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How to avoid taking on too much mortgage

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The tighter mortgage standards introduced by the federal government on Tuesday will address some of the risky behaviour in today's hot housing market, but home buyers still need to be cautious to avoid getting in over their heads.

The rules, which kick in on April 19, will require new borrowers to qualify for a five-year, fixed rate mortgage, even if they are applying for a shorter, variable rate mortgage. The government is also reducing the maximum amount homeowners can withdraw when refinancing to 90 per cent of the value of their properties, from the current 95 per cent.

Even if you qualify for a large mortgage under the new rules, make sure you build enough flex in your budget to avoid taking on too much housing debt.

That's the message from Laurie Campbell, executive director of Credit Canada, a non-profit credit counseling agency. She frequently sees homeowners who can't afford the lifestyles they've committed to.

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”— Credit Canada's Laurie Campbell

While Ms. Campbell believes the new rules will prevent some buyers from becoming house poor, all homebuyers need to consider their life circumstances. “People think they can afford a house and just won’t eat out for five years.”

But a change in your lifestyle could quickly affect your ability to afford your debt. If you’re thinking about having a family, tally the extra expenses sure to hit your budget. Think about how you’ll cover costs for major car repairs or how you will manage if you get ill and can’t work.

“Look to see if you have a cushion,” Ms. Campbell says.

Rob Regan-Pollock, a Vancouver-based accredited mortgage professional with mortgage broker Invis, works closely with first-time homebuyers to make sure they can comfortably afford their mortgage debt.

“We work with homeowners three to four months in advance of a purchase so they can see how much they can actually save each month,” he says. “If they can actually set aside the money, they’ll know their capacity for making payments.”

Mr. Regan-Pollock appreciates that the new mortgage standards will discipline those buyers who were struggling to qualify for a mortgage based on a three-year variable rate. “We don’t want to see people qualifying at record lows like this,” he says.

He still expects the housing market to remain vibrant, as the government is not implementing some of the more controversial mortgage rules proposed by some, such as raising the minimum down payment from five per cent.

For those looking to get into the market without getting in over their heads, Mr. Regan-Pollock suggests meeting with an accredited mortgage professional to determine suitability and relevance of their lifestyle. “Lifestyle plays a huge role.”

Start putting away cash each month to mirror mortgage payments, so you “can correct anything that needs to be corrected.”

Ms. Campbell also has some rules of thumb to follow. First, make sure your mortgage payments won’t exceed 30 to 35 per cent of your gross income. Unsecured payments to creditors should represent no more than 15 per cent of your take home pay. And, just as important, keep an emergency fund that could cover three to six months’ worth of expenses.

“We see people that are one paycheque away from financial disaster.”