

Should You Rent or Buy a Single Family Home?

By

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Is it cheaper to pay rent on a single family home or pay a mortgage on a single family home?

While there are many reasons to rent or buy, as a starting point this report compares the average monthly rent paid to rent a single family home compared to how much the mortgage payment might be to purchase an average priced single family home in Greater Phoenix.

Below is the average single family rental rate and average single family purchase price in November 2010 for Greater Phoenix.

November 2010 Greater Phoenix	November 2010 Greater Phoenix
Single family average rental rate*	Single family average purchase price*
\$1,302	\$171,500

* Information from Arizona Regional Multiple Listing Service, Inc.

Question: If a monthly rental payment of \$1,302 turned into a mortgage payment, would \$1,302 support the purchase of a \$171,500 single family home?

Before I answer this question we have to create a common financing scenario often used to purchase: purchasing a home with an FHA guaranteed loan. In November in Greater Phoenix, 36% of single family homes purchased between \$150,000 and \$200,000 were with an FHA guaranteed loan, which was the most common way they were purchased in this price range. Now let's look at the FHA purchase scenario below to see if the average monthly payment for rent of \$1,302 would support the mortgage payment on a purchase price of \$171,500.

Scenario:

FHA purchase of a single family home at average purchase price.

Will the monthly mortgage payment on a single family home purchased at \$171,500 be more or less than the single family rental rate of \$1,302?

<i>\$171,500 purchase price</i>
<i>FHA loan includes mortgage insurance</i>
<i>3.5% required FHA down payment</i>
<i>4.5% interest rate</i>
<i>30 year fixed</i>

\$972
Is the monthly payment for principal, interest and mortgage insurance.
Or
\$330
less than paying \$1,302 in rent
\$1,302 (1,302 - 972 = 330)

Some Other Costs Associated With Owning

In addition to the monthly principal, interest and mortgage insurance the new owner will pay, they will need to pay property taxes and homeowner's insurance. Let's estimate the monthly costs for property taxes at \$150 and \$50 for homeowner's insurance. Adding these two costs to the monthly payment of \$972 brings the monthly payment to 1,172 ($150 + 50 + 972 = 1,172$).

\$1,172

Is the monthly payment for principal, interest and mortgage insurance and an estimate for monthly property taxes and homeowner's insurance.

Or

\$130

less than paying \$1,302 in rent

\$1,302 ($1,302 - 1,172 = 130$)

Additional Costs of Home Ownership

Not all single family homes have a monthly Homeowner Association's fee, but many do. The buyer needs to find out from their real estate agent if they will have to pay a monthly HOA fee. The buyer also needs to factor in home maintenance costs.

A Benefit of Owning: Tax Deductions

If a homeowner itemizes on their federal tax return they may take a tax deduction for the annual mortgage interest paid and annual property taxes paid.

Possible tax deduction for above scenario
<p>\$7,467 mortgage interest paid first year on loan plus \$1,800 in property taxes paid first year =</p> <p>\$9,267 x 22% federal tax rate = \$2,039 tax deduction</p> <p>(the actual tax rate will vary according to owner's income and is only an estimate for this scenario)</p> <p>\$2,039 may be deducted from federal taxes. \$2,039 divided by twelve months is \$170</p>
<p>\$1,002</p> <p>Effective monthly mortgage payment if owner itemizes and able to take deductions.</p> <p>(1,172 – 170 = 1,002)</p> <p>Or</p> <p>\$300</p> <p>less than paying \$1,302 in rent</p> <p>(Of course you do not get the tax deduction monthly but annually. The buyer/owner needs to see an accountant for their specific loan.)</p>

Additional Financing Scenarios
Monthly Payments for
Conventional and VA Compared to FHA

Single Family Average Purchase Price \$171,500.	<u>Monthly payment</u> Principle, interest, mortgage insurance.	<u>Monthly payment</u> Principle, interest, mortgage insurance, and estimate for property taxes and homeowner's insurance.	Average monthly rent payment for single family home.
Conventional loan*: 5% down payment with mortgage insurance and 4.5% interest rate for 30 years.	\$931	\$1,131	\$1,302
VA loan: 0% down payment,** 4.5% interest rate for 30 years.	\$888	\$1,088	\$1,302
FHA loan: 3.5% down payment with mortgage insurance and 4.5% interest rate for 30 years.	\$972	\$1,172	\$1,302

*This scenario is for a conventional loan with mortgage insurance a 5% down payment. Some mortgage insurance companies require a minimum 10% down payment.

** VA loans are 100% financing up to \$417,000. VA requires a 2.15 funding fee which is usually financed into the loan. There is no monthly mortgage insurance premium as there is for FHA. VA loans are for active and retired military personnel.

