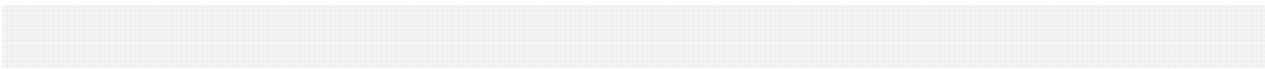


Enhancing Toronto's Business Climate

It's Everybody's Business



A Report by the Deputy City Manager and Chief Financial Officer



July 4, 2005

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Introduction

“Toronto the Good” is a good place to do business. However, in our increasingly competitive economic environment, we must do even better. If we are going to compete successfully in the 21st century, Toronto must become a great place to do business.

This paper outlines an action plan for the City of Toronto to manage the next transition: to compete globally as the heart of one of the five largest city regions in North America.

This discussion paper begins with a review of Toronto’s competitive position in the international economy and briefly highlights how Toronto became the economic centre of Canada. It then outlines some of the challenges that Toronto businesses are facing today.

To address these issues the City convened a series of consultation sessions in 2004, the results of which are summarized in Attachment two. This discussion paper also proposes an action plan.

We know that Toronto - like every major city - competes for investment and jobs. It is the goal of this paper to “kick start” the discussion on an action plan, which will make Toronto a location of choice for business development in the 21st century.

Toronto: A Good Place to do Business

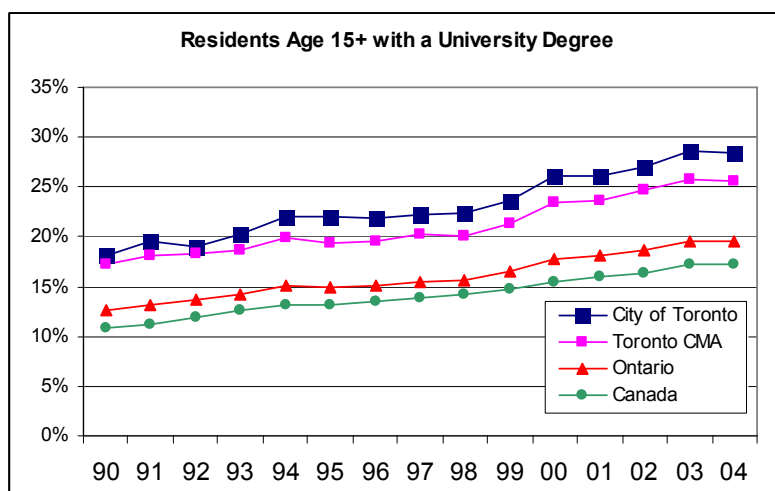
Toronto has many advantages. It is the largest city in Canada and one of the most rapidly growing urban areas in North America. In spite of its rapid growth since World War II, Toronto has justifiably maintained its reputation as a clean and safe city that offers its residents an enviable quality of life.

Toronto is Canada's corporate capital and leading business address. It is home to more nationally and internationally top-ranked companies than any other Canadian city. Toronto is the third largest financial services centre on the continent and is the headquarters of Canada's five largest banks, Canada's six largest accounting companies and nine of Canada's ten largest law firms.

Toronto is also a centre of culture and creativity. It is the English language media capital of Canada and a major centre for live theatre and music. Major expansions are currently underway at every major cultural facility in Toronto. Toronto is truly a centre of life-long learning, with three universities, five colleges and an excellent public school system. Toronto is the largest centre of higher education in the country, and the Toronto Public Library is the busiest in North America.

Canada's largest concentration of sophisticated medical services is located on University Avenue. The city's telecommunications infrastructure is one of the best in the world. We have one of the largest networks of fibre-optic cable of any North American city. The TTC carries more passengers than any other transit system in North America other than New York.

Most important, however, Toronto's highly skilled, educated and multilingual workforce provides the knowledge and know-how to keep Toronto businesses ahead of the rest. Toronto has been very successful in attracting the best and brightest from across Canada and indeed from around the world.



Toronto is also one of the world's most cost-competitive cities for business. Toronto has lower business costs than most of the European, North American and Asian cities studied in the 2004 Competitive Alternatives report by KPMG. The biggest savings are on skilled labour and industries doing R&D. In analyzing 27 business costs across 17 business operations, the study found Toronto to be the least costly of the 30 large industrial cities studied.

Toronto ranks first in cost competitiveness against such U.S. cities as Birmingham, Boston, Chicago, Dallas, New York, and San Jose, and global cities such as Amsterdam, Frankfurt, London, and Sydney. Even when smaller cities are added to the analysis, Toronto has lower costs than 99% of all U.S. cities studied. Cost advantages vary from 4.3 to 31.6%.

This cost advantage is also enjoyed by office-based firms as the following chart shows. Even at an 81 cent dollar (the current exchange rate in late June 2005) Toronto-based financial services businesses are competitive with US cities.

Annual Operating Costs - 15 Person Financial Services Firm in 4,000 sq ft of Class A Office Space

In US\$ (Can\$ = .81)	Toronto	Boston	Jersey City	New York	Chicago	Atlanta	Charlotte NC	San Francisco	Los Angeles
Total labour costs	1,438,405	1,790,885	1,832,383	1,894,512	1,812,916	1,674,508	1,655,312	1,962,177	1,897,903
Office space	145,800	152,000	108,000	188,000	152,000	88,000	84,000	120,000	106,000
Telecommunications	32,568	28,639	27,465	30,721	29,337	29,058	28,325	28,524	28,573
Business taxes				525				22,837	70,920
Capital taxes	5,146				2,625	1,250	7,875		
Total costs	1,621,919	1,971,524	1,967,848	2,113,758	1,996,878	1,792,816	1,775,512	2,133,538	2,103,396

Source: http://www.toronto.ca/business_publications/pdf/business_cost_comparisons.pdf

The second line in the table above, labeled “office space”, includes all payments made by an office tenant for office space. Total occupancy cost, or “gross rent”, typically includes net rent, building operating costs (including heat, light, power, security) and property taxes. The table above highlights the relatively small role that office occupancy costs play in the over-all cost structure of a typical office-based firm. However, when the decision has already been made to locate in the Toronto region, differences in office occupancy costs may be the difference between locating in the City of Toronto or in an adjacent municipality.

The table above shows total office occupancy costs for a financial district firm. It was based on an estimated gross rent of \$45 Canadian per square foot. The following table provides a breakout of net rents, building operating costs and property taxes for eight office nodes in the Toronto area. It shows that property taxes are a relatively small part of total occupancy cost.

Class A Office (psf)	Toronto				Other Areas			
	Downtown	Midtown	North York City Centre	Scarborough Town Centre	Mississauga City Centre	Mississauga Heartland	404 & 7	Vaughan
Total Mkt Size Sq Ft	37,528,612	6,153,255	6,375,695	1,950,196	2,256,752	2,032,156	6,207,700	800,321
Posted Net Rent	\$26.42	\$17.58	\$17.70	\$14.99	\$18.67	\$16.16	\$16.13	\$12.68
Oper Cost	\$10.45	\$8.79	\$8.41	\$9.15	\$8.50	\$6.84	\$6.68	\$6.01
Realty Tax	\$13.76	\$9.22	\$8.82	\$8.53	\$4.61	\$3.51	\$3.96	\$2.55
Gross Rent	\$51.25	\$36.57	\$35.67	\$32.71	\$33.19	\$27.84	\$27.32	\$22.47

Source: InSite Real Estate Information Systems Inc (Q1 2004)

Toronto: Competing for Business in a Changing World

Toronto must compete for investment and jobs with other large urban areas in North America and increasingly around the world. However, at the same time we have to remain competitive with other Canadian centres and our own rapidly expanding “905” suburbs.

During the seventies and eighties, Toronto successfully managed the transition from its historic role as a prosperous regional centre in Canada to become Canada’s corporate capital. The bank towers built at King and Bay in that period serve as a powerful symbol of Toronto’s emergence as Canada’s corporate capital. By the late 1980’s downtown office users were demanding, and were absorbing, the equivalent of one new Scotia Plaza every year. The Free Trade Agreement and technology changed everything. In a few short years Toronto shed 200,000 jobs as industry restructured to meet the new realities of free trade.

At the same time new technologies in telecommunications and information technologies freed many firms from central city locations. The decentralization of office employment has been happening across North America and has led several American observers to herald the end of the era of great cities. The evidence in Toronto is mixed. Unlike some American cities, total gross rents downtown are still higher than in the suburbs, indicating that office tenants are willing to pay a premium for being downtown. Unfortunately, the premium is not sufficient to justify new construction.

A major contributing factor for office sprawl in Toronto is a central city commercial property tax differential that is one of the largest of any city in North America. While several US cities have significant central city property tax premiums, these tax premiums are often mitigated by extensive tax abatement programs.

