

# **Your Personal Guide to Understanding Mortgage Financing Options for Small Business Owners and Entrepreneurs**

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It's a favorite daydream of working Canadians: to go into business for themselves! For some Canadians who are self-employed, their situation is the consequence of corporate downsizing. For others, it is a carefully planned decision to leverage their knowledge and experience to improve their own bottom line. Typically a very innovative and energetic bunch, the self-employed now comprise approximately 16% (1 in 6) of Canada's total workforce. These individuals – who may actually be more financially successful than ever – often do not fit traditional mortgage lending criteria.

They enjoy a successful professional life, but when applying for a mortgage, they find themselves on the defensive – trying to prove to lenders that they actually earn enough income to service the mortgage they want. Many are turned down because their income just doesn't measure up.

Hard to believe, but true. If you work independently or own a business yourself, then you know that it pays to keep your taxable income as low as possible. An astute business owner with a good accountant will be working hard to minimize taxable income for the business: a smart financial strategy. But according to traditional lending formulas – this business strategy could flag you as a high-risk borrower as lenders really have no certain way to confirm your actual income and repayment ability. Your income – at least on paper – may not support the mortgage payments, and you could be penalized for smart income management.

Small business owners are usually expected to provide detailed financial statements for their business for the past two years. And what picture do those statements paint for the lenders? That can be a problem.

Many lenders are still most comfortable with the traditional parameters for verifying employment and income. An employment letter and a steady stream of pay stubs are the simplest methods of assessing your ability to service the mortgage debt.

Without an established stream of pay stubs from an employer, lenders have none of the traditional assurances that you can meet your mortgage obligations. You may be expected to undergo a long and complicated process to prove your ability to service your debt. Lenders want to verify

your employment and your income – not a simple task for someone who is self-employed. Lenders are also looking ahead; they will want some evidence that payments can be made for the life of the mortgage – not just over the next year.

### **Thank goodness those times have changed for the self-employed!**

These days, self-employed homebuyers have the same access to mortgages as their salaried counterparts. It doesn't matter what the nature of your income structure: whether you work on contract, whether your work is seasonal, or whether you're a small business owner or an independent professional.

As a “Self-employment” Mortgage Specialist, I am pleased to see that lenders have noticed that the traditional lending criterion was leaving many Canadians out in the cold. I am absolutely delighted that the most innovative lenders have begun to address some of these gaps with many great new options. It's great news that entrepreneurship and prudent income management are no longer a liability when it's time to buy a home. It's an exciting time for entrepreneurs to be buying a home – with more options than ever before.

For the self-employed – who build their own success on understanding the needs of their customers – the new mortgages designed for them are good business. And they're also welcome news to the growing number of Canadians who are building their own success in their own way.

### **What types of programs are available for Entrepreneurs?**

The most flexible and innovative lenders have discarded the old formulas for their self-employed clients. Some of the best mortgages for self-employed Canadians don't even require proof of income. You could qualify for your mortgage simply on your own good credit and employment history. If you're self-employed, or considering taking the plunge into business for yourself, you'll find that it's a new mortgage world. Check out your options... and get the credit you deserve.

## **What documentation is required to qualify?**

Each lender will have its own requirements and guidelines. With dozens of lenders and hundreds of self-employment programs available, guidelines and requirements vary with each individual application

However, the basic requirements are similar to the majority of programs:

### **Requirement 1: Proof of Business Ownership**

You must be able to prove that you own your own business. Providing any 1 of the following may do this

- Articles of Incorporation
- Business License
- GST / HST Return
- T1 Generals with Statement of Business Activities
- Business Credit Report

If you are unable to provide this verification, you may be able to use other sources to confirm your business ownership such as:

- Previous Invoices
- Business Bank account
- Website
- Phonebook Advertisements etc.

Typically, lenders will want to see you in business for 24 months, however there are now programs available for those who have been self-employed for 1 day! I will discuss this option in a further section.

### **Requirement 2: Down-payment Verification**

You must confirm that you have a down payment available. As these mortgages are considered higher risk, lenders like to see the down payment funds coming from your own resources - not borrowed from family etc. Based on the strength of your application and experience of your Mortgage Consultant, you may find a lender willing to accept a borrowed down payment.

Most self-employment programs require a minimum 5% down payment, however there are new program requiring as little as 3% down payment!!

**What documentation do I need to prove down payment funds?** Any one of the following

- 90 days bank statements to show money accumulating in your account
- Investment statement(s)
- Sale of existing home – Showing Net equity

Essentially you just need to show you have the money available.

**Requirement 3:** Confirmation of No Personal Taxes Outstanding

This is simply to prove to the lender that you do not have tax liabilities outstanding. This can be provided through:”

Your most recent Notice of Assessment (NOA) – The income shown on your NOA is insignificant, the NOA is simply to prove there are no taxes outstanding. Often times the lender will allow you to black out your income.

