

RESIDENTIAL SUBCLASSES AND OPTIONS FOR 'OTHER RESIDENTIAL' PHASE-OUT

RECOMMENDATION

1. That the February 15, 2023, Financial and Corporate Services report FCS01153, be received for information.
2. That Attachment 3 of the February 15, 2023, Financial and Corporate Services report FCS01153 remain private pursuant to sections 24 (advice from officials) and 27 (privileged information) of the *Freedom of Information and Protection of Privacy Act*.

Requested Council Action	Information only		
ConnectEdmonton's Guiding Principle	ConnectEdmonton Strategic Goals		
CONNECTED This unifies our work to achieve our strategic goals.	Urban Places		
City Plan Values	LIVE. ACCESS.		
City Plan Big City Move(s)	Catalyze and converge	Relationship to Council's Strategic Priorities	15-minute districts Climate adaptation and energy transition Conditions for service success
Corporate Business Plan	Transforming for the future		
Council Policy, Program or Project Relationships	<ul style="list-style-type: none"> • The City Plan • Fiscal Policy for Revenue Generation (C624) • Edmonton Zoning Bylaw 12800 		
Related Council Discussions	<ul style="list-style-type: none"> • FCS00457, Implications of Adjustments to Residential Tax Rates and Subclasses - Further Analysis, Executive Committee, February 16, 2022 • FCS00131, Land Use Density Options - Residential Subclasses Impact, Executive Committee, March 1, 2021 • CR_8022, Options to Adjust Tax Allocation Based on Infrastructure Efficiency, Executive Committee, October 16, 2020 		

Previous Council/Committee Action

At the March 9, 2022, Executive Committee meeting, the following motion passed:

That Administration consult with industry and community stakeholders to develop options to phase out the other residential subclass, as well as, exploring the use of property tax sub-classing to support The City Plan, including possible definitions and information on the effectiveness and considerations associated with property tax sub-classing and return with a report to Committee.

Executive Summary

- Alberta municipalities use a market value system to determine the appropriate distribution of property taxes.
- Classes and subclasses are the foundations of property tax systems and should reflect strategic priorities and objectives to maintain consistency and predictability over time.
- Phasing out the Other Residential subclass would reduce taxes for Other Residential properties by 11.7 per cent and increase taxes on general residential properties by 1.6 per cent, which could be spread over multiple years.
- Subclassing could support The City Plan's focus on higher density through a lower tax rate for denser residential properties.
- Two approaches to defining a density-based subclassing structure have been identified:
 - A Dwelling Count Approach is based on the number of dwellings per unit of land.
 - A Dwelling Density Ratio Approach is based on the ratio of dwellings per land area.
- Administration recommends that Council only consider a density-based subclass if the Other Residential class is first eliminated, along with further public engagement and detailed analysis.

REPORT

Property tax is Edmonton's primary revenue source and is the largest financial interaction between most property owners and their municipal government. As such, municipalities need to manage the impacts of property taxation by ensuring that taxes are distributed fairly among taxpayers, and that the financial incentives created by taxation align with a strategic vision.

Alberta's property tax system determines tax distribution through a market value assessment process. Property value is used to determine the overall share of a budgeted amount required by a municipality from each property owner. Property owners with a greater share of assessment value pay proportionally more than those with less. Adding tax subclasses introduces elements of tax policy into the distribution process, effectively basing tax distribution on something other than share of total property value. Municipalities may change the proportions through subclasses in an effort to address questions of equity, or to incentivize particular property market behaviour. In either case, rationale for changes in distribution should be clear to taxpayers.

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Making changes to the tax system to reflect a municipality's changing priorities can have both positive and negative impacts. A stable tax environment allows people and businesses (including residential property developers) to predict their future costs with greater certainty, which encourages development by reducing risk. The primary purpose of property tax is also to raise the necessary revenues to fund municipal operations equitably, rather than to achieve specific policy outcomes.

