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The Buy-and-Hold Connection: Investing Fundamentals, Courtesy of the American Homeowner The American Dream—or Reality?

This book has a good deal to do with the fundamentals of investing, and a good deal more to do with how to perform at a higher level than the great herd of investors who settle for average results. But before turning to above-average performance, my first duty is to convince you that even average investing is well worth your time. In this chapter, we investigate the very concept of average investing—and from what I believe to be a very distinctive and instructive point of view:

I believe that if you can truly understand the dynamics and payoffs related to buying and living in a home, you will stand on a rock-solid foundation from which to invest in the stock and bond markets. In other words, this foundation is the average on which we build an above-average strategy.

When stacked against each other, home-owning and stock market investing form a weighty parallel because each activity so completely instructs the other. You see, homeowners and stockowners are identical in many ways. They desire the returns that their investments will generate and, more important, believe that these returns will, in fact, materialize. They display levels of risk that, in relation to returns, are satisfied by their investments—basically, their fear of "getting burned" is low. The lingo attached to each of their activities is much the same as well. Let me throw a few terms at you, all of which we discuss in this chapter: *buy-and-hold, price appreciation, transaction costs, capital gains, imputed income, leverage,* and *total returns.* Taken together, these terms set the parameters of performance for investors of all stripes. And for homeowners in general, they set the parameters for *average* performance.

When it comes to buying and living in a home, average is the established and profitable American way. Think of it this way: If you invest in something and it appreciates in relation to a historical average that has proven to deliver substantial positive returns, then you win. You make money. *Average,* here, equates with *success*—and with homeownership: In general, the prices of all homes go up over time. So if you invest in a home, you stand to gain on that investment. This is why you "buy," and it is one of the two dominant forces that drive homeownership. The second force has to do with why you "hold" that investment. For now, I state plainly that you hold it until it becomes profitable to sell it.

Already you should sense a parallel between owning a home and owning a portfolio of stocks and bonds. Each you buy, and each you hold. Simple enough. But *simple* will empower you in the pages

ahead as we transfer the fundamentals of home-owning into the foundational rules for investing in the stock and bond markets.

The American Dream: As Real as Ever

Millions of Americans understand the value of investing in residential real estate. They start small, and when the time is right, they sell, at a profit, and move to a bigger place. Some call this the American Dream, but it's not a dream at all. At this writing, homeownership in the U.S. stands near 69 percent—up from 63 percent in 1970, 55 percent in 1950, and 48 percent in 1930.[1] That's an impressive climb. At no time in history have more Americans owned homes—that's yet more evidence that this is not only the land of opportunity, but also the land of personal responsibility. After all, what's more responsible than taking advantage of an investment that's almost certain to make you better off? True, no investment is 100 percent guaranteed. But historically, homeownership comes pretty close.

Most Americans know this. They know that home prices usually go up over time, so much so that the fears attached to home-owning relative to other forms of investing are very low. They know that if they hold on to their properties long enough, they might very well enjoy a nice payday if they decide to sell. The data backs this up, and conversations at the kitchen table verify this reality every day: "You paid *how much* for your house 20 years ago? And now it's worth *how much*? Holy cow." Americans also know that owning and living in a home is a low-tax activity; in fact, for most Americans, it is a tax-free activity, a tremendous incentive to buy rather than rent.

These are the basics of the buy-and-hold strategy as it relates to residential real estate. But with participation rates in this strategy near 70 percent today, buy-and-hold becomes an authoritative force worthy of deeper investigation. Who are these buyers and holders, and what are the range of factors that both motivate and guide their actions?

In what follows I'll introduce you to two: Their names are Jennifer and Carlos, and their actions in relation to the buy-and-hold formula are like a textbook.

The Motivating Force of a Demand-Led Expansion

Jennifer and Carlos are a lot alike. After finishing college the same year, they each landed good jobs in the same U.S. city. They worked hard, saving and planning, and as luck would have it, they purchased homes in the same suburban development during the same month three years later. The units they liked went for $200,000 a piece, and they each figured they could live happily with one bedroom and one small bath until they decided to settle down and have families. After a few years of bumping into each other nearly all the time, the two began to date, and it wasn't all that long before Carlos proposed to Jennifer. At the five-year mark of homeownership and only six months before their wedding day, they put their units up for sale—but they had gauged the market accurately and knew that selling wouldn't be too difficult in a short period of time. And they were right. Their sales went quickly and profitably, and with cash in hand, they began their lives together deeper in the suburbs, where the homes come with in-ground pools, big lawns, and two-car garages.[2]

A nice story with a happy ending? Sure. But the forces of economics and fundamental investing behavior are swirling behind the scenes.

