TO: HALTER TEAM

FROM: PETE HALTER

RE: THOUGHTS ON THE FUTURE OF THE SECOND HOME MARKET

DATE: 2/9/2009

All,

I have been working on three presentations I am scheduled to give this month. One is for Clemson University MBA students majoring in real estate and two are for the Urban Land Institute. In preparing these presentations I have been forced to take a hard look at how the economic meltdown is affecting the present and future of the second home industry. As you all know, for many years I both advised and been directly involved in the development of master-planned communities, condominiums, second home, and resort properties around the country. From this I have developed a strong sense for the market, which is reflected herein. While no one knows where these uncharted waters will take us, my fear is that with so much emphasis being placed on foreclosures and the "primary housing crises," the economic impact on the second home industry is being ignored. As a result, this segment of the real estate business may be nearing financial collapse for many developers and possibly even some of their lenders. So, in the "for what it's worth" category, below are Cliff notes of my talks, along with a "catharsis" on why I am so concerned and where I think the industry may be headed.

WAKE UP CALL

The State of the Second Home Market

There are now forces at work in the second home industry that no one could ever have anticipated or planned for. Regrettably, with all that is going on in today's economy, the second home industry is becoming the "forgotten" segment of the overall real estate industry. As a result, this lack of attention may be sending the second home industry into chaos. It appears that this part of the real estate industry is now the "tail on the real estate dog." If not helped quickly by programs coming out of Washington or banks lending to the industry, this multi-billion dollar segment of the economy might just become the one with little hope of a quick recovery. Below are a few observations and thoughts on the state of the second home industry and how many developers and lenders might be forced to deal with it:

1. **Change.** The "baby boomer" demographics have not changed, but the psychographics have!

2. **Don't be confused.** It is important to understand that there is a notable difference in both the psychology and motivations of a second home buyer when compared with the retirement home buyer. Considering a retirement home is a lifestyle decision. Conversely, a second home is a luxury and thus a discretionary decision. These decisions occur at very different stages in the consumer's life. While both markets will be affected, the second home market will be hit the hardest.

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3. **Gone.** The "old" (4 months old) second home market was made up of 30% to 50% investor buyers. It is important to note that even pre-retirees often cost justified the purchase of a second home or lot as an investment. Remember, "real estate values never go down." Today, the second home investor buyer, along with the investment psychology that motivated them, has all but disappeared.

4. **The "wealth effect."** The loss of the "wealth effect" is real, not just psychological. Many potential second home buyers who had either discretionary or real wealth have lost 30% or more of that wealth in stocks and in the value of their homes and businesses. Astonishingly, most of this loss has occurred within the last 120 days! As a result, many of these consumers are no longer enjoying the financial security they felt this time last year. It will likely take years for many to rebuild their personal wealth to the point where they once again experience this "wealth effect." Without this, expensive discretionary purchases such as second homes will be severely curtailed.

5. **Time is the enemy.** With the recession, concerns over decline in corporate earnings, possible job losses, and other market uncertainties, time is no longer on the side of many "baby boomers." While no one knows what effect the stimulus package will have on the overall economy, most agree that it will not create an accelerated "U" or "V" shaped recovery. Instead, it may look more like an "L," thus protracting even further the time required for the re-creation of wealth and the second home market recovery. Now many potential second home buyers and "baby boomers" have no option but to refocus on the other real life needs of their family, extended family, and businesses. The years it will take for many of these consumers to recapture the equity in their homes, investments, and retirement portfolios, will carry a large number of these potential buyers right through what used to be the second home and pre-retirement stage of their lives. Therefore, I predict many of those making up "yesterday's" second home market may, in fact, NEVER BUY A SECOND HOME AT ALL! This does not mean that in time they will not purchase a retirement home.

6. **Nobody cares.** It is also important to note, given all of the talk in Washington regarding a real estate "bailout" plan, that you hear no mention of the second home industry. Of all the priorities proposed for the use of the bailout money, it is highly unlikely that second home developers, lenders, or buyers will be on any legislator's list of "people we need to help!" This is especially true if any relief is perceived to be helping an "affluent" consumer. This is sad and short sighted. Those in Washington are overlooking the fact that this is not about helping an "affluent" consumer; it is about helping the economies of many small towns and even regions of the country that rely heavily on the direct and indirect employment and consumer spending that second home and resort developments create. It is interesting to note that the government can find eight billion dollars to build a new train line from L.A. to Las Vegas, but not a dime to help create jobs in rural areas being served by second home developments. If some help does not find its way into the second home business, the consequences could be devastating for many small towns and communities that have few other options for employment.

