Mortgage loans not impossible for self-employed

By Karen Mayfield

With so many entrepreneurs and start-up companies, a common question I hear is, “How do people who are self-employed get a mortgage?”

Mortgage lenders have different treatments for different types of income, whether it is an annual bonus, commissions, overtime pay, or income from self-employment, either full-time or as a secondary source of income.

Because your lender needs to verify that you have the ability to repay your mortgage, the income you use to qualify for a mortgage should be as stable and predictable as possible, and likely to continue for the next three years.

Bonuses, overtime, and self-employment income are not always considered stable and predictable. So lenders are usually especially careful when they factor income from those sources into a loan application review.

Here are some tips for various sources of income:

Self-employment: First of all, you should be aware that lenders tend to require two years of verifiable self-employment history to approve a mortgage loan based on that income. If you don’t have the two years, you may be required to wait until you have a two-year track record. You will likely be required to provide two years of tax returns and possibly a year-to-date profit-and-loss statement.

Be ready to provide the lender evidence of a net profit, with a current year-to-date profit-and-loss statement, as well as the most recent year’s income tax returns for this self-employment activity.

Self-employed loan applicants face a bit of a challenge dilemma. Higher expenses offset income and lower your tax bill. But by lowering your net income, you may be reducing the income your lender will use for a mortgage approval. If you're looking to buy a home, consider balancing your tax strategy with your housing aspirations.

Overtime: If you are employed and want to use overtime pay as part of your income for a mortgage, your lender may use a 24-month average of your overtime pay and add that to your regular income.

Bonuses or commissions: Lenders typically use a 24-month average of your income from bonuses or commissions and add that to your regular salary or monthly income.

Business ownership: If you own 25 percent or more of any business entity, your lender may use a 24-month average of income, unless it is declining. If the entity's income is declining, lenders usually take the lowest annual amount and use that as your qualifying income.

Family business: If you work for your family's business, you will probably need to provide standard employment verification as well as evidence that you are not an owner of the business. Discuss the various options with your lender or tax accountant.

Borrowers generally want to use as much of their income as possible when applying for a mortgage, first to ensure the application is approved, and second to qualify for the loan amount needed to purchase the home they desire.

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