BRIEF TO THE TASK FORCE ON HOUSING AND URBAN DEVELOPMENT

by the

Bureau of Municipal Research, September 1968

The Bureau of Municipal Research of Metropolitan Toronto wishes to bring to the attention of the Task Force on Housing and Urban Development several findings from its research programme that do not appear as yet to have been brought forward. As the Bureau, with a membership of over 300 drawn from interested individuals and businesses, has operated as an independent research body since 1914 in the heart of one of Canada's fastest growing metropolitan areas, it is hoped that these findings will prove meaningful and useful to the members of the Task Force.

Areas of Bureau Concern

There are three areas which appear to have been overlooked in discussions to date and they are as follows:

(1) the impact of reduced property tax assessment for farms on the costs of raw land for development;

(2) the impact of the withdrawal of municipalities from subdivision servicing on the costs of housing; and

(3) the hidden costs of proposed 'satellite cities' on existing metropolitan centres.

These three areas will be dealt with in turn and several suggestions arising from the analysis will be offered.

Reduced Property Tax Assessment for Farms

It is normal for property tax increases to be deplored because of their inflating effect upon the costs of shelter. Yet the Bureau believes that removal of a present assessment benefit enjoyed by farms would lead to a much sought reduction in the cost of housing.

In the Metropolitan Toronto area, the benefits of expansion and growth in public municipal services and private business are spilling over from present urban areas to the adjoining undeveloped land. As a result, market values of raw land are skyrocketing beyond levels supportable from the earning power of farm operations.

Market or actual value, however, has been found to be the best index for apportioning the costs of municipal services over those properties which could gain from the availability of these services.[1] Yet, since 1960, the Ontario Assessment Act has contained special provisions requiring that under certain specified conditions farm lands and buildings be assessed in relation to their present use without reference to their possible future use for a purpose other than farming. When a farm is surrounded by urban growth (as in the case of Windfield Farms which recently sold for a reported $13 million), the degree of long-standing under-assessment is dramatized.

It cannot be assumed that under-assessment automatically leads to under-taxation, although this is often the case. If there were only farms in a municipality, and they were all equally under-assessed, then there would be no effect on taxation. Near metropolitan areas, however, the number of farms is decreasing and other uses increasing, so that the degree of under-taxation will gradually become equated with the degree of under-assessment.

While we are aware that public attention is being directed to the under-assessment of farm lands with a resulting tendency to have farm taxes subsidized by taxes on other properties, we are not aware of any public sensitivity to the impact that this tax benefit for farms has on the cost of raw land made available for development. Perhaps an example would prove helpful in illustrating what is meant.

For our example, let us use a 100-acre farm in, say, Vaughan Township, just north and west of Metropolitan Toronto. It may well have a market value of $4,000 per acre ($400,000 in all) yet be assessed without reference to purposes other than farming at about $250 per acre ($25,000 in all). If the mill rate were 90 mills, the annual property tax would be $2,250 which would make property taxes a major cost to recoup from farming operations each year. With the prospect of ever-increasing market prices in future, however, the farmer would likely continue to farm and hold the land looking to realize the large ultimate capital gain.

If, overnight, market values were to replace farm use value for assessment purposes, then there would be an immediate rise in the farm tax load. Because his farm is more heavily under-assessed (at one-sixteenth of market value) than other property (generally at one-third), if farms constituted one half of the market value of all assessable property in Vaughan Township the extent of rise in farm taxes would be major. The new mill rate of about 20 mills would apply against a $400,000 assessment and annual property taxes would rise to $8,000. At this level, farming could not likely continue and the political impact of this short-run effect has not been lost sight of.[2]

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(1) Recommended in the Report of the Ontario Committee on Taxation, 1967, Ch.11, para. 40, and supported in the subsequent Select Committee Report, 1968, page 35.

(2) Rejection in the Select Committee Report, 1968, page 41.

