**Report:** COR-FSD-19-17

## 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 9, 2019 **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 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-19-11 dated March 19, 2019.

Development charge collections and funded exemptions in 2018 totaled $56.8 million. Appropriations exceeded collections in 2018 leading to a decrease in the overall consolidated RDC reserve position to $36.8 million from the $45.4 million closing balance in 2017. Although the consolidated position remains positive, it should be noted that $184.7 million in growth related debentures have been issued for projects in Wastewater ($113.7M), Paramedic Services ($2.3M), Police ($2.1M), Airport ($3.1M), Library ($0.2M) and Conventional and Light Rail Transit ($63.3M). The associated annual debt servicing costs of $14 million will be recovered from future RDC collections.

Through the 2019 Budget process, staff estimated that additional growth-related debt in the amount of $238 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).

Through the RDC By-law review that is currently underway, staff will recommend new RDC rates and policies that will help ensure the long term sustainability of the Region's capital program and to ensure that development pays an appropriate share of growth related capital costs.

**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 rules 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 and growth related debt servicing costs for 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: In 2018, full downtown core exemptions existed 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 expired 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, 2018 to December 31, 2018 are shown in the following table:

| RDC Collections & Funded Exemptions/Discounts | | | |
|---|---|---|---|
| **January 1, 2018 - December 31, 2018** | | | |
| **($000's)** | **Residential** | **Non-Residential** | **TOTAL** |
| **RDCs Collected** | **$39,553** | **$12,038** | **$51,591** |
| Exemptions: | | | |
| Downtown Core | 5,571 | 1,547 | 7,118 |
| Brownfield | 65 | 0 | 65 |
| Industrial Discount | 0 | 3,078 | 3,078 |
| Total Exemptions | 5,636 | 4,625 | 10,261 |
| Less: Unfunded Core Exemptions | (3,963) | (1,100) | (5,063) |
| **Total Funded Exemptions** | **1,673** | **3,525** | **5,198** |
| **Total Collections & Funded Exemptions** | **$41,226** | **$15,563** | **$56,789** |
| % of Total | 73% | 27% | 100% |

Development charge collections and funded exemptions during 2018 under RDC By-law 14-046, as amended, totaled $56.8 million. Of the total revenue, $41.2 million was attributable to residential development and $15.6 million was for non-residential development.

Based on the maximum permissible rate calculated in the 2014 DCBS, RDC revenue in 2018 was estimated to be approximately $110 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 2018 of approximately $5.5 million, all other things being equal.

The following table shows the development charge collections & funded exemptions/ discounts as contemplated in the 2014 DCBS for 2018 both at the maximum permissible rate and at the Council approved rate versus the 2018 actual RDC revenue.

| Development Charge Collections & Funded Exemptions/Discounts | | | |
|---|---|---|---|
| January 1, 2018 - December 31, 2018 | | | |
| ($000's) | Per 2014 DCBS at Maximum Rate | Per 2014 DCBS at Approved Rate | 2018 Actual* |
| RDC Revenue | $110,000 | $100,000 | $56,789 |

*Net of $5.1 million of unfunded core area exemptions

Actual RDC revenue in 2018 is lower than contemplated by the 2014 DCBS due to a number of factors including:

- discounted rates (10% reduction of water, wastewater and roads RDC rates)
- statutory RDC exemptions
- the type and timing of development
- lower non-residential development than contemplated by the 2014 DCBS
- Unfunded core area exemptions
- a significant number of building permits were issued in early 2019 in advance of the downtown core area exemption expiring on Feb 28, 2019

**Exemptions and Discounts**

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, $5.1 million of "unfunded" downtown core area exemptions in 2018 will be transferred to the development charge reserves at $510,000 per year over the 2019-2028 timeframe.

