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NAR: Baby Boomer Investors Fueling Second Home Market Sales

The U.S. second home market is gearing up for what is virtually certain to be a series of record years for sales volume. But new research suggests that the buyers currently jumping into that market are strikingly different from buyers barely three years ago.

The new wave of second home purchasers--the leading edge of the baby boom demographic shock wave--are far more investment-oriented than their predecessors, according to a new national study conducted by the National Association of Realtors in conjunction with Escapehomes.com. Many more of them are buying to make money, not to spend weekends at the beach sipping margaritas.

Whereas just 20 percent of second home buyers in 1999-2000 had investment returns as their primary motivation, nearly double (37 percent) of second home buyers last year ranked rental income as their primary objective. The study defined "investment" properties as those rented out for an aggregate six or more months per year, and rarely if ever used personally by their owners.

Traditional "non-investment" second homes, by contrast, are primarily purchased for personal use and only sporadically rented out.

Why the dramatic switch?

According to NAR economist Thomas Beers, the "slumping stock market" and the continuing high appreciation and capital gains from residential real estate have grabbed the attention of the baby boomers. While the Dow Jones index is off by 25 percent over the past three years and the Nasdaq down by 65 percent, Beers notes, residential property has been gaining value impressively. Nationwide, home values are up by an average 38 percent over the past 60 months alone, according to the Office of Federal Housing Enterprise Oversight. But for many resort areas on the East and West coasts and in resort communities elsewhere, average gains have been even higher. Some well-located properties along the mid-Atlantic coast have doubled in resale value since 1997.

Who are the new, investment-minded baby boomers snapping up resort condos and homes? The NAR study of a national statistical sample found that the typical purchaser is 56 years of age, married with no children living at home under age 18, and is relatively affluent, with a household income of \$92,000.

Equally important: the baby boom shock wave is just getting started on second homes. Each year for the coming decade, according to NAR estimates, enough consumers will hit their mid-50s--the prime buying years for second homes--to expand construction in this sector by 150,000 units a year.

A key sub-trend documented by the study: Nearly 30 percent of all buyers expect to convert their second homes into their primary homes sometime in the future. That move would provide a neat way to get maximum use of the federal \$250,000/\$500,000 tax-free capital gains exclusion.

For example, a married couple in their mid-50s right now could buy a second home in a resort community, rent it out for the next five to seven years, then sell their principal home tax-free, and convert the rental home to their new principal residence. That would start the tax clock ticking again on their resort residence, and allow them to pocket all gains on the house tax-free (up to the \$500,000 limit) after just 24 months of ownership and use.

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The University of California Transportation Center, founded in 1988, facilitates research, education, and public service for the entire UC system. Activities have centered on the Berkeley, Davis, Irvine, Los Angeles, Riverside, and Santa Barbara campuses.

