

Development charges: The case for and against

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Land Acknowledgement

We wish to acknowledge this land on which the University of Toronto operates. For thousands of years it has been the traditional lands of the Huron-Wendat, the Seneca, and most recently, the Mississaugas of the Credit. Today, this meeting place is still the home to many Indigenous people from across Turtle Island and we are grateful to have the opportunity to work on this land.

Questions?

Ask in person

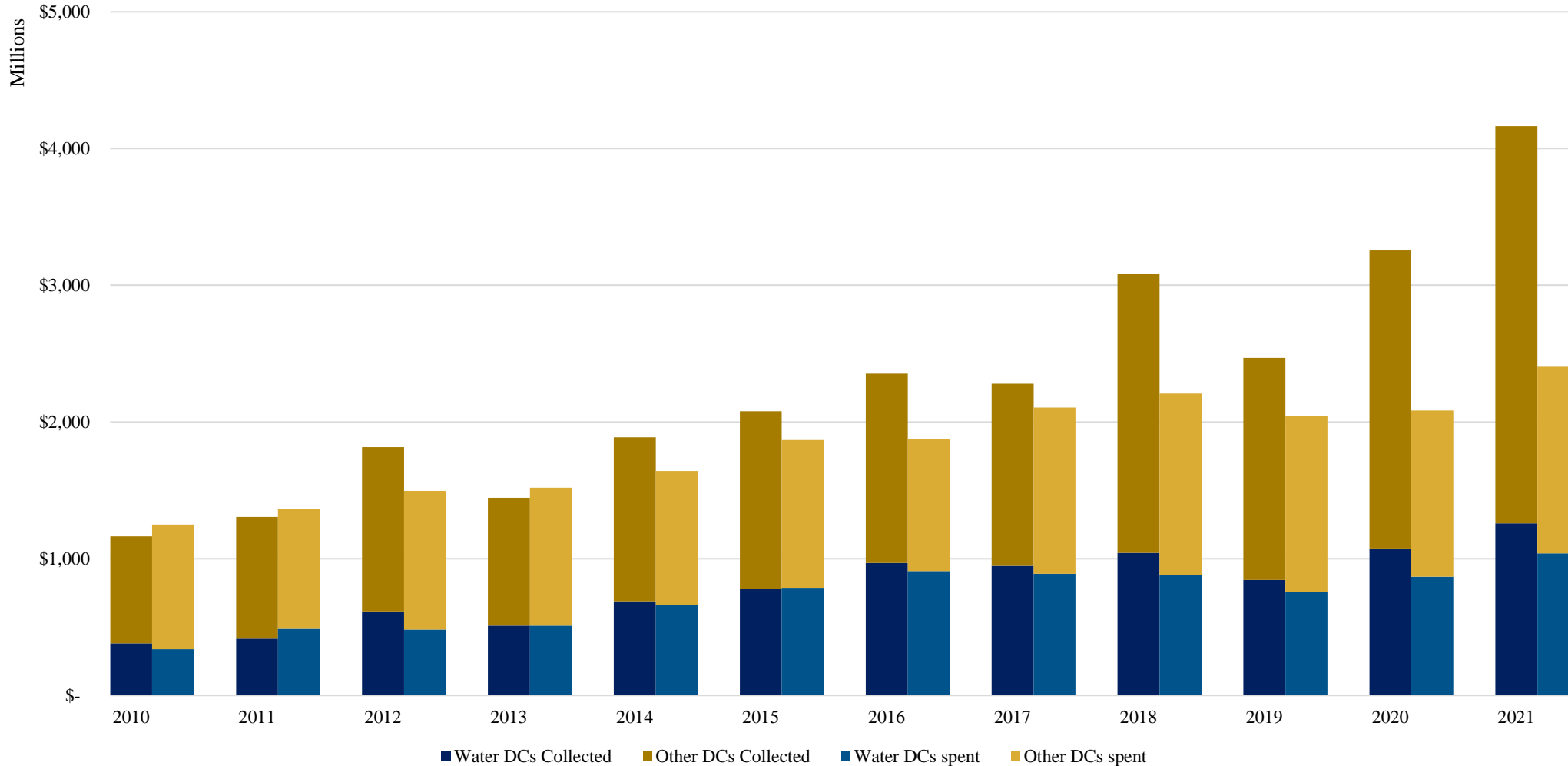


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How much Ontario cities collect in DCs



Ontario Development Charges Collected and Spent, 2010-2021



Water-related DCs largest single item collected: ~30% of DCs collected.

