FINANCING MUNICIPAL SERVICES:

A LAWYER, AN ENGINEER, AND AN ACCOUNTANT ARE DRIVING DOWN THE ROAD…

NOVEMBER 30, 2012

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I. INTRODUCTION

Constructing, expanding, and upgrading municipal services and systems, and particularly capital services such as sewer, drainage, water, parks, and highways can be expensive. Determining how to pay for such services can also be a complicated task. This paper will serve as a primer on several options for financing municipal services, specifically:

(i) General services and parcel taxes;

(ii) Local area services;

(iii) Development works agreements pursuant to s. 937.1 of the *Local Government Act*;

(iv) Works and services requirements and agreements under Division 11 of Part 26 of the *Local Government Act*, including latecomer agreements; and

(v) Development cost charges.

This paper focuses on servicing options in municipalities. The statutory provisions that relate to general and local area services in regional districts are different from those discussed here for municipalities, and so caution should be taken in applying the guidelines below to regional districts.

II. FINANCING GENERAL SERVICES

A service which is provided throughout an entire municipality is a general service. An example may be fire protection, if the municipality makes it available to all residents. A general service may also be provided in only a small area of the municipality, but be considered by Council as one that is of benefit to the entire municipality. For example, a municipality may undertake a service of providing hanging flower baskets and watering them in only the downtown core, but consider that this is a benefit to the entire community that should be provided and financed through general revenues. The hanging baskets would then be financed as a general service. Many services that do not require borrowing or intensive capital investment are financed as general services. Even sewer or water services that may not yet extend throughout an entire municipality may be established and financed as general municipal services, if Council considers them to be of general benefit to the community.

A. Establishment of the Service and Approvals

A general municipal service may be established by council resolution or bylaw under section 8(2) of the *Community Charter.*

There is no elector approval needed for council to establish a general service.

B. Cost Recovery

The costs of general services may be recovered from general municipal revenue, property taxes, parcel taxes, fees, grants, gifts and other sources of municipal revenue, or any combination of them. Below we will specifically discuss some of the legal issues engaged by the use of service fees and parcel taxes.

1. User Fees

If the costs of a general municipal service are recovered by charging a user fee imposed on persons using the service, the result of this may be that only some persons within the municipality pay for the service (for example, library users) or it may be that only persons within a particular area pay for the service (for example, persons within the garbage collection area). User fees may only be charged to users of a service, however. While fees may be levied at the same time, or together with property taxes, they cannot be levied against properties that do not use the service. Furthermore, user fees are voluntary in nature, as opposed to taxes which may be levied regardless of whether a person or property chooses to use a service. Significant difficulties arise where a fee is charged that bears the hallmarks of a tax, where a tax is not authorized. The most recent example of this was considered in *Canadian Wireless Telecommunications Assn. v. Nanaimo (City),* 2012 BCSC 1017.

Generally we would not recommend the use of user fees for essential services, or services that generally benefit the entire community, and not just those in immediate need of the service. Fire, police and bylaw enforcement services are not well suited to service fees, as it is generally in the entire community's interests that these service providers be called upon without regard to who may be liable to pay a fee for requesting the service.

2. Parcel Taxes

In municipalities, the costs of a general municipal service may be levied by a parcel tax applicable to the entire municipality pursuant to s. 201 of the *Community Charter.* A parcel tax is applicable to all properties that have the opportunity to be served in a broad sense (see *Yoo (c.o.b. Pita Wrapbit) v. Cranbrook (City)* 2007 BCSC 1635) even if they are not connected to the service, but cannot be recovered from properties with no opportunity to be served at all (see s. 201(2) of Community Charter).

A parcel tax may be used as a cost recovery method for a general service or a local area service scheme. A parcel tax may be:

(a) A single amount per parcel,

(b) An amount based on the taxable area of a parcel, or

(c) An amount based on the taxable frontage of a parcel.

Section 201(2) of the *Charter* provides that a parcel tax may be imposed only on parcels that have the opportunity to be provided with the service, whether or not they are in fact being provided with the service. An example would be a vacant property that has the opportunity to be connected to a water main.

To recover the costs of a municipal service by way of parcel tax, a municipality would need to enact a bylaw under s. 200 of the *Community Charter* identifying the service for which a parcel tax is imposed. In order to capture or recover costs on the basis of existing or potential capacity or use of the service, a taxable area basis for the parcel tax would have to be adopted. Where taxable area or frontage is to be determined, the method must be based on physical characteristics of the parcel, and the basis for the tax must be fair and equitable.

