COUNCIL REPORT

IMPLICATIONS OF ADJUSTMENTS TO RESIDENTIAL TAX RATES AND SUBCLASSES - FURTHER ANALYSIS

RECOMMENDATION

That the February 16, 2022, Financial and Corporate Services report FCS00457, be received for information.

Report Purpose

Information only.

Council is being informed of the implications of eliminating the Other Residential property tax subclass, and potential options for establishing a new density-based residential subclass.

Previous Council/Committee Action

At the March 1, 2021, Executive Committee meeting, the following motion passed:

That Administration further analyze the implications of adjustments to residential tax rates and subclasses, as outlined in options 2 and 3, as outlined in the March 1, 2021, Financial and Corporate Services report FCS00131, and provide a report to Committee.

Executive Summary

- Council has the ability to establish residential subclasses on any basis it considers appropriate, and set different tax rates for each subclass with few restrictions.
- Edmonton currently has one residential subclass called Other Residential, which comprises residential properties with four or more dwelling units on a single title.
- This report analyzes the potential impacts of eliminating the Other Residential subclass, and considers other possible subclasses intended to encourage greater residential density.
- Further guidance is required for Administration to conduct a full analysis of a density-based residential subclass.

Implications of Adjustments to Residential Tax Rates and Subclasses - Further Analysis

- The Other Residential subclass could be effectively eliminated for the 2022 tax year, though Council may wish to consider a longer transition period.
- A density-based subclass could be created for taxation in 2024 at the earliest, though timing would depend on how Council chooses to define the new subclass.

REPORT

At the March 1, 2021 Executive Committee, Administration outlined three options for adjusting residential subclasses and tax rates to reflect density in Financial and Corporate Services report FCS00131, Land Use Density Options - Residential Subclasses Impact. Executive Committee asked for further analysis of option 2 (eliminate the Other Residential subclass) and option 3 (eliminate the Other Residential subclass and establish a new subclass based on density). This report provides further analysis of these two options to support a discussion in the context of the City Plan.

City Council has the ability to set municipal property tax policy within the constraints set out in the *Municipal Government Act*. In particular, Council may establish subclasses of residential property on any basis it considers appropriate. Each subclass can have a different tax rate, as long as the lowest residential rate is not less than 20 per cent of the highest non-residential rate. Tax policy is a tool Council can use to pursue City goals, but it is difficult to specifically target one outcome with tax policy without creating unintended effects. Property tax is a highly regulated tool that is rigid, requires clear definition built into bylaws and is subject to reinterpretation at the Assessment Review Board. As such, Administration generally recommends using other tools first. There are four major reasons for this:

1. **Effectiveness:** Property taxes are usually a relatively small expense compared to the other costs involved in buying, developing and maintaining property, which makes outcomes of property tax policy difficult to identify and measure. If Council uses property tax policy to attempt to affect prices with the intent of changing consumer behaviour, the desired outcomes may not be distinguishable within the effects of broader market conditions.
2. **Definitions:** The implementation of tax policy relies on clear definitions of that which is being taxed. Definitions need to be robust enough to withstand challenges at the Assessment Review Board and in court, or an unfavourable decision could invalidate or undermine a subclass established by Council.
3. **Transparency:** Using tax policy to pursue City goals adds complexity to, and reduces transparency of the assessment and taxation process. This can increase the administrative cost of the property tax system by requiring more information to prepare assessments and assign tax classes, more effort to ensure compliance, and more resources to manage formal complaints and informal inquiries. Increased complexity of property taxes also erodes trust in the City government.
4. **Unintended Consequences:** Tax policy can have unintended consequences. For example, from 1987 to 2000 Calgary maintained a higher multi-residential rate to recognize that

landlords can deduct property taxes as a business expense, but this had the effect of encouraging landlords to condominiumize their properties.

