CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# CORPORATION LENDING GUIDELINES

## Notice and Disclaimer

The contents of this manual are provided and intended for use by Alberta Credit Unions.

The manual encompasses accepted principles and the associated guidelines as set out under legislation of the Credit Union Act, Credit Union (Principal) Regulation and Credit Union (Ministerial) Regulation. The manual is intended as a guide and reference source.

The Corporation will attempt to keep material current; however, is not responsible for losses in the event of legal change, legislated change or misinterpretation. Legal counsel should be sought in the event of uncertainty.

## Using the Guidelines

- There are nine (9) functional sections. Each section contains applicable guidelines.
- There are several methods to access a guideline or subtopic within a guideline:
    1. Use the Table of Contents. In the "Table of Contents" hover the cursor over the guideline and left click to go to the specific topic.
    2. Use the Navigation Pane:
        a. If not already open, open the "navigation pane" by left clicking on the small arrow to the left of the reading pane.
        b. Select "bookmark" to open the bookmarks (these can be expanded and collapsed); left click on a bookmark to go to specific points of interest using bookmark links.
        c. Alternatively, but not as functional, select "page thumbnails" to go to specific pages using the thumbnail images.
    3. Use the Adobe Acrobat toolbar "find text" (Ctrl+F) function.
- Within some of the guidelines there maybe hyperlinks to other guidelines or external URL's as applicable.

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# Useful Information

- This is a live document that is best used in "soft copy" format for ease of access to various links. As well, it ensures that all users are working with the current version of the guidelines.
- While credit unions will have detailed policies, the core content should not materially differ from the Corporation Lending Guidelines. For consistency and awareness of the guideline content, the Corporation encourages access to these guidelines by all involved in lending.
- Guidelines under review are illustrated with an "under construction" sign.
- Stakeholders will be notified by memorandum or guidance, or in some instances both, when new guidelines or updated guidelines are complete and ready for distribution.

# Table of Contents

# 1. GENERAL INFORMATION

# Credit Union Deposit Guarantee Corporation Credit Policy

Within the authority set out in the Corporation By-Laws and the Credit Union Act/Regulations, the Corporation shall monitor sound credit underwriting, appropriate security, and administration in the credit union applications and other information coming to its attention. Particular consideration will be given to ensure each application addresses the Five C's of Credit.

The Corporation will explore reasonable alternatives for all credit applications where deemed appropriate. The Corporation endeavors to review each application so that it conforms to the Corporation's Lending Guidelines. Prudent lending and sound business practices are to be applied, with the goal to improve credit union lending skills and maximize the independence of the individual credit unions. Responses will be timely and will recognize the credit unions' needs to meet competitive pressures.

# Lending Objectives

The Corporation has identified the following lending objectives to be considered when addressing any member borrowings:

- To grant loans, which meet the reasonable, legitimate and constructive credit requirements of the community located within the trading/service area of the initiating credit union. In view of the additional risks associated with lending outside a credit union's area, such situations should only be considered in rare and exceptional circumstances when the loans are well secured and the member's character is undoubted.
- Loans granted should generally be to borrowers/principals/members who exhibit a good credit background and character, plus in the case of commercial and agricultural lending, a depth of first-hand knowledge and experience in the type of financing plus clear evidence of sufficient management expertise and resources to overcome emergencies.
- To structure loans on a basis where direct cash flow is the primary source of repayment and pledged security provides a secondary source of take-out based on realistic valuations as confirmed through an independent third party source.
- To price loans on a competitive basis with consideration given to net yield, bearing in mind the credit union's liquidity position. Fee income, where available, is a consideration in loan pricing and is normally applicable to short term consumer loans, real estate loans, commercial and agriculture loans, acquisition/equity financing, deteriorating accounts requiring extra administration, and accounts requiring frequent requests for new funds (temporary bulges, construction draw mortgages, etc.).
- To negotiate, structure, and manage loan opportunities in a manner that the mutual interests of the credit union and the members are satisfied. The credit union, as a responsible financial institution, will have an interest and understanding of the business and personal financial affairs of each member and/or guarantor as well as the credit union's ability to deliver proposed financing facilities on a timely basis.
- Provisions of the Credit Union Act, related Credit Union (Principal) Regulation, and Credit Union (Ministerial) Regulation, along with other Federal and Provincial legislation, must be observed when granting loans.
- With the exception of lines of credit, loan proceeds should be advanced within 90 days of the approval date. In the case of construction mortgages, the first draw is to be made within 90 days. Where funds have not been advanced within 90 days of the approval date, a further review will be required to determine/confirm that no material change in risk has occurred, there is sound rationale for continued commitment, and justification to leave the interest rate as is (i.e., rate should be adjusted if after 90 days prime rate or mortgage rates etc. have changed).

- All applications presented by credit unions for approval of the Credit Union Deposit Guarantee Corporation must include the written acknowledgement of the credit union Credit Committee, and/or another recognized level of authority. Where there is a material change in risk and/or terms such as loan pricing, etc., loan renewals must also be approved by the credit union Credit Committee. Any exception to credit union policy must also be fully disclosed and documented in the application.
- Recognizing that good quality loan growth is an essential "building block" of a successful credit union, it is the mandate of the Credit Union Deposit Guarantee Corporation to assist the credit union in working towards these goals. In this regard, the resources of the Corporation can be made available to assist or consult in complex underwriting situations when and if required.

# Credit Evaluation

The granting of sound loans is directly related to assessing credit on the basis of fundamental lending principles, including:

- Understanding the purpose of the loan and identifying the source of repayment.
- Establishing the character, integrity and reputation of the borrower to meet obligations promptly.
- Establishing the capacity of the borrower to repay all obligations based on historical financial information and realistic projections.
- Determining the adequacy of the collateral for loans.
- Establishing the member's management skills and succession planning (in the case of commercial and agricultural credits).
- Assessing the competitive environment and any external factors that could impact the borrowing member.

Although unforeseen events can arise and result in the deterioration of a credit, most problems result when basic lending principles are disregarded. Each credit union must have a prudent and effective formal evaluation process that allows for an independent and objective assessment of credit requests.

# Connection Rule and Direct Obligations

## Connection Rule

Interpretation and application of a connection is defined in the Credit Union Act Section 128(1).

Those accounts, which do not fall under the definition but are associated by way of common principals, guarantees, etc. would then generally be classified and reported as "related accounts". It is important to track these "related" accounts to monitor the level of involvement and/or exposure to any one individual or corporate entity.

The over-riding consideration when determining if an account is connected or related must be the risk to the credit union of funds that may be committed to any one borrower or to any closely associated group of companies or borrowers, the safety and recovery of which is interconnected. Accounts in this category are connected as to risk and the connection rule is only to apply in such situations, although for Corporation monitoring purposes, all "related" accounts will continue to be included in application recaps.

Good business sense will be the most important requirement for determining the nature and extent of the connected risk. Credit unions should proactively investigate and assess the impact and risk associated with member borrowings at their credit union, other credit unions, or Credit Union Central Alberta that may either be connected, or related, with appropriate risk tolerance levels set within credit union policies. Application of the connection rule and loan maximums (as outlined in the Credit Union Act Sections 128(1) and 130(1) and Credit Union (Principal) Regulation 54(1)), is to be carefully considered by the lending officer and/or credit union Credit Committee at the time of each authorization. If there is any doubt, the matter should be referred to the Corporation Credit Department for a ruling.

## Direct Obligations

Where a legal entity (personal or corporate) has borrowings in its own name and has joint borrowings with another entity, all the borrowings are considered direct obligations opposed to related or connected.

> *Example: John Smith has a mortgage and then borrows jointly with Richard Jones, both debts are direct obligations to John and must be taken into consideration when John applies for other loans and when calculating John's debt service capacity*

# Classes and Sub Classes of Loans

In keeping with the Credit Union Act Section 128 (3), loans are to be classified and monitored under the following loan classes and sub classes:

a. consumer loans

b. residential mortgages

c. commercial loans

d. agricultural loans

The foregoing is consistent with the information provided on the Monthly Financial and Statistical Report.

# Loan Maximums

A credit union shall not make a loan to any person or connection as defined under the Credit Union Act Section 130(2) (a) that exceeds the maximum prescribed under Credit Union (Principal) Regulation Section 54.

Each credit union must establish, by formal resolution, a maximum aggregate of money to be loaned to a specific borrower or connection giving consideration to specific terms and security. Loans exceeding the maximums permitted must be syndicated on a pari-passu basis or referred to another credit union or Credit Union Central Alberta.

### Related Guidelines

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|---|---|
| Connection Rule and Direct Obligations | Syndication of Loans or Loan Participation |

# Loans Secured by Negotiable Securities

### Credit Union Non-Equity Deposit Instruments

- Loans written in this category should mature prior to the deposit instrument held as security.
- Funds must be formally pledged using an Account Set-Off Agreement. Maintaining of proper diaries and "flagging" of the deposit instrument is important to ensure deposit funds are not released in error.
- Register a financing statement at Personal Property Registry for all accounts in excess of $10,000 or where the term of the loan will exceed 12 months.
- Normal assigned lending limits apply for any aggregate amount in excess of the face value of the credit union non-equity deposit instrument.

### Government of Canada or Provincial Government Guaranteed Bonds

- 100% of face value of parity bonds (i.e., principal does not fluctuate based on market factors).
- 80% of face or market value, whatever is lesser, of bonds not having a parity feature, with frequent verification/margining required.
- Obtain a Hypothecation of Securities form signed by the registered bondholder.
- Obtain executed powers of attorney.

### Canadian Municipal Bonds, Canadian Corporation Bonds or Money Market Mutual Funds

- Canadian Corporations must be nationally recognized.
- 75% of face value or market value, whichever is lesser.
- Obtain a Hypothecation of Securities form signed by the registered bondholder.
- Obtain executed powers of attorney.
- Monitor/margin quarterly.

### Shares of Canadian Corporations and Mutual Funds

- Shares in Canadian Corporations must have traded at $5 or more for at least two years on the Toronto Stock Exchange (TSX).
- Mutual Funds in this category exclude Money Market products.
- 50% of market value at time loan is advanced. This minimum margin for stocks is to be maintained as long as the loan is outstanding and values confirmed no less frequently than on a weekly basis and for Mutual Funds, quarterly unless the market is volatile, in which case weekly margining is to be completed.

- Obtain a Hypothecation of Securities form signed by the registered owner of the shares.
- Obtain executed powers of attorney.

  Notes:

  - This type of lending carries a high degree of risk and should not be aggressively pursued.
  - The credit union must be firm when margining stocks (i.e., take the same approach as a broker whereby margin calls are to be made promptly and the member forced to cover the shortfall or sell sufficient shares in order to bring the margin back into line).

**Related Guidelines**

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| Cash Secured Loans | Perfection of Security Interest on CU Deposit Instrument |

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# Syndication of Loans or Loan Participation

When entertaining a lending situation where the total financing exceeds the credit union's loan maximum set out in the Credit Union Act Section 130(2) and Credit Union (Principal) Regulation Section 54(1) or where a credit union wishes to limit its lending exposure rather than lose the lending opportunity, consideration can be given to syndicating advances between one or more lending institutions.

- Preference is to be given to syndicating within the Credit Union System, including Credit Union Central Alberta Limited, with outside syndication entertained on a selective basis. Given the administrative difficulties involved with lines of credit or authorized overdrafts, syndications would generally be restricted to term and/or mortgage loans.
- Each credit union must complete the normal due diligence requirements before making their decision to become a syndicate partner.
- The originating credit union should act as the "Lead Lender" (unless otherwise agreed to by the participants), assuming full negotiating and administrative responsibilities, and unless otherwise permitted, will be the sole contract with the borrower.
- In order to qualify as a "True Syndication," all participations will be on a pari-passu basis (or "equal as to risk") with no commitment, either real or implied, to indemnify the participant from any loss or to repurchase their interest in the loan.
- The Lead Lender is normally entitled to a "fee" for administering the loan(s) which is generally limited to 1/8% to 1/4%, depending on the size and/or complexity of the loan, with this fee deducted from each payment made to each participant.
- All syndicated loans are to be documented by way of a Participation Agreement, available through Credit Union Central, unless otherwise approved by the Corporation. Credit unions should be selective when entertaining a minority position outside of the Alberta Credit Union System, the Province of Alberta, and their area of expertise.
- Under Credit Union Act Section 131, the Corporation must approve all loan syndications where the aggregate loan amounts exceed any one of the participating credit union's lending limits assigned by the Corporation.

### Duties and Responsibilities of the Lead Lender

- Negotiate the terms of the loan and maintain contact with the borrower.
- Notify all participants of any material change in risk. Action plans developed to address these changes are to be advised to and concurred with by all participants.

- Any changes in terms or conditions requested by the borrower are to be advised to and concurred with by all participants.
- Administer the loan account and hold the security documentation on behalf of the syndication; updating, renewing, and re-registering same as required.
- Follow for the reporting requirements and report any deficiency to the participants.
- Prepare and circulate copies of the annual review of the account, together with a copy of the Corporation's approval pursuant to Credit Union Act Section 131, to all participants.

### Duties and Responsibilities of the Participating Lenders

- The participant credit union is accountable and responsible in respect to its involvement in a syndicated loan.
- Initial authority for participation requires the participant credit union to analyze the risk and present the Lead Lender's application with recommendation for approval to its Credit Committee.
- By Amendment format, the participant credit union is to submit a request to the Corporation for approval to participate. The Amendment is to confirm that the Credit Committee has approved participation.
- It is not necessary for the participant credit union to complete a formal annual review to the Corporation.
- Lead Lender prepared annual reviews with the Corporation's response are to be read by the Credit Committee with any concerns addressed to Lead Lender.

# Loans to Directors/Employees of Credit Unions

Each credit union is to develop a Conflict of Interest Policy which is to govern conduct of employees, directors, and officers of the credit union.

### Loans to Credit Union Directors

- Loans to directors of the credit union must be in accordance with normal loan underwriting criteria as set out in the Credit Union Act Sections 129 and 133 with no special consideration or compensation given to terms, approval, and/or pricing.
- Where a director of a credit union is a participating member of the credit union Credit Committee or the loan application requires credit union board approval, in accordance with credit union policy, that party is to refrain from participation in the approval process or that of a connected/related party.
- Where a loan to a Director of a credit union is delinquent for a period exceeding 45 days, the credit union is to so advise the Corporation and the Alberta Superintendent of Financial Institutions in writing, as well as its board, on the next scheduled meeting date as set out in Section 134.
- Under Credit Union Act Section 65(2) (h) and Credit Union (Principal) Regulation Section 21, a person is not qualified to be a credit union director if repayment of principal or interest is in arrears for 60 days.

### Loans to Credit Union Employees

- Employee loans are to be granted in accordance with of the Credit Union Act Section 133 and the credit union's written policy, which is to include the requirement for prior credit union board approval for those amounts exceeding the approval levels established by the Corporation under Section 133(8) (b).
- All employee loans are to conform with conventional loan terms and amortizations, albeit pricing may be lower than the fair market rate (the member rates quoted at the time of approval based on a similar purpose, term, and security) if approved by the credit union board in writing as per Section 133(6).
- All employee loans reflecting a preferred rate of interest are to be documented at market rates with the preferential rates and terms set out in a separate Letter of Agreement, with a copy placed in the employee's security file.
- It is suggested that where a solicitor is preparing documentation such as a mortgage, a copy or the Letter of Agreement be forwarded as part of the credit union security documentation package for execution and return. In the situation where the credit union will be preparing its

own documentation, as would normally be the case for consumer lending, the Agreement should be completed in duplicate with a copy retained by both the credit union and the employee.

## Resources

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| Credit Union Act | Credit Union (Principal) Regulation |

# Loan Management and Monitoring Overview

Loan monitoring and control is a vital part of the credit granting process. Adherence to conditions of approval, early detection of problems, and timely corrective action will mitigate loan losses. Accordingly, credit unions must establish adequate procedures to administer and monitor all categories of credit. At minimum, these are to include:

- A final new loan audit to be performed within two days of the loan being funded. This loan audit would normally be conducted by senior staff assigned by the general manager and would, at a minimum, entail checking of the security documentation, the rate, and amortization. In small credit unions, the audit committee or its designate may be required to perform this function on a regular basis and at the earliest possible date.
- A random loan audit of credit files, to be completed periodically by the general manager or a senior qualified designate to ensure compliance with conditions of approval, timely completion of annual reviews if required, and to ensure that security is in order. In small credit unions, the audit committee or its designate may be required to perform the function.
- Review of the account following the Credit Reviews guideline.
- Timely and effective account management and monitoring of LOC/AOD's.
- An effective delinquency follow-up procedure which is to include a permanent record of collection activities.
- Review a random sample of declined loan applications.
- Effective use of Diary System.
- Implementation of effective criteria for the ongoing identification and reporting of potential problem accounts to ensure that such accounts are identified, followed up with appropriate corrective action, classified as unsatisfactory where appropriate and provisions established where necessary.
- Periodic plant or farm visits. Note: these are to be completed in all cases at time of, or prior to, initial loan funding and periodically thereafter depending on the nature of the business or financing.
- Annual review (and update if required) of lending policies and procedures. Economic conditions in the credit union's trading area, or loan losses in a particular market segment, may dictate more frequent updates.
- An effective internal loan audit function. This should be conducted on a random "spot-check" basis and include an assessment of the underwriting, a check to ensure terms and conditions of approval have been met, as well as a review of loan/security documentation.

- A Borrower Risk Rating program.
- A "Watch List" report based on the risk rating system for accounts requiring special attention.
- Periodic review/assessment of security values either as a part of the annual review process or at the time of requests for additional financing by the members.
- Periodic reviews of the adequacy of loan loss provisions/charges for loan impairment.
- Write-off procedures and monitoring/collection of written-off accounts.

# AOD LOC Unauthorized Excesses and Delinquency

Recognition of AOD/LOC unauthorized excesses and delinquency is triggered as follows:

### No Deposit

- For the majority of commercial and consumer AOD's and LOC's, the expectation is for monthly deposits to the account. If the AOD or LOC is in a debit position and there has not been a deposit for 31 days from the date of last deposit, then the facility would become delinquent, increasing as the number of days since the last deposit increases.
- For accounts such as agricultural credits where the expectation is for quarterly, semi-annual or annual deposits, delinquency would commence 30 days after the arranged deposit date (similar to a loan payment past due or as stated above).

### Over Limit Situation

- If the account is over its authorized limit at month end, it is classified as delinquent; for an extended period, it would be categorized as 30, 60, 90 or over 90 days, as applicable.
- If the account is one that is subject to approval from the Corporation, the excess is to be reported immediately upon occurrence unless the amount is within 10% of the credit union's All-Inclusive Lending Limit or Non-Residential Mortgage Limit and providing such excess is expected to be covered within five business days.
- In the event the excess is not covered within the allotted five business days, it will be necessary to promptly submit an interim loan request to the Corporation (supported by details as to expected date of coverage, source of coverage, and additional security, etc. obtained), with appropriate recommendations.
- If there are multiple borrowers in a connection, total excesses to the connection cannot exceed the 10% criteria.
- For over limit situations covered within five business days and for future reference/analysis of the facility, the entire transaction is to be recorded on an Interim Commercial/Agricultural Credit Application with appropriate approval supported by a copy of the chequing account statement denoting the date of occurrence. Copy of statement is to be placed in the member's file. This procedure is designed to reflect Commercial/Agricultural excesses.
- For personal AOD's, recording activity as outlined may not be practical and is optional depending on the amount of the accommodation.

# Delinquent, Doubtful and Impaired Loan Management

Standards of Sound Business and Financial Practices, M-3: Credit Risk states that it is sound business and financial practice to have appropriate policies, as well as, procedures and controls for managing credit risk. Effective loan administration must include procedures and management information systems to monitor and control loan delinquency.

A collections policy addressing monitoring systems to alert management to problem situations must be established. Successful recovery efforts require early action, structured strategy, and appropriate follow up to reduce potential losses to the credit union.

Written collection procedures and processes supporting the collections policy are required to ensure a robust collection program, assist with management of delinquent loans, and include guidelines governing doubtful and impaired loans.

Reporting based on trending and approved tolerance levels is required monthly to senior management and quarterly to the Board.

An internal report must be in place to identify impaired consumer and mortgage loans. To be recognized as impaired, a loan must meet the criteria of an impaired loan as defined for risk rating category 9-Impaired found in the Borrower Risk Rating Business Lending Guideline. There is no requirement to provide this report to the Corporation; however, may be requested at CUDGC's discretion.

Deterioration in credit quality needs to be identified at an early stage when a number of strategic alternatives are still available to the credit union such as:

- Re-negotiation of the terms of the credit
- Reorganization of the borrower
- Liquidation of the borrower

Extending, postponing or renegotiating a loan is not an option if the underlying problem causing delinquency is not addressed.

Impaired loans and provisions are to be recognized in accordance with accounting standards.

### Related Guideline

Borrower Risk Rating

# Perfection of Security Interest on CU Deposit Instrument

There is an incorrect view that a term deposit, GIC, deposit account, etc. being in "possession" of the credit union results in a perfected security interest and, as a result, no financing statement needs to be filed.

- A security interest in intangibles and non-negotiable documents cannot be perfected by possession. This form of asset does not have a physical existence and therefore possession is insufficient to perfect a security interest.
- Section 24 of the Personal Properly Security Act defines "tangible" assets; with neither a deposit account nor term deposit conforming to any of the definitions.
- Possession of a non-negotiable document of title does not perfect a security interest in the goods described in the document. To establish a priority claim pursuant to an Account Set-Off Agreement, it is necessary to perfect this interest by way of registration at PPR.
- The common law right of set-off is a right commonly used by lending institutions. However, there is an exception to the right of set-off when the account holder (or recipient of the funds) is a lending institution. The courts have held that a lender has no right to set off the credit balance of a customer's account against an un-matured debt payable to the lender. A term loan would be an example of an un-matured debt. If the loan is a demand loan, then the lender has a right to set off accordingly. As a result, if a member has assigned funds in a deposit account to a third party and the third party exercises its right pursuant to the assignment, the credit union would have no choice but to honour the assignment if the member's term loan was in good standing. To avoid any dispute of the credit union's entitlement to these funds, it is recommended such be pledged by way of Account Set-Off Agreement and registered at Personal Property Registry.
- Where a credit union already holds a General Security Agreement registered at PPR, it is not necessary to register a Financing Statement in support of a subsequently obtained Account Set-Off Agreement.
- Not all instances need be registered as a security interest at Personal Property Registry. Each credit union must establish a reasonable limit over which registration of a financing statement becomes material as to securing its loans. The Corporation suggests this limit be from $10,000 - $25,000 depending on the size of the credit union.

### Related Guidelines

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|---|---|
| Cash Secured Loans | Loans Secured by Negotiable Securities |

# Security Interest in Personal Property

There have been noticeable variations in the wording utilized in registering a security interest in all the debtor's present and after-acquired property (allpaap). The confusion comes from the use of "proceeds" in the description.

If a debtor is granting a security interest in all of their present and after-acquired property, the collateral description to be utilized in the Financing Statement should be as follows:

"all present and after-acquired personal property"

Such a description does not require a proceeds description. Proceeds are already included in the description and therefore it would be redundant to describe proceeds. The description *should not* read:

"proceeds: all present and after-acquired personal property"

# Credit Reviews

An important component of portfolio management is to ensure that risk is managed appropriately but this needs to be balanced with good business fundamentals. Credit unions maintain accountability and responsibility for the administration of the review process; however, the following guidelines may be applied for conducting reviews. The guidelines may be amended in recognition of the uniqueness and specific needs of the individual credit union.

- Reviews are established to assist the credit union in assessing the risk of the borrower and seek marketing opportunities or providing some other service to enhance the relationship.
- The frequency of reviews and methods in conducting them is predicated on the appropriate initial due diligence and credit structure being in place at the outset.
- Reviews are conducted in a number of ways and include assessing information gained from:
    - computer generated monitoring reports
    - the Borrower
    - information provided with the request for additional funds
    - formal annual review
- There are a number of internal reports that will reflect whether the account needs to be reviewed. These out of order situations will trigger some sort of formal or informal review of the account:
    - credit limits being exceeded
    - deposits not being made on a timely basis (monthly with the exception of businesses that are seasonal in nature)
    - payment conditions on term loans not being adhered to

  In cases where the account falls into non-performing status, then a formal review with appropriate action plans is to be developed.
- The risk associated with conducting frequent reviews at the expense of seeking other business opportunities needs to be carefully reviewed.
- Good prudent practices should be incorporated into the credit unions lending policies to ensure that an adequate credit review process is in place.

### Facilities Granted Within Credit Union Discretionary Lending Limits

| Facility | Guideline for Review |
|---|---|
| Residential Mortgages | Reviews not required |
| Personal Term Loans | Reviews not required |
| Unsecured Personal Lines of Credit or Overdraft facilities up to $10,000 | Reviews not required |
| Unsecured Personal Lines of Credit or Overdraft facilities of between $10,000 and $25,000 | Reviews to be completed a minimum of every 3 years |
| Secured Personal Lines of Credit or Overdraft facilities up to $50,000 | Reviews not required |
| Commercial and/or Agriculture Term Loans and Mortgages | Review a minimum of every three years or expiration of the term; whichever is the longer |
| Unsecured Commercial and/or agriculture Lines of Credit or Overdraft facilities up to $25,000 | Reviews not required |
| Secured, not subject to margin, Commercial and/or agriculture Lines of Credit or Overdraft facilities up to $50,000 | Reviews not required |
| Cash Secured Loans – Regardless of amount | Reviews not required |
| In all other situations as well as the following:<br>• Accounts Risk Rated "5" or worse<br>• Hospitality Loans<br>• Principal payment delinquency (over 30 days) has occurred at any time during the preceding 12 months<br>• Syndicated Loans (only the lead lender completes the formal annual review) | Annual Review is required |

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## Facilities Granted Above Credit Union Discretionary Lending Limits

| Facility | Guideline for Review |
|---|---|
| All Facilities | The Credit Union may recommend the date of the next review or whether it should be waived; recommendation is to be supported by appropriate conditions and rationale.<br><br>The Corporation's approving officer has the full discretion to establish the review dates on the account/connection.<br><br>If an account is in excess of the credit union's discretionary lending limit, notwithstanding that the Corporation may have waived involvement in future reviews/renewals, should delinquency occur the Corporation is to be advised.<br><br>In the event legal action is considered, the involvement and prior concurrence of the Corporation is necessary. |

## Annual Reviews

When completing annual reviews the following is required:

- Full updated security disclosure and financial analysis.
- Full application format is to be followed.
- Regardless of risk rating, financial statements for analytical purposes are to be provided within a maximum of 90 days of the borrower's year end with the review normally completed within 120 days.
- Priority should be given to addressing higher risk rated accounts.

# Out of Order Reporting

While every credit union should be keeping track of problems with all loan files, it is particularly important for those involved in commercial and agricultural lending, and even more crucial for revolving credits. A specific reporting format should be developed for this purpose, to be completed on a minimum monthly basis. The out-of-order report should include the following situations:

1. missing lists of inventory or receivables (has not met most recent reporting deadline)
2. problems with documentation preparation or execution
3. problems with registration or priority of security
4. other warnings of distress or potential problems
5. AOD/LOC with no deposits (i.e., delinquent)
6. over limit AOD's/LOC's
7. AOD's/LOC's with margin deficits
8. expired credits/AOD/LOC facilities (overdue annual reviews)
9. trust conditions with solicitor outstanding more than 90 days

Many of these factors will also need to be reported to the Corporation if it is a Corporation approved credit. For example, if the loan is outside its margin requirements, it is also outside the conditions of approval and needs to be reported. In any event, a permanent record should be maintained in the security file for *all* advances (with the exception of small consumer AOD's) to ensure a paper trail exists for future reference and account analysis. By maintaining a permanent record, the credit union can utilize this information at review/renewal to properly assess the facility and make adjustments based on actual performance.

# Customer Automated Funds Transfer (CAFT)

- It is critical to perform a complete risk analysis on each business member prior to approval to become a CAFT generator.
- CAFT was introduced by Payment Services to provide credit unions and their business members a service to exchange electronic transaction files.
- Business members become CAFT originators and are given access to CAFT and its reporting features once they are approved by the credit union.
- Once a business member is given access to the CAFT system they have total control of the transactions they create and release.

## Credit Risk Assessment

- A risk assessment is to be conducted to ensure any potential funding or charge back situation is covered.
- Normal credit disciplines are to be incorporated into the credit union's CAFT policy.
- Normally, the credit risk represents 10% of the member's annual expected dollar value of transactions. This can be protected by:
    - a letter of guarantee from another recognized financial institution
    - other security
    - unused overdraft facility
    - the overall financial strength of the member
- The rationale for granting a CAFT facility must be clearly addressed in the member's credit file.
- A credit assessment is to be completed on all CAFT users; however, where the CAFT is pre-settled it is not considered in aggregate debt to the borrower.

# Subprime Lending

This guideline is for those credit unions that have or anticipate having a specific program for those members who do not meet normal lending guidelines and are therefore referred to as subprime. The following are to be considered in the development of a business case and related lending policies for subprime lending.

- Credit unions that wish to be involved in subprime lending are to exercise caution and due care.
- A business case should be developed, in all situations, using Enterprise Risk Management fundamentals. Reputation, opportunity and financial risk should be clearly delineated in the business case as well as the potential risk to capital.
- The credit union board should also be apprised of the contents of the business case and fully appreciate the associated risks prior to providing their approval. This discussion includes direct lending or indirect managed product through the investment portfolio of the credit union.
- The credit union is to have a policy, approved by its board and reviewed by the Corporation which specifically addresses its subprime lending.

### Business Case

| **Activity** | **Comments** |
|---|---|
| Background | Brief status of the credit union and its financial position. Identify the purpose of the business case. |
| Opportunity | Rationale for participating in subprime lending and expected benefits. Identify the type of lending (e.g., mortgages, consumer loans, Dealer Plan, commercial loans) and establish a "cap" (maximum to be lent out, in aggregate, with these products) which is to be imposed. |
| Best Case, worse case, expected case scenarios | Define the profitability scenarios and the assumptions which are related to them. |
| Impact on Capital | Refer to comments below. |
| Alternatives | The alternative uses of capital and the potential rate of return and risk assessment for those alternatives. |
| Enterprise Risk Assessment | Likelihood and impact of risk. Assessment of risks including reputation, opportunity and financial risk and summary of risk to capital. The mitigating factors and tolerance level of these risks. |

| | |
|---|---|
| Compliance with legislative requirements | Address those legislative issues which affect the product and approvals required. |
| Controls | Explain the controls which will be in place. |
| Reporting | Outline the requirements and frequency of reporting or monitoring the portfolio. |
| Investment in or loans granted by third parties | Full disclosure of the third party, the relationship with the credit union and their financial position and management ability |
| Policy | The policy related to the business case should be appended. |

### Capital

- Capital adequacy rules are predicated on loans and investments being made based on normal or better risk parameters.
- Participation in subprime requires a capital impact assessment. It is appropriate to recognize the continuance of the strong economic situation will not endure indefinitely and could change without warning, quickly and severely. Subprime lending will be the greatest exposure and capital has to be sufficient to manage through this potential crisis.
- A minimum collective provision should be applied but would be deducted from the cap prior to applying the formula against capital. The amount of capital required will depend on:
    - The nature of security taken and the potential ultimate loss. A lower loss would likely be experienced with mortgage security but unsecured should attract up to a 100% potential impact.
    - The definition of the subprime lending needs to be clearly delineated. Depending on the criteria, a transaction could be considered “Near Prime”. The difference needs to be clearly understood and appropriately analyzed as to risk.
- The rationale supporting the percentage of risk needs to be articulated. The following is an example of how a calculation could be made to reflect the aggregate risk to capital, or the additional capital required in order to enter into a subprime program:

| | | |
|---|---|---|
| Capital Surplus | | $20,000,000 |
| Cap for Portfolio | $10,000,000 | |
| Less Provision | 1,000,000 | |
| Net | $ 9,000,000 | |
| At 25% | | 2,250,000 |
| Revised Capital Surplus | | $17,750,000 |

### Policy

| **Policy** | **Documented Comments** |
|---|---|
| Type | The type of subprime lending (mortgage or consumer, auto finance, etc.). |
| Cap | The dollar "cap" exposure. The maximum the credit union will lend. |
| Parameters/Criteria | Distinct underwriting guidelines. The basis and rules for lending. Security, TDSR, GDSR, credit history, type of business tolerance levels, etc. |
| Delinquency Control | Early aggressive follow up on delinquent loans:<br>30 days<br>60 days<br>90 days |
| Establishment of Specific Provision | Accounting guidelines for impairment and specific provision are to be followed. |
| Segmentation | The portfolio should be segmented for tracking purposes. Consideration for a separate division. |
| Products | Products which will best serve to rehabilitate members with blemished credit (e.g., blended payments vs. interest payment only; fixed rate vs. floating; term loans vs. lines of credit). |

| | |
|---|---|
| Management | Programs should be centralized so that appropriate continuity in administration, accountability and control are ensured. |
| Approval Process | Step by step approval process for these loans |
| Remuneration Expectations | Interest rate and fees. Premium pricing to offset the risk. |

## Exception

Credit unions which are involved in one off situations need not comply with this guideline.

# Five C's of Credit

CHARACTER: This encompasses the history, habits and attitude of the borrower towards responsibility for repayment of debt

CONDITIONS; The ability to minimize the risk given the economic and business conditions related to the type of industry or business

CAPACITY: The ability to repay the debt(s) from proven income sources or verifiable projected sources

COLLATERAL: The available security pledged to ensure debt can be repaid from proceeds of disposal of same in the event orderly repayment of the debt is discontinued

CAPITAL: The underlying worth of the member/guarantor and/or investment in a project or business

# Minimum Mortgage Criteria - Commercial/Agricultural

- Within its Discretionary Lending Limit a credit union can participate in government guaranteed programs which allow for financing qualified real estate in excess of 75% of the market value of the property.
- Regardless of the amount being within the credit union's discretionary lending limit, unless a commercial or agricultural real estate mortgage loan is government guaranteed, the prior approval of the Corporation is required prior to committing to any financing that exceeds 75% of the lending value of the real estate being charged.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Standard Mortgage Repayment Terms

### Term

- Up to 5-years, open or closed.
- The ability to provide terms exceeding  5 years, is to be included within the credit union Residential Mortgage Underwriting Policy and may require specific criteria or appropriate approval authority.

### Amortization

- Standard amortization 25 years, with careful consideration given to the estimated remaining economic life as determined by the appraiser.
- Maximum amortization 30-years, if allowed in the Residential Mortgage Underwriting Policy. Risk premiums should be considered to reflect extended repayment risk.

