Written Submission for the Pre-Budget Consultation in Advance of the 2024 Federal Budget

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Appraisal Institute of Canada

Overview of Recommendations

1. Exempt Mortgage Renewals From The Application Of The Stress Test When Moving Between Federally Regulated Financial Institutions: So That Canadians Can Obtain The Most Competitive Rate Possible
2. Address Housing Challenges by Focusing on Housing Supply Initiatives
3. Continue to Apply Prudent Underwriting Guidelines

About

The Appraisal Institute of Canada (AIC) is the premier real property valuation organization in Canada with the mission to "Advance the Canadian real property appraisal profession in the public interest through education, self-regulation and member support." Founded in 1938, AIC is a self-regulating professional organization that grants the distinguished Professional Appraiser (P.App.) trademark accompanied by either the Accredited Appraiser Canadian Institute (AACI) or Canadian Residential Appraiser (CRA) designations to individuals across Canada and around the world. Our members adhere to the nationally and internationally recognized Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP) and are respected worldwide for meeting the rigorous AIC designation program and its ongoing professional development requirements.

An integral part of the real estate market in Canada, Professional Appraisers are hired by residential, commercial and industrial market participants as well as the public, to provide independent, real-time opinions of the value of real property to help them make informed decisions. Each year, AIC Professional Appraisers conduct over one million appraisals valuing over one trillion dollars.

Introduction

Over the past few years, our lifestyles and our entire economy have been upended. The impact of inflation, coupled with the seemingly perpetual rise in interest rates, have reduced purchasing power for many that have still not entered the housing market. While conventional thinking would suggest house prices would fall when purchasing power is considerably impacted, various factors (i.e., immigration, low unemployment, low housing inventory) have either minimized the decline in prices or made them stagnate. For those who have purchased a home at the peak of the housing boom, their equity has been reduced, or even eliminated, and many are seeing their monthly payments rise. The Bank of Canada (BOC) has recognized that the share of households affected by higher interest rates and the inability to service their debts will continue to rise over the next few years (2023 BOC Financial System Review[1]).

The AIC and, by extension, its Members have a strong focus on consumer protection. We – the AIC and its Members - uphold independent, third-party valuation fundamentals that help mitigate risks by ensuring lenders, insurers, and consumers have the information they need to make informed decisions. Appraisers, working alongside home builders, realtors, mortgage brokers, and home buyers, are an important part of Canada's real estate industry.

To continue supporting Canadians, it is important to make policy decisions that help home buyers and homeowners, while ensuring the health of the financial system and the real estate market.

The AIC believes that the **following three recommendations** will help mitigate risk in the market as well as make housing more affordable to those aspiring to purchase a home.

[1] https://www.bankofcanada.ca/2023/05/financial-system-review-2023/

Exempt Mortgage Renewals from the Application of the Stress Test under B20 Guidelines

The B20 Guidelines under the Office of the Superintendent of Financial Institutions (OSFI) call for a “stress test” to be applied to mortgage loans. This entails Federally Regulated Financial Institutions (FRFIs) applying a Minimum Qualifying Rate (MQR) equal to the greater of: the mortgage contractual rate, plus two percentage points, or 5.25%. The stress test applies to all mortgage loans whether they are new originations, renewals, or refinances.

Of concern is the application of the stress test to mortgage renewals and its impact on the consumer’s ability to obtain the most competitive interest rate possible amongst FRFIs –especially in the current interest rate environment (ten increases since March 2022 representing a 1900% increase). We believe that all existing FRFI mortgage borrowers should have the option to switch FRFI lenders, without being restricted by the application of the stress test, should they find a better interest rate at another FRFI. Applying the stress test on borrowers who want to switch lenders at renewal could result in a higher interest rate for the consumer at its current FRFI, resulting in even higher interest payments than the potential alternative and what the market is offering. With many Canadians facing the challenges of higher costs in practically every aspect of daily life, a competitive interest rate can have a substantial impact on consumer cash flow.

Whether it is at the end of the mortgage’s first term or several terms down the road, mortgage borrowers seeking to renew their mortgage at an FRFI have already completed and met the obligations of their original mortgage term and have demonstrated their ability and capacity to repay their loans. These individuals have proven to be responsible borrowers, have not accumulated additional debt on their mortgages, and have prudently managed their financial obligations.

Furthermore, transferring a mortgage from one FRFI to another does not add any additional financial risk to FRFIs as the original lender would be renewing the mortgage in the vast majority of, if not all, cases. The stability of FRFIs would not be affected.

Certain parameters could be applied, such as restricting the borrower’s ability to refinance at renewal/obtaining a home equity line of credit, or verifying whether the borrower increased their loan amount through the lifespan of the mortgage. Further, a loan-to-value (LTV) ratio threshold could be instituted to determine whether the ‘stress test’ should still apply. If transferring from one FRFI to another, the new FRFI could obtain a professional appraisal to determine the current LTV ratio. Finally, the application of the stress test can continue to be a requirement if the consumer is seeking to renew a mortgage at an FRFI from a non-FRFI.

