

Should I Buy a Vacation Home?

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Many dream of owning a vacation home — a place where they can escape daily life, relax, and create cherished memories with loved ones. While the allure of having a retreat to call your own is tempting, be sure to weigh the costs and responsibilities before taking the plunge into owning a second property.

Financial Considerations

Some believe that purchasing a second home is a wise financial decision since the property can appreciate in value and you'll save money on travel expenses. However, the reality is that buying and maintaining a vacation home can be more costly than you'd think.

Upfront costs

Purchasing a home often requires a significant down payment upfront. To cover this expense, you'll likely have to withdraw money from your invested assets, thus reducing your spendable cash. Real estate isn't like stocks or bonds – you can't just withdraw money from a house whenever you want. If you need quick access to cash, you may have to resort to borrowing against the value of your home or even using a reverse mortgage.

Further, you could be withdrawing from assets with higher expected returns, whereas real estate's growth potential is heavily reliant on the location and the housing market. Even if you love a location, it might not be the best place to make a real estate investment.

Other expenses

Apart from the upfront costs, you'll need to furnish the new property and handle regular upkeep and maintenance expenses to keep it in good condition. If you plan to use the home only during specific times, you'll need someone to check on the property periodically.

Don't forget to factor in your monthly mortgage, property taxes, and, if applicable, HOA fees, depending on the home's location. However, that's not all; transportation costs should also be considered. If the vacation home is nearby, driving may be convenient. However, if it's in another state, you'll need to budget for airfare and rental cars, or explore other transportation options. All these costs will add up and impact your overall financial commitment.

Costs for an out-of-state vacation home

Purchasing an out-of-state vacation home adds another layer of complexity to the financial and logistical considerations. You'll need to determine which state will be your primary residence, as that's where you must file your taxes. Keep in mind that each state has its own tax rates, and your vacation home could be subject to significantly higher taxes depending on its location.

If you do plan to spend a significant amount of time at the vacation home and are considering making it your primary residence, this could impact how you will be taxed if you sell the property. If you use the second property as your primary residence for two out of the last five years, you might qualify for a home sale tax exemption, which will minimize the amount of capital gains tax you owe on the sale. If you're strictly using the second home as a vacation property, you won't qualify for this exemption when you sell the home.

Additionally, you'll need to account for insurance rates and, in some instances, specialized coverage for your vacation home. For example, if you buy a property in Florida, you must consider flood insurance due to the state's vulnerability to tropical storms. However, with Florida being a high-risk area, insurance companies may be more selective and offer aggressive rates.

Personal Considerations

While financial considerations certainly play a role, personal desires can outweigh the costs. There are a few compelling reasons why someone might consider purchasing a second home: the allure of having a cherished getaway spot, escaping from a cold climate, or being closer to family.

Purchasing a home in an area you'll visit regularly means you won't spend money on hotels or rentals every time you visit. In some cases, it can also spare you from the emotional toll of staying with family.

However, if you're buying a second home as a place to vacation, it may make you feel handcuffed to one spot. When you choose to vacation elsewhere, you might worry that you're not making the most of your second home. Consider whether you'll be content with consistently vacationing in the same place or if you'd prefer the flexibility to explore other destinations.

If you treasure familiarity and have no desire to change your vacation spot, or if you're moving to spend more time with family, then the benefits of owning a vacation home may outweigh the costs. It can provide a sense of stability and a place to call your own when visiting.

The Bottom Line

Owning a vacation home can be a luxury, but it's important to be aware of the commitment involved. Many focus on the cost of a down payment and mortgage but tend to overlook the expenses that follow. Before making a decision, you need to compare the expenses and the benefits of owning a second home. Having a clear picture of what you're signing up for is essential.