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Mortgages for the Self-Employed & Business Owners

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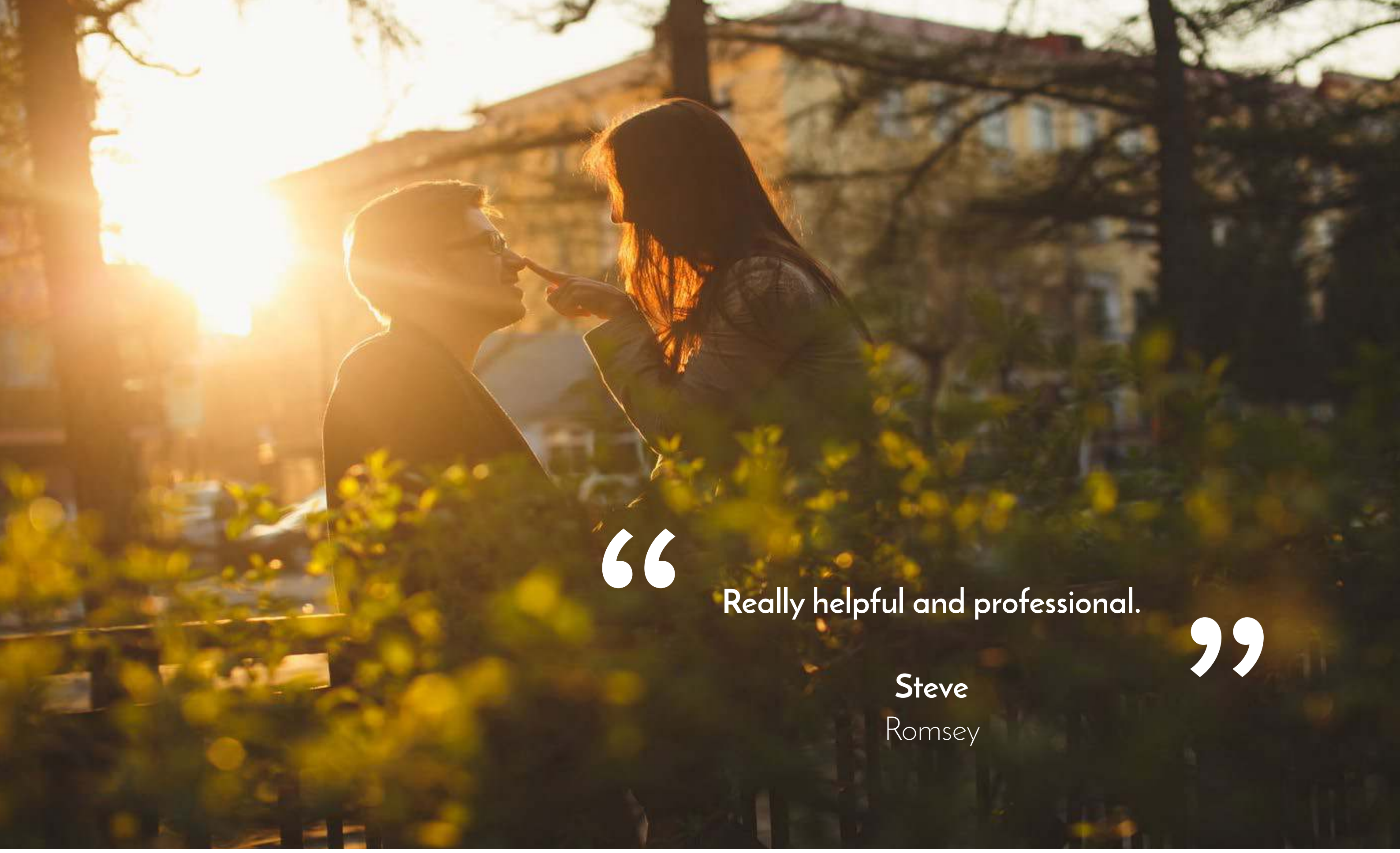

A Choice Mortgage Solutions Guide

The past few years have seen a significant increase in the number of people who are self-employed. In fact, there are now 4.81 million people in the UK who are self-employed, equivalent to 15% of the working population.

