



# Opening Doors to Housing Success

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***Too often people consider only the monthly mortgage payment when deciding if they can afford to buy a home. Other costs are very important such as loan costs, new housing expenses, and current living expenses.***

## **Can You Afford to Buy?**

When you decide to buy a house, one of the hardest things to figure out is how much you can afford. The important thing is only to spend as much as you can comfortably afford.

## **What do you need to know about home loans?**

Most people borrow money to buy a home. If you take out a home loan, then you will have a monthly mortgage payment. This payment has several components. These parts of a mortgage payment are called PITI – principal, interest, tax and insurance.

-  **Principal.** The principal is the loan amount remaining unpaid.
-  **Interest.** The interest is the amount charged for borrowing money.
-  **Real estate taxes.** The real estate taxes are collected each month by the lender until the annual property tax bill comes due, and then the lender pays the tax bill.
-  **Homeowner's insurance and mortgage insurance.** Lenders often require homeowner's insurance and mortgage insurance as part of your payment. Homeowner's insurance provides protection if something major happens to your house such as a fire, and the mortgage insurance protects your lender in case you don't make your payments.

## **What Are Other Costs of Home Ownership?**

Too often people consider only the monthly mortgage payment when deciding if they can afford to buy a home. Other costs are also very important such as loan costs, new housing expenses, and current living expenses. When you borrow money, a lender may charge fees such as an application fee. Another initial cost can be points.



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# Can You Afford to Buy?



## How Much Money Can You Borrow?

The lender sets a limit on how much you can borrow. Lenders want to know how much of your **gross income** (your total income before taxes or any deductions) will go towards your mortgage payment. You must qualify to get a mortgage loan. You may want to pre-qualify for a loan so that you can shop for homes in your price range.

To qualify you for a loan, a lender will look at two major factors: your earnings and your existing debt. To decide if you make enough money for a mortgage payment, most lenders use the **housing-expense ratio**. Typically lenders will allow you to spend up to 28% of your gross income for a mortgage payment. For example, a family earning \$50,000 gross annual income earns \$4,167 per month gross income (\$50,000 divided by 12 = \$4,167). This family would qualify for a loan with a \$1,167 monthly mortgage payment (\$4,167 multiplied by .28). However, keep in mind this ratio uses gross income not take-home income. You must decide if you can comfortably afford this high of a monthly payment plus your other expenses.

Lenders also use the **debt-to-income ratio**. This method calculates how much of your gross monthly income is used to pay debt. Payments for the mortgage, car loans, credit card debt, student loan payments and other debt are all considered. Lenders often use a 36% debt-to-income ratio. However, taking on such a large payment obligation isn't wise unless you feel confident you can live on what remains of your income. See Table 2 on the back page to calculate your debt-to-income ratio.

Lenders consider other factors too. A poor credit history, unstable income source, or inadequate cash reserves can disqualify you as a borrower. The lender also must approve the house you want to purchase. Usually this approval requires an appraisal of the property.

## What Are Your Options?

Don't be discouraged if at first it seems you can't qualify for the loan you would like. There are many programs to help first-time buyers. These programs usually offer loans at low interest rates or with a low down payment. Be sure to check on the availability of these first-time buyer loans and also FHA (Federal Housing Administration) and VA (Veterans Administration) loans. You may want to reevaluate the home price you thought you wanted. Perhaps you could qualify for a less expensive home.

It may be that it's important to pay down your current debt or save some cash before you buy a home. Set yourself a goal to save or reduce debt by a certain date. When you've met your goal, apply for a loan again.

By carefully considering all the costs of home ownership, you can choose a home that you can comfortably afford.

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Sources:  
Fannie Mae. (1996). *A Guide to Homeownership*. Washington, D.C.: Author.



## Can You Afford to Buy?

**Table 2: What is your debt-to-income ratio?**

<b>Gross monthly income</b>	<b>Example</b>	<b>Your numbers</b>
Annual gross income	\$50,000	
Divide by 12 months	÷ 12	
<b>Gross monthly income (A)</b>	\$4,167	
<b>Current monthly debt payments</b>	<b>Example</b>	<b>Your numbers</b>
Car payment(s)	\$300	
Credit card payment(s)	\$100	
Student loan payment(s)	\$100	
Installment loan payments(s)		
Alimony/child support payment		
Medical/health care payment		
Other		
<b>Total monthly debt payments (B)</b>	\$500	
<b>Debt-to-income ratio</b>	<b>Example</b>	<b>Your numbers</b>
Gross monthly income <b>(A)</b>	\$4,167	
Multiplied by .36	X .36	
Equals	\$1,500	
Minus total monthly debt payments <b>(B)</b>	- \$500	
<b>Maximum allowed for PITI</b>	\$1,000	

For more housing information, see other *Opening Doors to Housing Success* fact sheets.