What the Self-Employed Need to Know When Applying for a Mortgage

Buying a home or owning a property can often feel like a pipeline dream for those that are self-employed, or working as a freelancer. Typically, any lender will carefully evaluate the financial criteria of any mortgage applicant. What many lenders are hoping to see is someone with a steady, full-time job, and a bulky paycheck.

This can create a big problem and numerous challenges for those who are self-employed or freelancing. Luckily, you're not the only one who might be doing this alone, as several sources claim that there are millions of people across the United States currently working as freelancers or tax-registered as self-employed.

The Small Business Administration (SBA) claimed that more than 27.1 million people claimed a "non-employer" small business – considered to be those without employees nationwide, had filed Schedule C tax documents during the most recent tax year.

Being approved for a mortgage loan is typically a lengthy process, not to mention the complexities of ensuring you submit all the necessary documents. As a self-employed worker or even someone who works on a contract-to-contract basis, you want to make sure that you have checked all the boxes before you apply for a mortgage loan.

What You Should Know When Applying for A Mortgage?

As a self-employed worker or freelancer, you might experience the process being slightly more complex, as you will need to prove to lenders that you have the financial stability to meet loan demands and requirements.

Build Good Credit

Unfortunately, applying for a mortgage will require you to have an existing credit score. This is one of the hardest things for many freelancers and contract workers seeing as credit scores are used to evaluate your debts, income, and any savings. What's more, the credit score you will need will mostly depend on the size of the loan that you're applying for.

On average, lenders consider a credit score between 580 to 669 as fair, while anything between 670 to 739 is considered a good credit score. The threshold between 740 to 799 is very good, and a credit score above 800 is excellent, according to the credit bureau company, Equifax.

Make sure that you have already started building your credit score, and if you haven't done so already, apply for a credit card, and make use of it for daily purchases. Be sure not to spend beyond your threshold, and that you can make the repayments.

Clear Outstanding Debt

Additionally, you will want to make sure that you are clear of any other outstanding debts, beforehand. This may include things such as car loans, student loans, or outstanding hospital bills. While these accounts may still be active, consider decreasing your debt as much as possible before you

apply.

While there are cases where individuals have been approved for a mortgage loan, while still having additional debt obligations, as a freelancer or contract worker, you will need to prove that your debts do not exceed your income or earnings.

Make sure that you minimize any debt you may have, either by making monthly installment payments or paying all of your debts off at once. Try not to deplete your savings or emergency funds at the same time while doing this, as this will be reflected on your bank statements, which will be reviewed by a loan officer.

Work with A Professional

While you or your partner may be considering going about this alone, you must take some guidance from a professional to help you throughout the process. Getting a professional on board will help clear out any questions you may be having, but also put you in the right direction in terms of what documents you may need to gather and information you need to provide mortgage lenders with.

At times you may feel that hiring a professional or using their services is considered irrelevant, however, as someone working for themselves, you will need as much professional guidance as possible.

You can reach out to your bank, or even consult with a mortgage officer beforehand, they will provide you with the necessary forms you will need to complete. Additionally, you can also speak to a real estate professional, as they typically have a good grasp of how the process works, and what lenders require from self-employed mortgage applicants.

Have Sufficient Savings

Before you can apply for a home, a loan officer or mortgage lender will require you to have sufficient savings to use as a down payment or deposit for your loan. The amount may vary, depending on the size of the loan required. However, many people typically have a 10% value of the property as a down payment.

This isn’t always the case, and many times applicants tend to have less than 10%, anything around 5% for a downpayment. Nonetheless, it’s important to consider that having a larger down payment will help reduce the loan amount significantly, and can also help you secure a better mortgage rate.

Experts suggest that anything between 15% to 20% of purchase value is considered a good deposit amount, as this will help decrease the loan amount, but also provide you with substantial financial cushioning.

What You Need to Do Before Applying for A Mortgage

Before you can be approved, and sign the deal on your future home, you will need to make sure that you have all the necessary documents and financial statements within arms reach to help smooth out the application process.

Tax Filings

One of the first steps in the process is to compile all the necessary tax filings. These documents will be used alongside your application, and lenders typically evaluate a person’s financial risk based on their historic tax filings.

Seeing as you may be a freelancer or a self-employed worker, you will need to collect at least the last two years worth of

tax filings. This will help give lenders more clarity on whether you have received a stable income over the last 24 months, and whether you meet the financial threshold of the loan you are applying for.

For individuals that are self-employed, or have registered as a small business, with no employees, you will need to submit at least two years of business tax returns, which can include K-1, 1120, and 1120S forms.

You may also be required to submit a business license, a year-to-date profit and loss statement, and your current balance sheets. This is to thoroughly evaluate the financial well-being of your self-employed business.

Income Statements

Apart from your tax filings, you will further need to provide lenders with your income statements. This may also sometimes be called bank statements, and can be used to prove your employment history, and whether you meet the financial threshold.

