BCMMA MIC Mortgages

A GUIDE FOR BORROWERS IN BRITISH COLUMBIA

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Please note – this document is not intended to be legal advice. Professional advice about investments, mortgages or related topics should be sought elsewhere.

Section 1 – British Columbia MIC Managers Association (BCMMA) Purpose and Information

The BCMMA was founded by a core group of 12 MIC (Mortgage Investment Corporation) management companies in 2010 with three main goals:

1. Facilitate the exchange of information and best practices within the industry,
2. Educate regulators and the public on what a MIC is and its role in the economy, and
3. Establish and uphold MIC industry standards for ethics, education, and professionalism.

The BCMMA is currently comprised of 35 MIC management companies with aggregate assets under management of greater than $2 billion. Our membership is a diverse group of residential, commercial, and land development MICs with many years of industry experience.

To qualify for membership, Member Candidates must, in the opinion of the Board of Directors, meet the following criteria:

- Their primary source of income is derived from managing a 'Mortgage Investment Corporation', as defined in the Canadian Tax Act;
- The 'Mortgage Investment Corporation' under management has a minimum of $10 million in shareholder capital;
- Their head office is situated in British Columbia; and
- They conduct business in an ethical, professional, and respectful manner.

Member Candidates recommended by the Board of Directors will be considered at Member Meetings and will be voted upon using sealed ballots and must be approved by no less than 75% of the ballots cast.

B.C. MICs are registered under the Mortgage Brokers Act. The Act regulates the brokering and lending activities of MICs. The British Columbia Financial Services Authority (BCFSA) oversees the Mortgage Brokers Act. Capital raising and investment marketing are regulated by the British Columbia Securities Commission (BCSC).

For more information:

British Columbia MIC Managers Association – BCMMA- www.bcmma.org

British Columbia Financial Services Authority – BCFSA - www.bcfsa.ca

British Columbia Securities Commission - BCSC - www.bcsc.bc.ca

Section 2.1 - What is a MIC?

Mortgage Investment Corporations (MICs) were created in 1973 by the Residential Mortgage Financing Act. At the time, Parliament believed a housing crisis was coming. With population growth in Canada expected to generate the need for new homes by 1981, it was estimated that mortgage financing would be required annually for new housing. The Canadian economy was facing an annual funding gap and to compound the problem, traditional lenders like the Chartered banks started to tighten their lending guidelines as inflation became a concern and interest rates began to rise.

A private lending market in which individuals directly lent their own funds to Borrowers had been operating in Canada for many years before Parliament created the MIC. However, private lending was unable to quickly scale up to fill the funding gap. Private lending required individual investors to have large amounts of capital and expert knowledge of mortgage lending and private lenders' mortgage investments were generally illiquid and their loan portfolios generally lacked diversification.

The advent of the professionally managed MIC allowed smaller investors to pool their funds together and established corporate supports such as full-time underwriters and administration of funds. MICs made passive mortgage investing available to a much wider shareholder base. In the larger MICs, professional managers manage a pool of mortgages and investors gain liquidity and diversification as the portfolio of mortgages expanded. As competition increased and the role of independent mortgage brokers also became more prominent, MICs began to specialize in areas of lending that were underserviced by traditional lenders, such as small-scale construction, equity-based lending, bridge financing and lending to new immigrants.

Over the years, the MIC market in Canada has grown from millions to billions of dollars. The industry serves two groups: the investors looking for an investment vehicle and the Borrowers who don't meet the Banks' lending guidelines and/or require interim financing.

Section 2.2 – How can a MIC mortgage help you?

There are many reasons why some people cannot qualify for a mortgage with a traditional financial institution even when they have assets or real estate equity.

MICs can provide solutions to Borrowers who are self-employed, new immigrants, real estate developers, have newly established businesses, are income challenged or have bruised credit, and recently divorced, just to name a few.

MICs generally offer short term mortgages, lending to Borrowers who have established assets or real estate equity that can be pledged as security and within a relatively short-term meet the qualification requirements to refinance with a traditional lender or sell their property in an orderly manner. Due to the short-term nature of these mortgages, Borrowers typically have an exit strategy in place to either refinance or pay out the mortgage via the sale of the property.

The pricing (rates and fees) of a MIC mortgage is greater than a traditional financial institution and reflects the higher risk of the Borrower, the security being pledged, the circumstances (the story) of the Borrower and their ability to repay the mortgage.
While MIC mortgages are like traditional mortgages they are also unique in many ways, even amongst the various MICs, as they each have unique characteristics related to their investors' risk and return appetite.

For most, obtaining a mortgage loan will represent the largest debt obligation in one's life. Each Borrower will have different life plans and therefore it is prudent to express what these are to your mortgage broker / lender. Mortgages vary in terms and can be tailored to meet your goals.

