Buying vs. Renting

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Over many years of working in the property market I have heard the following phrases many times:

1. 'Renting is throwing money away',
2. 'Your home is your biggest INVESTMENT
3. 'Buying is always better than renting'.

My answers to those statements have always been 1. No, it isn't. 2. Your home is NOT an investment and 3. It depends.

Well, let's just delve a little deeper here and see if that holds true.

I am not talking about property investment here, time for that in a further article, this is just about your actual residential property – where you live.

Taking the first statement – Renting is throwing money away – there are at least three arguments put forward as 'proof':

1. Rent is an expense,

2. Mortgages build equity.

3. Renters lose out on rising property values.

However, property equity is measured by what you own minus what you owe:

Take, for example, a house valued at £268,380 (average house price England 2021).

When buying you put down a 10% deposit of £26,838, therefore you (at the start of the mortgage) owe £241,542 to the mortgage company. At the start of the mortgage the equity you actually own is £26,838. However, during the process of buying the property you had buying costs and stamp duty to find; the actual duty you will pay is £3442 and buying costs in the region of £1000. We have assumed that you are not a first-time buyer for a property of this value.

Mortgage Calculator UK

Home Price - £	268380.00
Deposit - £	26838.00
Mortgage Amount - £	241542
Interest Rate - %	2.29
Term - Years	25.000

Full Monthly Payment	£1,058.23
Interest Only	£460.94
Months	300
Total Interest Payable	£75,927.09
Total Loan Payments	£317,469.09
Total Cost	£344,307.09

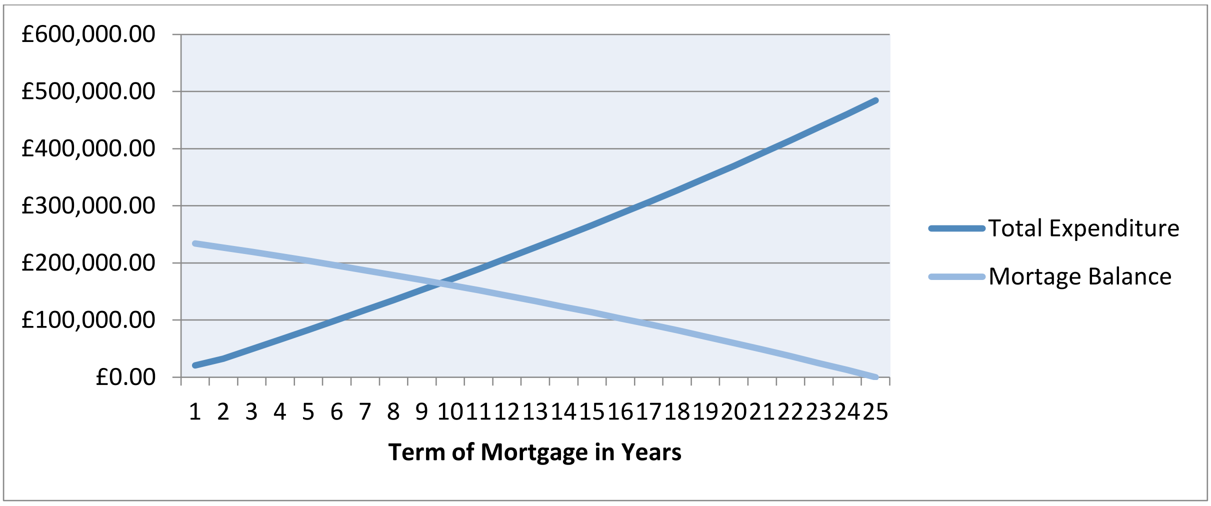
BELVOIR!

Mortgages are amortised, this means that the overwhelming majority of your initial payments are applied towards interest rather than principal. In the trade this is called 'front end loading'. To understand what this means I have included a link to a free calculator here:

Mortgage Calculator

The point where more money is set against the principal rather than interest is based on the interest rate. This calculator shows that it's only from the 11th year onwards that you start paying off more of the principal.

Taking the example above – House value £268,380 deposit 10%: £26,838 and a term of 25 years, you will see that after paying out £16,944.36 over the first year you still owe £236,561.63- the equity only increases by £4980.37! Then we must take account of the buying costs - £4442 – that knocks it down to an increase in equity of £538.37. Owning a property also means that, if you have a mortgage, you must insure it – so add £500 per year (ish) you also have to bear all the costs of maintaining the property – fixing things that break or wear out, cleaning gutters and windows etc. Add in an average of £3000 a year for those and pray the boiler doesn't break down!



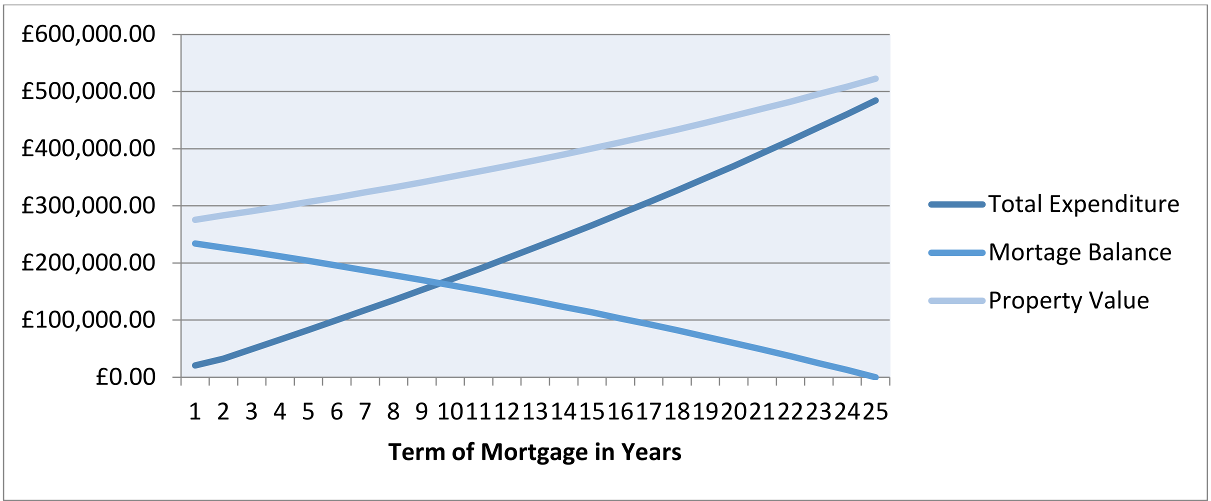
Before you go off on one about interest rates being lower than 5% at the moment, interest rates have averaged 5% for years and mortgage rates are always a few percent above that – look at the rate in 1980 (19%) and 1990 (15%) and think if you have the financial ability to pay those rates for a period of time! In our example above 19% would equate to £3859 per month!! Some of us lived through those times!

