



Mortgage Finance for the Self Employed

A free E-Book by

**Phoenix Mortgage Solutions - specialists in Mortgage Loans
for the Self Employed**

Licensed Finance Brokers No 3354

www.phoenixmortgages.com.au

Call Phoenix Mortgage Solutions on

08 9481 7281

Important Notice

If you have a family member, friend, or business associate who you feel would benefit from this e-book, please pass it on, or alternatively you can tell them to visit our website to receive a free copy for themselves at www.phoenixmortgages.com.au

Also, if you have any question or concerns, please feel to immediately email us at admin@phoenixmortgages.com.au

Remember, we are here to help with any mortgage loan solution for the self employed that you may require.

Introduction

Next to the great Australian dream of owning your own home, probably the next big 'wish for' item for many Australians is the opportunity to be able to work for himself/herself in a business of their own.

For many Australians, the prospect of long hours, hard work and a bit of entrepreneurial get up & go, far outweighs the benefits of being a lifelong 'wage slave'.

However, like many things in life, there is plenty of upside as well as downside when a decision is made to 'go it alone'! One of those 'small' disincentives, is the prospect of an income stream that is neither guaranteed and more often than not, isn't consistent.

For the start up business proprietor (less than 2 years in business) in particular, the difficulties associated with getting a bank or mainstream lender to look seriously at their mortgage loan application, often seem insurmountable.

Over the last few years however, a number of 'alternative' non bank lenders have come onto the scene, offering leading edge mortgage loan products that specifically suit the requirements of the self employed.

These products take into account the essential requirements of 'start up' (or reasonably new) business's, and are vastly more flexible in tackling the issues of 'Business income' verification. By reviewing some key issues for the self employed, we hope that you will learn & understand that for the Australian business proprietor, the prospect of not being able to secure mortgage

finance, simply due to your employment status has changed dramatically, & for the better!

Can I get mortgage finance even if I have just started a new business?

The quick answer here is a simple, Yes!

However there are always a number of factors that lenders (including 'non bank' lenders) consider when assessing a mortgage loan proposal from a self employed applicant. These factors take into account a number of credit tests or filters. that broadly cover:

- Your understanding and experience in the chosen business venture
- Your capacity to repay the mortgage (& other financial commitments)
- The security offered (Basically, the real property security)
- Your credit history
- Purpose of the loan

These are probably the basic filters or tests applied by most lenders, however unlike traditional or mainstream lenders, an element of flexibility in the credit process (loan assessment) can be applied, particularly when it relates to income verification and/or an adverse credit history.

Of course, this does not mean that anyone who simply registers an ABN can expect to get a mortgage loan. Prudent lending practices always take into account the whole story, not just a segment or two of your personal circumstances.

Specialist mortgage brokers in this area of finance can provide additional information and detail, relative to your own personal

circumstances; however, your chances of a successful outcome from your mortgage loan application will be increased dramatically by securing the services of a professional & licenced mortgage loan broker.

Should I expect to be charged a higher rate of interest?

The quick answer is, it depends!

What it depends on is the 'credit risk' assessed by various lenders. If you compare the following two scenarios, ask yourself, would you lend the **same** amount of money to these two individuals at the **same rate**?

Client A:

- Wants to borrow \$200,000 for working capital requirements
- Is a discharged bankrupt, 3 years ago
- Has two current loan defaults
- Has started a new business (restaurant)
- Has been employed as a Train Driver for 23 years just prior to starting the restaurant
- Has 2 credit cards (Maxed out), 1 personal loan and a secured Car loan.
- Has a single residential property as security valued at \$240,000

Compared to

Client B:

- Wants to borrow \$200,000 for working capital requirements
- Has a .clean. credit history . no defaults
- Has started a new business (restaurant)
- Has been employed as a Restaurant Manager / Chef for 10 years just prior to starting the restaurant
- Has 1 credit card (zero balance) and a secured Car loan.
- Has a single residential property to be offered as security valued at \$380,000

Of course there are many other factors taken into account when assessing credit risk, however based on the above scenarios, even a layperson with no finance industry experience could easily identify that Client B would (and should) obtain mortgage finance at a better rate of interest than Client A.

