Buying a Second Home

By ANNA CHANG-YEN | Green Shoot Media

If vacation has been so much fun that you don't want it to end, a second home might be for you. Think carefully about all the issues surrounding owning a second home, however, because there can be major financial implications.

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The decision to purchase a second home comes with major financial considerations. Be sure you're financially fit and educated about the financial ramifications of your purchase.

INVESTMENT PROPERTY VS. VACATION HOME

The most important decision is whether your home will primarily be an investment or a true second home. How you use the home throughout the year will determine how it is classified by the IRS. A true second home is one that only you and your immediate family use. It's tempting to help cover your expenses by renting out the home to other vacationers while you're not using it, but in the eyes of the IRS, you may have just become a real estate investor.

TAX IMPLICATIONS

You can't write off the mortgage interest on an investment property in the same way you do your primary residence, and you must report the rent you receive as income. In certain situations, you may be able to offset the rental income with deductions for interest, taxes, depreciation and home maintenance.

The catch is that the IRS is very interested in the number of days you use the home for personal use each year. If you use the home frequently, you can deduct only the expenses that are proportional with the amount of time you rented out the home. Also, if you rent the unit below market value to friends or family members, the IRS might consider that to be personal use.

As you can see, your tax situation can get complicated in a hurry. Consult a tax adviser before you buy, so you can be sure you understand how the new home will affect your bottom line at tax time.

FINANCING

Financing a second home also can get complicated. If you have an FHA loan on your primary residence and took advantage of the low down payment option, prepare to cough up more cash for a second home than you may be expecting. Because private mortgage insurance won't cover a second home or investment property, you'll need to put down at least 20 percent.

FHA only insures loans on primary residences, so your second home loan will have to be a conventional loan. This means tighter lending standards, particularly when it comes to whether you can afford the payments. Lenders will look closely at your income vs. housing expenses on both homes and may require strict adherence to debt-to-income ratios. Be prepared to show that your income is sufficient to keep both homes afloat.

OTHER CONSIDERATIONS

Add up all of the costs before putting in an offer. Don't forget utilities, home maintenance costs and overhead that can add up, such as furnishings and decor. Also think about how much it will cost to travel back and forth to the home.

If you will rent out the home while you're away, don't forget about property management fees, and be sure to research average local occupancy rates so you're prepared for periods with no revenue.

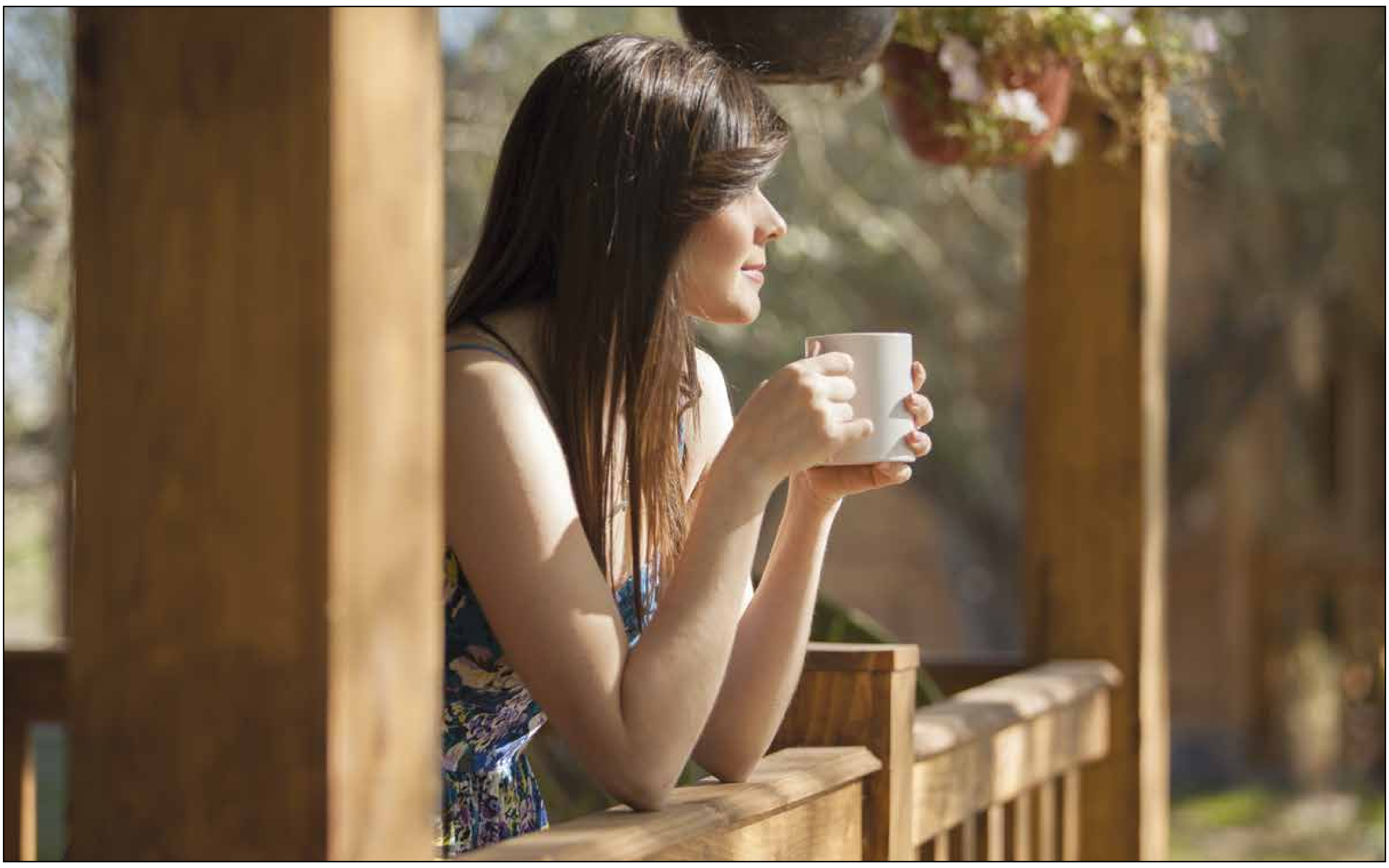
If you get in over your head, your "dream" vacation home could become the stuff of nightmares.

REAL ESTATE 101

Dreaming Big?

If your second home is used only for personal use, the mortgage interest may be fully deductible. According to the Internal Revenue Service, "The total amount you can treat as home acquisition debt at any time on your main home and second home cannot be more than $1 million ($500,000 if married filing separately)." IRS Publication 936 discusses the issue in detail. Read the 2015 publication at **irs.gov/pub/irs-pdf/p936.pdf**.

HOMEWISE Real Estate Tips and Advice



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HOMEWISE GLOSSARY

Home acquisition debt: a mortgage you took out after October 13, 1987, to buy, build, or substantially improve a qualified home (your main or second home). It also must be secured by that home. If the amount of your mortgage is more than the cost of the home plus the cost of any substantial improvements, only the debt that is not more than the cost of the home plus improvements qualifies as home acquisition debt. The additional debt may qualify as home equity debt.

SOURCE: Internal Revenue Service