

# Brazil – Latin America's emerging luxury second homes' location

A European perspective

Itacaré Capital

Knight Frank 



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# 01 Introduction

Second home ownership has been apparent since ancient times, although the financial ability to achieve this has remained the preserve of a very small minority until relatively recently. It is only over the past few decades that the ability to acquire a second home has become more widespread across society.

This trend has gathered pace as not only the scale of second home acquisition has increased exponentially but both the drivers and the geographical horizons have also evolved and expanded.

This has had considerable impact on a number of key areas of modern day life – from environmental issues, banking systems and local economies to general attitudes towards lifestyle. Not all of this impact has been positive and some voices have questioned the longer term sustainability of what has become a major industry in its own right.

However, we live in a consumer driven society and it is clear that a large and growing number of households wish to acquire a second home, whether it be for leisure or for investment reasons. Combined with their ever greater financial muscle and an increasingly wide choice of second home product it is hard to see an end any time soon to the growth of the second homes' market.

Thanks to greater purchasing power and the rapid growth and geographical spread of air travel, together with greater media coverage and the development of the internet as a marketing medium, second home buyers are increasingly looking at overseas opportunities.

This is often also linked to the desire for a location which offers the usual benefits of good climate and attractive surrounding environment, but which also offers something different from "the pack" whether it be an exotic location, ethnic interest or idyllic seclusion.



It is for these reasons that many locations, previously only popular among tourists, are beginning to attract second home, and in some cases, retirement buyers to locations outside their own country. The 2008 Knight Frank/Citi Private Bank Wealth Report suggests that certain emerging markets, including Brazil, "should be on every investor's radar" because of their strong GDP growth and wealth creation.

This report considers the market for luxury second homes in Brazil from a European perspective, how it is evolving and what prospective buyers may expect from a country which offers some of the world's most spectacular landscapes and exotic culture.

In putting this report together, we have drawn on the experiences of Knight Frank in the international second homes' arena, as well as those of our Brazilian partners Knight Frank Newmark, together with selected interviews with developers and HNWI (High Net Worth Individual) buyers.

# 02 The Brazilian luxury second homes' market

Within an international context, the Brazilian second homes' sector falls into the category of "emerging market" with relatively little product currently available, of which only a very small proportion can be described as being of genuinely luxury quality. However, the next few years are expected to bring a significant increase in the overall volume of second home supply in Brazil (including an increase in luxury developments) which, allied to a more widespread marketing approach, should place Brazil firmly on the map as a location of choice for international buyers.

In the following sections we examine the evolution of the market for luxury second homes in Brazil and its likely future direction, focussing on the key growth drivers.

## 2.1 Market origins & evolution

There is an obvious and important link between tourism and second home ownership – arguably the majority of second home owner-occupiers will have holidayed in the region in which their properties are located. Brazil has traditionally attracted the more intrepid traveller seeking a sense of adventure as well as the beauty and uniqueness of its natural environment and culture. Thanks to a concerted effort by the Government, this is changing and Brazil is on the road to becoming a more mainstream tourist destination.

The Programme for the Development of Tourism in the Northeast (PRODETUR-NE) which commenced in 1994 invested heavily in diverse tourism related areas including environmental planning, basic infrastructure, marketing and job skills training as well as extending and modernising tourist facilities. The Ministry of Tourism has subsequently developed the National Plan for Tourism (NPT), which aims to achieve the following core objectives:

- Increase the number of inbound tourists to nine million a year;
- Generate US\$8 billion annually in tourism revenues;
- Achieve 65 million domestic arrivals per year;
- Create 1.2 million new jobs.

The fruits of these efforts can be seen in the substantial influx of international visitors in recent years, in particular in the northeast of the country, accompanied by significant foreign inward investment. The next few years will be characterised by the maturing of the Brazilian tourism industry, through increased professionalism and greater destination diversity. The quality and range of services and facilities should also improve greatly, as more international luxury resort developers enter the market.

## 2.2 Geography, climate, cultural attractions

Brazil is a vast country offering a wide variety of landscapes and topography, spanning four time zones, and straddling both the Equator and the Tropic of Capricorn. Occupying roughly half of South America and bordering the Atlantic Ocean, it covers a total area of 8,514,215 km<sup>2</sup>. Brazil is bordered by Argentina, Bolivia, Colombia, French Guiana, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela.

Having such a large land mass Brazil has many different climatic regions. Typically, though, it is a tropical country with beautiful beaches and the world's largest tropical rainforest. Brazil also boasts more ecological diversity than any other country in the world.

The biggest cultural event on the Brazilian calendar is the Carnival in Rio de Janeiro. This world famous event and its evocative music and dancing is synonymous with how Brazil and Brazilian's are depicted internationally, and the country is generally viewed as a fun loving, relaxed destination. Brazil is also associated with "the beautiful game" (a phrase accredited appropriately to Brazil's most famous footballer Pelé) and will host the Football World Cup in 2014 which is expected not only to bring in even more visitors but also trigger major infrastructure investment.

## 2.3 Security

Whilst Brazil is linked with the glamour of carnival, bikini clad beaches and its love of football, the country is also

characterised by a high level of crime – although this is mainly apparent within the urban areas of Rio de Janeiro and São Paulo. Poverty and a lack of recreation facilities and education are root causes – 75% of Brazil's municipalities have no cultural or leisure facilities and the adult literacy rate is around 89%.

This scenario is typically characteristic of developing countries and many of these negative traits are diminishing as the economy expands and matures. We should not forget that many developed economies who have benefited from the transition from agrarian to industrial and most recently a technology driven services-based economy are also not free from crime and security issues.

#### 2.4 Demographic situation & outlook

Brazil is a country of some 190 million people – the fifth most populous in the world. The relatively young population has a median age of 28.6 years and a growth rate of 1% (low by South American standards). Catholicism is Brazil's dominant religion stemming from its Portuguese colonial roots. Most Brazilians can trace their ancestry back to the country's indigenous people, the Portuguese colonies and African slaves.

This melting pot of different cultures has allowed Brazil to develop its own unique colourful culture.