Why?

Let's assume that both of our fictitious clients were successful in securing mortgage finance from the same lender, using the same product.

Lenders can only be certain of the past; however they cannot be certain of the future. Client A may have genuine reasons for the bankruptcy and the current loan arrears; however there doesn't appear to be any correlation in 'skill sets' between being a train driver & becoming a restaurant proprietor. (Maybe he just likes food!)

If client A was successful in securing his loan, it would be prudent of the lender to apportion a 'risk premium' over &

above a 'standard' rate of interest to take into account the range of known 'past' credit issues.

Conversely, even though Client B will not be able to demonstrate clearly what income will be generated from the restaurant, by having a clear credit history, modest current debt commitments, solid levels of equity (ownership) of the proposed security offered as well as having 10 years of direct industry experience, enables a lender to assess the risk (of default) as substantially less than Client A.

There are always basic rules in mortgage lending in assessing 'credit risk'. Mainstream lenders tend to use 'credit scoring' techniques which requires basic credit assessment filters to be passed or scored. What this means is an answer to a 'check' or 'filter' must be either black or white, No greys I'm afraid!

Historically, even client B would struggle to get a mortgage loan approved, simply because of the lack of 2 years of business financials. But things are entirely different today.

What are these Low doc / No doc products I've heard about?

Simply put, if you have limited or no financials (usually due to your business being reasonably new (i.e. operating for 2 years or less), lenders are prepared to offer some flexibility in assessing the likelihood of loan 'serviceability' or your capacity to repay the mortgage loan.

What this means is, you can either

1. Self certify your income (Basically a declaration of what your income is) or
2. For business or investment purposes, depending on how much you borrow relative to the security offered (it's value) minimal income substantiation is required.

Low doc / No doc loans are becoming very popular with the Australian borrowing public, however, a prudent stance should always be taken when securing any form of mortgage finance.

Don't be tempted into borrowing more than you can reasonably expect to repay and if you select a variable rate of interest, (as opposed to a fixed rate) keep in mind what happened in the late 1980's. If interest rates move up substantially, your costs in servicing a mortgage loan will increase as well.

My business has made a loss this year. Can I still apply for a mortgage loan?

Yes! So long as the rest of your credit criteria is satisfactory.

Mainstream as well as 'Non bank' lenders will however, identify the reasons for the loss, however if the fundamentals of your business (& the industry that you operate in) are sound, there is every chance that your mortgage application will be successful.

Do I need to supply financials with my mortgage application?

It depends!

With all other things being equal, if a lender receives a mortgage loan application on a self certified basis, there is a greater level of 'credit risk', than would be with an application supported by detailed financials. Therefore an expected risk premium will be applied (Higher rate of interest)

It's a commonsense approach. If you have the financials, and they support the serviceability criteria of a lender, then why not!

If your business is without financials because you've only been operating for 6 months or so, then obviously a different approach must be adopted.

What if I've had some bad credit in the past?

Having a bad credit history in itself does not automatically exclude you from securing mortgage finance. The key elements behind any **unsuccessful** mortgage loan application (with a history of bad credit) can be best described as one that the applicant has:

- Hidden credit information from a proposed lender
- Hidden credit information from your mortgage broker
- Been untruthful in any way

As mentioned earlier, a lender does not have the capacity to know what future events may unfold (if they did, every loan they funded would never default).

However, if confronted by a mortgage loan applicant with a poor or bad credit history and if they are prepared to honestly outline any relevant details asked of them, so long as a number of other credit criteria checks out satisfactorily, a good chance of a positive outcome could be expected.

If however, an applicant lies or withholds information, this clearly demonstrates to the lender that the 'character' of the applicant is in question.

The clear message here is simple. If you have an adverse credit history, tell your mortgage broker the full story and he/she will give you a reasonable indication of whether the application will fulfil the lending criteria of a number of lenders.

Fail to do this & your mortgage application won't get past first base. Ask your broker, how to get a copy of your credit file is also a sound idea!

Do I have to use my own home as security for a business loan?

If it's the only property you have available for a lender to secure the loan against, then yes. If you have other 'real' property and it is seen as an acceptable security, then you may be able to use these properties as well.

