Charting Your Course to Home Ownership

What Price Home Can You Buy?

Wanting to purchase a home, knowing what type of home you would like to purchase and having your finances in order are all steps you must take in order to reach home ownership. There are more factors that must be considered and worked through as well. Knowing the limit on what you can afford is very important.

Five Factors used to determine your housing price limit:

1. **Loan Type** (conventional, adjustable-rate, etc.)

   Qualifying guidelines and down payment requirements vary by type of loan and lender.

2. **Your Income** (or household income if purchasing jointly)

   The maximum amount of your income that may be spent on your house note is set by the lender or the mortgage instrument. This is calculated to see how large a loan you may qualify for. Keep in mind that qualifying for a certain loan amount **does not always mean you can afford it**. It may be helpful to estimate monthly payments and affordability before you comparison shop.

   Lenders use two ways to estimate the maximum amount you can spend on all housing expenses. This is usually determined by two income ratios: front-end ratio or back-end ratio. If a **front-end ratio** is used, your total monthly housing expense [principal, interest, taxes, insurance,(PITI)] **cannot exceed 25-29% of your stable monthly income**.

Front-End Ratio Example using 28%

Gross Monthly Income (pre-tax)	$4,000
x Housing Debt Qualifying Ratio	X .28
= Allowable Monthly House Payment (Principal, Interest, Taxes, & Insurance)	= $1,120

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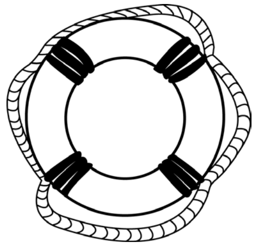

Life Saver/Rule of Thumb:

To get a quick and easy ballpark estimate of your affordable housing range, multiply your annual gross income times 2.

3. Your Debts

Your debts include such items as; house payment, credit cards, car payments, and other loans. Lenders using a **back-end ratio** require that monthly debt payments **not exceed 33 – 41% of monthly gross income**.

Back-End Ratio Example using 36%

Gross Monthly Income (pre-tax)	$4,000
X Housing Debt Qualifying Ratio	X .36
= Maximum total Debt Allowed	= $1, 440
– Total Monthly Debt Payments	– $500 *(car note and credit cards)*
= Total allowable monthly house payment	= $940

4. Your Savings

Your savings will be needed to use as a down payment in order to qualify for a loan. Down payments range from 0-20% of home price and vary by lender and type of loan. You will also need cash reserves (savings) for miscellaneous fees and charges at closing (varies from 2-10% of the mortgage loan amount).

5. Your Credit History

A **credit report** is a record of your history of credit card debt and other loan repayments. It shows how much debt you have and if you pay on or before the due date. Information in your credit report is used to determine your **credit score,** which is used by creditors to make decisions about whether to give you a loan and the interest rate they will charge. An advantage of credit scoring is that it avoids discrimination.

Ways You Can Estimate Your Price Range

Use Internet Web sites (online Mortgage Calculators)

Numerous Web sites can assist you in estimating mortgage payments on a monthly basis. The sites are easy to use and allow you to see what size loan you can realistically afford. Many online mortgage calculators will also supply you with current interest rates on mortgage loans in your area. Mortgage calculators can be accessed through Internet search engines.

Getting a lender or realtor to "prequalify" you for a loan gives you a good estimate of how much you might be able to borrow for a home. **Prequalifying does NOT mean you are approved for the loan**.

Housing Price Chart

Another way to estimate the price of a home you can afford is to review the Housing Price Chart. This chart shows how much your monthly principal and interest mortgage payment will be if you made a 5% down payment on a conventional loan and also the estimated annual income needed.

Income Needed to Qualify for a 30 Year Fixed Rate Mortgage with a 5% down payment

	$80,000	**$100,000**	**$120,000**	**$140,000**	**$150,000**	**$160,000**	**$180,000**	**$200,000**	**Price of Home**
Interest Rate									
5.0 %	$408	$510	$612	$714	$765	$816	$918	$1,020	principal & interest only payment
	$20,342	**$25,428**	**$30,513**	**$35,599**	**$38,142**	**$40,784**	**$45,770**	**$50,855**	**income needed**
6.0 %	$456	$569	$683	$797	$854	$911	$1,025	$1,139	principal & interest only payment
	$22,385	**$27,982**	**$33,578**	**$39,174**	**$41,973**	**$44,771**	**$50,367**	**$55,963**	**income needed**
7.0 %	$506	$632	$758	$885	$948	$1,011	$1,138	$1,264	principal & interest only payment
	$24,527	**$30,659**	**$36,790**	**$42,922**	**$45,988**	**$49,054**	**$55,186**	**$61,317**	**income needed**
8.0 %	$558	$697	$836	$976	$1,046	$1,115	$1,255	$1,394	principal & interest only payment
	$26,757	**$33,446**	**$40,135**	**$46,825**	**$50,169**	**$53,514**	**$60,203**	**$66,892**	**income needed**
9.0 %	$612	$764	$912	$1,070	$1,147	$1,223	$1,376	$1,529	principal & interest only payment
	$29,065	**$36,331**	**$43,597**	**$50,863**	**$54,497**	**$58,130**	**$65,396**	**$72,662**	**income needed**
10.0 %	$667	$834	$1,000	$1,167	$1,251	$1,334	$1,501	$1,667	principal & interest only payment
	$31,441	**$39,301**	**$47,161**	**$55,022**	**$58,952**	**$62,882**	**$70,742**	**$78,602**	**income needed**

Source of Calculations: Income Needed to Qualify for a Mortgage Calculator,
http://college.cengage.com/business/garman/personal_fin/9e/assets/students/calculators/chapter9.html

Qualifying Ratio Worksheet

Use the following work sheet to determine what allowable monthly house payment is best for you.

1.	**Gross Monthly Income** *(pre-tax income)*	$	(A)
2.	**Monthly Debt Payments** *(nonhousing debts: car, credit cards, other loans)*	$	(B)
3.	**Savings**	$	

"Housing Debt" Ratio (Front-End Method):

Front-end ratio compares the total annual PITI expenditures for housing with the loan applicant's gross annual income to assess the borrower's ability to pay the mortgage.

1.	Gross Monthly Income	$	(A)
2.	Times the "Housing Debt" qualifying ratio (%) *Example 28%*	X .28	
3.	Equals the allowable house payment (PITI)	=	(C)*

"Total Debt" Ratio (Back-End Method):

Back-end ratio compares the total of all monthly PITI expenditures plus auto loans and other debts with gross monthly income.

1.	Gross Monthly Income	$	(A)
2.	Times the "Housing Debt" qualifying ratio (%) *Example 36%*	X .36	
3.	Equals the maximum total debt allowed	=	
4.	Minus monthly debt payments	—	(B)
5.	Equals the allowable house payment (PITI)	= $	(D)*

* The amount you can afford to spend on PITI (principal, interest, property taxes and home owners insurance) is the smaller of amounts C or D.

Adapted from: Reichel, C. (1998). Your Path to Home Ownership. Baton Rouge, La.: LSU AgCenter.
Additional Resources: Garman, E.T., & Forgue, R. (2008). Personal Finance (9th ed.). Boston: Hougton Mifflin Co.

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