

New type of security

Mortgages can be investments

Most people understand the concept of mortgages from the borrowing side, but it's important also to know about mortgages as an investment.

In the '70s the first of many types of investments was created in the United States giving individual investors the opportunity to participate in the relatively high yield of home mortgages. The '80s have seen an explosion of additional securities to capitalize on the growth and further development of the mortgage market, and the introduction of these securities to Canada.

This new category of investments is called, descriptively enough, mortgage-backed securities (MBS).

In the U.S., mortgage-backed securities are the fastest growing segment of the fixed-income marketplace, currently encompassing about \$550 billion or about one-third of all existing residential mortgages.

In Canada, more than \$500 million worth of these securities were issued in 1987, the first year of the market's existence. Canada surpassed the American first-year experience by over \$50 million. One of the main reasons for the growing popularity of the MBS is the active secondary market that enhances the liquidity of the investment.

Another feature of MBSs is their high yield; they typically earn as much as or greater than GICs of comparable maturities.

Mortgage-backed securities are among the safest of all investments. In order to qualify, an underlying mortgage must be a high quality first residential mortgage.

The securities are insured by the Government of Canada through Canada Mortgage and Housing Corporation for the full amount of principal and interest as well as timely payment. This insurance compares favorably with the \$60,000 maximum insurance on GICs provided by the Canada Deposit Insurance Corporation.

In addition, the timely payment guarantee ensures that your payment is received on the 15th day of each month regardless of whether the mortgagors have made their individual payments.

MBSs are undivided interests in Government-insured first residential mortgages. This means that you, as an investor, are buying into a pool of perhaps 100 mortgages. The payments you receive are made up of in-

terest, principal and prepayments.

There is no fixed sum or formula to tell you how much of the principal is paid back to you in each blended monthly payment. Much will depend on the actions of the underlying mortgagors. As a rough guide, think of the first years of your own mortgage and in particular to the

amount of principal paid off in your monthly payments at that time.

Because you are buying into a pool that could have over 100 mortgages in it, however, it is possible that in any given month one mortgagor could, for whatever reason, elect to either prepay part or all of his mortgage according to the prepayment

and liquidation terms offered by the issuer. All prepaid principal is immediately returned on a prorata basis to the investors in the next monthly payment.

To date, MBSs in Canada have been issued in 5 and 20 year terms. The minimum denomination available is \$5,000 with multiples of \$5,000 thereafter.

At McLeod Young Weir, we speak of mortgage-backed securities as a partnership between the investor and the Canadian homeowner. Investors make more money available for homeowners to borrow while strengthening nearly any investment portfolio with some of the safest securities available.

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