

Regional's Clark Report is published to provide information and provoke debate on property matters. In this edition, some of the challenges faced by local government and property tax payers are discussed.

Unrealized wealth is the amount an owner could realize if they were willingly in a disposition mode. At any given moment, most property owners are not at a point where they want to dispose of their property, and as a result property tax is based on someone else's opinion or estimate of property value.

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Taxes on Wealth

by John Clark

Some people just don't get it. Property taxes are a tax on wealth.

Taxation options available to government are limited and simple. Income, acquisition, consumption and wealth are the big four measurable items that can be taxed. Flat rates or head tax are a fifth and politically courageous option.

Municipal government gets the short end of the stick as it comes to taxation with the bulk of taxation room taken up by the federal and provincial governments. Cities are left to pick up the remainder. Income, consumption and acquisition taxes are in the exclusive domain of the two senior levels, leaving local government with little room and/or few tax tools, notwithstanding that this level provides the most direct and daily services to its residents.

City council's revenue bases, outside the uncontrolled and perhaps arbitrary transfers from senior levels, are limited to direct charges for services such as water and parking tickets. Other sources do include some flat rate charges. However, primary revenue sources in most provinces are property taxes – a tax on unrealized wealth.

Wealth taxes have a long history and extend across many cultures and continents. Even though this has been around for centuries many politicians have a real difficulty in dealing with this tax base, and can't accept that in reality it is a fair tax, providing that the concept is not corrupted by taxing property that doesn't have market value.

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Snapshots

Average MLS Prices

Vancouver	\$591,722
Calgary	\$429,298
Toronto	\$382,689
Ottawa	\$276,379
Montreal	\$234,654
Halifax	\$219,705

Average Household Income

Vancouver	\$69,100
Calgary	\$88,300
Toronto	\$86,700
Ottawa	\$77,770
Montreal	\$57,200
Halifax	\$65,300

Ratio - Prices vs Income

Vancouver	8.56
Calgary	4.86
Toronto	4.41
Ottawa	3.56
Montreal	4.10
Halifax	3.36

SOURCE: Canadian Real Estate Association
Financial Post Canadian Demographics 2006

Regional Consulting / Valuation

Practice areas include advisory services - development options; lease review - due diligence; valuation; and assessment and property tax administration. Value added benefits go to the bottom line. The Consulting and Valuation Division of Regional, through its due diligence work, has saved clients up to \$900,000 on single assets alone.

Other taxes are based on reasonably factual things such as income. Consumption or acquisition taxes are based on the contract amount paid with the tax based on a hard number.

Confusion reigns with property taxes. Many residents and politicians get mixed up by thinking that a reassessment of property value will automatically result in a tax increase. From one year to another, unless a city increases its total expenses, a reassessment won't necessarily change the taxes on a specific property. For example, if a reassessment increases all the property in a city by 10%, and the assessment on a specific property also rises by 10%, there would not be an increase in taxes for that property. Rather, the tax rate for the city would decline to offset the increase in total assessment. However, for parts of a city that rise above the average, those affected properties will see a tax increase. For example, if the assessment for the city on average increased by 10% and an individual property went up 20%, that owner could expect a 10% increase. Conversely, a property that had no change to the assessment would actually show a drop in taxes by roughly 10%.

What hurts, and can hurt hard, are above average assessment increases for property owners on fixed incomes. These residents can see an ever-increasing amount of household income going to property taxes. These shifts are generally caused by colonization of neighbourhoods by higher income households. For example, parts of some Canadian cities while generally attractive historically showed assessments at 60% of the city-wide average, and their residents paid taxes at 60% of the city-wide norm. Leap forward. With the colonization of these older neighbourhoods with new residents boosting property values, these now trendy areas can show values and assessments at 180% of the city wide average. The result being that their individual taxes become 180% of the city wide mid rate. The new residents can afford this as they are the ones that have driven up the prices. However, the older residents that bought in at the old 60% rate may be severely disadvantaged by paying taxes at three times the rate that would have been the case without colonization. The older residents may be wealthy on paper but may not have the cash to pay the new taxes. Provincially funded tax deferrals are the solution.

In the absence of revenue transfers from other levels of government, or the uploading of expenses to those senior levels, local cities are boxed in. Mitigating schemes are in place to phase-in either assessment or tax increases. Of these, assessment phase-in is the simplest and easiest to understand. Tax phase-ins tend to be extremely complicated and inordinately increase compliance costs for both tax payer and collector.

Some jurisdictions have lobbied for or have implemented assessment freezes. Property values are locked in at a sale price until some future date when the property is resold. This is hardly fair with long time residents paying a small fraction of what new owners would be paying. A property that had not been sold since the 1960's would have an assessment of say \$20,000 as compared to the neighbour's which just sold for \$400,000. The neighbour would be paying 20 times the amount of the older resident.

Periodic (three or four year reassessments) as opposed to annual reassessments result in less frequent, but potentially greater tax shifts. A phase-in slows the change and neighbourhoods showing above average tax increases will benefit in the short term. The only fair method is for frequent (ie: annual) reassessments coupled with a tax deferral program to assist those longer term residents on fixed incomes.

continued ...

Snapshots

The table below details the clawback rates for the commercial class since 2002. One minus clawback rate is the amount of refund a taxpayer "nets" upon assessment reduction.

