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**For Information**

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**REPORT TITLE: Response to C.D. Howe’s Call for the Elimination of Development Charges**

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**OBJECTIVE**

To provide an update on current and past calls from C.D. Howe Institute for the elimination of water and wastewater development charges and the potential impact to utility rates.

**REPORT HIGHLIGHTS**

- C.D. Howe Institute asserts that development charges have been collected and are stored in reserves instead of being invested in growth infrastructure.
  - For water and wastewater growth-related infrastructure, significant expenditures are incurred many years prior to the collection of the development charges that fund them.
  - As of June 30, 2024, Peel has issued \$1.7 billion of debt (\$1.5 billion currently outstanding) to finance the timing difference between its growth-related expenditures and the collection of development charge revenue.
  - Studies show that the elimination of development charges would not decrease the prices of new housing as housing prices are driven by market demand.
  - Elimination of development charges would result in an estimated increase to current utility rate bills of up to 181 per cent or \$2,083 per household per year.
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**DISCUSSION**

**1. Background**

The Region of Peel currently has the second largest water and wastewater system in Ontario and the fourth largest in Canada with an infrastructure replacement value of \$26 billion. Municipalities in Ontario, including the Region of Peel, have limited sources of revenue which are comprised of: Development Charges (DCs), Property Taxes, User Fees, and Federal and Provincial funding. For growing municipalities, DCs are an essential source of revenue that is used to recover the cost of growth-related infrastructure needed to enable the development of new residential homes and businesses. DCs underpin the ‘Growth pays for Growth’ philosophy, funding the infrastructure necessary for residential and business growth across Ontario. Water and wastewater DCs are crucial to the creation of serviced land for housing.

On January 25, 2024, the C.D. Howe Institute made a presentation to the Ontario Sewer and Watermain Construction Association titled “Full Cost Recovery and Municipal

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Infrastructure Financing”, which outlined a case for water and wastewater DC charges to be eliminated and instead collected through utility rates using a “full cost” model. This presentation is in addition to and largely reiterates positions from an earlier report published by C.D. Howe (Benjamin Dachis) on August 9, 2018 titled *“Hosing Homebuyers: Why Cities Should Not Pay For Water and Wastewater Infrastructure with Development Charges”* and a 2021 memo titled *“Time to Re-Think How To Do Water and Wastewater Investment”*, all of which have been appended to this report as Appendices I, II and III.

The main assertions presented by C.D. Howe are as follows:

- i. DCs are worsening housing affordability.
- ii. Homebuyers are paying too much for water/wastewater infrastructure upfront through DCs when other equity or debt finance is a better solution, suggesting that the cost of infrastructure be fully built into utility rates.
- iii. Municipalities are collecting DCs before construction and are not developing infrastructure in a timely fashion and are sitting on large reserves.
- iv. Municipalities should create region-wide, standalone utilities.

Item iv above will not be addressed in this report.

## 2. Findings

Regional staff reviewed the assertions made in the C.D. Howe reports and presentation to understand the specific facts and impacts for Peel. Many of the findings were provided to Council on February 14, 2019 in a report titled *“Recent Calls for The Elimination of Water and Wastewater Development Charges”* ([www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf](http://www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf)) and remain unchanged. This report provides a summary of the main findings from the 2019 report and updates the figures as at December 31, 2023.

### i. Assertion #1 - DCs are Worsening Housing Affordability

Despite suggestions from C.D. Howe, the Municipal Finance Officers Association (MFOA), the Ontario Regional and Single Tier Treasurers (ORSTT) and the Association of Municipalities of Ontario (AMO) advocated that house prices are not driven by DCs, but by market demand. On December 7, 2018, MFOA and ORSTT wrote to the Minister of Municipal Affairs and Housing to express their position on the assertions. Further, on January 31, 2019, AMO also provided their position, articulated in the Provincial Housing Consultation, *“Increasing Housing Supply in Ontario”*. The letter and consultation paper can be found in 2019 Regional Council Report ([www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf](http://www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf)).

