



To Buy or Rent? The Choice

Debra Pankow
Family Economics Specialist

In some parts of the country the American dream of owning your own home may no longer be a practical possibility for many lower and middle income Americans. Real estate prices have risen nearly out of their reach, and in addition, the investment benefits of home ownership have diminished. Annual home appreciation is now often less than the current inflation rate. While over the past 25 years home ownership has yielded higher rates of return than many other investments — including stocks, certificates of deposits, savings, and most bonds — in the decades since the eighties, home appreciation has been minimal. In some areas home values have actually declined.

So for many people, renting has become increasingly popular as the preferred housing choice in the 21st century.

Housing is the single largest budget item for most families. With the large variety of choices in today's housing market, the decision concerning what to buy or rent has become even more complex.

Housing Options

Renting

Usually when you think of renting you think of an **apartment**, a single-family unit within a larger unit. Some apartment complexes are as small as four units while others have hundreds of individual units.

Also available for rent are rooms, duplexes, individual homes, condominiums and townhouses. Another option is house-sharing — that is, renting a unit with someone else, and sharing the cost.

Buying

All of the following types of housing can be purchased new or used:

A **conventional home**. This is a simple one-family, site-built homes. Today most individual homes have about 1,200 to 1,800 square feet of floor space.

A **manufactured home**. These homes are increasing in popularity, especially among young married couples and retired couples. They were called **mobile homes**, but this term has become obsolete, since very few of these homes are actually ever moved once they are set into place. Prefabricated and modular homes fit into this category and are available in a wide array of sizes and styles.

A **cooperative apartment**. This is an apartment operated this way: the dweller buys a share in the corporation that owns the building, and then leases an individual unit from that corporation.



North Dakota State University
Fargo, North Dakota 58105

JULY 2002

A **condominium**. This is an apartment (in a multi-unit project) that is owned by an individual who also owns a proportionate interest in the common areas outside the apartment. Association fees are usually assessed monthly to cover common services and repairs such as garbage, water, yard care, and snow removal. Additional charges may be imposed by the membership.

A **duplex** or **twinhome**. This is a multi-unit structure that includes two housing units with a common wall or common ceiling and floor. Both units may have separate ownership. In some cases, one owner owns both units.

A **townhouse**. This is one of a number of side by side units in a row, each of which are owned separately.

ECHO Housing (elder cottage housing opportunity), also called a granny flat. This is a manufactured housing unit installed on the side or backyard of an existing single-family home to accommodate an elderly parent or other relative. It is designed for temporary use and removed from the property when no longer needed. Check on local zoning ordinances before considering this option.

What to Look For

Since housing is only one of the needs to be provided from the family income, consider it in relation to the total needs of the family.

- What size is your family? Do you expect the size to change in the next 2-3 years? In 10 years?
- What are the ages and gender of family members?
- What are their interests, goals and lifestyles?
- In what ways does the family entertain?
- Is family employment stable?
- How much is the family willing to invest without fear of loss?
- If renting, what is the lease period?

Consider the family lifestyle:

- Are there enough bedrooms?
- How far are members of the family willing to commute to school, work and other activities?
- Is there adequate storage space?

Because every family's needs vary, no one shelter can satisfy all those needs. The family should be prepared to make some trade-offs.

At What Price

Another consideration when determining the type of shelter is the monetary commitment. The amount that is spent is influenced by personal considerations and the amount of income, both present and future. A definite family budget permits a family to plan for future expenses and allows the family to determine more clearly how much money can be spent each month. It is necessary to weigh the advantages of investing savings in shelter rather than in other investment choices.

Rules of Thumb

There are several generally recognized rules of thumb to help individuals and families determine the amount of money to spend on housing. Housing expenses include not only the mortgage payment or rent, but also a wide variety of other household expenses such as utilities, water, telephone and even cable television. For a more detailed listing of items included in housing expenses, see the "Housing Expenses" budget form on the following page.

Many experts recommend that no more than 25 to 30 percent of total net monthly income be spent for total housing expenses. Another rule of thumb is that first-time buyers should not pay more than 2½ times their annual gross income. Yet another rule of thumb is that the monthly housing expense combined with other installment debts should not exceed approximately 33 percent of take-home pay.

General guidelines can be useful in helping consumers evaluate their own situation. In reality, however, your own situation needs to be carefully considered. Do you rely on two incomes? Is your job seasonal?