Section 2.3 – Understanding MIC mortgages

The following are some key questions you can use to educate yourself in understanding mortgage financing with a MIC.

1. Will you be able to afford the mortgage?
Consider not just how much money or equity you have today but consider your financial position for the term of the mortgage. Can you continue to make the payments in full and on time? Consider how the payments will affect your ability to service other debt, maintain your lifestyle (spending money) and deal with sudden or unexpected financial needs.

2. How stable is your income and employment?
This is especially important for self-employed, seasonal and contract workers as well as all Borrowers where a significant portion of income is variable (commission, bonus, overtime). A decrease in pay or job loss could seriously affect the affordability of the mortgage and your ability to make the mortgage payments.

3. How much does owning a home cost?
Owning a home costs more than the amount of the mortgage. When a home is purchased, there are closing costs, including legal and other fees, property taxes, appraisal fees, and land transfer taxes. Once the home is yours, there are moving expenses, property taxes, insurance, strata fees, home repairs, and so on. Make sure to include all these expenses as part of the total cost when you are considering affordability.

4. Will owning a home affect other financial and life decisions?
Mortgage payments could limit your ability to manage other expenses. After making the mortgage payments, will you have enough money to pay for the things you might need in the years ahead? You may need a vehicle, wish to travel, have children, experience a health issue or assist family. Consider if a mortgage could prevent you from managing other commitments or goals.

5.What type of mortgage best suits your needs?
The most common choices are fixed interest rate, variable interest rate and home equity line of credit (HELOC). Sometimes these mortgage types are available in combinations. A fixed interest rate mortgage has the interest rate set for a specific term and the rate can only change upon renewal (maturity date / end of term).

A variable interest rate mortgage often has an initial interest rate that can increase or decrease during the term of the mortgage. The variable rate is subject to change based on a formula established at the outset and may change at the end of the term.

A line of credit provides an amount that you can borrow and you can use it when you need it. You can pay it back and use it again, like a credit card. Typically, payments are interest-only on the amount you have used. Credit reporting agencies sometimes treat a

HELOC as consumer credit when reported. The credit limit on a HELOC is subject to change at the discretion of the lender.

6. What happens if you can't pay your mortgage?
Not paying a mortgage on-time and in-full could negatively affect your credit score, cause you to incur fees and possibly have foreclosure proceedings commenced against you. If you are in default, the lender has the right to act on its interest via foreclosure, which may grant the lender the authority to sell the property in order to recover the money still owed on the mortgage. If the home sells for a price that is less than what is owed on the mortgage (a shortfall), you will be liable to pay the difference.

7. Will your property value increase or decrease in future?
A home is often viewed as a good investment. However, like all assets,the market value of real estate may fluctuate. A decrease or increase in value would result in loss or gain of owner's equity and may also affect the opportunity to renew or refinance your mortgage.

8. What is the total cost of the mortgage?
The total cost of the mortgage depends on the terms and conditions for paying it back, such as the interest rate, fees and the amount of time it takes to pay off the entire mortgage or "amortization period" (which is not applicable if "interest only"). You will need to determine if the rate, amortization period and total cost of the mortgage are right for you. The mortgage broker or lender must provide you with a disclosure document that estimates the total cost of borrowing for the term of the mortgage.

9. How does the Interest rate affect the cost of the mortgage?
While the actual rate being charged is important there are other factors to consider. Choosing a variable, fixed, or convertible rate will have an impact on the cost of borrowing over the mortgage term. The frequency of the compounding period will also have an impact. The more frequent the compounding period, the higher the effective interest rate. MICs generally utilize a monthly compounding period.

10. Is the interest rate reasonable for you and can you afford it?
If the interest rate is variable, there is a risk that it might increase. Even if the rate is fixed, the interest rate can still increase if/when the mortgage is renewed. Increasing interest rates can raise your payment amount and can make the total cost of the mortgage much higher in the long run. What is the impact on your finances if interest rates increase?

11. Do you understand all the fees over the mortgage term?
Not all mortgages are the same. There are often fees included in a mortgage contract at inception, during the term, at renewal, and at discharge. These include, but are not limited to, fees for arranging the mortgage financing, NSF (non-sufficient funds / bounced payment) fees, discharge fees and renewal fees. Be sure to understand not only which fees may apply and when, but also how the lender calculates the fees. There can also be

broker fees in addition to lender fees. Lenders and brokers must provide information on fees to you in disclosure forms.

