



STAFF REPORT ACTION REQUIRED

Settlement of Bank Towers Assessment Appeals

Date:	April 8, 2013
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2013\Internal Services\rev\ec13011rev (AFS17087)

SUMMARY

In November 2012, City Council approved the proposed settlement of property assessment appeals in relation to six (6) bank tower properties (Brookfield Place, Commerce Court, First Canadian Place, Royal Bank Plaza, Scotia Plaza and the Toronto Dominion Centre) for taxation years 2001 to 2012 inclusive, and authorized the Director of Revenue Services to sign the proposed Minutes of Settlement and related agreements on behalf of the City. By the end of March 2013, the Minutes of Settlement for all six bank towers were finalized and executed, and the resulting property tax adjustments were processed.

Now that the Minutes have been signed, this report provides information on the final financial impacts arising from the execution of the Minutes and recommends the allocation of the resulting one-time operating surplus.

RECOMMENDATIONS

The Deputy City Manager and Chief Financial Officer recommends that:

1. City Council establish a reserve called 'Assessment Appeal Stabilization Reserve' in Schedule 3 – Stabilization Reserves of Chapter 227 of the City of Toronto Municipal Code to provide funding to offset any annual shortfall in amounts budgeted for property tax decreases (tax deficiencies) due to assessment appeal losses and the actual amount of tax deficiencies occurring during the year, as described in Attachment 2 to this report.

2. Council allocate the one-time operating surplus associated with the unused portion of the assessment appeal provision previously established for the 2001 to 2012 taxation years, in the amount of \$94.0 million, as follows:
 - a. \$30.0 million be allocated to the newly established 'Assessment Appeal Stabilization Reserve' to be used to offset any annual shortfall between amounts budgeted for property tax decreases (tax deficiencies) due to assessment appeal losses and the actual amount of tax deficiencies occurring during the year, for 2013 and future taxation years;
 - b. \$34.0 million be allocated to the Social Housing Stabilization Reserve (#XQ1106); and,
 - c. \$30.0 million be allocated to the Capital Financing Reserve (#XQ0011) and dedicated to begin to address the state of good repair backlog for Parks, Forestry and Recreation, to be distributed in the 10 year capital plan through the 2014 Capital Budget process.
3. City Council amend Chapter 227 of the City of Toronto Municipal Code in accordance with Recommendation 1 above.
4. City Council grant leave for the introduction of any necessary bills in Council.

Financial Impact

As reported to City Council in November 2012, the executed settlement agreements between the bank tower owners, MPAC and the City resulted in property tax reductions ranging between 2.0% to 5.4% for the bank tower properties (with an average total tax reduction of 3.3%) for taxation years 2001 to 2012 inclusive, representing a total decrease of \$94.9 million. Of the \$94.9 million reduction:

- \$65.4 million is related to the education portion of property taxes and is fully recoverable from the province/school boards, with no impact on municipal revenues;
- \$29.5 million is the municipal portion of the property tax reduction. There was no negative financial impact as a result of this reduction as the City's portion of the tax reduction was provided for and included in the City's account titled "Allowance for Doubtful Tax Receivables".

At the end of each year, the City must estimate what portion of its municipal tax revenue is at risk of being reduced / refunded as a result of assessment and tax appeals which are outstanding at the end of the fiscal year (i.e., appeals that have yet to be heard, settled or processed as at December 31st). A provision is established in the City's account titled "Allowance for Doubtful Tax Receivables," in an amount sufficient to fund the estimated potential reductions in property tax revenues arising from outstanding assessment and tax appeal losses.

