LENDER ATTITUDES TO GRADUATED PAYMENT MORTGAGES AND SOCIAL HOUSING LOANS

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A Report Prepared For

Canada Mortgage and Housing Corporation

Prepared By

Clayton Research Associates Limited

November, 1980

SUMMARY

The results of the interviews held with 13 mortgage lenders and 2 private mortgage insurers produced the following general findings:

- Lenders are opposed to the principle of the Graduated Payment Mortgage (GPM); their opposition is especially intense for homeowner GPMs; several lenders look more favourably on rental GPMs.

- Lenders generally support loans to non-profit and co-operative groups; most lenders expressed no hesitation about making such loans in rural communities providing they have an office nearby and the loans make sense.

- Lenders generally are negative toward making loans in rural communities to borrowers receiving debt service subsidies from CMHC.

- Several of the lenders surveyed expressed the view that CMHC should restrict its activities to social housing (*e.g.*, stop promoting the GPMs); in the mortgage insurance field several of the lenders interviewed felt that CMHC should have to compete with the private insurers under the same rules the private insurers face.

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INTRODUCTION

This report deals with the attitudes of mortgage lending institutions to graduated payment mortgages(GPMs) and social housing loans.

Interviews were conducted during the last week of October, 1980 with 13 mortgage lenders and 2 private mortgage insurance companies:

Mortgage Lenders Surveyed

Chartered Banks:	Bank of Commerce (Kinross) Bank of Montreal Bank of Nova Scotia (Scotia Covenants) Royal Bank Toronto Dominion Bank
Trust Companies:	Canada Permanent Trust Canada Trust Credit Foncier Trust Investors Syndicate Trust Montreal Trust Victoria and Grey Trust
Life Insurance Companies:	London Life Mutual Life
Mortgage Insurance Companies:	Mortgage Insurance Company of Canada Insmor Mortgage Insurance Company

A copy of the list of questions around which the interviews were structured is included as an appendix. This list was used only as a guide. Some topics included on the list received very poor responses so they are not discussed in the report. The questions on the most likely candidates for GPMs and the characteristics of applicants turned down are examples of the questions which had poor responses.

Clayton Research wants to express its thanks to all the lenders taking part in the interviews. Without their very willing cooperation, the assignment would not have been possible.

GENERAL ATTITUDES TO GRADUATED PAYMENT MORTGAGES

● Fewer than half of the lenders surveyed have done any GPM lending

Five of the 13 lenders surveyed have made at least 1 GPM loan (either NHA or private insured or both). Two of these lenders were banks and 3 were trust companies.

	Chartered Banks	Trust Companies	Life Insurance Companies	Total
Have made at least 1 GPM loan	2	3	0	5
Have made no GPM loans	3	3*	2	8

* Includes a trust company which made 1 rental GPM loan on behalf of an investor client.

● Only 3 of the 5 GPM lenders surveyed have generally available GPM programs and 1 of these is limited to rental loans

Only the 3 trust companies making GPM loans have instituted generally available GPM programs. Two of these companies make both homeowner and rental GPM loans while the third restricts its activities to the rental sector. One of the 2 banks making GPM loans has only committed a limited number of homeowner loans and even fewer rental loans. The other bank has made a small but significant number of GPM loans; however, it restricts ownership GPM lending to customers of selected pre-approval builders. This bank has also made a limited number of rental loans.

ATTITUDES TO HOMEOWNERSHIP GRADUATED PAYMENT MORTGAGES

- The lenders surveyed are virtually unanimous in their opposition to the general concept of homeownership GPMs

The lenders surveyed generally do not like homeownership GPMs in principle. Twelve of the 13 lenders and 1 of the private mortgage insurers surveyed expressed a distaste for a mortgage instrument which is predicated on the continuation of inflation.

> "Totally opposed; morally irresponsible to depend on inflation; can't see telling a borrower who faithfully paid his mortgage payments for 5 years that he now owes $3,000 more than what he started with."
>
> "Against principle of relying on future inflation."
>
> "Principal objection to GPM is that it replaces AHOP - increasing incomes are required to pay back larger outstanding balances."
>
> "In principle just don't like them; gambling on inflation."
>
> "GPM = 'go poor mortgage'."

Several of the interviewees also dislike the GPMs on the grounds they entice borrowers into the market before they are ready by creating an artificial stimulus in the marketplace.

