How to Avoid Becoming "House Poor"

It goes without saying that everyone wants the nicest home they can possible afford. And you can certainly expect plenty of encouragement from your real estate agent and your lender. Each will be able to provide you with plenty of good reasons to buy at the top of your price range. In addition, lenders offer a variety of creative loan products from adjustable rate mortgages to hybrid loans to help you buy the most house you can possibly buy. The philosophy is, you are going to trade up eventually...so why not buy the home you want now? There are savings to consider, of course. For instance, you'd save money by eliminating new finance costs, closing costs, moving costs, Realtor and marketing fees, not to mention lost time at work and the hassle of moving. In addition, the housing market could change in a few years, making the house you would like to have unaffordable. All things considered - it's better to buy the most home while you can.

Leading financial advisors, however, will argue just the opposite. Financial advisors have 1 simple goal in mind. To help you build wealth. For this reason they think in terms of return on investment (ROI) vs. risk. Homes offer a fair hedge against inflation, but you really can't expect much more from them as investments. The rise in home values are mostly offset by the continued cost of maintenance, repairs and market fluctuations. All will agree, however, that home ownership offers many more financial benefits than renting. Advisors will insist that you diversify your assets...meaning that you should have a portfolio containing a cash reserve and other investments, in addition to your home. This risk-managed approach allows you to live a little more secure with the knowledge you can handle future events, such as reversals in your finances due to job loss or additions to your family.

While the ideology presented by each side is sound, the solution lies in the expression..."how to have your cake and eat it, too". Ultimately, you will want to buy the most home possible without becoming so poor that you cannot leave the house (hence the term, house poor). Accomplishing this goal will, of course, depend on several things. One being how much you tell the lender, a second being the type of loan you choose, another being how long you plan to stay in the home, and yet another being what your personal financial goals are.

To begin, don't tell your lender everything.

Lenders are in the business of loaning money based on certain guidelines and risk assessments. This is to ensure that their loans can be insured and their risks will be reduced. The amount of your loan will be determined by four basic factors - income, assets, debts and the interest rate. Most insurer guidelines state that you cannot spend more than 28% of your income on your mortgage, and your debts cannot exceed 8% of your income.

Income. Lender's qualify income as gross yearly pay, including overtime, part-time, seasonal pay, commissions, bonuses, and tips. They may also include dividends from investments, business income, a pension or Social Security income, veterans benefits, alimony and child support.

The question is, do you really want to count all this income? Take a moment to think about it. The only income you should really provide is RELIABLE income. For instance, if you included overtime in your gross yearly pay, is overtime really a reliable source of income? Are you willing to commit to working overtime for the next 30 years to hold on to your house? Of course not, so don't include overtime in your income statement. What about child support? Now, be honest with yourself...have you ever received your check on time? More than likely not, so again, don't include it.

If your goal is to own your house and still be able to eat, you'll want to keep some of your financial information to yourself. You're better off to see what kind of a loan you can qualify for based solely on your annual income, without extra bonuses. As for dividends, you could be reinvesting them to make your stock account grow. Better to not include them as income.

By editing your income statement, you can give yourself bargaining room later, should you decide to buy a home that is a little outside the lender guidelines. In this situation, however, there is another option available to you - choose a more favorable loan.

Use the Lender's loan products to leverage more house. A 30-year fixed rate mortgage is considered to be the standard of the loan industry. Whether it is the right loan for you depends upon two things. One, how long do you plan to occupy your new home; and two, whether you have chosen a home that is just over your edited income range.

For many first-time home buyers, the average time you'll spend in your new home is about four years. Repeat buyers usually average around 7 to 12 years of occupancy. The idea here is simple. The shorter the time you occupy your home, the less time you have to reduce your principle. Until you begin reducing your principal, you aren't really building any equity in the home. Here's something to remember: Equity equals ownership. If you are planning to stay in your home for only a short period of time, make sure your interest rate is as low as possible. You'll also want to avoid paying points, and finance as much of the closing costs as possible.

Typically, 30-year loans represent a high risk for lenders. This is why your credit, debt and income picture must be in such good shape to qualify for one. An alternative loan product would be a variable rate mortgage. While this does require a small risk, the interest rates are usually a point or more lower than the traditional 30-year rate. Variable rates do two things. First, they provide you with a lower interest rate, meaning that you pay less towards interest and more towards principle each month that your in your home. Second, they provide lower monthly payments, freeing up some of your cash for use on other things. That being said, you'll want to strongly consider whether this option is right for you. Many people choose variable rate mortgages if they know they're only going to be in the home for a short period of time, say 4 to 5 years (or less). You'll want to decide on your goals before you commit to a loan product, but be sure they are realistic.

The bottom line is, only you can determine what is comfortable for you. It requires you to look at your lifestyle, income, spending habits, and future financial goals, knuckle down and make a decision. That being said, here's an idea to consider.

Look at the loan amount you qualified for. Now, when looking for homes, try to find homes that range anywhere from 10 to 15 percent less in cost. Chances are, you'll find a home that suits your needs and tastes, but won't overextend your finances. Then, you can take the difference you would have spent on a higher house payment and invest it elsewhere. Add to it monthly. The extra $100 or $200 that you would have spent on your house could be contributing to an IRA (which is tax-deductible) or an investment portfolio. And, if you were willing to spend that money on the house to begin with, then would you really miss it?