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Canadian vs. US CRE Loans

Explaining some of the material differences for
Land and Construction financing.

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MarshallZehr Group Inc. | Mortgage Administration #11955
Mortgage Brokerage #12453

Canadian vs. US CRE Loans for Land & Construction financing

At MarshallZehr, we often attract investor interest in commercial real estate ("CRE") lending from institutions outside of Canada, many of whom have more familiarity with investing in the United States. The risk and return characteristics of investing in Canada and the US are generally considered quite similar across a broad spectrum of asset classes. However when it comes to CRE lending for pre-development land and construction financing, there are some subtle but important distinctions to note.

Canada's financial system has a reputation for a conservative approach to risk, and CRE lending standards in Canada are often more stringent than those typical in US markets. We believe that it is important to highlight some of the key differences in pre-development land and construction financing that often distinguish CRE lending in Canada from that in the United States:

Guarantees

Canadian CRE loans require a guarantee to ensure the repayment of the loan in full. This guarantee provides legally binding recourse to the lender which can be enforced in the case that a 'Power of Sale' event fails to provide sufficient repayment to cover outstanding debts secured against the value of the project or property. Most often, the senior mortgage lender will require a 'Joint and Several', personal and corporate guarantee with demonstrated net asset value equivalent (at minimum) to the full loan amount.

Pre-Sales

In addition to personal and corporate guarantees, the initial advance of funds from a construction lender will typically require finalized pre-sales in an amount equal to the full value of the construction loan. For the purpose of meeting this threshold, pre-purchasers are limited to 4 units or less per person/entity in order to discourage block sales to non-arm's length entities and to limit the risk of price speculators 'doing dark' in the event of reduction in the value of of their pre-purchased units. Purchaser deposits are 15% of the purchase price up front, plus an additional 5% on closing.

Conservative Leverage

Canadian CRE loans have lower senior mortgage leverage (approximately 50% to 65% LTV for land and construction financing respectively). Risk aversion pervades the Canadian financial system and as a result, senior mortgage lenders (typically banks) will only provide a maximum of 50% LTV on land transactions and up to 65% LTV on construction financing.

Deposit Insurance

In Canada, deposit insurance allows borrowers to insure and capitalize their deposits for use in the project. For a project with fully loan liquidating presales, this funding source usually covers 10% to 15% of the budget. The cost to the borrower for this insured source of funds is typically approximately 1% to 2%.

Sales Contracts

Canadian CRE land sales contracts usually require large non-refundable deposits of 5% to 10% of the purchase price to tie up a property prior to going firm on closing conditions. Sales contracts usually provide a very limited scope for a buyer to 'go dark' without losing their deposit. It is typical for the ability to finance the acquisition to have been already vetted prior to making an offer to avoid a situation where the buyer loses their deposit.

Lower Prime Rates

Canada has lower Prime Interest Rates (as of today: Canada 2.45% vs USA 3.25%). A lower prime interest rate lowers the cost of capital for banks and other lenders. The lower cost of capital for senior lenders also reduces the expected gross yield on mezzanine financing. However, spreads over prime remain healthy - between 100 and 300 bps for senior loans, and between 600 and 1200 bps for mezzanine loans.

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Founded in 2008, **MarshallZehr Group Inc.** ("MZ") is an industry leader, providing select mortgage lending and customized financial opportunities in real estate construction and development.

Specifically, we specialize in transformative projects (ground-up and value-add) across multiple build types, focusing on generating risk-adjusted returns.

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