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In Search of Paradise

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COVER | Affordable waterfront property for retirement or a vacation retreat is still within your grasp. *By Jeffrey R. Kosnett*

Peter Huff doesn't boat or fish, but he and his wife, Kathleen, have purchased three waterfront lots on Mustang Island, a strip of land on the Texas Gulf Coast opposite Corpus Christi. The Huffs plan to build a family vacation home on one front-row lot, hold a second lot next-door as a buffer and put up a rental house on a third lot in a nearby community. Once they close on the lots, their financial commitment will be around \$600,000, which Peter considers a steal. "I've seen shore-front property throughout the whole country, and this area has by far the best bang for the buck," says Huff, 34, who moved to Texas from California and owns a venture-capital investment company in Austin.

About 1,300 miles to the north, John Schrei and his wife, Christin, recently paid \$89,000 for an acre of property in Empire Hills, on northern Michigan's Great Lakes shore. It was the Schreis' second land purchase. Four years ago, they paid \$79,000 for an acre of land about a mile from the Lake Michigan beachfront but with hilltop views of the water. In 2003, the Schreis built a four-bedroom house on that property for \$220,000. They purchased the latest parcel to protect their water view. They figure that the house and first lot are now worth \$400,000, but they hope never to sell. "This is for our kids to enjoy and for their kids as well," says John.

The Schreis don't expect their hideaway to become a landmark like the Kennedy compound at Hyannisport, Mass., or the Bushes' retreat at Kennebunkport, Maine. But young families and empty nesters alike regard a waterside refuge as something to grab for now and pass along.

If only it were easy to find. Travel the Atlantic Coast from rustic Maine to Cape Cod and south to the Outer Banks of North Carolina, or drive the Pacific Coast Highway from Malibu to Oregon, and it seems as if all the open land is spoken for. Twenty years ago, the northern section of the Outer Banks was literally a wilderness. Today, you can pay \$400,000 for a lot--if you can locate one--and end up sharing your island retreat with *tapas* bars and Home Depots.

Modern-day homesteaders like the Huffs and the Schreis are competing for a dwindling supply of sites where you can still build what you want by the water, so prices are rising. Hard figures for undeveloped land other than farmland are rare, but real estate people swear by the maxim that waterfront acreage appreciates at one and a half times the rate of other property. Given the prices that sellers are demanding--and that frenetic buyers are willing to pay--that's not out of line, at least as long as real estate in general remains healthy.

So if you stumble upon a slice of waterfront that's vacant, isn't near an oil refinery and is available at a price that's not preposterous--such as much of Mustang Island--you'll wonder if it's for real. "This is the last frontier," says Gene Guernsey, a native Texan who makes a living off the land--not ranching or drilling for oil, but selling coastal real estate. Guernsey is extremely busy, and for good reason. Mustang Island and neighboring North Padre Island offer terrific windsurfing and fishing, and sit just a few minutes from Padre Island National Seashore.

In the past year and a half, several miles of beachfront on Mustang Island have come on the market after years of being tied up in bank crises or in the hands of foreign investors. In one development, La Concha Estates, 60-foot-wide front-row lots by the dunes that sold for \$170,000 to \$180,000 in early 2003 now go for \$350,000. Back lots, about a ten-minute walk to the beach, sell for \$80,000 to \$90,000, up from \$35,000 not very long ago.

Those numbers attracted Scott Harvey, 41, a business executive from Harrisburg, Pa. When Harvey vacationed in Texas last year, he picked up a few real estate fliers. Accustomed to inflated values at the New Jersey shore, he thought the prices in Texas were misprints. A few months ago, he bought a waterfront lot near the Huffs' land. Unlike the Huffs, Harvey doesn't plan to build. He wants to sell the land in two to three years and expects to clear hundreds of thousands of dollars in profit, even after interest expenses and taxes. "Given the history of beach property," says Harvey, "there's no possible way this could go down."

Or could it? If you can find land that's available and affordable, price appreciation isn't necessarily a sure thing. And even if it is, undeveloped land can cost you plenty before you build or sell at a profit.

What's more, land is a blank canvas. "I think raw land is the riskiest area of real estate because you have to make a bet

on future development," says Lenore Sullivan, associate director of the Center for Real Estate Finance at the University of Texas. New roads, favorable zoning rulings and other local land-use decisions over which you have no control can make your land more valuable--or not.

It's rumored, for example, that a giant golf resort will be built on North Padre Island, which would boost property values and might even put a brake on property taxes. But it would also change the area's quiet character. "When the big developers all come in and tie it up, and they will, you won't be able to buy a lot," laments Guernsey. "They'll make you pay for houses in planned, gated, corporate communities."

