How Much Can You Afford To Purchase?

By: Chad Moore

Download each of my pillars for Mortgage qualifying at www.chadmoore.co/mortgage-calculator.

You'll learn about:

- Income eligible for Mortgage qualifying.
- Down payment eligible for Mortgage qualifying.
- Credit required for a successful Mortgage application.

For other information related to understanding your Mortgage qualifying, the local Real Estate market and for strategic economic updates, please visit my blog:

www.chadmoore.co/blog.

My goal is to become the number one Mortgage Broker in Alberta by 2025. My plan for doing so is to ensure you feel confident in your Mortgage plan and strategy that helps achieve your Real Estate goals.

I do this with expert advice, personal customer service and ongoing Mortgage management so you feel very confident referring your friends, family and co-workers.

Reach my team or I by calling 403-809-5447 or emailing chad@canadamortgagedirect.com

Thank you,
Chad Moore

How Much Can You Afford To Purchase

When you're meeting with your Mortgage lender, I want you to expect to be doing 75% of the talking. Answering questions. Getting real.

This applies to you if you're renewing your Mortgage; going through a refinance or purchasing a home. The principles here are the same: YOU matter.

I think this is where many sales and service people fall down when meeting with clients. And if you're making a change to your life that involves a Mortgage, being heard is ***critically important***.

Why?

Because understanding how your Mortgage fits into your life & lifestyle is the difference between loving where you live OR hating it.

Here's what I mean …going through the Mortgage process is a very emotional time. Being caught up in the flurry of pragmatic Real Estate understanding and emotional desire is tough to navigate.

You want a clear picture of how your Mortgage fits into your life, serving your lifestyle, not crippling it.

And this begins with a crystal clear understanding of how much Mortgage you can afford to purchase, and why.

The last thing you want is to say no to legendary travel plans, once-in-a-lifetime family moments, or simple date nights with special people because your Mortgage is over-your-head.

That's most people's nightmare!

Let's help you now with clear, simple advice on understanding how much Mortgage you can afford, and why:

Mortgage Qualifying Ratios Explained:

Here is THE formula lenders use to calculate your Mortgage affordability. When you understand how much you are eligible to borrow AND you know your down payment amount, you can determine your home purchase price.

There are two Mortgage qualifying ratios:

1. Gross debt servicing.

2. Total debt servicing.

<u>Gross Debt Servicing Ratio (GDSR or GDS):</u>

Here are the terms of the GDS formula first:

P = Principal portion of your Mortgage payment.

I = Interest portion of your Mortgage payment.

T = Tax of your new home.

H = Heating cost of your new home.

½ C = ½ any condo or homeowner association fees.

Gross Income = Your BEFORE tax earnings.

<u>The GDS Formula:</u>

$$\frac{P + I + T + H + \frac{1}{2} C}{\text{Gross Income}}$$

This formula creates what is called the "gross debt service ratio". Also referred to as GDS or GDSR.

When I input my numbers into this formula, I am left with a ratio. This ratio tells the lenders how much of my BEFORE tax income is going towards paying for my basic home living expenses.

To feel comfortable lending hundreds of thousands of dollars, the maximum this ratio is allowed to be is 0.32 or 32%.

Said another way …up to 32% of your gross income is eligible to go towards your Mortgage payment, tax, heat and ½ condo fees (if applicable) with a reasonable chance of Mortgage approval.

<u>Total Debt Servicing Ratio (TDSR or TDS)</u>

Another ratio the lenders look at when qualifying me for a Mortgage is the "total debt-servicing ratio".

This is the EXACT same ratio as the GDS but also calculates how much other debt I have.

Other Debt = any outstanding revolving or fixed payment debt I may have.

A revolving debt instrument functions like this: when I pay down the balance of my debt I am able to re-borrow the money again. For example, my credit cards or lines of credit are revolving debt.

When qualifying for a Mortgage the lenders use 3% of any outstanding revolving debt balance as a monthly liability on my Mortgage application.

For example, if my total credit card debt were $2,500 I would use 3% of that balance as a monthly liability in the TDS ratio. This payment would be $75/month as a liability on my Mortgage application ($2,500 * 0.03 = $75).

Installment loan debt is a set/fixed repayment schedule. When the balance of my installment loan debt is repaid, I do not automatically re-borrow that money.

For any installment loan debt, the monthly principle and interest payment is used as a liability for Mortgage qualifying.

For example, if I have a car loan payment or student loan payment, both of which are fixed payment, I use that actual payment as a liability in Mortgage qualifying.

Therefore, the TDS formula looks like this:

<u>The TDS Formula:</u>

$$\frac{P + I + T + H + \tfrac{1}{2} C + \text{Other Debt}}{\text{Gross Income}}$$

When I crunch the numbers from this formula I am given a ratio. The maximum ratio I am allowed to have is 0.42 or 42%.

Said another way, a maximum of 42% of my gross income (before tax) is eligible to pay for my basic home and Mortgage expenses AND service all of my other debt.

You might notice these qualifying ratios DO NOT factor in other monthly expenses I typically incur in my life: gas to fuel my vehicle, cell phone, internet etc.

I also think it is important for clients to understand the lifestyle they want to maintain as a homeowner (eating out, vacations, saving for retirement and or home improvements etc).

The list of additional expenses associated with home ownership is extensive (relative to renting). These expenses might be home repair, appliance replacements or responding to uninsurable damage.

I help all of my clients understand the reality of homeownership by helping them understand their current lifestyle and what might need to change (if anything) as a new homeowner.

I think understanding these qualifying ratios is important because it helps you understand the rules of the “game” we are paying together. Imagine playing soccer, baseball or football without understanding the rules.

Mortgage lenders lay out the framework or “ballpark” that Mortgage qualifying is built around. If my affordability is higher than I am comfortable purchasing, then lowering my purchase price and qualifying ratios is a good thing.

If I find my affordability is lower than what I expected, now I can plan and make different decisions to help increase my affordability. When I am aware, I can make changes to produce an outcome I prefer.