



# Building wealth?

## Renting vs. owning: Each provides opportunities

**F**or Matt Ufford of Paola, Kan., the time was right, the interest rate was low and the decision made sense. So, in late 2010, the elementary school teacher and recent college graduate took the plunge and became a first-time homebuyer.

After renting apartments throughout college, Ufford (pictured above) wanted to put down roots in a community he liked. He was also looking toward the future and the potential for having a nice home with more than one bedroom and a backyard to eventually raise a family.

“I just felt it was a good time to get my own place and make it how I want it,” Ufford says of his decision to enter the homeownership ranks. “Having my own place makes me feel more free. No one can tell me I can’t paint a room this color or do this to the outside.”

While Ufford’s desire to settle down was

a significant reason he purchased a home, the investment potential that homeownership could provide was also a consideration. By working on do-it-yourself projects, he hopes to eventually increase his home’s value.

“Maybe in five years or so it would be a nice return, but I think having a place to live was a bigger factor for me in deciding to buy,” Ufford says.

Despite the struggles of the nation’s housing market, Ufford’s feelings about homeownership are still common among those who have bought recently or are considering a home purchase in the near future. A recent survey by the National Association of Realtors found that 95 percent of homeowners and 72 percent of renters felt that owning a home made more sense than renting over a period of years.

But Jordan Rappaport, a senior economist

at the Kansas City Fed, cautions that homebuyers should carefully consider their decision if they think investment potential is the main reason to buy a home. While homeowners in the past have often been able to build more wealth over time than those who rent, that hasn't always been the case, and much depends on when a home is purchased and where a home is located.

"It's not always clear that buying a home will build more wealth than renting," says Rappaport, who recently researched the issue. "It's important that people look carefully at the costs and benefits of owning a home versus renting—and that they not assume owning is always a better deal. Sometimes it is a better deal but not always."

Homeowners face some costs that renters don't: a large initial down payment, ongoing maintenance costs, interest on mortgage payments and property taxes. At the same time, homeowners receive tax benefits through mortgage interest deductions and receive what Rappaport calls "consumption benefit," which includes pride in owning a home, a sense of stability and being able to enjoy a house that fits individual needs.

However, there is a lot of risk with homeownership as well, Rappaport adds.

"You have a lot of risk if, for instance, your house has mold and your insurance won't cover it," he says. "The downside of that risk is lower if you're a renter. You would just pack up and move."

"Whether homeownership makes more sense from a wealth-building perspective obviously depends on house price appreciation," Rappaport says. "If your home decreases in value—which we've seen in many places for a while now—you're not going to build much wealth."

## **Renting vs. buying: a framework**

To analyze the effectiveness of homeownership in building wealth, Rappaport set up a hypothetical situation comparing owning with renting during 10-year periods from 1970 to 1999.

Under Rappaport's framework, a hypothetical household purchases a home with a 20 percent down payment. This household also pays the origination fee on a 30-year, fixed-rate mortgage. In addition, the household makes recurring mortgage interest and principal payments and payments for insurance, maintenance, and taxes while also taking advantage of the mortgage interest deduction on their tax return.

At the same time, a second hypothetical household begins renting an identical house. This household makes an investment in stocks and bonds equal to the homeowner's down payment and other purchase-related costs. During the next 10 years, the renter continues to make monthly rental payments that increase at the national rate of inflation for rentals. The renting household also continues to make investments in stocks and bonds so that its total rental and investment payments equal the homeowner's total home-related payments.

At the end of 10 years, the homeowner sells his home, pays any selling costs and pays off the outstanding mortgage balance. The renter liquidates his stock and bond holdings and pays off any taxes due.

So, who ends up with more wealth at the end of the decade? The short answer, according to Rappaport: It depends.

In some periods during 1970 to 1999, homeowners came out ahead, while in others, renters built more wealth. Rappaport's analysis found that homeowners came out ahead about half the time, renters fared better about a quarter of the time, and it wasn't clear who ended up with higher wealth the remaining quarter of the time.