7. **Financing.** Without the availability of reasonably attractive mortgage financing for second homes, the recovery time will be dramatically impacted. Along with the current tightening of credit for potential second home buyers, this will, in and of itself, further eliminate potential buyers.

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8. **Construction.** Ultimately, most second home developments and the economies they serve survive on site development, construction, and the sale of lots, homes, and condominiums. Simply put, for a second home development to be successful, it must have resident homeowners and club members using and paying for both the amenities and homeowners' association services. For the most part, this cannot be done without housing. The big question is how long will it be before second home builders and developers can get financing? How long will it be before speculative construction of any type reappears? Without construction financing, it will be very difficult for many of today's second home developments to survive, especially if they are forced to rely solely on lot sales for cash flow. It should be noted, for some time to come, the success of developer lot sales will be severely impacted by competition from existing owner re-sales.

9. **We are from the government and we are here to help you.** An interesting and compounding factor now facing all condominium developers (not just second home developers) are the new Fannie Mae and Freddie Mac 50% and 70% presale requirements that must be met before any unit in a new building can be closed. Sadly, this now even applies to pre-existing completed inventory that was started before the requirements were imposed! Apparently, the wisdom of those in Washington imposing these guidelines did not consider grandfathering condominium developments that were started before January 1st, 2006, and completed by the end of this year. These new requirements mean Washington has knowingly (or unknowingly) exacerbated the housing crisis and is potentially putting many developers (in and out of the second home business) and even their lenders in great peril. Today, there are many completed condominiums with buyers in place or under contract that will not be able to close on their purchases without the construction lenders' offer to warehouse mortgages until the presale requirement is met for the building. Simply put, without the warehousing of loans, both the lender and the second home condominium developer with buildings either under construction or completed are out of business! To further compound this problem, these products will now be even harder to sell because future purchasers will not want to buy a home they cannot close and begin enjoying. The reality of these new restrictions will result in the loss of drastically needed sales and cash flow for developers and lenders.

10. **First things first.** When the recession draws to a close, many potential second home buyers will defer a second home decision to focus on the many purchases they have postponed during the recession. These will include items such as cars, appliances, home remodeling, and even college tuition for their children or grandchildren. Simply put, when a recession ends, there will be many demands for the consumers' discretionary income that could further delay the purchase of a retirement or second home.

11. **Market Contraction.** Given the foregoing, along with many other factors, a crisis is likely on the horizon for the second home industry. It appears to me the second home market is now set to go through a serious and prolonged contraction! This could leave billions of dollars invested in second homes and second home developments at risk and even poised to fail. If this happens, the small towns and communities that serve these developments will be hit hard and take years to fully recover. It is my belief that most lenders, developers, and especially legislators, have not focused on the full extent of the problem.

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What Will Happen?

I believe for some time to come (2 to 5 years) that the industry will be challenged, but the market will not totally disappear! There will always be some semblance of a market for both second homes and resort real estate. However going forward, without some help, the industry will look very different than it has in the recent past. In fact, for the near term, many second home developers will feel as though the market has all but disappeared! Some thoughts on this are:

1. **There are still some buyers out there.** In the short term, the "new" second home market will initially be comprised of:

    a. Bottom fishers that have survived the downturn.
    b. Those that have retained some portion of their wealth. This group will adapt to the "new normal" sooner than most and will once again re-enter the second home market to take advantage of the opportunities that will emerge.
    c. Younger "boomers" who have time on their side and can rebuild their personal wealth over time.
    d. Those inheriting wealth during the recovery period.
    e. International buyers who historically have had "stealth wealth" that they "parked" in U.S. real estate. One question is, as a result of the global recession, will these buyers still be out there in the numbers we have seen in the past and will they want to invest in resort real estate, which may have depreciated in value?

