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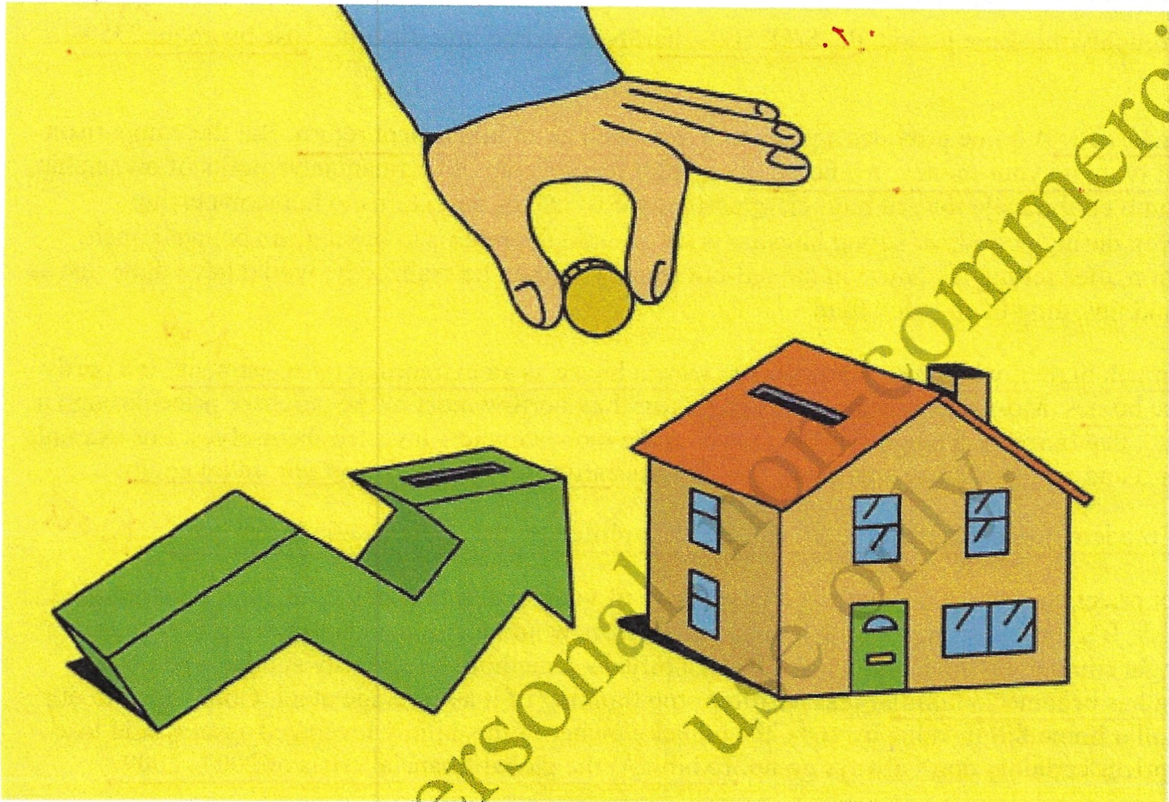

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The Case for Renting

Homeownership is treated like the holy grail of good investment. But what if it isn't?

BY MICHAEL LUCA AND RAYMOND FISMAN

In a 1931 address, Herbert Hoover argued that "to own one's own home is a physical expression of individualism, of enterprise, of independence and of the freedom of spirit." Nearly a century later, his reverence for homeownership remains part of the American psyche.

That sentiment is reinforced from all sides. Realtors insisting you buy before you're priced out of the market. Cocktail-party chatter recounting fortunes made simply by living in the same home for 20 years.

Note

Advice from well-meaning friends and family warning that renting is just throwing away money. But homeownership should be neither deified as a moral imperative nor presented as a surething investment opportunity. The rent-versus-buy decision involves real trade-offs that too often go unrecognized, especially by those who can comfortably afford to buy. Buying a home also bundles two very important, but very different, decisions: where to live and how to invest a large chunk of your life savings.

Take a simple example: Suppose you had a million dollars you could use to purchase a house, or you could instead rent the same house from its current owner. Buying has a certain appeal: It spares you from paying rent and allows you to benefit if housing prices increase. Given the long-run upward trend in housing prices, it is tempting to focus on that potential upside.

But this misses a key cost that is easy to overlook: what economists call the opportunity cost of capital. If you do not buy, you are free to invest the million dollars elsewhere, since it wouldn't be tied up in a house—as so many Americans' wealth tends to be.

The past decade has been a relatively good one for homeowners. Note According to the Case-Shiller Index, home prices increased by about 87% from December 2015 through December 2025.

This sounds like a lot. But over roughly the same period, the S&P 500—hardly an exotic investment—rose by about 235%, Note excluding dividends.

These figures aren't directly comparable: A home provides a place to live as well as an investment return. But the comparison illustrates the opportunity cost of tying up your money in a home. Even after recognizing other financial benefits of ownership, such as a tax code that puts a thumb on the scale toward buying, opportunity cost makes the returns to homeownership considerably less spectacular. Even during periods of strong housing price growth, the returns to buying can be, well, meh. When one of us did this calculation after selling his house in the red-hot Boston market, he realized he would have done just as well by renting a similar home and investing in an index fund.

If stock-market returns were so much higher, why do so many people view a house as an extraordinary investment? Note It's partly the result of the way we purchase homes. Most homeowners don't pay cash; they borrow most of the purchase price through a mortgage. When house prices rise, that borrowing magnifies the return on the money owners invested themselves. For example, a homeowner who puts 20% down and sees the house appreciate by 10% has earned a 50% return on their initial equity.

These sorts of stories are part of modern homeownership folklore, surely amplified by the real-estate industry itself. Note

Leverage works great when asset prices rise, but concentrating a large share of your wealth in a single, illiquid, undiversified asset also magnifies downside risk. It's for this reason that few financial advisers would recommend borrowing hundreds of thousands of dollars to buy a single company's stock, yet many of us happily do something remarkably similar when we purchase a house. Mortgage debt has become so familiar that we often stop thinking of it as leverage at all. Going back to our earlier example, if the million-dollar home fell in value by 10%, the unlucky owner of this highly leveraged asset would lose 50% of their initial equity. And prices certainly don't always go up. Exhibit A: the global financial crisis of 2007- 2009.

None of this is to say no one should ever buy. In the U.S., factors such as tax implications may push us to buy at the margin. And there are real frictions in rental markets as well, from limited supply to the risk of having to move—something you might be willing to pay a lot to avoid. Plus, if you are a tinkerer, homeownership allows you to knock down walls without a landlord's permission.

For those who can afford it, these can all be good reasons to own a home. But they are different from the reasons to see a home as a good investment.

The mistake we see all too often is the tendency to bundle two very different decisions. Where you want to live need not be where you want to invest. *Ray Fisman is the Slater Family chair in Behavioral Economics at Boston University. Michael Luca is professor of economics, technology and policy at Carnegie Mellon University.*

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