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

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- Interest Rates
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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

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

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<thead>
<tr>
<th></th>
<th>Subject</th>
<th>Comp 1</th>
<th>Comp2</th>
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<tbody>
<tr>
<td>Size</td>
<td>$152,000</td>
<td>$150,000</td>
<td>$161,000</td>
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<tr>
<td>Garage</td>
<td>1800 sqft</td>
<td>1700 sqft + 8000</td>
<td>2000 sqft - 16000</td>
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<tr>
<td>Indicated Value of Subject</td>
<td>$153,000</td>
<td>$152,000</td>
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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
- An 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.

Budget

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

Robert Kohl
Internship Report UTSA
Fall 2007

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?

The Foreclosure Process

Note: Darker Color = Higher Risk
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

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<tr>
<th>Reason</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Rent as is</td>
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<tr>
<td>Sell as is</td>
<td>0%</td>
</tr>
<tr>
<td>Renovate to rent</td>
<td>25%</td>
</tr>
<tr>
<td>Renovate to sell</td>
<td>20%</td>
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<tr>
<td>Personal Home</td>
<td>15%</td>
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(Note 80% do not plan on using a loan)

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

<table>
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<tr>
<th>Profit Range</th>
<th>Percentage</th>
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<td>10-30%</td>
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<tr>
<td>30-50%</td>
<td>25%</td>
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<tr>
<td>50-75%</td>
<td>10%</td>
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<tr>
<td>75%+</td>
<td>5%</td>
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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

Descriptive Statistics N=2471

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<thead>
<tr>
<th>Variable</th>
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OLS Regression: Opening Bid

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<th>Covariate</th>
<th>Estimate</th>
<th>t stat</th>
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<td>Fannie</td>
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<td>Square Feet</td>
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<td>Note Rate</td>
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<td>Adj R-squared</td>
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San Antonio House Price Trends

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<tr>
<th>Year</th>
<th>Price</th>
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<tr>
<td>1999-01</td>
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<td>2000-01</td>
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<td>2001-01</td>
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<td>2005-01</td>
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<tr>
<td>2006-01</td>
<td>200,000</td>
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<td>2007-01</td>
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<td>2021-01</td>
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San Antonio House Price Trends
Logistic Regression: Probability of a Third Party Sale

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<tr>
<th>Covariate</th>
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<th>p-value</th>
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<th>p-value</th>
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OLS Regression of Final Bid for sales going to a third party

<table>
<thead>
<tr>
<th>N = 355</th>
<th>Model C</th>
<th>Model D</th>
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<tbody>
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<td>Adj R-squared</td>
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</table>

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).