> "I decry any scheme including the GPM which creates artificiality in the market place. Let the market operate without these schemes."

The view was also put forth by 1 interviewee that the Canadian mortgage market is flexible enough to adjust to changing circumstances without government pressure to force the industry to accept GPMs.

> "In Canada, we have a damn good mortgage market; cooperation between the lending community and the Federal Government has allowed the market to keep up with the times; the U.S. situation is much different."

• Lender opposition to homeownership GPMs is based on practical grounds as well

Several interviewees expressed concerns about the difficulties of implementing a general program of GPMs which would exist even if they supported the principle. One interviewee, however, discounted the real importance of these difficulties:

> "Lenders talking about administrative costs, etc., as reasons for not doing GPMs are using these as an alibi."

The need to make substantial changes to existing computer programs or to administer GPM loans manually

All except 1 of the lenders surveyed have their mortgage administration function computerized. These computerized systems are designed to handle the administration of the traditional equal payment mortgage. Several interviewees stated that the administration of the GPM, where the monthly mortgage payment changes in the early years, would require significant computer reprogramming. Lenders doing GMPs are administering the loans manually.

> "Administration is a problem; unless we could see GPMs as becoming 15%-20% of our mortgage business we can't justify changing current procedures and computer programs."

> "Since payment on a GPM is not in full it shows up as an arrears in our computer; to change existing programs would take a major rewriting."

The one lender who is on a manual system for administering its mortgage accounts also stated that administrative costs were higher for GPMs.

The term required on GPM loans is not compatible with the term on incoming funds

The matching of terms on assets and liabilities has become a crucial issue for many mortgage lenders. The issue is a direct outgrowth of the volatile interest rate pattern of the past year. Some interviewees said that GPMs are not an attractive mortgage instrument at this time since the GPM requires a term of at least 3 years to be workable. This conflicts with incoming funds available for mortgage lending which are largely of 1-year term.

"Big concern - 5-year term; hard to commit funds for 5-year when incoming funds are shorter term."

"GPM has to be a long-term instrument (5 years); we are getting very little 5-year money; have to match term of assets and liabilities."

Not all lenders are having trouble attracting 5-year funds at present. Life insurance companies, for instance, appear to have a plentiful supply of 5 year money. Two of the banks surveyed reported a good inflow of 5-year money as well. One of these banks said the low rate payable on Canada Savings Bonds is probably a contributing factor. The other attributed its success in getting 5-year money to an aggressive sales compaign.

<u>The GPM has negative cost flow consequences and interest rate uncertainties</u>

The trust companies, in particular, raised cash flow concerns as reasons to avoid GPMs. Their cash flow is reduced since income tax is payable on interest income accrued on GPMs but not received. In addition, increases in the outstanding balance of GPMs have to be financed with new funds. Lenders have no idea what interest rates will be payable on these additional funds; yet they are tied into a fixed rate for a 5-year term on the GPMs.

- <u>The majority of lenders surveyed feel that risks on homeownership GPMs are greater than on the traditional equal payment mortgage</u>

More than half the interviewees feel that the current NHA GPM with a maximum initial loan of 90% of value is at least marginally riskier than a maximum equal payment mortgage loan of 95% of value.

"The GPM is riskier; won't touch without Quick Settlement."

"A 30% gross debt service ratio is okay in the first year if income is expected to go up; a 30% ratio for 5 years means taking a lot of risks."

"The year in which the maximum outstanding loan is reached under the GPM (about year 6) is the same as the turnover of the average existing home; the high loan could reduce the marketability and, hence, the resale value of homes with GPM loans."

The view was expressed by a couple of respondents that the risk with the 2 NHA mortgage instruments (assuming maximum loans) is likely to be the same.

> "There is no difference between a 90% GPM and a 95% equal payment mortgage; both require inflation or there could be trouble."

The one mortgage insurer insuring GPMs implicitly feels that the risk on a GPM is greater since this is still an experimental program; this is why they charge an extra ¼ of 1% premium on GPM loans.

- For the most part GPM borrowers do not appear to be marginal first time buyers

One has to distinguish here between borrowers obtaining (a) private sector GPMs (e.g., MICC's GPM, NuWest's YES and Victoria Wood's FLIP); (b) the general NHA version with Quick Settlement; and (c) the NHA version without Quick Settlement.* Virtually all non-NHA GPMs have been insured by the Mortgage Insurance Company of Canada who reports few, if any, of the GPM borrowers have modest incomes.

