RICHMOND HILL
INCORPORATED 1873

Staff Report for Capital Sustainability Steering Committee

Date of Meeting: June 4, 2024
Report Number: SRCFS.24.029

Department: **Corporate and Financial Services**
Division: **Financial Services**

Subject: SRCFS.24.029 2025 Capital Budget Strategy Considerations

Purpose:

This report provides the Capital Sustainability Steering Committee ("CSSC") with an update on the 2025 capital planning process initiated in May of 2024, including key factors impacting capital sustainability such as the Asset Management Plan (AMP) and developer funding legislative changes. The report recommends the 2025 Capital Budget Strategy for consideration during the 2025 capital planning process.

Recommendation(s):

a) That report SRCFS.24.029 regarding the 2025 Capital Budget Strategy Considerations be received, and all comments be referred back to staff for consideration during the 2025 capital planning process.

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Report Approval:

Submitted by: Sherry Adams, Commissioner of Corporate and Financial Services

Approved by: Darlene Joslin, City Manager

All reports are electronically reviewed and/or approved by the Division Director, Treasurer (as required), City Solicitor (as required), Commissioner and City Manager. Details of the reports approval are attached.

Background:

The annual capital planning process sets out the path to capital and financial sustainability. Comments from the CSSC, and directions set by Council at the beginning of the process enable staff to implement a capital budget strategy to achieve long-term capital sustainability. This report includes key factors to be considered during the 2025 capital planning process, including internal factors such as the 2024 Asset Management Plan (“AMP”) and external factors such as legislative changes via Bill 185.

The City of Richmond Hill's (“City”) Capital Budget and Forecast process follows an iterative approach whereby the first year’s capital budget is approved, and the nine-year capital forecast is received by Council. This ten-year capital budget and forecast development approach provides both the immediate capital investment needs as well as identifies the longer-term outlook of future capital needs, so these pressures can be proactively planned for and addressed in a financially sustainable manner. The Capital Budget and Forecast is informed by the recommendations from the City’s Enterprise Asset Management System and the Corporate Asset Management Plan, growth related Master Plans and Studies and the Fiscal Sustainability Strategy. Together they result in optimal prioritization of infrastructure needs and capital funding allocation.

Through ongoing evaluation and review of the City's long-term plans, such as the Asset Management Plan, Recreation and Culture Plan and Transportation Master Plan, the lifecycle and growth related capital forecast is adjusted to reflect changing needs, emerging priorities and external circumstances. This process enables the City to prioritize capital projects, allocate resources efficiently, and make informed decisions that support a growing, changing and developing community.

2024 Asset Management Plan

The 2024 Asset Management Plan, presented to the Committee of the Whole on May 29, 2024, proposes an asset renewal plan to maintain the City’s assets that have an estimated replacement value of $11.4 billion. Since the 2021 AMP, the estimates have increased significantly. The assets are on average in “Good” and “Very Good" condition but will require ongoing investments to maintain them to sustain reliable services. The annual asset renewal need is estimated at $80 to $87 million from 2024 to 2033, and $145 to $173 million from 2034 to 2051. In comparison, the approved 2024 Capital Budget was $57 million.

Considering “like for like” renewal needs for the City’s existing assets and using the City’s approved 2024 Capital Budget and Forecast as a baseline for the annual asset renewal plan, the 2024 Asset Management Plan identified a $284 million infrastructure backlog to maintain the City’s assets in their current condition-based levels of service.

To address the infrastructure backlog, the AMP recommends a gradual increase in annual investments from 2025 to 2051 to maintain the current asset condition-based Level of Service of “Very Good”.

The recommended annual increase averages $4.6 to $6.1 million which is comprised of:

- $0.4 to $0.6 million of water and wastewater rate-supported assets
- $0.5 to $0.8 million for stormwater management rate supported assets
- $3.7 to $4.7 million for tax rate supported assets

In addition, the AMP recommends an additional annual provision of $3 million for stormwater pond rehabilitations, and $0.3 million for street and park tree replacements due to storms and invasive species.

