Altura
Mortgage Finance

Self-employed? What you need to know before you apply for a mortgage

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As of January 2024 there were around 4.3 million self-employed workers in the UK.

While self-employment offers many benefits, from flexible hours to ‘being your own boss’, there can be some downsides - especially when it comes to getting a mortgage.

Charles McDowell of Aldermore Bank says that research it has carried out shows that three in ten self-employed homeowners believe the mortgage process is biased against them.

The truth is rather different. Most lenders are more than happy to lend to self-employed applicants, and you generally have access to the same range of deals as employees.

However, there isn’t a ‘one-size-fits-all’ approach to underwriting self-employed mortgage applicants. So, whether you’re a company director, a contractor, or you own your own business, what a lender considers ‘your income’ really matters – and this guide is here to help you.

Wide experience of helping self-employed borrowers

If you’re self-employed and you want to maximise your borrowing potential, we can help. We have wide experience of helping business owners, company directors, freelancers, and contractors to get the finance they need to remortgage or buy their new home.

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What do mortgage lenders consider 'self-employed'?

Firstly, it's important to understand what a lender means by 'self-employed' and how this translates into the income they use to underwrite your mortgage application.

You might assume that self-employed people are just sole traders as their 'income' is essentially the money that they make.

If you own a limited company, and you are paid by your limited company, then it's easy to think that you're not self-employed. If your business pays your income, surely you're a salaried employer of that business?

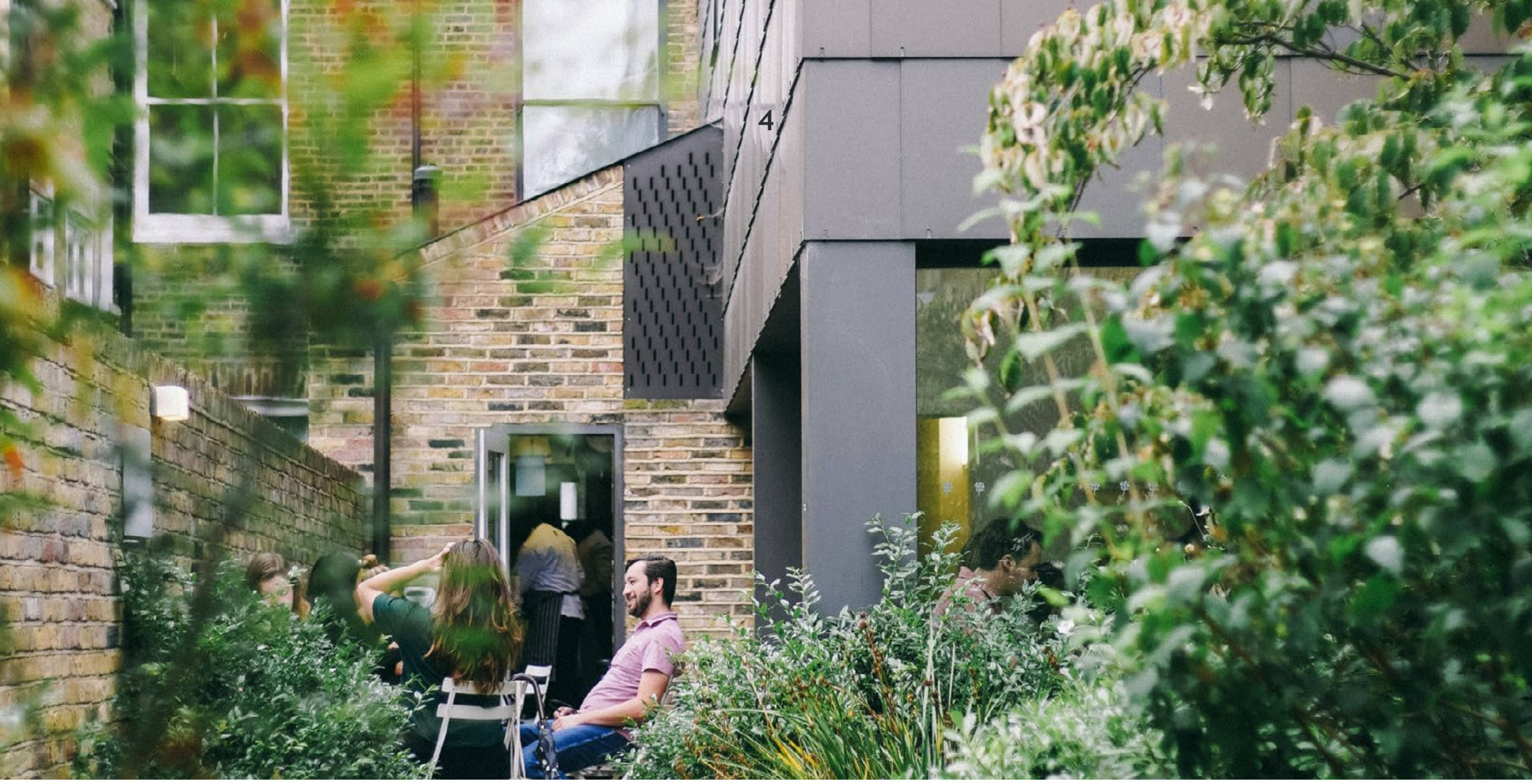
The answer is: not necessarily.

