Looking for Luxury

August 2023

Featuring:

Rick Calero, *Head of Banking and Lending, BNY Mellon Wealth Management*
Catherine Finney, *Head of Residential Appraisals, BNY Mellon Wealth Management*

VO [00:00:01] Is your wealth strategy supporting your long-term goals? Welcome to *Your Active Wealth* with BNY Mellon Wealth Management, where we offer insights that can help you move closer to your goals. We'll tackle timely topics through the lens of the five pillars that comprise our Active Wealth framework: Invest, Spend, Manage, Borrow and Protect, and provide guidance on navigating the unpredictable, to help you build and sustain wealth.

Rick [00:00:29] Hi, I'm Rick Calero, head of banking and lending at BNY Mellon Wealth Management and the host of today's episode. Welcome back to *Your Active Wealth*. Today, we're going to discuss the luxury residential real estate market and how to buy or sell a home at this echelon. This includes how to gauge the market, personal factors to be considered and creative financing solutions. Only about 100 regional markets in 22 states make up most of the luxury market in the US. That said, coastal states have a higher share of these opportunities than those at the center of the country. With different climates and other factors influencing the seasonal and sometimes transient nature of regional popularity, it can be difficult to ascertain when to make a purchase or sale. While working with a dedicated professional is always a smart idea when engaging a highly specialized market, there are measures you can take to better understand trends and valuations. Today we're speaking with Catherine Finney, head of residential appraisals at BNY Mellon Wealth Management, who will provide an inside look at the luxury residential market and share best practices. Hi, Catherine.

Catherine [00:01:38] Hey Rick, great to be here.

Rick [00:01:39] Welcome. To start, what are some of the general differences between the luxury market and the broader real estate market? And are there criteria that properties must meet to be considered luxury.

Catherine [00:01:51] On a national level, we consider the luxury market to be anything above $1,000,000 and or the top 5% of the market. Now, there are lots of places where $1,000,000 is still expensive, and then there are places where $1,000,000 is a buy in for a starter home, if that. The luxury market works a little bit differently because a lot of the activity is purely discretionary. This range of the market is less subject to the everyday forces and pressures of the broader market. Our mortgage platform is geared to providing great service specifically in the luxury segment, so we spend a lot of time looking closely at this market to understand the bigger picture and provide great and expert advice to our clients. One thing we see is that over the past five years, when we analyze the luxury market, it is a much more stable asset class than the broader market.

Rick [00:02:43] So you categorize the market in four distinct buckets: primary, secondary, trophy and mixed. Can you briefly define those categories and perhaps describe their significance in analyzing market trends?

Catherine [00:02:56] Sure. Primary markets, those are places that you go to work from, and you come home to, and this is where you live most of the time. And these tend to be in or adjacent to major economic centers. This is your Rye, New York or your Wellesley, Massachusetts or your Lake Forest in Chicago, or your Beverly Hills, or your Menlo Park or your River Oaks. There's a subset of this market that's known as lifestyle, and those are the places where you go to both work and play. Usually, outdoor recreation is a huge part of those markets. Those would be places like Austin, Seattle, Denver. Generally speaking, primary markets tend to be in very consistent, stable neighborhoods over the decades, and they move up and down in values that are more directly tied to the area economy.

Secondary or resort markets is the next category. This is where you swim in it, ski down it, hunt on it, you look at the scenery, you get warm, you get cold. This is your beach, lake, ski, or desert type market. For a long time, many of these were predominantly East Coast other than the big ski markets, but you're seeing more creation of these markets in the West as the California based tech economy has gained much more traction. Funnily enough, as a lender in our portfolio, we have right now the highest average property values are in Montana, Wyoming, Utah, California, and then New York and Florida, which is where you might expect them to be otherwise. Your third market is your trophy or ultra luxury market, that is usually $30 million and above. You've got Manhattan topping out at close to $190 million or Palm Beach at $170 million or LA at $125 million or Miami or Malibu or the Hamptons or Aspen. Those tend to be your celebrity markets or what I call a founder's market, you know, tech company founders all have their play homes there. And then the last category is a mixed market where you get a little bit of each. You see that a lot in LA, you see that in some of the New York markets. It's interesting to note that the high-end markets in the middle of the country, Kansas, Missouri, Michigan, those tend to generally be at the lower end of the luxury threshold while the coastal markets are more highly priced. We see 90 of the top hundred zip codes by value are in California. Then you get New York, Massachusetts, Florida, etc. The National Association of Realtors tells us that the $1 million and up market makes up about 13% of the market in the West, 5% in the Northeast, 3% in the South and 1% in the Midwest.

Rick [00:05:31] Fascinating on the portfolio there. So maybe a little bit more to build upon that, what's the main metric used to analyze market trends. Is it price, is it inventory? And how do those metrics allow us to gain insight into purchasing power?

