

# CMHC Multi-Family Underwriting

## Presented to The Members of the Real Estate Investment Network™

Mortgage Loan Default Insurance  
CMHC Rental Properties



Everything you need to open new doors

Canada



www.cmhc.ca

**DECIDE UPON YOUR GOAL AND  
TAKE ACTION.**

THE ACT OF TAKING THE FIRST  
STEP IS WHAT SEPARATES THE  
LOSERS FROM THE WINNERS.

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**MY GOAL**

- SHOW YOU ANALYTICAL  
FRAMEWORK FOR  
UNDERWRITING MULTI-FAMILY  
MORTGAGE LOANS (5 UNITS +)

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**MY GOAL**

- SUGGEST A RISK MANAGEMENT  
APPROACH IN YOUR REAL ESTATE  
INVESTMENTS

**MY GOAL**

- IN REIN TERMS:  
  
SHOW YOU HOW TO BE A  
BETTER PLAYER IN SAND BOX  
# 6 – HIGH RATIO MULTI-FAMILY  
PROPERTY

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**MY GOAL**

- HELP YOU TO GET BANKS TO  
SAY YES TO YOU

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<b>MORTGAGE INSURANCE</b>
<b>MORTGAGE <u>DEFAULT</u> INSURANCE</b>
<ul style="list-style-type: none"><li>▪ <b>RISK = BORROWER DEFAULTING ON LOAN</b></li></ul>

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<b>MORTGAGE INSURANCE</b>
<b>MY JOB AS MULTI-FAMILY UNDERWRITER IS TO:</b>
<ul style="list-style-type: none"><li>▪ <b>ANALYZE &amp; MITIGATE RISKS</b></li></ul>

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<b>Mortgage Default Insurance</b>
<b>ADVANTAGE FOR BANKS:</b>
<ul style="list-style-type: none"><li>▪ <b>ELIMINATES MORTGAGE LENDING RISKS FOR BANKS</b></li><li>▪ <b>AS LONG AS <u>CONDITIONS</u> ARE MET BY BANK</b></li></ul>

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<b>CMHC ADVANTAGE FOR YOU!</b>
<ul style="list-style-type: none"><li>▪ <b>LOWER INTEREST RATE DUE TO NO RISK TO BANK</b></li><li>▪ <b>INSURANCE PREMIUM COST RECOVERED WITHIN 5 YEARS</b></li></ul>

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<b>CMHC ADVANTAGE FOR YOU!</b>
<ul style="list-style-type: none"><li>▪ <b>LESS CAPITAL / DOWNPAYMENT REQUIRED BECAUSE CMHC WILL ENSURE <u>LENDING VALUE</u> UP TO:</b></li><li>▪ <b>85% LOAN-TO-VALUE</b></li></ul>

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<b>CMHC LENDING VALUE</b>
<b>IT IS THE LOWER OF:</b>
<ol style="list-style-type: none"><li>1. Cost (purchase price) <b>OR</b></li><li>2. CMHC's Lending Value as supported by:<ul style="list-style-type: none"><li>▪ <b>Income &amp; Expenses Analysis</b></li><li>▪ <b>Comparable sales</b></li></ul></li></ol>

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### RISK ANALYSIS

**FOCUS IS ON THESE RISKS:**

1. PROPERTY / SECURITY
2. MARKET
3. SECURITY VALUATION
4. BORROWER

\*\*\*EACH PROPERTY MUST CASH FLOW ON IT OWN!  
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### RISK ANALYSIS

**EACH PROPERTY MUST CASH FLOW ON ITS OWN.**

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### UNDERWRITING STEP #1

**1. MAKE SURE LENDER'S PACKAGE IS COMPLETE.**

- **TIP #1 - SOPHISTICATED INVESTOR BINDER IS GOLD! GOLD!**
- CMHC's CHECK LIST

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### UNDERWRITING STEP #2

**2. RUN THE NUMBERS (SUBJECT VALUATION)**

- Determine if requested Loan can be supported
- Possible Mitigation: REDUCE L.A. (dialogue with lender)

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### UNDERWRITING STEP #3

**3. ANALYZE, RATE & COMMENT EVERY RISK & MITIGATE WHERE NECESSARY**

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### WARNING

- **NO TWO MORTGAGE APPLICATIONS ARE THE SAME**
- **KEY TO UNDERWRITING IS CORRELATION BETWEEN INDIVIDUAL RISK FACTORS**

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SUBJECT VALUATION	
<b>Income &amp; Expense Analysis for the Property</b>	
<ul style="list-style-type: none"><li>▪ RENT ROLL (INCOME VERIFICATION)</li><li>▪ ANCILLARY INCOME (LAUNDRY, POP MACHINE)</li></ul>	

