

Western Regional Headquarters

The Luxury Real Estate Report



homeLand lifestyle **world**

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Saved by Supply

For the first time since the beginning of 2003, the third quarter experienced a short period during which mortgage interest rates averaged above 6%. Rates have since returned to the sub-6% levels that analysts credit for the residential real estate boom which has swept the nation. Nonetheless, the market's reaction is precedent for what may happen when rates inevitably return to higher levels down the road.

As interest rates rise, refinancing equity out of a home becomes less attractive. From a purchase perspective, housing becomes less affordable. It should be no surprise, then, that applications for refinancing were down more than 50% for the month of August while mortgage applications to purchase homes were down 13%. But NAR's Chief Economist David Lereah says that the fundamentals are in place for continued strength in the housing market referencing, among other things, the lean supply of homes. USA Today's Thomas Fogarty agrees. He shows that "tighter inventory control by builders and the people who finance them, coupled with high demand, has squeezed the availability of finished homes

just about everywhere." These favorable supply conditions are the basis for continued price growth. They will sustain the strongest overall housing market on record.

A Market Mosaic

The "residential real estate market" is actually a mosaic of smaller real estate markets, many of which share almost nothing in common. Therefore, the forecasts that economists are making must be tailored to specific markets, and within those markets, to specific price-points and product types.

Luxury markets should fare particularly well. Despite extremely high inventory levels, new supply is limited by builders not delivering unsold product, and demand for this market segment will only increase as the economy improves. Lawrence Yun, Senior Forecast Economist at NAR, notes that "recent stock market gains could unleash some luxury homebuyers for whom mortgage rate moves are not a factor in homebuying." He cites a recent survey showing that almost 33% of million dollar homes are purchased without debt.

From a value perspective, two of the cities with the highest median home prices also had the highest median home price increases. Beverly Hills and Malibu, with median home prices of \$1.12M and \$1.19M, respectively, saw those medians increase 58% and 79% since July 2002. According to this data, high prices are getting even higher. As employment and consumer confidence improve, luxury buyers will emerge and the upper-end of the market will benefit.

"Lean supply" is a relative term. It is only lean compared to the currently robust level of demand. Fortunately, indications are that demand will remain strong in the foreseeable future and that ultra-luxury markets over \$3M will be even stronger, helping to maintain this favorable disconnect.

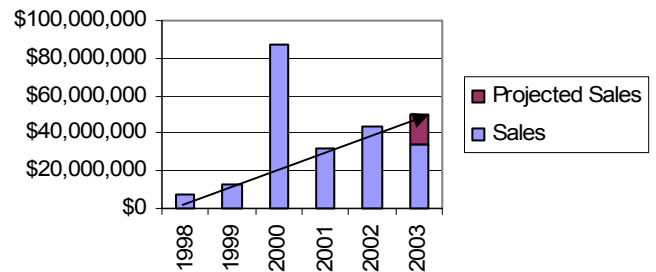
In California, politics are also favorable. Legendary market analyst Tracy Herrick from Wall Street's Jefferies Group, Inc. is optimistic that "California real estate could become more valuable, as demand could rise" resulting from the business-friendly platform of California's new governor.

By the Numbers:

Interest Rates	↑
Existing Home Sales	↑
New Home Sales	↓
Housing Starts	↑
Housing Affordability	↓

