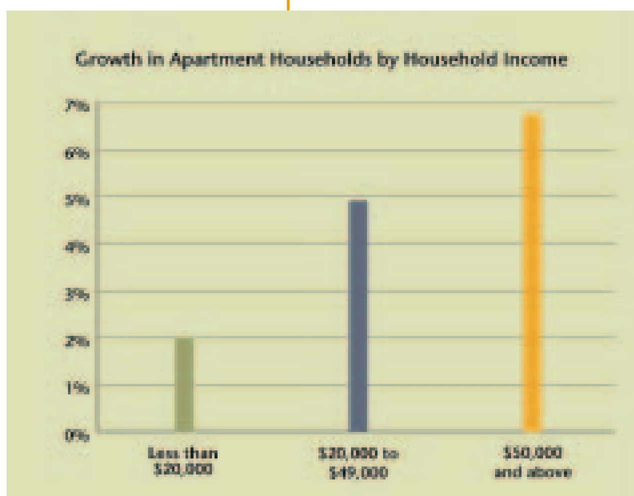
Don't buy the myths

Renting Can Be A Smart Investment

"You need to buy a house."

How many times have you heard that? Turns out that could be bad advice. Here's why:

Every year, thousands of Americans jump into homeownership for the wrong reason, usually pressure from friends or family. It turns out a lot of them could actually save money by renting.



As the *Wall Street Journal* wrote in a 2001 article, "Contrary to popular opinion, renting can often be the better alternative, especially if there's a chance you'll stay put less than five years." [1.]

This brochure is designed to help you make an educated decision about your housing choice. There are many good reasons to buy a house, but most of them are not financial. The investment potential and the tax savings associated with homeownership are often overstated, while the costs of homeownership are frequently understated.

Instead of feeling pressured to buy, you should choose the housing that best suits your lifestyle. If you value convenience, amenities, flexibility and superior locations, you probably ought to rent. This brochure explains why you can do so with the knowledge that you are **not "throwing your money away."**

The fastest growing segment of the apartment market is households earning $50,000 or more.[2.] *What do they know that you don't?*

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On the inside cover: Photo courtesy of The Bozzuto Group © Pearson Photography

MYTH# 1: I'll reduce my tax bill if I buy a house.

The biggest homeownership myth in the country is that owning a house is a huge tax break. If your mortgage interest and other qualifying expenses aren't more than the standard deduction *($9,500 for joint filers, $4,750 for singles in 2003)*, there is no tax advantage to owning. That's one reason why only 34% of all taxpayers itemize.[3.]

Photo courtesy of McCormack Baron & Associates, Inc.

Even if you are able to deduct your mortgage interest and property taxes, remember that depending on your tax bracket, you are still only saving no more than 10 cents to 35 cents in taxes for every dollar you pay in mortgage interest.

Reality Check

Assume you buy a $200,000 house with a 5% downpayment at a 6% interest rate. Your total net tax savings, assuming you are in the 28% tax bracket, is a mere $514.

That's right. You will be able to deduct $11,336 in mortgage interest, but you would have gotten a $9,500 standard deduction without buying. So your tax savings are $11,336 minus $9,500 times 28% tax rate, which equals $514.

Once you factor in your maintenance and repair expenses, your tax savings could quickly disappear. Maintenance costs often run between 1% and 2% of your house's value annually, depending on the house's age *(See Myth# 3)*. **Assuming a conservative 1% maintenance cost, you may have to spend $2,000 to save $514 in taxes.**

Once you factor in the standard deduction and maintenance costs, you could end up spending thousands just to save a few hundred dollars in taxes.

Reality: A majority of owners reap no annual tax benefits from owning a house.

MYTH# 2: Paying rent is throwing away money. I could be building equity.

During the first five years, more than 80% of your monthly mortgage payment is interest. And nearly one third of all homeowners move within five years, before they start building any real equity. Add in the money they spent during that time on maintenance, taxes, insurance and the costs to buy and sell their house, and most would have saved money by renting.

Reality Check

Assume you buy a $200,000 house with a 5% downpayment at a 6% interest rate. After five years of mortgage payments, you will have paid $55,152 in interest and only $13,196 in principal. In addition, you will likely have paid between $10,000 and $20,000 in maintenance and repair *(see Myth# 3)* to earn that equity. **Chances are you could earn more than this in a number of investments that are more diversified and less risky than putting all of your eggs in one basket.**

APARTMENT LIVING IS A GREAT CHOICE FOR:

- Young adults just starting careers
- Single parents who haven’t the time for maintenance or the money to buy a house in a desired school district
- Empty nesters who want to travel
- Anyone tired of long commutes to work
- Anyone who wants abundant amenities and social activities where they live
- Professionals who transfer often

Photo courtesy of SARES•REGIS Group

Reality: **For the first five years of ownership, you are simply giving away money to the bank.**

Don't Buy the Myths

By "renting …we quickly achieved more space, better appliances, better fixtures, better every-thing …I estimate that by renting, instead of owning, we have more than doubled the value of dollars we spend on housing."[7]

Jonathan Cohen
The New York Times

MYTH# 3: My mortgage payment will be less than my rent.

