The City of Toronto

## Update: Evaluation of Potential Impacts of an Inclusionary Zoning Policy

May 2020





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#### Disclaimer:

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.

This report has been prepared solely for the purposes outlined herein and is not to be relied upon, or used for any other purposes, or by any other party without the prior written authorization from N. Barry Lyon Consultants Limited.

#### **Executive Summary**

The City of Toronto has retained N. Barry Lyon Consultants Limited (NBLC) to prepare an update to its Evaluation of Potential Impacts of an Inclusionary Zoning (IZ) Policy in the City of Toronto, completed in May of 2019. This document serves as an addendum to the May 2019 analysis by updating key market and cost parameters in the analysis and by testing revised policy parameters. As part of this updated assessment NBLC has been directed to test impacts from IZ when the policy is applied to a percentage of total development yield. This report should be read in conjunction with our original study.

Of note, this analysis was completed without the benefit of a finalized regulatory framework pursuant to Bill 108 and prior to legislative changes introduced through Bill 197. With direction from City staff we have therefore made certain assumptions with respect to municipal fees and charges in this work. Further review may be required once the regulations have been implemented, along with any emerging Community Benefits Charge by-law that may be implemented by the City of Toronto. Moreover, market impacts flowing from COVID-19 are affecting Toronto's housing market and will likely influence housing market conditions in the near term (market data and assumptions in this update are were developed in February and March of 2020). We assume that once the impacts of COVID-19 are shed, the housing market will return to normalcy.

#### Approach

To undertake our assessment, we assume that the IZ policy would have the following key elements:

- The policy framework considers the implications for development if a developer were to pursue land acquisition and development under various market conditions throughout the City. In each case we assume, as part of the development approval, a portion of the development would be "set aside" for affordable housing.
- A range of affordable unit requirements are tested, starting with a set-aside rate of 10% of all residential GFA in a building, then testing impacts with a 20% set-aside rate for each test area. These tests are conducted assuming a base land value (calculated based on the "existing use or as-of-right" zoning).
- This testing is completed based on costs associated with current planning policy as it relates to Section 37 and Section 42 of the Planning Act. In addition, a sensitivity analysis is also included which attempts to mimic the emerging Community Benefits Charge (CBC) framework that was introduced through Provincial Bill 108. In this case, a 15% CBC rate is

assumed (which includes parkland), however no adjustments to development charge rates were made.

- This testing is intended to provide a basis of evidence for future decision making, with setaside rates, depth of affordability and length of affordability established by City staff for the purposes of modeling.
- No offsets such as tax incentives or bonus development density were considered in this testing.

	Current Pla	nning Policy	Emerging CBC Framework		
Key Variables:	Lower Set- Aside	Higher Set- Aside	Lower Set- Aside	Higher Set- Aside	
Set-Aside Rate % of Total GFA	10%	20%	10%	20%	
Depth of Affordability for IZ Units	80% AMR	80% AMR	80% AMR	80% AMR	
Period of Affordability	99-Years	99-Years	99-Years	99-Years	

The following table outlines the updated IZ permutations considered as part of this assessment:

As described in our May 2019 analysis, the City of Toronto is comprised of diverse submarkets. This evaluation therefore considers the potential impacts of a potential of the feasibility of high density residential development in 11 locations along existing/ planned transit. 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 asof-right density and the added density, in consultation with City staff, that might be approved in a rezoning application.
- We tested a market rental and an ownership (condominium) project in each submarket.
- For each submarket we undertake research to assess local pricing dynamics which are used to develop a 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 land value.

- We estimate the existing land value given (underutilized) land uses and as-of-right zoning to estimate "as-is, where-is" land value for each prototype site as a baseline.
- We then evaluate the land value based on the conceptual development scenarios at market rates, and also with the IZ policy variations presented earlier.
- If the land value of the development scenario, with the IZ requirements, 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 residential purposes). However, if the resulting land value, with IZ policies considered, remains at least 10% greater, there is a viable Inclusionary Zoning policy outcome.

#### Findings

The majority of Toronto's residential apartment 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 shows evidence that that the land market should have capacity to absorb the impact of potential IZ policy without jeopardizing development viability. Following are other key findings from this evaluation:

- The primary impact of an IZ policy is to reduce the development revenue from a project. When revenues are decreased, the amount a developer can pay for land decreases. When land value is reduced below that of the existing use of the land, the motivation for the land to be redeveloped, and for housing to be created, is similarly reduced and investment potential undermined.
- In weaker suburban market areas, where revenues are already low, or in areas where the available density is modest, an IZ policy could have a negative impact on investment and the production of housing. The research illustrates that in stronger market areas the potential for a successful IZ policy is greater.
- Our work illustrates the highly variable market conditions for development across the City for both condominium and purpose-built rental projects. The feasibility for IZ varies depending on the tenure, the location, the site conditions and allowable density. Condominium developments, for example, typically have more ability to absorb an IZ policy than purpose-built rental. Applying the same policy that might be viable in downtown Toronto to a weaker market area could discourage new investment.
- A long-term IZ policy approach would allow land markets to adjust and developer expertise to grow. As the high-density residential submarkets in Toronto continue to mature, there is potential to create significant amounts of affordable housing over time. However, it will be important to gradually introduce and 'ramp up' IZ expectations as these markets adjust.