The City of Toronto remains a net importer of labour from the rest of the Province. Approximately, 100,000 more people commute into the City to their jobs each morning than the considerable number of reverse commuters. However, the total number of jobs in the City today is roughly 100,000 less than it was at the previous peak in 1989. During the same time, the number of jobs in the 905 area has grown by over 700,000 and the number of jobs in Ontario has increased by more than 1 million new jobs.

Business Location Decisions in the GTA

It may be inevitable that growth in an expanding urban region will be greatest at the periphery. In the Greater Toronto Area (GTA), much of the recent employment growth has followed the rapid suburbanization of the region's population into the outlying parts of the developing urbanized area. The factors which influence the location decisions of new firms coming into the region or the relocation decisions of existing firms within it are complex and often interrelated, and include such considerations as:

- Labour market and costs
- Transportation and accessibility
- Proximity to clients and business contacts
- Prestige and visibility
- Land costs and availability
- Building rents, maintenance and utility costs
- Property taxes

Some firms may have considerable choice among these factors and can often be drawn to locations where out-of-pocket expenses are lowest. In contrast, there are other activities, which have much stronger linkages to particular locations. Lawyers that must make frequent personal appearances in downtown courts and convenience retailers have quite specific location requirements, for which they are prepared to pay a premium.

Many other firms will, of course, fall somewhere in the spectrum between the extremes of completely footloose and very attached. New advances in telecommunications and information technologies have generally allowed firms to become increasingly footloose, particularly those in the office sector.

When looking for reasons to explain the difference between the rates of employment growth in the City and the surrounding region, the two most commonly cited factors are congestion and property taxes.

The congestion (or accessibility) argument seems the more disputed of the two. It is not clear that peak-period congestion is, overall, any worse in the City than elsewhere in the region.

In fact, the Downtown enjoys the unparalleled benefits of being at the hub of the public transit system. Suburban expansion in the GTA has been very dependent on the use of the car and roads in these areas are frequently more congested than City streets.

City residents and workers generally have a greater choice of alternative travel modes in the forms of public transit, taxis, cycling and walking. Generally higher land values in the City are partly a reflection of higher levels of accessibility and this may be a particular force in sustaining the above average prices of residential properties in Toronto. The future of strong suburban growth remains dangerously dependent on the continued availability of cheap oil supplies to fuel this car-dependent pattern of low density urban development.

On the other hand, it is clear that commercial property taxes as a percentage of market value (a ratio known as the “effective” tax rate) are much higher in the City of Toronto than in the surrounding GTA. This is a situation that has been some sixty years in the making and one which neither the provincial or local level of governments have so far been able to effectively address.

Since the introduction in 1998 of Current Value Assessment (CVA) and related legislative changes that have affected properties across the province, numerous additional issues and concerns have arisen that make the case for a review of current property tax policies ever more pressing, especially in the City of Toronto.

City Council recognizes that there is a structural problem in its property tax system that, if left unattended, will only worsen. Consequently, in June 2004, Council approved a public consultation process to explore City and Provincial tax policies and possible remedies to existing problems for 2005 and beyond.

For its part, the Province, in 2004, introduced interim measures to give municipalities’ greater flexibility in the exercise of their taxation powers during what has now become to be seen as a transition period in the process of property tax reform. There has seldom been a better or more promising time for the City and the Province to work together to solve these long-standing issues concerning the stability, fairness, flexibility, and simplicity of the municipal tax system.

It is helpful to review, in a broader context, the role that property taxes play in influencing the location choices of firms and the resultant patterns of employment growth in the City and the GTA. However, fixing the property tax system alone is not enough. As noted above, there are many factors that influence the location decisions of different firms in different ways. What is called for is a comprehensive strategy involving all three levels of government.

All other factors being equal, differences in property taxes may be the deciding location factor. That is to say, footloose firms are more tempted by the lure of lower property taxes than are more attached firms. To understand the economic effects of relatively high commercial taxes in the City it is helpful to distinguish between net rent and gross rent. Gross rent is the total rent paid by an office tenant; it is typically broken out into net rent, operating costs and property taxes.

Potential tenants make their location decisions based on total occupancy costs (gross rents); however, developers make their decisions to build or not to build based on the net rents they expect to collect. High commercial property taxes will result in relatively high gross rents or relatively low net rents or some of both, depending on the ability of landlords to pass on higher taxes to tenants. This distribution of the burden of high property taxes will take place at the times when leases are negotiated.

For footloose firms who would not hesitate to move if gross rents increase, higher property taxes cannot be shifted forward to tenants. They must be borne, in large part, by landlords in the form of lower net rents and resulting lower property values. This, in turn reduces the incentive to develop new property.

Where firms have a strong need to be in a specific location or are very attached to their particular situation, the tenant will bear more of the burden of high property taxes; gross rents, net rents and property values will be relatively unaffected by high property taxes. The burden of higher property taxes comes down to the question of the relative significance of footloose versus attached firms and the changes that may be occurring in this mix.

The table in the previous section, comparing office occupancy costs in 416 and 905, serves to illustrate the relative magnitude of the property tax competitiveness issue. All three components of office occupancy cost (net rent, operating costs and property taxes) are higher in the downtown than in the suburbs. However, net rents need to be significantly higher downtown, because building an office tower with underground parking is much more expensive than a low rise building with parking at grade. Downtown cannot compete as the lowest cost office location in the GTA.

Since the Downtown is the largest office node in the City of Toronto (and in fact in Canada), most of the discussion to date has been focused on the ability of the Financial District to compete with the 905 suburbs.

However, the issue of competitiveness is even more acute for peripheral office nodes in the City of Toronto. The location attributes of an address on the south side of Steeles Ave. are virtually the same as a location on the north side of Steeles Ave. The major difference between locating on the north side versus the south side of Steeles is the City of Toronto property tax premium.

Improving the City's Competitiveness

City Council recognizes the issues and of the economic importance of Toronto's businesses to the local and provincial economy. Economic growth provides the private and public wealth necessary to improve the quality of life.

Stimulating economic growth and creating jobs is a central component of any sustainable long-term strategy to address pressing community issues such as homelessness, child and family poverty and neighbourhoods at risk, and to sustain quality public amenities and services.

At its meeting of August 1, 2, 3 and 4, 2000, City Council adopted the Economic Development Strategy for the then new City of Toronto. The principal goal of the Strategy is to improve the liveability and quality of life in the City through economic growth that creates high quality jobs, generates wealth and investment, and helps to ensure the City's long-term fiscal health.

The strategy focuses on five major themes – People, Place, Prosperity, Positioning and Partnerships – and identifies strategic directions critical to success.

The single most important message in Council's Economic Development Strategy is the need for an 'alignment of strategic intent', that is for all orders of government, business, labour, institutions, not-for-profit and volunteer sector, and residents to find ways to work together to build a better City.

A number of integrated initiatives, aligned to produce win-win results, are already underway. The Film Board, Toronto Financial Services Alliance (TFSA), Toronto Biotechnology Initiative (TBI), Fashion Industry Liaison Committee (FILC), and the Design Industry Advisory Committee, for example, all bring together public and private sector stakeholders with a common goal to advance the various industry clusters.

The MaRS (Medical and Related Sciences) development located adjacent the University of Toronto Medical School and Toronto's world renown teaching hospitals and research centres, is a tangible example of this collaborative approach that will accelerate commercialization of research, create high quality jobs in Toronto, and help increase the City's assessment base.

The strength of Toronto's economy has been the major catalyst for job creation, economic growth and prosperity across the Toronto region and, in fact, throughout Ontario. However, as Council's Economic Development Strategy notes, Toronto is at its own crossroads and there is a need to reinvest in the City in order to ensure sustained economic prosperity, enhance Toronto's competitive position and establish a vital cycle of economic growth.

Strategies to increase economic activity, jobs and the City's assessment base must seek win-win solutions and concentrate on maximizing the benefit to firms of being in the city. We must address the "value proposition", not necessarily by being the lowest cost location, but rather by offering the best value for a wide range of businesses.

To this end, City Council has identified nine Priority Areas for its 2003 – 2006 term, one of which is to "*Improve the Business Climate*". City staff has responded to the challenge of addressing Council's priorities in a number of areas.

Finance staff, in association with Economic Development, Planning and Housing staff undertook a stakeholder consultation process and developed an Action Plan which deals with tax policy and associated business cost competitiveness issues.

Economic Development staff is developing a broader Action Plan, which complements the proposed tax policy and cost competitiveness initiatives identified, but also includes other (non-tax) strategies to improve the business climate and stimulate job creation and assessment growth and is consistent with the Economic Development Strategy.

Public Consultation – Enhancing Toronto’s Economic Vitality

Toronto’s residents, business owners, landlords, tenants and other stakeholders were consulted in the summer of 2004 on property tax policies and the broader issues of business competitiveness. While the City’s public consultation meetings in the summer of 2004 were initially focused on property tax policy, as the meetings went on it became increasingly obvious that what is required is a comprehensive competitiveness strategy for the City of Toronto. The interest in this issue was evident by the level of participation and the insightful advice provided by the participants.

