

**APPENDIX F**  
**DEVELOPMENT CHARGE ECONOMIC IMPACT MATERIAL**



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## **APPENDIX F**

The following summarizes the results of previous research conducted by Watson & Associates concerning the potential impact of (increased) development charges on economic development. In addition, the last part of the Appendix sets out the Executive Summary of a DC Economic Effects Study carried out by Prof. David M. Nowlan for the City in 2004.

1. There are two fundamentally different ways of viewing the City's current comparatively low development charges. The first view is that this is sound policy, reflecting the City's servicing cost economies of scale, as well as enhancing its competitive position in attracting residential, commercial and industrial growth. The second opposing view is that higher DC's would not tangibly inhibit growth and the City is failing to fully utilize this significant capital funding source. As a result, its tax levy and water/sewer rates are higher than would otherwise be necessary and/or needed works are being deferred.
2. Many municipalities impose the full residential DC and, in some cases, discount or exempt only a portion of their non-residential (i.e. industrial/commercial) charges, in the interests of attracting more of such development. Their policy position, implicitly or explicitly, is that the rate of industrial and/or commercial development may be impacted by the quantum of their DC's. Their actions suggest that this is not the case with residential development, or at least that the "growth pays for growth" philosophy is expected to be more operative in that case.

### Residential Development Impacts

3. A change in DC quantum is thought by some to reflect itself directly and automatically on house prices. However, in the strong market experienced for years in Toronto, house prices reflect demand pressures, more than a simple cost recovery formula. DC increases are absorbed in pricing (and/or land purchase), but may not always be a significant determinant of such pricing, due to overall market dynamics. However, in poor markets, house prices may be unable to fully absorb DC increases. As a result, DC increases may impact profits and/or construction activity. Over a longer period of time, DC increases may result in compensating land price decreases, where the selling price of the final product cannot be increased sufficiently. This is particularly the case where there is a high "value-add" to the undeveloped land value.
4. The potential impact of DC quantum shifts on the residential housing market is also impacted by the competitive environment and by the price and nature of the housing involved. For example, Toronto is surrounded by four Regions which impose much higher residential DC's; however, land costs, building forms, the planning process, ease of construction, tax rates, municipal and commercial service levels and lifestyle also vary

significantly between those two markets. It is the cumulative effect of these socio-economic forces which determines whether a significant addition to Toronto's residential DC's will diminish its rate of residential growth. This, in turn, raises the question of whether a small reduction in residential growth, resulting from an increase in DC quantum which better equips the City to fund its growth-related servicing needs, is an acceptable trade-off.

5. Housing projects which are geared to the rental market, affordable or assisted housing, or sites which are expensive to service or remediate, could be impacted by a significant increase in DC's. For example, a DC increase of \$10,000 is only 5% of a \$200,000 housing price, but at the margin, that may be the difference between an acceptable financial return and one which is not. Thus, there may be housing projects which are made less feasible as a result of a significant increase in DC's.
6. When one plots DC quantum against residential development activity amounts in different municipalities, an indirect cause and effect relationship is not apparent. That is, in part, because municipalities which are attractive, high growth areas, are able to impose high DC's as part of maintaining high service levels. Municipalities with lower market appeal tend to moderate DC's in the hopes of encouraging more growth. However, the primary determinants of the amount of residential development in a municipality generally relate more to serviced/zoned land availability, amenity/lifestyle, access to job opportunities, development industry focus, etc.