Recently, the BC Courts have approved the incorporation of zoning considerations as a factor in the setting of taxable area calculations. In *O'Flanagan v. Rossland (City),* 2009 BCCA 182, the Court of Appeal upheld a parcel tax imposed on the basis of the maximum build-out of a parcel under the applicable zoning regulations, being satisfied that the development potential of parcels was based on their physical characteristics.

In *Yoo v. Cranbrook (City)*, 2007 BCSC 1635, the court found that taxable frontage is not the same thing as actual frontage, and refused to set aside a panel decision upholding a frontage calculation based on a variety of factors including land use and parcel depth.

The benefits of using a parcel tax to recover costs are largely that it allows for a cost recovery system for the service that more closely correlates with the burden or use of the service. Depending on the service, a flat per parcel tax may be most appropriate. Alternatively, for road or sidewalk improvements, taxable frontage can be the most fair recovery method. Finally, for large parcels of land where development or subdivision is anticipated, parcel taxes on the basis of taxable area can provide a distribution of costs most consistent with engineering concepts of anticipated use and capacity burdens.

The primary drawback to this option is the labour intensive process of creating and maintaining a parcel tax roll, particularly one that is based on zoning or development potential. A bylaw of this nature requires careful drafting and engineering calculations, can be a labour intensive process in the first year, and requires continual updating every year to ensure that properties that are subdivided or go through a rezoning process are properly reflected on the parcel tax roll.

C. Borrowing

Borrowing for a general municipal service must be done under sections 178 through 182 of the *Charter*. Assuming the cost of constructing the capital works associated with the service cannot be financed by short term capital borrowing, a loan authorization bylaw must be adopted. The bylaw must receive the approval of the Inspector of Municipalities and the approval of the electors within the entire municipality.

In addition, moving to a parcel tax system on the basis of development potential may have other consequences that may or may not be desirable for a municipality. For example, large properties within the municipality that are not yet developed and have low assessed values based on industrial use or resource use may see a substantial increase in their property taxes if development potential is the basis for their taxation on the sewer service.

Additionally, and continuing with the example of a sewer service, there may be properties that are not serviceable by the existing sewer service. With respect to those properties it may be arguable that they do not benefit from the service, and would then be exempt from the taxation for the service. Overall, a move to a development based taxable area parcel tax has the tendency to put pressures on undeveloped properties to develop to the extent that they must participate in the sewer costs on the basis of their potential development even before they develop. Therefore Council, on a broader policy basis, may want to consider the overall effect of such a switch from greater sewer taxes on higher assessed value properties to greater taxes on larger properties with development potential that the municipality desires overall.

III. LOCAL AREA SERVICES

In contrast to a general service, a local area service is one that Council considers provides a particular or greater benefit to only part of the municipality, where Council considers that area should be entirely or primarily responsible for financing the service. The *Community Charter* authorizes municipalities to provide municipal services that the Council considers provide particular benefit to a part of the municipality as local area services. Formerly called “specified areas”, a local area service is created under sections 210 to 219 of the *Community Charter.*

Local area services are generally subject to a special tax levied for the purpose of repaying municipal debt incurred to construct services of particular benefit to the local service area: it may be a tax levied on assessed value of land and improvements, or a parcel tax based on a single amount per parcel, taxable frontage of the parcel, or taxable area of the parcel.

Portions of the costs of local area services may also be recovered by means of other authorized municipal revenue sources, such as user fees, Provincial grants, etc. However, s. 210 of the *Charter* would appear to require that at least some portion of the cost be recovered by way of either a parcel tax or a property tax on the benefitting area.

A. Establishment of the Service and Approvals

A local area service must be established by bylaw under section 211 of the *Charter*.

Before Council may consider enacting a bylaw to establish a local area service, approval must be received in one of the following ways:

(a) The service and its cost recovery methods must have been proposed by a petition from owners within the local service area that make up 50% or more of the total number of parcels and assessed value in the area;

(b) the service and its cost recovery methods must have been proposed by council initiative, subject to a petition against it by the owners of parcels within the local service area that make up 50% or more of the total number of parcels and assessed value in the area; or

(c) The bylaw establishing the local area service must have received the assent of the electors within the local service area.

B. Cost Recovery

For local area services, sections 210(1) and 216(1) of the *Charter* require at least part of the costs of a local area service to be recovered by a property value tax and/or a parcel tax. Use of a parcel tax based on taxable area, as discussed above, is often one reason that a local area service is considered the most appropriate option for a developing area. Parcel taxes based on taxable area allow costs related to capital works and services that are directly related to development to be recovered in a way that is more reflective of development potential than property taxes, or user fees.