This report builds upon the results of the 2004 public consultation process to develop and identify a comprehensive action plan along with recommended changes to the property tax system and related business incentive options for a further round of public discussion before moving on to the implementation stage in 2006.

Proposed Action Plan - Improving the City’s Competitiveness Tax Policy and Cost Competitiveness Initiatives

1. Long-term Strategy to Reduce Commercial, Industrial and Multi-Residential Tax Ratios from the current level of approximately four-times residential to 2.5-times residential over a maximum 15-year period
 - (a) allowing commercial, industrial and multi-residential (CIM) tax increases at one-third pass-through of residential tax increases (e.g. 3% res. & 1% CIM)
 - (b) accelerate CVA-related tax burden shift from non-residential to residential
2. Request the Province reduce Toronto's business education tax rates to the average of the surrounding GTA municipalities to create a 'level playing field'
3. Phase-out of capping/clawback regime over fifteen years by utilizing capping limit of 5% of CVA taxes

4. Property tax relief program for the neighbourhood retail class by way of an accelerated phase-in to a tax ratio of 2.5 times residential over a maximum 10-year period
5. Property tax rebate program for designated heritage properties
6. Lower tax rate for new office, hotel and industrial development (2.5x residential)
7. Tax abatement for vacant portion of new office during initial lease-up period
8. New tenant business tax credit equal to the existing vacancy allowance for defined period of time
9. Expand Tax Increment Equivalent Grant program in Community Improvement Plan Areas to protect selected employment areas
10. Waive building permit fees for all new office, hotel and industrial development

Non-Tax Policy Initiatives

11. Invest in proactive programs to stimulate job creation by anchoring existing jobs and firms in Toronto. For example:
 - i. start-up assistance for new businesses, support for key industry clusters, and expansion of BIAs
 - ii. labour force development initiatives, including strengthening linkages to Toronto's diverse communities and partnerships with universities and colleges
12. Stimulate investment, revitalization and assessment growth through non-tax policy initiatives. For example:
 - i. streamlining the development and building approvals process
 - ii. enhance quality of place to lever employment related investment
 - iii. partnerships with the Federal and Provincial governments and improved coordination of intergovernmental policies and programs
13. Promote the Toronto 'brand' locally and internationally to increase the City's profile and showcase our competitive advantages

14. Initiate business focused outreach and engagement program. For example:

- i. establishment of a Mayor's Business Roundtable and other mechanisms to ensure ongoing engagement and involvement of the business community
- ii. establishment of an Interdivisional Economic Growth staff team to evaluate and improve programs and services to meet the needs of business
- iii. implementation of a comprehensive communication strategy to advance this tax policy and economic competitiveness action plan

Property Tax Initiatives

The factors which influence the location decisions of new firms coming into the region or the relocation decisions of existing firms within it are complex and often interrelated. While property taxes are not the sole driver in business location decisions, they are cited as an important factor and are a concern for businesses.

There are a few core principles that are essential and must be addressed to help retain and enhance the value of existing non-residential employment and development:

- correcting the imbalance in tax ratios
- creating a level playing field in the GTA with respect to the Provincial business education tax rates
- addressing the historic inequities caused by the capping and clawback regime
- protection of neighbourhood retail
- tax relief for designated heritage properties

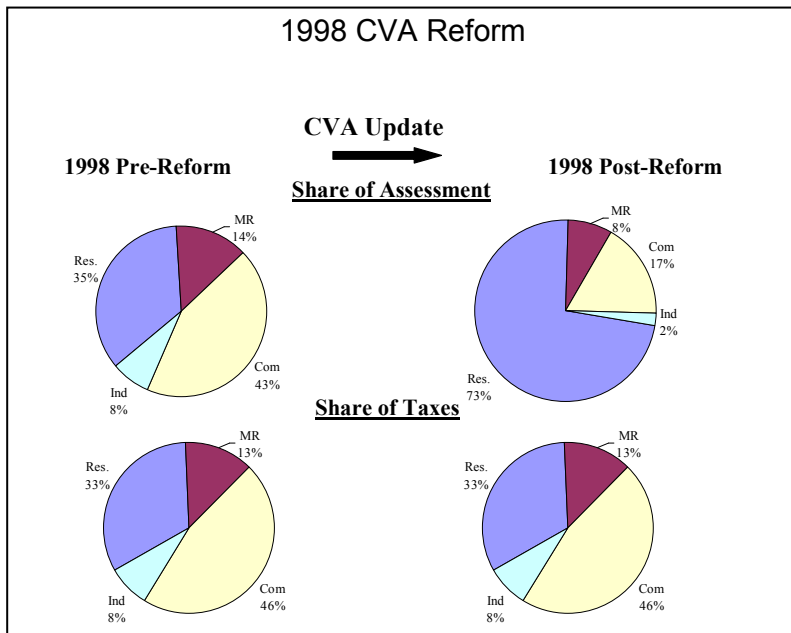
1. Correcting the Imbalance in Tax Ratios:

The intent of CVA was to provide transparency by allowing for comparison of property tax burdens within a municipality, and from municipality to municipality across the province. In Toronto, the implementation of CVA highlighted the tax rate disparity between Toronto's non-residential property classes and the residential property class.

This disparity between residential and non-residential tax rates was the result of long-standing Provincial policies compounded by an outdated assessment system. In some cases real estate values for property taxation purposes were based on a valuation basis dating back to the 1940's.

With the 1998 valuation based on current value, the assessed value of residential properties appreciated 37-fold, while multi-residential, commercial and industrial properties experienced only a 5 to 10 fold increase. Due to residential properties appreciating in value at a rate greater than that of the non-residential property classes, the real taxation level on the residential class was kept lower than it ought to have been vis-à-vis the other property classes, which became transparent with the move to Current Value Assessment.

As a consequence of more than five decades of frozen assessment, Toronto's non-residential commercial, industrial and multi-residential tax rates are approximately four-times that of the residential tax rate, and are amongst the highest in the Ontario, partly because Toronto's residential tax rate is amongst the lowest in Ontario.



This is best illustrated by the fact that in 1998, the residential property class made up 73% of the total assessment base, and paid 33% of the municipal taxes, in contrast to the non-residential property classes, which made up 27% of the assessment base but paid 67% of the taxes. With subsequent reassessments since 1998 and because of the restrictions on tax increases on non-residential properties, the situation has somewhat improved. As of 2005, residential homeowners now make up 71% of the assessment base and are now paying 40% of taxes for municipal purposes.

Tax Ratio Target:

Research could not find any hard evidence of a 'right' number for tax ratios. There was sufficient information, however, to make some basic comparisons of the treatment of residential verses business properties.

Among Canadian cities, taxes are generally higher on non-residential compared to residential properties. Where provincial governments set the tax ratios between residential and business properties, they are relatively low.

Tax Ratio Defined

- Tax Ratio is the ratio of the tax rate for a property class in comparison to the residential tax rate.
 - Relates only to **municipal** portion of taxes
- $$\frac{\text{Commercial Tax Rate}}{\text{Residential Tax Rate}} = \frac{2.25\%}{0.59\%} = 3.8$$
- Commercial tax rate is 3.8 times the residential tax rate

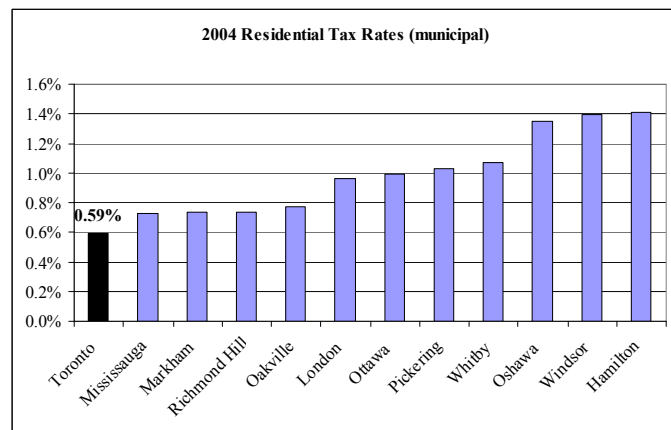
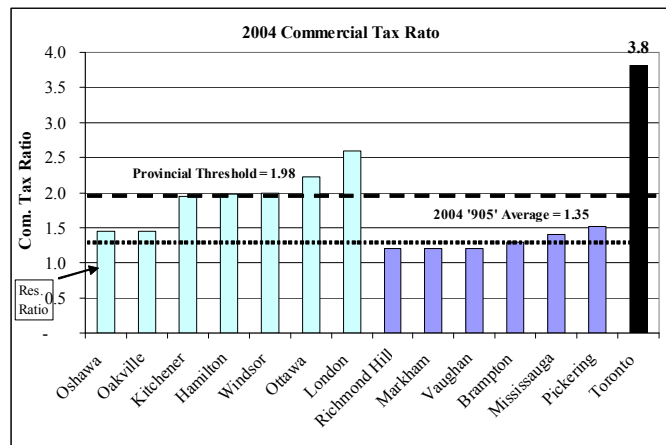
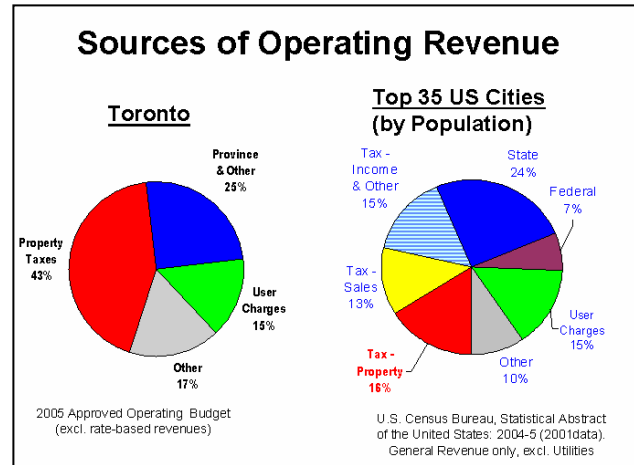
For example, in Saskatchewan, the ratio is 1.43 for commercial and industrial, and in Manitoba, it is 1.4 for business.

