PH6.2.18

Inclusionary zoning policy options based on detailed market analysis

Submission to the City of Toronto Planning and Housing Committee regarding the Inclusionary Zoning Official Plan Policy Directions

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Context

Inclusionary zoning (IZ) is a tool the City of Toronto can use to optimize the amount of affordable housing that can be funded from the high growth market it is experiencing. As the creation of IZ units is dependent on development, effective IZ policies need to ensure that the market incentive to develop is maintained.

To inform its IZ policy recommendations, the City obtained analysis from N Barry Lyons Consulting (NBLC), which assessed the potential impacts of various approaches to IZ on the development market. NBLC's analysis relied on development concepts created to simulate potential development scenarios, and assessed the viability of IZ within specific parameters set by City staff. NBLC's study was published along with the staff report on IZ. The City also conducted cross jurisdictional analysis that was summarized in a table included in the staff report as "Attachment 2".

Our analysis builds on NBLC's work. While NBLC's work used a selection of specific sites using viability parameters set by the City, our analysis uses area averages for actual land sale values for different areas in Toronto. We applied the analysis from both our research and NBLC's study to the City's Proposed Policy Directions for IZ to determine how policies could optimize the housing provided by IZ without deterring development.

Because Toronto has many different aspects to its housing market that affect development economics, we looked at the different types of housing development markets in Toronto, including:

1. High value zones, where housing development is most profitable, such as the downtown core and the Yonge Street Corridor
2. Medium value zones, where housing development is robust but less lucrative
3. Lower value zones, where development is less active, and housing is less costly

To assess the optimization of IZ, we looked at different factors that could expand or constrain the provision of appropriate affordable housing, including:

1. Applying IZ to the broadest range of types of development, including both as-of-right (existing zoning) and rezoned development (with added density)
2. Applying IZ as broadly as possible geographically
3. Applying IZ at "set aside rates" (the share of units that are designated as affordable) that provide the greatest amount of affordable housing
4. Keeping the housing affordable for the greatest duration
5. Ensuring IZ units reach deeper levels of rental housing affordability to reflect the need for deeply affordable rental housing

This analysis assesses each of those factors in all three types of markets to determine if the policies could provide more optimal supply of affordable housing, in each market, without creating undue financial pressures that would deter development.

Analysis of Options

The evidence shows that we can do more with IZ, in each of those areas, than the current proposed policy direction.

1. Apply IZ to as-of-right and rezoned development

The City's Proposed Policy Direction recommends applying IZ only to added density, approved by the City in addition to the current, as-of-right, zoning.

Our analysis shows that as-of-right developments, using only existing zoning, can support IZ units. While these developments can rarely meet the 20% threshold, as-of-right developments, at least in the high and medium value sites, can support in excess of a 10% set aside (see Figure 1). While the City's market analysis never explores what as-of-right developments could support, their analysis of total density (including as-of-right plus added density) shows that there are several areas of the city where the entire building can sustain IZ requirements in excess of 10%, including areas that benefit from minimal added density (see NBLC Report, Table 6).

2. Apply IZ as broadly as possible geographically

The City's Proposed Policy Direction recommends applying IZ only in high and medium value markets.

Our analysis shows that IZ can be applied in all areas of the city, if it is applied at varying set aside rates (see Figure 1). Higher value areas can carry the highest set aside rates, but lower rates can be applied in other areas. In low land value areas, those rates are negligible, for as-of-right developments (see Table 1, line K) and only 8-9% on average for sites given added density (see Figure 1). While this provides a very limited number of units, the development of some affordable housing is achievable even in that context. The City's analysis did not test set asides under 10% for condo developments.

3. Apply IZ at set aside rates that provide the greatest amount of affordable housing

The City's Proposed Policy Direction recommends applying IZ at 20% in high value markets, 10% in mid-value markets and at 2.5%-5% for purpose-built rental housing.

