

# Evaluating Your Portfolio in an Uncertain Market

An eBook for Lenders of All Sizes


•  \$540,000

•  \$280,000

•  \$360,000

•  \$390,000

•  \$710,000

•  \$800,000

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# Overview

It's no secret that the financial community as well as governments in Canada (especially in Ontario and British Columbia) are watching as interest rates rise and the housing market adjusts after recent, sweeping regulatory changes.

New regulations, such as the B-20: Residential Mortgage Underwriting Practices and Procedures from the Office of the Superintendent of Financial Institutions (OSFI) and the IFRS-9, the latest change to the International Financial Reporting Standard from the International Accounting Standards Board, have changed the landscape for many lenders. They now need access to data to not only stress test individual deals, but also to stress test their overall portfolio and keep in compliance with B-20 regulations.



## B-20

# Overview

Higher interest rates also shift supply and demand in urban centers.

Take for example the Greater Toronto Area. Property values on new single-detached homes skyrocketed above \$1 million in 2017, according to the Building Industry and Land Development Association. (Source: <https://www.thestar.com/business/2017/02/23/newly-built-gta-home-passes-1-million-average-price.html>)

A mortgage on a \$600,000 property at 2.5% means something very different than a \$600,000 mortgage at 5% interest. This is precisely why the government's regulations force us to consider what that reality could look like now.

The new B-20 regulations don't apply to all lenders, but even lenders that are not required to comply also stand to gain major benefit by adopting and deploying some of the measures therein.

We have seen the housing market dip and then fall flat in the past months, with these key market drivers in play. Other areas have maintained a monthly status of declining values, especially where certain property types are concerned.

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# Overview



This eBook will explore how you can best prepare your lending operation to adapt operationally to current changes in the Canadian housing market and subsequently mitigate risk, comply with mortgage regulations (if that applies to you), and be more competitive.



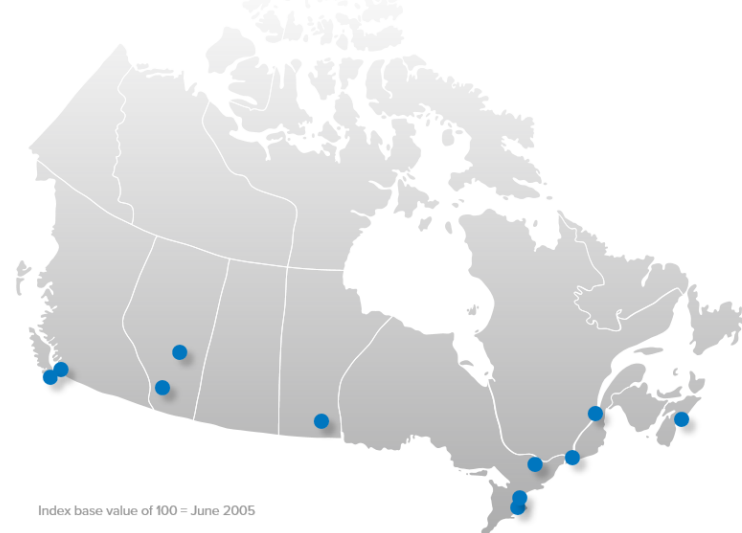
# Canadian Housing Market Trends

We created the graph on the next page to show the increases and decreases in housing values of single-detached homes (as reported by the Teranet-National Bank House Price Index™) to interest rate increases (announced by the Bank of Canada).

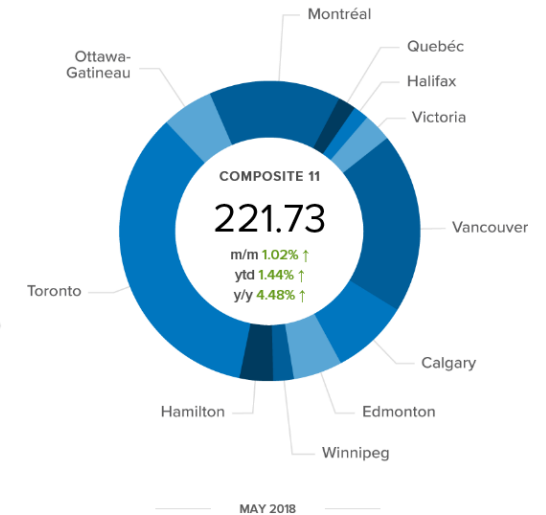
The new mortgage regulations came into effect in January of 2018. What is interesting is that even with rate increases, the values of single-detached dwellings are holding steady nationally.

## Teranet–National Bank House Price Index™

An independent representation of the rate of change of Canadian single-family home prices.

