

# REAL ESTATE FUNDAMENTALS

## U.P. ISSUES

When you buy land in the U.P. or any less developed area there are issues you may take for granted where you live that you should think about. Here you will find wildness, beauty, serenity, security, and recreational opportunities that can recharge your batteries and give you perspective on who you are and what you do. You can find a refuge from some of the less livable features of urban living: crime, traffic, noise, and a severe lack of privacy. As always, there are tradeoffs.

Not every U.P. property connects to a public road. Some do not even have legal access, a recorded easement from a public road to the property. When land belonging to others has been used for more than 15 years a “proscriptive” right of access may be created and it may be possible to convert this to a legal easement. Sometimes “legal” access exists but is over terrain where it is not practically possible to build a usable road. Obviously you need the legal right to access your property over usable terrain.

Many public roads are “seasonal,” which means they are not plowed in the winter. In these areas people may have a vehicle with a plow or hire it done; but the length and/or nature of the access can make that nearly impossible or expensive. If you have land in such a place you will reach it by snowmobile, cross country skis or snowshoes in the winter.

Consider utilities: In some areas it is difficult to drill a well because of rock, and the water you get may contain impurities that will need to be removed. This will make your system more expensive. Rural areas have no sewer systems. Sewage treatment requires a septic system or one of the new aerobic or wetland systems. In some areas these systems work very well; in others they require additional features that cost more and/or work less well. Some areas will not “perc” and septic systems are not possible.

Your land may have electric and phone lines, or they may be close enough to extend at reasonable cost. If not you will need a generator if you want electric power, and cellular or radiophone systems if you want phone service. Some people make decisions on how they value privacy and wildness and do without or use alternate systems.

The U.P. has excellent medical facilities that may not be close to the property you choose. The distance to a good airport with scheduled service is a consideration, as is the convenience of a good grocery store, restaurants, and a good hardware store.

Some areas have it all. Others do not, and the trick there is not to be uncomfortable, but to be comfortable without conveniences. Again, there are tradeoffs: beach fires, Northern Lights, trout fishing, and a simpler lifestyle. People come and enjoy the North Country experience, build traditions, and pass them on to their children BECAUSE it is less developed. A broker can help you sort through alternatives, find an area with features and

benefits that meet your needs, and a place within that area that will become dear to your heart.

## **TAXES**

### **Commercial Forest Act**

The Commercial Forest Act is relatively unknown and unused below the bridge, but it has had a significant effect on life in the U.P. Half the land in the U.P. is in public ownership. The majority of the rest is owned in large tracts by timber and mining companies. The Act offers reduced tax rates of \$1.38/acre for owners of 40 acres or more when property is properly registered and used solely as commercial forestland. In return public access to this land is required for the walking public for purposes of hunting, fishing and recreation, and it is this act that has made so much of the U.P. accessible to the public for outdoor recreation.

CFR land can be transferred and can also be withdrawn from the Act on payment of a penalty that amounts to the difference between the ad valorem tax rate and the rate actually paid under CFR (about a third of the typical ad valorem rate). Copies of the Act are available from the Michigan DNR. You will see "CFR" in the plat book on tracts that have been so designated.

### **Millage**

"Millage" is the tax rate levied against property, expressed in tenths of a cent. For example, "38.41 mills" = \$0.03841 per year or \$32.41 per thousand dollars of real estate valuation.

### **"Homestead" property**

Your first home in Michigan qualifies as "Homestead" property which is taxed at 18 mills or \$18 per \$1,000 of taxable value less than other real estate such as vacant land, a vacation home, or commercial property. You can only have one Homestead property, but interestingly the law considers "home" to be where the heart is, not necessarily where you spend most of your time.

### **Taxable Value, Assessed Value, True Cash Value, & State Equalized Value (SEV).**

When property is transferred the local assessor re-assess the property based on all the comparable sales in the area over the last three years. Under Michigan law the value he places on the property should be the "true cash" value, or what the property will sell for in the marketplace. In practice, the assessor is a local elected official using comparable sales from the last few years. The valuation process is therefore back loaded and assessments tend to be below the price at which property changes hands. Not many people are willing to sell their property at the "true cash" assessed value. I have seen cases where "true cash value" was less than half actual market value. For the same

reason, you should not expect that the tax appraisal of a property is a likely purchase price, or even a good negotiating tool.

