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4 Questions to Ask Before Buying a Home

by Steven Podnos, MD, CFP® (https://www.cfp.net/public-policy/consumer-outreach/cfp-board-ambassadors/cfp-board-ambassador-bios#Podnos)

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Many families enjoy the fruits of their labor by living in a nice house. But that luxury comes at a cost. Not only is a home often the largest single life purchase for families, it also consumes a great deal of annual income. In addition to the mortgage, taxes and insurance, there are the costs of maintenance, landscaping, and the much love and attention that you spend on furnishing your home. The bigger the house, the more money you need.

1. How much does the house cost in relation to your income?

2. How much does the house cost in relation to your savings?

3. How much do you spend and save otherwise?

Then, ask yourself a fourth question to gauge the emotional value of the house to you:

1. In the list of things that you find immensely important to your quality of life, where does the house rank (say, vs. travel, nice clothes, nice cars, etc.)?

I'll give you two extremes to illustrate. A young professional, newly in practice, making $250,000 dollars a year, wishes to buy a $1 million home. The family has little savings to date but no other debt. The monthly payment on (https://www.mortgagecalculator.org/) a 30-year mortgage, at 4 percent a year (assuming a down payment of 20 percent), approaches $4,000 a month.

Adding in the lost opportunity of investing the down payment elsewhere, the property tax and the insurance, the total annual cost of ownership is "house poor."

In comparison, let's move to the case of a financially established family in their 50s. The primary income earner has a well-funded retirement plan that the family's CERTIFIED FINANCIAL PLANNER™ professional says is more than adequate for the family's needs. The primary worker is earning $300,000 dollars per year and saving more than 25 percent of this. There are no plans for retirement in the next decade or two. The family lives in a $500,000 home with only a very small mortgage, and has no other debt. They would like to move up to a $1 million-dollar home. I'd say "no sweat." They have well-established patterns of savings and have accumulated much in the way of financial security. The new home will not impair this.

It's true that the equity in a nice home is not "spent." It remains available if needed in future years by the act of downsizing, taking home equity loans, refinancing and/or taking a reverse mortgage. But many homeowners have discovered the really poor returns of residential real estate over the last decade (and longer in many areas). Historically, appreciation of 2-3 percent a year nationwide is a prudent assumption.

So, the amount of house you can afford is relative to all the factors above. But if you overspend on a house, you could be shortchanging retirement and other financial needs, not to mention putting tremendous stress on the

A CFP® Professional can help you develop a financial plan that balances the home of your dreams against the rest of what you want in life.

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