Roofstock RESEARCH

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Time Horizon Matters in Decision to Buy vs. Rent

While investors purchasing homes make offers based on target yields and total returns, homeowners have different motivations. Housing for would-be homeowners is viewed more for the tangible and intangible benefits they perceive from being an owner and living and raising their families in the type of home and neighborhood they desire. Household budgets, credit availability, and expectations for asset appreciation factor into offer prices, but the decision to buy is much less a financial and profit motivated exercise for households than it is for investors.

Given the impact of home price appreciation and higher interest rates on affordability, and the limited inventory of homes for sale, more households may be zeroing in on the actual cost of homeownership and weighing it against rental costs. There are a variety of ownership cost calculators out there, but the Research team at Roofstock spent some time building one to track the cost of ownership versus renting over time and to test various assumptions.

The accompanying chart tracks cost of ownership versus renting using Roofstock's calculator and the following assumptions.

Ownership Scenario Assumptions

$407,600 purchase price (National Association of Realtors, U.S. median, April 2024), 5% down payment, appraisal, inspection, and other closing costs, property taxes, homeowners insurance, maintenance, 30-year mortgage at 7%, mortgage insurance, 2.4% annual home price appreciation (Moody's Analytics' 10-year forecast), and finally, at the end of each period we assume a sale that returns the homeowner's equity less a 5% sales commission. Note, we do not assume any updates or renovations to the home at move-in or prior to sale. These are common, but discretionary, expenses.

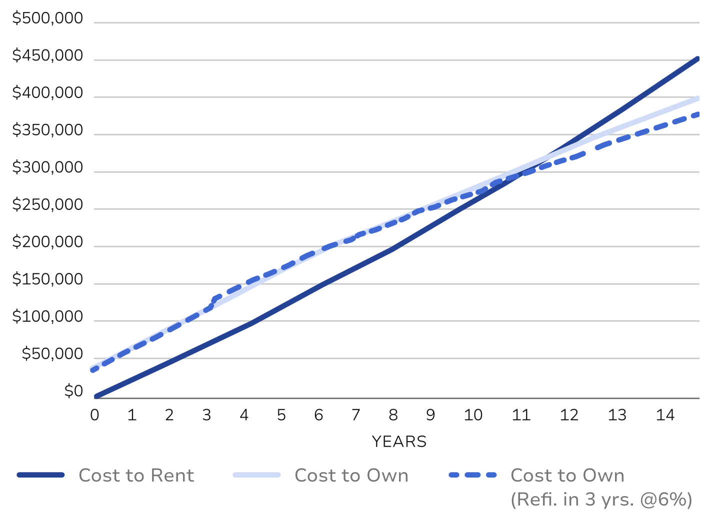
Renting Scenario Assumptions

$2,193 per month median national single-family rent as calculated from Rental Genome, Roofstock's proprietary database which aggregates and tracks property characteristics, financial metrics and ownership activities associated with over 120 million homes in the U.S. We have also assumed 3% annual rent escalation and a cost reduction based on a 5% annual return on upfront costs to purchase (down payment & closing costs). A return on monthly payment savings is not factored into the rental scenario, some renters may save and invest this money and others may spend it.

These assumptions result in a cost to own that is nearly $45,000 more than the cost to rent on average over the first five years. It is over $48,000 cheaper to rent over a five-year period. In those first five years, nearly 85% of mortgage payments are consumed by interest on the loan. It takes more than 11 years to reach the breakeven point, when the financial edge begins to shift in favor of ownership. After 15 years, the owner is around $55,000 better off than the renter, provided the home appreciates at the 2.4% annual rate we have used here.

We have included a refinance scenario where the buyer reduces the interest rate on the loan to 6% and commences a new 30-year loan in year three. Although

It Takes More Than a Decade for Buyers to Break Even*



closing costs and resetting the amortization schedule make this a more expensive approach for several years, the breakeven point versus renting arrives about a year sooner and the long-run benefits are substantial as shown in the accompanying chart.

Those considering homeownership may look at this and feel undeterred and perhaps even encouraged. The sooner you buy, the sooner you get to the inflection point where ownership pays, and in the interim, you have the home you want in the neighborhood you want.

The reality financially could be quite different for a myriad of reasons. What if the house the household can afford to buy now is not the home they want to live in five years from now or even 10 years from now? The high transactional costs of ownership mean having to move and buy again after a short period of time will be costly. Households that know they will have to move for work or family reasons much earlier than 10 years from now should find it more financially favorable to rent.

This analysis also does not contemplate the cost of remodeling or replacement of major home systems such as a roof, HVAC, windows, or another expensive item that would rise above our maintenance assumption. Such expenses will inevitably occur and push the breakeven point between ownership and renting out further.

While this analysis does not contemplate a major recession that negatively impacts employment and home values, these events do occur, and renters may find the financial flexibility and geographic mobility afforded to them by being a renter and not an owner beneficial in those moments. There are risks to taking on the large financial obligation of a home purchase.

Households may derive intangible benefits from ownership and if they stay in the home long enough, they may see financial reward as well. The latter is particularly true in periods of higher home price appreciation than we have assumed here. But the higher medium-term costs, repair/replacement risks, and lower financial and geographic flexibility mean a decision to buy should be scrutinized closely.

The financial payback for buying is unlikely to be seen for a decade or more due to the high costs of ownership. Rental options can and should play a vital role in reducing housing availability and affordability challenges in the U.S., especially as the national homeownership rate is in line with typical historical levels. Single-family rental homes, which serve as a substitute for the type of home households typically purchase, are a particularly critical component of U.S. housing infrastructure today and they should remain so as prevailing demographics drive demand in the years ahead.

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* Source: Roofstock Research, Rental Genome, National Association of Realtors, Moody’s Analytics, Federal Reserve, The Urban Institute's Housing Finance Policy Center, Rocket Homes, Ally