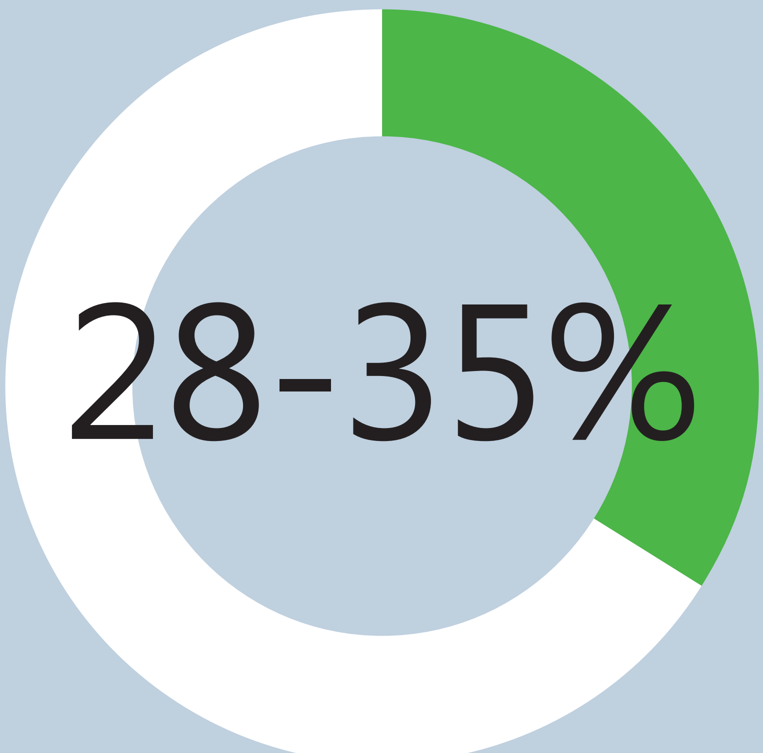
# How much can you **afford?**

# Rule of Thumb

Before you ever speak to a real estate agent or mortgage officer, determine how much house you can comfortably afford. Real estate agents, lenders and your own wants may tempt you to buy a home that you cannot afford. This is your decision and you must feel comfortable with it.  Here is a good rule of thumb to follow:




No more than **28-35 percent** of your income should go toward housing expenses.  This includes PITI (Principle, Insurance, Taxes, Interest), utilities, and maintenance costs. It is smart to budget about one percent of your house's costs for annual maintenance.

# Upfront Costs

In addition to determining how much you can afford on a monthly basis, you also need to make sure you have enough funds to cover the upfront costs required to purchase a home.  Let's look at what these costs are.

# 1 Down Payment

The down payment is a portion of a purchase price that a buyer pays in cash. It is not included in the amount of money you borrow. The amount you need for a down payment depends of the type of loan you secure. Here is the average down payment for the two most common loan types:

## Conventional Loan

**10-20%**
of the purchase price

A conventional loan is a long-term loan from a non-government lender, such as a credit union or bank.

## FHA Loan

**3.5%**
of the purchase price

An FHA loan is a mortgage loan that is insured by the Federal Housing Administration (FHA). Borrowers can qualify for an FHA loan with a down payment as little as 3.5% and a credit score of 580 or higher. The borrower's credit score can be a little lower (between 500 – 579) if a 10% down payment is made. It's important to remember though, that the lower the credit score, the higher the interest rate borrowers will receive.

# 2 Earnest Money Deposit

Earnest money is used to demonstrate the buyer's serious intent to buy the home. The earnest money deposit is usually between 1-5% of the purchase price. It becomes part of the down payment if the offer is accepted, is returned if the offer is rejected by the seller, or it is forfeited if the buyer changes their mind and pulls out of the deal.

# 3 Closing Costs

Closing costs are costs above and beyond the sale price of the property that must be paid to cover the transfer of ownership.  These costs include attorney fees, title insurance, appraisals, points and property taxes. Closing costs vary by geographic location.  However, they are typically about 3-5% of the loan.  You may be able to finance your closing costs, as part of your loan, but this could cost you more in the long run, due to the interest that would be charged on these amounts.

# 4 Post-Purchase Reserve Funds

The lender wants to see that you have some savings to protect against potential cash flow problems after purchase. Reserve funds need to be relatively liquid, and are typically in checking or savings accounts, or investments in stocks, bonds, mutual funds, CDs, money market accounts or trust funds.  Reserve funds may also be the amount vested in a retirement savings account or the cash value of a vested life insurance policy.  Typically, unacceptable sources of reserves would be funds that have not been vested or personal unsecured loans.

Minimum required reserve funds vary, depending on a number of factors.  The basic idea of reserve funds is to protect the lender against potential cash flow problems after closing. This requirement needs to be taken into consideration and thought of as an upfront cost.