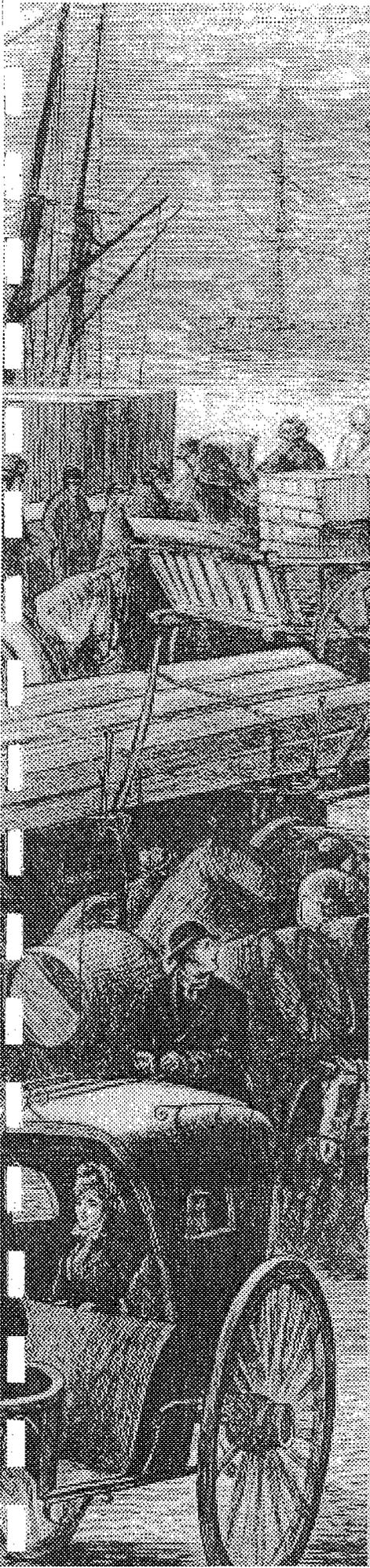


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The Land Use/Transportation Connection (cont'd)

BACK IN THE 1950s and 1960s, a basic aim for the newly proposed BART system was to curb urban sprawl. The trick was to reinforce major metropolitan centers and create new suburban subcenters. Because land adjacent to BART's station sites would be highly accessible, its planners expected they'd be powerful magnets attracting offices, shops, and high-density housing. Those concentrations would make for culturally enriched residential life and a more viable local economy. In turn, they'd attract riders to BART and thus help reduce traffic congestion.

Our mid-'70s assessments of promised land use effects were pessimistic, but probably premature, because land use changes are slow to show up. Now, some two decades later, it is possible to assess BART's influence on Bay Area development with greater precision and confidence.

John Landis and Robert Cervero have conducted a new series of land use studies around BART lines and stations, and they summarize their findings here. Their conclusions confirm those of the earlier assessment: Downtown San Francisco's office employment has indeed expanded dramatically near BART stations, but there has been only modest development around other stations—whether urban, suburban, or exurban. They find BART has had little influence on the location of either population or employment. Indeed, growth rates were lowest in those suburban corridors served by BART, and suburban office construction favored places that lack BART service.

Patronage has also fallen short of expectations. Initial forecasts expected 258,500 daily riders in 1975. Now, 24 years later and after a 30 percent increase in population, there may not yet be even that many riders on the original lines.

Metropolitan areas around the country have been building or extending rail systems and, with some notable exceptions, experiencing similarly disappointing patronage and urbanization effects. One exception is Washington's Metro, whose Orange Line route into Virginia is now a rapidly urbanizing corridor with a series of new, high-density subcenters surrounding stations. Although BART is several years older, nothing resembling such dense concentrations has emerged near its suburban stations (see photos on page 12).

Four explanations may account for the differences.

(1) At the outset, more auto ownership and an extensive network of highways and freeways endowed the Bay Area with

a higher level of region-wide accessibility. The additional accessibility at BART stations was but a small increment and hence largely inconsequential.

(2) In the absence of numerous transit riders living or working at stations, these sites are less attractive to real-estate investors than are dispersed and spacious sites readily accessible by automobile.

(3) Unlike Metro's complex network of intracity lines, BART is essentially a suburban commuter railroad with two main lines reaching to outlying stations. Those stations are largely surrounded by paved lots offering free parking and occupying much of the adjacent land.

(4) As Jonathan Levine explains in his accompanying article, so long as land use regulations continue to limit locational choice for families and businesses, the land market can't respond to induce desired urban and travel patterns.

Suburban centers along Washington Metro's lines are direct products of active engagement by local governments collaborating with private land developers. Together, they changed land use regulations, exploited urban-redevelopment options, created joint-development enterprises, and forged tax and other financial incentives that encouraged high-density housing and high-rise office buildings. Metro thus became an effective instrument for city-building.

In contrast, it seems that BART saw itself primarily as a railroad rather than as an agent of urban development. So it didn't actively work with local governments to change the zoning, or with real-estate developers and financial institutions to build at stations. The absence of intensive suburban centers then translated into too few riders. In turn, BART's low patronage was little inducement to concentrated suburban development. In further turn, continued low density meant continued low patronage.

Our experience here suggests it's not enough just to install rail transit. It should now be apparent that we can't rely on trains alone to restructure the land market so that it spontaneously induces desired urban forms or attracts sufficient riders. Once again, events have exposed the intrinsic interdependencies between land use and transportation, showing that we can't treat the one without the other.

