COUNCIL
REPORT

Edmonton

DOWNTOWN RESIDENTIAL DEVELOPMENT PROPERTY TAX OPTIONS

Recommendation

That the March 20, 2024, Urban Planning and Economy report UPE02198, be received for information.

Requested 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	THRIVE		
City Plan Big City Move(s)	A Rebuildable City Catalyze and Converge	**Relationship to Council's Strategic Priorities**	15-minute Districts Economic Growth
Corporate Business Plan	Transforming for the Future		
Council Policy, Program or Project Relationships	• Policy C625A 2021 Edmonton Economic Recovery Construction Grant Incentive Policy • Downtown Vibrancy Strategy		
Related Council Discussions	• June 15, 2022, Urban Planning and Economy report UPE00847, Update on 2021 Edmonton Economic Incentive Construction Grant Program • October 31, 2023 Urban Planning and Economy report UPE01836 Downtown Community Revitalization Levy (CRL) Financial Incentives Funding Program • October 31, 2023 Urban Planning and Economy report UPE01864 Office Tower Conversions • March 20, 2024 Urban Planning and Economy Report UPE02298 Residential Incentive Program Options		

Previous Council/Committee Action

At the October 31, 2023, Urban Planning Committee, the following motion passed:

That Administration provide a report outlining options and impacts for a program that freezes property taxes for a defined timeframe for new residential construction or office conversions in downtown Edmonton.

Executive Summary

- Administration considered stakeholder input, economic impact and forecast data and financial risks and determined that economic conditions do not warrant a grant program for new residential construction or office conversions.
- Industry stakeholders indicated that tax freeze programs and programs that mimic a tax freeze are less desirable than a lump sum program, and stakeholder input suggests that a financial incentive grant structured to mimic a freeze of property tax would spur residential development in the near term only if it was in effect for a period of 10-15 years.
- Municipalities in Alberta are not able to freeze future property taxes on residential properties, however a similar effect can be achieved through a grant program.
- If Council wishes to proceed with a grant program equivalent to a tax freeze, Administration proposes that it be paid out annually as a rebate of the uplift in municipal property taxes, until the cumulative amount paid reaches $40 per square foot.
- A program budget of $33.6 million would be sufficient to fund approximately 1,000 units.

REPORT

Residential development is one of the critical elements in creating a vibrant Downtown and is highlighted as a primary goal of the Capital City Downtown Plan and Downtown Vibrancy Strategy. Downtown Edmonton is central to the vision of the City Plan as an attractive place that is easily accessible to all and one that supports and grows economic, cultural, institutional and residential prosperity. A growing residential population Downtown supports local businesses, contributes to activity outside of traditional working hours, and improves utilization of public and active transportation for daily activities. However, residential development is currently challenging, as construction and financing costs have increased significantly, and while downtown residential rents have increased, they have not yet offset the increase in costs.

The *Municipal Government Act* does not allow municipalities to cancel or freeze future property taxes of residential properties. The City can cancel property taxes (or a portion thereof) on an annual basis and only for the current or previous years. Alternatively, the City can pay grants to property owners that offset some or all of their property taxes, and commit to these grant payments for a number of years, effectively resulting in the monetary equivalent of a property tax freeze.

Cancellation of Municipal Property Taxes

A true tax freeze program, where the municipal property taxes owed by a property are reduced to a baseline amount would only be possible with annual consent from Council to cancel any increase in property taxes assessed that year. When Administration spoke with internal and external stakeholders several issues arose. First, financiers would not consider the tax freeze when investing in projects as any future Council could choose to not renew the freeze. Second, because the amount is unknown in advance, and becomes increasingly difficult to project in later years, the value of the incentive in today's dollars can not be calculated accurately. Taken together, stakeholders indicated that a tax freeze would only help with operating costs, and while that is beneficial for the property owner post construction, in most cases it would not create enough of an incentive to start a project. For these reasons, there would be significant barriers to a true tax freeze program.

