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Ms. Gina Stephens
Senior Policy Advisor
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Via email: mblaa.consultation@ontario.ca

Re: 2018 Legislative Review of the Mortgage Brokerages, Lenders and Administrators Act, 2006 and Recent Regulatory Changes re. Syndicated Mortgages

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Dear Ms. Gina Stephens,

We are writing as both a Mortgage Brokerage and a Mortgage Administrator which gives us a somewhat unique perspective. We are a large brokerage that primarily provides significant financing for the development and construction activity in Ontario. Our lenders provide critical capital not currently provided by other financial institutions to facilitate much needed construction of housing and infrastructure. The mortgages we typically provide are classified as Non-Qualified Syndicated Mortgages (NQSM's) and we generally work with parties that are institutional or have the qualifications of a designated class of investor. This area of mortgage activity is very different and more complex than the typical residential mortgage brokerage activity and has seen recent regulatory changes implemented on July 1st, 2018. Many of our comments specifically address these regulatory changes.

Establishing an appropriate regulatory framework for development and construction mortgages requires specific industry and financial knowledge. Protecting stakeholders' interests, both borrowers and lenders, requires and understanding of the standard practices, risks involved, and how lenders are able to realize against their security should the mortgage not perform as expected. We are willing to support this process as necessary.

We understand and take the obligations we have to our stakeholders very seriously. We fully support initiatives designed to ensure parties entering into these transactions are aware and understand the associated risks, and ensure the transactions are suitable for the risk profile of these parties.

We have had the opportunity to work with and digest the impact recent changes have had on our business. We support the impetus behind the recently amended regulations under the Mortgage Brokerages, Lenders and Administrators Act, 2006 (MBLAA) effective July 1, 2018 and the regulatory changes/clarifications made to address syndicated mortgages and more specifically, NQSMs. From a functional perspective, we are proposing modifications to the prescribed process that more appropriately address the need for clear and meaningful disclosure with the goal of protecting lenders, particularly vulnerable and unsophisticated individuals. Further, we would like to participate in the evolution of the system and regulatory framework supporting the mortgage brokerage and administration activities in Ontario to meet the needs of all stakeholders involved.

Summary

From a functional perspective, we are proposing modifications to the prescribed process we believe more appropriately address the need for clear and meaningful disclosure with the goal of protecting lenders, particularly vulnerable and unsophisticated individuals. The suggested modifications fall into the following categories:

- Forms – Generally, we are suggesting various refinements to the forms used to process NQSMs to make them clearer and easier to use.
- Appraisals – Given how a development/construction project is funded and security improved, we are suggesting "leverage" and "value" be reviewed in a more sophisticated way and disclosed to the lenders in a more detailed manner. While an "as is" appraisal has some meaningful value at a point in time, a lenders' understanding of value and leverage throughout the life of the project is critical to their understanding of the associated investment risk. Methods to disclose this information in a more comprehensive way should be prescribed in the regulations.
- Audited Financials – Providing professional financial information to lenders is a key component in evaluating risk, however the recommended standard should be modified to better match the burden on borrowers with the corresponding reduction in risk. Further, situations, such as a default or non-performance by the borrower, must also be considered to allow for alternative options to properly protect lender security.
- Defaults and Protecting Lender Security – Construction and development does not always unfold exactly as planned; as such the alternatives available to lenders to advance additional funds to protect their interests need to be contemplated in the Regulations even if the borrowers are not willing or able to perform as required.
- Investor/Lender Limit – Non-accredited persons should be precluded entirely from participation in NQSMs.
- Cooling Off Period – Persons and organizations whose primary business is lending, investing, or providing financial services should have the ability to declare themselves as an exempt class of investors, thereby waiving the requirement to receive and complete Forms 3.0 - 3.2 and the related cooling off period.

New Forms

While we agree the prescriptive nature of the new forms 3.0, 3.1 and 3.2 adds clarity and understanding of FSCO's specific requirements, we believe there are refinements that could be made to improve the usability of the forms and provide better disclosure of information.

