

October 30, 2023 – Wealth Planning Commentary

Is the Buy vs Rent Debate Skewing Towards Rent?

One of the most ubiquitous financial decisions Americans make is whether to buy or rent a home. By some measures, the difference in the cost of buying instead of renting is at its highest since 1996. The average monthly mortgage payment is now 52% higher than a new rental. Higher interest rates and strong home prices make renting an attractive option. However, as with any important financial decision, the details and intentions of occupying a home matter.

The average cost of a fixed-rate 30-year mortgage in the U.S. was 8% in October. This current rate is higher than the fifty-year average of 7.75%. Homes are maintaining their value and recently matched the July 2022 high according to the S&P/Case Schiller index. Many current owners don't want to sell, leading to a low inventory of available homes to purchase and higher prices for the ones for sale. Homeowners who locked in historically low interest rates during and after the pandemic are often unwilling to give up a low-interest rate loan for a new, high-interest rate loan, even if they would prefer to move.

Although renting might be a more financially sound option today, if one plans to stay in a home for a reasonable amount of time, it could make more sense to buy in the long term. A commonly cited rule of thumb for home ownership is the five-year rule; this adage recommends renting unless the plan is to stay in the property for at least five years. One can improve upon the rule of thumb by performing a breakeven analysis and assessing the costs of renting versus owning (or vice versa).

Those looking to purchase a home might not have considered the hidden costs of buying. A break-even analysis can include cost assumptions for general maintenance, property taxes, HOA fees, and renovation estimates. It's also important to incorporate a lower return assumption for homes compared to a liquid investment portfolio; this is based on the U.S. stock market historically outperforming residential real estate. Time and hassle are other hidden costs, albeit more qualitative.

A break-even analysis may consider factors that favor buying. For instance, it's possible to finance a purchase with an adjustable-rate mortgage in anticipation that rates will go down, and then refinance if they do. Likewise, a homeowner can refinance a fixed-rate mortgage if rates decrease in the future. Another benefit of buying is the ability to build equity: the longer the client holds the property and pays down the mortgage, the more equity they will build. Lastly, homeowners enjoy tax benefits such as the mortgage interest deduction, property tax deduction, and homeowner's gain exclusion upon sale.

Once all the variables of a home purchase are factored in, buying may cost more than renting. Does this mean buying is a bad idea? Not necessarily. Buying might outweigh renting if home ownership will bring satisfaction. Math is not the only determinant – assuming that the home purchase will not jeopardize the long-term wealth plan and is within the purchaser's means.

There are qualitative factors to consider in the conversation. Some investors are biased toward ownership. A home is a tangible asset, which can be comforting because it is easy to understand. Homeowners may find security in knowing they control the property and cannot be evicted by a landlord. Others might embrace avoiding the inevitable fluctuations in the rental market by 'locking in' a consistent, regular mortgage payment. Landlords are now using AI to price rentals, and this may lead to aggressive increases. Lastly, a 2023 survey from Bankrate found that 74% of U.S. adults cited homeownership as an essential part of the American dream. Thus, homeowners may consider viewing their primary residence as a personal use asset rather than as an investment.

On the other hand, renting provides flexibility. Moving is cumbersome, but it's easier to terminate a rental than sell a property. For those who are in a transition phase of life, it usually makes more sense to rent. A primary residence is often a homeowner's largest asset and there's likely an opportunity cost of buying because renting allows for greater diversification of assets and potentially higher rates of return.

Whether one should buy or rent depends on individual circumstances. There may be a correct answer from a technical standpoint, but it's also important to factor in your preferences. Please reach out to your Wealth Manager with questions about buying vs renting.

Disclosures

Investment advisory services offered through Robertson Stephens Wealth Management, LLC ("Robertson Stephens"), an SEC-registered investment advisor. Registration does not imply any specific level of skill or training and does not constitute an endorsement of the firm by the Commission. This material is for general informational purposes only, has not been tailored to the needs of any specific client, and should not be construed as individual tax, legal or investment advice. Please consult with your individual tax advisor prior to making any tax-related decisions. The information contained herein was compiled from sources believed to be reliable, but Robertson Stephens does not guarantee its accuracy or completeness. Investing entails risks, including possible loss of principal. Past performance does not guarantee future results. This material is an investment advisory publication intended for investment advisory clients and prospective clients only. Robertson Stephens only transacts business in states in which it is properly registered or is excluded or exempted from registration. A copy of Robertson Stephens' current written disclosure brochure filed with the SEC which discusses, among other things, Robertson Stephens' business practices, services and fees, is available through the SEC's website at: www.adviserinfo.sec.gov. © 2023 Robertson Stephens Wealth Management, LLC. All rights reserved. Robertson Stephens is a registered trademark of Robertson Stephens Wealth Management, LLC in the United States and elsewhere.