in Action
colorado state university extension service

How to buy a house— what can I afford?

Betty Jo White 1/

no. 9.909

Buying a home and then maintaining and improving it is likely to be the largest single expenditure most people will make in their lifetime.

After determining the family needs and deciding to purchase a house (see Service in Action sheets 9.907, 9.908), this worksheet may be used to determine how much can be invested comfortably in a home. It will be time-consuming, but may save a family later discouragement and disillusionment and perhaps financial loss if there is a failure to make a realistic analysis of their ability to buy

Service in Action sheet 9.910, *How to buy a house—Finding one you can afford*, will help in evaluating a particular house in terms of what total amount will be required before moving in, as well as estimating the *total* monthly housing costs for that unit.

Rules of Thumb

There are a number of rules of thumb that have been in use for some time to help persons "guess" what house and/or monthly payments they can afford. The rules are easy to use but can be misleading and cannot be used alone because they do not take into account the individual situation of each family.

These guidelines may be used to initially give you a range of "affordable prices." But a family must take precautions not to find itself "house poor" by spending more than it can afford and having to give up things that are really important. Although monthly mortgage payments should be as large as possible in order to pay less interest in the long run, at the same time guard against getting in too deep.

Complete the answers to the following popular rules of thumb in terms of your income. You probably wil get different answers for each rule—a good reason to read further.

*Spend no more than one week's take-home pay on monthly payments on principal, interest, property taxes and homeowner's insurance. ________________.

*The purchase price should not exceed 2 to 2½ times the family's gross annual income ____________ (Lower income persons should lean toward the lower figure.)

*One per cent of the sales price of the house should not exceed one week's pay. ________________.

**Total* monthly housing costs should not exceed 50 per cent of monthly take-home pay. ________________.

*If it would be necessary to extend payments beyond 30 years to keep within the budget, the house may be too expensive for that income.

There are other reasons why these rules of thumb must be carefully used and only as a begining in the analysis. Not all the rules define "income" and "housing." There are great differences between gross and net income; the income of one wage earner and two; full- or part-time income; and supplemental income from "moonlighting."

A mortgage payment which includes only repayment of principal plus interest, and does not include property tax and homeowner's insurance payments, will be significantly less than a payment which includes all of these.

If housing costs include only the mortgage payment, it would be much less than if the following also were included: utilities, house service costs, furnishings/equipment payments, repair and maintenance costs and reserves, and housing-caused expenses. Together they represent the total occupancy cost.

Finally, what you can afford depends on income level, stability and prospects. As income rises, the percentage spent on housing usually goes down even though the dollar amount may go up. It also depends on other expenditures resulting from the stage in the family life cycle, size and health of family, lifestyle and housing-caused expenses.

The best way to determine how much your particular family can afford is to examine your current income and expenditures, financial reserves and future financial prospects, and answer the "more" or "less" questions in the following worksheet. The time to complete the sheet will be well spent when the family selects and enjoys the home most affordable.

Monthly Income

In this section list all income that is "steady" and can be expected to continue (exclude unreliable income from overtime, or nonrecurring income). Include income from both wage earners, even though the family may later decide not to include the income from a secondary wage earner or include only part of it.

Lending institutions are required to "count" all reliable income in the mortgage loan qualification process, but the family needs to give careful thought as to whether to make long-term financial commitments on the basis of two full, continuing incomes. This is an individual family decision.

	Husband	Wife:	Total:
GROSS (TOTAL) MONTHLY INCOME (salary/wages):	$ ______	$ ______	$ ______
Payroll deductions made from gross income:			
Federal income tax withheld	$ ______	$ ______	$ ______
State income tax withheld	$ ______	$ ______	$ ______
Local income tax withheld	$ ______	$ ______	$ ______
Social Security (OASDI)	$ ______	$ ______	$ ______
Pension/retirement plan	$ ______	$ ______	$ ______
Disability benefits	$ ______	$ ______	$ ______
Insurance (life and/or health)	$ ______	$ ______	$ ______
Savings (bonds, etc.)	$ ______	$ ______	$ ______
Charities	$ ______	$ ______	$ ______
Other-list ______________	$ ______	$ ______	$ ______
Total deductions:	($______)	($______)	($______)
NET (TAKE-HOME) MONTHLY INCOME:	$ ______	$ ______	$ ______

Now add the following only if they apply:

Monthly net profit from farm, business, or investment property	$ ______
Monthly interest/dividend payments received	$ ______
Other *steady monthly* income (source: ______________)	$ ______
TOTAL NET MONTHLY INCOME:	$ ______

Present Monthly Housing Costs

How much money is now being spent on housing? If the family has no records of monthly housing expenses, they can

1/ *Betty Jo White, CSU assistant professor, housing (9/1/76)*

Issued in furtherance of Cooperative Extension Work in Agriculture and Home Economics, Acts of May 8 and June 30, 1914, in cooperation with the United States Department of Agriculture. Lowell Watts, Director of Extension Service, Colorado State University, Fort Collins, Colorado 80523. By law and purpose, the CSU Cooperative Extension Service is dedicated to serve all people on an equal and nondiscriminatory basis.

be compiled using cancelled checks, receipts, tax forms, and other records. The total annual expense divided by twelve is the average total monthly housing cost.

In the list below, enter those items that apply. Do NOT list installment payments on furnishings or equipment. Mark an "F" beside those items which are fixed or not easily changed, and a "V" beside those that may vary from month to month.