Form 3.0 – Investor/Lender Information for Investor/Lender in a Non-qualified Syndicated Mortgage
Form 3.1 – Suitability Assessment for Investor/Lender in a Non-qualified Syndicated Mortgage
Form 3.2 – Disclosure Statement for Investor/Lender in a Non-qualified Syndicated Mortgage

- Form Numbering
  Numbering sequence should be intuitive and align with the order the forms are expected to be completed. Currently, Form 3.1 is expected to be completed after 3.0 and 3.2, renumbering to match the order of completion would make more sense.

- Form Section Applicability
  In Form 3.0, it should be clear what the requirements are in relation to the various categories of investor (i.e. Individual, Personal Investment Entity, Corporation/Partnership/Trust). Based on our understanding of the current wording, it would appear a large portion of the form is not applicable to corporations; however, we have been told FSCO had perhaps provided different direction to some. The form should be tailored to request and group only applicable information that is relevant to the investor category. For example, corporations should not be asked to provide employment information and spousal information or if savings are being used for educational savings.

- Form Field Formatting
  There are fields within the electronic forms which are not properly formatted and do not allow information to be inputted correctly or display correctly.

  FSCO Form 3.2 specifically:

  - Page 1 – Mortgage Brokerage License number adds a comma to the number – 12453 shows as 12,453
  - Page 10 – #7 – all fields should accommodate numeric and letters
  - Page 19 – #6 – Tarion Warranty Corporation # - form adds a comma to the #
  - Page 21 – #1 – Tarion Warranty Corporation # - form adds a comma to the #
  - Page 20 – Year 1: example – 2016 shows up as 2,016
    Year 2: example – 2017 shows up as 2,017

  All fields within the forms should be formatted to allow for the appropriate input formatting and have the ability to insert additional lines to accommodate any additional information we are providing.

- Form Date Requirement
  In FSCO Form 3.2 - Page 3 – Section 1 – the shaded area – It is asking the lender to insert a date that they received the Form 3.1. If we are not to provide Form 3.1 to the lender until 2 days after we provide them with the Form 3.2, then we feel this question is not appropriate for Form 3.2.

- Leverage Calculation
  In Form 3.2, the leverage calculation in our opinion is overly simplistic given the nature of development and construction financing with multiple fundings over the life of a project against a "committed financing facility". We believe it is overly punitive to perform the calculation based on the maximum facility without including the incremental value added by the spending associated with the fundings throughout the project. These funds will only be advanced based on a cost consultant's report or the achievement of certain milestones outlined in the Commitment Letter. Further, there is typically a capped leverage amount that cannot be exceeded during the life of the project.

  In addition, loan to value added costs (versus loan to value) is likely a more relevant measure in development and construction mortgages, given it is exceptionally difficult to determine the value of a project which is partially completed. Determining value for a partially completed project is typically a function of the initial value plus additional costs, which may not necessarily be reflective of the liquidation value of a project's security.

- Material Contracts
  In Form 3.2, the Material Contracts requirement is vague and given the nature and magnitude of the numerous contracts in a large project, specific examples with respect to material contracts should be included.

Recommendation
- A more comprehensive "leverage schedule" should be developed and provided as part of Form 3.2 to properly disclose the leverage related metrics of a mortgage project.
- Make improvements/corrections to the forms to address content requirements, input and display issues.
- Renumber the forms to match the order of completion would make the forms more intuitive.

Appraisals

We understand providing an appropriate "as is" appraisal at the outset of a project is an important part of determining the due diligence process and assessing the risk associated with lending against the security being valued by the appraisal. That said, once development and/or construction begins on a project, any "valuation" becomes very subjective and is typically based on the initial value plus a portion of costs spent to improve the security or an assessment of value to be delivered upon completion of the project less the costs necessary to achieve completion.

In addition, “liquidating” an uncompleted project half way through construction is both difficult and will likely come with a significant discount which is impossible to determine without going through a liquidation process. The existing Tarion licensing, existing pre-sales and outstanding obligations which cannot be satisfied with the security value available, must all be considered in maximizing security value for outstanding creditors. Further, raising the necessary financing to complete the project, given the only real cash events with which outstanding debt will be repaid comes from closing with a Purchaser or a refinancing. Lenders may often be better served by continuing to fund a project to completion to maximize their security value.

