Report: COR-FSD-18-06

Region of Waterloo

Corporate Services

Financial Services & Development Financing

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

Date: April 10, 2018 **File Code:** F27-50

Subject: Annual Adequacy of Regional Development Charge Collections Review

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 fund balances to assist in determining the adequacy of the RDC rates established under the current Development Charge By-law. Details relating to the RDC collections and appropriations can be found in the annual DC Transaction Report, COR-FSD 18-02 dated March 20, 2018. The collection of development charges in the Region of Waterloo is governed by the Region's RDC By-law 14-046 which came into effect on August 1, 2014. The RDC By-law was amended effective January 1, 2017 by By-law 16-053, which established a new Transit charge and introduced a Waste Management charge.

Development charge collections and funded exemptions in 2017 totaled $57 million. Appropriations exceeded collections in 2017 leading to a decrease in the overall consolidated RDC reserve position to $45.4 million from the $66.4 million closing balance in 2016. Although the consolidated position remains positive, it should be noted that $119 million in growth related debentures have been issued for projects in Wastewater ($112M), Paramedic Services ($0.6M), Police ($2M), and Transit ($4M).

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Through the 2018 Budget process, staff has estimated that additional growth-related debt in the amount of $228 million will be required over the next five years in order to finance planned infrastructure investments. This is an 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 (as indicated in previous Adequacy reports).

Due to the anticipated completion of several master and business plans and given that the development of a background study and by-law review is currently underway, staff believe that no further action with regards to the Region’s existing Development Charge By-law 14-046, as amended, is warranted at this time. Staff will continue to monitor growth in the Region, RDC collections, and RDC reserve balances throughout 2018 and will report to Council in the spring of 2019 with regards to the adequacy of the RDC Reserve Funds. A new RDC By-law will be in place by August 1, 2019.

Report:

Background

The purpose of the Regional Development Charge (RDC) is to recover a portion of 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 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 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 assist in financing growth-related capital 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 impose and collect development charges.

The collection of development charges in the Region of Waterloo is governed by the Region's Development Charge (RDC) By-law 14-046 which came into effect on August 1, 2014 and expires on July 31, 2019. RDC By-law 16-053, which amends the Transit charge and introduces a Waste Management charge, came into effect January 1st 2017. 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 in Appendix A.

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 (development charge revenues over the past 5 years are shown in Appendix B). 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: Currently, full downtown core exemptions exist in Kitchener and Cambridge. Since January 1, 2017 development in the core area of the City of Waterloo has received a 77% discount off the Transit RDC and 100% discount off the Waste Management DC. 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, 2017 to December 31, 2017 are shown in the following table:

RDC Collections & Funded Exemptions/Discounts			
January 1, 2017 - December 31, 2017			
($000's)	**Residential**	**Non-Residential**	**TOTAL**
RDCs Collected	**$41,631**	**$12,550**	**$54,181**
Exemptions:			
Downtown Core	2,332	1,443	3,775
Brownfield	430	0	430
Industrial Discount	0	1,340	1,340
Total Exemptions	2,762	2,783	5,545
Less: Unfunded Core Exemptions	(1,515)	(929)	(2,444)
Total Funded Exemptions	**1,247**	**1,854**	**3,101**
Total Collections & Funded Exemptions	$42,878	$14,404	$57,282
% of Total	75%	25%	100%

Development charge collections and funded exemptions during 2017 under RDC By-law 14-046, as amended, totaled $57 million. Of the total revenue, $43 million was attributable to residential development and $14 million was for non-residential development.

The total cost of development charge exemptions and discounts is financed from user rates and the property tax levy. As detailed in Report COR-FSD-17-33 dated November 22, 2017, Regional Council approved a strategy to fund downtown core area exemptions arising in 2017 that are in excess of 2017 budget (and those arising in 2018 and 2019 up to and including Feb 28, 2019) over a 10 year period. This strategy was implemented to better align the timing of core area exemption funding with the actual development of the sites, to preserve the Region's reserve balances and reduce overall financial risk to the Region while complying with the intention of the DCA given the potential for significant increases in building permit activity within the core areas and the resulting exemption costs with the pending expiry of the core area exemption on Feb 28, 2019. Accordingly, $2.4 million of "unfunded" downtown core area exemptions in 2017 will be transferred to the development charge reserves at $244,000 per year over the 2018-2027 timeframe.

