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A Home Mortgage: How Much Can I Afford?

Home-owning is the American dream. If it is one of your dreams, you may be wondering how you can ever make it a reality. Home prices in many areas today are very expensive, in some areas prices have even doubled during the past five years because of the housing boom. The key to becoming a home owner is determining just how much of a house you can truly afford.

One of the most basic measures of how much you can afford to pay for a home is to choose a property that costs two to two-and-a-half times your yearly income. So for example, if you make $50,000 each year, the guideline suggests that you look for a home that costs between $100,000 and $150,000. If you live in one of the former real estate hot spots like Florida, Arizona, or California though, you may complain that even a salary twice that of the example would barely pay for a decent home. Fortunately this basic measure is not the only way you can calculate how much you can afford.

One of the ways most lenders determine your eligibility for a certain mortgage loan amount is by figuring out how much debt you have. They will plug that dollar total into a debt-to-income ratio. The ratio consists of two numbers. The first is the amount of money you plan to spend on your mortgage payments, divided by your monthly income. Lenders like to see this number under 28%, but some will accept higher percentages. To calculate how much money you can put towards a monthly mortgage, find a sum that meets the 28% ratio. The formula is to multiply your monthly income by 28% or 0.28. For example, if your monthly income is $4500, multiply that number by 0.28, and you find that the amount of money you should be able to devote to your monthly mortgage payment is $1260.

The second number in the ratio may change the real total of how much you can afford. This ratio takes into account your total debt. The basic principle is that the more debt you have, the less able you are to take on new debt, like a home mortgage. This ratio is calculated by adding your proposed monthly mortgage debt to your other total monthly debt and dividing that by your monthly income. Lenders prefer this ratio to be below 36%, although there are of course lenders who will make exceptions to this rule.

Beyond simple income qualifications and calculations, in order to determine how much mortgage you can afford you must take into account the down payment requirement. Traditionally lenders required a down payment that was 20% of the value of the loan. Contributing that much today is still preferable and will secure a great loan with a nice, low interest rate but such a sum is sometimes impossible for borrowers to scrape together today. Fortunately there are lots of lenders who will accept some lesser percentage. There are even some programs that offer a no-down payment feature. Be aware those that these types of loans will cost you in points and the interest rate. You should plan to make some sort of down payment, even if it is just 3% or 5% of the home price. This means taking money out of your savings, money you will not be able to use for further mortgage payments. Be sure to calculate how much a down payment will set you back in the home owning process.

There are many things to consider when figuring out how much home you can afford, including many personal and lifestyle preferences. Be sure to consult with a financial or mortgage professional to help answer your questions about the right house price range for you.