Report to Council

Date: March 19, 2018

File: 0100-01-002

To: City Manager

From: Johannes Saufferer, Real Estate Services Manager

Subject: Provincial Budget 2018 - Real Estate Taxes

Recommendation:

THAT Council receives, for information, the report from the Real Estate Services Manager dated March 19, 2018, with respect to the Provincial Budget 2018 - Real Estate Taxes;

AND THAT Council support issuance of a letter from the Mayor to the appropriate Provincial Ministry in a form consistent with the recommendations in this report;

AND THAT the Province consider provincial equity with respect to application of any new real estate related taxes and remove the geographic delineations proposed;

AND THAT the Province consider implementation of a transactional speculation tax as opposed to a tax that acts as a vacant home tax, in a form similar to what was recommended in the UBCM policy paper, *A Home for Everyone: A Housing Strategy for British Columbians*;

AND THAT the Province consider utilizing the taxation revenue generated from any new real estate related taxation in Kelowna for affordable housing initiatives in Kelowna as a means to assist with housing affordability and homelessness challenges;

AND THAT the Province consider providing clarity on all the detailed terms and exemptions of the Speculation Tax in an expedient timeframe to reduce the impact on Kelowna's local real estate market due to the uncertainty it has caused;

AND FURTHER THAT the Province consider, through local consultation, an economic assessment of the potential unintended impacts of the proposed new Speculation Tax, which acts as a vacant home tax, if the Province aims to bring forward the associated legislation.

Purpose:

To provide Council background information on the proposed real estate taxes that were identified in the 2018 Provincial budget.

Background:

On February 20th, the Provincial Government released *Budget 2018*, which outlines the government's fiscal priorities and objectives over the next year. Key focus areas targeted in the budget included child care, housing and affordability.

As a cornerstone of *Budget 2018*, the government released a 30-point plan for housing affordability in British Columbia. The 30-points contained in this plan were broken down into the following five categories:

- Stabilizing the market;
- Cracking down on tax fraud and closing loopholes;
- Building the homes people need;
- Security for renters; and,
- Supporting partners to build and preserve affordable housing.

A total of 7 specific initiatives were identified to assist in accomplishing the first objective of stabilizing the market. Of these, 4 initiatives are anticipated to have the most significant impact on our local community and are further discussed in the balance of this report. These specific initiatives are:

- Increasing the property transfer tax on the value of homes over $3 million;
- Increasing the foreign buyers tax to 20%;
- Expanding the foreign buyers tax to areas outside of Metro Vancouver; and,
- Taxing speculators.

While *Budget 2018* appears to have support from the general public[1] and a number of non-profit agencies and groups, real estate specific groups, such as the Urban Development Institute and the BC Chamber of Commerce voiced significant concerns regarding its impact on the real estate sector in particular, and the larger economy in general.

INCREASE IN PROPERTY TRANSFER TAX RATE

Description

Budget 2018 increases the property transfer tax rate for residential properties from 3% to 5% for the portion of fair market value in excess of $3 million. A summary of the property transfer tax rate structure before, and after, *Budget 2018*, is provided below.

	Property Transfer Tax Rate	
Portion of Fair Market Value	**Before Budget 2018**	**After Budget 2018**
0-$200,000	1%	1%
$200,000 - $2,000,000	2%	2%
$2,000,000 - $3,000,000	3%	3%
$3,000,000 +	3%	5%

[1] See Appendix E

Intended Purpose

As stated in *Budget 2018*, the intended purpose of the change to the property transfer tax rate is to stabilize the housing market.

Property Specific Impacts

As the rate increase only affects that portion of the market value in excess of $3m, the vast majority of properties within the City of Kelowna will be unaffected. Of the +/-54,000 residential properties in Kelowna identified by BC Assessment, around 400 properties, or less than 1%, are assessed at over $3m.

For those properties that are affected by the increase in the luxury tax rate, the table below shows the impact of *Budget 2018* on the theoretical sale of a $4m property.

	Property Transfer Tax Payable	
Portion of Fair Market Value	**Before Budget 2018**	**After Budget 2018**
0-$200,000	$2,000	$2,000
$200,000 - $2,000,000	$36,000	$36,000
$2,000,000 - $3,000,000	$30,000	$30,000
$3,000,000 +	$30,000	$50,000
Total Property Transfer Tax Payable	**$98,000**	**$118,000**
Net difference due to tax change	*$20,000*	

Market Impact

Statistics from the Multiple Listing Service ("MLS") show that there were a total of 6 property sales in the City of Kelowna in 2017 with a sale price of over $3,000,000. In 2016 there were 14 sales that exceeded this threshold within the City, and in 2015 there were 8. The cumulative impact of *Budget 2018* on these historical sales would been in the range of $150,000 to $300,000 per year, as shown below.

