Think Small, Save Big

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By ANNA CHANG-YEN | Green Shoot Media

How much house can you afford?

If the Great Recession taught us anything, it's that getting approved for a loan for the home of our dreams doesn't always mean we're shopping within our means.

Perhaps a better question is, "How much house can I RESPONSIBLY afford?"

In a previous HomeWise, we looked at ways to get more house for you money. This week we look at an altogether different concept: less house.

THE OLD WAYS

Some standard measures of affordability are the debt-to-income ratios used by banks. These numbers take inventory of all of your sources of income — from a regular paycheck to stock dividends to child support payments — as well as your monthly expenses (everything from the mortgage and other housing-related expenses to credit cards and student loans). Traditionally lenders have required a debt-to-income ratio of no more than 36/28, in which the first number represents all monthly debt payments including those related to the home, and the second number represents only housing-related expenses.

For someone earning $4,000 per month, that would make for a mortgage payment of $1,120 or less and total monthly debt payments of no more than $1,440. Throw in a car loan and credit card payments, and before long, an applicant with an income of $48,000 per year could find himself struggling to qualify for a mortgage on a home priced at $200,000.

A NEW DAY

It's important to remember, however, that even borrowers who fell within these limits — and of course many who skirted the rules — found themselves in rough financial shape during the past decade. You can plug your income and expenses into a "home affordability calculator" all day long, but at the end of the day, what we each can truly afford is as unique as we are. There are plenty of reasons to dream small when it comes to homeownership.

According to the U.S. Census Bureau's Consumer Expenditure Survey, housing expenses have taken a larger share of Americans' earnings since 1984, consuming $18,000 of our annual incomes on average in 2014. That held true for renters and homeowners. It's easy to see how taming home-related expenses can help families put aside more money for food, transportation, health care and education.

LESS IS MORE

In a 2013 article, U.S. News and World Report pointed out that living in a modest house is one of "5 Frugal Habits of the Rich." "Warren Buffett famously still lives in the Omaha, Neb., home he bought back in 1958 for $31,500," according to the article. "Take Buffett's cue and don't overwhelm yourself with a large monthly mortgage payment. Buy a modest and comfortable home and use the money you save to build your savings and retirement fund."

That doesn't necessarily mean drastically slashing your housing budget, but it does mean many Americans are considering ways to tighten their belts in every area.

Lower utility costs, smaller property tax bills, a smaller impact on the environment and less time spent mowing the lawn are all perks of those who go modest vs. flashy when it comes to buying a home. And if that's not enough to entice you, consider this: Opting for a charming $125,000 cottage in the avenues vs. a $350,000 mini-mansion in the suburbs isn't just about buying only what you really need. It can save you an astronomical $150,000 in interest payments over the course of a 30-year mortgage — enough to put one child through college in 20 years.

HOMEWISE Real Estate Tips and Advice

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REAL ESTATE 101

Feed the Pig

A 2015 study published by the American Economic Association concluded that "mortgage debt is an important determinant of saving rate" and noted that "the recent financial crisis in the US has magnified the negative impact of mortgage debt on both personal and private" nest eggs. Visit **FeedthePig.org** for tips and tools from the American Institute of CPAs about budgeting, using credit responsibly and planning for the future.

HOMEWISE GLOSSARY

Net payoff: the amount paid to a creditor to pay off a loan or account. Any pre-computed charges or interest are deducted to determine the figure.
Nominal interest rate: the stated rate of interest in a loan agreement.

SOURCE: Wisconsin Department of Financial Institutions