The Canadian Real Estate Association

PRE-BUDGET SUBMISSION

AUGUST 2007

CREA
CANADIAN REAL ESTATE ASSOCIATION

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Executive Summary

The Committee has asked Canadians to address the theme of "a tax system for a prosperous future"; in other words, designing a system that results in the collection of the revenues needed to fund government activities while ensuring the prosperity and productivity of both residents and businesses. Housing and real estate are very relevant to this theme.

Prime Minister Stephen Harper recognized the importance of housing to Canada's overall success as a nation in his speech to the World Urban Forum 3 in Vancouver in 2006. He committed the federal government to helping build safe neighborhoods and sustainable cities. "Another key to a safe and successful environment is affordable housing," Prime Minister Harper said. "If our cities are to succeed and prosper, we must find ways to provide housing that meets the needs of people at all income levels."

It is the view of The Canadian Real Estate Association (CREA) that this can only be accomplished with the development of an integrated national housing policy. It may be argued that such a policy is difficult to develop because housing crosses both provincial and federal jurisdictions. This is precisely why the federal government must provide leadership as well as funding to ensure national standards are applied to ensure that all citizens have equal access to programs.

The elements we consider essential in a comprehensive federal housing strategy include new options for home ownership directed at lower-income earners, measures to combat homelessness, radical change for aboriginal housing, and measures to maintain and make better use of existing housing stock.

We recommend that parliamentarians themselves take responsibility for examining the evidence and providing guidelines for a new federal housing strategy. In the past, parliamentary committees have conducted hearings and undertaken studies that have made valuable contributions to national policy. We urge the federal government to provide broad terms of reference to a special committee with a fixed mandate to develop a comprehensive national housing strategy.

Housing is a major contributor to the Canadian economy. In 2006, the local Multiple Listing Service® operated by real estate Boards and Associations across Canada facilitated the sale of 522,560 properties with a total value of more than $143.3 billion. In the first half of 2007, MLS® sales broke all records for dollar volume and average residential price.

A study by Altus Clayton Research Associates of Toronto prepared on behalf of CREA shows that in the period 2004-2006, each sale facilitated by a local MLS® system generated an additional $32,200 in ancillary economic activity, equivalent to $15.3 billion annually. Between 2004-2006 these MLS® real estate transactions also generated more than 158,600 jobs.

Specific Recommendations

The Committee has asked for specific proposals for tax initiatives required for a prosperous future. This submission contains several recommendations dealing with initiatives that accomplish two things: they provide opportunity for prosperity, and do it without a major drawdown on government revenues.

The Canadian Real Estate Association believes all of the measures outlined in this submission would contribute to improving the quality of life of Canadians, our national productivity, and overall economic growth. CREA asks the Committee to give particular attention to the following recommendations:

Home Buyers' Plan

The national Home Buyers' Plan (HBP) allows individuals to borrow up to $20,000 from their RRSP ($40,000 per couple) towards the purchase of a first home. More than 1.8 million Canadians have used this program to date. Home prices have climbed nationwide since the HBP was first implemented, but the maximum HBP loan has not been adjusted to account for inflation.

The lack of inflation adjustment is an obvious oversight in the design of the national Home Buyers' Plan. The maximum HBP loan available should immediately be raised to $25,000, and adjusted every five years to account for consumer price inflation.

Reinvestment in Real Property

Capital gains tax and the recovery of capital cost allowance upon the disposal of real property assets can be viewed as "voluntary" taxes, in that the taxes can be avoided simply by retaining the asset. This has a negative impact on real property investments as an asset class, as it provides a disincentive to sell assets that have increased in value. It is also a disincentive to maintaining the overall quality of both commercial and residential investment properties.

The application of these taxes skews the investor's decision away from what might be prudent changes in their property investments due to the capital loss incurred in what is essentially a property exchange.

CREA recommends the Income Tax Act be amended to enable a deferral of both the capital gains tax and the recaptured capital cost allowance recovery for all real property investments when an investment property is sold and the proceeds are invested in another real property within a specified time period.

