

An Analysis of the Use of Property Tax Policy to Influence Housing Markets

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EXECUTIVE SUMMARY

Rapidly increasing housing prices in Vancouver, perceived to be caused by speculators, have raised concerns about housing affordability for British Columbians and the possible existence of a housing bubble, creating the danger of a market crash. There have been calls for implementation of some form of taxation to raise transaction costs in order to discourage speculation. Such a tax is known as a “Tobin tax” because it was first suggested (though not for housing markets) by Nobel-prize winning American economist James Tobin. The Property Taxation Branch and the Tax Policy Branch are interested in collecting information to determine whether a property tax policy may be an effective tool to influence housing prices in key markets, and this report has been produced to provide information to the Ministry of Finance.

Two questions are explored:

- Could British Columbia use property tax policy to influence the province’s hottest housing markets, primarily Metro Vancouver – i.e., implement a form of property tax to reduce the upward trend in housing prices?
- Could the adoption of provincial policies have unintended negative consequences – e.g., what could happen in areas of British Columbia not experiencing rapid increases in real estate prices?

Within the context of municipal property taxes in British Columbia, and the Property Transfer Tax, a literature review and scan of jurisdictions examine four property tax measures that are identified as having been used in attempts to have an effect on prices:

1. **Site value** or land value taxes, based on the assessed value of land (including or excluding improvements, depending on implementation);

2. **Vacant land** taxes (often as a penalty for not having improvements on land);
3. **Incremental value** or capital gains taxes, based on the increase in value of a property between two property transfers; and
4. **Transfer taxes**, based on the sale price of property.

The overarching findings are either inconclusive or conclude that the measures should not be used to influence housing prices. The consequences of implementing property tax policy have not been fully explored in the literature, leaving a significant gap in knowledge as to the implications of applying any of these measures. Intending to influence only the hottest housing markets in British Columbia by applying a property tax policy provincially would be challenging.

In summary of the analysis, Figure 1 and 2 indicate the desirableness of each tax measure with yellow indicating caution, red indicating undesirable and green – which is not shown – would indicate desirable. As shown in Figure 1, in reference to the ability to reduce an upward trend in housing prices each tax measure is determined to be either cautionary or undesirable, and Figure 2 shows that the risk of unintended implications was determined to also be either cautionary or undesirable for each tax.

FIGURE 1 ABILITY TO REDUCE THE UPWARD TREND IN HOUSING PRICES

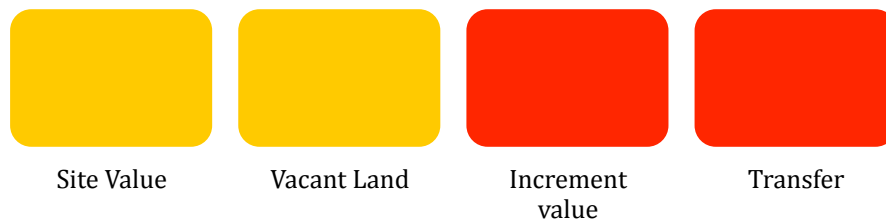
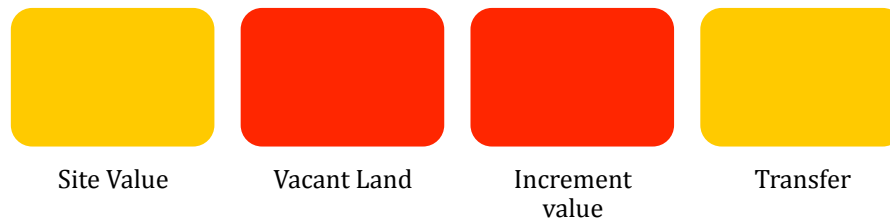


FIGURE 2 RISK OF UNDESIRABLE UNINTENDED IMPLICATIONS



From this analysis, two options are presented to the Property Taxation Branch:

- Option 1: Option 1: Status Quo – No Action
- Option 2: Develop a Two-Rate Site Value Tax

As the implications of putting in place any of these policies are not well understood, and none of the measures appears to be low in risk or high in ability to influence prices, the report therefore recommends the status quo, i.e. to not implement a property tax policy with the intent to reduce the upward trend of housing prices in the hottest markets. Should a property tax be the government's desired action, despite the conclusions of this research, further steps towards implementation of the property tax option are included in an appendix to the report.

TABLE OF CONTENTS

- Acknowledgements..... i
- Executive Summary ii
- Table of Contents..... v
- List of Tables vii
- List of Figures..... vii
- 1.0 Introduction..... 1
- 1.1 Defining the Problem..... 1
- 1.2 Project Scope 4
- 1.3 Project Client 5
- 1.4 Project Objectives and Research Questions..... 6
- 1.5 Organization of Report 6
- 2.0 Policy and Analytic Context..... 7
- 2.1 Drivers of Housing Prices..... 7
- 2.2 Affordability and Policy Response..... 9
- 2.3 Property Taxation in British Columbia..... 10
- 2.4 Use of Property Tax to Influence Housing Prices 11
- 3.0 Methods..... 14
- 4.0 Literature Review and Jurisdictional Scan 15
- 4.1 Introduction..... 15
- 4.2 Site Value..... 17
- 4.2.1 Literature Review..... 18
- 4.2.2 Jurisdictional Scan 20
- 4.3 Vacant Land..... 22
- 4.3.1 Literature Review..... 22
- 4.3.2 Jurisdictional Scan 24
- 4.4 Incremental Value..... 25
- 4.4.1 Literature Review..... 25
- 4.4.2 Jurisdictional Scan 29

4.5 Transfer	32
4.5.1 Literature Review.....	32
4.5.2 Jurisdictional Scan	34
4.6 Summary	36
5.0 Findings and Analysis.....	37
5.1 Introduction.....	37
5.2 Site Value.....	37
5.3 Vacant Land	38
5.4 Incremental Value.....	39
5.5 Transfer	40
5.6 Summary.....	42
6.0 Options, Recommendation, and Conclusion.....	47
6.1 Introduction.....	47
6.2 Options	47
6.3 Recommendation	47
6.4 Rationale	47
6.5 Conclusion	48
Appendix A Housing Prices.....	49
Appendix B Housing Speculation.....	52
Appendix C Option 2 Rationale.....	56
Appendix D Defining Vacancy.....	60
Appendix E Two options for an Incremental Value Tax.....	62
References.....	63

LIST OF TABLES

Table 1 Characteristics of Site Value, Vacant Land, IncrementAL Value, and Transfer Taxes ..	16
Table 2 Analysis of the Form of Tax Measures' Ability to Influence Housing Prices and the Risk of Unintended Consequences.....	43

LIST OF FIGURES

Figure 1 Ability to reduce the upward trend in housing prices.....	iv
Figure 2 Risk of undesirable unintended implications	iv
Figure 3 Ability to reduce the upward trend in housing prices.....	46
Figure 4 Risk of undesirable unintended implications	46

1.0 INTRODUCTION

1.1 DEFINING THE PROBLEM

Last year, in response to rising housing prices, the Mayor of Vancouver called on the province of British Columbia to implement a ‘speculation’ tax (Robertson, 2015). The mayor’s letter noted the affordability crisis in Vancouver, a trend that is quantified through economic reports, such as RBC Economics Research’s Canadian Housing Trends & Affordability Report, which regularly identifies Vancouver’s real estate market as adding, by far, the most pressure on housing prices (RBC Economics (RBC), 2015; RBC, 2015a; RBC 2016; RBC, 2016a). In response to the mayor, British Columbia’s Premier denied the need for such a measure, and indicated an awareness of the challenge of purchasing property in Vancouver (Clark, 2015).

This interaction provided the backdrop for further debate in the media during the winter of 2015/2016. With national media coverage and continuing analysis by experts across sectors this issue remains current into the summer of 2016. In January, professors from the University of British Columbia and Simon Fraser University issued a statement calling for the implementation of a surtax to be paid by property owners whose property is vacant and who have little to no earnings in Canada (Bula, 2016). There also continues to be public outcry at the level of foreign investment in the Vancouver housing market, and the Canadian Mortgage and Housing Corporation will be looking into the matter (Dmitrieva, 2016). The Mayor of Vancouver has recently re-iterated his initial call for a speculation tax (Robertson, 2016), in addition to asking the provincial and federal governments for support in connecting underdeveloped land to the housing market (Curry & Bula, 2016). A scandal in the real estate profession, regarding a practice known as shadow-flipping, had the Real Estate Association of British Columbia

conducting a review of practices (Bell, 2016). The Government of British Columbia released their most recent budget and directly addressed housing affordability by implementing new measures under the property transfer tax, primarily exempting buyers of newly built homes valued under \$750,000, and outlining a plan to collect data on foreign investors in the real estate market (Government of British Columbia, 2016). In June the Mayor of Vancouver was in the news again, describing the intent of the city to find a method of implementing a tax on vacant property in order to force any unoccupied housing to be rented. Details of the plan are still under consideration by the City of Vancouver (Bailey, 2016). Yet, housing prices continue to rise across the province, continuing most dramatically in Vancouver; however, other British Columbia housing markets, primarily Victoria, are also experiencing dramatic increases in prices (RBC, 2016a, p.1). For this reason, the Ministry of Finance's Property Taxation Branch is interested in exploring the availability and effectiveness of property tax policies to influence housing markets. Events are unfolding rapidly in British Columbia, but this report does not include consideration of events taking place after the first draft was prepared in March 2016.

Rapidly rising housing prices, such as seen in Vancouver, are a signal to many economists of a housing bubble. In the late 1970s housing markets in British Columbia experienced a drastic rise in prices, which influenced the affordability of housing and, when the market proved cyclical and dropped, had severe economic impacts for British Columbians (Skaburskis, 1988, p. 558). Further analysis of the macroeconomic conditions that existed at the time of past dramatic rises in housing prices, particularly in analyzing any policy measures that were undertaken to address the shifts in housing markets in British Columbia, may be of historical relevance in the consideration of the effectiveness of government responses to perceived problems in the housing market.

Although this a high-level policy consideration, what is important to consider is that nearly three and a half decades later the perception of a housing bubble continues to raise concerns.

To respond to both the concern of market crashes, as well as the inability of British Columbians to be able to afford to purchase houses in the hottest provincial markets, local, provincial and/or federal governments would need to properly identify the source of the increase in real estate prices and apply a measure to counter-influence the behaviour(s) leading to the increase in prices. A popular view is that certain actors may be purposely gaming the housing market to make themselves richer and, in doing so, causing prices to increase. This has led government leadership, such as Vancouver's mayor, to call for a tax on this activity (Penner, 2015), which is known as speculation. Yet, economic theory sees this same activity as the ultimate market stabilizer; these actors – i.e., the speculators – are absorbing risk and “bringing better information to the market” (Skaburskis, 1988, p. 558). Should speculation currently exist to a significant degree in Metro Vancouver, which is unknown, this dichotomy of views illustrates a challenge for governments. Further popular perception is that non-citizens are purchasing property for speculative purposes or are leaving their Canadian residences vacant, thereby disconnecting housing from the market.

