Town of Morinville

A Roadmap Towards a Long-Term Tax Strategy
September - 2018

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Introduction

Council Direction

Morinville Town Council has recognized the need to review and plan for the tax revenue required to achieve strategic goals, maintain service levels and ensure long-term financial sustainability.

On April 24, 2018, Council's direction to Administration was:

"To move forward with the development of a long-term tax strategy, prior to the 2019 Budget that will include a discussion on split mill rates, including the MGA allowance for subclasses in non-residential taxation over the coming months. This discussion would include a public engagement component and discussion with residential and non-residential property owners."

Administrative Response

Administration has responded to Council's direction with this report, intended to deliver the following:

1. A comprehensive review and analysis of the key areas of a long-term tax plan that would provide the Town of Morinville with confidence in its long-term financial sustainability;
2. A clear understanding of the factors that affect the municipality's budget and long-term financial sustainability;
3. A review of Morinville's current tax structure, including observations on strengths/weaknesses and recommendations to ensure long-term financial sustainability; and
4. A list of the guiding principles to be utilized now and in the future for key financial decisions and long-term tax planning

Current Situation

The Town of Morinville is a vibrant and growing Town of nearly 10,000 people approximately 20 minutes from the City of Edmonton. The town is youthful in its demographic with an average age of 33. Morinville has numerous amenities such as a splash park, a skateboard park, hockey arena, curling rink, walking trails, numerous playgrounds and a soon-to-be open multi-purpose recreation facility.

The Town has become an attractive location for young families to locate to and has ample opportunity for both residential and business growth. The Town's evolution has it facing numerous challenges as it grows, succeeds and modernizes. These challenges include growth pressures, inflation pressures, intermunicipal challenges, infrastructure needs, and growing service demands from citizens. A review of the Town's taxation structure indicates the need for review, analysis, discussion, goal setting and strategy.

The first review of the Town's taxation structure highlights the Town has an imbalance in both its residential and non-residential tax rates when compared to other municipalities in the region. Out of 13 municipalities in the region, Morinville has the third highest residential tax rate. Conversely, it has the second lowest non-residential rate in the region. The ability to generate enough tax revenue to pay for the multitude of services citizens demand and desire is paramount to its success.

The Town also introduced a non-residential improvement policy commenced for the 2013 tax year. The purpose of this policy was to encourage and stimulate the development of non-residential property within the Town of Morinville. It forgives 50% of municipal non-residential taxes for a maximum period of one year for new construction and major additions and/or renovations to property when the total value assessed is twice the current assessment. Future discussions on tax strategy should include an evaluation of this policy's effectiveness and its fairness overall, considering the residential and non-residential tax rate imbalance.

For several years, the Town has reflected a budgeted deficit in its municipal tax supported operating budget. Overall, Morinville's consolidated operating budget (tax and utility supported operations) reflects a surplus. This however, is not sustainable and nor fiscally healthy for the municipality. For Morinville to maintain service levels as well as its financial health, the budget must be balanced. Having an appropriate tax structure is critical for the long-term sustainability of the Town of Morinville.

This report will provide Council with insights into the Town of Morinville's current property tax processes, provide an assessment of the Town's tax structure, and make recommendations with a proposed timeline.

Taxation 101

(Source credit – City of Edmonton Property Assessment and Taxation White Paper)
The discussion on a long-term tax strategy begins with background information on how municipal taxes work, the tax/cost relationship in the budget, and the cost challenges faced by municipalities, particularly the Town Morinville.

Role of Property Tax

Property taxes are the single largest revenue source for the Town of Morinville representing approximately 70% of the annual tax supported revenue. The Town of Morinville also has other revenue sources, such as franchise fees, fees and charges, permit revenue, rental revenue and government grants. These revenue sources fund the fee-for-service model. Property taxes pay for most services that deliver clear public benefit to residents. User fees and charges rarely recover 100% of the services they are charged for. Recreation services, as an example, provide significant public benefit in terms of health and wellness outcomes. However, recreation services are heavily subsidized, as 100% cost recovery would make the services unaffordable for most residents. Property taxes fairly distribute the cost of municipal services amongst property owners that create clear public benefit to property owners.

Municipal Revenue Toolbox

In the development of a long-term tax strategy, it is important to understand the Town of Morinville's revenue limitations. Overall, municipal revenue sources are very limited in scope. Provincial and federal levels of government have multiple revenue sources stemming from both income and consumption taxes (personal income tax, corporate tax, GST, user fees, liquor and tobacco tax, gaming revenue etc.).

The municipal revenue toolbox has not increased in scope in any meaningful way historically, though numerous social services have been downloaded to municipalities from the provincial and federal levels of government. This has increased the load carried by property taxes, as municipalities have become more responsible for social programming. Though municipalities provide the majority of direct and visible services to citizens, they are very disadvantaged in their ability to generate revenues.

Further complicating the challenge for municipalities, property taxes are not progressive and do not increase naturally. Both financial and federal taxes will increase as individual and corporate income and consumption increases. Additionally, income and consumer taxes increase through real growth, and prices for consumer goods also increase.

Municipal revenues differ, as they require a transparent tax rate increase completed through the political budget process. The need to generate additional revenue puts both political and public pressure on municipalities.

Municipal Tool Box

vs.

Federal & Provincial Tool Box

Assessment Value and Taxes

Municipal taxes are levied on property owners within the municipality. The level of tax levied is dependent upon the municipal mill rate (tax payable per dollar of assessment of the property) along with the assessed value of the taxable property. The assessed value strives to accurately reflect the market value of the property. Accurate assessment of properties allows for a fair, equitable and transparent distribution of the tax requirement. The basic methodology of property taxation is the equitable distribution of the cost of municipal services equitably to property owners based on the value of their property. From the equity perspective, a property owner's taxes will increase or decrease based on the value of the property compared to the average property value within the municipality.

Key principles of assessment include:

1. Fairness, equity and accuracy
2. Openness and transparency
3. Legislative clarity, efficiency and stability
4. Administrative consistency, efficiency and stability

Tax Classes

The Town of Morinville's property assessment and tax system is dictated by the Municipal Government Act (MGA). The Town assessor must follow provincial legislation when it comes to assessing property; however, Town Council does have options regarding how it implements tax policy through tax rates associated with assessment classes.

The four basic assessment classes are:

1. Residential
2. Non-residential (commercial, business and industry)*
3. Farmland
4. Machinery and equipment

*Non-residential also includes linear property (ie: pipe and power infrastructure within a municipality).

The MGA has recently been modernized to improve municipal funding models and ensure a balanced, consistent and efficient collection of municipal revenue sources. Town Council now has the authority to apply different rates to each assessment class.

It is critical for a long-term taxation strategy and long-term municipal sustainability to analyze and understand the Town of Morinville's separate assessment classes to determine the appropriate and optimal distribution of property taxes within the municipality.