A total of $3.1 million of the exemption and discount costs were funded in 2017 with $2.2 million coming from property taxes and $0.9 million from User Rate Reserves. The remaining $2.4 million will be funded from the applicable property tax and user rate sources over the 2018-2027 timeframe. Funded exemptions and discounts for 2013-2017 are detailed in the following table:

2013-2017 Funded Exemptions & Discounts						
($000's)	**2013**	**2014**	**2015**	**2016**	**2017**	**Total**
Downtown Core	0	$4,879	$129	$1,670	$3,775	$10,453
Less: Unfunded Core Exemptions	0	0	0	0	(2,444)	(2,444)
Brownfield	844	2,066	1,172	366	430	4,878
Farming, Public Hospitals	0	0	0	155	0	155
Industrial Discount*	NA	381	464	802	1,340	2,987
Total	**$844**	**$7,326**	**$1,765**	**$2,993**	**$3,101**	**$16,029**

* Came into effect Aug 1, 2014

Based on the maximum permissible rate calculated in the 2014 DCBS, RDC revenue in 2017 was estimated to be approximately $87 million. However, in order to reduce the magnitude of the increase in RDC rates at that time, 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 2017 of approximately $5.8 million, all other things being equal.

The following table shows the development charge collections & funded exemptions/ discounts as contemplated in the 2014 DCBS for 2017 both at the maximum permissible rate and at the Council approved rate versus the 2017 actual RDC revenue.

Development Charge Collections & Funded Exemptions/Discounts			
January 1, 2017 - December 31, 2017			
($000's)	**Per 2014 DCBS at Maximum Rate**	**Per 2014 DCBS at Approved Rate**	**2017 Actual***
RDC Revenue	$87,000	$81,200	$57,282

*Net of $2.4 million of unfunded core area exemptions

Actual RDC revenue in 2017 is lower than contemplated by the 2014 DCBS due to a number of factors including:

- a significant number of building permits were issued towards the end of 2016 in advance of the amending by-law for Transit and Waste Management coming into force on January 1, 2017.
- statutory RDC exemptions
- discounted rates (10% reduction of water, wastewater and roads RDC rates)
- the type and timing of development

Staff continue to closely monitor RDC collections and report regularly to the Administration and Finance Committee.

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.

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
Paramedic Services Master Plan	Completed 2016
Airport Business Plan	Completed 2017
GRT Mobility PLUS Business Plan	Completed 2017
Grand River Transit Business Plan	Completed 2017
Wastewater Master Plan	Spring 2018
Regional Transportation Master Plan	Spring 2018
Biosolids Master Plan	Spring 2018
Regional Accommodation Master Plan	Fall 2018

`These master plans, which form the basis of future capital programs and future development charge background studies, will be reflected in the 2019-2028 Preliminary Capital Program.

Development Charge Background Study and By-law Review

As prescribed by the Development Charges Act (DCA), Development Charge By-laws must be updated at least every 5 years. The Region's Development Charge By-law 14-046, as amended came into effect on August 1, 2014 and expires on July 31, 2019.

Staff have engaged Watson and Associates to assist with the development of the Development Charge Background Study (DCBS) that will support implementation of a new RDC By-law effective August 1st, 2019. A RDC Steering Committee comprised of Senior Regional Staff and members of Council will be formed early in 2019. The proposed schedule for the DCBS and By-law review is presented in the table below:

Task	Expected Completion Date
Data Gathering & Analysis	Mar-Sep 2018
Prepare & Review Draft DCBS	Oct 2018-Jan 2019
RDC Steering Committee Meetings	Jan-May 2019
Stakeholder Meetings	Throughout Process
Release DCBS to Public	Early 2019
Public Meeting	Spring 2019
By-law Passage	May 2019

RDC Collection and Rate Adequacy

The Region's current RDC By-law expires on July 31, 2019. Due to the anticipated completion of several master and business plans (as indicated in the table above), and given that a new background study and by-law review is currently underway, staff believe that no further action with regards to the Region's existing Development Charge By-law 14-046, as amended, is warranted at this time. Keeping the existing By-law in force until the planned expiry in 2019 will allow for growth-related capital works identified through the various master planning processes to be included in the next development charge background study. Allowing the existing by-law to remain in force will also provide a level of cost certainty with respect to regional development charges for the development community until July 31, 2019. Indexing of RDC's will continue as set out in the By-law on January 1, 2019.

