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The Wealthy & Real Estate

<u>The continued flow of grim news on the overall economy – and especially home sales – suggests that the real estate bust has longer to unfold before a recovery can begin in earnest</u>. More than nine months' worth of housing inventory still languishes unsold, even though selling prices have come down nearly 10 percent nationwide in the past year (more than twice that in once-overheated markets like Las Vegas and Miami) as a growing number of properties come to market after bank foreclosures. In Nevada, one out of every 165 mortgaged properties is in foreclosure; nationwide it's one in 557. As painful as the "price-readjustment" process now seems, working off inventory is essential if a recovery is to get underway. Things are *not* different this time.

<u>There are other signs that the nadir has passed, including action from Washington, even if the solutions may sow the seeds of the next crisis</u>. Congress and the trio of presidential candidates are all promising varying degrees of relief to distressed homeowners even if it means more pain for lenders, while the Federal Reserve has indicated a commitment to keep interest rates low even though it may result in an even weaker dollar and spiraling inflation. The Fed is also taking extraordinary steps to keep the financial machine well greased, including bailing out (or snuffing out, if you prefer) failed investment banks à la Bear Stearns. One convincing indication that the storm's fury may be on the wane can be seen in the forward-looking stock market, where shares of homebuilders have been bright spots in an otherwise dim 2008, surging nearly 40 percent as a group in the past three months while the S&P 500 Index has dipped 3.5 percent.

<u>Just as stock market investors are anticipating better times ahead for the builders, some wealthy individuals view the current phase of the real estate cycle as a buying opportunity—but they are still a distinct minority</u>. The Luxury Institute in late March surveyed wealthy individuals nationwide to learn about their current real estate holdings and any planned purchases for the remainder of 2008, as well as important property features and their use of realtors and real estate listings sites. All respondents had annual income of at least $150,000 ($287,000 average) and net worth for the group averaged $2.9 million.

<u>More than three in every four wealthy individuals (76 percent) indicate that they do not plan to make a real estate purchase this year</u>. Economic uncertainty is at the heart of why a majority of the wealthy plan to stay out of the real estate market in 2008, but personal factors do play a large role, too. The top three *specific* reasons offered by respondents for staying put: a belief that the decline in prices has yet to hit bottom (27 percent); a desire to keep investments liquid (25 percent); and general uncertainty about the direction of the economy (24 percent). Almost one-third of the wealthy (32 percent) cite "other" reasons. About one in six (17 percent) say that they would need to sell their current home before buying a new one but that current prices are "too low" to make that option attractive.

Sixteen percent of the wealthy cite the "depressed" real estate market for keeping them from buying. Twelve percent say they are unsure about the presidential election's impact on the economy, and 11 percent see a real estate purchase now as being unduly risky. Just seven percent cite interest rates as a deterrent; 38 percent say that rates were "about the same" as they are now when they bought their last home, and 31 percent say that rates were higher. One in five last bought a home when rates were lower and eight percent say that rates were *much* higher.

Almost one-fourth (24 percent) of the wealthy indicate that they do plan to buy in 2008. Of potential buyers, 49 percent cite the attractiveness of the investment opportunity as a factor motivating their purchase, and 19 percent even view it as a safer investment than stocks. "Low real estate prices" are a factor for 42 percent of the wealthy, and 40 percent point to low interest rates. More than one in four (28 percent) buyers says that they are in the market for a vacation home. Sixteen percent say that trading up from a smaller residence is their motivation for moving, while six percent are looking to downsize. Four percent of wealthy homebuyers want to live out a commitment to social responsibility and will build or buy a "green" home this year, and 18 percent will require their new homes to be at least "eco-friendly."

Purchase of a primary residence (24 percent) is a popular reason for buying but the lure of an attractive investment looms even larger. Twenty-nine percent of wealthy buyers say that their next purchase will be a residential investment property, although far fewer (9 percent) are willing to speculate on vacant land or invest in commercial space (5 percent). The investment appeal of real estate for upcoming purchases is even stronger now than it was when many wealthy homeowners last acquired real estate. Just 12 percent of wealthy buyers say that their last real estate purchase was residential investment property – a percentage that has more than doubled.

