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– W. Brett Wilson, OC

# BUYING U.S. REAL ESTATE

## The Proven and Reliable Guide for Canadians

RICHARD DOLAN • DON R. CAMPBELL • DAVID FRANKLIN

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# Praise For Buying US Real Estate

"I would consider this the bible for any Canadian wanting to invest in US real estate."

— W. Brett Wilson, entrepreneur, philanthropist, adventurer and "Dragon," and recipient of the Ord of Canac

"*Buying US Real Estate* is a must-read for any boomer who wants to spend the next 30 yea fulfilling dreams, leaving a legacy, and living a purposeful life."

— Dr. Sherry Cooper, chief economist, BMO Capital Markets, and best-selling author of *The Ne Retireme*

"This book encourages you to take the time to figure out who you are, what you like, where you w love and what you value. If you ask yourself the tough questions, the odds on finding your passio and living your dream dramatically increase."

— Patricia Lovett-Reid, host of the *Pattie Lovett-Reid Show* and former chief economist, TD Bar

"The book's thesis is that the older people get, the more likely they will buy a home-away-from home. The spoils will go to those who act in the next two years."

— Jonathan Chevreau, editor of *MoneySense* magazine and author of *Findependence Da*

"Every now and then a book comes along that fundamentally changes the game. This book draw upon real science and substance to permanently elevate the way people and place come together."

— Dr. Paul Stoltz, visiting professor, Harvard Business Scho

"As a proponent of education and lifelong learning, this body of work represents the foundation f anyone in the world to begin their journey to learn."

— Rod Paige, former secretary of education of the United States of America (2001–200

"Brilliant collection of insights, education, research and direction."

— Phil Town, MSNBC financial commentator, *New York Times* bestselling author of *Rule #1* ar *Payback Tin*

"Insightful. Canadians, especially baby boomers, will find a place on the planet to enjoy family li more."

— The Right Honourable Brian Mulron

"Many Canadians are buying US property as retired or retiring individuals. This book is a sma start to buying south of the border."

— David Sersta, vice president, Zoomer Med

"I understand *tailoring solutions* and suggest starting with this invaluable guide in tailoring yo education about US real estate."

— Harry Rosen, founder of Harry Rosen In

"This book captures the essence of why owning real estate internationally can be a profitab venture in so many ways."

— Dr. Richard Ragatz, president, Ragatz and Associat

"This is Canada's quintessential guide for buying US real estate today, wisely."

— Hunter Milborne, chairman (ret.) and partner, Sotheby's International Realty Canad

“Anyone thinking about making an investment into US real estate will want to be educated. T make a final decision with comfort and ease, start here with this book.”

— David Pelletier, Canadian Olympic gold medali

“A guide for Canadians with property dreams that's right for the time.”

— Jamaal Magloire, Toronto Rapt

“These authors are the world's greatest real estate educators, in my personal opinion.”

— Juwan Howard, Miami Heat, 2012 NBA Champio

# Buying US Real Estate

## The Proven and Reliable Guide for Canadians

**Richard Dolan**
**Don R. Campbell**
**David Franklin**

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# Foreword

by Ambassador Frederick Bus

Foreign investors are investing in US real estate at a record pace, and Canadians are a major part that trend. Four-plus years of economic stagnation, combined with interest rates at an all-time low ar the Canadian dollar at par, have resulted in billions of dollars flowing into the US. Should you join th crowd?

There is a lot to consider when investing over distance. How do you know if you're getting a goo deal? What neighborhoods are worth looking at? How can you best manage the purchasing proces The writing team of Richard Dolan, Don R. Campbell, and David Campbell walk the potential invest through all the steps they need to take to acquire property in the US.

*Buying US Real Estate* is an info-packed road map for finding a property that meets an investor wish list. The authors have covered the topic from A to Z, including the selection of investmen properties, financing and ownership options, legal pitfalls to look out for, and the essential need fo proper tax planning, as well as how to carry out renovations and work with a property manager. Th authors are careful to warn against buying "emotionally" and provide excellent advice on th importance of investing with one's head and not with one's heart.

This definitive manual is easy to follow and provides the reader with all the tools needed understand the financial implications of what has to be one of the most exciting real estate buyin opportunities ever witnessed in North America.

