

SELF-EMPLOYED HOME BUYER SURVIVAL GUIDE

The complete playbook for qualifying when you own your own business

Dr. Robert McNeill | NMLS #844916 | Matador Lending LLC

832-701-8144 | robert@matadorlending.com | www.drrobmortgage.com

"Most self-employed buyers find out their tax return is working against them while sitting in a lender's office, already emotionally attached to a house. This guide gives you that knowledge first — so you walk in with a strategy instead of a surprise." — Dr. Robert McNeill

WHAT THIS GUIDE COVERS

Section	Topic
Section 1	Why Your Tax Return Lies to Your Lender — the core problem explained clearly
Section 2	How Lenders Actually Calculate Self-Employed Income — every add-back, every rule
Section 3	Real-World Income Calculation Examples — 6 business types worked through completely
Section 4	Your Six Loan Options — conventional, FHA, and four Non-QM paths explained
Section 5	The Real Cost of Non-QM Loans — honest side-by-side payment comparisons
Section 6	Strategic Tax Planning Before You Buy — how to work with your CPA right now
Section 7	Business Structure & What Lenders See — sole prop, S-Corp, LLC, partnership
Section 8	The Income Trend Rule — the hidden killer nobody warns you about
Section 9	Complete Documentation Checklist — every document, every loan type
Section 10	Self-Employed Buyer Readiness Checklist — is it time to apply?

Section	Topic
Section 11	Month-by-Month Action Plan — 12 months from unprepared to approved
Section 12	Free Tools & Resources

SECTION 1: WHY YOUR TAX RETURN LIES TO YOUR LENDER

This is the most important section in this guide. Everything else builds on it. If you read nothing else, read this.

The W2 vs. Self-Employed Gap

Buyer Type	Income Used for Qualification	Example
W2 Employee	Gross income — before taxes, before deductions	Earns \$90,000/yr W2 → qualifies on \$7,500/month
Self-Employed (Conventional/FHA)	Net profit from Schedule C — after ALL business deductions	Grosses \$120,000 but deducts \$55,000 → qualifies on only \$5,417/month
Self-Employed (Bank Statement)	Average monthly deposits x income factor (no tax return needed)	Deposits \$12,000/month avg → qualifies on \$6,000–\$7,200/month

The self-employed buyer in the example above grosses \$120,000 — \$30,000 more than the W2 employee — yet qualifies for \$25,000 less in income. Their write-offs, which saved them \$15,000+ in taxes, cost them \$220,000+ in purchasing power. This is not a bug. It is the direct, mathematically inevitable result of how lenders are required to calculate income under federal lending guidelines. Understanding this is the foundation of everything that follows.

WARNING | The Deduction Trap

Every dollar you deduct from your business income on Schedule C reduces your qualifying income by the same dollar. A \$10,000 equipment write-off saves you roughly \$2,200–\$3,700 in taxes depending on your bracket — but removes \$10,000 from your qualifying income. At a 43% DTI limit and a 7% mortgage rate, that \$10,000 reduction in qualifying income costs you roughly \$90,000–\$120,000 in purchasing power. This calculation should inform every tax decision you make in the 2 years before you buy.

The Two-Year Averaging Rule — And Its Exceptions

Conventional and FHA lenders require two full years of federal tax returns and calculate a 24-month average of your net income plus allowable add-backs. But averaging is not always what happens — and the exceptions can work for you or devastate you.

Scenario	What Lender Does	Outcome
Year 1 and Year 2 income are stable or increasing	Averages both years	Predictable qualifying income
Year 2 is higher than Year 1	Averages both years (full 2-year average)	Good — higher recent year pulls average up
Year 2 is significantly LOWER than Year 1	Most lenders use Year 2 only — not the average	Potentially catastrophic — can cut qualifying income in half
Year 2 is slightly lower than Year 1 (under ~15%)	May average with explanation letter from accountant	Depends heavily on lender and AUS output
Business less than 2 years old	Cannot qualify on conventional/FHA at all	Non-QM or bank statement loan required

Scenario	What Lender Does	Outcome
Dramatic income swing year over year	Underwriter discretion — often unfavorable	Document the reason with CPA letter upfront

WARNING | The Growing Fast Trap — The Counterintuitive Math

If your business went from \$50,000 net in Year 1 to \$90,000 net in Year 2, your 2-year average is \$70,000 — \$833/month LESS than if you had flat \$73,000 income both years. Now consider this: if that \$90K Year 2 is followed by a \$60K Year 3 (perhaps due to a large equipment purchase or a slow quarter), many lenders will use \$60K only — cutting your qualifying income by 33% from just one year ago. Stable, predictable, upward-trending income is worth far more to a lender than a dramatic growth story.

SECTION 2: HOW LENDERS ACTUALLY CALCULATE YOUR INCOME

Lender income calculation for self-employed borrowers follows a specific worksheet — typically Fannie Mae Form 1084 or Freddie Mac Form 91. Knowing exactly what they add and subtract lets you calculate your own qualifying income before you ever sit down with a lender.

