Possible Solution to Housing Problem: Long Term Housing Investment Plan

Tucker Reed
California Polytechnic State University
San Luis Obispo, California

The purpose of this paper is to provide young men and women entering the work force with the ability to invest towards acquiring a large plot of land to live on. In the current housing condition, Americans, more exactly those living in large urban populations are finding it difficult to find a permanent home in the same city as their workplace. This is particularly true for those whose professions require frequent relocation. The research conducted is meant to provide a person with little to no knowledge of construction with the conceptual understanding of the correct channels to purchase land and then develop on it. Less than 3% of Americans are involved in the Construction industry, therefore there are a lot of people who could utilize this information. This research is meant to provide initial understanding and it is the requirement of the reader to conduct in depth research into each of these topics and see how they apply to individual circumstances. The paper begins by looking at how one gains capitol to invest, then it discusses various preconstruction considerations, next it discusses post construction considerations, and finally it discusses new information and a conclusion.

Key Words: Invest, Family, Acquiring, Conceptual Understanding, Housing

Introduction

Unless one was to work in the construction sector, they would be clueless to the nuances that found in residential construction development. This paper is meant to bridge the gap. There are many Americans who would like to be more involved in the building process of their very own single-family home but 'don't know what they don't know'. This undergraduate research is meant to be a reference guide for a family, or group of individuals, who would like to purchase land together and develop on it. The paper will discuss how a group of people will join into one entity and build wealth together, the topics discussed will be what sort of entity should the group join into and once joined what are some wealth building tools that can be used to later procure land. Next it will discuss the specifics of acquiring land, what to look for as well as the costs that are associated. Then the paper will discuss the specifics of developing on the land previously acquired, in this section there will be specifics relating to off grid living considerations as well as zoning complication considerations. Finally, the paper will address potential problems that may arise after construction, such as one person attempting to move or passing away.

Literature Review

The current knowledge regarding this topic is available but scattered. What this means is that if someone had the knowledge regarding all of the topics, they would have the capability to create a similar paper. However, the main purpose of this research paper was to create a starting point for someone with little knowledge of the topic. Each individual existing topic contained immense amounts of research individually. The two areas that contained no prior information were whether there was demand for the concept and a location where all information was located in one place.

Methodology

The Methodology used in this research paper was derived through quantitative data gathered by a questionnaire sent to Cal Poly Construction Management Students. The questionnaire asked respondents a series of questions beginning with 'would you be interested' to 'what percentage of your paycheck would you be willing to invest'. The purpose of the survey was to gather further information as to whether or not this is a style of retirement plan that people would be interested in. Most of the preliminary ideas and knowledge was derived from the author's college courses. Since this is a relatively new concept, an outline structure was required prior to investigating available sources of material. The research was broken down between pre-construction and construction related activities. This research paper was conducted using both scholarly articles and vetted websites to gather information on the subtopics. Finally, a research survey was sent to individuals who will soon be entering the work force in order to gather new information. The strength of the research is that it provides the common person with little to no construction background a base of knowledge. However, due to the breadth of the subject matter, this paper is limited in quantity of information and only provides a reference point to conduct further research

Investment Phase

The two most advantageous and well-known ways for families to join into contract are either to organize as a Limited Liability Corporation (LLC) or to create a Trust. This section will explore these two as well as a third.

There are several problems that need to be identified on a personal basis and will not be answered in this research paper but still need to be stated.

- Within the terms of the entity how will it be structured and how often as will payments be made?
- Will the payments be salary based or equal?
- What will happen if a member stops recurring payments? What if it is justified by unemployment?
- Who will be the controlling member/members?
- Does the controlling person(s) have authority to make purchases/trades or is there a percentage approval vote needed?
- If one person is responsible for making a purchase how will they be compensated?
- How will dividends and distributions be made? How about loss allocations?
- Can members sell their portion of the company?