Lenders will typically consider you as self-employed if you own more than 20% to 25% of your company. It doesn't matter how you pay yourself, or if you own 100% of the business.

If you own more than 20% of your business, a lender will say that you have control over the company. That control means that it's not up to someone else to decide how you are paid – the decision is up to you. You have an input into whether the company can meet its bills and pay your salary.

This is also the reason that a lender will need to see a longer track record of income than three months' payslips; typically accounts or tax returns.

Irrespective of the way you pay yourself, they must confirm the long-term sustainability of the company and ensure that the business is going to be able to keep paying you in the future.



Why the way lenders assess your income matters

Different lenders use different methods to determine your income. But why does this matter to you, and why is it worth getting expert advice?

You'll be able to borrow more

Most lenders and mortgage brokers will work out your income in the same way – and this will give you a maximum borrowing amount.

Experts like Altura will look at a range of specialist lenders, and work out which method of income calculation is best for you. They will then find the right lender who will accept that income.

The outcome: you'll be able to get the mortgage you need.

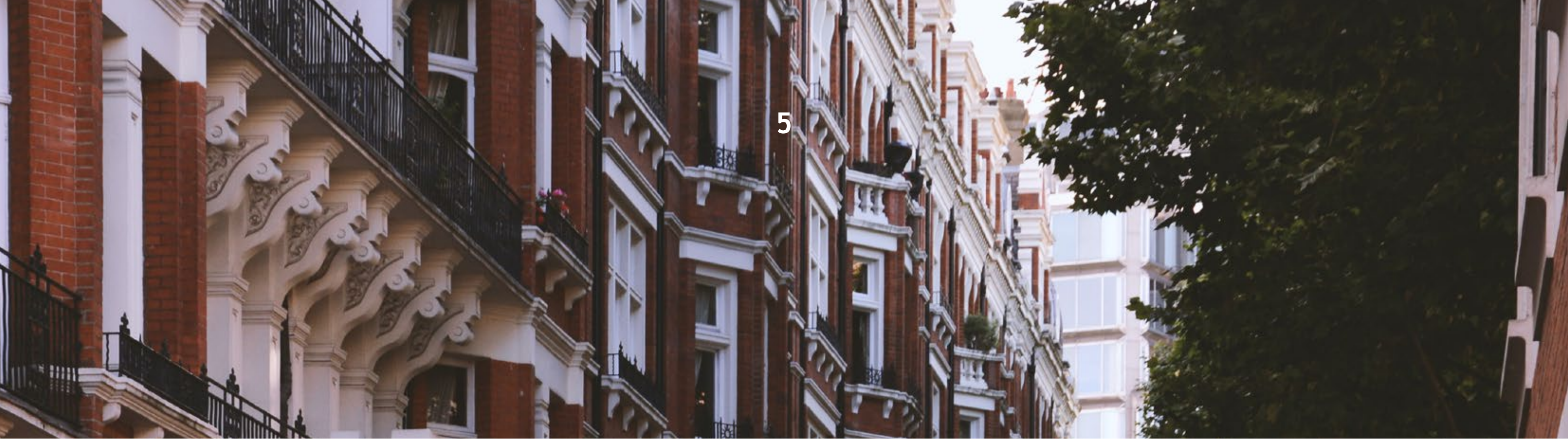
You'll get a better mortgage deal

Your average lender or broker will use a traditional way of calculating income – and maybe that will be enough to get you the mortgage you want.

