Thursday, November 05, 2009

Top 6 Things to Know When Investing in Real Estate in Retirement

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With the real estate market seemingly ripe for the buyer, many investors are turning to property as a long-term asset. For those nearing retirement, owning a home can provide an extra layer of security, but it's not without its own share of headaches. We checked in with experts to find the top six things to consider when investing in real estate later in life.

1.) **Ask first: Does this make sense financially?**

"At any age, especially nearing retirement, you never want to be 'house poor'," said Kathy Braddock, a partner at Charles Rutenberg Realty, one of the top 10 real estate firms in New York.

Whatever a person might be spending on a house, he or she should make sure there is enough money left over to enjoy the other things they want to experience in retirement. There is always a danger of not leaving enough liquid assets after the purchase of a home, and most people get prequalified from a mortgage broker or bank for the amount they can afford, not the amount they should be spending.

"Because a bank isn't going to factor in the $5,000 European vacation that you and your family might want to take, it's important to put in writing all the additional expenses you might incur in a year and compare that against the monthly mortgage payment you might take on," said Braddock.

2.) **Pick an area you're familiar with.**

Though that condo in Florida might look enticing, you'll be better off sticking with an investment in an area you already know, according to Braddock.

"It's very much like dating. You can meet someone online and they might seem great, but until you go face-to-face with them, you are never really sure," Braddock said. "Just like with a person, there needs to be a unique chemistry with property. If it feels good to you, it will feel good to others when the time comes to sell it."

If buyers invest in an area they already know, they'll be aware of any problems in the neighborhood and able to feel that instant "chemistry" so desirable with property, Braddock said.

3.) **Interview your broker.**

Before you purchase a home, you'll need a broker, and that broker is going to be working for you. As the boss, you'll need to interview your prospective employee.

"Absolutely interview them, because brokers are not all created equally. Some of them are simply fabulous, and others are a nightmare," said Braddock.

Choosing the broker should be given as much thought as choosing a doctor or a lawyer, said Braddock, because they're going to be helping you with the single-largest financial investment you may make in your life.

"You would never choose your surgeon based on whether or not they were someone's cousin or friend who needed the business, and you shouldn't choose your broker that way, either," said Braddock. "It's critical you are in the hands of the right person, because they can make or break the transaction."

4.) **Watch the cycles.**

Although the real estate you buy today might be value-priced, you have to consider how much it will sell for when the time comes to put it back on the market.

Over the last 35 years, real estate prices have fluctuated up and down in eight to 12-year cycles, according to William Bronchick, Founder of the College of American Real Estate Investors based in Denver, Colorado.

"If you're planning to sell the property one day, you have to ask if the investment is going to be appropriate at the time you sell it as much as you have to ask if it's appropriate now," said Bronchick. "Ideally, you would time it so that you're buying when prices are low, and selling when prices are high."

Identifying the cycles can be tricky, but a good real estate broker can help you with your decision by analyzing housing sales and inventory of the market in which you're investing, said Bronchick. Studying these patterns can give you enough of a general idea where there's money to be made.

5.) **Consider the cost of management if buying a rental property.**

Many retirees invest in rental properties as a steady source of income in their retirement, but the costs of management and upkeep should not be overlooked.

"If you're planning on keeping rentals as a retirement investment, who is going to manage it? If you're not physically able to do it, or if you don't have the time, that's going to be an added expense," said Bronchick.

Typically, a management company charges 7%-10% of the gross monthly rent for property upkeep.

"Keep in mind that if you have five rentals and each one brings in $1,000 a month, it's not a $5,000 profit — it will be closer to $4,500 or the added cost of your own time if you do it yourself," said Bronchick.

6.) **Tax deductions on primary residence vs. secondary homes**

Primary residences and secondary homes are alike in that a homeowner can deduct the property taxes and the interest on their mortgage from both properties.

However, when a homeowner sells a secondary home, the property is treated no differently than any other investment like stocks or bonds, and capital gains taxes on that home would weigh in at 15%, according to Jay Butler, associate professor of real estate at the W. P. Carey School of Business at Arizona State University.

"If a home is not your primary residence, you need an accountant," said Butler. "There are so many 'ifs' 'ands' and 'buts,' it's unbelievable."

Unlike a secondary home, when a primary residence is sold, the owners can collect up to $500,000 in profit tax-free. A trick for homeowners looking to avoid capital gains on that secondary home? If you live in a home for two consecutive years in a five year period, it automatically becomes a primary residence.