BATCHER, WASSERMAN
Barristers, Solicitors & Notaries

Comments on Regulation Affecting Private Lending

2020-09-21

Private Mortgages and High-Risk "SMI" Products

Problems:

Consumers invested in high-risk development projects that were called "Syndicated Mortgages" (SMIs)

- Highly speculative risk-level was misrepresented
- Investments were called mortgages but were something quite different

Regulatory response identified these problems by number of investors instead of by risk factors

- Creates 'red tape' for traditional mortgage syndication businesses that are unrelated to targeted deals
- Makes borrowing by small business, new immigrants, individuals very difficult, affects economy

Ideal Regulatory Response:

- Transfer of regulatory authority for ***high risk development projects*** to OSC
- Expand qualified mortgage "carve-out" to keep low-risk investments under FSRA (0. Reg 188/08)
- Balance the protection of borrowers and investors against regulatory drag

Market objectives:

- Healthy, open financial markets
  - Loan options for families in need, small businesses, entrepreneurs
  - Investment opportunities for small and large investors alike
- Coordinated regulatory regimes – Mortgage Brokers, Exempt Market Dealers
- Let Ontario be a leader in creating a regulatory regime that is 'open for business'

What is a "mortgage"?

Legal definition – "security over real property", usually as collateral for a loan

Consumer perceptions: *mortgages are safe, fully backed by real assets*

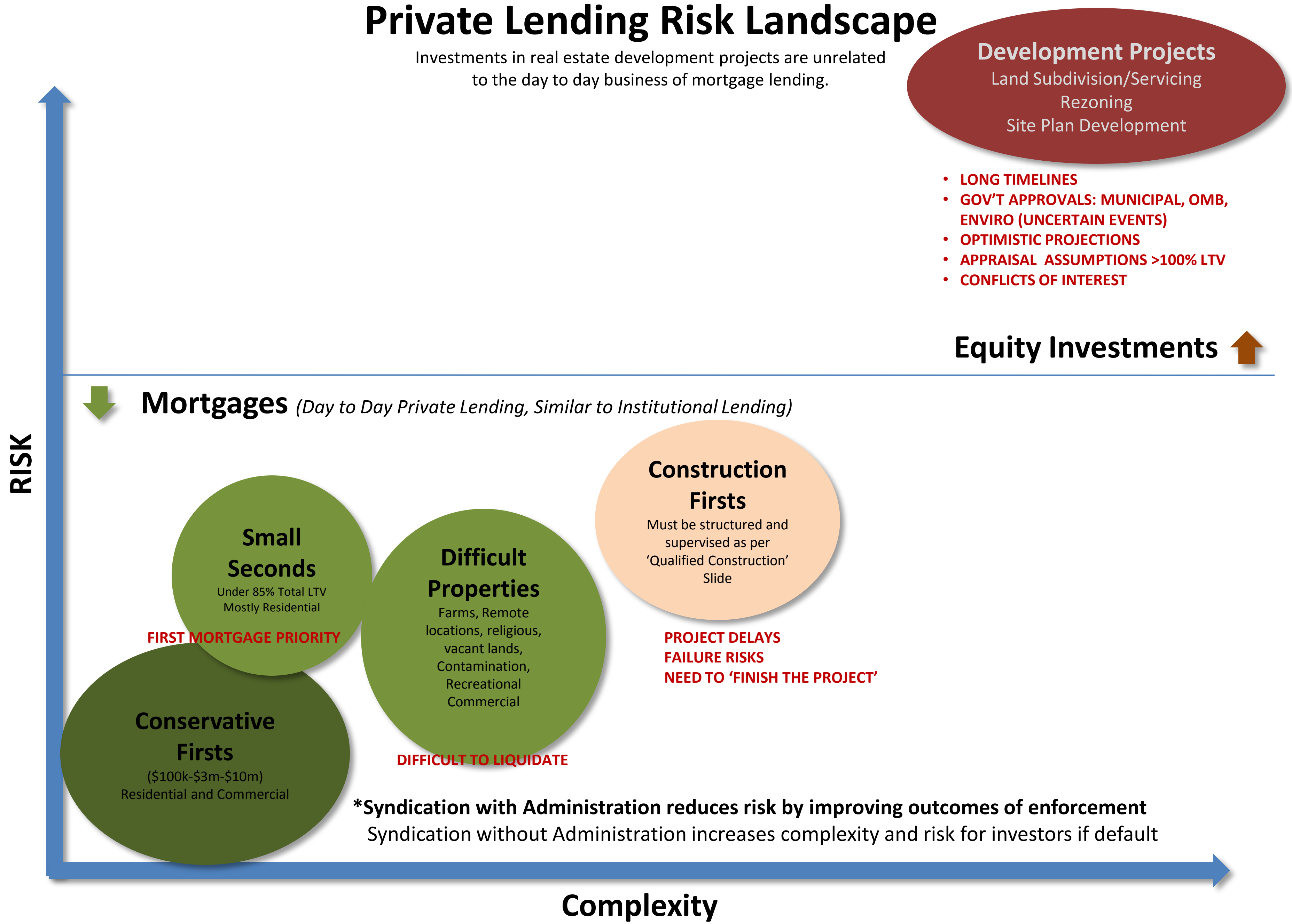
Institutional Mortgages	**Private Lending Mortgages** *(for those that are aware and involved)*
• Safe, trustable – like a loan from bank to buy your home, • happens every day	*People helping People* • Asset-based loans for borrowers who can't get a bank mortgage • Opportunity to invest with superior returns, managed risk • happens every day

