

How Much Can You Qualify For - Self Test

Imagine you have just completed a search that included hundreds of hours of looking at the exteriors and interiors of houses. You have sized up siding, reviewed roofing and perused the petunias. And finally, you have found the house of your dreams. Now imagine that this house of your dreams costs much more than you can afford.

If you are house hunting and have not done an important piece of homework, you could be in for this kind of heartbreak. The first thing you need to know when shopping for a home is how much you can spend.

A general rule is that you can purchase a house valued at twice your annual income, but this does not take into account your debts, a large down payment, or other factors which can add to or detract from the amount you can afford.

The purpose of this document is to help give you a more specific idea of what priced house you can afford. It will address what you are worth and what you owe on a regular basis (your assets and liabilities) and what costs you would most likely encounter once you bought your new house. In general, you will be examining the same things a lender looks at when deciding how large a mortgage you can afford.

Can I Buy This House?

Lenders and Realtors will not tell you how much house you can afford. Instead they will calculate how much they believe an institution will loan you. This is two totally different amounts. A lender wants to loan you the maximum loan it feels you will repay. It is up to you to decide how much house you can afford. Only you know what future plans you have for children, retirement, and employment. Even the most affluent among us can get into trouble if they purchase more home than they can afford.

The first question you must ask yourself is "what can I afford to spend on a home?"

In order to answer that question, you will need to look at the costs involved in buying and owning a home.

Completing the worksheets below should save time while shopping for a home because it will narrow your choices based on costs. When you finally do talk with lenders, you will have some answers for many of their questions, speeding up your loan's processing.

It should be noted, however, that today many lenders will qualify you in advance for a mortgage, even before you begin to shop for a home. Many lenders advertise this service in the local newspaper, but contact any lender to see if this is possible.

Down Payment

Lenders expect home buyers to have enough money available to make the down payment

(usually up to 20 percent of the purchase price for the house) and to pay their share of the closing costs (3 percent to 6 percent of the loan amount). You should figure this amount (which will depend on what you decide you can afford) into your home buying budget. The down payment and closing costs are usually made up of money drawn from your total assets.

Your Mortgage

A mortgage is the loan you take to buy the house. Most people do not come close to having enough cash assets lying around to purchase a home. That makes a mortgage essential.

With a few exceptions, most mortgages are typically repaid in 15 or 30 years. Almost all require monthly payments. Let's suppose you are purchasing a \$150,000 home and that you are putting 20% down on the house. You're down payment would be \$30,000 (\$150,000 X .20) and your mortgage (the amount of loan you will need) would be \$120,000.

If the only mortgage options available to you were a 15 or 30 year fixed rate (fixed rate means the interest rate will stay the same for the entire term of the mortgage) your payments would look like this:

\$120,000 15-year mortgage @ *7.00 percent = \$1,079 per month

\$120,000 30-year mortgage @ *7.25 percent = \$ 819 per month

*Interest rates are generally a little lower on a 15-year fixed.

One of the first things you should notice is how much higher your payment will be on the 15-year fixed. That is because you are paying that loan off in 1/2 the time. Even though your payments are considerably higher, look at the difference in the amount of interest you will pay on the loan at the end of its term:

Mortgage Option	Total Payments	Total Interest
15-year mortgage	\$194,147	\$74,147
30-year mortgage	\$294,700	\$174,700

Even though you are paying much less in interest over the life of the loan on a 15-year fixed, this loan may not be the better loan for you. If the lower payments on the 30-year loan allow you to qualify for the loan, buy a better property, or possibly to save more money into a retirement account, the 30-year fixed may be the better option. Besides, if you want to pay less interest over the life of your loan, you can always pay extra on the principal. Just make sure there is not a pre-payment penalty built into the loan program that you choose. If you have a pre-payment penalty there will be certain penalties that

will apply if you pay down your principal balance early. Restrictions such as this must be clearly spelled out in the loan papers you sign.