The 2019 report provides several competing arguments to the affordability assertion below:

The Fraser Institute argues it is “unwise to focus on any single element of housing demand when trying to explain rapid price growth ... fundamentals include population growth, income growth, housing supply and interest rates.”

The Pembina Institute, in a joint study with RBC, stipulates that “development charges in the GTA increased ... However, the increase in these charges account for only a small fraction of the increase in home prices.”

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Watson and Associates explain, that “It would be short-sighted to eliminate DCs to stimulate a marginal increase in housing ... while possibly causing many marginal income homeowners to lose their homes due to the increased tax/rate charges.” (2019 Regional Council Report: [www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf](http://www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf))

### ii. Assertion #2 – Replace DC with “Full Cost” Utility Rate Financing Model

One of the primary assertions made by C.D. Howe is that the elimination of development charges, with the development charges replaced through “full cost” user pricing that would be built into the utility rates, results in more affordable housing and better outcomes. However, there is no evidence that DC cost savings would pass from developers directly to home buyers. Replacing development charge revenue with utility rate revenue from water and wastewater bills would result in significant increases to the utility rate bill. Table I below provides a summary of the estimated impact on the average utility rate bills for the average household and small business in Peel.

**Table I: Impact of the Elimination of DCs on Utility Rate Bills**

For the period from 2024 to 2033	DCs	Utility Rate Increase needed	Annual increase to the average utility rate bill	
			Household	Small Business
Annual revenue to finance existing debt for growth-related infrastructure	\$110M	33%	\$377	\$396
Annual revenue for previously forecasted growth-related infrastructure expenditures	\$250M	68%	\$781	\$821
Estimated Annual Debt payment for additional infrastructure to achieve new Housing Target	\$250M to \$300M	68% to 80%	\$781 to \$935	\$821 to \$973
<b>TOTAL</b>	<b>\$610M to \$660M</b>	<b>169% to 181%</b>	<b>\$1,939 to \$2,083</b>	<b>\$2,038 to \$2,190</b>

As seen in Table I above, there would be an estimated increase of up to 181 per cent to the utility rate if the utility rate revenue was needed to replace the elimination of the development charge revenue that funds growth-related water and wastewater infrastructure.

For the period from 2024 to 2033, Peel is forecasting to receive, on average, \$360 million of development charge revenue per year. The development charges would be used to fund three general areas of the growth-related capital program for water and wastewater:

- Debt previously issued to finance the gap between DC revenues and current growth-related infrastructure.
- Previously forecasted growth-related (DC) infrastructure expenditures.
- Financing the additional growth-related infrastructure to achieve the new housing targets.

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The growth-related expenditures mentioned in sections a) and b) below do not include the full impacts and costs of advancing the required infrastructure to meet the Province's 2031 growth targets.

### **a) Impact of financing existing Debt with Utility Rate**

Debt has historically been used to manage the timing mismatch between DC revenues and expenditures. Contrary to what is asserted in the C.D. Howe report, revenues are not collected upfront and put into a reserve but rather the expenditures for the infrastructure are made upfront by Peel after which DCs are collected once development occurs. The Region has issued \$1.7 billion (\$1.5 billion currently outstanding) in DC-supported infrastructure debt related to water and wastewater, for which annual debt service costs are approximately \$110 million, the majority of which will continue to be required to service the existing debt for another approximately 20 years.

The elimination of DCs would necessitate debt services costs be funded from another revenue source, most likely the utility rate or the property tax base, noting that all municipal debt is general obligation debt. To raise the equivalent of \$110 million per year to fund the current debt if DCs were eliminated, the current utility rates would need to be increased by 33 per cent. This would have an impact of an additional annual cost of \$377 for the average household and \$396 for the average small business.