The Other Residential Subclass

Edmonton currently has one residential subclass called Other Residential, comprising properties with four or more dwelling units on a single title. This class largely comprises rental properties, ranging from fourplexes to high-rise rental apartment buildings, but notably does not include residential condominiums, because these units are individually titled. Properties in the Other Residential subclass currently pay a 15 per cent higher tax rate than residential properties outside the subclass, such as single detached houses.

City Council first established the Other Residential subclass in 1974¹. In 2023, the broad arguments for and against the subclass are similar to the points presented on either side of the debate in 1974. Property taxes of rental properties are generally recouped from tenants, who have, on average, lower net-worth, so some consider the higher multi-unit rate inequitable. On the other hand, owners of rental apartments usually earn income from these properties and can deduct building operating costs (including property taxes) from their income taxes, so some believe the higher rate is more equitable. While some municipal costs increase as population increases, others scale with geographic factors such as distance. A report prepared for the City as part of The City Plan development² suggests that denser development is more cost-efficient for the City on balance, a finding which is supported by ample research in other jurisdictions.

If Edmonton's Other Residential subclass were eliminated immediately, properties currently in this subclass would see a reduction of about 11.7 per cent on the municipal portion of their property tax bill and properties in the general Residential subclass would see an increase of about 1.6 per cent, based on 2022 tax rates, a shift of \$13.2 million of the tax burden from Other Residential to Residential. Another option is to phase the subclass out over time, as set out in the table below, for example.

Phase Out Period	Annual Municipal Tax Rate Change	
	Other Residential	Residential
None	-11.7%	1.6%
Three Years	-3.9%	0.5%
Five Years	-2.3%	0.3%

The short-term outcome of eliminating the Other Residential subclass would be an increase in taxes for owners of Residential property (mostly single detached houses and condominiums) and a tax decrease for owners of Other Residential properties. It is unlikely that these savings would

¹ Olive Elliot, "Bid to equalize mill rate voted down by council," *The Edmonton Journal*, May 15, 1974, p. 43.

² Hemson, City Plan Growth Scenarios Relative Financial Assessment. February 13, 2020.

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be passed along to tenants through reduced rents (see Attachment 1), because rental rates are primarily dependent on market supply and demand factors. The City has no means of forcing owners to pass along any tax savings. Tax changes would be difficult to discern in the short-term among annual variations in property assessments.

Over the longer-term, a lower tax rate on multi-family apartment buildings may support more investment in these types of properties. Additional investment could mean more construction of rental dwelling units, which may increase the vacancy rate and moderate rents over time. While some industry stakeholders indicated that property taxes are one of their largest expense items, others suggested that decision-making in the sector depends more on other factors such as interest rates and the cost of construction and procurement. A modest shift in property taxes is unlikely to change investment decisions in most cases.

The decision to eliminate the "other residential" subclass is a policy choice. Administration has no significant concerns implementing the change if so desired by Council.

Tax Subclassing and The City Plan

The City Plan identifies four levers of change to support the growth of the city to two million people. One of these is "Incentives, Pricing and Subsidies" (defined as applying a premium to cost or a reduction in cost to support a shared outcome or influence behaviour). Property tax subclassing falls into this category. While tax subclassing can be considered as such a lever, the impacts of shifting the property tax system's strategic foundations would be broad and would manifest over a long period of time. Property tax changes could help achieve long-term strategic shifts, but are not as useful for short-term objectives.

Accommodating two million people within Edmonton's current municipal boundaries, as The City Plan intends, will require greater density of both population and dwelling units. Many elements of The City Plan address density by encouraging, supporting and leveraging it to meet the needs and expectations of Edmontonians. A tax subclassing structure could make the objectives of The City Plan more achievable by reflecting and incenting density, while recognizing that other tools and approaches will be required to achieve specific outcomes. If Council wishes to shift tax policy towards encouraging greater density, a first step would be the elimination of the Other Residential subclass.

Going beyond the equalization of residential tax rates to introduce lower tax rates for higher density development may be motivated by different factors - a high-density subclass could be established to reflect the smaller financial impact of denser development, or to incent denser development in the future. However, the rationale for establishing a new subclassing structure has important implications for how it will be understood and received by the public, and how easily it may be defended if challenged through the courts.

