LIFE

How Much House Can I Afford? Here's What Home Buyers Should Know

Because as much as you want that home, the last thing you want to be is house poor.

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How much house can I afford? It's a question that a lot of home buyers ask themselves. And it's perhaps the most important to raise because when all your money is going towards your home, your house feels like a prison.

Vacations are out of reach. Restaurants seems like a luxury. And while you can't escape your house, you know that a major emergency could leave you with nothing.

If more than 30 percent of a person's income goes into their home, they're "house poor," meaning that they spend so much on their mortgage, repairs, and other such overhead costs that they can't afford to save or even the daily expenses of life. It's not as rare a situation as many might believe. While American homeowners are generally in far better shape than they were during the housing crisis and great recession of the 2000s, a 2017 joint Harvard study found that 38.9 million American households pay more than they can afford for housing.

So, How Much House Can I Afford?

Ah, the question of the day. Home buying is complicated. But a handful of financial advisors we spoke to recommend following the 28-percent/36-percent Rule. Broken down, this means that you shouldn't drop more than 28 percent of your monthly income on home costs and 36-percent on debts. There are a number of 28/36 calculators online to help crunch the numbers.

This means you need a firm budget. Calculate how much you and your partner earn every month. (This includes paychecks, yes. But also earnings from financial investments such as other property.) You also need to know monthly payments (credit card debts, phone bills, student loans, etc). Then there's home costs to consider: What's your down payment? What will the interest on your mortgage be? What are the property taxes?

After looking at all the money in and money out, you can work with an advisor to tally up and consider your options.

Here's an example: Say, combined you pull in $5,000 a month. Twenty-eight percent of 5,000 is $1,400. That's the 28 percent you can throw into your house every month. Depending on what your debts are, it may be difficult to find that 28-percent/36-percent ratio. However, maintaining that will ensure that your housing costs are not going to be so much that you can't afford anything else.

Of course, there are more factors to consider. How much you put into down payment. What your mortgage rate is. However, the 28/36 Rule is important to keep in the back of your mind, as it's a ballpark figure to work off so you don't get into a sticky situation.

Why Do People Become House Poor?

So why do people become house pour? Reasons ranging from bad advice and quirks of psychology to simple bad luck. But financial advisors say that being house poor is a preventable and curable condition, provided the homeowners thoroughly examination of their finances and the emotions that drive them.

"Buying a house is just as much of an emotional decision as it is a financial decision," Ohio-based financial advisor Michael Caligiuri says, noting that homebuyers can be vulnerable to anchoring bias, where they rely too heavily on information they receive early when they're making their decisions. For example, if a realtor mentions a mortgage rate, the buyer might accept that number as a yardstick. If they get anything slightly lower, it's a victory and they won't shop around for a lower mortgage rate.

"When it comes to buying a plane ticket, you can be sure that somebody's going to Expedia and measuring everything," he says. "But if buying a $200 plane ticket is so important to you to get a deal, then why isn't buying a $400,000 to $500,000 house?"

Before buying a house, it's important know your options and seek out expert opinion, whether it's a first time home buying class or consulting a financial advisor. If nothing else, they might provide valuable context and perspective about spending money.

It's no secret that houses are expensive. But many significant costs of home ownership are poorly advertised. A 2015 study by Zillow found that the American homeowner pays just over $6,000 a year on hidden homeownership costs and maintenance expenses — and in more expensive areas like the Boston metro area, those unavoidable surprise costs can be as much as $9,000.

"When people make the home purchases, they sometimes don't fully understand the financial ramifications resulting from that home purchase," Caligiuri says. "They may be looking at the principal and interest payment on the home and not taking into account the amount of money that they're going to have to pay for property taxes."

New Jersey-based financial educator and blogger Tiffany Aliche says homebuyers need to understand that they have more control than they think.

"One thing I wish I would have known when I was 24 and buying my first house was that I was in the driver's seat," she says.

When buying a home often base their decision on what their family members, friends and coworkers have bought, which can lead to problems. "One of the main causes [of being house poor] is trying to 'keep up with the Joneses,'" California financial advisor Lindsay Martinez says. "Ask yourself if a family of four really needs a 3,000 square foot home, for example."

Realtors and lenders can make it hard to keep costs down. Since they make more when you spend more, they'll naturally encourage you to max out or go over your price range your maximum budget. It's important to remember they work for you.

"Don't let the mortgage lender tell you what you can afford because they're not living your life," Missouri-based financial planner Kyle Hill says. "They don't know what you can afford and they're going to approve you for more than you can realistically afford. You know what your life looks like; you decide."

When his clients are considering buying a house, Utah investment advisor Spencer Stephens shows them how real estate professionals determine what buyers can afford. Afterwards, he creates a more detailed picture of their net income after benefits, taxes and fixed expenses like phone and internet service to compare to projected new housing expenses. The difference between the real estate number and the more true to life one can be eye-opening.

"I had one client recently that I went through this exercise and from their lender perspective, they were at about like a 25 percent debt-to-income ratio, so it was really great," Stephens says. "Anything below 36 percent is awesome. But their expense to income ratio after their actual expenses and actual income basically came out that they would be putting 106 percent into just living like their bare minimum lifestyle."

What If You're Already House Poor?

If it's too late to prevent being house, you can ease the pain. Your fixed costs might be less fixed than you think. One of Aliche's clients thought her education debt obligations kept her from owning a home without realizing she had control over the situation.

"Her student loans were about $400 a month and she thought she'd never be able to buy a house," Aliche says, noting that federal student loan repayment plans vary by family size. "But I told her she got her student loans when she was single and now you're married and you have a child. Adjust your household size. And she did and she got them lowered to about $40 a month."

You may be able to refinance your mortgage. "This is why having good credit and maintaining good credit is so important," Aliche says.

If refinancing isn't possible, it might be time for some tough decisions, something Aliche knows well. She didn't hold onto that condo she bought in her 20s for long. After losing she lost job at the height of the great recession, her bank eventually foreclosed on it in her early 30s.

"Sometimes you have to choose between worse or worser, you know?" she says. "So sometimes it might mean walking away."

Walking away from your house won't feel good. It's a loss. But still, there are ways to lose smart. Aliche burned through her savings and dipped into a retirement account trying to save her condo, a move she'd later regret.

"That was like $30,000," she says. "If I was going to lose the house anyway, I could have lost the house and kept my $30,000."

Aliche faced the worst case scenario for being house poor. But there are degrees of being house poor. Some families can make it work. Stephens bought his house while a graduate student based on a projection of future income that has yet to come to pass. While he wishes he could save and invest more, he's happy with his home.