As such, we recommend that mortgage renewals be exempt from the application of the stress test so that Canadians can obtain the most competitive rate possible within FRFIs. We believe that this policy change is well aligned with the spirit and objectives of B20, as it would not impose any additional risks to the solvency of FRFIs. It would also demonstrate that the regulator is making adjustments based on the realities of the market.

Address Housing Challenges by Focusing on Housing and Supply Initiatives

It goes without saying that the need for/access to/availability of housing is a major issue and challenge for governments across Canada. The last few years have seen governments focus more on supply as opposed to continuous policy changes on the demand side.

The AIC applauds the federal government's recent launch of the Housing Accelerator Fund which will help address the shortage of housing supply, however, more needs to be done as soon as possible to incentivize new housing starts. Targeted policies that help to increase the supply of housing in Canada are necessary to address housing affordability, a continuing concern for Canadians. While the housing market saw modest price declines due to rising interest rates, the shortage of housing supply remains and will intensify as immigration numbers continue to climb and unemployment and inventory remains low. These factors are forcing house prices to remain high and hinders the efficacy of BOC interest rate adjustments to reduce inflation.

The AIC believes a holistic approach to supply needs to be considered, where industry and municipal, provincial and federal governments all work together if there is any possibility for solving the lack of inventory and encouraging affordable housing prices.

There are many factors impeding housing starts/construction/completion. Many of them are due to approval delays (permits, inspections, etc.), the lack of trained/skilled labour, NIMBYism, and restrictive or improper zoning requirements. As an example, permit delays should 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.[2] 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.

While housing starts in June 2023 were up 2.3% from May 2023, corresponding to the six-month moving average of seasonally adjusted and annualized monthly housing starts across Canada, the year-to-date housing starts for the first half of 2023 were 8% lower than they were over the same period in 2022[3]. The federal government should expand its focus on the supply aspect in all facets of home building, including an increase in education and availability of skilled labourers and other home building professionals, as well as the accessibility and affordability of building materials.

To address housing supply shortage there needs to be people to build them. With the construction industry expected to lose 20% of its 2022 labour force due to retirement[4], the federal government should prioritize investment in training programs and recruitment strategies that equip individuals with the necessary skills for the various construction trades, collaborating with trade unions, educational institutions and industry associations. There is a significant opportunity to

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[2] https://www.cdhowe.org/expert-op-eds/three-ways-ottawa-could-really-help-boost-housing-supply-without-crossing-line-financial-post-op-ed
[3] https://www.cmhc-schl.gc.ca/media-newsroom/news-releases/2023/record-month-to-month-increase-saar-housing-starts-reverses-trend-june
[4] https://www.buildforce.ca/en/node/12330

offer this training and career path to the hundreds of thousands of immigrants choosing Canada as their new home over the next several years.

Regarding home building affordability, Canada's residential construction price index (CPI) has increased by record levels – up 51% since the start of the pandemic – due to rising costs of building materials such as concrete, steel and lumber.[5] Providing builders with access to affordable and quality building supplies is crucial to boost housing supply. The federal government should work with all levels of government to implement initiatives that would lower the cost of building supplies. This could include implementing reduced tariffs, taxes and import fees on essential building materials or increasing investment in local manufacturing of building supplies though grants or tax incentives - including avoiding and eliminating any intra-provincial costs currently being applied.

Continue to Apply Prudent Underwriting Guidelines

A core element of a healthy and balanced real estate market is the timely availability of reliable property valuations. AIC Professional Appraisers play an essential role in providing independent, third-party opinions of value to help stabilize and secure the market, as well as protect Canadians, while supporting the real estate market by contributing their expertise and knowledge to the lending industry and providing sound valuation advice to consumers and key stakeholders.

The Residential Mortgage Underwriting Practices and Procedures (B-20 Guidelines), under the authority of OSFI, include provisions for FRFIs to obtain appropriate numbers of on-site inspections and independent appraisals to verify the value of collateral used during the mortgage underwriting process. As always, knowing and understanding the value of the collateral is important to mitigate risk when there is a high loan-to-value ratio, when markets are in flux, such as in the current case, or when the creditworthiness of the borrower may be in doubt.

In Canada's current economic state, continued application of prudent underwriting guidelines, which include strong valuation fundamentals, is equally, if not more important than ever. Many mortgages are now over the 100% loan to value ratio threshold – proper valuation criteria could mitigate those elevated risks by obtaining an accurate and real time opinion of value.

While many participants in the market are seeking to expedite transactions, ultimately, the proper due diligence offered by an independent, third-party Professional Appraiser ensures that decision-makers have a reliable appraisal report providing a well-supported opinion of value.

Requiring FRFIs to apply proper due diligence by requiring valuation reports based on on-site, in-person inspections performed by qualified appraisers is a sound practice. It enables lenders to confirm the current valuation of the collateral when processing a mortgage loan application and provides the assurance that they are doing so with a valuation carried out in a fair and objective manner. In summary, we recommend that the Government of Canada continue to mandate, enhance, and enforce strong valuation fundamentals within FRFIs.

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[5] https://thoughtleadership.rbc.com/proof-point-soaring-construction-costs-will-hamper-canadas-homebuilding-ambitions/