CHOICE
mortgage solutions

CONTRACTORS GUIDE

A Choice Mortgage Solutions Guide

The popularity of contracting in the UK is growing, thanks to workers seeking flexibility and more businesses recognising the benefits o f working with an agile employee base.

However, without a guaranteed monthly salary enjoyed by employees, getting a mortgage may be harder. As independent mortgage advisers and specialists in working with contractors, we want to share some tricks of the trade with you.

> **“There is absolutely nothing we can fault you on”**
>
> **MV**
> London

Proving your income: part one

All mortgage lenders require applicants to be able to prove their income. For contractors this is more complex than your typical employee.

Where contractors are concerned, most mortgage lenders will look for you to have been contracting, not necessarily with the same company, for at least a year. With such a short contracting history, it may be the case that the number of lenders willing to offer you a mortgage is limited, and the size of the deposit required higher. Conversely, the longer your history of contracting and the more stable your income has been, the greater the choice you'll have in terms of lenders prepared to offer you a mortgage.

It's therefore important to find the right time to make a mortgage application, taking into account the length of time you've been contracting and desire to buy a house.

Proving your income: part two

Every mortgage lender will take a slightly different view as to how they assess your income. Some, for example, will look at your net profit, while others will consider your salary and dividends taken or use another method of calculation entirely. To maximise your borrowing potential we are able to find lenders who will consider using your gross daily rate.

By following the calculation below, this will often enable you to borrow substantially more. You need to take your day rate, multiplying it by the number of days you work a week, and then again by the number of weeks you work per year. So, let's say your typical day rate is £450, you work five days a week, and take six weeks holiday a year. You'd simply calculate £450 x 5 to give you £2,250, which you'll then multiply by 46 to give you an annual income of £103,500 before expenses, tax, and other associated outgoings, which you'll need to deduct.

£450 Day Rate

X

5 Days per Week

X

46 Weeks per Year

=

£103,500

Using this calculation will mean you are able to borrow substantially more than using salary/dividend or net profit figures.

If you're working for an umbrella company, the process differs slightly. The umbrella company will be responsible for deducting your tax on a PAYE basis as they technically act as your employer, as well as offsetting some of the income through expenses claims, such as travel and accommodation. If you use an umbrella company they should issue you with a P60 at the end of the tax year, which will clearly state your income and amount of tax and National Insurance paid, making it easier to prove your income. In addition, many umbrella companies provide further benefits, such as holiday pay, which can mean your income varies significantly depending on how you're operating.

The key though is finding the right balance between declaring an income sufficient for you to obtain a large enough mortgage to buy the house you want and minimising tax bills. This theory applies whether you are trading as a limited company, partnership, or sole trader.

> **“It's best to take an average in terms of the rate you charge and how frequently you work over say the last three years.”**

Be mindful of holidays

When you approach a mortgage lender as a contractor, they will expect you to take holidays throughout the year. For this reason, your annual income is usually worked out based on your average rate over a 46-week period. But issues may arise if you've taken extended breaks from working.

If you've taken over eight weeks holiday in a single year, for example, it may look as though your contracts aren't stable and that you've been frequently out of work.

To maximise your chances of being approved for a mortgage, keep in mind how many holidays you're taking as you save for a deposit. Spreading out time off work can improve how your earnings are viewed by lenders. Where you have taken extended breaks from work, have an explanation ready and demonstrate the value of contracts you do work on, which allow you to weather periods out of work.

Check your credit score

It's important to look at your credit score; if it's poor, you're not going to get anyone to lend you any cash.

Whether you're a contractor or not, your credit score will be critical when the time comes to apply for a mortgage. Lending decisions are based on risk, and your credit score gives lenders an indication of how likely you are to default on payments.

The first step is to create a plan to make sure your credit is as good as possible; minimise debt and where possible pay this off before you approach lenders.

Next, check your credit score and remedy any risk factors that are having a negative impact. Steps such as ensuring you're registered on the electoral roll, meeting minimum payments for credit cards, and not utilising all the credit available to you are places to start when you're trying to improve your score.

The decision of whether you'll be accepted for a mortgage isn't based on your credit score alone, but it is an influential factor.

Keep good records

Linking to the above points relating to your income, you'll need to prove how much you earn and keeping good records will be essential for this step.

Lenders will usually want six months of earning history, along with two to three years of accounts. You should already have a good recording system in place, but if not, now is the time to review it. Make sure all your contracts are up to date, signed and readily available, including the one you're currently working on and any upcoming projects.

