

BUYING A HOME: WHAT CAN YOU AFFORD?

If you're thinking of purchasing your first home, you probably have a lot of great ideas about what you'd like - such as several thousand square feet of living space, a two-car garage, large fenced-in lot, one or two fireplaces and a panoramic view. But it may be time for a reality check.

Most first-time buyers want their dream home right away. However, that dream home likely sells for several hundred thousand dollars and the down payment is more than you earn in two years. Not to mention the mortgage payments - which are three times your monthly take-home salary!

The best way to deal with this reality is to match your financial capabilities with the home that meets as many of your needs as possible.

Many first-time buyers purchase what is commonly known as a "starter home." There's nothing wrong with this approach. In fact, it's good common sense to avoid buying a home that will stretch your budget to its breaking point. Remember, the starter home is just that - a way to get started in long-term real estate investment.

To see how much you can afford, you should take a close look at your financial situation. The vast majority of home buyers lack the funds required to buy a home without assistance from a bank or other financial institution (commonly called a "lender"). So, for most of us, buying our first home means combining our savings with money borrowed through a special type of borrowing arrangement called a "mortgage."

Borrowing to purchase is not only acceptable, it's desirable. Even people buying millions of dollars' worth of real estate borrow to make the purchase

There are two types of costs in buying a home:

- the amount of money you'll need for the initial purchase; this consists mainly of the down payment and other costs such as legal fees and taxes; and
- the ongoing costs of paying back your mortgage, along with monthly operating costs for utilities, maintenance, insurance and annual property taxes.

Costs of buying a home =

- * Down payment & * Mortgage
- * Legal fees
- * Utilities
- * Inspection fees
- * Maintenance
- * Taxes
- * Insurance
- * Property taxes

When lenders assess your ability to buy, they look at your ability to pay both types of costs in determining how much money they will lend you. Before you ever visit a lender, you can predetermine this amount, using the same formulas they do.

Lenders use several factors in judging your ability to handle a mortgage, including your income, employment record and credit worthiness. However, one way you can estimate the price range you can afford is to look at the amount of money you have available for a down payment.

The most common mortgage is a "conventional mortgage." In this type of arrangement, lenders will loan up to 75 per cent of the "appraised" value (estimated market value) of the property or the purchase price - whichever is lower. The remaining 25 per cent is the amount you will contribute as down payment.

If you want to buy a home that has an appraised value of \$200,000, a lender may loan you 75 per cent or \$150,000 on a conventional mortgage when you contribute a down payment of \$50,000.

If you plan to borrow funds through a conventional mortgage, multiply the money you have available for a down payment by four. For example, if you have access to \$40,000, you may be able to purchase a home with an appraised value of \$160,000 ($\$40,000 \times 4 = \$160,000$).

This assumes, of course, that you have sufficient income to make the payments on a \$120,000 mortgage (75 per cent of \$160,000). Most lenders will not permit a borrower to take on a debt load the borrower can't carry. That's why reputable lenders "qualify" potential borrowers before issuing mortgages.

Most lenders say that your monthly housing expenses (mortgage payment and taxes), plus condominium maintenance fee, if applicable, would not exceed 30 per cent of your monthly gross family income.

This is called your Gross Debt Service (GDS) ratio. Some lenders will go as high as 35 per cent, depending upon a number of variables.

Lenders also use a second calculation in qualifying you for a mortgage. It's called the Total Debt Service (TDS) ratio. Generally speaking, no more than 40 per cent of your gross family income may be used when calculating the amount you can afford to pay for mortgage payments and taxes plus other fixed monthly expenses.

These other fixed costs are your ongoing commitments and can include auto, student or personal loans, as well as revolving charge accounts. Again, the 40 per cent calculation may vary slightly among lenders.

By knowing exactly what you can afford, you can make your home purchase with confidence.

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