BUYING REAL ESTATE IN THE US

The Concise Guide for Canadians

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Acknowledgments

Thos book was seeded during the great recession of 2008, when so many Canadians were buying US properties at bargain basement prices. I began writing the first edition in 2009 and 2010, and it was published in 2011. I mention this because, in an odd sort of way, I have to acknowledge the recession for providing the impetus for me to write this book.

Further inspiration came from my business partner, Robert (Bob) Keats. He was already a successful author when I met him 21 years ago. Bob Keats is the author of a Canadian best-selling book titled *The Border Guide*, now in its eleventh edition, and *A Canadian's Best Tax Haven, The US*, now in its second 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 an undertaking as large as this. Their patience and encouragement allowed me not only to write this book, but co-author a second (*Taxation of Canadians in America*), and a third, (*Taxation of Americans in Canada*).

I want to acknowledge and thank the co-authors of *Taxation of Canadians in America*, Sally Taylor and David Levine, for allowing me the time to update this book while under pressure to complete our next book together, *Taxation of Americans in Canada*.

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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 it would not have been possible.

Lastly, I want to acknowledge all of the readers of the first edition who provided excellent feedback and were a source for new content ideas.

Introduction

Thanks to the questions and comments I have received since the first edition of the book, I have added new information and clarified existing information. Though much has been added, the book still provides concise information in an easy-to-read format.

Many Canadians have a goal of buying a home in the United States to get some relief from the long and cold winters in Canada. Dreams of days on or near the ocean, or daily rounds of golf in sunny and warm destinations in the US Sunbelt, have inspired Canadians to buy second homes in places like Palm Springs, Phoenix, San Padre Island, and numerous locations throughout Florida.

With record or near-record prices for real estate in Canada, US real estate is a bargain, whether you are simply buying a second home or you are looking to invest in a number of properties. While plenty of opportunity exists, there are several potential pitfalls if you fail to plan or use competent professionals to help you through the process. In many ways, the process seems obvious with few, if any, roadblocks. In fact, it is so easy that many Canadians choose not to seek proper advice, or they get bad 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 a regular basis I get questions that go 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. For example, if you asked your realtor whether you can own a property in your corporation, he or she would say yes (which is the correct answer), but would not know to add that you should not own the property in the corporation because it would cause 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?".

While I attempt to answer the most common questions, it is impossible to answer every possible scenario that may arise. 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 received good advice in the first place. Additionally, your facts, circumstances, goals, and timeframes 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 may give perfectly good advice for one country, but give bad advice overall because he or she did not understand the implications on the other side of the border. It is imperative that your advisor fully understands the implications of any advice on both sides of the border.

I have tried to make a complicated and dry subject readable, and hopefully at least a little interesting, through the use of examples and tables summarizing my points. I have also added notes and cautions throughout to make sure you do not miss important points. Appendix I is a checklist for you to use when buying real estate in the US.

This book is written largely from a tax perspective, so the material can be complex in parts and is forever changing. I hope you agree that this is an essential book for Canadians buying real estate in the US; it is through your comments that I am able to add new material and make improvements. For this reason, I would like it if you would provide reviews of the book on www.self-counsel.com, www.amazon.ca, www.amazon.com, or through whatever site you happened to have purchased the book.

Best of luck in your real estate investing endeavors.

1

Why the US?

When I first wrote this book in 2010, the US real estate market had just crashed, declining up to 70 percent in some areas. The reasons for investing in US real estate were obvious and there were many opportunities for those with the courage and cash to do so. I would guess that the vast majority of those who bought into the US real estate market from 2009–2011 did very well.

Today, opportunities are not as great as they were back then, but millions of US homes continue to be owned by Canadians for many different reasons. Some want to have a second home where the weather is warm; because prices are still a bargain compared to most Canadian markets; because they need to move for work or business; or because they are simply trying out the cross-border lifestyle before making a decision as to whether they will want to spend their winters (or more) in the US upon retirement.

In this chapter I will lay out why buying real estate in the US may still be a good idea for you. I will briefly discuss how short sales and foreclosures work in the US, and talk about currency and why US currency is mostly likely fairly priced; if you are waiting for the US and Canadian dollars to go back to par again, you may be waiting for a long time.