	2015	2016	2017
Residential sales > $3m	8	14	6
Cumulative difference in PTT due to Budget 2018	$325,000	$250,000	$160,000

Assuming the number and value of future sales in excess of $3m is in line with historical trends, the overall impact of Budget 2018 on Property Transfer Tax revenue collected from that portion of sales in excess of the $3m threshold may be in the range of $200,000 to $300,000 per year.

Potential Implications

The implications of the changes to the property transfer tax rate on the Kelowna real estate market and the overall community are anticipated to be relatively nominal. The reasons for this are three-fold:

1. The portion of residential properties affected by the change is a small sub-set of the overall market (less than 1%).

2. The impact of the change on those properties that are affected constitutes a small portion of the overall acquisition price (an additional $20,000 on a $4m acquisition); as a result, the change is not likely to act as a deterrent to those individuals engaged in these type of sales.

3. The increase to the property transfer tax rate will be implemented on a province-wide basis; as such, there will be no incentive to make an acquisition in a different area of the province to avoid the impact of this tax.

Summary

- The proposed changes to the property transfer tax rate are not expected to have a material impact on the local real estate market, or the larger community.

FOREIGN BUYERS TAX

Description

In addition to the property transfer tax, *Budget 2018* dictates that foreign nationals, foreign corporations and taxable trustees must pay an additional tax on residential properties that transfer within specified areas of the province[2]. Prior to *Budget 2018*, the foreign buyers tax applied only to Metro Vancouver, and the applicable tax rate was 15% of the fair market value of the property. *Budget 2018* increased the tax rate from 15% to 20% of the property's fair market value, and expanded the applicable areas to include the following:

- Capital Regional District;
- Fraser Valley Regional District;
- Greater Vancouver Regional District;
- Regional District of Central Okanagan; and,
- Regional District of Nanaimo.

The following municipalities are included within the Regional District of Central Okanagan:

- Lake Country;
- Kelowna;
- Peachland; and,
- West Kelowna.

[2] A foreign buyers tax is one of a number of policies available to governments to limit non-resident owner of residential property. A summary of initiatives limiting and restricting investment to foreign non-residents is shown in Appendix A.

Intended Purpose

The stated purpose of the foreign buyers tax is to ensure foreign buyers contribute more for the high quality of life they enjoy when they move to the province.

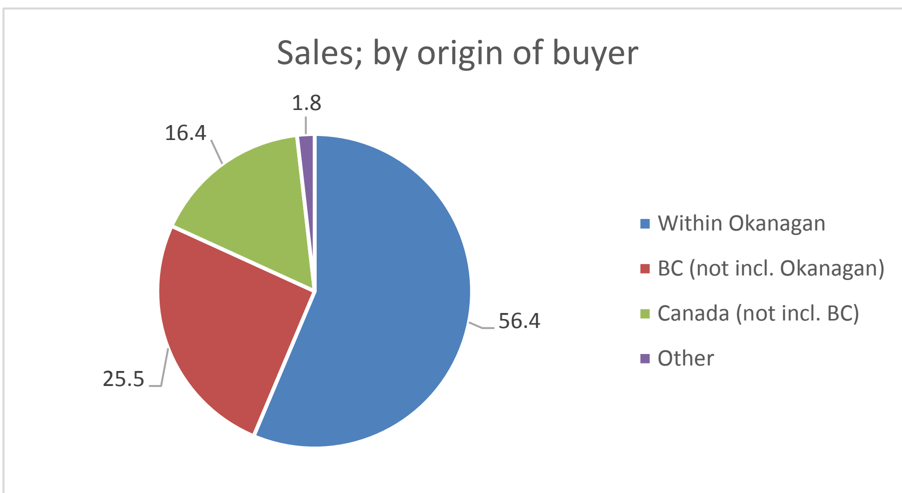
Property Specific Impacts

As a result of *Budget 2018*, a 20% one-time, transaction tax will apply to non-domestic purchasers of residential property within the City of Kelowna. As shown in the table below, the impact of this additional tax on each of the three typical property types within Kelowna is significant.