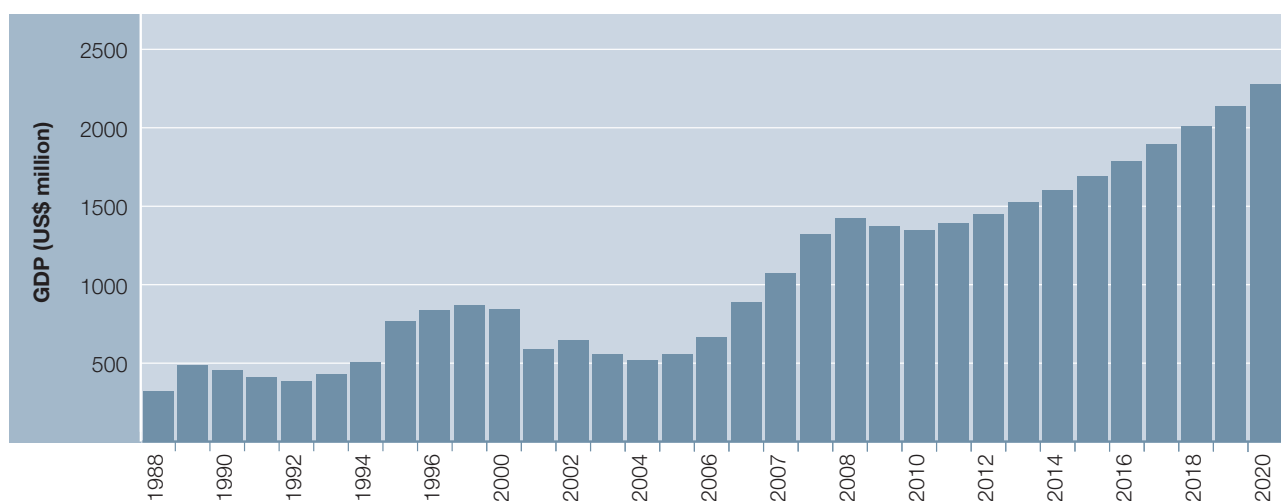
Despite Brazil's economic growth and subsequent strength, 31% of the population remain under the poverty line with an unemployment rate of 10%. The lowest 10% of Brazil's income earners only account for 0.9% of the country's total income whilst the top 10% account for 45%.

#### 2.5 Economic situation & outlook

Brazil recently topped the Morgan Stanley Capital International (MSCI) Global Emerging Markets Index as the world's biggest emerging market – usurping global behemoth China for the first time. The Brazilian economy is heavily biased towards primary production, both minerals and agriculture. Recent record global mineral and food prices have enabled Brazil to achieve GDP growth of 5.4% in 2007 compared to 3.8% in 2006.

Brazil is becoming a more transparent and open economy and is adopting, as well as developing in its own right, technology to increase the productivity of its primary production. The country is looking forward to a prosperous future with a commodity

Figure 01: Brazil's GDP



Source: WTTTC

## 02 The Brazilian luxury second homes' market

driven current account surplus which means the economy is less exposed to any fluctuations in the US economy. Growth in Brazil's middle class as a result of successive years of economic growth and the introduction of long term mortgages (previously unavailable) have prompted many pundits to predict an increase in home ownership and a subsequent increase in property values. This should additionally have some positive knock-on effect for the second homes sector.

The economy is expecting a considerable boost following the discovery of what is believed to be the world's largest offshore oil field. The "ultra-deep" Tupi field off the coast of Rio de Janeiro is unlikely to fully come on line until 2013 but is expected to have a total value of US\$25 billion to US\$60 billion allowing Brazil to join the ranks of the World's major oil exporters.

Additionally, the Government is actively encouraging tourism growth which is viewed as a means of fast tracking economic growth. Investor confidence in Brazil is best exemplified by the massive growth of foreign direct investment (FDI) flowing into the country, which doubled in 2007 to US\$37.4 billion, exceeding FDI flows to Japan and India.

### 2.6 Accessibility

Brazil has a relatively underdeveloped road infrastructure. Conversely, the country has a well developed air transport system, including 48 main airports, 21 of which are international. Given the size of the country, air travel is likely to be the preferred option for tourists to travel any distance within the country. The former CEO of Jet Blue has recently announced plans to set up a new nationwide airline service within Brazil.

### 2.7 Second homes' supply

The second homes' market is concentrated mainly in the coastal regions of the states in the northeast (a popular destination with Europeans and Americans) and along the coasts of the states of São Paulo, Rio de Janeiro and Florianópolis (popular with wealthy Brazilians and other South Americans). There is also a traditional market for country homes located in mountainous regions in the states of São Paulo, Minas Gerais and Rio de Janeiro.

The north east coast of Brazil is where the majority of development intended mainly for the international market is currently focussed. Within this area, Bahia state is currently the focal point for high-end residential real estate development although Alagoas, to the north of Bahia, is likely to be the next state to see luxury residential development on any scale. The states of Rio Grande and Ceara have seen a fair amount of development, although there are no genuinely luxury products. A major advantage which Ceara enjoys, however, is its relative proximity to Europe – the state capital Fortaleza is around 6 hours flight time from Portugal.

Further south in the North East region the resort market is dominated by domestic buyers, primarily wealthy households from São Paulo, Brasilia and Belo Horizonte. Relatively few second home buyers come from Rio de Janeiro as they already live by the sea. Argentineans have at times been active in this market, although their volatile economy often dictates whether they are purchasers or sellers.



The northeast coast has approximately 3,300 km of beaches and currently boasts around 150 developments on the market. The majority of these projects are small (typically not exceeding 50 units with site areas of less than 50 hectares) and of

questionable quality. Many developers lack the sophistication to complete high quality resorts; about half are foreign and of the Brazilian developers, few are nationally known. The rapid emergence of this market has also attracted a number of speculators with varying abilities resulting in hugely varying resort qualities and prices.

This situation is expected to change in the near future as a number of large national and international developers as well as investors enter the market, who will develop large, fully integrated resorts offering a luxury product. As the quality of the resort offer improves this should attract more high-end buyers to the market.

### 2.8 Second homes' demand

Although there is domestic demand for luxury second homes, the target buyer market is largely focussed at international buyers, especially for resort properties in the northeast of the country. Our survey of developers currently operating within the northeast coastal area reveals that the majority of their enquiries are from Portuguese buyers (see Figure 2 below). This is

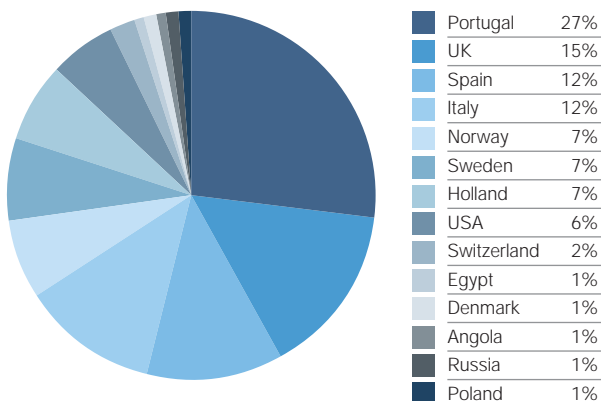
unsurprising as Brazil is a former Portuguese colony and the two countries share the same language. The next most active buyer group is from the UK (15%) followed by the Spanish and Italians, both accounting for around 12% of demand.

It is clear from this analysis that Europeans currently account for the bulk of enquiries – over 90% – which suggests that developers are right to focus their attention on the European buyer market.

Whilst the above illustrates the proportion of enquires from each country, local marketing agents expect that the majority of actual purchasers, in the shorter term at least, will come from Portugal, Spain and Italy with the UK in fourth place.