Administration does not consider density-based subclassing alone to be an effective tool to increase residential density. The difference in tax rates between a high-density subclass and a general residential subclass rarely results in different decisions, unless the rate differential is significant or the total investment is large. However, there is ample research³ that suggests

³ Enid Slack, "Municipal Finance and the Pattern of Urban Growth", *C.D. Howe Commentary*, No. 160, February 2002.

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denser development is more efficient from a municipal finance perspective, including the Edmonton-specific Hemson report cited earlier. A high-density subclass may be more readily explained and defended if the stated rationale is to make property tax more equitably reflect municipal costs, as compared to a high-density subclass intended to encourage denser development.

Density Subclasses

Administration has identified two approaches for creating a new residential subclassing structure based on density: Dwelling Count and Dwelling Density Ratio. Each approach would require several subsequent decisions, such as:

- the number of subclasses to be created,
- the thresholds that would define each subclass,
- and the treatment of certain property types such as mixed-use properties, mobile homes and stratas.

Attachment 2 presents a hypothetical illustration of how each approach could be implemented,, Administration recommends that Council consider whether it wishes to proceed with either of these general approaches before finalizing a new subclassing structure. If Council states its objectives and supports a broad approach, Administration will be better able to undertake the public engagement, data collection and policy analysis required to inform and support the subsequent decisions needed to complete development of a new subclassing structure.

Dwelling Count Approach

A Dwelling Count approach would divide the residential class into subclasses depending on the number of dwellings located on each unit of land, which would be defined as a titled lot for most properties, the area of a condominium plan for condominiums and individual units for bare land condominiums. A property may be considered part of a 'high-density' subclass if there are more than a certain number of dwellings associated with the unit of land on which the property is located.

This approach is similar to the current Other Residential subclass structure, with the primary difference being the inclusion of condominiums. While the Other Residential subclass excludes condominium developments, because each unit is on a separate title, the dwelling count approach would include them, because each unit shares a single parcel of land. Bareland condominium units, where land is divided into separate condominium units that can be built upon, would continue to be considered separate parcels. This approach does not directly reflect density because it does not consider the amount of land occupied by the property, but it would provide a reasonable proxy.

Dwelling Density Ratio Approach

In a Dwelling Density Ratio approach, the residential class would be divided into two or more subclasses based on each property's dwelling density ratio: the number of legal dwellings on a property divided by the size of the land it occupies. The ratio would be calculated for every residential property in the City, and subclasses would be defined as a range of values within which the dwelling density ratio would fall. This approach acknowledges that properties with the

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same number of dwellings may have very different densities depending on the amount of land they occupy. The graphic below provides examples of how the dwelling density ratio would be calculated.



This approach provides Council flexibility to decide what it considers to be meaningful levels of dwelling density for the purpose of setting tax rates. Since this approach is based directly on density, it means that similar building types may be placed into different subclasses depending on the amount of land each building occupies.

Comparison of Approaches

The two approaches are similar in some respects, but they have different implications.

- The dwelling count approach does not require any calculations, and is more straightforward for property owners to understand.
- The dwelling count approach does not directly reflect density because it does not include the land area. In some cases, properties in a 'high-density' subclass defined under this approach may have fewer dwellings per land area than properties in the general residential subclass. This issue could likely be mitigated by additional criteria (e.g., excluding single detached properties).
- The dwelling density ratio approach would take more administrative effort to establish and maintain, and would have higher administrative risk because the number of dwellings would be critical information for every residential property in the City. By contrast, the dwelling count approach only requires a precise dwelling count for properties near the threshold.

Both approaches create an incentive for denser development, though the impact is not expected to be significant. The two approaches may also create different secondary incentives:

- The dwelling count approach could potentially incent new single family development to condominiumize to access the 'high density' tax rate without impacting density.

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- The dwelling density ratio approach could potentially incent more dwelling units in a development, which could mean smaller dwelling units, fewer family-sized units, and less green space around apartment buildings.

If Council wishes to proceed with density-based subclassing, Administration will perform further analysis to determine the most cost-effective and equitable approach.