Conclusion

While there are many reasons to rent or buy as a starting point this paper compares the average monthly rental amount paid for a single family home in Greater Phoenix compared to the amount of a monthly mortgage payment using three different financing scenarios to purchase the average priced single family home in Greater Phoenix. If analyzed only by the amount of the monthly payment buying trumps renting in the examples given. Of course there are many other factors that must be considered when renting or buying.

Questions



Question: What if a current renter wants to own again but went through a short sale or foreclosure?

Answer: The steps to owning again will be contingent on what I call the *Waiting Period Factors*. These factors are as follows:

- 1) The reason why the person lost their home. Was it because of a short sale or foreclosure or deed in lieu and did they file bankruptcy.
- 2) The future financing they will use to obtain a loan.
- 3) Credit check to cleaning up credit if necessary.
- 4) Saving for a down payment.
- 5) Saving for closing costs to close the transaction. Note: since it is a buyer's market the seller often pays some or all of the buyer's closing costs.

Attached to this document is a matrix of the Waiting Periods (this matrix is subject to change at any time). For example, Fannie Mae will allow someone to purchase again in two years if they went through a short sale and have 20% as a down payment. FHA will allow someone to use FHA financing in three years if they went through a foreclosure or short sale. FHA also has extenuating circumstances in which if someone went through a short sale and never missed a payment they may purchase again immediately with FHA.

See **Appendix A** for the Waiting Period Matrix for Post Foreclosure, Short Sale, Bankruptcy and Loan Type.

Question: What is the hottest residential real estate market in Greater Phoenix?

Answer: The hottest residential real estate market measured by estimated months of supply is the single family rental market. There is a two-month supply of single family rentals overall in the Greater Phoenix market. And when a single family home is priced right in a great location it will be on the market for only two-hours.

The hot demand for single family rentals has been driven by the high number of **single family owner occupied homes** that have been foreclosed on or being sold through a short sale. Most previous single family homeowners after a foreclosure or short sale prefer to rent a single family home rather than a patio, condo or apartment.

If demand for single family rentals continues and pushes rent rates up, many renters will consider the benefits of owning.

Question: Is it true that the first-time homebuyer's tax credit and the move-up tax credit are still available to members of the military?

Answer: Yes. The tax credits are available to members of the U.S military, members of the Foreign Service of the U.S., or employees of the intelligence community who had "official extended duty" outside of the United States for at least 90 days during the period beginning after **December 31, 2008** and ending before **May 1, 2010**. For the tax credits to apply these homebuyers must be under contract on or before **April 30, 2011** and closed by **June 30, 2011**.

Arizona has many U.S. military members who may be eligible for the tax credits.

Reasons Why a Renter Might Want to be Buyer

1. Save money: It may be cheaper to own than rent. Your mortgage payment may be less than your rent payment. See your real estate agent for details.
2. Trulia.com analyzed the largest 50 cities in America as to which are better to buy in versus rent in. They ranked Mesa #6 and Phoenix #8 as the best to buy in! **(See Appendix B)**
3. Affordability: Many buyers who could not afford to buy a home a few years ago can now afford to buy. The Greater Phoenix median purchase price level is close to what it was in the year 2000.
4. Interest rates are low! Save money! The lower the interest rate the lower the monthly house payment.
5. Save on taxes: If a buyer itemizes on their federal tax return they can deduct mortgage interest and property taxes. Taking the tax deductions may mean the effective cost of owning is less than renting. For example, if someone paid \$12,000 in mortgage interest in a year and were at a 25% federal tax rate, they may receive up to a \$3,000 annual tax deduction. (The buyer needs to see their accountant as to which is better for them: itemizing deductions versus taking the standard deduction before buying).
6. Supply: A home buyer has so many choices!
7. Negotiating power: Since it is a buyer's market, the seller often will pay many of the buyer's closing costs and prepaids.
8. If you previously owned and lost your home to a short sale or foreclosure you may be able to buy again and don't know it. See your real estate agent for details.
9. Home ownership means a place of your own and place to put your own stuff!
10. Someday home prices will go up again!



