Before you decide, perform a financial analysis.

BY JON A. HULTMAN, DPM, MBA

A friend of mine retired a few years ago in Southern California at the age of 66. When thinking "retirement", he determined that he needed to sell his home in order to assure savings that would last into "old age"—which he defined as 100. Recently, I asked if he planned to continue renting or to eventually purchase a home less expensive than his original one. He said that he felt he could never again afford to buy a home and, by default, planned to continue renting. I then asked what his monthly rent was, to which he replied, "$2,500." Whether you are early in your career and trying to determine at what point you can afford to buy a home, or late in your career and trying to determine whether renting is a better option than buying, it is important to re-think a conclusion such as his "lack of affordability", and base that "re-thinking" on appropriate analysis.

Doctors frequently make "buy/lease" decisions for their medical practices. Whether the potential purchase/lease is a medical building, expensive office equipment, or an automobile, there is a standard way to determine which decision makes the most sense. The difficulty when we apply this same business logic to making a personal "buy/rent" decision regarding a home is that the tax ramifications of home purchase are vastly different. Whether we are working or retired, young or old, we still need a place to live, and we need to best assess our choices. Let us consider the type of analysis that should go into making a buy/rent decision.

As an example, let us consider the $2,500 a month rent that my retired friend is currently paying. According to the December, 2016, *National Apartment List Rent Report*, $2,500 is twice the national average for renting a two-bedroom apartment. This monthly rental cost of $2,500 gives us a $30,000 yearly total. This is the equivalent to the purchase payments on a $500,000 home—assuming a $100,000 down payment, a $400,000 mortgage at 4% ($22,916 a year), property taxes of $6,250, and homeowner's insurance at $834. While the cost for either option (buy/rent) is $30,000 a year, this is where the similarity ends. When purchasing a home of this price, the first month's payment on the mortgage is $1,909.66 ($1,333.33 applied to interest and $576.33 to principal). The $576.33 principal portion of the payment is money the buyer is actually paying him/herself. It has the same impact on his/her net worth as putting that same amount in the bank. The interest and property taxes are fully tax deductible which, if the buyer's marginal tax rate is 25%, reduces these costs by 25%. At the end of the first year, payments total $7,044.15 in principal, $15,871.79 in interest, and $6,250 in property taxes. The interest plus the property taxes—$22,121.79—reduces income tax by $5,530.45 (at a 25% bracket)—making the actual year's total interest and property tax payments $16,591.34. Compare this to $30,000 a year in rent. Also, the principal payments increase the buyer's net worth by $7,044.15. Because the interest portion of each payment is based on the remaining principal balance, this advantage of owning will

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steadily increase going forward. Each month, the amount going to interest drops slightly and the amount going to principal increases. By the thirteenth year, these amounts are about equal, with $11,541.15 applied to interest, and $11,374 to principal.

It should not be overlooked that a significant advantage of owning a home in retirement—or at any age for that matter—is that investment in a home also serves as a hedge against inflation. I remember a patient who in the early 1970s had just retired, sold his home, and moved into an apartment. He was in my office, excited about the sale of his home because there had been a bidding war involved in the sale—pushing the final price up to $160,000. Unfortunately, even though this was a lot of money at the time, going forward, the United States experienced a decade of double-digit inflation. The prices of homes increased significantly, and correspondingly, so did his rental rate. Ten years later that same patient came to my office saying that he was moving in with his son's family because his rent had become too high. If he had, instead, bought and moved into a smaller home when he sold his larger one (at the time, there were still nice homes in Los Angeles selling for $60,000), all he had needed to do was invest $12,000 from his $160,000 profit in a down-payment and borrow $38,000 for a mortgage. His "rent" payments on that mortgage, at 8% interest, would have remained fixed at $278.83 a month—regardless of inflation or short-term fluctuations in home prices, and today, that smaller home would be valued at over $1 million. While today's home prices are greater than they were in the early 1970s, the analysis is the same because home prices are still in proportion to income. Whether you are at the beginning, middle, or twilight of your career, if you are making this same rent/buy decision, look at the numbers and determine from there what will work best for you. **PM**

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