Councillor Briefing Session

(6^{TH})

Request for Recommendation
Priorities Committee

Greater | Grand Sudbury
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Type of Decision

Meeting	April 4, 2007			Report Date	March 29, 2007			
Decision Requested		Yes	X	No	Priority	X	High		Low
	Direction Only			Type of Meeting	X	Open		Closed

Report Title

Property Tax Policy - Information

Budget Impact / Policy Implication	Recommendation
☐ This report has been reviewed by the Finance Division and the funding source has been identified.	
N/A	FOR INFORMATION ONLY
☐ Background Attached	☐ Recommendation Continued

Recommended by the Department	Recommended by the C.A.O.
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Report Prepared By	Division Review
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BACKGROUND

Property tax policy is a complex issue, Finance staff will make a presentation to provide Council with information regarding assessment, property tax policy and tax policy decisions adopted by the City of Greater Sudbury in the past.

This process will provide Council with an understanding of the implications of property tax policy and allow Council to review the analyses and recommendations that will follow at a later meeting date.

Please find attached a Property Tax Policy Background briefing paper for your information. Later in April, Council will be presented with a policy discussion paper for 2007 tax policy decisions.

PROPERTY TAX POLICY
BACKGROUND BRIEFING

City of Greater Sudbury

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I BACKGROUND

- The property tax is a tax on the capital value of real estate. It is not a tax on the income of the property owner (like the income tax). Nor is it a tax on consumption like the sales tax.

- The property tax has been a feature of local municipal finances in Ontario since 1793 and has been criticized for probably just as long. Despite the criticisms, no satisfactory alternative has been found and it is now the "colossus" among local revenue sources.

- The basic manner in which the tax operates is very simple. Each year the amount that has to be raised through the tax (the levy) is divided by the relevant assessed values of the properties to be taxed. The resultant tax rate is then applied to the individual assessments to determine each property's tax bill.

- In Ontario, the basic approach has modified the application of "weightings" to the various classes of properties with the result that a property in a given class will pay more or less tax than a property of the same value in a different class.

- The assessed values of properties in Ontario are based on what is referred to as "Current Values" which are synonymous with market values.

- The framework of the current assessment and taxation regime was introduced in 1998. This represented the first major reform to the system since 1970. Since 1998 numerous other smaller changes have been made, most of which have been designed to overcome shortcomings of the original reforms or to ease the effect of tax shifts caused by reassessments.

- The first part of this review provides a short introduction to the assessment component of the overall system. This is followed by a brief description of the municipality's role in taxation system. Finally information regarding the property tax situation in Greater Sudbury is reviewed.

II ASSESSMENT IN ONTARIO

A. ADMINISTRATION

- In Ontario the assessment process is governed by the provisions of the Assessment Act. The requirements of the Act are fulfilled by the Municipal Property Assessment Corporation (MPAC) which is jointly owned by municipalities. MPAC's head office is in Pickering and there are branch offices in centres across the Province including one in Sudbury. Although there are local staff, many specialised types of properties (such as mines, paper mills, or shopping centres) are valued by assessors with Province wide responsibility.

- MPAC is responsible for preparing an annual Assessment Roll. The Roll is delivered in preliminary form in November when Assessment Notices are sent out to owners. The Roll is delivered in final form by mid December. MPAC also provides municipalities with Supplementary Assessment Rolls during the course of the year which contain assessments of properties which change during the year and of amounts that were omitted when the roll was originally returned.

B. WHAT IS ASSESSED

- The current tax roll that is being used for the 2007 taxation year is based on a valuation date of January 1, 2005, which represents the value of each property on that date.

- With certain specific exceptions, all real property is subject to assessment and taxation.

- The categories of properties that are exempt from taxation is extensive. It includes the following main categories:

    - Federal, Provincial and Municipal property
    - Schools, universities, libraries and hospitals
    - Churches, Cemeteries, Seminaries, etc.

- Red Cross, St. John's Ambulance, Boy Scouts, Girl Guides, Children's Aid Societies
- Battlefields
- Conservation lands
- Airports
- Theatres for "live" performances
- Many types of electrical generating facilities

- Also exempted is machinery and equipment used... "for the purpose of a concentrator or smelter of ore or metals including the foundations on which they rest..."

