REPORT

To: ONE Joint Investment Board
From: Colin MacDonald, Manager of Investments, ONE Investment
Date: March 1, 2023
Re: Municipal Insights Report 1
Report: ONE JIB 2023-009

1. RECOMMENDATIONS

It is recommended that the Board:

1. Receive the report.

2. SUMMARY

Municipalities are experiencing significant pressures as they work through their annual budget cycles. Significant changes to legislation are likely to impact the way they pay for growth-related infrastructure. Initial estimates indicate that the province-wide impact on municipal finances could be in the range of a $5 billion shortfall over the next nine years. The actual impact is unknown due to some yet unanswered questions about implementation and support the province may provide to keep municipalities "whole." Additionally, municipalities are dealing with inflationary pressures, which will likely lead to difficult decisions involving a mix of property tax and user fee increases, service level reductions, and infrastructure maintenance deferrals.

3. BACKGROUND

Many municipalities in Ontario use development charges and parkland dedication cash-in-lieu provisions to fund growth-related expansion to infrastructure

Development charges are fees collected on new development and are the primary funding source for infrastructure needed to service growth in municipalities. The *Development Charges Act, 1997* (DCA) sets out the rules to enable municipalities to collect development charges (DCs) to fund growth-related capital costs related to new development. The *Planning Act, 1990* (PA), on the other hand, allows municipalities to collect parkland dedication funds (parkland cash-in-lieu) for park and recreation capital costs related to new development. The PA also permits the collection of community benefit charges (CBCs), which can be applied to developments that will increase density by building higher. The combination of DCs, parkland cash-in-lieu and CBCs allow municipalities to pay for the infrastructure that unlocks growth and builds communities.

The *More Homes Built Faster Act, 2022* (Bill 23) makes significant changes to the legislation governing development charges and parkland dedications

Bill 23 received royal assent on November 28, 2022. The Bill introduced many changes to the legislation including, but not limited to:

- Exemptions and discounts for certain types of residential units, which would apply to both the DCA and the PA,
- Introducing a 5-year phase-in period for new DC By-laws (which set out DC rates)
- Making previously eligible costs for DCs ineligible (e.g., DC background study and costs for acquisition of land on which to build infrastructure)

The intent of the legislation is to increase housing supply by reducing some of the up-front municipal fees and the length of municipal approval processes for new housing projects. This is based on an assumption that the time and money saved by the development industry will be reinvested into additional housing projects. The changes further assume that this increase in supply will eventually affect the market price of housing in Ontario. Moreover, through the legislation the province is introducing new housing build targets for municipalities, indicating that some provincial funding will be tied to meeting these targets.

Municipalities, like the public, are feeling the impacts of high inflation, which could adversely affect reserve fund forecasts

Municipalities, like everyone, are feeling the impacts of high inflation. The Consumer Price Index (CPI) alone is usually not an accurate indicator of changes to municipal costs. As municipalities must build a lot of capital infrastructure, the Non-Residential Building Construction Price Index (NRBCPI) is often used as a proxy for forecasting inflationary pressure on capital budgets, particularly with respect to facilities. However, both measures are imperfect indicators of municipal inflation. Some municipalities, and the Federation of Canadian Municipalities, have advocated for Statistics Canada to develop a Municipal Price Index (MPI), while others use an internally calculated MPI for the purposes of budget discussions. The most recent inflation figures for Ontario can be found in Table 1.

Table 1: Price Indices often used by municipalities to forecast inflationary pressure (Source: Statistics Canada)

Index	Period	Census Area
CPI	Dec 21 – Dec 22	Ontario – 6.03%
NRBCPI	Oct 21 – Oct 22	Toronto – 15.6% Ottawa – 12.56%

Source: Statistics Canada Tables 18-10-0004-01 (CPI) and 18-10-0135-01 (NRBCPI)

Some factors that may affect a municipality's ability to manage inflation include but are not limited to:

- collective bargaining agreements may contain specific provisions on cost-of-living adjustments
- public sensitivity to property tax rate increases
- supply chain issues, resulting in municipalities sourcing used rolling stock (e.g., vehicles, snowplows) through auctions or other channels

- high demand in the construction industry, resulting in higher-than-expected bids for capital projects, an issue that may be exacerbated in northern or rural communities where fewer bids are often received.

4. ANALYSIS

The full financial impact of Bill 23 on municipalities is currently uncertain, but one estimate suggests a potential shortfall of approximately $5 billion over the next nine years

The Association of Municipalities of Ontario released early estimates of the financial shortfall of Bill 23 at $5 billion across the province over the next nine years. The Provincial government has committed to keeping municipalities "whole" and is launching a third-party audit of municipal finances in select communities. At present there is no consistent methodology for calculating the financial impacts of Bill 23. However, work is underway at the Municipal Finance Officers' Association of Ontario to develop a consistent framework to estimate these impacts.

The effect of the new legislation will be to shift a portion of growth-related costs from new development to existing residents. Municipalities have signaled that significant property tax rate increases are likely if the province does not cover the shortfall in development charge revenue. They have also indicated that without provincial funding they may not be able to construct the infrastructure required to meet the new housing targets. They may even approve fewer new housing developments than they are now to avoid excessive property tax increases for existing residents.

Six of the nine Participating Municipalities collect development charges and all collect parkland dedications cash-in-lieu

Of the nine Participating Municipalities, Quinte West, Bracebridge, Huntsville, Innisfil, Whitby and the District of Muskoka collect development charges. While the proposed legislation will impact all pf these municipalities, development charges are more heavily relied upon in high growth areas. As a very high growth municipality with high DC reserve fund balances, Whitby's reserve forecasts may see an impact in the nearer term. Innisfil, which has been projecting significant DC collection growth, will also see its forecasts reduced.

The municipal budgeting cycle takes place throughout the winter and spring, meaning decisions and impacts with respect to inflation are still being made

Municipal budget deliberations typically begin in the latter part of the year and flow through into the next year, with most budgets approved in the Winter or early Spring. The pressures of inflation and looming uncertainty around Bill 23 will require municipalities to find a delicate balance. They will need to ensure the services on which the public depends do not suffer unduly and necessary infrastructure investments continue to be made, while also considering the effect of property tax increases on their residents and businesses. This will likely result in a combination of property tax increases and user fee increases that may not meet the projected shortfall. It also means that other approaches, including increased transfers from reserves, increased debt, service level decreases (including deferring capital maintenance), will be required to make up the difference.

5. CONCLUSION

New legislation and increased cost pressures are likely to affect future reserve levels and therefore municipal long-term financial planning. The effect on infrastructure investment to support new development is unclear. ONE Investment staff is not yet seeing the impact of the new legislation on reserve forecasts and MCQ updates; however, it is likely to have cascading effects in future years.

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