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Moving Out of Your Parents' Basement: Should You Buy or Rent?

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According to the Pew Research Center, 32.1 percent of emerging adults (18- to 25-year-olds) are living in their parents' home. It is increasingly more common for emerging adults to live with their parents for longer or to move back in with them after college. Either way, emerging adults (and their parents) have a goal of eventually being fully independent. Before moving out of your parents' house, there are some things you need to know, things you can be doing to prepare, and some things to consider. Let's start with some basics you may need to know before you get out into the real world by yourself.

What You Need to Know

Begin by establishing a deadline for when you want to move out. Chances are that neither you nor your parents want you living at home forever. So, first, talk to your parents about both your and their expectations for how long you will be living with them. This will give you an idea of how long you have to save, to budget, to search for a new place, and to prepare for #adulting.

Next, you need to create a realistic budget. It is imperative that you budget and save during this time with your parents. Some parents might ask you to pay rent while others might not. Regardless, begin practicing your budgeting skills by setting aside how much you think you will pay in rent every month plus the amount you would need for bills and any "going out" money. Keep in mind that housing, transportation, and food will be the majority of your budget. If you allocate your money properly, you should be able to begin saving for your own place.

It is important that you know what you are budgeting for. In other words, are you planning to rent an apartment or are you hoping to purchase your own home? The choice can seem overwhelming; especially if this will be the first time you are living on your own. However, for some people who lived in a rental during college, they might feel ready to buy a place. Here is a rundown of important questions to ask, what is included when renting an apartment or house, and the pros and cons of buying.

Renting

There are some expenses associated with renting a property you will need to consider. Some apartments, houses, or duplexes include utilities in the rent while others do not. In addition, you will need to furnish your new place unless it is pre-furnished. Cable and internet are two more expenses you will need to consider when moving into a new apartment. Finally, many people get renters insurance which covers damage or loss of property.

When you are starting your rental search, look on property management or realtor websites, online listings on sites such as Zillow or Trulia, ask friends, or go to online forums for the city you live in or are planning to move to and ask for advice on the best places to live on your budget.

Compare different rental properties before deciding. Make a list of what you want in a rental. Make sure the properties fit within your budget. Take a tour of each option so you can see them in real life and get a sense of how you would fit into the complex. When touring, and before signing a rental agreement or application, ask whether the rental price will go up if you do not sign by a certain deadline.

Questions to ask during your rental search:

- How much is rent and when is it due?
- What is the length of the rental agreement?
- Who pays utilities? How do I set them up?
- What amenities are available? Are there any extra charges for them?
- What is the policy for guest parking and pets?
- Who pays for maintenance on my apartment? Whom do I contact?
- What are the eviction terms?

After you have chosen your apartment, you are ready to sign your rental agreement. You may have to pay a security deposit, which may or may not be refundable at the end of your lease. The property may also ask you to pay first and last month's rent and/or have a co-signer. The rental company may need additional information such as who is living in the apartment, your income or employment information, rental history, references, and a credit history check.

Always read the rental agreement and ask any questions you have before you sign.

Buying

Having a stable house payment allows you to incorporate that expense into your household budget much easier. Although it is possible for your mortgage payment to increase over time because of changes in insurance fees and property taxes. If you have a fixed-rate loan, your principal and interest payment will remain set for the life of the loan, which could be as long as 30 years.

Many people view home ownership as an investment with potential return. In addition to building equity with your monthly mortgage payment, the value of your home could increase in value. Finally, home ownership offers the owners a sense of stability and freedom, knowing that you have a place of your own to meet the needs of your family.

Although buying a home can be very exciting and has many benefits, it is also important to think about the disadvantages associated with home ownership. In many cases, monthly rent at an apartment complex would be less than a monthly mortgage payment.

Some of the monthly costs of home ownership include:

- Your mortgage payment, property taxes, insurance, utilities, and maintenance.
- In most cases, if you do not have a 20 percent down payment, lenders will require you to pay private mortgage insurance (PMI), which is an additional expense.
- As a homeowner, you must either make repairs yourself or pay someone to do the work.
- Often with home ownership, you have reduced flexibility, meaning you will most likely need to sell or rent your house before you can move.
- Finally, the opportunity to build equity is generally considered an advantage to home ownership. However, it is important to realize there are no guarantees that a home will increase in value.

Consider This

After carefully weighing the pros and cons of home ownership, there is something else to consider before making your decision to buy or rent: How long you plan to live at the residence.

Depending on the housing market, it may make financial sense to rent instead of buy. Although an advantage to buying is the buildup of equity while you are living there (as opposed to paying rent to a property owner), there are several upfront fees called "closing costs" associated with setting up a mortgage. If you plan to live in a home for a short time, consider how much your home value would need to increase before you would recoup the fees you paid in closing costs, in addition to any real-estate broker fees you would pay when selling the house. Because it can be difficult to predict the real-estate market, buying doesn't always make sense.

Four C's of Credit

Capital is the amount of cash you have available. As part of the home-buying process, you usually will need capital for the down payment, loan fees, closing costs, reserves, and moving expenses.

Capacity is your ability, based on your income, to pay your new mortgage payments as well as your other debts and living expenses. Your capacity is calculated based on your current income, income history, future earning potential, and amount owed, including car payments, student-loan payments, credit card accounts (Visa, MasterCard, etc.), and any other monthly payments.

Credit refers to your credit report and credit history. If you do not have a credit history, you will need to go through the process of building a credit history with receipts and payment slips showing regular monthly payments to property owners and utilities.

Collateral will be your new home. The lender will do an appraisal of the home you decide to purchase to determine the value of the house. Collateral provides the lender with security on the loan if the borrower defaults (or does not pay the mortgage).

A general rule of thumb to determine how much you would be able to qualify for is 2.5 to 3 times your gross annual income. This is assuming that you are in good financial shape, have a steady income, low debt, a sizeable down payment, and good credit. Using this as a guideline, a family earning $60,000 a year, would probably qualify for a loan between $150,000 and $200,000. Mortgage lenders often use ratios to determine the maximum loan amount for a borrower.

Two common ratios used by lenders are housing expense-to-income ratio and debt-to-income ratio.

- The **housing expense-to-income ratio** represents the maximum percent of the borrower's gross monthly income that can be used for the house payment. Twenty-eight percent is a common percentage, but different lenders will have different percentage requirements, normally ranging from 25 percent to 33 percent. Using 28 percent as an example, if your gross monthly income is $2,000, the maximum amount you could spend each month on your house payment, including principal, interest, taxes, and insurance (PITI) is $560. ($2,000 * .28 = $560).
- **Debt-to-income ratio** is another number often calculated by lenders. The debt-to-income ratio represents the maximum percentage of the borrower's gross monthly income that can be used for all debts, including the house payment. Typically, to be able to qualify for a loan, lenders will have a preset limit between 36 percent and 41 percent. If your loan has a maximum limit of 36 percent, and if your gross monthly income is $2,000, the maximum amount you could spend on your home mortgage plus all other debts, such as car payment, student loan, etc., is $720. ($2,000*.36 = $720).

Want to move out of your parents' basement? Follow this guide to begin budgeting, saving, and planning your move. If you pay off loans, take care of your credit, and weigh your options carefully, you will be living independently in no time at all.

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