CITY OF VANCOUVER

COUNCIL REPORT

Report Date:	July 11, 2023
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Meeting Date:	July 26, 2023

Submit comments to Council

TO: Standing Committee on Policy and Strategic Priorities

FROM: General Manager of Planning, Urban Design and Sustainability

SUBJECT: 2023 Annual Inflationary Rate Adjustment to Development Cost Levies

Recommendations

THAT Council approve, in-principle, a 2023 inflationary rate adjustment of 8.3% for the Vancouver Development Cost Levy By-law, the Vancouver Utilities Development Cost Levy By-law and the Area Specific Development Cost Levy By-law;

FURTHER THAT, in recognition that in 2022 Council approved a two-phase Development Cost Levy increase with the second phase scheduled to come into effect on September 30, 2023, the implementation of the 2023 inflationary rate increase be deferred and included as part of the 2024 annual inflationary rate adjustment.

Purpose and Executive Summary

This report seeks Council approval, in-principle, to adopt a 2023 inflationary rate adjustment of 8.3% to Development Cost Levies (DCLs) and to defer the implementation of the increase to 2024. The deferred rate increase will be included as part of next year's, inflationary rate adjustment. Following Council approval of the 2024 annual inflationary adjustment, new rates (including the deferred 8.3% increase) would be effective September 30, 2024.

The inflationary rate adjustment to development contributions (e.g. DCLs, Community Amenity Contribution (CAC) targets, density bonus contributions) is applied annually and allows the City to keep pace with the increasing cost of providing growth-related amenities and infrastructure. The calculated 2023 inflationary rate adjustment to DCLs is 8.3%. This adjustment reflects the annual increases in the cost of land and non-residential construction, both of which are key inputs in the City's delivery of growth-related amenities and infrastructure. The recommendation to defer this year's inflationary adjustment to 2024 takes into consideration the current uncertain real estate environment and the remaining phased-in rate increase that Council approved as part of the 2022 DCL update.

Council Authority/Previous Decisions

- In June 2003, Council adopted the Financing Growth Policy that sets the framework for the collection and allocation of DCLs to help pay for eligible amenities and infrastructure needed for growth: parks, housing, childcare, and various engineering infrastructure.
- In October 2009, Council adopted the annual inflationary DCL rate adjustment system, with the new rates effective on September 30 of each year.
- In July 2022, Council approved a comprehensive update to the City-wide DCL and Utilities DCL with the rate increase to be phased-in over two years.

City Manager's Comments

The City Manager concurs with the foregoing recommendation.

Context and Background

Development contributions such as DCLs are a primary funding source for amenities and infrastructure necessary to support growth. Development contributions offset the cost of growth and limit the impact on property taxes and other City funding sources.

The annual inflationary rate adjustments to DCLs form an integral part of Vancouver's development contribution system. These adjustments help the City maintain its purchasing power year over year to deliver the necessary growth-related amenities and infrastructure. This report outlines the 2023 inflationary rate adjustments to DCLs. This year's inflationary adjustment to CAC Targets and density bonus contributions will not apply since a comprehensive recalibration of these rates took place earlier this year.

Included in Appendix A is an overview of the annual inflationary rate adjustment system, the annual inflationary index from 2014 to 2023, a review of current local economic indicators, and detailed background information on DCLs.

Discussion

The annual inflationary rate adjustment includes a review of current local market trends and forecasts to inform rate adjustments. The City also retained Coriolis Consulting to assess real estate market conditions which indicates that current economic conditions are challenging. Project costs have been negatively impacted by both rising construction costs along with sustained Bank of Canada interest rate increases. For more on Coriolis' market assessment see Appendix A.

In June 2022, Council approved the comprehensive update to DCLs and the phase-in of increased rates over two years. Effective September 30, 2023, the remaining 12% to 20% increase from the 2022 DCL update will come into effect. If the City were to apply the annual inflationary adjustment in addition to the pre-approved DCL rate increases, this would result in significant total DCL rate increases of 20% to 30% for 2023 (see Table 1). In light of this, and the uncertain real estate market conditions highlighted in Appendix A, staff are recommending the 2023 inflationary rate adjustment be deferred and included as part of the 2024 inflationary rate adjustment.

Table 1: Total DCL rate increase with 2023 inflationary adjustment

DCL Rate Category	Pre-approved phased-in rate increase (Sept 30, 2023)	Deferred 2023 Inflationary Adjustment (Sept 30, 2024)	Total DCL rate increase with 2023 Inflationary Adjustment (Sept 30, 2024)
Residential	+ 12.5%	+ 8.3%	+ 20.8%
Non-residential	+ 20.0%	+ 8.3%	+ 28.3%

Communications Plan

To ensure broad notification of this recommendation, the following engagement steps were taken:

- Website posting of proposed rates on the City's Community Benefits from Development web page;
- Notice of staff recommendation in the City's Development Cost Levy Bulletin; and
- Staff notification to local industry groups (Urban Development Institute, National Association of Industrial and Office Properties (NAIOP), Homebuilders Association Vancouver).

