

YOUR HOME: BUY OR RENT?

JOHANNESBURG: One of the eternal debates in the personal finance arena is whether you should buy your home or rent one. The intuitive response to this question is almost always the same – buy the home! However the issue is not as simple as it seems. It often makes sense to rent a home and not buy. The research used for this article shows that it might be best to rent for a period then buy. Obviously the decision to buy a home may be driven by lifestyle factors but you need to be aware of all the facts before making the “obvious” decision.

THE NUMBERS FAVOUR RENTING...IN THE BEGINNING

After an internal office debate between some serious number crunchers at a Private Equity firm, I received an email from Zeyn Angamia who is a Principal at the private equity firm, Medu Capital. He asked me about some of the returns I quoted on residential property in a previous article. After our discussion, Zeyn and his colleagues built a financial model using the actual returns of shares and mortgage rates for the 20 year period from 1990 to 2009 and the best available information on residential property returns. This 20 year sample includes a number of different periods of growth and decline in the property and stock markets and is therefore fairly representative.

The model provided some interesting results and certainly changed my thoughts about residential property ownership. The results show that it is better to rent a home whilst saving money and to buy your home with the savings after 10 to 12 years. However, there is a very big “BUT”. You have to save the difference between your rental payment and bond repayments every month for the whole period. The savings must be invested in the stock market (you could use an ETF) and would be used as a lump sum to buy your property within 10 to 12 years.

These results were eye opening for me and provided a new twist to an old debate. As a staunch supporter of the renting faction, I had never seriously considered buying a home but it seems that I may have to rethink my views. As the model shows, you could easily be in a position to buy your home with savings after having rented for 10 to 12 years. People who followed this course of action starting in 1990 were in a position to pay 90% of the purchase price of their home by 1999 despite the fact that the property market had experienced some good growth over the period. Conventional wisdom dictates that it makes sense to buy your home as quickly as possible but the model shows us that conventional wisdom is sometimes flawed. As Benjamin Franklin said, “I have experienced many instances of being obliged, by better information or fuller consideration, to change opinions, even on important subjects, which I once thought right but found to be otherwise.” This certainly describes my current thoughts on home ownership.

It goes without saying that the model is based on historic data and there is no guarantee that the next 20 years will follow the same trend but 20 years is still a long period and provides useful insights.

A MAJOR CAVEAT

If you are disciplined with money and can save according to a fixed schedule, you should strongly consider the rent and save model. If you are not disciplined with money, then the fear of losing your home may be enough to warrant buying instead. There is no magic financial model that can protect you from your own financial frailties, so rather be honest with yourself before making serious financial decisions. There are also very important lifestyle issues that cannot be factored into a

financial model. Many people derive emotional security from owning their own “castle” which would outweigh any other considerations.

WORK THE MODEL & LET US KNOW WHAT YOU FIND

The model has been attached [\(here\)](#) so that you could work on it yourself. For those who are so inclined, you can adapt or expand the model as you see fit. For instance, I would be very interested to know what happens if you factor in the transaction costs of buying a home and selling it every 10 years. How would this affect your long term returns? Similarly, what happens if you rent and save your money as per the existing model and then use half your savings every 10 years to pay a lump sum into the bond? If there are sufficient additional insights that add to the debate, I will certainly write a follow up piece in future. Thanks once again to Zeyn at Medu Capital for adding valuable new information into an old debate!