

Rent or Buy?

Many factors must be taken into consideration in making this decision. It is impossible to deal with all of them because each case is different, and because some factors are so deeply personal.

The myriad of potentially contributing factors aside, a few are common to all and it is just one factor that we address today.

Possibly the foremost factor is the cost difference between renting and buying. Again, many things influence this factor, not the least of which is the expectation of future value of the home being considered. In other words, how much will the home appreciate, or will it appreciate?

It is impossible to determine this figure with any degree of accuracy whatsoever. Proof of this can be found in the virtual blizzard of news articles, editorials, and commentaries speculating about a potential housing bubble. For purposes of this discussion, we remain neutral. Therefore, our figures contain neither a gain nor a decline in value. It is easy enough to plug in an annual appreciation figure if that is your belief.

One last comment before going into an analysis: the figures given are illustrative only and are not to be taken as tax advice. Individuals should consult their own CPA or attorney for an accurate analysis.

Consider a couple in the combined state and federal tax bracket of 45%, paying \$2,500 per month in rent. Assume they are contemplating buying a home with a purchase price of \$750,000. Without factoring in any potential future rent increases, property value increase, or maintenance costs of the home, let's make some simple calculations.

In order to make the calculations as simple as possible, assume the couple obtains 100% financing (paying only closing costs) and assume interest only financing. So, no investment and no loan amortization.

The total housing payment, consisting of interest, property taxes and insurance comes to \$4,519.

Obviously this is a before tax difference of \$2,019 per month. It costs more to buy the house.

But wait. Don't forget about income tax deductions. Included in the monthly payment of \$4,519 is \$4,219 for interest and property tax. The only non-deductible part of the house payment is insurance at \$169 per month.

Using the 45% combined rate, the couple saves \$1,898 in income taxes. So their effective monthly house payment drops to \$2,620. Compare that to \$2,500 in rent.

Again, we caution you that these figures are illustrative only. Your CPA will undoubtedly come up with something different. If he/she doesn't, you're paying too much for their tax advice. But to continue: if you believe the home will appreciate at, say, 3% per year (\$1,875 per month), the advantages of buying a home increase significantly.

Another thing to think about is the immediate "payment shock" going from \$2,500 per month to \$4,519. That's a big jump, but it can be mitigated by adjusting your monthly withholding to equal (as closely as possible) your tax savings. This gives you money in hand to make the higher monthly payments, which is more beneficial than a tax refund next year.

Also, the monthly payment includes \$781 for property tax in this example, so the actual payment each month is (only) \$3,738. You will pay 50% of the annual property tax each December and April. These dates were obviously set by someone with a twisted sense of humor, timing them to closely coincide with the Holiday Season and Tax Season.

Oh well, that's a minor annoyance compared to the other joys and benefits of home ownership.

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