The City of Toronto

Evaluation of Potential Impacts of an Inclusionary Zoning Policy in the City of Toronto

nblc

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The conclusions contained in this report have been prepared based on both primary and secondary data sources. NBLC makes every effort to ensure the data is correct but cannot guarantee its accuracy. It is also important to note that it is not possible to fully document all factors or account for all changes that may occur in the future and influence the viability of any development. NBLC, therefore, assumes no responsibility for losses sustained as a result of implementing any recommendation provided in this report.

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Executive Summary

The Province of Ontario has adopted enabling legislation that will allow the creation of affordable housing through inclusionary zoning (IZ) techniques. The City of Toronto is in the process of evaluating a policy of this nature. This study examines economic feasibility of adopting an IZ policy in the City.

The Province defines Inclusionary Zoning as follows:

"Inclusionary zoning is a land-use planning tool that a municipality may use to require affordable housing units (IZ units) to be included in residential developments of 10 units or more."

Most of the policy experience with IZ has been in the United States. In most jurisdictions where IZ has been successfully implemented, the central principal is that development density is traded to offset the costs of delivering affordable housing. In some instances, there are also financial programs utilized (tax incentives, etc.), but it is this exchange of density for affordable units that has underpinned the success of these policies.

Approach

To undertake our assessment of impacts from a potential IZ policy, we assume that a potential approach to IZ has the following key elements:

- Developers apply for a density increase above the as-of-right zoning permission. Assuming the density increase can address all other planning issues, it is approved. The density increase is used to calculate the affordable housing requirement. Of note, sensitivity testing was also conducted to evaluate an approach that would apply affordable housing requirements to all density in a project.
- A range of affordable unit requirements was tested from 5% to 25% of the density increase.
- The affordable housing units were assumed to be provided as rental tenure, with rents set at 100% of CMHC's city- wide average market rent (AMR). This was both to ensure a conservative valuation of impacts, and to test the approach which would have the most enduring impact on housing affordability. Additional sensitivity analysis was conducted to evaluate impacts with affordable rents set to 80% of AMR.
- A range of affordability periods were tested from 15 to 99 years.
- The cost of providing affordable housing would be offset by added density (above as-of-right). No other incentives are provided for the units (such as "Open Door" funding).
- The added density, less affordable units provided, would be subject to all municipal fees, including Section 37 of the Planning Act.

Toronto is a very diverse marketplace. Our study therefore explores how this policy approach would impact the feasibility of residential development – and therefore the policy – in 11 submarkets within the City. The following summarizes our methodology:

- Submarket areas were selected around existing higher order transit, or emerging market areas with existing and/ or planned higher order transit infrastructure improvements.
- In each of the 11 submarkets we develop prototypical development concepts based on the as-of-right density and the added density, in consultation with City staff, that might be approved in a rezoning application.
- We tested a rental and an ownership tenure project in each submarket.
- For each submarket we undertake research to assess local pricing dynamics which are used to developed a financial proforma or residual land value model (RLV). The RLV model assesses all the project revenues. From these revenues we subtract the costs of development including the developer's profit. What remains is the land value.
- We estimate the existing land value given (underutilized) land uses and as-of-right zoning.
- We then evaluate the land value based on added density scenarios and the IZ policy discussed earlier.
- If the land value of the added density, with the IZ requirements, falls below or is not 10% greater than the existing land value, we assume the policy would not be feasible. (Under this circumstance we assume that the owner of the land would not be motivated to sell for high density purposes).

Findings

- In no scenario did the added density completely offset the tested affordable housing requirements. In each case the IZ policy resulted in additional costs to the development which impacted land values.
- However, in most of the high growth test locations, the IZ policy scenarios tested were found to be feasible. That is, the downward adjustment to land values as a result of IZ policies remained greater than the value attributed to the existing use of land.
- On average the impact of providing 20% of added density in affordable housing reduced residual land value by an average of $17 psf in the scenarios tested. The impact ranged from about $45 psf in the Downtown area to about $5 psf in the Etobicoke Centre example where base zoning is assumed to be relatively permissive (fewer affordable units required). On a percentage basis, the average negative impact to land value was about 30% across all test scenarios (31% decrease in land value for condominium projects, 29% impact to land values for rental projects). For context the spread between existing land values and the residual land value attributed to the site through redevelopment was greater in the Downtown test site, than in Etobicoke.
- In most of the market locations tested, these reductions would still result in higher land values than the current as-of-right value of the property. If pricing continues to increase in these areas, any costs associated with an IZ policy might be absorbed with upward market momentum over time.

- In low growth areas and in all rental housing scenarios, the IZ policy showed signs of impacting the viability of development. This was also the case in the Yonge-Eglinton market area, where the difference between the tested as-of-right density and the added density scenario was not great, and existing land values are strong.
- Without a thoughtful policy implementation framework, the creation of affordable housing through IZ policies may have possible negative impacts on affordability in two inter-related ways:
    - by a reduction in the supply of housing due to the increasing number of projects that would become unfeasible, largely in low growth areas, given local area market pricing; and,
    - by increasing the minimum cost of delivering a home. Currently this is not significant concern in the Downtown given the rapid escalation of pricing in the Downtown. However, in weaker market areas, where pricing is not as strong, it will perpetuate affordability issues for entry level housing by increasing the price that would need to be charged to create a viable development.

Recommendations

The City has a range of implementation opportunities that have the potential to yield a steady supply of affordable housing through the use of Inclusionary Zoning. The financial testing in this analysis demonstrates that this may be especially true in the Downtown and around many transit stations. As the City considers an IZ policy, we offer the following recommendations:

- A successful IZ policy requires as-of right zoning to form the basis by which land values are established. The value created by adding new density provides a revenue source to fund affordable housing. However, in some areas of Toronto, especially in the Downtown and around emerging transit stations, the as-of-right zoning is often out of date or below what is anticipated in the Official Plan (or emerging Official Plan policies). Given the very strong demand for these properties developers are forced to pay what they view to be achievable, less about what might be legally permissible. Having already paid for the anticipated density in advance – the ability to fund affordable housing is undermined.
- Consideration of existing zoning by-law permissions should be included in the development of the City's potential approach to implementing IZ. This notion is important given proposed changes resulting from Bill 108 which would require that zoning be updated prior to IZ applying in those locations. This would have a positive effect on speculative land purchases over time as there would be increased certainty on what is achievable for a site.
- Apply an IZ policy in strong market areas such as the Downtown planning area, and at many Smartrack/ GO/ TTC station areas. A key issue to consider are the near-term impacts of an IZ policy. As with development charges or any new cost to development, a phase-in policy is recommended to help the market adjust – especially for projects that have already been initiated. Consideration should be given to the following:

- A phase in period starting as low as a 5% IZ target with annual increases; or,
- Announce to the market that the IZ policy will come into force in a certain period of time, e.g.in three to five years. Either approach would allow markets to adjust and for sites which are currently in pre-development stages to proceed.
- Of note, Provincial review of both IZ policies and the lead up to establishing protected MTSA and other DPS areas might effectively act as a phase-in period, the City should also consider this as it develops transition policies.

- Apply IZ policies now to emerging areas where transit investments are being made and policy changes are underway or anticipated in the future (i.e. Downsview, Golden Mile). These areas will require a policy structure that creates reasonable base land value and then a framework for the approval of additional density – with the expectation of affordable housing in return – in order to limit speculative land acquisitions that undermine the opportunity for IZ. In some cases, additional financial incentives could be warranted in order to encourage near term investment as these locations evolve.
- Municipal financial incentives should not be applied to projects in high growth areas. Density should be the preferred offset approach in these locations.
- Avoid implementing IZ in areas where investment is being encouraged and the market for new residential investment is currently weak, such as Neighborhood Improvement Areas. In areas such as the Finch Corridor (not including Keele/Finch), it is the new LRT than will play a role in improving the market to encourage investment. Application of an IZ policy in these areas would discourage this emerging investment.
- Significantly reduce IZ requirements for purpose-built rental projects, or projects that will be renting under a benchmark (i.e. over 200% of AMR).
- For the program to have an enduring impact on affordability in the City, the City should seek affordability for units created through IZ in perpetuity, where possible.
- Seek to develop a cash-in-lieu policy that is based on an annual calculation of the capital subsidy requirement for a rental unit at the target affordability level. Update the subsidy calculation annually.
- Update the IZ policy at regular intervals to ensure that the policy is nimble and able to adjust to the economic realities of the day.

Our analysis assumes that the added density in each prototype tested would be subject to Section 37 of Planning Act where community benefits are typically payable. However, recently proposed Provincial reform stemming from Bill 108 may significantly impact the manner in which Section 37, Section 42 and development charge payments are approached; potentially rolling these into a 'Community Benefits

Charge'. It will be important to conduct further evaluation of IZ impacts when there is greater clarity around the dynamics of this revised approach.

This analysis cannot assume the wide variations of market factors and the interests of developers and land owners. For example, the analysis does not consider landowners of shopping centres who have marginal or no land costs, or developers that might accept a lower rate of return. The results therefore should be considered at a high level and used to provide general direction in developing an IZ policy.

1.0 Introduction

The City of Toronto has retained N. Barry Lyon Consultants Limited (NBLC) to assess the potential impacts on residential development in select areas of the City of Toronto as a result of the potential implementation of an Inclusionary Zoning (IZ) policy.

The Province of Ontario has also adopted enabling legislation that will allow the creation of affordable housing through inclusionary zoning techniques. The City of Toronto is in the process of evaluating the potential city-building benefits of a new affordable housing policy, but is also cognizant that an IZ program could represent additional costs to the development industry.

This study examines the possible impact of a potential IZ policy using market research and a financial model to consider the land value implications for developers that would need to acquire land in today's market in order to proceed with a development. Achievable development density (above current as-of-right zoning) and market dynamics are established for a range of market locations throughout the City in order to consider the nuance of varying market dynamics across the City. And, through an understanding of the subtleties between various markets in the City, we examine how the costs of providing affordable housing could impact the viability of a typical development.

2.0 Housing Prices and Costs – Fundamental Factors

This section reviews how home prices and costs are established and the connection between these two fundamental factors that impact real estate development. The effect of an IZ policy would be to exchange additional density on a site in exchange for affordable housing units. The effect would reallocate a portion of a residential development's yield to affordable housing, decreasing available project revenue; or, increasing costs as a share of revenue.

2.1 Factors Influencing the Price of Housing

The highest and best use of a site is established by determining the most marketable housing types, achievable pricing, product positioning (e.g. mid-market, luxury), sales absorption rates, target purchasers and marketable suite mix, required project amenities, and other similar items. Often, these inputs feed into a financial analysis to evaluate project viability, land values, and profit. When deciding how to price homes, it is important to consider both demand and supply conditions in the local market area. This generally involves an analysis of the following:

- The process of establishing pricing typically begins by characterizing the demand-side of the market, which includes identifying target purchaser groups, assessing recent growth patterns and projections, defining the market strengths and weaknesses of the site and area, preferences of target purchasers, impact of lending rates and regulations (e.g. mortgage stress tests, foreign buyer taxes), and other similar analyses.