When Jennifer and Carlos shopped for their original homes, they each noticed two things: First, a lot of properties were available. Second, prices overall seemed pretty steep. But this latter fact didn't turn them off, if only because they believed that prices would continue to increase the longer they put off making a purchase. So they entered the house-hunting market with enthusiasm—in effect, joining the very powerful group that today drives America's *demand-led* housing

expansion: Simply stated, steady economic growth in America over time has led to a steady increase in the demand for homes. As the population has become larger and more affluent, it has increasingly looked to own residential real estate, raising the demand for this particular good.

In economic terms, any such demand-led expansion can be satisfied through either price increases, increases in supply, or both. In the U.S. example, an upward shift in the demand for homes has produced a movement along the "supply curve" that has resulted in higher prices *and* higher output (or more homes).

Jennifer and Carlos might not have been able to state this like an economist, but they understood it well enough: Homeowners profit very simply because they buy and hold properties. Buying and holding allows people to take advantage of the secular uptrends in home prices, while riding out any short-term downward fluctuations in prices. This is an insurance policy on success. Buy something at $1, hold it while its value increases despite any bumps along the way, and sell it at $2—or more. That's the one-two punch for homeownership, just as it's the winning combination for investing in the stock market.

Buy and Hold, but for How Long?

There's one obvious follow-up question to all this: How *long* does one hold? Foresight is part of the answer—one holds a home until selling it is profitable, a time in the future that one can easily calculate by studying price movements in a neighborhood. But I'll argue that another, equally influential force goes a long way toward determining buy-and-hold behavior: It is the *transaction cost*—and, in fact, it's what kept Jennifer and Carlos in their homes long enough for the two to finally get together.

In the U.S., the average homeowner owns a house for between four-and-a-half and seven years. This holding period can be explained

in good part by the transaction costs associated with the purchase and sale of a home combined with the expected increase in average home prices. Technically, a transaction cost is the difference between the price a purchaser pays and the net price a seller receives. In this regard, it is similar to a sales tax: It drives a wedge between the price the consumer pays and the price the seller pays. In tax terms, the dynamic is simple and often minimal. Seven cents on the dollar doesn't feel like all that much when you buy a $10 shirt. In the case of residential real estate, however, transaction costs can be substantial and often determine the point at which homeowners feel "free" to sell their properties.

Continuing with the story of Jennifer and Carlos, they were each able to sell their properties for $240,000. Five years earlier, the purchase price in both cases was $200,000, so it looks as if they each cleared $40,000—a 20 percent gain. But if the transaction costs each suffered $20,000, or 10 percent, they each realized only half that amount ($40,000 – $20,000 = $20,000), for a 10 percent gain net of transaction costs. Jennifer and Carlos both did well, but those transaction costs mattered.

Transaction Costs (Greatly) Influence Holding Periods

I've gone through the pain of moving several times during my marriage, so I can attest to the fact that transaction costs can be significant. Today, based on average realtor fees, we can set the initial transaction cost at around 6 percent. Any financing involved in the transaction adds some costs (bankers and lawyers need to get paid, too). And you can also throw in moving expenses as well as the psychological costs to the family members who are moving. (Psychological costs might be hard to calculate, but they do exist.) Putting all this together, we can make a reasoned estimate that the transaction costs

involved in purchasing residential real estate could easily exceed 10 percent of a home price in general.

So if a family moves, how long will it take before the price appreciation of their new house makes up for the transaction costs incurred in selling their old one? Well, since 1960, the median house price has gained an average of 5.6 percent per year. This means that the transaction cost of an initial purchase and move, using the estimates we just made, is equivalent to at least one year's worth of home appreciation (5.6 percent) and probably two years or more. Viewed this way, one can safely argue that, unless forced to move by circumstances, any move a homeowner makes based purely on investment considerations requires a holding period long enough to attain returns that at least make up for the original transaction costs.[3]

Here it would seem that upward-trending home prices are the true friend of the homeowner; they will systematically, and in a relatively short period of time, compensate for transaction costs incurred. But what if home prices in an area are going down? Should homeowners in the neighborhood panic? The answer, based on the data and personal experience, is more than likely a big "No."