- A key issue to anticipate is the timing of when land was purchased. If, for example, land was purchased in 2019 and a policy was introduced in 2020, the 2019 price would not have accounted for the reduced revenue impacts associated with IZ. This could create financial hardship in the development community and discourage the creation of new housing stock.
- In weaker market areas where reinvestment and new affordable housing is an objective, targeted financial incentives – potentially through Community Improvement Plan(s) – could mitigate adverse near-term impacts by offsetting the reduction in revenue caused by affordable unit requirements.
- If an aggressive IZ policy was applied in weaker market areas without offsets such as density increases or tax incentives IZ policies could have negative impacts on affordability in two inter-related ways:
  - By eroding the feasibility of projects, thus reducing the supply of housing, which at a macro level can put upward pressure on net demand (and pricing) of available units; and,
  - Assuming land values cannot be reduced below the base land value, the cost of delivering an entry-level apartment unit would increase.
- Another important consideration in order to mitigate unintended consequences of this nature would be to develop the policy alongside a framework for transition. An implementation approach that phases-in the implementation of IZ would allow for ongoing market monitoring and create time for markets to adjust.

#### Recommendations

Inclusionary Zoning presents a long-term policy opportunity which could yield a new supply of affordable housing units for the City. Introducing IZ now – even at low set-aside rates – including in weaker high-density submarkets, may mean that it takes longer for new development to occur (without counteractive intervention, in the form of financial incentives, for instance). However, with a longer-term policy vision in place, the early introduction of IZ is beneficial because it sets a standard for doing business that will be priced into future market activity. As the City of Toronto considers a potential IZ policy, we offer the following recommendations:

- Develop the IZ framework alongside clear development entitlements in each MTSA. A successful IZ policy requires a measure of clarity in station area plans to form the basis by which land values are established.
- The City should consider whether each MTSA could have different set-aside rates to allow for market variances as it relates to the percentage affordability and allowable densities determined through MTSA planning processes. Generally speaking, set-aside rates can increase with allowable densities.

- IZ policies must acknowledge the varied characteristics of local submarkets. These measures in weaker market zones could include Community Improvement Plans or other focused public investments such as new transit, parks or community facilities that help improve the market appeal of the area.
- The City could consider implementing a framework to allow for the IZ policy to be amended or waived in instances where developers can demonstrate a lack of feasibility (e.g. in purpose-built rental apartment scenarios) and/ or where other significant community benefits are being provided.
- The City should consider a phase in period starting with a low IZ set-aside rate with specified (e.g. annual) increases; and/ or an announcement to the market that the IZ policy will come into force in a certain period of time (e.g. as MTSA plans are implemented). Both approaches would allow markets to adjust and for sites which are currently in pre-development stages to proceed, allowing new development lands to be priced accordingly.
- IZ policies should consider whether rules about who owns and operates the units and maintains oversight of the depth and duration of affordable as well as the unit types are necessary. This represents a next step for the City as it consults with council and stakeholders, beginning to frame a preferred policy approach.
- The IZ policy should be revisited at regular intervals to ensure that the policy is nimble and able to adjust to the economic realities of the day. Of note, this analysis was completed without fully phased in Community Benefits Charge policies relating to Bill 108 and Bill 197. Moreover, at the time of drafting this report considerations relating to novel coronavirus COVID-19 are impacting global markets. Illustrations of policy and market fluctuations like this emphasize the need for flexibility and regular monitoring of potential IZ policies throughout the City.

This analysis cannot assume the wide variations of market factors and the interests of developers and landowners. 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 IZ policies. Further review or consideration could be warranted once MTSA plans are advanced and as market conditions evolve.

#### 1.0 Introduction

The City of Toronto has retained N. Barry Lyon Consultants Limited (NBLC) to prepare an update to its Evaluation of Potential Impacts of an Inclusionary Zoning (IZ) Policy in the City of Toronto, completed in May of 2019. This report serves as an addendum to the May 2019 analysis by updating key market and cost parameters in the analysis and by testing revised potential policy parameters. This report should be read in conjunction with our original study.

