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TD Economics

Data Release: B.C. Takes the Plunge on Taxing Foreign Real Estate Investors

- On July 25th, the B.C. government introduced a four-pronged plan to help improve housing affordability.
    - First, as of August 2nd, foreign individuals and corporations will be subject to an additional 15% land transfer tax on the purchase of residential property. At this point, the surtax will only be applied in Metro Vancouver, but policy makers may choose to apply it to other jurisdictions should they deem it necessary. Moreover, the government has given itself some flexibility, with the rate adjustable between 10% and 20% depending on the impact. The 15% levy will add $300,000 to the provincial government's coffers on a $2 million residential transaction for homes bought by foreigners in the Vancouver area.
    - Second, the government plans to provide an initial investment of $75 million into a Housing Priority Initiatives Fund that will support provincial housing and rental projects. The fund will be supported through a portion of the revenue generated by the new tax on an ongoing basis. The details of the fund are still pending.
    - Third, the province is amending the Real Estate Services Act to end self-regulation of the real estate industry and will implement all recommendations highlighted by an independent advisory group report.
    - Fourth, the government made amendments to the Vancouver Charter to provide the city the legislative rights to implement and administer a tax on vacant homes. The City of Vancouver will design the framework of the vacancy tax, including details such as the tax rate, the timing, and its scope (along with any exemptions).
- The new legislation is intended to cool the overheated Vancouver housing market by stemming foreign speculation. The B.C. government has recently begun to track foreign real estate activity. Early results (for the period between June 10th and June 29th) suggested that international buyers accounted for only 5% of transactions in Metro Vancouver and 3% of B.C. activity overall – equivalent to$390 million in purchases province-wide. However, data released along with the policy announcement indicates that foreigners spent a total of $1 billion on B.C. housing between June 10th and July 14th, suggesting that foreign transaction activity rose significantly in the first two weeks of July. All told, the data implies that foreigners accounted for roughly 14% of all sales in BC during that period, with 86% of those purchases occurring in the lower Mainland.

Key Implications

- The beautiful surroundings, a large luxury home market, and relatively lax tax regulations for foreigners have made Vancouver an attractive place to invest in real estate globally, helping push prices up by 30% (or $200,000 on an average home) in just a year. The newly legislated policy is intended to help restore housing affordability for residents in the Metro Vancouver Area by raising non-residents' cost of purchasing and, on the margin, discouraging foreign speculation. By relieving demand and price pressures at the top end of the market, affordability benefits are likely to ripple down the price spectrum. Moreover, the government intends to utilize some of the money raised by way of the tax to help boost housing supply.

- In our view, this measure is very likely to achieve the goal of cooling market conditions in the near term. This partly reflects the fact that it is being implemented at a time when Vancouver's resale housing market has already been showing significant signs of cooling. Existing home sales fell by 14% in the three months since March and the average home price has dipped 2%. In addition, new housing construction has responded to the pick-up in demand, and hit a record high in the first half of 2016. This additional supply was already poised to return the market closer to balanced territory.

- A comparison with other countries that have recently levied various forms of taxes on non-residents highlights the significance of this tax. Earlier measures came in the form of increased land transfer taxes (Australia and Singapore), capital gain taxes (London, UK) and flipping taxes (Hong Kong). A year ago, the Australian state of Victoria introduced a "stamp duty" tax (effectively a land transfer tax) of 3% which increased to 6% this month, while New South Wales introduced an additional tax of 4% in June. The tax announced by B.C. is more than twice the level implemented in Australia.

- Several years ago Singapore also introduced a stamp duty of 10%, raising it to 15% in early-2013. This measure came along with additional changes to property tax rates and macro prudential regulation, which together hit the market as it was in the midst of a significant supply response. Still, even with a plethora of measures aimed to curb foreign housing activity, prices only fell 10% from 2013 to now.

- There is a fair bit of uncertainty as far as the exact impact of the new measures on the Vancouver market. For one, our views are based on B.C.'s foreign activity measures which span mere several weeks, with the government only recently starting the data collection. As such, the numbers themselves can be misleading given the inherent seasonality and volatility in housing data. The later was further exacerbated by the fact that it spans the time period just prior to and following up on the Brexit vote which saw sharp movement of capital towards safe-haven assets and likely an flight out of UK housing assets. Additional uncertainty is related to the key unknown of whether, and to what extent, non-residents may be able to circumvent the newly imposed rules.

- Based on a foreign share in the 5-14% range, our models point to a reduction in sales of 15% to 20% over the next 3 quarters and about a 5% decline in average prices.

- The uncertainty surrounding impacts becomes even more pronounced beyond the near term. In general terms, measures imposed internationally, including in Australia, had the effect of temporarily slowing the market, before prices later resumed their upward momentum. Despite the loftier tax, the Vancouver region could see a similar rebound especially if the Canadian dollar loses ground and global uncertainty continues to send foreign capital searching for a safe home.

- This policy, along with the government's recently-announced plan to allow municipalities in the GVA to levy a vacancy tax, should help to strengthen the stock of rental housing in the region. By targeting only residential purchases with the land transfer tax, the government may have insulated foreign investment in purpose-built rentals, which are deemed commercial and are very much needed in the city. The vacancy tax will raise the incentive to rent out empty units in the secondary market.

- With any tax change, there may be some unintended consequences. For one, the move may shift foreign attention to other markets in B.C., such as Victoria, or elsewhere in Canada. Even prior to the new policy announcement, we believed that foreign investors had already begun to gravitate to the more affordable Toronto market. As such, prices in Toronto could see some significant upside pressure in the coming months as foreigners look to new markets.

- A sharp drop in prices could also erode household equity and the wealth effects could have ripple through effects for the rest of the economy. All this remains to be assessed in the many months ahead, as the full implications begin to reveal themselves in the data.

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