



Report: COR-FSD-16-10

## Region of Waterloo

### Corporate Services

### Financial Services & Development Financing

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**To:** Chair Sean Strickland and Members of the Administration & Finance Committee

**Date:** April 12, 2016      **File Code:** F27-50

**Subject:** Annual Adequacy of Regional Development Charge Collections Review

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#### **Recommendation:**

For Information

#### **Summary:**

The Annual Adequacy of Regional Development Charge (RDC) Collections Review presents analysis and commentary relating to the Region's development charge collections/reserve funds to assist in determining the adequacy of the development charge rates established under the current Development Charge By-law. The Region's current RDC By-law came into effect on August 1, 2014 and will expire on July 31, 2019 unless repealed earlier. Development charge revenue during the first 17 months under RDC By-law 14-046 has been lower than originally anticipated for a number of reasons including discounted rates, the type and timing of development, and statutory RDC exemptions.

**Through the 2016 Budget process, staff have estimated that additional growth-related debt in the amount of \$166 million will be required over the next five years in order to finance planned infrastructure investments. This is a strong indication that current development charge collections and rates are not sufficient to fund the anticipated growth related capital investments, particularly with respect to water and wastewater infrastructure.**

Through Bill 73, the Province has introduced amendments to the Development Charges Act (DCA). Report COR-FSD-16-02 “Development Charges Act Amendments and Proposed Next Steps” was approved by Council on January 20, 2016 and as a result the Region is in the process of undertaking a scoped Development Charges Background Study for Transit and Waste Management with the goal of having new RDC rates for these services approved by Council in the fall of 2016.

Due to the anticipated completion of several master and business plans and given that a background study is underway for Transit and Waste Management, staff believe that no further action with regards to the Region’s existing Development Charge By-law 14-042 is warranted at this time. Staff will continue to monitor growth in the Region, RDC collections, and RDC reserve balances throughout 2016 and will report to Council in the spring of 2017 with regards to the adequacy of the RDC Reserves, and provide Council with a recommendation as to whether the RDC By-law should be opened for all services in 2017/2018 or remain in force until the planned expiry in 2019.

## **Report:**

### **Background**

The Development Charges Act (DCA) provides the legislative authority and framework for municipalities to impose development charges upon the development of land and sets out the associated processes, procedures and reporting requirements. While the DCA provides municipalities with the authority to recover growth-related infrastructure costs from new development, the exclusion of certain municipal services and the methodology prescribed for calculating the charge constrain the ability to adequately recover the overall cost to support growth.

The purpose of the Regional Development Charge (RDC) is to recover, to the greatest extent possible, growth-related capital costs from those segments of the community (namely residential and non-residential development) which give rise to the need for additional growth-related capital works.

The DCA prescribes how the development charges are to be calculated. The RDC rates are established by projecting growth, determining the increase in capital infrastructure necessary to service that growth (taking into account service level standard constraints and existing excess capacity), estimating the costs of that infrastructure, and determining the unit charges which may be recovered from development to provide the necessary revenue to finance growth-related expenditures.

The Region prepares a Development Charges Background Study (DCBS) which incorporates all these principles in order to calculate the maximum allowable RDC rate under the DC Act. There is an opportunity for public input and review of the Background Study and draft By-law. Council then approves the By-law to collect development charges.

The Region's current RDC By-law came into effect on August 1, 2014 and will expire on July 31, 2019 unless repealed earlier. Appendix A lists the services for which the Region collects development charges and a 5 year history of the RDC reserve fund balances.

Development charges are collected by the area municipalities on behalf of the Region at the time of issuance of a building permit. The funds are remitted to the Region on a monthly basis and are allocated to service-specific reserve funds, which in turn are used to finance approved capital expansion projects in the Regional services areas listed above.

### **Development Charge Revenue**

Development charge revenue is comprised of RDC collections from residential and non-residential development as well as funding from Regional sources to offset discretionary exemptions and discounts. The DCA requires that any shortfall in development charge revenue resulting from development charge exemptions and discounts approved by Council be funded from sources other than higher charges on other development. The following such exemptions are provided in the RDC By-law:

- 1) Downtown core exemption: provided in any area municipality which enacts a similar exemption. Currently, full downtown core exemptions exist in Kitchener and Cambridge. All Regional downtown core exemptions will expire on February 28, 2019.
- 2) Remediated Brownfield Site: an RDC exemption is provided in the amount of the eligible remediation costs to a maximum of the RDC payable.
- 3) Farming and public hospitals.
- 4) Since August 1, 2014 the Region has discounted the industrial RDC by 50%, in order to encourage new industrial development.

