

The Big Move

# 'I don't know if it's worth dealing with tenants': Should I convert my home into a rental, or sell it?

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By [Jacob Passy](#)

'I can rent it for \$1,800 to \$2,000. But I don't know if this is the best option because I could also sell it for close to \$500,000'



Being a landlord involves maintaining the property on an ongoing basis — and that's just one of the many headaches property owners must deal with.

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**Dear MarketWatch,**

I have enough money to put down on a second home — I need a slightly bigger place and another bedroom. I currently live in Portland, Ore., but I am planning to move outside of Portland.

However, I'm contemplating whether I should sell or rent the house I currently have. I bought the house for \$188,500. I have refinanced twice and got cash out last time. My interest rate is 2.75%, and I still have 18 years to pay it off. I can rent it for \$1,800 to \$2,000. But I don't know if this is the best option because I could also sell it for close to \$500,000, which is the highest value currently.

It would be great to have the tenants pay my second mortgage, but I don't know if it's worth dealing with tenants and repairs they may ask for all the time. After all, it is an old house. What should I do?

Sincerely,

Packing up in Portland

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**'The Big Move'** is a MarketWatch column looking at the ins and outs of real estate, from navigating the search for a new home to applying for a mortgage.

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## Dear Packing,

The competitive housing markets has many homeowners considering the very move you're thinking of making. Homeowners see rising rental rates, and many are taking advantage. In February, rents were nearly 18% higher compared with a year ago nationally, [according to real-estate website Apartment List](#), representing record growth.



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To some extent, homeowners are fueling that rent growth by converting their starter homes into rentals. Those homes would have otherwise provided much-needed supply to the home-buying markets. Instead, there are so few homes for sale that many Americans are being forced to rent for longer than they had hoped because they can't find a property to purchase. More people renting means more competition for rental units, and thus rents are rising.

Just because so many homeowners are going this route doesn't mean you should though. "It makes sense to convert a home to a rental property if and only if you understand all of the potential issues that exist with becoming a landlord," said Michelle Gessner, founder and owner of Gessner Wealth Strategies, a financial advisory firm based in Houston.

It's easy to imagine the benefits of being a landlord — using the extra income to pay off your second mortgage and perhaps once that's paid off pocketing the money to save for retirement. But if the pandemic has taught us anything, it's that being a small mom-and-pop landlord isn't for the faint of heart.

You've already hit on some of the challenges in being a landlord. You'll need to interact with tenants and work with them to maintain the property. And chances are, tenants won't treat the home as nicely as you might have, forcing you to pay to fix it up regularly. That's just the tip of the iceberg.

***'It makes sense to convert a home to a rental property if and only if you understand all of the potential issues that exist with becoming a landlord.'***

— Michelle Gessner, founder and owner of Gessner Wealth Strategies

It sounds like you're financially stable, but could you afford to pay both the mortgage on your first home and your new home yourself? Many landlords found themselves facing foreclosure and bankruptcy on their rental properties in recent years as tenants struggled to pay their rent due to the pandemic. In the end, many of these property owners opted to sell the homes to cut their losses.

If you don't think you're up to that stress, then I'd strongly reconsider becoming a landlord. There are other financial reasons to think twice. When someone sells their primary residence, they get to exclude up to \$250,000 of capital gains (or \$500,000 if married and filing jointly.) So, if for instance, you sold the home for \$500,000, but only paid \$300,000 to purchase it originally, you wouldn't face capital-gains taxes on the \$200,000 in profit you earned.

Should you opt to convert the property into a rental home and then later decide to sell, you might face a steep tax bill. To take advantage of the exclusion on capital gains, you must have lived in the home for two of the last five years, but it doesn't need to be the two most recent years. So, in essence, you have a bit of a grace period. And there are tax deductions you could tax as a landlord.

Let's say though that you rented the home for six years and then decided to sell. You wouldn't get the \$250,000 (or \$500,000) exclusion then, so all of the money you make from the sale would be considered taxable income. There are ways you could avoid that tax hit — in particular, you could reinvest that money into another rental property through a Section 1031 exchange. Otherwise, the tax bill will be larger.

Another financial consideration is whether your mortgage lender would even allow you to convert the property into a rental in the first place. Mortgages typically include clauses that require the borrowers to live in the home for a set period of time. Should you attempt to move out and rent the property before that timeframe has expired, you could be engaging in mortgage fraud. Given that you refinanced fairly recently, you should study your mortgage documents carefully.

You have a better sense of your tolerance for risk and financial complexity than I do. If you're still interested in moving forward with this plan, definitely consult with an accountant and a financial planner who can help you map out the best approach. My gut instinct is that you're not sold on this idea. If that's the case, then I'd consider other options. After all, the money you make from selling the home would likely go a long way toward paying down debt or other financial goals.

Plus, being a landlord isn't the only way to invest in real estate. "Additional proceeds can be invested to generate income or growth or even in real estate-related securities," said Kashif Ahmed, president of

American Private Wealth, a financial advisory firm in Bedford, Mass. Investing in a real-estate investment trust, for instance, could broaden your portfolio, but is much more liquid than having all that money tied up in a house.

Ultimately, I feel that you can't go wrong by making the choice that feels the most comfortable to you. So whatever choice that is, I wish you the best of luck.

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**Jacob Passy**

Jacob Passy is a personal-finance reporter for MarketWatch and is based in New York.



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