Weekly Updates Issue # 573

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1. Weekly Markets Changes

[July 15, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,482.42 +222.6 +1.56%	2,161.74 +31.84 +1.49%	18,516.55 +369.8 +2.04%	5,029.59 +72.83 +1.47%	$0.7710 +0.41¢ +0.53%	$1,337.70 -29.70 -2.17%	$46.28 +1.16 +2.57%

2. Manufacturing sales dipped in May: StatsCan

[July 15, 2016] Statistics Canada says manufacturing sales fell 1% to $49.9 billion in May, while economists had expected a drop of 0.7%, according to Thomson Reuters.

The decline came as sales of motor vehicles and petroleum and coal products dropped. In particular, motor vehicle sales fell 4.2% to $5.6 billion, while sales of motor vehicle parts declined 2.3%.

"Firms aren't in a rush to invest, and with another weak print in manufacturing for May, it isn't hard to see why," says a CIBC Capital Markets release by director and senior economist Nick Exarhos.

The dip in manufacturing sales suggests "it will be some time still before capacity constraints force manufacturers into ramping up capital spending," it adds. "The volume decline of 2.1% leaves the trend in real output essentially flat from the middle part of 2014. The weakness in May was foreshadowed by the lackluster performance of exports during the month."

Further, says CIBC, "The meaningful drop in volumes is another strike against the May GDP outlook, which was already set to be hammered by the outages in the energy sector caused by the Alberta wildfires. Today's news should be negative for the C$, and supportive for bonds."

More details

Sales in the petroleum and coal products industry fell 2.2% to $4.1 billion.

Overall, sales fell in 15 of 21 industries, representing nearly 70% of total manufacturing.
Constant dollar sales fell 2.1%, indicating a lower volume of manufactured goods was sold in the month.

3. National homes sales fall again

[July 15, 2016] National home sales declined further in June 2016, according to statistics released today by the Canadian Real Estate Association (CREA).

Highlights include:

- National home sales fell 0.9% from May to June.
- Actual (not seasonally adjusted) activity came in 5.2% above June 2015.
- The number of newly listed homes rose 2.2% from May to June.
- The MLS® Home Price Index (HPI) rose 13.6% year-over-year in June.
- The national average sale price climbed 11.2% in June from one year ago; net of Greater Toronto and Greater Vancouver, it advanced 8.4% year-over-year.

Sales activity was down from the previous month in about half of all markets in June, with declines in Greater Vancouver, the Fraser Valley and Greater Toronto having eclipsed gains in comparatively less active housing markets.
"While national sales activity remains strong, there are still significant differences in housing market trends across Canada," says CREA President Cliff Iverson. "Home sales activity and price growth are running strong in B.C. and Ontario, [but] they remain subdued in other markets where homebuyers are cautious and uncertain about the outlook for their local economy."
Gregory Klump, CREA's Chief Economist, adds, "June sales extended trends observed the previous month. As was the case in May, the monthly decline in national sales activity was led by the Lower Mainland of British Columbia and by markets in or around the GTA.
"In keeping with the law of supply and demand, exceptionally low inventory combined with high demand continues to translate into strong price growth in these housing markets, where year-over-year price gains have been running in double-digit territory since late last year."
New home supply climbed among a broad majority of all local markets, led by Greater Toronto, Oakville-Milton, Montreal, Quebec City, and B.C.'s Fraser Valley. The return of activity in Fort McMurray following its evacuation in May also contributed to the national increase in new listings.

With sales down and new listings up, the national sales-to-new listings ratio eased to 63.3% in June 2016, compared to 65.3% in May; a sales-to-new listings ratio between 40% and 60% is generally consistent with balanced housing market conditions, with readings below and above this range indicating buyers' and sellers' markets respectively.

Overall, there were 4.6 months of inventory on a national basis at the end of June 2016, which is unchanged from May's reading and the lowest level in more than six years. The number of months of inventory has been trending lower since early 2015, reflecting increasingly tighter housing markets in B.C. and Ontario. It currently sits near or below two months in a number of local markets in British Columbia, the GTA and environs and Southwestern Ontario.