Winnipeg and Montreal have a business tax ratio of approximately 2.0. Vancouver was the only Canadian city with a business tax ratio higher than Toronto, at approximately 5 times its residential rate.

The Council of the City of Vancouver has been attempting to rebalance its tax burden by actively shifting taxes from its non-residential classes to the residential class. Shifts equivalent to approximately one percent (approximately \$4 million) of the total tax levy were approved by Vancouver City Council in 1994, 1995, 1997, 2000, and one-half percent in 2003. Despite these efforts, Vancouver's business tax ratio continues to rise, most recently to 5.3 times residential, because its residential properties continue to appreciate in value at a greater rate than its commercial properties.

In contrast, commercial and industrial properties in U.S. cities are generally taxed at much lower rates compared to residential properties than their Canadian counterparts. The net result is that most U.S. states provide a much more business-friendly property tax climate and expect their residents to pay a greater share of property taxes to support local governments than is the case in Canada. Part of the reason for this stems from the fact that U.S. municipalities have more alternative revenue sources than their Canadian counterparts, such as sales and consumption taxes, as well as greater federal and state support.

The most relevant of these comparisons is between GTA municipalities. One reason is that the funding structures and constraints tend to be similar to Toronto.



Also once a business has made the decision to locate in the GTA, then tax competitiveness between neighbouring municipalities becomes an important location factor.

The commercial tax ratios for Toronto’s neighbouring municipalities are 1.5 or less, and the Towns of Richmond Hill and Markham are at 1.2 times the residential rate, compared to Toronto at 3.8 times residential. The average 2004 commercial tax ratio across Ontario is estimated at 1.75.

The provincial average (“threshold”) tax ratios first introduced in 2001 was 1.98 for commercial, 2.63 for industrial and 2.74 for multi-residential. These were based on the provincial average tax ratio at that time for each class, and were used to determine whether or not a municipality would be restricted from passing on municipal levy increases to the non-residential property classes if its ratios exceeded that of the provincial average. The Province has not revisited these ratios, even though subsequent reassessments have driven the provincial averages downward, and the average non-residential ratio is now in the range of 1.75 to 2.4 times residential.

Tax Ratios

	Toronto Current	2004 ‘905’ Average	2004 Estimated Provincial Average	Provincial Threshold (established in 2001)
Commercial	3.80	1.35	1.75	1.98
Industrial	4.27	1.79	2.39	2.63
Multi-Residential	3.76	1.67	2.05	2.74

At the City’s public consultation, ‘Tax Policies for 2005 and Beyond’, stakeholders strongly encouraged Council affirm its intent and commitment to reduce Toronto’s tax ratios. Business representatives recognize and generally accept that the business property tax rate will be higher than the residential rate, but not four-times more. The general consensus was that a non-residential tax rate of 2 to 2.5 times that of the residential tax rate was a fair and appropriate longer-term target. One rationale given for a higher rate for businesses was the income tax deductibility of property taxes for business enterprises whereas such benefit does not extend to residential property taxpayers.

In the consultation, no solid rationale was identified for differentiating tax ratios between commercial, industrial and multi-residential (e.g. a higher industrial rate verses commercial rate would have the inadvertent effect of favouring warehousing over manufacturing). Some stakeholders, particularly multi-residential representatives, have suggested a multi-residential tax ratio target of 1:1 (i.e. tax at the residential rate).

Given that, in addition to income tax deductibility, multi-residential properties are assessed differently than residential properties, wherein a comparable multi-residential rental unit is assessed at approximately half of the value of a residential condominium unit (multi-residential properties are valued using a gross income multiplier, whereas residential properties are valued using comparable sales), staff feel that a longer-term tax ratio target of 2 to 2.5 times residential, from a tax policy perspective, is also appropriate for the multi-residential class.

After considering all of the issues and input, staff believe that establishing a target ratio of 2.0 to 2.5 times residential would be helpful to the economic vitality of Toronto within the GTA, and will encourage new development and result in net new property taxes for the City in the long-run.

Moving to Target Ratios:

Within the scope of tax policy, there are two ways to correct the imbalance in tax ratios:

- (i) by restricting tax rate increases on the non-residential classes; and/or
- (ii) by phased shifting of tax burden from the non-residential class to the residential class.

In the first case, by restricting tax increases on the non-residential class, as tax rates increase over time on homeowners, the disparity between residential and business tax rates will be corrected over time. The greater the differential in tax rate increases, the faster the correction. This was the intent of the budgetary levy increase restriction provision in the Municipal Act (“Bill 140”).

Secondly, Council could elect to impose a tax burden shift from the non-residential class to the residential class in concert with annual updates in CVA values on each property. In effect, a nominal additional tax rate increase would be imposed on the residential class, with a corresponding tax rate decrease on the non-residential classes, in order to move the tax ratios closer together over time. Both these tools could and should be used together in order to reach a desired tax ratio target over a reasonable period of time.

Other ways to reduce the non-residential tax rate could include expenditure reductions or new revenue sources, either of which could be directed to reducing the non-residential tax rates. These means are beyond the scope of this tax policy report. However such an option will always be available for Council to use in addition to tax shifts should the opportunity arise.

To move to a non-residential tax ratio of 2.5-times residential by way of tax shift alone would require a tax shift onto the residential class of \$310 million (a 28% increase in tax burden), with a corresponding decrease spread amongst the commercial, industrial and multi-residential classes.

For comparison, to move to the current provincial threshold ratios would require a tax shift onto the residential class of \$381 million (a 34% increase in tax burden), and a move to a non-residential tax ratio of 2.0-times residential would require a \$469 million tax increase on residential (a 42% increase in tax burden).

Reasonable Time Frame:

Given the potential impacts above, making such a tax shift over a short period of time would be an unrealistic expectation. Because the tax burden imbalance arose over five decades, an approach that gradually phases-in this shift over time is being advocated by staff.

The time frame to reach the target tax ratios will depend on both the year-over-year relative CVA reassessment changes (residential assessment will appreciate faster than commercial over long run), the residential tax rate increases in relation to business tax increases, and the magnitude of policy-related tax burden shifts between classes.

With respect to the public consultation, there were various responses regarding a reasonable time frame to achieve the target ratios. Business owner opinions ranged from immediate, to 3 to 10 years. Even residential participants, once educated on the issues, acknowledged the inequity and need to reduce tax ratios, suggesting a time frame of 10 to 20 years as reasonable.

Options considered were combinations of:

- tax ratio targets
- levy increases
- tax burden shifts
- time frames

After careful consideration of the issues and impacts, staff have short listed four options, intended to improve the business climate vis-à-vis the status quo situation, for further stakeholder consideration.

In all cases, including the status quo, staff estimate there will be on average a \$13 million dollar annual tax shift from the non-residential classes to the residential classes from regular updates to current value assessment. This is based on historic trends in relative property appreciation rates between these classes.

In other words, because residential properties are projected to continue to appreciate faster than business properties, periodic (possibly annual) adjustments in tax burden will be required in order to keep the non-residential tax ratios from increasing. To do otherwise would in effect perpetuate the problems of the past and which would see the tax ratios continue to escalate beyond their already high levels. Adherence to the existing rules governing that tax ratios cannot increase is paramount from the perspective of staff.

