Appraisal Institute of Canada
Institut canadien des évaluateurs

The Appraisal Institute of Canada
Submission to the House of Commons Standing Committee on Finance
2019 Pre-Budget Consultation
August 2018

Executive Summary

The Appraisal Institute of Canada (AIC) is the nation's leading real property valuation association with more than 5,440 members across Canada. Established in 1938, the AIC works collaboratively with its 10 provincial affiliate associations to grant the distinguished Accredited Appraiser Canadian Institute (AACI™) and Canadian Residential Appraiser (CRA™) designations. AIC members provide unbiased appraisal, review, consulting, reserve fund planning services on all types of real property and machinery and equipment valuation within their areas of competence. Our mission is "to promote and support our members in providing high quality property advisory services for the benefit of clients, employers, and the public." AIC's accredited appraisers are guided by the Canadian Uniform Standards of Professional Appraisal Practices (CUSPAP) and a Code of Conduct.

The Appraisal Institute of Canada (AIC) is pleased to provide the following recommendations to the Standing Committee on Finance for the 2019 pre-budget consultations. Our submission is focused on the following:

What steps the federal government can take to support and/or encourage Canadians and their businesses to grow the economy in the face of a changing economic landscape.

- Expanding the Office of the Superintendent of the Financial Institution (OSFI) B-20 and B-21 Guidelines to all lenders providing mortgage financing.
- Mandating appropriate valuation fundamentals for investments that include real estate assets within the investment portfolio.
- Enhancing access to reliable and affordable real estate data necessary to complete rigorous valuations of real property.
- In partnership with industry stakeholders, the federal government should undertake an awareness campaign to inform homeowners of the potential detrimental impacts home cannabis cultivation can have on their home.

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The real estate market is a vital component of the Canadian economy, affecting everyday Canadians' quality of life and investment/retirement plans. The Canadian housing market has continued to show high regional variances in the last fiscal year. The impact of federal and provincial measures targeted at indebtedness, overheated housing markets and foreign ownership underscore the need for independent, unbiased and reliable valuations of both commercial and residential real estate.

One of the central themes for the federal government over the last several years has been reducing the exposure of Canadians to excessive debt and financial risk, helping the middle class get ahead and supporting those working to enter the middle class. We believe our recommendations to the committee are in alignment with those efforts.

Issues for Consideration of the Standing Committee of Finance

I. Expanding the Office of the Superintendent of the Financial Institution (OSFI) B-20 and B-21 Guidelines to all lenders providing mortgage financing is recommended to help protect the public from indebtedness and long-term mortgages from non-federally regulated financial institutions.

The Residential Mortgage Underwriting Practices and Procedures (B-20 Guidelines) and the Residential Mortgage Insurance Underwriting Practices and Procedures (B-21 Guidelines) under the authority of the Office of the Superintendent of Financial Institutions (OSFI) include provisions for mortgage insurers and federally regulated financial institution (FRFIs) to obtain appropriate numbers of on-site inspections and third-party appraisals to verify the value of collateral used during the mortgage underwriting process. This policy is particularly important to mitigate risk when there is a high loan-to-value ratio, when markets are in flux or when the credit-worthiness of the borrower is questionable.

Federal and provincial policy decisions related to the real estate industry have placed more scrutiny on potential borrowers from regulated lending institutions; as a result, an increasing number of Canadians have sought financing through private lending channels. In fact, data from the Department of Finance Canada showed that the market share of unregulated lenders has grown from 6.6 per cent in 2007 to 12.5 per cent in 2015[1]. Furthermore, a report released by Urbanation and the Canadian Imperial Bank of Commerce in April 2018[2] which focused on condo investors in the Greater Toronto Area stated the following with regards to new condo mortgages by lender: "The 'Big 5' banks provided three quarters of credit to investors, and smaller banks, trust companies and credit unions accounted for close to 20%. Private and individual lenders accounted for 5% in terms of dollar amount, but close to 10% in terms of the number of transactions. Interestingly, the distribution of credit providers was almost identical for non-investors." This indicates that up to 25% of lenders may not be federally regulated financial institutions,

[1] Department of Finance Canada, Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future, August 16, 2016, Page 15
[2] Urbanation and Canadian Imperial Bank of Commerce, A Window Into the World of Condo Investors, April 6, 2018, Page 2

thus not obliged to follow B-20. These institutions typically charge higher interest rates to compensate for the higher risk borrower/transaction.

As a result, imbalances have been built up in our system and a parallel, less-regulated industry has established itself with a growing share of the Canadian mortgage market. Not all market players apply the same rigor to the credit-granting process as those that are federally regulated. Due to this relative lack of oversight, institutions that fall outside of OFSI's responsibility bring people into the market that may not otherwise qualify for the same level of mortgage, exerting upward pressure on demand and therefore prices. It also adds to the level of indebtedness of Canadians, including the middle class, thereby increasing vulnerability in the lending market and the economy as a whole

While AIC recognizes that federal regulatory oversight of the financial system has been very sound over the past challenging decade, it is time to ensure consistency across the country and across all lenders by bringing non-federally-regulated institutions under the regulatory umbrella that has served Canadians and the economy well in the recent past. It is time to apply the same rules to everyone operating in Canada's mortgage lending space, in the interest of consumer protection and market stability and ensuring that Canadians don't overextended themselves and get buried in debt.