Additionally, to ensure fairness and equity within assessment classes, a subdivision of assessment classes should be explored in taxation policy decisions related to long-term tax strategies. This improves the ability of municipalities to recognize different levels of business and develop rates that will not deter new business retention, attraction, and expansion, or create undue hardship for small businesses.

The New MGA – Subclasses

The New MGA – Allowances for Taxes

This section provides Council with information on the new allowances for taxation in the new MGA, as required in its motion.

To improve municipal funding models to ensure a balanced, consistent and efficient collection of municipal revenue sources.

Source: MGA Review Alberta – How We Consulted

Municipal Revenue Collection

Collection

Compliance with the Linked Tax Rate Ratio

What's currently in place: The *MMGA* set a maximum property tax rate ratio of 5:1 between the highest non-residential property tax rate and the lowest residential property tax rate. Municipalities with property tax rate ratios above 5:1 (non-complying municipalities) may not increase their ratio and are not required to lower their ratio.

What we heard: Stakeholder engagement indicated that further consultation was required to determine whether municipalities currently outside of the 5:1 ratio should be required to come into compliance with the maximum ratio within an established timeframe rather than have their ratios maintained at current levels.

What's changing: Create authority for a regulation that will require non-complying municipalities to comply with the tax rate ratio of 5:1 over a period of time.

What this means: Municipalities with property tax ratios above 5:1 will be required to change their non-residential and residential property tax rates over a period of years to bring them into compliance. Municipalities would continue to set their own tax rates but within the ratios set out in the regulation.

When this takes effect: The related sections of legislation came into force May 31, 2016 however the regulation has yet to be developed.

Linking Residential and Non-Residential Property Tax Rates

What's currently in place: Municipalities are free to set non-residential and residential tax rates independent of one another.

What's the issue: Non-residential municipal property taxes have increased at rates faster than residential taxes. In some municipalities, this has resulted in owners of industrial property paying a much higher tax rate than residential property owners.

What we heard: Stakeholders from business and industry have requested a municipal tax framework that more equitably distributes property taxes among all property owners. Municipalities have indicated that any changes to the property tax framework should consider tax implications on residential property owners. Municipalities have emphasized that local councils are in the best position to make decisions for their taxpayers.

What's changing: The *MGA* will be amended so that the highest non-residential tax rate can be no more than five times the lowest residential tax rate. Grandfathering provisions will be put in place to protect residential taxpayers from an immediate, dramatic increase to their residential tax rates if they live in a municipality where non-residential tax rates are greater than five times the residential rate.

What this means: For most Albertans, property taxes will continue to be wholly set at the discretion of their local councils. In municipalities where the non-residential tax rate is more than five times the residential tax rate, the percentage increase in the non-residential tax rate may not be more than the percentage increase in the residential tax rate. There were 19 such municipalities in 2015. It is anticipated these municipalities will, over time, move closer to the proposed five to one ratio.

Effective Date: May 31, 2016.

Splitting Non-Residential Property Tax Rates

What's currently in place: Non-residential properties are split into two subclasses for municipal taxation purposes: "improved" and "vacant." Residential properties may be split into in any number or type of subclasses considered appropriate by the local municipality. In both instances, different tax rates may be applied to each subclass.

What's the issue: The "improved" non-residential property class includes a range of businesses from large industrial plants to small local convenience stores. All businesses are charged the same tax rate despite their very different impacts on the municipality.

What we heard: Municipal stakeholders have asked for the ability to set different property tax rates for subclasses of improved non-residential property. They believe this will allow for a fairer property tax framework. Business and industry stakeholders oppose creating new subclasses for the improved non-residential tax rate. They believe this could lead to high-value industrial properties being taxed at a disproportionately higher rate than other businesses within the non-residential property class.

What's changing: The *MGA* will be amended to enable splitting of the municipal non-residential class into subclasses. The regulations to accompany this change will be created with input from municipalities, assessors, and non-residential property owners to determine how splitting should be implemented to best enable a fair distribution of municipal non-residential property taxes. Any subclasses established under these provisions will be subject to the new limits on the ratio of non-residential tax rates as compared to residential tax rates.

What this means: Municipalities will be better able to set tax rates in a manner that reflects local circumstances.

Effective Date: January 1, 2018.

MGA – Matters Relating to Assessment Subclasses Regulation

The following information provides Council with specific detail on the new MGA regulations related to assessment subclasses. The change with the greatest implication for tax strategy is the subclassification of small business. Businesses with less than 50 employees can now be taxed at a rate different than larger businesses. Town of Morinville Council could, through a bylaw, subdivide the subclass further if it so wishes.

Source: Municipal Government Act – Regulation 202/2017

Prescribed subclasses

2(1) For the purposes of section 297(2.1) of the Act, the following subclasses are prescribed for property in class 2:

a) vacant non-residential property;
b) small business property;
c) other non-residential property.

(2) The subclasses referred to in subsection (1) can be applied to both Urban and Rural Service Areas for Lac La Biche County and the Regional Municipality of Wood Buffalo as if the service areas were separate entities.

(3) For the purposes of subsection (1)(b), "small business property" means property in a municipality, other than designated industrial property, that is owned or leased by a business

a) operating under a business licence or that is otherwise identified in a municipal bylaw, and
b) that has fewer than
   (i) 50 full-time employees across Canada, or

(ii) a lesser number of employees as set out in a municipal bylaw, as at December 31 or an alternative date established in a municipal bylaw.

(4) For the purposes of subsection (3), a property that is leased by a business is not a small business property if the business has subleased the property to someone else.

(5) For the purposes of subsection (3), a municipality may, by bylaw, prescribe procedures to allow for the effective administration of the small business property subclass tax rate, including, without limitations, a method for determining and counting full-time employees, and the frequency of that count.

Tax rates

3(1) For the purposes of section 354(3.1) of the Act, the tax rate set for section 297(1)(d) of the Act to raise the revenue required under section 353(2)(a) of the Act must be equal to the tax rate set for property described in section 2(1)(c) to raise revenue for that purpose.

(2) The tax rate set for property referred to in section 2(1)(b)

a) must not be less than 75% of the tax rate for property referred to in section 2(1)(c), and
b) must not be greater than the tax rate for property referred to in section 2(1)(c).

This Regulation came into force on January 1, 2018.

