

Contents

68 New mortgage rules explained

74 Product listings
Canadian Real Estate compares mortgage products currently available from a range of lending institutions across Canada

New mortgage

The Canadian government introduced new rules this year. Peter Kinch discusses how these changes may impact your current and future investments

Real estate investors across the country woke up a little shocked on Feb. 17 to find that they would no longer be able to use CMHC as a vehicle for putting less than 20 per cent down on the purchase of a rental property. This was one of three new rule changes that will come into effect shortly in an effort by the Canadian government to prevent an over-heated housing market turning into a ‘bubble ready to burst.’

Let’s take a look at the three rule changes and analyze what they really mean to the average Canadian and to you as a real estate investor:

Any borrower who chooses a short-term mortgage (one to three years on a variable-rate mortgage) must now qualify at the five-year rate in order to get a CMHC-insured mortgage.

Impact:

Negligible.

The fact is that most lenders already require that anyone taking a variable-rate mortgage must qualify at the ‘three-year posted rate.’ What’s of interest is that the government announcement did

not distinguish whether the five-year rate is a ‘posted rate’ or ‘discounted rate.’ The difference is about 1.5 per cent. The irony is that the current three-year posted rate is higher than the five-year discounted rate, so if the government rule requires that you qualify at the five-year discounted rate, this could actually serve to ‘relax’ the rule not strengthen it.

In addition to that, recent surveys indicate that as much as 70 per cent of Canadians already choose fixed-rate long-term mortgages.

Bottom Line:

Great move regardless of whether you are a homeowner or a real estate investor. It is practical and imperative that anyone taking a variable-rate mortgage today factor in a three per cent increase in rates over the next two to three years. I still believe there are huge savings to be had if you take a variable today, but only if you increase your current payments to match the current discounted five-year rate. In doing so, you will accomplish two things:

You will accelerate the rate at which you pay off your mortgage, thus reducing your principal mortgage balance at the time of renewal. This will help to negate the impact of an increase in rates at that time.

You will adjust your family budget

today to the inevitable higher rates in the future – thus avoiding ‘payment shock’ to your budget.

Smart and prudent – but will it achieve the effect of helping to cool off the housing market and slow things down? Not at all – this one is purely optics.

The maximum amount you can refinance your home has been lowered from 95 per cent to 90 per cent.

Impact:

Again this one is negligible.

Smart move by the government to make mandatory what should be common sense. The only reason anyone would leverage their residence up to 95 per cent would be to pay off high interest credit card debt with the extremely low interest mortgage debt. Others may want to simply access as much money as they can at these historically low rates in hopes of generating a greater return in the market. Either way, it is extremely imprudent for anyone to over-leverage their principal residence. Whether there is a bubble or not, it certainly doesn’t take much of a market correction to eliminate five per cent in the value of any home. For the average Canadian, their home represents their greatest investment and with that, their largest source of net worth. It also represents

rules explained

a major component of the average Canadian's retirement plan. It should be a source of 'equity development' and not be used as an ATM to subsidize current lifestyle.

Bottom Line:

Smart and prudent move. Will it have the desired effect of slowing down the housing market? Not at all. The truth is that the percentage of Canadians refinancing to that extent is an extremely small percentage of the population so this will have a very small impact.

The minimum down payment on non-owner occupied properties purchased for speculation will now be 20 per cent.

Impact:

Significant.

This is by far the most significant of the new rule changes – especially if you are a real estate investor. Although the announcement specifically stated that they were targeting the 'speculator' not the 'investor,' the net effect is that all investors will be impacted. However – and this is *very* important. The impact will not be the fact that investors must now put 20 per cent down. The truth is I've been teaching that for years. Any investor should look to put 20 per cent down for cash flow reasons if nothing else. But the real reason this is a major rule change is the sub-text to this rule change that was not included in the original announcement and not reported in the press. In addition to no longer allowing high-ratio mortgages, CMHC has also changed their underwriting

policy. Whereas they previously allowed for an 80 per cent offset of an investor's existing portfolio when underwriting a mortgage, they will now revert to a 50 per cent addback. Now, to the average Canadian this is a meaningless change. But to the real estate investor, the change is significant. It will create three major changes:

A 50 per cent addback is significantly less favourable to an investor than an 80 per cent offset. Let me make it simple: if you currently own more than three rental properties, you will never be able to qualify for a mortgage using only 50 per cent of the rental income from your portfolio.

