Is Your Home a Sound Investment?

You may want to find a safer place to park your assets – outside your house.

Unlike your portfolio, your home is an illiquid and concentrated investment that cannot be sold quickly.

By Lou Carlozo April 15, 2015 | 9:37 a.m. EDT+ More

Whether it's beautiful new construction or a rehabbed fixer-upper, the place we call home demands time, attention and upkeep over the years. All this can enhance its value, and to be sure, Rich Arzaga inhabits a fabulous residence in San Ramon, California. The founder and CEO of Cornerstone Wealth Management estimates that its value approaches $1.9 million. The 5,400 square-foot abode boasts a swimming pool and a built-in barbecue, and has undergone more than a half-million dollars in improvements since he purchased it in 2005.

He considers the money well-spent: But does his home a double as a sound financial investment? As much as Arzaga loves his lodgings, he'd also argue that homeownership doesn't translate into a smart addition to his portfolio – or anyone else's, for that matter.

“We have seen many scenarios where a family would be much better off today, and in the future, renting,” Arzaga says. “Most people who insist that owning is a great investment are purely emotional on the matter and have not done any serious overall calculation. They are blinded by a feeling.”

Arzaga says he’s got the statistical analyses to back up his assertions. Yet expert opinion varies greatly as to whether a home represents a great investment. No single answer reflects a one-size-fits-all scenario any more than a cute brick bungalow resembles a sprawling suburban mansion.

“A home is a significant investment, but homeowners must not make the mistake of thinking of a home in the same terms as your stock portfolio,” says Elle Kaplan, CEO and founding partner of LexION Capital in New York. In Kaplan’s view, a home’s central place in life means that it can’t be traded on par with even the most nonconvertible investment. Selling a vintage sports car, for example, could be easy by comparison.

“Owning a home is very different than investing in the context of the markets,” she says. “In contrast to your portfolio, a physical home is an illiquid and concentrated investment. You can't just sell your home right away if you need cash, because you need a place to live.”

But what if you’re just starting the search for a new home with an eye toward holding it for the long term in the manner of certain stocks? “Real estate can be a good investment, and there are several factors that can have a significant impact on the returns,” says Dan Smith, president of PrivatePlus Mortgage, based in Atlanta. So which factor comes first?

“I know it is trite, but location, location, location,” Smith says. “The best neighborhoods in any area tend to appreciate the most in the good times and depreciate the least in the tough times.”

Location, in a broad geographic sense, also affects whether the cost of home improvement projects can lead to even greater gains in home value. But that only happened in two markets in 2014: San Francisco and Honolulu (both around 110 percent), according to Remodeling magazine's 2014 Cost Vs. Value Report.

What’s more, Remodeling’s figures for 2015 show that overall, only one improvement returns above its cost, and barely. A replacement steel door that costs $1,232 will increase value by a paltry $22. On the minus side, a home office remodel costing $29,066 will only produce $14,155 in added value, meaning you’ll recoup less than 50 percent of your investment.

“When people remodel, they don’t add value to the property,” Arzaga notes. “Rather, they change the look and feel to their liking.”

Now, let’s consider Arzaga’s findings, which he prepared for U.S. News. He based them on lost investment income at a 7.5 percent annual return because the money went into the home instead of the stock market.

He calculates that over 40 years, a $500,000 home will cost you $1.5 million due to property taxes, $900,000 in remodeling costs, $600,000 for maintenance and $195,000 for paying property insurance as opposed to renters’ insurance. That totals about $3.2 million. Although that’s what

Jennifer Aniston may plunk down for a new walk-in closet, that kind of cash drain doesn't match the financial aspirations of any investor.

"Most of us have been told that our home is our biggest asset, our most valuable asset and our largest purchase, but nothing could be further from the truth today," says Mike Chadwick, CEO of Chadwick Financial, in Unionville, Connecticut. Using similar metrics to Arzaga, he cites the example of a home purchased in 1995 for $136,800 that has appreciated to $375,000 in 2015, which is a 175 percent increase.

"It appears I'm a genius, but sadly I'm not," Chadwick says. He calculates that major expenses set that homeowner back about $265,000. "We've done the roof, driveway, siding, furnace, garage door, kitchen, bathrooms and more. The taxes we pay every year are $6,000 and insurance is $1,200. … This is not the good investment we've been taught."

But some observers counter that other expenses come into play that a home may actually reduce as opposed to increase.

"Living in a house discourages miscellaneous spending," says James Roche, president and CEO of Houseplans.com, a San Francisco-based online network of stock home designs. He asserts that homeowners will cook at home, watch movies in the living room and entertain themselves more readily than renters because their digs are less cramped and more comfortable. "That keeps us away from the great American pastime of wandering around commercial areas, spending money on things that provide modest, transient pleasure at best," he says.

Still, others pit themselves on both sides of the debate over the value of homeownership from an investment angle. "My view is that a home is not an investment, but it can certainly be a profitable noninvestment," says David Reiss, a professor of law and research director at the Center for Urban Business Entrepreneurship at Brooklyn Law School.

Reiss maintains that the notion of "value" should revolve around financially intangible factors, although certainly, those could increase a home's value over time. "Are there good schools and playgrounds for your kids? Is it near your job and your social network? If the answer is no, that's a good reason to pass on a house that seems like a good deal," he says.

So although a dream house may cost a good bit of money to purchase and protect, there's a solid argument in favor of searching for investment returns elsewhere: In other words, find a safe home for your assets outside of the house.

"You can invest in a diversified global portfolio of stocks, fixed income and commodities," Kaplan says. "But buying a home for most people means concentrating a very large portion, if not the majority of their assets, into that one investment."