Knowing What You Can Afford

Buying your first home is exciting, but before beginning your search, it is important to answer one big question:

How much home can I comfortably afford?

A lender can tell you how much you may qualify to borrow, but that amount is not always the same as what comfortably fits your budget. Your goal should be to choose a monthly payment that allows you to pay your regular bills, save for emergencies, maintain your home, and continue enjoying your everyday life.

What Determines Home Affordability?

A home may be considered affordable when you can comfortably pay all your housing expenses while still managing your other debts and living expenses.

Your estimated housing costs may include:

- Mortgage principal
- Mortgage interest
- Property taxes
- Homeowners insurance
- Mortgage insurance, when required
- Homeowners association fees, when applicable
- Utilities
- Maintenance and repairs

Your total monthly mortgage payment is often higher than the principal and interest alone because property taxes, homeowners insurance, and mortgage insurance may also be included.

Understanding the 28/36 Guideline

The 28/36 rule is a traditional budgeting guideline that may help you estimate an affordable payment.

It suggests that:

- Your monthly housing expenses should generally remain near or below 28% of your gross monthly income.
- Your total monthly debt payments, including housing, should generally remain near or below 36% of your gross monthly income.

Your **gross monthly income** is the amount you earn before taxes and other deductions.

For example, if your gross monthly income is $5,000:

- 28% would equal approximately $1,400 for housing expenses.
- 36% would equal approximately $1,800 for all monthly debt payments combined.

This is only a starting guideline. It is not a guarantee of loan approval, and lenders may use different limits depending on the loan program and the buyer's complete financial situation.

What Is a Debt-to-Income Ratio?

Your debt-to-income ratio, commonly called your **DTI**, compares your required monthly debt payments with your gross monthly income.

Lenders may include debts such as:

- The proposed mortgage payment
- Car payments
- Credit-card minimum payments
- Student loans
- Personal loans
- Child support or alimony obligations
- Other required monthly debts

To estimate your DTI, add your required monthly debt payments and divide that amount by your gross monthly income. Lenders use this calculation as one way to evaluate whether you may be able to manage a mortgage payment.

Factors Lenders Consider

Your Income and Employment

Lenders review your income and employment history to determine whether your earnings are sufficient and reliable enough to support the proposed mortgage payment.

Your Existing Debts

The more monthly debt you already have, the less room you may have in your budget for a mortgage. Paying down credit cards or other debts before buying may improve your financial position.

Your Credit

Your credit history and credit scores may affect:

- Whether you qualify for a mortgage
- Which loan programs are available
- The interest rate you receive
- Your required down payment
- The overall cost of the loan

A stronger credit history may help you qualify for more favorable loan terms. However, there is no single score that guarantees approval or a particular interest rate. Requirements vary by lender and loan program.

Your Down Payment

A larger down payment reduces the amount you need to borrow and may lower your monthly principal-and-interest payment.

However, you should not use every dollar of your savings for the down payment. It is also important to prepare for closing costs, moving expenses, repairs, maintenance, and unexpected emergencies.

The Interest Rate

Your mortgage interest rate directly affects your monthly payment and the total amount you will pay over the life of the loan.

Even a small rate difference can affect your buying power. Ask your lender to show you how different rates, loan amounts, and down payments would change your estimated payment.

Property Taxes and Insurance

Property taxes and homeowners insurance vary depending on the home and its location. These expenses should always be included when deciding whether a property fits your budget.

Insurance costs may be especially important when buying in an area with elevated wildfire, flood, or other environmental risks. Obtain an insurance estimate before removing important contingencies or completing the purchase.

Mortgage Insurance

Some loans require mortgage insurance when the buyer makes a smaller down payment.

Mortgage insurance can increase the monthly payment, so ask your lender:

- Whether mortgage insurance is required
- How much it will cost
- Whether it is temporary or permanent
- When or whether it may be removed

Homeowners Association Fees

A condominium, townhome, or planned community may require monthly homeowners association fees. These fees are generally separate from the mortgage payment but must still be included in your monthly housing budget.

Understanding Your Monthly Payment

The four basic parts of many mortgage payments are often called **PITI**:

- **Principal:** The amount borrowed
- **Interest:** The cost of borrowing the money
- **Taxes:** Property taxes
- **Insurance:** Homeowners insurance

Depending on the loan and property, your total payment may also include mortgage insurance and homeowners association fees.

Do Not Forget the Other Costs