If Council chooses to use property tax policy to incent behaviour, Administration recommends that policy be designed for the long term, since outcomes should be expected to manifest over a long period of time. Administration also recommends avoiding regular changes to tax policy, since frequent changes create an uncertain tax environment which makes it more difficult for people to make decisions in the real estate market.

Planning tax policy for the long term also allows City Council and Administration reasonable time to set, maintain and measure expectations for changes in resident behaviours and outcomes. Important decisions such as where to live, where to buy property, and how to develop property are usually based on complex factors. Establishing an incentive through tax policy may influence some of these factors, but many others are beyond the City's control. Incentives should be understood as an indirect influence on behaviour that make a desired outcome more likely, but do not ensure it.

The City Plan and Density

The City Plan envisions a city of two million people within its current boundary. It sets the strategic direction for the way Edmonton grows, its land use, mobility systems, open spaces, employment and social networks. The City Plan does not define density, but identifies intensification as development at a higher density than currently exists, particularly in support of nodes and corridors, non-residential areas and other locations, aligned with mobility systems and other infrastructure investments. While all areas of the city can be expected to densify over time, deliberate urban intensification will take place within a network of nodes and corridors. The City Plan prepares for and guides the anticipated growth and identifies four levers to enact change and achieve specific city building outcomes. Applying a density-based residential subclass would fall within the Incentives, Pricing and Subsidies and/or Policy levers. The City Plan indicates that each area of growth requires the levers of change to be applied to varying degrees to achieve city building outcomes. In some cases, multiple levers will need to be used at the same time.

The Rebuildable City, Big City Move enables the continuous reimagining and rebuilding of Edmonton through adaptation and responsiveness, while preserving its heritage. This Big City Move has two associated targets: 50 per cent of new units are added through infill city-wide; and 600,000 additional residents are welcomed into the redeveloping area (i.e., inside Anthony Henday Drive). Both targets require that greater residential density occurs within Edmonton's current boundary over time. Through the Growth Management Framework, The City Plan identifies that growth and change will occur citywide and that higher anticipated dwelling unit growth and higher density development will occur at nodes and along corridors through the application of the levers of change, including Infrastructure Investment and Partnerships.

One of The City Plan's policies is to encourage medium and high density residential development that serves households above the average Edmonton household size. Furthermore, policy direction 2.2.1 is to promote compact, mixed use development within districts that supports equitable access to employment, education and amenities.

Other parts of The City Plan address density indirectly. For example, to support the elimination of poverty the City will enable all districts to achieve more income-diverse neighbourhoods and a greater mix of land uses. Greater density is assumed to support directions related to mass transit, the environment, and efficient infrastructure investment. Implementation of The City Plan will couple the expansion of the mass transit network in alignment with nodes and corridors, making more of what Edmontonians need within reach by foot, bike or transit.

Eliminating The “Other Residential” Subclass

The Other Residential subclass comprises properties with four or more dwelling units on a single title. It includes rental accommodations such as fourplexes and high-rise apartments, but excludes condominium buildings with multiple independently-titled units. The Other Residential subclass was created in 1974, the first year Alberta municipalities were legally permitted to set different rates for different types of property. Prior to 1974, single detached houses benefitted from preferential treatment through the assessment process; when this preference was no longer permitted under provincial legislation, the new tax subclass was created partly to maintain this benefit. The tax rate for the new multi-residential subclass was initially set to be the same as non-residential property, which at the time was about 43 per cent higher than general residential property.

Over time, the ratio between Edmonton’s Other Residential tax rate and the general residential tax rate has decreased. Other Residential was taxed about 43 per cent higher from 1974 to 1986, and ranged from 15 to 20 per cent higher from 1988 to 2005. A committee struck by Council recommended in 1998 that the ratio remain at 20 per cent. In 2006, Council began a four year phase-out of the Other Residential tax rate differential, reducing the Other Residential premium to 15 per cent. The phase out was cancelled the following year when rental prices did not decrease in response to the tax rate reduction, and the Other Residential rate differential has remained at 15 per cent since then. Calgary also established a multi-residential rate in 1987, but began phasing it out in 1998 before eliminating it in 2000.

