Is a home purchase a good investment in future wealth?

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Ask a Lender
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Key Points

Is a home purchase a good way to build wealth?

- As homeowners build equity, they own a greater share of their home.
- As mortgages amortize, homeowners pay more in principal.
- Population growth and a shortage of homes mean home appreciation is likely to continue.
- A 2017 study found renters could build more wealth than homeowners if they invested wisely.
- Most renters, however, spend rather than invest, any money they accumulate.

There are many vehicles for building wealth, from stocks, to bonds, to savings accounts. But one of the most common ways Americans build wealth is through a home purchase (/advice/buying-a-home/). As homeowners gain home equity, and as the home appreciation of their property increases, houses frequently become their single-largest assets. But how exactly do you build wealth by making what's likely to be the single largest purchase of your life?

Wealth through equity

One way that homeowners build wealth is by accumulating home equity. Homeowners gain a certain amount of equity in their homes right off the bat via their down payments, said economist George Ratiu, director of quantitative and commercial research for the National Association of Realtors (NAR). Over the years, that equity grows through monthly mortgage payments (/find/home-purchase-lenders/). This home equity growth accelerates as homeowners begin paying more toward the principal amount than toward interest. In this way, a mortgage serves as a sort of forced savings account, Ratiu said.

Mortgage expert Barry Habib, founder and CEO of MBS Highway, agreed. The highest-earning savings accounts generate about a 1 percent return on investment, whereas homes earn about 5 percent, he said. As the mortgage amortizes and the homeowner begins paying down more of the principal, homeowners earn an even higher return, he added.

“It’s kind of like the best kept secret in the mortgage and real estate industry — there is an enormous amount of wealth created through amortization,” Habib said. “Through the process of just paying your mortgage as you normally do, a significant portion of your monthly payment is your own money. It’s the best forced savings account there is.”

Price appreciation

Home appreciation is another way homeowners build wealth. Although home appreciation is not guaranteed, the available data indicate home prices will continue to appreciate over time, according to Habib.

“There’s a huge demand for housing as our population grows,” he said, citing immigration and increasing birth rates as drivers of population growth. A shortage of homes on the market is driving prices up even further; home builders haven’t been able to keep up with demand due to the increased costs of purchasing land, hiring workers and obtaining financing, according to Habib. The imbalance between supply and demand has made it difficult for prospective homebuyers to find houses they can afford, which has sent prices soaring.

That’s bad news for homebuyers (/advice/should-you-buy-a-house-now-or-wait/), but if you’re a homeowner, rising home prices give you more home equity. Ratiu, the NAR economist, said the result is that homeowners tend to accumulate wealth much faster than renters.

“We’ve learned in the last downturn that … prices can go down as well as up but looking over the long term — and by this, I mean 30 years, not just the last seven to eight — home prices tend to generally appreciate,” he said.

Tax benefits

The U.S. tax code also bestows a variety of tax benefits to homeowners, although those benefits were diminished (/advice/buying-a-home-heres-how-the-tax-cuts-and-jobs-act-impacts-you/) by the tax reform bill passed in December 2017.

Homeowners can deduct mortgage interest up to $750,000 — down from $1 million. They also can deduct state and local taxes up to $10,000 per household, where there had previously been no limit. The proceeds of home sales also are exempt from capital gains taxes up to $250,000 for single people and $500,000 for married couples.

The tax reform bill nearly doubled the standard deduction, however, so many homebuyers wouldn’t be any better off itemizing their taxes to take advantage of these tax deductions, Habib noted.

Renting vs buying

A November 2017 study published in the Journal of Housing Research cast doubt on the idea that buying a home is the best way to create wealth, arguing instead that renters can come out ahead of buyers, if they are diligent.

Eli Beracha — who holds a doctorate in finance with a specialty in real estate and is an associate professor and director of the Tibor and Sheila Hollo School of Real Estate at Florida International University — is one of the study’s authors. He also is one of the creators of the Beracha, Hardin and Johnson Buy vs. Rent index, which tracks whether it’s better to buy or rent (/advice/should-you-rent-or-buy-or-a-house/) in the U.S. overall and in 23 major cities across the country. The index was used in the 2017 study to determine whether people were better off — in most cases — renting or buying when it comes to generating wealth.

"What we found is that in the majority of the cases, renting was actually preferred to buying from the perspective of wealth creation," Beracha said. "Basically, if somebody were to rent a home and invest the money that they otherwise would spend on a down payment and all other expenses related to the home … they would actually be ahead of somebody who had just purchased a home and just accumulates wealth via price appreciation and building equity."

In the real world, however, most renters don't invest that money, Beracha acknowledged. Further, many people don't know how to properly invest in stocks or bonds, he added.

"At the end of the month, whatever is left, (renters) are spending on other things … because it's just easy to spend money when you have it there," he said. "It's not so easy to spend money when it is locked into your house."

That sentiment is echoed by Ratiu. "Renters rarely have the discipline, as well as the strategic approach, to … (invest) like that," he said. "Whereas for homeowners, the mortgage tends to provide a lot more discipline, given the alternative, which is failing to pay your mortgage. One would lose both the house as well as any equity in it."

Whether or not a home is the best investment, it's clear that it tends to be a good one for Americans over the long-term, Ratiu said.

"Housing and homes should generally not be viewed for people as a speculative investment, but rather a long-term investment — one that, over a long enough horizon, tends to boost homeowners' wealth," he said.

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