

Homeward Bound: Investing in the American Dream

Your home is more than a shelter, it's a sanctuary from the world around you. It's also a daycare center, restaurant, laundry facility, and entertainment complex all rolled into one. And for some, it's a status symbol. But is it an investment?



Just a few years ago, with home prices steadily increasing, the answer might have seemed obvious. But recent double-digit annual declines in housing prices have--not surprisingly--led to a chorus of calls to rethink the way homeownership is viewed. Your home, you might hear, is just a place to live, not an investment. The truth is that even if your primary motivation for owning a home isn't financial, your home qualifies as an investment.

The profit motive

An investment can be defined as a purchase or an allocation of dollars with the intention of generating income or profit. Certainly, if you purchased your home with the intent of fixing it up and "flipping" it, your home would qualify as an investment under this definition. Even if your primary motivation for buying a home is the enjoyment the home provides, however, your home has characteristics that make it an investment--it generates current "income" and provides potential profit in the form of long-term appreciation.

Your home generates income

If you didn't own a home, you would be paying rent. If you own your home outright (i.e., you don't have a mortgage), the value of what you would otherwise be paying in rent might be considered a type of "income" that your home generates each and every month.

Similarly, if you have a mortgage, each payment you make is offset by the value of this generated income. For example, let's say that each month you make a mortgage payment of \$2,500. If it would cost you \$2,000 each month to rent a comparable home, the incremental cost of buying rather than renting is \$500. In effect, you're paying \$2,500 each month for your home, but receiving an immediate income benefit of \$2,000 each month.

Another consideration: while rent can increase (or decrease) from year to year, most homeowners (at least those with fixed mortgages) will make the same monthly payments over the term of their mortgage. And mortgages have a finite term--you'll eventually own your home outright and will continue to benefit from the generated rental income thereafter.

Of course, equating your home to an income-producing asset is more complicated than we're describing here. A detailed analysis might account for factors like home maintenance costs and property taxes, as well as tax breaks associated with homeownership.

Potential for appreciation

When you purchase a home (and you may own several over the course of a lifetime), getting the best value for your money is usually a concern. Although you may not purchase a home with the intent of flipping it for a profit in the short term, you probably expect that your home will appreciate over the long term. The future value of your home is important, whether you hope to sell your home some day, or intend to leave your home to your children.

In addition to expecting your home to appreciate in value over the long term, if you have a mortgage, you probably anticipate building wealth through equity as you pay down the mortgage. With each mortgage payment you make, more and



Since 1987, when the Case-Shiller index of 10 major cities begins, it's risen from an index value of 63 to 151. Annual return: Just 4.1% per year. During that period, according to the Bureau of Labor Statistics, consumer prices rose by 3% a year. Net result: Home prices produced a real return of just 1.15% a year over inflation over that time.

Brett Arends, Is Your Home a Good Investment? WSJ, May 27, 2009.

more money (equity) is potentially available to you to use toward future goals or to serve as a financial safety net in retirement.

That's not to say that a home is necessarily the most *efficient* way to accumulate wealth. Depending on where you live, and how long you intend to reside in your home, you might come out ahead financially by renting and investing the dollars you save by doing so. The point is, that as bleak as the current housing market is, over the long term, you probably view your home as a relatively safe vehicle for wealth accumulation. As with any investment, that expectation may or may not be reflected in actual performance over time.

The bottom line

Your home is likely your single largest investment asset, playing a critical role in the overall accumulation of wealth during your lifetime. But, as is the case with all investments, whether owning a home is the most efficient allocation of your dollars depends in part on your expectations and tolerance for risk.