

ONTARIO 360 – LAND-VALUE TAXATION – TRANSITION BRIEFING

Rethinking how Ontario cities tax to promote housing affordability and finance public transit

Issue

Ontario’s municipalities – particularly in the Greater Toronto Area (GTA) – are facing considerable challenges with regards to housing affordability and improving public transit. Addressing both challenges is critical to support investment, job creation, and high quality-of-life for provincial residents in the short- and long-term.

There have been various proposals to deal with each of them – including new taxation powers, new governance arrangements, new taxes on foreign buyers or housing speculation, public-private partnerships, higher transfers from other levels of government, and so on. These policy solutions may or may not have merit. That is beyond the scope of this transition briefing. But the incoming government should consider enabling municipalities to enact new land value taxation as part of any set of policy solutions. This new approach could improve the incentives for land development and provide resources for transit investment.

Overview

Ontario’s municipalities may not face two greater challenges than housing affordability and access to high-quality public transit. Both are essential ingredients for making our cities attractive places to invest, work, and live.

The City of Toronto has enacted various policies and initiatives to make progress in these areas. But demands are significant and will only continue to grow. Toronto’s top transit priorities under its SmartTrack plan, including the downtown relief line, Eglinton East and West and Waterfront LRT, and the

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Scarborough Subway extension, will cost an estimated \$17.4 billion.¹ Average detached homes in Toronto, even after recent price adjustments, are still well over \$1 million. And with the population of the GTA expected to grow by 2.9 million over the next 25 years, the demand for housing and infrastructure can only be expected to increase.²

How can Greater Toronto and Ontario afford this – especially in light of the tangled web of intergovernmental fiscal arrangements identified in an earlier Ontario 360 transition briefing?³

One important way is to capture some of the increased land value that will come with policy-driven increases in housing density and improved transit. The value of land is primarily determined by its location. Every time a new subway station or new condominium development is built, it increases the value of the land in the surrounding area, regardless of whether that land is the site of a vacant lot or a large office and retail complex. If taxpayers from across the province are subsidizing new transit lines or affordable housing in the GTA, then they are in effect subsidizing increased values for the property owners neighbouring those developments. And surely one of the fairest ways to help finance transit and housing investment today is to tax back some of that unearned incremental property value increase in future taxation.

Land-value taxation is a model used in various international jurisdictions including Denmark, Hong Kong, Singapore, and some sub-national jurisdictions in Australia and Mexico.⁴ This form of taxation tends to have support among economists due to its efficiency (it does not distort development decisions) and among progressives because it collects on the

¹ Ben Spurr, “Toronto will get billions for transit,” Toronto Star, March 15, 2018. Available at: <https://www.thestar.com/news/gta/2018/03/14/toronto-transit-plans-get-major-boost-from-federal-provincial-governments.html>.

² Phillip Preville, “How Toronto’s population will change over the next 50 years,” Toronto Life, October 20, 2016. Available at: <https://torontolife.com/city/torontos-population-will-change-next-50-years/>.

³ Gabriel Eidelman and Zack Taylor, “Municipal affairs – transition briefing,” Ontario 360 (University of Toronto’s School of Public Policy and Governance), April 18, 2018. Available at: <http://on360.ca/30-30/municipal-affairs-transition-briefing/>.

⁴ City of London (London Assembly), Tax trial: A Land Value Tax for London?, February 2016. Available at: https://www.london.gov.uk/sites/default/files/final-draft-lvt-report_2.pdf.

economic rents that accrue to landowners.⁵ It may therefore be in the political economy sweet-spot for marrying good policy with politics and securing support across the political spectrum.

It is for these reasons that the City of Toronto has proposed to use Tax Increment Financing (TIF), which would divert part of the increase in property taxes in areas surrounding new transit developments, to pay for part of its transit plan. But TIF will not come anywhere close to covering the full cost of new transit development, only bringing in \$1-2 billion over 25 years, or only 5-10% of the capital cost of the SmartTrack priority projects.⁶

The need for reform

Perhaps it is time to take a more comprehensive look at how the GTA and Ontario tax property values. For the most part, property taxes in Ontario are based on the assessed value of property. Property value assessment considers not just land value, but the value of the commercial or residential buildings erected on the land. Thus, if you add an extra bedroom or renovate your kitchen, or build a condominium complex on a parking lot, the assessed value of your property increases accordingly. Yet if your neighbours improve their properties, or a new subway station is built a kilometre from your home or business, your land value will increase whether you do anything or not. If we want to encourage more housing development, and if we want to help finance future transit and other infrastructure, then we should focus on taxing the unearned increases in land value due to improvements in the local area, rather than taxing improvements on one's own property.