After much consideration and analysis of the impacts, and balancing the risk of ongoing loss of jobs and assessment with the implications on tax revenues and budget pressures, and in managing the tax impacts on residential taxpayers, staff are recommending a plan to equalize commercial, industrial and multi-residential tax ratios to a maximum of 3.38 times residential by year five (2010), to 3.0 times by year ten (2015), and 2.5 times by year fifteen (2020).

It is also proposed that the tax ratio targets be reviewed every five years, with a view to identifying opportunities to accelerate the reductions to the desired target level.

Proposed Recommendations – Correcting the Imbalance in Tax Ratios:

- *Council endorse in principle a longer-term commercial, industrial and multi-residential tax ratio target of 2.5*
- *Council adopt 1st phase five-year plan to equalize Commercial, Industrial and Multi-Residential (C, I, MR) tax ratios to 3.38x over 5-years (2010)*
- *Council adopt in principle tax ratio targets of 3.0x by 2015, and 2.5x by 2020, to be reviewed every five years*
- *The Province be requested to amend legislation to allow, as part of this long-term strategy, for up to one-third of any residential tax rate increase to be passed through to the C, I, and MR tax classes.*

2. Business Education Tax Fairness:

When the Province took over responsibility for education finance in 1998, residential education tax rates were immediately equalized across the province. However the Province did not equalize commercial and industrial education tax rates. Instead the Province still levies far higher education tax rates on Toronto businesses than those in the outer suburbs, preserving an obvious incentive to outward migration.

There remain wide discrepancies between municipalities in the business education tax rates which are set by the Province. So while Toronto's municipal tax ratio is approximately 4-times that of similarly valued residential properties, the relative tax rate for education taxes is 8-times that of the residential education tax rate. In other words, for two identically valued properties, one being residential the other being commercial, the business property will pay 8-times more in education taxes than the residential property.

The business education tax rate has been the subject of continued concern both by City Council and Toronto's business community. During the public consultation process participants unanimously supported the position that the province be again requested to take action to reduce, by phase-in if necessary, the education tax rates imposed on Toronto's businesses.

When fully implemented, this initiative would reduce commercial and industrial taxes paid by Toronto's businesses by approximately \$120 million annually.

Existing tax rules ensure that any reduction in education tax rates would go directly to reducing the property taxes paid by businesses. It does not provide "tax room" to increase the municipal portion of business taxes – to do so would result in an increase in tax ratios.

City Staff recommends that the Province reduce its Toronto business education tax rates as part of a partnership. On its part the City will do its part to reduce the municipal portion of business tax rates. The reduction of business education taxes in Toronto from both partners, together with the City's other initiatives, will be a positive influence on Toronto's economic climate.

Proposed Recommendation - Business Education Tax Fairness:

- *The Province be again requested to reduce Toronto's business education tax rates to GTA average to create 'level playing field'.*

3. Making Progress to CVA-Taxation (Capping & Clawback):

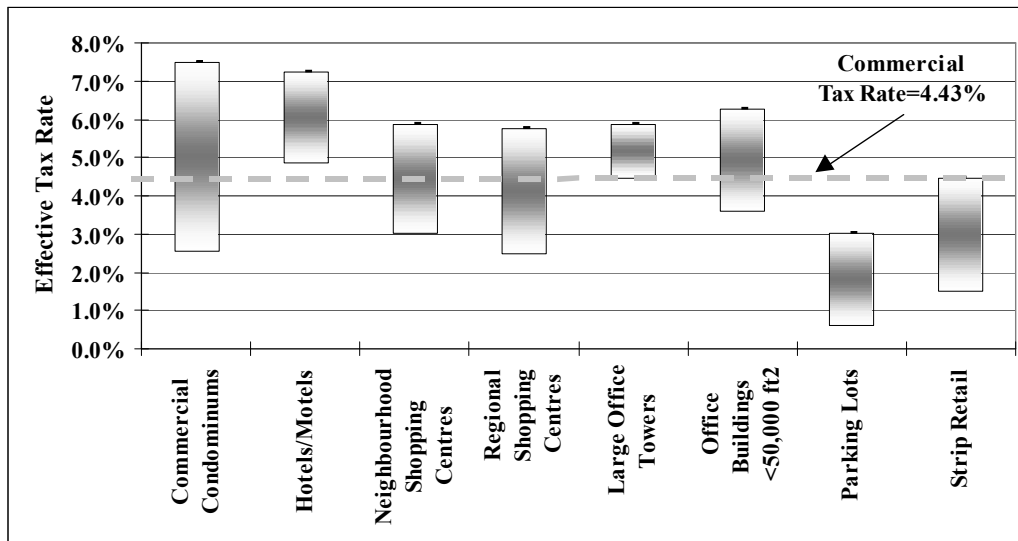
In 1998, when current value assessment (CVA) was implemented on a province-wide basis, many commercial, industrial and multi-residential properties in Toronto would have experienced significant tax increases in the absence of any intervention. In fact, 37% of non-residential properties in Toronto would have faced tax increases in excess of 100%, and 54% of non-residential properties were more than 50% above or below their full-CVA level of taxation.

As a result, Provincial policymakers introduced a capping regime which limited CVA-related tax increases for commercial, industrial and multi-residential properties to 5% of a property's prior year's tax (a cap of 2.5% applied for 1998 through to 2000 in Toronto). However, with each reassessment, rising values have pushed some properties even further away from CVA, and it is now apparent that it will take decades to make any significant progress towards fair taxation.

Now, six-years since the implementation of CVA, there still remains 18% of properties facing tax increases in excess of 100% (verses 37% in 1998), and 29% of properties remain 50% above or below their full-CVA level of taxation (versus 24% in 1998). Because the City claws back tax decrease to fund the foregone revenue from the caps, this could mean that over 40% of non-residential properties will continue to pay more than their CVA-taxes for many years to come.

Stakeholders and municipal tax administrators have identified several concerns with the capping program, including perpetuation of 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 Chart below shows the variation in effective tax rates being paid by different property types, and variation even within property types.

**Current Effective Tax Rates (distribution) Due to Capping
Six-Years Since the Introduction of CVA**



In response to these concerns, the Province has made legislative changes to the *Municipal Act* to provide municipalities with two additional capping options in order to increase progress towards CVA. The additional options include:

1. increasing the amount of the annual cap to 10% of previous year's taxes
2. the option to base the cap of up to 5% on a property's full CVA-level taxes instead of the previous year's taxes.

These enhancements to the capping program are intended to allow municipalities to 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 allows local governments the opportunity to respond to local conditions.

A survey of major municipalities has revealed that most municipalities are planning to or already have adopted options that maximize the progress to CVA.

From the City's stakeholder consultation, most participants felt that progress to CVA-taxation needs to be accelerated to achieve equity in taxation levels between the different business property types, and that the current 5% limit on prior year's taxes is ineffective and will result in caps remaining in place for many properties for decades.

Secondly, it was also generally acknowledged that in order to facilitate the transition to CVA, any changes to the capping program should have regard for maintaining a manageable pace of change for property owners. Small business represents a significant proportion of the properties that will experience additional tax increases through any accelerated capping program.

Under the status quo scenario (e.g. 5% cap on prior years' taxes), it is projected that it will take another seven years (2012) before half of the capped properties reach their full-CVA level of taxation, assuming all else remains constant. It is also estimated that it will take 17 years (2021) for 80% of capped properties to reach CVA, and 25 years (2030) for 95% to reach CVA. Strip and neighbourhood retail properties benefit the most through the existing capping protection, and as such, any alternative that accelerates the progress to full-CVA taxation will most impact these property types. Options for the protection of small business are discussed in the following section.

City staff recommends that the City utilize a 5% cap based on a property's full CVA tax (instead of being based on the prior year's tax). With respect to progress toward full-CVA taxation, this option is comparable to that of the alternate option (10% cap on prior year's tax) during the first ten years. After 10 years, however, the amount of taxes clawed-back under this option is lower, and assuming there is no significant volatility in future annual reassessment, this option will result in virtually all properties reaching full-CVA taxation within 20 years, with 95% of capped at full CVA within 15 years.

City staff recommends this option because it reduces the amount of taxes clawed-back. Also, it will effectively result in the phase-out of capping within 15 years, complementing the strategy to reduce the imbalance in tax ratios.

Proposed Recommendation - Making Progress to CVA-Taxation:

- *Phase-out of capping/clawback regime over 15 years by utilizing a capping limit of 5% of full CVA-taxes.*

4. Protection for Neighbourhood Retail:

Discussions surrounding the special treatment or tax relief for specific sub-groups of properties is probably one of the more complex issues to be dealt with as part of any property tax policy reform initiative. 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 storefront properties that had traditionally been under-assessed in relation to other commercial property 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%. Ultimately, the imposition of caps on tax increases for all properties in the commercial, industrial and multi-residential classes effectively eliminated the immediate need to address CVA-related tax relief for small business properties.