Additional data

- The Aggregate Composite MLS® Benchmark price rose by 13.6% year-over-year to $564,700 in June 2016, the biggest gain since December 2006.
- For the fifth consecutive month, year-over-year price growth accelerated for all Benchmark property types tracked by the index.
- Two-storey single family home prices continued to post the biggest year-over-year gain (+15.5%), followed by one-storey single family homes (+14.0%), townhouse/row units (+13.6%), and apartment units (+9.8%).
- While prices in 9 of the 11 markets tracked by the MLS® HPI posted year-over-year gains in June, price growth continues to vary widely among housing markets.
- Greater Vancouver (+32.1%) and the Fraser Valley (+35.5%) posted the largest year-over-year gains, followed by Greater Toronto (+16.0%), Victoria (+15.7%), and Vancouver Island (+10.6%). By contrast, prices were down -4.1% and -1.4% year-over-year in Calgary and Saskatoon, respectively.
- Home prices gained further traction in Regina (+3.6% year-over-year), Greater Montreal (+1.9% year-over-year), and Ottawa (+1.0% year-over-year). Home prices in Greater Moncton recorded their eleventh consecutive year-over-year gain, rising 7.9%.
- The MLS® Home Price Index (MLS® HPI) provides the best way of gauging price trends because average price trends are prone to being distorted by changes in the mix of sales activity from one month to the next.

- The national average price continues to be pulled upward by sales activity in Greater Vancouver and Greater Toronto, which remain two of Canada's tightest, most active and expensive housing markets. The actual (not seasonally adjusted) national average price for homes sold in June 2016 was $503,301, up 11.2% year-over-year.
- If these two housing markets are excluded from calculations, the average price is a more modest $374,760 and the gain is trimmed to 8.4% year-over-year.

4. Four major trade unions back Energy East pipeline

[July 15, 2016] Four major trade unions have joined forces with TransCanada to push the proposed Energy East oil pipeline.

Those trade unions are the:

- Labourers International Union of North America;
- International Union of Operating Engineers;
- Teamsters Canada; and
- United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry of the United States and Canada.

The alliance, symbolized by a memorandum of understanding signed Thursday, gives the 4,600-kilometre pipeline from Alberta to New Brunswick a rare public relations boost after many months of public protests and highly publicized rejections.

"What we know is that there's a silent majority of folks that understand the need for energy and the need to supply it responsibly," said TransCanada CEO Russ Girling at a trade union training facility in suburban Ottawa.

Union and company representatives say construction and conversion of the oil line, two-thirds of which already exists as a gas pipeline, will support 14,000 jobs annually for almost a decade. Girling expects the pipeline to be operational by late 2019 or early 2020.

The National Energy Board is about to begin a two-year environmental assessment of the $15.7-billion proposal, after which the Liberal cabinet in Ottawa will decide its fate.

In December 2015, The Conference Board of Canada issued a report estimating the 14,000 direct and spin-off job numbers from Energy East, but environmental groups dispute the long-term employment impact.

The advocacy group Environmental Defence issued a press release Thursday saying TransCanada's own projections suggest only 132 permanent and direct jobs from the pipeline will be created in New Brunswick, while 114 will be created in Ontario and 33 in Quebec.

For tradespeople in the pipeline building industry, that's an argument for another day.
Joe Mancinelli, the international vice-president for the Labourers International Union of North America, which hosted the news conference, gave an endorsement of the pipeline. He cited arguments that ranged from skilled trades training and job creation to safety, avoiding another Lac Megantic-like deadly train derailment and displacing imports of foreign oil.
"We are not going to eliminate these fossil fuels from coming out of the ground," says Mancinelli.
An internal Finance Department analysis in December suggested that low global oil prices mean Canada won't need any additional pipeline capacity "until at least 2025." But the sentiment at the union shop Thursday was that oil is going to be transported and it better be by pipeline rather than rail.
Forecasts for oil sands developments that are already underway suggest production will rise by about 300,000 to 500,000 barrels per day by 2020, says Girling. "If we don't build a pipeline, it will get moved by rail."
Girling said Energy East has 20-year contracts with producers and refiners who "see the need for that [oil] five years out and 25 years out and are willing to sign those long-term agreements."
Several speakers at Thursday's news conference stressed the pipeline as a means to get Canada off foreign imports, although Irving Oil has already said it expects to continue importing Saudi oil to its New Brunswick refineries, and much of the Canadian crude is expected to be exported by ship to heavy oil markets abroad.
"We're not going to dictate to our shippers where the oil goes," Girling told reporters when asked about displacing foreign oil.
Economics will determine how Energy East's product is used, said the TransCanada CEO, while wryly noting that "traders try to find a nickel of arbitrage between moving barrels around the globe."
The message, he says, is "build it and we'll see what happens."
The irony that major trade unions—a movement vilified by the former Harper government—are now advocating for major resource infrastructure that was a top priority of the federal Conservatives is not lost on Mancinelli.
In an interview, the union boss laughed off the political paradox. "Let me put it this way: it's vital also to the NDP government in Alberta," Mancinelli said of the pipeline.
"It all depends on what you're after. What we're after is continued jobs for our members, so it's really not a matter of who's in power or who we support politically. It's more to do with the jobs."

