

Why second home's a better investment than stocks

It's more than just the 'pleasure' component

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[By Tom Kelly](#)

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Ted Jones never has tried to keep up with the Joneses. The senior vice president and chief economist for Stewart Title drags his own huge net to filter financial data and often offers opinions that are over the top compared to his housing brethren.

When it comes to second homes, he really heads back to basics and suggests potential buyers do the same.

"My definition of a second home is one that is purchased with no intention ever to sell it," Jones said. "If you sell it or even intend to sell it, it's an investment. Period. If you do, you've lost my definition of a second home.

"We plan to pass ours on to our daughters as a part of their inheritance. In fact, we don't want it to go up in value because then we would have to pay more property taxes."

Clearly, Jones' idea of value of a second home has little to do with wealth accumulation. His only value gauge comes from the ability to enjoy the property -- sunset over the lake, cocktails by the seventh fairway, a breathtaking mountain view just a short walk up the road, etc.

While it's easy to agree with Jones about the basic idea of a second-home investment, most potential shoppers can't afford to consider only the pleasure component; they are in need of a larger total package. So, let's consider investing in a second home versus common stocks to help explore the possibilities.

Conventional wisdom still holds that common stocks offer the best returns over time. If you measure cash-on-cash return, this may be true, but when you look at total return, the picture changes. The ownership of real estate offers four distinct advantages over stocks:

1. Real estate prices are less volatile in most areas. As we have seen in the opening years of this century, stocks can move a great deal in both directions. This makes ownership of stock a crapshoot, with profit solely dependent on timing. If you cashed out in December 1999, your returns were huge; if you waited a year, you probably lost a great deal. Since then, it's been up and down. House prices fluctuate, but within a lesser range. If real estate prices don't shoot up the way stock prices do in a bull market, real estate markets don't crash the way stocks do when the bull runs out of steam. In short, it's a less risky investment.

2. Real estate is a leveraged investment. You can own a second home with an equity investment (down payment) of no more than 20 percent. In fact, there are many programs that let you buy with a lot less. Most people can't do this with stock. You need to pay the entire price of the stock. So, when the price of a stock rises 5

percent, you make 5 percent on your money. If your real estate rises by 5 percent in value, your return is upwards of 25 percent.

3. Real estate is tax-advantaged. Any interest incurred for the financing of a second home is deductible from ordinary income for tax purposes. If your second home becomes an investment property, tax can be deferred and sometimes eliminated. You still pay capital gains tax on stock and you can't deduct the interest on any debt incurred for the purchase of financial assets.

4. And finally, here's the only return that drives the Jones camp: you can live in real estate. Stock certificates are pretty, with great colors, cool writing and embossed letters. Unfortunately, you can't go to sleep in them or stand on them to watch the sunset over the lake, or hold a party for your friends and family in them. They just (hopefully) make you money. Real estate provides many different kinds of satisfaction that money can't.

While I absolutely concur with Jones and about the pleasure power of a second home, I also believe deeply in its long-term wealth-building powers. In a nutshell, if you think a house is good enough to live in and enjoy, someone else will too, and they'll pay you for the privilege to rent it. The ownership of an investment, particularly that property you can personally enjoy, pays dividends on a variety of levels and can be a very profitable road.