Options to Adjust Tax Allocation Based on Infrastructure Efficiency

Recommendation

That the October 16, 2020, Financial and Corporate Services report CR_8022, be received for information.

Previous Council/Committee Action

At the January 27, 2020, Executive Committee meeting, the following motion was passed:

> That Administration conduct further analysis of revenue collection options available to the city to adjust tax allocation based on infrastructure efficiency for residential development, e.g greater use of local improvements and/or special taxes, to reward the efficient use of land in both new development and redevelopment context, and provide a report back to Committee.

Executive Summary

Cities must balance demand and desire for growth with their capacity to provide services. A principle of the new City Plan is more efficient, compact city building to improve Edmonton's long-term financial viability. Lower density development increases costs for linear infrastructure such as roads, sidewalks, street lighting and drainage. The current assessment and taxation system generally does not reflect the lower relative costs of linear infrastructure for higher density development.

Taxation and revenue collection have two high-level considerations: how much should be collected and how this amount should be distributed across contributors. This report discusses distributive fairness of revenue collection for purposes of municipal infrastructure. The July 8, 2020, Office of the City Manager report, CR_8379 Reimagine - Strategic Response to COVID-19 to City Council, recommended greater use of cost distribution/sharing tools to reduce strain on the property tax base while ensuring a more equitable distribution of capital costs across residents, businesses and properties (Reimagine Recommendation no. 29).

The City of Edmonton has three financial tools to align revenue collection and tax allocation with the land-use intensity and infrastructure efficiency of residential properties: local improvement tax, development charges and off-site levies, and residential sub-classes. Local improvement taxes can be used in new development

areas or in mature neighbourhoods for a variety of infrastructure projects. Development charges and off-site levies are more practically applied only in new subdivisions at this time. Residential sub-classes can be applied citywide or to any area of the city. Examples of where the City could apply principles of infrastructure efficiency to capital projects include the Alley Renewal Program, the Neighbourhood Renewal Program and the proposed Rollie Miles Recreation Centre.

Report

Land Use Intensity's Effect on Infrastructure Costs

Edmonton's urban form affects the City's long-term financial viability. For some community infrastructure, distances or length impact overall costs. For example, the total infrastructure costs for roads, sidewalks, street lighting, drainage and LRT increase as linear distances increase. Factors such as density, urban design, geographic area, and infrastructure design standards influence the City's total cost of building and maintaining this infrastructure.

Based on the City's current infrastructure design standards, many forms of lower density development yield lower infrastructure efficiency. The linear length and value of infrastructure that supports these developments is high relative to the density of taxable assessment (the City's primary revenue base). Growth and renewal then requires significant investment, but the relative assessment densities underlying these development models are low.

Through its new City Plan, the City of Edmonton is emphasizing more infrastructure-efficient, compact city building for long-term financial viability. As part of the City Plan's technical review process, Administration engaged urban planning consultant Hemson conducted a Relative Financial Assessment of growth scenarios. Hemson also compared the draft City Plan land use concept to a business-as-usual base case. The evaluators calculated that a more compact urban form will reduce some capital growth requirements for new road infrastructure, fire stations, recreation facilities and libraries. The comparison report is available in Attachment 1.

Some of these infrastructure efficiencies would be offset by higher costs for transit service and public realm improvements, but a more compact urban form is expected to improve net financial efficiency. The City Plan looks long term, to Edmonton's growth to two million people. Any significant improvement to financial viability due to changes in Edmonton's urban form will not be immediately apparent, but will be realized increasingly over time.

Allocating Infrastructure Costs According to Land Use Intensity

The City's costs for delivering linear infrastructure to residential neighbourhoods and properties vary depending on land use intensity, typically measured through dwelling

unit density. The more linear length of required infrastructure (such as roads and sidewalks) to service a property or urban design format, the higher the cost to the City.

