



Considering Buying an Investment Property?

Vacation Rental Versus Long Term Rental

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Now would be a good time to purchase property held for investment and due to market conditions, a rental home in the San Juans would be the most appropriate. We are not like the metropolitan areas nearby with multiple offers on every property and robust appreciation; we remain in a buyer's market in most categories of property.

Once you have made the decision of the type of property to purchase, then how you intend to use that property is the next process; vacation rental or long term rental. To assist you with this process, I have compared the different aspects of each below.

Vacation Rental General Description.

Buying a home with an existing permit, customer list, website and income history is the most preferable avenue. The permit for a vacation rental runs with the land. It is annually renewed automatically but can be voided by the County should the home not be used as a vacation rental within the last 12 months.

The cost to obtain a vacation rental permit can be as high as \$1400 which includes the consultant that will process the application and the County fees. The process requires the corners of the lot be well marked, which may require a survey if you are not able to locate them. The application requires a current water test, if on a private well and recent septic inspection. The owner must evidence adequate parking and access roads to allow for fire protection and emergency vehicles.

The owner or manager should publish rules of conduct for the individual home as well as a telephone list of emergency and contact numbers.

The County does not have rules or regulations to guide the occupant's use, however many homeowners have developed their own set of rules, such as being respectful of the neighbors, recycling and water use conservation suggestions. The County does restrict head count based on a maximum of three people

per bedroom for occupancy and a total allowed for gatherings. Some homeowners have a pet restriction as well. Providing details of operation is advisable, especially for appliances and systems.

The most desirable properties include waterfront homes, homes with docks, hot tubs, pools and those that offer gaming tables such as a ping pong or a pool table.

Most any property is eligible for a vacation rental permit however there are some exceptions.

- If you are in town and on town water, vacation permits are not allowed unless you are commercially zoned.
- If you are in the County and hooked up to town water, vacation permits are not allowed.
- Many plats contain a provision in their Covenants, Conditions and Restrictions which prohibit vacation rentals.
- If you have a home and guest house on one parcel, one of the structures must be owner occupied or have a long term rental, you may not have individual vacation rentals in both structures.

Long Term Rental General Description

A non-transient rental property is described as a rental occupied by a tenant on at least a month-to-month agreement or a term lease. The typical lease is for 12 months and will terminate with notice at the end of the term or convert to a month-to-month until terminated. Notice of termination is normally given in the range of 20-60 days.

Some plats have Covenants, Conditions and Restrictions that restrict against occupancy by a long term tenant, but very few. The Oaks manufactured home park on San Juan is an example, but they also have an exception for homes on the market.

Income and Expense Review

Most property owners will consider the net income calculation for each type of rental as their decision maker. For the example shown below, I used a three bedroom, two bath home with approximately 2000 sf and a water view. The home is valued near \$550,000 and has a well and septic. Per the vacation rental calendar on a similar home, the rent range is from \$275 to \$325 per night subject to the time of year. I used the calendar schedule of varying nightly rates and 128 days of occupancy which was generally the end of May through September.

Proforma for Vacation Rental Versus Long Term Rental for 12 months

	Vacation Rental	Long Term Rental
Income	\$38,525	\$1,700/mo - \$20,400/ yr
Expenses:		
Power	\$1550	Paid by Tenant
Propane	\$1300	Paid by Tenant
Rental Home Insurance	\$2520 - Commercial	\$1260- Standard

Umbrella Policy	\$200	\$200
Garbage	Included in Mgt Fee	Paid by Tenant
Taxes	\$3400	\$3400
Management Fee	30%-35% or \$11,557-\$13,483	First month's rent plus 10% monthly or \$3570.
Phone Line & DSL	\$1120	Paid by Tenant
Website/ VRBO	\$300	0
TV Dish or Direct	\$600	Paid by Tenant
Yard Maintenance	\$1300	Done by Tenant?
Cleaning	Billed to Tenant	Done or Paid by tenant
Repairs	???	???
B&O Tax	Applicable	Not applicable
NET INCOME	14,678-\$12,752	\$11,970

Maintenance and Repairs

The overall property maintenance will be more for a vacation rental as the property grounds must be mowed and tidied up regularly. Repairs will also be higher for a vacation rental as the tenant is less likely to be familiar with the various systems and operation of the home versus a long term tenant so damage may occur, requiring regular maintenance. The property management firm bills out repairs at \$50 per hour and cleaning at \$35.