- Of particular relevance to Sudbury, the Act also exempts... "The buildings, plant and machinery under mineral land and the machinery in or on the land only to the extent and in the proportion that the buildings, plant and machinery are used for obtaining minerals from the ground, and all minerals, other than diatomaceous earth, limestone, marl, peat, clay, building stone, stone for ornamental or decorative purposes, or non-auriferous sand or gravel, that are in, on or under land." (Assessment Act - Section 3.20)

- Although the types of properties noted above are exempt from taxation, municipalities are provided with "Payments in Lieu" of taxes (PIL) for both Federally and Provincially owned properties. As well, many electrical generating facilities make payments on a PIL basis. While most PIL are equivalent to full properties taxes, payments for certain types of properties and facilities such as hospitals and universities are not tied to property values but instead are calculated on a per bed or per student basis.

C. VALUATION APPROACHES

- To assess properties, three main valuation approaches are used by MPAC assessors.

1. Direct Sales Approach

This involves analysing sales that have occurred using relevant property characteristics and then applying the results to the properties being valued. It is the approach most commonly used for valuing residential properties. MPAC conducts its analyses using a technique known as 'Multiple Regression Analysis.' The analysis is computerised.

2. Income Approach

This approach is based on the investment principle that a property is worth the capitalised value of the net revenue it is capable of generating. It is used to value properties which are owned and operated for their income potential. Such properties include apartment building, office building, shopping centres, hotels and motels. The method, by its nature relies primarily on the revenue and expense characteristics of properties and only indirectly on the physical characteristics.

3. Cost Approach

Under the cost approach, property values represent the sum of the value of land (calculated using the direct sales approach) and the replacement cost of buildings less allowances for depreciation and obsolescence. The approach is used to value properties which are not normally rented or which do not sell on a regular basis. Large special purpose properties, particularly industrial properties, are usually valued using this approach. MPAC uses a computerised costing system (ACS) to develop these values.

D. PROPERTY CLASSIFICATION

All properties are also classified according to use. The broad classes that are specified in the Assessment Act are:

- Residential
- Farm
- Managed Forest
- Multiple Residential
- Commercial
- Industrial
- Pipeline

- Within the Commercial and Industrial classes there are 'optional' classes which municipalities can choose to adopt for tax policy purposes. They are:

Commercial
- Office Building
- Shopping Centre
- Parking Lot

Industrial
- Large Industrial

- In both the commercial and industrial classes, properties which do not fall into the optional classes characteristics are maintained within the residual commercial or industrial class. Properties within the office building and shopping centre optional classes also have the first 20,000 square feet of building assigned to the commercial class.

- Commercial and industrial properties can also have portions of their sites classified as excess or vacant.

E. APPEALS

- Owners of properties (and others) have the right to appeal assessments to the Assessment Review Board (ARB). The ARB is an independent administrative tribunal under the responsibility of the Attorney General. Municipalities can also appeal assessments. As well, they have the right to participate in hearing under certain conditions.

- Most appeals are heard within the year. However appeals involving complex properties with large assessments often take several years to resolve. Only a small percentage of appeals require a hearing. A large majority are resolved through discussions and negotiations.

- In addition to a formal appeal, owners can make a "Request for Reconsideration" to MPAC. This is a less formal approach and is completely within the discretion of the assessor as to whether or not a change is made to the assessment.

III TAX POLICY & THE MUNICIPALITY

- As described in the Background the largest source of revenue for most municipalities is the property tax. It is used to raise the required municipal levy. The share of the levy to be paid by each property is based on three factors; the property's assessment, the classification of the property and the tax rates applicable to the property class.

- While the assessment of each property is established by MPAC, municipalities are responsible for setting tax rates within parameters of the Municipal Act and its associated regulations.

- The key areas in which municipalities have a policy role are:

    - Decisions concerning the establishment of area rating
    - Weighting to be applied to tax rates for particular property classes
    - Adoption of optional classes and/or graduated tax rates for commercial and industrial properties
    - Discounts to be applied to vacant or excess industrial and commercial land and to farmland awaiting development
    - The manner in which property tax caps on multiple residential, commercial and industrial properties are funded
    - Arrangements for phasing in the effects of reassessments

  Each of these policy areas are discussed.

