I EARN ENOUGH, WHY DON'T I QUALIFY?

You've used the online calculators and you might have even gotten pre-approved by your bank, but now you've found your dream property! Next step, get approved … right?

Online calculators are great when you are salaried, with a minimum of two years at your current job. They work well too if you have no bonuses, commission, or overtime income and certainly not on probation.

But what if your income is not standard, salaried with tenure? Sure, when you use your "real" income, the calculator says you will qualify but will the lender be able to use all your income?

Depending on the lengths your lender goes to for your pre-approval, it might not be worth the paper it's printed on. All too often homebuyers are pre-approved but once they have an offer on a property, the bank declines them.

Here are some situations that might throw a wrinkle in your Real Estate purchasing plans.

Understand your pre-approval

A few years ago, Canadian Mortgage Trends published an article which exposed the misconceptions of realtors and borrowers alike when it comes to mortgage "pre-approvals".

The biggest takeaway was: "virtually no lender actually offers a pre-approval that matches the marketplace's definition". When I try to explain to borrowers that a pre-approval is just a rate hold, they become confused and often ask why it isn't just called a "rate hold"? Great question!

Even lenders who internally refer to the process as a rate hold issue a pre-approval certificate to fuel the confusion.

So why is a pre-approval just a rate hold?

From the lender's perspective, they see the pre-approval process as a bit of a waste of time. Only one in ten pre-approvals ever becomes a live deal, meaning that the file is submitted to the same lender for approval. So, pre-approvals can be a waste of valuable resources.

For this reason when a file is submitted to a lender for pre-approval, they look through the information in the application and they MAY review the credit bureau. For several lenders, this process is automated so isn't even reviewed by an underwriter.

What is missing for this to be a true pre-approval?

1. None of the documents that you submit, if they are even asked for, are reviewed and accepted by the lender
2. There is no property to verify fits the lenders guidelines

If your income isn't guaranteed, there is not a two-year history of "proven income", or the property or reason for purchase (i.e. rental property) doesn't meet the lenders guidelines, they won't know this until they review all the documentation. This is when your deal can go sideways.

When income is an issue

As previously mentioned, there are numerous reasons why a lender may not be able to use the same income as you might for qualification.

1. ***Self-employed***

   Those of us that are self-employed know that we rarely claim all our income because when we do that, we pay more income tax. Being able to claim less income is one of the advantages to being self-employed.

   The disadvantage of claiming a lower income is what you qualify for when it comes to a mortgage. Lenders want to see a two-year history of line 150 of your Notice of Assessment (NOA), and this is income they will typically use for qualification.

   If you're a sole proprietor, we may be able to add back your non-cash expenses or even gross your income up. If you're incorporated, and not claiming enough income, you may have to qualify under a different program – Business for Self (BFS).

   If a borrower is qualifying under a BFS program, we can look at the corporation's income instead of the individual's personal income. The downside to this program is, like all mortgage rules, it's getting more and more difficult to qualify.

   There is a trade-off: do you claim less income, pay less tax, but not qualify, or qualify at higher rates, for the home you want to purchase; or do you claim more income, pay more tax and qualify for the purchase price you want?

   The answer is "it depends" but if you plan to increase your income, you might need two years' head start to get your two-year average where you want it to be.

2. ***Hourly***

   Provided you're guaranteed a MINIMUM number of hours, or have been at your job for at least two years, hourly income will not be an issue. If you are not guaranteed a minimum number of hours you may have to wait until you've been with your employer for two years, or have a minimum of 20 per cent down, to use your income to qualify for a mortgage.

When using guaranteed income, we can only use the minimum number of hours a borrower is guaranteed (not average, or overtime) if they've been at the job less than two years. So, if your guaranteed hours are 40 per week, but you typically work at least 3 hours of overtime, we can only use 40 for income qualifying purposes.

If a borrower has been at their job for two or more years, and is casual or part-time and/or works overtime or receives incentives, as with someone who is self-employed, we must use a two-year average of their income – using line 150 of their NOA.

3. ***Bonus/Commission/Tips***
   Bonus, commission and tip income are just a few examples of varying income. They are considered in a similar fashion to hourly income - we need a two-year average. So, if there isn't a two-year average, this "discretionary" income can't be used to qualify.

