

How Much of a Mortgage Can You Afford?

A mortgage is one element of total household expenses, such as taxes and heating costs, which are likely to increase over time. It's important to consider increases in household expenses in addition to your mortgage payment.

For many households, it's important to arrive at a monthly mortgage payment that is affordable without financial strain. When deciding how much mortgage you can afford, you may want to review guidelines that lenders follow when evaluating mortgage applicants. These criteria apply to traditional private mortgages, and criteria for special situations, such as obtaining a mortgage through the Federal Housing Administration, may differ.

- A combined mortgage payment, insurance, and property taxes that do not exceed 28% of gross monthly income.¹
- A total debt-to-income ratio of 36% or less.
- A reliable source of income. If you are working, two years or more in your current job is favorable. Lenders may ask you to specify how much of your income comes from ongoing sources, such as wages, as compared with commissions or bonuses.
- A good credit score. Typically, 680 or higher will result in the lowest mortgage rates.
- An appraisal indicating the property is worth what you are paying for it.

The amount of your down payment has a direct bearing on how much you need to borrow and your eventual monthly payment. If you are not comfortable with payment terms that mortgage lenders have presented, consider whether you may benefit by delaying your purchase and saving toward a bigger down payment.

Long-Term Planning

Keep in mind that a mortgage is one element of total household expenses, such as taxes and heating costs, that are likely to increase over time, and it's important to consider increases in household expenses in addition to your mortgage payment. Your ability to manage a mortgage payment over time may depend, in part, on the stability of your monthly payment. Although an adjustable rate, which typically offers a lower initial payment, may be tempting in the short term, your interest rate and monthly payment are likely to increase over time. An unexpected event such as unemployment could potentially jeopardize your ability to cope with increases. In contrast, a fixed rate is consistent throughout the life of the mortgage, which makes long-term planning easier.

Also, when evaluating your ability to carry a mortgage, consider the importance of pursuing additional financial goals, such as saving for retirement or a college education. A mortgage payment that leaves you with the flexibility to pursue additional goals may be in your long-term best interest.

¹Source: Mortgage Bankers Association.

Because of the possibility of human or mechanical error by Financial Communications or its sources, neither Financial Communications nor its sources guarantees the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. In no event shall Financial Communications be liable for any indirect, special or consequential damages in connection with subscriber's or others' use of the content.

© 2011 McGraw-Hill Financial Communications. All rights reserved.

February 2011 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Allan W. Moskowitz, CFP®, AIF®, a local member of FPA.

Registered Representative and Investment Advisor Representative through Protected Investors of America, Member FINRA, SIPC, and SEC Registered Investment Advisor.

The information contained in these pieces does not necessarily reflect the views of PIA or any of its affiliates