Ontario's *Fair Housing Plan*: Multiple Measures with Uncertain Impact

- **Ontario's newly-announced housing policies are likely to have a cooling effect on the Greater Golden Horseshoe housing market in the near-term.**
- **Over the medium- to long-term, we continue to see broad upward support for Ontario's housing markets from solid GDP growth, low interest rates, strong net interprovincial in-migration, increased international immigration, and continued inflows of foreign capital.**

Ontario has taken action to cool the red-hot housing markets in Toronto (charts 1 and 2) and its surrounding communities with a broad package of measures that address short-term demand dynamics. Initiatives in Ontario's *Fair Housing Plan* include a 15% tax on non-resident buyers in the Greater Golden Horseshoe (GGH), the expansion of rent control to all private rental units in the province, and legislation to allow Toronto (and potentially other municipalities) to tax vacant homes. A number of other measures aim to raise longer-term supply and affordability, such as encouraging the construction of purpose-built rental, market and affordable housing; streamlining development approvals; strengthening tenant rights; and increasing transparency in real estate transactions (see appendix for additional policy action details).

We expect these proposed measures to have a cooling impact on the GGH housing market in the near-term. At a minimum, they should succeed in shifting housing market psychology, dampening sentiment, and curbing some speculative activity, to put price growth on a more moderate path.

Foreign purchases are likely to be reduced, though the lack of solid data on the number of foreign buyers in Ontario prevents any evidence-based assessment of the potential extent of the impact. Vancouver home sales fell 24% following the August 2016 imposition of a 15% foreign-buyer tax on non-resident purchases and price appreciation has slowed from a high of 33% y/y at end-2015 to 13% y/y in March. However, sales volumes had already declined sharply in the months prior to the imposition of the tax, implying affordability challenges, shifting sentiment, and federal and BC policy changes implemented earlier in the year played a significant role in the slowdown. Vancouver home sales and prices have begun to edge up in recent months, which implies that the tax may not have had a sustained cooling impact on demand.

Canadian real estate, particularly in its largest urban centres, is expected to remain popular with some foreign investors despite these policy measures. Capital will continue to flow into Canada to offset the roughly CAD 68 bn current account deficit (3.3% of GDP) in our international balance of payments. With policy rates likely to remain on hold into 2018 and still-modest yields in Canada's fixed-income markets, it is nearly inevitable that at least a small share of this foreign capital will continue to be directed toward Canadian real estate; the foreign-buyers' taxes in BC and Ontario may simply divert these flows toward other provinces' major cities.

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Chart 1

Sources: Scotiabank Economics, CREA.

We continue to argue that broader measures to slow speculation among both domestic and foreign buyers would be more effective and equitable.

For the most part, domestic buyers may not be hugely affected by these proposals, and could benefit from increased price stability. Underlying demand across the region remains well supported by low borrowing costs, solid job gains expected to average over 1.25% this year and next, and favourable demographics, including ageing millennials, increased immigration, and provincial in-migration. The latter has swung from an average outflow during 2003–15 of nearly 10,800 to a 2016 inflow of almost 20,000.

POSSIBLE IMPACT OF INDIVIDUAL MEASURES

The proposed measures aimed at addressing supply are encouraging, but may not succeed in significantly bolstering the stock of new housing or longer-term affordability in the GGH. There is clear evidence that supply is not keeping up with demand despite the strength in housing starts. The inventory of unsold homes is below its long-term average, once adjusted for population growth (chart 3), and rental vacancy rates are near historic lows.

In particular, the expansion of rent control to all private rental units in the province threatens to stall the nascent pickup in purpose-built rental construction. While the measure will likely increase affordability for existing tenants, the proposed offsets are likely not sufficiently large to energize considerable new construction. Over time, this could inhibit the addition of new rental market supply and potentially worsen housing affordability.

Demand for buy-to-rent condos also may become considerably less attractive. A nominal 2.5% hard cap on rent increases implies lowered expectations for future rent rises in *pro forma* cash flow projections relative to pressures on maintenance fees, services (utilities, etc.), carrying costs, and prices. Just over one quarter of Toronto's rental stock—and the vast majority of all new units built over the past decade—are rented condominiums as opposed to purpose-built rental units (chart 4).

