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NEW PROPERTY TAX CAPPING OPTIONS FOR THE COMMERCIAL, INDUSTRIAL AND MULTI-RESIDENTIAL CLASSES

The Finance and Administration Committee recommends:

1. **the presentation from Ed Hankins, Director of Policy, Risk and Treasury, be received; and**
2. **the recommendations contained in the following report, March 21, 2005, from the Commissioner of Finance, be adopted:**

1. RECOMMENDATIONS

It is recommended that:

1. The following tax capping options be adopted for properties in the Commercial, Industrial and Multi-Residential classes for 2005 and future taxation years:
   a) Assessment-related property tax increases be limited to an amount which is the greater of,
      (i) 10% of the previous year's annualized property taxes, or
      (ii) 5% of the previous year's property taxes at Current Value Assessment (CVA).
   b) Properties, for which tax increases have been capped (protected) but are within $250 of their full CVA taxes, be moved to the CVA tax level within the current taxation year.
   c) Properties, for which tax decreases have been clawed back but are within $250 of their full CVA taxes, be moved to the CVA tax level within the current taxation year.
   d) Eligible properties (new construction/new to class) within the meaning of subsection 331(20) of the *Municipal Act, 2001*, be taxed at a minimum of:
      (i) 70% of their full CVA tax value for the 2005 taxation year,
      (ii) 80% of their full CVA tax value for the 2006 taxation year,
      (iii) 90% of their full CVA tax value for the 2007 taxation year, and
      (iv) 100% of their full CVA tax value for the 2008 taxation year and beyond.

2. The Regional Solicitor be authorized to prepare the necessary by-law to give effect to the above recommendation.

3. The Province be requested to permit municipalities to exclude those properties in the Multi-residential, Commercial, and Industrial classes that have reached their CVA level taxes from future capping and clawback provisions.

2. PURPOSE

As part of the 2004 Budget, the Province introduced amendments to the *Municipal Act, 2001* ("the Act") that provided new options to municipalities for the capping of assessment-related tax increases on properties in the business classes. The purpose of this report is to review the capping related amendments, to provide recommendations for the application of the tools to the capping calculations for York Region, and to provide a recommendation to maintain CVA level taxes through subsequent reassessment periods once CVA tax levels have been achieved.