Our concern is that the focus on an “as is” value disclosure does not properly represent the various options available, given the “as is” value is representative of the “worst case” scenario and not necessarily the “most likely” path the lender would and should pursue.

Furthermore, throughout the course of a year from receipt of an “as is” appraisal multiple fundings against the loan facility can occur, thereby increasing the leverage relative to the appraised value. The leverage ratio can become skewed as the appraised value and the loan balance diverge because the loan outstanding is a floating number, whereas the “as is” value is a static number. Fundings against the loan facility are conducted to pay for costs that improve the value of a project and there should be an opportunity to reflect these value-added activities in loan leverage calculations.

Recommendation

- A more comprehensive “leverage schedule” should be developed and provided as part of Form 3.2 to properly disclose the leverage related metrics of a mortgage project.

Audited Financials

In our opinion, this requirement has been the most difficult to address and the effort and cost does not correspond with an appropriate reduction in risk for the lenders.

The requirement for audited financial statements from the borrower creates significant additional costs, lead time constraints (audited financials can take 3 plus months to prepare), and time demands on the borrower. While we feel there is benefit provided by professionally prepared and validated financial statements, in our opinion, the following factors must also be considered:

- Lenders in this space are primarily “asset-based” lenders and focus a significant amount of attention on the value of the security supporting the mortgage.
- Financial statements have typically been part of the due diligence materials required of borrowers along with appraisals, cost consultant approved budgets and reports, security opinions, legal advice, environmental, geotechnical, commitment letters with explicit pre-funding conditions, project milestones, pre-sale requirements, borrower execution history and qualifications, etc. While “audited” financial statements would improve the consistency and accuracy of the financial information received, they are not “foolproof” and the additional value gained from an audit may be limited, especially if the borrower is a newly created special purpose vehicle as is often industry practice. Further, it is possible this could lead to transaction structuring, which will limit the “borrower(s)” listed as parties to a loan

and steer borrowers away from providing corporate entities/security value. This could potentially expose lenders to risk in an attempt to avoid more involved audit efforts.

- The requirement for audited financial statements from borrowers is a requirement that is not in place at many other financial institutions regulated by OSFI, which essentially erodes our competitive position.
- The wording within the Regulation is very confusing:
    - It appears in all cases, "audited" financials are required other than some interim statements. If that is the case, it should be stated more clearly.
    - Who can provide "audited" financial statements? A suggestion that the Brokerage could provide audited financial statements adds further confusion as there is specific CPA licensing required to provide "audited" financial statements depending on the FSCO definition of audited. Further, meeting a standard of providing IFRS compliant statements seems to be both overly burdensome (most domestic large companies do not look to achieve this standard (more likely to be Accounting Standards for Private Enterprises (ASPE)) and appears inconsistent with the provision of audited financial statements by the Brokerage.

Recommendation

- We believe the requirements in section 31.1 paragraph 15 and 16 should be revisited. A standard should be developed which is clear, practical, and consistent with providing professional financial information without imposing a burden on the stakeholders involved that does not provide a corresponding reduction in risk.
- Situations, such as a default or non-performance by the borrower, must also be considered to properly protect lender security.

Defaults and Protecting Lender Security Value

We believe it is important to acknowledge and outline how existing lenders on a project can protect their security position where a borrower/mortgage is not performing or is in default. Historically, in challenging situations, existing lenders have been best served by advancing additional "defensive funds" required to complete a project to protect and maximize their available security value. The following should be considered:

- Half-built residential construction projects have significantly less value than a completed project and it is often difficult to find a buyer or a builder to complete a project;
- Replacing the existing Tarion-qualified builder on the project risks the existing pre-sales being cancelled and putting the project's sales and revenue at further risk; and
- Within the existing Regulations, there does not appear to be any accommodations available where additional funds can be advanced against a mortgage while regulatory deliveries are required from the borrower (i.e. audited financial statements) without being in direct conflict with the requirements of the Regulations. This is primarily of concern where the existing lender group has not committed to fund on a pro-rata basis to completion of the project.

