

May 30, 2018

## **Request for Comments Response Regarding OSC & Syndicated Mortgages:**

The proposed amendments to National Instrument 45-106 Prospective Exemptions and National Instrument 31-103 Registration Requirements and Ongoing Registration Obligations relating to “Syndicated Mortgages and Proposed Changes to Companion Policy 45-106CP Prospectus exemptions fail to define the various types of syndicated mortgages and thereby needlessly and harmfully target and disrupt mortgage syndications, mortgage investors and mortgage companies, brokers and agents.

A mortgage syndication is any mortgage that is being funded by more than a single investor. The OSC imputes “risk” into mortgage terminology by its generic use of the term “Syndicated Mortgage”. The OSC proposed amendments are being established in response to the activities of very few companies such as the failed Tier One and Fortress Developments and related Fortress entities. These companies and very few others like them were able to dupe the public and the regulators by the simple action of registering a collateral charge on title (a mortgage) to appear to secure its investor’s investments and then attach the word mortgage to them for belt and suspenders. These investments were misrepresented to investors, many of which were unsophisticated who did not receive proper ILA, suitability investigation, or other required diligence. The investments themselves were in fact not mortgages but loosely secured equity investments disguised as mortgages.

Most every type of mortgage investment outside of the likes of Fortress and Tier One products are subject to an equity test based on current value and in the case of a development property, both the AS IS appraised value and AS Completed value. Properly structured development and construction projects are funded on a “cost to complete basis” so that there is always enough funding in place to start and complete a project inclusive of contingencies. The Fortress and Tier One products did not employ these necessary tests for quality, substance and preservation of capital. Their products which you term “Syndicated Mortgages” were used to fund “Soft Costs” and since the Borrower typically had little to no real equity in the project, these investments in fact represented pure equity.

If you were to analyze the capital stack in any of these failed company programs it becomes evident that each of them is close to being underwater at the time of closing of the initial funding of the investment. Typically, the investor rank is subject to postpone to every type of development financing arranged by Borrower often including but not limited to, a First Mortgage to 75% of Land Value in First Place, A Second Place Vendor Take Back Mortgage to 85% of the value of the land, a third place Bond or charge to secure purchaser deposits that may be drawn upon to reduce the requirement for construction financing, and in Forth place will be City and Regional Development Charges in order for the City or region to insure that the builder/developer complies with terms of the site plan approval and completes necessary works. Then in fifth position comes what you call the “Syndicated Mortgage” with its investors, ranking just above the Borrower whom may have little or no equity in the transaction. Needless to say, that “Syndicated Mortgage” investors represent all of the risk capital without any chance at of principal repayment save and except the successful sell out and completion of the project. Now you tell me please ..... is this syndicated equity or is this a mortgage?

The answer is clear that this is not a mortgage but rather syndicated equity and yes, the OSC needs to institute changes and amendments **to better recognize, monitor and regulate these highly specific types of investments.**

**The only way to properly implement the proposed amendments is to address the real problem outlined above which requires the OSC and the MOF to define these investments as “Syndicated Equity Investments” and remove them completely from the realm of mortgage brokerage by removing the prospectus exemption and move them alone under OSC registration obligations. There is absolutely no need to change the regulations for any other type of mortgage syndication.**

Let us draw upon a parallel. Just because 2 schedule A banks get together on a loan and they register a collateral charge on title to the real property of a business to secure a business loan does not redefine their loan as a “Syndicated Mortgage”. It remains a secured business loan.

So why are syndicated equity products being defined by the OSC as something they are not? The only mortgage like quality they retain is that they are registered as a charge on title. No different then any other secured loan.

Why not define these products for what they are and carve out legislation to deal with them specifically rather than disrupting an otherwise perfectly healthy industry? The mortgage industry has for over 100 years syndicated residential, commercial, industrial, hospitality and special purpose property mortgages successfully. The mortgage industry is providing an essential service to business people and consumers as an alternative to the Chartered Banks or other institutional lenders in a very competitive environment. There is no need for special regulation beyond the current programs overseen by FSCO save and except “Syndicated Equity” disguised as a mortgage and being defined by the OSC, MOF, FSCO and hence the media as “Syndicated Mortgages” which definition is wrong and imputes risk into terminology. Calling these syndicated equity products Syndicated Mortgages lends them an incredibly broader and safer meaning. Please focus the proposed amendments only on “syndicated equity programs” like Fortress Developments Products, failed Tier One and similar high-risk equity investments as well as those that create and market those products who have skirted securities regulations only by virtue of a valueless mortgage registration.

