

Second Chances How to squeeze more money out of vacation homes

Vacation homes, once a sign of prosperity, have become financial burdens to many amid the economic slump. With a little creativity, however, it is possible for owners to squeeze extra cash from properties that might otherwise be a drain

Highlights: Become a landlord, help yourself - and others, appeal your taxes, share the load

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Some people who bought second homes as national real-estate prices peaked during 2006 now have less money to pay the bills and are facing the unenviable choice of selling at a loss—if they can—or waiting out the market. The median price of a vacation home fell 23% in 2008 from 2007, according to the National Association of Realtors, and sales have dropped nearly 31% from 2007.

“Second homes have become an ugly stepchild in an environment [where] people aren’t even buying first homes,” says Cicily Maton, a financial planner for Aequus Wealth Management Resources LLC in Chicago.

Owners who are stuck with those homes can try to make do, at least temporarily, by using their homes to produce extra income and minimize taxes. Some options, such as refinancing to a more favorable loan or delaying improvements, are obvious. Others require more planning.

With that in mind, here are some ideas about how to keep a vacation home afloat on less money:

Become a Landlord

Some people who once used their vacation homes solely for their own enjoyment are now renting them out, says Sarah Kuzma, corporate relations director for Meyer Real Estate in Gulf Shores, Ala. A second income stream, in addition to tax write-offs for maintenance and repairs, makes this option appealing in many cases, she says.

Homeowners can hold on to more of that rental income by marketing the property themselves. An effective do-it-yourself Internet campaign can cost less than \$500, compared with the 10% to 25% of total rental income that real-estate agents and management companies may charge to find tenants.

Jack Russell of Lexington, Ky., who bought a five-bedroom vacation home in Kiawah Island, S.C., in 2004, has chosen the do-it-yourself route. For \$249, he advertised his home on a Web site called Vacation Rentals By Owner, or VRBO.com. A Facebook group he started at no charge directs users to that ad. He also advertised on Google, which produced hundreds of clicks, for about \$200 during a three-month period, he says.

The strategies have generated substantial interest, says Mr. Russell, who expects to rent the property for 26 weeks per year. A property-management company oversees cleaning and inspections of the home, which rents for \$7,600 per week during the summer.

Renting a property for even one or two weeks can produce found money. Homeowners can rent their property for up to 14 days without reporting the income to the Internal Revenue Service, says Michael Kay,

a certified financial planner in Livingston, N.J. The strategy can produce a windfall for people who own property in areas that hold one-time annual events, such as the Sundance Film Festival in Park City, Utah.

Help Yourself—and Others

Donating vacation-home use to a charity that auctions the time to raise cash provides a tax break that could help homeowners in softening vacation rental markets, such as Malibu, Calif., and Kauai, Hawaii.

Honore Frumentino of Northbrook, Ill., donated her vacation home in Palm Bay, Fla., to two silent auctions—one that benefited a church and another to help defray medical costs of a seriously ill community member. Typically, people who attend the auction bid on the vacation week and pay the sum to the charity. The homeowner can, in many cases, then deduct the fair market rental value from his or her income taxes, regardless of the amount paid to the charity.

Some companies offer online services that link vacation-home donors with charities that want to auction vacation time. VacationHomesForCharity.org is one such Web site. Run by The Society of Leisure Enthusiasts, a Denver company that provides marketing support to vacation homeowners and rental companies, the service lists donated vacation-home time free of charge and negotiates with charities to contribute a small portion of rental proceeds toward the owner's cleaning costs. Property owners can mandate their own rules, such as bans on pets or smoking.

Many retirees decide to settle down in a longtime family vacation home. But some treasured locations are becoming more difficult to afford as retirement portfolios and incomes decline. Donating a home to charity, while retaining a life estate—the right to live in the house until death—can generate a substantial tax deduction that can stretch across several years, according to Rawson Hubbell, vice president, investment management and trust, at Boston Private Bank & Trust Co.

He recently advised a 65-year-old couple, who live in a \$2 million lakefront home in New Hampshire, to set up a charitable life estate. Too much of the couple's net worth was tied up in the home, whose mortgage had been paid off, he says. The couple was expecting a significant payout of deferred compensation, which is taxable as income. He suggested setting up a charitable life estate to offset that burden, leaving them more money for spending. A charity would own the property after their deaths, but the couple would receive a \$900,000 tax deduction, which could put as much as \$315,000 in their pockets over five years, he says.

Generally, people can deduct up to 30% of their adjusted gross income for this type of gift, so a deduction this large is best planned for a year in which there is a major taxable event, he says.

The couple has no children, but those who do and want to leave something behind may have to weigh other options, such as selling or living on less cash.

Appeal Your Taxes

Property taxes are becoming more burdensome for many vacation homeowners, particularly as more municipalities try to make up for budget shortfalls by raising taxes.

James Rubino, a tax attorney in Stamford, Conn., says property-tax appeals are now more common. Many homeowners whose properties were reassessed when the real-estate market peaked are stuck with high values for tax purposes, even though prices have since declined. "People aren't very happy about that," he says.

To get a reduction, homeowners must argue the valuation is wrong, either because an appraiser compared the home with properties that weren't equivalent, or made a mistake, such as miscalculating square footage, says Mr. Rubino.

David Carmichael, a property tax lawyer in Eugene, Ore., says he is helping a friend appeal taxes on land in Bend, Ore., a city near the Cascade Mountains. The property cost \$100,000 in April, but the tax assessor recognizes \$310,000 as its real market value, says Mr. Carmichael. He plans to use that discrepancy to argue a tax appeal.

Property taxes in Oregon, he says, are based on either assessed or real market value, whichever is lower. He is hoping the assessor will reduce the property's real market value, for tax purposes, to \$100,000, which would be less than half the 2008 assessment of \$239,270. The owner's property taxes could decline by more than \$2,000 annually if the appeal is successful, he says.

Homeowners need to weigh, however, if the savings will outweigh legal costs. Some attorneys will work on a contingency basis, typically charging one-third of the taxes a homeowner saves if the appeal is successful. Others may charge between \$200 and \$300 per hour, regardless of who wins.

Share the Load

Some owners run vacation homes like businesses. Finding a partner to purchase an interest in the home and contribute to overhead expenses could relieve some of the burden.

The best partner isn't necessarily a friend or relative, but someone who will adhere to a written agreement that outlines responsibilities, income and a schedule for personal use, says Andy Chapman, president of Halo Business Advisors in Clinton, Miss. "Make sure you get either your share of the income or time," he says. These types of investment properties typically operate through a legal structure, such as a limited liability corporation or general partnership. A lawyer or accountant can determine the most appropriate option for minimizing taxes and liability.

Many families set up family limited partnerships or family limited liability companies to reduce a property's value for estate-planning purposes. Giving relatives an immediate ownership interest in a property, instead of making them wait until the owner dies, may inspire them to contribute to the home's upkeep. "It doesn't need to be looked at only as an estate-planning tool but as a way of sharing wealth and also the burdens," says Mr. Kay, the financial planner in Livingston, N.J.

Typically, the home's owners set up a general partnership or company and then give shares to family members. They're often difficult for recipients to sell or convey, making the property less valuable, which can help minimize estate taxes. Mr. Kay warns, however, to follow IRS guidelines about discounting the property's value in a fair and reasonable manner. The IRS has scrutinized what he calls "ridiculous" discounts. "They have problems when people get greedy," he says.