Explanation of Part 1 of Dominion of Canada National Housing Act

Purpose of the Act. How the Purpose May be Accomplished. Requirements. How Mortgage Loan May be Secured. Terms. Methods of Repayment. How to Proceed Under the Act.

Below will be found a detailed explanation of the National Housing Act, as furnished by the National Housing Act branch of the Dept. of Finance at Ottawa:—

Purpose

Many families, perhaps most families, hope that some day they will own a home of their own. They desire a home built to their own individual needs with modern conveniences that they may have been forced to forego in their present abode—those little things that make the difference between a house and a home. The purpose of Part I of the National Housing Act is to make this wish come true.

While the war effort now constitutes a heavy drain upon the resources of the Dominion, it has been decided, nevertheless, that in view of the serious shortage of houses the loan facilities provided by Part I of the Act should be continued for certain classes of houses. Whereas in the original legislation either single family, two family or multiple family houses were eligible to be financed, loans are now limited, under regulations issued December 5th, 1939, to the financing of single family houses of low and moderate cost. The maximum loan which may be granted to finance any house is $4,000.

This means in effect that the complete facilities of Part I are now directed to the assistance of families of low and modest incomes who desire to own homes of their own.

How Accomplished

Part I of the National Housing Act endeavours to make it possible to achieve this ideal by providing generous financing at reasonable interest rates and by establishing a plan for moderate monthly instalments for interest, principle repayment and taxes which in most cases, should be less than the monthly rental now paid.

This plan of financing involves a first mortgage loan which in the normal case may be for any amount from 70 per cent to 80 per cent of the lending value of the completed property. The lending value of a completed property is either the cost of construction or the appraised value, whichever amount is the lesser. The cost of construction includes the cost of the land, the cost of the building, legal and other actual expenses, architect's fees and the cost of all permanent improvements to the property.

The fact that the prospective home owner may secure from 70 per cent to 80 per cent of the lending value of the completed property should make it unnecessary to secure any additional funds by second mortgage financing. Second mortgage money is always costly and, under present conditions, is almost impossible to secure. The mortgage, moreover, runs for a long term of years and bears a low rate of interest. These desirable objectives are accomplished by the Dominion Government entering into agreements with approved lending institutions whereby the Government makes an advance, at a very low rate of interest, for an amount equal to one-fourth of the amount of the total loan.

In practice, since the maximum loan is now $4,000, the highest "lending value" which may be financed by an 80 per cent loan is $5,000, and in the case of a 70 per cent loan, $5,714.

The plan is even more generous in case of very low cost homes. Thus in the case of a single family dwelling where the lending value does not exceed $2,500 the first mortgage loan may be for an amount from as low as 50 per cent to as high as 90 per cent of the lending value, provided that the house is being built for occupancy by the borrower himself and, not for sale or rent. Families, therefore, of low incomes who desire to own homes of a value of $2,500 or less may be enabled to do so if the family is able to provide an amount equal to 10 per cent of the completed property. Approval lending institutions are given special inducements to make such loans by a generous guarantee from the Dominion Government.

In other words, the plan makes possible a mortgage loan for a high proportion of the total cost or value of the completed property, a low rate of interest, and the privilege of monthly repayments spread over a long term of years.

Requirements

In order to be eligible to borrow under Part I of the National Housing Act, the prospective home owner must have the required amount of "equity." That is to say, he must be able to make an investment from his own resources equal to the difference between the cost of the new house and the proceeds of the mortgage loan. This equity may be in the form of available cash or a building lot, or both. In addition to this, if his application is to be considered favourably by an approved lending institution, the borrower must have a reputation for meeting his obligations promptly and be reasonably assured of sufficient income to meet his monthly payments for interest, principal, and taxes. The house which he proposes to build must also comply with minimum standards of construction, formulated by the Minister of Finance, which are designed to assure the erection of a sound and durable house, and the location should be such as to give reasonable protection against undue depreciation in property values.

Who May Obtain a Mortgage Loan

Mortgage loans under Part I of the National Housing Act may be made only to assist in the construction of a new house. They are not available to finance alterations, repairs or improvements to houses already built, nor can they be used to refinance old mortgages on existing properties. Under the Home Improvement Loans Guarantee Act, 1937, loans may be secured through chartered banks and other approved lending institutions to finance repairs or improvements to existing houses.

A house to be financed by a loan under Part I of the National Housing Act must now be a single family dwelling, built solely for the purpose of human habitation. In other words, loans cannot be made for a duplex or apartment house, for stores or other commercial projects, or for a house which includes a dwelling place and a store or other commercial project. However, the house may have an attached or detached garage.

Loans may be made to two classes of owners:—

(a) An owner building a house for his own occupancy.

(b) An owner building a house for sale.

In the case of class (b) 25 per cent of the amount of the loan will be withheld until the house is sold under conditions satisfactory to the approved lending institution.

Terms of Mortgage

As already indicated, mortgage loans will be made in the normal case on the basis of 80 per cent of the lending value of the completed property. In some cases the owner may be able and willing to provide more than 20 per cent equity, or the lending institution may not be willing to share in a mortgage loan for an amount as high as 80 per cent for reasons connected with the location or the character of the property. Provision is, therefore, made for loans for an amount ranging from 70 per cent to 80 per cent of the lending value. As an inducement to the lending institution to make the higher percentage loans wherever they may be needed, special guarantees are provided by the Dominion. The borrower's equity will range from 20 per cent to 30 per cent depending upon the percentage which the approved first mortgage loan bears to the lending value of the completed property.

