A SPECIAL REPORT

It's Not What You Sell It For, But What You Get To KEEP That Counts

The profitable use of every $$$
of your real estate equity

Seniors' 15 most frequently asked questions are answered in this Report

SAREC members are not qualified to give legal or tax advice and SAREC does not guarantee the accuracy of its members' information. All clients are strongly urged to contact a real estate attorney, certified public accountant to obtain legal or tax advice.

ABOUT SENIORS REAL ESTATE SPECIALISTS

"Seniors Real Estate Specialists (SRES) are licensed salespeople or brokers, members in good standing of the National Association of REALTORS®, who have taken the additional hours of training needed to help senior clients make wise decisions when buying, selling or investing in real estate. Many seniors have not invested or sold in years and their issues, requirements and needs are special in order to protect and enhance their equity.

ABOUT THE AUTHOR

Tim Corliss is a sixth-generation Californian, who grew up in Los Angeles. A Realtor since 1962, Tim has always been on the cutting edge of real estate. His passion for serving real estate buyers and sellers has gained him tremendous recognition and respect throughout California and the nation. He enjoys the challenges of understanding & solving clients' problems while fulfilling their needs.

Tim opened Corliss & Associates Realtors in 1964. His firm grew to 15 offices with more than 300 agents with divisions in investment property, mortgages, escrows and insurance. When he sold the company to Merrill Lynch in 1982, Tim remained on board as senior vice president of Merrill Lynch Realty until 1987 when he opened Westside Properties.

Tim's numerous professional designations include the following:

Graduate, Realtors Institute (GRI)
Certified Residential Specialist (CRS)
Certified Residential Broker (CRB)
Certified International Property Specialist (CIPS)
Seniors Real Estate Specialist (SRES).

Tim is a member of the California Association of Real Estate Teachers and a Master Instructor for the California Association of Realtors' continuing education program. He is also a lecturer and author, and has spoken at UCLA, USC, Pepperdine and Loyola Marymount universities.

Tim's extensive experience in representing senior clients for more than 30 years and his vast knowledge of senior issues make him eminently qualified to author this comprehensive report. Tim says his most memorable business accomplishment is that he has personally negotiated more than 5,600 real estate transactions and neither he nor any of his clients has stepped foot inside a court room as a result of any one of those transactions.

INTRODUCTION

"One good real estate investment is worth a lifetime of labor."

Over the last thirty-nine years, I have heard repeatedly from clients, professional investors, and business people that the purchase of real estate is the single largest investment a person will ever make. If this is true, and I believe it is, then it follows that the **sale** of that real estate will be the largest single **business** decision a person will ever have to make. Nowhere is this more apparent than when seniors plan to sell their real estate. Whether you sell for $75,000 or $750,000, that transaction becomes the most meaningful economic decision that you will ever make. Also, it is made at a time in your life when you cannot afford to make any mistakes.

Traveling around North America, I have talked to senior clients and REALTORS® from such diverse communities as Eagle Grove, Iowa; Nashville, Tennessee; Haverhill, Massachusetts; and Seattle, Washington. I was struck by the fact that all seniors buying or selling real estate, in every price range, have very similar situations and questions.

So the examples contained here, both from my personal experiences and from Seniors Real Estate Specialist REALTORS® around the country, reflect questions and concerns that are truly global.

Some Examples of Property Appreciation:

In San Fernando, CA a home purchased for $29,000 in 1965 sold for $170,000 in 1997.
In Seattle, WA a property purchased for $38,000 in 1977 sold for $107,000 in 1998.
In Clearwater, FL a home acquired for $60,000 in 1955 sold for $450,000 in 1998.
In Reno, NV a property acquired in 1970 for $50,000 sold for $220,000 in 1998.
In Fort Worth, TX a duplex acquired for $22,000 in 1980 sold for $94,000 in 1997.
In Brentwood, CA a home purchased for $80,000 in 1969, sold for $1,250,000 in 1996.

Throughout most of the country, substantial appreciation has occurred with properties owned for 20-30 years or more. For most of us, the value of our home or income property is critical to our financial security. When I started marketing real estate in 1962 at the age of 22, most of my clients were 10-15 years older than I was. Now that I'm over 60, most of my clients are preparing to sell, retire, and/or relocate. Most of them are realizing that their property's equity is needed to maintain their current lifestyle. My experience and training over the last 39+ years has led me to become an expert in learning to **save every dollar possible for my clients**.

In other words, *it's not what you sell it for but what you get to* KEEP *that counts*.