As the Brazilian second homes' market becomes more sophisticated and is more widely promoted, and with increased activity from international developers, it is likely that the demand from international purchasers will increase and emanate from a broader range of nationalities.

Figure 2: International demand for Brazilian luxury second homes



Source: Knight Frank Newmark



## 02 The Brazilian luxury second homes' market

The limited supply of luxury second home resort property in Brazil means that there is also a limited pool of actual purchasers from which to draw analysis. From our research we have identified a typical age profile of between 35-50, employed in either a senior managerial capacity within industry or in financial services, or a professional. However, with wealth being accumulated at a younger age than ever before and HNWI's building up their wealth from an increasingly diverse range of activities, this profile may well change over time.

A common theme among luxury purchasers in Brazil which has greatly influenced buying decisions is the commitment shown by the developer towards the quality of both the build and design of properties. To this can be added the undoubted attraction of a recognised brand which is also involved in the development – whether it be a 5 star hotel operator, or an internationally renowned architect or designer.

Looking ahead, we are aware that a number of leading international hotel operators are looking for resort opportunities in Brazil. This will greatly help to raise the profile of the luxury residential sector which in turn should generate increased international buyer interest.

Finally, it should not be overlooked that as the Brazilian economy expands, a growing number of households will become sufficiently wealthy to enter the luxury second home market which should provide an additional stimulus for growth.

The discretionary nature of second home purchases, together with the large number of factors which can influence international second home buying decisions (which we consider in more detail in Section 4), make it extremely difficult to predict what future demand will be. Additionally, there is no official monitor of second home sales volumes in Brazil in the public domain and it is therefore not possible to assess future demand against historic demand. However, we can look at examples of other markets which have evolved from a position similar to that which Brazil currently finds itself in.

For example, due to various legal and planning difficulties, the integrated residential resort market in Greece is only just beginning to emerge. According to the Invest in Greece Agency, recent studies suggest that potential foreign buyer demand for second homes in Greece could reach up to one million units over the next decade. It is not unreasonable to suggest that Brazil's market potential could equal or even exceed that of Greece given its draw not only for the European market but also from North America as well as the rapidly growing South American markets.

### 2.9 Prices

Given the immaturity of the market for second homes of genuinely luxury standard, it is not surprising that average capital values in the sector are low by international standards. Our research reveals that current average unit prices in resorts along the northeast coast of Brazil are around US\$335,000 revealing a price of US\$1,422/m<sup>2</sup> for villas and US\$1,903/m<sup>2</sup> for apartments, although of course there are properties which considerably exceed this. Within the few genuinely luxury resorts, average values currently range between US\$3,000-US\$3,500/m<sup>2</sup>.

Average price growth in this area has been very strong over the past couple of years – in 2007 alone, values appreciated on average by circa 30%. This performance is reflective of the strength of the Brazilian economy, the increasing popularity of international second homes and the increasing quality of the Brazilian resort market. It is also reflective of a strong rise in land values as developers have sought to acquire prime sites.

As this market becomes more established and Brazil's economy strengthens further we expect strong price inflation to continue. However, as this market is heavily reliant on international purchasers and the strength of the international economy, it may be affected by any downturn in the global economy. Any oversupply will also impact on price growth, although in this regard it is typically prime property which proves to be more resilient than the mainstream sector.

## 2.10 Buyers' Guide

### 2.10.1 Typical acquisition costs

Purchase costs are generally lower than in most European countries and are typically as shown below:

- Municipal transfer tax (ITBI – Imposto Sobre Transmissão de Bens Imóveis) – varies between municipalities but typically 2%-3% of the sale value
- Legal fees are less than 1% of the sale value
- Agent's fees are usually in the range of 4%-6% of the sale value – this is normally paid by the seller
- Mortgages are not widely available for foreigners in Brazil and funds are typically transferred from abroad – this process attracts some additional costs.

### 2.10.2 Legal framework

Citizens of the following European countries do not require a visa to enter Brazil for tourism purposes and may stay for up to 90 days at a time and 180 days in any year:

Andorra	Hungary	Romania
Austria	Iceland	Slovakia
Belgium	Ireland	Slovenia
Bulgaria	Italy	Spain
Croatia	Liechtenstein	Sweden
Czech Republic	Luxembourg	Switzerland
Denmark	Monaco	Turkey
France	the Netherlands	United Kingdom
Finland	Norway	the Vatican
Germany	Poland	
Greece	Portugal	

With the exception of some limitations applicable in certain specially designated areas such as those along Brazil's international borders, agricultural land or marine land, there are no major restrictions with regard to foreigners buying residential properties in Brazil.

In order for a foreigner to be allowed to buy property in Brazil, it is however first necessary to obtain a Brazilian tax identity (called

a CPF – or Cadastro de Pessoa Física.). This is a number issued by the Brazilian Government to both Brazilians and resident foreigners and is a means of tracking tax liability. This is a relatively straightforward process which can be arranged by a local lawyer without the need for the foreign buyer to set foot in the country.

Freehold ownership of land and property is available and all property sales are titled – importantly, foreign buyers receive the same investment and possession rights as Brazilians. It is important to ensure that titled property is registered in the official Real Estate Register ("Registro de Imóveis") held at the notary office (Cartório) of the town where the property is located. Possession of the title deed in itself is not sufficient: it has to be registered in order for it to become legally valid and binding towards any third party.

### 2.10.3 Ownership costs

There are various taxes which are liable on the ownership of residential property in Brazil, the key ones being:

- Income from renting out a property is taxed within the normal personal income tax system, which has progressive rates from 15%-27.5%. For foreigners, the rate is 15% (or 25% if resident within a tax haven jurisdiction)
- Capital gains are taxed at a flat rate of 15% of the declared value
- There is an annual urban municipality tax (IPTU – Imposto sobre a Propriedade Predial e Territorial Urbano) with rates varying between municipalities, but typically less than 1% of the assessed property value. There is also an annual rural property tax levied on land located outside the urban zones of the municipality. This is a federal tax and rates vary depending on area of the land and the ratio of utilised land to the total land area
- For properties acquired within integrated resort developments there will be a monthly service charge which will vary between developments and according to the level of services / facilities required by the owner. This is subject to private law and the particular conventions of each project.



# 03 European buyer demand for luxury second homes'

Given the size and importance of the European second homes market it is both frustrating and surprising that there are so few official statistics on the subject. Even in those countries that do offer some degree of data provision, there are often differences in definitions and reporting depth. Our analysis therefore reflects a combination of official data and primary research, including Knight Frank's own experiences within the market.

Part of the reason why so few official statistics exist on the subject is to do with the problem of defining and identifying second homes. Different people can and do have different understandings of what the term means – for example, are mobile homes included and how are holiday properties let out to third parties and never occupied by their owners treated?