Melvin M. Webber



INITIAL EXPECTATIONS AND PROCESSES OF CHANGE

Initial Expectations

The politicians, planners, and business and civic leaders who advocated building BART in the 1950s and 1960s did so expecting that BART would affect Bay Area development patterns in three related ways. First and foremost, BART would relieve mounting congestion problems on the Bay Bridge and major freeways, thereby insuring San Francisco's continuing dominance as the economic and political center of northern California.

Second, they hoped BART would serve as a structure for the inevitable outward suburbanization of the Bay Area. Rather than decentralizing willy-nilly, as Los Angeles was doing, the Bay Area would evolve into an efficient hierarchy of interdependent urban centers and subcenters, each specializing in some activity essential to the economic life of the region. Downtown San Francisco would stand at the apex of this hierarchy. One level down, Oakland and San Jose would serve as regional centers. One level further down were various subregional centers: Berkeley, San Mateo, Palo Alto, San Rafael, and Walnut Creek. BART would support this structure by linking these centers to each other and to suburban residential areas, creating points of high accessibility that would attract offices, high-density housing, and commerce. In doing so, BART would discourage leapfrog development and urban sprawl, which were regarded as economically and socially wasteful.

Third, BART would serve as a catalyst promoting redevelopment and reinvestment in older areas of Oakland, Berkeley, and Richmond, while promoting higher-density residential and mixed-use development in growing suburban jurisdictions. BART's success in meeting this last objective would depend on supportive land use and redevelopment policies at the local, neighborhood, and station-area levels. In the absence of such policies, BART's effects on the prospective built form of the Bay Area would be minimal.

Processes of Change

The processes through which transportation investments like BART affect urban development patterns are reasonably well understood. The principal effect of metropolitan transportation investments is to make previously distant sites more accessible, thereby adding to the supply of developable land within the metropolitan area. Able to purchase land more cheaply and still maintain their prior level of accessibility, households, stores, and businesses respond by moving outward. The resulting competition for suburban land causes site prices to rise above previous agricultural levels but below central city levels. If and when new agglomeration economies arise, usually among complementary land uses, land prices may increase further. Alternatively, rail transportation investments may serve to relieve congestion. ➤

Employment Changes

Outside San Francisco, a similar pattern emerged in employment changes (Figure 2). From 1970 to 1990, job growth mostly occurred away from BART. Employment grew 84.5 percent in non-BART superdistricts compared to 38.9 percent in the BART-served ones, mirroring the trend of job decentralization that was occurring throughout the U.S. At the county level, employment grew seven times faster in non-BART portions of Alameda County than in the BART-served portions, and non-BART superdistricts in Contra Costa County added jobs at twice the rate of BART-served areas. Growth percentages can sometimes be misleading: in absolute terms, 153,000 more jobs were created in BART-served superdistricts of Alameda and Contra Costa Counties than in the non-BART superdistricts.

A finer-grained analysis of employment growth by zip code showed marked disparities between San Francisco and the other counties for the 1980-90 period according to data at zip code level from *County Business Patterns*. The 35 zip codes in the three counties with BART stations gained 139,400 jobs from 1981 to