Experience has proven that proper planning for the eventual sale of your personal residence or investment property, with competent professionals, is absolutely critical. Why? Because you and your family's short and long term financial security is at risk. In all too many instances, I have witnessed people being trapped into making bad, irreversible real estate and investment decisions. Without the professional input of an experienced Realtor®, a thoroughly prepared plan, and a top financial team, many seniors and their family have lived to regret those snap decisions.

The purpose of this report is to trigger your thought and planning processes. The real estate problems and issues facing us, as seniors, are very different from other property owners. A properly planned real estate strategy can help provide you and your family with a comfortable income for the rest of your life.

Detailed discussions with a *Senior Real Estate Specialist Realtor®, CPA, and Attorney* are critical to your success in any real estate transaction. I must urge you to seek the advice of all of these professionals before making any major decisions about your property.

SENIORS' 15 MOST FREQUENTLY ASKED QUESTIONS/CONCERNS

Certain questions have come up repeatedly over the course of numerous planning sessions I have had with prospective senior sellers. The following list summarizes the fifteen most commonly asked questions or concerns voiced over the years. These clients have owned both homes and income property. In some instances, they have lived in one of the income units. In those cases, they were able to treat the unit as their home for real estate tax purposes. I hope that you will find the following examples stimulating and thought provoking in your search for the proper solution to your particular issues and needs. Please remember that adding a "Seniors Specialist" Realtor® along with a CPA, Attorney, and Financial Planner to your support team can greatly relieve your stress.

We have used the "Question and Answer" format to simplify the explanation of these considerations step by step.

1. I've already planned my retirement, so all I need to do now is sell my property. Right?

Retirement planning is very different from the planning required in selling your property. Many people have made economic plans based on retiring at 60 or 65. We plan to live in our home until we either sell our property or pass on. But sometimes circumstances change, and our property must be sold in a relatively short period. Having a pre-planned financial strategy for the sale of your property can make all the difference in the tax ramifications you will face and the peace of mind you deserve.

It's important to analyze all of the important factors discussed in this report to ensure that you are properly prepared. Even though you may not be planning to sell now, making these preparations will allow you and your family to rest comfortably. Clients who may have to sell need to know exactly what to do to gain the best possible economic outcome. Also, if something happens and you're unable to perform in the way you want, your property's equity can still provide for your security.

2. I'm going to have to pay taxes someday, so why don't I just get it over with now?

A certain percentage of clients feel like "Eventually we'll have to pay the piper, so why not do it now?" However, because today's senior can very easily live to 95 or older, seniors will probably need every dollar of their equity. The money that you would pay on Federal and perhaps your State government* (which is generally at least 20% to over 30% of the profit/gain that is made on the sale) is money that you need to keep in use and earning interest for as long as you can. Why? Because most of us probably will never be able to earn this amount of money again.

Recent studies have shown that we Americans live longer and enjoy a more active life. We also have a greater need for cash flow to maintain our lifestyle in the last quarter of our life. Proper planning and tax considerations in the sale of your property are critical even though your retirement situation may already be established. Later on we'll look at a couple of examples of how improper tax planning, or lack of planning, can create horrendous tax consequences.

Most of my clients have realized substantial appreciation (capital gains) on their property and, as responsible citizens, believe that they should pay their fair share of any tax responsibility. The question is when do you pay it? Most of us need the cash flow from the taxable gains and are willing to let our estates worry about paying the taxes. I believe, in most instances, that this is the approach to take. With proper planning, our cash flow is stable, and we save on estate taxes as well.

**With the 1997 Federal tax changes, it is very important that you talk with your CPA, Tax Attorney, and Realtor® to determine your current State capital gains tax requirements.*

3. If you specialize in tax-deferred sales, what do you suggest?

This is a question I'm asked over and over again. The first step in properly answering this question is to analyze, in detail, the acquisition of the property that you're considering selling.

- When did you acquire it?
- How did you acquire it?
- What are the costs incurred to improve it?
- Do you have written records of those expenditures?
- Is there current financing on it?
- Do you have it in a trust with a will?
- What's the total value of your estate?

The 1997 Tax Reform Act makes a combination of several tax benefit programs available. All property owners are now allowed to take the $250,000 (single) or $500,000 (married couples) exemption from the sale of their ***personal*** residence ***tax-free***. You must have lived there two of the last five years to qualify. This means that at the time of sale any appreciation or profits up to these amounts are yours to keep, invest, or spend for your future and **NO** taxes are due. If the gain on your property is under the $250,000/$500,000 limits and you have other **secure** places to invest your equity, then the most prudent plan may be to take the tax-free cash proceeds and reinvest them.