The wealthy are also inclined to take advantage of the downturn to improve their lifestyle and add to their living space. The second most popular type of planned purchase for 2008 is an additional residence or vacation home (27 percent). A majority of wealthy homeowners (61 percent) last made a real estate purchase to acquire their primary residence—14 percent were buying second homes.

High-end buyers will buy high-end homes, but the middle of the market will see a lot of action, too. More than one-fifth (22 percent) of wealthy would-be buyers plan to spend $1 million or more on their next real estate purchase, and 11 percent will spend more than $2 million. The most active segment of the market, however, should be homes selling for prices that range from $250,000 to $499,999. Twenty-seven percent of wealthy buyers say that they plan to buy a property within this price range, while 19 percent are looking to spend between $500,000 and $749,000, and 20 percent are trying to pick up a property for less than $250,000.

Where are the wealthy buying in 2008? While these are certainly individual and localized decisions, the two states in which the wealthy show the most interest are California and Florida, with both states the focus of interest for 15 percent of wealthy buyers. This should help to stabilize these two hard-hit states. Even Nevada, the unofficial real estate bubble theme park, is seeing interest, but from just two percent of wealthy buyers. New York looks strong, with seven percent indicating a forthcoming purchase in the Empire State, and five percent looking in neighboring New Jersey. Another high-population state, Illinois, is where five percent of wealthy buyers are shopping, and six percent are doing so in Texas, where the energy boom is helping local real estate markets buck the national trend.

Younger wealthy individuals – and particularly men – are especially likely to be in the market to buy real estate this year. Nearly one-third (31 percent) of wealthy individuals younger than 45 years of age say that they are considering a purchase for 2008, compared to 24 percent of the 45-54 year-old cohort, and 20 percent of the wealthy 55 and older. With regard to gender, 26 percent of wealthy men say that they intend to be buyers this year, while 21 percent of wealthy women say the same.

Wealth and income levels, perhaps unsurprisingly, are extremely highly correlated to the propensity to buy real estate now. Households with annual incomes of $300,000 and higher are more than twice as likely to be in the market than those earning less than $150,000 (38 percent vs. 18 percent); 20 percent of those earning between $150,000 and $300,000 say that they are buying this year. Similarly, 35 percent of wealthy individuals worth at least $5 million are considering a purchase for 2008, versus 21 percent of those with a net worth less than $1 million, and 23 percent of those worth between $1 million and $5 million.

As an asset class, real estate is no stranger to the balance sheets of high-income households. It is, in fact, often the single largest component of net worth, accounting for 35 percent of the total assets, on average, of wealthy individuals—greater than the combined value of holdings of individual stocks (15 percent) and mutual funds or hedge funds (17 percent). The wealthiest and highest-income individuals generally hold a smaller percentage of their total assets in real estate (about 30 percent) compared to those of more modest income and net worth (40 percent). Women and younger individuals tend to hold slightly higher percentages in real estate. Also in the typical asset allocation breakdown of wealthy Americans are cash (12 percent), bonds (5 percent), automobiles (5 percent), art and collectibles (4 percent), and other alternative investments (4 percent).

One is not enough. Fifty-one percent of wealthy homeowners own at least two properties and 22 percent own three or more. The proclivity for holding multiple properties escalates with income and wealth—and with age. Almost two thirds (63 percent) of individuals earning more than $300,000 and 74 percent of penta-millionaires own more than one piece of real estate. Fifty-five percent of wealthy individuals older than 55 own multiple properties, compared to 48 percent of their younger counterparts. Nearly all of the wealthy respondents we surveyed (96 percent) own their primary residence, while another 30 percent own a vacation home. About one out of every three (32 percent) is an owner of investment property.

The wealthy do not mind borrowing and a majority do employ leverage in real estate transactions. Most wealthy buyers (54 percent) will finance a portion of their upcoming purchase with a mortgage from a bank or credit union, and 21 percent will get a mortgage from another financial institution such as broker or a mortgage specialist. Forty-six percent will use some cash in the deal, but 15 percent will buy their next properties with cash only. Ten percent indicate that they plan to sell some stocks to move more heavily into real estate, and just one in six (16 percent) are relying on the proceeds from the sale of another property before buying a new one.