Based on past use in other jurisdictions, a ‘speculation’ tax could take several forms, including a capital gains tax on property, a flat amount, or a percentage of the sale price (Bowden, 1975; Hagman & Mischynski, 1975; Malprezzi & Wachter, 2005; Marcuse, 1984). The concept of a ‘speculation’ tax is known in economics as a “Tobin tax” because it was first proposed (though not for housing markets) by Nobel-prize winning American economist James Tobin. Tobin taxes are designed to raise the cost of transactions, and thereby discourage short-term and speculative purchases.

To facilitate making an informed decision, this research is based on both a theoretical background and empirical results. There are numerous examples including a prominent case of speculation tax in Ontario, that provide an important basis for analysis in advance of the Ministry of Finance considering legislating a property tax measure to reduce the upward trend of housing prices in Metro Vancouver¹. This project is designed to inform the policy debate around the use of property taxes as a provincial remedy to influence local housing markets.

1.2 PROJECT SCOPE

The current provincial economic outlook, stemming from Budget 2016, predicts that housing prices will begin to slow in the near-term, in response to a potential rise in national interest rates (British Columbia, 2016, p. 87). Changes in interest rates are indicative of larger economic shifts and are decisions taken at the national level. As such, they would not have differential effects in British Columbia or in Metro Vancouver (i.e., be isolated to either jurisdiction), and are therefore not directly relevant to this project. Interest rate changes and measures that are beyond provincial authority were out of scope for this research.

However, the Bank of Canada recently announced that overnight interest rates would remain unchanged at 0.5%, noting its expectations for 2% inflation in 2017, and identifying Vancouver as a vulnerability for inflation (Bank of Canada, 2016). The adjoining Monetary Policy Report profiles five separate risks. The nature of the vulnerability that leads to identifying Vancouver (as well as Toronto) in the second risk category pertains to consumer spending. The Bank of

¹ In this paper, Metro Vancouver, which was formerly known as the Greater Vancouver Regional District, is considered to include 21 municipalities: Anmore, Belcarra, Bowen Island Municipality, City of Burnaby, City of Coquitlam, Corporation of Delta, Electoral Area A, City of Langley, Township of Langley, Village of Lions Bay, City of Maple Ridge, City of New Westminster, City of North Vancouver, District of North Vancouver, City of Pitt Meadows, City of Port Coquitlam, City of Port Moody, City of Richmond, City of Surrey, Tsawwassen First Nation, City of Vancouver, District of West Vancouver, City of White Rock, and City of Abbotsford.

Canada considers that if changes in prices, or an adverse shock to the housing market, takes place in either jurisdiction, there would be a corresponding effect on the consumer spending ability of households, an underlying risk to core inflation (Governing Council of the Bank of Canada, 2016).

Although this research was undertaken with the express consideration that national interest rates could not be influenced by the Province on the grounds of the rise in housing prices, it now appears that the situation in Vancouver has become an important consideration for the Bank of Canada. Within this developing context it may be appropriate for further research to be undertaken to consider the ability of the Ministry of Finance to work with the Bank of Canada to further understand the risks associated with the rising prices.

Rural property taxation in BC (outside of municipalities) is also out of scope for this project.

1.3 PROJECT CLIENT

The client is the Executive Director of the Property Taxation Branch (PTB), Revenue Division, Ministry of Finance, British Columbia. This project is also of interest to the Tax Policy Branch (TPB), Policy and Legislation Division, Ministry of Finance. Both of these branches have frequent contact with the Minister of Finance, but they perform separate functions. The PTB is mainly focused on operations and administration of legislation, such as the Property Transfer Tax Act or the Home Owner Grant; whereas, the TPB takes direction directly from the Premier and considers high level tax policy for the province.

1.4 PROJECT OBJECTIVES AND RESEARCH QUESTIONS

To complete the requirements of the University of Victoria's Master of Public Administration and provide analysis to the PTB, this research will explore two questions:

- Could British Columbia use property tax policy to influence the province's hottest housing markets, primarily Metro Vancouver – i.e., implement a form of property tax to reduce the upward trend in housing prices?
- Could the adoption of provincial policies have unintended negative consequences – e.g., what could happen in areas of British Columbia not experiencing rapid increases in real estate prices?

1.5 ORGANIZATION OF REPORT

Following the introduction, this report will outline the policy and analytical context of the issue, and describe the methods used to collect information. A significant portion of the report is dedicated to developing a detailed description of the theory, empirical studies, and practical examples of four categories of property tax policy. This exploratory research leads to findings and analysis before further discussing how the results apply to the research questions. A final chapter outlines two options for the PTB and recommends a path forward for the near term.

2.0 POLICY AND ANALYTIC CONTEXT

This chapter explains the context of the analysis for the PTB.

2.1 DRIVERS OF HOUSING PRICES

Building on media coverage of housing prices and anecdotal information outlined in the introduction, the Government of British Columbia – in its Budget 2016 – identified four factors that it considers to drive housing prices (British Columbia, 2016, p. 62):

- low interest rates;
- economic activity;
- in-migration; and
- constrained geography.

Economists, such as Berry and Dalton (2004), consider a longer list of near-term and long-term influences on housing prices:

- investment demand;
- economic climate and growth;
- innovation;
- financial deregulation;
- land-use regulation;
- demographics; and
- wealth levels and distribution.

As may be expected with such a varied list of influences, there is acknowledgment that the impacts, relationships and/or interactions between the drivers are complex and not completely

understood. This makes policy development and implementation challenging. As Berry and Dalton (2004) conclude in their analysis of price influences in the Australian Housing Market:

“Given that housing prices are over-determined by the complex interaction of short-term, institutional and long-term forces, in a situation characterized by second- and higher-order effects, speculative feedback loops and spatial sub-market segmentation, simple single-dimensional policy interventions are unlikely to succeed in improving affordability outcomes for most of those households in need (p. 89).”

Complex, looping and multi-dimensional are all adjectives that could also describe housing markets in British Columbia. Housing prices in British Columbia are driven by key markets (primarily Metro Vancouver) and, as the most recent provincial budget explores, housing price increases are resulting in a decrease of local housing affordability. The Government of British Columbia (2016) notes that multiple factors, e.g. increasing population and relatively stagnant development of single family dwellings, are leading to an affordability crisis. The province uses these factors, as well as others such as geographical location, to describe the particular challenges in the Metro Vancouver housing market (p. 62). Economists typically use ratios, such as whether the price:rental value or prices:income levels, to determine whether housing prices are overvalued, typically calculated over a 25 or 30 year average (Berry & Dalton, 2004, p. 84). However, some researchers caution that these metrics may not be sensitive to all the circumstances affecting housing prices. Himmelberg, Mayer and Sinai (2005) propose an alternate analysis of “the imputed annual rental cost of owning a home” (p. 2) to determine if prices are overvalued. Their research attempts to correct issues with other more conventional ratios, but they acknowledge that their model does not allow the determination of whether the current market has reached an unsustainable price, as it is only applied to past trends (p. 2).

2.2 AFFORDABILITY AND POLICY RESPONSE

In British Columbia's context, as Budget 2016 explored, the price of housing is inherently tied to the issue of housing affordability. Periodically RBC Economics Research produces a Canadian Housing Trends & Affordability Report with specific analysis for each province. The most recent publication of this report, in June 2016, points to housing prices in Vancouver as the primary driver of province-wide housing affordability indicators, although Victoria's affordability is also dropping considerably (RBC, 2016a, pp. 1-2).

In Budget 2016, the Province of British Columbia announced a suite of policy measures intended to address housing affordability, yet none of these measures were enacted with the explicit intent of reducing the upward trend in Metro Vancouver housing prices. One of the changes was targeted at an existing form of property tax, the property transfer tax, legislated under the Property Transfer Tax Act. This tax is levied at the time of transfer on buyers as a percentage of the sale price of property and the revenue is collected by the provincial government. The primary legislative change is the creation of a New Housing Exemption. This measure exempts buyers from paying property transfer tax on houses that are newly built with a value less than \$750,000. A secondary change is the creation of a higher tax rate on properties valued above \$2 million. These changes received Royal Assent through the Budget Measures Implementation Act on March 10, 2016, although the Property Transfer Tax provisions were backdated to be in effect starting when the Budget was announced in February (Bill 10: Budget Measures Implementation Act, 2016, s.45-62). Other measures announced in Budget 2016 include:

- new support of affordable housing;

- continued support of rental-stock housing, first time home buyers, and other low-income grants and supplements; and
- improving data collection on real estate trends, in particular collecting new data on the citizenship of buyers in the real estate market (pp. 62-65).

2.3 PROPERTY TAXATION IN BRITISH COLUMBIA

British Columbia has two streams of property tax legislation. In addition to the Property Transfer Tax Act, British Columbians are subject to an annual local property tax². Historically, property taxes have taken different forms in British Columbia. Of historical interest to this project is a legislative change to the municipal property tax from 1989 to 1993. In 1989, municipalities were given the option to levy two further forms of tax; one was a flat rate on all property (land and improvements) and the other was a split rate. As Berniaz (2009) explains, the flat rate tax was a levy where the same flat dollar amount would be charged on all property, regardless of assessed value, within the entire municipality; under the legislation, the flat rate tax could only be adopted if it replaced the traditional property tax. The split rate allowed for changes to the traditional property tax to allow for different tax rates to be applied to land and improvements. Neither new tax was widely implemented and, as a result, the change was rescinded in 1993 (pp.8-16).

Municipal property taxes are levied by municipalities, supported by Provincial legislation, under either the Vancouver Charter Act (applicable only in the City of Vancouver) or the Community Charter Act (applicable everywhere else in British Columbia, including the other 20 Metro Vancouver municipalities outside the City of Vancouver). The charters allow municipalities to levy tax on the market value of land and improvements. The market value is independently

² Local taxes can be municipal or rural, depending on whether the property is in a municipal area; rural taxes are out of scope for this project.

assigned by a crown corporation, the B.C. Assessment Authority. The primary difference in the charters pertains to the ability for the City of Vancouver to raise funds more autonomously than other municipalities, e.g. the city is able to more easily borrow money from traditional lending institutions whereas other municipalities do not have the same flexibility; in essence, the basic property taxation powers are the same in the two charters. The municipalities and the province, represented by the Ministry of Community, Sport and Cultural Development have a working relationship to oversee the implementation of both charters. The PTB also has an inter-ministerial working relationship with the Ministry of Community, Sport and Cultural Development as it relates to the property tax sections of the charters.

