

BUSINESS

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Steve and Patty Kozier built this luxury house on 'spec' on Northwoods in Deerfield. — Joel Lerner/Staff Photographer

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If you build it, will they come?

Housing slowdown hits luxury homes

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Experienced players in the real estate market say they can handle a slowdown, but the same may not be true for amateur speculators, as the market for luxury homes softens in the Chicago area.

The number of homes on the market in all price ranges is increasing, but the numbers reach the "oversupply" level only in the \$1 million-plus luxury home category, recent figures from Naperville-based Headrick-Wagner Appraisal group show.

"We have been charting these numbers since 1993. It is all supply and demand. Since 1999, in all Chicagoland it has been a stable to declining supply (of luxury homes). This is the first time we have seen an increasing supply," said Chip Wagner of Head-

rick-Wagner.

With an oversupply of the luxury homes, amateur speculators may already be feeling pain, said Tim Thompson of Hinsdale-based Tim Thompson Custom Homes.

"I think some have already been hurt and put a couple of spec homes on the market without understanding the market," Thompson said.

Amateur speculators have been lured into the market in the last five years, attracted by ever-rising home values.

27% of nation's homes bought for investment

The number of speculators is difficult to measure in the luxury end home market, because it is "small and volatile," said Walter Molony of the National Association of Realtors. But nationwide, the percentage of homes

More months on market

The supply of homes in the Chicago area market has gone up recently, with an oversupply of homes in the \$1 million and up market. The months of supply is calculated by dividing the number of active listings over the typical number of homes that sell in a month. An oversupply is considered to be more than six months, a balanced supply is between four to six months, and an undersupply is less than four months of inventory.

12 months ending:	12/31/04		3/31/06	
	Sale price	Months of supply	Sale price	Months of supply
Evanston	\$530,000	1.98	\$598,000	2.76
Wilmette	\$836,000	1.78	\$901,000	4.06
Northbrook	\$560,000	2.90	\$679,000	4.56
Northfield	\$751,000	2.53	\$930,000	4.70
Glenview	\$542,000	2.54	\$686,000	4.77
Kenilworth	\$1,674,000	5.74	\$1,781,000	5.86
Winnetka	\$1,391,000	1.76	\$1,615,000	6.25
Glencoe	\$1,252,000	3.95	\$1,480,000	8.02

Source: Headrick-Wagner Appraisal Group, Naperville

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bought for investment has been steadily rising, making up about 27.2 percent of homes bought in 2005, or 23.2 million homes, up from 1.8 million in 2004, and 1.47 million in 2003, NAR figures showed.

With higher interest rates, investment home figures may decline in 2006, the March 2006 NAR release stated.

"There are fewer incentives to

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speculate in the market with price appreciation cooling in much of the country, and more oversight being encouraged in the mortgage market," stated NAR chief economist David Lereah in the release.

"It's hard to say how much speculation there may be in housing, but it's probably a single-digit percentage of home sales," stated NAR chief economist David Lereah in the release.

Fewer speculators in Chicago market

In Chicago, speculators have made up a much smaller percent of the market than in areas where home price increases have been more dramatic, such as San Diego or Las Vegas, figures from Mesirow Financial's chief economist Diane Swonk showed.

With a slight softening at the high end of the market, some of the amateur speculators may retreat, said senior vice president Andy Hommowan of Deerfield's brand new CenTrust Bank.

"These Johnny-come-latelies will either get out — or go back to a market they are familiar with," said Hommowan, who has 17 years of experience in commercial lending.

Some builders may decide to rent properties while waiting out the market, said Allyson Hoffman of ReMax, who sells in the north suburbs of Chicago.

Others may use it as a chance to get bargains.

"Some of the builders may look at this as a chance to pick up (teardown) houses," she said.

Slowdown here, but not a collapse

Experts all agree the popping of real estate bubbles that is of concern in other parts of the U.S. will not occur in the Chicago market. Instead, the rate of increase in home prices is becoming less steep, as the amount of time it takes to sell a home gradually lengthens.

"It is not a collapse. It is more of a return to normalcy," said Bob Headrick of Headrick-Wagner Appraisal Group.