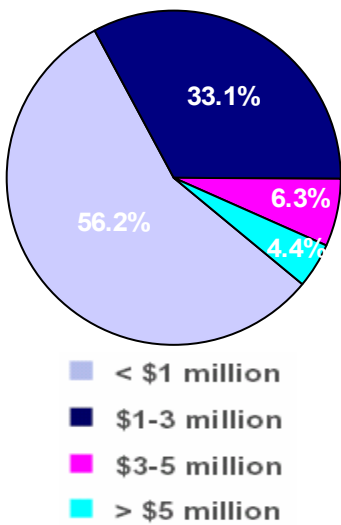
Spotlight on Aspen

Aspen, Colorado is the quintessential luxury real estate market. Despite having lower sales volume than other first class ski destinations such as Park City, Utah and Lake Tahoe, Nevada, Aspen has consistently stronger volume above \$3M. Since January 1, 2003 Aspen has had 65 sales above \$1M. Of those, more than 45% were above \$3M. By comparison, only 11% and 15% of the sales above \$1M in Park City and Lake Tahoe, respectively, were for greater than \$3M. Because the general rule is that properties purchased for more than \$2.5M are not “loan dependent” as they are often traded for all cash or very low LTVs, it is safe to assume that \$3M+ sales will continue if not strengthen in Aspen despite increasing interest rates. That is why Brent Waldron of Aspen’s Coates Reid & Waldron does not anticipate an increase in the inventory of luxury homes on the market in Aspen over the next quarter...



Actual and Projected Sales in Aspen from 1998-2003: For listings priced from \$6M - \$8M, sales are projected to increase for the third consecutive year after decreasing 63% from 2000 to 2001. Excluding 2000, the essentially linear slope of increase in sales from 1998 through the present shows that 2000 was the outlier and that 2001’s apparent decrease is actually consistent with historical trends.

Sales Profile



Sotheby's International Realty First Half 2003 Sales by Price Range:

For the first time since 2000, the \$3-\$5M price range has seen increased sales volume of almost 7% (5.9% to 6.3%). This is more than likely a result of combined optimism about the immediate economic future, and listings being discounted from \$5M+ into this price range, then subsequently selling.

Aspen Antidote

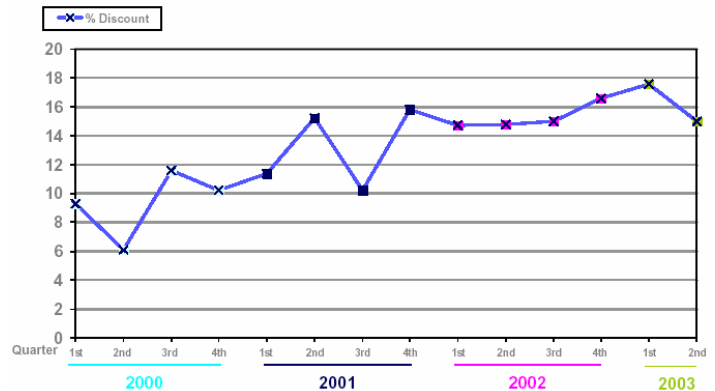
One of the most frequently asked questions of Sotheby's International Realty is “Where’s the next Aspen?” We have always been reluctant to speculate. But in the article “Paradise Bought” in the October 6th issue of *Fortune Magazine*, Mike Grudowski answers it for us. Not surprisingly, 3 of those “Edens” are in the Western U.S. and serviced by Sotheby's affiliates. From east to west, Montana’s Flat-

head Valley, Arizona’s Sonoita/Patagonia and Northern California’s Anderson Valley were all identified as areas where “sizable tracts of acreage are still available and worth the price.”

Whether any of these areas reach the values that Aspen has achieved, only time will tell. But you can learn more about each of them on the next page in the “Regionally Speaking” section.

List to Sales Price Discount

Sotheby's International Realty Average Discount from Original Listing Price to Closing Price. The decrease in listing to closing price discount for the first time since Q1 2002 indicates that sellers are becoming more realistic with their pricing expectations, and buyers are anticipating tighter inventory levels. This will ultimately have the effect of decreasing absorption times and will bring the markets closer to equilibrium, which should reign price appreciation rates in to a healthier level of 4%-5% annually according to NAR.



