




Turning your nightmare
prospects

Into

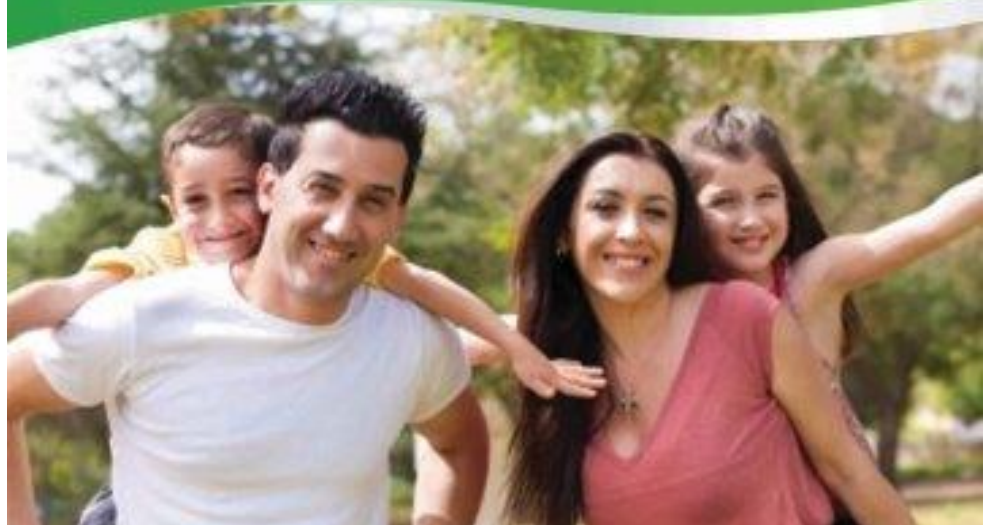
Dream Clients 



Turning your nightmare prospects into your dream clients
-How to close the self-employed borrower

Presented by your favorite lender 

Tuesday May 26th



So what is a Self-employed borrower?

Per Fannie Mae Selling guide

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

What are types of self-employed?

DBAs / Sole proprietors → “Sch C”

Ex- Vocational / licensed jobs such as plumbers; electricians; general contractors; lawn service; consultants; attorneys; real estate agents (1099s)

Partnerships – LLCs; LP; LLP; PCs → “1065 Form”

Ex – Investors; Real estate investors; C-suite officers; typically with 50 or less employees

Corporations - S-Corps; C-Corps → “1120 Form”

Ex – Family businesses; retail business; brokerage; franchise owners; small to mid-sized company typically with 50 or greater employees

Pitfalls of working with the self-employed

Your concerns

- Don't know if they qualify
- Last minute denials
- Large write-offs
- Low Cash flow
- Cash for down payment coming from company
- Cash for down payment comes from gift
- Tax filings not up to date
- Records not readily available
- Only self-employed 1yr
- Multiple lines of business & income

Result: Client not financially qualified for a mortgage OR “Not under writeable” however is interested and driven

You waste your time that could have been spent on a productive client

Pitfalls of working with the self-employed

Challenges

Personal Profile

- Typically Well educated
- Accomplished
- Wealthy
- Confident; self-driven
- Anything can be done attitude (*don't bother me with the details*)
- Low tolerance for many questions; want action
- Leaders by nature; as a result, not easily lead by non-equal

Mavericks; rules are good but not necessarily to be followed; rule breakers

Pitfalls of working with the self-employed

Challenges (cont)

Employment

- Was W2 but recently became self-employed but in same line of business
- Slugger (*low income stability but hits it out of the park every 3yrs*)
- Employee of own company
- Doesn't matter if they are W2 and are using payroll service such "Paychex; ADP; Quicken"

Just because you are making money doesn't mean the underwriter will recognize it!

Pitfalls of working with the self-employed

Challenges (cont)

Debt

- Not separating business and personal debt therefore all debt on personal profile
 - Ex - “Company takes out installment loan for printer and expenses cost of printer on company return thereby reducing corporate income however the loan was made in the personal name therefore it shows up on personal credit report. As a result, loan payments are counted against personal income resulting in double hit to income”
- No personal debt; all corporate debt
 - Corp debt typically does not report to credit bureaus. As a result, client’s credit report file may be considered “thin” from lack of credit lines.