The Add-Back System — Getting Income Back

Certain deductions you took on your tax return are added back to your Schedule C net income because they do not represent real out-of-pocket monthly costs. Most self-employed buyers are unaware of how significant these add-backs can be.

Item	Added Back?	Source on Return	Why
Depreciation (all types)	YES — always	Form 4562 / Sch C Line 13	Non-cash accounting entry — no money actually left your account
Business use of home	YES — always	Schedule C Line 30	Fannie Mae adds this back in full per guidelines
Depletion	YES — always	Schedule C Line 12	Non-cash resource accounting entry
Amortization of business startup costs	YES — always	Schedule C / Form 4562	Non-cash amortization entry
Vehicle depreciation component	YES — partial	Form 4562	Only the depreciation portion of mileage/vehicle deduction
One-time non-recurring documented losses	YES — if documented	Various	Requires CPA letter confirming non-recurrence
Casualty or theft losses	YES — if documented	Schedule C	Non-recurring events proven by documentation
Meals & entertainment (50%)	NO	Schedule C Line 24b	Ongoing operating expense
Advertising & marketing	NO	Schedule C Line 8	Ongoing business cost — expected to continue
Health insurance premiums	NO	Schedule 1 Line 17	Ongoing personal expense
Home office utilities (not depreciation)	NO	Schedule C Line 30	Only the depreciation component is added back
Employee wages paid	NO	Schedule C Line 26	Real ongoing liability
Interest expense	NO	Schedule C Line 16b	Real monthly cost
Rent/lease payments	NO	Schedule C Line 20b	Real monthly obligation

The Calculation Formula — Step by Step

How to Calculate Your Own Qualifying Income (Sole Proprietor)

Step 1: Find Schedule C Line 31 (Net Profit or Loss) — Year 1 and Year 2

Step 2: Add back Form 4562 total depreciation for each year

Step 3: Add back Schedule C Line 30 (business use of home) for each year

Step 4: Add back Schedule C Line 12 (depletion) if applicable

Step 5: Subtract any non-recurring income (one-time large gains should not be averaged forward)

Step 6: Subtract Schedule C Line 9 (car/truck mileage expense minus depreciation component already added back)

Step 7: Add Year 1 adjusted total + Year 2 adjusted total, then divide by 24

Result: This is your approximate monthly qualifying income for conventional/FHA

Use the free SE Income Calculator at www.drrobmortgage.com to do this automatically.

SECTION 3: REAL-WORLD INCOME CALCULATIONS BY BUSINESS TYPE

The same rules apply differently depending on how you structure your business and what deductions you take. Here are six common scenarios worked through completely.

Example 1: Sole Proprietor — Contractor / Tradesman

Item	Year 1	Year 2
Gross Revenue	\$145,000	\$158,000
Schedule C Net Profit (Line 31)	\$62,000	\$71,000
Add: Form 4562 Depreciation (tools/equipment)	+\$18,000	+\$14,000
Add: Business Use of Home (Line 30)	+\$3,200	+\$3,200
Adjusted Annual Income	\$83,200	\$88,200
2-Year Average		\$85,700
Monthly Qualifying Income		\$7,142/month
Without add-backs (Line 31 only)		\$5,542/month
Add-back impact on qualifying income		+\$1,600/month = -\$200,000 more home

Example 2: S-Corporation Owner — Consulting or Professional Services

Item	Year 1	Year 2
W2 Salary from S-Corp	\$65,000	\$70,000
S-Corp Net Income (from K-1, before distributions)	\$38,000	\$45,000
Add: Officer Compensation already in W2	(already counted)	(already counted)
Add: Depreciation from S-Corp return	+\$5,000	+\$5,500
Add: Amortization	+\$2,000	+\$2,000
Total Qualifying Income (W2 + adjusted K-1 share)	\$110,000	\$122,500
2-Year Average		\$116,250
Monthly Qualifying Income		\$9,688/month
Key Note	Must own 25%+ of S-Corp to be treated as self-employed	

Example 3: LLC Taxed as Sole Proprietor

Item	Year 1	Year 2
Gross Business Revenue	\$210,000	\$235,000
Schedule C Net Profit (Line 31)	\$44,000	\$52,000
Add: Depreciation (heavy equipment, vehicle)	+\$31,000	+\$28,000
Add: Business Use of Home	+\$4,800	+\$4,800
Adjusted Annual Income	\$79,800	\$84,800
2-Year Average		\$82,300
Monthly Qualifying Income		\$6,858/month
Without add-backs (Line 31 only)		\$4,000/month
Key Insight	High equipment costs create large depreciation add-backs that dramatically increase qualifying income	

Example 4: Partnership (50% Share)

