

## How much home you can afford?

From Business Week

**As you know from the basics page you just read, to buy a home you need both up-front money as well as the ability to make monthly mortgage payments.** You therefore

might be tempted to ask, "How much will I need in order to make the monthly payments?" But actually we'll approach this question from the other direction: We'll find out the most expensive house you can buy given your income and savings. This is called *how much home you can afford*. You won't necessarily buy the most expensive home you can afford, but you still want to know what your upper limit is. You don't want to waste your time looking at homes you can't afford, and you also don't want to pass up homes you *thought* you couldn't afford but which might actually be within your reach.

**Here's the super-quick rule of thumb:** Most people can afford a home that costs up to three times their annual household income, if they can make a 20% down payment and have only a moderate amount of other debt. If you have little to no debt and can put 20% down you can probably buy a house worth up to four times your annual income.<sup>1</sup>

**Examples:** If you make \$57,200 a year (which was the median household income for first-time homebuyers in 2006) and have money for a down payment saved, you can probably buy a \$171,600 home if you have moderate debt (debt payments of <12% of your income), and a \$229,000 home if you have little or no debt. But of course, this is just a quick rule of thumb and you'll want to get a more accurate figure. The rest of this page will help you with that. Also, if your income is small but you're sure you can make the mortgage payments and you have excellent credits there may be other options for you, which we'll get to later.

**The first concept for figuring how much home you can afford is pretty simple.** Since you pay for your house with a combination of a down payment and a bank loan, the total of both is the cost of the home:

**Down Payment + Biggest Loan You Can Get = How Much Home You Can Afford**

The down payment part of the equation is easy to figure -- this is the total of your savings that you're willing to put into your house. (We'll cover down payments in more detail on the next page.) We assume you have money for a down payment because if you don't then you probably can't afford *any* home, since it's hard to get a loan with 0% down. You usually need a bare minimum of 3% of the purchase price down, more typically 10% or more.

The amount you can get from a lender is a little trickier since it's based on many factors.

Here's a calculator that will help you with that.

Fill in Your Details	
\$3000	<b>Monthly Income</b> (before taxes)
\$0	<b>Monthly Debt Payments</b> <i>(Min. pmts. on credit cards, auto loans, student loans)</i>
\$10000	<b>Money available for Down Payment</b>
Fill in the Financing Details	
6.0%	<b>Mortgage Interest Rate</b> <i>Avg. rate was 5.4% in July 2004. Get <a href="#">current rates from Yahoo</a>.</i>
[2.0% V]	<b>Annual property taxes &amp; insurance (% of home price)</b> <i>Check with your county tax office and an insurance company to get your local figure</i>
[Calculate]	

  

See how much home you can afford -- rough estimate		
15-yr.	30-yr.	
\$	\$	Most expensive home you can afford
\$	\$	Maximum Loan
\$ (%)	\$ (%)	Down Payment
\$	\$	Total Monthly Payment
\$	\$	Monthly Principal & Interest Payment
\$	\$	Monthly Taxes & Insurance

Formulas from [Wizard of Odds](#), [DollarBank](#) and the [Motley Fool](#), with clarification from [Financial Planning Toolkit](#).

### ***Here's what's important about the values in the table above***

- **Putting 20% or more down opens lots of doors.** When you can make a down payment this big you're almost certain to qualify for *some* kind of loan. The bank will

be willing to loan more money than otherwise, and you won't have to pay for private mortgage insurance (PMI), which in turn helps you afford even more home.

- **Debt holds you back.** The more debt you already have the less home you can buy. Decreasing your debt allows you to afford a more expensive home, everything else being equal. There's more on this on our pages about the Debt Ratio and How much loan can you get?
- **Buying a duplex or a house with a garage apartment increases your buying power.** When you get a home with a unit you can rent out, you can count the rent you'll receive as income. This can allow you to buy a substantially more expensive home than otherwise -- which will be a much better investment. Your net monthly payments could actually wind up being cheaper, too, once you subtract the rent you'll receive.
- **30-year loans vs. 15-year loans.** The advantages of a 30-year loan are that the monthly payments are lower, and with a 30-year mortgage you can qualify for a much larger loan and buy a much larger (or nicer) house. The downside is that you have to make payments for an extra 15 years vs. a 15-year loan, and you'll pay a lot more total interest over the life of the loan. Still, in most cases you'll go with a 30-year loan. We'll cover the differences between these later, but if you can't wait then read about 15 vs. 30-year loans.
- **We've left out one important thing -- closing costs.** You'll need to either pay the closing costs from your savings (lowering the amount you have available for a down payment), or qualify for a loan that's a little larger than the house you want to buy, and have the closing costs added to the loan (which is called "rolling the closing costs" into the mortgage).

## ***How much do homes cost?***

**Now that you have an idea of how much home you can afford, how do you find out whether that's enough?** That is, are there homes to be had for the amount you can afford? We'll cover that later (in the start looking section), but here are two quick pieces of advice.

**First, don't get sticker shock by looking at the pictures ads of homes for sale in the newspaper, or in those real estate magazines,** because it's the more expensive homes

that get advertised. Cheaper houses definitely exist, it's just not cost-effective for realtors to buy big ads for cheap houses.

Second, you can get an idea of [the cost of homes in a given neighborhood](#) at Zillow.com.

Ignore the national median figure of \$225,000 in 2006. Homes could be way less or way more than that depending on where you live and the size & condition of the home you want to buy.

### ***Figuring your monthly payment***

Figuring the max you can afford is all fine and good, but once you have a specific home in mind you'll want to know what your payments will be on *that* home. We have [a separate page on figuring your monthly payment](#) in more detail, but here's a quick table to give you a rough

idea. A general rule of thumb is that your monthly payment will be between **0.75% to**

**1.15%** of the purchase price.

<b>Estimated Monthly Payment based on Home Price</b>						
<i>for 5/10/20% down on a 30-year loan • includes est. taxes &amp; insurance see <a href="#">the calculator</a> to figure your situation</i>						
	<b>\$100,000</b>	<b>\$150,000</b>	<b>\$200,000</b>	<b>\$250,000</b>	<b>\$275,000</b>	<b>\$300,000</b>
<b>6.00%</b>	800 / 745 / 646	1199 / 1118 / 969	1600 / 1490 / 1292	1999 / 1863 / 1616	2199 / 2050 / 1777	2400 / 2236 / 1938
<b>6.33%</b>	820 / 765 / 663	1230 / 1147 / 995	1640 / 1530 / 1326	2050 / 1912 / 1659	2255 / 2103 / 1824	2460 / 2294 / 1990
<b>6.67%</b>	841 / 785 / 681	1262 / 1177 / 1022	1682 / 1570 / 1362	2103 / 1962 / 1703	2313 / 2158 / 1874	2524 / 2354 / 2044
<b>7.00%</b>	862 / 805 / 699	1293 / 1207 / 1048	1724 / 1610 / 1398	2155 / 2011 / 1747	2371 / 2213 / 1922	2586 / 2414 / 2096
<b>7.33%</b>	883 / 825 / 717	1325 / 1237 / 1075	1766 / 1650 / 1434	2208 / 2062 / 1792	2429 / 2268 / 1971	2650 / 2474 / 2150
<b>7.67%</b>	905 / 845 / 735	1358 / 1268 / 1103	1810 / 1690 / 1470	2263 / 2114 / 1838	2490 / 2325 / 2022	2716 / 2536 / 2206