NO SURE THING

With real estate booming, it's difficult to conceive of a situation in which waterfront property, or prime recreational land in the mountains, would fall in value or even fail to appreciate. But such a scenario is not unprecedented. About a decade ago, a real estate depression across New England sent shock waves all the way to the Maine coast. Land on Mount Desert Island, site of Acadia National Park and the village of Bar Harbor, one of the country's oldest summer retreats, lost 10% to 20% of its value and then flattened out for several years before resuming its upward trajectory.

To purchase recreational land, buyers often pull equity from their primary residences. So if rising interest rates slow or depress surging home prices in and around Boston, Washington, D.C., and Los Angeles, waterfront values in New England, the Outer Banks and the Pacific Northwest could falter as well. Areas such as Texas, where gulf-side land values are just catching up with other coastal regions, would be less vulnerable to rising rates.

But land that is cheap to buy is not necessarily cheap to hold. Although it costs little or nothing to insure or maintain undeveloped land, there is the matter of taxes. On Mustang and North Padre islands, parts of which are within the boundaries of Corpus Christi or its suburbs, land is typically assessed at 3% of its market value. At that rate, Lynn Bollman and his wife, Mimi Castle, pay \$2,500 a year in taxes for a pie-shaped canal-front lot on North Padre Island that's barely big enough for a narrow, vertical house.

The lure of reasonably priced land on the Texas Gulf Coast has been drawing out-of-staters like Bollman and Castle, who are retired and divide their time between Seattle and Texas. But as scenic as a piece of land might be, you can't judge its value by the view alone. One of the best investments you can make is to hire a fishing or tour boat for a day and chat up the captain, who is likely to know the scoop on local development issues.

In Texas, for example, you'd find out that one reason for the land boom on Mustang and North Padre islands is a \$30-million channel-dredging project. When the project is completed in 2005, boats will be able to enter and exit the Gulf of Mexico through a passage called Packery Channel. The channel is close to hundreds of houses and so-far empty lots, and prices are soaring. It's unlikely that the dredging would be stopped, but if it were, real estate prices could plunge.

Price appreciation isn't necessarily a sure thing, and undeveloped land can cost you plenty before you build.

WHERE THE DEALS ARE

Finding affordable acreage in or near prime areas can be a challenge (for tips on how to conduct your search, see the box on this page). John Schrei discovered Michigan's Great Lakes shore when, as a boy, he visited his grandparents' lakeside cottage. Four years ago, during a family vacation with their two young children, the Schreis decided they'd like to do more than visit.

Great Lakes property can be as expensive as oceanfront land--witness Door County in Wisconsin, across Lake Michigan from the Schreis' land, where waterfront parcels routinely sell for more than \$300,000. The Schreis found their acreage through the McKeough Land Co., which assembled and resold the property as a complete package, installing utilities, handling permits and establishing an owners' association. Building rules prohibit trailers and fishing shacks, and require that any house be at least 1,200 square feet on the first level.

Three weekends a month during the summer, John, an executive with a company that schedules and manages MRIs and other diagnostic tests, and Christin, who sells advertising, drive five hours from their home in the Chicago suburb of Frankfort, Ill., to Empire Hills, 25 miles from Traverse City. They hike, swim, kayak and run speedboats, and switch to skis and snowmobiles during the winter. "I've wanted someplace like this ever since my childhood," says John.

Conditions are just as scenic but a bit more primitive on the tip of Deer Isle, off Maine's Blue Hill Peninsula. There, in a dot on the map called Sunshine, two sisters who've long since moved away are selling a portion of their family's land. For \$299,000 you can get a tad under three acres with 250 feet of deep-water frontage on an arm of the Atlantic Ocean, with views of Mount Desert Island and Acadia National Park.

It could be a marvelous retreat, but anyone who hopes to build there faces "obstacles," says Morgan Eaton, a real estate agent in the nearby village of Stonington. Sunshine, which isn't actually a town, lacks municipal sanitation, and the land has no installed utilities. Taxes are only \$800 a year, but Eaton ticks off everything you'd need to spend to prepare the land for construction: at least \$5,000 for a septic system, \$2,000 to \$5,000 for an access road and more than \$1,000 for extending electric lines. Some rural land isn't habitable at all if the soil won't support a septic system--something the seller must tell you.

Sunshine is so remote that a trip to a full-service supermarket or major hospital takes more than an hour over twisting two-lane roads, including a high, narrow bridge that frequently ices over. The nearest airport with commercial service, in Bangor, is at least two hours away. That could help explain why the Sunshine plot was reduced in price in April from the original \$350,000. Eaton says it might have fetched \$125,000 two years ago.

SEIZE AN OPPORTUNITY

When you're in the market for a house, newspapers and online databases list recent and comparable transactions, and everyone seems to know what the Joneses down the block got for their house. Prices for undeveloped land aren't nearly as transparent. You can attend a land auction, but properties can be so dissimilar or flawed--located downwind of a paper mill, for example--that learning the going price per acre in the vicinity can be misleading (for more on financing undeveloped land, see the box on this page).