Given the coordinated efforts of MPAC and City staff, the settlement of the bank tower appeals has resulted in smaller than anticipated property tax reductions (from what was originally estimated) for these properties and has reduced the provision required for other business properties under appeal, resulting in an overall reduction in the City's "Allowance for Doubtful Tax Receivables" of \$94.0 million as follows:

- a) \$71.9 million representing the difference between the total provision that had been established for the bank tower properties for the 2001 to 2012 taxation years (the *potential* assessment appeal losses), and the *actual* reduction in taxation revenues resulting from the settlement of appeals for these properties; and,
- b) \$22.1 million representing a reduction to the provision for other business type properties under appeal. The assessment values settled upon for the bank tower properties for the years under appeal has reduced the level of risk / exposure for potential reductions in assessment values, and thus municipal tax revenues, associated with other business properties under appeal. The percentage used to estimate the amount at risk for pending appeals on commercial assessments was reduced from 7.25% to 6.8%, from 13.0% to 10.6% for industrial assessments and from 2.5% to 2.1% for multi-residential assessments.

Allocating the resulting one-time surplus associated with the bank tower settlement according to the recommendations in this report ensures that sufficient funds will be available to offset potential assessment appeal losses in 2013 and future years, and provides much needed funding for social housing stabilization and state-of-good-repair projects for Parks, Forestry and Recreation.

The unused provision (i.e. one-time operating surplus) and the recommended allocations are summarized in Table 1, below.

**Table 1: Changes in Assessment Appeal Provisions –2001 to 2012
and Allocation of Provision Reduction / One-time Surplus (\$M)**

	Original Provision	Revised Amount	Provision Reduction
Bank Tower properties Difference between total assessment appeal provision established for the six bank towers and actual reduction in taxes for years 2001 – 2012 based on the settlement	\$101.4	\$29.5	\$71.9
Other Business Type Properties Adjustment in total assessment appeal provision due to adjusted at-risk percentages (Bank Tower settlement reduces the level of risk for potential reduction in municipal tax revenue for other business properties under appeal).	\$285.3	\$263.2	\$22.1
Totals	386.7	292.7	\$94.0
Recommended Allocation of Unused Provision		Reserve Acct. #	Allocation (\$ M)
1. Assessment Appeal Stabilization Reserve		new	\$30.0
2. Social Housing Stabilization Reserve		XQ1106	\$34.0
3. Capital Financing Reserve, dedicated to begin to address the State of Good Repair backlog for Parks, Forestry and Recreation		XQ0011	\$30.0
Total			\$94.0

DECISION HISTORY

At its meeting of April 12, 13 and 14, 2005 City Council endorsed the participation of City staff in the assessment appeals before the Assessment Review Board (ARB) for the bank tower properties. See Policy and Finance Committee Report 4, Clause 35: *Pending Assessment Appeals on Commercial Office Towers*, available at: <http://www.toronto.ca/legdocs/2005/agendas/council/cc050412/pof4rpt/cl035.pdf>

On February 22, 2008, the ARB issued an Interim Decision that set out its legal interpretation of current value, in essence adopting the position that the legal definition of current value meant that the bank towers should be valued as if they were completely vacant.

Subsequently, on March 3, 4 and 5, 2008, City Council adopted item MM17.28: *Bank Towers – Interim Assessment Appeal Decision*, authorizing the City Solicitor to seek leave to appeal the Interim Decision of the ARB dated February 22, 2008 to the Divisional Court. Council's decision is available at: <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2008.MM17.28>

Most recently, at its meeting of November 27, 28 and 29, 2012, Council approved the proposed settlement of assessment appeals for the bank tower properties for the 2001 to 2012 tax years (re: Member Motion MM28.20: *Bank Towers Assessment Appeals – Proposed Settlement*). Council's decision is available at: <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2012.MM28.20>

ISSUE BACKGROUND

The bank tower properties are comprised of twelve (12) buildings located in Toronto's financial district near the intersection of Bay and King Streets. These properties, identified in Table 2 below, are known in the industry as triple A office buildings, and represent some of the most valuable commercial real estate in Canada.

