If You Can Pay All Cash for a Home, Should You?

House Beautiful

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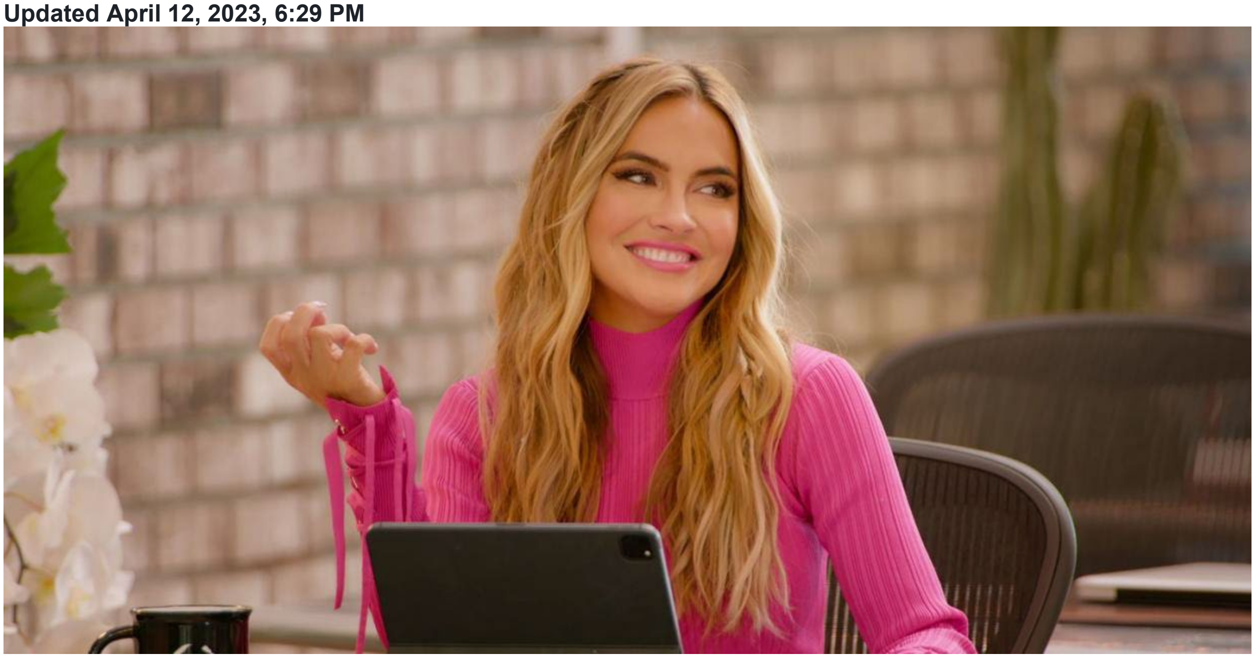
Updated April 12, 2023, 6:29 PM



Should You Pay All Cash For a HomeNetflix

When interest rates plunged to historic lows and dropped below three percent in 2020, taking out a mortgage seemed like a no-brainer. But now rates on the most popular home loan product—the 30-year-fixed rate mortgages—are back up to around seven percent. Which begs the question: If you can swing it, should you try to pay all cash for a home? Or is does it make more financial sense to get a mortgage? Which is the smartest financial decision?

Believe it or not, nearly one third of U.S. homes are bought with all cash, according to a 2021 analysis from Redfin real estate company. Having an all-cash offer can help you stand out in a competitive homebuying market because, with fewer contingencies, you can get to the closing table quicker.

If you're in that enviable position, bravo. Just keep in mind that even if you can buy a home all-cash, according to the experts, whether you *should* do so depends on your overall financial picture and opportunity costs.

For example, if you're thinking of selling stock to buy a home, you'll need to consider the capital gains tax you'll have to pay. If they're sizable, it may be cheaper to have a mortgage, says Melissa Cohn, regional vice president at William Raveis Mortgage. She recommends considering today's rates to be a "bridge loan" and refinancing when rates drop.

Buying a home also has tax implications, especially if you itemize your deductions instead of taking the standard deduction. Buyers who take out a home loan, for instance, can claim a mortgage interest deduction that could reduce their taxable income, says Levon Galstyan, a Certified Public Accountant at Oak View Law Group. The deduction is available for mortgage interest paid on the first $750,000 of mortgage debt.

Tax issues aside, for those who have cash to buy a home, the overarching question is: "Will I have enough leftover for an emergency fund?" That amount—set aside in case you lose your job or have a medical emergency—should equal between three to six months of expenses, says Kendall Meade, CFP, and a financial planner for SoFi. Three months may be enough if you are a dual-income family; six months is good for those who have fluctuating incomes. Consider your emergency fund separate from, and in addition to, other expenses associated with moving, like closing costs, hiring movers, and buying new furniture.

If you've got your emergency fund taken care of, and have money leftover, you'll want to consider where to invest it. While your home can be a valuable asset in your overall financial picture, it is far less liquid than other investments, says Jill Fopiano, the CEO of O'Brien Wealth Partners. Ideally, along with real estate, you should have a balance of liquid investments you can access easily should you need cash or see an investment opportunity, she says.

If you don't go the all-cash route when buying your next home, you can invest that money elsewhere. "The best way to invest in the markets over time is to have a diversified portfolio with a mix of stocks and bonds that is suited to your personal and family goals," Fopiano points out. "High interest rates generally mean lower prices for purchasing bonds as an investment, so it may actually be a good time to be investing."

Still not sure what to do? Keep in mind the upfront investment you put into a home doesn't have to be all or nothing, Meade says. A happy medium might be offering a sizable down payment and getting a mortgage, which will save you interest over the years.

While mortgage rates are higher than they were a year ago, they are still pretty reasonable historically, Fopiano points out. As an alternative to a complete refinance, some mortgage companies offer a rate reset option that allows you to lock in lower rates for a relatively small fee if rates fall.

The bottom line: Whether or not you should buy a home in an all-cash deal depends on several factors, each of which has to do with your own, specific financial set-up. Your best bet is to meet with a financial planner who can take into account your unique financial situation and help determine what's the right move for you.