



# **WRITTEN SUBMISSION FOR THE PRE-BUDGET CONSULTATIONS IN ADVANCE OF THE UPCOMING FEDERAL BUDGET**

**AUGUST 2021**



Appraisal Institute  
of Canada



## Recommendations

1. Continue to Apply Prudent Underwriting Guidelines
  - a. Caution of over-reliance on Automated Valuation Models
2. Focus on Housing Supply Initiatives Such As:
  - a. Requiring infrastructure grants to go to areas that expedite development, such as near mass transit
  - b. Applying water-related charges on a pay-per-use basis rather than upfront
  - c. Creating a program to train individuals in the use of e-permitting



## Introduction

Our lifestyles and our entire economy have been upended by the pandemic, to say nothing of the thousands of people who have been directly impacted by the virus. During this unprecedented time, provincial governments, with the federal government's guidance, have designated certain services and industries as essential to the functioning of our society, economy, and our general well-being. One of these industries is financial services; Canadians need to know that their financial resources are secure and accessible through this challenging time. Faced with financial hardship due to work disruption, some Canadians have been forced to tap into the equity of their homes in order to make ends meet. Some Canadians were also in the process of selling or purchasing a property – a process which cannot easily be interrupted.

As part of the financial services value chain, Appraisal Institute of Canada (AIC) Designated Appraisers have been working, uninterrupted, while taking the appropriate safety precautions throughout the pandemic, to ensure that Canadians can access the financial resources they need to weather this time of turmoil. Appraisers, like all Canadians, have had to modify their behaviours and practices in order to maintain physical and social distancing guidelines, all while continuing to provide high quality, professional services that allow the mechanisms of finance for commercial and residential real property to serve the needs of all Canadians.

Appraisers continue to be an essential part of Canada's real estate market. Independent opinions of value in real estate transactions help maintain the integrity of our financial system. AIC-designated appraisers apply unbiased valuation fundamentals and help mitigate risks by ensuring lenders, insurers and consumers make informed decisions. For example, as affordable housing projects are developed, an appraiser works with government to ensure that value is well met. Appraisers, working alongside home builders, realtors, mortgage brokers and home buyers, play an essential role in Canada's real estate industry.

In 2021, the AIC launched the President's Council on Equity, Diversity, and Inclusion (EDI) to expand opportunities for aspiring appraisers and help combat bias and discrimination in the real property appraisal process. As many Canadians still face biases and discrimination, the AIC and its Members want to be part of the discussion and solution in advancing EDI objectives.

In order to continue supporting Canadians, it is important to make policy changes that help home buyers and homeowners while ensuring the health of the real estate and financial markets. The AIC believes that the following recommendations will help ensure the market remains somewhat risk averse as well as making housing more affordable to those aspiring to purchase a home.



## **Continue to Apply Prudent Underwriting Guidelines**

One of the core elements of a healthy and balanced real estate market is a systematic approach and commitment to reliable property valuations. Unbiased and independent real estate appraisals are a critical component of sound lending practices, and on-site appraisals carried out by qualified professionals are an effective way to mitigate lending and property investment risk. Appraisals ensure that properties are not overvalued and also assist in detecting and preventing fraud or other issues involving real property transactions. When conducted by a qualified and experienced professional - drawing on a sophisticated methodology - an appraisal will validate the characteristics of the property, analyze the current market conditions, and take into consideration the surrounding neighbourhood. This is always important, but particularly crucial during these turbulent and unpredictable times.

Strong valuation fundamentals helped Canada's economy remain strong during the 2008/2009 global financial crisis at a time when many of the world's leading economies faltered. Members of the AIC helped to maintain those fundamentals by contributing their real estate expertise and knowledge to the lending industry and providing sound valuation advice to clients and key stakeholders. This is as important as ever as we continue to navigate through the COVID-19 public health crisis.

The Residential Mortgage Underwriting Practices and Procedures (B-20 Guidelines), under the authority of the Office of the Superintendent of Financial Institutions (OSFI), include provisions for Federally Regulated Financial Institutions (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, such as the current case due to the COVID-19 pandemic, or when the credit-worthiness of the borrower may be less than optimal.

Therefore, the importance of continued application of prudent underwriting guidelines, which includes strong valuation fundamentals, is equally if not more important during the COVID-19 pandemic at a time when Canadians' finances have been dramatically impacted and their buying power has been impacted.

On a related note, we have seen evidence over the last several months where some lenders are taking shortcuts to providing certain mortgage loans and seemingly bypassing proper due diligence in the terms of verifying the collateral being used to secure the loan. This can create significant risks in a volatile market and we do caution against the over-reliance on alternative valuation methods such as Automated Valuation Models (AVMs). AVMs use mathematical or statistical modeling combined with databases of existing properties and transactions to calculate values on a property.