2. **Market share vs. cash flow.** The problem for the near term (3-5 years) will be the size of the second home market segments noted above. I fear there will simply not be enough buyers in these segments to sustain either the sales or the needed operating cash flow for most of today's existing second home developments. This is especially true for those with completed and operating amenities such as golf courses, clubhouses, spas, marinas, lodging, and other "expensive to operate" amenities. It is important to note that most of these amenities cannot be shut down, especially if homeowners are in place and the subject property is to remain competitive.

3. **Overcoming the love/hate relationship between real estate and the club.** Today, one of the biggest sales challenges a second home development has is the disdain buyers have that require them to join a club in order to use amenities. There are currently thousands of people attempting to resign from their clubs, but are learning they cannot because there is no replacement member waiting for their membership. As a result, they will be very cautious about club membership in the future. Developers will have no option going forward but to revise the use rights for the club and amenities. Some of these changes will be designed to encourage practical use privileges that do not penalize infrequent, seasonal users, or non golfers. This will require changing membership plans and fee structures. Once the membership obstacle is removed or modified, more buyers will be attracted to second home communities. I should note there will always be a place for the high-end, super luxury club. The problem is almost all existing second home developments were designed as private memberships to appeal to the affluent consumer. Today, these membership programs and their

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associated cost can and will become a deterrent to sales for many potential buyers. Going forward, more clubs will offer priority tiered use rights, seasonal dues structures, outside memberships, priority "pay to play" programs, and even public access. Regrettably, this change will also have a potential negative impact on the existing financing and appraised value.

4. **Location, location, location.** Market share and cash flow will be especially problematic for the remote, destination-oriented, second home properties that are time-consuming and expensive to get to. These developments had better have a "big idea!" This is especially true for those without a dramatic natural setting or amenities such as skiing or the beach. Those developments offering only a private golf club, swimming, tennis, parks, and trails, will be challenged. These amenities alone will likely not prove to be enough to drive the market to a remote location.

5. **The winners could be the losers.** Ironically, many developers that survive this downturn may find themselves with overpriced products trying to compete with other second home and resort properties that have been re-priced by lenders or replacement developers to attract a larger market share.

6. **Strange relationships will be born.** All of the foregoing leads me to believe that structural change is coming. With most of the profit and equity eroded in many developments, along with little hope of paying off the development loan in its entirety, developers and lenders will have to quickly begin working together, virtually as venture partners, in order to survive. If this assumption is correct, it could dramatically impact the balance sheet of many banks. Currently, it appears many lenders have not yet fully anticipated the depth of the problem or the potential further erosion in the second home market, which will likely lead to ongoing funding requirements (losses) that may be waiting for them in the future.

7. **The "shadow market."** One big element of competition that is not yet fully understood by lenders and developers is the size of the re-sale "shadow market" waiting to emerge. This "shadow market" will be comprised of property owners that have waited out the downturn before putting their homes or lots back on the market. These re-sales will be in addition to the re-sales and foreclosures currently on the market in most second home developments. Once there is evidence of an economic recovery, this "shadow market" will surely emerge.

8. **More losses may be coming.** If the "shadow market" assumption is correct, and I believe it is, there is little doubt the key to survival for many developments will rely on lenders to both lower their release prices and write down their loans. This will allow the developer inventory to be re-priced so that developer products can be favorably positioned against re-sales. It should also be noted that in many developments this will be necessary, not only to compete with existing property owner re-sales, but to compete with other developments in the same sub-market or region that have likewise also been written down.

9. **Too many talking to too few.** One thing has not changed; there will be too many developments targeting the same local and regional metro markets for customers. Ironically this was already happening, especially in the southeast, before the meltdown! Most regional markets simply could not, and can not, supply the number of customers needed to make all of these developments successful.

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As a result of the financial meltdown and the predicted contraction of the second home market, the simple fact is the universe of "ready, willing, and able" buyers is smaller now than could ever be imagined, especially when considering the demographic size of the "baby boomer" market.