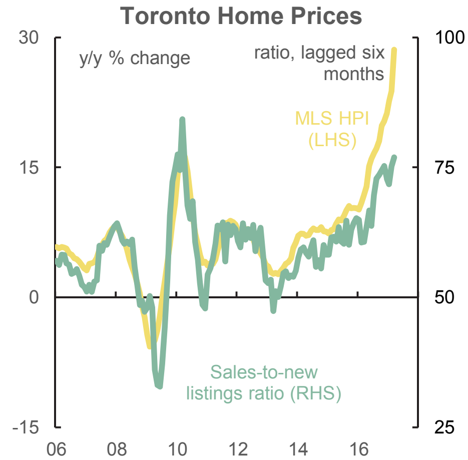
VACANCY TAX

The risk this policy proposal may have is highly uncertain at this point. After Ontario's steps to allow municipalities to charge vacancy taxes, we will need to see individual municipal proposals to implement these measures in order to draw conclusions. It is our preliminary understanding that municipalities are free to set the terms surrounding vacancy taxes such as the length of vacancy, enforcement mechanisms, and penalties. The effects may stretch beyond Toronto's vacancies to other markets and possibly include seasonal properties.

CRACK DOWN ON FLIPPING

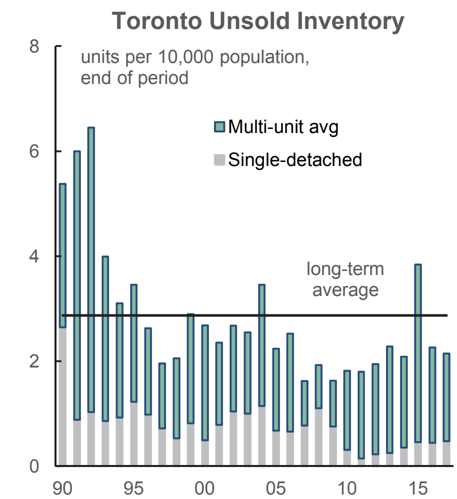
It is unclear how much the crackdown on flipping of pre-construction units will affect the market. The precise mechanism for addressing this activity is uncertain to us. The issue is people who buy and sell units from builders very quickly before any paperwork gets filed and therefore they get away without reporting income and paying taxes. Bringing these transactions above table and paying taxes on them makes sense. But there are potential consequences associated with successful efforts to ban the practice. After builders got stuck with inventory in the 1980s and early 1990s, they

Chart 2



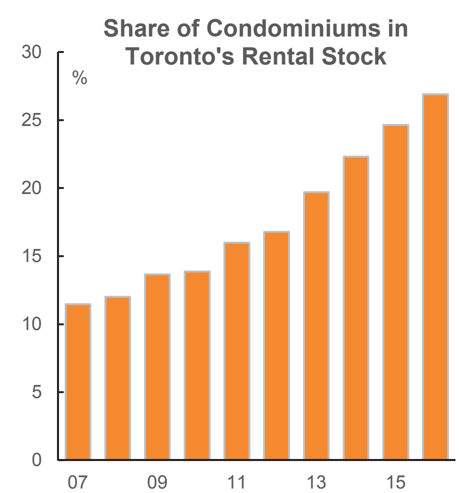
Sources: Scotiabank Economics, CREA.

Chart 3



Sources: Scotiabank Economics, Statistics Canada, CMHC.

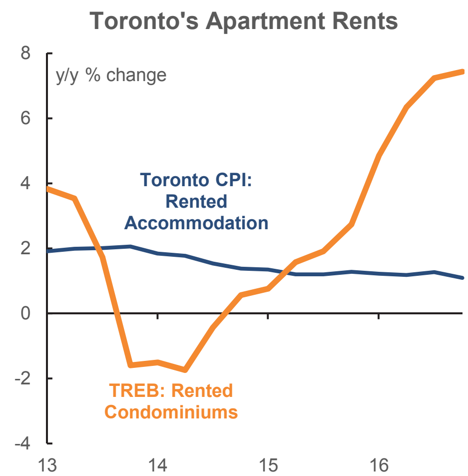
Chart 4



Sources: Scotiabank Economics, CMHC.

shifted toward underpricing and moving units quickly on to this segment (call them 'speculators') to then take the risk in moving the unit to the ultimate buyer who had a higher willingness to pay. Builders got their returns practically guaranteed in a cash-flow driven model and didn't get inventory risk which allowed them to clear product quickly while others captured a leveraged spread for taking the risk away from builders. If that model is now gone or impaired, then builder inventories may back up as the risk now shifts back toward them late in the cycle.

