

## Spring Market News

### March 2007

Over the past few months, I've written a series of articles that have been geared towards teaching real estate investors about the ins and outs of mortgage financing through the eyes of a Mortgage Broker who specializes in consulting investors. Through my experience, I have come to realize that it is impossible to really help an investor with their mortgage financing unless we first stop to consider what it is all going to look like when it's done. At the end of the day I have come to realize that there is a cause and effect to everything we do and a simple analysis of that cause and effect before taking action will most often prevent mistakes.

To that end, I found myself analyzing the new Spring Market campaigns that are being launched by the banks throughout the month of March. One of the biggest innovations in the Investor market is in the area of high ratio insurance. One of my previous articles covered 7 Options on Down Payments for Rental Properties. In there I stated that CMHC offers a high ratio insurance program for rental properties but that it's not very effective or useful. I also mentioned that there were as many as three new Insurance companies looking to enter into the Canadian market place. As a result, CMHC and Genworth Financial (who have held a virtual monopoly on the high ratio insurance game for years) have had to re-evaluate their programs.

Well by the time you read this, you may well have heard of the Splash that Genworth made in the pool – They have come out with a new program for Real Estate Investors geared at helping you get into a property with as little as 10% down. They are also going to let you use a 40 year amortization to help qualify for it. Now before you jump up from your desk and call your local bank, it's important to note that as of yet, no major bank has jumped on board and agreed to offer the product. At the time of writing, it is only available through Maple Trust and a few Credit Unions.


But here's the real question I want to ask you. Is this mortgage a good option for you on your next rental purchase? Remember what I said earlier, your answer lies in a simple analysis of the cause and effect of each decision.

Let me explain: Let's take a typical real estate investor and look at his portfolio from what I call the 3000 foot view. Let's suppose that he's self-employed, has a mortgage on his principle residence, owns a few rental properties and has \$50,000 to invest. His goal is to buy between 15 and 20 properties over the next 5 to 10 years. Sounds pretty simple right; and in fact, looking at that situation, the typical thought process would be to try and stretch the \$50,000 over as many properties as possible. So, on the surface being able to put only 10% down sounds like a great idea.

But let's take a closer look. Without even knowing anything about this client other than what I've already told you, we already know he has two obstacles standing between him and his goal: Qualifying based on his debt service ratios and coming up with enough down payments to buy his properties. As his broker, I'm going to make a couple of assumptions that are probably quite accurate. One, I'll assume that since he's self-employed, he probably makes more money than is reflected on line 150 of his tax return. So let's review what we know about banks and how they calculate debt service ratios. A bank will typically look at a 2 to 3 year average of line 150 on your tax return. Then they will want me to use only 40% of that to service your personal consumer debt. Personal consumer debt is defined as the mortgage on your principle residence along with your property taxes and any item that shows up on your credit bureau that requires a monthly payment – such as credit cards, loans or leases. Now this is where I'll also assume that our self-employed business owner probably has guaranteed a few items for his business that show up on the credit bureau as personal expenses.

Now up to this point a good broker is probably still doing ok with his client. We would look for some areas to add back income from our client's financial statements and present a reasonably strong argument that there is sufficient income from the business to service the client's personal consumer debt. So let's say for arguments sake, that we've been able to present this in a way that although the debt service ratio is at or above 40 % (remember the deal is typically declined when the TDS is over 40) the lender is willing to look at the rental property. Well the first

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thing the lender is going to want to know is whether or not the property cash flows. Why is this important? Simple; if the client's portfolio shows a positive cash flow, we can add any surplus to his income to help offset personal consumer debt. But if the existing portfolio is negative cash flow, the shortfall gets added to his personal consumer debt and puts further strains on the ability to qualify based on the client's self-employed income. So, as you can see having a surplus of positive income in your rental property portfolio can be quite critical depending on how much income you declare and how much personal debt you carry.

So what does this have to do with the new Genworth program allowing 10% down? It means you have to ask yourself an important question before jumping in; what would this mortgage do to my cash flow? In most markets today, it's hard enough to get breakeven or positive cash flow with 25% down payment, let alone only 10% down. Having said that, Genworth allows you to amortize this mortgage over 40 years, so that may well be the saving grace. But going back to our self-employed investor, it becomes critical to ask the tough questions and always analyze the cause and effect. If putting 10% down creates negative cash flow on this property, how does that affect my portfolio and how will it impact my ability to qualify for my next purchase. Keep in mind that our sample client ultimately wanted to buy 15 to 20 properties and the only appeal in putting 10% down in the first place was to make his down payments stretch further. In some cases that may well be a good strategy if the numbers still work. But if they don't, then your best bet instead of trying to stretch one dollar into two – is just go find two dollars in the first place. And the best way to do that is through developing the ability to find joint venture partners. But, that's a whole other topic that we'll leave for next month.

Until then, Happy Investing

Peter Kinch