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The rent versus home purchase decision is fundamental for most families. The math of that decision has changed significantly over the past three years as the dramatic decline in prices has made homeownership more affordable. Lower-priced homes mean lower monthly mortgage payments, smaller down payments, and lower property tax bills.

In making the rent/purchase decision many consumers compare the monthly cost of ownership to renting. If the difference between these costs is similar homeownership becomes more attractive. When one accounts for tax credits and potential gains in equity the benefits to homeownership become even greater.

In Ventura County the difference in cash flow requirements between owning and renting has shrunk dramatically due to falling home prices. Median home prices in Ventura County peaked in June 2006 at \$620,000. From the peak to May 2009 median home prices have fallen 42.7 percent.

Unlike housing, the rental market has remained fairly stable. In July 2006 the average rent for a 3-bedroom apartment in Ventura County was \$1,862. By January 2009 this number had increased to \$1,938. This represents a 4.1 percent increase over two and half years.

The bottom line is that Ventura County home prices have fallen dramatically, while rents have risen slightly. So, is it cheaper to buy or rent?

To answer this question we collected data on median home prices and rents. Median home price data come from the California Association of Realtors (CAR). CAR data is widely quoted in newspapers throughout California. The rent data comes from the Dyer Sheehan Group, Inc. Dyer Sheehan is a Ventura city company that specializes in real estate consulting. Every six months they conduct a thorough rental survey. Their latest survey, January 2009, has data for 20,464 apartments in Ventura County. For the purposes of this analysis we use the average monthly rent for 3-bedroom apartments.

To calculate the cost of homeownership the following assumptions were made. A 30-year loan with 20.0 percent down and a 5.0 percent interest rate is used to calculate the mortgage payment. Other costs, such as taxes and insurance, are 1.5 percent of the purchase price.

Mortgage insurance is excluded due to the 20.0 percent down payment assumption. The total cost of homeownership is the sum of mortgage payments, taxes, and insurance.

The following table contains the results of our calculations. Note that the median home price has a compositional component. Today, a significant proportion of home sales are distressed properties, such as foreclosures and short sales. This analysis does not address the maintenance cost of home ownership, potential gains or losses in equity, or interest rate tax credits.

Homeownership vs. Renting

	<u>Jul-06</u>	<u>Jan-07</u>	<u>Jul-07</u>	<u>Jan-08</u>	<u>Jul-08</u>	<u>Jan-09</u>
Median Home Price	\$605,000	\$570,000	\$580,000	\$480,000	\$420,000	\$335,000
Mortgage Payment	2,598	2,448	2,491	2,061	1,804	1,439
Taxes & Insurance	<u>756</u>	<u>713</u>	<u>725</u>	<u>600</u>	<u>525</u>	<u>419</u>
Total Cost of Ownership	3,354	3,160	3,216	2,661	2,329	1,857
Average Rent	<u>1,862</u>	<u>1,887</u>	<u>1,946</u>	<u>1,954</u>	<u>1,969</u>	<u>1,938</u>
Difference	\$1,492	\$1,273	\$1,270	\$707	\$360	(\$81)

Note: Nominal amounts.

The gap in cash flow requirements between owning and renting has shrunk dramatically. On average, the monthly cash-flow requirements are about the same if you rent or buy in Ventura County today. This is welcome news for a battered housing market.

The results also suggest that equilibrium is being restored in the housing market. In general, the difference between owning and renting should be small. When the difference becomes too great, as it did in 2006, the market becomes unstable. Home prices and sales start to decline as the market searches for a new equilibrium between owning and renting.

Does this mean that every renter should run out and buy a home? No. The rent/purchase decision is more complicated than a simple comparison of monthly cash-flow requirements. A home is often a very illiquid investment. Transactions costs—the cost to purchase or sell—are high. Those costs imply a relatively long holding period (investment horizon) is appropriate. Many households' circumstances may not be compatible with a long holding period.