Although they do borrow, most wealthy buyers (59 percent) make at least the standard down payment of 20 percent when buying a home. One-third (32 percent) of wealthy respondents say that they typically make a down payment equal to between 21 percent and 30 percent of the home's purchase price; one in four puts down between 11 percent and 20 percent, and 15 percent typically make a down payment of 10 percent or less. There is a significant contingent (11 percent) of fiscal conservatives who either buy homes outright or finance less than 30 percent of the purchase price.

A majority of the wealthy population bought homes during the "bubble years" but they are not getting burned as badly thanks to their generally prudent use of credit. Almost one third (29 percent) of the wealthy made their last real estate purchase between 2005 and 2007 and another 27 percent last bought between 2000 and 2004 when home prices were still in the early stages of meteoric rises. One in four has not bought a home since 1995, or earlier. Three percent already took the leap in the first quarter of 2008.

Very few wealthy individuals received *any* amount of real estate through an inheritance, but nearly half plan to leave some to their own families. Eighty-seven percent of wealthy individuals inherited no real estate although 46 percent say they intend to pass along some of their holdings to heirs—and another 32 percent are considering leaving a real estate legacy. This is good news for wealth managers and attorneys, since many wealthy individuals will make real estate and other legacy decisions within the broader framework of overall estate planning. Wealthier and higher-income individuals—above $300,000 in annual income (and a net worth greater than $5 million) are three times more likely than those below these thresholds to have inherited some of their real estate holdings.

Real Estate Purchase Considerations

When it comes to the actual selection of something to buy, the old maxim about location certainly proves to be true. On a local level, forty percent of the wealthy we surveyed will make their next purchase decision based on the quality of the neighborhood; 20 percent will choose based on proximity to work or school, and 13 percent will select a home because of the *quality* of the schools. One in five plans to buy near where they or friends and family already own property. On a more regional or national level, twenty-eight percent will choose to move to an area because they already vacation there, and 24 percent will buy because they like the attractiveness of a particular market for investment.

When buying a home, the square footage of the house itself is more of a consideration for the wealthy than the acreage of the property—but only slightly. Fifty-four percent of wealthy homebuyers say that square footage is more important than the size of the lot, but 46 percent see it just the opposite. Regardless of what they consider to be more important, the wealthy do like to spread it out a bit. The average size of a wealthy individual's primary residence is 3,326 square feet, with almost one-fourth of respondents (23 percent) reporting living in homes with between 4,000 sq. ft. and 5,999 sq. ft. of living space. Seven percent have homes between 6,000-7,999 sq. ft. in size, and four percent own expansive homes greater than 10,000 sq. ft. A large majority of wealthy homebuyers (63 percent) are considering purchasing homes in the 1,000-3,999 sq. ft. range.

Some amenities assume *sine qua non* status in turning home shoppers into homebuyers. Atop that list is a multiple-car garage, a required home feature for 70 percent of the wealthy as they approach their next purchase. The kitchen is no place to skimp on updates and upgrades either if you're targeting wealthy buyers: 54 percent demand gourmet kitchens. Curb appeal counts, too: 50 percent demand a landscaped property. High-tech features like wired rooms (41 percent) and media rooms (19 percent) are also essential for a big portion of wealthy buyers. Recreation and rejuvenation factor highly in the process, as well, with 19 percent of the wealthy requiring a pool in their next home, and a home gym demanded by 14 percent. Twelve percent will shop for homes with spas and three percent are looking for a tennis court.

Realtors have had to readjust their expectations for income over the past two painful years, but the good news is that most wealthy buyers and sellers do work with them on both sides of the fence. But not all do. Wealthy individuals more frequently employ a full-service realtor to sell their home than they do when they're buying one—77 percent vs. 69 percent, respectively. When selling, eight percent use discount realtors who charge less than the traditional 6-percent commission; five percent of the wealthy call on discount realtors when they buy. Just 15 percent sell their homes themselves, unassisted by realtors, although 26 percent go it alone when they go buying.