[UK Interest Rate History]

Now that we've established this background, lets return to the original argument: If you rent you are building no equity at all, if you are buying then you are building some equity - that's seems obvious – even if you're not building equity then at least some is better than none!

Not necessarily.

Over the past century or so house prices have historically kept pace with inflation, when someone says: my house has increased in value by such and such what they are really saying is that the money they have invested in bricks and mortar has kept up with inflation. The pay-out from premium bonds also keeps in lockstep with inflation (usually) – would you put all of your cash into them?



Don't take my word for it – check out Nobel prize winning economist Robert Shiller, Google him – he wrote the book 'Irrational Exuberance' and he gained public notoriety for predicting the Great Recession.

During 2005 Shiller issued warnings about a probable impending reduction in residential property values that could see a 40 percent drop.

He stated:

"Housing is traditionally not viewed as a great investment. It takes maintenance, it depreciates, it goes out of style. All of those are problems. And there's technical progress in housing. So, the new ones are better. ("Robert Shiller: Don't Invest in Housing - Pragmatic Capitalism")

So, why was it considered an investment? That was a fad. That was an idea that took hold in the early 2000's. And I don't expect it to come back. Not with the same force. People might just decide, 'Yeah, I'll diversify my portfolio. I'll live in a rental'. That's a very sensible thing for many people to do.

From 1890 to 1990 the appreciation in US housing was just about zero. That amazes people, but it shouldn't be so amazing because the cost of construction and labour has been going down.

Ah, you might say – that's the US not the UK, but the crash started in the US and hit us very shortly afterwards. Every housing peak or bubble is followed by a tragic, painful, ugly fall (no real problem if you are living in your forever home and the mortgage is paid off); however, if you have a mortgage, you are now in negative equity, paying out on a property worth less than the value of the outstanding mortgage. Once again, not a problem if you are staying put, but if you need to move….

House prices in many areas have doubled since the 2008-2009 lows. But in the same time period the total UK stock market has nearly tripled. In 2008 the FTSE index was 2456, at the end of 2020 it stood at 7069, nearly 3x more!

Any cash that is tied up in home equity, including the deposit, is locked in a lifetime of just keeping pace with inflation.

The solution for each individual comes from running scenarios based on a massive variety of factors: what savings you start with, prevailing interest rates, tax brackets, utility costs, alternative investment opportunities, how long you will be living in the area etc.

Everyone has their own unique data points, that's why everyone should crunch the numbers based on their own personal situation.

If you don't like the numbers in the example below re-run the scenario using your own numbers, THAT'S THE POINT!

Don't buy into oversimplified cliches like; renting is throwing your money away, **don't oversimplify a six-figure decision:**

Take Alice and Brian – they both have a cash pot of £44,838 (savings, bank of Mum and Dad, inheritance)

Alice decides to rent – her rent costs £1400 per month

Brian decides to buy. Following his 10% deposit of £26,838 his mortgage costs are £1412 per month.

They live in comparable properties.

Alice paid her landlord a security deposit of £1400, and then invested £44,838 into a Stock market index fund that earns an 8 percent long term annualised average. All maintenance and insurances are paid by her landlord.

Brian's mortgage consists of £1402 for principal and interest, he also pays out round £3500 a year for insurances and maintenance. He has a 25-year fixed rate mortgage with a 5 percent interest rate, which means after his deposit of £26,838 his loan balance is £241,542 and the value of the home is £268,380. To buy this house Brian made an initial payment of £44,838 which is made up of £26,838 deposit plus £17000 stamp duty and £1000 solicitor's costs.

Both live in their respective home for 10 years

After 10 years Alice's investment is worth £99,524.23

Brian's home value climbs 2% per year and sells for £327,745, therefore his final equity is £59,365. However, he has selling costs of approximately £5000 which reduces it to £54,365. When you add in the insurance and maintenance (£3500 per year) it reduces to £19,365.

Please note that this entire article presupposes that both Alice and Brian saved their initial stake to allow them to follow their own investment aims.

During the early years of home ownership people will stay in their properties for shorter periods before finally settling into a family home. Their first home is outgrown due to marriage or children, their job changes or moves location etc. In the UK during the 1980s people bought and sold their home every 8 years. Today, due to the high cost of property, stamp duty, moving costs etc the average is now 21 years!

For renters the length of time residing in one place varies widely throughout the country, but the average is 4.1 years.

When doing your own research on property a very good starting point is

zoopla

which has historic and up to date statistics on property throughout the country.

However, for local market vagaries, it is always best to talk to your local Estate Agent

BELVOIR!

and for mortgage advise use an independent mortgage adviser such as

Futures. financial