



Deciding to Buy a Home

How Much House You Can Afford

Deciding to Buy a Home: How Much House You Can Afford

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The foundation for buying a home is good money management skills. You need to review your financial readiness to buy a home and to find out how much you can afford to borrow while still meeting other household expenses.

Financial Readiness

If you have completed the Managing Money module of this program you probably have completed many of the work sheets necessary to determine if you are financially ready to be a homeowner. If you have not already done so, complete the Net Worth Work Sheet, the Spending Plan Work Sheet and the How Much Do You Owe Work Sheet.

These work sheets will help you answer the nine questions below about your readiness to buy a home.

1. Do I have a steady source of income?
2. Have I been employed on a regular basis for two to three years? If you own your own business, do you have your income tax records to confirm your income?
3. Is my income reliable? If you receive child support, alimony, an annuity or other forms of income, do you have a 12-month history of receipt in order to document reliability?
4. Do I have a credit history? This refers to whether you have ever borrowed money for any purpose. If you haven't checked your credit

report(s) recently, now is a good time to do this.

5. Do I have a good record of paying bills? Paying utility bills, rent and other bills on time establishes an alternative credit record if you haven't previously borrowed money.
6. Am I able to pay my bills and other debts on time and have money left at the end of the month to save?
7. Am I able to make the mortgage payment every month plus handle additional costs for taxes, insurance, maintenance and repairs?
8. Do I have money saved for closing costs? The closing costs are the fees involved during the home-buying process. These may include but are not limited to appraisals, title work and inspection fees.
9. Do I have money saved for a down payment? The down payment is the portion of a home's purchase price the buyer pays in cash. The more you have for a down payment, the less you will need to borrow.

Lenders prefer that you have 20 percent of the purchase price for a down payment. For example, 20 percent of a \$50,000 mortgage is \$10,000. However, there are many special loan programs that require a smaller or no down payment, including those for first-time homebuyers. Many people start the home-buying process with one of these programs or with one offered by local community organizations. Government loan

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programs are generally targeted to individuals and families with a modest income. Even if you qualify for a smaller or no down payment, you will need money saved for unexpected expenses.

If you make a down payment of less than 20 percent, you will generally have to purchase Private Mortgage Insurance (PMI) or participate in a government mortgage program. Mortgage insurance only protects the lender (not the buyer) if you default on the loan. It is an additional cost to the mortgage.

If you answered yes to the above questions, you may be ready to buy a home. If you answered no to any of the questions, concentrate on strengthening those Managing Money module or look for homebuyer education classes in your area. These classes are a good source of information and will help you prepare for homeownership.

How Much You Can Borrow: Do It Yourself

You can figure out for yourself about how much mortgage you can afford. This estimate will give you an approximate price range for a home.

Step 1: To get a general idea of the maximum monthly payment you can afford use this rule of thumb: your monthly mortgage payment (PITI - that is principal, interest, taxes and insurance) should total no more than about 28% of your monthly gross income. Remember, your monthly gross income is the income you receive before taxes and other paycheck deductions are made.

Gross Monthly Income:	\$3,800.00	
	<u> X .28</u>	
Maximum Mortgage Amount		\$1,064.00

If you are comfortable using a computer, you can find mortgage affordability calculators on the Internet such as the one at the Ginnie Mae website (Ginnie Mae is the name used for Government National Mortgage Association).

The calculator allows you to enter your financial information and try various loan options such as interest rates. Mortgage interest rates affect how much you can afford. The lower the interest rate, the larger mortgage you can afford. These simple calculators allow you to see how current interest rates affect a mortgage payment. The Web address for the Ginnie Mae calculator, Your Path to Homeownership, is listed at the end of this module.

Step 2: The amount of debt you have affects your ability to buy a home. Lenders do not want borrowers to have more than about 36% of their gross monthly income going to repay debt. This includes mortgage payments and all other debt payments such as credit cards and personal loans.

Gross Monthly Income:	\$3,800.00	
	<u> X .36</u>	
Maximum Total Debt		\$1,368.00

Step 3: If your monthly income is \$3,800, you could afford \$1,368.00 in total monthly debt including the \$1,064.00 mortgage payment. This means all other debt payments, including credit card, auto and personal loan payments, can not be more than \$304.00 per month.

Maximum Mortgage Amount	\$1,064.00
Minimum Credit Card Payment	204.00
Personal Loan Payment	100.00
Maximum Debt (36%)	\$1,368.00

If you are not sure about your other credit obligations, use the **How Much Do You Owe Work Sheet** to calculate monthly debt information.

How Much You Can Borrow: Pre-Qualification

When you are financially ready, you may want to get a more exact idea of how much you can borrow by consulting one or more mortgage

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lenders. One way to do this is to pre-qualify. It does not require a commitment on your part to borrow from the lender or for the lender to make the loan to you.

Pre-qualification is an informal way a financial institution can tell you the amount you can borrow to finance or refinance a house. It is important to know that the financial institution is making a tentative decision based on information that has not yet been verified. This is only an estimate and subject to change. You can pre-qualify by giving the lender some basic information over the phone or the Internet including:

- Employment
- Income
- Down payment information, and
- Outstanding debts

How Much You Can Borrow: Pre-Approval

The next step is pre-approval, which requires you to spend money for various applications and fees. Pre-approval is a commitment from a lender to lend you money and is used when you have not yet found the house you want to buy.