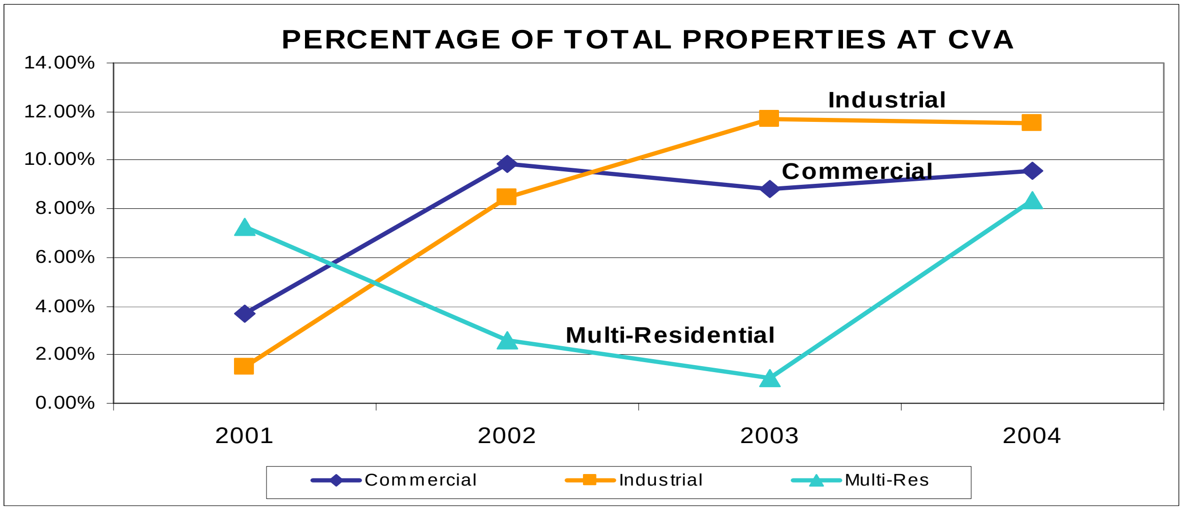
3. BACKGROUND

Bill 79, *The Fairness for Property Taxpayers Act, 1998*, introduced the "10-5-5" capping provision to limit the allowable assessment-based annual realty tax increases for the business (also termed "protected" classes due to the capping) property classes commencing in the 1998 taxation year. Under this legislation, property tax increases due to property tax reform were limited to 10% of the 1997 annualized taxes, an additional 5% of the 1997 taxes in 1999, and a further 5% of the 1997 taxes in 2000.

Bill 140, the *Continued Protection for Property Taxpayers Act, 2000*, continued the protection for the business classes limiting the year-over-year assessment related tax increases to 5% on an indefinite basis. Bill 140 also expanded the definition of properties eligible for protection under the "New Construction/ New to Class" provision. For the first year that a property undergoes a change described in the legislation, the realty taxes will be the lower of the property's full CVA level taxes and the average level of taxes levied on up to six comparable properties. The property will then be subject to the capping provisions in future years.

Properties are not progressing toward CVA taxes as anticipated. As illustrated in Chart 1, it could well be decades before a significant portion of the taxable properties would reach CVA level taxes. The effect of this lag perpetuates a lack of taxpayer fairness by entrenching taxation inequities.

Chart 1: Historical Overview of Protected Class Properties at Full CVA Level Taxes



Municipalities have expressed significant concerns with respect to the capping legislation. The capping legislation is so complex that many municipalities cannot administer the legislation without external assistance. The Ministry of Municipal Affairs and Housing was required to create the Online Property Tax Analysis tool (OPTA) to assist municipalities with the capping calculations. The complexity of capping leads to a lack of transparency to taxpayers and to municipalities alike.

The Province has recognized the concerns of municipalities and has provided a partial remedy to the capping provisions through amendments to the Act contained in the 2004 provincial Budget. A municipality may use the new options provided either individually or in combination and the options may be individually tailored to each of the business classes. Effective for the 2005 taxation year, municipalities will now have the following tools available for use:

1. Municipalities can implement the greater of,
    i) An increase to the annual capped taxes from 5% to a maximum of 10%, or
    ii) An annual increase for capped properties of up to 5% of CVA taxes.

   Prior to the amendments, municipalities were limited to a maximum increase of 5% of the previous year's capped taxes.

2. Municipalities can move capped properties ("increasers") directly to their CVA taxes if capped taxes are within $250 of the CVA taxes. The dollar value is discretionary from $0 to $250. This option is calculated subsequent to the prior options and may be applied singularly or in addition to other options.

3. Municipalities can move clawed-back properties (those properties in each class that are currently paying more than their CVA level taxes or "decreasers") directly to their CVA taxes if taxes are within $250 of the CVA taxes. Again, the value is

discretionary from $0 to $250 and may be applied singularly or in addition to other options.

4. Municipalities can establish the minimum percentage of CVA taxes that would be paid by "new construction/new-to-class" properties. For 2005 the minimum percentage that can be established is up to 70% of their CVA taxes, rising by 10% each year, at the option of the municipality, to a maximum of 100% in 2008 and beyond. This applies only to new properties in 2005 and not to properties already capped in prior years. The option may be applied singularly or in combination with other options.

3.1 The Funding of Property Tax Protection for the Business Classes

York Region funds the capping cost in each of the protected classes by retaining (clawing back) tax decreases for those properties in each class that are currently paying more than their CVA level taxes (the "decreasers"). The Act prescribes that the Region must ensure that decreases and increases are equalized across the lower tier municipalities through a process termed "bankering".

If there are insufficient decreases available in a given class to fund the amount of protection to the capped properties, there is a shortfall in the class that is funded jointly by the upper and lower tier municipalities including the educational portion. In 2004 there was a shortfall for the Multi-residential class in York Region which, as shown in Table 1, was $483,692.