Information Campaign: 2011 Is the Year of the Buyer

Fletcher Wilcox and representatives from Grand Canyon Title have been leading an information campaign throughout Greater Phoenix speaking to real estate agents and lenders as to reasons *Why a Renter Might Want to be an Buyer*. For more information contact Fletcher at Fwilcox@GCTA.com or 602-648-1230



Appendix A

Waiting Period Matrix for Post Foreclosure, Short Sale, Bankruptcy and Loan Type

Occurrence	Fannie Mae	FHA	VA	USDA Rural	Jumbo*
Foreclosure	7 Years from completion date	3 Years from completion date	2 Years from completion date	3 Years from completion date	5-7 Years from completion date
Short Sale	2 Years with max 80% LTV ratio 4 Years with max 90% LTV ratio 7 Years – LTV per eligibility matrix	3 Years from completion date **Per FHA ML 09-52, FHA financing can be obtained in less than 3 years under certain conditions.*	No specific information on this yet, assume foreclosure rule of 2 years.	3 Years from completion date	5-7 Years from completion date
CH. 7 Bankruptcy	4 Years from discharge or dismissal date	2 Years from discharge date	2 Years from discharge date	3 Years from discharge date	4-7 Years from completion date
CH. 13 Bankruptcy	2 Years from discharge date 4 Years from dismissal date	1 Year of the payout must elapse & payment performance must be satisfactory; buyer must receive permission from the court to enter into a mortgage	1 Year of the payout must elapse & payment performance must be satisfactory; buyer must receive permission from the court to enter into a mortgage	3 Years from discharge date	4-7 Years from completion date

**Waiting period time frames may be less in situations with extenuating circumstance. *Jumbo waiting periods may vary by lender.

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Appendix B: Trulia.com

Rent versus Buy June 3, 2010

<http://info.trulia.com/index.php?s=43&item=91>

Top 10 Cities to Buy vs. Rent

	City	Price-to-Rent Ratio
1.	Minneapolis, Minnesota	8
2.	Arlington, Texas	8
3.	Miami, Florida	8
4.	Fresno, California	8
5.	San Antonio, Texas	8
6.	Mesa, Arizona	9
7.	Jacksonville, Florida	9
8.	Phoenix, Arizona	10
9.	El Paso, Texas	10
10.	Las Vegas, Nevada	11

Trulia.com Rent vs. Buy Index Interpretation Key: **Price-to-Rent Ratio of 1:15=** It is much less expensive to own than to rent a home in this city. **Price-to-Rent Ratio of 16:20=** It is more expensive to own a home in this city. The total costs of ownership of a home in this city are greater than the costs of renting, but it might still make financial sense depending on the situation. **Price-to-Rent Ratio of 21+=** the total costs of owning a home in this city are much greater than the costs of renting. Trulia calculates the price-to-rent ratio using the average list price compared with the average rent of two-bedroom apartments, condos and town homes listed on Trulia.com. To create the list, **Trulia analyzed the largest 50 U.S. cities by population.**



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- Fletcher is proud to be a part of Grand Canyon Title Agency, Inc. The company has been closing escrows in the Valley for twenty-seven years and has seventeen escrow offices in the Valley.
- Born and raised in Arizona, Fletcher remained in the state to receive his Bachelor of Science degree and a Master of Arts degree from Arizona State University. Obtained an Arizona Real Estate license in 1985. Co-listed and closed a \$2.5 million dollar commercial property in 1986.
- He is a member of the following associations
Arizona State Escrow Association <http://www.azsea.org/>
Arizona Association of Realtors www.AAROnline.com
Scottsdale Area Association of Realtors www.SAAROnline.com
Education V.P. for the Arizona Mortgage Lenders Association www.azmortgagelenders.com/
Publicity coordinator and statistician for the Heart of Scottsdale Tour <http://www.saaronline.com/marketing/scottsdale.php>
Past statistician for the Scottsdale Luxury Tour <http://www.saaronline.com/marketing/scottsdale.php>
- Fletcher is author of "**Residential Focus**" a newsletter which provides statistics and analysis for real estate trends and market conditions in Greater Phoenix; he has been a guest speaker on KTAR, KJZZ/NPR and KFNN/Financial News Radio and his market analysis has been mentioned in the Arizona Republic and AZCentral.com. He is a contributing columnist for the *Arizona Journal of Real Estate & Business* and has written for the Arizona Association of Realtors publication *Arizona Realtor Magazine*; He teaches renewal courses on the Residential Resale Real Estate Purchase Contract, short sales and foreclosures and on the new Good Faith Estimate and HUD-1. From 2006 through 2008 was chairman and MC for the Industry Partners Conference: a conference involving the Arizona Association of Realtors, the Arizona Mortgage Lenders Association and the Arizona State Escrow Association.
- He served eleven years as a citizen board member on the Phoenix Police Department's Disciplinary Review & Use of Force Boards.
- Fletcher joined Alice Cooper's Solid Rock organization as a board member. The organization has been bringing the arts to teenagers. He attends Living Streams Christian Church.
- Fletcher started snowboarding in 2008 going on six trips. He is not very good.