However, will it be the very best deal?

When you speak to an expert like Altura, we work hard to ensure you get both the amount you need to borrow, and a great deal. We work with lenders across the market to ensure our clients always get the right combination of lender and rate.

Next, read about the three ways lenders calculate your income if you're self-employed, and how this could affect the amount you can borrow.



Calculating your income method 1: Your personal income

In simple terms, your income as a self-employed person is the amount your business has earned, less the amount that you have spent.

For a sole trader, that is generally easy. Your account will show your revenue and your expenses, and your personal income is what's left.

If you're a business owner or company director, it can be slightly more complex.

Many owners and directors will typically pay themselves a minimum salary. This is often below the Personal Allowance and National Insurance threshold of £12,570 (2024/25 tax year).

You can then balance your salary with dividend payments - as long as your business is making enough profit to cover them. Unlike salary, dividends are exempt from National Insurance, and the tax rates are lower than Income Tax rates.

The total amount of salary and dividends that you take out of your company is your income. This belongs to you.

This is the way that most lenders will determine your income. They will add your salary and dividends together and base their lending on this figure.

In some cases, this will be sufficient to get you the mortgage that you need. But what if you don't take all the money you could from your business? What if there are retained profits? Or you make pension contributions from your business?

If this is the case, speak to Altura as you'll need an expert that can help you with method 2.

What documents you'll have to provide

When a lender is using salary and dividends as their method of calculating income, you'll typically have to provide the following documents to support your application:

- Two or more years' certified accounts. Ideally, these will have been prepared by a qualified, chartered accountant
- Both your SA302 forms and tax year overviews (from HMRC) for the past two or three years
- 6 months' business bank statements

Calculating your income method 2: Salary, dividends and retained profits

We've seen that most brokers and most lenders will simply use your salary and dividend income to determine what they will lend you.

It's important to remember here that a limited company is not a person. Even if you own 100% of the company, any money you bill belongs to the company, not to you. If a client pays your £10,000 invoice, that's company money.

It's also worth remembering that you can only pay yourself a dividend if the business can afford it. Dividends are taken from profits which means that dividends are typically less than the profit your business has made.

A useful example

If you're a 100% owner of a business and you make a profit of £80,000, you might take a salary of £12,570 to remain under the Income Tax and National Insurance threshold. You might then take dividends of £60,000 and leave the remaining £20,000 in the business.

Using the calculation in method 1, your income would be £72,570 – equivalent to your salary and dividends.

However, a lender who uses 'retained profits' as income would consider your income to be £92,570 – equivalent to your salary and the £80,000 you could have taken as a 100% owner of the business.

This method can also work if you own a share of a business. Using the example above, if you were a 50% shareholder in the business and you decided to take £12,570 as salary and £30,000 as dividends, your income under method 1 would be £42,570 but under method 2 would be £52,570. This is because you could have taken the full 50% split of profits (£40,000) if you wanted to.

Retained profits can be included as income

This may seem like a technicality, but it can make a significant difference to the amount you can borrow if you're retaining profits in the business. It's useful if you're looking to apply for the biggest mortgage possible based on your self-employed income.

It's important to note that a far smaller proportion of lenders work like this.

Some always calculate income this way, while others can use both methods depending on the client (the latter method can be more complex in terms of underwriting).

Don't forget pension contributions

It is also common for companies to pay private pension contributions to directors before tax. There are tax benefits to the business for arranging contributions in this way.

Again, a director could take this pension contribution as a salary should they choose to do so.

For this reason, there are also mortgage lenders willing to consider a pension contribution as potential income, and will include this in the calculation when establishing your borrowing potential.

As we specialise in this type of lending, we know which lenders operate in this way and so which lenders are likely to be more generous in terms of lending.

We're also comfortable with limited company accounts, so we know how to position your application and income with a lender.