The main tool for the City to recover these costs is property taxes. The tax burden is distributed by assessment value, but this approach does not factor in how properties variably drive infrastructure costs. Some properties will under contribute in taxes relative to the cost of servicing their property, while other properties will over contribute to make up the difference. For example, a detached skinny house with assessed value of $600,000 on a 25x150 foot lot would pay 50 percent more in property taxes than a $400,000 detached bungalow on a 50x150 foot lot, even though the bungalow drives twice as much cost for linear infrastructure services. This cross-subsidization is amplified when higher density properties are factored in; the general trend is for high-density residential properties to cross-subsidize low-density residential properties. Low-density properties with high assessment values can be exceptions.

This method of cost allocation can incentivize low-density development. The City has three financial tools to align revenue collection and tax allocation with the land-use intensity and infrastructure efficiency of residential properties: local improvement tax, which is applied when local improvement projects are advanced, development charges and off-site levies, and residential sub-classes.

Local Improvement Tax

A local improvement is a project that City Council considers to be of greater benefit to an area of the city than to the whole of the city. This can be any type of capital project, from roads and decorative street lighting to recreation facilities, libraries and transit stations. Local improvements are paid for, in whole or in part, by a local improvement tax. The City can propose a local improvement, or property owners can petition City Council for a local improvement.

Any local improvement comes with some risk, as property owners can object to the improvement through a petition. A petition is sufficient if it is signed by two-thirds of the owners liable to pay the local improvement tax (for underground improvements) or 51 percent of the property owners (for surface improvements), as long as the owners who sign represent half of the assessed value of properties on which the tax will be imposed. This is in accordance with City Policy C619 Local Improvements - Surface.

For small projects, a one-year local improvement can apply a one-time tax to cover the full cost of the project. But it is more common for local improvement projects to be higher cost, in which case it is more feasible for the City to debt-finance the project, with the local improvement tax levied over the duration of the loan to cover the debt servicing charges. This smooths out the cost of the local improvement tax for contributing properties.

The local improvement tax is more flexible than standard property taxes. For property tax, the distribution of taxes within an assessment class can only be made according to the assessed value of properties. The local improvement tax, however, can be based on assessment value, each parcel of land, each unit of area, or each unit of frontage—the length of the property facing the road on which it fronts. This enables the tax to account for the infrastructure efficiency and land-use intensity of each contributing property.

Where the cost of a local improvement is driven by distance, length or land area, basing the local improvement tax on units of frontage or land area aligns revenue collection with how costs are driven. For example, if a residential neighbourhood was reconstructing its sidewalks, levying the tax based on frontage would fairly distribute costs—a detached house with 50 feet of frontage would typically contribute twice as much as one with 25 feet of frontage. Similarly, higher density multi-family buildings would contribute less per dwelling: a high rise apartment building with 200 dwelling units on 150 feet of frontage would be apportioned the same local improvement tax as three detached houses each with 50 feet of frontage. This approach more equitably distributes capital project costs according to the land-use and infrastructure efficiency of each property.

Local Improvement Tax in New Neighbourhoods

The City can apply the local improvement tax in newly built neighbourhoods if Council believes that the area has a greater benefit from the infrastructure than the whole of the city. This could include any new capital project or facility that is not contributed to the City through the land development process, such as transit stations, bike lanes, public realm and park enhancements. Local improvement taxes are not currently applied for this, but they are a possible tool. Where the cost of any local improvement is sensitive to density, or where an incentive structure for density is desired, the local improvement tax can be based on frontage or units of land area.

Local Improvement Tax in Mature Neighbourhoods

The local improvement tax has more applications in mature neighbourhoods, as a local improvement project can be any new facility or infrastructure project, as well as the renewal or replacement of any existing capital asset, so long as the improvement is of greater benefit to the area of the city that is liable to pay the local improvement tax than to the whole of the city.