These figures do not include increases to the asset inventory levels from growth assets acquired or constructed to accommodate development beyond 2024, nor enhancements to the City's existing assets such as upgrades due to environmentally friendly initiatives.

To comply with the last phase of the O. Reg. 588/17 (July 1, 2025), proposed future level of services will be included in 2025 Asset Management Plan and brought forward to CSSC for consideration. Council's desire to address the infrastructure backlog sooner or later, increasing or decreasing the level of service of "Very Good" or increasing or decreasing funding will help guide the required investments to achieve the future desired performance of assets.

Developer Funding Legislative Updates

A. Cutting Red Tape to Build More Homes Act, 2024 ("Bill 185") – Proposed Changes to Development Charges Act, 1997 ("DCA")

On April 10, 2024, the Province of Ontario (the "Province") introduced Bill 185, Cutting Red Tape to Build More Homes Act, 2024 ("Bill 185"). The legislation proposes to amend 15 existing Acts, including the Development Charges Act. Bill 185, if enacted, would be effective for DC By-laws passed after the Bill comes into effect. Bill 185 contains provisions that would remove and amend some of the Development Charges changes from the previous legislative changes made through the enactments of Bills 108 and 23, including the following:

Mandatory Phase-in of Development Charges

Bill 185 contains provisions that would remove the mandatory phase-in of DCs resulting in the reversal of the required five-year phase-in of DC imposed through the enactment of Bill 23.

The removal of the five-year phase-in would reduce the estimated revenue loss from Bill 23 (estimated at $29M during the 2024 Development Charges Update) and better enable the City to support the infrastructure costs to facilitate growth with less reliance on municipal property taxes to fund the shortfall.

Eligible Capital Costs – Growth Studies

Bill 185 would amend the definition of eligible capital costs to allow for the inclusion of studies in the DC calculation. The proposed amendment would allow municipalities to fund studies, consistent with By-laws passed prior to Bill 23 thereby allowing for the funding of Master Plans, DC Background Studies, and similar studies that inform the capital costs of the DC Background Study.

The reinstatement of studies as an eligible capital cost would reduce the estimated revenue loss from Bill 23 (estimated at $7M during the 2024 Development Charges Update) and avoid the transfer of the financial burden of funding required for these studies to property tax and ratepayers.

Development Charges Freeze Period

For certain types of developments, the DC rate is “frozen” at the rates that were in effect at the time a Site Plan and/or a Zoning By-law Amendment application was submitted. Once the application is approved by the municipality, the DC rate is “locked-in” for two years. Bill 185 contains provisions that would reduce the two-year timeframe to eighteen (18) months with the intent of expediting building processes and incentivizing developers to obtain Building Permits promptly following approval of a Site Plan or Zoning By-law Amendment application.

The City does not anticipate significant impacts to DC collections as a result of this proposed change.

Development Charges By-laws Amendments and Next Steps

Bill 185 contains provisions to establish a streamlined process to allow municipalities to undertake minor amendments to DC By-laws for the extension of the expiry date, the reinstatement of studies as an eligible capital cost, and the removal of the mandatory five-year phase-in of DCs. Minor amendments related to studies and the phase-in of DCs may be undertaken only if the DC By-law being amended was enacted after November 28, 2022, and before Bill 185 takes effect. The amending by-law must be enacted within six months of Bill 185 taking effect.

Staff will initiate the DC By-law amendment process to reflect the legislative changes once Bill 185 receives Royal Assent and enacted by the Province.

B. Affordable Housing Bulletin

Bill 23 identified an exemption of DCs for Affordable Residential Units. This exemption was subsequently revised through Bill 134, Affordable Homes and Good Jobs Act, 2023 with respect to when a residential unit shall be considered to be an “affordable residential unit”. The affordable housing exemption applies to DCs, as well as Community Benefits Charges (“CBCs”), and parkland dedication. Subsequent to the introduction of Bill 185, the Province released the Affordable Housing Bulletin, which provides the Affordable Unit Prices (ownership and rental) that will be used to determine eligibility for the affordable housing exemption and is seeking to enact this exemption beginning on June 1, 2024.