Above all else, most wealthy clients demand expertise (78 percent) and trustworthiness (77 percent) from their realtors. Confidentiality is also a key consideration in choosing a realtor, mentioned by 44 percent of the wealthy. So is transparency, a factor for one in four wealthy homebuyers. Having an agent who works well with other professionals—accountants, lawyers and brokers—is important for about one-third of the wealthy. Nonetheless, the wealthy are active participants in the search for property and are much more likely to find a home that they eventually buy on their own. Just 10 percent say that they bought in an area simply because their realtor brought the property to their attention.

Real estate listings on the Web make the process of shopping for homes much more convenient than the shoe-leather approach and the wealthy greatly appreciate this. The most popular single site to browse listings is still Realtor.com, used by 11 percent of the wealthy, followed distantly by MLS.com, with a four-percent mention. Newer sites with more advanced features such as aerial browsing and data on past sales are also gaining traction. Zillow.com, a site that also features estimates of value, gets a mention from three percent of the wealthy—so do Remax.com and even Google. One percent each says that they use the Coldwell Banker, Century 21, and Homes.com websites.

Luxury Bathroom Fixtures – Brand Status

Inside the bathrooms of some of these soon-to-be purchased homes, you are likely to find fixtures from Rohl. The Irvine, Calif., company has exclusive relationships with eclectic designers and craftsmen in Europe and America to produce luxury fittings for the kitchen and bath and the products have thrilled wealthy consumers. Rohl finishes first among 17 brands in the recent Luxury Institute Luxury Brands Status Index (LBSI) survey for the bathroom fixture category. Wealthy consumers rank Hansgrohe and Toto second and third, respectively, for overall brand status among providers of bathroom fixtures.

Luxury Audio/Luxury Video – Brand Status

Finding Bang & Olufsen products inside the media rooms of wealthy households is a safe bet. The 83-year old Danish company earns top honors in two separate LBSI surveys – one for luxury *video* brands, and the other for luxury *audio* brands. Wealthy consumers appreciate Bang's design and functionality, calling them "stylish and high quality." Finishing second and third, respectively, in the video rankings of 26 brands are Nakamichi and Sony. Among the 35 luxury audio brands, Bose and Bowers & Wilkins rank second and third, respectively.

Cruise Lines – Brand Status

Smaller cruise lines continue to be among the most prestigious in the eyes of the wealthy. Silversea, which offers a 110-day world cruise for $78,000, earns top honors as the cruise line with the strongest brand stats in the Luxury Institute's LBSI survey for the cruise line category. Wealthy fans say that Silversea offers "by far the best in cuisine, service and luxury" along with "classy personalized experiences." Seabourn and Lindblad Expeditions rank second and third, respectively.

Luxury Hotels – Customer Experience Leadership

When making accommodations on land, the wealthy find the experience at Small Luxury Hotels of the World to be tops. The collection of 440 eclectic hotels in 70 countries earns the highest ranking from wealthy consumers in the Luxury Institute's Luxury Consumer Experience Index survey for the luxury hotel category. Small Luxury Hotels' fans raved about its "high quality surroundings, excellent service, beautiful locations, spacious rooms and bathrooms and free parking," and call it "reliable luxury." The brand enjoys its strongest support from men older than 50 who earn at least $200,000 and have a net-worth of more than $1 million. Ritz-Carlton and Four Seasons round out the top three luxury hotel brands delivering the best customer experience.

Luxury Fashion – Customer Experience Leadership

Gucci gets it done, delivering the best customer experience of any luxury fashion brand. Louis Vuitton and the one-time Nordstrom-owned Façonnable rank second and third, respectively, according to wealthy consumers taking part in the Luxury Institutes Luxury Customer Experience Index (LCEI) survey in the fashion brand category. The wealthy applaud Gucci's "leading edge style," "immediate recognition," and "beautiful handbags."

Living In Interesting Times – But Not The End of Time

A gusher of dim economic data seems to have convinced any holdouts that the widely forecasted recession has indeed arrived – and with a flourish. Both on the home-sales front and among retailers, the grinding slowdown in activity intensified and spread during the first quarter. The Bureau of Labor Statistics reports that American businesses cut

80,000 jobs from their payrolls in March and shed a net of 232,000 jobs during the full first quarter, sending the unemployment rate above five percent for the first time in three years. Higher prices for food and fuel further squeeze the discretionary spending out of the budgets of lower-income workers.