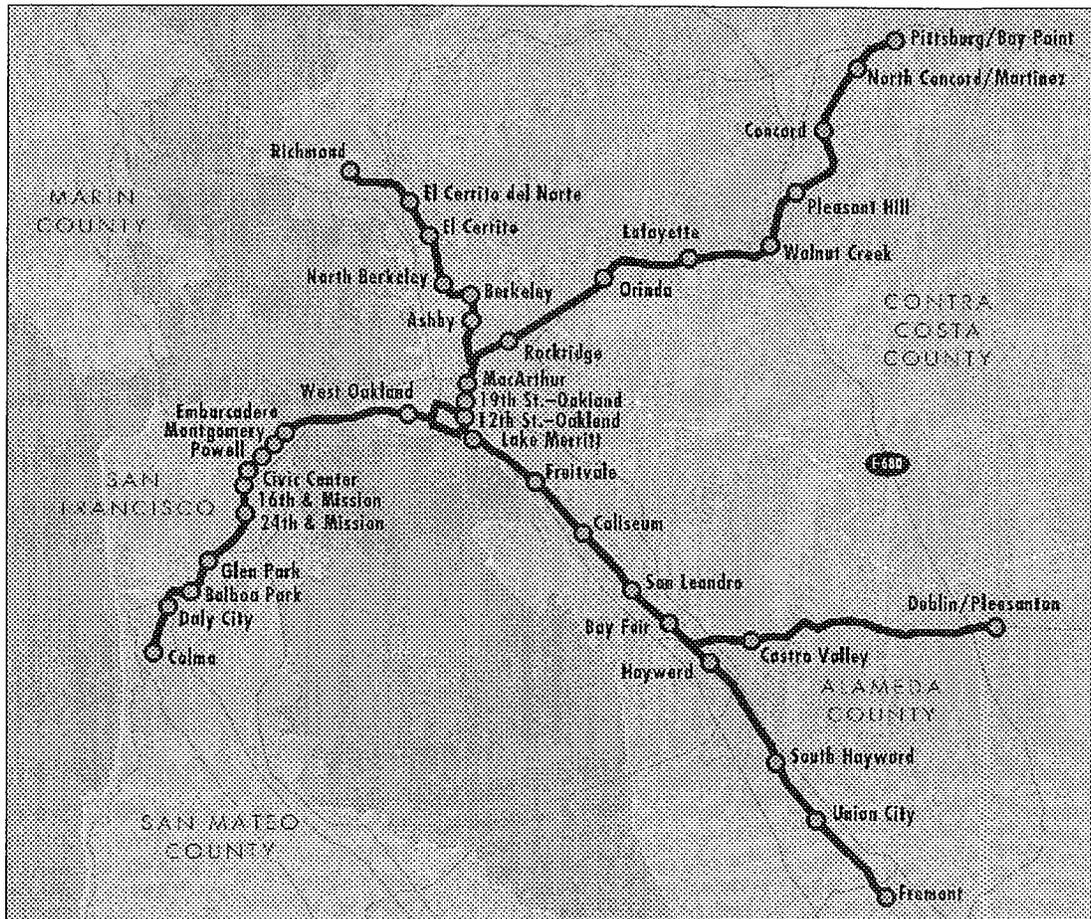
1990, growing by 30.3 percent and accounting for 57.1 percent of employment growth in the three counties. Employment in the 117 non-BART zip codes increased by 110,300, or 19 percent. However, almost all the BART-related employment growth occurred in San Francisco. Jobs in East Bay zip codes by comparison increased just 1.1 percent.

We also compared BART and non-BART employment growth differentials by business sector. The two sectors in which employment growth was most consistently concentrated in BART-served zip codes were Finance Insurance and Real Estate (FIRE), and non-Business Services. Even in these two sectors, however, employment growth was hardly uniform: it most favored BART-served zip codes in downtown San Francisco and along the north I-680 corridor.

In summary, job growth has been consistently higher around BART stations in downtown San Francisco than elsewhere in the region. In the East Bay, job growth has generally been faster away from BART, especially in the south I-680 corridor. ➤

BART SYSTEM MAP

-  BART line
-  BART station
-  Major highway



DEVELOPMENT ACTIVITY IN AND AROUND BART STATIONS

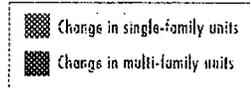
Residential Construction

We estimate that approximately four thousand housing units were demolished during construction of BART and related redevelopment projects. Once construction was completed, planners hoped these units would be replaced, and indeed, added to. But it didn't quite work out that way: disinvestment in housing near BART stations continued well after BART was completed. Between 1970 and 1990, housing units within a quarter-mile of BART stations declined by nearly four thousand units, or roughly -11 percent. In contrast, the number of housing units in BART-served cities grew by 20 percent, and Alameda, Contra Costa, and San Francisco counties together experienced a 25 percent increase. The loss of housing units around BART stations was mostly a downtown phenomenon in Berkeley, Oakland, and San Francisco (Figure 3).