Item	Year 1	Year 2
Partnership Gross Revenue	\$380,000	\$420,000
Borrower's Share of Net Income (K-1 Line 1)	\$58,000	\$67,000
Add: Borrower's Share of Depreciation	+\$12,000	+\$11,000
Add: Borrower's Share of Depletion	+\$0	+\$0
Adjusted Annual Income (borrower's share)	\$70,000	\$78,000
2-Year Average		\$74,000
Monthly Qualifying Income		\$6,167/month
Key Note	Lender uses borrower's proportional share only; full partnership income is not used	

Example 5: Seasonal Business — Landscaping / Tourism / Construction

Item	Year 1	Year 2
Schedule C Net Profit (Line 31)	\$71,000	\$79,000
Add: Depreciation	+\$16,000	+\$13,000
Add: Business Use of Home	+\$2,400	+\$2,400
Adjusted Annual Income	\$89,400	\$94,400
2-Year Average		\$91,900
Monthly Qualifying Income		\$7,658/month
Key Note	Seasonal income must show 2-year history; lender may require employer confirmation of seasonal pattern	
Red Flag	Gaps in income during off-season are expected — but must be documented and explainable	

Example 6: The Write-Off Heavy Year (Year 2 Decline)

Item	Year 1	Year 2
Schedule C Net Profit — Year 1	\$88,000	
Add: Depreciation — Year 1	+\$9,000	
Adjusted Year 1 Income	\$97,000	
Schedule C Net Profit — Year 2 (large equipment purchase)	\$31,000	
Add: Depreciation — Year 2	+\$47,000	
Adjusted Year 2 Income	\$78,000	
2-Year Average (if lender allows)	$\$87,500 \div 12 =$	\$7,292/month
Year 2 Only (if lender uses declining income rule)	$\$78,000 \div 12 =$	\$6,500/month
Key Lesson	The large equipment purchase created \$47K depreciation that was added back — partially saving this buyer. But the Year 2 income decline still triggered scrutiny. Always discuss major purchases with your loan officer BEFORE making them.	

SECTION 4: YOUR SIX LOAN OPTIONS AS A SELF-EMPLOYED BUYER

You have more paths than most buyers realize. The right loan depends on what your tax returns show, how long your business has existed, what you can put down, and how urgently you need to buy. Here is every option, honestly assessed.

1. Conventional Loan (Fannie Mae / Freddie Mac)

Best if your tax returns show 2+ years of consistent qualifying income after add-backs.

Factor	Detail
Minimum Down Payment	3% first-time buyers / 5% repeat buyers
Minimum Credit Score	620 required / 740+ for best rates
Income Documentation	2 years federal tax returns, Schedule C, Form 4562, YTD P&L;
DTI Limit	43–45% back-end (some lenders to 50% with compensating factors)
Mortgage Insurance	PMI required below 20% down — drops automatically at 80% LTV
Rate	Market rate — best pricing available
Self-Employment Requirement	25%+ ownership for 2+ years — must show 2 full Schedule C returns

Best For

Best for buyers whose Schedule C income plus add-backs qualifies them for their target price with 2 years of consistent returns.

2. FHA Loan

Same tax return requirement as conventional but allows higher DTI and lower scores.

Factor	Detail
Minimum Down Payment	3.5% (score 580+) / 10% (score 500–579)
Minimum Credit Score	580 for 3.5% down
Income Documentation	Same as conventional — 2 years Schedule C required
DTI Limit	Up to 50% with compensating factors
Mortgage Insurance	MIP for life of loan if less than 10% down — does not cancel
Rate	Market rate + MIP surcharge
Best For	Higher DTI or lower credit score self-employed buyers with solid 2-year tax return history

Best For

FHA is not a fallback — it is the right tool for self-employed buyers with higher DTI or lower scores who have 2 clean tax return years.

3. Bank Statement Loan (Non-QM)

No tax returns required. Lender averages your business bank deposits to calculate income.

Factor	Detail
Minimum Down Payment	10% typical / lower available with higher rate
Minimum Credit Score	640+ most lenders / 680+ for best Non-QM pricing
Income Documentation	12 or 24 months business bank statements — no tax returns
Income Calculation	Average monthly deposits × expense factor (typically 50% sole prop / 40–50% corp)
DTI Limit	Up to 50%
Rate Premium	Approximately +1.0–1.5% above conventional rate
Best For	Buyers with strong deposits but aggressive write-offs that gut Schedule C net income

Best For

The most powerful tool for write-off-heavy self-employed buyers. If your deposits are strong but your Line 31 is weak, this is your loan.

4. P&L; Only Loan (Non-QM)

A CPA-prepared Profit & Loss statement replaces tax returns entirely.

Factor	Detail
Minimum Down Payment	10–15%
Minimum Credit Score	640+
Income Documentation	CPA-prepared P&L; for 12–24 months — no tax returns required
CPA Requirement	Must be prepared and certified by a licensed CPA — self-prepared not accepted
Rate Premium	Approximately +1.25–1.75% above conventional
Best For	Newer businesses (12–24 months) or buyers whose P&L; shows significantly more income than their tax return

Best For

Good for buyers in rapid growth who cannot wait for 2 tax return years, or whose CPA-certified P&L; substantially exceeds Schedule C net.