Roads and structures next largest.

\$4 billion collected in 2021: well more than outlays that year.

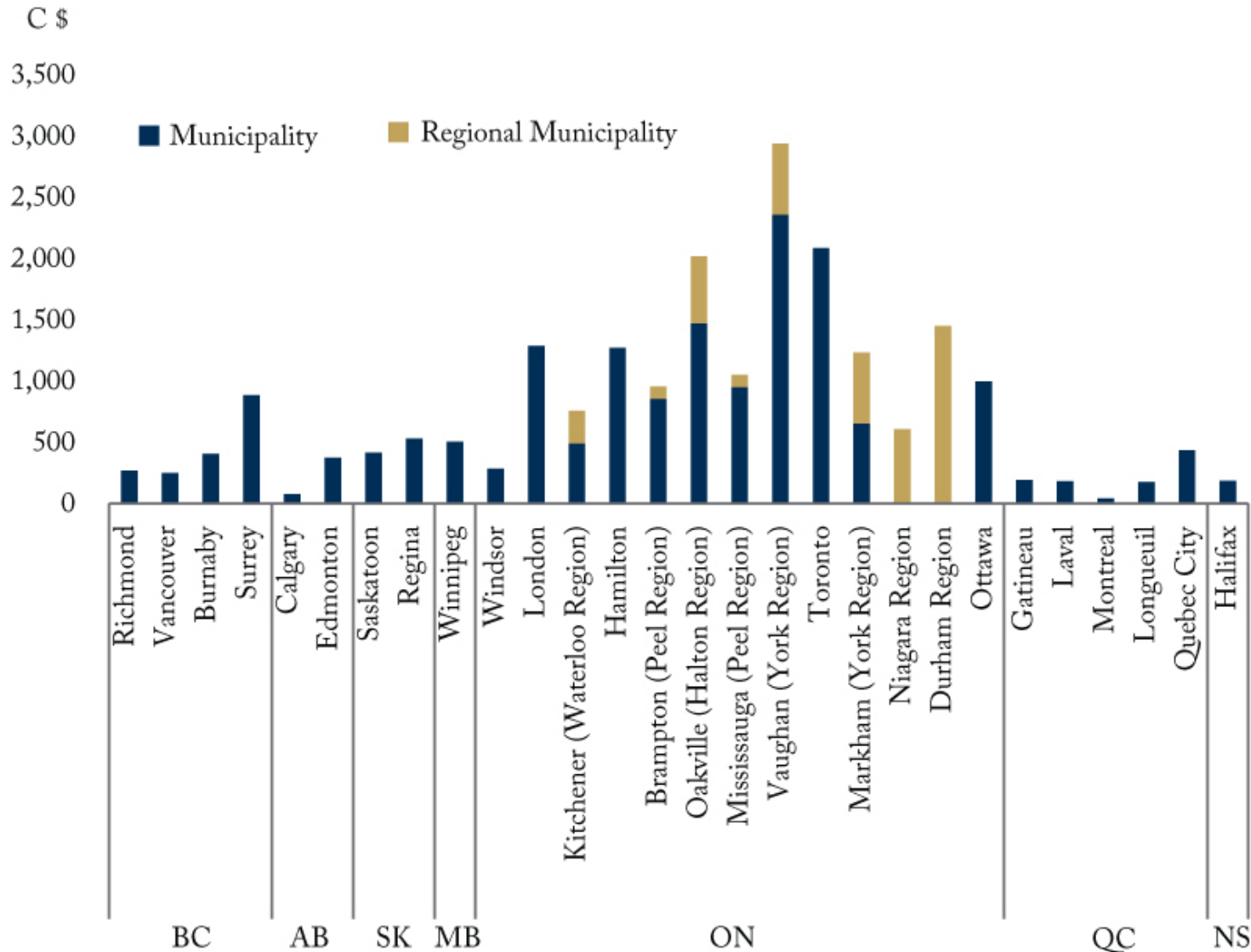
Note: 2020-2021 not available in provincial-wide summary. Totals calculated from each municipal FIR return.