Determining the size of the mortgage loan that you can afford can be a little tricky. Once you have determined the total you feel you can afford to spend monthly for housing, you then have to know the costs involved, including the mortgage payment, which combined will equal your housing cost. In addition to the mortgage payment you must also calculate the cost for property taxes and insurance, as well as any association fees and maintenance costs.

First, start with the mortgage payment. You can figure the size of your mortgage payments yourself by using the chart below. Multiply the relevant number by the size of your mortgage expressed in thousands of dollars. For example, if you will be taking out a \$150,000 30 year mortgage at 6.75% you would multiply 150 by 6.49 (see the table below). This would give you a mortgage payment of \$973.50.

Monthly Mortgage Payment Calculator

Interest Rate	15-Year Mortgage	30 -Year Mortgage
4.0%	7.40	4.77
4.5%	7.65	5.07
5.0%	7.91	5.07
5.25%	8.04	5.53
5.5%	8.17	5.68
5.75%	8.31	5.84
6.0%	8.44	6.00
6.25%	8.58	6.16
6.5%	8.71	6.32
6.75%	8.85	6.49
7.0%	8.99	6.65
7.25%	9.13	6.83
7.5%	9.27	6.99
7.75%	9.42	7.17
8.0%	9.56	7.34
8.25%	9.71	7.52
8.5%	9.85	7.69
8.75%	10.00	7.87
9.0%	10.14	8.05
9.25%	10.30	8.23

9.5%	10.44	8.41
9.75%	10.60	8.60
10.0%	10.75	8.78

Your housing expense will be totaled using the following example:

Item Estimated Monthly Housing Expense

Mortgage payment	\$ _____
Property taxes +	\$ _____
Insurance +	\$ _____
Improvements, maintenance, and Other +	\$ _____
Home-ownership expenses (pre-tax) =	\$ _____
Tax Savings -	\$ _____
Home-ownership expenses (after-tax benefits) =	\$ _____

Private Mortgage Insurance

In the event you do not have a 20 percent down payment, lenders will allow a smaller down payment - as low as 5 percent in some cases. With a smaller down payment, borrowers are required to carry **Private Mortgage Insurance**. Private mortgage insurance will require an initial premium payment of 0.5 percent to 1.0 percent of your mortgage amount plus an additional monthly fee depending on your loan's structure. On a \$75,000 mortgage with a 10 percent down payment, this would mean a premium of \$338 to \$675 for the first year and an extra \$15 to \$20 a month in subsequent years.

What Are Your Assets?

The first thing you have to examine is how much you are worth. Take into account your income, savings, investments and other holdings such as Individual Retirement Accounts (IRAs) or Keogh plans, cash value of your life insurance, pensions or corporate savings plans, and equity in real estate. Lenders will need this information before deciding to extend you the loan.

Often, the amount you earn may not be as important as how you earn it. Bonuses and commissions can vary greatly from year to year, and lenders are reluctant to depend on them if they make up a large part of your income. There are similar problems when a large portion of your salary is based on overtime pay, and you rely on it to qualify for the loan. To get a realistic view of what your income level actually is, average your income (including bonuses, commissions and overtime) for the past two or three years.

As a last resort, pensions and corporate thrift plans can provide another source of down payment money. Most plans or policies give you the option of either withdrawing your

money with no repayment or borrowing against the cash value. Though it is not the best policy for most home buyers to borrow from these sources in addition to borrowing mortgage money, they can often get rates substantially lower than those on many other kinds of loans. Remember - if you borrow against the cash value of your life insurance or employee thrift plan, you will be making principal and interest payments for these separate from your mortgage. You should estimate these payments under installment loans on the worksheet below.

While turning your savings, investments and other holdings into cash (making them "liquid"), remember, you will probably have to pay tax on most of it. One source of tax-free money often overlooked is a gift, or money given by a parent or other relative that need **not** be repaid. A person may give another person up to \$10,000 per year without either party being taxed. Your parents, for example, could give you and your spouse up to \$40,000 tax free.