5. DSCR Loan — Investment Properties Only (Non-QM)

Your personal income is completely irrelevant. Qualification is based entirely on the rental property's cash flow.

Factor	Detail
Minimum Down Payment	20–25%
Minimum Credit Score	640+
Income Documentation	None — no personal income documents required
Qualification Metric	$DSCR = \text{monthly rent} \div \text{monthly PITI payment}$. Most lenders require 1.0–1.25 minimum
Rate Premium	+0.75–1.25% above conventional
Best For	Self-employed buyers purchasing rental properties — your business income suppression does not affect this loan at all

Best For

The cleanest path to investment property for self-employed buyers. Your write-offs are completely irrelevant. Only the property's rent matters.

6. Asset Depletion Loan (Non-QM)

Qualify using your liquid assets — savings, brokerage, retirement — with no income documentation.

Factor	Detail
Minimum Down Payment	10–20%
Minimum Credit Score	680+
Income Documentation	Asset statements only — no income verification
How Income Is Calculated	Eligible liquid assets ÷ loan term in months = monthly qualifying income
Example	\$720,000 in eligible assets ÷ 360 months = \$2,000/month qualifying income
Rate Premium	+1.0–1.5% above conventional
Best For	Asset-rich, income-light self-employed buyers — those who have built significant wealth but show modest taxable income

Best For

Ideal for buyers who have accumulated significant assets but have aggressively managed taxable income. Retirement accounts, brokerage accounts, and savings all count.

SECTION 5: THE REAL COST OF NON-QM LOANS

Non-QM loans solve real problems. They also cost real money. Every self-employed buyer deserves to see this comparison in plain numbers before they decide whether to pursue a Non-QM loan now or wait to qualify conventionally.

Loan Type	Rate Example	Monthly P&I; \$300K Loan	Monthly P&I; \$450K Loan	Extra Annual Cost vs. Conventional
Conventional (if qualifying)	7.00%	\$1,996	\$2,994	—
FHA	6.875%	\$1,971	\$2,956	Similar rate + MIP cost
Bank Statement (12-month)	8.25%	\$2,252	\$3,378	+\$3,072 (\$300K) / +\$4,608 (\$450K)
Bank Statement (24-month)	8.00%	\$2,201	\$3,302	+\$2,460 (\$300K) / +\$3,696 (\$450K)
P&L; Only	8.50%	\$2,307	\$3,461	+\$3,732 (\$300K) / +\$5,604 (\$450K)
DSCR (investment property)	8.00%	\$2,201	\$3,302	+\$2,460 (\$300K) / +\$3,696 (\$450K)
Asset Depletion	8.25%	\$2,252	\$3,378	+\$3,072 (\$300K) / +\$4,608 (\$450K)

These are illustrative rates — actual rates vary by lender, credit score, LTV, and market conditions. The principle is consistent: Non-QM loans carry a rate premium of 0.75–1.75% above conventional. On a \$400,000 loan, that is \$3,000–\$7,000 per year in extra interest. Over 5 years, \$15,000–\$35,000.

When the Extra Cost Is Worth It

- > Your Schedule C net income, even with add-backs, qualifies you for far less than you can actually afford based on your deposits
- > Your business is less than 2 years old and conventional/FHA are simply not available yet
- > You are buying an investment property where your personal income is irrelevant (DSCR)
- > You have significant liquid assets and little reportable income (asset depletion)
- > You are buying in a rising market and the cost of waiting 1–2 years to qualify conventionally exceeds the Non-QM rate premium
- > You plan to refinance into a conventional loan within 2–3 years once your tax return history improves or waiting periods are met

When to Wait and Fix the Tax Strategy Instead

If you have 12–18 months of flexibility and your business income genuinely supports conventional qualification, the math sometimes clearly favors adjusting your tax strategy over paying the Non-QM premium. Here is how to think through it:

The Rate Premium vs. Tax Strategy Decision

Ask your CPA: "What would I need to show in net income to qualify conventionally for my target loan amount — and what would I pay in additional taxes to show that income?"

Ask your loan officer: "What Non-QM rate would I qualify for today, and what is my total additional interest cost over the next 3 years versus a conventional rate?"

Compare: Additional taxes paid to show higher income vs. additional interest paid on Non-QM rate. Sometimes the tax is less. Sometimes it is more. The math will tell you which path is cheaper — but you have to run it explicitly. Most buyers never do.

SECTION 6: STRATEGIC TAX PLANNING BEFORE YOU BUY

The tax decisions you make in the 1–2 years before you apply directly determine what home you can qualify for and what rate you pay. This section is where this guide pays for itself. Share it with your CPA.

PRO TIP | Have This Conversation With Your CPA At Least 12 Months Before You Buy

Tell your CPA explicitly: "I am planning to purchase a home in the next 12–18 months. I want to maximize my qualifying income while staying completely tax-compliant. What should I be doing differently this year?" A good CPA who works with self-employed buyers will understand immediately. If they look confused or dismissive, find a CPA who regularly works with real estate investors and self-employed borrowers — the strategy is specific and important.