A. AREA RATING

- Where a service is not being provided generally throughout a municipality or is being provided at different levels or in a different manner in parts, councils can choose to designate the service for area rating. In doing so the net costs of providing the service in the defined area(s) are raised through a property tax that is applied only to properties within the area(s). The City of Greater Sudbury currently area rates two services: Transit and Fire Services.

B. CLASS TAX RATE RATIOS

- The most significant tax policy decision that council can make relates to the weighting to be placed on the tax rates for each property class. The weighting is controlled by property class tax ratios. These ratios are set in relation to the class ratios of 1 which the Province has set for the residential class across the Province.

- Property classes which have ratios set at greater than 1 will pay more for given amount of assessment than residential properties of the same value. Properties in classes with ratios that are less than 1 will pay proportionately lower taxes for a given amount of assessment.

- The Province has established fixed tax ratios for both the residential and managed forest class. It has set target ranges for the other classes. The ratios ranges are referred to as "The Range of Fairness" and are the ranges within which the Province would prefer municipalities to set tax rate weightings. The range of ratios is follows.

RANGE OF FAIRNESS		
	Low	**High**
Residential	1	1
Multiple Residential	1	1.1
Commercial	0.6	1.1
Industrial	0.6	1.1
Pipeline	0.6	0.7
Farmlands	0.01	0.25
Managed Forest	0.25	0.25

In 1998, Farmlands were originally given a fixed ratio of 0.25.

- Prior to 1998, the tax system did not operate on the basis of tax ratios. Taxes were based on the application of either commercial or residential tax rates to assessed values that had no specific relationship to the current market of properties. In addition, properties occupied by businesses were liable for a business tax, which varied according to the type of business of the occupant.

- In 1998, the Province calculated the effective tax ratios for each property class that applied in 1997 for each County, Region District and Separated City. On a simplified basis, the effective or "transition" ratios were calculated in two steps.

  1. First, effective class tax rates were calculated by dividing the total amount of taxes paid by properties in each class by the total CVA of the properties in the class.
  2. Second, the transition ratio was calculated by dividing the effective tax rate for each tax class by the effective tax rate for the residential class. For example:

$$\frac{\text{Effective Commercial Tax Rate (4.50\%)}}{\text{Effective Residential Tax Rate (2.25\%)}} = \begin{array}{c}\text{Commercial Class} \\ \text{Transition Ratio} \\ \text{(2.0)}\end{array}$$

- Because the effective tax rates varied from place to place and from class to class, each municipality had its own unique set of transition ratios for 1998. For the majority of municipalities, the transition ratios were above the Province's "Range of Fairness." As a result the tax rates applied to properties not in the residential or farm classes were higher than the Province's target in relation to the rates applied to residential properties.

- Municipalities are permitted to maintain ratios that are outside the "Range of Fairness" but have been encouraged to reduce them in order to bring taxes more in line with Provincial policy objectives.

- In municipalities where ratios for either the multi-residential, commercial or industrial classes are greater than the average of the ratios for the class province wide, it has been prohibited to increase applicable class tax rates to pay for increases in levy requirements. Effective in 2004, this prohibition has been modified and now municipalities will be permitted to pass on half of any proportionate increase in the levy for tax classes with a ratio higher than the provincially mandated ratio.

- A key factor in a municipality's decision concerning the adjustment of tax ratios is that until 2004 they could only be moved closer to the "Range of Fairness." The only exception was for ratios that were within the "Range of Fairness" in which case they could be moved up or down within the range.

- In 2004 The Province modified the rules regarding the movement of ratios. From 2004 to the present in reassessment years, municipalities can request the Province to establish new transition ratios for the municipality that are further from the "Range of Fairness" than current ratios, but only to bring the tax share of the affected class back to a revenue neutral position compared to the previous year's taxes. This change has been permitted because of the effects of the reassessment on some classes of property that would have reduced that classes share of the levy. In 2007, this is not the case as this is a non-reassessment year and the valuations for 2007 are based on the same valuation as the 2006 values.