### Monitoring

- Mortgages with terms in excess of 5-years should be monitored and included in credit portfolio reporting. Aggregate exposure limits should be considered within the Residential Mortgage Underwriting Policy.
- Mortgages with amortization in excess of 25-years should be monitored and included in credit portfolio reporting. Aggregate exposure limits should be considered within the Residential Mortgage Underwriting Policy.

### Insured Mortgages

- Requirements of the insurer apply for those loans insured under an insurance policy issued by an insurer.

**Related Guidelines**

| | |
|---|---|
| Residential Mortgage Financing | Use of Residential Mortgage Lending Limits |

# 2. STANDARD TERMS AND CONDITIONS

# Standard Terms and Conditions

- There are required standard terms and conditions that have or will be complied with for the completion of credit applications.
- Not all requirements are applicable to all applications and not all documentation as specifically outlined in the individual topics need to be enclosed with the credit submission; however, may be specifically requested by the officer adjudicating the transaction.
- Comments are to be made relative to each document not enclosed to address or mitigate the associated risk.
- The standard certification recited in credit applications will need to refer to "standard terms and conditions".

## General Terms and Conditions

(Applicable to commercial, agricultural and consumer loans)

- Searches do not need to be enclosed with an application; however, must be listed under enclosures with detailed comments required in the credit application outlining the results of each respective search. This includes Credit Bureau Report, PPR, Corporate, Bank of Canada, Land Titles, WCB, CRA, Commercial Credit search, etc.
- The Corporation is to be advised prior to funding, if a report is obtained subsequent to approval and evidences derogatory items.
- All sources of personal income used to establish debt service capacity have or will be confirmed, with evidence kept on file for all consumer and residential mortgage loans.
- Financing Statements registered at PPR relative to General Security Agreements recite "All Present and After-Acquired Personal Property".
- Confirmation/evidence that the member's required down payment is in place before the loan/mortgage is funded.
- Personal net worth statements and sole proprietorship farm statements/applications, will be dated and signed by the member(s) before the loan is funded.
- Financing Statements have/will be registered at PPR in support of Account Set-Off Agreements covering deposits assigned which are $10,000 and over.
- Credit Committee approval and/or Board approval (where applicable) will be obtained and retained in the credit file.
- Bills of Sale will be obtained and retained in the credit union's credit file relating to assets financed (vehicles, R.V.'s, equipment, cattle, etc.).

- A new Line of Credit Agreement or Overdraft Protection Agreement for new/increased LOC's/AOD's will be obtained.
- The credit union will notify the Corporation via Amendment if any applied for/outstanding LOC/AOD bulge is not covered/cancelled by the expiry date or any short term demand loans applied for/outstanding are not repaid by the agreed to date.
- A loan agreement is held/will be obtained for each term loan.
- A loan agreement and letter of indemnity is held for each issued letter of credit/guarantee facility.
- Adequate insurance has been confirmed as being in place for assets taken as security (vehicles, machinery) - unless the credit union has sufficient impairment coverage in place to permit waiver.

### Business

(Applicable to commercial and agricultural loans; incorporated or otherwise)

- The appropriate company signing officers will sign the company's yearend/interim financial statement.
- The Guarantees Acknowledgement Act-Certificate of Notary Public forming part of personal guarantees have/will be executed and completed in front of the members' solicitors or an independent solicitor.
- A Commitment Letter is issued and acknowledged by the company/member and guarantors for all commercial and agricultural lending situations.
- Accounts receivable listings, inventory declarations, and accounts payable listings are/will be signed by a company signing officer attesting to the authenticity.
- A Borrowing Resolution is held/will be obtained for each corporate loan (assumes a General Borrowing Resolution is not held for all debt and individual resolutions must then be obtained for new loans).
- Section 45 requirements under the Business Corporations Act for corporate guarantees have been satisfactorily addressed.
- Corporate guarantees are supported by the necessary Solicitor's Opinion Letter to confirm the enforceability and ability to provide guarantees (refer to Corporate Guarantees).
- Bank of Canada and WCB searches have been completed and indicate no registrations by another lender, etc.

## Real Estate

(Applicable to all loans secured by real estate)

- The property taxes have been confirmed as paid/current on an annual basis as identified in narrative.
- The water rates/levies (relating to irrigated lands) have been confirmed as paid/current on an annual basis and comment made as applicable.
- Updated and detailed rent rolls will be obtained at least annually for any multi-tenant revenue properties financed by the credit union.
- Copies of the leases do not need to be included, however, a listing of the tenants is to be included along with specific comments as to quality, duration, price, terms, restrictive covenants, etc.
- Where applicable/required, Real Property Reports will be obtained once the roof has been completed.
- Where applicable/required, satisfactory water potability/well flow tests will be obtained and retained on file.
- Caveats have/will be registered at Land Registry over the applicable properties in support of any Memorandum of Charging Land recited in the security panel/application.
    - **Note:** Not applicable for interim financing loans (pending a sale closing) unless sales do not close.
- Only the Executive Summary of the Environmental audit needs to be provided. Should the summary include a negative comment, then that portion of the report addressing the concern should be included as well. Comment should be made in the narrative to address the environmental audit as required.
- Solicitor's Letter of Opinion will be obtained/is held to confirm the credit union holds a valid and enforceable (first, second, etc.) charge against the real estate charged under the mortgage(s).
- Title Insurance has been obtained.
- Finalized/accepted copies of offers to purchase relating to real estate transactions will be obtained and retained in the credit file.
- If appraisals are not prepared for or addressed to the credit union, a written letter of authority will be obtained from the relative appraisal firm to confirm the credit union can use it for the purpose(s) intended.
- Appraisals for owner occupied, single family dwellings only need to be included if there is a material negative feature reported that may impact the credit decision. Where not included the credit application requires a brief summary of appraisal in the narrative including appraised

value, property type, lot size, negative features, neighborhood influences, etc. or indicate that the approval is subject to a satisfactory appraisal in the identified minimum amount.

- Adequate fire insurance is in place/assigned and includes (as applicable) business interruption/loss of rentals, liability, boiler, inventory, and "Builder's All Risk" coverage. This information still needs to be recited in all security panels.
    - **Note:** If a co-insurance clause is indicated, the credit union will ascertain that the member has the financial ability to cover/pay their potential portion, if any claims/ losses are incurred.
- All requirements of Builders' Lien Act and Credit Union Central's mortgage manual with respect to progressive/construction mortgages will be adhered to, and advances will be made on a cost-to-complete basis (i.e., credit union to ensure the not drawn portion of the mortgage is sufficient to complete the project).
    - Construction costs are supported by written quotes and/or paid receipts/invoices.
    - Copies of plans and specifications are obtained and retained on file.
    - All appropriate permits and municipal/civic approvals are obtained and retained on file.
- Evidence of insurer approval is obtained and retained on file and all requirements per the insurer's guidelines have been complied with.

# 3. DISCRETIONARY LENDING LIMITS

# Discretionary Lending Limits

The Credit Union Act and Regulations establish the loan maximum to a specific borrower and to persons connected with that borrower based on the credit union asset size. The credit union Board is required to pass a resolution to establish the limit for loans to be granted, within the terms of the Act and Regulations, which may be lower than the maximum allowed by Regulation.

The Act requires the Board to establish written procedures to ensure prudent lending standards are applied and that there is a minimum annual review. The Corporation has published a model Board Credit Risk Management Policy (CRMP) that may be amended, or enhanced to reflect the unique characteristics of the credit union, including the scope of credit risk activities and the sophistication of risk management and technology.

The CRMP includes the Board credit risk philosophy and risk appetite. In addition to a general statement on the level of risk the Board determines acceptable, there must be measurable criteria that can be monitored and reported to support Board oversight. The policy outlines the credit risk framework, portfolio concentration targets, product & industry exposure limits and risk tolerances.

Credit union management shall implement and monitor credit policies that support the Board CRMP, aligned with the credit risk philosophy and risk appetite and incorporating regulatory requirements, Corporation guidance and industry best practice. The credit policies are expected to be consistent with the lending guidelines published by the Corporation.

The Board will request the Corporation establish a Discretionary Lending Limit (DLL) allowing the credit union to approve loans within their discretion. The requested limit should reflect the local market for lending to members and the credit union adjudication, risk monitoring capabilities and resources. Loans in excess of the DLL and within the loan maximum established by the Board resolution, may be forward to the Corporation for adjudication.

Credit union management, based on their Board direction is required to utilize a standard process to apply to the Corporation for the discretionary lending limit. The Corporation approval will be based at a level providing appropriate autonomy, accountability and responsibility for the credit union dealing directly with members.

### Corporation Assessment of Request for DLL

- Statistical Information: the previous year-end, most current year-to-date and trends.
- Credit Portfolio Management: Credit Risk Management Policy consistent with the Corporation model policy, aligned relative to the unique risk characteristics and risk management resources of the credit union.
- Credit Risk Framework: Credit policies aligned with the Credit Risk Management Policy and consistent with CUDGC Lending Guidelines.

- Internal controls: including delegation of lending limits, segregation of duties, internal loan transaction review, compliance, monitoring and reporting.
- Review of Internal Audit reports indicating an effective Internal Audit process supporting a third line of defence.
- Adjudication results of applications forward to the Corporation for approval, including declines and withdrawals.
- Results of the Corporation Loan Transaction Review (LTR) program for underwriting assessment, including agreement with the CU decision, determination of acceptable risk and the number of exceptions identified.
- Review of the credit union quarterly Watch List and Doubtful Loan reporting.
- Results of the Corporation Credit Risk Assessment (OSV) process.

The request for (increased) discretionary lending limits is reviewed by the CU assigned Manager Regulation & Credit Risk Assessment with recommendations through the Corporation credit adjudication process and approval by the President and Chief Executive Officer. The approval letter will be addressed to the Chair of the Credit Union Board, who will delegate all or a portion of the limit to the CU President & CEO and/or the Management Credit Committee. The President & CEO or Management Credit Committee may delegate specific lending limits to credit union employees, based on the individual's training and experience.

### Discretionary Lending Limit Approval Letter

- The approved limit is typically "all inclusive" in that it applies to a combination of all types of credit exposure on an individual and connected basis.
- The approved limit may be segmented for residential mortgages and other loans and may be subject to limiting conditions or restrictions
- There may be a provision for additional lending discretion relative to temporary non-consumer overdrafts and individual loan programs, such as Conditional (Retail) Sales Contracts, RRSP loans and personal overdrafts or Lines of Credit as specifically identified in the DLL approval letter or guided by provisions of this Discretionary Lending Limit Guideline.
- There may be a provision allowing the credit union to complete an internal annual review of credit previously approved by the Corporation, subject to the borrower maintaining a Borrowers Risk Rating of "4" or better.
- Loans and guarantees for employees, above the limit specified in the approval letter require Board prior approval, even where within credit union delegated lending authority limits.
- Loans and guarantees to directors and related parties, including persons who have been directors in the previous 12-months must be approved by the Board.
- The Board may approve a resolution allowing management to approve these loans to current directors, within certain conditions, as specified in the CU Act 133 (5).

- Exceptions to the Board Credit Risk Management Policy may require prior approval by the Board or reporting based on the material nature of the exception.
- Exceptions to management credit policies should be documented, mitigated and subject to approval of the next authority level; up to the Management Credit Committee.
- The credit union is required to maintain records of loans approved, including renewals and forward a monthly list to the Corporation, who will request a sample of loans to be assessed for underwriting through the Corporation's LTR Program.
- Credit unions are encouraged to periodically reassess their market, adjudication and risk management capabilities and apply for an increased limit when warranted. Where limits have been increased, the Corporation may select all loans approved above the previous DLL for underwriting assessment through the LTR program.
- The Corporation reserves the right to impose action plans, including restrictions or limit reductions, whenever there is a material change in the credit environment, management or performance of the credit union.

## Syndicate Loans

The Act requires that where a loan is made by two or more credit unions in Alberta, including Central, the aggregate of the loan funds are deemed to be made by each credit union.

- When the aggregate limit is in excess of the lead credit union's discretionary lending limit, the lead credit union is required to submit their application for credit to the Corporation for adjudication.
- Where the aggregate limit is within the lead credit union's discretionary lending limit, the Syndicate participant is required to submit their application to the Corporation for approval.
- Where the loan has been approved by the Corporation, each participant is required to submit an amending application to the Corporation, confirming they have completed their due diligence, and accepted the risk, independent from the Syndicate Lead.
- Preference is given to Syndication with Alberta Central, who will offer sub-syndication opportunities to Alberta credit unions.
- Additional care must be taken to assess risk and Lead Syndicator capabilities for any syndication opportunities outside the credit union market area, and in particular opportunities outside the Province.

## Special Loan Programs

### Non-Members

The Credit Union Act (132 (d)) and Regulations (PR 54.2) require where loans are made to individual non-members, as part of a program, that Corporation approval is required. The Corporation has established guidance for non-member exposure and business case requirements for third party opportunities or special loan approvals, which may include Mortgage Pools, Conditional Sales Programs and Vehicle Leasing programs.

### Members

Promotional loan programs to members that would not meet the criteria set out in Credit Union Act 135 or other specific programs outside normal lending criteria, require Corporation approval as per Ministerial Regulation 14 (2).

## Exceptions to Discretionary Lending Limits Lending

### Premiums/Fees

Credit union Discretionary Lending Limits can be exceeded by the amount of personal disability and life insurance premiums and by the amount of an insurer's insurance fee.

### Cash and Negotiable Securities

- Where securities held are those as outlined in the Credit Union (Principal) Regulation 54(3) and are formally pledged by either Account Set-Off Agreement (for credit union deposits) and Hypothecation of Securities (for all other securities), the lending limit established by the Corporation for the credit union would be increased by the value of the deposits or securities pledged.
- Securities pledged are/will be held for all member loans present and future
- If the designated securities are held for a specific loan, the lending limits for the credit union is increased only by the amount of the secured loan.
- "Cash security" must be registered in the borrower(s) name. Cash security pledged by a third party does not qualify as the credit union would have to pursue the guarantee of that party before attaching the pledged deposit in a litigation scenario.

### Personal Lines of Credit/Authorized Overdrafts

Without the prior approval of the Corporation, credit unions may approve personal AOD/LOC's with borrowings in excess of the credit union's non-residential mortgage lending limit or where approval of an AOD/LOC facility would cause borrowings to be in excess of the discretionary lending limit providing the following conditions are met:

- Maximum authorized facilities are limited to 10% of the credit union’s present Non-Residential Loan limit to a maximum of $10,000 in aggregate.
- Credit granting criteria must be within the credit union’s established lending policies.
- Facility must meet Consumer Lending Criteria and Debt Service Capacity.
- All loans with a balance under this exception must be identified should a future submission to the Corporation be required.

### RRSP Loans

- Loans for credit union RRSP products to a maximum individual and aggregate amount of $50,000 may be made to a member, outside the approved discretionary lending limit.
- Facility must meet Consumer Lending Criteria and Debt Service Capacity.
- Loans must be due in full within one-year or amortized with monthly payments over a maximum of 5-years.
- RRSP products are not assignable and other security should be considered if the member is not entitled to this level of unsecured accommodation.
- All authorized loans under this exception must be incorporated in future submissions to the Corporation.

### Temporary Non-Consumer Excesses

If the account is one that is subject to approval from the Corporation, the excess is to be reported immediately upon occurrence unless the amount is within 10% of the credit union's All-Inclusive Lending Limit or Non-Residential Mortgage Limit and providing such excess is expected to be covered within five business days. See further explanation under Over Limit Situation.

## Discretionary Lending Limit Principles

- Individuals dealing with the member are responsible for credit risk assessment, including verification of information and the final decision, whether approved or declined.
- In addition to individual risk characteristics, the decision must consider the Board risk appetite relative to target concentration and Industry risk.
- Approvals must consider funding risk and any limitation of other policies, including Capital and Liquidity.

## Alternative Lending Limit Framework

The Corporation has developed an Alternative Lending Limit Framework (ALLF) providing the maximum autonomy for credit union credit decisions, while maintaining legislative requirements, promoting higher standards for credit discipline and minimizing risk to the Corporation deposit guarantee fund:

- The credit union will submit a comprehensive Board Credit Risk Management Policy for Corporation approval.
- The Board risk appetite for individual and connected borrowings in the CRMP becomes the lending limit approved for the Credit union. There will be no opportunity to submit credit applications to the Corporation for approval, except in the following circumstances:
    - Approval is required prior to syndication with another lender, which will reduce the credit union exposure to below their authorized lending limit
    - Special Loan Program for non-member loans
    - Changes to the CRMP require approval of the Corporation

- The ALLF limit is subject to annual review.

## ALLF DLL Approval Process

The application follows the traditional request for (increased) discretionary lending limit process. The Corporation will place increased reliance on:

- Board risk appetite, including concentration limits and risk tolerances supported by regular reporting
- Credit risk framework, including internal controls, with special attention to credit union exception monitoring, pre-disbursement compliance and segregation of duties, including independent sales, credit adjudication, funding and where appropriate financial reporting and special account management (collections)
- Management credit policies aligned with Corporation Lending Guidelines and any special Corporation Guidance
- The Board and management are required to have an appropriate level of oversight while credit officers are required to have the experience and ability to manage within their assigned discretionary lending limits.

## Corporation Credit Application Decline and Appeals

### Loan Declines

No single Manager Regulation & Credit Risk Assessment has the discretion to decline an application. Where a decline is recommended, the application must be submitted to the next level of authority for concurrence and the final level being the President and Chief Executive Officer.

Regulation & Credit Risk Assessment's primary consideration is to explore all reasonable alternatives to restructure the credit and mitigate risk as opposed to declining the application on the basis presented. The Corporation believes its mandate is to provide restructuring alternatives, where possible, rather than simply decline the loan. However there may not be a structure or conditions that would support an acceptable credit risk. The credit union or member may not agree with the proposed restructure, resulting in a withdrawal of the request or decline.

In every case where a loan is declined, the Manager Regulation & Credit Risk Assessment contacts the credit union to advise of the decision and convey the Corporation's inability to support the application either on the basis submitted or under amended terms. The rationale for the decline is also provided.

### Credit Appeals

To ensure the fair and equitable treatment of any credit application under appeal, the Corporation credit guidelines require that the appeal is referred to the next higher level of approval, up to and including the Corporation Board Risk Management Committee. In each case, a copy of the original application, Regulation & Credit Risk Assessment's internal write up, a copy of the response letter and the correspondence received from the credit union are provided to the appeal body.

All decisions are based on a full review of the facts including any new information that may have been presented.

**Related Guidelines**

| | |
|---|---|
| AOD LOC Unauthorized Excesses and Delinquency | Consumer Lending Criteria |
| Debt Service Capacity | Forms and Documents |
| Loans to Directors/Employees of Credit Unions | Loans Secured by Negotiable Securities |
| Perfection of Security Interest on CU Deposit Instrument | |

# Use of Residential Mortgage Lending Limits

- To qualify for funding under the Residential Mortgage Lending Limit, the loan proceeds must be used to purchase or build an owner occupied residence or represent an equity take-out with the mortgage set up following standard mortgage repayment terms.
- A Home Equity Line of Credit (HELOC) secured by real estate qualifies if the following criteria is met:
    - Security is a collateral mortgage on the borrower's principal residence.
    - Debt Service Capacity guidelines for qualification must be met.
    - Borrower must qualify using a maximum 25-year amortization.
    - If the HELOC is in second position, the first mortgage must be an amortized mortgage with no ability to readvance.
    - Must meet the "quality mortgage loan" definition as set out in the Credit Union (Principal) Regulation.
    - Advance must meet the quality mortgage definition – this includes all financial charges.
    - Market value is to be established following the Residential Mortgage Financing guideline.
- The dwelling must meet the property type criteria.
- The following situations will not fall within the Residential Mortgage Lending Limit and are to be dealt with under the credit union's Non-Residential Discretionary Lending Limit:
    - The LOC qualifies using interest only payments
    - LOC's secured by revenue property
    - LOC's secured by recreational property
    - LOC's secured by Encumbrance Agreements

### Related Guidelines

| | |
|---|---|
| Consumer Lending Criteria | Residential Mortgage Financing |
| Standard Mortgage Repayment Terms | Debt Service Capacity |

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# 4. BUSINESS LENDING - GENERAL

# Borrower Risk Rating

The Standards of Sound Business and Financial Practices, M-3 Credit Risk, requires credit unions to have an effective assessment and rating system for credit risk, supporting an on-going, appropriate and effective process for managing credit exposures that warrant special attention and an effective methodology for identifying, estimating, providing for and recording credit impairments.

The Borrower Risk Rating (BRR) is a measurement of the probability of default based on risk characteristics of the loans and the borrower. The numerical ratings of risk reflect the ability to collect aggregate loans. The higher the number, the greater the risk.

A system for risk rating commercial and agricultural loans is a tool which assists credit union management and the board of directors:

- Quantify on a consistent and common basis the lending risk for a specific member assisting with underwriting, risk mitigation, pricing and adjudication.
- Identify higher risk borrower loans that require increased monitoring and reporting.
- Measure risk and risk trending of the credit union's non-consumer loan portfolio or an industry, supporting credit portfolio risk management and reporting.
- Support collective allowance modeling when the BRR is utilized to establish the probability of default or a significant increase in risk.

## Risk Rating Categories and Definitions

There are nine risk rating categories used and defined below, with a numerical value being assigned to each. Risk ratings 1 through 6 are materially based on calculation of key management financial and security characteristics; however, the rating may be downgraded (risk increased) based on lender or adjudication reasoned judgment. Risk ratings 7 through 9 place more emphasis on additional assessment criteria.

### 1. Excellent Risk

This category applies to a borrower where the credit union's exposure is at absolute minimum risk, with a near zero probability of default, or any potential loss covered by cash, government bonds or government guarantee. Includes:

- Loans to a government or agency, as well as, municipalities.
- Loans with 100% cash collateral (excluding third party security) or Government of Canada issued securities.

### 2. Very Good Risk

This category applies to a high quality borrower, with minimal risk of default or loss. Assessment would be based on the following:

- Extended history of strong net income and operational cash flow.
- Very strong balance sheet ratios, including working capital and debt/equity when compared with its industry.

- Very strong debt service capacity, as measured by operating cash flow to debt servicing commitments.
- Borrower has open access, at their discretion, to raise substantial funds through public markets.
- Credit exposure guaranteed, with supporting security, by a party who fits this category.
- Includes loans to regional health authorities, school districts, etc.

### 3. Good Risk

Borrowers in this category represent normal business risk.

- The balance sheet ratios, compared to industry, are adequate for the credit union's exposure.
- The debt servicing capacity, as measured by cash flow to total debt servicing, is adequate and meets the guidelines for the loan type. Also, it is in line with the average for the industry or type of business.
- The member is able to withstand a moderate untoward financial event.

Borrowers whose aggregate borrowings are $100,000 or less, supported by standard security lending values may default into this category, while maintaining an acceptable loan repayment history. In these cases, for risk assessment purposes, ratio calculations are not required.

### 4. Acceptable Risk

These borrowers are considered to be in the higher tier of average risk and do not fall into the broad definition of risk rated "3" accounts but the risk is still considered acceptable.

- The underlying value of the assets is a greater factor in risk evaluation.
- The balance sheet is a standard for the operation in its industry.
- Financial performance is reasonably consistent and the outlook is stable or better.
- The credit exposure may require increased monitoring of security coverage or other tests.

Borrowers whose aggregate borrowings are $100,000 or less and, are not supported by standard security lending values, default into this category while maintaining an acceptable loan repayment history. In these cases, for risk assessment purposes, ratio calculations are not required; however, the credit union's standard underwriting criteria must meet.

### 5. Caution Risk

This category would apply in the following circumstances:

- The nature of exposure represents a higher risk but it is expected that it will be reduced within an acceptable period of time.
- A significant event has occurred, not necessarily reflected in the financial statement which could have a negative impact on the business. Examples would be management change, loss of a major customer, loss of a major supplier, material change in industry or market, union strike, etc.
- A borrower who is experiencing a major change in its capital structure.

Some key characteristics are:

  - Heavy reliance on security to protect the exposure.

- o Heavy reliance on debt including credit union facilities to finance the business.
- o Cash flow is weak and there is some doubt to being able to withstand a moderate untoward event.
- o Balance sheet ratios are weak but the assets and security supporting the loans is deemed to be adequate.
- o A readily available alternate source of financing, except from the credit union, is unlikely.
- o There is a need for frequent monitoring of the operation to ensure maintenance of acceptable credit quality.

**6. Watch - Monitoring**

Accounts in this category are to be reported in the Watch and Doubtful Report. This category includes accounts where principal or interest are not at risk but performance trend is negative and unless reversed could lead to losses for the credit union. This is a transitional rating as the expectation is to be able to upgrade the account within the next 12 month period. The credit union would not be averse to losing the relationship and justification for account retention must be considered. If retention cannot be rationalized, then an action plan is to be developed to exit the relationship.

The account may require close supervision due to one or more of the following:

- Negative trends are being experienced in key balance sheet ratios and debt servicing ability to the extent that there could be a potential loss to the credit union if the situation is not reversed.
- The borrower is experiencing a material disruption due to litigation, labor, or environmental problems.
- While principal and interest payments are being made there is a real risk there will be a default, if corrective action is not taken.
- The assets securing the loan have deteriorated in value, either on a going concern or on a liquidation basis; however, full recovery of principal and interest would still be reasonably expected.
- The account is frequently appearing on banking system reports as delinquent, over limit, or past due for review.

**7. Watch - Concern**

Accounts in this category are to be reported in the Watch and Doubtful Report. The characteristics in the risk “6” category are exhibited; however, more active monitoring is required as the risk of default is elevated based on the following characteristics:

- Scheduled payments of principal and/or interest is 60 or more days in arrears.
- Material breach of loan covenant(s) or deterioration in security margins.
- Outlook for the member or its Industry is a material concern.

**8. Doubtful**

Accounts in this category are to be reported in the Watch and Doubtful Report.

- Demand for payment has been issued.

- Security realization has been initiated.
- Includes any or all of the six default criteria (recited below in 9-Impaired); however, no provision recorded as loss of principal or interest is not expected based on estimated net recovery value of prime security (i.e., No benefit to guarantees, unless securitized by tangible assets).

**9. Impaired**

Accounts in this category are to be reported in the Watch and Doubtful Report. Loans will be transferred to impaired status consistent with IFRS, based on any one of the following default criteria:

- "Significant" financial difficulty;
- Breach of contract, including principal or interest delinquency;
- Lender granting a concession that would otherwise have not been granted, other than due to financial difficulty;
- Probability of bankruptcy or financial reorganization;
- Disappearance of an active market for a financial asset because of financial difficulties; or
- Observable data supporting a measurable decrease in estimated future cash flows from a group of financial assets.

**AND**

There is objective evidence that an impairment loss has been incurred, based on the difference between the book value and the net present value of future cash flows (recoveries).

## Re-Structured Loans

A higher risk loan (BRR 6 through 9) may be restructured to improve recovery efforts, which may include a reduction in interest rates and/or increase in amortization. These restructured/workout loans are to retain the higher risk Borrower Risk Rating classification; however, may be re-classified after a minimum of one year based on an acceptable repayment trend and return to near market terms.

## Mapping BRR to External Risk Ratings

A Borrowers Risk Rating system typically is consistent with external credit risk ratings such as Standard & Poor, Moody's, etc. External ratings BBB and higher are often referred to as "Investment Grade".

| BRR | Public Equivalent | Risk | Description |
|---|---|---|---|
| **1** | **AAA** | Excellent | Cash or Bond Secured; municipalities, hospitals, public schools. |
| **2** | **AA** | Good | Very Strong ability to meet commitments |
| **3** | **A** | Above Average | Strong ability to meet commitments. |
| **4** | **BBB** | Average | Adequate ability to meet commitments; Susceptible to deterioration under adverse conditions. |
| **5** | **BB** | Caution | Able to meet commitments, however without a significant buffer; Susceptible to become a problem account under adverse conditions. |
| **6** | **B/CCC** | Watch – Monitoring | Material weakness in capacity or financial position; Susceptible to becoming non-performing with a potential loss under adverse conditions. |
| **7** | **N/A** | Watch - Concern | Watch account escalated to active monitoring. |
| **8** | **N/A** | Doubtful | Demand issued; security realization initiated; no provision. |
| **9** | **N/A** | Impaired | IFRS 9 Loss event and provision. |

## Risk Rating Factors

Five key risk characteristics have been designated to be the primary factors in determining the borrower risk rating.

In all cases, prudent practices must be used in assessing the overall risk rating; however, in some situations there may be subjective elements that should be considered when establishing the risk rating for the borrower. These elements can be comprised of positive mitigating factors that can impact the risk rating decision. Acceptable mitigating factors are limited to those outlined below and can be used, with appropriate rationalization, to move the overall risk rating by one category only. However, such movement can only be made by the approving officer for risk rating borrowers 1-5. All other amendments require at least the “Next Level” approval but are still restricted to one category movement.

While mitigating factors provide flexibility to the process, caution must be exercised to ensure the assessment is reflective of the true risk exposure.

### Risk Factors

MANAGEMENT CATEGORY

- Considers various management structures, years of experience, succession planning, management information systems and access to capital.

SECURITY COVERAGE CATEGORY

- Acknowledging the reduced risk due to the availability of Government Guarantees where all documentation conforms to established program guidelines.
- Acknowledging that surplus lending value under all-purpose mortgages may be used to secure other advances.

WORKING CAPITAL (CURRENT RATIO) CATEGORY

- May consider that current portion of long term debt (CPLTD) is repayable over a short term and could be extended to normal guidelines if necessary (i.e., a managed shortage of working capital).

DEBT SERVICE COVERAGE CATEGORY

- May consider that credit is supported on a “project” basis rather than the company’s income statement when financing real estate.
- May consider that CPLTD is repayable over a short term and could be extended under normal guidelines if necessary.
- If projected cash flow is used, then the rating for this risk factor is to be downgraded by one category.

DEBT TO EQUITY CATEGORY

- May consider that the credit is supported on a “project” basis rather than the company’s balance sheet when financing real estate.
- May be adjusted based on current market value of real estate vs. book value.
- Adjusted by formally postponed shareholders loans.
- Recognizes that there are specialized industries where higher ratios of financing are generally acceptable.

Special consideration based on the nature of specific industries, such as:

1. **Commercial Real Estate**: a lower working capital ratio may be acceptable based on the industry's dependence on long term financing of material assets, resulting in a larger CPLTD.

| **Commercial Real Estate** | **1 Excellent** | **2 Very Good** | **3 Good** | **4 Acceptable** | **5 Caution** | **6 Watch** |
|---|---|---|---|---|---|---|
| Working Capital | N/A | ≥ 1.25 | 1.00 to 1.24 | .75 to .99 | .50 to .74 | ≤ .49 |

2. **Hotels**: a lower working capital ratio may be acceptable; however, the standard acceptable minimum debt service ratio is 1.40X and the standard maximum acceptable debt/equity ratio is 2:1.

| **Hotels** | **1 Excellent** | **2 Very Good** | **3 Good** | **4 Acceptable** | **5 Caution** | **6 Watch** |
|---|---|---|---|---|---|---|
| Working Capital | N/A | ≥ 1.25 | 1.00 to 1.24 | .75 to .99 | .50 to .74 | ≤ .49 |
| DSC | N/A | ≥ 2.00 | 1.70 to 1.99 | 1.40 to 1.69 | 1.25 to 1.39 | ≤1.24 |
| Debt/Equity | N/A | ≤1.00 | 1.01 to 1.50 | 1.51 to 2.00 | 2.01 to 3.00 | ≥3.01 |

3. **Agriculture**: a lower Debt/Equity ratio is required due to the significance of the land base and income volatility.

| **Agriculture** | **1 Excellent** | **2 Very Good** | **3 Good** | **4 Acceptable** | **5 Caution** | **6 Watch** |
|---|---|---|---|---|---|---|
| Debt/Equity | N/A | ≤.25 | .25 to .75 | .76 to 1.00 | 1.01 to 2.00 | ≥2.01 |

## Risk Rating Worksheet

The commercial and agricultural loan risk rating system makes use of a Borrower Risk Rating Worksheet for "Commercial" or "Agricultural" borrowers; to be completed for each borrower and retained on file as a permanent record. The risk rating should be re-assessed with each additional loan request, in conjunction with the annual review and once the lender is aware of material changes to the risk nature of the loan(s).

A weighted average system is to be applied as follows:

| | |
|---|---|
| Management | 15% |
| Security Coverage | 25% |
| Current Ratio | 10% |
| Debt Service Coverage | 30% |
| Debt/Equity Ratio | 20% |
| Total | 100% |

For borrowers whose credit accommodation is $100,000 or less, a ratio analysis is not required. Providing the relationship is satisfactory the borrower will generally default to BRR 3 or 4.

## Instructions for Worksheet Completion

- The new spreadsheet is protected and makes use of dropdown menus in various cells, as well as, pre-set calculations. Hardcopy preparation is not recommended.
- The rating for management is based on the completed management section that forms part of the borrower risk rating worksheet.
- Security coverage will be based on the security value reported on the security panel net of prior encumbrances versus the amount of mortgage secured loans.
- The financial category ratios (i.e., current ratio, debt/equity ratio and debt service coverage ratio) will be calculated from the most recent financial results (i.e., financial statement(s), income tax return(s), PNW statement(s), etc.). These calculated ratios are then compared to the risk rating ratio tables for Commercial or Agricultural loans with possible ratings from 1 to 6.
- After all ratios are entered; the final tabulated score rounded up or down, becomes the overall risk rating for the borrower account being rated.
- If projected cash flow to debt servicing ratio is used, then the rating for this risk factor is to be downgraded by one category.

## Accounts Risk Rated 6 or Worse

**Watch List (**Definition)

- A Watch List is a list of loans identified for additional internal monitoring due to increased risk (refer to the Reporting section below).
- Watch accounts have a negative performance trend which if not reversed could lead to losses for the credit union.
- Watch accounts are transitional as the account will be eventually paid out, upgraded to a caution or acceptable rating, or moved to the doubtful or impaired category.
- The report should be updated monthly.

## Removal of Accounts from Watch and Doubtful Report

- Once the underlying concern is no longer a factor and the account is upgraded to a risk rating of "5" or better.

Rationale is to be clearly provided in the credit file as to justification for retaining the relationship with target dates established to bring the account into a satisfactory position. In those cases where security realization is required to recover the outstanding debt, clear action plans with step by step objectives are to be addressed.

## Watch and Doubtful Loan Reporting

The Corporation has developed a quarterly Watch and Doubtful Report that is to be submitted to CUDGC by the 20th business day following the credit union's most recent quarter. The report or summary of the report should be included in the credit union's next Board reporting package.