Budget 101

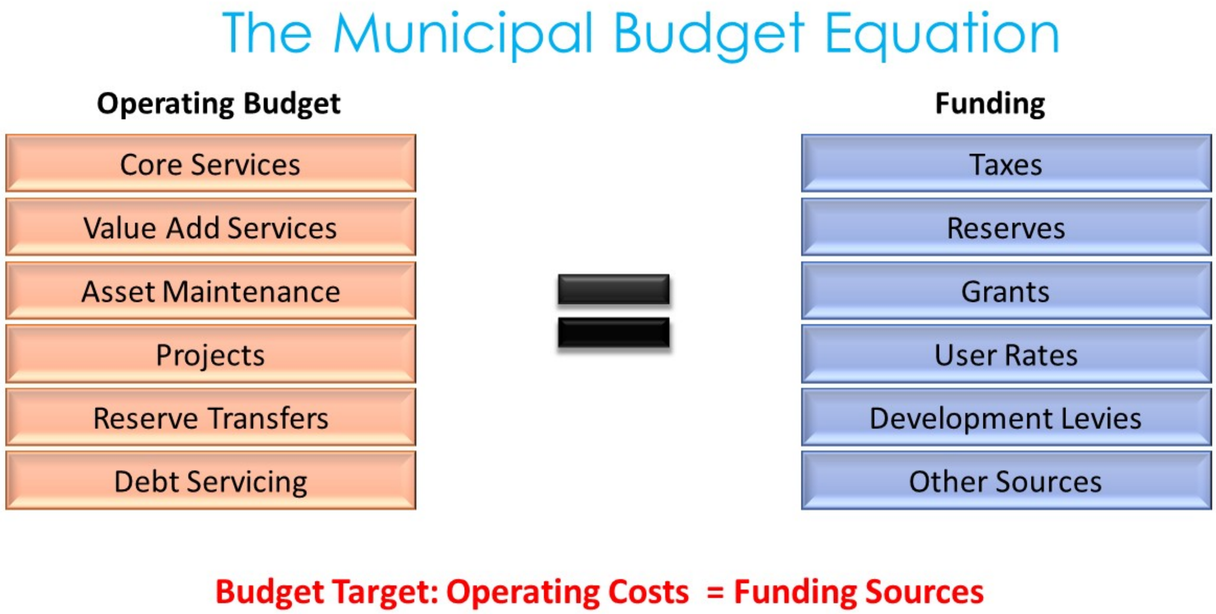
The Budget-Based Approach to Tax Rates

It is important to note that municipalities in Canada do not take advantage of market fluctuations from increases in property market value. The tax revenue requirement is directly linked to the budgeted costs for providing Council-approved services within the municipality. Property values increase collectively due to market conditions, and the tax rate is adjusted accordingly <u>to collect only the revenues required by the municipality for Council-approved services</u>. This allows for property owners to have a predictable and consistent annual tax burden, and for municipalities to have a stable and predictable revenue source. In positive real estate market conditions, the tax rate decreases; conversely, in poor real estate market conditions the tax rate increases to collect exactly what is required for the budget. This is known as “market neutrality.”

The Town of Morinville uses the budget-based approach to setting tax rates as all municipalities do. The budget-based approach to tax rates follows the process of determining the cost of delivering services prior to calculating the tax revenue requirement from property owners. For the Town of Morinville, tax payable is derived from two factors:

1. The assessed value of the property
2. The budgeted tax requirement to deliver Council-approved services

An increase in assessed value to the property does not necessarily mean that there will be a tax increase; however, a budget increase will result in a tax increase. It is important for property owners to be made aware of the assessed value of their property compared to the average assessed value of property within a class, as it directly affects their taxes payable.



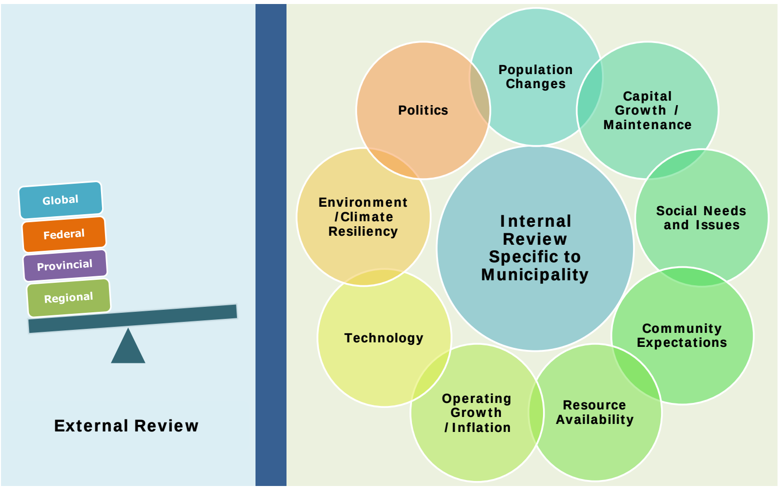
The Municipal Product "Quality of Life" – Tax Revenue Justification

As stated, municipal taxes are the primary revenue source for municipalities. Municipalities provide infrastructure, services and programs that are essential for creating a community and providing residents with quality of life. These include infrastructure and services required for daily needs, safety, health, economic well-being and overall quality of life. Municipal services also directly and indirectly enhance the economic viability of the community and the financial well-being of businesses within the municipality. Resident quality of life and local business viability is directly affected by the municipalities' level of service and the quality of infrastructure provided.

In both the short and long term, municipalities are challenged by numerous external and internal factors that drive cost pressures and increase the budgetary demands. These factors and challenges are similar for all municipalities; however, each municipality's circumstances are unique. Analysis and insight are necessary to understand how those circumstances will affect current and future budgets.

The Municipal Budget Challenge

The factors and challenges that municipalities face include maintaining infrastructure, need for new infrastructure, inflation, growth, resident wants and needs, economic challenges, new legislation, social challenges, crime, the environment, technology, regional issues and provincial and federal downloading of services. These are just a few examples of the multitude of factors that can affect costs in a municipality.



Municipalities are extremely complex, as they deliver a multitude of unique services. This increases the challenge of sustainability planning. Residents expect service quality to be consistent and stable and often desire new and improved services. To be able to compensate for the increased costs related to resident needs and expectations, municipalities must have a structure in place to increase revenues accordingly. Without the necessary tax revenue required to match the costs of services and infrastructure, invariably services and infrastructure will degrade. This will decrease the quality of life for residents and the long-term sustainability of the municipality overall. The Town of Morinville faces many of the above mentioned factors in its budget challenges.

Primary budgetary factors to be addressed in a long-term tax strategy:

1. Inflation
2. Growth (operating and capital)
3. Service level changes
4. Maintenance and replacement of Infrastructure

Understanding Municipal Value for Tax Dollars

An important part of the Town of Morinville's development of a long-term tax strategy will be increasing public communication efforts to ensure that taxpayers understand the value of the services they receive in relation to the taxes they pay.

Municipalities are not unlike private businesses, as they provide a product. This product is quality of life. Municipalities deliver hundreds of unique services each and every day to residents. Those services are essential to residents' daily life and enhance their overall quality of life.

Municipalities provide a unique and diverse range of services, including fire safety, transportation, snow removal, recreation, land-use planning, traffic safety, policing, family services and grass cutting. A municipality can be described as up to 20 different businesses with multiple services being delivered under one umbrella. The complexity of having one entity deliver so many services creates a great challenge in communicating to the public the value of the product they are receiving each day.