Catherine [00:05:43] My answer to that for the last three years, and particularly for the last year is, this is my motto, inventory tells the story. Price tells you straight up purchasing power, but inventory actually tells you about what I call secondary purchasing power. And the simple way to look at this is what percentage of homes offered in the market sell at any point in time. There's a group called the Institute for Luxury Home Marketing, and I get a lot of data from them. They're a good source and they've sort of set this metric as more than 20% of the inventory sold is considered a seller's market, 15-20% is a balanced market and less than 15% is a buyer's market. So basically, if one out of every five homes sells, that's a seller's market. Then you have a shifting market, you know, that's moving back and forth. Then you have a balanced market that kind of tends to stay consistent mostly in those primary markets that we were talking about earlier. Using inventory as a metric lets you look beyond price, which is useful because price tells you what did happen, but inventory tells you what didn't happen or hasn't happened yet or isn't likely to happen. This is where your smart investment decisions come in and this tells you what and how much negotiation you can build into a deal. And this is where you can also hone in on specific undervalued locations and look for opportunity, and that's what I consider to be secondary purchasing power.

Rick [00:07:10] So you classify the market conditions into four groups, right? Seller's market, buyer's market, shifting market and balanced market. How do you use price and inventory to determine what kind of market we're in? I understand there's some regional differences, but where does the U.S. luxury market currently sit?

Catherine [00:07:27] Well, what we see at the moment is variability. But the luxury end of the market is really holding up much better than we would expect given the shift in interest rate environment and also based on the dramatic news stories that we see every day. We are solidly in a seller's market. There's regional volatility, but that's mostly in areas that have now outstripped their underlying economic demographics. And you need to, when you're in this market, you need to consider your approach differently. You know, in a seller's market, price, you're probably going to end up above what the last guy paid in the neighborhood, right? Financing, do you have to make a cash offer? Can you build financing in upfront? We have a lot of situations where clients will use a credit line to purchase a home with cash and then they'll come in and put a mortgage on after that because it makes their offer much stronger in a seller's market. You want to know about your time to get the deal done. You want to get your ducks in a row, you want to line up your experts, you want to do your due diligence, you want to make sure you have an appraisal. You want to not ever waive your inspections. You always want to have an attorney review your contracts. And then you also want to know about competitive access. Do you need that one realtor who's the person that gets to every oncoming property first? Do you need your wealth experts to make sure your picture is solid and your financial planning is solid? All of that sort of thing.

Remember that from the fourth quarter of 2020 up until the second quarter of 2022 and still ongoing in some ways, it was kind of a historic and unprecedented moment in the U.S. real estate market. Everybody is looking for a correction, right. But what we're actually seeing is when we look at summer 2023, against summer 2022, when the rates started to rise, in the luxury segment, prices are up 1%, sales are only down around 6%. Inventory, on the whole is up 1%. New listings are down 19% and days on market is up 66%. But what does that actually mean, right? When you look at pre-pandemic when rates were already pretty reasonable, sales are flat and they've only gone moderately up and down since January of 2020. In terms of price, there's kind of a median price in the segment of about $1.4 million. And literally, if you look at 2020 to now, the median price in the luxury range nationally speaking has remained between $1.3 million and $1.4 million. So, when you look at these number of homes selling, going down, it looks like negative trending. But, you know, consider if new inventory is down 19%, there are simply going to be fewer good homes to buy. So, there are going to be fewer sales.

Rick [00:10:10] Great. Thank you, Catherine. So, to understand inventory, what questions should you be asking outside of sold listing information? Should you be asking about expired, cancelled, or withdrawn listings, for example?

Catherine [00:10:23] That's a great question Rick, and one that I encourage everybody to think about in this kind of market. You want to ask about expired, cancelled, and withdrawn listings just as much as you want to see the sold listing information. You want to focus in on what isn't happening as much as what is happening or what has happened. And how you do this is you do it by focusing on the specific locations that you're interested in and getting a very deep dive and a holistic snapshot. And your team should be able to help you do that.

Rick [00:10:54] So maybe to pivot a little bit. What personal factors should one consider when buying and selling a home in the luxury market?

Catherine [00:11:01] You know, when I look at all of the goals, you want to understand your short and long-term goals, you want to understand your financial position, and you want to look at your intended use profile for the property. And you want to have a very clear, both short-term picture and long-term picture. You want to look at your financing options versus your cash purchase. You want to look at the value of the use of enjoyment and or the offset of the cost of vacation rentals, travel, property taxes, all that stuff. You want to establish a plan for resource allocation for your property management and how you're going to occupy the property, and then your secondary cost of ownership. And you want to establish short or long-term ownership and transfer strategies. You want the input and advice of professionals beyond just what a realtor will offer. Typically, realtors drive these deals, but I'm here to say that you ought to focus on the secondary members of your team. And this is something that our wealth teams and mortgage bankers are really good at.