4. We've owned a mountain resort property for years and want to sell it, but the capital gains taxes are huge. What can you suggest?

There is a solution for your dilemma. The revised tax law will allow you to move into your mountain home and claim it as your primary residence for the next two years. Then you can sell it, and take either $250,000 or $500,000 (depending on whether you're single or married) from the sale ***tax-free***.

You must actually live there, get your mail there, and prove in an audit (if required) that this is your primary residence. If you own an income property, for example, you can move into the largest unit in the building for two years and use it as your primary residence. A substantial part of the potential taxable profit could be turned into your home deduction and treated as a tax-free sale. While this may be a short-term inconvenience, it could legally save you thousands.

It is important to consult with your Seniors Realtor, CPA, and the rest of your financial team. Perhaps a combination of tax-free profits and the installment sale could save you thousands of dollars and give you management-free income for the rest of your life.

If you plan to just place the money from the sale in the bank as a CD (certificate of deposit) or if you are concerned about keeping others from taking or using these funds, you should consider the installment sale. You may obtain a substantially better interest rate return by carrying the First Mortgage/Trust Deed on your property. Ask these questions of your local Seniors Real Estate Specialist, CPA, and your other advisors.

The **installment sale** is certainly one of the more beneficial provisions that the government has created with the IRS code. It allows deferring the payment of federal taxes in any sale on the equity that is taken back by the Seller as a Trust Deed (Mortgage).

Until a client receives any principal return on the Note (cash received), the client does not have to pay any tax on their equity. If a first or second trust deed (mortgage) is "carried back" on the property being sold, and is payable at "interest only," then none of the principal is subject to any tax consequence until it's received (cashed in) by the client. The interest received is taxed as ordinary income. This is called an **installment sale**. The amount of cash that you do receive as a down payment can be coordinated with the $250,000/$500,000 federal tax exemption to reduce or eliminate your tax payment at time of sale.

If you live in one of the units of an income property and you treat it as your home, you can also coordinate these programs along with a **1031 tax deferred exchange**. You could "buy down" into a smaller condominium, retirement home, or property either where you live or anywhere in the country.

As you can see, **taking the time to discuss and analyze your exact tax situation prior to the time of sale can save you an enormous amount of money**. The money you don't have to pay in taxes now can be used by you to generate interest income to you until the time you receive cash and have to pay the full tax consequence.

Wait a minute, I'm 65 years old and I can't wait 30 years for my money. I'm not the bank!

This is one of the many misconceptions of property owners who have owned their real estate for many years. The reality is that a customized tax deferred installment sale can be created for you. You can receive your principal (equity) in as little or as long a time as you personally need. For example, you could create a note for one, three, five, or even ten years or longer. The amortization schedule (the amount of principal and interest received monthly to equally payoff the debt) can be set up for thirty years (which is the standard time used by most savings and loans and banks), but the due date (payment in full date) can be whatever you establish. The length of time can be based on your personal economic situation and financial planning.

Because the "carried back" principal amount is not subject to any federal taxes until received, you will pay taxes only on the interest you receive. What this means is that the percentage of your equity that may have been subject to capital gain taxes is now invested and earning interest daily.

Check the financial section in your local newspaper today for the rates for three and five year certificates of deposit (CDs). At the same time, look at the interest rates that are currently being charged on first trust deeds. You could probably obtain at least 1-2% more interest than from the CDs by "carrying back" paper on an installment sale.

Properly done, you could obtain a higher, secure and controlled return on equity. **Best of all, the interest you received would be on both your tax-free equity (per IRS guidelines) and taxable (deferred) dollars.** With proper planning and professional advice, you can structure any transaction to be beneficial to you.

5. Isn't carrying the loan too risky? How would I know who is a good credit risk?

This is an important question, particularly in today's market. With the Installment Sale concept, you do act as the lender or the bank and must be very cautious about screening your potential "borrower."

Proper advance planning will allow you to analyze the credit, financial statements, and any other pertinent information of a prospective purchaser in exactly the same way as a bank. When analyzing these documents, a Seniors Specialist Realtor®, along with your CPA and Attorney, will assist you in evaluating and analyzing the credit worthiness of your particular buyer. Please keep in mind that all of these recommendations are based upon the buyer/investor placing a substantial down payment on the property.

