POLICY COMMENTARY No. 1
November 2014

A New Direction for Funding Growth-Related Water and Wastewater Infrastructure in the Greater Toronto Area and Hamilton[1]

Issue and Questions Addressed

Utilities which provide services to households and businesses in Ontario, in common with the business community at large, price their services to cover all current and capital costs and generate a profit. These utilities include private sector companies which provide natural gas and telecommunications services, and municipal and provincial utilities which distribute electricity. Capital costs include the maintenance of the existing infrastructure networks in a state of good repair (SOGR outlays) and network expansion to accommodate new development (growth-related infrastructure).

Municipal water and wastewater (sewerage) providers in Ontario, in contrast, fund growth-related infrastructure through development charges. Under this means of financing, the occupants of new residential and non-residential development ultimately bear the bulk of the cost of the infrastructure system expansion.

Why are growth-related capital outlays of water and wastewater providers funded differently than other similar monopolistic-type businesses and, indeed, the broader business community? What are the economic implications of this difference? Should the funding model be changed to correspond with general business pricing practice?

These questions are addressed within the confines of the Greater Toronto Area and Hamilton (GTAH) with the discussion primarily focussed on the residential sector (i.e., occupants within the existing housing stock and new development).

1. This Policy Commentary is based on a forthcoming CUR research report *A New Direction for Funding Growth-Related Water and Wastewater Infrastructure in the Greater Toronto Area and Hamilton* authored by Dr. Frank A. Clayton, Senior Research Fellow, CUR.

The opinions expressed in this Policy Commentary and the research report on which it is based are those of the author only and do not represent opinions and views of either CUR or Ryerson University.

Implications of Using Development Charges to Fund Growth-Related Water and Wastewater Infrastructure

The economic consequences of relying on development charges to fund growth-related water and wastewater infrastructure are threefold:

- **Fosters economic inefficiency through overconsumption of water and wastewater over the entire user base.**
  Water and wastewater users as a group over-consume water and wastewater services since they are not paying the full cost of providing these services. This results in over-investing in infrastructure to provide service to the new development.

- **Diminishes housing affordability**
  Relying on development charges to fund growth-related water and wastewater infrastructure directly increases the development cost for all types of new housing by as much as $26,000 per unit. Also, prices of existing housing are inflated because of the competitive interaction of the new and resale housing submarkets. This aggravates an already serious housing affordability problem in the GTAH.

- **Creates inequity between water and wastewater users residing in the existing building stock and the occupants in new development**
  As well as bearing the costs of growth-related infrastructure, occupants in new developments are paying a portion of the costs of maintaining the existing municipal-wide water and wastewater infrastructure in a state of good repair (SOGR outlays) through their user charges. The existing water and wastewater infrastructure primarily benefits residents who, and businesses which, are accommodated in the existing building stock. Thus, users in existing properties pay lower user fees than they otherwise would because of the contributions of the occupants of new developments to maintaining the existing infrastructure system.

Basis for Funding Growth-Related Water and Wastewater Infrastructure through Development Charges

In the period immediately following World War II there was an upsurge in the demand for new housing and employment floor space. Municipalities were beneficiaries of financial subsidies from the provincial and federal governments to fund much of the required expansion of sewer and water infrastructure.

Reduced funding from the senior governments and reluctance on the part of municipal councils to impose significant increases in user fees for growth-related infrastructure (or indeed the maintenance of the quality of the existing infrastructure) resulted in municipalities looking for alternative revenue sources. Developers and builders who were active in their communities were obvious targets for funding growth-related infrastructure which often became a condition for planning approvals.

In 1989, all municipalities in Ontario were given legislative authority to impose development charges to fund growth-related infrastructure under the *Development Charges Act, 1989*. However, development charges had to be tied to the costs of providing infrastructure for growth-related services under the premise that “growth must pay for growth”.

The main purpose of development charges, then and now, is to raise revenue to finance growth-related infrastructure without burdening existing taxpayers. In more recent times, there has been increased support from within the urban planning community to regard development charges as a planning tool to encourage more compact, dense growth and discourage lower density development on the urban fringe.

Assessment of Funding Growth-Related Water and Wastewater Infrastructure through User Charges Rather than Development Charges

In recent years the Province has been encouraging municipal water and wastewater utilities to fund capital outlays relating to the maintenance of the existing water and wastewater infrastructure (SOGR outlays) through full-cost pricing. A priori, there is no reason to treat growth-related infrastructure investment differently from the SOGR infrastructure outlays given the benefits of growth and their distribution.

