

## SHOULD YOU RENT OR BUY YOUR NEXT HOME

# Dollars & Sense

**M**ore than two-thirds of Americans own their homes. Many assume that it's better to own than to rent. After all, there are tax advantages to owning. In a booming market, a house's equity (its current value minus the mortgage balance) could grow tremendously. For most owners, their home is their greatest investment and the one most likely to provide a significant profit when sold.

But home ownership is not for everyone. Indeed, some people would be better off renting than owning. So, if you're thinking of moving, take some time to analyze whether it is best to rent or buy your next home. Following are some factors to consider.

### MORTGAGE VS. RENT

If you buy a house, usually you will have to make a down payment. Most lenders require that you put down 20 percent of the closing price. Many young adults have difficulty coming up with a down payment and may need assistance from family members. However, there are many loan programs that will permit the borrower to come into a home with less than 20 percent, assuming the borrower has excellent credit (above 700 FICO score). In addition, you may have to pay points (1 percent to 2 percent of the loan amount is considered normal) to the lender. There also may be additional fees and costs. Your mortgage professional should compare the pros and cons of paying points versus paying a slightly higher rate (without paying points).

One advantage of a mortgage is that you can deduct your monthly interest payments on the loan when you file your annual income taxes. Your interest payments depend on the loan period (usually 15 or 30 years) and the interest rate the lender charges. You can get a mortgage at a fixed rate (the interest rate never changes over the loan's life) or at an adjustable rate (the lender periodically adjusts the interest rate depending on various indices used by lenders). If the adjustable rate goes up, your monthly mortgage payment increases accordingly. "Interest only" loans have become increasingly popular since they reduce the monthly debt service by several hundred dollars; however, they should be used cautiously since they convert to adjustable rates within 3-, 5- and 7-year terms.

Most new owners reap the benefits of lower taxes by adjusting their withholding exemptions during the year to reflect the anticipated tax savings, thus they have more disposable income with which to pay the higher housing costs.

On the other hand, if you rent, you do not need a down payment. Normally, you will just pay first and last month's rent along with a security deposit upon signing a lease agreement. Your monthly rent usually remains the same for a set period, after which the owner may increase it. You do not get to deduct any of your payments from your income taxes, unless you use any portion of your home for business.

### INSURANCE

As a homeowner, you need homeowner's insurance to cover the cost of rebuilding part or all of your home in the event of certain disasters such as fire. The policy also reimburses you for the replacement costs of furnishings, clothing and other items in such situations, or because of burglary or theft. Homeowner's insurance, however, does not cover all disasters that may destroy your home. In some parts of the country, you may want to buy earthquake or flood insurance.

A renter does not need homeowner's insurance, as he or she will not have to rebuild the property. But a renter does need renter's insurance, which covers his or her clothing and furnishings. Renter's insurance costs much less than homeowner's.

Both homeowner's and renter's insurance provide some liability coverage. This will protect you financially should you be responsible for injuries to other people or damage to their property.

### TAXES

A homeowner usually must pay local property taxes, which are pegged to the currently assessed value of the property per the county of residence.

Accordingly, property taxes often increase over time. Renters do not pay property taxes, although the property owner probably factors property taxes into the monthly rent he or



she charges. Homeowners can deduct their property taxes from their income taxes, but renters cannot do so—even if a portion of their monthly rent goes to property taxes.

### ASSESSMENTS AND OTHER FEES

Communities may charge homeowners special assessment fees for improvements like sidewalks and street lighting. If you are a member of a homeowners' association, you likely will have to pay a monthly fee for upkeep of common areas, such as parks and swimming pools, and for the insurance that covers those areas. Your association agreement also binds you to maintain your property in accordance with its terms.

If you own a condo or are part of a co-op, you will have fees to cover maintenance and insurance costs of the building you live in. You still will need your own homeowner's insurance to cover personal liability and other items excluded in the general policy. These fees can increase over time, or the governing boards of the condominium or co-op may levy special assessments for major repairs or improvements. Renters, of course, do not directly pay such fees, although they may be "hidden" in their monthly payments.

### UPKEEP AND IMPROVEMENTS

Houses, apartments, condos and their contents deteriorate. Homeowners, therefore, should budget for things like periodic painting, plumbing repairs and replacement of air filters and broken windows. They may eventually want to make major improvements, such as modernizing the kitchen or the adding another room. Those that have homes with yards will need to maintain landscaping. Other expenses may include swimming pools and fencing. Renters, of course, do not directly pay for such things, but maintenance and improvement costs usually are lumped into their monthly payments.

### OTHER CONSIDERATIONS

A major consideration for determining whether homeownership or renting is best for you is time. How long do you plan to live in the house or the apartment? Usually the longer you plan to stay in your home, the greater the likelihood that homeownership may be right for you. A person who owns his

home and has lived in it for at least two out of the past five years does not have to pay capital gain tax on the first \$250,000 of profit (\$500,000 if a married couple) when the home is sold. Thus, if you live in a booming housing market where housing prices continually go up, you may be able to turn a nice profit as an owner. But if the housing market is flat or going through a downturn, you may lose money as an owner. In such markets, it may be better for you to rent.

You also should factor in your job situation and family status. If your job requires you to relocate every few years, renting will save you a lot of money. Likewise, if you plan to frequently switch jobs or are self-employed, renting may be less expensive in the long run than ownership. If you are single and without heirs, renting may be better than owning. But if you have a family, you may want the permanency that homeownership implies. Also, many landlords do not allow their renters to have pets or alter the property. These are things a homeowner normally does not need permission for.

Age, of course, is another consideration. The older you are, the less time you likely will have to pay off a mortgage and all the initial costs of homeownership. This may make renting more attractive to you. In some cases, elderly people with large equity but little income may benefit from a reverse mortgage, where a financial institution pays them a lump sum or monthly payments based on their age and the equity in their home.

Before you make the decision to rent or buy, you should discuss it with your family as well as a trusted financial adviser. You also may want to check a "rent or buy" calculator. Such calculators allow you to plug in fees, home cost, monthly payment and various financial assumptions, which can help you determine which option is best for you. 

