Market Watch – March 1, 2024

I'm losing money on my rental property, which has a $420,000 mortgage and a 7.9% interest rate. Should I sell?

'My recent refinancing increased my mortgage rate from 5.14% to 7.9%, essentially eating up all my cash flow'

Aarthi Swaminathan || March 1, 2024

"The costs to keep this house are currently higher than the monthly income." GETTY IMAGES

Dear Big Move,

I'm struggling with the idea of selling a rental property that has both a high monthly maintenance fee and a high mortgage rate. The costs to keep this house are currently higher than the monthly income it generates.

I recently refinanced in order to pull out $100,000, so now I owe $420,000 on the property, which is worth approximately $750,000.

My recent refinancing increased my mortgage rate from 5.14% to 7.9%, essentially eating up all my cash flow.

I'm on the fence. Should I sell, or should I refinance for a better rate to free up cash flow?

Losing Money Fast

Dear Losing,

The fact that you're bleeding money from this rental is not good. You need to either bring down your interest rate or raise rents so you can turn a profit in order to make it a worthwhile investment. But keep in mind that many people are sitting on the sidelines waiting for interest rates to fall, so you might not get your desired price if you decide to sell.

Your mortgage rate is likely the biggest reason your monthly costs have jumped so much. Rates are expected to fall to around 6% or lower by the end of the year. You could refinance then, but do the math to see if it's worth it.

You've already been through the wringer with refinancing, and you likely paid various application, appraisal, attorney and origination fees — in addition to closing costs — to extract that $100,000. All of that is expensive, and now you're thinking of going through it again.

Even if you refinance again at a lower rate, would that be enough to make a profit? Were you able to turn a profit on that property when rates were at 5%? If not, would you be able to raise rents for your current tenants or perhaps find new tenants who would be able to pay more? And is the house in need of repairs or upgrades?

Unless you can make a profit on the property in the next couple of years, there's little reason for you to hold onto it, unless you believe that it's in an area that will experience a significant appreciation in value — you'd want to see appreciation of 20% or more, given the fees you would have to pay upon selling.

Part of your retirement plan

At the same time, a second property is nearly always a good investment. Do you think there will be considerable demand for the rental in the medium to long term? Is it in an area where you might be able to find tenants who would pay enough to cover your costs in the near term so you can at least break even? If so, it's a good idea to try to hold onto the property, especially if it's part of your retirement plan.

Provided that you have enough savings to help you get through this current era of 7% rates, and you have the money to refinance down the road to get your monthly costs down to a level where you can have a healthier cash flow, it may be worth keeping the home.

Selling isn't an easy or simple decision. Because this is not your primary home, you'll need to factor in the capital-gains taxes you would have to pay, along with 6% in real-estate commissions.

If you do decide to sell at some point in the future, you could roll that money into another like-kind property in order to qualify for a 1031 exemption, in addition to a lower rate.

The bottom line: You need to think like a real-estate investor and leave emotion out of this decision. If the property is not making money or it's not going to at least break even at some point, you have your answer. But keep in mind that the real-estate market can surprise on the upside and that once you sell the home, you will not be able to take back that decision.