Our analysis shows that some areas of the City can carry set aside rates that are significantly higher than others. While a 20% set aside has been treated as the base case in the City's analysis, our analysis shows it can rise as high as 30% in the most profitable markets (see Figure 1). The city's interjurisdictional analysis also shows that rates as high as 30% are viable in other cities including New York and Montreal (see PH 6.3 attachment 2). The sensitivity testing in the City's analysis shows IZ rates as high as 25% (the highest they tested) as viable in 6 of the 11 areas tested (see NBLC Report, Table 5). Consequently, limiting rates to either 10% or 20% does not reflect market capacity or best practice.

4. Keep the housing affordable for the greatest duration

The City's Proposed Policy Direction recommends keeping IZ units affordable to 25 years, and that set aside rates should be cut in half for developments that exceed the 25-year requirement.

In our research, all analyses assumed keeping housing affordable in perpetuity, rather than only 25 years, and showed that this affordability period was financially viable at varying set aside rates in all areas of the City (see Figure 1). The City's own analysis shows that the consequence of raising affordability periods from 25 to 99 years is modest (see NBLC Report, p. 29). The City's interjurisdictional analysis shows that most major cities use 99 years or perpetuity as the duration of affordability (see PH 6.3 attachment 2). Consequently, limiting affordability to 25 years, or cutting set aside rates where 25 years is exceeded, does not reflect market capacity or best practice.

5. Ensure IZ units reach deeper levels of rental housing affordability, wherever possible, to reflect the need for deeply affordable rental housing

The City's Proposed Policy Direction recommends that IZ units be rented at 100% of Average Market Rent (AMR) with 10% of these available at 80% of AMR.

Both our analysis and the City's analysis shows that the number of units the market can create declines as the depth of affordability increases. Although the greatest number of "affordable" units are generated using the City's current standard of 100% of AMR, the most severe shortage in this city is for homes well below that price level. As such, efforts should be made to prioritize deeper affordability. The evidence shows that this is achievable.

The City's analysis shows that the difference between creating units at 100% of AMR and deeper levels of affordability is even more modest than the cost of extending affordability periods (see NBLC Report, p. 30). Our analysis shows that units can be generated at affordability levels as deep as 60% of AMR (see Figure 1). The number of units that can be created in lower value areas is limited but in medium and high value areas, the 20% set aside rate can be met where rezoning is occurring and set aside rates over 10% can still be met for as-of-right developments (see Figure 1).

Summary

The evidence, from NBLC's report, the City's jurisdictional analysis, and our own research indicate the following amendments should be made to the City's Proposed Policy Direction:

1. Apply IZ requirements, at low set aside rates that reflect the market analysis, to the as-of-right portion of developments, not just the added density.
2. Apply IZ requirements, at variable set aside rates that reflect the different market capacities, across <u>all</u> areas of the City.