An example of daily service delivery in the Town of Morinville:

Protect Residents
Fire and ambulance services, police services, traffic safety measures

Increase Quality of Life
Culture, history, community events.

Ensure Financial Sustainability
Financial policy and controls, long term financial planning, quality reporting

Provide Transportation
Build and maintain roads, sidewalks, trails and public transit

Support Community Economics
Local business attraction, economic sustainability planning

Facilitate Planning for the Future
Strategic planning, master plans, long term capital plan, budgeting

Promote Health and Wellness
Fitness facilities, hockey arenas, pools, sports fields, family and individual support

Facilitate Positive Growth
Land use planning, MDP, development negotiations, plan for growth infrastructure, project management

Foster Sustainability
Green initiatives, climate mitigation

Create Community Beauty
Cut grass, maintain trees, weed control, maintain infrastructure, public art

Provide Transparency
Effective and timely reporting and communication

Protect Community Assets
Asset management, long-term capital planning and infrastructure maintenance

Municipalities and Private Business Both Deliver "Products"

Private business delivers a service for a fee that covers the cost and a profit. Municipalities deliver services for a fee (property taxes, user fees etc.) that are 100% cost recovery only. This correlates to the budget-based tax rate philosophy described earlier.

When approaching a long-term tax strategy, it is important to communicate to residents:

1. What they get for their taxes
2. Why taxes increase
3. The value of what they're getting

Individuals pay for numerous services and products from private companies every day that are essential or enhance quality of life. These products and services increase in price continually, often without significant complaint from customers. A long-term tax strategy should acknowledge and communicate that municipal services are not unlike the services and products received from private enterprise. Consistent and fair tax increases are required to meet the increased cost of delivering services.

Understanding Inflation (MPI vs. CPI)

A key budgetary challenge is inflation. It is a constant driver of cost increases for municipal services and is not controllable. The "municipal basket of goods" is vastly different than the consumer's and is thus exposed to a different level of inflation. This is known as Municipal Price Inflation (MPI). The MPI is often higher than the Consumer Price Index (CPI). Municipalities compete for labour, supplies, contractors and commodities with private enterprise and other levels of government. Municipal services increase in cost annually as they inflate.

If there are not corresponding tax increases, expenses will eventually outpace revenues and service levels will decrease as they become unaffordable.

Consumer Price Inflation CPI

The largest preparation of the CPI consists of families and individuals living in urban and rural private households in Canada. It considers the prices of hundreds of things this group commonly spends money on including:

- Rent
- Childcare
- Groceries
- Mortgages
- Utilities
- Car payments

Municipal Price Inflation MPI

The MPI is developed to reflect the complex expense base of a municipality. A number of different purchases and expenses influence the town of Morinville's index such as:

- Wages
- Fuel
- Contracted services
- Asphalt
- Road supplies
- Parts and equipment

Why a Long-Term Tax Strategy?

Generating Adequate Resources for the Town of Morinville

Property tax is the primary funding source for the Town of Morinville, thus it is essential the Town has a taxation structure that provides adequate revenue resources to match the short- and long-term cost requirements and service delivery needs of the Town. Long-term planning, analysis and resulting evidence are required to anticipate future cost increases.

Morinville's Municipal Sustainability Plan (MSP) describes the economic goal of a "healthy" (80:20) resident to business tax split. Council's 2018-2020 Strategic Plan also reflects a priority of balancing the 3-year operating budget.

Municipalities historically plan for tax rate increases year-to-year without regard for the long-term implications. They go through highly intensive and difficult budget processes to arrive at an outcome – tax rate impacts. This practice rarely results in municipalities achieving the revenue levels they require. Further complicating the issue, the budget process is publicly and politically challenging for both administrations and municipal Councils. This can result in making short-sighted decisions that are not in the best interests of the municipality's long-term sustainability. A long-term tax strategy and implementation plan forces the municipality to think about its best interests in the long term, prompting better decisions that create a foundation for sustainability.

Study Indicators Illustrating the Need for a Long-Term Tax Strategy

1) The town has the 3rd highest residential tax rate in the Edmonton region.

2) The town has the 2nd lowest non-residential tax rate in the Edmonton.

3) The town does not employ a split mill rate between residential and non-residential property owners and thus has the lowest non-residential split mill rates in the region

4) The town's tax structure indicates an imbalance between residential and non-residential taxpayers and raises questions about fairness and equity between assessment classes.

5) The town has experienced relatively low annual tax increases in the past 7 years. The 2018 tax increase of 1% does not appear to be tied to budgetary factors, but more to strategic rationale. When the consideration of growth inflation and interest replacement pressures are taken into account, the historical average tax dollar increases do not appear to be sufficient.

6) The town has numerous financial challenges in its cost base, which include inflation growth, service demands and, more specifically, the opening of a new multipurpose recreation facility, all while working toward balancing the tax supported operating budget.

A Long-Term Tax Strategy has Benefits

For the Town of Morinville, the benefits of a long-term taxation strategy are many:

1) A long-term tax strategy forces a better understanding of the challenges Morinville faces now and in the future.

2) Engagement with the public will improve as citizens and business must be informed of the rationale, goals and actions required for long-term municipal sustainability.

3) Decision making considers the long-term impact of decisions made today on the future of the municipality.

4) There is less pressure on the annual budget process as Administration, Council and the public are better aware of the necessary tax increases that are required in the long term.

5) Taxation revenues become more predictable and sustainable.

6) Municipal taxation revenues become sufficient to maintain service levels and maintain infrastructure.

Goals of a Long-Term Tax Strategy

The Town of Morinville long-term tax strategy goals are:

1. **Engage the public –** Provide a comprehensive understanding for citizens of the services they receive for the taxes they pay.

2. **Engage the business community –** Develop a rapport with the business community to gain a shared understanding of the role non-residential property owners play in contributing to tax revenues.

3. **Find the residential and non-residential taxation balance –** Conduct the necessary analysis to determine the optimal split between non-residential subclasses and residential classes.

4. **Reflect Council's direction –** Create a tax structure that reflects Council's vison for an equitable distribution and level of taxes enabling the strategic vision for the town.

5. **Generate sufficient taxation revenue –** Create a tax structure that is sufficient to fund the operational, financial and infrastructure needs of the town.

6. **Link the budget to long-term incremental tax increases –** Conduct analysis to understand the key financial challenges faced by the municipality. Forecast and commit to the necessary incremental tax increases necessary to fund the long-term needs of the town.

7. **Policies and principles –** Develop the appropriate policies and principles that guide taxation decisions now and, in the future, to ensure the Town of Morinville's long-term sustainability.

