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FIN424

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4/21/2023

## Investing in the Housing Market

We decided to purchase a single family house in Riverview, Florida. The address of the house is 11036 Stone Branch Dr, Riverview, FL 33569. The four bedroom, three bathroom house built in 2006 is listed at \$475,000 on Zillow.com. We felt like Florida was a good place to invest based on its growing popularity and the past price appreciation of the home and properties around it. According to Redfin.com, Florida had the highest ratio of people looking to move into rather than from the state. Florida also has no income tax and has more tourists than any other state in the US. As Florida's population continues to rise, people will need more places to live. Right now renting a house is a more viable option for many people looking for a place to live, especially with interest rates on mortgages well over six percent. This home sold for as little as \$120,000 in October of 2014, and resold for \$220,000 just 2 months later. Now the home has been relisted for \$475,000

as of 4/12/2023. The graph

to the right shows the

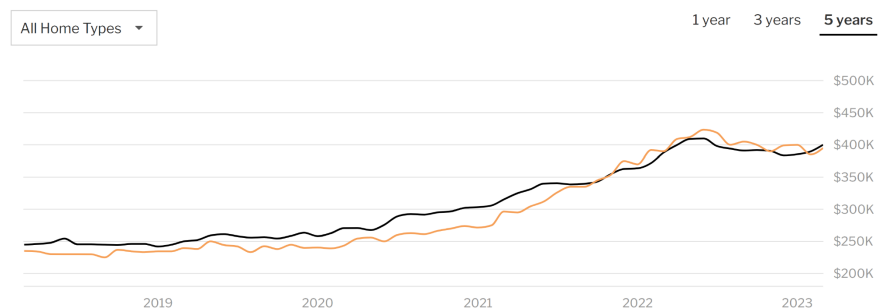
growth in median home

prices in both the state of

Florida(black) and

specifically Riverview, FL(orange). The Florida real estate market has been booming over the

last few years, with total appreciation over the last year at 19.59% and appreciation over the last



10 years of 179%, with average yearly rates ranging from 10.8% to 22.2%. This new listing price is fair and comparable to most homes in the surrounding area, all listed in the \$400,000 to \$500,000 range.

We looked at three different mortgage options: a 30 year fixed rate mortgage, a 15 year fixed rate mortgage, and 5/1 adjustable rate mortgage. The 30 year fixed rate mortgage had an APR of 6.51% from a lender called Strong Home Mortgage. The 15 year fixed rate mortgage had an APR of 5.52% also from Strong Home Mortgage. The 5/1 adjustable rate mortgage had an APR of 6.21% from the lender Third Federal Savings and Loan. There are several fees and additional expenses associated with purchasing a house. The fees include application fee, appraisal fee, home inspection fee, credit check fee, title insurance, title search fee, property tax, homeowners insurance, and utilities.

Table 1: Expenses and Fees

Expense/Fee	Cost
Down Payment	\$95,000
Application Fee	\$100
Appraisal Fee	\$500
Home Inspection Fee	\$500
Credit Check Fee	\$100
Title Insurance	\$2,700
Title Search Fee	\$500
Total Due at Closing	~\$99,400

We are estimating that it will cost us \$99,400 upfront when we finalize the purchase of the house. Based on the recent history provided for the house and averages for houses in Florida, we expect property tax to be \$300 per month, homeowners insurance to be \$190 per month, and utilities to be \$300 per month if consumed appropriately.

For the 30 year fixed rate mortgage, we would have a \$2,404 monthly payment, the 15 year fixed rate mortgage would come out to be a \$3,109 monthly payment, and the 5/1 adjustable rate mortgage would give us an average payment of \$7,383. Determining what to charge for rent depends on the type of mortgage chosen, and the homeowner's risk tolerance. According to Zillow, the rent estimate for 11036 Stone Branch Dr is \$2,598 per month, which would cover the 30 year mortgage payment, but not the others. Making a rent and mortgage decision can also depend on the owner's plan for the property long term. A 30 year mortgage may be more appropriate if the owner plans on keeping the property for themselves, while a 15 year mortgage may be more appropriate for a property that the owner only wants to rent out and then sell.

