Estimating the Outlays of Renting and Owning: The Risks of Hidden Ownership Costs

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Introduction

Housing constitutes the largest expenditure category in the typical American family's household budget (Gieseman & Rogers, 1986). The impact of consumer housing decisions can dwarf many other consumer expenditure decisions. Consequently, it is vital that consumers and consumer educators be well informed about the realities of housing choices and housing costs. Mistakes about housing costs can lead to misallocation of resources (Brueckner, 1997) or, in some cases, foreclosure. Because of the variety of initial and ongoing expenses associated with homeownership, families in rented housing are particularly vulnerable to miscalculating the costs of homeownership. Although the sub-prime mortgage market has cooled recently due to regulation and foreclosures, it is still far easier for moderate-income families to take on large amounts of mortgage debt than in past decades (Courchane, Surette & Zorn, 2004; Ho & Pennington-Cross, 2007; Immergluck & Smith, 2004).

For those making the tenure switch from renter to homeowner, accounting for these costs can be daunting. Aside from the initial homeownership expenses, home maintenance and repair costs rarely concern renters, but can be a major source of expenditure for homeowners. Certain utilities, such as water or trash, are commonly included in rent payments, but must be paid for separately by homeowners. There are demonstrated effects of volume discounting and economies of scale that renters enjoy regarding energy costs that elude homeowners (Rong, 2006; Linneman & Voith, 1991). Also, renters have less consumer demand for such things as furniture and appliances, due to smaller overall living area and the advantage of having such features included within the rental unit. Consequently, renters rarely encounter the need to replace major appliances, and may not project a change in this reality after becoming homeowners. Recent increases in mortgage foreclosures may provide some evidence of these kinds of miscalculations by consumers (Goldstein, 2004).

This paper addresses two questions:

(1) In what expense categories do renters' housing-related expenditures differ from housing-related expenditures of homeowners with a mortgage?
(2) After controlling for demographic variables, how do total housing costs differ (absolutely and as a percentage of income) for renters and homeowners with a mortgage?

Data for this paper came from the Consumer Expenditure Survey (CE), a national rotating panel survey used to track household expenditures. We examined participating households for the ten-year period from 1995 to 2005. Consistent with the design of the CE and previous research, we treated each quarterly observation as independent (Passero, 1996; Sharpe & Abdel-Ghany, 1999; U.S. Department of Labor, 2006, p. 277). All dollar figures were inflation-adjusted using the Consumer Price Index, and included such categories as liquid assets, income and housing expenditures.

Table 1 provides an examination of the differences between housing expenditures of both renters and homeonwers. It helps to dispel some of the common notions about cost advantages of homeowning over renting. There were 162,610 observations of renters and homeowners with a mortgage, after eliminating records of those homeowners without a mortgage. Comparing rent with non-principal mortgage payments revealed only a slight difference between renter and owner expenditures. However, homeowners encountered several additional costs. Property taxes, maintenance, repairs, and property insurance expenses were nearly zero for renters, but averaged over $600 per quarter for homeowners – approximately half the non-principal cost of mortgage payments.

Household furnishings and equipment expenditures were more than twice the level for homeowners, which may have been due to the need to purchase and replace household appliances. In addition, the typically larger square footage of owned homes may have generated greater furnishing needs.

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Homeowners also took on additional expenses in the area of utilities, paying much more on average for things like water. In this sample, over 76% of renters indicated making no payments for water – most likely due to inclusion in the fixed rent. Even those renters who did pay water bills (where it was not included in the rent) paid significantly less than homeowners, possibly due to smaller family sizes and potential volume discounts. Regarding energy expenditures, homeowners paid 73% more for these utilities than renters, reflecting the smaller square footage of rental units and the energy advantages of heating and cooling smaller spaces. The total housing expenditures of renters and homeowners were dramatically different also, highlighting the misleading nature of directly comparing rent with interest-only mortgage payments. For renters, rent covered more than 2/3 of total housing costs; meanwhile, interest payments of homeowners covered less than 40% of total housing costs.

In Table 2, we employ ordinary least squares multivariate regression analysis to determine the absolute and relative affordability of renting. Renter status was associated with a reduction in total housing expenses as compared to similarly situated homeowners with a mortgage. Renter status was also associated with a reduction in the percentage of income spent on total housing expenses, although this impact was less statistically significant and the fit of the model was very low.

There are numerous documented potential benefits to consumers from homeownership (McCarthy & Quercia, 2000). However, accurately estimating the costs of homeownership is critical for consumers and consumer educators, particularly for lower-income renters transitioning to homeowners. These households may be at risk of foreclosure when unplanned costs of homeownership inevitably arise. As the largest component of consumers' budgets, it is particularly important for consumer educators to move beyond just a comparison of rent with simply mortgage payments and accurately convey both the obvious and hidden costs of housing choices.

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Table 1: Tenant and Homeowner Quarterly Expenditures
1995-2005 Consumer Expenditure Survey: Mean (standard deviation)

Variable	Renter	Homeowner w/ Mortgage
n	73,131	89,479
Rent / mortgage (non-principal)	$1,157.95 ($1,021.44)	$1,235.58 ($1,299.58)
Property tax	*n/a*	$356.98 ($517.77)
Maintenance, repairs, insurance	$2.85 ($74.18)	$248.03 ($926.54)
Household furnishings & equipment	$123.62 ($446.32)	$334.27 ($989.83)
No gas/electric/oil (included in rent)	20%	n/a
No water (included in rent)	76%	n/a
Gas/Electric/Oil (not included)	$191.95 ($177.63)	$332.05 ($245.07)
Water (not included)	$83.31 ($84.29)	$115.41 ($103.33)
Total housing expenditure	$1,721.67 ($1,522.43)	$3,102.65 ($2,849.37)
Rent / mortgage (non-principal) as a % of total housing expenditure	67.3%	39.8%
Total expenditures	$4,579.66 ($4,560.77)	$8,851.62 ($8,066.40)
Housing as % of total expenditures	38%	35%
Gross income	$8,152.71 ($7,681.52)	$18,783.48 ($14,238.45)
Housing as a % of gross income	21%	17%
Liquid assets	$2,195.53 ($32,330.90)	$10,842.61 ($99,383.57)
Married	30.6%	71.7%
Single male	27.9%	10.9%
Single female	41.4%	17.4%
White	75.6%	86.7%
Black	17.4%	8.2%
Age	41.1 (17.5)	45.9 (12.6)
No. of household members	2.3 (1.5)	3.0 (1.5)

Table 2: The Impact of Renting on Housing Expenditures
Ordinary Least Squares regression: Parameter Estimate (Standard Error)

Independent Variable	Dependent variable: $ spent on housing	Dependent variable: % of income spent on housing
Renter	-433.4065*** (12.5407)	-2.1447** (0.7625)
Gross income ($10k scale)	194.2729*** (1.1802)	-0.6375*** (0.0718)
Liquid assets ($10k scale)	10.7038*** (0.6971)	0.0433 (0.0424)
No. of household members	65.6949*** (4.1309)	0.0565 (0.2512)
Age	-0.353 (0.3677)	-0.0335 (0.0224)
White	34.3698* (14.0332)	0.8088 (0.8532)
Single female	-93.3847*** (14.7044)	-2.7591** (0.894)
Single male	-231.6115*** (17.051)	-1.5121 (1.0367)
Intercept	1460.9186*** (30.7416)	8.5138*** (1.8691)
R^2	.2353	.0005
n	162,610	162,610

*p<.05, **p<.01, ***p<.001
Including only renters and owners with a mortgage
1995 – 2005 Consumer Expenditure Survey