Town of Morinville – Analytics

Town of Morinville – Net Tax by Department

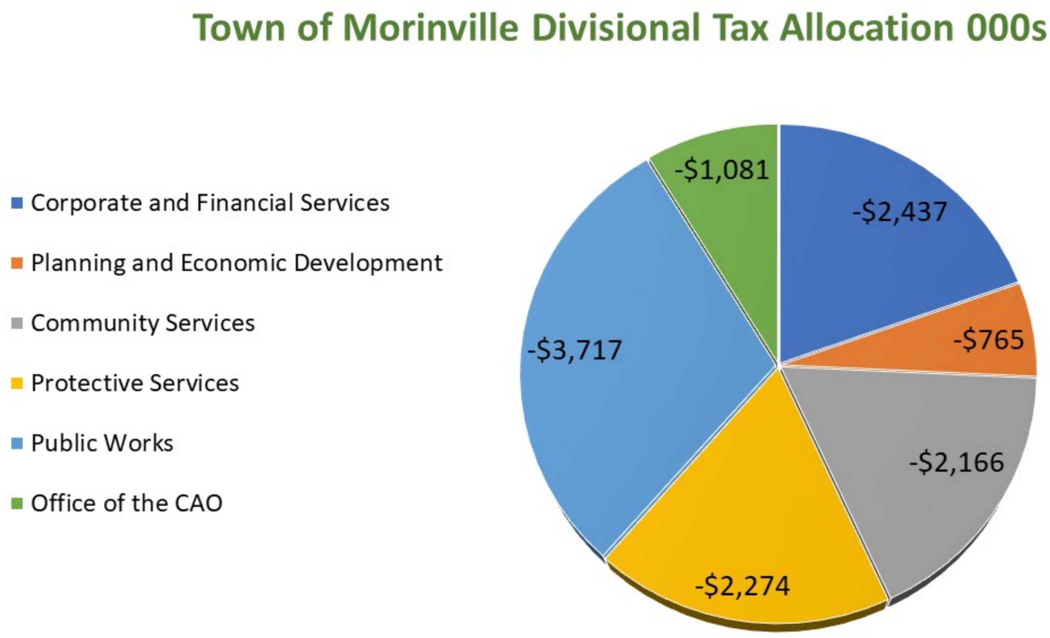
Municipalities are structured to deliver numerous valuable services to residents. The net tax allocation by department represents the cost of services specific to that department.

Town of Morinville - Tax Supported Departments - 2018 Budget

	Revenue	Expenses	Net Tax Support
Corporate and Financial Services Division			
General Government Services	11,360,045	78,064	11,281,981
Financial Services	40,500	1,909,318	-1,868,818
Human Resources	44,500	612,249	-567,749
Total	11,445,045	2,599,631	8,845,414
Planning/Economic Development Division			
Economic Development	70,000	322,759	-252,759
Planning and Development	257,500	769,433	-511,933
Total	327,500	1,092,192	-764,692
Community Services Division			
Community Engagement	16,523	752,284	-735,761
Cultural Performing Programming	63,650	256,370	-192,720
Family and Community Services	283,352	396,328	-112,976
Community Services Administration	117,196	848,989	-731,793
Cultural Events Programming	12,000	234,251	-222,251
Sports, Recreation and Bus	37,200	207,547	-170,347
Total	529,921	2,695,769	-2,165,848
Protective Services Division			
Corporate Operations	22,224	322,223	-299,999
Police	657,811	1,635,719	-977,908
Fire Department	115,332	752,087	-636,755
Enforcement Services	448,577	807,926	-359,349
Total	1,243,944	3,517,955	-2,274,011
Public Works Division			
Arena	307,424	428,461	-121,037
Open Spaces	18,000	756,329	-738,329
Public Works	0	1,212,524	-1,212,524
Roads	0	1,574,058	-1,574,058
Storm Sewer	0	71,279	-71,279
Total	325,424	4,042,651	-3,717,227
Office of CAO Division			
Council	0	368,259	-368,259
CAO	0	712,825	-712,825
Total	0	1,081,084	-1,081,084
Total Municipal Operations	13,871,834	13,948,198	-1,157,322

Net Tax Allocation Service Distribution

The Net Tax Allocation by department for the Town of Morinville illustrates a balanced approach to service delivery to its residents. The Town tax allocation is typical of an urban municipality covering such service areas as safety, culture, sports and recreation, transportation needs and economic development. Total municipal tax allocation is $12.4 million.



Historical Tax Rate Increases

The following chart illustrates the Town of Morinville's historical tax dollar increases over the last 7 years. The 7-year average is 2.55%. 2018 had the lowest tax dollar increase in the seven-year period, Discussions with the Town of Morinville Administration has provided evidence that the town has a responsible and effective budget process. However, historically, the budgeted tax dollar increase has not always been linked to specific and budgetary factors or strategic rationale.

Compounding this is the current tax supported budget deficit of approximately $1.2 million dollars. A 1% tax dollar increase for the town is approximately $93,000. This means the town would require a12.9% tax dollar increase to balance the budget.

Town of Morinville Historic Property Tax Analysis

	2012	2013	2014	2015	2016	2017 **	2018	Total	Average
Annual Budgeted Tax Increase	4.0%	2.0%	2.0%	2.0%	3.0%	2.0%	1.0%		2.55%
Total Tax Revenue	$ 6,984,598	$ 7,230,780	$ 7,631,991	$ 8,108,935	$ 8,683,500	$ 8,927,051	$ 9,288,900		
Residential %	88%	87%	87%	87%	87%	86%	86%		
Non Residential %	12%	13%	13%	13%	13%	14%	14%		
Vacant Non-Residential Tax Grant		$3,814.73	$1,170.49	$7,935.61	$26,650.19	$8,257.39		$ 47,828.41	
Residential millrate	6.5109	6.5946	6.5489	6.6096	6.6706	6.8967	6.9724		
Non Residential millrate	6.5109	6.5456	6.5489	6.6096	6.6706	6.8967	6.9724		

Edmonton Metropolitan Region – Tax Comparison

The development of a tax strategy for the Town of Morinville must consider the relative position of the town's tax rates compared to those of other municipalities in the Edmonton Metropolitan Region. This provides evidence of the opportunities that exist in the development of the strategy. The comparative analysis also provides insights into the equitable division of the tax burden between residential and non-residential property owners. It is important to note for this analysis that assessment values may vary among municipalities in the region, which impacts the analysis.

Three focuses of the comparative analysis are:

1) Residential rate comparative
2) Non-residential rate comparative
3) Split tax rate ratio (residential – non-residential tax rate ratio)

The following table includes raw data taken from the region's 2018 tax rate bylaws. Some municipalities identify recreation debt servicing separate from the municipal tax rate. These have been added back to the tax rates to ensure an accurate comparative analysis.