You should assume the "worst case when you estimate your future taxes. Assessors recommend you use the price you expect to pay for the property when you estimate its likely "true cash" and assessed values. It will not be less than the current SEV unless you are successful in an appeal, and the SEV/first year Taxable value may well be increased by the Assessor. Real estate tax obligations often change significantly when property is transferred.

Under Michigan law property is taxed at 50% of the "true cash" value. The county reviews the total value of the property in each category and may require the local assessor to make an adjustment to the total valuation in his jurisdiction. The final result is the "state equalized value" or "SEV".

In the first year of ownership your SEV will also be the property's "Taxable Value", the amount on which you are taxed. After the first year, increases in TV are limited to the lesser of the rate of inflation or 5% (plus any improvements to the property). Over time this will encourage owners to hold and improve property, as a parcel that has been owned for a long time will pay less tax than an identical adjacent parcel that has transferred more recently. California has a similar system and that has been a result there.

Summary: True Cash/2 = Assessed Value/SEV = the 1st year Taxable Value. Subsequent years SEV may rise but TV is capped at the lesser of 5% or the rate of inflation multiplied by the voted millage = your tax. If the property is Homestead property the millage will be 18 mills less than any other property you own.

If you have questions or want further information call the Equalization Office in the governmental jurisdiction where the property is located. I have found the people who work in these offices to be most helpful and informative.

## **Capital Gains**

A taxpayer in the 15 percent marginal tax bracket who sells property held less than five years pays a 10% capital gains tax; for property held more than five years the rate is 8%. A taxpayer in a 28 percent or higher marginal tax bracket pays 20 percent capital gains through 12/31/05. On or after 01/01/06 the rate drops to 18 percent if the asset is owned for more than five years.

## **1031 Exchange**

Tax evasion is illegal. Tax avoidance is not. Disposing of one parcel of real estate and acquiring another with a properly structured 1031 exchange defers capital gains taxes until the replacement property is sold. However it can be exchanged again, deferring capital gains taxes further into the future. In this way the tax can be deferred indefinitely. A tax deferred is in effect an interest free loan from the government. Can you make

money with an interest free loan? You bet. It is however critical that the letter of the law, not just the intent of the parties, is followed precisely to have a successful exchange, and there are some traps for the unwary. See your tax consultant and/or attorney.

No less an authority than a former Chief Justice of the Supreme Court has said, "The 1031 tax deferred exchange is the finest tax loophole available to the average American." He added: "It is the duty of every American to his family to pay the minimum tax that he is legally required to pay under the law."

"Section 1031" property is "property used in a trade or business or held for investment." Essentially that covers any real estate but your house. (Second homes may or may not qualify, depending on the circumstances.) "Held for investment" is a matter of intent. A typical exchange involves three or more people, not two. They are a person, "A," who wants to dispose of a property and defer capital gains taxes, "B" who owns a parcel "A" would like to acquire, and "C" who is willing to buy the parcel "A" no longer wants.

The first step for "A" is to find a buyer for the property he has. When "A" gets an acceptable offer, he accepts it with language that says, "subject to structuring a 1031 exchange." "A" now has a contract and knows how much he has to acquire a new property. The basic rule is that to achieve a totally tax deferred exchange one has to acquire a new property of equal or higher value. "A" negotiates the purchase of a new property he wants just as if he were "buying" it for cash, but he makes his offer to buy "subject to completing a 1031 exchange." This does not affect the "B" or "C", and their attorneys or tax advisors will tell them so.

In essence what happens at closing is "C" buys "B's" property for cash (taxable for "B"), and swaps that property for the parcel he wants from "A". "A" then has the property he wants and capital gains tax is deferred.

1031 exchanging is a big subject and cannot be boiled down to a few paragraphs. There are many additional advantages to exchanging. It is possible to get cash out tax free by financing before or after the exchange. A free and clear smaller property can be exchanged into a much larger leveraged property. You can move from one type of property, vacant, income, management free or management intensive, to another.

A vacant parcel held for investment that has negative cash flow can be exchanged for a net leased income property with positive cash flow. An income property that demands constant management can be exchanged for a free and clear vacant parcel. If you are interested in 1031 exchanging call Huey Real Estate for a more complete explanation than is possible here. Again, all of this must be done precisely within the rules and they are complex, but if there is a big capital gains the savings are significant and the law is clear.