The Watch and Doubtful Report is a workbook in Microsoft Excel format that consists of the following five (5) worksheets:

1. Recap: Includes total number and dollar amounts for the current quarter, the previous quarter and the change over the past 3-months for Watch list and Doubtful loans.
2. Watch - Monitoring RR6 Accounts: A brief summary of each member loan classified in in this category.
3. Watch – Concern RR7 Accounts: A brief summary of each member loan classified in this category.
4. Recap Doubtful RR8 & RR9 Accounts: A brief summary of each member loan classified in these categories.
5. >$500K RR8 or RR9 Detail: Individual detailed reports for Doubtful (BRR8) and Impaired (BRR9) loans over $500,000. Management or the Board may require the individual reports be provided at a lower dollar threshold. CUDGC may approve a higher threshold.

## Related Guidelines

| | |
|---|---|
| Delinquent, Doubtful and Impaired Loan Management | Forms and Documents |

# Definition of Business Loans

A business loan is defined as "any credit facility accorded where the borrower, purpose, or security is business related and payment is dependent on commercial sources".

### Type of Borrowers

- Corporations
- Partnerships
- Limited Partnerships
- Sole owner, proprietorship including farmers or individuals operating under a trade style
- Societies, churches, associations, clubs, etc.
- Joint ventures
- Individuals seeking funds for business investment purposes

### Types of Loans

- Operating Lines of Credit - authorized overdrafts
- Term Loans
- Government Guaranteed Loans
- Farm Loans or agricultural related loans (incorporated entities)
- Investments where the investment financed is also the primary source of repayment
- Mortgage Loans:
  - Interim and Construction Loans (residential or commercial)
  - Conventional Mortgages (revenue producing and/or owner occupied properties)
- Letters of Credit/Guarantee

The business loan definition may not apply to lending situations where individual members arrange for loans, which are secured by personal assets (generally residential mortgages) and repayable from personal resources, even though the purpose of the loan is to invest in a business in which the member is active. If, however, the debt service on the loan is clearly beyond the member's capacity to pay relative to normal wages drawn from the business (i.e., repayment is substantially dependent upon unproven future bonuses or any other type of direct non-wage assistance from the member's business), the loan must be classified as a business loan. The normal wage level from the member's business is based on previous years' financial statements, history of the business, and the wage level the member may expect if employed in a similar position with another employer.

# Guarantees

## Personal Guarantees

- With few exceptions, guarantees of the shareholders/principals of the company will be required when lending to a limited company.
- Preference is to be given to obtaining a guarantee for an unlimited amount (the credit union's claim under the guarantee is restricted to the borrower's outstanding loans including the total approved maximum under any Line of Credit, Authorized Overdraft, and/or Letters of Credit) or the specific aggregate debt owing at that time.
- Where the borrower is considered to be undoubted, the guarantees may be limited to a percentage (i.e., 50%, 25%, etc.) of the total loans outstanding.
- Guarantees of the spouse should also be pursued as in most instances the personal assets would be registered in joint names and recourse would be restricted in a recovery scenario.
- It is generally advisable that where a spouse does not hold an ownership in the corporate entity, the spouse should only execute a guarantee (and pledge of personal assets if appropriate) with the benefit of legal advice independent from the credit union and borrower's solicitor to ensure that party acknowledges the potential risk and liability in providing the guarantee.
- It is recognized the covenant of a guarantor may only represent nominal worth or value; however, this form of financial commitment does provide "moral" support or commitment to the loan repayment and can permit recourse against jointly owned assets.
- Where a personal guarantee is refused, the credit union must be fully satisfied with the lending risk as the principal is requesting the credit union to undertake a risk that the principal is not prepared to accept.
- Assets pledged by an individual in support of a company or another party's debt must be pledged in support of that party's guarantee in order to connect the security to the borrower.
- Should an unrelated party or the spouse of an officer of the corporate entity jointly or solely own these assets, a certificate of independent legal advice is to be provided in support of the guarantee.
- Where a guarantor(s) is released or the guarantee amount is amended/compromised, it is imperative the written consent and acknowledgement of all remaining guarantors be obtained, otherwise the enforceability of all guarantees may be prejudiced.
- Where a Notice of Limitation related to a guarantee is received, the liability under that guarantee is "fixed" after 90 days, and any form of new funding is to be discontinued as of that date. The guarantor remains liable for the fixed amount as established as of the date 90 days following the Notice, which liability would include both direct and contingent liabilities such as Letters of Credit, etc.
- Where a Notice is received, such should be referred to either legal counsel or the Corporation.
- In all instances, the Guarantee and Postponement form available through Credit Union Central is to be used with the Guarantees Acknowledge Act Certificate of Notary Public/Statement of

Guarantor. A new replacement guarantee for the gross amount then authorized should be taken when the guarantee amount is increased to avoid any future challenge that the new guarantee was in substitution or otherwise limited, with the previous guarantee document returned to the guarantor.

Note:

i. Ensure the applicable guarantors have the Guarantees Acknowledge Act Certificate of Notary Public section executed by, and in front of, an independent solicitor (i.e., do not use the solicitor acting on behalf of the credit union).

ii. In the event any terms and conditions of the credit change during the term, it is advisable to have these changes acknowledged by both the borrower and guarantor(s). The foregoing is normally accommodated by having the borrower and all guarantors sign a Commitment Letter, which include the full disclosure of all loans, security, terms, and conditions.

### Corporate Guarantees

To ensure there is no misunderstanding as to the requirements applicable when obtaining corporate guarantees, the following criteria is to apply.

Where a corporate guarantee is to be obtained, the documentation required is normally provided to the company's solicitor (whether directly or via/through the credit union's solicitor) who needs to review and complete, or have completed, the following:

- the Guarantee and Postponement form
- the Corporate Guarantee Resolution (certified copy)
- the Certificate of Non-Restriction
- the Guarantee Certificate (as it relates to Section 45 of the Business Corporations Act)
- a solicitor's letter of opinion which is to address the following:
    - confirm having reviewed the Articles/Minute Book of the Corporation to ensure the company has the authority to execute the guarantee
    - confirm all necessary steps have been taken by the officers/directors of the company to enable the granting of the guarantee
    - confirm the guarantee has been properly executed
    - confirm the company is in good standing at Corporate Registry

**Note:** Whenever a financing transaction involves financial assistance by a corporation, generally in the form of a guarantee, the lender must consider the application of Section 45 of the Business Corporations Act, ensuring that the guarantee is in compliance with said Act.

# Higher Risk Loans

The Corporation views certain industries or types of businesses as being "above average risk" situations for different reasons and suggests caution be exercised when entertaining an application for any of the following:

- Art dealers
- Cannabis production, manufacturing, distribution and retail operations
  - New industry
  - Highly regulated
  - Limited management or financial performance
  - Difficulty in assessing security values
  - Reputation and social accountability risks
- Casinos and Gaming Rooms
- Drilling contractors
- Exotic and specialty/purebred livestock (unless the security includes a charge over real estate or other marketable assets)
- Fad industries and companies (tanning salons, entertainment centres, etc.)
- Golf courses, bowling alleys, and other sports related facilities
- High-tech and/or specialty industries (where product marketability is not yet firmly established)
- Hotels and motels
- Jewellery manufacturers
- Limited partnerships
- Lumber mills
- Restaurants and night clubs
- Retail operations, particularly in leased premises
- Turnaround Situations
  - Soliciting this type of loan should not be actively pursued for obvious reasons.
  - Special care must be exercised in carefully analysing the circumstances leading to the problem, the historical and projected financial information, and other data to ensure problems of the past have been permanently remedied. The improved performance must be evident for a full fiscal term as opposed to a matter of months (i.e., reasonable evidence of a track record evidencing the turn-around has occurred and will be maintained). Particular attention must be given to ensuring accounts payable are current and all creditor debt is declared (and confirmed by way of searches). If the company has been re-capitalized, it is also imperative to identify any preferred investment terms and/or have all shareholders' loans formally postponed (and acknowledged by the company) in favour of the credit union.
  - Audited financial statements should be obtained. However, if audited statements are not available, statements prepared by a recognized accounting firm on a Review

  - Engagement basis and an independent feasibility study should be completed by a source acceptable to the credit union.
  - Security values must be supported by appraisals and/or written evaluation by a qualified third party.
- Venture Capital
  - In view of the higher risk generally associated with new ventures given their unproven viability, such loans should be approached cautiously. Where possible, the borrower should be encouraged to utilize government guaranteed loan programs particularly if there is any question or concern regarding market acceptance of the company's product or service.

Financing for the above categories should not be actively marketed; however, should opportunities become available which warrant credit union support, each application may be considered on a case-by-case basis.

Each application should clearly identify approval would be on an exception basis and include commentary outlining the rationale for proceeding and confirming the historical debt servicing capacity (140% or higher), as well as, suitable security margins, preferably with additional tangible assets pledged to provide a secondary source of repayment in the event of a distress situation.

Where acceptable tangible background security is not available a more conservative approach to lending values is required. Proposals entertained must clearly provide lower or reduced lending values/security margins to represent a "secured risk" where the safety of the credit union funds is not assured.

All applications recommending financing in these categories must include a detailed rationalization, identify all secondary sources of repayment, and clearly outline the above-normal lending risk.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Letters of Credit/Letters of Guarantee

- Letters of Credit/Guarantee represent a revocable or irrevocable commitment to a third party (Beneficiary) to honour cheques, drafts, demands, or other claims on presentation or within a specific term.
- Most Letters of Credit are for domestic purposes; however, where a Documentary Letter of Credit (import/export) or domestic credits issued under the Uniform Customs and Practise for Documentary Credits is required, requests are to be referred to Credit Union Central Alberta Limited.
- A Letter of Guarantee can be issued in irrevocable or revocable form. An Irrevocable Guarantee is one, which carries the clear commitment of the issuing credit union to pay or accept drawings there under, provided the drawings conform to the terms and conditions of the guarantee. An Irrevocable Guarantee cannot be cancelled or amended without the consent of all parties concerned.
- A Revocable Guarantee may be cancelled or withdrawn at any time by the member, the Beneficiary, or the credit union depending on the written terms of agreement and upon receipt by the Beneficiary of the credit union's written notification to that effect.
- All Letters of Guarantee must recite an expiry date, which must not exceed a year from the date of issue, except in special circumstances. Under normal circumstances, where Letter of Guarantee relates to a contracted commitment exceeding one year, the guarantee would be renegotiated for renewal by the member for a further period of one year or less, and/or annually thereafter.
- Reasons for Requesting a Letter of Guarantee
    - Requests to issue a guarantee to a Government Agency such as the collector of Customs or the Income Tax Department for payment of tax arrears.
    - Requests to issue a guarantee to another bank to honour payroll cheques presented for encashment, or to the post office or Alberta Gaming and Liquor Commission to accept uncertified cheques.
    - Requests to guarantee payments under an agreement entered into by the member.

## Application of Credit Limits

- Any issued Letters of Guarantee are to be considered a credit commitment or credit facility granted to the member and is to be included as an authorized credit facility and the amount is to be recorded in the "outstanding" column of the front page of credit applications or amendments. The credit union's credit granting limits, including the non-residential lending limit, will be applied in granting Letters of Guarantee. If a request for a Letter of Guarantee exceeds the credit union's authorized non-residential lending limit, prior approval of Corporation must be obtained by way of application for credit. Normal credit granting and underwriting criteria should be followed, as the credit risk is the same as any other credit facility.

## Documentation Required

- Revocable Letter of Guarantee, Irrevocable Letter of Guarantee, Letter of Indemnity forms, and Letter of Guarantee ledger.
- Prior to the issuance of a Letter of Guarantee, a signed Letter of Indemnity must be obtained from the member. This is to be supported with a Demand Loan Agreement dated the same day as the Letter of Indemnity and with any additional security documentation to be collateral to the Loan Agreement (i.e., mortgage, GSA, etc.). The administration or application fee for the issuance of the Letter of Guarantee is to be recited in the Letter of Indemnity; while the interest rate applicable, if the Guarantee is drawn upon, is to be reflected in the Loan Agreement.
- An executed copy of the Letter of Indemnity is to be attached to the credit union's copy of the Letter of Guarantee and filed along with the other collateral security documents in the security file. The original Letter of Guarantee is either given to the member or directly forwarded to the Beneficiary.
- While the Indemnity contemplates renewals of the attached Letter of Guarantee, it is preferable to obtain a new indemnity with each renewal, particularly if any terms or conditions are varied.
- It is important to note that if the credit union requires any other person to sign the indemnity other than the direct borrower (member) say in the capacity of a co-borrower or guarantor, and then a Guarantee Acknowledgement Certificate must be executed and attached as per the Guarantees Acknowledgement Act.

## Preparation

- As the format proposed for a Letter of Guarantee is designed to fit the majority of situations, it is acknowledged there will be situations where specific wording may be required by a Beneficiary. In the case of guarantees for the collector of Customs, and/or for the payment of Federal Income Tax Arrears, special forms are provided by these Government Agencies which must conform to the requirements of a specified amount, a fixed expiry date, and contain no commitment or provision whereby the credit union is required to perform a duty or function other than to honour all properly documented drawings. Caution should be exercised in incorporating this wording, and if in doubt, we would encourage consultation with legal counsel or submit a copy to Credit Department.
- Requests to issue a Letter of Guarantee to a Beneficiary outside Canada for import/export facilities, or otherwise, would normally be by way of a Documentary Letter of Credit. Requests for Letters of Credit should be referred to Credit Union Central for preparation of a suitable Letter of Credit and support documentation (i.e. Bills of Lading, etc.).

## Recording and Accounting

- All Letters of Guarantee are to be assigned a reference number, which is recited at the top, right hand corner of the document, for credit union control and audit purposes.
- The details of the Letter of Guarantee are to be recorded on a Letter of Guarantee Ledger Card, or other similar method of recording. The practice of recording the total of these outstanding Letters in a note on the financial statement of the credit union is encouraged.

## Presentation of Draws

- On presentation of an Order to Pay or draft (representing a "draw") the credit union is to ensure the draw conforms to the terms recited in the Letter of Guarantee and providing this is the case, the draw is to be "honoured" and converted to a loan receivable under the member's name. If the Order or draft is presented across the counter or on collection, the credit union should then issue a money draft or credit union cheque payable to the presenting institution reciting particulars of the Letter of Guarantee, generally at no cost to that institution. The amount of the draw is then to be recorded on the ledger (amount column to be adjusted to reflect the remaining balance where partial drawings are permitted) or the Letter of Guarantee cancelled in its entirety where partial drawings are not permitted. A payment advice is then to be sent to the member outlining the amount of the draw and any associated fee/commission charged.
- The credit union must receive back the original Letter of Guarantee once the Letter of Guarantee draws have all been made.

## Renewals

It is preferable to obtain a new indemnity on each renewal, although as an alternative, the member's written request to extend the term is acceptable providing it contains specifics as to the new term and conditions. If the principal amount is to be increased/decreased, the appropriate adjustments are to be made to the ledger.

# Current Asset Financing

- Current asset financing refers to operating funds required to cover working capital needs where reliance is on accounts receivable and inventory to secure the advances. Inventory financing is discouraged and should only be made available for operations that have strong leverage and equity positions.
- Current asset financing is a sector of commercial lending that requires significant monitoring and risk assessment.
- Current Asset financing has significant inherent risks but these can mainly be mitigated by instituting appropriate monitoring controls.
- Declines in a member's business can happen quickly, requiring immediate credit management response. Accordingly, ongoing close monitoring is an essential component to managing the risk.
- The credit structure with its applicable controls is important, not only to protect the credit union's asset but also assist the borrower in building a financially strong enterprise.
- Current asset financing brings its unique challenges and opportunities.
- This guideline is to assist credit unions in managing those accounts that have significant current asset financing. It is not all-inclusive, as situations differ for each borrower, but the concepts can be used and modified to meet each unique situation.
- The emphasis is placed on those relationships with current asset borrowings in excess of $250,000; however, the expressed ideologies may be considered for those borrowers being availed a lower amount of credit facilities.
- It is preferred that for smaller operations, real estate security be taken either directly or in support of guarantees to avoid the requirement to margin operating facilities.

### Risks of Current Asset Financing

| Asset | Risk |
| --- | --- |
| Receivables | Receivables are generated as a result of a service or contract being completed or a product provided. Some identified risks are as follows: |
| | 1. *Concentration Risk*. The member has a limited number of customers. If they lose one customer it would create financial difficulty. The more spread the customer base, the less the risk. Where concentration risk is evident, consideration should be made to reducing the available margin. |
| | 2. *Management Risk*. Assessment of management in the way they monitor their receivables is essential. Lack of credit investigation and |

| | |
|---|---|
| | collection procedures could negatively impact the security position and viability of the business. |
| | 3. *Product Risk*. Lack of quality in product and/or service will negatively impact security and potential profitability of the operation. |
| | 4. *Customer Risk*. Knowledge of the member's customer base not only from a financial perspective but also by reputation is becoming an important risk exposure factor. |
| Progress Billings | Most contractors either in the construction or the oil field industry invoice at certain stages of the contract. They generate a receivable when the invoice is issued. This is referred to as progress billings. There are significant dangers in respect to financing progress billings: |
| | 1. *Contractor Risk.* If the contractor is unable to complete the project, then the owner will likely have to incur additional costs to procure the services of another contractor to complete the project. This can create a defense in respect to payment of the borrower's invoice. |
| | 2. *Sub-contractor Risk*. Financing a sub-contractor provides additional risk and appropriate due diligence should be completed on the general contractor to mitigate the risk. |
| | 3. *Collection Risk*. If it becomes necessary to signify on progress billing receivables, the owner can claim substandard work and refuse payment. |
| | 4. *Project Completion Risk.* There could be an obligation for the credit union to complete the project prior to the payment of the receivable. |
| Inventory | Inventory is very fluid, in some cases has a limited market and is often subject to obsolescence. Realization values can be low; 10 cents on the dollar is often a good expectation. Inventory can be subject to prior charges and can include a significant work in progress component. Accordingly, such financing is discouraged but in those unusual circumstances where inventory financing is being considered, the following should be considered: |
| | 1. *Type Risk*: The inventory should be net of trade (supplier) payables and other prior charges (GST, employee obligations etc.) prior to applying a maximum 50% formula. This not only protects the credit union from a |

| | |
|---|---|
| | security perspective but also avoids the potential to double finance. The margin should be adjusted downward based on type. |
| | 2. *Saleability Risk:* The inventory should be readily saleable. Special attention should be made to clothing operations where some sizes/styles of product may not be saleable. |
| | 3. *Buyback Policy Risk*. Check in respect to buyback policy of the manufacture/wholesaler. Depending on the nature of the buyback and if the operation is a recognized franchise, a more generous margin formula may apply. In these situations, refer the matter to the Corporation for assistance. |
| | 4. *Supplier Information Risk*. Investigation in respect to the source of supplies and alternative sources need to be known. Ability to take advantage of discounts should be investigated. |
| | 5. *Inventory Information Risk.* Inventory information may not be accurate. If the member is not using a perpetual inventory system, the information provided is likely suspect. |
| | 6. *Trade Preference Risk*. In stress situations, the supplier may be paid in preference to the credit union to ensure delivery of supply. Also, the supplier could have prior knowledge of a deteriorating situation and could seize the inventory before the credit union is able to act. Normally, suppliers can have rights against identifiable inventory for 30 days after delivery |

### Margin

- The concept is to manage the maximum availability of an operating facility on a forward basis.
- The margin calculation should be completed at least monthly and calculated on current lists provided by the member.
- The calculation should be made by a Credit Union officer and then verified by the respective account manager.
- Any margin deficit is considered to be an unauthorized loan and must be addressed.
- Lending value/margin for progress billings should not be more than 60-65% and in some cases, depending on the financial strength of the borrower, it should be less. In situations where more than 60% is considered warranted such a position should be clearly rationalized.
- Inventory considered in the margin formula should be net of trade (supplier) payables and other prior charges (GST, employee obligations, etc.) prior to applying the normal 50% formula. This

not only protects the credit union from a security perspective but also avoids the potential to double finance. The margin should be adjusted downward based on type.

- The Margin Position Record (or similar format) is to be used by credit unions for recording the financial information necessary to evaluate the lending value of current assets (accounts receivable, inventory) in order to determine the maximum allowable advances for a member's revolving operating facility for a particular period; usually one month between reporting periods.
- When completing the margin calculation special care should be made to the under noted:
    1. Comparisons should be made to the previous listing to ensure reasonableness of aging. For example, an account that has had the same balance in the "current" column for more than one month needs to be investigated.
    2. Inter-company accounts and foreign accounts should be identified and deducted.
    3. Those accounts that may be subject to financial difficulty, notwithstanding their aged position should be deducted.
    4. Any account that is over 60 days should be commented on as to the ultimate collectability and actions being made by the member to collect the outstanding funds. These accounts are past due 60 days and since most companies provide 30 day terms, the account has really been outstanding for 90 days and action should have been initiated to collect. A large portion of the receivables in the over 60 day category could increase the bad debt expense, negatively impacting profitability.
    5. When a receivable from one customer is over 60 days and the same customer has other receivables less than 60 days, then deduct all the receivables from that customer from the margin.
    6. Check that the lists of receivables, inventory and payables match the reported amounts on the interim financial statements, of the same date, and rationalize any discrepancies.
    7. A payable list should also be provided to identify and deduct contra accounts.
    8. Review the payable list to monitor the payment habits of the member.
    9. Review the margin for trends. Except for seasonal adjustments, as the margin surplus deteriorates it could be a warning sign that the financial performance is also deteriorating.
    10. Review accounts over 120 days and applicable provision/write-off policy of the borrower so that profitability of the operation is adequately addressed pertaining to those accounts.
    11. Consider completing credit checks on those accounts over $50,000.

## Margin Wording

"Advances under the overdraft facility are subject to the lesser of the amount of the facility or the margin calculated on a forward basis as follows:

75% of accounts receivable less those accounts past due 60 days or over, accounts in dispute, foreign accounts, inter-company accounts, contra accounts, progress billings and any other accounts deemed unacceptable by the Credit Union*.

*NOTE: See Exceptions to Margining Guidelines

Plus

60% of progress billings accounts receivable less those accounts past due 60 days or over, accounts in dispute, foreign accounts, inter-company accounts, contra accounts and any other accounts deemed unacceptable by the Credit Union.

Plus

50% of inventory, at the lower of cost or net realizable value, that is free and clear and not subject to any prior encumbrance or provided on a consignment basis. Total inventory is to be net of trade payables and other prior charges. Inventory that is used for margin purposes is to be comprised of raw materials and finished goods. It is not to include work in progress. The net amount of inventory used for margin purposes is to be capped at (express dollar amount)".

## Exceptions to Margining Guidelines

- It is recognized that it is appropriate to amend the margin when including receivables from major oil and gas companies. In this regard, the margin calculation may be amended to:
    - Include receivables up to 120 days due from national/multi-national major oil and gas companies.
    - Deduct only that portion of the receivable greater than 120 days unless it is determined the account is in dispute, wherein the entire balance should then be deducted.
- The foregoing is subject to the Credit Union retaining on file documentation confirming that the following criteria are met:
    - Company publicly trades on the TSX/NYSE
    - Company records a minimum equity of one Billion dollars
- The supporting documentation is to consist of a copy of the company's audited financial statement plus evidence of being publicly traded on one of the stipulated stock exchanges and is to be updated at minimum on an annual basis.
- All "other exceptions" to standard margin conditions relating to receivables should be accomplished by way of recommendation to the appropriate credit approval authority, accompanied by the following minimum supporting commentary/documentation:
    - What the member's credit granting policies are and whether specific lines of credit are established for existing and prospective creditors

  - The length of time in business of the customer and the experience the member has had with them, as well as confirming there are no hold backs or disputes
  - Equifax report or credit check confirming the credit worthiness of the member's customer
  - Alternatively, or if the above is not available, a copy of the most recent financial statement, together with a brief analysis of the financial position
- All "other exceptions" should be of a short term and temporary in nature (not exceeding two months in duration); otherwise more frequent than annual analysis would be required as part of the ongoing assessment of the Credit Union's security position.

### Security

- Unless the line of credit (LOC) or authorized overdraft (AOD) is relatively small ($5,000 - $10,000) and/or secured by tangible assets (example: registered charge against real estate), security is to include a General Security Agreement (GSA) containing a charge on all present and after acquired property (allpaap) which includes not only receivables and inventory, but also all other assets.
- On an exception basis only, the Security Agreement Covering Accounts and Instruments and Inventory Security Agreement may be substituted, although in doing so, the credit union is relinquishing its priority claim to other assets and the ability to appoint a Receiver Manager.

### Projections

- In the current financial environment a key management tool is a business plan supported by projections.
- The projections developed for the forthcoming fiscal year should be based on a month by month balance sheet position, income statement and cash flow.
- The cash flow will assist in the determination of the working capital needs and the required level of financing. It should also address the need for capital expenditure and the source of funding for those items.
- While it is recognized unforeseen contingencies can occur, the projection provides a map to achieve financial goals and objectives. Throughout the financial cycle rationalized adjustments may be appropriate to respond to the current reality.

### Financial Statements

- Year-end financial statements should be at least "Review Engagement".
- Analysis should be completed to assist the reader in understanding the segments of the balance sheet.
- Full details as to the composition and nature of the assets and liabilities should be provided.
- Explanation and rationale in respect to changes in liquidity and leverage positions that are not evident should be addressed.

- Details to assist in completion of this analysis are outlined in the Commercial Application Completion Guide.
- When providing current asset financing, copy of at least monthly internally prepared financial statements, including balance sheet and profit and loss should be provided for analysis. The results of the interim statements compared with the previous year's results and projections should be completed.
- Any significant deviation of actual results to projections should be rationalized and recommendations made to the approving officer.
- Interim financial statements provide an opportunity to monitor the credit facility for compliance to operating or working capital needs.
- Operating facilities should not be used for capital expenditures.

## Certificate

- Ultimate responsibility for the monitoring of financial performance rests with the member. Accordingly, it is strongly suggested that together with the monthly reports the member provides a certificate confirming that to the best of their knowledge:
    1. All terms and conditions and credit facilities granted by the Credit Union (and other lenders) are in compliance.
    2. Debt to Tangible Net Worth covenant calculated as follows ________ is in compliance (e.g. inter-company debt, intangibles deducted from equity)
    3. Debt Servicing Ratio is calculated as follows _______ is in compliance
    4. Shareholder remuneration is calculated as follows ________is in compliance
    5. The calculation of the margin is as follows:_________
- The advantages of having a certificate signed by the member are:
    - The member completes the calculations and the Credit Union verifies them.
    - It avoids any misunderstanding in respect to the margining position and ratio covenants.
    - It negates the requirement to advise the member should there be a decrease in availability of credit as a result of the margin calculation.
- In all cases, the member must certify that the lists provided to the Credit Union are accurate.
- Rationale in respect to significant differences for actual results compared to projections, collection activity for accounts over 90 days, ratio covenants deviation, as well as other meaningful information should be appended to the certificate provided by the member.

## Ratios

- When current asset financing is being provided, performance criteria (i.e., ratios) should be stipulated and meet at least the industry average with exceptions being well mitigated (e.g. by guarantees).
- The requirement to have appropriate leverage and liquidity positions cannot be over emphasized.

- The ability for the member to be able to absorb a moderate untoward event is a critical component of the overall risk assessment.
- The member must have a stake in the transaction and take a major portion of the risk.
- Members that do not have sufficient tangible equity in their operation have little strength to manage through a major financial challenge.

## Fixed Assets to Support Operating Facilities

- Using fixed assets to support operating facilities, except for background support and small credit lines is generally discouraged for the following reasons:
    1. Working capital deficit positions should be funded by term loans supported by capital assets. Such loans will be subject to normal lending values and repaid within the life of the asset.
    2. It is normally inadvisable to use a depreciating asset to support an operating facility. As the value of the security goes down the availability of the facility remains unchanged and according risk increases.
    3. An important element of margining the position when providing current asset financing is the ability to monitor the borrower and the related financing activities. In situations where margining is not in effect as a result depreciating assets being provided as security this element of monitoring is normally not available.
    4. Fixed assets provided as background support normally provide the necessary comfort to make the financial arrangement acceptable.
    5. Exception – Agriculture accounts where lending against grain inventory is discouraged. In this case, fixed assets may be the primary security.

# Business Succession Planning

A good succession plan ensures the owner or shareholders have given thought to an exit plan that will be beneficial to all involved. It will provide for family, for management, for employees, and prepare for a smooth transition in ownership.

Having employees operate the company may be sufficient for its continuity in the short term; however, if the management component is not predetermined and planning to ensure adequate funding is in place to complete the financial goals, the continuity of the company could be jeopardized. The goal is to see an orderly transition, to realize the full value of the company and not selling for the wrong reasons.

If the intent of the owner is to keep the business in the family, determining if the family wishes to keep operating the company and maintain jobs in the company is key. Who is going to operate the business and in what capacity? What will be the compensation for those family members not participating?

There are some basics to the approach taken in the planning such as:

Discuss your plan with your lawyer, your accountant and other key financial planning/estate planning professions.

1. Let others, such as your family and the management team, know your general details to avoid any surprises and eliminate any concerns.
2. Identify your successor early in the process and get them familiarized with the business. This may take years.
3. If the succession plan entails business partners, an agreement on how the business will shift, or perhaps a buy-sell agreement should be in place.
4. While a buy-sell agreement can ensure the business will stay with family or business partners, life or disability insurance should be considered as well. It may provide adequate funds to fulfill the commitment of the agreement.
5. Once established, your plan should be reviewed periodically and changed immediately if a major event, whether personal or business, has occurred (e.g. divorce, marriage, etc.).

Whether for continuity or for an orderly exit (i.e., avoid a forced sale), a well thought out business succession plan should be in place. It should be in place whether you are young and the business is new and most certainly well in advance of retirement. Too often business succession plans are not given consideration due to the age of the owner and this can be detrimental to the business and family if a personal life change/event occurs. In addition, too often it is thought that family will take over when in actuality there is no desire to do so.

For lenders dealing with business accounts it is not sufficient to simply ask if a business succession plan is in place. The discussion with the owner/key managers should entail addressing the basics of succession planning with the intent that they will pursue the implementation of a plan within a reasonable time.

# 5. BUSINESS LENDING – COMMERCIAL

# Commercial Loan Types

For all commercial loan types, appraisals over machinery, equipment or real property are to be completed by qualified independent evaluators/appraisers.

### Construction Mortgage

- To assist with the construction of condominium projects, commercial and residential builder/developer projects.
- Security is by way of a mortgage representing a first charge over land and buildings and GSA.

### Term Loan

- To assist with short term lending (i.e., subdivision financing, equipment, machinery, etc. - 1 to 7 years).
- To be scheduled to be repaid within the expected useful and economic life of the asset(s) securing the loan.
- Term loans for equipment should generally be repayable over 3 - 7 years (always within the useful and economic life of the asset).
- Where a government guarantee or insurance is considered the term may be increased; however, the applicable guidelines for the program are to be followed.
- Repayment to be monthly blended payments of principal and interest with less frequent payments granted on an exception basis where revenue is less frequently than monthly. Interest payments must not exceed intervals of 3 months or such longer period as prescribed in Credit Union (Ministerial) Regulation Section 14.
- The credit union may choose, at its option, to set up on a blended or principal plus interest basis.
- Security generally taken by way of General Security Agreement or mortgage and GSA.

### Mortgage

- To assist with the construction of a project or purchase of new or existing building and land.
- To be scheduled to be repaid within the expected useful and economic life of the asset(s) securing the loan.
    - Term of 1 to 5 years and amortization of 15 to 20 years subject to industry type guidelines.
- Repayment to be monthly blended payments of principal and interest with less frequent payments granted on an exception basis where revenue is less frequently than monthly. Interest payments must not exceed intervals of 3 months or such longer period as prescribed in Credit Union (Ministerial) Regulation Section 14.
- Security is by way of a mortgage and GSA.

### Related Guideline

Commercial Real Estate Lending Overview

# Change of Business Ownership

Generally financing should be limited to businesses that have historically demonstrated successful operations with satisfactory financial results and are projected to remain successful under the new ownership.

Occasionally and possibly due to poor management, a business that has historically performed poorly and is being sold, may under new ownership operate successfully. Consideration can be given to financing the purchase if projections for the business are reasonable for the type of operation and/or new management has the skill and acumen to bring the operation to a profitable position.

### Terms and Conditions

Conditions Precedent

1. A copy of the Purchase Agreement executed by both buyer and seller is to be obtained, together with copies of all Bills of Sale transferring title over all machinery, equipment, and other chattels.
2. Where real estate is involved, a copy of the Transfer of Title and new Land Titles Certificate are to be obtained.
3. If the sale involves or is limited to the purchase of company shares, it is prudent for the credit union to involve legal counsel to review all agreements and provide an opinion on the new corporate structure (i.e., shareholders, directors, details of all outstanding common and preferred shares) as set out in the company's Minute Book.
4. Caution should be exercised when giving any value to "goodwill"; does not normally have value.
5. Business plan and projections for the new operator supported (if available) with financial statement from the previous operator/vendor.
6. Personal financial statements of guarantor(s).
7. Satisfactory credit investigation of the borrower and guarantor(s).
8. An offer of financing is to be issued to the member, acknowledged by the company as well as all the guarantors.

Ongoing Conditions

- Borrower's yearend financial statement provided annually within 90 days of fiscal year end.
- Personal financial statements of guarantor(s) obtained at a minimum every two years.
- Satisfactory credit investigation of the borrower and guarantor(s).
- Financial performance of the borrower shall be maintained at an acceptable level as confirmed through borrower risk rating.

Loan Type

- Term Loan
- Mortgage amortization of up to 15 - 20 years; subject to a 1 - 5 year term based on useful economic life and obsolescence factors.

## Loan Amount/Financing Levels

Equipment

- Equipment should be limited to 50 - 75% (depending on age, condition, marketability, etc.) and based on independent valuations.
- For competitive reasons where a General Security Agreement is held consideration can be given to advancing up to 80%.
- Where financing is under a government guarantee or insurance program, a higher level of financing can be entertained depending on the program guidelines and/or limitations of the underlying guarantee.
- Tools, miscellaneous shop equipment, computers, etc. are considered to have nominal value for lending purposes, and if a lending value is to be entertained, it should be restricted to 25 - 35%.

Land/Buildings/Improvements

- Loan to value ratio should generally not exceed 65% of the appraised value as determined within the preceding 6 month period, with the primary consideration to be the income approach to value.
- Normal lending values should be suitably reduced where single purpose or owner-occupied buildings are involved.

## Loan Security

- Mortgage representing a first charge over land and buildings.
- Assignment of leases and rents registered on title via caveat.
- Registered GSA providing a first charge over equipment and personal property as it relates to this specific project.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrowers Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.
- Personal/Corporate Guarantees of the shareholders/investors.
- Adequate insurance coverage over buildings and/or equipment must be evident/in place.