Metro Region Res/Non Res Tax Rate Comparison - 2018

Municipality	Residential Tax Rate	Non Residential Tax Rate	Notes	Split Ratio
Town of Morinville	6.97244	6.97244		1.00
City of Spruce Grove	5.96840	8.52530	Includes Tri Leisure Debt	1.43
Town of Stony Plain	5.89300	7.85500		1.33
Town of Beaumont	6.25287	8.80435		1.41
City of St Albert	7.89750	11.0082	Includes Service Centre Debt	1.39
City of Fort Saskatchewan	5.26327	9.22569	Includes Dow Centre Debt	1.75
Town of Gibbons	6.40410	11.8660		1.85
Parkland County	3.96798	7.85974	Includes TLC and MRB rates	1.98
Sturgeon County	3.64650	10.3820		2.85
Strathcona County	4.16810	8.51920		2.04
City of Leduc	7.15500	8.56800		1.20
Leduc County	3.29000	6.87000		2.09
City of Edmonton	6.19820	17.43540		2.81
			Average Non Res Split	1.84

The following is a simplified analysis illustrating the effect of splitting the non-residential tax rate. This is intended for illustration and discussion purposes only. This is to provide a financial impact context for the split tax rate policy decision in the long-term tax strategy.

This table provides a high-level example of the five-year impact of splitting the non-residential tax rate and moving to the Edmonton Metropolitan regional average. The annual tax revenue impact is approximately 2%.

Draft - Town of Morinville Split Tax Rate 5 Year Plan Scenario - Regional Average (simplified)

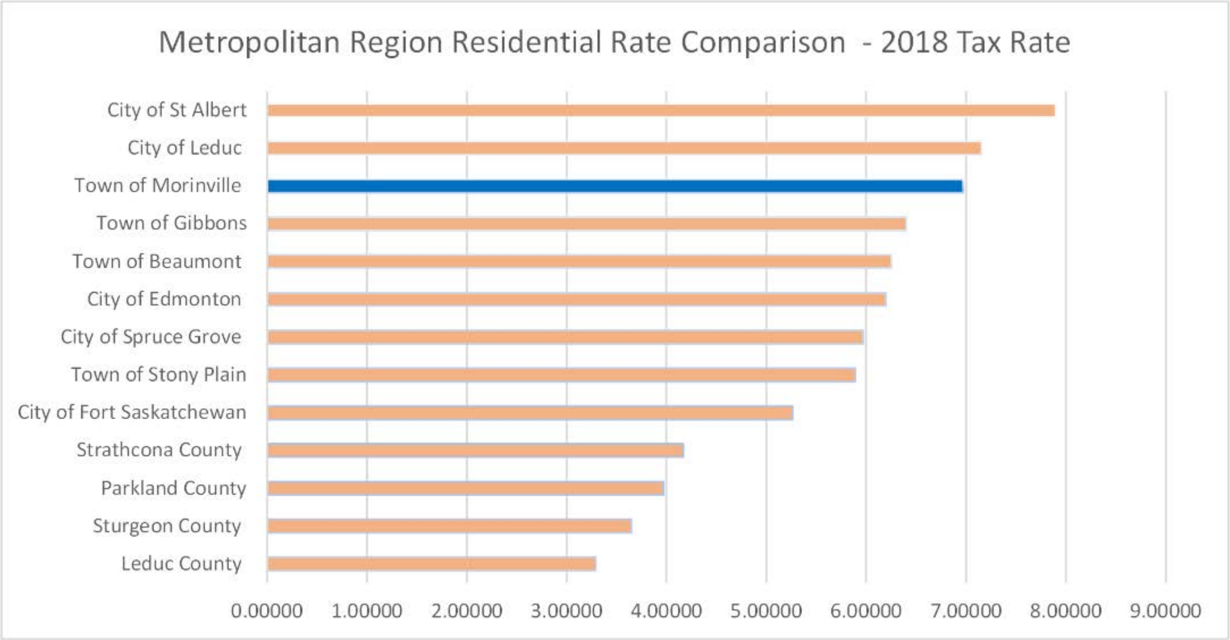
Year	Five Year Plan To Reach Regional Average	Total Non- Residential Tax Revenue	Incremental Annual Tax Revenue Change (not compounded)	Cumulative Tax Revenue Change	Cumulative Tax Dollar Equivalent (2018 base year comparative)
2018	1.00	1,032,494			
2019	1.17	1,208,018	175,524	175,524	1.9%
2020	1.34	1,383,542	175,524	351,048	3.8%
2021	1.51	1,559,066	175,524	526,572	5.7%
2022	1.68	1,734,590	175,524	702,096	7.6%
2023	1.84	1,910,114	175,524	877,620	9.4%

1% tax dollar increase (2108 tax rate bylaw)
$92,889

***This analysis is for illustration purposes only. It does not take into consideration forecasted assessment growth, annual budgeted tax dollar increases and compounding.**

Residential Tax Rates

This chart illustrates that the Town of Morinville residential rate is the third-highest in the region. This, however, is offset by the Town's lower-than-average property assessments compared to those of other municipalities closer to the Edmonton core.

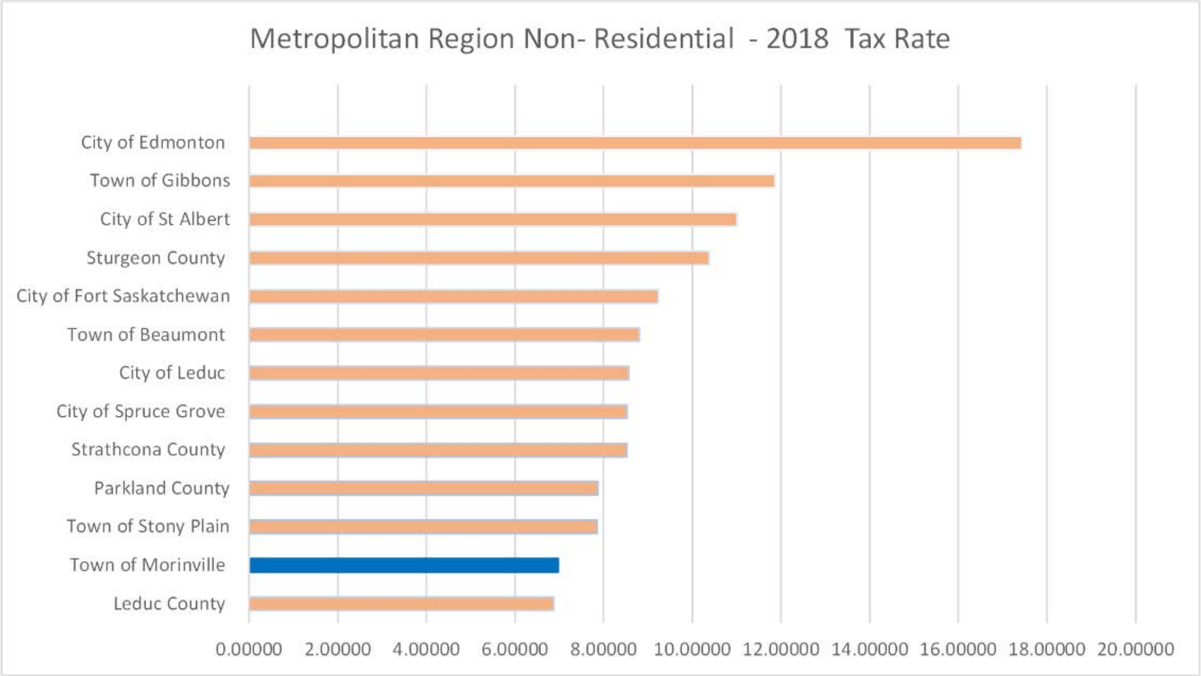


Taking lower assessment values into consideration, the Town of Morinville's actual residential tax burden is average in the region. From a long-term tax strategy perspective, Council should consider how it wants residents to be taxed relative to the average. This provides directional evidence that will help with planning for the long-term service levels.

