

# Edmonton Apartment Association Split Mill Rate: 2005 Perspective May 2005



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# Executive Summary

- In 1974, the Province of Alberta amended *The Municipal Taxation Act*, to give municipal councils the power to levy different mill rates for different classes of property. This change led to the introduction of a property tax concept known as a Split Mill Rate.
- **Split Mill Rate (“SMR”)**: depending on the type of ownership, identical properties are assessed on the same principles but are taxed differently. Alberta municipalities can utilize a SMR for different types of residential properties. For example, a municipality in Alberta can choose to apply a higher mill rate on *rental apartment* properties (i.e. income producing properties) compared to the mill rate applied to *single family & condominium* properties even if the assessed values of the two classes of properties are equal. The City of Edmonton is one such city that utilizes the SMR when taxing its different residential property classes.
- In **1974** the **City of Edmonton** introduced the SMR with separate mill rates for rental apartment properties and single-family residential properties (including condominiums). During this year the mill rate ratio was 1.4 (for rental apartments) to 1 (for single-family); thus, reflecting a 40% property tax surcharge on rental apartment properties. This surcharge was gradually reduced until 1993 when the mill rate ratio was 1.2 to 1 reflecting a 20% surcharge. The 20% surcharge remains in place to day.

# Executive Summary

- In **1998** the issue of the SMR differential between single family and rental apartment properties was considered by the Edmonton Property Tax Committee (“EPTC”). The EPTC recommendation, accepted by City Council, was to maintain a mill rate ratio of 1.2 to 1. In **2002** a City Council motion to equalize the SMR was defeated.
- In **2004** Edmonton’s City Council established a **Property and Business Tax Structure Review Committee (“PBTSRC”)** with the objective to review the appropriateness of the tax burden on Edmonton tax payers. This includes an examination of the SMR.
- PricewaterhouseCoopers (“PwC”) was engaged by the Edmonton Apartment Association (“EAA”) to review the City of Edmonton’s property tax policy of a SMR between rental apartment properties and all other types of residential properties (i.e. single family, condominiums, etc) with a focus on the fairness & equity, stability, and competitiveness of the practice.
- A review of the current property tax practices of major Western Canadian Cities was completed as an integral phase of the study. The practices of the Cities of Edmonton, Calgary, Vancouver, Winnipeg, Regina and Saskatoon were reviewed.

# Executive Summary

- The 2005 PwC study determined:
  - **The City of Edmonton is the only major Western Canadian City that continues to use an SMR.**
  - The Cities of Regina and Saskatoon are in the process of phasing out the SMR practice.
  - Calgary, Vancouver, and Winnipeg have already eliminated any differential in residential tax policy.
  - Replacement taxes such as a Business Tax are not implemented when a SMR practice is discontinued.
- The profile of a renter is that of a low income household required to spend a higher percentage of their income on accommodation, and are typically living in accommodation that may not meet their core housing needs.
- Canada Mortgage and Housing Corporation defines the housing *affordability standard* as 30% of the household's before-tax income.
  - 15% of household owners exceed the affordability standard.
  - 37% of renters exceed the affordability standard.

This demonstrates that there is a disproportionate amount of renters requiring larger percentages of their income for housing than owners.

# Executive Summary

- The Cities of Calgary, Saskatoon, and Regina have all either implemented or concluded a phased elimination of the SMR. The duration of the phasing for Calgary was 3 years (1998 – 2000), Saskatoon is currently phasing out over 10 years (2001 – 2010), and Regina will begin the phase-out process over 5 years (2006 – 2010). The phase out periods are reflective of the economies of each municipality. The larger the surcharge differential the longer the phase-out period.
- There are a number of approaches available to address the loss of revenue from the elimination of the SMR. The most prevalent approach is to adjust over time, to achieve a new all-encompassing residential mill rate to offset the loss.
- Currently Edmonton's **PBTSRC** has the mandate to review the appropriateness of the tax burden on Edmonton tax payers which includes an examination of the SMR. The openness of the PBTSRC to examine the SMR in conjunction with the findings of this EAA initiated study creates an opportunity for a change in the City of Edmonton's policy on the use of the SMR for different residential classes.