Few prospective owners truly appreciate how expensive annual maintenance on a house can be. *A Wall Street Journal*-commissioned study concluded that "almost every house, no matter how recently or expertly built, is a money pit."[4]

On average, you should expect to spend 1% to 2% of your house's value annually on maintenance.[5] For a $200,000 house, that means $2,000 to $4,000 a year for maintenance. And that doesn't include property taxes, homeowner's insurance or any home improvement, decorating or landscaping you decide to do.

Owning also requires a different kind of budgeting discipline. You need to be prepared for the unexpected, like the furnace that needs to be replaced, the roof that needs to be fixed or the leaking basement. Renters, on the other hand, have the convenience of knowing exactly how much their housing is going to cost them each month.

Photo courtesy of Archstone-Smith

Reality Check

Writing of her experiences as a new homeowner, one columnist said, "Taking care of your humble abode can be so time-consuming that the American dream can turn into a night-mare." "I've been a homeowner for only six months, and already I've spent thousands of dollars beyond my closing costs and downpayment…**but most of the expenses, unfortunately, I won't ever recoup.**"[6]

Reality: Your mortgage payment is just the beginning. The "hidden costs" of ownership can add up to thousands of dollars a year.

MYTH# 4: As an owner, my housing costs will stay constant. I won't have to worry about rent increases.

Your mortgage payment is just part of your housing cost as an owner. You also have to factor in the cost of property taxes and homeowners insurance, both of which have been rising significantly in recent years. Homeowners saw annual property tax hikes averaging 4-5% — for a total increase of 18% — between 1997 and 2001.[8] And homeowners insurance rose 7% in 2003 and is expected to increase another 8% in 2004. Since 1999, average premiums have skyrocketed 26%.[9] And if you have an adjustable-rate mortgage, your costs will rise if interest rates go up.

CALLING ALL EMPTY NESTERS

If you are an older homeowner tired of maintaining your house, the tax laws make it easy and cost-effective for you to switch to renting by exempting up to $500,000 in profit from selling your house from capital gains taxes *($250,000 for single tax filers)*. Selling your house not only simplifies your life, it also gives you easy access to capital and, by investing the proceeds, enough extra income to pay the rent.

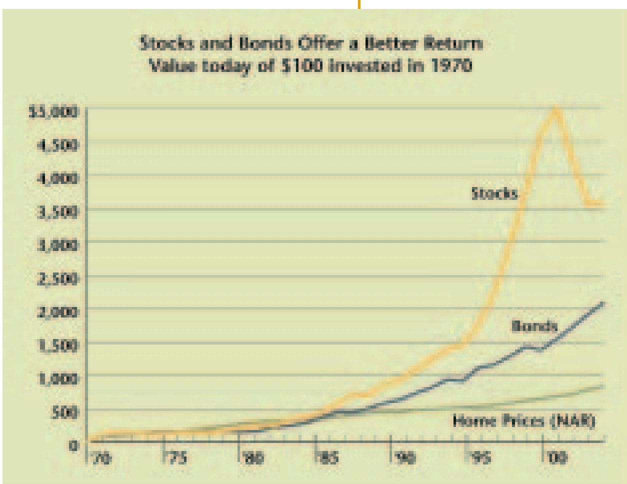
"We are at a point in our lives where we want less and less responsibility and more and more service."

Beverly and Ralph Shearer, Atlanta, Georgia

Reality: **Only your mortgage payment will remain constant. Other costs can go up every year. And if you have an adjustable rate mortgage, your monthly payment can rise too.**

MYTH# 5: Investing in a house is a safe investment.

House prices are not a one-way escalator going up. They can also go down. Predicting whether a specific house in a specific market will appreciate is very difficult. As financial columnist Jane Bryant Quinn noted, "any single (house) sale is as much a lottery as trading stock is."[10] If prices do fall even slightly and you have taken out a low- or no-downpayment mortgage, you could find yourself owing more on your house than it is worth.



Source: National Association of Realtors; CRSP: Lehman Bros.