	Typical Condo	Typical SF Home	Waterfront Home
Market Value	$332,000	$680,000	$3,000,000
Tax Rate	20%	20%	20%
Additional Tax	$66,400	$136,000	$600,000

Market Impact

According to the Okanagan Mainline Real Estate, buyer statistics in 2017 (by origin) are as follows:



The 2017 data aligns with historical averages which suggest that approximately 2% of residential purchasers within the Okanagan Region are from outside of Canada[3].

According to the MLS, there were approximately 3,400 residential property sales in the region in 2017. There were approximately 4,000 residential property sales in 2016 and 3,200 in 2015. In addition to MLS based sales, anecdotal evidence suggests approximately 15% of sales are non-MLS based (e.g. for sale by owner, direct sale by developer, etc.). Assuming 2% of residential transactions were completed by non-domestic purchasers, the total number of acquisitions of Kelowna residential real estate by foreign entities over the last three years is summarized as follows:

[3] See Appendix B

	2015	2016	2017
Residential MLS Sales	3,200	4,000	3,400
Residential Non-MLS Sales	480	600	510
Total Residential Sales	**3,680**	**4,600**	**3,910**
Estimated Number of Foreign Buyers	74	92	78

The anticipated impact of the inclusion of Kelowna within the specified area to which the Foreign Buyers Tax applies are twofold:

1. Negative impact on sales due to a reduction in purchases by foreign buyers; and,
2. Increased taxation revenue due to implementation of foreign buyers tax on the sales by 'foreign' buyers that do occur.

Reduction in Purchases by Foreign Buyers

Statistics from the Metro Vancouver region suggest that the number of foreign buyers decreased by approximately 75% when the Foreign Buyers Tax was first implemented in that region in August of 2016[4]. However, this reduction was short-term in nature and much of the foreign buyer market has returned. Assuming the same ratio holds for Kelowna, the number of foreign buyers is anticipated to decrease from around 70-90 per year to approximately 20-25 per year, as shown in the table below.

	2015	2016	2017	2018 (f)
Total Residential Sales	3,680	4,600	3,910	4,000
Est. Number of Foreign Buyers	74	92	78	25

Estimated Tax Revenue Generated in Kelowna

Based on the typical market value of a single family home in Kelowna, the anticipated additional tax revenue generated as a result of *Budget 2018* can be calculated as follows:

(number of sales) x (typical price per sale) x (tax rate)
25 x $680,000 x 20%
$3,400,000 per year

Note that the estimated additional tax revenue could be substantially higher if either more foreign buyers continue to be active in the local market (i.e. the reduction in foreign buyers is less than 75%), or if the average purchase by a foreign buyer is not reflective of the average single family home price of $680,000. If either of these assumptions are too conservative, the net taxation impact of this tax could increase substantially.

[4] See Appendix C

Potential Implications

Given the annual sales volume of +/-4,000 residential units, the anticipated "loss" of 50-70 sales per year to non-domestic purchasers is not anticipated to have a significant impact on overall market supply/demand conditions within the community. Nevertheless, there are a number of important factors to be aware of with respect to the foreign buyers tax:

- While a significant portion of local real estate market participants buy *and sell* as part of their market activity (e.g. family selling townhouse to upside to a single family home or empty nesters selling single family home to downsize to a condominium), the loss of foreign buyers represents loss of 'pure' additional demand on the local housing market. As such, the loss of 50-70 sales may have a disproportionate – though still relatively minor – impact on the local market.

- Anecdotal evidence suggests that foreign buyers target higher-end or luxury type properties. Given the limited demand for properties of this nature, the foreign buyers tax may have a material impact on the luxury market within the City.

- Given that the foreign buyers tax is applicable to specific communities within the province, implementation of *Budget 2018* may cause foreign buyers to pursue acquisitions in nearby, or similar communities, not impacted by the tax. For instance, following the implementation of the foreign buyers tax in Metro Vancouver, the ratio of foreign buyers in the Capital Region (which was not impacted by the original tax) appeared to increase[5]. Similarly, the proposed implementation of the tax within Kelowna may result in increased foreign buyer activity in nearby communities such as Vernon, Penticton, or Kamloops.

- The foreign buyers tax may have a negative impact on the City of Kelowna's international reputation as a community that seeks to attract and welcome a diverse array of market participants.

Summary

- While the foreign buyers tax is not anticipated to have a significant impact on the local real estate market, or the larger community as a whole, certain areas of the market – particularly luxury properties – may be disproportionately impacted.

