I have earned a reputation for getting loans approved when banks declined them. Here are some tips that can help your self-employed clients prevent a lot of the issues that come up in underwriting residential loans.

"An ounce of prevention is worth a pound of cure"

Tips to Help Self-Employed Borrowers Qualify for a Home Loan

1120S and 1065 Tips

Most lenders now use the **lesser of** your taxable income or Distributions reported to qualify you for a home loan. I find that many K-1's do not report Distributions. **This issue could be a deal killer for you.**

Distributions

Give your accountant the information necessary to prepare an accurate Balance Sheet and report Distributions, even if the IRS doesn't require it. The nuances of this lender guideline are complex, so if you have any questions or doubts about it, please call me. But the simple answer is to report Distributions accurately.

Short Term Debt

This is reported on Schedule L (line 16d on the 1065; line 17d on the 1120S). Standard lending calculations require the underwriter to deduct the amount found on this line from income available to qualify. The reason is that they assume you had to take that money out of cash flow to pay the debt in full.

I find that many accountants characterize lines of credit as Short-term Debt. However, lines of credit typically roll over from year to year, and do not have to be paid and closed that year. **It more beneficial for lending purposes to report lines of credit as Long-term Debt.**

Schedule C

Business Use of Home

Lenders add back the Business Use of Home deduction. But if you characterize those expenses as Rent and Utilities on Schedule C, they do not add it back.

All Self-Employed People

Business Checking Account

Most self-employed people have a separate business checking account. If you don't, I recommend you get one. If you pay your car payment and business credit card bills from a business account, and can prove that fact to the lender for the last 12 months, then they do not have to count that debt against you in the debt-to-income ratio calculation. Note that I am not telling you to deduct 100% of your car payment. The percent you deduct is determined by the percent you used your car for business.

Meals Expense

The IRS allows you to write off 50% of your reported Meals expense, because the assumption is that you ate half of the food. **Lenders deduct the 50% you could not write off from your income available to qualify.**

Not all food expenses should be characterized as "Meals". If you provide food for an event to promote your business, it should be characterized as Advertising and Promotion (because you likely did not eat half of the food). The deduction from income is the same for lending purposes, but at least you get the tax benefit of deducting the entire expense.

Schedule E Rental Income

Most people know that lenders add back Depreciation, and most lenders add back Amortization. But few people know that most lenders deduct the principal portion of your mortgage payment in their calculation. This is important because if the net rental income is negative, **it counts as a debt in the calculation. It is not deducted from income anymore.**

Why is this important? Because anything counted as a debt needs about 2½ times that amount in income to overcome it (because the DTI allowed is typically 43% to 45%). It is best to avoid being aggressive on Schedule E deductions if doing so will create negative income by lending standards.

I'm here to help

I offer the Excel worksheets that lenders use to calculate income free. However, I find that people's eyes often cross when they see it, and they don't want to deal with it. So I will do the calculation for you.

Few bankers or loan officers know how to perform this calculation. So they may think you qualify for the loan, only to find out that the underwriter's complicated calculation disqualifies you.

I will help you prepare for loan approval, and let you know how an underwriter will analyze your tax returns. If you know in advance of going into escrow whether or not you will qualify when the underwriter does the complete analysis, then you won't waste money and energy applying for a home loan that will be declined when the underwriter reviews it. The underwriter review is typically a week or two into the process (after you have paid for an appraisal, credit report and an inspection, if you are buying a home).

Many of my clients ask their accountant to send me the draft of their tax returns so that I can perform the calculations before they file the return. This makes it simpler to make adjustments if the draft taxes would ensure you do not qualify for the loan you want to receive.

MAKE SURE TO CONSULT YOUR TAX PROFESSIONAL

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