



The Appraisal Institute of Canada
Submission to the House of Commons Standing Committee on Finance
2018 Pre-Budget Consultation
August 2017

Executive Summary

The Appraisal Institute of Canada (AIC) is the nation's leading real property valuation association with more than 5,400 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, and machinery and equipment valuation services on all types of real property 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 is a self-regulated organization guided by the Canadian Uniform Standards of Professional Appraisal Practices (CUSPAP) and a Code of Conduct.

The Appraisal Institute of Canada is pleased to provide the following recommendations to the Standing Committee on Finance for the 2018 pre-budget consultations. Our submission is concise and directly addresses the two key submission focuses:

1. What federal measures would help **Canadians** to be more productive?

- 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 incurring high interest rates and long-term mortgages of non-federally regulated financial institutions.
- 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.
- Enhancing financial literacy in the areas of mortgage lending and the dynamics of the Canadian real estate market is needed, especially for seniors and new Canadians.

2. What federal measures would help **Canadian businesses** to be more productive and competitive?

- 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 provides more effective policies based on objective and evidence-based research.



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Introduction

The real estate market continues to be a vital component of the Canadian economy and society at large, affecting how everyday Canadians view their quality of life and future 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 unbiased and reliable valuations of both commercial and residential real estate.

One of the central themes for the federal government over the last many years has been reducing the exposure of Canadians to undue debts and financial risk and incentivizing Canadians to save more money. We believe our recommendations to the committee are in alignment with those efforts.

Issues for Consideration of the Standing Committee of Finance

- I. **Expanding OSFI B-20 and B-21 Guidelines to all lenders providing mortgage financing is recommended to help protect the public from indebtedting itself in high interest rates and long-term mortgages of 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) introduced by the Office of the Superintendent of Financial Institutions (OSFI) include provisions for mortgage insurers and federally regulated financial institutions (FRFIs) to obtain appropriate numbers of on-site inspections and third-party professional 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 creditworthiness of the borrower is questionable.

The expansion of B-20 and B-21 Guidelines to non-federally regulated mortgage lending is critical. Recent federal and provincial policy decisions have placed more scrutiny on potential borrowers; as a result, an increasing number of Canadians have sought financing through secondary lenders. In fact, data from the Department of Finance Canada showed that the market share of unregulated lenders grew from 6.6 per cent in 2007 to 12.5 per cent in 2015. This is evident by the increasing percentage of non-regulated financial institutions within the marketplace. These institutions serve as a cohort of the Canadian market that may be higher-risk in nature than the median client of one of the federally regulated institutions.

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 rigour to the credit-granting process as those that are federally regulated. Due to this relative lack of oversight, institutions that fall outside of OSFI'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.



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 space, in the interest of consumer protection and market stability.

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 some higher-risk investments attractive.

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 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.

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 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 industry in Canada.

III. Enhancing financial literacy in of the areas of mortgage lending and the dynamics of the Canadian real estate market is needed, especially for seniors and new Canadians.

Although governments proactively educate Canadian consumers on issues relating to financial literacy, there continues to be confusion within the marketplace on the full range of fees associated with mortgage financing and refinancing as well as the role of various professionals involved in the transaction. Seniors and new Canadians are especially vulnerable.

A disclosure of all fees incurred as part of obtaining a loan should be a mandatory requirement for all lending institutions – federally and non-federally regulated – to ensure that Canadians understand the



financial commitment involved in what is often the largest investment in their lifetime. This includes the appraisal management fee and the appraisal fee.

Furthermore, Canadian consumers need to clearly understand the role of various professionals involved in the mortgage financing/refinancing process, including appraisers, real estate agents, home inspectors, lawyers, appraisal management representatives, mortgage brokers, and lenders.

AIC feels that it is important that the appraisal process – including the purpose of an appraisal report and the process through which the property value is estimated – be explained at the forefront of the lending process since it is the appraised value of a property that is used to advance a loan for financing or refinancing. Information on the risks of mortgage fraud can also be included in this material to engage Canadians in the detection and prevention of this crime.

IV. 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 provides 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 to prepare a report that is accurate and reliable.

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 breached, the affordability of the data will become prohibitive and the reliability of the data will be compromised.

The recent announcement of the creation of a federal Housing Statistics Framework to assemble multiple data sources to develop a National Property Registry is an initiative that AIC welcomes and 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.



AIC recommends:

- The National Property Registry be accessible to professional appraisers and other real estate professionals to ensure reliable, consistent and comprehensive data when determining the value of residential property.

The Need for Action

The Appraisal Institute of Canada and member appraisers across Canada are committed to supporting the government in their goal of helping to reduce risk to Canadians, the real estate market, and the wider Canadian economy. As highlighted above, and in the context of the four recommendations raised, there are a number of steps that can be taken to address our concerns.

AIC has outlined modest recommendations that will make a real difference to Canadians and Canadian businesses. We are keen to work with the Standing Committee on Finance, the federal and provincial governments, and all relevant stakeholders to move these recommendations forward over the coming months.