New Mortgage Prepayment Rules for Social Housing Mortgages

Ontario

SH notification

social housing

Subject: New Mortgage Prepayment Rules for Social Housing Mortgages

☐ Legislation/Regulation   Release 13-02

☑ Operational

Purpose

To provide information about Canada Mortgage and Housing Corporation's (CMHC) new mortgage prepayment rules for social housing mortgages.

General Background

- In general, CMHC-funded social housing mortgages are fixed to maturity. This means that if a housing provider wants to pay off the mortgage early or refinance with another lender, the provider has to pay to CMHC all interest chargeable under the mortgage, in addition to principal.
- On January 29, 2013, CMHC announced that for eligible social housing projects that need capital repairs and renovations CMHC will be accepting prepayment of closed mortgages with a yield maintenance prepayment penalty. (See Appendix A for CMHC press release)

New CMHC Policy - Prepayment of Closed CMHC Mortgage Loans

For projects requiring capital repairs and renovations, effective January 29, 2013, CMHC will allow the prepayment of closed mortgages. CMHC has identified the following criteria for eligibility:

1. The housing project must be financially viable, and must continue to be viable after the expiration of the operating agreement.
2. Capital investment in the property is required to address the replacement or repair of major capital building components and the housing provider does not have sufficient funds in its replacement reserve or will not be able to accumulate the required funds before the maturity of the loan, necessitating refinancing.
3. The project must have a capital replacement plan in place, spanning a minimum of ten years, which identifies and supports the proposed capital repairs and renovations.
4. The housing project must continue to be subject to their operating agreement with CMHC until its scheduled expiry.

Eligibility

- The new policy applies only to housing projects with Section 95 operating agreements and to Section 26 and 27 housing projects that have operating agreements and that have CMHC as their lender.
- Only housing projects that intend to pre-pay their mortgages and refinance for the purpose of undertaking capital repairs and renovations may take advantage of the new policy.
  - Capital repairs and renovation could include regeneration activities.
- Housing providers that want to refinance their closed CMHC mortgages with another lender for the sole purpose of lowering their interest rates cannot take advantage of the new policy.
- Housing projects with operational, governance and financial difficulties that are deemed Projects In Difficulty (PIDs) cannot take advantage of the new policy.
- Some existing housing projects created after 1968 under the Section 26 Limited Dividend Program are permitted to pre-pay their mortgage with CMHC after 15 years and pay a prepayment penalty of 3 months of interest, provided they have a clause in their mortgage agreement giving them the right to do that.

Penalty Calculation under the New Policy

- When eligible housing providers make mortgage pre-payment requests for the purposes of undertaking capital repairs and renovations, CMHC will no longer calculate the penalty based on the full interest lost costs, as per their previous policy.
  - For Section 26 and 27, the full interest lost costs were calculated until the full mortgage maturation date.
  - For Section 95, the full interest lost costs were calculated until the mortgage renewal date.
- Instead, CMHC will offer a yield maintenance penalty based on the difference between the original mortgage interest rate and the interest rate that CMHC can obtain when re-investing the balance for the remaining term of the mortgage.
- The re-investment rate will be based on CMHC's cost of funds.

Sample Calculation for a Section 27 project

Original Loan Amount:	$1,788,631
Interest Rate:	9.625%

Borrower Rate:	8.000%
Original Maturity Date:	April 1, 2029 (50-year loan)
Monthly Loan Payment:	$11,967
Federal Subsidy:	$2,228

Prepayment Penalty as of May 1, 2013 – Previous CMHC Policy
(full interest lost to CMHC for 16 remaining years)

Outstanding principal	$ 1,400,770.35
Prepayment Penalty	$ 984,513.76
E-Registration Fee	$ 71.30
Un-earned Capital Contribution (S.27)	$ 63,264.63
Total payable to CMHC	**$2,448,620.04**

Prepayment Penalty as of May 1, 2013 – New CMHC Policy
(cost differential between the existing mortgage rate and the amount that would be realized through re-investment for 16 remaining years)

Outstanding principal	$1,400,770.35
Prepayment Penalty	$ 757,280.00*
E-Registration Fees	$ 142.60
Un-earned Capital Contribution (S.27)	$ 0
Total payable to CMHC	**$ 2,158,192.95**

*Note that reinvestment rates cannot be known in advance and as such, the penalty estimate provided above is for illustrative purposes only. Actual penalty charged could vary significantly from what is shown above.