## **ENVIRONMENTAL**

A call or visit to three governmental offices should disclose most regulatory issues involving land. These organizations have a wealth of information that can be useful. Contact (or use the links to the web sites at the end of this discussion), the Michigan Department of Environmental Quality (MDEQ), the County Health Department in the county where the land is located, and the Township/County Zoning Administrator. Ask:

**\*MDEQ:** "Would you please check if there are any designated special areas (rivers, erosion areas, endangered species, critical dunes, wetlands, known pollution problems), or anything else I should know before I buy this property?" MDEQ maintains a database that flags problem areas in each square mile.

**\*County Health Department:** "Would you expect perc or well problems on the property in which I am interested." They will have the facts on nearby wells and perc tests.

**\*Township Supervisor or Zoning Administrator:** "What does the zoning allow? Do you know of anything I should know before I buy this property?" These officials are closest to the land, live in the community, and should know of any obvious problems.

### **Endangered species**

Piping plover, eagles, barred owls, Kirtland warblers, wolves, moose, ladyslippers and Lake Huron pansies are just a few of the endangered species found and protected in the U.P. under this act. The U.P. really is "like it used to be": Endangered species can be found almost anywhere. That they still live here is reason for celebration. We need to be good stewards of the land. The Michigan DNR is responsible for endangered species issues.

### **Floodplains**

Building in high risk flood areas is restricted for the safety of the owner and to insure that the natural flood flows of the river are allowed to dissipate as quickly as possible. Permits are required from the Land and Water Management Division, DEQ, and from local building and zoning organizations.

### **Great Lakes Submerged Lands**

In general the public has the right to use the surface waters of the State of Michigan, so long as their access to the water is legal. Regardless of the location of the surveyor's "meander line" along the shore, which is always located back from the water at the discretion of the surveyor, and regardless of the level relative to the ordinary high water mark, the riparian (waterfront) owner owns and controls his property to the water's edge. On rivers and streams and some inland lakes an owner may also own bottomlands. On the Great Lakes Michigan Common Law provides that if you have gained lawful access to the water, you may walk along the shore provided you remain in the water.

On the Great Lakes Permits are required for filling, dredging and permanent structures such as piers, pilings, etc. lying below the Ordinary High Water Mark (OHWM) and on all upland channels extending landward of the OHWM of the Great Lakes. Contact the Land and Water Management Division of the Michigan Department of Environmental Quality, the US Army Corps of Engineers' Detroit District Engineer's Office, and local and county regulators.

### **Great Lakes Shoreline**

Environmental areas, flood risk areas and high erosion areas that may be damaged by various land use activities along the Great Lakes shoreline generally require permits from the DEQ Land and Water Management Division as follows:

\*Designated Environmental Areas require permits for dredging, filling, grading, and alteration of natural drainage, alteration of vegetation used by fish and wildlife, and placement of permanent structures.

\*Designated Flood Risk Areas require a permit for permanent structures on a parcel of land of which any portion is designated.

\*Designated High Risk Erosion Areas require a permit for the erection, installation or moving of a permanent structure on a parcel of land of which any portion is designated.

\*Setbacks from the water, or the "green line" where beach grasses begin to grow, or the tree line where the forest begins, are required under most zoning ordinances.

### **Inland Lakes and Streams**

A permit is required from DEQ to affect bottomlands by dredging or filling; constructing or altering structures; creating, enlarging or diminishing an inland lake or stream, or interfering with the natural flow of water. Setbacks from the water are required for structures under most zoning ordinances.

### **Natural Rivers**

Several outstanding rivers including the Fox and the Two Hearted River (and most of their tributaries) are in a designated Natural River District. All lands within 400 feet of the river are protected and permits are required for any building construction, platting of lots, cutting of vegetation, land alteration or bridge construction. Township/county zoning administrators controls permits in areas with approved Natural River zoning. The state zoning administrator controls permits in State-zoned areas of Natural Rivers. Contact MDNR Forest Management Division, Natural Rivers Program -- Doug Carter, 517 373-1175 or Dan Pearson, 517 335-3441.

### **Sand Dunes**

In designated and mapped critical dune areas all proposed new uses that significantly alter contours, including roads and recreational and silvicultural (forest management) activities, require permits from DEQ.

### **Soil Erosion and Sedimentation Control**

Permits are required for all earth changes that disturb one or more acres of land or are within 500 feet of a lake or stream. The regulatory bodies may include the county, DEQ, DNR, charter townships, cities and villages.

### **Toxic Materials**

#### [Radon](#)

Radon is a colorless, odorless, radioactive gas that occurs in some areas of the UP (and throughout the U.S.) and can, in sufficient concentrations, represent a health hazard. It is a good idea to have existing structures tested for radon accumulations.