Riding Out the Dips: A California Story

Once again, no investment is 100 percent guaranteed. Sometimes pockets of the housing market are infected by price declines—such as Texas during the oil-price drop of the 1980s, California in the early 1990s, and Northern California after the Internet bubble popped in 2000. But these are fluctuations around the long-term trend. Although home-owning is not always a sure thing on a shorter-term basis, the longer you own a property, the greater your chances are of navigating through any disturbances in the market.

In my home state of California, real-estate prices declined by a third in the early 1990s. Worse, in many cases, home prices fell *below*

the value of mortgages. In California, home loans are "nonrecourse," meaning that when homeowners walk away from mortgages, creditors must either chase them down or take possession of their vacated properties. In general, creditors have chosen the latter. So back in the early 1990s, the temptation to abandon a home in California and let the creditor worry about it was great. But did those who took this option act prudently (at least, in a cold, economic sense)?

This is a simple calculation. Using the average annual gain of the median home price, 5.6 percent, we can figure out how many years a sample California couple in the early 1990s needed to wait to recapture the full value of their property. (Central to this calculation is the belief that home prices can recover from situations such as the one that occurred in California. But the long-term trends for home prices in the U.S. are simply too positive and reliable not to be banked on.) Let's assume that our California couple held a home loan with an 80 percent loan-to-value ratio (meaning that the value of the loan was 80 percent of the home price) when the price shock occurred. So a 30 percent decline in the value of their home meant their loan was worth 10 percent *more than* the value of their home. That is, the California couple was suddenly 10 percent underwater. Time to flee? Well, we now know this 10 percent deficit to be in the neighborhood of two years' worth of home appreciation, on average, or 5.6 percent plus 5.6 percent. So if the California couple held on to their house for just two years more, they may very well have been made "whole" again.

On the other hand, had they jumped, they would have lost even more than their original investment. The loss the bank or lender would have realized if the house were taken back would have been considered a "gift-in-kind" to the couple that abandoned their mortgage. The couple would have been expected to pay taxes on that gift, and the mortgage bank would have sent them a 1099 tax form to facilitate the process. So what we now have are two types of incentives: On the positive side, we have the historical appreciation of home

prices; on the negative, we have the complete loss of an original investment, coupled with a sudden gift-in-kind tax owed to the IRS.

That, in a nutshell, is why people tend to buy and *hold* through thick and thin—homeowners and stock investors alike.

The Returns: Capital Gains

Something in this story might already be telling you that it pays, in general, to stick with your investments. It does. And now you know the minimum length of the holding period: until the transaction costs are covered. After that, your choices are clear. You can switch to another investment if you feel the new investment will give you a higher rate of return. You will incur new transaction costs if you decide to switch, but. presumably. the new investment will, in time, cover those costs and produce returns to your liking. Alternatively, if no new investment can make such a promise, you can stay the course with your original investment, further minimizing the impact of the original transaction costs and maximizing your net take.

Applied to homeownership, it's interesting to consider that the buy-and-hold formula is largely *induced* by transaction costs: Homeowners generally will not consider cashing in until those costs are covered. And once they are covered, they still might sit on their properties, particularly if they're interested in making hay with their investments. And by "hay," I mean *capital gains.*

A capital gain is the increase in the value of an asset that you realize when you sell that asset. Jennifer and Carlos each sold their properties for $240,000, or 20 percent more than they paid for them. Twenty percent is a nice capital gain over five years.

If you round out the average holding period for homes in the U.S. to 5 to 7 years and look back at the appreciation of homes for the last 45 years, you clearly can see the possible magnitude of capital gains

that homeownership offers. It's a pretty wide range: In the 45-year period between 1961 and 2005 (see Table 1.1), people who sold their homes in the five- to seven-year holding period realized a minimum 11.23 percent capital gain, on average, and a maximum 76.28 percent gain. These gains are based on the appreciation of owner-occupied residential real estate in the U.S., with the minimum gain coming in both 1966 and 1967 after a holding period of five years, and the maximum gain occurring in 1980 following a seven-year holding period. Both the low and high results are worlds apart, but, importantly, each leaped an estimated transaction cost of 10 percent and brought additional capital gains, to boot.

