How Much Can You Afford?

Housing payments are relentless. Month-after-month, monies are due -- no matter what. When you make your housing budget, therefore, think in terms of monthly obligations.

"What can I afford to spend on housing each month?"

As a homebuyer, it's the most important question you can ask yourself. And ranges won't do, either. Find your specific number.

Once you know your monthly budget, determining whether a home is "affordable" for you is a matter of working some basic mortgage math. You'll need a mortgage calculator for this step.

First, sum the following three figures:

1. The home's annual real estate tax bill, divided by 12.
2. The home's estimated annual cost to insure, divided by 12. Your insurance agent can help determine this number.
3. The home's monthly dues, if an association is present.

Next, subtract this sum from your monthly budget amount and you're left with your maximum monthly mortgage payment.

Example: If your budget is $1,500 and the above sum is $400, you have $1,100 left monthly to spend on your mortgage.

This next step is tricky.

Using your mortgage calculator, enter your maximum payment amount (e.g., $1,100), your loan's expected term (e.g., 30 years), and your expected interest rate (e.g., 4.750%).

Then, have the calculator solve for "loan size", add to that figure your expected downpayment amount, and -- voila -- you've found the maximum price you can pay for a given home while still remaining within your budget.

Quick Tips

✓ **Budget For Changes**
A home will never be as cheap as when you first buy it. Over time, tax bills get bigger and insurance costs rise. Therefore, when you set your monthly budget, make sure you give yourself some breathing room. Your monthly housing payment will likely be larger 5 short years from now.

✓ **Keep Some Money In The Bank**
It's okay to make a big downpayment, but make sure you leave some money in the bank. "Life happens" and there's no substitute for cash-on-hand. Keep at least 6 months of reserves in cash, if possible, for whatever emergencies arise.

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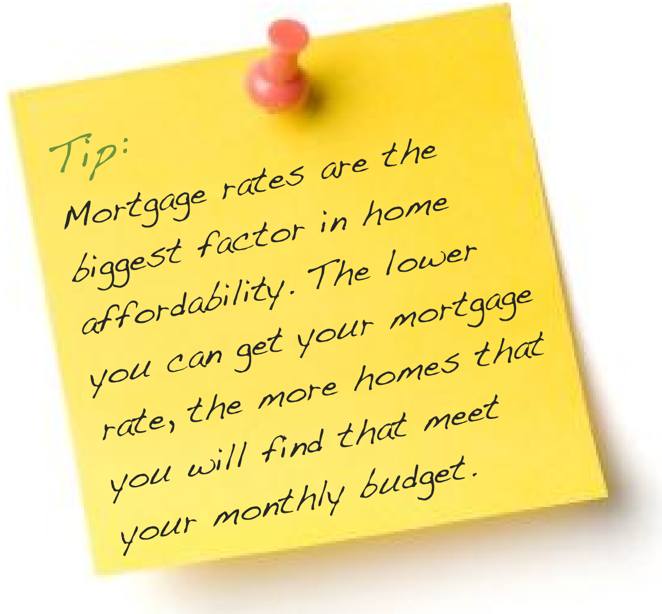
Home Affordability

Homes are more affordable today than at any time in recorded history. It's not because home prices are down, though -- it's because mortgage rates are.

Low mortgage rates extend a buyer's housing budget farther than falling home prices ever could. But with mortgage rates changing every 4 hours on average, affordability can be short-lived.

Every time mortgage rates change, so does your budgeted maximum purchase price. And the changes can be dramatic.

Example: For each 0.125% increase to mortgage rates, your maximum purchase price must fall by 1.45% to stay "in budget".



This is why timing the housing market is foolish. Rising mortgage rates can quickly erase your savings.

Picking the Proper Mortgage Product to Fit Your Needs

Mortgage rates are a major influence on your monthly housing budget, but, they're outside of your control. Mortgage rates based on the price of mortgage-backed securities; bonds bought and sold on Wall Street.

You can, however, control with which mortgage product you finance your home. And, by making better mortgage choices, you can avoid "over-paying" on your home loan, like using a 30-year fixed rate mortgage when a lower-rate adjustable rate mortgage is more suitable.

Homeowners planning to sell within 7 years, for example, don't need a 30-year fixed-rate loan. Yet, most will opt for one anyway, citing "peace of mind". It's an expensive insurance policy that can hits you hard in the wallet.

Example: In mid-2011, mortgage rates for the 30-year fixed-rate mortgage were 130 basis points higher than for an otherwise identical 5-year ARM, equal to a 12 percent increase to your monthly mortgage payment.

Take note, though. Adjustable-rate mortgages should not be used as a means to "afford more home". They're most suitable for people with a relocation history and/or ambivalence about higher mortgage rates in the future.