*Frederick Bush served three US presidents—Gerald Ford, Ronald Reagan, and George H. W. Bush– in a variety of roles. He helped found the Canada Institute at the Woodrow Wilson Internationa Center for Scholars while serving as the center's associate director. Frederick is currently a executive with the Vail Valley Foundation in Vail, Colorado.*

# Your Life's Intent: Applying the Right Mindset to Investing in Real Estate

As professionals in the real estate markets, we have worked with thousands of real estate investors ar businesspeople, and we know that there is something different about the mindsets of successf individuals. They approach life with a certain set of assumptions, enabling them to apply analytic strategies to their decision-making and, as a result, create positive professional and personal lives.

Why is having the right mindset important? Investors the world over are reeling from the effects the Great Recession. Those effects have, of course, been felt financially, but there are dee psychological scars as well, which have shaken investor confidence. Getting that mindset back, th inner game that is the ability to assess and embrace risk, knowing that some risk is inherent in eve investment decision, is what all investors have to work at now. And that mindset is essential if you a going to achieve success in real estate investing in the United States.

We know that Canadian real estate investors like you are watching US property markets and lookin for tried-and-true investment strategies. So the goal of this book is to give investors solid real esta investment principles to put into action—but we also realize that giving you this information witho asking you to consider your mindset is a lot like giving you a car without a steering wheel!

When we work with real estate investors and professionals, we often hear them say they a “passionate about real estate.” Exploring this further (are they really passionate about bricks ar mortar?), we find that in fact, it is not real estate they are passionate about, but rather what real esta can help them get. Some reasons are financial—the freedom to choose what you do with your tim time off work, and extra cash flow—but more often than not, their real passions are linked to famil spirituality, or a desire to give back to the community or others who need their help. Using money accomplish our goals and living according to our values makes us happy.

We share this with you because we believe that it is important that you are very clear on “why” yo are buying real estate before you start. This clarity will help you develop the mindset that will allo you to be more focused and, in turn, more successful, and will also give you the mental edge to boun back from the days when things don't seem to be going right. Time and again, it is the investors wh have a clear understanding of why they invest who are better able to get back up, dust themselves of and move on when a situation knocks them down. In this business, that kind of resilience is a virtue.

The premise of this book is to show you how to use core principles to make US real esta investments work. The subject makes sense because there is no doubt that solid investme opportunities exist in the United States right now that, based on hard market fundamentals, a appealing because of their price (especially compared with hot urban markets in Canada).

But is the fact that you *can* invest in US real estate enough? And does the fact that now is particularly good time for Canadian real estate investors (or Canadians who want to be real esta investors) mean that you should rush south and pick up a deal—or two or three?

The point is that long before you figure out what kind of real estate property you are going to buy the United States and map out the road ahead, you need to determine why you are investing in the fir place. Once you know that, it's relatively easy to look at the type of investment vehicle that best sui you. The challenge is to recognize how you can fine-tune your goals to hone a business strategy th balances your investment and personal goals. In the meantime, be clear about *why* you want to inve in US real estate, because even the best investment market has risks. Figure out which investme vehicle you really want and be honest about how that decision will affect your life. Real esta investment is an enterprise best focused on long-term wealth, not short-term profit.

# Capitalizing on US Opportunities

By buying this book, you have decided that you are interested in investing in residential real estate the United States. You may already be invested in the Canadian market, but you will assuredly fin that your experience here is not directly transferable to the US market. For one thing, the America market is a lot larger than the Canadian market—the population of California, for example, is larg than all of Canada! This means that you have to focus on a couple of states and master the investme variables there.

The sheer size of the US market means that there are different opportunities on offer in differe parts of the country. In some areas, the best investment play is the buy and hold—with relatively hig *capitalization rates* (net income over purchase price) giving the investor steady income streams ov the time it takes for property prices to recover and appreciate.

In other areas, the cap rate might be relatively low, but an expected influx of population will p upward pressure on property prices, and property values will recover more quickly. Consider, fo example, the almost 34.5 million baby boomers currently living in the northern US states who may b looking to retire in Florida or Arizona over the next decade, when you are looking at investing in thos markets.