- As a result of the magnitude of the foreign buyers tax (20% of the fair market value of the property), revenue collected by the provincial government from the sale of properties within the City of Kelowna will likely be substantial. Conservative revenue estimates are in the range of $3.5m - $5m per year.

- The most significant effect of the foreign buyers tax will likely be the negative impact on the City of Kelowna's overall reputation and desirability as a destination for international buyers. The

[5] See Appendix D

effects of this may reach beyond the real estate market and impact the local economy as a whole, due to the associated loss in business and commercial investment.

SPECULATION TAX

Description

Budget 2018 introduces a speculation tax that targets foreign and domestic speculators in BC. The speculation tax will apply to the Metro Vancouver, Fraser Valley, Capital and Nanaimo Regional District, as well as the municipalities of Kelowna and West Kelowna. The Province will administer the new speculation tax outside of the property tax system and property tax cycle.

In 2018, the tax rate will be $5 per $1,000 of assessed value. In 2019, the rate will increase to $20 per $1,000 of assessed value.

The majority of BC homeowners will be exempt from this tax via three identified exemptions:
1. Exemptions for principal residences
2. Exemptions for qualifying long-term rental properties
3. Exemptions for certain special cases

For those BC residents to which the above exemptions do not apply, a non-refundable income tax credit will help offset the impact of the speculation tax. At the time of publication of this report, information regarding the terms relating to these exemptions, particularly, what will constitute a long-term rental, were not available.

Intended Purpose

To temper speculation and the associated distortion of the provincial housing market.
To encourage homeowners to add their vacant properties to the province's long-term housing stock.

Property Specific Impacts

The table below summarizes the impact of the speculation tax on three typical properties types within the City of Kelowna. Note that as previously discussed, the speculation tax rate is proposed to increase from 0.5% of assessed value in 2018, to 2% of assessed value in 2019 (and in subsequent years).

	Typical Condo	Typical SF Home	Waterfront Home
Market Value	$332,000	$680,000	$3,000,000
Annual Property Tax (approximate)	$1,800	$3,600	$16,000
Annual Speculation Tax	**$6,640**	**$13,600**	**$60,000**

Market Impact

The proposed Speculation Tax is anticipated to impact the Kelowna market in three distinct ways, as further discussed below.

#1 – Impact on BC resident home-owners that do not qualify for an exemption

Original wording in *Budget 2018* suggested that BC residents that do not qualify for one of the tax exemptions (e.g. Vancouver resident who owns a non-primary residence in Kelowna that is not rented out long-term) will get relief from the new tax in the form of income tax credits that helps offset the tax. Further to public concern regarding the whether or not the tax credits would off-set all or a portion of the speculation tax, it appears that the provincial government is now considering ensuring that British Columbians that pay income tax in BC are not subject to the speculation tax.

#2 – Impact on buyers from outside of BC

Based on the total of 3,910 residential property sales in 2017, and based on the estimated 18.2% of purchasers that were either outside of BC or outside of Canada, an estimated 712 units were purchased in the Kelowna area by non-BC residents. While it is expected that the majority of these purchasers would either eventually move to BC or rent their units long-term, the proposed speculation tax will likely deter a portion of these 712 individuals from purchasing in Kelowna. If one considers that there remains 1in3 to 1in4 purchasers that are removed from the market as they would not be willing to rent their unit or do not intend to reside in Kelowna, this would have a decrease in unit demand of 33% to 25% of the 712units. The loss of 235 units (at the high end) may represent a moderate loss of 6% of the 3,910 residential property sales in the Kelowna area. This potential unit demand decrease is not linearly proportionate to a commensurate decrease in pricing, particularly in light of the current sellers' market for real estate in Kelowna.

#3 – Impact on residential vacancy in Kelowna

As stated in *Budget 2018*, one of the key intentions of the speculation tax is to encourage home-owners to add their vacant properties to the local rental housing stock. Based on the 2016 census data, of the 57,433 private dwellings in the City of Kelowna, approximately 3,530 (or 6.1%) were unoccupied. Statistics Canada identifies unoccupied dwellings in the 2016 Census are defined as "unoccupied" or "occupied solely by foreign residents and/or temporary present residents". Of these 3,530 units, a significant portion are owned by BC residents who will likely not be affected by the speculation tax, due to the proposed income tax credit. Estimating a 50% BC-ownership rate of the occupied units suggests that 1,765 unoccupied units are owned by non-BC residents. These individuals will have four primary choices with respect to the speculation tax:

- Sell the property;
- Move to Kelowna and occupy the property;
- Make the unit available for rent; or,
- Pay the tax.