10. **Nobody wants to be the greater fool.** Finally, to achieve the sales and cash flow needed by most lenders and/or developers for the foreseeable future, success is going to boil down to location, completeness of amenities, price (deal), and the **new** imperative of confirming the financial strength of the developer and, believe it or not, their lender. Until the consumer is satisfied that all of these factors are in place, especially the new imperative, neither the lender nor the development have a reasonable chance of succeeding in today's economic environment. After all, what buyer wants to be "the greater fool"?

I Have Been Here Before; Mistakes Made and Lessons Learned

Having been through something like this three times before (never this bad), it is my opinion that we are likely to see some well-meaning, but fundamentally flawed, mistakes made by both developers and lenders. Below are observations of past "mistakes made and lessons learned:"

1. **Denial**. First, it is important to note denial is not a strategy! For the short term, both lenders and developers will have the desire to "buy time." In my view, this will cause unneeded delays in making many of the critical decisions required to mitigate problems, protect values, and control cost. A decision to "wait and see" typically manifests itself in plans to accrue interest, offer forbearance, or require more equity for interest reserves. While such actions may be viable for a few developments, in most cases these programs not only defer the inevitable, but ultimately lead to price increases in order to cover the additional debt service. Price increases are the last thing most second home developments need for the foreseeable future if they are to compete. Again in today's economic environment, "wait and see" is not a strategy, it is simply ***denial***.

2. **It takes a forensic team.** Typically, a troubled asset is initially controlled by a credit officer and the troubled asset division of a bank. There is no doubt this is required, however I have seen more damage done to the value of an asset during the initial time of negotiations between the lender and borrower than at any other time. More often than not, I have seen the credit officer focus on the asset and overlook the fact that the **lender is taking control of an operating company**. In the second home industry, the value of the asset is often tied directly to the quality of the development's operation. Simply put, in this industry it is very difficult to "save your way to success" and not devalue the asset, especially when there is no replacement buyer for the development standing by in the wings. The credit analyst is essential to audit the situation. However, if the initial analysis can be done in concert with a diverse team of experienced consultants that can analyze the entire development and not just the loan, the results can be far more meaningful. This analysis would include operations, amenities, sales and marketing, real estate products, pricing, the competition, and the cash flow needs for ongoing operations. This approach will create less disruption to the

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operations of the development and, most importantly, lead to far less devaluation of the asset. Simply put, often credit analysts focus on the numbers more than the impact their decisions can have on the development's integrity, property owners, and sales-in-process. It must be remembered that nothing can be fixed in a troubled development until "somebody sells something," which means somebody still believes in the development enough to "buy something." Protecting this fine line for taking over and repositioning a troubled development is often overlooked during the initial workout phase.

3. **The wrong change is made.** The mistake of "throwing the baby out with the bathwater" can prove very costly. Unlike the past, it is important to note that this economic crisis, for the most part, has not been caused by the developers! It has been caused by Wall Street, the federal government, and the mismanagement of the financial markets. As a result, there still remain very capable developers that should be left in place to manage their properties even if it is on a fee basis. Sometimes, "change for the sake of change" can prove to be an unnecessary and costly decision.

4. **When is change needed?** Conversely, the mistake of ***not*** "throwing the baby out with the bathwater" can also be very costly. The truth is that there are second home and resort developers in business today that are in the business because they had the luxury of either relatively inexpensive land and/or the financial strength to obtain financing. Unfortunately in reality, some of these individuals had no resort development experience and, in many cases, wish they had never gotten involved. When the market was super-heated, these developers looked brilliant. Now that the market has softened, it is becoming apparent that many of them did not have the skills needed to plan, market, or operate a second home or resort property. In these situations, putting the right team in place sooner rather than later can create untold savings for a troubled development.

5. **Forget appraisals.** For the near term (12-24 months), most appraisals will be meaningless. While required by the banks and federal examiners, they can create a false sense of hope and value, and in some cases, unnecessarily and negatively impact the bank's balance sheet. The truth is that values are now changing daily or even with the next buyer's offer. Now because prices are so fluid, no one can track prices inside or outside of a resort or second home development with any reasonable degree of certainty.

6. **They won't buy without confidence.** It goes without saying that, in the short term, the current situation will lead to extraordinary opportunities in all segments of the second home market for those who have retained wealth and continue to have discretionary income. The trick will be finding developments in which the developer and/or lender can reassure these affluent buyers of the financial stability and long-term viability of the development. If confidence in the development and/or the developer cannot be exhibited, it is not likely these sophisticated consumers will purchase, irrespective of how compelling the offer may be.