These mortgages are common, happen every day and drive our economy

Promoted as 'Syndicated Mortgage Investments': *not fully backed by real assets*

High-risk real estate development projects *(Real estate development is a business venture, not a loan on existing collateral)*
• Not based on actual property value (as-is appraisal) • Appraisal involves assumptions, uncertain events and/or projected income • Loan-to-Value > 100% • Conflicts of interest are common • Priority can change

Using the word "mortgage" for these development projects is misleading


Private Lending Risk Landscape
Investments in real estate development projects are unrelated to the day to day business of mortgage lending.
Development Projects
Land Subdivision/Servicing
Rezoning
Site Plan Development
• LONG TIMELINES
• GOV'T APPROVALS: MUNICIPAL, OMB, ENVIRO (UNCERTAIN EVENTS)
• OPTIMISTIC PROJECTIONS
• APPRAISAL ASSUMPTIONS >100% LTV
• CONFLICTS OF INTEREST
Equity Investments
Mortgages (Day to Day Private Lending, Similar to Institutional Lending)
RISK
Small Seconds
Under 85% Total LTV
Mostly Residential
FIRST MORTGAGE PRIORITY
Difficult Properties
Farms, Remote locations, religious, vacant lands, Contamination, Recreational Commercial
Construction Firsts
Must be structured and supervised as per 'Qualified Construction' Slide
PROJECT DELAYS
FAILURE RISKS
NEED TO 'FINISH THE PROJECT'
Conservative Firsts
($100k-$3m-$10m)
Residential and Commercial
DIFFICULT TO LIQUIDATE
*Syndication with Administration reduces risk by improving outcomes of enforcement
Syndication without Administration increases complexity and risk for investors if default
Complexity

Proposal: Qualified Simple Mortgage

Change the "carve-out" to allow all property types (commercial, mixed, etc)

Borrower market:
Anyone not able to go to an institutional lender
Home/business owners, *Entrepreneurial* Ontarians (including families), New Immigrants, Those establishing new credit

Defining Characteristics

- **'As is'** direct comparison valuation certified by recognized and insured appraiser
- **LTV <90%** (Fully Drawn)
- **NO** subordination/ postponement/ dilution provisions
- **NO** Brokerage conflicts of interest
  - borrower/builder
  - advisors
  - vendor

Eligible Investors

- Any single lender
- Single 'Permitted' Lender
- Multiple 'Permitted' Lenders (QSMI)
- Multiple Retail Lenders
- Agents and brokers

Syndication is not an indicator of loan/borrower risk.

Mortgage Brokers are writing these deals every day

They are successful professional brokers for their private lenders, protecting investors, borrowers and their mortgage businesses alike.

If these were high risk one offs, they would not have multiple generations of families investing and borrowers returning with new properties, renewals and projects.

Proposal: Qualified Construction Mortgage

Additional "carve-out" for Fully Approved and Funded Construction

Initial advances on a Qualified Construction Mortgage can be on a 'Simple Mortgage' basis, e.g. 'land loan' phase, before project approvals, subject to 90% LTV on 'as-is' valuation only

Defining Characteristics

- **Both 'As-is' and 'As if complete' valuations certified by recognized and insured appraiser**
- **Fully funded to completion**
  - Allowing for lender to step in and finish the job without requiring new funds if action required
  - Full loan amount subscribed/ funded, managed by broker/administrator
  - Remaining loan advances fund project to completion including construction lien requirements etc.
- **Certified project review and progress reports**
  - Plans, budget /construction progress certified by licensed and insured Professionals:
    - Qty Surveyor
    - Appraiser (AACI)
    - Architect / Engineer
- **All approvals /contracts in place**
  - Zoning, use, site plan all approved
  - Building permits issued
  - General Contractor
  - Tarion, Insurances, etc
- **LTV < 80%** at all times on '*cost to complete*' basis
- **NO** subordination/ postponement/ dilution provisions
- **NO** Brokerage conflicts of interest

Borrower market:
Small home-builders
Entrepreneurial Ontarians (including families)

Eligible Investors

- Any single lender
- Single 'Permitted' Lender
- Multiple 'Permitted' Lenders (QSMI)
- Multiple Retail Lenders
- Agents and brokers

Legitimate construction mortgages are easy to identify:

- They follow a very detailed and specific process
- They are created and managed by companies that do this regularly and often and generally do it very well.

