



Mortgage Loan Default Insurance
CMHC Rental Properties
5 units & plus





Everything you need to open new doors

Canada 

NO WALL


$$\frac{\text{PITH (ALL PROPS)} + \text{All other income (all props)}}{\text{GROSS ANNUAL INCOME}} \leq 42\%$$



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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 amount	% 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

- MINIMUM DCR =
 - 1.30 for term less than 10 years
 - 1.20 for term more than 10 years
- MINIMUM DCR IS ALSO **RISK-BASED**

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MAXIMUM LOAN AMOUNT


Maximum insurable loan is limited to the **lesser of**:

- 85% of Lending value

OR

- Loan amount that can be supported at DCR or **acceptable to CMHC for project**

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1) PROPERTY RISK FACTOR

Detailed property description including:

- # of suites by bedroom types, **suite size & layout**
- Exterior, interior, curb appeal
- Structure type: wood frame or concrete ****

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PROPERTY RISK FACTOR

- Parking (int. or ext, energized, etc)
- Heating system
- Roof
- Code compliance
- Common facilities / amenities


RATE CONDITION OF EACH FACTOR
POOR - GOOD

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PROPERTY RISK

- TIP # 2:** Ask vendor if has an appraisal and/or property condition report – useful even if dated
- GET Property Condition Report & ask for **REL (remaining econ. Life) & Effective Age**

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MITIGATE PROPERTY RISK FACTOR

Mitigation Action may include:

- Holdback for repair & improvement
 - E.g. Replace Roof, Boiler

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2) MARKET RISK FACTOR

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

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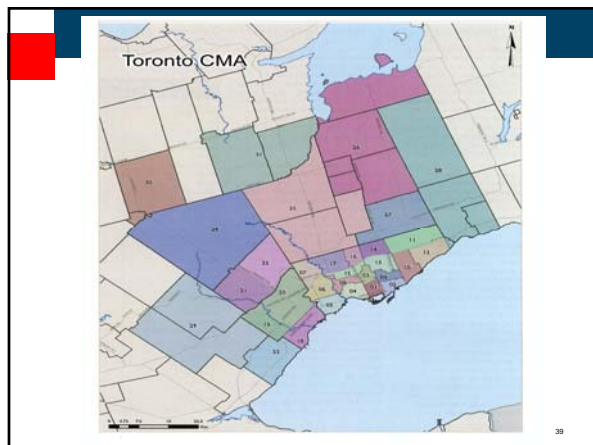
MARKET RISK FACTOR

- 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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MARKET RISK FACTOR

- Compare Market Data, rents & vacancy, of Zone to the property's rents & vacancy
- Detailed description of Market Zone

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MARKET RISK FACTOR

- **Explain / justify discrepancies between property and the market**
 - Where are property's rents in relationship to market average rents? (e.g. within 2 to 5% of market, less / more)?

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MARKET RISK FACTOR

- Are the property's rental rates supportable and/or achievable?
- If not, explain why?
 - Larger suite, better location, higher end finishes in 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 (**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

- Overall portfolio Assessment – CMHC's Exposure
- 3. Capacity (financial)
 - 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-RECOURSE 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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SPECIAL CONDITIONS

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

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SPECIAL CONDITIONS

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

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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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CMHC : Free Market Data www.cmhc.ca



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