# Community Service Lending

- The Alberta Gaming and Liquor Commission (AGLC) licenses and manages charitable gaming activities in Alberta (bingo, casino, raffle, and pull ticket events).
- Gaming activities may only occur when eligible charitable or religious groups apply for and receive licences to conduct the gaming activities.
- Financing should be restricted to existing members on an event by event basis.

### Terms and Conditions

Conditions Precedent

1. Advances to allow applicants to bankroll a casino/bingo night are to be supported by a "No Loss" Agreement from the licensed operator which is to be assigned to the credit union.
2. In these types of loan situations, the lending officer should be satisfied that proper security procedures are in place regarding transporting of funds to and from the credit union.

Ongoing Conditions

n/a

### Loan Type

- Demand loan

### Loan Amount/Financing Level

- As applicable per event consistent with any guidelines that may be established by the AGLC.

### Loan Security

- The credit union must satisfy itself that the operator has a good reputation and the financial capacity to honour a "No Loss" Agreement as confirmed through AGLC.
- Failing the "No Loss" Agreement, personal guarantees of the service club executive officers will be required if such are considered to provide adequate value and support.

# Equipment

- Equipment loans generally represent an acceptable risk. Where specialized equipment is involved the risk can be higher; however, either additional tangible security or a reduced level of financing should be considered to mitigate the risk.

### Terms and Conditions

Conditions Precedent

- Borrower's yearend financial statements for the latest three year ends (if in business for at least 3 years) and projections (if new direction is being taken or additional equipment being purchased that will affect/increase revenues).
- Personal financial statements of guarantor(s).
- Satisfactory credit investigation of the borrower and guarantor(s).
- List of equipment with current values from a reliable source provided.
- Bill of Sale for new equipment.
- A Commitment Letter is to be issued to the member, acknowledged by the company as well as all the guarantors.

Ongoing Conditions

- Borrower's yearend financial statement provided annually within 90 days of fiscal year end.
- Personal financial statements of guarantor(s) obtained at a minimum every two years.
- Updated list of equipment with current values.
- Satisfactory credit investigation of the borrower and guarantor(s).
- Financial performance of the borrower shall be maintained at an acceptable level as confirmed through borrower risk rating.

### Loan Type

- Term loan

### Loan Amount/Financing Levels

- New Equipment:  limited to a maximum of 65 - 75% of cost (depending on the type and confirmed marketability). For competitive reasons consideration can be given to advancing up to 80%.

- Used Equipment:  50 - 60% based on an independent evaluation (by a recognized/approved equipment appraiser, dealership, or auction company) confirming current market value.

- Where financing is under a government guarantee or insurance program, a higher level of financing can be entertained depending on the program guidelines and/or limitations of the underlying guarantee.

- Normal lending values should be reduced to 50 - 60% where specialized equipment (i.e., delimbers, drilling rigs, lathes, cranes, etc.) are financed or where specialized equipment mounted as an accession (i.e., picker units, testing units, power tongs, etc.) are financed.
- Tools, miscellaneous shop equipment, computers, etc. are considered to have nominal value for lending purposes, and if a lending value is to be entertained, such should be restricted to 25 - 35%.

### Loan Security

- A General Security Agreement is preferred, although a Specific Security Agreement (*For All Indebtedness)* may be considered on an exception.
- For government guaranteed loans, it is advisable to specifically charge the asset(s) taken as security for that facility under a separate Specific Security Agreement regardless of whether or not a GSA is already in place.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrowers Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.
- Adequate insurance coverage must be evident/in place.

# Hospitality Industry Financing

## Overview

- This industry includes a broad category of fields that includes accommodation (hotels, motels, bed and breakfast enterprises, etc.) and food service (restaurants, fast food chains, etc.).
- Loans to this industry represent "above average risk" and caution must be exercised when entertaining financing.
- It is important in all markets for the credit union to consider its concentration as it relates to both number of facilities and number of rooms in the service/market area.
- The Corporation has established the level of exposure for accommodation at a maximum cap of 15% of the credit union's combined commercial/agricultural portfolio and a maximum cap of 5% for food service. The credit union Board may adopt a lower risk appetite.
- The credit union is to provide a recap of all accommodation or food service loans, including approved but not yet funded facilities, with all new financing requests. A hospitality recap should include the following:
  - Detail of all loans granted to this industry
  - The name of the member
  - Location of restaurant
  - Location of hotel/motel
  - Number of units
  - Appraised value and date
  - Amount authorized and amount outstanding
  - Aggregate loans should be shown as a percentage of the credit union's total commercial/agricultural portfolio and be within parameters set both by the credit union and the Corporation
  - Aggregate percentages are to be recorded separately for accommodation and food services facilities

## Accommodation

| Guideline | Comments |
|---|---|
| *For the purpose of this guideline, the CU Market area is an area within 100KM of a credit union branch.* (The credit union may define their market in a different way). | |
| **Prime Market**: Franchised hotels less than 10-years old in the **CU market area*** | • *Standard* maximum loan-to-value 65% (lower of cost or appraised value)<br>• *Exception* maximum loan-to-value 70%, where mitigated and subject to exception approval authority |

| | |
|---|---|
| **Secondary Market**: Franchised hotels more than 10-years old in the **CU market area*** | • *Standard* maximum loan-to-value 60% (lower of cost or appraised value)<br>• *Exception* maximum loan-to-value 65%, where mitigated and subject to exception approval authority |
| Tertiary Market: Non-franchised hotels and motels outside the CU Prime or Secondary market | This recognizes the increased risk of non-franchised hotel operations, particularly where located outside the credit union's core market service area:<br>• *Standard* maximum loan-to-value 50% (lower of cost or appraised value)<br>• *Exception* maximum loan-to-value 60%, where mitigated and subject to exception approval authority |
| Recreational Vehicle Parks and Work Camps | Accommodation financing conditions will apply; however, each case is to be assessed on an individual basis. |
| Extended Risk – To Be Addressed | Accommodation financing is typically completed on a project by project basis; however, a global risk assessment covering all properties, is required. |
| Financial Ratios | Debt Servicing: ≥ 1.40X<br>Debt to Equity: ≤ 2:1<br>Adherence to these ratios is considered to be indicative of an acceptable financial structure. |
| Renovated Properties | In instances where appraisal income includes cash flow from improvements, the incremental cash flow should be treated conservatively. This may also result in a lower manager's valuation. |
| Credit Union's Loan Maximum | The Board should establish a maximum risk appetite for individual or connected loans within this industry, which may be lower than the credit union's loan maximum as per Credit Union (Principal) Regulation 54(1). Any excess must be syndicated, with the syndicate partner committing in advance of funding. |

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| Capital Expenditure Restrictions | Maximum CAPEX covenant is required to control expenditures relative to cash flow, without lender approval. There may alternatively be a minimum CAPEX covenant to promote a regular planned improvement program. Should CAPEX be lower than required to maintain the hotel, the short fall may be transferred to a CAPEX reserve. |
| Financing Outside The Province | a. Financing out of province should be restricted to existing relationships.<br>b. Extra-provincial financing is subject to liquidity, capital and non-member requirements and where allowed, on a participation basis with a local financial institution acting in a syndicate lead position. |
| Cash Equity | Equity is to be in the form of cash and existing land/buildings at market value, with appropriate controls in place to restrict payback to shareholders/related parties until a sufficient period of proven financial results is evident. Other equity formats will be considered on an exception basis only. |
| Equity Withdrawals | a. Financing requests to further leverage new or renovated projects to provide equity withdrawals are not to be considered without a minimum of 3 successive years results (confirmed via Review Engagement financial statements) demonstrating acceptable financial performance.<br>b. Repayment to shareholders/related parties from cash flow should not be unduly withheld provided there is acceptable financial performance (see bullet a above) and withdrawals are contained within covenant adherence. |
| Management | Preferably the owners are involved in management of the enterprise and should have an acceptable level of experience in the industry. Management ability is a critical success factor in hotel operations. The Management Information System should provide sufficient reporting to monitor monthly hotel operations. |

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| VLT (Video Lottery Terminal) Income | VLT income, if included in Funds Available for Debt Service (FADS), to a maximum 25% of total cash flow and subject to assessment for reasonableness, as it may be volatile year to year; consider using the lowest or average of the last 3 years VLT income.<br>The ratio of VLT revenue to accommodation revenue should be reviewed when considering its contribution to NOI. A ratio of more than 25% VLT revenue may be an indicator of potential concerns with the stability of the hotel operation<br>If historical VLT income is not applicable, treat on a conservative basis. |
| Official Gaming Room | Official Gaming Room income could be considered an exception to the 3 year income requirement for VLTs and should be assessed on a one-off basis. |
| Construction Loans | Requirements under the Construction Loans/Residential Builder Mortgages guideline apply. |
| Funding for Furnishing and Soft Costs | Funding for furnishings and soft costs, if financed, are to be disbursed against paid invoices (or confirmation of payment) or direct payment, as the case may be. |
| Environmental | Requirements under the Environmental Risk guideline apply. |
| Engineering Report | Financing of properties over 10 years old: a satisfactory engineers report is to be obtained confirming structural (including roof), mechanical and electrical system integrity. The credit union should complete a site visit. |
| Franchise | Where the accommodation enterprise is to be affiliated to a national/international franchise, a copy of the Franchise Agreement is to be obtained. |
| Government Guarantee Financing | Financing under an established program must be within the program guidelines. |

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| Offer to Purchase | An Offer to Purchase for the property is to be provided and the owner's total equity is to be invested in the project and confirmed prior to any advances by the credit union. |
| Appraisal | a. An appraisal, preferably by a hotel valuation company, supported by an appropriate feasibility study is to be obtained. The feasibility study is to provide a full analysis of the market area, competition and detailed data as to occupancy levels of the existing competition and that expected for the new project.<br>b. The credit union should critically review the appraisal and determine a manager's value based on an analysis of cash flow and an appropriate CAP rate. Management should also review the appraisal sales comparisons relative to like conditions and sale date. |
| Commitment Letter | A Commitment Letter is to be issued to the member, acknowledged by the company, as well as, all the guarantors. |
| Ongoing Conditions | a. There can be no change in ownership (shareholders of the company or sale of partnership interests) without the credit union's prior written consent. This condition is to be acknowledged by the borrower at the outset.<br>b. Annual accountant prepared Review Engagement statements are to be provided within 90 days of yearend.<br>c. Quarterly in-house financial statements are to be provided within 30 days of quarter end. Covenant adherence should be reviewed at least quarterly.<br>d. Annual Franchisor (inspection) report and customer satisfaction reports, if available. |

## Food Services

| Guideline | Comments |
|---|---|
| Recognized Franchise Operations | • Maximum loan-to-value 75%.<br>• This refers to national franchise operations (e.g., A&W, McDonalds, etc.), where there may be an applicable lease buy back by franchisor and where generally the |

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| | risk is related to the franchise name. Those that are well recognized usually carry less risk. |
| Non-franchised Restaurants – Buildings | • Maximum of loan-to value 60%.<br>• Care must be exercised to ensure that the building does not have a limited use. |
| Non-franchised Restaurants – Other Assets | These should be financed or supported by tangible outside security (e.g., mortgage security over personal residence) or under government guaranteed financing, which must be within the established program guidelines. |
| Financial Ratio | Debt Servicing: ≥ 1.40X<br>Debt to Equity: ≤ 2:1<br>These financial covenants provide for an acceptable position to cover moderate unforeseen financial setbacks. |
| Working Capital Loans | These should not be entertained. This is a cash related business and there should be no need for working capital loans. |
| Management Assessment | Management ability is a critical success factor in restaurant operations. The borrower should have proven management expertise with the owners having sufficient tangible net worth to inject funds into the operation, if required. |

### Total Industry

| Guideline | Comments |
|---|---|
| Loan Type | a. Term Loan<br>b. Mortgage: the *standard* amortization period is not to exceed 15 years; however, on an exception basis, amortization may be extended for new construction in prime markets.<br>c. Government guaranteed financing where applicable. |
| Loan Security | a. Loan advances are to be secured by a registered first mortgage charge over the property.<br>b. A General Security Agreement is to be provided and registered at PPR. |

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| | c. An Assignment of Rents supported by a registered caveat is to be obtained.<br>d. Guarantees from all shareholders, preferably in "unlimited"/or full covering format are to be obtained. On an exception basis, consideration will be given to accepting guarantees which provide an aggregate coverage of at least 50% of total financing. Full covering guarantees should be obtained for food service operations. Exceptions may be applicable for government guaranteed financing which may restrict the level of available guarantee.<br>e. Formal Assignment and Postponement of Shareholders Loans registered at PPR and the borrower's accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.<br>f. Adequate insurance coverage must be evident/in place.<br>g. Government guarantee documentation, as applicable. |

### Related Guidelines

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| Higher Risk Loans | Environmental Risk |
| Construction Loans/Residential Builder Mortgages | Formal Assignment and Postponement of Shareholder Loans |
| Guarantees | Forms and Documents |
| Insurance Coverage | Syndication of Loans or Loan Participation |

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Loans to Professionals

Advances of up to $150,000 will be considered on a reduced security basis for recognized professionals (i.e., doctors, dentists, lawyers, and accountants) to assist with the establishment or financing of a practice, to pay off personal debt and/or student loans. Consideration must be given to the worth/value of the practice to ensure that it warrants loan(s) at the requested level or that the covenants of the guarantors offer reasonable support.

### Terms and Conditions

Conditions Precedent

- Business plan and projections (if new direction is being taken or additional equipment being purchased that will affect/increase revenues) for the new professional corporation.
- Personal financial statements of guarantor(s).
- Satisfactory credit investigation of the borrower and guarantor(s).
- A Commitment Letter is to be issued to the member, acknowledged by the company as well as all the guarantors.

Ongoing Conditions

- Borrower's yearend financial statement provided annually within 90 days of fiscal year end.
- Personal financial statements of guarantor(s) obtained at a minimum every two years.
- Satisfactory credit investigation of the borrower and guarantor(s).
- Financial performance of the borrower shall be maintained at an acceptable level as confirmed through borrower risk rating.

### Loan Type

- Term Loan

### Loan Amount/Financing Levels

- Advances up to $150,000.

### Loan Security

- General Security Agreement.
- Where financing is to be made to a professional corporation, the personal guarantee of the principal is to be taken.
- Where financing is to the individual practising under the professional corporation, the guarantee of the corporation supported with a GSA should be taken to connect the professional income to the debt.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrowers Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union

# Operating/Revolving Credit

## Lines of Credit/Authorized Overdrafts

- The most common application is to provide operating credit facilities by way of authorized overdraft (AOD) through the deposit system. The Overdraft Protection Agreement does not specifically require revolving of the credit facility. Interest is payable monthly.
- Lines of credit (LOC) generally contemplate a revolving multiple and are advanced under the loan origination program.
  - Revolving of the credit facility is required.
  - Interest is payable monthly.
- As a general guide, financing inventory and receivables should not be entertained in isolation, but rather as part of an overall financing package including machinery/ equipment, real estate, etc. Inventory and receivables are classified as "moving" or fluctuating assets, which represent a higher risk to the lender.

## Monitoring

Successful management of business loans and accounts requires a consistent approach to monitoring the various financial trends, one of the most important being the margining of the maximum allowable advances at any given time under an authorized operating facility.

Unless the line of credit (LOC) or authorized overdraft (AOD) is relatively small ($5,000 - $10,000) and/or secured by tangible assets (e.g., registered charge against real estate), security is to include a General Security Agreement (GSA) containing a charge on all present and after acquired property (allpaap) which includes not only receivables and inventory, but also all other assets.

## Related Guideline

Current Asset Financing

# Public Sector Lending

- Public sector lending, including loans to municipalities, school boards, and health authorities/hospital districts, is encouraged and maybe a good source of referral business.
- The legislation governing the borrowing by these entities is complex and care should be taken to ensure proper procedures are followed and proper documentation is obtained along with reference made to the credit union's solicitor.
- The maximum allowable borrowing by legislation must be reviewed when considering this type of lending.

### Terms and Conditions

Conditions Precedent

- Copy of bylaw/resolution to be obtained prior to any advance of funds.

Ongoing Conditions

- Audited statements to be provided within 90 days of year-end.
- Deposit accounts to be held at the credit union.

### Loan Type

- Operating Loan - AOD/LOC
- Term Loan
- Mortgage

### Loan Amount/Financing Level

- To be consistent with the guidelines set out in the applicable legislation.

### Loan Security

- Financing of this sector is usually limited to a general operating facility secured by a formal Resolution/Bylaw, financing current expenditures, and/or capital expenditures. A General Security Agreement should be taken.

## Typical Commercial Member Profile

A typical commercial member would fit within the following profile.

- Privately owned companies
- Acceptable internal management information systems (MIS) - capable of providing monthly/quarterly and annual financial information
- Proven management skills and ability
- Satisfactory earnings/cash flow record
- Cash flow from specifically identified sources to represent the primary source of repayment with realistic recovery values of pledged security providing a secondary source of repayment in the event of default
- Regular monitoring of company performance and trends available by way of:
    1. monthly/quarterly interim financial
    2. periodic plant/site visits with frequency dictated by the type of assets financed and nature of business
    3. full annual review (preference given to auditor-prepared financial statements on a Review Engagement basis, albeit a Notice to Reader format may be conceded in certain circumstances)
    4. independent asset valuations obtained where warranted
    5. ongoing qualitative analysis of receivables and payables (generally monthly where accounts receivable and/or inventory is margined in support of an operating loan)
- The security offered is environmentally acceptable.

# 6. BUSINESS LENDING – COMMERCIAL REAL ESTATE

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Commercial Real Estate Lending Overview

The following summarize the Corporation's directions and objectives in real estate lending activities.

- New credit union real estate financing (excluding residential mortgages) should be directed into good quality commercial revenue and/or owner occupied properties (i.e., apartments, office/warehouse buildings, shopping centres, etc.) providing prudent lending practices and guidelines are followed.
- Construction/project financing loans should only be entertained where the credit union would be comfortable in providing the long term financing of the asset following completion.
- While the credit structure may provide for pooled security and servicing arrangements, the source of cash flow requires careful analysis to ensure each pledged property is self-supporting on a standalone basis, servicing its respective debt without reliance on general corporate cash flow and/or extraordinary income.
- Mortgage security is to be provided in preference to an Encumbrance Agreement - Memorandum of Charging Lands unless a prior mortgaged interest is held by the credit union.
- A secondary charge can be contemplated (i.e., a second or third position charge) if the credit union has the prior charges. With a secondary charge behind another lender, the credit union is technically "guaranteeing" the prior charge(s) to retain its secured interest in the event of default/foreclosure.
- All mortgage loans must meet the "quality mortgage loan" definition. If financing is for commercial (including residential revenue properties) or agricultural real estate and is in excess of 75%, minimum criteria must be met.
- Prior to financing consideration on an existing revenue property that is not known to the credit union, a site visit is warranted
- Lending against revenue properties should generally be limited to 1-5 year terms; the amortization should be limited to 15-20 years.
- Mortgage financing over undeveloped raw land should only be considered to a maximum 50% loan to value for established relationships, with a proven history of successfully developing the type of property financed and where the property will be developed within a short period, such as two years. If the property is not developed within the expected time frame, a short extension could be considered or the loan placed under monthly repayment with a maximum 10-year amortization. Risk mitigation options include obtaining a mortgage interest in additional property that would provide cash flow support through sales or operations that would cover the secondary repayment.
- Lending conditions should generally prohibit or restrict subsequent charges against the mortgaged properties in order to permit maximum flexibility to the credit union in the event of difficulties and/or provide for re-advancement.
- Mortgage financing of a partial interest in a property title (i.e. an undivided half interest) or a mortgage interest not signed by the parties registered on title as tenants in common or joint

tenancy should not be entertained. The credit union must have an effective and absolute claim (100%) against the property.

- Environmental risk must be addressed for all commercial and agricultural properties, as well as, residential, where applicable.

### Sensitivity Analysis

- Debt service capacity is to be based on use of the Credit Union's posted 5-year fixed residential or commercial mortgage rate, as to the type of property being financed.
- For commercial borrowing, risk analysis will include an interest sensitivity analysis that indicates the borrower produces sufficient cash flow (i.e., DSCR 1.00X or better) to meet scheduled payments using incremental basis point increases to the current 5-year fixed interest rate.

### Total Commercial Real Estate

- Total Commercial Real Estate (TCREA) includes commercial real estate, construction and hospitality; loans are considered to have a higher level of inherent credit risk. The loans are typically large exposures and on an aggregate basis, can represent in excess of 50% of the credit union total non-consumer loan portfolio. The loans are financed over an extended repayment period of 15 to 25 years, encompassing several business cycles. Although secured by tangible real property, asset values can be volatile relative to changes in income during challenging economic periods and due to changes in CAP rates, caused by changes in market interest rates.

### Monitoring

- TCREA loans require experienced credit union staff (lenders, credit and special debts management) to complete a comprehensive risk analysis, support monitoring through the life of the loan and direct appropriate action to address delinquency and collection issues.
- The credit union's Credit Risk Management Policy must have Board approved aggregate exposure limits, based on available capital, for TCREA and each component. The Board limit, evidencing their risk appetite for this higher risk industry financing, should be based on the credit union risk framework, risk characteristics, environment and risk management capabilities. Aggregate exposures should be reported to the Board at least quarterly and compared to the risk limits.

### Related Guideline

Commercial Loan Types

# Condominium Development Financing

- Experience of the members in completing such a project is paramount and if they had no prior experience, the project would need to be overseen by a reputable engineer.
- Appraisal required to show the "as is" value of the property and include a feasibility study addressing the absorption rate in the specific area covering the past five years and expectations over the next several years.
- Full details of competitor projects in the area is necessary. Appraisers must address comparable projects and advise whether it is feasible for all units on the market to be sold in a reasonable period of time.

### Terms and Conditions

<u>Conditions Precedent</u>

- Executed commitment letter.
- Detailed PNW financial statements from all guarantors/investors with acceptable Credit Bureau investigations on each.
- Completion and registration of all security.
- An original current Real Property Report of the property with compliance certificate thereon or Condominium Plan and Bylaws.
- Appraisal over property from a credit union approved appraisal firm confirming "as is" value of land and market value of the condominium units as supported by an acceptable feasibility study.
- A current Phase I Environmental Assessment or Phase II as required from a credit union approved Environmental Engineering Firm.
- A list of all investors in the project.
- Opening balance sheet prepared by the borrower’s accountant confirming the shareholders/investors investment representing a minimum equity percentage (normally 35% minimum) of the cost "as is" of land and fixed price construction contract.
- Evidence of percentage (generally 50%) pre-sales of units being constructed indicating a minimum aggregate gross selling price. All pre-sold units are to be unconditional and are to be accompanied by a minimum 10% deposit from all arm’s length purchasers with a 15% deposit from any of the investors. Deposits to be non-refundable and will be held by the credit union's solicitor "in trust" for the credit union for application as permanent pay down on the construction loan.
- A copy of the fixed price contract from a bonded contractor.
- Evidence that all Municipal regulatory requirements have been met/approved (i.e., building permits, etc.); and Engineer’s written confirmation that construction is completed in accordance with all approved plans and specifications.
- Evidence of approval of the finalized plans by the local Municipal authority.
- Approval of the Condominium Association By-laws by the credit union and their solicitor.

- Assignment of called for Life Insurance coverage or waiver, as agreed to by the credit union, to be completed by the Guarantors/Investors.
- The borrower is to be a legally incorporated entity properly identified prior to any advances.
- Bank of Canada, WCB and Title searches before funding and WCB and Title searches before each advance confirming no registrations by other creditors.
- Solicitors letter of opinion confirming the validity and enforceability of credit union's security.
- Funding/Advances will be completed on a "Cost to Complete Basis" after review/confirmation of the overall costs and inspections prepared by the credit union's assigned Chartered Quantity Surveyors & Project Cost Consultants or acceptable Engineering firm at the cost of the borrower.

Ongoing Conditions

- Provision of the Condominium Plan and compliance certificate confirming no encroachment.
- Partial discharges are to be provided on each condominium unit subject to applying 100% of the net sale proceeds (net of the arm’s length real estate fees only) as a permanent reduction to the outstanding construction mortgage.
- All security documentation shall be prepared and registered by the credit union's solicitor at the cost of the borrower.
- The borrower is responsible for payment of all GST.
- Construction overruns are the responsibility of the borrower and are to be covered at the time they occur from the borrower’s own sources before the next draw advance will be considered.
- Title must be satisfactory to the credit union's solicitor.
- The credit union solicitor is to confirm that the credit union mortgage represents a clear first charge and that any restrictive covenants on title will not affect its first registered position.
- All advances are to be funded through the borrower's solicitor who will be responsible for controlling the applicable Builders Lien Fund.
- Annual review
    - i. Financial statements in a "Review Engagement Format" provided to credit union within 90 days of company’s yearend.
    - ii. Annual evidence of insurance coverage/renewal.
    - iii. Annual evidence of property tax payments.
    - iv. Updated Guarantor financial statements as required.
- Appropriate signage may be displayed by the credit union.

### Loan Type

- Construction Mortgage

### Loan Amount/Financing Levels

- Advances to assist with construction will not exceed 65% of cost of construction and land as evidenced by fixed price contracts and offer to purchase or appraised "as is" value of land.
- Any other level of financing entertained will need to meet the minimum criteria.

## Loan Security

- Mortgage representing a first charge over land and buildings.
- Assignment of leases and rents registered on title via caveat.
- Registered GSA providing a first charge over equipment and personal property as it relates to this specific project.
- An assignment of all construction contracts, plans, permits and other approvals as deemed necessary by the credit union's solicitor.
- Assignment of Builders All Risk Insurance during construction with evidence of adequate Liability Insurance being carried by the borrower.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrowers Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.
- Personal/Corporate Guarantees of the shareholders/investors.

# Construction Loans/Residential Builder Mortgages

## General Requirements Applicable to all Construction Loans

- The overriding factor for this type of lending is to emphasize the location, project quality, and track record of the builder/developer.
- This type of financing should only be entertained where the credit union is prepared to carry the longer term financing or a recognized institution has provided a firm take-out commitment.
- There must be a reasonable expectation of meeting all completion financing commitments.
- The financial viability of the project must be achievable, based on realistic projected income (or historical alternative cash flow) with sufficient debt service capacity, to support the completion financing under standard mortgage terms & conditions.
- The builder/developer must have the confirmed ability to complete the project as evidenced by current financial information, an established track record, satisfactory business reputation/integrity, and the financial resources to supplement debt servicing, if required.
- Liquidity, cash flow, ability/willingness to bring in additional investors should be addressed as potential sources to cover cost overruns, interest carrying costs, etc.
- "Relationship banking" is encouraged opposed to entertaining project financing in isolation for builders/developers whose primary banking is maintained with another institution.
- Projects should be in locations with good visibility/demand as supported by an appraisal and/or market feasibility study. Construction loans outside the credit union market service area should only be considered under a syndicated loan facility with a local lender as lead to monitor construction. Construction loans outside the Province should be considered only under very exceptional situations to established members.
- The builder/contractor must be reputable, prepared to enter into a fixed price contract, or alternatively, a cost plus contract with a guaranteed maximum price, and is bondable.
- An outside cost consultant/engineer should review the plans, specifications, and budgets for the credit union in situations where the developer/borrower is also the general contractor.
- A geotechnical or soils report, adequate to support new improvements provided by a qualified outside engineer may be required.
- A current environmental assessment pursuant to the Environmental Risk Lending Guideline is to be obtained.

## Terms and Conditions

Conditions Precedent/Pre-disbursement

- All hard and soft costs (including interest reserve, fees, etc.) are to be set out in a construction budget with funding identified either by way of cash equity or allocations under the loan advances. **Note:** All cash equity must be injected and utilized to cover costs-to-date prior to any construction loan draws. *The only exception to be considered would be for easily identifiable future sources of funds, such as maturing investments, net sale proceeds from a confirmed sale of other assets, etc. subject to the credit union securing a registered claim against these assets.*

- Major cost items must be supported by firm written quotes prepared by known/reputable suppliers.
- The interest reserve category or cost item under budget should be *conservatively* established and reflect the proposed period of construction plus the anticipated leasing/sales absorption and time frame.
- The loan term will in most cases be limited to the period of construction only (typically 12-months) while an additional period of up to 6-months may be allowed to stabilize income.
- An independent appraiser (preferably with an AACI designation, although a CRA can be accepted for residential property appraisals for single family units up to a four unit building), must appraise the project (as if completed) utilizing cost, market, and income approaches.
- The appraisal is to address the feasibility of the project and must reflect current market criteria (rents, vacancy rates, operating costs, interest rates and cap rates) without consideration for "future values" based on unproven market considerations.
- The appraisal report must be acceptable for mortgage lending purposes and prepared for the credit union based on the guidelines for appraisals as established by the Appraisal Institute of Canada. If not prepared for the credit union a transmittal letter from the appraiser is required.
- Unless long term completion financing has been approved as part of the construction approval, alternative take-out commitments are to be in place and acknowledged assignments held by the credit union.
- Conditions precedent to take-out funding are to be satisfied prior to any credit union funding.
- It is recognized that some conditions cannot be satisfied prior to funding occurring (lease achievement, completion of construction, etc.); however, the credit union is to satisfy itself that these conditions can be reasonably achieved in the current marketplace.
- The wording and preconditions of a take-out commitment are to be acceptable to the credit union, as well as, the reliability and integrity of the long-term lender, and will preferably be assigned to the construction loan through a Tri-party Agreement where this can be negotiated. In any event, all conditions of the take-out which can be reasonably met should be confirmed throughout the various stages of the project development.
- Where there is no pre-arranged take-out, a combination of substantial cash equity and arm's-length pre-sales or pre-leasing sufficient to substantiate the viability of the project must be present.
- In the case of commercial projects, pre-sales of a minimum of 50% of the units (supported by meaningful deposits held by a solicitor on behalf of the credit union; 10% to 15% down payment for arm's length transactions and 20% down payment for non-arm's length transactions) sufficient to retire in excess of 60% of the construction mortgage loan or pre-lease rentals sufficient to cover interest servicing upon completion would be considered acceptable.
- Regardless of the intended disposition of the project (i.e., sale or lease), the loan must be limited to the amount supported under standard debt service covenants.

- All municipal approvals including building permit/development agreement, Provincial/ Federal environmental approvals, etc., necessary to the development must be confirmed to be in place prior to any funding.
- Confirmation of the approved financing is to be extended by way of a formal commitment letter issued by the credit union and acknowledged by the borrower plus all guarantors.
- Prior to any disbursement being made, the credit union is to confirm the member's equity has been placed into the project.
- The credit union must request and obtain a Solicitor's Letter of Opinion and a copy of the Land Titles Certificate upon registration of the mortgage. The letter of opinion must confirm that:
    a. The mortgage represents a valid and enforceable first charge over the property in favour of the credit union. **Note:** *Solicitors who prepare and register mortgage security for a lending institution in Alberta must include the wording "valid and enforceable first charge" in the opinion letter and not "good and marketable".*
    b. All property taxes are current/supported by a tax certificate.
    c. Property boundaries, buildings, etc. are as represented/supported by a Real Property Report (surveyor's certificate). In the event a real property report is not obtained, it will be necessary that the credit union carry Survey Impairment Insurance Coverage.

<u>Ongoing Conditions</u>

- Construction loans are to be completed on a standard cost to complete basis and as follows:
    a. The member is to comply with all requirements under the Builders' Lien Act.
    b. A satisfactory certificate from an approved quantity surveyor/architectural/engineering firm evidencing and/or confirming:
        i. Detailed breakdown of original estimated costs, revised costs per change orders (if any) and completed construction to date, as well as, confirmation sufficient undrawn funds are available to complete the project (i.e., cost to complete basis).
        ii. All construction work is completed in accordance with the approved plans and specifications with the appropriate civic approvals confirmed as in place.
        iii. Construction work is progressing within the original construction schedule.
        iv. Receipt of satisfactory land titles searches evidencing no liens have been registered.
        v. All draws are to be supported by a signed declaration of the general contractor and borrower confirming all sub-trades and supplier accounts are in good standing.
- Where cost over runs are identified exceeding the approved contingency allowance, the borrower is to inject additional cash equity prior to advancing further funds.
- Where a lien is registered against title or the credit union is advised a lien is about to be registered, further funding is to be placed in abeyance and the issue referred to the credit union's solicitor for guidance.

## Loan Type

- Construction mortgage.

## Loan Amount/Financing Levels

- Standard financing is to be based on 65% of the lower of cost (as supported by a detailed budget as confirmed by an architect, engineer, or quantity surveyor) or appraised value.
- Exceptions for loan to value must be in keeping with the limitations under the quality mortgage loan criteria set out in the Credit Union (Principal) Regulation and minimum criteria set out by the Corporation.
- Mortgage charge(s) capturing equity in residual land should not utilize a LTV greater than 50% of the appraised value/recent purchase price in lieu of cash participation.

## Loan Security

- A registered first mortgage charge over land and buildings.
- Assignment of leases and rents registered on title via caveat (if applicable).
- A General Security Agreement is to be provided.
- An assignment of all construction contracts, plans, permits and other approvals as deemed necessary by the credit union's solicitor.
- Assignment of Builder’s All Risk Insurance during construction with evidence of adequate Liability Insurance being carried by the borrower.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrower’s Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.
- Personal/Corporate Guarantees of the shareholders/investors supported by current verified PNW statements.
- Environmental Indemnity Agreement/Questionnaire as applicable.

## Requirements Applicable to Residential Builder Mortgages

Funding Conditions

1. Funding to be on an Evergreen-revolving basis and utilized for construction of units for immediate resale.
2. A maximum cost and/or mortgage amount for each spec house carried under the evergreen facility should be set.
3. Speculative residential financing should be restricted to single detached houses, townhomes or duplexes.
4. Maximum number of spec houses to be carried simultaneously is to be determined and be dependent on tenure of relationship with credit union, diversity of the borrower (i.e., local small market or Provincial/National), and evidence of stable financial performance.
5. A cost projection, including the cost of the lot, for each project being financed under a spec mortgage is to be provided.