Overabundance or not enough debt are both problematic need it just right

Pitfalls of working with the self-employed

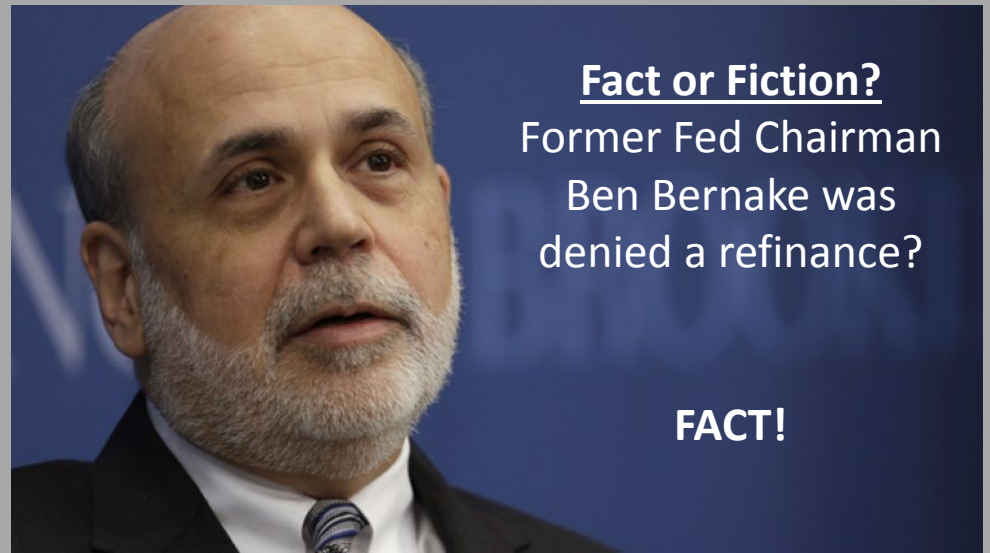
Challenges (cont)

Income

- “Expense Loopers”
 - *Low income due to expensing what otherwise would have been personal expenses “car; mileage; phones; home office; trips” as corporate expense thus artificially but legally reducing business income*
- “Hobbyist syndrome”
 - *Never declare income or always declare very low income*

Tax avoidance through “tax wizardry” has its consequences. Want mortgage; show income

Why are Self-employed borrowers so difficult to finance?



Fact or Fiction?
Former Fed Chairman
Ben Bernake was
denied a refinance?

FACT!

Profile

This is a guy who can

- Charge up to \$250k per speaking engagement
- Received \$1MM for a book deal on his memoirs

BUT...

- Left his job Jan 31st 2014
- Denied September 2014

Mostly likely denied due to lack of employment
and recent self-employment

Why are Self-employed borrowers so difficult to finance?

Lack of Knowledge at Bank (cont)

Bank loan officers are ill-equipped

- Borrowers turn to Bank Rep
 - *As a business owner relationship probably exists with rep at local bank for business accounts and/or credit*
 - *Bank lent money before; why wouldn't they lend to purchase home*

Problem: Bank reps are not experts in mortgages thus they refer to internal mortgage loan officer

- Mortgage loan officer does not know the client personally (*details lost in translation*);
- Did not source client directly (*"banker" is true client*) and;
- Mortgage loan officers often are not career loan officers but rather working through corporate path to become a relationship banker or VP

Why are Self-employed borrowers so difficult to finance?

CPAs & Mortgage Loan officers *(like cats & dogs)*
(cont)

CPAs / Tax preparers can be Loan officer's worst Nightmare

- CPAs/Tax preparers are paid to complete clients taxes & minimize income taxes
 - *Reduce Income minimize income tax*
- Contrast that to a Mortgage loan officer's stated goal; get the lowest rate for the most loan possible.
 - *Maximize Income increase loan amount*

We are at polar ends when it comes to income goals

Why are Self-employed borrowers so difficult to finance?

Underwriters (cont)

Underwriters are lazy

- Want easy to understand income with room for margin of error
- Overburdened with service level agreements to get through “so many” files a day. Easy ones get dealt with first
- Do not have hours to look over one aspect of loan, maybe can provide 1 or 2 hours on a file but every file

Why are Self-employed borrowers so difficult to finance?

