TORONTO STAFF REPORT

July 20, 2004

To: Ad-hoc Committee on the Development of a Long Term Fiscal Plan

From: Chief Financial Officer & Treasurer

Subject: Transmittal – Staff Report "Property Tax Policies for 2005 and Beyond – Consultative Framework"

Purpose:

The purpose of this report is to update the Committee on the consultative framework for property tax policies for 2005 and beyond.

Financial Implications and Impact Statement:

There are no direct financial implications arising from adoption of this report.

Recommendations:

It is recommended that this report be received for information.

Background:

Council at its meeting of June 22, 23, and 24, 2004, adopted Clause No. 27 of the Policy and Finance Committee Report No. 5 entitled 'Property Tax Policies for 2005 and Beyond – Consultative Framework' from the Chief Financial Officer and Treasurer which set out a policy framework and a public consultation process.

Comments:

Four consultation workshops have been held - July 6, 7, 12, and 13, 2004. At these consultations, the discussions have been with regard to (a) tax ratios and restrictions on budgetary levy increases, (b) complexities of the capping and clawback mechanisms, (c) measures to provide protection to vulnerable small businesses, (d) inequities in the business education tax rates as well as heritage tax issues.

Public feedback at these meetings will be reported to the Policy and Finance Committee for its meeting in September 2004, on the outcome of these stakeholder consultations.

Conclusion:

This report is an update on the consultative framework for the property tax policies for 2005 and beyond. The present schedule is to provide recommendations to Council in September on a longer-term property tax policy strategy for consideration by Council and the Province.

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List of Attachment:

Appendix #1 - Policy and Finance Committee Report 5, Clause 27, considered by City Council on June 22, 23 and 24, 2004.

APPENDIX #1

Consolidated Clause in Policy and Finance Committee Report 5, which was considered by City Council on June 22, 23 and 24, 2004.

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Property Tax Policies for 2005 and Beyond - Consultative Framework

City Council on June 22, 23 and 24, 2004, adopted this Clause without amendment.

The Policy and Finance Committee recommends:

(1) adoption of the report (June 8, 2004) from the Chief Financial Officer and Treasurer; and

(2) that the Chief Financial Officer and Treasurer be requested to report to the Policy and Finance Committee on the feasibility of establishing a "big box" category for retail and how, if possible, that classification could be achieved.

The Policy and Finance Committee submits the report (June 8, 2004) from the Chief Financial Officer and Treasurer:

Purpose:

To seek approval of guiding principles and of a consultative framework with regard to City and Provincial property tax policies for 2005 and beyond.

Financial Implications and Impact Statement:

There are no direct financial implications arising from adoption of this report. Staff will report back to the Policy and Finance Committee at its meeting in September 2004, on the outcome of public and stakeholder consultations and to recommend a longer-term property tax policy strategy for consideration of Council and the Province.

Recommendations:

It is recommended that:

(1) the following guiding principles with respect to property tax policy be endorsed:

(I) Tax ratios are an important measure of tax fairness and equity between the various property classes. Reasonable targets for tax ratios should be set, and tax policies regarding budgetary levy increases and tax ratio-related tax burden shifts between classes should be made with a view of respecting and achieving these targets over a reasonable period of time.

(II) The current capping regime is ineffective and will prolong historic tax inequities. However, any changes to the capping program in order to facilitate the transition to Current Value Assessment (CVA) should have regard for maintaining a manageable pace of change for property owners. A longer transition period should be available for those properties facing large increases.

(III) It is recognized that small retail businesses are an important sector of the economy. They contribute to the vitality and character, and hence value, of our communities. Property tax protection for vulnerable business must be developed in conjunction with any other changes that facilitate the transition to CVA, with a view to achieving equity to the extent possible between various property types, objectivity in defining eligible properties, longer-term stability and certainty for property owners, and transparency in administration.

(IV) A view to achieving equity and fairness in tax rates for both the municipal and education portion taxes should be taken. The Province must be encouraged to show its commitment to reduce Toronto's business education tax rate disparity vis-à-vis the surrounding GTA municipalities.

(2) staff be directed to hold stakeholder consultations during July and August with the objective of making recommendations to the Policy and Finance Committee in the Fall of 2004 in order to meet the Fall session of the Provincial legislature; and

(3) the appropriate City Officials be authorized and directed to give effect thereto.

Background:

Assessment and tax policy in Ontario is generally governed through provisions made under the *Assessment Act* and the *Municipal Act.*

In 1998, the Province of Ontario undertook the first major reform of the property assessment and taxation system with the implementation of the Current Value Assessment (CVA) system on a province-wide basis. The CVA of a property represents an estimated market value, or the amount the property would sell for in an arm's length, open market sale between a willing buyer and a willing seller.

Given that, prior to 1998, Toronto's assessment base had not been reassessed in over five decades, the full implementation of CVA in 1998 would have resulted in significant tax increases for many property owners in Toronto. As a result, the Province subsequently legislated mandatory caps/limits on tax increases for commercial, industrial and multi-residential properties to help mitigate the tax impacts arising from CVA, and the option to phase-in tax increases resulting from the re-assessment for residential homeowners. Special provisions were also implemented to protect low-income seniors and low-income disabled persons, as well as for charities and similar organizations, from large tax increases as a result of reassessment.

In 2001, further amendments to the *Municipal Act* relating to tax ratios were introduced that restricted municipalities from passing on municipal levy increases, even inflationary related, to the non-residential property classes (commercial, industrial, and multi-residential) where the tax ratio for these classes exceeded a provincial threshold ratio. The threshold tax ratios were set at the provincial average tax ratio at that time for each class. A tax ratio is a measure of the tax rate for a property class in comparison to the residential tax rate.

In Toronto, tax ratios for the commercial, industrial and multi-residential tax classes all exceed the provincial thresholds. Under the provisions of the *Municipal Act*, this means that no municipal levy (budgetary) increases can be passed on to these classes so long as the ratios exceed the threshold limits. Any budgetary increases, therefore, can only be passed on to the residential class. The rationale behind this limitation is that, for municipalities whose business tax rates were higher than the provincial average, as tax rates increased over time on homeowners, the disparity between residential and business tax rates would be corrected. The City of Toronto is the only municipality in the GTA, and one of only a handful of municipalities in Ontario (Ottawa and Hamilton being other major municipalities) affected by this budgetary levy restriction. Under existing rules, assuming that a 3 percent per annum residential tax rate increase was sustainable, staff estimate it would take more than twenty years before the City regained access to its entire property tax base.

Furthermore, in the 2004 taxation year, for the first time since the introduction of CVA, the tax ratio rules would have resulted in a shift of tax burden from the commercial class to the residential class for the sole reason that residential properties had increased in assessed value faster than commercial properties. This impact, estimated at $60.00 per household, would have been above and beyond any financial impact to the residential class arising from the budgetary levy increase restriction on the non-residential class.

