Recovery Tips

Let's Talk Straight

As mortgage professionals we need to better educate borrowers. That starts by first asking them: How much house can you afford?

By Chip Poli

Ever since home ownership first became a reality for many Americans, buyers have been tasked with assessing their purchasing power for what will likely be the most significant acquisition of their lives. And before jumping headfirst into the sometimes tumultuous real estate market, the first question a homebuyer should be asking is, "How much house can I afford?"

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As a real estate agent endeavoring to help land that buyer the home of his dreams, you realize that "How much house can I afford?" translates into "What are my lending options?" Just as you are responsible for helping your client find the perfect property to fit his lifestyle, you are also tasked with understanding his purchasing power. It may seem intuitive that you need to understand your client's buying power before heading out on that first round of showings. You don't want to waste your time or your client's time looking at homes that are out of their price range.

But some homebuyers, particularly those buying a home for the first time, might not be as versed as you in understanding how to calculate that purchase price. Online mortgage loan calculators are abundant and can provide a rough estimate of what a buyer can spend on a home, but you can help your client understand all of the variables taken into account at every step in the process. Here are just a few of the considerations your client will need to take into account when planning for financing a new home:

- Different types of loans demand different qualifications. Your knowledge of conforming, jumbo, FHA, and VA loans can help your client understand which types of loans he might qualify for.
- Down payments typically range from 5% to 20% or more. Federal Housing Administration (FHA) loans generally only require 3.5% down. If your client qualifies for a VA or USDA rural loan, he may not have to provide a down payment.
- Front-end debt-to-income ratio is a comparison of total monthly housing costs (mortgage payment, home insurance, and property taxes) against gross monthly income. While opinions vary on an exact number, most lenders lean toward 28-30%.
- Back-end debt-to-income ratio is similar, but adds in other fixed monthly costs to the equation. In addition to housing expenses, this includes car payments, fixed loans, and credit card debt. This number should be around 35-36%, although FHA loans may allow for up to 45%.
- It is also worthwhile to counsel your client to consider about other monthly expenses that can vary widely, like utilities, home maintenance, gas and groceries,

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travel, and savings for college or retirement. While these numbers are not taken into account when calculating a debt-to-income ratio, taken together they can have an impact on how much a buyer feels comfortable spending on a mortgage payment.

- A borrower's credit standing is very important. Generally, a good credit rating will qualify your client for a lower interest rate. If your client has poor credit, it might be worth waiting a few months and trying to improve his credit standing before pursuing a loan. Some loans, like FHA loans, have credit standards that are designed to extend home ownership to buyers with less-than-stellar credit.

Finally, you'll need to take into account your client's lifestyle. Most people don't necessarily want to buy the most expensive home they can afford and risk ending up "house poor." Buyers should think about how much they can borrow versus how much they want to borrow in order to live comfortably and afford any "extras" that a very expensive home might preclude.

What can your client reasonably afford to pay back, taking into account unforeseen expenses, hobbies and pastimes, and other costs inherent to his particular lifestyle? What circumstances might foreseeably change during the lifetime of the loan? Is a 15- or 30-year loan term more agreeable to your client's sensibility and lifestyle?

Partnership with an experienced mortgage broker can help all of your clients formulate the personal financial snapshot necessary to understand how much they can afford before even beginning a house hunt. Up front, a licensed mortgage originator can assist in the preapproval process, resulting in fewer surprises when the client wants to lock in financing. And when it comes time to apply for a mortgage loan, a licensed mortgage originator can pinpoint the most favorable loan terms and the most competitive rates available based on your clients' means and needs.

The abundance of foreclosures and loan defaults seen in the real estate market in recent years has left some potential buyers skittish about making an investment that could potentially sour. By arming yourself with the knowledge and partnerships necessary to help your client find the best possible home financing scenario for his situation, you will be able to help streamline his path to home ownership. ❖