What documents you'll have to provide

When a lender is using salary, dividends and retained profits/pension contributions as their method of calculating income, you'll typically have to provide the following documents to support your application:

- Two or more years' certified accounts. Ideally, these will have been prepared by a qualified, chartered accountant
- Both your SA302 forms and tax year overviews (from HMRC) for the past two or three years 6 months' business bank statements

Calculating your income method 3: The value of your contract

As increasing numbers of contractors are paid a day rate according to their contract, specialist lenders have begun to offer mortgages targeted at contractors.

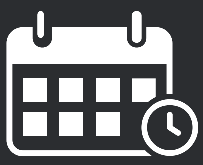
Using the value of your contract can help you to maximise the amount of borrowing that is available to you.

A useful example

You are self-employed, on a six-month contract at £400 per day.

A lender will typically consider your income to be:

£400 x 5 days a week
x 46 weeks a year
= £92,000



Some lenders will even consider up to 48 weeks – again, trusting an expert can help you to find the right lender for your needs.

The main benefit to using the value of your contract rather than your accounts is that it almost certainly maximises the amount you can borrow. Essentially a lender is considering your ‘revenue’ as your income, not your net profits, or salary and dividends.

Another key advantage here is that you often don’t need a two or three-year track record of self-employment.

There are lenders that can consider your application even if you have only a few months of contracting/self-employment behind you. Each lender has different criteria when it comes to your contracting history, contract length, and the remaining time that must be left on your contract, so it really pays to speak with an expert for advice.

Using the example above, a good accountant will claim all business expenses, and ensure you take a small salary and dividends for tax purposes. Instead of revenue of £92,000, your net profit might be just £50,000, so a salary of £12,570 plus all of the dividends might only give you an income of £62,570.

If a lender applies a four-times multiple of salary, using a lender that uses the value of your contract could mean your borrowing was increased by more than £125,000 compared to methods 1 and 2 as explained.

What documents you’ll have to provide

When a lender is using the value of your contract as their method of calculating income, you’ll typically have to provide the following documents to support your application:

- Your most recent one or two contracts
- Both your SA302 forms and tax year overviews (from HMRC) for the past two or three years (mainly to confirm your tax has been paid)
- 6 months’ business bank statements

The three methods compared

This example will show why it matters that you find an expert with experience of assisting self-employed borrowers when it comes to getting a mortgage, and demonstrates the value Altura can add.

You're a contractor, earning a day rate of £400.

According to your latest accounts, your net profit was £60,000 after you took a salary of £12,570. You decide to take dividends of £40,000.

	Method 1 - salary and dividends	Method 2 - salary, dividends and retained profits	Method 3 - Value of contract
Salary	£12,570	£12,570	
Dividends	£40,000	£40,000	
Retained profit		£20,000	
Revenue (assuming 5 days a week, 46 weeks)			£92,000
Borrowing potential at 4x income	£210,280	£290,280	£368,000

Self-employed? We'll help you find the right mortgage

As we have seen, lenders treat self-employed applicants in a range of ways. Whether you're a sole trader, you own a 25% stake in a large business, or you're a freelancer or contractor, each bank and building society will treat you differently.

Most mortgage brokers are comfortable with method 1, and that's what they will use. They may tell you that your maximum borrowing level is based on your salary and dividends, and that's the biggest mortgage they can obtain for you.

At the other end of the spectrum, there are some brokers who specialise in working with contractors. While they might be able to find the lending you need, they won't consider alternative ways of measuring your income and so are restricting the choice of lenders available. This means you might not get the best rate.

When we meet self-employed clients, we always consider all three ways of measuring income. Only by doing this can we get you both the amount you need to borrow and the most competitive deal available.

Additionally, our wide experience in working with self-employed clients means we can make sure you're completely prepared and in a great position to move quickly.

For example, one of the advantages of working with Altura is that we can give you advice on how you structure your income well in advance of applying for your mortgage.

Chatting to a specialist even a year or two before you apply can give you some idea of the level of income you'll need to declare in your accounts or self-assessment in order to get the mortgage you need.

To find out how we can help you to find the mortgage you need

Call: +44 (0)20 3411 0079 Email: info@alturafin.com

Please Note: Your home may be repossessed if you do not keep up repayments on a mortgage or other loans secured on it.

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