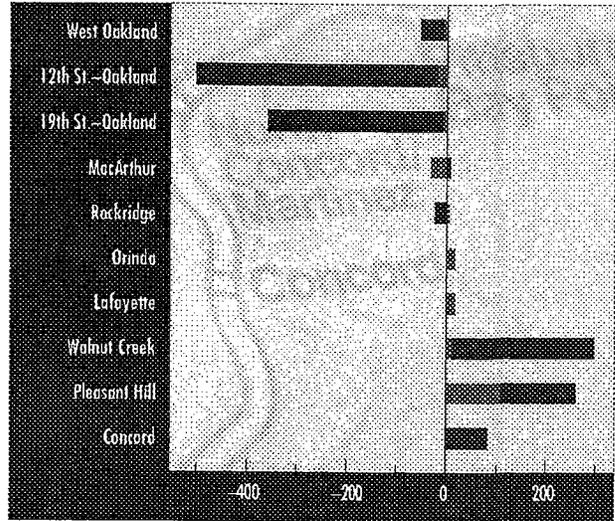
Additions to the housing stock, where they have occurred, have been concentrated at suburban stations, along the Fremont line, and near the end of the line. Most gains—as, indeed, most losses—have been apartment units. Property values and congestion levels near BART stations are generally too high, and neighborhood services and amenities too low, to attract single-family homebuilders.

FIGURE 3

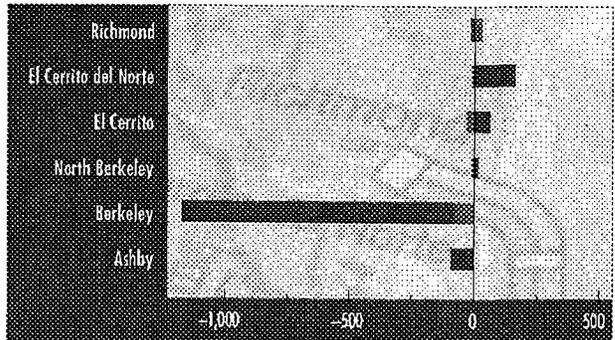
BART station areas: change in single- and multi-family housing units, 1970-1990



