ODLUM BROWN REPORT

11 2021

ODLUM BROWN
Investing for Generations®

INSIDE THIS ISSUE

Odlum Brown Limited
Suite 1100 - 250 Howe Street
Vancouver BC V6C 3S9

Main 604 669 1600
Toll Free 1 888 886 3586

Kelowna 250 861 5700
Victoria 250 952 7777
Chilliwack 604 858 2455
Courtenay 250 703 0637
Langley 604 607 7500

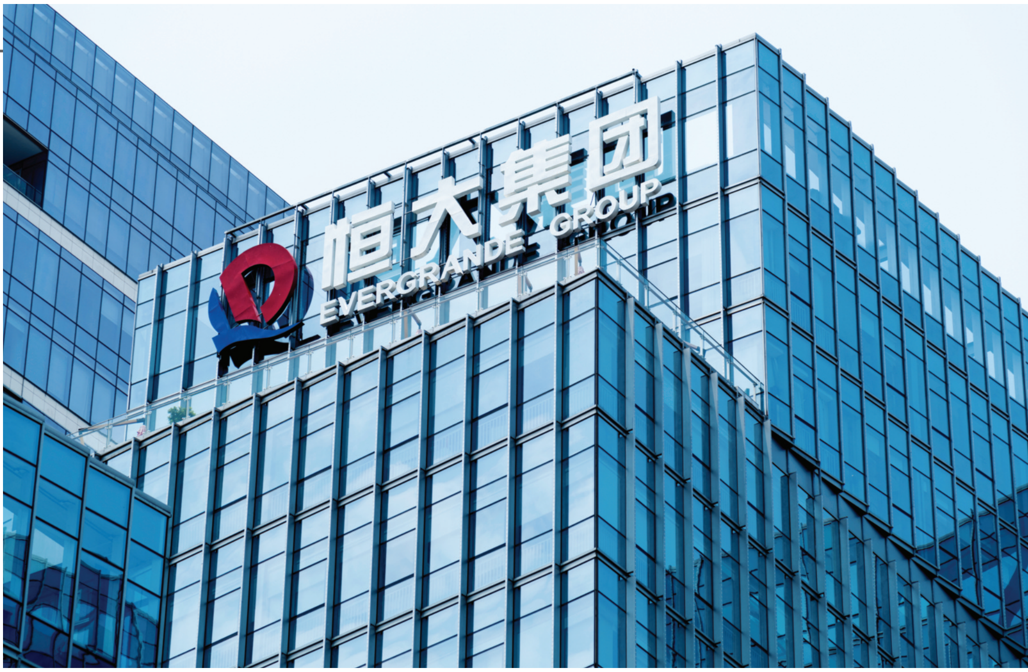
Email information@odlumbrown.com

Odlum Brown Limited

Odlum Brown Community

@Odlum_Brown

OdlumBrown



The Evergrande Fiasco: Short-Term Pain for Long-Term Gain?

In September, shock waves reverberated through global financial markets on news that Evergrande Group, China's second-largest real estate developer, was on the verge of defaulting on its U.S.-dollar bonds. For a brief moment, stock prices all over the world dropped as nervous investors wondered whether Evergrande's collapse would be China's Lehman Brothers moment, and the trigger of a major global financial disaster.

Western media is busy debating whether Evergrande is too big to fail and if the Chinese government will rescue it from creditors. While the jury is still out on that front, investor fear has abated. Stocks have recovered, and most investors have concluded that Evergrande's problems are containable and not likely to create significant collateral damage for China or other global economies. While we don't disagree with the market's assessment, there are important insights, lessons and possible longer-term implications worth considering.

The first thing to appreciate is that there is a material difference between the U.S. government's attitude toward Lehman Brothers prior to its 2008 bankruptcy and Evergrande's recent woes. The U.S. government *wanted* to save Lehman Brothers, yet failed to do so, whereas the Chinese government purposely created the policies that precipitated Evergrande's financial difficulties.

Among other things, the Chinese government is concerned about inequality and excessive leverage and speculation in their real estate market. The issues are related, and they are also common problems in much of the world. Dealing with them will cause economic turbulence in the near term, but a little short-term pain might be the right recipe to build a stronger economic foundation and sustain a brighter future.

To understand the present issues in China, it's important to acknowledge the magnitude of its real estate boom and its significance to their overall economy.

Up until the 1990s, Communist Party rules prevented most Chinese citizens from owning their own homes. That changed in 1998, when the government moved toward private homeownership over the traditional employer-allocated housing model. People were encouraged to buy their homes from government-owned or controlled businesses, which were sold at heavily discounted prices. This created a huge transfer of wealth from the state to its people, seeding the growth in the residential housing market as homeowners reinvested their gains back into the market by buying bigger and better homes. This fueled the mother of all housing booms, with an estimated 95% of urban households owning at least one home by 2019.

Continued on next page

St. Paul's Foundation – Lights of Hope
November/December 2021
Vancouver, BC

For 18 years, Odlum Brown has supported St. Paul's Foundation and Lights of Hope, and we are proud to return as a Silver Sponsor. This year, Odlum Brown team members will also join hundreds of volunteers to build the display at St. Paul's Hospital.