6. What's the worst thing that could happen to me if I carried back some of my equity in a trust deed (mortgage)?

The very worst scenario is that you would have to foreclose on the property. Then you would own it again. The Buyer would forfeit the down payment and other moneys that were paid to you. A specialized service company would do the entire foreclosure process. As horrible as this sounds, less than 3% of all the sellers with installment sales are ever put into this situation, and most of those occur because buyers use very low down payments. Those owners have very little equity to protect. **I recommend that a First T.D. (mortgage), and only a First T.D., secure any financing "carried back."**

Your financial plan will require a substantial down payment and detailed credit checking, along with a complete analysis of the buyer's ability to pay. This puts you, as an investor, in a very favorable position. However, there is always the possibility that changes in the market could occur and a major recession or depression could hit. Then the question would be: "Am I better off having this real estate or having my money in a financial institution?" These questions require time, planning, and discussion to evaluate the tax ramifications of selling for cash versus creating a personal tax deferred program. Your realtor, CPA, and attorney are invaluable here.

7. This sounds interesting. Could I keep my money out at interest for a longer period of time?

This is often asked, and the answer is generally **yes**. As long as the note is secured by the property, you keep your equity earning interest and tax deferred. The interest rate you receive might have to be flexible, depending on the marketplace and timing. If the interest rate is too high, the buyer might want to refinance and pay off the loan. Many clients who sell their property and become investors realize the continuing tax benefits of keeping their trust deed current and interest rate flexible so that the buyer will have a market rate incentive to make payments. They also discover that they can carry their loan for a specific period of time and then renew it for another specific period. Obviously, all of the installment sales we're talking about must have the proper protection clauses in them. The attached glossary gives you some of the terms that will help to clarify these concepts. An *acceleration clause, notice of default, late charge provisions,* and other protections can be placed on all of these instruments giving you the right to control the situation in the event the property might be resold.

8. What if I did an installment sale, and then I needed cash in an emergency? Can I do this?

The answer to this is **YES**. You have two or three options. One of the extraordinary benefits of an installment sale is that you can carry back equity with beneficial tax consequences and at the same time have an asset that, in the event of an emergency, is very liquid. A trust deed (mortgage) in an installment sale that has been "seasoned" (meaning that payments have been paid regularly for a period of time) can be borrowed against by you or sold. First, you could **sell** the note, although you don't have to. The sale of any note and trust deed does create a tax problem. Most trust deeds and notes are sold at a discounted value from as low as 5% to as much as 25%—sometimes even more. However, **borrowing** against it could be a very creative way to solve your cash flow needs.

Second, a bank or other financial institution can generally lend you up to 50% or more of the current value of the loan. So for every $100,000 of equity that you "carried back," you could borrow $50,000 of that amount fairly easily, and often at a very competitive interest rate. The advice of your CPA or tax attorney is needed to determine the proper procedures to meet your needs.

9. I've heard that a *1031 exchange* can save me money. How does it work?

People get confused between the **tax-deferred exchange** and the **installment sale**. The *1031 exchange* is basically designed for trading income property. You would be exchanging your equity in one property for another income producing property. To be tax deferred, it has to be of equal or more value than the property you are selling or trading.

If you live in one of your units or decide to convert your residential property into an investment property, an exchange could have strong tax saving possibilities. You could also depreciate the property and create another tax benefit. A *1031 exchange*, however, is totally different from the *installment sale* that I previously discussed. Again, proper analysis of your individual situation by an experienced Realtor® along with an accountant and tax attorney can help you to determine the value of a *1031 exchange*. It doesn't work for everyone, but for certain clients, it is the only way and provides an absolutely exciting opportunity. The delayed exchange allows you to find a Buyer for your property, place your equity with a qualified accommodator, and then buy/trade for another property across town (or across the country) and be totally tax deferred. You could still have the income producing benefits of all your equity.

10. Why don't I just refinance the property and live off the money?

Refinancing any piece of property can provide a cash flow and will allow you to have money to use. The difficulty of refinancing and living off the cash flow is that once that cash flow is gone, the property becomes a negative equity situation. We'll talk about negative equity a bit later. Refinancing is not a benefit to most people. There are reverse annuity mortgages that allow you to borrow against your equity by creating a loan that is paid out to you in monthly installments, or you could receive the cash all at once. It does not yet have the confidence of many seniors. One problem seems to be that often there are very high costs deducted from the loan right at the start. Please contact your local Reverse Mortgage Consultant for a free interview before signing any documents.