In addition to parcel taxes or property taxes, part of the costs of a local area service can be recovered by any other method:

"210(3) Nothing in this Division restricts a municipality from recovering part of the costs of a local area service by means of any other source of municipal revenue."

This means that part of the costs of a local area service may be recovered by way of user fee. However the entire costs of a local area service cannot be recovered from fees and charges. In addition, provision is expressly made in s. 211(2)(c) and (d) for some portion of the costs to be allocated and recovered through general municipal revenues and property taxes.

C. Borrowing

If all the costs of borrowing are to be recovered by a local service tax (ie. property tax and/or parcel tax), then the loan authorization bylaw does not require the separate approval of the electors. Instead, the requisite elector approval of the borrowing is accomplished through the same petition or counter-petition process required to establish the service.

If only part of the costs of the local area service are to be recovered by a local service tax (ie. property tax and/or parcel tax), and another part still requires general municipal borrowing, then the approval of the electors for the general municipal borrowing portion is still required.

D. Local Area Boundaries

Local area services must have defined service area boundaries. Clear delineation of these boundaries is essential to both the petition process, and the bylaw that establishes the service. Generally, the boundaries should reflect all properties that will have an opportunity to be served by the service. That does not mean that they must be immediately adjacent, but depending on the service, there must be a reasonable basis for considering that the property has the potential to benefit from the service.

There are two court cases where regional district service establishment bylaws were struck down because the service area boundaries were held to be unreasonable.

In *Canadian National Railway Co. v. Fraser-Fort George (Regional District)* [1996] B.C.J. No. 3116, the B.C. Court of Appeal upheld a trial judgment that set aside a bylaw establishing telephone service to a remote community of 18 residential properties, with 30 to 40 residents. CNR, which had no need of the service and did not intend to use it, owned 85% of the area which would be assessed and CNR would be charged with 95% of the cost. The boundary of the service area was drawn in an extremely irregular fashion to follow the CNR right-of-way.

The trial judge stated:

> "The fact that nearly all of a local improvement tax falls on a single property owner is not always unreasonable. A pulp mill or smelter with a large tax base, for example, could reasonably be included in a local service area providing services to a nearby community associated with the plant. The links between the plant and the community could justify local services at the plant's expense. In this instance, C.N.'s connection with the local area is peripheral. C.N. is a convenient deep pocket to reach into for the cost of a telephone system that the prospective users could not support on their own."
>
> "The shape of the service area is so eccentric as to be an obvious gerrymander extended to include much of the C.N. line solely to create a tax base to support the system. The boundaries of the local service area are a transparent attempt to provide local telephone service to the residents at C.N.'s expense."

Then in *Westcoast Energy Inc. v. Peace River (Regional District)* [1998] B.C.J. 2387, the B.C. Court of Appeal struck down a bylaw which established a service for the construction of an artificial ice arena in a rural area north of Fort. St. John. The area originally planned as the

service area was reduced when some rural communities indicated they did not want the service. That left the northern 2/3 of the service area basically owned by the oil and gas industry.

The Regional District pointed out that with the northern 2/3 included in the service area, the oil and gas industry would carry 95.7% of the tax base, but even if the northern 2/3 was excluded, the industry would still carry 94.24% of the cost.

The court was not persuaded:

> "The inclusion of the upper two-thirds of the service area which of itself covers several thousand square kilometers could not have been motivated merely by a desire to include the community of Milligan, which is the only population in that upper two-thirds apart from a few individuals along Highway 101. The evidence is clear that apart from some 18 homes in the Milligan Jay-Pee corner and a few residents along Highway 101, there is virtually no other population in the upper two-thirds of the proposed service area."
>
> "In my view, there can be no reasonable explanation for the inclusion of the upper two-thirds of the local service area, except to draw upon the large possible oil and gas industry tax base for financing of the project."

On the other hand, in *Yoo (c.o.b. Pita Wrapbit) v. Cranbrook (City)* 2007 BCSC 1635, a property that was not fronting on a road improvement was still considered to reasonably benefit from that improvement, through reduced traffic in the lane shared by all properties in the local service area.