If, however, one projects over the long run, a new situation would occur. As the subject farm and others are put up for sale and the number of buyers willing to gamble on the future capital gain decreases, market values would come down. If the maximum tax load supportable from farm or other holding operations, such as drive-in theatres and golf driving ranges, in our 100-acre case were say $2,250 per year, then the market value would drop to about $65,000. Assuming a similar value drop in all farm land, about this level of annual property tax would be produced at the revised mill rate of about 35 mills (higher than 20 mills as the assessment base is reduced by the market value drop).

The long-run effect will therefore not be an increase in property tax at all but rather a reduction in the market value of the farm land. In our illustration and assuming 4 homes to the acre, the reduction in the raw land cost component of homes would be over $800 for each home. But the farmer need not sell if he chose to continue farming for a longer period. However, neither farmers nor developers could look to under-assessment to permit them to frustrate orderly urban development and growth while shooting for the later pot of gold.

Any radical change in assessment philosophy which could affect values as much as our suggestion should be approached with caution and probably in stages. Notwithstanding the provincial direct responsibility for assessment legislation, we see no reason why the federal government, with its considerable interest in the provision and costs of accommodation, should not authorize careful study of the process and make the findings known through the channels already well developed with regard to studies and plans for urban renewal. Accordingly, we suggest that:

(1) The Task Force recommend studies on the impact of property taxation as it affects the raw land cost component of housing and on alternative solutions including the desirability of staging changes.

Withdrawal of Ontario Municipalities from Subdivision Servicing

The general withdrawal of Ontario municipalities from the installation and financing of services within subdivisions has been well documented.[3] What have not been well documented or discussed are the causes of this withdrawal or the ultimate effects that this withdrawal has had in increasing the cost of housing.

Defects in the administration of local government taxes have been an important cause of the shift of this load to developers. Despite attempts to control residential property taxes by a special added tax on business, by the use of the split mill rate favouring residential properties and

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(3) Covered in the Report of the Ontario Committee on Taxation, 1967, Ch.15, para. 60 to 70.

by hidden assessment tipping in favour of single-family residential properties,[4] the costs of services associated with residential property have continued to exert upward pressures too great for local politicians to accept. The temptation to avoid any burden on the municipality by transferring responsibility for installing and financing internal sbudivision services onto the developer, himself anxious to receive municipal approval to proceed, was too compelling to resist. As a result, developers have been forced to put considerably more capital at risk per lot and have frequently had to resort to very high-cost bridge financing in the order of 12% to 15% to finance the services ahead of any sales revenue. Pressures for increasing profit margins to compensate for the higher amounts at risk have been a natural result.

This process has had its inevitable effect on the price charged for the developed land in the final cost of the home or rented accommodation. With developers now spending from $3,000 to $5,000 extra per lot for services and interest previously financed by municipalities, little wonder that from 1951 to 1967 for homes financed under the N.H.A., the cost of serviced lots grew 206% as against a rise in the cost of building on the lot of a lesser 43%. The real culprit is becoming clearer.

Once again, it is possible to obtain some measure of the extent of the effect of this municipal withdrawal on the costs of homes by the use of an example.[5] Let us assume that developer financing and installation of services adds $5,000 to the price of a home and that a prospective purchaser can qualify for the maximum N.H.A. insured loan of $18,000 at an 8 7/8% rate. Let us also assume that he can obtain second mortgage financing at 13% and that he can invest any surplus funds at a 7% rate. The financial impact in this case will be the difference between the following alternatives:

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(4) Documented in Assessment--The Recurrent Controversy, Bureau of Municipal Research, 1967.

(5) We are aware of the increased involvement by the Ontario Water Resources Commission as a favoured-rate financer of development service needs, but consider the Commission's maximum potential in this field inadequate to meet total needs.

Impact of Alternatives for Subdivision Servicing

	With Municipal Financing	With Developer Financing High Down Payment	With Developer Financing Low Down Payment
INITIAL CASH REQUIREMENT			
Price of home	$ 20,000	$ 25,000	$ 25,000
Less:			
1st mortgage	18,000	18,000	18,000
2nd mortgage			3,500
Total Needed	$ 2,000	$ 7,000	$ 3,500
Down payment higher by		$ 5,000	$ 1,500
FIRST YEAR COST TO CARRY			
Interest*			
1st mortgage 8 7/8%	$ 1,598	$ 1,598	$ 1,598
2nd mortgage 13%			455
New local improvement tax - 7% on $4,000 municipal cost	280		
Earnings foregone on down payments 7%	140	490	245
Total	$ 2,018	$ 2,088	$ 2,298
Carrying charge higher by		$ 70	$ 280

* Although borrowers, whether private parties or governments, are concerned primarily with total debt service costs (principal plus interest), our illustration does not include principal considerations.