The first and most important phase of developing on a property is to acquire capital in order to fund the project. Funding is the foundation, without it nothing else is possible. In order to do this, there must be somewhere to begin funding.

Joining Into Contract

This undergraduate research will focus on, and briefly describe the options that a family would have in order to co-own a property. This will include potential ways to invest money into cash flow producing assets in order to fund the final product. The three methods of entering into a contract explored are: Family Trust, Limited Liability Partnership, Limited Liability Company

Family Trust

It is important to first understand some of the legal language that is used.

- Grantor or Trustor- This is the creator of the trust. It is most commonly a parent for the purpose of passing assets through to children.
- Beneficiary- The individuals those gain profits of the trust. Most commonly the children

Some important information regarding a Family Trust are:

- Trustors can transfer assets into the trust
- Trusts are privately held and therefore cannot be made public unless
- It is sued and a judge orders the identity to be disclosed
- It is filed publicly in a court, which would be willfully done by the grantor
- Beneficiaries do not have to pay estate or gift taxes on the property. They only have to pay a capital gains tax from profits
- Lastly, if a loan is taken and then property is placed into the trust, the person who took out the loan is still financially responsible for the mortgage. Not the other beneficiaries or the trust itself

There are 2 types of trusts. Revocable and Irrevocable.
Revocable:

- Income is distributed to grantors
- Upon death, property transfers to the beneficiaries.
- After death the beneficiaries can avoid probate (the need to prove a will in court).
- There are also no tax advantages of revocable

Irrevocable:

- Once the asset is placed in the irrevocable trust, the grantor is no longer the owner, the beneficiaries are.
- There are Tax, Estate, and Legal benefits of this type
- Such as safe from legal judgements and removing income taxes generated by the asset.

The information used in the above section was gathered from Family Trust: What Is A Family Trust: Trust Fund: What Is A Trust Fund. (2019, November 07).

Family Limited Partnerships (FLP)

Some of the important information regarding FLP's are:

- Similarly, to a Trust, the FLP has very generous tax exclusions in regard to gifting estate for inheritance purposes. The main reason for this is that parents have the ability to gradually place assets into the Partnership without exceeding the taxable threshold.

- If a parent places an asset into a FLP, the IRS uses the valuation of the estate as the amount when onboarded. This means that if the asset goes up in value, it will be taxed at the original amount when the parent passes
- Asset Protection: Under the FLP creditors cannot gain control of assets unless signed by all members
- Since the FLP is structured as a business the General, or managing Partners, have unlimited liability of the assets. Meaning that if they are sued, the assets can be seized

The information used in the above section was gathered from Wong, B. (2019, June 26).

Limited Liability Corporation

LLC's have numerous benefits ranging from tax benefits to estate planning
An LLC is a non-corporate entity that allows for pass through taxation, similar to a partnership. Meaning that the entity is not taxed on profits, but members are taxed on income. At the same time an LLC offers personal liability protection. Meaning that assets of members cannot be seized in arbitration of the entity and that assets of the entity cannot be seized in arbitration of a member. As seen in Purcell, E. M. (2015)
LLC's also have the ability to devalue assets in estate planning. "Asset devaluation occurs because the fair market value of the percentage of LLC shares is not equal to that percentage of the fair market value of the LLC. Fair market value is defined as "the price that a willing buyer would pay a willing seller in the relevant marketplace with neither being under a compulsion to enter into the sale."78 For example, if an individual owns a 10% share in an LLC worth $100,000, the fair market value of that 10% share is actually less than $10,000. This is due to the discounts of minority and marketability. The minority discount deals with control or, more specifically, the lack thereof. A minority shareholder lacks the control over business decisions in a way that a majority shareholder does not, because there is additional value intrinsic in decision-making authority.79 The actual amount of the discount will vary, but studies show it can, on average, be as much as 36% (Purcell, E. M. (2015)).
If a group decides to organize under the structure of an LLC it is important to view legislation in the state they plan to operate. Many LLC's choose to organize in Nevada or Delaware since they offer significant advantages through, low to no taxes, privacy of assets, low filing expenses, ease of incorporation, and asset protection from creditors.
The information used in the above section was gathered from Kennon, J. (2020, January 27)

Raising Capital

Once the Trust, Partnership, or Organization is formed there are many ways to build wealth. Some options are more risk prone and some more risk averse. For the purposes of this research the two methods evaluated are Real Estate and Mutual Funds/ ETFs.

