

Can John and Marcia Afford the Home of Their Dreams?

Four years later, John and Marcia are pleased with their financial decisions. They have been able to reduce their expenses to purchase the second car. They have enjoyed the convenience of owning a second car, their income has increased, and Marcia's college loan has been paid off. But new challenges have arrived. The car payment is greater than the college loan was. While having two cars has made life much better, the extra car has added to insurance and car expenses. Also, increased income means the couple pays more in taxes and Social Security.

Marcia and John know that to be financially successful they need to begin acquiring better assets. Owning a home is on the top of their personal and financial wish list. They have saved \$10,000 for a down payment on a \$150,000 home.

Answer the questions below to determine whether John and Marcia can afford to purchase the home.

- a. Use the table below to determine the monthly house payment for a 30-year, fixed-rate mortgage loan at 6 percent. To use the table, go down the column on the left to find the loan amount you want and follow across to the interest rate available. The figure on the table represents your mortgage payment of principal and interest (PI). For example, a \$100,000 mortgage with an interest rate of 6.5 percent would have a monthly payment of \$632.

What would the monthly payment be for John and Marcia's home loan? _____
(Hint: \$150,000 – down payment = loan amount.)

Loan Amount	Interest 6%	Interest 6.5%	Interest 7%	Interest 7.5%
\$100,000	\$600	\$632	\$665	\$699
\$110,000	\$660	\$695	\$732	\$769
\$120,000	\$720	\$758	\$798	\$839
\$130,000	\$780	\$822	\$865	\$909
\$140,000	\$840	\$895	\$932	\$979
\$150,000	\$900	\$948	\$1,049	\$1,101
\$160,000	\$960	\$1,011	\$1,065	\$1,119
\$170,000	\$1,020	\$1,074	\$1,131	\$1,189
\$180,000	\$1,080	\$1,138	\$1,198	\$1,259
\$190,000	\$1,140	\$1,201	\$1,264	\$1,328
\$200,000	\$1,200	\$1,264	\$1,331	\$1,398

- b. The monthly payment covers Principal and Interest (PI), but John and Marcia also would need to pay for insurance and real estate taxes (TI), which total \$210 each month. So their total house payment, which includes PITI, equals how much?
- c. A rule of thumb for some lenders is to qualify you for a mortgage if the payments you would incur meet two criteria: a) the mortgage payment with taxes and insurance will be less than 28 percent of your monthly gross income, and b) the monthly mortgage payment of principal, interest, taxes, and insurance (PITI) plus other monthly consumer debt (such as a car loan and credit card payments) will not exceed 36 percent of your gross monthly income. John and Marcia have \$430 of monthly consumer debt, including a car loan and credit card payment (see budget on Exercise 8.3). Their monthly gross income is \$5,400. Using the two lending criteria, would John and Marcia qualify for the loan they are considering, based on your answers below?

$$\$5,400 \times .28 \underline{\hspace{2cm}}$$

$$\$5,400 \times .36 \underline{\hspace{2cm}}$$

- d. As homeowners John and Marcia will have to pay higher utility costs. They expect to budget \$365 per month for utility payments. However, one of the benefits of homeownership is the ability to reduce your income taxes by deducting mortgage interest expenses. If they become homeowners, John and Marcia will pay \$3,000 less annually in state and federal income taxes during the first year (which means their fixed expenses in this category would decline by a monthly amount of \$250). John and Marcia have calculated their budget expenses after buying the home to be \$3,240 for fixed expenses (including \$400 for saving) and \$2,260 for variable expenses, for a total of \$5,500.

Do John and Marcia have enough flexibility in their budget to accommodate the additional costs of home ownership (mortgage payment, taxes, insurance and higher utilities)? Why or why not?