2.4 USE OF PROPERTY TAX TO INFLUENCE HOUSING PRICES

The Bank of Canada's most recent Monetary Policy Report surmises that housing prices may be affected by the way that expectations are being formed in the housing market in Vancouver (Governing Council of the Bank of Canada, 2016). Further analysis of housing prices, how they are formed and policy interventions to address rising prices can be found in Appendix A. As the source of the rising prices is not expressly known or understood this research sets forth possible interventions that could be influenced by the PTB, noting that without full knowledge of the source of dramatic rise in prices choosing an appropriate intervention, and applying it, would be challenging. If prices are being formed based on non-fundamental expectations, as is the case in a market where speculators are active, as explored in Appendix B, the market may not be able to correct or regulate itself without intervention. By exploring possible interventions, the research aims to isolate, regardless of the jurisdiction's reasons for implementation, the effect on prices and any further impacts. Although the report attempts to isolate the analysis to the effect on prices and unintended consequences, putting in place a form of tax policy to affect prices would,

in theory, generate revenue. Generated revenue could be recycled in numerous ways and could possibly be targeted towards other forms of policies and measures to address challenges in the province's 'hot' housing markets.

In addition to listing further forms of policy measures that may affect prices, Appendix A reviews the theory of housing prices and considers problems that may arise in housing markets if prices appear to be too high. Further to this supplementary information, land or property tax policies are often perceived as one of the more effective tools to address increasing housing prices. Although the purpose of property taxation is most often revenue generation, to finance the operations of municipalities and other local or regional services (Slack, 2006, p. 213), as Smith (1997) observes, property tax measures have also been used with a secondary intent, in an attempt to correct perceived problems that pertain to rising prices in real estate markets (p. 338). It is this effect for which the political leaders and others in British Columbia have been calling on the provincial government to implement a property tax measure

In two papers Smith (1977;1978) describes the historical use of property tax measures to influence prices, and further examines four predominant forms of property taxes that have been used to achieve price changes. Smith pulls upon older literature and historic examples in describing trends in markets, the following quote outlines the relevance of analyzing past experiences and research in this field. As Smith (1977) describes:

“These problems are not new. Nor is the implementation of tax policy in an attempt to deal with the situation produced by large increases in land prices new. What is new is the recognition that tax measures have various impacts on aspects of the national economy

which must be taken into account in designing measures for collecting government revenues and for bringing economic developments under rational control.” (p. 337)

It is within this context of continually rising housing prices, that this research into both the ability to influence prices and impacts or implications is important. Because of the relatively unchanging policy toolkit over the past century, older research contains valuable lessons and considerations.

3.0 METHODS

This research is primarily exploratory and analyzes property tax policies to develop recommendations pertaining to their use in reducing the upward trend of prices in the hottest housing markets in British Columbia. The research does not aim to test any preconceived notions of the applicability of property tax measures in influencing British Columbia's housing markets; rather, it collects secondary data and reviews from other jurisdictions, and analyzes any patterns that may emerge. Using this approach, the emphasis is on discovering any relevant information on the ability of various tax measures to influence the housing market. Potential property tax policies that could influence housing markets are identified through a literature review and a jurisdictional scan.

The analysis draws on information obtained in both the jurisdictional scan and the literature review to explain how property tax policies have been used to influence prices in housing markets. Based on this explanation, and the characteristics of British Columbia's housing market, the analysis assesses the likelihood that the property tax policy measures investigated in the literature review are relevant to the current situation in British Columbia, i.e. whether they would or would not likely be effective in reducing the upward trend in prices in Metro Vancouver. In order to answer both research questions, the analysis also assesses – to the extent possible – other possible effects (including unintended consequences) of the various property tax policy measures in order to develop options and a recommendation for the PTB.

4.0 LITERATURE REVIEW AND JURISDICTIONAL SCAN

4.1 INTRODUCTION

The literature on influencing real estate prices through tax policy names dozens of different property tax policy measures that have been implemented or considered by different jurisdictions. This chapter provides a literature review and a discussion of empirical results from secondary data sources, primarily economic research. To supplement the discussion a jurisdictional scan follows the literature review and case studies are outlined, where applicable, to exemplify the use of property tax policy in attempting to reduce upward trending prices in housing markets. To effectively cover the scope of measures – as well as ease comprehension – the following review and scan will group the tax measures into four categories, based on those used by Roger S. Smith in his 1977 research on land policy and housing prices. Smith’s four categories are not an exhaustive list of property tax policies; however, they provide guidance in the exploration of the forms of property tax policy that are commonly used in attempts to reduce upward trends in housing prices. With this in mind, the four main types of property tax policy that could be used to influence housing prices are:

1. **Site value** or land value taxes, based on the assessed value of land (including or excluding improvements, depending on implementation);
2. **Vacant land** taxes (often as a penalty for not having improvements on land);
3. **Incremental value** or capital gains taxes, based on the increase in value of a property between two property transfers; and
4. **Transfer taxes**, based on the sale price of property.

Table 1 summarizes the characteristics of the four types of property taxation. This table describes the most traditional and pure form of each tax, although in application there are often numerous ways to implement each of these taxes. For example, a site value tax – although most pure in its application as a percentage of assessed value on land only – is most often applied within a tax system which levies tax on both land and improvements. This chapter will explore similar complexities regarding each of the property tax measures that are considered to play a potential role in influencing upward trends in housing prices.

TABLE 1 CHARACTERISTICS OF SITE VALUE, VACANT LAND, INCREMENTAL VALUE, AND TRANSFER TAXES

Category	Base	Method	Typical Frequency
Site value	Land	% of assessed value	Annually
Vacant land	Difference between current assessed value and ideal assessed value (with optimal improvements)	% of the difference in value	Annually
Incremental value	Land and improvements (property)	% of increase in value between two transfers	Time of transfer
Transfer	Land and improvements (property)	% of sale price	Time of transfer

The usual form of property tax in the Canadian system, that which is levied at a single rate on the combined assessed value of both land and improvements by municipalities, is not explicitly examined in this research, as the primary purpose of such taxes is revenue generation and they are not considered to be likely to moderate rising prices.

For each of the four tax measures above, the following sections will review the literature, summarize the results of the jurisdiction scan, and describe any significant cases found.

4.2 SITE VALUE

Typically levied annually on the assessed value of a site (land only), the literature on site value taxation is a spin-off of the literature on taxes that are levied based on assessed value of both land and improvements. A traditional or pure site value tax sees a levy applied uniquely to land and not to any improvements on land. The proponents of site value taxation have had significant presence in the literature since Henry George introduced the idea of taxing land more heavily than improvements in the late 19th Century (Anderson, 2005, p. 416). However, researchers – such as Brueckner (1986) – have noted a lack of empirical analysis (p. 49).

Levying land more heavily than improvements – a differential or two-rate property tax – differs from a pure site value tax, as it taxes both components of property, but at different levels. With recent contributions from Brueckner and others, such as Anderson and Skaburskis, the literature has begun to reflect some empirical results; yet, it remains heavily influenced by theory. Among relatively inconclusive empirical results, the effect of site value taxation in Pittsburgh, Pennsylvania is often cited throughout the research, and this case will be described below. In this section the policy change implicitly being considered is shift from equal taxation of land and improvements to lower tax rates for improvements and higher tax rates for land.

4.2.1 LITERATURE REVIEW

As previously described, site value taxation literature defines the most pure form of the site value tax as a single tax applied to land value only, with no taxation of improvements and no other taxes applied to land (Anderson, 2005, p. 416; Skaburskis, 1995, p. 5). Smith (1978) explains that the intended form of implementation of such a land value tax is as a percentage of the current value of the land (p. 56). Although a single value tax is theoretically possible, the practical form of a site value tax is typically what is known as a two-rate property tax regime, where both land and improvements are taxed, but with a higher tax rate on the assessed value of land.

The literature on site value taxation emphasizes that its implementation is intended to have a positive effect on development. A site value tax measure is intended to improve efficiency in the market by improving the use of land, increasing density and intensity, and reducing waste (Skaburskis, 1995, p. 5). Despite having existed for close to a century, this effect on development was still a controversial question among researchers in the 1970s (Smith, 1978, p. 52), yet has been empirically proven under certain circumstances in subsequent research (Brueckner, 1986). The intended effect of an increase in development would be a corresponding increase in housing quantity, thereby affecting housing prices. An increase in quantity would, in theory, result in lower prices or a reduction in price increases. Most of the literature focuses on the developmental effect of this tax; however, some of the researchers develop findings on other factors that would impact its effectiveness to influence prices.

Empirical results into the effectiveness of taxing land at a higher rate than improvements, therefore spurring development, were still practically non-existent in the 1980s. Slightly before the end of the previous decade, Smith (1978) used a simple model to determine whether

development timing is affected by a site value tax. Smith's model determines that if the tax is implemented as planned – i.e., as a percentage levy on land – then it does have a positive effect on real estate development. As this tax removes penalty from developing further improvements on land, it could thereby be expected to reduce housing price increases. Yet, Smith indicates that in the long-run there could be little effect (pp. 54-56). These findings are further empirically examined in the following decades.

Often cited, Brueckner's (1986) research shows that implementing a two-rate or single-rate site value tax would see development increasing in the long term, and he also goes on to show only a slight effect on price. Brueckner observes that in the long-run, these results are highly dependent on the characteristics of the housing market it is applied to. He concludes that if a form of site value taxation is introduced in only a portion of a larger market then it is likely to have negligible effect on prices, simply spurring further investment in improvements. However, if the whole housing market is affected by the property tax, it is more likely that housing prices will drop. He attributes the drop in prices to the fact that landowners would experience capital loss due to the increased tax, which he considers would ultimately benefitting consumers by the reduced price of housing (p. 56).

Although theoretically a price reduction does not logically flow from sellers paying the tax, Anderson (1999) runs a model to test Brueckner's main results and find they would still be valid and he also finds that there are other considerations that factor into housing supply and any effect that the quantity of housing on the market may have on prices (p.189). Results from Anderson (1999) show the distinction between the urban circumstances and the effect of the a two-rate property tax. What he finds is that in decentralizing or declining urban markets a two-rate tax can

have the desired effect of spurring development. Yet, “in a growing urban area... the effect of a movement to a two-rate property tax regime is theoretically ambiguous” (p. 187).

Skaburskis (1995) also observes that the net effect of a site value tax on housing prices is ambiguous. He agrees that “the policy can increase land values when it is applied to a small portion of a housing market and can reduce land values when applied across the entire housing market” (p. 17). He also finds, upon reviewing the literature of other economists, that the same ambiguity of effect is pervasive. He references the work of Grosskopf, to say that changing from a traditional property tax system to one that levies land more heavily does usually appear to cause a reduction in prices, yet Grosskopf dampens his own conclusion by stating that it is not necessarily an effect of the two-rate tax (p. 8). Skaburskis goes as far as suggesting that other measures, such as zoning regulations, may be more appropriate if the jurisdiction is looking to make the market less restricted (p. 13).

4.2.2 JURISDICTIONAL SCAN

There are numerous cities, subnational governments and even nations that have taxed land at a higher rate than improvements. Some of the more commonly-cited examples include cities across New Zealand, Australia, Canada, Jamaica and the United States, (Anderson, 2005 p. 417). Others include Trinidad and Tobago, Barbados, Kenya, Tanzania, Greece, Iraq, Denmark, South Africa, Malawi, Rhodesia, and Zambia (Smith, 1977, p. 342). However, the most frequently analyzed case is that of Pittsburgh, Pennsylvania.

