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Financial Briefs
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How Much House Can You Afford?

Even after the Great Real Estate Crisis of 2008, buying a house is still a key part of the American dream.

Whether you're dipping your toes into the real estate market for the first time or are a current homeowner looking to buy a new place, there's one big question you need to ask yourself: How much house can I afford?

Sky-high home prices and unaffordable mortgages both contributed to the most recent real estate bubble and the subsequent crash. Now home prices are on the rise again in many parts of the country. That means would-be homebuyers need to carefully think about what they can reasonably afford well before they make an offer.

There are many online calculators you can use that will help you assess how different down payment amounts and mortgage terms will affect your monthly housing expenses. Here are seven tips that everyone who is considering buying a house should keep in mind.

Rent does not equal a mortgage: Just because you pay $2,000 every month in rent doesn't mean you can afford a monthly mortgage payment of $2,000. One of the beauties of renting is that your landlord covers certain expenses, like repairs. As a homeowner, you'll be responsible for those, and they'll take a bite out of your monthly budget. When considering how much house you can afford, be sure to budget for ongoing maintenance, unexpected repairs, property taxes, insurance, and homeowners association fees. And don't forget to include one-time costs, like closing costs, moving expenses, and new furniture.

The down payment makes a difference: The more you pay upfront, the lower your monthly payment. Also keep in mind that if you put down less than 20%, your lender will likely require that you get private mortgage insurance (PMI), which typically costs between 0.15% and 2.5% of your total loan amount.

Your interest rate will affect

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Debt and Your Credit Score

These days, your credit score (also known as your FICO score) can affect everything from where you live to the kind of car you drive to the job you may obtain.

Credit scores are calculated based on the information in your credit report. As a general rule, you can expect the following factors, weighted in order of importance, to influence your score:

Your payment history: 35%
Your total debt: 30%
Length of your credit history: 15%
New credit: 10%
Types of credit: 10%

As you can see, your total debt has a big impact on your overall credit score. The only factor that carries more weight is your record of making on-time payments.

When it comes to debt and your credit score, however, it's not necessarily your absolute amount of debt that matters. Revolving debt is the real factor here; and for most people, that means credit cards.

If you have several credit cards and are close to the limit on each of them (what is known as a high credit utilization ratio), this can drag your score down. Why? Because creditors worry that since you're using most or all of your available credit, you're financially stretched.

How Much Debt Is Too Much?

Generally, using more than 30% of your available credit is a red flag. If you have a high balance on one card, you may be able to boost your score by transferring some of that

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How Much House?

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your payment: Lowering or raising your interest rate by just 0.5% can substantially change your total interest payments over the term of your mortgage.

Your mortgage type affects how much you pay: Thirty-year, fixed-rate mortgages are common, but if you can afford the higher monthly payment, consider a 15-year loan. You'll pay more each month, but your overall interest costs will be lower, and you'll be debt free sooner. If your lender offers something other than a 15- or 30-year loan, proceed with caution. Other mortgage products abound, but you need to make sure that you understand all the risks before signing up for one of those loans.

Aim for 25%: Ideally, you shouldn't be spending more than one-quarter of your monthly take-home pay on housing expenses. While you may be approved for a mortgage that results in payments that total 30% or 40% of your income, that doesn't mean you should spend that much.

Your debts and credit score matter: If you have a lot of debt or a low credit score, it will affect your ability to buy a home, no matter what you think you can afford. Lenders will look at your liabilities and credit, and they may offer you a loan at a higher interest rate or deny you altogether.

Don't forget the future: Let's say you and your spouse just got married and are ready to buy your first home. You both have good, stable careers and together make a healthy six-figure income. You're doing well for yourselves, and you want a home that reflects that. But what happens if one of you loses a job or decides to step off the corporate fast-track and shift to a lower-paying career? What if you have children, and one spouse wants to stay home? All these factors should be considered before deciding how much house you can afford.

Taking Charge of Your Debt

If debt is hampering your ability to pursue your financial goals, consider these debt management strategies:

- **Get a handle on your debt.** List all your debts and monthly payments, listing the debts from highest to lowest interest rates. Then calculate your debt ratio, which equals your monthly debt payments (excluding your mortgage) divided by your monthly net income. The general rule of thumb is that this ratio should not exceed 10% to 15% of your net income. Yet don't become complacent if your debt is in this range.
- **Watch your credit card debt closely.** Credit card balances typically carry higher interest rates that are not tax deductible. The best strategy is to only use credit cards if you can pay the balance in full, thus eliminating interest payments. If you can't manage that, at least make sure to pay more than the minimum payment. If you carry a balance on your credit card, call the company and ask for a lower interest rate. Those having difficulty controlling credit card purchases should consider more drastic measures, such as refraining from using credit cards until debt is under control. Instead, use only cash or a debit card, which automatically deducts charges from your bank account.
- **Don't prepay your mortgage unless all other debts are paid in full.** In general, interest paid on mortgages with balances of up to $1,000,000 and on home-equity loans up to $100,000 is deductible on your federal tax return, provided you itemize deductions. Also, interest rates on mortgages and home-equity loans are typically lower than rates on other consumer debts. Thus, you should pay off your consumer loans before paying down your mortgage. Start by paying extra on the card with the highest interest rate. Once that debt is paid in full, move on to the next highest interest rate, continuing until all your debt is paid in full.
- **Be cautious when using a home-equity loan to pay off consumer debt.** While in theory it is a good strategy to replace higher interest consumer debt with a lower-interest home-equity loan with tax-deductible interest, the danger is that you will just run up your consumer debts again. Only use this strategy if you make sure not to overuse your credit cards again.
- **Work on your spending habits.** You're probably in this situation because you have trouble controlling your spending. Put yourself on a budget and stick to it. Look for ways to reduce spending so you'll have more money to pay down debt.
- **Compare interest rates at several lenders.** Interest rates can vary significantly among lenders, so periodically review all your debt to see if less-expensive options are available.
- **Don't purchase items on credit that don't appreciate in value.** Use cash for items like clothing, vacations, entertainment, and dining out. Most people find it harder to spend cash than to charge a purchase on a credit card. Hopefully, that will cut down on your spending; but if not, at least you won't be paying interest on top of it.
- **Consider using savings to pay off consumer debts.** Since you don't get a tax deduction for interest payments on consumer debts, paying off a credit card balance with an 18% interest rate equates to a 24% pretax return for those in the 25% tax bracket. If you aren't earning at least that amount on your savings, use it to pay down your debt.

Your Credit Score

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balance to another card that has little or no balance. Another strategy for improving your credit score is to call your credit card company and ask them to increase your credit limit, thus decreasing your total credit utilization.

Unpaid Debts

Having a lot of debt can lower your credit score, sometimes significantly; but the real credit-score killer is when a debt moves to collections. This happens when you fail to make multiple payments on a debt, and the owner of a debt transfers it to a collections agency.

Reduce Your Debt, Improve Your Credit Score

Fortunately, reducing your debt is one of the easiest and fastest ways to improve your credit score. If you expect to apply for financing (such as a home or car loan) in the near future, check your credit score now. If it's not where you'd like it to be (700 or above is a good target number), start getting aggressive about paying down credit cards or other loan balances. Within a few months, you should boost your score and may qualify for a better loan. As you pay off credit card debt, don't automatically close those accounts, however. You want to keep your available credit high, so keep those paid-off credit cards active.

And there's one more catch: Having some debt may actually be a good thing. Not using credit cards at all (even if you have open accounts) means that a credit scorer can't evaluate your ability to manage debt and make payments. Using your credit card for some purchases and then paying off the balance in full every month can boost your score.

The bottom line: Having a lot of debt can affect your ability to get new credit, qualify for home or other loans, and make the loans you do qualify for more expensive. If you have questions about debt and your credit score, please call to discuss.

Debt and Your Retirement

Most people's vision of retirement not only involves freedom from work but also freedom from debt. A debt-free retirement is a laudable goal, but it's one that has become increasingly difficult for many to achieve: two-thirds of people between the ages of 65 and 74 have some form of debt (Source: University of Michigan Retirement Research Center, September 2013).

The Debt-Free Retirement Goal

When you retire, you stop actively earning income and start living on your savings. If you're still paying off debt, those payments will be another fixed expense, which means you'll have to draw more from your nest egg and have less to spend on things you truly enjoy. By going into retirement debt free, you'll lower your living expenses.

Reducing Debt before Retirement

If at all possible, you'll want to eliminate your debt before you retire. Of course, some types of debt are worse than others. High-interest credit card debt can be a significant burden, so you'll want to eliminate it as quickly as possible. Look for areas in your budget where you can cut back and make extra debt payments, or consider a second job to make extra payments.

Getting debt-free before retirement may mean aligning your mortgage pay-off date with your retirement date; you may be able to bring your mortgage pay-off date closer by making extra payments. Often, retirees want the peace of mind that comes with knowing they'll own their home when they retire. But that accelerated pay-off plan might not be right for everyone. If you have a relatively low-interest mortgage, no other debt, and are already maxing out your retirement savings, you may feel comfortable sticking with your standard repayment plan, especially if you can get more from investing the money that you'd otherwise use to make extra mortgage payments.

One thing you shouldn't do: take money out of your retirement accounts to pay off credit card or mortgage debt. If you focus all your financial resources on paying off your loans, you run the risk of retiring with inadequate savings. Another potential misstep: prioritizing debt payoff over saving. While you don't want to be saddled with excessive debt, you also don't want to end up cash poor in retirement without enough money to meet everyday expenses.