As a result of the numerous issues arising from the current assessment and tax system, Council, at its meeting of January 27, 28 and 29, 2004, directed, amongst other things, that the Mayor and/or Chief Financial Officer and Treasurer meet with the Minister of Finance and other Provincial staff as appropriate to discuss issues related to the property assessment and taxation system, with a view of identifying and implementing regulatory and legislative changes necessary to achieve property tax stability and fairness in Toronto. The subsequent staff level meetings have been productive. There was an early recognition of short-term actions that could be implemented for 2004, with a view to engaging stakeholder consultation on a longer-term tax policy strategy for 2005 and beyond.

On March 15, 2004, Finance Minister Greg Sorbara announced adjustments to the municipal rules under the Ontario Property Tax System for 2004. These adjustments enabled the avoidance of the tax burden shift from the commercial class to the residential and multi-residential classes that would otherwise have occurred due to the changes in CVA for 2004, and provided partial relief from the budgetary levy restrictions imposed on municipalities whose tax ratios were above the provincial threshold level (e.g. Toronto). The relief allowed for tax increases on the non-residential classes of up to 50% of the municipal residential tax rate increase for 2004. These adjustments are intended as interim or stop-gap measures for 2004, and to enable a consultative process to allow for the identification of legislative and regulatory changes to improve the stability, fairness, flexibility and simplicity of the property tax system starting in the 2005 taxation year.

This commitment was reinforced in the 2004 Provincial budget, which announced, amongstother things, a deferral in the reassessment cycle for 2005 to allow for a transition to a January 1st, 2005, valuation date for the 2006 taxation year to allow MPAC (the Municipal Property Assessment Corporation) and municipalities more time to analyze assessment data and to make tax policy decisions. The announcement also provided additional tools to allow municipalities to progress toward full CVA taxation, together with additional options for targeting tax reductions to small business properties. The Province will analyze and continue to consult with municipalities and stakeholders on additional assessment and tax measures to continue to improve the stability, fairness, flexibility and simplicity of the property tax system.

This report is intended to highlight key longer-term assessment and tax policy issues for stakeholder consideration, and to seek Council's approval of guiding principles and a consultative framework with regard to City and Provincial property tax policies for 2005 and beyond.

<u>Comments</u>:

This section provides background and analysis of key issues to be included in the stakeholder consultation.

The three key inter-related issues to be included in the consultative framework will include, but is not limited to:

(i) tax ratio rules and tax burden shifts between classes and budgetary levy increase restrictions;
(ii) capping reform; and
(iii) protection for vulnerable businesses.

In order to ensure sufficient lead time for the enactment of legislative changes and/or for the Minister to make regulatory amendments in time for the 2005 taxation year, and to allow time for the City to make any necessary tax process or system changes, the following timelines for the City of Toronto's consultative work is proposed:

Policy and Finance Committee consideration and approval of guiding principles and consultative framework	June 14, 2004
Council consideration and approval of guiding principles and consultative framework	June 22 – 24, 2004
Stakeholder consultation	July – August 2004
Policy and Finance Committee review of recommendations	September 15, 2004
Council consideration and adoption of longer-term tax policy strategy, for consideration of Province	September 28-30, 2004
Fall Session of Provincial Legislature	September 27 – November 4, 2004

(A) Assessment and Tax Policy Issues:

(I) Historic perspective:

The apparent tax rate disparity between Toronto's non-residential and residential sector is not a result of any action or inaction of City Council. In Toronto, the higher tax burden on the non-residential sector (commercial, industrial and multi-residential classes) was inherited by the City when municipalities assumed control of the tax rate setting process from the Province in 1998.

The disparity between residential and non-residential tax rates was the product of a long-standing provincial policy and an outdated assessment system that had not been updated in over five decades. Prior to 1998, under the then in force *Assessment Act*, properties were classified as either residential or non-residential for the purposes of property taxation. Legislation prescribed that residential properties, which included multi-residential rental apartment buildings, be taxed at a rate of 85 percent of the non-residential tax rate (i.e. commercial and industrial properties). Put another way, the non-residential tax rate was fixed at 117 percent of the residential rate.

Although the assessment system was the subject of several initiatives for reform in Toronto, none occurred, and real estate values for property taxation purposes were generally based on a valuation basis dating back to the 1940's. Due to the valuation methodology, the assessment returned on the roll for taxation purposes did not reflect the fact that residential properties were appreciating in value at a rate greater than that of the non-residential property classes, and hence, the real taxation level on residential was kept lower than it ought to have been.

In 1998, the Province introduced the first major reform to the assessment system. From then on, properties were to be assessed on their current value. Chart 1 shows the changes in assessment by simply moving to the more current base. It shows that the assessed value of residential properties appreciated 37-fold between the old assessment methodology and the current assessment methodology, while multi-residential, commercial and industrial properties experienced only a 5 to 10 fold increase. Because tax ratios between the residential and non-residential classes were frozen until 1998, these value increases were not translated into property taxes.

Chart 1- Assessment Valuation of Properties in Toronto - Pre and Post CVA

	Pre-1998 Assessment (based on 1940's valuation)	1998 Current Value Assessment (based on 1996 valuation date)	Change
Multi-Residential	$1.24 billion	$12.42 billion	10.0 fold increase
Commercial	$3.87 billion	$27.86 billion	7.2 fold increase
Industrial	$0.68 billion	$3.56 billion	5.2 fold increase
Residential	$3.16 billion	$117.86 billion	37.3 fold increase

Chart 2 further illustrates the relationship between changes in assessed value and tax rates. It shows that, although the tax differential between the residential and non-residential classes was fixed at 85 percent under the old system, by moving to a current value assessment system the tax rates become different, even though there is no change in the amount of taxes paid by each class (tax burden). That is, neither the residential or non-residential classes are paying any more in 1998 after assessment reform, than they were paying pre-1998.

Chart 2 - Pre verses Post Assessment Reform Municipal Tax Burdens

	Pre- 1998			1998 CVA			
	Average Mill Rate	Tax Rate Differential vs. Res.	Tax Burden	Tax Rate	Tax Rate Differential vs. Res.	Tax Burden*	Change in Tax Burden
Residential	465	1.0 x	$1,459 million	1.3%	1.00 x	$1,459 million	None
Multi-Residential	465	1.0 x	$576 million	4.6%	3.54 x	$576 million	None
Commercial	547	1.17 x	$2,060 million	7.4%	5.69 x	$2,060 million	None
Industrial	547	1.17 x	$357 million	9.9%	7.62 x	$357 million	None

*Source: City of Toronto 1998 CVA Impact Study
*Before impacts of provincial service level realignment (downloading)

The key observation from the historical data is that, without periodic adjustments in tax burdens to reflect relative changes in assessed values between classes, tax rate disparity will arise due to these relative changes in assessed values.

