Ten top tips for securing contractor mortgages and loans

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Contractors can improve their chances of securing a mortgage or loan by understanding how lenders rate their customers and by adopting some basic financial strategies.

"Contractors are a genuinely unique case when it comes to financial products," explains Taj Kang of specialist mortgage broker Contractor Mortgages Made Easy (CMME). "So the greater understanding they have of how lenders think, the greater chance they will have of securing finance for their dream home."

Kang has assembled ten top tips contractors can use when applying for a mortgage or loan.

1 - Avoid high street lenders

"Contractors often find that they receive an initial positive response from high street lenders, such as banks and building societies, but are then turned down for a mortgage once they put an offer in on their new home," notes Kang.

This is because high street lenders initially only conduct a superficial credit check. When they complete a more in-depth check when the contractor formally applies for a mortgage, the lender attempts to pigeon-hole the contractor.

Either the financial institution assumes the contractor is a limited company director where typically only salary and dividends will be taken account of, or as a permanent employee employed by an umbrella, where issues arise when payslips are heavily weighted towards commission and expenses.

"What's worse is that contractors who have failed a mortgage application with a high street lender through no fault of their own then find it difficult to secure any lending, because the failed application has left a mark on their credit file. Contractors should only go to specialist IFAs and lenders," adds Kang.

2 - Find a lender happy to use annualised contract rates to set lending limits

The good news for contractors is that those lenders and mortgage brokers who understand them use an annualised contract rate when calculating how much they can borrow. Kang explains: "Contract-based underwriting takes a contractor's daily rate and multiplies it typically by 48 weeks per year to come up with an annualised rate. That annualised rate is then subject to an affordability calculation by the lender, typically it can be multiplied by circa four times to give the contractor's borrowing limit."

Alternatively, some lenders will look at the total salary and dividend paid based on the past two to three year's accounts. Kang says that using the annualised contract rate tends to be better as contractors can present a better picture of their affordability for the new mortgage.

3 - Use your company accounts to back up your mortgage or loan application

Freelancers, who tend to work on a project and ad hoc basis rather than having a contract, qualify for special underwriting, which uses the salary plus the net profit of the business, based on company accounts.

"Lenders understand that freelancers take a low salary for tax reasons, but tend to be highly profitable, even though many don't take all of the profits they could as dividends," says Kang.

When applying for mortgages, freelancers need to supply up to three years of accounts, three months of bank statements and two forms of identification.

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> Taj Kang, CMME

4 - When doing your sums, remember you can't use company money for offset mortgages

"Contractors can run up huge cash surpluses during the year, made up of money saved for corporation tax, income tax and VAT," says Kang. "But this money belongs to the contractor's company and not them personally.

However, this doesn't stop contractors from utilising this popular loan type as many link their savings and current accounts to the offset account to significantly reduce their mortgage interest.

5 - Make sure you achieve and maintain a good credit rating

"Contractors must have a good credit rating to ensure they qualify for the most competitive contractor mortgages," warns Kang. He says that events adversely impacting on credit ratings include:

Missed or late payments for loans, credit cards and utility bills. These remain on a contractor's credit profile for up to six years

Having a credit facility that remains unused. A contractor might have a credit card they never use with a £10,000 limit ready for emergencies. But even unused the £10,000 limit contributes to the contractors total liability. Contractors not using such facilities should close down or reduce them

Credit cards up to their limits and large overdrafts suggest that a contractor is reliant on this credit, which will harm their rating

Contractors should be on the electoral register where they are living. They should make sure they are not on old registers from previous addresses, and that they have changed their address with all of their contacts. Multiple addresses are a negative factor

County Court Judgements (CCJs), debt management plans and individual voluntary agreements (IVAs) are a definite 'no no'. They will remain on a contractors records for up to six years, while a bankruptcy remains for life, blighting the chances of securing any credit at all

Financial links to other people, such as a spouse or housemate. If a contractor's spouse has a poor credit history, this will impact on the contractor's ability to borrow.

"If a contractor is no longer linked to an ex-spouse or partner, they should ensure that link is removed in case that person gets into financial trouble," adds Kang.

Contractors can have a shock in some circumstances, finding that their potential lender rejects their application because of something in their past.

6 - Understand how targeted lenders use credit ratings

According to Kang, most lenders use a bespoke algorithm to evaluate credit scores and create an internal score card for each contractor: "Some lenders view events differently from others. A lender evaluating a £100,000 loan with a 30% deposit will view a contractor's financial history differently from one being asked for a £500,000 mortgage with a 5% deposit.

"It's important to try and understand what the lender might see as 'too risky', and target your application accordingly."

7 - Big deposits win

Not surprisingly, contractors with large deposits are more likely to secure a mortgage. Lenders look at the contractor's credit profile and their loan to value ratio. Contractors with smaller deposits borrowing with a high loan to value ratio may have to answer more questions and jump through more hoops because the lender views them as a bigger risk.

This is also true for remortgages, but if a contractor has an existing mortgage and has always made timely payments, this will work in their favour and should increase the chances of them being awarded the mortgage.

8 - Avoid breaks in contracting

"One of the attractions of the contracting lifestyle is the ability to take long breaks for holiday, travel and other reasons," explains Kang. "But if those breaks exceed eight weeks over an average twelve-month period, then lenders start to have concerns."

Most lenders look for a 12-24 month employment or contracting track record with no more than eight weeks between each contract. Lenders can view contractors as inherently risky, but a contractor's good track record will encourage a lender to take a calculated risk. Contractors also tend to get better deals via more choice of lenders if they can prove their healthy track record.

9 - First-time contractors can still qualify for mortgages

"Despite the requirement for a track record, there are lenders who will offer first-time contractors competitive mortgage deals," says Kang. "A track record will secure the best deals, but first-timers can still get their foot on the property ladder."

Kang continues: "Because contractors are unique, the best mortgage and loan deals are offered by lenders who understand contractors and who are represented by specialist mortgage brokers. There are some deals which only specialist contractor brokers can access."

10 - If your contracting sometimes leaves you cash rich, apply for mortgages that allow additional payments

"When savings rates are low, it's a great time to pay off mortgages or over-pay your monthly payment," says Kang. Contractors are often in a good position to do so, as they can have runs of high-paying contracts that allow them to pay healthy dividends.

Taj Kang

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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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“When the interest on savings is less than mortgage interest rates, then it makes sense for contractors to pay off their mortgage rather than have their savings appreciate at a rate lower than the interest they are paying on loans,” says Kang. “So, if you’re likely to be able to make over-payments or pay off your mortgage early, this needs to be planned for when making the application.

“Make sure the lender will allow you to pay chunks off early without penalty", he says. “But be aware that most mortgages don’t allow contractors to pay off more than around 10% a year, if at all.”

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