

Mortgage Loan Default Insurance

CMHC Rental Properties

5 units & plus

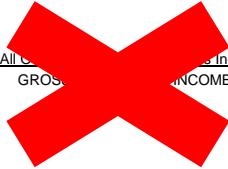


Everything you need to open new doors

Canada 

NO WALL

~~PITH (ALL PROPS) + ALL OTHER INCOME / GROSS INCOME (all props) ≤ 42%~~



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NO WALL

- EACH PROPERTY MUST CASH FLOW ON ITS OWN

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SANDBOX # 6 – HIGH RATIO MORTGAGES + 5 UNITS



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2 GOALS

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

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MY GOAL

HELP YOU TO GET CMHC TO SAY YES TO YOUR BANK, WHICH IN TURN WILL SAY YES TO YOU!

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MY GOAL

2) SUGGEST A RISK MANAGEMENT APPROACH IN YOUR REAL ESTATE INVESTMENTS



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MORTGAGE INSURANCE

- INSURANCE TO PROTECT BANKS AGAINST MORTGAGE DEFAULT
- RISK = BORROWER DEFAULTING ON LOAN
- PAY INSURANCE PREMIUM

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MORTGAGE INSURANCE

MY JOB AS MULTI-FAMILY UNDERWRITER IS TO:

- ANALYZE & MITIGATE RISKS

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Mortgage Default Insurance

ADVANTAGE FOR BANKS:

- ELIMINATES MORTGAGE LENDING RISKS FOR BANKS
- AS LONG AS CONDITIONS ARE MET BY BANK

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CMHC ADVANTAGE FOR YOU!

- LOWER INTEREST RATE DUE TO NO RISK TO BANK
- INSURANCE PREMIUM COST RECOVERED WITHIN 5 YEARS WITHIN YOUR PROPERTY'S CASH FLOW



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CMHC ADVANTAGE FOR YOU!

- LESS CAPITAL / DOWNPAYMENT REQUIRED BECAUSE CMHC WILL ENSURE LENDING VALUE UP TO:
 - 85% LOAN-TO-VALUE (LTV)
 - GREATER ROI

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PURCHASE 8-UNIT WOOD FRAME STRUCTURE		
	CONVENTIONAL	CMHC-INSURED
Purchase Price	\$400,000	\$400,000
Rental Income	\$52,000	\$52,000
Vacancy & Operating Expenses	\$17,000	\$17,000
Net Operating Income (NOI)	\$35,000	\$35,000
Minimum Equity Requirement	\$100,000	\$60,000
Loan (Before CMHC Premium & Fee)	\$300,000	\$340,000
CMHC Premium @ 4.5% (85% LTV)	N/A	\$15,300
CMHC Application Fee	N/A	\$1,200
Total Loan	\$300,000	\$356,500
INTEREST RATE	6.0%	5.4%
Annual Principal & Interest (25 yr amort)	\$23,033	\$25,864
Cash Flow (NOI – P & I)	\$11,967	\$9,136
Return on Investment (ROI)	12%	15.2%
ROI (Incl. Capital Repayment)	17.4%	26.9%

CMHC LENDING VALUE

IT IS THE LOWER OF:

1. Cost (purchase price) **OR**
2. CMHC's Lending Value as supported by:
 - Income & Expenses Analysis
 - Comparable sales

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CMHC'S LENDING VALUE

CMHC's LENDING VALUE as supported by:

- RISK ANALYSIS

CMHC'S LENDING VALUE IS MARKET-DERIVED, **IS NOT NECESSARILY MARKET VALUE**

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RISK ANALYSIS

FOCUS IS ON THESE RISKS:

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

***EACH RISK IS RATED & COMMENTED IN DETAILS

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UNDERWRITING STEP #1

1. MAKE SURE LENDER'S PACKAGE IS COMPLETE.

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

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UNDERWRITING STEP #2

2. RUN THE NUMBERS (SUBJECT VALUATION)

- Determine if requested Loan can be supported
- Possible Mitigation: REDUCE Loan amount

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UNDERWRITING STEP #3

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

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WARNING

- EVERY MORTGAGE
INSURANCE APPLICATION IS
ANALYZED ON ITS OWN
MERIT, CASE BY CASE
- UNDERWRITING DOES NOT
PRODUCE COOKIE-CUTTER
RESULTS

