

Fin 5413 CHAPTER SEVEN

SINGLE FAMILY HOUSING: PRICING,
INVESTMENTS, AND TAX
INVESTMENTS

Demand Determinants- Single Family Housing

- Population Growth
- Household formations
- Employment
- Household Income
- Interest Rates
- Federal Income Tax Policy
- Cost of Renting

Tax Treatment of Personal Residence (see Exhibit 7-4)

- Maximum interest deductions
 - Acquisition debt- \$1,000,000
 - Limited to the cost of property plus improvements
 - Home equity debt- \$100,000
- Points on mortgage loans – deductible in year of purchase on primary residence – amortized on refinances
- Real Estate taxes – deductible in year paid
- Capital gain exclusion - \$500,000 married couple, every 2 years (principal residence)

Tax Treatment of Second Home

- Interest – same as primary
- Points- amortized over life of loan
- No capital gain exclusion
- Vacation homes- special rules if also rented for income

Rent versus Purchase

- Advantages of Renting
 - Easy to move with low cost
 - No funds needed for down payment and closing
 - Credit quality less important
 - No investment risk
 - Maintenance is done for you

Rent versus Purchase

- Disadvantages of Renting
 - Limited in personalizing your residence
 - May be evicted or lease not renewed
 - Must live under someone else's rules
 - May be fewer locational choices
 - Is probably more expensive over the long run
 - Does not build housing equity
 - Less stake in your community

Financial comparison of Rent versus Own

- Treat like a capital budgeting decision
- See Exhibit 7-2, 7-3
- Need to have money for a down payment, or borrower larger amounts.
- Often need at least a 3 year ownership horizon to overcome the buying and selling costs.
- Overall advantage to housing depends on what it will be sold for in the future

Valuing Property: Appraisals

- Market value is the probable price that would be paid in a competitive market
- Three common approaches
 - Market or sales comparison approach – compare to similar properties which sold recently
 - Cost approach – cost to reproduce
 - Income approach – PV of potential CF's
- One generally cannot get a mortgage without some sort of appraisal –based on the minimum of purchase price and appraised value

Sales Comparison Approach

- Find similar properties that have sold recently (typically three) Adjustments for:
 - Time, Location View, Design appeal
 - Quality of construction, Age, Condition
 - Size, Features, Functional utility
 - Type and condition of systems, i.e., HVAC
 - Sale or financing concessions

Sales Comparison: Example

	Subject	Comp 1	Comp2
	\$152,000	\$150,000	\$161,000
Size	1800 sqft	1700 sqft + 8000	2000 sqft - 16000
Garage	2 car garage	3 car garage - 5000	1 car garage +7000
Indicated Value of Subject		\$153,000	\$152,000

Cost Approach

- Value of land plus cost of improvements
- Deduction for Depreciation
 - Physical depreciation
 - Houses "wear out" or age (roof wearing out)
 - Functional obsolescence
 - Old kitchen, low ceiling, old wiring, small closets
 - External obsolescence
 - Such as shifting land use
 - Curable vs. incurable
 - New paint, carpets, roof, etc. vs. ceiling height

Income Approach

- Gross rent multiplier
 - The ratio of house prices to monthly rents
- Example – could rent out for 775 per month. If the Gross rent multiplier is 137, then the indicated value of the house is \$106,175
 - This is like the P/E ratio approach to value a stock
- Difficult to use for single family residential properties as most houses are not used as rentals

Investing In Distressed Properties

- Foreclosures are at record highs, indicating there may be some real estate bargains
- On alternative is to buy "pre foreclosure"
- Owner with equity may sell at a bargain to prevent foreclosure
- Lender may be willing to accept a "short sale" to avoid foreclosure

Investing In Distressed Properties

- Borrower unable to meet mortgage payments
- Market value of property below loan balance
- Delinquent in property taxes
- IRS liens
- Civil judgments/bankruptcy/divorce
- Mechanics and/or construction loan liens
- Personal debts
- Estate settlements

Investing In Distressed Properties

- Buyer must be aware of quality of title when investing in distressed properties
- To profit from investments in distressed properties, the investor must buy low and sell high
- The gain will be the selling price (less selling expenses), less the cost of improvements, less the financial holding costs, less the price the property was purchased for.