The decisions that Council makes with respect to the capping options will affect the cost of funding protection in the business classes, directly influencing the amount required to be "clawed back" from the assessment related tax decreases. It also affects the amount, if any, of a capping shortfall.

Table 1
Clawback Percentages and Funding Amounts for 2004

Property Class	Clawback	Funding Requirement for Cap	Available Decreases	(Shortfall)
	%	$	$	$
Multi-Residential	100.0000	671,594	187,902	(483,692)
Commercial	84.0267	24,180,741	28,777,449	N/A
Industrial	81.5553	6,629,066	8,128,308	N/A

Source: OPTA August 5, 2004

4. ANALYSIS AND OPTIONS

Since 1998 Regional Council has advocated for taxpayer fairness through the movement of properties to CVA level taxes. The background material illustrates that properties in

York Region's protected classes have not been moving quickly, if at all, to their full CVA tax level. In 2004, less than 15% of the properties in protected classes were paying CVA taxes. This has perpetuated a lack of taxpayer fairness within the classes and has created intermunicipal shifting of tax dollars to fund the cost of protection.

The modelling that follows utilizes the 2004 tax rates and the adjusted assessment for 2004 after the Return of the Assessment Roll. The final capping calculations may be subject to further revision.

4.1 Capping Options

The Budget amendments provide for five new capping options. The current or "Status Quo" option is presented for comparison in the illustrations that follow. This report's recommendation follows Council's previous direction to move properties, that are either currently protected through capping or not receiving their full benefit of tax decreases due to clawbacks, to their CVA level taxes as quickly as possible. The options are presented as four additive combinations which have been developed to achieve the maximum movement of properties to their actual CVA taxes.

4.1.1 Option 1: Increasing the cap up to 10% of the previous year's taxes ("10/0/0/0")

This option, termed "10/0/0/0" for the purposes of the following illustrations, entails increasing the annual cap from the current 5% of the previous year's capped taxes to a maximum of 10% and results in accelerating the rate of movement of capped properties to CVA. This option has the greatest impact on those properties that are currently capped at more than 50% of their CVA taxes. In York Region the bulk of properties pay taxes at or above 50% of their CVA taxes. This option is projected to bring 1244 additional properties to their CVA level taxes, an increase of 38% over the "Status Quo" option.