At the time of finalizing this report, staff had not received any correspondence from industry stakeholders.

Financial Implications

A core principle of the City's Financing Growth policies is that development should pay its fair share of growth costs. Development contributions also must be set accordingly and should not deter development or negatively impact the delivery of housing and job space.

DCLs, together with other development contributions such as CACs, density bonus contributions, and engineering conditions, help fund amenities and infrastructure to support new development and growth in the City and reduce the impact on property taxes and other City funding sources.

Rate adjustments to DCLs have financial implications for the City and the development industry.

Financial Implications for the City

Should Council approve the recommended deferral of the 2023 inflationary adjustment set out in this report, the City will forego approximately $10 million in DCL revenue.

Financial Implications for Development

An independent review found that in Vancouver, development contributions result in downward pressure on the cost of land, which supports affordability. This review also confirmed that when rates are set based on economic feasibility testing, rates will not negatively impact housing affordability or the supply of job space and development sites. If rates are set too high or do not allow sufficient time for the industry to adjust, then the supply of new housing and job space could be negatively impacted especially in the short-term.

Legal Implications

The Vancouver Charter does not require Council to increase DCLs, and Council can lawfully defer any increases.

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APPENDIX A
OVERVIEW

1. Overview of Inflationary Index System

The annual inflationary rate adjustment system was developed using local and national best practices and is guided by a set of Council-adopted principles that require the system to:

- use publicly accessible, third party data;
- use transparent calculations that are accessible to external stakeholders;
- adjust rates upward or downward based on inflationary trends;
- adapt to changes in the market; and
- be supportable by industry & stakeholders

The system itself consists of two components. The first component is an index calculation based on year-over-year changes in property value (BC Assessment property roll) and a non-residential construction price index (Statistics Canada Non-Residential Construction Price Index). These inputs are blended together to reflect the City's current Capital Plan program and anticipated expenditure on land acquisition and construction (see Table 2).

Table 2: Annual Inflationary Index (2014 – 2023)

Annual Inflationary Index		Data used to calculate index *(for information only)*			
Year	Annual Inflationary Index	Local Property Value Inflation	Local Construction Cost Inflation	Capital Plan Blend: Land	Capital Plan Blend: Construction
2014	1.6%	0.8%	3.0%	65%	35%
2015	3.4%	8.6%	1.7%	25%	75%
2016	4.6%	16.5%	0.6%	25%	75%
2017	11.9%	29.2%	6.1%	25%	75%
2018	4.8%	5.1%	4.7%	25%	75%
2019*	5.2%	1.2%	6.0%	17%	83%
2020	-0.8%	-8.9%	0.8%	17%	83%
2021	1.2%	1.4%	1.2%	17%	83%
2022	8.8%	10.3%	8.5%	17%	83%
2023	8.3%	3.9%	9.2%	17%	83%

***** In 2019, Council approved the 5.2% increase to non-residential rate categories, but opted not to proceed with the 5.2% increase to residential rate categories in response to weakening market conditions in this sector.

Linking rates to an annual inflationary index results in rate increases when inflation is positive and rate decreases when inflation is negative. The 2023 BC Assessment[1] property roll for the City of Vancouver indicated a 3.9% annual increase in assessed property value, while the Statistics Canada[2] Non-Residential Construction Price Index for Q1 2023 recorded an increase of 9.2% from Q1 2022. The City's 2023-2026 Capital Plan[3] is anticipated to invest 17% towards land acquisition and 83% towards construction costs.

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[1] BC Assessment, Property Roll for the City of Vancouver, 2023
[2] Statistics Canada, Non-Residential Building Construction Price Index for Vancouver, Q1 2023
[3] City of Vancouver, 2023-2026 Capital Plan

It is important to note that the inputs into Vancouver's index calculation lag behind the most current market conditions. BC Assessment property values for 2023 are based on property values that were assessed in July 2022, and Statistics Canada's non-residential construction price index is based on data from the first quarter of 2023. This could occasionally result in situations where the inflationary rate adjustment as calculated by the index does not reflect shifting market conditions. To address this, a further step in the annual inflationary rate adjustment system is a review of local economic indicators. This review helps to ensure that rates are aligned with inflationary trends.

The inflationary adjustment system provides predictability/certainty to both the development industry and the City, and has been broadly supported by industry stakeholders as this results in more incremental changes between comprehensive updates done every four years. Over the years, Council has approved inflationary rate adjustments with average rate increases of approximately 4% between 2013 and 2022 (see Table 2). It is important to note that in 2019, Council approved a 5.2% increase to non-residential rate categories, but opted not to proceed with a 5.2% increase to residential rate categories in response to weakening market conditions in residential sector. In 2020, the inflationary index was -0.8%, which is the first time rates have decreased under the inflationary index system.

