CMBA CANADIAN MORTGAGE BROKERS ASSOCIATION

MB MORTGAGE BROKER

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COVID-19 IMPACTS ON APPRAISALS

The following is our understanding at the time of writing (April 13, 2020). The situation is subject to quick changes. Specific practices will vary between appraisal companies. You should contact the appraiser to discuss any specific issues.

Personal Inspections

Are appraisers required to do personal inspections?

- an appraiser, while not legally required to personally inspect the property, will generally do so as a matter of prudency, to meet association requirements, and/or to meet lender requirements
- an appraiser must gather sufficient credible information to form the opinion as to value
    - the information can come from sources including the client, owner, occupant, building plans, municipal permits, MLS data, property assessments, and Landcor data
    - to use the information for the appraisal, the appraiser must believe it to be credible and representative of the current quality and condition of the property

Are appraisers permitted to do personal inspections?

- public health requirements are not only different across the provinces, but they are fast-changing. If you are wanting an appraiser to do a personal inspection of property, you will need to contact an appraisal association or appraiser in your province to determine whether they are at that time permitted to do one.
- currently, the specific answer to the question varies across the provinces
    - some provinces have included appraisers as providing an essential service
        - essential services are encouraged to remain open
    - some provinces have implied that appraisers provide needed services to essential services (such as to banks and other financial institutions) and as such are themselves essential services
    - some provinces permit appraisers to provide their services as long as they comply with public health guidelines and requirements
    - some provinces have required that certain types of businesses (for example, hair salons, pubs, and dine-in restaurants) close

        - appraisers are not on those lists
- except if and when appraisers are required to be closed in your province, this means appraisers can continue to provide their services provided they comply with the respective province's health office requirements
    - the primary requirement is that social distancing must be practiced. The distance requirement varies between 1-2 metres, depending on the province.
    - other requirements generally concern increased sanitation and limiting the size of gatherings, neither of which generally concerns appraisal situations
- appraiser's associations recommend that regardless of whether they are considered an essential service, appraisers:
    - comply with the indicated social distancing for customers
    - not enter properties to do interior inspections

How are appraisers to inspect interiors of buildings?

Residential

- appraisers now gather information as to the interiors of properties by photographs and/or video. The process is dynamic but generally includes the following steps:
    - the client is notified as to how the appraisal will be done
    - the appraiser connects with the property owner and confirms the owner's identity with photo ID
    - the property manager (if any) and the occupant (if the property is not owner-occupied) are notified as to the upcoming attendance of the appraiser and what will occur during the attendance
    - the appraiser gathers information needed to prepare the appraisal, such as to the quality of construction, number and types of rooms, size of buildings, and size of the lot. The sources of information can include the client, owner, occupant, building plans, municipal permits, MLS data, property assessments data, and Landcor data.
    - the appraiser attends at the property at the scheduled time:
        - does not meet the occupant face-to-face
        - does a perimeter viewing of the property, from outside of the structures and gathers what information is possible
            - peeks in windows, where possible
            - takes photographs of the exterior and, where possible from the exterior, the interior
    - while remaining outside of the property, obtains true, accurate and verifiable photos of the interior of the property (including avoiding the

possibility that the obtained images are selective or misleading, such as by avoiding showing the water-stained ceiling or leaky foundation)

- some appraisers accept photographs taken by a 3rd party, as long as they are geotagged (providing latitude and longitude location) and date-stamped (generally as taken within the last 24-48 hours)
- some appraisers require the geotagged and time-stamped photographs to be taken and sent to them electronically while they are in the driveway
- some appraisers, while in the driveway, will guide the occupant (or arranged person) through a virtual tour/inspection of the interior by way of FaceTime, WhatsApp, Google Duo, Skype, Zoom, or other such video program
    - the appraiser obtains photo ID of the person controlling the camera
    - the appraiser guides the person to perform a video tour of the interior of the property
    - the appraiser directs the occupant as to features of the property to focus on in the video tour
    - the appraiser asks questions and gathers information from the cameraperson as needed during the tour
    - the appraiser can use the software to record the tour and from the footage select frames as still photos
- the appraiser saves the photographs and virtual inspection recording to the work-file

Construction properties

- some appraisers will do a personal inspection if social distancing is practiced
- some appraisers follow the tour protocol indicated above with the owner, real estate agent, or property manager being the cameraperson

Vacant properties

- as it appears that the virus can survive on various surfaces for at least many days, some appraisers will decline to do a personal inspection even where the property is vacant

How can mortgage brokers help?

