PEKOE
MORTGAGES

# The Self-Employed Mortgage Guide

The 24 month standard, the two ways to present your income, and the six things to do before you apply.

## The standard is not what most people think it is

**24 months** operating the business, **or** 24 months of experience in the same line of work. Those are alternatives. Six years as an employed electrician who went out on her own eleven months ago satisfies the second limb.

> **And under 24 months either way is still possible.** Supporting factors include acquiring an established business, sufficient cash reserves, predictable earnings, prior training or education, and a demonstrated credit management history.

## What self-employment does not change

The ceiling. Maximum loan-to-value is the same as for a salaried borrower, **up to 95%** on one to two unit properties. Being self-employed does not force a larger down payment.

## The documents, which are the whole file

- [ ] The last two **T1 Generals**.
- [ ] The **Statement of Business Activities**, form **T2125**, for each of those years.
- [ ] The matching **Notices of Assessment**, showing no amount owing.
- [ ] Business registration, or articles of incorporation if incorporated.
- [ ] Twelve months of business banking where the filings do not tell the whole story.
- [ ] If incorporated: two years of financial statements and the T2 returns.

## The tension nobody warns you about

Good tax practice and good mortgage practice pull in opposite directions. Every allowable deduction lowers the net figure on your T2125, and the net figure is where a lender starts.

There are two recognised ways to deal with it.

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| Approach | What it does | Works best when |
|---|---|---|
| **Gross-up** | Sole proprietorship and partnership income may be increased by **15%** | Expenses are modest and genuinely recurring |
| **Add-backs** | Eligible deductions are added back to the net figure | Deductions are large, non-cash or one-off |

Which serves your file better is arithmetic on your own return, not a preference. A business with a big equipment write-off usually does better on add-backs; one with steady modest costs usually does better on the gross-up.

## Ratios still apply, and so does the stress test

**GDS about 39%**, **TDS about 44%**, measured on the income as established above.

You qualify at the greater of your contract rate plus 2%, or a **5.25%** floor.

Unsecured lines of credit and credit cards count at **no less than 3%** of the outstanding balance per month.

A secured line of credit counts at least as a payment on the balance amortised over 25 years at the contract rate.

## Six things to do before you apply

- [ ] File everything. A missing or late year removes the evidence the whole approach rests on.
- [ ] Clear any CRA balance owing, and have the Notice of Assessment that proves it.
- [ ] Separate business and personal banking if they are mixed. A reviewer who cannot tell them apart will assume the worse reading.
- [ ] Do not restructure late. Incorporating partway through, or changing how you draw income, resets the picture a lender is reading.
- [ ] Ask your accountant for a summary of deductions by category, which is what an add-back analysis needs.
- [ ] Pull your credit report and read it before anyone else does.

## Figures used in this guide

| Figure | Value | Source |
|---|---|---|
| Self-employment standard | 24 months in business or in the same line of work | CMHC, Self-Employed |
| Maximum loan-to-value | Up to 95% on 1 to 2 units | CMHC, Self-Employed |
| Gross-up | 15% on sole proprietorship and partnership income | CMHC, Self-Employed |
| GDS and TDS | About 39% and 44% | CMHC, Calculating GDS and TDS |
| Stress test | Greater of contract plus 2% or 5.25% | OSFI B-20 and insurer qualifying rate |
| Unsecured credit in TDS | No less than 3% of the balance monthly | CMHC, Calculating GDS and TDS |

No mortgage rate appears in this guide. Current rates are at pekoe.ca/rates.