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Rent or Buy? How Falling Mortgage Rates Change the Calculus

BY VERONICA DAGHER

THE MILLIONS OF American renters longing to buy a home are doing the math again after the Fed's rate cut. It still doesn't add up.

Though average rates on a 30year mortgage dropped to just over 6% this week, high home prices keep the monthly payments out of reach. Rents are high, too, but the gap between the two is still often hundreds of dollars apart on average.

Home buyers would need 30-year fixed mortgages to fall to about 5.25% before the monthly payment on a $419,000 home would close in on the average U.S. rent of $1,840, said Nick Villa, an economist at Moody's.

With rates at this level, many renters remain either priced out of the dream of homeownership or unmotivated to take on the risk of such a large purchase. Homeowners are thus less willing to put their houses on the market over worries it won't go for top dollar. Many of these owners also still have an enviable mortgage rate at 3% or lower.

This combined shortage of buyers and sellers has sapped the market's usual frenzy, leading home sales to decline in August even as mortgage rates fell.

Asef Wafa, 30 years old, said the Fed's recent rate cut helps, but it is going to take more to persuade him and his wife to give up their rental in Jersey City, N.J. The couple pay about $3,200 a month for the twobedroom apartment that includes access to a pool and gym.

They figure owning a three-bedroom home in their desired neighborhood of Tenafly, N.J., would cost them about $6,000 a month. It is too expensive to buy a house there now with mortgage rates still above 6%. Besides, he said, there doesn't appear to be many homes for sale.

"Buying becomes more justifiable if interest rates are below 4.5% or if we have a child," he said, speaking of the need for more space.

Many turn to a rent vs. buy calculator to check whether it makes sense to trade their landlord for a mortgage. Comparing the two monthly payments is probably more useful as a barometer for the market than a point of action, since it doesn't factor in all the costs and benefits of ownership.

Homeowners have to come up with a down payment and face rising bills for insurance, taxes, utilities and repairs. Renters, on the other hand, don't build wealth with a portion of each payment, and their monthly payment can't be fixed for decades. They do have more flexibility.

ZIP Codes change the math

Home buyers find the buy vs. rent equation, like everything in real estate, depends on location.

Take a home in Chicago with a $400,000 purchase price and 10% down. Monthly principal and interest on a mortgage at 6.25% would be about $2,217, not including property taxes, homeowners insurance, private mortgage insurance and maintenance costs, said Jeff Ostrowski, mortgage analyst at Bankrate.

Median rent in Chicago is about $1,969, according to Zillow. It would cost hundreds of dollars a month more to own than to rent—and coming up with a $40,000 down payment could be a big hurdle for many first-time buyers, he said. *

In New Orleans and Pittsburgh, it is cheaper to buy than to rent if you just compare the rent with a mortgage payment. That assumes a 20% down payment and doesn't include taxes and insurance, according to a Zillow analysis. Such metro areas tend to have lower home values than the national average as building has generally kept up with housing demand, said Skylar Olsen, Zillow chief economist.

In other areas such as San Antonio and Philadelphia, the typical rent payment and mortgage payment are roughly equal, Olsen said.

Buyers in many cities find there are too few homes to choose from, a shortage that has been compounded by years of underbuilding. Both presidential candidates have promised a fix. Home insurance also factors into the buy vs. rent calculus more these days as it has become especially more expensive and difficult to get coverage in parts of the country prone to storms, wildfires and the effects of climate change.

Time and money

Even when the math isn't perfect for buyers, major life changes such as a new job, a baby or a divorce often change the equation.

It might make sense to buy if you plan to live in the home long term (typically at least five years) due to the time it takes to break even on the closing costs and other fees such as real-estate commissions, said Anthony Syracuse, a financial planner in Scottsdale, Ariz.

If the monthly rent is roughly equivalent to the total monthly cost of homeownership (mortgage payment, insurance, taxes, utilities and maintenance), buying is probably better, said Rick Sharga, founder and CEO of CJ Patrick, a real-estate consulting firm. Most people will gain equity and some tax savings in homeownership.

Waiting game

Renters are choosing to stay put. Sixty-two percent of renters renewed their leases in the second quarter of this year, up from 60.5% a year ago, according to RentCafe.

Laura Heninger, 35, would like to buy a two-bedroom condo in Orlando, Fla., instead of the one she rents for about $3,500. She estimates it would run about $5,000 a month to get a similar condo, including the cost of insurance.

Heninger, who previously owned a home with a roughly 2.5% mortgage, would like to see rates come down again to around 3% before she buys.

"I feel like I'm asking for the impossible," she said.

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