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ARE HOMES GOOD INVESTMENTS?

Much has been made of the run-up in U.S. single-family house prices over the last several years. Many advisers and the general public see single-family housing as a great investment; particularly during this period when stock and bond returns have seemed modest by comparison. The cycle has gotten so extreme that some commentators even recommend short-term trading of homes ("flipping") and using maximum leverage (debt) in the form of "no money down", "interest only" and even "reverse" mortgages.

There may be perfectly good reasons for buying a home - - to raise a family, as a place to rest up after a busy workday, or just as a means of expressing your lifestyle. But can housing be depended on as a great investment? Not necessarily. Suppose your house quickly goes up in value. You sell it, pay transaction costs and then what? You're now on the street and are likely to go right back into the housing market to buy another overpriced one. Are you ahead?

More significantly, for most Americans single-family home ownership is an income ***consuming*** rather than income ***producing*** investment (unless they rent out their homes and live elsewhere.) As many of us know, the costs of homeownership are substantial - - property taxes, insurance, utilities, maintenance, sales charges and closing costs - - to name just a few. These costs dramatically lower the value of housing as an investment.

Jonathan Clements, a financial writer for the Wall Street Journal, attempted to find out if his own home made him much money since he purchased it ("How Houses Eat Money," Wall Street Journal, Real Estate Journal.com, June 15, 2005). He bought his New Jersey home in late 1992 for $165,000, and by mid-2005 estimated it was worth $500,000 - - about a 200% gain. Sounds great! However, after deducting property taxes, mortgage interest, home improvements, maintenance, closing costs, etc. he found he had barely broken even over his thirteen years of ownership!

Thornburg Investment Management also published a study of the real returns of single-family homes for the **twenty-year** period from 1984-2004 ("A Study of Real Real Returns", Volume 12, June 2005). After adjusting for inflation, taxes, and expenses (but not maintenance costs, which would have made the results worse), Thornburg found that homes returned a pitiful 1.15%/year vs. 3.11%/year for long-term municipal bonds, 5.76%/yr. for the Dow Jones Industrials stock index and 7.20%/yr. for the S&P 500.

Even if stock/bond prices seem to be going nowhere, income producing investments are great to own. Certain municipal bond interest is tax-exempt and qualifying dividends from stocks are currently taxed at very favorable rates. Moreover, stocks and bonds don't normally incur maintenance, insurance or utility costs. Most U.S. stocks and bonds have also proven to be highly liquid in virtually all economic conditions, whereas only rarely in our nation's history could the same be said of homes. Moreover, astute stock and bond investors pay miniscule transaction costs versus the significant sales commissions and closing costs associated with housing.

Financially strong companies also tend to increase cash dividends on their stocks over time. For example, the dividend-paying, "core" stocks we hold in client portfolios increased their dividends 18.2% on average in 2005 (vs. a 3.5% increase in the inflation rate as measured by the Consumer Price Index). Some of these companies' stocks are now yielding between 10-14%/year versus their original purchase prices:

Company (Ticker)	Original Purchase Date	Original Purchase Price	Annual Dividend Now	Yield on Original Purchase Price
Illinois Tool Works (ITW)	6/22/1989	$9.53	$1.32	13.85%
Sysco Corp (SYY)	6/2/1995	$6.75	$0.68	10.07%

Comparing stocks/bonds vs. homes shouldn't be taken too far - - after all, you can't live inside a stock/bond portfolio. But that isn't the issue. What we have been discussing is **"investment merit"**; and, if history holds, stocks and bonds beat homes hands down. Our advice? After you pull into your driveway, go into your lovely home, hug the people you treasure and enjoy the heck out of them all. But, as you turn in for the night, you'll sleep best if you have a great bond/stock portfolio silently paying for what this domestic paradise consumes.

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