

The Second-Home Boom

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The housing market has just posted its fifth consecutive year of record-setting home sales. And the U.S. homeownership rate bears this out: the U.S. Census Bureau reports that the nation's homeownership rate was 68.9 percent at the end of the year. More than 74 million American households own their own home.

But this record-breaking housing boom was not just limited to those homes purchased as primary residences. The second-home market also benefited. Generational low interest rates, increased variety of mortgage products and home equity built through strong home appreciation made it easier for home buyers to not only trade up their primary residence homes, but to purchase additional properties as vacation or investment homes.

Behind the Trend

Tax law reforms that took effect in 1997 helped propel the surge in second home demand. These reforms allowed home sellers to exclude up to \$500,000 in capital gains from taxation. Homeowners did not have to buy expensive homes to avoid capital gains tax any more. Instead, buying a smaller/less expensive primary residence and a second home (whether used as a vacation home or an investment vehicle) with the tax-free gain made second-home buying more financially attractive to homeowners than ever before.

Many homeowners purchase second homes to diversify investments. Real estate gains have been offsetting stock market declines. For example, from 2000 to 2004, existing home price appreciation increased 55 percent while the Standard & Poor's 500 index declined 15 percent. As an investment choice, the housing market presented an attractive alternative to stocks for investors.

NAR Research analyzed the trend in the U.S. second-home market using data collected in compliance with the Home Mortgage Disclosure Act (HMDA). Each individual loan application record is submitted with detailed information on the applicant's demographics, geographic location of the property, and details about the loans (mortgage rate, terms, length of the loan, etc.). Although the use of this data has some limitations*, it provides a rich set of tools to analyze the housing market.

Loans for Primary Residence and Second Homes							
year	Total # of Loans (thousand)		Share of Loans Second Homes	Median Income of Loan Applicants		Median Loan Amount	
	Primary Residence	Second Home		Primary Residence	Second Home	Primary Residence	Second Home
2000	4,316	405	8.60%	\$51,200	\$78,500	\$102,400	\$78,400
2001	4,416	446	9.20	53,700	81,300	112,100	88,500
2002	4,495	546	10.80	56,100	87,200	121,800	94,300
2003	4,858	660	12.00	56,800	92,800	130,300	104,500
2004	5,332	881	14.20	60,800	101,900	136,000	118,000

Source: Federal Financial Institutions Examination Council, HMDA Raw Data 2000-2004

Historical Trends

According to HMDA data, the national share of purchase loans for second homes – defined as “other than owner-occupied as a principal dwelling” – increased from 8.6% to 14.2% from 2000 to 2004. That represents an annual average growth rate of 16% during that time period. The actual number of purchase loans doubled, increasing from 405,000 to 881,200.

The median incomes of second-home buyers were higher than those of primary home buyers by 50 percent or more. *The 2005 National Association of REALTORS® Profile of Second-home Buyers* confirms this as well. According to the NAR survey, though, the difference was narrower. In 2004, the median incomes were \$66,700 for primary home buyers and \$80,700 second home buyers.

The median loan amounts for primary homebuyers were consistently higher than those for second-home buyers. This is quite interesting because the median price of second homes – \$172,000 – was higher than the median price of primary homes – \$170,000. (The NAR survey report breaks down second-home prices by purpose – \$190,000 for vacation homes and \$148,000 for investment homes). One possible explanation for the difference between second-home and primary-home prices could be wealthy baby boomers nearing retirement and buying properties in more expensive regions.

Second Home Trends by State from 2000 to 2004

State	5 Year Average Second Home share	Annual Average Growth in Share	Cumulative Growth
U.S.	11%	16%	112%
Nevada	17	35	384
Arizona	18	28	231
Utah	10	24	224
Virginia	8	29	211
Idaho	13	21	192
District of Columbia	10	25	187
Maryland	8	25	186
Florida	19	19	171
New Mexico	12	18	141
Washington	9	17	140
California	9	17	136
Hawaii	27	5	125

Source: Federal Financial Institutions Examination Council, HMDA. Row Date: 2000-2004

Hot Spots

According to the NAR Survey, the majority of second-home buyers desire homes close to their primary residence or job/school. Investment property buyers are more likely to choose a second home near their primary residence than vacation homebuyers. Although vacation home buyers still consider places close to certain vacation spots with appealing climates and lifestyles, the survey results revealed a new trend toward shorter vacation rather than long-term breaks, markets close to major cities are strong.

Second homes are located throughout the country, but there are some areas more “popular” than others. States such as Florida and Hawaii have been all-time favorites for both vacation homes and investment properties; indeed, almost all metropolitan areas in Florida recorded high second-home shares in 2004.

But recently the number of second-home purchases in states such as Nevada, Arizona and Utah is growing faster than in any other states with a measurable second home market. One reason why these states in the West are experiencing such a second-home boom is because they are known for their vacation spots that afford opportunities for skiing, gambling, golf, camping, and other leisure activities. At the same time they are experiencing high population growth with active migration inflows. Other fast growing second-home states are those close to large metropolitan areas including San Francisco CA, Washington DC, Los Angeles CA, Boston MA, New York NY and Seattle WA.

Conclusion

As is the case in the primary home market, the majority of second-home purchasers are baby boomers. Boomers are still in their peak earning years and they can afford second homes for vacation purposes or as investment vehicles to diversify their portfolios. For the next decade, baby boomers still will continue to drive housing markets, particularly the second-home segment.

**Since the data set is collected through loan applications, it does not include those home purchases made with all cash. Another limitation is it does not differentiate between home equity loan or primary mortgage loan applications until 2004.*

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