

## UBCM Webinar: July 10, 2012

### Advance Briefing: Major Industrial Property Taxation Impacts Study

**For audio dial:** 1-866-740-1260, access code 3837032#

**For technical difficulties:** Please call 1-800-843-9166

**Please note:** As noted in the invite, attendance is limited to the first 150 participants. This session will be recorded and sent to all invitees. Another session can also be held if needed

**Speakers:** Robert Hobson, RDCO, Brenda Gibson, UBCM

**Facilitator:** Jan Enns, Jan Enns Communications

# Welcomes and Introductions



## □ Robert Hobson

- Co-chair, Major Industrial Property Taxation Steering Committee
- Chair, Regional District of Central Okanagan
- Councillor, City of Kelowna

## □ Brenda Gibson

- General Manager, Victoria Operations, UBCM
- Staff Support, Taxation Review
- Member, Advisory Committee

# Agenda



- Overview of Major Industrial Properties Steering Committee process
- Major Industrial Property Taxation Impacts Study
  - ▣ Methodology
  - ▣ Findings
- Steering Committee Final Report/Wrap-up
- Broader Context and Next Steps
- Questions and Answers

# Poll Question



- How many of you represent communities with major industrial facilities – also known as Class 4 properties?

# Steering Committee Report vs. Impact Study

## □ Steering Committee

- Established in 2010, and has recently completed its work, so it is nearly ready to issue its Final Report
- Robert Hobson was co-chair, and will be speaking to the work of the committee and its final report

## □ Impact Study

- Independent analysis of impact of taxes on business decisions
- Undertaken by UBCM and the Province **outside** of the Steering Committee process
- Primary focus of today's webinar
- Brenda Gibson will be speaking to this study and its findings

# Major Industrial Properties Steering Committee

- Membership
  - Province
  - UBCM
  - BC Business Council
- Began in 2010 – largely in response to several high profile court challenges of municipal property taxes imposed on major industrial facilities
- Met regularly throughout 2010 and early 2011, then hiatus until May 2012

# Major Industrial Property Tax Issues: UBCM membership views

- UBCM membership feedback obtained through
  - ▣ Convention plenary sessions 2010 and 2011
  - ▣ 2010 member consultation
  - ▣ Several resolutions, including those calling for causality analysis
- Membership appeared divided
  - ▣ Some felt there is no evidence that property tax is a problem
  - ▣ Others wanted help with near crisis situations in their communities when a facility shut down or did not pay its taxes
- Membership questioned whether Steering Committee should work more on clearly identifying the problem it was trying to solve

# Steering Committee Considered Membership Concerns



- Steering Committee discussed whether or not to undertake a study to determine the impact of municipal taxes on business decisions
- No consensus on Terms of Reference for a study, or even if one should be undertaken
- Study was therefore undertaken outside of the Steering Committee process



# Major Industrial Property Taxation Impacts Study



- Conducted on behalf of the Province and UBCM
- External consultants:
  - ▣ Davies Transportation Consulting Inc.
  - ▣ Wave Point Consulting Ltd.
  - ▣ Lane Property Advisors Inc.
- Final report dated March, 2012
- Released publically today

# Impact Study:

## What question did we ask?

- Assess the impact of municipal property taxation on significant business decisions related to major industrial facilities (Class 4 properties)
- Business decisions encompassed:
  - ▣ Investment in new facilities
  - ▣ Ongoing operations and temporary closures
  - ▣ Re-investment in existing plants
  - ▣ Economic obsolescence and plant closures

# Study Methodology

- Some economic and statistical research
  - ▣ Property tax system: assessment legislation, municipal and provincial property tax rates, etc
  - ▣ Economic theory of business behaviour
  - ▣ Property tax policy and industry economic cycles
- Case studies for major industrial sectors (pulp and paper, sawmills, mining, aluminum and refining, shipbuilding, marine and grain terminals)
  - ▣ Analysis of industry life cycle, commodity price cycles, financial returns, and competitive factors
  - ▣ Sector overview plus specific information on major firms in each sector
- Industry views
  - ▣ Extensive interviews with representatives from wide selection of companies encompassing major sectors

# Commonalities



- Common themes amongst all sectors in BC:
  - Price takers
  - Commodity prices go through cycles
  - Plants have a life cycle
  - Investors want to maximize returns and minimize risk
- Common behaviour patterns:
  - Plants operate at maximum capacity as long as price exceeds variable costs
  - During price declines, lower cost plants operated, higher cost ones may be shut down
  - Capital investments flow to projects with highest rate of return
  - Where rate of return is not sufficient, firms will look to cut costs

# Study Findings



- Property taxes are not a major competitive issue under typical operating conditions
- Property taxes are not a significant factor in investments in major capital projects
- Property taxes do affect decisions on re-investment in existing facilities, which may affect the long term viability of operations
- Property taxes become a major factor for firms in financial distress due to structural or cyclical factors

