



Purchasing a Second Home? 19 Things to Know

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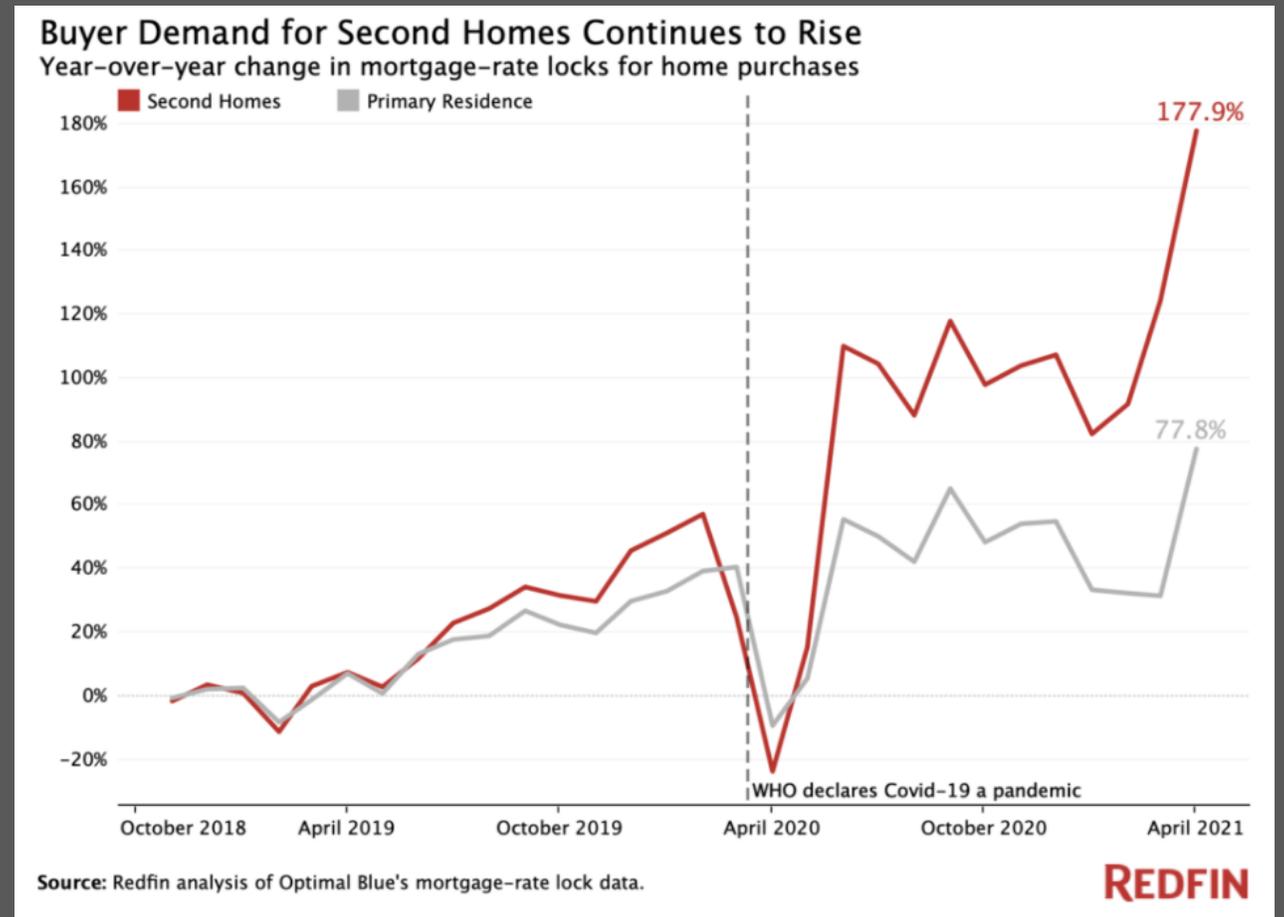
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Introduction

The number of second home buyers soared in April of 2021¹

Fueling the rise:

- Remote work
- Increasing wealth
- Retiring Baby Boomers
- Investors see opportunity for rental income
- Sellers see opportunity to cash out