For the purposes of this study, we define a second home as a permanent structure intended for residential use, which is occupied by the owner for certain periods of time but which is not the owner's primary residence. A second home is a discretionary purchase as distinct from a primary home which is where a household is normally resident. Inevitably, there is

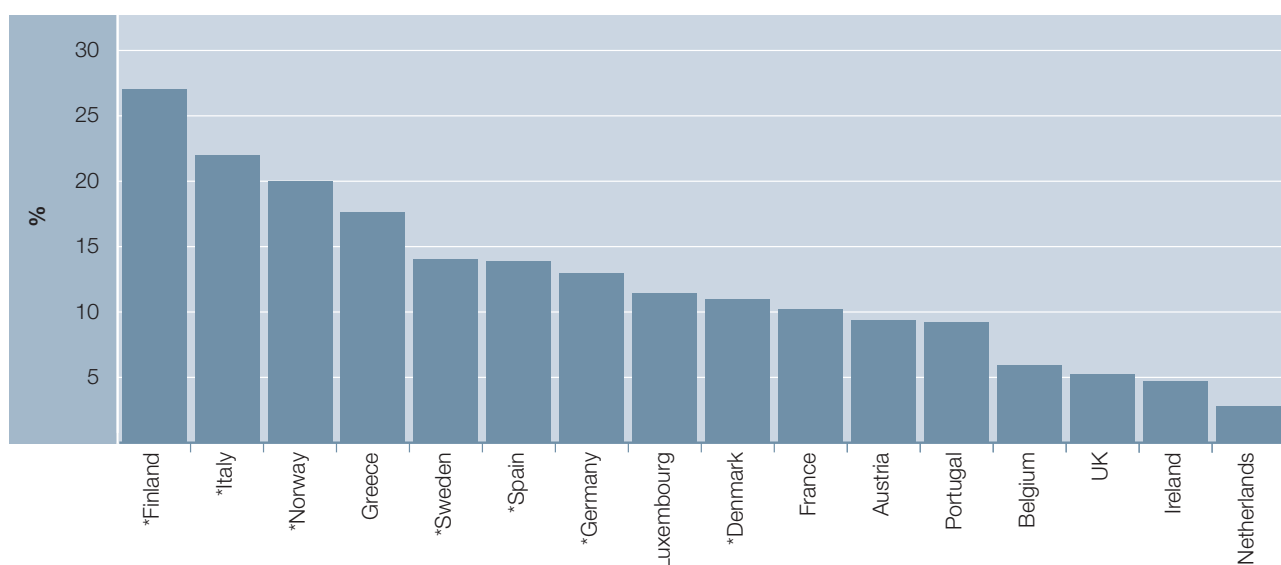
definitional blurring with regard to investor buyers – in this study we only cover those households who are not professional investors (i.e. buy-to-let investors who do not occupy the secondary properties they own) but who may rent out their second home to third parties when not in use by themselves.

Figure 3 below indicates the level of second home ownership in selected European countries, which includes those owned both within and outside their country of residence. The considerable level of second home ownership is apparent, a trend which we expect to increase as household wealth rises over time.

### 3.1 Drivers of European demand

The tremendous growth in the demand for second homes outside the buyer's country of principal residence in Europe over the past decade has resulted from a combination of factors. These have appeared pretty much simultaneously to create a hitherto largely unconsidered / unattainable opportunity for an increasing number of households, and which we examine briefly overleaf.

Figure 3: Proportion of second home ownership among European households (1996 unless otherwise stated)



Source: Various

\* Finland 1998, Spain 2001, Italy, Sweden, Germany 2002, Norway, Denmark 2006

# 03 European buyer demand for luxury second homes'

## Economic performance

The importance of a healthy, expanding economy for creating wealth, employment and consumer confidence which will have a spin-off effect on residential property demand has been demonstrated in many countries. This is important in helping to create and sustain domestic market demand and reducing the importance of overseas buyers. Although economic growth in Europe is slowing and will probably remain moderate going into 2009, the ECB believes the Euro area has sound fundamentals and longer term growth prospects are generally positive.

## Financial

There has been an unparalleled growth of significant personal wealth in recent years. This is an important trend, influencing consumption and investment patterns across the globe. This increase has also had a direct impact on the demand for second homes'. The Cap Gemini and Merrill Lynch 2007 World Wealth Report projected that high net worth individuals' wealth will increase by 6.8% per annum to 2011 – a proportion of which will undoubtedly be spent on second homes.

Tax can be a major influence in determining the purchase of a second home. This, in part, explains the popularity of countries such as Monaco and Switzerland, which offer considerable tax advantages as well as a high level of financial anonymity.

The availability of cheap and flexible credit has been a key facilitator in enabling those households lower down the wealth food chain but who nonetheless aspire to owning a second home abroad. Although the global credit crunch is currently placing strain on financial systems and there is doubtless further bad news to emerge before we finally come out of the situation, it is hard to imagine that matters will not return pretty much to where they were given the steady economic growth prospects over the medium to longer term – financial meltdown being the alternative, and less likely, scenario!

In an age when households are seeing a gloomy outlook for corporate and state pension provision and there is widespread frustration about the inherent volatility of stock markets, residential property is increasingly being regarded as a viable investment option. Furthermore, an astute second home

purchase can wash itself over time by renting out to third parties when not in use by the owners. Indeed, sometimes owners sell their primary residence and move into their second home after retirement.

Acquisition and disposal costs can also influence a purchase decision if other key factors are broadly comparable.

Currency risk can likewise affect a transaction. Exchange rate fluctuations could either add to or reduce the cost of a property depending upon completion time. The weakness of the US dollar, for example, has made dollar-denominated properties much more attractive over the past 12-15 months.

## Lifestyle

Although some second home purchases abroad are work related, most are purchased for leisure use, albeit often with a view to partial renting to third parties. In our high stress, time-deficient world many people want to "escape" to a more relaxing, pleasant environment where they can recharge batteries and where they can enjoy the fruits of their labour. Access to an environment largely dedicated to the buyer's favourite leisure pastime – such as golfing, yachting or skiing – is an additional attractant.

For others, it is as much to do with the status of second home ownership and making a tangible statement about their achievements. Depending on work/commitments and proximity to their second home, second home owners only spend on average around 4-5 weeks per annum in residence although there are some that may spend as much as 3-6 months.

## Accessibility

The rapid expansion in the number of low cost air routes has made the prospect of owning a second home abroad a more viable proposition for a wider cross-section of the population. Among the super-rich, increased private jet ownership has broadened the scope of accessible locations even further. In addition, many foreign governments have made considerable investment in improving internal infrastructure provision, making themselves more attractive as second home locations.

Financial accessibility has also been improved for buyers with developers offering staged payment options on off-plan properties which can help considerably to spread the burden of the initial cost. The opportunity, if they so choose, for buyers to sell on their property before completion adds a further element of financial flexibility.

### **Technology**

Advancements in technology are also having an impact on people's attitudes towards buying second homes. Electronic mail, global cellular phone connections and the internet allow executives to maintain contact with their companies while on vacation.