# Executive Summary

- Based on the findings of the study PwC **recommends** that the City of Edmonton
  - **Eliminate the SMR effective with the 2006 Tax year.**
  - **Equalize Residential Mill Rates**
  - **Utilize a phased approach to achieve the change**, if required, as this approach eliminates the impacts of the SMR while still providing sufficient time to adjust to the equalization of all residential mill rates.
  - **Decrease the mill rate for rental apartment properties in proportion to a single-family increase to help offset the potential loss in tax revenues.** This solution will ensure that the proportion of residential to non-residential tax income is maintained.
  - **Avoid implementing additional or replacement taxation (i.e. Business Tax).**

# Project Objective & Methodology

## Objective:

- To review the City of Edmonton's property tax policy of a Split Mill Rate ("SMR") between rental apartment properties and all other types of residential properties (i.e. single family, condominiums, etc) with a focus on the fairness and equity, stability, and competitiveness of the practice.

## Methodology:

- STEP 1:** Define and understand the rationale of a SMR.
- STEP 2:** Review the history and current perspective of the City of Edmonton on the SMR policy.
- STEP 3:** Benchmark the residential property tax practices of major Western Canadian Cities.
- STEP 4:** Examine current homeownership and rental trends.
- STEP 5:** Assessment of the Future of SMR's.
- STEP 6:** Review the City of Edmonton's continuing use of the SMR.
- STEP 7:** Recommend a go forward strategy for the City of Edmonton's SMR policy.

# Split Mill Rates

- In 1974, the Province of Alberta amended *The Municipal Taxation Act*, to give municipal councils the power to levy different mill rates for different classes of property. This change led to an introduction of a Split Mill Rate.
- **Split Mill Rate (“SMR”)**: Depending on the type of ownership, identical properties are assessed on the same principles but are taxed differently. A municipality can utilize a SMR for different types of residential properties. For example, a municipality in Alberta can choose to apply a higher mill rate on *rental* apartment properties compared to the mill rate applied to *single family & condominium* properties even if the assessed values of the two classes of properties are equal. The City of Edmonton utilizes the SMR when taxing its different residential property classes.

# Split Mill Rates

## Key Residential Property Classes:

- **Rental Apartment:** Any income producing rental property. In Edmonton, rental apartment refers to any income producing property with more than 3 units.
- **Single Family & Condominium:** This term (for the purposes of this report) refers to all other residential housing types. The distinguishing key between this class of residential property and rental apartment property is that each dwelling unit within the single family & condominium class is contained within a single title (with the exception of apartments with 3 units or less).

## Example of the Impacts of Split Mill Rates:

Using the City of Edmonton’s 2004 property tax formula and mill rates the following example demonstrates the impact of the SMR on a single family & condominium property compared to a rental apartment property:

$$\text{Single family} = (\$100,000 \text{ (Assessment)} \times 5.8429 \text{ (Mill Rate)} / 1,000) = \underline{\$584.29}$$

$$\text{Rental apartment} = (\$100,000 \text{ (Assessment)} \times 7.0115 \text{ (Mill Rate)} / 1,000) = \underline{\$701.15}$$

**The two identically valued residential properties are taxed differently.**

# Split Mill Rates

## Rationale for the SMR:

- Rental apartment properties are income producing properties. The owners are in the business of renting units and all business are taxed. Owners of the property have the advantage of deducting for income tax purposes, the dollars used to pay municipal taxes. As a result:
  - Single Family & Condominium property owners pay municipal taxes with “*after tax dollars*”; and
  - Rental apartment property owners pay municipal taxes with “*before tax dollars*”.
- Municipal tax planners utilized the differential tax system (i.e. SMR) to offset the supposed advantage rental apartment property owners have over single family & condominium property owners and creating an even footing with all residential property owners.

