BUYING REAL ESTATE IN THE US
The Concise Guide for Canadians

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Acknowledgments

I have wanted to write a book for at least 20 years and now I finally have. I could hardly have done it at a more demanding time; running a fast-growing company, and still having kids at home, made this time one of the busiest of my career.

The initial inspiration for this book came from my business partner, Robert (Bob) Keats. He was already a successful author when I met him 17 years ago. Bob Keats is the author of a Canadian best-selling book titled *The Border Guide*, now in its tenth edition.

Ultimately, if it were not for the support, understanding, and inspiration of my wife, Charlene, and children, Elysha and Neal, I would not have been able to accomplish a large undertaking such as this. Their patience and encouragement to finish the book got me through nearly a year of writing, researching, and editing.

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Shant Epremian, a realtor and friend in Florida provided most of the information for the first chapter.

Lastly, I want to thank all of the clients I have worked with over the years. It is the clients who have put me in a position to be able to write a book on this topic in the first place; without them this book would not have been possible.

Introduction

Buying a home in the United States is a goal for many Canadians so they can get some relief from the long and cold winters in Canada. Dreams of daily rounds of golf in the sunny and warm destinations of the US Sunbelt has inspired Canadians to buy second homes in places such as Palm Springs, California; Phoenix, Tucson, and Yuma, Arizona; San Padre Island, Texas; and numerous locations throughout Florida.

Now, with economic conditions being as they are, many more Canadians are looking to invest in US real estate. With US real estate prices severely depressed due in part to the worldwide economic crisis and bad US policies, the buying opportunity in the US has become a once in a lifetime event for everyone, not just Canadians. Combine the fact that the Canadian economy is healthy and the Canadian dollar is (at the time of writing) essentially at par with the US dollar, Canadians have unique buying opportunities that may never be seen again.

While plenty of opportunity exists, there are a number of potential pitfalls if you do not plan and use competent professionals to help you through the buying process. In many ways, the process seems obvious with few, if any, roadblocks. In fact, the process is so easy that many Canadians do not seek proper advice or get incorrect advice from people who do not specialize in this area.

An adage I have long lived by is "just because you can, doesn't mean you should," and that adage is particularly applicable in this situation. On almost a daily basis I get a question along the lines of, "Can I do that with the property?" The answer is nearly always, yes you can do that, *but you shouldn't* do that. For example, if you asked your realtor if you can own the property in your corporation, he or she would say yes (which is the correct answer), but the realtor would not know to add that you should not own the property in the corporation because it would cause a double taxation. If you get nothing else out of this book, I want you to get the fact that you need, first and foremost, to hire knowledgeable professionals to assist you through the process and to change your questions from, "Can I do this?" to "Should I do this?"

I believe you will find many issues addressed and answered in this book that you will not find in any other book on the subject. That is why I wrote this book: to provide useful and practical advice that was missing from other books. The book is written largely from a tax perspective, so the material is complex and ever changing.

While I will attempt to answer the most common questions, it is impossible to answer every possible question. Every situation is different; do not rely on the fact that your friend bought a house in a certain way and assume that way will work for you. To begin with, you don't know if your friend did it correctly in the first place. Additionally, your facts, circumstances, goals, and time frames will likely be different from your friend's. I strongly recommend that you seek advice that is customized to your particular situation.

When seeking advice, look for a professional with a substantial amount of cross-border experience. There is a clear pattern that can be seen among the Canadians I talk to; an advisor on one side of the border gives perfectly good advice for his or her country, but ultimately gives bad advice because he or she did not understand the implications on the other side of the border. It is imperative that your advisor fully understand the implications of his or her advice on both sides of the border.

I have tried to make a complicated and dry subject at least readable and hopefully interesting through the use of samples and tables summarizing my points. I have also added throughout the book "Notes" and "Cautions" to make sure you do not miss important points. At the end of the book there is a checklist for you to use when buying real estate in the US.

I wish you the best of luck in your real estate investing endeavors.

1

A RARE OPPORTUNITY

A Rare Opportunity

"It's too good to be true."

While this statement is usually true, it appears to not be the case when talking about the real estate investment opportunities that exist right now for Canadians in the United States. The combination of drastically reduced home prices, Canadian currency prices near an all-time high relative to the US dollar, and low financing options create what appears to be a once in a lifetime opportunity for Canadians to buy US real estate. Before we dive into the opportunities that exist, it is important to understand the genesis of these opportunities and why they exist.

1. How the Opportunity Was Created

Let's go back in time to about 2005; the stock market was hot, the housing market was on a steady climb, and the general consensus was that housing prices would continue to steadily climb month after month, year after year with no end in sight. People of all social classes jumped on this bandwagon and became real estate investment experts overnight as they proceeded to invest purely on emotion. Without much thought, experience, or education, they refinanced their homes, maxed out their credit cards, and used all their available savings in an effort to pour as much money as possible into their real estate purchases. Credit was extended with such ease that it was difficult to resist the temptation, making real estate investing seem like child's play.