4.1.2 Option 2: The higher of 10% of previous year's taxes or 5% of CVA taxes

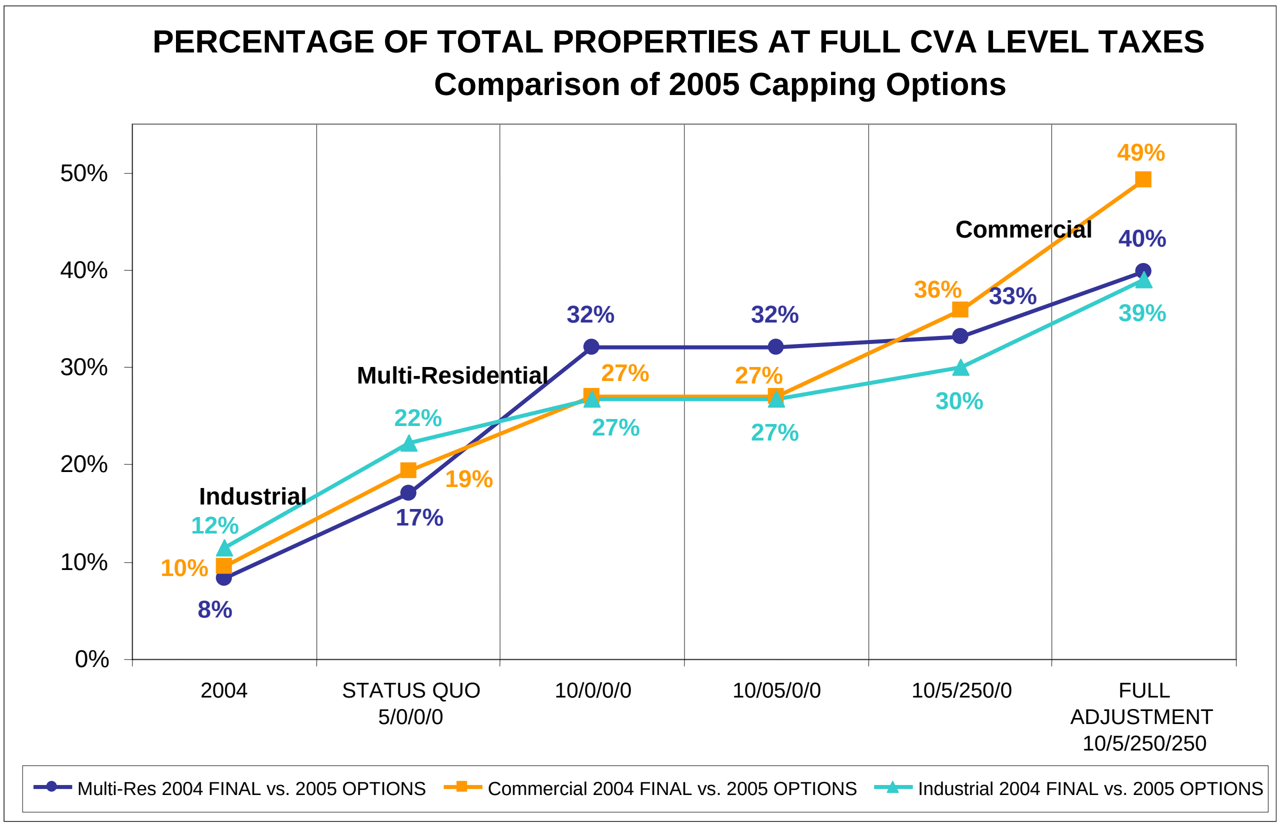
The second option, termed "10/5/0/0", involves applying an increase that is the greater of 10% of the previous year's capped taxes or 5% of the previous year's CVA taxes. This option has the effect of also targeting properties that are capped at less than 50% of their full CVA tax obligation. While adding this option brings no additional properties to their full CVA tax level, it significantly reduces protection and results in over $267,000 in additional tax increases on 1706 capped properties, over Option 1 alone.

4.1.3 Option 3: Applying a $250 Threshold to Capped Properties

The third option, termed "10/5/250/0", allows municipalities to bring "increasers" who are within $250 of CVA taxes immediately to their full CVA tax level. Increasers are those properties being taxed below their CVA taxes (i.e. capped) and for which an increase is required to get to full CVA level taxes. The intent is to remove a multitude of properties from capping protection that are close to the CVA tax level. While the proposed $250 threshold is low, the large number of properties does produce a substantial impact. This option brings a further 1325 properties to their full CVA tax level and increases taxes from those properties by an additional $137,000.

4.1.4 Option 4: Applying a $250 Threshold to Properties Clawed Back
The recommended option, termed “Full Adjustment” or “10/5/250/250”, also allows “decreasers” that are within $250 of their destination taxes, the final reductions necessary to get these properties to their CVA level taxes. Although this option slightly increases the clawback on the balance of the properties to compensate for the loss of the decreasing properties (e.g., 0.86% increase in the commercial class clawback rate), it would bring 2093 additional properties to full CVA tax level. This option is the most consistent with the principal of maximizing the movement of properties to their full CVA level taxes, as it expedites the greatest number of properties out of capping and clawback. Also, by granting the properties with decreasing assessments their full tax decreases, this option is in closest concurrence with Council’s previous direction towards achieving taxpayer fairness.