The total cost of development charge exemptions and discounts is financed from user rate reserve funds and property tax reserve funds/levies. The development charge collections and funded exemptions/discounts from January 1, 2015 to December 31, 2015 are shown in the following table:

<b>Development Charge Collections &amp; Funded Exemptions/Discounts</b>			
<b>January 1, 2015 - December 31, 2015</b>			
<b>(\$000's)</b>	<b>Residential</b>	<b>Non-Residential</b>	<b>TOTAL</b>
RDCs Collected	\$32,662	\$9,888	\$42,550
Industrial Discount	-	464	464
Downtown Core	45	84	129
Brownfield	1,172	-	1,172
<b>Total</b>	<b>\$33,879</b>	<b>\$10,436</b>	<b>\$44,315</b>
<b>% of Total</b>	<b>76%</b>	<b>24%</b>	<b>100%</b>

Development charge collections and funded exemptions during 2015 under RDC By-law 14-046 totaled \$44.3 million. Of the total revenue, \$34 million was attributable to residential development and \$10.4 million was for non-residential development. The \$1.8 million of exemptions was funded from the tax levy (\$1.2 million) and user rates (\$0.6 million). Funded exemptions and discounts for 2009-2015 are detailed in the table below:

<b>2009-2015 Funded Exemptions &amp; Discounts</b>							
<b>(\$000's)</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Downtown Core	\$12,225	\$114	\$1,014	\$252		\$4,879	\$129
Brownfield	619	725	277	579	844	2,066	1,172
Farming, Public Hospitals	53		138				
Industrial Discount						381	464
Rate Implementation Deferral*	10,029						
<b>Total</b>	<b><u>\$22,926</u></b>	<b><u>\$839</u></b>	<b><u>\$1,429</u></b>	<b><u>\$831</u></b>	<b><u>\$844</u></b>	<b><u>\$7,326</u></b>	<b><u>\$1,765</u></b>

\* Council deferred implementing the RDC Rate increase prescribed by RDC By-law 09-024 from August 1, 2009 to January 1, 2010.

Based on the maximum permissible rate calculated in the 2014 DCBS, RDC revenue in 2015 was estimated to be approximately \$76 million. However, in order to reduce the magnitude of the increase in RDC rates, Council approved a 10% reduction in the capital costs related to Roads, Water and Wastewater. Accordingly, the approved RDC rate was 9.7% lower than the maximum permissible rate, resulting in an effective revenue reduction in 2015 of approximately \$7.4 million, all other things being equal. The following table shows the development charge collections & funded exemptions/ discounts as contemplated in the 2014 DCBS for 2015 both at the maximum permissible rate and at the Council approved rate versus the 2015 actual RDC revenue.

<b>Development Charge Collections &amp; Funded Exemptions/Discounts</b>			
<b>January 1, 2015 - December 31, 2015</b>			
<b>(\$000's)</b>	<b>Per 2014 DCBS at Maximum Rate</b>	<b>Per 2014 DCBS at Approved Rate</b>	<b>Actual</b>
RDC Revenue	\$76,400	\$69,000	\$44,315

Actual RDC revenue in 2015 is lower than contemplated by the 2014 DCBS due to a number of factors including:

- The Region’s current RDC By-law came into effect on August 1, 2014. In anticipation of an RDC rate increase, a significant number of building permit applications were received in the weeks leading up to the expiry of the former RDC by-law on July 31, 2014. The total value of RDC collections and funded exemptions/discounts in July 2014 alone was almost \$19 million, where under the previous by-law, typical RDC collections and funded exemptions/discounts in a given month would have averaged approximately \$2-4 million.
- The type of development that has proceeded over the last year was different than had been anticipated. In particular, the number of apartment units to be developed in 2015 was lower than originally contemplated in the 2014 DCBS.
- Although development activity remains strong, the rate of population growth has been marginally lower than was expected.

- The DC Act provides statutory exemptions for development related to the creation of additional dwelling units in residential buildings, the enlargement of the gross floor area of existing industrial buildings up to 50% of the existing gross floor area, and development on land owned by municipal, provincial and federal governments and local boards. The Region does not collect RDC's on these developments nor are these exemptions required to be funded from other sources as the non - statutory exemptions (i.e. Downtown Core and Brownfield) are. These exemptions can fluctuate significantly year over year and have averaged roughly \$5-\$6 million annually over the past 5 years.

### **Building Permit Activity and Development Charge Collections**

Development charges, where applicable, are collected upon the issuance of building permits. It should be noted that there are several situations where the issuance of a building permit does not result in the collection of a development charge due to statutory exemptions, redevelopment allowances and the type of building permit issued (i.e. RDC's are only collected on the first permit issued). Also, in some cases, there can be a time lag between building permit application and issuance which can result in the development charge collections and building permit activity being reported in different periods. Consequently, increases in building permit activity in a given period, does not necessarily translate into increased development charge revenue over the same period.