# History of SMR in Edmonton

- **1974** - The City of Edmonton introduced the SMR with separate mill rates for rental apartment properties and single-family residential properties. During this year the mill rate ratio was 1.4 (for rental apartments) to 1 (for single-family); thus, reflecting a 40% property tax surcharge on rental apartment properties. This surcharge was gradually reduced until 1993.
- **1993** - The mill rate ratio was 1.2 to 1 reflecting a 20% surcharge.
- **1998** - The issue of the SMR differential between single family and rental apartment properties was considered by the Edmonton Property Tax Committee (“EPTC”). The EPTC recommendation, accepted by City Council, was to maintain a mill rate ratio of 1.2 to 1 and was based upon the following principles:
  - **Fair and Equitable:** All property owners pay a reasonable share of municipal property tax. That share is not tied to the amount of civic services used by a property owner;
  - **Stable:** Tax policy programs are predictable, enabling individuals and businesses to have increased confidence in long-term planning decisions;
  - **Competitive:** Property taxes do not disadvantage the City relative to other municipalities.

# History of SMR in Edmonton

- **2002** - A City Council motion to equalize the SMR was defeated.
- **2004** – Edmonton’s City Council established an **Property and Business Tax Structure Review Committee (“PBTSRC”)** to review the appropriateness of the tax burden on Edmonton tax payers including an examination of the SMR.

# Benchmarking

## Comparable Municipalities:

- Benchmarking of the current property tax practices for residential property was completed for the municipalities of:
  - Vancouver;
  - Winnipeg;
  - Regina;
  - Saskatoon; and
  - Calgary;

# Benchmark Findings

## Vancouver

- The City of Vancouver currently taxes all of its residential property classes in the same manner with equal mill rates for rental apartment and single family/condominium properties.
- No business taxes are applied to apartment properties.

# Benchmark Findings

## Winnipeg

- Prior to 1992, the Province of Manitoba set the portioning rate (i.e. the percentage of the assessed value of a property to which taxation is applied) for apartment and rented condominiums at 1.5 times the residential rate and 2.2 times the rate of owned condominiums.
- In 1992, the Manitoba government began a phase-out of this differential in ten equal annual increments. The 10-year phase is now complete and apartment renters are portioned the same as single family owners (i.e. 45%).
- Mill rates in the City of Winnipeg for all residential property classes are equalized.
- As a result of provincial and municipal tax policies all residential classes are taxed in a consistent and harmonized manner.
- No business taxes are applied to rental apartment properties.

# Benchmark Findings

## Regina

- Rental apartment properties pay disproportionately more in property taxes than do single-family/condominium properties.
- A standard municipal mill rate applies to all property classes in the city, however, Regina applies a *mill rate factor* (i.e. the factor used to determine the proportion of tax revenue that each property class will pay) which differs between rental apartment properties and all other residential types.
- Currently, the City's municipal mill rate is 17.6987. The City's residential mill rate factors are:  
  
Rental Apartments = 1.27557 versus Other Residential = 0.83423
- Rental apartment properties are subject to a 53% tax surcharge over other residential properties.
- In December of 2004, the Saskatchewan Rental Housing Industry Association convinced the Regina City Council to eliminate the gap between single-family/condo and rental apartment property tax rates.

# Benchmark Findings

## Regina (Cont'd)

- The City of Regina approved harmonized mill rate factors for all residential properties to be phased in over a 5-year period beginning in 2006 and ending in 2010. The mill rate factor for rental apartment properties will decrease with an increase in the single-family residential mill rate until an equilibrium is achieved. This approach will enable the City to offset any potential losses in tax revenue over the phase-in period.
- No business taxes are levied against rental apartment properties.

# Benchmark Findings

## Saskatoon

- Rental apartment properties pay disproportionately more in taxes than do single-family and condominium properties.
- Saskatoon applies a standard municipal mill rate to all property classes and differing mill rate factors for rental apartment and other residential properties.
- Currently, the City's municipal mill rate is 12.2731. The City's residential mill rate factors are:

Rental Apartments = 1.3461 versus Other Residential = 0.8817

- Rental apartment properties are subject to a 53% tax surcharge over other residential properties.
- No business taxes are levied against rental apartment properties.
- In 2001, The City of Saskatoon committed to eliminating the mill rate factor differential between residential property classes by 2010.