Builders and developers could not keep up with demand and it was common for projects to sell out within days of being placed on the market. It was a bidding war; to the point where investors would commonly sell units that they had on deposit to other investors at a profit without ever taking possession. Keep in mind that these were multiple transactions on dwellings that were not even built! Housing projects were erected at such a fast pace that we had a shortage of drywall in the US and proceeded to import drywall from Asia. The good times had no end in sight, so why not jump right in?

Here was the problem: All good things do come to an end. The housing market started to level off and cool down in late 2006. At first, investors thought that the market was actually giving them a new opportunity to jump in before it continued its steady climb but in actual fact, the only thing that was ahead was several months of steady decline. Week after week, month after month, we saw a freefall in property values throughout much of the country. This crisis was led by states such as Florida, Arizona, and Nevada where prices were the most inflated.

Unfortunately the market turned so fast that it caught many investors by surprise. It was too late to change course for the hundreds of thousands of people who had either refinanced, or bought a second or third home or investment property to try and sell it because by this point there was already a surplus of inventory. The problem, however, was not so much the surplus inventory, but the surplus *in* inventory, plus the consumers' inability to pay for their properties due to large amounts of leverage. The combination of high leverage and declining property values created a situation in which owners could not sell because their mortgages were more than the value of the properties.

To make matters worse, the subprime or second-chance loans were widely sold during the height of the market. These loans were very popular and so easy to get that people often mocked, "If you had a pulse you could qualify for a mortgage!" These loans were so bad they are now called "toxic" loans. The types of loans written included the following:

- 40- or 50-year loans
- Adjustable Rate Mortgages (ARM)
- Option ARM loans
- Negative amortization loans
- No document loans
- Interest-only loans
- 100 percent+ financing loans
- Stated income stated assets loan
- No income no assets loans
- 80/20 loans

Someone could easily write a book just on the types of subprime or second-chance loans that were available, but my point is not to educate you on the types of loans; rather to give you a better idea of the options that were available to these consumers and the ease at which they were able to borrow money. Let's face it, when you are lending someone funds based on stated income and stated assets with no document verification, or you have to amortize the loan over 40 or 50 years so that the person can afford the payments, these are signs of trouble and it is evident that many consumers who should never have been given credit were extended credit.

Some will argue that lending institutions should have been more diligent when extending credit; others put the blame on the government for having weak oversight on these policies; and, finally, some blame the consumers themselves for being irrational and overextending themselves. Regardless of who is to blame, the important thing to keep in mind is that most people were not concerned about the type of loan they had, or the minimum payment they had to meet because everyone assumed that they would flip the property in 3, 6, or 12 months at a profit, and never actually had to deal with paying anything more than the interest on the note. What people failed to realize is that the slightest change in interest rates or the state of the economy would mean that they would be stuck with the mortgages and they could barely afford the interest let alone the principal payments. For this reason we began to see such an influx of delinquencies week after week, month after month. People could not sell their properties, and rates on their notes adjusted from interest only to principal and interest. To make matters worse, most loans had clauses that allowed lenders to add extra interest on loans if payment was received late.

By now I hope you understand how many Americans got into this mess, and will therefore appreciate the opportunity that currently exists in the distressed property market. The moral of the story is to remain rational and not to get caught up in the market hype.

2. The Three Types of Real Estate Transactions

The words "short sales" and "foreclosures" have become synonymous with "great deals." However, there are fundamental differences between them and it's important that you understand the differences before investing.

Caution: Remember that cheap does not always mean that it is a deal; it could be cheap for another reason. In addition, always have an exit strategy in mind when you are buying.

Generally speaking there are three types of real estate transactions:

1. Traditional sale
2. Short sale
3. Foreclosure or bank-owned property

The following sections include a brief review of each transaction.

2.1 Traditional sale

The traditional sale is the type of sale that you are used to if you have ever purchased a property. It involves two parties — the buyers and the sellers. The sellers may or may not have a mortgage on their property but the important thing to understand is that the amount of the note or mortgage does not exceed the sale price of the property. In this case the sellers at their *sole discretion* can sell the property at a price that is convenient for them and do not need third-party or lender approval to do so, because the proceeds from the sale more than cover all expenses including the repayment of the note.

2.2 Short sale

A short sale is unique in the sense that the sellers of the property are facing financial distress. Often they are late on their mortgage payments due to any number of reasons, and they are trying to sell the house for less money than is actually owed on the note or mortgage. For example:

Mr. and Mrs. Smith purchased their home at the height of the market in 2005 for $300,000. At the time they really could only afford a $200,000 home but they were lured into a five-year, interest-only loan that made them feel that they could afford a $300,000 home because of the low interest payments. They proceeded to purchase their home with 0 percent down-payment and, therefore, owed the full $300,000 plus closing costs, for a total of about $310,000. The Smiths had opted for an Adjustable Rate Mortgage (ARM), where after five years the rate adjusted to prime plus 5 percent.

