Los Angeles Times REAL ESTATE

The switch to self-employment has mortgage implications

By Lew Sichelman

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Despite excellent credit, it's still possible to be turned down for a mortgage due to new rules on verifying that borrowers have the ability to pay.

I am an unintended consequence.

I have loads of money. I own four properties free and clear. I have no debt. My credit file is impeccable. I have a credit score of 760.

And I was just turned down for a mortgage.

Not just any mortgage, but a cash-out refinance of less than six figures on a foreclosure I bought for cash, rehabbed and turned back on the market as a rental. Furthermore, I was only asking for a loan-to-value ratio of 70%, meaning I was leaving 30% of the home's value as equity. And I was rejected.

All of my rental properties are fully leased, each supported by current rental agreements. The lender had copies of my tax returns for 2011 and 2012, each year validated by copies from the IRS. The lender also had copies of each and every one of my bank statements.

And the lender still said "no."

I pay all my bills on time. As soon as a bill arrives in the mail, a check goes out — in full. The very next day. Every bill, no matter how big or small, out the next day. Sometimes I even take the envelope to the post office the same day. But the lender doesn't think I am a good risk.

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The reason: I had recently switched from being a W-2 employee who also had 1099 wages to a full-time 1099 worker. That is, I left the world of the fully employed to that of a full-time freelance journalist.

And because I could not show that I earned enough 1099 income over the last two years to pay for the loan — the history just wasn't there — the lender's underwriters said I wasn't a good enough risk.

Here's what my denial form letter said: "Due to change of employment from some W-2 to all self-employment, Fannie Mae cannot approve due to the short time of all self-employment."

Now, my loan officer is as aghast as I am. But he's not the one who gets to make the decision. He's basically a salesman. It's the underwriters who have the final word. Not even my agent's branch manager held any sway. The underwriters said "no," and that's that.

Oh yeah: I was told, come back in 2014 when you can show at least 12-18 months' worth of freelance or contractor income, and we will give your loan application another look.

Thanks a lot, Dodd-Frank. Thanks much, Consumer Financial Protection Bureau.

Dodd-Frank is the common name associated with the Dodd-Frank Wall Street Reform and Consumer Protection Act, the law Congress passed in 2010 to make sure the kind of lending that brought on the housing recession never happened again. You know, the liar loans, also know as no-doc ("no documentation") loans, in which all the borrower had to do was fog a mirror. And the Consumer Financial Protection Bureau is the federal agency created by the law to carry out its dictum.

But surely lawmakers didn't mean people like me when they changed the rules. Now everything is income-based, and borrowers have to prove — and I mean prove — they have the ability to repay. Apparently I can't, at least in the eyes of the underwriters.

It doesn't matter what the underlying value of the property is. It doesn't matter what kind of assets you have in the bank. It doesn't matter whether you have a profit and loss statement. It doesn't matter what your credit score is. It doesn't matter whether you can validate everything.

All those factors are still important, of course. But if you can't show you have enough coming in to support what's going out, those things don't mean diddly.

Don Frommeyer, an Indiana mortgage broker and president of the Assn. of Mortgage Professionals, calls the new ability-to-pay rules the "new gold standard for lending." He says

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lenders now must follow a set of guidelines to establish your income, assets and obligations before deeming you eligible.

And things are becoming particularly tough on self-employed borrowers like me because income is calculated to consider the borrower's write-offs: the tax deductions all of us self-employed dudes take to reduce our taxable income.

So here I sit. What I thought was a slam-dunk mortgage has turned into a pink slip. You got me, legislators. You nailed me, regulators.

You have protected the mortgage system — and the greater economy — from the likes of me. People who have worked hard all their lives and done things the right away. We save, we pay our bills on time — but we can't get a home loan.

I hope you are satisfied.

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