Don't Shut the Door on Quality Borrowers

Bank-statement loans can offer a solution for self-employed clients with complicated finances

By Joseph Lydon

Nontraditional borrowers such as business owners and high-commission salespeople have always faced challenges to document income. For mortgage lenders and originators, there is a solution. Bank-statement loans help self-employed borrowers qualify based on their actual income rather than the number that appears on their tax returns.

While these types of nonqualified mortgages (non-QM) are widely used as a workaround to the strict underwriting of agency loans, there's both an art and a science to guiding bank-statement borrowers through the qualifying process. Non-QM loans are often quality mortgages that don't meet the strict guidelines to be purchased by the government-sponsored enterprises.

Understanding the full picture of a business owner's income stream can be tricky. Understanding the income and expenses of a business may require examining multiple sets of bank statements as well as various income sources. Assembling all the pertinent information means you have to ask smart questions.

Solving puzzles

Mortgage originators want to offer the best available loan options for their clients. Bank-statement loans provide excellent opportunities and flexibility for self-employed borrowers. This flexibility can help originators win more business.

Underwriting for agency loans is a straightforward matter of looking at W-2 forms, which have very little wiggle room. But digging into a bank-statement loan requires further due diligence. These loans aren't one size fits all.

Each self-employed borrower's situation is unique. To take advantage of these loan opportunities, originators must examine every detail of their borrower's financial background to ensure an optimal situation.

Given the unique nature of bank-statement borrowers, mortgage originators can feel a bit like they're solving a puzzle. The right questions aren't always obvious.

Multiple accounts

Start your underwriting process with a simple rule: Don't presume that all business owners manage their companies the same way. There's no one way for a business owner to set up their bank accounts.

For instance, it's quite possible that a food-service entrepreneur has separate bank accounts: one for cash receipts and another for credit card payments. Many restaurateurs have multiple locations, with separate bank statements for each. If you look at only one of these accounts, you won't get a full picture of the borrower's finances. The obvious risk is that you'll say no to a borrower who really is creditworthy, if only you knew where to look.

A physician's office might use one bank account for insurance company reimbursements and another account for payments made directly by patients. This can be an easier way to run the business — but if an underwriter doesn't look at activity in both accounts, the doctor might not qualify for a loan. What's more, a medical practice with multiple locations likely has multiple bank statements.

You may run into a situation where you have a married couple and each person generates nontraditional income. Let's say the couple has separate bank accounts, one for income via rental properties and a second that shows their business receipts — she's an artist, he's a musician. The rental income alone might not be enough to qualify the couple for a mortgage, but a review of both accounts could.

Complete picture

The theme in all three of these examples is obvious: Borrowers often have multiple bank accounts and you'll want to look at everything that's relevant. By the same token, some bank accounts aren't what they seem. Some business owners execute payroll from a separate bank account and simply transfer money in for payday.

To make the most of your bank-statement lending business, you need to invest time and energy into the transaction. Only by being flexible can you put together a complete understanding of the borrower's finances. Take the extra time to understand how borrowers manage their books.

Another opportunity for flexibility arises in the expense factor. If you take a one-size-fits-all approach to expenses, you might deny some borrowers based on the asset-heavy nature of their businesses.

For instance, an engineer or programmer who works from home has few expenses for such things as office rent and cost of goods sold. An auto mechanic or retailer, on the other hand, has much higher expenses for facilities, labor and supplies. If you apply cookie-cutter underwriting to these very different types of businesses, you'll miss out on lending opportunities.

The number of self-employed Americans was on the rise even before the COVID-19 pandemic, but this trend has only accelerated during the past three years. Bank-statement loans can help borrowers qualify based on their actual income instead of what shows up on their tax returns.

Verifiable income

Self-employed borrowers often have trouble documenting their income, even if they have strong financial pictures. Savvy tax planning means that business owners should reduce their income via business expenses. But the approval process for a traditional mortgage doesn't accommodate this reality.

By examining bank statements, you'll quickly determine true income figures for a borrower, allowing you to determine a debt-to-income ratio. This leads to a solid number that both the borrower and lender can work with to ensure prequalification and, ultimately, a successful loan closing.

You may work with many clients who are self-employed and fall into categories such as insurance agents, contractors, plumbers, attorneys, doctors, accountants, cosmetologists or property investors. Many of these borrowers possess substantial wealth but need to demonstrate income in a different way than a traditional W-2 borrower.

The details vary by lender, but a typical scenario involves a borrower providing 12 to 24 months of bank statements. Lenders also want to see consistent deposits each month. This can be in a personal or business bank account, and some bank-statement borrowers submit a combination of both.

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The bottom line is that financing is available for borrowers who don't fit into traditional underwriting boxes. You'll need some creativity and the right partners to get these deals done, but options are available if you know where to look. •

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