CALIFORNIA ASSOCIATION OF REALTORS®
Market Snapshot

Imputed Rent? Buyers Be Aware!

On top of the many financial benefits (we're not even counting social and emotional ones) to owning a home, the biggest one that people do not generally know, or think about is "imputed rent" - that as a homeowner you get rental income and pay it... to yourself, tax-free.

Wait what? It's a little hard to get your mind around this, but the idea is that when you live in your own home, you don't have to pay taxes on rent that you pay yourself. Again, what? Ok, imagine if you and your neighbor owned almost identical homes and you decided to switch because you each liked the color that the other home was painted in. You each have now become both a landlord and a renter and pay the identical rental income to the other person, so nothing changes right?

Well, no. Since you are now being paid rental income, you must report that on your taxes and pay a portion of that income to the government. This is the imputed rent. If you then decided - wisely, to switch back to your own houses you now pay yourself that tax instead of the government.

Homeowners in some other countries do pay taxes on this income that they pay to themselves, but in the United States we decided that homeowners should not pay taxes on this income, that people pay themselves. If you live in your own house, you are generating an implicit income that is tax free.
Despite changes to the tax-code that reduced the Mortgage Interest Deduction, and deductions on state and local taxes, imputed rent remains a big financial advantage of owning, and the excess imputed rent, on top of normal appreciation, is money that becomes net wealth that is built through homeownership.

Of course, there are extra costs associated with owning that renters don't have: property taxes, insurance, HOA dues or condo fees where applicable, and dealing with repairs and normal wear and tear. All factors that take time, energy, and hassle. But as a renter many of these costs do get passed directly to you from your landlord. But even disregarding property value increases, the financial benefits of owning can and do outweigh the costs for many homeowners.

So how much does this imputed rent come to? Well it depends on your financial situation, interest rates, likely appreciation, and maintenance.

For California, it would go something like this: The median price of a home is now $600,000, and the median rental is $2500 per month.

So, the imputed annual rental dividend would then be ($2500 * 12) / $600,000 = 5%.

From this you subtract local and state property taxes, insurance and general maintenance, but add the annual appreciation for homes (in California, for 2018 it has been 7.5%, but in your local area it will, of course vary). What remains after this is an after-tax return of owning outright. Of course, most people do not buy out-right, so you have to take into account (or subtract) the cost of the mortgage: the interest rate. All of these taken together represents the costs and benefits of owning.

“Buyers beware” but also “be aware” of the financial costs and benefits involved in homeownership!

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