THE WALL STREET JOURNAL.

WEEKEND INVESTOR | JULY 23, 2011

Vacation Homes: Why It May Be Time to Buy

BY: JESSICA SILVER-GREENBERG

“The clouds hanging over upscale vacation-home markets are starting to lift. While prices are still falling in most regions, the luxury segment is picking up, and brokers are reporting more inquiries than they have had in years.

The upshot: If you have the money and plan on staying put for the long term, now may be a good time to buy.

Five years after housing’s peak, markets that once were out of sight even for well-heeled buyers are now in range. On Hilton Head Island, S.C., a three-bedroom home nestled between the Atlantic Ocean and Calibogue Sound changed hands in April for $750,000, after having sold for $1.2 million in June 2006. In Vail, Colo., a three-bedroom home that fetched $3.3 million in 2008 sold in February for $2.5 million.

Overall, the median second-home price was $150,000 in 2010, down 11% from 2009 and roughly 25% from 2006, according to the National Association of Realtors. That isn’t pretty, but it is only slightly worse than the 22% drop for the overall housing market. The higher end of the market—homes in the $5 million-plus range—has held up better, says Douglas Duncan, chief economist at Fannie Mae. "At the top of the market, particularly luxury homes, prices have proven very elastic, and have sprung upward quickly," he says.

Buyers are taking heed. On Palm Beach Island, Fla., sales were up 50% in the year ending June 30. Transactions in the Hamptons, on New York’s Long Island, jumped 59% in the second quarter from a year earlier. In Aspen, Colo., sales for the year ending May 31 were up 10%.

The number of people looking at properties is up as well: In Vail, Hilton Head and Palm Beach, foot traffic has jumped by at least 30% this year, according to local real-estate agents. "People have frugality fatigue," says John Burns, president of John Burns Real Estate Consulting Inc. in Irvine, Calif.

This isn’t to suggest the boom is back. In general, properties situated in prime locations—on the water or near a ski slope—are selling well, but homes in less desirable spots are languishing on the market. Banks are increasingly wary of making second-home mortgages, particularly "jumbo" loans above federally guaranteed limits; 10% of banks raised their standards on such loans last year, according to the Federal Reserve. And the tax deduction for mortgage interest on second homes is at risk of being cut back.

Geography is the best guide to today’s vacation markets: In some places prices are holding up, while in others they are still tanking.

The blue-chip market consists of a handful of spots where prices have stabilized and could soon rebound as sales pick up. Some, such as Hilton Head, have benefitted from tough restrictions on building, which kept inventories manageable during the bust. Prices there have risen by 4% during the past year.

The other market is still very much in crash mode. In places like Miami, Fla. and even Martha’s Vineyard, Mass., prices have continued to drop as foreclosed properties flood the market. But bargains abound as sellers cut their asking prices or accept less to unload properties. In March, for example, a three-bedroom home on Palm Beach Island, Fla., listed for $4.6 million sold for just $2.5 million.

With the broader housing market still so sick, it might seem the height of folly to jump into such unpredictable investments now. Even in blue-chip markets there isn’t a guarantee of price appreciation anytime soon. Indeed, over time vacation-home markets don’t do noticeably better than primary-home markets. Homes on Martha’s Vineyard appreciated by 40.9% over the past 10 years, edging out Boston’s 40.5%. But Hilton Head’s 15% gain was trounced by nearby Charleston, S.C.’s 25.4% rise.

Then again, most vacation-home buyers aren’t looking to make big investment profits. More than 80% of second-home buyers surveyed by the National Association of Realtors in May reported that they bought for consumption reasons—to live in the house and enjoy it.

And many second-home buyers are wealthy enough to pay in cash, sidestepping the restrictive and time-consuming mortgage process. Last year, 36% of vacation-home transactions were all-cash deals, up from 29% in 2009, according to the National Association of Realtors. "If you have cash right now, you are in unique position," says Paul Dales, senior U.S economist with research firm Capital Economics.

If you are thinking of taking the plunge, here is a look at some prominent markets across the country.

Blue Chips

These markets are stabilizing and, in some, prices already have started to rise.

Aspen, Colo.

MEDIAN HOME PRICE: $781,000

MEDIAN HOME PRICE FIVE YEARS AGO: $802,000

MARKET SNAPSHOT: Housing economists look to Aspen as a luxury-market bellwether. Dotted with upscale boutiques and four-star restaurants, the ski town is welcoming buyers with ample cash on hand, says Steven Shane of SDS Real Estate, a local real-estate broker. Sales of $1 million-and-above are on the rise—especially on the higher end. So far this year, 18 properties priced at $5 million or above have sold, up from 14 in the same period last year.

WHO'S BUYING: Laura Stovitz, a Los Angeles lawyer, already had a second home in Aspen but couldn't resist the opportunity to trade up. In April, she sold her town house for $3 million and purchased a $6.5 million home with three bedrooms, an office, gym and adjacent guest house. She says she isn't worried about falling prices because the posh ski town seems so "European in its appeal and will likely be insulated from the domestic market's doldrums."