Region of Waterloo

Corporate Services

Corporate Finance

To: Administration and Finance Committee

Meeting Date: December 6, 2022

Report Title: Bill 23 Financial Impacts in Waterloo Region

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1. Recommendation

That the Regional Municipality of Waterloo direct Staff to circulate report COR-CFN-22-04, Bill 23 Financial Impacts in Waterloo Region, dated December 6, 2022, to all Members of Provincial Parliament and all Area Municipal Councils within the Region.

2. Purpose / Issue:

To provide Committee members with an overview of the estimated financial impacts of the proposed amendments to the Development Charges Act (DCA) set out in Bill 23, *Building More Homes Faster Act*.

3. Strategic Plan:

This report aligns with two Corporate Strategic Plan objectives:

- Thriving Economy – 1.2. ensure an adequate and strategic supply of employment lands in the Region
- Responsive and Engaging Public Service – 5.4. to ensure the Region provides value for money and long term financial sustainability

4. Report Highlights:

- Bill 23, Building More Homes Faster Act, received Royal Assent on November 28, 2022. This is despite the public comment period on the DCA and other portions of the bill being recently extended to December 9 from the original November 24 deadline.
- The Bill reduces the amount of Development Charges (DC), Parkland Dedication (PD) fees and Community Benefits Charges (CBC) revenue needed by municipalities to fund the cost of infrastructure for new housing to be built. As municipal revenue is reduced, municipalities will need to consider delaying the construction of infrastructure needed to accommodate new housing and assume

additional risk by taking on more long-term debt and the associated debt financing costs (which require DC revenue to fund).

- There is no demonstrable evidence that reducing development charges will translate into lower home prices, as such prices are market driven. This Bill will not result in more housing being built faster. To the contrary, housing supply could be slowed as infrastructure projects are deferred due to restricted municipal cash flow.

- The Region was considering adding a housing services component to its Development Charge through the next background study to help fund the Waterloo Region Housing expansion. Eliminating housing as a DC-eligible service will require Region to fund these costs through the property tax base.

- Existing and future taxpayers will pay more for growth, which already does not pay for itself under pre-Bill 23 DCA rules. Accordingly, the total cost of housing will increase due to higher property taxes and user rates. This comes at a time when municipalities are experiencing capital cost escalation in the range of 15%-50% and the cost of borrowing is at the highest level it has been in over 10 years.

- The balance in municipal DC reserve funds will vary from year to year for many reasons including the actual pace of development and timing of capital costs, the need for water supply and wastewater treatment infrastructure to be in place before development occurs (which is often debt financed), the accumulation of DC revenues in order to have the funds available to pay for the infrastructure costs to meet community needs without the need for borrowing, and isolated increases in the issuance of building permits (e.g. in advance of an increase in DC rates due to indexing or new rate calculations) which can contribute to unexpectedly higher DC reserve fund balances on a temporary basis.

- The government amended the DCA through Bill 108, More Homes, More Choices Act, 2019 (effective January 1, 2020) resulting in the deferral of certain DC payments until 5 to 20 years from occupancy – accordingly a significant and growing portion of DC reserve balances is not actually money in the bank, but rather is shown as a receivable on municipal balance sheets.

- Any year-end DC reserve fund balance is used to pay for future debt servicing costs and to pay for new infrastructure as it is built. The Region of Waterloo had $85 million in its DC reserve fund at the end of 2021 (of which $58m was cash and $27m was DC receivables), but also had $327 million in growth-related debt outstanding, and has a capital program that requires over $1.2 billion in DC funding over the next 10 years. DC reserve funds are allocated to future capital works and future debt servicing costs for works already in place.

5. Background:

Municipalities are responsible for the new infrastructure and increased capacity on existing infrastructure needed to allow new housing to be built (e.g. water treatment and distribution, wastewater collection and treatment, and roads) and the essential services expected by the community (e.g. public transit, parks and community centres, arenas, libraries, and emergency services such as police, fire and ambulance). Such infrastructure is to a great extent funded by development charges (upper & lower tier), parkland dedication fees (lower tier) and community benefits charges (lower tier).

