Chief Financial Officer's Report to Combined Meeting of Council
2019 March 18

ISC: UNRESTRICTED
C2019-0352

Downtown Tax Shift Response ~~- Updated~~

EXECUTIVE SUMMARY

The very steep and rapid decline in the market value of a small number of very high valued non-residential properties redistributed the property tax responsibility to other non-residential properties such that some non-residential properties have suffered untenable property tax increases. It is estimated that, more than half of non-residential property owners are experiencing increases greater than 10% over last year (excluding the impact of business tax consolidation (BTC)) if no actions are taken. At the same time, with the decline in downtown non-residential property assessments, downtown property owners have been the beneficiaries of reduced property taxes since the dramatic drop in oil prices.

The City has several mechanisms that can be implemented in the short term to assist the non-residential property owners (and their tenants/businesses) who are the most severely impacted from this redistribution. Such mechanisms include:

- Overall budget reductions that can benefit both classes of taxpayer or can be directed towards one,
- Tax room, if available, to be directed to the benefit of the non-residential taxpayer
- A shift of some of the tax responsibility paid from the non-residential properties to residential properties,
- One time or short-term mitigation programs to moderate the impacts of shifting the property tax responsibility within or between property classes. Other mitigation programs may also be targeted at the non-residential properties (and/or their tenants) who are the most impacted by the redistributive effect.

This report focuses on the short term options that Council may consider with respect to the 2019 budget and the determination of the 2019 municipal property taxes. Other mid and long-term strategies and options that speak to the underlying cause of this issue which is largely economic in nature will also need to be considered and will be brought forward for Council discussion at a later date.

ADMINISTRATION RECOMMENDATIONS:

That Council:
1) Receive this report for information;
2) File the recommendations contained in PFC2019-0148;
3) Adopt the proposed Guiding Principles as described on page 3 of this report;
4) Direct Administration to further refine and update the proposed roles and responsibilities of the Financial Task Force and bring an updated Terms of Reference for the Financial Task Force for discussion and consideration of Council after 2019 April 1; and
5) Forward this report and direct Administration to return to the 2019 April 1 Strategic Session of Council for the purpose of 2019 tax rate finalization.

PREVIOUS COUNCIL DIRECTION / POLICY

As Council direction on this topic is extensive, Administration has included Attachment 1 which summarizes and references all previous Council direction. At Priorities and Finance Committee

("PFC") on 2019 March 5, Council referred report PFC2019-0148 back to Administration to work with the Mayor and interested Members of Council on potential revisions and come back to Council on 2019 March 18.

BACKGROUND

As noted above, at PFC on 2019 March 5, Administration presented a report entitled "PFC2019-0148 Downtown Tax Shift Response" that was discussed and referred back to Administration to work with the Mayor and interested Members of Council on potential revisions. The original PFC2019-0148 report is included as Attachment 2. The presentation provided at PFC is also included as Attachment 3.

The members of PFC also requested that a drop in white boarding session be held for members of Council prior to the next Council meeting on 2019 March 18 to have a discussion on the Downtown Tax Shift issue and brainstorm potential solutions.

On 2019 March 12, a two hour long drop in white boarding session was held with attendance from Council members as well as Administration. A group discussion followed and was focused primarily on 2 objectives:

1. What is the problem that we are trying to solve?
2. What potential solutions should be considered further? These would include previous scenarios discussed or new ones identified.

This report includes preliminary results of the discussion which include:

1. Problem identification
2. Recommended guiding principles for decision making on 2019 scenarios
3. Possible scenarios for discussion

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Problem Identification

Throughout the discussion on problem identification many points were raised by Council members that addressed various aspects of the problem facing City Council. A summary of the key issues raised by Council members during the white boarding session is included as Attachment 4.

The very steep and rapid decline in the market value of a small number of very high valued non-residential properties redistributed the property tax responsibility to other non-residential properties such that some non-residential properties have suffered untenable property tax increases. It is estimated that, more than half of non-residential property owners are ~~experiencing increases greater than 10% over last year (excluding the impact of BTC) if no~~ actions are taken.

A key question for consideration is - what are the appropriate mechanisms to use to assist the most impacted non-residential property owners (and their tenants/business)?