Advantages of Renting

- **Low initial investment.** Buyers need 5 to 10 times as much cash to move into a home.
- **Less costly.** Funds not used for a down payment or higher monthly payments may be invested in other forms of savings with higher returns, especially in situations where the property is kept less than four years.
- **Limited responsibility.** Problems and repairs are left to the landlord.

- **Less tax impact.** The renter is not influenced directly by fluctuating property values. Increases in property taxes are felt gradually.
- **Budgeting ease.** Rent is a fixed amount that may even include utilities.
- **Greater ease of mobility.** Leases may be very short term.
- **Less responsibility.** Renter not usually responsible for repairs and maintenance.
- **Lower insurance costs.** Only contents need be insured.
- **Low moving-in costs.** There may be less deposits required and no down payment.

Advantages of Buying

- **Cost savings.** In some areas and situations, the actual cost of ownership can be less than the cost of renting.
- **Leverage.** You control the property and realize capital gains from the very beginning.
- **Forced savings.** This is especially important if the buyer will pay down the principal balance by a considerable amount.
- **Tax advantages.** Interest and property taxes can be tax deductible when itemized.
- **Personal freedom.** There is a feeling of independence to remodel, redecorate or make improvements.
- **Less restrictions.** There are fewer rules having to do with noise, pets and children.
- **Better credit rating.**
- **Pride of ownership.**

Fitting the Housing of Your Choice into Your Budget

To aid your family or household in determining if they have the financial stability to afford the housing of their choice, the following form may be helpful. If records are not available to determine your spending patterns, look back at the past three months' spending and divide by three to find the average spent for each basic expense. Your check register and billing statements are a good place to start.

Living Expenses

Food	\$ _____
Clothing	_____
Transportation	_____
Medical and dental	_____
Recreation/entertainment	_____
Personal allowances	_____
Appliances/furnishings	_____
Insurance premiums	_____
Pension/retirement, etc.	_____
Education	_____
Savings	_____
Installment loans	_____
Miscellaneous	_____

Total living expenses (minus housing)	\$ _____

Now you can take your total monthly family income and subtract this figure from it. This will give you the total amount you have been spending on housing. You can break your housing expenses down on the following form. The form can also be used when you are looking at housing options.

Housing Expenses

Fixed expenses

Rent or mortgage payment	\$ _____
Property insurance	_____
Property taxes	_____
Association fees	_____

Flexible expenses

Heat	_____
Gas	_____
Electricity	_____
Water	_____
Telephone	_____
Cable television	_____
Special assessments	_____
Home and yard equipment	_____
Maintenance	_____
Other	_____

Total housing expenses \$ _____

For Additional Help

If you need additional help in determining whether or not your budget can handle increased housing costs, contact a mortgage lender, a real estate agent or a consumer credit counselor. They may have additional resources to help you make that decision.

In addition, there may be first time homeowners classes available in your community, which can make you eligible for special financing. Local real estate agents, lenders and your extension agent can provide further information.

Making the Choice

In making the choice to buy or rent, first identify the needs and long-range goals of the household. Consider the financial responsibilities. Then ask, "Do I really want the responsibility of owning?" It is important to remember that both the cost and personal factors involved in shelter decisions will change over time.

The general economic climate of the country and your community greatly affect the financial decision of whether to own or to buy. When rental costs are relatively low for example, when monthly rent on a \$100,000 property is .5 percent or \$500 — the house would be a lousy buy and renting would make more common sense. It also pays to rent if housing prices are consistently flat — that is, if the annual gain in value is less than 2 percent, or if it is consistently less than the inflation rate.

On the other hand, when rents approach 1 percent of market price (\$1,000 on a \$100,000 house or \$300 on a \$30,000 home), it generally pays to be an owner. In small rural communities it is not uncommon to see small houses for sale for \$5,000 to \$10,000 yet renting for \$200 to \$300. This represents rents from 2 percent to 6 percent of market price. If you think home ownership is for you, buying in these situations would be a good choice, from an economic standpoint.

The choice can only be made by the individual household. Will it be best, at this time, to buy? Or to rent?

Additional fact sheets available from the NDSU Extension Service

HE-238 Shopping For A Mortgage

FE-258 Saving and Investing Today . . . For Tomorrow

Other resources in North Dakota

Your local banker or mortgage lender.

Your local or state board of realtors.

For more information on this and other topics, see: www.ag.ndsu.nodak.edu