Development Charges and Off-Site Levies

Development charges and off-site levies are imposed at the time of subdivision or development permit to pay for a specific type of infrastructure or facility. The payment

must be proportional to the benefit derived from the infrastructure or facility. Off-site levies are a subtype of development charge that are implemented by bylaw.

Examples of development charges include Permanent Area Contributions (PACs) and Arterial Roadway Assessments (ARAs). The PAC system was developed in the early 1970s as a mechanism for funding and cost sharing major pieces of drainage infrastructure, such as trunk sewers, stormwater management facilities and sanitary pumping stations. ARAs are an off-site levy under Section 648 of the *Municipal Government Act*, and are implemented through bylaw (Arterial Roads for Development Bylaw No. 14380). ARAs are the only off-site levy the City currently has, though proposed bylaws for fire stations and libraries in new subdivisions are being drafted.

The City generally establishes development charges and off-site levy rates by dividing the total cost of the infrastructure or facility by the benefiting area (dollars per hectare, for example). Every development within the benefiting area would pay based on the land area being developed multiplied by the established rate.

Development Charges and Off-Site Levies in New Subdivisions

This City's general approach to development charges and off-site levies in new subdivisions distributes costs according to land area being developed, not on a per dwelling basis. This incentivizes infrastructure and land use efficiency. For example, a 1,000 square metre lot being developed in a new subdivision would have the same development charges and off-site levies regardless of how many residential dwellings were constructed on that land; the more dwellings on that lot, the lower the fees per dwelling.

Off-Site Levies in Mature Neighbourhoods

Off-site levies can be applied in mature neighbourhoods and apportioned by land area being developed. This would reward efficient use of land, as increasing development intensity on a parcel of land would lower the per-dwelling off-site levy.

While off-site levies are legal in mature neighbourhoods, they are not financially feasible at this time, due to insufficient infill and redevelopment activity. Infill and redevelopment activity tends to be sporadic, meaning few properties in mature neighbourhoods would be paying the levy and annual revenues would vary. As infill and redevelopment activity increases in Edmonton, use of off-site levies will be reevaluated.

Use of Residential Subclasses

For assessment and taxation, all properties fall under one of the following classes: residential, non-residential, farm land and machinery and equipment. The *Municipal*

Government Act permits Council to divide the residential class into subclasses on any basis it considers appropriate. Differential tax rates can be applied to each residential subclass.

The City currently has an 'Other Residential' subclass, which includes any property with four or more self-contained dwelling units under one title. This subclass captures multi-family apartment-style residential properties that produce income for the owner. The City applies a 15 percent tax rate differential, above the residential tax rate, on the Other Residential subclass.

Council could create a residential sub-class based on land-use intensity or density and apply a lower tax rate differential. This would see residential properties above a defined density threshold pay a lower rate than residential properties below that threshold. Residential subclasses can be applied citywide or to any area of the city that Council considers appropriate. A drawback is that additional subclasses raises administrative costs while increasing the complexity of the tax system. Administration would conduct additional analysis about the benefits and tradeoffs of subclass options if Council wanted to pursue this strategy.

Some Options for Consideration

Two capital programs and one proposed capital facility provide models for local improvement: the Alley Renewal Program (ARP), Neighbourhood Renewal Program (NRP) and proposed Rollie Miles Recreation Centre. Any capital project can be a local improvement, so these models are not the only possibilities, but give examples of how revenue collection can be aligned with land use intensity and infrastructure efficiency.

<u>Alley Renewal Program</u>

With Council direction, the City can propose any type of capital project as a local improvement under its own initiative. The ARP renews and rebuilds alleys throughout Edmonton. The ARP has been approved for $5.38 million of ongoing tax levy funding in 2021 and $5.3 million in 2022. Alleys are a linear infrastructure asset, which means the costs to renew and replace them are driven by distance or length.