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Proposed guiding principles

One of the topics of discussion that was undertaken at the drop in white boarding session was that "guiding principles" should be developed to facilitate clear decision making by Council. Administration recommends that Council approves the following:

1. Transparency and accountability
2. Certainty
3. Simplicity
4. Equity and fairness
5. Minimize the use of one-time solutions as these one-time solutions create considerable "bow wave" effects
6. Ensuring there is a sunset clause on any program to be developed to avoid unintended long term consequences

Short / Medium / Long Term

As noted in previous reports, this is a large and complex issue that has persisted and may be expected to continue for some period of time. In consideration of the direction provided by Council and in discussions within the Assessment Tax Working Group (ATWG), there was a desire to approach this large and complex issue in stages:

- What can be done in the short term to best support the most affected non-residential properties (and their tenants/business) and the need to focus on the immediate issue related to 2019 property tax bills. The review and analysis of the various scenarios that address 2019 (and impact future years) are the focus of this report.
- What can be done in the medium and long term? The medium and long term include a larger discussion on the economy, Calgary's economic resilience, Downtown Strategy, possible alternatives to and/or changes to the current assessment/taxation system, alternative revenue sources, and other relevant topics. These would be key areas of focus for the upcoming Strategic Session of Council as well as for the Financial Task Force.

Scenarios to consider

Administration has reviewed and analysed several scenarios proposed by various Council members. These scenarios are not the only possible avenues or alternatives that can be implemented, but the intent is to review these scenarios at the Strategic Session on 2019 April 1 and discuss them within the context of the principles to reach some conclusions regarding the 2019 budget and 2019 property tax levels.

Before reviewing each scenario in detail, it is important to understand the fundamental levers / options that are available in the short run. In summary, the levers revolve around:

- **How is the overall property tax responsibility shared between residential and non-residential taxpayers?**

  In general terms, under the existing legislation, the two groups that contribute to property taxes are the residential and the non-residential property owner. If there is a desire to alter the current shares of overall property tax responsibility – how much should be moved and how quickly?

- **Should available tax room be considered as a source of funding to mitigate the tax shift?**

  Available tax room is not a reliable source of funding on a year to year basis, however if the room is available it can be considered for use to mitigate the shift. A significant benefit of using tax room, if available, is that it provides a long-term/ongoing solution; ie. it is not "one-time". Council has directed Administration to consider the use of any available tax room for use to mitigate the shift as a highest priority. If tax room is available, a decision needs to be made on the amount and timing of the tax room to be applied towards mitigation of the tax shift.

- **Should one-time funding sources be used to buffer or mitigate tax shift impacts?**

  The economic issue facing Calgary has an unknown timeline for improvement and therefore the impact upon the downtown property values is also unknown. Given the uncertainty related to how many future years would continue to require "one-time funds" should these programs continue to be considered? If they are, then what level of funding is available and what type / form of mitigation program should be implemented? Should the program be aimed at non-residential or residential property owners? How long should the program last? These options must be considered with the full understanding of the bow wave effect.

- **Should further efficiencies and potential budget reductions in addition to those already identified through One Calgary be explored**

  What level of efficiencies or reductions are possible to achieve the property tax supported budget and what are the corresponding service impacts? The One Calgary plans and budgets have certain revenues and expenditures assumptions. Administration has committed to find a further $60 million in efficiencies and reductions. If Council makes different decisions as a result of the Downtown Tax Shift discussion, changes to the business plans and budgets will be need to be made identifying areas of budget reduction as well as identifying the corresponding service level reductions

Scenarios to consider

The scenarios included in this report are as follows:

Scenario 1 – 2018 November 14 Council Direction - Current One Calgary Approved Budget (Attachment 5)

- At the 2018 November 30 meeting, Council approved that Administration find salary and wage savings to achieve a property tax rate increase of 2.45% in 2019, and fix the residential tax rate increase at 3.45% to reduce by $8 million taxes attributable to the from non-residential assessment base.
- While an additional mitigation program for non-residential property owners has been discussed (similar to either the 2017 or 2018 Phased Tax Programs), this scenario does not include any specific mitigation program funded from one-time sources.
- The tax increases for 2020 to 2022, the remaining years of this budget cycle, remain as provided to Council.

Scenario 2 – PFC2019-0148 Administration Recommendation (Attachment 6)

- Scenario 2 builds on the currently approved budget.
- Efficiencies or reductions of $20 million per year in The City's tax supported operating budget will identified by Administration with the benefit being applied to benefit only the non-residential property tax class. This effectively will bring the non-residential tax rate increases in each of the next three years to below 1%.
- This also effectively alters the overall split of the proportion of total municipal property taxes paid, with the non-residential property tax class contributing proportionally less (transfer from non-residential to residential
- Use one-time funds of $44 million to create a Phased Tax Program for 2019 to limit the municipal non-residential property tax increase for eligible properties to 10%.
- Should tax room become available in 2019 include an option to apply all or a portion of the tax room to reduce the overall contribution of property taxes from the non-residential property tax class.
- The indicative tax increases for the remaining years of this budget cycle remain.

