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Ontario's Development Charges Regime Recent Developments

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Ontario Development Charges Regime - Recent Developments

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Historical Perspective

In the past century, Ontario experienced significant population growth which in turn led to a boom in construction and development, and rapidly expanding urban municipalities. This boom was not necessarily accompanied by a corresponding provision of adequate servicing and transportation facilities. As a result, municipalities in Ontario had to explore different ways of financing municipal infrastructure required to meet the increased need for services resulting from growth and land development.

Municipalities have used various methods to finance municipal infrastructure, including (i) the issuance of debentures, (ii) special capital levies, (iii) subdivision agreements, (iv) lot levies (which have been overtaken by the development charges regime), (v) developer cost sharing agreements, (vi) provincial grants and subsidies, and (vii) property taxes. An historical overview of some of the methods used to finance municipal infrastructure can be found in our paper entitled *Financing of Municipal Infrastructure to Support Development: An Historical Perspective*[1].

In 1989, the Province enacted the *Development Charges Act, 1989* (the "*DC Act, 1989*")[2], which gave municipalities the authority to pass by-laws imposing charges on all forms of development to recover the net capital costs of services related to the development.

The legislation was amended significantly with the passage of the *Development Charges Act, 1997* (the "*DC Act, 1997*")[3]. Among other things, the *DC Act, 1997* reduced the scope of the services that could be funded through development charges by eliminating services that were not considered to be essential for new development and that would benefit the community more broadly. A list of ineligible services, i.e. services for which a development charge may not be

[1] *Financing of Municipal Infrastructure to Support Development: An Historical Perspective*, by Dennis H. Wood and Sharmini Mahadevan, December 2004, www.woodbull.ca (Resources, Wood Bull Publications).

[2] *Development Charges Act, 1989*, S.O. 1989, c. 58.

[3] *Development Charges Act, 1997*, S.O. 1997, c. 27.

imposed, is included in subsection 2(4) of the *DC Act, 1997*[4]. The list in subsection 2(4) is not exhaustive, as it provides for other ineligible services to be prescribed by regulation[5]. The 1997 legislation also identifies "the method" for determining development charges[6].

The Province is now contemplating further changes to the development charges regime, with the introduction of Bill 73, *Smart Growth for Our Communities Act, 2015*, on 5 March 2015. This paper does not comment on the proposed Bill 73 amendments, as Bill 73 is being addressed in other presentations.

Development Charges

With the introduction of the *DC Act, 1989*, municipalities had the option of financing municipal infrastructure related to growth through the imposition of development charges. The *DC Act, 1989* defined a "development charge" as "a charge imposed with respect to growth-related net capital costs against land under a by-law passed under section 3"[7]. While the *DC Act, 1997* does not include a definition of "development charge", subsection 2(1) describes a development charge as a charge "against land to pay for increased capital costs required because of increased needs for services arising from development"[8]. The legislation is based on the principle of ensuring that "growth pays for growth"[9].

Although there are several ways in which municipal infrastructure can be funded, development charges have become an important option to many municipalities and an integral part of financial

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[4] *Development Charges Act, 1997*, s. 2(4).

[5] *Id*, s. 2(4)7.

[6] *Id*, s. 5(1).

[7] *Development Charges Act, 1989*, s. 1.

[8] *Development Charges Act, 1997*, s. 2(1).

[9] MMAH, *Development Charges in Ontario, Consultation Document, Fall 2013*, page 1.

planning. Many municipalities across the Province now use development charges as a key tool to finance "hard" services such as roads, water, storm water, and waste water, and "soft" services such as libraries, recreational facilities, and parkland development.

In the face of the increasing use of development charges as a funding mechanism and the escalating amounts of such charges, the interpretation of the method and the methodology used by some municipalities to calculate development charges has come under considerable scrutiny. This scrutiny has resulted in lengthy Ontario Municipal Board ("Board") proceedings and landmark decisions regarding the methodology used to calculate development charges.

This paper focuses on the decision of the Board, issued on 18 March 2015[10], in a recent case involving a challenge by the Building Industry and Land Development Association ("BILD") and others relating to the methodology used by three GTA municipalities to determine development charges. The decision of the Board (the "Clarington/Markham Case") addresses the first phase of the Board's proceedings relating to the appeals of the Municipality of Clarington and the City of Markham development charges by-laws.