7. **Avoiding the downward pricing spiral.** Failure to deal with the brutal reality required to re-price to the market early on to avoid being caught in a downward pricing spiral is difficult, but essential for success. This is one of the biggest mistakes I have witnessed. This downward spiral begins when either the lender or developer resists aggressively re-pricing inventory during the first stage of analysis and repositioning. Again, it is part of the "wait and see" mentality. In my experience, as painful as it

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may be, it is best to re-price to the low side of the market, deal with existing owners one time, and generate a value proposition that creates "fear of loss" and sales even in a down market. In doing so, hopefully the bank will deal with the write-down one time, giving the developer or replacement developer the opportunity to sustain some momentum. This will also help the development compete with re-sales in the property, as well as other nearby competition. Perhaps most important is the opportunity the new pricing gives the development's sales and marketing team to reengage with the development's existing prospect database by using the new prices and positioning for the development as a "call to action." Properly done, this can produce sorely needed cash flow. Those lenders and developers who are unwilling to aggressively re-price their products in this economy will find themselves eventually falling into a downward pricing spiral. This continual lowering of prices will lead to distrust among prospects and realtors, contempt among recent buyers, and a long term loss of integrity for the development. This not only grinds sales to a halt, but is very expensive to recover from. Again, what buyer wants to be the "greater fool?"

8. **Why make it so difficult?** To state the obvious, "this time is different." With this said, neither the lenders nor the developers seem to realize that fighting with each other during this real estate "depression" will only cause unneeded conflict resulting in devaluation of the asset. Ironically, often the developer and the lender seek the same goals of protecting the value and integrity of the asset, but in the end they have an unavoidable conflict of interest. Today, lenders have no option but to focus on saving their banks. Their top priorities are trying to protect their stockholders, dealing with bank examiners, and protecting their own jobs. This often means that what is best for the development may not be best for the lender. Conversely, the developers will focus on recovery of their equity, ongoing cash flow needs, minimizing their liability, and protecting their reputation. These conflicts of interest quickly shut down sales and marketing, and negatively impact all of the development's operations. As a result, this sends shockwaves through the development, its staff, property owners, the outside realtor community, customers, and the media. The results lead to damaging "street talk" and the interruption of sorely needed cash flow by both parties. Most importantly, this leads to the devaluation of the asset. Can this be avoided? Usually not because both sides are trying to protect their investments and legal rights, and sometimes even their egos. Unfortunately, the results of all this posturing usually leads to no more than "buying time." Both parties seem to fail to accept the fact that this time the problem has been caused by the financial market and the impact it has had on the financial institutions, consumers, and developers. In this economy, both the lenders and their developers are going to have problems and, where possible, are going to have to work together to best protect the asset. My observations are, "the right decision is always made, but only after all other options have been pursued." With this said, at this time it appears the banks and developers are still going to use the same negotiating strategies they used in 1990 and 2000. This generally breaks down to a good guy/bad guy debate. So far, it looks like the lenders are going to handle each troubled asset as though it is a "one of a kind" situation. It goes without saying, every development has its own personality and special conditions, but the underlying business principles for operations and sales and marketing are not substantially different. Accepting this reality would change the rules of engagement for workout issues. I doubt they will, but it is my opinion that both the banks and the Fed would be better served if they created a menu of standardized options such as the following:

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a. The first option is a decision to stay the course. In today's troubled environment, it is important to remember that not all developers are incompetent and may simply be caught up in this economic mess along with everybody else. The truth is that in many situations, the existing developer may be the best solution for managing the property. This program would involve either a workout or a friendly foreclosure that would occur quietly and almost overnight. This would be much like the Fed closing a bank on Friday and reopening it on Monday. The lender would leave the developer in place to manage the development for a fee until it can either be sold to a third party or re-sold back to the developer, so long as there is an acceptable payoff of the bank loan. Such a program would motivate the developer to work toward buying back their development, while maintaining operational consistency.