In some instance, when you are providing a sizable down payment, lenders may not require a Notice of Assessment (NOA).

**How does the lender know how much I am earning?**

If I am not required to show any income verification, tax returns, or employment letters, how does the lender know how much I earn, and what amount I qualify for?

These business-for-self programs utilize what is called a “stated income” option. With a stated income program, you do just that - state your income. For example, if you own a construction business and earn a gross of \$150,000 – this is the amount that is used to qualify you on your application!

Regardless of what is claimed on your personal tax return. This way, you can include all your earned income, cash, revenues etc.

A myriad of stated-income mortgages have been launched over the last few years. But this concept of stating an income figure is an idea that's long overdue.

It is important to note however, that there is a level of reasonability expected when stating your income. For example if a sole proprietor with a lemonade stand is stating an income of \$300,000 after 2 years in operation, further documentation may be requested as this may not be considered reasonable.

### **So how does the lender assess whether you're a good credit risk?**

They look at your credit history. If you have consistently paid your bills and loans, then you have demonstrated the kind of financial responsibility that suggests you can manage your mortgage. You've taken on debt that you said you could manage, and you've kept your word with your lenders. That's the record your mortgage lender will rely on, although they will also verify your employment and assess the loan amount based on your field of work.

So to re-cap, you can now qualify for your mortgage based solely on what you state your income to be, and after confirmation that your lending ratios, credit and tax liabilities are in good order. It can be that quick, that easy!

A few concerns....

### **What if I don't have good credit?**

If you have had some credit issues in the past, it does not mean that you cannot qualify for a mortgage. There are many lenders who will still provide entrepreneurs with financing in these situations. However, as a premium for lending to higher risk borrowers, these lenders may charge higher rates and fees. These rates and fees vary, and are dependent upon each application and its strength. As there is no obligation with your mortgage application it is always a good idea to have yourself pre-qualified. This way you know what terms you may expect to receive. After reviewing your options, the decision to proceed with financing is at your discretion.

Another important note with these “bruised credit” mortgage options is that they should be used as short-term strategies only. Once your mortgage is approved, make sure you are counseled on how to improve your credit. Once your credit is re-established you can look into entering a mortgage with better terms and options.

### **What if I don't have a down payment?**

If you don't have a full down payment available, there are still options available. Based on individual circumstances, you may be able to borrow your down payment or receive 100% financing. Also, some lenders have adopted 3% down payment as the new minimum requirement.

### **What if I have not been business for self for 24 months?**

If you're new to the self employment world...congratulations! Though lenders typically like to see 2 years in business, it is no longer a strict requirement. New self-employed professionals now get credit for their past work experience as well. If you have 2 years experience in your field of expertise – whether you were salaried or self-employed – you can still meet all eligibility requirements.

These new changes greatly help self-employed Canadians who have extensive experience in their chosen field, but who are newly in business for themselves in that field. For example, maybe you've been a landscaper for years in a salaried workplace, and have decided to step out on your own. Now you can get credit for your experience. The lender and insurance guidelines specify that you should be “performing essentially the same function with the same skill requirements” for your past experience to qualify. The guidelines apply to any insured mortgage... from any institution. It's worth noting, of course, that some lending institutions are friendlier to the self-employed than others.

### **What rates do I qualify for?**

Here's the best part, if you have a good credit history, down payment and no taxes outstanding, you qualify for the lowest market rates!

**So if the lender is providing funds to me with no income verification and lowest rates, how are they compensated for the extra risk, what's the catch?**

To compensate for the low documentation self-employed programs, the lenders will add a premium to your insurance fee. Each lender, whether you are salaried or self-employed must have your mortgage insured. These insurers (CMHC, Genworth and AIG) insure the lender against default on your mortgage. Whether you are salaried or self-employed, this insurance fee will be capitalized (added to your mortgage amount). They are not required to be paid upfront. The difference is that self-employed will have a higher insurance fee added to their mortgage balance.

Again, accepting these terms is always at the discretion of the applicant. However, given the advantages of these mortgage products and home ownership, a small increase in the fee is of small consequence to most borrowers.

**Do Mortgage Brokers charge fees for these services?**

No, if your mortgage consultant arranges a mortgage for you, the lender simply pays the consultant a referral fee. There are no consultation costs.

**Final Thoughts...**

As more lenders enter this market niche, you'll find that not all products are equal. As a group, the self employed often delegate to other professional service providers and this is a situation where you may want to seek advice from a professional mortgage consultant so you get the best mortgage for your needs.

It is my pleasure to help the passionate group of small business owners and entrepreneurs in achieving their financial dreams. I hope this report has helped you to further understand the options available to you. If I can help you in anyway, please do not hesitate to contact me.

All the very best to you,

Travis Kulasekere, B.Comm