The main argument in favour of a higher tax rate for multi-residential property is that such properties effectively operate as businesses. As such, owners profit from their property and can deduct property taxes from their income taxes. The benefit expense deduction to the property owner varies based on the owner’s circumstances. This same argument is also used to support the larger differential between residential and non-residential tax rates. There are equity-based arguments both for and against the higher Other Residential rate. Since Other Residential properties can earn income for their owners, it may be considered more equitable for them to pay a greater share of taxes, similar to non-residential property owners. On the other hand, property taxes are an operating expense for a rental property and are indirectly passed on to tenants through their rent. Therefore it may be considered inequitable for rental properties to be charged a higher rate because the costs are ultimately borne by renters rather than owners.

Implications of Adjustments to Residential Tax Rates and Subclasses - Further Analysis

Additional considerations with respect to eliminating the Other Residential subclass include:

- The change would reduce taxes for owners of multi-residential properties, but would increase taxes for other residential property owners. Administration estimates that multi-residential property owners would see a 11.7 per cent tax reduction and general residential property owners would see a 1.6 per cent tax increase. This assumes that the ratio between residential and non-residential tax levies is maintained, and that no budget changes are made to fill the estimated $13.9 million revenue shortfall that would otherwise occur.
- Eliminating the subclass may support some forms of density. For example, the change may incent development of new rental apartment buildings, but would not incent development of new condominium buildings with similar density.
- This change could theoretically exert a downward pressure on rental rate growth over the long term. This does not mean that rents will decrease, however, since other factors such as general market conditions have a greater impact on the rental market (this was also corroborated by Edmonton's experience in 2006-2007 referenced previously, though at that time rental apartment vacancy rates were below two per cent, and average rental rates recorded double-digit increases).
- In the short term, this change would likely create a windfall for multi-residential property owners. There would be little incentive to reduce rents in occupied rental accommodations and owners may only feel the need to pass the savings along to renters if they are struggling to fill vacancies.
- Eliminating the Other Residential subclass may impact decisions about whether buildings are operated as rental accommodations or sold as condominiums. The relatively higher rate on multi-residential rental properties compared to similar condominium buildings may create an incentive to condominiumize, and eliminating the subclass may lead to a relatively greater share of rental properties over time. In some cases, building owners have chosen to condominiumize their properties and then manage the condominiums as rental properties to access the lower rate (though the occurrences of this in Edmonton are less clear).

The Other Residential subclass is authorized by Bylaw 19519 - Residential Assessment and Supplementary Subclass Bylaw (passed at the January 25, 2021, City Council meeting), but it is effectively distinguished from the general residential property class by setting a different tax rate for the subclass in the Property Tax and Supplementary Property Tax Bylaw (usually brought forward to Council in April). If Council wished to eliminate the Other Residential rate, it could direct Administration to apply the same tax rate as the general residential rate in 2022, though a phased reduction over several years would result in less abrupt tax shifts.

Eliminating "Other Residential" and Creating a New Density-Based Subclass

Report FCS00131 considered a subclass that attempted to reflect density based on how properties were used. Currently, every property is assigned one or more land use codes as part of the assessment process, and for analysis the codes were divided among those considered to be low density and those considered medium/high density. While land use codes do not map directly to Edmonton's zoning categories, low density properties in this analysis included those found within the RF1 to RF3 zones, representing 68 per cent of the total residential assessment (including some properties currently included in Other Residential). Medium/high density comprised properties usually located in areas zoned RF4 or higher, typically triplexes, row houses and larger buildings.

This approach was brought forward for Committee's consideration because it reflected Administration's assumption of Council's objectives with respect to density, and because the information required to perform the analysis was readily available.

