



**The Appraisal Institute of Canada**  
**Submission to the Standing Committee on Finance**  
**Pre-Budget Consultation**  
**February 2016**

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The Appraisal Institute of Canada (AIC) proposes the following recommendations to the Standing Committee on Finance during its 2016 pre-budget consultations.

- **Improving Financial Literacy and Consumer Awareness**– AIC recommends enhanced consumer education is needed to outline the roles of all professionals involved in purchasing and financing a home. Furthermore, the mandatory disclosure of all fees that a consumer must pay when obtaining mortgage financing needs to be more transparent.
  - For most Canadian consumers, the purchase of a home represents the single largest investment they will ever make. Educating consumers about all of the professional services that are required directly or behind the scenes when obtaining mortgage financing is critical. More specific to the appraisal industry, additional transparency is required to educate consumers on the role of appraisers and the delineation of fees for appraisers, appraisal management companies, lenders and other professionals involved in the mortgage financing/refinancing process.
  
- **Ensuring Quality Valuation Fundamentals are Maintained to Safeguard the Long term Stability of Canada’s Lending System** - AIC recommends a national consultation and review of the mortgage financing industry to determine if consumers are being protected and the industry is healthy.
  - There are rising concerns within the industry that need to be investigated, such as: concerns regarding the ownership of sales data and the impact it has on the access to information needed to conduct comprehensive research for quality valuations; the impact of technology on the real estate market including potential breaches of public privacy; the impact of rising competition among mortgage brokers, lenders, and appraisal management companies on consumers; and the increasing risk of mortgage fraud.



## **Background**

The Appraisal Institute of Canada (AIC) is the nation's leading real property valuation association with more than 5,000 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 and reserve fund planning 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 real estate market is a key building block of the Canadian economy. It affects every segment of our society and has the potential to help financial systems, investors and everyday Canadians prosper.

In a decade when global real estate markets have been plagued by volatility, Canadian real estate has been recognized for its stability and for the effectiveness of its regulatory framework. As the 2008 - 09 financial crisis so clearly demonstrated, real estate markets - when not appropriately regulated and managed - can contribute to the instability of a nation's lending institutions and their economy.

One of the core elements of a healthy and balanced real estate market is a systemic approach and commitment to reliable property valuations. Unbiased and independent real estate appraisals play a vital role in assisting individuals, businesses and governments to make informed decisions during real property transactions.

On-site appraisals carried out by qualified professionals are the most effective way to mitigate lending and property investment risk. Appraisals help to ensure that properties are not overvalued and also help to detect and prevent mortgage fraud or crimes involving real property. Conducted by a qualified and experienced professional - drawing on a sophisticated methodology - an appraisal will validate the characteristics of the property and take into consideration the surrounding neighbourhood and its market conditions.

Strong valuation fundamentals helped Canada's economy remain strong during the global financial crisis at a time when many of the world's leading economies faltered. Members of the Appraisal Institute of Canada 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.

Ensuring that consumers are well educated about the appraisal process and its role within mortgage financing as well as maintaining the quality of the valuation fundamentals to protect the public is AIC's primary concern.



## Issues for Consideration of the Standing Committee of Finance

### **I. Financial Literacy and Consumer Awareness - Third-Parties and Fees Associated with Mortgage Financing**

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

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 investments 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.

### **II. Ensuring Quality Valuation Fundamentals are Maintained to Ensure the Long term Stability of Canada's Lending System -**

#### **a. Access to Data**

AIC members have a professional obligation to complete appraisal reports and other valuation assignments in accordance with the Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP).

One of the key requirements under CUSPAP is for the practitioner to conduct a three-year sales history and a one-year listing history search and analysis of the subject property. Understanding the dynamics of the transactions (e.g., list prices, sales prices; number of days on the market; who the buyers and the sellers are; “quick flips” and properties that have exchanged within a short period of time, etc.) can provide valuable information on market trends. It also assists in fraud detection and/or prevention – an increasingly significant and costly challenge for the lending industry.

Access to reliable and timely data is a critical element in the delivery of a quality appraisal. Through the appraiser's due diligence, research and analysis of key market and property data, lenders can use appraisal reports to better understand the property's sales and listing history; exposure time to sell a property; supply and demand for similar property; structural characteristics; assessment data; title restrictions; zoning; and, land use controls. This important information is extracted from a number of sources including real estate boards, municipal and provincial records and private data providers.



Recently, however, some data providers (both private and public) have placed greater restrictions on the ability to access and use the data. For example, there has been a significant increase in the cost associated with accessing the full scope of data; some historical data is not accessible; or, the custody of the source data has been transferred to a third party.

As a result, AIC Members are concerned that the cost to access part or all of the data has, in some jurisdictions, become prohibitive. It is increasingly challenging to meet the professional obligations under CUSPAP to complete a thorough and reliable appraisal report on a subject property due to the limited access to the full spectrum of data that is required. Furthermore, their ability to safeguard their client against mortgage fraud is obstructed during the mortgage underwriting process.

**b. Systemic changes and competitive lending practices**

The mortgage lending industry is highly competitive and complex with a number of organizations vying for market share. Today's homebuyer can choose from a wide range of mortgage product offerings from small niche players, private lenders, brokers, and credit unions to large insurance companies and banks. The highly competitive nature of the market increases the industry's need to seek out costs savings and efficiencies at every stage of the process.

An outcome of this market trend is the outsourcing of a large portion of the appraisal activity to Appraisal Management Companies (AMCs). AMCs compete to secure business from lending institutions through service level agreements that include performance standards such as defined turnaround times, set appraisal fees, appraisal management costs, data extraction and analysis and reporting.

While this business model is not expected to change in the near future, there are significant concerns regarding the long-term viability of the real estate appraisal profession and the inherent risks of commoditizing the residential appraisal function.

Simply stated, this downward pressure on fees and increasing demand for quicker turnaround times, combined with the restrictions on accessing good and reliable data, may ultimately drive professional appraisers away from completing mortgage finance work. In some areas, there is already a risk of reaching a "tipping point" on this front.

The AIC continues to discuss these concerns with AMCs and financial institutions, however, the focus on "faster and cheaper" residential appraisal reports appears to be driving the business model rather than the value of an appraisal report as an important tool that will mitigate the risk and properly inform a decision maker during an important real estate transaction. Real estate valuation professionals must adhere to internationally recognized standards of practice and their value as professionals must be recognized as an integral part of the lending process.

A national review of the "mortgage-lending system" is needed to ensure that quality appraisal reports to protect the public continue to be the focus vs the bottom line.