As Smith (1977) notes, the use of forms of land policy to influence housing markets is not new. This is further emphasized by the case of the State of Pennsylvania, that has had legislation in place for almost a century that allows cities to tax land and the improvements on land at different

values. The case is an interesting example of a subnational government that enacted legislation allowing different cities to determine on a case-by-case basis whether they implemented a two-rate property tax. Mathis and Zech analyzed the four cities that had (in 1982) chosen to implement the tax: Pittsburgh, Scranton, Harrisburg and McKeesport. In Pittsburgh, the second largest city in Pennsylvania, the two-rate tax system was set at a ratio of 2:1 land to improvements. In 1979 the city increased the tax, further shifting the tax burden onto the assessed value of land. The new ratio of land to improvement taxes then became 5:1.

The subsequent change in development is what has interested researchers. Mathis and Zech (1982) concluded, using a multiple regression analysis, that a two-rate tax scheme did not affect development in any of the Pennsylvania cities that had implemented a two-rate tax. They recommended that other cities in Pennsylvania should not use the tax (pp. 4-5). Oates and Schwab (1992), the researchers who conducted the most frequently cited research on land value taxes in Pennsylvania, specifically looked at the case of Pittsburgh. They analyzed local economic data in comparison to the history of tax reform within the state and city. What they concluded was that it would be incorrect to completely discount the use of site value taxation in spurring development. They did observe increased development following the tax policy change in 1979; however, they also noted that it would be unrealistic to attribute increased rates of development only to an increase in this tax. The implementation of this tax in Pittsburgh was seen to, at the very least, be useful as a revenue collection device that has minimal side effects and seemingly none of which are negative (pp. 17-19). Anderson (2005) notes that by the mid-2000s 17 municipalities in Pennsylvania had implemented a two-rate property tax and his conclusions reinforced that any observed changes are likely not significantly attributable to the tax (p. 417).

4.3 VACANT LAND

4.3.1 LITERATURE REVIEW

Typically levied annually, or on a regular basis, a vacant land tax is levied on the value of the difference between the current value of the improvements on the property and the ideal value of improvements. The literature often describes a vacant land tax as a tax on the lack of improvements (Grimes, 1975, p. 18).

In many cases a contributing factor to the problem observed in jurisdictions that choose to implement this type of tax is that housing is vacant or underutilized. To address this problem, the jurisdiction must define the adequate level of housing (improvements) for each property, collect data that assesses the current level of improvements, calculate both in monetary terms and tax the differential if the property is found to have insufficient levels of housing – i.e., ‘vacant’.

Improving land found to be ‘vacant’ is almost synonymous with development. Under this form of property tax, applied to un- or underdeveloped property, a goal is often to bring more housing onto the market. Smith (1978) describes a vacant land tax’s intent as a spur on the development of land (p. 57).

The literature on this form of taxation is quite scarce, especially any discussion of its direct effect on housing prices. The historical use of a vacant land tax has most often been to develop the periphery of a housing market; however, a modern use of this tax is described by Kelly, Jr. (2013) as the use of a tax to force foreclosure of properties that were deemed to be vacant and “reconnect... vacant houses to the market” (p. 109). Applying a tax so high that the property owners are no longer able to hold the property vacant and must re-sell or find tenants is often part of the motivation behind this tax. Although Kelly Jr.’s (2013) research is primarily focused

on housing markets in American cities and the challenge of dealing with derelict, abandoned property, it is a recent contribution to the literature on this form of tax. The source of vacancy in his research is, admittedly, of a different origin than that of the perceived high rates of vacancy in Vancouver; yet, the overarching theory is that forced development through the taxation of vacant land is a possible remedy. In his words, what the jurisdiction is trying to achieve with this tax is:

“Us[ing] an owner’s failure to meet basic public obligations as a basis for liquidating all the title interests in the derelict property should the stakeholders not step forward and bring the property into compliance” (Kelly, Jr., 2013, p. 139).

In addition to this research into determining the type of recourse that a jurisdiction may choose to take to ensure property development or reconnection of vacant properties to the housing market, further literature outlines the data collection and analysis required to determine what properties are considered vacant and, once identified, what type of vacancy the property is experiencing. Adams et al. (2002) determined that different forms of ownership model, e.g. the land rights are divided or the land is held in a trust, often determine the behaviour of the owner(s), e.g. willing or unwilling to sell. In turn, these would affect development rates. They find that anecdotal evidence of the behaviour of vacant landowners is not accurate and should be empirically corroborated before making any explicit policy decisions (pp. 412-413).

Smith (1978) concludes that since such a tax would not make it worthwhile to continue holding vacant land, forcing either development of land with no improvements or reconnecting housing to the market, quantity or supply may be effected and land prices could be lower than they may have been without the tax. However, in essence, the effect of taxing vacant land is unknown (p.

59). Kelly Jr.'s (2013) examination of the redevelopment of vacant land through tax policy is also inconclusive (p. 139).

Others, such as Grimes (1975), have found that the implementation of any vacant land tax has been ineffective because the tax rate was set too low to change property owners' behaviour.

What he notes is that many countries turn to other forms of subsidies or taxes that encourage improvements (p. 18), rather than a vacant land tax in attempts to influence housing prices.

4.3.2 JURISDICTIONAL SCAN

Several examples of the implementation of forms of vacant land taxes can be used to consider their use – or attempted use – in several jurisdictions:

- France attempted to implement a vacant land tax known as 'taxe d'urbanisation' in the late-1960s, but ran into a roadblock because the government could not find an appropriate way to measure market values of the improvements (Grimes, 1975, p. 18);
- England had a proposal for what was known as the Land Hoarding Charge in a government issued white paper in the late-1960s, only to have it effectively disappear off the agenda with a change of government (Hagman & Misczynski, 1975, p. 440). Grimes (1975) described this proposed tax as one that would have seen the application of a 30 percent annual tax on assessed land value for land remaining undeveloped three years after receiving planning permission for development (p. 18).
- Korea applied the Abnormal Capital Gains Tax Act to vacant land to address rising prices by forcing property back onto the market, but only within markets where the price of vacant property was increasing more quickly than national average price increases. Lee (1990) observed that the implementation of this measure was too specific, which narrowed the tax

base and likely lessened the effectiveness of curbing price rises due to what was considered to be speculation. Lee also observed that with the narrow application of the tax, it allowed evasive behaviour of actors in the real estate market (pp. 121-122).

- Alberta provides an interesting – albeit historic – Canadian example, with no empirical data to measure results. In the early 19th Century, “super assessments” were applied, in cities such as Medicine Hat and Lethbridge, to land that was considered underdeveloped in desirable areas. The intent was to impose a burden on owners who did not live on the properties (Smith, 1977, p. 341).

4.4 INCREMENTAL VALUE

4.4.1 LITERATURE REVIEW

Typically levied on the increase in value of property at the time the property is sold, many jurisdictions have aimed to implement a form of property taxation that applies to increases in property value. This form of tax comes under many names, and can take the form of a capital gains tax or a betterment levy. When the term ‘speculation tax’ is evoked it is also commonly referring to a form of incremental value taxation. Given the frequent use of ‘speculation’ taxes to influence housing prices, Appendix B explores the use of taxes to curb speculation and the vast coverage of this phenomenon in the literature.

The typical application of an incremental value tax would see a levy that decreases over the length of time a piece of property had been held, often with little to no tax applied to the sale price after it has been owned for two years. An exemption is often given for the primary residence of a property owner, with the tax often only being levied on any additional properties.

Researchers in the mid-1970s were only beginning to analyze the implications of such a tax. Hagman and Mischynski (1975) refer to any tax on increased real estate prices as ‘Special Capital and Real Estate Windfall Taxes’ or SCREWTS. At the time, policies were in place across the world to capture value on the incremental increases in housing prices, although Hagman and Mischynski focus on experiences in Canada, Australia, New Zealand and the United States. They identify three characteristics that are critical in identifying a SCREWTS. First, “they are based on changes in value rather than on absolute value... Second, they are limited to real estate. Third, [according to rhetoric] they [apply to perceived] undeserved [gains or] windfalls” (p. 437).

Fundamentally, an incremental value tax is simply a version of a capital gains tax, levied on gains in property values (Smith, 1978, p. 59)³. An incremental value tax’s purest form, a capital gains tax on the increased value of property, differs from an associated form of revenue collection known as a ‘betterment levy.’ As a form of incremental value taxation, a betterment levy captures the increment of increased value that is considered to be attributable to public policies. If, for example, a new park or street is constructed and the resulting increase in housing prices is directly caused by the actions of the jurisdiction, then the implementation of a betterment levy can recoup gains that otherwise fall to the homeowner (Smith, 1978, p. 343). Beginning with a historical view of the origins of betterment levies in English law, Hagman and Mischynski (1975) consider them to be unsuccessful at recapturing ‘betterment’ (p. 437). And, as property owners’ taxes would be the source of funding for such improvements, the logic and fairness of municipalities confiscating the resulting gains in property values is questionable.

³ Although Smith describes this as a levy on ‘land values,’ he does not make a clear distinction between property, land, and improvements in his work.

Although betterment levies are often mentioned in the literature, more recent research focuses on capital gains taxation. Fuest, Huber and Neilsen (2004) outline the major arguments for and against capital gains taxation. They explain that the proponents of this form of taxation argue that it does two things:

1. Allows for redistribution from the rich (who are buying houses and paying the tax) to the poor, as revenue generated could fund housing subsidies; and
2. Reduce price changes in the housing market (as proponents argue the market becomes less cyclical when both nominal and accrued gains and losses are taxed).

The second of these arguments is relevant to this literature review, as it pertains to the perception that an incremental value tax may be able to have an effect on housing prices. Although this is one of the main arguments that proponents tout, those who are against this tax disagree. As such, Fuest, Huber and Neilsen are cautionary in introducing these arguments; they want the reader to understand that the literature is not conclusive or very clear about the arguments for and against capital gains taxation (pp. 1-2).

In opposition, amidst several arguments against such a tax, the one that stands out the most across the literature is that it can cause a lock-in effect. This, as Aregger, Brown and Rossi (2012) discuss, arises under the tax's typical application, where the tax rate decreases the longer the property is held, often leading property owners to wait to sell their property until they will not need to pay the tax. This lock-in effect withholds properties from the market, and can cause further acceleration in housing prices (pp. 5- 6).

