

Comparing the Costs of Buying and Renting

When you are deciding whether to buy or rent, *and* you have a substantial amount of money in savings, you have two options: (1) use the money as a down payment for a home mortgage or (2) rent a home and use the money as an income investment.



Study Tip

A \$350,000 home that rents for \$2000 per month has a “price-to-rent” ratio of about 15, which is typical.

$$\frac{\text{Cost of home}}{\text{Annual rent}} = \frac{\$350,000}{\$24,000} \approx 15$$

EXAMPLE 5 Comparing Buying and Renting

You take out a home mortgage for \$250,000 for 30 years at 6%. After 5 years, you move to a different state and sell the home for \$367,850.

Expenses and Savings Related to Buying

Cost of home: \$350,000	Realtor’s fee: 6% of cost of home
Down payment: \$100,000	Home insurance: \$1000 per year
Mortgage: \$250,000	Property tax: 3% of cost of home per year
Monthly payment: \$1498.88	Home repairs: \$17,000
Closing costs: 2% of cost of home	Income tax savings (interest): \$18,000

Compare the costs of buying the home and renting a comparable home for \$2000 per month.

SOLUTION

Here are your expenses and savings with buying.

60 mortgage payments	89,932.80
Closing costs of 2%	7,000.00
Realtor’s fee of 6%	21,000.00
Home insurance	5,000.00
Property tax:	52,500.00
Home repairs:	17,000.00
Income tax savings	–18,000.00
Increase in equity	–17,850.00
Total:	\$156,582.80

If you had rented for 5 years, you would have paid $60(2000) = \$120,000$ in rent. However, you could also have invested the \$100,000 down payment and perhaps earned \$16,000 in interest. So, your total cost would have been about \$104,000.

So, in this case, the cost of renting is about \$53,000 less than the cost of buying.



Home maintenance is often called the “hidden cost of home ownership.” You should expect to spend between 1% and 2% of the cost of your home each year on home repairs and maintenance.

✓ Checkpoint

Help at Math.andYOU.com

- Describe other issues that can affect your decision to rent or to buy.
- Do you agree with the federal income tax policy that allows homeowners a deduction for interest paid on mortgages, but does not allow a comparable deduction for renters? Explain your reasoning.