In general, for 10-year periods during the 1970s and 1990s, homeowners built more wealth, while renters built more during most of the 1980s. And while the data are not complete, it appears that for the 10-year period now under way, renting will likely prove to be a better decision in terms of building wealth, given the ongoing steep fall in national house prices that began in 2007.

Rappaport acknowledges that his analysis

requires several caveats that would be difficult to translate into a real-world situation. For example, as those looking to rent often experience, it can be much more difficult to find rental units that match individual tastes than to find purchase units that do so. In addition, Rappaport says, “there’s no guarantee that a renter will take their savings and invest it in stocks and bonds.” In many cases, that savings ends up being spent on other things.

“Principal payments,” says Rappaport, “serve as a commitment to save into the distant future.”

Also, Rappaport’s analysis doesn’t account for differences in home price appreciation across different markets.

“There’s no doubt that homeownership can be a spectacular investment, but there

are a lot variations in time and place,” Rappaport says.

For example, homeownership in the Tenth Federal Reserve District, an area that includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado, and northern New Mexico, has generally been less risky than other parts of the country.

On the whole, that’s been the case during the last several years in the Kansas City metro, says Lee McClelland, president of the Kansas City Regional Association of Realtors. The organization’s data show that the average home price in the Kansas City area rose about 1 percent in 2010, even as prices for the rest of the nation continued to fall last year.

“I think that speaks to the Midwest and

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**RENT OR OWN?** In terms of building wealth, either buying a home or renting one provides potential opportunities, according to Jordan Rappaport, a senior economist with the Kansas City Fed. Rappaport recently looked at the effectiveness of homeownership in building wealth and found that much depends on when and where a buyer purchases a home.

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our low cost of living,” McClelland says. “We haven’t seen the huge highs, and we don’t get the big lows. We’ve always had gradual rises and gradual declines.”

McClelland is optimistic for 2011, citing foot traffic numbers that were higher during the past winter than a year before.

“People are feeling a little better about their jobs,” he says. “I think we’ve seen the bottom, and the market seems to be building back up.”

## Benefits of renting

Still, despite signs of life in the residential real estate market and the potential wealth-building benefits homeownership provides, the decision to rent still makes sense for some.

Amber Nash, a certified public accountant in Kansas City, expects to buy a home sometime next year, but for now, she and her fiancé have decided to continue renting.

“We are planning to rent until we have a solid down payment ready,” Nash says. “With rates as low as they are, it would be nice to buy now, but we don’t want to jump into anything before we’re ready.”

Nash has heard from many who consider renting to be “throwing away money,” but she points to things such as maintenance costs and the lack of mobility that can come with homeownership. She’s also reminded of the experience of friends who rushed into a home purchase, only to find their incomes eaten up by mortgage payments that seemed too high and homes worth less than the amount of their mortgages.

When the time is right, Nash says she will enjoy having her own place to live, but she and her fiancé are not considering any investment potential when they start looking for homes.

“We are not planning to buy for an investment purpose,” she says. “We haven’t even considered the investment aspect. It’s more of a desire to have a nice place to live. Any investment benefit would be nice, but it’s not our focus.”

That attitude is a good one for homeowners to have, Rappaport says. In general, those

“consumption benefits” of homeownership are worth considerably more than any investment benefit.

“Homeownership has traditionally been described as an investment first, and then, second, as having a place to live,” Rappaport says. “But, the benefits you get from living in and enjoying a home almost always exceed homeownership’s investment benefit by a wide margin. It’s probably more accurate to describe homeownership as having a place to live that includes an investment benefit.”

Having a better place to live was the primary reason Nick Dale of Shawnee, Kan., decided to purchase his first home last year. Dale, who married around the time he bought his home, said his previous apartment seemed too cramped for two people.

“We outgrew the apartment and we wanted something more permanent and stable,” Dale says.

“There have been a few surprises,” such as a plumbing problem that needed to be fixed, “but we enjoy living in a nice neighborhood. The decision to buy a home has been a good one for us.”



BY BILL MEDLEY, TEN CONTRIBUTING WRITER

## FURTHER RESOURCES

### “THE EFFECTIVENESS OF HOMEOWNERSHIP IN BUILDING HOUSEHOLD WEALTH”

By Jordan Rappaport  
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