> "We have never had assistance to modest income home purchasers as an objective (unlike CMHC); in practice, therefore, a significant percentage of clients are not at the margin; the loans are frequently used to achieve a bigger house."

One of the more active lenders under the various MICC-insured GPM programs confirms the absence of marginal first time buyers.

> "We are not seeing any marginal purchasers; the majority of borrowers are generally young professionals who like a free-wheeling way of life and are upwardly mobile; our first GPM borrower was a couple whose use of the GPM allowed them to buy the home they wanted and at the same time to have sufficient money to take a trip to Hawaii."

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* One bank has had a modified NHA-insured GPM approved by CMHC.

The 1 lender surveyed which has limited its NHA GPM lending to loans qualifying for Quick Settlement states that virtually all of its GPM borrowers are marginal purchasers.

> "Almost all are marginal purchasers; if purchaser can't qualify for an equal payment mortgage, then they are qualified for a GPM; many borrowers are really people who shouldn't be in the market."

A lender who has done NHA-insured GPM loans which exceed the price limits for Quick Settlement reports that most GPM borrowers are not marginal.

> "GPM borrowers fall into two groups - blue collar workers with working wives, who can pretty well project their immediate term income growth, and higher income wage earners (frequently without a working wife); majority of borrowers fall into the first group; find people go for what they can afford; still go up to a 30% gross debt service ratio; so they buy a more expensive home under a GPM than they otherwise would."

- Lenders responding generally feel that GPM loans are most appropriate in high cost areas and areas experiencing rapidly rising house prices

Lenders expressing a view on whether GPMs are more appropriate in some parts of the country than others responded in the affirmative. They frequently mentioned Alberta, British Columbia and submarkets such as downtown Toronto as most appropriate areas for GPM lending.

> "GPMs are most appropriate in those parts of the country where the economy is buoyant and conditions look correspondingly good for the years ahead. Calgary and Edmonton are good examples."

> "Most applicable in high cost areas (*e.g.*, downtown Toronto, Vancouver) or in boomtowns; in most rural/suburban areas houses are affordable without relying on inflation."

> "Do not consider GPMs appropriate in depressed areas where income growth prospects are restricted."

- <u>Most lenders responding feel the downpayments should be larger for GPMs than for equal payment mortgages</u>

There is a consensus that if equal payment mortgages have a 95% maximum loan, the comparable GPM maximum loan should not exceed 90%. The view was also put forth that the maximum outstanding balance under a GPM should never exceed the maximum loan available for an equal payment mortgage.

> "Obviously yes."
>
> "Downpayments have been different on NHA loans; we agree with this."

One lender who opposes the principle of GPM wondered about the effect of lower GPM downpayments.

> Higher
> "Lower downpayments partially defeats the purpose of the GPM."

- <u>Underwriting criteria are either the same or only slightly more rigorous for the GPM as for the equal payment mortgage</u>

Of the 4 lenders doing GPM homeowner loans, 2 use identical underwriting criteria for GPMs and 2 use slightly more rigorous criteria. The private insurer insuring GPM loans stated that they are more concerned about future income under a GPM than with a equal payment mortgage.

> "Rules are the same."
>
> "Would be hesitant to recommend to CMHC GPM applicants whose gross debt service ratio or total debt service ratio go above 30% or 40%; with the equal payment mortage will go higher for some applicants."
>
> "In a way, yes. We don't have a generally available GPM program; people who want a GPM have to go through a builder we have approved, and we have approved relatively few builders; we also probably look at income growth potential more on GPMs than on equal payment mortgages."

- <u>Lenders making homeownership GPMs would not want the annual escalation rate to exceed 5% to 7½%</u>

The 4 lenders and 1 mortgage insurance company involved in GPM homeownership lending are unanimous that an escalation rate exceeding 5% to 7½% would be excessive.

> "5% is about right though might be prepared to look at something different if it was offered."
>
> "No higher than 5%."
>
> "Do FLIP which has a 7½% escalation built into it."

- <u>Quick Settlement is not a prerequisite for NHA GPM lending by all lenders doing this type of lending</u>

Only 1 of the 3 lenders making NHA-insured GPM loans regards Quick Settlement as a prerequisite for such lending. However, 1 of the other 2 lenders said they would be more willing to participate in GPMs if there was Quick Settlement on all NHA-insured GPMs.