You want your records to demonstrate that you'll be able to continue making mortgage repayments once your current contract ends, so evidence of regular, sufficient income is important. Ensuring all the documents are ordered, accessible, and transparent will make it easier for the lender to fully understand your circumstances.

An area that's often an afterthought when it comes to keeping records are your bank statements. In the past you might have simply discarded them, but they're important for the mortgage application process. Keep them to hand and organised for when they're needed.

Another thing to keep in mind is the transactions that go through your bank account. Lenders will look through you banks statements and there are some transactions they won't be too keen on, such as payments to payday lenders and gambling organisations.

Ensure your accounts are up to date

We've already highlighted how important your accounts and records are, so it should go without saying that getting them in order before you approach a lender is critical.

Your lender is going to want to see up to date accounts, tax computations and other records that demonstrate your ability to pay your mortgage. Ensuring everything is up to date gives lenders a clearer indication of your current situation and what you can afford.

Taking this step now, and keeping on top of it, means the mortgage application process will be smoother. Rather than having to scramble around to find paperwork your mortgage lender has requested, you'll know exactly where it is.

Approach lenders when you have a contract

When you approach a lender, they'll typically want to see at least 12 months of history in terms of contracts; but they'll also want to look at your existing situation. For this reason, timing is important for contractors.

It's best to approach lenders when you're at the beginning of a long-term contract, ideally with six months or more left to run. A lengthier contract shows that you'll be receiving a consistent income as you search for a house and, if you find the property for you, during the first months that you're in your new home. It also indicates that you have the skills and connections to secure long-term work, putting you in a good position in the future.

On top of this, you'll also likely need to show a copy of your CV. As a contractor, your ability to pay the mortgage comes down to your skills and experience rather than the company you work for after all.

Mortgage lenders will be looking for a CV that shows stability, expertise in your field, and a snapshot of your past history, which, hopefully, demonstrates why your application should be approved.

It might not be the first task that springs to mind when searching for a mortgage but reviewing your CV could improve your chances of being approved and accessing a better rate. You should seek to clarify any employment gaps, highlight stability, and focus on the qualifications and professional development that makes you an attractive contractor for businesses to work with.

If your contracts tend to be shorter or your existing pipeline of work is, it doesn't mean you'll automatically be refused. The type of contract you're working on when you approach a lender isn't the be all and end all, but it is something to think about if you want to improve your chances.

Manage your outgoings

Much like any mortgage applicant, you will need to show that you can budget. At the end of the day, mortgage lenders and brokers are assessing your ability to consistently meet your repayments on time. As a result, when you start thinking about applying for a mortgage, taking a look at your income and outgoings should be considered a crucial step.

Set a budget, keep track of what you're spending, and regularly assess how your outgoings match up with what you're earning and saving.

Getting to grips with your daily finances also helps you to understand what is affordable given your circumstances. It can be tempting immediately start looking at properties that are at the top of your budget when you receive a mortgage offer. But you need to make sure you can afford your mortgage repayments, along with all your other essentials, even on months when there's a slump in work.

Build up a sizeable deposit

Whether you're a first-time buyer or taking another step up the property ladder, the amount you'll be putting down as a deposit on your new home is important.

First-time buyer

For first-time buyers, you'll be expected to offer at least 5% of the property's value as a deposit, though the required amount can vary. If you've only been working as a contractor for a short period of time, be prepared for lenders to request a greater percentage. Saving more for a deposit where possible will certainly go in your favour.

As a contractor and first-time buyer, a goal of saving around 10 - 20% can help improve your chances of being approved. It demonstrates your ability to manage money and shows you have a disposable income coming in from your contracts, making you a more attractive customer. If you've consistently been putting money away too, it'll highlight your ability to pay your mortgage repayments on time and build up a fund for emergencies.

Building up a deposit of 20% can be a significant sum but there are government-backed schemes that are designed to help you reach your target quicker. One option is the Lifetime ISA (LISA) if you're eligible. There are some restrictions with a LISA, but it effectively gives you up to £1,000 annually in 'free money' if you deposit the maximum amount. Each year you can put up to £4,000 in a LISA, receiving 25% bonus on top tax-free.

However, if you want to withdraw your money before the age of 60 for a reason other than buying your first home, you will face a penalty, so it's not right for everyone.

