Buy a Home Versus Renting an Apartment?

Which makes more sense?

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A friend of mine retired in Southern California at the age of 65. Looking forward to retirement, he determined that he needed to sell his home and tap some of his $1.5 million equity in order to assure savings that would last into "old age"—which he defined as 100. About five years after he retired, I asked if he planned to continue renting or eventually purchase a home—one less expensive than his original. He said that he felt he could never again afford to buy a home and, by default, would continue renting.

I then asked what his monthly rent was, to which he replied, "It started at $4,000 a month but has increased to $5,500." Later, we will take a closer look at the options this renter considered at the time he retired. Whether you are early in your career and determining at what point you will be able to afford to buy a home or late in your career and deciding whether to sell and tap the equity in your home for spending in retirement, you should consider the "affordability situation" that my friend ended up in and be optimally analytical in planning for the future.

Whether you are early in your career and determining at what point you will be able to afford to buy a home or late in your career and deciding whether to sell and tap the equity in your home for spending in retirement, you should consider the "affordability situation."

A similar situation exists for doctors who frequently make "buy/lease" decisions for their medical practices. Whether the potential purchase/lease involves acquisition of a medical building, a piece of expensive office equipment, or an automobile, an analytical process exists by which one can determine which choice makes the most sense. When we apply this process to making a personal "buy/rent" decision regarding a home, one thing that stands out is the positive impact that home purchase has on taxes.

Every buyer should examine this potential. Whether we are working or retired, young or old, we need a place to live, and we need to know how to best assess our choices. The

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following is the type of analysis that should have gone into my friend's initial buy/rent decision.

Let's consider the $5,500 a month rent that my friend is currently paying. The initial rental cost of $4,000 totals $48,000 yearly. This is equivalent to the purchase payments on a $800,000 home or condo—assuming a $160,000 down payment from his $1.5 million equity and a $640,000 mortgage at 6.4%. Buying an $800,000 home using a $160,000 downpayment would have left him $1,340,000 to add to his retirement funds. While the cost for either option (buy/rent) would initially have been $48,000 a year, this is where the similarity ends.

When purchasing a home of this price, the first month's payment on the mortgage is $4,003.24 ($3,413.33 applied to interest and $589.91 to principal). We can consider the $589.91 principal portion to be money that the buyer is actually paying him/herself—an investment. This portion of the payment has the same impact on his/her net worth as putting the same amount in the bank.

It should not be overlooked that when one owns a home in retirement—or at any age for that matter—their investment in that home serves as a hedge against inflation.

The interest and property taxes for a home of this price are now fully tax deductible (note that Trump's "Big Beautiful Bill" significantly increased the total amount of mortgage interest and property taxes that can be deducted from Federal taxes).

In contrast, none of the original $4,000 rental payments would be tax deductible (the same holds true for his $5,500 payments today). Because the interest portion of each mortgage payment is based on the remaining principal balance, the amount going to interest drops slightly each month, and the amount going to principal increases. These amounts become about equal by the thirteenth year, with half of the $4,000 monthly mortgage payment going towards the owner's net worth at that point. In contrast, his non-deductible rent payments have now increased to $5,500. If he were to live to 100, his mortgage would be paid off at 95 years old, and he would own an asset that has substantially increased in value.

It should not be overlooked that when one owns a home in retirement—or at any age for that matter—their investment in that home, as in the above example, serves as a hedge against inflation. This asset increases in value during periods of inflation; yet, monthly payments remain constant. Rents, on the other hand, can increase substantially.

Whether you are at the beginning, middle, or twilight of your career and are making this same rent/buy decision you should, before making a hasty decision, carefully analyze the numbers to determine what will work best for you over the long term.

Another example: In my early years of practice, I remember a patient who had just retired, sold his home, and moved into an apartment. He was excited about the sale of his home because it had involved a bidding war—pushing the final price up to $160,000. This was 1972, and at the time, this was a lot of money. Going forward, the United States experienced a decade of double-digit inflation. The price of homes increased significantly, and so, correspondingly, did the rate for rentals.

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 unaffordable. At the time that he had sold his home, there were still nice homes in the nearby West Los Angeles area selling for $60,000. If, instead of renting, he had downsized—bought and moved into a smaller home following the sale of his larger one, all he had needed to do was invest $12,000 of his $160,000 profit (his mortgage had been paid off) in a down-payment for a less expensive $60,000 home and borrow $48,000 for the new mortgage.

He would have had $100,000 in profit from his sale which he could have added to his retirement funds. His "rent" payments on that mortgage, at 8% interest, would have remained fixed "forever" at $352.21 a month—regardless of inflation or short-term fluctuations in home prices. Today, that smaller home would be valued at over $2 million.

While today's home prices are not what they were in the early '70s, the analysis remains the same. Home prices should still be viewed in proportion to income. Whether you are at the beginning, middle, or twilight of your career and are making this same rent/buy decision you should, before making a hasty decision, carefully analyze the numbers to determine what will work best for you over the long term. **PM**

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