Report to Council

City of Kelowna

Date:	August 22nd, 2022
To:	Council
From:	City Manager
Subject:	Update to Development Cost Charge Program
Department:	Financial Services

Recommendation:

THAT Council receives, for information, the report from Financial Services dated August 22nd, 2022, with respect to the Development Cost Charge program update;

AND THAT Council endorse the updated 20-Year Servicing Plan and Financing Strategy,

AND THAT Development Cost Charge Bylaw No. 12420 and Development Cost Charge Reserve Reduction Bylaw No. 12419, be given reading consideration;

AND THAT the interest on the amount borrowed for the anerobic digestor be included in the Development Cost Charge rate calculations,

AND FURTHER THAT Council direct Staff to submit the new Development Cost Charge Bylaws and supporting documentation to the Ministry of Municipal Affairs for their review and approval prior to fourth reading and adoption by Council.

Purpose:

To provide Council with the update to the Development Cost Charge program required to ensure capital financing is in place to support infrastructure investment to service the 2040 Official Community Plan's growth strategy and for Council to give reading consideration to the new DCC Bylaws.

Background:

Development Cost Charges (DCCs) are designed to assist local governments in recovering costs expended on core infrastructure needed to support development. DCCs facilitate development by providing a method to finance capital projects related to public roads, water, sanitary sewer, drainage and parkland acquisition and development.

The foundation document to the DCC Bylaw is the 20-Year Servicing Plan & Financing Strategy that details the infrastructure projects and financing required to service growth as outlined in the 2040 Official Community Plan (OCP). The 20-Year Servicing Plan and DCC Bylaw are interrelated and for simplicity will be collectively termed herein as the 'DCC program'.

The last update to the DCC Program was February 2020 with the inclusion of a new Parks Development DCC. Prior to that, the DCC Program was updated in April 2019 to bring project cost estimates in line with market construction and land acquisition costs. The last major update to the DCC Program that reviewed growth forecasts and infrastructure servicing strategy was in 2011 in conjunction with the 2030 OCP. With the recent adoption of the 2040 OCP, an amendment to the DCC Program is required to ensure capital financing is in place to support infrastructure investment to service the anticipated growth by 2040.

A previous report to Council (September 13th, 2021) outlined the proposed changes to the DCC program.

Resolution	Date
THAT Council receives, for information, the report from the Infrastructure Engineering Manager dated September 13, 2021, with respect to updating the 20-Year Servicing Plan and the associated Development Cost Charge Bylaw (No. 15015); AND THAT Council direct Staff to move forward with stakeholder engagement prior to returning to Council for reading consideration.	September 13th, 2021

Since that time, staff have received feedback from key stakeholders including Urban Development Institute (UDI), Canadian Home Builders Association, UBCO, and Okanagan College (Attachment 1).

Discussion:

Summarized below are the DCC program inputs, challenges and proposed changes that have been reviewed with key stakeholders. The reader is directed to the attached 20-Year Servicing Plan & Financing Strategy for complete details (Attachment 3).

The 2040 OCP estimates Kelowna's population will grow by 25% adding an additional 45,000 residents. Housing needs related to the 2040 population projections anticipate that demand for apartment, townhomes and compact family-friendly housing options will outpace the demand for single-detached housing.

Commercial, Institutional, and Industrial land uses were estimated based on the non-residential land available for development. Modest growth in each of the non-residential categories is expected in the 2040 planning horizon.

The DCC program is comprised of 234 infrastructure and parkland acquisition projects valued at $1.3 billion and revenue from the DCC program is legislated to be used exclusively to fund this large capital program that extends to 2040. The DCC program is funded from DCCs (65%), City funding (29%), and developer constructed works and grants (6%). An important element of the funding strategy for this update is that the City's share of funding (29%) is the same as the previous program. Assumed grants are not part of the financing strategy and if the City receives provincial/federal grants the DCC program will be updated to reflect the financial benefit of grant revenue.

Table 1- *Total DCC Capital Program recoverable costs ($ Millions).*

Service	Developer Funded		City Funded		Government Funded	Total
	Developer Construct	DCCs	Tax	Utility	Grants/ Partnership	
Transportation	40.4	311.2	167.2		9.0	527.8
Water	3.6	32.1		26.2		61.9
Wastewater Trunks	4.1	38.4		20.1		62.7
Wastewater Treatment		85.0		36.8		121.8
Drainage		9.2	28.0		20.8	57.9
Parkland Acquisition		217.8	26.7			244.5
Parks Development		142.4	74.7			217.1
Totals	**48.1**	**836.1**	**296.6**	**83.1**	**29.8**	**1,293.8**

Construction and land acquisition increases. Global supply chain issues, inflation, labour shortage and an oversupply of construction projects flooding the market have caused upward pressure on construction costs, with tender costing coming in significantly higher than engineering estimates. Construction and land costs in the DCC program have not been updated in three years and since that time construction costs have increased on average by 20% and land costs have increased more than 40%. All project costs in this update reflect 2021 costs so are approximately 1 year old and may not reflect the recent surge in construction and land costs. If construction and land costs continue to trend upward, the DCC Program costs may need to be updated within a year to keep pace with inflation.