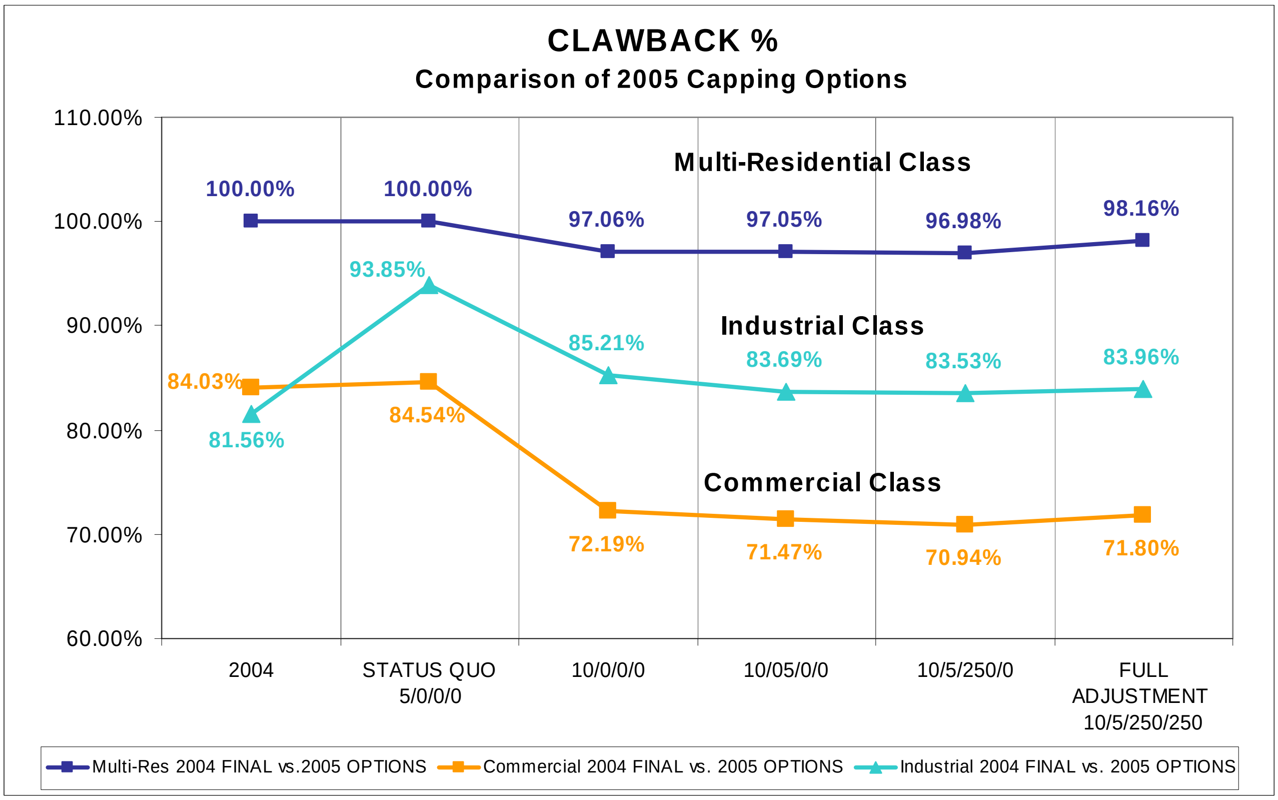
Chart 2: The Effect of the Capping Options on Properties at CVA



There are a number of factors that must be considered when judging the effect of the tax tool policy options in Chart 2 above. For example, the Status Quo option indicates 2699 commercial properties at CVA level taxes in 2005, compared to 1327 in 2004. This change is in part due to a large number of severances in 2004 (e.g., splits of condominium properties in the commercial class into multiple units with unique assessment roll numbers) that are listed at full CVA. These properties are subject to the New Construction (“Bill 140”) provisions that will reduce the taxes payable below CVA level in 2005, resulting in an overstatement of growth in the number of properties at full CVA level taxes.

Chart 3 shows the incremental effect of each of the options on the clawback rate. The "Full" option increases the clawback percentage slightly by giving "decreasers" the additional deduction to CVA level taxes and thereby slightly increasing the capping cost to the balance of the decreasers above the $250 mark.