### **Development Charges Background Study for Transit and Waste Management**

Report COR-FSD-16-02 "Development Charges Act Amendments and Proposed Next Steps" was approved by Council on January 20, 2016, and as a result the Region is in the process of undertaking a scoped Development Charges Background Study for Transit and Waste Management in 2016. Staff is currently developing the background study with Hemson Consulting. It is anticipated that the background study will be available for public review and comment over the summer of 2016, with the goal of having new development charges for Transit and Waste Management approved by Council in the fall of 2016.

### **Financing of Growth-Related Capital Projects**

A working group comprised of the CAO, Commissioners, Directors and Managers from Transportation and Environmental Services, Corporate Services, and Planning, Development and Legislative Services has met on several occasions to discuss the financing of growth related infrastructure in the Region of Waterloo. The group's discussions to this point have focused on the following:

- Mitigating potential shortfalls in development collections should RDC collections be lower than anticipated as discussed above

- Proper alignment of the timing of the capital plan with anticipated growth
- Ensuring that the Regional DC reserves maintain adequate balances
- Approach to debt financing major infrastructure projects

The group developed and incorporated strategies for financing certain major infrastructure projects into the 2016-2025 Capital Plan. A combination of spending adjustments, interim financing and long term borrowing was implemented. This group will continue to meet throughout 2016 to develop recommendations and proposed strategies relating to the 2017-2026 and future capital programs.

### Master Plans

There are a number of program-specific master plans and business plans currently underway, as set out below.

Program Area	Expected Completion Date
Waste Management Master Plan	Completed 2013
Water Master Plan	Completed 2014
Grand River Transit Business Plan	June 2016
Paramedic Services Master Plan	Fall 2016
DCBS Transit and Waste Diversion	Fall 2016
Airport Business Plan	Late 2016
Wastewater Master Plan	Fall 2017
ION Phase 2 EA	2017
Regional Transportation Master Plan	December 2017
Regional Accommodation Master Plan	Mid 2018
Biosolids Master Plan	Spring 2018

These master plans, which form the basis of future capital programs and future development charge background studies, will include financial implications and projections of future capital investments, operating costs, long term borrowing requirements, reserve and reserve fund forecasts, and potential development charge implications.

### RDC Collection and Rate Sufficiency

The Region's current RDC By-law will expire on July 31, 2019 unless repealed earlier. Due to the anticipated completion of several master and business plans (as indicated in the table above), and given that a background study for Transit and Waste Management is currently underway, staff believe that no further action with regards to the Region's existing Development Charge By-law 14-042 is warranted at this time. **That being said, staff have estimated that additional growth-related debt in the amount of \$166 million will be required over the next five years in order to finance planned infrastructure investments. This is a strong indication that current development charge collections and rates are not sufficient to fund the anticipated growth**

**related capital investments, particularly with respect to water and wastewater infrastructure.**

Funding for wastewater infrastructure is particularly problematic given that the additional capacity must be available well in advance of the issuance of building permits and corresponding collection of RDCs. As well, because wastewater plant expansions are large in scope and cost, the benefit to future growth usually exceeds the time horizon of the RDC by-law. Accordingly, RDCs related to wastewater plant expansions may be collected over 20 or 30 years, depending on the timing of growth.

