City of Mississauga

Corporate Report

MISSISSAUGA

Date: January 8, 2021 To: Chair and Members of General Committee From: Gary Kent, CPA, CGA, ICD.D, Commissioner of Corporate Services and Chief Financial Officer	Originator's files:
	Meeting date: January 27, 2021

Subject

Development Charges Interest Rates and Associated Payments Policy

Recommendation

1. That the report entitled "Development Charges Interest Rates and Associated Payments Policy" dated January 8, 2021 from the Commissioner of Corporate Services be received.
2. That the Development Charges Interest Rates and Associated Payments Policy attached as Appendix 1 to this report be approved.
3. That a full time equivalent (FTE) Financial Analyst position (Grade F) be approved to administer the responsibilities being moved to Development Financing, including the calculation and collection of DCs and new administration related to the DC Interest Rates and Associated Payments Policy, and including on behalf of the Region of Peel.
4. That a new reserve fund entitled "Discretionary DC Exemption" Reserve Fund #35600 be created to be used to fund future exemptions related to the DC deferrals.
5. That the Commissioner of Corporate Services and Chief Financial Officer and the City Clerk, or their delegate, be authorized to execute any necessary agreements under the *Development Charges Act, 1997* and Development Charges Interest Rates and Associated Payments Policy.

Report Highlights

- Legislative changes that came into effect January 1, 2020, to the *Development Charges Act, 1997* and *Planning Act* have an impact on how development charges are calculated and collected for certain developments.
    - Development Charges (DCs) can be frozen or "locked in" at an earlier stage in the development process for site plan and zoning amendment applications.

- Certain types of developments (rental housing, institutional development and non-profit housing) are now entitled to a DC deferral over a number of annual instalment payments.
- The legislation allows municipalities to charge interest on DC rates that are frozen, and on deferred DC payments.
- An interest rate of 5.5 per cent per annum is proposed to be applied to DC rates that are frozen, and an interest rate of zero per cent per annum is proposed to be applied to deferred DC payments, retroactive to January 1, 2020 as per the legislation effective date. These interest rates are in line with those charged by the Region of Peel.
- The zero per cent annual interest rate on deferred DC payments is considered a discretionary exemption, and must therefore be made up through non-DC (i.e., tax) sources. The estimated cost to the City for offering a zero per cent interest rate on DC deferral payments is $2.8M per year.

Background

On May 2, 2019, the Honourable Steve Clark, Minister of Municipal Affairs and Housing presented the “More Homes, More Choice: Ontario’s Housing Supply Action Plan” (the Plan), with the goal of increasing the supply of new ownership and rental housing in Ontario. The Plan is supported by the *More Homes, More Choice Act, 2019,* omnibus Bill 108, that was introduced to the Provincial legislature and carried on the first reading (May 2, 2019).

Bill 108 and the *Plan to Build Ontario Together Act, 2019* (Bill 138) amended the *Development Charges Act, 1997* (DC Act) and *Planning Act, 1990*. Some amendments have been proclaimed and came into effect on January 1, 2020. More recently, the *COVID-19 Economic Recovery Act, 2020* (Bill 197) came into effect on July 21, 2020.

One of the changes that came into effect on January 1, 2020 allows municipalities to apply an interest rate to development charges (DCs) under certain circumstances, and affect when and how DCs are calculated and collected. DC rates are now frozen at the time of site plan or zoning application submission rather than being determined at building permit issuance. Furthermore, a number of development types are eligible for DC deferral instalment payments beginning at occupancy permit. In both of these instances, the legislation allows municipalities to charge an interest rate to a “maximum prescribed rate” although at this time no maximum prescribed interest rate has been identified in the legislation.

Region of Peel Council approved an interest rate policy on July 9, 2020. The policy allows for a DC freeze interest rate of 5.5 per cent per annum (not compounded) and a DC deferral interest rate of zero per cent per annum for developments eligible for the regulated deferral (this includes non-profit and for-profit rental developments). The City collects DCs on behalf of the Region. In an effort to streamline the collection and administrative process, the interest rates proposed in this report align with the Region of Peel rates.

Comments

The intent of the recent legislative changes is two-fold. First, the changes provide greater cost certainty of development charges payable for all development types earlier on in the planning process (DC freeze). Second, the deferrals represent a financial incentive to help certain developments, particularly non-profit developers, by providing cash-flow management assistance.

