COUNCIL REPORT

Edmonton

BUDGET UPDATE - NON-RESIDENTIAL TAX BASE GROWTH CHALLENGES

Recommendation

That the June 19, 2024, Financial and Corporate Services report FCS02483, 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.		**Regional Prosperity**	
City Plan Values	LIVE		
City Plan Big City Move(s)	N/A	**Relationship to Council's Strategic Priorities**	Economic Growth Conditions for service success
Corporate Business Plan	Managing the corporation		
Council Policy, Program or Project Relationships	• Fiscal Policy for Revenue Generation (C624) • Debt Management Fiscal Policy (C203C) • Financial Stabilization Reserve (C629) • The City Plan		
Related Council Discussions	• March 12/13, 2024, Financial and Corporate Service report FCS02350, Budget Process Update • June 19, 2024, Urban Planning and Economy report UPE01548, Industrial Investment Action Plan - 2024 Update		

Executive Summary

- The non-residential tax base is essential for the financial viability of the City, as it historically pays significantly higher taxes than the residential sector, while consuming fewer City services.
- Edmonton is absorbing a relatively small share of the region's non-residential real growth. From 2010 to 2022, there was an estimated $29.9 billion of non-residential real growth in the

Edmonton region (inflation-adjusted 2022 dollars). Of this, $12.4 billion (41 per cent) occurred in Edmonton, and $17.5 billion (59 per cent) occurred in the region.

- A consequence of this sustained period of below-average real growth has resulted in Edmonton's share of total regional non-residential (industrial, retail, office, and special purpose) tax base declining:
    - Edmonton’s share of non-residential assessment in the region has substantially declined from 72 per cent of the region's base in 2008, to 60 per cent in 2022.
- This pattern can lead to a worsening cycle of escalating non-residential property taxes in Edmonton relative to the surrounding municipalities, which could drive further declines in Edmonton’s share of non-residential tax base.
- Continued monitoring of residential versus non-residential growth is needed. One response to this concern is the City's Industrial Investment Action Plan.

REPORT

The City had a $3.5 billion operating budget in 2023, of which $1.9 billion (56 per cent) was supported through residential and non-residential property tax[1]. Reliance on property taxes is a common feature of the municipal finance model in most Canadian jurisdictions, as taxation powers of municipalities are limited by legislation. In 2023, the City’s non-residential tax base was valued at $42 billion, and comprised industrial properties (38 per cent), retail (29 per cent), special purpose (11 per cent), office (10 per cent), land (10 per cent) and hotel (1 per cent).

In general, throughout most of Canada and the United States, the residential sector receives proportionately more direct benefit from municipal services than the non-residential sector; concurrently, the non-residential sector pays significantly higher taxes than the residential sector.[2] Under this tax model, non-residential property owners effectively subsidize the provision of services to residents, as they pay for more than they consume and residents pay for less than they consume. The non-residential tax base is therefore the backbone of City finances, enabling the delivery of City services to the broader community.

Edmonton Regional Economy

The Edmonton metropolitan region functions as one large interconnected urban economy as commerce, trade, labour and investments cross municipal borders with ease. However, when it comes to the fiscal position of municipalities, the borders are much more significant, as each municipality only generates property taxes from the properties within its boundaries.

[1] Other revenue sources include, but are not limited to: user fees, fines, permits, franchise fees, EPCOR and other investment dividends, and transfers from reserves. edmonton.ca/sites/default/files/public-files/assets/PDF/2024-BudgetHighlights.pdf

[2] Kitchen, Harry, and Enid Slack. 2012. “Property Taxes and Competitiveness in British Columbia.” A report prepared for the BC Expert Panel on Business Tax Competitiveness; City of Vancouver Property Tax Policy Review Commission - Final Report. 2007; Jordan, Mike. 2021. “Business Property Taxation by Cities: What We Know, What We Don’t, and What We Should.” City of Saskatoon, Discussion Paper; Mintz, Jack, and Tom Roberts. 2006. “Running on Empty: A Proposal to Improve City Finances.” C.D. Howe Institute Commentary, No, 226; Bish, Robert L. 2004. “Property Taxes on Business and Industrial Properties in British Columbia.” Fraser Institute Digital Publication.