- Once the demand-side has been adequately characterized, the supply of housing in the local market is assessed. This is completed by surveying other comparable housing developments that are actively marketing to understand how competitive supply is priced, the rate at which product is absorbed by the market, the positioning and amenities included, and other design/market features that warrant review.
- Understanding the resale market is also an important consideration, as purchasers will often consider both a new-build and an existing home when making a purchase. Pricing must therefore remain competitive with both comparable existing homes and other new housing developments.

Ultimately, developers are seeking to determine the maximum they can charge purchasers or renters and still sell or lease-up their project within a predetermined time frame. If a developer sells or leases very few homes, this is generally a sign that pricing was too high for the project (or some other project flaw). Conversely, if the entire project sells out immediately, the developer may have priced the project too low.

Developers carefully examine supply and demand to ensure this does not happen. Instead, the industry works to ensure that projects charge the maximum price that the market will bear while still maintaining a healthy sales absorption pace. Developers will also monitor supply and demand conditions throughout a sales campaign, often increasing pricing throughout the process at specific thresholds (e.g. at the beginning of construction). Some developers also may not release all units to the market at the same time, in order to adjust pricing or other elements based on the market's response to an initial phase. This is an important consideration, as developers can, and often do, increase pricing if the market supports such an increase, independent of any shift in development costs.

An IZ policy would therefore have the effect of reducing the amount of revenue that can be attributed to a development project, due to the affordability requirements for a proportion of the units in a residential development.

2.2 Factors that Influence the Cost of Housing

The delivery cost of housing sets the minimum price a home can be sold for. If the market pricing falls below this bench mark the project is not constructed.

The costs of building housing generally fall into one of four discrete categories:

1. Hard Construction Costs
2. Soft Development Costs
3. Developer Profit
4. Land Cost

The following provides a brief description of each cost category, including commentary related to how these costs are determined.

2.2.1 Hard Construction Costs

Hard construction costs encompass all of the materials and labour required to physically construct a building. These costs include construction contracts, building materials, appliances, site servicing, landscaping, site preparation (e.g. demolition, excavation, grading), parking, and other related costs. Hard construction costs will vary from project to project as factors such as topography and grading, geotechnical issues, site contamination, building materials (e.g. concrete vs wood), the height of a building, surface vs. underground parking, and other similar considerations can all impact construction costs.

Hard construction costs are dictated by the market, albeit a different market than home prices:

- Developers will purchase building materials in the market like any other commodity, which are subject to fluctuations in price. Macro-economic trade impacts (e.g. steel tariffs) can also impact the price of materials and other commodities.
- Similar to building materials and commodities, developers must pay the market price for labour, which can fluctuate based on availability, unions, and other factors.
- Competition amongst builders can also increase the cost of building materials and specialized labour under particular supply and demand conditions.

Overall, once the specifics of a development project are well defined, hard construction costs become relatively fixed.

2.2.2 Soft Development Costs

Soft development costs include all of the other costs that a developer will encounter when developing real estate. These items include government imposed development charges and policies, as well as a host of other costs including, among others:

- The consultant team - typically consisting of urban planners, architects, urban designers, landscape architects, engineers, lawyers, public consultation experts, and others.
- Project marketing costs.
- Sale commission fees.
- Construction financing costs.
- Development and construction project management.
- Overhead and cost contingencies.
- Legal fees.
- Project/construction insurance costs.

Similar to hard costs, soft development costs can also shift depending on the specifics of a development project. Factors such as project scale and absorption rates can impact development timing, which can affect financing and other carrying costs. These costs can also shift depending on the approvals required, size of the property, value of the land (cash in lieu of parkland), the Section 37 agreement negotiated, changes to development charges, and others. Changes to development related charges therefore directly increase the soft development costs of delivering new homes.

2.2.3 Developer Profit

Developers require a certain profit threshold to undertake a development project. They are investing their skills and equity, as well as taking on significant risk in order to make a profit that is superior to the rate of return that might be achievable through another investment vehicle.

If an acceptable profit margin cannot be achieved, developers will seek development opportunities in other markets, invest in other real estate asset classes, or choose another investment vehicle altogether.

2.2.4 Land Acquisition Cost

The value of land is directly connected to the market strength of an area. Typically, strong market areas support higher land values than weaker market areas.

2.3 Increased Costs Primarily Impact Land Values

Understanding that market pricing is largely independent from costs, developers must seek to transfer additional costs to others in order to mitigate risk and maintain appropriate returns. Developers are investing their skills, time and equity to make a profit. If an acceptable profit level cannot be achieved by passing on costs, they will either invest in a new community, delay development or select another investment vehicle. Construction costs tend to be relatively consistent across markets. In a market that shows steady demand and pricing increases, such as Toronto, it is possible that these costs can be absorbed in time, without impacting the viability of development, or land values. However, in more stable markets, with return expectations and costs relatively fixed or inflating in parallel, the impact of any cost increase or downward pressure on revenue is largely compensated for in the land value.

2.4 Understand Land Values for High Density Projects

Accurately assessing the land value for high density development is based on two fundamental inputs: revenues and expenses.

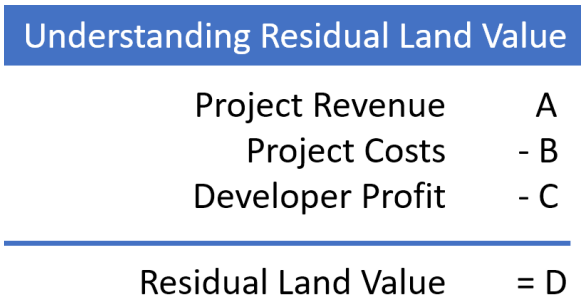
Project revenues are driven by the sale value of homes as well as other sources such as parking spaces, storage lockers, and ground-floor commercial space within an apartment building. Once project revenues have been estimated, developers will then begin to calculate all anticipated hard and soft project costs. As illustrated by **Figure 1**, developers will then subtract all development hard and soft costs, as well as their required profit from the estimated revenue of the project. The remaining amount, or residual amount, is referred to as the Residual Land Value (RLV). The RLV represents the maximum price a developer could pay for the land to construct the housing project and make an attractive profit.

The RLV will result in one of two scenarios:

- **RLV is equal to or higher than the asking price of land in the market:** If the RLV of a proposed development is greater than the asking price of the land in the market, a developer can, in theory, purchase the land and build the project while meeting their profit expectation.

- **RLV is below the asking price of land in the market:** In this situation, the housing development would not be considered viable because a developer could not pay the asking price of land and still maintain their minimum profit margin.

Figure 1



Example: *Assume a site zoned and used for a gas station with an estimated land value of $3.0M. If the land value of the site for high density development is depressed due to the impact of an IZ policy to $2.5M then we assume the owner would continue to use the property for its current use. The owner would not be motivated to sell.*

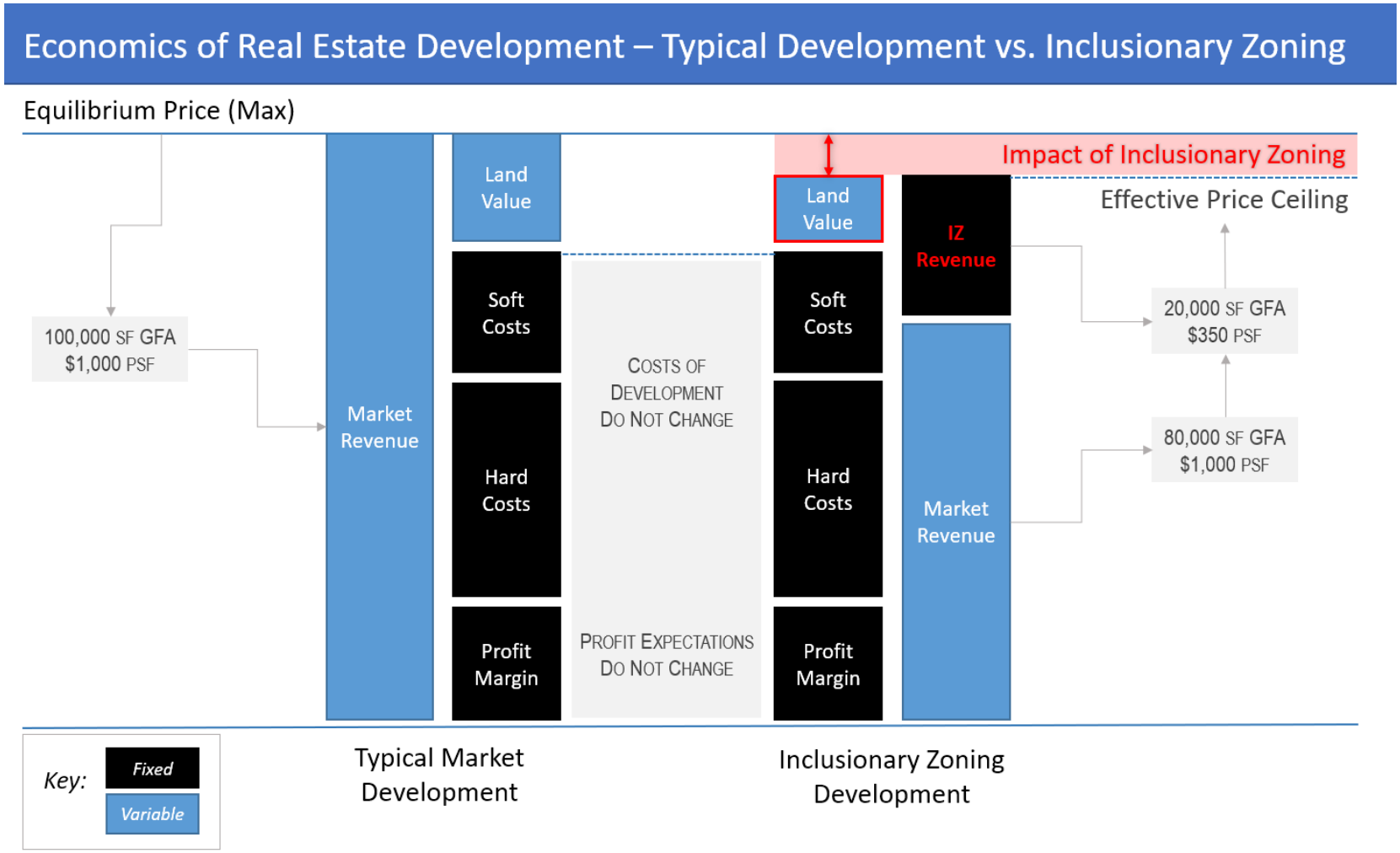
If costs increase (or increase as percentage of revenue, in the case of an IZ scenario), the amount subtracted from the project's revenue will also increase, which results in a lower RLV. In other words, the developer would pay less for the development site because costs have increased.

The RLV is impacted because the other elements of the equation (**Figure 1**) are generally fixed. Developers are not likely to reduce their profit expectation as discussed earlier in this report. Developers also cannot simply increase the price of homes beyond what the market will support. If the market does support an increase in the price of new homes, developers are likely to increase pricing regardless of any change in costs.

Rising costs, as the result of an IZ policy, would be treated no differently than a developer discovering soil contamination issues at a property they are considering for purchase. A developer will not pay market value for a site with soil contamination issues and attempt to recapture the increased cost by increasing the sale value of homes beyond what is supported in the market. Rather, if the soil remediation costs will require $2.0 million in added project costs, the developer would pay $2.0 million less for the property.