b. The second option is to create an entity much like the Secured Communities model I ran for C&S Bank in the 80's. With this model, the banks would enter into an agreement with a third party developer to set up a development holding company (the Secured Communities model) in which the bank would own stock. Troubled second home properties would be transferred into this company and thereafter run by the holding company. Having such an entity would expedite due diligence, provide a competent replacement developer to instantly facilitate control of operations, and most important, have in place a new development team to re-brand and reenergize the development and take over operations, the builder program, sales and marketing. This type of concept makes the lenders comfortable in that they have more control over operations while working out or disposing of the asset. The first two options would allow for a speedy transfer of the asset without significant disruption or devaluation.

c. The third option is an outright, and usually unfriendly, foreclosure. In the current economic environment, a developer pursuing this option may well likely be in denial with respect to recovery of their equity, the value of their real estate, and even the short term viability of the second home market.

9. **The business of sales and marketing.** When dealing with a troubled asset, failure to understand the new business model for success, among other things, must be built around a new sales and marketing program. This is in part a result of the super-heated market that allowed most sales programs to be built around a "launch" concept that created "hype" and demand that was subsequently serviced by the sale agents. Those days are gone! Today it is "back to the basics" if a development is to have a chance of competing in the future. My observations are at the moment most developments appear to either be ignoring the need for reinventing their sales and marketing program or are simply going "to do what they have always done and expect a different result." Few are not taking advantage of the current downtime to rebuild their sales teams or taking advantage of recruiting from the wealth of talent now available in the market. Underestimating the importance of having a qualified sales team and marketing program in place can cost a distressed property both time and money. The point is, whether retraining the existing sales team or rebuilding a new team, it must be done early on. It is not prudent to wait until the market recovers. These basic fundamentals seem simple, but most agents have not had to use them in the past and, as a result, for many it will be starting all over. The fundamentals for selling in the "new normal" include the following:

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a. Refocusing on the art of relationship selling.
b. Improved co-op realtor relationships.
c. Creative and constant follow-up with customers, realtors, owners, and members.
d. Owner referrals.
e. Data and web-based marketing.
f. Well-trained sales staff who are managed to goals and objectives.
g. Creative incentives that drive traffic to the site.
h. Additional onsite sales incentives that create value and "fear of loss" in the mind of the customer when onsite.
i. A strategy to create ongoing real estate releases to re-motivate previous visitors to return to the development to take advantage of an incentive-driven private offering for a "new" release.

10. **It will take more then good sales people.** In today's economy to be successful, developers and/or lenders must realize that many other factors must also be in place during and after the lender assumes control of the developer or the property. If these are not in place, property values will crash even more than already anticipated. These factors include:

    a. New and improved pricing.
    b. Completed inventory.
    c. Site enhancements to avoid a distressed or foreclosed appearance.
    d. Buyer financing.
    e. Restoration of property owner and/or member confidence in the development.
    f. A targeted marketing plan to reposition the development

11. **Homeowners can make the difference.** Today, a major problem for a troubled development is the failure of either the bank or the developer to engage homeowners and club members during the initial phase of the workout. Developers are often fearful and embarrassed to confront owners, while lenders are often afraid to be confronted by owners and are usually advised by counsel not to interface with them. The simple fact is that if no communication occurs, the owners will take charge of the story and the resulting "street talk" will be negative. When this occurs, the development's value suffers greatly. Also, if communication does not occur, the bank can quickly become either the "savior," resulting in unrealistic owner expectations, or even worse become distrusted. Again remember, this time we are all in this together. It is a financial meltdown, not just a real estate problem. Therefore communicating with the owners and members early can actually improve relations and help protect the value of the asset. Today's sophisticated second home owners know what is happening in the economy, with the bank, and the developer. It's this thing called the *internet*. They also know that the value of their real estate has declined, including their second home "investment." What they really want to know is whether someone capable is in charge and what steps are being taken to stabilize the situation. They can even take the bad news as long as there is leadership.

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What Now?
Where is the Silver Lining in All of This?

Even though many Americans have lost faith in the United States' financial system and the government's ability to fix things (for the moment hopefully), I encourage all of you who have not been through this before to not forget we are blessed to be living in a country where creativity, ingenuity, and hard work have always led us out of our problems, including many of those noted herein. It may take some time, but the current "time out" consumers are in will eventually end and a "new normal" will emerge. Below are some silver linings that may be out there:

1. **All real estate is local!** There will be many second home developments and resorts that will do much better than others because of their brand, previous success, special characteristics, amenities, and locations.

