

## Getting Real With East End Real Estate: Putting A House To Work

Moderated Joseph P. Shaw | May 5, 2021



Chris Furchert



Janet Hummel



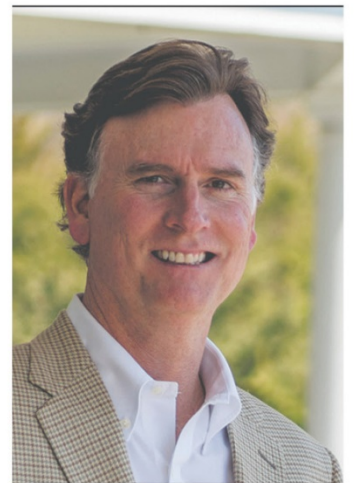
Tim O' Connor



James Peyton



Cindy Scholz



Drew Green

The option that many white-collar workers have to work remotely and the continuing restrictions on travel have driven up the cost of a Hamptons rental ever since the onset of the coronavirus pandemic in New York in March 2020, and the unprecedented prices have many homeowners on the South Fork wondering if they should put their houses on the summer rental market for the first time.

During its second Getting Real with East End Real Estate virtual event on Thursday, April 29, "Putting a House to Work: How to Turn a Second Home Into an Income-Maker," the Express News Group asked a panel of local real estate professionals what interested homeowners should know and consider. The experts were transparent about both the

positives and negatives of becoming a landlord and shared best practices for securing a tenant as well as their outlook for the 2021 and 2022 rental seasons.

Going back to the start of the pandemic and the shutdown of New York City, there was a frenzy for preseason Hamptons rentals, often with near-immediate occupancy desired. The fact that many Hamptons homeowners stayed put in 2020 meant that available rental inventory was down just as demand was way, way up. Not wanting to be left out in 2021, many 2020 renters renewed early and at higher prices, according to the panelists. They also advised that if there was ever a time to make some extra income off a house in the Hamptons, it's now — while inventory is scarce and demand is high.

"People that usually have not rented their house are thinking about it for the first time," said Corcoran agent James Peyton. Some homeowners don't want anyone else living in their homes, he acknowledged, but he said they are seeing the significant gains recently and are considering changing their minds.

"This region has long been known as a place that's a playground for the rich and a place for people with a lot of money to make more money on the real estate market, but in recent years, it's really come down to the locals finding that there are opportunities here as well," said Joseph P. Shaw, the executive editor of the Express News Group and the moderator of the panel. He noted that for most homeowners, their houses are their most valuable asset, and they can sell it, retire and move to a less expensive place to live. "But we're finding out in recent years there are other ways that local people can make money on their own homes — and even maybe on buying second homes — so that's what we're here to explore," he added.

### **What Renters Are Looking For**

A homeowner with a nice house, free of any turn-offs, can rent it out easily right now, was the panel's consensus.

"But it has to be the right product for it to move at the right price," said Brown Harris Stevens agent Tim O'Connor. "People have to really feel they're in a special place to make it work. It just can't be run of the mill."

Drew Green, an associate broker with Saunders, said the days of shabby chic are gone. Most renters want a clean setting, he said, and the standard request is four bedrooms or more, a pool and proximity to the ocean.

According to Janet Hummel, a managing partner at Town & Country, these days even a house as small as a three-bedroom is renting readily. "The timing is perfect to do it, and they rent right away," she said.

"Particularly for this summer, people will settle and take any kind of home, basically, because they want to have proximity to the action," said Cindy Scholz, an associate broker with Compass. "I know a lot of my peers felt like they lost out on a whole year of their lives, you know, whether it was dating or networking for work or anything like that. So they want to make sure that they're out in the Hamptons this summer for personal and professional reasons."

### **Cost And Benefits**

It was common 20 years ago to get a 20 percent return on investment from a Hamptons rental property, Ms. Hummel said, but that dropped over the years to about 5 percent.

As a result of the pandemic, rental rates have inflated more than sales prices, and owners are now seeing 10 percent return on their investments, according to Mr. Green.

Even with the high rental rates that can be attained at the moment, after factoring in increased purchase prices, buying a house just to rent it out may not lead to a profit right now. However, someone planning on enjoying a house personally when it's not occupied by tenants should factor into the decision, the panel advised.

Douglas Elliman agent Christopher Furchert said buying another house for the purpose of renting it out makes sense for someone who is open to the responsibility and risk: "It's not an easy thing, and I think that everybody needs to be aware that it's not a one, two, three, and you have a wonderful tenant. There's a lot that comes with it as well, but there's no doubt that now's the time to try."