Existing Operating Agreements and Un-earned Capital Contributions

- Generally, existing operating agreements for federally-administered projects are automatically terminated upon the maturity or prepayment of their CMHC mortgage loan. Under the new policy, CMHC will require the operating agreements to remain in force until the original maturity date.
- The new policy will require an amendment to project operating agreements for Sections 26 and 27 housing projects. The agreements will be amended to expire as of the CMHC loan's original maturity date. The earnings of forgivable capital contributions for Section 27 projects will continue notwithstanding the early prepayment of the mortgage.
- The project operating agreement for Section 95 housing projects will remain in place until its scheduled expiry. The federal subsidy for Section 95 projects will continue under the existing operating agreement.
- Housing providers must continue to operate the projects as social housing and continue to abide by the terms of their operating agreements.

Test of Current and Future Financial Viability

- To qualify to pre-pay the mortgage under the new policy housing providers must demonstrate financial viability during and after the expiration of the operating agreements. (See “Implications for Service Managers” section for more information)
- Given that the province indemnifies CMHC against losses, CMHC will rely on MMAH’s assessment as to the viability of the project at the time of prepayment request.
- CMHC will allow housing providers to refinance their mortgages beyond the maturation date of original CMHC mortgages.
- CMHC will not act as a lender for the refinanced loans. Housing providers will need to find another lender.
- CMHC has advised that projects with refinanced loans under the new policy cannot obtain National Housing Act (NHA) mortgage insurance and therefore the new lender may charge higher interest rates.

Implications for Housing Providers

- Housing providers should review provisions about prepayment penalties contained in their project mortgage agreements as there are many variations.
- Housing providers wishing to prepay their closed CMHC mortgages need to discuss this matter with their Service Managers. The Service Manager’s consent for mortgage prepayment is required.
- The financial impacts of the new CMHC policy will vary. While for some providers the benefits of pre-paying their mortgage, refinancing and undertaking capital repairs and renovations will outweigh the costs, for others they may not.
- Prepaying a closed mortgage and arranging a new mortgage will trigger a number of fees for housing providers that include legal fees, administration fees, appraisal fees, title insurance fees and mortgage broker fees among others.
- Housing providers will need to undertake internal analysis/calculations and have a fulsome discussion with their Service Managers on whether to take advantage of the new CMHC policy.

Implications for Service Managers

- Service Managers are expected to do their due diligence before requesting MMAH to facilitate a mortgage prepayment for a housing provider.
- This includes determining whether a housing project meets CMHC’s eligibility criteria. The Service Manager must affirm that:

    1. The housing project is financially viable and will continue to be viable after the expiration of the operating agreement.
    2. The housing provider needs to obtain capital to do capital repairs and renovations and the housing provider does not have sufficient funds available in replacement reserves or not able to accumulate the required capital before the maturity of the loan.
    3. The project has capital replacement plan in place spanning a minimum of ten years to support proposed capital repairs and renovations.
    4. The housing provider will continues to operate the project as social housing and abide by all terms of existing operating agreement until its scheduled expiry.

- Along with its consent, the Service Manager must provide a written confirmation to MMAH that the project meets all the eligibility criteria for mortgage prepayment.

Role of the Ministry of Municipal Affairs and Housing (MMAH)

- A housing provider and its Service Manager need to contact MMAH with a request to make a mortgage prepayment on a project.
- MMAH will work with housing providers and Service Managers on a case-by-case basis.
- MMAH will submit the prepayment request to CMHC together with written confirmation that the aforementioned project eligibility criteria have been met.

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Attachments:
Attachment A – CMHC Press Release - PDF