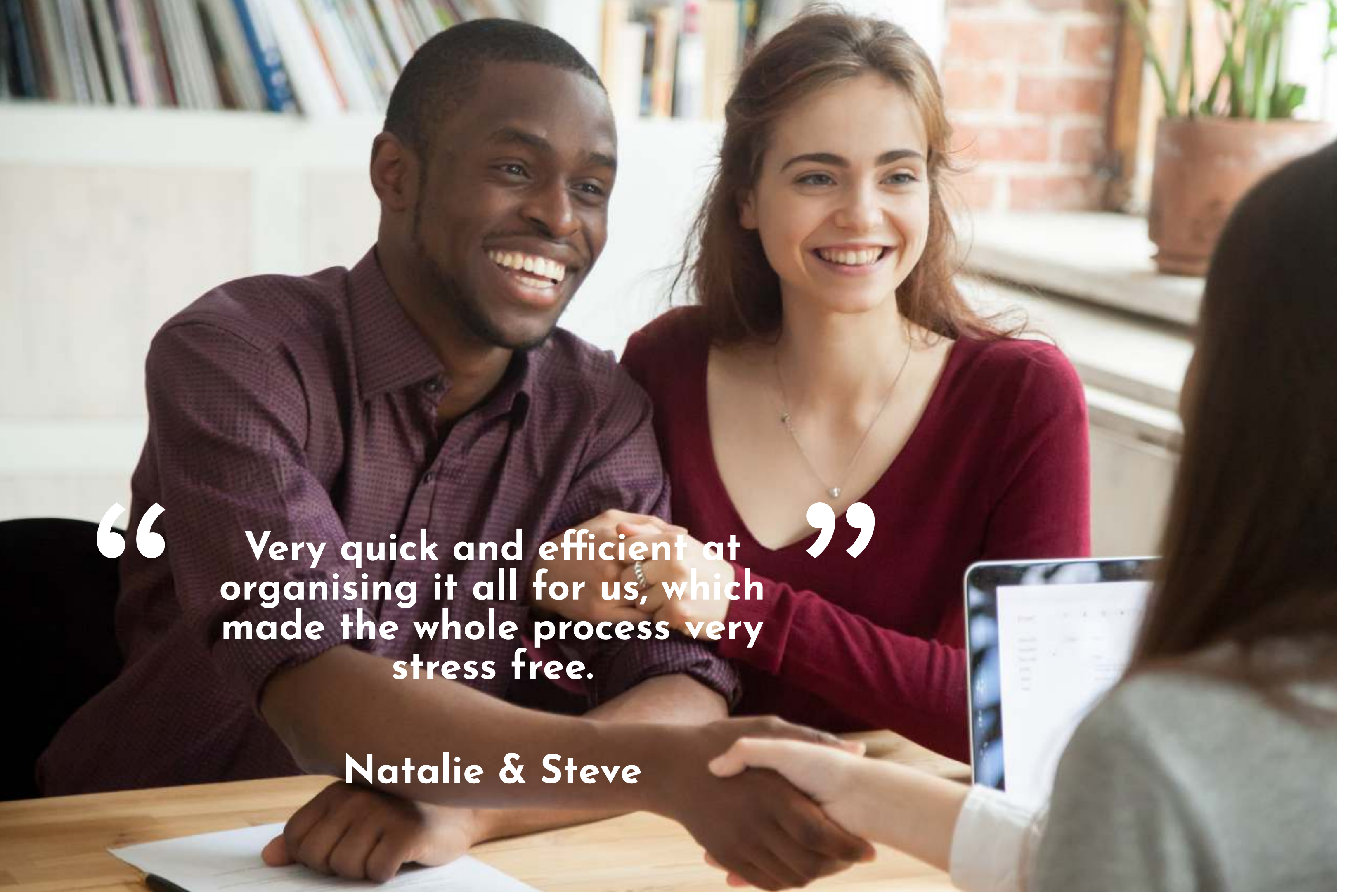
Re-mortgaging

Whether you're searching for a better deal or are looking to move home, you'll usually be in a better position when re-mortgaging than when you're a first-time buyer.

If you've kept up with your mortgage payments, you'll have proven that you're reliable and are unlikely to default; so, you'll often have access to better interest rates. On top of this, you're probably not building up your deposit from scratch.

