Significant Increase Outliers in Property Tax

Recommendation

That the October 16, 2020, Financial and Corporate Services report CR_8023, be received for information.

Previous Council/Committee Action

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

> That Administration provide a report on significant in property tax increase outliers, and the effect a cap and re-distribution approach would have had on 2019 taxes, using a cap of 10% and 15% increase in year over year individual property taxes, including a high level jurisdictional scan with pros and cons.

Executive Summary

This report outlines three possible tools that could address outlier properties with higher than typical property taxes. One possibility is a tax capping approach. Analysis of a 10 percent and 15 percent cap shows these caps would benefit five percent and two percent of property owners, respectively, and increase taxes on the remaining property owners. The magnitude of the offsetting tax increase varies between 0.4 percent and two percent for non-residential properties, and 0.1 percent and 0.2 percent for residential properties.

Report

Tax regimes determine the appropriate distribution of the overall tax levy. Under a property tax regime, the mechanism used to determine the appropriate distribution is assessment value, which is a reflection of a property's market value and a proxy for wealth.

To reflect market values, Edmonton assessors review market evidence, including but not limited to property sales, rental information and the cost to construct. Assessments for a given tax year use the market conditions as of July 1 of the previous year and properties' physical condition as of December 31 of the previous year. For example, the assessment values used for the 2020 tax year are based on market conditions as of July 1, 2019 and properties' physical condition as of December 31, 2019.

When an assessment value increases, there is a direct tie to market evidence - such as sales of similar properties being strong, rental rates going up or vacancies going down. Conversely, decreases in assessment values reflect a softer sales market, decreases in rents or higher vacancies. As assessment values shift, the share of taxes each property owner pays changes. If, Council passed a zero percent tax increase, properties that experienced above average assessment changes would have tax increases and properties that experienced below average assessment changes would have tax decreases. In this way, property taxes are distributed in a fair and equitable manner according to the value of the property.

Market fluctuations are seldom uniform. Significant assessment shifts can mean significant tax increases or tax decreases. While this results in less tax predictability, it allows for an annual redistribution of the tax burden from those with less wealth in property to those with more.

If Council wishes to limit the tax impact of more significant assessment shifts, two possible strategies could be employed: tax phasing or tax capping.

Tax Phasing

Tax phasing is the process of phasing in tax increases for a particular property owner. In the case where a property owner may experience a significant tax increase because of assessment shifting, a portion of the tax increase could be deferred until a subsequent year. The property owner would still be responsible for paying the full tax bill, but City Council could direct that the payback time be amended. This approach would not result in tax shifting to other property owners, but would increase administrative costs to track accounts and manage penalties for deferred amounts. The City would also need to carefully track property sales and transfers to ensure the outstanding tax balance is paid by the appropriate party. Finally, because the City would not collect its full budget requisition within a given year, some cash-flow management would be required. Properly establishing a tax phasing program would require additional time and analysis.

Tax Capping

Tax capping involves limiting the overall tax increase a property owner can experience. If, for example, a tax cap of 10 percent was set, property owners that would otherwise receive a 12 percent tax increase due to assessment shifting would only receive a 10 percent tax increase. In practice, tax rates would still be calculated using the entire assessment base and the initial tax calculation for individual accounts would be unaltered. However, any accounts that experience a tax increase above the chosen cap would receive a rebate from a capping program budget. Such a program would only apply to assessment changes that were the result of market value change. Accounts that experience high assessment value increases because of physical changes (e.g., new construction) would be excluded.

Tax capping is within the City's authority to implement using a combination of budget tools and section 347 of the *Municipal Government Act* (MGA), which allows Council to provide tax rebates to particular property owners if they consider it equitable to do so. Developing a capping module within the City's Taxation Assessment and Collection System (TACS) would take time and resources, and Administration would first need direction from Council before looking to cost and resource such a module.

<u>Tax Capping Impact Analysis</u>
Administration analyzed the City's assessment base over the past five years, and Attachment 1 discusses those impacts in more detail. Analysis shows that a 10 percent cap would decrease the taxes on approximately five percent of property owners and increase taxes for the remaining 95 percent. A 15 percent cap decreases taxes for approximately three percent of property owners, while increasing taxes for the remaining 97 percent.

Reviewing the data over five years, a non-residential tax increase of 0.4 to 2 percent and a residential tax increase of 0.1 to 0.2 percent would be required each year to support a 10 percent or 15 percent tax capping program. Assuming the capping impact was limited to the relevant tax class, this would also result in different tax increases for the residential and non-residential inventories every year and add complexity to public communication.