No problem you say – I'll just put 20 per cent down. Well the secondary issue here is that all the non-institutional lenders such as Merix, Street Capital and DLC Mortgages are Mortgage-backed security (MBS) lenders and require that all the mortgages in their portfolio be insured – even if they are conventional

(20 per cent down). That means they need to follow the CMHC guidelines. This means those lenders are no longer an option for real estate investors with three or more properties even with a 20 per cent down payment.

This will shift more of this business to the chartered banks, all of which are tightening their guidelines on rental properties, meaning the next issue investors will face is 'cap space.' You will have a cap on how many mortgages you can get with each bank and you now have fewer choices. This will make the need to have a strategic plan even greater.

Bottom Line:

Significant impact on investors.

But as for cooling down the overall market – again negligible, simply because real estate investors as a whole represent less than five per cent of the overall market so their impact on the housing market in Canada is muted.





Key lessons

- So what does all of this mean to you as a real estate investor? Well, first and foremost, it's important to clarify that the new rule changes only apply to residential mortgages insured by CMHC. So to effectively answer this question we need to separate the investment market into four camps:
- ➔ You focus mainly on commercial or multi-family purchases.
 - ➔ You are new to investing and are either buying your first rental property or you have less than three rentals.
 - ➔ Your current rental portfolio is between three and 10 properties and you have relied mainly on one lender/bank for your mortgages to date.
 - ➔ You are a mature investor with over 10 properties and have used multiple lenders/banks to date.

If you are purchasing commercial properties or multi-family buildings, none of the above rule changes affect you. CMHC has not made any changes to their insurance program for multi-family units to date, so you can still purchase an apartment building with as little as 15 per cent down as long as the cash flow warrants it. This is a completely different sandbox compared to the residential housing market and not one that was targeted by Flaherty.

If you fall into category No. 2, then these rules will not have a major impact on you other than the fact that you will have to come up with a 20 per cent down payment, but as I mentioned earlier, this is a prudent thing to do regardless since you are likely buying real estate for a combination of net worth and cash flow. As a new investor, you still have many options at your disposal in terms of lenders, including Street Capital, Merix and DLC Mortgages, all of whom require their conventional mortgages be CMHC-

Offset/Addback explained

The difference to a real estate investor between an 80 per cent offset and a 50 per cent addback is critical.

An 80 per cent rental offset works like this:

(Total amount of rental income in your portfolio x 80 per cent) – Total amount of mortgage payments. The result will be either a surplus or a shortfall. If you have a large portfolio of between three and 15 properties that have positive cash flow, they will more than likely generate a small surplus using this calculation. Using this form of underwriting makes having more properties an asset.

A rental addback works like this:

The lender will take only 50 per cent of the total rental income in your portfolio and add it back to your verifiable income. The new total verifiable income will then be multiplied by 40 per cent (your TDSR) to determine your total verifiable income. Meanwhile, 100 per cent of the expenses from all of your rental properties will be added to your debt. The only way for you to qualify for a mortgage is if 40 per cent of your verifiable income is sufficient to service 100 per cent of your debt. This form of underwriting will work for individuals with a large verifiable income and less than three rental properties, but once you have three or more rentals in your portfolio, it is virtually impossible to qualify for a mortgage using the addback policy.

The biggest challenge borrowers will face moving forward is that second-tier lenders such as Street, Merix and DLC Lending require that all of their mortgages be insured regardless of the loan to value. So these lenders are now no longer an option for anyone with three or more rental properties in their portfolio regardless of how much money they have to put down.

Source: Peter Kinch

insured. These lenders will now be applying a 50 per cent addback instead of an 80 per cent offset. Using a 50 per cent addback is still a potential option if you have less than three rental properties and show enough verifiable income. Keep in mind that the new rules only impact CMHC policy, so putting 20 per cent down with a chartered bank will still afford you many non-CMHC options as well. So depending on how much income you can verify, you will still have the maximum amount of lenders at your disposal. The key here is to be very strategic. If you plan on buying more than three rental properties, it is critical to use your lenders in the right order. Use the above-mentioned lenders for your first three purchases, and then revert to a chartered bank for all future purchases.