Plus, experience suggests that even in a booming housing market, you'd probably earn more on your money in stocks than in real estate. According to the editors of *SmartMoney* magazine, "compared with the average share prices or even bond returns, house prices plod up at a very slow rate: since 1979, about 4.4% a year. If you can't do better than that in the stock market, you need to fire your broker."[11]

In 2001, Harvard University's Joint Center for Housing Studies found that "in many places at many times, and for many holding periods during the past 15 years, renting made better financial sense than owning."[12]

"In many places at many times, and for many holding periods during the past 15 years, renting made better financial sense than owning."[13]

Harvard University

Reality Check

"In short, this investment (homeownership) is not a slam dunk. For decent returns on any home, **you need either stupendous luck or a holding period long enough to amortize your many costs."**[14]

Jane Bryant Quinn
Newsweek Columnist

Reality: There are very few risk-free investments and a house is certainly not one of them.

MYTH# 6: I can't afford not to buy with these low interest rates.

It sounds counterintuitive, but low interest rates can actually make housing more expensive, not more affordable. How? Well, if low rates bring a lot of new buyers into the market, housing can turn into a seller's market. Now that there are more prospective buyers competing for the same houses, sellers can demand higher prices. So, interest rates may be low, but they haven't made housing more affordable if they have also pushed up sales prices.

Plus, if interest rates increase, the seller's market could quickly turn into a buyer's market. If you paid the peak prices commanded during the seller's market, you could find yourself having to sell your house for less than you paid for it if higher rates reduce the number of prospective buyers.

The lesson here is that while interest rates matter, you should not feel compelled to buy just because they are low. You may be overpaying for that house just to lock in a low rate.

Photo courtesy of Shea Properties

"I feel safer in an apartment, because other people are around and I like the planned social activities, which are on-site so I don't have to drive."

Tracy Harper
Elementary School Teacher
Atlanta, Georgia

Reality: **Low interest rates may actually serve to make buying more expensive.**

"I have owned three homes previously and dislike the typical owner headaches, such as mowing the lawn, painting, replacing roofs, etc. I like the sense of family, friendly surroundings and professional atmosphere associated with apartment living."

Don Grainger
Account Executive
San Antonio, Texas

MYTH# 7: I know I'll make money on my house because I plan to stay there at least five years.

Most people who buy a house plan to stay there for a long time, but many end up moving sooner than planned for job and personal reasons. Short-term homeownership can be a costly proposition.

The cost of a round trip into and out of homeownership can be as much as 10% of a house's sale price. If you move in a few years, those costs could easily exceed whatever equity and appreciation you've realized. In a worst-case scenario, you might have to write a check in order to sell your house. Or you could find yourself needing to either sell your house at a loss or forego a superior job opportunity elsewhere.

● *Reality Check*

According to one research report, buyers who sold within four years paid, on average, 19% more as owners than they would have paid as renters.[15.]

If you think there is any chance you may be moving again within the next several years, renting deserves serious consideration.

Photo courtesy of Archstone-Smith

Reality: Nearly one third of all homeowners move within five years and many end up losing money.

MYTH# 8: Buying a house will force me to save and help build a nest egg for retirement.

Mortgages can work like a forced savings program. Instead of paying rent, you pay your mortgage and build up equity, assuming you stay long enough to cover the costs of buying, maintaining and then selling the house. But remember, nearly one third of all owners move within five years, before they start building any real equity.

But even if you stay, is this really a wise investment strategy? First, it's risky. It's like putting all your wealth in a single stock. Second, over time, you are likely to earn a better return in the stock market *(See Myth# 5)*. The editors of *SmartMoney* magazine came to the same conclusion in a February 2002 article. They wrote,

> "For most of us, building wealth with our residence is a slow and inefficient process — if it works at all. It's especially hard in this era of low inflation, simply because the underlying asset, your home, typically doesn't appreciate very quickly… The fact is, when it comes to outsized returns, equities win walking away."[16.]

Photo courtesy of Centergate Residential

Reality Check

"Forget what your friends say. **Owning a home is hardly the best way to save for retirement.** How do we know? We ran the numbers."[17.]

SmartMoney, February 2002

Reality: This is a risky and unwise investment strategy.

MYTH# 9: I know buying is better for me because I used an online "Rent vs. Buy" calculator.