1. US Housing Appears to Be a Bargain

I am not a realtor and cannot give advice on real estate, but as an accountant the numbers are telling me that if I were to purchase and then rent out a US property, I could charge approximately the same amount for rent (after converting for currency differences), but only have to invest about half as much, or less. In essence, I would be doubling my yield, all other things being equal. For example, if I compare Toronto to Fort Lauderdale I find that instead of having to invest, on average, $526,175 USD ($649,599 CAD x $0.81) to receive a gross monthly rent of $2,167 USD, I can invest $171,800 USD, on average, to receive a gross monthly rent of $2,056 USD. The gross annual rent yield in Toronto is 4.94 percent, while the gross annual rent yield in Fort Lauderdale is 14.36 percent.

Table 1
A Comparison of Housing Costs

Market	Home Sale Value	Monthly Cost of Renting[3]
US[1]	$205,670 USD	
Palm Springs, CA	$181,571 USD	$1,800 USD
Phoenix, AZ	$212,087 USD	$1,317 USD
Fort Lauderdale, FL	$171,800 USD	$2,056 USD
Canada[2]	$450,886 CAD	
Montreal	$338,685 CAD	$1,820 CAD
Toronto	$649,599 CAD	$2,675 CAD
Calgary	$465,941 CAD	$2,473 CAD
Vancouver	$905,701 CAD	$2,969 CAD

1 Average price of homes, June 2015, Realtor.com
2 Average price of homes, May 2015, The Canadian Real Estate Association
3 Monthly or renting a three-bedroom apartment, June 2015, Numbeo.com

One of the most important concepts in investing is the fact that diversification reduces risk. Investing in the US provides important diversification that you cannot get by investing in Canada only. Even if you own a number of different types of properties in a number of different locations in Canada, you are still not as well diversified as you could be. The same holds true for your stock or bond portfolio; by holding an all-Canadian portfolio, you have more risk than if you added securities from other countries. Remember that risk is defined as volatility.

US real estate appears to provide more potential upside, better income, and on top of that should serve to reduce the overall volatility (risk) of your real estate portfolio. It appears that all you have to do is to decide if you want one, two, or more US properties.

2. Short Sales and Foreclosures

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 a bad reason. Always have an exit strategy in mind when you are buying.

Generally speaking there are three types of real estate transactions:

1. The traditional sale.
2. The short sale.
3. The foreclosure or sale of bank-owned property.

Let's briefly review each in the following sections.

2.1 The traditional sale

The traditional sale is likely 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 note 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 the 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 The short sale

A short sale is unique in the sense that the seller of the property is facing financial distress and often he or she is late on mortgage payments because of any number of reasons, so is 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-only payments. They proceeded to purchase their home with a zero percent downpayment 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 + 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 the market conditions and declining property values, it would be impossible for them 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 the term "being upside down," this is what's being referred to. Simplistically, a short sale is where 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., that of 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. But now that you have placed your offer for the property, both the lender(s) 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 sale 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 make the decision.

Now let's twist this situation slightly and assume for a second 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 is when the mortgage holder requires the sellers to sign off on a personal promissory note. The reasons behind why it may or may not be required are complex and not important for you to understand; as the buyer, however, it is important for you to understand that this may delay the process.

These are two common reasons that short sales take time and 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 first-hand horror stories where clients purchased distressed properties; hopefully they can guide you through the numerous issues. The short sale negotiation process requires certain skills and methods to ensure smooth transactions, and thus it is important that you select the right 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 and help avoid issues.

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. If we take the previous example with the Smith family and assume they stopped paying the 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 a livable standard.

3. Currency

Table 2 shows the Canadian dollar expressed in US funds since 1950. The average over those 65 years is $0.8838. While the currencies were trading around par in 2011 and 2012, they were not at par for nearly 40 years prior to that.

I have many Canadians tell me how high the US dollar is (how low the Canadian dollar is) and that they would lose 20 percent if they invested in the US now. I want to make two points here;

1. From a historical perspective, the Canadian dollar is not that low compared to the US dollar.

2. A Canadian who converts his or her money to US dollars will not lose 20 percent (assuming an $0.80 dollar). If that statement were true, then it would follow that if

I converted US dollars to Canadian dollars, I would make 20 percent, but no one ever makes that claim. However, if A is true (losing money one direction), B must be true (making money the other direction). To carry this one step further, if losing or gaining money were actually possible I would turn all of my assets into Japanese Yen and become a billionaire. You do not lose money by converting currency from one to another (with the exception of any fees paid to banks or other convertors).

