HIGHTOWER
Westchester

Determining If You Can Afford to Buy Your First Home

Purchasing a home has long been a major part of achieving the American Dream. Young adults' attitudes toward homeownership don't appear to have changed: For example, 95% of 18–25-year-olds surveyed believe homeownership is something to be proud of, and 90% believe it's a sign of success.[i]

But if you are nearing the point at which you want to buy a home, how do you know if it's a move you can afford to make? You may find some helpful information while searching online, but the mortgage process can be overwhelming and confusing, particularly as a first-time homebuyer.

To help you navigate this important decision, here are some steps for understanding whether it's the right time financially to make the leap — and at what price point.

STEP ONE Review Your Credit Ratings

Whether you rent or buy, the time to build good credit is now. Prospective landlords and lenders alike look at this information as an indicator of whether you can make your payments. The minimum credit score needed to buy a house ranges from roughly 500 to 700, depending on the type of loan, and a higher credit score can help you qualify for a lower interest rate.[II]

Your credit score is impacted by many variables, including (but not limited to):[III]

- Whether you have made credit card and other loan payments on time
- How much you owe relative to the amount of credit available to you
- The length of your credit history
- If and how much new credit you've recently taken on

You can check your credit score by visiting AnnualCreditReport.com, where you can order your free annual reports from each of the three nationwide credit bureaus — Equifax, Experian and TransUnion — in one place.[IV]

STEP TWO Understand the Full Costs of Homeownership

In addition to qualitative factors, there are many costs to consider when deciding whether to rent or buy. And some are more obvious than others. The following side-by-side comparison provides some of the main costs to calculate.

	RENTING	BUYING
Upfront Costs	■ Security deposit ■ Broker's fee (not always applicable)	■ Down payment (the median down payment in 2022 was 13% of the purchase price)[V] ■ Closing fees (typically about 2-7% of purchase price)[VI] ■ Any renovations needed to make the home move-in ready
Regular, Ongoing Costs	■ Monthly rent ■ Renter's insurance ■ Utilities (unless covered by the landlord)	■ Mortgage payments ■ Property taxes (usually added onto monthly mortgage bill) ■ Homeowner's insurance (national average is $1,854 per year)[VII] ■ Mortgage insurance, if your down payment is less than 20% ■ Utilities ■ Homeowners association fees (may not apply)
Ad Hoc Costs	Usually none or minimal	■ Maintenance (one rule of thumb is to set aside at least 1% of the purchase price per year) ■ Optional renovations to help maintain/increase the value of your home
Qualitative Benefits	■ Predictable expenses ■ Low stress/responsibility Flexibility to relocate/move	■ The potential to build home equity (value in your house that exceeds the amount of debt you owe on it)[VIII] ■ Tax deductions ■ Control – ability to renovate and manage financial decisions (i.e., you can't control when your land-lord raises rent or decides to renovate)

STEP THREE Determine How Much You Can Afford

The home price you can afford depends on the following four main variables:[IX]

1. **The type of loan you take out.** For example, your loan may be a 30-year fixed, 30-year adjustable, 15-year fixed, etc. You can review these options with a mortgage broker. There are also online tools you can use.
2. **The loan's interest rate.** This is driven largely by market interest rates (i.e., the economy and monetary policy; not anything specific to you) as well as an assessment of how risky you are as a borrower using your credit score, income, debt, etc. You can estimate this too by consulting with a mortgage broker and with various online tools.
3. **How much you can pay monthly.** While everyone's situation is unique, and there isn't necessarily an exact, "right" percentage that applies to everyone, here are a couple common rules of thumb:[x]
   a. 31%–36% on mortgage debt rule: Lenders usually don't want you to spend more than 31% to 36% of your monthly income on your total mortgage-related payment, including principal, interest, property taxes and insurance.
   b. 43%–50% on total debt rule: Lenders usually don't want you to spend more than 43% to 50% of your monthly income on your total debt, including your total mortgage-related payment as well as any credit card, auto, student loan or other debt.
4. **Your down payment.** This could vary considerably, but for perspective, here are a few metrics to consider:
   a. A 20% down payment is ideal. If you put down less than this, you will likely need to pay for mortgage insurance. Mortgage insurance adds to your monthly costs.
   b. According to the National Association of Realtors, the median national down payment was 13% in 2022.[v]
   c. While usually not advisable, it is possible for first-time home buyers to get a conventional mortgage with a down payment as low as 3%. [xi]

STEP FOUR Get Help from a Human

There is little doubt: The mortgage process and affordability question can be confusing. Online advice and tools can help but can also be overwhelming and difficult to synthesize into actional next steps.

Consult with someone who is knowledgeable, unbiased and has your best interests at heart. This may be a parent, your parent's financial advisor or your own financial advisor. You may be surprised at how easy and affordable it is to get help.

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