*Note: On October 29, 2024, the Region issued an additional \$265.3 million in debt for water and wastewater infrastructure which has not been included in the figures.*

### **b) Previously forecasted growth-related (DC) expenditures**

As mentioned earlier, current forecasts estimate that water and wastewater related DC revenues will average ~\$360 million per year between 2024 and 2033. After accounting for the \$110 million required to service existing debt, \$250 million is available to support current growth infrastructure costs.

If DCs were eliminated, then an increase to the utility rate of 68 per cent would be required to generate the revenue lost from DCs. This would have an impact of an additional annual cost of \$781 for the average household and \$821 for the average small business.

### **c) Funding/Financing the infrastructure to meet the new Housing Target**

Based on 2024 Capital Plan, water and wastewater DC expenditures are forecast to exceed the estimated \$250 million available to fund growth infrastructure. Current debt forecasts estimate that by 2033 annual debt service costs would reach approximately \$250 million to \$300 million per year.

If DCs were eliminated, an increase to the utility rate of 68 per cent to 80 per cent would be required to generate the revenue necessary to cover expected annual debt service costs. This would have an impact of an additional annual cost of \$781 to \$935 for the average household and \$821 to \$973 for the average small business.

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### Other considerations and Risks

#### Fairness

- Existing homeowners and businesses, who have already paid development charges in the past and are currently paying water and wastewater bills, would be funding the development of new residential households and new businesses.

#### Competing needs

- Eliminating dedicated growth funding and relying on the same funding source for the maintenance of existing assets could create competition between new growth and existing asset management plans (due to mandatory asset management requirements in the *Infrastructure for Jobs and Prosperity Act*).
- This forced prioritization could further slow the supply of serviced land available to developers and as a result, increase house prices.

#### Impact to Residents

- The extent of the cost transfer to utility rate payers may be tempered by opposition to new growth, as those rate payers realize new development will now result in higher rates.
- Higher rates will reduce housing affordability for seniors and lower income residents (as demonstrated in the Watson and Associates submission to the Province (refer to 2019 Regional Council Report: [www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf](http://www.peelregion.ca/council/agendas/2019/2019-02-14-rc-agenda.pdf)).
- Bill 23, the *More Homes Built Faster Act* (“Bill 23”), which the Province passed on November 28, 2022, limits municipalities’ ability to collect DC revenue to pay for growth-related expenditures. Bill 23 is estimated to result in a DC revenue shortfall of \$1.2 billion for the Region over a 10-year period, placing additional pressure on utility rates and/or property taxes to fund growth-related expenditures unless the Province makes the Region financially “whole” through other funding streams.

### iii. Assertion #3 – Municipalities have Substantial Water and Wastewater DC Reserve Funds and are not Deploying them on a Timely Basis

#### a) Current and historical water and wastewater DC reserve funds

C.D. Howe suggest that Ontario municipalities are sitting on large DC reserve funds, with large sums already collected but not yet deployed for water and wastewater infrastructure. Given actual historical data, this is not an accurate reflection of Peel’s current situation or historical practice.

As at December 31, 2023, the Region’s DC reserve fund balance for water and wastewater was negative \$430 million. While the Region has issued \$1.7 billion in debentures since 2010 to bridge the timing mismatch between growth-related expenditures and DC revenue collections, the Region has total future debt obligations of \$2.4 billion after taking into consideration interest payments on outstanding debt and other adjustments related to the debt.

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Table II below provides the details of the debt obligation.

**Table II: Summary of Water/wastewater DC Obligation**

	<b>Summary (\$millions)<sup>1</sup></b>
Gross Debt Issued (2010-2023)	\$1,709
Less: Prior Debt Maturities	\$200
<b>Total Debt Outstanding</b>	<b>\$1,509</b>
Less: Sinking Fund Assets	\$471
<b>Net Debt Outstanding</b>	<b>\$1,038</b>
Add: Outstanding Interest Payments	\$964
Less: DC Reserve Balance, Dec. 31, 2023	(\$430)
<b>Total DC Reserve Obligation</b>	<b>\$2,432</b>

Net Debt Outstanding expected to be partially offset by investment earnings over the life of the sinking funds.