Secondary Suites and Carriage Houses. It is estimated that 30% of single-family homes in Kelowna will be built with suites or carriage houses. Council agreed in 2008 to charge a flat fee DCC of $2,500 for all secondary suites and carriage houses which would normally be charged a much higher rate (equivalent to a condominium); with the revenue difference borne by taxation and utility funding. The current practice was flagged by the Ministry as an area that needed to be amended because it provided a specific land use subsidy which is not permitted, as any subsidy must be applied evenly for all land uses.

In response to the Ministry's concern, this update has introduced a new category for Carriage Houses and assessed a higher DCC in the range of $23,000 - $28,000, to better reflect the actual infrastructure impact of these stand-alone units.

Secondary suites are often exempt from paying DCCs because their construction value is less than the $50,000 minimum required to trigger DCCs as defined by the Local Government Act. For this update, it is proposed that suites are not assessed a DCC. Simply stated, once the developer pays their residential DCC for the base build, the secondary suite can be constructed with no further DCCs levied. With the expected increase in suites and their associated demand on infrastructure, tax/utility funding used previously to subsidize suites has been carried forward and applied to the municipal tax assist to offset the infrastructure burden that suites may cause. The Ministry agreed that increasing the municipal assist is an equitable and transparent approach to addressing the incremental infrastructure impacts caused by suites on the overall program.

The municipal assist increase to offset the infrastructure burden caused by suites is unique to Kelowna with most communities not accounting for these impacts and allowing the program to absorb them.

Industrial DCCs. The City has some of the lowest Industrial DCCs in the province, which does not fully fund the servicing demands of the shifting 'light industrial' development trend. To better reflect the true cost for servicing, the Industrial category has been split into two categories – Light Industrial and Heavy Industrial. The Light Industrial DCC is approximately 50% of the Commercial DCC rate and is more in line with the cost of servicing this development form. The Heavy Industrial DCC is consistent with the previous DCC program and collects DCC based on a gross site area for land intensive industrial developments like gravel extraction, wrecking yards, outdoor storage and asphalt and concrete plants.

Storm Drainage DCC. DCC legislation permits the inclusion of a Drainage DCC to fund the infrastructure required to meet the demands placed on drainage systems and natural flood zones by development. The recent floods of 2017 and 2018 have demonstrated a need to better manage the City's major drainage systems which include the City's creeks and streams.

The City's growth strategy focuses development in the core area and urban centres, densifying development and putting more demand on the drainage system. A new Drainage DCC is proposed to fund the work along the City's primary drainage corridors and outfalls. The first major project is capacity improvements to Mill Creek that runs through the City's core area and is an area of future development densification.

The project funding split assigns 25% to growth and 75% to City funding sources and equitably accounts for improvements necessary to remedy existing deficiencies along Mill Creek as well as the demand from new development.

Parks Acquisition DCC for Commercial/Industrial. Council approved the Parks Development DCC in February 2020 and as part of the preferred scenario Council directed staff to explore the inclusion of a Parks Acquisition DCC for the Commercial and Industrial DCCs. This Parks Acquisition DCC is now included in Commercial and Industrial DCC rates.

Shift to City Wide DCCs. The City's DCC program dates to the 1980's and, back when it was first developed, area specific DCCs were used extensively as there were many suburban areas of the City that had unique servicing demands. With the recent adoption of the 2040 OCP, the City's land use plan is shifting with more emphasis on development within the core area and urban centres. This change has caused the City to rethink the area specific approach and move to a municipal-wide approach where appropriate. The proposed DCC program assesses DCCs on a municipal-wide basis for all service areas except Transportation where the sectors were consolidated from six in the current program to three for the proposed DCC program. The three sectors within Transportation were retained as there are unique transportation servicing challenges to each sector that warrant the sector approach.