TABLE 1.1 Holding Period Appreciation for Owner-Occupied Residential Real Estate

	1 Year	2 Years	3 Years	4 Years	5 Years	6 Years	7 Years
1/1/61	3.74%						
1/1/62	3.93%	7.67%					
1/1/63	1.89%	5.82%	9.55%				
1/1/64	1.82%	3.71%	7.64%	11.38%			
1/1/65	3.45%	5.28%	7.16%	11.10%	14.83%		
1/1/66	0.14%	3.59%	5.41%	7.30%	11.23%	14.97%	
1/1/67	3.93%	4.06%	7.52%	9.34%	11.23%	15.16%	19.09%
1/1/68	4.23%	8.16%	8.29%	11.75%	13.57%	15.46%	17.35%
1/1/69	8.12%	12.35%	16.28%	16.41%	19.87%	21.69%	23.52%
1/1/70	5.36%	13.48%	17.71%	21.64%	21.77%	25.23%	28.68%
1/1/71	7.53%	12.89%	21.01%	25.24%	29.17%	29.31%	29.44%
1/1/72	7.38%	14.92%	20.28%	28.39%	32.63%	36.55%	40.48%
1/1/73	7.92%	15.30%	22.83%	28.19%	36.31%	40.54%	44.78%
1/1/74	10.19%	18.11%	25.49%	33.02%	38.38%	46.50%	54.62%
1/1/75	9.81%	20.00%	27.92%	35.30%	42.84%	48.20%	53.56%
1/1/76	7.63%	17.45%	27.64%	35.56%	42.94%	50.47%	58.01%
1/1/77	11.87%	19.50%	29.31%	39.50%	47.42%	54.80%	62.18%
1/1/78	12.68%	24.55%	32.18%	41.99%	52.18%	60.10%	68.02%
1/1/79	13.43%	26.11%	37.98%	45.61%	55.42%	65.61%	75.80%
1/1/80	11.04%	24.47%	37.15%	49.01%	56.65%	66.46%	76.28%
1/1/81	6.53%	17.57%	31.00%	43.68%	55.55%	63.18%	70.81%

	1 Year	2 Years	3 Years	4 Years	5 Years	6 Years	7 Years
1/1/82	2.09%	8.62%	19.66%	33.09%	45.77%	57.63%	69.50%
1/1/83	3.62%	5.71%	12.24%	23.28%	36.71%	49.39%	62.07%
1/1/84	2.94%	6.56%	8.65%	15.19%	26.22%	39.65%	53.08%
1/1/85	4.19%	7.14%	10.76%	12.84%	19.38%	30.42%	41.45%
1/1/86	6.16%	10.36%	13.30%	16.92%	19.01%	25.54%	32.08%
1/1/87	6.39%	12.56%	16.75%	19.69%	23.31%	25.40%	27.49%
1/1/88	4.23%	10.62%	16.79%	20.98%	23.92%	27.54%	31.16%
1/1/89	0.22%	4.46%	10.85%	17.01%	21.20%	24.15%	27.09%
1/1/90	2.75%	2.98%	7.21%	13.60%	19.77%	23.96%	28.15%
1/1/91	5.40%	8.15%	8.37%	12.61%	19.00%	25.16%	31.32%
1/1/92	2.64%	8.04%	10.79%	11.02%	15.25%	21.64%	28.03%
1/1/93	3.35%	6.00%	11.39%	14.15%	14.37%	18.60%	22.83%
1/1/94	3.90%	7.25%	9.90%	15.29%	18.05%	18.27%	18.49%
1/1/95	3.03%	6.93%	10.28%	12.93%	18.32%	21.08%	23.83%
1/1/96	4.68%	7.72%	11.62%	14.97%	17.61%	23.01%	28.40%
1/1/97	5.05%	9.74%	12.77%	16.67%	20.02%	22.66%	25.31%
1/1/98	5.28%	10.33%	15.01%	18.05%	21.95%	25.30%	28.65%
1/1/99	3.75%	9.02%	14.07%	18.76%	21.79%	25.69%	29.59%
1/1/00	4.19%	7.93%	13.21%	18.26%	22.95%	25.98%	29.01%
1/1/01	6.14%	10.33%	14.07%	19.35%	24.40%	29.08%	33.77%
1/1/02	6.74%	12.88%	17.06%	20.81%	26.08%	31.14%	36.19%
1/1/03	7.26%	13.99%	20.13%	24.32%	28.06%	33.34%	38.62%
1/1/04	7.97%	15.23%	21.96%	28.10%	32.29%	36.03%	39.78%
1/1/05	5.56%	13.53%	20.78%	27.52%	33.66%	37.85%	42.03%

Source: Global Insight

Perhaps more important, for the sample period in question, no evidence exists that the aggregate of home prices ever failed to post positive gains. This means that even if you hold a property for one year, you have a good chance of making a capital gain. (At face value, the data does not reflect local price dips, such as those experienced by Californians in the early 1990s. However, the broad data is more assurance that homeowners should ride out any price-decline storms.)

