Financing Your First Investment Property

Introduction: The Fuel for Your Investment Engine

You've learned the strategies and you know how to analyze a deal. Now it's time to tackle the most critical step in the acquisition process: securing the financing. Understanding how to get a mortgage for an investment property is fundamentally different from getting one for the home you live in.

Lenders view investment properties as a business transaction, and they assess the risk differently. This guide will walk you through the primary loan options, lender requirements, and key strategies for successfully financing your first rental property in Canada.

Chapter 1: Understanding the Down Payment Requirement

For investment properties in Canada, the down payment is the most crucial financial hurdle. While the absolute minimum for a standard residential rental (1-4 units) is **20%**

of the purchase price, this is just the starting point.

Unlike a primary residence where you can get an insured mortgage with as little as 5% down, investment properties require a larger "conventional" down payment. The exact amount can range from 20% to 35%, depending on several factors:

- **Property Type:** A duplex might qualify for a 20% down payment, but a larger multi-family apartment building or a commercial property will almost certainly require 25%, 30%, or even 35% down.
- **Lender Requirements:** Different lenders have different risk tolerances. Some may require a larger down payment for certain types of properties or locations.
- **Deal Strength:** The property's ability to generate strong cash flow can influence the lender's decision. A property with a higher down payment represents less risk to the lender.

It's safest to assume 20% is the best-case scenario and be prepared for a higher requirement as you explore different types of investment properties.

Chapter 2: Your Primary Loan Options

You have several avenues for securing a loan. Here are the most common paths for a first-time investor:

- **Conventional Mortgages:** This is the most common route for properties with 1-4 units.
    - **'A' Lenders:** These are the major banks (RBC, TD, Scotiabank, etc.). They offer the best interest rates but have the strictest qualification criteria (strong credit, stable income).

    - **'B' Lenders:** These include credit unions and alternative mortgage companies. Their rules can be more flexible, which is helpful for self-employed investors or those with unique situations, but their interest rates are often slightly higher.
- **HELOC (Home Equity Line of Credit):** If you already own a primary residence and have built up equity, this is one of the most powerful tools available. You can borrow against the equity in your home to use as the down payment for your investment property. This allows you to acquire a rental with minimal cash out of pocket.
- **Private Lending:** Private lenders are individuals or companies that lend money for real estate deals. Their interest rates are significantly higher (often 8-15%), and loans are typically short-term (1-2 years). This option is generally used for "fix and flip" projects or for investors who cannot qualify for a conventional mortgage but have a clear plan to refinance with a traditional lender later.
- **Seller Financing (Vendor Take-Back Mortgage):** In some cases, the seller of the property may be willing to act as the bank and provide you with a mortgage directly. This is less common but can be a creative way to secure a deal, especially if the property is difficult to finance conventionally.

Chapter 3: Understanding Loan Terms & Timelines

Securing a mortgage isn't just about getting approved; it's about understanding the structure of your loan and the time it takes to get it.

- **Typical Loan Terms:**
    - **Amortization Period:** This is the total length of time it will take to pay off the mortgage. For investment properties, this is typically **25 years**, though some lenders may offer 30 years.
    - **Mortgage Term:** This is the length of your contract with the lender. Common terms are **3, 4, or 5 years**. At the end of the term, you must

renew your mortgage at the current market interest rates.
    - **Interest Rate:** You will choose between a **fixed rate** (which stays the same for the entire term) or a **variable rate** (which fluctuates with the Bank of Canada's prime rate). Investment property interest rates can be slightly higher (often 0.1% to 0.5% higher) than those for a primary home.
- **Typical Approval Timeline:**
    - **Pre-Approval (1-3 business days):** This is your first step. You submit your initial financial information to a mortgage broker, who tells you how much you can likely borrow. This is crucial before you start looking at properties.
    - **Full Approval (5-10 business days after an accepted offer):** Once you have an accepted purchase offer on a property, you submit the property details and final documents to the lender. They will review everything, order an appraisal, and issue a final commitment letter.
    - **Closing & Funding (~30 days from offer acceptance):** The entire process from having your offer accepted to the money being transferred and you getting the keys typically takes about 30 days. Your lawyer handles the final steps during this period.

Chapter 4: How Lenders See You: The 5 C's of Credit

When you apply for an investment property mortgage, the lender will evaluate your application based on five key areas:

1. **Character (Your Credit):** Your credit score is a snapshot of your reliability as a borrower. Lenders will want to see a strong credit score (typically 680 or higher for the best rates) and a consistent history of paying your debts on time.
2. **Capacity (Your Income & Debts):** The lender needs to know you can afford the payments. They will analyze your income and your existing debts (car loans, credit cards, student loans) to calculate your **Debt Service Ratios**. They will also consider the potential rental income from the new property. A common rule of thumb is that lenders will add **50% of the property's gross rental income** to your qualifying income.
3. **Capital (Your Money):** This is your down payment. Lenders need to see that you have the required down payment plus extra funds for closing costs (typically 1.5% of the purchase price). They also want to see that you have some cash reserves left over after closing as a safety net.
4. **Collateral (The Property):** The lender will order an independent appraisal of the property to ensure it's worth the price you're paying. The property itself is their security for the loan.

5. **Conditions:** The lender will consider external factors, such as the market conditions in Edmonton, the type of property (e.g., a condo vs. a single-family home), and the overall economic outlook.

Chapter 5: Your Most Valuable Partner: The Mortgage Broker

While you can go directly to your bank, working with an independent mortgage broker who specializes in investment properties is highly recommended.

Why? A good broker has access to dozens of lenders—including 'A' lenders and 'B' lenders. They know which lenders are "investor-friendly" and understand the nuances of how different institutions treat rental income. They can shop your application around to find the best possible interest rate and terms for your specific situation, saving you time, stress, and money.

Conclusion: Get Prepared, Then Get Pre-Approved

Financing is not something you figure out after you find a property; it's something you prepare for before you even start looking. The best first step any aspiring investor can take is to speak with a mortgage broker to get a clear picture of their budget and borrowing power.

Getting pre-approved for a mortgage shows sellers you are a serious, credible buyer and gives you the confidence to make strong offers when you find the right opportunity.

Jey Arul, BA, MBA
President, Investment Broker
AJS Capital Inc.
www.ajscapital.com