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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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PROPERTY VALUATION

Income & Expense Analysis for the Property

- For valuation of the Property we
use the INCOME
CAPITALIZATION APPROACH
- ALL NUMBERS ANALYZED ON
YEARLY BASIS



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PROPERTY VALUATION

- INCOME VERIFICATION –
CURRENT RENT ROLL
- ANCILLARY INCOME (LAUNDRY,
POP MACHINE)

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PROPERTY VALUATION

- DETERMINE EFFECTIVE GROSS
INCOME (EGI)
- EGI = INCOME MINUS
VACANCIES / BAD DEBTS

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PROPERTY VALUATION

- Operating Statements 2 to 3 yrs (expense verification)
- Establish Operating Expense Ratio (Exp / EGI)
- Operating Expenses exclude Mortgage payments & Interest (P & I)

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SUBJECT VALUATION

- Determine **NOI > NET OPERATING INCOME** (EGI minus Exp)
- Establish Value using Cap Rate (incl. value per door)
- Max **INSURABLE** value is 85% LTV

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Analysis of Lender's numbers

- Can the requested loan amount be supported using the parameters submitted by the Lender?
- Parameters =
 - Loan amount
 - Interest rate
 - Term

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Analysis of Lender's numbers

- Can the value submitted be supported & at what LTV?
- Different LTV translates into different premium bracket

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Premium is RISK-BASED:

Loan-to-Value Ratio	% of Loan amount
▪ Up to & incl. 65%	- 1.75%
▪ Up to & incl. 70%	- 2.00%
▪ Up to & incl. 75%	- 2.25%
▪ Up to & incl. 80%	- 3.50%
▪ Up to & incl. 85%	- 4.50%

▪ PREMIUM RECOVERED WITHIN 5 YRS

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SUBJECT VALUATION RISK FACTOR

- Does subject property meet the **DCR** requirement based on submitted Loan parameters (int. Rate, term & amortization period)
- **DCR** calculation formula =
 - NOI (Net Operating Income)
 - Principal & Interest Payment

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SUBJECT VALUATION RISK FACTOR	MAXIMUM LOAN AMOUNT
<ul style="list-style-type: none"> ▪ MINIMUM DCR = <ul style="list-style-type: none"> ▪ 1.30 for term <u>less than</u> 10 years ▪ 1.20 for term <u>more than</u> 10 years ▪ MINIMUM DCR IS ALSO <u>RISK-BASED</u> <p style="text-align: center;"> CANADA MORTGAGE AND HOUSING CORPORATION</p>	<p>Maximum insurable loan is limited to the <u>lesser of</u> :</p> <ol style="list-style-type: none"> 1. 85% of Lending value <p style="text-align: center;">OR</p> <ol style="list-style-type: none"> 2. Loan amount that can be supported at DCR or <u>acceptable to CMHC for project</u> <p style="text-align: center;"> CANADA MORTGAGE AND HOUSING CORPORATION</p>

1) PROPERTY RISK FACTOR	PROPERTY RISK FACTOR
<p>Detailed property description including:</p> <ul style="list-style-type: none"> ▪ # of suites by bedroom types, suite size & layout ▪ Exterior, interior, curb appeal ▪ Structure type: wood frame or concrete **** <p style="text-align: center;"> CANADA MORTGAGE AND HOUSING CORPORATION</p>	<ul style="list-style-type: none"> ▪ Parking (int. or ext, energized, etc) ▪ Heating system ▪ Roof ▪ Code compliance ▪ Common facilities / amenities <p>RATE CONDITION OF EACH FACTOR POOR - GOOD</p> <p style="text-align: center;">CANADA MORTGAGE AND HOUSING CORPORATION</p>

PROPERTY RISK	MITIGATE PROPERTY RISK FACTOR
<ul style="list-style-type: none"> ▪ TIP # 2: Ask vendor if has an appraisal and/or property condition report – useful even if dated ▪ GET Property Condition Report & ask for <u>REL (remaining econ. Life) & Effective Age</u> <p style="text-align: center;"> CANADA MORTGAGE AND HOUSING CORPORATION</p>	<p>Mitigation Action may include:</p> <ul style="list-style-type: none"> ▪ Holdback for repair & improvement <ul style="list-style-type: none"> ▪ E.g. Replace Roof, Boiler <p style="text-align: center;">CANADA MORTGAGE AND HOUSING CORPORATION</p>

