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REGIONAL MUNICIPALITY

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Halifax Regional Council
January 23, 2007

TO: Mayor Kelly and Members of Halifax Regional Council

SUBMITTED BY:
Dan English, Chief Administrative Officer

Geri Kaiser, Deputy Chief Administrative Officer - Corporate Services and Strategy

DATE: January 17, 2007

SUBJECT: **By-law T-702, Residential Property Tax Deferral: Proposed Interest Rate**

ORIGIN

This report is initiated by staff of HRM Financial Services. In May, 2005, Regional Council approved amendments to the by-law (formerly T-300) that included an annual interest rate on amounts deferred under the authority of Regional Council. The 2005-06 interest rate was set at 0% for administrative reasons.

RECOMMENDATION

It is recommended that:

1. Regional Council approve implementation of an interest rate of Prime -2% on cumulative property tax deferred under the authority of By-law T-700, as detailed in the Discussion section of this report, effective April 1st, 2007;

2. The interest rates for the program be calculated using the Prime rate in effect on April 1st of each fiscal year;

3. Regional Council set a date for a public hearing to revise By-law T-700 by revoking Item 3.4.

EXECUTIVE SUMMARY

Table 1. Existing Interest Rates and Proposed New Rates: Summary

	Type of Interest Charge	Interest	Rationale
Existing Interest Charges	Overdue Property Tax	Prime +4%	Penalty. Incentive to pay in full and on time
	Local Improvement Charge	Prime +2%	Cost to borrow capital over mid to long term
Proposed Graduated Interest Rates	Deferred Tax Customer in Program (<$27,000)	Prime -2%	'Cost' for customer to 'borrow' from HRM HRM's cost of non-collection is carried by all taxpayers
	Repayment of Tax. Customer ineligible to remain in program due to increase in income (>$27,000)	Prime +2%	Applicant previously on deferral whose income now exceeds $27,000 is required to pay deferred tax or LIC through either a payment plan or a lump sum payment.

- The interest rate for customers in the program (Prime -2%) would be a one-time interest calculation based on the cumulative value of taxes deferred as of April 1st each year. This sum would be added to the deferred amount and shown on an annual account statement sent to each customer.

- The interest rate for customers no longer eligible for the program and starting a repayment plan (Prime +2%) would be a daily interest rate as per other customer tax accounts payable, albeit at a lower rate.

- If approved by Regional Council, all customers presently using the deferral program (~300 accounts) will be notified in writing of the introduction of an interest rate effective April 1st, 2007, along with an individual account statement.

- **Note:** interest is calculated on the cumulative value of deferred tax as of April 1st and is a one-time sum applied to the account for the fiscal year; this is not a retroactive calculation of interest.

BACKGROUND

Under the authority of the Municipal Government Act (1998), HRM has instituted a by-law to permit lower income homeowners to postpone payment of real property taxes and local improvement charges, including area rates. Section 71 (2) (e) of the Act permits interest to be charged on the amount deferred. Deferred taxes are a lien against the property. While there is a 'cost' to the municipality in terms of the cost to borrow money, loss of interest earned from investment, and administration, all monies deferred remain a revenue and are collected when:

- title is transferred; or
- the owner(s) chooses to retire the debt; or
- the applicant is no longer eligible for a deferral based on income.

In 2005, the residential tax deferral and exemption programs were revised. One significant change was that eligible customers can now apply for *both* a tax rebate *and* a deferral (May 3, 2005). In the 2005-06 tax deferral program, for example, 117 eligible deferral applicants were automatically considered for a tax exemption. In 2005-06, their average tax bill was $1,250, the average tax rebate was $408 and the average amount deferred was $431 (a significant decrease as compared to prior years). **Even with the introduction of a modest interest rate most deferral customers will still receive a net tax subsidy.**

Please Note: In the report of May 3rd, 2005, By-law T-700, Item 3.4 stated:

> *"Applicants who have received a deferral prior to March 31st, 2005 will be exempt from the addition of interest on amounts deferred up to March 31st, 2006".*

Due to the above clause in the by-law, in order to apply interest on the cumulative value of tax deferred starting in 2007, Item 3.4 must be revoked and Items 3.5 and 3.6 re-numbered accordingly. Hence, a public hearing is required. A public hearing is not required to set the rate, therefore in future years any change to the interest rate can be set during the regular annual budget process.

Notice of interest on deferred taxes was provided to new and repeat customers in the 2005-2006 program newsletter which states *"Applicant can defer all or a portion of the balance of taxes. A modest interest rate will be charged on the deferred amount. Rate to be set by Regional Council"* (p.4). However, staff would like to provide personal notification to all deferral clients, including a statement of their account. The program's newsletter will be updated for 2007-08 for new and recurring applicants and staff will be provided with revised procedural guidelines.