- It is most important to understand that when a tax ratio change is made it will affect the taxes paid by other classes of property. This effect can be counteracted by also making ratio changes to other classes which are permitted to have variable ratios. However, for the residential class which has a fixed ratio, effects cannot be modified. Since in most municipalities, including Greater Sudbury the ratios on most classes are above the "Range of Fairness" any ratio change (excluding the exception noted above) is likely to lead to an increase in the share of the levy to be paid by residential properties.

C. OPTIONAL CLASSES

- A second tax policy tool available to municipalities is the power to adopt "optional" commercial or industrial classes. Since each optional class also has its own tax ratio, municipalities can use this tool to establish differential tax responsibilities for specific types of property within a broad class. The most commonly adopted "optional" class, and the one that has since 1998 been maintained in Sudbury is the "Large Industrial" class. This class encompasses properties which contain buildings of more than 100,000 square feet and that are used for manufacturing or processing.

D. GRADUATED TAX RATES

- Councils also have the authority to apply differential tax rates to properties within the commercial or industrial classes on the basis of the value of properties. This is done by the council setting a number of parameters. They are:

    - Setting CVA value(s) as the boundary(ies) between the differential tax "bands." There can be either two or three tax bands.

- Establishing which percentage of the rate for properties in the highest value band that will be applied to properties in the other one or two bands of value.

- An example of such a graduated tax rate approach would be where the CVA boundary for commercial properties is set at five million dollars with properties below the boundary value paying a tax rate of 80% of the rate applied to properties in the high band. It is to be noted however that on an overall class basis the share of the levy remains the same. It is the distribution of taxes within the class that is altered by the policy.

E. DISCOUNTS

- Councils are permitted to modify the tax rate discount which must be applied to vacant or excess commercial and industrial land. The standard discount is 30% for commercial properties and 35% for industrial properties. It is to be noted that municipalities are also required to provide tax refunds for commercial and industrial building space that is vacant. Refunds are made on the basis of approved applications by property owners. Where farmland is awaiting development, Councils can also provide discounts.

F. TAX CAPPING FOR MULTIPLE-RESIDENTIAL, COMMERCIAL AND INDUSTRIAL PROPERTIES

- One of the most significant elements of the 1998 system reforms was the imposition of mandatory caps on tax increases for properties in the multiple-residential, commercial and industrial classes. This was not originally part of the reforms but was introduced after it became clear that the taxes on many properties, particularly in municipalities that have not been reassessed for many years were increasing by amounts that some owners and tenants could not afford to pay.

1. The Basic Approach

In simple terms, the tax cap program that was implemented had the following features:

- Base taxes on a property (excluding levy increases) in 1998, 1999 and 2000 could not rise by more than 10%, 5%, and 5% for the three years. Base taxes were the amounts paid in 1997.

- The difference between the total amount of taxes that should have been paid by "increasing" properties (CVA taxes) and the "capped" taxes was held back from the tax decreases that other properties in the class would otherwise have received. In this way "capping" could be revenue neutral compared to properties in other classes.

- Municipalities could choose not to hold back decreases by funding all or part of the "capping" requirement from other sources.

2. Capping Now a Permanent Tax Fixture

- In 2001 tax capping was made permanent with annual increases being limited to 5% (plus any levy increase requirement). Because reassessments now occur annually capping requirements and the decreases or the class available to fund them are continually changing.

- In 2005 municipalities had the option of setting the cap in the range of 5% to 10%.

- Also in 2005 municipalities were allowed to remove business properties from the capping exercise if the cap or clawback of taxes was within $250 of their current value assessment taxes.

3. Shortfalls

- Since within a capped class decreases are not always sufficient to cover the capping requirement, shortfalls must either be paid for from reserves or through an addition to the levy. However councils can affect the size of a shortfall by adjusting class ratios. If a ratio is lowered, the tax responsibility for the class drops which in turn reduces the amount of the required cap. Although it is possible to eliminate shortfalls in this way, any required change in tax ratios cannot be reversed in future years.

4. Treatment of New Construction and Properties New to a Capped Class

- The tax capping provisions of the Municipal Act have been amended several times in regard to the treatment of properties with new construction and properties that become part of a capped class. In both situations these "new" properties have their starting point taxes set at the lower of either the level of taxes being paid on comparable properties in the class or full CVA taxes.