A lot of Canadians' current interest in US real estate markets has strong ties to the *snowbi* community, that group of retired and semi-retired Canadians who routinely migrate south to escap the cold winter temperatures of their home country. Over the last couple of years, these seasonal U residents have noticed the dramatic proliferation of Foreclosure and For Sale signs, and a growin number are asking if they should be treating their routine US holiday homes as investme opportunities. The answer is a resounding maybe! With US residential real estate prices at dee discounts, can these people reasonably expect to buy a US property, use it personally for part of th year, and then rent it out the rest of the time? If this is what you're thinking of doing, we recommen extreme caution.

# Don't Confuse Lifestyle with Investment

Residential real estate is a major purchase. However, we see too many Canadians buying vacatio property with an “investment” focus, who have no real clue about what's really at stake—it's like “field of dreams” strategy. So let's be clear: just because you buy it, does not mean vacationers wi rent. That doesn't mean that this strategy cannot work. But it won't work unless you treat it like business strategy and have a solid marketing plan in place to make sure the property meets yo revenue projections.

There are several key reasons why US vacation homes are not as easy to market as some Canadian expect, beginning with the fact that people looking for US vacation property currently have a gre deal of choice. Why would they stay in your two-bedroom condo in a gated community for peop aged fifty-plus, when they may be able to rent a house with its own pool or a beachfront property?

Timing is another concern that many people fail to incorporate into their vacation-home investme dream. For all of the differences between the Canadian and US climates, our summers and winte follow a remarkably similar path. If you plan to use the vacation property during the coldest Canadi months—aka, a prime winter vacation period—who's going to rent it during the off-season? And the can be other problems, too. For example, the southern United States may be beautiful in the fall, b that's also prime hurricane season. In other parts of the United States, tornado season coincides wi prime summer vacation periods.

Another factor to consider is financing. While some American banks will lend to Canadians to buy second home, your options are limited. And if you are buying property as an investment, be aware th these loans are hard to come by because US banks know that real estate investment looks easier than really is.

Think about what that means. The US lender is banking on your ability to meet a second-hon payment. They think you have what it takes to make those payments. If you're buying that hon because you think someone else (a renter) is going to make those payments, be careful. This strateg is not an investment if it puts your lifestyle at risk, so you have to consider that your investme property will have to be financed out of cash or against your existing Canadian property.

Financially, you have to consider your long-range view of the value of the Canadian dolla Currently at par, the strong dollar makes investing in the United States attractive. If the US doll increases against the Canadian dollar over time, your income and any appreciation in property valu will be in US dollars, offering a higher rate of return. And as a Canadian, once you invest in a rent property in the United States, you are going to have to file a US tax return, and pay US income tax on your US income. This will be credited against any Canadian tax owing on the income, but you a going to have to hire a cross-border professional advisor to structure your investment so that yo reduce liability and US estate taxes.

You should also think about property management, because seasonal contracts are difficult to set u and tough to maintain. It makes sense to factor quality property-management fees into a buy-and-ho investment cash-flow strategy. But if your place is only rented a few weeks of the year, how will yo handle ongoing maintenance or repair issues, let alone make sure the place is properly clean between vacation tenants? You can hire property managers, but if the property's not renting the wa you figured it might, that may not be an affordable option.

From a control point of view, you will not be able to “touch” the property or undertake renovation or management yourself, largely because of the distances involved—much as if you were living Toronto and wanted to invest in Calgary or Vancouver. The added wrinkle for the American market i that US law prevents you from working in the US without a visa. You will have to rely on America contractors and property managers or become a partner or joint venture with Americans and rely upo their capabilities. Alternatively, you can buy “turnkey” properties from providers, whose business buying through foreclosure, short sales or “good” deals, and renovating, renting, and providi property management, which makes your cost and returns more defined.

## A Longer-Term Strategy

Let's say that you do a good job of goal planning and you know you want to retire in five to ten year With that mind, you are looking for an investment that will help make that possible. In the meantim

you don't want to live entirely for the future, but might want to break up the last years of your workin
life with a few special vacations.