DISCUSSION

The proposed introduction of an annual interest rate is intended to:

- Reduce the inequity between households with an income <$27,000 and those whose income is marginally higher (See: Table 2 on page 5);

- Reduce inequity between ex-deferral program participants and non-participants. Presently, when a customer is no longer eligible for a tax rebate or deferral because their income exceeds $27,000 they must commence a payment plan to re-pay the deferred tax. However, under the present system these customers do not pay interest irrespective of their income.

- Provide a property owner with an incentive to make timely payment of property taxes as circumstances allow, and conversely to avoid any perception of penalizing homeowners in similar circumstances who do pay their taxes;

- To avoid assuming the role of lending institution while recognizing that the majority of deferral clients are in the lower income range some of whom would be ineligible for a reverse mortgage, personal loan, or other forms of commercial financing due to income, age, disability, employment status, equity etc;

- To design and maintain assistance programs that are cost-effective and sustainable so as to provide consistency and a degree of predictability for property owners.

Customers with tax deferrals and prospective new customers need advance notice of any substantive change to the program's criteria and the opportunity to make a timely decision regarding the benefits of a deferral or continuation of same. HRM staff need an orientation to the new system and program materials need to be revised. Hence, staff recommend that an interest rate of 0% continue through 2006-07 and the new rate be implemented next year.

Comparable Municipal Deferral Programs

A brief scan of selected municipal tax deferral programs in Canadian municipalities suggests that HRM's program is distinct in that there is no age limit and the value of tax deferred is not restricted to any annual incremental increase only (Ontario). See: **Attachment 1.** There appears to be no comparable program in Nova Scotia. Typically, deferral programs are restricted to seniors over 60 or 65 years of age. In contrast, customers in HRM can enter the tax deferral program at a much younger age, for longer duration, for the full value of tax payable, and receive a municipal rebate. As such, HRM's deferral program carries a comparatively greater financial risk and cost when compared to programs across Canada. In HRM, only the former City of Dartmouth had a tax deferral option with an interest rate applied at the same level as tax arrears. See: **Attachment 2.** Under HRM access to a deferral of property tax has been expanded to include the entire geographic region and participation is based on income, irrespective of age or other demographic descriptors (eg. disability or family composition).

Rationale for Introduction of Interest Rate in 2007-2008

- The concept of ability to pay and affordability are complex; nevertheless, as shown in Table 2, the scope of assistance provided by HRM to homeowners whose income is <$27,000 is significantly greater than that afforded those whose income is marginally higher, for example $27,001.

- Assigns a portion of the program cost to the beneficiary of the service. In effect, a modified form of user-pay service. The aim is not to generate a profit from taxes deferred; simply to recover a very modest portion of the cost (eg. HRM's cost to borrow money, administration etc).

Table 2, shown below, compares the scope of assistance and interest rates for program customers whose income is <$27,000 as compared to lower income homeowners ineligible to participate in the program. It should be noted that the interest rate on deferred tax was introduced within the context of changes to the tax rebate program (Administrative Order 10) that significantly increased rebate values for the lowest income sector (<$17,000). As such, in the majority of cases the value of rebate will more than offset a modest interest charge. As a consequence of the alignment of both assistance programs all deferral clients receive a rebate whereas previously they had been excluded from eligibility.

Table 2. Tax Assistance Options for Homeowners by Income Level		
Income Range	**$0 to $27,000**	**$27,001>**
Assistance Options	1.) Municipal Rebate 2.) Municipal Deferral 3.) Payment Plan	1.) Payment Plan
Interest Charges	Proposed interest at Prime -2% for current program users Proposed interest at Prime +2% for former program participants whose income exceeds $27,000	Interest at Prime + 4%
Potential Penalties	Deferred taxes are a lien	Tax arrears are a lien Tax sale for non-payment (>3 years)

Recommended Interest Rate Value

Staff recommend that the interest rate charged on deferred taxes be based on the bank Prime rate. This rate is the rate offered by financial institutions on a line of personal credit to "preferred" customers . Using this rate recognizes that many users of the tax deferral program might not be able to access personal credit or loans secured by assets due to age, employment status, disability, credit rating, etc. The rate is easy to understand and administer compared to other rates such as the municipal overdraft borrowing rate, municipal long-term borrowing rate, overnight interest rate, or an arbitrary program-specific rate.

- Staff recommend that the interest charged on the cumulative value of deferred tax for eligible applicants whose gross combined household income is <$27,000 be set at Prime -2%.
- Staff recommend that when a deferral customer's income exceeds $27,000 and they are no longer eligible for a deferral the interest charged on the cumulative value of deferred tax be Prime +2%. Repayment can be made through a payment plan arrangement.