Fast forward five years, Mr. Smith loses his job, and to make matters worse his mortgage payments tripled overnight because of the adjustment in rate. Now the family definitely can't afford the new mortgage payments and are forced to sell their home. Unfortunately, because of market conditions and declining property values, it would be impossible for them to sell their house for the amount of the mortgage. Therefore they are selling the property for a shortfall which constitutes a short sale.

When you hear about the term "being upside down," this is what's being referred to. Very simplistically, a short sale is when there is a sale and the person owes more on the property than the property is worth.

You are probably wondering why this is relevant. Well, it's important that as a buyer you understand that when you put an offer on the Smiths' residence, for example, you are in fact facing a situation where the sale is subject to third-party approval (i.e., the lender or lenders).

Here is how a short sale works: Like a traditional sale, you would put an offer on the property that interests you and request that the selling party accept the terms or price of the sale. So far it's the same process as a traditional sale; however, now that you placed your offer for the property, both the lender and the owners must decide whether they will allow the property to be sold at this price or not. Remember the lenders are potentially taking a large loss on this property (the difference between the outstanding mortgage and the sales price). This is the part that can be very time consuming and frustrating, if you work with a realtor who does not understand the negotiation process and all of the things that need to be provided to the bank to help it make its decision.

Now let's twist this situation slightly and assume that two years after the property was purchased, the Smiths refinanced their home and took a second mortgage. Now both mortgagees need to agree to a payoff amount for the deal to happen since we know that there are not enough funds to cover both loans at the current purchase price. It is also important to note that both the first and second mortgage holders need to agree on a settlement before the short sale can be approved and the transaction can occur.

One more common caveat: Beware when the mortgage holder requires the sellers to sign off on a personal promissory note. The promissory note is the bank's way of trying to recoup loses in the future (over five or ten years) for clients who did short sales. This often delays the process because the seller doing the short sale may strongly oppose the personal promissory; the point of the short sale is to wipe out all ties to the property in question. Because this is often unexpected to clients there is usually a delay in getting this promissory note signed. The clients feel that the bank may come after the sellers for the entire amount of the short sale. At that point some people will opt out of the short sale entirely simply because they are misinformed. The reasons behind why it may or may not be required are complex and not important for you to understand; however, as the buyer, it is important for you to understand that this situation may delay the process.

These are only two common reasons that short sales do take time and do require patience to get a final approval, but the time and frustration can be justified by the potential deal that one may get.

There are many realtors who think they understand this process, but few that have actually mastered it. Look for real estate professionals who have seen firsthand horror stories of clients purchasing distressed properties and can guide you through the numerous issues. Needless to say this negotiation process requires a certain skill and method to ensure a smooth transaction and thus it is important that you select a real estate professional to represent you in this purchase. Do not attempt this on your own. Certain key steps early in the process can help mitigate the time it takes to get the short sale approved.

2.3 Foreclosure or bank-owned property

In simplistic terms, a foreclosure is a property where the note bearer has forcefully evicted the inhabitants for nonpayment of their mortgages. Basically if we take the previous example with the Smith family and assume they stopped paying their mortgage, eventually they would be driven out of their home and the bank would take over the property. Since lenders are not in the business of owning property, they proceed to sell the property in an *as is* condition on the open market.

Bank properties are often the fastest deals to close, but have their own challenges because they are often properties that have not been lived in for a while and therefore need attention to bring them up to living standards. In some markets, approximately one-half of all resales are foreclosures. For example, in September 2010, 46 percent of the greater Phoenix market's single family home resales were foreclosures.

3. The Window of Opportunity

Opportunities will always exist in real estate; however, most professionals believe that the window of opportunity that currently exists may be short-lived. This is primarily because lenders are not extending credit today like they were in the past; they are being very prudent and as a result the chances of consumers defaulting on loans will be greatly minimized. One of the main reasons the US got into this mess was the so-called subprime or second-chance mortgages. I believe that we will not again see this abundance of distressed properties for a long time.

The three rules in real estate have always been and will always be: location, location, location. No matter what part of the country you are thinking of investing in, my professional opinion is that it is always worth spending a little extra when you are buying to get a desirable location. Not all bargains are good deals. As the buyer you are in the driver's seat. There is an abundance of inventory, the Canadian dollar is near parity, and interest rates are very low. There are tremendous deals to take advantage of that are 30 to 70 percent less, relative to the height of the market, depending on location and property type. The time to invest is now; do not let this opportunity pass you by, but remember that you can still lose money if you are not careful.

In closing, I would like to stress the importance of working with reputable real estate professionals. The professionals that you surround yourself with in making this important choice can make a world of difference. Decisions are always better made when you are well informed of the process; it never hurts to be too well informed.

Being well informed is more than finding the right property, in the right location, at the right price. You have to understand how best to take title to the property, and consider what the tax implications are when you own, when you sell, and when you die. These items and more will be covered in the following chapters.