Mr. Peyton said he works in the new construction sales market, and 50 percent of the homes that are bought are put right back on the rental market.

"We are in an environment where these properties can be carried very easily for their summer rents, and that enables these families to carry more properties in their portfolio," he said.

### **But of late, things are different.**

Mr. Peyton said that, considering where prices are at the moment, buying a second Hamptons house now for the sole purpose of renting it out does not have a lot of upsides: The rent may be able to carry the cost of the home, but there would be no income out of it.

However, he added, another return on the investment is the ability the owners will have to use the property themselves for 10 months of the year while paying for that year's mortgage payments simply by renting it out for July and August. He called this "lifestyle dividends."

Those who are best positioned to earn money right now are current homeowners who have someplace else to go while the house is rented out, since they bought at a lower price.

"It's better for someone who already owns a property to really seriously think about the rental market," Mr. O'Connor said.

Mr. Peyton stressed weighing the costs versus the income: "Even if you have a big home on the ocean, and you look at the money and you look at taxes you have to pay, your expenses, what you're paying for your smaller rental, it might just not be worth it at the end. It might be close to a wash."

### **What To Do Before Renting Out A House**

There are steps to take before turning a house into a rental for the first time, and at the top of that list is getting a town or village rental permit. This requires having certificates of occupancy and safety measures in place, such as smoke alarms.

The Town of East Hampton is a little more flexible when it comes to permits, while the villages and Southampton Town are more stringent, according to Mr. O'Connor. "You really have to go through a lot of paperwork to make sure that, you know, every 'i' is dotted and 't' is crossed," he said of East Hampton Town.

Mr. Peyton pointed out that last summer, many tenants discovered they needed to show a valid rental permit to get a beach pass.

Ms. Hummel said in addition to securing rental permits, it's important to let the homeowner's insurance company know the house will be used as a rental, and Mr. Furchert stressed the importance of speaking to an attorney.

Ms. Hummel also advises owners to get a caretaker if they will not be around.

"If something's broken, you have to be there or have someone on point," Ms. Hummel said. "You can't just say, 'OK, I'm gonna rent my house and take off.'"

The panelists all agreed that, even for a short-term rental, it's easiest and best to rent a house that is empty.

“Most people want it to be that they’re moving in, they’re making it their own home,” Mr. Furchert said. “They just want the furniture.”

“No one wants to live in someone else’s stuff, if you will,” Mr. O’Connor added.

He shared that he tells new landlords that they have to take down their photos.

“I had one client say to me, ‘I can’t understand why my house doesn’t rent,’ and I’m like, ‘Well, you have your entire family down the staircase in oil paintings,’” he recalled. “People are not interested in paying top dollar and being in someone else’s home. ... It has to feel much more like a hotel.”

The expense of storing personal belongings is another cost to consider before renting, Mr. Furchert said. “Maybe you have a place to go, but do you have a place for all your belongings?”

### **Write-offs And Deferrals**

When owning an investment property, there are tax implications to think about, but expenses may be written off and taxes can be deferred.

An aspect of the tax code that owners can use to their advantage is known as a 1031 exchange — the swap of one investment property for another. Rather than paying capital gains taxes on the appreciation of an investment property upon sale, they can defer it by rolling the investment into a new property. As far as the IRS is concerned, they have not cashed out yet, so they do not owe taxes on the gains.

“Once they close that property, they have so many months in order to move that money to a new property that has rental income,” Mr. Furchert explained.

Eventually, when a landlord sells an income property and does not purchase another one right away, the capital gains taxes come due. What’s considered gains is relative to how much depreciation the owner wrote off over the years of owning the house and what the owners’ expenses were.

“Rental properties are great because you can write everything off,” Ms. Hummel said. “If you’re just using that specifically for 12 months to rent, you can write all the expenses off on the house that you have, you know, from insurance to utilities to maintenance to repairs — everything.”

Writing off depreciation “creates a loss” for tax purposes even as landlords are earning money and house values are appreciating, she added.

### **What Happens When Tenants Overstay**

The challenge of evicting tenants who stop paying or overstay their lease is another common concern for prospective landlords, and this is further complicated by the state’s Housing Stability and Tenant Protection Act of 2019. The law makes it illegal for a landlord to collect more than one month’s worth of rent as a deposit or an advance, and it does not distinguish between long-term and short-term rentals. A landlord can no longer collect the rent for the entire summer upfront, as had previously been the common practice here.