Robert Kohl Internship Report UTSA Fall 2007



Budget



- Foundation
- Doors/windows
- Siding
- Roof
- Water heater
- Cement cap
- Closet
- Drywall

Budget

- Fixtures
- Kitchen/Bath
- Paint: Interior/exterior
- Back porch
- Flooring
- A/C
- Staging
- Total – Approx \$25,000



Project Repairs



- Re-leveled foundation
- New windows
- New doors throughout
- New siding
- New bath
- New kitchen
- Install A/C
- Drywall work
- New fixtures

Project Repairs



- Put cement cap on addition
- Build master bedroom closet
- Install water heater
- Pour new back patio
- New flooring throughout
- Paint interior/exterior
- New 30 year roof

Timeline

- 6 Weeks
- Before one project is completed another subcontractor has to be lined up
- Some projects can run at the same time
- Actually took 7 weeks



Timeline Extension

- Due to unforeseeable problems, the timeline had to be extended
- Extension was 1 week
- Due to subs taking longer than expected
- Also due to having to pour concrete cap



Unforeseeable Problems



- During leveling rain prolonged the job
- During leveling the addition could not be leveled due to no rebar in slab
- Concrete cap was poured to level the addition

Problems with sub contractors



- Took longer than agreed upon
- Walking off the job
- Not showing up on time or at all
- The quality of work was below average
- I had to fix a fan that was hung wrong

The Sale



- Listed for \$99,900
- For Sale by Owner
- Staged home with furniture for quicker sale
- 2 contracts were received after staging

Final Product



- Completed in 7 weeks
- \$25,000 budget was met
- Total investment approx 70,000
- Sold for approx 100,000
- 6 weeks to sell home
- From purchase to closing took 17 weeks

Finished Product



Before and After



On the Courthouse Steps:

A preliminary investigation of mortgage foreclosure auctions in Bexar County, Texas

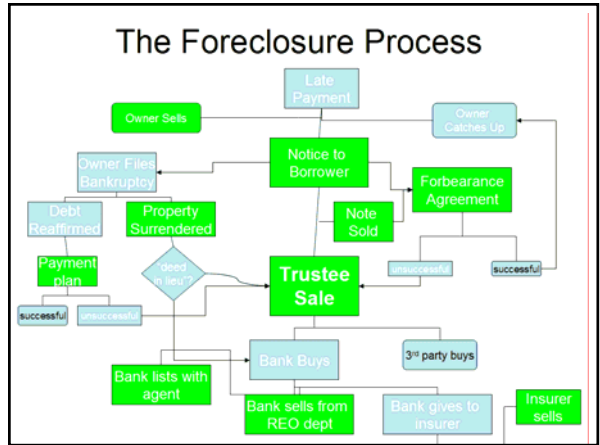


Jose Gutierrez
Jennifer Larson
Thomas A. Thomson

The American Dream



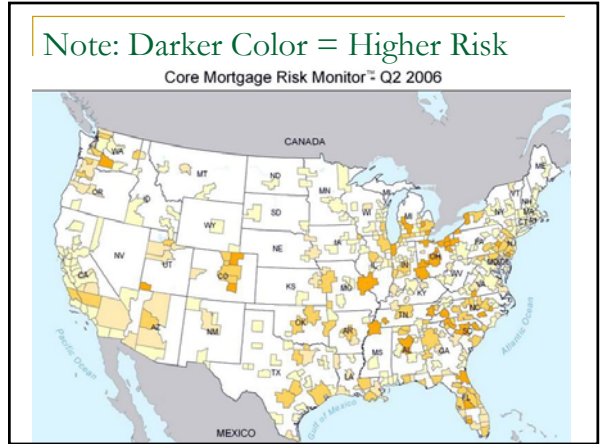
The American Nightmare?



