

CMHC LEASEHOLD LENDING REQUIREMENTS

Overview of Process

While CMHC will review the lease for mortgage loan insurance purposes, in accordance with prudent lending practices, the Approved Lender is responsible for title matters and as such the Approved Lender:

- i) must carry out its own review of the lease as a title document as well as review the lease to ensure compliance with CMHC policies for leasehold lending;
- ii) be satisfied as to the existence and sufficiency of the land title/registry system and legal framework supporting real property and mortgages.

The Approved Lender must secure the loan with a mortgage (or charge) on the borrower's leasehold interest in the land and ensure that the Approved Lender will be in a position to transfer a good and marketable leasehold interest to a purchaser or to CMHC pursuant to the mortgage in the event of a claim under the mortgage loan insurance policy.

Following its review of the lease and related documentation, the Approved Lender must provide CMHC with a copy of the ground lease with the Approved Lender's opinion, supported by the Approved Lender's solicitor's opinion, regarding compliance with CMHC's leasehold lending policy.

Leasehold Lending Requirements

Lease term

The term remaining of the lease at the time the mortgage term begins must exceed the remaining mortgage amortization by at least 10 years. Renewal or option periods are not to be taken into account in determining the remaining term of the lease (except in the case of leasehold lending for properties in National Parks).

Note: For social housing and properties meeting CMHC Affordable Housing criteria, the remaining lease term must exceed the remaining amortization period by at least five years.

Ground rent

Generally ground rent for homeowner leases would be prepaid.

No ground rent escalation

The lease must not contain provisions for ground rent escalation.

Note: CMHC may consider loan applications submitted for CMHC mortgage loan insurance with ground rent escalation clauses on a case-by-case basis where it is demonstrated that the financial uncertainties created by the escalation and timing of rent escalation are appropriately mitigated (e.g. purchase of a derivative investment where escalation is tied to CPI).

Waiver of net ground rent

Any rent payable to the Landlord, excluding the portion of rent which relates to real property taxes and utilities, must be waived during any period of time that CMHC holds leasehold title as a result of foreclosure, title transfer or other action on the security in the event of default under the mortgage or the lease. A waiver of net ground rent is **not** required where:

- the remaining term of the lease exceeds the remaining mortgage amortization by at least 25 years AND if the lease contains any ground rent escalation clause, it must be acceptable to CMHC (ground rent escalation clauses may be considered on a case-by-case basis per the above); or
- an irrevocable and unconditional letter of credit or collateral security for the remaining amortization in an amount sufficient to cover 12 months of ground rent is provided by the borrower to the Approved Lender as additional security.

Note: Where there is an option to purchase rather than a waiver of net ground rent, the Approved Lender must specifically acknowledge, in a form signed by an officer authorized to so bind the Approved Lender, the obligation to convey freehold title in the event of a claim under the loan insurance and should specify the agreed option price. The option price must be acceptable to CMHC and determinable at the time of funding the loan.

Default Notice to and Remedies of Mortgagee

The lease must provide for the Landlord to give written notice to the mortgagee of any material default or breach of covenant of the lease, where the Landlord intends to exercise its right of distress or re-entry or termination of the lease if the default or breach is not cured. The mortgagee must be given sufficient time to cure the default or breach (a minimum of 45 days from the date of notice to cure the breach) or if the default cannot be reasonably cured within that time, the mortgagee must be given sufficient time to complete all acts necessary to cure the default or breach. Where the mortgagee notifies the Landlord of its intention to foreclose or otherwise realize on its security, the mortgagee must be given sufficient time to carry this through to conclusion, at which time it will become the new lessee AND once the mortgagee commences proceedings, the Landlord shall not re-enter or otherwise terminate the lease (provided the mortgagee actively prosecutes the proceedings to conclusion). In this regard, there must be no restrictions in the lease on the mortgagee's right to assign in the event of foreclosure or other action on the security.

Entitlement of possession

The lease must entitle the mortgagee to take possession of the improvements and to administer the property (including the collection of all rents, etc.) even as against the Landlord, in the event of a default under the terms of the mortgage.

No onerous covenants

The lease must **not** contain any onerous covenants which for example, increase default risk under the lease, restrict, limit or cancel the tenant's legal rights or recourses. For example: the tenant must have the right to contest liens; the repair and maintenance clause must expressly exclude normal

wear and tear; failure to comply with rules/regulations of the Landlord must not result in termination of the lease; etc.

No restrictions on use or assignment

- i. The lease must **not** contain **any** restrictions on use of the property (e.g. that it be used exclusively as student housing, or as affordable housing, or rental housing, etc). As such, the Approved Lender or CMHC or a subsequent transferee must be in a position to transfer the leasehold interest, in the event of a claim under the loan insurance, free of any restrictions on use contained in the lease;
- ii. There can be no restrictions on the mortgagee or CMHC's freedom of alienation or that of a transferee from CMHC or the Approved Lender (i.e. the right to assign the leasehold interest to a third party) except where:
 - a. the Landlord provides an unconditional loan guarantee for the full loan amortization period; or
 - b. the Landlord agrees that in the event of default; the Landlord must cure the default within 120 days or find a replacement tenant; otherwise, the restriction must be waived.

