Appraisal Institute of Canada
Institut canadien des évaluateurs

Written Submission for the Pre-Budget Consultations in Advance of the Upcoming Federal Budget

February 2021

Recommendations

1. Mandate Appropriate Valuation Fundamentals to all Mortgage Lending Entities.

2. Exempt mortgage renewals from the application of the stress test so that Canadians can obtain the most competitive rate possible from Federally Regulated Financial Institutions.

3. Introduce a Renovation Tax Credit.

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. Financial institutions are offering alternate payment arrangements to mortgage and loan borrowers in order to ease their debt-service burden during the pandemic. 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.

In order to continue supporting Canadians and restart the Canadian economy, it is important to make policy changes that help home buyers and homeowners while ensuring the health of the real estate market. Small changes can make a big difference for millions of Canadians who have lost their jobs, lost their savings, or have otherwise been financially impacted by the pandemic. We urge the Government of Canada to implement these recommendations to support Canadians and the economic recovery.

Mandating Appropriate Valuation Fundamentals to all Mortgage Lending Entities

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. 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 this uncertain and unpredictable time.

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 is questionable.

There are some imbalances in our system as a parallel, less-regulated industry, such as Mortgage Investment Corporations and other private lending conglomerates, 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 and the less-regulated market may take advantage of this fact, at the expense of Canadians and that of the stability of the financial system. Due to this relative lack of oversight, institutions that fall outside of OSFI's purview may 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.

As mentioned, strong valuation fundamentals helped Canada's economy remain stable during the global financial crisis at a time when many of the world's leading economies faltered. The importance of mandating 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 considerably reduced. This needs to be achieved in the interest of consumer protection – from predatory lenders who stand to benefit by encouraging Canadians to take on loans beyond their means – and market stability.

As such, we **recommend** that the Government of Canada continue to mandate strong valuation fundamentals within FRFIs and encourage and work with their provincial counterparts to apply mortgage lending guidelines that are based on two core principles: careful consideration of both the borrower's creditworthiness and the value of the collateral.

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

The B20 Guidelines under OSFI call for a "stress test" to be applied to all mortgage loans (insured and uninsured). This entails FRFIs to apply a minimum qualifying rate equal to the greater of: The Bank of Canada's five-year benchmark rate or its contractual rate, plus two percentage points. 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. We believe that all existing FRFI mortgage borrowers should have the option to switch 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 higher interest payments than the potential alternative. When many Canadians face unemployment and loss in savings, especially during the current realities of a pandemic, a better 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 holders 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 are responsible borrowers who have proven track records, 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 stress to FRFIs as the original lender would be renewing the mortgage in the vast majority of, if not all, cases. The stability of FRFIs as a whole would not be affected.

Certain parameters could be applied, such as the borrower not having refinanced, obtained a home equity line of credit, or increased their loan amount through the lifespan of the mortgage.

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 would be well aligned with the spirit and objectives of B20, as it would not impose any additional risks to the solvency of FRFIs as a whole.

Home Renovation Tax Credit

As recommended by the Canadian Home Builders Association, the Government of Canada should consider introducing a home renovation tax credit for all types of home renovations for work performed after July 1, 2020 and completed before December 2021. Eligible renovations could include renovations or any enduring alterations to a building, and should be stackable with the existing accessibility renovation credits and any other renovation or retrofit tax credits or rebates introduced. This measure will stimulate economic activity as the economy opens.

More importantly, this initiative could help Canadians adapt the most important place in their lives to their needs, especially given the current changing realities within which Canadians live. Many Canadians may be re-evaluating their family living conditions and want to expand their current home to accommodate additional family members joining the household (such as creating an in-law suite), creating office space to facilitate working from home and respecting physical/social distancing, or simply needing to retrofit their home for new household members that may have reduced physical abilities (for example, adding a ramp at the entrance).

We certainly support the commitment made in the December 2020 Fall Economic Statement to provide $2.6 billion over 7 years to Natural Resources Canada to help homeowners improve their home energy efficiency by providing grants to help homeowners make energy-efficient improvements to their homes. However, we believe the home renovation tax credit will have more of a far-reaching impact to support Canadians in their renovation needs – whether brought on by the pandemic realities or not.

Conclusion

As we move into the post-COVID-19 recovery phase, the Government of Canada must consider low to no cost policy changes that can have a large positive impact on Canadians. Ensuring consumer protection by applying prudent mortgage guidelines to all borrowers will help Canadians make sound financial decisions and know what they can and cannot afford. Exempting mortgage renewals from the stress test will allow homeowners to seek out the most competitive rate possible and potentially reducing monthly payments. A home renovation tax credit could help Canadians adapt to the current realities presented by the COVID-19 pandemic.

The recommended actions will help to support the finances of Canadians which have been dramatically impacted through unemployment and the loss of savings. To rebuild our economy, we must ensure that Canadians are adequately supported and that future borrowers or current homeowners have all the tools available to them to make financially sound decisions. By putting our trust in Canadians, we can emerge from the pandemic stronger than ever.

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.