The Town of Morinville faces a number of financial challenges now and in the future. Having a strong understanding of Council's direction when it comes to residential tax rates will allow for evidence-based long-term planning.

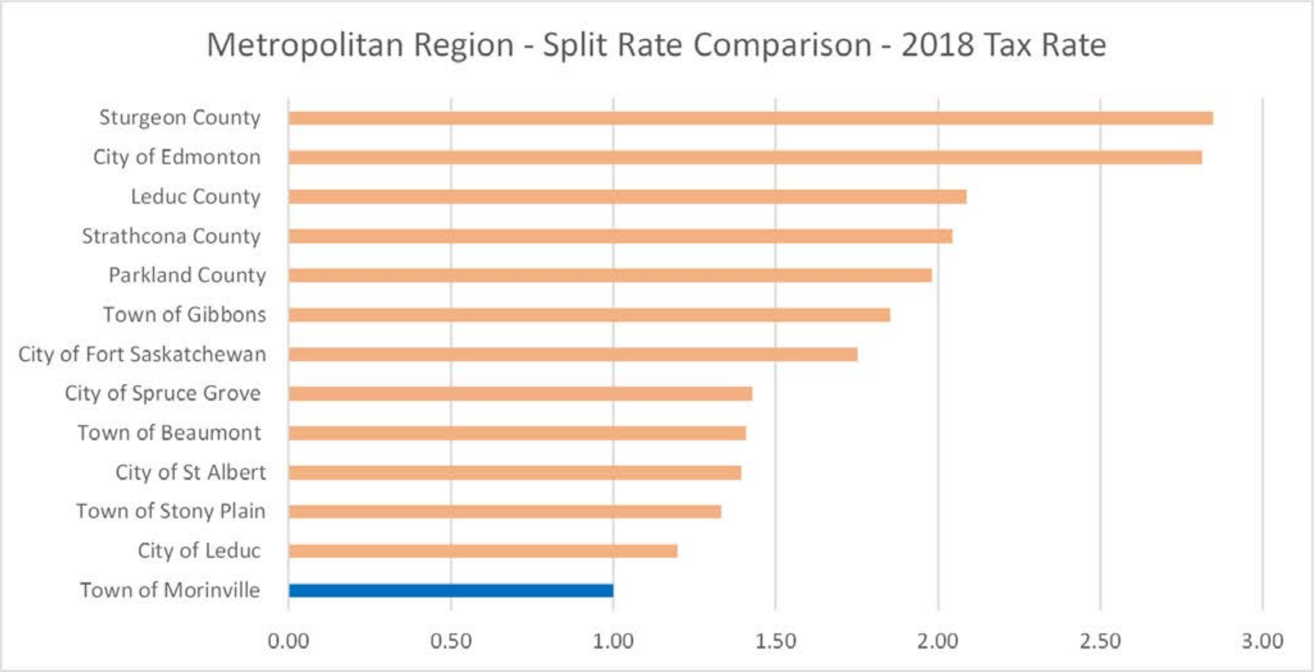
Non-Residential Rates

The Town of Morinville has the second-lowest non-residential tax rate in the region. It is the only municipality in the region and province that does not take advantage of splitting the tax rate between the residential and non-residential classes. The Town of Morinville currently has an 86%:14% residential to non-residential tax revenue allocation. A common financial planning goal for urban municipalities is to achieve an 80%:20% revenue allocation between residential and non-residential tax classes. The Town of Morinville Council has identified this as a long-term goal.



Split Rate %

The split rate percentage is the ratio between residential and non-residential tax rates. The Town of Morinville currently does not have a split between residential and non-residential tax rates.



This analysis indicates that the Town of Morinville has the lowest non-residential rate in the region, as it does not employ a split. It is not typical for a municipality not to utilize the split tax rate between residential and non-residential assessment classes, for numerous reasons. Non-residential property owners typically have higher rates due to advantages they have over residential property owners. Which includes the ability to deduct property tax expenses from their income tax. In addition, non-residential properties generate income, so tax increases may be passed on to customers through price increases by businesses.

Town of Morinville Tax Strategy Considerations

3 Tax Stream Opportunities

The Town long-term tax strategy identifies further streams that need to be explored.

These three streams are:

1. Split tax rates philosophy for residential and non-residential assessment classes

2. The subdivision of non-residential assessment classes to segregate small and large business to allow for separate tax rates to be applied

3. Short, mid, and long-term incremental tax increases to meet budgetary requirements

Each strategy will require review, analysis and public engagement.

Tax Rate Subclasses

One focus in the determination of a long-term tax strategy is the subdividing of separate tax classes. This allows for different rates to be applied to separate classes based on desired policy outcomes. Currently, the Town of Morinville assessment subclass structure is typical of most municipalities with residential and non-residential classes.

The primary opportunity that exists is the further subdivision of both residential and non-residential system classes based on property and business type.

The MGA now allows for an "improved" tax class, allowing non-residential tax classes to be broken into ranges from large industrial plants and businesses to small local businesses. This is an important consideration for the Town of Morinville, as not all businesses have the same "ability to pay." The division of the non-residential classes to recognize small, medium, and large-scale businesses may allow for more equitable distribution of the tax burden.

Town of Morinville Municipal Taxes - 2018						
Assessment Class	**Taxable**	**Payment in Lieu**	**Total Taxable Assessment**	**Tax Rate**	**Municipal Taxes**	**Percentage of Budgeted Taxes**
Residential	1,149,569,010		1,149,569,010	6.972441	8,015,302	86%
Non-Residential	143,109,060	4,973,030	148,082,090	6.972441	1,032,494	11%
M & E	2,370,830	-	2,370,830	6.972441	16,530	0%
Vacant Farmland	260,410	-	260,410	33.740048	8,786	0%
Vacant Non-Residential	11,709,010	-	11,709,010	18.429338	215,789	3%
Totals	157,449,310	4,973,030	1,311,991,350		9,288,902	100%

One of the main challenges of this strategy is the administration of the process. A methodology must be developed that is trackable, measurable and fair.

One option to consider is the classification of business by the number of staff employed. In theory, the number of employees is a good indicator of the revenue generation of a business and the responding value of the business property. Once this exercise is completed, policy considerations can be used to apply different rates to the different subclasses.

