

— BUYING A VACATION RENTAL —

By
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WeNeedaVacation.com has been advertising vacation rental homes on Cape Cod, Martha's Vineyard, and Nantucket since 1997. The information in this document is based on nearly 20 years of experience in helping homeowners market their homes in this area.

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CONSIDERING?

Are you considering purchasing a vacation home but are fraught with indecision and questions? Will it be worth the effort? Will there be sufficient payback? Will you find trustworthy tenants? The answers to these questions can be yes, but you need to be willing to put in the effort and do your homework.

Renting a private home has become extremely popular with vacationers in recent years. The vacation industry has seen a sizable shift away from hotels and motels as vacationers have come to enjoy the many benefits of a home that offers plenty of both indoor and outdoor space, privacy, savings, and amenities.

As with any investment, it's important to take your time. Factor in your other financial goals, research the market carefully, and do the numbers to be sure you can comfortably afford the costs.

Keep in mind that renting out a vacation home is a business. It's not something that you enter into lightly. You can expect to encounter bumps along the road, but with proper planning and careful research, you can create a sound and rewarding investment.



INVESTMENT PROPERTY OR SECOND HOME?

What is your goal? The answer to the question about whether to buy a vacation rental home – and which home to buy -- depends, in large part, on your motivation. Are you looking at it strictly as an investment that you'd like to flip in a few years, or are you in it for the long haul? The longer you hold onto a vacation home, the better chance you have of making money on the property.

If you're buying a home for your own enjoyment and/or as a future retirement home, owning it for a long time will enable you to withstand the inevitable ups and downs of the market.

For mortgage purposes, you need to determine whether you will be using your vacation home as a second home or as an investment property. This will make a big difference in the type of mortgage you apply for.

To qualify for a “second home loan,” you generally have to be able to afford it just as you would your first home. Under this type of loan, there is no consideration given to potential rental income. Second home loans have about the same interest rates as a primary home loan.

With an “investment property loan,” the bank will want to know the rental history of the property, or, if it was never rented out, they will want to know its potential rental income. They will take this into consideration for your affordability factor. This type of loan is considered by the lender to be higher risk, which might well result in higher interest rates and fees.

THE FINANCIAL PIECE

This can be the trickiest, yet most important, factor in your decision about buying a rental property. Your goal, of course, is to buy a home that will rent for enough to cover the costs of owning and running it, or at least come close. Many owners turn a profit, but that can take some time, as you can usually count on some unexpected but necessary expenses when you first purchase the home. The following are some key factors to consider when determining what your annual expenses are and what you can expect to bring in for rental income.



EXPENSES

The Usual Expenses

As with any home you own, you can count on the usual expenses: mortgage payments, taxes, insurance, utilities, and maintenance.

If the home is near the water, you may be required to get flood insurance. And some insurance policies can cost more simply because the home might be empty more often.