In effect, the tradeoffs for additional tax predictability and a cap on tax increases would be increased taxes for the majority of property owners, increased system complexity, and reduced equity in accordance with a market value property tax system.

<u>Additional Tools - Assessment Averaging and Assessment Cycles</u>
Two other strategies could add predictability to the property tax system at the cost of equity and would require legislative change before implementation. The first is assessment averaging and the second is introducing longer assessment cycles.

Assessment averaging involves the use of rolling averages on assessment changes over a period of multiple years. For example, the City would still track the actual market value of the property each year, but the effective market value used to calculate the overall tax rates as well as taxes on a given property would be different. This approach is likely to narrow the band of tax changes for any particular property (both up or down). This creates more predictability for property owners, but properties performing below market would pay more than their fair share while properties performing above market would pay less than their fair share. Using this averaging tool would require legislative change by the Government of Alberta and so cannot be implemented at this time.

Edmonton reassesses property on an annual cycle. This approach is considered by the International Association of Assessing Officers to be the most equitable. However, some jurisdictions have longer assessment cycles and phase in assessment changes over time. This approach has the effect of phasing in changes, but the changes at the beginning of a cycle can be even more dramatic because of the longer time-period between reassessments. Further, it has the potential to have even larger redistributive effects that are difficult to defend from a market value standpoint and would require legislative change from the Province.

Jurisdictional Scan

Calgary implemented a Municipal Non-Residential Phased Tax Program (PTP) in 2017 and approved its continuation in 2020. The program was originally implemented as a result of significant assessment valuation shifts in Calgary's downtown office market. The PTP worked in a similar manner to the tax capping described above, but rather than redistribute the cost back to the tax base, Calgary primarily used allocated funding from its Fiscal Stability Reserve to cover the cost. From 2017-2019, the program had a budget of $217 million. In 2020, the approach was adjusted slightly and is expected to cost an additional $30 million (approximately $10 million of which is drawn from the previous budget). Beyond the cost of this program, the approach resulted in an effect coined as the "bow wave", where the tax increase the City had to address each year was progressively magnified.

British Columbia has a land assessment averaging program. Properties that see significant assessment increases are assigned an effective assessment value using the average land value over the past three years plus the improvement value. The program was made available to 'residential', 'light industrial' and 'business and other' tax classes. This approach would not necessarily limit possible tax increases, but it would smooth the highs and lows, with the higher value increases paying less and the lower value increases paying more.

New Brunswick has a Spike Protection Mechanism (SPM) on owner-occupied properties. This program works on the assessment value of the property where the assessment authority tracks the true market value of the property and the effective assessment used to calculate property taxes. When the true market value of a property increases results in a tax increase of more than 10 percent, the lower effective assessment is used to cap the tax increase. For example, if the real and true value of a property goes up 20 percent in a year, the value for taxation will increase 10 percent per year until it catches up to the real and true value. This program only applies to increases that are due to market value changes. The SPM does not apply to new construction, newly sold properties as well as when there is a change in use.

Ontario uses a four-year assessment cycle. Increases in assessed values from one base year to the next base year are phased in over the four years. Decreases are applied immediately and not phased in. In addition, Ontario has had various capping and clawback programs that were imposed on municipalities. Starting in 2001, the legislation requires municipalities to limit assessment reform-related tax increases on commercial, industrial and multi-residential properties to five percent per year from the previous tax year for 2001 and subsequent years. Limits on increases (capping) were to be funded from within a property class. This meant that tax decreases would be limited in classes where the cap was applied (clawback). Alternatively, municipalities had the option to introduce new residential and non-residential property tax classes as well as graduated tax rates. In 2005, some municipal flexibility was introduced to allow the cap to increase to 10 percent per year, among other changes.

Nova Scotia implemented a Capped Assessment Program (CAP) in 2010. This program limited the possible assessment increases on residential properties to no more than the Nova Scotia Consumer Price Index. Eligibility was limited to the original owner of the property when the program was implemented or a family member who subsequently became the owner. Non-residential and multi-residential properties were excluded from this program.

Corporate Outcomes and Performance Management

Corporate Outcome(s): The City of Edmonton has a Resilient Financial Position			
Outcome(s)	**Measure(s)**	**Result(s)**	**Target(s)**
Property taxes are fairly distributed in accordance with provincial standards and market value principles	Assessment to Sales Ratio (Res)	0.994 in 2019	0.95 - 1.05
	Coefficient of Dispersion (Res)	8%	</= 15%

Attachment

1. Capping Analytics

Others Reviewing this Report

- B. Andriachuk, City Solicitor