Scenario 3 – NOMC2019-0358 Alleviating the Tax Burden and Businesses and Creating Tax Equity Through Budget Reductions (Attachment 7)

- The foundation for this scenario comes from the Notice of Motion C2019-0358.
- Propose to reduce the tax supported operating budget in 2019 by $100 million.
- Transfer approximately $80 million from non-residential to residential (effectively creating an equal share between the total tax collected from the non-residential class and the residential class).
- Reconsideration of the 2019 March 5 decision on Major projects to remove $54.1 million from a Council directed Reserve and in addition to the $70.9 million currently allocated, provide $125 million in one-time funding over the budget cycle to apply as a credit on a declining basis to the residential property taxpayer to lessen the effect of the transfer of the property tax responsibility from non-residential to residential.

Scenario 4 – Transfer property tax responsibility from the non-residential property class to the residential property tax class, and use one-time funding and other sources of funding to buffer the increases to the residential property owner. (Attachment 8)

- Transfer the property tax responsibility from non-residential to residential in 2019 to effectively have a split between the non-residential to the residential of 51% non-residential and 49% residential in 2019. Then in 2020, transfer additional property tax responsibility from non-residential to residential to achieve a 50% - 50% allocation of the overall tax supported operating budget. Future years retains the 50% - 50% split.
- Use one-time funding and other sources to provide a credit program for residential property owners to provide a buffer or mitigation program to limit their municipal property tax increase to what would have been expected in the current One Calgary budget proposal for 2019 and provide a credit program to buffer residential municipal property taxes in further years.

Scenario 5 – Reduce Pay As You Go (PAYG) operating budget to the benefit of non-residential taxpayers until assessment values rebound and PAYG accretes back into the base operating budget based on the pace of assessed values rebounding. Use reserves to fund capital projects that would otherwise be paid by PAYG funds (Attachment 9)

- While there is a downturn, beginning in 2020, take $55 million from PAYG in the base and direct all savings for non-residential
- Capital projects funded from the $55 million in PAYG to be paid from reserve funds
- Reconsideration of the 2019 March 5 decision on Major projects to ensure reserve funds available
- Continue until there begins a recovery (to be defined, could be assessed values today compared to assessed values in 2015)
- When recovery begins, begin to increase the PAYG budget in the base proportionately by the percentage of the comeback of assessed values
- This scenario to be reviewed by Council in 5 years to minimize the risk of ongoing funding from reserves.

Scenario 6 – Apply all base budget efficiencies or reductions to Non-residential (Attachment 10)

- Start with the approved One Calgary budget
- In 2019 approve the continued use of one time funds in the amount of $44 million for a 2019 Phased Tax Program (2019 PTP) to be funded from the Fiscal Stability Reserve. Criteria would be consistent with that used for the 2018 PTP.
- For 2020 to 2022, continue with the proposed 3.03% tax rate for residential properties and apply annual efficiencies or reductions in the amount of $30 million annually ($90 million total) against the non-residential properties. This effectively transfers property tax responsibility from non-residential properties to residential properties.
- In 2019, use an amount (to be determined), funded from the Opportunity Calgary Investment Fund, to create a program to assist small business.
- Develop a strategy to sell City owned land and real estate, as well as aggregate and asphalt operations to assist with additional non-residential relief programs.

Scenario 7 – An alternative mitigation option that can be used with each scenario (Attachment 11)

Many other these scenarios contain a mitigation program that either addresses / benefits the non-residential or the residential property owner as a way of buffering municipal property tax increases. The implementation of a Phased Tax Program (PTP) in 2019 that was similar to the PTPs in 2017 and 2018 has been suggested (included in scenario 2). An alternative to that mitigation program could be a very targeted credit / support program for the most impacted non-residential property taxpayer. A certain budget amount could be set (the source would be one-time funds), and a program can be developed to quickly and efficiently allocate these funds.

Further detail on how such as program could function is contained in Attachment 11.

Summary on Scenarios

These scenarios are presented for review and discussion. An outcome or conclusion may be one of these scenarios, or a mixture of them – in alignment with the established principles.

Administration is proposing to take any output / direction received at this meeting, perform further analysis as required and subsequently present refined options, and any recommendation(s), to the Strategic Session of Council on 2019 April 1. Administration would use the guiding principles on page three, should they be approved by Council, as a basis for its work leading up to the 2019 April 01 strategic council meeting. The result of and decisions emanating from the 2019 April 01 Strategic Session of Council will be used to finalize the 2019 property tax rates, and prepare the 2019 property tax bylaws for the consideration of Council on 2019 April 8.

The assessment/tax discussion, at the 2019 April 1 Council strategic meeting, will be complementary to, and integrated with, the downtown strategy discussion which Council has also directed be brought to that meeting.

Stakeholder Engagement, Research and Communication

A significant amount of engagement has taken place around the tax shift discussion as well as the broader topic of economic diversification, downtown rejuvenation and resilience of the community. Many groups and committees have been or will be engaged with including Calgary Economic Development, the Chamber of Commerce, Business Improvement Areas and many others. In addition to these groups, there have been discussions with the real estate advisory committee and other small business community members. A summary of this engagement is included in Attachment 2 – PFC2019-0148.

