Mortgage Qualifying Today and Tomorrow

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A tax professional is trained and motivated to do two things, get tax forms right and minimize tax liability. They are not trained to make sure that tax returns are constructed in such a way that maximizes income for mortgage loan qualifying purposes. Most real estate investors are not tax experts. They just sign the tax documents where indicated by their CPAs and then send in the tax returns. This can unknowingly have a negative impact on their access to low cost financing.

An active real estate investor needs and requires access to capital, otherwise they are stuck using cash, personal credit, and other expensive arrangements not entirely under their control. To maintain adequate access to low cost funds all lenders will be very interested in the ability to repay the loan and will insist on verification. The days of "stated income" and "no income" loans are a thing of the past for residential real estate loans. The main source of information that most lenders rely on is what is submitted to the IRS, or more simply the tax returns averaged over two years, the amount one claims as income, the amount and classification of expenses, and how one pays for operational costs. ALL of this information matters when it comes to maximizing your "mortgage" income.

Let's start with the basics and several tips:

1: Whether owned in a personal name or a business entity, establish a business checking account for your real estate activities.

2: An absolute must is to make certain that the bank you choose provides an online functionality that allows you to print copies of any and all transactions made. Fannie Mae (FNMA) requires ALL deposits in excess of 15%, in single or in aggregate, of standard payroll deposits to be verified and proven. If your bank does not have a web-site that is robust enough, this task can be almost impossible to achieve, especially if your tenants pay in cash. By splitting out the business activity from personal, the personal checking account can be used solely for loan approval reasons without having to verify every non-payroll deposit.

3: Do not co-mingle funds. Keep personal accounts for personal reasons and business accounts for business reasons. Have the business pay all its debts from the business account. If you need to move money from one account to the other be sure to write yourself an invoice and retain for record keeping, calling it a loan from or to owner, share holder, or member. Loans are not income. Repayment of the loan from or to a stock holder is only taxable income in the amount of interest paid. Repaid principle is not income. If you dig into your own pocket, make sure the business pays you back.

4: Establish some business credit cards even if they are in your own name. Make certain that 100% of the credit card payments are paid by the business account.

For example, an applicant approached me frustrated because he believed to have great credit, cash in the bank, and to have MADE money with his dozen rentals on top of his day job, but all the banks had turned him down for debt ratio. I asked for his last two years of tax returns so I could help. He had 14 credit cards, all with balances and totaling about $78,000 in debt. His minimum payments were $2,340 per month. My knowledge of taxes allowed me to notice that in his deductions, not only was he claiming mortgage interest, but "other" interest as well.

When I inquired what all this "other" interest was he explained, "Oh, whenever I get a home I give it a credit card. That credit card pays for repairs and other expenses for that house, and that house's rent covers the mortgage and its credit card." I asked do you have a business checking account for the rentals. He did. I asked could we prove the business account made the last 12 payments in a row on these credit cards, which we could with his on line bill pay. Because he properly set up and documented his business expenses, we were able to make that $2,340 leave his debt ratio and he went from 88% debt ratio, denied to 32% debt ratio approved. Loan officers matter too. An active real estate investor's tax returns are usually beyond the ability of most mortgage originators to underwrite and they simply forward the tax returns with minimal review and no explanation. You need an *experienced specialist to make sure all allowable income is counted and all allowable add backs, like one-time expenses, repairs and upgrades or depreciation are included for loan qualification purposes.*

5: Document depreciable improvements, add to acquisition costs and write off.   Depreciate everything you can, as much as you can. You never write a check to depreciation and we call that income for loan qualifying purposes. I regularly see taxes with no depreciation claimed on a property bought 3 years ago with $40,000 in rehab costs. Help your CPA by letting them know what repairs and upgrades you made on the property during the year. Many expenses incurred after purchase can be added to the basis price and depreciated such as a furnace, air conditioner or a roof.

For example, I was reviewing my applicant's taxes and saw $18,000 in "supplies" for that tax year. That is $1,500 a month! I asked what this was and she explained it was the supplies for rehab of the home. It was for windows, roofing, etc. She coded these expenses as "supplies" in her accounting program and her CPA did not inquire. Were it properly documented this cost of rehab would not be held against her income for that tax year and would have lowered her debt ratio more than 25%. The method of expensing did achieve absolute tax minimization but at the detriment of her ability to get approved for a loan. She could also be faced with penalties and fees if even audited.

6: Do not claim mileage in excess. It is an easy way to lower your tax liability but there is no way we can wash it out or add it back to your income. If you claim it, it is an expense.

Once you find that mortgage individual who knows how to review tax returns, be sure to show your taxes to them before filing. The industry has stopped allowing an applicant to amend their taxes and apply for a loan using the amended tax returns. Once you file, you own it for two years as the industry averages the last two years income in review of the ability to pay.

Let's finish with this thought.

If that $6,000 income tax refund you get in April causes you to be ineligible for a new loan in your own name for the next two years, overall how expensive was that refund? How do you grow your real estate business without access to loans? Think, how many deals you cannot do, all for a $6,000 tax refund?

If you would like to speak to an expert on qualifying for a mortgage, please feel free to contact me, Graham Montigny CRMS, at 614-309-0427.
**The above is not legal advice or tax advice. The above IS mortgage qualification advice.*

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ReCasa Financial Group, LLC specializes in providing loans to successful real estate investors for the purchase, refinance or rehab of one to four family, non-owner occupied residential properties. The rehab program offers 100% financing for the purchase, improvements and soft costs associated with a rehab project. If you wish to learn more about ReCasa Financial Group and how they help investors please visit www.ReCasaFinancial.com or call 614-221-6770.