Annual rate adjustment reporting to Council occurs in June or July proposing new DCL rates, CAC targets, or density bonus contribution rates that have been adjusted for inflation. If approved, these new rates come into effect annually on September 30th.

For more information on the Council approved annual inflationary rate adjustment system, see http://vancouver.ca/home-property-development/annual-inflation-index.aspx.

2. Review of Current Local Economic Indicators

As part of the annual inflationary rate adjustment process, current economic indicators are reviewed to verify the proposed rate adjustments are in-line with current local market trends and forecasts. In addition, the City of Vancouver retained Coriolis Consulting to perform an assessment of current real estate market conditions in Vancouver.

Economic Context

- Central 1 Credit Union is forecasting British Columbia's economy to slow this year in line with broader trends as the cumulative impacts of higher interest rates on consumer spending and business investment unfold. A modest 0.8% increase in British Columbia's Gross Domestic Product (GDP) is forecast for 2023 (in comparison, recent years have seen 3.0% to 4.0% BC GDP increases).[4]
- Vancouver CMA (Metro Vancouver) unemployment rate is 5.1% as of May 2023, which is up from 4.6% in January 2023.[5]

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[4] Credit 1 Central Union, BC Economic Outlook 2023-2023, May 2023
[5] Statistics Canada, Labour Force Characteristics Table 14-10-0380-01, May 2023

Market Indicators:

- According to City data, the value of year-to-date building permits issued (as of Apr 2023) has decreased by half from last year's year-to-date value[6]
- According to CMHC, year-to-date housing starts in Vancouver (as of April 2023) have increased by 25% compared to 2022[7]
- According to data from the Real Estate Board of Greater Vancouver (May 2023), resale activity for Vancouver apartments decreased about 25%-30% when comparing March-May volumes between 2022 and 2023. All property types saw annual price decreases since May 2022 (Detached: 5-6%, Townhouse: 2-4%, Apartment: 2-3%)[8]
- Colliers Q1 2023 office market report shows Downtown Vancouver vacancy at 8.4% and the Broadway Corridor at 5.9%, both showing increases from a year ago. Asking rental rates for office in the Downtown and Broadway markets have remained stable from last year.[9]
- Colliers Q1 2023 industrial market report shows Vancouver vacancy at 1.4%, unchanged from last year.[10]

Furthermore, Coriolis Consulting was commissioned in spring 2023 to perform an assessment of current real estate market conditions in Vancouver (all market sectors were reviewed including residential strata, residential rental, office, and industrial).

<u>Coriolis Market Condition Assessment (Spring 2023)</u>

Since DCL rates were increased in June 2022, project costs have increased and demand has slowed, but market values are mixed depending on the real estate sector. Key market indicators are as follows:

a) Project costs have increased since the new DCL rates were adopted in June 2022:
    - Construction costs have increased for all product types. Increases are likely on the order of 5% to 6% over this time period (Statistics Canada data).
    - Interest rates have increased significantly since June 2022, making construction financing significantly more expensive. Construction financing is often linked to the prime lending rate, which increased from 3.2% in June 2022 to 6.7% today (Bank of Canada).

b) The value of completed space for each main product type has been stable or slightly increasing since June 2022:
    - Values for office and industrial space have remained relatively stable (or slightly increased) since June 2022 (Colliers data).

[6] City of Vancouver, Statement of Building Permits Issued, Apr 2023
[7] CMHC, Housing Information Portal, Apr 2023
[8] Real Estate Board of Greater Vancouver, Monthly Market Report, May 2023
[9] Colliers, Vancouver Office and Industrial Market Reports Q1 2023
[10] Colliers, Vancouver Office Market Report Q1 2023

- Rents for apartment units in Vancouver have increased significantly since June 2022 (Rentals.ca).
- Residential values (townhouse, apartment) declined during the second half of 2022, but have been increasing during 2023 and are similar to June 2022 (Real Estate Board of Greater Vancouver HPI).

c) MLS sales volumes for residential product have declined during the second half of 2022, but have been increasing during 2023. Total volumes are currently significantly lower than March to June 2022 (Real Estate Board).

d) Vacancy rates for office and industrial in Vancouver have increased marginally since June 2022 (Colliers).

Overall, the current market is more challenging compared to Q2 2022 (particularly due to construction cost and interest rate increases), but values for all product types remain high and re-sale activity has been increasing in recent months.