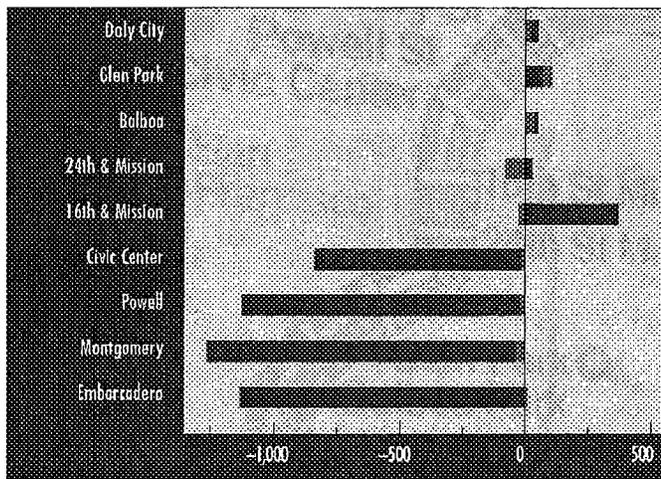
Concord Line



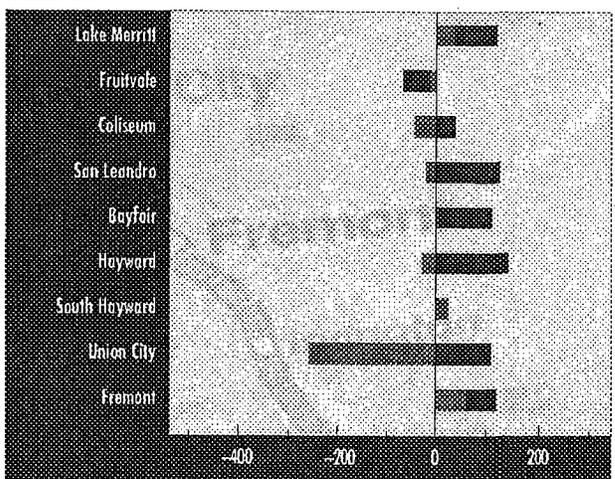
Richmond Line

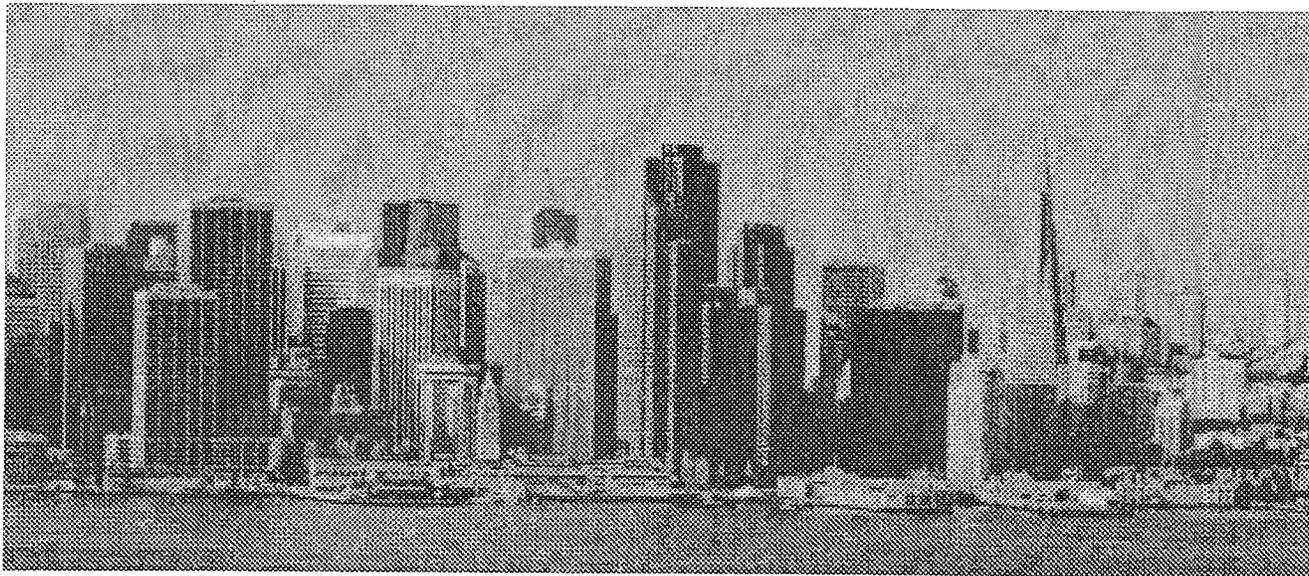


San Francisco Line



Fremont Line





The photo at left is at the same scale as the one above.

1992

To test these propositions, we compared 1990 prices and characteristics among a sample of 2,360 home sales in Alameda and Contra Costa counties. We used a geographic information system (GIS) to address-match each transaction to its street address, and then measure its distance to the nearest BART station and the nearest freeway interchanges, and determine whether or not it was within 300 meters of an above-ground BART line or freeway.

All else being equal—that is, controlling for house size, age, number of bedrooms and bathrooms, income in 1989, neighborhood ethnic makeup, and being directly adjacent to a BART line or freeway—homes near BART stations in Alameda and Contra Costa counties sold at a premium, while homes near freeway interchanges sold at a discount.

For every meter closer an Alameda county home was to the nearest BART station (measured along the street network), its 1990 sales price increased by \$2.29. For Contra Costa homes that sold in 1990, the sales price premium associated with the nearest BART station was \$1.96 per meter. The opposite effect held for freeway proximity: Alameda and Contra Costa homes near freeway interchanges sold for less than comparable homes elsewhere. For every meter it was closer to a freeway interchange, the 1990 sales price of an Alameda county home declined \$2.80. The per meter discount associated with highway accessibility was even greater in Contra Costa County: \$3.41.

These findings are subject to three caveats. First, as significant as they are, these transit premiums are not large enough by

themselves to promote redevelopment or increased residential densities. Supportive land use policies and, where appropriate, subsidies and incentives, are also necessary to encourage residential upgrading. Second, the existence and magnitude of a station-access capitalization effect is by no means a sure thing. A similar analysis of houses near Sacramento and San Jose light-rail stations and San Mateo CalTrain stations failed to identify any such premiums.