Reference has already been made to the fact that where the lending value does not exceed $2,500 the first mortgage loan may be for an amount from 50 per cent to 90 per cent of such lending value. Accordingly, the borrower's equity in such cases might be for an amount from 10 per cent to 50 per cent of the lending value. An equity as low as 10 per cent is permitted in order to enable persons in the low income groups to finance the erection of a modest home, even though they may not have already accumulated any large amount of personal savings. There will, however, be other cases in this group where a substantially larger equity can be provided, either because the borrower has already secured a part or all of the necessary materials for building his home as well as a lot or because he may be able to build all or a substantial proportion of the house by his own labour.

The mortgage is drawn for a term of ten years but provision is made for a renewal of the mortgage for a further period of ten years, subject to revaluation of the security and on conditions mutually agreed upon at the time of renewal.

The rate of interest payable on the mortgage is 5 per cent per annum. This rate which applies in all cases, no matter what percentage the mortgage loan bears to the lending value of the property, is a very reasonable one and is made possible by the very low rate which is required on the portion of the loan advanced by the Dominion Government. It compares favourably with interest rates charged on similar security in the United States and in Great Britain.

Method of Repayment

One of the greatest advantages of mortgage loans obtained under Part I of the National Housing Act is the privilege of using the monthly instalment plan. The mortgage provides for monthly payments to cover the 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 higher payment in order to retire his loan more quickly, say, in ten or fifteen years. Also at any time after three years he may pay off his mortgage in full upon payment of a bonus equal to three months' interest on the amount of the loan then outstanding. The monthly payment for interest is slightly less than 1-12 of the annual interest charge inasmuch as the borrower is entitltd to be credited with interest on every monthly payment he makes. The monthly payment for taxes is 1-12 of the estimated annual taxes.

An illustration will make clear the working of the monthly instalment plan. On a property costing, or appraised, when completed, $2,750, an 80 per cent mortgage would involve a loan of $3,000. The equity which the borrower would have to put in, either in the form of a lot, or cash, or both, would, therefore, be $750. The borrower in this case would have to make monthly payments of $19.62 (excluding taxes, which will vary with the particular community in which the house is located); and by the end of twenty years if he kept up his payments regularly he would own his property free and clear. At the end of ten years his loan would have been paid down to $1,858.84 and at the end of fifteen years to $1,042.24. By adding to the monthly instalment of $19.62 for interest and principal referred to above, 1-12 of the normal annual taxes on a $3,750 property in his own community, the reader will be able to calculate the total monthly instalment which should be required for an 80 per cent loan on such a property and should be able to determine for himself how closely this compares with the rent which he would have to pay in the same community for similar accommodation. If he desires to determine the corresponding monthly payment for any other size of loan, all he needs to do is to calculate the monthly instalment for interest and principal on the basis of $6.54 for each thousand dollars of loan and to add 1-12 of the amount required for taxes. The monthly payments are planned to commence after the house is compelted.

The advantage of this monthly instalment plan will be readily apparent. It enables the borrower to budget his income, and to set aside each month a fixed amount to protect his most precious investment, his home—and the amount should not be beyond his capacity to pay with reasonable comfort. The plan, therefore, is free from the difficulties which are present with straight mortgage loans, where quite large payments for interest and for taxes have to be made on two or three dates during the year. When such heavy payments come due, it is frequently found that the money with which to meet them is not available. The plan moreover is cheaper than any straight mortgage plan; it saves frequent renewal fees and the monthly retirement of a stipulated proportion of the principal amount of the loan means in effect that the borrower is investing that amount of savings at 5 per cent, compounded monthly. These are all advantages secured by the borrower. To the lender the plan involves more book-keeping cost but this additional cost is likely to be far more than outweighed by the increased safety of the investment.

Minimum Standards of Construction

Plans and specifications for the new house to be financed under Part I of the Act are required to be submitted with any application for a loan. The Minister of Finance, under authority of the Act, has issued Minimum Standards of Construction which lay down Minimum requirements to which plans for all houses must conform before an application for a loan will be approved. He has also issued Memorandum Specifications which make it easy for the prospective home-owner to decide upon the type of materials and the method of construction which will give him the best value for the investment he wishes to make, and which also makes it possible for the architect or builder to comply readily with the requirement that specifications must be submitted with any application for a loan. If the house is constructed according to these Standards and the Memorandum Specifications, the owner should have a well-built house.

The lending institutions have agreed, in order to protect their own interests and that of the Government, to make several inspections of the house during construction, thus providing a further safeguard against faulty construction and poor workmanship. It should be noted, however, that the inspection by the lending institutions is to protect the security of the mortgage only, and in no sense does this inspection relieve the owner of his obligation to see that the plans and specifications are complied with and that the house is completed as security for the loan according to the requirements of the National Housing Act.

How to Proceed

If you wish to secure a loan in order to build a house under Part I of the National Housing Act, you should write to or apply personally to an approved lending institution. Give all details as to what type of house you propose to build and, if you already own a lot, the location of such lot. If you do not own a building lot, you would be well advised to consult an approved lending institution before purchasing a lot. You should also give the lending institution information about yourself which will indicate to the lending instituton your ability to repay the loan. If this information is satisfactory, the lending institution will send you application forms and complete instructions regarding the plans, specifications, and other documents required.

Progress Advances

As a loan is made to assist in the construction of a new house, the proceeds will be advanced as construction proceeds. Therefore, at certain periods, in accordance with the usual practice of the lending institutions, a proportion of the proceeds will be advanced, upon the recommendation of the lending company's own inspector.

It should of course be understood that the borrower must contribute his agreed equity before any moneys are advanced under the mortgage.

An Example

It has already been shown that in the case of a house which has a lend-

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