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Self-employed face mortgage hurdles

By Tanya Powley

Self-employed borrowers with their own limited companies are seeing their mortgage applications rejected by high street lenders due to the inflexible ways banks assess their income – leaving many of these homebuyers with limited mortgage options.

Many of these borrowers have a good record of profitability but because directors of limited companies will often choose to take a small salary and retain profits in the company for tax reasons, they are being refused loans by high street banks,

According to mortgage brokers, most banks and building societies only recognise income that is withdrawn from the business in the form of a salary and dividends. Any profit retained in the business is ignored.

"We have many clients who, for legitimate tax and business reasons, take a modest income via these routes and leave the majority of profits in the company as retained profits," explains Nigel Bedford of Largemortgageloans.com.

"When they want to trade up to a bigger property with a bigger mortgage they can simply draw more income from the business to cover increased costs, but most banks will not take this potential income into account."

This difficulty in getting a mortgage on the high street has only occurred over the past year following new lending rules, proposed by the Financial Services Authority last July, which require all borrowers to prove their income.

This has put an end to self-certification mortgages, which have been dubbed "liar loans" due to the propensity of borrowers and mortgage brokers who used the product to inflate their earnings and take out larger loans.

Self-employed borrowers now need to submit a minimum of two years of accounts as proof of earnings, with some lenders insisting on three years of accounts.
However, experts argue that individuals who set themselves up as a limited company rather than as a sole trader have been hit with a "double whammy" of problems with lenders refusing to look at their overall ability to pay.

This means many are unable to get the amount of borrowing they require for their next purchase and are effectively trapped in their existing mortgage.
"We've seen numerous people come to us who have a big mortgage and want to remortgage but can't get the loan size they got in 2006/2007," says Simon Gammon of Knight Frank Finance.

Brokers believe one big problem with many banks is that they are computer driven. "You don't even have the opportunity to say what the retained profits are on the application form," says Ray Boulger of John Charcol, the mortgage broker.
But there are a small number of high street lenders who will base affordability on net profit plus salary, says Bedford. This includes Skipton Building Society, Northern Rock, Coventry Building Society, Lloyds and Woolwich.

Some lenders will also consider borrowers with only one year's trading. Kensington Mortgages, which only lends through mortgage brokers, takes a minimum of 12 months' accounts. However, its mortgage rates are likely to be higher than the major high street banks, brokers warn.

Aaron Strutt of Trinity Financial says Halifax will also potentially lend based on one year's trading with a good record and credit score, if the application is made through a mortgage broker. "Lenders can be more flexible if you have a good credit score," he notes.

For those with large mortgages and significant earnings, private banks are a better option for many self-employed borrowers.

"Private banks take more of a global view – they will look at assets and liabilities as well as income and recognise that for people who own all or most of the company, retained profits in the business is effectively adding to their wealth," explains Boulger.

Some private banks can also be more flexible on trading history. Largemortgageloans.com recently had a private bank agree to lend 75 per cent loan-to-value to a client who, with two others, set up a new business six months ago. He had no other experience of self-employment.

"They were prepared to do so because of the client's strong record of earnings from employment in the same sector as the new business, the status and record of his business partners, the profits already achieved in the first six months of trading, and the very strong ongoing income stream from contracts secured with other large well-known client companies," explains Bedford.

However, private banks will not be an option for all borrowers. “Not everybody would get close to satisfying the basic criteria for private banks, therefore it is a big issue for a lot of people,” says Gammon. “We can usually find an option for them but it’s much harder than before.”