We decided to go with the 30 year mortgage because we think holding onto the house will benefit us greater in the long run. People aren't going to stop coming to Florida for vacations anytime soon and we think we can capitalize on that. The \$2,404 monthly payment gives us more flexibility too. The monthly payment of \$2,404, property tax of \$300 per month, homeowners insurance of \$190 per month, and utilities at \$300 per month totals to \$3,194, we'll round to \$3,200. We are going to add another \$250 per month in other miscellaneous expenses, such as maintenance, just to be safe. Our total monthly costs are \$3,444.

We have a few options as to how we can rent the property. Given the increasing popularity in the state of Florida as a whole, we do not expect there to be an issue finding someone to rent out the property. A long term rental like one to three years would provide a

steady stream of rental income. Tampa is a quick 25 minute drive away which is a good commute if working there. Also, Tampa has a lot of restaurants, bars, and things to do which makes it a popular destination for people visiting Florida for vacation. However, the house is only a 10 minute drive to the nearest beach which makes it a great rental for tourists looking to enjoy Florida's warm weather and beaches. According to CBS News, Florida had a record 137.6 million visitors in 2022. With such a large number of people visiting Florida and needing a place to stay, renting out for week-long periods of time could be very profitable on platforms like Airbnb or VRBO. To figure out how much we could ask for per month for a long term rental we looked at other properties for rent in Riverview, Florida with similar characteristics.

Most properties are rented out for the full year and the monthly rent ranges from \$2,500 to \$2,900. With our estimated total cost per month of \$3,444, it doesn't make sense to rent out for year long periods of time. Instead we will rent out for shorter periods of time. First, we figured out the most popular times of the year that people would travel to Florida. Our list contained college spring break (the month of March), February break for high school, April break for high school, and the summer months (May to early September). The total number of weeks equated to about 28 weeks.

Airbnb and VRBO have several properties available in Riverview and the area surrounding. We compared the prices of houses with similar characteristics in similar locations and then we found a rough average price we should be able to charge. After the research we noticed that prices actually increase significantly during the weeks of college spring break, high school February break, and high school April break. The price per night cost averaged between \$200 to \$450. With the amenities our property provides we think we could rent closer to the \$400 number. Below is a table that organizes the specific events that increase the demand for

renting, how many weeks they are, and the prices we'll change based on the rough averages we created from data we found on Airbnb's and VRBO's websites.

Table 2: Times to Rent

Event	Time of Year	Our Price Per Night	Our Price per Week
High School February Break	3 weeks in February	\$400	\$2,800
College Spring Break	4 weeks in March	\$400	\$2,800
High School April Break	3 weeks in April	\$400	\$2,800
Summer Vacations	18 weeks May-September	\$300	\$2,100
Total	28 weeks		Yearly Rental Income: \$65,800

Earlier we estimated our total monthly costs to be about \$3,444 which is \$41,328 per year. Above we estimated our yearly rental income to be \$65,800. The difference between the two is \$24,472 which we can use to earn back the money spent on the down payment and closing fees. We estimated the total amount due at closing to be \$99,400. If we divide \$99,400 by \$24,472 it equals about 4 years, the time it would take to earn the money spent on closing. According to our plan, we are only renting 28 out of 52 weeks of the year. However, we are going to try to take advantage of the nearby universities during these not so popular times. The University of South Florida and the University of Tampa are both less than a 30 minute drive away and have a combined student population of more than 60,000 students.

We will be able to rent to parents who are coming to visit their children at college and we might be able to rent to foreign academic individuals who have traveled to visit these colleges to collaborate with professors or maybe contribute to some research. These two strategies won't

bring in as much rental income as shown in table 2, but it should be enough for our situation. We think we could capitalize on these opportunities to rent for an additional 5 weeks at a discounted rate. During this time of the year the average cost per night on Airbnb and VRBO is about \$160 per night. Since we are making a majority of our rental income during the summer months and school vacations, the discounted price wouldn't negatively impact our income. If we are able to rent for an additional 5 weeks at \$160 per night that would give us an extra \$5,600. That puts us at an estimated \$71,400 in rental income per year.

