

Recycling Your Down Payment

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Last month we talked about the CMHC 2nd Home Mortgage Program as a way to purchase a summer home or cottage with as little as 5% down. This month we'll take a look at the same product and show you how a new investor can use this tool to recycle the same down payment money and use it twice.

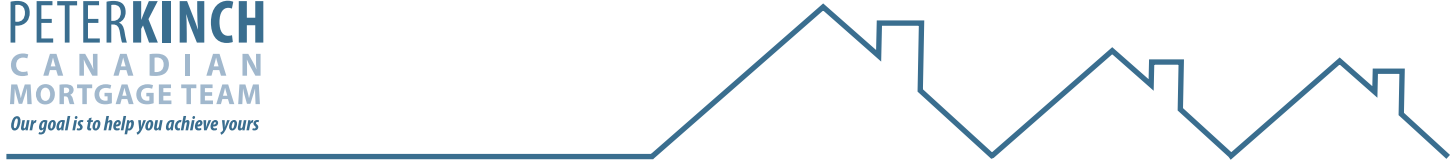
As a new or relatively new investor it is quite likely that you have already discovered that one of the major obstacles in developing a revenue portfolio is how to make the amount of capital you have available for down payment funds stretch over a number of properties. There are of course, many answers to this dilemma, but for the purpose of this article, I will focus on one solution – the CMHC 2nd Home Mortgage Program.

So what is the 2nd Home Mortgage Program? CMHC will allow you to purchase a secondary home utilizing any of their insurance products as long as it fits into their criteria. In order for you to qualify, the property must be intended for occupancy at some point during the year by the borrower or a relative of the borrower on a rent-free basis. The key point here that many investors miss is 'relative of the borrower'. This means that if you have a son or daughter in University, you can purchase a home or apartment for them to live in while going to school and qualify for a CMHC mortgage on that property.

But here's a real life example of how to use this product to recycle the same down payment twice. I have a client who bought a 4-plex up in Prince George a few years ago. The client also happened to have a nephew going to university in Prince George at the time. The nephew was renting and paying \$800 a month for rent. Since the nephew qualified as a 'relative', we could submit this file for qualification under the 2nd home mortgage program. But upon further examination of the client's goals, we discovered that they wanted to be able to buy two properties over the next 6 months but they only had \$45,000 available for down payment. The purchase price was \$175,000 and the traditional 25% down would have required \$43,000. Clearly, if our client had made the purchase with 25% down, they would have had no money left over to purchase their second property. So we went to work and did some quick calculations:

- He purchased the 4-plex with 25% down (\$43,000) but used an Open mortgage.
- He got a good deal on the property with a long close, so there was equity in the property at the point of closing.
- Over the course of the six months the property continued to increase in value.
- An appraisal 6 months later showed a value of \$195,000.
- We then refinanced the property using the CMHC 2nd Home Mortgage Program since his nephew was a resident in one of the units.
- The guidelines on a 4-plex limit the loan to value to 90%.
- 90% of the new appraised value of \$195,000 is \$175,500, which was equivalent to the original purchase price.
- The client received \$44,500 back in refinance money (less legal costs) effectively making this a zero down deal.
- The client then had \$44,000 to use as a down payment for their next purchase.
- The net effect was to take the client's down payment funds of \$45,000 and recycle it to use the same money to buy two properties.

So what's the catch? Well, the catch is that in order to use this product, you will end up playing in the CMHC sandbox and as such, you will have to follow their rules. It's important to realize how CMHC analyzes rental income on an existing portfolio when calculating your debt service levels. When playing in the CMHC sandbox, they will require that you be able to verify enough income to service all of your personal consumer debt (including the mortgage and taxes on your personal residence) along with the mortgage on the new property. With this program, you are not allowed to use any income from the unit that is owner-occupied for qualifying purposes, but you can use 80% of the rent from the other 3 units. If you have a portfolio of properties outside of the property you are buying, CMHC will only take



50% of the rent and add it back to your income for qualifying purposes. That is the reason I recommend this as a great tool for new investors. Typically, anyone who has a large portfolio would have difficulty qualifying if they were only able to use half of their rental income. When combined with the fact that many real estate investors with larger portfolios are self employed and their tax returns are not always reflective of their real income you can pretty well bet CMHC will decline the deal. "But that's not fair" you say – I know, but it's their Sandbox, they make the rules!

So who is this good for? This program is perfect for a relatively new investor who has good verifiable income and minimal personal debt. A perfect candidate would be empty-nesters who have kids in university and some good equity built up in their principle residence. If done properly, they could access the equity from their home to make the initial purchase, follow the above example and recycle that down payment into one more deal. Once that money is spent, they would have to look for joint venture partners to keep building the portfolio. It should be noted that at the time of writing this article, CMHC was coming out with a new program allowing 100% financing on rental properties with CMHC insurance. If this product is available, you can do the exact same as outlined above, but you don't have to worry about finding a relative to live there.

There are a lot of ways to be creative while still staying within the lender guidelines and avoiding the gray area of fraud and misrepresentation. You just have to learn their rules and work with professionals who understand how to make the bank rules work with your goals.

Until next time,

Happy investing!

Peter Kinch