6. Appraisals of building plans and costs to be completed by a credit union approved appraiser, confirming market value.
7. Borrower's equity must be in place prior to any credit union advance.
8. Loan advances on each pre-sold residence will be contained to 75% of purchase price based on an unconditional offer to purchase and evidence that financing is approved if mortgage is not with the credit union.
9. Purchasers of pre-sales must be arm's length with minimum 10% deposit held in Trust; non arm's length pre-sales must be supported by a minimum 20% deposit in Trust; the deposit for an insured mortgage can be less than 10% with evidence of approval from the insurer.
10. Loan advances on each individual spec mortgage will be restricted to the lesser of 65% of appraised value or 75% of cost (excluding builder's profit, realtor fees and GST).
11. Funds on each spec mortgage and pre-sold will be advanced supported with:
    a. A cost to complete inspection report provided by a credit union approved appraiser.
    b. Signed declaration by the borrower confirming all sub-trade and supplier accounts are in good standing.
    c. Title search confirming no liens have been filed.
12. Mortgage for each construction unit is to be retired from net sale proceeds.
13. A "right of first refusal" can be considered on all individual take-out mortgages to qualified purchasers.
14. All costs (legal, appraisal, inspection, LTO searches, etc.) are for the account of the borrower.
15. Confirmation of New Home Warranty.
16. Evidence all municipal regulatory requirements have been approved/met.
17. Repayment on interest only during maximum 12 month construction period thereafter reverting to conventional mortgage repayment terms with a maximum 25 year amortization.

<u>Ongoing conditions</u>

1. As one mortgage is assumed by a purchaser (sale closed and title transferred), funding for construction of an additional unit may be provided at the discretion of the credit union.
2. Regular visits are to be conducted by the lender to the construction sites, with a minimum of one visit per calendar quarter. The visits are to be documented with appropriate note to the credit file.

### Loan Security (in addition to general requirements)

- At the borrower's option either a registered first mortgage charge for 95% of appraised value plus applicable insurance fee against each individual lot on which construction funding is to be provided or a registered first mortgage of 80% of appraised value against each lot on which construction funding is to be provided.
- An encumbrance agreement and solicitor acknowledged assignment of sale proceeds can be used for pre-sold residences financed under the Evergreen.

## Related Guidelines

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|---|---|
| Minimum Mortgage Criteria | Environmental Risk |
| Guarantees | |

# Environmental Risk

- All credit unions should have an environmental policy in place.
- Financing of real estate where environmental contamination is evident or suspected based on prior use of the property is to be avoided without exception.
- To knowingly or unknowingly finance a contaminated property may subject a credit union to direct cost or liability for "clean-up" and for the potential loss should there be default on repayment of the loan. Recognizing the credit union could potentially acquire title to the real estate, each lending situation should be approached with caution.

### Residential Property

It is reasonable for the lender to assume the lending risk is acceptable and no further action need be taken unless:

1. The property to be mortgaged is located adjacent to or near a higher risk commercial property (i.e., gas station, chemical manufacturer/storage, railroad line, etc.) or, lender has reason to believe the property has been used for commercial purposes where contamination may/could have occurred.
2. The appraiser suggests there is soil "staining" or evidence of contamination.

### Commercial Property

1. Where the historical use of the property to be mortgaged is personally known to the lender and confirmed by a lender’s site visit to show no evidence of contamination, no further action need be taken other than to have the member provide a signed statement to include:
    a. To the best of their knowledge and belief, the properties do not now contain nor have they ever contained any hazardous materials, substances, contaminants, pollutants, toxic gases, or wastes all as defined in any applicable statutes, regulations, order, and by-laws enacted or adopted for the protection and conservation of the natural environment.
    b. There are no claims, either oral or written, no actions, prosecutions, charges, hearings or other proceedings of any kind in any court or tribunal, and no notice of any such proceedings, and no complaints by any person which relate to any discharge, deposit, escape, or release from the properties of a contaminant into the natural environment, and there are no circumstances of which the company is aware which might give rise to any such proceedings or complaints which the company has not disclosed fully in writing to the credit union.
    c. Usage of the properties will continue to be restricted to environmentally acceptable activities or to activities which fall within the scope and/or limits allowed under any special permits granted and in force.
    d. To advise the credit union in writing of any breach which may arise under any applicable statutes, regulations, order, and by-laws enacted or adopted for the protection and

conservation of the natural environment with respect to the properties and to resolve the same expeditiously.

e. To indemnify the credit union and hold it harmless from any claims, assertions, obligations, liabilities, costs, or damages without limitation as to amount or time which may arise as a consequence of a breach or claimed breach of any applicable statutes, regulations, orders, and bylaws enacted or adopted for the protection and conservation of the natural environment by the company, lessee(s), or adjoining property owner(s) and affecting the property.

2. In the event the historical use of the property is not known or where a purchase of a new property is involved, an Environment Checklist is to be completed. If completion of the Checklist reveals any potential for contamination, a Phase I site assessment (cost to the member) is to be commissioned through an engineering firm approved by the credit union to conduct environmental assessments. Should the Report confirm evidence of contamination, proceeding with the mortgage financing is to be re-addressed.
3. When financing of any amount includes renovations to properties constructed prior to 1980 an asbestos survey is to be completed by a qualified engineer and if necessary an abatement plan provided. This is to be followed by confirmation that the issue(s) raised have been remediated to Governmental Standards.
4. Credit unions should not actively solicit mortgage financing from businesses in High Risk industries, such as:
    - gasoline/propane service stations and fuel distributors/wholesalers
    - vehicle/engine repair shops or storage facilities
    - welding shops
    - chemical manufacturers/retailers
    - wood treatment plants
    - paint retailers/manufacturers
    - battery storage or repair facilities
    - medical waste storage/treatment facilities
    - dry cleaning facilities
    - metal fabrication
    - waste management & remediation services
    - funeral homes
5. Financing of any high risk business is to be supported by environmental clean-up, liability and impairment insurance coverage for a minimum $1,000,000 per incident and $100,000 on site clean-up. Coverage limits should be set based on the degree of risk for the industry involved. Insurance Policies are to be followed closely for renewal at maturity to ensure continuing coverage while financing is in place.

## Agricultural Property

A farm visitation should be undertaken to determine if:

- the farming enterprise includes intensive livestock, swine, or poultry operations
- higher than the recommended levels of fertilizers, pesticides, or other chemicals are used
- underground storage tanks are evident
- tanks or property are located on or near streams or wetlands

The foregoing could suggest a higher than acceptable environmental risk and warrants further investigation to ensure the farmer is operating with the environmental tolerance factors as established by Alberta Agriculture, Alberta Environmental Protection, and Environment Canada.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Revenue Producing Properties

- Loans in this category should only to be entertained as part of a member relationship; provision of a mortgage on a rental property without a more extensive relationship should be discouraged.
- Financing should be limited to a first mortgage interest; a secondary charge to the credit union's priority position is acceptable.
- Individuals are considered "real estate operators" if three (3) or more revenue producing units are owned; excluding personal owner-occupied residence and personal recreational property. Loans for additional revenue property financing are to be adjudicated on a commercial basis. Rental units may be under one roof or individual properties (i.e., a 4-plex would be considered to be 4 units).
- To limit concentration risk to a single borrower exposure, financing involving multi-unit condominiums should be restricted to a maximum of 15% of the available units (i.e., a development with 50 units, only 8 should be purchased/financed).
- A credit union may offer individuals residential mortgage type terms and conditions; however, the mortgage is to be classified as a commercial loan.
- Financing proposals for property rented to and being operated as hospitality business (i.e., Bed and Breakfast, cabins, etc.) are subject to the Hospitality Industry Financing Guideline in addition to this guideline.
- Financing of low-income or boarding house properties should only be considered with the support of a government or agency, or municipality.

### Terms and Conditions

Conditions Precedent/Pre-disbursement

- Financing is to be supported by an independent appraisal prepared on the three method approach (i.e., market, cost, and income valuation); the report is to be reviewed by the credit union and determined to be satisfactory.
- A building condition inspection report is to be obtained to confirm acceptability of the residential property for financing if the appraisal reveals possible structural concerns, or other issues of concern.
- A building condition report prepared by a qualified firm for commercial properties being financed, is to be obtained. A report for buildings less than 20 years old, is at the credit union's discretion. The report is to cover structural integrity, condition of the roof, and mechanical systems, as well as, outline the associated costs along with a timeline for remediation based on urgency of repair. Immediate significant issues addressed in the report are to be remediated prior to funding.
- A current environmental assessment pursuant to the Environmental Risk Lending Guideline is to be obtained.

- Debt service capacity should reflect a minimum of 1.25 times coverage on an historical basis and/or reasonable expectation of rental increases to support projections (i.e., lease escalation clause, confirmed below-market rates with lease terms maturing in the near term, letters of intent to lease, formal notice of rental increases given to existing tenants, etc.).
- Real Property Report with City or Municipality Compliance Certificate.
- When financing a multiple unit property pursuant to a recent purchase agreement, the credit union's solicitor is to obtain an estoppel certificate relating to any rental deposits held by the former owner.
- Fire insurance is to be assigned by way of mortgage endorsement clause/standard mortgage clause and include boiler (if appropriate), business interruption and rental coverage.
- The credit union must request and obtain a Solicitor's Letter of Opinion and a copy of the Land Titles Certificate upon registration of the mortgage; alternatively title insurance is to be obtained.
- Rent roll is to be obtained.
- Copies of tenant leases for existing revenue properties are to be obtained to validate the rental information in the rent roll.

Ongoing Conditions

- Rent roll and income statement for the property (properties), certified as to its correctness by the borrower, are to be provided annually to the credit union.
- Copies of new tenant leases are to be obtained.
- Expired lease terms and/or leases nearing maturity are to be addressed as a risk and mitigated appropriately at each scheduled review.

### Loan Type

- Mortgage with amortization of up to 15 - 20 years; subject to a 1 - 5 year term based on useful economic life and obsolescence factors. Amortization should be at least 5 years less than the remaining economic life of the property.

### Loan Amount/Financing Levels

- Loan to value ratio is generally not to exceed 65% of the lower of cost or appraised value as determined within the preceding six month period. Generally, the primary consideration is to the income approach to value; however, the lowest of the values will apply in most cases. Consideration of up to 70% LTV may be warranted for properties demonstrating a history of full lease-up and good quality tenants over the past five years.
- Financing using minimum criteria may be entertained.
- Financing up to the maximum available under the Quality Mortgage definition may be entertained for single family units up to a four-plex.
- Normal lending values should be suitably reduced where single purpose buildings are involved.

## Loan Security

- Mortgage representing a first charge over land and buildings.
- Mortgage charge(s) with priority to the credit union capturing equity in additional properties in lieu of cash participation or to strengthen the security/LTV position can be obtained.
- Assignment of leases and rents registered on title via caveat.
- Registered GSA providing a first charge over equipment and personal property as it relates to this specific project.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrowers Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.
- Personal and/or Corporate Guarantees of the shareholders/investors/related parties supported by current personal net worth statements or accountant prepared financial statements.
- Indemnity Agreement signed by the borrower and all guarantors is to be obtained.

## Related Guidelines

| | |
|---|---|
| Hospitality Industry Financing | Environmental Risk |

# Assignment of Rents

- A separate document providing for an assignment of rents and registered on title via caveat must be obtained in all circumstances where rental revenue is being generated from lands/properties. Although the standard mortgage form may contain an assignment of rents within its terms, the provisions are not usually detailed as to procedures, default, etc.
- A separate document creating an assignment of rents generally includes provisions that:
  i. Allow the lender to exercise the borrower's powers (including the power to collect rents) in the name of the borrower;
  ii. Limit the lender's responsibility to those rents that are actually collected by the lender and negate any responsibility on the part of the lender for collection of rents from or management and operating of the rental property or for observance of any other terms of any leases;
  iii. Warrant the payments made by the tenants to the lender pursuant to the rent assignment or discharge the tenants in respect of the amounts so paid;
  iv. Acknowledge that exercise by the lender of the rights under the assignment will not constitute the lender a mortgagee in possession.
- A lender having a separate assignment document would, in the event of a default by the borrower, be in a position to serve notice of the assignment on tenants and appoint an agent for purposes of collecting the rents. No court application or proceeding would be required in order to take such steps. It allows a lender to react immediately and on a timely basis, if so required. Without an assignment of rents, a lender would have to bring an application before the courts requesting that an agent be appointed for purposes of collecting rents.

# Insurance Coverage

When financing real estate, adequate fire insurance must be in place and assigned (via mortgage clause endorsement), and includes (as applicable) business interruption/loss of rentals, liability, boiler, inventory, and "Builders All Risk" (during construction phase) coverage.

### Co-Insurance Clause in Fire Insurance Policies

- Virtually all commercial insurance programs now have a co-insurance clause included in the policy/contract. This clause is frequently misunderstood and has the potential of limiting the amount payable under a policy in the event of any loss. This clause applies to both property (buildings or equipment) and business interruption coverage.
- The security section of the credit application is to identify and comment on whether the member(s) can afford to cover the company's portion of any losses, which may be incurred.
- The co-insurance clause provides for the sharing of any loss between the insured (credit union member/borrower) and the insurer (insurance company) if the insured does not maintain insurance to a stipulated percentage of value. Typically, most co-insurance clauses are in the 80% to 90% range.
- It is imperative that all involved in lending understand the effect on a member's operation if a loss (full or partial) is suffered. Comments in each credit application (security section comments) need to be included to indicate the credit union is satisfied (or otherwise) that the member can cover their portion of any loss.

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# Sub-Division Financing

- Experience of the members in completing such a project is paramount and if they had no prior experience, the project would need to be overseen by a reputable engineer.
- Appraisal required to show the "as is" value of the property and include a feasibility study addressing the absorption rate in the specific area covering the past five years and expectations over the next several years.
- Full details of competitor subdivisions in the area. Appraisers must address comparable projects and advise whether it is feasible all lots on the market can be sold in a reasonable period of time.

### Terms and Conditions

Conditions Precedent

- A detailed marketing plan which includes:
  i. Information on realtor to be used.
  ii. Full details on the project including projections covering all expenses and income based on "X" amount per lot.
  iii. Proposed selling price and how it compares to market/competition.
  iv. Town/City's requirements relative to bonding/Letter of Credit to cover/ensure completion. Details are required as to how the company will cover this. **Note:** Normally require cash or a Letter of Credit pledged until project fully completed.
- Contracts with all subcontractors would need to be on a fixed price basis and all contractors must be bonded.
- Liability insurance coverage is required.
- Member must have a demonstrated ability to service the debt from outside sources (other than lot sale proceeds) in the event sales do not materialize.
- It is preferred that there is at least 50% bona-fide pre-sales before the development proceeds. This would confirm demand etc., and ensure permanent pay down of the construction loan to 50% of the original amount advanced**.** **Note:** These should not be options or conditional sales.
- A commitment letter covering all terms and conditions would need to be signed by the company and guarantors.
- Prior to funding, registration of the subdivision must be confirmed, as well as all regulatory requirements met.
- A current environmental assessment pursuant to the Environmental Risk Lending Guideline is to be obtained.

Ongoing Conditions

- The credit union would need to engage a Quantity Surveyor/Engineer to approve all draw requests and ensure same is completed on a "Cost to Complete" basis.
  **Note:** All costs for members' accounts, with member to cover any overruns from own resources at the time of occurrence.

- Project reports to be provided monthly, or minimum quarterly based on the nature of the development, by the member detailing number of lots sold/completed, offers on hand, closing dates, selling price and net proceeds.
- 100% of net sale proceeds from each lot sale (after real estate/legal fees only) must be applied against the loan, with no withdrawal of any equity from the project prior to the credit union being paid in full.
- Credit union has the right to place a sign on the property.
- Credit union has the first right of refusal to provide financing to any of the purchasers of the lots.
- Ensure monitoring/record system is in place to track the sales and subsequent discharges of security.
- No sale or transfer of the property is to occur without the consent of the Credit Union, other than in the normal course of business.
- Holdback is to be in accordance with Builders Lien Act.

### Loan Type

- Term Loan - Loans should be repaid over 12 to 18 months maximum. If a longer term is necessary, additional equity/security would be required and member/guarantors would need to demonstrate the ability to service the debt from outside sources, if needed.

### Loan Amount/Financing Levels

- Normally a maximum of 50% to 65% of confirmed/substantiated costs should be financed or alternatively, additional clear title property taken in lieu of equity.

### Loan Security

- Registered first mortgage drawn/worded to permit re-advances and includes receivership clause/powers.
- General Security Agreement (allpaap).
- Assignment of Builders All Risk Insurance during construction with evidence of adequate Liability Insurance being carried by the borrower.
- Formal Assignment and Postponement of Shareholders Loan registered at PPR and the Borrowers Accountant notified in writing that no withdrawals of same will be permitted without the written consent of the credit union.
- Personal/Corporate Guarantees of the shareholders/investors.

# 7. BUSINESS LENDING - AGRICULTURE

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Agricultural Benchmarks

# Provided Courtesy of

AlbertaCentral

# Ag Price Guide

## JANUARY 2018

### Introduction

It is recommended that the "Average Price" be used as a guide in determining the price that the lender would use when completing long term projections. * See Uses of Price Information

The use of lower or higher commodity prices may reflect the individuals' management ability and should be supported by comment in the loan write up. **See Pitfalls of Benchmarking

### Sources of Information

Four primary information sources were used to collect the data:

- Canfax (livestock data)
- Agriculture Financial Services Corporation
- Bank of Canada
- Canadian Pork Council

### Benchmark Price Guide Layout

The Price Guide provides the following information:

- *Commodity* – while this list is not exhaustive, we have provided information on several common commodities.
- *Region* – we have provided a regional breakdown of prices for non-board grains and forage. Regional differences for other commodities were statistically insignificant.
- *Grade* – the grade or other identifying information has been noted.
- *Comments* – this provides the years used in the analysis and whether the data is provided on a yearly, quarterly, monthly or weekly basis.
- *Units* – describes how the prices are quoted
- *Average Price* – this is the average price based on the data provided.
- *Range* – a range has been provided that is plus or minus one standard deviation. This means that approximately 68% of the time, the historic price data fell between the low price and the high price.

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*The "Standard Deviation" is a statistical term that is used to describe how all the data is clustered around the average. For example, you may note that Bred Cows range in price from $1,009 to $1,484 with the average being $1,246 per head. When all the data was analyzed there was a wide range of prices. A wider range of prices causes a large standard deviation. This suggests that the calculated average price is not as meaningful to the user of this information.*

### *Uses of Price Information

Commodity prices may be utilized in a number of different ways when analyzing a farm operation. These include; balance sheets / net worth statements, cash flows, long term projections and security valuation.
Each of these areas may include the same commodity but use a different price.

#### Balance Sheets / Net Worth Statements

Agricultural balance sheets are usually developed using current market values for all of the assets. *This* means that inventory prices would reflect what that asset would sell for on the statement date.

*Recommendation:* For balance sheet (net worth) purposes, prices should reflect the market value as of the day the statement is completed.

Please note: when analyzing income, breeding stock inventory values should be consistent from the beginning of year to end of year to ensure that accrual income results are not skewed.

#### Cash Flows

Cash flow statements are created to provide a look at the cash operating requirements for the farm business and are a measurement of the cash going into and out of the farm operation.  It can also be used to assess the timing of expense or debt payments. The prices used in the cash flow statement should reflect what the farm operator would actually receive for their product over the cash flow period.

*Recommendation:* Current market prices should be reflected when completing a short-term cash flow (up to one year). When going beyond the one-year time horizon and under stable market conditions, the Price Guide average may be considered.

#### Long Term Projections

When analyzing the borrowers' ability to repay a longer-term loan, a strong argument can be made to use price projections that are likely over a longer term. It should be remembered however that short term prices will provide an indication of short term repayment ability. Consideration should also be given as to the "direction" of prices, i.e. where in the cycle are current prices and in what direction are they headed.

*Recommendation:* The lender may want to consider more than one price scenario when completing projections. A longer term average price will indicate viability over the longer term while using current prices will provide an indication of repayment over the next year. The lender should make comment as to what prices are being used and why.

### Security

Market values should reflect the value that a willing buyer would pay to a willing seller under **normal** market conditions; however, for lenders it may be prudent to be somewhat more conservative.

*Recommendation:* It is recommended that current market prices be used for security purposes giving attention to quality and all other general market conditions that may impact the price obtained for the product. These prices should be reported on the security panel.

Note: Current market values should be utilized if an operating facility was being margined against market livestock/inventories with regular inventory declarations being provided. If breeding stock is being utilized as supporting (non-primary) security of a loan exceeding one year, then the Price Guide average may be utilized. These prices should be reported on the security panel.

Please note that the range of cattle prices quoted by sources such as Canfax is extremely wide due to the inclusion of all ages and qualities of animals, i.e. bred cow sales.

## **Pitfalls of Benchmarking

There are dangers with using benchmark or average prices for all your analysis. Relying only on a statistical average eliminates allowances for an individual's management of the farm operation. We often think of management only in terms of production, for example, the number of bushels grown per acre.
Management can and does impact the price that producers ultimately receive for their product. Better farm managers may be able to grow a better quality product, which increases the sale price. They will also market their commodity in such a way as to increase the price for that commodity. With the possible exception of sales through the Canadian Wheat Board, producers sell commodities over a range of prices, either above or below the average.

Lending Service

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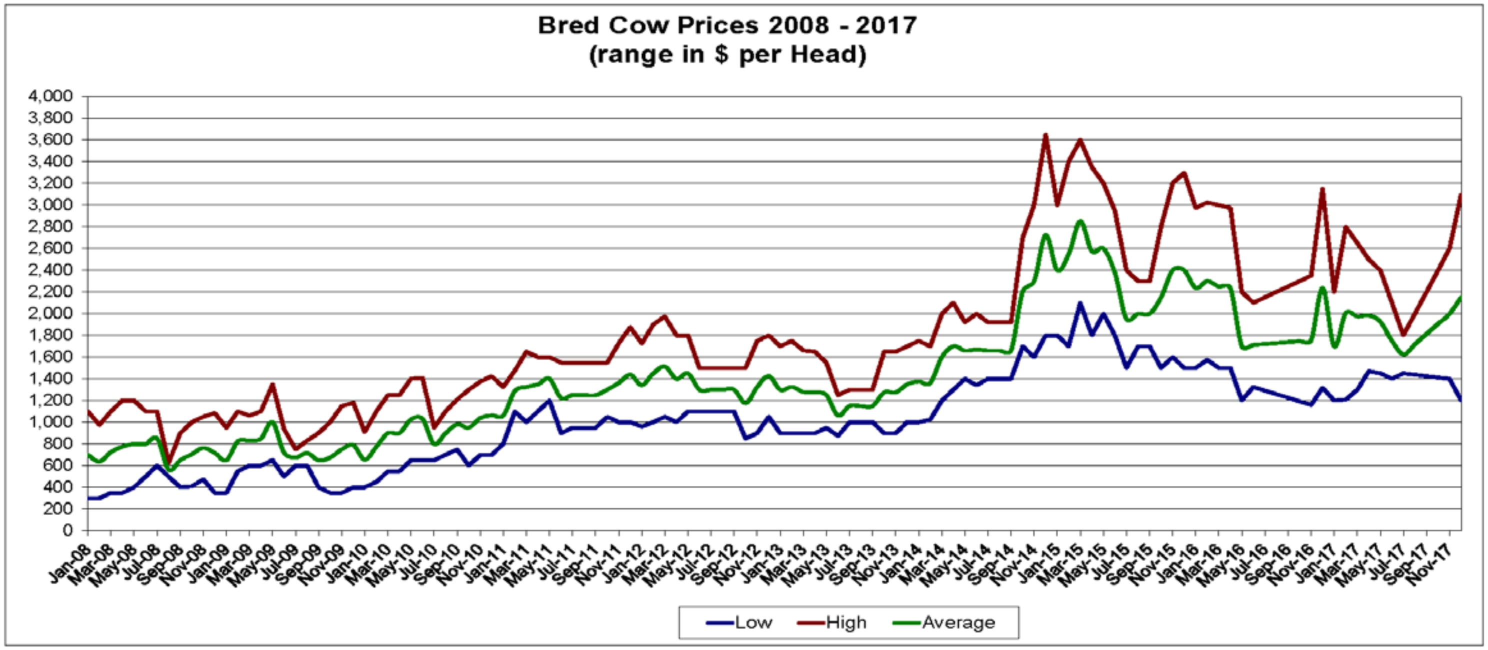
# Cattle Price Graphs



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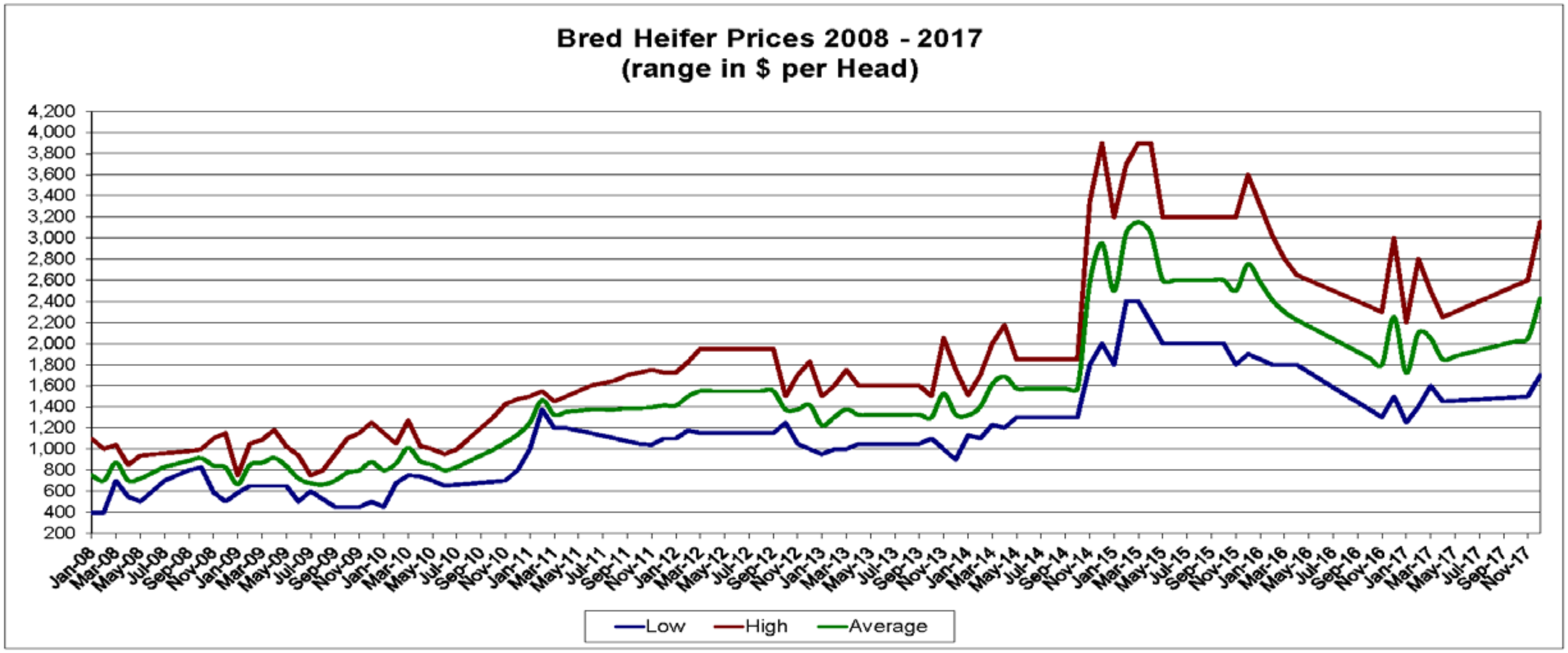
# Cattle Price Graphs



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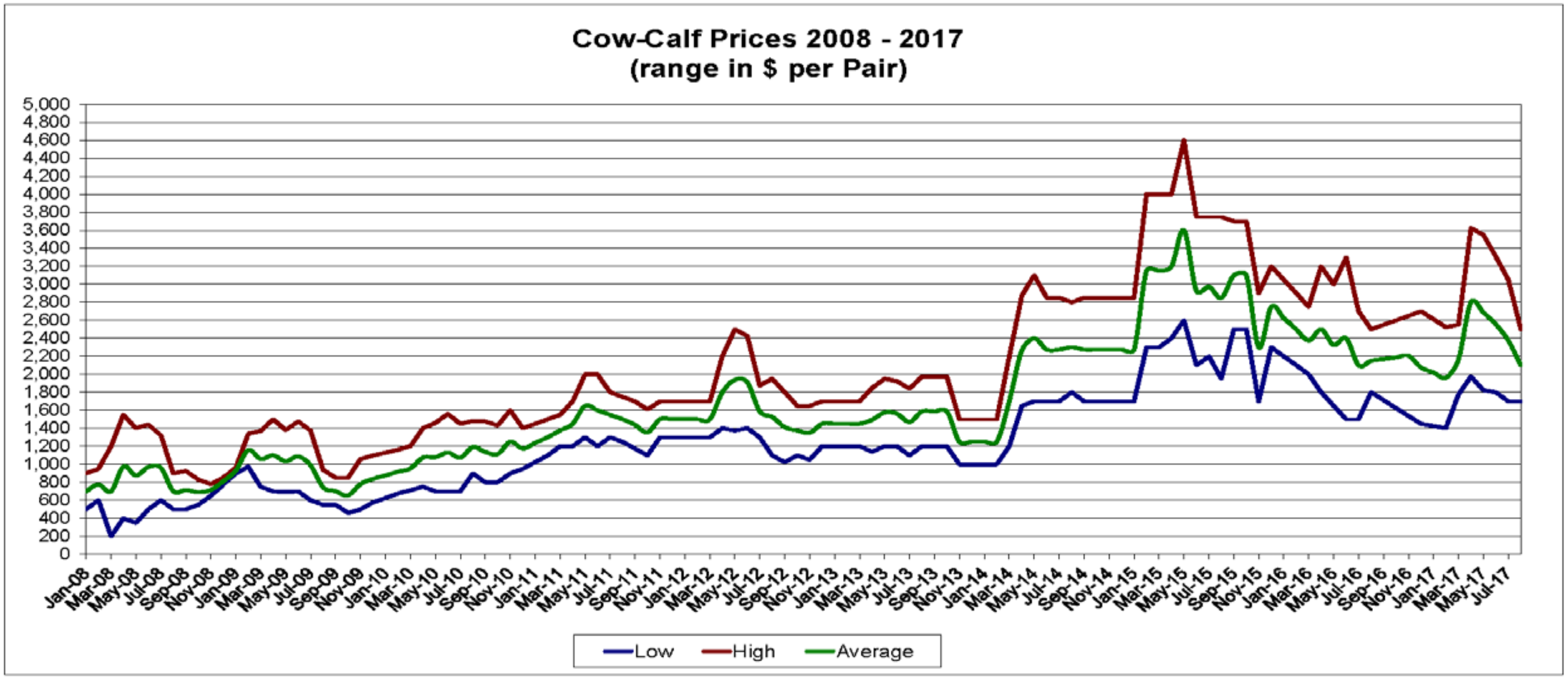
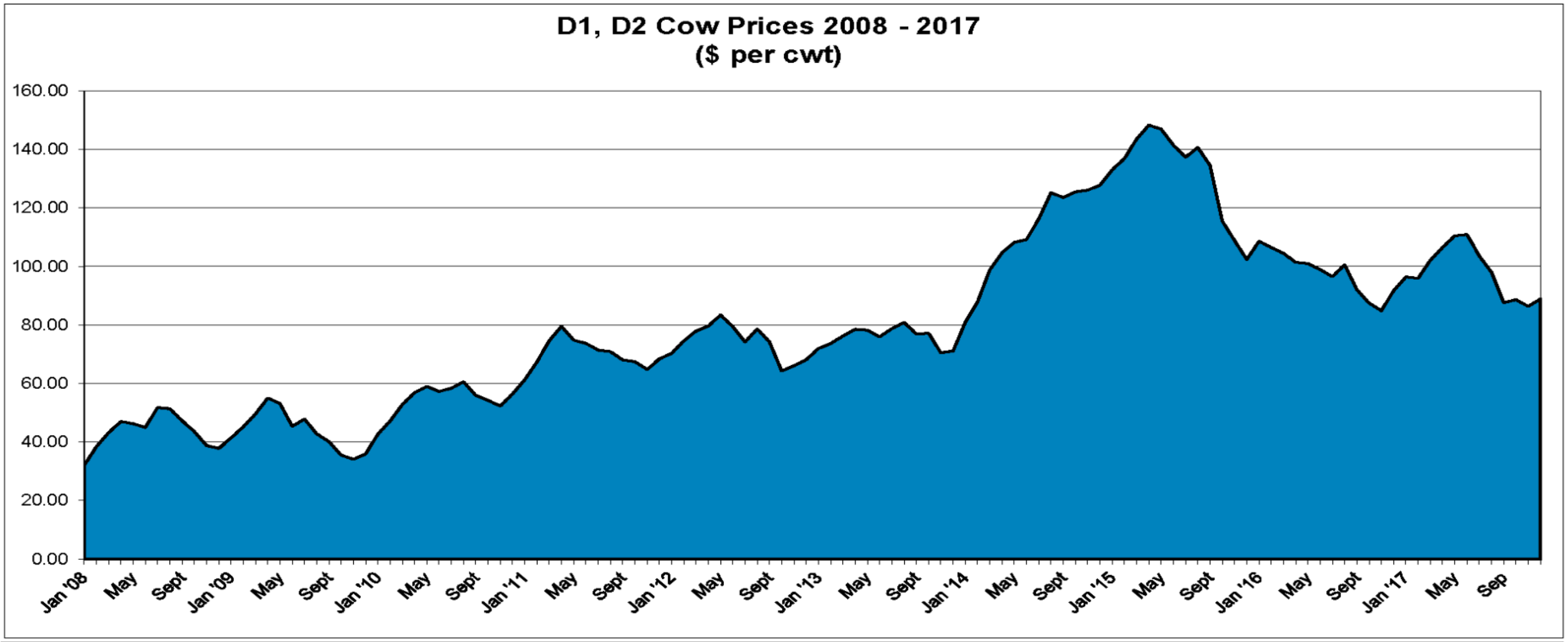