#### [Lead paint](#)

Residential structures built prior to 1978 may contain lead based paint that can be a health hazard. Purchasers of such housing should obtain and read the HUD-EPA information pamphlet Lead-Based Paint: Protect Your Family

#### *Mercury*

The DNR fishing guide lists some lakes and streams where the fish should not be eaten because of naturally occurring mercury in the water. (These are some of the best fishing spots for us "catch and release" types!)

### **Wetlands**

A "wetland" is sometimes not obvious and may not be identified by standing water or even a high water table but by soils, vegetation or other factors. The DEQ determines if lands are "wetlands". If so they cannot be disturbed by filling, dredging, developing (including building structures or roads), or draining the wetland. Permits are obtained from the Land and Water Management Division of DEQ, the US Army Corps of Engineers, and various other local regulators.

## **DIVIDING LAND**

### **Legal descriptions**

A land description is a description of a parcel of land in legally acceptable terms that shows exactly where it is located and the number of acres of land it contains. The trick in reading descriptions is to read them from the back end towards the front. In the U.P. (and about half of the country) the U.S. Rectangular Survey System is used.

"Metes & Bounds" land description describes the size and shape of a tract of land starting at a known specific point (an unchanging natural landmark or a surveyed permanent marker), and run a given number of feet in a particular direction, continuing around the perimeter, and eventually coming back to the "point of beginning".

### **Plat books**

Plat books showing the ownership of land and details such as lakes and streams, roads, and governmental boundaries are available from every county. They are sold by various offices depending on the county. The best place to ask is at the County Clerk, Register of Deeds, or Cooperative Extension office. Helpful information on reading land descriptions is included in the front of the plat book.

### **Subdivision Control Act REVISED 1/22/97**

Under the new regulations (Public Act 591 of 1996) land may be divided into the following maximum number of parcels of any size in any 10 year period of time without formal platting:

20 acres: 7 splits

40 acres: 9 splits

80 acres: 13 splits

120 acres: 17 splits

For each additional 40 acres 1 additional split is allowed.

Up to two additional splits for keeping more than 60% of the parcel and bring road access to the property may also be allowed.

By way of example, a square mile can now be divided into 30 parcels of any size. If more splits are desired a plat must be filed, which routinely takes two years. Platting includes reviews by the Land and Water Management Division, the Michigan Departments of Transportation, Health, and Treasury, and various local regulators. Part of the focus of the Act is to insure that each lot has access and to insure that the building site is not prone to flooding up to the 100-year flood levels. Because of the time and expense involved the platting process acts as more of a barrier to development than a guide. Further legislation is expected.

Under the old law a subdivision was required if land was divided into 5 or more parcels of 10 acres or less in any ten year period of time, regardless of ownership. Any number of parcels larger than 10 acres could be split off without complying with the Act. That is why 10+ acre parcels are so common in the U.P. That will not be true in the future.

For an excellent, detailed explanation see [Michigan Association of Realtors: Hot Topics](#)

### **Michigan Land Sales Act**

When land is divided into 25 or more parcels registration with the state is required under the Land Sales Act and all purchasers must receive a copy of the Property Report.

## **Zoning**

Zoning regulates land use. Most U.P. property is zoned. Detailed information on the zoning classification of any specific parcel of land is available from the Zoning Administrator of the township or county where the property is located. Rural zoning may allow only "seasonal" homes. This does not mean you are limited as to how much time you can live there and use it. The "seasonal" designation is rather a warning not to expect services such as a school bus, garbage pickup, plowing and other services paid by the township or the county. Zoning usually includes building setbacks from the edges of the parcel of land and from any rivers or lakes.

Regardless of the zoning, I believe we all have a responsibility to be good stewards of the land while we have it for those who follow in the future, and I strongly encourage landowners to visit the County Conservation District office and/or your County Extension office where much helpful advice is available.

## **Other laws & Regulations**

**Many other issues including civil rights, fair housing, handicaps, construction codes, and truth in lending are covered by laws affecting real estate. This section of this web site is intended as a guide to your further research. It is beyond the scope of this review to discuss all laws and regulations that could affect your land.**

## **UTILITIES**

### **Water**

Getting water for your home in much of the U.P. can include expenses and systems common here but unfamiliar to you. Your well may have good water or water that needs various kinds of treatment or pressure enhancement. Most Lake Superior shoreline and much of the central U.P., for example, relies on the Jacobsville sandstone, an unreliable water source that may provide low pressure or have various impurities.