An earlier decision of the Board involving the Orangeville District Home Builders Association and the Town of Orangeville (the "Orangeville Case")[11] is also discussed as it provides important context to the Clarington/Markham Case.

Legislative Prerequisites

The authority for a municipality to impose development charges is set out in subsection 2(1) of the *DC Act, 1997* which provides that:

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[10] *Smooth Run Developments Inc. v. Clarington (Municipality)*, [2015] O.M.B.D. No. 229.

[11] *Orangeville District Home Builders Assn. v. Orangeville (Town)*, [2010] O.M.B.D. No. 762, motion for leave to appeal dismissed [2011] O.J. No. 1393 (Div. Ct.).

> *The council of a municipality may by by-law impose development charges against land to pay for increased capital costs required because of increased needs for services arising from development of the area to which the by-law applies.*[12]

The two prerequisites are: (i) there must be an "increase" in the needs for services, and (ii) there must be an "increase" of capital costs arising from the increased needs. As indicated by the Board in the Orangeville Case, subsection 2(1) "ensures and demands that the development charges would be for the increase in costs arising from the increased needs of the service and not for the entitlement or privilege of using the service"[13].

As the language of subsection 2(1) refers to an "increase" in the needs for services, the Board in the Orangeville Case clarified that a municipality cannot resort to development charges to fund a new service.[14] Once a service has been funded through other mechanisms, the foundation would then be laid for the imposition of development charges in the future if the requirements of subsection 2(1) are met.

Subsection 5(1) of the *DC Act, 1997* establishes "the method that must be used …. to determine the development charges that may be imposed"[15]. The method to be used includes the following:

> 1. *The anticipated amount, type and location of development, for which development charges can be imposed, must be estimated.*
>
> 2. *The increase in the need for service attributable to the anticipated development must be estimated for each service to which the development charge by-law would relate.*
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> 3. *The estimate under paragraph 2 may include an increase in need only if the council of the municipality has indicated that it intends to ensure that such an increase in need will be met. The determination as to whether a*

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[12] *Development Charges Act, 1997*, s. 2(1).

[13] *Orangeville District Home Builders Assn. v. Orangeville (Town)*, [2010] O.M.B.D. No. 762, para 33.

[14] *Id*, paras 35 and 40.

[15] *Development Charges Act, 1997*, s. 5(1).

council has indicated such an intention may be governed by the regulations.

4. *The estimate under paragraph 2 must not include an increase that would result in the level of service exceeding the average level of that service provided in the municipality over the 10-year period immediately preceding the preparation of the background study required under section 10. How the level of service and average level of service is determined may be governed by the regulations. The estimate also must not include an increase in the need for service that relates to a time after the 10-year period immediately following the preparation of the background study unless the service is set out in subsection (5).*

5. *The increase in the need for service attributable to the anticipated development must be reduced by the part of that increase that can be met using the municipality's excess capacity, other than excess capacity that the council of the municipality has indicated an intention would be paid for by new development. How excess capacity is determined and how to determine whether a council has indicated an intention that excess capacity would be paid for by new development may be governed by the regulations.*

6. *The increase in the need for service must be reduced by the extent to which an increase in service to meet the increased need would benefit existing development. The extent to which an increase in service would benefit existing development may be governed by the regulations.*

9. *Rules must be developed to determine if a development charge is payable in any particular case and to determine the amount of the charge, subject to the limitations set out in subsection (6).*

While subsection 5(1) sets out a detailed set of rules, it does not provide the specific methodology to be followed in calculating the charge.

The requirements set out in subsection 5(1) include the requirement for a municipality to develop rules subject to the limitations set out in subsection 5(6) which provides as follows:

The rules developed under paragraph 9 of subsection (1) to determine if a development charge is payable in any particular case and to determine the amount of the charge are subject to the following restrictions:

1. *The rules must be such that the total of the development charges that would be imposed upon the anticipated development is less than or equal*

to the capital costs determined under paragraphs 2 to 8 of subsection (1) for all the services to which the development charge by-law relates.