   Some lenders will even cap the amount of commission income a borrower can use. If you're 100% commission based, you want to understand if this is going to be an issue with the lender you choose.

   The same goes for tip income – like in the case of serving staff. If it's not on your pay cheque, and you aren't claiming it, unless you have 20 per cent down, you won't be able to use it.

4. ***Retired***
   Retirement is our goal in life, isn't it? We'll be debt free, living the good life, no cares in the world, right? Well, for many, that's not the case.

   With the increasing number of Canadians hitting retirement without a pension, bringing in enough money to cover their monthly costs, or get just a little more out of retirement, is stressful.

   There are options! How about downsizing and using some of that home equity to invest and start paying yourself monthly? In this scenario, we can use CPP, OAS and pension income when it comes to qualifying for a mortgage.

   There's also a reverse mortgage. A reverse mortgage allows you to use the equity in your current home without having to make monthly payments. You paid off your mortgage for a reason, right? Let that hard-earned equity help you enjoy retirement. The advantage here, because you don't have to make payments, qualification is based on the property and the equity you've built.

   I've heard many negative comments about reverse mortgages but I truly believe they are a great tool. If my parents get to the point that they need a little extra at the end of each month to enjoy life or pay for unforeseen medical expenses, I would recommend this product to them. They earned it, they should reap the reward.

I've always said, if they die at the ripe old age of 110, with one cent in the bank, that would make me happy. Inheritance is the consolation for losing your loved ones too early for them to spend all their hard-earned money.

It's not you, it's the property

1. ***Rentals***

   The new mortgage rules, those introduced in the fall of 2016, have made it difficult for many lenders to continue to offer the same products that they used to offer.

   If you're buying or trying to refinance a rental property, for example, you'll find that many lenders are no longer offering these products. If they are still offering them, they're doing so with much greater restrictions.

   Another issue may be whether you can use rental income to help you qualify for the purchase. Is there already an active lease agreement? That will certainly help.

   Despite a lease agreement, most lenders will still only allow you to use 50% of the rental income to help you qualify. They don't like to see heavy dependence on rental income, it can make the deal look very risky – when the rental market turns and the property sits empty for a few months, will you go into default? Believe it or not, the lender doesn't want your property, they want you to pay, on time and stay with them for the life of your mortgage. Foreclosure is costly …

   It's important to make sure your intentions are clear when you talk to your lender about getting pre-approved. If the property is going to be a rental, make sure they know that up front so that you're not wasting your time and working under false expectations.

2. ***Type of property***

   The type of property has a lot to do with whether a lender will approve the loan. Condos, agricultural land and raw land are just some examples of harder to finance properties.

   When lenders, or default insurers (i.e. CMHC), have had a bad experience with a certain builder or property, as can be the case for condominiums, regardless of whether you qualify, the property will be declined.

   In this scenario, your only defense is ensuring you have access to multiple lenders and these lenders have access to all three default insurers. This ensures your bases are covered in the case you have a lender or insurer that's not on board.

   In some cases, this might be a red flag that you might want to look further into, but in many cases, these are well managed, well maintained properties and the lender or insurer are working off outdated information. Unfortunately, you don't usually have time to gather the required data to change their minds.

When it comes to property that is zoned agricultural, or doesn't have a home on it (i.e. raw land), many of the traditional lenders balk or have very stringent lending requirements, like increased down payment.

When it comes to these types of properties, mobile homes being another, we often turn to local Credit Unions. They have their finger on the pulse and understand the local market and needs of Albertans.

3. ***Location, location, LOCATION!***

   Just like various property types, not all lenders like all the nooks and crannies of Alberta.

   Rural Alberta is beautiful and, for some, offers the lifestyle they've been looking for. However, it doesn't come without its own qualifying challenges.

   Just like with all the other income and property scenarios listed, if you want to live somewhere that's not on the beaten path, you may have access to fewer lenders and, potentially, higher rates.

Now, it gets even more complicated when you combine two or more of the above situations – you're self-employed and you want to buy in rural Alberta. This is where a Mortgage Broker can help you find which lenders will offer the product you need, before you fall in love with a property you might not be able to qualify for.

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