PETER LAZAROFF

Rent vs. Buy Worksheet

Rent or Buy?

Whether a home purchase makes sense depends on several financial and emotional factors. The following is a series of questions and exercisers that, when answered truthfully and realistically, will help you make an informed decision.

To get the most out of this worksheet, it helps to have your Goals Planning Worksheet, Cash Flow Worksheet, and Net Worth Worksheet completed. All of those can be downloaded on my **Resources page**.

1. Do you plan to live in the same place for at least five years?

If the answer is no, then you should definitely rent. It takes at least five years for a house to appreciate enough to offset the broker fees and closing costs, which can add up to 10 percent of the home's purchase price. The longer you live in your home, the more likely you'll benefit financially from owning it. The following are common life events that can turn an ideal home purchase into a bad financial decision by simply shortening the time horizon in the property:

- Getting married
- Having children
- Going back to school
- Moving to a new city
- Changing careers

Honestly reflecting on how long you can reasonably expect to live in the same home is an important exercise. Envision where you want to be in five years with your career, family, and financial goals? How does a home fit into these dreams? How would buying a house impact you financially if life turns out differently than you expected? Will the cost or the responsibilities associated with owning a house prevent you from living the life you truly want?

2. Is owning less expensive than renting?

This seems obvious, but most people don't evaluate the true cost of ownership versus renting. Comparing monthly rent to a potential mortgage payment misses a huge amount of costs associated with buying a home. The table outlines some of the major monthly and one-time expenses that must be considered to make a fair comparison. Fill it out and compare to your rent payment to give you an informed answer to this question.

If you are confident about living in the same home for at least five years, then it's fine to buy a house even when ownership is more expensive than renting. The key is to make sure the higher cost of ownership is included in your **Cash Flow Worksheet** and doesn't interfere with your ability to meet other life priorities listed in your **Goals Planning Worksheet**.

	ESTIMATED MONTHLY EXPENSE
Mortgage Payment	
Property Taxes	
Insurance	
Private Mortgage Insurance (PMI)	
Maintenance (Home Price x 1.0%) ÷ 12 Months	
Home Services (Landscaping, Pest Control, etc)	
Improvements	
Other (Utilities, Dues, Assessments)	
Tax Savings	
ESTIMATED MONTHLY EXPENSES	

	ESTIMATED ONE-TIME EXPENSES
Closing Costs (2% to 5% of Amount Borrowed)	
Broker's Fees (4% to 7% of Home Price)	
Moving Costs, Initial Repairs and Furnishing Expenses	
ESTIMATED ONE-TIME EXPENSES	

3. What are your current and future career prospects?

Your future earnings are relevant to how a mortgage will impact your life. A general rule of thumb is you should not spend more than 25 percent of your gross monthly income on your monthly housing payment. This will greatly inform the house you can afford, but it also might restrict the career choices you make upon purchasing a home.

Owning a home makes it more financially restrictive to relocate for a job opportunity, go back to school, change career paths, or start a business. If you have a high degree of career uncertainty, renting is a safer choice because it provides greater financial flexibility.

4. Can you afford the down payment and upfront costs associated with buying a home?

Whether you are buying a first home or preparing to move into a bigger second home, the down payment and closing costs will take a big bite out of your savings. Review your **Net Worth Worksheet** to identify the assets you will need to utilize in order to buy a house.

In the Assets section, it's fine to draw from cash accounts, but leave the emergency fund and cash buffer in your primary checking account intact. If you need to tap tax-deferred retirement accounts such as an IRA or 401(k) to meet the up-front costs of buying a house, then you are probably better off waiting to buy a home.

You Decided to Buy a Home. Now What?

Congratulations, you've decided to purchase a home! Throughout the home-buying process, there is a lot of pressure to spend more than what makes sense for you. To avoid overextending yourself, fill out the table below to calculate how much home you can afford. There are four key variables in this calculation:

1. Start with the percentage of gross monthly income you can dedicate to a monthly home payment, which I generally prefer to cap at 25 percent of gross monthly income. For metropolitan areas where real estate prices are higher than the rest of the country, a case can be made to boost that percentage to 36 percent.
2. Subtract out the total amount of monthly principal and interest payments for other debts such as a student or auto loans. Conventional lenders typically will not lend to people with total monthly debt service payments greater than 36 percent of gross monthly income. The less debt you have, the bigger the mortgage payment you can obtain.
3. The mortgage interest rate makes a dramatic difference in your purchasing power. The lower the interest rate on a mortgage, the more expensive a home you will be able to afford.
4. Your down payment also figures into the purchase price. The bigger the down payment, the more expensive a home you can afford.

	ESTIMATED MONTHLY EXPENSE
Gross Monthly Income x 25%	$
- Total Monthly Debt Service (Principal + Interest)	- $
MORTGAGE PAYMENT YOU CAN AFFORD	$
Mortgage Payment You Can Afford x 12 Months	$
÷ Mortgage Interest Rate Available	÷ %
x (1 + % Down Payment)	x
HOME PRICE YOU CAN AFFORD	$

Just because you can spend a certain amount on a house doesn't mean you should. Keep this in mind as you decide where to cap the amount of monthly income you dedicate to a mortgage payment. In my experience, 25 percent of gross monthly income is prudent. A few reasons that may justify a higher percentage include having a high degree of certainty about earning more income in the future, planning to live in the house for at least 10 years, or living in an area where real estate prices are relatively stable.

As for your down payment, the best practice is to put down 20 percent of the purchase price. One argument for making a bigger down payment is it creates a smaller loan and less interest costs over time. However, a larger down payment is rarely a better choice than building up an emergency fund or contributing to your investment portfolio.

For people putting less than 20 percent down, I generally recommend they continue renting, but it’s possible to obtain a conventional mortgage with the help of private mortgage insurance (PMI). Lenders require PMI because borrowers are more likely to default on a loan in which they have very little invested. While paying for PMI increases the cost of ownership, the payments aren’t permanent. Once you have built up 20 percent equity in your home, PMI payments go away and leave you with just the mortgage payment.