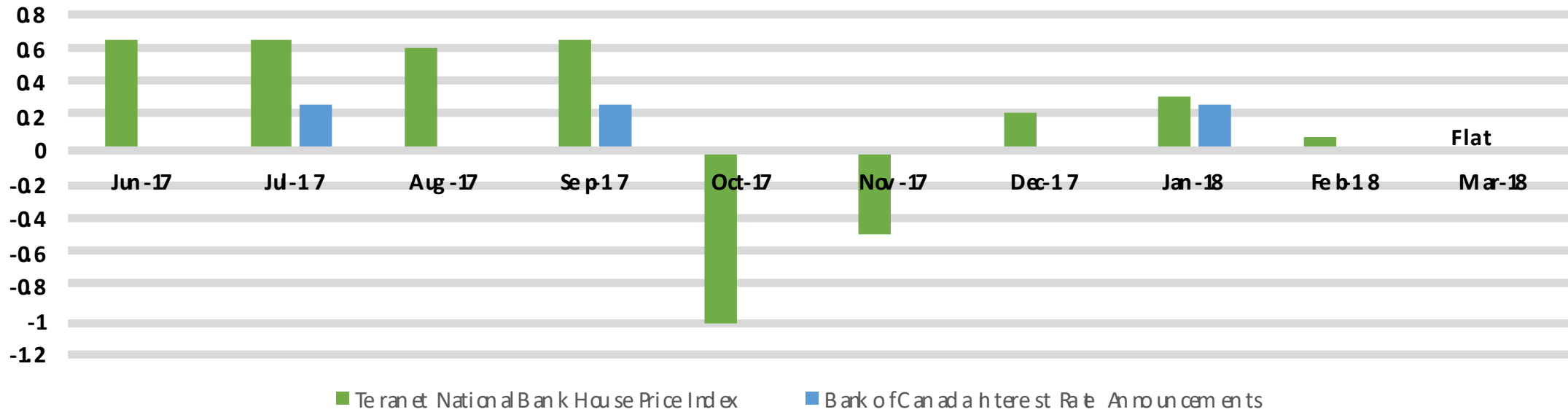


## Composite 11



# Canadian Housing Market Trends

TERANET-NATIONAL BANK HOUSE PRICE INDEX™  
MONTHLY INCREASES AND DECREASES: JUNE 2017 – MARCH 2018

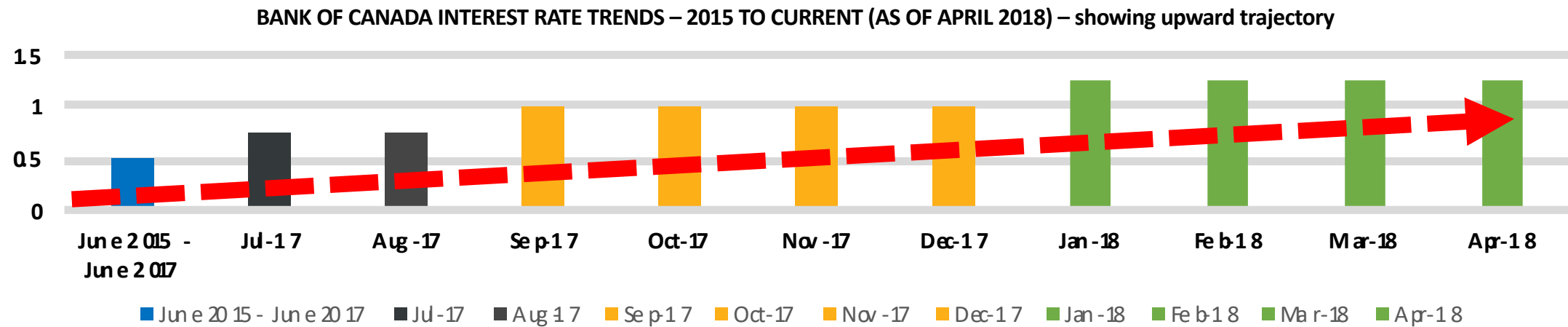


## Sources:

- Teranet National Bank House Price Index™ <https://housepriceindex.ca/#maps=c11>
- Bank of Canada Rate Announcement <https://www.bankofcanada.ca/core-functions/monetary-policy/key-interest-rate/>

# Canadian Housing Market Trends

The table below looks at Bank of Canada rate increases over the past three years. What we can see is an upward trajectory beginning in the summer of last year, which may or may not continue. Because no one has a crystal ball, in uncertain markets it is best to know more!