Keep in mind that some rural properties, inner city apartments, and other specified properties may be unacceptable as a security.

Ask your mortgage broker whether your property is an acceptable property for a proposed mortgage finance application that you may be considering.

I've started a new business, but it's in a different industry to what I've been working in! Is that OK?

The straight answer here is, it depends on how much you wish to borrow, relative to the value of the property being offered as security.

In the mortgage industry, the term used for this equation is the LVR (or sometimes known as the LSR). This acronym stands for, the **loan to value ratio** (or loan to security ratio)

Essentially the LVR ratio is expressed as a percentage of the amount borrowed, relative to the value of the security being offered.

If an LVR is only 20%, (eg: Borrowing \$40,000 to a property value of \$200,000), then a lender is taking on substantially less risk than if a borrower required a mortgage loan of \$190,000 on the same value security. (Here the LVR would be 95%)

Aside from any other assessable risks the lender will carry (or not as the case may be), with a lower LVR, the overall credit risk is reduced. This is due to the fact that if the security (property) must be sold by the lender (as mortgagee) due to default (by the mortgagor - the borrower), the chances of realising a loss will be reduced significantly due to the LVR exposure.

So, if you wish to borrow at say, a 40% LVR and you are participating in an industry that you have not been associated with in the past, the lender is 'compensated' with a lower credit risk exposure than if the same proposal was presented with an LVR of say 90%.

Again, it's a commonsense approach that many lenders will adopt. Your mortgage broker should be able to outline these issues with you in assisting with your mortgage loan proposal.

Will my accountant have to certify my income to support a mortgage loan application?

Perhaps!

Depending on the 'chosen' lenders required credit criteria requirements and the nature of the product selected, will often determine if this is a requirement or not.

Again, your mortgage broker should be able to assist you with this issue

Professional advice

Of critical importance to most successful mortgage loan applications is the engagement of a qualified, licenced and professional mortgage broking service.

With the myriad of lenders and products now available, by simply applying to the first lender that comes to mind or that has been recommended by a friend or family member, could result in a less than suitable choice or worse, a declined mortgage loan application.

This is not only a waste of time (& usually money) but the poor selection can detract from any future efforts you may make in endeavouring to secure mortgage finance in the future.

Phoenix Mortgage Solutions are licenced and specialist finance

brokers that can assist self employed applicants throughout the entire mortgage loan process.

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CASE STUDY

Self - employed with less than two years financials:

In this situation, our client(s), a husband & wife business partnership, were seeking additional working capital for their small business. Having been customers of their 'mainstream bank' for over 9 years, they initially sought to obtain another \$60,000 over and above their \$185,000 home loan.

As the business was operational for less than 12 months and due to the proprietors not having a history of working in a 'like' industry, the Banks' 'credit scoring' approach resulted in a **declined application.**

What makes this case study somewhat disturbing is that a number of other 'Credit' factors seem to have been ignored. This included evidence of strong trading figures for the 8 months of operation, substantial equity available in their own home, (Conservatively valued at around \$360,000) and a personal credit

history that is without evidence of default or arrears. Not only that, our clients had a business plan that demonstrated a thorough understanding of their business strategy.

You might have thought that the 'business' banking division of the 'bank' may have looked at this opportunity, but no one even suggested it, so our clients were politely 'shown the door'. The bank did ask however; if they would like a credit card or two, just to keep face. Not an option really!

When these clients were referred to **Phoenix Mortgage Solutions** and following our initial meeting, we were able to identify a number of 'non bank' sources of mortgage finance that could assist these clients with their working capital requirements. A combined loan of \$245,000 was approved within 48 hours, giving our clients access to their working capital (through a revolving line of credit) as well as refinancing their home loan at a competitive rate.

One of the more satisfying remarks made by our 'new' clients were that they will never deal with **that** bank again. Not because their application was turned down, but more by the way that the whole process was handled. They were just a number. Because they were a square peg, trying to fit into the 'banks' round hole, it was never going to happen.

Recently we spoke with our new clients, and as expected, the business is going from strength to strength. A great result!