



Sell vs. Rent Comparison Fact Sheet

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1. Introduction

This fact sheet is intended to assist today's home seller with the decision of whether to sell, rent or hold as a primary residence a home in today's real estate market.

First, a brief market update and review of recent news headlines is given (see full market update and forecast at www.MoveSanDiego.com under 'Market Update' tab) with estimates of what phase in market cycle we are in now and what is coming.

Next, simple calculations are given with sample properties so you can quickly determine and compare what selling vs. holding costs are associated with home ownership in light of the current market trends and future values.

Finally, a cost vs. benefit analysis of ownership, landlord issues, 55+ benefits and other costs associated with home ownership are shown and examples of how to benefit from this Fact Sheet.

2. Executive Summary – If you don't have time to read all... read this...

This document provides you with the information needed to help make the decision to sell or rent your home. Links are provided to reference additional materials where available and of course check with you tax and estate planning advisor.

There will be many aspects for you to consider but by choosing to convert a 'primary residence' into an 'investment property' by 'renting it out', the final decision must be made from an investor mindset and what makes financial sense.

Market Trends: Markets across the country and especially in California have seen large increases in inventory and decreases in sales which experts feel is the start to a 3-4 year decline (bottom 2009-2011) that will see a average 20-40% decrease in home values (even in nice neighborhoods... especially in condos, multi-family, vacant land and 'high end' homes).

You must ask yourself the following questions:

1. How long do you plan to rent?
2. Where will the real estate market be when you want to sell?
3. Do you want to deal with tenant/landlord issues?
4. Even if rent is covering mortgage, taxes and insurance can the property justify; the time required to manage, the opportunity cost of cash 'locked' into property and how much property will be declining in value?
5. How much tax value can you derive from depreciation deductions or losses from sale if you sell later for less than you purchased? (Remember you may lose capital gain homeowner deduction if you convert property to an investment property)

Loan Program changes:

Foreclosure rates are increasing due to adjusting of 'teaser rate' qualification loans, stated income 'liar loans' and when values decrease people cannot 'refinance' out of financial problems. This has caused lenders who are looking at losses coming up and those providing mortgage insurance to these loans to change their lending standards. What the impact would be of new rules restricting 'no doc' or 'low doc' loans and limiting loan to value ratio of 80-90%? It would be huge... a 10% decline in purchasing ability to start. Finally... the decreased ability for those needing to refinance to successfully do so.

Market Psychology: It has been proven markets move in psychological phases

Example: The 'Market States' from low to high to low...

Resignation (that market is at bottom), **Disbelief** (that market is rising), **Rising expectations** (feeling better), **Mindless Euphoria** (buy, buy, buy), **Disbelief** (is market really going down?), **Despair** (it really has dropped), then **Resignation...** (desperation sales, bottom feeding, time to buy to hold)

I think market is in the 'Disbelief' before 'Despair' stage.

Executive Summary Conclusion:

If you're still unclear about what path you wish to take then read the rest of this document and complete the calculations to gain the best perspective on what to do.

If you have decided to sell or want us to run 'what if' calculations for you based on your individual circumstances call us at 858-254-6741 and leave a message to schedule an appointment.

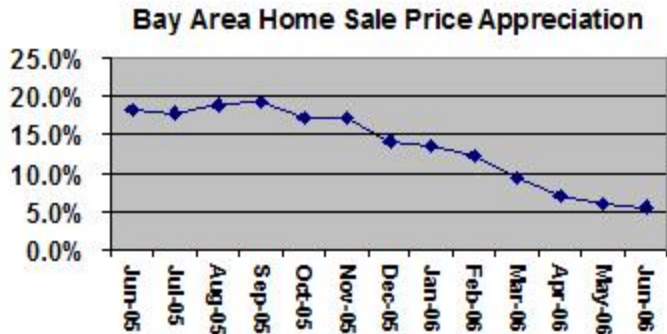
Time is of the essence! If you decide to sell then sooner is better than later... Call us right away to get the process started. If you decide to rent then we can help you with all aspects of property management. Call 858-254-6741.

If you need a referral to a tax advisor, estate planner or real estate attorney then call us and we'll help you out.

Contact us with any questions. **Call today 858-254-6741.**

3. Market Updates (Northern and Southern California):

Northern California (Hey... I feel good)



Bay Area home sales decline, new price peak Home sales in the Bay Area continued to slow last month as prices reached new highs. Prices increased at their slowest pace in more than three years, a real estate information service reported.

Foreclosure rates are coming up from last year's low point, but are still below normal levels.

