Impacts On Borrowing Capacity

Your decision to enter the property market can be influenced by both market conditions and your personal financial position.

While you may not have an ability to influence changes in the property market you do have greater control over your own financial position.

Being well prepared financially will place you in the best possible position to capitalise on favourable market conditions. Understanding how a lender will look at your financial position when applying for a loan will allow you to act and make appropriate financial decisions to improve your chances of loan approval.

Below are the issues that can impact your borrowing capacity.

Security

Lenders require security to cover unforeseen events that may occur in your life resulting in your inability to make repayments. This security allows for fluctuations in the market value of the property and will also be utilised to cover the costs in selling the home in the event this is required to recoup outstanding loan balances.

Generally, lenders will allow you to borrow up to 80% of the property's value, however this may increase to up to 95% with lenders' mortgage insurance. You may be able to borrow 100% of the purchase price if you also utilise surplus security within an alternate property.

The balance of the purchase price will need to be funded from other means. Most likely this will be in the form of a deposit created from a savings plan.

Parents can also provide assistance to first home buyers. This assistance can include a financial gift to assist with the deposit, additional security in the form of a mortgage over their own property or a cash deposit.

Serviceability

The other key consideration in determining borrowing capacity is your ability to make repayments over the term of the loan.

This will be determined by both your earning capacity (income) and your normal living expenses.

It is important to note that your current habits will be taken into consideration when determining your ability to service the loan. If you have discretionary spending habits that have been undertaken over a long period of time, they will be part of your normal pattern of spending and could impact your borrowing capacity.

One of the best ways to demonstrate your ability to repay a loan is through an established savings plan executed over a period of time.

With the introduction of open banking, lenders now have a greater ability to track every financial transaction you make and accordingly you need to be conscious of the financial decisions you make in the lead up to making a loan application.

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Employment

When determining your ability to repay your loan, lenders not only want to look at your earning capacity but they will also consider the certainty of these earnings continuing.

Lenders will consider:

- your employment history, including if you are self-employed
- if you are within a probationary period of employment, and
- more recently the industry that you are employed in.

While these alone are unlikely to determine if your loan will be approved, they will have an influence on how the application is assessed.

Credit score

While having a credit card will not detrimentally affect your ability to gain approval for your application it may have an impact on the amount of money that a lender is willing to lend you.

Even if you do not currently have any outstanding moneys owed on your credit card, lenders will generally deduct from your borrowing capacity the limit of all the credit cards that you hold. This is done on the basis that even if you do not have money owing, you could still increase your debt level up to the limits and detrimentally affect your ability to repay their loan.

Accordingly, it is best to only hold credit cards with limits that you require and remove credit limits surplus to your needs.

Personal and car loans

These loans are generally taken out over shorter periods of time than traditional property loans and accordingly the repayments are generally higher.

These higher repayments will reduce your borrowing capacity as they are included in your expenses. To increase your borrowing capacity there may potentially be better strategies that can be implemented than repayment before you make an application for a property loan, such as re-financing these through the loan application process.

Withdrawal from super

With recent events, the federal government has allowed individuals to apply for an early withdrawal of funds from their superannuation if adversely financially affected by Covid-19.

With the basis of a withdrawal being on grounds of financial hardship, some lenders are looking unfavourably at loan applications made by individuals who have applied for this early release.

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