From 3 to 10 properties

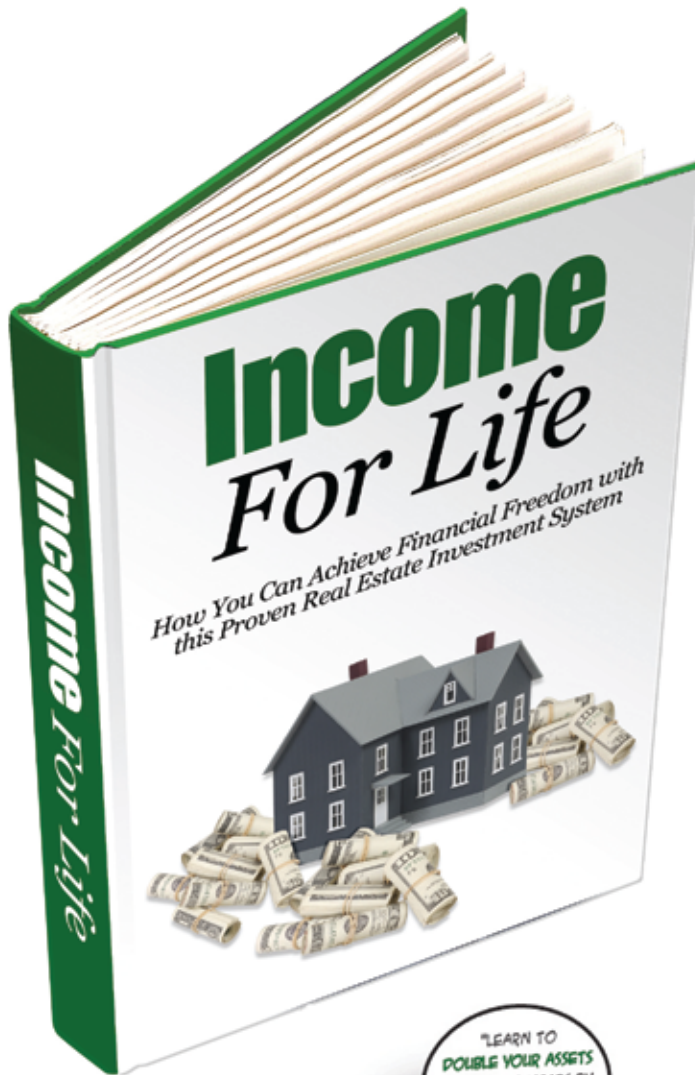
If you have purchased more than three rental properties but less than 10, then

you are in an interesting position. These new rule changes will have an impact depending on what your future plans are. If you plan to continue buying more real estate for investment purposes then the issue you will face moving forward will be 'cap space.' It is important to note that I am using the numbers 'three' and '10' as a rough guideline and the actual number of properties will vary from lender to lender. The challenge with individuals in this category moving forward is the fact that any lender using a 50 per cent rental addback policy (CMHC's new guideline) will not be an option for you, even if you do put 20 per cent down. That means you will now be forced to work with deposit-taking chartered banks that have a rental program, which does not require CMHC insurance. Those would include; CIBC, Scotia Bank, TD, RBC and National.

If you have used one of these primarily as your lender to date, you

URGENT! A Timely Message from Bob Mangat

“FREE Real Estate Investing Book Reveals How You Can Create Complete Financial Independence Using this Breakthrough Homes-Buying-Homes Strategy”



HOW YOU CAN ACHIEVE FINANCIAL FREEDOM WITH THIS PROVEN REAL ESTATE INVESTMENT SYSTEM.

