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ning How Much of a Home Mortgage You Can Afford: Lender Requi

Searching for a new home can be an exciting process. It can also be very disappointing if you start shopping before you figure out just how much of a home you can afford. Finding the right home will be a much easier process if you take a little time before you hit the open houses to determine how big of a home mortgage you can reasonably manage.

You should consider several different factors in figuring out your ability to afford a certain home price. First, this article will discuss how you should be advised of the general requirements lenders will follow in deciding how much to loan you. The next part will show how it is important to discover exactly how much money you now have and will have in the future to contribute to home mortgage payments. Finally the last article in this series will explain how you should balance your income and assets with you liabilities and future debts to figure out what a comfortable price range will be.

Lender Requirements

While the complete analysis of your financial abilities by your lender is complex process of computations, a simple and very common way for lenders (and you) to calculate how much home you can afford is by applying the “28/36 ratio.” This standard rule reflects your debt-to-income ratio. The “28” means that most lenders require that your monthly mortgage payment be no more than 28% of your monthly gross income. For example, if you bring in $4,000 a month, the biggest monthly mortgage payment your lender would reasonably allow would be $1120. The second half of the ratio, the “36,” means that only 36% or less of your monthly income should go toward total debt payments. Those debts should include your housing payment, plus any recurring or outstanding debts, like credit card balances, auto or student loans. So if your monthly pre-tax income is $4000, and you have $400 of monthly debt, the largest mortgage payment you could afford would only be $1040.

There are some lenders and loan programs that allow for more generous ratios, but typically the 28/36 ratio is the rule. By calculating your gross income and your total debt, you should be able to come up with a rough estimate of how much you will be able to afford.

Besides the 28/36 ratio, lenders will often tell you that you can afford a home that is about 2 to 2 ½ times your annual salary. With the $4000 a month income scenario, your annual yearly salary would equal $48,000, pre-taxes. That means lenders would not want to loan you more than between $96,000 to $120,000. If you are looking to buy in a real estate hot spot, like southern California, Boston, or New York, don’t let the stated numbers crush your hopes of ever affording a home in your area. Since homes in these places can often have median values around $500,000 and average incomes have not yet grown enough to compensate, lenders have several different “exotic” loan programs, like interest-only and option ARMs, that may be the solution for your problem.

Look for the next part of this article “Determining How Much of a Home Mortgage You Can Afford: Income & Assets” to give you further guidance in calculating your potential new home mortgage range.