

Real Estate Investment vs. the Stock Market

By Robert L Cain

Stock brokers don't have much use for real estate investing. If you want to get one going, tell him or her you invest in real estate. Then just sit back and listen. Some will even show you charts and graphs that "prove" the stock market is a better investment than real estate.

I received a brochure in the mail the other day from the stock broker who handles my grandchildren's trust account entitled "Home Sweet Home." In this brochure Van Kampen Investments compares "home real estate median prices from 20 cities across the country over the past 20 years" to some of Van Kampen's long-standing mutual funds. Wow! If you take their figures, you'd have to be a complete idiot to invest in real estate when there are mutual funds out there.

What is interesting are the selective calculations used in this brochure. While they provide the total increase in value in each of three investments and give an annual return over a 20-year period, they leave some things out.

I took what they cited as their best performer, the Comstock Fund. Since 1980 it has an average annual return of 13.2 percent. Not bad, and certainly it is better than you would get if you stuck it in the bank. At the same time they listed 20 cities and the real estate returns over 20 years. Of the cities they listed, and they were selective in which they used as examples, the best annual return was Los Angeles, California with 7.3 percent, followed closely by Washington, DC with 7.2 percent.

The figures Van Kampen Funds used are for home prices and return, not investment real estate. So that's their first problem, not comparing apples and apples. While many people look at their home as a real estate investment, that is a secondary reason for buying for most people. In first place is having a nice place to live.

I decided to compare apples to apples. I loaded up Real Estate Investment Analysis Software, available from us, used the 10-year projection, and entered typical numbers. The reason I used the 10-year projection is that is about the longest most investors keep an investment property. I used the example of a single-family dwelling priced at \$100,000 with the buyer (landlord) putting 20 percent, or \$20,000, down. So the investor's total investment is \$20,000. Here is the magic of leverage.

Second, I assumed a monthly rental amount of \$900-below what it would fetch in some markets, but higher than what it would in others. I also assumed an appreciation of 5 percent a year and a rent increase of 5 percent a year. Neither is unreasonable and the differences would average out over 10 years. I also figured \$500 per year in capital improvements and an 8 percent operating expense ratio. Here's what you get after 10 years.

- Sale price: \$162,889.
- Net income during the period: \$23,757
- Net gain at sale: \$75,315
- Total return over 10 years: \$97,072
- Total return on initial investment: 485%
- Annual return on initial investment: 48.5%. The annual returns grow from 33.9 percent the first year to 64.5 percent in year 10.

Gee, that's a lot better than 13.2% that Van Kampen is bragging about, isn't it?

What could affect our real estate returns? The first is how intelligently we buy. When we buy a stock or mutual fund, they set the price. When we buy real estate, we can search out underpriced gems. We can take our time and find the best deals in our markets. On the other hand we can buy dumb. Remember the adage: you make your profit when you buy the property; you realize it when you sell.

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