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 publicly 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 to 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
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
  

  - 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:

Brenda Gibson
General Manager, Victoria Operations
UBCM
250-356-0862
bgibson@ubcm.ca