Renting versus buying a home: Deciding what's best for you

When finding a place to call home, the decision to rent or buy can impact your lifestyle and financial situation. Both renting and buying offer distinct advantages and considerations, and it is important that you carefully evaluate them before making a decision.

For example, while renting provides the flexibility to change locations easily and typically requires less upfront costs, buying a home offers the potential for building equity and the freedom to personalize and invest in your property.

By understanding the differences that affect your lifestyle and your pocketbook, you'll be better equipped to make an informed choice that aligns with the life you envision.

The cost to get started

One of the first things to consider as you consider whether now is the time to rent or buy is how much of an initial investment of time and money you are prepared to put into your new residence. There are significant differences in up-front costs and ongoing maintenance and improvement costs to consider.

Renters: When you rent, you should expect to pay an application fee and security deposit of 1-3 months in rent payments. The security deposit is usually refunded back to you either at the beginning of the lease as a credit towards your first monthly payment or when the lease terminates, assuming there are no damages to the rental property.

Buyers: When you buy, you should expect to pay an "earnest money" deposit (typically $1,000-$2,000) to ensure that you are a serious buyer; this deposit is usually applied to your closing cost if you purchase the property. In addition, your mortgage provider will generally require a down payment of 20% of the home purchase price. Exceptions can be made using special mortgage programs such as FHA or first-time homebuyers. However, you may incur additional expenses to purchase private mortgage insurance until you have at least 20% equity in the property. The third set of expenses to plan for are the transaction's actual "closing fees" and home inspection costs.

Insights into your monthly payments

Both renters and homeowners share responsibility for monthly payments. Whether renting or buying, it is important to consider your financial situation and adhere to general guidelines that recommend spending 28% or less of your gross monthly income on housing expenses and a maximum of 36% of your gross income on all debts[1].

Renters: As a renter, you typically pay monthly rent to a landlord or property management company each month based on your negotiated lease for a specified period.

Homeowners: As a homeowner, your monthly payment is based on a predetermined amortization schedule that involves paying back your mortgage loan plus interest over time, often 15-30 years. Property taxes and homeowners insurance can also be included in this payment schedule if the mortgage company is responsible for paying the bills on your behalf.

Your interest rate can significantly impact the overall affordability and long-term cost of owning a home. Let's look at an example of a mortgage interest rate of 7%[2] has on the monthly payment and overall price you pay for a home. Suppose you are buying[LG1] a home for $400,000 with a down payment of 20% ($80,000) and a 30-year mortgage. Your monthly payment would be $2,129, and over 30 years; you would end up paying $766,440 for your home. In a lower interest rate environment, your monthly payment and overall cost to own your home would be significantly less.

Taxes and insurance add up

When comparing renting and buying a home, you must also consider property taxes and insurance costs.

Renters: As a renter, it is recommended that you purchase renter's insurance to protect your home. But, since you do not own the property or building, you don't have to worry about paying property taxes since the landlord takes care of that.

Homeowners: When you buy a home, you may receive some tax benefits, like deducting property taxes and mortgage interest payments from your taxes. Since these deductions may help reduce your tax bill, we recommend you speak with your accountant about this as part of your buying decision.

Building equity

One of the most significant advantages of buying a home is the opportunity to build equity. Equity refers to the portion of the property's value that you truly own. As you make mortgage payments over time, this will gradually reduce the loan amount and increase your equity stake in the property. Additionally, property values may appreciate over the years, further contributing to equity growth. This equity can serve as liquidity you can tap into in the future, either through selling the property or obtaining a home equity loan. On the other hand, renting does not accumulate equity in the same way since you do not have ownership of the property.

Understanding the potential for equity growth is essential when considering the long-term financial benefits and investment potential of buying a home. It opens up the possibility for tax-advantaged growth, therefore avoiding capital gains. However, it's crucial to understand that this increase in value only happens sometimes. Appreciation rates can vary widely due to shifts in the housing market, especially during varying market conditions, so the present rate may not accurately predict future value changes.

Maintaining a home

Another critical distinction between renting and buying a home lies in the responsibility for home maintenance.

Renters: As a renter, you may enjoy the advantage of not being directly responsible for the upkeep and repairs on the property. When a maintenance issue arises, such as a leaky faucet or a malfunctioning appliance, it is typically the landlord's or property management company's responsibility to address and resolve these issues at no cost to you.

Homeowners: As a homeowner, you are responsible for maintaining the property. Annual home maintenance costs, which can range from 1% to 4% of the home's value [3], are necessary to ensure the property's upkeep, preserve its value, and address any repairs or upgrades that may be required. This responsibility can be a significant consideration, as it requires time, effort and financial resources to maintain a home properly.

In addition to maintenance costs, many homeowners want to invest in home improvements. In fact, the scope of initial home improvements should be carefully considered with determining how much house you can afford and what those monthly mortgage payments will be.

Factoring in flexibility and stability

Flexibility and stability are two important lifestyle factors that differentiate renting and buying a home.

Renters: As a renter, you may enjoy more flexibility in the ability to change locations relatively easily and less responsibility when it comes to the financial obligations of owning a home. However, this flexibility may come with accrued short-term costs — such as moving expenses — and the need to purchase new furniture to accommodate new properties.

Homeowners: Homeownership tends to imply a longer-term commitment and therefore, greater stability, allowing you to establish roots and build a sense of community.

How to decide what's best for you

The decision between renting and buying a home involves weighing various factors that impact personal finances, lifestyle preferences, and long-term goals. Understanding the fundamental differences between the two options is essential for making an informed choice. Renting offers flexibility, minimal maintenance responsibilities, and the absence of property taxes but lacks the potential for building equity. On the other hand, buying a home allows one to accumulate equity, enjoy stability, and benefit from tax deductions. Still, it comes with maintenance obligations, property taxes, and a long-term financial commitment. Each option has advantages and considerations, and it's crucial to assess your unique circumstances and priorities before deciding.

Your Mesirow Wealth Advisor can help you evaluate factors such as monthly payments, property taxes, insurance costs, equity growth, maintenance responsibilities, and flexibility, enabling you to determine whether renting or buying aligns best with your needs and long-term goals.

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[1]https://www.cnbc.com/select/what-is-the-28-36-rule-for-buying-a-home/#:~:text=According%20to%20the%2028%2F36,(including%20your%20mortgage%20payment

[2] https://fortune.com/recommends/mortgages/renting-vs-buying-a-home/

[3] https://www.usatoday.com/story/money/personalfinance/real-estate/2022/02/12/average-american-home-costs-3-k-per-year-to-maintain/49780837/