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PROPERTY REPORT

6.1% Biggest one-week REIT gainer: Royal Host » *CIBC*

18.7% Biggest one-week REIT decliner: Lanesborough » *CIBC*

9.2% Biggest one-week stock gainer: Mainstreet Equity Corp. » *CIBC*

10.9% Biggest one-week stock decliner: Homburg Invest Inc. » *CIBC*

TAXES

Levies on rents a Canadian 'cash cow'

Study shows that taxes on commercial property rents are greater here than anywhere else in the world

STEVE LADURANTAYE
REAL ESTATE REPORTER

Canada is the world's most expensive country in which to own office towers, at least when it comes to how deeply taxes cut into profits.

Taxes on commercial property rents in Canada are a "massive" 53 per cent of total income, according to a study by international tax advisory firm Taxand. The United States, the next highest country on the list, taxes its commercial property rents at 41 per cent.

"The alarmingly high total tax rate in Canada is largely the combined result of high levels of both income tax, which stands at a rate of 30 per cent, and real estate tax at 3.6 per cent," the study concludes.

The study looked at how much tax a landlord pays on the rent payments it receives. That includes value-added taxes such as Canada's goods and services tax, property taxes and corporate income taxes.

Finland charges the least tax on commercial rental income at 8.99 per cent.

Part of the reason for the gap between Canada and other countries is that the Canadian market held up better through the recession. Landlords had easier access to credit, and there were few distressed sales to drive down values.

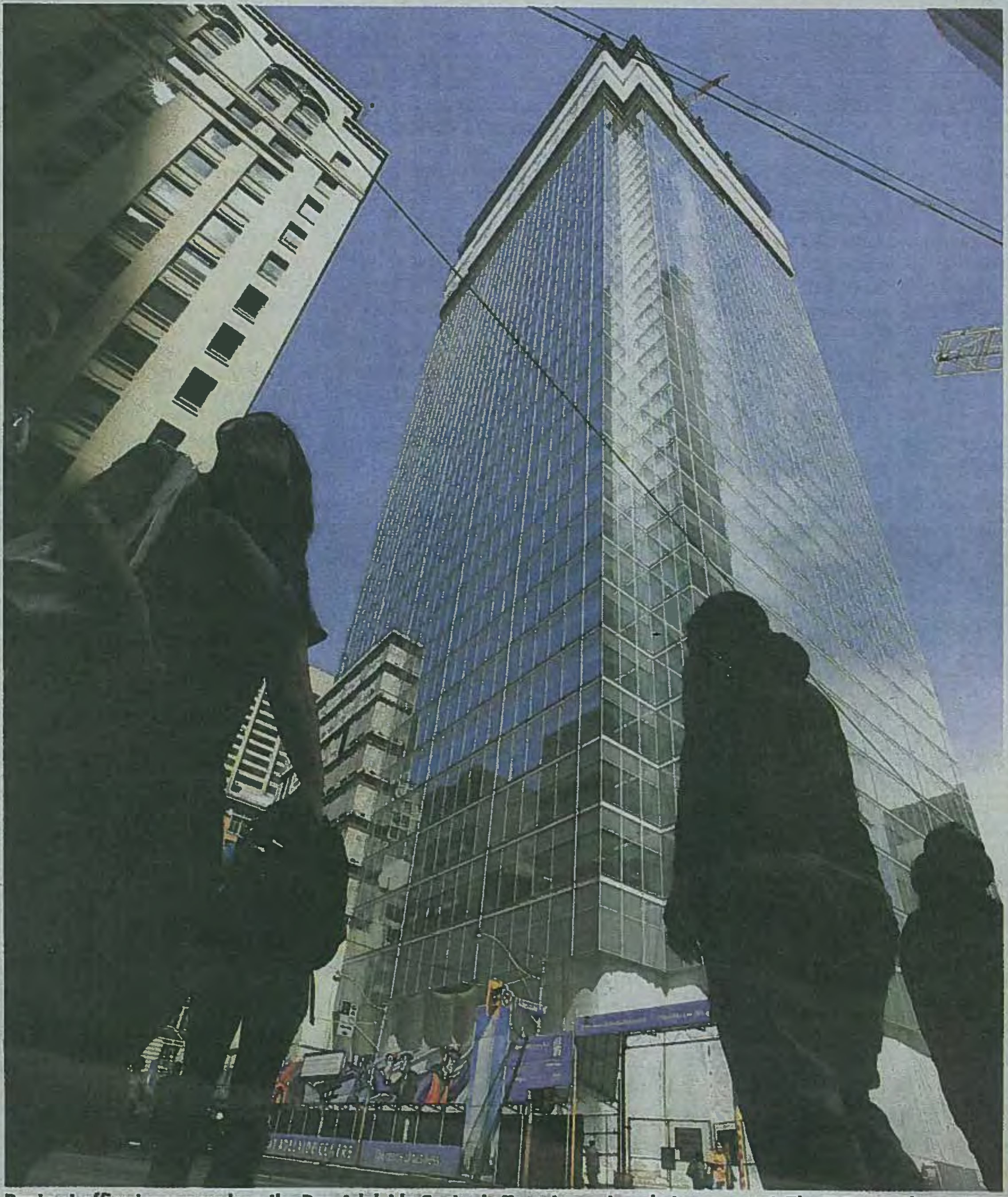
In key cities such as Toronto, vacancy rates didn't decline as much as some had expected, allowing landlords to keep their tenants. With vacancy rates holding steady, the municipalities haven't felt the need to lower tax rates to remain competitive and help landlords hang on to their tenants.