The Province of Ontario has adopted legislation that will allow the creation of affordable housing through Inclusionary Zoning techniques. The City of Toronto is actively developing strategies to address housing affordability; part of this work includes evaluating the potential City-building benefits of Inclusionary Zoning. As part of this review, the Provincial Regulations require that municipalities evaluate the potential impacts of an IZ policy on development viability.

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 offsetting financial programs (tax incentives, etc.). But it is this exchange of added density for affordable units that has underpinned the success of these policies. Notwithstanding this, as part of this updated assessment NBLC has been directed to test impacts from IZ when the policy is applied to a percentage of total development yield.

This update to our May 2019 study reviews 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 and market dynamics are established for a range of market locations throughout the City in order to consider the nuance of varying market dynamics. Through an understanding of the subtleties between various submarkets, we examine how the impact of providing affordable housing in market development could impact the viability of a typical project.

Of note, this analysis was completed without the benefit of a detailed regulatory framework related to Community Benefits Charges (CBCs) pursuant to Bill 108 and Bill 197. At the time of writing, a proposed Community Benefits Charge approach had been tabled and was subject to ongoing consultation. Further review of this evaluation could be warranted once final regulations are implemented. This analysis considers existing development charge and parkland acquisition policies in place today, as well as an adjustment to soft costs which might occur through the implementation of a CBC by-law.

In addition, impacts flowing from the response to novel coronavirus COVID-19 are affecting Toronto's housing market and will negatively influence market conditions in the near term (market data and assumptions in this update are were developed in February and March of 2020). However, we remain optimistic about Toronto's resiliency and recovery.

#### 2.0 Housing Prices and Costs – Fundamental Factors

As discussed in NBLC's May 2019 analysis, the effect of an IZ policy would be to exchange the additional density achieved on a site through a planning application process for affordable housing units. This would reallocate a portion of a residential development's yield to affordable housing, decreasing available project 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, pricing, product positioning (e.g. mid-market, luxury), sales absorption rates or lease-up 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 value, and profit. When deciding how to price housing, it is important to consider both demand and supply conditions in the local market area.

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 been able to charge more for the product.

Developers carefully examine supply and demand to ensure this does not happen. Instead, the industry seeks 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, later adjusting pricing or other elements based on the market's response to an initial release. This is an important consideration, as developers can – and often do – increase pricing if the market supports such an increase. This adjustment to pricing is independent of any shift in development costs.

An IZ policy would 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. In other words, costs increase as a proportionate share of revenue.

#### 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 market pricing falls below this benchmark, the project is not constructed.

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

- Hard Construction Costs
- Soft Development Costs
- Developer Profit
- Land Costs

Hard construction costs encompass all the materials and labour required to physically construct a building. 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. Soft development costs include all 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, consultants, financing costs, and commission fees.

Hard construction costs are dictated by the market, albeit a different market than house prices. Developers will purchase building materials 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. Labour demand and supply conditions (e.g. competition) also affect hard costs and fluctuations. Overall, once the specifics of a development project are well defined, hard construction costs become relatively fixed.

Like 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 vary 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.

Refinements to the Planning Act through the implementation of a Community Benefits Charge (CBC) framework may further impact the way soft costs are calculated in a developer's proforma. Further updates to this analysis should be considered once final regulations are implemented the City begins to develop CBC By-laws.

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.

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 pricing (revenue) 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. Therefore, where costs increase – or revenues decrease, in the case of IZ – a proportional increase in pricing or decrease in land value must occur to keep a project viable.

In a market that has demonstrated gradual improvements to high density residential pricing, it is possible that impacts associated with IZ will be absorbed over time, without impacting the viability of development, or land values. However, in markets where price growth is not strong, with return expectations and costs relatively fixed or inflating in parallel, the impact of a revenue decrease is largely compensated for in land value.

The only exception to this is where the cost increase occurs after the land acquisition has occurred. In which case, a developer either: accepts a lower return; delays the project until the market is more favourable; or, cancels the project.

#### 2.4 Understanding Land Values for High Density Projects

Accurately assessing the land value for high density residential development is based on two fundamental inputs: revenues and expenses. Project revenues are driven by the sale or rental value of homes as well as other sources such as parking spaces, storage lockers, and ground-floor commercial space within an apartment building. 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 theoretical 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.

If revenue decreases (or costs increase, as they do on a percentage basis compared to 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.

Figure 1						
Understanding Residual Land Value						
Project Costs	- B					
Developer Profit	- C					
Residual Land Value	= D					

A reduction in revenue, 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 would not pay full market value for a site with soil contamination issues and then later attempt to recapture the increased cost by increasing the sale value of homes at pricing beyond what is supported in the market. Rather, if soil remediation works were to require \$1.0M in added project costs, the developer should seek to pay \$1.0M less for the property.