Fuest, Huber and Neilsen (2004) use a model to make similar conclusions about capital gains taxes and go so far to indicate that most thinking on the topic is "highly misleading" (p. 22) and

they find that in a market that is prone to boom-bust cycles the implementation of an incremental value tax would further reinforce these cycles by rewarding those who were able to buy property during busts and penalizing those who buy property during boom periods. As such, the intent of redistributing money from the rich to the poor tended to work in an opposite manner under their model (pp. 22-23). These type of conclusions are the trend amongst the literature on the effects of value increment or capital gains taxes. Aregger, Brown and Rossi (2012) begin their research with this understanding of the effect of a capital gains tax on housing prices and what they find corroborates the theory. They find a capital gains tax tends to have the opposite effect of its intention: further fueling price increases by causing a lock-in effect. After conducting empirical research on the effect of property tax policies in Switzerland, they further emphasize that this form of tax is counterproductive. In their words:

“...due to lock-in effects for existing home-owners, taxes on (short-term) capital gains may be counterproductive to the objective of more stable housing prices” (p. 24).

As with the betterment levy mentioned above, another less common form of incremental value taxation is that of a periodic tax on unrealized gains. This form of capital gains tax is not levied at the time of transfer; rather, it would see a jurisdiction levying a property tax on increases in assessed value. This form of tax is applied at either a regular or irregular interval. To illustrate implementation, this tax may be levied annually as a percentage of any assessed increases in property values each year. In this example, this tax would be levied annually regardless of transfer or any other change in ownership, which is not typical of an incremental value tax. The characteristics of this form of the tax are complex and it has not often been adopted as a tool to influence behaviour in housing markets; however, several jurisdictions have adopted this method, one of which will be profiled in the following section.

4.4.2 JURISDICTIONAL SCAN

Different forms of incremental value tax exist, and despite the empirical results that find that the most common form – capital gains taxes – are counterproductive, they remain a popular form of taxation on property in attempts to influence housing prices. Several examples include:

- New Zealand, which enacted a speculation tax in 1973, applying an additional tax to gains on properties held for less than two years. Bowden found that this form of tax may have had some effect, but that other efficient policy measures exist that could have had an equal effect (Bowden, 1975, p. 520-521).
- Korea first implemented a tax on property capital gains with the Temporary Anti-Speculation Tax on Real Estate. This tax has undergone many revisions; yet, its initial implementation was based on a calculation that took into account the transaction amount, improvements, transfer fees, as well as set deduction and appreciation amounts (Lee, 1990, pp. 99-100). Of interest is that Lee (1990) considers that the application of a capital gains tax did not cause any effect on housing prices. Although the prices dropped the year after implementation, Lee attributes it to a natural housing price cycle and describes how the government had waited too long to implement any corrective measures. He also discusses how, in the long run, some economists may consider that a government's interference in the property tax system may further contribute to instability in the housing market (pp. 117-124).
- Denmark provides the interesting case of a capital gains tax based on the unrealized increases in property value. Smith (1977) points to it as a jurisdiction where, for over thirty years, assessments were conducted every four years and owners were taxed on any incremental gains (p. 345).

Ontario's 1974 Land Speculation Tax Act (the Act) is particularly relevant to this research. The Act was in response to problems in the housing market that have been characterized in numerous ways. Hagman and Mischynski (1975) characterized the problem as "spiraling land prices blamed in part on intense speculative activity, Foreign (especially United States, German and Arabian) speculators were perceived by some as due for much of the blame" (p. 439). This is a theme that often re-surfaces with the discussion on land policy and has been examined more fully in research such as McFayden's analysis of public concern and the policy controls on foreign ownership in Canada (McFayden, 1986).

In Smith's (1976) exploration of the effectiveness of Ontario's tax, he describes the intent of this form of tax as threefold to:

1. capture increases in property value;
2. curb speculation; and
3. encourage development (p. 1).

The features of this tax were dependent on the length of time a property had been held, as well as the incremental value of the increase in price. Smith (1976), Smith (1981) and Hagman and Mischynski (1975) provide further details in their analyses of the tax. However, Slack (2004) gives a simplified explanation of the tax. The tax was applied at a rate of 20 percent on increases in property value at the time of transfer (p. 78). Smith (1977) further explains that it was to be applied to all 'land' (p. 347), although he meant land and improvements, exemplifying the confusion in terminology in the literature regarding land (excluding improvements) and property (including improvements).

For numerous reasons this tax was repealed. Slack (2004) outlined that it had no long term effect on housing prices⁴, seemed to cause a reduction in competition in several industries (e.g., construction), left properties to deteriorate as the funds were not available for improvements, and that any revenue generated was not significant enough to cover administrative costs (p. 49).

This case highlights a few important considerations:

- There was a feeling that the tax would be repealed, which may have contributed to its lack of success (Hagman & Mischynski, 1975, p. 440).
- Revenue gained in the first few months fell short of the intended revenue expectations (Hagman & Mischynski, 1975, p. 440).
- The act exempted many properties, which could have influenced the revenue generation, as the tax base was eroded, or relatively non-existent⁵ (Smith, 1977, p. 347) .
- Empirical evidence of the effect on speculation was difficult to find. It seems that housing prices dropped slightly in Toronto immediately after implementation and began rising again thereafter (Smith, 1981, p. 5).

This Ontario example of the implementation of a capital gains tax levied at time of transfer is often cited in the literature. The problem it was trying to fix was increasing property prices, and the suspected causes of the problem were speculation, foreign ownership, and windfall gains, all commonly cited reasons for implementing this form of tax. The results align clearly with other empirical research and show that there are inconclusive results as to the effect on housing prices.

⁴ Analysis of the ratio of sales to MLS listings in Toronto before and after the implementation of the tax noted that there was an initial drop in price and spike in listings, but that prices reverted back to their upward trend after six months, seemingly as if there had been no intervention (Smith, 1976, p. 5).

⁵ There were ten exemptions, listed under section four of the Act. These exemptions ranged from businesses and principal residences to land that was gifted and land to be developed (Land Speculation Tax Act, 1974, c. 17, s. 4).

4.5 TRANSFER

Typically levied at the time that property ownership changes, theoretical and empirical literature on the topic of transfer taxes, “have not received much attention in the housing literature” (Lundborg & Skedinger, 1999, p. 385). This point is further reinforced by Areggor, Brown and Rossi (2012) who note that no empirical research exists that explicitly deals with housing prices and transfer taxes (p. 6); yet, there is enough mention of the tax in the housing price literature to give a general definition and provide a brief exploration of its empirical effects. The jurisdictional scan is used to supplement the discussion.

4.5.1 LITERATURE REVIEW

Researchers who have analyzed incremental value, or capital gains, taxes often also include transfer, or transaction, taxes in their analysis (Aregger, Brown & Rossi, 2012; Fuest, Huber & Neilsen, 2004). Parallels in application between the two taxes have caused researchers to clarify that a transfer tax is not levied on capital gains, rather it is levied on the full property price (Lundborg & Skedinger, 1999, p. 386).

By definition a transfer or transaction tax applies directly to activity in the housing market. The tax base is the value of properties that are changing ownership and it can be levied either on buyers or sellers. A percentage of the price of sale is typically captured as tax when the transfer is recorded. (Smith, 1977, p. 347). Also, in its typical application Mintz (1991) emphasizes that the percentage of transfer tax that is paid is dependent on how often the property changes ownership, allowing lower tax rates for longer ownership spans (p. 251); however, such a provision could tend to create lock-in effects, as with incremental value taxes.

As the act of purchasing property will cost more with a transaction tax in place, it would be expected that, at the very least, there would be a reduction in net price realized by the seller equivalent to the tax (Smith, 1978, p. 62-63); however this effect may not appear in strong markets where properties are selling above listing price, as currently in Metro Vancouver.

Examples, such as transfer taxes implemented in some jurisdictions of California in the 1970s, show how the implementation of such a tax can make it appear similar to a capital gains tax. Cunningham (1978) notes that jurisdictions, such as Huntington Beach, levied a transfer tax on the difference between the purchase price and the sale price. These taxes were challenged in court, as it was unclear whether this was a disguised version of a capital gains tax. The distinction is important because, as in Canada, capital gains taxes (a form of income taxation), are not allowed to be levied by municipal governments. However, a transfer tax can also be implemented as a form of license fee, which falls within municipal powers (Cunningham, 1978, pp. 326-330). Cunningham (1978) notes that “the challengers charged that the transfer tax... was actually a property tax” (p. 327) and the court of appeals found that it was an excise (or wealth) tax, not a property tax (p. 327), and therefore disallowed it. This example is illustrative of the debate over a jurisdiction’s right to exercise transfer taxes, showing that on a constitutional basis the tax may be allowed or disallowed.

Another example of a transfer tax is the case of Switzerland, as set out in Aregger, Brown and Rossi (2012). Their analysis looked at the effect of implementing forms of property taxation on housing prices. What they note is that the Swiss taxation system allows for income taxes to be levied at all three levels of government, while property and wealth taxes are only levied at the two subnational levels of government. Transaction taxes, which technically fall into both property and wealth tax categories, were levied at both levels of subnational government. The

tax, typically levied on buyers, was applied to the selling price of the property at the time of transfer (p. 12).

Data collection issues, in measuring the results of a transfer tax, have made it difficult to determine the effect. As Smith (1977) explains, the tax encourages tax evasion, and could lead to contracts of land transfer not being recorded and/or understating the selling price (p. 347).

However, there is one well-regarded empirical study in the literature on transaction taxes, which was conducted by Swedish researchers Per Lundborg and Per Skedinger (1999). They ran a model from which they concluded that implementing a transaction tax will cause a lock-in effect. However, they note that their findings are tested in simple models only and there are many levels of uncertainty that could be added to testing transaction taxes in housing markets (p. 389).

Because of the paucity of empirical research on this form of taxation, Lundborg and Skedinger's finding is often cited (Arregor, Brown & Rossi, 2012; Fuest, Huber & Neilsen, 2004); yet, they also concluded that a transaction tax on either sellers or buyers influences either player to wait to sell or buy and, thereby, results in fewer transactions (p. 398). Aregger, Brown and Rossi (2012) who conduct their own empirical analysis find that, as with a capital gains tax, transaction taxes are likely not suitable to use in stabilizing housing prices. Their findings show that a transaction tax would not have an influence on housing prices (p. 24).

4.5.2 JURISDICTIONAL SCAN

Jack Mintz (1991) analyzed wealth taxes in Canada and identified the Canadian jurisdictions that have implemented property transfer taxes. He lists two Maritime Provinces, New Brunswick and Nova Scotia, and four others, Ontario, Manitoba, British Columbia and Quebec. Although he

only lists these Canadian jurisdictions, he does make note that some of the transfer taxes are implemented at the provincial level and others at the municipal level (p. 251).

With the propensity for Canadian provinces to implement this form of tax, this jurisdictional scan focuses on Canada and examines in depth the case of Ontario and how the City of Toronto currently levies a different form of property transfer tax than the rest of the province. The Government of Ontario levies a tax on property transfers throughout the province. However, as of 2008 an additional tax, the Municipal Land Transfer Tax (MLTT), began to be levied on property purchases within the City of Toronto at a rate of 1.1% of the sale price. This tax is still in effect. The city's jurisdictional powers are different than those of other municipalities in the province, as legislated under the City of Toronto Act, 2006, giving Toronto the ability to raise alternate forms of revenue.