In the short term, Canadians in this situation may want to look at buying a US buy-and-hold rent property with positive cash flow. When you buy a single-family residential investment property Canada, gross rent is considered attractive if it is 8 to 10 percent of the purchase price, whereas in th United States it is possible to achieve gross rents of 12 percent. These houses should be located communities where capital appreciation is forecast and where there is an increase in first-tim homeowners. As you're looking ahead and enjoying life now, you could use the cash flow you earn t fund those vacations you're dreaming about.

Down the road, several other options may open up. You could use that rental property as you second home, leverage it to buy a second home, or sell it and use the proceeds to buy your drea vacation home. Instead of tying yourself to an investment strategy premised on risk, you've used re estate investment fundamentals to create future wealth and some pretty exciting pre- and pos retirement options.

So let's begin the journey. In Part 1 of this book, we'll look at the economic factors that will affe your investment decisions, as well as our recommendations about the US states where the econom factors are positive. In Parts 2 and 3, we'll give you the ins and outs of buying distressed properties the United States. In Parts 4 and 5, we'll examine tax and legal issues, while Parts 6 and 7 will b devoted to financing and insurance.

# Part I

# The Decision to Invest

# Insight 1

# The Economics Behind the US Market

Much has been reported and written about the collapse of US housing market values. Villains hav been identified, bail-outs have been negotiated, and banks have new, more stringent lending rule Media reports have focused on banks foreclosing on homeowners unable to meet their mortgag obligations, and for families who have lost their homes, it has been a cruel time. There is no doubt th since September 2008, foreclosures of distressed properties have been one of the prime investme opportunities in the United States.

So what is the situation at the writing of this book? Those Canadian investors looking f opportunities in the US real estate market will find that they do exist. But how is the market differe than three years, a year, or even six months ago? A lot of factors indicate that while there are sti opportunities in this market, they are decreasing. The lesson for the savvy investor is to work fa before they dry up. But first, let's look at some of the fundamentals behind today's US real esta market.

## What Trends Are Driving This Opportunity?

- Because of the economic crisis, people are defaulting on their mortgage payments and their homes are being foreclosed.
- Homebuilders, bruised by the faltering economy, were caught between slowing business and increased availability of vacant homes; in 2012, for the first time since 2005, US residential construction is expanding according to the US Census Bureau.
- While people have lost their homes, they still need somewhere to live, and because of that, the rental market in the United States is exploding.
- Baby boomers from Canada and the northern states are looking to migrate to warmer states like Florida and Arizona. To put this into perspective, 34.5 million people live in the northern United States and might soon be considering life without having to shovel snow!
- Global economic uncertainty acts as a catalyst for investors to look abroad for opportunities.

## No Income, No Assets, No Worries!

The economic catastrophe we've endured over the last few years can be traced to several conditio that combined to make the “perfect storm.” One of these was the subprime mortgage crisis caus when lenders gave mortgages to home purchasers, many of whom who did not have the means qualify. In some cases, no proof of income was required and mortgages were given for more than 1 percent of the purchase price (housing values were often inflated so the banks could lend out eve larger amounts of money), giving rise to the infamous NINJA loan (no income, no job, no assets). T make it easier for people to get loans, banks offered forty- and fifty-year mortgages, negati amortization loans, and “no document” loans. In some cases, purchasers were encouraged to add th ~~value of a new car or plasma TV to their mortgages. It didn't matter if the purchaser had a job—th~~ bank was going to loan them the money anyway. Banks put anyone and everyone into a home, fuellin the “housing bubble.”

We all know that the sand that the housing and mortgage industry was built on shifted, and th market collapsed, leading to the merger of Bear Stearns with JPMorgan Chase, and the bankruptcy Lehman Brothers and numerous small US banks. In addition, the US mortgage insurers, Fannie Ma and Freddie Mac, had to be bailed out by the United States government and remain under th conservatorship of the Federal Housing Financial Agency.

When the market crashed in 2008 and the banks came calling for their money, few people had th funds to pay. With house prices dropping up to 100 percent in some areas, the phenomenon o *negative equity* appeared—where homeowners owed more money on their mortgages than the actu value of their homes. Called the *underwater mortgage*, this term became familiar to the man mortgagors who borrowed money, bought houses, or refinanced during the housing boom.