Next Steps

The mechanics of phasing out the Other Residential subclass are straightforward. Administration could be directed to bring forward annual tax rate bylaws that align the Other Residential and Residential tax rates immediately or over a defined number of years, which could start as soon as 2023. After the rates have been equalized, Administration would bring forward amendments to Bylaw 19519 - Residential Assessment and Supplementary Assessment Subclass Bylaw to formally eliminate the Other Residential subclass. No additional administrative effort or resources would be required. If Council decides to eliminate the Other Residential subclass, Administration recommends that it be phased out over a period of three years to spread out the resulting increase for residential taxpayers.

If Council wishes to pursue a new subclass structure, Administration recommends that consideration is given to ensure that the new subclassing structure supports the City's long-term strategic objectives. This would allow the City to commit to the new structure for an extended period, providing certainty for residents and businesses. Administration recommends the following actions before any potential implementation of a density-based subclass:

- Administration confirms and enhances existing data on dwellings to prepare more robust analysis of potential implications of the subclass approach preferred by Council.
- Administration conducts significant public engagement to build awareness, assess public support, inform subsequent decisions and identify unintended consequences.
- Administration provides the results of the engagement and analysis, and options to support subsequent decisions that would define the particulars of the subclass structure in a subsequent Council report. These would be formalized in amendments to the residential subclass bylaw (Bylaw 19519).
- The City phase in any new subclassing structure via a schedule of gradual changes to the tax rate differentials, allowing time for residents and businesses to adjust to the new structure.

Budget/Financial Implications

Changing Edmonton's residential tax subclassing structure would be revenue neutral from the City's tax collection perspective. However, a change like this will impact all residential property owners and Administration believes a comprehensive engagement and communications approach will be necessary. The plan and budget for such an engagement have not been developed yet. Based on Council's direction, Administration will return to Council with any potential costs to execute this plan.

A new subclassing structure would incur administrative costs to develop the systems and processes to support it, but these costs would be presented in a subsequent report.

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Establishing new subclasses and setting differentiated tax rates will require additional investment in the Taxation, Assessment and Collections System (TACS), the information management application that underpins the City's property tax and assessment system. The preliminary, high-level estimate is that this work will require an investment of up to \$300,000 and could take up to about 21 months to complete, though more detailed business requirement identification and project scoping is needed to determine a more accurate estimate. Another important consideration is the many concurrent projects planned or underway to enhance aspects of TACS such as the Clean Energy Improvement Program (CEIP), as well as TACS Transformation, which was funded in the 2023-2026 capital budget. Since these projects require the same limited staff resources, this may impact how quickly the system can be enhanced to support new or additional subclasses.

Legal Implications

The elimination of the existing residential subclass is solely at the discretion of Council. The creation of new residential class subclasses is possible, but must be done in accordance with the requirements of the *Municipal Government Act* and associated caselaw. Generally there are a number of general rules that should be followed when creating a new subclass:

1. The subclass cannot be created for an improper purpose.
2. The subclass cannot be discriminatory.
3. The legislation requires a subclass to be a division of the class.
4. A subclass cannot be defined in a way that is legally vague.
5. The definition of the subclass cannot be delegated outside the bylaw.

Private Attachment 3 outlines the legal requirements involved in the creation of a new residential subclass in greater detail.

COMMUNITY INSIGHT

Administration conducted research and engagement in the summer and fall of 2022 with industry and community stakeholders to gather thoughts and perspectives on a potential phase-out of the Other Residential subclass, including potential timelines, and explore possibilities for subclassing to support policy objectives in The City Plan. This involved the use of multiple channels as shown below.

Method	Date	Number of Participants	Purpose
Edmonton Insight Community Survey	August 9 - 15, 2022	3,739 Respondents	Feedback from the broader public
Engaged Edmonton Page	September 19 to October 17, 2022	480 total visitors	Feedback from the broader public
Virtual Industry Event - By Invitation	October 7, 2022	10	Feedback from pertinent industry stakeholders (e.g., developers, major owners / landlords)

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Virtual Community Events (2)	October 17 and 19, 2022	20	Feedback from interested and impacted community stakeholders
Total		4,239	

A summary of the engagement results is included in Attachment 1.