The following analysis uses this principal to estimate the potential impacts of an IZ policy across various market locations in Toronto. The model estimates the impact to residual land value resulting from the IZ approach (relative to the amount that a developer might have paid for a market development prior to IZ), and compares that to the existing value of land. If RLV after IZ is still greater than the existing land value, development would be viable. If the RLV is lower than the existing land value, development would be infeasible. **Figure 2** illustrates the key differences between a typical redevelopment pro forma, and one with IZ.

Figure 2


Economics of Real Estate Development – Typical Development vs. Inclusionary Zoning
Equilibrium Price (Max)
100,000 SF GFA
$1,000 PSF
Market Revenue
Land Value
Soft Costs
Hard Costs
Profit Margin
COSTS OF DEVELOPMENT DO NOT CHANGE
PROFIT EXPECTATIONS DO NOT CHANGE
Impact of Inclusionary Zoning
Land Value
Soft Costs
Hard Costs
Profit Margin
IZ Revenue
Market Revenue
Effective Price Ceiling
20,000 SF GFA
$350 PSF
80,000 SF GFA
$1,000 PSF
Key:
Fixed
Variable
Typical Market Development
Inclusionary Zoning Development

3.0 Market Context

The City of Toronto has experienced significant population growth over the past decade driven by strong immigration and employment growth. This, combined with a continued program of public and private investment and an increasingly cosmopolitan lifestyle make the City increasingly appealing for a broad range of Canadians and newcomers to call home. This growth is forecasted to continue, with the vast majority accommodated in high density apartment formats.

3.1 Affordability Underpins Demand for both Condominium and Rental Housing

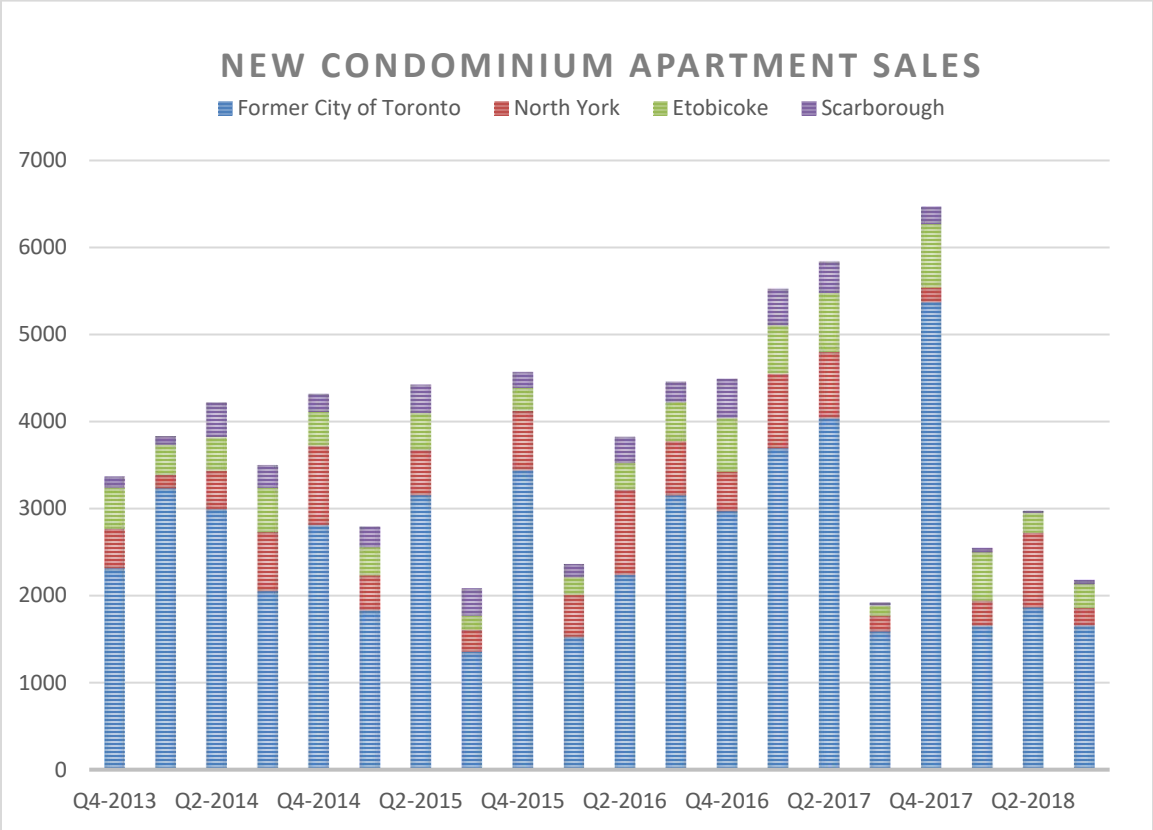
Over the past 10 years, roughly 15,700 housing units have been completed annually in the City of Toronto, with about 80% of these completed units being apartments. The relative affordability of condominium and rental apartments, compared to traditional low-density housing choices, has contributed to the growth in demand for high density living. According to the most recent Census, between 2011 and 2016 average household incomes in the City of Toronto have risen by 18%, while, over the same period, the average resale price of detached homes in the City has risen by 83%. Average pricing for townhomes, the most compact ground-oriented housing type, also increased by 78% during this timeframe. It is this disparity between housing costs and incomes, combined with declining household sizes and lifestyle changes that is pushing more and more households towards condominium and rental apartment living.

3.2 Majority of Housing Demand is in the former City of Toronto

In terms of supply, condominium sales records (**Figure 3)** show that about 70% of the new condominium sales in the City over the past five years have occurred in the former City of Toronto. North York and Etobicoke account for 14% and 11% respectively, while about 5% of sales have occurred in Scarborough.

The concentration of new high-density development and sales tends to follow rapid transit service in the former City of Toronto and North York, with significant concentrations in the Downtown, Yonge-Eglinton, North York Centre, and along Sheppard East subway line. In the future, we expect that this pattern of growth will be influenced by the new Eglinton Crosstown and Finch LRTs, Relief Line, Yonge and Scarborough Subway Extensions and the GO Regional Express Rail transit improvements. However, the traditional high growth areas are likely to continue to capture the majority of sales for the foreseeable future due to their existing critical mass of transit, jobs, shopping and services.

Figure 3



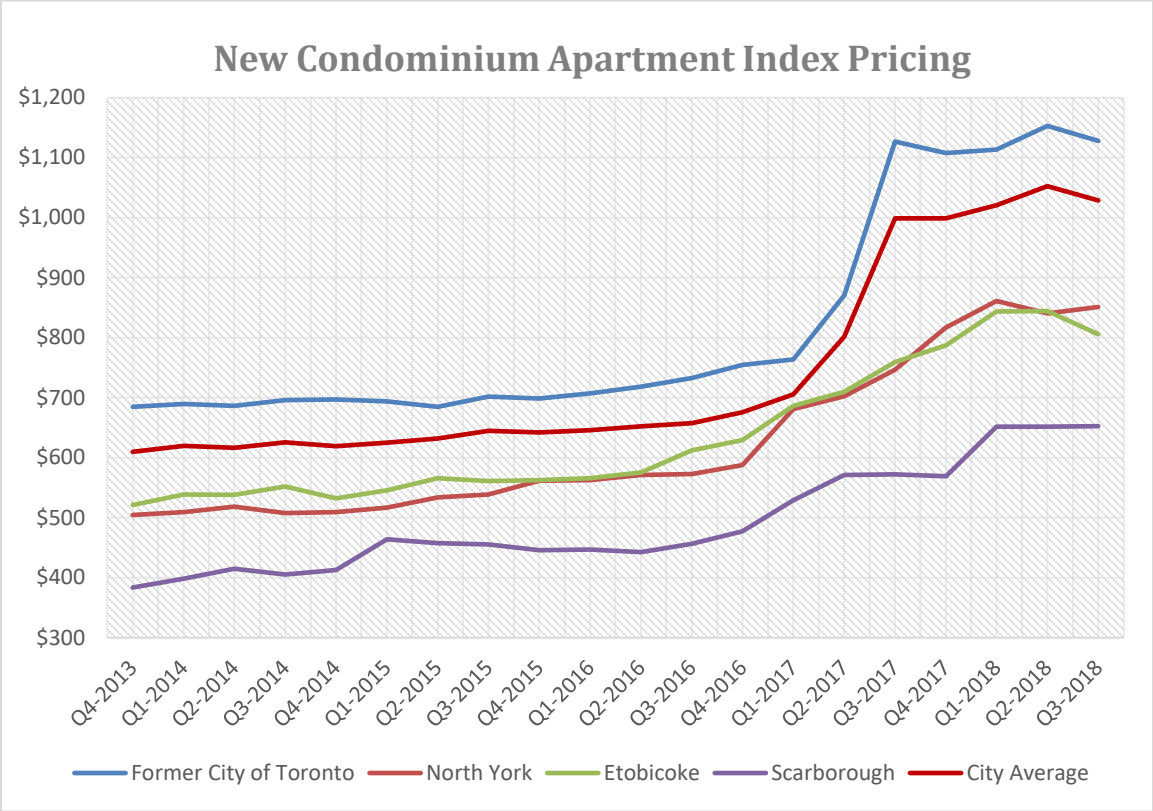
Source: RealNet

3.3 High Volume of Sales and Increasing Pricing

Over the past five years, annual sales averaged about 15,000 units per year in the City of Toronto. Strong sales volumes were experienced in 2017 with a total of nearly 20,000 sales, despite a dip in Q3 following the announcement of the Ontario Fair Housing Plan. In 2018, sales in the first three quarters fell below the five-year average pace, partially due to fewer new product launches. Nonetheless, projects launched in 2018, especially those centrally located, continued to experience very strong sales activity.

The undeniable attractiveness of city-living has escalated pricing to unprecedented levels. As **Figure 4** demonstrates, the average price of a new condominium apartment was about $610 per square foot in the City just five years ago. A steep price escalation was observed in the first two quarters of 2017, and as of Q3 2018, this value has increase by 70% to $1,029 psf. This City average is heavily skewed by the average price in former City of Toronto, where most of the projects are located and the sharpest price escalations have occurred. By late 2018, the average index price in the former City of Toronto had surpassed $1,250 psf. Steady increases in both sales and pricing point to strong, consistent demand. As new developments and projects complete and communities continue to evolve, Toronto and particularly the Downtown, will build upon its reputation as a diverse, energetic and dynamic place to live.

Figure 4



Source: RealNet

3.4 Rental Demand is Strong but at a Disadvantage

Declining affordability of homeownership, population growth and other demographic changes are driving demand for new rental housing. Over the past five years, the overall purpose-built rental vacancy rate in the City of Toronto has been less than 2%, and has been declining each year. Secondary rentals have been a key component in the City's rental market. Vacancy rates for condominium apartment rentals are very tight at below 1%, despite an expanding supply and escalating rental rates.