2. *If the rules expressly identify a type of development they must not provide for the type of development to pay development charges that exceed the capital costs, determined under paragraphs 2 to 8 of subsection (1), that arise from the increase in the need for services attributable to the type of development. However, it is not necessary that the amount of the development charge for a particular development be limited to the increase in capital costs, if any, that are attributable to that particular development.*

3. *If the development charge by-law will exempt a type of development, phase in a development charge, or otherwise provide for a type of development to have a lower development charge than is allowed, the rules for determining development charges may not provide for any resulting shortfall to be made up through higher development charges for other development.*[16]

In considering the legislative system for determining development charges, the Board in the Clarington/Markham Case commented as follows regarding the provisions of the *DC Act, 1997*:

> *Together they form a system for the determination of the level of service, the increase of need, the maximum funding envelope, the trigger points for collection and the appeal mechanism. Together, they delineate a restrictive rule-based universe for the design and imposition of the charges. There is a parameter to ensure that development charges would not be used to benefit existing development, and that the increase in the level of service would not be unduly spiked in comparison to what had been imposed in the preceding span. There is a provision dealing with excess capacity that must be accounted for before increased need can be had. There are also areas of services that are ineligible because of its critical mass. To vouchsafe this defined and restrictive system, the Board's jurisdiction is strictly circumscribed. It can decrease charges under appeal. But it is enjoined to increase charges. It is also prohibited to abridge exemptions directly or by technical tinkering.*[17]

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[16] *Id*, s. 5(6).

[17] *Smooth Run Developments Inc. v. Clarington (Municipality)*, [2015] O.M.B.D. No. 229, para 13.

Orangeville District Home Builders Association v. Orangeville (Town)

The central point in the Orangeville Case[18] related to a change in the population projection methodology used to calculate the development charges for certain "soft" services. The background study prepared by the Town of Orangeville's consultant and advanced by the Town used gross population (i.e. the total population projected to live in new dwelling units in the Town) to calculate the increase in the need for services attributable to new development. The appellant, Orangeville District Home Builders Association, contested the use of gross population on the basis that this new methodology was not consistent with the requirements of the *DC Act, 1997*. The Association's position was that net population should be used. There was no dispute that the average household size in Ontario has been declining over the last decades.

The Board rejected the gross population methodology advanced by the Town for the following reasons.

Firstly, the Board found that the gross population methodology was inconsistent with subsection 2(1) of the *DC Act, 1997* as it would "allow a charge not based on increased needs, but based on simply the overall service requirement of the new development"[19]. This would enable the charge to slip outside the purview of subsection 2(1) and the scope of the language in the legislation.

Secondly, the Board found that using gross population would not be consistent with clause 5(1)4 of the *DC Act, 1997*, as it would have the effect of funding a "service increase that will result in the level of service exceeding the average level of service provided in the municipality over the 10-year period immediately preceding the preparation of the background study".[20]

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[18] *Orangeville District Home Builders Assn. v. Orangeville (Town)*, [2010] O.M.B.D. No. 762.

[19] *Orangeville District Home Builders Assn. v. Orangeville (Town)*, [2010] O.M.B.D. No. 762, para 75.

[20] *Id*, at para 76.

Thirdly, the Board concluded that "a development charge that is based on the calculation of the gross population cannot help but to offend s. 5(1)5", as it does not account for excess capacity created by the projected decline in the population.[21]

A longer term effect of using gross population would be to ratchet up the level of service and future charging rates.[22]

The Town's motion seeking leave to appeal the Orangeville Case to the Ontario Divisional Court was not successful.[23]

Smooth Run Developments Inc. v. Clarington (Municipality)

The Clarington/Markham Case[24] arose in the aftermath of the Board's decision in the Orangeville Case. The panel hearing the first phase of the proceedings included two of the same Board members that formed the panel in the Orangeville Case. The consultants providing evidence on behalf of BILD and the municipalities also were the same as in the Orangeville Case.