Once in a while, you can spot a deal even in a prime location, especially if the owner is eager to sell. Last winter Shep Harris, a Bangor stockbroker, offered 50 acres, enough to build precisely five houses (but not adjacent to the water), on Mount Desert Island for \$585,000. Harris said he wanted to raise cash to retire debt on another 1,000 acres he owns on the island. A group of five investors negotiated to buy the 50 acres for \$550,000.

One of the investors, Keating Pepper, is betting the property will at least double in value in three to five years. And he may be right. On Mount Desert Island, where one-third of the acreage is parkland and much of what remains is subject to preservation covenants, buildable property is hard to come by: An acre of land with a harbor view and a rustic cabin just sold for \$960,000. Maybe paying \$299,000 to be duke or duchess of Sunshine isn't as wacky as it seems. ■

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Where to get HELP in your hunt

If you know where you'd like to buy property, there's no substitute for showing up on the scene and driving around to get to know the area. To paraphrase Yogi Berra, you can see a lot just by looking. Web sites such as LandLister.com and sites operated by individual real estate agents are useful. But you really need to see (and feel and smell) a property and its community to know if it's right for you.

Real estate agents in coastal areas specialize in waterfront property, so they know about soil testing, beach conditions, navigation and, yes, hurricanes. Ask a buyer's broker to show you available land on the water. But don't be surprised if the pickings are slim. In Wiscasset, Maine, buyer's rep Bill Morison will take your case, but warns, "If you're looking for land that's near deep water and costs less than \$200,000, I can't find it for you." For \$80,000, he could show you three acres within sight of (though not on) a lake, but it'll be a fair distance from salt-water beachfront on a bay or the ocean.

Typically, real estate agents in waterside areas (including nearby towns and cities) have far more houses and commercial properties, such as defunct restaurants, in their inventory than building lots or land parcels. (The reverse is true in interior areas such as Wyoming, where land is still plentiful.) And with land values appreciating so rapidly, owners feel no urgency to sell unless they need to raise cash for business reasons or to pay estate taxes, for example. If you stumble upon that kind of opportunity, grab it.

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Three ways to FIND THE CASH

FINANCING YOUR DREAM

The only thing tougher than finding your little piece of heaven on the beach may be coming up with the money to pay for it. Borrowing to buy undeveloped land is nowhere near as easy or as competitive as getting a mortgage or refinancing a home. Land is more difficult to appraise than a house because it doesn't turn over as often and may have soil or drainage flaws. And there's no Fannie Mae to buy land loans from lenders who don't want to hang on to them. If you put down 10% or 20%, some banks are willing to lend money on recreational land--but only in their immediate area. Others require 50%

down or simply refuse to finance land deals. And forget land-finance companies that charge as much as 12% interest.

Tap your assets. The best way to buy recreational property is to dip in to your financial assets and pay cash. If that's not feasible, the next-best option is to use your home equity or do a cash-out refinancing.

Get a package deal. Sometimes a seller will arrange for "dealer" financing. McKeough Land Co., which sold John and Christin Schrei lakefront acreage in Michigan (see the accompanying story), refers buyers to local banks near its developments. For example, Independent Bank, in Traverse City, Mich., has a 30-year adjustable-rate loan at 5½% (the rate comes up for review in three years). That's a fair deal, but it's available only for land sold by McKeough, which operates in Kentucky, Michigan, Tennessee and Wisconsin. To finance their first land purchase, the Schreis got a loan from their home bank in Illinois, then rolled the balance into a mortgage when they built a house on the property. Mortgage interest on a second home is deductible, on up to \$1.1 million in combined debt on both houses.

Find a friendly bank. If you're not buying from a developer with a financing program and you can't borrow against your primary residence, or don't want to, go directly to a local bank and hope the lender is willing to exhibit some good old civic boosterism--especially if property values are rising. Because of the land boom on the Texas coast, "loans are easier to get," says Tom Corry, a land investor and developer in Rockport, Tex. "Two years ago you needed 20% down. Now, you really have to have bad credit not to be able to get a 15-year loan with 10% down."

Expect to pay an interest rate in the neighborhood of 7%. Unlike interest on a mortgage or home-equity loan, however, interest on a land loan may not be fully deductible. Even if you plan to build a house later, borrowing money to buy undeveloped land will be considered an investment, and the loan will be treated more like a margin loan on stocks than a mortgage. For tax purposes, interest is deductible, but the deduction can't exceed your total investment income in any given year. If it does, the excess is carried over to future years. Note that in this case investment income does not include long-term capital gains or qualifying dividends, the two components that make up most of the income from many investments.

A \$100,000 loan for 15 years at 7% costs \$900 a month--steep if the interest isn't fully deductible. A home-equity loan is cheaper, but your primary residence is on the line if development plans fall through or something else goes awry with your land investment. Stranger things have happened.