Internet technology, along with greatly increased media coverage, has also enabled buyers to become more knowledgeable than ever before on international second home markets and has opened their eyes to new and emerging locations. It also offers developers an opportunity to establish differentials between their competitors in what is becoming an increasingly crowded market.

### **Availability**

The supply of second homes has risen exponentially during the noughties. Whether in a coastal, mountain or city centre location buyers now have a range choice which has never existed before. This applies equally to the type of property and the environment within which it is offered – from apartments to townhouses and villas, and from solus properties to fully integrated resort developments. In this regard, the removal or simplification of the local regulatory framework (e.g. with regard to planning matters and the ownership of real estate by foreigners) has greatly assisted availability.

### **Security**

The emergence of modern, integrated resort developments which offer a secure, gated environment is appealing to many HNWI's. Additionally, some countries will offer some form of residency status, as is the case for example in Switzerland and Mauritius.

### **Market perception**

Buyer perception of any residential market is an important factor, especially with regard to capital value growth prospects and liquidity. Clever and sustained use of the media can help to raise both buyer awareness and the profile of a market as a second home location. The influence of journalists should not be underestimated as consumer confidence can be heavily influenced by what it reads / hears in the media. It would also help if developers in general marketed their products more widely and in a more sophisticated manner, an aspect which is usually approached more professionally on the more exclusive developments.

### **3.2 Sources of European demand**

Traditionally, the majority of second home buyers have come from the Baby Boomer generation, however changing demographic and economic patterns are resulting in a greater variety of buyer groups.

Younger middle class buyers ("Generation X") are increasingly apparent in the second home market, the majority of whom are married. The rate at which people amass wealth is increasing and the sources are becoming more diverse. Successful entrepreneurs and employees in areas such as technology and investment banking and finance are able to accumulate significant wealth at a much earlier age than their parents' generation. Although they have attained wealth relatively early in their working lives, they have nonetheless worked hard to achieve it and they are able and willing to acquire luxury products which reflect their status, including second homes'.

Another group which is likely to have an increasing impact on the luxury residential resort market is the so-called "Generation Y". This young, largely unmarried, group is benefiting from the wealth their Baby Boomer parents have amassed over time. Often their employment is merely a sideline to their social life and they will typically seek out luxury destinations where they can party with friends of a similar background, often but not always, in seclusion.

## 03 European buyer demand for luxury second homes'

Demand for second homes has grown exponentially over the past decade, in particular for overseas properties. Frustratingly, there are few official statistics which track this market and those that exist are imprecise. For example, the UK Government's Annual Survey of English Housing contains an estimate of the number of UK households owning second homes abroad – but it does not claim to be comprehensive and it does not track the actual number of properties owned. However, it does provide a broad indication of how dynamic the trend has been: in 1994, an estimated 329,000 households in Great Britain owned (at least one) second home, 27.5% of them outside the country. By 2006/07, 248,000 households owned a second home abroad. This equates to just over 47% of total UK second home ownership.

Second home ownership is by no means just a UK phenomenon – according to the Spanish Census, second homes accounted for around 16.5% (3.4 million units, of which 1.2 million to 2 million owned by foreigners) of the total Spanish housing stock in 2001, and a survey by INSEE revealed that there are around 3 million second homes in France (0.25 m – 0.4 m owned by foreigners).

Ownership of second homes outside the country of residence is more limited, but nonetheless rising, and is dominated by the developed economies of northern Europe (notably from the UK, Ireland, Germany, Scandinavia, Benelux, Austria and Switzerland) and a small but growing number of emerging eastern European economies (predominantly from Russia but with some buyers from Poland, Hungary and the Czech Republic). Southern Europeans often own second homes but these are usually within their own country as they do not need to travel abroad in search of a better climate and/or proximity to the coast.

Buyers of second homes in luxury resort locations in general will typically fall within three broad categories: private-owner occupiers, private investors and corporate/institutional investors.

**Private owner-occupiers** will tend to be affluent households, with the household head in a professional or senior managerial position. They may or may not look to rent out their property when they themselves are not in occupation, although generally speaking the more expensive the property the less likely the owner is to rent it out. They will nonetheless be conscious of the capital value growth prospects of their second homes and will typically want to buy into a scheme which offers every chance of being successful. Buyers are unlikely to want year round occupancy although there is growing interest from retired purchasers. However, buyers are increasingly interested in year round seasonality. UK Government statistics reveal that the majority of UK second home buyers are more mature – 57% fall within the 45-64 age group.

**Private investors** – i.e. those who buy properties to rent out and who have no intention of occupying their properties – will be interested not only in rental income but also capital value growth. They will usually buy smaller properties which offer the advantages of being cheaper to acquire, require less maintenance and are generally easier to let. They will, for the same reasons, often also be easier to sell on. Their age profile can be much younger than that of owner-occupiers, especially those who are professional buy-to-letters.

**Corporate / institutional** buyers have been slow to enter the second homes market and still represent a very small proportion of buying demand. To date, they have mainly been involved in the primary homes market and the hotel sector, however, we are aware of growing interest from this category with prominent recent examples being the acquisition of Cypriot developers Lanitis Development (including the flagship Aphrodite Hills scheme) and Aristo by institutional funds. Depending on the size of the fund, this buyer category will look to buy either a portion of a completed development or the entire development, while others may be prepared to share the development risk. They will usually want to negotiate a sizeable discount when buying however they can offer a valuable alternative for developers who either run into trouble on a development or require quick bulk sales to maintain cash flow.

### 3.3 Type of product Europeans seek

A common theme linking many HNWI is that they are invariably cash rich but time poor and they increasingly prefer resorts that provide an “off-the-peg” 5-star fully serviced environment. There is additionally a status element from some buyers who wish to demonstrate their wealth in a tangible manner.

Typically, the main reasons driving second home purchases are holiday use (i.e. discretionary purchase), future retirement (i.e. primary – and in some cases a secondary – residence in retirement) and investment. There can be an element of overlap between all three.

High-end European buyers are increasingly seeking second homes within a secure, fully-serviced environment which offers a range of leisure facilities. This environment typically also offers owners the opportunity to become part of an exclusive community of like-minded people without being intrusive – i.e. which they can choose to participate in either fully, partially or not at all. Buyers within luxury resorts will often be characterised by a number of key requirements, which can be summarised as follows:

- Location – typically this will involve attractive views, with dramatic scenery being favoured (e.g. mountains, valleys, sea/lakes/rivers and, most commonly, proximity to the coast) to which a premium price can be attached
- Accessibility (i.e. time and ease of getting to and from the resort) – in our experience, owners will ideally not want to travel for much longer than 60-90 minutes from the airport
- Quality of local infrastructure
- Quality of the real estate – with regard to both build and design
- Provision of local facilities (e.g. shopping, medical, gastronomic) and entertainment (e.g. cultural, heritage, nightlife)
- Security – resort developments will usually offer not just personal security but also security for their property when the owner is not in occupation (this latter point is important given that the owner is only likely to spend around 3-4 weeks per year in occupation)

- Availability of property-related services (especially property management)
- Exclusivity – purchasers of luxury resort properties will typically want to feel that they are buying something which stands out from the rest of the market and this is likely to become more apparent the more expensive the property is
- Price (although typically the more expensive a property, the more important the property characteristics are rather than the price)
- Investment prospects – even if the owner is not an “investor” he will want to know, as far as is possible, that he is making a wise purchase in terms of capital value growth prospects. This is where the importance of branding comes into play as a prospective buyer will derive comfort if he recognises a quality brand name which is involved with the development
- Exit opportunities – purchasers are increasingly aware of buying into markets which offer the opportunity to re-sell easily
- Legal framework – another very important area, ranging from establishing clear title, through planning requirements to the acquisition and disposal process
- Local environment – this is an area which is often overlooked yet often cited as a reason why owners of second homes / retirement homes abroad decide to sell up and select an alternative location. Language/cultural difficulties can combine to make life frustrating / intolerable as can lack of local area amenities and infrastructure.