Use of fire and standard peril insurance proceeds

CMHC does **not** accept any lease requirement that insurance proceeds from damage or destruction must always be applied to rebuilding at the sole option of the Landlord. Where damage or destruction exceeds 25 percent of the insurable value of the property, the lease cannot call for proceeds of insurance to be used to repair or rebuild. In such event, the mortgagee must have the option of applying the proceeds of insurance to repay the mortgage debt.

Note: If the Approved Lender verifies that the borrower can and will maintain rental interruption insurance for at least 24 months, the lease may contain a condition which requires that insurance proceeds from damage or destruction be used to repair and rebuild a property, provided the damage exceeds 50 percent of the insurable property value.

The lease must not stipulate that the Landlord has a claim on monies paid or payable by an insurer due to damage or destruction of the improvements securing the mortgage loan in priority to the leasehold mortgage.

Ability to Mortgage

The lease must expressly state that the Tenant's interest is capable of being mortgaged or is otherwise being made available for the purpose of obtaining financial assistance. There must not be any restrictions or stipulations regarding the right of the tenant to mortgage.

Claim on expropriation monies

The lease must not stipulate that the Landlord has a claim to all moneys paid or payable by an expropriating body in priority to the leasehold mortgage.

Arbitration

The lease must entitle the mortgagee to participate in any arbitration or other dispute resolution process if the mortgagee considers that such proceedings may affect the mortgage security.

CMHC as Mortgagee

In addition to the Approved Lender being a Mortgagee, the lease must also specifically reference CMHC as Mortgagee.

Considerations On-Reserve

Leasehold arrangements on reserve lands can be quite complex, particularly as regards the headlease/sublease structure and the registration of lease. As is the case off-reserve, lenders and their counsel must be in a position to issue an unqualified opinion regarding good and marketable title and be in a position to register a first priority security of a mortgage. CMHC is open to the appropriate system of registration being either a Land Torrens or registry system, but in our view, any such system of registration would need to include both the underlying interest in land and the leasehold interest (and not simply be a “leasehold only” system of registration).

Where a headlease/sublease model is used on-reserve, appropriate mechanisms must be in place to ensure that a default under the Headlease as well as defaults by other subtenants do not affect a subtenant in good standing who has granted a CMHC-insured mortgage to an Approved Lender. Acceptable mechanisms to reduce the above risk may include a homeowner’s corporation, but should also include additional protections such as non-disturbance and direct leases or waiver of default as against subtenants in good standing under their own subleases.

Other Considerations

While the above represent CMHC’s general requirements for leasehold lending, we note that other underwriting and legal issues may arise based on the individual terms and conditions of the particular lease, which may require amendments beyond those strictly outlined here (e.g. default triggers/cross-defaults in leases, the requirement that the lease must be capable of being registered in an appropriate system etc.). CMHC would expect any such issues to be rectified.

Sample Clauses

General

Below are some sample clauses approved by CMHC in the past and which comply with certain of the conditions outlined above, for CMHC-insured leasehold loans. These are provided for information purposes only. We note that we see variations of these clauses and do not expect that the clauses will be adopted “as is”. In fact, in some cases, it might not be appropriate to adopt the clauses in the current form below depending on the content of the lease as a whole. Furthermore, additional changes to the clauses below may be required depending on the contents of the lease and the circumstances or the transaction. The Approved Lender and CMHC must review each lease for compliance with the leasehold lending requirements and may identify additional issues not addressed by the clauses below which also must be resolved.

Sample Clauses

Notwithstanding any other provisions of this Lease, where the whole or any part of the interest of the Lessee under this Lease is mortgaged to a Mortgagee, insured against borrower default, under the *National Housing Act*, then:

- a. The Lessor shall not exercise effectively as against the Mortgagee any right of re-entry, distress, or termination of this Lease until the Lessor gives to the Mortgagee at least 45 days' written notice of the intention to re-enter or to distrain or to terminate the Lease specifying the full particulars of the grounds therefore.