(II) Tax Ratio Projection and Budgetary Levy Increase Considerations:

A tax ratio is a measure of the tax rate for a property class in comparison to the residential tax rate. Tax ratios can be used to compare taxation levels between different classes within a municipality, or to compare a municipality's tax rates against provincial standards (e.g. ranges of fairness or threshold ratios) for a class. In Ontario, from a regulatory perspective, the term tax ratio applies to the municipal portion of taxes only.

For example, a commercial tax ratio of 3.8 means the commercial tax rate is 3.8 times that of the residential tax rates.

In Toronto, tax ratios for the commercial, industrial and multi-residential tax classes all exceed the provincial thresholds, as shown in Chart 3. Accordingly, no municipal budgetary levy increase can be passed on to the commercial, industrial and multi-residential classes so long as the ratios exceed the threshold limits, and therefore, any budgetary increases can only be passed on to the residential class.

Chart 3 - Toronto's Tax Ratios vs. Provincial Threshold Ratios

	Toronto's Tax Ratios (multiple of residential rate)					
	1998 to 2000	2001 Taxation year	2002 Taxation year	2003 Taxation year	2004 Taxation year (per announcement)	Provincial Threshold Ratios
Multi-Residential	5.235	4.174	4.001	3.987	3.789	2.74
Commercial	4.276	3.798	3.640	3.622	3.861	1.98
Industrial	5.969	5.301	5.081	4.243	4.336	2.63

Residential Tax Increase	None Required	5.0%	4.3%	3.0%	3.0%
Non-Residential Tax Increase		Not Permitted (Bill 140)			1.5% (2004 Flexibility)

As previously noted, the Province has permitted two flexibility adjustments in this regard for the 2004 taxation year. The first enabled the City of Toronto to allow tax ratios to increase in 2004 so as to avoid a CVA-related tax burden shift from commercial (and industrial) onto the residential (and multi-residential) class. The second adjustment permitted the City of Toronto (and other municipalities affected by budgetary levy increase restrictions) to increase taxes on the non-residential classes by up to 50 percent of the municipal residential tax rate increase for 2004. These two exceptions to the current legislative and regulatory rules were made, in consultation with municipal stakeholders, with the understanding that it would provide time for municipalities and their Council's to consider the longer-term implications and to adopt a longer-term tax policy strategy in this regard, rather than the ad-hoc approach that has been taken from year-to-year.

Chart 4 below summarizes the analysis of the longer-term implications of various scenarios for 2005 and beyond with respect to tax ratios and budgetary levy increases on the non-residential classes.

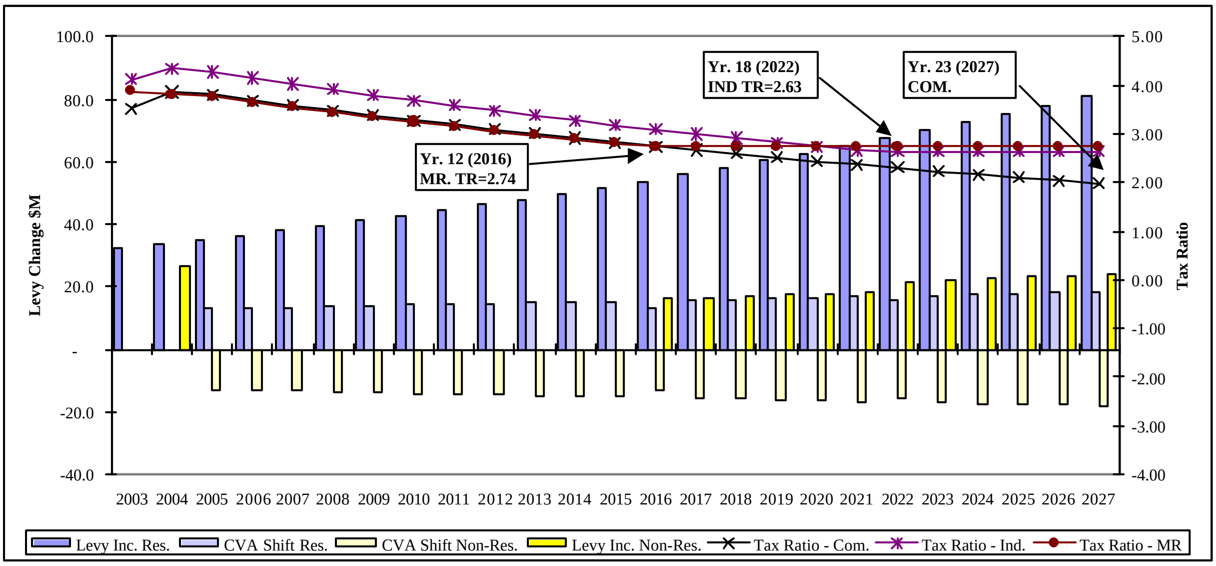
Chart 4 - Summary of Tax Ratio and Budgetary Levy Increase Scenarios

Scenario	Budgetary Levy Increases on Non-Residential	3% Levy Increase Raises	Tax Ratio-Related Tax Burden Shifts Between Classes	Impact on Tax Ratios
1. Status Quo	NO	$33 M – Res.	YES	Ratios fall over time (23 years to reach threshold ratios)
2. No Constraints	YES	$86 M ($33 M – Res; $53 M – Non-Res.)	NO	Ratios increase over time (double in 20 years)
3. Partial Constraints (a)	YES	$86 M ($33 M – Res; $53 M – Non-Res.)	YES	Ratios remain at current levels
4. Partial Constraints (b)	Partial (50% pass-through)	$59 M ($33 M – Res; $26 M – Non-Res.)	YES	Ratios fall over time (46 years to reach threshold ratios)

The status quo scenario (Scenario 1), based on the existing rules, is premised on no budgetary levy increases being permitted on the restricted classes so long as their tax ratios exceed the provincial threshold ratios, and that tax burden shifts occur in response to relative changes in CVA between classes. The results of projections of the status quo scenario indicate that the tax ratios for the multi-residential class will fall to the provincial threshold ratio (2.73) in twelve years (2016), after which there would be no budgetary levy restrictions on this class, the industrial class in year eighteen (2022) and the commercial class in year twenty-three (2027). That is, the City would have unfettered access to its entire tax base for budgetary levy increases in twenty-three years, as shown in Chart 5.