Revitalizing Canadian Communities

A key ingredient in any strategy for revitalizing our communities is the rehabilitation of environmentally impaired real estate, which is often identified as brownfields. Brownfield sites often occupy prime real estate in Canada's urban centers. Many are abandoned and provide no employment opportunities for the local community. Most are not reaching their full economic potential.

The revitalization of many communities can be initiated if the impediments to the rehabilitation and redevelopment of environmentally impaired properties are removed. Placing redevelopment projects on a competitive playing field with greenfield sites will naturally draw the investment dollar of the Canadian entrepreneur.

CREA recommends the federal government allow developers to treat remediation costs as a deductible expense for income tax purposes. This deduction should be claimed in the year the cost is incurred, or may be carried forward indefinitely to subsequent years.

CREA also encourages the federal government to consider an amendment to CMHC's mandate to include mortgage guarantees at commercial lending rates for brownfield redevelopment projects with a residential end-use component.

First Nations Housing

REALTORS® welcomed the announcement of the $300 million fund to encourage aboriginal home ownership that was incorporated in the last Federal Budget. There are several implementation issues that must be addressed, which are included in this submission. If some of these issues can be addressed, the First Nations Market Housing Fund may be a step in the right direction.

It is misleading for the federal government to suggest that the proposed fund "will provide First Nations families and individuals with the means to purchase, build, and renovate on-reserve housing." If the government really wants to give aboriginals the benefits of home ownership, it will have to offer an alternative option to living under the Indian Act – one that provides for true ownership with tenure.

Why the Home Buyers' Plan Must Be Updated

The Issue

After 15 years without adjustment, it is time to update the Home Buyers' Plan. Raising the borrowing limits from $20,000 to $25,000 per plan holder ($50,000 per couple) with future indexing to the rate of inflation is a modest proposal that would bring the plan closer to its 1992 value.

Background

The Home Buyers' Plan (HBP) allows individuals to borrow up to $20,000 from their RRSP ($40,000 per couple) towards the purchase of their first home. The current borrowing limit was set when the plan was introduced in 1992.

- The MLS® residential average home price rose 85 per cent between 1992 and 2006.
- The Consumer Price Index rose 27 per cent over the same period. If the maximum loan available under the plan were adjusted for inflation it would now stand at $25,980.

More than 1.8 million plan users have borrowed $18.6 billion from their RRSPs to purchase a home since the plan's inception in 1992. The plan is estimated to have helped with over 900,000 home purchases, including over 53,000 homes bought in 2006.

The Home Buyers' Plan has proven to be of enormous social and economic benefit. Home purchases attributed to the plan have resulted in nearly $20 billion in economic spin-off benefits in addition to the major benefits arising from new home construction. The plan also encourages Canadians to start retirement savings earlier, since owning a principal residence represents the foundation of an overall financial and retirement plan.

Annual repayments of RRSPs over 15 years are a fundamental feature of the plan. The latest statistics show home buyers are repaying their loans under the HBP. Repayments as a percentage of withdrawals under the HBP amounted to 41.3 per cent in 2004, 49.0 per cent in 2005, and 59.9 per cent in 2006.

The Home as Retirement Security

The Home Buyers' Plan allows Canadians to save for retirement and save for a home at the same time. Previously they had to choose between saving for retirement and saving for a home, or greatly dilute both savings plans.

Since home ownership is the cornerstone of retirement for the vast majority of Canadians, they should not have to choose one or the other. The Home Buyers' Plan has allowed Canadians to save for retirement, leaving open the option to borrow against their RRSP savings at a later date to access ownership. This is very important because, unlike other proposals for the use of RRSP holdings, borrowing from a plan to purchase a home does not divert retirement funds from the goal of retirement security.

The Home Buyers' Plan (HBP) is a means of strengthening homeownership in Canada at no cost to the taxpayer. As such it is the ideal government program.