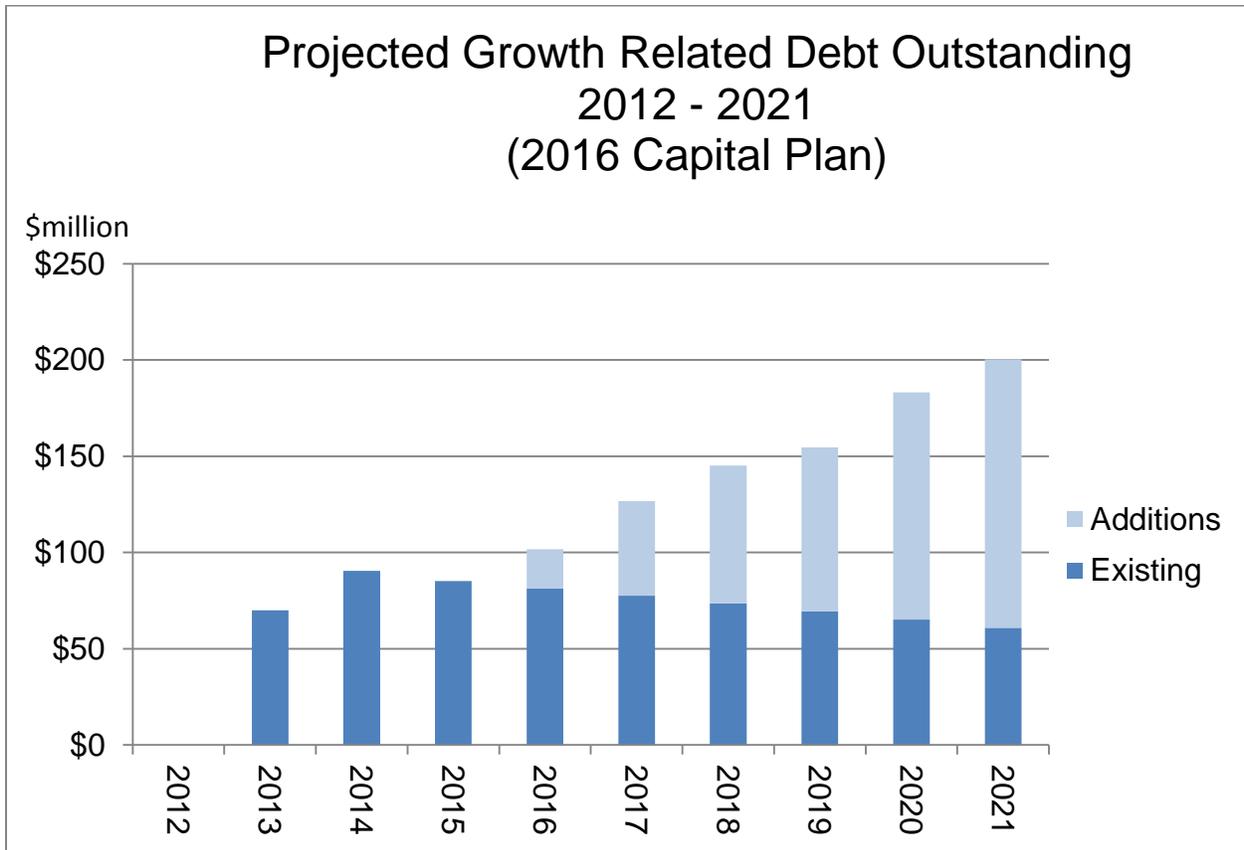
RDC balances for other services are manageable and the funding available will continue to be considered in developing the Region's 2017 – 2026 Capital Program. RDC collections in the first quarter of 2016 are \$11.2 million, exceeding 2015 first quarter collections of \$6.9 million by 62%. Staff will continue to monitor growth in the Region, RDC collections, and RDC reserve balances throughout 2016 and will report to Council in the spring of 2017 with regards to the adequacy of the RDC Reserves and recommend whether the RDC By-law should be opened for all services in 2017/2018 or remain in force until the planned expiry in 2019.

**Corporate Strategic Plan:**

This report supports strategic objectives found in the Corporate Strategic Plan, and particularly Focus Area 1.2 - Plan for and provide the infrastructure and services necessary to create the foundation for economic success.

**Financial Implications:**

The Regional Development Charge is a significant component of financing the Region's capital program. Over the period of the By-law from 2014-2018, it is anticipated that approximately \$0.5 billion of RDC funding is required to fund the projected growth-related capital costs for that period. Despite the amount available in reserves at the end of 2015, the timing of certain growth related water, wastewater and roads projects relative to expected development charge collections will necessitate the issuance of additional growth-related debt estimated at \$166 million over the next five years. The chart below shows the anticipated growth-related debt outstanding from 2012-2021:



The need for additional growth-related debt exposes the Region to development charge revenue risk, in that the Region will need to meet the contractual obligation to pay debt servicing costs from an uncertain, and potentially inadequate, development charge revenue stream. Staff will continue to monitor this risk and report back to Council through the budget process and future RDC collection reviews.

**Other Department Consultations/Concurrence:**

Input was provided by Planning, Development and Legislative Services staff.

**Attachments:**

Appendix A - Development Charge Reserve Funds Closing Balances 2011-2015

**Prepared By: Shane Fedy, Manager, Infrastructure Financing**

**Approved By: Craig Dyer, Commissioner, Corporate Services/Chief Financial Officer**

### Appendix A

#### Development Charge Reserve Funds - Closing Balances 2011-2015

(\$000's)	2011	2012	2013	2014	2015
Transportation	58,852	42,086	37,521	38,088	21,910
Water & Wastewater*	6,148	(18,638)	22,815	30,470	31,350
Airport	(2,827)	(2,523)	(2,158)	(1,444)	(878)
Paramedic Services	96	(158)	(205)	81	188
General Government	425	(302)	(697)	(1,245)	(1,442)
Library	133	108	75	59	5
Operations	1,214	1,548	1,901	2,436	2,757
Police	942	(1,236)	(374)	89	274
Transit	3,414	777	(2,553)	(2,264)	(1,837)
<b>Total RDC Reserves</b>	<b>68,396</b>	<b>21,662</b>	<b>56,325</b>	<b>66,269</b>	<b>52,327</b>

\* \$93 million in debentures have been issued for growth related Wastewater projects. The annual debt servicing costs (\$6.7 million in the 2016 Budget) are funded from the Wastewater RDC Reserve Fund.