Debt in Retirement

Unfortunately, many people still end up nearing retirement holding a significant amount of debt. If that's your situation, you have several options. One is to delay retirement for a few years while you concentrate on paying off debt. Plus, if you continue to work, you're not tapping your nest egg, and it can continue to grow. In addition, if you delay claiming Social Security, your monthly payment may increase by up to 8% a year until you reach age 70.

If you must enter retirement with debt, you may need to pare down your lifestyle — traveling less frequently, moving to a smaller home, or giving up your boat or RV — to reduce debt and minimize the risk of outliving your retirement savings. You could also continue to work part-time or as a consultant. That can bring in extra income, and many people enjoy a more gradual transition to full retirement.

Finally, know that going into retirement with debt poses some other specific risks. While most creditors can't garnish your Social Security payments, the federal government is an exception. If you owe back taxes, student loans, alimony, child support, or certain other types of payments, you may lose up to 15% of your Social Security benefit.

Please call if you'd like to discuss this in more detail.

Business Data

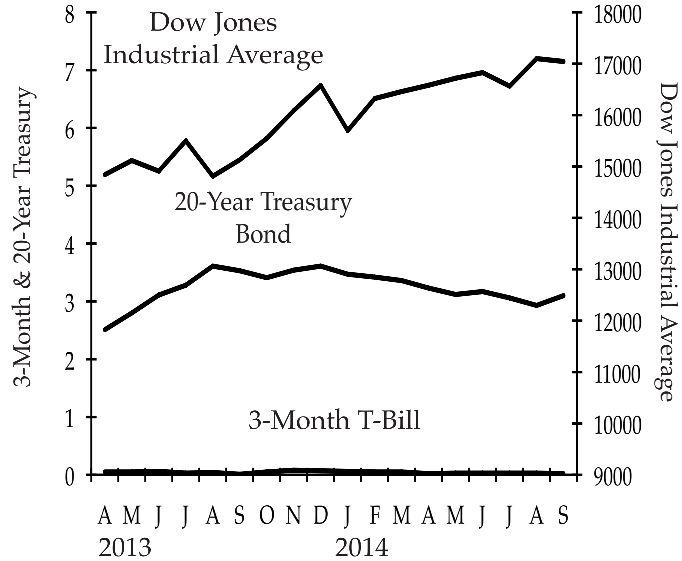
	Month-end				
Indicator	**Jul-14**	**Aug-14**	**Sep-14**	**Dec-13**	**Sep-13**
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.03	0.03	0.02	0.07	0.01
10-year T-note yield	2.53	2.41	2.61	2.89	2.79
20-year T-bond yield	3.06	2.93	3.10	3.61	3.53
Dow Jones Corp.	2.81	2.72	2.90	3.11	3.09
GDP (adj. annual rate)#	+2.60	-2.10	+4.60	+2.60	+2.50

	Month-end			% Change	
Indicator	**Jul-14**	**Aug-14**	**Sep-14**	**YTD**	**12-Mon**
Dow Jones Industrials	16563.30	17098.45	17042.90	2.8%	12.6%
Standard & Poor's 500	1930.67	2003.37	1972.29	6.7%	17.3%
Nasdaq Composite	4369.77	4580.27	4493.39	7.6%	19.1%
Gold	1285.25	1285.75	1216.50	1.2%	-8.3%
Unemployment rate@	6.10	6.20	6.10	-12.9%	-16.4%
Consumer price index@	238.30	238.30	237.90	2.1%	1.7%
Index of leading ind.@	102.40	103.60	103.80	5.6%	7.5%

— 4th, 1st, 2nd quarter @ — Jun, Jul, Aug Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

April 2013 to September 2014



News and Announcements

Borrow Wisely

- Use debt only for items that have the potential to increase in value, such as a home, college education, or home remodeling. Avoid incurring debt on items like clothing, vacations, or other luxuries.
- Consider a shorter term when applying for loans. Even though your monthly payment will be higher, you will incur much less interest over the life of the loan.
- Make as large a down payment on your car or home as you can afford. If you can make prepayments without incurring a penalty, this can also significantly reduce the interest paid.
- Replace high-interest-rate debts with lower-rate options. It is typically fairly easy to transfer balances from higher-rate to lower-rate credit cards. Another option is to obtain a home-equity loan to pay off your consumer debt. In many cases, home-equity loan interest rates are lower than other forms of personal loans, and as long as the home-equity loan balance does not exceed $100,000, interest payments are tax deductible.
- Compare loan terms with several lenders, since interest rates can vary significantly. Negotiate with the lender. Although most lenders have official rates for each type of loan, you can often convince them to give you a lower rate if you are a current customer or have outstanding credit. Review all your debt periodically, including mortgage, home equity, auto, and credit card debt, to see if less expensive options are available.
- Review your credit report before applying for a loan. You then have an opportunity to correct any errors that might be on the report.

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