



BUY, SELL OR HOLD? Advice for a Hot Real Estate Market

BY KRISTI MATHISEN CPA, J.D. AND BRIDGET BURGESS, CFP



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With the red-hot real estate market in the Puget Sound – and across the country – a lot of people are thinking “Buy! Sell! Now!” But does the excitement come from true opportunity or a false sense of urgency?

The uncertainty is understandable, given that Seattle-area single-family home prices are near all-time highs (see chart), close to double the price level in 2000. Such price gains can lead to outright bad or sub-optimal decisions (remember 2007 anyone?), as buyers begin to think that prices can only go up from here, while sellers try to cash in on

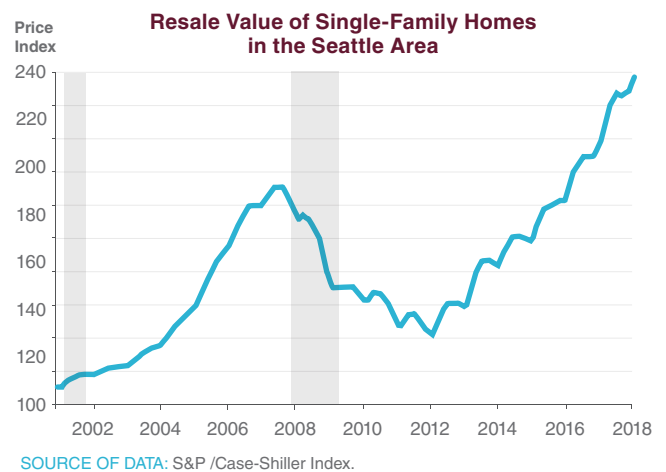
what they think is a market peak. As we’ve seen first-hand, a decision to buy or sell real estate is not something you can undo quickly or easily.

For insights on buying or selling in a revved up market, we sat down with Kristi Mathisen, LNWM’s Managing Director of Tax Planning, and LNWM Client Advisor Bridget Burgess, both of whom advise a wide variety of clients – from seasoned real estate investors to those thinking of buying their first home.

Q: What would you say to people thinking of either buying or selling in today’s real estate market?

Kristi: I think it’s important to realize that a frothy market can lead you astray from what’s in your best long-term interest. The core question is: Is there real opportunity here for me in this transaction? Or is the urgency I feel misguided? This forces you to evaluate what YOU want and need, so that the buy/sell decision fits in with your life, not the other way around.

Bridget: We have seen that over time, the same property can have different primary purposes, depending on where you and your family are in your lives. So begin by asking: What is the primary purpose of the property I want buy or sell now, and how does that fit into my overall plan?





Remember: A Property’s Purpose Can Change

Main Purpose	Definition	Tax Incentive to Buy*	Tax Break on Selling*
Primary Residence	Where you live more than 6 months a year	Mortgage interest deduction*	No tax on gains up to \$500,000#
Secondary Residence	Where you live less than 6 months a year	Mortgage interest deduction*	No tax on gains up to \$500,000#
Vacation Home	Varies	Mortgage interest deduction*	No
Family Homestead/ Legacy	Varies; often inherited	No	No
Investment Property	Held for lease, rent and/or appreciation	Limited	May defer gain if exchanged*

*Tax benefits depend on meeting tax code qualifications. #For married couples; \$250,000 for singles.

Q: Let's start with purchase of a primary residence.

Kristi: Each type of property has key attributes, either financial, lifestyle or both. A primary residence, for example, should pencil out financially because it is a long-term, illiquid equity investment. It is a financial planning tool, too, since it forces savings (monthly mortgage payments), appreciates tax-free, takes advantages of federal tax breaks and may capitalize on today’s very low interest rates. For these reasons, owning the house you live in is still a better long-term deal than renting in most US markets. There are lots of online rent vs. buy calculators that help you crunch the numbers (see box next page).

But...the home ownership decision has to be made in context. A key question: Can I really afford this? We don’t mean “technically” afford — having the 20% down payment and approval for the mortgage loan. You need to consider your life now and in the future.

In the old days — when mortgage rates were 5%, 7% or 9% — the usual advice was this:

**“Buy the biggest house you can finance.
Try to get the worst house in the best neighborhood and fix it up.”**

The idea was to stretch to buy now and refinance later to lower your payment. This advice is now questionable because mortgage rates are already at historically low levels (about 3.5% for 30 years 2.8% for 15), so it is unlikely refinancing can ever save a current buyer money. If anything, rising property taxes and insurance costs will increase your payment over time. Add to that the cost of home renovation and maintenance and you begin to get a more accurate picture of total, ongoing costs.

Bridget: Real affordability allows for flexibility, should your life circumstances change. It usually means: **(1)** Your monthly mortgage is not much higher than what you could rent the house for should you want to move or change jobs. **(2)** After paying the mortgage and other housing costs, you can contribute to all your other savings accounts – rainy day fund, pension at work, travel, kids’ private school or college.

