Real Estate Talk:
Alternative financing

Description

Using an alternative lender in a purchase other than a tier-one bank

By **Joseph Marovitch**

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A buyer is purchasing an income property with 15 units (unit is the term for an apartment). The property is in very good condition with minor physical issues. Any physical issue in an income property is an opportunity to invest via renovation and increase the rent.

This property is fully rented and the rate of return, also known as the capitalization rate, which indicates the percentage of profit after expenses or the percentage on the investment, is 4.5%. Examination of all the leases and expenses verified the rate of return.

The buyer's inspection was good and so was the phase 1 environmental test which indicates if there are any pollutants in the air, in the ground, on the walls or anywhere else.

The only condition left is financing. The buyer has a certain number of days to provide proof of financing in the form of a **final mortgage approval document** from their financial institution, an alternative lender.

> In most cases, a buyer will go to one of the five main banks, known as tier-one banks, to acquire a mortgage.

During the due diligence process, another buyer comes along and makes a **second-tier offer** or an offer that is conditional upon all other prior offers being rendered null and void by a certain date. Now the first buyer is under pressure to produce a final mortgage approval by their deadline knowing that, if they do not, their offer may be rendered null and void, permitting the second buyer to perform their due diligence and consequently purchase the property.

In most cases, a buyer will go to one of the five main banks such as RBC, BMO, Scotia, TD or CIBC, known as tier-one banks, to acquire a mortgage. However, there are alternative lenders that will provide a mortgage with higher or lower interest rates but more or less stringent terms that do not always follow the protocol that protects sellers.

In cases like these, the seller's broker is required to follow protocol. For instance, if the lender is not a tier-one bank and they provide a mortgage approval with conditions, this would not be considered a final mortgage approval. A mortgage approval without conditions and being the final condition to satisfy an offer would cause the property to be legally sold. All that would be required is that the notary perform their work and notarize the sale.

A sale cannot be final with a conditional mortgage approval. A mortgage approval with conditions, if accepted by the seller, would mean the sale can fail right up to signing if the notary finds issues.

Usually, if there were issues found such as infringements, incorrect certificate of location or other, the notary would find a remedy such as title insurance to protect against future lawsuits, or blockage of a window with an illegal view to the neighbour, or a written agreement between parties that the issue is acceptable. What would not occur is the annulment of the sale. Conditions in a mortgage approval permit an annulment of the sale.

> 'There are advantages to using a lender that is not a tier-one bank. The lender may be more flexible in that they will lend to investors with lower credit scores or to investments that tier one banks may consider risky…'

Sometimes the seller might accept a mortgage approval with conditions risking the sale. However, the listing broker (the broker selling the property) would inform the seller in writing of the issue and risk.

There are advantages to using a lender that is not a tier-one bank. The lender may be more flexible in that they will lend to investors with lower credit scores or to investments that tier one banks may consider risky. They can provide **temporary bridge loans** meaning short-term loans. However, there are always more rules or terms that a tier-one bank will not place in the agreement. Alternate lenders may want to scrutinize the investment more closely over the time the buyer owns the property, require more collateral or personal guarantees, or be permitted to place a lean on the property or contents.

If using a second lender and not one of the five main banks is a consideration, all the terms and risks must be assessed as well as the possible gain to make sure it is worth going forward with.

Should you have questions or comments, please refer to the comments section at the bottom of the page. As well, to view past articles, **click here**.

Next article: **Fixed rate vs. variable rate**

State of the market

With Russia going to war on Ukraine this past week, sharp rises in interest rates were subdued. The bank of Canada raised interest rates by 0.5%, which is less than expected. The war has affected everything from the price of oil to groceries, and the stock market has become more volatile. With the war and its effect on world economies, we are looking at rising inflation.

> '… with higher costs for everything and an increased interest rate, buyers may have more room to negotiate.'

There appears to be more property for sale each day yet prices continue to rise due to continued high demand with no expectation demand will slow down soon. However, with higher costs for everything and an increased interest rate, buyers may have more room to negotiate.

Have a great week and stay safe.

Let's not forget that people with cancer are vulnerable too!

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Other articles by Joseph Marovitch

Joseph Marovitch** has worked in the service industry for over 30 years. His first career was working with families from Westmount and surrounding areas, hosting children between the ages of 6 to 16 as the owner and director of Camp Maromac, a sports and arts sleep away summer camp established in 1968. Using the same strengths caring for the families, such as reliability, integrity, honesty and a deep sense of protecting the interests of those he is responsible for, Joseph applies this to his present real estate broker career. Should you have questions please feel free to contact Joseph Marovitch at 514 825-8771, or **josephmarovitch@gmail.com

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