The potential tax impact resulting from this new subclass depends on the degree of differentiation between the tax rates. For individual properties it also depends on whether they are currently included as part of the Other Residential subclass. For example, Administration has estimated the following shifts may occur if the Other Residential rate was eliminated and the low density tax rate was 10 per cent higher than the medium/high density rate.

- Properties in the general residential subclass that would become part of the low density subclass (about 68 per cent of all residential properties) would see a tax increase of nearly five per cent.
- Properties in the general residential subclass that would become part of the medium/high density subclass (about 22 per cent of all residential properties) would see a tax decrease of about five per cent.
- Properties in the Other Residential subclass that become part of the low density subclass (less than one per cent of all residential properties) would see a tax decrease of about nine per cent.
- Properties in the Other Residential subclass that become part of the medium/high density subclass (about 10 per cent of all residential properties) would see a tax decrease of about 17 per cent.

If Council pursues this option, Administration would need to return to Council with a report that proposes a formal definition based on density for the bylaw, and provides a more precise estimate of the resulting tax shifts. The definition must be clear enough that assessors can distinguish which properties belong in each subclass and robust enough to withstand challenges in quasi-judicial and judicial hearings.

The approach analyzed above is one way to incorporate density into residential subclasses, but other approaches are also possible. Subclasses need to be defined based on the physical characteristics of a property such as the number of dwelling units, parcel area, floor area, and height (storeys). For example, subclasses could be structured based on the ratio of dwellings per parcel area, the ratio of floor area per parcel area, or the number of dwellings per parcel. Collecting and maintaining these variables to a sufficient standard will take effort and resources and these would be evaluated in a potential future report.

Any new subclassing approach comes with challenges. There are resource implications for establishing and applying a new subclass, potential risk of unintended consequences, and no guarantee that the subclass will provide the outcomes Council desires. Resource implications would vary depending on the type of subclass that Council chooses to pursue, and would require further analysis to estimate. The primary resource implications are related to reviewing properties to determine which fall within the new subclass, modifying IT systems used to manage assessments and tax accounts, developing and resourcing processes to collect necessary additional data, and defending assessments against complaints based on the new subclass.

A new subclass would be expected to generate a significant number of assessment complaints. Assessment complaints are a normal part of the assessment process and Assessment Review Board decisions will help clarify how assessors should apply the subclass; however, preparing for and participating in hearings consumes considerable staff resources. The City can minimize the required resources by creating a clear and robust definition of any new subclass.

If Council chose to add subclasses, these would be established by bylaw, and the subclass would be applied by assessors through the annual assessment process. Depending on the complexity of the subclass and any requirements for additional data collection or system enhancements, it may take more than one year to complete the categorization of properties. Once the subclass has been applied to properties, Council can set the tax rate via the annual Property Tax and Supplementary Property Tax Bylaw which is generally brought forward in April. If Council establishes a relatively simple density-based subclass in 2022 it may be available for taxation in 2024, but a more complex subclass could require a longer implementation period.

Next Steps

This report is intended to support Council's discussion regarding a density-based residential subclass and the future direction of the existing Other Residential subclass. If Council provides direction to pursue a tax subclass, Administration will develop a subsequent report to propose formal definitions for a subclass. The report will also evaluate the anticipated outcomes and resource requirements associated with the subclass and more specific GBA+ considerations.

The following questions may help guide the discussion:

- Does Council consider the current Other Residential subclass and its 15 per cent rate differential to be equitable and appropriate?
- What does Council hope to achieve with a density-based residential subclass?
- If other tax subclasses were added, what principles should be used to set the subclass tax rate differential?

Budget/Financial Implications

This report assumes that any changes to residential subclasses would be revenue neutral (meaning redistribution of the tax burden would occur across the residential tax class), so there are no budget or financial implications from a policy perspective. Eliminating the Other Residential subclass would also have no budget implications from an operational perspective, but establishing a density-based subclass would have operational considerations depending on how the subclass is structured. These would be analyzed and presented in a subsequent report once direction is established.

