# Module 4 - Renting a Home vs. Buying a Home

## Renting

As college students, many of you have already experienced the renting process. Renting requires minimal commitments initially: there is a lease (a legal document) that outlines the requirements for the rental agreement, including responsibilities for both you and your landlord; there is a security deposit, typically one or more months of the rent; and most landlords conduct a background check for applicants before leases are signed.

When you complete your degree and begin teaching, you will, most likely, rent. Deciding to rent or purchase a home typically follows certain life choices or stages. The following table outlines several advantages and disadvantages to guide you in when you might transition to home ownership (or back to renting).

|  |  |  |
| --- | --- | --- |
|  | **Pros** | **Cons** |
| **Renting** | Lower financial obligations  Limited expenses  More liquidity (less resources invested into renting)  More mobility | Less certainty for expenses year to year  Limited ability to modify the space  Limitations to your lifestyle (pets, smoking, etc.)  No equity gained  No tax deductions |
| **Owning** | Accumulation of value/equity over time (usually)  More choices  More predictability (within reason)  You can deduct interest on the mortgage loan from your taxable income | Substantial financial obligation, particularly up front  Higher yearly expenses  Less liquidity (i.e. much of your financial worth is tied into the home)  Less mobility (it is difficult to move) |

Table 1. Comparison between the affordances and constraints of renting vs. owning a home

For a first-time renter, most need to save the security deposit, anywhere from a few hundred to thousands of dollars (location, size, and quality dependent). In addition, the background check and application usually carry a nominal fee for each place you seriously consider. Outside of furnishing, these are your financial commitments, meaning renting is more accessible for most people. Purchasing a home is a significantly different process.

## Purchasing a Home

As mentioned in the introduction, purchasing a home is typically the most significant investment of our lifetime. It is both a living space and an asset that holds value. In other words, it is both our nest and our nest egg.

A home purchase is typically financed with a mortgage, a debt that carries a significant monthly expense. A mortgage is a long-term debt – the most common type of mortgage is 30 years in duration. As such, the significant monthly expense of your mortgage payment is expected to last 30 years as well.

Homes carry additional benefits and drawbacks. There are added expenses that come with home ownership, expenses like insurance, upkeep, and maintenance. Additionally, it is a burdensome process to sell a home, so it becomes more difficult to move once you own a home. However, most homes increase in value, particularly in the last two decades, so it is common to expect a home to be an investment that builds wealth, albeit an investment that is difficult to quickly convert to cash (i.e. illiquid).

While there are advantages to renting (more mobility, maintenance and upkeep handled by the property manager, etc.), this module will focus on the logistics of purchasing your first home.

## Home Types

There are several options you have when purchasing a home, and they impact what financing options are available for you:

* Mobile/Tiny homes – classified by their rolling chassis, these homes are designed to be moved (usually infrequently) but may be installed on permanent sites. Many communities have restrictions on whether mobile homes can be used, and even the more contemporary version, tiny homes, carry the same limitations.
* Condominiums (Condos) – homeowners own a unit in a multi-unit dwelling. Common areas are owned and managed by the owner’s associations, and condo owners pay a fee to cover costs for building and operating expenses. In addition, owners can be billed special assessments for major costs.
* Townhomes – similar to condos, townhomes are units in a multi-unit dwelling with the exception that the buildings have fewer units. Typically, town homes have multiple stories, and many have garages.
* Multi-family homes (duplexes, apartment buildings) – these are location dependent, but they differ from condos or townhomes in that the owner purchases the entire building with the intent to create rental income.
* Single-family homes – finally, single family homes are the traditional, free-standing homes, common across most suburban and rural areas of the United States. Single family homes have the most options for financing. In addition, the owner is responsible for all maintenance and upkeep costs.

## How much home can I afford?

Before you begin your house hunt, it is worth identifying how much house you can afford to purchase. Most individuals, including first-year teachers, require financing to purchase a home. Lenders evaluate multiple metrics to determine your ability to finance a house including income, job stability, liquid assets like checking and saving accounts, and debts such as student loans and credit card balances (through metrics like your debt-to-income ratio). Before you approach your lenders, it is worth determining how much home you can afford. For example:

Assume your lender requires that at most 38% of your monthly gross income should cover your mortgage principal, interest, taxes, and insurance (PITI). A first year teacher in Hall County in Georgia with a Bachelor’s degree makes $47,598.

|  |  |  |
| --- | --- | --- |
| 1 | Gross Monthly Income | $47598/12 = $3966.50 |
| 2 | PITI and other debt payments | $3966.50 \* 38% = $1507.27 |
| 3 | Other debt payments (estimated) | $200 |
| 4 | Affordable monthly PITI payments | $1507.27 - $200 = $1307.27 |
| 5 | Monthly taxes and insurance (estimated) | $450 |
| 6 | Affordable monthly mortgage payment | $1307.27 - $450 = $857.27 |
| 7 | Mortgage factor | 6.65 |
| 8 | Affordable mortgage | (6) / (7) x 1000 = $128,912.78 |
| 9 | Down payment | 20% |
| 10 | Affordable purchase price | (8) / (1 – (9)) = $161,140.98 |

While this calculation makes several assumptions (you have saved a 20% down payment; you are single; your debt), they are useful as they give you a clearer idea of what you can afford.

## Searching for a Home

Traditionally home buyers use a realtor to assist in the home purchase process. However, several websites like [Realtor](https://www.realtor.com/), [Zillow](https://www.zillow.com/), and [Redfin](https://www.redfin.com/) offer you the option to search for homes and watch markets before you begin your search in earnest.

