Commentary on Watson & Associates' Report on 'City of London's Economic Impact of Proposed Development Charges'

Report Reviewed by:

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A Brief Profile of Reviewer

- **Dr. Godwin Arku** is an Associate Professor at the Department of Geography, Western University, London, Ontario. He teaches courses in urban and economic development. Dr Arku's research focuses on the global economic changes and their impacts on municipal economic development efforts, relationships between housing and economic development, and impacts of economic restructuring on the urban built environment. Dr Arku has extensive publications on these topics in both national and international peer review journals. Dr Arku holds a master's degree in Urban and Economic Geography from the University of Toronto, and Doctorate from McMaster University.

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The report by Watson and Associates Economists Ltd investigates the economic impact of the proposed Development Charge (DC) rates increases for the City of London. The report examines the impact on housing affordability and housing market demand, housing construction, the burden on commercial and industrial development within the City, as well as its broader impacts on the local and regional market. The investigation determines:

1. Whether an increase in DC rates will negatively affect the rate and the overall vitality of residential, industrial, commercial development in the short and long term; and
2. The broad impacts the proposed increase in DC rates will have on the local and regional economy.

To determine these issues, the consultants used relevant statistical data and input from builders and developers within the city. The text below summarises key strengths, weaknesses, consistencies and inconsistencies of the report.

Statistical Data and market indicators: A major strength of the report is that it is grounded in diverse, relevant and up-to-date statistics, considering all the different and multiple aspects of housing, industrial, commercial development, as well as the broader local and regional economic indicators.

The report's data sources are reliable and variable, and include those obtained from Statistics Canada and Canada Mortgage and Housing Corporation (CMHC). The housing market indicators which are provided in the report (e.g. building permits, housing sales to new listing, and home prizes) are typically those utilized in this kind of economic impact analysis; any increases in DC rates might be expected to affect these indicators and the profit of residential development within the municipality, especially in the short term. However, as the report rightly noted, DCs only represent a small portion of overall housing costs when compared to land and construction costs. Yet it is equally true that DC rates are also about "perception", as noted by the builders and developers, and the ability of the city to compete at all geographic levels (i.e. local, regional, national and global). The statistical data for the market indicators cover a sufficiently long period of time (about 10 years; 2004 – 2013) to draw tentative conclusions on the potential impacts of DC increases on the rates of housing, industrial and commercial development in the city; the period comprises pre-recession, peak of recession, and ongoing recovery era.

Comparative municipal analysis: The report compares the City of London with a sample of municipalities within the surrounding and regional area. This comparative analysis is instructive, as it shows not only the market strength of London compared to its competitors, but also the relative impacts of the proposed DC rates increases on London's economy in relation to the other municipalities.

In general, the range of municipalities utilized in the report are sufficiently diverse and numerous and it provides a good context for the kind of economic impacts analysis contained in the report. Two of the comparative analyses are particularly worth citing. The first relates to London's DC rates relative to its competitors, as demonstrated in Figure 8. Under the proposed DC rate of $28,143 per unit, London's residential charge would be the second highest within the local and regional area. The second relates to London's development charges as a percentage of new home price on a single family home, which reveals that London would have the highest within the local and regional area in this category.

Key analysis and conclusions: Although the report has a wealth of information in the report to draw tentative conclusions on the economic impacts of DC rates increases on London's economy, not all conclusions are supported by the available data provided in the report. Key conclusions are commented on below:

Residential market analysis

- In comparison to its competitors (e.g. Hamilton, Kitchener, Waterloo and Brantford), the available housing market indicators provided in the report show that London's economy is gradually recovering, but the residential market is still relatively weak and could be impacted negatively by large increases in DC rates. Against this backdrop, the current review agrees with the report's conclusion that "the City of London housing market is not as well positioned to absorb a significant increase in residential development charges in comparison to the other municipalities considered to the east" (reference: page 16 of the report).
- The report also concludes that the proposed DC rates increases would result in an increase of 1% in the average price of new single detached homes in the city and that this increase would have a minimal impact on housing affordability. However, a 1% overall increase should not be considered minimal. Increasing the DC rate by 1% to 7.2% of a new home price puts London at the top of the list of sample cities included in the report. The sample cities have a narrow range of DC rates per new home price (between 3.4% and 6.3% of new housing price; a 2.9% spread) and therefore a 1% increase in London is likely to have more than minimal impact.
- On housing development in the city, the report concludes that "it is unlikely that the proposed DC increase would have a significant long-term impact on the rate of housing construction, or the construction sector as a whole" (reference: page 16 of the report). This conclusion is contrary to an earlier proposition, as stated on page 4: "it is difficult to identify a direct correlation between the level of residential development charges and the rate of development in municipalities over the longer term due to broader economic factors …". This review agrees with the latter proposition as a richer and rigorous analysis will be required to draw a definite conclusion on the long term economic impacts.

Non-Residential sector analysis

- The analysis on the potential impacts on DC rates increases on industrial development is generally adequate and clear in terms of both scope and coverage approach. However, in order to provide a clearer understanding of market dynamics it would be important to show raw numbers used to create Figures 14 & 15 of the report. This is because if construction costs, land costs, and development costs remain constant, it may be misleading to show these decreasing after the introduction of increased development charges. This way of presenting the data also suggests that developer profit increases with higher development charges. As well, it would have been better to show all components of calculations in Figures 16 & 17. The underlying assumptions within these specific calculations are not entirely clear in the current version of the report.
- If all calculations contained in the report are accurate then this review agrees with the conclusion that "a 15% increase in the overall costs of industrial development is significant and would have a negative impact on the City's competitive position" (reference: page 24). However, this negative implication is unlikely because the report indicates that the City will not be charging the industrial rate, as there is a commitment to DC exemption under the current Community Improvement Plan (CIP).
- Similar to industrial development, the analysis on the potential impacts on DC rates increases on commercial development is adequate and clear in terms of illustration and depth of information, and the review agrees with the key conclusion of the report, that "a 3% increase in total annualized development costs is expected to have a modest impact on the cost competitiveness of the commercial retail market in the City of London" (reference: page 25 of the report).

Overall Report Conclusions

In general Watson and Associates' report is technically sound and the conclusions are by and large consistent with the available data and analysis – noting areas of inconsistency and disagreement above. Two important conclusions are worth reiterating here.

1. First, London's housing market would be more sensitive to a significant increase in residential development charges in comparison to the other Ontario municipalities.
2. Second, with respect to the industrial and commercial sectors, the City of London is more sensitive to DC rates increases in comparison to stronger markets in the east direction towards the GTA where average land values are relatively higher and economic conditions are generally more favourable.

Along with Watson and Associates' report, both of these conclusions align with the reviewer's professional knowledge of the property market, and also consistent with recent academic evidence. To strengthen the report, it would be worthwhile to contrast the economic impact analysis with the survey insights gained from the builders and developers within the city (Chapter 4 of the report). In conclusion, it is important to mention that DCs are essentially meant to recover growth costs, and the rates are determined on forecast growth over a given period. It also based on the projected costs of infrastructure and facilities required to service the projected growth. The capital costs needed to service the projected growth may vary among municipalities.