Recommendations

Increase definition of 'Qualified Syndicated Mortgages' to include:

- The addition of all land types, enabling commercial deals and others to be written without residential components
- The addition of construction mortgages (as detailed in this submission)
- Definitions for the administration requirements of syndicated mortgages

Final Statement

Our experience is with asset-based private lending, often misunderstood even within the industry, but a very important part of our economy. For borrowers, it enables new businesses to buy a property, religious communities to come together, new immigrants to get a home, and allows regular people to get second chances and get back to institutional lending without losing their property.

On the lending side, it is an opportunity for regular people to help their immediate communities and neighbours, and achieve much better returns than elsewhere. The investment is backed by real assets, legitimate appraisals and, depending on loan to value ratios, can withstand significant market corrections with minimal risk. When these loans are syndicated, investors can take smaller amounts in individual deals, diversifying their risk.

This kind of lending is completely different from the speculative, forward looking equity investments found with real estate developments, speculative land buys etc, but it is being painted with the same brush. We applaud how FSRA and OSC have so clearly identified the risks involved in high risk speculative investments, and it's such a shame that they chose to identify those investments based on how many lenders are involved (syndication), rather than the risks they so clearly identified. The 'carve out' for qualified syndicated investments helps, but that definition still remains unnecessarily narrow.

Regular mortgage brokers and retail lenders should be able provide mortgages to small businesses, religious groups and charities for their commercial real estate. Similarly, shutting out construction and renovation projects that are supported by <u>as is</u> appraisals hurts entrepreneurial Ontarians. Many in the mortgage industry are very good at these kinds of deals, they have had to be, their business depends on their ability to write good deals where both the borrower and the lenders involved are very well protected.

Drawing on the decades of experience in this firm alone, there are sensible ways to distinguish between high-risk development projects and normal mortgage loans that serve hard working borrowers and lenders. This type of lending is especially important for Ontarians in remote and rural areas that have few options other than private lending.

Appendix

What is a “syndicated mortgage”?

Risks and Mitigations of Mortgage Types

What is a “syndicated mortgage”?

Funds for a mortgage loan are provided by multiple lenders

Examples:

- Small institution (e.g. Credit Union) brings in other lenders for a large loan
- Families/friends provide a mortgage for a friend/community member
- Mortgage broker organizes a group of investors to fund an asset-based loan

There is no additional risk in having multiple lenders vs. a single lender, risk is inherent to the investment, not the number of lenders.

Risks and Mitigations of Mortgage types

Single Lender Vs Syndication

<table>
<tr><th></th><th></th><th>Single Lender</th><th>Syndicated Lenders</th></tr>
<tr><td>LTV</td><td>Must anticipate possible market corrections, GTA historically was 30% in 1990’s</td><td colspan="2">In our market segment, a standard LTV Maximum is 65% of appraised value. Uncertain times (such as a pandemic), location, commercial vs residential, complications etc come into play reducing that maximum. In the face of more potential adversity, techniques such as pre-paid interest and payout incentives are employed to ensure the success of the deal.</td></tr>
<tr><td>Appraisal</td><td>Must be certified by licensed and insured appraiser, offering avenue for legal action if power of sale is short</td><td rowspan="3">Single lenders must have the resources to pursue actions/enforcements if required</td><td rowspan="3">Syndicated mortgages allow lenders to invest in multiple properties/deals, diversifying their risk, otherwise there is almost no difference between a syndicated mortgage and a single lender mortgage.

Some brokers simply have a lawyer write up the deal with every investor listed on the charge and then distribute post dated cheques, walking away from the deal. This can create opportunities for problems as each lender has the right to initiate an action. They must each also monitor all cheques for returns, issues etc and in the case of an action, they need the resources to initiate the action and results can vary.

To mitigate this risk, we have found it both invaluable and essential to manage each deal under a trustee, where all lenders are represented and acted on behalf of as one. Each lender is provided with full disclosure and receives a fully automated cheque every month, from all of their investments, as reliably as a phone bill.</td></tr>
<tr><td>Position</td><td>A 2^{nd} must anticipate market correction plus the costs and fees of a 1^{st} in the event of a power of sale, in addition to no control over process</td></tr>
<tr><td>Mortgage Administration</td><td>Admin quality ranges from simply passing on post dated cheques to the employment of a trustee intermediary</td></tr>
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