THE WAY HOME

Don’t let your bigger home own you

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The Way Home is a series looking at the challenges faced by different generations of people who are in the market for a home – from first-time buyers and growing families to baby boomers who are downsizing.

With a little boy who’s just learning how to walk, Fred and Erin Desjardins would like to have a second child. However, their current home could prove challenging for their growing family.

The 1,000-square-foot, two-storey townhouse has several stairs, which make things tricky when they’re transporting kids, a stroller and groceries. They’ve been preapproved for a bigger mortgage, but they’re aware of the potential downside to upgrading.

“We’re not willing to put our family in a financial situation where we’re bankrupted,” says Mr. Desjardins, who works as an online broker. “We’re young parents, and we’re not going to jump into something unless the opportunity happens and we’re all comfortable with it and the math works.

Adds Erin, who is a dental hygienist: “We want to be smart. We’re not crazy risk-takers, like other people who take on a kajillion-dollar mortgage. These interest rates are not going to stick around.”

The Desjardins, who met while Erin was studying dental hygiene in Fred’s home city of Montreal, are looking at other townhouses on Vancouver’s North shore, ideally one with some outdoor space for their child and pet whoodle to run around. They handle their finances with care: They meet regularly with a financial planner, contribute to registered retirement savings plans, are diligently paying down debt, and seek guidance from their parents and friends’ parents on money matters. They’ve set a ceiling price and plan to hold each other to it.

Not everyone moves up in the housing market with such caution. And not being realistic about what you can afford can lead to trying circumstances down the road.

Edmonton-based Barbara Knoblach, an associate with Money Coaches Canada, has seen several cases of people taking on too much mortgage.

“This is a difficult situation as the clients have already bought too much house and locked themselves into payments that they really cannot afford,” Ms. Knoblach explains. “Sometimes it is possible to change the way the mortgage is set up. For example, some people opt for an accelerated-payment plan not realizing they can’t make the payments. In this case, the monthly payments can sometimes be lowered.

“In one extreme case, I had to convince the client to get out of the house as soon as possible as he really could not afford the payments,” she says. “This was of course an unfortunate situation, and the client ended up paying a ton of money for all the legal transactions, realtor fees, moving expenses and so on.”

When it comes to being approved for a mortgage, banks take into account income and debt. However, as Ms. Knoblach emphasizes, being approved for a certain amount does not mean you need to sign on for that much.

“What the banks do not look at is a person’s lifestyle,” she says. “Some people spend most of their time at home, but others have an active social life that involves a lot of going out and entertainment. Yet again other people spend a lot on their vehicles or on travel. So just because you get approved by a bank does not mean that you can afford this mortgage. Look at all of your expenses and ask yourself what you are willing to give up to buy that house.

“Also remember that you are in a house for the long term,” she adds. “Skipping your summer vacation once might be acceptable, but giving it up permanently in order to make mortgage payments? These are the questions you need to ask yourself when shopping for a new house.”

As a rule of thumb, you’re in a comfortable spot when your fixed expenses are no more than 50 per cent of your after-tax income, Ms. Knoblach says. So for a family making $10,000 a month, having monthly fixed payments of $5,000 would be acceptable. But for a family making $7,500 a month, $5,000 in fixed payments would be too high, as there wouldn’t be much left over for basic costs such as groceries and transportation, and even less for discretionary spending such as a dinner out or weekends away.

Then there are interest rates to consider. For any transaction a client is considering, Ms. Knoblach pretends the interest rate is 5 per cent. If someone can comfortably make the payments at this rate, it’s a go.

North Vancouver, B.C., senior mortgage broker Karen Gibbard, founder of Gibbard Group Financial, says she can’t stress enough the importance of realistically examining all the numbers. When people are looking at options involved in selling their existing home and upgrading to a new one, her team goes through a three-step calculation that lays out all the various costs associated with selling and buying properties so that there are no surprises.

The process starts with establishing a realistic sale price of a person’s existing home.

“Ideally, clients should have a professional give them an estimated sale price so we have a solid starting point to run a thorough calculation of the costs of selling their home,” Ms. Gibbard says. “The estimated costs considered in this first set of calculations are the early payout penalty on their existing mortgage, realtor fees with GST, and legal fees.”

The second step looks at the costs associated with the purchase of a new home. Ms. Gibbard says people should generally budget approximately 2 per cent of the purchase price to cover closing costs, including property transfer taxes, legal fees, appraisal costs, title insurance and moving expenses.

“Step one establishes the net proceeds out of the sale of the home,” she says. “Step two establishes the costs associated with buying, and this amount needs to be subtracted from step one to give the client a solid number that they can use toward the down payment on a new home. “Now that a realistic amount for a down payment is established, we can work through options for the purchase of a new home, looking at purchase price, mortgage amount, and monthly payments.”

One financial consideration that seems to catch people off-guard is the need to have a deposit for the new home at the ready, she says.

“Usually clients have all of their equity in their home and coming up with a 5-per-cent deposit on a new home can be difficult and stressful at the last minute,” Ms. Gibbard says. “With guidance, clients can have this deposit arranged beforehand, and it removes that step out of the flurry of activity required right at the time of selling and buying.”

There are other factors to consider when upgrading – including the eventual need to scale down. “Most upgrades are followed by some downsizing later on,” Ms. Knoblach notes. “So at first the family needs more space for the noisy teenagers. But once the teenagers have moved out, they may have too much space. It’s good to plan an upgrade with this in mind. Could I convert the basement into a separate suite that I can rent out once the kids have left the home? A bit of preplanning can be very helpful to always have a home that fits our stage in life.”

While it’s understandable to want a comfortable place, Ms. Knoblach says that being stressed about mortgage payments isn’t necessarily worth the extra space.

“If your house ends up owning you, you have overdone it,” she says. “A house is just one component of our lives and we should not sacrifice everything else just to own a trophy.

“I deal with a fair number of clients who do not stay put in one particular property but are consistently house hunting and wanting to upgrade,” she adds. “I try to convince these people that they end up making everybody else in the real-estate industry rich, but not themselves.”