The demand for high quality rental supply has encouraged private investment in new rental construction. In 2018, the City had over 2,500 rental apartment starts, a new record high over the past two decades. Nonetheless, the volume of new rental construction still falls far behind new condominium construction, which totaled over 18,000 starts in 2018. Compared to condominium projects, rental developers are commonly subject to higher equity requirements, stricter construction financing requirements, and profit is realized over a much longer term. Collectively, this increases (perceived) uncertainty and risk. For these reasons and others, rental projects often struggle while competing for resources such as land.

3.5 Land Values Increasing in Sync with Pricing

With increased demand and pricing, the value of properties suitable for high density residential development in the City has increased especially in the Downtown and traditional high growth areas of the City.[1] An analysis of high density land sales data across 17 land transactions between April 1, 2016 and April 1 2017 in the TOcore (Downtown) planning area illustrated an average land value sale of $103 per buildable square foot.[2] Looking at the same period between in 2017 and 2018, the average sales value across 20 transactions was $157 per buildable foot. Between April 2018 and March 2019, nine transactions in the downtown averaged about $140 psf, pointing to some leveling off in prices.

Land values have also increased in suburban areas of the City, but only by modest amounts relative to the Downtown.

3.6 Costs Increasing – But not at the same Pace as Pricing

From a cost perspective, residential construction costs are increasing, but not at the same rate of unit or land pricing appreciation. While a detailed analysis of construction cost trends was not conducted as part of this research, we reviewed the Altus Canadian Cost Guide which is commonly used in the industry as an initial point of reference when considering development. Looking back at the 2017 report and comparing it to the 2018 benchmarks, it appears that residential construction pricing increased 6% to 8%, while between 2018 and 2019, benchmark residential construction costs appear to have increased by over 10%. This is consistent with findings from NBLC's informal dialogue with developers in the City.

[1] In this report High Growth Areas refer to the Downtown, the Yonge Corridor, North York Centre, and the Central and Etobicoke Waterfront.

[2] Only transactions where the proposed gross floor area of the development could be identified were used. High and low transactions were removed.

4.0 The Conceptual Inclusionary Zoning Policy

The following section summarizes theoretical affordable housing requirements evaluated in this report.

4.1 Considering Offsets in the Design of an IZ Policy

A key consideration when designing an IZ policy is whether to:

- not offer any offsets to developers, requiring that projects absorb the affordable housing requirement, without municipal incentives;
- apply additional density above the current approved zoning, to offset the cost of an affordable housing component;
- apply municipal financial incentives to the project to offset some of the costs of the affordable housing contribution; or,
- a combination of the above.

Determining which is the most appropriate approach is complicated by the fact that the City's housing market is very diverse. Across the City there are a variety of market conditions that impact on the nature of demand; including the type and cost of housing. This diversity also extends to the relationship between as-of-right zoning and achievable density, which would impact the amount of IZ required in a redevelopment.

In high growth areas, additional density is usually highly valuable. Therefore, a policy that trades additional density for affordable housing is likely to be more viable in these areas. In some instances, this might allow the City to calibrate its IZ approach so that there is no impact to land value. If enough additional bonus density was made available to a developer, the market value of this added development scale could cancel out any net cost resulting from IZ.

The City could, in theory, establish an IZ approach that does not impact land value. To do so, the City would need to consider the amount of additional density that could be reconciled from a planning and built form perspective, then tailoring the IZ percentage to that context. In this instance, the percentage of units achievable without impacting land value would likely be significantly less than the 20% or 25% IZ requirement considered in the financial models that follow in this analysis.

Of note, in emerging high-density market locations or low growth suburban areas, where demand is weaker, density has less value. In fact, there are instances where added density would actually detract from the viability of a project by adding market risk, time and, or costs. Therefore, a policy that exchanges density for housing is potentially less viable outside of the core, where financial incentives may be more effective.

From a municipal finance perspective, the provision of density as an offset approach is likely to be the most sustainable and enduring opportunity for the City to pursue because it would not require that the City forgo development levies or property taxes which are required to cover growth related expenses.

However, there will also be instances where financial offsets are more effective, or a combination of both density and financial tools is required in order to encourage investment in low growth areas.

4.2 Establishing an IZ Requirement for Testing

In most jurisdictions where IZ has been successfully implemented, the principal is that additional development density is traded to offset the costs of delivering affordable housing. In some instances, there are also financial programs utilized (tax incentives, etc.), but it is this density exchange that is critical to an enduring and sustainable approach.

This analysis is intended for information purposes as the City of Toronto considers implementing IZ regulations. So, while the ultimate policy has yet to be determined, this analysis establishes a conceptual approach(es) to test as a starting point.

To undertake our assessment, we assume a potential IZ Policy, with the following key elements:

- IZ requirements are calculated as a percentage of the increment between as-of-right density permissions and density the City would support through rezoning application.
- A range of affordable unit requirements was tested from 5% to 25% of the density increase. First, a 20% IZ requirement on the density uplift above as-of-right is tested across all sites and tenures. Then, a sensitivity analysis considers adjustments to the IZ percentage based on initial findings.
- IZ units must be provided in rental tenure, with rents set to 100% of CMHC's city-wide average market rent (AMR). This is assumed to be the case whether the market development component is in ownership (condominium) or rental tenure. While the Provincial regulation allows for IZ units in either rental or ownership tenure, IZ units are assumed to be rental to both ensure a conservative valuation of impacts, and to test the approach which would have the most enduring impact on housing affordability.
- IZ units must remain affordable for at least 25-years. To simulate this and quantify the eventual transition to market rental rates, the model estimates the value of affordable rental rates by calculating the present value of the affordable rental cash flow over the 25-year period of affordability, adding that to the value of those units as market rental suites after 25-years of discounting.
- The added (market) density would be subject to all applicable charges and fees, including under Section 37 of the Planning Act.
- No other incentives are provided for the units (such as "Open Door" funding).

5.0 Approach to Assessing Impacts

Following is a discussion of key issues that helped guide our methodology for testing impacts. This section also summarizes our study areas and key assumptions associated with the financial analysis and building typologies tested in the analysis.

5.1 Introduction

- Toronto is a very diverse marketplace. Our study therefore explores how this policy approach would impact the feasibility of residential development in 11 submarkets within the City. The Submarket areas were selected around transit stations or growth centres, and included both strong and emerging market areas with existing and/ or planned transit infrastructure improvements.
- In each of the 11 submarkets we develop prototypical development concepts based on the as-of-right density and the added density, in consultation with City staff, that might be approved in a rezoning application.
- We tested a rental and an ownership tenure project in each submarket.
- For each submarket we undertake research to assess local pricing dynamics which are used to developed a financial proforma or residual land value model (RLV). The RLV model assesses all the project revenues. From these revenues we subtract the costs of development including the developer's profit. What remains is the land value.
- We evaluate the land value given its existing use and as-of-right zoning.
- We then evaluate the land value based on added density scenarios and the IZ policy discussed above.

5.2 Land Value as a Measure of Feasibility

To evaluate the potential impact of an IZ policy, we measure land value results though a financial analysis. To do this, we employ a residual land value (RLV) model in line with the approach discussed earlier in this report. Prototypical redevelopment scenarios were generated with input from City staff to determine how much added density could be reasonably applied to each test site.

For each of the prototypical developments in the City the RLV model is developed using local market inputs. With the chosen IZ parameters for testing established, the model tests the viability of both an ownership (condominium) and rental apartment development.

In our analysis, the IZ policy creates new costs that reduce land value. We compare these land values to those of the existing as-of-right land value. If the land value of any redevelopment scenario approaches (within 10%) or falls below the existing value, we assume that the viability of the project is in question. A developer would not be motivated (or able) to purchase the site for the purposes of redevelopment. Or, in other words, if the RLV does not exceed that of the existing use, the land owner is unlikely to be motivated to sell.

Based on the above analysis, we look to see where the financial model creates unviable outcomes. These will be the areas where we would expect to see development interest weaken or delayed as a result of IZ until the market can support higher pricing.

5.3 Establishing the Value of the Existing Land Use

To establish the benchmark where land owners become less motivated to redevelop their property for high density housing, we estimate the value of the land based on a review of the existing approved zoning and existing (underutilized) land use which represents the "floor" development potential and land value.

5.4 Financial Model Methodology

The following summarizes our methodology:

- A redevelopment scenario was developed to compare to the existing land value. The redevelopment scenario was tested in ownership and rental tenure across each of 11 market locations which were selected in consultation with City staff. The market areas selected reflect those which are either well established locations with transit connections, or emerging market areas with existing and/ or planned transit infrastructure improvements.
- The test sites balance areas where development is viable and occurring currently, with others that are anticipated to emerge as new high-density market areas given investments in transit infrastructure and other City planning initiatives.
- For this reason, the selected market locations are not evenly distributed across planning district boundaries. This is reflective of the Toronto market's historical western bias, but also the fact that the market and demographic characteristics in outlying or emerging locations of the City often have many similarities with respect to variables that would inform a development project's key inputs.
- The development scenarios selected have a mix of built forms (mid-rise and tower formats), and built form projections provided by City staff reflect the types of development that have been recently completed, active or recently approved in these submarkets.
- In some instances, where a current planning study is underway but not yet complete, to estimate the potential uplift in density above as-of-right residential permissions, City staff have directed NBLC to use estimated as-of-right density assumptions. This is to acknowledge that currently underway planning studies will have the effect of updating the land use permissions, such as the Golden Mile.
- A relatively conservative approach has been employed to establish assumptions around existing site values for comparison to the land value resulting from redevelopment. The analysis utilizes the greater land value of either a typical existing underutilized land use, or the likely land value of as-of-right residential density as informed by market data. In practice, there will be variation in value amongst underutilized sites in any market area. Sites may have different existing values or receive more density than what was tested in this analysis. These variations will have an impact on viability.

- Of note, this analysis only tests residential floor area notwithstanding the fact that there are areas in the City where the Official Plan will require the replacement of office space as well as other planning frameworks which require at grade retail or a certain amount of non-residential floor area. The intent in isolating residential space through this review is to ensure that comparisons between market areas are comparable. In practice, the affect that non-residential space in a development may have on land value would be subject to local market demand.
- The following table outlines the density and built form assumptions for each test site.

Table 1

Summary of Prototypical Test Site Parameters						
Site No.	**Market Location**	**Test Site Area (sm)**	**As-of-right Residential FSI**	**Tested Residential Built Form**		
				No. Storeys	**No. Units**	**FSI**
1	Etobicoke Centre	3,800	3.5	28	200	4.3
2	Stockyard / Junction	4,400	3.0	12	261	4.7
3	Weston (NIA)	3,400	2.5	25	240	5.2
4	Finch West	6,600	2.0	14	256	3.1
5	Yonge Eglinton Centre	2,000	3.0	15	222	9.8
6	North York Centre	3,500	4.5	38	283	8.6
7	Downtown	2,600	5.0	47	640	15.7
8	Toronto West	3,698	2.0	16	352	7.3
9	Toronto East	700	2.0	6	16	3.7
10	Golden Mile	24,900	2.0	39	227	3.6
11	Scarborough Centre	4,500	2.0	41	398	7.0

- The model establishes the site's "as of right" RLV (without IZ) as described in Table 1. This RLV assumes the application of existing development charges and other municipal fees, including emerging cash-in-lieu of parkland rates provided by the City.
- We then then repeat the RLV analysis to determine the value of the site based on the "Tested Residential Build Form" and the IZ policy.
- Again, if the residual land value of the redevelopment opportunity on the site exceeds the as-of-right land value of the site, by at least 10%, redevelopment is considered to be viable.
- If the land value falls below this benchmark it signals that the policy is negatively impacting the viability of development.