A total of $5.2 million of the exemption and discount costs were funded in 2018 with $3.6 million coming from property taxes and $1.6 million from User Rate Reserves. The remaining $5.1 million will be funded from the applicable property tax and user rate sources over the 2019-2028 timeframe. Funded exemptions and discounts for 2014-2018 are detailed in the following table:

| 2014-2018 Funded Exemptions & Discounts | | | | | | |
|---|---|---|---|---|---|---|
| **($000's)** | **2014** | **2015** | **2016** | **2017** | **2018** | **Total** |
| Downtown Core | $4,879 | $129 | $1,670 | $3,775 | $7,118 | $17,571 |
| Less: Unfunded Core Exemptions | 0 | 0 | 0 | (2,444) | (5,063) | (7,507) |
| Brownfield | 2,066 | 1,172 | 366 | 430 | 65 | 4,099 |
| Farming, Public Hospitals | 0 | 0 | 155 | 0 | 0 | 155 |
| Industrial Discount* | 381 | 464 | 802 | 1,340 | 3,078 | 6,065 |
| **Total** | **$7,326** | **$1,765** | **$2,993** | **$3,101** | **$5,198** | **$20,383** |

*Came into effect Aug 1, 2014

The following table provides a summary of downtown core exemptions over the 2017-2019 period per the approved Core Area Strategy:

| Downtown Core Area Exemptions ($000's) | | | | |
|---|---|---|---|---|
| | **2017** | **2018** | **2019 (Jan 1 to Feb 28)** | **Total** |
| Funded | $1,331 | $2,055 | | $3,386 |
| Unfunded | $2,444 | $5,063 | $33,005 | $40,512 |
| Total | **$3,775** | **$7,118** | **$33,005** | **$43,898** |

The total cost of downtown core exemptions based on permits issued in 2017, 2018 and up to February 28, 2019 (when the exemption expired) was $43.9 million. This figure is at the low end of the estimated range provided to Council back in late 2017 when the funding strategy was approved. The “unfunded” component of these exemptions totals $40.5 million and, per the approved strategy, will be transferred to the development charge reserves at a rate of $4.05 million per year over the 2019-2028 timeframe. The sources of funding are listed in the following table:

| **Funding Sources** | **$ Million** |
|---|---|
| Transportation Operating Budget | $ 1.951 |
| Water & WW Operating Budget | 1.400 |
| RTMP Reserve Fund | 0.526 |
| Police Operating Budget | 0.047 |
| Corporate Financial Operating Budget | 0.127 |
| Total Annual Funding | **$ 4.051** |

### 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.

### RDC Collection and Rate Adequacy

Through the 2019 Budget process, staff estimated that additional growth-related debt in the amount of $238 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.