Chart 3: The Effect of the Capping Options on the Clawback Percentage



4.1.5 New Construction/New-to-Class

Under the provisions of the Act, eligible commercial, industrial and multi-residential properties are new construction or new to a property class and are subject to property taxes at a level representing the average tax rate of up to six comparable properties. The properties appear on the Assessment Roll as paying full CVA taxes but are subsequently adjusted to the "Bill 140" comparable levels requiring a refund of the excess tax paid. As a result, these eligible properties have been taxed from about 10%-100% of their CVA values.

The new legislation permits a municipality to establish a floor for new properties to the amount of protection at up to 70% of their CVA level taxes in 2005, rising by 10% per year to 100% by 2008.

4.2 Properties That Have Reached Their CVA Tax Levels

It is a continual source of frustration to municipalities that gains in moving properties to CVA level taxes are often undone following a reassessment year. Chart 1 provides an indication of the anomalies that occur from the effects of reassessment years. For example, 2001 and 2003 are taxation years for which a reassessment applies. The objective of moving properties to CVA taxes is simply the attempt to achieve taxpayer fairness by removing the inequities that currently exist in the business classes.

Fair treatment of taxpayers in the business classes could be more consistently achieved if municipalities could be assured that once a property reaches its CVA level taxes it then remains at the CVA tax level for future reassessments. This would require a change in legislation to achieve this goal; therefore, it is recommended that the Province be requested to allow municipalities to maintain properties at CVA level taxes once properties have reached the CVA tax level. The Association of Municipal Tax Collectors of Ontario has made a similar recommendation to the Province.

Staff will continue to support this position with other municipal financial stakeholder groups.

5. FINANCIAL IMPLICATIONS

Provincial capping and clawback provisions pertain only to reassessment related property tax increases and decreases in the Commercial, Industrial and Multi-residential classes. Tax increases as a result of municipal budgetary requirements are not affected.

There are no direct financial implications to the Region except where there is a region-wide shortfall in the decreases available in a particular class to fund the cost of the protection afforded under the legislation. In 2004 the cost of the shortfall to the Region was $302,476 (the Region’s portion of the $483,692 overall shortfall).

The projected shortfall in 2005 under the Status Quo option is estimated at just over $222,000, however the use of the recommended “Full Adjustment” option anticipates that there would be no shortfall in the Multi-residential class.

Table 2

2005 Capping Tools - Clawback Percentages and Funding Requirements (Status Quo vs. Full Adjustment Option)

	Status Quo Option			Full Adjustment Option		
Property Class	Clawback %	Funding Requirement for Cap $	(Shortfall) $	Clawback %	Funding Requirement for Cap $	(Shortfall) $
Multi-Residential	100.00	410,195	(222,433)	98.16	182,087	N/A
Commercial	84.54	20,120,309	N/A	71.80	16,882,725	N/A
Industrial	93.85	5,983,972	N/A	83.96	5,326,081	N/A

