

Financially Speaking

With Trisha Arndt

Make Sure You Can Afford Your Mortgage

The fact that I am no longer “young” has been hitting me in the face a lot lately. My oldest son now has bigger feet than me, sales clerks have started calling me “Mam” and suddenly the teams I play against in my winter volleyball league are literally half my age. It really struck me though when the child of one of my clients recently contacted me to ask questions about buying her first house. Buying a house I thought? When did you become old enough to do that? Aren’t you still like 10?

In reality of course the young lady is now in her mid-twenties, graduated from college with no debt and has a good job that she has been at for almost 3 years. She is a good candidate for buying a house but I’m glad that she called to talk about it before starting to look.

For many buying a first home is a rite of passage, kind of a stepping stone as they strive toward their vision of the American dream. It is also often the biggest financial transaction that many people will ever make and as such it is very important to avoid potentially costly mistakes.

Before you even start seriously looking it is important to think carefully about what you can afford. One of the most common mistakes that I see is for people to look first and get their hearts set on features that are outside of what their price range should be. Don’t set yourself up for potential disappointment by looking at more than you can afford.

Determining what you can afford is somewhat of a subjective process but there are some rules of thumb that you can use to help get you started. Some mortgage brokers will help you work through this process as well but often their job is help you determine the maximum that you can qualify for, which isn’t necessarily the same as what you should be spending.

As a general rule your total monthly debt and housing costs should come to no more than 36% of your monthly gross income. This is based on the amount you earn, not your net take home check. For example, if your salary is \$60,000 per year, or \$5000 per month, your total debt and housing payments should be no more than \$1800 per month. This should include all debt payments – not just housing costs - including vehicle loans, credit cards, student loans, etc.

It is important to remember that housing costs include more than just the basic mortgage payment. You also need to factor in real estate taxes, home owner’s

insurance and any condo or association fees. Often homeowners will add their real estate taxes and home owner's insurance to their monthly mortgage payment in the form of an escrow but it is important to account for those costs either way. Another commonly used rule of thumb says that your total monthly housing costs should not exceed 31% of your gross monthly income.

Rules of thumb don't work for every situation though so be sure to think carefully about your cash flow and what you can comfortably afford. Things like daycare costs aren't factored into most mortgage affordability calculators but absolutely should be accounted for when looking at your personal finances.

A down payment is another factor in determining what you can afford. Mortgage rules have tightened since the financial crisis of 2008 so the vast majority of mortgage programs are now going to require a meaningful down payment. Minimum down payment requirements vary but I tell people to plan on putting at least 5% of the purchase price down up front. That means that if you are looking at a \$200,000 house that you should plan on being able to pay at least \$10,000 up front.

Ideally I recommend that people strive for a 20% down payment. Most mortgage programs charge an extra amount each month, called Private Mortgage Insurance, or PMI, if you borrow more than 80% of the cost of the home. PMI can add up to a sizeable amount, especially over time, so paying enough up front to avoid it can really make sense.

While a down payment is important, so too is a comfortable cash reserve. When buying a house you have to worry about lots of things that most renters don't have to. If the water heater breaks in your house you can't just call the landlord – you are responsible for fixing or replacing it. And if something happens to your job your mortgage payments don't typically stop. It is a good idea to have between 3 and 6 months' worth of expenses set aside in an emergency fund, especially if you own your home.

When it's all said and done, make sure that the house that you buy isn't going to stop you from enjoying your life and saving for your other goals, like retirement. Having a beautiful house can certainly be fulfilling but in the end it is just a place to live. Keep your housing costs affordable so that you don't find yourself feeling "house poor".

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