We expect our total annual cost to be \$41,328 and our total annual income to be \$71,400, a difference of \$30,072 per year. There is no income tax in Florida but they do apply a sales and use tax for rental income which is 6%. The 6% tax is applied to the revenue earned on a rental property. We estimated that we would earn \$71,400 in rental revenue per year which equates to \$4,284 in taxes per year. That comes out to a final rental revenue of \$67,116, less total annual costs of \$41,328 equals a profit of \$25,788 per year. To calculate our return on investment we'll need to figure out our final proceeds from the property using information like rent, projected price of the house after the investment period, remaining mortgage balance at the end of the investment period, and fees and taxes. We used an appreciation rate of 11.82% because that was the average rate of appreciation for this house from 2018 to today. We calculated this by calculating the percent change in price for each year and then taking the average. We thought this would be more accurate than using the average appreciation rate in the US as a whole because this is more specific to our investment property. The table below shows the return on investment for a 10 year, 15 year, 20 year, and 25 year investment period with a \$95,000 down payment and using our estimated appreciation rate of 11.82%.

Table 3: Return on Investment

	<b>10 Year Investment Period</b>	<b>15 Yr Investment Period</b>	<b>20 Yr Investment Period</b>	<b>25 Yr Investment Period</b>
<b>Final Proceeds</b>	\$766,981.93	\$1,867,399.83	\$3,678,505.22	\$6,726,105.33
<b>Initial Investment</b>	\$95,000	\$95,000	\$95,000	\$95,000
<b>Investment Period</b>	10 Years	15 Years	20 Years	25 Years
<b>Return on Investment</b>	23.23%	21.96%	20.06%	18.58%

We are choosing an investment period of 10 years because it provides us with the greatest return on investment at 23.23%. We wanted to compare this return to the return of the S&P 500 over the last 10 years to see if it is worth the investment. Over the last 10 years, the average return for the S&P 500 was about 9.42%. The 23.23% return on investment from our rental property is 13.81 percentage points higher and 146.60% higher than the average return of the S&P 500 over the last 10 years. As for bonds, if we were to invest in United States 10 Years Government Bonds at a 3.60% yield, we would have gotten a lower return on investment. According to Charles Schwab's data, over the last 30 years, the average return on corporate bonds was about 6.1% which is significantly lower than ours at 23.23%. Before assuming a 23.23% return, we must think about the current state of the economy. As of March 2023, the US inflation rate sits at 5%. According to Jerome Powell and the Fed, the goal and expectation is that inflation will return to 2% over time. All the numbers available to us right now are inflated, due to the current state of the market. Assuming the Fed can control inflation and reach their goal, we must adjust our expectations. To find our inflation-adjusted return, we must take in to account the 3% excess inflation that exists right now. After calculation, we get a final return on

investment of 19.64%, still very much above the 6.1% corporate bond returns. In the end, we think it would be incredibly difficult to beat a 19.64% return on investment using any financial instrument.

The sale-to list ratio is a number that reflects the market's supply and demand of real estate in the area. This number is calculated by dividing the sales price by the listing price. If the number is over 100%, it means that the property sold for more than the asking price, and vice versa. According to Realtor.com, the sale-to-list ratio for the real estate market of Riverview, FL is 99.77%. Based on this data, we can assume that our property that is listed for \$475,000, would most likely sell for asking price. Also from Realtor.com, the median amount of time for a property on the market in Riverview is 69 days.

While the sale-to-list ratio was slightly under 99.77%, and that would mean an average price for our listing as \$473,908, we will assume that we will pay closer to or possibly slightly above asking price because the property was only recently listed around one week ago. When thinking about the resale value at the end of our investment period, we can go back to the appreciation numbers for Florida real estate. As stated before, the biggest average annual jumps were the two years from Q4 2020 to Q4 2022. We believe that these numbers are unsustainable under normal circumstances, and that this 22.2% appreciation rate was largely fueled by COVID-19. The average yearly appreciation rate over the past 10 years is 10.8%, which is very close to our estimated 11.82% that we calculated using prices of our specific house in the past.



Sources:

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