Recommendation

- Provide accommodations for projects that are not performing or are in Default. It is important to acknowledge providing the lenders with flexibility on addressing these matters will better protect their interest (i.e. the lender may not wish to pursue certain recovery alternatives if the borrower continues to cooperate).
- An alternative allowing for "new funds" from lenders that are not currently involved in a project should be considered where the borrower is unwilling or unable to provide the Regulatory requirements to attract new funds. The new lender must clearly understand the situation. Such lenders are often brought in to participate in a priority position relative to existing lenders, in order to move the project forward for the benefit of all stakeholders.

Investor/Lender Investment Limit

We agree with limiting the involvement of investors/lenders that are not part of a designated class of investors/lenders in non-qualified syndicated mortgages. We would also suggest the necessary regulatory framework could be simplified if "retail investors" did not have to be considered as potential parties to these transactions.

Recommendation

- Consider only allowing those that meet the designated class of investors to participate in non-qualified syndicated mortgages.
- If retail investors are to participate, consider language that is specific to different classes of investors/lenders.

Cooling Off Period

From our perspective, this requirement would provide the most value when a "retail investor" is involved in a transaction. The lenders we work with are typically regular participants in transactions we originate. They are sophisticated real estate development and construction debt investors and many have professional portfolio managers representing their interests. In our opinion, the two-day "cooling off" or waiting period is unnecessary for this class of professional investor. We believe consideration should be given to allow these lenders to waive this obligation if they choose to do so.

Recommendation

- Consider providing a waiver option for the designated class of investors described above.

Thank you for considering the commentary provided above. We would be happy to arrange a meeting to discuss these items and any other items you wish to discuss further. We appreciate the position you are in as a regulator to protect the public interest and understand the need to make the changes outlined in the new regulations. Our desire remains to ensure all stakeholders are protected and understand the risks they are taking and balance that with workable regulations to achieve this objective.

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APPENDIX A.- Excerpt from O. Reg. 188/08

REQUIRED DELIVERABLES BY BROKERAGE FOR A NON-QUALIFIED SYNDICATED MORTGAGE

Same, syndicated mortgages

31.1 (1) A brokerage shall give each lender or investor the following information and documents with respect to an investment in, or loan in respect of, a syndicated mortgage other than a qualified syndicated mortgage that the brokerage presents for consideration to the lender or investor:

1. A completed syndicated mortgage disclosure form, in a form approved by the Superintendent, signed by a broker.
2. A copy of an appraisal of the property relating to the syndicated mortgage that satisfies the following criteria:
   - i. It was prepared within 12 months before the day the syndicated mortgage disclosure form was provided to the lender or investor.
   - ii. It was prepared by a member of the Appraisal Institute of Canada who is independent, as described in subsection (2), and who holds the designation of Accredited Appraiser Canadian Institute.
   - iii. It was prepared in accordance with the Canadian Uniform Standards of Professional Appraisal Practice published by the Appraisal Institute of Canada, as amended from time to time.
   - iv. It provides an estimated market value of the property relating to the syndicated mortgage that reflects its condition and stage of development as of the day of the inspection or any day within 60 days after the day of the inspection.
   - v. The estimated value of the property referred to in subparagraph iv must not depend or rely on,
     - A. assumptions about proposed or future development of the property,
     - B. assumptions about proposed or future improvements to the property, or
     - C. any other condition that is not in existence as of the date selected for the estimated market value of the property.
3. If the investment is in, or the loan is in respect of, an existing mortgage, a copy of the mortgage instrument.
4. If the investment is in, or the loan is in respect of, an existing mortgage, a statement indicating whether the mortgage is in arrears and whether any mortgage payments are delayed or owing.
5. A copy of the certificate of mortgage interest, the assignment of the mortgage or any other document that provides evidence of the investment or loan.
6. If an agreement of purchase and sale in respect of the property relating to the syndicated mortgage has been entered into in the preceding 12 months and is available to the brokerage, a copy of the agreement of purchase and sale.
7. Documentary evidence of the borrower's ability to meet the mortgage payments.
8. A copy of the application for the mortgage and of any document submitted in support of the application.
9. If the investment is in, or if the loan is in respect of, a new mortgage, documentary evidence of any down payment made by the borrower for the purchase of the property relating to the syndicated mortgage.
10. A copy of any administration agreement that is applicable to the lender or investor.
11. A copy of any trust agreement that is applicable to the lender or investor.
12. A copy of the commitment letter or document setting out the terms of the lender's or investor's commitment to advance funds to the borrower.
13. The information required to be given under sections 21, 22 and 23.
14. A copy of any agreement that the lender or investor may be asked to enter into with the brokerage.
15. If the borrower is not an individual, one of the following:
    - i. Both,
      - A. the borrower's financial statements for its most recently completed financial year that ended more than 120 days before the day the syndicated mortgage disclosure form was provided to the lender or investor and for the financial year immediately preceding that financial year, and
      - B. the borrower's interim financial statements from the day after the end of the most recently completed financial year referred to in subsubparagraph A to the end of the most recent interim