- Mortgage Brokers can help by:
    - being a liaison between the appraiser and the client/owner/occupant
    - advising the client, in advance, of the process and current protocols
    - advising the appraiser of any special needs concerning:

        - language barriers
        - physical challenges to participate in using the camera and software
        - knowledge or mental challenges to participate in the process of using the camera and software
    - working with the client to overcome any challenges so that the appraiser can get the data needed to provide the appraisal (such as by providing an interpreter or someone to assist or replace the person with the challenges)

What impact is COVID-19 having on valuations?

Generally

- appraisals are based on current available data rather than on future projections
- COVID-19 has not yet significantly impacted valuations as the current available data of recent sales is comprised almost entirely of pre-COVID-19 deals
- the lack of COVID-19 sales data leads to more market uncertainty than is usual
- sellers and buyers appear to be in a holding pattern
    - many listings have been taken off the market
    - many buyers appear to have held off buying
    - this can have a longer-term impact on pricing, but there is not enough data to determine the present impact

Pre-sale strata/condo units

- it is always a concern whether a pre-sale strata or condo unit has held its value from the date of the agreement to the date of the appraisal, COVID-19 elevates this concern
- there is not enough data to determine the impact of COVID-19 yet

Commercial valuations

- commercial properties are, for appraisal purposes, more distinctive from each other than are residential properties from each other
- capitalization rates (cap rates) are important in determining valuation. They are essentially the rate of return on investment in the commercial property.
- there has been and is going to be a higher rate of vacancy because of COVID-19
    - some businesses have failed or have to close down and will not be coming back
- the greater vacancy rate negatively impacts cap rates and therefore valuation, the amount of impact is as of yet uncertain

Tenant not paying rent

- the market value of the property is the unencumbered value, so the non-payment of rent does not itself directly impact valuation
- however, the tenant not paying the rent can mean the landlord cannot pay the mortgage and lead to foreclosure proceedings or distress sale
- the lower prices triggered by distress sales can trickle down to reduce the value of rental properties
- the data created by lower priced sales would impact later valuations, but there is not sufficient data as of yet

How can mortgage brokers help?

- when possible, order the appraisal while the pre-COVID market is still relevant in finding comparable properties
- adjust client's expectations as to the valuation, particularly if properties start to drop in value

Is the impact of COVID-19 on appraisals for cashflow different than those for equity lenders?

- the valuation process and the resulting value does not differ depending on the type of client, the value is the value
- however, as a practical matter, mortgage investment corporations (MICs) and private lenders tend to want more detailed reports to allow them to make their lending decisions and banks tend to prefer fewer details. Appraisers tend to accommodate these preferences.
- so, the form of the appraisal may differ but the valuation does not

Limitation clauses and extraordinary assumptions concerning COVID-19

Why do appraisals now contain COVID-19 limitation clauses and extraordinary assumptions?

- appraisals are point-in-time valuations (they indicated the value at the time of the appraisal, not before and not after)
- typically, clients are comfortable using the point-in-time valuation for a period (generally 60-90 days) after the date of the appraisal

- typically, clients understand that appraisers will follow certain processes and collect certain data in preparing appraisals, but those processes and the collection of data has changed in the COVID-19 world
- limitation clauses and extraordinary assumptions alert the user to the fact that not only might COVID-19 make the useful period of the appraisal shorter than usual, but the appraisal was prepared under circumstances that might reduce its usefulness even on the day it was prepared
    - for example, advising the client that the appraiser did not personally inspect the interior of the property could be important if it was later discovered that a personal inspection would have disclosed the smell of mold

What are some COVID-19 related limitation clauses and extraordinary assumptions?