Source: Financial Information Return, Schedule 61, adapted from [Dachis \(2020\)](#)

Ontario cities have significant deferred revenue



Deferred Revenue per Person in Major Canadian Municipalities, 2021



Deferred revenue is a liability. It means the funds are dedicated to a certain purpose and/or a certain time. An important (but not only) source of this deferred revenue are development charges.

Large Ontario municipalities' (single- and combined lower- and upper-tier) accumulated deferred revenues are much higher than in other major cities in Canada.

Source: <https://www.cdhowe.org/graphic-intelligence/unspent-funds-canadas-major-municipalities>

The problem with DCs for water and wastewater



Debt transfer to (all) homebuyers

Homebuyers financing municipal capital via mortgages. Homebuyers pay now, assets built later.

Cities face lower risk than individual households. Debt at municipal level will lower net financing costs and reduce overall social costs.

Accounting understates issue

Figures in graph are cash inflows and outlays.

When outlays re-expressed as capital services via ‘amortization’ line in budget, annual services to residents much less than what is paid. Timing mismatch worse!

Misallocation of capital and water

Capital charges should be spread over time the asset in use: user-pay principle.

Households will consume based on full cost at time of actual use.

Paying up-front encourages wasteful over usage and over-investment in capital.



Create regulator

Defining how to allocate costs over generations without taxpayer subsidy.

Ensures water builder chooses cost-efficient plan.

Litigation if not.

Requires investment to meet environmental standards (eg, UK Ofwat).

User-fee revenue only

Cities could apply regulatory principles to ensure capital costs are embedded in forecast user fees. Lowers upfront charge on homes.

Utility developer only paid once water flows and user fees paid: encourages the fast construction of services.

Municipal utility

Standalone water utility outside of line departments. Similar to model for municipal electricity companies. Economies of scale and scope with regional utilities. Will Peel Region dissolution test this design?

Need to revisit *Municipal Act* to determine if user-fee-only bonds affect (poorly designed anyway) annual repayment limits and lenders have recourse to tax base.

The Case for Development Charges...in Ten Minutes

Adam Found, PhD, PLE

Presentation for the Institute on Municipal Finance and Governance

November 14th, 2023

What Are Development Charges?

- Municipalities in Ontario rely heavily on development charges to recover growth-related capital costs.
- Development charges are one-time fees levied on development, which facilitates growth and thus requires expansion of municipal service capacity.
- MFOA (2019) found that development charges as a share of housing prices are 5-7% in Ontario.
- According to AMO and MFOA, development charges are essential to ensuring that “growth pays for growth.”

Upfront Expansion is Necessary

Growing municipalities must expand service capacity upfront, often decades in advance, for three reasons:

- Engineering Reality: Bridges, road lanes, traffic signals, ice arenas, snow ploughs, etc. provide all-or-nothing capacity.
- Legal Constraints: Water and sewage systems, landfills, etc. are subject to regulations requiring advance expansion.
- Cost Factors: Cost-efficiency requires expansion or replacement of major municipal assets, such as water treatment plants and trunk sewers, to be highly infrequent.

Insufficiency of Property Taxes and User Fees

- Efficient property taxes and user fees are designed to recover costs under full utilization of capacity, regardless of how capital is financed.
- But municipalities must continuously carry and reserve significant excess capacity for growth, often for decades, as growth occurs gradually.
- And since growth generates revenue only upon its materialization, efficient property taxes and user fees fail to fully recover growth-related capital costs.

Externality of Excess Capacity

- In the absence of an alternative, municipalities must levy excessive property taxes and user fees to recover growth-related capital costs.
- This necessarily has the inequitable effect of shifting such costs to established ratepayers.
- Naturally, established ratepayers then call for lower service levels and greater restrictions on development.
- This fiscal distortion is the “externality of excess capacity.”

Function of Development Charges

- Development charges recover from growth the portion of growth-related capital costs that is necessarily unrecoverable by efficient property taxes and user fees.
- This resolves the externality of excess capacity by permitting property taxes and user fees to remain at efficient levels.
- Development charges work in conjunction with, but are not replaceable by, property taxes and user fees.

Merit of Development Charges

- Efficient property taxes and user fees necessarily leave a portion of growth-related capital costs unrecovered, regardless of how capital is financed.
- Increasing property taxes and user fees to recover such costs necessarily shifts them to established ratepayers, giving rise to the externality of excess capacity.
- Using development charges instead maintains efficiency and equity in municipal levies and services and promotes acceptance of development.