Treatment for impurities such as hardness, iron, tannins and/or chlorides individually or in combination can cost from \$700 to \$3,000 depending on the number of people using the system, the kind and severity of the problem, and the amount of treatment required.

The costs of drilling a well depend on the soils/rock encountered, the size of the well, and its depth, but average about \$3,000 - 4,000 assuming \$18/foot for an 8" well plus casing, grouting, pump, electrical, etc.

Fortunately there are excellent contractors in most areas of the U.P. who regularly deal with and know how to solve most problems. Water is not free anywhere. Like the costs of

a road, building materials, an architect and a contractor, wells and water treatment are a part of U.P. living. The county health department has well logs of the existing wells in your area and will have a good idea of the conditions you are likely to encounter.

### **Septic systems**

A septic system is an excellent way to solve the problem of sewage disposal in rural areas where there are no city sewer systems provided the soils are adequate. Septic systems work well in sand, and not so well or not at all in heavier soils, clays, and areas with a high water table or seasonal runoff or flooding. The county health department issues permits for septic systems, can advise you on your area, and will for a modest fee conduct a "perc test" on your property in advance of closing to assure you that they will issue a septic permit when the time comes. The cost of a septic system depends on the soils, the size of the home, whether there are garbage disposals and washers and other factors, but averages around \$3-4,000. If the soils where you want to build will support construction but not septic disposal, it is often possible to pump wastewater to other areas of the property. Such systems can increase costs to \$5-6,000.

### **Electric power**

Rates vary for extending power to some of the more remote areas in the U.P. If there is existing power along the road costs can be anywhere from a modest connection fee to \$1,000. If there is no power, extending overhead lines has generally run about \$20,000/mile. The power company no longer quotes "by the mile", however, and will give a specific quote based on the degree of difficulty of the job. Underground power can sometimes actually be cheaper than overhead lines depending on the situation because it is less labor intensive.

At Laughing Whitefish Point, the power company has in the past charged \$100+ for a connection fee and has run underground power up to 200 feet at \$2.28/foot. Beyond that it costs about \$5.88/foot for underground power, plus the trenching.

Telephone

**Ameritech says the charge for bringing dial tone to a typical residential connection where the contractor has run phone line and everything is in place is \$42. Beyond that, rates vary and the phone company declines to estimate costs saying "each situation is different."**

### **GOVERNMENTAL CONTACTS**

Many local, state and Federal organizations oversee various environmental laws and regulations and provide resources to the landowner. Some of the most important in the U.P. are listed below.

**MDEQ:** [Michigan Department of Environmental Quality, Land and Water Management](#) (wetlands, endangered species, critical dunes, underground storage tanks). Region 1 Headquarters: 1990 U.S. 41 So., Marquette, MI 49855 906/228-6561

**MDNR:** [Michigan Department of Natural Resources](#) (Forest management plans and technical on-site assistance, wildlife practices, hunting, fishing, recreation, Natural Rivers, endangered species). 1990 U.S. 41 So., Marquette, MI 49855 906/228-6561

### [Michigan State Government](#)

[US Army Corps of Engineers](#) (breakwaters): The Marquette office is at 906/228-2833 or 313/226-2218. The Detroit District office is at P.O. Box 1027, Detroit, MI 48231.

**HUD:** [Housing and Urban Development](#), [Home Buyers Help](#), [Fair housing](#), [Lead Paint](#)

**County/township zoning.** (Regulates land use and setbacks).

**County health department.** (Regulates wells, septic, & radon).

[County Soil & Water Conservation District:](#) (Forestry and conservation plans; on site technical assistance and property evaluations; Forest Stewardship plans; spring tree sale; aerial photos.) Marquette 906/226-2461; Alger 906/439-5555

[Cooperative Extension Service:](#) (Informational and educational materials, technical assistance, taxation information and research data.)

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**Last revised on 03/01/01**

**Disclaimer:** I am not licensed as an attorney or accountant and do not give legal or tax advice. The comments included here are intended to be a primer for those interested in real estate. They deal with practical issues in layman's language based on my experience. I have attempted to boil down complex language to simple statements as a general overview. DO NOT rely on this material when buying real estate or making financial decisions. The subjects discussed are a "moving target. This is therefore subject to errors, omissions and/or change without notice. It includes statements and conclusions that are mine alone and with which others may disagree. Where legal or tax questions are involved I recommend you consult with your attorney or tax advisor.