3. Development Cost Levies (DCLs)

Development Cost Levies (DCLs) are a growth-related charge collected from most new development and an important source of funding for amenities and infrastructure needed to serve new residents and workers. DCLs help relieve pressure on other City funding sources and property taxes.

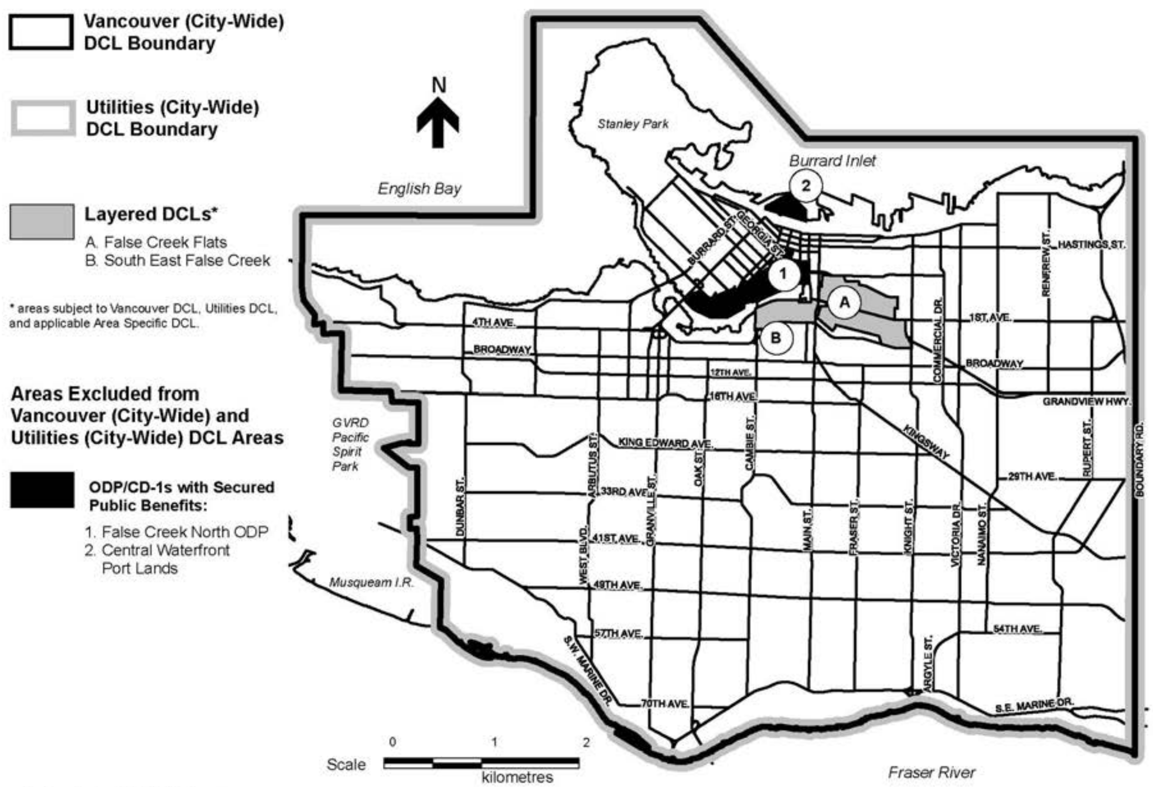
DCLs are applied on a per square foot basis and payment is due at Building Permit issuance. DCL revenues pay for specific growth-related capital projects (as permitted by the Vancouver Charter). The City-wide DCL is allocated to park development and improvements, replacement (affordable) housing, childcare facilities, transportation, and utilities (affordable housing). The Utilities DCL is fully allocated to utility infrastructure (sewer, water, and drainage).

The current DCL system, which has been significantly simplified over the years, consists of 4 DCL Districts (each with its own rates) and 2 additional planning areas excluded from DCLs. The Vancouver (City-wide) and Utilities DCL Districts apply to most of the city and the 2 Area Specific DCL Districts apply to smaller planning areas across Vancouver.

DCL By-laws establish area boundaries of each DCL district where the City has been moving towards a city-wide DCL framework. Levies collected within each district must be spent within the area boundary, except for DCLs collected for replacement housing which can be spent city-wide. DCL districts are divided into two general categories:

1. Base DCL Districts: This includes the City-wide DCL District and the Vancouver Utilities DCL District. These districts apply across the city and most developments are subject to both DCLs.
2. Layered DCL Districts: These are specific geographic areas in which the Area Specific DCL, the City-wide DCL, and Utilities DCL all apply. There are two such areas shown on the map as A and B (False Creek Flats and Southeast False Creek). These are or were industrial areas where new plans identified potential for significant redevelopment and a higher need for facilities than could be covered by the City-wide DCL and Utilities DCL alone.

DCL Districts Map



note: boundaries of highlighted areas area approximate and shown for illustrative purposes only.