11. Isn't there a way that I could sell my property and stay here until I'm ready to move?

Most people who ask this question are generally talking about what's called a **Life Estate**. It's a technique where people can sell their property to someone else, creating a tax savings situation in some instances, and still reserve the right to live in the property for a specific period of time or until they die. However, with property that has appreciated, it is difficult to find a buyer who will go along with this for an unspecified length of time because generally it's not economically feasible. You also lose control of your property.

However, **Life Estates** can be very effective if you own an income property—for example, a 6-8 unit building where you are living in one unit. That unit could be left in your control as a Life Estate. You could sell the property, get away from the management responsibilities, and still have a place to live for as long as needed. Again, a personal review with your Seniors Realtor®, Attorney, and your CPA are critical.

12. How does the 1997 federal tax exclusion work?

Currently, **IRC. 121** allows any homeowner who is selling his/her principal residence an excluded $250,000/$500,000 federal tax exemption from the gain on the sale ($250,000—single person, $500,000—couple). This exclusion is a powerful program that has been developed by the government, giving most of us, particularly seniors, an opportunity to put all or most of the profits from the sale of our primary residence into our pocket ***tax-free***. To qualify, you must have owned the property and used it as your principal residence for two of the last five years. The effective date of this exclusion was May 7, 1997, and all sales closed after this date are subject to the new laws.

13. There aren't any more capital gains, right?

Yes, there still is capital gains tax!

This question is often asked because of the ever changing federal and state tax situations. Since the 1930's, there has always been capital gains and subsequent tax. How the amount is arrived at, and at what rate of tax, has been subject to change. Capital gain is the difference between the basis in your property and what you'll sell it for, less your selling expenses. The 1997 Federal Tax revisions set the capital gains tax rate for most property owners at 20% of the gross profit after expenses on property held for 12 months or longer. If this is your personal residence, $250,000/$500,000 of gain is excluded from tax if you occupied it for two of the last five years. Of course, on the sale of your principal residence or income units, you do have to apply the federal tax exclusions before calculating the amount of any capital gains.

If you have lived in income property over the years and treated it as your home, it is very important to determine your original basis. Why? Because the amount subject to capital gains is generally the amount of profit between your original basis and the sales price of your current property, less sales expenses and exemptions.

For Example:

1. A single client sold a home in California for $450,000 with a basis of $60,000. Even with the new tax laws, the original purchase price (basis) is still important. The actual amount subject to capital gain is the difference between the net sales price (after the basis and all selling fees are deducted) and the income tax exclusions ($250,000/$500,000). In this case, the expenses of $41,500, basis of $60,000, plus the exclusion of $250,000 (single person) were deducted, leaving $98,500 subject to capital gains.
2. However, clients in Bozeman, Montana sold a 4-plex (they lived in one unit) and needed to know their basis in the property to determine the amount of their taxable gain. Basis is the acquisition cost of the property plus any capital improvements, such as roof, plumbing, etc., and is subtracted from the sale of that property along with the sale expenses. Generally speaking, the **difference** between the **gross acquisition** price and the **net sale price** ***less your exemption*** represents **capital gains** and is **taxable**.

All real property is generally subject to a maximum federal capital gains tax rate plus whatever your local state tax requirements call for. In fact, in some instances, the sale today, when added to other sources of income, might move you into a higher capital gains tax bracket. Capital gains tax has not gone away.

As you can see, it is imperative when planning the sale of your property that you consult with a Seniors Realtor®, CPA, and Tax Attorney who are aware of all the tax consequences.

14. How can I get my equity to work for me and not against me?

This is probably the most critical of all the questions. Because of the appreciation of real estate over the last 20+ years, most of us who have owned property since then (or even longer) have substantial equity today. **Maximizing this equity (getting its highest and best use) and converting it to a working asset for you is the exact reason for this report.** Clients have often said, "Tim, I own my property free and clear, so it costs me almost nothing to live here." This isn't true, and here is an example of how your equity can actually work against you instead of for you:

> A property in Florida was acquired for $50,000. It is free and clear and now worth $300,000. The property taxes are $3,000 per year ($250 per month). The insurance, utilities, etc. are somewhere in the area of $200 per month. On the surface, $450 per month is a pretty reasonable living expense, although you must add in the ongoing maintenance and upkeep. However, to be totally accurate you must add in the income producing value of your $300,000 equity at some reasonable interest rates.