While there may be instances when using an AVM can be appropriate, the reality is that using technology such as AVMs often does not provide real time, detailed insight into a housing market, nor does it necessarily include current information on an individual property's condition (good or bad). Features such as finished basements, upgraded granite countertops, or new windows can substantially increase a home's value; but these items may not be captured or reflected in an AVM's valuation.



AVMs often rely on recorded sales data which, in an active market may be almost in real time however in a mature market that data may be years – or even decades – old. In an extremely active market, such as those that exist now, recorded sales data may be outdated in a matter of weeks or even days. Professionally prepared full appraisal reports rely on analysis of real-time, current data – what is happening in the market right now and on the experienced eye of an appraiser physically visiting a property. As we have seen throughout the COVID pandemic, individual markets can shift very quickly, and only a real-time evaluation can truly capture these fluctuations.

A full appraisal report prepared by an appraiser remains the best risk management tool for market participants and when markets begin to normalize that option will become even more important.

Encouraging FRFIs to continue to undertake proper due diligence by requiring valuation reports based on personal on-site inspections performed by qualified appraisers ensures that the decision maker has a reliable appraisal report providing a well-supported and reliable opinion of value.

In summary, we recommend that the Government of Canada continue to promote prudent underwriting within FRFIs and caution against the over-reliance of Automated Valuation Models.

### **Addressing Canada's Housing Crisis**

Prior to the COVID-19 pandemic, housing was already a major issue for the federal government and provincial governments across Canada. Federal government policies have been more focused on addressing the demand side of the housing equilibrium. Programs such as investments in affordable housing, the new First-Time Home Buyer Incentive and the proposed tax on foreign non-resident owners have helped to alleviate some of the pressures on the housing market.

However, the pandemic has increased the need for more targeted policies that help to increase the supply of housing in Canada. The House Price Index (HPI) was up 16% in June 2021 when compared to the year before, representing the largest 12-month gain on record.<sup>1</sup> While affordable housing measures support low-income families in Canada, housing affordability continues to be a major issue for the middle class.

To address Canada's housing crisis, the federal government must work with provincial governments to implement policies that help to increase the supply of housing. While there is no perfect policy to addressing the housing crisis, the following three recommendations first put forth by the CD Howe Institute<sup>2</sup> would help to support Canadians and the need for more housing supply.

<sup>1</sup> <https://housepriceindex.ca/2021/07/the-12-month-rise-of-home-prices-in-june-broke-the-2017-record/>

<sup>2</sup> <https://www.cdhowe.org/expert-op-eds/three-ways-ottawa-could-really-help-boost-housing-supply-without-crossing-line-financial-post-op-ed>



First, the Government of Canada should require that infrastructure grants only go to areas that expedite development. For example, the federal government could require that provinces adopt an expedited approval process for areas near mass transit when they receive federal infrastructure funding. Provinces like Ontario already have such a tool, but they need incentives to use it.

However, transit isn't the largest infrastructure need by municipalities. In 2018, cities in Ontario invested \$3.2 billion in water and wastewater assets, compared to \$2.3 billion on transit. Currently, water infrastructure is primarily funded by development charges, which are upfront fees on homebuyers. Ontario, Alberta and British Columbia have similar charges that can sometimes be the largest component of charges on purchasing a home. To rapidly build out new water infrastructure without burdening municipalities or homebuyers with debt, provinces and cities need to take steps to create standalone water and wastewater utilities. Municipalities in Ontario and BC need to be incentivized to spend funds they have already collected from development charges. They would expedite development on water-related infrastructure if they were given access to water-user revenues instead of upfront charges. To that end, the federal government should make utility-style water pricing a grant condition.

Finally, permit delays could be reduced by creating a program to train individuals in the use of e-permitting. The issue of permit delays in Canada is well known. For example, in Toronto a developer must wait 249 days, while in Singapore it takes just 36 days and in Denmark and Finland only 65 days. These three countries are world leaders in using e-permitting. By funding training for individuals currently working in and with today's paper permitting system, both in government and industry, the federal government can reduce these delays that hamper the building of new housing supply in Canada.

## About

The Appraisal Institute of Canada (AIC) is a leading real property valuation association with over 5,400 members across Canada. Established in 1938, the AIC works collaboratively with its 10 provincial affiliated associations to grant the distinguished Accredited Appraiser Canadian Institute (AACI™) and Canadian Residential Appraiser (CRA™) designations. AIC Designated Members are highly qualified, respected professionals who undertake comprehensive curriculum, experience and examination requirements. Our members provide unbiased appraisal, appraisal review, consulting, reserve fund study and machinery and equipment valuation.