**Table 2
Bank Tower Office Complexes**

Property/Office Complex	Owner	Number of parcels / properties
Brookfield Place (formerly BCE Place) (161, 171 and 181 Bay Street)	Brookfield Office Properties	3
Commerce Court (199 Bay Street)	British Columbia Investment Management Corporation	1
First Canadian Place (100 King St. W.)	The Manufacturers Life Insurance Co.	1
Royal Bank Plaza (200 Bay Street)	Oxford Properties	1
Scotia Plaza (40 King St. W.)	SP 1 Nominee Inc	1
T-D Centre (55 and 77 King St. W., 222 Bay St., 79 and 100 Wellington St. W.)	Oxford Properties	5

The assessment appeals for these properties related to taxation years 2001 to 2012. The bank tower owners argued that the current value assessments (CVA) for these buildings were too high, suggesting that the CVAs should be reduced by 15 to 20 per cent. The hearing of the appeals began in 2005. The Assessment Review Board (ARB) chose to hear all of the bank tower property appeals as a group, given that the basis of the appeals and the bank tower owners' arguments were similar for all of these properties.

The initial ARB hearing ended in January 2007, with the ARB reserving its decision. On February 22, 2008, the ARB issued a lengthy Interim Decision that set out its legal interpretation of current value, in essence adopting the position that the legal definition of current value meant that the bank towers should be valued as if they were completely vacant. Had this interim decision of the ARB been upheld, the property assessments on the bank towers properties may have been reduced by up to 40 per cent. Given the potential impacts such a decision may have had on the assessment of the large bank towers, and by extension, the assessment of other office and income producing buildings across the City, City staff sought and received Council's approval in March 2008 to appeal the ARB's interim decision to the Divisional Court. The Divisional Court overturned the interim decision of the ARB and ordered that the matter be returned to a new ARB panel.

The bank tower owners subsequently appealed the Divisional Court's ruling to the Ontario Court of Appeal. In October 2010, the Court of Appeal decided in favour of the City and MPAC, dismissing the bank tower owners' appeal, but varied the Divisional

Court decision by sending the matter back to the same ARB panel that had made the interim decision.

In November 2012, a proposed settlement was reached between the bank tower owners, MPAC and the City, avoiding the need to hear the matter before the ARB. The proposed settlement agreement was approved by Council at its meeting of November 27, 28 and 29, 2012. By the end of March 2013, the Minutes of Settlement were signed and executed, and resulting property tax adjustments were processed.

COMMENTS

The bank tower properties, comprising 12 buildings, represent over 9% of the City's total commercial assessment base and approximately 9% of its commercial property tax revenue. As such, any reductions or assessment appeal decisions regarding these properties would significantly impact the City's municipal tax revenue and set a precedent for how other business properties are valued. As explained earlier in this report, the bank tower property owners were seeking significant reductions in the assessment values for their properties (in the range of 15% to 20%) for multiple taxation years.

In accordance with generally accepted accounting principles and in order to protect the City's financial position against potential future revenue reductions, at the end of each fiscal year an amount is set aside (i.e. a provision is established) for each year under appeal to reflect the amount of municipal taxation revenue at risk. The provision established for the bank tower properties, based on a historical average assessment appeal loss for commercial properties of 7.25%, was \$101.4 million.

In November 2012 City Council approved Minutes of Settlement with respect to the bank tower properties resulting in property tax reductions ranging between 2.0% to 5.4%, with an average total tax reduction of 3.3% (including both municipal and education taxes) for all years under appeal. This represents a total decrease in property taxes of approximately \$94.9 million for all bank tower properties for all years under appeal (2001 to 2012 inclusive). The municipal portion of this tax reduction is \$29.5 million, while the education portion of the reduction is \$65.4 million, which is fully recoverable from the Province/school boards.

In the first quarter of 2013, the agreed upon assessments and the associated reductions in the levied taxes were processed to the respective property tax accounts. As such, it is now possible to compare the actual decrease in municipal property tax revenue to the amounts that had been estimated and provided for in each prior budget year to reflect potential appeal losses for these properties. As summarized in Table 3, below, the settlement of the bank tower properties resulted in municipal property tax reductions of \$29.5 million for all years under appeal (2001 to 2012), which is significantly less than the \$101.4 million provision.