**Table III: Water/wastewater Year End DC Reserve Fund Balance**

Table III below provides a summary of Peel’s DC water and wastewater reserve fund balance since 2009, which has been in a deficit position 11 times in the last 15 years.

	<b>Year End Balance (\$millions)<sup>1</sup></b>
2009	(\$282)
2010	(\$250)
2011	(\$3)
2012	\$140
2013	\$211
2014	\$67
2015	(\$102)
2016	\$8
2017	(\$79)
2018	(\$132)
2019	(\$239)
2020	(\$125)
2021	(\$163)
2022	(\$145)
2023	(\$430)

The water and wastewater DC reserve fund is not to mistaken with the water and wastewater capital reserve. This capital reserve is used to fund the state of good repair of Peel’s water and wastewater infrastructure as it ages and eventually needs to be

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<sup>1</sup> Figures in brackets represent negative values.

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replaced. Based on the 2024 Budget and Business Plan, the capital reserve is sufficient to sustain the state of good repair capital plan in the short term but projects a shortfall of \$1.8 billion over the next 20-year period which will require future infrastructure levies to fund the needed state of good repair work. This does not provide any excess balances to fund growth-related infrastructure.

### **b) Timing of Spending**

C.D. Howe contends that municipalities collect DCs prior to construction and are not developing the intended infrastructure on a timely basis, effectively "hoarding" DCs. Certain growth-related expenditures (e.g. water and wastewater related works) are required prior to development proceeding. As a result, DC expenditures are required prior to collection of the corresponding DC revenue. This may result in cashflow impacts for a municipality.

Many of the capital-intensive services Peel provides (e.g., water and wastewater) require the expenditures to be incurred well in advance of the building permit stage. Peel currently funds these projects from existing DC reserves or through debenture issuance to manage the timing mismatch between revenues collection and expenditures outlay. Recent trends (e.g., economic impacts on growth, increase in secondary units, increased work at home employment, legislative changes, etc.) have resulted in lower DC revenue collections than projected. Thus, creating greater pressure on timing mismatch between revenue and expenditure. Peel has also accumulated debt to pay for growth-related infrastructure and these debt charges must also be serviced through DC revenues. Any further increases to levels of debt may also negatively impact Peel's strong financial position.

## **RISK CONSIDERATIONS**

As presented in the February 14, 2019, staff report to Council, there is no evidence that DC cost savings would pass from developers directly to home buyers. DC reductions transfer infrastructure costs to existing homeowners (including low-income families and seniors, as well as businesses and the public sector) through increased utility rates. It is expected that any increases could cause opposition to new growth as homeowners and businesses begin to experience higher water and wastewater rates.

Eliminating DCs would also necessitate increased debt levels for the Region to manage utility rate increases and the debt services costs for existing and new debt would have to be funded from another revenue source, likely the utility rate or the property tax base. In addition, there is no guarantee that growth will occur at the pace expected and therefore the infrastructure expenditures and related debt charges will be borne by existing rate and/or taxpayers.

## **CONCLUSION**

Proposals to eliminate water and wastewater infrastructure costs from DCs would result in increases to the utility rate for households and businesses. There is no evidence that implementing such proposals will increase housing affordability. Further, contrary to C.D. Howe's claims, the Region's water and wastewater DC reserve balance has generally been

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negative given that the Region builds necessary growth infrastructure in advance of collecting related DC revenues.

### **APPENDICES**

Appendix I – Hosing Homebuyers: Why Cities Should Not Pay for Water and Wastewater Infrastructure with Development Charges

Appendix II – Time to Re-Think How to do Water and Wastewater Investment

Appendix III – Full Cost Recovery and Municipal Infrastructure Financing

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