- **Good Faith Deposit:** Some MICs will require a good faith deposit upon acceptance of the Commitment Letter. The Commitment Letter outlines general terms and conditions of the loan approval. The good faith deposit amount can vary depending on the complexity of the transaction or the amount of funds required. On residential mortgages, this deposit is credited to you at time of funding. Should the mortgage loan not proceed, the good faith deposit, less any third-party costs, is refundable. In commercial transactions the deposit is not necessarily refundable.

- **Legal fees:** While some MICs allow the same Lawyer or Notary to act for both the Borrower and lender, other MICs require their own legal representation separate from the Borrowers. All legal expenses are borne by the Borrower.

12. Are there pre-payment options?
A pre-payment is paying more than the scheduled payment amount or paying off the entire mortgage ahead of schedule. Depending on the mortgage terms, prepayments can come with penalties. Make sure you understand the pre-payment privileges, rules, administrative fees, and penalties included in the mortgage. Determine whether they are suitable for you. Open mortgages generally allow pre-payment of mortgages with no restrictions or penalties.

13. Can your purchaser assume the mortgage?
Some traditional financial institutions allow homeowners to sell their property by allowing the purchaser to take over their mortgage contract. This is a mortgage assumption. Most MIC mortgages do not allow a mortgage to be assumed. All Borrowers should consult their solicitor prior to accepting an offer that includes the purchaser assuming their mortgage.

14. Can a mortgage contract restrict a change in property use during the term?
A mortgage might include a restriction on how you may use the property. There can be restrictions that prevent you from changing how the property is used (i.e. changing the property from a residence to a place of business or a rental property or removing or altering structures). The lender may have the right to foreclose when there is a change of use.

15. Can a late payment or other circumstances result in additional fees?
A lender may charge fees if you are late making a mortgage payment. Additionally, the lender may take steps to protect the security of the mortgage by paying overdue property taxes, property insurance, and strata fees or assessments and may charge fees for doing so.

16. What is an Inter Alia Mortgage?
An inter alia mortgage is set up as one mortgage over two or more properties. There are two examples where an inter alia mortgage may help:

a) To pledge an existing property that is for sale together with a property being purchased; the mortgage will be registered against each property equally. Once the existing property sells, a predetermined amount of the proceeds will be paid against the mortgage in order to release (discharge) the sold property, leaving the newly purchased property as the sole remaining security for the mortgage loan.

OR

b) To take one or more additional properties as further security to provide enough equity to support the funds you may need or to mitigate the risk to the lender if other factors are evident (credit challenges; primary property has deficiencies, etc.).

Section 2.4 – How long will the process take?

There are many steps that take place from the time that the application is received by the lender until the completion of the transaction. With MIC financing, the Borrower is often working with a mortgage broker. If this is the case, your mortgage broker will assist with the steps below. Depending on the workload of the lender, the loan subject conditions and the lawyers' workload can all impact the length of the process. The steps involved are outlined below.

What can you expect?

- An application is completed and submitted to the lender with your credit bureau report, at minimum;

- The lender reviews the documentation and undertakes appropriate due diligence;

- The lender provides a written offer of financing (Commitment Letter) subject to specific conditions being met (documentation, appraisal, inspection, etc.);

- Terms are accepted by the Borrower and the commitment is returned signed together with a good faith deposit, if required;

- An appraisal, if required, is ordered and other documentation is gathered and provided to the lender;

- Once the lender is in receipt of all requested documentation, including the appraisal report, and is satisfied with the results, the Solicitor will be provided with the lender's Mortgage Instructions (The Lender can also adjust the terms or loan amount or decline the loan at this point);

- The Solicitor is required to complete a number of tasks in order to be in a position to ensure that the lender has a good and valid mortgage charge;

- When all documentation is in order, an appointment will be made for the Borrower to meet with the Solicitor/Notary for signing;

- Finally, the Solicitor will request funds from the lender in order to complete the transaction.

Section 3 – Glossary of Common Mortgage Terms

Appraisal

This is a report, prepared by an independent Professional Real Estate Appraiser, to determine a fair market value in order to support a mortgage loan. Requirement for an appraisal and the preferred appraiser(s) will vary from lender to lender.

Costs of Borrowing

There are numerous costs associated with arranging a mortgage loan. These will include, but are not limited to, land transfer tax (if purchase), appraisal fee, legal fees, lender fee, mortgage broker fee. The APR (Annual Percentage Rate) together with a breakdown of the costs are provided by way of the Cost of Credit or Cost of Borrowing Disclosure Statement on residential mortgages. This may not be provided on commercial transactions.

Interest Rates

- **Prime Rate**
  The Prime Rate is the annual interest rate often used by banks and major financial institutions to set mortgage lending rates. Rates are often expressed as a percentage above or below "Prime". Prime Rate typically refers to the Bank of Canada Prime Rate however it may also reflect a specific major bank's prime lending rate.