5. Don’t compare the booms in Toronto, Vancouver real estate

[July 13, 2016] Home price growth may be double-digits in both Toronto and Vancouver, but that’s where the similarities end, warns Royal LePage president Phil Soper.

“You can’t include Toronto in the same discussion [as] Vancouver, because the situations are dramatically different,” he says.

Compared to this time last year, houses in the Greater Toronto Area rose 10.2%, and Vancouver’s rose 24.6%, while nationwide prices grew 9.2% year-over-year, Royal LePage data shows.

The typical Vancouver home now costs $1.1 million, while in Toronto, it’s $656,000.

Toronto’s growth is still within the realm of a strong market, Soper explains. “Over the long term, with homes in Canada having appreciated over the decades at about 5%, we typically see markets that range from flat to 10%.”.

But Vancouver’s situation is similar to the fast climb in housing prices that Calgary experienced from 2003 to 2005, when housing prices also increased by 30% a year. “What happens is they overshoot, and they tend to move into a period, in Calgary’s case, of a prolonged flat value,” he says.

“Prices in Calgary from 2007 – well before the global financial crisis hit Canada – just weren’t going anywhere. I would suspect that they’re headed for something like that in Vancouver. Rises of 30%-plus, particularly when you already have the most expensive prices in the country, clearly aren’t sustainable.”

By the end of the year, the real estate company projects home prices will increase 12.4% nationwide, compared to the end of 2015. Soper says it’s the biggest increase since at least the early 2000s.

Company economists had predicted a mild slowdown in Toronto and Vancouver home prices toward the end of the year. They expected interest rates to rise by the end of the year, but as that becomes increasingly unlikely, Soper says not to expect any correction.

The federal government, the Bank of Canada and the Office of the Superintendent of Financial Institutions have all expressed concern in recent weeks about the affordability and sustainability, especially in Toronto and Vancouver.

OSFI recently asked banks to take a sober look at their mortgage lending practices, something Soper says institutions are taking seriously.

“My expectation is that significant changes are already happening within our major financial institutions to review and tighten lending standards, [but] not a lot because they were already among the tightest in the developed world.”

He adds the default rate on the riskiest insured mortgages in Canada is low at about 0.3%.

Residents and politicians are concerned wealthy foreign investors who have family or business ties to Canada are the ones pushing up home demand in Vancouver, but Soper says there’s no reliable data to back that up – yet. Governments can gather data on owners, but the task is onerous, says Soper.

“It involves many levels of government – municipal, provincial, federal — and it involves banks and real estate companies,” he says. But until policymakers have the data, “everybody is working with guesses and opinions, and it’s dangerous to make public policy based on tabloid headlines.”

A survey found that 71% of Toronto real estate agents and 74% of those working in Vancouver said that purchases by foreign owners have increased since last year. The agents estimated foreign owners still make up less than 10% of the market in either city.

In the meantime, Vancouver is moving forward with a tax on vacant properties. Soper cautions that while taxation is appealing in a hot market, it’ll eventually be a drag, as investors could add up their tax burden and consider buying a home somewhere else.

If all of Canada were to tax foreign homeowners, he’s concerned other countries would reciprocate. He says the stereotype of a foreign owner right now is someone from China, but many Americans own vacation properties in Whistler, B.C., Mount Tremblant, Que., and Ontario’s Muskoka region. If Canada were to tax them it could provoke American governments to tax snowbirds, he says.

Brexit

Fears that Britain’s withdrawal from the European Union could push up Canadian home prices are overblown, says Soper.

“The speculation that somehow someone who was investing in residential real estate in London would suddenly change their mind and start investing in Toronto is a stretch,” he says. “Most residential real estate investment is related in some way to the owner’s presence in the country.”

In the short term, it’s unlikely large numbers of people living in Britain will pick up their stakes and move to Canada, he says. That may change in the long term, however, if the U.K.’s international image is tarnished. In that case, other developed English-speaking countries like Australia and the U.S. would also stand to benefit from expatriates.

The British decision has encouraged central banks to keep interest rates low. Today, the Bank of Canada said it would be holding its key interest rate at 0.5%, and that it predicts Brexit will shave 0.1% from the Canadian economy. Lower lending rates for longer mean there's no central bank policy in the way of the housing market continuing to heat up.
Residential real estate may not see Brexit-related investment, but there is an opportunity for commercial property.
Canada's commercial real estate could see an immediate boost from Brexit, Soper says, as wealthy investors decide to buy property here instead of the U.K as they wait for Britain's exit negotiations with the EU to be settled.