"The market is definitely slowing but can only be considered "slow" when compared to the hot market of 2004 and 2005. In reality, today's market is pretty normal and balanced, right between the grim times of 1993 to 1995 and the frenzies of 1999 and 2004-2005. The Bay Area's market is reaching the end of a real estate cycle, it looks like prices could flatten out sometime this fall.

San Francisco Bay area is currently in stage three (transitioning to disbelief)

1. **Disbelief** - late 90's 'are prices rising?' (bottom)
2. **Rising expectations** – After 2000 to 2003
3. **Mindless Euphoria** – 2003 to now... but starting to fizzle (top)

Southern California (Oh #&!\$... what's happening?)



Some of the largest construction companies building on San Diego's outskirts and in its core have begun to reduce the number of homes they are constructing at any time, a trend that could impact a regional economy that has thrived with the help of the booming real estate and construction industries. Countywide, 2,836 residential building permits were issued in the first quarter of 2006, compared to 4,818 in the same period last year -- a 41-percent decrease.

<http://www.dqnews.com>

"Southern California home prices climbed to a new peak last month but at the slowest pace in more than six years. Prices edged higher even as June sales fell to a seven-year low, the result of higher borrowing costs, more inventory and less urgency among buyers...

We view this as the normal winding down of a real estate cycle, where declining demand gradually erodes price growth until it halts or reverses. We expect more markets to see prices flatten or decline a bit in the second half of this year," said Marshall Prentice, DataQuick president.

With 20,000 homes on the market in the county, all the analysts know something has to give. Whether disappointed sellers pull their homes off the market until things calm down, or relent on prices and give up some of the gains of the past few years, remains to be seen.

There are currently 22,890 (up from 11,000 July 2005) homes listed for sale in San Diego, according to real estate brokers ZipRealty. Dennehy said sellers are starting to realize that if they want to sell their home, they'll have to drop their price.

<http://www.voiceofsandiego.org/housing>

Depreciation estimates from investor groups:

- ✓ 20-40 % decline statewide
- ✓ Vacant land, multi-family, 'high end' and condos biggest losers
- ✓ Entry level, established areas will do better but all will decline

San Diego is currently on stage one going to stage two (as of Winter 2006)

1. **Disbelief** - Why is my home is not worth more than last year?
2. **Despair** - After price declines, mortgages due, foreclosures hit
3. **Resignation** – Forced sales, few buyers, investors buy to hold

Time Estimates: Disbelief – now Despair 2007 Resignation 2010-2011

4. Sell vs. Rent Calculations and Examples

Sell Calculation Example:

(rough estimate only, talk to accountant for specific details)

Cost of sale: Sale price x 10% = _____ x 10% = _____
Simple conservative calculation: Cost of sale is 10% of final sales price.

Cash from sale to invest: Sale price – loans – cost of sale = \$ _____

Use of cash:

Invest at minimum 4% in unleveraged investment = Cash + 4% / year = \$ _____

Example 1: 500,000 home 250,000 loan, cost of sale \$ 50,000 = \$ 200,000

Example 2: 1,000,000 home 700,000 loan, cost of sale \$ 100,000 = \$ 200,000

Example 3: 1,500,000 home 1,200,000 loan, cost of sale 150,000 = \$ 150,000

\$ 200,000 x 4% (conservative investment yield) = \$ 8,000 (both # 1 and 2) \$ 6,000 (#3)

Net Tax deductions:

Interest 250,000 @ 7% = 15,000/yr x tax bracket (30%) = 4,500 - * Property tax \$ 5,500 = - \$ 1,000

Interest 700,000 @ 7% = 49,000/yr x tax bracket (30%) = 14,700 - * Property tax \$ 11,000 = \$ 3,700

Interest 1,200,000 @ 7% = 84,000/ yr x tax bracket (30%) = 25,200 - * Property tax \$ 13,200 = \$ 12,000

* **Note:** Calculated at 1.1%. Actual tax base will change property tax so adjust as necessary.

Other 'variable costs': Insurance, HOA, Mello-Roos, and maintenance.

Opportunity cost of cash: Investment (example of CD at 4%) – Home (current investment)

Difference: Example 1 Costs you: \$ 9,000 per year (8,000 – <-1,000>) excluding 'variable costs'

Difference: Example 2 Costs you: \$ 4,300 per year (8,000 – 3,700) excluding 'variable costs'

Difference: Example 3 Benefits you: \$ 6,000 per year (6,000 – 12,000) excluding 'variable costs'

Take all these costs + cost of rent/keep into account when considering to sell vs. rent or keep

Rent / Own Calculation

Example # 1 \$ 500,000 home \$ 250,000 loan (50% LTV), Rent 2,000 / month, Interest \$ 15,000 / yr

Example # 2 \$ 1,000,000 home \$ 700,000 loan (70% LTV), Rent 3,500 / month, Interest \$ 42,000 / yr

Example # 3 \$ 1,500,000 home \$ 1,200,000 loan (80% LTV), Rent 4,300 / month, Interest \$ 72,000 / yr

- All interest only loan @ 6% (very conservative), expenses: OOC 2%, NOO 40%, 30% tax bracket, 75% improvement value.