2. **Some buyers still have money.** Nobody knows what impact Washington's economic plan will have on the speed of the economic recovery or the "wealth effect" needed to reenergize the second home market. This notwithstanding, there are many who will come through this with their jobs and retained wealth. Hopefully they are only momentarily holding back from the purchase of a second home. My bet is this universe of potential buyers will return to the market sooner than one might think if properties are properly repositioned and their new offerings are compelling.

3. **Not everybody has lost their job.** As sad as it may be, it is important to remember that only 8% to 10% of those employed in America could lose their jobs. 90% will still be employed! Through every recession there are those who actually prosper. This will be true this time as well. There are many working in relatively recession-proof jobs that will continue to accumulate wealth. They could be among the first to take advantage of opportunities that will emerge in many second home developments. The unknown is what has happened to their investment portfolios and their appetite for a second home.

4. **Lenders to the rescue.** If the Fannie Mae and Freddie Mac presale and underwriting requirements prevail, many second home lenders will have no option but to get actively involved in helping their developers survive. To this end, they will find a way to provide construction financing for builders, operating capital for developers, and even attractive mortgage financing for buyers.

5. **Priced to sell.** Some opportunities for second homes will become so compelling (re-priced) that the value equation will, in fact, create a market that otherwise might not have existed. Many buyers will decide to "get on with their lives" once the shock is over. For many, this will be driven by lower prices and affordability.

6. **Are they stacking up?** The 75 million "baby boomers" are still out there. While many will be temporarily out of the market, it is impossible to know how many in this demographic are actually in the process of "stacking up" and will eventually re-enter the second home market in mass.

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7. **Drive-to destinations will win.** In all probability, the survivors will be the second home developments within a 2 to 3 hours drive time from major metropolitan markets or those developments with irreplaceable natural amenities such as skiing, beaches, or lakes. Potential buyers will consider one of these options as either an "irreplaceable" opportunity or the best of both worlds because they can own both a weekend and second home in a convenient location. These types of second home developments will be seen as more practical and less risky options. Personally, I'll bet on the drive to weekend/second home locations.

8. **Success will breed success.** Another silver lining will be found in those developments that have already sold sufficient real estate and club memberships whereby the development will be virtually self-sustaining. The advantage these developments have is the "sphere of influence" created by existing residents that will drive referrals and the credibility for potential new buyers. Conversely, those developments that are in the early stages of development will need strong evidence of a strong developer, substantial equity investor, or lender that can reassure early buyers the development will survive without financial disruption.

9. **Re-sales will be priced to sell.** Another opportunity for buyers will be the opportunity to purchase a discounted, "like new" re-sale in a completed or nearly completed successful development. As noted, the primary "sales team" for these developments will be the existing owners. As the market recovers, there will be an abundance of opportunities for "like new" re-sales over the next 24 to 36 months. This situation can also create an opportunity for developers to capture additional revenue by expanding their onsite sales organizations into the re-sale business.

10. **New and innovative products.** I also believe the change in the market will lead to smaller, lower-priced homes and condominiums. It is important to note that previously, many buyers bought or built far more home than they needed; again, the "wealth effect." This phenomenon in the second home industry will diminish substantially. Many builders and developers will begin producing more competitively priced products in order to reach a larger market and more easily obtain construction financing. Such changes will once again open the second home industry to a larger market. It is important to note, however, that there will always be the "mega rich" who will buy and build what they want. With this said, most developments can simply no longer take the risk of only targeting this market. As a result, most developers will stop pushing their prices. Finally, while no one is focusing on it, if inflation raises its ugly head as a result of the trillion dollar bailout infusion, interest rates will rise. Ironically, this could happen simultaneously with the recovery of the second home market. If this happens, it will impact the cost of ownership, and the only way the developer and/or builder can compete will be through lower product pricing!

