

Mortgage Minute

Thinking of a job change?

Mortgage qualifying ramifications for the self-employed borrower

When it comes to qualifying for a mortgage, there is a drastic difference between those who are considered self-employed and employees who are W-2'd or salaried. Unfortunately these differences are usually realized only *after* someone becomes self-employed and they learn of how limited their financing options might be. This month's newsletter is designed for you or someone you know who is thinking about leaving the security of a W-2'd job and what ramifications this might have on your ability to get home financing.

Before outlining the differences in qualifying, let's first define who are considered self-employed for loan qualification purposes. In general a borrower is considered self-employed if they are paid with a 1099 instead of a W-2. Business owners, those who have at least 25% interest in a corporation or partnership, are considered self-employed, even those who provide themselves with a W-2 from the company. Those whose income is from commissions might not technically be self-employed, but they are treated with similar qualifying guidelines.

The misconception of many self-employed borrowers is thinking that revenue equals income. The business expenses have to be subtracted from the revenue to determine the actual *income* of the borrower. The income of a self-employed borrower is not always

predictable. Lenders need to see a two year track record to have confidence that a minimum amount of income will continue going forward.

The revenue and expenses of a self-employed borrower is determined using the previous two year's tax returns. Two years of income and expenses give the lender a good idea of what the borrower's income and costs will be going forward. There are some items in the tax return that will reduce the tax burden but will not reduce actual income, like depreciation for example, so lenders do not simply use the adjusted gross income for calculating the two-year average. Determining income for a self-employed borrower is challenging so it may be wise to get professional help, from someone like myself, analyzing the returns to see what numbers a lender would use.

Because two years of tax returns are needed to calculate income, generally a self-employed borrower needs to have been self-employed for two years to qualify. It is important to point out that because an average income is used, the income used for qualifying could very well be much smaller than the present income the self-employed borrower is enjoying. This is especially true if the borrower has to use the first year of being self-employed as one of the two years, this first year usually yields little to no income.

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Today's Rates at a Glance

30-year fixed
5.500%
(APR 5.681%)

VA 30-year fixed
Up to 100% no MI
5.750%
(APR 5.913%)

Rural Housing
30-year fixed no MI
Up to 102% LTV
5.500%
(APR 5.661%)

Calculations based on a first-time homebuyer purchase, loan amount of \$200,000 and an 80% loan to value (unless otherwise noted). Rates include a 1% origination fee and are as of 10-6-08 and are subject to change.

Credit Score Tip of the Month

Closing old credit accounts, even if you don't use them, will probably not help your score. If the account is older than other accounts you have, it may actually hurt your score because your credit will be younger.

Mortgage Question of the Month

Q: If I have less than 20% to put down when purchasing a home, do I have to have mortgage insurance, MI?

A: Not necessarily. There are several programs that would allow you to avoid the monthly MI. MI used to be avoided partly because it was not tax deductible. That is not the case anymore, at least for the time being.

Random Useless Piece of Information

The character played by Alan Hale Jr. on the comedy Gilligan's Island during the mid 1960's was always referred on the show as "The Skipper". The character's real name was Jonas Grumby, which might explain why he was always referred to as The Skipper.

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I have had many people tell me that becoming self-employed is not what they expected in regards to how the financial and lending world perceives them. It is possible that they see the freedom or flexibility of being their own boss and they fail to think through all

of the financial ramifications a move of this type has. It would be wise if someone were contemplating a move of this type that they seek the council of financial professionals and others who have made this change. This will help them realistically assess their future needs and allow them to better plan for the change.



Josiah, Zac, Jenny and Logan before the Oregon State vs. Hawaii game last month.



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