Example:

A) $300,000 @ 8% = $24,000 annually or $2,000 per month. Add the $450, and ***your actual cost to live there is $2,450 per month + maintenance***.

B) $300,000 @ 9% = $27,000 annually or $2,250 per month. Add the $450, and ***your actual cost to live there is $2,700 per month + maintenance***.

The real cost to live in any free and clear (unencumbered) property must include a reasonable rate of return of the equity involved, plus the actual hard expenses (monthly out of pocket and maintenance) that are always substantially higher than you think.

The answer, then, creates some new questions:

- Are you getting the best economic and emotional return on your total equity in today's market, or do you need to re-evaluate and plan for tomorrow?
- Is the "real" cost of living in the property a profitable use of equity? Or could you live somewhere else more reasonably and use the extra cash for other needs?
- Would you get a better value for those dollars by converting to another use?
- Do you have enough cash flow to enjoy the balance of your life?

15. How can I be sure that I'm doing the right thing and using my equity to its optimum?

I used to tell my clients that if they were over fifty and their children were in college, they were either very wealthy or really foolish to still be living in a single family home. I realize that this could be taken as a harsh statement, but as I have grown older, I believe it to be absolutely true. What if they took their equity and purchased a duplex, triplex or fourplex with an owner's unit? It could be in the same neighborhood that they're living now or out in the country, maybe even in a golf community. My point is that with this kind of residential income property, your equity continues to work for you and your family still has a place to call home. It is still appreciating, generating a positive cash flow, and providing security in your senior years. This is just one of many ideas to think about. It's never too late to start utilizing all your assets to create a positive cash flow.

The purpose of the planning, discussion, and analysis we've talked about in this Special Report are all brought to fruition here. Only by taking the time to sit down with your Seniors Specialist Realtor®, CPA, and Attorney can you come to a proper, logical decision of what is **right for you**. Some actual case studies might help you to put this Special Report and its data into perspective.

CASE ONE

Recently, I represented a client who owned a property in Santa Monica, California. The property was worth about $850,000, and she had lived there for nearly thirty-five years. She decided it was time to sell and had already spoken with several brokers. One had brought her a cash buyer for $850,000. However, she had not yet signed anything when she called me. Our discussion provided the following information. She and her husband had acquired the property for $27,000 and then subsequently divorced. She then acquired her husband's interest in the property for another $25,000. Her entire basis in the property was approximately $60,000.

If she had sold the property for $850,000 cash, her net after expenses would have been about $800,000. Less her exclusion of $250,000, she would have had approximately $500,000 still subject to capital gain. With a combined California State and Federal Tax Rate of +/-30%, her capital gains tax could have been as much as $150,000. She was 64-years-old and still working, but looking to retire and take life a little bit easier.

By analyzing her tax situation and finding out exactly what she wanted to do, I was able to create a sales scenario that accomplished the following:

1. She received a $300,000 down payment. After deducting the basis and sale expenses, her realized gain was approximately $740,000 from which she deducted her $250,000 exclusion. Only about 58% ($173,000) of the down payment was subject to capital gain. Her federal and state tax of +/-30% was approximately $52,000, thereby deferring nearly $100,000 of gain while receiving 8% interest on it as part of the trust deed.
2. She carried back a tax-deferred $550,000 note secured by a First Trust Deed (mortgage) at 8% interest, payable interest only, ($3,666) per month for 5 years with an option to renew.

3. She purchased (putting 50% down) a smaller, nearly new condominium in Santa Monica more than adequate to provide her with the home that she needed.
4. She received the cash flow she needed to retire. She now has a **$3,666 monthly** income from her equity in addition to other income. Plus, she has a beautiful new home, instead of the 67-year-old home with a leaking roof. To date, she has paid no capital gains tax on the sale and has placed herself in a financially secure position.

CASE TWO

Now let's discuss clients who, by making very quick decisions without planning, put themselves into a very different position. Recently, a retired couple in Palm Beach, Florida decided to sell their home for $1,900,000. Being quite anxious because of a recent illness, they contacted brokers, received an offer, accepted it, and entered into a firm contract. Only after signing final papers did Dad decide to have a discussion about the pending sale with his family.

