

# Report to Council



**Date:** July 24, 2023  
**To:** Council  
**From:** City Manager  
**Subject:** Proposed amendments to the Revitalization Tax Exemption Program  
**Department:** Policy & Planning

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## **Recommendation:**

THAT Council receives, for information, the report from the Policy and Planning Department dated July 24, 2023 with respect to the bylaw updates to the Revitalization Tax Exemption Program Bylaw 9561;

AND THAT Council direct staff to bring forward a new Revitalization Tax Exemption Program Bylaw for Council consideration.

## **Purpose:**

To provide an update on the Revitalization Tax Exemption Program accompanied with details on proposed bylaw changes to minimize tax impact and improve the efficacy of the program.

## **Background:**

The Revitalization Tax Exemption (RTE) program aims to encourage investment in specific areas of the City by providing a property tax reduction to parcels which undergo new development. The program is guided by Revitalization Tax Exemption Bylaw No. 9561, which was originally adopted in 2006. The RTE program supports Council's priority of *Affordable Housing* by encouraging development of new market rental housing which in turn facilitates more movement throughout the housing system.

Staff continually monitor the RTE program to ensure it remains relevant to Council and other policy priorities. The RTE Bylaw has seen numerous amendments over the years as result. A recent review of the program sought to identify any opportunities for improvements that could support improving housing supply or affordability, as well as ensuring the programs objectives remain relevant.

Based on this recent review, a number of changes have been identified as warranted. These would aim to minimize the programs tax impact, maximize its effect on incentivizing desired development, and improve the application process. The balance of this report provides a summary of the current RTE program, how it is supporting its objectives, a description of its financial impact, and a detailed description of new bylaw changes which are proposed to improve the program and its effect.

## Background: Existing RTE Program and Financial Impact

Tax exemptions (enabled by the *Community Charter*) are intended to spur economic investment and/or development activity and advance specified objectives in pre-determined areas of the City for identified land use types. RTE programs must be established by Bylaw but can be structured around chosen geography and land uses. The City of Kelowna's RTE program focuses broadly at two objectives:

1. Encourage the development of new purpose-built rental housing throughout the Core Area to increase housing diversity and rental housing supply.
2. Encourage new development in the Downtown and Rutland Urban Centres to support their growth as prominent centres of employment, commerce and residential land uses.

The RTE program has four geographic areas with different incentives. Generally, these are Downtown and Rutland for all land uses, and a large portion of the Core Area specifically for purpose-built rental housing. The specific tax exemptions that apply to each are detailed in Table 1.

*Table 1: Bylaw No. 9561 Incentive Areas and Exemption Amounts (See Attachment 1 for maps)*

	Area 1	Area 2	Area 3	Purpose Built Rental **
<b>Location:</b>	Downtown	Downtown	Rutland	Core Area (Portion)
<b>Exemption:</b>	100% of the value of the improvements	Developments over 40,000sq.ft.: 100% of the value of improvements  Developments under 40,000sq.ft: 75% of the value of residential uses and 50% of the value of commercial uses	100% of the value of the improvements	100% of the value of the improvements related to purpose built rental housing.  **Projects must also enter into a 10 year Housing Agreement requiring rental only tenure.

Tax exemptions apply only to the municipal portion of property tax and only to the increase in property value resulting from new improvements (any renovations, new buildings, landscaping, etc). Property tax is still collected on the land value regardless of an exemption. Additionally, for Purpose Built Rental Projects, the Province of BC exempts the School Tax portion of property tax (which increases the exemption amount the owner receives by more than 40% for these specific projects).

Applications to the program are accepted once a project has been issued Development Permit. Groups of applications are brought forward for Council approval approximately twice a year, pending the number of applications received. The tax exemption takes effect in the year following completion of the project's construction and applies for a 10-year timeframe (per Bylaw No. 9561).

### *Approved Project Summary*

The RTE program has benefited a total of 51 approved projects, with an additional 8 in the application process (and which are described in an accompanying report) for a total of 59 projects (see Table 2). The first tax exemption took effect in 2014 and participation has since grown with approximately five applications being approved annually. Beginning in 2024, the earliest approved tax exemption agreements will complete their 10-year term. Following this, the number of properties receiving an exemption will fluctuate annually as existing agreements expire and new exemptions are approved.