#### Industrial/Commercial Development Impacts

7. The City is not presently imposing industrial/office/institutional development charges, although the Toronto Catholic District School Board does impose education development charges. The City is one of very few major municipalities in Ontario not imposing development charges on these forms of development.
8. The decision as to whether or not Toronto should establish industrial/office/institutional development charges and, if so, how high they should be and whether they should vary between industrial and commercial uses, is an important policy issue. Essentially, it involves a trade-off between increased capital contributions (which must otherwise come from property taxes and/or user rates) and a potential deterrent of indeterminate size to new and expanded development activity within the City.
9. The potential impact of DC quantum shifts on the industrial and commercial market is also impacted by the competitive environment and by the price and nature of the development involved. For example, Toronto currently waives DCs for industrial and office development, but imposes substantially higher municipal taxes on these properties than surrounding municipalities. Land costs, building forms, the planning process, ease

of construction, tax rates, municipal and commercial service levels and lifestyle also vary significantly between those two markets. It is the cumulative effect of these socio-economic forces which determines whether a significant increase to Toronto's industrial and office DC's will diminish the rate of growth. Since DC's provide a one-time contribution, while property taxes establish an on-going revenue stream to municipalities, this, in turn, raises the question of whether a reduction in industrial and office development, resulting from an increase in development charges, improves or diminishes the City's financial position.

Industrial and commercial properties are generally acknowledged as paying more in property taxes than the cost of the municipal services they consume. It is this net positive contribution to municipal revenues that helps support the services and programs the City provides to its residents. The long-term fiscal sustainability of such municipal services is therefore benefited by maintaining a strong industrial and office property tax base.

10. Municipalities are generally more concerned with attracting industrial/office development, than with residential development, because the former brings local jobs, commercial services, no increased need for some municipal services, economic stimulus and more highly taxed assessment.

In this regard, industrial and head office development is often given added attention, in comparison with retail and service sector employment, which is generally "population-related". Also, "major destination retail" which serves the entire GTA, differs somewhat from community-specific retail services. The latter is more captive to urban population centres than industry (for example, the automotive industry, which has located plants in smaller communities such as Alliston, Cambridge and Ingersoll).

11. Industrial site selection analysis generally focuses on non-financial matters, such as transportation access to markets, proximity to labour and suppliers, quality of life/image/amenity and the suitability of the available real estate. Financial matters are often less important and relate more to land and construction cost, as well as property tax and utility rate costs. DC's are a relatively small component of the latter, but at the margin, can have an impact on a cumulative basis, particularly where property taxes are high, as in Toronto.
12. Notwithstanding the fact that Toronto has the lowest DCs for industrial and commercial development of any municipality in the GTA, the City has experienced a steady decline in industrial employment. In the face of this trend, can the City afford to establish development charges for such uses? The financial answer to the question lies, in part, with the trade-off between the one-time DC revenue figure and the long-term, net property tax surplus stream created by new non-residential development.

13. "Market optics" can play a role in a municipality's ability to attract industrial/commercial development. This often relates more to planning approval matters, but having no DC's or heavily discounted DC's, can be part of sending out a favourable message – once again at a price.
14. Some of the ways that are sometimes used to moderate the negative impacts of non-residential development charges include transition measures such as:
  - "grandfathering" certain types of previous approvals;
  - providing a "grace period" for the introduction of the charge;
  - phasing in the increase in the charge over a period of years;
  - leaving the indexing of the charge as a discretionary annual decision and one which can be waived by Council in poor economic periods;
  - fully or partially exempting those types of development likely to be most negatively impacted by a DC increase (subject to difficulties involved in distinguishing one type of development from another at the point of DC collection).

The City has, in the past, used a number of these measures. It is evident that all of these measures involve sacrificing capital revenues that must be generated from other sources in order to provide the real estate and development market with sufficient opportunity to adjust to any significant change in DC quantum or policy. This is particularly the case in the event of a significant economic downturn relating to international financial turbulence.

**Economic Effects of the Calculated 2004 City of Toronto  
Development Charges**

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**Excerpts Only**



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## Economic Effects of the Calculated 2004 City of Toronto Development Charges

Appendix D

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Increase in residential development fee is \$4353 per unit;	
increase in commercial development fee is \$72.87 per square metre	



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## Executive Summary

If the City were to implement the higher development charges calculated in the *City of Toronto 2004 Development Charge Background Study* (April 21, 2004) there would be some but generally minor effects on the amount and type of residential development in the City over the 2004 to 2014 period. There could be a more noticeable effect on the pattern and pace of non-residential development.