Their son, an attorney and long time friend of mine, invited me to participate. His parents' basis and closing costs were about $230,000, and even with their one time exclusion of $500,000, **the amount subject to capital gain was over $1,170,000. They paid taxes of over $400,000 on this sale.**

Even though already successfully retired, the purpose of the sale was to raise additional funds so that he and his wife, who was ill, could relocate to a smaller home without invading any other capital funds. They also wanted to give some money to their children. This could have been accomplished much more effectively. Instead of paying Uncle Sam over $400,000 of their equity in taxes, they could have used the installment sale. Selling the home for $1,900,000 with

$600,000 down payment (tax free because of the $500,000 exemption plus $130,000 in selling costs), they could have carried a first mortgage for $1,300,000 at 8.5%. Approximately $320,000 in taxes could have been deferred, and the couple would have received approximately **$27,000 taxable interest per year** on those deferred funds…interest that could have been used to fund their children and grandchildren's financial future.

Lack of pre-planning, coupled with a quick decision without analyzing all of the ramifications and foregoing competent advice from those professionals who were available to help, cost this couple, their children, and grandchildren the use of a substantial amount of money. **Good planning, proper discussions, and good professional guidance would have enabled them to take the right steps.**

And, by the way:

If my Santa Monica client were to be put in a position where she needed to raise money, she has a $500,000 note paying her 8% interest. She could borrow up to $250,000 or more against her note, probably within 48 hours, still be in a position to have the payments that she is receiving on her note, cover the interest payments on the money she borrowed, and still have her needed cash flow.

SUMMARY

While very few of us own million dollar properties and these examples may not address the specific dollar value of your specific property, the rationale remains the same.

Without proper planning and professional real estate advice, mature clients are extraordinarily vulnerable at crisis decision-making time. If you evaluate your individual situation in advance of the time of sale, then whether you sell for cash or use some form of creative financing, you will have the best situations and tools available to minimize your liabilities.

All in all, with the proper planning, there are tremendous tax and positive cash flow benefits available to all who are smart enough to acquire property in the last twenty-five to fifty years. You've gone through the traumas, the difficulties, and the sleepless nights to make sure that your properties were cared for and paid for. **When the time comes to sell your residence or income property, doesn't it make good sense that you analyze, evaluate, and seek a competent professional before you make any decisions? Whether you're going to sell in six months or six years, having a plan makes it so much easier.**

Don't forget our original premises . . .

"A good real estate investment is worth
a lifetime of labor"

and

"It's not what you sell it for that counts;
it's what you get to KEEP!*"*

REAL ESTATE TERMINOLOGY

BROKERAGE TERMS

Caravan: A group of Realtors, usually from several offices, will join together to view properties that are available in an effort to become more familiar with them prior to introducing them to potential clients.

Co-Brokering: When one broker lists the property and another office sells the property, they share the commission through the listing office. The commission fee is not doubled; it is shared by the two offices.

Client: The client of the broker is the individual who pays the fee for the brokerage service.

Customer: The individual that has been attracted by the service provided.

Escrow: All deposits held by the broker are held in escrow; a customer's account, separate from all other business accounts of the firm.

Home Inspections: A potential buyer has an opportunity to obtain a satisfactory structural and termite inspection within a reasonable length of time after the offer to purchase has been accepted. The buyer has the ability to cancel the transaction with the results of this inspection.

Listing: A property that has been offered for sale by a broker.

MLS: The Multiple Listing Service is a means of making possible the orderly dissemination and correlation of listing information to its members so that "realtors may better serve the buying and selling public."

Open House: An opportunity to let the public view the property that is for sale during a specific period of time without an appointment. The property is advertised as an "open house" and interested parties visit at random and talk with the agent present.

Real Estate Broker: An individual who is licensed by law to be employed by another, for a fee, to assist in real estate transactions.

LEGAL TERMS

Administrator: Person appointed by a court to take possession of property of a person who died without leaving a will.

Closing: That date on which the property is transferred from one individual to another.

Covenant: An agreement between the parties in a deed whereby one party promises to do or not to do certain acts with respect to the land (e.g. land used only for residential purposes).

Deed: The written instrument by which the title to land is transferred from one to another.

Easement: The right of use which one person may have over the lands of another (e.g. a right of way to install, operate, and maintain utility lines).

Encroachment: The intrusion of any improvement partly or entirely on the land of another.

Encumbrance: Any interest in land held by persons other than the owner which will lessen the value of the title (e.g. mortgages, liens, etc.).

Fixture: Personal property that by state law becomes real property upon being attached to real estate (e.g. drapery rods).

Legal Descriptions: A property description which by law is sufficient to locate and identify the parcel of real property.

Lien: A claim of charge on property of another for payment of some debt.

Life Estate: An individual's right to the use and occupancy of real property for life.