That being said, staff has estimated that additional growth-related debt in the amount of $228 million could potentially be required over the next five years in order to finance planned infrastructure investments. This is an 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 (as described in the previous Adequacy reports).

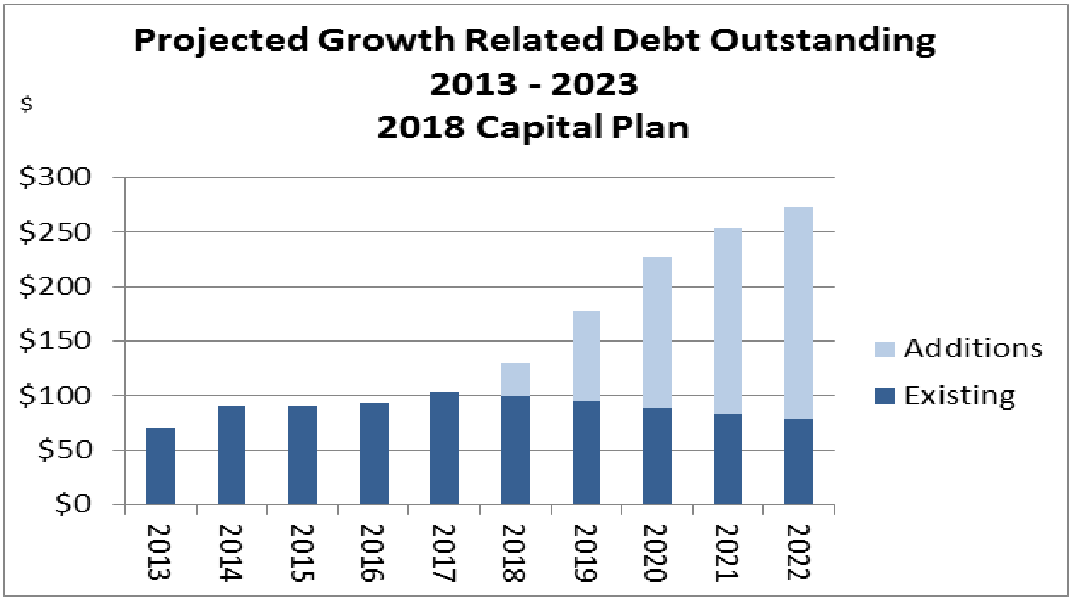
Funding for wastewater infrastructure is particularly problematic given that the additional capacity must be available well in advance of the issuance of building permits and corresponding collection of RDCs. As well, because wastewater plant expansions are large in scope and cost, the benefit to future 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.

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. The Region's approved 2018-2027 Capital Program requires $1.1 billion of RDC funding to fund the projected growth-related capital costs for that period. Despite the amount available in reserves at the end of 2017, the timing of certain growth projects relative to expected development charge collections will necessitate the issuance of additional growth-related debt estimated at $228 million over the next five years. The following chart shows the actual amount of growth-related debt outstanding from 2013-2017 and the forecast for 2018-2023:



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:

Attachments:

Appendix A - Development Charge Reserve Funds Closing Balances 2013-2017

Appendix B – RDC Revenue 2012-2017

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

Appendix A

Development Charge Reserve Funds - Closing Balances 2013-2017

($000's)	2013	2014	2015	2016	2017
Transportation	$37,521	$38,088	$21,910	$19,540	$5,903
Water & Wastewater*	22,815	30,470	31,350	43,352	35,834
Airport	(2,158)	(1,444)	(878)	212	313
Paramedic Services*	(205)	81	188	616	581
General Government	(697)	(1,245)	(1,442)	(1,552)	(1,957)
Library	75	59	5	23	11
Operations	1,901	2,436	2,757	3,325	3,326
Police*	(374)	89	274	752	135
Transit*	(2,553)	(2,264)	(1,837)	141	1,147
Waste Management	NA	NA	NA	NA	90
Total RDC Reserves	**$56,325**	**$66,269**	**$52,327**	**$66,409**	**$45,383**

* $119 in debentures have been issued for growth related projects in Wastewater ($112M), Paramedic Services ($0.6M), Police ($2M), and Transit ($4M)

Appendix B – RDC Revenue ($M) 2011-2017