This year's Living Light installation will allow donations to be made directly on site in support of our health care heroes, funding urgently needed equipment, life-saving research, community programs, and other essential patient and resident services.

Since its inception in 1998, Lights of Hope has become a holiday tradition that brings thousands of visitors to St. Paul's Hospital to see the spectacular display, and has raised more than $43.5 million to support the greatest needs of patients, residents and frontline health care workers.

For more information, visit lightsofhope.com.

Indeed, over the last three decades, the massive movement of workers from farms to cities, together with enormous real estate and infrastructure development, helped create China's economic miracle. Real estate spending accounts for 14% of China's GDP today, compared to just 3.5% when the homeownership rules changed in 1998. Factor in all the other activities like home furnishing that are indirectly influenced by construction and it's estimated that real estate-related activities account for 25% of the Chinese economy.

The real estate bonanza has been a virtuous cycle, with rapidly rising home prices driving tremendous wealth creation for developers and citizens alike. Government tax revenues have exploded in lockstep with the expanding economic base, and much of the country's amazing infrastructure has been funded by selling land to developers, who have erected entire cities knowing that the speculative environment makes it easy to sell homes before they are built.

Unfortunately, China's real estate boom, like most, has been fueled by debt. According to the Bank of International Settlements, China accounted for two-thirds of the world's $12 trillion increase in household debt between 2009 and 2019.

We have long worried about the sustainability of the debt-financed building frenzy in China, pointing to ghost cities and empty shopping malls as reasons for concern. But the boom continued, and many of these developments have filled up over time. While booms often last longer than expected, it seems that the Chinese government feels that this one has gone on too long.

It's estimated that 20% of homes in China sit empty, which is massive compared to the less than 1% of U.S. homes that are unoccupied. With the price of the average Chinese home nearly 10 times the average income, housing is a leading contributor to inequality and a considerable source of political unrest.

The Chinese government tried to moderate home price inflation and the associated buildup of financial leverage with regulatory initiatives, including higher down payments, limiting purchases to first-time buyers and restricting demand in some cities to residents only. But, like similar initiatives around the world, they failed. This year, the government changed its focus and implemented policies aimed at limiting developer debt as the primary means of moderating speculation and leverage in the real estate sector. We believe the authorities knew that Evergrande and other highly leveraged developers would be casualties of these policies. Moreover, we think they appreciate that tackling this problem will hamper the country's growth in the near term, but that it is a necessary action to put their country on a healthier and more sustainable growth path.

Rising inequality in the world is our biggest concern, as it stokes social unrest that may ultimately undermine economic progress and the value of investments. While globalization and technology have contributed to rising inequity, we believe well-intentioned yet misplaced monetary policies have been the primary cause of the growing gap between the haves and the have-nots. In recent decades, central banks have responded to each economic crisis with progressively lower interest rates and more and more money printing. The wealthy benefit the most from these policies, as they disproportionately own the real estate and other assets that get inflated by accommodative monetary policies.

These policies have been a boon for investments, yet we worry that they are not sustainable. There is already considerable discontent and political unrest in the world, which will only get worse if central banks continue to flood the economic system with cheap and easy money at every sign of trouble. Moreover, these policies have encouraged greater and greater debt in society, and history teaches us that excessive leverage is ultimately destabilizing.

While China has plenty of policies that we don't support, efforts to moderate debt leverage is a very desirable initiative, in our view. The Western world would be wise to consider doing the same. There is no doubt that lessening societies' appetite for debt will slow economic growth in the near term, but we believe some short-term pain would lead to long-term gain.

MURRAY LEITH, CFA
Executive Vice President and Director, Investment Research
@murrayleith

Planning Tips for Charitable Donations

This month, we are pleased to share 10 tips to help you get the most value from your charitable donations:

1. **By claiming receipts totaling over $200 on a single tax return, you save more tax.** As illustrated in Table 1, the first $200 of charitable donations that are claimed on a single tax return receive a lower tax credit rate than the rate available on the portion of donations above this threshold.

2. **If you and your spouse or common-law partner combine donations on one tax return, you may reach the $200 threshold for a higher donation tax credit sooner.** Donations can be claimed on either spouse's tax return.

3. **Donations made from income subject to the highest marginal tax rate (MTR) receive higher donation tax credit rates.** For example, any portion of donations over $200 that were made from income over $216,511 (federally) and $222,420 (provincially) for a BC taxpayer in 2021 can receive the higher tax credits illustrated in Table 1.

Table 1: 2021 Combined Federal and Provincial Donation Tax Credits

	On the first $200 of donations	On the portion of donations that exceeds $200		Example of the combined tax credits for a $1,000 donation	
		If made from income subject to the		If made from income subject to the	
		Highest MTR	Lower MTR	Highest MTR	Lower MTR
BC	20.06%	53.50%	45.80%	$468.12	$406.52
Alberta	25.00%	54.00%	50.00%	$482.00	$450.00
Ontario	20.05%	44.16%	40.16%	$393.38	$361.38

4. **Donation receipts can be claimed on a current tax return or carried forward up to five years.** Tax credits for donations made in 2021 can be claimed on any tax return from 2021 through 2026. By accumulating and claiming credits for receipts exceeding $200 on a single tax return, more of your donation dollars benefit from the higher tax credit rates.