Anerobic Digestor. The City is planning the construction of a large anerobic digestor in 2030 to reduce the amount of biosolids produced at the wastewater treatment plant. This large capital investment ($78 million) will require borrowing and the interest is included in the DCC rate calculations. The Ministry requires Council resolution for inclusion of interest on the amount borrowed in the DCC rate calculations. Staff are working on the feasibility study for the digestor and will bring future report(s) to Council for consideration. Should the strategy for solid waste management change the DCC Bylaw will be amended.

Changes to DCC Bylaw.

- The DCC Bylaw has been updated to align with the new Zoning Bylaw. The new Zoning Bylaw is anticipated to be adopted by Council in September 2022 after Ministry approval.
- The new Carriage House and Light Industrial categories have been added to the DCC Bylaw and the new Drainage DCC has been included.
- Secondary suites are no longer required to pay DCCs and the existing Council approved subsidy has been carried forward but is now shown as a municipal assist factor for transparency.
- There are 4 residential dwelling categories based on the existing density gradient formula that encourages higher density developments through lower DCCs.
- The Residential 5 category (small apartment < 600 sq. ft.) was rolled up into the Residential 4 category (apartment). A review of occupancy patterns determined that the difference in occupancy between Residential 4 and the Residential 5 category was not enough to warrant a separate rate, particularly given that micro suite units of less than 300 sq. ft. are already exempt, per legislation.
- The proposed DCC program assesses DCCs on a municipal-wide basis for all service areas except Transportation where the sectors were consolidated from six in the current program to three for the proposed DCC program.
- In addition to the new DCC Bylaw (12420), a new DCC Reserve Reduction Bylaw (12419) was developed to draw down existing reserves for the sectors that were consolidated as part of this update. The two Bylaws will work together to fund the program but only the DCC Bylaw (12420) will be the 'forward-facing' Bylaw that will be used to collect DCCs.
- A legal review of the DCC Bylaw was completed and there were several housekeeping edits to improve readability, transparency, and consistency with the Local Government Act.

Financial/Budgetary Considerations:

DCCs have increased on average by 14% since the last update in 2019 and are dependent on where development is occurring in the City (Figure 1 and Attachment 2). City Centre area encompasses about 87% of the forecasted growth in the City and DCCs have increased less than 5% per year for the past 3-

years leading up to this update. The average overall DCC increase in this area is 13% since the last update and is within recent inflation for construction and land.

City Centre - Sector I			
Category	per	Proposed DCC	Current DCC
Residential 1	unit	$ 35,083	$ 30,989
Residential 2	unit	$ 32,992	$ 29,003
Residential 3	unit	$ 28,237	$ 24,678
Residential 4	unit	$ 26,997	$ 23,977
Carriage House	unit	$ 22,419	$ 2,500
Commercial	sq. m.	$ 92.15	$ 81.84
Institutional A	sq. m.	$ 67.44	$ 60.17
Institutional B	sq. m.	$ 28.03	$ 28.43
Heavy Industrial	Ha	$ 95,526	$ 87,453
Light Industrial	sq. m.	$ 46.78	New

North of City Centre - Sector E			
Category	per	Proposed DCC	Current DCC
Residential 1	unit	$ 41,800	$ 33,147
Residential 2	unit	$ 39,064	$ 31,438
Residential 3	unit	$ 32,750	$ 26,410
Residential 4	unit	$ 31,110	$ 25,772
Carriage House	unit	$ 24,960	$ 2,500
Commercial	sq. m.	$ 114.39	$ 87.75
Institutional A	sq. m.	$ 89.68	$ 66.08
Institutional B	sq. m.	$ 24.72	$ 22.22
Heavy Industrial	Ha	$ 109,047	$ 86,097
Light Industrial	sq. m.	$ 57.90	New

* Most of Sector E not serviced by City water so charges assume no water DCC. Service provided by others.

SW Mission - Sector B			
Category	per	Proposed DCC	Current DCC
Residential 1	unit	$ 50,531	$ 48,508
Residential 2	unit	$ 46,957	$ 45,615
Residential 3	unit	$ 38,616	$ 36,519
Residential 4	unit	$ 36,455	$ 35,166
Carriage House	unit	$ 28,264	$ 2,500
Commercial	sq. m.	$ 143.31	$ 139.39
Institutional A	sq. m.	$ 118.59	$ 117.71
Institutional B	sq. m.	$ 28.03	$ 26.10
Heavy Industrial	Ha	$ 133,684	$ 128,216
Light Industrial	sq. m.	$ 72.36	New

