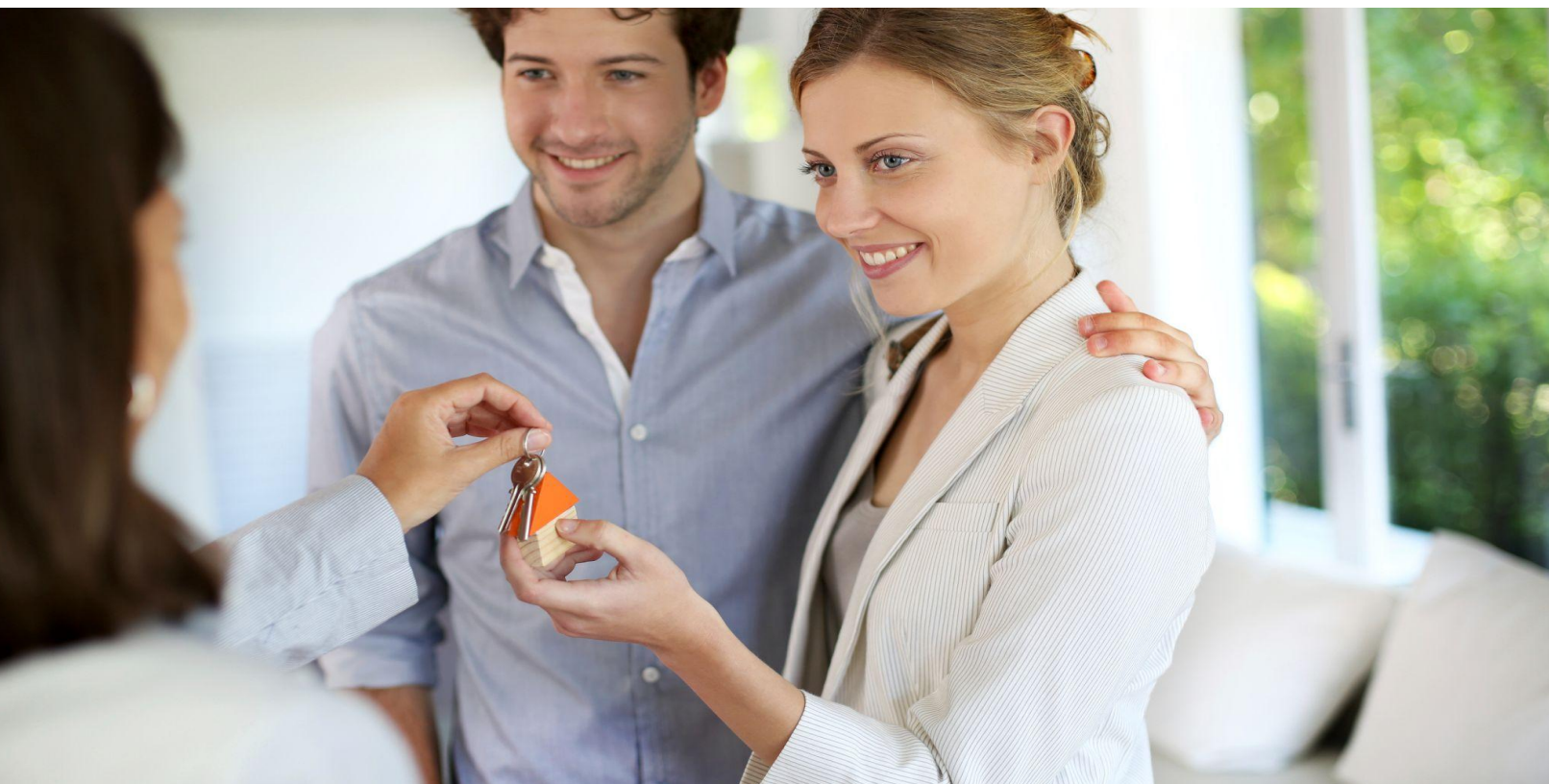




# Analyzing **Self-Employed** *Clients*

FOR FUTURE HOME BUYING





## WHO WE ARE

### *Black Diamond Mortgage Corporation*

We are a small, boutique-style Mortgage Company located in Whitefish, MT. We serve homeowners, future homeowners, current and past residents of Montana, and business owners. Our passion is homeownership and independence! We want everyone to understand how a home is one of the biggest assets you can have and how our goal is to work with others in order to make it possible! Everyone deserves a Home!