5.5 Financial Model Assumptions

The following assumptions are applied in all scenarios:

- The City wide average affordable housing rental rate of $1,372 per month (100% CMHC Average Market Rate) is used.
- Hard construction costs are estimated from the Altus Construction Cost Guide 2019, using midpoints for cost ranges applicable to each built form concept;

- An additional hard cost premium of 10% is assumed in the Downtown and Yonge-Eglinton to acknowledge the common complexity of developing on tight sites, often with heritage considerations or other extraordinary considerations to manage.
- Current City of Toronto property tax rates, planning application fees and development charges are included in the model.
- Other soft costs including consultants (engineering, architectural, etc.), project management, legal, insurance and marketing fees are accounted for.
- For construction financing, it is assumed the developer can borrow 75% of construction costs at 5.0% per annum. This assumption is also used for rental developments which in some cases may require higher developer equity contributions.
- Section 37 assumptions have been developed based on information provided by the City of Toronto, using recent agreements in each submarket as precedent.
- Pre-development timelines and construction timelines are estimates based on anticipated absorption rates and pace of construction for each prototypical development concept.

The following tables highlight the range of other key assumptions applied throughout the modeling exercise as well as assumptions which were developed for each market area and prototypical development concept based on market research.

Table 2

Financial Model Assumptions		
Variable	New Residential	Existing Use
Revenue Inflator, per annum	2.00%	2.00%
Capitalization Rate	4.00%	6.00%
Vacancy & Bad Debt	2.00%	2.00%
Operating Expense Ratio (Affordable)	40%	-
Operating Expense Ratio (Market)	36%	36%
Hard Costs		
High Density Office (Class A)	$255	-
Hybrid Construction up to 6 storeys ($psf)	$215	-
Apartment up to 12 storeys ($psf)	$225	-
Apartment 13 to 39 Storeys ($psf)	$228	-
Apartment 40 to 60 Storeys ($psf)	$230	-
Apartment over 60 storeys ($psf)	$253	
TO Core & Yonge EG. Hard Cost Premium	*10.00%*	-
Underground Parking ($psf)	$138	-
Surface-Level Parking Construction	$28	-
Servicing, Landscape / Hardscape, Site Prep ($psf)	$121	-
Contingency Factor (% of hard costs)	10.00%	-
Cost Inflator, per annum	2.00%	-
Soft Costs		
Planning Application Fees		
OPA and ZBL - base fee	$29,165	-
OPA and ZBL - additional fee (psm)	$2.88	-
Site Plan Application - base fee	$21,257	-
Site Plan Application - additional fee (psm)	$4.83	-
Plan of Condominium - base fee	$9,375	-
Plan of Condominium - additional fee (unit)	$26	-
Municipal Development Charges		
Apartments 1 Bed and Bach.	$30,656	-
Apartments 2 + Bedrooms	$46,963	-
Multiples 1 Bed and Bach.	$33,266	-
Multiples 2 + Bedrooms	$66,313	-
Educational Development Charges	$1,793	-
Section 37 Contribution	**Variable*	-
Cash-in-lieu of Parkland Contribution	**Variable*	-
Property Tax Rate	0.636%	-
Consultants, PM, Legal, Insurance, Marketing, Development & Construction Management	14.50%	-
Sales Commission Fee	2.50%	-
Lender's Administrative Fee	0.80%	-
Construction Loan Interest Rate	5.00%	-
HST Rate	13.00%	-
Other Rates & Timing		
Profit Margin (Ownership Tenure)	15.00%	-
Discount Rate	6.00%	-
Absorption Rate	**Variable*	-
Construction Period	**Variable*	-

Table 3

Area Specific Model Assumptions										
Site	Market Location	Area Specific Cost Variables		Area Specific Market Assumptions						
		Downtown/ Yonge-Eglinton Cost Premium	S.37 cost per unit*	Avg. Unit Size (sf)	Condo Sales Absorption Rate (per mo)	Condo Pricing $PSF	Condo Parking Revenue	Rental Pricing $psf	Rental Parking Revenue (per mo)	Parking Ratio
1	Etobicoke Centre	-	$2,800	750	12.0	$775	$35,000	$3.25	$120	0.90
2	Stockyards / Junction	-	$2,600	700	20.0	$800	$40,000	$3.40	$120	0.65
3	Weston (NIA)	-	$2,400	750	10.0	$675	$35,000	$2.75	$85	0.80
4	Finch West	-	$1,800	700	10.0	$725	$40,000	$3.00	$85	0.70
5	Yonge Eglinton Centre	10%	$3,200	720	15.0	$1,000	$70,000	$4.00	$150	0.35
6	North York Centre	-	$5,600	700	15.0	$950	$60,000	$3.75	$125	0.80
7	Downtown	10%	$4,800	710	20.0	$1,200	$90,000	$4.25	$180	0.25
8	Toronto West	-	$3,000	700	20.0	$975	$75,000	$4.00	$150	0.50
9	Toronto East	-	$3,400	750	12.0	$950	$65,000	$3.75	$150	0.60
10	Golden Mile	-	$2,600	750	10.0	$740	$40,000	$3.05	$85	0.90
11	Scarborough Centre	-	$2,000	750	10.0	$745	$35,000	$3.10	$85	0.90

*Assumptions developed though input and information provided by the City of Toronto

5.6 Limitations of this Analysis

A major variable affecting the outcomes of this analysis is the relationship between existing zoning and the ultimate built form which may be achievable through a planning process. More specifically, the amount of 'uplift' in residential density between the existing zoning and eventual approved permissions.

For instance, in locations where there are currently no residential permissions within existing zoning, the impact of potential IZ requirements would be significantly more onerous than in scenarios where the discrepancy between existing zoning and proposed development parameters are more marginal. It is not uncommon throughout the City of Toronto for existing zoning to be outdated. However, as required by the Growth Plan, the City's zoning will need to be updated as part of Major Transit Station Area (MTSA) work; the Province's proposed Bill 108 would further limit the application of IZ to these areas and those where a Development Permit System is being implemented.

Conversely, there may also be locations where as-of-right development density represents the maximum achievable density for that context. The North York Secondary Plan for examples already recognizes in its zoning by-law significant as-of right densities. In instances such as this, IZ might produce a marginal affordable housing requirement (or none at all).

Also related is the nature of development or redevelopment potential throughout some areas of the City. This analysis isolates evaluation to one single development phase. However, in some locations throughout Toronto the nature of redeveloping areas is such that large lot areas will result in multi-phase developments. This analysis pro rates the valuation of existing land uses to the area required to support a single phase of redevelopment.

Another important factor to highlight in this analysis is the comparison of a site's value through redevelopment to existing as-of-right value, or the value of an existing use. These existing use valuations are conducted at a high level given the characteristics of prototypical redevelopment sites. However, slight variations in these valuations could shift the results of these analyses. And, there will be more or less valuable sites in any given market location.

Finally, this analysis cannot capture certain nuance arising from the nature of a historical land purchase or the former capitalization of land costs through the operation of an income-generating use in the interim. Nor can it contemplate the acquisition of land at speculative values, not fully appreciating the magnitude of impacts from future policy adjustments.

Moreover, there will also be instances throughout the City where land vendors, developers or operators have operating assumptions that differ from those in this report. For this reason, it is possible that development may or may not occur in practice which might be contrary to the results of this work. Again, this analysis is intended to provide the City with a high level view with respect to the opportunities or barriers related to a potential IZ approach in scenarios which are thought to be reasonable protypes for development occurring under current market conditions within the premise of willing buyer, willing seller. The results of this analysis should be used to inform policy decision making, but should not be construed as absolute metrics as the policy approach is implemented.

6.0 Analysis

Tables 4 and 5 illustrate the percentage change in land value that occurs when IZ requirements are layered onto the prototypical redevelopment in each market area. The summary tables illustrate green results in instances where development prototypes support land values which are more than 10% above existing land values. Developments that show signs of economic weakness are identified in orange.

6.1 IZ Policies Impact Land Values throughout the City – But at Widely Different Rates

The impact of the tested IZ approach would reduce the revenue of each project while holding costs relatively stable (i.e. increasing costs as a share of revenue). The value of the units that would have been sold at market rates are now reduced. In the rental model, annual rents are reduced to reflect affordable pricing. Affordable pricing is insufficient to cover the cost of construction. Therefore, the shortfall is absorbed as a cost to the overall project (reflected in a reduction to the land value).

On average the impact of the conceptual IZ approach reduced the supportable land value by an average of $17 psf in the scenarios tested (with a 20% IZ requirement). The impact ranged from about $45 psf in the Downtown area to about $5 psf in the Etobicoke Centre example where base zoning is already relatively permissive (fewer affordable units required). On a percentage basis, the average negative impact to land value was about 27% across all test scenarios.

6.2 Downtown and High Growth Areas Show the Best Potential to Generate Affordable Units through IZ

The land value impacts vary between each prototype and market area. In general, however, the analysis illustrates that the policy could be successful in the Downtown area and other strong market areas. However, in markets that show relatively less residential market strength, or where the value of alternate/ existing uses is strong, even a modest IZ requirement (based on the assumed density) can be a significant burden and undermine project viability.

In areas where viability is technically maintained, the impact to land value results can still be significant (up to 53% less than a development scenario without IZ). It is likely that the degree to which this is acceptable and sustainable without impact to the prospect of redevelopment would be subject to other site-specific factors, including the motivations of land owner and developer interests involved.

6.3 IZ Depends on Realistic Underlying Zoning

A successful IZ policy requires the as-of right zoning to form the basis by which land values are established. However, in some areas of Toronto, especially in the Downtown and around emerging transit stations, the as-of-right zoning is often out of date or below what is anticipated in Official Plan or Secondary Plan policies (or emerging policies). Given the very strong demand for these properties, developers are forced to pay what they view to be achievable, less about what might be legally permissible. Having already paid for the anticipated density in advance – the ability to fund affordable housing is undermined in these situations. A clear policy direction (and transition period as IZ is

introduced) should help to add an element of restraint to speculative land acquisitions over time, allowing for a subsequent density bonus to offset additional costs.

In other areas like North York Centre and Yonge-Eglinton the existing uses/ as-of-right densities are also valuable and many sites already have fairly high densities. Therefore, there is relatively limited opportunities for additional density gains to fund affordable housing through the tested IZ policies.

A review of as-of-right zoning and the potential uplift potential in areas where IZ is being considered is necessary to ensure the policy will be effective. In some instances (i.e. high growth areas), this might allow the City to calibrate its IZ approach so that there is no impact to land value. For instance, if a 10% IZ approach was implemented on the Downtown test site, an additional 2.0 FSI of market density would be enough to reinstate the RLV of the site without IZ. Or, on the Toronto West example, an additional 1.5 FSI would be enough to reinstate market land value in a 15% IZ scenario. Proposed Provincial Bill 108 would also require that further articulation of development permissions be incorporated in order to implement IZ.