It would seem that residential real estate is something of a capital gains–generating machine. And the machine still functions when we figure in taxes. Since 1997, single individuals selling their homes have been exempt from paying taxes on the first $250,000 in capital gains they realize.[4] For couples, the tax-free amount is a whopping $500,000. Thus, in most cases, homeowners in America can roll over their investments from one house to another tax-free, quite often increasing their cost basis, or the price they pay for a residence. Put another way, the new home price becomes the new number from which the $500,000 in tax-free capital gains then is calculated.

The Returns: Imputed Income

Homeowners also enjoy the income produced by their properties, which, more technically, is the *imputed income*—an amount that is not necessarily visible in the value of a house, although it does exist. Simply, the imputed income of a home is the amount of money one would have to spend in renting an equivalent residence, had one not owned the home in the first place. Specifically, you can think of this income as the imputed rent. If you own a home and live in it, you essentially act like a renter who is not paying any rent. This sounds like a nice deal, and it is. Under current law, homeowners do not have to report the income attributed to living in their homes, so imputed income is also tax-free. (You also can think in terms of the imputed income that *you* carry around. If you are an electrician and you rewire your house, you performed a service that has a monetary value and cannot be taxed.)

Imputed income is a valuable thing, and you can get a good sense of this by looking at the contrasting situations of renting and homeowning. Let's say a group of renters spends a quarter of their monthly incomes on rent, and a group of owners spends a quarter of their incomes on mortgages. Let's further assume that members of the two groups earn roughly the same amount and live in comparable houses.

Okay, so it's the first of the month, and rent and mortgage payments are due. The renters use their income, which is taxed either paycheck to paycheck or when they file with the IRS, to make their rent payments; those payments are then taxed as income generated by their landlords. Contrastingly, the homeowners can deduct the interest on their mortgage payments when they pay their taxes, while not having to report the imputed rental income that comes with living in their homes. In effect, the homeowners are not paying as high a tax on their home-related income as are the renters.

Calculating Your Total Return

To discover the *total return* generated by any investment, you must account for all the gains (income + price appreciation) generated by the investment, the cost base (the initial price of the investment) to which those gains will be applied, the tax treatment of those gains in all their forms, *and* the transaction costs.

So, in terms of total return, how did Jennifer and Carlos do?

Well, the cost basis in each case was $200,000. Because they each sold for $240,000, they each had a capital gain of $40,000. And because they each lived in their homes rent-free for five years, we can set their imputed incomes at a reasonable $20,000 each (a modest $4,000 a year in imputed rent). This gives us a pre-tax total return on the sale of each unit of $60,000. And now for taxes. The $20,000 imputed (rental) income is not taxed at all. Because single taxpayers can realize $250,000 worth of capital gains every two years tax-free, the $40,000 in gains is not taxed, either. This means that the pre-tax and post-tax total return is the same for each: a full $60,000, which is 30 percent of the original cost base. However, after subtracting 10 percent in transaction costs, or $20,000, based on an original purchase price of $200,000, the total return drops to $40,000. In percentage terms, a 30 percent total return falls to 20 percent, although this is still an attractive number.

And because Jennifer and Carlos finally got married, their total-return story climbs one more profitable notch. Again, for a married couple, the first $500,000 in capital gains on the sale of a home is exempt from taxes. Putting their resources together, if Jennifer and Carlos bought their next home for $400,000 and sold it five years later for $500,000, again moving up in life, they would pay no capital-gains taxes on that transaction.

When it comes to total returns, it's hard to beat homeownership. And the case can be made even better when you look at how homes are financed.

The Impact of Leverage on Your Total Return

As I've noted, Jennifer and Carlos are a lot alike—almost identical. But Jennifer is a lot smarter than Carlos, as I see it. Not yet revealed in their story is that, when they purchased their first homes, Carlos decided to pay the entire $200,000 up front, while Jennifer opted to finance her purchase by putting down $40,000, or 20 percent.