2) MARKET RISK FACTOR

Correlation analysis of the subject's (the property) performance in comparison with market Rental rates & Vacancies

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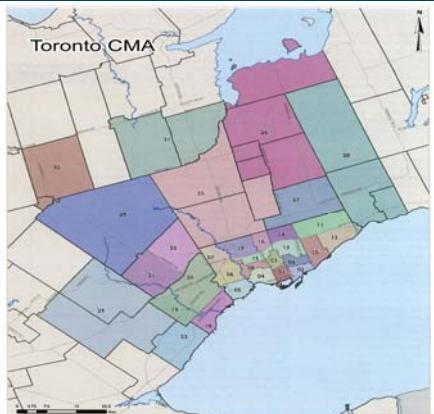
MARKET RISK FACTOR

- How does the subject property compare with similar properties in the market place
- Review of historical rents and vacancy rates profile of at least 5 years of ZONE (5-yr average VS Current)

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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 (very 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 NOT zone-specific)**

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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 to tenants (must provide copies of actual notices)
- **INCOME IS IMPORTANT AS VALUE IS DERIVED FROM NOI**

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3) SECURITY VALUATION

TO VALUE THE PROPERTY WE USE THE

INCOME APPROACH
(INCOME CAPITALIZATION)
VS
COST APPROACH

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3) SECURITY VALUATION

VALUE IS ESTABLISHED BY DIVIDING THE **NOI BY CAPITALIZATION RATE (Cap Rate)**

- Cap Rate is a % derived from comparable sales in the market place

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SECURITY VALUATION

CORRELATION ANALYSIS

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

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SECURITY VALUATION

- Are the following items in line with market ranges:
 - Chosen Cap Rate
 - Value per door
 - Operating Expense Ratio
 - > 40% <

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BORROWER RISK

ANALYSIS OF:

1. Ownership structure (is simple, complex?)
- WHO HAS CONTROL OF THE ASSET?
- WHO HAS VOTING SHARES? WHAT %?

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RISKING THE BORROWER

2. BORROWER'S COMPETENCE

- Track record in the multi-family business
- Property management experience:
- **IF LESS THAN 5 YEARS, MUST HIRE A PROFESSIONAL PROPERTY MANAGER**

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RISKING THE BORROWER

3. Capacity (financial)

- Overall portfolio Assessment – CMHC's Exposure
- Net Worth (tiered) of 25% of Loan amount, minimum of \$100,000
- Access to liquidity (LOC, Cash, RRSP)

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NET WORTH

- CMHC TIERING OF BORROWER'S NET WORTH
- BORROWER'S REAL ESTATE ASSETS ALLOCATED FULL VALUE

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BORROWER RISK

4. Personal Guarantees

- When borrower is corporation, additional personal or corporate guarantees are required over & above the loan covenant

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PERSONAL GUARANTEE

- 2% of Loan Amount (LA) for each percentage point in LTV above 60%.

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PERSONAL GUARANTEE

- Example: L.A. \$1,000,000 @ 85% LTV
 - 25% above 60%, therefore guarantee amount is \$500,000 or 50% of L.A.
- Guarantee is not cumulative between different loans

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NON-RE COURSE LOAN

If LTV is does not exceed 60% =
Loan is non-recourse.

This means only the property is
taken as security, not personal
assets.

Borrower must still qualify.

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SPECIAL CONDITIONS

- 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 on the Lender
- Special Conditions are another way to mitigate risks.

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 CMHC SCHL
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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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 CMHC SCHL
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SPECIAL CONDITIONS

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

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 CMHC SCHL
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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

- Consider using an underwriting / risk management approach (with mitigation) with your real estate investments

- Might help you find potential JV Partners



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CONCLUSION

- CMHC's Underwriting Guidelines are very conservative
- If your deal is CMHC-approved, the numbers will work



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CMHC IS YOUR FRIEND

- CMHC's Mortgage Default Insurance is a sound way to mitigate risks in Real Estate Investing
- CMHC's Insurance used by Large successful Landlords
- USE CMHC **FREE** STUFF

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