The cost of the higher charge would be borne principally by developers in the first instance but would quickly become transformed into lower prices for land being assembled or ripe for development. Thus, most of the increased development charge would be borne by the owners of developable land.

The presumption that the full increase in the development charges would or could be passed forward to new buyers and tenants is incorrect. As explained below, some amount, generally small, may be passed forward, but there are many restraints on the extent to which selling prices can be raised to recover the higher charge. Principal among these restraints is the competition that exists from the existing stock of dwellings and floor space in the City. The number of new dwelling units and amount of new non-residential floor space that is expected to be built annually over the 2004-2014 period will be only about 1 per cent of the existing stock. In addition competition from outside the City limits the ability of City developers to raise prices.

Competition from the existing stock of dwellings and space and from outside the City will be less for projects that are unique in either design or location. In the case of such projects, more of the increased charge can be passed forward to buyers, but with alternatives always present even this ability is limited. It is likely that projects in the outer parts of the City will face more competition than those in the central city and so find it more difficult to pass on development charge increases.

The higher development charges, if implemented, are expected to raise additional revenue of between \$590 to \$680 million over the ten-year period. This amounts to a savings in property tax and user charges that I estimate to be about \$134 per City resident or \$350 per dwelling unit, and about \$4.50 per square metre of non-residential space. All taxpayers benefit, existing as well as newcomers, but the newcomers will have their benefit offset by the ability of developers to charge a higher selling or renting price that just equals this benefit. That is, competition will not limit a price increase of, on average, just this amount since it is a payment for a benefit received, namely lower property taxes and user charges. This means that, in the case of residential projects, about 9 per cent of the increase in the development charges can be passed forward to buyers with no effect on buyer demand. In the case of non-residential projects, the proportion that can be passed forward in this way is about 6 per cent.

The financial effects of a higher development charge may induce real effects in the pattern of development. A higher residential development fee can have the effect of encouraging developers to build fewer units in any one project, or to build larger units. In chapter 3, a number of plausible examples are analysed in order to help determine the likely magnitude of these effects. The conclusion from these examples is that the real effects of the higher residential charges are likely to be very small and in some cases non-existent – developers will find that their best course of action is to proceed with a project just as it was initially planned before any fee increase and to absorb the loss. As my examples show, any other decision, in many cases, will cost the developer even more. Even if the whole of the increased development charge (less the tax and user-charge benefit which can always be passed forward) is borne by the developer or landowner, its magnitude is likely to be quite small for residential projects: in the examples of chapter 3 this cost was between 1 and 5 per cent of the land value.

For the non-industrial projects, the financial effects are larger and so too will be the real effects. One example in chapter 3 shows how the increased charges could influence the

mix of residential and commercial space in a mixed-use development -- commercial space would be reduced and residential space increased.

With the increased non-residential fee having the possibility of reducing land values by 20 per cent or more, as the examples of chapter 3 show, perhaps the greatest real effect will come from decisions by developers or land owners not to proceed with a planned project, at least not at this time. If the existing use for some property slated for early re-development yields relatively high property value (relative that is to the anticipated value in a new use), the re-development may well be delayed. If the value of their existing use is low for some properties -- so-called "soft" properties --, then the higher fee will have less of an effect on the development decisions.

Again, in unique locations, such as the central area, the possibility of passing forward to new buyers or tenants the cost of the increased fee is much higher than in other locations, so the developer will bear less of the burden and the real effects will be smaller. Also, it appears that less than half of the new non-residential floor space expected to be developed over the next ten years would be subjected to the new development fee, if implemented. This high percentage of exempt projects would of course moderate the real effects of the development charge and the existence of exemptions would create a small bias in favour of development-charge-exempt projects, compared with the situation with no development charges.