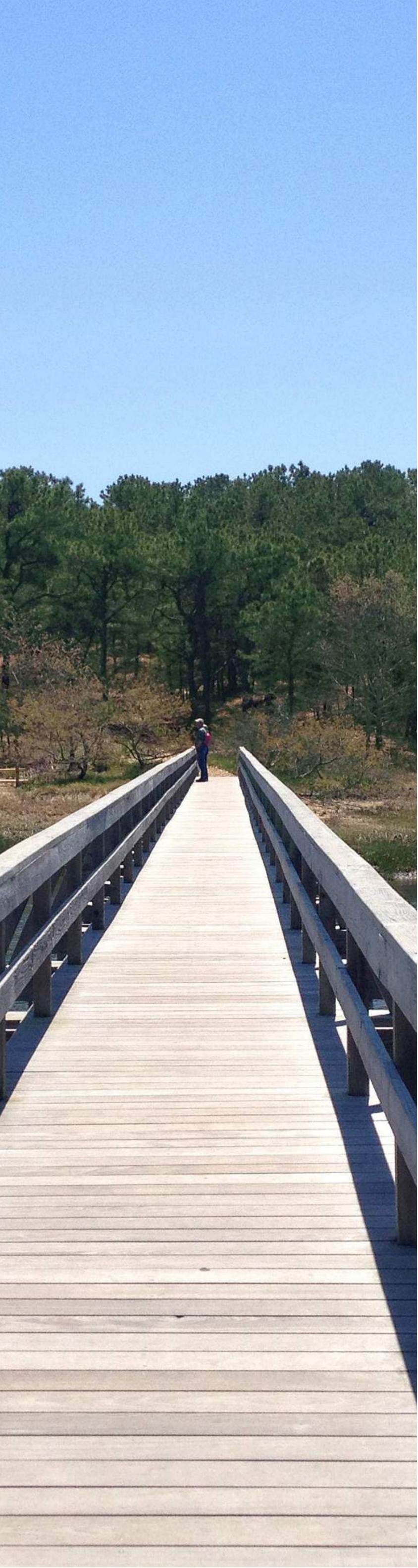
Maintenance and Repairs

Be aware of the added costs associated with owning a second home. To determine maintenance costs, get an idea from someone who lives in the area full-time about what it takes to keep a house in good condition. A home near the ocean, for instance, is usually more vulnerable to the elements.

Especially if you live a distance from the home, you might have to hire people to perform some routine maintenance and repair tasks that you would normally do yourself, such as mowing the lawn or repairing a broken screen. Service providers can be quite expensive, especially during the busy rental season when they're in high demand.

Like any home, a vacation home is subject to wear and tear. The National Realtors Association estimates that you should budget for 1.5% of the cost of your home to be spent annually on repairs and general upkeep. If you purchase a \$100,000 vacation home, for example, you should budget \$1,500 to put back into the property every year.

Other operating expenses include turnover cleaning, lawn care and landscaping, and trash and recycling.



TO OFFSET EXPENSES

Tax Deductions

When you rent out your vacation home, you are essentially running a business. So your mortgage expenses, utilities, supplies, furniture purchases, and advertising are all tax deductible. This will necessitate your keeping careful records of every purchase you make for your rental home.

You can even deduct your travel expenses if you are doing work on the house while you're there.



PRICING

One of the biggest factors in your decision about the purchase of a home is the rent that the home will generate. How much can you reasonably expect to make in rental income relative to similar properties?

One of the best methods of determining a realistic price is to check the rental rates of comparable rental properties in the area. Take into account the number of bedrooms, the number of guests the home accommodates, and some of the home's key amenities. How does your potential home stack up to similar homes in terms of price?

Comparing homes is not an exact science. The home you're considering might be newer and have more amenities, while another in the same price range might be closer to the beach. But you'll get a good sense of the price point for similar homes.

It's best to come up with a conservative estimate of rental income, especially until you are established and begin to get repeat guests and positive guest reviews. Keep in mind that you'll want to have tiered pricing, with your highest price for the peak summer weeks and somewhat less (sometimes by half!) for off-season weeks.

PRICING

BY THE NUMBERS

While the rent will vary from week to week and from home to home, the size of the home clearly makes a difference. To give you an idea of how the size of a home affects its rental price, we set a 3-bedroom home as the “average” rental rate. In comparison:



1 bedroom rate =
 $\frac{1}{2}$ of 3 bedroom



2 bedroom rate =
 $\frac{2}{3}$ of 3 bedroom



4 bedroom rate =
50% more than 3 bedroom



5 bedroom rate =
2 times 3 bedroom



6 bedroom rate =
 $2\frac{1}{2}$ times 3 bedroom

A scenic view from a wooden deck overlooking a coastal landscape. In the foreground, a wooden deck is furnished with several lounge chairs, some with patterned cushions and others with plain white ones. The deck is surrounded by lush greenery and flowering bushes. In the middle ground, a large, dark green tree stands prominently. Beyond the tree, a body of water (likely a pond or lagoon) is visible, followed by a grassy area and a small house with a chimney. The ocean is visible in the background under a clear sky.

