

Buying Your First House

Owning your own home has been part of the American Dream for years. The pride of ownership and sense of belonging somewhere have been strong factors in motivating over 60% of all households to own their own homes. In addition, there can be true financial rewards from home ownership. But, not always.

How Much Home to Consider

Buying and owning a home is expensive. You will need funds for a down payment (perhaps 20% of the purchase price) and any mortgage closing costs before you buy. After you buy, you will have monthly mortgage payments, property taxes and insurance. Then, there are the other expenses like utilities and maintenance. Finally, if you are like most homeowners, you will want to furnish it. All of these items cost money.

Deciding how much to spend for a home can be complex. You probably want as nice of a home as possible, but you want to be able to afford it. What you can afford depends on the size of your mortgage, mortgage rates, costs of home ownership, your other expenses and your income. One rule of thumb to consider is that the total of your mortgage payment, property taxes and insurance should be no more than 28% of your household income. Here is a worksheet and a table of mortgage payments to help with the calculation.

Sample Monthly Mortgage Payments for a 30 Year Fixed Mortgage

Monthly Mortgage Payments at different interest rates (30-year fixed rate mortgage)						
	Mortgage Interest Rate					
Mortgage amounts	3.25%	3.50%	3.75%	4%	4.5%	5%
\$50,000	\$217.60	\$224.52	\$231.56	\$238.70	\$253.34	\$268.41
\$75,000	\$326.40	\$336.78	\$347.33	\$358.06	\$380.01	\$402.62
\$100,000	\$435.20	\$449.04	\$463.12	\$477.41	\$506.69	\$536.82
\$150,000	\$652.81	\$673.57	\$694.67	\$716.12	\$760.03	\$805.23
\$200,000	\$870.41	\$898.09	\$926.24	\$954.83	\$1,013.37	\$1,073.64

Many financial websites include mortgage calculators to provide more precise payment levels and you can also calculate mortgage payments for other lengths of mortgages.

Worksheet

	Sample	Sample		
Mortgage amount	\$100,000	\$150,000	\$	\$
Monthly payment x 12	$(\$477.41 \times 12) =$ \$5,729	$(\$716.12 \times 12) =$ \$8,593		

Property taxes	\$3,500	\$3,500		
Insurance	\$1,500	\$1,500		
Total	\$10,729	\$13,593		
Household income	\$50,000	\$50,000		
Times 28%	x.28	x.28	x.28	x.28
What you can afford	\$14,000	\$14,000		
Difference	+\$3,271 Affordable	+\$407 Stretching affordability	+ or –	+ or –

The sample is based on buying a \$175,000 house with a 4% 30 year mortgage. As the chart shows, this person can probably comfortably afford buying the home with a much larger down payment. As a practical matter, the person could probably be comfortable with a mortgage in the \$125,000 to \$130,000 range.

Tax benefits from home ownership

Many taxpayers find that the interest on their mortgage and the annual property taxes they pay are large enough to enable them to itemize their deductions instead of using what is commonly referred to as the standard deduction. The standard deduction for single filers on their 2020 tax returns is \$12,400 and \$24,800 for joint filers. For many homeowners, their interest and property taxes exceed those amounts, however there are limits on mortgage and property tax deductions. Be sure to keep track of when you pay your property taxes. Some taxing districts have due dates close to the end of the year and you must have paid the tax before December 31st to get the deduction.

The IRS also allows you to exclude any gain on selling your house up to \$500,000 if you file a joint income tax return and meet certain requirements. You may want to investigate these tax advantages further or talk to a tax accountant to completely understand the tax advantages.

Potential gains from selling your home

The housing market in many areas of the country is currently suffering. While that may be bad news for existing owners, it can be very good news for those buying their first home. When the housing market improves, and the odds are good that it ultimately will, the value of your home may rise.

Summary

If you are like millions of others, owning your own home is a primary financial and lifestyle goal. The pride of home ownership and the financial rewards are attractive. Just make sure you understand that there can be some downsides before you make the decision.