Tax Freeze Equivalent Grant Program

A potential grant program could mimic a property tax freeze by providing an annual grant payment equivalent to the increase in property taxes above a baseline value for a number of years. The 2021 Edmonton Economic Recovery Construction Grant Incentive program is an example of this kind of grant program (Attachment 1). Some financiers may view a grant program more favourably than a tax freeze as it is a binding contract with the City, this may make residential rental development more financially viable and may encourage some developers to proceed with construction. However, for most developers, it is not as attractive as a grant that is paid at occupancy, as it does not reduce the amount of capital the developer needs to put into the project. It can also be difficult for financiers to accurately estimate a property tax grant when evaluating the cost of a development.

The development environment today is more challenging than in 2021. Most stakeholders engaged for this report indicated that a tax freeze grant would need to be in the 10-15 year range in order to influence development decisions. Based on current assessment estimates, this equates to approximately $40 per square foot.

Should Council direct the creation of a grant program to achieve the equivalent of a tax freeze, Administration would establish a fixed total grant amount of $40 dollars per square foot of new residential space developed, and pay it out as a "tax freeze" grant over time. This approach was designed in collaboration with stakeholders. The maximum grant obligation would be known and a contingency fund for future grant obligations would not be required. The unknown variable would be the number of years that the grant is paid, which would vary depending on the particular project. This structure may also be beneficial for developers in their interaction with financiers, who could depend on receiving a grant amount that is fixed in advance. Attachment 2 provides a draft Council policy that would allow the implementation of the grant program to offset property tax based on assessment uplift.

Successful applicants would receive an annual grant that would be equal to the value of municipal tax increases for a period of years, until the cumulative grant payments reach $40 per square foot of new residential development. A maximum grant period of 25 years would also be implemented. Municipal taxes would still apply, but a grant would offset the municipal taxes levied. Education taxes would not be offset under this program.

For example, a hypothetical high-rise residential building with 210,000 square feet of residential space could receive a maximum $8.4 million in grant payments (210,000 square feet x $40 per square foot). Each year it would receive a grant payment equivalent to the uplift in property taxes above the baseline year, up to a maximum of $8.4 million. Administration estimates that the maximum would be reached in approximately 13 years, although the actual number of years would depend on the particulars of the building, future market values, and future tax rates. Additional details of this calculation are available on page 9 of Attachment 3.

An alternative approach would be to provide a tax freeze grant based upon a set number of years. The drawback of this format is that the total amount of the grant is unknown at the outset. It is not possible to accurately estimate market value changes and tax rates (and therefore the future grant payment amounts) a decade or more into the future. As a result, the City would need to set aside or plan for a substantial contingency amount to cover grant obligations, should they exceed initial estimates.

Although a grant worth $40 per square foot amount is approximately the same as a 10-15 year tax freeze, it is less than the $75-100 per square foot amount requested by stakeholders during engagement for the October 31, 2023 Urban Planning and Economy reports UPE01864, Office Tower Conversions and UPE01836, Downtown Community Revitalization Levy (CRL) Financial Incentives Funding Program.

If Council wishes to proceed with a “tax freeze” equivalent grant program, Administration proposes the following program criteria identified in the accompanying draft program guide (Attachment 3).

The Downtown Priority Growth area is proposed as a program boundary, but an alternative would be to use a smaller, targeted area, such as the Central Warehouse area[1]. This would encourage a clustering of new development, which could create a greater concentration of activity compared to development that is dispersed across Downtown. However, it would limit the potential uptake of the grant by limiting the number of eligible applicants.

<u>Lump Sum Grant</u>

A third option for an incentive program would be an up to $40 per square foot grant paid at occupancy to the developer. This is the simplest option as it allows the developers to obtain financing through current well understood and accepted procedures, and it clearly gives developers and financiers a specific amount to factor into their proformas. This is the preferred option as expressed by stakeholders, including industry groups, lenders and developers. This option would also apply equally to potential office conversions, where an incentive tied to property tax would not.