The issues in the Clarington/Markham Case relate to the underlying assumptions and methodology advanced by Clarington and Markham relating to the application of the concept of "households", or a hybrid of that concept, for the calculation of certain "soft" services. The concept of "households" on its own or in combination with other traditional drivers, namely net population and employment, was proffered by Clarington and Markham as an alternative methodology in light of the Board's findings in the Orangeville Case.

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[21] *Id*, at para 77.

[22] *Id*, at paras 53 and 76.

[23] *Orangeville District Home Builders Assn. v. Orangeville (Town)*, [2011] O.J. No. 1393 (Div. Ct.).

[24] *Smooth Run Developments Inc. v. Clarington (Municipality)*, [2015] O.M.B.D. No. 229.

In using the driver of "households", Clarington and Markham relied on clause 5(1)1 which provides that the "anticipated amount, type and location of development" must be estimated. In their consultant's view, household number should be used as a proxy for the location and amount of development lands, and, in some cases, the location of the facilities that will serve growth.[25]

BILD rejected the approach of calculating the maximum allowable funding envelope on the basis of "households", "population plus households" and "employment plus households". Its consultant's opinion was that these methodologies, like gross population, do not appropriately account for the impact of the projected decline in the population in existing homes. BILD also did not agree that the number of households or household growths is a proxy for the localized features of the services or for the amount and location of development lands.[26]

In the Clarington/Markham Case, the Board first analyzed the alternative methodology in the context of its conceptual features, and then tested the methodology in a sector by sector analysis of the disputed services. In doing so, the Board reaffirmed the principles established in the Orangeville Case.

The Board did not accept the case put forward by Clarington and Markham. In rejecting the methodologies of "households", "households and net population" or "employment and households", the Board stated as followings in its conclusion:

> *Since the Board's decision in Orangeville, it is well established that a methodology for the calculation of development charges should take stock of the decline of population in existing households to help to meet the increase of need for services. The proposed new methodologies at these proceedings involve the household or household as a hybrid driver to calculate the maximum allowable funding envelope. Our finding is that as the fountain head of these methodologies, the concept of household is afflicted by the same deficiency as that of the methodology of gross population. It either wipes out the decline of the population or simply does not account for it fully in the determination of the increased need of service. As such, it does not comply with s. 2(1) and s. 5(1)5 of the Act. ….*

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[25] *Id*, at paras 18 and 19.

[26] *Id*, at paras 20 and 21.

> *The use of household or household growth is purported to be a proxy for the amount and location of developed lands. We find that they do not provide for the meaningful information as it has been claimed. In some cases, we find that the amount and location of developed lands have little relevance, nexus or verisimilitude to the service-sector under analysis. In our detailed micro-analysis, we find the use of household will often lead to an over-estimate of the increased need of service, contrary to s. 2(1) of the Act. In other cases, household as an instrument does not have the ability of recognisance to fathom, to probe and accurately assess the terrain of services. In short, one is not persuaded that the concept of household possesses the value of a dependable forecast for the increased need of service within the context of the Act.*[27]

The Board also specifically found that the net population methodology addresses the requirements of the *DC Act, 1997* and reflects the ways that Markham and Clarington plan for new development (i.e. on the basis of population, not households).[28]

In reaching its conclusions, the Board found that net population, a historic driver, "is a much simpler, more accurate and ultimately an effective forecast for the increase need of service in all the service sectors" analyzed by the Board[29].

Where to from here?

While the Orangeville Case rejected the use of the gross population methodology, it left open the opportunity to use a methodology other than the net population methodology.

The Board's decision in the Clarington/Markham Case rejects the alternative methodology based on the concept of "households". It also makes a clear finding that the net population methodology addresses the requirements of the *DC Act, 1997*, and provides a simpler, more accurate and effective forecast for the increase in the needs for services.

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[27] *Id*, at paras 101 and 102.

[28] *Id*, at para 108.

[29] *Id*, at para 107.

Questions that remain include:

- Will the search for alternative methodologies continue, and are there other methodologies that would not offend the restrictions of the *DC Act, 1997* and that could increase the funding envelope?

- In what way will the proposed Bill 73 amendments affect the maximum allowable funding envelope?

- Is it time for municipalities that use development charges as a primary funding tool, to also consider other options for financing municipal infrastructure?