- In 2005 municipalities were allowed to set minimum levels of taxation at 70% of uncapped taxes. Municipalities have the opportunity of increasing the minimum level by 10% in each year after 2005 with the ultimate elimination of the comparable properties in 2008.

5. Administration

- The administrative requirements arising from the tax capping provisions are very substantial. This is because each year it is necessary to undertake a complex analysis to establish the capped or clawed back tax position of each affected property. It is also necessary to make numerous post-billing adjustments to reflect revised tax responsibilities that arise because of events such as appeals, supplementary assessments, class changes, etc.

G. RE-ASSESSMENT PHASE-INS

- The final significant tax policy tool within the jurisdiction of Councils relates to the phasing in of the effects of reassessments. Phase-in programs can be quite flexible in their terms, including the period of time over which they run, the rate at which increases and decreases are implemented and the scale of any threshold amounts.

- The recent 2007 Provincial budget announced that any assessment related increases resulting in the 2009 Provincial reassessment would be phased in over a four year period and that assessment related decreases would be realized immediately. Details regarding how this would be achieved have not yet been released.

H. ESTABLISHING TAX RATES

- The process by which tax rates are calculated is relatively straight forward. Once the various tax policies have been set, it involves the following steps:

  1. Multiply the total assessed value of properties in each class by the class ratio. This produces the weighted assessment.
  2. Apply the relevant discounts to the weighted assessment of excess and vacant industrial and commercial property. This produces the discounted weighted assessment.
  3. Sum the total weighted, discounted assessment and divide it into required municipal levy. This produces the residential tax rate.
  4. Apply each class ratios to the residential tax rate. This produces the tax rates for all other classes.
  5. Apply the discount factor to the commercial and industrial rates to determine the tax rates for excess and vacant commercial and industrial properties.

- Where area rates are applicable the normal rate calculation process is followed except that only the assessed of the properties covered by each respective area rate is used in the calculation.

- The process described above is used to calculate municipal tax rates. The Province sets education tax rates. There is a Province-wide rate for residential properties. Non-residential education tax rates are established using the assessed values for the municipality and a provincially set levy requirement. The 2007 Provincial budget announced that the business education taxes would be reduced over time.

IV THE PROPERTY TAX POLICY ENVIRONMENT IN GREATER SUDBURY

- In 2006, Greater Sudbury had a municipal levy of $156.1 million, and education taxes of $50.2 million were also levied, based on Provincially-set rates..

- The breakdown of taxes by class were as follows:

	$ (millions)	%
Residential	97.4	62.4
Multi-Residential	12.7	8.1
Commercial	31.7	20.3
Industrial	4.6	3.0
Large Industrial	8.8	5.6
Pipelines	0.8	0.5
Farmlands/Managed Forests	0.1	0.1
Total	156.1	100

- Greater Sudbury's starting tax ratios by class for 2007 are as follows:

Residential	1
Multiple Residential	2.0591
Commercial	1.720574
Industrial	2.559614
Large Industrial	2.901185
Pipelines	1.475204
Farmland	0.25
Managed Forests	0.25

- All ratios that are within the control of Council are above the Provincial "Ranges of Fairness."

- The broad industrial class ratio (which is the weighted average of the industrial and large industrial ratios) is 2.7722. This is above the Provincial average ratio which is 2.63. If Council does not reduce the ratio, only 50% of any applicable levy increase could be passed onto the industrial class. Reducing the tax ratio below the provincial average allows the City to pass on the levy change to the industrial class. However, in 2006 more tax burden was kept on the industrial class by keeping the tax ratio above the Provincial threshold and passing on 50% of the levy increase than reducing the industrial tax ratio to the Provincial threshold.

- In 2006 the Tax Capping Program had the following key elements:

Class	Tax Cap Requirement	Decrease Clawback
Multi-Res	$56,190	67.3%
Commercial	$1,799,760	53.7%
Industrial[1]	$290,900	38.1%

- There were sufficient tax decreases available to fund the cap in each of the three tax classes.

[1]Tax capping is calculated on a broad class basis.