



2022 Pre-Budget Submission February 2022



Appraisal Institute
of Canada



Overview of Recommendations

1. Address the Housing Crisis by requiring infrastructure grants to go to areas that expedite and promote sound development practices, such as near transit stations
 - i. Rapidly deploy the new Housing Accelerator Fund
2. Continue to Apply Prudent Underwriting Guidelines
 - i. Caution on the over-reliance of Automated Valuation Models
3. Complete improvement of the quality of terrain data, such as flood maps
4. Ensure the proposed Underused Housing Tax is based on appropriate property valuation



Introduction

Our lifestyles and our entire economy have been completely upended, to say nothing of the thousands of people who have been directly impacted by the COVID-19 pandemic. 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 use the equity in their homes in order to make ends meet. Some Canadians were also in the process of selling or purchasing a property – a process that cannot be easily interrupted.

As part of the financial services value chain, Appraisal Institute of Canada (AIC) Designated Appraisers have worked tirelessly throughout the pandemic. Appraisers, like all Canadians, have had to modify their behaviour 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 estate property to continue to function in order to serve the needs of all Canadians.

Appraisers continue to be an essential part of Canada's real estate market. They continue to uphold independent, third-party 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 value is well met. Appraisers, working alongside home builders, realtors, mortgage brokers, and home buyers, form an important part of Canada's real estate industry.

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

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 primarily focused on addressing the demand side of the housing equation. Programs such as investments in affordable housing, the new First-Time Home Buyer Incentive, and the proposed tax on non-resident foreign 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 15% in December 2021 when compared to the year before, representing one of the largest 12-



month gains on record.¹ While affordable housing initiatives have gone to support low-income families in Canada, housing affordability continues to be a major issue for middle-income Canadians.

To address Canada's housing crisis, the federal government must work with provincial and municipal governments to implement policies that help to increase the supply of housing. While there is no perfect policy to address the housing crisis, we do believe supply is one of the solutions to a more balanced marketplace.

Solutions could include The Government of Canada requiring 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 with transit stations when they receive federal infrastructure funding. The newly announced, but yet to be launched, Housing Accelerator Fund is a step in the right direction but must be implemented rapidly to address the current housing crisis that has become even more acute with the rise in inflation. The Fund must address the key challenges to new supply, which by all accounts, are related to local/municipal restrictions or hurdles like zoning restrictions, density limits, and NIMBYism. Supporting municipalities in addressing those challenges, whether it be financially or, in some cases, more importantly politically, will go a long way in getting new supply to the market.

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. Independent, third-party real estate appraisals are an essential component of sound lending practices, and on-site, in-person 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 estate property.

Strong valuation fundamentals helped Canada's economy remain steady 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.

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

¹ <https://housepriceindex.ca/2022/01/december2021/>



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.

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 impacted and the real estate market is inexplicably volatile, independent appraisals protect Canadians.

On a related note, we have seen evidence over the last several months of some lenders taking shortcuts by providing mortgage loans without the proper due diligence in terms of verifying the collateral being used to secure the loan. This can create significant risks in a volatile market, and we caution against the over-reliance on alternative valuation methods such as Automated Valuation Models (AVMs). AVMs use mathematical and statistical modeling combined with databases of existing properties and transactions to estimate values.

While there may be instances where using AVMs may 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 the most current information on a property's condition (good or bad). AVMs often rely on recorded sales data. In an extremely active market, such as exists 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 walking through 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.

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

In summary, we recommend that the Government of Canada continue to mandate strong valuation fundamentals within FRFIs and caution against the over-reliance of Automated Valuation Models.

Complete Flood Mapping

Over the last several years, communities across Canada have been hit by abnormally high-water levels. Hundreds, if not thousands, of Canadians across the country have struggled in preparing for and managing these extreme flooding occurrences. Reports suggest that climate change is one of the factors that is contributing to recurring flooding. In fact, the Insurance Bureau of Canada estimates that over one million homes across Canada are at



high risk of being impacted by flooding, and a portion of those is at very high risk of flooding.²

As an integral part of the real estate market in Canada, appraisers are hired by mortgage lenders, mortgage insurers, mortgage brokers, real estate representatives, and the public to provide unbiased and independent opinions of the value of real property to help them make informed decisions. Appraisers have no vested interest in the outcome of a transaction or in the value of a subject property.

On-site appraisals conducted by qualified professionals are the most effective way to mitigate lending and property investment risk. They help, amongst other things, to validate the characteristics of the property.

Homes and buildings that are situated in flood zones are often less valuable than properties outside of flood zones and, as the current climate changes, floods will occur more frequently and in areas that were not affected in the past. This affects not only existing homes and buildings; but also new developments, as well.

Prospective homeowners and the mortgage lending industry rely, in part, on information gathered by appraisers to make their buying and lending decisions. Updated flood maps and other climate related risks being made available to the real estate industry would assist appraisers to provide more accurate information to those relying on their reports.

The federal government should continue their efforts to improve the quality and timeliness of the terrain data that is the foundation of all flood mapping. Floods are just one example of climate risk – issues like drought, severe storms, and wildfires can all affect the value of a property. Governments will need to take a leading role in ensuring information on these risks is widely and consistently available going forward.

Implementing an Underused Housing Tax

The government is currently exploring the possible implementation of an Underused Housing Tax (UHT) to help address the current housing crisis. To AIC, the proposal and its objectives seems sound and reasonable and could have a minor impact on cooling the housing market.

Finance Canada states that the UHT would apply to the “specified value” of property. The specified value is further defined as originating from an assessment, from a recent sale price, or the fair market value. While the assessed value and most recent sale price can sometimes be reasonable methods to determine the value of the property, in reality, they do not always reflect the true current value of a property, nor do they reflect the ever-changing housing landscape and the volatility to which it is subject.

² <http://assets.ibc.ca/Documents/Disaster/IBC-National-Flood-Action-Plan-recommendations.pdf>



Full appraisal reports provide a more accurate reflection of the value of a property on a specific date because they are based on onsite inspections, the completion of comprehensive research on the subject property, and the inclusion of an analysis of comparable properties to arrive at an unbiased, independent opinion of market value. Through the appraisal process, a professional appraiser typically gathers information about the owner or occupant; the ownership history; vacancy circumstances; the sales and listings history including: dates of sales, and purchase, list and selling prices; and the intended use and users of the report.

An AIC designated appraiser provides structured reporting documentation and gathers information from on-site activities, transaction activities, bona fide purchasers, and objective data about marketplace activity. This information allows appraisers to formulate an opinion of value that is more reflective of current realities than what might be reflected by an assessed value or a sale price; and thus, more accurate for the purposes of the UHT and the Canada Revenue Agency. It is worth noting that appraisers also have the capability to provide a retrospective opinion of value for a past date.

This is why we believe that the fair market value must be provided by a certified appraiser. This will ensure that the UHT is properly applied to the appraised value of a property that has been properly calculated.

About

The Appraisal Institute of Canada (AIC) is Canada's leading real property valuation association with over 5,400 members across the country and around the world.