> "Not interested in GPMs if there is not Quick Settlement."
>
> "At beginning Quick Settlement on all NHA-insured GPMs; then changed by CMHC to only GPM loans not exceeding local market price ceilings; liked it best the first way; with NHA insurance still have substantial 'people' costs for arrears, defaults, etc.; much more willing to participate in GPM lending if Quick Settlement available on all NHA-insured GPM loans."

- <u>Default and foreclosure rates are anticipated to be the same or, perhaps, marginally higher for GPMs than for equal payment mortgages</u>

The 3 lenders and 1 mortgage insurance company answering this question generally do not anticipate any great difference in default or foreclosure rates under GPMs than with the equal payment mortgage of comparable term. None of the lenders have had sufficient experience to provide hard data on GPM defaults.

"No worse for privately-insured GPMs."

"There could be a little higher arrears and default rate on GPMs; people are taking on a very heavy debt load which increases over the term of the loan; this could create marital problems and lead to defaults."

"Probably the same but really don't know."

- Mixed reactions given to whether mortgage insurance premiums should be higher on GPMs and whether premiums should be based on the initial or peak loans amount

The 4 lenders involved with homeownership GPMs hold varying opinions on the question of differing insurance premiums and the loan basis for the premiums for such loans. The private mortgage insurer insuring GPMs charges an extra $\frac{1}{4}$ of 1% premium for GPMs with the premium based on the intital loan amount.

"Premium should be the same and based on the initial loan amount."

"We have no opinion on the size of the premium but feel it should be based on the peak loan."

"Probably should be higher."

- There is a large divergence of opinion among lenders on whether there is likely to be a high demand for GPMs in the 1980's

It is probably fair to state that most lenders, given their dislike for this form of mortgage instrument, hope that there will not be a strong demand for GPMs in the 1980's. Beyond this, 3 points of view were expressed.

Borrowers will increasingly want GPM financing

"People are learning to live with inflation and are adjusting their behaviour accordingly; hence, will want to kept current payments as low as possible; see GPM used in big way for refinancing; people whose current rate is 10%-11% will go for GPM when their present term mortgage expires to reduce the jump in monthly payments at higher interest rates."

"We see increased demands from borrowers; this demand will be stifled, however, by lenders."

There is unlikely to be an overall high demand for GPMs

"Do not think there will be an overall high demand for GPMs; there will be a greater demand in places like B.C. and Alberta where salaries are high and increases will probably outpace the national average; just don't see it catching on in areas of stable prices; Canadians generally are very conservative people."

"Surprisingly, many people look at FLIP but don't take it; they end up preferring the equal payment mortgage when they know the implications of both; FLIP in contrast with the NHA GPM version gives people a detailed printout of what their payments will be over a 5-year period; they know exactly what they are getting into."

There will be pressure applied by builders for lenders to expand GPM lending

"New house builders are, of course, supporting GPMs; but it is an artificial stimulus to the market like AHOP, buy-downs, etc.; builders seem to be hoping that artificial stimuli like GPMs will help them weather the storm in 1980 with the false hope that rates will go down again to 10½%-11%."

"Builders need GPM in many areas to sell their homes."

- Only 1 of the lenders surveyed anticipates that a substantial proportion of its mortgage commitments for ownership housing will be in GPMs within 5 years

All of the lenders surveyed except 1 are in agreement that GPMs will not be a significant part of their ownership housing mortgage commitments over the next 5 years. Several interviewees stated that if GPMs were to grow to 15%-20% of the total residential mortgage market, then they would likely have to reconsider their opposition. Moreover, if 15% to 20% of their mortgage lending was in the form of GPMs, it would justify reprogramming their computers to handle GPMs.

> "If GPM share of the market grew to say 15%-20%, we would have to start doing GPMs; market necessity; have to keep pace with the competition."

> "GPMs are not worth doing if they account for only 1% to 2% of our business."

> "If we wanted to increase our market share, we might consider alternative mortgage instruments like the GPM; but we are happy with our present share."

> "Administration is a problem; unless we could see GPMs becoming 15%-20% of our mortgage business can't justify changing current procedures and computer programs."

- Several lenders prefer the new NHA Interest Prepayment Option Plan to the NHA-insured GPM

While some lenders expressed opposition to the recently introduced NHA Interest Prepayment Option, others saw it as an improvement over the GPM; some implied it should replace the GPM.