6. Bank holds rate, says Brexit will trim Canadian growth

[July 13, 2016] The Bank of Canada says the impact of the United Kingdom's vote to leave the European Union could trim Canada's GDP by 0.1% over the next two and a half years.
The central bank assessed the impact of the so-called Brexit vote for the first time as it released today a package of downgraded economic projections for Canada.
In a scheduled announcement, governor Stephen Poloz also left the bank's benchmark interest rate locked at its rock-bottom level of 0.5%, as expected.
The bank also says the effects of the Alberta wildfire that erupted in May, which shuttered key oilsands facilities and led to Fort McMurray's evacuation, shaved 1.1 percentage points from second quarter growth and forced the economy to contract by one per cent.
However, the bank's quarterly monetary policy report predicts the resumption of oil production and rebuilding efforts in the region will boost third-quarter growth by 1.3 percentage points and help the economy expand by 3.5%.
The bank is also lowering its growth projection for this year to 1.3 per cent from its April estimate of 1.7 per cent, saying weaker investment and export outlooks have more than offset the positive effects of the recent rise in oil prices.
Once again, the bank singled out the housing market for concern, writes CIBC economist Nick Exharos in a note to analysts.
"As a counter balance to the more muted growth outlook, the Bank is now using more explicit language on housing vulnerabilities. The statement cites that financial vulnerabilities are 'elevated and rising,' with Vancouver and Toronto singled out," he writes. "That's a significant escalation in language from the last statement, which had mentioned risks 'moving higher.' Although

still-anemic growth rules out [rate] hikes anytime soon, the stance on the housing market clearly sets a high bar to further easing from here."

7. B.C. supports housing vacancy tax in Vancouver

[July 12, 2016] The B.C. government will support the city of Vancouver's request for a tax on vacant housing, but questions remain about who will pay the costs of enforcement.

Finance Minister Mike de Jong has announced the legislature will meet July 25, 2016 to consider revisions to the Vancouver Charter that would allow the city to create and collect the tax.

De Jong says the levy is aimed at improving the supply of rental homes in the city's superheated real estate market, while waiting for new construction to come online.

"There's no question that, in addition to the conversations that we have been having about affordability with respect to the purchasing market, there are challenges for folks wanting to rent," he says at a news conference. "It is ultimately about supply. It is about trying to increase the supply of rental accommodation."

Mayor Gregor Robertson and de Jong met two weeks ago to discuss the city's demand for a tax. At the time, the mayor said if the province wouldn't help, the city would create the levy on its own using existing, but unwieldy mechanisms in the charter.

The finance minister says the province would share data, including electricity usage and information it gathers through a homeowners' grant to help the city identify vacant homes and enforce the tax.

De Jong adds the city would be responsible for day-to-day administration, but Robertson says at a separate news conference that those details hadn't been worked out yet.

"We haven't gotten to the point where we've made decisions around how this is going to be administered," Robertson says.

He notes city and provincial staff will continue to work together and consult with the public and stakeholders to design how the tax works. The city is hoping for a "co-operative arrangement," with a tax in place by next year.

A recent city-commissioned study found that about 10,800 homes were left empty for a year or more, most of them condominiums. The city's rental vacancy rate is 0.6%.

Robertson says it's too early to say how much owners of vacant homes would be taxed. He acknowledges some are so rich that a tax won't be a strong enough incentive to rent out their units. "If people are wealthy enough to hold

these houses empty 12 months of the year, then they should be paying a higher tax. That money can be used for affordable housing."

The tax wouldn't target snowbirds or part-time residents — only people who are keeping homes vacant year-round.

NDP Housing critic David Eby says the province has the tools to levy taxes on people who are using housing as an investment instead of a place to live, but it has refused to do so. "The action they're allegedly taking is, as always, the absolute least that they could do. They're asking the city of Vancouver to do (the province's) job of protecting the interests of Metro Vancouver residents who can't afford to buy a place, simply because they're unwilling to do it themselves."

Eby says he'll have to see what de Jong puts forward in the legislature before he decides whether to support it.

The province is also set to introduce legislative changes to end self-regulation of the real estate industry, fulfilling a promise Premier Christy Clark made last month after a damning report concluded realtors had lost the public trust.