An economic analysis of the leading calculators found numerous problems. Some fail to include basic costs like maintenance, insurance or property taxes. Others leave out the transaction costs of buying and selling a house. Almost all of them assume you will itemize your tax deductions, when only 34% of all taxpayers actually do. Most do not factor in the returns you could earn by investing your savings instead of using it as a downpayment. The end result is that consumers who rely on these tools may make one of the most important decisions of their lives based on misleading data.[18]

Photo courtesy of Archstone-Smith © Owen McGoldrick Photography

Reality: **Most of these calculators are overly simplified and seriously flawed.**

The Bottom Line

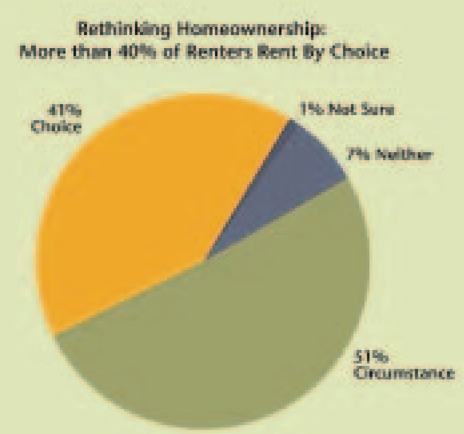
RENTING IS EASIER.
Apartments offer maintenance-free, hassle-free living.

RENTING IS MORE FLEXIBLE.
When you rent, you can relocate for job opportunities without incurring the cost of selling a house.

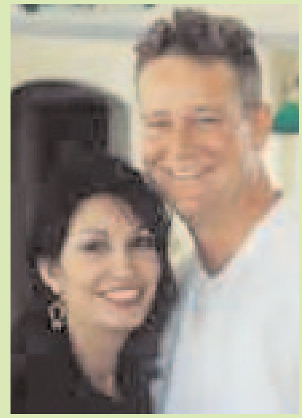
RENTING IS LESS RISKY.
When you rent, instead of tying all your wealth up in a single investment, you can invest in a variety of stocks, bonds and mutual funds. In fact, you can still invest in real estate through Real Estate Investment Trusts (REIT), either individually or in REIT mutual funds.

APARTMENTS OFFER A LIFESTYLE ALTERNATIVE.
Today's apartments offer amenity packages that rival — and often surpass — single-family houses as well as access to new technologies that may be unaffordable in single-family houses. Apartments often are located in neighborhoods with convenient access to transportation, employment, retail and entertainment.

RENTING OPENS DOORS.
Renting allows you to use your "downpayment money" for other investments, to start a small business, to travel, or even to change careers.



Source: Fannie Mae Housing Survey, 2000



"We wanted to be free of the responsibility of a homeowner and to be able to invest all of our money in the business. Apartment living is ideal because it is maintenance-free, convenient and worry-free."

Rose and Gary Trousdale
Sports Management
Business Owners
Phoenix, Arizona

NOTES

1. "Unwise Wisdom: Buying a house is better than renting." *The Wall Street Journal*, January 29, 2001.
2. NMHC tabulations of 2003 U.S. Census Bureau/Bureau of Labor Statistics *Current Population Survey* March Supplement.
3. Magali Rheault, "Tax Time: How America Files." *Kiplinger's Personal Finance*, April 2004.
4. June Fletcher, "Every House is a Money Pit." *The Wall Street Journal*, September 4, 1998.
5. Liz Pulliam Weston, "The hidden costs of home ownership." *MSN Money* Web Site. http://moneycentral.msn.com/content/Banking/Homebuyingguide/P37628.asp on April 13, 2004.
6. Ibid.
7. Jonathan Cohen, "The American Dream, Revised as a Rental." *The New York Times*, July 12, 1995.
8. NMHC tabulations of the U.S. Census Bureau's *American Housing Survey* for 1997 and 2001.
9. Insurance Information Institute. Found at www.iii.org/media/facts/statsbyissue/homeowners/ on April 14, 2004.
10. Jane Bryant Quinn, "Home Prices Bounce Back: But a third of buyers won't hold their property long enough to make money." *Newsweek*, March 16, 1998.
11. Jersey Gilbert, "Is Your House Really a Good Investment?" *SmartMoney*, February 2002.
12. *The State of the Nation's Housing 2001*. Joint Center for Housing Studies of Harvard University, 2001.
13. Ibid.
14. Jane Bryant Quinn, "Home Prices Bounce Back: But a third of buyers won't hold their property long enough to make money." *Newsweek*, March 16, 1998.
15. "The High Cost of Short-Term Homeownership." *Research Notes*, National Multi Housing Council, December 1, 1997. www.nmhc.org/Content/ServeContent.cfm?IssueID=215&ContentItemID=534 on April 13, 2004.
16. Jersey Gilbert, "Is Your House Really a Good Investment?" *SmartMoney*, February 2002.
17. Ibid.
18. "Rent vs. Buy Calculators: How Helpful Are They?" *Research Notes*, National Multi Housing Council, June 29, 2001. www.nmhc.org/Content/ServeContent.cfm?ContentItemID=1159&IssueID=80 on April 13, 2004.

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