To give landlords greater confidence that tenants will pay as promised and leave when they are supposed to, clauses can be written into leases.

“It’s a holdover clause that if they don’t move out by the end date, depending on the value of the rental, it’s up to \$5,000 a day or up to \$20,000 a day, depending on the overall price on the rental,” Mr. O’Connor said. “And it’s paid every day.”

New York State has an eviction moratorium in place through August 31 due to the pandemic, but an exception has been carved out for leases of less than a year. Still, eviction is an arduous process that can be lengthy.

“Ultimately, to get someone out of your house is a lot tougher than getting them in,” said Adam Miller, the principal of Adam Miller Group, the Bridgehampton real estate law firm that sponsored the event,

### **Don't Stretch**

If you have to stretch financially to buy a second home, think twice, Mr. Green advised. “A starter home is at a million dollars at this point, and that’s a home that most likely needs a lot of work, too,” he said. “So, it’s not for somebody without assets.”

“If it was easy, everyone would do it,” Mr. Furchert added.

Mr. O’Connor said he stops homebuyers in their tracks when they ask what rent they could expect to get on a property. “Do not do your finances based on income from rent,” he tells them. “It’s the gravy on top. Because if you’re building your portfolio and incorporating that into your finances, it’s a sketchy situation. Because I don’t want them to be disappointed when they were counting on that \$60,000 to \$100,000 rental income that didn’t mature.”

### **Winter Rentals**

2020 and 2021 are anomalies in that high rental rates were fetched during the offseason. Typically, renters only pay a premium for the period between Memorial Day and Labor Day.

Winter rental rates are dramatically less in a non-anomaly year, Mr. Peyton said, and there is added wear-and-tear that comes with having a winter tenant.

“For a really nice home, for the low dollar that you would get in the wintertime, most people frown upon that because they can get a much bigger bang for the buck in the three months in the summertime,” he said.

The panel agreed that having a winter tenant also makes it difficult to show a house to potential summer tenants or buyers.

But there is an upside: A winter tenant keeps the heat on and acts as a live-in house watcher.

“You want to be selective,” Mr. Green emphasized, saying an offseason tenant has to be someone the homeowner knows will look out for the house and not beat on it too hard.

Ms. Hummel warned to be wary of a winter holdover tenant who rolls over into the pricey summer months.

Ms. Scholz noted that homeowners want to be able to come to the Hamptons year-round, and they lose that option when they have a winter tenant.

### **The 2021 And 2022 Outlook**

Mr. Miller said that he is not seeing the rental mania that was seen at this time last year.

“I received more rental inquiries from brokers and clients that I had in the 20 years previous combined,” he said, noting that many landlords wished to have leases reviewed because of changing rental laws.

Ms. Scholz said she is seeing some renters are getting one-year leases starting this September because they want to secure a place for summer 2022.

Still, no panelists appeared to expect that the 2022 summer rental market would be anywhere near as hot as it has been of late.

“Next year, I think it’s going to be a very light market,” Mr. O’Connor said. “I just think people are going to be traveling. It’s not going to be ‘the place to go’ because they can go somewhere else. I think everyone who bought a home during this period is thinking that they’re going to travel and make money on it. There is just going to be a huge inventory.”

Mr. Peyton said that last year he told his clients who were renting to offer their current landlord a 5 percent higher rate to lock in 2021’s rental.

“No one would normally do that,” he said. “We’re always saying, ‘Oh, I’ll take it next year, and I’ll take a 15 percent discount because I’m your good tenant.’”

He also anticipates that in 2022 there will be a lot of inventory put on the market by recent buyers, and it will be “the clean, crisp homes that get the tenant.”

### **The Days Of The Share House Have Passed**

A Hamptons share house is a house rented out by the room or by a large group of friends for a summer or even just by the weekend, typically attracting tenants who come to party. Though share houses have been illegal for some time across the South Fork, that hadn’t stopped many landlords — until a few years ago.

“We haven’t seen those in a long time,” Mr. Green said. He attributed that to crackdowns by local municipalities, fines and rental registries.

“The share houses are a thing of the past,” he said. “They were fun days, but they’re a thing of the past.”

Mr. Peyton pointed to another reason share houses have gone by the wayside: “The marketplace has absorbed all those homes, bringing that back into single-family houses with lots of amenities and lots of bedrooms.”

Mr. Furchert saw price as another factor. There’s not much out there that’s affordable for 21-year-olds to rent, even split among 10 people, he said.