Furthermore, the fact that a BART-access premium existed in the East Bay in 1990 does not mean that home values were correspondingly higher in every home in every neighborhood near a BART station. In neighborhoods suffering from weak housing demand, or where the quality of the housing stock is poor, there may well be no additional value associated with transit access.

BART and Office Rents

We used a similar approach to investigate the influence of BART service on office rents. We compared differences in 1993 office-building rents and vacancy rates in Alameda, Contra Costa, and San Francisco counties as a function of proximity to the nearest BART station. We culled listings for individual office buildings from *Black's Office Leasing Guide: 1993* (San Francisco Bay Area edition), and matched addresses to their appropriate street locations. BART proximity was measured using concentric rings of 1/8, 1/4, 3/8, and 1/2 mile around each BART station, except in downtown San Francisco, where it was measured using 1/8 and 1/4 mile rings only. ▶

Just about everyone agrees that developing housing near BART stations is a good idea. In practice, it has always been a tough sell. Until recently, Bay Area apartment developers were more interested in suburban properties than older urban neighborhoods. Local general plans and development policies were—and to some extent, still are—indifferent to multi-family housing development. In addition, residents of established single-family neighborhoods around BART stations like North Berkeley and Rockridge have long opposed residential densification of any form. Except at a few isolated stations like Fremont, Pleasant Hill, and now Fruitvale and Castro Valley, opportunities for large-scale residential development have been sparse.

Thus, notwithstanding thirty years of demolition and construction, most near-BART housing is what it was and where it was two decades ago. In 1990, apartments comprised about three-quarters of the housing stock at BART station areas, about the same as in 1970.

Office Construction

In contrast to housing, BART has had a significant concentrating effect on office development, but only in San Francisco (Figure 4). In 1962—the year local funding for BART was approved by voters—the supply of office space in San Francisco stood at 18.8 million square feet. About half this total was located in the downtown area, within a quarter-mile of what would be

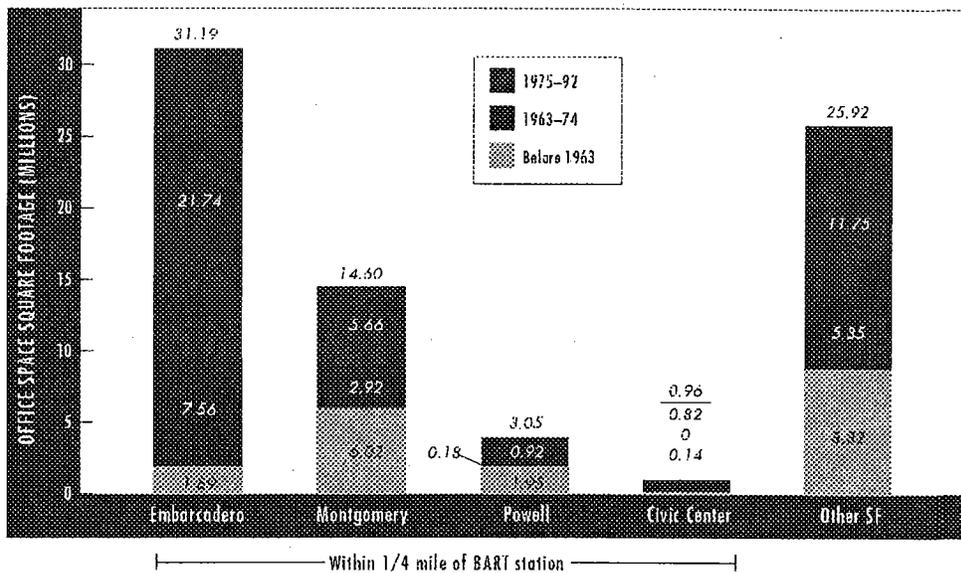
SOME HOUSING SUCCESS STORIES

There have been some notable exceptions to the tepid performance of housing around BART. BART's greatest housing success story is at the Pleasant Hill station, on the Concord line. Until 1988, the Pleasant Hill station was surrounded by a mix of modest single-family homes and open fields. Between 1988 and 1993, over 1,900 housing units were built within a quarter mile of the station—despite the station's being enveloped by BART's largest parking lot and lying in an unincorporated part of Contra Costa County. In many situations these conditions would have suppressed land development.

