



**The Appraisal Institute of Canada
Submission to the Standing Committee on Finance
2017 Pre-Budget Consultation
August 2016**

Executive Summary

The Appraisal Institute of Canada (AIC) is the nation's leading real property valuation association with more than 5,100 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, reserve fund planning and machinery and equipment valuation 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 Appraisal Institute of Canada (AIC) is pleased to provide the following recommendations to the Standing Committee on Finance for the 2016 pre-budget consultations. Our comments have been framed in response to the request for proposals that will meet the following objective:

- **Federal measures that would help Canadians generally – and such specific groups as the unemployed, Indigenous peoples, those with a disability and seniors – maximize, in the manner of their choosing, their contributions to the country's economic growth**

AIC suggests the following initiative to help Canadians become better educated about financial issues as well our suggestions to help reduce several financial system vulnerabilities. Working in parallel, these initiatives would both contribute to a stronger middle class and economy.

- **Improving Financial Literacy and Consumer Awareness**– AIC recommends enhancing consumer education to more clearly outline the roles of all professionals involved in purchasing and financing a home. Furthermore, AIC recommends the mandatory disclosure of all fees that a consumer must pay when obtaining mortgage financing.
 - 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 and fees associated with 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 be conducted by the Standing Committee on Finance to help ensure consumers and the health of financial system continue to be well protected.
 - There are rising concerns within the real estate industry that need to be investigated, such as the changing marketplace and evolving roles of mortgage brokers, lenders, and appraisal management and the need for consistent regulation of all financial institutions/ mortgage lenders.



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Introduction

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.

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 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.

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.

AIC actively supports efforts to ensure that consumers are well educated about the appraisal process and its role within the mortgage financing process. This education will assist in maintaining the quality of the valuation fundamentals needed to protect the public and the financial system.

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 full range of 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 national review of each step of the “mortgage-lending system” by the Standing Committee on Finance is recommended to ensure that the public and the lending system is protected.

a. 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. These efficiencies increase the risk that the quality of the checks and balances which are inherent in our current system become vulnerable.

For example, an outcome of this market trend is the outsourcing of a large portion of the management and oversight of 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 turnaround times, 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 inherent risks of commoditizing the residential appraisal function.

b. Expansion of OSFI’s Guidelines B-20 and B-21 Should Apply to All Financial Institutions to Reduce Over-Reliance on Automated Valuation Models

Automated Valuation Models (AVMs) have progressed through technological advancements, now providing online access to property values based on the compilation of sales data.

Although the recent changes to the Residential Mortgage Underwriting Practices and Procedures (B-20 Guidelines) introduced by the Office of the Superintendent of Financial Institutions (OSFI) and the draft Residential Mortgage Insurance Underwriting Practices and Procedures (B-21 Guidelines) include provisions for mortgage insurers and federally regulated financial institution (FRFIs) to obtain more on-site inspections and third-party appraisals, AIC believes that the current B-20 and



B-21 Guidelines need to be expanded to include all financial institutions providing residential mortgage financing.

Lending institutions, mortgage insurers and regulators must recognize that the effectiveness of AVMs is limited. Over-reliance on AVMs poses a significant risk for all stakeholders.

For example, the AVM value does not consider certain elements that are critical to an appraisal value, including the:

- maintenance provided to the property;
- extensive sales data on which to conduct comparable sales analysis;
- current condition of the property;
- location of the property and its surroundings; and
- intangible features of the property.

Due diligence through on-site valuation ensures that the decision-maker has a reliable appraisal report with a well-supported opinion of value.

The Need for Action

Individually and collectively, these issues expose Canada's real estate market, the lending industry and Canadian homeowners to greater risk.

A national conversation is needed among AIC, lenders, mortgage insurers, Appraisal Management Companies, realtors and brokers and regulators and agencies to ensure the protection of Canadians' greatest investment.