Using an econometric model based on both regression discontinuity and estimation of differences-in-differences, researchers Dachis, Duranton and Turner (2012) show that in the months following the implementation of the MLTT the sale price of houses decreased by the same amount as the tax (p. 347). The same researchers also performed earlier analysis of the same issue and came to the conclusion that there were several disadvantages of its existence:

“The disadvantages of the LTT relative to an ordinary property tax include: millions of dollars per year in lost mobility, substantial additional administrative costs, a seemingly unfair reliance on a small tax base, and increased variance in municipal revenue”

(Dachis, Duranton & Turner, 2008, p. 15).

Peer-reviewed research into the effectiveness of this tax appears to be limited to two studies by the same researchers, Dachis, Duranton and Turner, which limits comparative description of this

case. The observed drop in housing prices was noted between February 2008 (when the MLTT was first applied) and August of the same year (when the researchers collected their data).

Dachis (2012) also produced an advocacy paper on the MLTT for the C.D. Howe Institute that notes that housing prices rose dramatically in 2009 (p. 6). Given that the timing of the implementation of this tax, and the disruption in financial markets before and during the market crash of 2008, the effect of the tax on housing prices is inconclusive.

4.6 SUMMARY

This chapter reviewed the use of four types of property tax policy to influence housing prices. From two-rate property tax regimes in Pennsylvania to land speculation taxes in Ontario, there is a long history of property taxes being used with the intent of influencing housing markets. Some measures, such as a site value tax, have weak results that may show some demonstrable influence on housing markets, whereas others, such as incremental value taxes, seem to have negligible desired impact. What is also observed throughout the literature and the jurisdictional scan is the lack of understanding of other implications, such as the possible development of evasive behaviour designed to avoid the new tax, or effects on larger regional housing markets.

5.0 FINDINGS AND ANALYSIS

5.1 INTRODUCTION

This chapter uses the evidence gathered through the literature review to analyze the application of each type of property tax measure in the case of British Columbia and summarize by answering the research questions. The two questions that guided the literature review and jurisdictional scan, and – in turn – the analysis are:

- Could British Columbia use property tax policy to influence the province’s hottest housing markets, primarily Metro Vancouver – i.e., implement a form of property tax to reduce the upward trend in housing prices?
- Could the adoption of provincial policies have unintended negative consequences – e.g., what could happen in areas of British Columbia not experiencing rapid increases in real estate prices?

5.2 SITE VALUE

What is found in the literature and the application of a site value tax in other jurisdictions is mostly inconclusive. Although a site value tax, in its purest form, would tax only the assessed value of land, the most practical application of this tax would be as a differential or two-rate tax that levies a more stringent tax on land than improvements.

Based on theory, a new two-rate tax system that levies land more heavily than improvements, something similar to the split rate that was previously adopted and rescinded in British Columbia, could possibly have an effect on development, increase housing supply and lower housing prices. However, with inconclusive empirical findings and less than convincing

application in other jurisdictions, further British Columbia-based research would be desirable before implementation. Two important findings were that:

- Where the tax is implemented is a contributing factor to its success. The tax would likely need to be applied throughout the affected housing market to have a chance of being effective; and
- The circumstances of the market in which the tax is being applied change the effectiveness of its application and can cause different effects, as such its implementation in a growing market would not likely be as effective as its application to a declining city.

Appendix C applies the theoretical possibilities to British Columbia's current situation to determine whether this measure could be applied to influence housing prices.

5.3 VACANT LAND

The findings on the use of vacant land taxes do not lend them much credibility as a source of influence over housing prices. What is apparent is the need for thorough data collection and analysis in order to consider applying a tax to vacant land. This tax could take two forms: applying the tax to land that does not have improvements or applying the tax to land that has improvements that are not considered to be adequate. Any tax policy that is enacted to develop housing or reconnect housing to the market would likely need be supported by significant evidence. The evidence needed for such an undertaking is explored in Appendix D.

The findings demonstrate that the unknown factors are significant and it is easy to imagine possible negative consequences of implementation of a vacant land tax. This type of tax would be challenging to apply on a province-wide basis and, if made obligatory, many municipalities

would suffer from unintended consequences where it was not economically viable to develop vacant land.

Although the effects are unknown, the few empirical results lead to the conclusion that the influence on housing prices is likely to be – at best – a short-term dip in prices with vacant or underutilized properties being added or reconnected to the market. In other words, the tax could encourage a behaviour change, but it would only have a one-time effect on prices and could deter vacancy or underdeveloped property in the future.

5.4 INCREMENTAL VALUE

Incremental value taxes apply to the increase in value of property – both the land and the improvements on land – between two transfers. Such taxes are often used in an attempt to influence prices in housing markets. Their popularity has likely been a result of the theoretical effects of this form of tax, including a redistribution of income, as well as a more stable price of housing. Yet, empirically it has been proven, again and again, that incremental value taxes do not have the desired influence on housing prices. Instead of causing prices to stabilize and possibly find a new point of equilibrium, the taxes cause lock-in effects and further increase prices. It seems that when it comes to the effectiveness of these taxes many jurisdictions end up rescinding them, often citing a lack of revenue generation that would have allowed the redistribution of wealth (despite the fact this is not typically the primary goal of their policies).

These findings are important to emphasize in the consideration of property tax policy as a measure to influence housing markets. To re-iterate: incremental value taxes do not appear to have a dampening effect on housing price increases. In fact, such a tax would likely result in further increases in housing prices in the long-run. Regardless of these results, many jurisdictions

have still chosen to implement this form of tax because of the pressures to take action from the media and the public.

The case of Ontario's speculation tax in the 1970s serves as a cautionary example, as British Columbia's perceived problems are similar to many of the perceived problems in Ontario.

Lessons to be learned from this case are, as follows:

- Narrowing the scope of the tax base will significantly reduce revenue generation. The tax base needs to be broad in order to generate revenue;
- As such, revenue generation cannot be an expected outcome of this tax;
- Although it would not likely be cited as a reason to implement, upon any failures in revenue generation the lack of funds received could become a reason to rescind; and
- If property owners consider that the tax may be rescinded in the future, many will hold on to their property (lock-in effect), potentially reducing the supply of properties for sale and further increasing prices in a market where demand remains strong.

Despite these areas of caution, should the Province choose to implement an incremental value tax there would be two ways in which this tax could be applied to properties in British Columbia, and these are described in Appendix E.

5.5 TRANSFER

The final measure is the transfer tax. The findings show that empirical research was close to non-existent on the use of transfer taxes to influence housing prices. That being said, the few empirical results show that this form of tax has not been found to be a suitable method of significantly influencing housing prices. Yet, the findings results reinforce that if the tax is levied on buyers then it has the most chance of influencing prices. The literature also noted that transfer

taxes likely result in fewer transactions within the markets affected and that enacting a strong levy may result in evasive behaviour, e.g. avoiding contracts or underreporting sale amounts.

In the context of British Columbia, which already levies a Property Transfer Tax at the provincial level, the case of the City of Toronto provides a recent and relevant example of how two levels of subnational government can work together to apply a transfer tax. Although little research has been conducted into the effectiveness of an additional transfer tax in the City of Toronto, the few results confirm that the size of price change is similar to the size of the tax, e.g., housing prices dropped 1.5% with a 1.5% levy. However, these results were found in a weak market, affected by the 2008 economic recession, and would likely not be applicable to the current case of Metro Vancouver. The scope of the other consequences found by the limited research prove to be additionally cautionary, such as lost mobility and variance in revenues collected.

The recent changes to the property transfer tax, from Budget 2016, have the intent of influencing housing affordability. Although the changes to the property transfer tax are not directly intended to have an effect on prices, they are intended to provide relief to lower and middle income buyers and tax higher income buyers more heavily. Although the issue of housing affordability includes – to some extent – the idea that prices would stabilize or decrease, that is not the primary intent of these recent policy changes.

Because of the weak effect on prices and the possibility of negative unintended consequences that surround this form of taxation (e.g., evasive behaviour or lost mobility), as well as the fact the current legislation has recently undergone amendments, it is likely there would be little appetite to further alter the tax in the near term. If any changes were to be considered to attempt

to influence housing prices, despite the fact that researchers have not found them to be effective at influencing prices in strong markets, the Province would have to raise tax rates across the province. However, applying a province-wide policy continues to be concerning for markets that are not experiencing rising housing prices. This form of tax is not a viable measure to address the rising prices in the Metro Vancouver housing market.

5.6 SUMMARY

This chapter has analyzed the four forms of property tax measure, and the concept of speculation, in the context of British Columbia. Based on this analysis, Table 2 links the property tax measures to the two research questions that were outlined in the introductory chapter, showing the likelihood of each tax measure influencing housing prices or having unintended consequences.

Regarding influence on prices, 'Low' describes analysis that did not point to the ability to influence housing prices, 'Medium' to results that indicated somewhat more of an ability, and 'High' to results that indicated that the form of property tax policy may be able to influence housing prices. In terms of unintended (negative) consequences, the low-med-high scale characterizes risk level, where 'Low' indicates less likelihood of negative consequences and 'High' indicates findings that indicate high likelihood. This table and its characterization of the tax measures is intended to inform the development of options in for the PTB related to influencing housing prices.

TABLE 2 ANALYSIS OF THE FORM OF TAX MEASURES’ ABILITY TO INFLUENCE HOUSING PRICES AND THE RISK OF UNINTENDED CONSEQUENCES

Form of Tax	Influence over housing prices	Unintended implications
Site value	Medium	Medium
Vacant land	Low	Medium
Incremental value	Low	High
Transfer	Medium	High

For the four types of tax measures analyzed, the findings are generally inconclusive or they demonstrate that the measures are not effective in reducing upward trends in housing prices. Many of the areas lacked significant empirical research and academic literature, which is a finding that is corroborated throughout the work of other researchers. Without burdening the following summary of findings by belabouring this lack of evidence, the following draws out other considerations that were apparent throughout the research.

Research Question #1

Could British Columbia use property tax policy to influence the province’s hottest housing markets, primarily Metro Vancouver – i.e., implement a form of property tax to reduce the upward trend in housing prices?

The results leave a few overarching impressions:

- A property tax measure may have little to no effect on housing prices, especially in the long-term.

- It seems that using a two-rate site value tax (to reduce taxes on improvements and increase taxes on land value) may have some stimulus effect on property development and, thereby, may increase supply, moderating prices; yet this effect cannot be clearly attributed to the tax policy in question, or to other concurrent policy measures or economic circumstances.
- The burden of a property tax policy would likely need to be relatively significant in order to cause behavioural change.
- With some property tax policies there may be a near term (or one-time) dip in the upward trend in prices; yet, as observed in other jurisdictions, prices tend to continue their upward trend without stabilizing in the longer-term.
- The findings for some of the taxes indicate that taxes need to be applied throughout the market, e.g. all of Metro Vancouver, in order for regional prices to be affected. Because municipalities are allocated property tax collection through two separate charters, one of which isolates the City of Vancouver, it would further complicate the implementation. Given the legislative structure of the relationship between British Columbia and municipalities, choosing a policy that would apply to the whole of Metro Vancouver's housing market could only be done by making a tax mandatory across the province.

