



## Vacation Home – What You Should Hear Before You Buy

Many people would love to have a beach home or mountain cabin to escape to on weekends or holidays. I thought that vacation home sales would be breaking records since Baby Boomers are better positioned to buy them than any previous generation. There are a number of other factors which should be propping up the vacation home market: a strong economy, a 10-year bull market in stocks, and relatively low mortgage rates. However, vacation-home sales have been relatively weak for the last four or five years and the price appreciation in popular vacation home areas has lagged non-vacation home areas by 10 percentage points from 2015 – 2018.

One reason that real estate professionals suspect vacation home sales have slowed is Airbnb and VRBO. Those services have made it easy to find vacation rentals in desirable places for as long or as short a period as you wish—without any down payment, mortgage, or upkeep costs.

### However, here are a few things to consider, if you decide to buy a vacation home:

1. **Costs** – The median vacation home price nationwide is just over \$200,000, and the most popular areas were beach locations. In Delray Beach, Fla., a popular beach town, the median house price is \$299,900. That seems reasonable, but do not underestimate the ongoing expenses. Even a modest, low maintenance home will likely have \$700 - \$1,000 in monthly expenses (Utilities, HOA, maintenance, landscaping, taxes and insurance).
2. **Financing**. Approximately 30% of second-home buyers pay all cash. The remaining buyers will need to come up with a hefty down payment. Most banks require 25 to 35% down on vacation and rental properties, charge higher interest rates, and require a higher credit score. This is because these types of properties have higher default rates than primary residences.
3. **Insurance** – Homeowners insurance tends to be more expensive for vacation homes than for primary residences because vacation homes are at greater risk for damage or theft since they are not lived in year-round. You may be required to carry a “landlord policy,” which can cost 20 to 30% more than typical homeowners insurance, and many vacation homes are in earthquake, hurricane, or flood zones, which doesn’t help your insurance bill either.

4. **Renting It Out** – People who rent out their vacation homes do so for an average of 18 weeks per year, according to [HomeAway](#), a vacation rental marketplace. Property management firms typically get 20 to 33% of the rental income, or you can do the work yourself. I have some clients who make a pretty significant side income by [renting out their guest house on AirBnB or VRBO](#), but it takes a few hours a week to respond to inquiries and coordinate check ins, check outs, reviews and cleaning services. To model your potential rental income vs. expenses, check out this [rental income calculator](#).
5. **Classification as a Rental Property** – If you limit your personal use of your second home to 14 days, or 10 percent of the time it's rented, it can be classified as a rental (investment) property. This means you will be able to write off most of the expenses (insurance, maintenance, utilities, interest expense, depreciation, etc.) against the rental income. If the result is a loss, it is typically considered a Passive Activity Loss (PAL). PALs may or may not be able to be used in the year incurred (depending on your level of income), but these losses can always be carried forward and used when you eventually sell that home.
6. **Classification as a Vacation Home** – On the flip side, your property will be categorized as a vacation home if it is used primarily for personal use. You do not get to write off all of the expenses like you do with a rental, but if you rent it for 14 days or less, you can keep that rental income tax-free. In addition, you can write off the interest expense as an itemized deduction (just like you do with your primary residence) as long as your total mortgage debt for both homes is under \$750,000.

Second homes can be a great place to make memories with your kids and grandchildren. They can also be a major expense and time commitment. The wealth-maximizing strategy is to have a friend with a beach house and offer to house sit.

Have a great week.

-Jeremy Kisner, Director of Financial Planning and Senior Wealth Advisor