It is important to weigh the benefits of all tax policy decisions in terms of both project outcomes and unintended consequences. The option of creating subclasses must be considered carefully, as it may require a substantial effort to maintain. This includes continuously updating the inventory, communicating subclass rationale to the public and defending decisions at Assessment Review Board hearings.

Split Taxes

An effective tool in the tax strategy tool box is utilizing a split-tax rate. This methodology is currently not used by the Town of Morinville. It is highly recommended that this opportunity be considered. It is legislated that the split rate can be no higher than a 5:1 ratio. This means that taxes levied on the non-residential class can only be up to five times higher than taxes levied on the residential class. The rationale for higher tax rates for non-residential classes should be considered and made transparent for the community.

The justification for non-residential rates is based on four key factors:

Fairness, equity and rationale for non-residential rates:

1) **Tax Deduction Potential**. Business property tax is deductible as a business expense, whereas residential taxes must be paid with after-tax income.

2) **Transferability.** Businesses have the ability to pass on their costs. The price for goods and/or services sold by business can be increased to compensate for property tax.

3) **Income Production**. This factor acknowledges that businesses are income-producing properties. A pre-tax cost is offset by a property's ability to generate income. Residential taxpayers realize no property income, but are responsible for the full tax burden associated with the property.

4) **Social Equity.** The final factor is a combination of the previous three creating social equity justification. The basic principle and taxation methodology is that those who can afford it, pay more. When the gap between residential and non-residential properties narrows, additional pressure is put on residential property owners to pay a greater portion of the tax burden. Tax policy must consider this in the determination of appropriate tax distribution.

A key recommendation is the implementation of a split tax rate plan in the Town of Morinville's long-term tax strategy. The goal of the split tax rate policy decision is to develop a distribution ratio that generates positive taxation, supporting the Town's sustainability while clearly demonstrating fairness **and** equity to residential and non-residential assessment classes.

The strategy of subdividing non-residential assessment class integrates with the strategy of splitting tax rates. Varied rates will be applied to the newly created subclasses to achieve the predetermined taxation revenue goals. The goal of Council is to achieve an 80:20 split between residential and non-residential system classes. To achieve this goal, careful consideration will have to be given in a review of the subdivided non-residential class. The subdivided non-residential assessment classes and associated tax rates will have to be considered equitable.

The Edmonton Metropolitan Region split tax rate average is 1.84. If the Town of Morinville implements a split tax rate equal to the average, this will generate approximately an additional $878,000 annual tax revenue (approximately a 9% tax dollar equivalent). It must be noted that this would likely not be considered fair or reasonable to non-residential property owners if the Town were to create a split of this magnitude in one year. An advisable course of action would be to develop a five-year plan, incrementally increasing the Town's split rate to eventually meet the region's split rate average.

Budgetary Increases (rationale for increases)

The third stream of the long-term tax strategy recognizes the need for annual tax increases. These increases are needed to compensate for base operating budget increases and to allow for maintenance and replacement of infrastructure. Municipal budget processes must strive to achieve a balance between revenues and expenses. To continue the delivery of quality municipal services, adequate and sustainable funding is required.

Each year, the cost of delivering municipal services increases due to several factors. Many of these cost increases are not controllable. Assessment growth and resulting taxation revenue is typically outpaced by the increased costs associated with growth and other factors.

If tax revenue increases do not match the service expense increases, service levels will degrade over time, as funding will not be adequate to meet the cost structure of the municipality.

Basic tax strategy and budgeting principles include tax increases which are required to compensate for:

1. Inflationary impacts to budgets
2. The cost of growth not matched by revenue growth
3. Resident wants and needs for increased service levels
4. Special projects to support municipal sustainability and efficient delivery of service
5. Funding the replacement and maintenance of infrastructure

Long-Term Tax Strategy – Observations and Recommendations

Council made a motion for Administration to create a long-term tax strategy prior to the 2019 budget. The motion requested the strategy is to address split mill rates, subdivision of the non-residential assessment class, and to include public engagement with both non-residential and residential taxpayers. Though it would be prudent to integrate certain components of a long-term tax strategy into the 2019 budget, careful review, analysis, engagement, discussion and final consideration needs to be conducted prior to a comprehensive long-term tax strategy being implemented. It is strongly recommended that the necessary, systematic steps required to create a prudent and responsible long-term tax plan be well planned for and cautiously carried out.

The goal is to develop a long-term tax plan that is well understood and embraced by both citizens and business owners in the Town of Morinville. At the same time, the long-term tax strategy is to provide sufficient financial resources to meet the goals linked to long-term sustainability of the Town of Morinville. To achieve both goals will be a challenge. The long-term tax strategy will likely indicate the need for systematic tax increases and an increase to the non-residential tax burden which will have to be implemented with political prudence.

Long-Term Strategy Council Direction Statements

Public engagement with both residential and non-residential property owners, administrative analysis and development of potential scenarios are required to inform Council and receive direction. This is necessary to develop policy and guiding principles for the realization of a long-term tax strategy.

Council policy questions to be answered are:

1) Does Council want to employ a split tax rate to generate additional tax dollars from non-residential property tax owners? If so, to what level? When?
   a. To the regional average?
   b. Less than the regional average?
   c. More than the regional average?
2) Does Council want Administration to subdivide the non- residential assessment class into specific business classes? If so, to what level? When?

3) Does Council want to link to budgetary factors? If so, to what extent?
    a. The rate of inflation
    b. To cover the cost of growth
    c. To cover service level increases
    d. To pay for special projects that result in service enhancements for sustainability?

4) Does Council want to link tax increases to the replacement and maintenance of capital assets and/or the procurement of new capital assets? If so, to what extent, and when?

Implementation Options for Council to Consider:

In addition to setting tax rates to reflect incremental revenue requirements necessary to fund long term needs, the following options are available for Council to consider:

1) Keep an equalized tax rate for both the residential and non-residential classes

2) Split the non-residential tax rate, with a phased in approach of achieving goals outlined by Council

3) Split the non-residential tax rate and further sub-divide into subclasses as prescribed within the MGA, with a phased in approach of achieving goals outlined by Council

Recommendations

1) Present the Tax Roadmap to Council for consideration and feedback.

2) Seek Council direction for which tax options to further analyze and bring back for consideration through the 2019 Budget deliberations.

Conclusion

The review of Morinville's taxation structure and relationship to its budget, aging infrastructure and current financial position illustrates that Council's direction to Administration to consider the development of a long-term tax strategy is both prudent and required. The Town of Morinville is at an important time of its evolution as a municipality. It is growing, vibrant and healthy. It requires adequate financial resources to continue the path of success. A process of working closely with citizens in the business community and developing a long-term tax strategy will go far in securing the Town's long-term success and financial sustainability.

Town of Morinville - Long-Term Tax Strategy - Draft Project Timeline