DC Rate Freeze

Prior to this new legislation, DCs were payable at the time of building permit issuance, based on the DC rates in effect at that time. Under the new legislation, DC rates are “locked-in” or frozen at an earlier stage of the development approval process; at either site plan application date or zoning by-law amendment application date, for those applications made after January 1, 2020. In the event a developer resubmits a site plan or zoning by-law amendment application, DC rates are recalculated based on the new submission date. Building permit issuance must occur within two years of the site plan approval or enactment of the zoning by-law amendment to maintain the frozen DC rate, otherwise DCs are calculated at the DC rates at time of building permit issuance. DCs are still collected at the time of building permit issuance for developments that are not eligible for the DC freeze rate.

Freezing DC rates at an earlier stage in the development application process will lower DC revenues. The frozen DC rates are no longer subject to DC rate indexing which is a semi-annual adjustment for inflation. A more significant loss of revenue is expected when the DC rates are updated through the DC background and by-law updates, as there is no opportunity to adjust the frozen rates. The freezing of rates at an earlier period than when it is collected creates a disconnect between when DCs are payable and when services are expected to be developed.

As such, it is reasonable that the City apply interest to development charges that are frozen to account for adjustments in inflation and expected revenue losses over time.

<u>Interest Rate Proposal for the Freeze Rate:</u>

As permitted under Section 26.2(3) of the *Development Charge Act,* staff recommend a 5.5 per cent annum interest rate (not compounded annually) applicable to DC freeze rates. This aligns with the Region of Peel DC freeze annual interest rate.

DC Deferrals

Bill 108, as amended by Bill 138, provides developers of rental housing, institutional developments, and non-profit housing development the option of deferring DC payments over a defined number of years. Rental housing and institutional developments (including long-term care homes, retirement homes, universities and colleges, and memorial homes) can now defer DC payments over five years in six annual instalments. Non-profit housing developments can defer DC payments over 20 years in 21 annual instalments. These annual instalments begin on the earlier of the date of the issuance of a building permit authorizing occupation of the building and the date the building is first occupied. This is a change from the existing process where full payment of DCs are due at building permit issuance.

The purpose of DC deferrals is to help certain developments manage cash flow pressures, as the legislation recognizes some of the financial challenges that institutional developers and purpose-built rental housing developers (both market and non-profit) encounter early on in the development process.

This incentive is in line with the City's Housing Strategy – *Making Room for the Middle* – which identifies the need to reassess City charges and taxes and to "make the pro forma work" to ensure that costs and charges are not unintentionally discouraging the development of affordable housing, including rental housing, housing for individuals requiring assistance, and housing developed by non-profits. The Housing Strategy calls on the City to explore ways to support new affordable housing, including consideration of financial support or granting relief from charges for affordable units. The Housing Strategy also speaks to the need to incentivize purpose-built rental housing, which can help to improve the City's current vacancy rate of 1.2%, which is considered "unhealthy."

Although DC deferrals represent an incentive to specific development types, these deferrals create a significant gap in the period of time between when services are needed to support growth and when DCs are received. This will result in a negative impact on the City's capital spending cash flow. Deferral of DCs also creates a non-collection risk to the City given the extended instalment period. Developments that are deferring DC payments will be asked to enter into a Development Charges Payment Agreement with the City that outlines the payment schedule and terms. The legislation does allow for overdue DC payments to be transferred to the tax roll and collected in the same manner as taxes. Since granting of deferrals is automatic in legislation, the City will also be entering into Development Charges Prepayment Agreements when a developer chooses to not defer their DC payments or agrees to a shorter or different deferral agreement.

Interest Rate Proposal for Deferral Payments:
Staff recommend a zero per cent interest rate on deferred DC payments, to support the City's Housing Strategy and alignment with the Region of Peel DC deferral annual interest rate.

Administrative and Financial Issues Associated with the New Policy
The deferral of DCs with no interest rate applied will further improve the financial viability and sustainability of specific developments, including affordable housing projects. Based on eligible developments currently in the pipeline, and assuming an interest rate of 5.5% (the same interest rate applied to frozen rates), staff estimate the value of the foregone interest to be $28M over the next 10 years, or $2.8M annually.

The zero per cent annual interest rate on deferred DC payments is considered a discretionary exemption, and must therefore be made up through non-DC (i.e., tax) sources. This exemption is similar in nature to the grant approved by Council for Places for Religious Assembly, where the square footage dedicated to new worship space is exempt from DCs, but an equivalent amount is contributed from tax.