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There are three fundamental features of the Edmonton regional economy:

1. Most non-residential development in the Edmonton region has historically demonstrated a market preference for suburban-oriented business and industrial parks;
2. The Edmonton region is a conglomeration of 13 municipalities with Edmonton at the centre;[3] and
3. A large proportion of non-residential properties are place-bound to the Edmonton region for economic and business reasons, but are not place-bound within any specific municipality.

Together, these three factors create an environment where most types of non-residential development can occur anywhere in the region, with municipalities competing for business and industrial tax base amongst themselves. Municipalities surrounding Edmonton may be more attractive for business development, as they have lower property taxes, lower design standards and lower land prices.[4] From the perspective of the business, buildings and structures are capital inputs towards some productive output—the creation of a good or service sold on the marketplace. Property taxes on non-residential properties are effectively a tax on capital. Taxes on capital can have distortionary effects in the marketplace, with potential impacts on investment levels and/or locational choice.[5] In Edmonton's case, higher relative property taxes may be a contributing factor towards pushing non-residential development to surrounding municipalities.

With respect to industrial properties, which is a subset of non-residential properties, feedback from stakeholders[6] indicated that the City's property tax rates are a barrier for industrial development within the City. Compared to other municipalities in the region, the City's property taxes are higher and can result in increased costs over time.

Non-Residential Tax Base Growth Challenges

Real growth is defined as improvements that add value to a property, and can take the form of new building construction or improvements to existing properties. Real growth expands the City's tax base: as newly constructed properties are added to the City's assessment roll each year, real tax growth is the largest revenue growth item in each year's operating budget.

From 2010 to 2022, there was an estimated $29.9 billion of non-residential real growth in the Edmonton region (inflation-adjusted 2022 dollars). Of this, $12.4 billion (41 per cent) occurred in Edmonton, and $17.5 billion (59 per cent) occurred in the region.[7] Edmonton's share has trended lower in recent years: within the latter part of this period, from 2018 to 2022, there was $7.7

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[3] The Edmonton Census Metropolitan Area (CMA) consists of 34 municipalities (or equivalent). This statement only considers the municipalities with a population of 5,000 or greater, which are members of the Edmonton Metropolitan Region Board (EMRB). The EMRB consists of the 13 largest municipalities in Edmonton CMA, and comprises 98.7 per cent of the CMA's population.

[4] "Industrial Investment Action Plan," Attachment 1, June 19, 2024, Urban Planning & Economy report UPE01548, Industrial Investment Action Plan - 2024 Update

[5] Found, Adam. 2014. "Essays in Municipal Finance." [PhD Thesis, University of Toronto]; Dahlby, Bev. 2012. "Reforming the Tax Mix in Canada." University of Calgary, The School of Public Policy, SPP Research Papers, Vol. 5, Issue 14; Mintz, Jack, and Tom Roberts. 2006. "Running on Empty: A Proposal to Improve City Finances." C.D. Howe Institute Commentary, No, 226

[6] KPMG "What We Heard" report, Attachment 5, June 19, 2024, Urban Planning & Economy report UPE01548, Industrial Investment Action Plan - 2024 Update

[7] Regional growth figures are estimated by comparing year-over-year assessment change while factoring out market value shifts using common assumptions.

billion of real growth, of which $2.7 billion (35 per cent) occurred in Edmonton and $5 billion (65 per cent) occurred in the region.

The imbalance of real growth can also be demonstrated on a per-capita basis. From 2010 to 2022, Edmonton's surrounding municipalities[8] absorbed an annual average of 3.8 times more real non-residential growth per capita ($3,859 annually per capita) than Edmonton ($1,023 annually per capita, inflation-adjusted 2022 dollars). Population is one of the largest drivers of municipal expenditures, and sufficient growth in the non-residential tax base is required to support expenditure responsibilities to maintain or grow municipal services. As shown by comparing per-capita non-residential real assessment growth, Edmonton is far below its neighbours given the needs of its growing population.

As a consequence of this sustained period of below-average real growth, Edmonton's share of non-residential assessment in the region has substantially declined from 72 per cent of the region's base in 2008, to 60 per cent in 2022. This is largely due to real growth of the non-residential tax base disproportionately occurring outside Edmonton's borders.

