



PRATO CAPITAL



## REAL ESTATE INVESTMENTS

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**A well-diversified portfolio can benefit from investments in real estate but is buying another house for personal use or as a rental property a good fit for your financial plan?**

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Home ownership is certainly part of the American dream. 64% of Americans own their primary residence and for most of us, it is one of the largest assets of our net worth.

Many of us dream of a vacation home on a lake, in the mountains with a ski area nearby or maybe a home overlooking the beach that can sleep the whole family. Perhaps it's a dream of purchasing several rental properties to provide a source of income for retirement. Could any of these be the best use of our limited resources? How does this fit into our Financial Life Plan?

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## Location, Location, Location

According to the New York State Department of Taxation and Finance, in 2018 the median home sales price in New York State ranged from \$67,000 in Allegany County to \$622,500 in Westchester County<sup>1</sup>. Within Westchester County, home prices will vary from one municipality to another. The prices are different in Yonkers when compared to Mamaroneck and Scarsdale. Even within a municipality like our hometown of White Plains, prices will vary with location. Homes near one of our local golf clubs will have different values from those closer to the downtown area. In Westchester County, home prices have increased just over 30% since 2004, just over 2% per year. Nationally, the domestic housing market has risen about 45% in the same time period, about 3% per year.

[1]. Data from New York State Department of Taxation and Finance. Sales Price information includes arm's length residential sales coded non-condominium.

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## Add Up the Costs

When we add up the costs of homeownership, it can be significant with property taxes, insurance, repair costs, upgrades and mortgage interest to mention only a few. Most of these costs will also be incurred for a second home, including the limit for deductions of property taxes under the latest tax code. For a vacation home as a second home, the costs add up even more as the home will need to be furnished and maintained, even when you are not there. If an investment property will be purchased for rental income, the property maintenance and commission for a rental agent will add to the overall expenses. For some real estate investors, they'll chose to manage the property on their own to cut down on some costs. This can lead to the inevitable late-night phone call about the roof leaking or the dishwasher not working. Although there are some tax advantages for rental properties, a tax professional should be consulted before purchasing any rental property and this tax advise comes at a cost.

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## Diversification

For many investors today, a primary residence can be a large percentage of their total net worth. If other residences are purchased for investment purposes, the balance of real estate holdings compared to other assets often becomes out of balance.

One way to invest in real estate without spending hundreds of thousands of dollars is through a Real Estate Investment Trust or REIT as they are more commonly called. A REIT, is a company that owns income-producing real estate, including commercial and residential properties in the US and around the world. Many REITs are traded on public stock exchanges.

Buying a REIT is similar to buying stock or shares in a mutual fund. Shares are purchased and sold, and dividends are paid to their shareholders.

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### Some Advantages of REIT's

Since REITs trade on stock exchanges, they are much more liquid than a second home. This means if funds are needed for any reason, the shares can be sold and available for withdrawal from your account in a few days. With a second home, optimistically it can take many weeks to several months to sell a property and receive your funds.

With a REIT, it is easy to invest in both commercial and residential real estate. Most REITs invest in a combination of real estate assets to include office buildings, apartments, cell tower owners, storage unit companies, and shopping centers. There are also REITs that focus only in specific areas of the real estate market.

The amount of money needed for investing in a REIT is considerably less than a down payment on a vacation or rental home. This can keep any Financial Life Plan on track.

