

# How Much Mortgage Can I Afford?

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*Jeremy writes in with the following question regarding maximum mortgage payments:*

What percentage of your net income should go towards a mortgage? I don't want to rush into anything so I was hoping you could give me some ideas as to what to avoid. Would you consider giving me a couple pointers?

Thanks for your question, Jeremy. Before we get into specific numbers, I have to commend you for even taking the time to ask the question. Unfortunately, many people are still rushing out to sign up for a mortgage without considering the years of financial obligation they are taking on, and what impact that will have to their overall financial plan down the line.

## **The 28/36 Rule**

**There are several ways to look at the answer to, "How much mortgage can I afford?"**

Some people, including most Realtors and mortgage brokers, banks, etc. use what's called the 28/36 rule. The formula means mortgage lenders like to see your monthly mortgage payment come in at less than 28% of your gross income, and your total monthly debt payments, including your mortgage, represent less than 36% of your gross income. Notice I said gross income, as in before taxes and deductions. The fact you asked your question specifying "net income" means you are on to something.

When someone asks how much our annual income is we typically respond with our annual salary, and any other income from self employment, etc. But the number we use to budget from, and live off, is much lower after Uncle Sam stakes his claim along with benefits deductions for [health insurance](#), and other employment-related expenses that come right out of our paychecks. So why not use this figure to determine mortgage affordability?

**Because using *gross income* increases the amount of house an agent can sell you and mortgage brokers can lend you, which means higher commissions and larger interest payments in their pocket.** It's not that they are doing anything wrong; it is just a different way of looking at the question of affordability.

## The Frugal Mortgage Calculator

I actually have a more frugal formula for determining how much you can borrow for a home. **I personally would not spend more than 25-30% of my *take home* pay on housing.** So if your combined household income is \$4,000 a month, meaning the direct deposit or paychecks from your employer totals \$4,000 a month, then I would not spend more than \$1,200 a month on a mortgage. To do so would mean giving up money towards another financial goal such as debt freedom, kids college savings plans, or even an early retirement.

## What If the House I Want Comes With a Higher Mortgage?

Well, this is a case of suffering from champagne tastes with a beer pocketbook. Who doesn't want to buy more than they can afford at some point in their lives? As I see it, you have three options.

- Ignore my advice and buy the bigger home with a bigger mortgage payment.
- Save up for a larger down payment to drive down the amount financed, and the resulting monthly mortgage payment.
- Shop for a more modest home.

Of course I would strongly consider option number three, because larger homes come with larger expenses (taxes, utilities, maintenance, etc.), even if you can get the monthly mortgage payment lowered with a large down payment. Still, option two does have some advantages. By waiting to save a larger down payment, chances are you can also clear some debt, which may improve your credit score and qualify you for a lower interest rate (and a lower payment). Still, consider the increased costs of owning the larger home, even if you technically qualify for it based on income.

If you are wondering, **we currently spend about 18% of our monthly take home pay on housing.** But that wasn't the case when we first moved in (fortunately our income has increased over the years) - and it caused a real pinch those first few months. Don't make the same mistake we did!