Chart 5- Tax Ratio Projection – Status Quo Scenario (Scenario 1)

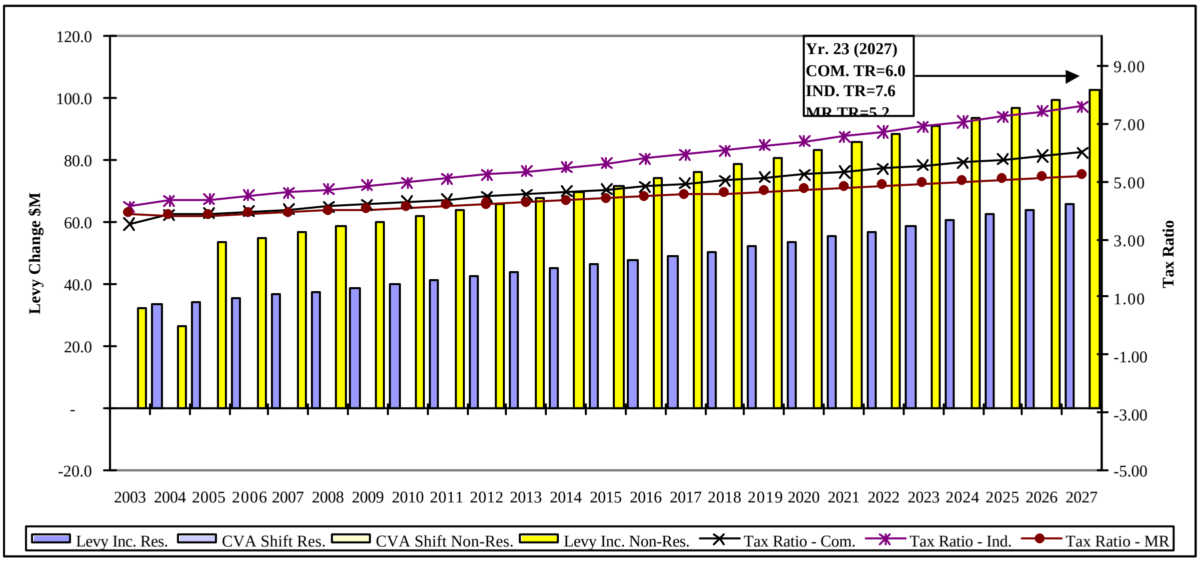
(3 percent per annum residential levy increase; no levy increases on non-residential classes; CVA-related tax burden shifts occur)



Council also has on previous occasions made motions to the effect that the City should have unrestricted access to its entire tax base for the purposes of levy increases. The no-constraints scenario (Scenario 2) is premised on this unrestricted access (e.g. a 3 percent levy increase across all classes raises $86 million annually), as well as not permitting any tax ratio-related tax burden shifts onto the residential class. The results of projections indicate that the tax ratios for the non-residential classes will continually escalate under this scenario as shown in Chart 6 (business tax rates will increase to 5-8 times that of the residential rate over the same period as the status quo scenario). In effect, such a scenario would lead to a perpetuation of the pre-1998 tax policies in that the lack of periodic adjustments to tax burdens will result in tax ratios escalating over time.

Chart 6 - Tax Ratio Projection – No Constraints Scenario (Scenario 2)

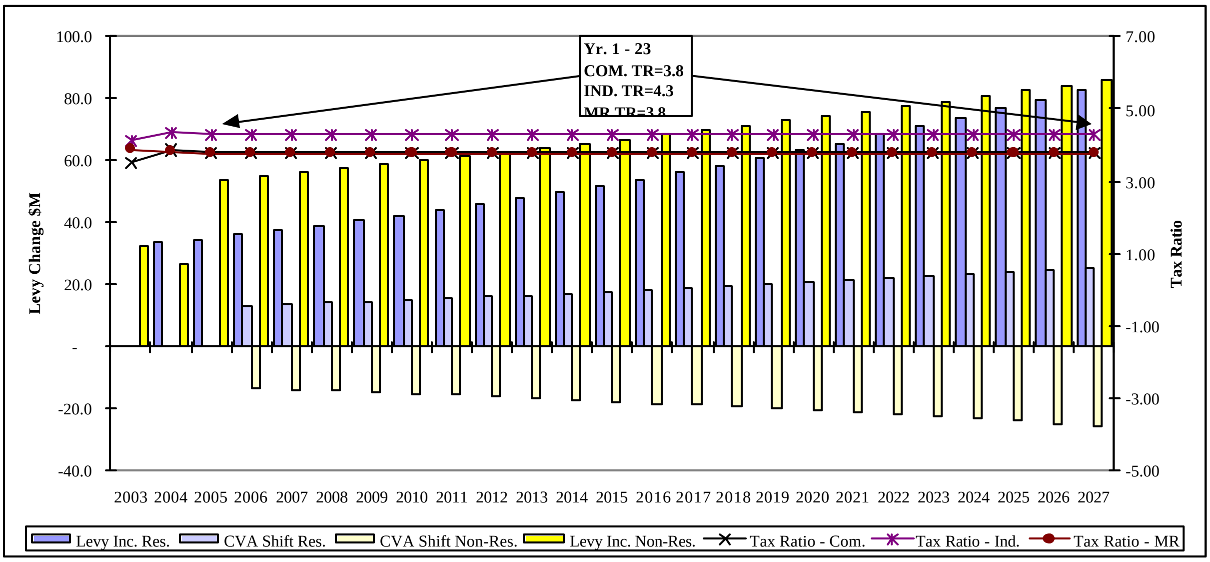
(3 percent per annum levy increase across all classes; No CVA-related tax burden shifts between classes)



The partial-constraints scenario (Scenario 3) is a modification of Scenario 2, wherein tax-ratio related tax burden shifts are permitted to occur, with unrestricted budgetary levy increases permitted on the non-residential classes. Under this scenario, it is projected that tax ratios will remain at their existing level (3.8 to 4.3 times the residential rate). In other words, there will be no progress in reducing the tax ratios of the non-residential classes from their current level.

Chart 7 - Tax Ratio Projection – Partial Constraints Scenario (Scenario 3)

(3 percent per annum levy increase across all classes; CVA-related tax burden shifts between classes permitted)