6.4 IZ Relies on Density

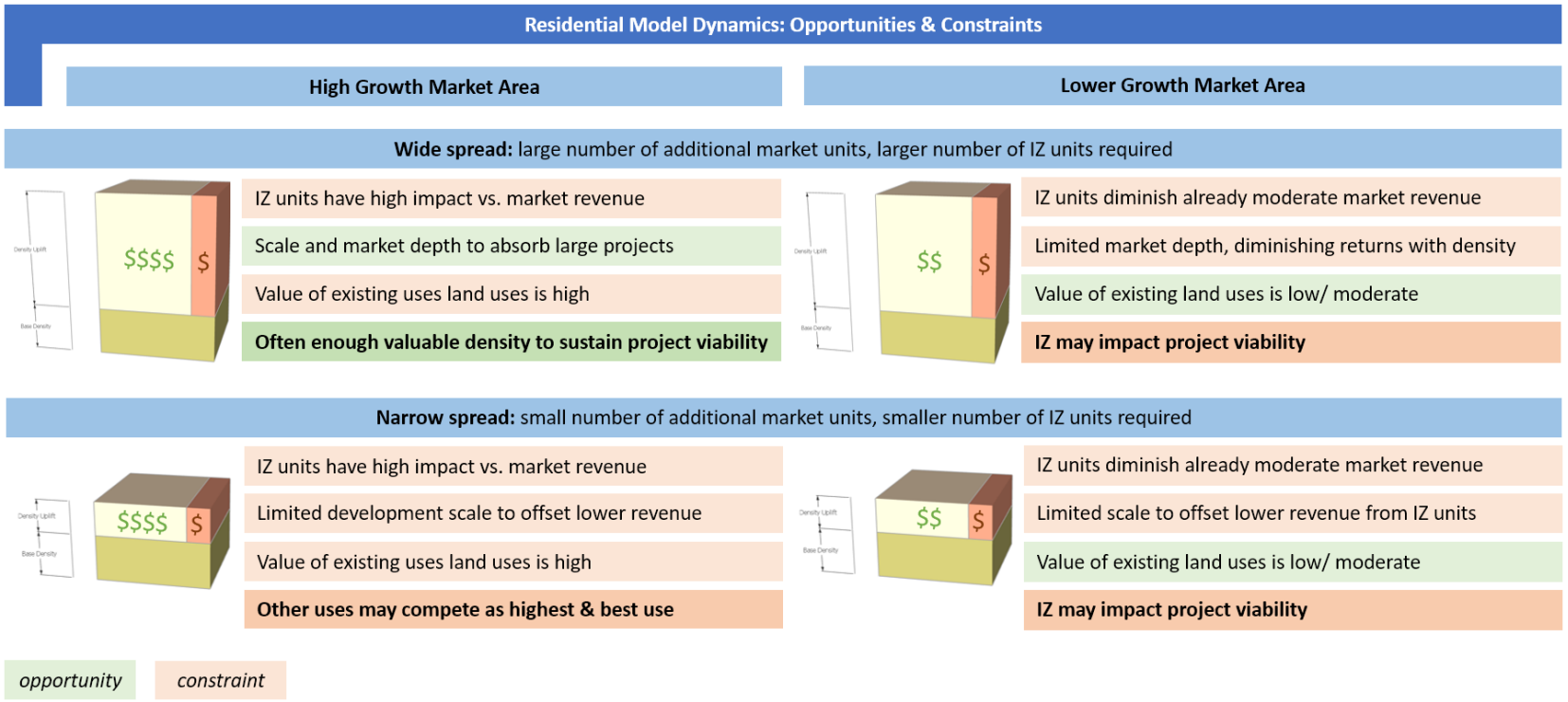
Another major dynamic affecting these results is the amount of density subject to the IZ calculation in the first place. The relationship between existing development permissions and the ultimate built form on a site drives the magnitude of IZ requirements on a site. And in turn, the amount of foregone revenue in the development. In practice, slight variations in these model inputs (among other underlying market variables) can have meaningful impacts on project-specific results. The following chart (**Figure 5**) illustrates the relationship between density uplift and market value, illustrating the typical instances where IZ can be absorbed, or create challenges from a redevelopment perspective.

6.5 Impacts at Emerging Transit Stations

There are locations in the City where new transit investment decisions are being made and where new development investment will be desired in order to create transit supportive density. Transit can be a meaningful market influence for high density development, but is also true that some of these emerging market locations are less desirable from a market perspective relative to the City's traditional high growth nodes. The analysis suggests that in the Finch West, Weston, Scarborough City Centre, and Etobicoke Centre market locations, the application of a significant IZ requirement could create a significant impact to land value and in some instances might jeopardize the prospect of near-term development investment.

In some of the City's transit station areas that have been identified for growth – but are currently designated for employment uses, or have low residential density permissions – this disconnect could also jeopardize viability. The secondary planning process for areas like this might seek to establish a base as-of-right zoning and then mechanisms with planning tests to allow increased density – which would be subject to IZ. A gradual, or moderate, application of IZ policy in these locations may be warranted (along with potential offsets) to balance the City's objectives around affordability and intensification in these market areas.

Figure 5


Residential Model Dynamics: Opportunities & Constraints
High Growth Market Area
Lower Growth Market Area
Wide spread: large number of additional market units, larger number of IZ units required
$$$$
$
IZ units have high impact vs. market revenue
Scale and market depth to absorb large projects
Value of existing uses land uses is high
Often enough valuable density to sustain project viability
$$
$
IZ units diminish already moderate market revenue
Limited market depth, diminishing returns with density
Value of existing land uses is low/ moderate
IZ may impact project viability
Narrow spread: small number of additional market units, smaller number of IZ units required
$$$$
$
IZ units have high impact vs. market revenue
Limited development scale to offset lower revenue
Value of existing uses land uses is high
Other uses may compete as highest & best use
$$
$
IZ units diminish already moderate market revenue
Limited scale to offset lower revenue from IZ units
Value of existing land uses is low/ moderate
IZ may impact project viability
opportunity
constraint

6.6 Impacts on Affordability

As discussed in the previous sections, the impact of an IZ policy would be to put downward pressure on revenue, and therefore on land prices. As land prices decline, owners may be less likely to sell or redevelop property. This could result in reducing the supply of housing entering the marketplace until demand increases pricing sufficiently to trigger development. In some cases, other uses such as office buildings or even retail uses, which support lower land values, can now compete for these properties.

Related to the above, the introduction of IZ policies would add to the delivery cost of housing. This means that the minimum price a developer can charge and still make a return would increase. In the downtown core, this has not been a significant concern given the rapid escalation of pricing. However, in weaker market areas, where pricing is not as strong, it will perpetuate affordability issues.

As such, the impacts on affordability are felt in two interrelated ways:

- by increasing the minimum cost of delivering a home across the City, shifting development interest away from areas which might be marginally viable today; and,
- by a reduction of supply due to the increasing number of projects that would become unfeasible given local area market pricing.

Given this, the implementation of an IZ policy in Toronto should carefully consider an appropriate transition period to phase-in the approach over time, as well as the market reality of the areas in which it is applied.

6.7 Impacts on Other Land Uses

If IZ is applied in a manner that creates a significant impact to residential land values, an unintended consequence might be an improvement in the ability for other non-residential uses such as office development compete for land in prime locations. This should be considered relative to other growth objectives that the City has at emerging transit nodes and other locations in the City.

6.8 Rental Projects

Of note, the following results show land value impacts through the introduction of IZ on a percentage basis. The percentage change experienced by rental projects is almost always less than the change experienced in condominium apartment test scenarios. This is not because rental projects are better at adjusting to the IZ requirement; rather, these rental projects are starting from a lower land value result (relative to condo equivalents) in the first place, so the magnitude of change is therefore lower.

Rental development, which is currently feasible in most of the study area locations, albeit at much lower land values than condominium projects, becomes increasingly less competitive from a land value perspective under the conceptual IZ approach.

Rental housing is disadvantaged in Ontario for a number of reasons including:

- **Financing:** In a condominium project, financing can be supported with less equity due to the pre-sale process. The pre-sale process allows lenders to become comfortable with the viability of the project, years before the development is completed. In rental housing, leasing cannot begin until the building is very close to completion. The market risk between the time the project is initiated and the leasing period is much more difficult to assess. The equity requirement for rental building can be as high 50% of the total costs compared to a condominium where the requirement is typically in the 20% range.

- **Revenue:** Related to the above, a rental development requires the developer to go many years into the development process without any revenue. Even once the building is constructed it can take many months for the building to become fully occupied and 'stable'. In a condominium development, subject to obtaining deposit insurance, purchaser's deposits can form an inexpensive source of project financing. When the development is ready to be occupied the developer can immediately charge all purchasers interim occupancy rents until the project is registered and purchasers register their mortgages.

- **Market and Risk:** For many developers the market opportunity for condominium development offers much less risk and relatively quick returns compared to rental development where returns are earned out over a longer period of time.

- **Hard to compete against condo developers for land:** For the reasons identified above, rental developers must attribute greater discounting to their projects to reflect risk and time-value-of-money. This often means that a rental developer cannot pay the same land price that a condominium developer can.

The following table illustrates the pro forma results which demonstrate the impact to land value where the percentage change in RLV is measured against the RLV of the development opportunity on each site without IZ. The colour coding represents whether the site's resulting land value falls below, or is within 10% of the value of the site under its existing use (i.e. development would not be viable).

Table 4

Preliminary Financial Results - Affordable Rents at 100% AMR, 25-Year Affordability Timeline

Site No.	Market Location	TREB/Altus Market Area	Est. of Existing Site Land Value	Assumed Base Density (FSI)	New Density (FSI)	Built Form	Tenure	IZ Percentage on Density Uplift	Residual Land Value		Est. Number of Affordable Units Generated
									No IZ	With IZ *(% Change to RLV)*	
1	Etobicoke Centre	Central Etobicoke	$7,194,000	3.5	4.3	Tower	Condo	20%	Viable	Viable, 10% to 20% impact	8
							Rental	20%	Challenge	Challenge, < 10% impact	
2	Stockyards / Junction	Toronto West	$11,351,000	3.0	4.7	Mid Rise	Condo	20%	Viable	Viable, 10% to 20% impact	20
							Rental	20%	Viable	Viable, 10% to 20% impact	
3	Weston (NIA)	York	$5,329,000	2.5	5.2	Tower	Condo	20%	Challenge	Challenge, > 50% impact	22
							Rental	20%	Challenge	Challenge, > 50% impact	
4	Finch West	North York West	$10,037,000	2.0	3.1	Tower	Condo	20%	Challenge	Challenge, 20% to 30% impact	19
							Rental	20%	Challenge	Challenge, 20% to 30% impact	
5	Yonge Eglinton Centre	North Toronto	$19,310,000	3.0	8.3	Tower	Condo	20%	Viable	Challenge, 20% to 30% impact	26
							Rental	20%	Challenge	Challenge, 10% to 20% impact	
6	North York Centre	North Yonge Corridor	$16,983,000	4.5	8.6	Tower	Condo	20%	Viable	Viable, 10% to 20% impact	37
							Rental	20%	Viable	Viable, 10% to 20% impact	
7	TO Core	Downtown West	$28,268,000	5.0	15.7	Tower	Condo	20%	Viable	Viable, 20% to 30% impact	71
							Rental	20%	Viable	Viable, 10% to 20% impact	
8	Toronto West	Downtown West	$7,840,000	2.0	7.3	Tower	Condo	20%	Viable	Viable, 20% to 30% impact	50
							Rental	20%	Viable	Viable, 10% to 20% impact	
9	Toronto East	Toronto East	$1,620,000	2.0	3.7	Hybrid Wood	Condo	20%	Viable	Viable, 10% to 20% impact	3
							Rental	20%	Viable	Viable, 10% to 20% impact	
10	Golden Mile	Scarborough Central (and Southwest Scarborough)	$3,572,000	2.0	3.0	Tower	Condo	20%	Viable	Viable, 20% to 30% impact	17
							Rental	20%	Viable	Viable, 20% to 30% impact	
11	Scarborough Centre	Scarborough City Centre	$4,345,000	2.0	7.0	Tower	Condo	20%	Viable	Viable, > 50% impact	54
							Rental	20%	Viable	Viable, 30% to 50% impact	

6.9 Sensitivity Testing

A sensitivity analysis was prepared in order to evaluate the impacts to land value results from the initial prototype testing when varying percentages of affordable housing are required through inclusionary zoning (sill being calculated on the uplift in density).