Rent or mortgage payment	$ _____
Property taxes (if separate)	$ _____
Property insurance (if separate)	$ _____
Utilities:	
Heat/air conditioning	$ _____
Electricity	$ _____
Water/sewer	$ _____
Services:	
Trash removal	$ _____
Yard Care	$ _____
Other ____________	$ _____
Maintenance and repair	$ _____
Housing-caused expense:	
Laundry	$ _____
Storage/garage rent	$ _____
Other ____________	$ _____
Other—list ____________	$ _____
____________	$ _____
TOTAL MONTHLY HOUSING COST:	$ _____*

*(This represents ____% of the family's total net monthly income.)

Estimated Monthly Nonhousing Costs

Use an "F" and "V" again to note fixed and variable expenses.

Food/household supplies (include meals eaten away from home)	$_____
Clothing (including upkeep) and personal care	$_____
Transportation costs (car payments, insurance, gas, repairs, commuting)	$_____
Education (tuition, board, travel, supplies for children and adults)	$_____
Installment debt (furniture, appliances, revolving charge accounts, credit card payments)—list	
____________ $_____	
____________ $_____	
____________ $_____	
____________ $_____	
____________ $_____	
____________ $_____	
Total	$ _____
Life insurance (if not payroll deduction)	$ _____
Medical expenses (including health insurance premiums if not payroll deductions)	$ _____
Recreation and entertainment (movies, hobbies, sports, books, records, vacation fund)	$ _____
Church/charity contributions, membership dues/fees, personal gifts (including Christmas club)	$ _____
Telephone	$ _____
Child (day) care	$ _____
Pet costs (food, grooming, vet)	$ _____
Other fixed expenses (alimony, support payments to children or elderly relatives)	$ _____
Regular savings/investment program	$ _____
Emergency fund	$ _____
Other recurring monthly costs—list	$ _____
TOTAL MONTHLY NONHOUSING EXPENSES:	$ _____*

*(This represents ____% of the family's total net monthly income.)

If the percentage of net monthly income going to housing were to go up, which if any of the above areas would the family be willing to lower and by how much? (Look at the variable items.)

Financial Reserves

How much cash/savings, etc. does the family have on hand and how much is potentially available (that is, can be converted to cash) to apply to the downpayment, settlement costs, moving expenses, furnishings and equipment? The minimum acceptable downpayment depends on the age and/or price of the house and the lender. Other pre-occupancy costs vary from community to community and will depend upon the size of the house, level of living desired, and amenities.

	On Hand:	Potential:**
Savings account/cash on hand	$ _____	$ _____
Excess in checking account	$ _____	$ _____
Equity in present home/lot	$ _____	$ _____
Short-term employment/overtime	$ _____	$ _____
Current value of stocks/bonds/ mutual funds	$ _____	$ _____
Sale of other property/investments	$ _____	$ _____
Income tax refunds	$ _____	$ _____
Security deposit refund	$ _____	$ _____
Garage sale proceeds	$ _____	$ _____
Other—list ____________	$ _____	$ _____
TOTAL RESERVES:	$ _____	$ _____

**List only those assets that can be liquidated; list at present cash value minus capital gains taxes and commissions, if applicable. Realize that in liquidating investments and closing savings accounts, you will be losing some potential income from income-producing property, loss of interest, or lost appreciation.

How much of the total will you hold in reserve for emergencies related to the new home, the family, the car, etc.?$____________.

If more cash is needed for the downpayment, etc., can it be borrowed from parents or against life insurance, or from other sources? ____________.

What human resources do you and your family possess that might allow you to spend less in cash and more in time and talents? ____________.

Financial Prospects

To be reasonably sure that the family can manage payments in the years ahead, answer two questions:

1. What are the future income prospects (steady, up OR down, and how much)?

2. What are the future nonhousing expense prospects (excluding homebuying costs), particularly in the next five years (up OR down, and how much)?

The "Bottom Line"

Finally, a family can afford to buy a *higher-priced house and/or make larger monthly payments* if it is able to check most of the statements in the first list below:

____1. There is a large downpayment or equity available from a previously-owned house.

____2. Income is steadily rising and expected to continue to do so.

____3. The family doesn't have or expect major financial obligations.

____4. Savings and insurance are available for emergencies.

____5. Nonhouse expenses (including transportation) can be kept to a minimum.

____6. The family is willing to give up other things for the home.

____7. The home being purchased is equipped with new appliances and requires little or no maintenance and repair and/or the family members are "handy" and can do-it-themselves.

____8. Property taxes and special assessments in the area are low and expected to stay that way.

____9. Expenditures related to family size are minimal.

If the family must check most of the statements in the following list, it should buy a *lower-priced house and/or make lower monthly payments:*

____1. An adequate downpayment or financial reserves for that use are not available.

____2. Income is expected to decrease, fluctuate, be interrupted or stop altogether.

____3. Family members expect to change jobs, receive transfers, and/or the future is uncertain.

____4. The family is carrying heavy debt, or epxects unusual expenses or heavy financial obligations, such as a major savings plan for children's education.

____5. The family is not prepared for emergency expenses.

____6. Other wants equal a house in importance, thus other expenditures are high.

____7. The home being purchased is older or one in need of repairs that are expensive and/or the family cannot make their own repairs.

____8. Property taxes and special assessments in the area are high and going up.

____9. Expenditures related to family size are significant.