Understanding Your Debt Service Ratios

When you're looking for a new mortgage or refinancing, lenders will look at both your debt servicing ratios and your credit score as part of the process. Your debt servicing ratios give lenders information about your ability to repay the money you borrowed while your credit score provides information about the way you manage credit.

It's not just having a good credit history and making your payments on time. Lenders will compare your financial obligations to your income—and there's a ratio for that.

How are debt servicing ratios calculated?
There are two ratios you need to worry about — gross debt servicing (GDS) and total debt servicing (TDS)

- **Gross debt servicing (GDS)** is the maximum amount you can afford for shelter costs each month. It's your monthly housing costs divided by your monthly income.
- **Total debt servicing (TDS)** is the maximum amount you can afford for debt payments each month. It's your monthly debt and housing costs divided by your monthly income.

If too much of your income is already going to housing costs and debt payments, according to your lender, you may not be able to afford to take on more debt.

What is a debt servicing ratio and why is it important?
Lenders use ratios to assess risk and understand if you will be able to make your monthly payments on a mortgage. Generally, traditional lenders like to see a GDS ratio between 35% and 39% and a TDS ratio that is between 42% and 44%

If the ratios are higher, that does not mean you won't qualify for a mortgage, but you may end up paying a higher interest rate. In fact, taking a shorter term with an alternative lender might allow you to extend both ratios up to 55%.

In general, the better your debt servicing ratios and credit score, the lower your interest rate will be. This is because lenders view you as more reliable and it shows that you manage your money well and make your payments on time. Even if you need to refinance at a slightly higher rate, you can look at getting into a lower rate in a couple of years when your mortgage renewal is up.

Your debt servicing ratio also lets you know how well you're managing your budget. If your TDS ratio is over 44%, you are spending too much of your income on debt already, and you may be unable to borrow without a co-signer. A co-signer's credit history and income are factored in with yours. This gives the lender some reassurance that the payments will be made because the co-signer is as responsible for the mortgage as you are.

Calculating your personal debt servicing ratios
Start by adding up your monthly debt payments. Include those fixed costs that you must pay every month:

HOUSING COSTS	DEBT COSTS
Rent or mortgage payments	Loan payments, such as car, student, or personal loans
Property taxes	Credit cards (3% of the outstanding balance)
Heat	Outstanding bill payments not on a credit card (dental, medical, repairs)
50% of condo fees	Interest charges for line of credit payments
	Spousal or child support payments

Next add up your monthly income:

- Pay cheque (before taxes)
- Retirement or pension payments
- Benefits payments
- Spousal or child support
- Rental income
- Any other monthly income

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Formulas:

Gross debt servicing ratio

$$\frac{\text{Housing Costs}}{\text{Total income}} \times 100$$

Total debt servicing ratio

$$\frac{\text{Housing Costs + Debt Costs}}{\text{Total income}} \times 100$$

Examples:

Your income (before taxes) is $6,500 per month. You have a monthly mortgage payment of $1,400, property taxes of $ $300, and $ $100 for heat. Your GDS ratio is calculated as $1,800/$6,500 x 100 = 27.69%

Your income (before taxes) is $6,500 per month. You spend $300 for your car payment. You have $2,500 in credit card debt, and 3% of the outstanding balance is $75 for a total of $375 per month. Your TDS ratio is calculated as $2,175/$6,500 x 100 = 33.46%.

To learn more about specific mortgage approval ratios, check out this handy article.

Note: If you have a two-income household, include the debt payments and income for both of you. This is important because you have more income between you, and you share the cost for some of the debt.

Now that you know how a lender is going to assess your mortgage application, you can take the necessary steps to lower your debt servicing ratios and get a mortgage approval!

Information subject to change without notice.