City staff were consulted to arrive at the following assumptions for sensitivity testing:

- Acknowledging the imbalance between the supportable land value results between rental and condominium apartment projects, all rental scenarios were tested with a 5% IZ requirement;
- Where the results of the first round of IZ testing (20% requirement) produced challenging results for a condominium apartment project (and/ or an impact of greater than -50%), a 10% IZ requirement is tested; and,
- Where the results of the first round of IZ testing (20% requirement) produced viable results for a condominium apartment project, a 25% IZ requirement is tested.

Overall, the results of this sensitivity testing show a general trend towards lessening the severity of dampened land values, except on sites where a 25% IZ requirement was assumed. Overall, the average percentage change to land value results through this sensitivity testing was in the order of 18%, versus 27% in the initial prototype tests.

- Condominium apartment projects that resulted in unviable financial results in the initial protype tests (now tested with a 10% IZ requirement) experienced a 19% increase in land value results versus those results. The land value impacts vary by site, but demonstrated a negative 19% change in land value, versus a 38% decline in the 20% IZ scenario.
- Condominium apartment projects that had viable financial results in the initial prototype tests at 20% (now tested with a 25% IZ requirement) experienced a further 5% decrease in land value (from an average of -21% in the initial tests). In these scenarios, land values were shown to decline on average by 26% when compared to land value outcomes without IZ.
- Rental apartment scenarios in the sensitivity analysis were tested with a 5% affordable housing requirement (versus the initial 20% requirement in the first series of prototype testing). The land value impact of this reduction in these scenarios was an average of 14% compared to 27% in the initial 20% IZ scenario.

Of note, using varying IZ percentage requirements for ownership and rental projects had some impact on reducing the discrepancy between the land value results between the housing tenures themselves. When comparing the land values between condominium scenarios and rental scenarios in the initial tests (20% IZ in all scenarios), rental scenarios had land typically 31% less than their ownership counterparts. However, the results of the sensitivity testing show this average premium declining to about 14%.

Table 5

Preliminary Sensitivity Analysis Results - Affordable Rents at 100% AMR, 25-Year Affordability Timeline											
Site No.	Market Location	TREB/Altus Market Area	Est. of Existing Site Land Value	Assumed Base Density (FSI)	New Density (FSI)	Built Form	Tenure	IZ Percentage on Density Uplift	Residual Land Value		Est. Number of Affordable Units Generated
									No IZ	With IZ *(% Change to RLV)*	
1	Etobicoke Centre	Central Etobicoke	$7,194,000	3.5	4.3	Tower	Condo	10%	Viable	Viable, < 10% impact	4
							Rental	5%	Challenge	Challenge, < 10% impact	2
2	Stockyards / Junction	Toronto West	$11,351,000	3.0	4.7	Mid Rise	Condo	25%	Viable	Viable, 20% to 30% impact	25
							Rental	5%	Viable	Viable, < 10% impact	5
3	Weston (NIA)	York	$5,329,000	2.5	5.2	Tower	Condo	10%	Challenge	Challenge, 30% to 50% impact	11
							Rental	5%	Challenge	Challenge, > 50% impact	5
4	Finch West	North York West	$10,037,000	2.0	3.1	Tower	Condo	10%	Challenge	Challenge, 10% to 20% impact	9
							Rental	5%	Challenge	Challenge, < 10% impact	5
5	Yonge Eglinton Centre	North Toronto	$19,310,000	3.0	8.3	Tower	Condo	10%	Viable	Challenge, 10% to 20% impact	13
							Rental	5%	Challenge	Challenge, < 10% impact	7
6	North York Centre	North Yonge Corridor	$16,983,000	4.5	8.6	Tower	Condo	25%	Viable	Viable, 20% to 30% impact	46
							Rental	5%	Viable	Viable, < 10% impact	9
7	TO Core	Downtown West	$28,268,000	5.0	15.7	Tower	Condo	25%	Viable	Viable, 20% to 30% impact	89
							Rental	5%	Viable	Viable, < 10% impact	18
8	Toronto West	Downtown West	$7,840,000	2.0	7.3	Tower	Condo	25%	Viable	Viable, 30% to 50% impact	63
							Rental	5%	Viable	Viable, < 10% impact	13
9	Toronto East	Toronto East	$1,620,000	2.0	3.7	Hybrid Wood	Condo	25%	Viable	Viable, 20% to 30% impact	4
							Rental	5%	Viable	Viable, < 10% impact	1
10	Golden Mile	Scarborough Central (and Southwest Scarborough)	$3,572,000	2.0	3.0	Tower	Condo	25%	Viable	Viable, 20% to 30% impact	21
							Rental	5%	Viable	Viable, < 10% impact	4
11	Scarborough Centre	Scarborough City Centre	$4,345,000	2.0	7.0	Tower	Condo	10%	Viable	Viable, 20% to 30% impact	27
							Rental	5%	Viable	Viable, 10% to 20% impact	14

6.9.1 Additional Sensitivity Tests – Adjusting Affordability Timelines & Depth of Affordability

For one high growth and one low growth market location, additional sensitivity testing was completed in order to evaluate the impacts associated with varying the length of time that an IZ unit must remain affordable, or varying the depth of affordability. These permutations were conducted for the Downtown and Scarborough City Centre test locations (which both generate a similar number of affordable units), and included the following matrix of permutations:

- Varying affordability periods: 15, 25 or 99-year timelines;
- Varying affordability standards: 80% AMR and 100% AMR; and,
- Testing of a scenario where 50% of density uplift is required to be moderately affordable (e.g. 150% of AMR, for either 15, 25 or 99-years).

Following are key findings from this additional sensitivity work:

- The duration of affordability required by the City in an IZ policy could have a measurable impact on affecting development viability, but longer timelines aren't more impactful to land value results in a linear fashion. The nature of cash flows and time-value-of-money is such that the percentage change in land value generated through an IZ approach with a 15-year affordability period would have a measurable improvement versus a 25-year scenario. However, extending the transition timeline from 25 to 99-years (effectively, into perpetuity), creates a similar magnitude of percentage change in land value results. This reflects typical rental investment horizons which might commonly span 25 to 50 years in total. Afterwards the value of future market-rate cash flows hold very little value.
- In the Downtown illustration, moving between a 25 to 15-year affordability period produced a 3% to 5% improvement to land value results. The impact of this change would likely be more pronounced in market areas with thinner margins. The Scarborough City Centre example illustrates an 10% to 15% improvement in residual land value when moving from 25 to 15-years of affordability. A change from 25 to 99-years produced a negative land value impact of 1.20% to 3.26% in the Downtown illustration, or 12% to 18% in Scarborough City Centre.
- This type of trend is similarly experienced when moving between a requirement for IZ units at 100% AMR versus 80% AMR. Projects located in stronger market locations generally have more robust pro forma conditions and can sustain the further decrease to project revenue without impacting land value as significantly. In the Downtown illustration, an additional negative impact to land value in the order of 1% to 2.5% was experienced subject to the duration of affordability and tenure of the market components in the development. However, in the Scarborough City Centre illustration, the additional negative percentage change ranged between about 4% and 10%. Of course, the amount of inclusionary units required in a particular development would have an impact to these results.

- The reason that extending affordability timelines have a greater impact on land value results than the depth of affordability (80% AMR vs. 100% AMR) in our model is due to the spread between market and affordable revenue. Assuming a 725 square foot average unit, moving from 100% AMR to 80% AMR is a decrease in revenue equivalent to about $0.40 per square foot (from $1.90 to $1.50). However, with market revenue significantly higher ($4.25 psf in the Downtown scenario), the spread between affordable benchmarks is much less consequential than the pace at which IZ units are permitted transition to market rates (if at all).

    - It is important to reiterate that our model is focused on evaluating land value impacts, i.e. a build and sell scenario. The perspective of an owner operator could be different if seeking to maintain minimum debt service coverage ratios or in seeking to achieve certain return metrics which are evaluated based on the asset's operating income.

- The final sensitivity scenario tested a scenario where 50% of the uplift in density was positioned at 150% of CMHC AMR for wither 15, 25 or 99-years. This approach resulted in significant downward pressure on residual land value in either of the Downtown or Scarborough Centre test sites; with the Downtown model faring better given the strong revenue of remaining market units working to a cross-subsidize these units. The results of this illustration showed a 30% to 55% decrease to base land value in Downtown, and a 44% to 100% change in land value in the Scarborough Centre illustration. The model illustrates that where there is significant density uplift over as-of-right conditions, requiring a large proportion of that density to be deployed at below market revenue would detract significantly from development viability. This approach might be more palatable if a project's density uplift was less significant.

6.9.2 Additional Sensitivity Tests – Applying IZ to all density

Another approach to applying an IZ policy, rather than applying the affordable housing to an uplift in density, would be to apply the IZ requirement to all residential density; albeit at a lower percentage. The advantage of this approach is that the need to rationalize the zoning for the site is eliminated. The developer would assess the increasing costs of IZ, along with other costs, as they seek increases in density. A disadvantage of the approach is that determining the right IZ requirement becomes more sensitive. For land owners who have as-of–right densities, the additional charge for IZ could be seen as punitive and discourage investment.

To demonstrate this approach, an additional sensitivity analysis was conducted. The approach was to calibrate the resultant IZ percentages so to equal the affordable unit yield from the initial 20% IZ test and sensitivity analysis. This demonstrates the magnitude of the IZ requirement that would result if the percentage was based on the development's total density, yielding the same number of affordable units.

The following tables outline the results of this test. The major finding is that in each location, a large variation in IZ percentage would result; further lending credence to an area specific approach for IZ implementation. To equal the affordable unit output of the scenarios which tested IZ requirements on 20% of density uplift above as-of-right, between 4% and 14.5% of total yield would be required, and to

match the sensitivity analysis findings (variable IZ percentages), the analysis yields IZ requirements of between 1% and 18% on total residential yield in the test locations. Further consideration and testing should be undertaken to consider this approach as the City prepares an implementation strategy for IZ as minor adjustments to the IZ percentage when applied to all of a building's density can yield significant impacts.