Bill 23, Building More Homes Faster Act

Through this Bill the Province has amended the Development Charges Act and the Planning Act in a manner that reduces DC, PD CBC revenue. Virtually all of the changes to the Development Charges Act result in less DC revenue collected by municipalities to fund the costs of growth-related infrastructure that supports both new housing as well as commercial/industrial development. Specifically this Bill:

- Exempts certain development from the payment of DCs
- Introduces mandatory DC discounts
- Requires a mandatory discounted phase-in of new DC rates (for residential and non-residential development)
- Makes the costs associated with studies and certain land acquisitions ineligible
- Removes Housing as a DC-eligible service
- Caps the interest rate on frozen and deferred DCs
- Expands the historical service standard from 10 to 15 years, thereby generally creating a lower service standard for services, other than Public Transit which has a forward-looking service level

In addition, the Bill amends the Planning Act to exempt more growth from the payment of PDs and CBCs.

The Consequences of Passing Bill 23

The changes approved through Bill 23 will result in:

- Reduced DC, PD and CBC revenue collected and therefore less municipal capacity to fund the cost of growth-related infrastructure

- A transfer of cost responsibility from new development onto existing and future taxpayers and ratepayers
- Delays in infrastructure projects needed to allow new housing to be built
- Deferred or cancelled infrastructure to deliver the services needed by new residents
- More long term debt and risk for municipalities
- More pressure on municipal budgets and provincially mandated municipal asset management plans at a time of very high inflation and rising costs of borrowing
- Less ability for municipalities to invest in green spaces to provide park amenities to support the increased housing density

6. Area Municipality Communication and Public/Stakeholder Engagement:

Area Municipality Communication:

Staff have worked with the Treasurers of the area municipalities within Waterloo Region to estimate the financial impacts of some of the key Bill 23 provisions.

Public/Stakeholder Engagement: Nil

7. Financial Implications:

Municipalities have limited revenue sources to fund capital investments needed to deliver essential services, and this legislation reduces municipal fiscal capacity to fund necessary capital investments to allow new housing supply to be built. The inevitable result of the legislation is that existing and future taxpayers and ratepayers will need to pay more to allow growth to happen and the emplacement of infrastructure required to support housing development will be delayed.

The financial impacts of the legislation are difficult to estimate due to the timing of the implementation of the changes. Some of the amendments come into effect upon subsequent updates to DC and CBC By-laws, while others come into effect immediately. To provide context, Regional and Area Municipal staff have utilized information available in current DC by-laws and capital programs to demonstrate the potential impacts of the legislation relating to four key areas under the *Development Charges Act*, namely the phase-in of DC rates and the removal of housing, studies, and land as eligible services.

Illustrative Financial Impact of Bill 23 in Four Key Areas Under the DCA				
All figures in $ Millions	Phase-In of DC Rates	Removal of Housing*	Removal of Studies	Removal of Land
Region	$45	$260	$40	$100
Cities	$30	n/a	$28	$20
Townships	$5	n/a	$2	$5
Total	**$80 over 5 yrs**	**$260 over 10 yrs**	**$70 over 10 yrs**	**$125 over 10 yrs**

*assumes 50% DC eligible

As set out in the table above, had the phase-in provisions been in place under current DC by-laws, this would have resulted in approximately $80 million less in DC collections over the 5 year term of the by-laws equating to a reduction in DC collections of roughly 8-10% over the life of the by-laws. This likely understates the potential impact of the phase-in moving forward as this will largely come into effect under subsequent by-laws. Based on current ten year capital programs, $70 million in studies will no longer be eligible for DC funding and $125 million in land may no longer be eligible for DC funding which will shift the burden onto the property tax levy and user rates. In addition, the Region has $520 million in growth-related housing planned over the next 10 years. Removing housing as an eligible service means that the entire cost will be borne by the tax levy. Further amendments to the DCA that will reduce municipalities' ability to fund growth-related infrastructure for which estimates are not currently available include:

- Mandatory discounts for purpose built rentals
- Exemptions for affordable and attainable housing
- Caps on interest rates for frozen and deferred DCs
- Lower service standard calculation which reduces the amount of capital that is eligible for DC funding

The actual impact will be higher once new background studies are completed due to the significant capital cost escalation experienced over the last 12-24 months. This analysis excludes impacts relating to Parkland Dedication fees and Community Benefits Charges at the lower tier municipalities in Waterloo region.

