

You have chosen your home at the beach. Is it a second home or is it investment property?

You will make this decision twice,
once with your lender and once with Uncle Sam.
The criteria for each are different.

According to a lender:

The definition of a second home can vary per lender. Generally, if it is your first property on the Outer Banks and if you can qualify for the monthly payment without proposed rental income, your new property can be classified as a second home. This is important because you may put as little as 10% down and your interest rate will be the same as if you were purchasing a primary residence. You will be asked to sign a statement that you will be occupying the property yourself at least fourteen days per year.

If this is your second property on the Outer Banks and/or you need rental income to qualify for the monthly payment, your new property may be classified as an investment property. Investor loans generally require larger down payments, have higher interest rates, and do not allow gifts for any portion of the cash needed for down payment and closing.

These are all general rules and vary per lender. You will achieve your best results by meeting with your lender prior to viewing the property. You can meet in person or over the telephone. Your lender will ask questions that you will easily be able to answer regarding your employment history, income, cash assets, and monthly obligations. Your lender should be able to pull your credit report. At this point, you can be "prequalified." This means the loan officer can confirm that you can be approved for the loan amount you have requested.

This "prequalification" may or may not be accurate depending on the ability of your loan officer. It is a very good idea to continue the process and have your loan approved by an "underwriter" while you are deciding on a property. The approval process can be immediate via the online computer or take several days depending on your personal situation and the loan product. When you have selected your property, and are negotiating the contract, having a loan approval in hand may increase your negotiating ability.

Knowing your loan is approved. Knowing the monthly payment. Knowing the cash required. These are the navigational markers to "smooth sailing" through the exciting process of purchasing your home on the Outer Banks.

According to Uncle Sam:

Vacation home ownership on the Outer Banks falls into two main categories:

1. Second home used as a vacation home
 - Taxpayer may deduct property taxes and mortgage interest by itemizing on Schedule A of the tax return.
 - The taxpayer may not deduct operating losses, repair expenses, or depreciation.
 - For tax purposes, the taxpayer may only have one second home.
2. Second home used as a rental property
 - Most second homeowners fall into this category.
 - The second home must be rented.
 - The homeowner may not personally use the home on an annual basis more than 14 days or 10% of the total time home is available to be rented.
 - Personal use as defined by the IRS includes days or parts of days the owner or owner's family uses the home; and days when the property is used by a relative.
 - Personal use does not include days spent maintaining the home, days spent preparing the home for summer rental, days spent closing the home for winter.
 - All income and expenses associated with renting the property including depreciation, are deductible on Schedule E of the tax return.
 - Losses incurred on the rental of a second home are subject to the following passive loss rules:
 - The losses are available only if the taxpayer "actively participates" in managing the rental property.
 - The taxpayer may take up to \$25,000 in rental or passive losses if adjusted gross income does not exceed \$100,000.
 - If the taxpayer's adjusted gross income is more than \$100,000, the amount that may be deducted is reduced by \$1 for every \$2 above \$100,000.
 - If the taxpayer's adjusted gross income is more than \$150,000, then the rental losses are disallowed entirely for that year.

Please check with your tax advisor to see how these tax benefits apply to your personal financial situation.

Courtesy of Beach Realty & Construction