

Should You Rent or Buy in 2009?

Given recent changes in home prices and the current low mortgage rate climate, there have been significant gains in affordability for prospective first-time homeowners. Earlier in 2009, a provision in the Stimulus Bill provided for a first-time Homebuyer Tax Credit of 10 percent of the purchase price of the home up to \$8,000. The California Association of REALTORS® analyzed the difference between renting and buying a home in light of recent market and policy developments. Housing costs and tax implications of buying a home and renting a home were computed as a part of the analysis.

Existing tax laws allow homeowners to itemize and deduct the mortgage interest and property taxes from their taxable income. In addition, for First-Time Buyers purchasing a home between January 1 and November 30, 2009, the Homebuyer Tax Credit substantially elevates the tax benefit of buying a home this year. For example, consider two households earning the same income—\$48,900 a year—which is also the minimum income needed to purchase the statewide entry-level home price of \$248,000. The household that purchases a home (First-Time Buyers) at this price along with the prevailing market factors will give that household a tax deduction of over \$15,800 in the first year of ownership (assuming a full year of mortgage interest) as well as the one-time tax credit of \$8,000 at that home price. The other household that continues to rent (Renters) will most likely only be eligible for the IRS Standard deduction of \$10,900, less than that of their home-buying counterparts without even factoring in the \$8,000 tax credit. In the first year, the taxable income for the First-Time Buyers is roughly \$5,000 lower than that for the Renters, and the difference in the tax liability totals over \$8,700 in favor of the First-Time Buyers, mainly due to the Homebuyer Tax Credit in 2009.

The tax benefit in subsequent years of homeownership decreases as the mortgage note approaches maturity, the amount of interest declines each year assuming all else remains constant. However, the overall tax liability savings in the first 5 years of ownership is well over \$11,000 for the First-Time Buyer household.

With the current market environment, prospective first-time buyers will also save when taking into account the monthly out-of-pocket expenses of owning versus renting. Using the same two household scenarios, the First-Time Buyer's monthly PITI is \$1,630. That is \$250 less than the Renter's monthly expense of renting a 3-bedroom/2-bathroom apartment including renter's insurance for \$1,875. In 12 months, the First-Time Buyer household saves nearly \$3,000 in monthly out-of-pocket housing expenses compared to the Renter household. That differential jumps to nearly \$15,000 in 5 years of owning a home.

While these comparisons consider the tax benefits and cost savings homeownership offers prospective home buyers, there are many other non-monetary benefits of homeownership, including an overall economic stimulus to the lagging economy. In addition, homeownership tends to boost social benefits such as education and civic involvement, as well as lower crime rate and welfare dependency.

The many benefits of homeownership coupled with the bargains that can be found in today's real estate market, makes 2009 a special year to buy a home, especially for first-time buyers.

The following are the assumptions used in calculating the figures above:

- The household currently rents a 3-bedroom, 2-bathroom apartment at the prevailing rent and purchases rental insurance. The prevailing rent for a 3-bedroom, 2-bathroom apartment was \$1,855 per month (Q4 2008, latest available). The household purchases renter's insurance at a cost of \$247 per year or \$20 per month.
- The household considers the purchase of a home at the entry-level price, which is 85 percent of the statewide median price. The monthly cost of housing is equal to the mortgage payment, taxes, and insurance.
- The entry-level home is priced at \$248,000, or 85 percent of the prevailing median-priced home of \$291,800.
- The monthly payment including taxes and insurance (PITI) was calculated using a 10-percent down payment, a 40-percent qualifying ratio, the prevailing 1-year ARM mortgage rate, and a 1.038 percent assumed insurance costs and property taxes. The monthly PITI payment under these assumptions is \$1,630.

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Beverly Scott, President
Yosemite Gateway Association of REALTORS®
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