What to Consider Reducing, Deferring, or Restructuring

Item	Strategy	Impact on Qualifying Income
Section 179 / Bonus depreciation elections on equipment	Defer new equipment purchases until after closing if possible	Can add \$10,000–\$50,000+ back to qualifying income in the purchase year
Vehicle depreciation elections	Use standard mileage instead of actual — or defer new vehicle purchase	Reduces deduction taken, increases net income shown
Business-use-of-home deduction	Keep claiming it — it gets ADDED BACK by underwriters anyway	No strategy needed here — it does not hurt you
Retirement contribution elections (SEP, Solo 401k)	Consult CPA on trade-offs: contributions reduce net income but have long-term benefits	Every dollar contributed reduces qualifying income by one dollar
One-time large discretionary expenses	Defer to year after closing if possible	Preserves net income in the qualifying years
Business structure changes (sole prop to S-Corp)	Do NOT restructure in the year before applying — mid-year changes confuse underwriters	Timing matters more than structure for mortgage purposes
Prepaid business expenses	Avoid prepaying large annual expenses in a qualifying year	Reduces Year 2 net income — can trigger declining income rule

What NOT to Change (These Help You)

Item	Why to Keep It	Underwriter Treatment
Depreciation on existing assets	Underwriters add it back — reducing it gains you nothing	Added back in full — does not hurt qualifying income
Business use of home	Added back by underwriters — no reason to reduce	Added back in full

Item	Why to Keep It	Underwriter Treatment
Revenue recognition timing	Do not defer legitimate revenue into a later year	Lower revenue = lower qualifying income — keep it in
Documented one-time losses	If you can prove non-recurrence with a CPA letter, it may be excluded	Can be backed out with proper documentation

WARNING | Do Not Amend Returns Just to Show More Income

Some buyers want to amend old tax returns to show higher income for mortgage purposes. This is legal — but most lenders require a 24-month waiting period after an amendment before using the amended income. The amendment may also trigger IRS scrutiny. If you are considering this, consult both a CPA and a tax attorney before proceeding, and tell your loan officer first. Some lenders will not use amended returns at all.

SECTION 7: BUSINESS STRUCTURE & WHAT LENDERS SEE

How your business is structured determines which tax forms lenders examine and how they calculate your income. Many buyers do not realize their business structure directly affects their qualifying process — sometimes in significant ways.

Business Type	Tax Form Used	How Income Is Calculated	Key Documents
Sole Proprietor / Single-Member LLC	Schedule C (on Form 1040)	Net profit (Line 31) + allowable add-backs ÷ 24 months	Form 1040 with Schedule C, Form 4562
S-Corporation (25%+ owner)	W2 salary + K-1 (Form 1120-S)	W2 wages + proportional share of S-Corp net income + add-backs	Form 1040, K-1, Form 1120-S, W2
Partnership (25%+ interest)	K-1 (Form 1065)	Proportional share of partnership net income + add-backs	Form 1040, K-1, Form 1065
C-Corporation (25%+ owner)	W2 only (C-Corp income not passed through)	W2 wages only — C-Corp retained earnings cannot be used	Form 1040, W2, Form 1120
Multi-member LLC (taxed as partnership)	K-1 (Form 1065)	Same as partnership above	Form 1040, K-1, Form 1065
Contractor / 1099 Worker	Schedule C (on Form 1040)	Same as sole proprietor — net profit + add-backs	Form 1040 with Schedule C, 1099s

The S-Corporation Advantage — and Its Hidden Complexity

Many self-employed buyers switch to an S-Corp to reduce self-employment tax — a smart move for tax purposes. But S-Corp ownership creates complexity for mortgage qualification that many buyers do not anticipate.

- > You must own 25% or more of the S-Corp to be treated as self-employed by the lender — if you own less, you qualify using only your W2 salary
- > Lenders look at BOTH your W2 salary AND your proportional share of the S-Corp's net income (from the K-1)
- > If the S-Corp has losses in one year, those losses are subtracted from your qualifying income
- > The S-Corp must show positive cash flow sufficient to support the income claimed — lenders examine the business return closely
- > If you take distributions significantly in excess of salary, the lender may scrutinize the business cash flow and sustainability
- > Both the personal return (1040) AND the business return (1120-S) are required — two years of each
- > Some lenders require a business viability letter from your CPA confirming the business is ongoing and stable

WARNING | The C-Corporation Trap

If you operate as a C-Corporation and pay yourself a modest W2 salary (a common tax strategy), the lender qualifies you on your W2 only. C-Corp retained earnings, dividends, or distributions cannot be used as qualifying income under conventional guidelines — regardless of how profitable the corporation is. A buyer with \$500,000 in C-Corp retained earnings and a \$60,000 W2 salary qualifies as if they earn \$60,000. If you operate as a C-Corp and plan to buy, consult your CPA about restructuring well before you need to apply.