Table 3
Assessment Appeal Provision Vs. Actual Municipal Property Tax Reduction
Bank Tower Properties – 2001 - 2012

	\$M
Provision established for Bank Tower properties under appeal for tax years 2001 to 2012 inclusive	\$101.4
Actual reduction in municipal taxes for the bank tower properties based on approved and executed settlement	\$29.5
Unused portion of the Provision	\$71.9

The settlement of the bank tower appeals also has an impact on valuation of other business properties under appeal given that the assessment values settled upon for the bank tower properties reduces the level of risk for potential reductions in municipal tax revenues for other business properties under appeal (including other commercial, industrial and multi-residential properties). In determining the amount of provision to be set aside for outstanding appeals for taxation years prior to 2013 for other property types with outstanding appeals as at December 31, 2012, the at risk percentages were revised for each property class. This reduction in the at-risk assessment percentages reduces the total provision required for other business properties with outstanding appeals by \$22.1 million. Table 4, below, summarizes the reduction in the provision for both the settlement of the six bank towers and the impact on other business properties under appeal. In total, reductions to the City's provision for "Allowance for Doubtful Tax Receivables" resulted in a one-time operating surplus for the 2012 fiscal year of \$94.0 million.

Table 4:
Changes in Assessment Appeal Provisions – 2001 to 2012

	Original Provision	Revised Amount	Provision Reduction
Bank Tower properties Difference between total assessment appeal provision established and actual reduction in taxes for years 2001 – 2012 based on the settlement	\$101.4	\$29.5	\$71.9
Other Business Type Properties Under Appeal Bank Tower settlement reduces the level of risk for potential reduction in municipal tax revenue for other business properties under appeal.	\$285.3	\$263.2	\$22.1
Totals	386.7	292.7	\$94.0

The balance of this report discusses the recommended allocation of the one-time surplus associated with the settlement of the bank tower properties.

Establishing an Assessment Appeal Stabilization Reserve

As indicated in Table 5, below, the annual loss of municipal taxation revenue experienced as a result of assessment appeals heard and disposed of or settled on an annual basis fluctuates significantly from year-to-year based on a number of variables including the number of appeals filed or heard in a year, whether the year is a reassessment year, etc.

Table 5 illustrates that annual property tax losses due to assessment appeals for all property types have ranged between an overall low of \$28.5 million in 2009 to a high of \$153.7 million in 1999, with losses tending to be greater in the re-assessment years. As tax reductions due to assessment appeal losses vary by year and are difficult to estimate in advance, the annual amounts budgeted to fund tax deficiencies (i.e. reductions in municipal tax revenue) have been insufficient to cover the actual tax reductions in 8 years of the last 15 years (1998 to 2012).

