

Should you join the second-home club?

The vacation getaway. The rental income generator. There are lots of reasons to consider buying a second home. But before you sign that mortgage, carefully consider both the pros and cons of second-home ownership.



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Key takeaways

- Test your assumptions about why you might want to own a vacation property.
- Easy access to your primary home, as well as to health care facilities, should be a key consideration when selecting a location.
- If you plan to rent out your second home, run the numbers carefully before you buy.

The image of owning a second home holds plenty of allure. The idea of having a retirement getaway, a gathering spot for the whole family or a rental-income generator—and maybe all three—has lots of people taking the second-home plunge.

Should you join the second-home club? To answer that question intelligently, you have to look beyond the excitement that the prospect of a second home might generate and apply some careful, rational thinking.

With that in mind, here's a look at the pros and cons of second-home ownership, and some big considerations to weigh if you're thinking about adding another home to your life.

To own or not to own

The first major consideration is whether to buy a second home at all. Some of the factors here include the following:

- 1. How often you'll visit.** If you plan to consistently set up shop in one location for several months each year—then owning may be the best route. If, on the other hand, you expect to vacation somewhere for just a few weeks annually, renting a house or two in the area may make better financial sense.
- 2. Possible reasons for wanting to own.** Give yourself a reality check by testing any assumptions about why you think a second home is a good move. For example:
 - Say you envision a retirement getaway that's always there waiting for you. Ask yourself whether visiting the same location year in, year out reflects your ideal retirement, or whether other options—such as traveling to various locales—might be more in line with your goals.
 - Perhaps you're thinking about a place where you can easily gather with extended family and friends. If so, consider whether the people in your life have the time and inclination to spend their vacations in that way. If you're thinking about buying another home to be closer to family or good friends, assess whether they're likely to remain in that geographic area.

There is no correct answer that fits everyone—the right move for you will depend on factors like your goals, your family situation and your willingness to take on ownership duties for two properties.



What to buy, and where to buy it

If you think a second home is the way to go, the next steps are to consider where to buy and what to look for. Some key items that should be on your list here include:

- 1. The basics.** The home itself should be large enough to accommodate your vision of how it will be used and by whom. Example: If you hope to see multiple generations of family bonding as they prepare meals together, be sure the kitchen is large enough to make that happen. Adequate parking for family and friends is another seemingly obvious but sometimes overlooked issue. And is there enough room to store the items you want to leave in the house all season or all year—especially if the house will sometimes have rental guests?
- 2. Distance from your primary residence.** Consider the location of a second home relative to your first. If you want your property to be a rental (more on that below), you might choose a place that's no more than an hour or two away so you can more easily take care of guest requests and maintenance. The same might be true even if the place is solely for your use. For example, consider whether you really want to hop on multiple airplanes or drive eight hours each way every time you want to visit your home away from home—knowing that the answer could be a resounding yes if the house is located somewhere you love to be and the effort is worth it.
- 3. Access to health care.** Significant health issues you have today (or may likely develop) should factor into your second-home decision-making. Depending on the severity of the issue, you might favor a home that's close to excellent medical care for your needs. That said, one lesson from the coronavirus is that it might make sense to set up shop near excellent hospitals and medical professionals even if you're in tip-top shape and your personal health outlook is good.
- 4. Maintenance and upkeep.** How much do you want to work on a second home versus relax in one? Determine how much renovation and upkeep the house might require given the size of the property and the state of the plumbing, heating system, siding and other features.

- 5. Costs.** It should go without saying—but we'll say it anyway—that you need to do the math to ensure the second home's mortgage, taxes and other expenses (such as homeowner association fees) don't leave you in a financially compromised position. These costs might look a bit different than they do with your primary residence.* One general rule of thumb: Add up all the expenses you can, then add another 25 to 33 percent of that amount.

The rental route

For some buyers, a second home means a rental home. And you may be able to generate steady revenue from your property—especially if you own in an area tourists flock to year-round.

That said, this is a route that can be filled with real estate land mines to navigate. Some advice to keep in mind:

- 1. Don't get starry-eyed.** Realtors may tell you how easy it will be to rent out your second home, highlighting great occupancy rates and rental rates that usually reflect marquee properties during the peak season. If your home hits all the hot buttons, and if you're willing to rent the house throughout the peak season and not take days for yourself, you could generate significant rental income consistently. But before you assume that your second home will pay for itself and maybe even turn a profit, consider some important caveats.
 - HomeAway, a vacation rental site, estimates that rents don't cover even 75 percent of the mortgage payments for about half of vacation homeowners who rent out their homes. (On top of the mortgage, there may be costs for cleaning, repairs, homeowners' associations, liability insurance and so on.)
 - The average homeowner is able to rent his or her home for only about one-third of the year. Those times tend to be during high or peak season, of course—when many owners and their families would prefer to use the property for themselves. Therefore, taking a peak week for yourself can crimp revenues—perhaps significantly.

Pro tip: Ask the seller for rental receipts or ask to see the records from the company that manages the property for the seller.

