

How Much House Can You Afford?



Throw out all those magic formulas you heard about for calculating what price home you can buy. The truth is that there are many factors which go into the answer to this question. And you cannot rely upon the online calculators, either, because different lenders have different programs and criteria that the calculators do not take into account, and the criteria may be flexible.

The best way to find out how much house you can afford is to touch base with me and my financial partners – or an experienced loan originator of your choice. In the meantime, here are the factors that impact the answer to this question:

Down payment

The amount of cash that you invest, together with your loan amount, will equal the price of the house. The larger your cash down payment, the more house you can buy, and vice-versa. That being said, housing is not a liquid investment; it is necessary to sell, or at least re-finance, to take cash out of your home once it is invested.

For this reason, most people make a down payment no greater than 20% of the purchase price. Some homebuyers put down as little as 5% or even no money at all. It is important to know that borrowers who put down less than 20% may be charged an extra closing cost and/or monthly fee known as Private Mortgage Insurance (PMI), which protects lenders against loss if a borrower defaults. My lender partners usually help my clients obtain a loan with minimum down payment and no PMI charge – but this is an exception rather than the rule in the mortgage market.

Generally speaking, the down payment should be your personal funds such as savings, insurance proceeds, investments, equity from a previous home, or a gift. As part of your loan application process, your lender will verify your assets to confirm that your down payment is not borrowed money; if your down payment is a gift, the donor will be asked to provide a letter stating that no repayment is required or expected.

Credit qualifications

It's a good idea for you to obtain a credit report in advance of making loan application so you can identify any inaccuracies and report them to the credit bureau(s); it could take 30-45 days for any inaccuracies to be verified and corrected on your credit report. If you do this several weeks before you start shopping for a home and mortgage, you may save time in the mortgage loan processing, which could be delayed if inaccuracies are not discovered until the

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lender orders your credit. While doing this is desirable, it is not required, and most people do not have inaccuracies on their credit reports.

Your credit-worthiness is indicated by the FICO Score on your credit report; borrowers with higher scores will have more loan programs to choose from and a better interest rate than borrowers with a lower score. My lender partners have a knack for finding the best loan for each of my clients – whether they have a recent bankruptcy, no credit at all, or the best credit in the world. Don't let concerns about poor credit stop you from pursuing home-ownership because I've helped many clients overcome this obstacle so they could, indeed, buy a home!

Monthly payment

The amount of home loan for which you qualify depends primarily on these factors:

Monthly income and obligations are measured against your gross income to make sure your mortgage payment does not exceed your ability to pay. First, your housing expense (PITI) is calculated as a percentage of your gross income (before any deductions), and then your total debt obligations (including your housing expense) are calculated as a percentage of your gross income. For example, if the ratios required for a loan are 28/36, that means your housing expense (PITI) cannot exceed 28% of your gross income and your total debts cannot exceed 36% of your gross income. The ratios permitted will vary from one loan program to another – some are more liberal than others.

Current interest rates will significantly impact the amount of your home loan because just 1% could make it harder to achieve the required ratios. As interest rates increase, more creative mortgage loan programs become available to help homebuyers cope with the situation. For example, adjustable rate mortgages (ARM) or buydown mortgages. You can trust my lender partners to work with you to obtain a loan that works for you, whatever the interest rates may be. Whenever interest rates come down, you can refinance at minimal cost to take advantage of an improving market.

Taxes, insurance and condo/HOA fees will be included in your totally monthly payment. For that reason, it may be prudent to purchase in a community with lower costs, assuming the purchase prices are equal.

Generally speaking, I am not a fan of online mortgage mills which may have a fancy website, but may be operated out of someone's garage in Iowa or Pakistan. Local lenders work every day with appraisers who know this market well, who provide prompt turnaround and can be counted on for all

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of the background information required by the firm's loan underwriter. And local lenders work on a first-name basis with local title companies to handle all the paperwork for your settlement.

It has been my experience that working with a local lender is the best way to determine how much house you can afford. If any lender quotes you significantly lower closing costs or interest rate, you can be sure that the loan will come with hidden costs that more than make up for any savings. Disreputable lenders rely upon the fact that you may not know what questions to ask, and even some credit unions rely upon your loyalty over common sense.

Instead of relying upon the Internet, online do-it-yourself calculators, or obsolete "magic formulas" to determine how much house you can afford, obtain a reliable answer from one of my lender partners by simply completing and submitting the brief information form on the FINANCING page of this website.

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