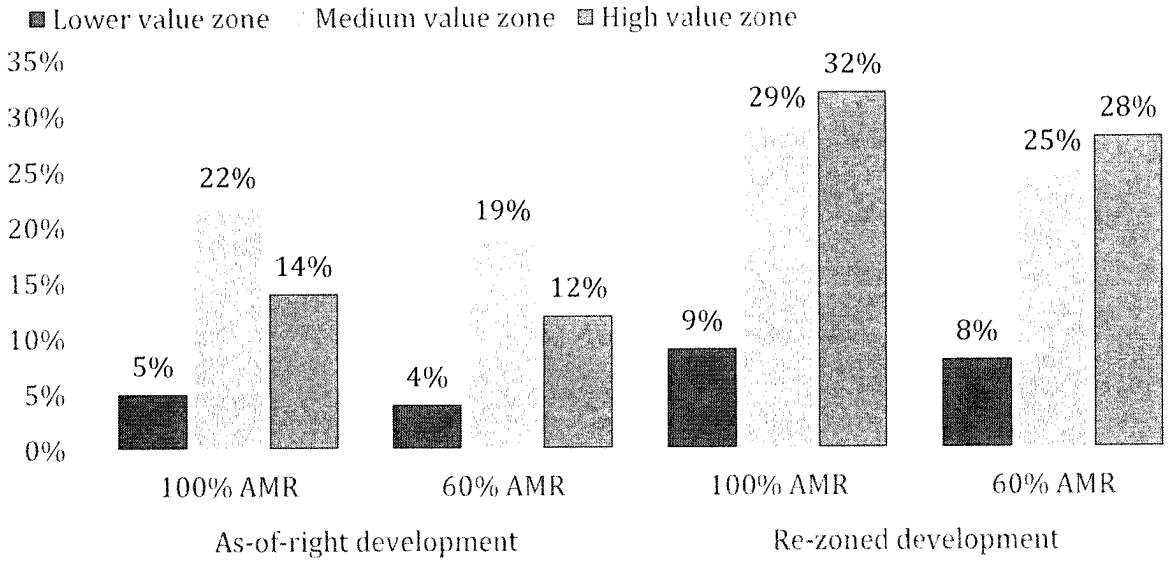
3. Do not limit set aside rates to 20% or 10%. Apply the higher set aside rates of 25%-30% to areas of the City where the market analysis shows it would not impede development, and apply lower rates to areas where a 10% set aside is seen as a market deterrent.
4. Require IZ units to be perpetually affordable.
5. Create blended range of affordability levels as low as 60% of AMR, adjusting set aside rates to reflect the added cost.

Data Analysis

Steve Pomeroy of the Focus Consulting Inc. carried out additional data analysis, building on NBLC's work for the City. Focus Consulting used the assumptions employed in the NBLC analysis, with the following exceptions:

- development "soft costs" were estimated at 35% based on a line by line assessment and case examples;
- land values were calculated based on recent sales of similar land in the area without incorporating anticipated rezoning;
- affordable units were assumed to be perpetually affordable with no time limit; and
- the analysis was applied to an illustrative "typical" buildings, with consistent lot size, varying only to allow for different allowable densities in each area.

Figure 1: Maximum potential set-aside for inclusionary zoning in lower, medium and high value market zones in Toronto, under four policy scenarios



The detailed analysis tables are below:

The following tables present results on a per unit basis. The amount required to cover net cost of IZ units is calculated by determining the foregone revenue to a developer. The developer gives up the revenue from selling condos at market prices, and replaces this with the lower revenue value generated by the net income from the affordable units. These are converted to a capital

value using a 5% capitalization rate. As the tables present results on a per unit basis, only a fraction of the condo value is foregone based on the IZ rate – here 20%. The net cost is foregone condo revenue (line G) less capitalized value of affordable (line H).

Table 1: Detailed calculations for as-of-right developments, within current zoning, & rents at 100% AMR

Market Area	**Low zone**	**Medium zone**	**High zone**
A: Total units at current densities	100	100	160
B: Total Construction (soft & hard cost & profit)	$451,842	$ 454,317	$484,397
C: Condo total sales revenue (incl parking)	$519,000	$ 670,500	$774,000
D: Surplus available for land & IZ (C-B)	$ 67,158	$ 216,183	$289,603
E: Required for land cost at current 2019 prices	$ 52,500	$ 112,500	$210,938
F: Net remaining to cover IZ requirement (D-E)	$ 14,658	$ 103,683	$78,666
Affordable Inclusion (at 20% of units)			
G: Foregone Revenue per unit from allocating 20% to IZ	$103,800	$134,100	$154,800
H: Capitalized value of revenue from IZ units @100% AMR	$41,152	$41,196	$40,461
I: Net unit cost of allocating 20% to IZ units	$62,648	$92,904	$114,339
J: Does net revenue cover net IZ costs at 20% (F-I>0)	No	Yes	No
Potential Set Aside Rate			
K: What set aside rate is potentially feasible (Net revenue from units/net cost of IZ units) (Fx20%) ÷ I)	**5%**	**22%**	**14%**

Table 2: Detailed calculations for as-of-right developments, within current zoning, & rents at 60% AMR

