Utah Retirement Systems

Making Big Purchases

For many of us, if we can get two common big purchases right (a home and a car), we can achieve our other financial goals more easily and lower our financial-stress levels.

Buying a House

The traditional way to purchase a home is to determine how much home you can afford. Mortgage lenders suggest no more than 28% of your monthly gross income be spent on a home (including a monthly amount for a mortgage payment, property taxes and homeowner's insurance.)

However, *consider taking a step back* before accepting the standard industry guidelines. If saving for a particular goal is important to you (such as retirement, an emergency fund, college savings, charitable donations, etc.), then factor in that goal first into your spending plan.

Let's use 10% for saving for retirement as an example. That means you then base your maximum monthly mortgage payment on 90% of your gross income, rather than 100%. Doing so will allow you to protect your goal of being able to save 10% of your income. Your maximum mortgage loan is based on a 90%-income level.

Here's a dollar example. Assume your household monthly gross income is $4,000. You have decided to save 10% for retirement, or $400/month. That leaves $3,600 to use as your after-savings monthly gross income. The maximum monthly mortgage payment you could now afford would be $3,600 multiplied by 28% = $1,008.

Buying a Car

If you're going to finance the purchase of a car, lenders typically like to see no more than 36% of gross household income going towards all debt payments. For example, if your mortgage payment is 28% of your gross income, 8% can go toward all other debt payments including a car loan.

Continuing the math from our earlier example, you decided to put 10% towards saving for retirement, leaving you 90% for all other living expenses. Based on that 90%-dollar amount, subtract the amount you expect to go towards a mortgage payment—assume 28%. That means a maximum of 8% could go towards a car loan ($3,600 multiplied by 8% = $288 per month). Why only 8%? Because 28% plus 8% equals the 36% combined maximum limit that lenders prefer to see for combined debt payments.

SEE OTHER SIDE

Once you know that dollar amount, you can talk with a lender about the maximum car loan they would be willing to make, based on your customized budget and savings goal, rather than a generalized guideline that may not take into account your specific goals. Following this approach keeps you in charge of your overall goals, rather than generic lending guidelines that may stress you out financially.

I Already Own a Home and a Car: What Can I Do?

Many of us are already in the position of owning a home and one or more cars. Are there options for people in this situation? If you change residences at some point in the future, that's a great opportunity to re-adjust a mortgage loan to fit your overall goals (including a savings goal), following the approach described above.

For cars, the options are more flexible now. If you are currently spending more than you want to on car payments, realize you may be able to sell an existing vehicle and purchase a less-expensive one. Or depending on public transportation options in your area, don't overlook the possibility of trying out public transportation for a few months.

If you sell a vehicle and use public transportation, that may eliminate a car payment for several months, resulting in lowered financial stress. Then you can eventually re-assess whether you want to buy another vehicle in the future, again with a payment amount based on your customized spending plan and savings goals.