In many cases, you'll be moving to a new home that has a greater value than you're existing one. As a result, you may need to borrow more to secure it, in turn, increasing the deposit you'll need. Depending on how much extra you want to borrow, the amount left on your current mortgage, and how the value of your home has changed, you may need to add extra funds as a deposit on your new home.

Understanding where your current mortgage is at, your property's value and how this relates to the amount you'll need to borrow and put down as a deposit is important for ensuring your expectations are realistic.



Look beyond High Street Banks

When you think about which mortgage lenders you'll approach first, it's likely the high street banks that will spring to mind. However, looking beyond these can improve your chances of securing the mortgage you want, and you could get a better deal.

There's a range of providers to research, including those that specialise in offering mortgages to workers with inconsistent incomes. Exploring your different options rather than going with the first provider you think of can help you to find a lender that's right for you. So, if you're rejected for a mortgage the first time around, don't be disheartened, it doesn't mean all providers will take the same view.

We can help you when it comes to lenders. Our expertise in this area means we can help connect you with lenders that you don't currently have access to because they're not on the high street or you've simply never heard of them. These are reputable lenders that are specialists in helping those in circumstances that are unusual, increasing the chances of your mortgage application being accepted.

“if you're rejected for a mortgage the first time around, don't be disheartened, it doesn't mean all providers will take the same view”

Work with a mortgage adviser

As you prepare to approach a mortgage lender, it can seem like a daunting prospect with so many different elements to bring together. Before you take that all-important step, working with a mortgage adviser can help.

Getting in touch with one of our mortgage advisers can help you figure out the way to best present your finances, making it clear what your income and expenditure are. It's a good idea to take this step around six months before you plan on approaching lenders, allowing for plenty of time to gather documents you need, correct any potential mistakes, and ensure you know what's affordable for you.

Mortgage lenders can only make their decision based on the information they have and the way it's presented can make it more accessible. As a result, working with a mortgage adviser can improve your chances of securing the mortgage you want, cutting out delays and reducing the number of hard credit checks that are undertaken.

Bonus tip: When you're exploring the different mortgage options, it may be worthwhile weighing up the pros and cons of an offset mortgage. This is where you reduce mortgage interest payments by holding a savings account with the same bank or building society. It can be a useful tool for self-employed workers when you're already putting money aside from each pay cheque to cover your tax bill.

With an offset mortgage savings account, you can typically add to it as often as you like to reduce the interest payments. As a result, it can be a good option for those with inconsistent pay looking to build up savings in an efficient way.

If you're a contractor looking to secure a mortgage, whether it's for your first home or as you take a step up the property ladder, contact us today to get your finances in order and understand what your next steps should be.

Case Study

Mr and Mrs S, a professional couple living in London, were looking to re-mortgage their home after their existing fixed rate deal had come to an end.

They had an outstanding mortgage amount of £450,000 on a property that was valued at £600,000 and simply wanted to ensure that they were getting the best rate available to them and to fix that rate for 2 years to give them security of payment.

Both Mr & Mrs S were self-employed, with Mrs S working as a contractor, and after failing to find a lender who could help them they approached Choice Mortgage Solutions. Thanks to our extensive experience working with the self-employed and contractors, we understood that the typical high street bank wasn't necessarily going to offer the best loan amount and knew it would take some specialist knowledge to help this client.

Mrs S had been contracting for over 9 years and had a daily rate of £550 but took a salary and dividends income of £43,000. Because of this, typical lenders would only allow her to borrow against this income figure. The majority of lenders when assessing income work off the average of the last 2 years salary and dividend income, which meant lenders took this income figure of £43,000 and then multiplied by approximately 4.5, to give a total borrowing figure of £193,500.

£550 Day Rate

X

5 Days per Week

X

46 Weeks per Year

=

£126,500

X **4.5** multiplier =

£569,250

mortgage loan secured

Using our experience and with knowledge of lenders that have specific lending criteria for contractors, we were able to find a lender that would lend on Mrs S's daily income rate of £550 per day. Her annual income was assessed using her day pay rate of £550, multiplied by 5 days per week and then by 46 weeks of the year totalling £126,500, which using the above multiple of 4.5X income, meant we could secure a loan of £569,250 – a whole £375,750 above what many high street lenders would lend.

Choice's experience with contractor mortgages, and ability to assess the whole of the intermediary market ensure that Mr and Mrs S received a high enough mortgage offer, at a competitive fixed rate without having to pay a premium for being self-employed.

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Your home may be repossessed if you do not keep up repayments on your mortgage.