3 Reasons Why Your House Is a Really Crummy Investment

Description

If you take a look at the typical person’s balance sheet, chances are the majority of assets are tied up in their house. This is especially true for young people who simply haven’t had the time to diversify into other assets.

For many people, this is an intentional choice. They’ve witnessed the outstanding long-term performance in markets like Toronto and Vancouver, and they want a piece of the pie. Why would they take risk in the stock market when they can own a beautiful home that also happens to steadily go up in value?

But as we’ll see, owning your own home isn’t all that it’s cracked up to be. At least from an investment point of view. Here are three reasons why your house might be a bad investment.

The dangers of leverage

The typical homeowner puts down between 5% and 20% of the value of their house and finances the rest of the purchase. Most of the time, this works out pretty well. But sometimes it doesn’t, and it can have a devastating effect on your net worth.

Say you spend $50,000 of your own cash to buy a $500,000 house. Immediately afterwards, the underlying real estate market falls by 10%. Your $500,000 house is now worth $450,000.

The hit is even bigger if we focus on your equity in the property. You haven’t just lost 10%; you’ve actually lost 100% of the down payment. That cash is gone. The only thing left is debt.

Now, this isn’t a huge deal if you hope to hold for a decade or two. But what if life changes and you need to move? A renter can move tomorrow and only be out a security deposit and a little rent. A homeowner has to pay mortgage penalties, legal fees, and a realtor if they want to sell.

Maintenance

People only remember how much their house has appreciated over time. Nobody remembers the cost to keep it nice.

Every homeowner knows repairs and maintenance are a never-ending headache. Appliances need to be fixed. The furnace is making a weird noise. It never ends.

And every decade or so, you're forced to spend a bunch of money on a big project like replacing the roof or redoing the kitchen.

It gets worse. You can at least delay many major home repairs. There's no putting off paying your property taxes, insurance, or condo fees.

All these costs can easily add up to hundreds of thousands of dollars over your home's life, yet nobody factors them in when figuring out how much profit they make on their home.

It's a poor asset

Many folks take a lot of pride in the amount of equity they have in their home. And I don't doubt making that last mortgage payment is an incredible feeling.

But home equity isn't a great asset. It just kind of sits there, doing nothing. You still have to pay the mortgage. It doesn't generate any income. You can't even access it unless you borrow from a bank.

Some people intentionally minimize their home equity, choosing to stay in debt longer and use the excess cash to invest in excellent stocks. I think that's a sound strategy.

The better way to buy real estate

If you're looking for real estate exposure in your own portfolio, the better way is to buy investment real estate.

I'm personally doing so by buying Canadian REITs — an asset class that generates significant income, comes with professional managers to do all the work for me, and is currently on sale. The REITs I buy today should generate significant income for decades to come.

Here's an article talking about one of the REITs I own, **SmartCentres REIT**. SmartCentres features a solid portfolio, oodles of redevelopment potential, one of the best management teams in the business, and, perhaps most importantly, an excellent distribution yield. Shares are currently on sale, too.

The bottom line

There's nothing wrong with buying a house. It's nice to have somewhere you can call your own. Creating stability in your chosen neighbourhood is a good thing, too. And you can always borrow against it if you really need cash.

Just remember that it's not really a great investment.

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