Should you buy a house or keep renting?

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There's a widespread belief that you should always own a home instead of renting, because if you rent you're "throwing your money away," while buying a home means you're building up equity. There's obviously something to this — all else being the same, it's better to accumulate equity than not — but it's definitely not true that you should always buy a house as soon as possible, no matter what.

When you make a mortgage payment, some of the money goes to pay off the principal of the loan, allowing you to build equity in your home. But for the first few years of the loan, a majority of your mortgage payment — nearly 70 percent at current interest rates — will be paying interest rather than principal. A good way to think about this is that you're paying "rent" to the bank to use some money instead of paying rent to a landlord for using an apartment.

Whether renting makes financial sense depends on whether the rent is higher than the costs — interest payments, foregone interest on your down payment, property taxes, maintenance costs, homeowners insurance, and so forth — you'd have to pay as a homeowner. It also depends on whether you'll live in the house long enough for the savings to offset the substantial transaction costs involved in buying a home.

Many people will come out ahead financially by buying a house rather than renting. But it depends on the market, a renter's particular circumstances, and how long the renter plans to live in the house. The New York Times has a handy calculator that helps you run the numbers.

Here are five key rules to follow when weighing whether to rent or buy.

Don't buy unless you expect to stay in the same place for more than four years

(bikeriderlondon/Shutterstock)

The length of time you'll stay in a home is by far the most important consideration in the rent-or-own calculus. The total cost of a home sale is usually between 5 and 8 percent of its value. That's approximately one year's rent for a similar property. While this cost is generally split between the buyer and the seller, you'll wind up paying both sides if you buy a house and then sell it again within a few years.

What this means is that buying a house that you'll have to sell a few years later is an expensive mistake. While homeownership can provide a variety of cost savings in the long run, it will take several years for these savings to outweigh the transaction costs of buying the home in the first place.

"Buying a house that you'll have to sell a few years later is an expensive mistake"

So if there's a good chance you'll need to move to another city within a few years, it probably makes sense to rent. Similarly, if you're single but are hoping to start a family within a few years, that's something to take into account. Once you meet that special someone, you might find the place you buy isn't big enough, that it's in the wrong part of town, or that he or she already owns a nicer place.

The number of years it takes to recoup the costs of buying a house depends on many individual factors. But for most people, it doesn't make sense to buy a house they'll live in for fewer than four years. And almost everyone will save money if they live in a house for more than a decade.

The richer you are, the bigger the tax breaks you get from buying

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One of the biggest advantages of buying a house is that mortgage interest payments are tax-deductible, whereas rent payments are not. The richer you are, the more significant this tax break becomes.

The value of the home mortgage deduction depends not only on how much interest a taxpayer has paid, but also on the taxpayer's tax bracket. Because rich people tend to both buy bigger houses *and* be in higher tax brackets, they get a larger tax benefit *per dollar of housing*.

This means the higher your tax bracket, the greater the financial benefits of home ownership. A couple making $130,000 per year and buying a $250,000 house will save about 30 percent more on its taxes, thanks to the home mortgage interest deduction, than a couple with $70,000 in income would save on the same house.

Home ownership benefits wealthy Americans in another way too. Contributions to tax-sheltered retirement accounts such as 401(k)s and IRAs are currently capped at $23,500 per year for most workers. That's more than enough for most people, but wealthy workers often want to save more, and a house is one of the few productive assets a wealthy family can buy that, like a 401(k) or IRA, doesn't trigger federal income taxes. If the family bought stocks, they'd have to pay taxes on the dividends they receive. If they bought a rental property, they would have to pay taxes on the renta income. But they don't have to pay any taxes on the valuable housing services provided by their primary home. Even better, the first $500,000 of a home's price gains is protected from capital gains taxes.

Buying means you're on the hook for repairs

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When you rent, you're not just paying for housing, you're also paying for the landlord to make routine repairs and bear the financial risks involved in property ownership. Once you become a homeowner, those hassles and risks fall on your shoulders. When something in the house breaks, you have to either fix it yourself or hire a handyman to do it for you. And if a major appliance like the furnace breaks, you could suddenly find yourself on the hook for major repairs.

Renting limits how much you can deck out your place

The flip side of this is that homeowners have a lot more freedom to customize a home to their liking. If you own your home, you can add a bathroom, remodel the kitchen, or build a back deck.

These kinds of expensive upgrades don't make sense in a rental property. The landlord won't want to pay for them because the next tenant may not be willing to pay extra for them. And tenants won't want to pay for improvements they'll only get to enjoy for a few years. So many renters wind up living in homes they don't love and can't improve. If you're one of them, that's an argument for buying.

Buying a home is betting that your job is secure and your city will keep doing well

One possible downside to owning a home — especially early in your career — is that it limits your economic mobility. Suppose you had gotten a job in the Detroit automobile industry in the early 2000s. If you'd bought a home, you could have wound up in a terrible situation in 2009: Not only could you lose your job, but you could get stuck with a mortgage that was worth more than your home, making it difficult to move to another metropolitan area to get a job.

Some economists see this as a big downside to owning a home. It's good investment practice to diversify: to spread your economic risk around so that one calamity won't wipe you out financially. Buying a home in the same metropolitan area where you work is the opposite of diversification.

"Renters face the risk that surging housing demand will cause rents to rise faster than their incomes"

However, this argument has limits. For one thing, not all jobs are alike. For example, many government workers enjoy robust civil service protections and don't need to worry that an economic downturn will lead to layoffs. Health-care professionals are less vulnerable to layoffs than most other private sector workers. If you have a secure job and you expect to keep it for many years, then there's little reason to worry about getting underwater with your mortgage — you'll be able to continue living in your home and paying the mortgage regardless of how much it's worth.

Meanwhile, renters face the risk that surging housing demand will cause rents to rise faster than their incomes. If you have a stable job but little prospect for getting raises — or you're retired and on a fixed income — then rising rents could actually be a bigger financial worry than the local economy imploding. Buying a house allows you to hedge against future changes in the housing market, ensuring that you'll be able to afford housing no matter how expensive the rental market gets.