All in all, as emphasized in the disclaimer in this section, overall the research points to property tax policy not being a suitable method of influencing housing prices.

Research Question #2

Could the adoption of provincial policies have unintended negative consequences – e.g., what could happen in areas of British Columbia not experiencing rapid increases in real estate prices?

There are several unintended implications that should prove cautionary:

- It was found that if property development increased it could have the benefit of tempering the rise in prices as quantity rose. However, in cases where this has been observed researchers, such as Smith (1976), also observe strain on the systems that support development, e.g., construction and production of materials, which can further distort the market (pp. 11-12). In addition to distorting the markets, other unintended consequences of property tax policy measures include:
 - Reducing market efficiency by intervening;
 - Evasive behaviour (e.g., contracts of land transfer not being recorded and/or understating the selling price (Smith, 1977, p. 347));
 - Lost mobility (e.g., lock-in effect).
- Putting in place a policy that may only have a one-time or short-term effect on housing prices would create unnecessary administrative burden.
- Further, attempts to influence prices by implementing a province-wide property tax measure would add a burden on all property owners in the province, including areas that are not experiencing rapid increases in property values. The impact of such policies in other regions is not fully understood, but a concern is that their implementation may hamper local housing markets and local economic development.

In summary of the analysis, Figure 1 and 2 indicate the desirability of each tax measure with yellow indicating caution, red indicating undesirable and green – which is not shown – would indicate desirable. As shown in Figure 1, in reference to the ability to reduce an upward trend in housing prices each tax measure is determined to be either cautionary or undesirable, and Figure 2 shows that the risk of unintended implications was determined to also be either cautionary or undesirable for each tax.

FIGURE 3 ABILITY TO REDUCE THE UPWARD TREND IN HOUSING PRICES

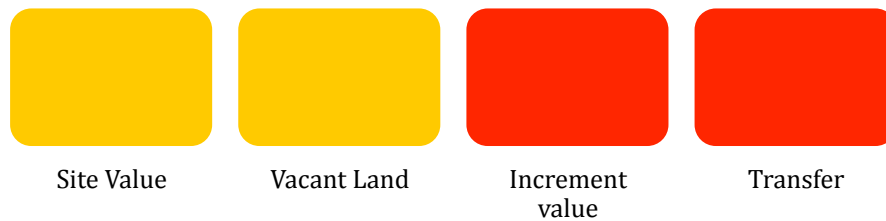
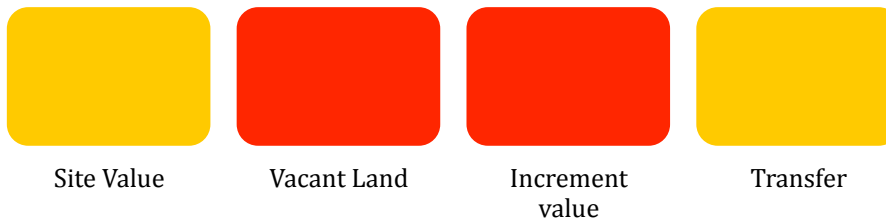


FIGURE 4 RISK OF UNDESIRABLE UNINTENDED IMPLICATIONS



Given the disclaimer of limited literature and empirical results, and in response to the research questions, tax policy is unlikely to be effective in reducing housing price increases in Metro Vancouver. However, if a tax was implemented and was successful in tempering the increase in prices it could also have unintended implications for municipalities elsewhere in British Columbia and any adjoining municipalities that chose not to implement the tax. The next chapter will develop options for the PTB to attempt to influence housing prices in the hottest markets in British Columbia.

6.0 OPTIONS, RECOMMENDATION, AND CONCLUSION

6.1 INTRODUCTION

Property tax policy does not appear to be a promising policy lever for influencing Metro Vancouver housing prices without negative consequences elsewhere. However, if housing prices continue to rise, it is likely that the public and other stakeholders will continue to call on the province to take action, and property taxes remain an important lever in the policy toolkit. In light of this research, two options are considered.

6.2 OPTIONS

Option 1: Status Quo – No Action

Take no action to change property tax policy.

Option 2: Develop a Two-Rate Site Value Tax

Implement a two-rate property tax regime (a form of site value tax that levies land more heavily than improvements) on an optional basis for both the Vancouver and Community charters.

6.3 RECOMMENDATION

Option 1: Status Quo – No Action

6.4 RATIONALE

Based on the findings of this paper, using property tax policy to attempt to influence housing prices does not appear to be particularly effective or desirable. There are many other forms of policy measures that may be more appropriate in influencing housing prices; some of these are listed in Appendix A.

The first option is advisable as it avoids the unknown factors that surround the application of a two-rate municipal property tax. However, in order to provide considered analysis for the Minister of Finance further analysis of the second option is outlined in more detail in Appendix C.

6.5 CONCLUSION

This report considered the evidence concerning the use of property tax instruments to influence rising housing prices, and concluded that effectiveness is uncertain, and unintended negative consequences are likely. Accordingly, no change in Provincial property tax policy is recommended.

APPENDIX A HOUSING PRICES

This appendix explores and clarifies definitions for the concepts of property, land, and housing.

This project works with the definition of ‘property’ as taking into account both land and improvements (buildings or structures; B.C. Assessment, 2016). In other words, land refers to the ground or a physical lot, whereas property refers to both the land and the improvements on it.

The terms land and property are often used interchangeably throughout the literature. Policies that are enacted on land may or may not take into account the improvements. Although the genre of policy measures to be analyzed in this research are categorized as land policy measures, the explanations used throughout this research will explicitly indicate if the measures discussed would be applied to land, improvements or both (i.e., property).

The price of housing is determined the combination of land and improvements. A housing price is determined by the present value of the rent that could be collected from a piece of property (Lee, 1990, p. 95), and the calculation of future rent is determined by the conditions of demand and supply (Skaburskis, 1988, p. 557). Krashinsky and Milne (1987) note that for buyers and sellers the development of expected or anticipated prices is critical in the calculation of net rent, which relies on information about the market (p. 289). This calculation, setting housing prices, has potential areas for errors to be made. Prices may be incorrectly set if there are:

- Gaps in access to information between the buyers and sellers, including any form of imperfect knowledge or misleading information.
- Challenges of the principal-agent relationship between a buyer or seller and their real estate agent. Primarily, principal-agent problems are centered around the fact that one party

estimating the price (real estate agent) is not the party primarily affected (buyer or seller) by the price.

- Issues around behaviour, e.g. choices are not being made rationally.

Malprezzi and Wachter (2005) consider irrational behaviour, and other challenges to successful acquisition of information in their analysis of how speculation, and price misconceptions, are formed in housing markets and the role these expectations play in boom-bust cycles often observed in housing markets.

If housing prices are considered to be inflated the worry of continued increases or an impending bust causes anxiety for policy makers, politicians, potential buyers or sellers, and the public at large. Globally, issues ranging from inflation and financial sector instability, to unequal distribution of wealth and difficult market entry have been linked, primarily anecdotally, to housing prices and the decision to implement measures to influence housing prices (Ha, 2010, pp. 255-256; Smith, 1977, p. 337; Arregor, Brown & Rossi, 2012, p. 2; Marcuse, 1984). An interesting phenomenon, that is often cited as both a cause and effect of housing prices that are increasing at a rate higher than economic growth, is speculation. Although speculative practices are not limited to the housing market they make up a considerable portion of the analysis in the literature on policy options for influencing housing prices. Further analysis can be found in Appendix B.

Cullingworth (1984) describes land policy issues in Canada as “a battleground of conflicting ideologies, academic disciplines and political expediencies” (p. 343). This view is not isolated to the Canadian experience; in analyses of housing markets across the world researchers conclude that rhetoric, conspiracies, folklore, populist psyche, and myths drive intervention in housing

markets (Lee, 1990; Cullingworth, 1984; Hagman & Mischynski, 1975; Malpezzi & Wachter, 2005; Smith, 1981). From rent controls in New York City (Marcuse, 1984, p. 942) to taxes such as the 'Abnormal Capital Gains Tax' on unused land in Korea (Lee, 1990, p. 121), the forms of policy interventions vary from jurisdiction to jurisdiction and the literature lists complementary and contrasting measures that have been implemented to influence housing markets.

There is a wide range of policy options for housing market intervention. These options include:

- Cap on the loan-to-value ratios of mortgages (Aregger, Brown & Rossi, 2012, p. 2);
- Tax relief on the interest paid on mortgages (Baudewyns, 2007, p. 57; Memery, 2010, p. 94);
- Increase of transaction costs such as a registration fee, notary fee, or stamp duty.
(Baudewyns, 2007, p. 37; Cunningham, 1978, p. 319; Memery, 2010, p. 92)
- Ensuring competition in the mortgage market. (Ha, 2010, p. 262);
- Subsidies – through capital grants or low-interest loans – to families to enable them to stay within a desired neighbourhood and/or to renovate the homes they purchase (Ha, 2010, p. 267; Baudewyns, 2007, p. 53);
- Land banking, or providing public lands for development needs (Cullingworth, 1984, pp. 353-356);
- Mixing of land tenures to ensure mixed income neighbourhoods (Memery, 2010, p. 101);
- Building and maintenance of social housing (Baudewyns, 2007, p. 53);
- Rent-to-buy schemes (Baudewyns, 2007, p. 54);
- Anti-speculation ordinances to curb speculation (Cunningham, 1978, p. 391).

APPENDIX B HOUSING SPECULATION

Although often included among the list of problems that increasing housing prices contribute to, there is also one practice that is thought to further drive up housing prices: speculation. A common view is that certain actors may be purposely gaming the housing market, i.e. speculating, to make themselves richer and, in doing so, causing prices to increase dramatically.

The literature on housing prices most often looks to speculation as one of the primary influencers in ‘hot’ housing markets. However, in theory, speculative behaviour has the opposite effect to what popular opinion supposes. Economic theory explains that speculation smooths the shifts in prices because it allows ‘speculators’ to buy up temporary excess in supply and release it when there are excesses of demand, moderating the housing market (Bowden, 1975, p. 513; Lee, 1990, p. 93).

Although theoretically speculation is considered to be stabilizing, there continue to be numerous cases where politicians look to constrain speculators or, as Skaburskis (1988) describes them, “the archetypal urban culprit” (p. 558). What Smith (1976) finds is that the perception of housing speculation can be destabilizing in itself, because – whether it exists or not – the perception can trigger atypical behaviour in other market actors. In other words, the perception of speculation drives demand because buyers believe that speculators hold more accurate information about future prices; this activity en masse causes prices to rise dramatically (pp. 3-4).