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SUBJECT VALUATION	
Operating Statements 2 to 3 yrs (expenses verification)	
<ul style="list-style-type: none"><li>▪ Establish Expense Ratio (Exp / EGI)</li></ul>	

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SUBJECT VALUATION	
<ul style="list-style-type: none"><li>▪ Determine NOI (EGI minus Exp)</li><li>▪ Establish Value using Cap Rate (incl per door)</li><li>▪ Max value is 85% LTV</li></ul>	

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Analysis of Lender's numbers	
<ul style="list-style-type: none"><li>▪ Can the requested loan amount be supported using the parameters submitted by the Lender?</li></ul>	

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Analysis of Lender's numbers	
<ul style="list-style-type: none"><li>▪ Can the value submitted be supported &amp; at what LTV</li><li>▪ Different LTV translates into different premium bracket</li></ul>	

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PREMIUM STRUCTURE	
Premium structure is Risk-based:	
Loan-to-Value Ratio % of Loan amount	
<ul style="list-style-type: none"><li>▪ Up to &amp; incl. 65% - 1.75%</li><li>▪ Up to &amp; incl. 70% - 2.00%</li><li>▪ Up to &amp; incl. 75% - 2.25%</li><li>▪ Up to &amp; incl. 80% - 3.50%</li><li>▪ Up to &amp; incl. 85% - 4.50%</li></ul>	

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SUBJECT VALUATION RISK FACTOR
<ul style="list-style-type: none"><li>▪ Does subject property meet the DCR requirement based on submitted Loan parameters (int. Rate, term &amp; amortization period)</li><li>▪ DCR calculation formula = <math>\frac{\text{NOI} (\text{Net Operating Income})}{\text{Principal &amp; Interest Payment}}</math></li></ul>

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SUBJECT VALUATION RISK FACTOR
<ul style="list-style-type: none"><li>▪ Maximum DCR =<ul style="list-style-type: none"><li>▪ 1.30 for term less than 10 years</li><li>▪ 1.20 for term more than 10 years</li></ul></li></ul>

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MAXIMUM LOAN AMOUNT
<p>The maximum insurable loan is limited to <u>the lesser of</u> :</p> <p>1.85% of Lending value</p> <p>OR</p>

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MAXIMUM LOAN AMOUNT
<p>2. Amount of Loan that can be carried by borrower at DCR deemed acceptable by CMHC for the project</p>

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PROPERTY RISK FACTOR
<p><b>Detailed property description including:</b></p> <ul style="list-style-type: none"><li>▪ # of suites by bedroom types, <b>suite size</b> &amp; layout</li><li>▪ Exterior, interior, curb appeal</li><li>▪ Structure type: wood frame or concrete ****</li></ul>

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PROPERTY RISK FACTOR
<ul style="list-style-type: none"><li>▪ Parking (int. or ext, energized, etc)</li><li>▪ Heating system</li><li>▪ Roof</li><li>▪ Code compliance</li><li>▪ Common facilities / amenities</li></ul>

RATE CONDITION OF EACH POOR -  
GOOD

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PROPERTY RISK
<ul style="list-style-type: none"><li>▪ <b>TIP # 2:</b> Ask vendor if has an appraisal and/or property condition report – useful even if dated</li><li>▪ <b>RATE THE RISK</b></li></ul>

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MITIGATE PROPERTY RISK FACTOR
<p>Mitigation Action may include:</p> <ul style="list-style-type: none"><li>▪ Holdback for repair &amp; improvement<ul style="list-style-type: none"><li>▪ E.g. Replace Roof, Boiler</li></ul></li><li>▪ Request Property Condition Report to confirm REL &amp; Effective Age</li></ul>

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MARKET RISK FACTOR
<p><b>Correlation analysis of the subject's performance in comparison with market Rental rates &amp; Vacancy</b></p>

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MARKET RISK FACTOR
<ul style="list-style-type: none"><li>▪ How does the subject property compare with similar properties in the market place</li><li>▪ Review of historical rents and vacancy rates profile of at least 5 years of ZONE (5-yr average VS Current)</li></ul>

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MARKET RISK FACTOR
<ul style="list-style-type: none"><li>▪ Compare Market Data, rents &amp; vacancy, of Zone to the Subject's rents &amp; vacancy</li><li>▪ Detailed description of Market Zone</li></ul>

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MARKET RISK FACTOR
<ul style="list-style-type: none"><li>▪ Explain / justify discrepancies between subject and the market<ul style="list-style-type: none"><li>▪ Where are subject's rents in relationship to market rents? (e.g. within 2 to 5% of market, less / more)?</li></ul></li></ul>

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### MARKET RISK FACTOR

- Are the subject's rental rates supportable and/or achievable?
- If not, explain why?
  - Larger suite, better location, furnished suites, what's included in the rental rates (e.g. all utilities, etc.)

