B.C. Budget 2018 – Housing Plan Speculation Tax and Foreign Buyers Tax

Economics

Highlights

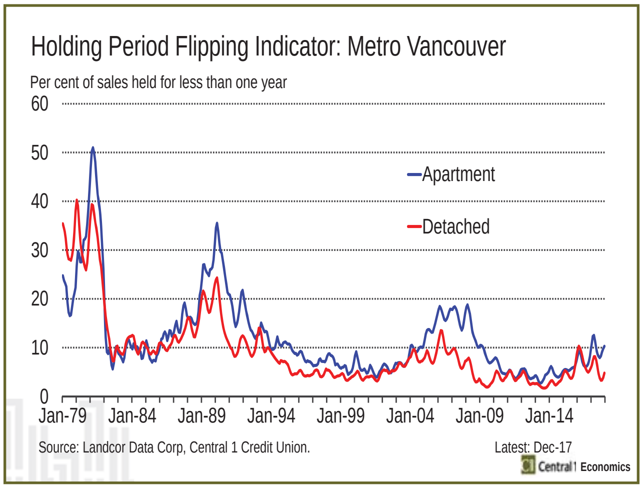
- Speculation in housing will slow due to tax and enforcement measures
- Foreign buyer tax increased and expanded
- Market impacts not likely to cause a housing collapse or stop prices from rising

Budget 2018 introduced a 30-point housing plan to stabilize the market, crack down on tax fraud, build affordable housing, and increase security for renters. This report examines the new housing speculation tax and the expanded Foreign Buyers Tax with a view to assessing their possible market impacts. A recap of the 30-point housing plan and a general overview of *BC Budget 2018* can be found be found here.

A prominent measure in the 30-point housing plan is the new speculation tax. In 2018, a new speculation tax will be levied on residential property in BC targeting foreign and domestic home owners who do not pay income tax in BC, including those who leave homes vacant. Satellite families will also be captured by the tax. The tax will apply to the Metro Vancouver, Fraser Valley, Capital and Nanaimo Regional Districts (RD) and in the municipalities of Kelowna and West Kelowna. In 2018, the tax rate will be $5 per $1,000 of assessed value. In 2019, the tax rate will rise to $20 per $1,000 of assessed value.

The definition and coverage of speculation are general, and specifics need to be finalized. The measure's intent is to discourage speculation and thereby take some demand pressure off housing prices. The type of speculation activity this measure aims to slow is flipping, or those buyers whose only intent is to resell on the expectation of higher prices, and a capital gain, without any intention to use as a principal residence or investor owned rental. Most would consider flipping as unproductive speculation, as compared to productive speculation in the case of an investor owned rental property, for example.

Another example of productive speculation is a builder or developer buying a property for future



redevelopment. While not explicitly stated in *Budget 2018*, this activity would not qualify for the speculation tax because a builder or developer would be a business owner, not a homeowner, and in any case, would pay income tax in BC.

The instance of second or vacation homes is a grey area. BC resident owners who pay income tax in BC would be exempt, but not foreign owners. Would it include Albertans who own vacation property in BC, for example? If the intent is to capture anyone who does not pay income tax in BC, then the definition casts a wide net. However, the definition of foreign here is presumably the same as in the Foreign Buyers Tax.

There are many markets in BC where Albertans, other Canadians, and foreigners own vacation properties. Whistler, the Okanagan, Fernie, Invermere, and other markets have a substantial foreign or non-BC ownership component, which contributes to those local economies in the real estate investment and in tourism spending. This type of property ownership is considered productive investment, not speculation in any case.

How much speculation occurs in the markets identified in *Budget 2018*? There is no comprehensive database on this issue and some of the measures in the 30-point plan addresses this issue. However, there is data that sheds some light on the issue.

Data from the BC Assessment Authority via Landcor Data Corp. using a one year holding period shows about 10 per cent of condo apartments and five per cent of detached units are resold within one year of purchase in Metro Vancouver. This flipping measure is shown in the graph and can be seen rising during every housing cycle expansion phase, and interestingly, the current expansion phase has seen less flipping than in previous cycles.

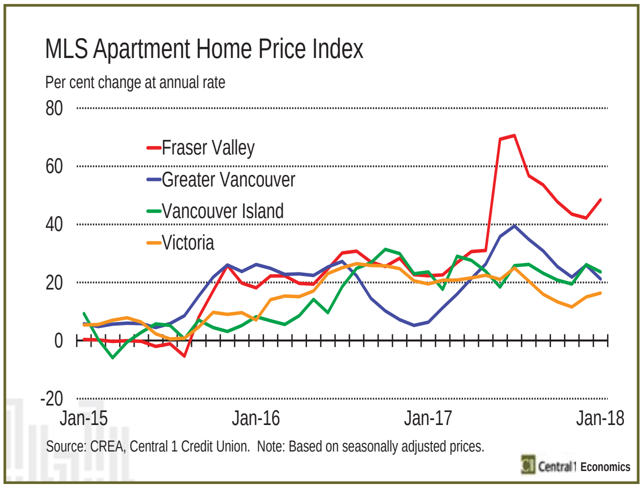
In other markets the speculation tax will apply, a similar pattern exists, namely, apartment flipping is higher than in detached units and flipping is lower than in previous housing cycles. In the Capital RD, Central Okanagan RD, and Nanaimo RD, flipping rates are currently around five per cent.

