

FINANCIAL POST

Rosemary McCracken, Postmedia News · Mar. 30, 2011 | Last Updated: Mar. 30, 2011 4:04 AM ET

How much home can you afford?

Newly minted professionals shopping for their first home in downtown Toronto are real estate agent Andrew Bodnar's typical clients. "They see home ownership as a status symbol," says Mr. Bodnar, an agent with ReMax Condos Plus, "and an investment."

But young people who have just entered the full-time workforce probably don't have large amounts of money to put down; they may even find the mandatory minimum down payment of five per cent of the purchase price difficult to come up with. "For a \$300,000 condo, a buyer will need minimum down payment of \$15,000, plus about \$7,500 in closing and legal fees, which means he'll need \$22,000 in liquid cash," Mr. Bodnar says.

And they'll need to determine how much they can afford to service the mortgage each month. "Before we start looking at properties with clients," Mr. Bodnar says, "we go through a personal financial analysis including monthly income and expenses, such as car payments and entertainment, to determine how much is available for mortgage payments."

95% FINANCING

A homebuyer's income level will determine whether he or she qualifies for 95% financing, and lenders look at prospective clients' "total debt service ratio," or TDSR, the percentage of gross family income required to cover mortgage payments and other expenses.

"The formula lenders use to arrive at this percentage is to add up the annual mortgage payments, property tax, other payments such as car and credit card payments, 50% of the condominium fee and heating costs. And divide that total by gross family income," says Feisal Panjwani, senior mortgage consultant at mortgage broker Invis Inc. in Surrey, B.C.

Prospective buyers whose TDSRs exceed 40% won't qualify for a mortgage with most lenders, although Mr. Panjwani says some individuals with exceptionally strong credit ratings may be allowed up to 44%.

Changes to Canadian mortgage rules introduced by federal Finance Minister Jim Flaherty in January will make it more difficult for some people to qualify for 95% financing.

The amortization period for government-backed mortgages has been lowered to 30 years from 35 years. With a lower amortization period, mortgage payments will be higher, increasing the percentage of gross family income required to cover them.

But do buyers who qualify for 95% financing feel comfortable acquiring a debt of this size?

Homebuyers should keep well under the maximum they qualify for in order to have a buffer for emergency expenses, Mr. Panjwani says. "Interest rates will likely increase in the next few years. Most economists are expecting an increase of at least per cent on the variable rate over the next two years."

First-time homebuyers can use assets from their RRSPs to increase their down payment, he adds. Under the federal Home Buyers' Plan, they can borrow up to \$25,000 (\$50,000 for a couple) from their RRSPs without having to include the withdrawal on their tax returns, but must repay the amount into the plan within 15 years. "But young people may not yet have put much into their RRSPs," he notes.

Renting out space in the home, such as a basement suite, can augment income for those on tight budgets. "But only half of this rental income can be added to gross income to help buyers qualify for a mortgage," Mr. Panjwani says. "This is to allow for the fact that this space may not always be rented out."

If 40% of a homeowner's gross income is going to service his mortgage, he'll have very little left over for living expenses or for improvements on the home, says Peter Veselinovich, Investors Group's vice president, banking and mortgage

operations, in Winnipeg.

"He may be taking on more debt than he's comfortable with," he adds. "Would-be homeowners often panic, thinking if they don't buy now, and interest rates and house prices go up, they'll never have a home. But first-time homeowners are typically young people who may not be prepared for life's happenstances, such as having a family and getting laid off from their jobs."

A home shouldn't make its owner house-poor, Mr. Bodnar adds. "It should complement your life, not rule it."

Mr. Veselinovich recommends looking at a mortgage as part of the family's overall financial plan, and recommends working with a financial advisor before buying who will put the prospective homeowners on a savings plan tailored to the family's goals and needs.

"The advisor may well suggest that the first home be more modest than what the client has envisioned," he adds.

100% FINANCING

Those determined to get into the housing market may be able to get financing for their down payment. Buyers with good incomes and excellent credit ratings may be able to access "free down payment mortgages" that will give the purchaser five per cent of the purchase price for a mortgage on closings.

"This is basically a cashback program for people with good credit and income, and the rate is bonused to cover the 5% given towards the down payment," Mr. Panjwani says.

Mr. Veselinovich cautions against 100% financing. "Buyers are taking on a huge debt at a period in the housing market when they might not realize much growth in equity for a while. And right now it's only a matter of when interest rates will go up.

"If they can't save the per cent needed for a down payment," he adds, "they probably need advice on developing discipline in planning and saving for their plans. Life changes may occur that will force them to sell because they can no longer afford their home."