## Financing a Home

Just as your home may be your most significant investment in your lifetime, your mortgage loan may be your most significant debt. As you can see in the earlier example, the mortgage may well be several times your yearly salary. Various institutions sell mortgages (banks, credit unions, financing companies, etc.) Each offer different terms for their mortgages, so it makes sense to shop around. As you shop around, these institutions offer a pre-approval process where they gather various documents, check your credit, and calculate (estimate) how much they are willing to loan you. As part of this process, they will ask you about your down payment. While the size of your down payment does not affect the price of the house you plan to purchase, it can affect your financing. Down payments are discussed in terms of the percent of the cost of the house, i.e. the percent down you are paying. For the financial institutions that are selling you a mortgage, a larger down payment means less risk for them, which means you are more likely to secure financing during the purchasing process. Because of this, a larger down payment also means you have less risk to someone selling their home. Finally, the size of your down payment also affects how much you are financing, i.e. the size of your mortgage. The following table shows various sizes of down payments for homes and mortgage payments (based on 7% interest rate and a 30-year fixed mortgage).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Purchase Price** | **% Down** | **Down Payment** | **Mortgage** | **Mortgage Payment** |
| $250,000 | 5% | $12,500 | $237,500 | $1,580 |
| $250,000 | 10% | $25,000 | $225,000 | $1,497 |
| $250,000 | 20% | $50,000 | $200,000 | $1,331 |
| $350,000 | 5% | $17,500 | $332,500 | $2,212 |
| $350,000 | 10% | $35,000 | $315,000 | $2,096 |
| $350,000 | 20% | $70,000 | $280,000 | $1,863 |
| $450,000 | 5% | $22,500 | $427,500 | $2,844 |
| $450,000 | 10% | $45,000 | $405,000 | $2,694 |
| $450,000 | 20% | $90,000 | $360,000 | $2,455 |

Table 2. Varying down payment and mortgage payment amounts by home price

For example, assume you wish to purchase a $250,000 home. If you put 5% down ($12,500), expect your mortgage payment to be $1,580 a month (not including Private Mortgage Insurance, homeowner’s insurance, or property taxes). For the same $250,000 home, if you put 20% down ($50,000), expect your mortgage payment to be $1,311 a month (again, not including additional, necessary monthly expenses).

This example uses a 30-year fixed mortgage, which means the interest rate is fixed for the 30-year life of the mortgage. To return to the pros and cons of renting vs. buying, this means your expected monthly housing payment will remain constant for 30 years. On the other hand, the down payment (particularly 20% down payments) are a significant hurdle for most would-be buyers.

## Quiz Questions

1. Based on Table 1, which is not one of the affordances of renting?
   1. Lower finanical obligations
   2. Limited expenses
   3. Less liquidity \* Answer
   4. More mobility
2. Based on Table 1, which option requires more significant upfront financial obligations and usually results in the accumulation of equity/value over time?
   1. Renting
   2. Owning \*Answer
   3. Neither
   4. Both
3. Based on Table 2, how much money is needed to make a 5% downpayment on a $450,000 home?
   1. $70,000
   2. $22,500 \* Answer
   3. $45,000
   4. $90,000
4. Based on Table 2, what is the resulting monthly mortgage payment for a $350,000 home with a 20% down payment?
   1. $2,212
   2. $2,096
   3. $1,863 \* Answer
   4. $2,844
5. Which type of home is classified based on its rolling steel chassis and is designed to be moved?
   1. Mobile Home \* Answer
   2. Condominium
   3. Multi-family home
   4. Towmhome

## Vocabulary

Definitions from [Oxford Languages](https://languages.oup.com/google-dictionary-en) and [Wikipedia](https://en.wikipedia.org/wiki/Main_Page)

* Background Check: a process a person or company uses to verify that an individual is who they claim to be, and this provides an opportunity to check and confirm the validity of someone's criminal record, education, employment history, and other activities from their past
* Condominium: individual ownership of a unit in a multiunit structure (such as an apartment building) or on land owned in common (such as a town house complex)
* Down Payment: a sum a buyer pays upfront when purchasing an expensive good such as a home or car
* Fixed-rate mortgage: a home loan that has a fixed interest rate for the entire term of the loan
* Homeowner’s Insurance: a form of property insurance that covers losses and damages to your residence, along with furnishings and other assets in the home
* Landord: the owner of property (such as land, houses, or apartments) that is leased or rented to another
* Lease: a contract outlining the terms under which one party agrees to rent an asset—in this case, property—owned by another party
* Liquidity: Liquidity refers to the efficiency or ease with which an asset or security can be converted into ready cash without affecting its market price
* Mobile/tiny home: a dwelling structure built on a steel chassis and fitted with wheels that is intended to be hauled to a usually permanent site
* Mortgage: a legal agreement by which a bank or other creditor lends money at interest in exchange for taking title of the debtor's property, with the condition that the conveyance of title becomes void upon the payment of the debt
* Multi-family home: a classification of housing where multiple separate housing units for residential inhabitants are contained within one building or several buildings within one complex
* Private Mortgage Insurance: insurance that a mortgage lender may require you to purchase if your down payment is less than 20%. Private mortgage insurance is designed to protect the lender in case you default on the payments
* Realtor: a person who acts as an agent for the sale and purchase of buildings and land, in particular a member of the National Association of Realtors; a real estate agent
* Security Deposit: money that is given to a landlord, lender, or seller of a home or apartment as proof of intent to move in and care for the domicile
* Single Family Home: a standalone residential structure, designed to be occupied by an individual household
* Townhome: a multi-story house in a modern housing development which is attached to one or more similar houses by shared walls

## Task

In this module’s task, you’ll be guided through analyzing the cost and benefits of renting vs. Purchasing a home for a hypothetical couple.