Financial/Staffing/Other Implications:

The City's capital budget and forecast process is a continuous, annual exercise. In the past, Council approved the “Pay as You Go” strategy involving lower annual expenditures and annual increases to the Capital Asset Sustainability Levy to manage the funding gap of the Tax-supported assets and reserve funds. This strategy has become unattainable as the City learns more about its assets and future replacement needs, leading to growing annual capital expenditure requirements and widening of the funding gap.

In 2019, Council and Senior Management identified the need for a CSSC to establish a sustainable long term capital investment strategy that includes all areas of tax supported and storm-water capital investments.

Ongoing work by staff and consultation process with CSSC will result in an updated Financial Sustainability Strategy to inform the annual capital budget strategy. An interim capital budget strategy is being recommended by staff for the 2025 Capital Budget Strategy by following a similar approach as previous years using a funding envelope for each major funding source.

Tax Supported Funding Envelope

The Capital Asset Sustainability Levy (“CASL”) was approved in 2016 to minimize the state of good repair infrastructure funding gap over ten years. The CASL is applied based on the Current Value Assessment of a property as determined by the Municipal Property Assessment Corporation and was expected to reach its goal of increasing contributions to the tax supported reserve funds by 2025. Council adopted the Capital Asset Sustainability Strategy, gradually moving the City towards a “Pay As You Go” capital approach. This approach became unrealistic and exacerbated the AMP backlog.

In late 2020, the *Financial Sustainability Strategy (SRCFS.20.026)* report recognized imminent funding gap pressures without increases to the CASL. This report identified additional information on City assets and the true 'gap' which necessitated consideration of increasing the levy, moderating spend and potential debt. However, it was dependent on City Plans that were still in progress at the time (e.g. Official Plan, Transportation Master Plan, Urban Master Environmental Servicing Plan and Parks and Recreation Master Plan, and Corporate Asset Management Plan), and deferred implementation.

In 2024, Council approved 1.5% CASL from 1% to increase contribution to gradually close the gap.

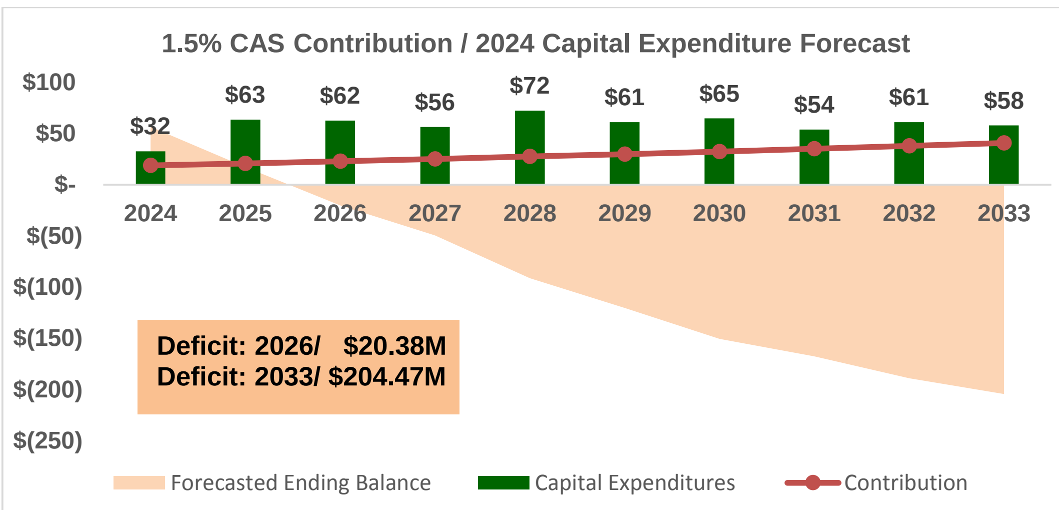
Staff considered three scenarios for setting the 2025 Capital Budget Strategy on the tax supported funding envelope by analyzing the projected expenditures based on the:

1. 2024 Capital Forecast
2. Modified Phased-in 2024 Asset Management Plan – based on the 2024 Asset Management Plan and modified to include beyond like-for-like, e.g., growth and enhancements.
3. Indexed Historical Capital Budget Average (same approach for the 2024 Budget)

1. 2024 Capital Forecast

The chart below compares the tax supported capital expenditures to the annual tax supported reserve fund contributions from CASL for the years 2024 to 2033.