Assuming somewhere between 25-50% of non-BC owners decide to make their property available for rent in the local market, between 450 and 900 rental units would be added to the local market. The current inventory of rental units in Kelowna is 17,136. All things being equal, this supply increase would represent a 3-5% increase in the number of units available on the market.

Potential Implications

Key implications with respect to the proposed speculation tax are summarized below:

- The tax may have limited impact on addressing speculative purchases in the form of property flipping. The proposed tax is based on an annual assessment and is not transactionally based (e.g. a "true" speculation transfer tax). The short term nature of such speculation holdings (via property resales or 'flips') may limit the tax's intended consequences. Conversely, a tax based on annual assessment encourages property speculators to flip the property sooner to avoid the ongoing tax and does not address the market distortion caused by property flipping.

- The speculation tax appears to act more like a vacant home tax than its intended purpose of addressing speculation in the marketplace. If the goal of the tax is to address speculation, other, arguably more effective, tools are available.

- The speculation tax targets those holding property from outside of the province and encourages them to either rent the property, move to the province, or divest the property to a local.

- Market data suggest that the speculation tax will have a moderate impact in reducing purchases of Kelowna residential real estate by out of province buyers.

- Despite the anticipated moderate quantitative impact, qualitative factors around perception and uncertainty could have a significant impact on the local community. The associated implication that out-of-province buyers are not welcome in certain communities compared to others, and the uncertainty around tax rules until they have been fully adopted, may have a significant impact on Kelowna's real estate market in 2018. This was demonstrated in Vancouver with the introduction of the foreign buyers tax. Providing clarity on the speculation tax in an expedient manner, and treating all areas across the province equitably with the tax would help mitigate this impact.

- Inequity of areas impacted by the speculation tax will drive buyers to certain municipalities at the expense of others. Opportunities lost to Kelowna as a result of the speculation tax will likely benefit the neighboring communities of Lake Country, Vernon, and Penticton, as they are not subject to the tax. It is conceivable that an entrepreneur would choose to setup a business, technology focused or otherwise, near their secondary residence as they transition to a new community. This would put Kelowna and West Kelowna at a disadvantage in attracting these entrepreneurs compared to other areas of the region.

- The tax may have a positive impact on the availability of rental housing, with a focus on the higher end of the housing spectrum. Based on data provided from Statistics Canada, implementation of the speculation tax could result in a reasonable number of units currently vacant being added to the local seasonal rental housing stock.

Summary

- The speculation tax's intention to temper demand and housing prices may have a different effect in the Okanagan than in the Lower Mainland, due to a different buyer demographic.

- From the perspective of solely achieving the goal of reducing speculation, the concept of an ongoing tax based on assessment value is likely not the best tool to address "flipping" of real estate.

- The proposed speculation tax will have an impact much more reflective of a vacancy tax. Without a more thorough analysis and consultation on the impact of a vacancy tax in the Okanagan, there will very likely be unintended economic consequences.

- Uncertainty of the tax changes will likely cause a significant decrease in out of province purchasers due to perception, lack of clarity, and concerns that the tax rules may change again in the coming years.

- UBCM has identified the need to manage speculative demand in their policy paper, A Home For Everyone: A Housing Strategy for British Columbians. The document identifies targeted needs and recommendations of how to address concerns in a collaborative manner. Excerpts from the UBCM policy paper are included in the addendum to this memorandum.

CONCLUSION

Budget 2018 introduced three significant real estate tax changes. While it is anticipated that the proposed foreign buyers tax and the increase in the luxury tax rate will have limited impact on the local market, the proposed speculation tax, in its current form has the potential to have a significant impact. Unfortunately, due to its structure, the speculation tax is not likely to be successful in reducing speculation and 'flipping' of property in the housing market. Instead, the speculation tax will have its greatest impact as a vacancy tax, once the terms of the new tax are clearly defined. In the meantime, the lack of clarity and perception of the tax will have a negative impact on the local real estate market from out of province purchasers.

Internal Circulation:

Divisional Director, Financial Services
Divisional Director, Corporate Strategic Services
Divisional Director, Community Planning and Strategic Investments

Considerations not applicable to this report:
Legal/Statutory Authority:
Legal/Statutory Procedural Requirements:

Existing Policy:
Financial/Budgetary Considerations:
Personnel Implications:
External Agency/Public Comments:
Communications Comments:
Alternate Recommendation:

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