Insurance and Taxes

Get Landlord Insurance

If you're renting a home, it might not be covered by home owners insurance, so look into landlord insurance instead.

Homeowners insurance covers your house if it burns down, your possessions if there's a break-in, and medical and legal bills if someone gets hurt on your property. Problem is, homeowners insurance might not offer protection if you decide to rent out your home. Landlord insurance does. Set aside half a day to research policies.

Renting Out Your Home Raises Risks

Homeowners insurance typically covers owner-occupied, single-family residences, says John W. Saunders, president of Slemp Brant Saunders, an independent insurance brokerage in Marion, Va. When your home doesn't meet that definition because it's being rented out regularly, it's no longer covered.

Most homeowners policies will cover an occasional short-term rental if, say, you're going away for a few weeks, says Dave Millar, a partner at Riley Insurance Agency in Brunswick, Me. "But if you have a summer home you've decided to use as an income property and are putting different people in there every week," he explains, "that's a lot higher risk for the insurance company."

The risk is also higher for both you and your insurer when you rent out your home on a full-time basis. You have an increased responsibility for injuries on the property, whether to your tenants or your tenants' guests, says Bob O'Brien, vice president of Noyes Hall & Allen Insurance in South Portland, Me.

Insurers also experience more claims on tenant-occupied properties because tenants typically don't care for properties as well as owners would. Renters are less likely to either identify or report maintenance needs, says O'Brien, and may be unfamiliar with a home's systems like the location of the water shut-off.

Avoid Costly Financial Mistakes

1. 4 Dangers You Face If You Don't Back Up Your Income Tax Documents
2. How Long to Keep Tax Records

3. Are You Getting the Home Tax Deductions You're Entitled To?

Look Into Landlord Insurance

When you decide to become a landlord, inform your insurer and ask about a specific landlord insurance policy, sometimes known as a dwelling fire policy or special perils policy. Coverage from a basic landlord policy isn't quite as broad as a homeowners policy, says O'Brien, but it includes big risks like fire, wind, theft, and ice damage.
There are several levels of dwelling fire policies: DP-1, DP-2, and DP-3. The higher the number, the better the coverage. "A DP-3 policy might provide replacement cost on the house and theft of contents coverage for your belongings," says Millar.

Expect to pay 15% to 20% more for landlord insurance than you did for homeowners insurance. In recent years the average cost of homeowners insurance was $822 a year. Tack on 20%, and that would put the average annual premium on landlord insurance at about $986.
A landlord policy covering a one-year rental for a home in Maine insured for $370,000 and personal property for $10,000 would cost $1,170, for example, says Millar. Expect to pay even more if you allow short-term rentals. The same insurance for the home if rented by the week for 12 weeks during a year would be $2,170.

Other Insurance Policies to Consider

Landlord insurance typically covers the house itself, other structures on the property such as sheds, the owner's possessions (but not the tenant's possessions), lost rental income if the house is damaged and uninhabitable, and some liability protection for the owner in case of injury or a lawsuit. Policies vary, however, so read the fine print. If lost rental income isn't included, you might be able to add the coverage for an additional $50 a year, says Saunders.

Also consider an umbrella policy that provides additional liability protection beyond the limits of your landlord policy. "If you're talking about owning more than one house, and your net worth is starting to build up, then you should consider an umbrella policy," says O'Brien. You can usually get an additional $1 million worth of liability coverage for $250 to $300 a year.
Finally, O'Brien advises that you require tenants to buy renters insurance that protects their own property. Remember, landlord insurance only covers the owner's property. In recent years, the average cost of renters insurance has run $182 annually.

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Why Purchase a Rental Property Before the End of the Year?

This may seem bold to hear from your CPA. I'm not a realtor selling your real estate, but as a tax lawyer, I am actually trying to help you save taxes and build wealth at the same time.
I consistently repeat and encourage my clients and students everywhere I go that working towards buying a rental EVERY year is critical to building a retirement and wealth. It's a goal that is tangible, emotional, conceivable and realistic for most Americans.

Now I realize a rental may not be for everyone, AND some of you have had a bad experience before with real estate. However, I would at least like to encourage you to consider it and get the process started. Maybe you already have a deal in the works.

A good rental property strategy will not only to build an incredible long-term and sometimes immediate tax strategy, it will inevitably build wealth for future retirement and should provide current cash flow benefits if you choose wisely.

Here is a diagram of the 4 benefits to Rental Property I want to discuss briefly with you and suggest you consider this strategy seriously as part of your investment and tax planning strategy.

The 4 Benefits to Rental Property

Appreciation	**Mortgage Reduction**
Tax Benefits	**Cash Flow**

Appreciation. This is a rental property you are keeping at least 7-10 years. This is not a fix and flip strategy. The National Association of Realtors ("NAR") has reported that real estate nationwide has averaged over 6.74% appreciation during the past 50 years.
This rate of return outperforms the S&P 500 and most Wall Street investments. Now I realize not all property in every market experiences this growth, but some actually do even better than the national average. Don't discount appreciation.

Mortgage Reduction. This is often an overlooked benefit to rental property. Think about it. If you purchase wisely, the property should be at least be 'breaking even' in cash flow and thus the renter is paying the mortgage for you.

The principal reduction in the mortgage instrument is an ongoing tax-free benefit along with appreciation as you hold the property. This is a return you can calculate and count on overtime with a typical mortgage. Keep this in your spreadsheet as you calculate your total Return on Investment.

Tax Benefits. It's no secret that rental properties lose money on paper. With the power of deprecation, the fact you get to deduct the mortgage interest your renter is paying for you, and not to mention travel, property taxes, HOA fees, repairs, maintenance, home office, supplies, cell phone, etc... the tax benefits add up quickly!! Now of course, as I have discussed in a previous article, how you are 'classified' as a real estate investor is critical (Passive, Active or Professional). Review this article *here.*

However, at the very least, you will be able to carry these losses forward indefinitely to write off against future property sales, if you aren't able to deduct them immediately against your other income. The tax benefits can be phenomenal.

Cash Flow. If the economic downturn and the drop in real estate values have taught us anything, it's that we MUST analyze and purchase property based on cash-flow. Good rental property cash flows...bad property does not.

It's absolutely critical that we shoot to purchase cash flow property and mysteriously the other 3 benefits fall right into place. It's amazing!! Ironically cash flow also becomes a rate of return and a tax-free benefit due to the ability to maximize all of the expenses related to rental property.

In summary, many a savvy investors realize they can experience tax-free cash flow and have double digit, if not, triple digit rates of return on their leveraged rental property.

When it comes to the tax benefits coupled with quality investment strategies, it's no surprise that the most wealthy and successful people in America hold rental property as a large part of their portfolios in one form another.

To analyze your tax position in regards to rental property and how it would affect your tax return, please give us a call to schedule a consultation with one of our tax advisors.