Committee Report

To:	Warden Hicks and Members of Grey County Council
Committee Date:	August 11, 2022
Subject / Report No:	CAOR-CW-07-22
Title:	Rising Construction Prices and Impacts on Development Charges
Prepared by:	Randy Scherzer and Mary Lou Spicer
Reviewed by:	Kim Wingrove
Lower Tier(s) Affected:	All Municipalities
Status:	

Recommendation

1. **That report CAOR-CW-07-22 which provides information with respect to rising construction prices and the potential impacts on Development Charges be received; and**
2. **That staff be directed to continue to monitor the Development Charges Reserve and advise Council immediately should the Development Charges Reserve start approaching negative levels.**

Executive Summary

The County Development Charges Background Study was completed in 2021. A number of growth-related capital projects were identified as part of the background study and form the basis for the per unit development charges levied on new construction. The funds available in the development charges reserve are impacted by both the cost of growth-related capital projects and the amount of DC eligible new building activity taking place.

The costs for the growth-related capital projects in the DC background study were estimated using the best available information at that time. Construction prices have risen significantly over the past few months which has been attributed to a number of factors including an increase in costs associated with labour, fuel, materials, etc. The County has experienced anywhere between a 10 to 30% increase in various construction costs compared to 2021 estimates and it is expected that construction prices will continue to increase into 2023.

On the revenue side, given the increase in construction costs, and escalating interest rates, the rate of development growth and corresponding DC contributions could decrease compared to what was previously projected.

The increase in construction costs combined with the potential slowdown in growth and the withdrawal of funds for Rockwood Terrace and affordable housing builds that only become DC eligible projects in the 2021 study will likely impact the development charges reserve and push this into a negative position prior to the development charges 5-year review scheduled to occur in 2026. County development charge rates are subject to annual indexing according to changes in the Statistics Canada Non-residential Building Construction Price Index (NRBCPI) for Toronto; charges will increase on January 1, 2023 if there has been an increase in that index. Staff recommend that the situation be continually monitored and to provide any further updates to Council if there is a significant shift to the DC reserve levels, the capital project costs, and the amount of DC revenue received through growth.

Background and Discussion

The County prepared an updated Development Charges Background Study in 2021 with the assistance of Hemson Consulting. The Development Charges Background Study provides a summary of the housing and employment growth projections estimated at that time and also identifies the growth-related capital projects required to accommodate the projected growth. Housing and Long Term Care became eligible categories after the previous study was completed and were therefore incorporated in the 2021 study. This information was then used to calculate the development charge rates to be applied to both new residential and non-residential developments. The estimated capital costs for the projects identified in the Development Charges Background Study was based on what we were seeing in terms of construction prices in previous years as well as what was being experienced in 2021.

Construction prices have increased significantly over the past few months, and it is anticipated that construction prices will continue to increase in 2023. The County has experienced anywhere between a 10% to 30% increase in various construction costs compared to 2021 which can be attributed to a number of factors including an increase in costs associated with labour, fuel, materials, asphalt concrete (AC), etc.

For growth-related capital projects, the DC eligible portion is typically funded from DC reserves which is based on the DC revenue that has been collected to cover the growth-related portion of the capital project costs. The DC Revenue from residential and non-residential growth is collected based on the DC rates that were calculated as part of the DC Background Study and which are reflected in the DC By-laws. The development charge rates are adjusted annually on January 1st of each year to account for any increases seen in construction prices. The adjustments (indexing) of the development rates are in accordance with the (NRBCPI) for Toronto based on the preceding twelve-month period ending September 30th. This index is the only index permitted under the Provincial legislation for indexing development charges. A future report will be provided to Council later this year once the CPI is known. The annual CPI reported in the 1st Quarter of 2022 was 17.3% and therefore if construction prices stay the same or continue to increase then we could see an increase to the development charge rates by at least 17.3% which would come into effect January 1, 2023. In speaking with Hemson, they noted that there is typically a lag between the index and the actual tendered costs for capital projects. Hemson also noted that the index typically does not fully reflect municipal expenditures for construction capital projects, even though the index is calculated using specific construction materials and labour costs.

Although the Construction Price Index could increase the development charge rates applied to each development, the actual revenue received from development is based on the amount of development that occurs. Given the rising costs of construction and the increasing interest rates, we could see a slower rate of growth compared to what we have experienced over the past several years. If the rate of growth is less than the original growth projections identified in the DC Background Study this could have an impact on the amount of revenue received from development charges.

The combination of an increase to capital projects due to rising construction prices and a potential decrease in DC revenue should a slower rate of growth be realized, could result in the Development Charge Reserves going into a negative positive over the next 5 years. For 2023 Capital Projects, staff will be applying increased estimates for projects to account for the anticipated construction price increases. For growth related capital projects, the DC eligible percentage shown in the DC Background Study is being applied to increased capital project costs. For example, if a project was estimated to cost $900,000 in 2021 with $810,000 being funded from DC's (i.e. 90% DC eligible) and the 2023 project estimate is now $1,000,000, then the DC eligible portion would be shown as $900,000 (i.e. 90% - same DC eligible percentage identified in the DC Background Study for that project).