The green bars indicate the 2024 Capital Forecast expenditures, inclusive of project management and overhead costs. The red line represents the annual funding contributions from the CASL, increasing at a 1.5% tax rate equivalent and beyond initial plan of 10-years.



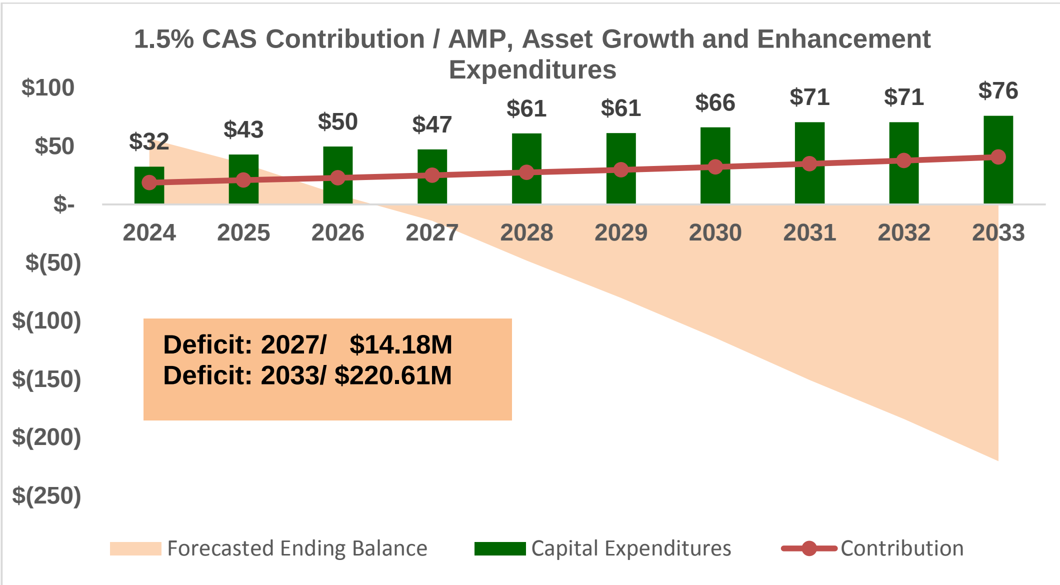
If the annual capital expenditures are approved at the 2024 Capital Forecast level, this scenario results in a deficit of $20.38M in tax supported reserve funds by 2026, and $204.47M deficit by 2033.

2. Modified Phased-in 2024 Asset Management Plan

Similar to the previous scenario the chart on the next page shows the tax supported capital expenditures to annual tax supported reserve fund contributions from CASL for the years 2024 to 2033.

The green bars indicate the capital expenditures, inclusive of project management and overhead costs, based on the **Phased-in AMP**. The Phased-in AMP consists of state of good repair projects for the 2024 approved level of funding adjusted for a 2% annual incremental increase, and an average of $4.2M phased-in to gradually elevate the existing capital need backlog identified in the AMP. In addition, the modification includes component of the growth projects and studies funded through tax supported reserve funds. The red line represents the annual funding contributions from the CASL, increasing at a 1.5% tax rate equivalent until 2033.

The 2024 AMP described in the "Background" section of this report includes a phase-in of the infrastructure backlog of $4.2M per-year, and a compounded 2% annual increase. For purposes of this analysis, the AMP figures were modified to include assumptions for the accumulation of growth-related assets, enhancements and other non-like-for-like capital investments.

