IDEAS

How Much Should You Really Spend on a House?

Even the experts don't know for sure.

By Olga Khazan

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At the familiar, treacherous hour of 3 a.m., I wake up in a cold sweat, my heart galloping in my chest. I drink some water and take half an Ambien. Then I turn to a sacred document that comforts me in uncertain times. I've read it so often, I can practically recite it from memory: "No more than 28 percent of the borrower's gross monthly income should be spent on housing costs," says the article from Rocket Mortgage.

When I get these panic attacks, it's often because a house has finally come up for sale in the neighborhood to which my partner and I are hoping to move. If we bid way over asking price, we could probably get it. But my nocturnal anxiety attaches itself to one question: Can we afford it? The Rocket Mortgage article can't answer this question, but rereading it soothes me, its precise-sounding percentages sliding beneath my thumb like worry beads.

Versions of the "how much house can you afford?" article get published every few months, and they all tend to include the same few estimates. In addition to the 28 percent rule, there's a different rule that says all your debts—including, most notably, a mortgage and student loans—shouldn't exceed more than 35 percent of your income. (This means that if your mortgage is your only debt, your housing costs alone could conceivably eat up more than a third of your pay.) Under this rule, someone making $60,000 a year and with no existing debts could afford a mortgage of $1,750 a month, which currently equates to a home priced at about $250,000. Yet another rule, from the financial guru Dave Ramsey, recommends spending no more than 25 percent of your *take-home* pay on your mortgage. I'm not sure houses that cheap exist anymore: With interest rates at their highest point in recent memory, houses that were once within reach now cost hundreds more a month.

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Like many timeworn texts, mortgage-advice articles offer more parable than prescription. The numbers above are all wildly different; the discrepancy between them can represent thousands of dollars a month. Most of them don't take into account things like 401(k) contributions or taxes, which can be high for people, like me, who are occasionally self-employed. And they don't factor in other expenses, such as food and child care, that have shot up with inflation. At some of those percentages, my partner and I could afford a large house, but not a child to populate it with. Or we could have a nice kitchen, but would have to stop eating. They're all significantly higher than what we spend on our current home, about 20 percent of our take-home pay.

I worry about being locked into a huge monthly payment—one that would make us unable to afford child care, or to weather a job loss or a downturn in the housing market. Throughout our home-buying "journey," such as it is, various people have implied to us that real estate is a good investment, so we shouldn't stress too much about buying an expensive house. But also that homes, through their upkeep, repairs, and various other vicissitudes, often end up costing more than you bargained for, so you should bargain conservatively. Which is right?

I interviewed nine real-estate experts to help me understand why the numbers vary so much and, I hoped, help me figure out the right one to use for myself. They confirmed that, yes, the mortgage-affordability numbers are all different, and though some lenders use them to approve mortgages, they are basically guesstimates. "To some extent, they're

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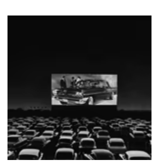

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plucked out of the air," Robert Van Order, an economics professor at George Washington University, told me. "A lot of these numbers are pretty arbitrary," added Edward Seiler, the associate vice president of housing economics at the Mortgage Bankers Association. "It's just based on people staring at data and thinking, *What are the tipping points that force people into delinquency?*" If the percentages don't seem ironclad, it's because they aren't.

Okay, I said, then how much should a responsible person pay for their house? Forget the otherworldly figure that optimistic lenders might approve you for; how much should you actually spend? The experts seemed confused by this premise. "What does the word *responsible* even mean?" mused Morris Davis, a real-estate professor at Rutgers.

Spending more than 30 percent of your income on housing means you're "cost burdened," according to the federal government. After sufficient badgering, most of the experts coughed up this 30 percent figure, or about a third of your income, as a safe limit for your housing costs. But lenders sometimes approve buyers for house prices higher than that, and higher than they can realistically afford, explains Daryl Fairweather, the chief economist of Redfin. Instead of relying on calculators, Fairweather recommends that people comb through their accounts, add up all their expenses, and consider their housing budget to be whatever's left over. (While good advice, this is trickier to do if you plan to change careers or have kids.) Another expert offered an interesting alternative: Look for a house that costs no more than two and a half times your annual income, which should help you fall below the 28 percent rule with an easier mental calculation.

Some, though, suggested that in this bonkers housing market, people should simply move somewhere cheaper so they don't have to think as much about affordability. "There are these deeper questions out there that people aren't asking, which is why don't people want to move to lower-cost places?" Davis said. (Of course, during the coronavirus pandemic many people *did* move to cheaper places, like Austin and Miami, and subsequently made those places much more expensive.)