Jack Miller's
FORECLOSURE
FORTUNES

Anyone Can Make Money With Foreclosures

Where **When** **How**



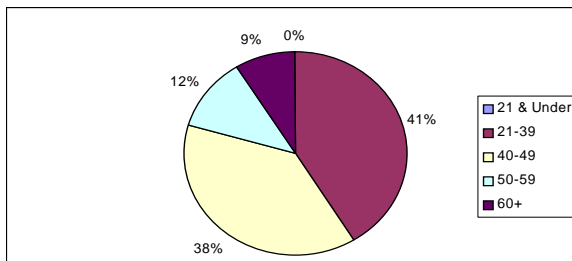
Objectives

- Some reporters questions (who, what, when, where, why)
- What can the data tell us about the bidding process?

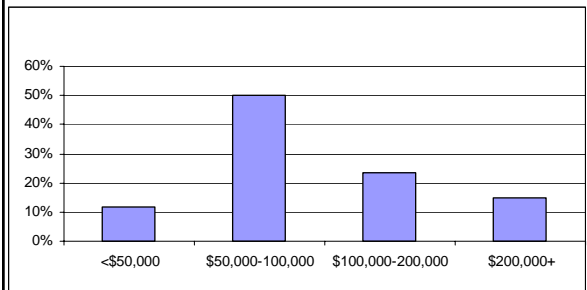
Bexar County Foreclosures

- First Tuesday of each month from 10 AM to 4 PM
- On the back steps of the County Courthouse
- Loud mostly disorganized
- Sheriff's sale on left – mortgage and homeowners associations sales on right. We only consider mortgage sales
- Administered a survey to those willing to participate, mostly before the auctions began and during the lunch break

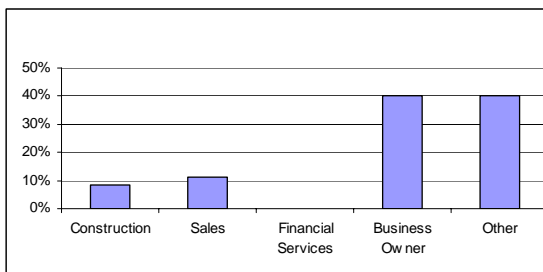
Respondents' age. N=34 (Note: About 2/3 of respondents are male)



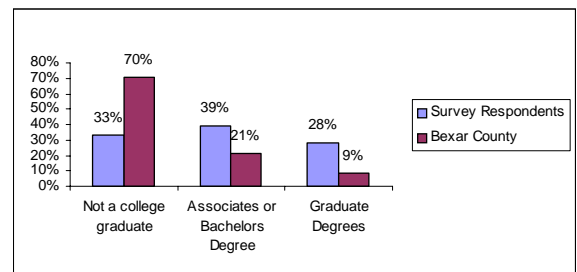
Respondents' annual household income. N=34



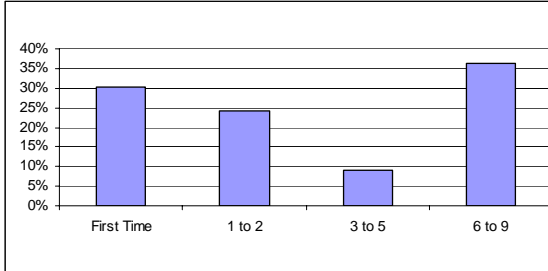
Respondents' occupation. N= 35



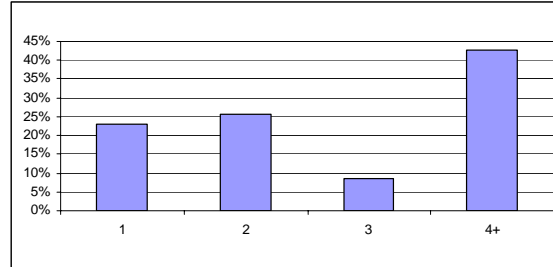
Respondents' education (and compared to county average). N=36