Strategic Alignment

This work aligns with all Council's priorities and directions as the budget is the means by which the priorities and directions as contained in the 2019 – 2022 One Calgary Business Plans and Budgets are enabled.

Social, Environmental, Economic (External)

The decline in oil prices, which started in early 2014 has structurally changed the composition of businesses and our economy. The decline also contributed to a 19-quarter decline (to date) in the demand for downtown office space. It fell from a peak of 39.1 million square feet to a trough of 32.9 million square feet. Factors responsible for the decrease include:

a) the 2015-16 recession and the resulting loss of jobs through cyclical unemployment;
b) job losses for those occupational categories typically associated with office work;
c) shifts in the geography of jobs away from the downtown core to the Beltline and suburbs; and
d) a continued shift to more efficient space utilization through a transition from offices to cubicles.

In addition to lower downtown office demand, a significant increase in quantity and improvement in the quality of downtown office supply has put further downward pressure on resale prices and lease rates. For the period from 2001 Q3 to 2018 Q2, the downtown office market experienced:

a) additional supply with a 14 per cent increase in the number of downtown office buildings;
b) more supply per building with an 18 per cent increase in square footage per building; and
c) a shift to better quality space with a 53 per cent increase in Class A space.

Calgary's dynamic and cyclical economy affects property values and the property taxes paid by properties within the various property tax classes. The very steep and rapid decline in the market value of a very small number of high valued non-residential properties (mainly downtown office buildings) of approximately $14 billion, has led to a material decrease in non-residential property taxes paid by these property owners of over $250 million since 2015. These property taxes are then reallocated to other properties within the non-residential class, such that some non-residential properties whose market values have remained relatively stable have suffered untenable municipal property tax increases. Many of the economic cycles experienced by Calgary in the past have not has the same unusually prolonged impact on the downtown office market.

Optimistic forecasts that reduce the current high downtown office vacancy rate and project assessment values to return to their previous values rely on four assumptions that may or may not materialize:

a) No new investments in office buildings in the medium term;
b) Sustained recovery of crude oil prices to above $50 per barrel;
c) Renewed investments in the energy sector; and
d) Job growth for office workers that keeps pace with overall job growth in the Calgary region

The assessment/tax discussion, at the 2019 April 1 Council strategic meeting, will be complementary to, and integrated with, the downtown strategy discussion which Council has also directed be brought to that meeting.

Financial Capacity

Current and Future Operating Budget:

On 2018 November 14, Council directed Administration:

- that if provincial tax room should become available for 2019, to make use of the tax room to reduce the municipal non-residential tax property tax rate Council's highest priority; and
- find salary and wage savings to achieve a property tax rate increase of 2.45% in 2019, and fix the residential tax rate increase at 3.45% to achieve a shift from non-residential assessment base to the residential base.

Any other decisions on how the tax responsibility should be shared by the residential and non-residential property accounts will inform the impact on the operating budget and how the

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property tax bylaws are finalized. The amount of efficiencies and reductions to be found will inform Administration's work for 2019.

Current and Future Capital Budget:

Certain capital projects are funded through the operating budget. Any changes to the capital portion of the operating budget will inform Administration's work for 2019.

Risk Assessment

Each scenario is illustrated separately in Attachments 5 through 11 and key assumptions and parameters along with the risks, pros and cons are summarized in these attachments.

A Tax Rate Bylaw must be passed by Council to enable 2019 Property Tax Bills to be mailed in 2019 May. The latest date for decisions on the bylaw contents must be made by 2019 April 1 for the all three readings of the bylaw on 2019 April 8. Taxes are due by 2019 June 28, the last business day in June.

REASON(S) FOR RECOMMENDATION(S):

The recommendations in this report focus on a variety of scenarios that can be implemented for 2019. This information is to be discussed at the 2019 April 1 Council Strategic Session.

ATTACHMENT(S)

1. Attachment 1 – Previous Council Direction
2. Attachment 2 – PFC2019-0148, recommendations to be filed
3. Attachment 3 – PFC2019-0148 Presentation
4. Attachment 4 – White Boarding Session: Problem Identification Ideas
5. Attachment 5 – Scenario 1 - 2018 November 14 Council Direction
6. Attachment 6 – Scenario 2 - Administration Recommendations PFC2019-0148
7. Attachment 7 – Scenario 3 – NOM C2019-0358
8. Attachment 8 – Scenario 4 - Transfer from Non-Residential to Residential over two years and offer rebates over the One Calgary Budget Cycle
9. Attachment 9 – Scenario 5 - PAYG and Reserves
10. Attachment 10 – Scenario 6 - All efficiency or reduction to NR
11. Attachment 11 – Scenario 7 - Targeted business program