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Mortgage affordability

What a lender considers when deciding how much you can borrow

Understanding how mortgage affordability is calculated is crucial when you're considering buying a property. The lender's decision on how much you can afford might seem shrouded in mystery, but it's based on a simple affordability formula. So, let's explore the factors that mortgage lenders consider.

Role of your income

Historically, your income was the sole factor that mortgage providers relied upon to make their decisions. However, the landscape has evolved and become more intricate since then. Despite these changes, your income remains a critical determinant of whether you can manage to repay the mortgage loan.

Certain mortgage lenders may offer larger loans to individuals in professions with higher earnings or households with higher combined incomes. In some instances, the income multiple you qualify for may depend on the loan-to-value ratio of your borrowing. However, in the wake of the coronavirus outbreak, many

mortgage lenders have implemented stricter rules on borrowing amounts.

Proving your income

As such, you must demonstrate your annual income to mortgage providers. Suppose a significant portion of your income derives from sources other than your regular salary, such as overtime, bonuses, commission or dividends. In that case, you'll need to identify a mortgage provider who will consider these. Some providers may also consider pension income, tax credits and allowances.

Your credit score is a key consideration

Mortgage providers will check your credit score via a credit reference agency before agreeing to lend you money. Your credit score will reflect any financial difficulties you've experienced in the past six years, including loan defaults, county court judgements, individual voluntary arrangements or bankruptcy. These factors

will influence whether a mortgage provider will lend to you, the amount they will lend and the interest rate on offer.

Importance of your deposit

Having a substantial deposit (relative to the value of the property you intend to buy) demonstrates a degree of financial responsibility to mortgage providers. It also reduces the risk associated with lending to you, as the loan money could be more easily recovered if the property were sold following a default on the loan. In general terms, the more you have saved, the larger the sum you'll be able to borrow.

Assessing your outgoings

In the evolving mortgage lending landscape, understanding your outgoings has become as vital as knowing your income. Changes in affordability checks mean that mortgage providers now scrutinise how much of your income is spent on essential outgoings. After all, dedicating 70% of your earnings to bills and





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loan repayments paints a less-than-rosy picture of your mortgage affordability.

Necessary essential outgoings

Essential outgoings form the backbone of your expenditure. They include groceries, toiletries, cleaning supplies, household bills such as gas, electricity, broadband, and car costs like vehicle tax and fuel. Other transport costs, insurance premiums (home, life, medical, critical illness), medical costs for things like contact lenses or prescriptions, and any debt repayments also play a significant role.

Beyond essential lifestyle costs

Aside from essentials, mortgage providers consider your lifestyle costs. This includes how much you spend on dining out, entertainment, shopping, holidays, non-essential travel and gym memberships. If a large chunk of your salary is dedicated to these non-essentials, it could hinder your ability to keep up with future mortgage repayments. Therefore, if you're willing to sacrifice certain luxuries to afford a larger mortgage, trim these costs several months before applying.

Looking ahead at future outgoings

Mortgage providers don't just assess your current ability to afford a mortgage. They need to forecast your future financial situation as well. They'll evaluate various scenarios that could occur during your mortgage term, such as redundancy, serious illness or having a baby. If you're currently pregnant or have young children, the cost of raising them may be factored in, even if it's not reflected in your current spending. Having enough cash savings – at least enough to cover three to six months' worth of outgoings – can demonstrate to a mortgage provider that you'd still be able to afford your mortgage in the face of unforeseen circumstances.

Preparing for a change in future interest rates

Other future changes, such as interest rate fluctuations, could impact your ability to repay your mortgage. Over the lifespan of your mortgage, rates could rise and fall multiple times, potentially leading to an increase in your monthly repayments. A mortgage provider will check if you still have enough income left after

your essential outgoings and other spending to make these repayments, based on certain assumptions they use.

While mortgage providers broadly use the same affordability criteria when deciding how much to lend, there are small differences in what they'll each check. This could mean one mortgage provider might lend you more than another, making it time-consuming to find the provider that will offer you the best deal. ■

Ready to secure the best mortgage deal available?

Navigating the world of mortgages can be daunting, but we're here to help. We can guide you through every stage of finding and applying for a mortgage to ensure you get the right deal. If you require further information or wish to discuss your situation. For more information, please get in touch with us.