To obtain a pre-approval, you will need to assemble financial records and fill out an application. If you have completed the Managing Money module, you may have most of this information organized. It will be easy to pull it together and complete the loan application. The lender will tell you what to bring or send but you will usually need:

- Pay stubs for the last two-three months
- W-2 forms for the last two years
- Tax returns for the last two years
- Information about your assets and long-term debts

- Recent bank statements
- Proof of any additional income

The lender will not commit to a loan until the information you submit is verified and may require additional information or details. This same process is used if you have already found a house and want to apply for a mortgage. It is covered in detail in the Home-Buying Process module.

The pre-approval process tells you the maximum amount you can borrow and tells sellers you are approved to buy a house. Pre-approval is contingent on meeting the requirements of the title, appraisal and inspections determined by the lender at the time of pre-approval.

The amount you actually borrow will be repaid to the lender in a monthly mortgage payment. This is just one of the costs involved in homeownership.

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Net Worth Work Sheet

Net Worth Statements For Three Years

Assets owned	Date	Date	Date
Cash on hand			
Cash in checking accounts			
Cash in savings accounts			
Cash value of life insurance			
Savings bonds*			
Money other people owe you (that they will repay)			
Furniture and appliances*			
Miscellaneous personal property* (furs, jewelry, antiques, heirlooms, boats, art)			
Cars*			
Home*			
Other real estate*			
Stocks*			
Bonds*			
Mutual funds*			
Government securities*			
Annuities and other retirement plans			
Other assets*			
Total assets	\$	\$	\$

* Current market value—what you could get for the item if you were to sell it today.

Net Worth Work Sheet (Cont.)

Liabilities owed	\$	\$	\$
Mortgage and liens			
Car loan			
Installment debts			
Personal loans			
Life insurance loans			
Credit cards			
Other charge accounts			
Other unpaid bills			
Total liabilities			
Your Total Net Worth			
	Date	Date	Date
Total assets			
Total liabilities			
Net worth = assets - liabilities			

Spending Plan Work Sheet

Balancing Your Budget

Everyone can't use the same budget or spending plan. Each family has unique needs, wants and resources. Therefore, the money should be managed so that you are able to meet your needs and wants and still get the most from your income. Take the time to complete each of the steps to balance your budget.

Estimate Your Income Income Sources

	Weekly	Twice A Month	Monthly	Other
Wages (take-home)				
Child support				
Unemployment insurance				
TANF				
Pension/retirement				
Social Security				
Interest/dividends				
Alimony				
Other				
Total				

Total income for the planning period \$ _____

Step 2: Estimate Fixed Expenses and Savings (Other than consumer debt)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Housing												
Rent or mortgage												
Major fuel bills												
Protection												
Life insurance												
Health insurance												
Disability insurance												
Car insurance												
Household insurance												
Other												
Contributions												
Religious												
Donations												
Other												
Taxes												
Licenses												
Regular Savings												
Short-term goals												
Long-term goals												
Other Major Items												

Set Aside Weekly (divide by 52) \$ _____

Set Aside Monthly (divide by 12) \$ _____

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Step 3: Emergency Fund

Accumulate fund to	\$
Yearly Totals:	\$ (Transfer to Balance Sheet)
Amount for fund weekly/monthly	\$

Step 4: Estimate Flexible Expenses

	Weekly/Monthly Amount		Weekly/Monthly Amount
Food and Beverages		Transportation	
At home		Trains, buses	
Away from home		Private car	
		Parking	
		Operations	
Household Costs			
		Gifts	
Operations (utilities)		Personal Allowances	
Maintenance (upkeep)			
Supplies (cleaning, paper)			
Clothing			
Purchase		Entertainment	
Repair laundry, cleaning		Other Expenses	
Personal Care			
Medical/Dental			
Recreation			

Note: Your household accounts are the best sources of information for expense estimates. Adjust the figures to reflect changes that have occurred in your own situation. If you do not have a system for keeping household records, start now to keep track of your expenses so you can control spending leaks and get more mileage out of your income. now to keep track of your expenses so you can control unnecessary spending leaks and get more mileage out of your income.

STEP 5: Compare Income and Expenses

Comparison of income and expenses (Balance Sheet)

Total all expenses and compare with expected income. If income exceeds expenses, plan for more debt repayment, savings, etc. If expenses exceed income, rework your plan to reduce flexible expenses, reschedule debt repayment, etc.

Planning Periods (weekly, monthly, etc.)

	Dates		Dates	
	Actual	Planned	Actual	Planned
Income (total)				
Expenses				
Fixed				
Emergency fund				
Debt repayment				
Flexible living expenses				
Total expenses				
Balance (+ or -)				

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This resource is one in a series on Deciding to Buy a Home which include:

Homeownership Considerations

Deciding to Own

Needs and Wants

Finding the Right Home

How Much House You Can Afford

The Cost of a Home

Shopping for a Home

Housing Types and Construction

Types of Construction

Choosing Site-Built Homes

Choosing Manufactured Homes

Types of Homeownership

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