Contractor mortgages: a guide to mortgage options

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Contractors are able to access the same wide range of mortgage options and competitive rates as salaried employees, when they use specialist brokers says Taj Kang of Contractor Mortgages Made Easy (CMME), who specialises in advising contractors.

"The myths that, because they don't have a regular salary from employment, contractors can't apply for mortgages are just that – myths," says Kang. "Thanks to our efforts and working with key lenders, mortgage companies now recognise that contractors represent a distinct and growing section of the UK's workforce, and we have been able to influence the development of financial products to suit their needs."

So what's the process? Once a contractor decides they want to buy a home and have chosen their property, the next step is to secure a mortgage from a lender. Working with the assistance of a contractor specialist Mortgage Consultant, the contractor will choose what kind of mortgage suits their financial needs.

A Mortgage Consultant can find deals that are not normally available direct to high street customers and will assess how much the contractor can borrow and afford to repay. The Consultant will then approach the lender on their behalf to arrange a mortgage agreement in principle.

What is a mortgage?

"A mortgage is essentially a long-term loan provided to a contractor to enable them to purchase a property. Residential mortgages are for properties that are intended to be their main residence. If you are purchasing an investment property then there are other types of mortgages available such as buy to let," says Kang.

Mortgages are just like any other loan but, as Kang points out, they have distinguishing features, such as the term over which the loan is taken, the level of interest, how this interest is charged, and the fact that the property is used as security for the lender.

So, a contractor borrows the capital, a chunk of cash used to actually buy the property, and then repays the loan usually over an agreed period, typically between five and thirty years. Depending on the type of mortgage, repayments can be made up of a combination of interest on the loan and paying back the original sum borrowed, the capital or borrowers can follow the increasingly rare interest-only route.

As with most loans, mortgage interest is calculated as a percentage of the original loan amount borrowed. Interest rates determine how much extra money a contractor must pay on top of the original loan amount and they can have a huge impact on monthly repayments. Even seemingly tiny moves in percentage points can make a big difference to a contractor's monthly mortgage payment. For example, an increase of 1% in the Bank of England base rate would result in an average increase of approximately £165 per month in a mortgage payment, for a loan of £198,000.

How lenders assess contractors for mortgages

According to Kang, the days are long gone when self-employed contractors had to present three years of accounts, or go down the expensive self-certification route to determine what they could afford to borrow. Lenders will now base mortgage size on affordability calculations that are applied to gross contract values.

"The lender will want to see a signed copy of the contract" continues Kang, "and will calculate an annual contract rate based on the hourly or daily rate and the number of hours and days worked in a year. The amount the contractor can borrow is based upon affordability these days rather than a multiple of income. However, if you want a very crude multiple to work with, usually a multiple of around four times the annualised contract rate isn't too far away from the affordability calculation for most. This approach often means that contractors can borrow more than their permanent employee counterparts."

Kang warns contractors about trying to seek mortgages from regular high street lenders: "Contractors will find that high street lenders' mortgage advisers, and mortgage brokers who are not contractor specialists, are highly unlikely to be able to package your application in a way that can ensure success because they simply don't understand how contractors work and lack the key contractor friendly contacts within the lenders' underwriting teams."

Repayment mortgages

There are two main options for repaying the loan, repayment mortgages and interest-only mortgages.

“A repayment mortgage is where the contractor borrows the capital to purchase their property and immediately begins repaying the mortgage debt,” says Kang. “Each monthly payment has a component of interest and a component of repayment of the original capital sum borrowed.”

The advantage of a repayment mortgage is that contractors start to pay off the original mortgage capital from day one. The monthly payments can be higher than interest-only mortgages but to counteract this you could take the mortgage over a longer term to reduce your monthly repayments.

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>
> Taj Kang, CMME

Interest-only mortgages

An interest-only mortgage can offer contractors, particularly first-time buyers, the option of low monthly payments, but Kang warns that, because the monthly payments only cover interest and do not pay down the original capital sum, contractors should always consider taking out an interest-only mortgage alongside another financial product or investment vehicle. The idea of this is that the investment should generate sufficient sums to pay off the full amount of the debt in the future, just in case the equity in the property does not cover the capital when the contractor sells.

Interest-only mortgages often ran alongside the endowments sold in the eighties and nineties. These investment plans built up over time with the intention of clearing the loan at the end of the term. However, these were often mis-sold and many endowment mortgage holders found that the value of their endowment fell short of the sum required to repay the loan.

As a result, endowment mortgages are no longer sold. If a repayment mortgage really isn’t the right route, then an Individual Savings Account (ISA) or pension mortgage can be far more transparent, cost effective and tax efficient an investment than the old style endowment route but, as with any stock market based plan, returns will inevitably be uncertain and there is no guarantee that the eventual pay-outs will be sufficient to repay the debt.

Taj Kang

Mortgage Specialist

Contractor Mortgages Made Easy

Taj Kang was formerly a Mortgage Consultant with 12 years of advice experience, and is now Business Development Director for Contractor Mortgages Made Easy.

Contractor Mortgages Made Easy are a specialist, mortgage and protection advisory service who have been servicing the needs of contractors and freelancers since 2004. **Read Full Profile...**

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Kang urges contractors who may have thought they were unable to gain access to a mortgage to seek advice from specialist advisers. He concludes: “Not only can contractors get a mortgage, but they can also often afford to buy a better home than a traditional employee.”

For further details of the various contractor mortgage products currently available, see the ContractorCalculator article, “Contracting and mortgages: contractor mortgage products.”

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