January 2018

# Cattle Price Graphs



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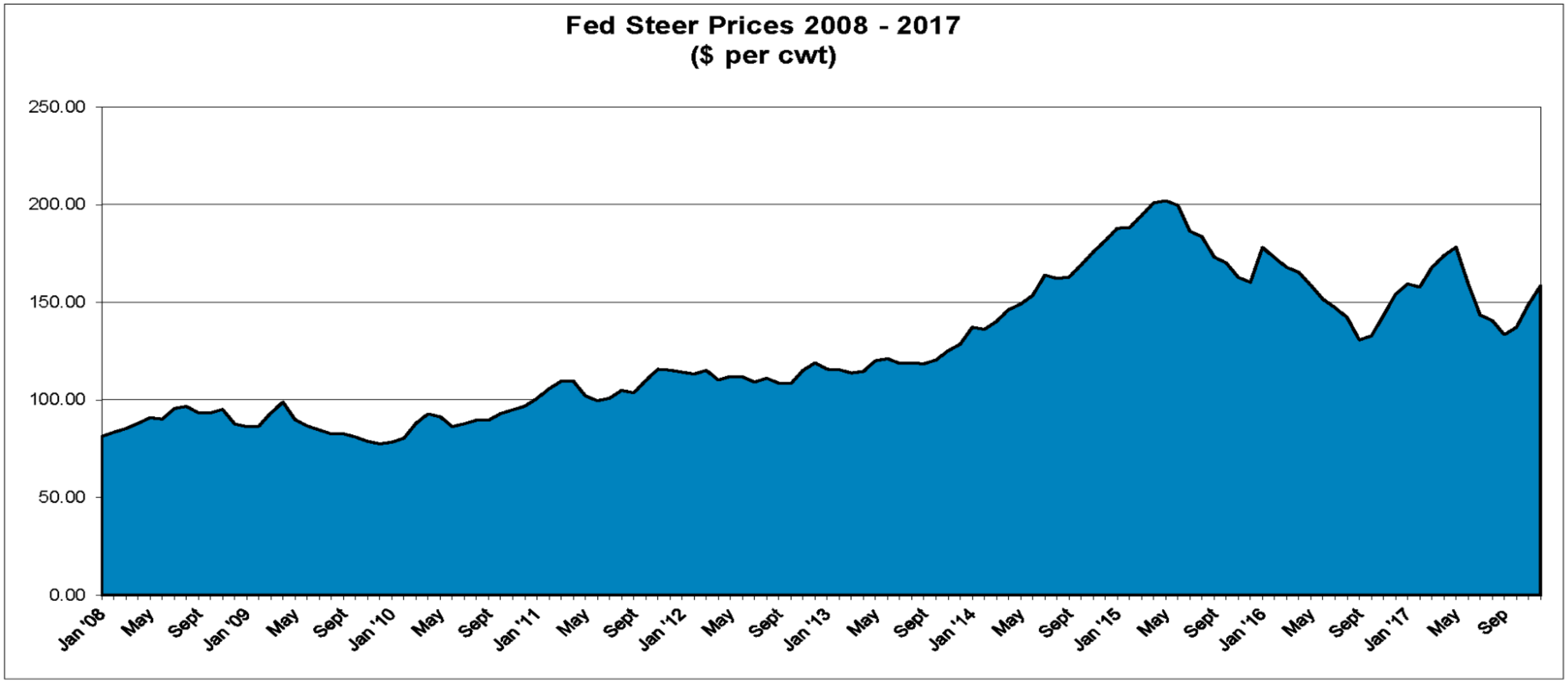
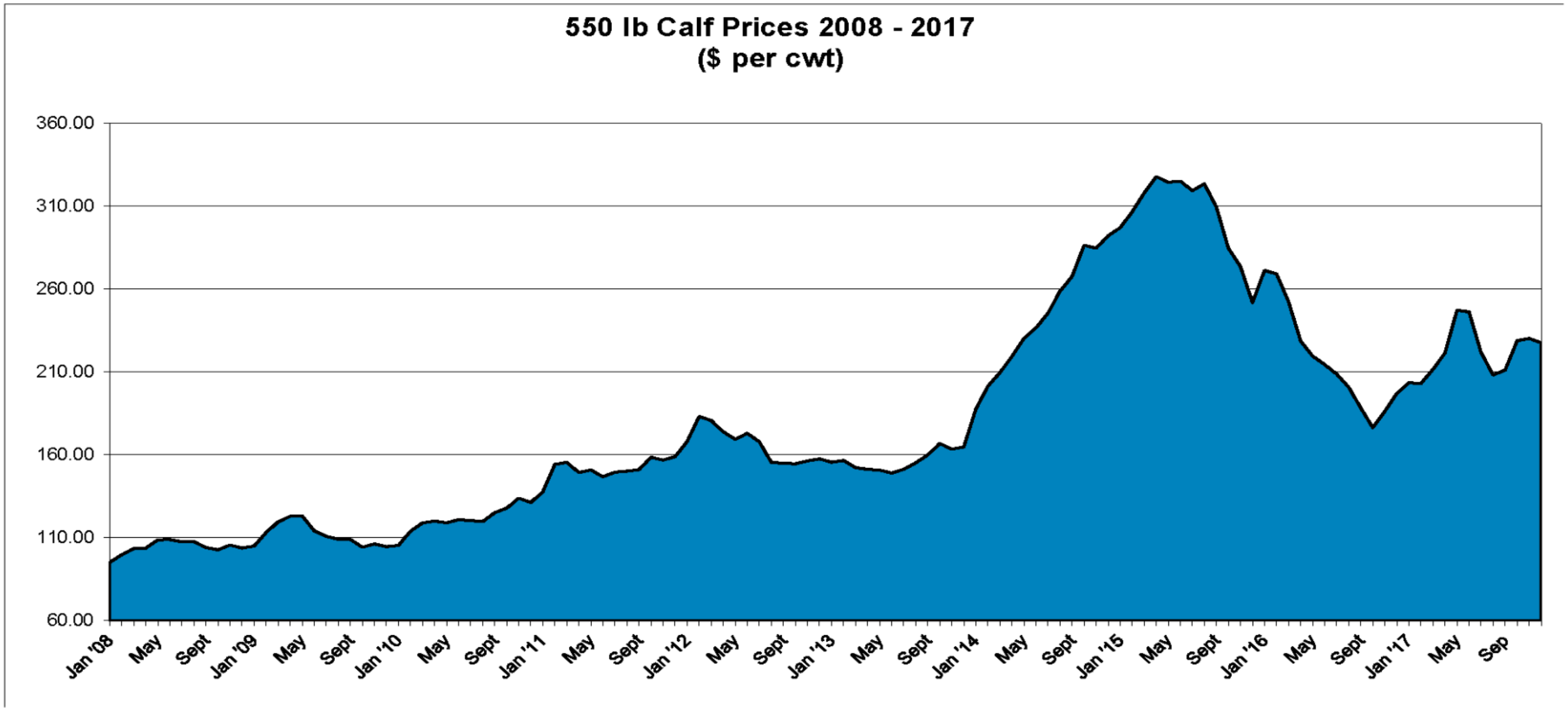
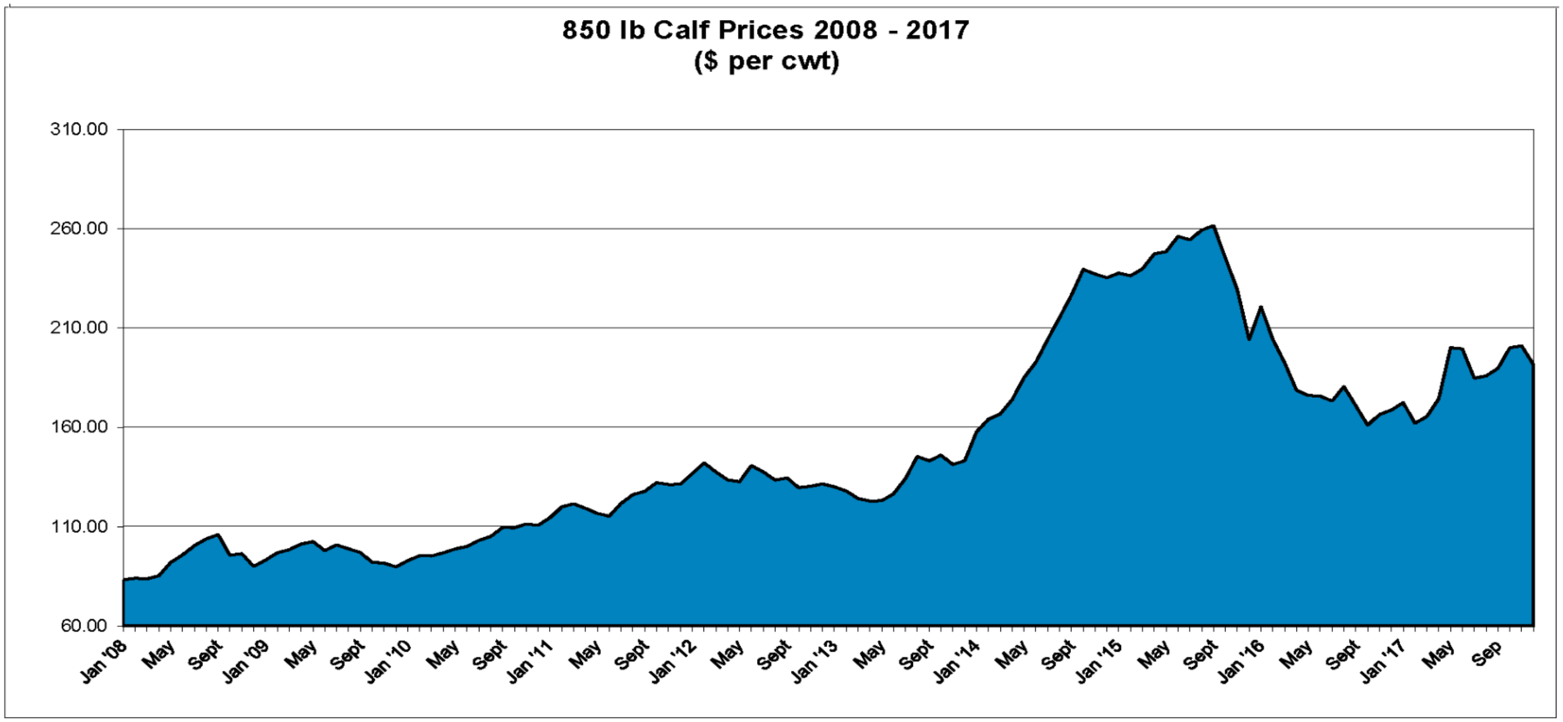


Credit Union Deposit Guarantee Corporation Alberta

# Cattle Price Graphs



# Cattle Price Graphs



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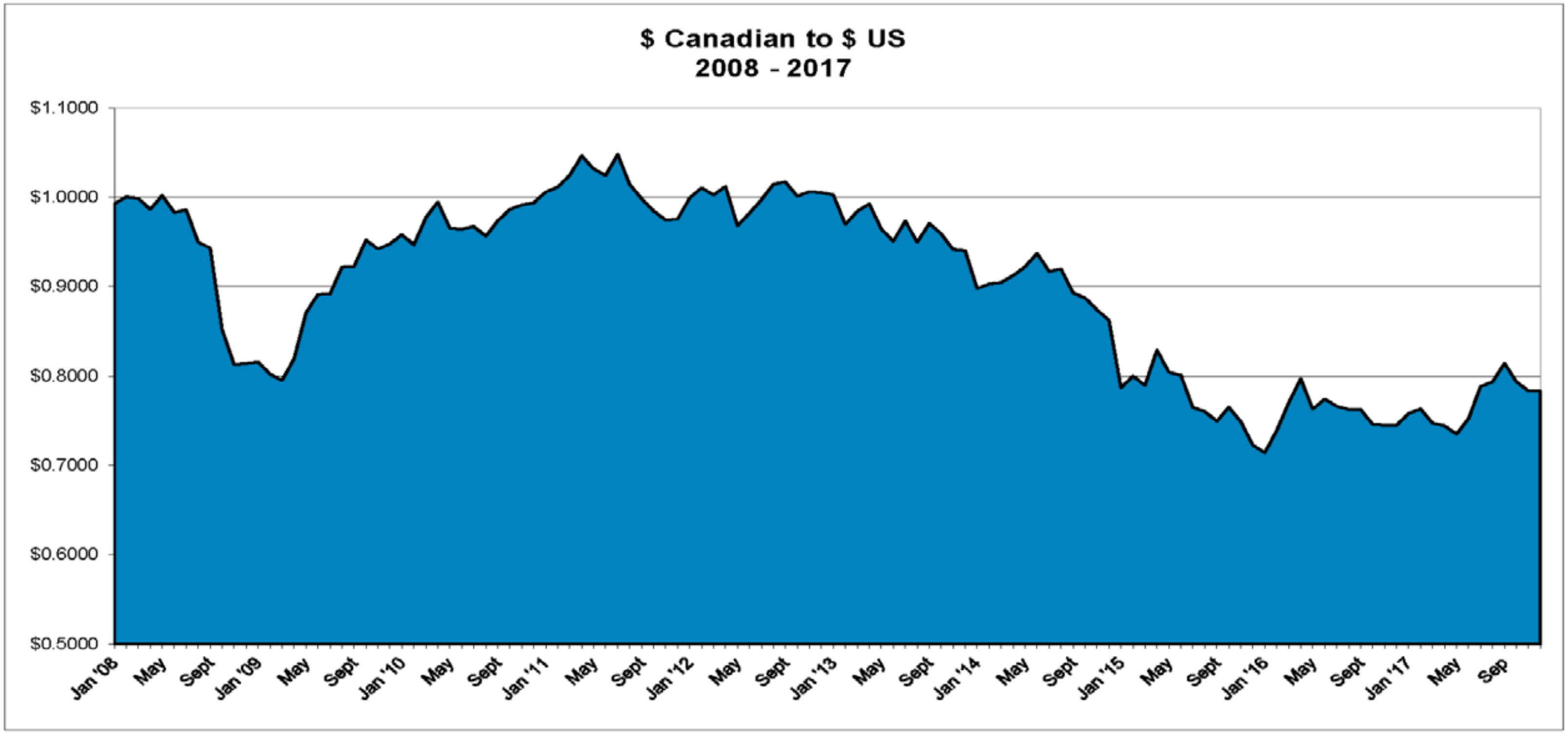
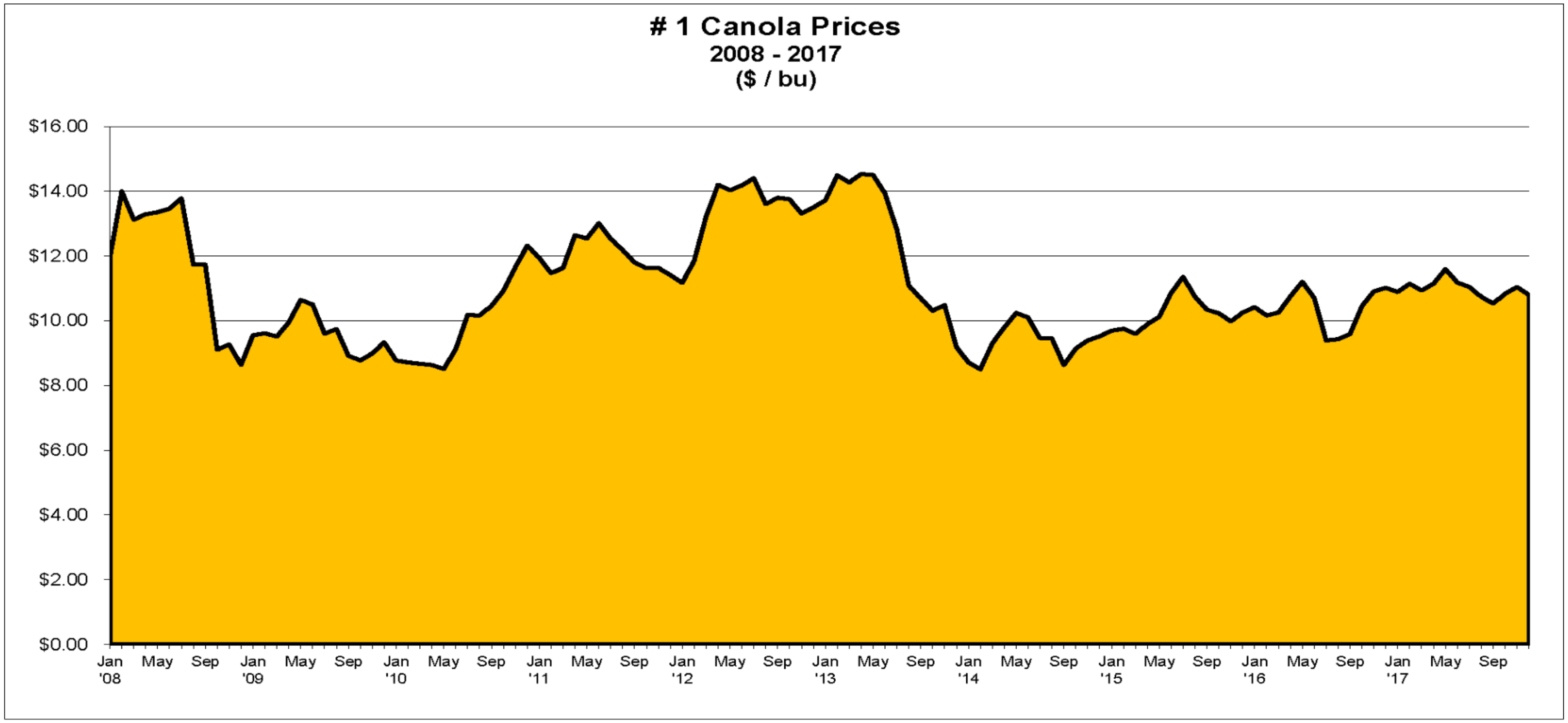


# Grain Price Graphs



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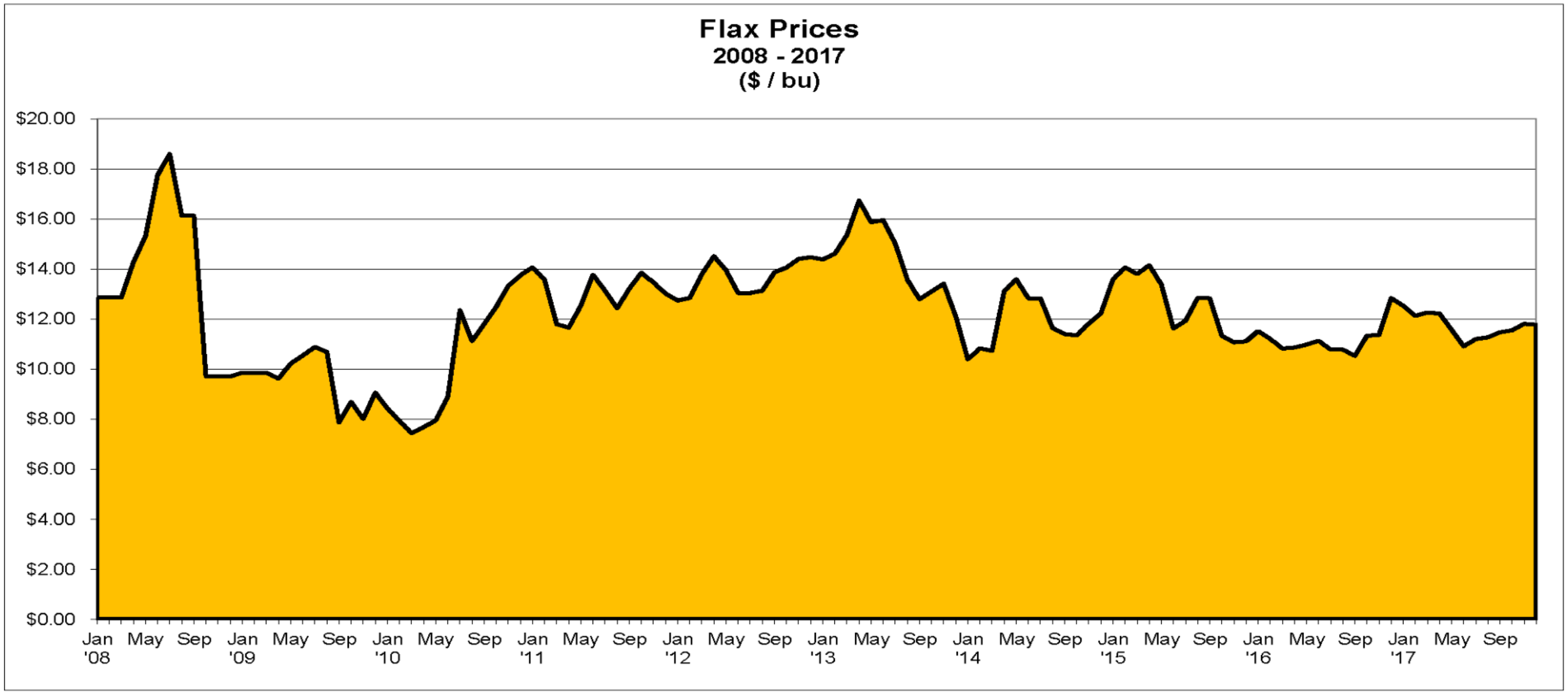

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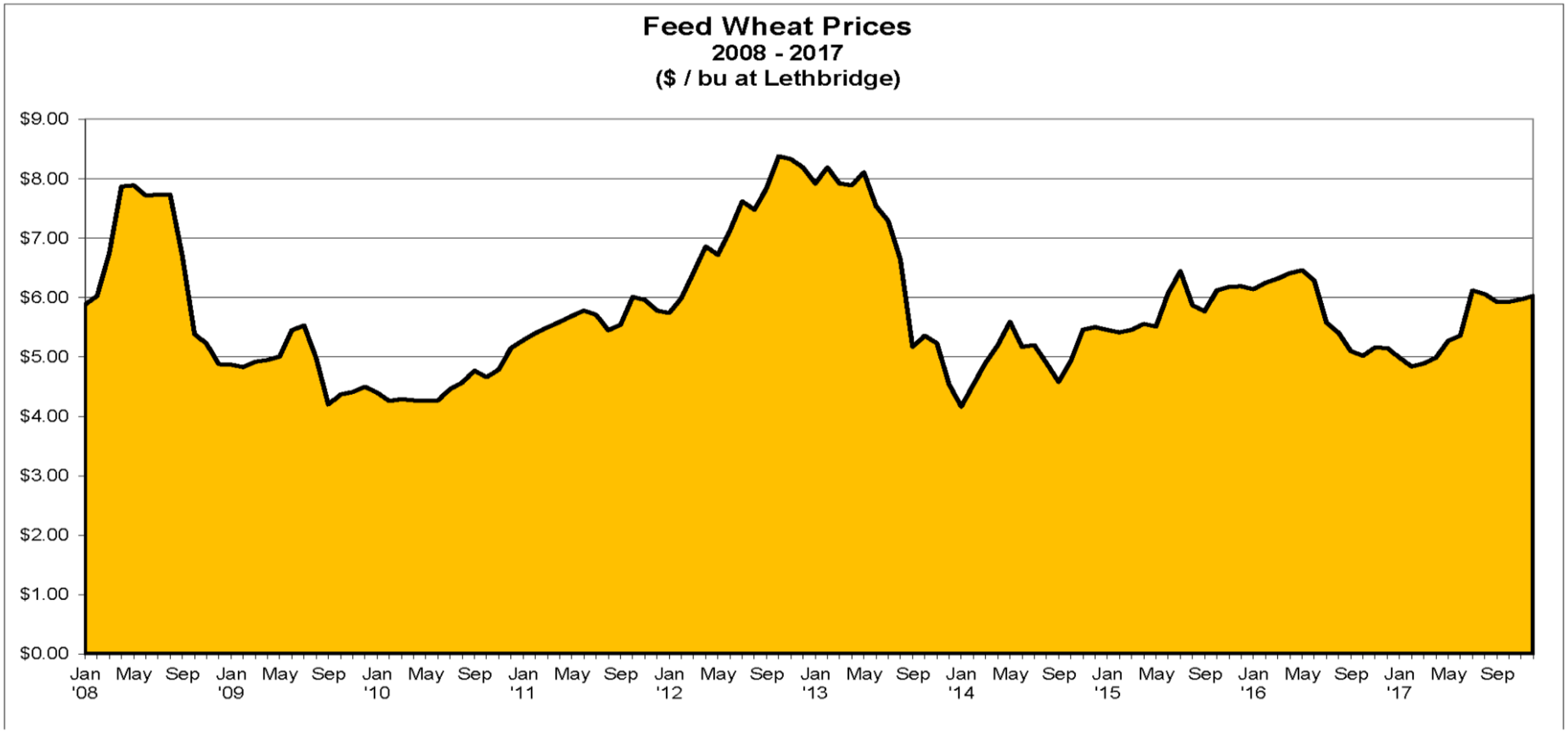

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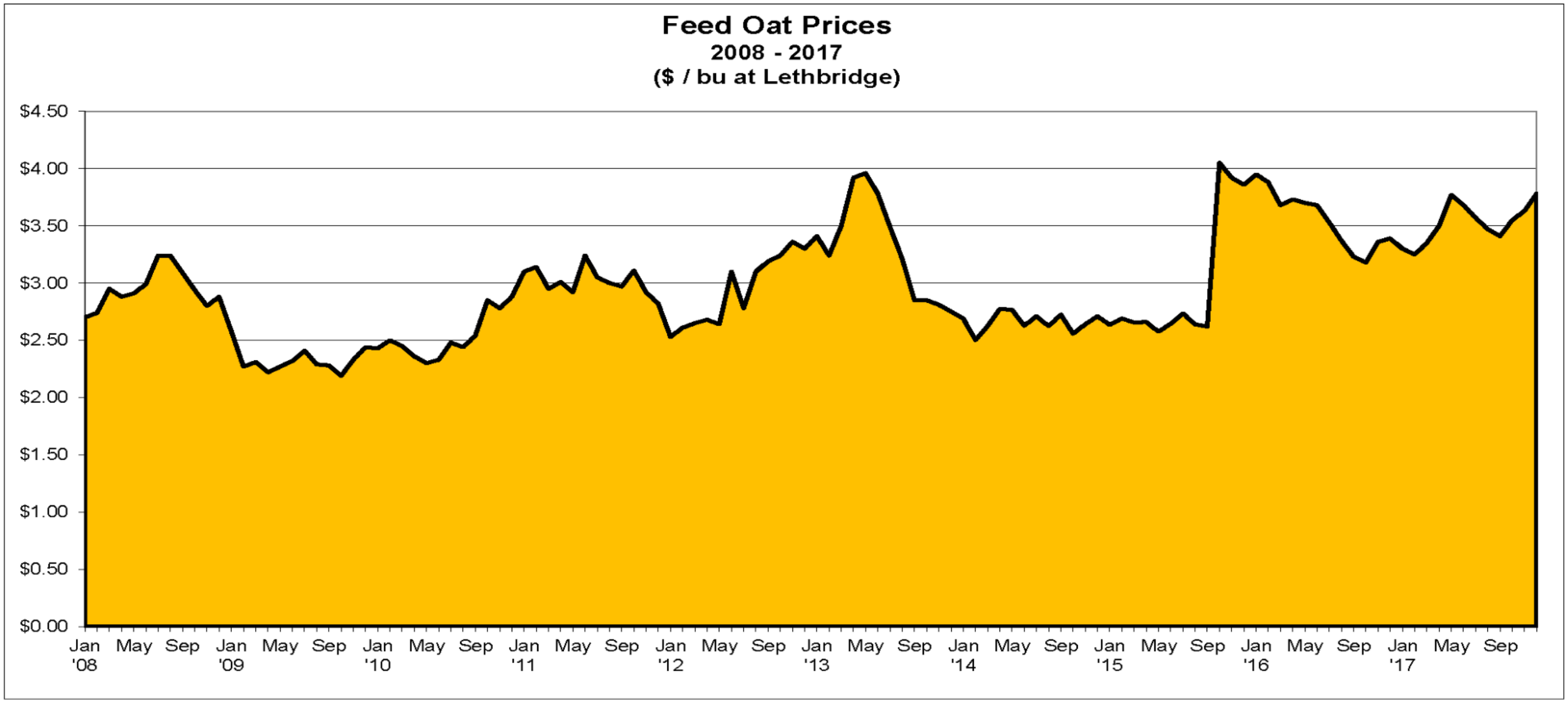

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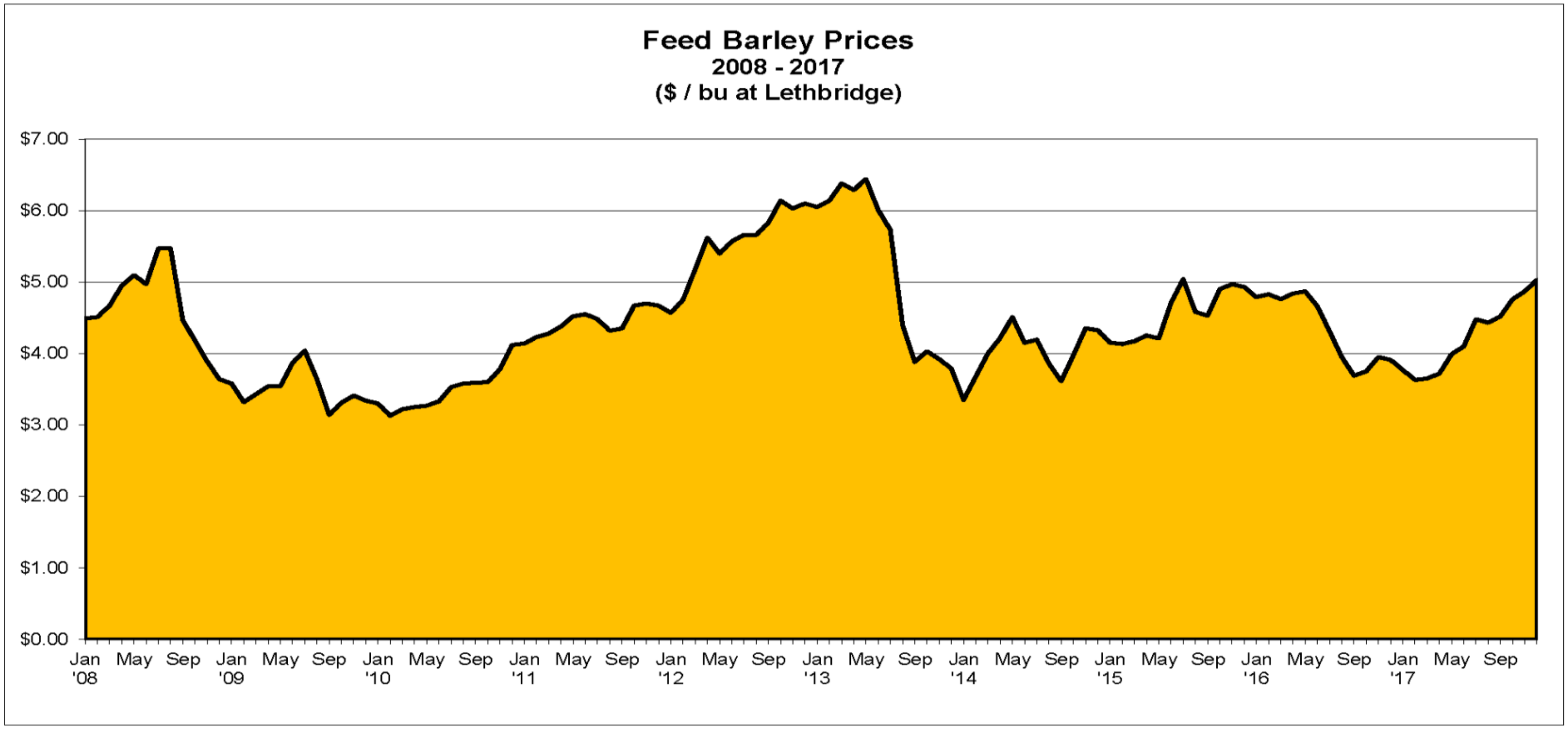


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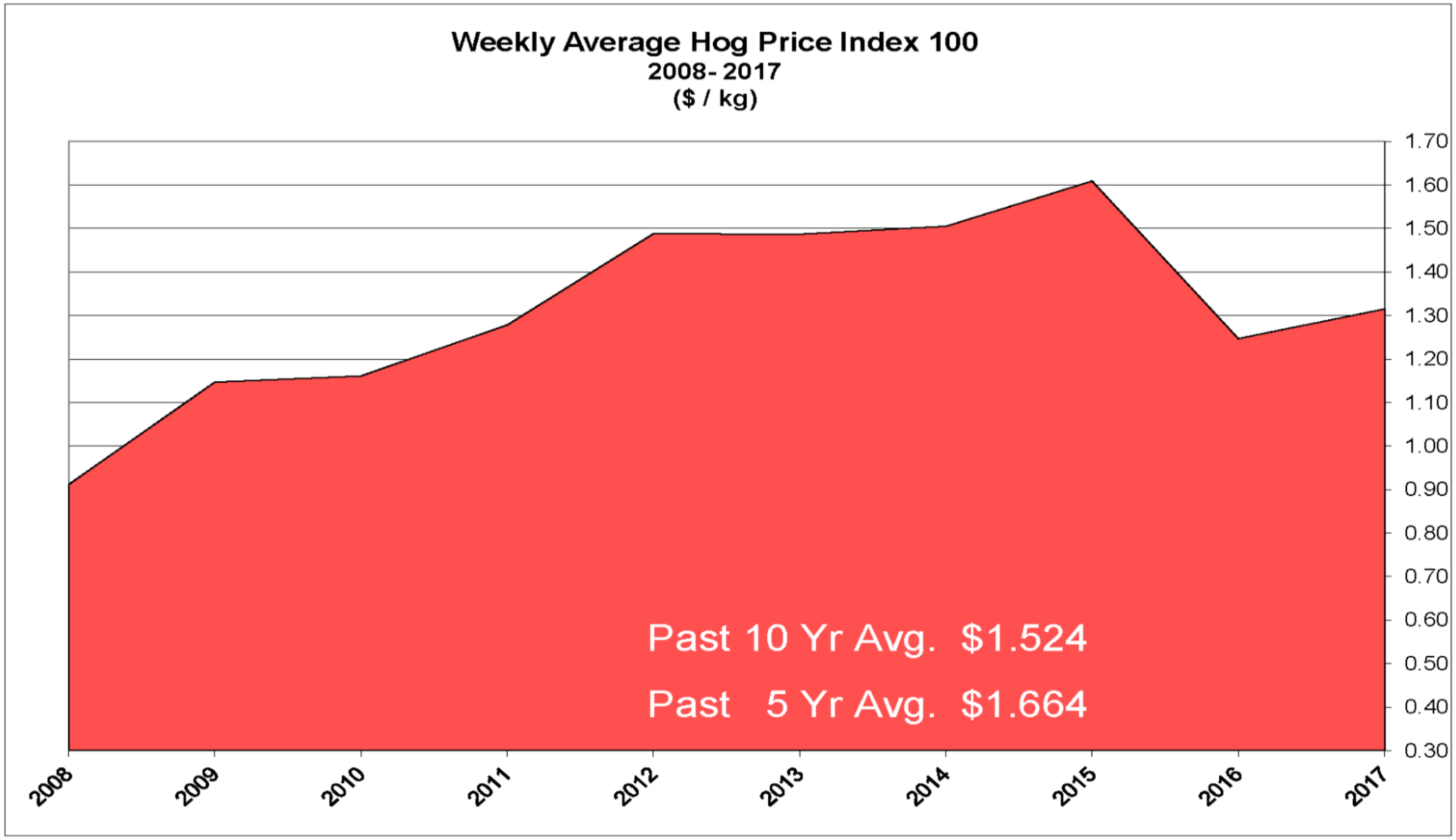
# Hog Price Graphs