The general types of repairs would be similar, although a long term tenant may be more accepting of a broken microwave versus a vacation tenant. It is not possible to include the analysis for maintenance and repairs in this article unless I had the data on a home that was a vacation rental for one year then a long term rental for the next.

Proforma

In the proforma above for this typical home, it is more favorable to rent under a vacation rental situation, but if one takes into consideration the wear and tear associated with luggage, coolers and smuggled in pets, these items may tip the scale.

I also did the analysis on a waterfront home with dock and guest house and the numbers are shockingly different and strongly favor the vacation rental. Of course each type of home will warrant a different rental rate, but the breakeven point appears to be a home valued around \$450,000. Further, homes near this price range rarely have docks, pools and recreation areas which are an attraction to the vacation tenant. Income and expense for homes below the breakeven price point should favor the long term tenant scenario and those above should favor the vacation home.

One should note that a waterfront home with dock and guest house is not the typical long term rental property that is being sought by a resident that works on the island as the rent would be in the range of \$2,500-\$4,000 per month on a lease.

Other differences include the following:

Property Management

Vacation

The management for a vacation rental is very complex. They are running the home similar to a hotel and are on call 24-7. The management fees vary subject to the level of service but the range is 30-35%. They operate a website that showcases the property, most feature it on Vacation Rental by Owner (VRBO), make reservations, collect rent, deposits, and prepare the home for each tenant. They must make immediate repairs as needed and have repair persons and cleaning people on staff or 1099 contractors at their beck and call. The firm is not required to have a Washington State Brokers license or Trust account for the deposits.

Long Term

The long term rental management can be a phased management. You can hire them to run ads, screen and credit check the tenant, write the lease and collect the first month's rent, damage deposit and last month's rent, and then end their services. This first phase of the service charge is typically equal to the first month's rent. If you want full service, then they would also collect the monthly rent and provide any notices and administer final departure services required with the tenant. They monitor the condition of the property during the tenant's occupancy. Typical fee is equal to the first month's rent plus 10% monthly thereafter. The firm must hold a broker's license and have a trust account for funds.

Self-Manage

As a property owner you may self-manage a property and avoid the management fees. However, you must be willing to complete all of the necessary functions. The lure of a lucrative investment is strong but the romance of it ends quickly once you must go out and unplug a toilet in the middle of your own dinner party. I have interviewed many property owners who started off as self-managed and soon changed their approach to hiring the professionals that have regular connections with service providers. VRBO and Air B&B are common websites that owners join to self-manage.

If you self-manage or hire management, a business license is required for the operation, which of course, will require payment of B&O taxes. Proof of payment of B&O tax is what the County may require as evidence of an active rental which is required for the permit renewal.

Options for property management firms are very low on San Juan Island. We have more options for vacation rental management firms as the regulations are less; no brokerage license required or state regulated trust accounts. It is easier to manage vacation rentals from a regulatory standpoint but more difficult in reality. The only long term management firm on San Juan is "Brand X" whose name I won't

use in an article written by a Coldwell Banker agent. Generally, property management is a difficult field to work in; very demanding and very competitive.

In addition to considering working through one of the management firms, we often suggest that our clients looking for long term rentals view the online newspapers looking for direct rentals or use Facebook; San Juan Buy and Sell and San Juan Island Rental/House Share.

It is painful to find a property management firm on this island and as the island offers more vacation rental managers versus long term; this may be the decision factor for some of the property owners.

Value Added

The tax assessor no longer adds to the value of a home if it has a vacation rental permit. The value to buyers can be recognized or discounted. The vacation rental or long term lease will narrow the size of the buyer pool for the property if the buyer had hoped to occupy their new home immediately after closing. Further most lenders require occupancy by the borrower within 60 days of closing if the loan was intended for a primary residence.

More buyers in our market are looking to purchase for second home or primary residence versus a rental property. I attribute this to lack of appreciation in our market for the last 9 years. Many are willing to purchase subject to the rental agreements or reserved vacation rentals but transactions have been lost due to tenant's rights.