Integrity of Savings Protected

An effective mechanism is in place to protect the integrity of retirement savings. First, borrowed savings are invested in a principal residence, which is a pillar of security for retirement. The plan requires the borrower to repay the borrowed RRSP funds plan over 15 years. As an incentive to repayment, funds not repaid are fully taxable. Experience in recent years shows a healthy rate of repayment. The rates of repayment, as a percentage of total annual borrowings are 41.3 per cent (2004), 49.0 per cent (2005) and 59.9 per cent (2006). Given the 15-year payback period, annual repayments in this range show the plan is working as intended.

Home Ownership Rate Misleading

Since the Home Buyers' Plan was introduced in 1992, the rate of homeownership has increased from 62.3 per cent (1991) to 66.1 per cent (2001). The plan can take some of the credit for the expansion. Mortgage insurance flexibilities have been expanded and interest rates have dropped over the same period.

While the growth in the overall rate is positive, it masks actual reductions in the ownership rates for younger age groups. Research by the Vanier Institute of the Family shows that the overall increase has been driven by those aged 55 and over. Their ownership rate increased from 68 per cent in 1981 to 74 per cent in 2001.

According to the Vanier Institute, over the same period, the rate for those aged 34 and under fell from 44 per cent to 41 per cent. The rate for those aged 35 to 44 fell from 72 per cent to 67 per cent. Both of these age groups had almost flat earnings over two decades. The rate for those aged 45 to 54 fell by a smaller margin but still dropped from 76 to 74 per cent.

In addition, research by Michael Haan of the University of Alberta shows that ownership rates for immigrants have declined – from 62.9 per cent in 1981 to 57.9 per cent in 2001. The research concluded that income was a large part of the reason for the decline.

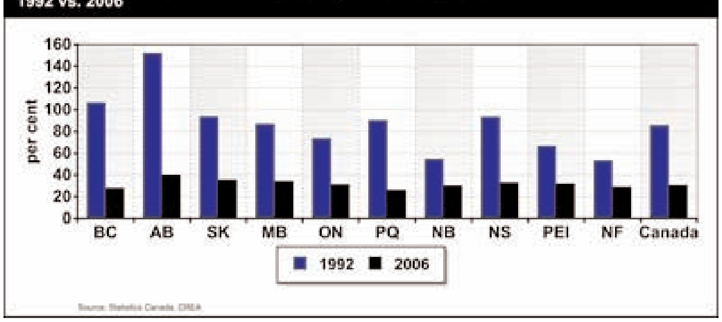
Helps Build Down Payments

The Home Buyers' Plan is unique among support programs for home ownership in that it encourages savings and maximizes down payments. The claim is sometimes made that low interest rates and increasingly flexible mortgage insurance options provide all the support necessary for home ownership. Those measures are important but they facilitate borrowing and larger levels of indebtedness. By emphasizing the down payment the Home Buyers' Plan, on the other hand, helps the buyer to minimize the level of indebtedness over time.

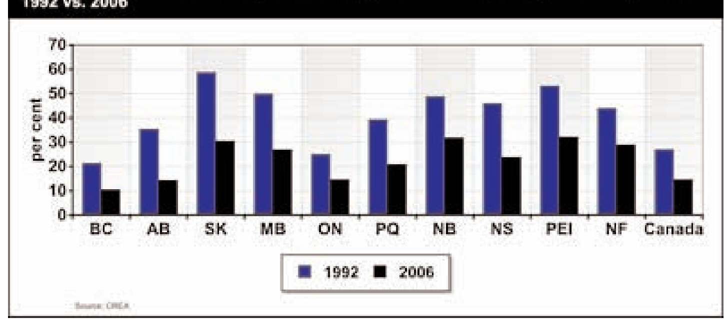
Recommendation

Potential homebuyers, particularly in immigrant populations and younger age brackets, have experienced increasing difficulty in raising a home down payment in many current urban markets. REALTORS® recommend the federal government act immediately to raise the borrowing limits under the Home Buyers' Plan from $20,000 to $25,000 per plan holder, indexed to the rate of inflation, effective immediately.