Given the often sizeable apartment element of many modern resort schemes, many developers establish a rental pool, either with guaranteed returns for a fixed period or without. Owners of properties within the pool will have a set number of days allocated for their own personal use. The concept has attractions for both operators and scheme members. Buyers can generate rental income on their property when they are not in occupation, while operators can also receive a good income stream, particularly on resorts with longer seasonality.

# 03 European buyer demand for luxury second homes'

## 3.4 Where are Europeans buying?

As noted earlier, the lack of detailed statistics on the subject means that it is not possible to be definitive about European second home purchases. However, in broad terms it is possible to track where Europeans are buying if not the actual numbers involved.

With regard to general type of location, the majority of resort properties are located within coastal areas, followed by mountain and lakeside resorts. There is also clearly a large demand for urban second homes, and for non-resort properties in non-urban locations, however these are not the focus of our analysis.

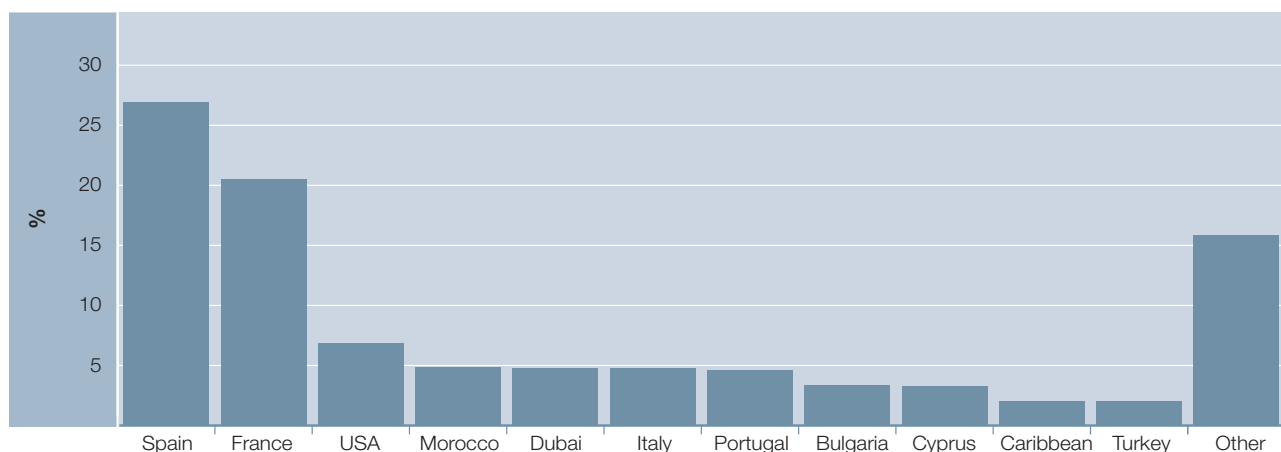
Figure 5 below illustrates where the majority of second homes in resort locations were purchased by Europeans in 2007. As expected Spain and France top the list at 26.9% and 20.5% of purchases respectively, although we are aware anecdotally that second home sales in Spain aimed at the foreign buyer market have fallen substantially so far in 2008. The USA's popularity has a lot to do with the favourable exchange rate. The emerging markets of Morocco and Dubai also proved popular.

Looking ahead, Europeans have demonstrated their willingness to buy into new markets as they emerge, provided they offer a broad basket of the basic requirements of second home ownership. This suggests that there is likely to be untapped latent demand for Brazilian second homes. We believe that this is more

likely to emanate from the luxury segment as buyers within this category are less likely to be deterred by long distance travel. They are also arguably more desirous of new and exotic locations, and of course they have greater buying power than their counterparts within the mainstream market.

