



Please note that this is the first two pages of a complete document. [Log in](#) to obtain access to the complete tutorial. If you don't have a username yet, [registration](#) is free. We do not spam our user community.

Step 2: Check Your Financial Health

Everyone would like to be able to live in Beverly Hills, but options for most of us are limited to the neighborhoods available and our financial well-being. Now is a good time to assess your spending habits and capacity to carry a mortgage payment.

In general, you must determine what you currently own, how much you currently owe on it, what your income is, and what you spend your income on. A loan officer will perform the same analysis, but you should know your financial picture before you start looking for houses.

There are some easy to use worksheets here you can use to check your financial health. Check out our [net worth](#) worksheet to determine what you own vs. what you owe on it. Fill out our [cash flow](#) statement to figure out where your money goes during the month.

Evaluating Your Financial Status

Check the net worth value at the bottom of the worksheet to see if the number is negative. If you are within ten years of graduating from school, you might have school loans which create negative net worth (you don't own anything to offset them). If your rent causes you to have negative net worth, don't worry. Your mortgage payments replace your rent and are offset by a substantial asset, therefore, you will be better off. However, if you have other debts without corresponding assets, you might have reason to be concerned.

Note that the cash flow statement does not include money spent on rent or a current mortgage. This is because the intent of the statement is to determine how much you have to spend on a mortgage payment, not how much money you have at the end of a month. If your cash flow is close to zero or negative before considering rent or a mortgage, it will probably be difficult for you to take on a mortgage payment unless you can change how you spend your money. Home ownership does require a little sacrificing, especially if it is your first home. Take a look at what you spend.

- Do you spend beyond your means and are those expenditures really necessary?
- Would a monthly budget help in limiting some of the impulse or discretionary purchases?
- Are you willing to forgo some purchases in order to buy a house?

You might also consider projecting your net worth and cash flow statements into the future. One to five years from now, your income may be different which will make your mortgage payments easier to handle. Set some financial goals and develop a budget if you think it will be helpful towards achieving your house purchasing objective.

You might be able to reduce outflows for expenses you must incur. Consider getting new quotes on your existing auto, health, or life insurance policies to see if you can get the same service at lower costs. Include a savings plan in your future budgets.

Many lenders apply percentage rules to determine your mortgage carrying capacity. The **28% rule** states that your mortgage payment should not be more than 28% of your monthly income. The **33% rule** states that your total monthly debt payments (mortgage, car, school, credit card,





etc.) should not exceed 33% of your monthly income. The 33% is not a hard and fast rule. Depending on your financial picture and the amount of money you put down on a house, you might be allowed a ratio in the range of 33-40%. When calculating debt ratios, lenders generally disregard debt that will be paid off within six months.

Even if the 28% and 33% rules are working against you, try not to worry just yet. Other lenders may use different criteria, such as a combination of assets, income, and credit history to determine your ability to carry a mortgage. You can read more about choosing a lender in the [Financing](#) section.

You can approximate the monthly payments you can afford given an amount borrowed, an interest rate, and a loan term by using the [loan payment calculator](#) worksheet.

Note that the calculation only tells you how big a payment you can afford; it doesn't tell you whether you would be comfortable with a mortgage of that size. If you are approved for a loan, a lender may approve a mortgage that is bigger than what you should borrow. You want some discretionary income left after your mortgage payment for savings, recreation, vacations, or, as is more likely, home furnishings, repairs, and redecorating. You should also include property taxes and homeowner's insurance on your home in your monthly payment estimates. Remember that the size of the monthly payment you can afford is **your** decision.

Check your credit report

A second exercise should be to check your credit report. Many people are nervous about obtaining their credit report because:



- they have never seen it and don't know what to expect
- they fear not understanding it
- they fear that asking for a copy of their report reflects badly upon them
- they fear finding erroneous information and not knowing how to correct it

It is true that in the past, credit data vendors were reticent about supplying information to the people about whom they collected data. Federal and state laws have changed the way vendors respond to data requests. First, vendors **must** supply you with a copy of a credit report if you ask for one. Second, they are allowed to charge only a nominal fee for a report if you ask for it. That fee averages about eight dollars. Some states require vendors to supply one free report each year to individuals who ask for it. Third, if you have been declined credit within the past two months, a data vendor must supply you a copy of your report for free.

There are three major credit data reporting vendors. You can call any of them toll free and obtain a copy of your report by keying in numbers on your telephone via an automated voice response system:

Information in this document is deemed reliable but is not guaranteed.

This document copyright 1999-2002 by [hometoday.com](#) and may not be reproduced or retransmitted for commercial purposes without the express written permission of the authors.