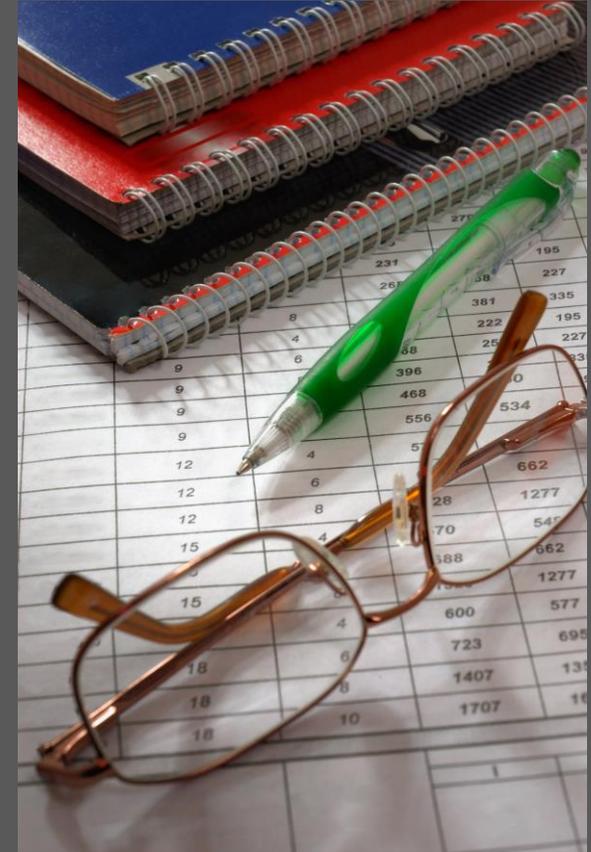
Source: "Demand for Second Homes is More than Double Pre-Pandemic Levels," Dana Anderson, Redfin, 5/1-/2021

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Introduction

When deciding on a Second Home

- Set your goals
- Develop a financial plan
- Determine how to purchase
- Know how you will manage the property
- Decide how best to pass it on to heirs
- Q & A



Goal Setting

What Are Your Goals?

1. What do you want to achieve in buying a second home?
 - Is it a family investment for future generations?
 - Is it a retirement home?
 - Is it a vacation home?
 - Is it an income property?
 - Is it an overall investment property?
 - Is it a tax reduction strategy to eventually move to another state?

What Are Your Goals?

2. What type of property?

- Waterfront or oceanfront
- Mountains or woods/remote
- Single family or condo/townhome

3. What can you afford?

- 10% of net worth
- Debt-to-income ratio of 36% or less
- Check out on-line calculators



Financial Planning

Financial Planning

4. How Does Your Home Fit Into Your Financial Plan?

- Understanding Expenses
 - a) Purchase price (cash or mortgage?)
 - b) Utilities and taxes
 - c) Furnishing, improvements, lifestyle changes
- Income potential as a rental property?
- Income from a future sale to fund retirement?



Financial Planning

5. Liability Issues to Consider:

- Umbrella policy and landlord's homeowners' policy
- Establishing an LLC to own the property if used for rental income



Financial Planning

6. Taxes

- Local property tax
- Deductibility of Mortgage and Home Equity Line of Credit interest



Financial Planning

Taxes – Rental Property

- “Personal Residence” - 14 Rental Day Rule
- “Rental Property” – Rent out for more than 15 days

A graphic of a sign that says "for Rent". The sign is orange with a white dashed border and is mounted on a dark grey horizontal bar with two grey circular fasteners. The word "for" is in a smaller font above the word "Rent", which is in a larger, bold font.

for
Rent

Financial Planning

7. Becoming a resident in another state

- State income tax rates
- Establishing residence
- How Minnesota looks at this



Purchasing a Second Home

Purchasing a Second Home

8. Finding a Real Estate Agent

- **Benefits of an agent**
 - Local knowledge
 - Contract jargon
- **Agent commissions**
 - Between 5%-6%²
 - Seller usually pays



Purchasing a Second Home

Finding a Real Estate Agent

- Additional costs and fees for closing
 - Costs associated with purchase
 - Financing costs and fees
 - Origination fee³
 - Mortgage insurance⁴
 - Other fees



Purchasing a Second Home

9. Learn about area and property

- Property taxes—differs by region⁵
- Assessments
- Homeowner's Insurance



Purchasing a Second Home



Learn about area and property

- HOA fees and rules for the property
- Tennis courts or other amenities—will you use these?
- Utilities and access—well or city water, city sewer or septic tank, internet broadband access, etc.