Table 2: Revitalization Tax Exemptions by Incentive Area

	Downtown Incentive Areas	Rutland Incentive Area	Purpose Built Rental Incentive Area	Total
Approved and completed	8	4	32	44
Approved and under construction	1	1	5	7
Application Process	0	0	8	8
<b>Total # of Projects</b>	<b>9</b>	<b>5</b>	<b>45</b>	<b>59</b>
<b>Total 2023 Exemption Amount</b>	<b>\$363,192*</b>		<b>\$1,377,598*</b>	<b>\$1,740,790*</b>

*\*This is the 2023 amount and does not those in the application/construction process It will increase as new projects are approved or completed. Further details are provided below in 'Financial//Budgetary Considerations'*

### Discussion:

What is working: The RTE program has contributed to its objective of supporting an increase in purpose built-rental housing supply as follows:

- **Meeting growing demand for rental housing:** Increasing the stock of rental housing is a critical aspect of addressing affordability challenges in the housing system. The RTE program has been, based on industry feedback, vital to this. The program has supported more than 3,500 new purpose-built apartments, with an additional 1,529 rental units in the RTE application process. Of note, the City's RTE program is one of only two in British Columbia that support purpose built rental housing and takes advantage of the additional School Tax exemption offered by the Province. Kelowna consistently develops more rental housing than comparable and larger sized municipalities in recent years. The RTE program is likely to be a factor in this success, and as such, should continue given current and ongoing rental housing market constraints.
- **Creating a competitive advantage in attracting development to Kelowna:** Developers compare cities for favorable development conditions. Feedback from the local development community indicates the RTE program is a consideration for initiating projects in Kelowna.
- **Supporting the financial viability of rental projects:** Current interest rates make the purpose-built rental housing market financially tenuous. Industry feedback suggests that an RTE can tip the balance of financial viability for a new project by reducing operating costs for the first 10 years. As purpose-built rentals continue to be built, the vacancy rate will increase from its current rate of 1.2% to a healthier number (3-4% target) and rents will stabilize or decrease.

The RTE program has contributed to its objective of encouraging new development in the Downtown and Rutland Urban Centres as follows:

- **Fostering an active Downtown:** Supporting 9 development projects in the Downtown Urban Centre, including more than 150,000 square feet of new commercial and office space, that results in more foot traffic, new businesses, and new employment opportunities in this area.
- **Supporting business development.** Industry feedback indicates that RTEs make a meaningful impact on the development proforma for commercial properties downtown. Exemption amounts are usually passed forward through lease agreements on commercial and office space to the building tenant, making new businesses and new commercial development more viable.

What can be improved: Observations by staff as well as development community feedback indicate the following aspects of the program require attention:

- **Application Timing:** The timing of RTE approval late in the development approval process makes it difficult for developers to confidently factor the benefit into financial models and analysis with certainty and thus for it to truly function as an incentive.
- **Application Requirements:** Application requirements and processes identified in Bylaw No. 9561 are inefficient and outdated which adds unnecessary time and staffing resources to application processing. In addition, Housing Agreements are still required for purpose-built rental projects that have rental only zoning, which creates redundancy and extra work;
- **OCP Inconsistency:** The boundaries of the Core Area have expanded with adoption of OCP 2040, whereas the Core Area map within the RTE Bylaw reflects the old [repealed] OCP.
- **Market (strata) apartments:** When the RTE program was established in 2006, new investment in the Downtown and Rutland areas was limited. The RTE program was designed to incent all residential and commercial development. Demand for strata (ownership) apartments in these areas has since increased drastically. Tax exemptions benefit the purchaser of strata units, but do not have a material impact on a developer's viability of the larger project. As such, there is limited benefit in continuing to provide tax exemptions to owners who can afford upscale apartments.
- **Limited Commercial Investment:** Uptake of the RTE program for new commercial development in the Rutland Incentive and Downtown Incentive Area #1 (centered on Leon and Lawrence Avenues) has been limited. The OCP contains policy direction to maintain an ongoing tax exemption incentive in these areas (and as such no changes are proposed).

Below-Market Housing: The opportunity to use the RTE program to create additional below-market affordable housing units was investigated as a part of this review. This involved project-scale financial analysis as well as interviews with several developers who have recently built rental housing in Kelowna.

The analysis indicates that using the RTE program to incent or subsidize new below-market housing is unlikely to be financially feasible. The scale of the financial benefit of the RTE program is not enough to offset the cost of subsidized (below-market) rentals. Even if a relatively small number of below market units could be subsidized via a tax exemption (for example 2 or 3 in a building of 100 units), the cost and complexity of ongoing management of these in an otherwise market rental building makes the subsidized units financially improbable. Their inclusion would negate the financial benefit of the RTE.

Tax exemptions are a development incentive and to be successful they must provide a financial benefit. What contributes to the success of Kelowna's RTE program is this assurance and simplicity of the program. Adding complexity to the qualifying criteria or introducing mandatory below-market requirements that add cost are likely to detract from voluntary uptake in the RTE program. This, coupled with the financially tenuous rental housing market (based on current interest rates), may have the impact of discouraging participation in the RTE program with unintended consequences of reducing the production of rental housing overall.

Increasing the City's stock of purpose-built rental housing is vital to the housing system. There will be an opportunity to investigate coupling the RTE program with other strategies to support below market housing during the development of a new Housing Strategy, scheduled to begin later this year. At this time, however, it is not recommended to attempt to incorporate below-market requirements.

