Affording a Home

If you are like most people, you have an image of your dream home tucked somewhere in your mind. But can you afford it? Your dream home could become a nightmare if you end up 'house poor', with most of your money going to pay for the mortgage and little left over for enjoyment.

A real estate professional can help you find a home that you both love and can afford. A REALTOR® can also assist you in evaluating your mortgage options and obtaining financing at the most attractive prevailing rate. In the meantime, here are some ways to determine your *affordability quotient*.

What you can afford to buy

Setting a maximum price range is more important than simply establishing an upper price limit because unanticipated costs could push you into the 'house poor' danger zone. To determine your affordability price range, you must calculate two amounts: the amount of cash you can afford to put towards the purchase (the down payment) and the maximum amount of loan (mortgage) you can comfortably carry.

About the down payment

A mortgage covers the difference between the purchase price and your down payment. The larger the down payment, the less you have to borrow, the smaller your monthly mortgage payment, and the lower your cost of interest over the term of the mortgage. It makes sense, therefore, to put down as much of your own money as possible.

You should keep a cash reserve for unexpected expenses and such typical post-purchase expenses as taxes, legal fees, mortgage arrangements, moving expenses, new furnishings and appliances, and insurance.

How much you can afford to borrow

The first step towards establishing a maximum mortgage limit is to calculate a monthly payment you can afford. Financial institutions do this by calculating your total debt service (TDS) ratio.

To calculate your TDS ratio, list all your loans (car, personal loans, monthly credit card balances). The sum of these loan payments and your mortgage payment (including principal, interest and taxes) should not exceed 40% of your gross income.

A faster way of calculating your debt service ability is to use the gross debt service (GDS) formula. In this case, the principal, interest and taxes (PIT) on your mortgage loan should not exceed 30% of your gross income.

Increasingly, financial institutions tend to include energy costs in the PIT formula, in which case the GDS moves from 30% to 32% of gross income.

In addition to the TDS ratio, the lender will also be looking at your overall credit rating, the number of years at your present job and other factors in assessing you as a loan risk.

Interest rates and other variables

The size of the mortgage you can arrange, based on payments you can afford, depends on interest rates. The lower the rate, the larger the possible mortgage and the more affordable housing becomes.

The rate of interest is not the only factor. There are other mortgage terms to consider as well. How open is the mortgage? Would prepayment be allowed? Is the mortgage portable?

Take the opportunity to discuss your mortgage options with a REALTOR®, your banker or a financial advisor.

Where to get a mortgage

The usual source of mortgage funds is a lending institution such as a bank or trust company, and it is the particular policy of the lending institution that determines the maximum loan allowed. But there are other sources of funding too, and a REALTOR® or mortgage broker can help you choose the best lender at the best rate and terms.

Above all, don't be afraid to ask questions. REALTORS® have a broad knowledge of mortgages and can make recommendations that save you time and effort as you look for a dream home that won't stretch your budget to the breaking point. Using a REALTOR® ensures you will receive the highest level of service, education and integrity when buying your home.