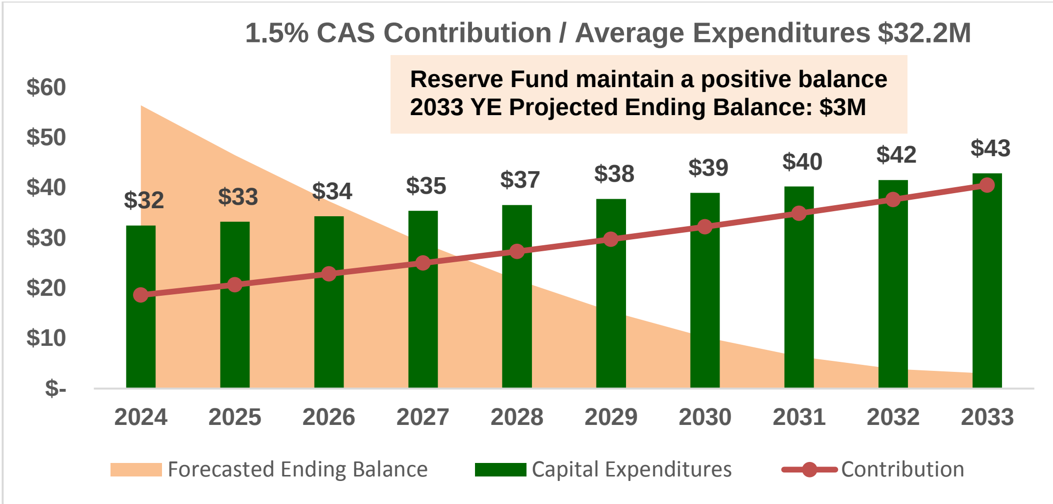


This scenario results in a deficit of $14.18M in tax supported reserve funds by 2027, and $220.61M deficit by 2033.

3. Indexed Historical Capital Budget Average

Similar to the previous scenarios the chart below compares the tax supported capital expenditures to the annual tax supported reserve fund contributions from CASL for the years 2024 to 2033.

The green bars indicate capital expenditures, inclusive of project management and overhead costs based on a funding cap utilizing a historical capital budget average, indexed by the annual non-residential construction building price index. The red line represents the annual funding contributions from the CASL, increasing at a 1.5% tax rate equivalent until 2033.



This scenario results in a $33.3M cap in 2025, inclusive of project management and overhead costs, and escalating by 3.24% to factor in inflation in each of the following years. This scenario maintains a postive reserve fund balance throughout the capital forecast period to maintain financial sustainability however the reserve fund is trending towards a deficit.

Based on the 2024 AMP, current funding levels are unsustainble based on the 2024 Capital Forecast.The 2025 Asset Management Plan work will review proposed levels of service and a financing strategy. It will explore options on how the funding may be increased in the future, in consideration of changes to the current levels of service, ideal asset condition, and abiltiy to increase contributions without incurring debt for tax supported assets. This is anticipated to be ready for implementation as part of the 2026 or 2027 Capital Budget process.

For this and and future CSSC discussions, considerations and options are:

- Potenteial service level changes
- Increase in contributions to the tax and rate supported reserve funds
- Target reserve fund levels
- Financing options

Rate Supported Funding Envelope

The rate supported funding envelope is separated into two separate components: water and wastewater, and stormwater management.

1. Water and Wastewater Funding Envelope

The Water and Wastewater Financial Plan was presented to Committee of the Whole on May 29, 2024. Following the annual capital expenditure levels identified in the 2024 Capital Forecast, water and wastewater rate supported reserve funds will result in a deficit balance by 2027. The Water and Wastewater Financial Plan recommended smoothing out expenditures and increasing contributions to Watermain Repair and

Replacement Reserve Fund through decreasing Sanitary Sewer Repair and Replacement Reserve Fund contributions from 2025 to 2029. This was to take into consideration the 2024 Capital Forecast smoothed out, to achieve financial sustainability.

Pending COW/Council endorsement of the Financial Plan, the 2025 water and wastewater rate supported funding envelope will follow the principles of the Water and Wastewater Financial Plan and evaluated during the budget process.