SECTION 8: THE INCOME TREND RULE — THE HIDDEN KILLER

This is the rule that surprises more self-employed buyers than any other. Most buyers assume lenders always use the 2-year average. They do not. When income is declining, lenders use only the lower year — and sometimes only the lower amount as a worst case.

How the Declining Income Rule Works

Income Pattern	What Lender Does	Example Impact
Stable: Y1 \$75K, Y2 \$76K	Averages both years	\$75,500 qualifying income — \$6,292/month
Growing: Y1 \$60K, Y2 \$85K	Averages both years	\$72,500 qualifying income — \$6,042/month
Declining slightly: Y1 \$80K, Y2 \$72K	Most lenders use Y2 only; some average with CPA explanation	\$72,000 qualifying income — \$6,000/month
Declining significantly: Y1 \$90K, Y2 \$50K	Lender uses Y2 only — no averaging allowed	\$50,000 qualifying income — \$4,167/month
Y1 \$90K, Y2 \$50K (with CPA letter + good explanation)	Some lenders may average if well-documented	\$70,000 qualifying income — \$5,833/month
Loss in Year 1, profit in Year 2	The loss is subtracted from Year 2 profit — result can be severely reduced	Y1 (\$15K loss) + Y2 \$80K = \$65K ÷ 24 = \$2,708/month

The Year 1 Loss Scenario — Especially Dangerous

If your business showed a net loss in Year 1 and a profit in Year 2, many lenders will subtract the loss from the profit before averaging — or simply use the most conservative number. This is the scenario that eliminates many buyers who thought their growing income made them clearly qualified.

Real Example: The Loss Year Problem

Year 1: Schedule C shows (\$18,000) net loss — startup year with heavy initial expenses

Year 2: Schedule C shows \$76,000 net profit — business stabilized and growing

Buyer's expectation: "I have \$76K income this year — surely I qualify on that?"

What lender does: $\$76,000 - \$18,000 \text{ loss} = \$58,000 \div 24 \text{ months} = \$2,417/\text{month}$ qualifying income

What buyer needed: \$6,500/month to qualify for their target home

The buyer was turned down — not because their business wasn't successful, but because of one startup year that legally had to be included in the calculation. The solution: apply after Year 3, when Year 1 drops out of the 24-month lookback. Or use a bank statement loan that ignores tax returns entirely.

How to Protect Yourself From the Declining Income Rule

- > Plan major expense years so they do not fall in your most recent tax year before applying — if you need a big equipment purchase, do it in Year N-2, not Year N-1
- > If Year 2 income is lower than Year 1 for a legitimate reason (equipment purchase, one-time loss, natural disaster), have your CPA prepare a detailed letter explaining it — some lenders will consider this
- > Pull your tax returns 12 months before applying and calculate what the declining income rule would do to your qualifying number — do this calculation before you fall in love with a house
- > If you are in a declining income situation, discuss the bank statement loan option with your loan officer — it bypasses the tax return calculation entirely
- > Avoid filing for any year until you have reviewed the income trend implications with your loan officer — an extension gives you time to think through the strategy

SECTION 9: COMPLETE DOCUMENTATION CHECKLIST BY LOAN TYPE

Being organized is one of the highest-value things a self-employed buyer can do. A complete, organized file closes faster, generates fewer conditions, and signals to the underwriter that you are a reliable, prepared borrower. Disorganization creates delays that can cost you a home in a competitive market.

Conventional / FHA Loan Documentation

Document	Details / Common Mistakes
Federal 1040 tax returns — 2 years	Must be COMPLETE — all pages, all schedules, all attachments. Signed. Unsigned returns cause delays.
Schedule C — 2 years	Line 31 is your income baseline. Know this number before you walk in.
Form 4562 (Depreciation) — 2 years	Critical for add-back calculation. Many buyers don't know this form exists or where to find it.
Business returns (S-Corp/Partnership) — 2 years	Form 1120-S or 1065. Both years, complete. All K-1s included.
W2s — 2 years (if S-Corp or paid salary)	Must match exactly what is on the tax return.
Pay stubs — most recent 30 days	If you pay yourself W2 salary from your business.
Personal bank statements — 2–3 months	All pages. Even blank pages. Missing pages = conditions = delays.
Business bank statements — 2–3 months	Required if down payment funds will transfer from business to personal account.
YTD Profit & Loss statement	CPA-prepared strongly preferred. Must be current within 60 days of application.
Business license or entity documents	Proves 2+ year business existence. Pull these now — some take weeks to obtain.
CPA / Accountant contact information	Lender will likely call your CPA to verify the returns are accurate. Prepare your CPA.
Explanation letter for any unusual items	Large one-time expenses, losses, income swings — prepare written explanations in advance.

Bank Statement Loan Documentation

Document	Details / Common Mistakes
Business bank statements — 12 or 24 months	ALL pages every month. No gaps. Missing a single month creates a condition.
Business license or entity formation docs	To verify business existence and ownership percentage.