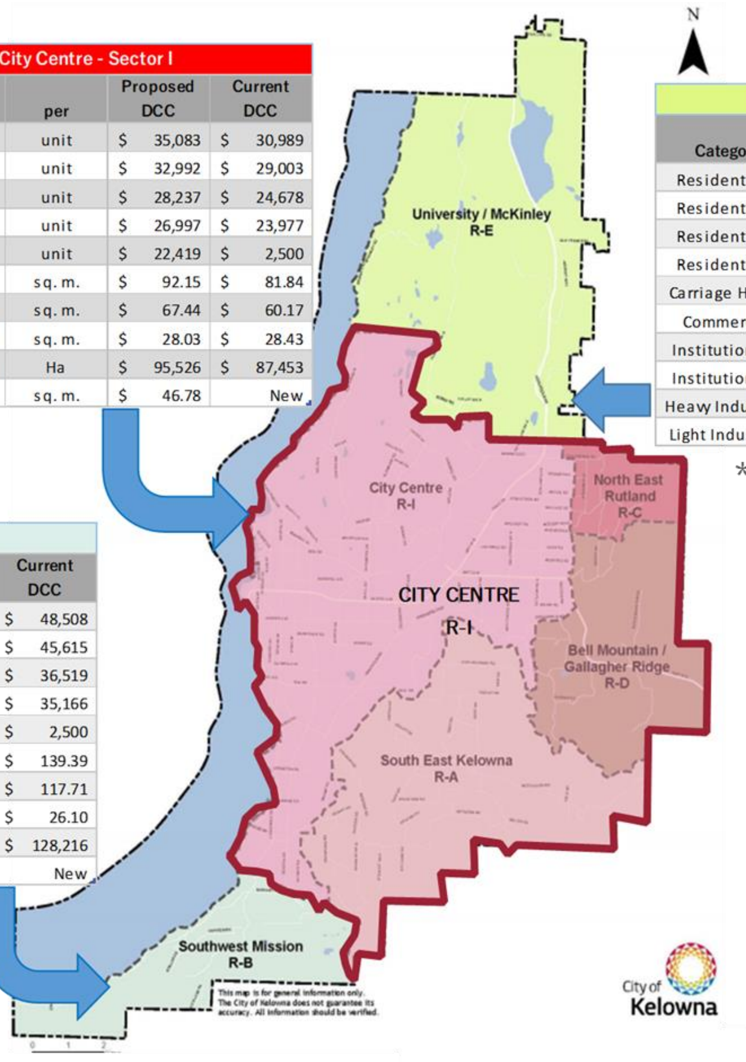

Figure 1- *Total combined DCC by land use and sector.*

Southwest Mission is nearing buildout with some of the infrastructure already in place. Encompassing 5% of the forecasted growth, this area is seeing the smallest DCC increase but still has the highest overall DCCs due to high costs of extending services to this area. The average overall DCC increase in this area is 4% since the last update.

North of City Centre encompasses 8% of forecasted growth and DCC rates have increased in the range of 4% to 12% per year since the last update in 2019. The average overall DCC increase in this area is 25% since the last update.

In addition to inflationary impacts, this increase reflects the large transportation infrastructure projects needed to support growth in this area including:

• Acland 2 (Airport Way – John Hindle Dr)	$15.2 million
• Commonwealth Rd.	$10.5 million
• Glenmore 5 (Union – John Hindle)	$10.5 million
• Glenmore Rd Safety Upgrades (John Hindle – Lake Country)	$14.8 million
• Hollywood Rd and ATC (various phases).	$27.3 million

The Local Government Act requires municipalities to provide a level of financial assistance through a municipal assist factor (MAF) which reflects Council's desire to encourage development and is largely a political decision. The way the City has historically applied the MAF for the purpose of DCC calculation is different than most municipalities in BC and not consistent with best practice. The difference is how existing reserves are accounted for in the DCC calculation and is negligible when reserve balances are low, but when the reserve balances are high the difference in the municipal assist amount is appreciable.

The Council approved subsidy for secondary suites was carried forward in this update but it is now shown as part of the municipal assist as opposed to buried in the DCC calculations. The Ministry agreed that increasing the municipal assist is an equitable and transparent approach to addressing the incremental infrastructure impacts caused by suites,

Table 2 *- Municipal assist factors for both the base MAF and the secondary suite assist.*

	Municipal Assist Factors (%)				
	Transportation	**Water**	**Sewer**	**Drainage**	**Parks**
Base	15%	1%	1%	1%	8%
S. Suites	1%	1%	1%	1%	3%
Total	**16%**	**2%**	**2%**	**2%**	**11%**

Communications:

The DCC Program update has been ongoing for two years with many touch points with UDI, CHBA and external stakeholders (see Attachment 1).