The Mortgagee, during that 45 day period, must either remedy all specified proper grounds for re-entry, distraint, or termination of Lease, OR where the specified proper grounds cannot be reasonably remedied within that time, the Mortgagee must give to the Lessor notice in writing that the Mortgagee intends to take or has taken formal proceedings for the enforcement of its mortgage and the protection of its position. The Mortgagee, having given notice to the Lessor as specified herein, has been provided with sufficient time to pursue to their conclusion all reasonable proceedings for the enforcement of its mortgage and the protection of its position. Once proceedings are commenced, the Lessor shall not re-enter, distrain or terminate the Lease, provided the Mortgagee actively prosecutes the proceedings to their conclusion;

- b. If, upon the conclusion of proceedings by the Mortgagee for the enforcement of its mortgage and the protection of its position, the rights of the Lessee have been released to the Mortgagee or foreclosed or sold, all then-existing grounds for re-entry or distress or termination (if any) of re-entry or distress or termination shall terminate and the Mortgagee or purchaser shall become the Lessee free of all liability for such grounds; and
- c. Where the Lessor, at the request of the Lessee/Mortgagor, intends to terminate the Lease, either by surrender of Lease or otherwise, notice of such intention shall be given in writing to the Mortgagee, allowing the Mortgagee at least 60 days to obtain repayment in full of the outstanding mortgage, inclusive of interest and penalties, or to take mortgage default enforcement action with its rights pursuant to paragraph (a) herein intact. If the Mortgagee provides to the Lessor notice of its intention to commence or notice of the commencement of mortgage default enforcement action to realize on its security, including but not limited to foreclosure proceedings, the Lessor shall not accept the surrender of Lease; and

- d. Throughout any period of time during which, as a result of proceedings for default under the mortgage including transfer of title under the *National Housing Act*, Canada Mortgage and Housing Corporation as successor is in leasehold possession of the premises or holds leasehold title to the premises,
- i. the Lessor waives, as against the Mortgagee and Canada Mortgage and Housing Corporation and their successors and assigns, all rent and additional rent and interest accruing and otherwise required to be paid under this Lease, but for the purposes of this waiver, rent and additional rent do not include municipal real estate taxes, school taxes, local improvement charges, water rates and utility charges required to be paid by the Lessor or the Lessee and the actual costs of construction, maintenance and repair of damage that are the responsibility of the Lessee, and
 - ii. the review and approval of the Lessor shall not be required with respect to plans, specifications, contractors, workers, tradesmen, materials, proposals, details and drawings for repairs, replacements, maintenance, improvements, alterations, and decorations, and
 - iii. the consent of the Lessor shall not be required with respect to any vacancy of or removal of goods from the demised premises; and
- e. No restriction on assignment or subletting of this Lease by the Lessee applies to any assignment or subletting or release of this Lease to or by the Mortgagee or Canada Mortgage and Housing Corporation or to or by any successor, assignee or subsequent purchaser AND the Mortgagee and Canada Mortgage and Housing Corporation shall not remain liable on the Lease after assignment or release by either of them; and
- f. If at any time the premises are damaged or destroyed to the extent of twenty-five per cent (25%) or more of their full replacement cost, then the Mortgagee or Canada Mortgage and Housing Corporation as successor may elect to require that the insurance proceeds not be applied toward the repair or rebuilding or restoration of the demised premises, and in the event of such an election the insurance proceeds shall be applied, in priority,
- i. first, but only if and to the extent required by the Lessor or the Lessee, toward clearing and restoring the lands as nearly as possible to their condition prior to the commencement of construction,
 - ii. second, towards payment of all moneys owing on the mortgage,
 - iii. third, towards payment of all moneys payable to the Lessor under this Lease, and
 - iv. fourth, in payment to the Lessor and the Lessee in accordance with their interests therein,
- and the Lessee shall not be obligated to repair or rebuild or restore; and
- g. There shall be no obligation on Canada Mortgage and Housing Corporation to arrange or maintain any insurance.

Where Canada Mortgage and Housing Corporation makes the election specified in section (f) and there exists no or insufficient proceeds, as a result of Canada Mortgage and Housing Corporation not having arranged or maintained insurance, Canada Mortgage and Housing Corporation shall not be required to do more than clear and restore the lands, as nearly as possible, to their condition prior to the commencement of construction, and shall be entitled to apply to that end whatever insurance proceeds may be available; and

- h. There shall be no obligation on Canada Mortgage and Housing Corporation to indemnify the Lessor except where that Corporation would be so obligated apart from the terms of this Lease; and
- i. The party requiring arbitration or any other dispute resolution process shall give timely notice of all arbitration proceedings to the Mortgagee and the Mortgagee may participate fully in the proceedings, if in the Mortgagee's reasonable opinion the outcome may affect its security; and
- j. Without restricting the generality of the foregoing, the word "Mortgagee" includes Canada Mortgage and Housing Corporation.
- k. If, at any time during the term of the Lease, any public body or paramount authority shall take or expropriate the whole or a portion of the premises, then the Lessor and the Lessee may exercise fully all rights, remedies and claims for compensation which each may have under applicable legislation. The Lessor and Lessee shall inform each other fully of the claims for compensation made by each of them in the event of any expropriation, shall not claim compensation on any basis inconsistent with this Lease, and shall afford reasonable co-operation with each other in the prosecution of any proper separate claims. The Lessor and Lessee shall co-operate with each other regarding any expropriation of the Lands or any part thereof so that each receives the maximum award to which it is entitled at law.