LOCATION,
LOCATION,
LOCATION

Not surprisingly, most vacationers would like to be within walking distance (half mile or less) of a beach and are willing to pay a premium for this. Of course, the sales price for these homes is naturally higher than for homes that are farther from the beach, too.

The ocean beach is not the only draw for vacationers, however. There are hundreds of lakes and ponds on the Cape and Islands, and homes near these bodies of water are generally less expensive – both for the buyer and the vacationer –

than those that are near the ocean. Vacationers love to spend time swimming, kayaking, or fishing, all of which they can do at a lake or pond.

Homes that are on the water (not necessarily on the beach) or have a water view are highly desirable. Vacationers often comment on how much they enjoy sipping their morning coffee or an evening glass of wine as they enjoy the view from their rental home. And they are willing to pay for this luxury.

% Increase in Price by Proximity to Salt Water

Walk to beach vs inland: 20% higher

Waterfront vs. inland: 43% higher

Beachfront vs inland: 104% higher





HOW BIG?

Your budget and needs will dictate the size of the home you buy. Four-bedroom homes generally rent for more than three-bedroom homes, especially if two of the four bedrooms can serve as master bedrooms. This setup allows for two small families to share a home and split the cost.

The number of bathrooms is important, too. Even a two-bedroom cottage is more desirable if it has two bathrooms, or at least one full and one half.

Homes that have a family room in addition to a living room provide families with nice options for spreading out, and sunrooms and screened porches are extremely popular.

Keep in mind that larger homes (4+ bedrooms) are more difficult to rent in the shoulder season than smaller homes. Thus, although you can usually count on renting 8-10 weeks in the summer, the spring and fall weeks are not guaranteed.

OUTDOOR LIVING

Vacationers love to spend as much time outdoors as possible, and one of the biggest advantages of a private home over a hotel is the private outdoor space that a home can offer. A deck, patio, porch, and yard are all very important amenities and can positively affect the rental value.



POPULAR AMENITIES



- **Air Conditioning:** Increasing numbers of vacationers are requesting, if not requiring, air conditioning, and they are willing to pay more for homes with it. Although it rarely gets as terribly hot on the Cape and Islands as it does in most other parts of the country, it tends to be quite humid, and air conditioning is most effective in keeping a home dry and less prone to mold and mustiness.
- **Outdoor shower:** Many vacationers find this a novelty and frequently comment that it is a refreshing daily ritual while on their Cape or Island vacation. Of course, the shower should be enclosed and have hot water if possible.
- **Well-equipped, updated kitchen:** One of the biggest advantages of a home over a hotel or inn is that you can save money by preparing some of your meals at home rather than dining out. A fully stocked kitchen with modern appliances, along with a pleasant dining area (both indoors and out), is highly desirable.



MANAGING YOUR RENTAL

You will need to decide if you will manage your rentals yourself or hire a management company or realtor to do it for you. A realtor or management company would advertise, screen tenants, deal with the lease, and handle and dispense money. But they will also take a healthy cut of the rental income, usually around 15% of the rent.

There are two major advantages to managing the rental yourself. The first is financial: You will retain more of the income, which will enable you to reinvest it in improvements to your home or simply have more profit. The second, and even more important, reason is that by doing it yourself, you get to decide who stays in your home. You will know your home better than anyone and will be able to screen your tenants to be sure that they are a good fit for your home.





WILL YOU TAKE THE PLUNGE?

The final step is to compare the projected income with the monthly expenses. You should have a positive cash flow or at least come close to breaking even.

Take your time, and do your research. If you choose a home in an area you enjoy and put your heart and soul into caring for it, you will find that your paying guests will enjoy it, too. Who knows, you may end up keeping the home in the family for future generations. You can't put a price on that!