Interesting Suggestions in Reference to the Financing of Small Homes

(By F. W. Nicolls, M.R.A.I.C., Director of Housing.)

NOTE: Under regulations effective as of and from January 1, 1940, loans under Part I of the National Housing Act may be made only to assist in financing single family houses. The maximum loan in respect of each single family house is also limited to $4,000. With the exception of these changes the other features of Part I of the act have been retained. The same loaning facilities which were available to the low-cost home owner in 1940 are therefore still available in 1941.

For the large majority of families contemplating the construction of a new home, the matter of financing their program is of prime importance. In only a small proportion of cases is the prospective owner able and willing to provide the entire capital from private resources. It follows, therefore, that for most families, resort must be had to credit financing. It is also evident that the ease or difficulty of securing this credit on favourable terms will be a major factor in their decision to go forward with their program.

Prior to 1935 the family of moderate income was faced with certain difficulties in building a new home. In Canada the bulk of monies available for investment in first mortgages were trust funds, and the investment of these funds was limited by law to 60 per cent of the value of the home. In practice it was often necessary for various reasons to further restrict these investments to 50 per cent of the lending value of the home. Thus, the family was required to accumulate a substantial proportion of the cost or to resort to the expensive procedure of securing a second mortgage.

A second difficulty was that the usual mortgage was for a short term, repayable in full at maturity, generally in five years. The mortgage was usually renewed when it became due. Eventually, however, the mortgage was not renewed and, as frequently happened, the borrower found himself obligated to make a large payment at just the time he was unable to do so.

In order to meet this situation the Dominion Government with the cooperation of the lending institutions worked out a plan for higher percentage loans, with a longer term to maturity and with the payments to be made by the borrower arranged more in line with the budget of the average family.

This was in 1935, and since then the new method of home financing has grown in popularity. In 1938 the Dominion Housing Act was repealed, and the National Housing Act, a more comprehensive measure, was passed.

Under the new legislation the maximum loan on the new house is 80 per cent of the cost or appraised value, whichever is the lesser, or it may be for an amount ranging from 70 per cent to 80 per cent of this value. This is true in all cases, excepting where the lending value is $2,500 or less. For very modest homes of this lower value the legislation is even more generous, and the loan may be for a maximum of 90 per cent of the lending value or for an amount ranging between 50 per cent and 90 per cent of this value. In no case, however, may the loan now exceed $4,000.

It must be noted that all National Housing Act loans are based on the "cost or appraised value, whichever is the lesser," and that this lesser amount is known as the "lending value." Cost is the amount actually spent to produce the finished property; value is the worth of the property when completed. The owner's cost includes the cost of the land, building, architect's fees, legal and other expenses necessary to complete the house. A large number of factors enter into arriving at the appraised value as distinct from the owner's cost, and a brief outline of some of these may assist the prospective owner to follow those rules of procedure which will gain for him a satisfactory appraisal, equalling or closely approximating his total cost.

If the prospective borrower does not already own a building lot he will be wise to seek competent advice as to the location of the site for the new home. Many of the leading institutions keep detailed records of the growth of communities, and may be able to assist the applicant in this respect. Generally, the lot should not be in a declining section of the municipality and it should be legally protected from detrimental influence by zoning ordinances. Water, sewer, electric, and other services should be adjacent to the property. School, church, shopping, and amusement centres should be nearby without being too close, and in the larger centres transportation service should be close at hand. Finally, the neighborhood chosen should be one made up of homes approximately the same value as that which the borrower plans for himself, and the cost of the lot must not be more than 20 per cent, and preferably not more than 10 per cent of the amount which the owner plans to spend on the entire program.

In planning the house, again competent advice should be obtained by the prospective home owner. It is advisable to engage an architect, but if one is not available very careful attention should be given by the borrower to the selection of a practical and livable plan, designed to meet his real needs. The house should be suitable to the site upon which it is to be constructed, and this should be kept in mind when choosing the lot. The exterior should be pleasing, simple, and attractive, in line with the modern simplicity of design. A wise selection of materials will ensure slow physical depreciation and should reduce maintenance costs. The borrower should have a thorough understanding of his obligation to see that the house complies in all respects with the Minimum Standards of Construction and Memorandum Specifications which have been established under the National Housing Act, and to which all houses must conform. Finally, bids should be secured from several competent builders enjoying a good reputation among those for whom they have built, in order that the best price may be obtained on the contract.

If all these details are given careful study and consideration, the cost will quite likely be in line with the lending value of the property and be satisfactory as the basis for the loan; also, the property will not be subject to the rapid loss of value of unprotected and poorly constructed houses.

Of interest to the prospective small house builder and owner are the plans available through the Housing Administration. These are minimum cost houses ranging in cost from $2,000 to $4,000, and provide for one storey, one and one-half, and two storey houses. Sketches and data are available on request to the Housing Administration, Department of Finance, Ottawa.

As we have already noted, National Housing Act loans may be for 70 per cent to 80 per cent of the lending value, and in the case of very modest homes with a lending value of $2,500 or less, the loan may be from 50 per cent to 90 per cent of this value. The main factors in a determination of this percentage are the borrower's ability and willingness to meet his obligations. It is quite obvious, for instance, that the applicant's past record of meeting his obligations will have a bearing in considering the risk of granting him a large percentage loan, and also that a bad credit record will make any loan impossible.

The borrower's income and his probable future income will also be among the limiting factors taken into consideration when his loan application is being considered. A borrower who wishes to build a home costing more than he can afford should not expect to receive the maximum percentage loan on his property, and in this connection experience would indicate that he should not spend an amount in excess of 2 to 2½ times his yearly income as the total cost of his home.

All National Housing Act loans are secured by amortized mortgages. Each mortgage provides for monthly payments to cover 5 per cent interest on the loan, repayment of principal, and the estimated annual taxes on the property. The retirement of principal is provided for in accordance with a standard amortization table at a rate sufficient, in the normal case, to retire the full amount of the loan in 20 years. If, however, the borrower so desires, he may arrange for a larger monthly payment in order to retire his loan more quickly, say, in 10 to 15 years.

The monthly payment required to fully amortize the loan in 20 years is $6.54 per thousand dollars of loan. A 15-year amortization requires a payment of $7.85, and a 10-year amortization requires a payment of $10.55. The payment for taxes, which must be added to arrive at the total monthly instalment, is one-twelfth the estimated annual taxes.

An illustration will clarify the manner in which the monthly payment is calculated. Suppose a property, including house, lot, architectural, legal and other expenses, is to cost $3,000, and that its appraised value is about the same; an 80 per cent mortgage would involve a loan of $2,400 and the equity which the borrower would have to provide, either in the form of a lot, or cash, or both, would be $600. Assuming that the borrower is to amortize the mortgage over 20 years, the monthly payment for principal and interest would be 2.4 times $6.54, or $15.69. In one community the taxes on this house might be $48.00 a year. Therefore, the total monthly payment would be $15.69, plus $4.00, or $19.69. In another community the taxes might be $72.00, and the monthly payment would therefore be $21.69.

By adding one-twelfth the estimated yearly taxes on a $3,000 property in his own community to the interest and principal charge of $15.69, the prospective borrower will be able to calculate the approximate total monthly payment which would be required on an 80 per cent loan on a property in his community. By adjustment of the factors he will also be able to determine the approximate payment required for a loan more or less than $2,400. For example, on a property

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