Chart 5



Sources: Scotiabank Economics, Statistics Canada, TREB.

ONTARIO'S FISCAL IMPACT INTERTWINED WITH MUNICIPAL EFFECTS

For Ontario, as it announces the resumption of a balanced operating budget as of fiscal 2017–18 (FY18), a fiscal risk is softer tax receipts near-term from this *Plan*. Hot housing markets in the Greater Toronto Area added at least CAD 300 mn to Ontario's FY17 Land Transfer Tax, and the resulting surge of over 11½% adds to the earlier 31% gain during FY15 and FY16. Metro Vancouver's 15% Foreign Buyers' Tax, in effect since early August 2016, is expected to yield CAD 100 mn in FY17 and CAD 150 mn during each of the following three fiscal years, but overall, its Property Transfer Tax receipts are forecast to drop almost 24% in FY18, and fall a further 7.6% over the following two years. Any comparison, however, is complicated by the specifics of Ontario's situation and the details of its proposed *Plan*. Revenue from other taxes, such as Ontario's Harmonized Sales Tax, might be dampened, but increased attention to tax evasion related to real estate transactions may offer a significant and long-term offset.

The increase in expenditures beyond the five-year CAD 125 mn programme to encourage rental housing may receive further definition in next week's *Budget.* For Ontario's municipalities, the *Fair Housing Plan* suggests significant changes for local governments, including property tax adjustments. The City of Toronto, as the only Ontario municipality levying a Municipal Land Transfer Tax, has the added challenge of relying on gains in this Tax to support its projected fiscal 2017 revenue growth. All Ontario municipalities will see their share of the provincial gas tax double from FY20 to FY22, but for Toronto, this is an offset to its highway tolling proposal that was disallowed. Longer-term, the greater degree of housing-market stability targeted by this *Plan* is positive for provincial and municipal competitiveness and growth.

In Ontario's *2016 Fall Statement,* the Province authorized the collection of additional information on real estate transactions and foreign purchasers through the Land Transfer Tax system. We look forward to this additional data, particularly the extent and composition of non-resident purchases. Evidence-based policy would benefit from all the Provinces collecting this information for all types of land transfers, including agricultural land and industrial/commercial properties. Today's *Fair Housing Plan* builds in the flexibility to adapt to new data and developments. A multi-disciplinary housing advisory group is proposed to meet quarterly and advise on the state of the housing market, the *Plan's* impact, and any additional required measures. This adds to Ottawa, Ontario and Toronto's commitment to regular update meetings, ongoing consultations between BC and Vancouver, and the renewed federal focus on enhanced housing data and analysis.

INFLATION AND MONETARY POLICY IMPLICATIONS

The implications for monetary policy entail viewing the effects of rule changes through the lens of the Bank of Canada's inflation mandate. On this note, there are competing possible effects.

The rent component in Toronto's CPI is rising by only 1% y/y. This is much lower than other rent measures (chart 5), and there may be data issues (the data come from a bolt-on question to the Labour Force Survey) but it's how CPI captures what is going on. If 2.5% is the rent increase that everything converges toward, perhaps there is mild upward pressure on this component of shelter costs within CPI. An extra 1.5 percentage points added to rent within Toronto's CPI would add about 0.1% to the national CPI add-up over a period of time as rents adjust.

An offsetting effect may be a slowdown in the real estate market across southern Ontario and how that may affect a potentially broad number of prices. At this point we're assuming a relatively minimal overall net effect on inflation that does not give cause for the Bank of Canada to deviate from its neutral policy bias in the near-term. By extension, this should mean a relatively neutral influence on borrowing spreads relative to the US and the Canadian dollar. Clearly this viewpoint will evolve in data-dependent fashion and as policy clarity improves.