- **Fixed-Rate Mortgage**
  A Fixed-Rate mortgage has a set interest rate that will remain constant throughout the term despite any fluctuations to the Prime Rate.

- **Variable-Rate Mortgage**
  The interest rate for a Variable-Rate mortgage is usually expressed as the Prime Rate plus (or minus) a certain percentage. The interest portion of the payments for this mortgage would change whenever the Prime Rate changes.

- **Annual Percentage Rate (APR)**
  The Annual Percentage Rate reflects the overall annual percentage rate including costs of borrowing (interest to be paid over the term of the mortgage, lender fee, broker fee, appraisal fee, legal fees, etc.) The APR will be higher than the stated rate of the mortgage as a result. The APR, together with a breakdown of the costs, is provided by way of the Cost of Credit or Cost of Borrowing Disclosure Statement on residential mortgages.

Loan-To-Value Ratio (LTV)
This ratio represents the loan amount to property value. Example: Mortgage Loan Request $700,000; Property Market Value $1,000,000. $700,000 divided by $1,000,000 equals 70% (Loan to Value Ratio). If the property has an existing mortgage and is obtaining a 2nd mortgage the existing and new mortgage amount are added together to calculate the LTV. Each lender will have their established threshold for their LTV Ratio.

Payments

- **Repayment Frequency**
  Typically, mortgage repayment occurs monthly, semi-monthly, bi-weekly or weekly. Flexibility on accelerated repayment will vary from lender to lender.

- **Interest-Only Payments**
  This is one method of mortgage repayment that may be available. As it states, the expected payment represents the interest component only; therefore, the principal mortgage balance (gross loan) will not reduce at any time during the term of the loan (non-amortized).

- **Principal and Interest Payments (P&I)**
  Payments of an amortized loan include paying the interest owing as well as an additional amount to reduce the principal of the loan.

- **Amortization**
  The number of years, at a constant rate of repayment, required to repay the mortgage in full (longer amortization = lower payments - longer to repay in full = higher total cost; shorter amortization = higher payments - shorter time to repay in full = lower total cost). Repayment of an amortized loan is a blended principal and interest payment. Amortization periods may differ between mortgage lenders.

Prepayment Penalty
Some mortgages may require a penalty should the mortgage be paid out prior to its maturity date or may only allow the mortgage to be paid out on a bona fide sale.
Each mortgage is unique and will vary by institution and product.

Prepayment Privilege / Terms
Some mortgages may contain allowances for mortgage payout or principal pay down without penalty. These include, but are not limited to:

- Fully Open – allowance for payment directly to principal and/or allowance to increase monthly payments.

- Closed – meaning that there will be a fee or penalty for additional principal reductions during the term of the mortgage. Details will depend on the mortgage terms.
- Open (partially) – meaning that there is some allowance or privilege for extra principal repayment during the term. Details will depend on the mortgage terms.

Security
This is the property or properties offered as security for the mortgage loan.

Standard Mortgage Terms

Standard Charge Terms are part of every mortgage document. These may vary slightly from lender to lender but basically represent the expectations of performance and obligations of the Borrower in more detail.

Term / Maturity
The length of time that the mortgage's conditions, such as interest rate, are fixed. At the end of the term (maturity date), the Borrower will be offered a renewal or will be requested to repay the loan in full.

Types of MIC Mortgages

- **Purchase**
  A mortgage arranged to complete the purchase of a property.

- **Refinance (Re-fi)**
  Replacing a mortgage on title with a new mortgage or re-negotiating a current mortgage.

- **Debt Consolidation (Debt Consol.)**
  A mortgage arranged to combine (consolidate) debts into one payment, usually at a lower rate than the current debts.

- **Equity Take Out Mortgage (ETO)**
  An Equity Take Out mortgage is a mortgage that draws on the equity portion of the security. Equity is the difference between the property value and the balance of any mortgages on title.

- **Renovation (Reno)**
  This is an Equity Take Out mortgage (see above) where funds are utilized for home improvement.

- **LOC – Line of Credit, PLOC – Personal Line of Credit, HELOC – Home Equity Line of Credit**
  A mortgage loan that is re-advanceable or revolving and allows the Borrower to draw on funds paying interest only on the advanced portion of the loan.

- **Inter Alia Mortgage**
  A mortgage that is registered over two or more properties.

- **Reverse Mortgage**
  A reverse mortgage (sometimes referred to as a CHIP mortgage) is a mortgage available to homeowners age 55+ who have substantial equity in their property. Interest is added to the principal of the loan, thereby allowing the homeowners' equity to pay for the loan payments in lieu of monthly repayment.