For a limited time, you can receive my new 104 page E-book, *Income for Life*, for FREE. I have decided to give my book away for FREE to the first 50 investors who request it. I'm giving away my new book for free because I believe today's housing market represents one of the best investment opportunities in the last 30 years. I want investors to take advantage of this incredible opportunity before it disappears. In my FREE *Income for Life* E-book, you'll learn:

- ✓ How You Can Turn 3 Single-Family Homes into 24 Homes without Investing any additional money using the *Income for Life – Homes Buying Homes Secret!* (See page 19)
- ✓ How \$10,000 Can Make You Wealthy – The Buy and Hold Strategy kicked up a few notches (See page 19)
- ✓ A Unique 10/10/10 Investment Formula That Yields 200% Returns (See page 32)
- ✓ How to Find and Buy Nice Homes Below Value (See page 41)
- ✓ Why the Best Way to Market Your Home is to Advertise Using These THREE Magic Words (See page 63 for the magic words)
- ✓ Costly Investor Mistakes and How You Can Avoid Them (See page 86)
- ✓ How You Can Create a Million Dollars for Your Retirement (See page 97)

Request this book online @
www.FreeIFLBook.com

invigo
 REALTY LTD.



will quite likely start to experience a 'cap space' issue. Simply put; every lender will have a limit or 'cap' as to the maximum exposure they will want to have with one individual client. That limit may be a maximum number of properties or it could be a dollar amount – either way, every lender will have its limit.

For example: you may have been able to finance your first six purchases through RBC with no problem to date, but your plan is to buy 12 properties all together. Well regardless of the new rule changes, RBC would not likely grant that many mortgages to one individual. However, depending on your cash flow and verifiable income, there will be other chartered banks that you could work with to accomplish that goal. Properly structured, your limitation will be hitting the cap space at each bank, not the CMHC guidelines. Where the new rules hinder you, is that you can no longer use non-chartered banks such as Street Capital after your third purchase. This will have the effect of putting more pressure on your cap space at the chartered banks.

Cap space

The last category will be those investors who have already experienced cap space issues at their chartered banks. The strategy up until now for those individuals was to spread out their mortgages over as many lenders as possible and maximize the cap space at each lender. A key component of this strategy was to use the non-chartered banks, applying an 80 per cent rental offset. CMHC's previous guideline, which many of these lenders such as Street Capital used, would allow you to use an 80 per cent offset on your entire portfolio. The catch was that you typically could only have a maximum

But for the real estate investor, there will be a significant impact on how you structure your portfolio moving forward

aggregate total of \$1.5 million worth of CMHC mortgages with these lenders. If you currently have more than 10 properties and have not already taken advantage of these non-chartered bank lenders, you will need to rely solely on the chartered banks moving forward, which again, will result in cap space issues.

Those who have been strategic however and utilized the \$1.5 million worth of cap space with the non-chartered CMHC-insured lenders, will now have that much more room to work with chartered banks and will find that the new rule changes will have no impact. The key here is to be strategic and learn about your cap space options.

Timing

One further point that should be noted is that the rule changes for CMHC may come into effect on April 19, but each bank is free to implement any of these rule changes immediately and we've seen this happen in the past. Therefore, anyone who fits into the last three of the above categories should be looking to utilize the \$1.5 million

of cap space at a non-chartered bank before the changes come into effect. This would include anyone who already has a real estate portfolio and is looking to refinance their existing home for the purposes of accessing equity to make more purchases.

At the end of the day, the finance minister walked a thin line between addressing concerns about an overheated real estate market in Canada and not over-correcting the problem at the risk of causing damage to the overall economy. For the average Canadian, these new rules will have a negligible effect. But for the real estate investor, there will be a significant impact on how you structure your portfolio moving forward. There has never been a more important time than now for real estate investors to act strategically and plan their future.

Until next time; happy investing. 🏠

Peter Kinch is a bestselling author and owner with Dominion Lending Centres.

Peter's next book, The Canadian Real Estate Action Plan is being released this month.

THE ONLY NATIONAL PUBLICATION FOR CANADIAN
REAL ESTATE INVESTORS

Subscribe Today and Save 32%



SPECIAL OFFER

12 issues for only

\$65

plus taxes

Please quote
promo code CREOP04

In every issue

- ✓ Secrets from seasoned investors
- ✓ Property management how-to's
- ✓ Advice from industry experts (legal, tax, mortgage)
- ✓ Finance strategies to get more bang for your buck
- ✓ Commercial investment do's and don't's
- ✓ Hot renos to boost your property value
- ✓ In-depth property price guide + property roundup

3 EASY WAYS



www.canadianrealestatemagazine.ca



416-644-8740



subscriptions@kmimedia.ca