

Mortgage Assumptions and VTBs in a Rising Interest Rate Market

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In light of substantial increases in interest rates, real property purchasers are looking for alternative lending arrangements. Some alternatives include assuming existing mortgage debt, which would typically require lender consent, or building in a vendor take-back mortgage to the purchase transaction.

Mortgage assumption allows a purchaser to assume the existing mortgage loan of the property as is, with the same remaining principal balance, interest rate and repayment terms.

If the existing mortgage loan to be assumed is insufficient, the borrower/purchaser can request that the lender "blend and extend", meaning, the mortgage loan would be increased with additional funds at the present interest rate and/or the loan term would be extended.

The purchase and sale agreement should include: 1) the concept of the mortgage assumption; 2) which party is responsible for coordinating the lender consent; and 3) who is responsible for the lender costs (assumption fee, legal costs, etc.).

Ultimate decision on approval of a mortgage assumption rests with the lender as it is rare that a mortgage loan allows for the borrower to assign the mortgage loan without lender consent. The lender will review the terms of the loan, creditworthiness of the new borrower and may request additional guarantees.

Another alternative lending arrangement is the vendor take-back mortgage ("**VTB**"), where the vendor "takes back" a mortgage loan from the purchaser as part of the purchase and sale transaction.

When establishing a VTB mortgage, the purchase document should include the terms of the VTB outlining the loan amount, interest rate, term, ability to prepay, etc.

Borrowers may utilize a VTB strategy where their first mortgage loan does not provide for sufficient funding for the purchase transaction. In this case, ensure that the first mortgage lender allows for the VTB secondary financing and the VTB terms in the purchase agreement explicitly allow for the first mortgage financing and require the VTB holder to enter into a subordination agreement.

A VTB can be an attractive alternative for vendors as they generate income from the interest earned over the term of the VTB and defer taxes on capital gains from the sale.

Ultimately, both the mortgage assumption and VTB are attractive alternatives for borrowing in a high interest market.

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