Working for yourself, or running a business, can bring huge rewards and satisfaction. However, there are times when it will make your life more challenging. That includes being able to get a mortgage.

In our experience, most people who are self-employed, or run their own business, usually manage their money well. It is therefore surprising that many lenders view the same people as presenting a greater risk.

Lenders often reach this conclusion because:

- Their income might not be as stable as an employee
- Their business may not have a particularly long track record
- They could go bust

Of course, the opposite may also be true.

Your business may be truly flourishing, and your income could be as stable as any employed person, who could be made redundant at a moment's notice. Regardless, lenders still view the self-employed and business owners differently to people who are employed, often making it difficult to get accepted for a mortgage.

Another factor making it harder for the self-employed to get a mortgage is that self-certification mortgages, where proof of income wasn't required, are no longer available, having been banned some years ago.

Who this guide is intended for:

Unsurprisingly, this guide is aimed at people who are self-employed, and want to:

- Buy their first home
- Move to a new house
- Remortgage

But it's more complex than that. The term 'self-employed' is a broad one covering a variety of people including:

Sole traders who work for themselves and have not incorporated into a limited company structure.

Partnerships where the business is owned and managed by two or more people with profits divided between the partners. This also includes Limited Liability Partnerships (LLPs) which are becoming increasingly common in the legal and financial world.

Shareholders and directors of limited companies who typically own 25% or more of the business. This category includes large, multimillion-pound turnover businesses with many staff, right down to companies where you are the sole director or shareholder.

For simplicity, in this guide, unless we need to be more specific, we will use the term 'self-employed' to cover all three groups.

Some things to remember

As you read this guide, please remember:

- Every mortgage lender is different. Where one lender declines an application, another may be more accommodating
- Broadly speaking, the same mortgage products are available to self-employed people as those who are employed
- There are also a handful of lenders who specialise in offering mortgages to self-employed people

That means, if you are self-employed, there are numerous options available to you. Sure, getting a mortgage application agreed may be harder than if you are employed, in a stable job, but there are always options. You just need to know where to find them; or know someone, such as ourselves, who does.

> "Getting a mortgage application agreed may be harder than if you are employed, in a stable job, but there are always options."

The biggest hurdle: Proving your income

Every mortgage lender has a responsibility to ensure you can afford to make your mortgage repayments. That means they need to understand how much you earn and see proof of your earnings.

If you are employed, proving what you earn is easy. All you need is:

- Payslips
- A P60
- Perhaps bank statements or an employer's reference

If you are self-employed it's harder. That's partly because accounts are often historical, and also, because of the greater perceived risk attached to being self-employed, lenders want to see a longer track record of receiving income, compared to if you were employed.

There are several things to consider:

Proving your income

Typically, lenders want to see that you have been trading for at least two or three years and have accounts, ideally prepared by a Chartered or Certified accountant, covering that period.

There may be a limited range of options for people with only a one-year trading history. However, as a rule of thumb, the fewer years you have been trading, the more restrictive your choices will be. This could lead to higher interest rates.

Defining your income

Again, if you are employed it is relatively simple to agree what you actually earn. Lenders will work on your basic salary and will usually add a proportion of any regular bonuses or commission.

If you are self-employed, it isn't so simple. Different rules apply, whether you are sole trader, a partner in a business or a shareholder / director. In summary:

Sole traders: Lenders will usually work on the net profit i.e. turnover, less expenses, shown in your accounts, ideally prepared by a chartered or certified accountant. Alternatively, if your tax is calculated via the Self-Assessment system a tax calculation form will show your earnings and may be acceptable to a lender.

Partnerships: Your share of the net profit as evidenced by accounts or a tax calculation form.

