B.C. tax on foreign home buyers almost too good to be true

By Barrie McKenna
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The B.C. government's move to slap a 15-per-cent tax on foreign purchases of Vancouver real estate is getting surprisingly good reviews.

Supporters are promising all sorts of good things from the tax, including freeing up more homes for British Columbians to buy, curbing rapidly rising prices and raising a pile of cash to build affordable housing – all without jeopardizing the equity people have built up in their homes.

It's a fantasy to think B.C. can have it all.

There are really only two possible scenarios here. Either the tax is such a powerful disincentive that Chinese speculators abruptly stop buying in Vancouver, or it will have minimal effect and the influx of foreign cash continues unabated.

In the first scenario, the tax successfully cools the market, but would generate little or no revenue for the government. That's because Chinese buyers would take their money, and the problem, elsewhere – to Toronto, Victoria, Kelowna or Seattle.

The other possibility is that the tax has virtually no effect, leaving the market as red-hot as ever. Buyers will either see the tax as a reasonable premium to pay for investing in Vancouver real estate, or they'll find clever ways to avoid the levy by using proxy purchasers who are residents of Canada. In this second scenario, the government might well collect some revenue, but the market won't look much different from now.

The government can raise a lot of money or control the market. It can't do both. And if B.C. successfully deflates the housing bubble, it's inevitable that current homeowners will bear some of the pain as home values take a hit.

The tax could also produce a host of unintended and unwanted consequences. Top among them is that Vancouver's problem could simply shift elsewhere as foreign buyers seek to avoid the tax. Cities such as Toronto and Victoria are already bracing for knock-on effects.

Meanwhile, the real estate industry is warning that the retroactive application of the tax could cause cascading problems in the market. That's because the new tax applies to all housing sales registered after Aug. 2, including transactions already in the works but not yet finalized. The worry is that some buyers pull out of these transactions, including condominium presales, because they don't want to pay the tax. That could leave Canadian sellers, who might already have purchased another property, stuck with two homes and two mortgages.

All this is a cautionary tale for other jurisdictions, including Ontario, which might be pondering ways to curb foreign buying and engineer a devaluation of frothy housing markets. Ontario Finance Minister Charles Sousa acknowledged this week that he's looking at B.C.'s new tax "very closely." However, Toronto Mayor John Tory is cool to the idea, suggesting that Torontonians don't want action simply "for show business or political purposes or even for revenue-generating."

A lot depends on how foreign buyers react.

Figures released this week by the B.C. Finance Ministry showed that one in 10 homes bought in Metro Vancouver between June 10 and July 14 went to non-Canadians. That represents nearly a nearly $900-million influx of foreign cash in just five weeks – a period when prices were rising at more than 30 per cent a year in the city. Since 2005, house prices are up nearly 250 per cent.

Governments may be fighting a losing battle. The Vancouver and Toronto real estate markets have become collateral damage in an unprecedented global flight of capital. As much as $1-trillion (U.S.) flowed out of China last year and the trend shows no sign of slowing down this year.

Canada is an attractive destination for that money – a safe haven with a weakened currency and strong property rights. Paying $1-million (Canadian) for a bungalow might seem outrageous to most Canadians, but it could be a bargain to a buyer from Shanghai, even at $1.15-million (the price of the house including the new 15-per-cent land-transfer tax).

Throw in the low-interest rate fuel that continues to drive the market, and it’s a powerful mix.

Even if the tax fails to deliver as promised, it’s a masterful political stroke. And in the end, politics rather than economics may be what this is all about.

British Columbians are understandably angry and frustrated about what is happening in the real estate market. And taxing offshore buyers, who don’t vote, may feel good.

Just don’t expect it to miraculously fix the problem.