Economists have long recognized land value taxes as one of the fairest and most efficient forms of taxation since the time of Adam Smith and David Ricardo, with the free market champion Milton Friedman calling it “the least

⁵ David Cooper, “Why all progressives should support a land value tax,” *The New Statesman*, February 18, 2013. Available at: <https://www.newstatesman.com/politics/2013/02/why-all-progressives-should-support-land-value-tax>.

⁶ Adam Found, “Tapping the Land: Tax Increment Financing of Infrastructure,” C.D. Howe Institute E-brief, March 29, 2016. Available at: https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/e-brief_232_0.pdf.

bad tax.” Because the supply of land is finite and fixed, it is the one thing that will not be reduced by taxing it. If we tax income, some people will work less. If we tax buying clothes, people will reduce their clothing budget. If we tax corporate profits, people will start fewer businesses. If we tax the houses built on land, construction activity will fall. And so on.

But the supply of land itself is fixed, so we do not have any less of it if we use it as the basis for taxation. Instead, the tax system will encourage land to be used to its greatest economic value – and improvements on neighbouring land will drive those holding underutilized land to improve their own properties, driving a virtuous cycle. Land value taxation encourages the densification of the urban core, rather than suburban and exurban sprawl, thus bringing considerable environmental benefits as well.

This is an essential point: a shift to land-value taxation would not only generate revenues to help finance new transit investments, it could also improve incentives for developers to make efficient use of land – including adding housing supply.

Nineteenth-century economist Henry George advocated replacing all other taxes with a “single tax” on land value. But while such a radical shift may be implausible, there is nothing implausible about shifting our property tax base from taxing the value of housing and buildings to taxing the land itself. For starters, Ontario’s property assessment system should assess land and improvement value separately. Over time, the tax rate on land value should increase and the tax rate on buildings and improvements should decline, with the aim that say within a decade, taxes on land value should collect two or three times the amount collected on improvements. By doing this, landowners would be encouraged to develop properties to their highest, best use and the future value of infrastructure improvements such as new subways would be captured naturally through the workings of the property taxation system without the need for special TIF zones or other forms of taxation to finance public improvements.

Moving to land value taxation too rapidly could have downsides, so it may be that other transitional measures would be needed to protect lower income property owners in areas of escalating land value, or perhaps to partially

exempt principal residences. But over time, Ontario, and its economic engine in the GTA, would be better served economically, socially, and environmentally by making land value, not the value of improved buildings, the primary basis for property taxes.

How to move forward

What does this mean?

The Ontario government should continue to support the City of Toronto as it experiments with the TIF to determine what, if any, provincial policy changes should be made to better enable these efforts and to possibly expand them elsewhere in the province.⁷

As a first step, the provincial government might encourage other municipalities of different sizes, needs, and capacity to test out the model to see its applicability and utility elsewhere. These experiments should test out different models and governance structures – including split rate taxation involving a combination of land-value taxation and regular property taxes, regionalized models, and the use of graduated rates.⁸ The goal would be to assess the application of these different models in different parts of the province.

The upshot though is that land-value taxation can be a useful tool as Ontario's cities – particularly in the GTA – grapple with housing and transit and seek to enable investment, jobs, and higher qualities of life.

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⁷ Adam Found, "Tapping the Land: Tax Increment Financing of Infrastructure," C.D. Howe Institute E-brief, March 29, 2016. Available at:

https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/e-brief_232_0.pdf.

⁸ Metrolinx, Land Value Capture Discussion Paper, August 2013. Available at:

http://www.metrolinx.com/en/regionalplanning/funding/Land_Value_Capture_Discussion_Paper_EN.pdf.