There is no question that small retail is important to the communities within the City. Neighbourhood commercial contributes significantly to quality of lifestyle that is considered desirable by many and helps to generate value in adjacent residential communities. They are centres of leisure activity and provide shopping within walking distance of the majority of its patrons. The City's Official Plan promotes a strong and diverse retail sector by permitting a broad range of shopping opportunities for local residents and employees, and encourages traditional retail development along avenues and the establishment of a high quality pedestrian environment.

Other reasons given for supporting and protecting neighbourhood retail include:

- encouraging community streetscapes with small neighbourhood shops
- reducing the tax burden on small businesses in an effort to sustain and promote economic development
- 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)

On a go-forward basis, in the context of a longer-term tax policy vision for the City of Toronto, it is the strip retail/neighbourhood retail properties that will most be affected by changes to the existing capping regime, and it is for this reason that a re-examination of options for these property types is warranted. The adjacent chart shows the average tax impacts that would be felt by the various property types by moving to full CVA taxation. It shows that, in the absence of intervention, strip retail as a class will experience a tax increase of \$77 million, or 54% on average.

Tax Impact of Moving to Full CVA Taxes

	No. Properties	2004 Taxes Paid (\$M)	Current CVA Destination (\$M)	Current CVA Impact (\$M / %)	
Com. Condominium	2,866	\$23.5	\$21.4	(\$2.1)	(8.9%)
Hotel/Motel	336	\$93.9	\$70.5	(\$23.3)	(24.9%)
Large Office Towers	40	\$450.9	\$429.0	(\$21.9)	(4.9%)
Neighbourhood Shopping Centres	954	\$210.7	\$200.4	(\$10.3)	(4.9%)
Office Building <50,000 ft2	1,263	\$549.2	\$482.3	(\$67.0)	(12.2%)
Other	3,750	\$248.4	\$257.3	\$9.0	3.6%
Parking Lots	306	\$12.9	\$39.9	\$27.0	209.5%
Regional Shopping Centres	15	\$126.6	\$136.8	\$10.2	8.0%
<i>Retail/Strip Retail</i>	<i>13,600</i>	<i>\$143.1</i>	<i>\$220.5</i>	<i>\$77.5</i>	<i>54.2%</i>
Total All Commercial	31,502	\$2,155.3	\$2,155.3	\$0.0	0.0%

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.

Some of the issues to be addressed include:

- tax rate target? (e.g. 2x res, less than 2x res?)
- time frame? (immediate vs. gradual?)
- funding? (within class vs. general who qualifies)
- revenue?
- budgetary tax increase? (none? .. same as commercial? .. same as residential?)
- capping & clawback (none? .. same as all commercial? .. different than rest of commercial?)

Furthermore, 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 relief to specific individual tenants within a multi-tenanted building.

The issue of relief for small businesses became most divisive when it came to the issue of identifying a source of funding for any such relief. While most stakeholders did not sternly object to relief for small business, they were adamant that such relief not be funded by way of increasing the already high taxes on other businesses.

Others noted that a differential tax rate would only result in creating further inequities in the property tax system – that it could result in different taxes being imposed on two identical businesses depending on whether they were located in a “neighbourhood retail” property or say in an office building.

Specific proposals to assist neighbourhood retail that were made during the City’s public consultations included:

1. using the existing ‘Optional Classes’
2. creating a separate property class or sub-class for “small business” or “neighbourhood commercial” properties
3. imposing graduated tax rates to apply lower tax rates to lower-valued business properties
4. using geographic boundaries to determine which properties would be eligible, such as Business Improvement Areas

5. various other non-specific proposal such as definitions based on physical characteristics of properties (e.g. street frontage with no more than three storeys), or using a variety of means tests such as number of employees.

These options are more fully described below:

Option	Description	Pro's	Con's
1. Optional Class	Existing legislation allows municipalities the option to adopt the following five optional commercial classes: Large Office, Shopping Centres, Parking Lots, Large Theatres, and, Large Sports Facilities. Properties not in one of the above classes falls into the Residual Commercial Class. Most small retail would fall into the Residual Commercial Class	-available in existing legislation -optional classes already defined and identified in assessment roll; - could be implemented in 2006	- 'Residual Commercial' optional class too broad, making targeted tax relief neighbourhood retail ineffective
2. Separate Property Class	The Minister of Finance could be requested to make a regulation prescribing new classes of properties. The assessment roll provides property codes identifying the primary physical use of the property. Approximately 41% of properties in the Commercial class are included in the Retail property codes (471, 410, and 472)	- can be more specifically targeted at types of neighbourhood retail - existing property code identifiers in assessment roll	- MPAC property code may not yet be at 'appealable standard' for 2006 taxation year - regulation required defining eligible property codes
3. Graduated Tax Rates	Existing legislation allows municipalities the option to adopt up to three 'bands' of assessment to which lower tax rates could apply to the lower portions of assessment.	-available in existing legislation - all properties benefit from lower rate on 1 st portion of assessment; avoids definitional issue - could be implemented in 2006	- applies to all commercial properties – funding impact can be significant for meaningful relief - if funded within class – higher tax rates for larger properties and the small businesses located within it
4. Geographic Areas	Legislation would be required to prescribe new classes of properties based on geographic location and physical characteristics. E.g. within BIA, less than 15,000 sq. ft, not in office or shopping centre classes	- BIA boundaries already defined - could be implemented in 2006 if defined as in BIA	- Boundary issues – continual pressure to expand eligible boundaries to include more properties - regulation required defining eligibility

Optional Property Class:

Existing legislation allows municipalities the option to adopt by way of by-law certain optional classes of the commercial class. The available optional classes are:

- the Large Theatre Class (more than 1,000 seats)
- Large Office Class (greater than 25,000 ft. sq.)
- Large Shopping Centre Class (greater than 25,000 ft. sq.)
- Large Sports Facilities, and
- Parking Lots

Properties that do not fall into one of these classes are included in the ‘Residual’ commercial class. The make-up of the residual class, in terms of assessed value, includes offices less than 25,000 ft. sq. (15%), industrial uses within commercial (18%), neighbourhood shopping centres (10%), and hotels (7%).

Most strip retail/neighbourhood retail properties fall into the residual class, representing 20% of this optional class. In terms of number of properties, the residual class accounts for approximately twenty-five thousand properties of the total of thirty-one thousand commercial properties on the assessment roll.

Staff analysis has indicated that the use of optional classes would not be an effective way to provide a lower tax burden for “small retail business”, as this group represents only a small portion of the residual class.

Separate Property Class:

Defining a separate property class for neighbourhood retail is problematic in that there was no consensus or uniform definition of what constitutes a “small business” or “small retail” establishment. The various eligibility criteria’s put forward were usually met exceptions that should be included and of examples of types of businesses that would inadvertently be included.

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 a particular category of properties.

Related to definitional issues, the Municipal Property Assessment Corporation (MPAC) has been undertaking a review of its inventory of property codes with the goal of better identifying and defining property types. This project has now been completed and will be put in effect for the assessment roll for the 2006 taxation year.

This review has included more precise definitions for property types such as:

- Retail – one storey, under 10,000 square feet
- Retail or Office – with residential units above or behind, under 10,000 square feet, street or onsite parking
- Retain with Office – less than 10,000 square feet, with Offices above

Targeted tax relief for these property types could be implemented as early as the 2006 taxation year.

Graduated Tax Rates:

Existing legislation allows for up to three tax rates within the commercial class, with lower tax rates for lower valued commercial properties. Graduated tax rates can be used to provide limited relief to lower valued properties, but does present some challenges.

For one, because this is broad-brush approach, as every property benefits from the lower rate on the first assessment portion, the cost of relief can be very expensive. For example, if a tax rate of two-times residential were desired for the first \$500,000 of property value, then this would represent a funding requirement of approximately \$100 million, which would have to come from other sources (i.e. a general tax increase), or from increasing the already high tax rate on balance of commercial assessment (i.e. a 21% tax increase on commercial).

For another, this approach can also result in inequitable treatment of similar properties. For example, for two identical small businesses, the one who chooses to locate in a higher valued building will pay a higher tax rate. Furthermore, properties on the most successful retail strips in the city would likely be provided very little protection by graduated tax rates.

A graduated tax rate program could be implemented for the 2006 taxation year.

Geographic / Physical Characteristics:

Various proposals based on geographic considerations were also considered. Such examples included that, to receive tax relief consideration, the property must be within a Business Improvement Area (BIA), be say 15,000 square feet or less, and not be in the Shopping Centre or Office Building classes.

Staff have estimated that above criteria would encompass approximately 5,200 of the City's 32,000 commercial properties. Such a program would be implemented by way of an application and review process.

Equity in Property Taxation for all Businesses:

The issue of tax relief for small business was the most divisive and complex matter that staff have had to consider as part of the broader tax policy review. There is no one solution that addresses all of the concerns, and any recommendation will be met with criticism by one group or another.