Shareholders and directors of limited companies: This is more complex. Some mortgage lenders may consider just your salary, which can be an issue when low salaries are often supplemented, for tax reasons, by dividends.

Therefore, many lenders will include your salary and dividends in their affordability calculations. Other lenders will also consider your business's net profit, which may be higher than the combination of salary and dividends.

If you need to borrow a large amount, it may be better to consider a lender who will use your net profit when calculating how much you can afford to borrow, rather than a combination of your salary and dividends.

Be careful though, you've still got to make the mortgage repayments!

More about your Tax calculation documents

You may not have come across this document before, so it's worth explaining a little more.

The tax calculation document shows:

- The income you have declared
- The income tax and National Insurance that you need to pay

It is either produced by you or your accountant when you submit your self-assessment tax return. If you complete your own self-assessment online, and don't produce accounts, HM Revenue & Customs (HMRC) will send the tax calculation documents to you. You can also log in to the same online portal and download the tax calculation documents for the past four years. Although, some mortgage lenders may still require the original documents. These can be obtained by calling the Self-Assessment Helpline on 030 200 3310. You will need to have the following to hand:

- National Insurance number
- Unique Taxpayer Reference (UTR)

It's worth planning ahead though, original tax calculation documents can take a couple of weeks to arrive.

> "If you are self-employed, it isn't so simple."

A word about remortgaging

Remortgaging is essentially the process of moving your mortgage to an alternative lender, usually to a cheaper, or more appropriate, product.

Even though you have paid your mortgage on time each month, and you probably aren't increasing the amount you borrow, the new lender will carry out all the usual checks. That includes proving your income.

If you are self-employed, without a two or three-year history, and accounts to prove earnings, you might find remortgaging difficult.

However, if you are struggling, all is not lost. It's probably worth approaching your existing lender, or asking an independent mortgage adviser to do it for you, to check if they are prepared to offer you an alternative product. This is usually called a 'product switch' and unlike a remortgage, doesn't normally require you to prove your income.

Can you get a mortgage and how much can you borrow?

Every mortgage lender has different lending policies which dictate who they will offer mortgages to, and how much they will lend. The answer to both questions depends on several factors, including:

- How much you earn
- The length of time you have been self-employed
- Your credit history
- The size of your deposit
- The type of property you are buying

There is only one way, for certain, to find out if you can get a mortgage: submit a Decision in Principle (DIP) application.

A DIP is effectively a mortgage application made before you have found the property.

That might initially sound illogical; you don't need a mortgage unless you have found a house, surely? However, the reverse is true; why go house-hunting unless you know you can get a mortgage and afford the repayments?

When a DIP application is submitted, the prospective mortgage lender will carry out all the usual checks they would make on a full application. Except, of course, those relating to the property, because you haven't found one yet!

After assessing the DIP application, you will be told:

1. Whether the lender will (in principle, hence the name) accept your application
2. How much they will lend you
3. The likely monthly repayments

You will also be given documentation to prove you have been accepted. That's very useful when you're house hunting. It shows you are serious and able to proceed should you make an offer, making you an attractive purchaser.

It's also possible that having been already approved for a mortgage could save you money. There is evidence that some vendors are prepared to accept a lower offer, because the buyer is well placed to proceed.

Remember, if a lender declines your DIP application there may well be other options and lenders who are prepared to consider your circumstances.

That's where an independent mortgage broker comes in to play.

How can a mortgage broker help?

There are two ways of arranging a mortgage:

1. Do it yourself, by approaching the mortgage lender directly, either in a branch, on the phone or online
2. Using a mortgage adviser, such as ourselves

We could be accused of bias; however, we believe there are several very good reasons to use a mortgage adviser. These include:

1. As we have shown, getting accepted for a mortgage when you are self-employed, isn't always straightforward. An experienced mortgage adviser will know the market and which lenders offer the best chance of success, given your circumstances
2. That knowledge and experience of the system could save you time
3. Furthermore, mortgage advisers use sophisticated sourcing systems, which compare all the mortgage products available to you, calculating which offers the best value
4. An independent mortgage adviser, like Choice Mortgage Solutions, will have access to a wider range of mortgage lenders than you will have by taking the DIY route
5. Finally, your mortgage adviser will know how to present your application in the best possible light, taking time to explain to lenders anything which might cause them concern

Six ways to improve your chances of getting a mortgage

1. Keep your accounts in good shape

We have already explained that you will, usually, need to have been trading for at least two years, with accounts to prove your income.