Purchasing a Second Home

Learn about area and property

- Flood plain or coastal?
- Lake conditions —water levels, invasive species, etc.
- Learn about lake association rules regarding zoning requirements, setbacks, docks, etc. if you plan to improve or build



Purchasing a Second Home

10. Financing the Purchase

- Mortgage
- HELOC — Home Equity Line of Credit
- Bridge Loans
 - PAL — Pledged Asset Line
 - Construction loan



Purchasing a Second Home

Other Financing Options

- Intrafamily loans using AFR rate⁵
- IRA—How you can use this?



Property Management

Property Management

11. Using the home—yourself

- What are the HOA/community rules and maintenance requirements?
- Beware of fines!
- Seasonal maintenance (water shut off, docks in, docks out, storing boats, etc.)



Property Management



12. Security

- Monitor the property
- Deter theft and vandalism

Property Management

Do you want to rent it out?

- How will that impact your use and fit with your goals?



Property Management

13. Managing Rentals

- Advertise for renters and conduct showings
- Create and sign a Lease Agreement
- Collect a security deposit and rent payments
- Transfer utilities to the tenant's name
- Address maintenance issues and repairs
- Deal with renter issues — late payments, damage, etc.

Property Management

Managing Rentals

- Permanent rental using a management service like Renters Warehouse, etc.
- Short-term rentals using VRBO, AirBnb, etc.



Property Management

Do you want to share it with family?

- How are decisions made, how are disagreements resolved?
- What are the usage rules? Can owners allow guests to use the property?
- Who pays for what?



Property Management

14. If property is co-owned, some questions to consider:

- How are repair costs covered?
- Who does what to maintain the property?
- Can sweat equity from one party offset monetary contributions?



Property Management

If property is co-owned, some more questions to consider:

- How do you avoid or deal with a “squatter” family member who decides to live there permanently?
- What are exit strategies when a family member wants out or can't afford their share of the upkeep? How is the value of their share determined?



Estate Planning

Estate Planning

What do you
want to see at
your passing?



Estate Planning

15. Who or what entity owns the home, and why does that matter?

A. Probate avoidance

- Owning the home in your name(s) means it will be probated
- Owning it in a trust, LLC or TODD allows for a direct transfer to heirs

B. Estate tax avoidance

- If you are the owner, it will be included in your gross estate
- There are strategies to employ during life to remove the home from your estate

Estate Planning

What are the main options to consider that avoid both Probate and Estate Tax?

Gift the home to your children

- Through an FLLC
- In Trust
 - QPRT
 - Cabin Trust



Estate Planning

16. Family or Cabin LLC

Senior Family Members

- Owners of family asset
- Wish to give the asset to children and grandchildren over time



Transfer Asset
Ownership to FLLC

Family Limited Liability Company

- Senior Family Members retain the GP interest and control of the business
- Create LP interests which they also own
- No gift taxes as owner is same



Gift ownership to children over time

- Gifts of LP interests are made to children at a discounted value
- Income and taxes pass to children in proportion to ownership
- When Senior Family Members are ready, the GP interest is gifted or sold to the children

Estate Planning

17. Qualified Personal Residence Trust (QPRT)

Senior Family Members (Grantors)

- Transfer cabin to QPRT
- Grantors decide term of years they will live there and retain possession
- Grantor's term of years is retained interest and is not subject to gift tax
- Future interest is gift; file gift tax return



Transfer Asset Ownership to QPRT after Term of Years

QPRT

- Senior Family Members retain the right to live in the home for a term of years
- At end of term, kids own the property
- Grantors would pay rent to kids if they wanted to continue living there



QPRT (Children) Owns the Property

- Gifts of QPRT interests are made to children-beneficiaries at a discounted value
- If grantor does not outlive the term, the entire value of the cabin goes back into grantor's estate
- Children take on the grantor's basis in the property. No step-up in basis at death

Estate Planning

18. Cabin Trust

- Transfer ownership to children via an irrevocable trust
 - Removes cabin from your estate today
 - Requires gift tax return
 - Retains original basis
 - Has protections of trusts
- Title cabin in your revocable trust
 - Gives senior family members most flexibility and control
 - Transfer of ownership occurs at death – get step up in basis
 - Value of cabin remains in your estate



Estate Planning

19. What if one of your kids wants cash instead, or won't use the home?

- You can gift other assets to the non-cabin-using child
- Consider life insurance that pays out to that child in lieu of the cabin interest



Q & A



Thank You



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