Document	Details / Common Mistakes
CPA letter on business expense ratio	Some lenders require this to support their income factor calculation.
Personal bank statements — 2–3 months	For asset verification and down payment sourcing.
Personal tax returns — some lenders still request	Even if not used for income, some lenders want them for file completeness.
List of large non-revenue deposits	Transfers between accounts, loan proceeds, or other non-income deposits must be identified so they are excluded from deposit average.

P&L; Loan Documentation

Document	Details / Common Mistakes
CPA-prepared P&L; — 12 or 24 months	Must be prepared and signed by a licensed CPA. Self-prepared P&Ls; are not accepted.
CPA license verification	Lender will verify CPA is licensed and in good standing.
Business bank statements — same period as P&L;	To cross-reference the P&L; figures for plausibility.
Business license or entity docs	To verify business existence.
Personal bank statements — 2–3 months	For asset and down payment verification.

PRO TIP | Create a "Mortgage Ready" Folder Today

Right now — set up a digital folder labeled "Mortgage Documents [Year]" in Google Drive, Dropbox, or on your desktop. Every time you receive a tax return, bank statement, CPA letter, business license renewal, or any relevant document, drop a copy in immediately. When you are ready to apply, you will have everything organized and retrievable within minutes instead of scrambling for weeks. This single habit can shorten your loan process by 1–3 weeks and eliminate most underwriter stall conditions.

SECTION 10: SELF-EMPLOYED BUYER READINESS CHECKLIST

Use this before calling any lender. If you can check every box in your target loan type, you are ready to apply. If not, you know exactly what to work on first.

Income & Tax Returns — Conventional/FHA

- I have 2 complete years of federal tax returns including Schedule C and Form 4562
- I know my Schedule C Line 31 net profit for both years
- I have calculated my add-backs (depreciation, home office, depletion)
- My adjusted qualifying income qualifies me for my target home price
- My Year 2 income is equal to or higher than Year 1 (no declining income issue)
- My business has been operating for 2+ continuous years
- I have a current YTD P&L; statement prepared by my CPA
- I have spoken with my CPA about my qualifying income at least 12 months before applying

Income — Bank Statement Loan (if using)

- I have 12–24 months of complete business bank statements (all pages, no gaps)
- I have calculated my average monthly deposits over the statement period
- I have identified all non-revenue deposits (transfers, loan proceeds) that will be excluded
- After applying the lender's expense factor, my income qualifies me for my target amount
- My deposits have been consistent — no dramatic gaps or unexplained spikes

Credit

- My credit score is at least 620 (conventional), 580 (FHA), or 640 (Non-QM)
- I have reviewed all three credit reports for errors
- No collections or charge-offs in the past 12 months
- Credit card utilization is below 30% on every individual card
- I have not applied for any new credit in the past 6 months

Assets & Down Payment

- My down payment funds have been in my bank account for at least 60 days (75 to be safe)
- I can document the source of every large deposit in the past 3 months
- I have enough for both the down payment AND estimated closing costs (budget 2–5% extra)
- I have 2–3 months of mortgage payment reserves remaining after closing
- If using business funds: they have been in my personal account for 60+ days

Debts & DTI

- I know all my monthly minimum debt payments (car, student loans, credit cards)
- I have calculated my estimated back-end DTI with my actual qualifying income and target PITI
- My DTI is at or below 43% for conventional, 50% for FHA/Non-QM
- I have a specific plan for any debts pushing me above program DTI limits

Documentation Ready

- 2 years personal tax returns — complete, all pages, signed
- 2 years business returns if applicable (1120-S or 1065) — complete
- 2–3 months personal bank statements — all pages
- 12–24 months business bank statements if using bank statement loan
- Current YTD P&L; — CPA-prepared and dated within 60 days
- Business license or entity documentation
- CPA contact information current and CPA is aware you are applying

SECTION 11: 12-MONTH ACTION PLAN FOR SELF-EMPLOYED BUYERS

This plan assumes you want to buy in 12 months and need to qualify conventionally. If you plan to use a bank statement loan, the timeline compresses — but the documentation and credit steps remain the same.

Months 1–2 — Assessment & CPA Strategy

- [] Pull all three credit reports at AnnualCreditReport.com and review for errors
- [] Get your actual FICO scores at myFICO.com — not your app score
- [] Calculate your current qualifying income using the add-back formula in Section 2
- [] Meet with your CPA and say exactly: "I am buying a home in 12 months — what should I be doing with this year's taxes?"
- [] Identify every deduction you can legitimately defer or restructure to improve qualifying income
- [] Calculate your current DTI using your real qualifying income and a realistic target home price
- [] Open a dedicated down payment savings account and set up automatic transfers
- [] Dispute any credit report errors using certified mail — use the templates in the Credit Repair guide