Finance staff have run some scenarios to account for the anticipated construction price increases and the projected DC revenue received from growth, and it is possible that the Development Charges Reserve could go into a negative position as early as 2027. There are several options that could be considered to avoid having the DC Reserve going into a negative position.

1. **Defer Capital Projects** - Adjust growth-related capital projects based on the amount of growth being experienced and based on the availability of funds to finance the capital projects. If growth were to be slower than projected, growth-related capital projects could be deferred until growth picks back up and until the DC revenue/reserves are sufficient to fund the growth-related capital projects. This may be challenging as there are some growth-related capital projects that need to move forward based on the growth that has occurred over the past few years. In some cases, it also better to move forward with projects ahead of the anticipated growth to ensure that the infrastructure and services are ready for the growth when it does occur. Staff will continue to monitor the growth, as well as the available funding, to ensure that the timing of the growth-related capital projects is appropriate based on the rate of growth.

2. **'Open' up the DC By-law and Update DC Background Study** - Should the DC Reserves start to go into a negative position prior to the next DC Review Update, an option would be to 'open' up the DC By-law to determine if the DC Rates should be increased based on the increase cost of capital projects. This would require an interim update to the DC Background Study to recalculate the DC rates and would require a public meeting. A consultant would need to be hired to assist with this process. Staff would continue to track construction pricing against the index, as well as continue to monitor the DC revenue/reserves to fund growth-related capital projects and should the DC Reserves approach a negative position then staff would recommend that the DC by-law be 'opened' prior to 2026.

3. **Put DC Reserves into Negative Position or Debt-Finance** - Another option is to drive the DC Reserve funds into a negative position with the hope that growth rates will continue as projected. This would ensure that growth-related capital projects continue; however, the potential risk is that should growth be less than what was projected then it could mean the DC reserves remain in a negative position for quite some time or worst-case scenario may never recover. For fast-growing municipalities this option is less risky as the DC revenue will likely remain consistent or continue to increase to help put the reserves back into a positive position. There is also the option to debt-finance certain growth-related capital projects and to pay back the amount borrowed that is DC eligible using the DC Revenue that is collected over a period of time. Again, the risk could be that growth may be less than what was anticipated and therefore paying back the portion of the debt to be financed through DC's could take longer than anticipated or interim funding sources may be required to pay back that debt until the DC's are collected. Staff do not recommend putting the DC reserves into a negative position if possible and would only recommend debt-financing associated with larger projects where a portion of the funds is to come from DC revenue and where the debt-financing could work (e.g. Rockwood Terrace Campus of Care, Patrol D, County Housing Builds, etc.).
4. **Monitor Capital Costs Against DC Reserves and DC Revenue** – Another option is to continually monitor the DC Reserves and incoming DC Revenue against the Capital project costs to ensure that the DC Reserves are not approaching a negative position. Staff generally do this already but given the increasing construction costs and the uncertainty of the impact on growth associated with the rising interest rates and inflationary increases, it is recommended that staff monitor this on a quarterly basis. If staff see a significant shift in DC Revenue (i.e. significant drop in growth rates) or a significant shift in capital project costs resulting in the DC Reserves being utilized at a quicker rate than anticipated, then staff would report back to Council and may recommend some of the other options outlined above.

Based on the current state of the DC Reserves, staff recommend Option 4 at this stage (i.e. monitor DC reserves and DC revenue against capital project costs) and report back to Council should any significant shifts occur to DC revenue and capital project costs or if DC reserves start approaching a negative position. Staff will also continue to monitor the growth that is occurring compared to the projected growth rates to ensure that the timing of the growth-related capital projects is appropriate.

Legal and Legislated Requirements

Sections 5 and 10 of the Development Charges Act, 1997 requires that the amounts of development charges to be collected under a development charges by-law be determined by a formal background study, including increases in amounts of charges over and above increases due to indexing.

Section 7 of Ontario Regulation 82/98 specifies that the only permissible index for indexing development charges is the Non-Residential Building Construction Price Index

Financial and Resource Implications

Work on the 2023-2032 10 Year Capital Forecast is currently underway; preliminary numbers indicate that the Development Charges Reserve Fund will have a negative balance of approximately $2.2 million in 2027 and reach a negative balance of $5.8 million in 2032. A number of factors are considered in developing the capital forecast including the timing and cost of the various projects. Housing and Long Term Care became DC eligible categories in the 2021 study and the projected timing of withdrawals for the Redevelopment of Rockwood Terrace and Housing builds has an impact on the reserve fund.

The Development Charges Reserve Fund estimated balance is based on the unit growth forecast and annual increases to the development charge per unit from the 2021 Development Charges Background Study and reflects funds to be withdrawn for DC eligible projects. These assumptions will continue to be monitored and refined as information becomes available.

Relevant Consultation

☒ Internal: Finance, Transportation Services

☒ External: Hemson

Appendices and Attachments

Development Charges Background Study

DC By-law 5127-22 County-Wide Roads and Related Development Charges

DC By-law 5128-22 General Services Development Charges