Whilst many self-employed people, as well as business owners, are programmed to do things themselves, this is a perfect time to enlist help. Having an accountant prepare your accounts will give the lender more confidence. A Chartered or Certified accountant is a bonus for some lenders, but a necessity for others, who won't accept accounts produced by unqualified 'bookkeepers'. As always, do your research beforehand.

2. Focus on net profits

If you are employed, it's easy for a mortgage lender to see what you earn.

For a self-employed person, or someone running their own business through a limited company structure, the picture is less clear. For example, people trading under a limited company umbrella may pay themselves a relatively small salary, topped up by dividends. Whilst some lenders may be comfortable with that approach, others will be less so.

Furthermore, many self-employed people, as well as those who run their own business, will know that paying themselves only enough to live on is often beneficial, for reasons such as:

- Tax efficiency
- Cash flow
- Rainy days

If you take this (very sensible) approach, some lenders may consequently reduce the amount they will lend to you.

There are alternatives though. Other lenders will focus on your net profits and not the amount you withdraw from the business.

The key thing to remember is that every lender will treat the self-employed and business owners differently. Where one might want to see high levels of income, another will focus on net profit. The tricky thing is to understand which does what; that's where a knowledgeable, experienced and independent mortgage adviser, who can access the whole of the market, comes into their own.

Finally, lenders like to see increasing or consistent net profits. They are often wary of decreasing net profits, unless there is a very good reason, even then, they may decline your application.

3. Plan ahead, get your account and mortgage adviser talking to each other

If you know you are going to need a new mortgage over the next couple of years, start planning early.

Ideally, your mortgage adviser and accountant should be in regular communication to ensure that, where possible, the figures shown in your accounts will support the size of mortgage you will apply for.

Of course, there's only so much that can be done. However, if your advisers are talking to each other, a strategy can be put in place. This will hopefully keep your tax liabilities low, while still allowing your mortgage application to be accepted.

4. Avoid big changes to your structure

There are times when it makes sense to move from trading as a sole trader, or partnership, to a limited company. Occasionally, the opposite is also true.

If you are considering such a change, speak to your mortgage adviser first to understand the implications for future applications.

5. Save up a substantial deposit

The larger the deposit you have, the wider your choice of lenders will be. This is true for every borrower, but particularly so for the self-employed.

Not only will a large deposit increase your chances of being accepted in the first place, it will also work wonders for your interest rate.

If you only have accounts for one year and your deposit is looking a little thin, there may still be options available to you. However, it may be worth waiting. The time taken to build a bigger deposit and amass a longer business track record, may put you in a much better position to get accepted on a more competitive interest rate.

6. Keep a clean record

If you are an employee, a good credit history is important. It is even more so if you are self-employed.

It isn't the end of the world if you have a few things on your record you'd rather forget. But a good credit history means you will likely get a better rate, and have a wider choice of lenders who are willing to accept you.

To read about the differences between credit score, credit history and a credit check, read our in-depth article here.

Don't lose hope; take advice

There's no doubt that getting a mortgage can be tricky if you are self-employed.

Tricky, but by no means impossible.

If you are self-employed, whether you're a sole trader, in a partnership or run a limited company, we are here to help.

Our team has helped countless self-employed people get accepted for a mortgage. If you want to buy your first home, move to somewhere larger or remortgage your existing property, don't hesitate to get in touch on 0800 612 8099, or complete the enquiry form on this page.

We look forward to hearing from you.

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