even further south, in Latin America and the Caribbean."

While the high cost of real estate was certainly a primary factor in the internationalization of the vacation home market from an American perspective, a secondary cause was the evolution of the travel industry.

First, baby boomers began traveling overseas as young adults in the 1960s and 1970s and even if they stopped doing so (or did so intermittently) during their career-building and baby-rearing years, when they approached the empty-nester time of life, they started to travel again. Middle-class baby boomers had a comfort level with international travel.

Second, through the last half of the twentieth century, the global travel industry created a vast infrastructure of hotels, resorts, cruise lines, and travel routes to make international travel easier and when possible, risk free. At the same time, an ever-expanding airline industry could bring travelers to every part of the globe at reasonable prices.

Third, the Internet not only made travel easier, but it helped create the internationalization of real estate by allowing anyone around the globe to search for information, agents, local listings, local conditions, and selling prices for just about any place on earth.

"With the Internet, information is at your fingertips," Hornberger notes. "People can find out about buying property in Nicaragua or Panama in a short amount of time. They can get a grip on how much beachfront property costs, how long it takes to get there, and how strong the local currency is compared to the dollar. This is all coveted information. People are doing the research online then getting on a plane."

Fourth, many countries that Americans are now considering as potential second home locations have gone from politically unstable to stable, democratic governments. Manuel Noriega is long gone from Panama, and today Panama is a hot real estate market for Americans.

A *New York Times* article in 2005 told the tale of an Aspen, Colorado, married couple who bought a half-acre of land in Altos del Maria, a second home community about 90 minutes from Panama City for $54,000. The magazine interviewed the husband, who told the reporter they were considering installing an infinity pool. He was quoted as saying: "Labor here is very cheap. High-end construction is about $65 a foot. In Aspen, the norm is $400." Another formerly unstable country, Croatia, is booming with second home buyers from other parts of Europe and the United States. The same article quoted a Brooklyn man who was looking overseas for a second home and chose Croatia's Dalmatian coast. "It's the new Riveria," the man exclaimed. "Croatia is still relatively undeveloped. And relatively cheap."[10]

Finally, Americans have gotten more comfortable buying overseas because so many U.S. real estate and financial companies are now global. Names are familiar and practices are standardized, all of which heightens that comfort level. If, for example, a couple from New Jersey has used Century 21 to help them buy their last two homes, the odds are the couple could find a Century 21 agent in many of the foreign places they would look to buy a second home. If the couple liked gated communities, it would be no problem in most second home markets worldwide. And if they needed to deal with a bank, Citicorp has probably gotten to wherever they may want to go first.

In 2006, many U.S. real estate markets turned tepid. Interest rates climbed, the stock market bulls came out roaring, and overbuilding occurred in a number of communities. None of this affected the trend line for buyers of vacation homes overseas. "The fact is," says Hornberger, "the real estate slowdown in the United States has not quieted the international marketplace. Americans are just getting started abroad."