

Should I Rent or Buy?

Even with the turmoil in the housing market over the last several years, owning a home is still part of the American Dream. Done the right way, a home is a solid investment that can build wealth over the years.

Even so, home ownership isn't for everyone. If your move is short term, you don't know where you want to live for the next 7 to 10 years, or if interest rates are high and property values are dropping, it may be worthwhile to rent – even if that means dealing with a landlord for a while.

You also need to determine if your career and income are stable. If you're just starting out in your career or planning to change jobs, and your income won't be steady, you might need more flexibility than you would get by locking yourself into a 15-year or 30-year mortgage.

Take a look at your personal life as well. Are you in a steady place or do you expect some significant changes over the next few years, such as a marriage, divorce or children? Knowing where you want to live and who you want to live with for the next five to ten years is crucial to deciding whether to rent or buy a home.

Keep in mind that while home ownership provides some security, it almost certainly won't give you the high returns provided by some other investments. If history is any indicator, you can reasonably expect an 8 to 10 percent annual gain in your stock portfolio. Home prices, on the other hand, typically follow the rate of inflation (the fluctuation of monthly consumer spending) over the long term. Housing economists say that home values typically rise just above the rate of inflation, or about 3 to 4 percent per year. (Since the housing crash in 2006, home values have dropped an average of 30 percent.)

On the other hand, home ownership offers a significant tax advantage. If you're single, you can keep up to \$250,000 in profits tax free when you sell your home. Married couples can keep up to \$500,000 in profits tax free.

And that's not the only tax advantage of home ownership. If you itemize your federal income tax return, your mortgage interest and real estate property taxes may be deductible. Also, the points you pay to get your mortgage in the year of purchase may be deductible. You should talk with your tax preparer to find out whether you'll benefit tax-wise from home ownership.

Determine if home ownership is right for you

Of course, buying a home isn't strictly a financial decision. For a lot of Americans, owning a home is an enormous emotional achievement. It makes them feel as though they've achieved a milestone with their finances.

On the other side of it, being a renter isn't that much fun. For most people, the thought of losing the security deposit every time they pound a nail or paint a wall isn't particularly appealing. But being a renter is often much less expensive than buying a home, and you're only committed to staying in the rental for the period of time specified in your lease. It might be a month, six months, or a year, but at the end of the lease, you have the flexibility to walk away if you don't like where you're living or who you're renting from.

Here are some other things to consider before deciding whether to rent or buy:

- Do you like a neighborhood enough to make a long-term commitment? This may sound too simple, but if you can't find a neighborhood and a home you just plain like enough to stay for seven to ten years, you probably shouldn't buy. Getting a tax deduction isn't as good as feeling emotionally connected to the neighborhood you live in.
- Research the sales price trends of homes in the neighborhood. If it looks like homes in the area are declining in value, then avoid making the commitment that comes with buying a home. You're probably better off renting—at least until the market changes.
- Buying a home requires cash – and lots of it. If you do decide to buy, and don't want to use an FHA loan, you will probably need to put down at least 20 percent of the purchase price—for example, \$30,000 on a \$150,000 home—and have an excellent traditional credit score (675 or above) to boot. (You'll need less cash for a down payment with an FHA loan.) Even with all the great deals on the housing market right now, lenders are very cautious. They're only going to give a mortgage to the best borrowers out there. If you need to boost your credit score before thinking about buying, take a look at some of our other articles about building good credit habits and improving your credit trustworthiness.
- Home ownership is a well of expenses. Don't forget, even with the tax breaks of home ownership, you will still be incurring out-of-pocket costs you wouldn't encounter as a renter—everything from the cost of ripping down wallpaper to repairing a leaky roof. You'll also have to consider paying county taxes, homeowners insurance and any homeowners' association dues. So before you buy, estimate how much those costs will be and make sure you have enough saved for these costs, plus your down payment and closing costs.

If you have the down payment and the credit score, can afford the monthly mortgage, the tax and upkeep that go along with it, and if you love your neighborhood and plan to stay there for at least five years, buying a home may be the way to go.

On the other hand, if you're unsure of where you want to be and if your job and love life will cooperate with a longer-term plan, being a renter will offer you the maximum flexibility and a lower-cost way to live.