# Benchmark Findings

## Saskatoon (cont'd)

- The decision to eliminate the mill rate factor differential stems from the Local Tax Review Committee Report in 1997, produced by a citizen's committee appointed by Council. The committee concluded there is no justification for taxing rental apartments at a different rate than condominiums or single family homes. All residential properties should be treated equally.
- In 2005, after the completion of the general reassessment, the plan will be reviewed by Council to determine if the phase-in should be accelerated or decelerated. Saskatoon has also committed to reducing the mill rate factor for commercial properties.
- Together with a reduction of commercial mill rate factors and an equalization of residential mill rates the new residential mill rate factor will be adjusted to offset any lost tax revenues.

# Benchmark Findings

## Calgary

- **1987:** the City implemented an SMR between rental apartment and single family residential properties. The differential was 15% higher for rental apartment properties than for single-family residential properties.
- **1994:** the rate on rental apartment properties was 37% higher than on single family property.
- **1995:** City Council established the Tax Review Committee to examine the manner in which taxes were raised from property taxes.
- **1996:** The *Report to City Council* from the Calgary Tax Review Committee recommended that:  
  

***“The split mill rate, and any other city policy imposing a higher levy on Multi-Family (i.e. Rental Apartment) units, as compared to Single Family (including condominium) units, be discontinued.”***
- Based upon the recommendation the differential mill rate between rental apartment and single family properties was eliminated over a 3-year period beginning in 1998.
- The loss in tax revenue was offset by the growing tax base.
- No business taxes are levied against rental apartment properties.

# Benchmark Findings

## Calgary Tax Review Committee (1996) Rationale

- It was assumed that property taxes will be borne by the landlord rather than the tenant. In reality; **property taxes are an expense item passed directly into the rental charges paid by the tenant.**
- Many landlords had converted rental apartment buildings from a single title, into condominiums with separate titles for each dwelling unit. As such, the landlord as registered owner of each new title issued for condominium could take advantage of lower tax rates and still rent their units. Depending on the type of plan or ownership, identical properties are assessed on the same principles but taxed differently, thus **creating an inequity in the taxation of identical properties.**
- The Calgary Tax Review Committee **could not find any justification for maintaining the split mill rate** other than the challenge of replacing the revenue that would be lost by abandoning it.

# Benchmark Findings - Summary

## Summary

- The City of Edmonton is the only major Western Canadian City that continues to use an SMR.
- The cities of Vancouver, Winnipeg and Calgary have phased out their SMR practice.
- The cities of Regina and Saskatoon are in the process of phasing out the SMR practice.
- Replacement taxes such as a Business tax are not implemented when SMR is discontinued.

# Home Ownership & Rental Trends

## Home Ownership:

- Across Canada, the rate of home ownership is rising for various factors including:
  - Low mortgage rates;
  - The ability to purchase with little to no down-payment;
  - Aging population; and
  - Rising disposable incomes
- Census Data for 1991 and 2001 indicate that the rate of home ownership across Canada increased from 62.6% in 1991 to 65.8% in 2001.
- According to the 2001 Census under 33% of recent immigrant households own their home, compared to 67% of non-immigrants.

# Home Ownership & Rental Trends

## Rental:

- In the City of Edmonton according to the 2001 Census information approximately 34% of all households were rented.
- The profile of a renter is that of a low income household required to spend a higher percentage of their income on accommodation, and are typically living in accommodation that may not meet their core housing needs.
- Further a renter is more than likely to be a member of one of the following groups: an immigrant, female lone-parents, Aboriginal people and seniors. The incidence of being reliant on some form of government income or living on a fixed income is higher for these groups than the population at large.
- The 2001 Census information reports that immigrants make up the largest percentage of renters in major Canadian cities and have more people residing in smaller residences than non-immigrant renters.
- Also according to Census data, Canadian renters were 3-times more likely to live in crowded housing than owners.
- Moreover, 66 <sup>2</sup>/<sub>3</sub>% of renters who lived in crowded conditions in 2001 had enough income to pay the median rent of alternative housing. This was well below the proportion of 90% for homeowners. *The difference reflects the significantly higher incomes of owners.*