Cancelling vacation rental reservations is not a simple process and most management firms have a 120 day notice provision if the property is on the market for sale. In order to cancel, the vacation rental client may need to be reimbursed for their air-flights and other travel arrangements that they have made. Can you imagine making that phone call to the coordinator of the July family reunion?

Technically, the property management firm has earned their fees for the transaction so those are due as well. Agents will comment in the remarks section of a listing if the property is subject to any form of lease or vacation rental and whether they have a delayed closing date.

Impacts to the Neighborhoods

Impacts to a neighborhood are very difficult to measure. For a vacation home, a tenant may travel on the roads four times a day for the 128 days the home is occupied. During long term occupancy, the tenant may travel on the roads two times a day for 300 days a year, taking the weekends off; minor differences.

For those homes on community water systems or sewer, most communities have a provision for excess use which is billed to the owners or tenants if long term.

There may be a gathering at the vacation home that results in noise beyond what the neighbors would determine is acceptable. The sheriff is always available to respond to this type of disturbance. Based on

the number of vacation rentals as compared to all homes, the sheriff is more likely responding to a primary residence disturbance.

Impacts to the Economy

Homes offered into the long term rental pool provide local housing for islanders. Residents living and working here over the long term tend to have pride in community which results in maintenance of the home and may result in a home purchase in the future.

Vacation homes offer economic gain into the community and to the owner. While visiting, tenants enjoy retail therapy, restaurants, kayaking, and whale watching. Some may end up deciding that purchasing a home here is in their future.

B&O tax is generated back from the state into our local government.

Deciding to use your investment as a vacation rental will reduce the number of homes in the long term rental pool and will drive up the rental rates for the remaining long term properties due to demand.

As the market has improved, many owners have decided it is time to sell versus having the home as a long term rental which has added more pressure.

Seasonality

The vacation rental homes are mostly occupied in the summer months and this coincides with when the second home owners return and desire to hire staff or service providers to help with their property maintenance. These service providers may be the very ones seeking housing.

Bottom line:

Very few homes on this island “pencil out” as an investment when you take debt service into consideration. If you own the home free and clear you may enjoy some cash flow. Our rents are not high enough to balance with the price of the homes. The investor needs to rely upon their Schedule E for tax write offs and appreciation to come out ahead on a rental property here. Having said that, a Sand Piper Condominium in Friday Harbor will almost “pencil”, the rent covers the expenses and debt service at 70% Loan to Value.

Long term rentals are in demand in our community. Not a week goes by that a prospective tenant doesn't contact our office looking for a rental house. In last week's Journal, 8 of the 9 public notices were for vacation rental permits.

Relief

Allowing detached guest homes on parcels that are less than 5 acres may create inventory in the rental pool. (Currently you may have a guest house on less than five acres only if it is attached to the main house)

Allowing the rental of the guest houses in addition to the main house, this would generally result in the rent being lower as they are smaller homes.

Zoning and the cost of construction including hookup fees all need to be considered. Investors have no interest in building an apartment or other multifamily units as they do not "pencil" on island. The town fees for water and sewer hookups per unit and the monthly fees are too high for a typical investment proforma, so there is no incentive. At the present time, it is more cost effective to purchase existing than it is to build custom. It has been many years since an apartment was constructed in town by the private sector.

If a hard working resident must work two jobs to afford a rental or camp, we have an issue. Ask any of the general contractors looking for skilled labors, the turnover is too high.

As an author, I have tried to remain neutral in this article but as a REALTOR I find it difficult. In a perfect world, an owner of a home valued under \$450,000 will decide their home doesn't "pencil" as a vacation rental and should be offered as a long term rental. The owners of high-end homes should continue to offer them as a vacation rental as it is good for our economy. Each investor needs to do the math and make their own decision.

As for my disclosure, as usual, this article is meant for informational purposes and not intended to be all encompassing of the details. My proforma of income and expense comparison is not perfect.

Once again I apologize for being lengthy, I am a wordy gal.

Referrals:

Consultant for Vacation Rental Permit

Francine Shaw 360-378-6278

Jack Cory 360-378-4900

Property Management Firms:

San Juan Property Management

Vacation Rentals Only 360-378-2070

www.sanjuanpm.com

Vacation Doorways

Vacation Rentals Only 800-391-8190

www.vacationdoorways.com

Windermere Property Management

Long Term Rentals 360-378-3600

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