"Where are you based?" Davis asked me.

I told him the name of the Northern Virginia exurb where I live.

He pointed out that, even here, more than 25 miles from D.C., home prices are high. "Why?" he asked. "[That's] kind of far from D.C. … You're a writer; you could be anywhere."

"This is the whole impetus for the story!" I shot back. We were, in fact, trying to relocate to Florida, a generally less expensive state where houses still cost more than we expected. "I'm trying to move!"

Despite hearing the 30 percent figure from many of the experts I talked with, I was surprised to learn that most *current* homeowners actually spend much less on their housing. So do most renters. The median homeowner with a mortgage spends 16 percent of their gross income on their house payment, including taxes and insurance.

That number is higher—24 percent—for low-income households, but it's still less than 30 percent. Renters spend an average of 26 percent of their income on housing. In other words, if you take the mortgage calculators at their word and spend 28 percent, you're paying much more for a house than the average American does.

But in today's market, it's extremely difficult to buy a house for just 16 percent of your income—or 28, or 30. The average new homebuyer today, according to Zillow, will spend 34 percent of their income on housing—the highest amount since 2004, which is as far back as Zillow's data goes. That's if they have a 20 percent down payment. If they don't, the cost burden will be even higher. Prices are still high because housing stock is so low: With mortgage rates at about 7 percent, people who locked in 3-ish-percent rates a few years ago aren't moving. "It is clear that affordability has become the No. 1 challenge for new buyers and renters in the housing market today," says Orphe Divounguy, a senior economist at Zillow.

The gravest danger of spending too much on a house is that, in the event of a personal or global catastrophe, you won't be able to keep paying for it. That risk is, admittedly, modest: Even homeowners who spend up to 38 percent of their pay on their mortgage don't tend to default, especially if they have good credit and put down a large down payment, according to research by Davis. But a large monthly payment could nevertheless prevent you from saving for retirement, maintaining an emergency fund, visiting far-flung family, or having as many kids as you want. It could keep you from indulging in the many pleasures of life that aren't a house.

This possibility, of being "house broke," can knead away at your thoughts as you click through DocuSign screens of enormous numbers. John Grable, a financial-planning professor at the University of Georgia, told me that during the post-2008 housing collapse, he and his wife lost six figures on their house. “It’s ingrained in my mind, in my being, not to lose money like that again,” he told me. I also remember those years. I remember my friends graduating from college and working at pizza places, my first boss’s voice trembling as he laid me off, people walking around with broken teeth because they didn’t have insurance. The Great Recession ingrained itself in my memory, too. I don’t know if I’ll ever be able to extract it.

Owning a home is generally considered financially smarter than renting, and that’s still true for many people. Unlike with a rental, the day you buy your home, your house payment is the largest it will ever be, assuming you have a fixed-rate mortgage. Your income will likely rise in time, but your mortgage won’t. Homeownership is still a major engine of wealth generation: When you sell a home, you might make a little money, but leaving an apartment, you definitely won’t. And of course, if you stay in your home all 30 years of the mortgage, you’ll own it free and clear. This is why many people, when they first buy a home, stretch financially, says Mike Loftin, the CEO of Homewise, a New Mexico–based organization that helps low-income people buy houses. Most of his customers, he says, spend more than 30 percent of their income on housing.

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But the staggering cost of homeownership today is making renting look less bad by comparison. Right now, for a typical home, owning costs about 25 percent more a month than renting, and there are only four metro areas where buying is currently cheaper than renting, according to Redfin: Detroit, Philadelphia, Cleveland, and

Houston. And because interest rates are so high, today's homebuyers are not building equity at the same clip that someone with a 3 percent rate would be. Especially if you don't plan to stay in one city for at least three years, renting is reasonable. It's just, by its nature, less permanent. "If you're paying 500 bucks a month on your guest-house rent, like, yeah, don't give it up," Loftin says. "But be prepared that when the landlord's kid moves back to Santa Fe, they're gonna be moving in."

The reason it's so hard to get a straight answer on this—how much to spend? To buy or to rent?—is that buying a home is not purely rational. It's also emotional, evoking feelings of stability and community, and potentially, of stasis and strain. The concept of "a home" can be comforting for some and smothering for others. As our physical selves take up residence, so do our hopes for the progression of our careers and the growth of our families. There's not one right amount to spend, because there's not one right future for everyone.

In fact, some experts suggested a different kind of mortgage calculator, what's known as the "eight-hour rule": "Don't do anything where you're not going to be able to sleep at night," Davis said. By that measure, I might not buy a home for a while.