Also, keep in mind that unexpected risks can materialize that may jeopardize a rental income stream. In 2020, of course, the spread of COVID-19 has caused would-be renters and vacationers across the country to cancel their plans. But even a more typical catastrophe, such as a natural disaster, could damage your rental income goals.

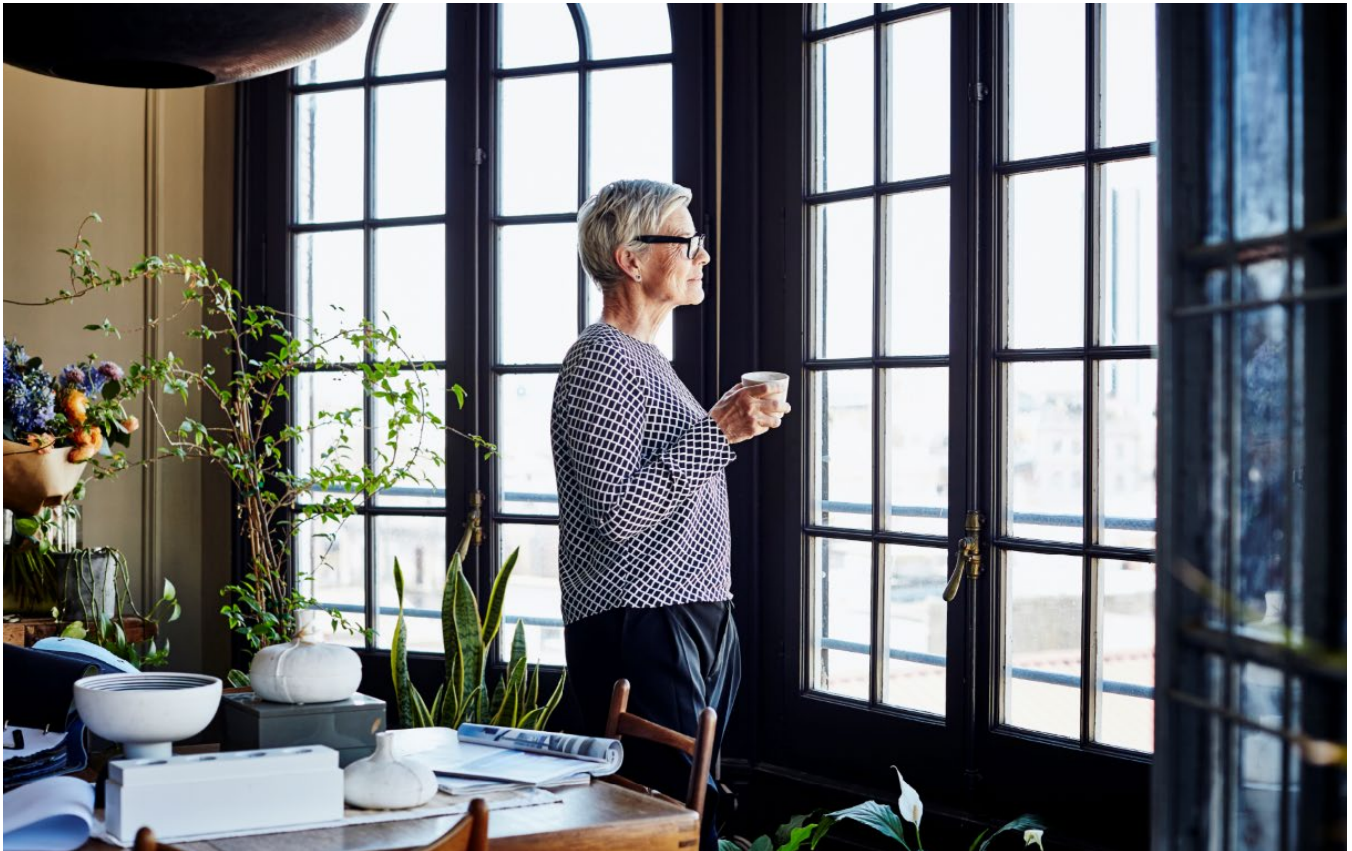
- 2. Recognize the amount of work that may be involved.** HomeAway also estimates that vacation rental owners spend an average of nine hours per week marketing or managing their properties. Pesky renter requests can keep you busy, especially if your property is far away from your main residence—yet another reason to think carefully about location and distance. Maintenance and fixes might take up much of your free time, too. All told, a rental home could wind up feeling like a second job.

Of course, you don't have to do any of those things. Management companies and other third-party providers will happily take most vacation home duties off your plate—for a price, which will eat into your revenues.

- 3. Understand the taxes.** A rental property comes with its own special tax treatment. The rules involving rental income, deductions and capital gains can get complex, so it's best to discuss this matter with a trusted advisor.

Conclusion

Owning a second home can be a fantastic new chapter in your life and the lives of your loved ones. It also can be a headache. Think through the many aspects of second-home ownership—enlisting the help and insights of family and trusted advisors—so you can decide the right move for you.



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