

When Should You Stop Renting and Buy Your 1st Home?

*This choice often comes down to a financial decision:
Can you afford what you want? But that's not the whole story.
There are more things to think about when trying to
decide if it's time to take your first real estate plunge.*

Cost-Benefit Analysis is the term for figuring out if something is worthwhile doing or not. When you analyze a situation and decide that the benefits are greater than the cost, then you may want to go forward. Conversely, if the cost exceeds the benefits, you may decide to wait.

Sometimes when you weigh the benefits against the cost, the benefits are higher, but not high enough. In that case, you might want to increase the benefits or lower the cost before taking action.

These are exactly the thoughts you should be having as you plan to buy your first home.

To help you weigh the benefits and costs of buying vs. renting, this report offers key elements to think through, including evaluating the monthly payments correctly, estimating home ownership costs, weighing location against price, evaluating purpose and home investment strategy, and improving credit and interest rate to decrease payments.

The most important factor when thinking about buying is to not “panic buy.” Don’t jump in just because interest rates *might* rise or prices *might* rise. Buy when you are ready and don’t let the market dictate your timing.

Costs & Benefits of Renting

What are the benefits of renting?

- One benefit is living in a property without having to spend great chunks of money to replace the roof or fix the plumbing.
- Another benefit is that you may be able to rent a type of home or rent in a location that you could never afford to buy.
- You have no stress or worry about maintenance. That's the landlord's job.
- You can pick up and move without wondering if you can sell your house.
- If your income drops, you can rent somewhere less expensive.
- If you are late with a payment, you can discuss it with the landlord.
- You probably won't get a serious ding on your credit if you're a month late.
- In many places, renting is the only option because there isn't enough housing for sale, or the prices are beyond reach for the average mortal.

What are the costs of renting?

The landlord charges you X amount and as long as you pay that amount, you get to live in that property. The cost is X. But there are other costs:

- By renting, you lose the opportunity to build equity (the money you gain if you sell the property). So when you move, you move with no money in your pocket.
- You lose the opportunity to pay off the house and eventually own outright.
- You lose the opportunity to put down permanent roots, do what you like to the property, and raise capital by getting a second mortgage or home equity loan.
- You lose any tax benefits that might be available. (Tax benefits vary between countries. **Buyers need to discuss deductions with their own accountants or mortgage providers.**)

Costs & Benefits of Owning

What are the benefits of owning?

- Build equity through rising values and making payments.
- Pay off the home and eventually have the security of owning outright.
- Be able to increase your wealth...by selling and profiting, by renting, or by getting a home equity line to use the money somewhere else.
- Put down deep roots in the house and community.
- Do what you want to the house...paint it orange and pink if you want (as long as you don't live in a Planned Community or Condominium).

Costs:

- Monthly fixed and variable maintenance costs are higher than renting.
- Interest on your mortgage loan.
- Time involved in maintaining a home that would not be involved when renting.
- Possible falling values that mean you can't sell when you want to.
- Inability to work with the loan holder when you're late with a payment.
- Possibly higher monthly payments than would be with renting.
- Possibly not being able to live in the community you want because you can't afford to buy there.

Compare Costs and Benefits

Here are several questions that will help you decide if it's time to buy, or if you should keep renting.

What can you REALLY afford to pay each month?

Let's look at an example. (This example uses US\$.)

- Suppose you feel that you can afford to pay \$1,500/mo. in a mortgage payment.
- Add another \$200/mo. in utility costs for ownership vs. renting.
- Put aside a little each month to pay for large projects (painting, new roof, new kitchen, etc). 5% for homes in decent condition—10% or more for homes in poorer condition. That's \$75/month, based on \$1,500.
- Now, instead of paying \$1,500/mo, you're really looking at $\$1,500 + \$275 = \$1,775$.
- You have a choice. If you really are only comfortable paying \$1,500/mo, you will need to SUBTRACT \$275. So your target monthly payment is more like \$1,225. **That can mean a difference of \$40,000 in your purchase price**, so it is important to calculate maintenance costs before buying.
- If you don't include maintenance costs up front, then the costs will come from somewhere else after you buy—your vacation budget, your new car budget, etc. **You could become what's known as "house poor," a term that means you have a house, but a lower quality lifestyle.**

What mortgage would you qualify for?