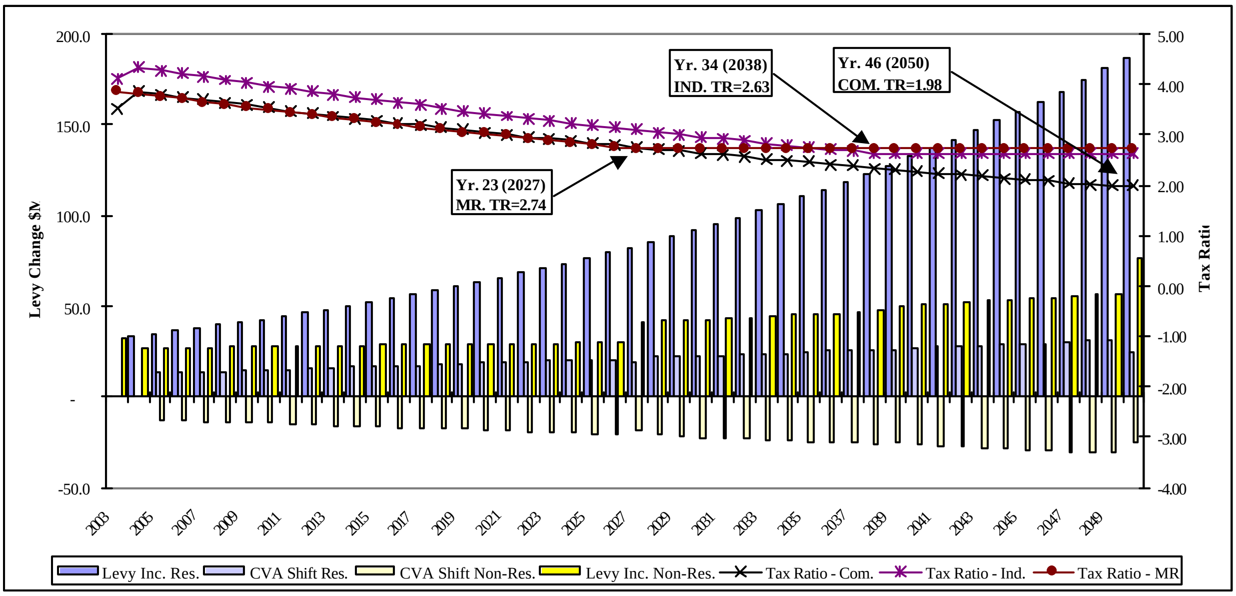


The final scenario modelled is premised upon permitting CVA-related tax burden shifts to occur between classes, but allowing a portion of the residential tax rate increase (e.g.

50 percent) to be passed on to the non-residential classes, as was done in 2004. Under this scenario, periodic shifts in tax burden from the non-residential class onto the residential class will occur in years where residential properties appreciate in assessed value faster than business properties (e.g. as would have occurred in 2004). In years where business properties appreciate in assessed value faster than residential properties, there would be a shift in the other direction (e.g. as occurred in 2001). Based on historical experience, over the long-run, the residential class is expected to appreciate in value faster than non-residential properties, with an average estimated annual tax shift estimated in the range of $8 million to $12 million. However, this would be more than offset by the City's ability to raise taxes from the non-residential class of $26 million annually assuming a 50 percent pass through of the residential tax rate increase assumed at 3 percent. On this basis, the tax ratios for the multi-residential class will fall to the provincial threshold ratio (2.73) in twenty-three years (2027), after which there would be no budgetary levy restrictions on this class, the industrial class in year thirty-four (2038) and the commercial class in year forty-six (2050) (see Chart 8). In effect, it would take twice as long as the status quo scenario for tax ratios to fall to the threshold levels. In the context that the existing tax rate disparity occurred over the last 50 to 60 years, then it may not be unreasonable to expect that correcting such an imbalance would take some forty years to redress.

Chart 7 - Tax Ratio Projection – Partial Constraints Scenario (Scenario 4)

(3 percent per annum levy increase across all classes; CVA-related tax burden shifts between classes permitted)



Several key conclusions can be drawn from the analysis of the above scenarios. The first observation is that relative changes in CVA-value between classes through reassessment can result in tax rate disparity unless periodic adjustments to tax burdens are made.

Secondly, with respect to passing-through of budgetary levy increases, if there is an acknowledgement of intent to reduce the tax ratios of the non-residential class, then only a portion of any residential tax rate increase can be passed through to the non-residential classes. On this basis, the following guiding principle is proposed:

Guiding Principle 1:

Tax ratios are an important measure of tax fairness and equity between the various property classes. Reasonable targets for tax ratios should be set, and tax policies regarding budgetary levy increases and tax ratio-related tax burden shifts between classes should be made with a view of respecting and achieving these targets over a reasonable period of time.

This guiding principle is consistent with the City's position that continued property tax increases, even that arising from inflationary pressures, cannot be sustained over the long run, and that there are more fundamental structural funding issues that cannot and should not be addressed through the property tax system, and that needs to be addressed with the senior levels of governments.

(III) Capping Reform:

In 1998, when current value assessment (CVA) was implemented on a province-wide basis, many commercial, industrial and multi-residential properties in Toronto would have experienced significant tax increases in the absence of any intervention. In fact, 37 percent of non-residential properties in Toronto would have faced tax increases in excess of 100 percent, and 54 percent of non-residential properties were more than 50 percent (above or below) their full-CVA level of taxation. As a result, the Province subsequently legislated a tax capping program for these properties, which would limit the annual assessment-related tax increases to 2.5 percent of the previous year's taxes in Toronto, at the request of the City of Toronto, and with a limit of 10 percent, 5 percent, and 5 percent in 1998, 1999 and 2000, respectively, for the rest of Ontario. Subsequent, the introduction of Bill 140 prescribed a 5 percent limit on CVA-related tax increases for the non-residential classes for 2001 and beyond.

In order to recoup the revenue that is lost from limiting taxes on properties facing increases, municipalities may limit or "claw back" the decreases of properties whose taxes are declining under CVA.

In the absence of a limit on CVA-related tax increases, the property taxes payable by these properties would be the product of their assessed value and the respective tax rate for the class. However, what most of these properties are currently paying in property taxes is based on their 1997 taxes plus the cumulative effect of the limit on increases and decreases. Further, with each reassessment, their full CVA level of taxation – the destination tax – keeps changing. As a result, there has been marginal progress towards CVA taxation for these classes. Now, six-years since the implementation of CVA, there still remains 18 percent of properties facing tax increases in excess of 100 percent (verses

37 percent in 1998), and 29 percent of properties remain 50 percent (above or below) there full-CVA level of taxation (verses 24 percent in 1998).

Stakeholders and taxpayers have identified several concerns with the capping program, including historical tax inequities, the very slow rate of progress towards CVA, and the complexity of the system that leads to a lack of transparency for property owners. The rules surrounding newly constructed properties, severances and consolidations, and changes of class exacerbate these issues.

Issues surrounding the 5 percent cap on tax increases have been included in the discussions with the Minister of Finance in relation to the property assessment and taxation system, with a view to identifying options that facilitate progress towards CVA, but that still offer some form of protection for those properties in need.

In response to stakeholder concerns, the Province as part of its 2004 Budget announcement has indicated its intent to introduce legislation to provide municipalities with a range of options to modify the tax-capping program in order to increase progress towards CVA. These proposed options, which would be available for 2005 and future taxation years, include (i) increasing the amount of the annual cap from 5 per cent to up to 10 per cent of previous year's taxes; (ii) the option to base the cap on a property’s CVA-level taxes instead of the previous year’s taxes; and (iii) the option for a threshold within which a property would move directly to their CVA taxes (e.g. if they are within $250 of their CVA taxes). These proposed enhancements to the capping program would facilitate the transition to CVA while still maintaining a manageable pace of change for property owners. The Province also indicated its willingness to consider additional or alternate assessment stabilization measures as may be put forward during the consultation process. Leaving the decision as a municipal option would allow local governments to respond to local conditions.

