Global Financial Private Capital

A Home Is Not An Investment

SYNOPSIS

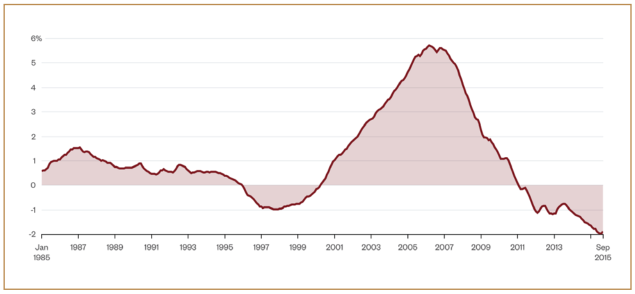
- One of the biggest financial misconceptions is that home ownership is a good investment over the long run.
- Not all assets qualify as investments, and a primary residence almost always fails to meet the conditions necessary to carry this designation.
- Homes are assets with intangible value, which offers far more than just the potential for financial profit.

HOMEWARD BOUND

One of the biggest financial misconceptions is that home ownership is a good investment over the long run. In reality, owning a primary residence rarely leads to attractive profits.

Robert Shiller is an economist at Yale University and is considered by many to be the leading expert on housing data. His analysis finds that real estate generally keeps pace with inflation but seldom offers any return premium above that.

The chart below supports his findings by showing just how meager the "real" returns, which is a geeky way of saying "inflation-adjusted" returns, have fared over the last 35 years:



Source: U.S. Bureau of Labor Statistics

This data may come as a surprise after reading so many headlines of surging home prices over the past decade in major markets across the U.S. The only time period of any broad-based gains were a few years leading up to the financial crisis, and that's about it.

> *A home is an asset and likely a great place to create memories while raising a family, but it should not be treated as an investment.*

These returns look even less appealing after factoring in repairs, periodic maintenance costs, transaction fees, annual property taxes, insurance, and other "hidden" costs of home ownership. For example, using a real estate broker will typically run the seller around 6% at the time of sale.

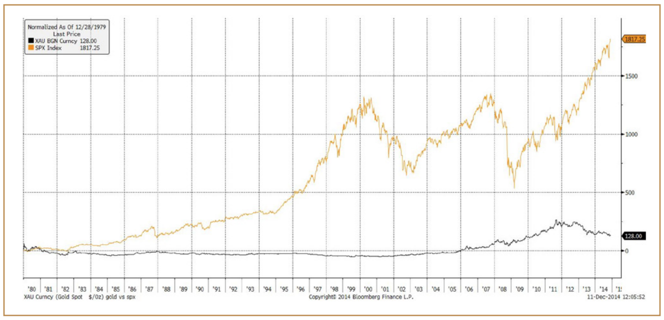
NOTE*: In the spirit of full disclosure, I absolutely despise home improvement. The thought of wasting a weekend to fix a leaky faucet is almost more unappealing than camping. Although I sound biased, save every receipt this year that goes towards home repairs/improvement. Add up the total in January and you may be dealt an unpleasant surprise.*

The obvious question is why the returns from home ownership have been so shockingly poor. The answer becomes apparent when comparing the characteristics of a home (a.k.a. "primary residence") to stocks, bonds, and other traditional investments.

Homes do not create and sell innovative products or buy rivals to grow market share, so they cannot be compared to equities. They also rarely generate cash flow, and when they do, the cash received from renting that spare bedroom doesn't pay the mortgage, so it's hard to say they share the characteristics of bonds or dividend-paying stocks.

Only a select few real estate examples possess the required attributes. Landlords generating monthly rental income above their costs, and restoration experts that repair properties and sell them for a profit can certainly claim to own investments. The rest are nothing more than assets.

Homes are not the only assets commonly mistaken for investments. Despite the fear mongers who preach its value, the chart below shows gold's performance versus the S&P 500 from 1980 to 2014:



Source: Bloomberg, Aviance Capital analysis

The black line indicates that gold was slightly above 100% over a 35-year time period, yet the S&P 500 exceeded 1,800%. Making matters worse, the table below shows that gold has actually been more volatile that the S&P 500 in most instances:

Annualized Volatility			
Period	Gold	SPX	+/-
Daily	19.85%	18.23%	1.62%
Weekly	18.56%	16.54%	2.02%
Monthly	17.83%	15.30%	2.53%
Qtrly	15.57%	16.26%	-0.69%
Annualy	16.53%	16.48%	0.05%

Source: Bloomberg, Aviance Capital Analysis

A natural reaction to this data is to conclude that gold has been a terrible investment since 1980. However, I believe such a statement to be unfair to the shiny metal, because it's equivalent to chastising a minivan for losing a race to a Ferrari. Minivans lack the suspension, horsepower, tires, and other attributes required to classify as a "sports car," so it is unreasonable to expect it to perform like one.

Gold suffers from the same limitations as a home. It generates no income, requires expensive storage and insurance costs, cannot compound over time, etc. Since gold does not possess the characteristics of a real investment, it should also not be expected to perform like one.

Simply put, not all assets can be considered investments, and homes have delivered such lackluster returns because these assets fail to meet the qualifications of a true investment.

IMPLICATIONS FOR INVESTORS

After having rented in New York City for many years, my wife and I finally purchased our very first apartment last July. Given the data above, it's justifiable to ask why we would want to lock up capital in a down payment, spend cash periodically for maintenance, and waste weekends on tasks that I truly despise, only to achieve a rate of return that may not exceed inflation.

The answer lies in what we hope to gain over time through home ownership. Assets that do not qualify as investments can still carry "intangible" value, which is importance that cannot be seen, touched, or quantified.

Within this context, we made the largest purchase of our lives for three reasons, each having very little to do with making money:

1. **Establish Roots**: Home is where the heart is, and we wanted a place that we could grow into over time and raise a family.
2. **Nesting**: We wanted to buy an apartment and make it our own by choosing paint colors, new countertops, and any other modifications as our lives evolve.
3. **Tired of Moving**: Few tortures in our known universe are more awful than moving in NYC. The stress, time, coordination, and disruption is rarely worth the effort, and the scars we carry from so many combined moves over the years may never heal.

There's no question that there was a huge financial component to our decision to buy. Obviously we hope to earn a profit, and home ownership provides us a number of financial advantages. For example, we can write off the mortgage interest and avoid annual rent hikes in a city where prices seem to rise every fifteen minutes.

We also were very careful to buy an apartment in a neighborhood that has historically maintained is value. Leverage works both ways, so we did not want to put ourselves in a situation that would pose outsized risk to our down payment.

However, since our apartment is not part of our investment portfolio, we maintain realistic expectations that it will (1) do little more than track inflation over time, and (2) mostly serve as a way to keep us sheltered and happy as we get older.

The bottom line is that a home is an asset and likely a great place to create memories while raising a family, but it should not be treated as an investment.

Sincerely,

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