Is real estate, i.e. property holdings, a good investment? Specifically, are residential holdings, in the form of houses or condominiums, good investments?

This is a popular question asked by investors. However, the appropriate answer for each investor will differ. Whether the property is a primary residence, the region of the country in which the property is located, the investor's marginal tax rate, and the liquidity needs of the investor are just a sampling of the information required to determine whether real property holdings are a good investment for a particular investor.

This short briefing will be the first of a series covering real estate as an investment. We will start off this series by looking at historical returns of real estate in key metropolitan areas versus investments in real estate proxies, assets that derive their values from the key drivers of the real estate markets. We are not advocating one asset over another, but, rather, reviewing how different investments would have performed in the past.

Our sampling period spans the period from the start of 1990 to the latest data available for each asset at the time that this brief was written in May of 2016. Using residential housing price data from Case-Shiller, we calculate the gross returns from investing in the three key U.S. metropolitan areas of New York City, Los Angeles and San Francisco.[1] We then compare them against the returns from alternative real estate proxies consisting of home improvement stores, a leading home builder, and a real estate investment trust.

Table 1 shows the total return from holding real estate in the three major metropolitan areas. San Francisco has done the best over this period delivering almost two dollars of gains for each dollar invested. Los Angeles and New York City, respectively, follows. But from a purely

[1] The Case-Shiller housing data is significant since it has the most comprehensive housing indices data with the longest track record. It essentially tracks the normalized, weighted average returns for housing in each of the metropolitan areas that is covered.

investment standpoint, are these returns competitive with alternatives in the financial markets?

TABLE 1

Metro Area	NYC	San Francisco	Los Angeles
Total Returns	119.5%	199.7%	143.4%

Source: Case Shiller/Standard and Poors

In the next table, we have total returns for the S&P 500, Investment grade bonds, and a benchmark portfolio of 60% stock and 40% bonds. From Table 2, we see that over this period from 1990 to 2016, an investor would be substantially better off in stock, bonds, or a portfolio consisting of both. There is simply no comparison.

TABLE 2

Financial Investment	S&P 500	Investment Grade Bonds	60% Equities 40% Bonds
Total Returns	875.0%	376.8%	679.4%

Source: Capital IQ/QuantScape Asset Management LLC

So is the housing market really a terrible place to invest? Actually, with any industry, it is always better to be selling the "picks and shovels" than to be the miner looking for the gold. If we look at alternative investments to actual housing ownership, such as stocks of home improvement companies, homebuilders, and real estate investment trusts, we realized that 1990 to 2016 was a good time to invest in housing. In Table 3, the total return from holding home improvement stores, such as Home Depot and Lowes, home builders, such as Lennar, and real estate investment trusts, such as the Fidelity Real Estate Investment Trust Fund, would have made for excellent investments.

TABLE 3

Investment Alternatives	Home Depot	Lowes	Lennar	Fidelity REIT
Total Returns	9,205.0%	9,573.6%	4,366.2%	1,414.8%

Source: Capital IQ/QuantScape Asset Management LLC

Home Depot would have returned 92 dollars per one dollar invested, Lowes would have returned almost 96 dollars per one dollar invested and Fidelity's REIT Fund would have returned 14 dollars per one dollar invested.

Even if we make the assumption that a single stock holding is only 10% of an investor's portfolio and that the value of the remaining 90% of the portfolio goes to zero (a very unlikely scenario), Home Depot, Lowes and Lennar would have provided returns much greater than holding real estate in the best market of San Francisco.

Note also that the average amount of capital needed to invest in housing is at least $100,000 while the alternative real estate investment in stocks and mutual funds would be on the order of $1,000. Finally, housing liquidity is poor and lags that of the stock market.

TAKEAWAY

From a purely investment standpoint, owning housing may not be the best for creating wealth. That is not to say housing is a bad investment. However, if the goal is to maximize wealth over time, housing ownership may not be the most optimal way of doing so.

Again, this analysis is based on past data and only serves to provide insight, not investment advice, as to the relative merits of holding real estate relative to its alternatives.

In the future, we will explore in detail the costs and benefits of holding real estate as a rental asset.

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