Proposed RTE Program changes: While the RTE program continues to be relevant and impactful, some changes are proposed to improve application efficiency, ensure the program continues to incent development per its stated purpose, and ensure that tax impact of the program is minimized as much

as possible while the financial benefit of exemptions is allocated where it is needed most. A description of proposed bylaw changes is listed below:

- Removal of eligibility for market (strata) residential development in all areas of the City. (Exemptions for commercial/office space and would remain unchanged). Strata residential projects in these areas that are already approved for an exemption would not be impacted;
- Modify the eligible map area for purpose-built rentals to align with the Core Area Map as it is now identified in the 2040 Official Community Plan;
- Replacement of the requirement for a Housing Agreement for Purpose Built Rentals with a restrictive covenant and only in instances where rental-only zoning is not in place;
- Delegation of the approval of tax exemption agreements to the Divisional Director of Planning & Development as means to simplify and streamline the approval process;
- Include parameters detailing the extent of delegated authority for approving tax exemption agreements. This would include a per-project annual exemption maximum of 0.175% of the City's annual tax revenue, resulting in an upper limit of approximately \$335,000 per project. This number will capture more than 90% of RTE applications. Any application to the RTE program that falls outside of these parameters would be brought to Council for consideration, meaning that projects of higher financial impact would not be delegated for approval.
- Introduction of a requirement for a monitoring report to be provided to Council every other year, ensuring a review of budget impact, program efficacy and opportunities for adjustments;
- Changes to clarify application timing, process, and to reduce unnecessary requirements. Includes a provision for Council consideration of late applications in extenuating circumstances.

To improve readability and achieve the goal of streamlining process, it is recommended that the existing Revitalization Tax Exemption Bylaw No 9561 be repealed and replaced with a new bylaw. This allows for a reformatting of the new bylaw for clarity and removal of unnecessary clutter resulting from numerous previous amendments. No substantive changes other than those listed above are proposed.

### **Conclusion:**

The Revitalization Tax Exemption program supports Council's priority of Affordable Housing by encouraging the development of new rental housing supply. It has contributed to the creation of more than 3,500 new purpose-built rental units with an additional 1,529 units in the RTE application process.

There continues to be a need and justification for retention of the RTE program in Kelowna, particularly with respect to purpose-built rental housing. Despite Kelowna being a provincial leader in rental housing development, more units are needed to increase the vacancy rate, reduce pressure on rental price increases, and lend support to a financially tenuous rental development market. Continuing to provide incentives for new commercial development in the Downtown and Rutland Urban Centres supports numerous other OCP and Council priorities.

While the program is unable to directly produce below market housing, incenting market rental housing has an important secondary impact of improving the opportunity for movement throughout the housing system. Opportunities to incorporate or bundle the program with other below-market strategies can be investigated during development of a revised Housing Strategy scheduled for 2024.

The changes proposed to the RTE program will maintain its intent while minimizing tax impact and improving the approval process. Regular monitoring will continue to be necessary and, in line with the

proposed bylaw changes, an update report will be brought to Council in 2025. At that time, the impact and effectiveness of the RTE program can be re-evaluated.

**Internal Circulation:**

Development Planning  
 Financial Services  
 City Clerk

**Legal/Statutory Authority:**

Community Charter, Section 226

**Existing Policy:**

*Official Community Plan Bylaw No. 12300:*

- Policy 4.4.7. Downtown Revitalization Tax Exemption. Continue to support a revitalization tax exemption program to encourage investment Downtown.
- Policy 4.7.6. Rutland Revitalization Tax Exemption. Continue to support a revitalization tax exemption program to encourage investment in Rutland.

**Financial/Budgetary Considerations:**

The forecasted tax impact of the Revitalization Tax Exemption program from 2024 – 2033 is provided below. This includes the total annual exempted tax amounts and the percentage of total annual tax revenue that the RTE represents. These are estimates. Future annual budgets are not finalized until December of the year prior. Estimates should be expected to increase as new applications are received.

Also note that estimates from 2024 and beyond include seven RTE applications that are approved and under construction, as well as eight in-process RTE applications described to Council in a separate report on the July 24<sup>th</sup> Regular Council Agenda titled "Revitalization Tax Exemption Agreements and Rental Housing Agreement Bylaws".

*Table 3: Total Estimated Tax Impact 2024 - 2033*

Year	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
<b>Total Tax Exempted (X 1,000)</b>	2,491	3,697	3,972	4,604	4,513	3,856	3,503	3,371	2,769	2,650
<b>Percentage of Tax Demand (Estimated)</b>	1.34%	1.90%	1.95%	2.17%	2.03%	1.66%	1.44%	1.32%	1.04%	0.95%

Submitted by: D. Sturgeon, Planner Specialist

Approved for inclusion:



J. Moore, Infill Housing Planning Manager

**Attachments:**

1. Tax Incentive Area Maps (Schedule A of Bylaw No. 9561)