Investing in Real Estate

There are many methods of investing in Real Estate, however, for the purposes of this undergraduate research the 3 types that were evaluated were Single Family Home (SFH), Duplex/ Quadplex, and Apartment Complex. With an honorable mention of Real Estate Investment Trusts (REITs). The Duplex/Quadplex and Apartment Complex options are often referred to as Multi Family (MF), as there are more than one unit.

Single Family Homes

Purchasing a Single-Family Home for one's self is often a better investment than Renting. However, there are some circumstances when Renting one's own home makes more sense. This is when the mortgage is higher than what landlords are charging for rent. However, for the scope of the paper the business entity is looking to purchase properties with the sole intent of renting them out to tenants. SFH are often times the first place a person looks when investing in real estate, because usually that is all one knows. However, if the property is vacant the landlord must pay 100% of the mortgage while searching for a new tenant. This can cause obvious problems, additionally the landlord pays maintenance fee's which can be a problem if one does not live close. Lastly, if the demand for homes goes down in an area the mortgage may cost more than what one can rent it for. Another important point to make is that often times in economic hardships tenants are more likely to leave their SFH and either move in with family or move into a cheaper option. "Between 2005 and 2010 12 Million people walked away from their homes."
The information used in the above section was gathered from CityLab, & University of Toronto's School of Cities and Rotman School of Management. (2018, July 30)

Multi Family Unit

The Multi Family is a much more desirable option for providing cash flow. This is fairly straightforward because there are more units being rented. Not only does this mean more money but also because of this if one, or depending on the size of the complex, a few units do not have tenants it may not overburden the property manager. Additionally, it is easier to have an on-site manager who looks after the property. Looking further into the future, if there are multiple apartment complexes the profit from one may cover the losses of another's. The disadvantage is that it requires a lot more capitol in order to purchase an apartment complex and if for some reason the majority do not pay rent or cannot be filled the monthly costs will add up very quickly.

Land Acquisition Phase

The second phase will be land acquisition. In this portion of research, the particular site conditions and the costs associated with them will be investigated.

Impacting factors

There are many factors that one will want to consider when acquiring land. This section will outline some that are very important, however, it is important to conduct additional research as this section in particular has many nuances that can be specific to one's intent for the property.

Some important considerations are:

- Zoning. This will be touched on more in depth in the next section, however, it is important because it drives what you are authorized to do on the property
- Location. Not only because the purchase price of the land will be affected. The property tax will also be affected. This will also drive some other considerations such as the required structural capacity of the house due to snow, seismic, wind, etc.
- Annual Tax Obligation: This is important because if one plans to purchase the property to develop on years later, they will have this fixed cost every year that one will be paying

- Available Public Utilities: Water, Sewer, Phone, Gas and Electric. Depending on whether or not one was to choose a house in a rural location this can be a large expense. There are two ways that PGE will run lines, below ground and above ground. Below ground lines will general cost about $3 million per mile, however, if the lines are traveling great distances it can be a safer option. The cost to put above ground lines is $150 per foot or $800,000 per mile. These estimates may vary on the complexity of the situation. These costs go up with other utilities as well.

