HOUSING RESEARCH

Research Insight

APRIL 2021

Mortgage Investment Corporations: 2017 And 2018 Update

> This research aims at providing clearer views on the activity of mortgage investment corporations (MICs) within the Canadian residential mortgage industry. It builds on reports that were published for previous years.[1]

Introduction

As alternative lenders, MICs typically provide shorter-term mortgages at higher fees and interest rates to borrowers who have difficulty qualifying for loans from more stringently regulated lenders. These borrowers often include self-employed individuals, business entrepreneurs, real estate investors (with more than one property) and borrowers with short-term cash needs (due to bruised credit, divorce, health issues, bridging for a presale or home purchase, etc.). The distinct characteristics of MIC loans reflect the riskier profiles of their clients. MICs, unlike traditional lenders, do not conform to prescriptive underwriting criteria. However, they generally define exit strategies to determine the borrowers' eligibility for a loan, meaning the lender will analyze the borrowers' capacity to improve their financial situation to repay the loan within a certain time, either through a contingency plan, which should allow the borrowers to return to the traditional lending space at the end of the loan term, or through the sale of the property. While this function supports some stability in the market by providing alternatives to borrowers, it also has the potential to introduce additional vulnerabilities into the housing finance system. In this Research Insight, CMHC uses key findings from a study and a survey of MICs actively providing residential mortgage loans in Canada to monitor trends and develop a better understanding of the role and risks of MIC activity.

Project Overview

CMHC commissioned Fundamental Research Corporation to provide an annual update on the activity of MICs in Canada. The study relies on public information, surveys and interviews to compile detailed information on MICs operating in Canada. In 2018, there were over 200 active MICs in Canada with a total market size of approximately $12.5 billion, representing less than 1% of outstanding mortgages in Canada.

[1] **Mortgage Investment Corporations : 2016 Update:** https://eppdscrmssa01.blob.core.windows.net/cmhcprodcontainer/sf/project/cmhc/pubsandreports/research-insights/research-insight-mortgage-investment-corporations-update-69450-en.pdf
Mortgage Investment Corporations : 2016 Update https://eppdscrmssa01.blob.core.windows.net/cmhcprodcontainer/sf/project/cmhc/pubsandreports/pdf/68768.pdf

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- present major findings of the research

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Fast Facts

- In 1973, the federal government passed laws enabling the creation of MICs to increase the "flow of mortgage funds" and provide a channel for small investors to participate more directly in housing finance markets through private lending.
- MICs are governed by the *Income Tax Act*, which requires compliance with certain directives:
  - All interests in real property held by MICs must be in Canada.
  - They must have oversight via provincial securities legislation, and they may accept foreign investment.
  - They must invest at least 50% of the assets in residential mortgage loans, cash and insured deposits. The remaining assets can be invested in commercial or industrial properties, developments or other assets.
  - They must have a minimum of 20 shareholders, and no shareholder can own over 25% of the total shares.
- MICs do not pay corporate tax and act as a flow-through entity. In order to avoid entity level taxation, a MIC has to pay 100% of all of its income as dividends to investors.

Key Findings

Market continues to grow rapidly

- The 88 MICs that are the focus of this study[2] held an estimated $9.49 billion in mortgage loans at the end of 2018, a 14% year-over-year increase (following an 18% increase in 2017).
- Eighteen MICs had portfolios of $100 million or more in 2018. There were seven publicly traded MICs, accounting for an estimated 27% of the total mortgages held by the largest 88 entities.

[2] These 88 entities were determined based on the quality of the data gathered from publicly available information, company websites, management interviews and surveys.

Risks increase

- In 2018, about 77% of the loans held by MICs were first mortgages, meaning that MICs have first claim on the property, down from 81% in 2017. The downward trend in the share of first mortgages held by MICs indicates an increasing appetite for risk on the part of these alternative lenders.
- Further, the average loan-to-value (LTV) ratio for funds with a portfolio exceeding $100 million was 59%, down from 61% in 2017.
- MICs maintained stable lending parameters and reported decreasing realized losses in 2018; this was especially true for the larger lending entities. Nonetheless, the risk profile of both larger and smaller MICs increased slightly during this period. Data shows that MICs had an increasing average portfolio size, a growing debt-to-capital ratio and declining trends in first mortgages and LTV ratios. The combination of these factors signals a higher appetite for risk (see figure 1).
- Investors in the larger MICs received an average yield of 7.5% in 2018 (7.1% in 2017) and, for the smaller funds, the average was 7.1% (7.0% in 2017). A potential explanation for the observed increase in average yields is the risk-adjusted returns in the sector. These relatively attractive yields encourage investors' capital to keep flowing. In addition, we highlight that lending to MICs by the larger banks also increased during that period.

Concentration increases in Ontario

- The majority of mortgage holdings are located in Ontario and B.C., mostly concentrated in urban centres such as Toronto and Vancouver. Between 2017 and 2018, we observed a concentration of activity in Ontario, most likely driven by the stronger real estate market in Toronto during this period. In 2018, larger funds, those with more than $100 million in holdings, had 45% (39% in 2017) of their holdings in Ontario and 38% in B.C. (40% in 2017). Smaller funds (with less than $100 million in holdings) had their holdings concentrated in B.C. (54% of holdings in 2018, compared to 57% in 2017) and Ontario (30% of holdings in 2018, compared to 26 % in 2017).

Figure 1: Risk profile changes of MICs in 2018

	MICs With Over $100M AUM	MICs With Under $100M in AUM
Total Assets under management (AUM) held by MICs	Increase in risk level	Increase in risk level
Average mortgage size	Increase in risk level	Increase in risk level
Diversification	*No change in risk profile*	*No change in risk profile*
Priority (share of 1st mortgages)	Increase in risk level	Decrease in risk level
Loan-to-Value (LTV) ration	Decrease in risk level	Increase in risk level
Leverage	Increase in risk level	Increase in risk level
Realized Loss	Decrease in risk level	Decrease in risk level

Sources: Fundamental Research Corporation and CMHC

Implications for the Housing Industry

- MIC mortgage holdings continued to grow, rising from an estimated $9 billion in 2015 to $12.5 billion in 2018. Between 2017 and 2018, this segment of the industry grew by approximately 10%. Total outstanding residential mortgage debt in Canada increased at a significantly slower pace from 2017 to 2018, rising by 1.5% and reaching $1.54 trillion.
- Many MICs use different strategies to mitigate risk exposure. These include setting loan-to-value ratios at reasonable levels, renewing or refinancing with more flexible conditions, and negotiating the sale of the property to avoid foreclosure. These practices can limit the risks faced and posed by MICs by aligning them with lenders operating in the regulated market. How broadly these measures are followed continues to be unclear.
- MIC mortgage lending does not appear to be a source of systemic risk at this time given its maintained relative small size; CMHC will continue to monitor the alternative lending market to understand its growth and links to the broader mortgage market.

Project Managers

Tania Bourassa-Ochoa, Senior Specialist
Housing Research, CMHC

Michael C. Oram, Specialist
Housing Policy, CMHC

Consultant

Fundamental Research Corporation

Full Report

Mortgage Investment Corporations – Update (2017)
https://eppdscrmssa01.blob.core.windows.net/cmhcprodcontainer/sf/project/archive/research_6/69745_rr1.pdf

Mortgage Investment Corporations – Update (2018)
https://eppdscrmssa01.blob.core.windows.net/cmhcprodcontainer/sf/project/archive/research_6/69745_rr2.pdf

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