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Obtain the Mortgage You Can Afford



The most important thing to remember when buying a home is that you have to pay for it. This may seem obvious, but when people are buying a home, emotion sometimes causes them to buy without doing the math first.

Just because your bank will approve you for a large mortgage does not mean you can afford to pay for it. You need to look at your lifestyle and decide what makes sense for you before you make an Offer To Purchase on any home.

A good rule of thumb is that most people will qualify for a mortgage equal to about three times their gross annual income. This will give you a very rough idea of what you will qualify for, not what you can afford. You need to look at your cash flow and determine what makes sense for you.

If you like to eat out three or four times a week, you're not going to be able to afford as much as the person that bags lunch every day. It's all about lifestyle. Decide how much you can afford to pay each month for your shelter costs i.e. mortgage, property taxes, heat, hydro, water, etc. Then you can work backwards and figure out how much of a mortgage you need.

Find a payment calculator and play with it until you find a mortgage amount that includes payments equal to what you can afford. (For a quick and easy calculation, use The Gillis Group ['Do I Qualify for a Mortgage' Calculator](#).)

If you are paid a salary or an hourly wage, this is a fairly straightforward process. If you are self-employed or receive large bonuses or commissions as part of your compensation package, then you have other issues to think about.

The big banks don't like taking risks. They perceive people who are self-employed or commissioned to be higher risk because of the uncertainty of their future income. The banks will typically look, not at your gross income, but at your net income after you have deducted all your expenses for tax purposes. They will then average your income by looking at it over a two- or three-year period.

This means that a commissioned or self-employed person with \$50,000 in gross income would not qualify for the same mortgage amount as a salaried employee who makes \$50,000 per year because the commissioned or self-employed individual can write off office expenses, car expenses, cell phones, entertainment, etc. In my business, I see lots of people who can afford a large mortgage but cannot qualify for the mortgage because they declare very little income for tax purposes.

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In the last few years, there have been a few lenders who have acknowledged the fact that self-employed and commissioned people are not as bad at repaying their mortgages as the banks once feared. Now there are a few programs geared specifically at these people to allow them to buy a home without showing any, or very little, income. The biggest difference is that these programs usually require a down payment of at least 15% of the purchase price or more.

Once you have determined what you can afford, you should get a pre-approved mortgage. This will allow your bank or broker to review your financial situation, do a credit check and tell you the maximum mortgage amount for which you would qualify.

Make sure they do a credit check and verify your income. A lot of the banks will try to save time by relying on your application to grant the pre-approval (sometimes referred to as a pre-qualification). They will not do a credit check and they will not verify your income, which are the two of the most important parts of the approval process.

In about 50% of the applications I see, people overstate their income by including overtime, commissions or bonuses that may or may not be ongoing. The banks will only include this sort of income when qualifying you for a mortgage if you can demonstrate that this income is ongoing and has been consistently paid over the last two to three years. If you are relying on this income to be approved for your mortgage, you need to know up front if it will work.

In about 20% of the applications I see, there are credit issues that people were unaware of, forgot about or failed to disclose which would impact their ability to get approved for a mortgage. If this is discovered after an Offer To Purchase is made, there is usually very little time to resolve or deal with these issues.

The other benefit of getting a pre-approved mortgage is that the banks will guarantee you a mortgage rate for up to 120 days. This means that you know exactly what your rate will be if you are able to buy a home and close within the rate-guarantee period. This service is free and it gives you a little added peace of mind when shopping for a home.

Keep in mind that getting pre-approved with a lender does not mean you have to deal with that lender if and when you find a home. The mortgage market is very competitive, and your bank will usually not offer the best available rate at first. Approach a reputable mortgage broker to look at your alternatives. A broker can usually find several lenders who will want your business.

Determining what you can afford is all about doing your homework before you buy a home. If you do the math first, you will not have any nasty surprises once you find your dream home.