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Is investing in real estate right for you?

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In the process of financial planning, the topic of investing in real estate is commonly encountered. Typical issues include how much to spend on one's home, whether to own a business office, and whether to own commercial or residential rental property.

The first issue is of most importance to most families- i.e. how much home to own. Most of us live much less modestly than we "need" to. Renting a small home or apartment may be the most economical way to live for most of us, so that having anything else is a quality of life, if not luxury decision. Doing so is fine, as living in a nice house is one way we enjoy the fruits of our labor. It can add markedly to the enjoyment of life, but the economics are still important to consider.

At extremes, buying too much of a house can make one relatively poor. The cost of owning a residence is usually somewhere between 7-10 percent of the purchase price very year (considering the cost of money, repairs, taxes, insurance, maintenance, etc.). Owning an expensive house can be a substantial economic burden. But, is it a good investment? Usually not, as the price returns of residential real estate in the United States over the last thirty years or so is 1-2 percent a year (below inflation). Certainly there are times and locales in which you can do much better, but as many found out in the last seven years, the reverse is true as well. Owning an expensive home is unlikely to be a good economic choice, but involves other significant life choices. If you are fortunate enough to earn or have substantial assets, than spending on a nice lodging may be "worth it."

The second real estate investment often considered is whether or not to own an office housing a family business.

Here, the investment usually works out well. As long as ownership costs are not substantially more than just renting the space, a long term business owning its own real estate may turn out to be a good economic choice. Risks of doing so involve a deteriorating business environment due to changes in

the market, or choosing a building much larger than the business needs and expecting to be able to rent out the rest (see next paragraph).

Finally, owning commercial or residential real estate for rental purposes is an investment choice. As a blanket statement, I'd say that the vast majority of families I've seen do so have not been happy with the results. It is work to own and manage rental properties (residential more so than commercial). Real estate is not liquid and has carrying costs that are substantial, even if it sits empty. Without going into more detail, I'd advise a very careful discussion with your advisor before venturing into this investment choice.

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