Modest or insufficient growth to the non-residential tax base compromises the fiscal sustainability of the City. It presents both a short-term and long-term fiscal challenge: in the short term, there is inadequate real tax growth from the non-residential base, which then requires higher tax increases to close the operating gap each budget year; in the long term, the City's ability to generate tax revenues becomes compromised, as non-residential tax base is insufficient relative to population—the principal driver of expenditure responsibilities. The effect is a worsening cycle of declining regional tax-base share:

1. As the Edmonton population continues to grow, the City's expenditure budget also grows;
2. A growing expenditure budget in the absence of proportional real growth revenues requires higher tax levy increases (where business property owners already pay a higher rate than residential owners);
3. The growing non-residential tax levy is then apportioned to a relatively smaller non-residential tax base;
4. This drives up non-residential tax rates in Edmonton relative to surrounding municipalities;
5. This creates a tax rate disparity between Edmonton and surrounding municipalities, which pushes non-residential growth to surrounding municipalities/counties with lower taxes on capital (lower non-residential taxes);
6. Surrounding municipalities see higher rates of non-residential real growth.

This cycle then repeats; in 2010, Edmonton's non-residential tax rate was 1.5 times the average rate of surrounding municipalities; by 2022, Edmonton's rate was 2.3 times the average rate (Attachment 1, Table 5).

[8] Includes the 12 EMRB member municipalities surrounding Edmonton.

Fiscal Disparity in the Edmonton Metropolitan Region

Fiscal disparity occurs across the Edmonton Region when tax rates and tax bases vary across municipalities, despite the region being a singular urban economy. The Edmonton region on the whole had $303 billion of taxable assessment in 2022, which was split 71 per cent residential and 29 per cent non-residential (Attachment 1, Table 2). Edmonton, in contrast, biases heavily towards residential, with $189 billion of taxable assessment that was split 78 per cent residential and 22 per cent non-residential. This difference is fiscally important, as non-residential properties generally pay more in property taxes than it costs to service them, while residential properties pay less.

Edmonton's share of the regional population is 73 per cent (Attachment 1, Table 1). In contrast, Edmonton's share of total regional tax base is disproportionately low: Edmonton's residential tax base is only 68 per cent of the regional total; its non-residential tax base is 60 per cent (Attachment 1, Table 3). As noted above, the low non-residential share is due to the real growth of non-residential properties disproportionately occurring in the region.

When examining tax base per capita, Edmonton is significantly below average: Edmonton's residential tax base per capita is $135,261, whereas the regional average is $158,970; Edmonton's non-residential tax base per capita was less than half of the regional average, at $37,584 compared to $76,631. When factoring machinery and equipment into the non-residential base, which the City does not tax, there is even greater disparity, with the City's per capita assessment at $38,384 and the regional average at $109,835 (Attachment 1, Table 4).

Next Steps

The City will need to continue to monitor the growth of residential development against the growth of non-residential development. Consideration should be given to the size of the non-residential tax base relative to the residential tax base, and non-residential tax rates relative to both residential tax rates and non-residential rates in the region. Consideration should also be given to the City's overall land-use plan with respect to non-residential/industrial parks. The June 19, 2024 Urban Planning and Economy report UPE01548, Industrial Investment Action Plan - 2024 Update, outlines steps the City is taking to attract and retain industrial investment, which is one component of non-residential development, to support the City's sustainable fiscal position.

Community Insight

As the intent of this report is to provide quantitative economic and financial information about Edmonton and its region, community insight was not part of its development.

To develop the June 19, 2024, Urban Planning and Economy report UPE01548, Industrial Investment Action Plan - 2024 Update, Administration held engagement events with 30 industry stakeholders, including representatives from EPCOR, ATCO, Urban Development Institute (UDI), Building Owner and Managers Association (BOMA), National Association of Industrial and Office Properties (NAIOP), Alberta's Industrial Heartland Association, Edmonton Global, Edmonton Unlimited, Alberta Innovates, industrial land developers and business owners.

As part of that engagement, stakeholders indicated that “the City’s property tax rates are a barrier for industrial development within the City. Compared to others in the region, the City’s property taxes are higher and can result in increased costs over time. Stakeholders noted that the City should identify and communicate what additional levels of service that developers and companies will receive by investing in the City for the relatively higher taxes they pay, such as access to transit, and impact on overall lifestyle and access to nearby amenities.”

GBA+

As the intent of this report is to provide quantitative economic and financial information about Edmonton and its region, GBA+ was not part of its development.

Attachment

1. Supporting Tables