HELM
INVESTMENT MANAGEMENT

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# *HOME SWEET HOME?*

No. 6

There are all kinds of reasons to think of homes differently than investments. No one lives in their stock portfolio. You don't buy a certain bond due to its location in a desirable school district.

But if you (or your real estate agent) are using investment arguments to convince yourself to stretch for a more expensive home or a nice second or third home, it might be appropriate to compare the investment value of a home vs. how you would have done (or are expected to do) in stocks or bonds. It can be done, if you think about the numbers.

First, find a rate of return on your home:

1) Take the overall gain on your house – the difference of what you sell the house for minus what you paid for it.
2) Subtract any cash you spent on major improvements, say a new kitchen. This is your net gain.
3) Divide the net gain by the sum of the purchase price plus money spent on improvements to get your percentage gain.

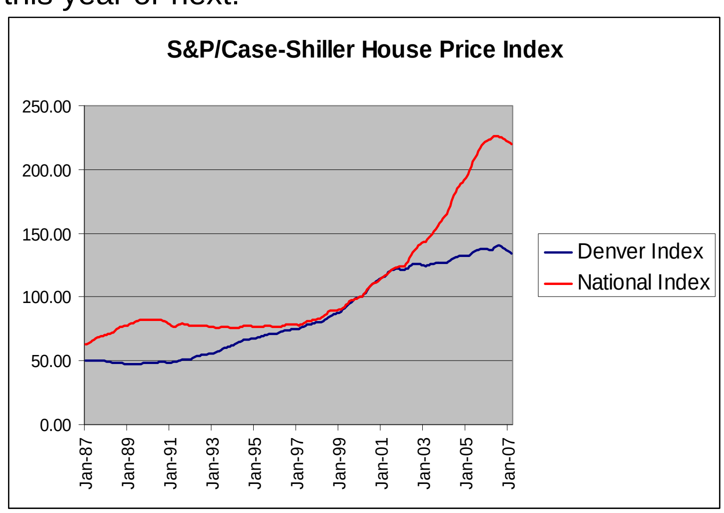
Think of a home bought in Denver 20 years ago for $250,000 now valued at $750,000. Congratulations: You beat the average Denver gain by a good bit (you're up 200% vs. the S&P/Case-Shiller Denver home price index gain of 168%).

Seems like a great gain. But now subtract selling costs (real estate commissions, taxes, etc) of at least 6%. So you net $705,000. Don't forget to add the 1987 value of the $50,000 kitchen put into the house in 1997. That adds $35,390 to the starting number. You end up with a gain of $419,610 above the total investment of $285,390, or a 147% return. That's 4.6% a year after taking into account the effects of compounding. Hopefully, that's free of the capital gains tax.

In the 20 years ended Dec. 31, 2006, the S&P 500 gained 486%. That's 8.2% a year. Figure a rough 2% more a year from dividends and the stock returns of 10.2% were double those of the house.

It could be worse. If you bought a house in Boston or San Diego two years ago, you're likely facing a loss. Robert Shiller, the Yale economist who helped create the S&P/Case-Shiller index, notes that high home prices in many cities (especially on the coasts) have the characteristics of a speculative bubble.

Not all cities are as speculative as others. As you can see in the chart, the average gains in Denver the past few years are well below those of other parts of the country – a good thing if the bubble pops this year or next!

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