Rick [00:12:01] We hear a lot about the market, some form or fashion. There's lots of headlines out there at any given point. How much should market participants pay attention to headlines? Do you have advice, for example, for ignoring the noise?

Catherine [00:12:14] What I tell everyone, and my other mantra besides inventory tells the story is, read past the headlines. You know, these days, what we consume as news has a lot of competition to get eyeballs. So if you read most of the doom and gloom articles in the quote news, you will almost always find that there is one statistic at the heart of the story, and it is generally presented with zero context. And it's usually a dramatic statistic that is comparing now against what was the most dramatically positive moment in the history of the U.S. real estate market. So even though that market already feels a little bit distant, it's still the current baseline for the headlines. So read critically when you read about real estate.

Rick [00:13:01] How should buyers think about the seasonality of changing market conditions? For example, is early summer generally a good time to buy a home in Florida?

Catherine [00:13:09] Absolutely. Florida's in the off season. For the most part, Colorado is in the off season, although they have summer activity as well. But skiing markets, you know, are in the off season. And the pro-tip here is buy off season if you can. You're always going to get a better deal, right. Because anybody who puts their house on in the off season probably has something else they want to do. So even though that goes against everything in human nature and everything in human nature for high-net-worth individuals with complete discretionary purchasing power, it's a great idea because it really will get you a better deal and it probably gives you more to pick from if you buy off season.

Rick [00:13:47] Great advice. What's the main catalyst behind the low inventory you think that we're seeing throughout the country?

Catherine [00:13:53] Oh, I think the clear reason why inventory is low is that, you know, everybody's sitting on a low rate mortgage and they don't want to get rid of that or give that up. So while sales volume is down, you know, the inventory is still way down and that's keeping the pressure on the market. Also, you know, more wealth is being created in a shorter period of time these days. And new home inventory got slowed by all of the supply chain issues of 2020 to 2022. So those factors have put additional pressure on supply. And if people start to need to sell and the inventory increases significantly, that's when you'll start to see price movement and that's when the inventory will start to snowball on itself.

Rick [00:14:36] You touched upon mortgages. In the current environment, do mortgages still make sense? And when it comes to the strategic use of lending, can you give an example of a creative strategy in this environment?

Catherine [00:14:47] Oh, sure. I think mortgages are still and pretty much always a great leverage tool. If you have a lot of different financial options, you know, and you're putting your portfolios and your investments together with your experts, because while rates are up, you know, you also expect that your returns on safe investments are going to be higher, all that sort of thing. So it turns out like I see mortgages usually as having a parallel offset, and that doesn't really matter what the rate is, right? It's going to be corresponding. One of our mortgage programs here at BNY Mellon, and that, I think, is one of the best leverage tools in the market, no matter what the rates are, is our construction loan program. And this is a program that lets you pledge assets at the start of the build, we basically look at the equity in the site at the start, and then you pledge assets to meet the equity deficit while you build the home. You can take as much of the balance of the loan as you want on day one, and then we go back and appraise the home when it's complete and we release your pledge. What that does is it gives you maximum flexibility without having to liquidate assets or go through the pain of the incremental payouts that most construction loans require. And, you know, that's something that our clients appreciate the resource and time savings on, on that kind of mortgage, because if you've got to make sure once a quarter that to pay your contractor, you know, you've got to get out there and get inspections and meet all these deadlines and that sort of thing. That's a much more labor-intensive mortgage that probably also is not going to allow you the pledge piece. So those two aspects of our construction tools are one great creative way that we approach the very smart use of mortgages for leverage.

Rick [00:16:26] Wonderful. And Catherine, any final takeaways for our listeners?

Catherine [00:16:30] Yeah, I don't think we're going to see anything dramatic in the luxury range in 2023. I think there's still enough demand and not enough inventory that unless, you know, some major cataclysmic event occurs, I think we're going to keep going. I think 2024 may tell a different story. But while we're sorting that out, read beyond the headlines and inventory tells the story. So do your research. Put an expert team together. The current market continues to require expert and creative approaches that are specifically tailored to high-net-worth individuals. And I'd just say that this is what we do all day long, and we're here to help.

Rick [00:17:10] Great insights, Catherine, thank you for joining us today.

Catherine [00:17:13] Thank you, Rick.

Rick [00:17:14] To learn more about luxury residential real estate, I encourage you to reach out to a BNY Mellon wealth manager, or visit our website at bnymellonwealth.com. Thanks for joining us and we'll see you on our next episode of *Your Active Wealth*.

VO [00:17:29] Thank you for listening to this episode of *Your Active Wealth*. Be sure to subscribe to this podcast on Apple Podcasts, Spotify, Google Podcasts or Stitcher and visit bnymellonwealth.com to view the latest insights on the subjects that matter most to you.