In general, external stakeholders are appreciative of the level of engagement and opportunity to provide industry feedback. Their remaining concerns are shown below (italicized) with the City's rationale following:

- *Secondary Suites and how the subsidy is now shown as part of the municipal assist. Their preference would be to present the secondary suite subsidy as a stand-alone item like the current practice.*
    - The current practice was flagged by the Ministry as an area that needed to be amended because it provided a specific land use subsidy which is not permitted, as any subsidy must be applied evenly for all land uses. The Ministry agreed that increasing the municipal assist

is an equitable and transparent approach to addressing the incremental infrastructure impacts caused by suites,

- *Historic accounting of the municipal assist amount and how it did not align with best practice.*
  - The City changed the accounting practice as part of this update and is now in-line with best practice.
- *The shift from sector based to city wide for water infrastructure is inequitable to Sector B development.*
  - The City has provided justification for growth related infrastructure and completed analysis of Sector B reserves. Sector B DCCs remain the highest in the community but they have the smallest percent increase in this update compared to other sectors, in part based on the outcomes of this analysis. The shift from sector based to city wide for Sector B sewer and water has provided a financial benefit to this area through reduced DCCs.
- *The DCC increase negatively affects housing affordability.*
  - The City's residential DCCs represent only a small part (3-5%) of the purchase price of residential housing a**nd DCCs as percentage of housing price are equal to or less than what they were 10-years ago**. DCCs fund critical infrastructure that support growth and facilitate development and housing supply by providing a method to finance infrastructure investment needed to support development. Without DCCs, development and housing supply would be constrained because developments that triggered upgrades would be burdened with 100% of the cost, making many developments unviable. Although not desirable, the overall average DCC increase of 14% is well within inflationary escalation for construction and land in the past 3-years since the last update. **Several other BC communities struggling with the same inflationary challenges are proposing DCC rates increases in excess of 30% and as high as 85%.**

Legal/Statutory Procedural Requirements:

The Local Government Act requires the Inspector of Municipalities to approve local government DCC bylaws. The following process, which is recommended by the DCC Best Practices Guide, is being followed by staff for amending the DCC Bylaw.

- Development of draft DCCs by staff – Jun 2020 – Sep 2021
- Report to inform Council – Sep 2021
- Stakeholder engagement – Oct 2021 – June 2022
- Council readings (1st, 2nd and 3rd) of proposed DCC Bylaw – August 2022,
- Submission of DCC Bylaw and Supporting Documentation to Ministry of Community Services – Aug 2022,
- Statutory approval from Inspector of Municipalities – 8 weeks (estimate)
- Fourth Reading and adoption of DCC Bylaw by Council - Nov 2022 (estimate)

Legal/Statutory Authority:

The DCC Bylaw (12420) sets out the charges collected from developers for public roads, water, sewer, drainage and public parkland acquisition and development when subdividing or constructing, altering, or extending a building, pursuant to the Local Government Act. DCC Reserve Reduction Bylaw (12419) was developed to draw down existing reserves for the sectors that were consolidated as part of this update. The two Bylaws will work together to fund the program but only the DCC Bylaw (12420) will be the 'forward-facing' Bylaw that will be used to collect DCCs.

The new DCC rates will be in force immediately after the adoption by Council of the DCC Bylaw. The Local Government Act provides in-stream protection of up to 1-year from changes to DCC rates for subdivision and building permit applications provided the application is complete and all application fees have been paid prior to DCC Bylaw adoption date.

Conclusion:

The City has demonstrated its commitment to achieving a balanced approach for this DCC update. While key cost drivers (land and construction costs) are entirely beyond the City's control, the City has contained the size of the DCC program and implemented improvements that reflect the true cost of servicing growth while at the same time ensuring the DCC program is understandable, transparent and aligns with best practice.

Internal Circulation:
Divisional Director, Infrastructure
Divisional Director, Planning & Development Services
Divisional Director, Partnerships & Investments
OCP Project Planner
Parks & Buildings Planning Manager
Utility Planning Manager
Strategic Transportation Planning Manager
Transportation Engineering Manager
Financial Analyst, Infrastructure
City Clerk
Senior Airport Finance and Corporate Services Manager

Considerations not applicable to this report:
Existing Policy:
External Agency/Public Comments:

Submitted by:

J. Shaw, Acting Financial Services Director

Approved for inclusion:

Attachment 1 – Stakeholder Engagement
Attachment 2 – Proposed DCC Rate Schedule
Attachment 3 – 20-Year Servicing Plan and Financing Strategy
Attachment 4 – DCC Presentation