NATIONAL BANK OF CANADA FINANCIAL MARKETS

Public Sector Research

Fixed Income Trading Desk Research

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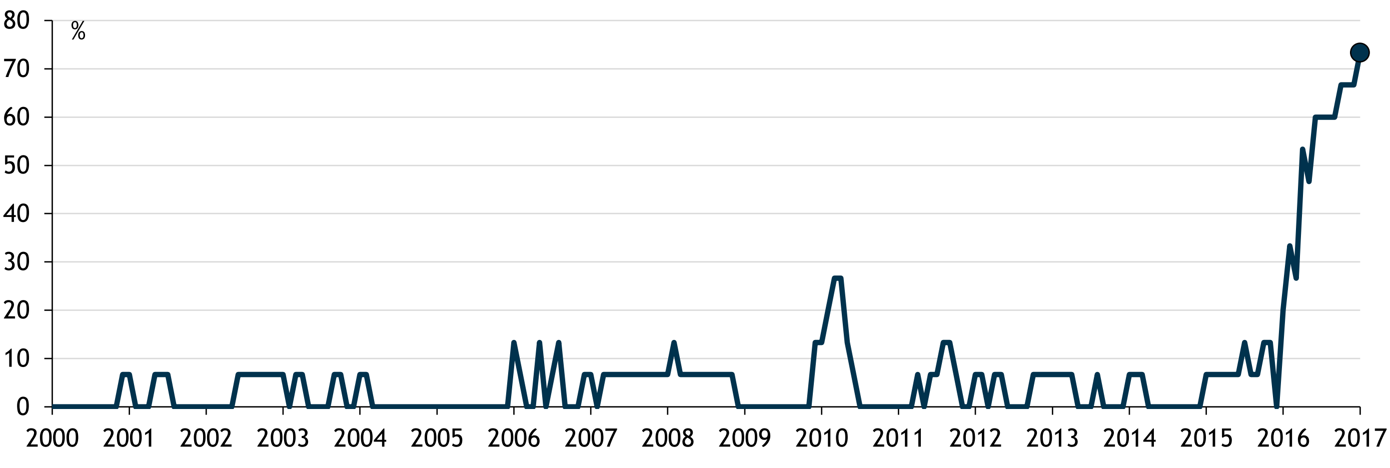
Quick Hit — Ontario moves on housing. Really, it had to be done

Cast yourself, for a moment, as finance chief of a large regional economy where housing prices are skyrocketing, a growing number of local residents are being priced out of the market and associated risks to the stability of your financial system are ratcheting up. Broadly speaking, you have two courses of action. You could do nothing, let a housing bubble inflate away, reap the economic and fiscal gains from a wholly unsustainable pattern of growth while you can, and then pick up the pieces of a broken economy when the bubble inevitably bursts. Alternatively, you could take action in the face of pronounced risks, implementing policies designed to both tame speculation and spur needed development, thereby placing the resulting housing market on a more sustainable footing. Ontario's finance minister has opted for the latter course of action, and it's a decision we applaud. Just what is Ontario doing? The government has today rolled out a series of measures, and at the heart of the strategy is a non-resident housing speculation tax. We had previously endorsed such a policy, seeing it as one-part of broader solution to Ontario's housing "problem". This new 15% tax will be levied on non-resident purchasers and applied not just in the greater Toronto area but across the entire Golden Horseshoe region. In a number of ways, this is similar to the incremental property transfer tax on foreign purchases implemented by the British Columbia government in the greater Vancouver area. Ontario's intent is to curb foreign speculation, not to erect figurative walls standing in the way of those seeking to make the province their home or place of study. Indeed, the government will rebate the tax paid by international students, foreign workers and/or those transitioning to permanent residency once certain conditions are met. This is a reasonable approach, placing the onus on the foreign buyer to demonstrate that their demand for housing is legitimate, rather than a speculative play. Ontario went further, agreeing to the City of Toronto's request to implement a vacant home tax (via an amendment to the *City of Toronto Act*). Other municipalities can seek similar authority to tax vacant property. Moreover, all municipalities will be given the ability to tax vacant land, which could encourage greater development for approved and serviced housing. That's part of the supply-side response to today's unbalanced market. In an effort to further tackle eroding affordability, rent controls will be expanded to *all* rental properties. Currently, only those units built prior to 1991 are subject to rent control. Some had argued against expanded rent control, thinking it might erode the incentive to bring new units onto the market. To spur rental construction, Ontario will rebate a portion of the development charges related to the construction of new rental units. Landlords will maintain the ability to adjust rents to the prevailing market level as tenants move out. Alongside these new measures, Ontario is moving to collect more data on real estate transactions, including citizenship and residency status. This is likewise a welcome decision, enhancing the government's understanding of how much influence foreign buyers are exerting on the market. (Anecdotal evidence suggests non-residents account for ~5% of transactions in the greater Toronto area, but that share was seen as on the rise, in part due to the recent diversion of foreign activity from the Vancouver market.) Let's be clear, standing by while housing prices shot to the moon in more than 70% of its main urban centres (Chart) was no longer a viable option for Ontario—the risks were simply too great. So we support the government's actions. We'll need time to assess the impact of today's announcement, but based on our initial assessment, the overall revenue implications for the province could be relatively modest, as the extra foreign speculation tax revenue could be offset by reduced regular (i.e., existing) land-transfer tax revenue and/or the development charge rebate to spur new rental units. Other provinces will be watching closely to see if Ontario's new regulations drive foreign capital into their residential property markets, with Montréal having already sparked overseas interest.

Warren Lovely & Stéfane Marion

Chart: Ontario home price inflation not confined to the GTA

Share of regional markets in Ontario where price inflation is 10% or more year-over-year*



*Source: Teranet-National Bank | * 15 markets in total*

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