This was a very smart move on Jennifer's part. When she sold five years later, the $60,000 she cleared (capital gains + imputed income) represented a gain of 150 percent because it was based on an original investment of $40,000.

This example shows the impact that *leverage* can have on the total return of an investment (leverage being the degree to which an investor or business uses borrowed money). Borrowing often gets a bad rap because it is thought of as acquiring and spending money that is not yours. But leverage can increase a shareholder's return on investment because it is the use of smaller amounts of cash to obtain assets of greater value. Jennifer was entitled to the total gains of her house, which were applied to only her original investment when calculating her total return. So by putting down only 20 percent, or one-fifth, of the purchase price, she essentially leveraged her investment (or down payment) five times when compared to the purchase price.

Yet by risking only one-fifth, she got control of the whole investment and captured the full capital gains produced by her property.

Now, whether this is a wise strategy depends on what homeowners do with the money they decide to not put toward their homes when they make their purchases. Let's say Carlos had decided to put down only 20 percent of the original purchase price, or $40,000, just like Jennifer. This means he would have had $160,000 to "put to work" in another endeavor. That's a good amount, and to make certain that the new endeavor would generate some additional hay, it would have to pay only in excess of the loan rate of his mortgage.

Let's say that in the five years he held his home, he netted 2 percent over the loan rate by way of a new endeavor (which could have been an investment in the stock market, the bond market, or a business). This means he would have added a 10 percent return (2 percent × 5 years), or a total of $40,000. This amount would be subject to taxes—capital gains, dividend, and/or income taxes—as well as the transaction costs related to the investment. But even when these are factored in, his additional take still would have been worth it.

Of course, maybe Jennifer simply didn't have that $200,000 to put down at the time of her purchase, making her smarter than Carlos only by default. But Carlos proved rather risk-averse, in that he did not leverage the investment in his home and put his available money to work where it could have grown in excess of the loan rate.

Onward and Upward to the Stock Market

You thought this was a book about investing in the stock market, and now you're being led to believe that owning a home might be the best place for your money. Well, there are important twists to this story.

In touring the ins and outs of homeownership, you now should understand how to measure any investment—how to compute your total return while accounting for the transaction-cost effect. Taken

together, this should always be your bottom line—it will allow you to assess your investment performance as well as judge how you're doing relative to other investors. You also should have a grasp of the fundamental investing concept known as buy-and-hold, *through thick and thin.* When you think of it, what do you get when you average out the good times (the thick) and the bad (the thin)? Well, you get average performance over time. Add in the fact that home prices appreciate significantly over time, and you have a winning, though average, formula.

So armed, we can now make the case for taking the next step to owning and managing your very own portfolio of stock and bond investments. If you can understand the fundamentals of owning a home as outlined in this chapter, you can grasp the basics of investing in the stock market. But in the next two chapters, we use the same fundamentals to show how the returns generated by stock market investing can soundly beat the returns delivered by homeownership. In doing so, we inch up from average to above-average investing. Perhaps, not surprisingly, transaction costs will again hold center stage: Because these are so much lower relative to stocks than to residential real estate, unlike Jennifer and Carlos, you won't have to hold your investments for five or so years to generate a total return to your liking.

Endnotes

1. U.S. Census Bureau. According to the National Association of Realtors, U.S. homeownership could exceed 70 percent by 2013.
2. Jennifer and Carlos are fictional representations of real-life Americans in terms of the average period of time they held on to their properties before selling and their rationale for doing so (e.g., their mutual desire to profit on their investments,

which required that they hold on to their investments long enough so that their initial transaction costs were covered and their desire for capital gains was satisfied).

3. If you own a home, you might have to move regardless of whether you covered your transaction costs or whether you can get a better return on your investment elsewhere: Maybe your job changes or the size of your family outgrows your living space, and you simply must relocate. But without these pressures, the combination of when you cover your transaction costs and the total financial attractiveness (new transaction costs + the promise of higher gains) of housing alternatives determines when you leave one residence for another. Not only is this stated in terms of a financial best-practice, but it is how most American homeowners behave.
4. Since the passage of the Taxpayer Relief Act of 1997, married couples filing jointly have been exempt from taxes on profits (i.e., capital gains) of up to $500,000 on the sale of their residences. For singles, the exemption cut-off is $250,000. In both cases, sellers need to have lived in their homes for two out of five years prior to the sale.