Your Home is a Lousy Investment

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At the risk of heaping more misery on the struggling residential property market, an analysis of home-price and ownership data for the last 30 years in California—the Golden State with notoriously golden property prices—indicates that the average single family house has never been a particularly stellar investment.

In a society increasingly concerned with providing for retirement security and housing affordability, this has large implications. It means that we have put excessive emphasis on owner-occupied housing for social objectives, mistakenly relied on homebuilding for economic stimulus, and fostered misconceptions regarding homeownership and financial independence. Capital has been diverted from more productive investments and scarce public resources have been misallocated.

Between 1980 and 2010, the value of a median-price, single-family house in California rose by an average of 3.6% per year—to $296,820 from $99,550, according to data from the California Association of Realtors, Freddie Mac and the U.S. Census. Even if that house was sold at the most recent market peak in 2007, the average annual price growth was just 6.61%.

So a dollar used to purchase a median-price, single family California home in 1980 would have grown to $5.63 in 2007, and to $2.98 in 2010. The same dollar invested in the Dow Jones Industrial Index would have been worth $14.41 in 2007, and $11.49 in 2010.

Here's another way of looking at the situation. If a disciplined investor who might have been considered purchasing that median-price house 1980 had opted instead to invest the 20% down payment of $19,910 and the normal homeownership expenses (above the cost of renting) over the years in the Dow Jones Industrial Index, the value of his portfolio in 2010 would have been $1,800,016 in 2010. The stocks would have been worth more than the house by $1,503,196. If the analysis is based on 2007, the stock portfolio would have been worth $2,186,120, exceeding the house value by $1,625,850.

In light of this lackluster investment performance, and in the aftermath the recent housing market collapse, why is there such rapt attention being paid to the revival of the homebuilding industry and residential property markets? The answer is that for policy makers whose survival is dependent on economic recovery, few activities have such direct, intense and immediate positive economic impacts as new home construction.

These positive impacts are transitory, however, when local economies have insufficient permanent employment to justify a constant level of demand for new housing stock. Existing housing does little to create new employment beyond limited levels of service employment. By contrast, a business investment in the amount of the several hundred thousand dollars represented in the value of a house would likely create many permanent jobs, produce income, profits, and competition. As with most things, the benefits of building new homes come with a sobering caveat: What becomes of the workforce once the party is over?

Home values may gain value over time, but home equity is locked-in until the house is sold. The profits may then be reinvested or spent, creating significant stimulative effects, but usually this happens when market conditions are strong, exacerbating unsustainable market booms. When troubled assets are dumped, or when defaults occur during weak market conditions, the trough is deepened.

Housing markets may be forever doomed to cyclicality for many reasons, but public policies that stimulate new construction or home purchases by tax and financing subsidies, reduction of qualifying incomes, buyer credits, mortgage backstopping, and preferential zoning and permitting, only intensify these cycles. Efforts to reduce loan balances and to create special rescue programs have reduced the security of loans, challenged the enforceability of contracts, and driven up real borrowing costs. Nearly a third of our states do not do not allow lenders the recourse provisions necessary to go after a borrower's personal assets in case of default on a residential mortgage. The sanctity of mortgage obligations has become the rough moral equivalent of the 55-mile per hour speed limit.

There is also a misconception that paying off a home mortgage is a path to financial or retirement security. The reality is that tapping the equity is expensive: Home-equity loans or lines of credit made with low qualifying incomes, for example, often command high interest rates and costs. If an emergency occurs—the loss of a job, or a business setback—it's likely that the same conditions creating the problem will lower the value and impede the marketability of the home and curtail the availability of financing of a potential buyer. Funds truly set aside for emergencies should always be in the form of liquid assets.

Is it wise for coming generations to continue to view ownership as the cornerstone of personal finance? Young people planning for retirement increasingly face a choice between house payments and contributions to retirement accounts. They simply can't afford both. With the specter of looming cuts in Social Security and other entitlement programs, or even possible systemic insolvency, the challenge for tomorrow's retirees is income self-sufficiency.

A nation of house buyers becomes captive to economic cyclicality caused by bursts of construction activity, and is not lifted nor sustained by the limited levels of service employment related to existing housing. By contrast, a nation of business startups and investors supports our capital markets, creates long-term employment, income, exports and the myriad technological advancements desperately needed by an expanding American society as the future unfolds.

New home construction and the markets for existing homes should be recognized as activities secondary to, and dependent on employment. Healthy job markets create healthy property markets, not the reverse. Housing demand driven by job growth creates conditions capable of sustaining a stable level of construction employment, attracting private equity investment, sustaining competitive private debt markets, encouraging capital growth, and ensuring the lowest possible housing prices.

Owner-occupied homes will always be the basis for healthy and stable neighborhoods. But coming generations need to realize that while houses are possessions and part of a good life, they not always good investments on the road to financial independence.

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