Limitations of Current Tax Billing System

Presently, in the Richter system all deferred amounts, both tax and LIC's, principal and interest, are shown as a single amount. Staff must make manual adjustments to separate these amounts, calculate interest, and re-enter on a case-by-case basis. Interest must be manually calculated prior to any issuance of a tax certificate for property sale, title transfer, or estate settlement. If the interest portion is missed on deferred amounts HRM would have to pay for the error. A deferral is non-transferrable.
Further graduation of interest rates (beyond the addition of one rate for deferred tax) becomes cost-prohibitive in terms of developing a fully computerized, customized interest calculation capability in the new Hansen tax billing module (~$100,000). While the current system cannot track the cumulative value of deferred tax relative to the 75% of assessed value threshold it is anticipated that the Hansen system will have this ability.

Exclusion of Local Improvement Charges

For clarity, there shall be no additional interest applied to deferred local improvement charges (LIC). Each LIC has a rate of interest fixed at the time residents are notified of the project's commencement. Typically, an LIC is retired over a 10 or 20-year period. Technically, an LIC is a one-time charge and all LIC customers are charged Prime +2%.

- Staff recommend that LIC's remain at an interest rate of Prime +2% because there is an immediate and direct benefit to the property owner, and such improvements enhance the value of the owner's equity in the asset (eg. water and sewer). In contrast, the general tax rate is driven more by market conditions.

Recommend a Fixed Interest Rate for Current Program Users

Interest rates could be adjusted annually, semi-annually, quarterly, monthly or daily. Staff recommend a fixed formula be used annually. The proposed interest formula uses the Prime rate as of April 1st and calculates a one-time value to be applied to the account for the 12 month period of the fiscal year. Because the interest rate is set using a formula, approval by Regional Council would only be required in the event of changing the formula.

From a customer service perspective, a fixed rate specific to the program is easier to understand and aids predictability thereby reducing the uncertainty associated with fluctuating interest rates. For example, if a customer asks "How much interest will I pay this year on $1,000 deferred?" it is easier for all concerned if the answer is " $55 " rather than "It depends on how much the interest rate fluctuates". Participation in the *Residential Tax Deferral Program* is modest (an average of 80-100 households per year) and therefore a fixed annual interest rate will not result in significant financial risk to HRM.

Recommend a Daily Interest Rate for Former Program Participants

The proposed interest rate for customers no longer eligible to participate in the program is a fixed formula but calculated on a daily basis as per other tax customers. However, these customers are assisted through a lower interest rate (Prime +2% as compared to Prime +4%) and a payment plan option. There are comparatively few deferrals retired annually.

By-Law Amendment

In May, 2005, Regional Council approved the application of an interest rate on deferred taxes within the context of (a) increasing the income eligibility threshold to $27,000 and (b) access to both the rebate and the deferral program. As per the report's recommendation By-law T-700 was amended with the addition of Section 3.4 and Section 5.1as follows:

> *3.4 "Applicants who have received a deferral prior to March 31st, 2005, will be exempt from the addition of interest on amounts deferred to March 31st, 2006".*
>
> *5.1 "Interest shall be charged on deferrals at the rate set by Regional Council. Local improvement charges and trunk sewer charges that are otherwise subject to interest are not subject to additional interest under this By-law"*

Staff recommend that clause 3.4 be revoked and interest charged on the cumulative value of tax deferred as of the implementation date of April 1st, 2007. **Note:** this is not a retroactive application of annual interest; it is the cumulative value of taxes deferred to date as of April 1st, 2007 and annually thereafter.

BUDGET IMPLICATIONS

Deferrals are a cost to the municipality in terms of lost investment income earnings, loss of interest on arrears, administration and collection costs. The overall cost of the program varies annually with (a) program uptake, (b) tax assessment values and tax rates, (c) administrative costs, and (d) interest rates. However, the program tends to be used as "a measure of last resort" by homeowners and many who are eligible to participate in the program do so on an annually recurring basis. The cumulative value of debt to HRM is secured by a lien against the property. The ability to collect is further secured with a limit on the value of cumulative debt; currently that cumulative debt shall not exceed 75% of the assessed value of the property.

FINANCIAL MANAGEMENT POLICIES / BUSINESS PLAN

This report complies with the Municipality's Multi-Year Financial Strategy, the approved Operating, Capital and Reserve budgets, policies and procedures regarding withdrawals from the utilization of Capital and Operating reserves, as well as any relevant legislation.

ALTERNATIVES

1. Regional Council could defeat the staff recommendation to introduce an interest rate on deferred taxes April 1st, 2007.

This action is not recommended: the distinction between those homeowners assisted by the deferral program and those ineligible is very small ($1) yet the difference between an interest rate of 9.5% and 0% is significant. An interest rate has been approved by Regional Council but the value of the interest rate needs to be determined for 2007-2008.

2. Regional Council could set interest at a higher or lower rate than those recommended by staff.

3. Regional Council could set the interest rate for former program users at Prime +4% as per other customers with tax owing.

