May 2, 2019

In response to your request for comments regarding changes in mortgage brokerage regulations, I wanted to offer some insights from industry, in hopes of having an impact on its governance going forward. I am happy to talk in person or by phone to discuss any of my concerns. My apologies for the length of this email – feel free to use parts or the entire email – but as you will see, I'm not usually at a loss for words.

I attended a consultation with FSCO, OSC and the Ministry of Finance, along with some industry professionals on April 18, 2018 to offer feedback on the proposed forms, and would welcome the opportunity to be part of any future solution rather than sit idly on the sidelines and let our industry be so drastically altered by the recent changes to disclosure requirements and investor participation. I recently participated in a Stakeholder Roundtable on March 6, 2019 with Mr. Doug Downey and other industry professionals, and followed that with a personal meeting with Mr. Downey and his assistants in his office on March 21, 2019. After the meeting, Mr. Downey's assistant, Gina Stephens, encouraged me to share my thoughts with you directly.

Private Mortgage Capital Funding Ltd. ("PMC Funding" – FSCO Lic. 12583) is licensed as a Mortgage Brokerage, having incorporated in late 2014, and is focused on sourcing, underwriting, and syndicating private mortgage loans, which are all administered by my administration company, Private Mortgage Capital Holdings Ltd. ("PMC Holdings" – FSCO Lic. 12582). As the name indicates, our primary focus is providing an alternative source of funds for borrowers who either cannot or will not borrow funds from traditional institutional lending sources. Having worked in the industry since 2002 and been licensed as a Mortgage Broker for more than 10 years, I primarily focus on providing opportunities to participate in private mortgages for private lenders – an endeavour that helps both borrowers and lenders satisfy their borrowing and investment needs.

In speaking with many colleagues who are sources of private funds like PMC Funding, there is a number of concerned parties who are very worried about the impact of the changes that were implemented on July 1, 2018. While I am sure you will receive plenty of "feedback" from experienced mortgage professionals in the industry, I want to specifically address the definition of (1) a "non-qualified SMI" and (2) some unintended consequences of the recent changes.

I would add that a <u>'syndicated' loan</u> shouldn't be implicitly considered a 'bad' loan or 'risky' loan; by definition, it only means that <u>the loan has been funded by more than one lender</u>. In other words, as long as I place a commercial or industrial loan with a single investor/lender, it would be considered "qualified", which is counterintuitive. How is the lender protected from risk by investing such a large amount in a single loan? In my view, putting all their eggs in one basket exposes the lender to greater risk, not less.

<u>Non-Qualified SMIs</u>:

I appreciated being involved in the April 18, 2018 meeting after offering my support to Rocca D'Angela, though I was surprised to learn that the definition of a "non-qualified SMI" had already been determined and enacted into Law. Neither I nor any of my colleagues recall being asked for input or feedback as to what should constitute a qualified vs non-qualified SMI. The vast majority of my private loans would be considered "non-qualified" under the current definition due to the asset class, as our focus is lending against commercial and industrial properties.

I acknowledge the need for increased oversight due to companies like Fortress placing investors into loans that were not appropriate for them, however I think the current changes should specifically address that aspect of the industry, without affecting private mortgage syndicators who have extensive knowledge and experience at underwriting and assessing private lending risk. There should be a distinction made between "equity financing" which Fortress performed and "debt financing", which is being done by many seasoned mortgage brokers, acting responsibly.

While there are countless brokers/lenders who are focused on lending on residential properties – many to 85% LTV or higher – at PMC Funding I choose to focus on the commercial and industrial sector, as I feel those deals are stronger in general. In my experience, people who are <u>borrowing privately *for shelter*</u> are doing so because they have demonstrated either an <u>inability</u> or an <u>unwillingness to service their debts</u> historically (i.e. people with poor credit or unverifiable/nonexistent income). Many of these private residential mortgages are intended to consolidate debt, with borrowers subsisting solely on their ability to tap into and access equity in the inflated values of their homes, with many subsequently owing more than they originally paid for the property. Those who <u>borrow privately *for investment*</u> are doing so either for <u>speed or convenience</u>, as financial institutions require more extensive underwriting documentation and can take months to close a commercial mortgage transaction. Private lenders are much more responsive and can close deals expeditiously, enabling the borrowers to generate a cash flow from their properties sooner – time is money.

In underwriting risk, I have a very difficult time accepting that a residential loan to 85% LTV to a 'deadbeat' (for lack of a better term) *contains less risk* than a commercial/industrial loan to 50-60% LTV for a commercial borrower who has the necessary cash flow to service the debt, and has a worthwhile reason for arranging private financing, other than it being the only lending alternative available to them. While this is obviously my personal opinion and business focus, it has served me well over the years, as evidenced by our 0% default rate; to wit, we have only had a single borrower's payment declined since we began operations in 2014, which was subsequently replaced with certified funds within 48 hours. In other words, my conservative underwriting and focus on lending only to borrowers that have the ability to service the debt has contributed to nothing but successful loans since incorporation, simultaneously satisfying both borrowers' and lenders' interests.

A "non-qualified SMI" should be limited solely to development projects (i.e. residential or commercial subdivisions of 5 units or greater), which can be highly speculative in nature and require a greater depth of underwriting of the developer's experience and financial strength and ability to respond and react to cost overruns and delays. <u>A property that is zoned commercial/industrial is not necessarily a riskier investment just by virtue of its asset class</u>. Additionally, small construction (i.e. infill homes and renovations) should not be considered non-qualified, as these are not speculative development projects that may or may not ever be built, but quick, short term financing opportunities which fill an industry void, as most institutional lenders are not bullish on construction financing.

The current definition of a "non-qualified SMI" needs to be revisited, as it does not appear that the new regulations take into account the way the industry actually operates. The definition of a "non-qualified SMI" should be narrowed to include loans where the future value is something different than the current value, or loans where a lender's priority can change without their knowledge or consent. They should not include loans on commercial or industrial properties.

<u>Unintended Consequences</u>:

By limiting a non-'designated' or 'accredited' investor to lending less than $60K per annum, the new regulations are actually <u>exposing them to more risk</u> rather than protecting them from risk, as the rules essentially preclude them from participating in 1st mortgages and relegate them to participating in 2nd mortgages, even though the reduced risk inherent in 1st mortgages would better fit their conservative lending profile. Most commercial and industrial mortgages are larger than $60,000, and, with the excessive paperwork required for non-qualified SMIs, it isn't feasible to syndicate the loan into units as small as $60,000. The issue is that this class of investor – those who would benefit from participating in more conservative loans – are precluded from participating in loans that would objectively be deemed to be more appropriate for them. A balanced investment portfolio should consist of a variety of investment vehicles, including stocks, bonds, funds and investment in private mortgages, thus mitigating the investor’s risk. It is not fiscally responsible to exclusively participate in private mortgage, however it is just as inappropriate to preclude an investor from participating in same.

The bottom line is that while the changes that have been recently introduced are generally well-intentioned and useful, the definition of a “qualified” vs “non-qualified” SMI needs to be revisited and amended, as it does not accurately reflect what is happening in the industry. Throw the book at the Fortresses of the world, but recognize that not all successful private lending brokerages are alike. One size definitely does not fit all, just as every loan should be treated on its own merit. Amending the definition of a non-qualified SMI will simultaneously address the issues raised regarding the unintended consequences of the new regulations.

I am happy to meet in person to discuss this further.

Best regards,

Stephen Lidsky
President, Principal Broker
PMC Funding