11. **Lower "post purchase" shock.** More creative club membership programs will emerge, including how initiation deposits are paid and even how club dues are handled. For the near term, helping lower these costs will be necessary to keep the buyers from postponing their buying decisions because of the "post purchase" shock that comes with a second home purchase. Today, it is possible for price to be the most attractive part of the purchase decision. The club initiation deposit, club dues, homeowner association dues, insurance, taxes, maintenance cost, and fear of special assessments, can all be seen as additional cost of ownership that is prohibitive. Therefore, more creative programs for club costs will have to be created until the market recovers. You may see programs such as seller financing that defers some or all of the

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initiation deposit for 5 years or until the buyer's property is resold. The reality is that the club needs the dues line and members, so you may see more imbedding of 3-5 years of club dues in the price of the purchase in order to attract new buyers. You may also see forgiveness of one year's dues with every homeowner referral. In other words, with price reductions, sales incentives, and lower cost of membership, it will get less expensive to purchase a second home than previously experienced.

12. **Creative sales options.** If the Freddie Mac and Fannie Mae presale requirements prevail, you may also see creative lease purchase programs for completed homes and condominiums. These will stay in effect until the presale requirements are met. Such programs may allow the purchasers (not yet owners) to rent their units or homes and recapture what would be the owners' share of the rental income. This revenue could be applied towards their club dues or down payment. Such programs would be used by developers as incentives to achieve their presale requirements.

13. **No new developments.** For the survivors, one of the competitive advantages that will come out of this downturn is the probability that virtually no new second home development will be started for the foreseeable future (3-5 years). This will not only eliminate what was going to be new competition from proposed developments, but it will also create opportunities for developers to purchase deeply discounted, well-located, and entitled second home properties. While this will require substantial passive equity, those who have it will find many lenders willing to deeply discount their loans and continue to finance such properties, as long as the new buyer can escrow 2-3 years interest on the loan and fund all other associated carrying costs of the development.

14. **Opportunities abound.** The same scenario as above also applies to existing operating developments (of all types), as long as the borrower can show the ability to both pre-pay the interest and carry the operating cost of the development for an acceptable term of the loan. Those choosing this route should be very careful and do their homework. In some situations, buying an operating development may be the cheapest part of the purchase.

15. **Product Extension.** In times such as these, many developers need to use their platform and their market to consider new business and joint venture opportunities. Some of these could include:

    a. Reorganization for efficiency
    b. Re-sales/Brokerage
    c. Remodeling of re-sales
    d. New home construction
    e. Mortgage brokerage
    f. Insurance brokerage
    g. Leasing/rental management
    h. Landscape maintenance
    i. Retail

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16. **Buy now build later.** For many developers that have historically developed and constructed their own product, a new program may be initiated that defers the overall cost of the purchase. This program will be through a "buy now build later" concept. Through this program, a customer could buy a home site, but not be required to build the home for a predetermined period of time. They would be required to select a home from the builder portfolio, as well as use the developer/builder to construct their home. Such a program will take buyers out of the market and create developer cash flow. It will also allow the buyer to enter the development at a lower cost, use amenities, and construct their home when their personal financial situation allows, so long as it does not exceed the agreed upon date for their building requirement.

17. **Interval ownership.** As strange as it may sound, the current situation will likely create an even larger and more robust market for timeshare, interval ownership, and private residence programs, especially those offered by major brands such as The Ritz-Carlton, The St. Regis, etc. These programs offer the reassurance of a brand, comprehensive amenities, luxury, location, lower prices, sufficient usage, and the flexibility to "exchange" with other comparable resort locations all over the world. Don't be surprised to see this segment of the industry increase dramatically for all aspects of the market.

18. **Don't underestimate the best and brightest.** Finally, I should note that I am blessed to personally know many of the leaders in the second home and resort industry. I will bet on them all day long! They are smart, creative, and will find solutions for many of the challenges herein. They are some of the best businessmen and women the real estate industry has to offer. Don't underestimate them!

Well folks, there you have it. More than you wanted to know. I offer these as reflections on the past, the present, and the future of the second home industry as "the world seen by Garp" Halter. So put all of this in the "for what it's worth" category. As you can, see I am convinced this is an industry in transition and, as such, there are going to be some great management and/or replacement developer opportunities waiting for us. Let's go find them!

Thanks,

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