Months 3–4 — Tax Strategy Execution & Credit Repair

- [] Implement any tax strategy adjustments agreed with your CPA — before the tax year closes
- [] Defer non-critical equipment purchases if they would significantly reduce net income this year
- [] Pay all credit cards below 30% utilization — individual card by individual card
- [] Do NOT apply for any new credit of any kind
- [] Confirm dispute responses from credit bureaus — follow up on anything unresolved
- [] Review your bank statements: identify every large deposit and make sure you can source and explain each one
- [] If using business funds for down payment: transfer to personal account NOW — start the 60-day seasoning clock

Months 5–6 — Documentation Building

- [] Gather 2 years of complete tax returns — all pages, all schedules, all attachments
- [] Locate Form 4562 for both years and confirm your depreciation add-back number
- [] Obtain a current YTD P&L; from your CPA — confirm it is dated and signed
- [] Gather 12 months of business bank statements — all pages, chronological order
- [] Confirm your business license is current and your entity documents are accessible
- [] Pull 3 months of personal bank statements and flag any large deposits that need explanation
- [] Push all credit card utilization to 10% or below

Months 7–8 — Income Recalculation & Pre-Application

- [] Recalculate your qualifying income using the most current data — has anything changed?
- [] Run your DTI with your actual target purchase price, taxes, insurance, and HOA in your target area
- [] Talk to a real estate agent — get realistic on actual prices in your market
- [] Begin comparing lenders — get quotes from at least 2–3, including one who specializes in self-employed borrowers
- [] Ask each lender: "What loan programs do I qualify for based on my income type, and what is the complete list of documents you need?"
- [] Research down payment assistance programs in your county — ask each lender which DPA programs they are approved for

Months 9–10 — Pre-Approval & Active Search

- [] Submit applications to 2–3 lenders within a 14-day window (mortgage shopping counts as one inquiry)
- [] Compare Loan Estimates line by line: APR, total closing costs, monthly PITI, mortgage insurance
- [] Select your lender and get a strong pre-approval letter — not just pre-qualification
- [] Begin active home search within your pre-approved budget — keep a 5–10% cushion for bidding situations
- [] Do NOT make any large purchases, open new credit, change jobs, or transfer large sums during this period

Months 11–12 — Under Contract to Closing

- [] Respond to all lender document requests within 24 hours — delays cascade into closing delays
- [] Do NOT deposit any large cash amounts without notifying your loan officer first
- [] Always get a home inspection — even on new construction, even in competitive markets
- [] Review your Closing Disclosure at least 3 business days before closing — compare every line to your Loan Estimate
- [] Confirm wire instructions by phone with the title company before sending any wire
- [] Get keys.

SECTION 12: FREE TOOLS & RESOURCES

Resource	What It Is	Where to Find It
SE Income Calculator	Enter your Schedule C numbers and add-backs — get your monthly qualifying income instantly	www.drrobmortgage.com
DTI Calculator	Calculate your back-end DTI with your real income and your target PITI	www.drrobmortgage.com
PITI Estimator	Estimate full monthly payment including taxes, insurance, and HOA for any target price	www.drrobmortgage.com
Bank Statement Income Calculator	Estimate your bank statement loan qualifying income from your deposit history	www.drrobmortgage.com
Closing Cost Estimator	Estimate total cash needed at closing for any purchase price and loan type	www.drrobmortgage.com
AnnualCreditReport.com	Official free credit reports from all 3 bureaus — federally authorized	AnnualCreditReport.com
myFICO.com	Your real FICO scores — the model mortgage lenders actually use	myFICO.com (~\$19.95/mo)
IRS Schedule C Instructions	Official IRS guidance on what can and cannot be deducted	IRS.gov — search "Schedule C Instructions"
Fannie Mae Form 1084	The actual worksheet lenders use to calculate self-employed income — read it yourself	FannieMae.com — search "Form 1084"
HUD Housing Counselors	Free federally approved housing counseling — in person or by phone	HUD.gov/find-a-housing-counselor
TDHCA My First Texas Home	Texas down payment assistance — up to 5% for qualifying buyers	TDHCA.state.tx.us
Personal Strategy Call — Dr. McNeill	1-on-1 review of your income, tax returns, loan options, and timeline	DrMcNeill.as.me/?appointmentType=87745268

Ready to calculate your exact qualifying income and find out which loan is right for you? Book a free strategy call with Dr. McNeill: DrMcNeill.as.me/?appointmentType=87745268 | 832-701-8144 | www.drrobmortgage.com

This guide is for educational purposes only and does not constitute a loan application, pre-qualification, pre-approval, or commitment to lend. Income calculation examples are illustrative — actual qualifying income depends on your complete tax return, lender guidelines, and current program rules, which change frequently. Non-QM loan availability and rates vary by lender and market conditions. Tax strategy suggestions should be reviewed with a licensed CPA or tax professional before implementation. Nothing in this guide constitutes tax, legal, or financial advice. Dr. Robert McNeill | NMLS #844916 | Matador Lending LLC | Houston, TX | Equal Housing Opportunity