Keep in mind that the financial requirements for a mortgage can be different, based on the loan type. However, the general consideration is that lenders will evaluate the criteria of an applicant based on their income, credit score, credit history, and any current debts they may be carrying.

Additionally, you will need to prove that you have any form of liquid savings or assets. This is usually the deposit or down payment you will be making on the purchase of the home you’re looking to purchase. A general rule of thumb is to already have a 10% deposit based on the current market value of the property you want to purchase.

Employment History

This is where a lot of the complexities begin to take shape. Seeing as you're not employed full-time, and don't have a standard 9-to-5 job, you will need to provide lenders with proof of work or employment, even if you are working on a contract-to-contract basis.

Typically, a loan provider or loan officer will determine your financial well-being by reviewing any work you have completed in the past, any current contracts you are working on, and whether these will exceed at least three years beyond the loan closing.

As a self-employed person, running a small business, you will need to ensure that your business prospects look good and that you can provide sufficient information that proves you receive a stable income as a self-employed worker.

One of the biggest downsides in this scenario can be that for periods, or months where you experienced declining income or received less-than-expected income, you may decrease your chances of qualifying for the mortgage you applied for.

5 Tips to Help Increase Your Chances of Getting a Mortgage as A Freelancer

While it's not always an easy process to apply for a mortgage as a freelancer or someone who might be working on a contract-to-contract basis, it's not completely impossible. Here are some tips you can follow to help improve your chances of getting approved for a mortgage loan.

Get All Your Documents Sorted

Make sure that you have all the necessary documents, including

bank and income statements, tax filings, and any work-related contracts that will help support your application. There’s a lot of paperwork that goes into applying for a mortgage loan, so make sure you have all of this on hand when the time comes.

Take on More Work

Take on as much work as possible, without overwhelming yourself. Being able to prove that you have substantial work and income, will help strengthen your chances of being approved. The more you can show lenders that you have the financial capacity to make your repayments, the better.

Don’t Do It Alone

As a freelancer, it may be somewhat harder to get that mortgage loan you’ve been hoping for, however, you can always apply for the loan with someone else. If your partner has a full-time job and steady income, apply for a joint mortgage. Lenders will still evaluate both your incomes, however, their full-time employment will help give your application more leverage.

Bulk up On Savings

Don’t ignore how important having enough savings in the bank can be when applying for a mortgage loan. Make sure that you already have at least between 5% to 10% of the value of the property at hand that you can use as a deposit or down payment.

Talk to An Accountant

There is no harm in talking to an accountant before applying for a mortgage loan. As a self-employed individual or even a small business owner, you want to make sure that your balance sheets are in good shape. An accountant will also be able to advise on any forward-looking guidance and provide you with

insight into what you will need to do to help boost your chances of being approved by a mortgage lender.

Frequently Asked Questions

How Much Will I Be Able to Borrow as A Freelancer?

This is where things tend to become a bit tricky, however, mortgage lenders will typically assess your income from the last two to three years to evaluate your affordability. As a freelancer or contract worker, lenders will then usually assess the combined value of your contracts, while there are instances where they may evaluate your affordability based on your day-to-day rate.

How Do Mortgage Lenders Assess My Self-Employment Income?

As part of the process, you will need to provide your lending officer, or mortgage lender with at least two to three years of income statements and tax filings. For instances where you are registered as a small business, lenders will typically assess your business balance sheets, income history, and tax records. Being able to provide lenders with proof of income, i.e. project contracts is the best way to showcase financial stability.

Do I Need a Credit Score as A Freelancer to Apply for A Mortgage?

Yes, many lenders will often require you to have an existing credit score before applying for a mortgage loan. Your credit score will be used to measure your affordability, but also your financial well-being. Having bad credit will only make it harder to be approved for a loan, and it’s advised that any

freelancer or self-employed individual build a credit score before they apply for a loan.

Can Freelancers Get a Joint Mortgage with Their Partner?

Having the option to apply for a joint mortgage will help to shorten the process. Freelancers and self-employed individuals can apply for a joint mortgage with their partner if their partner can prove they have full-time employment, and receive a steady income.

Instead of doing this alone, consider applying with a spouse or partner for a joint mortgage, as mortgage lenders will evaluate your application based on their income and less on fluctuations that may occur in your income as a freelancer or self-employed individual.

Final Thoughts

While you might think that it’s impossible to secure a mortgage loan as a contract worker or freelancer, the process is typically more challenging and may involve a considerably large amount of paperwork and documentation.

Getting everything in place beforehand will help you save a lot of time, but more importantly, consider how improving your financial situation in advance can help boost your chances of being approved.

If you get turned down, take the necessary time to process all of the information that has been given to you, and ask as many questions as possible, as this will help you ensure that you have all your ducks in a row if you need to apply again, or consider working with a different lender.

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