In the absence of the Province developing mechanisms to offset the lost funding to keep municipalities whole from an infrastructure funding perspective, municipal Councils will be forced to make choices between maintaining existing assets and building new infrastructure with limited tax levy/user rate sources. This will ultimately lead to the deferral of growth-related infrastructure projects which contradicts the Province's goal to build more homes faster.

DC Reserve Funds

It has been suggested by some that DC rates can be reduced without impacting property tax or water/wastewater rates due to the presence of DC reserve funds. Municipal Treasurers manage the ebb and flow of DC collections and growth-related capital costs through the DC reserve funds, which are referred to as "obligatory" and are reported as such on year-end audited financial statements, in the annual Financial Information Return, and in the prescribed annual DC transaction report.

The Provincial Government amended the DCA through Bill 108, *More Homes, More Choices Act*, 2019 (effective January 1, 2020) resulting in the deferral of certain DC payments until 5 to 20 years from occupancy – accordingly a significant and growing portion of DC reserve balances is not actually money in the bank, but rather is shown as a receivable on municipal balance sheets. Roughly 30% of the approximately $200m reported in DC reserve balances by the Region and the area municipalities at December 31, 2021, is actually a receivable which will be paid 6-21 annual instalments following occupancy, leaving approximately $140m available for use.

DC reserve funds are mandated under the DCA, and the balance in DC reserve funds will vary from year to year for many reasons, including:

- The actual pace of development and the actual timing of capital costs relative to the assumptions used in the DC rate calculations. The last 3 years have seen very strong building permit volumes and DC collections – and this will temporarily increase DC reserve balances. During a period of slower economic growth, DC collections will be lower and accordingly so will the DC reserve fund balances.
- In some cases (e.g. water supply and wastewater treatment infrastructure), capital costs are incurred before development takes place. This often requires municipalities to issue debt or to run a negative balance in their DC reserve funds. When debt is issued, the resulting debt servicing costs will be funded from future DCs. The balance in the DC reserve will increase initially as development occurs, and that balance will then be used to fund future debt servicing costs.
- Capital expenditure can vary from the estimates used to calculate DC rates due to the timing of environmental assessments, utility relocations, property acquisitions, etc.
- In other cases municipalities may collect DCs over a period of time in order to have the funds available to pay for the infrastructure costs to meet community needs without the need for borrowing – this will cause the DC reserve fund to increase over a period of time until such investment occurs.
- In other cases, there can be an isolated (and often dramatic) increase in the issuance of building permits (e.g. in advance of an increase in DC rates due to

indexing or new rate calculations). This can also contribute to unexpectedly higher DC reserve fund balances on a temporary basis.

Any year-end DC reserve fund balance is used to pay for future debt servicing costs and to fund new infrastructure as it is built. The Region of Waterloo had $58 million in its DC reserve fund at the end of 2021 (the non-receivable component), but also had $327 million in growth-related debt outstanding, and has a capital program that requires over $1.2 billion in DC funding over the next 10 years. DC reserve funds are allocated to future capital works and future debt servicing costs for works already in place.

Finally, DC rates must be reset at least every 5 years (Bill 23 changes this to a maximum of 10 years) and the DC reserve fund balance is taken into account when calculating new DC rates - a higher reserve balance will result in lower future DC rates.

8. Conclusion / Next Steps:

Staff will review the Preliminary 2023-2032 Capital Program to assess the changes that will be needed to reflect the changes approved under Bill 23.

9. Attachments:

Nil.

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