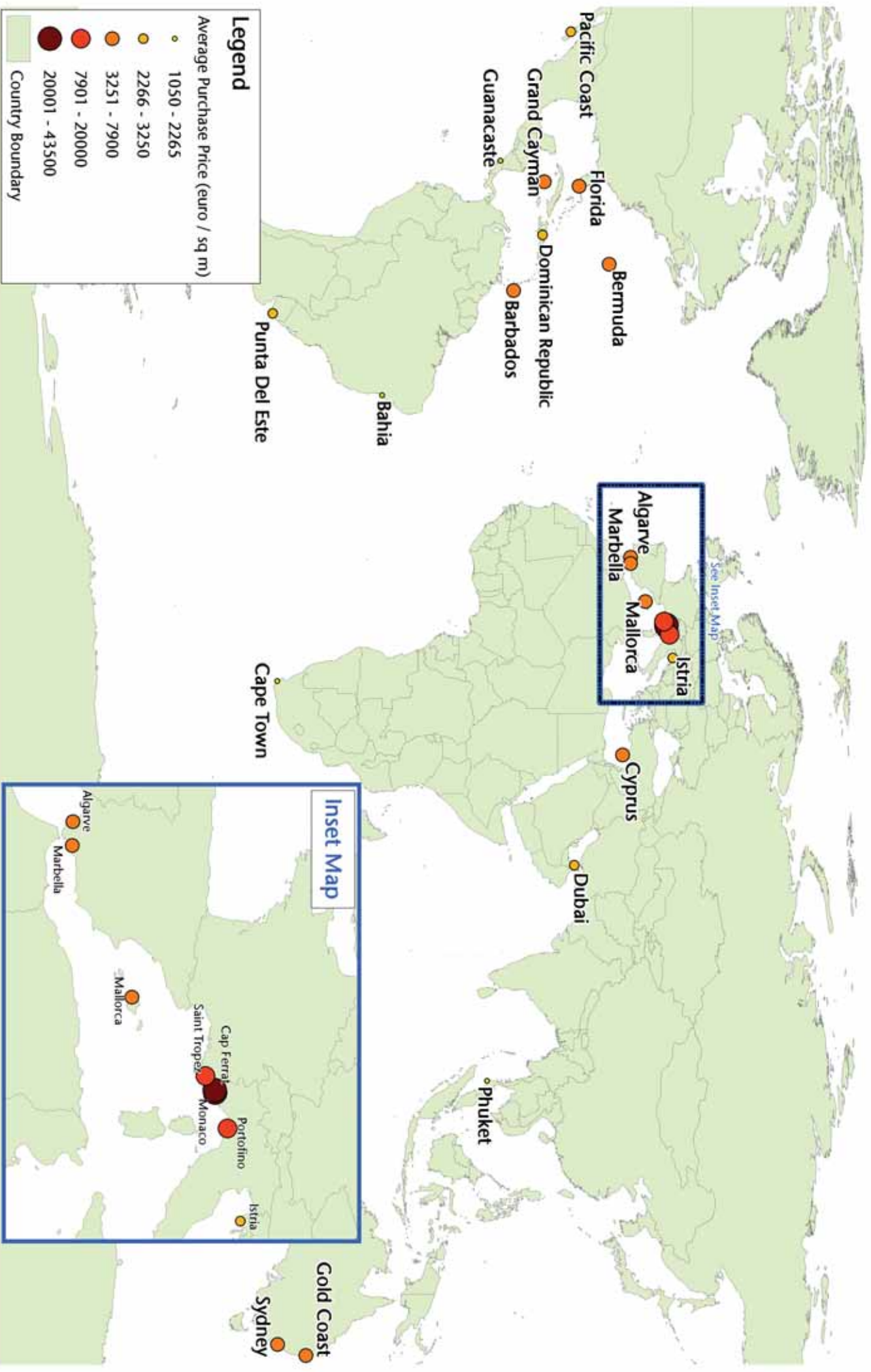
Luxury residential resort average prices (March 2008)	
Location	Average purchase price (€/m <sup>2</sup> )
Monaco	43,500
Cap Ferrat, France	35,500
Porto Fino, Italy	20,000
St. Tropez	15,650
Barbados	7,900
Bermuda	7,200
Sydney, Australia	7,000
Mallorca	6,300
Florida	6,100
Gold Coast, Australia	6,100
Marbella, Spain	5,500
Quinta do Lago, Algarve, Portugal	5,500
Cyprus	5,250
Grand Cayman	4,900
Pacific Coast, Mexico	3,250
Punta del Este, Uruguay	3,200
Istria, Croatia	3,000
Dubai	2,750
Dominican Republic	2,750
Phuket, Thailand	2,265
Cape Town	2,000
Bahia, Brazil	1,910
Guanacaste, Costa Rica	1,750

Figure 4: Most popular second home locations for European buyers (2006/07)



Source: Various

# Luxury resort properties – average purchase price (euro/sq m as at March 2008)





# 04 Key features of a luxury integrated resort development

Defining a luxury integrated resort can be a subjective exercise. Many developers will market their schemes as “luxury” however, they may not fall within the parameters of what is generally understood to represent luxury within an international context either from a quality or a pricing perspective, or both.

The volume of genuinely luxury resort developments is relatively limited in proportion to the total number of resorts and therein lies part of their appeal – HNWIs typically enjoy the image which accompanies owning an asset which is both of real quality and exclusive. We set out below some of the key features of modern luxury resort developments.

## 4.1 Scheme size

There is a broad range of scheme sizes throughout the luxury resort sector – from the large integrated resorts which offer in excess of 1,000 units, as well as a completely self contained service and facility offer, through to the super luxury boutique resorts which can contain fewer than 50 units. The size of a resort, though, does not necessarily indicate quality. There are many small mass market resorts which fail to offer much in the way of luxury besides location; equally there are high-end resorts which are in excess of 500 units.

A trend which is significant within the luxury market though is that of the smaller, super high-end resort. Once the super prime level of luxury is achieved prospective buyers want to believe that they are purchasing an exclusive and prestigious property. The size of a resort scheme will also be conditional on local planning regulations, geographic constraints and land availability as well as underlying demand.

## 4.2 Residential component

The decision on the type of units to build is largely dependent on what will be easiest to sell whilst achieving the highest possible price (planning constraints being the other major consideration), whilst delivering a high level of quality. The units on luxury schemes

are typically in keeping with the type of desired overall environment within the resort and the intended market perception.

The residential accommodation offer should provide a mix of unit types to reflect the likely profile of target buyers and their usage requirements and enable the developer to offer a choice of unit types and prices to optimise the chances of sales success. These decisions will also be influenced by the site plan / master plan and permissible densities under local planning.

### 4.2.1 Unit design and specification

The specification and design of the residential units will be an important factor in helping to achieve the targeted sales velocities and sustaining values. Not only is the architectural style an important element in delivering a premium to the product in terms of value, it is essential that this is underpinned by an underlying design concept that delivers a build finish, design, specification and supporting services of such a quality that the development is perceived as being a premium product in the market.

## 4.3 Sales options

Developers can facilitate the purchase of second homes by offering various options with regard to the ownership of residential properties. The most common of these are summarised below.

### 4.3.1 Freehold

This is arguably the preferred (and most common) form of ownership of second homes. Provided the title is clear and can be registered, it offers the buyer the most complete ownership rights, i.e the property is fully owned and the land / plot in which it stands. It is also, generally, the most expensive ownership option, however when the buyer sells the property he will be able to realise the full proceeds from the sale.

The majority of resort properties in Brazil are, however, owned on a condominium basis of one sort or another.

# 04 Key features of a luxury integrated resort development



## 4.3.2 Condominium

Less common than freehold but prevalent in Brazil, condominium ownership grants title to the units but not to the land on which the property sits – essentially portions of the property are commonly owned and other portions are individually held. Colloquially, the term “condominium” is often used to refer to an apartment unit itself and should not be confused with the use of “condominium” which refers to a type of ownership.

Typically, a condominium consists of units in a multi-unit dwelling (i.e., an apartment or a development) where each unit is individually owned and the common areas such as hallways and recreational facilities are jointly owned (usually as “tenants in common”) by all the unit owners in the building.

There are a number of advantages to condominium ownership: it is typically less expensive to buy than freehold property and it can provide an “instant” sense of community. A resort condominium will also often include the use of recreational facilities such as swimming pools, tennis courts, marina facilities and health club facilities which are available to residents for free or at reduced rates.

There are, however, drawbacks for owners. Condominium operators may impose restrictive covenants, their maintenance charges and fees may be high, their effectiveness may vary, and as the lease length reduces the value of the property interest will diminish and lease extensions may be difficult and/or expensive to negotiate.

## 4.3.3 Sale and leaseback

A sale-and-leaseback agreement offers the buyer the advantage of freeing up capital to reinvest elsewhere whilst retaining the right to occupy the property on a long lease. In some cases, it may be possible to buy back the property at a pre-agreed price or the property may revert automatically back to the owner.

It is a popular method of ownership in France, offering the benefits of a guaranteed rental income (the purchaser buys the property and then leases it back to the developer or a rentals company for a pre-determined period – usually around nine years – at a fixed rental) and tax advantages (no VAT is charged on leaseback scheme properties).