From the assumptions in this illustration, it becomes clear that the only way for a homeowner to come close to protecting himself from the higher interest charges inherent in shifting municipal services to a developer is by having cash sufficient to make high down payments. For the large group with little available cash, more expensive forms of permanent financing than municipal financing will be required and the added interest cost of financing a home this way could well exceed $2,000 in total. This seems a dreadful price for the homeowner to carry when it could be avoided by municipalities returning to the financing and installation of services.

Also, the trend into high-rise apartment living might well be reversed if substantial reductions in down payments were to be achieved in the same way.

In addition to these disadvantages for homeowners and potential homeowners, governments are also disadvantaged by the municipal withdrawal from subdivision servicing. Social housing costs are higher when government is the landlord but serviced land must be acquired from others. Insurance maximums for the N.H.A. must be higher than otherwise because of the higher prices of homes to be financed. Pressures for the government to finance serviced land costs (through land assembly projects or schemes for rental of land such as the Ontario H.O.M.E. plan) are increased by the higher levels of prices for serviced lots. The unfortunate fact is that governments tend to be led into financing all or part of housing costs where the assistance multipliers do not work in their favour. For example, the same $4,000 that a municipality would need to assist one home would assist only 1/2 a home under a land lease plan,[6] 1/4 to 1/5 of a home if direct mortgage lending were still available, and even less if the full home were to be completely financed by government as in some special types of housing. Were governments ever to consider financing all new housing as some are heard to suggest, then at the current annual level of 175,000 housing starts, upwards of $4 billion annually would have to be found--a rather staggering thought when total federal revenues now run around $8 billion.

The answer seems to lie in encouraging municipalities back into the subdivision servicing business through a new programme of federal loans for this purpose together with tax reform to remove the fiscal penalty on municipalities when new residential housing is approved. Tax reform is a subject well beyond this brief, but we can be more specific as to the form that these new loans might well take.

Fortunately, in the federal bag of tricks there are at least two convenient vehicles whereby federal government assistance can be given to municipalities with the assistance of the provinces. One is C.M.H.C., which participates with provincial and local levels of government and could administer these loans. Another is the ill-fated but still potentially useful Municipal Development and Loan Board which has handled over $400 million in loans to municipalities since 1963. It is now nearly phased out, but the machinery still exists in the federal Finance Department and could quite appropriately be pressed back into service for this new purpose. Conditions attaching to the loans, such as the mandatory use of local improvement taxation to avoid burdening non-benefitting residents, should be clearly stipulated and would require agreement of both municipality and developer. Because of this, and in order to avoid any possible concern over the benefits accruing to the original landowners or developers, one qualifying condition might well be a maximum re-sale price of the developed lot. It is not hard

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(6) The average cost of serviced land for new NHA financed bungalows in Toronto in 1967 was $8,306.

to see how this would assist in controlling ultimate costs, but a less obvious advantage would be the ease of accelerating or decelerating the use of the loans by altering the maximums below which serviced land must be sold to qualify. Regional disparities in the need for the loans could likewise be recognized in this way.

Although a lessened chance has been signalled of new federal funds being directed into housing in the face of the increased amounts going into specialized social housing,[7] it is hard to see who might oppose the loan plan proposed. It is obvious that this loan programme, if it extended to say 50,000 of the 250,000 annual housing unit starts expected to be needed, would reduce the need for funds for social housing serviced lots as an offset to the $200 million in new loans to municipalities. Furthermore, unlike many government loans of today, repayment could be expected in full. The added dual bonus, of course, would stem: from the spill-over effect on home prices if even one builder and developer in an area followed the plan; and from permitting the re-entry into the building field of the smaller builder and developer who was forced out of the competition by inability to finance the services for whole subdivisions.