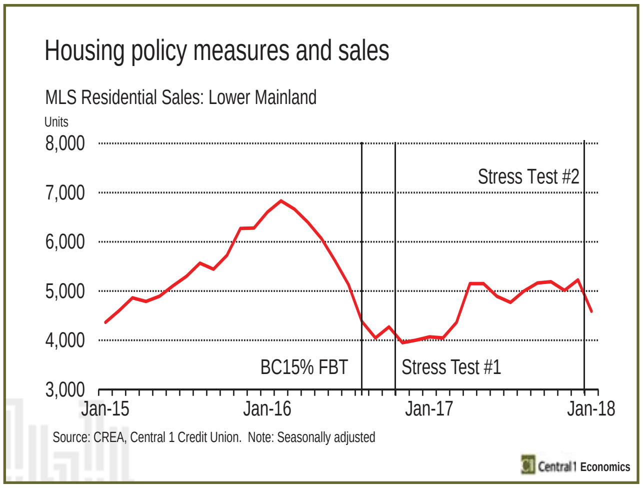
The one year flipping measure is used because the Canada Revenue Agency (CRA) uses this time frame to determine whether a property qualifies as a principal residence and is exempt from the capital gains tax on sale, typically by owner-builders. There are legitimate reasons, such as a change in employment or household circumstances, for a principal residence to be resold in less than one year.

The flipping data does not capture presale flipping or pre-sale reassignments on units not built or under construction. This is another area addressed in the 30-point housing plan under the heading of "Cracking down on tax fraud and closing loopholes". The government will require developers to collect and report information about the assignment of pre-sale condo purchases and this information will be shared with federal and provincial tax authorities.

The market impact of this measure could be considerable for some condo projects and for the condo market. This type of speculative activity falls in the unproductive category. Some condo developers have taken proactive steps to exclude or minimize pre-sale assignments. At the margin, and to the extent this activity drops off, the condo market will potentially experience less sales demand leading to a longer sell-out period, and over time, less new construction. Condo apartment prices have been rising rapidly during the past two years.

Other measures under this umbrella include tracking beneficial ownership through numbered companies, trusts, and proxy owners to hide actual ownership. Enhanced data collection through amendments made to the Property Transfer Tax Act, Homeowner Grant Act, Income tax Act, Land Tax Deferment Act, along with increased co-operation with the federal





government and access for tax administrators to relevant information on property transfers held in a Multiple Listing Service (MLS) database.

The combined impact of the speculation tax, presales assignments, and the integrated information on property transfer and ownership will reduce unproductive speculation in the market. The extent of the impact is uncertain, and it will be difficult to isolate the impact of these measures with other factors impacting sales and prices, but it will take some pressure off prices and the condo market.

The expansion of and increase to the Foreign Buyers Tax (FBT) is another element in the government's housing plan. The FBT was introduced in Aug. 2016 at a 15 per cent rate applied to Metro Vancouver only. In *Budget 2018,* the tax is increased to 20 per cent and coverage extended to include the Fraser Valley, Capital, Nanaimo, and Central Okanagan Regional Districts.

The expanded coverage will have an impact on those markets depending on the extent of foreign buyer activity, which is not known with much clarity. In Metro Vancouver, the FBT did not have a significant negative impact on market-wide housing sales and prices, but it did have a significant negative impact in sub-markets such as Richmond, West Vancouver, and Westside Vancouver on high-end detached properties. A similar outcome is expected in the expanded coverage markets. Increasing the tax to 20 per cent is not likely to have a material impact above what has been experienced in Metro Vancouver.

Foreign purchasing outside Metro Vancouver has been low at less than four per cent. We anticipate this to have mild downside impact on sales, with the government estimating only a modest increase in PTT revenues of $35 million.

The market impact of these tax, enforcement, and information collection measures will dampen sales and cool price increases, but not to a large extent and not market wide. Some sub-markets may experience a more negative impact. No housing recession is expected as a result of these measures, and following a temporary negative reaction, the market will likely hold up and resume generating higher prices due to other demand and supply factors at work.

As long as the economy and population continue to expand, the demand for housing will also increase, and in land supply constrained markets, this will only result in higher prices in the longer term. In the shorter term, this cycle expansion phase will persist until there is an economic recession or geopolitical crisis event triggering a recession, or until the combination of rising mortgage rates, higher prices, and potentially additional policy measures slows the market into a 'soft landing' during the next two to four years.

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