period that ended more than 60 days before the day the syndicated mortgage disclosure form was provided to the lender or investor.

ii. The borrower's financial statements for its most recently completed financial year that ended 120 days or less before the day the syndicated mortgage disclosure form was provided to the lender or investor and for the financial year immediately preceding that financial year.

iii. If the borrower's first financial year ended more than 120 days before the day the syndicated mortgage disclosure form was provided to the lender or investor and the borrower's second financial year did not end before that day,

A. the borrower's audited financial statements for the first financial year, and

B. the borrower's interim financial statements from the day after the end of the borrower's first financial year to the end of the most recent interim period that ended more than 60 days before the day the syndicated mortgage disclosure form was provided to the lender or investor.

iv. If the borrower's first financial year did not end before the day the syndicated mortgage disclosure form was provided to the lender or investor or ended 120 days or less before that day, the borrower's audited financial statements for the period from its inception to a date that is 120 days or less before the day the syndicated mortgage disclosure form was provided to the lender or investor.

16. All other information, in writing, that a lender or investor of ordinary prudence would consider to be material to a decision about whether to lend money on the security of the property relating to the syndicated mortgage or to invest in the syndicated mortgage. O. Reg. 96/18, s. 7.

(2) For the purposes of subparagraph 2 ii of subsection (1), a member of the Appraisal Institute of Canada is independent if there are no circumstances that, in the opinion of a reasonable person aware of all relevant facts, could interfere with the member's judgment regarding the preparation of the appraisal. O. Reg. 96/18, s. 7.

(3) The following rules apply to the financial statements required by paragraph 15 of subsection (1):

1. The financial statements must be prepared in accordance with generally accepted accounting principles applicable to publicly accountable enterprises, the primary source of which is the *CPA Canada Handbook - Accounting*.
2. The most recently completed financial year referred to subparagraph i or ii of that paragraph must be audited.
3. For greater certainty, the brokerage may provide an audited version of a financial statement even if that paragraph does not require it to be audited.
4. Any audit of the financial statements must be conducted in accordance with generally accepted auditing standards, the primary source of which is the *CPA Canada Handbook - Assurance*.
5. Any unaudited financial statements must clearly be labelled as "unaudited". O. Reg. 96/18, s. 7.

Meaning of interim period

(4) In paragraph 15 of subsection (1),

"interim period" means a period that ends three, six or nine months after the end of the borrower's financial year. O. Reg. 96/18, s. 7.

Disclosure form for lenders re mortgage renewals

32. (1) A brokerage shall give each lender the following information and documents with respect to a renewal of a mortgage that the brokerage presents for the lender's consideration:

1. A completed renewal disclosure form, in a form approved by the Superintendent, signed by a broker.
2. If an appraisal of the property has been done in the preceding 12 months and is available to the brokerage, a copy of the appraisal.
3. If an agreement of purchase and sale in respect of the property has been entered into in the preceding 12 months and is available to the brokerage, a copy of the agreement of purchase and sale.
4. All other information, in writing, that a lender of ordinary prudence would consider to be material to a decision about whether to renew the mortgage. O. Reg. 188/08, s. 32 (1).

(2) Subsection (1) does not apply if the lender is a member of a designated class of lenders and investors. O. Reg. 188/08, s. 32 (2).

(3) A brokerage shall obtain the lender's written acknowledgement that the brokerage has disclosed the information and documents required by this section. O. Reg. 188/08, s. 32 (3).

Ontario Regulation 188-08 (Jul 1-18)(w. C