Just because you believe you can afford \$1,500/mo, that doesn't mean the mortgage provider will agree with you. In addition, what you think you can buy with \$1,500/mo isn't necessarily going to buy as much home as you think it will.

Several factors go into determining what the lender will decide you can pay and what that will allow you to buy.

Compare Costs and Benefits,

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- Your loan amount is based on your **income**, **debt**, and **interest rate**.
- The **interest rate** you are given by the lender may mean a \$20,000 difference in the price of home you can buy.
- Your interest rate is determined based on your credit rating—which is based on your history of paying your debts, as well as the amount of overall debt you carry.

So, although you feel comfortable paying, say \$1,500/mo, the mortgage lender might disagree. The lender might say that based on your income, debt, and credit score you really are more comfortable from their perspective paying \$1,400/mo.

And that means, instead of getting a mortgage for \$239,000, you can only get a mortgage of \$219,000.

So work with your mortgage professional, and go through the entire loan application process. Fill out the loan application. Provide the documentation. Yes, it's arduous. But it's the only way to get accurate figures, and get the coveted "pre-approval letter" that you need when buying a home.

Why do you really want to own a home?

Here are your choices: 1. Financial reasons. 2. Pride and roots reasons. Of course, it's both for most people. As a first time buyer, you're aware that ownership has financial benefits. And you also want to live in a place you love and put down roots.

Unfortunately, for most first time buyers, the second reason is often out of reach. Most real estate and mortgage professionals will recommend that first time buyers look at lower cost alternatives that allow them to build equity and eventually buy up into the area

Compare Costs and Benefits,

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they want to put down roots. Here are the lower-cost alternatives:

- Buying a much smaller home or condominium near the area you want to live.
- Buying a fixer-upper near where you want to live.
- Buying a home in an area you don't want to live, then putting a renter in place for a few years or fixing and flipping it.

Each choice has its own costs and benefits. With each choice, the goal is to increase equity so that you can sell and have a larger cash down payment on a home in your preferred location. Create a long-range plan. Then work towards that goal by increasing savings, building equity, and improving your income. And always, always work on reducing debt.

Is your rent low enough?

If you're paying \$1,000/mo in a \$3,500/mo area, and you have a good landlord, maybe you'd be better off investing in other things instead of buying a home. Perhaps putting money into stocks will give a better return. It is OK to *not* buy a home if it makes financial and emotional sense not to.

What could you earn by putting your down payment money into stocks, bonds, and other investments vs. buying your home? The result will vary greatly by the value of the stock, future interest rates, the kind of investment, and even inflation. Because of that complexity, many people simply don't have the investment savvy to feel comfortable with those investments. Home ownership can seem "simpler." For them, perhaps buying a home as an investment is a good choice.

If you want to compare potential investments against home ownership costs and returns, have that conversation with a professional financial advisor.

Using a Mortgage Calculator

Mortgage calculators should be used as guidelines only, as just another data point. Once you're really serious about buying, the only truly accurate way to know what you can afford and what your payments will be is to go through a full pre-approval process with a mortgage professional.

But until then, mortgage calculators can be a useful tool to help you see how adjustments in down payment, interest rate, and income can affect purchase power. Just be dead sure that the estimate you get includes Principle, Interest, Taxes, Insurance, and Extras charged on the loan, such as Private Mortgage Insurance. If you leave out any of these costs, you will be surprised when your mortgage professional shows you a figure lower than you thought.

Calculators come in several varieties. Here are four calculator suggestions. Use a calculator designed for your country.

1. House Price Based on Payment
2. Payment Based on House Price
3. Payment Based on Income
4. Rent vs. Buy

Final Word

As a first time buyer, you are swept up in the excitement of buying—the dream of owning. You look at homes online and imagine putting in your own garden, painting the baby’s room, and decorating the way you want.

But you are smart. You know you’re making a financial decision, not simply an emotional one. You know the factors that go into deciding when to stop renting and buy a first home are complex.

There are no simple answers. But I’d like to leave you with this final word:

Don’t let fear of buying stop you from buying a home. There are plenty of professionals out there who can guide you through this decision and help you make a sound financial choice. Find a real estate consultant you trust to sit down with you and discuss the ideas presented in this report. Work with a mortgage professional to get accurate figures.

I want you to know that I’m always available to you—or your friends and family—for a home buying consultation. And I want you to know that I’ll spend whatever time you need to answer your questions so you can make the right decision in your own time.

Call me to arrange an initial consultation appointment.