Note: You can lose money via a change in currency over time. For example, if I bought $100 CAD and converted it to $80 USD today and a week later, I converted the $80 USD back to Canadian dollars but only received $95 CAD, I would lose money. To summarize, you cannot lose money by exchanging it for another currency (ignoring the fee), but you can lose money for transactions that span a period of time because of exchange rate fluctuations.

Also keep in mind that you can have a gain on the real estate, but a loss on the currency exchange, or vice versa. Many people are surprised to find that they had a loss on their US real estate, but had gain to report in Canada due to the increase in the currency. Your gain or loss in Canada will have to account for the currency difference. For example, if you bought a home in 2010 for $200,000 USD when the currency was $0.97, it took $206,186 CAD to buy the house. If you sold the home in 2014 for $225,000 USD when the currency was at $0.91, you will have a $25,000 USD gain for US purposes and you would have converted the $225,000 USD into $247,253 CAD, for a gain of $41,067 CAD.

4. Before You Get Started

I would like to stress the importance of working with reputable real estate professionals. The professionals that you surround yourself with when making such an important decision can make a world of difference. Decisions are always better made when you are well informed of the process and it never hurts to be to be too well-informed, if there is such a thing.

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, what the tax implications are when you own and sell the property, and when you die. These items and more will be covered in the next chapters.

Table 2
Canadian Dollar in US Funds (Annual Average)

CANADIAN DOLLAR AS EXPRESSED IN US FUNDS
(AVERAGE ANNUAL)

1950 -	$1.00	CDN	= $0.9181 US	1983 -	$1.00	CDN	= $0.8115 US
1951 -	"	"	= $0.9498 "	1984 -	"	"	= $0.7723 "
1952 -	"	"	= $1.0216 "	1985 -	"	"	= $0.7325 "
1953 -	"	"	= $1.0168 "	1986 -	"	"	= $0.7197 "
1954 -	"	"	= $1.0275 "	1987 -	"	"	= $0.7542 "
1955 -	"	"	= $1.0138 "	1988 -	"	"	= $0.8124 "
1956 -	"	"	= $1.0161 "	1989 -	"	"	= $0.8444 "
1957 -	"	"	= $1.0429 "	1990 -	"	"	= $0.8570 "
1958 -	"	"	= $1.0329 "	1991 -	"	"	= $0.8727 "
1959 -	"	"	= $1.0427 "	1992 -	"	"	= $0.8276 "
1960 -	"	"	= $1.0312 "	1993 -	"	"	= $0.7726 "
1961 -	"	"	= $0.9869 "	1994 -	"	"	= $0.7293 "
1962 -	"	"	= $0.9355 "	1995 -	"	"	= $0.7284 "
1963 -	"	"	= $0.9272 "	1996 -	"	"	= $0.7334 "
1964 -	"	"	= $0.9271 "	1997 -	"	"	= $0.7225 "
1965 -	"	"	= $0.9276 "	1998 -	"	"	= $0.6743 "
1966 -	"	"	= $0.9282 "	1999 -	"	"	= $0.6766 "
1967 -	"	"	= $0.9270 "	2000 -	"	"	= $0.6793 "
1968 -	"	"	= $0.9281 "	2001 -	"	"	= $0.6458 "
1969 -	"	"	= $0.9287 "	2002 -	"	"	= $0.6368 "
1970 -	"	"	= $0.9578 "	2003 -	"	"	= $0.7135 "
1971 -	"	"	= $0.9903 "	2004 -	"	"	= $0.7683 "
1972 -	"	"	= $1.0096 "	2005 -	"	"	= $0.8253 "
1973 -	"	"	= $0.9994 "	2006 -	"	"	= $0.8818 "
1974 -	"	"	= $1.0225 "	2007 -	"	"	= $0.9304 "
1975 -	"	"	= $0.9830 "	2008 -	"	"	= $0.9381 "
1976 -	"	"	= $0.9862 "	2009 -	"	"	= $0.8757 "
1977 -	"	"	= $0.9404 "	2010 -	"	"	= $0.9709 "
1978 -	"	"	= $0.8770 "	2011 -	"	"	= $1.0110 "
1979 -	"	"	= $0.8536 "	2012 -	"	"	= $1.0004 "
1980 -	"	"	= $0.8554 "	2013 -	"	"	= $0.9710 "
1981 -	"	"	= $0.8340 "	2014 -	"	"	= $0.9054 "
1982 -	"	"	= $0.8103 "				