Increase in CPI & MLS® avg. home price
1992 vs. 2006



Downpayment as a percentage of MLS® avg. home price
1992 vs. 2006



Reinvestment in Real Property

The Issue

Expert research commissioned by The Canadian Real Estate Association shows that current capital gains tax law is dampening economic growth, entrepreneurial activity, and the efficient allocation of capital. This in turn is contributing to slipping Canadian productivity levels as measured by the OECD.

The Income Tax Act should be amended to allow real property investors to defer the capital gains tax and the recaptured capital cost allowance on the sale of an investment property when the funds are reinvested into another within a specified time period.

"In the past, investing in real estate was viewed as a game for the wealthy with few social or macro-economic benefits. Today, maintaining the flow of capital into real estate investments is essential to our domestic economy and long-term prosperity, and to maintaining a strong and competitive global position.

"While Canada has followed the trend in lowering corporate taxes, other tax measures are still required and among those most worthy of consideration is the tax deferral of capital gains for real estate, if for no other reason than to mitigate the "lock-in" effect. Such a move would not be seen as pioneering, but it would bring in us into line with our largest trading partner and convey the message that Canada is aggressive in pursuing tax policies that will reestablish our competitive leadership in the global arena."

(Source: *An International Comparison of Capital Gains Tax* by Professor James McKellar - August 2007)

Background

The amendment would provide significant benefits for Canada, including:

- Leveraging underutilized wealth in the Canadian economy.
- Placing small investors on a level playing field with larger ones.
- Allowing Canadians to better manage their retirement investment portfolios.
- Supporting labor mobility – an essential element to Canada's economic prosperity.
- Addressing Canada's international competitiveness problem that results from the highest marginal effective tax rate (METR) in the OECD.

The proposed Income Tax Act change would also position the federal government as an active proponent of urban renewal and intensification.

Real property investors currently face significant financial penalties when changing asset classes. This discourages investment in real property, and the maintenance and upkeep of these properties. It also makes it difficult for investors to grow their real property investments.

The taxes on capital gains and recaptured capital cost allowance upon the disposal of real property assets can be viewed as "voluntary" taxes, as they can be avoided simply by retaining the asset. This has a negative impact on real property investments as an asset class, as it provides a disincentive to sell assets that have increased in value. It is also a disincentive to maintaining the overall quality of both commercial and residential investment properties.

When a property owner reinvests the proceeds from the sale of one property into the acquisition of another property, no real economic gain has been realized that provides funds to pay the tax. The taxpayer is retaining an investment in real property but it is in a different form. In addition, when a property investor reinvests the proceeds from the sale of one property into another, and where the net proceeds of the first property exceed its un-depreciated capital cost, tax law treats this as recaptured depreciation that must be included in income, and is fully taxable. Again, no real economic gain has been realized as the investor is retaining his or her investment through the purchase of a new property.

A "lock-in" effect occurs when holders of old assets, with low or reduced returns, keep them because of punitive tax consequences rather than sell them to invest in new assets with higher returns. The result is that these old assets are not turned over to different types of investors that are interested in rehabilitating or redeveloping the sites.

Unlike a simple capital gains tax cut, a deferral of the capital gains tax and the capital cost allowance recovery would directly remedy this "lock-in" effect. It would allow an investor the freedom to change asset classes, locations and/or sizes without penalty and without the loss of value that has grown in many cases due to inflationary pressures.

The proposed amendments would address some of the unique difficulties associated with holding real property as an asset class, such as a lack of liquidity, a lack of portability, and the inability to increase overall asset size over time by smaller incremental amounts.

The concept of a tax deferral is not new to the Income Tax Act. Subsections 13(4) and 44(1) allow taxpayer to defer capital gains where a "former property" is involuntarily disposed of, or a "former business property" is voluntarily disposed of and a "replacement property" is acquired. Subsection 14(6) provides similar treatment with respect to eligible capital property. However, rental property is specifically excluded from the definition of "former business property".

REALTORS® propose that the very same mechanism currently being used by real property investors with more than five employees be extended to all income producing property. Furthermore, there is no evidence from other jurisdictions, such as the United States, that tax deferrals are problematic or costly to administer.