Staff are of the opinion that property taxes are not the ideal vehicle for promoting or bonusing one business verses another, and are advocating that in the long-run, the tax policies adopted by Council should be based on the principle of achieving equity and fairness for all properties. Over the long-term, the recommended tax ratio correction largely avoids the need for subsidy of one property type over another. It is intended that, in fifteen years, all commercial (and industrial and multi-residential for that matter) will be taxed at the lower rate of 2.5 times the residential rate.

Nonetheless, staff do recognize that, in the short term, neighbourhood retail will be affected by a slight acceleration in CVA-related tax increases that will arise from the recommended changes to the capping regime. To mitigate these impacts, staff are supporting that a separate class be established for neighbourhood retail, and that tax ratio target of 2.5 times residential be achieved in 10 years for this class, as compared to the rest of commercial.

This relief is projected to result in a \$40 million cumulative reduction in property taxes that would otherwise be paid by the neighbourhood retail. Funding for this relief in the amount of \$4 million annually would be from general revenue, resulting in a 0.2% annual tax increase pressure on residential and 0.07% on non-residential.

Proposed Recommendation – Tax Relief for Neighbourhood Retail:

- *The Province be requested to create a new neighbourhood retail class and MPAC be requested to identify and re-classify properties eligible for this class in the City of Toronto;*
- *Council endorse in principle an accelerated phase-in over a maximum 10-year period commencing in 2006 in the reduction the municipal tax rate for the neighbourhood retail property class to 2.5-times the municipal residential tax rate; and,*
- *Funding for the reduction in the municipal tax rate for the neighbourhood retail property class be provided for, commencing in the 2006 operating budget, by way of a municipal tax rate increase of 0.2% on the residential property class (~\$3m) and 0.07% on the non-residential classes (~\$1m) in the years 2006-2014 inclusive*

5. Tax Rebate Program for Heritage Properties

The *Municipal Act*, 2001, provides for a municipality to establish a program to provide tax reductions or refunds in respect of eligible heritage property. To be eligible, a heritage property, or portion of a property, must be designated under the *Ontario Heritage Act* and that is subject to an easement agreement with the municipality or with the Ontario Heritage Foundation, or an agreement with the municipality respecting the preservation and maintenance of the property or portion thereof.

In 2002, Council adopted a program under this provision for a heritage property tax rebate program based upon 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.

The implementation of the proposed rebate program was subject to the Province enacting amending 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.

During the Tax Policy public consultations held this past summer, support for the heritage tax rebate program was clearly voiced with the opinion that the program be implemented as soon as possible, recognizing the benefit heritage properties have for the residents of the City, and the extra costs associated with the preservation of such buildings.

Staff are recommending the Heritage Tax Rebate Program be initiated in 2006, initially limited to the eight National Historic Registered properties, at a cost of \$1.2 million annually, with a full roll-out of the program for all eligible designated heritage properties (approximately 150 properties) in 2007 at an estimated cost of \$4 million annually.

Proposed Recommendation – Tax Rebate Program for Heritage Properties:

- *Recommend funding in the amount of \$1.2 million be made in 2006 to commence the program first for national historic sites, and an amount of \$4.0 million in 2007 to include all eligible heritage properties, by way of a municipal tax rate increase on the residential property class of 0.06% in 2006 and 0.13% in 2007 (0.03% and 0.07% on the non-residential classes)*

6. Lower tax rate for new office, hotel, and industrial construction (2.5x Res.)

One tax policy option that deserves careful consideration is to set the tax rate for new office, hotel and industrial buildings at the target levels (i.e. 2.5x residential as outlined in the core principles section) as soon as they are constructed.

This program may help bring new buildings on-stream sooner than would occur in the absence of this program.

If Council adopts the timetable for addressing the tax ration imbalance within the City, these tax reductions for new buildings would be for a relatively short time, which would moderate concerns from the owners of existing buildings.

In order to create a win-win situation for the owners of existing buildings, Council should also commit to using the additional taxes generated by new buildings that benefit from this program to lower overall C&I tax rates.

7. Tax abatement for vacant portion of new office during initial lease-up period

One of the impediments to constructing a major new office tower in downtown Toronto is the uncertainty regarding the lease-up period. Before construction of a new office building can start, a lead tenant must be secured. However, a building is typically not 100% pre-leased. Therefore, the developer must include in his/her cash flow projections an allowance for the carrying cost of the vacant space until it is leased. Property tax levels in the City of Toronto are higher than in the surrounding 905 regions; therefore, the carrying cost of vacant space during lease-up is greater in the City of Toronto than in the 905 suburbs.

The existing Assessment Act and regulations provide for a 30% tax rebate for vacant commercial space. The proposal in this report would increase that rebate (perhaps to 100% of taxes payable) for vacant space that has never been leased and occupied. Once the building is fully leased, it would be levied taxes at the same rate as existing office buildings.

This relatively modest incentive for the developers of new office buildings is an attractive low cost city-building initiative. From a messaging point of view it also shows that the City is willing to be a “partner” in the decision to build additional office space and is willing to share some of the upfront risk.

8. New tenant business tax credit equal to the existing vacancy allowance

Unlike proposals 7 and 10, which are incentives to encourage the construction/development of new commercial and industrial space, this initiative is directed at attracting new tenants and thereby encouraging new development and assessment growth.

A new tenant credit (perhaps equal to the tax credit for vacant space) could be structured by treating office/hotel/industrial space occupied by a qualified new tenant, as if it were vacant for a specified period of time.

Since the existing tax system provides a 30% tax rebate for vacant commercial space and a 35% rebate for vacant industrial space, this measure would have no cost to the City, if the space would have sat empty in the absence of the new business locating in Toronto.

A difficulty with the new business tax credit is how to ensure that the firms would not have come to Toronto without the program. Since it is very difficult to devise hard and fast criteria, these programs are usually negotiated as one-off “deals”, which is a very expensive and time-consuming process with potential transparency issues. As many American jurisdictions have also learned, it is difficult to say “no” to an existing business that threatens to leave unless it is treated the same as new businesses.

If these programs are successful in attracting new businesses to Toronto, the demand for office space will increase, reducing vacancy rates and increasing net rents, which will increase development activity in the long-run.

9. Expand Tax Increment Equivalent Grant (TIEG) program in Community Improvement Plan (CIP) areas

An incentive that is permitted under current legislation is Tax Increment Equivalent Grants, which are typically targeted at specific areas. The New Toronto Community Improvement Plan (CIP) contains a pilot program of tax incremental grants, where businesses that make specified investments receive a grant that is equal to a portion of the increase in municipal taxes that results from their investment.

The portion of the incremental tax revenues eligible for the grant typically declines to zero over some period of time (ten years in the case of South Etobicoke). The grants are funded entirely from new incremental tax revenues. The balance of new tax revenue, after paying out the grants, contribute to the City’s overall tax revenues arising from new assessment growth.

Tax Incremental Financing (TIF) plans have been used in many municipalities in the United States to revitalize blighted areas and clean up severely contaminated sites. A key consideration in designing an effective area specific program would be to limit the number of areas and to ensure that they are effectively aligned with designated employment areas in the Official Plan.

Since these are area-specific programs that are implemented in the context of a comprehensive Community Improvement Plan, their implementation is typically part of an area-specific land use planning process. CIPs are currently under-consideration for the East Bayfront area to stimulate development on the waterfront. It is proposed to continue to consider TIEG programs as part of a comprehensive approach to stimulate job creation and assessment growth in designated employment areas.

10. Waive building permit fees for new office, hotel and industrial development

Waiving building permit fees for new office, hotel and industrial development is a modest but cost-effective incentive to stimulate the construction of new office and industrial buildings. It is similar to the existing development charge exemption for non-retail commercial and industrial buildings. However, we cannot implement this measure without permission from the Province, since the Building Code Act does not grant the City specific authority to do so.

The Building Code Act only says that municipalities cannot collect more in building permit fees, than they spend on processing building permit applications.

Waiving permit fees is a cost-effective strategy because it reduces the up-front costs of development. Developers typically have higher borrowing rates than the City. Therefore, they discount future considerations (for example, future tax abatements) at a higher rate than the City. For the same net present value to the City, a reduction in up-front fees will, therefore, have greater impact on new construction than a property tax abatement that is spread out over the next ten or twenty years.

A policy to exempt non-retail, commercial and industrial development from building permit fees would be consistent with the “City Building” initiative and with the City’s development charges policy, which exempts all non-retail business development.

The major issue with regard to waiving permit fees is the potential foregone short-term revenue (up to \$12 million annually in commercial and industrial building permit fees). Implementing this incentive would reduce the Buildings Division estimated revenue from issuing permits and would have to be replaced. It is expected that in the short to medium term, i.e. immediately following construction (2-3 years), this targeted incentive would increase the City’s tax base and therefore be a net fiscal benefit to the City.