5. **Consider donating eligible securities[1] "in-kind" from a non-registered account rather than donating cash.** In addition to receiving a donation tax credit based on the market value of your donation, you also benefit from not having to include in your income any capital gains on donations of eligible securities that have appreciated in value.

Table 2: Example of Donating Securities (Assuming BC Marginal Tax Rate of 45.8%)

	Sell shares, donate cash	Donate shares directly
Value of Donation	**$5,000**	**$5,000**
Original Cost of Shares	($3,000)	($3,000)
Capital Gain	$2,000	$2,000
Taxable Capital Gain (50% of Capital Gain or NIL)	$1,000	NIL
Income Tax (before credit)	**$458**	**NIL**
Donation Tax Credit ($200x20.06%) + ($4,800x45.8%)[2]	**($2,239)**	**($2,239)**
Economic Cost of Donation to You	**$3,219**	**$2,761**

As Table 2 illustrates, if you sell the shares and donate the proceeds to an eligible registered charity, you can expect to pay $458 in capital gains taxes and, after receiving donation tax credits of $2,239, your total economic cost is $3,219. If you instead donated the shares directly, your economic cost would be reduced to $2,761.

6. **If you are considering making large gifts, including bequests upon death, seek professional tax advice on how to maximize the tax value of the gifts.** The annual limit that can be claimed, for most types of donations,[3] is 75% of net income for the year, except in the year of death or year before death, when the limit is 100% of net income.

Continued on next page

Consider donating eligible securities[1] "in-kind" from a non-registered account rather than donating cash. In addition to receiving a donation tax credit based on the market value of your donation, you also benefit from not having to include in your income any capital gains on donations of eligible securities that have appreciated in value.

7. **You can name a charity as beneficiary on your registered accounts.** In contrast to making a charitable bequest in your will, designating a charity as beneficiary of a registered account such as an RRSP or TFSA enables a direct transfer from the financial institution holding the accounts to the charity upon your passing, bypassing your estate and probate. You can change the beneficiary designation at any time.

8. **You can donate life insurance.** The three most common ways are:

   i. **Name a charity as the beneficiary** of an existing policy and claim the donation tax credit for the proceeds of the policy upon death. You remain the owner of the policy and can change the beneficiary during your lifetime. Because this arrangement is revocable, you do not receive any donation tax credits during your lifetime.

   ii. **Purchase and donate a new policy** making the charity both owner and beneficiary of the policy. You pay for (and effectively donate) the ongoing premiums and receive a corresponding tax receipt annually. Under this irrevocable arrangement, you do not receive a tax credit for the death benefit ultimately paid to the charity.

   iii. **Transfer the ownership of an existing policy** to a charity with the charity as beneficiary. This may be a good option if you no longer need the policy. As with donating a new policy, you receive annual tax receipts for the premiums you pay to keep the policy in force.

   For transfers of existing policies (iii), a tax receipt may also be available based on the value of the policy at the time of transfer. Consult with your tax and insurance professionals prior to transferring ownership of a life insurance policy.

9. **Consider donating through a Donor Advised Fund.** With a Donor Advised Fund (DAF), you establish a charitable fund by donating cash, securities and, depending on the fund, other assets like real estate, and receive an immediate donation tax receipt. The funds invested within the DAF are tax-exempt and, although irrevocable, you maintain involvement in advising which organizations and projects receive grants over time. For many donors, this arrangement serves as a valuable way to involve and engage family members in their philanthropic vision. Donors may also designate successor advisors to continue after their own death or incapacity.

10. **Consider donating through a public foundation.** This could be done to establish an endowment or to effect more rapid grantmaking, whether during your lifetime or by bequest. Donating through a public foundation is also a practical option if you are considering a bequest to smaller charities that may not withstand the test of time or are undecided how you want to impact your community. By consulting with the public foundation of your choice in advance, you can often direct your bequest to areas of interest without needing to identify specific charities.

If you would like more information on charitable donation options, please ask your Odlum Brown Investment Advisor or Portfolio Manager for our additional charitable donation articles or contact us through your advisor.

MICHAEL EREZ, CPA, CGA, CFP®
Vice President, Director
Odlum Brown Financial Services Limited

DEBBIE STUART, CLU, CHS, TEP
Estate and Insurance Planner
Odlum Brown Financial Services Limited

[1] Examples of eligible securities may include securities listed on prescribed stock exchanges, mutual funds, segregated funds of life insurance companies, and employee stock options that meet other criteria. Please obtain professional income tax advice.
[2] Assumes that the full value of the donation tax credit is claimed on your or your estate's eligible income tax returns.
[3] The annual donation limit may increase to 100% of net income for gifts of ecologically sensitive land to a municipality or certain charity, or for "certified cultural property."

Odlum Brown Financial Services Limited is a wholly owned subsidiary of Odlum Brown Limited offering life insurance products, retirement, estate and financial planning exclusively to Odlum Brown clients.