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HOMES

Investors Buy Real Estate At Record Pace

Wary of Stocks, More Individuals Buy Condos and Rental Property; REITs vs. Owning It Yourself

By RUTH SIMON
Staff Reporter of THE WALL STREET JOURNAL
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A growing number of Americans are buying real estate as an investment, driven by the combination of low interest rates, rising property values and tepid stock-market returns.

Investors accounted for 8% of mortgages used to purchase homes in the first eight months of this year, up from 7.5% in 2003 and 5.7% in 2000, according to an analysis prepared for The Wall Street Journal by LoanPerformance, a San Francisco-based firm that tracks the performance of 46 million mortgages monthly. It's the largest investor share since at least 1986, according to the firm. The number of mortgages used to buy investment property may actually be higher since those figures don't include loans taken out to buy second homes that are used by the owner but may also provide rental income.

The demand for investment property is particularly apparent in rapidly appreciating markets, including Las Vegas, Arizona and parts of California, according to LoanPerformance. But it's evident in other markets as well: In Miami, speculators account for as much as 80% of the preconstruction purchases of luxury condominium units, according to Mark Zilbert, an associate with Esslinger-Wooten-Maxwell Realtors.

In one new South Beach condo building, ICON, roughly half of the apartments were bought by investors and then resold before the building's official opening this week, according to the developer, the Related Group of Florida.

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See the five **top-performing mutual funds that invest in REITs** and other real-estate companies, based on their five-year records.

PROPERTY VALUES

Thinking of investing in real estate? Keep these points in mind:

- In many markets, rising prices have made it tougher to cover expenses.
- You'll need a managing agent to handle repairs and other headaches, or do it yourself.
- Local laws and rising taxes can add to costs.

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The steady upward appreciation of housing prices has provided a sharp contrast to the stock market's performance during recent years. Median home prices climbed 7.7% during the third quarter from a year earlier, with many coastal markets posting double-digit gains, according to the National Association of Realtors. For the five years ended Sept. 30, median home prices rose 39%, versus a loss of 13% for the Standard & Poor'

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AP/Wide World Photo

Investors helped drive up housing prices in Las Vegas

Those gains have attracted many individual investors. Investing in real estate is a wiser decision than putting into a stock market or savings account or savings bond, says James J. McDonnell, a recruiter for an educational testing company in Amherst, Mass. Ms. McDonnell is currently shopping for a two-family duplex she can rent out and then, she hopes to profit in a few years.

But investors betting on double-digit gains could be disappointed. Falling interest rates have helped fuel a rise in home prices, but rates are more likely to rise than fall. Already, there are signs that the housing market is cooling. A decline in the increase in median home prices during the third quarter, which is above historical levels, represents a decline from the gain posted in the second quarter, according to the

Association of Realtors.

One alternative: real-estate investment trusts, which buy and then rent out such as apartments, office buildings and other real estate.

REITs give investors access to a diversified mix of properties and a hefty dividend. But they can also give investors management headaches. Already this year, investors have poured a record \$5 billion into real estate funds that invest in real estate, according to AMG Data Services in Arcata, Calif., which cover the period through a week ago today, exceed the record \$4.75 billion into real-estate funds in all of 2003.

Though considered a relatively safe investment, REITs can also be volatile. They fell roughly 20% during a six-week period this spring after a strong jobs report raised the odds that the Federal Reserve would be more aggressive about raising interest rates. That makes the yields on REITs less attractive.

Prices have since rebounded, but whether REITs can maintain their upward trend is a matter of debate. They currently trade at roughly 19 times adjusted funds from operations, a commonly used measure of REIT earnings -- well above their historical average of about 10 times, according to Mike Kirby, a principal with Green Street Advisors, a REIT research firm. The average yield on a real-estate fund is now 2.8%, according to Morningstar Inc., down from about 4% three years ago. "On a pure valuation basis, it's hard to make the case that real-estate funds are a good buy now," says Morningstar's analyst, John McNeela.

