SCOTT LYLE REALTORS

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Calculate Your Income Vs Debt

Most lenders don't want you to take out a loan that will overload your ability to repay.

As you think about applying for a home loan, you need to consider your personal finances. How much you earn versus how much you owe will likely determine how much a lender will allow you to borrow. First, determine your gross monthly income. This will include any regular and recurring income that you can document. Unfortunately, if you can't document the income or it doesn't show up on your tax return, then you can't use it to qualify for a loan. However, you can use unearned sources of income such as alimony or lottery payoffs. And if you own income-producing assets such as real estate or stocks, the income from those can be estimated and used in this calculation. If you have questions about your specific situation, any good loan officer can review the rules.

Next, calculate your monthly debt load. This includes all monthly debt obligations like credit cards, installment loans, car loans, personal debts or any other ongoing monthly obligation like alimony or child support. If it is revolving debt like a credit card, use the minimum monthly payment for this calculation. If it is installment debt, use the current monthly payment to calculate your debt load. And you don't have to consider a debt at all if it is scheduled to be paid off in less than six months. Add all this up and it is a figure we'll call your monthly debt service.

In a nutshell, most lenders don't want you to take out a loan that will overload your ability to repay everybody you owe. Although every lender has slightly different formulas, here is a rough idea of how they look at the numbers.

Typically, your monthly housing expense, including monthly payments for taxes and insurance, should not exceed about 28% of your gross monthly income. If you don't know what your tax and insurance expense will be, you can estimate that about 15% of your payment will go toward this expense. The remainder can be used for principal and interest repayment.

In addition, your proposed monthly housing expense and your total monthly debt service combined cannot exceed about 36% of your gross monthly income. If it does, your application may exceed the lender's underwriting guidelines and your loan may not be approved.

Depending on your individual situation, there may be more or less flexibility in the 28% and 36% guidelines. For example, if you are able to buy the home while borrowing less than 80% of the home's value by making a large cash down payment, the qualifying ratios become less critical. Likewise, if Bill Gates or a rich uncle is willing to cosign on the loan with you, lenders will be much less focused on the guidelines discussed here.

Remember that there are hundreds of loan programs available in today's lending market and every one of them has different guidelines. So don't be discouraged if your dream home seems out of reach.

In addition, there are a number of factors within your control which affect your monthly payment. For example, you might choose to apply for an adjustable rate loan which has a lower initial payment than a fixed rate program. Likewise, a larger down payment has the effect of lowering your projected monthly payment. Plan on contacting and investigating a number of lenders to find a loan program that meets your needs.

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