Table 5
Tax Deficiencies – Budget Vs. Actual – 1998 – 2012

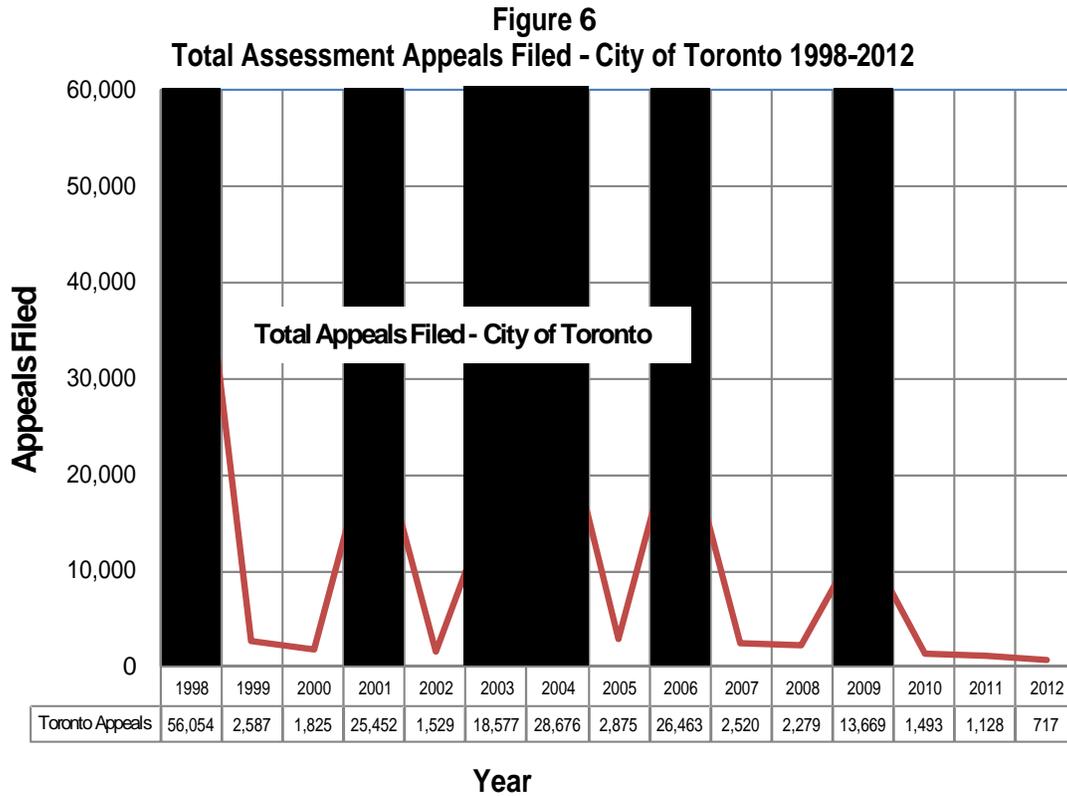
Year	Budget	Actual	Variance
1998	\$127.3	\$145.5	-\$18.2
1999	\$159.7	\$153.7	\$6.0
2000	\$109.6	\$113.8	-\$4.2
2001	\$116.0	\$129.4	-\$13.4
2002	\$84.0	\$94.4	-\$10.4
2003	\$85.5	\$66.2	\$19.3
2004	\$74.3	\$95.4	-\$21.2
2005	\$92.6	\$62.2	\$30.4
2006	\$87.0	\$75.6	\$11.4
2007	\$75.0	\$76.9	-\$1.9
2008	\$78.0	\$57.9	\$20.1
2009	\$81.9	\$28.5	\$53.4
2010	\$68.9	\$79.0	-\$10.0
2011	\$73.0	\$96.9	-\$23.9
2012	\$65.0	-\$31.3	\$96.3 ^{Note 2}

Note: Shaded columns indicate re-assessment years

Note 2: The 2012 budget variance of \$96.3 million includes \$94.0 million associated with the processing of the bank tower appeals as identified in this report plus \$2.3 million in appeals and adjustments which are not attributable to the bank tower appeals.

The shaded columns in Table 5 illustrate that actual tax reductions due to assessment appeal losses closely correlate with reassessment years, i.e., the first year following a province-wide reassessment of all properties by MPAC. When new CVA values are

established by MPAC that reflect revised assessments based on an updated base year for valuation, it can be expected that assessment appeals are higher than average in the first year of the reassessment, as property owners challenge their newly-established CVA values. This trend is illustrated in Figure 6 below, which shows the total number of assessment appeals filed in the City of Toronto. The spikes in the line graph correspond closely to reassessment years (shaded years).



Note: Shaded columns indicate reassessment years

Source: Assessment Review Board

In order to help stabilize the impact on the City's annual operating budget and annual municipal taxation revenues from fluctuating assessment appeal reductions from year-to-year, this report recommends that an Assessment Appeal Stabilization Reserve be created and funded initially by using a portion of the unused provision arising from the settlement of the bank tower appeals.

The rationale for establishing an assessment appeal stabilization reserve for 2013 and future years is based on four important factors.