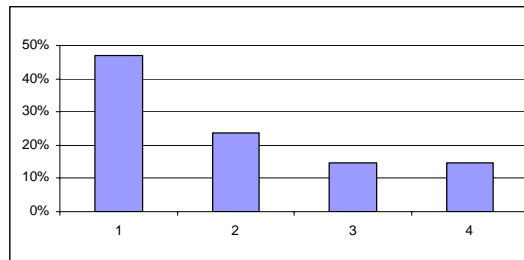
How many auctions have you attended in the past year? N=33



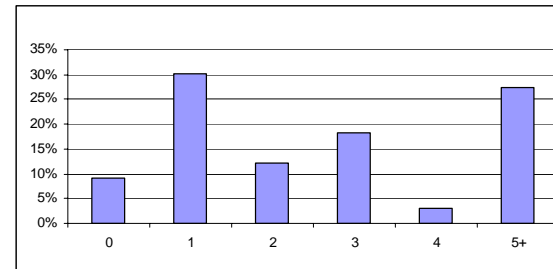
How many homes are you planning on bidding on today? N=35



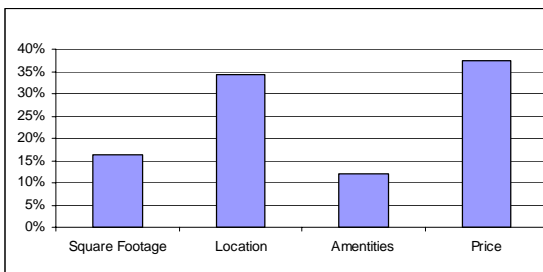
How many homes are you hoping to buy today? N=34 (total homes = 67)



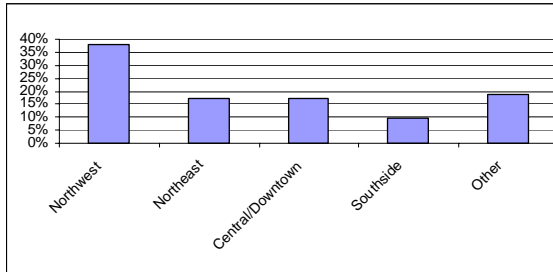
How many homes have you purchased at foreclosure? N=33 (total homes = 85+)



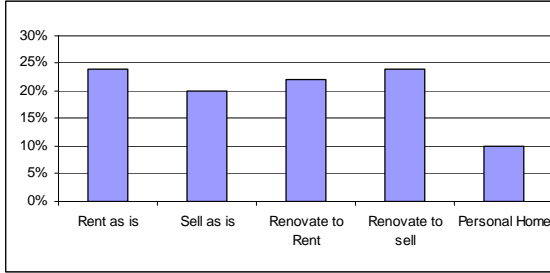
What do you consider on homes you bid on? N=67



In which areas are the homes you plan to bid on? N=53

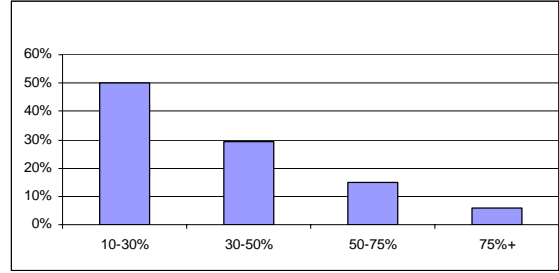


What are your reasons for purchasing auctioned homes? N=50



(Note 80% do not plan on using a loan)

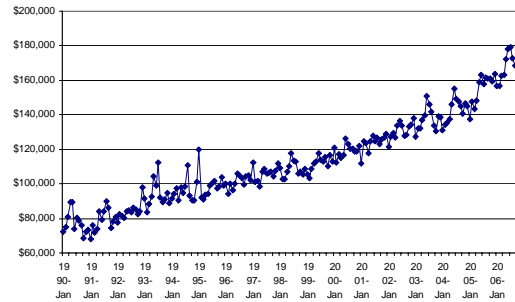
If you flip homes, about how much profit do you target?