The ARP, as currently designed, will be funded by property taxes, which means taxes are distributed according to assessment value. If the ARP were a local improvement in all residential neighbourhoods with alleys, with the cost distributed based on alley frontage or the property's land area, tax collection would reflect the land-use efficiency of each property. This would also apportion costs only to properties abutting alleys and would not place a burden on the overall tax levy. As a consideration, implementing the ARP as a City-initiated local improvement would require additional administrative resources, likely reducing the scale of the program that could be completed as initially planned.

Neighbourhood Renewal Program

The NRP is a comprehensive infrastructure renewal program for existing neighbourhoods. The NRP is funded largely through tax levy, though the sidewalk component is funded through a local improvement tax, cost-shared 50/50 between the City and property owners. The NRP was incrementally ramped up from 2009 to 2018, and the tax levy component became fully funded in 2018 at $156.3 million per year. Since 2009, approximately 44,000 properties have been paying the 50/50 local improvement tax for the sidewalk component of the NRP, with a cumulative contribution of approximately $100 million. Neighbourhoods may also petition to upgrade from standard galvanized street lights to decorative street lights through a local improvement tax (100 percent funded by property owners).

The tax levy component of the NRP distributes taxes by assessment value. However, most aspects of the NRP include the renewal and replacement of assets where costs are driven by distance or length, such as curbs, gutters and roads. This can create cross-subsidization issues. Should Council choose to do so, the NRP could be shifted to a local improvement based program that apportions costs based on land area. This would distribute program costs more equitably according to infrastructure cost drivers, rewarding the efficient use of land. Higher density residential properties would pay less, while low-density properties would pay more, if all other factors remain the same.

However, there are a number of risks and considerations for converting this program to a local improvement:

- Some property owners may not find these changes agreeable, particularly since the program has operated as a tax supported program since its inception.
- Property owners can petition against the local improvement and, if a sufficient petition is made, the City must not proceed. This could cause delays in the NRP, or cancel renewal for certain neighbourhoods altogether.
- Shifting an existing tax supported program to a local improvement would come with administrative costs and would likely mean delays to neighbourhood reconstruction.

Proposed Rollie Miles Recreation Centre

The third example of how the City could apply principles of infrastructure efficiency to capital projects is the unfunded Rollie Miles Recreation Facility, a large recreation centre proposed for the Rollie Miles Athletic Field District Park. The estimated capital cost is $76 million based on the City’s most recent concept plan. If the Rollie Miles Recreation Centre were a local improvement, fully financed by the City through self-liquidating debt with a 25-year loan, the annual debt servicing payments would be $4.1 million for the duration of the loan (based on interest rates as of June 15, 2020).

To provide a rough measure of distribution, if 25,000 residential properties were within the benefiting area, the average property would pay $163 per year for the duration of the loan.

Generally, a more compact urban form reduces recreation costs, as fewer facilities are needed to provide residents access. However, as the area around the Rollie Miles site is already developed, the project's costs are not impacted by the surrounding land-use intensity. A local improvement tax could incentivize and reward intensive land use: high-density properties would pay below the annual average local improvement tax payment, while low-density properties would pay above it.

Corporate Outcomes and Performance Management

Corporate Outcome(s): Edmonton is developed to support growth and social, cultural, economic and environmental well-being			
Outcome(s)	**Measure(s)**	**Result(s)**	**Target(s)**
Access to Amenities	Edmontonians' assessment of their access to infrastructure and amenities that improve their quality of life	75% (2019)	TBD
Density	Number of Edmontonians living within the boundaries of the city	1,240 population per square km (2019)	TBD

Attachment

1. City Plan Growth Scenarios Relative Financial Assessment

Others Reviewing this Report

- C. Owen, Deputy City Manager, Communications and Engagement
- J. Meliefste, Acting Deputy City Manager, Integrated Infrastructure Services
- R. Smyth, Deputy City Manager, Citizen Services
- S. McCabe, Deputy City Manager, Urban Form and Corporate Strategic Development
- B. Andriachuk, City Solicitor