Liabilities

Your liabilities are those expenses for which you are responsible each month. These include loans such as student, auto, personal and credit card balances. When calculating your liabilities, use the entire limit for your credit cards, as if you had to pay them off entirely this month. That way, you give yourself some breathing room should you run up an unusually high balance during your mortgage term.

You should estimate these payments under liabilities on the worksheet.

Emergency Funds

It is always wise to put a little money away "for a rainy day" - especially when you are paying off a mortgage. If something arises such as unexpected medical costs or substantial auto repairs, you want to be able to pay those expenses without jeopardizing your ability to meet your mortgage payments. Most financial experts suggest that you always have six months income on hand in case of emergency.

Annual Income

When calculating your annual income, remember to take into account all sources. You may, for example, receive dividends from investments, alimony or child support payments. Calculate your annual income below.

Annual Expenses

This list should get you started, but you may have special expenses that are not listed here. Remember, when you buy your house you will no longer have to pay rent, and your utilities costs will change. You can use this money for your mortgage payments or other operating costs associated with your new home.

The Costs of Home Ownership

Of the costs of home ownership, the ones listed on the next page are the most important. Homeowners insurance premiums usually run about \$300 to \$500 per year, and property taxes and maintenance costs will vary, of course, depending on the size, age and condition of your new house. Estimates for the costs of utilities, maintenance and improvements can be obtained from Realtors, local utility companies and others.

Some home buyers will have an additional cost if they are purchasing a condominium or a co-op. Condo and co-op fees are an additional amount paid monthly on top of the mortgage payments. Some homeowners will also incur a home owners association fee for their block or neighborhood. These fees vary greatly from location to location.

Net Worth Worksheet

Assets and Liabilities	Annual Expenses	
	Rent	_____
Add up your assets and subtract your total liabilities.	Food	_____
	Clothing	_____
	Transportation	_____
This is your Net Worth.	Medical/Dental	_____
	Insurance Premiums	_____
Assets	Life	_____
Cash on Hand _____	Auto	_____
Savings Accounts _____	Renters	_____
Cash Value of Stocks _____	Other	_____
Mutual Funds _____	Tax Payments	_____
Bonds _____	Utilities	_____
Life Insurance Cash Value _____	Savings	_____
IRAs _____	Tuition/Day Care	_____
Keogh Plan _____	Alimony/Child Support	_____
Employee Savings Plans _____	Loan/Charge Acc. Payments	_____
Pensions _____	Recreation/Entertainment	_____
Real Estate _____	Other	_____
Other _____	Total Annual Expenses	\$_____
Total Assets		\$_____
	Estimated Operating Costs	
Liabilities	Homeowners Insurance	_____
Installment Loans _____	Property Tax	_____
Credit Card Balances _____	Maintenance/Improvements	_____

Student loans	_____	Utilities	_____
Other Debts	_____	Condo/Co-Op/Homeowners	_____
Total Liabilities	\$_____	Association Fees	_____
		Other	_____
Subtotal Your Total Liabilities		Total Estimated Operating	
from Your Total Assets.		Costs	\$_____
This is your Net Worth	\$_____		
		Add Your Annual	
		Expenses,	
Emergency Funds		and Operating Costs.	
(Six Months Income Sug.)	\$_____	Subtract Them From Your	
		Annual Income.	\$_____
Subtract Your Emergency Funds			
From Your Net Worth. This		Add back in the costs for	
is the amount you have for		rent, utilities and	
down payment and closing		renters insurance. You	
costs.	\$_____	will be able to spend this	
		money on your new house.	
Annual Income	\$_____	The total is the amount	
Gross salary	_____	you can spend per year on	
Alimony	_____	your new house.	\$_____
Child support	_____		
Interest	_____	Divide this amount by 12	
Dividends	_____	to get a monthly mortgage	
Tax refunds	_____	payment amount.	\$_____
Other	_____		
Total Annual Income	\$_____		