

Is Owning A Home Always Better Than Renting?

By Charles G. Hebert

Everywhere we turn it seems we are bombarded with the notion that buying a home is always preferable to renting. We hear statements like, "Young people need to build equity" or "Rent is just throwing money away" or "It is never better to rent than to own." The key point to take from this is that any time you hear the words "always" or "never," red flags should fly up and alarm bells should go off! Just remember, "never" is a very, very long time.

Making a Fair Comparison

In order to fairly evaluate the individual merits of owning a home versus renting, we must first place the cash flows required on equal footing, and then we can evaluate the future value of each option. For example, let's say you want to buy a house that will require a monthly cash outlay of \$1,000, which includes mortgage payment, basic fire insurance, principle mortgage insurance, neighborhood association dues, property taxes, basic maintenance, etc. The rental you are considering will cost you \$500 per month, which includes rent and rental content insurance.

To make a fair comparison, we would have to add an extra \$500 in cash flow to the rental option, which we will invest into a stock index mutual fund returning 10% annually over the long term. If we estimate to live in the home for 10 years, we would next calculate what the value of the stock market investment would become, and then calculate the equity we will have built in the home, accounting for principle payments and price appreciation.

The option with the largest total wins!

A Real World Example

Let's assume you are currently renting a home for \$600 per month plus an extra \$25 for rental content insurance. Over the years, you have managed to save several thousand dollars for the purchase of a new home. You find a home you absolutely love for \$100,000. This home will require monthly insurance payments (fire & flood) of \$100, property taxes of \$1,000 per year, annual maintenance expenses of approximately \$500, and \$3,000 in closing costs. If you put \$20,000 down on a 30 year mortgage at 6%, your monthly mortgage payments will be \$480, and total expenses will reach \$705 per month. Assuming you hold onto the home for 10 years and the home appreciates at 3% annually, you will realize a profit of \$67,987. The home purchase option sounds good so far, doesn't it?

Now let's look into the rental option. To equalize the cash flows, we will immediately invest \$23,000 into our stock index mutual fund - \$20,000 for the down payment and

\$3,000 for the closing costs. Also, for the entire 10 year period, we will invest \$80 per month in our stock index mutual fund to account for the difference in monthly cash flow between the two options. Assuming the stock index mutual fund returns 10% annually, at the end of the 10 year period your account value will be \$78,576 - or \$10,589 MORE THAN THE PROFIT REALIZED FROM THE HOME PURCHASE OPTION! In this example, the rental option is the correct choice.

Summary

From a strictly financial perspective, the correct choice between renting and owning changes frequently and depends on many factors. The key thing to remember is that to make a fair comparison, the cash flows between the options must be placed on equal footing. Once this is accomplished, the option with largest accumulated profit is the correct one.

Charles Hebert shares his views on personal finances from his website, [<http://www.smartmoneyadvocate.com/>] Smart Money Advocate, which advocates simple strategies for achieving financial success.