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Can you still build wealth with a home?

By Curtis Seltzer

I've noticed several news stories during the last few months that raise doubts about whether home ownership remains a path to building wealth. Typical of this perspective is David Streitfeld's piece in The New York Times (August 22, 2010), "Housing Fades as a Means to Build Wealth, Analysts Say."

The analysts quoted argue that 1) there is no iron law that real estate must appreciate; 2) housing values will keep pace with inflation in coming years, but that's it; 3) negative changes in the economy will reduce housing demand in the future, which will keep a lid on appreciation.

Streitfeld quoted the experiences of two homeowners to illustrate the analysts' points. One involved a couple who bought a Chicago condo in 2003, watched it quickly appreciate by \$50,000 and can't find a buyer -- at an unspecified price -- in 2010. The other describes a Phoenix lawyer who paid \$200,000 for his home in 2000, saw a similar home rise to \$500,000 five years later and now figures his home is worth what he paid for it. He laments that he can't sell his house, buy a boat and sail around the world.

I am the first to admit that a number of factors inflated residential real-estate values beyond reasonable, sustainable and sensible numbers in many places -- both rural and metropolitan -- between 1990 and 2006-7. Buyers paid too much for too little. Lenders extended credit to risky borrowers for too much, because they could dump the mortgages into pools, thus getting out from under any risk. Brokers and sellers benefited from inflated selling prices, so they had no incentive to put on the brakes. Speculators fed on their own frenzies. Like any Ponzi scheme, everyone won until the inevitable losing started.

If 2000-2010 is the baseline data on which a home-is-not-a-good-investment analysis is based as it is with the two homeowners Streitfeld quotes, then his conclusion is confirmed. It's called cherry-picking the data.

Both individuals cited in the story expected the 2000-2006 annual appreciation rates to continue forever, even improve. That is, they expected the bubble to keep getting bigger. Their stories tell us nothing at all about whether or not home ownership is a good investment. They do show us that it's best to get out before a bubble pops.

Residential housing, like any other place where invested capital can appreciate or not, succeeds as an investment according to the price the buyer paid for the intrinsic value obtained, the terms of the purchase, the length the asset is held, the timing and terms of the sale, the condition of the asset when it's marketed for sale, the net effect of changes in the neighborhood during the time of ownership, the cost of money, tax laws and a dozen other purchase-specific factors.

I can't predict the future any better than the three analysts Streitfeld quotes for their pessimistic views on homes as an investment. But even accepting a 15- or 20-year period of 1 percent average annual GDP growth (instead of the more or less common assumption of 3 percent + or -), buying a home today...at a sensible price, at today's interest rates, with today's tax-deductibility for mortgage interest and (most) property taxes, with the current exclusion of a certain amount of capital gains from taxation on the sale of a principal residence and with the current estate-tax breaks for the passing of property to spouses, among others...looks like a safer and more profitable long-term investment than any alternative available to average Americans.

No other investment is as tax advantaged. If you think of a home purchase as an investment in a business, no other alternative business investment can be leveraged so highly or at such low interest rates. Most businesses would love to be tax-treated as homes are.

The conditions for making homeownership work as a business investment are: 1) hold it for at least 15 years, longer is better; 2) get a low, long-term fixed-rate mortgage that, preferably, you hold for its term (paying it off before term raises the effective interest rate because of interest front-loading); 3) don't buy more house than you can currently and foreseeably afford; 4) don't buy with the idea of flipping in a couple of years or speculating on trends; 5) have enough liquidity to ride

out a year or more of unemployment; 6) don't gamble on sketchy neighborhoods or sketchy properties; and 7) don't overpay for what you're buying.

Habitat for Humanity makes homeownership available for low-income buyers. I think the country would be better off if we applied some form of the Habitat model for marginal buyers rather than keeping them locked in and locked up in dead-end rental housing. The model I have in mind is not offering no-doc, risk-shifted, subprime loans with killer ARM terms to poor folks, which is the model that was used in the go-go years, not that far back.

Investing in a home is not opening a piggybank account. Equity buildup should be for long-term objectives like retirement, not short-term gratifications like sailing trips. (I write this as a sailor.)

As retirement accounts go, I would take a 30-year home purchase as outlined above against any alternative retirement investment, including a ROTH IRA. With private pension plans scaling back or disappearing and Social Security on the road to tighter eligibility standards and perhaps lowered benefits, homeownership is the least risky retirement account available to middle-income and blue-collar Americans.

Purchased stupidly and for the wrong reasons, a home investment will tank like any other investment purchased stupidly and for the wrong reasons. But, in my opinion, its many current advantages still outweigh the risks compared to the alternatives, especially if the future is dismal.

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