# Home Ownership & Rental Trends

**Owner and Tenant Household Costs\* As A % of 2000 Household Income\*\* In Edmonton**

| % of Households                      | Owner       | Tenant      |
|--------------------------------------|-------------|-------------|
| < 15%                                | 47%         | 22%         |
| 15% - 19%                            | 18%         | 17%         |
| 20% - 24%                            | 13%         | 13%         |
| 25% - 29%                            | 7%          | 10%         |
| 30 - 34%                             | 4%          | 8%          |
| 35 - 39%                             | 3%          | 5%          |
| 40 - 49%                             | 3%          | 7%          |
| > 50%                                | 5%          | 17%         |
| <b>Total</b>                         | <b>100%</b> | <b>100%</b> |
| <b>Exceed Affordability Standard</b> | <b>15%</b>  | <b>37%</b>  |

Source: Statistics Canada, Census of Population

- Canada Mortgage and Housing Corporation defines the housing *affordability standard* as 30% of the household's before-tax income. This suggests that spending more than 30% on housing becomes a riskier investment given the burden other expenses that are incurred.
- According to the table:
  - 15% of household owners exceed the affordability standard.
  - 37% of tenants exceed the affordability standard.
- This demonstrates that there is a disproportionate amount of renters requiring larger percentages of their income for housing than owners.

## Notes:

\* **Owner Household Costs:** Electricity, fuel, water, and other municipal services, mortgage payments, property taxes and condo fees.

**Tenant Household Costs:** Renters: Electricity, fuel, water, and other municipal services, and monthly rent.

\*\* **Household Income** = The sum of the total incomes (including earnings, government transfer payments, investment income, and other income) of the household aged 15 years and over.

# Home Ownership & Rental Trends

- The “renter” is the group that can least afford to be impacted by a property tax structure which is not fair and equitable.
- The profile of the people who rent is an important consideration when examining the practice of utilizing SMR for residential properties. Studies clearly demonstrate that a social and economic divergence exists between renters and owners which has the potential to increase when SMR is applied to rental apartment properties particularly with the higher SMR property tax cost passed on to the tenants.

# Future of SMR's

## Rationale for the SMR:

- Rental apartment properties are income producing properties. The owners are in the business of renting units and all business are taxed. Owners of the property have the advantage of deducting for income tax purposes, the dollars used to pay municipal taxes. As a result:
  - Single Family & Condominium property owners pay municipal taxes with “*after tax dollars*”; and
  - Rental apartment property owners pay municipal taxes with “*before tax dollars*”.
- Municipal tax planners utilized the differential tax system (i.e. SMR) to offset the supposed advantage Rental apartment property owners have over single family & condominium property owners and creating an even footing with all residential property owners.

# Future of SMR's

## Comment on Rationale

- To support an SMR on the basis of eligibility to deduct expenses and whether municipal taxes are paid with before or after tax dollars ignores that the principles of taxation for businesses and individual taxpayers are significantly different.
- Owners of rental apartment properties are a business and as a consequence all costs of doing business are passed to the tenant. The SMR creates an inequity between the homeowner and the renter, they both pay housing costs with after tax dollars. Further study demonstrate that 37% of renters pay a higher percent of their income for accommodation than a homeowner creating an inequity.
- An examination of the rationale for SMR's from the perspective of equity highlights weakness in the rationale.

# Future of SMR's

## SMR's Advantages & Disadvantages

- **Advantages**

- Will maintain higher tax revenues from rental apartment properties
- Will avoid the challenge of replacing lost revenue if the SMR was equalized

- **Disadvantages**

- Tax policy remains discriminatory against renters, who represent 70% of low income households.
  - SMR is inequitable as identical pieces of property can be assessed under the same principles but taxed differently.
  - Landlords will continue to pass the burden of property tax increases on to the tenants.
  - Competitiveness is compromised in terms of rental apartment property investments as other jurisdictions have equalized their residential mill rates.
- It is the view of PwC that the disadvantages associated with utilizing a SMR outweigh the advantages.

