

Should you buy or rent?

by Andrew K. Jones, CFP®

Often people have a false perception that purchasing a residence is always the better financial decision than renting a home because they think renting is like throwing money away. While home ownership has its advantages, in some situations it is more beneficial to rent rather than purchase a home. When deciding whether to rent or purchase a house, it is important to ask yourself a few questions: What are your goals of home ownership? What is your financial situation? Then, weigh the pros and cons of buying versus renting.

What time period will you live in the home?

The most important variable in your home ownership decision is how long you intend to live in the home. Home ownership has many upfront costs including closing costs, which may take a few years to recoup through building equity in your house. Remember if you don't have a guaranteed income stream or emergency cash reserves it may be best to consider renting in the event that you lose your job and you need to sell your residence. The flexibility of renting is beneficial for variable incomes because you can easily increase or decrease your monthly payment in line with your earnings by changing where you rent.

Can you afford a home purchase?

Don't let a home purchase become a burden on your ability to meet monthly expenditures or your emergency cash reserves. You should plan to make a 20% down payment when making a home purchase. The 20% down payment will protect you from the additional monthly expense of private mortgage insurance (required without a 20% down payment) as well as protect your finances if you need to sell your home in a declining real estate market. Large down payments give you immediate equity in your home and protect you from owing the bank money should you sell your home for less than your purchase price.

Your goal for total expenses for home ownership or renting (mortgage payment or rent, insurance, and taxes) should be no more than 28% of your gross income. If your housing expenses are greater than 28% of your gross income, you will likely be unable to save sufficient funds for retirement or pay for miscellaneous expenses such as a vacation or new car. Keep in mind that mortgage payments are protected from inflation because you lock in at a payment while rent payments can be increased each year to keep pace with inflation.

Have you considered maintenance costs?

When you live in a rental home and the hot water heater breaks or the air conditioning stops operating not only do you avoid the frustration of arranging a repair or replacement, you also avoid the expensive costs. Be sure to keep maintenance costs and renovations included in your housing budget when comparing buying and renting. You don't want to increase your debt through credit cards should you need a new oven after six months of home ownership.

Don't forget to include costs of Home Owner's Association (HOA) fees charged in condominium buildings and residential communities. Additionally, you will need to consider the costs of property taxes and homeowner's insurance. Homeowner's insurance is typically much more expensive than renter's insurance. Be careful of overestimating the value of your home ownership tax deductions. Costs of property taxes and mortgage interest payments will be mitigated because they are income tax deductible; however, these tax deductible expenses are still costs you would not have incurred if you were renting.

What is the outlook of the real estate market?

While it is difficult to predict the future of the real estate market, home valuations



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have declined in recent years which may help you find your new residence at a price you can afford.

With an increasing supply of houses on the market there may be more opportunities to find your dream home. Historically low interest rates also make home ownership more affordable. If you can find your ideal home at an affordable price now is a great time to lock in to a long-term mortgage at a low interest rate.

For many people owning a home offers emotional benefits. Try not to allow emotions to outweigh the financial analysis of home ownership versus renting. The New York Times has an excellent online calculator that includes every financial variable needed to think through your home purchase or rental decision www.nytimes.com/interactive/business/buy-rent-calculator.html. Remember to consider your planned time period of ownership and your financial resources when making the final comparison of buying and renting. Before you make this important financial decision, consider all the pros and cons of renting or buying your home.

