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:

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