Even high-income luxury consumers are shopping around for bargains – or not shopping at all. Luxury retailers laid a collective egg on April 10 with reports of March sales coming in even lower than already morose forecasts. Nordstrom, for example, reported a 9.1 percent drop in sales compared to March 2007 at its stores open at least a year. The slump is more severe in its flagship full-price stores with a drop of 11.4 percent, while the off-price division eked out a 1.7 percent gain. Same store sales at Saks slumped 2.9 percent, far from the expected 3.5 percent rise. Softness is evident even at more premium price points though growth is still positive – if just barely. Neiman Marcus reports a small rise of 0.4% in sales from last year at its stores for the comparable five-week through the end of March.

Trading down? You bet. The affluent consumer is certainly more tight-fisted and even the truly wealthy are adjusting their spending trim tabs. Price is clearly much more of a consideration in the calculus of luxury consumers' shopping decisions during times of economic troubles, but it's important for far-sighted firms to understand the inescapable cyclicality of retail. Going down-market to juice sales might produce a positive jolt in the near term, but that kind of brand migration – or erosion – is a one-way street makes firms less able to command premium pricing and brand status when times again are fat.

Retail Strategy

At the bedrock of success in luxury retail are sensational customer experiences, but as the economy contracts, cost-control demands greater attention. Planning the location of future store openings more carefully, streamlining operations, optimizing inventory management and obtaining more favorable lease terms from landlords are all climbing to the top of luxury executives' to-do lists as top-line growth levels or even ebbs.

The good news is that landlords are willing to make deals in the current climate, Retail consultant Cynthia Groves, CEO of Washington, D.C., based CC Groves, LLC (www.ccgroves.com) has played both sides, as a leasing specialist with The Taubman Company and as a merchandise manager for five years with Neiman Marcus. She's busy lately helping to identify and create profitable growth opportunities for clients, including retailers like Zac Posen, J.W. Cooper, Charles Tyrwhitt, and real estate developers and financial investors like Vornado and Acadia. Targeted market research to identify customers helps on the top line, while keeping a lid on marketing expenses and negotiating better lease terms flows more to the bottom line. Indeed, a downturn is an excellent opportunity for companies to prune and groom for future growth.

Luxury Lifestyle Hub

With numerous opportunities to *experience* luxury without *owning* it, the choices in high-end travel, lodging and services are dizzying. That spelled a business opportunity for Halogen Guides, publisher of independent and objective lifestyle advice for affluent consumers (and formerly called the Helium Report). From the HalogenGuides.com homepage, visitors can learn about and comparison shop for deals on private jet travel, condo hotels, and fractional real estate. The San Francisco based private company started in 2005 as a single website dedicated to educating consumers about the new and growing destination club industry but its readership turned to the company for information on the also quickly developing industries of fractional jets and, more broadly, luxury real estate. The company plans to launch additional Halogen Guides throughout 2008. Information is indeed valuable currency in the luxury marketplace.

The Business of Etiquette

Which guests do I thank first? What kind of gift is appropriate when visiting business contacts in a social setting? If you have ever wrestled with questions of etiquette in your business career, you are not alone. As businesses go truly global, knowing how to conduct yourself gracefully no matter where you go has become a key skill for conducting international commerce. One company capitalizing on the trend is The Protocol School of Washington. Since 1988, PSOW has been the leading international protocol, corporate etiquette, and business image training authority, turning out more than 2,100 graduates from the U.S. and 42 other nations. Graduates include executives from multi-national corporations, government officials, consultants, and meeting planners responsible for events involving dignitaries. Five-day classes are taught by internationally recognized topic experts and costs $5,800 for U.S. and Canadian citizens, and $8,300 for international students. Enrollment is capped at 30 students per class, and classes are held at the Ritz-Carlton Tysons Corner in McLean, Va. Customized training is available on request. Visit www.psow.com for details.

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