Still, some analysts say that REITs remain attractive for investors with a long-term horizon. Mr. Kirby expects REITs to generate long-term returns of 9% a year



Investors interested in owning hard real-estate assets are turning to first-time speculators to wealthy individuals. Erik L. Johnson, an attorney, started buying San Diego real estate in the

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Investors snapped up units in ICON, a new luxury condo in Miami Beach, well before the building was completed.

set his sights on Arizona as prices in California climbed. "It came to a point where there weren't any properties that made sense to buy," says Mr. Friis, who recently sold a small apartment building in San Diego and used the proceeds to buy a 24,000-square-foot shopping center in Tucson.

In Long Beach, Calif., there's "more of a demand than ever for investment property," says Richard Gaylord of Re/Max Real Estate Specialists. "The problem is that inventory is so low that I'm pulling my hair out trying to find them stuff."

Many buyers are new to real-estate investing. In Tucson, "people who never looked at real estate as being part of their investment portfolio...are either acquiring residential income property or participating in partnerships," says Rosey Koberlein, president of Long Realty Co.

In Warwick, R.I., broker Ron Phipps says many investors are opting for properties with good locations, even if a high purchase price means they won't cover their costs for the next few years, Mr. Phipps says. Others are buying investment properties that may eventually be used by a child or aging parent.

Real-estate purchases are becoming increasingly popular among people with \$1 million to \$10 million in assets, says Kevin Ruth, a senior vice president and director of financial planning at UBS AG's UBS Financial Services unit. In the Wisconsin Dells resort area, condos that double as second homes and rental properties "are going like hotcakes," says Michael Dubis, a financial planner in Madison, Wis.

The rise in investment purchases has caught the attention of many who track the housing market, including Federal Reserve Board Chairman Alan Greenspan. In a speech before America's Community Bankers in October, Mr. Greenspan noted that purchases of single-family homes for rental or use as second homes have grown in recent years, though he said they still accounted for less than 11% of total home-mortgage originations in 2003.

Some housing experts worry that investor demand has helped fuel the recent gains in home prices and could accentuate any downturn as interest rates rise and demand slows. The country is experiencing "investor-driven price increases in certain markets. ... And these markets could soften as investor demand wanes, as it inevitably does," Fannie Mae Chairman Franklin Raines said in a speech last month.

The perils of betting on short-term profits has been particularly apparent in Las Vegas, where speculators helped push prices up nearly 54% in the past year, the highest growth rate ever measured in a metropolitan area, according to the National Association of Realtors. When a falloff in sales and traffic led a handful of builders to cut prices this fall, the reductions "hit investors hardest," says Larry Murphy, president of SalesTraQ, which tracks the Las Vegas real-estate market.

Owning real estate, meanwhile, isn't as simple as purchasing a stock or a bond. Investors need to be ready to handle late-night calls about broken water pipes and faulty heating systems -- or hire someone to manage these and other headaches. Management fees often run 5% to 10% of gross rents. Moreover, rising housing prices are, in many cases, making it tough for investors to cover expenses -- such as mortgage payments and property taxes -- through rental payments.

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The five top-performing mutual funds that invest in REITs and other real-estate companies, based on their five-year records.

Company (Ticker)	Five-year annualized return	Year-to-date Return	Dividend Yield	Expense Ratio
Alpine U.S. Real Estate Equity (EUEYX)	29.15%	23.54%	0.01%	1.67%
CGM Realty (CGMRX)	27.7	20.80	0.43	1.02
Phoenix-Duff & Phelps Real Estate Sec. (PHRAX)	23.90	26.04	2.02	1.30
Alpine Realty Income & Growth (AIGYX)	23.84	22.23	4.07	1.38
Third Avenue Real Estate Value (TAREX)	23.30	23.95	1.77	1.19

Source: Morningstar Inc.

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