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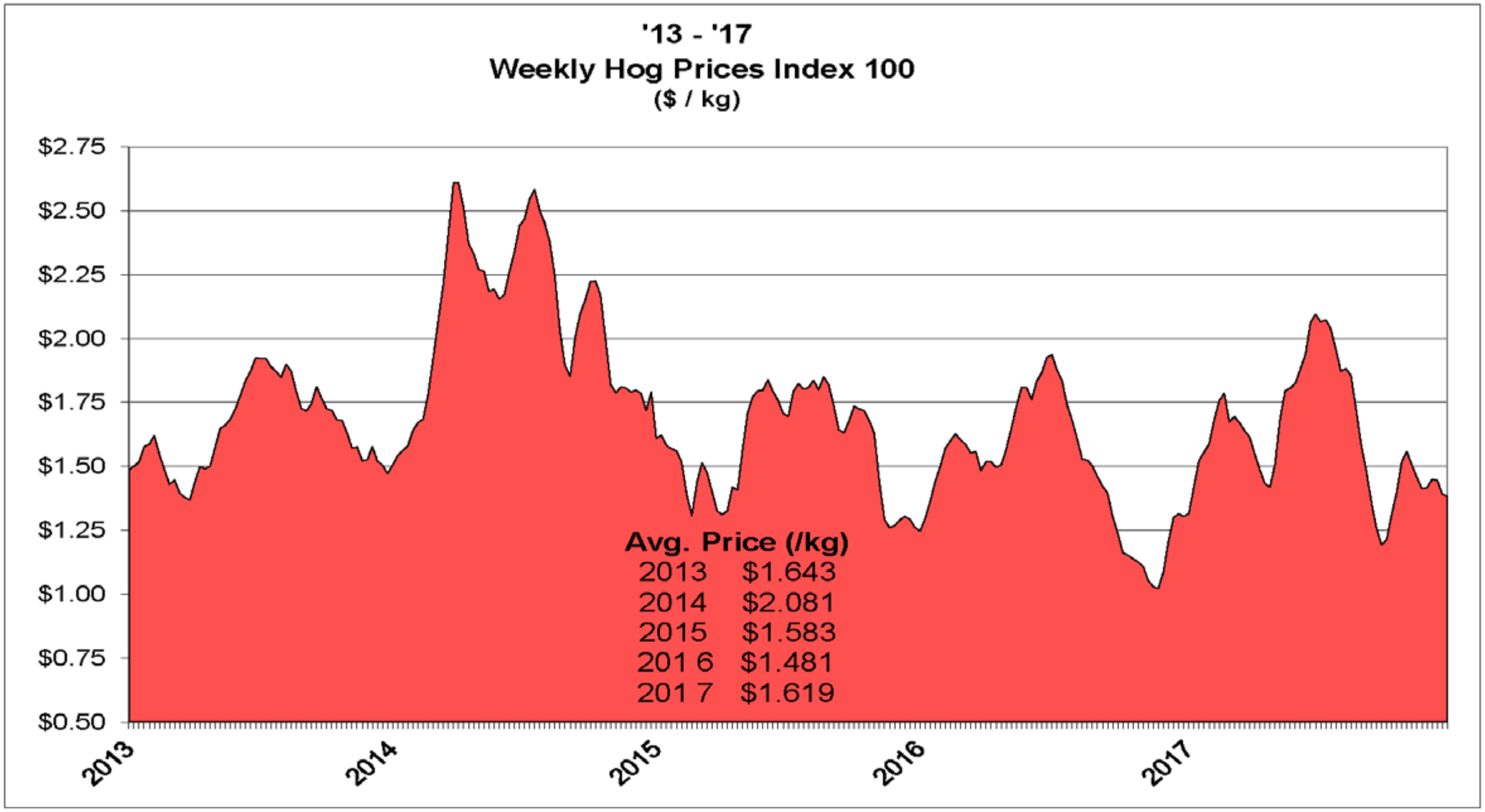
# Hog Price Graphs



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## Credit Union Benchmark Price Guide

| 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Commodity | Region | Grade / Crop | Comments | Units | Average Price | Range (- or + 1 St Dev) Low | High |
| CWB Wheat | Pooled Price | #1 13.5% Protein | 2013 to 2017 Yearly Avg | $ / bu. | **$6.35** | $5.71 | $6.99 |
| | | #2 13.5% Protein | 2013 to 2017 Yearly Avg | $ / bu. | **$6.04** | $5.38 | $6.70 |
| CWB Durum | Pooled Price | #1 13.0% Protein | 2013 to 2017 Yearly Avg | $ / bu. | **$7.68** | $6.91 | $8.44 |
| CWB Designated Barley (Malting) | Pooled Price | Designated Standard Select 2 Row | 2013 to 2017 Yearly Avg | $ / bu. | **$5.34** | $4.82 | $5.86 |
| NOTE: Freight and handing charges must be deducted from the CWB prices stated above (to provide the net to the producer). An average deduction of $48 per tonne for freight and handling is recommended for wheat and $52 per tonne for barley. This equates to the following per bushel deduction: Wheat $1.30 Barley $1.14 | | | | | | | |
| Non-Board Fd Grn | Grande Prairie | Wheat | 13 - 17 Monthly Avg | $ / bu. | **$5.04** | $4.02 | $6.06 |
| | | Oats | 13 - 17 Monthly Avg | $ / bu. | **$3.00** | $2.57 | $3.43 |
| | | Barley | 13 - 17 Monthly Avg | $ / bu. | **$3.62** | $2.85 | $4.38 |
| | Red Deer | Wheat | 13 - 17 Monthly Avg | $ / bu. | **$5.74** | $4.78 | $6.70 |
| | | Oats | 13 - 17 Monthly Avg | $ / bu. | **$3.36** | $3.00 | $3.72 |
| | | Barley | 13 - 17 Monthly Avg | $ / bu. | **$4.36** | $3.57 | $5.16 |
| | Lethbridge | Wheat | 13 - 17 Monthly Avg | $ / bu. | **$5.83** | $4.89 | $6.76 |
| | | Oats | 13 - 17 Monthly Avg | $ / bu. | **$3.55** | $3.15 | $3.95 |
| | | Barley | 13 - 17 Monthly Avg | $ / bu. | **$4.64** | $3.84 | $5.44 |
| Canola | Province | #1 | 13 - 17 Monthly Avg | $ / bu. | **$10.69** | $9.25 | $12.12 |
| Flax | Province | | 13 - 17 Monthly Avg | $ / bu. | **$12.37** | $10.88 | $13.86 |

January 2018

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Credit Union Benchmark Price Guide

## 2017

| Commodity | Region | Grade / Crop | Comments | Units | Average Price | Range (- or + 1 St Dev) Low | High |
|---|---|---|---|---|---|---|---|
| Forage | Peace | Legumes and Grass 1st Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.039** | $0.024 | $0.053 |
| | | Legumes and Grass 2nd Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.046** | $0.029 | $0.062 |
| | | Alflafa Hay 1st Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.045** | $0.028 | $0.063 |
| | | Alflafa Hay 2nd Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.049** | $0.031 | $0.067 |
| | | Silage | 13 - 17 Monthly Avg | $ / ton | **$40.15** | $33.38 | $46.92 |
| | Northeast (Edm NE) | Legumes and Grass 1st Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.054** | $0.029 | $0.078 |
| | | Legumes and Grass 2nd Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.063** | $0.035 | $0.091 |
| | | Alflafa Hay 1st Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.059** | $0.034 | $0.083 |
| | | Alflafa Hay 2nd Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.065** | $0.039 | $0.091 |
| | | Silage | 13 - 17 Monthly Avg | $ / ton | **$30.35** | $24.03 | $36.67 |
| | South | Legumes and Grass 1st Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.070** | $0.050 | $0.089 |
| | | Legumes and Grass 2nd Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.076** | $0.055 | $0.098 |
| | | Alflafa Hay 1st Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.077** | $0.059 | $0.096 |
| | | Alflafa Hay 2nd Cut | 13 - 17 Monthly Avg | $ / lb. | **$0.090** | $0.071 | $0.109 |
| | | Silage | 13 - 17 Monthly Avg | $ / ton | **$52.60** | $47.26 | $57.94 |
| Specialty Crops | Province | Canary Seed | 13 - 17 Monthly Avg | $ / lb. | **$0.23** | $0.21 | $0.26 |
| | | Feed Peas | 13 - 17 Monthly Avg | $ / bu. | **$5.81** | $4.90 | $6.71 |
| | | Laird Lentils | 13 - 17 Monthly Avg | $ / lb. | **$0.41** | $0.22 | $0.59 |
| | | Eston Lentils | 13 - 17 Monthly Avg | $ / lb. | **$0.35** | $0.19 | $0.50 |
| | | Yellow Mustard | 13 - 17 Monthly Avg | $ / lb. | **$0.37** | $0.30 | $0.44 |

**Metric Conversion Table**

| Commodity | Pounds per Bushel | Bushels per Tonne |
|---|---|---|
| Barley | 48 | 45.930 |
| Buckwheat | 48 | 45.930 |
| Canary Seed | 50 | 44.092 |
| Canola | 50 | 44.092 |
| Corn | 56 | 39.368 |
| Durum | 60 | 36.744 |
| Faba Beans | 60 | 36.744 |

**Metric Conversion Table**

| Commodity | Pounds per Bushel | Bushels per Tonne |
|---|---|---|
| Flaxseed | 56 | 39.368 |
| Mustard | 50 | 44.092 |
| Oats | 34 | 64.842 |
| Peas | 60 | 36.744 |
| Soybeans | 60 | 36.744 |
| Sunflower Seed | 30 | 73.487 |
| Wheat | 60 | 36.744 |

**Example: Canola: $10.43 per bushel equals $459.88 per tonne ($10.43 x 44.092)**

January 2018

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

## Credit Union Benchmark Price Guide

### 2017

| Commodity | Region | Grade / Crop | Comments | Units | Average Price | Range (- or + 1 St Dev) Low | High |
|---|---|---|---|---|---|---|---|
| **Cattle** | **Province** | Bred Cows / Bred Heifers | 13 - 17 Monthly Avg | $ / Hd. | **$1,793** | $1,353 | $2,233 |
| | | Open / Cull Cows | 13 - 17 Monthly Avg | $ / Hd. | **$1,286** | $1,013 | $1,558 |
| | | Bulls | 13 - 17 Monthly Avg | $ / Hd. | **$3,098** | $2,680 | $3,515 |
| | | 550 lb Steers | 13 - 17 Monthly Avg | $ / cwt. | **$229** | $175 | $283 |
| | | 850 lb Steers | 13 - 17 Monthly Avg | $ / cwt. | **$189** | $149 | $229 |
| | | Fed Steers | 13 - 17 Monthly Avg | $ / cwt. | **$154** | $129 | $178 |

**NOTE: When taking Registered Purebred Breeding Stock as security, a maximum premium of 25% above the listed security values is recommended.**

| Commodity | Region | Grade / Crop | Comments | Units | Average Price | Low | High |
|---|---|---|---|---|---|---|---|
| **Hogs** | **Province** | Boars - Pure/Cross Bred | 13 - 17 Quarterly Avg | $ / Hd. | **$692** | $657 | $727 |
| | | Boars - Genetic Companies | 13 - 17 Quarterly Avg | $ / Hd. | **$1,440** | $1,365 | $1,515 |
| | | Bred Sows - Pure/Cross Bred | 13 - 17 Monthly Avg | $ / Hd. | **$381** | $349 | $414 |
| | | Bred Sows - Genetic Companies | 13 - 17 Monthly Avg | $ / Hd. | **$468** | $439 | $498 |
| | | Weaner Hogs (from 9 to 22 kg) | 13 - 17 Monthly Avg | $ / Hd. | **$58** | $48 | $69 |
| | | Market Hogs Ave $ per Head | 13 - 17 Monthly Avg | $ / Hd. | **$181** | $148 | $214 |
| | | Market Hogs 100 Index | 5 Yr 13 - 17 Weekly Avg | $ / kg. | **$1.72** | $1.30 | $2.14 |
| | | Market Hogs 100 Index | 10 Yr 08 -17 Weekly Avg | $ / kg. | **$1.52** | $1.21 | $1.84 |

Hogs are paid on a dressed weight basis.
The target weight is 85 - 100 kg dressed
Hogs dress out at 80%, so the target live weight is 106 - 125 kg
Some packers have implemented a specialty grid that allows 20% of hogs to fall between 72 - 78 kg and still grade well
The price quote i.e., $1.34 / kg is based on a 100 index (100%) (10 yr average price)
Most producers will grade above 100 with very lean hogs averaging 109+. 109 index means the producer is getting 9% more for the hogs.

**Sample Calculation:**

Market price = $1.34/kg
Average index = 109
Average weight = 92 kg dressed
Return = $1.34 x 1.09 x 92 kg = **$134.38 per hog**

January 2018

# Farm Operating Line of Credit

- To cover input and other general operating needs pending sale of grain crop/livestock, etc.
- AOD's/LOC's are to be reviewed following the Credit Reviews guideline and based on current fiscal year end financial statements, agricultural analyst worksheet (i.e., ABA), copies of latest income tax return, and updated personal financial statements in the case of incorporated farms.
- Lack of complexity of the farming operation may not demand development of a full agricultural analyst worksheet; however, at a minimum, the review should include details of assets/liabilities (net worth statement), income and expenses (income tax return), and some form of plans/projections for the next fiscal period.

### Term

- Revolving on demand with interest paid monthly.

### Amount

- Financing is to be limited to 65-75% depending on the type and value of security pledged. In most cases, security would include current, intermediate, or long term assets and financing will be subject to close monitoring of working capital assets given this would be the prime source of repayment. Where sufficient intermediate/long term assets are not specifically pledged, advances are to be margined (monthly or quarterly) against working capital assets.

### Security

- A General Security Agreement conveying an "allpaap" and where available or necessary, a specific charge over serial numbered goods is to be taken.
  **Note:** Equity in Feeder Association owned cattle as well as outstanding Canadian Wheat Board advances are to be excluded or deducted. While there may be equity value in feeder cattle financed through a Feeder Association, no lending value can be assigned as title does not normally transfer to the farmer although the equity would continue to be recorded on the member's balance sheet.
- It is recognized the value of any claim over working capital assets (i.e., cattle, grain, etc.) will not become clear unless or until crystallization of security is undertaken; therefore, reliance on these assets as the sole source of repayment is not encouraged.
- Assignment of crop insurance where the borrower has an insurable crop. At the time of making the loan obtain written confirmation from the insurer that:
  - insurance premiums are current; and
  - there are no prior assignments of the insurance proceeds.
    **Note:** The assignment of crop insurance is considered to be a risk management tool and should not form part of the security valuations. Likewise participation in other revenue/production protection programs should be determined with participation details documented within the application.

- Assignment of insurance over equipment and/or property as applicable.
- Where the borrower is a limited company/corporate entity, full covering personal guarantees of the principals should be obtained and supported by tangible security if appropriate. Where it is considered prudent to ensure equity is retained in the corporate borrower, a Formal Assignment and Postponement of Shareholder's Loans is to be taken.
- Where married individuals operate the farming enterprise, all security documentation should be executed by both the husband and wife on a joint and several basis. Only in extenuating circumstances should the credit union permit execution by only one party and only if ownership of the real estate and operating assets is confirmed to be in the sole name of that party. Caution should be exercised where there is evidence of income splitting for income tax purposes.
- Where a degree of reliance is placed on the growing crop, the security documentation is to include a Specific Security Agreement (*For All Indebtedness*) obtained annually charging growing crops pursuant to PPSA Section 13. No lending value can be assigned to growing crops until such time as it is converted to inventory ("grain in the bin"). Notice of Security Interest (Form 17) should be filed on title to farmland (owned and/or rented) where available.
- As appropriate, assignment and/or redirection of income, particularly for dairy, poultry farming, etc. should be obtained.
- An Overdraft Protection Agreement or Line of Credit Agreement (as applicable).
- Where financing is placed under a Government Program security must conform to the Program guidelines.

# Farm Term and Mortgage Loans

- To assist with the purchase or refinance of equipment, livestock, farmland, etc.
- Review of the account is to follow Credit Reviews guidelines. Reviews should be supported with a completed agricultural analyst worksheet, copies of the latest tax returns, the member's next year's business plan and/or projections.
- The timing of these reviews should be scheduled to allow for the appropriate level of approval to be in hand prior to the next business cycle.
- The credit union should ascertain that the farm principals carry sufficient life insurance coverage on the "key" person, and in some cases, obtain an assignment.
- Due to the environmental issues relating to heavy intensive cattle and hog operations, most municipalities have been changing/amending their By-Laws whereby if an existing facility (barn etc.) burns down or is otherwise destroyed, the farmers must rebuild on a "set back" basis or on another part of the land. To ensure a member or the credit union is not impacted by Municipal By-Law Changes it will be necessary to request that agricultural borrowing members affected by the foregoing obtain and provide evidence of "By-Law Change" coverage in their fire insurance policy.
- When financing "intensive" agricultural enterprises (feeders, hogs, poultry, etc.), it will be necessary to ensure all Provincial Government and Municipal environmental and other criteria are met before funding can proceed (i.e., clearance certificates, etc.).
- Where appropriate, credit unions should encourage members to take advantage of the various Federal and Provincial Government guarantee loan programs as well as revenue/production protection programs.
- Where land values are influenced by "extreme" market conditions, values are to reflect the 5 - 10 year general average for that area of the Province to recognize the longer term mortgage commitment. Where this information is not available to determine the lending value, a more conservative 50% - 60% lending value is to apply.

### Term

- Refer to Farm Term and Mortgage Loans Chart

### Amount

- Dependent on the purpose and subject to the lending values assigned and repayment ability.

### Security

- Where financing of real estate is involved, mortgage security is to be taken in preference to an Encumbrance Agreement; however, an Encumbrance Agreement (interest registered on title by way of caveat) may be substituted where a prior mortgage charge over the property is held by the credit union and/or the term does not exceed five years.

- For farm term loans, a General Security Agreement supplemented by a mortgage charge over real estate are the preferred security documents to be taken.
- If the borrower is a corporate entity, personal guarantees of the principals are to be obtained, and if there is a potential for commingling of assets (i.e., the grain permit book, etc. is in personal names), the guarantee is to be supported by a GSA.
- Assignment of adequate farm, business, residence, and machinery insurance coverage.
- Any other documentation as appropriate.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Farm Term and Mortgage Loans Chart

| Purpose Of Loan | Lending Value Assigned | Amortization Period |
|---|---|---|
| Breeding livestock, including dairy cattle | New Purchase: Up to 75% of cost supported by bills of sale<br>Existing stock: Up to 75% of the estimated market value based on the five year average | Maximum of 5 years; however, up to 7 years for strong members |
| Exotic or Game livestock | 50-60% of cost or market value as confirmed through a qualified third party (arm's length) | Maximum of 5 years for breeding stock |
| Market livestock, including feeder cattle | To a maximum of 75% of cost supported by bills of sale | To be retired in full at sale date or maximum of 15 months |
| Machinery and Equipment | New and up to 2 model years: up to 80% for serial numbered goods and 75% of cost for non-serial numbered goods supported by bills of sale | 1-7 years depending on life expectancy of asset purchased/pledged<br>Where financing is extended under a Government Program, or as an exception for proven operators, up to 10 years may be granted for higher-end assets |
| | Used over two model years: 50-75% (depending on age, shape, etc.) of the lesser of purchase price (supported by bills of sale) or substantiated market value [Marshall's Guide, dealer-ship, Western Canada Official Guide ("resale cash" or appraised auction value) | 1-6 years, depending on remaining life expectancy of assets purchased/pledged unless under a Government Program |

| Purpose Of Loan | Lending Value Assigned | Amortization Period |
|---|---|---|
| Purchased or existing farmland | 60-75% of value as determined by way of an independent appraisal<br>50-60% maximum based on an in-house assessment from municipal land assessment value conditional to land values reflecting historical market factors | Maximum 25 years depending if the land is productive or not |
| Existing land, buildings, or improvements or land purchased in addition to existing farm property | 60-75% of value as determined by way of an independent appraisal<br>50-60% maximum based on an in-house assessment from municipal land assessment value conditional to land values reflecting historical market factors | A maximum of 15-20 years depending on the estimated economic life of the improvements. Only in limited circumstances should a 25-year amortization be entertained. |
| Specialized improvements (dairy, hog, poultry, etc.) | 50-65% of substantiated value of the real estate by way of independent appraisal. The higher lending value would only be applied where the improvements have an identified alternate use. | To a maximum of 12-15 years. Note: Caution is to be exercised where the land size is limited or the alternate land use will not enable the credit union to achieve maximum recovery in a foreclosure action. |
| Dairy, poultry quota, etc. | Only to be considered if member deals exclusively with the credit union. A maximum loan value of 25-30% to be applied to quota and provided GSA and assignment of contract income are obtained | Maximum amortization of 2-3 years. |

# Feeder Association Financing

The Feeder Associations Guarantee Act provides farmers with an alternative method of financing cattle for growing and finishing purposes.

The Feeder Association, which is a co-operative, own the livestock, but the care, feeding and marketing are the responsibility of the individual member.

In each Association a Board of Directors approves and monitors loans for feeder cattle. Each board hires a Supervisor and Secretary/Treasurer to administer loans and maintain financial records.

Feeder Association accounts are considered to be highly administrative particularly during seasonal peak livestock buying periods and also taking into consideration that they have monthly reporting that they require from their Financial Institution.

## Business Risks

- The length the association been in existence. The composition of the board (i.e., who are the association's Chairman or President, Vice Chairman or Vice President, Secretary/Treasurer, Supervisor and Directors).
- The tenure of each executive and/or director in their position.
- The background of the executive and/or board members.
- The executives and/or board members character.
- Contact the Provincial Supervisor of the Feeder Associations and perform a character reference check on the local Association, (i.e., has the local Association had any derogatory behaviour that the Province is aware of)? What is the Province's opinion of the capabilities of the present Board for the local Association? The discussion with the Provincial Supervisor should be documented.
- What is the association's application process? Obtain a copy of an application if possible and review the process of due diligence carried out by the Association when considering a new member. Areas of consideration are:
    1. Is a personal net worth statement obtained?
    2. Is a credit bureau report obtained and if so is this done by their FI or do they have another source to obtain?
    3. Is a bank reference check performed?
    4. Is a PPSA and BOC search performed? If yes do they have their own source to conduct the searches?
    5. If a search reveals other lien holders exist in order to ensure clear title to the livestock does the Association issue the proceeds payable jointly to the member as well as the lien holder(s) or alternatively obtain a letter from the lien holder that they do not have any interest in the said livestock?
    6. What role does the Association's Supervisor play in assessing new members?
- Inquire with the Association if it has established a formal written lending policy and if so request a copy for review.

- How does the Association monitor and/or assess ongoing risk with existing members i.e., what level of due diligence do they carry out?
- Obtain a credit bureau and/or Bank reports satisfactory to the Board as a qualifying condition for all new membership applications.

### Procedural Issues

- What is the Association's history of loan losses?
- When was their last loss incurred?
- Where does their current delinquency stand?
- What is the Association's policy regarding a member with a bad debt?
- What is the Association's policy regarding registering their Member's dealings under PPSA?
- What is the Association's policy regarding Member's having Feeder Association livestock custom fed? If they permit Members to place Feeder Association livestock in custom feedlots are appropriate priority agreements from the Feedlot Operator and the Feedlot Operator's FI obtained?
- Concerning livestock insurance to the Members, does the Association belong to the Provincial Livestock Indemnity Trust program or do they maintain their own program? Is participation voluntary or mandatory?

### Other General Areas of Consideration

- Review membership to determine "Concentration" i.e., number of family/related members controlling the association (as concentration increases so does the risk). This should be commented on in the application.
- Evidence of non-compliance i.e., roll over of contracts to withdraw equity is not allowed under the Feeder Associations Guarantee Act. The credit union should monitor for unusual activity as they are processing contracts.
- What does the Association's MIS consist of?
- Are copies of their reports available for review?

### Terms and Conditions

Conditions Precedent

- In that the Associations Board approves and monitors the loans the underlying risk lies in proper due diligence of the supervisor, strength of the board and its membership. There are a number of Business Risks and Procedural Issues that must be understood and addressed by the credit union.

Ongoing Conditions

- Annually, a satisfactory report is to be obtained on the Association from the Provincial Supervisor
- Assigned 5% Member deposits Plus value of assigned feeder cattle contracts is to provide 105% coverage of outstanding loans (monitored monthly)

- Abide by the Feeder Associations Guarantee Act and any recommended policy changes conveyed by the Provincial Association
- The Association is to confirm in writing to the credit union any future policy changes it has implemented (failure of the Association to follow the Lending Guidelines would constitute a breach of the lending agreement)
- All Livestock are to be branded with the Association's Brand
- Interest is payable at the earlier of the end of each contract or when the cattle are sold
- The Feeder Association has Reporting Requirements that must be adhered to:
    - Annual Audited Financial Statement to be provided within 90 days of the Association's year-end
    - Original fully executed contract is to be provided to allow for disbursement however if location is a concern acceptance of faxed signed contracts will be permissible for immediate funding with original contract to follow by not later than the next business day
    - A copy of the Feeder Association's monthly report to the Provincial Supervisor is to be supplied to the credit union detailing full particulars of loans outstanding

### Loan Type

- Demand Loan in structure, with a maximum term of any Feeder Contract to be 12 months from date of issue with a further 3-month extension permissible if specifically approved by the Feeder Association.
  Note: Any extension, a copy of approval letter is to be provided to the credit union.

### Loan Amount/Financing Levels

n/a

### Loan Security

- Certified Copy of Order in Council re: Province of Alberta Guarantee for the approved amount.
- Certified Copy of the Tri-Party Agreement (Province, Association & Financial Institution)
- General Security Agreement (ALLPAAP) with Resolution and Solicitor's Letter of Opinion
- Assignment of Credit Balances - (covers the 5% assurance fund deposit)
- Assignment of Specified Accounts (covers assigning the member's contracts)

# 8. CONSUMER LOANS AND RESIDENTIAL MORTGAGES

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Consumer Lending Criteria

## Criteria for all Consumer Loans

With few exceptions, the following criteria apply to all consumer loans (exceptions are to be supported by a recorded rationale):

1. Consideration must be given to the Five C's of Credit when granting credit to any one member.
2. Applicant(s) must be at least eighteen years of age. Applicant(s) under the age of 18 will require a co-borrower, not a guarantor.
3. Applicant(s) and/or co-borrower(s) must have a satisfactory credit rating.
4. Applicants and co-borrowers' employment and income must be confirmed by way of a copy of the most recent income tax return (supported by Notice of Assessment), letter from employer, payroll stub, etc. for both existing members and new members relative to employment/income status.
5. If the applicant(s) has existing borrowings or is an endorser or signatory on other loans, the outstanding balance is to be considered in the aggregate amount that may be loaned to the applicant.
6. If the assets or income of the spouse and/or other parties are required to meet the loan requirement criteria, the spouse and/or other parties must sign the loan agreement and other applicable loan documentation.
7. The total debt service ratio (TDSR), including the new loan payment, must not exceed 42%.
8. Stability of employment should be demonstrated (i.e., continuous employment with current employer for at least two years). **Note**: An exception may be considered for trade individuals who have continuously been working in the same trade for a number of years; however, have only recently changed employers.
9. Residential stability to be established (at least one year at the current residence).
10. The applicant(s) should have demonstrated satisfactory dealings with the credit union and/or another financial institution as confirmed by a credit search report that is no more than six months old.
11. Maximum amortization for unsecured loans (excluding RRSP) is 36-months. Exception must be mitigated or warranted within appropriate approval authority.
12. Meet the criteria of the credit union's credit policy.

## Criteria for Secured Loans

In addition to the above, the following apply to secured loans:

1. A search must be undertaken to determine the registered owner and any registered security interests for existing or purchased personal property being pledged as security.
2. Where a security interest exists, a discharge or a priority agreement to subordinate the secured party's interest to the credit union, is to be obtained prior to the advance of funds.

3. Where a secured party has an interest in the personal property, proceeds of the loan must be disbursed by official cheque made payable to the member and the secured party and/or vendor with confirmation obtained verifying the debt has been extinguished.
4. All parties with or obtaining a registered interest in the personal property to be pledged must sign all the personal term loan documentation.
5. When financing personal property being purchased from a seller of goods, a vendor's invoice or bill of sale is to be obtained confirming the serial number and the purchase price. In all other circumstances, the serial number must be searched and the condition of the personal property physically inspected.
6. The cost of any written appraisal and/or registration of the security interest normally is borne by the member whether or not funds are advanced. It may be prudent to determine the appraisal and/or registration cost prior to incurring any costs.
7. No funds are to be advanced on any security agreement (i.e., SSA, SSA (ALL), GSA) where the personal property was or continues to be registered in another jurisdiction (Province) unless a search both in Alberta and the other jurisdictions establishes that there are no outstanding liens or registered security interests.
8. If the security is relocated outside Alberta, PPR registration in the other jurisdiction (Province), is required.
9. Impairment insurance should be carried by each credit union.
10. Personal Property Security Act should be followed for registering security interests.
11. Registration should be in effect for the length of the loan.

### Related Guideline

| | |
|---|---|
| Debt Service Capacity | Five C’s of Credit |

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Debt Service Capacity

## General Requirements

- Capacity must incorporate regulatory and legal requirements, reflect industry best practices/standards and be consistent with related Guidances issued by the Corporation.
- A thorough assessment of an applicant's ability and likelihood to repay is necessary.
- Incomes utilized in qualifying applicant(s) are to be in writing (i.e., letter from employer, income tax return supported by Notice of Assessment); however, in some consumer lending situations (non-mortgage) it may be acceptable to confirm income with a pay stub.
- Income that cannot be verified or supported by way of income tax return (e.g., rental income, tips, etc.) may not be used when calculating eligibility.
- The earners of verified gross income must have a direct obligation to the debt.
- Balances of all debt obligations including credit cards declared by applicant(s) are to be verified. All discrepancies must be investigated and accurate balances, payments etc., agreed upon to determine an accurate debt service capacity.
- In calculating credit card payments, the preferable and most conservative method is to use a 3% payment component based on total credit card limits. Supposing a credit reporting agency report confirms satisfactory usage, a 3% payment component of the outstanding balances at the time of application may be used.
- Industry standards utilize 3% of any authorized overdraft limit or line of credit limit or an amortized payment as part of the debt service calculation.

## Employment and Income Verification

### 1. Employed by Others

- The applicant(s) should be employed by the current employer for minimum one to two years. A recent job/occupation change to better oneself, after good tenure in the previous position should not disqualify the applicant(s).
- Employment Letter should be in writing and current within 30 days on company letterhead. Letter must be signed, dated and include:
  - Confirmation of base salary – typically 100% is used as income
  - Confirm commission income (qualification based on a 2-year average)
  - Employment tenure and position
  - Confirmation of overtime and bonuses, if applicable

    **Note:** a 2-year average may be considered toward debt servicing if it is expected to continue in the future.
- Pay Stub for several recent pay periods can be used for smaller consumer loans.

2. **Investment Income**

   - Should only be used if it can be demonstrated that it has been available for at least two years with likelihood of continuing in the future.

3. **Guaranteed Income**

   - Includes pensions, annuities and insurance payments and must be confirmed if a determining factor in approving the loan.

4. **Self Employed**

   - Successful operation of the business for two years verified with copies of personal income tax returns and supported by Notice of Assessment.
   - If financial statements are available, viability of the company should be assessed.

5. **Other Income Sources**

   - Gratuities: can be used if confirmed by a minimum of 2-years income tax returns.
   - Alimony/Support Payments: supported by a copy of the divorce or separation agreement outlining the terms of the support payment with confirmation the income will remain regular for a least five years into the future.
   - Other verifiable sources, if applicable.

## Character & Credit

A thorough investigation of the applicant(s) confirming their credit worthiness must be conducted and is to include a report from an independent credit reporting agency. The report should be no older than six months.

## Debt Service Coverage Calculation

- Gross Debt Service (GDS) and Total Debt Service (TDS) should be calculated conservatively and take into consideration industry qualification requirements.
- The Standard maximum debt service qualification is GDSR 35% and TDSR 42%.
- Debt service for mortgage origination must incorporate the minimum qualifying interest rate test set out in the Residential Mortgage Financing guideline.
- Debt service requirements for mortgage origination:
  - Maximum GDS and TDS that may be considered when qualifying for a new mortgage or refinancing are 39% and 44%, respectively. The maximum threshold is to be based on the overall strength of the mortgage application, including a minimum credit bureau score of 650 and maximum 25-year amortization.
  - Exceptions to the above criteria are to be identified in the mortgage application and subject to appropriate approval authority.
  - Exceptions should consider increased pricing and reduced loan-to-value.
  - Exception approvals should be monitored and included in periodic risk reporting.

- For all mortgages (uninsured or insured) lenders must obtain the actual heating cost records of a property. Where no history is available, the heat expense used in debt ratio calculations must be a reasonable estimate taking into consideration factors such as property size, location and/or type of heating system. A cost formula set within credit union policy or as set out by an insurer must be used.
- Condominium fees are to be confirmed and investigated as there are variables within the fees. The Corporation does not view using 50% flat rate of the condominium fee as prudent. In some instances, heating is included and therefore an independent heating component is not required. In all cases, 100% of the condominium fee is to be used when calculating GDS unless it cannot be determined if heating is included in the fee. If the latter is the case, the condominium fee can be reduced by the heating component calculated by the credit union.
  **Note:** Under the Condominium Property Act, in Alberta, a condominium corporation registering a Caveat for any condominium fee arrears to the corporation has priority to a mortgage registered under the Land Titles Act.
- Homeowners Association (HOA) fees are to be confirmed with 100% of the fee used when calculating GDS. Any charge by the HOA is to be subordinated to the credit union.
- While not technically necessary, it is prudent to confirm GDS for renters, substituting rent plus any heating costs, if applicable.