An analysis of the longer-term implications of various scenarios for 2005 and beyond with respect to cap/limit on CVA-related tax increases will be included in the stakeholder consultation. Chart 9 below provides an illustration as an example of the impact of these options on sample properties in comparison with the existing capping requirement.

Chart 9 – Example of Impact of Available Options for Capping CVA-Related Tax Increases

					Status Quo (5% of prior years’ tax		Option 1 10% of prior years’ tax		Option 2 5% of CVA taxes	
	CVA Asmt.	Prior Year Taxes	CVA Taxes	% of CVA	Capped Increase	Years to CVA	Capped Increase	Years to CVA	Capped Increase	Years to CVA
Property 1	1,000,000	2,500	50,000	5%	125	62	250	31	2,500	19
Property 2	1,000,000	10,000	50,000	20%	500	33	1,000	17	2,500	16
Property 3	1,000,000	25,000	50,000	50%	1,250	15	2,500	7	2,500	10
Property 4	1,000,000	37,500	50,000	75%	1,875	6	3,750	3	2,500	5
Property 5	1,000,000	45,000	50,000	90%	2,250	3	4,500	1.1	2,500	2

For the City of Toronto, under the status quo scenario (e.g. 5 percent cap on prior years' taxes), it is projected that it will take another seven years (2011) before half of the capped properties (of 22,500 total commercial properties experiencing increases) reach their full-CVA level of taxation, assuming all else remains constant. It is also estimated that it will take seventeen years (2020) for eighty percent of capped properties to reach CVA, and twenty-three years (2026) for ninety percent to reach CVA. The enhanced options made available through the Provincial announcement affords opportunities to accelerate the transition to CVA taxation, for stakeholder consideration.

The Province has already announced that these two additional tools will be available for the 2005 taxation year. However, any alternative that accelerates the progress to full-CVA taxation will most affect those properties whose current level of taxation is low. For Toronto, this means that parking lots and retail/strip retail will be most impacted by changes to the current capping regime. Staff will also consider the feasibility of additional options that may arise during the consultation process, such as floors and ceilings, wherein minimum and maximum levels of taxation vis-à-vis full CVA taxation are established, and thresholds wherein properties within a certain dollar range of CVA taxes move immediately to CVA taxes. Options for the protection of small business are discussed in the following section.

Several key conclusions can be drawn from the analysis of the above scenarios. The first observation is that the current capping regime based on a 5 percent limit on prior year's taxes is ineffective and will result in caps remaining in place for many properties for decades. This prolongs historic inequities in taxation, whereby properties that would otherwise be entitled to a lower level of taxation will continue to see their decrease entitlement clawed-back to subsidize an artificially low level of taxation for other properties. Secondly, any changes to the capping program in order to facilitate the transition to CVA should have regard for maintaining a manageable pace of change for property owners. Small business represents a significant proportion of the properties that experience additional tax increases through any accelerated capping program. On this basis, the following guiding principle is proposed:

Guiding Principle 2:

The current capping regime is ineffective and will prolong historic tax inequities. However, any changes to the capping program in order to facilitate the transition to CVA should have regard for maintaining a manageable pace of change for property owners. A longer transition period should be available for those properties facing large increases.

(IV) Mitigating Impacts for Vulnerable Businesses:

This section presents an initial discussion of issues related to the establishment of a small business retail class in Toronto, and on the potential for property tax relief for such a class.

The idea of providing preferential property tax treatment to small businesses is not new, having been previously raised by various stakeholders and in various forums (e.g. Marcel Beaubien's Review of the Property Assessment and Classification System (2002), and the City of Toronto's Business Reference Group (1999-2001)).

The impetus for these discussions was that, with the introduction of CVA, small commercial properties that had traditionally been under-assessed in relation to other commercial properties were facing large tax increases due to CVA. In the absence of mitigating measures, more than half of these property types would have experienced tax increases greater than 100 percent. Ultimately, Council's decision to adopt a 2.5 percent cap on tax increases for all properties in the commercial, industrial and multi-residential classes for 1998 to 2000, and a 5 percent cap for 2001 and beyond, eliminated the immediate need to address CVA-related tax relief for small business properties.

Specific proposals that were made during these consultations included:

(i) creating a separate property class or sub-class for "small business" or "neighbourhood commercial" properties;
(ii) imposing graduated tax rates to apply lower tax rates to lower-valued business properties;
(iii) using geographic boundaries to determine which properties would be eligible, such as Business Improvement Areas; and,
(iv) using definitions based on physical characteristics of properties (e.g. street frontage with no more than three storeys, square footage, etc.), or using a variety of means tests such as number of employees.

Various objectives identified by stakeholders included: supporting community streetscapes with small neighbourhood shops; reducing the tax burden on small businesses in an effort to sustain and promote economic development; and to provide relief to small business properties that are facing assessment-related tax increases as a result of the assessment-related tax decreases that are being experienced by large business properties (e.g. to mitigate the tax shift from large office towers onto small properties). The objectives behind the proposals submitted by the various stakeholders are not synonymous. Some stakeholders want to see broad-based tax relief provided to all small businesses, recognizing the importance and fragility of the small business sector in our economy, while others are only seeking to confer a benefit on their particular category of properties.

There are several significant issues to be reviewed in respect of creating a small business class. Firstly, there is a definitional issue. There is neither consensus nor a uniform definition of what constitutes a "small business" or "small retail" establishment. In all likelihood, any definition will inadvertently include properties that should not be included, and inadvertently exclude properties that should be included. Secondly, there may be structural issues pertaining to the information contained in the property assessment rolls. The current assessment and taxation system assigns assessed values and taxes to the property as whole, whereas, the majority of businesses are tenants in multi-tenanted properties. As such, the property tax liability rests with the property owner, who through the lease, apportions and collects taxes from the individual tenants (subject to the capping/clawback rules). This may present some problems in finding a mechanism to deliver any such property tax relief to specific individual tenants within a multi-tenanted building.

Notwithstanding the foregoing obstacles, the City of Toronto and the Province recognize the importance of small businesses to the vitality of neighbourhoods and communities. As such, the introduction of any reform to the assessment and property taxation system, and specifically any modification to the capping regime, should be combined with measures to protect vulnerable businesses. Currently, municipalities have two options available to target tax reductions to smaller and lower-valued properties: graduated tax rates can be applied across the entire commercial property class to allow for a lower tax rate to apply to the lower portion of a property's assessment; and optional property classes can be used to adjust the tax burden of specific types of properties within the commercial class. Also as part of the 2004 Provincial Budget announcement, the government indicated its intent to introduce legislation to enhance these mechanisms by giving municipalities the additional option to combine these measures and apply graduated tax rates at the optional property class level. The Province also indicated its willingness to consider additional or alternate measures as may be put forward during the consultation process.