Commercial Clawback Rates (%)

	2002	2003	2004	2005
Peel	73	94	79	56
Halton	85	81	59	53
Toronto	78	92	94	90
Ottawa		88	90	81

2006 Assessment: Average Increases by Region

Western Niagara	5.0%
Hamilton	15.9%
GTA	20.6%
Central	5.4%
Ottawa	6.3%
N. Ontario	6.3%
Prov. Avg.	16.0%

source: <http://www.deloitte.com/dtt/newsletter/0,1012,sid%253D3634%2526cid%253D108413,00.html>

Property owners that really are disadvantaged by property taxes are the owners of property where the value is marginal or has floated away, but where rules are in place to establish arbitrary assessments or regulated taxes. To be fair, you either have a wealth tax, or you don't. To treat property owners differently because some have value and others may not, screws the system and creates greater distrust. As an example, take linear property like a railway. The value of a railway is in the business it does, and this happens at the terminal points where customers take delivery of goods. The distance between terminal points increases operating costs rather than value. While the land that makes up the corridor had an acquisition cost, that value has floated to the terminal points where the railway gets paid for goods delivered. To value both the right of way and the terminals is double accounting.

Similarly, the arbitrary valuation of property which may have some value, but in the disregard of market factors, is equally unfair. Some property owners are faced with excessive values simply because their property is viewed as special. What this really means is that there is no typical market for this type of asset, and many jurisdictions view this as an opportunity to place a high and non-market assessment on these properties. Owners of this type of property deserve fair treatment and the obligation should be to have an assessment at a realistic and market-based value.



PHOTO: COUVRETE/OTTAWA

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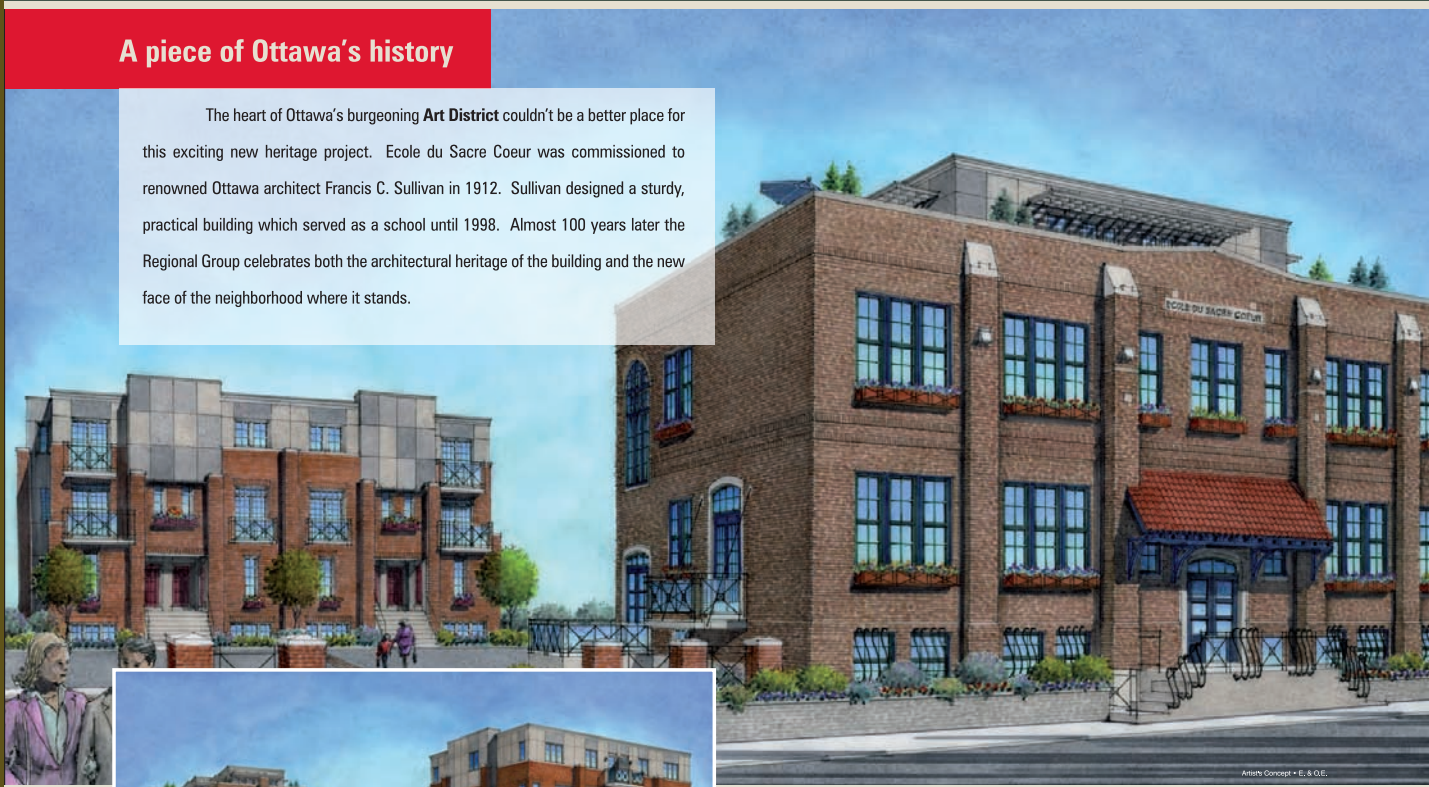
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"Success comes from the right to make decisions tempered by the responsibility to respect the rights of others."

A piece of Ottawa's history

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