> "We prefer the NHA buy-down over any GPM program; it gives us equal monthly payments; it doesn't create the same funding problem as GPMs; we get the buy-down fee up front so if there is early repayment we get a bonus; and it can be used with our existing computer programs."

> "More supportive of phased buy-down (than of GPM); already accepting buy-downs from builders."

> "We feel the phased buy-down is better, since it is done with the borrower's own money; hence, the borrower has a greater commitment to his investment than with a GPM."

A few respondents were less favourably disposed to the new buy-down program.

> "Interest buy-down; not going to do it; has accounting and administrative problems; who needs it; CMHC staff introducing it to justify their jobs."

> "Already doing buy-downs; could see a buy-down on a buy-down which would put pressure on prices."

> "I see many disadvantages to CMHC's new phased buy-down program; bad for the borrower; but good for the lender because of prepayment of interest."

ATTITUDES TO RENTAL GRADUATED PAYMENT MORTGAGES

- The lenders surveyed tend to be more favourably inclined to rental GPMs than to ownership GPMs

Nine of the 13 lenders surveyed have either made rental GPM loans or would be prepared to consider such loans under certain circumstances (e.g., loans to reputable developers who are building for their own portfolios). Four of the lenders who are totally opposed to the concept of GPMs for home buyers said they would be willing to consider GPM loans for rental projects.

> "We will do rental loans because of view that rents are currently under-priced and have to rise."
>
> "Rental loans are much easier than ownership loans to administer; a single account means a large dollar amount."
>
> "Not in total opposition to rental GPM loans though would be concerned about their viability in provinces with rent controls; would likely consider applications from reputable developers for their own portfolio but not from syndicators."
>
> "Could see rental GPMs; haven't been asked to do any."
>
> "Would probably give a rental GPM to a reputable developer like Cadillac Fairview but haven't been asked."

- Lenders responding do not have strong feelings one way or the other on the relative risks of rental GPM and equal payment mortgage loans

The view of lenders making rental GPM loans tended to be that a 90% maximum NHA-insured GPM loan was not anymore riskier than a 95% maximum NHA-insured equal payment mortgage.

> "The loan/value difference counters any additional risk."

One lender expressed the view that there could be some limited greater risk with the GPM.

- <u>Most rental GPMs have been made for tax shelter rental projects</u>

Most GPM loans made by the lenders surveyed have been to borrowers intending to sell the projects to individual investors as tax shelters.

- <u>Lenders active in rental GPM lending tend to rely heavily on CMHC appraisals</u>

Three of the 5 lenders which have made rental GPM loans state that they rely heavily on appraisals done by CMHC staff appraisers.

> "Appraisals for rental GPMs are a lot more complicated and must be more individualistic; we use the CMHC appraisals."
>
> "Rely on CMHC appraisals though we do look at cash flow; won't touch any rental GPM without Quick Settlement, however."

- <u>Lenders who have done rental GPMs tend to feel that demand will be high for such loans in the 1980's</u>

The view expressed by 3 of the 5 lenders making rental GPM loans is that as long as inflation continues and/or MURB is in existence, there will be a high demand for rental GPMs.

> "Both developers reselling and those holding projects for their own portfolio will find it advantageous to use GPMs; their cash flow is greater at the beginning."
>
> "Combined with MURB there is likely to be a high demand."
>
> "There will be a great demand for rental GPMs as long as there is inflation."

- <u>Only 2 of the lenders surveyed expected that a substantial proportion of their rental housing mortgage commitments would be in GPMs within 5 years</u>

Two of the lenders currently making rental GPMs said that they expect such loans to account for a substantial portion of their rental commitments during the coming 5 years.

ATTITUDES TO SOCIAL HOUSING LOANS

- Almost all of the lenders surveyed have made loans for non-profit housing

Eleven of the 13 lenders surveyed have made at least a few loans to non-profit groups. There appears to have been only a few loans made to cooperative groups by these lenders. Most of the lending has been for senior citizens housing.

> "Have done 8 loans; some co-op and some non-profit."
>
> "Have not done any loans to co-ops but have done several non-profit loans for our portfolio and for investors."
>
> "Have done a few non-profit loans."
>
> "Have done a couple of co-op loans in eastern Canada."
>
> "Have done about 40 projects; senior citizens, nursing homes, mental health rehabilitation centres, etc."
>
> "Have not done any co-op lending; but have done quite a large number of non-profit loans, particularly in B.C. - loans are given to local church groups, service clubs, etc."
>
> "Have done a couple."