Table 6

Preliminary Financial Results, IZ Applied to All Density - Calibrated to initial 20% IZ results

Site No.	Market Location	TREB/Altus Market Area	Est. of Existing Site Land Value	New Density (FSI)	Built Form	Tenure	IZ Percentage on Total Density	Residual Land Value		Est. Number of Affordable Units Generated
								No IZ	With IZ *(% Change to RLV)*	
1	Etobicoke Centre	Central Etobicoke	$7,194,000	4.3	Tower	Condo	4.0%	Viable	Viable, 10% to 20% impact	8
						Rental	4.0%	Challenge	Challenge, < 10% impact	
2	Stockyards / Junction	Toronto West	$11,351,000	4.7	Mid Rise	Condo	7.5%	Viable	Viable, 10% to 20% impact	20
						Rental	7.5%	Viable	Viable, 10% to 20% impact	
3	Weston (NIA)	York	$5,329,000	5.2	Tower	Condo	10.5%	Challenge	Challenge, > 50% impact	22
						Rental	10.5%	Challenge	Challenge, > 50% impact	
4	Finch West	North York West	$10,037,000	3.1	Tower	Condo	7.3%	Challenge	Challenge, 20% to 30% impact	19
						Rental	7.3%	Challenge	Challenge, 20% to 30% impact	
5	Yonge Eglinton Centre	North Toronto	$19,310,000	8.3	Tower	Condo	12.5%	Viable	Challenge, 20% to 30% impact	26
						Rental	12.5%	Challenge	Challenge, 10% to 20% impact	
6	North York Centre	North Yonge Corridor	$16,983,000	8.6	Tower	Condo	9.5%	Viable	Viable, 10% to 20% impact	37
						Rental	9.5%	Viable	Viable, 10% to 20% impact	
7	TO Core	Downtown West	$28,268,000	15.7	Tower	Condo	13.5%	Viable	Viable, 20% to 30% impact	71
						Rental	13.5%	Viable	Viable, 10% to 20% impact	
8	Toronto West	Downtown West	$7,840,000	7.3	Tower	Condo	14.5%	Viable	Viable, 20% to 30% impact	50
						Rental	14.5%	Viable	Viable, 10% to 20% impact	
9	Toronto East	Toronto East	$1,620,000	3.7	Hybrid Wood	Condo	10.0%	Viable	Viable, 10% to 20% impact	3
						Rental	10.0%	Viable	Viable, 10% to 20% impact	
10	Golden Mile	Scarborough Central (and Southwest Scarborough)	$3,572,000	3.0	Tower	Condo	6.8%	Viable	Viable, 20% to 30% impact	17
						Rental	6.8%	Viable	Viable, 20% to 30% impact	
11	Scarborough Centre	Scarborough City Centre	$4,345,000	7.0	Tower	Condo	14.3%	Viable	Viable, > 50% impact	54
						Rental	14.3%	Viable	Viable, 30% to 50% impact	

Table 7

Preliminary Financial Results, IZ Applied to All Density - Calibrated to Sensitivity Analysis

Site No.	Market Location	TREB/Altus Market Area	Est. of Existing Site Land Value	New Density (FSI)	Built Form	Tenure	IZ Percentage on Total Density	Residual Land Value		Est. Number of Affordable Units Generated
								No IZ	With IZ *(% Change to RLV)*	
1	Etobicoke Centre	Central Etobicoke	$7,194,000	4.3	Tower	Condo	2.0%	Viable	Viable, < 10% impact	4
						Rental	1.0%	Challenge	Challenge, < 10% impact	2
2	Stockyards / Junction	Toronto West	$11,351,000	4.7	Mid Rise	Condo	9.3%	Viable	Viable, 20% to 30% impact	25
						Rental	2.0%	Viable	Viable, < 10% impact	5
3	Weston (NIA)	York	$5,329,000	5.2	Tower	Condo	5.0%	Challenge	Challenge, 30% to 50% impact	11
						Rental	2.5%	Challenge	Challenge, > 50% impact	5
4	Finch West	North York West	$10,037,000	3.1	Tower	Condo	3.5%	Challenge	Challenge, 10% to 20% impact	9
						Rental	2.0%	Challenge	Challenge, < 10% impact	5
5	Yonge Eglinton Centre	North Toronto	$19,310,000	8.3	Tower	Condo	6.5%	Viable	Challenge, 10% to 20% impact	13
						Rental	3.5%	Challenge	Challenge, < 10% impact	7
6	North York Centre	North Yonge Corridor	$16,983,000	8.6	Tower	Condo	12.0%	Viable	Viable, 20% to 30% impact	46
						Rental	2.3%	Viable	Viable, < 10% impact	9
7	TO Core	Downtown West	$28,268,000	15.7	Tower	Condo	17.0%	Viable	Viable, 20% to 30% impact	89
						Rental	3.5%	Viable	Viable, < 10% impact	18
8	Toronto West	Downtown West	$7,840,000	7.3	Tower	Condo	18.0%	Viable	Viable, 30% to 50% impact	63
						Rental	3.8%	Viable	Viable, < 10% impact	13
9	Toronto East	Toronto East	$1,620,000	3.7	Hybrid Wood	Condo	12.5%	Viable	Viable, 20% to 30% impact	4
						Rental	3.0%	Viable	Viable, < 10% impact	1
10	Golden Mile	Scarborough Central (and Southwest Scarborough)	$3,572,000	3.0	Tower	Condo	8.3%	Viable	Viable, 20% to 30% impact	21
						Rental	1.5%	Viable	Viable, < 10% impact	4
11	Scarborough Centre	Scarborough City Centre	$4,345,000	7.0	Tower	Condo	7.3%	Viable	Viable, 20% to 30% impact	27
						Rental	3.8%	Viable	Viable, 10% to 20% impact	14

7.0 Conclusions

Without a corresponding density offset or financial incentive program, the overall impact of new Inclusionary Zoning would be a reduction in project revenue, largely absorbed by reducing land values. Where the supported land value of a development falls below the value of a property in its existing use, development will be discouraged or delayed until the market demand for housing in the area supports higher pricing. An unintended consequence in the interim might be a reduction in residential land prices which may improve the ability for other non-residential uses such as office development compete for land in prime locations.

The majority of Toronto's condominium development is found within the downtown, the Yonge Corridor, the waterfront areas and in North York along the Subway lines. These areas have very strong market fundamentals and the testing conducted throughout this study generally illustrates evidence that the land market could absorb the impact of potential IZ policy without jeopardizing development viability. The exception to this appears to be in Yonge-Eglinton where built form considerations limit residential density and might make residential redevelopment unviable with a 20% IZ requirement.

Notwithstanding this, and subject to the ultimate policy approach, the impact to the residential land values should not be understated. With potential downward swings of up to 35% in the IZ scenarios tested, it is likely that the degree to which this is acceptable and sustainable without impact to the prospect of redevelopment would be subject to other site-specific factors, including the motivations of individual land owner and developer interests involved.

This policy could also have negative near-term impacts on the viability of high-density developments in the areas of the City that have the weakest market characteristics. These projects are the most likely to be serving a lower priced segment of the market and community regeneration, however at thin margins. Downward pressure on achievable development revenue could impact the viability of these projects. At a macro scale, any large-scale restriction on supply over time could put upwards pressure on pricing for existing homes. And, entry level pricing of market housing will increase.

The City has a range of implementation opportunities that have the potential to yield a steady supply of affordable housing through the use of Inclusionary Zoning. The financial testing in this analysis demonstrates that this may be especially true in the Downtown and around many transit stations. As the City considers an IZ policy, we offer the following recommendations:

- A successful IZ policy requires as-of right zoning to form the basis by which land values are established. The value created by adding new density provides a revenue source to fund affordable housing. However, in some areas of Toronto, especially in the Downtown and around emerging transit stations, the as-of-right zoning is often out of date or below what is anticipated in the Official Plan (or emerging Official Plan policies). Given the very strong demand for these properties, developers are forced to pay what they view to be achievable, less about what might be legally permissible. Having already paid for the anticipated density in advance – the ability to fund affordable housing is undermined.

- Consideration of existing zoning by-law permissions should be included in the development of the City's potential approach to implementing IZ. This notion is important given proposed changes resulting from Bill 108 which would require that zoning be updated prior to IZ applying in those locations. This would have a positive effect on speculative land purchases over time as there would be increased certainty on what is achievable for a site.
- Apply an IZ policy in strong market areas such as the Downtown planning area, and at many Smartrack/ GO/ TTC station areas. A key issue to consider are the near-term impacts of an IZ policy. As with development charges or any new cost to development, a phase-in policy is recommended to help the market adjust – especially for projects that have already been initiated. Consideration should be given to the following:
  - A phase in period starting as low as a 5% IZ target with annual increases; or,
  - Announce to the market that the IZ policy will come into force in a certain period of time, e.g.in three to five years. Either approach would allow markets to adjust and for sites which are currently in pre-development stages to proceed.
  - Of note, Provincial review of both IZ policies and the lead up to establishing protected MTSA and other DPS areas might effectively act as a phase-in period, the City should also consider this as it develops transition policies.
- Apply IZ policies now to emerging areas where transit investments are being made and policy changes are underway or anticipated in the future (i.e. Downsview, Golden Mile). These areas will require a policy structure that creates reasonable base land value and then a framework for the approval of additional density – with the expectation of affordable housing in return – in order to limit speculative land acquisitions that undermine the opportunity for IZ. In some cases, additional financial incentives could be warranted in order to encourage near term investment as these locations evolve.
- Municipal financial incentives should not be applied to projects in high growth areas. Density should be the preferred offset approach in these locations.
- Avoid implementing IZ in areas where investment is being encouraged and the market for new residential investment is currently weak, such as Neighborhood Improvement Areas. In areas such as the Finch Corridor (not including Keele/Finch), it is the new LRT than will play a role in improving the market to encourage investment. Application of an IZ policy in these areas would discourage this emerging investment.
- Significantly reduce IZ requirements for purpose-built rental projects, or projects that will be renting under a benchmark (i.e. over 200% of AMR).
- For the program to have an enduring impact on affordability in the City, the City should seek affordability for units created through IZ in perpetuity, where possible.

- Seek to develop a cash-in-lieu policy that is based on an annual calculation of the capital subsidy requirement for a rental unit at the target affordability level. Update the subsidy calculation annually.
- Update the IZ policy at regular intervals to ensure that the policy is nimble and able to adjust to the economic realities of the day.

Our analysis assumes that the added density in each prototype tested would be subject to Section 37 of Planning Act where community benefits are typically payable. However, recently proposed Provincial reform stemming from Bill 108 may significantly impact the manner in which Section 37, Section 42 and development charge payments are approached; potentially rolling these into a 'Community Benefits Charge'. It will be important to conduct further evaluation of IZ impacts when there is greater clarity around the dynamics of this revised approach.

This analysis cannot assume the wide variations of market factors and the interests of developers and land owners. For example, the analysis does not consider landowners of shopping centres who have marginal or no land costs, or developers that might accept a lower rate of return. The results therefore should be considered at a high level and used to provide general direction in developing an IZ policy.