It should also be noted that local area service boundaries may be enlarged, but only through an additional petition or counter-petition process pursuant to s. 218 of the *Community Charter*. Only the area that wishes to join the service need petition: the existing participants in a local area service do not participate, and cannot essentially "withhold" the service from areas wishing to join (*Ridley Bros. v. Colwood (City) No. 1*, 2006 BCSC 1141). The remaining annual cost of the service is then redistributed over the enlarged area.

Local area services can also be merged pursuant to s. 219 of the *Community Charter*. However careful attention to elector approval and petition requirements is necessary where there outstanding debt exists in one or more of the areas (*Ridley Bros. v. Colwood No. 2*, 2010 BCSC 670)

E. Benefits and Drawbacks

Proceeding by way of a local area service achieves the goal of having a specific amount of the borrowing associated with a project borne by that local area service. It is highly beneficial to the developing properties to pay for the service in this way as the local government bears the initial financing and borrowing costs of the service, and developers may pass the entirety of the cost onto future purchasers of the property who will pay for the service in their annual taxes.

For the municipality, local area services can provide a way to facilitate development in a targeted area. However, it does require local governments to use their own borrowing capacity, and involves the additional administrative costs of creating and maintaining parcel tax rolls where a parcel tax is used to recover the costs.

IV. DEVELOPMENT WORKS AGREEMENTS

Section 937.1 of the Local Government Act provides for a kind of hybrid financing arrangement for capital works and services that have many of the features of a local area service, together with some of a contract.

This option is only available for providing, constructing, altering or expanding sewage, water, drainage and highway facilities, and improving park land.

It requires both an agreement with a developer for the provision of works by either the municipality or the developer, and a bylaw authorizing the agreement, and setting out the terms under which the costs will be paid. The bylaw may not be enacted without assent of the electors, or a petition process similar to that in a local area service, in the area subject to the agreement.

Uniquely, bylaws under this provision create a debt owing to the municipality by owners in the area established by the bylaw, as opposed to a tax or a fee. This raises uncertainty as to how it may be collected, particularly from owners in the area affected by the bylaw that are not parties to the development works agreement. This provision therefore seems to be better suited to financing works where the area subject to the agreement is wholly owned by the developer entering the agreement.

V. WORKS AND SERVICES REQUIREMENTS AND LATECOMER AGREEMENTS

Division 11 of Part 26 provides for an independent scheme for requiring road, water, sewer, drainage works as part of the development or subdivision process.

Section 938 of the Local Government Act allows local governments to, by bylaw, set standards for and require the provision of road, water, sewer, drainage related works within a subdivision, or on that portion of a highway immediately adjacent to land being developed or subdivided. However, the extent of the works that may be required under this section is limited by s. 938(8) to only those works directly attributable to the subdivision or development.

However, s. 939(2) of the *Local Government Act* authorizes local governments to require developers to construct works and services in excess of those works that are directly attributable to the subdivision or development, under specified circumstances. These excess or extended services must be paid for by the local government, or "if the local government considers its costs to provide all or part of these services to be excessive, by the owner of the land being subdivided or developed."

Where the local government requires the owner of the land to pay for these excess services, s. 939(5) requires local governments to impose and collect latecomer charges on future parcels connecting to the extended or excess service, and to remit those monies back to the original developer.

The excess or extended service, and latecomer provisions, are not always amenable to a clear application in any given case. Issues have been raised as to when works, that are not physically located on or adjacent to a property, but are required to complete subdivision requirements in terms of access, may be properly considered "excess" services. A related issue are works and services located on a property that is being developed, but which are required to be sized or extended to the far boundary of the property, in anticipation of additional extensions beyond the property boundary, also generally as a condition of subdivision. Those works may not be technically "directly attributable" to the subdivision or development under s. 938(8), however, they do not necessarily "provide access to land," or "serve land" "other than the land being developed" pursuant to s. 939(1).

This issue was partially addressed in *618061 B.C. Ltd. v. Anmore (Village),* 2008 BCCA 205, where the court deferred to the Village's decision to require latecomer charges in a situation where one developer had not completed the required works on its own property to the boundary of an adjacent developer, and the adjacent developer then completed those works as an extended service. The court held that the availability of other options to require and finance those works, other than as an extended service subject to latecomer charges, did not render the use of that scheme inapplicable or invalid.

