



Vacation Home Still Works For Some
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Interest rates are at rock bottom. Housing affordability is at a record high and the glut of available properties on the market has left buyers holding all the cards.

If your long-term financial plan includes the purchase of a second home, or vacation property, now may be the time to make your move.

"There are an abundance of properties available right now with sellers making concessions that they generally aren't going to make in a rising market," says James Boykin, author of "Investing in a Vacation Home for Pleasure and Profit" and a retired professor of real estate analysis at Virginia Commonwealth University.

Despite the incentives to buy, however, the mortgage crisis that crippled the market over the last three years has made it harder to qualify for loans—particularly true if you're purchasing a second home.

And with property values continuing to fall, homeowners who once relied on the equity in their primary residence to finance the purchase of a cabin or beachfront retreat are no longer able to tap those funds.

As such, if you're looking to expand your real estate portfolio in today's market, be prepared to bring more cash to the closing table and perform greater due diligence to ensure the property you do select meets your personal and long-term investment needs.

"Real estate is a very good alternative to stocks and perhaps other investments at this time, but it needs to be right for you personally as well as right for your portfolio," says Boykin.

Here's a look at how the second home market stacks up, what to look for when selecting a property and what it takes to land a loan.

Future Demand

According to Walter Molony, spokesman for the National Association of Realtors, the second home market is "fundamentally healthy," despite short-term ups and downs.

Indeed, the number of vacation homes sold fell 30 percent to 740,000 in 2007, from a record 1.07 million in 2006, according to NAR. The median price was \$195,000 in 2007, down 2.5 percent over the prior year.

While the results have yet to be tallied for 2008, Molony notes demographics bode well for that segment over the next decade.

"The long-term underlying demand is favorable for vacation homes because of the large number of middle-age, middle income Americans [who are the primary buyers of such properties]," says Molony. "In recent years, this market has been driven by the baby boomers, but there are two even larger population groups coming up right behind them. Those younger segments will continue to fuel this market for the next 10 years."

At the same time, NAR reports the housing affordability index rose 13.6 percent in January to 166.8, the highest since tracking began in 1970.

The January index, the most recent month for which data are available, indicates a median-income family, earning \$59,800 could afford a home costing \$283,400 in January with a 20 percent down payment, assuming 25 percent of gross income is devoted to mortgage principal and interest. A year ago, the same family could afford a home costing \$263,300.

"If you have the resources and are confident about your economic future, you're not going to find a better market than we've got today in terms of affordability and raw buying power," says Molony. "It doesn't get much better than this."

Who's Buying?

Those who buy vacation homes overwhelmingly do so for personal enjoyment, rather than investment potential.

A 2009 NAR study finds 84 percent of vacation homebuyers were most interested in owning a family retreat, while 25 percent bought with the intent to rent to others and 26 percent are looking to help diversify their investment portfolio.

A smaller percentage – 30 percent – expect to use their vacation home as their principal residence in the future.

Regardless of your intent for a vacation property, however, Boykin notes it's important to buy with resale value in mind.

Look for views, proximity to amenities and established resort communities, he says, especially if you hope to rent it out part-time.

It's also best to stay within driving distance of your primary home, enabling you to enjoy your vacation retreat more often and pop in to address problems as they arise.

First-hand knowledge of the market will also help you avoid buying into a community that's on the outs.

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Lastly, whatever you do, says Boykin, don't let yourself fall for the beautiful four-bedroom Victorian six blocks from the beach, when you can get a smaller beachfront condo for the same money.

"You can't fall in love with your vacation home," Boykin says. "If you don't buy a property that is attractive and well-situated you don't have much upside

potential. Remember, if you buy cheap, it stays cheap."

If you can't afford to buy in the best locale, he adds, consider creating an investment group with two or three other families and purchasing a higher end property together.

"If you can't afford what you want, partner with others who are in a similar financial situation and have compatible interests," says Boykin. "You can divide 10 weeks for each family which is more than you'd probably even be able to use. Just be sure to create an exit strategy first, that defines ways in which you can buy one another out if someone wants to sell down the road."

Landing A Deal

In most markets, buyers looking for instant equity and willing to roll up their sleeves flock to fixer-uppers. A little paint, some yard work and a minor kitchen rehab and you're able to lock in a hefty profit.

That's still true today, but it may not be necessary.

Many builders have huge inventories of unsold new construction and are more than willing to negotiate. Talk with them to find out where their properties are located and make sure you're not settling on location.

Though inventory abounds in many vacation hot spots, Donna Spinelli, a real estate agent with Coldwell Banker Timberline Real Estate in Vail, Co., says finding the best deals still requires homework.

With the income to support two mortgages, many vacation home owners can afford to reject lowball offers, or better yet, simply keep their home off the market (and potentially rent it out) until the economy recovers.

"A lot of people with second homes, even though they have been hit by the drop in the stock market, are relatively well off, so they don't have to sell and many choose to wait [until prices rebound]," says Spinelli. "That's especially true at the high end of the market."

You'll score the best deals by finding motivated sellers, those burdened by the cost of owning multiple homes.

"That isn't always reflected by price," says Spinelli. "When I find out a buyer's price range, I start calling around to other brokers and inquiring what that seller bought that property for, and how much room they have to wait. You have to do some research."

Bargain or no bargain, you'll want to review your finances before pulling the trigger to ensure the property and the price fit within your budget.

Get a thorough inspection of any property you plan to buy and create a realistic estimate of total monthly expenses.

"You need to look at it with cold steady eyes and be as business-like in your approach as possible," says Boykin. "Otherwise, you'll realize that after a year of eating peanut butter and jelly sandwiches you went about this all wrong."

Securing A Loan

In today's market, however, finding a vacation home and financing it are two separate things.

Thanks to the mortgage crisis and rash of foreclosures, banks have tightened their lending restrictions, requiring at least 10 percent down for a second home.

If you plan to rent your second home for more than two weeks a year, the bank considers that an investment property and will likely require the full 20 percent down payment.

Needless to say, a strong credit score is also a must.

Even perfect credit history and a fat down payment, however, won't do you much good if you've been unemployed – even temporarily – over the last few years, says Tam Toner, a real estate agent with David Stubbis Real Estate in Solana Beach, San Diego.

"The most important thing you'll want to show is that you have two years of steady income," she says. "Even buyers with a large down payment and a hefty bank account but spotty employment history, will not be in as strong a position as someone with less cash and a steady income."

Fortunately, many purchasing a second home don't require financing at all.

In 2007, NAR reports 30 percent of vacation home buyers paid cash. Those who don't typically put down far more than the 20 percent required to avoid paying private mortgage insurance.

The Ground Floor

Though market conditions are ripe for snapping up a second home, Boykin cautions buyers to take their time, do their research and manage their expectations. Don't overestimate your ability to maintain or rent the property, and don't count on flipping it for a profit anytime soon.

By buying smart, you should be well positioned to profit from your purchase down the road when the real estate recession subsides.

"The problem with following the crowd is that by the time you feel comfortable dipping your toe back in the market, it may have started to peak again," says Boykin. "When you buy near the top and the market goes down, you could be faced with the situation of having a house that is worth less than you owe. But when prices are down, as they are today, you're buying with some profit built in and that will help when you go to sell it, or if you find you need to sell a little earlier than anticipated."

- **Slideshow: Million Dollar Homes @ 2009 CNBC.com**

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