Regionally Speaking

Northern California/Nevada:

Lake Tahoe, Nevada: "The upper tier market is beginning to move. It has been rather soft for the past two years but recent sales activity has made us optimistic that this is changing." –*Shari Chase, Chase International*

Ukiah, CA: "The market has been quite brisk for most of summer, but has experienced a seasonal downturn in the past month from which it has yet to recover. This has resulted in a 20% increase in time on the market and fewer, more conservative offers. Luxury real estate, generally in the form of ranch or vineyard type properties without ocean views, is usually for use as retreats and second homes of people calling other parts of California home." –*Ernie Wolf, E.S. Wolf & Co.*

Montana/Wyoming:

Whitefish, Montana: "From 1996 to 2002 the overall Whitefish market increased at an average rate of 28%, while the market above \$500K increased at an average rate of 51%. The trend continues with an increase of roughly 20% so far in 2003. The average sale at Iron Horse, Whitefish's luxury community, was \$200K in 1998 and \$750K in 2002. These incredible growth rates can be attributed to Whitefish being an emerging destination which will not be affected by national resort trends until it catches up with its competitive markets." –*Pat Donovan, Iron Horse Properties*

Jackson Hole, Wyoming: "The market above \$1M has been picking-up with several sales of \$5M or more. However, those sales were discounted from initial listing price because the luxury market has decreased by roughly 25%. There is a large inventory of \$3M+ homes, which will take 3 years to absorb. Approximately 70% of buyers come from out of state and are multiple homeowners, although many make Wyoming their primary residence because of its favorable tax laws. Historically, 80% of Jackson Hole's tourists

come between May and September. However, the new ski-in ski-out Four Seasons, in addition to increased air service, may change that." –*Peter Linsey, Sotheby's International Realty*

Arizona:

Tucson, Arizona: "Tucson has a healthy local economy with a strong second-home market and lots of attention from retiring baby-boomers. The high-end luxury market is stable with strong development and continued growth in the \$1-\$4M price range. Tucson's luxury market starts at approximately \$800K, which is more of a local move-up market driven by regional economics, which are strong. Tucson's main industries are Real Estate, Bio-Technology, Defense, and Education (University of Arizona), and the cost of doing business is low so Tucson is the recipient of job relocations from California. This creates balance with the jobs that are moving offshore and churns the real estate market." –*Steve Quinlan, Long Realty*

Phoenix/Scottsdale, AZ: "The market above \$3M has been slow. The technology boom led to speculative overbuilding of luxury homes, resulting in an oversupply. The spec homes built last year are being absorbed today, which has increased the inventory of resale homes on the market. There has not been a dip in the overall housing market, just in the inventory of affordable homes." –*Michael Messenger, Russ Lyon*

Pacific Northwest:

Vancouver, British Columbia: "Thanks to low interest rates, the British Columbia marketplace is enjoying record setting sales levels in the affordable price ranges. However, at higher price points, sales levels slow dramatically. Above \$1.5M (Canadian) the inventory is large and sales levels are low. Sellers are starting to realize they have to change their expectations to be successful so we are starting to see flexibility in their pricing. The 2010 Olympic

Games will certainly improve the situation over the next 6 years." –*Neal Fisher, Premier Canadian Properties*

Seattle, Washington: "The higher priced luxury homes over \$1.5M are selling, but they sell one at a time. They do bring offers when they are very well priced in the market place, which is typically within ten percent of the asking price. The Seattle market is still very good with luxury properties selling on a consistent basis. Less expensive homes up to \$500K sell within a short period of time. Total sales in August were up 24% from the same month last year." –*Kitty Hughes, Madison House, Ltd.*

Colorado/Utah:

Park City, Utah: "Park City is on track for a record year. Dollar volume is up 4.4% and number of transactions is up 12.1% compared with 2002. Inventory levels have dropped by 31.7%. After three years of infrastructure work, lot and first home sales in Park City's world class golf developments exceeded all previous totals. After constant disruptions since 9-11, including the 2002 Winter Olympics, the Iraq war, and upheavals in the securities markets, a normal ski season is expected to produce a major improvement in the Park City luxury home and resort condominium market." –*Jim Lewis, Lewis Wolcott & Dornbush*

Aspen, Colorado: "There has been a significant pick up in buyer interest and showing activity over the past three months. However, this renewed buyer enthusiasm has been tempered by a cautious and conservative approach when it comes to making offers. Buyers are still focused on values and opportunities. With the significant buildup of inventory over the past two years, and the fact that luxury home prices per square foot have been relatively flat, increasing opportunities do exist. However, exceptionally well-located and quality properties continue to draw top dollar." –*Brent Waldron, Coates Reid & Waldron*

By the Numbers...