In the more recent decision of *Okanagan Land Development Corp. v. Vernon (City)*, 2012 BCCA 332, the Court of Appeal had occasion to consider several issues related to latecomer charges. Firstly, the Court of Appeal determined that latecomer charges may be allocated on a per unit basis. Vernon had imposed a proportional charge on various lands based on development potential, but had provided that the charges would be payable on a per unit basis. That is, if a parcel was capable of supporting a 20-unit development, the whole of the charge applicable to that parcel did not have to be paid on the first development, but could instead be paid incrementally as development up to 20 units on that parcel occurred. The Court of Appeal held that such an approach was sound, commenting that the result may lead to underpayment if all potential units on a particular development were not realized; however, full recovery was not a requirement. The per unit basis of payment of the charge was a "reasonable option" under the legislation despite the potential for the "first comer" to lose out in cost recovery.

Secondly, a latecomer charge may be made payable at connection, or before connection, such as upon subdivision or issuance of a building permit. The Court noted the *Charter* does not require payment on “connection or use”, rather it provided that the charge is a condition of connection.

One of the benefits of a latecomer system is that a local government does not have to use its own borrowing capacity to create extended or excess services. This option also allows a local government to identify the amount or cost of a particular project that is required and should be borne by taxpayers at large and the amount that is being built in anticipation of future needs, identified as an extended service. A latecomer agreement system allows a local government to identify properties that have not yet been developed but that are anticipated to be developed, and for which additional capacity has been built in to the extended service. A developer could then enter into agreements to recover those monies as those properties joined the service in question. Where local governments pay for the extended or excess service, it also provides a mechanism for the local government to recover their costs from future development in the area for up to 15 years.

The difficulty of latecomer schemes is their awkwardness in terms of administration. They may be in place for up to 15 years after the completion of the service. In addition, the requirement to impose and collect latecomer charges for excess or extended services exists under the *Act* regardless of whether an agreement setting out the terms of the latecomer fees has been reached. This can give rise to uncertainty and indeterminate liabilities for local governments.

VI. DEVELOPMENT COST CHARGES

Development cost charges, may be used to finance the construction or expansion of a highway, drainage, water and sewer facilities, and providing and improving park land. DCCs are generally used to raise funds for key infrastructure components in anticipation of these infrastructure requirements being needed, while localized infrastructure components are generally required as off-site works under works and services bylaws. It is a very good tool for capacity building, where it is anticipated that a capital service will require upgrading or expansion in the future. In some cases the establishment of a DCC scheme together with a local area service can provide both financing for the immediate capital services in a particular area (through the local area service), and a mechanism to collect money that may be required to upgrade the service in the future as a result of new development (through DCC’s). DCC’s, however, can only be levied in respect of costs not already being recovered by another source.

Under s. 934 of the *Local Government Act*, DCCs are permitted to vary with respect to different zones or other defined areas, different uses of land, different capital costs as they relate to different classes of development, and different sizes or numbers of lots or units in development. The setting of DCCs is essentially a capital planning process that involves at the outset the establishment of a costed program of capital works within the permitted categories – constructing sewage, water, drainage and highway facilities and acquiring and improving park land – which would normally be a component of the program of capital works that has been

established for the purposes of the financial plan required under s. 165 of the Community Charter (for municipalities), or s. 815 of the Local Government Act (for regional districts).

A DCC bylaw requires detailed analyses of the future works that are needed for the service that will be recovered through the DCC system, and an analysis of what properties would benefit and their equivalent populations in terms of use of that service. Inspector of Municipalities approval is required for the DCCs, and generally the Inspector will evaluate the above analyses, and this may take some time.

The benefit of the DCCs is that it allows the local government to pass on a predetermined portion of the costs of service and possibly additional capital works that are anticipated to be needed in the future. The calculation can include the potential for future development properties to share in this cost in a proportionate way.

On the other hand, the DCC option has the distinct disadvantage of requiring Inspector approval which may delay a local government's ability to collect development cost charges.

Also, DCCs require the local government to either front the cost of a service without guarantee of full recovery of that amount, or to wait to finance the service until it has accumulated sufficient funds. This may be acceptable where the extent of the work and the likelihood of recovery are well known, but are likely not acceptable when either of these scenarios are absent.

Finally, this option is also less attractive for developers as development cost charges must be paid up front as opposed to being borne over many years or by their subsequent purchasers.

VII. CONCLUSION

As discussed above, there are a variety of options, some of which are not mutually exclusive to each other, available to local governments for financing municipal works and services. Care must be taken as to which cost recovery scheme is being used, as problems can arise when the requirements of one cost recovery scheme are conflated with another.

Whether the service is a sewer, water, or drainage system, or acquiring or improving park land, local governments should carefully consider, in conjunction with appropriate legal advice, which financing option is best suited to the service in question.