Chart 10a shows the current effective tax rate on the various commercial property types arising as result of the application of capping tax increase on these property types. The chart shows that the current taxation level on parking lots (1.4 percent) and retail/strip retail (2.9 percent) to be well below the commercial class average of 4.43 percent. Generally, this is because that prior to CVA, these properties were taxed under the residential rate (parking lots/vacant land) and/or because no or a low 'business occupancy tax surcharge' was applied to these properties, and hence, these properties benefited the most from capping protection. In contrast, the current effective tax rates on hotels and large office buildings is well above the commercial class average, because historically, a high 'business occupancy tax surcharge' was imposed on these property types prior to CVA. The clawback regime impedes the progress for these properties towards the lower class average tax rate.

Chart 10a – City of Toronto 2004 Effective Tax Rates – Commercial Properties

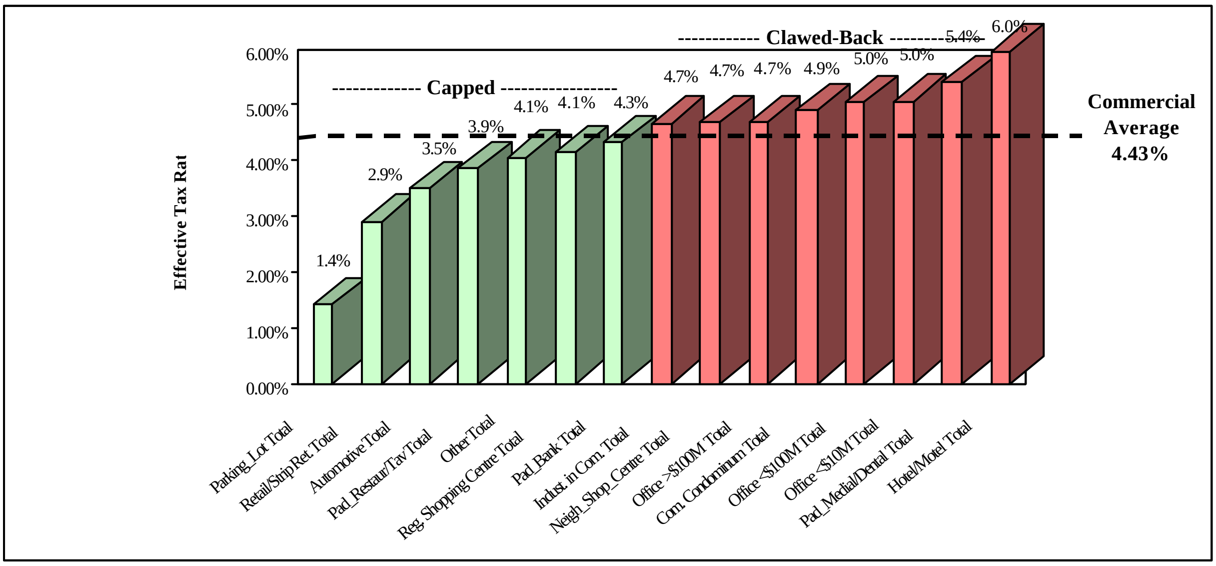


Chart 10b shows the impact of moving to full CVA taxation on Toronto's various commercial property types. It shows that strip retail currently benefits the most with the current capping regime, through the delay in the balance of the $77 million in tax increase (a 54 percent increase) that they will otherwise experience. Parking lots and regional shopping centres would also experience tax increases of $27 million and $10 million respectively. On the other hand, the primary beneficiaries of moving to full CVA taxation would include large and small office buildings ($89 million or approximately a 10 percent decrease) and hotels ($23 million or a 25 percent decrease).

Chart 10b – Impact of Moving to Full CVA Taxation – Commercial Properties

Commercial Property Type	No. Properties	2004 Actual Taxes ($ millions)	Full CVA Destination Tax ($ millions)	Tax Impact ($ millions)	% Impact
Automotive	1,185	$ 37.3	$ 47.7	$ 10.4	28%
Com. Condominium	2,866	$ 23.5	$ 21.4	($ 2.1)	(9%)
Hotel/Motel	336	$ 93.9	$ 70.5	($ 23.3)	(25%)
Indust. in Com.	6,429	$ 212.7	$ 203.8	($ 8.8)	(4%)
Neigh_Shop_Centre	954	$ 210.7	$ 200.4	($ 10.3)	(5%)
Office <$100M	265	$ 414.5	$ 362.4	($ 52.1)	(13%)
Office <$10M	998	$ 134.8	$ 119.9	($ 14.9)	(11%)
Office >$100M	40	$ 450.9	$ 429.0	($ 21.9)	(5%)
Other	3,750	$ 248.4	$ 257.3	$ 9.0	4%
Pad_Bank	219	$ 10.6	$ 10.9	$ 0.3	3%
Pad_Medical/Dental	129	$ 19.7	$ 16.3	($ 3.4)	(17%)
Pad_Restaur/Tavern	410	$ 16.0	$ 18.5	$ 2.5	16%
Parking_Lot	306	$ 12.9	$ 39.9	$ 27.0	209%
Reg. Shopping Centre	15	$ 126.6	$ 136.8	$ 10.2	8%

Retail/Strip Ret.	13,600	$ 143.1	$ 220.5	$ 77.5	54%
All Commercial	31,502	$ 2,155.3	$ 2,155.3	($ 0.0)	(0%)

Given the foregoing, the following guiding principle is proposed in respect of mitigating property tax impacts for vulnerable businesses:

Guiding Principle 3:

It is recognized that small retail businesses are an important sector of the economy. They contribute to the vitality and character, and hence value, of our communities. Property tax relief for vulnerable business must be developed in conjunction with any other changes that facilitate the transition to CVA, with a view to achieving equity to the extent possible between various property types, objectivity in defining eligible properties, longer-term stability and certainty for property owners, and transparency in administration.

The following summarizes various options for providing tax relief for small businesses that will be included, but not limited to, in the stakeholder consultation. A preliminary analysis of the impact of these options on various commercial property types, in the context of capping reform, will be included in the stakeholder consultation.

Options available under current legislation:

(i) Optional property class based definition.
(ii) Graduated tax rates at broad class or optional class level.

Options requiring legislative changes, but readily identifiable within existing assessment system:

(i) Property Code based definition (i.e. Strip Retail/Retail property codes - Business Reference Group Proposal).
(ii) Designated Areas (i.e. Business Improvement Areas, street fronting – TABIA proposal).

Options requiring legislative changes and assessment system changes:

Occupant based definition (e.g. use, square footage, number of employees, etc.).

(V) Other Tax Policy Issues to be Considered:

This section highlights two other outstanding tax policy issues that have yet to be resolved.