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### RISKING THE MARKET

- When discrepancies are significant Lenders may be asked to justify their # (e.g. Provide comparables)
- **POSSIBLE MITIGATION:**
  - Roll back rental income (rare)
  - Normalize the vacancy rate (common)

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### MARKET RISK

#### ▪ TIP #3

Make sure your rents are at market level using CMHC's Rental Market Reports **FREE (Spring Survey / CMA average only)**

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### TIP # 1 - CMHC Spring Rental Survey

Spring Survey is CMA Average ONLY  
& is not ZONE-SPECIFIC

ZONE # 2 Edmonton

	1-bdrm	2-bdrm	
Fall 07	Spring 08	Fall 07	Spring 08
Vacancy	1.3%	3%	1.3% 3.1%
Rent	\$673	\$837	\$820 \$1,000

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### TIP #4

#### PROJECTED RENTS

- CMHC will accept projected rental income if rental increases are effective within 3 months and rental increases notices have been sent (must provide copies of actual notices)

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### SECURITY VALUATION

#### CORRELATION ANALYSIS

- Underwriter's Analysis is contrasted with available market data, namely comparable sales

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SECURITY VALUATION
<ul style="list-style-type: none"><li>▪ Are the following items in line with market ranges:<ul style="list-style-type: none"><li>▪ Chosen Cap Rate</li><li>▪ Value per door</li><li>▪ Operating Expense Ratio<ul style="list-style-type: none"><li>▪ &gt; 40% &lt;</li></ul></li></ul></li></ul>

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BORROWER RISK
<p><b>ANALYSIS OF:</b></p> <ol style="list-style-type: none"><li><b>1. Ownership structure (is simple, complex?)</b></li><li><b>2. Competence</b><ul style="list-style-type: none"><li>▪ Borrower's Track Record in the business</li><li>▪ Property Management Experience</li></ul></li></ol>

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BORROWER RISK
<ul style="list-style-type: none"><li>▪ Overall portfolio Assessment – CMHC's Exposure</li></ul>
<p><b>3. Capacity (financial)</b></p> <ul style="list-style-type: none"><li>▪ Net Worth (<u>tiered</u>) of 25% of Loan amount, minimum of \$100,000</li><li>▪ Access to liquidity (LOC, Cash, RRSP)</li></ul>

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BORROWER RISK
<p><b>4. Personal Guarantees</b></p> <ul style="list-style-type: none"><li>▪ 2% of Loan Amount (LA) for each percentage point in LTV above 60%,</li><li>▪ e.g. LTV = 75%, guarantee = 30% of L.A.</li></ul>

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NON-RECOURSE LOAN
<p>If LTV is does not exceed 60% LTV, Loan is non-recourse.</p> <p>This means only the property is taken as security taken is subject, not personal assets.</p> <p>Borrower must still qualify.</p>

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SPECIAL CONDITIONS
<ul style="list-style-type: none"><li>▪ CMHC's Certificate of Insurance comes with a set of Special Conditions which are an integral part of the insurance coverage and are legally binding for the Lender</li><li>▪ Special Conditions are another way to mitigate risks.</li></ul>

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### SPECIAL CONDITIONS

- There are core Special Conditions which apply to every insurance coverage.
- Others are file-specific

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### CORE SPECIAL CONDITIONS

- Loan purpose (purchase, refinance)
- Advancing
- Proper Zoning
- Corporate Structure
- Professional Property Management
- ESA requirement

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### CORE SPECIAL CONDITIONS

- Holdback for repairs
- Secondary Financing
- Financial Statements (audited, review engagement, management-prepared, etc.)
- Rental Achievement Holdback
- ESA Requirement

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### CONCLUSION

- 1) Consider using an underwriting / risk management approach (with mitigation) with your real estate investments
  - might be worthwhile for your success
- 2) **CMHC IS YOUR FRIEND**
  - Many of the most successful and largest landlords in Canada gladly and openly admit that their success is largely owed to CMHC
  - Use what's available from CMHC free
  - Underwriting guidelines are conservative – if it passes CMHC guidelines, the deal should work

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### CMHC NEWS, NEWS, NEWS

- On July 09, Ministry of Finance announced (as Oct 15 2008) the end of:
  - LTV of 100% - now maximum = 95% LTV
  - Amortization period of 40 years – max now 35 years
- DOES NOT APPLY TO LARGE RENTAL PRODUCT!
- DO NOT KNOW IF APPLIES TO SMALL RENTAL???



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