---

---

## How lenders approve self-employed income



When determining the appropriate qualifying income for a self-employed borrower, it is important to note that business income (specifically from a business entity) reported on an individual IRS Form 1040 may not necessarily represent income that has actually been distributed to the borrower. The fundamental exercise, when conducting a self-employment income cash flow analysis, is to determine the amount of income that can be relied on by the borrower in qualifying for their personal mortgage obligation. When underwriting these borrowers, it is

important to review business income distributions that have been made or could be made to these borrowers while maintaining the viability of the underlying business. This analysis includes assessing the stability of business income and the ability of the business to continue to generate sufficient income to enable these borrowers to meet their financial obligations.

### ANALYSIS

- How much do they make?
- Big picture, do not rely on net taxable income.

Old school standard:

- Each form of income, individually analyzed (ie; businesses owned, properties owned, jobs, capital gains) a 2 year history = 3 years of
-

---

likely continuance (and 3 years of continuance is likely to demonstrate a borrower's payment capability to survive the loan term)

- On self-employed, tax return borrowers, a self-supplied financial statement is sufficient for the current year
- Reserves necessary for multiple properties with mortgages, etc.

The following factors must be analyzed before approving a mortgage for a self-employed borrower:

- the stability of the borrower's income,
- the location and nature of the borrower's business,
- the demand for the product or service offered by the business,
- the financial strength of the business, and



- the ability of the business to continue generating and distributing sufficient income to enable the borrower to make the payments on the requested mortgage.
-

---

Any individual who has a 25% or greater ownership interest in a business is considered to be self-employed.

What are Tax Transcripts? Does it matter if I have made my payments to the IRS? (Lenders validate tax return information off tax transcripts, payments to the IRS or both.

## Tax Returns

Are business tax returns required, on top of personal?

(25% ownership, generally, yes)

When two years of signed individual federal tax returns are provided, the lender may waive the requirement for business tax returns if:

- the borrower is using his or her own personal funds to pay the down payment and closing costs and satisfy applicable reserve requirements,
- the borrower has been self-employed in the same business for at least five years, and
- the borrower's individual tax returns show an increase in self-employment income over the past two years.

## Opportunities

- Limited review options: 1 year of tax return analysis (in business over 5 years) or underwriter discretion for a 1 year analysis... (if 2 years is deemed superior, then it is 2 years)
  - Depreciation
  - Eliminate "notes payable in 1 year"
  - Guaranteed Payments
  - W2 Wages added to net income
  - Non-recurring expenses
-

- 
- Depletion
  - Amortization

## Underwriter Discretion

- Read Fannie Mae Self Employed Guidelines  
<https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/Subpart-B3-Underwriting-Borrowers/Chapter-B3-3-Income-Assessment/Section-B3-3-2-Self-Employment-Income/1032990811/B3-3-2-01-Underwriting-Factors-and-Documentation-for-a-Self-Employed-Borrower-10-24-2016.htm>
- Read Freddie Mac Self Employed Guidelines  
<https://guide.freddiemac.com/app/guide/section/5304.1>
- Read FHA Self Employment Guidelines  
[https://www.hud.gov/sites/documents/4155-1\\_4\\_SECD.PDF](https://www.hud.gov/sites/documents/4155-1_4_SECD.PDF)
- Read VA Self Employed Guidelines  
[https://www.benefits.va.gov/WARMS/docs/admin26/pamphlet/pam26\\_7/ch04.pdf](https://www.benefits.va.gov/WARMS/docs/admin26/pamphlet/pam26_7/ch04.pdf)

## Use of Business Assets

Using assets from the business to pay the down payment:

- When a borrower intends to use business assets as funds for the down payment, closing costs, and/or financial reserves, the lender must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business. In order to assess the impact, the lender may require a level of documentation greater than what is required to evaluate the borrower's business income (for example, several months of recent business asset statements in order to see cash flow needs and trends over time, or a current balance sheet). This may be due to the amount of time that has elapsed since the most recent tax return filing, or the lender's need for information to perform its analysis. See
-

---

[B3-4.2-02, Depository Accounts](#) for additional information on business assets.

Here is a simple form for Cash Flow analysis.

<https://singlefamily.fanniemae.com/media/7746/display>

Less than 2 years:

- However, a person who has a shorter history of self-employment – 12 to 24 months – may be considered, as long as the borrower’s most recent signed federal income tax returns reflect the receipt of such income as the same (or greater) level in a field that provides the same products or services as the current business or in an occupation in which he or she had similar responsibilities to those undertaken in connection with the current business. In such cases, the lender must give careful consideration to the nature of the borrower’s level of experience, and the amount of debt the business has acquired.

Head to our website for the video presentation of this material [here](#).



[www.BlackDiamondMortgage.com](http://www.BlackDiamondMortgage.com) 406-862-4999

---