II. Mandating appropriate valuation fundamentals for investments that include real estate assets within the investment portfolio is required to mitigate the risk of fraud as well as ensure that investors are well informed about the value of the investment.

The issue of Canada's aging population is something that public policy makers at all levels of government are trying to proactively forecast and address. At a time when traditional investments are providing lower levels of return, retirees and potential retirees are seeking to increase the value of their life savings within the short term which makes them more vulnerable to high-risk investments.

The recent emergence of a range of mortgage-related investments on the Canadian investing landscape presents itself as an interesting opportunity for investors – including retirees or potential retirees. Though the Canadian housing market is fundamentally sound, recent experiences of fraudulent investments or mortgage-related investments that are not scrutinized properly, such as the recent RCMP investigation into syndicated mortgage investments, should serve as a reminder that investors should take time to fully understand the offering before participating in any product. Unfortunately, if an individual mortgage within a portfolio goes into default, the return of the mortgage investment is adversely impacted.

However, large institutional investors have a history of investing in real estate through a number of vehicles; they have access to the expertise and have a risk tolerance that is different from the average retail investor. Marketing mortgage investments to less sophisticated investors seeking for yield – potentially investing their life savings – is another matter altogether. As Canada's fledgling mortgage-investment market grows, investors and regulators should ensure that these investment opportunities are properly vetted and that the necessary due diligence of credit worthiness and collateral valuation has been carried out.

On-site appraisals carried out by qualified professionals are the most effective way to determine the true market value of a real estate asset which is a key element in an effort to mitigate lending and mortgage-related investment risk. Appraisals help to ensure that properties are not overvalued and also help to detect and prevent mortgage fraud or other issues involving real property, contributing greatly to the stability of the real estate market in Canada.

III. Enhancing access to reliable and affordable real estate data necessary to complete rigorous valuations of real property is important for all stakeholders involved in real estate transactions as it ensures the stability of the economy, protects Canadian property owners and allows for more effective policies based on objective and evidence-based research.

Access to comprehensive, reliable and affordable data is becoming more difficult for professional appraisers. This data is paramount, as appraisers require access to a minimum of three-years of sales history and other critical property information in order to prepare a report that is accurate and dependable.

AIC believes that quality market data is the foundation of quality appraisals that ensures the protection of consumers and lenders. All stakeholders within the real estate industry need to have access to public records of land registry, sales data, and other key data points in an equitable way.

Due to the complexity and cost of managing data effectively, provincial governments are turning to third-party organizations (private or crown corporations) to automate and administer their property and title registries. The move towards non-governmental ownership has proven to increase the cost of data for members. The high cost to subscribe may force some members to rely on data sources that are less comprehensive.

Furthermore, privatized data sources and data mining for the purpose of Automated Valuation Models has also become increasingly viable. There is a growing concern that consumer privacy will be breeched, the affordability of the data will become prohibitive and the reliability of the data will be compromised.

The creation of a federal Housing Statistics Framework to assemble multiple data sources to develop a National Property Registry is an initiative that AIC supports. This database will be valuable in providing property and owner information to governments to develop effective housing policies based on comprehensive and reliable data. It will also be a rich source of information for professional appraisers to use within their valuation assignments to ensure accurate opinions of value. Having an objective and comprehensive database of real property-related data is a matter of public good and will help protect the integrity of housing and lending markets, and be of benefit to all Canadians.

IV. Undertake a public awareness campaign to inform Canadians that home cannabis cultivation could have potential negative impacts on the value of their home.

As professional property appraisers, our Members have in-depth knowledge of the many components that go into determining the market value of a residential and non-residential property. Personal cultivation of cannabis could have unintended negative impacts on a property's value. In the absence of proper ventilation and proper equipment, mould and other detrimental conditions may occur. Those conditions could well have a negative impact on the value of a property and would conceivably affect the ability to sell, finance, refinance, rent or purchase a home.

Furthermore, with the anticipated increase in home cultivation, once legalization is enacted on October 17, 2018 , it is reasonable to expect problems arising from transparency (or lack thereof) in disclosure for homes which have seen cannabis cultivation at some point in their history. Ill effects can linger and indeed deteriorate long after plants are removed which could have negative consequences for subsequent buyers, and which may not be detected in a traditional property inspection.

Therefore, in partnership with industry stakeholders, the federal government should undertake an awareness campaign to inform homeowners of the potential detrimental impacts home cultivation can have on their home. AIC, and its industry partners, are uniquely positioned to work with government in implementing such a campaign.