

How much house can I afford?

Deciding to buy a house is one of the most important financial decisions a person can make in their life. If you are tired of renting and feel like you're in a good place financially to buy a house, you need to face the next step - determining how much money you can spend on a house given your current income and debt situation. Luckily, there are a few simple rules you can follow to find out how much house you can afford, what your monthly mortgage payment should be and all the other details!

Use the rule of 28 to calculate your maximum monthly mortgage payment

When it comes to calculating what your maximum monthly mortgage payment should be, there are a few different rules out there, some are more conservative, while others are more liberal. The most popular rule, however, is the 28% rule, which states that your monthly mortgage payment should be equal to or less than 28 percent of your gross (pre-tax) income each month. If your mortgage payment is more than that, you are risking becoming house-poor, which means that your house is so expensive that you have to significantly limit your other expenses, hurting your lifestyle.

Rule of 32%

As you probably know, your mortgage payment is not the only monthly expense that comes with buying a house. Once you become a homeowner, you need to pay for homeowner's insurance, property taxes, association fees, private mortgage insurance, repairs, and maintenance. All of this can add up quickly, so you need to take these expenses into account when buying a house. This is where the 32% rule comes in, stating that your total monthly housing expenses, including your mortgage and all the expenses listed above, should not be more than 32 percent of your gross monthly income. It's best to find out how much you can expect to pay in taxes and insurance before buying a home.

Rule of 40% - determine your maximum debt payment

The two previous rules only take your income into account when calculating how much house you can afford. But there's another important thing you have to keep in mind - your debt. If you have a lot of debt, you can't simply use the rule of 28 and the rule of 32 to calculate the maximum price of a house that you can afford. This is why you also need to use the rule of 40%, which states that your monthly debt payments should not make up more than 40 percent of your pre-tax income every month. So if you're paying off a car loan, student loans or have lots of credit card debt, you need to estimate how much you're spending on these payments every month and adjust your maximum mortgage payment accordingly. In most cases, banks won't actually approve your mortgage loan if you already have too much debt.

House down payment

Mortgage payments, insurance and taxes are not the only things you need to think about before buying a house. As you probably know, before you can buy a home, you need to put a down payment on the sum. Most commonly, the down payment is 10% of the cost of the home that you're buying, but it can be as much as 20%. Some lenders allow you to have a lower down payment but in that case, you might be required to get private mortgage insurance, which can significantly increase your housing expenses.