Source: Bank of Canada Rate Announcement <https://www.bankofcanada.ca/core-functions/monetary-policy/key-interest-rate/>



# Canadian Housing Market Trends

The added pressure in Ontario, specifically in relation to new mortgage regulations, has resulted in more turbulence in some local markets than what is showing in the national numbers, especially as they relate to single-detached family dwellings.

Reuters recently reported Statistics Canada data that revealed at a national level:



- New home prices were down 0.2% in February after being unchanged for the preceding two months.



- On an annual basis, prices were up just 2.6%, the smallest 12-month increase since June of 2016.



- Seven out of the 27 cities surveyed by Statistics Canada saw prices fall. Ontario's largest city and Canada's economic hub, the City of Toronto, saw the biggest monthly decline, down 0.6% in its largest drop since February of 2010. Builders cited unfavorable market conditions for the change.

Source: <https://ca.reuters.com/article/topNews/idCAKBN1HI1ZI-OCATP>



# What Housing Trends Mean to You



What does this mean to you as a lender? It means that you need to know how market conditions impact the value of your current portfolio, your risk rules, and loss ratios relating to current loans and future loans you plan to put on the books.

At a portfolio level you may want to ask yourself:

- 🔍 Are the properties you're funding currently worth what you think they are?
- 🔍 Were the properties you financed previously worth what you thought at the time you extended financing?
- 🔍 If you are regulated, are you currently compliant with B-20 and IFRS-9 regulations?
- 🔍 How do you become and remain compliant as market changes occur?

# What Housing Trends Mean to You

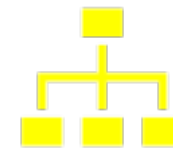
Everything boils down to value and the need to know what a property is worth. The third item in the above list about B-20 compliance may have made you smirk if you work for a mid- to larger-sized organization that is financing insured deals. You may be thinking that you have already made provisions to deal with B-20 compliance by your insurer performing an Automated Valuation Model (AVM) on Emili. If that's the case, read on...



# How Lenders Evaluate Property Data

Currently lenders big and small use the mechanisms below to validate a property:

- Automated Valuation Models – Emili, Purview
- Appraisals
- Customized Bulk Data



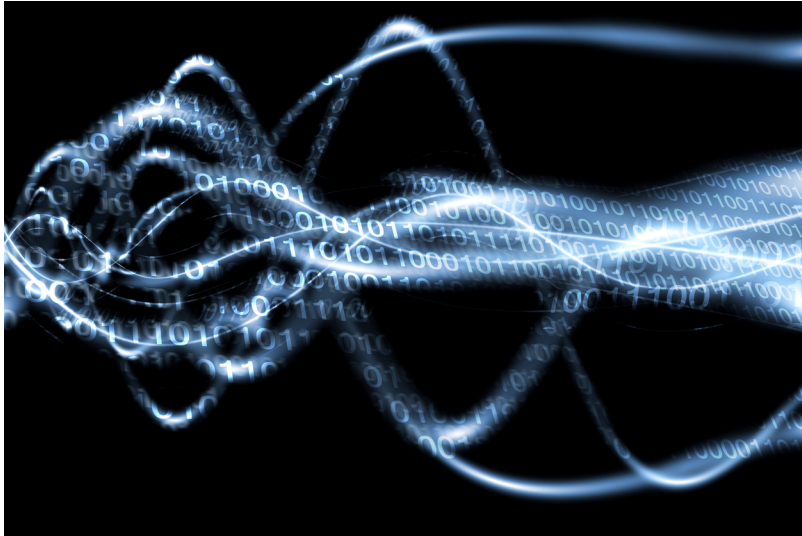
**Pop B-20 compliance question:** which AVM provider is not a compliant form to use to validate property value under B-20?

Answer: Emili.

Under B-20, “Lenders must be satisfied that the value of the property being financed has been confirmed by an independent third party.” If you are funding insured deals and relying on Emili alone to validate, you may be in trouble. Emili does not provide a value for a property being financed. Instead it evaluates an area and, based on the value in that area, agrees or disagrees with the value stated on the application. This means that when Emili agrees or disagrees with a value, you are not actually obtaining the value of the specific property being financed.

Source: <https://www.mortgagebrokernews.ca/people/a-B-20-breakdown-171135.aspx>

# How Lenders Evaluate Property Data



At the underwriting level, lenders often rely on AVMs, appraisals, and customized data as separate tools, but more often they look at all three. If you currently do not deploy all three, there are many reasons why you may want to consider the practice. We'll cover these later in this eBook. Regardless, if you are looking to assess your portfolio all or in part, doing so is impossible using only appraisals because it would be too time consuming, labour intensive, and cost prohibitive. The same goes for using only AVMs generated on a single-property basis. This is where customized bulk data comes into play. Even if you're a smaller lender, this can be a great resource.