Reasons given by the 2 lenders who have not made any non-profit loans include:

> "Haven't been approached; haven't looked at the program in any great detail."
>
> "We don't look favourably at the prospect of suing church groups or other non-profit groups providing housing for senior citizens."

- Quality of the sponsoring group appears to be a major criterion for lending funds for non-profit housing

The lenders interviewed are generally very supportive of the use of private funds to finance non-profit housing projects. Their main explicit criteria beyond those normally used for all rental projects is the capability of the sponsoring group to build and operate the project.

> "Quite open to proposals providing they are well thought out and well sponsored."
>
> "Our basic internal guideline is that the group getting the loan must be capable of managing the project; frequently a service club; church groups are generally good since they often have an accountant as part of the group."
>
> "The sponsoring group must be customers of our bank and have property management experience (or buy it.)"
>
> "We accept CMHC at their word: 'What are you worried about if the loans are insured?'"
>
> "We treat these loans no differently than a normal rental loan; we will not subsidize non-profit and co-op groups in any way."

- NHA insurance is crucial for lender involvement in non-profit and co-operative lending

The 11 lenders who have made non-profit loans were asked to indicate which of several features of the non-profit and co-operative housing programs were important to them. These features include: the requirement to set up surplus reserve, contingency funds, reserve funds; NHA insurance; the blended income nature of tenants; and assistance provided by CMHC to keep interest rates down to 2%.

The universal response was the NHA insurance is imperative; several lenders also mentioned the interest writedown. The other two features received fewer mentions.

"NHA insurance is essential."

"NHA insurance is needed definitely; the requirement about reserves is important; the blended income mix is not really significant; the CMHC assistance is required to make it viable."

"The requirement to set up contingency funds is a good thing; NHA insurance is very important; not overly concerned about blended income of tenants."

"NHA insurance is the most important factor."

"NHA insurance is the most important factor here; blended income nature of tenants is also important."

"NHA insurance and interest writedown are mandatory."

"NHA insurance is vital though we might make 1 or 2 loans to very reputable bodies in the absence of NHA insurance."

"NHA insurance is a definite necessity; so is the CMHC subsidy."

Three lenders mentioned they would like to have Quick Settlement on non-profit loans including the 2 who have not made any of these loans.

- <u>Several lenders mentioned the volatile nature of interest rates as affecting their willingness to make non-profit loans</u>

A few lenders said that they simply will not made non-profit loans for 5-year term anymore though they would lend for a short term. Several lenders stated they will no longer offer a fixed interest rate until near the completion of the project. Apparently, a number of non-profit groups are putting rates out to tender and trying to insist on a fixed rate commitment prior to commencement of construction.

"In a world of rapidly fluctuating interest rates, our bank with its liability structure simply cannot commit rental funds for either private or social housing for five years."

"The big problem with non-profit loans is the length of time from when proposal is made fixing the interest rate to the time the loan is funded; we would like to see a floating rate to a certain period of time and at a certain date the rate fixed."

"We will not fix the interest rate; if there are progress advances will do on a floating rate geared to prime; take out loan rate will be fixed near time of completion."

- Lenders would not generally treat applications for non-profit loans any differently if all tenants received subsidies in addition to the interest writedown

The prospect of funding projects having all subsidized tenants does not concern several of the lenders surveyed.

"No problem."

"Not concerned about this."

"Would certainly take a look at such projects if offered to us."

"Not material."

Some lenders qualified their responses:

"Maybe - if the property management group looks good."

"If all tenants subsidized we would have to take a close look; three years down the road the project could be vandalized; however, if the management group fully recognized what they were getting into we may still lend on such projects."

"Management is the key; if group is strong we would consider."

• <u>Virtually all of the lenders surveyed make loans in rural centres</u>

Most of the lenders surveyed currently make loans in rural centres (defined as communities having fewer than 2,500 persons). The main restriction on such lending is that the properties have to be in proximity to one of the offices of the institution. Banks with their extensive branch networks make loans in rural areas all across Canada. At the other extreme, life insurance companies have relatively few offices; they tend to restrict their rural lending to small communities near larger cities.