Should Council determine to create a paid at occupancy lump sum residential grant program, Administration would implement the program as a competitive process, where applicants identify the amount of financial incentive that they require (up to a maximum amount of $40 per square foot). Administration would establish a fixed application window and total budget followed by an evaluation process. Administration would evaluate all proposals on the basis of minimum criteria – project viability and readiness, Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) documentation, submission of a development permit application – and then evaluate

[1] As defined in the Capital City Downtown Plan (Bylaw 15200), the Central Warehouse area is approximately bounded by 104 Avenue on the north, 109 Street on the west, Jasper Avenue on the south and 104 Street on the east.

the eligible applications based on established criteria, weighted heavily toward projects that require the least amount of incentive on a per-square-foot basis. Administration would enter into grant agreements until all available funding is allocated. City funds would go toward those projects which need the least incentive and are closest to market viability. This would maximize the amount of residential development that occurs as a result of the City's investment. The draft Residential Incentive Program Guidelines use a market-driven approach meaning the types of units developed are determined by the market. Should Council prefer to focus on specific outcomes or unit types, this can be included in the program guidelines.

If the priority outcome of this program is to accelerate residential development Downtown, Administration proposes that the evaluation criteria be heavily weighted towards cost (lowest grant dollars per square foot). Non-financial criteria could also provide a portion of weighting. Administration would leverage already established programs like Canada Mortgage and Housing Corporation's (CMHC) MLI Select program, which award 'points' based on affordability, accessibility and energy efficiency. Using CMHC criteria reduces the administrative burden on applicants and the City and uses a third-party standard of non-financial criteria to ensure impartiality in grant evaluation.

If Council wishes to proceed with an "at occupancy" residential incentive, Administration would take the following approach:

1) Identify a funding source and establish a budget for a residential grant program at the 2024 Fall Supplemental Operating Budget Adjustment, including resources to assist in program administration.
2) Approve a grant policy/program guide that Administration would prepare in conjunction with the 2024 Fall Supplemental Operating Budget Adjustment.
3) Invite and evaluate grant submissions, and enter into grant agreements with successful proponents.

<u>Incentive Program Risks</u>

Development incentive programs can have other effects on the market, which could include diverting investment from other areas. For instance, a Downtown incentive program might attract investment to Downtown that would have otherwise occurred elsewhere in the Central District without an incentive. Also, the developments that receive funding through an incentive program may have been built eventually without an incentive, meaning that an incentive might only accelerate development rather than increase the volume of development that occurs over the long term. It is also possible that development conditions become more challenging and an incentive program in the future could be more costly to implement.

Office Conversions

Projects that convert office space to residential generate much less municipal property tax uplift than new construction, due to the value of the existing building being taxed based on non-residential tax rates, which are higher than residential tax rates. As a result, a tax freeze equivalent grant would be a less powerful incentive for office conversion projects, compared to a lump sum grant paid at occupancy. Office conversions may contribute to the health of the office market more broadly, due to the decrease in the supply of vacant office space. This would not result in any additional property tax revenue, but could shift some tax burden back to the remaining Downtown office buildings and away from other commercial properties located elsewhere in the city. This assumes a reduced market supply of office space also reduces vacancies in remaining office buildings, resulting in a market value increase for those buildings.

Program Cost

A program budget of $33.6 million could fund 840,000 square feet of residential development at $40 per square foot, which is approximately equivalent to 1,000 units. This would increase the number of residential units Downtown by approximately nine per cent. If the CRL-funded incentive program discussed in the report UPE02298 were to also proceed, Administration would suggest that this program budget be scaled down accordingly. These estimates do not consider any administrative costs for the program.

Administration would support projects that meet the location and impact criteria for any permitting requirements (e.g., Development Permit or Building Permit), and would provide coordination to secure predictable and negotiated project timelines.

Budget/Financial Implications

Each year, new construction, property upzoning, subdivisions and exemption changes affect the value of properties. These kinds of changes in value are labeled as “real growth” and are distinguished from market value changes. Market value changes, effectively how a property value changes due to market forces (supply and demand), do not affect City revenues. However, “real growth” does increase City revenues.