Schedule Overload (cont)

Self employed borrowers have 11 major schedules vs 1 for an Employee

- 1) Sch C (sole proprietor)
- 2) Sch E (supplemental income & loss)
- 3) K1s;
- 4) Rental props
- 5) Sch D (capital gains)
- 6) Sch F (farming)
- 7) Sch SE (self-employment tax)
- 8) Sch 2016 (unreimbursed exp)
- 9) Form 1065 (Partnership return)
- 10) 1120S (S-corp return)
- 11) 1120 (C-corp return)

Who would you rather deal with?

So what does an Underwriter look for in a Self-employer borrower?

Basic Tenets

- 1) The stability of the borrower's income
- 2) The location and nature of the borrower's business
- 3) The demand for the product or service offered by the business
- 4) The financial strength of the business
- 5) The ability of the business to continue generating sufficient income to enable the borrower to make the payments on the requested mortgage
- 6) Length of self-employment
 - * straight from Fannie Mae Selling guide

So what does an Underwriter look for in a Self-employer borrower?

Basic Tenets (cont)

A 2-year history of self-employment is generally required. 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 at a stable or increasing level in a field related to the borrower's prior employment or self-employment. Careful consideration must be given to the nature of the borrower's level of experience, and the amount of debt of the business. *Self-employment for a period of less than 12 months is unacceptable*

Ex- *"Engineer turned consultant for their prior employer"*

* straight from Fannie Mae Selling guide

So what does an Underwriter look for in a Self-employer borrower?

Basic Theory

3 key points

1) Past Income

- 2yr Income history in field/company;
- Proven through:
 - *Filed ; and*
 - *Verified Tax Returns*

2) Present income

- Currently earning income in endeavor
- Proven through:
 - *CPA letter*
 - *Current charter / license*
 - *YTD Financials*

3) Future Income

- Expectation of continued income
- Proven through:
 - *Positive Industry trends*
 - *Positive Financials trend*
 - *Extended contracts beyond 3yrs*

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What can you as a Realtor do?

Prior to taking on client

Set expectations

- Not easy; but not impossible
 - Get client ready for many questions
 - Help them not procrastinate
 - Make sure they are committed to process

- Get them to start pulling together financial documentation
 - Tax returns with ALL schedules for past 2yrs
 - YTD financials through last quarter

What can you as a Realtor do?

Prior to taking on client (cont)

Ask Key Questions

- Do you own 25% of the business that employs you? (*instead of "Are you self-employed"*)
- Have you been in business for at least 2 tax years?
 - Have you filed past years' return or extended?
- Are you reporting positive income for the past 2yrs?
- Career plans
 - Recently went from W2 employee to self-employed get to HomeStart immediately
 - Discourage becoming self-employed prior to purchase

What can you as a Realtor do?

Prior to taking on client (cont)

Get them Pre-approved NOT pre-qualified

- What's the difference
 - Pre-qualified – client qualified on verbal / circumstantial information in combination of credit report from one bureau (10 -30mins)
 - Pre-approval – client qualified on corroborated information; full credit report and automated underwriting system (2 – 8hrs)

Tell them you won't work with them unless they make that upfront commitment (*remember Ben?*)

What can you as a
Realtor do?

Negotiate strong contract

Best Practices

- If client not pre-approved, don't write contract or at least advise against
- Do not set closing date less than 30days out
- Use Third Party Financing contingency addendum with 21 days
 - Call us for parameters on loan
- Have pre-contract conference call with RMLO

What can you as a Realtor do?

Contract Management

Best Practices

- Have Post-contract conference call with RMLO
- Urge client to sign loan application immediately, underwriting doesn't start until loan application signed (*not sales contract*)
- Discourage use of business funds for earnest money/option period
 - Discourage movement between corporate and personal funds leading up to and during transaction

What if client not ready,
not qualified?

HomeStart has the answer

We have plan

- If client does not qualify we will explain why
 - Lack of history
 - Lack of income
 - Lack of down payment
 - Lack of credit; OR
 - Combination of all four
- Each above symptom has a best practice approach to maximize opportunity to obtain financing
- We can set in place plan to help them achieve their goal and yours

**We will stay in touch while client active through
weekly updates on progress towards pre-
approval**