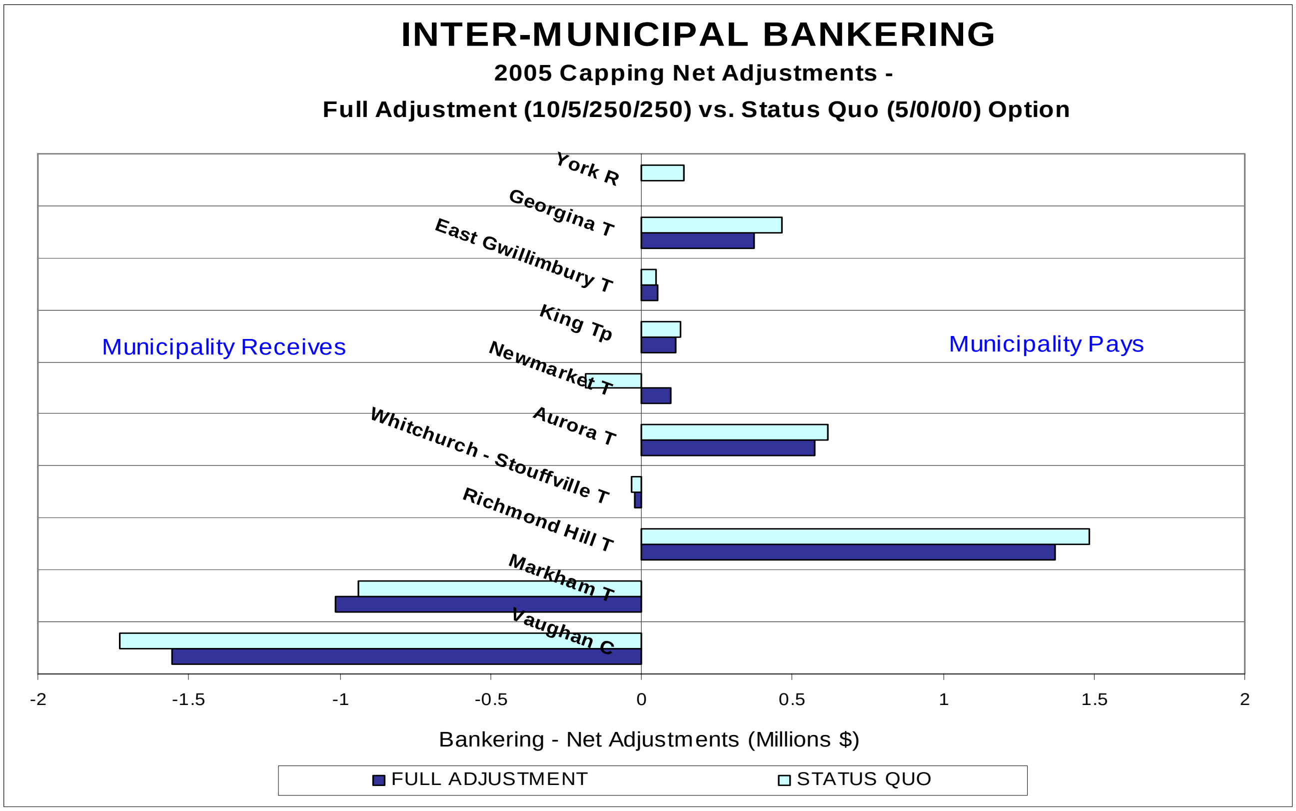
Source: OPTA data as of March 1, 2005

Applying the recommended tax tools eliminates the projected shortfall for 2005 in the Multi-residential class and reduces the clawback percentage in all three classes. Chart 3 demonstrates the impact of each of the policy options.

6. LOCAL MUNICIPAL IMPACT

Through the use of the tax tools, the projected shortfall, funded by both the upper-tier and local municipalities that would have occurred under the Status Quo option, has been eliminated. Chart 4 shows that with the recommended option, it is projected that the local municipalities that are contributors to funding the capping protection are required to contribute less through the inter-municipal bankering function of the Region. The exceptions to this trend are the Town of East Gwillimbury, which will be paying slightly more into the bankering under the "Full Adjustment" option, and the Town of Newmarket, which will move from being a recipient to being a contributor in the bankering.

Chart 4



7. CONCLUSION

It is recommended that the Region continue to encourage the movement of capped properties (increasers) and clawedback properties (decreasers) to their full CVA level taxation by applying the recommended combination of tax tools for each of the protected property classes. The combination of tax tools under the recommended 'Full Adjustment" option is most consistent with Council's previous direction. This option also eliminates the projected shortfall and has a favourable overall effect on the inter-municipal bankering.

In addition, it is recommended that a minimum percentage of CVA level taxes be established for new construction and new-to-class properties starting in 2005. The level of taxation is to be set at a minimum of 70% for the 2005 taxation year, rising by the maximum of 10% each year to 100% of the full CVA tax obligation of those properties in 2008 and beyond.

It is also recommended that the Province be requested to allow municipalities to maintain properties at CVA level taxes once properties have reached the CVA tax level.

The modelling of the preferred option has been discussed and is supported by the York Tax Policy Technical Group. The proposal has been reviewed by the York Area Treasurers.

The Senior Management Group has reviewed this report.