Testimony on H-5597:
An act relating to taxation —
Tax on Gains from the Sale or Exchange of Land

Tom Sgouros, Editor
Rhode Island Policy Reporter

24 April 2007

Honorable Committee Members:

For research for an article in issue 23 of the **Rhode Island Policy Reporter**(January 2007), I analyzed four years of residential property sales in Providence (2002-2006). These are the important findings:

- Property flipping is patchy. Some neighborhoods see very little and some see a lot. This tends to cluster around the borders of "good" neighborhoods.
- Where there is substantial flipping, there is a lot. In Providence's plat 43 (West End, around Cranston Street, Potters Avenue and Dexter Street), about 40% of sales between 2003 and 2006 were within a few months of the purchases. 197 properties there changed hands during the study period, but only 87 of them were involved in 220 sales. The pattern was repeated in other neighborhoods in South Providence and Olneyville.
- Of properties that were resold during the study period, only one in nine had made improvements that changed the assessment.
- City-wide, flipped properties sold for 15-20% more than not-flipped properties. This is a statistically significant finding that shows that flipping is not just investors passively taking advantage of a hot market. Flipped properties become more expensive, helping to create the heat in the market.
- More than 20% of all real estate investment in Providence—one buyer in five—is investment made for short-term gains alone. Projecting statewide, this is around a billion dollars per year. This is a tremendous amount of demand, and removing even a fraction of it while the supply of housing remains roughly constant will cut price inflation.
- The average difference between purchase and sales prices for properties held less than six months was $60,000, or a bit more than 50% of the amount invested.

- Conservative estimates are that around $65 million in gains was earned in each of the study years by selling real estate in Providence that was held less than four years. Statewide, this was likely around $200 million per year in the study years.

Some information about the tax created by H-5597.

- The tax in question is very similar to one that has been in place in Vermont since the 1970's.
- The tax falls most heavily on people who flip the property fastest.
- After six years, there is no tax. For owner-occupied housing, there is no tax.
- Vermont is also undergoing an affordable-housing crisis, but when you look at the actual changes in prices, housing inflation there has been *half* what Rhode Island has experienced.
- The tax in Vermont does not make a lot of money, earning $400,000 to $4 million, depending on the real estate market.
- Vermont's law has quite a number more exemptions than the proposed Rhode Island version, so the tax proposed in H-5597 would bring in more money, but it would still be very sensitive to the vicissitudes of the real estate market, and the unpredictable actions of investors. Next year, for example, it might bring in very little.
- Even so, with the bottom dropped from the market, the tax could bring in $8-10 million. In a good year it could be several times that amount.

Committee members may remember that the run-up in prices in 2001-2006 is only a repeat of a similar episode in the mid-1980's. The important role this tax has to play is to keep the market from heating up to the extent that we've seen over these two episodes. My research has shown that excessive demand by real estate speculators is a major contributor to the rise in real estate prices in Providence between 2002 and 2006, and a major cause of the lack of affordable housing.

According to the Rhode Island Realtors, the size of the real estate market in Rhode Island is over $5 billion a year. $50 million, the size of the affordable housing bond approved last fall, is only one percent of that. By itself, investing this much money cannot possibly affect the overall market. The crisis in affordable housing will not be solved without measures like H-5597 that address the real issues underlying the absurd run-ups in real estate prices we've seen, such as excessive demand from real estate speculators competing for houses with people who are just trying to find an affordable place to live.