Market Area	**Low zone**	**Medium zone**	**High zone**
A: Total units at current densities	100	100	160
B: Total Construction (soft & hard cost & profit)	$451,842	$454,317	$484,397
C: Condo total sales revenue (incl parking)	$519,000	$670,500	$774,000
D: Surplus available for land & IZ (C-B)	$67,158	$216,183	$289,603
E: Required for land cost at current 2019 prices	$52,500	$112,500	$210,938
F: Net remaining to cover IZ requirement (D-E)	$14,658	$103,683	$78,666
Affordable Inclusion (at 20% of units)			
G: Foregone Revenue per unit from allocating 20% to IZ	$103,800	$134,100	$154,800
H: Capitalized value of revenue from IZ units @60% AMR	$ 25,573	$ 25,616	$ 24,881
I: Net unit cost of allocating 20% to IZ units	$78,227	$108,484	$129,919
J: Does net revenue cover net IZ costs at 20% (F-I>0)	No	No	No
Potential Set Aside Rate			
K: What set aside rate is potentially feasible (Net revenue from units/net cost of IZ units) (Fx20%) ÷ I)	**4%**	**19%**	**12%**

Table 3: Detailed calculations for rezoned developments with rents at 100% AMR

Market Area	Low zone	Medium zone	High zone
A: Total units at projected densities (3.5-8 FSR*)	140	140	320
B: Total Construction (soft & hard cost & profit)	$451,842	$454,317	$484,397
C: Condo total sales revenue (incl parking)	$519,000	$670,500	$774,000
D: Surplus available for land & IZ (C-B)	$67,158	$216,183	$289,603
E: Required for land costs at current 2019 prices	$37,500	$80,357	$105,469
F: Net remaining to cover IZ requirement (D-E)	$29,658	$135,826	$184,134
Affordable Inclusion (at 20% of units)			
G: Foregone Revenue per unit from allocating 20% to IZ	$103,800	$134,100	$154,800
H: Capitalized value of revenue from IZ units @ 100% AMR	$ 41,152	$41,196	$40,461
I: Required to cover net cost of IZ units (C-G)	$62,648	$92,904	$114,339
J: Does net revenue cover net IZ costs at 20% (F-I>0)	No	Yes	Yes
Potential Set Aside Rate			
K: What IZ set aside rate is potentially feasible (Net revenue from units/net cost of IZ units) (Fx20%) ÷ I)	**9%**	**29%**	**32%**

Table 4: Detailed calculations for rezoned developments with rents at 60% AMR

Market Area	Low zone	Medium zone	High zone
A: Total units at projected densities of (3.5-8 FSR*)	140	140	320
B: Total Construction (soft & hard cost & profit)	$451,842	$454,317	$484,397
C: Condo total sales revenue (incl parking)	$519,000	$670,500	$774,000
D: Surplus available for land & IZ (C-B)	$67,158	$216,183	$289,603
E: Required for land costs at current 2019 prices	$37,500	$80,357	$105,469
F: Net remaining to cover inclusionary requirement	$29,658	$135,826	$184,134
Affordable Inclusion (at 20% of units)			
G: Foregone Revenue per unit from allocating 20% to IZ	$103,800	$134,100	$154,800
H: Capitalized value of revenue from IZ units @ 60% AMR	$ 25,573	25,616	24,881
I: Required to cover net cost of IZ units (C-G)	$78,227	$108,484	$129,919
J: Does net revenue cover net IZ costs at 20% (F-I>0)	No	Yes	Yes
Potential Set Aside Rate			
K: What IZ set aside rate is potentially feasible (Net revenue from units/net cost of IZ units) (Fx20%) ÷ I)	**8%**	**25%**	**28%**

* FSR is the ratio of land area to floor space – at 1 FSR, the gross floor area is equal to the size of the lot. Since buildings rarely cover the whole lot, buildings zoned at 2 FSR will usually be 3-4 stories high.

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