COOPERATIVE EXTENSION SERVICE
UNIVERSITY OF KENTUCKY COLLEGE OF AGRICULTURE, FOOD AND ENVIRONMENT, LEXINGTON, KY 40546

MANAGING IN TOUGH TIMES

FAMILY FINANCIAL MANAGEMENT

Name
Cooperative Extension Service
222 Street Road
City, KY Zip
(859) xxx-xxxx
Email

September 2014

'Like' us on Facebook!
Facebook.com/MoneyWise

View our videos!
www.uky.ag/MoneyWise/Videos

Visit our website!
www.uky.ag/MoneyWise

THIS MONTH'S TOPIC:
How Much Home Can You Afford?

Buying a home is typically the largest single purchase a person will make in his or her lifetime. Whether you are purchasing a starter home or your dream home, there are many factors to consider. Throughout the home buying process, buyers are typically focused on location, price, and home aesthetics such as the number of bedrooms, type of appliances, and floor coverings. Buying your first home or upgrading to a nicer home in a better neighborhood is always exciting.

Ninety percent of buyers will take out a mortgage to purchase their home. As a buyer, it is important to understand how much home you can realistically afford. You want to be cautious of becoming "house poor," meaning you are spending too much of your monthly income on your house payment and upkeep, and not able to fund other aspects of your

Continued on the back

VALUING PEOPLE. VALUING MONEY.
MANAGING IN TOUGH TIMES INITIATIVE

Ninety percent of buyers will take out a mortgage to purchase their home.

Continued from page 1

lifestyle such as retirement savings, college savings accounts, or even family vacations and general living expenses.

Understanding the Four C's of Credit

Typically, the amount you can afford is based on the 4 C's of Credit: **Capital**, **Capacity**, **Credit**, and **Collateral**.

- Capital is the amount of cash you have available. As part of the home buying process, you will usually need capital for the down payment, loan fees, closing costs, reserves, and moving expenses.

- Capacity is your ability, based on your income, to pay your new mortgage payments as well as your other debts and living expenses. Your capacity is calculated based on your current income, income history, future earning potential, and amount owed including car payments, student loan payments, charge accounts (Visa, MasterCard, etc.), and any other monthly payments.

- Credit refers to your credit report and credit history. If you do not have a credit history, you will need to go through the process of building a credit history with receipts and payment slips showing regular monthly payments to landlords and utilities.

- Collateral will be your new home. The lender will do an appraisal of the home you decide to purchase to determine the value of the house. Collateral provides the lender with security on the loan if the borrower defaults (or does not pay the mortgage).

A general rule of thumb to determine how much you would be able to qualify for is 2.5 to 3 times your gross annual income. This is assuming that you are in good financial shape, have a steady income, low debt, a sizeable down payment, and good credit. Using this as a guideline a family earning $60,000/year, would probably qualify for a loan between $150,000 to $200,000.

Determining Your Loan Amount

Mortgage lenders often use ratios to determine the maximum loan amount for a borrower. Two common ratios used by lenders are **Housing Expense-to-Income Ratio** and **Debt-to-Income Ratio**. The housing-expense-to-income ratio represents the maximum percent of the borrower's gross monthly income that can be used for the house payment. Twenty-eight percent is a common percentage, but different lenders will have different percentage requirements, normally ranging from 25% to 33%. Using 28% as an example, if your gross monthly income is $2000, the maximum amount you could spend each month on your house payment, including principal, interest, taxes, and insurance (PITI) is $560. ($2,000 * .28 = $560).

Debt-to-income ratio is another number often calculated by lenders. The debt-to-income ratio represents the maximum percentage of the borrower's gross monthly income that can be used for all debts, including the house payment. Typically, to be able to qualify for a loan, lenders will have a preset limit between 36 and 41%. If your loan has a maximum limit of 36%, and if your gross monthly income is $2,000, the maximum amount you could spend on your home mortgage plus all other debts, such as car payment, student loan, etc., is $720. ($2,000*.36 = $720).

MANAGING IN TOUGH TIMES

FAMILY FINANCIAL MANAGEMENT

By:
Jennifer Hunter, Ph.D.
Assistant Professor / Extension Specialist in Family Financial Management
University of Kentucky Cooperative Extension Service
(859) 257-3290 / jhunter@uky.edu

Layout by:
Jonathan A. Stanley
Extension Associate
University of Kentucky Cooperative Extension Service
(859) 257-2097 / jonathan.stanley@uky.edu

Stock images: 123RF.com

MoneyWise is a Managing in Tough Times initiative