In a given budget year, the City accounts for all expenses and revenues in order to determine the needed property tax increase. Before applying a property tax increase, an estimate of “real growth” revenue is assumed in the base budget. Between 2019 and 2023, growth has accounted for an average revenue increase of $30.8 million annually. Effectively, this means growth revenue has offset the tax levy increase by under two per cent per year. When growth revenue is forgone through a tax relief program, the gap between revenue and expenditures increases, causing a needed increase to the tax levy.

The goal of this grant is to incentivize development that would not proceed without support. However, it is difficult to prove that such incentive programs affect development outcomes. Growth is primarily driven by market conditions (supply and demand). It is difficult to incentivize a development based upon property taxes if market conditions would not sustain it in the long term.

As stated, if Council wishes to create a residential incentive program, a program budget of $33.6 million would fund approximately 1000 units. If funded through a tax increase, an ongoing increase of 0.16 per cent beginning in 2025 for 10 years would be required for a tax freeze equivalent grant program as the payments would occur over a greater period of time. Alternatively, a lump sum paid at occupancy program would require a one-time tax increase of 1.6 per cent in 2025 to achieve approximately $33.6 million.

Next Steps

Administration has considered stakeholder input, economic impact and financial risks in developing the possible programs outlined above, but would require Committee/Council direction to proceed. If Executive Committee wishes to initiate a downtown residential incentive program beginning in 2024, Committee and Council direction would be required.

Legal Implications

There are three legislative mechanisms that would allow economic incentives to offset taxation. First, Section 364.2 of the *Municipal Government Act* (MGA) allows Council to pass a bylaw that provides for tax exemptions for non-residential property. This exemption can apply to future years. A bylaw under section 364.2 cannot apply to residential class properties. Second, a grant program could be set up to offset taxes associated with assessment uplift. Such a grant program would have to be funded through the budget process. Third, Section 347 of the MGA allows Council to cancel or refund an existing tax. While this can apply to both residential and non-residential class properties, the cancellation can only be done once the tax is charged and is therefore a yearly process.

Of the three legal options, all three have the same financial implications, but the grant program approach provides the City with the greater flexibility and program control.

Community Insight

The October 31, 2023, reports UPE01836 and UPE01864 summarized feedback gathered from development industry stakeholders and identified that despite optimism about the long-term trajectory of Downtown, there are current challenges in undertaking new residential development. Construction and financing costs have increased sharply while residential rents have not risen significantly. As a result, new Downtown residential development may not be viable without some form of financial incentive.

Administration conducted interviews with eight industry organizations and 17 individual companies involved in downtown development, office conversions and real estate for the reports UPE01836 and UPE01864. City of Calgary staff were also interviewed about their office conversion program.

Administration met again with many of the same stakeholders, including representatives from 10 organizations and companies, in order to confirm findings from the initial round of engagement and refine details for how a tax freeze grant program could be structured.

Stakeholder insights gathered across both rounds of engagement have informed the understanding of current market conditions, the evaluation of options for residential development incentives and the prioritization of CRL Catalyst Projects.

GBA+

Edmonton's Housing Needs Assessment (included in the September 26, 2022, Community Services report CS01088, Updated Affordable Housing Strategy) explored available quantitative data supplemented with qualitative data from engagements with the housing sector and people with lived and living experience to determine the overall need for affordable housing in Edmonton, and how housing need disproportionately impacts different segments of Edmonton's population. Data that is disaggregated by gender, race, disability, age and other grounds can reveal patterns of structural inequality. Thirteen priority population groups were considered for the Housing Needs Assessment.

When considering housing options, each priority population group will have different needs and considerations. Most people do not fall into a single category; it is important to recognize that intersectional identities of multiple individuals within households can influence housing needs.

The residential incentive program described in this report is intended to increase the number of residential units available Downtown. It is not intended to provide new units specifically targeted to the 13 priority population groups, although program participants would also be eligible to apply for other incentive programs, like the City's Affordable Housing Incentive Program, which are intended to encourage development of affordable units.

Attachments

1. Background on 2021 Edmonton Economic Recovery Construction Grant
2. Draft 2024 Downtown Residential Development Incentive Policy
3. Draft 2024 Downtown Residential Development Incentive Program Guide