Offer to Purchase Property: A written instrument that is legally binding. It outlines the buyer's intent to purchase and under what specific conditions.

Power of Attorney: An instrument in writing by which one person, the principal, authorizes another to act for him or her in the specific action described in the instrument.

Purchase and Sale Agreement: A written instrument that is legally binding. It is usually in more detail than the Offer to Purchase, but includes the original details of the buyer's intent.

Recording: The noting in the designated public office, usually the registry of deeds, of the details of a properly executed legal document, such as a deed or mortgage.

Survey: A map of land made by a surveyor showing boundary lines, buildings, and other improvements of land.

FINANCE

Annual Percentage Rate (A.P.R.): The total amount of the finance charge including interest, points, and all loan fees (e.g. escrow, processing, etc.) calculated as a percentage of the borrowed amount and expressed as a yearly rate.

Application Fee: This is a fee which may be charged by the lender to cover the costs of processing your loan application. It is usually charged at the beginning of the application process.

Appraisal: An estimate of fair market value of a property prepared by a qualified real estate appraiser.

Loan-to-Value (LTV) Ratio: The amount of the loan as a percentage of the property's appraised value. For example, an 80% loan is determined by subtracting a 20% down payment from the property's appraised value.

Margin: The margin is the difference between the ARM index and the rate the lender charges. Example: an index rate of 8% plus a margin of 2.5% could result in a home loan rate of 10.5%. In some areas, the margin is referred to as the factor. The fixed margin over the index covers the lender's operation expenses and profit margin.

Mortgage: A mortgage is evidence of the security for a loan. It is the document, signed by the borrower, which gives the lender the right to the property if the loan borrower failed to live up to the loan arrangement.

Negative Amortization: This happens when the minimum monthly payment on an adjustable rate mortgage is not large enough to cover the full amount of interest that is due. The difference between interest owed and interest paid may then be added to the loan's principal balance, at the option of the borrower.

Origination Fee(s) (see also Points): Also called a Loan Fee, this is a fee assessed by the lender for processing the loan. Most lenders' charges are based upon the amount of the loan. One point equals one percent of the loan amount. These fees are normally paid by the borrower at closing. In some cases, however, they may be paid by the seller or shared by both parties. Also, the lender may "escrow" these charges to be deducted from the mortgage amount.

Payment Cap: This cap places an annual limit on the amount that a monthly payment can increase. This feature is offered by some ARM lenders instead of an annual interest rate cap.

Point(s): One point equals one percent of the loan amount (see Origination Fee).

Assumption Fee: The fee you pay the lender in order to assume someone else's mortgage loan.

Assumability (Assumption of a Mortgage or Assumption of a Deed of Trust): Agreement by a buyer to assume liability under an existing agreement between seller and lender. Not all loans or loan terms are "assumable." The lender typically must approve the new borrower.

Equity: The market value of a property minus the total amount of any existing liens.

FHLMC (Freddie Mac): Federal Home Loan Mortgage Corporation, an affiliate of the Federal Home Loan Bank, which creates a secondary market in conventional residential loans in FHA and VA loans by purchasing mortgages from members of the Federal Reserve System and the Federal Home Loan Bank System.

FNMA (Fannie Mae): Federal National Mortgage Association, a federally sponsored private corporation which provides a secondary market for housing mortgages.

Hazard Insurance: Insurance protection for the borrower and the lender against property loss due to fire, wind, or natural hazards. Many lenders require payment of the first year's premium as a closing cost.

Impound Account (also called Escrow Account in some states): This is an account held by the lender for payment of taxes, insurance, and other periodic debts against a property. The borrower pays a specific amount over and above the monthly loan payment, and the lender pays the bills with the accumulated funds. Some lenders require an impound account for certain types of financing.

Index: A published interest rate composite used by lenders. Its movements determine interest adjustments on adjustable rate loans.

Private Mortgage Insurance (PMI): This mortgage default insurance designed to pay the lender a portion of the outstanding balance of a loan in the event that the homeowner defaults. PMI may be required on certain types of loans; if so, the initial premium is usually one of the closing costs, while subsequent premiums are included in the borrower's monthly payments. This insurance usually applies to loans with only 10% down.

Refinance: The securing of a new loan either to pay off an existing lien or mortgage on the property or to access your equity.

Title Insurance: Insurance protection against the consequences of a pre-existing lien or encumbrance on a property that might be discovered after a change in ownership.

Underwriting: These are standards set by the lender which the borrower must meet in order to qualify for the loan.