Three factors contributed to Pleasant Hill's turnaround. First, a regional, specific plan created in the early 1980s served as a blueprint for guiding growth. Second, a proactive redevelopment authority aggressively sought to implement the plan by assembling irregular parcels into developable tracts, seeking out private co-ventures, and investing in supportive public infrastructure. Third, a local elected official became the project's political champion, working tirelessly and participating in numerous neighborhood meetings to shepherd the project through to implementation.

FIGURE 4

San Francisco office space construction by period



Source: Black's Guide 1993

along the Embarcadero during the 1950s and 1960s. Large parcels suitable for modern office buildings were thus available for development right at what would become San Francisco's premier BART station.

More recently, San Francisco officials and citizens have adopted a succession of public policies aimed at concentrating office development in the downtown area and preventing its intrusion into residential neighborhoods. The first such policy was the Downtown Plan, adopted by the Board of Supervisors in 1985 and subsequently followed almost to the letter. The Downtown Plan was followed in 1986 by the passage of Proposition M, a citizen initiative limiting annual office construction to 400,000 square feet, thereby forcing office developers to compete for allotments. The ratings system adopted by the city for evaluating competing office development proposals strongly favors downtown locations. This has had the effect of making downtown sites even more valuable.

Taken together, these three policy initiatives: site clearance and land assembly, downtown-oriented commercial zoning (later augmented with development incentives), and the construction of a supporting transportation infrastructure (BART) have successfully prevented office development from decentralizing within San Francisco.

Ironically, these same policies helped to promote office decentralization outside of San Francisco. As downtown San Francisco office rents rose, partly in response to Proposition M construction caps and partly because of the inconvenience and high cost of development downtown, more and more office tenants began looking elsewhere in the region for office space. These tenants found cities with excess highway capacity, plentiful supplies of developable land, relatively liberal zoning and land use policies, and a yen to become a suburban office center. In the absence of a regional growth-coordinating agency, cities began competing with each other for commercial development.

Oakland, the one other city in the region well-positioned to use BART to catalyze downtown development, was unable to attract significant new office development. Instead, office developers and office tenants turned their attention to the Interstate 680 corridor in central Contra Costa County. The northern part of this corridor, the area between downtown Walnut Creek and downtown Concord, was served by BART. The southern part, from Danville to Pleasanton, was not. Except in downtown Walnut Creek—and even there, not until the mid-1980s—BART service was not a significant inducement to office developers.

BART AND OAKLAND

While BART has clearly helped downtown San Francisco maintain its economic vitality, its relationship with downtown Oakland is more complicated.

During BART's first ten years, virtually no new buildings were built around downtown Oakland's three stations. Things changed markedly since the early 1980s, thanks mainly to the construction of Oakland City Center, an ambitious office-retail complex built atop and linked to the 12th Street BART station that has received several design awards. Credit for City Center belongs jointly to the Oakland Redevelopment Agency, which provided a combination of land-assembly, tax increment financing of public infrastructure, securing federal urban-renewal grants, subordination of loans, and equity participation (including majority ownership of a downtown convention hotel), and Bromalea-Pacific, a private development company that is headquartered in Toronto and thus familiar with transit-oriented downtown development.

Altogether, more than 1.6 million square feet of new office space (about 30 percent of the city's inventory) has been constructed in downtown Oakland since 1983. While this is certainly less than the volume of office space constructed in downtown San Francisco, it is probably more than would have been constructed in the absence of BART.

PATTERNS OF LAND USE CHANGE

Although BART has clearly had *some* localized influence on development activity at *some* stations, how far that influence extends and whether it has been systematic remain open questions. To gain a clearer understanding of BART's influence, we developed a series of statistical models of land use change in Alameda and Contra Costa counties between 1985 and 1995. (There were too few instances of land use change in San Francisco County.) The models track ten-year changes at the one-hectare (100m by 100m) site level.

We evaluated five types of undeveloped land use change and four types of redevelopment: no change in undeveloped land; change from undeveloped land to single-family residential use; change from undeveloped land to multi-family use; change from undeveloped land to commercial use; no change in developed land use; redevelopment from nonresidential to residential ▶