Shifting the source of funding of growth-related water and wastewater infrastructure to user charges would have a number of economic benefits to the wider community in the GTAH:

- **Better matching of infrastructure costs and the beneficiaries of urban economic growth**
  The fundamental argument raised in favour of using development charges to fund the expansion of urban infrastructure is that growth should pay its own way and not impose costs on existing property taxpayers living in the municipality.

  The theoretical underpinning for imposing development charges "that growth pays for growth" lacks credibility given that the expansion of municipal infrastructure contributes to economic growth and the benefits of growth are spread over the larger community including existing property taxpayers.

- **Increased economic efficiency through reduced consumption of water and wastewater over the entire user base**
  Shifting the cost of growth-related water and wastewater infrastructure to user charges has the benefit of ensuring that all users bear the full cost of the provision of these services, including growth-related capital infrastructure investment. Applying these higher full-recovery charges would encourage all water and wastewater consumers to reduce their consumption to the benefit of the environment. The lower consumption would also make more efficient use of existing infrastructure and lessen the need for the building of new infrastructure.

- **Increased housing affordability**
  Eliminating development charges for water and wastewater purposes would lower the cost base of building new homes. In a competitive housing market like the GTAH market, these lower costs in turn would ultimately be reflected in lower end prices.

- **More equitable treatment of water and wastewater users residing in the existing building stock and the occupants in new development**
  The shift in financing of growth-related infrastructure to user charges would also remove the existing inequity in the existing financing system: the occupants of new housing pay part of the capital cost of maintaining the existing municipal-wide water and wastewater infrastructure, but existing users do not contribute to the funding of growth-related infrastructure.

Pursuant to the *Places to Grow Act, 2005*, the Ontario government passed the *Growth Plan for the Greater Golden Horseshoe in 2006.*[2] Key goals of this very comprehensive, detailed plan are to create more intense, compact communities and to curb sprawl within the Greater Golden Horseshoe, which is a very large area centred on the GTAH. By dictating how much growth municipalities accommodate, and overseeing policies dealing with intensification and complete communities, the Province is affecting relative land prices and the location of residential and non-residential growth in the GTAH and beyond in accordance with the plan.

Under this pervasive provincial planning regime, the types of developments that are built will be obliged to be in accordance with the goals of the growth plan to promote land use efficiency. Therefore, there is no need to compromise development charge revenues by providing development charge subsidies to promote goals of more compact and dense communities.

Recommendation: Shift Funding of Growth-Related Water and Wastewater Infrastructure to User Fees from Development Charges

We recommend that the funding of growth-related water and wastewater infrastructure be done with user charges rather than development charges and that this change be phased in over a period of five years. The *Development Charges Act* should be amended to disallow the funding of growth-related water and wastewater infrastructure after five years.

We recommend that municipalities establish independent utilities to fund and operate water and wastewater services on a business basis like electrical and private sector utilities operating in the Province.[3] All capital outlays would be financed through user charges or through debt where servicing is funded through user fees. The new water and wastewater utilities should have the power to issue debt based upon the utility's financial situation separate from a municipality's debt. The board of directors of the new utilities should be drawn largely from the business community with municipal politicians and staff playing a limited role.

We also recommend that the Province appoint an advisory committee to provide advice on the implementation of the change. The committee should include representation from municipalities, the development/building community, and the broader business and non-business communities.

---

2. Ministry of Infrastructure, *Growth Plan for the Greater Golden Horseshoe, 2006* (Office Consolidation, June 2013), Toronto: Queen's Printer for Ontario, 2013.

3. Water and wastewater utilities would be required to register under Ontario's *Business Corporations Act* like municipal electricity providers were required to do under *Ontario's Energy Competition Act, 1998*.

CENTRE FOR URBAN RESEARCH AND LAND DEVELOPMENT

General Enquiries
416-979-5000, ext. 3348

Mailing Address
Ryerson University
Centre for Urban Research
and Land Development
GER-204D
350 Victoria Street, M5B 2K3

Campus Location
111 Gerrard Street East,
3rd floor, GER-204D
Toronto, Ontario

www.ryerson.ca/cur
cur@ryerson.ca