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SOLVING A TAXING PROBLEM

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IN ITS ENLIGHTENING SERIES LAST MONTH, THE GAZETTE took a critical look at Montreal's assessment system, raised issues regarding the relevance and adequacy of the property-tax system and suggested possible ways to alleviate the painful tax hikes some Montreal residents face. I want to expand on some of the issues raised in the articles.

Inspecting the building and its surroundings

As stated in The Gazette series, a major determinant of tax-roll quality is whether the basic information used to set values is reliable and regularly updated. This is of a paramount importance because market values are a reflection of the property's elements. These include such physical attributes as building and lot sizes, age, condition, the presence of a finished basement, garage or swimming pool and so on, but also neighbourhood characteristics – called "externalities" – that might affect value (access to services, noise, mature trees, pollution and crime) While these ought to be taken into consideration when assessing properties, this is rarely the case as assessors tend to emphasize building attributes rather than externalities.

Furthermore, property attributes might change over time. As a consequence of an aging housing stock, houses in Quebec have been experiencing major renovations over the past decades. Without a reliable on-site inspection – which ought to take place within the year of a sale when most renovations are done – there is no way to assure the quality of the assessment roll. This is a costly step, but essential.

GIS-driven MLR, a reliable tool to improve valuation

But a reliable database is not enough. Collected information must be processed using the proper assessment system, namely one that leads to roll uniformity and equity through an objective reading of the forces that shape property values. Values result from highly complex influences that the traditional market approach to valuation cannot handle properly. The availability of increasingly user-friendly statistical software make it possible to resort to one of the most powerful and versatile tools, referred to as MLR, or Multiple Linear Regression.

This proven analytical method can sort out cross-influences that compose market value and put a price on each attribute. It makes possible a reliable assessment of any property on the basis of its characteristics. Because it offers overwhelming advantages over the traditional approach, MLR is now widely used in the United States and around the world. As reported in The Gazette series, it is used for assessing properties in Winnipeg, Calgary and Regina as well as throughout Ontario.

Moreover, the relatively recent development of geographic information systems, called GIS, offers a powerful and increasingly popular complement to MLR. Thanks to the spatial statistic tools available on a GIS, it is now much easier to account for all sorts of externalities that affect house values.

A much-needed change in Quebec assessment culture

But turning to MLR and related technologies requires a change in the appraisal culture. Most assessment authorities in Quebec are reluctant to make the move, but this can be changed through education and training, as my teaching experience has shown at Université Laval where MLR has been part of valuation courses for a decade. Under proper supervision, experienced assessors can familiarize themselves with statistical modeling within a few weeks.

Is the current property-tax system adequate?

Criticizing property tax is both easy and popular. Among the most frequent criticisms is the fact that it does not properly reflect the level of service, or benefit, that is rendered.

To some extent, this is true: The garbage bag in front of a $1 million house does not cost 10 times as much to collect as the one in front of a $100,000 house; nor does the cost of snow removal vary by the wealth of neighbourhoods. In other words, wealthier homeowners are subsidizing those of lower-value properties.

On the flip side, another highly prized criticism is that the property tax is regressive, meaning its burden is proportionately higher for low-income households than for high-income ones.

While the second point is is by and large true if annual income is used as the reference, it is false when you look at the value of services rendered. On that basis, the property tax is clearly progressive.

Transferring the tax burden to non-residential uses

Similarly, the sharing of the local tax burden favours homeowners over commercial property owners. Indeed, under the current system, non-residential users bear a higher share of the local tax burden than residential ones (more than three times as much in Montreal).

But this kind of transfer is widely accepted throughout Canada. And the recent change toward the multiple-rate system in Quebec supports this trend: It is tempting for municipalities to shift part of the tax burden from residents (who are voters) to owners of large commercial properties (who most often are not).

Increasing local revenue through service pricing

Another argument regularly put forward by critics of the property-tax system is that property tax alone no longer can cope with cities' enlarged responsibilities. In that respect, it should be recalled that Canadian municipalities have been granted $5 billion over the next five years from the gas tax and that the recent seven-year (2007-2013) fiscal agreement between Quebec and municipalities provides the latter with a progressive tax refund on their purchases ($472 million by 2013).

There are others ways to increase local revenue. Quebec municipalities have the legal power to diversify revenue by charging user fees. This is the first source of alternative revenue that should be looked at because there is a strong economic rationale behind it: User fees prevent wasting scarce resources, such as drinkable water.

As of 2005, fees accounted for 11.7 per cent of total municipal revenues (16.5 per cent for municipalities under 100,000) for all of Quebec. As for Montreal, fees accounted for only 7.9 per cent of revenues in 2005, down from 8.2 per cent three years before. While fees are feasible and desirable, they might be more difficult to sell politically, especially to low- or medium-income households.

To summarize, while the current property-tax system might not be perfect, it remains the "least bad" option. It is relatively simple to understand and manage, is a tax on wealth – as opposed to a tax on income, allows diversification through fees and insures a flow of money for local authorities. And switching from property to, say, land tax brings no guaranty that more income will be collected.

How to handle tax bill increases?

For most people, the main problem remains local tax increases and the problem they pose for low- or moderate-income households in neighbourhoods where prices have surged. The issue might be adequately handled through a combination of the current Quebec government property-tax rebate plan, which offers households with income under $46,497 a maximum rebate of $554 a year, and the Allocation Logement program that limits maximum aid to $80 per unit per month. Both programs should be improved.

These are far better solutions for tempering painful tax hikes than freezing, delaying or extending a roll to spread out tax increases, distorting the system and making more complex.

Cutting the knot by controlling local expenditure

Finally, all these considerations about the need to reduce harmful tax rises fall short of addressing a major and inescapable part of the puzzle: The control – or lack of control – of large municipalities over their local expenditure. This, indeed, ultimately determines whether or not the local tax burden will rise. A comparative analysis of the City of Montreal budget over 2002-2005 shows that current expenditure has grown at a compound annual rate of roughly four per cent while overall inflation for the Montreal metropolitan region was only 2.3 per cent. This might be indicative of a structural problem which, if not tackled, could result in never-ending tax hikes for Montrealers.

Salaries and payroll costs form the most important budget item for a municipality – for Montreal, they amount to slightly more than 50 per cent of total expenditure. From 2002 to 2005, the remuneration of employees jumped by 13.5 per cent, a compound annual rate of four per cent. Even more worrying, the employer's contribution grew 9.7 per cent a year – a 32-per-cent jump over three years.

By the way, weren't municipal mergers supposed to generate economies of scale? Facts rather suggest the opposite. How surprising! Or is it?

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