

7 creative financing options

Accessing capital for rental property investments can be challenging. Here are ways to overcoming the obstacles

There are two obstacles to financing for real estate investors, one of them is qualifying at the banks for a mortgage, the other is coming up with the down payments for your rental property investment.

If you have followed the steps to qualify for a mortgage, then the next step is to come up with the down payment. A small but critical point to the success of overcoming obstacle No. 1 is having positive cash flow in your portfolio. For many novice investors, this creates a problem, since getting positive cash flow typically requires putting 20 per cent or more down as a down payment. This conflicts with many of the late-night TV shows that promote ‘low-down’ or ‘zero-down’ options. Since the Canadian government made changes to how and what CMHC (the government-owned mortgage insurance company) could do, high-ratio mortgages for investment properties were no longer available to Canadian consumers. Ultimately, the burning question becomes; ‘How do I make this amount of money stretch to be able to purchase as many properties as possible? As much as I’d like to say that there is a ‘magic answer’ – there isn’t. There are, however, a variety of strategies and options.

There are a variety of options when it comes to accessing capital for their down payment on a rental property – some more creative than others, but here is a list of the seven most common options that investors choose from:



1 Liquid assets
This is any money that you have that is readily available in cash form, or an investment that could

easily be ‘liquidated’ on short notice. Having 20 per cent of your own capital is ultimately the strongest position to be in, if for no other reason than the fact that you do not have to borrow it or partner with someone else in order to make a purchase. Since you are not paying any interest on your own money that you use for a down payment, you have the best chance to maximize your cash flow and make a profit.



2 Equity from real estate

This is an area that can create some confusion for someone who is new to investing. A percentage of money that you have as equity in your principal residence or another rental property may be used to form part or all of your down payment on an investment property. The confusion lies in the fact that Canadian banks will not allow you to finance a rental property 100 per cent. They will also not allow you to use borrowed money in the form of an unsecured line of credit as part of the down payment on a rental property. However, you may take money from a line of credit on your home or other property to use to formulate the 20 per cent required to purchase an investment property. The confusion lies in the fact that, technically, if you borrow your down payment from your home equity, then arrange a mortgage for the balance of the purchase price, you have essentially financed 100 per cent of your purchase. However, Canadian banks see the equity in your home as your own capital (as opposed to an unsecured line of credit) and as such, you are allowed to use it to formulate your down payment.

The formula for calculating the

accessible equity in your home is as follows:

$(\text{market value of home} \times 80\%) - \text{existing mortgage or line of credit} = \text{potential accessible equity.}$

*Note: * 80% is the conventional limit before the mortgage is considered ‘high ratio’ and requires insurance.*



3 Subprime mortgages

Prior to 2008, there were many subprime mortgage options on both sides of the border. We all know what happened in the U.S. with the subprime crisis and subsequent meltdown. But the subprime story in Canada is not as well documented. Up until 2008 the number of subprime mortgage options in Canada were growing and many offered zero-down options for Canadian real estate investors. After 2008, many of these subprime options either ceased operating in Canada altogether or, as was the case with Xceed mortgages, they applied for ‘bank status’ and became an ‘A’ lender, backed by CMHC. By 2010, this segment of the market was all but wiped out, with the exception of a few subprime lenders such as ‘Optimum Mortgages’ and ‘Home Trust.’ The few subprime lenders today will offer the flexibility of ‘stated- income’ or relaxed rules on income verification, but they will not likely allow for high-ratio mortgages and may even require as much as 35 per cent down payment. They are higher in rate and there may be a fee involved so they are not considered a ‘first choice.’

In my opinion, the tightening rule changes by CMHC have opened up an opportunity for a player in this segment of the market and I wouldn’t be surprised to see a lender step into this market niche. Look for more subprime options for real estate investors in years to come.