Business Education Tax Reductions:

In 1998, the Province committed to reduce commercial and industrial education tax rates in municipalities with tax rates above the provincial average. These education tax rate reductions were to be phased in over eight years.

By the end of 2003, Toronto's business education taxes had been reduced by a total of $262 million. Because Toronto's commercial and industrial assessments have increased much faster than elsewhere in the Province, Toronto's commercial and industrial education tax rates are now below the new provincial average rate of 2.65 percent. However, Toronto's tax rates for these business classes (i.e. commercial and industrial) are still approximately 28 percent higher than that imposed by the Province on the surrounding GTA municipalities.

Toronto's business sector continually expresses concern that Toronto's commercial tax rates are significantly higher than those in the surrounding GTA municipalities, and erodes locational competitiveness.

City Council has on previous occasions requested the Province to reduce Toronto's business education tax rate to the average of the GTA municipalities (including Toronto). Should the Province heed this request, Toronto's businesses would realize an education tax reduction of approximately $118 million annually, as shown in Chart 11. This option will again be raised with the Minister of Finance in the context of initiatives for property tax reform for 2005 and beyond.

Chart 11 – Moving Toronto's C&I Education Tax Rate to GTA Average

GTA	Wtd. Assessment	Education Levy	Wtd. Avg. Tax Rate			
Commercial	81,721,698,566	1,691,299,062	2.06958%			
Industrial	17,122,212,094	385,084,230	2.24903%			
Toronto	**Wtd. Assessment**	**2003 Ed. Tax Rate**	**Education Levy**	**Toronto if at GTA Rate**	**New Levy**	**Toronto Impact**
Commercial	46,054,347,701	2.29973%	1,059,127,032	2.06958%	953,133,335	(105,993,697)
Industrial	4,918,992,271	2.50173%	123,060,102	2.24903%	110,629,768	(12,430,334)
			1,182,187,134		1,063,763,103	**(118,424,031)**
					Provincial Impact	**118,424,031**

Guiding Principle 4:

A view to achieving equity and fairness in tax rates for both the municipal and education of portion taxes should be taken. The Province must be encouraged to show its commitment to reduce Toronto's business education tax rate disparity vis-à-vis the surrounding GTA municipalities.

Tax Rebate Program for Heritage Properties:

Council in February 2002 adopted a Heritage Property Tax Program, which if implemented would provide a 40% rebate of the total municipal and education taxes payable (up to a maximum of $500,000 per year) for eligible heritage properties (or portions thereof) within the commercial, industrial, multi-residential and residential tax classes. The implementation of the proposed rebate program was subject to the Province enacting legislation to enable Council to increase property tax rates in the commercial, industrial and multi-residential classes to the extent necessary to fund heritage tax rebates from within their respective classes.

This program specific legislation has not been enacted. City staff are continuing to work with Provincial staff to identify legislative amendments necessary to accommodate Council's resolution in this regard. Alternative program and funding scenarios, such as a separate heritage tax class, will also be included in the stakeholder consultation with a view to identifying a fair and equitable allocation of program cost so that such a program may be implemented in 2005.

(B) Framework for Consultation:

Over the past year, a working group jointly chaired with representatives of the Province (Finance and Municipal Affairs) and Ontario's municipalities has been meeting to discuss issues related to the Ontario property assessment and taxation system and to identify new tax mitigation tools for the Minister's consideration. This consultation has taken place, which has resulted in some of the changes recently announced. While no new consultation has been announced, the Province has indicated a willingness to consider additional or alternate measures that may be put forward by municipalities to address specific concerns regarding the stability, fairness, flexibility and simplicity of the property assessment system.

To this end, this report supports a consultation process to engage City of Toronto stakeholders in a discussing regarding the longer-term tax policy issues highlighted in this report. Staff will consider stakeholder input and feedback in the development of recommendations for the consideration of Council and the Province with regards to tax policies for 2005 and beyond.

The following consultative framework is proposed:

Description	Target Group (including, but not limited to)	Date/Time/Location

Industry/Business Association Consultation	Board of Trade (BOT), Urban Development Institute (UDI), Canadian Institute of Public and Private Real Estate Companies (CIPPREC) Toronto Association of Business Improvement Areas (TABIA) Greater Toronto Hotel Association (GTHA) Toronto Industry Network Canadian Federation of Independent Business	To be determined on individual basis.
General Public Consultation	Interested members of the general public	Scarborough Civic Centre - July 6, 2004, 6:00 p.m. - 9:00 p.m., Committee Rooms 1 and 2 North York Civic Centre – July 7, 2004, 6:00 p.m. - 9:00 p.m., Committee Room 3 Metro Hall - July 12, 2004, 6:00 p.m. - 9:00 p.m., Room 309 Etobicoke Civic Centre – July 13, 2004, 6:00 p.m. - 9:00 p.m., Boardroom

A City staff team consisting of representatives from Finance, Economic Development Culture and Tourism, and Urban Development Services (Planning) will participate in the individual and public meetings. Notice of the meetings, which will be open to the public, will be posted on the City's website along with this report and discussion paper. The input and feedback received will be incorporated in a report to the Policy and Finance Committee for their meeting in September, 2004, which will present specific implementation recommendations that are in keeping with the guiding principles embodied in this report.

Conclusions:

The recent Provincial announcement advises that stakeholder consultation will be sought towards the development of a longer-term tax policy strategy for 2005 and beyond. It also provides the time necessary for the senior levels of government to deal with the more fundamental structural funding issues that cannot and should not be addressed through the property tax system. The consultation will also include consideration of stakeholder concerns raised regarding tax ratios and restrictions on budgetary levy increases, the complexities of the capping and clawback mechanisms, measures to provide protection to vulnerable small businesses, and inequities in the business education tax rates. Following the consultation with stakeholders during July and August, staff will report through the Ad Hoc Committee on the Long term Fiscal Plan to Policy and Finance Committee with recommendations on these issues. This will allow Council to meet the timing of the Fall session of the Provincial legislature with recommendations that may require legislative amendments.

The City acknowledges that disparity exists between its municipal residential tax rate and its non-residential (commercial, industrial, and multi-residential) tax rates, which became most apparent upon the transition to the Current Value Assessment system in 1998. However, it must be noted this disparity was inherited from an outdated provincial assessment system, in which property values had not been updated since the 1940's, and is not a direct result of any action or inaction on the part of Toronto's former Councils. It must also be recognized that attempting to remedy a problem that has accumulated over 60 years cannot be reasonably accomplished over a short period of time.

This report provides highlights key longer-term property assessment and tax policy issues, and seeks Council's approval of guiding principles with respect to a l onger-term tax policy strategy. Support of the principles outlined in this report will provide reassurance and certitude to various stakeholders that the City of Toronto is committed fairness and equity in the property tax system.