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Communication
COUNCIL: <u>Dec 11/17</u>
<u>FAA</u> Rpt. No. <u>14</u> Item <u>1</u>

DATE: December 11, 2017

TO: Mayor and Members of Council

FROM: Laura Mirabella-Siddall, Chief Financial Officer and City Treasurer
Lloyd Noronha, Director, Financial Planning and Development Finance, Deputy City Treasurer

RE: Communication: Finance, Administration and Audit, December 4, 2017,
Development Charges – Semi-Annual Adjustment

Purpose

This communication responds to Item 1 of the December 4, 2017 meeting of the Finance, Administration and Audit Committee, specifically the request from Committee to provide preliminary commentary on the methodology behind Development Charge (DC) rate calculations and its potential incentivization or cross-subsidization between different types of development and land uses.

Background and Analysis

DC rates are calculated to recover growth related capital costs

The *DC Act, 1997*, as amended, provides Ontario municipalities with the authority to recover for growth related capital costs. Typically, this includes infrastructure such as watermain, sewers, roads, recreation centres, libraries and fire stations. Not all infrastructure is 100 per cent recoverable, nor is all growth-related infrastructure DC eligible. This is, however, a vital financial tool for many growing municipalities to help fund their capital plans. In the City of Vaughan, DC funding accounts for approximately 50 per cent of the next five year \$591M capital program.

The current methodology is widely used across Ontario

DCs in the City of Vaughan, and in most municipalities in Ontario, are charged on a per unit basis for residential uses and a floor space basis for non-residential uses. The charge per residential unit varies based on the type of unit. For instance, as of January 1, 2018 a single detached home in Vaughan would pay \$24,998, while a small apartment would pay \$10,988. In addition, they would pay Regional and Education DCs, as well as any applicable Area Specific DCs.

The residential rate itself is based on what is termed an “average costing model”. This means that all the growth-related capital costs forecasted to be spent until Vaughan is built out are divided by the expected population. An occupancy factor is applied to calculate the charge for different types of residential units. For instance, if single detached homes theoretically were assumed to have an average of four persons living in the unit versus a small apartment which are assumed at two persons, then single detached homes would be apportioned twice as much

of the charge across the City. The non-residential rate is based on a simpler approach in which capital costs are divided by total forecasted floor area of non-residential development until build out.

By determining the total capital program cost and then dividing it by the total forecast for single/semidetached homes, townhomes, large apartments, small apartments and non-residential floor space, the City is able to create rates that theoretically ensure that the City breaks even on its growth-related capital program by the time the City is built out. For illustrative purposes, the foregoing has been simplified considerably, but the important aspect to highlight is that the methodology is based on the cost driver of population. Under this methodology it is assumed that the number of people consuming the service is what drives the cost of that service.

The methodology may produce unintentional incentivization and cross-subsidization between types of development and land uses

As with any tax regime, DCs may have an impact on market behaviours. DCs are generally assumed to be passed on by developers to the home buyer and therefore form part of the purchase price of a home. One might assume, therefore, that a higher or lower DC equates to a higher or lower home price.

The current "average costing model" may provide unintentional incentivization and cross-subsidization because only the number of persons per residential unit is considered in calculating the rate. No consideration is given towards the actual incremental cost that a particular development may have on the municipality's capital cost. For instance, a single detached home that has 20 feet of frontage is charged the exact same DC as a single detached home that has 60 feet of frontage. The 60-foot frontage home may increase the infrastructure costs of the City to a larger extent than the smaller frontage home. As a result, the price of each home is being impacted by the same amount and it could be construed that the smaller frontage home is over-paying for their municipal infrastructure, while the longer frontage home is underpaying; causing distortions in the market pricing. Another example of this might be a townhouse being built as a part of redevelopment in area that already has municipal services versus a townhouse being built in a "green field" area, which has no municipal infrastructure. Each townhouse would be paying the same DC, even though one might argue that the townhouse being built in an area with existing services has less of an impact on the municipality's growth related capital program. There is much research on the comparative costs of greenfield vs intensification land development. Many variables effect this comparison and in some cases intensification costs can actually be greater than that of greenfield.