This action is not recommended: such amounts owing are not arrears per se and their postponement was made by agreement. However, if a the customer defaults from a payment plan arrangement HRM will pursue tax sale proceedings in accordance with legislation and policy.

ATTACHMENTS

1. Tax Deferral Programs: Selected Canadian Programs.
2. Former Municipal Program: City of Dartmouth.
3. By-law T-702 an Amendment to By-law T-700.

A copy of this report can be obtained online at http://www.halifax.ca/council/agendasc/cagenda.html then choose the appropriate meeting date, or by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

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Attachment 1

Property Tax Deferral: Selected Canadian Programs						
Province	**Min. Age**	**Includes Disabled**	**Maximum Income**	**Minimum Equity**	**Full Property Tax Value or Increase Only**	**Interest Rate**
PEI	65	No	$30,000	None	Full Value	0%
Ontario	65	Yes	GIS or disability pension	None	Assessment Increase Only	0%
BC	60	Yes	GIS or disability pension	25%	Full Value	Provincial borrowing rate less 2%
Manitoba legislation proposed in May, 2004 (Bill 213). Not enacted.						
Manitoba	60	Yes	Not stated	100%	Full Value	Provincial borrowing rate plus 1%
HRM	Open	Yes	$27,000	None	Full Value	Graduated range Prime -2% to Prime +2%

Municipal property tax deferrals are essentially shaped by provincial legislation: either prescriptive (gives a directive to act: "you shall") or permissive (gives the option to act: "you may"). Nova Scotia's legislation is permissive; tax assistance is provided at the discretion of each municipality. Across Canada, most tax deferral programs are restricted to seniors or persons in receipt of a disability pension. HRM's deferral program used to be restricted to persons aged 55 or over but is now unrestricted by age (By-law T-301, 2001). Some deferral programs, such as PEI's, do not have a maximum threshold. In effect, the cumulative value of deferred taxes could exceed the assessed value of the home at the time of title transfer and is written off by the provincial government. By comparison, HRM has a maximum of 75% of the assessed value with no provincial guarantee.

The Ontario program only permits deferral of the amount of a tax increase from year to year, not the full tax bill. The British Columbia program requires a minimum equity holding and is a form of low interest loan program that provides a public alternative to the market place; the loan is secured by the property. This public program compares favourably to private sector reverse mortgage programs that impose higher interest rates with more restrictive terms. Typically, reverse mortgage programs target seniors who are assumed to have a higher equity position in their home and a guaranteed minimum income as a function of federal income security programs and/or private pensions. By comparison, HRM's program is broader in scope: homeowners can enter the program at any age, for an extended duration in higher amounts, and if the cumulative value of debt exceeds the property value HRM assumes the risk. However, HRM has first priority in the event of, for example, personal bankruptcy, transfer of title, estate settlement etc.

Attachment 2

Former Municipal Program: City of Dartmouth

Prior to amalgamation in 1996, only one (1) of the four former municipality's provided a tax deferral for homeowners, and this at a time when the municipality's had responsibility for social assistance programs.

The former City of Dartmouth program shown below targeted assistance to seniors aged 55 or over, disabled persons as defined in the city's By-law T-300 as "....prevented from or impaired in earning an income from employment or self-employment", a surviving spouse, or "....the head of a single parent family supporting a dependent within the meaning of the Income Tax Act (Canada), whose income is less than the total of $14,000 per year plus $710 per year for each such dependent" (By-law T-300, January, 1990). The eligibility criteria suggest a comparatively higher workload in determining not only income but "disabled" and household or family composition as defined in the by-law. At the time local municipalities had social service departments and more designated staff to administer and manage assistance programs.

Since amalgamation interest has not been charged on deferrals, including those awarded by the former City of Dartmouth.

Property Tax Deferral: Former City of Dartmouth						
	Minimum Age	**Includes Disabled**	**Maximum Income**	**Minimum Equity**	**Limitations**	**Interest Rate**
City of Dartmouth	55	Yes	$14,000	None	Full value of assessment	Same rate as tax arrears
HRM	None	n/a	$27,000	None	75% of assessment value	Proposed Prime -2%

Attachment 3

HALIFAX REGIONAL MUNICIPALITY

BY-LAW T-702

RESPECTING TAX DEFERRALS

BE IT ENACTED by the Council of the Halifax Regional Municipality that By-law T-700 Respecting Tax Deferrals be amended as follows:

4. The By-Law is amended by revoking, immediately following section 3.3 (c):

   3.4 Applicants who have received a deferral prior to March 31st, 2005 will be exempt from the addition of interest on amounts deferred up to March 31st, 2006

2. Sections 3.5 and 3.6 shall be re-numbered accordingly.

Done and passed in Council this xx day of xx, 2006.

Mayor

Municipal Clerk