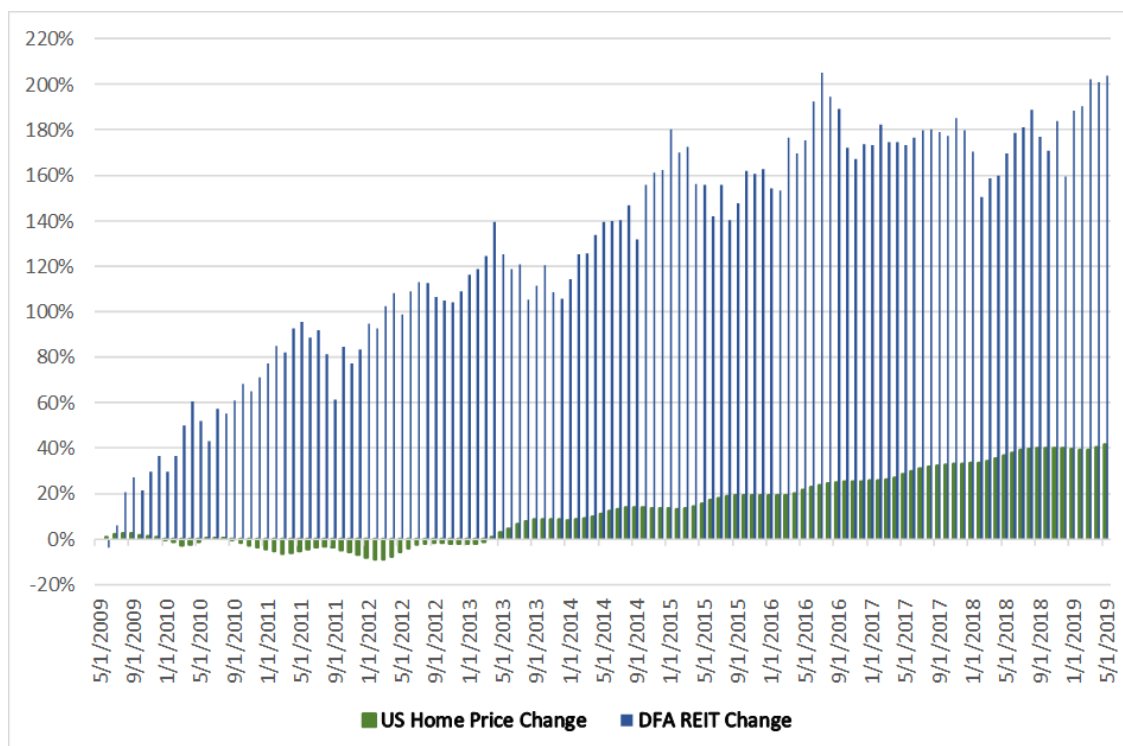
There are also REIT mutual funds which can diversify among companies, sectors and geographic areas. From a total portfolio diversification perspective, REITs will have a relatively low correlation to most equities and most fixed-income investments.

In **Exhibit 1** below, the Dimensional Fund Advisors Real Estate Securities

Portfolio has gained 203% while the average home price in the US has gained 41% over the past 10 years.

### Exhibit 1:

#### US REIT and Average Home Sales – Percentage Gain Past 10 Years



DFA US REIT Data: Dimensional Fund Advisors, Real Estate Securities Portfolio, <https://us.dimensionalfund.com/funds/real-estate-securities>, July 22, 2019.

Average Home Price Data: U.S. Census Bureau and U.S. Department of Housing and Urban Development, Average Sales Price of Houses Sold for the United States [ASPUS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/ASPUS>, July 22, 2019.

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## Conclusion

At Prato Capital Management, we believe there are advantages to owning real estate as an investment. For many of us, a REIT is an easy way to include real estate as part of a diversified portfolio without spending hundreds of

thousands of dollars. A REITs liquidity feature makes it more attractive when needing access to funds rather than trying to sell a property which can take months or even years to complete a transaction. A REIT can also capture the growth of the real estate market without the hassles and costs of owning an investment property.

REIT shareholders do not receive phone calls when the septic system backs up.

The following website shows where many REIT properties are located in the United States:

<http://www.reitsacrossamerica.com/#/>

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## PAST NEWSLETTERS

The graphic features a dark blue background with white smoke trails from jets. At the top, a purple banner with gold lettering reads "PRATO CAPITAL" with "WEALTH MANAGEMENT • SPECIALTY FINANCE • RETIREMENT PLANNING" below it. A circular emblem with the number "70" and wings is centered below the banner. A white box in the middle contains the text "Are you following us on Social Media?". Below this, "PRATOCAPITAL.COM" is written in large, bold, orange letters. At the bottom, there are five social media icons: Facebook, Instagram, Twitter, LinkedIn, and YouTube.

CLICK THE LINKS BELOW



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