- i) 2013 is a year of reassessment. It can therefore be expected that assessment appeal activity in 2013, and associated tax reductions, will be higher than in the preceding three (3) years, and likely higher in 2013 than in any of 2014, 2015 or 2016 (given that reassessments now follow a four-year cycle, and appeals, once settled, will apply to each of the remaining years in the reassessment cycle).

- ii) The 2013 approved operating budget (non-program accounts) includes funding for tax deficiencies of \$72.0 million. This is significantly less than the average annual tax deficiency actuals of \$93 million experienced over the period 1998 – 2011. Given that 2013 is a reassessment year, there is a strong possibility that the budgeted tax deficiency amount for 2013 may be insufficient to fund the actual tax reductions due to assessment appeals. Based on past experience, tax deficiencies in 2013 may be expected to be between \$90 and \$110 million - this could result in a net deficit (shortfall) in the tax deficiency budget for 2013 of \$18 to \$38 million. The recommended assessment appeal stabilization reserve would fund any shortfall experienced in 2013 and future years.

A number of properties within Toronto saw large increases in assessed value through the most recent reassessment in 2012 for the 2013 to 2016 taxation years. In the industrial class alone, while the average CVA increase for the class due to the reassessment was 18% over four years, more than 100 properties experienced CVA increases of 50% or more, with some experiencing increases approaching 500%. These CVA increases were not the result of assessment growth due to new construction or improvements, rather they were simply market-related value increases. There is a strong probability that such substantial increases could be successfully challenged and reduced through the assessment appeal process. This type of activity will directly affect the amount of property taxes at risk in 2013 through 2016, underscoring the need for a stabilization reserve to offset such losses.

If, for example, even a third of all commercial and industrial properties facing assessment increases greater than twice the class average were to successfully appeal their assessment, such that the assessment was reduced on appeal to a level equal to the class average, the potential unfunded revenue loss to the City would be in the order of \$6 million in 2013 alone (i.e., losses in excess of the amount included in the budget/provision), with potential further losses of approximately \$6 million in 2014 and future years if appeals covered multiple years. If half of the above properties were successfully appealed, the unfunded amount would increase to \$9 million.

- iii) Utilizing the unused provision arising from the settlement of the bank tower appeals for an assessment appeal stabilization reserve will protect the City against unfunded revenue losses from successful assessment appeals in future years, without putting pressure on already constrained operating budgets.

Accordingly, it is recommended that the assessment appeal stabilization reserve be created, and funded initially using a portion of the unused provision arising from the settlement of the bank tower appeals. Given that the net shortfall in the tax deficiency budget for 2013 could be from \$18 to \$38 million (from point (ii) above) with additional shortfall expected in future years, it would be prudent to initially allocate a minimum of \$30 million from the surplus provision towards the appeal stabilization fund.

The reserve will be used to fund any annual shortfall between amounts budgeted for property tax decreases (tax deficiencies) due to assessment appeal losses and the actual

amount of tax deficiencies occurring during the year, for 2013 and future taxation years. Further contributions to the reserve will be made in any future year in an amount equal to the surplus in the tax deficiency account resulting from unused assessment appeal provisions, subject to the approval of the Deputy City Manager and Chief Financial Officer.

Attachment 2 to this report provides a full description of the proposed assessment appeal stabilization reserve.

Allocating the Unused Portion of the Assessment Appeal Provision

It is recommended that the balance of the one-time operating surplus associated with the bank tower appeal settlements (\$54.0 million), be allocated as follows:

- a) \$34 million to the Social Housing Stabilization Reserve to help offset unfunded operating budget pressures anticipated in 2014 and future years. As explained during the 2013 Operating Budget review, the social housing program will be challenged throughout 2013 and beyond to find additional efficiencies to mitigate pressures resulting from the loss of Federal subsidies and the depletion of the program reserves that have primarily been used as a stop-gap measure to fund on-going social housing pressures. The recommended allocation of \$34 million to the Social Housing Stabilization Reserve will assist in offsetting a portion of the pressures for 2014 / 2015 allowing the program some additional time to find efficiencies, phasing-in potential tax impacts and formulate a go-forward operating funding strategy to continue to support the City's social housing and shelter portfolio.