8. Pitfalls with the Principal Residence Exemption

[July 12, 2016] When a person sells her home, thanks to the Principal Residence Exemption, she isn't usually taxed on capital gains. Similarly, if a principal residence is owned when a taxpayer dies, the residence will not attract a tax liability realized from the deemed disposition of assets. But it's not always simple to determine a residence's status for tax purposes.

What's a principal residence?

A principal residence does not have to be the place where the taxpayer normally lives. The property will qualify as a principal residence if the following people live in it at some point during the year:

- the taxpayer,
- the taxpayer's spouse or common-law partner, or
- any of the taxpayer's children.

In many situations, depending on the increase in value of the family home and the family cottage, it may be better to claim a cottage as a principal residence and not the family home.

Further, the property does not necessarily need to be located in Canada. Depending on the facts, a Canadian may designate a foreign vacation property as a principal residence and qualify for the principal residence exemption.

However, there are restrictions. For instance, after 1981, a taxpayer and spouse may only have one principal residence at any particular time. Prior to 1982, each individual could designate one principal residence. Therefore, if a

couple owns both a primary home and a cottage, the principal residence exemption is available for both properties for the period the properties were owned prior to 1982. For each year after 1981, the couple would be required to designate one of the properties a principal residence, claimable at the time a property is sold or deemed sold at death.

Also, if the residence is situated on a lot bigger than half a hectare, the taxpayer must be able to establish that any land over the half hectare is necessary for the "use and enjoyment" of the home.

Although the rules appear straightforward, big properties, certain rental properties and properties purchased to be resold (particularly condominiums) raise specific challenges.

Properties bigger than half a hectare

In 2011, the tax court heard Cassidy v. the Queen. A taxpayer sold a home situated on 2.43 hectares of land. The taxpayer argued that since he was unable to legally subdivide the land, the entire property was necessary for his "use and enjoyment." The court pointed out that the election to treat a home as a principal residence is made on a year-by-year basis. During most of the period, the property could not be subdivided and the court agreed with the taxpayer that the entire property was a principal residence. However, in the final year of ownership, the zoning had changed and allowed for land subdivision. So for that year, only a half hectare of the property could be claimed as a principal residence. The remaining property was subject to tax on the gain in its value during that one-year period.

The takeaway? Make sure you have solid evidence showing that the entire property is necessary, and that the evidence applies to every year you claim the PRE.

Rental property

A property must be occupied for personal as opposed to business or commercial use to be considered a principal residence. This may mean that where a taxpayer uses a portion of the residence to generate income, the taxpayer may lose the principal residence exemption on that portion of the building.

An exception to this rule normally applies if the income-producing use is ancillary to the main use of the property as a residence, there is no structural change to the property, and no capital cost allowance (CCA or depreciation) is claimed on the property. Also, where a residence is rented to a taxpayer's child who occupies the home as his residence, the taxpayer can still normally designate the home as the taxpayer's principal residence.

CRA recently issued an interpretation bulletin where a taxpayer had moved to a long-term seniors' centre, but allowed his child to live in his previous

residence at a below fair market rental. CRA confirmed the taxpayer could designate the property a principal residence for the entire period the child lived in it, pointing out that the definition of principal residence requires the taxpayer, his current or former spouse or common-law partner, or his child to ordinarily live in the house during the year (so, the last criterion was satisfied). Nothing in the definition of principal residence stops the owner from charging rental, below, at, or above market rate to his child.

The takeaway? An elderly taxpayer wishing to retain the family home after moving to an extended living facility is becoming more common. You can continue to rent your home to children without losing out on the principal residence exemption.

Properties purchased for resale

In an effort to take advantage of strong real estate markets, people are flipping properties with the goal of realizing a profit. Often, these people are claiming the property as a principal residence and not claiming a capital gain for tax purposes.

From CRA's perspective, these properties are purchased for resale and any flipping proceeds are considered business income and not capital gains. A short holding period only reinforces CRA's position.

The takeaway? Anybody who flips property should be prepared for the proceeds to be taxed as income, not capital gains.

Condo units

New condominium sales often have three time periods associated with ownership: the period when the building is being constructed, an interim occupancy period and finally the period after the unit's title is actually registered to the owner. Even though the taxpayer has an ownership interest in the unit during all three periods, it is only when actual title registration occurs that CRA considers the condo to be owned by the taxpayer for purposes of claiming the principal residence exemption.

The takeaway? If you sell your condo before being named on the title, the condo is not considered your principal residence and therefore not subject to the exemption.

Conclusion

The principal residence exemption is an important planning tool for Canadians owning property. However, it's key to understand the rules surrounding the exemption to ensure the property meets the definition.

Have a nice and fruitful week!