ABOUT THAT DREAM VACATION HOME…

With observance of Memorial Day behind us and vacation season at hand, it's time in many American households for two perennial questions:

- "Where shall we go this year?"
- "Should we pay rent in a hotel or resort again, or does it make more sense to apply the money toward getting a place of our own, which we will then have whenever we want to go there in the future?"

Many households answered the second question with a "yes" last year, and others are expected to do so again this year.

Vacation homes—of which the U.S. Census Bureau identified 6.8 million at last count—accounted for 12.2 percent of all homes purchased in 2005, and, at a record 1.02 million, such purchases were up 16.9 percent from 872,000 in 2004, a recent survey by the National Association of Realtors (NAR) reported.

Their median price—whether detached single-family homes, cabins or cottages, or multi-unit buildings—was $204,100, up 7.4 percent from 2004's $190,000. Their median size: 1,480 square feet.

Vacation homes' share of 2005 purchases lagged the 27.7 percent of homes which were bought for investment—whether to generate rental income, diversify assets, or both.

To David Lereah, NAR's chief economist, it was not surprising that the two categories of second homes combined would constitute almost 40 percent of residential sales, up from 2004's 36 percent. (Although commonly used, the term "second" home is a bit deceptive: about 6 of 10 second home owners surveyed by NAR were found to own two or more homes—for vacation and/or investment—beyond their primary residences.

"The baby boom generation is driving second-home sales," Lereah said in a statement. "They're at the optimum point in life when people become interested in second homes. They're at the peak of their earnings (and) interest rates remain historically low."

Economic conditions remain relatively strong despite inflationary pressures due mostly to rising commodity prices and lower consumer spending. The resulting higher interest rates have lead Lereah to expect a decline in purchases of investment homes this year. "There are fewer incentives to speculate in the market with price appreciation cooling in much of the country," he adds.

"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 a lifestyle purchase."

That, to be sure, is not to suggest that the vacation home market is going to be as firm everywhere in 2006 as in 2005. As Barron's concluded in its May 29 issue following a survey of the broad second-home market across the country: "After a long string of double-digit annual price increases, a number of second-home Meccas across the country are suddenly suffering from plunging sales volume and burgeoning inventories of unsold homes."

Though the official figures on sales prices have yet to reflect the current round of cuts, interviews with real estate pros and others strongly suggest that the averages are deteriorating in a number of key markets.

An April 14 overview of coastal resorts by its sibling, The Wall Street Journal, reported not only price cuts (“offers that would have been an insult a year ago are now being accepted,” according to a Cape Cod real estate broker), but also other steps to promote sales: cuts in brokers’ commissions, increases in housing ads large enough to inflate a newspaper’s size, and supplemental devices such as listings under glass tabletops at an ice cream parlor.

Despite the weaker prospects for 2006, the longer-run trends underlying the vacation home market are expected to remain on track, mostly due to the aging of the baby boomers.

“Vacation home buyers are making lifestyle choices and purchasing primarily for their own enjoyment,” Lereah emphasized, citing NAR’s 2005 survey findings for illustration: 72% percent of owners said they planned to use the houses for vacations and family retreats. Moreover, 18 percent expected their vacation homes to become their primary residences in retirement.

Economic motives seem to have played a minor role. While one-third bought to achieve greater diversification of their assets—well below the one-half of investment home owners who had that motive—only 13 percent bought to earn rental income vs. two-thirds of investment home owners. (Of vacation homes which their owners rent out, the median number of nights rented is only 12 per year, far fewer than the number of nights that owners of investment homes rent out theirs.)

The typical vacation home owner participating in the NAR survey was 59 and earned $120,600 last year. As many as one-third had paid cash, commonly out of savings or from proceeds of real estate sales, and of those who got mortgages, the median down payment was 27 percent. Of the total universe, 82 percent owned their vacation homes free and clear.

The median distance between a vacation home and the owner’s primary residence was 220 miles; 34 percent bought within 100 miles of their primary residences, and, ironically, another 34 percent bought 500 or more miles away, enough to get them to an ocean, river, or lake (66 percent of preferences), recreation or sporting activities (39 percent), vacation or resort areas (38 percent), and mountains or other natural attractions (31 percent).

Among the leisure activities of interest, beach, lake or water sports led the list at 57 percent of owners. Boating was next at 38 percent, followed by hunting or fishing (32 percent).

Of course, it’s imperative that those evaluating whether to buy or rent a vacation home should crunch the numbers. Most financial planners would recommend a thorough quantitative analysis showing the cost/benefit of buying or renting a vacation home..

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