Implications of Adjustments to Residential Tax Rates and Subclasses - Further Analysis

Legal Implications

Section 297 of the *Municipal Government Act* allows municipalities to establish residential subclasses on any basis it considers appropriate. Every subclass must be assigned a non-zero tax rate, and no residential subclass may have a tax rate less than 20 per cent of the highest non-residential rate. Despite the broad range of options in creating subclasses, the classification would need to be based on physical characteristics that relate to the property and cannot be created in such a way that is discriminatory. Classifications may be appealed to the Assessment Review Board.

COMMUNITY INSIGHT

No public engagement was undertaken for this report. Administration may conduct more formal engagement if Council wishes to change the current subclass approach.

Owners of multi-residential property are expected to support the elimination of the Other Residential subclass since this would directly lower their operating costs, resulting in a financial gain. Renters would also be expected to support the change in principle, but may grow frustrated if rents are not reduced accordingly. Owners of general residential property may not support the resulting tax increase, though some may be in favour of the City using tools at its disposal to increase density.

According to the 2016 census, about two thirds of people living in the Edmonton Census Metropolitan Area live in a single detached house, which would likely fall into a low density subclass.

GBA+

The GBA+ considerations of this issue relate to the characteristics of people who own or rent the types of property included in existing or potential residential subclasses.

Data availability is limited, but Statistics Canada has recently begun collecting and releasing more information through a new Canadian Housing Statistics Program and new analysis series called Housing Experiences in Canada. The Canadian Housing Statistics Program only has information available for BC, Ontario, Nova Scotia and New Brunswick, but data for other provinces is expected to be available by December 2022. Housing Experiences in Canada provides data at the national level. The analysis presented here is primarily related to the potential elimination of the Other Residential option, and a detailed GBA+ on a density-based subclass will be undertaken in a subsequent report if Council wishes to proceed in that direction.

Administration has no way to link demographic data directly to the properties in Edmonton's general residential and Other Residential subclasses. As such, this GBA+ analysis is based on the demographic characteristics of those who live in owner-occupied dwellings (assumed to represent people most impacted by the general residential tax rate), and those who live in rented accommodations (assumed to represent people whose housing costs are impacted by the Other

Implications of Adjustments to Residential Tax Rates and Subclasses - Further Analysis

Residential tax rate). These groups are used as proxies to illustrate which various sub-population groups may be impacted differently by changes to the Other Residential rate. It is important to remember that changes to the Other Residential rate or subclass may not actually impact rents, so any impact of the Other Residential tax rate on renters is indirect.

According to 2016 census data, 90.6 per cent of households that owned their dwelling in large urban centres in Alberta lived in single-detached or semi-detached houses, row houses, apartments or flats in a duplex, or moveable dwellings. About 59.2 per cent of households that rented their accommodations lived in apartment buildings.

While data is not available at the municipal level, gender does not appear to be a factor in whether people rent or own their accommodations. The Canada Mortgage and Housing Corporation indicated that in Alberta the same percentage (about 76 per cent) of women and men lived in owner-occupied dwellings based on historical federal census data. Statistics Canada data from British Columbia and Ontario (2020) shows that slightly more than half of the properties owned by a single person in each province have a female owner (52.9 per cent in BC, 52.4 per cent in Ontario). Single-owner properties with a female owner have the same median value as those with a male owner. Statistics Canada also found that ownership of multiple residential properties does not vary significantly between women and men.

The Housing Experiences in Canada series shows that 73 per cent of Canadians live in a dwelling owned by a member of the household (owners), while 27 per cent rent their accommodations (renters). While this data is not specific to Edmonton, at the national level property ownership rates are lower among the Black population, recent immigrants, and LGBTQ2+ households and higher among the Chinese population. It is important to note that subpopulation groups overlap. A separate analysis showed that in 2018 people in British Columbia , Ontario or Nova Scotia who owned residential property earned about twice as much income as those who did not own property.