Many countries lowered their taxes – both corporate and property – last year in an attempt to firm up commercial real estate markets. In the Netherlands, the overall taxation rate decreased to 17.67 per cent from 25.67 per cent, with most of the drop coming from changes that allowed landlords to deduct annual depreciation from their income tax base.

Germany also saw a decrease, to 13.7 per cent from 20.66 per cent. Overall, taxes on rents decreased 0.75 per centfrom last year's survey, which did not include Canada.

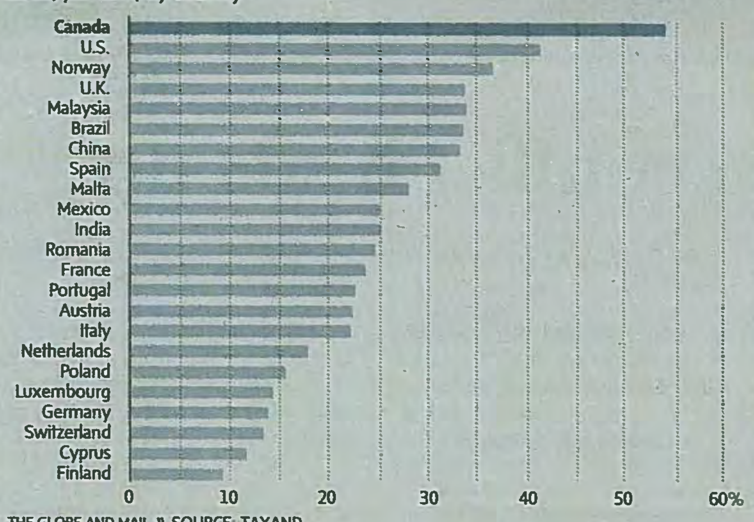
"The overall decrease has undoubtedly prevailed as a result of competition for inward investment in the wake of the global financial crisis," said Keith O'Donnell, Taxand's Luxembourg-based head of real estate.

"Whilst governments will undoubtedly have considered an increase to plug budgetary deficits, authorities are clearly more concerned about the potentially disastrous knock-on effect that could be caused by a depressed property market," Mr. O'Donnell said.



Rents at office towers such as the Bay Adelaide Centre in Toronto are taxed at 53 per cent. The U.S. was the next highest country on the list, at 41 per cent. DEBORAH BAIC/THE GLOBE AND MAIL

TAXES ON COMMERCIAL PROPERTY RENTS
2010, per cent, by country



THE GLOBE AND MAIL » SOURCE: TAXAND

Canadian taxes are higher because local municipalities have relatively few ways to raise money to pay for the services they deliver, said Gerry Divaris, the vice-president and national practice director at Cushman & Wakefield. Because of that, the temptation to raise property taxes – particularly on corporations – can be great.

Property tax rates charged to businesses in Canada are higher than the rates charged to homeowners. For example, in Toronto the property tax on an office tower is 4 per cent while a house is charged at 1.24 per cent.

> *To continue taxing this way is to lose investment to other parts of the world.*
>
> **Gerry Divaris, vice-president and national practice director at Cushman & Wakefield**

"The situation is that these assets are generally seen as cash cows, and the ability of most municipalities to generate new revenue is very limited," Mr. Divaris said.

"This needs to be viewed in light of globalization. We can't afford to tax the heck out of our assets because the folks who want to invest here will see their costs are significantly higher," he said. "To continue taxing this way is to lose investment to other parts of the world."

If municipalities hope to attract real estate investors they need to bring the two rates closer, said CD Howe Institute analyst Ben Dachis, especially because businesses don't tend to reap the benefits of municipal taxes in the same way as homeowners.

"There are very few services that businesses actually receive from municipalities," he said, adding landlords are typically charged user fees for things such as water and sewer services on top of their taxes.

"Most of the services and the education system they fund are for the residents, which only tangentially benefit the employer."

The taxman's sticky fingers don't seem to be hurting the country's investment landscape, however, with the value of commercial property deals set to reach $16-billion by the end of the year, according to Avison Young.

That's $4-billion more than in 2009, powered largely by real estate investment trusts that have been able to raise millions of dollars to invest in office, industrial, retail, land and multi-residential properties.

"This upswing is attributed to a number of factors, including stable and improving market fundamentals, historically low borrowing costs, high availability of debt, a narrowing bid-ask gap and the emergence of REITs as active buyers," said Avison Young's director of research Bill Argeropoulos.

Office sales have accounted for about $2.3-billion of 2010's sales, Mr. Argeropoulos said.