

Are renters better off than homeowners?

Empirical research shows that if the savings due to renting are prudently invested, the long-term growth in a renter's wealth will surpass a homeowner's

By: [Prashant Das](#) | Published: September 14, 2016 6:08 AM



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HOME ownership is often associated with a sense of security, pride and entitlement. Communities with more homeowners tend to have deeper investment in socio-political infrastructure which enhances welfare. There are some disadvantages too: Restricted mobility of homeowners may interfere with career prospects. Issues related to risks in title, construction-delay by developers and fears of adverse possession may take their own psychological tolls. However, it is the financial motivation which poses a bigger question.

Consider a flat worth R1 crore, say, in Noida. Also, consider a 20% margin, 30-year loan which costs 10% interest rate. Including the annual EMI, property taxes, insurance, fees, etc., and

adjusting the income-tax benefits, the annual cost of homeownership will be about R9 lakh. This means that in terms of cash flows, homeownership has a negative 9% yield initially. On the other hand, the after-tax rental income from such a flat (after adjusting for brokerage, maintenance, etc.) will hardly be R1.5 lakh. So, in the short run, the net-effect of homeownership is negative (-7.5%). A conventional hope is that whatever negative yield accumulates over the years will be “more than” compensated by real estate price appreciation.

However, Residex, the NHB’s residential real estate price index offers a reality check. Of the nearly 220 price indices tracked, most (120-odd) indices fail the investors, where year-on-year real estate price appreciation has been less than 7.5% in recent years. The price-appreciation averages at 5% ranging between -9% (Meerut) and 17% (Chennai). Of the 26 metros tracked, in nine the price appreciation is near-zero or subzero, in six, the prices appreciated at levels below 7.5% while only in 11 metros, the price appreciation was above 7.5%.

Some pockets of these metros which experienced high appreciations are, in fact, at the risk of bubble-building and are ripe for bursting. Interestingly, the 7.5% price appreciation benchmark only affords a homeowner to breakeven on the investment. It is the appreciation in excess of 7.5% which would mean growth in wealth. Even so, how many owners will actually sell their homes soon to capitalise on this gain?

The cash flows that appear so grim to the homeowners in the beginning years will, of course, improve in the long run. After all, the rental income will grow, but the mortgage payment may stay stable. Considering a 6% growth rate, the cash flows would still stay negative until the loan matures. If the home is sold at its market price (considering 6% to 10% annual appreciation) in the 30th year, a homeowner’s annual return would roughly be 5% to 11% which averages at 8%.

Similar returns may be generated from investing in bonds or fixed deposit bank accounts which are virtually risk-free and hassle-free. Even the optimistic real estate returns in the long run may be matched (or beaten) by mutual funds. Empirical research, too, supports this notion: if the savings (due to renting) are prudently invested, the long-term growth in a renter’s wealth will surpass a homeowner’s. Nevertheless, studies also caution that renters are too imprudent to capitalise on the opportunity.

The example cited here is typical to middle-class investment in multistorey flats; and may deviate from reality. For owner-occupied flats, the psychological perks of homeownership may outweigh all financial concerns. Also, investments targeted at parking cash in real assets or unleveraged investments in homes may offer a slightly different story. Nevertheless, despite India being among the lowest-ranked countries (among peers and developed nations) in terms of housing affordability, mortgage availability and per-capita income, our homeownership rates are among the highest globally. Is it time we rethought our obsession towards homebuying?

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