Smith (1976) outlines some of the more general conclusions regarding taxes implemented to affect speculation; he uses Ontario’s speculation tax as the basis for his analysis. He finds that in the short-run a tax could have destabilizing effects on speculative activity and expectations in the

housing market, but that these short-term effects would not offset considerable costs in the long run. Those long-term costs include:

- Favours development, the construction industry and owners of investment properties, which can distort the market structure;
- Reducing market efficiency, because property becomes a liquid asset rather than a consumption good;
- Driving up rental prices, as a result of a decrease in rental properties;
- Deteriorating investment properties;
- Reducing funds available to invest in property; and
- Developing a bureaucracy to implement the tax, although it is unlikely that the tax will have a high enough revenue generation to cover the costs of implementation (p. 11-12).

Further, Skaburskis (1988) finds that a speculation tax would be unsuccessful in influencing the market and that prices will continue to rise because people expect them to be rising. In his analysis of Vancouver's housing market bubble and crash in the late-1970s, early-1980s he concluded that prices continue to rise over the long-term because people expect them to do so. Any pain associated with previous market crashes would be forgotten and the stories of the gains would become folklore. This folklore, within itself, would have a significant influence in driving up prices again in the future (pp. 575-576).

Malprezzi and Watchter (2005) further explain the phenomenon of optimistic behaviour in housing markets and the tendency to forget disasters. They describe market actors as having 'disaster myopia' and, when they begin to formulate their expectations based on past growth experiences of runaway prices, inflated, speculative housing prices will develop (pp. 147-148).

They run simple models on housing supply and demand and conclude that it is the supply of housing that has, by far, the most influence on the stability of housing prices. They find that housing policies that improve the ability of the system to supply land are the most efficient at reducing housing price volatility (p. 160).

The consideration of a speculation tax complements the analysis of an incremental value tax. Taxes purporting to apply to speculative activity are common throughout the literature, but there is often not a clear understanding of whether speculation or simply the perception of speculation is driving up housing prices. Perception of speculation can trigger distorted behavior, based on atypical expectations of future housing prices.

If the Province was to take action to address speculation, in the hope that it would affect housing prices, it would have two methods to consider: address speculative activity through a tax or address speculative activity through alternate means. As this research is focused on tax policy, the first method will be more fully considered in this analysis; yet, alternate measures will be briefly explored, where appropriate. Before implementing any measures the Province may wish to collect data to allow them to determine if the behavior in the housing market is speculative. There is no common approach to determining if speculation exists; different researchers work within different analytical constraints. Past analysis of the Vancouver housing market uses transaction dates and sales prices in an attempt to discover speculative activity (Skaburskis, 1988, p. 564). As such, this type of modeling could apply to current data to understand movement in the market.

If speculation did exist and the province decided to apply a speculation tax, the findings are not favourable as to the success of implementing a tax to address speculative activity. The empirical

results of a tax on capital gains implemented at time of transfer, one of the more common forms of taxes used to address speculation, show that the tax may lead to a small short term dip in housing prices. Yet, this small short term effect of the tax would have numerous long-term implications, such as distorting the market and reducing efficiency – see Appendix A for a more complete list. Although a speculation tax most commonly refers to this form of incremental value tax, there are arguments to be made that any tax aimed at influencing housing prices in a market affected by speculation could use the term ‘speculation’ in its title.

Considering the findings on the effectiveness of an incremental value tax, alternate means may be more effective in influencing housing prices, even in markets where speculation exists.

APPENDIX C OPTION 2 RATIONALE

As municipalities currently collect property taxes based on assessed value in British Columbia, the application of a two-rate site value tax would be through the municipal property tax scheme. For its application to be successful it would likely have to be applied in each municipality throughout the hot housing market, which may prove challenging based on the past experience where few municipalities choose to apply the split rate tax. In this case the tax could be legislated by adding sections to the property tax portions of the Community Charter and the Vancouver Charter. These sections would outline the ability for municipalities to levy a heavier tax on the land portion of the assessed property values. What would be challenging is determining the extent to which municipalities would be in control of the rates. The literature is decidedly inconclusive regarding the rate at which land would need to be taxed, especially when the jurisdiction would still be taxing improvements.

It also becomes important to consider unintended implications of including this tax option for municipalities across the province, as it would be intended to influence only the hottest market(s). In light of this, there would need to be consideration of implementing this option under one or both of the charters. Another consideration is that it could be applied as mandatory or optional, and – as there are two charters – this choice could be applied identically for both charters or differently for each charter – i.e., the tax could be optional for one charter and mandatory for the other. Several scenarios result from these options, yet there are two most likely implementation scenarios. In British Columbia the implementation of such a tax may be more likely to take the form of:

1. An optional site value tax being implemented to both charters; or
2. A mandatory site value tax being implemented for the Vancouver Charter, as it is the hottest market, and an optional site value tax for the Community Charter.

The first scenario would see a site value tax implemented to the Vancouver Charter and the Community Charter. This tax would be optional in both charters but, if implemented in consultation with the City of Vancouver, it would very likely be applied in Vancouver. The other municipalities that may have an interest in applying the new form of taxation would be any other communities in the Metro Vancouver area, or in any or the other housing markets within the Lower Mainland. As this approach to implementation would not be mandatory its effectiveness would be unknown, and because some of the surrounding markets may choose to not apply the tax the research has shown that if not applied across the whole market the effectiveness of stabilizing or reducing the rise housing prices is unclear. Yet, if the tax was made mandatory under the Community Charter this broad of an application could be problematic for communities that have not been seeing housing price increases, as the tax could hamper development and cause further stagnation or declines in prices.

The second scenario is an alternative to the first. Also applied to both charters the site value tax would be mandatory for the City of Vancouver under the Vancouver Charter and would remain optional for the rest of British Columbia's municipalities under the Community Charter. This would address the same issue as the first scenario, and would be more likely to avoid consequences for municipalities that did not want to have an effect on housing prices. It would also circumvent any possibility that the measure would not be implemented in Vancouver, which would be the primary target of measures to influence housing prices.

Aside from the theory, the empirical research on these taxes remains relatively inconclusive as to the effectiveness of such a tax. In some cases it has been shown to have a positive effect on real estate development; yet, learning from the case of Pittsburgh this effect may be as a result of other measures implemented concurrently.

Should the Government of British Columbia decide to implement a two-rate property tax regime Option 2 (in Chapter 6) advises that it should be applied across both the Vancouver and Community charters on an optional basis appears to be the least disruptive form of property tax measure that may have some ability to influence housing prices. This form of site value tax would see land taxed at a higher rate than the improvements on land. As demonstrated in section 5.6, the analysis shows, that in comparison to the other measures analyzed, this type of property tax has a moderate chance of influencing housing prices and the consequences appear to be the least negative of the property tax options considered. As such, this is the only property tax policy that the PTB could consider implementing.

Taking into consideration the timing of this report, with a provincial election in less than a year, the final recommendation is to work to pursue Option 1 and advise the Government that using property tax policy to attempt to reduce housing prices is not likely to be effective. However, Option 2 may warrant consideration in any medium term planning exercises. To support any further work of the PTB, the following outlines initial next steps should the Province choose to implement Option 2.

Extensive analysis would need to be undertaken in the development of such a policy measure. Analysis of the two-rate policy implemented in the late-80s early 90s, as well as consultations and engagement with municipalities, would be needed to inform the policy development phase.

The literature review, as well as the additional analysis and discussions in this appendix provide a background for undertaking this option.

Initial consideration of implementation of a differential tax rate may follow the steps detailed below:

1. Analysis and evaluation of the previous two-rate policy;
2. Development of a draft policy taking into consideration successes and failures of the previous policy;
3. Internal preparation for possible announcement in Budget 2017; and
4. Post-budget consultation with municipalities to develop further legislative details.

APPENDIX D DEFINING VACANCY

This evidence could come from data that describes the significance of the deficit in improvements on land in British Columbia's hottest markets. The Province would need to define vacancy in terms of improvements and determine the extent to which it is a problem. This data could then be used to determine if, with the primary goal of influencing housing prices, a secondary goal is either to develop housing or reconnect housing to the market (these are the two forms of underutilization that could be defined as a 'vacancy'). Defining this secondary goal of a vacant land policy poses challenges, as the size of tax needed to reconnect underutilized property to the market would need to be large in order to shift behaviour of owners of underdeveloped land and/or absentee owners. In theory a steep levy on vacant or underdeveloped land would be successful in influencing the behaviour of the owners and the land would either be sold or developed; thereby, reconnecting it to the market.

In British Columbia part of the public debate, being played out in the media, is the perception that foreign nationals are purchasing property and leaving it vacant, which is a contributing factor to the high housing prices. To get a better idea of the magnitude of this problem, one of the measures adopted in Budget 2016 is a renewed focus on collecting data on the citizenship of individuals and corporations who are transferring property in British Columbia. Even with the collection of this additional data, the literature review shows that there would likely need to be further commitment to collect more data to determine if vacancy problems exist to the extent perceived. Before collecting further data, the Province would need to define land vacancy and determine within which parameters property would be considered underutilized. One factor in

developing this description would be to determine what constitutes a “failure to meet basic public obligations” (Kelly Jr., 2013, p. 139) of land ownership.

Without the definition that further describes the ideal characteristics of land, there would likely not be enough evidence to implement a vacant land tax. Taking the steps to define vacancy would be time consuming, expensive and likely raise significant civil liberty issues. Similarly as in the case of defining speculation, outlined in Appendix B, the results of undertaking any exercise to determine the extent of vacancy may not be satisfactory to the jurisdictions undertaking the analysis. Previous analysis into possible speculative activity in Vancouver found that the source of any speculation was not the ‘culprits’ expected, rather dentists and other professionals that were already acting within the market (Skaburskis, 1988, p. 564). If the expense and time needed to determine vacancy is not a deterrent, previous analysis into perceived challenges in defining culprits in British Columbian housing markets should be cautionary as the results may not target the populations expected. However, the Mayor of Vancouver has acknowledged that in the city’s consideration of this form of taxation that they will tax whomever is found to hold vacant housing, as a recent Globe and Mail article characterized the targeted demographic “from overseas buyers to snowbirds from elsewhere in Canada” (Bailey, 2016).

APPENDIX E TWO OPTIONS FOR AN INCREMENTAL VALUE TAX

Should the Province choose to implement an incremental value tax there would be two ways in which this tax could be applied to properties in British Columbia:

1. An incremental value tax that would be enacted by a new piece of legislation or by an amendment to the Property Transfer Tax Act (levied at time of transfer).
2. the Vancouver Charter and/or Community Charters (as the less popular form of incremental value tax levied on unrealized earnings).

The first method of implementation would fall within the jurisdiction of the Province. The second method could fail on constitutional grounds as it could be argued to be income taxation, and only federal and provincial governments can tax income. Allowing municipalities to levy tax on unrealized incremental values is a tax on capital gains and so may also exceed their powers. This method would necessitate a decision about whether to include the tax in both charters and whether it would be mandatory or not.

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