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## **AS GOOD AS IT SOUNDS, IT PAYS TO BE CAUTIOUS WHEN INVESTING IN REAL ESTATE**

CORRECTION- MONDAY 11-14-05

Columnist Warren Wall is not currently offering free seminars. Information included with his Wall on the Street column last week was incorrect.

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WALL ON THE STREET: As good as it sounds, it pays to be cautious when investing in real estate

by Warren Wall, CFP, CSA, SPECIAL TO THE CITIZEN-TIMES

As a general rule, the best time to avoid an investment class is when it is sold as a "can't lose" proposition. That is certainly the case recently with investment real estate. Real estate has been the bright light in many portfolios, showing double-digit gains while equities have largely gone sideways. But before you decide real estate is the way to go, there are some factors you should consider.

Real estate, unlike equities, has some hefty carrying costs, including property taxes, insurance, maintenance and interest expense if you have financed the property. Your annual rate of appreciation must exceed these combined costs or else your cost basis will increase.

Your home should typically not be considered a part of your investment portfolio because it cannot be liquidated without the need for you to replace it with another roof over your head. While it would be nice to sell your home and end up money ahead, all too often the cost of buying a new home neutralizes that gain.

An exception would be if you own multiple properties and use one for your home with the intent of selling it after two years to take advantage of the tax-free gains on the sale of personal residences of \$250,000 for single taxpayers and \$500,000 for couples.

If you purchase a property with the intent of renting it to offset your carrying costs, you need to consider whether you want to manage the property yourself or pay someone else to worry about tenants. Depending upon the property and the local rental market, your rental income may be insufficient to cover your carrying costs. You need to consider how you will pay ongoing costs should you run into problems with your renter and do not receive payments for a period of months. With renters, the risk of damage to the property must also be considered.

While real estate markets are less likely to see dramatic declines such as the stock market has experienced in recent years, there are no guarantees that prices will always go up. Often when real estate becomes

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overpriced, values dip, then plateau, leveling out for a period of years until the market is back to more normal levels. During a flat market, your investment goes nowhere, while expenses typically continue to increase.

Among the arguments for real estate continuing to increase is the comparison of the U.S. housing market with Western Europe, where restrictive zoning makes new construction even more difficult than in most areas of the United States. According to a recent study by ISI, Western Europeans pay seven times their annual salary to purchase an average home providing its occupants with 325 square feet per person. Americans on average pay 3.5 times their annual salary for an average 650 square feet per person.

While that makes U.S. real estate appear a bargain in comparison with Western Europe, Japan shows us another picture of how a real estate market can go sour. Since 1991, residential land prices have declined about 43 percent, and commercial prices about 67 percent.

If you chose to invest in real estate, you need to make certain it represents only a portion of your total portfolio. Remember, real estate is a relatively illiquid asset, which makes it harder to cut your losses when the market turns against you.

Warren W. Wall CFP, CSA is a local financial author and advisor with W. Wall & Company, Inc. a Registered Investment Advisor. Are you asking tough questions about retirement? For more info and a free copy of *The Answers to 46 Frequently Asked Questions About Retirement*, visit [www.Wallco.com](http://www.Wallco.com) or call (828) 651-9617.

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