

Riposte: “Don't Think Building A House To Live In Is An Investment”

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Speaking on Joy FM's Super Morning Show, Thursday, a Financial Advisor cum stockbroker, Abena Amoah is reported on Myjoyonline to have said that only a house that makes its owner money through rentals can be called an investment. Abena says a house becomes an investment only when it is rented out to tenants for occupation. She noted that since a house cannot generate income until it is rented out, living in it only makes it a utility and not an investment as quoted below:

"It is a utility because you need shelter and it needs maintenance. So having one house is not an investment. If you have one house to live in and you're able to build five other things that are able to generate rent for you where if you fall on hard times you are able to sell one of them, then that other one is an investment, not the one you live in," she explained.

I wish to disagree with this view. Before, I begin my argument, I wish to state that I will not be surprised if she has been taken out of context, as is the trade of Joy fm in recent times. The media house's penchant for sensationalism has become a concern to many people.

Indeed, there is nothing new under the sun. This view that homeownership is not an investment is nothing new. Traditionally, economists have viewed housing as a consumption good and not an investment good. As Arku (2006) opines about 1940 and 1950 economics: "It was seen as an unproductive investment, and its role was downplayed and labelled variously as a "resource-absorber", a "consumer good" and "social overhead". Critics, whom Solow (1955: p. 52) dubbed the "down-to-earth, hard fact analysts", believed housing had an extremely high capital-output ratio, especially when compared with investment in other sectors. These critics pointed out that housing investment contributed to inflation, used valuable foreign exchange resources, exerted pressure on the balance of payments position and tied up resources for a very long period of time (cf. Weissman, 1955; Harris & Gillies, 1963). The general assumption was that resources were limited and that there was a need to develop strategies that would use scarce resources in the most productive and efficient manner, mainly in sectors (e.g. industry) that promised quick returns and that enhanced the productive capacity of an economy. Housing was not seen as an activity that could achieve this goal". In this context, Abena Amoah's view is supported but technically flawed, which I will come to later.

Now, let's diagnose the statement sentence by sentence. The first sentence, "It is a utility because you need shelter and it needs maintenance" suggests that investments are not utilities and are not associated with maintenance cost. A utility is basically the satisfaction or benefit or value derived from something. Every investment, be it core investments like stocks and bonds, or alternatives like real estate and infrastructure are all associated with utilities or values – economic, social, or psychic, etc. Therefore, the fact that homeownership produces a certain utility (shelter) does not make it any less of an investment. Besides, being consumption good does not mean that it is not an investment good. The relationship is not mutually exclusive. Moreover, almost every investment, be it stocks or bonds among others is associated with costs. The cost of maintenance associated with homeowners is just nothing new. The second sentence, "[so] having one house is not an investment", which flows from the first sentence is just incredible. To suggest that a person necessarily needs to own two or more houses to constitute an investment is difficult to fathom. The third sentence is partially true. The idea that homeownership is not an investment because it does not generate a cash flow, which in the case of real estate investment is rent is flawed.

What is an Investment?

To proceed, let us have a closer look at the definition of an investment:

"the act of putting money, effort, time, etc. into something to make a profit or get an advantage, or the money, effort, time, etc. used to do this" (Cambridge Dictionary).

"the outlay of money usually for income or profit: capital outlay; also: the sum invested or the property purchased" (Merriam-Webster Dictionary)

"An investment is an asset or item that is purchased with the hope that it will generate income or will appreciate in the future. In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth" (Investopedia).

From these definitions, three views can be deduced. First, the capital outlay in itself is an investment. By implication, the money invested in a house is an investment. Second, making a profit or cash flow or income although expected does not necessarily define an investment. Indeed, an investment can make a loss. In other words, a rented house may generate a loss if the tenant defaults in rent payment. Third, investments do not only provide an income return but also a capital return (gains) when its value increases. Thus, putting money into something that does not yield income returns (rents) but capital returns is an investment contrary to Abena's view.

Why Homeownership is an Investment

The view that ownership does not produce rent is in the first instance flawed. In a world where housing is either through homeownership or renting, the investment analysis must be done between the two options. Owning a house does not mean that you don't pay rent; in fact, you pay (imputed) rent to yourself. So, on the mere basis that the earning capacity of a house is what makes it an investment, then owning a house is an investment. But there is more to this. The market value of an asset (i.e. a house) is based on the free cashflow or net operating income and not just its earning capacity; that is, its ability to earn rent = "cash flow". For example, if a rented house is generating a rent of GHS1,000 per month and the expense on the house is GHS1,000 or more, there is no free cash flow or net operating income to capitalise to determine the market value of the house. The market value of such an investment property is zero or negative from the investment approach to valuation.

To determine whether owning a house is a profitable investment or not, we must compare the imputed rent (R_f) on the owner-occupied house to the rents the same person would have to pay for renting another house (R_a) given his/her needs. If the imputed rent is greater than the rent passing on the rented property (i.e. $R_f > R_a$), there is a saving (cash flow or income) to the person if he owns the house than renting. That saving or income can then be expressed as a percentage of the initial capital outlay to estimate the income return or be capitalised to estimate the capital gains or return if the estimated capital value at any point in time is greater than the initial capital outlay. Abena's point will therefore only hold if $R_a > R_f$ and capital growth is zero (increase in the capital value of the house).

Moreover, owning a house does not only entitle you to implicit income returns (R_f) (net rent when the imputed rents are greater than the rent on a comparable house; i.e. $R_f > R_a$), but also capital returns (R_c) when the capital value of the house increases over time. It is the desire for capital return that encourages speculation in land.

People buy land and hold to sell on a later date when its value appreciates. Land therefore becomes a store of value and that is what an investment is. It is the same with homeownership. On this basis, investing in housing can be considered as legal speculation for capital gains.

Therefore, even if homeownership does not yield an income return, the value of the house may grow to produce a capital gain, which is the same in concept as capital returns on stocks. Thus, homeownership has the potential to generate a total return (R_t) on investment, which is the sum of income return and capital return; i.e. $R_t = R_f + R_c$. Hence, if the imputed rent on homeownership is zero ($R_f = 0$) but the value of the house increases over time ($R_c > 0$), then the total return is the capital return (i.e. $R_t = R_c$). So the mere fact that homeownership may not generate an income (rent), does not mean its capital return or total return are also zero.

In addition, besides the benefits of the house serving as collateral for credit, growth in the capital value can be accessed as income using a mortgage equity release product. So, these are but a few of the reasons to consider homeownership as an investment.

Conclusion

This riposte has argued the case to consider housing as an investment contrary to Abena Amoah's reported view. Homeownership must be encouraged as an investment.

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