- b) \$30 million to the City's Capital Financing Reserve, dedicated specifically to fund state of good repair (SOGR) projects for Parks, Forestry and Recreation. As noted through the 2013 Capital Budget review process, the SOGR backlog for Parks, Forestry and Recreation is currently in the range of \$300 million (or 13.5% of the \$2.2 billion asset replacement value) as of December 31, 2012. It is projected to increase to \$366 million (or 16.5% of the asset replacement value) by the end of 2017. Dedicating \$30 million, through the Capital Financing Reserve, will allow the program to begin to address its SOGR backlog.

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SIGNATURE

Roberto Rossini
Deputy City Manager and Chief Financial Officer

ATTACHMENTS

Attachment 1: Summary of Assessment Appeal Settlement: Bank Tower Properties
2001-2012

Attachment 2: Assessment Appeal Stabilization Reserve (description)

Attachment 1
Summary of Assessment Appeal Settlement: Bank Tower Properties
2001-2012

Property	Original Total City and School Property Taxes (\$M)	Revised Total City and School Property Taxes (\$M)	Total City and School Property Tax Reduction (\$M)	Percent reduction in property tax	Original City Provision (\$M)	City's Portion of Tax Reduction (\$M)	Unused Provision (\$M)
Brookfield Place (formerly BCE Place) (161, 171 and 181 Bay Street)	\$541.2	\$527.0	\$14.2	2.6%	\$19.5	\$2.8	\$16.7
Commerce Court (199 Bay Street)	\$334.7	\$322.8	\$11.9	3.6%	\$12.0	\$4.5	\$7.5
First Canadian Place (100 King St. W.)	\$500.3	\$484.0	\$16.3	3.3%	\$17.9	\$5.4	\$12.5
Royal Bank Plaza (200 Bay Street)	\$312.9	\$296.0	\$16.9	5.4%	\$10.1	\$10.1	\$0.0
Scotia Plaza (40 King St. W.)	\$317.2	\$309.7	\$7.5	2.4%	\$11.9	(\$0.0)	\$11.9
T-D Centre (55 and 77 King St. W., 222 Bay St., 79 and 100 Wellington St. W.)	\$843.5	\$815.4	\$28.1	3.3%	\$30.1	\$6.8	\$23.3
Totals:	\$2,849.8	\$2,754.9	\$94.9	3.3%	\$101.4	\$29.5	\$71.9

Attachment 2
Assessment Appeal Stabilization Reserve

1. Location within the Consolidated Reserves/Reserve Funds Schedule

This account will be included in Schedule 3 – Stabilization Reserves.

2. Statement of Purpose

The account will be used to offset any annual shortfall between amounts budgeted for property tax decreases (tax deficiencies) due to assessment appeal losses and the actual amount of tax deficiencies occurring during the year, beginning with the 2013 taxation year, and used as necessary in any future year.

3. Service Area or Beneficiary Program

The Deputy City Manager and Chief Financial Officer shall have primary responsibility for the account.

4. Initial Contribution (2013)

\$30,000,000 to be allocated from the operating surplus arising from a reduction in the City's provision for "Allowance for Doubtful Tax Receivables" for the 2012 fiscal year, associated with the settlement of the bank tower appeals for taxation years 2001 through 2012.

5. Contribution Policy

Further contributions to the reserve will be made in any year, in an amount equal to the surplus in the tax deficiency account resulting from unused assessment appeal provisions, subject to the approval of the Deputy City Manager and Chief Financial Officer.

6. Withdrawal Policy

Funds may be withdrawn in any year where there is a shortfall in the amounts budgeted for property tax decreases (tax deficiencies) due to assessment appeal losses and the actual amount of tax deficiencies occurring during the year, in an amount sufficient to cover the shortfall, with the funds to be transferred to the non-program account titled "Allowance for Doubtful Tax Receivables."

7. Review Cycle

This reserve will be reviewed annually. The account will remain open until further review by Council.