**It needs to be noted that the proposed amendments in its current form threatens over \$6 billion of private funded syndicated mortgages in Canada.** Many real estate developments could not be built without this funding. In fact, many would never be acquired as typically early stage land acquisition and development requires private funding. Private lending in syndication has for years saved many a homeowner from a temporary set back, funded renovations, helped revitalize whole communities through privately funding regentrification where bank financing is simply unavailable, saved families from foreclosure or power of sale, provided necessary working capital to businesses whose working capital or other ratios have put them offside with their bank and thousands of other examples where there is no need to fix what is not broken. Where a mortgage investment is a true mortgage investment where there is a test for real equity, ability to service debt, credit adjudication at a corporate and personal level, as well as property assessment, there is no need for change.

**The proposed amendments fail to recognize the costs associated with compliance and that additional processes and costs applied particularly where not needed to the mortgage industry will reduce competition resulting in private interest rates rising, fewer deals being consummated, where consumers will bear the brunt of these additional costs. The costs of the proposed amendments hugely outweigh the benefits save and except more laser focused implementation to better control the misuse of mortgage syndication to disguise and market syndicated equity investments.**

Request for Comments

March 8, 2018 (2018), 41 OSCB 1877

Appraisals

1. As proposed, an appraisal would be required in all cases where a syndicated mortgage is distributed under the OM

Exemption. Should there be exceptions to this requirement? For example, should an appraisal be required if the

property was acquired recently in an open market transaction with all parties acting at arm's length?

Mortgage broker requirements:

**- Unless a mortgage investor certifies that they consider themselves an expert and/or real estate investor or professional and agree in writing to waive an appraisal, the appraisal is necessary and should be provided and needs to be not older than 6 months and either addressed to the investor (investor group) or a letter of reliance to be provided from the appraisal company to the investor (investor group).**

2. Are there circumstances where requiring additional disclosure by and a certificate from a mortgage broker would not be

appropriate in connection with the use of the OM Exemption? If so, please explain why and whether there are other

participants in the distribution that should be subject to these requirements.

**- Chartered bank representatives are involved with placing true syndicated mortgages for all types of Borrowers and real estate as are lawyers and other previously exempt professionals. They should no longer be exempt to level the playing field.**

3. Is it appropriate to require a mortgage broker to certify that it has made best efforts to ensure that the offering

memorandum does not contain a misrepresentation with respect to matters that are not within its personal knowledge?

Exclusion of syndicated mortgages from the Private Issuer Exemption

**First define the type of syndicated mortgage you wish to address? Set standards to relate to your definition. Look at my example of the capital stack to address relative risk of an investment, provide a test to determine if the product is actually a mortgage. For example if a mortgage is over 85% Loan to Appraised Value then it is very high risk and either must be insured by CMHC or other insurer or it should be subject to your proposed amendments. All other mortgages should be left out of the proposal.**

4. Are there circumstances where the distribution of syndicated mortgages under the Private Issuer Exemption would be

appropriate and reporting to the securities regulatory authorities would not be necessary? If so, please provide

examples and explain why there are limited investor protection concerns in those circumstances.

**- As per my previous examples and discussion, provided investors complete a suitability test as well as provide a KYC form there is no need for the OSC proposed amendments save and except mortgages**

on real property in excess of 85% Loan to Value. For development or construction projects this LTV test should be reduced to 80% (of completed value) after which the proposed amendments should be applicable.

**Alternative prospectus exemptions – Should apply to all mortgage investments save and except “Syndicated Equity” and subject to the LTV test noted above.**

5. Should alternative prospectus exemptions be provided to facilitate the distribution of specific classes of syndicated

mortgages where the investor protection concerns may not be as pronounced?

- **Yes for all mortgages on residential owner occupied homes where current FSCO enforced regulation and processes is doing a great job.**
- **Yes where mortgages on residential and commercial mortgages are less than or equal to lower of 80% loan to appraised value or purchase price.**

6. Should we consider adopting an exemption for the distribution of syndicated mortgages on existing residential

properties similar to the exemption for “qualified syndicated mortgages” under British Columbia Securities Commission

Rule 45-501 Mortgages?

- **Yes where mortgages on residential and commercial mortgages are less than or equal to lower of 80% loan to appraised value or purchase price.**

7. Should an exemption be provided for the distribution of a syndicated mortgage to a small number of lenders on a property that is used for residential or business purposes by the mortgagor? If so, should the exemption be subject to

conditions? For example, should the exemption be available only for a distribution: (i) by an individual; and/or (ii) relating to a residential property; and/or (iii) involving a specified maximum number of lenders?

- **Keep it simple... Yes where mortgages on residential and commercial mortgages are less than or equal to lower of 80% loan to appraised value or purchase price. The size of the loan or property being secured does not matter.**
- **The syndicated mortgage should only be available for distribution by a licensed or exempt entity. Also there needs to be a friends and family exemption here particularly for family property (which might include a property housing a family business) and residential dwellings.**

Sincerely,  
David Mandel  
President

First Source Mortgage Corporation