2. Stormwater Management (SWM)

Historical underfunding and deferral of stormwater management projects, along with depleting of the reserve fund has culminated in the funding challenges the City now faces along with the infrastructure backlog for stormwater management assets. The SWM fee was implemented in 2013 to gradually phase-in rate increases to build up the reserve fund to provide long-term financial sustainability of the stormwater management infrastructure. The City has not implemented the rate increases necessary to achieve financial sustainability, and other municipalities face similar financial challenges. In November 2023, Council approved refinements to the previous rate structure, along with policy changes including a cap on residential vacant land, farmland and golf courses. This was to address concerns with an equity distribution of the stormwater management operating burden, with an impact analysis of the infrastructure funding gap in 2024.

The Stormwater Management Financial Plan exercise was initiated this year together with the Water and Wastewater Financial Plan. Preliminary results present financial challenges to consider and additional analysis will be undertaken. It will be finalized and presented to Committee and Council consideration in the fall, in conjunction with the 2025 budget process. Additional analysis will:

- Review legislative requirements, drivers and consequence of not meeting the requirements
- Review by asset sub-categories to understand requirements (stormwater ponds, piped infrastructure, road reconstructions and other)
- Focus on prioritizing significant projects within the ten-year plan

In the interim, it would be prudent to follow a pay-as-you go philosophy, prioritizing the 2025 capital based on the existing capital contribution levels.

Development Charges Funding Envelope

When Bill 185 is enacted, as discussed above, the overall DC revenue shortfall from Bill 23 impact will substantially decrease. This would include removal of the 5-year DC rate phase-in; including growth studies, and land costs, as eligible costs under the DCA.

Based on preliminary review of the short-term growth forecast, the trend of the housing starts across Ontario is down by 7% in 2023 from 2022, Ontario did not meet the housing target for 2023 set by the Province, in part due to economic slowdown and the high interest rate environment. A more thorough review of the short-term growth forecast is currently under way, however, at this time it is too early to assess whether the growth forecast can be achieved. Based on the existing growth forecast DC revenues are anticipated to increase significantly to approximately $44M in 2024 and $36M in 2025, this anticipated revenue trend is not supported by the 2023 DC revenues of $22.9M.

A cap will be set on DC funding (same approach in 2024) to reflect anticipated residual financial impact of Bill 23 and the potential loss in DC revenues, in the event that the projected growth forecast is not realized. The annual evaluation of timing of growth related projects is directly impacted by the pace of growth and is currently underway, which will enable staff to prioritize projects in the capital budget and forecast.

Cash in lieu of Parkland (“CIL”) Funding Envelope

CIL historical collections are approximately $8M per year, as a result of Bill 23 this amount was expected to be reduced to approximately $6M per year. However, as reported, Richmond Hill collected less than $3M in 2023.

As discussed in the Development Charges section, a cap will also be applied on CIL of Parkland funding (same approach in 2024) until the development market is more certain.

The annual evaluation of timing of growth related projects is directly impacted by the pace of growth and is currently underway, which will enable staff to prioritize projects in the capital budget and forecast.

Relationship to Strategic Plan:

Informing the CSSC of key factors impacting the long-term capital financial sustainability during the 2025 capital planning process relates to Pillar 3, Strengthening our Foundations, specifically, Priority 1, Make decisions that are evidence based and data driven to enable the City’s long term financial sustainability, as well as social, environmental and economic sustainability, services and events and fostering connections between the City and residents, as well as among community members themselves.

Conclusion:

The annual capital planning process sets out a path to capital and financial sustainability. Comments received from the CSSC, and the endorsement of the staff recommended funding approach will guide directions set by Council for the capital planning process. These recommendations consider external funding constraints while following Council priorities and will enable staff to implement a capital budget strategy to achieve long-term capital sustainability.

Report Approval Details

Document Title:	SRCFS.24.029 - 2025 Capital Budget Strategy Considerations.docx
Attachments:	
Final Approval Date:	May 30, 2024

This report and all of its attachments were approved and signed as outlined below:

Gigi Li - May 29, 2024 - 4:28 PM

Darlene Joslin - May 30, 2024 - 9:23 AM