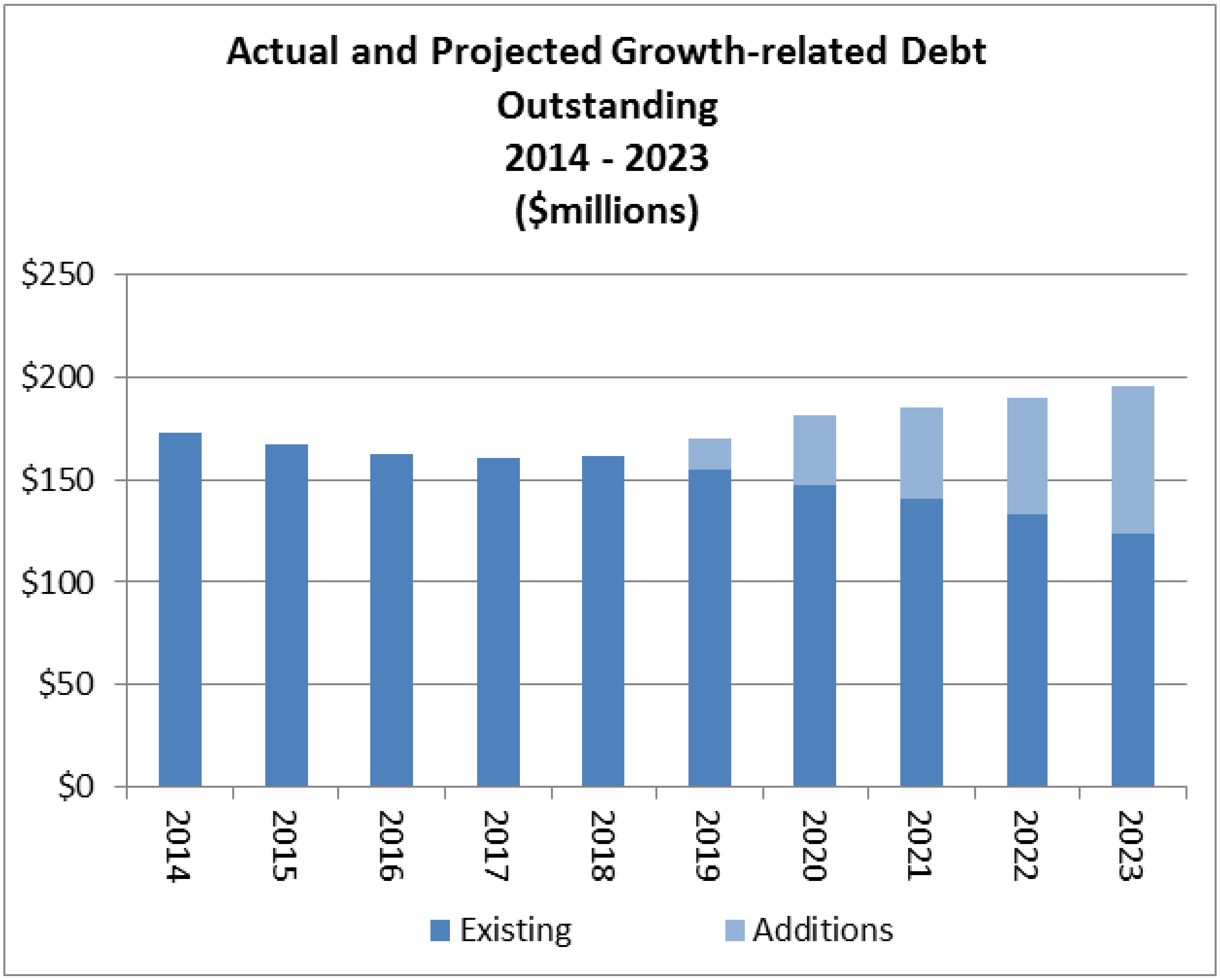
Through the RDC By-law review that is currently underway, staff will recommend new RDC rates and policies that will help ensure the long term sustainability of the Region's capital program and to ensure that development pays an appropriate share of growth related capital costs.

**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 for the Region's capital program. The Region's approved 2019-2028 Capital Program requires just under $1.0 billion of RDC funding to fund the projected growth-related capital costs for that period. The timing of certain growth projects relative to expected development charge collections will necessitate the issuance of additional growth-related debt estimated at $238 million over the next five years. The following chart shows the actual amount of growth-related debt outstanding from 2014-2018 and the forecast for 2019-2023:




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 adequacy of RDC collections reviews.

**Other Department Consultations/Concurrence:** Nil

**Attachments:**

Appendix A - Development Charge Reserve Funds Closing Balances 2014-2018

Appendix B – RDC Revenue 2014-2018

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

## Appendix A

### Development Charge Reserve Funds - Closing Balances 2014-2018

| ($000's) | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| Transportation | $38,088 | $21,910 | $19,540 | $5,903 | $6,975 |
| Water & Wastewater* | 30,470 | 31,350 | 43,352 | 35,834 | 24,246 |
| Airport* | (1,444) | (878) | 212 | 313 | 980 |
| Paramedic Services* | 81 | 188 | 616 | 581 | 695 |
| General Government | (1,245) | (1,442) | (1,552) | (1,957) | (2,292) |
| Library* | 59 | 5 | 23 | 11 | 48 |
| Operations | 2,436 | 2,757 | 3,325 | 3,326 | 3,645 |
| Police* | 89 | 274 | 752 | 135 | (729) |
| Transit* | (2,264) | (1,837) | 141 | 1,147 | 2,998 |
| Waste Management | NA | NA | NA | 90 | 242 |
| **Total RDC Reserves** | **$66,269** | **$52,327** | **$66,409** | **$45,383** | **$36,808** |

* $184.7 million in growth related debentures have been issued for projects in Wastewater ($113.7M), Paramedic Services ($2.3M), Police ($2.1M), Airport ($3.1M), Library ($0.2M) and Conventional and Light Rail Transit ($63.3M).

**Appendix B – RDC Revenue ($000's) 2014-2018**