The property is fully maintained by the managing agent and all costs incurred are paid for by them. At the end of the lease period, the property will be returned to the owner in perfect condition. Buyers also have peace of mind that their property is not left unattended for months at a time. Leaseback schemes also allow the owners to have use of the property for allocated weeks of the year.

Many of these properties include pools which can be accessed free of charge. Other facilities that a development may have, such as a gym, may be charged for. During the 'off-season' periods, although the property can be used, the extra facilities may not be available.

Sale and leaseback for residential property is a concept which does not yet occur in Brazil.

#### 4.3.4 Fractional ownership

Fractional ownership has gained popularity (and is beginning to appear in Brazil) as resort real estate prices have risen and occupiers seek a more cost effective alternative to outright ownership. This is especially the case as many outright owners tend only to use their property for between 4-12 weeks per year, yet still have to bear the costs attached to 52 weeks.

Fractional ownership allows for typically, 3-13 weeks' occupation per annum, with the comfort of knowing maintenance/repairs will be taken care of by the management company and appreciation potential. The contract is agreed for a fixed number of years after which time the property is sold and the proceeds are distributed back to the owners on a pro-rata basis. Owners can also elect to let out any of the weeks of their occupancy plan that they decide not to use for themselves.

Fractional ownership offers advantages over and above timeshares which suffer from a poor image and are often perceived to be of lesser quality, depreciate over time, and where people buy memberships for occupation (typically for shorter periods) without owning any part of the asset.

#### 4.4 Sales and marketing

Sales velocities are heavily dependent on the quality of the sales and marketing teams, the quality of the management of the resort and the quality of the properties themselves which will offer confidence to prospective buyers that the resort represents a high standard and is likely to be successful now and in the future.

In an increasingly competitive environment, where buyers have greater choice and are becoming more and more knowledgeable (thanks to increased media coverage of international second home opportunities and the internet) it is very important to establish the quality not just of the product being sold, but also that of the location, the lifestyle and investment opportunities which the development offers and any associated USPs e.g. quality and range of services, branding and reputation of the parties involved in the development.

Part of this process in Brazil involves the increasing use by developers of international agents of good standing, not only to reach foreign markets more effectively but also to put a seal of quality on their product.





# 04 Key features of a luxury integrated resort development

Assuming a campaign strategy is well thought out, the higher the budget allocation generally speaking the better the results should be. However, all marketing spend should be justifiable in terms of likely achievable results – in other words, simply spending a lot of money on marketing will not in itself guarantee success.

Having identified the core potential buying market, it is important to target that market in a focussed manner. This involves ascertaining what will elicit the best response in terms of content of marketing material as well as how and where it is distributed. For example, in the UK the *Sunday Times* often generates a good response from buyers within the luxury end of the market.

Any marketing campaign should be regularly reviewed and, if necessary, revised to take account of those aspects which are /are not working as well as anticipated.

## 4.5 Pricing

Pricing in second homes' markets varies considerably and there are both standalone and resort properties available to suit all budgets – from mass market up to super luxury. Resort developments will usually command a premium which will vary according to the range and quality of properties, facilities and services offered and the location and brand association. Key price drivers are as follows:

- Quality location offering excellent uninterrupted views and easily accessible
- The quality / reputation of the resort operator
- The presence of a 5-star hotel operator
- Golf course
- Marina
- Fully – serviced environment
- Build and design quality of the residential properties

Whilst profitable development is the ultimate objective, it is important not to price the product at such a level that buyers will be deterred – either by the absolute level or by comparison with competing product. Luxury units in Brazil are typically priced at a similar level to mid-market units in more established locations. The value of sound market research to establish achievable values cannot be overstated.

## 4.6 Wider scheme deliverables

In order to help achieve the targeted sales velocities and sustain values, certain wider scheme deliverables are usually employed on luxury developments. For example, the provision of private runways on luxury resorts is becoming increasingly important in Brazil as a means of facilitating access for foreign HNWI buyers.

The impact of these can be substantial and existing market average values can be exceeded through a combination of exceptional product and associated services allied to highly focussed and clever marketing. Furthermore, investors may be prepared to pay above market average prices if they feel the future capital (and rental) growth potential justifies this. Both of these can be greatly helped by what the resort has to offer in terms of product and services range and quality.

The key objective is to persuade buyers that the resort is the up and coming high quality residential / leisure location of choice and one in which their asset will appreciate in value over time.

# 05 Conclusions and outlook

Although there are limited official statistics on the subject, it is clear that both the supply of and the demand for second homes across the globe has risen steadily over the past decade. The current mood of uncertainty about shorter term economic and financial health has made purchasers more hesitant. However, we believe the underlying appetite for second homes remains firm, especially in the luxury sector, and will continue.

Brazil arguably stands at something of a crossroads – it represents an exciting yet largely unknown proposition for Europeans other than those who have visited as tourists.

It is also slightly handicapped by its distance from Europe. However, this has not hindered the growth of further long haul destinations such as the Caribbean, South Africa and Mauritius once a quality residential product became available.

We believe that Brazil offers many attractive features for the wealthy European buyer market – much of its coastal areas are unspoilt, the climate is excellent and it represents very good value compared to established locations and to many emerging markets. It can additionally capitalise on its exotic and slightly “frontier-edge” character, which are both appealing to many HNWI’s who often seek “something different” in terms of seclusion and ethnicity, yet within the security and comfort of a gated, fully serviced resort community. A further plus point with regard to security is the fact that Brazil has so far not suffered from any acts of international terrorism.

Confidence has clearly taken a knock in many of the world’s primary housing markets and this sentiment is, to some extent, filtering through to the international second homes’ market with a resulting slowing of transaction volume and price growth apparent in many locations. However, in more testing times it is

usually the case that buyers will look to the luxury segment to provide a certain measure of comfort. This often means that luxury property will hold up better than its mainstream counterpart in periods of general downturn.

The Brazilian second homes market is best described currently as nascent, especially with regard to developments which offer international standard luxury and of which there are at present very few. There is undoubtedly considerable untapped potential for a market which can appeal to European, North American and other Latin American buyers.

The task ahead for Brazil is to create the necessary infrastructure to cater for future growth (in which regard a sound platform has already been established) and to promote itself more widely and effectively as a destination of genuine quality for second home owners which offers lifestyle attractions as well as investment potential.

Brazil will also need to establish its credentials as a luxury residential location to an international audience via clever and well directed marketing if it is to compete most effectively in a truly global market where discretionary buyers have greater choice than ever. It is encouraging that a number of leading international 5 star hotel operators are already investigating opportunities within Brazil. Once established, the presence of these powerful brands will undoubtedly help the luxury market to take an important step forward in terms of greater international recognition and credibility.

As has happened in other emerging markets, early entrants are likely to take advantage of the strongest capital growth before the market matures and likely settles into a pattern of less robust growth.