Another consequence of the availability of cheap financing was that builders kept building home The end result was an oversupply of houses, especially in the states of Florida, Arizona, Nevada, an California. One of the main reasons for the oversupply in these particular states is that home builde expected baby boomers to move to these warmer states in droves. This over-building was anoth accident waiting to happen when the crash came, and contributed to the decline of housing prices.

# How Big Is the Foreclosure Market?

From September 2008 to April 2012, there were 3.6 million foreclosures across the United State People continue to default on their mortgages, and there are presently 1.6 million more homes “shadow inventory”—homes that could be foreclosed because they are technically in defau Together, Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA) now hold ove 250,000 foreclosed properties.

At the beginning of 2012, more than 11.1 million US homes (or 22.8 percent of all mortgages) ha negative equity, and an additional 2.5 million borrowers had less than 5 percent equity, or wer considered near negative equity. The total mortgage debt outstanding on properties in negative equi is $2.8 trillion; Nevada has the highest percentage of properties with negative equity at 61 percen According to CoreLogic, Arizona, Florida, Michigan, and Georgia round out the list of the top fiv states with negative equity.

From an investment standpoint, you may be wondering how long this situation can last, and yo would be right to wonder. Foreclosure filings for 2012 are decreasing at a rate of 1.45 percent, dow from 2.2 percent in 2010, the lowest point since 2007. In addition, the shadow inventory of 1.6 millio homes represents a five months' supply, down from 1.9 million last year. What's important for th investor to remember, though, is that prices have dropped by 50 percent and still haven't recovered pre-recession levels—presenting an opportunity, for now. And while it may sound like there is a lot o inventory around, it is important to identify the “good” foreclosures, where the market fundamenta add up to a good investment.

### Key Insight

Foreclosure filings are on the decrease, which means that this boom can't last forever. With housing prices still below pre-recession levels, now is the time for investors to act.

## The US Economic Recovery

For the last three years, we've watched as the Federal Reserve printed money as fast as it could in a effort to boost the economy. By introducing more physical currency in the world money supply, th net effect is that the value of each dollar is diminished, and the number of physical US bills worldwi has tripled in the last three years. Why would a government do this? Because it forces the value of i currency down while the actual numerical amount of debt owing on the ledger remains the same. Th end result is that the government ends up paying off its debt with money that is worth less. An despite the current downward trend in unemployment, and a growing economy that has avoided double-dip recession, there remains a protracted economic recovery. The constant politicking by bo the Republicans and Democrats, exacerbated by the fact that this is an election year, is distracting th politicians from creating real and sustainable economic growth.

Some positive events are in the forecast too. Some elected representatives are trying to help th public, and a bill was introduced at the end of January 2012 to forgive $100 billion in mortgage deb There is opposition to this proposal, however, and it is uncertain whether it will ever pass. In additio Fannie Mae is trying to get Wall Street back into the property market by offering 2,490 foreclose homes for sale to larger investors. (At printing, news reports indicate that the first auction has bee held and raised approximately $330 million.) And finally, the Federal Reserve is trying to stem th flow of foreclosed homes coming to market by proposing new regulations that would allow banks hold and rent foreclosed properties, instead of selling them and depressing prices further.

For Canadian investors, all these factors mean that the door on the foreclosure market remains ope for now. But what if any of these solutions, or even new ones, come into play? The market cou change overnight.

## New-Home Construction

The economic recession has shaken US consumer confidence, but more fragile than consum confidence is builder confidence. In order for construction companies to build homes, they nee customers who can borrow money—and that number has dropped. Builders are also competing wi the glut of available homes that are facing foreclosure—they can only build when there is deman What we are seeing now, however, are builders, who had been on the sidelines waiting for th foreclosure market to evaporate, starting to come back into the marketplace.

The US Congressional Budget Office reported that the annual number of housing starts required house the growing US population is approximately 1.5 million. Because of the housing crisis, fami formation dropped to 600,000 for 2009 and 2010, resulting in less demand for builders' homes. 2011, family formation increased to 1 million, still below normal. While the drop has caused th "doubling up" of families, it does not mean that the actual demand for housing has dropped—it is ju delayed. With the demand being short by nearly 1 million units over the last couple of years, how lon