An analysis of the CREA proposal conducted by Professor Thomas Wilson of the University of Toronto shows that the estimated current year revenue loss from implementing a capital gains tax deferral for individual investors selling income producing properties would be less than $225 million (based on a survey of federal income tax returns from the 2005 taxation year). A deferral would also lead to higher future revenues from capital gains taxes on investments in income producing properties.

Recommendation

CREA recommends the Income Tax Act be amended to enable a deferral of both the capital gains tax and the recaptured capital cost allowance for all real property investments when an investment property is sold and the proceeds are invested in another real property within a specified period.

Revitalizing Canadian Communities

The Issue

For a number of years, REALTORS® have been calling on governments at all levels to provide the necessary tools to assist the private sector in the rehabilitation of underutilized and environmentally impaired properties. These sites are often located on prime real estate in Canada's urban centers. Many are abandoned and provide no employment opportunities for the local community, and as a result are not reaching their full economic potential.

Background

The members of the Canadian Commercial Council of REALTORS® (CCC) of The Canadian Real Estate Association (CREA) are specialists in the fields of industrial, commercial and investment real estate, and have long recognized the benefits associated with the rehabilitation and redevelopment of existing properties that are underutilized or abandoned.

Increased property values and an increased property tax base are the immediate results of redevelopment in a community.

The utilization of existing municipal infrastructure and the reintroduction of population densities to Canada's urban cores reduces the demand on greenfields and slows urban sprawl.
The federal government has a role to play in ensuring there are no major impediments to discourage the private sector from investing in the redevelopment of these sites.

Major impediments to the redevelopment and rehabilitation of environmentally impaired real estate in Canada include current tax policy. The Income Tax Act requires remediation costs to be capitalized. This is an immediate cost that puts these sites on an uneven footing with greenfields from the start. Capitalizing this cost means that the recovery on the expense is over a number of years. A change to allow remediation costs to be expensed, rather than capitalized, would assist in the financial viability and the ability to finance these projects.

The inability to access upfront capital from conventional sources has been a significant barrier to the redevelopment of environmentally impaired properties. CREA recommends the mandate of Canada Mortgage and Housing Corportaion (CMHC) be expanded to provide mortgage guarantees at commercial rates for environmentally impaired properties that are being redeveloped for residential or mixed residential/commercial uses. The National Roundtable on the Environment and the Economy and the Canadian Brownfields Network also recommend this amendment to CMHC's mandate, and note that government mortgage guarantees have been helpful in encouraging brownfield redevelopment in the United States.

Recommendation

REALTORS® continue to call on the federal government to remove impediments to the rehabilitation and redevelopment of environmentally impaired properties in order to allow redevelopment projects to compete on a more level playing field for the investment dollar of the Canadian entrepreneur.

CREA recommends that the federal government allow developers to treat remediation costs as a deductible expense for income tax purposes. This deduction may be claimed in the year the cost is incurred, or may be carried forward to subsequent years.

CREA encourages the federal government to consider an amendment to CMHC's mandate to include mortgage guarantees at commercial lending rates for brownfields being redeveloped for residential or mixed residential/commercial uses.

First Nations Housing

The Committee is approaching this round of pre-budget consultations with the premise that one of the key roles of government is to support the prosperity and productivity of its citizens. For aboriginals, however, tax reform is not the answer. Instead, the role of governments should be to encourage and facilitate economic activity, community development, and personal self-sufficiency.

For several years The Canadian Real Estate Association has advocated radical change in aboriginal housing policy. Indian Affairs Minister Jim Prentice has spoken about the importance of extending the benefits of home ownership to aboriginal people living on First Nation territories.

REALTORS® welcomed the announcement of a $300 million fund to encourage aboriginal home ownership that was incorporated in the last Federal Budget. The federal government has now initiated an “engagement process” through Canada Mortgage and Housing Corporation (CMHC) regarding how the proposed fund will operate. While we welcome the objectives of the fund, there are several implementation issues that must be addressed.

Who Benefits from the Fund?