In order to minimize the impact on operating expenditures in any one year, the establishment of a “Discretionary DC Exemption” Reserve Fund is proposed. The purpose of this Reserve Fund would be to fund any discretionary DC exemptions approved by Council. The Discretionary DC Exemption Reserve Fund would be funded through tax, and the 2022 operating budget request may include up to $2.8M to fund this Reserve Fund.

The City collects DCs on behalf of the Region, GO, and the School Boards. Although DC payments will be more forecastable for developers, the introduction of the DC rate freeze and deferral payments have added additional complexity to DC administration:

- Quotes and invoices provided to developers will need to be very detailed and specific, identifying what amount of interest will be charged on the frozen DC rates, depending on when the developer requests a building permit. It is unknown when building permits will be requested, so multiple calculations will be needed based on a variety of scenarios. Developers can then determine how much DCs are payable, depending on the date they plan on pulling their building permit.
- Tracking systems must be established, and data must be monitored, regarding all DC applications based on site plan/zoning application date, building permit issuance date, occupancy date and six-to-21 years of deferral payments. The City does not currently specifically identify occupancy date, since DCs have been payable in full at the time of building permit issuance. Technology solutions to automate the tracking of payments are currently being investigated by staff.
- Processes and notifications will be developed to remind developers of payments due.
- Processing of payments, issuance of electronic fund transfer (EFT) information, processing of refunds for adjusted or cancelled building permits, calculation and processing of letters of credit.
- Responding to developer inquiries and education on new processes and legislation.
- DC adjustments (e.g., change of use) will be increasingly complex depending on the type of development.
- Legal agreements must be entered into for all deferral agreements, and specific legal agreements must be developed in the event a developer chooses to prepay when deferral is an option. The latter is completely at the discretion of the developer.
- DC projections will be much more challenging given the different cashflows based on the different type of developments. Reserve Fund projections will be increasingly complex, taking into account types of developments and potential interest rate deferrals. The Discretionary DC Exemption Reserve Fund will require particular attention to ensure sufficient funding is included in the operating budget.

To date, DC administration has resided within the Building Division. Given the additional complexities related to the new legislative changes, including the calculation of interest rate charges and tracking of payments, the Finance Division will be taking over the DC administration. The added work will require the addition of one FTE, as the Development Financing section is understaffed and cannot accommodate any additional workload. This complement will also be responsible for administering the Community Benefits Charge (CBC), planned to come into effect in early 2022.

Future Updates to DC Frozen and Deferral Interest Rates
Staff will monitor and review DC revenue impacts from both frozen and deferred DCs. Staff will report back to Council should a change in interest rates be needed.

Financial Impact

The zero per cent annual interest rate on deferred DC payments is considered a discretionary exemption, and must therefore be made up through non-DC (i.e. tax) sources. Based on eligible developments in the pipeline, staff estimate that the approximate value of the interest is $2.8M each year over 10 years. The new Discretionary DC Exemption Reserve Fund will be used to stabilize the impact of these exemptions on the operating budget. The 2022 operating budget may include a request up to $2.8M to fund this Reserve Fund on an annual basis.

One additional FTE is required in Finance to administer the new legislative changes as well as the transfer of DC calculations, invoicing and payment collections from the Building Division. This complement will also be responsible for administering the new CBC. Funding for this FTE will be accommodated in 2021 by the Finance and Building Divisions.

Conclusion

Recent legislative changes brought about by *The More Homes, More Choice Act, 2019* (Bill 108) and the *Plan to Build Ontario Together Act, 2019* (Bill 138) have resulted in a number of changes to the City's development charges processes. The legislation allows municipalities to freeze development charge rates at the time of site plan or rezoning application. It further allows DC payment deferrals for developments including rental housing, institutional developments and not-for profit housing.

An interest rate policy has been attached as Appendix 1 for Council approval. Staff recommend an interest rate of 5.5 per cent (not compounded) be applied to the frozen DCs and an interest rate of zero per cent for deferred DC payments, with an equivalent interest rate (based on 5.5%) to be contributed from tax. A full time equivalent (FTE) Financial Analyst position (Grade F) is requested to administer the responsibilities being moved to Development Financing from the Building Division including the calculation and collection of DCs, as well as to administer the new requirements related to the DC Interest Rates and Associated Payments Policy. A new Reserve Fund is also requested to fund future exemptions related to the DC deferrals. The DC interest rates will be reviewed over time and any adjustments will be presented to Council for consideration.

Attachments

Appendix 1: Corporate Policy Development Charges Interest Rates and Associated Payments

G. Kent.

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