Can You Afford to Buy?

Coldwell Banker Bain

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Take the fear out of buying a house by getting a handle on how much it costs. Once you understand the financial road from renter to home owner, you'll be better equipped to take that first step.

Maybe it was your neighbor's last all-night party, or pulling into the parking garage and finding your designated spot taken – again. Whatever the reason, you're ready to ditch apartment life and become a homeowner. But now you wonder, "Can I afford to buy a house? And if so, how much can I afford?"

Because buying a house is typically the biggest purchase many people make, it's important to consider the factors that influence the amount of house you can afford.

1

Income and expenses

To get started, take a look at how much money you make and spend each month (yes, even those lattes add up!). Experts suggest multiplying your annual gross salary by 2.5 to estimate your home price range. For example, if you gross $80,000 a year, you can likely afford a $200,000 house (depending on interest rates, debt and credit history, down payment, etc.). Consider, too, how much you pay for food, fun and fixed expenses; the more you spend on these each month means you'll have less to put toward a mortgage.

2

Mortgage calculator

Now that you know your home price range, use an online mortgage calculator to determine your monthly payment. Plug in the price of the house, your down payment, your loan amount, interest rate and amortization to get your monthly payment. Compare this with your current rent and monthly expenses, keeping in mind that homeowners also pay property taxes and insurance that could affect the monthly payment. Still feel comfortable?

3

Pre-qualified vs. pre-approved

Back up your DIY mortgage estimate with a visit to a mortgage lender and get pre-qualified for a loan. A lender will tell you how much you can borrow and what your monthly payment will be. It's a good idea to get estimates from several lenders. When you seriously begin your house search, then get pre-approved from a lender. This isn't the same as being pre-qualified; with pre-approval, a lender agrees to finance a set amount of money under specific conditions (length of loan, interest rates, etc). Being pre-approved not only confirms your price range, it makes you a stronger buyer: Sellers love buyers who are pre-approved.

4

Think like a lender

Lenders use a couple key ratios to determine how much money borrowers can afford, so use their strategies to help you too.

- Lenders use the **housing ratio** to look at total mortgage debt, including principal, interest, property taxes, homeowner's insurance and condo fees, if applicable. Ideally, this figure should be less than 28% of your monthly gross income. For wiggle room, you may want to use 28% of your take-home pay instead. For example, if you net about $5,350, your total monthly housing target would be $1,500 ($5,530 x 0.28 = $1,498).

- Using the **debt-to-income ratio**, lenders consider all your other debts (credit cards, student loans, auto loans, alimony, child support) and look for a total that's no more than 36% of your gross income. Again, use your take-home pay of $5,350 for added padding and aim for $1,926 or less in total debt ($5,350 x 0.36 = $1,926).

5

Down payment

To buy a house, you'll have to make a down payment; this is the amount of cash required by a lender to secure your loan. Typically, lenders require a down payment that's at least 5% of the home's purchase price. (For qualified first-time buyers, there are programs that offer down payment assistance, below-market fixed-rate loans, etc.). If you put down 20% or more, you'll avoid having to pay private mortgage insurance, or PMI, and lower your monthly payment.

6

Lifestyle today … and tomorrow

When you rent, your landlord may pick up your utilities and building maintenance. But as a homeowner you get to pay for everything! So on top of your mortgage costs, estimate how much you'll need for utilities (gas, electricity, sewer, water, garbage) and general home upkeep (lawn care, house cleaning). And don't forget to account for future major expenses such as a wedding or college tuition. Buy what you can comfortably afford today, not five years from now.

7

Closing costs

OK. You've followed all the above advice and you're itching to start looking at houses. But before you can collect the keys to your dream home, know that you'll have to pay closing costs. These fees (for home inspection, credit reports, home appraisal, discount loan points, etc.) are not part of your mortgage and can add 2% to 5% to the sale price of your home. For example, buying a $200,000 house would incur $4,000 to $10,000 in closing costs. Depending on market conditions, some sellers may opt to pay a buyer's closing costs out of their proceeds. Whether that applies to you or not, don't forget to factor in closing costs when calculating the total cost of buying a house.

8

Rainy-day fund

Many first-timers put all their money into buying a house, but it's a good idea to keep some money in reserve. You'll probably want to decorate and furnish your new place. And if you need to make repairs or weather a job loss, a rainy-day fund will come in handy. As a home owner, it's best to expect the unexpected.

Want more help? For more information, consider contacting a HUD-approved housing adviser for free and confidential financial assistance, or consult a professional financial planner to help you with your home-buying goals.

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