Net Operating Income (NOI) = Annual Gross Rents – Expenses (taxes, insurance, vacancy, mgt, maintenance, etc)

_____ - _____ (estimate 40% of gross rents if unsure) = \$

Example 1 \$ 24,000 – 9,600 = 14,400

Example 2 \$ 42,000 – 16,800 = 25,200

Example 3 \$ 51,600 – 20,640 = 30,960

Cash Flow: NOI (net operating income) – Mortgage payment =

_____ - _____ = \$ _____

Example 1 \$ 14,400 – 15,000 = - 600 / year

Example 2 \$ 25,200 – 42,000 = - 16,800 / year

Example 3 \$ 30,960 – 72,000 = - 41,040 / year

Realized Income: 'Owner' Occupied = Primary Residence Non-Owner Occupied = 'Rental' Property

'Owner Occupied' Income: Interest x Tax bracket = _____ – expenses + * loan pay-down =

Owner Occupied _____ x _____ % = _____ - _____ + * = \$

'Rental' Tax: NOI – Interest - Depreciation allowance (value x % improvement/27.5) = x Tax bracket =

Rental Tax: _____ - _____ - _____ = _____ x _____ % = \$

_____ 'Rental' Income: Cash Flow - Tax Credits + *Pay-Down =

Realized Rental Income: _____ - _____ + * = \$ _____

* (no pay-down since interest only, pay-down = payment - interest)

Depreciation: Present Value x 3-7% depreciation (5%expected) \$ _____ x 5 % =

Opportunity cost of capital: Equity x 4% (a safe CD yield you could be getting) = \$

Net Result Income (Gain or – Loss): Realized Income – depreciation - opportunity cost =

(All Per Year) <u>Rental</u>	Owner Net	Rental Net	Depreciation	Opportunity	<u>Owner</u>	Net Result
Example 1 30,730 loss	\$ - 5,500	\$ -4,270	\$ -25,000	\$ -10,000	\$ 35,000	loss \$
Example 2 65,579 loss	\$ - 7,400	\$ -3,579	\$ -50,000	\$ - 12,000	\$ 69,400	loss \$
Example 3 103,454 loss	\$ - 8,400	\$ - 16,454	\$ - 75,000	\$ - 12,000	\$ 95,400	loss \$
Your #'s:	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____	
	\$ _____					

Calculation Summary

Cost of ownership vs. sale comparison: 3 year decline at 5% per year (A) then 0 decline (B)
 Cost of sale – A: costs w/ market depreciation x 3 years and B: without market depreciation x 3 yrs
 (assuming no tax even sales, 150K cost of sale not realistic but kept in)

Owner Occupied: 3 Year outlook					A	B
(All Per Year) <u>Cost of Sale</u>	Owner Net	Depreciation	Opportunity	<u>Depreciation</u>	Net Result	<u>w/o</u>
<u>Depreciation.</u>						
Example 1 profit	\$ 50,000	\$ - 5,500	\$ -25,000	\$ -10,000	\$ 71,500	loss \$ 3,500
Example 2 41,720 profit	\$ 100,000	\$ - 7,400	\$ -50,000	\$ - 12,000	\$ 108,200	loss \$
Example 3 88,800 profit	\$ 150,000	\$ - 8,400	\$ - 75,000	\$ - 12,000	\$ 186,200	loss \$
Your #'s:	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____	
	\$ _____					

Rental Unit: 3 Year Outlook					A	B
(All Per Year) <u>Cost of Sale</u>	Rental Net	Depreciation	Opportunity	<u>Depreciation</u>	Net Result	<u>w/o</u>
<u>Depreciation.</u>						
Example 1 profit	\$ 50,000	\$ -4,270	\$ -25,000	\$ -10,000	\$ 121,810	loss \$ 7,190
Example 2 53,263 profit	\$ 100,000	\$ -3,579	\$ -50,000	\$ - 12,000	\$ 96,737	loss \$
Example 3 64,638 profit	\$ 150,000	\$ - 16,454	\$ - 75,000	\$ - 12,000	\$ 160,362	loss \$
Your #'s:	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____	
	\$ _____					