Nearly all others would have clear benefits. A <u>homeowner or apartment dweller</u> would benefit most as home prices would no longer need an element to cover services installed and their temporary financing. Down payments would be easier to meet, and interest savings in excess of $2,000 per home for those short of cash would be possible. Apartment dwellers with more modest savings could aspire to owning homes. With financing needs drastically reduced, <u>larger developers</u> would face reduced risks and <u>smaller developers and builders</u> could once again compete in the provision of housing. <u>Municipalities</u> would still be unaffected in their control over the level of services--exceeding minimum levels to qualify if they wished, or not participating if they preferred lesser levels of services. The <u>Ontario Municipal Board</u> controls on municipal borrowing should be unaffected if the lender is the federal government and if local improvement taxes are to be used for repayment. The <u>Ontario Water Resources Commission</u> should likewise be pleased to have municipal initiative in service installation to tie in with provincial water and sewer grids. Perhaps <u>lenders</u> might object to the loss of higher-interest types of loans, but the continued expansion of private sector and senior government capital needs suggests that sufficient borrowers would remain to be satisfied.

Accordingly, we strongly suggest that:

(2) <u>The Task Force recommend that the federal government encourage municipalities to re-enter the field of installing subdivision services to be financed on a local improvement basis through the introduction of</u>

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(7) R.B. Bryce in <u>Mortgage Investments for Trusteed Pension Plans</u>, C.M.H.C. Conference, 1968, page 3.

<u>a new programme of loans through the provinces to the municipalities at or near federal borrowing interest rates</u>.

<u>The Hidden Costs of Satellite Cities</u>

Although there exists no uniformly accepted concept as to just what constitutes a 'satellite city', they are being talked about increasingly as substitutes for the growth that would otherwise find itself tacked onto already large urban concentrations. The social advantages alleged for such satellite cities, and the direct costs to government in incentives and services to create such cities, are generally taken into consideration in decisions to proceed. Far more difficult to identify and frequently overlooked, although very real, are the hidden costs associated with the now slower growth in many of the metropolitan areas that would be left behind.

It is clear in the provision of municipal services, just as in manufacturing, that rapid growth tends to lower unit costs because the fixed elements present in most costs are spread over a broader base. This is sometimes not recognized because increased levels of service may more than offset economies of scale, leading to continued tax rises.(8) However, had growth not occurred, the effect of rising levels of service would have been even more pronounced.

Illustrations of the beneficial effects of rapid growth may be found in the case of many utilities, which can avoid price increases and even institute lower prices in periods of the most rapid growth. Since their operations are very like those of municipalities, their experience suggests that unit costs will suffer if growth is markedly slowed by reason of the creation elsewhere of a new satellite city to which growth is diverted by incentives or new regional services.

It is not our purpose to oppose the creation of satellite cities, but merely to assure that all relevant factors are taken into account. Accordingly, we suggest that:

(3) <u>The Task Force recommend that feasibility studies relating to satellite cities include consideration of resulting hidden costs in areas whose growth rate may be affected.</u>

<u>Conclusion</u>

The three areas of concern chosen by the Bureau of Municipal Research for comment involve the three levels of government for implementation. Farm taxation principles which can have a pronounced effect on

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(8) Aspects of economies and diseconomies (i.e. requirements) of scale are discussed in <u>Fourth Annual Review</u> of the Economic Council of Canada, 1967, Ch. 7, and in <u>Regional Government--The Key to Genuine Local Autonomy</u>, Bureau of Municipal Research, 1968.

the costs of raw land for housing, the inability of municipalities to finance subdivision servicing and the consequences of a withdrawal from this field on serviced land cost, and the studies that lead up to the creation of new cities will surely tax the patience of those responsible for negotiating intergovernmental arrangements.

However, the concerns over the trends that have been developing recently in housing in urban areas are such that the Bureau believes that the climate is more suitable and the need more demonstrable for intergovernmental accomplishments now. We wish the Task Force every success in its deliberations.