10 statistics that are regularly used to forecast trends in the housing market:

1) Mortgage Interest Rate — 5.43% on Oct. 1 for the 30-year fixed rate, a decrease from the third quarter's peak rate of just above 6%, which represented the first time in CY2003 that rates averaged above 6%. Economist Ken Goldstein of The Conference Board believes that if rates stay below 7%, which they are projected to do for the foreseeable future, it will have the positive effect of slowing sales and price growth to more reasonable levels, thereby preventing "a total implosion of the housing market."

2) Existing Home Sales — 6,120,000 seasonally adjusted annualized units in July, an all-time record and a 5% increase from the previous month. NAR's Chief Economist David Lereah says "There are no signs of home prices declining nationwide anytime soon, let alone portents of a price bubble bursting. Existing home prices have risen at a healthy 7% growth rate so far this year, and prices across the nation continue to climb, not decline."

3) New Home Sales — 1,165,000 seasonally adjusted annualized units in July. This is a slight decrease of 2.9% from June, but is still on track to make 2003 the first year this benchmark has topped 1,000,000 units.

4) Housing Starts — 1,820,000 annualized units in August, a 3.8% decline from July. Of these, there were 4.5 times more single family homes started than multi-family homes, which is consistent with demand. Interestingly, in the face of this decrease in home starts, the issuance of

housing permits surged by 4.8% according to the National Association of Home Builders.

5) Employment Growth — (93,000) in August, which brings CY2003's aggregate total to 595,000 jobs lost. Employment is the strongest macroeconomic driver of housing strength. "Job creation should be around 100,000 per month, and the unemployment rate will steadily shift downward from over 6% to 5.5% by the end of 2004," says NAR's Senior Forecast Economist Lawrence Yun. "An improving job market will provide support for demand even at higher mortgage rates."

6) Purchase Applications — 405,400 in August. "Mortgage applications for refinancing were down an incredible 51% for the month of August. Similarly, mortgage applications to purchase homes were down 13% during the same period," says David Lereah. "With bargain basement financing now gone, it is safe to state the obvious—the housing sector has passed its peak."

7) Housing Affordability— 136.5 and falling. Monthly payments get larger as mortgage interest rates increase. When combined with unchanging wages because of unfavorable employment conditions, housing becomes less affordable. The least affordable metropolitan statistical areas are San Jose and San Francisco, California, where workers must earn \$35.02 and \$34.13 per hour, respectively, to be able to afford reasonable housing.

8) Inflation — 1.5%, which is stable and consistent with the Fed's goals. In general, when rates are low, people can access cash in the form of equity from their homes. They can then spend that cash, keeping the economy strong, and making it unnecessary for the Fed to pump new dollars into circulation, thereby avoiding inflation.

9) Real Estate Stock Performance — According to Inman News, "Stock prices of a number of home builders, title insurers and mortgage lending companies have lost 10% or more of their value since rates began rising..." Ironically, bearishness on the part of investors toward real estate stocks indicates bullishness toward the overall economy. That is because real estate stocks have gone down "in anticipation that the economy is improving and mortgage rates are going higher," says Mike Jaffee of industrial research at Standard & Poor's.

10) Foreclosure Rate — 1.12% in the second quarter, which represents approximately 380,000 homes. This indicates that there is an inverse relationship between home price appreciation and foreclosures, which "might seem contrary to historical patterns because rising home values would tend to provide financially-strapped homeowners an exit from their difficulties," says Jessica Swezey of Inman News. "But experts point out that the tanking national job market and high-risk borrowers...are cause for the current highest national foreclosure rate on record."

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Did you know? Forbes .com's "Most Expensive Homes in America 2003" lists 5 Sotheby's listings in the "Top 10" and 3 of the top 11 are Western Regional Listings:

Mandalay Ranch - Coates Reid & Waldron, Aspen - \$63,000,000
Champs d'Or - Briggs-Freeman, Dallas - \$45,000,000
The Pines - Lake Tahoe, Chase International - \$36,000,000

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