The information used in the above section was gathered from Pge Currents (n.d.). Retrieved May 19, 2020

Soil

- Soil Percolation (Perc). This is a test that measures the rate of absorption of the soil
- Flood Zones. This is important for obvious reasons, it is important to know where these locations are so that no important structures are places on or near them
- Setbacks. A setback is the distance from a lot boundary that a building must be. This is more important in an urban setting
- On site drinking water well. This is self-explanatory. This may be an important consideration in a rural setting

The information used in the above section was gathered from The Truth About Land Investing: 15 Warning Signs To Look For When Buying Vacant Land. (2020, April 12).

Development

Zoning Considerations

Residential Area

The intent of this research ends with the purchase of a property to later develop multiple homes on. In order to do this, it is imperative that the owner ensures that the land it is zoned accordingly. More specifically the owner must look at subtypes, for example within the residential zoning type there is 1 for single family home, 2 duplex/ triplex/ quadplex, and 3 which is denoted for anything more than 4 units. It is also important to recognize that one property may have multiple designations or stipulations for example a rural zone may only allow for one residential building.

Although, not of extreme importance this is something that must be identified upfront. Regardless, it is important confirm with the governing authority. As seen on Ross, B. (2014, March 21)

It is possible to get zoning changed however, it is a very large hassle and should be avoided when possible.

Some other considerations that were not explored in the research paper but may be beneficial to look into are zoning for the following purposes: Fabrication, Manufacturing, Ranching, Auto Repair, Shooting Range, Landing Strip

Off Grid Power Considerations

Fixed Solar Panels

Solar Panels

- The Pitch must be correct for all seasons to optimize the usage.

It is important to identify the level of power that one intends to pull from the grid. The two designations are Partial or Full.

- Partial Grid would still require tying into the system. This would require electric lines run to the property and tied into "on site" electrical.
- Full Off Grid would mean that there is no alternative power, if the solar panels no longer work, there will be no electricity to the home. It also means that if there is a failure in the grid, the home will still have electricity

Storage

- One must collect the electricity captured with the solar panels
- The most effective manner to capture electricity is with Lithium batteries
- The only problem is that this requires physical space in the residence
- The other new innovative way is called an intertied system, this was not be explored in the paper

Figure 1: Example of how an off grid system would be set up. Panels which receive energy and then batteries which store it

Purchasing Costs

Purchase Now, Develop Later:

The final phase researched in this paper is the purchasing phase. There are multiple costs associated with Residential Construction and purchasing Residential Homes. However, for this section the only costs researched were associated with holding land to later develop. As with any costs and taxes, it is imperative to view local codes, however, a good rule of thumb is that the 'taxable amount is 1% of the Capital Improved Value (CIV) of taxable land. For example a CIV of $500,000 would be $5,000 per year' as seen on Vacant residential land tax. (n.d.).

This is not all bad news though, property taxes are a tax write off, a benefit to the owner As seen in Owning vacant land holds tax benefits. (n.d.)

It is important to realize that the owner will pay taxes on the vacant land, just for owning it. This sunk cost should be accounted for.

Veteran Affairs Loan

The last consideration only relates to individuals who served in the Armed Forces, as an Active Duty Servicemember or Veteran the Veterans Affairs offers 2 loans of interest: a Purchase Loan and a Refinance Loan
The Purchase loan allows one to “buy, build, or improve" a home, through a competitive VA-backed purchase loan. Some information is privy to change with time, however, as of now it is a zero percent down loan which will match Fannie Mae/Freddie Mac
Eligibility: in order to Qualify for a VA-backed home loan Certificate of Eligibility (COE), and
Meet our—and your lender’s—standards for credit, income, and any other requirements, and
Will live in the home you’re buying with the loan
Find out if you qualify for a VA-backed home loan Certificate of Eligibility (COE)

Conclusion and New Information

New information was received by a survey sent to the Cal Poly Construction Management Department. This information shows that 75% of the respondents are interested in the ideas outlined in the above research and gives readers a new type of home acquisition and investment strategy. Creating and investing in a real estate portfolio in order to purchase retirement property with the proceeds in the future is an alternative or additional strategy to the traditional 401K strategy. Additionally, the majority of those surveyed stated that they would be willing to invest ten to twenty percent of their monthly paycheck with the expectation of moving in at a maximum of ten years. Finally, the overwhelming majority plan to purchase a home as opposed to leasing or renting.