This initiative will provide $300 million for CMHC to manage. The fund is to be used only as a last resort, following default by both an individual and the band. It is reasonable to expect the $300 million fund to remain basically intact and generating interest. Where does the interest go and for what purpose? There can be no justification for a fund, aimed at expanding aboriginal ownership, that acts as a revenue source for CMHC. At the very least, interest acquired by the fund should be reinvested in aboriginal housing.

“The idea of building housing markets on-reserve in order to respond to housing needs has already been implemented in some innovative First Nations in Canada,” according to the CMHC consultation paper prepared to describe the proposed fund. “The First Nations Market Housing Fund is intended to assist other interested First Nations make a similar commitment to improving housing, following the lead of innovative First Nations.”

This refers to the successful on-reserve lending programs for home ownership developed by two of Canada's chartered banks. CREA drew international attention to these programs last year in a networking session at World Urban Forum 3. A major difference between those programs and this fund is the burdensome requirement to assess and qualify bands to be eligible for the proposed fund. At present, the banks do their own qualifying and risk assessment.

There are other serious issues. The key to creating the benefits of home ownership is to deliver a secure, appreciable asset. Security of tenure is fundamental to this. The consultation paper suggests the bands will be left to deliver this guarantee. The document says the fund will be applied equally across the country, but CREA's WUF3 project illustrated why this is a recipe for disaster. No two bands or regions functions in the same way.

Conclusion

If these issues can be addressed, the First Nations Market Housing Fund may be a step in the right direction. It is misleading for the federal government to suggest that the proposed fund “will provide First Nations families and individuals with the means to purchase, build, and renovate on reserve housing.” If the government really wants to give aboriginals the benefits of home ownership, it will have to offer an alternative option to living under the Indian Act – one that provides for true ownership with tenure.

Real Estate is a Major Influence in our Economy

Fuelled by historically low interest rates, Canada's housing market continues to be a pillar of the national economy. A total of 522,560 properties were sold through the Multiple Listing Service® in 2006. This is just 0.14 per cent below the highest annual level on record, which was reached in 2005.

MLS® sales in 2006 were valued at $143.3 billion – the eighth consecutive annual record for sales volume. Of those MLS® totals, 483,917 of the properties sold in Canada in 2006 were residential, with a total value of $134.0 billion. The national MLS® residential average price reached $276,921 in 2006, representing an annual increase of 11.1 per cent. This was the eighth consecutive annual record for residential average price and the largest annual increase since 1989.

The resale housing market in Canada has not lost any steam in the first half of 2007. National MLS® home sales activity in the first half of 2007 rose 8.2 per cent year-over-year to 287,862 units. Sales in the first half of 2007 ran ahead of levels for the same period last year in almost every province. The national MLS® residential average price also rose 11.2 per cent year-over-year in June 2007 to $315,332.

Resale housing transactions across Canada generate significant economic activity. The general economic benefits associated with these transactions were identified in a March 2007 report prepared by Altus Clayton Research for The Canadian Real Estate Association. The report says that between 2004 and 2006, each MLS® sale generated an average of $32,200 in ancillary economic activity.

That amount is above and beyond the actual price paid for the building and land, and covers expenses like professional fees, taxes, renovations, appliances and furnishings. This represents an average of $15.3 billion per year in additional spending that results from MLS® home sales – a significant contribution to the total Canadian economy.

The report also says that 153,400 jobs were generated by average annual MLS® resale activity in Canada during the period between 2004 and 2006

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About The Canadian Real Estate Association

The Canadian Real Estate Association (CREA) represents 90,000 REALTOR® members who are engaged in the purchase and sale of real property, and brokerage, management and appraisal services. REALTORS® have a direct business interest in the quality of life of their clients, and many are actively responding to the housing needs of their communities.

CREA owns the MLS® trade mark and has a proprietary interest in the REALTOR® trade mark. The REALTOR® trade mark is an assurance of integrity, and can only be used in Canada by members of The Canadian Real Estate Association who accept and respect a strict code of ethics.

The real estate database systems operated by our member Boards and Associations under the MLS® trade mark provide an ongoing inventory of available properties and ensure maximum exposure of properties listed for sale.

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