How Much Can You Afford?

Introduction

An old rule of thumb said that you could afford to buy a house that cost between one and a half and two and a half times your annual salary. In reality, there's a lot more to take into consideration. You'll want to know not only how much of a mortgage you qualify for, but also how much you can afford to spend on a home. In order to know how much you can truly afford, you need to take an honest look at your lifestyle and your standard of living, as well as your income and what you choose to spend it on.

Getting to the bottom line

If you have unlimited resources, you can afford to buy whatever home your heart desires. For most of us, though, that's not the case.

Unless you can afford to buy a house outright, you'll probably need to get a mortgage to help you pay for it. So, determining how much house you can afford is often a case of determining how much of a mortgage you can afford.

Start with some simple math: Take your monthly income and subtract all of your non-housing-related expenses. What you're left with is the amount per month that you have available to allocate toward housing.

Other housing expenses to factor in

In determining what you can afford to spend on a home, you should also take into account other housing-related expenses. The total amount of expenses may depend in part on what type of home you buy and where it's located. Such expenses include:

- Maintenance costs--everything from weekly rubbish removal to a new roof
- Utility costs--electricity, heating and/or air-conditioning, gas, water and/or sewer
- Homeowner association fees or condominium assessment fees

Deduct the monthly portion of these expenses from what you estimated your monthly housing allowance to be, and you're getting close to determining how much of a monthly mortgage payment you can afford. Of course, mortgage lenders have a slightly more sophisticated way of determining how much they think you can afford.

Mortgage prequalification and preapproval

Consider shopping for your mortgage before you start shopping for your house. Compare the mortgage rates and terms offered by various lenders, and then get preapproved or prequalified with the lender of your choice. That way, you'll know how much you can spend on a house before you fall in love with one that's just out of your reach. Make sure you understand the difference between prequalification and preapproval.

Prequalification is simply the process of estimating how much money you'll be able to borrow based on the qualifying ratios appropriate for the type of mortgage you're considering. Preapproval, on the other hand, means the lender has gone through the underwriting process and verified among other things your income and credit. Once you're preapproved, you'll get a letter stating that the lender will give you a mortgage up to a certain amount, provided that certain conditions are met (e.g., the property is appraised for an amount sufficient to cover the mortgage). Preapproval lets you know exactly how large a mortgage you can get. It also gives you more credibility as a buyer, since the preapproval letter lets the seller know that you'll qualify, financially, for a mortgage if your purchase offer is accepted.

Make sure you really can afford it

Remember that mortgage lenders can only tell you how much of a mortgage you qualify for, not how much you can afford. If homeowners insurance and property taxes are escrowed with your lender, these expenses will increase your monthly mortgage payment. The payment amount will be even more if you're required to carry specialty policies such as flood or earthquake insurance in addition to homeowners insurance. And if property taxes are especially high, you may find that you're unable to afford the home.

Tip: *Keep in mind that your actual mortgage payment will also depend on your interest rate and the term of the loan. Generally speaking, lower rates of interest and longer terms equal lower monthly mortgage payments.*

Now might be the time to think about revising your budget . Perhaps you can think of ways to reduce your non-housing-related expenses; doing so will free up money that you can apply toward your housing costs.

Also keep in mind any future plans that may affect your budget. Perhaps you'll need to buy a new car in a few years. If you haven't already done so, perhaps you'll be starting a family soon. If you have children, as soon as they're in kindergarten you'll need to think about saving for their college expenses. No matter how much of a mortgage a lender tells you that you qualify for, you must always be sure your mortgage payment is not beyond your means. After all, it's the roof over your head.