Personal inspection

Limitation clause

- the absence of personal inspection of the property by the appraiser must be stated as a limitation in the appraisal
- the limitation clause should describe:
    - the conditions that have led to a virtual inspection being relied upon
        - such as, due to COVID-19 and authorities recommending against or prohibiting contact with other people
    - the method of inspection and the virtual platform used
        - such as, how the photographs and/or video were obtained
    - the date and time of inspection
    - the name and contact details of the person who performed the video tour of the property interior
- Sample limitation clause: *Due to the Coronavirus pandemic, the government is prohibiting and/or local health authorities are strongly advising against contact with other people. Entering homes for inspection purposes is accordingly not permitted and/or is not advisable at this time. Accordingly, this appraisal was completed without physical access to the interior/exterior of this property. Property details have been identified and collected through other means as noted in this report.*

Extraordinary assumption

- the appraisal should also state extraordinary assumptions made because of the absence of personal inspection of the property by the appraiser
- Sample extraordinary assumptions: *Because of the inability to access and view the interior/exterior of this property, information and details concerning the*

interior/exterior finishing, quality and condition are taken from the following sources:

- *geotagged and date-stamped photographs supplied by the occupant*
- *photographs taken from a virtual tour conducted by _____ under the direction of the appraiser*
- *data from the local municipality, MLS, property assessment authority, etc.*
- *(the type of information) supplied by (name)*

The appraiser considers these sources to be reliable and the information to be a true, credible, and not misleading representation of the quality and condition of the subject improvements as of the effective date of this appraisal report.

If any of these details are subsequently determined to be inaccurate, the appraiser reserves the right to amend the report (including the valuation stated).

Valuation

- an appraisal being based on less than personal inspection can make it more likely than otherwise that the appraiser provides a range of values rather than a single estimate of value for a property

Value uncertainty

- appraisals are limited by value uncertainty created by COVID-19
- the limitation clause should address that:
  - *values and opinions contained in this report are based on market conditions as at the time (effective date) of the report.*
  - *the report does not predict future values*
  - *values and opinions may change rapidly and such potential future events have been not been considered in this report*
  - *clients and intended users are cautioned in relying on the report after the effective date noted herein*
  - *all of the above are accentuated by COVID-19*
- *Sample limitation clause: Values and opinions contained in this appraisal are based on market conditions as at the time of this report. Future values are not predicted. In the event of market instability and/or disruption, values and opinions may change rapidly and such potential future events (such as those that may be caused by COVID-19 are not considered in this appraisal. As this report does not and cannot consider any changes to the property or market conditions after the effective date, clients and intended users are cautioned in relying on the appraisal after the effective date noted herein.*

Market time

- appraisals generally contain a comment with respect to the estimated exposure time
- the reasonable marketing time is an opinion as to how long it would take to sell the property at the valuation price provided, or at a price indicated in the appraisal
- when value is predicated on a marketing time that differs from the subject's reasonable exposure time (such as by the appraisal using pre-COVID 19 property sales as comparables for post-COVID appraisals) the resulting value will not necessarily be market value
- Sample limitation clause: T*he comparable sales used in this report had exposure times of (blank) days. Due to the impacts of COVID-19 (including the recent state of the Canadian economy, the cost and availability of credit, and employment uncertainty), it is reasonable to expect a much longer marketing time than what would be indicated by historical exposure times.*

How can mortgage brokers help?

- assisting clients to understand the limitations and extraordinary assumptions, including the reasons for them, set out in an appraisal
- assisting clients to determine whether a new appraisal is needed because of changed circumstances (such as evolving impacts of COVID-19) that are not anticipated in an existing appraisal

Letters of Transmittal

No personal inspection

- Letters of Transmittal should clearly state:
  - when the property was not personally inspected by the appraiser or the limited extent to which the property was inspected
  - that it was not personally inspected due to government requirements and/or health authority guidance in place (as stated in the appraisal)

How can mortgage brokers help?

- explaining why an appraiser would not personally inspect the interior of property in the time of COVID-19 and the limitation and extraordinary assumption clauses possibly in the appraisal
- assisting the client to under the appraisal itself

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Appraisal Preparation Time

Expected times

- the more involved process to inspect the interior of property (by obtaining photographs and video) may slow down the appraisal process if the client is unable or unwilling to perform their role in the process efficiently
- the procedure may slow down if appraisers are unable to perform their duties due to, for example, being infected by COVID-19. This can slow down a particular appraisal where that appraiser is infected and the appraisal industry overall where there are fewer appraisers available to cover the marketplace.

How can mortgage brokers help?

- ordering the appraisal as early as possible
- encouraging their clients to assist the process by efficiently performing their role in the virtual inspection process concerning the interior of the subject property