**Gross Debt Service (GDS)**

1. Described as a percentage of gross income.
2. The purpose is to ensure shelter costs do not exceed the industry standard of 35% (mortgage origination stressed 39%).
3. Shelter Costs included in the GDS are only applicable to the primary/principal residence.
4. Shelter Costs consist of:
   a. Principal and interest payments on the primary residence
   b. Actual property taxes or estimate based on area/market
   c. Condominium and/or HOA fees (if applicable)
   d. Heating costs
   e. Can also be a combination of rent, trailer park fees, room and board plus a cost for heating
5. GDS is calculated as:

$$\frac{\text{Shelter Costs}}{\text{Gross Income}}$$

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**Total Debt Service (TDS)**

1. Described as a percentage of gross income.
2. Encompasses all other debt obligations:
    a. Lease payments
    b. Loan payments
    c. Credit cards
    d. Unsecured and secured lines of credit (excluding LOCs secured by mortgage over principal residence)
    e. Mortgages on recreational or personally held revenue properties
    f. Support payments
3. The purpose is to ensure shelter costs plus all other debt obligations do not exceed the industry standard of 42% (mortgage origination stressed 44%).
4. Shelter Costs are represented by the GDS calculation.
5. TDS is calculated as:

$$\frac{\text{Shelter Costs + All Other Debt Obligations}}{\text{Gross Income}}$$

## Related Guidelines

| | |
|---|---|
| Consumer Lending Criteria | Residential Mortgage Financing |
| Use of Residential Mortgage Lending Limits | Consumer Revolving Credit Facilities |
| Standard Mortgage Repayment Terms | |

# Personal Loans

## Demand Loans

- Demand loans are subject to all consumer lending criteria.
- Security is to be taken where appropriate (i.e., Mortgage, Collateral Mortgage, General Security Agreement, Specific Security Agreement, Hypothecation of Securities, Account Set-Off Agreement, etc.).
- Any terms or conditions related to the personal demand loan must be clearly identified in the loan file.
- Current financial information (preferably not older than six months), should be provided by the member at least annually. This information must clearly indicate the borrower's net worth and ability to repay and must be kept in the applicant's file at all times.
- All Personal Demand Loans should be repayable in full within one year, or at a minimum, subject to renewal annually (or on a less frequent basis, as may be determined by the lender and/or Credit Union Credit Committee).
- Interest on all Personal Demand Loans must be paid monthly, unless special circumstances dictates otherwise in which case pricing should be increased to reflect the delay in the collection of revenue and then not less frequently than annually pursuant to Credit Union (Ministerial) Regulation 14.
- Source of repayment should be clearly identified and/or confirmed.

## Term Loans

- Term loans follow the criteria set out in consumer lending criteria and the chart with recommended lending values and amortization period.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Residential Mortgage Financing

- Residential Mortgage Financing must incorporate regulatory and legal requirements, reflect industry best practices/standards and be consistent with related Guidances issued by the Corporation.
- Credit Unions should have a comprehensive Residential Mortgage Underwriting Policy in place.
- A member is eligible for one residential mortgage meeting the definition of a quality mortgage loan and residential mortgage loan set out in the Credit Union (Principal) Regulation.
- Where a Home Equity Line of Credit (HELOC) is being considered, requirements under this guideline and those set out in Consumer Revolving Credit Facilities guideline must be followed.
- All uninsured mortgage originations are to meet the minimum qualifying test using the qualifying rate stated as the greater of the contractual mortgage rate plus 2% or the five-year Bank of Canada rate.
- Insured mortgages must meet the insurer's requirements.

## First Mortgage

### Property

1. An owner occupied, primary residence, located within the limits of a City, Town, Village or Hamlet, including:
   - Single family detached dwelling
   - One to four units (Duplex, Tri/Four-plex) where one of the units is owner occupied
   - Condominium
   - Mobile home affixed to the property and where ownership of the property and the mobile home are common.
2. Property located outside the limits of a City, Town, Village or Hamlet is restricted to:
   - Single family detached dwelling located on a rural acreage not exceeding 40 acres
   - Mobile home affixed to a property not exceeding 40 acres
   - Water (well) and sewage (septic) services for acreage property must meet certification in accordance with Provincial/Municipal Standards.

### Appraisal Requirements/Criteria

- A current written appraisal (within three months) by an independent qualified appraiser (as defined in Credit Union (Principal) Regulation 84(1)) is to be obtained and retained on file. The appraisal is to indicate that the evaluation is for "mortgage lending purposes", prepared on behalf of the credit union. Where not prepared for the credit union, a transmittal letter must be obtained.
- An appraisal of rural properties and acreages is to include all land and buildings; however, the appraiser is to be tasked to provide a separate value for the house and 40 acres where the land component is greater than 40 acres. A mortgage for a property with more than 40 acres is still considered a quality mortgage albeit not a residential mortgage.

- Instances where the mortgage loan is to purchase a pre-owned residence (presently occupied) and the amount of the mortgage will not exceed 60% of the purchase price determined by a bona fide accepted offer to purchase and the member's equity is provided in cash (vendor take-backs or second mortgages do not constitute cash equity), it will not be necessary to insist on an appraisal. In lieu of an appraisal and to determine the value of the property, the credit union must undertake due diligence to ensure the security coverage is appropriate, such as:
    a. The most recent Municipal Property Assessment Notice.
    b. A written market valuation based on on-site investigation by a senior officer of the credit union complete with photos of the property.
    c. A realtor's market evaluation or comparable sales listings (if available).

**Security**

- A registered mortgage document must be prepared by the credit union solicitor who will provide a written opinion confirming the validity, enforceability and priority of the mortgage charge.
- Title Insurance from an authorized title insurance company may be utilized.
- Assignment of fire insurance with loss payable to the credit union with the policy including the standard mortgage endorsement clause.
- Where interim financing is necessary, in addition to the Solicitor Acknowledged Assignment of Sale Proceeds, an Encumbrance Agreement covering both the existing and new residence is to be obtained with registration required only in the event the sale of the existing residence does not proceed.

**General Conditions of Approval**

- Financing of fractional interests are not to be considered unless all registered owners qualify and execute the mortgage documentation.
- Subject to the Consumer Lending Criteria.
- The current market value of the property to be mortgaged must be determined and recorded in the member file before the final approval of the mortgage loan may be granted.
- All mortgage loans must meet the "quality mortgage loan" definition set out in Credit Union (Principal) Regulation 1 (1) (m).
- Maximum loan-to-value LTV of 80% based on the lesser of purchase price or appraised value.
- A dynamic LTV or sliding scale LTV based on the value of the home and housing market conditions must be in place.
- Lower LTV should be considered for refinancing, consolidation and recreational properties.
- Non-conforming residential mortgages should have a standard maximum LTV of 65%; this maximum threshold should decrease as risk increases. Exceptions up to 80% LTV may be considered with mitigation and appropriate approval authority.
    - Non-conforming mortgages:

  - Non-conforming mortgages are a subset of uninsured mortgage loans and are broadly defined as having higher-risk attributes or deficiencies, relative to other uninsured mortgages.
  - Non-conforming characteristics can include non-income qualifying loans, loans to those with low credit scores or high debt service ratios, security values where attributes of the property cause the loan to carry elevated credit risk (e.g., illiquid properties) or any uninsured mortgage that has clear deficiencies relative to a conforming uninsured residential mortgage.
- For insured mortgages, LTV requirements by the insurer will apply.
- Debt Service capacity guidelines must be met.
- Other than revolving facilities supported with a mortgage charge, standard mortgage repayment terms are applicable.
- Estoppel Certificates must be obtained for condominium financing.
- All mortgages are to be prepared by a solicitor.
- Funds must be disbursed in accordance with the written direction from the credit union's solicitor and/or supported by a written direction/authorization signed by all parties registered on title and the borrowing member(s), for the member(s), on every mortgage. Failing this, funds must be forwarded to the solicitor "In Trust" for disbursement.
- Mortgage documentation is to be restricted to those standard documents registered with Land Titles.
- All mortgages and modification of mortgages must contain events of default clauses calling for payment in full at the option of the credit union as well as the standard positive and negative covenants.
- The credit union must request and obtain a Solicitor's Letter of Opinion unless Title Insurance is used.
- A copy of Land Title Certificate is to be provided by the solicitor upon registration of the mortgage.
- Written evidence of insurance coverage is to be obtained.
- Mortgage impairment insurance should be carried by all credit unions.
- All fees for appraisals, engineer's reports, Real Property Reports (not applicable if appropriate impairment coverage is in place), legal fees, registration costs, etc. are to be paid by the mortgagor regardless of whether the funds are advanced or not. All costs related to the preparation of the mortgage are the responsibility of the mortgagee.
- If the property to be mortgaged is registered in joint tenancy or tenants in common and the mortgage charge is taken either in support of a guarantee or for purposes other than the acquisition of the property or improvements, a Certificate of Independent Legal Advice must be obtained from any party not receiving direct consideration or benefit from the mortgage proceeds.
- Considering market area, testing of the LTV at mortgage renewal or sooner, if dictated by unexpected economic situations, should be undertaken.

## Secondary Mortgage Charges

- In considering a mortgage other than a first mortgage, the preference is that all registered priority charges are with the credit union.
- Subject to same underwriting criteria as a first mortgage.

### General Conditions of Approval where the First Mortgage is with another FI

- Solicitor instructions must stipulate the mortgage is to be registered as a "second financial charge" on the property subject to a first financial charge not exceeding a specific dollar amount.
  Note: With financial institutions registering re-advanceable mortgages, the solicitor is to review the first mortgage document and define the maximum claimable under that document in his written opinion prior to advancing any funds.
- A statement of the balance owing and confirmation that there are no arrears of payments must be obtained in writing from the institution, company, or individual holding the prior charge before final approval of the application may be granted.
- The credit union must confirm in writing or through the credit union solicitor reviewing and providing a written legal opinion, what the interest rate, remaining term, amortization, and pre-payment privileges are under the first mortgage document. In addition, any non-conventional terms such as a first right of refusal, options to purchase, bonus payment/fee, reverse mortgage document, etc. are to be defined.
- The credit union is not to consider a second mortgage where the prior mortgage does not recite a monthly repayment sufficient to cover the monthly interest and retire the principal over a period not to exceed 25 years.
- Where the prior mortgage reflects a "reverse mortgage agreement," a subsequent mortgage interest is not to be entertained.
- The credit union's secondary mortgage together with existing debt under other mortgages on the property are not to exceed the "quality mortgage loan" criteria.

## Residential Construction Loan

- Subject to same underwriting criteria for a first mortgage.
- The Construction Loans/Residential Builder Mortgages guideline will apply for a residential construction builder.
- Residential Builders in Alberta must be licensed and carry new home warranty.
- A member built personal residence can be considered, but not preferable.
- Requirements under the Builder's Lien Act are to be adhered.
- Requirements for builder licensing under the New Home Buyer Protection Act are to be adhered.
  - As of December 1, 2017, program requirements came into effect allowing for provisional licensing; however, effective May 1, 2018 all builders must have a builder license in order to obtain new building permits and build new homes in Alberta.

- Requirements under New Home Buyer Protection Act for New Home Warranty are to be adhered:
  - As of February 1, 2014, every home constructed in Alberta will be protected by warranty under Alberta's New Home Buyers Protection Act.
  - New Home Warranty is mandatory; in all instances a credit Union must obtain evidence the home is covered by New Home Warranty before consideration of funding.
  - There is a requirement for New Home Warranty coverage for renovations to a property in excess of 75% of the enclosed square footage of the building being renovated/repaired. The requirements are addressed by Municipal Affairs and should be reviewed prior to granting approval for a substantial renovation loan.
  - In the case of an owner/builder New Home Warranty may not be required in order to receive a building permit; however, should the home be sold within 10 years, the owner will have to provide New Home Warranty to the purchaser. It is at the Credit Union's discretion if New Home Warranty is required prior to funding; however, it is preferred that it is obtained.
  - New Homes include:
    - Single family detached homes
    - Multi-family homes (i.e., duplexes, four-plexes, etc.)
    - Condominiums
    - Manufactured homes
    - Recreational properties
- All criteria set out in CUCA's Mortgage Manual for residential construction mortgages are to be followed.
- Where a government guarantee or insurance exists, all their guidelines are to be followed.

## Mortgages on Residential Rental/Revenue Properties

- Excluding the primary residence and one second residence (recreational/owner occupied), a maximum of three (3) revenue properties can be financed under this guideline.
- Rental Properties under the residential mortgage guidelines must be tracked for Risk Weighting for capital purposes.
- Over three (3) revenue properties refer to Revenue Producing Properties guideline.
- Standard LTV 70%; exceptions to 80% if mitigated with appropriate approval authority.
- Maximum 25-year amortization.
- Lease agreements are required; where not in place, reliance must be on personal income tax returns for confirmation of revenue.
- Debt service coverage for each existing property is to be calculated on a stand-alone basis, supported by income tax returns including the Statement of Real Estate Rentals.
- Any short fall in stand-alone coverage is to be included within the borrower's TDSR requirements.
- Debt service coverage (i.e., TDSR) for each new residential rental may include 75% of the actual lease rental payment or up to 50% of new rents not supported by a lease. In subsequent financing, debt service coverage is to be tested with the benefit of personal income tax returns.

- Must be supported with an Assignment of Rents registered via Caveat.

**Related Guidelines**

| | |
|---|---|
| Consumer Lending Criteria | Use of Residential Mortgage Lending Limits |
| Consumer Revolving Credit Facilities | Revenue Producing Properties |
| Standard Mortgage Repayment Terms | Debt Service Capacity |
| Construction Loans/Residential Builder Mortgages | Legal Opinions |
| Title Insurance | |

# Consumer Revolving Credit Facilities

## Authorized Overdraft (AOD)

- An AOD allows the member(s) to continue withdrawing money from a deposit account even if the account has no funds in it or not enough to cover the withdrawal.
- When overdrawn deposits are expected monthly.
- An Overdraft Protection Agreement must be signed by all parties who have signing authority on the chequing account.

## Line of Credit (LOC)

- An unsecured line of credit should not exceed the amount the member may qualify for on an unsecured personal loan basis.
- The balance available on any outstanding unsecured credit facility is to be taken into consideration when determining the amount to be made available.
- Interest is to be paid monthly, unless special circumstances dictate otherwise.
- The same criteria as for unsecured and secured loans apply.

## 6. General Conditions

- All LOC/AOD facilities are to be reviewed in conjunction with all other loans extended to the member(s).
- If a LOC/AOD becomes delinquent, no further advances are to be granted and availability under the facility should be "frozen" except for repayment.
- After a total of three months continuous delinquency, the LOC/AOD is to be cancelled. Appropriate remedial action is to be taken to collect the outstanding principal and interest or to return the account to good standing.
- A formal demand is to be issued to the member depending on remedial action initiated and the member's response to the credit union's requests to re-instate the account activity.
- Impaired facilities and provisions are to be recognized in accordance with accounting standards.

## Home Equity Line of Credit (HELOC)

- Residential Mortgage Financing guidelines and quality mortgage criteria apply.
- Industry standard is for loan-to-value (LTV) not to exceed 65% of confirmed value; any exposure over 65% LTV to a maximum of 80% LTV should be amortized using conventional mortgage terms.
- Any amount over 65% to maximum of 80% that is not amortized is to be treated as an exception and mitigated within appropriate approval authority.
- Aggregate exposure to exceptions should be monitored.
- The ability to meet debt service requirements using conventional mortgage repayment terms must be demonstrated.

- The Line of Credit Agreement is to be executed by all registered homeowners.
- Where considered appropriate (short term), the HELOC may be secured by an Encumbrance Agreement (Memorandum of Charging Lands) registered on title by way of Caveat.
- If a solicitor does not prepare the security documentation, the credit union must perform its due diligence (i.e., conduct searches, confirm insurance, taxes, etc.) prior to the advance of funds to ensure no factors exist that would preclude the credit union from taking a charge over the property.

### Related Guidelines

| | |
|---|---|
| Residential Mortgage Financing | Consumer Lending Criteria |
| Debt Service Capacity | AOD LOC Unauthorized Excesses and Delinquency |

# Personal Property Exceptions

In addition to the general terms and amortization in the chart, these general conditions of approval apply when financing or taking security over this type of personal property.

All prior requirements for obtaining a personal term loan must be met in order for the applicant to qualify for the loan.

### Light Aircraft

- The maximum loan available on an aircraft intended for private use must not exceed 75% of the appraised value or purchase price of the aircraft (whichever is the lesser).
- In the case of financing an aircraft that is equipped or will be fitted with "floats" or other accessions, a separate value for the floats must be obtained. Up to 60% of the appraised value or purchase price of the floats (whichever is the lesser) may be advanced.

  **Example:**

  | | |
  |---|---|
  | Value of Aircraft $25,000 x 70%= | $17,500 |
  | Value of Floats $8,000 x 60%= | 4,800 |
  | Maximum Advance "Aircraft and Floats" | $22,300 |

- An appraisal of the aircraft must be completed by a qualified aircraft engineer/appraiser having the ability to establish the fair market value of the aircraft.
- The appraisal must include the basic evaluation of the aircraft plus a list of additional equipment with details of serial numbers and model numbers. This equipment must be visually confirmed by the lender.
- The appraisal must also include a recent photograph of the aircraft along with an evaluation of its present condition and a quick sale or auction value.
- Cost of the appraisal should be borne by the applicant. Those individuals who are responsible for completing such appraisals shall require prior approval of the credit union. As an alternative, a Letter of Opinion from a reputable dealer combined with confirming value via the "Aviation Blue Book" can be obtained.
- The General Security Agreement is to be drawn and financing statement registered at Personal Property Registry by the credit union's approved solicitor. The solicitor should also conduct all required searches to ascertain that any registered interest(s) are cleared and discharged prior to or in conjunction with the advancement of funds and financing statement registration. "Call numbers" are to be recited in the General Security Agreement.

  **Note:** As different components of the aircraft often have individual serial numbers (propeller, hull, floats, and engines), it is imperative each is identified in the security documentation.
- The solicitor/credit union must also obtain and make copies of the current certificate of ownership/registration and certificate of airworthiness.
- A copy of the insurance policy (to include hull, personal liability, and property damage) must be obtained by the credit union and kept on file. It is the responsibility of the credit union to ensure

that insurance coverage is renewed by the borrower annually and evidence of renewal provided to the credit union.

- Full insurance (in motion and not in motion coverage a.k.a. flight and take off) evidencing loss payable to the credit union in the minimum amount of the appraised value must be provided prior to the advancement of funds and a current policy must be kept on file throughout the duration of the loan. This policy must contain a breach of warranty clause to protect the credit union in the event of a claim arising and being declared invalid by the insurance company due to an act of the insured. In such instances, the insurer will pay to the secured party (credit union) either the amount of the damages or the amount of the registered interest, whichever is the lesser. In any event, the most that will be paid in such circumstances is the limit of the aircraft physical damage coverage. It is incumbent upon the credit union to ensure this insurance coverage does not lapse.
- Maximum Insurance Deductibles:
    - In Motion $500
    - Not In Motion $100
- Insurance on aircraft floats must be obtained up to the appraised value of the floats. A copy of the insurance policy must be received prior to advancement of funds. Any claim for loss must be shown as payable to the credit union.
- As the Ministry of Transport has strict regulations on the maintenance of aircraft engines (as well as propellers and air-frames), the appraiser must carefully examine the aircraft's Technical Log Book, which records the running hours on the engine. This examination must be acknowledged in the appraisal report and the total number of hours left before an engine overhaul is required must be stated in the appraisal. In order to evaluate the value of this security over the term of the loan and beyond, the appraisal report should reflect the market value of the aircraft at the existing unexpired engine time and the term determined based on the same. The appraisal should record the effect on market value as time remaining on the engine runs out, indicate when the propeller is next due for overhaul and include approximate cost range relative to this required maintenance.
- As part of the review process, the lender will need to verify via a review of the Log Book and reference to the earlier noted Aviation Blue Book that required maintenance standards are being met.
- Only Canadian registered aircraft are acceptable for security purposes.
- The General Security Agreement and registered financing statement forthcoming from the credit union solicitor are to be accompanied by a legal opinion identifying the security as being a valid first charge against the aircraft and that it is binding upon the borrower and enforceable by the lender.
- Imported aircraft must have the appraisal and sales values reported in Canadian dollar equivalents.

## Mobile Homes

- A mobile home is specific security (Personal Property) when it is not a fixture to real property.
- If a mobile home becomes a fixture to real property financing is to be considered under mortgage lending criteria.
- It is recommended that in mobile home financing (specific security), the credit union periodically monitors the mobile home to ensure that it does not become a fixture to realty without the credit union filing a notice at the Land Titles Office.
- A General Security Agreement with specific charge over the mobile home to be obtained. The same is to be registered at PPR by way of financing statement.
- Assignment of fire insurance is to be confirmed/obtained when taking a specific charge over the mobile home.
- Landlord's written waiver/confirmation that he has no interest in the fixtures if situated on leased land.

  **Note:** A copy of the lease or rental agreement should be kept on file.
- Register the credit union's interest at Land Registry office regardless if on owned land or if on leased land.
- Loan amount is not to exceed the maximum amount permissible pursuant to the guidelines with respect to first mortgages and mobile homes.
- Where a mobile home is a fixture to real property, it is to be insured to full market value of the mobile home against the perils of at least Fire and Extended Coverage with the loss payable to the credit union under a Standard Mortgage clause. Certified copies of these policies should be obtained by the credit union and kept on file.
- Mobile home loans (specific security) may be insured under "chattel loan insurance" provided by an insurer in those instances where traditional real-estate mortgage financing is not available.
- Mobile homes situated on land owned by a third party (i.e., son has a mobile home on father's quarter section of land) require a waiver and/or consent of the property owner to be obtained by the credit union to ensure the third party cannot claim an interest at a later date. This consent should include unrestricted access from the land owner.

## Pleasure Boats

- In Canada, all vessels, commercial or pleasure, with an engine of ten horsepower or more must be either licensed or registered.

  **Note:** Each province has a different letter for boat registrations (i.e., "H" being Alberta's). Notwithstanding all boat registrations are done with the Department of Transport (DOT); therefore, change in ownership of a vessel does not necessarily constitute a change in registration. With the sale of a used vessel, DOT may transfer the existing registration to the new owner. Where a different letter in the identification number exists, it is necessary to check with the Department of Transport to determine the province the boat is registered in. Then lien and ownership searches must be conducted in the appropriate province.

- Security against licensed vessels (i.e., those with a DOT registration) would have to take the form of a Security Agreement (GSA, SSA (all)) over the hull and motor and a financing statement which is to be registered at Personal Property Registry.
- An assignment of insurance over the boat should also be obtained.

**Note:** In most cases, the purchase will include a boat, motor, and trailer as a unit; therefore, all components must be listed in the Security Agreement.

**Related Guidelines**

| | |
|---|---|
| Consumer Lending Criteria | Residential Mortgage Financing |

# Personal Property Loans Chart

**This chart provides a guideline for personal property lending.**

| Purpose Of Loan | Lending Value Assigned | Amortization Period |
|---|---|---|
| Automobiles, light trucks, vans (includes 4x4 vehicles) | New vehicle: 100% of purchase price based on the bill of sale | Up to 60 months; can go to a maximum of 84 months for competitive purposes. |
| | Used vehicles (1 - 3 years old): up to a maximum of 100% of purchase price or market value, whichever is the lesser. | Up to 60 months depending on the type, value, mileage and condition of the vehicle. |
| | Used vehicles: (4 - 5 years old) up to a maximum of 75% of the purchase price or market value, whichever is the lesser. | Generally up to 36 months depending on the type, value, mileage and condition of the vehicle. A longer term may be considered on an exception basis. |
| Recreational vehicles (travel trailers, motorhomes, truck campers, tent trailers) | New: 100% of purchase price based on bill of sale | Up to 15 years depending on the type and value.<br>Subject to terms of 1 - 5 years if a fixed rate is offered. |
| | Used: 50 - 75% of purchase price or market value, whichever is the lesser. | Up to 10 years depending on the type, age and value.<br>Subject to terms of 1 -5 years if a fixed rate is offered. |
| Sports vehicles (motorcycles, snowmobiles, quads, etc.) | New: 100% of the purchase price based on bill of sale. | Up to 60 months |
| | Used: up to 75% of the purchase price or market value, whichever is the lesser. | Up to 36 months |

| Purpose Of Loan | Lending Value Assigned | Amortization Period |
|---|---|---|
| Mobile Homes (used as permanent dwelling) | New: 75% of the purchase price or appraised value, whichever is the lesser. | Up to 15 years<br>Up to 25 years when covered by an insurer.<br>Subject to 5 year term if fixed pricing is offered |
| | Used: up to 75% of the purchase price or appraised value, whichever is the lesser. | Amortization not to exceed economic life confirmed by appraisal to a maximum of 15 years.<br>Subject to 5 year term if fixed pricing is offered. |
| Light Aircraft | 75% purchase price or appraised value, whichever is the lesser.<br>60% of the appraised value of the floats. | Up to 7 years<br>Subject to a 1 - 5 year term if fixed pricing is offered. |
| Pleasure Boats | New: 100% of the purchase price based on bill of sale | Up to 60 months |
| | Used: Up to 75% of the purchase price or market value, whichever is the lesser. | Up to 48 months depending on age, type and value. |

### Market Value

- The value of used (currently owned or privately purchased) vehicles may be established using the Red Book or Black Book.

  **Note:** The condition of vehicle is to be taken into account and value discounted accordingly.

- The value of used (currently owned or privately purchased) recreational vehicles, sports vehicles and pleasure boats should be confirmed by a reliable source (i.e., dealer, appraisal, etc.).

  **Note:** For older recreational vehicles a written inspection report from a qualified service, agent or dealership should be encouraged.

- Lending ratios and amortization restrictions for mobile homes will differ if the loan is insured by an insurer.
- Value of used mobile homes (currently owned or being purchased) must be confirmed with an appraisal.

**Related Guidelines**

| | |
|---|---|
| Consumer Lending Criteria | Debt Service Capacity |
| Standard Terms and Conditions | |

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# 9. CREDIT CORRESPONDENCE

# Executing Documents When Using a Trade Name

- To reduce any confusion on the execution of security documentation where a trade name has been used the following examples are provided:

  For an individual or corporate entity operating under a trade name of Super Products, documents may be executed as follows:

  "JOHN SMITH CARRYING ON BUSINESS UNDER THE NAME SUPER PRODUCTS

  ___________________________

  JOHN SMITH"

  "ALBERTA CORPORATION INC. CARRYING ON BUSINESS UNDER THE NAME SUPER PRODUCTS ALBERTA CORPORATION INC.

  PER: _____________________________"

  The use of the phrase "carrying on business under the name", "operating as" and "doing business as" are all similar and do not require any variation as to signing. Caution should be exercised in ensuring that the individual or corporate entity name is used with the trade name and not solely the trade name on security documents. The following example would not be a proper execution of a security document:

  "SUPER PRODUCTS

  PER: _____________________________"

- Financing Statements must use the individual or corporate entity name as there is no statutory requirement under the Personal Property Security Act to include the trade name as a debtor. However, it is a recommended practice to list the trade name as a second debtor in the Financing Statement when registering at the Personal Property Registry.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Formal Assignment and Postponement of Shareholder's Loans

While a form of postponement is incorporated into the Guarantee and Postponement, it is necessary to obtain a separate assignment and postponement agreement formally postponing shareholder loans. To ensure a common standard is in place at all credit unions, an Assignment and Postponement agreement must be completed.

The Guarantee and Postponement is acknowledged to include language postponing the guarantor's interests; however, there is some question if the language is sufficient to create a security interest. In addition, the guarantee does not require the written acknowledgement of the corporate debtor.

In each case where a formal Assignment and Postponement is obtained, a Financing Statement must be filed/registered by the credit union at Personal Property Registry. In addition, if an individual is granting the assignment and postponement and the individual has not provided a personal guarantee, the matter is to be referred to the credit union's solicitor with respect to the individual obtaining Independent Legal Advice. Wording used to describe postponements in the Financing Statements:

> "All Indebtedness, present and future, direct and indirect, absolute and contingent of (i*nsert name of Borrower from the Assignment and Postponement form*) to the Debtor and all proceeds including, without limitation, all goods, securities, instruments, documents of title, chattel paper, intangibles and money (all as defined in the Personal Property Security Act, any regulations thereunder and any amendments thereto)."

Where a credit union permits a payment in part of the formally postponed debt, notwithstanding the assignment and postponement remains in place, a partial release letter must be completed.

# Legal Opinions

- In situations where the security documentation is prepared by a solicitor, acting on behalf of a credit union, it is important to ensure the documentation is supported by a clear, favourable Solicitor's Letter of Opinion.
- A lawyer providing this opinion must be in good standing with the Law Society of Alberta, which ensures professional liability insurance coverage.
- While it is not preferred practice, it is acceptable for a solicitor to act for both the credit union and borrower/guarantor in situations which are considered to be straightforward security transactions, recognizing that both parties would need to seek new and separate counsel in the event of a dispute.
- Where a lawyer is acting for both parties, a written declaration pursuant to the guidelines established by the Law Society of Alberta is to be acknowledged by both parties.

### Commercial Transactions

- In commercial transactions, it is imperative each party be separately represented to avoid a potential conflict. All opinions must be in writing and confirm:
  - i. The ability of the borrower and/or guarantor to give the security. When a company provides its guarantee in support of a loan to an individual and/or other corporate entity, this opinion is to address any legal limitations under Section 45 of the Business Corporations Act.
  - ii. The authority to grant the security. Where a guarantor is an individual and does not have a financial interest nor is a shareholder/director/officer of the company, the guarantee is to be executed under "independent legal advice". This ensures that the guarantor fully comprehends and accepts the legal and financial liability represented by the guarantee.
  - iii. The security is valid and enforceable.
  - iv. The positioning or ranking of the credit union's security against the debtor/borrower and the property charged by the security.
  - v. The limitations or restrictions (if any), against the security that may restrict or pre-empt the credit union's claim against the security.

Except for "iii" above, the credit union's lawyer can place reliance on an opinion provided by the solicitor acting for the borrower/guarantor providing the credit union's lawyer confirms such opinion can be relied upon not only by him in rendering his opinion, but also by the credit union.

### Mortgage Transactions

- The credit union must request and obtain a Solicitor's Letter of Opinion and a copy of the Land Titles Certificate upon registration of the mortgage. The letter of opinion must confirm that:
  - i. The mortgage represents a valid and enforceable first charge over the property in favour of the credit union.

ii. All property taxes are current/supported by a tax certificate.
iii. Property boundaries, buildings, etc. are as represented/supported by a Real Property Report (surveyor's certificate).
iv. Evidence of insurance coverage must be in place. The policy endorsement must include Standard Mortgage Endorsement Clause with loss payable in favour of the credit union and in turn be for an amount sufficient to cover the value of the property improvements or the cost of replacement.

# Lending Values - Reporting Security on Security Panel

A standardized security panel is required to be used by credit unions when reporting lending values.

- To standardize reporting, specific charges such as Mortgages, Debentures, Memorandum of Charging Lands, Encumbrance Agreements, and Specific Security Agreements (other than those securing All Indebtedness) are to reflect the specific amount secured by the specific security document and not the amount the credit union would be prepared to lend against the asset.
- Unless the mortgage security provides for re-advancement of funds (which should be clearly recorded in the security panel), the Loan Value Assigned Amount is to be reported as the loan amount outstanding, which is the maximum available amount the credit union could realize from this specific security charge.
- Where the credit union has General Security Agreement or Specific Security Agreement (*For All Indebtedness*) security over equipment/vehicles where some are specifically held as security by other lenders, record only the values of the security specifically held by the credit union and apply normal lending values to the same. A footnote is to be made noting the value of the assets held as security by the other lenders and the actual debt owing against the same.

# Letters of Instruction to Solicitor

When referring security documentation to the credit union's lawyer for preparation, registration, or review (referred to as "vetting" the security), the credit union must place their instructions in writing.

By doing so, the credit union will avoid the possibility for misinterpretation regarding the scope and nature of the service requested. In addition, the credit union should provide copies of their standard legal forms (either available from Credit Union Central Alberta Limited or as otherwise prepared/approved for use by the credit union) to ensure standardization of their security documentation and costs are kept to a minimum.

The instructions given to the lawyer should include:

- A request to prepare and register the security documents. Where the lawyer is being requested to "vet" the security documents, this request should be substituted for the foregoing.
- A request to act on behalf of the credit union and immediately declare/report any conflict (either real or potential).
- A request to perform the appropriate public registry searches (Personal Property Registry, Land Titles, Bank of Canada, etc.) and/or retain agents to conduct same in other jurisdictions.
- Clearly outline any additions/deletions to be inserted into the security documents concerning any negative/positive covenants, clauses/paragraphs, etc.
- A request to provide a written opinion relating to the positioning of the credit union's claim against the security and the validity and enforceability of same. Preference should be given to providing the lawyer with either a format or "draft" reporting letter.

The following information/documentation should accompany the Letter of Instruction:

- Name, address and phone number for the member/borrower and guarantor(s).
- Name, address and phone number of the lawyer acting on behalf of the member/guarantor(s).
- Copy of any Commitment Letter/Letter of Offer.
- Particulars of the security to be charged, including, but not limited to:
    1. Personal Property
        i. full description including “add-on”/accessions and serial number(s)
        ii. copy of registration and the latest Personal Property Registry search if available
        iii. copy of Bills of Sale/invoice
        iv. copy of insurance document (if available)
    2. Real Estate
        i. full civic and legal description of the property
        ii. copy of most recent Land Title search if available
        iii. copy of the Real Estate Purchase/Sale Agreement
        iv. copy of the insurance document (if available)

- Copies of all documents signed/executed at the credit union specifically relating to the member's personal/business operation at the credit union (i.e. account authorities, related correspondence, etc.)
- Copies of the preferred wording for any specific paragraph or clause to be added to the security documents (e.g. re-advancement, receivership, prepayment penalty, etc.).

# Title Insurance

Title Insurance protects the lender against certain losses; therefore, the need for a solicitor to act on behalf of the lender is eliminated as is the requirement to obtain a Real Property Report.

Title Insurance protects mortgage lenders against losses due to:

1. invalid or unmarketable mortgage on title
2. unmarketability of title
3. defects in title
4. survey error
5. contravention of municipal zoning bylaws
6. priority of certain construction liens
7. priority of unregistered easements and right of ways
8. priority of other encumbrances
9. member fraud or forgery

### Related Guidelines

| | |
|---|---|
| Residential Mortgage Financing | |

# Training Aids

## Commercial Loan Application Completion Guide

This in-house training application was created to provide an explanation of requirements when completing a commercial credit application and can be found here.

## Credit Decision Guide

The material in the Credit Decision Guide is self-explanatory and can be of benefit to all involved in the lending process (i.e., lender, management, credit committee, etc.) and can be found here.

## Security Panel Completion Guide

This an example of recording value of assets and lending values and can be found here.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

# Forms and Documents

Amendment to Authorized Credit

Assignment and Postponement

Assignment and Postponement Partial Release Letter

Borrower Risk Rating Worksheet

Commercial Agricultural Credit Application

Interim Commercial Agricultural Credit Application

Irrevocable Letter of Guarantee

Letter of Indemnity

Margin Position Record

Offer of Financing Long Form

Offer of Financing Short Form

Offer of Financing Supplemental

Request for Increased Discretionary Lending Limits

Revocable Letter Guarantee

Watch and Doubtful Report