> "We do lots of rural lending in Ontario."
>
> "Yes - all provinces."
>
> "Do rural loans in areas adjacent to our offices."
>
> "Do such loans within a 5-mile radius of any of our many offices."
>
> "Make rural loans in small communities around the metropolitan areas where we have offices."
>
> "Yes around our nearly 175 branches."

Only one lender said it is avoiding rural lending at present:

> "Right now, we are staying away from rural areas; have too much business elsewhere."

• <u>Most of the lenders making loans for non-profit housing express no hesitation about making these loans in rural areas</u>

The main concern expressed by lenders about lending in rural areas is that the scale of the project must be appropriate to the size of the community.

> "We have no qualms about lending in these areas."
>
> "No hesitation; have made non-profit loans in 2 small towns in Manitoba."
>
> "Willing to make such loans for appropriately sized projects."
>
> "No concerns."

- The lenders surveyed would not generally look favourable to participation in a rural housing program in which borrowers received a debt service subsidy from CMHC and the mortgages are insured (or guaranteed) by CMHC

The first question raised by 3 of the lenders is the rationale for even considering such a program.

"Why have such a program? CMHC keep hands off."

"Why is it needed? If anything is needed in small towns, it is assistance to help people upgrade older housing."

"Why would it be needed? Small towns generally have reasonably priced houses as it is."

All but 2 of the lenders expressing a view on this hypothetical program either questioned its need or were not in support of it.

"Unlikely; wouldn't want to go through AHOP again."

"Doubt it very much; might get involved if there is Quick Settlement."

"We would not make loans on such housing based on only insurance or a guarantee; we still face administrative costs; we would end up being the loser."

- There is a mixed reaction to letting CMHC act as the agent for loans in rural areas where the borrowers would be receiving debt service subsidies

A number of lenders expressed unhappiness with an arrangement whereby CMHC would select the homebuyer and/or administer the loan for rural insured loans incorporating debt service subsidies to borrowers.

"No."

"Doubt it very much."

"Not overly interested."

"Probably not; we have a large branch system; don't need someone else involved."

Other lenders were more receptive providing rates were competitive with the private market and CMHC bore all administration costs.

> "Perhaps we would do this if the spread was profitable; it should be treated more like a bond issue; CMHC borrows and uses the funds to finance the programs; we don't worry about losses."

> "Really what is being talked about here is just another government bond; we would look at it accordingly; it would be similar to the late 1950's when private companies administered CMHC funds; so called agency loans."

> "Better ways of doing it; have mortgage debentures with same rate as prime mortgages; CMHC does what it wants with the funds."

> "Sure, if rate is competitive; be happy to fork over funds if CMHC does all servicing and administering and returns funds if loan goes bad."

ATTITUDES TOWARD CANADA MORTGAGE AND HOUSING CORPORATION

Several of the lenders during the course of the interviews expressed views about CMHC and the role they see for it in the housing area.

> "We like the way CMHC works with a non-profit group to put together a total package to present to the lender."

> "CMHC is acting like a secret capitalist; its role should be restricted to social housing."

> "I see the CMHC role as being concerned with social welfare; at present I see the CMHC trying to perpetuate their existence; it is wrong for CMHC, for example, to guarantee resale mortgage loans on $150,000 houses; this is not the role of CMHC."

> "CMHC should get out of private market or compete fairly; needs to be under the Superintendent of Insurance, etc.; it should have the same costs as private insurers; should be profit motivated; its rates have to be increased."

APPENDIX

LIST OF INTERVIEW QUESTIONS

APPENDIX

LIST OF QUESTIONS

INTERVIEWS TO DETERMINE MORTGAGE LENDER ATTITUDES TO GRADUATED PAYMENT MORTGAGES AND LENDING FOR SOCIAL HOUSING

GRADUATED PAYMENT MORTGAGE (GPMs)

Has your company ever made any GPM loans? If so, on what types of property and using what kind of mortgage insurance? (check below)

	New Properties			Existing Properties		
	Rental	Condo	Freehold	Rental	Condo	Freehold
NHA Insured	___	___	___	___	___	___
Private Insured	___	___	___	___	___	___
Not Insured	___	___	___	___	___	___

Ownership GPMs

1. What is your assessment of the relative risks involved between GPMs and the traditional Equal Payment Mortgage (EPMs)? What are the factors behind your answer?