# Future of SMR's

- Based on the findings of the this study, the approach of utilizing SMR's in major Western Canadian municipalities is a practice of the past.
- The elimination of an SMR is typically achieved by adopting the equalization of the residential mill rates. There are two alternatives available to a City when equalizing the residential mill rate:
  - Eliminate the SMR immediately; or
  - Phase out the SMR over a period of time
- Each alternative has advantages and disadvantages. The practice of immediately eliminating the SMR would result in a tax shock to the residents hence favoring a phase out approach.
- A phased approach facilitates adjustments to property tax policies gradually over time to ease the burden on taxpayers of replacing the lost revenue as well as enabling tax increases if they should be required.

# Edmonton's SMR

- Based on the benchmark findings and the demographic profile of purchasers and renters it is timely to examine the continuation of the City of Edmonton's practice of using a SMR.
- In 2002 The City of Edmonton supported the continuation of the SMR. The decision was based upon the Edmonton Property Tax Committee's (EPTC) consideration of the following principles:
  - **Fair and Equitable:** All property owners pay a reasonable share of municipal property tax. That share is not tied to the amount of civic services used by a property owner;
  - **Stable:** Tax policy programs are predictable, enabling individuals and businesses to have increased confidence in long-term planning decisions;
  - **Competitive:** Property taxes do not disadvantage the City relative to other municipalities.

# Edmonton's SMR

- In 2004 the PBTSRC guiding principles are the same as in 1998 and when viewed in the context of the findings of this EAA initiated study inconsistencies are identified that demonstrate Edmonton's current practice of using a SMR is not a sound fit with the articulated principles:
  - **Fair and Equitable:**
    - Landlords *pass the burden* of the surcharge on *to the renters through rental charges*.
    - Because renters are the ones ultimately penalized by the higher mill rates, SMR *discriminates* against the average apartment renter as they earn a lower income compared to the average condominium or single family dwelling owner.
    - Depending on the type of plan or ownership, identical properties are assessed on the same principles but taxed differently, thus *creating an inequity in the taxation of identical properties*
  - **Stable:**
    - Some apartment owners have taken advantage of the opportunity enabling them to *legally convert their properties* into condominium apartments and subsequently rented out to avoid the higher mill rate.

# Edmonton's SMR

## ➤ **Competitiveness:**

- Benchmarking demonstrated that all major cities across Western Canada with the exception of Edmonton have equalized or in the process of equalizing their residential mill rates.

# Recommendation

- **Eliminate the SMR effective with the 2006 Tax year.**
- **Equalize Residential Mill Rates.**
- **Utilize a phased approach to achieve the change**, if required, as this approach eliminates the impacts of the SMR while still providing sufficient time to adjust to the equalization of all residential mill rates.
- **Decrease the mill rate for rental apartment properties in proportion to a single-family increase to help offset the potential loss in tax revenues.** This solution will ensure that the proportion of residential to non-residential tax income is maintained.
- **Avoid implementing additional or replacement taxation** such as a Business Tax.

# Summary

- **Split Mill Rate (“SMR”)**: depending on the type of ownership, identical properties are assessed on the same principles but are taxed differently.
- In **1974** the **City of Edmonton** introduced the SMR with separate mill rates for rental apartment properties and single-family residential properties and continues to utilize the SMR. Since 1974 the only change has been the reduction from a 40% property tax surcharge on rental apartment properties to a 20% surcharge in place to day. In **2004** Edmonton’s City Council established an **Property and Business Tax Structure Review Committee (“PBTSRC”)** with an objective to review the appropriateness of the tax burden on Edmonton tax payers. This includes an examination of the SMR.
- PwC was engaged by the EAA to complete a review of the current practices of SMR and the impact of such practices. The study determined that Edmonton is the only major Western Canadian city maintaining the utilization of an SMR with no immediate plans to equalize residential mill rates.
- SMR is viewed as discriminatory against renters. Further the SMR creates inequities within the rental apartment properties.
- A continuation of an SMR by the City of Edmonton is inconsistent with the PBTSRC’s guiding principles for taxation by the City of Edmonton.

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