How to match the home you buy to your pocketbook

So, you've decided to take the big leap and purchase your first home. Most of us have a "dream home" tucked away at the back of our minds -- complete with six bedrooms, two fireplaces and a panoramic view. Before setting off to view properties you likely can't afford, step back and take a reality check.

Your "dream home" can easily become a nightmare when most of your money goes to pay the mortgage and there's little left over for anything else. Overextending yourself financially is the quickest way to destroy the excitement of home ownership and add stress to your life.

Smart home-buying means knowing what you can afford and being practical about it. Most first-time buyers, in particular, lack the funds needed to buy a home without assistance from a bank or financial institution. Buying a home means combining savings with money borrowed through a special arrangement called a mortgage.

To keep mortgage payments within their means, most first-time buyers purchase what is commonly known as a "starter home." A starter home is just that -- a way of getting started in long-term real estate investment.

To match the home you buy to your pocketbook you have to realistically assess your needs, determine what you can afford and, usually, lower your expectations. Begin by enlisting the services of a real estate representative. This individual will help you target your home ownership dreams and provide valuable information on mortgage options, interest rates and incentives, such as government programs, for first-time buyers.

In the meantime, here are some ways to determine how much you can afford.

Set a maximum price range

To determine your "affordability" price range, you must calculate two amounts: the amount of cash you can afford to put towards the purchase (down payment) and the maximum amount of loan (mortgage) you can comfortably carry. Typically, household expenses should not exceed 35 per cent of your gross income.

Put down as much as you can

The key to getting started for most first-time buyers is the initial down payment. This is the part of the purchase price you have to put down as cash. You may be able to buy a home for as little as five per cent down. But remember that the larger the down payment, the easier it will be to manage the other expenses (mortgage, utilities and property taxes).

An ideal down payment is 25 per cent of the purchase price. Keep some cash in reserve though for unexpected expenses related to a home purchase and typical expenses such as land transfer tax, legal fees and moving expenses.

Know how much to borrow
To establish your maximum mortgage limit, a financial institution will determine the monthly payment you can afford by calculating your debt-service ratio. List all your loans (car, personal loans, monthly credit card balances). The sum of these and your mortgage payment, including principal, interest and taxes, should not exceed about 40 per cent of your gross income. The mortgage payment and taxes should not exceed about 30 per cent of your gross income.

Understand interest rates
The size of the mortgage you can arrange, based on payments you can afford, depends on interest rates. The lower the rates, the larger the possible mortgage and the more affordable home-buying will be.

However, there are other variables to consider: How open is the mortgage? Is it portable? Would prepayment be allowed? Discuss your mortgage options with your Realtor, banker or financial advisor. Decide what's best for you, establish a limit and stick to it.

Look at other sources of funds
If you have been contributing regularly to a **Registered Retirement Savings Plan (RRSP)**, you may have to look no further for your down payment. The federal government's RRSP Home Buyers' Plan allows eligible taxpayers to withdraw up to $20,000 per person ($40,000 per couple) tax free from their plan to buy a qualifying home. However, you have to pay back every year at least 1/15th of the amount taken out until it is all paid back, or there will be a tax penalty.

The **Ontario Home Ownership Savings Plan** (OHOSP) is a provincial program which provides tax credits on annual contributions to an Ontario resident earning less than $40,000 a year (or less than $80,000 per couple) who has never owned a home. While there is no limit to the amount you may deposit in an OHOSP, you can only receive tax credits on annual contributions of $2,000 ($4,000 per couple) or less. Depending on your annual income and the money you invest, you can earn up to $500 individually or $1,000 a couple in tax credits a year. The plan must be closed and a home purchased by the end of the seventh year.

The **Canada Mortgage and Housing Corporation's** (CHMC) five per cent down mortgage program is available to both first-time buyers and those who have already owned a home. This benefits buyers who can afford the monthly payments, but would have trouble saving for a larger down payment. Under the program, CMHC may insure the mortgage on your home (against default in payments) for up to 95 per cent of the lending value. An insurance premium of about

3.75 per cent of the mortgage loan is charged. This amount can be added to the mortgage or paid on a monthly basis.

Other sources of funds you can tap into for a down payment include savings and investments and loans or gifts from your family or relatives. If you're already a homeowner and moving up, you can use money that you get from the sale of your present home.