Data Analysis

- We obtained auction data from RexReports
- We only use the mortgage part of the data. Must indicate conventional, FNMA, FHA or VA (we don't consider tax sales, home owners associations sales, 2nd mortgages, or home equity)
- We have data from 13 auctions
- About 700 mortgage notices per month
- About 250 sales per month
- About 15% are sold to third parties

San Antonio House Price Trends



Descriptive Statistics N=2471

Variable	Mean	StdDev	Min	Max
Note Amount	98.882	62.616	13.53	760.00
Note Rate	6.379	0.773	5.23	9.17
Term	28.642	4.194	5.00	40.00
Loan Balance	97.828	63.549	2.56	779.12
Equity	8.415	25.984	-191.43	194.98
FHA	0.400	0.490	0.00	1.00
VA	0.076	0.265	0.00	1.00
Not Fannie	0.085	0.278	0.00	1.00
Fannie	0.440	0.496	0.00	1.00
Square Feet	1.672	0.697	0.38	6.00
Loan Age	3.639	2.468	0.10	14.44
First Bid	101.004	63.901	1.00	716.41
Winning Bid	102.244	64.146	1.05	716.41
Bid Premium	1.240	6.685	0.00	108.16
Thirdparty	0.144	0.351	0.00	1.00

OLS Regression: Opening Bid

Dependent Variable	Opening Bid			
	Model A		Model B	
Covariate	Estimate	t stat	Estimate	t stat
Intercept	13.373	12.47	-13.712	-1.79
Loan Balance	0.896	97.43	0.788	57.28
Equity			0.120	4.86
FHA			7.805	5.96
VA			-7.958	-3.49
Not Fannie			-5.906	-2.63
Square Feet			14.111	11.24
Loan Age			-0.295	-0.73
Term			-0.178	-1.26
Note Rate			2.691	2.24
Adj R-squared		0.79		0.81

Logistic Regression: Probability of a Third Party Sale

Covariate	Estimate	p-value	Estimate	p-value
Intercept	-2.295	<.0001	-2.361	0.0063
Loan Balance			-0.009	<.0001
Equity	0.035	<.0001	0.037	<.0001
FHA			-0.808	<.0001
VA			-0.338	0.1804
Not Fannie			-0.176	0.4399
Square Feet			0.217	0.1330
Loan Age			0.142	0.0006
Term			0.044	0.0171
Note Rate			-0.159	0.2082
Corr_Square		0.10		0.16

OLS Regression of Final Bid for sales going to a third party

Covariate	Model C		Model D	
	Estimate	t stat	Estimate	t stat
Intercept	-5.68	-3.48	-11.20	-1.10
Loan Balance	0.99	71.68	0.97	36.70
Equity	0.57	19.77	0.50	14.20
FHA			-0.31	-0.14
VA			-4.43	-1.42
Not Fannie			-2.43	-0.95
Square Feet			4.57	2.27
Loan Age			1.02	2.22
Term			-0.31	-1.53
Note Rate			0.85	0.55
Adj R-squared		0.94		0.95

Note: Average Equity is about \$28,200 and average Bid Premium is about \$8,600

Summary

- It appears that lenders opening bid is about the amount they are owed
- Lenders bid about \$8000 higher on FHA loans, \$8000 lower on VA loans and 6000 lower on conventional loans compared to FNMA loans
- Third parties are most likely to bid when there is equity in the house (About 15% of sales)
- Third party bidders bid an average 31 cents on the dollar for equity (57 cents at the margin)

Thank You!

■ Questions?