Key themes emerging from the research and engagement include:

- Property tax subclassing is complex and many respondents felt they did not have enough background knowledge to provide informed responses. Some recommended broader engagement to ensure that the public is fully aware of and engaged in an issue with such a widespread impact.
- The tax subclassing structure should reflect the municipal costs incurred by different types of residential property. However, the survey responses indicate there are two contradictory perspectives about how residential property types impact municipal costs:
 - Properties that house more people incur higher costs for the City, because municipal costs increase as population increases. Therefore properties that house more people should pay higher taxes.
 - Properties that house more people incur less cost for the City, because municipal costs primarily scale with geography (e.g., amount of land occupied or distance from City core). Therefore properties that house more people should pay lower taxes.
- Except for the participants in the Virtual Industry Event, there was an aversion to reducing taxes for owners of Other Residential properties. Through all engagement channels, there was also skepticism that it would result in reduced rents.

While the results are mixed, overall community survey respondents supported a relatively higher tax rate for multi-family properties, particularly because owners of these properties earn income and receive income tax benefits. Most did not support eliminating the Other Residential subclass, but if it is eliminated they would prefer it be phased out over time (commonly three years). Members of the development and real estate industry favoured eliminating the Other Residential subclass immediately, suggesting that it would help spur investment in residential real estate. These stakeholders also agreed that eliminating the Other Residential subclass would not result in lower rents.

The engagement asked about subclassing in general terms to gauge support for using tax policies to ensure taxes are distributed fairly (equity) and to achieve policy objectives (financial incentives). More than half (51 per cent) of survey respondents agreed it is somewhat or very appropriate to use tax subclassing to change tax distribution (equity), while 39 per cent agreed it is somewhat or very appropriate to use tax subclassing to pursue policy objectives such as those set out in The City Plan (financial incentives). A subclassing structure intended to address fairness and equity may receive more public support than a structure intended to create financial incentives in pursuit of policy objectives.

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GBA+

This analysis is focused on the potential equity impacts associated with eliminating the Other Residential subclass. The equity dimensions of a potential density-based subclassing structure would be investigated in more depth in a subsequent report when an intended policy direction is set by Council.

The impacts of eliminating the Other Residential subclass relate primarily to the demographic characteristics of people who own or rent properties in this subclass versus property owners in the general Residential subclass. Administration is not able to link demographic data directly to properties. As such, this GBA+ 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 Residential tax rate). As noted earlier in this report, changes to the Other Residential rate or subclass may not impact rents, so any impact of the Other Residential tax rate on renters is likely indirect.

According to the 2021 census, in the Edmonton region (Census Metropolitan Area), about 69 per cent of households own their accommodations and about 31 per cent rent⁴. Statistics Canada data also shows that households that rent their accommodations are more likely to be financially vulnerable than those that own. For example, renter households (36 per cent) are more than twice as likely as owner households (16 per cent) to spend at least 30 per cent of their income on shelter costs. Across Canada, the average net worth of an owner household is nearly \$1.3 million, while the average net worth of a renter household is about \$252,000⁵.

While local information is not available, data at the national level from 2018 shows significant differences among home ownership rates of different population groups. While about 69 per cent of households across Canada own their accommodations (the same proportion as in Edmonton), home ownership rates are lower than the average among Indigenous people, recent immigrants, the LGBTQ2+ population, and the Black population, among others. Home ownership rates are higher than the average among the Chinese, Southeast Asian, and Japanese populations, and among seniors and veterans.

ATTACHMENTS

1. Summary of Research and Engagement Results
2. Density Subclassing Scenarios
3. Legal Analysis of Residential Subclasses (PRIVATE)

⁴ Statistics Canada. Table 98-10-0252-01 Shelter-cost-to-income ratio by tenure: Canada, provinces and territories, census metropolitan areas and census agglomerations: doi.org/10.25318/9810025201-eng

⁵ Statistics Canada. Table 36-10-0660-01 Distributions of household economic accounts, wealth, by characteristic, Canada, quarterly (x 1,000,000): doi.org/10.25318/3610066001-eng