Further Research

It is important to note that much more research must be conducted before any progress can be made toward this type of construction. The results were from a very limited number of students, most of which were Construction Management undergraduate students at Cal Poly San Luis Obispo. Of this group, there were only 9 responses Further research must be conducted throughout various parts of the U.S. with respondents from different socioeconomic backgrounds to determine whether or not it would be viable.

As stated previously in this paper, this is a broad outline of how to construct a starting point for developing property. Additional research might consist of what kind of construction would take place on this property, sustainability of the construction, the legalities of each partner involved, how much money each person would be willing to invest, and much more pertaining just to the physical or legal aspects of a project such as this.

References

3300 WATT SOLAR WITH 6000 WATT PURE SINE POWER INVERTER CHARGER 48VDC 120 VAC OFF GRID KIT. (2020, April 10). Retrieved May 19, 2020, from https://theinverterstore.com/product/3000-watt-solar-with-6000-watt-pure-sine-power-inverter-charger-48v-off-grid-kit/?gclid=Cj0KCQjw-Mr0BRDyARIsAKEFbeeCqNnnBpyYLnp_gjCAPs1Bp0BYCTBkBIloiEqFC1odHtai7sZWbMgaAhJnEALw_wcB

CityLab, & University of Toronto's School of Cities and Rotman School of Management. (2018, July 30). How Vacancy Traumatizes Cities. Retrieved May 19, 2020, from https://www.citylab.com/equity/2018/07/vacancy-americas-other-housing-crisis/565901/

Family Trust: What Is A Family Trust: Trust Fund: What Is A Trust Fund. (2019, November 07). Retrieved May 19, 2020, from https://www.m1finance.com/articles-2/family-trust/

Kennon, J. (2020, January 27). Here Is What You Need to Know About Investing With an LLC. Retrieved May 19, 2020, from https://www.thebalance.com/new-investor-s-guide-to-limited-liability-companies-357540

Owning vacant land holds tax benefits. (n.d.). Retrieved May 19, 2020, from https://www.inman.com/2013/06/21/benefit-from-tax-deductions-on-vacant-land/

Purcell, E. M. (2015). *The Family LLC: A New Approach to Insuring Dynastic Wealth* (Doctoral dissertation, Pepperdine University) (p. 499). 8 J. Bus. Entrepreneurship & L.

Purchase loan. (n.d.). Retrieved May 19, 2020, from https://www.va.gov/housing-assistance/home-loans/loan-types/purchase-loan/

Ross, B. (2014, March 21). Building on Vacant Land: Zoning Issues You Might Face. Retrieved May 19, 2020, from https://www.nolo.com/legal-encyclopedia/building-vacant-land-zoning-issues-you-might-face.html

Ross, B. (2014, March 21). Building on Vacant Land: Zoning Issues You Might Face. Retrieved May 19, 2020, from https://www.nolo.com/legal-encyclopedia/building-vacant-land-zoning-issues-you-might-face.html

The Truth About Land Investing: 15 Warning Signs To Look For When Buying Vacant Land. (2020, April 12). Retrieved May 19, 2020, from https://retipster.com/truthaboutlandinvesting/

(n.d.). Retrieved May 19, 2020, from https://www.pgecurrents.com/2017/10/31/facts-about-undergrounding-electric-lines/

Vacant residential land tax. (n.d.). Retrieved May 26, 2020, from https://www.sro.vic.gov.au/vacant-residential-land-tax

Wong, B. (2019, June 26). Pros and Cons of Creating a Family Limited Partnership. Retrieved May 19, 2020, from https://www.legalzoom.com/articles/pros-and-cons-of-creating-a-family-limited-partnership