I often hear “My house is my retirement fund” or “our house is our college fund.” There’s a certain comfort in making those statements. But it’s important to remember that a primary residence is just one type of investment. It’s wise to have other investments for the sake of diversification and liquidity. The reality is that over long periods of time real estate prices have appreciated only modestly. And they have also had down periods, as we saw in 2007 – 2011.

Q: What about selling the main home and downsizing?

Bridget: There's a big tax and estate planning component to selling that's important to think through before you put up the “For Sale” sign. Once you sell, that property is usually out of your life forever. So ask yourself: Do I need to sell (cash flow needs, divorce, zoning issues, etc.)? Or do I want to sell?

If you don’t need to sell, you should fully explore the reasons for the sale and evaluate alternatives. You could, for instance, give the house to your children on a deferred basis, essentially shrinking your estate if you are subject to estate taxes. With proper planning, you can continue to live in the house, albeit as a renter. Or you can rent out the house or even convert it into apartments (or even condos) if zoning permits, turning it into an income-producing investment property.

Kristi: A key consideration in selling is capital gains taxes. You can exclude up to \$250,000 in gains (\$500,000 if married) from the sale of a property that was your primary residence for two years during the five-year period preceding the sale. This can reduce the effective tax rate on the gain significantly. Keep in mind that gains above the tax-exempt amount are taxed at 15% to 20% currently (the long-term capital gains rate). And for higher-income households, the 3.8% Medicare tax also applies.

Bridget: Selling and being a renter for a while can be a really great option because it gives you both control and flexibility, allowing for deliberate decisions about what makes most sense for you. This could mean eventually buying a centrally located condo or a condo in a long-term care

RENT VS. BUY ONLINE CALCULATORS

Easily accessible and free, “rent vs. buy” online calculators can provide additional insight. Note, however, that they tend to have built-in assumptions about key rates of return for investments, rent increases and house price appreciation. We suggest typing in a conservative number for all return assumptions, such as 3%. Also, we suggest playing with the numbers to see the turning point, when the “buy” recommendation turns into “rent” and vice versa.

Sample “Rent vs. Buy” calculators can be found at:

- [Zillow.com](https://www.zillow.com/rent-vs-buy-calculator/)
- [Bankrate.com](https://www.bankrate.com/rent-vs-buy-calculator/)
- [NYTimes.com](https://www.nytimes.com/rent-vs-buy-calculator/)



facility, and continuing to rent wherever else you want to be. With all the housing exchange and rental options now available, renting can literally open up a whole new world of possibilities.

Q: What about real estate as an investment?

Bridget: Investment real estate is often easier to assess than residential. The numbers either pencil out or they don't. The right type of rental property can be a great source of additional income, while hopefully appreciating in value. If you purchase raw land, have a clear vision for it before buying.

Kristi: A key consideration: Are you in the right type of rental property for your cash flow needs and long-term goals? A Section 1031 Exchange allows you to swap your investment property for another one without paying gains taxes. I think part of the recent run-up in real estate prices is caused by people actively seeking to swap out of investment properties at high valuations, which are filtering down to the rest of the market.

Q: Second homes or vacation homes?

Kristi: These are great for lifestyle reasons. In certain circumstances, a second home may qualify for the gain exclusion discussed earlier and the mortgage interest deduction. The financial benefits of a vacation home may be limited, however, unless the property can be rented out consistently, which can actually work against the tax benefits.

Bridget: I think you also have to consider how long you're at that condo in Whistler, BC or in Kauai. Is owning really less costly than renting for short periods? Also, a second home often becomes a transition house from your primary residence into retirement. Will the second home allow for you to age in place?

dollars and sense

With real estate, there are no easy answers. Before making any major purchase or sale – especially real estate – it's a good idea to assess how this aligns with your overall financial plan and life goals. While we typically provide clients with financial projections for all their options, the final decision often comes down to more than just dollars.

Taking the time to explore your intent, the purpose of the property, as well as the tax and financial consequences is likely to lead to a decision that's best for you. ■



ABOUT THE AUTHOR

KRISTI MATHISEN is Laird Norton Wealth Management's in-house expert on tax and estate planning. She also provides advice on philanthropic strategies to the firm's client service team and to clients directly. She is an attorney and CPA and has more than 25 years of finance-related experience, much of it in accounting.

Kristi has a bachelor's degree in business administration with an accounting concentration from the University of Washington and a Juris Doctor from the University of Washington School of Law. She is a member of the Washington State and King County Bar Associations, the CPA Society of Washington State and the American Institute of CPAs.

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Prior to joining Laird Norton, Bridget managed her own financial-planning practice. From 2000 to 2011, she was President of Symetra Investment Services (formerly Safeco Investment Services), where she also served as Vice President from 1998 to 2000. Bridget is a CERTIFIED FINANCIAL PLANNER™ and has a B.A. in Business Administration from Washington State University. She is actively involved with the Puget Sound Financial Planning Association, where she served as Board Chair from 2008 through 2010 and as President during 2007.

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