No matter how you evaluate a property, the most important thing you need to look at is where the data you rely on comes from.

# Data Integrity is King

You need to know your property values are accurate, both for individual assessments, and for the security of your whole portfolio.

That's why data integrity is critical. You want to be dealing with the most accurate, complete, and current information. There are many different sources of property-related data, including municipalities, government, local MLS boards, real estate associations, and private enterprise. So, how do you choose which one to use?

The best source of property data comes from the land registry where property transfers, mortgages, and liens are registered as they happen.

For example, in Ontario Teranet is the exclusive provider of the province's online property search and registration. Teranet developed, owns, and operates the Province of Ontario Land Registration Information System (POLARIS), one of the most advanced, secure, and sophisticated land registration systems in the world. This system stores all registrations of properties in Ontario. This includes information such as a property's sales history, registered mortgages, ownership, and more. From this data, a lender can either generate an estimate of a property's value individually (a Purview report includes an AVM), or can evaluate their portfolio (meaning validate thousands of loans through bulk data).



# Stress Testing at the Micro Level

Before spending the time or financial investment on a drive-by or full appraisal for a single property, consider first looking at an AVM. Some AVM providers, like Purview, will offer an evaluation of a specific property, while others will provide agreement or disagreement based on an evaluation of the area solely. To be B-20 compliant, “the lender must be satisfied that the value of the property being financed has been confirmed by an independent third party.” Since Emili does not evaluate or provide a value, the property being financed relying on an Emili AVM is not B-20 compliant. The best AVM is one that evaluates the subject property *and* market conditions in an area to generate an estimated value.

AVMs are an excellent way to filter out deals where the property value is insufficient to proceed with the deal. The AVM will also validate who owns the home. Some providers can even provide insights into registered mortgages and liens. It may also uncover other flags that may make you decide to proceed differently through the underwriting process.

# Stress Testing at the Micro Level

Lenders can use all three property valuation methods — AVMs, appraisals, and customized bulk data — to have the most efficient process for knowing that the property they are financing is worth what they think.

## Ideal Flow



# Stress Testing at the Macro Level

The macro level, looking at an entire portfolio, is an area where many big banks excel. There are various things about your portfolio that you want to be aware of, some of which you may want to continually measure. This is especially true if you are a smaller lender who wants work towards being more competitive. Stress testing your portfolio at the macro level can be achieved through leveraging customized bulk data. Many banks use this data to define their business rules.

How does it work? You establish your rules – what data do you want assessed against what measures? You determine the co-hort of loans you want assessed. Example: Perhaps you begin with 50,000 loans that you want assessed.

Your data provider gives you a custom report assessing the specific data you requested. Examples:

- Perhaps you want to know what the properties are worth now in comparison to when you originally financed them.
- Perhaps you want to know if properties you have previously financed using other methods, such as an appraisal, were accurate at the time of financing.
- Perhaps you want to look at clients who have had subsequent liens or mortgages registered after yours.

# Stress Testing at the Macro Level

## **ACTIONABLE INSIGHTS**

From this data you gain incredible insights that enable you to:

- ✓ Look at the concentration of your loans as they relate to neighbourhoods and property types.
  - ✓ Identify problem areas and property types.
  - ✓ Identify properties and areas of opportunity.
- ✓ Identify trends that could indicate a region could be problematic in the future.
- ✓ Identify past problematic areas that have revitalized.
- ✓ Identify weaknesses in your underwriting process as it relates to policies and providers.
- ✓ Look at your portfolio from a bird's eye view.
- ✓ Adjust your risk rules and even establish new ones where there is an area that requires attention.



# Conclusion



Whether you operate a small finance company, a mid-sized credit union, MIC, trust company, or other alternative mortgage lender, you can take advantage of all the same tools that the big banks have been using for ages. Putting measures in place to leverage AVM technology to evaluate your portfolio makes you more agile in a changing real estate market and enables you to adapt quickly to changing conditions, greatly mitigating losses.

# About the Author

The eBook was produced by the Commercial Solutions team at Teranet. As a trusted provider to the financial services industry, Teranet delivers access to information that allows customers to mitigate fraud and make better mortgage underwriting and mortgage insurance decisions. Teranet also provides automated property valuation tools and other risk management products for Canadian financial institutions, mortgage lenders, property, title, or mortgage insurers, and real estate portfolio managers.

Find out more at:

- [www.purview.ca](http://www.purview.ca), [www.teranet.ca/commercial-solutions/financial-services](http://www.teranet.ca/commercial-solutions/financial-services)



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[purview.ca](http://purview.ca)