Benefits of renting a home may be underrated

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Credit: David Wagner/public domain

Renting rather than owning a home may not be as expensive as many people think, according to financial research from the University of Stirling.

The prospect of no longer having to pay rent, known as imputed rent, is often cited as a major incentive to owning a home. However, financial researcher Dr Isaac Tabner has argued that many buyers overlook costs included in their rent, such as building insurance and property maintenance.

He believes a failure to properly account for these outgoings can cause householders to overestimate the financial benefits of owning versus renting.

Dr Tabner said: "Individual circumstances and market conditions play a big part in determining whether it is smarter to rent or buy, but this research should help households, financial planners and policy-makers make an informed choice."

The new research, published in *International Review of Financial Analysis*, provides a step-by-step explanation of how households can objectively compare the costs of renting versus buying a home, while taking their own personal circumstances and macro-economic conditions into account.

In reviewing transaction costs, imputed rental yields, opportunity costs, inflation and the length of time owning a home, the study also shows that—during periods of deflation or zero inflation—people who rent are financially better-off than those who own their home.

Even when economic conditions are favourable, households may need to own their home for between five and 10 years before returns from the rent they are no longer paying are sufficient to compensate for the high transaction costs of buying. However, increases in inflation and imputed rent, tip the balance in favour of ownership.

Stirling's Dr Isaac Tabner, Senior Lecturer in Finance and Director of the MSc in Finance, said: "It is often thought that buying a house makes more financial sense in the long run: however, renting is frequently more worthwhile than buying for financially-constrained households, as well as households likely to relocate within 10 years.

"As well as a reduced ability to recover transaction costs, households relocating within a few years face a higher risk that medium-term prices will move against them, thus reducing or eliminating their equity, while financially-constrained households face much higher mortgage costs."

The research charts how deflation, or rising interest rates without a corresponding increase in wages, has the potential to impact negatively on homeowners.

The study shows that, for someone purchasing a home with no mortgage, deflation of just 1% per year can result in an equivalent loss of half the present purchase value of their home if they hold it for 45 years. By contrast, inflation—including wages—of 2% per year, results in the same individual gaining 50% of the present purchase value of their home if held for around 28 years.

Japan and, more recently, some Eurozone countries have experienced prolonged periods of deflation. Despite efforts to keep inflation positive, actual realised inflation has been consistently below the Bank of England's median inflation forecasts since the second quarter of 2013.

More information: Isaac T. Tabner, Buying versus renting – Determinants of the net present value of home ownership for individual households, *International Review of Financial Analysis* (2016). [DOI: 10.1016/j.irfa.2016.10.004](https://dx.doi.org/10.1016/j.irfa.2016.10.004)

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