TO BE CONTINUED…

Today's announcement from Queen's Park is unlikely to be the final word on Ontario housing. The probable impact of the measures announced today may be limited or transitory in some cases, and in others, the possible effects of these policy initiatives will remain highly contingent on the still-to-be-determined details of their implementation at the provincial and municipal levels. Given the number and variety of measures announced, the likelihood is high of unintended consequences that may require further remedial policy measures. Additionally, today's package will not mitigate the strong support Ontario's housing markets will continue to receive from solid macro fundamentals.

Appendix: Ontario's *Fair Housing Plan*—Further Significant Details

A 15% Non-Resident Speculation Tax (NRST) will be applied, as of April 21, 2017, to the purchase price or acquisition of an interest in a home in the Greater Golden Horseshoe (GGH)[1] by individuals who are not citizens or permanent residents of Canada. A rebate of the NRST is available to (1) a foreign national who becomes a Canadian citizen or permanent resident within four years of the acquisition; (2) a foreign national who has legally worked full-time in Ontario for a continuous year since acquisition; and (3) a foreign national student enrolled full-time for at least two years in an Ontario institution since the acquisition. The NRST will also apply to a foreign corporation or a taxable trustee. The NRST does not apply to multi-unit residential rental apartment buildings, agricultural land or commercial/industrial land.

To protect renters, rent control will be expanded, as of April 20, 2017, across the province to all private rental units to restrict increases in rents to the annual provincial rent increase guideline with a 2.5% cap. The annual guideline increase is the average y/y increase in Ontario's CPI over the 12 months to May. Above-guideline increases may be permitted if the unit is vacated, to recoup eligible capital or security service expenses, or if a jump of more than 50% occurs in municipal taxes or utility costs. Proposed changes to the *Residential Tenancies Act* include the development of a standard lease.

To encourage more purpose-built rental housing, the Province is also introducing a five-year CAD 125 mn provincial programme that is intended to rebate a portion of development charges. As well, for new multi-unit residential apartment buildings the property tax rate must be made similar to other residential properties.

The *Fair Housing Plan* states that Ontario will partner with the Canada Revenue Agency to explore more comprehensive reporting requirements to ensure that all federal and provincial taxes are remitted on real-estate purchases and sales. Delving into tax avoidance and excessive housing market speculation, reviews will include the "paper flipping" practice that assigns a contractual agreement to buy a residential unit to another person before closing.

To increase housing supply:

- A new programme will leverage the value of surplus provincial land assets to develop a mix of market and affordable housing. Possible pilot projects include 27 Grosvenor/26 Grenville in downtown Toronto and the West Don Lands (in the latter, an agreement with the City of Toronto specifies 20% affordable rental and 5% affordable ownership units);
- New legislation will permit the City of Toronto and potentially other municipalities to introduce a vacant homes property tax to encourage owners (including speculators) to sell their units or rent them;
- Greater flexibility will be provided to municipalities to use property taxes to unlock development opportunities, such as through a higher tax on vacant land already approved for new housing;
- A multi-Ministry working group will collaborate with the development industry and municipalities to streamline the approvals process; a "Housing Supply Team" with dedicated provincial staff will address barriers to specific housing projects; and
- Working with GGH municipalities, Ontario will proceed with its updated *Growth Plan* to promote intensification around existing and planned transit stations, to encourage higher densities in the suburbs to support transit, and to ensure a broader range of unit sizes in higher-density residential buildings.

To better protect consumers, Ontario wishes to make the Province a leader in real estate standards and to educate households on their rights, particularly when one real estate agent is representing more than one party in a real estate transaction.

1 The Greater Golden Horseshoe stretches from Niagara Falls west to Waterloo/Kitchener, north to Orillia and east to Peterborough. Specifically it includes Brant, Dufferin, Durham, Haldimand, Halton, Hamilton, Kawartha Lakes, Niagara, Northumberland, Peel, Peterborough, Simcoe, Toronto, Waterloo, Wellington and York.