



## Is Buying Real Estate for Your Children a Good Investment?

By Randy Burgess

Joy Phoenix wasn't thrilled to be shelling out thousands of dollars in dorm rental when her son Matt Johnson entered the University of Arizona as a freshman majoring in math—especially since some of his immediate neighbors seemed more devoted to partying than to academics.

So Phoenix took matters into her own hands: the next year she paid \$176,000 for a three-bedroom house near the university for Johnson to live in, trading the dorm expense for a tax-deductible investment in real estate. It's also been successful as an investment in her son's future; Johnson graduates this spring, and intends to get his PhD at the university as well.

"It's a win-win situation for both of us," says Phoenix, a Tucson attorney. "I like real estate as an investment, and now he has the privacy and convenience to focus on his studies."

Phoenix isn't alone: a growing number of parents have been going the same route in the last several years. Specific figures for college areas aren't available, but the number of second-home purchases identified as investments rose sharply (from 20% in 1999 to 37% in 2002) according to the National Association of Realtors. And realtors in college towns in different parts of the country have identified a trend, driven largely by low interest rates and the renewed attractiveness of real estate compared to stocks.

Bart Blake, a realtor in Gainesville, Fla., who specializes in working with parents of students attending the University of Florida, says he now does about 50 such sales per year, as opposed to 20 per year when he started his business four years ago.

### **One big risk, many possible rewards**

Buying a second home or condo for your child's use is serious business, and not without risk. "The potential disadvantage is the obvious one that the home

or condo will go down in price," says Gerald Robinson, a tax lawyer and author of *J.K. Lasser's Homeowner's Tax Breaks*. "That's been known to happen—not recently, but it certainly happened in the 1980s."

However, the advantages can be substantial, as long as the parent has sufficient net worth that such an investment won't hurt their own financial security or retirement plans:

- As with any real estate investment, the property may appreciate sufficiently to not only pay closing costs and taxes, but to make a profit. At the very least, parents who've made a sound purchase can hope to break even on the deal, whereas four years of dorm rent is an unrecoverable cost.
- Mortgage interest and real estate taxes on an investment property or second home are tax-deductible when properly handled; dorm rent is not.
- If the parent and child are comfortable with it, they can choose a large enough house or condo that the extra bedrooms can be rented out to other students, further defraying expenses.

### **Five key considerations**

Even with the allure of tax breaks and appreciation, owning your child's college housing isn't a strategy that will work for everyone. Parents and realtors offer these tips when considering not only whether to buy, but also what to buy:

#### **1. Make sure your child is mature enough to manage the property.**

This usually means waiting a year or two, even if your child is fairly mature for a freshman. "You have to know they're going to succeed in college and be there to take advantage of it," Phoenix says.

In the case of Janeen Parsons, she waited until her daughter Emily Overturf was a junior before co-signing the loan on a \$44,000 three-bedroom home near the University of Dayton, where Emily is majoring in business management and marketing. The idea was a natural for Parsons, who with her husband had a number of prior investments in real estate, but a surprise to Emily, who had lived at home as a freshman and in dorm housing as a sophomore.

"It was a little scary at first," Emily says. "I'd never had to pay all those bills. But I really enjoyed it once I got into it. And I found two roommates who I absolutely loved, so that really helped."

#### **2. Research the local real estate market thoroughly.**

Find out what the appreciation rate has been over the past few years. Also

research the various neighborhoods available: In some cases, off-campus student housing may be in such short supply that a student-dominated neighborhood is fine, while in other cases you may prefer a non-student neighborhood.

"Professionals living in the area are good for resale value," says Melanie Osborne, a Chapel Hill realtor who works with parents of children attending the University of North Carolina.

### **3. Don't plan on selling right away.**

Although a healthy appreciation rate may lead you to believe you can be in and out of a property in four years and still do well, this isn't a wise approach, Robinson says: "Four years later, you could be in a down-trend. You want to be sure you're in a position to continue to hold the property."

Parsons and her daughter Emily Overturf agree. "You have to be willing to become a student landlord for a few years," says Parsons. That's exactly what Overturf plans on doing: She graduates this spring, but even though the housing market is strong, she plans to hang onto the property and rent it out to future students rather than sell.

### **4. Get the right financing.**

A 30-year fixed mortgage probably isn't appropriate, Blake and Robinson say. Instead, look into adjustable-rate mortgages or other means of financing. Blake recommends brokerage margin accounts when feasible, since the interest rates are low.

In Joy Phoenix's case, she was able to buy her son's house without taking out a mortgage at all: She sold an investment property in California, and used the proceeds to buy the house. Under the tax code, this is considered a tax-free exchange of investment properties, meaning she paid no capital gains tax on the California sale.

### **5. Decide whether a home or condo is better for your situation.**

Condominiums have the advantage of lower maintenance costs; and since the condo association handles this end of things, your child will have to spend less time calling the plumber or arranging to have the roof fixed. On the other hand, some realtors caution against condos built specifically for the student market, saying they don't always hold the same resale value.

For example, Osborne says she generally steers parents away from the four-bedroom, four-bath condos built specifically for the student market in Chapel Hill: "The problem is the dorm-like feeling. They're thin-walled, the kids don't take care of them, and they have a party atmosphere. You're not going to make as much money when you resell." Bart Blake, on the other hand, says

four-bedroom, four-bath condos continue to appreciate in value in Gainesville, perhaps because there is little room for new construction near the University of Florida.

**Conclusion: Before you close, consult**

The tax advantages that can come with owning an investment property aren't automatic. Before you buy, it's wise to consult an attorney or accountant.

Robinson favors deducting the interest on the mortgage as "acquisition indebted," but you need to make sure you meet the requirements of this approach. For one thing, you need to include the interest on your primary home, and the total must be less than \$1 million. And beware the pitfall of having your child pay rent: even if your child works while going to school, the IRS may frown on this as less than an "arms-length" rental, Robinson says, and you may wind up paying tax on the mortgage interest after all.

Finally, only you can put a price on the hassle factor. Frantic calls from a child about repairs, another mortgage and set of bills to keep track of, and all the other responsibilities of property ownership may cost more time and energy than you want to spend. On the other hand, when a property purchase works out, the combination of savings and better housing can be well worth the costs.

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