How Much Money Can I Borrow?

How do banks decide how much money to lend you? They base their decision on their estimate of your ability to repay the loan.

To make this estimate, they look at your income, your available cash, your debt, and your credit history.

There are two debt-to-income ratios that banks check based on the information you provide on your loan application.

Front-End Ratio
First, they check to see how much of your income would go toward the mortgage payment. This is called the **front-end ratio**.

Their guideline is that your total payment, including principal, interest, and escrow payments, should not be more than 28% of your gross (pre-tax) monthly salary.

To calculate this for yourself, take your annual salary and multiply it by .28, then divide it by 12. This number is your maximum total mortgage payment per month.

Back-End Ratio
Banks also check how much of your gross income is required to pay all of your debts combined. This is called your **back-end ratio** and includes the mortgage as well as car payments, credit card payments, student loans, and child support and alimony payments.

Their guideline for this ratio is that your total debt payments should not be more than 36% of your gross income.

To calculate this for yourself, take your annual salary and multiply it by .36, then divide it by 12. This is the maximum allowable amount of your total monthly debt payments.

Don’t Be House Poor
Be cautious with these numbers however. Just because the bank says they are **willing** to lend you a certain amount, doesn’t mean you **need** to borrow that amount!

(Real estate agents and lenders make more commission on bigger houses and will naturally encourage you to borrow as much as you can.)

Instead, consider your own budget and lifestyle, and make sure you don’t end up with such a high mortgage payment that you can't put money away for retirement, go for a nice vacation, or even go out to eat.

Some debt counselors recommend that your total payment should not be more than 28% of your net pay (after taxes), leaving you money for a comfortable lifestyle as well as the other costs of home ownership, such as repairs, maintenance, and higher utility bills.

Another common rule of thumb is to not buy a house that costs more than two and a half times your current annual salary.