Example # 1 \$ 500,000 home \$ 250,000 loan (50% LTV), Rent 2,000 / month, Interest \$ 15,000 / yr
 Example # 2 \$ 1,000,000 home \$ 700,000 loan (70% LTV), Rent 3,500 / month, Interest \$ 42,000 / yr
 Example # 3 \$ 1,500,000 home \$ 1,200,000 loan (80% LTV), Rent 4,300 / month, Interest \$ 72,000 / yr

Calculation notes: Higher loan amounts, higher interest rates will significantly impact profit / loss calculations. Fully amortized loans although paying down principle balance have higher payments and since mostly interest is paid for the first half of the loan they would negatively impact calculations.

Properties with lower loans have better possibility for cash flow but also have higher opportunity cost of capital.

Considerations for Owner and Investor:

The real estate market in California and Southern California specifically is poised for a decline over the next 3-5 years. Investor groups that track these trends closely forecast a 20 to 40 % decline in the median price that will cause major price adjustments in over inflated / over appreciated areas.

Consider the following:

Investor / Second Home / Landlord Issues

- Loss of homeowner capital gains exemption (250,000 individual, 500,000 couple)
- Do I want to tie my money up in property or be 'covering' difference in rents vs. mortgage?
- What is the return on my capital and opportunity cost of capital I have tied up?
- What happened if property floods mold is discovered or tenants trash home? How much \$?

Primary Residence Issues

- Anyone 55+ can sell now near top of market and purchase within two years and keep original tax base and benefit from lower market prices down the road.
- What if you have a job transfer, life event or other need to sell... can you afford to do it?
- Tax issues: As revenues slow and deficits mount Fed and State will look for revenue streams including limiting mortgage deductions, depreciation allowances and 500/250K gain exemptions.

Both: Questions to ask yourself

- What if I need to sell in 3-5 years due to circumstances I do not see now? Can I afford to?
- Do I want to wait 5-7 years for values to return to present day level?
- Do you want to own a home you're paying a mortgage on that is worth less than you owe when you could sell now and rent, save and invest money then purchase same home for less later?
- Do your research. Calculate the Sell vs. Hold difference. Decide what is best for you.

About renting your home: There will be many renters out there happy to rent a home from someone else so they do not have to pay the mortgage, taxes, maintenance, home owner association costs and have the other responsibilities of home ownership. The question is now... Do you?

Bottom line is:

With the depreciation estimates included, in all three examples you lose between \$ 70,000 and \$ 150,000 at a minimum over just three years. The cost of sale estimates for the 1M & 1.5 million dollar property are too high and appear to make holding more attractive than it actually would be but I did not change them so as to be as conservative as possible in helping you make decision. Even with that in mind you can see it does not take much of a market correction to cover the cost of sale.

Ask your self these questions to help determine what you want to do:

- Do you want to own a liability that will be worth less in the near future than it is today?
- Or...
- Do you want to exit the market and use market knowledge to benefit you and your family?

So how do you benefit from what you now know?

A scenario to consider:

Sell now and wait 3-5 years for market to hit bottom. The market will be adjusted at least 20 percent so a 1,000,000 property on average will be worth 800,000. Motivated sellers can always be found... especially in slow markets, and individuals and banks that must sell will accept offers 10-30% below market asking price. Assume \$ 1,000,000 in real estate with \$ 500,000 in loans (adjust to fit your #'s).

Sell in 2006 \$ 1,000,000 - 10% closing costs = Net \$ 400,000

Buy in 2009 same property for 700,000 or less

Sell in 2014 or top of market for \$ 1,000,000 or more

Net profit just from appreciation minus cost of sale: \$ 200,000

This is a very simple example but the point shines through that holding real estate in appreciating markets can be worth the cost of sale to get out of declining markets.

5. Conclusion:

The decision to continue owning/renting and selling your home is influenced by many factors including taxes implications, age considerations (home and you), estate planning, personal preferences, and your ability to weather the market decline. Ultimately, the decision must be made based upon what is important to you and the realities of the marketplace.

We hope this Sell vs. Rent / Keep Comparison Fact Sheet helped you in your decision making process. Whatever you decide we look forward to assisting you in all your real estate needs. We can let you know for how much and how soon you can sell your home or investment property. Contact us anytime and let us know how else we may help.

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*** To view our exclusive 2006 – 2010 California Real Estate Market Forecast, click this link <http://filelibrary.myaasite.com/Content/18/18020/14884141.pdf> or visit www.MoveSanDiego.com and click on Market Update Tab for latest forecast, updates and market stats.

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