2. Who do you regard as being the most likely candidates for GPMs? Why?

3. In light of your experience to date with GPMs, what have been the general characteristics of borrowers?

4. How do these characteristics compare with the characteristics of EPM borrowers?

5. What are the characteristics of GPM applicants whom you turn down?

6. Do these characteristics differ from those of EPM applicants turned down? If so, in what way?

7. Do you feel that GPMs are more appropriate in some parts of the country than in others? If so, why?

8. Do you think that downpayments on GPMs should differ from EPM downpayments for the same sized loan? If so, why?

9. Are you more concerned about the source of the downpayment for a GPM than for an EPM? If so, why?

10. What are your views regarding advantages or limitations in private GPMs such as Victoria Wood's FLIP or NuWest's YES over the NHA version?

11. Does the fact that an applicant's family income may be produced by 2 earners rather than 1 earner take on any added significance for a GPM in contrast with an EPM? Why?

12. In general, do you use tighter underwriting criteria for GPMs than for EPMs? If so, in what way?

13. What do you feel is an appropriate escalation rate (in percentage terms) in annual GPM payments in the early years of the mortgage? Why?

14. At what annual escalation rate does the risk on GPMs become too great? Why?

15. Do administration costs for GPMs differ significantly from their EPM counterparts? Why?

16.
(a) Is Quick Settlement an appealing feature of NHA GPMs? Does your company regard it as an essential feature for NHA GPM lending (i.e., will you underwrite NHA GPMs with Quick Settlement but not without?)

(b) Do you anticipate any great difference in (a) default rates or (b) foreclosure rates with GPMs as compared to EPMs? Why? (Actual experience would be helpful here.)

17. Do you feel that mortgage insurance premiums should be higher on GPMs than on EPMs? Why?

18. Do you feel that mortgage insurance companies insuring GPMs should charge a premium based on the initial size of the loan or on the peak loan? Why?

19. What do you regard as the maximum peak loan-to-value ratio that a GPM should not exceed? Why?

20. Do you anticipate a high demand for GPMs in the 1980's? If not, why not? If yes, why?

21. Do you see raising your allowable gross debt service ratio on EPMs as a acceptable alternative to GPMs?

22. Do you anticipate that a substantial proportion of your company's mortgage commitments for ownership housing will be in GPMs within 5 years? If so, why? If not, why not?

<u>Rental GPMs</u>

23. What is your assessment of the relative risks involved between rental GPMs and homeownership GPMs? What are the factors behind your answer?

24. What is your assessment of the relative risks involved between rental GPMs and rental EPMs? What are the factors behind your answer?

25. Do you think (or have you found) that rental GPMs will appeal to a cross-section of builders/developers or to just certain types? Why?

26. Do you feel that appraisal techniques should differ for rental GPMs than for EPMs? If so, in what ways?

27. Do you anticipate a high demand for rental GPMs in the 1980's? If not, why not? If so, why?

28. Do you anticipate that a substantial proportion of your company's mortgage commitments for rental housing will be in GPMs within 5 years? If so, why? If not, why not?

LOANS FOR SOCIAL HOUSING

1. Has your company made any commitments to non-profit and co-operative groups for social housing under the NHA? If so, describe type of activity.

2. Does your company have any explicit policies about lending funds for non-profit and co-operative projects? If so, what are the main elements of these policies?

3. Are any of the following features of non-profit and co-operative housing loans important to you? If so, which ones and why?

   - requirement to set up surplus reserve, contingency funds, reserve funds
   - NHA insurance
   - blended income nature of tenants
   - assistance provided by CMHC to keep interest rates down to 2%

4. Would you consider loans for non-profit rental projects if all tenants were going to require subsidies in addition to the project's interest subsidy?

5. Do you make mortgage loans (either ownership or rental) in rural areas (areas with less than 2,500 population)? If not, why not? If yes, are you active in all provinces?

6. Would you have any hesitation about making non-profit and co-operative loans in rural areas? If so, why?

7. Would you consider lending homeownership funds to an individual living in a rural area who received a subsidy from the federal government to cover debt service payments if the mortgage was covered by insurance or guarantee? If not, why not?

8. Re (7), do you perceive the following to be problems?

   - payment collection in rural areas
   - nuisance associated with default procedures, etc.
   - high cost of administration

9. Re (7), would you consider letting CMHC act as the agent for such loans in rural areas (i.e.. CMHC selects the homebuyer and/or administers the loan with appropriate insurance) with your company providing loan funds?

Do you have any other views regarding GPMs or social housing lending which you would like to have communicated to CMHC?