Realtors say the softening is leading to some reductions in selling prices. "We are seeing some price reductions and some reluctance on the part of developers and speculators to grab things," said ReMax's Allyson Hoffman, who has her own real estate blog.

In order to build \$1 million-plus homes, buyers have been jockeying for the ranch homes that could be torn down to build them. In Naperville, about two-thirds of the \$1 million-plus homes on the market followed

teardowns, said Chip Wagner of Headrick-Wagner.

Teardown craze spreads to many more suburbs

Expensive homes are not confined to Chicago's tony suburbs, he said.

"Five or 10 years ago, a \$1 million dollar home was in Oak Brook or Burr Ridge or Hinsdale. Now you can find \$1 million dollar homes in every west suburban town — Naperville, Westmont, Downers Grove, Lisle, Wheaton, Addison, Elmhurst," he said.

Competition has driven up the price of teardowns, to the point where some speculators may have overpaid, Thompson said.

One problem is that amateur speculators do not always understand the towns where they develop, he said.

Market knowledge critical to success

"Speculators come in and don't understand Hinsdale. They pay \$100,000 or \$200,000 or \$300,000 more for a property than they should," Thompson said. Because they did so in another suburb, these speculators may think they can command \$1.5 million for a 3,000-square-foot house in Hinsdale that they built on the site of a torn-down home they bought for \$500,000, he said.

The usual rule of thumb is the sale price of the newly constructed home should be three times the price of the teardown lot for the developer to make a profit.

But if they don't know Hinsdale — where home prices are strongest between Ogden Avenue and 55th Street — they could end up paying closer to \$650,000 or \$700,000 for a teardown lot worth only \$500,000, he said.

Speculators lose money as a house sits unsold for months. A \$1 million "carry loan" to tide the speculator over until the sale can cost \$100,000 a year, he said.

The "location, location, location" mantra also matters in the luxury home market. Some luxury homes sold on busy thoroughfares, for example, may sit longer than those in neighborhoods that are more off the beaten path, said Steve Kozer, who has a \$2 million luxury home for sale in the leafy, secluded Northwoods neighborhood in Deerfield.

First teardown on block may be slow to sell

A new luxury home built on a block of ranch homes may also sit longer, said Hommowun. "I have an individual who sat on his property for a couple of years because he was the first teardown on the block. He waited for the market to catch up. It was a beautiful house, but he chose to sit there," Hommowun said.

Much of the time it boils down to whether "it is the right house on the right property at the right location at the right time," Hommowun said.

Experienced spec builders also criticize amateurs who don't use an architect, but instead rely on a "builder's model." Thompson said he uses his own architect and special materials to attract the upscale market.

Deerfield builder Steve Kozer agreed that his high-end clients are attracted by such flourishes in his luxury homes. The \$2 million home he has up for sale in Deerfield has Brazilian cherry flooring throughout the upper two floors, a "bubble tub" in a master bathroom that is itself the size of a normal bedroom, and two staircases to the second floor. The 2,000-square-foot finished basement is the size of a small home. The house was designed by architect Arif McAlpine.

Kozer, who has been in the construction business since 1971, agreed that some amateur speculators may be feeling pain.

Sale price must triple price of teardown

The \$2 million price tag of the new home is necessary when considering the rule-of-thumb that says the sale price of the luxury home must be three times the price paid for the teardown lot. In Deerfield, ranch homes to be torn down are now selling for as high as \$600,000 to \$700,000, up from about \$450,000 a year or two ago, Kozer said. Builders hunt for teardowns in towns such as Deerfield and Hinsdale because of the excellent schools, low crime rate, and good transportation.

Kozer, who had been a commercial builder, said he and his artist wife, Patty, who does much of the design work, made a decision to sell only one \$1 million-plus home a year on spec for the last five years.

Until this year, every luxury home Kozer built was snapped up, even before it was finished. Now the \$2 million home on Northwoods Drive in Deerfield has sat for the longest period ever, six months, although one prospective buyer expressed interest if Kozer agreed to add several more rooms to the back of the 7,000-square-foot home, he said.

But Kozer said he likes the risk and thinks he can keep building luxury homes in Deerfield for another 10 years before the supply of teardowns runs out.

"I'm a gambler. Are you asking if we sleep at night? Yes, we sleep at night. I have financing from banks. I don't worry," he said.