Non-Tax Policy Initiatives

Aligning municipal and provincial property taxes and user fees to encourage, rather than discourage, job creation and assessment growth is an essential prerequisite to ensuring the City’s long-term fiscal health and improving the quality of life for Toronto residents. As well there are a number of complementary and synergistic initiatives that could usefully compliment the actions recommended in this report.

11. Invest in proactive programs to stimulate job creation by anchoring existing jobs and firms

Small and medium sized enterprises (SMEs) account for about 80% of employment in the City. Assisting business start-ups and subsequently helping them to expand is key to job creation. It is estimated that 75% of small businesses fail in their first three years. Therefore, improving their survival rate by even a small amount can have a large impact on the level of economic activity in the City.

Providing support to Business Improvement Areas is another proven and cost-effective economic development initiative. BIA’s are an important mechanism to leverage public investments in streetscape improvements and facilitate cooperation by local merchants in revitalizing retail strips in the city.

Export industries account for a smaller percentage of employment within the City, but are critical to sustaining economic growth because they bring new wealth into the City which, in turn, supports the local economy.

The City can play an effective role in advocating for federal and provincial policies and programs that help to strengthen and expand key industry clusters.

Existing industry cluster groups, such as the Film Board, Toronto Financial Services Alliance, and Toronto Biotechnology Initiative/MaRS have been successful in bringing all orders of government together with private sector firms, universities, colleges and other stakeholders to collaboratively develop and implement initiatives designed to strengthen and advance the industry in Toronto.

Toronto has a highly educated, highly skilled and culturally diverse labour force that provides a strong foundation for future economic growth, however, we are under utilizing many of these skills, particularly in regard to youth and immigrants. We need to strengthen linkages to the City diverse communities, proactively market the wealth of talent and skills available within the City, and help employers recognize and assess these skills.

12. Stimulate investment, revitalization and assessment growth

Streamline the Development and Building Approval Process: In March 2002, City Council established the Development Review Task Force to oversee the streamlining of all development review processes. As many of the stakeholders who were consulted regarding tax policy indicated, this reform is crucial to the City's economic growth, our competitive edge and our quality of life. This initiative commenced by reviewing our planning procedures with the goals of creating:

- a co-ordinated, inter-departmental one-window approach to service delivery
- streamlined application review processes for quicker approval times with target timeframes
- clear service level expectations, including new ways of doing business
- clarity and transparency around submission requirements and development standards
- better quality application submissions

The STAR (Streamlining The Application Review) process was implemented by the City in early 2003. STAR establishes criteria for the streaming of most planning applications and sets target timelines for their resolution.

The STAR process establishes clear service level expectations, a co-ordinated approach to reviewing applications and clearly defined roles and lines of communication for City staff. Through harmonization, a one-window opportunity has been created by the City to facilitate development applications.

Improvements will provide clearer service level expectations, more certainty for staff and the development industry through the introduction of standards, a team approach to high value, high impact applications that include good cross-divisional communications and greater flexibility in managing workloads.

The 2005 City budget also included funds to hire an additional 37 staff in the Buildings Division to comply with the new and shorter service timeframes introduced by amendments to the Building Code Act. Finally as an administrative matter, it may be possible to give priority to development applications that have a substantial office, hotel or industrial component. However, it may be easier to fast-track expansions and renovations than new projects, as there is a public consultation process with statutory notice requirements for most new projects.

Enhance Quality of Place: We must invest in Toronto's quality of place. Although Toronto remains a relatively clean, safe, friendly city, the quality of the urban environment has noticeably diminished over the last decade. Much of the physical, social and community infrastructure that helped make Toronto 'the city that works' is in urgent need of renewal. In setting priorities, consideration should be given to investments that can be leveraged to create jobs and attract additional investment.

Partnerships with Federal and Provincial Governments: Improve service to business by better coordination with other orders of government. Recent initiatives at both the provincial and federal level provide an opportunity for the City to directly engage other orders of government in issues that impact on the city.

These issues include infrastructure finance, immigration, international trade, education, social services and other public policy areas critically important to economic growth that are vested with the federal or provincial governments. It would be mutually beneficial to cooperatively develop policies and programs to stimulate economic activity.

13. Promote the Toronto 'Brand' Locally and Internationally

The 'Toronto unlimited' brand, launched in June 2005, must be promoted to establish a positive, attractive image within Canada and internationally. Toronto is in many ways a model city for the world - particularly in terms of diversity, imagination and creativity - however research shows that Toronto has a limited identity around the world. This lack of awareness about the City and its attributes limits our economic growth reducing employment opportunities and the generation of new assessment dollars.

In today's global economy, Toronto competes with major urban centres around the world for tourism, trade and investment. A comprehensive program to reinforce Toronto's identity in local, national, and international markets is required to capitalize on the value of the brand work completed to date and ensure Toronto is 'on the radar screen' when investment decisions are being made.

In addition to stimulating economic activity, these campaigns should serve to establish and strengthen the sense of ‘pride of place’ among Toronto residents and local businesses. The City should seek to expand the reach of these campaigns and lever its resources by engaging partners as ambassadors to carry its message to the world.

14. Initiate business focused outreach and engagement program

In today’s dynamic, fast-paced economic environment, success requires the active participation of employers, investors, labour, educators, community groups and the public at large as well as all orders of government. Mechanisms to ensure ongoing community engagement and a collaborative, rather than a siloed approach, to policy and program development will help ensure timely implementation of plans that have broad based support.

We must be proactive about business and job retention, expansion and attraction. Business owners, small, medium and large, should feel that their contribution to the community is valued and their voice is heard at City Hall. Outreach programs should be expanded to solicit advice and address concerns.

A Mayor’s Business Roundtable would provide an excellent and proven forum to establish and strengthen partnerships to address areas of broad public import. Various options exist to the composition and structure of such a business engagement vehicle, including the structuring of working groups to address particular issues such as joint marketing of Toronto’s attributes as a headquarter/office market (including packaging of tax, incentives and non-tax value-added programs).

An Interdivisional Economic Growth staff team would engage City Divisions in collaborative and integrated decision-making to evaluate and improve programs and services to meet the needs of business. This initiative would be designed to strengthen relationships with the business community and build support for City initiatives (e.g. Neighbourhoods at Risk, Clean & Beautiful City). It would also be an effective tool to help establish a more innovative and holistic approach to problem solving within the City’s administration.

Implementation of a comprehensive communication strategy to ensure all stakeholders and the public are aware of the core, long-term principles and directions to be adopted by Council, will be critical to success.

The market is expected to respond positively when the recommendations put forward in this report are implemented. Business location decisions are often based on incomplete information; therefore, perceptions can be as important as reality.

Being perceived as a high-cost location may result in being screened out at a very preliminary stage in the site-selection process. Since real estate investments are long-lived assets, the decision to make an investment today must consider not only the existing economic environment, but also how that environment is likely to change over the next ten or twenty years. Being perceived as a “business-friendly” municipality can, therefore, be a very powerful incentive for attracting new investment.

Next Steps

The following is the proposed next steps towards the development of longer-term policies for the City of Toronto:

July 7, 2005	Policy & Finance Committee Presentation and stakeholder update.
July – September 2005	Public meeting and further stakeholder consultation.
October 2005	Policy & Finance Committee Final report and specific recommendations to Council.

Conclusion

Toronto is one of the world's most cost-competitive cities for business. Toronto has lower business costs than most of the European, North American and Asian cities studied in the 2004 Competitive Alternatives report by KPMG.

Toronto is Canada's corporate capital and leading business address, and home to more nationally and internationally top-ranked companies than any other Canadian city. Toronto's highly skilled, educated and multi-lingual workforce provides the knowledge and know-how to keep Toronto businesses at the forefront of their sectors.

As with any city, Toronto must compete for investment and jobs with other large urban areas in North America and increasingly around the world. Toronto also has to remain competitive with other Canadian centres and its own rapidly expanding "905" suburbs. The factors that influence the location decisions of new firms coming into the region or the relocation decisions of existing firms within it are complex and often interrelated.

Economic Development staff have been actively working to implement Toronto's Economic Development Strategy and to assist in Council's Priority Areas, one which is to improve the business climate.

In addition, a City staff team co-ordinated by the Deputy City Manager and Chief Financial Officer, and Corporate Finance, and including representatives from Revenue Services, Economic Development, Planning, and Shelter, Housing and Support, undertook a stakeholder consultation process related to long-term financial strategies.

Together, these have led to the development of an Action Plan which deals with tax policy and associated business competitiveness issues.

This discussion paper is intended to serve as a framework for a further public meeting and stakeholder consultations, with the objective of making specific longer-term tax policy recommendations at the Policy & Finance Committee meeting to be held in October, 2005.

The action plan presented in this paper, together with the new partnership arrangement with the other orders of government, will send an important signal to the City's taxpayers and businesses that the City is committed to fair tax treatment, to improving the business climate, and to strengthening Toronto's competitive advantage.