To solve for this issue, it is important to consider more accurately matching those who benefit with those who pay on an incremental basis. This means that instead of averaging costs across development types and land use patterns, that a methodology is used that considers the incremental cost a specific development and land use pattern has on the municipality's capital program and services. Under this approach, it is assumed that by more accurately matching the cost difference between one scenario and another, it will also drive the appropriate pricing structure in the market as DCs are passed on to the home buyer. Under this approach it is theorized that this in turn will ultimately drive more efficient use of land. It is also assumed that

it would be economically beneficial to the municipality in the form of better utilizing existing infrastructure capacity and promote financially sustainable development.

The City of Vaughan has been a leader in some aspects of allocating growth related capital costs to those who benefit from the infrastructure

The City has historically, and currently still does, use Area Specific DCs for the recovery of Wastewater and Stormwater infrastructure. Vaughan is one of very few municipalities to have this practice in place, which is now formally promoted as an endorsed methodology by the Province through the Bill 73 changes last year.

Area Specific DCs are charged on a land basis, rather than a unit basis. They are also on allocated to the benefiting area. In practice, this means that if 100 hectares of land were being developed and a sewage system costing \$10M was constructed to service that land, then the developers would pay \$0.1M per hectare. By charging for the infrastructure on a per hectare basis, rather than a per unit basis, it is theorized that this promotes the efficient use of the land by discouraging "sprawl" and encouraging intensification. This can be demonstrated by considering one hectare of land within this hypothetical example. If a single detached home was built on that hectare, it would have to pay \$0.1M for the infrastructure. If on that same hectare of land, a 50-unit apartment building was constructed, then each unit would only have to pay \$2,000 per unit. It should be noted that this is only a theoretical market force. There are many variables that affect a landowner's decision to develop different types of housing product. Historical land costs, current market conditions and supply and demand are but a few of these variables and could still lead to lower density developments.

The City, however, continues to calculate its DCs for other types of linear infrastructure (roads, watermains) on a citywide basis, which is an "average cost model". It should be noted that the "soft service" DCs for infrastructure such as recreation centres, parks, libraries and fire stations are likely still more fairly calculated using the average cost model given that they are more truly "people driven" services and therefore the persons per unit charge is the appropriate cost driver.

Several factors such as legislative restrictions, legal implications and ease of administration must be considered in changing methodologies

Aside from Vaughan for Wastewater and Stormwater Area Specific DCs, Cities such as Ottawa and Markham have implemented hybrid versions of incremental cost models for even their "city-wide" type services. York Region also has a differentiated non-residential rate for Office/Industrial/Institutional versus Retail based on the average trips (usage of roads) generated from these different types of uses. All of these approaches and innovations to attempt to match those who benefit with those who pay and in doing so, promoting more efficient use of land, have been accomplished under current legislation.

The degree to which a municipality wishes to pursue an "incremental cost model" would determine how accommodating the current legislation would be to the methodology. The current city-wide DC (average costing) methodologies used by Vaughan are also common practice across Ontario and have therefore been upheld by the Ontario Municipal Board in many respects. Pursuing a different methodological approach will also come with administrative challenges. For instance, while it may be the fairest approach to consider each individual building for its efficient use of land, the exact draw on municipal infrastructure and location

within an older or newer area in the City, this would be a completely impractical and inefficient method of calculating DCs. Any new methodology would need to balance the land use economic theory with the legal, financial and administrative considerations in adopting a new approach.

A more fulsome discussion can be brought forward during the 2018 DC By-law review

Should Council wish to explore further options on reducing unintentional incentivization and cross-subsidization, with a more fulsome analysis, then staff and consultants can bring further information during the 2018 DC by-law review. It should, however, be noted that it would likely be impractical to implement any methodology changes in the 2018 DC by-law update itself given the project timelines, the stakeholder consultation that is already underway and the expiration of the by-law in 2018. It would be more appropriate to make methodological changes in the next iteration of the by-law between 2018 and 2023.

Conclusion

The methodology to calculate DCs, while common practice across Ontario, may contain some inherent and unintentional incentives to promote inefficient use of land and infrastructure. Other methodologies exist that reduce this effect, to varying degrees. The City already uses one of these methodologies for its Wastewater and Stormwater DCs, but can consider further methodological changes in future updates of the DC by-law.

Report prepared by:

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Respectfully Submitted,



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