# Study Findings:

## Typical Operating Conditions

- **“Property taxes are not a major competitive issue under typical operating conditions”**
- Property taxes constitute a very small portion of overall costs
- As long as industries are operating profitably property taxes have little impact on business operating decisions such as output levels or the distribution of activity among multiple facilities

# Study Findings:

## Investments in major capital projects

- **“Property taxes are not a significant factor in investments in major capital projects because anticipated costs are small relative to total operating costs and potential revenue over the economic life of the new investment”**
- Projects tend to be undertaken in periods of high commodity prices, where there is the potential for extraordinary profits
- If firms have options among different locations, differentials in tax rates among municipalities can have an impact on investment decisions
- The study was not able to gather statistics on investment proposals that do not proceed because anticipated revenues cannot cover costs of the project, or risks deemed too large; property taxes may play a role in these decisions

# Study Findings:

## Re-investment in existing facilities

- **“Property taxes do affect decisions on re-investment in existing facilities, which may affect the long term viability of operations”**
- Investments may be undertaken in periods of low commodity prices – to maintain production capacity or provide incremental reductions in operating costs
- Rapid payback required – firms may seek tax exemptions for new investments to provide additional certainty for capital recovery
- Property taxes have larger impact for firms with multiple locations – investments will go to projects with highest return on an incremental basis; all other things being equal firms will favour investments in jurisdictions with lower tax rates



# Study Findings:

## Firms in financial distress

- **“Property taxes become a major factor for firms in financial distress due to structure or cyclical factors, because property taxes may constitute a larger portion of firms’ fixed costs”**
- Tipping point may be where there is a decline in profitability to the point where revenue is insufficient to cover the weighted cost of capital
- Decline in profitability may be due to short term cyclical fluctuations in commodity prices or long term structural issues

# Economic Obsolescence: Why

- Plants cease to be competitive for various reasons
  - Resource depletion
  - Entry of new low cost firms
  - Exchange rates
  - Cyclical or secular (long term) price declines
  - Rising variable costs (labour, energy, etc)
  - Rising fixed costs (capital, insurance, property tax, etc)
  - Obsolete technology
- Some factors are outside of the firm's control; almost all are beyond the control of local government

# Economic Obsolescence: What happens

- Restructure
  - ▣ Extends life of plant through financial restructuring to reduce fixed costs related to the original investment (write-down of capital value or sale – often bankruptcy or receivership)
  - ▣ Plant can be more competitive due to lower fixed costs, but property taxes becomes a much larger cost share and may become a major issue for plant owner
- Plant closure
  - ▣ No prospect of future profitable operations (market outlook and cost structure) or unable to continue operations due to cash flow
  - ▣ High cost to close plant (capital losses, severance, remediation) so investors will look to reductions in all components of existing cost structure (including property taxes) to avoid closure

# Our perspectives on the findings



- Goal of the study was to pinpoint the types of circumstance where property taxes could affect business decisions – and it did that
- The findings support localized, rather than province-wide, solutions, which can be targeted to specific circumstances
- The findings can help to refine and reshape our local tax policy decision making
  - ▣ Revitalization tax exemptions may work well for re-investment challenge
  - ▣ Financial distress is a reality that we need consider and manage

# Steering Committee Final Report



- Three major parts:
  - ▣ Background and context setting
  - ▣ Committee discussions, considerations and recommendations by thematic area
  - ▣ Next steps and conclusions
- Limited number of recommendations, none of which directly affect municipal tax policy autonomy
- Report represents the completion of the Steering Committee's work

# Steering Committee Recommendations



- Best practices: tax policy
- Best practices: revitalization exemption
- Enhanced tools for tax sharing agreements
- Assessment change: increase closure allowance
- Improve tax collection and recovery provisions
- Ongoing forum for dialogue

# Broader Context



- Focus has now shifted towards broader discussion of local government revenues and expenses
  - Expert Panel on Business Tax
  - MCSCD local government revenue review
  - Continuing pressure from various sources to lower taxes and control expenditures

# UBCM: Recent Activities and Next Steps



- Submission to Expert Panel on Business Tax
- Commented on the Terms of Reference for the Ministry's local government revenue review
- Internal research work (literature review, inter-jurisdictional scan)
- Executive established a Local Government Finance Committee
- LG finance session at Convention



# Website and Contact Information

- UBCM website Finance Policy page  
<http://www.ubcm.ca/EN/main/resolutions/policy-areas/finance.html>
  - Major Industrial Property Taxation Impacts Study (released today or tomorrow)
  - Major Industrial Properties Steering Committee Final Report (within a week or two)
  - UBCM Submission to Expert Panel on Tax (already released)
  - Page will be updated as new Local Government Finance information is available
  
- Brenda Gibson 250-356-0862 [bgibson@ubcm.ca](mailto:bgibson@ubcm.ca)

# Questions and Answers



- Type into 'chat box' on left-hand side of your screen
  - Will read out to all
- Or 'raise hand' - top left-hand side
  - When introduced, use \*7 to unmute your line and ask your question
  - When done, please use \*6 to mute your line

# Thank you!



- For more information:

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