The following analysis uses this premise to estimate the potential impacts of an IZ policy across various submarket 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 land to pursue a market development prior to IZ), and compares that to the base value of land (based on the value of a typical underutilized land use, i.e. the value of a 'soft site' as-is, where-is).

If the land value supported by redevelopment after IZ is still greater than the base (as-is, where-is) land value, development would be viable. If the redevelopment's land value is lower than the base land value, development would be infeasible. **Figure 2** illustrates the key differences between a typical redevelopment proforma, and one with IZ.

Figure 2



#### 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 appealing for a broad range of Canadians and newcomers to call home. While markets are currently adjusting rapidly due to impacts flowing from COVID-19, notable considerations driving Toronto's high density residential market include the following:

- Relative affordability underpinning demand for condominium and rental apartment housing forms relative to traditional low density housing choices.
- A general concentration of new high-density development and sales occurring in the former City of Toronto, in part following rapid transit service. It can be expected that this pattern of growth will be influenced by ongoing and planned transit improvements.
- A high volume of condominium apartment sales and increasing pricing in recent years since Toronto's rebound after the Financial Crisis. The undeniable attractiveness of city-living escalated pricing to unprecedented levels.
- New purpose-built rental demand has also been strong but is often at a financial disadvantage when compared to condominium formats. Overall, demand for high quality rental supply has been encouraging private investment in new rental construction.
- With increased demand and pricing, the value of lands suitable for high density residential development in the City have increased, especially in the Downtown and traditional high growth areas.
- From a cost perspective, residential construction costs are increasing, but is typically not at the same rate of unit or land pricing appreciation in strong market locations.

#### **3.1** A Note About COVID-19

At the time of writing this report, global markets are adjusting as a result of the public health implications related to a novel coronavirus pandemic. The degree to which COVID-19 will have long term implications on real estate markets is currently unknown. The underlying fundamentals of Toronto's local real estate market, particularly throughout traditionally strong locations, had been very strong to date. However, this crisis is eroding these conditions and is likely to affect the housing market, particularly with shelter-in-place measures and shifts to remote work / learning across large sectors of the business community and for educational institutions.

The COVID-19 pandemic is unprecedented and has necessitated a shelter-in-place response which is affecting the North American economy. The recent announcement that Ontario may have reached the peak of this pandemic is encouraging, as the Province prepares for a gradual reopening of the economy.

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In terms of the real estate market, sales have slowed significantly for both new and resale homes, which is expected to continue over the coming months. We are aware of developers pushing back launch dates for new projects and the pace of construction has slowed, putting further strain on supply in an already constrained market. Within the rental market, developers are delaying first occupancies in compliance with social distancing and many landlords have begun to defer rents for tenants who have hit financial difficulties. Another factor which may affect vacancy in the downtown in particular are the recent announcements from Universities who have signaled a move to e-learning for the fall semester.

Though the outcome of the current pandemic is unknown, we can look to the 2008 financial crisis to gain some understanding of how COVID-19 may impact the market. In 2008, the real estate market shut down for all intents and purposes. Launches were delayed, some projects were cancelled, and buyers, for the most part, stayed away. However, pricing in both the ownership and rental housing markets were not measurably impacted. Very little new rental product was in the market and vacancy rates remained incredibly tight. By the spring of 2009 confidence had been restored in the banking system and, driven by strong market fundamentals, the new sale and resale market regained its pre-recession strength.





Like with the recession a decade ago, our economy will eventually shed the effects of this pandemic. During this period there will naturally be softness, as all market participants including buyers/tenants, government staff and lenders take necessary precautions to protect public health, recuperate, re-assess their positions and adjust strategies. In fact, the success of recent sales launch activity in summer months amidst improving public health conditions has demonstrated that there is pent up demand in the market. As the post COVID-19 economy emerges, we expect that the

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fundamentals that underpinned the strong housing market in the GTA will similarly bolster the market's recovery, perhaps to more balanced conditions than had been experienced across the GTA after the 2008 financial crisis.

Overall, a continued low interest rate environment, the GTA's highly diversified workforce, high levels of pent up demand, and a forecast for a strong economic recovery – combined with international recognition for Canada's management of the pandemic – bode well for long term and sustained demand for housing in the region.

## 4.0 The Conceptual Inclusionary Zoning Policy

The following section summarizes the conceptual affordable housing approach evaluated as part of this update to the May 2019 study.

#### 4.1 Considering Offsets in the Design of an IZ Policy

In most jurisdictions where IZ has been successfully implemented, the underlying principle 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 often critical to an enduring and sustainable approach. Incentivising projects with financial tools can also be effective in emerging market locations where Inclusionary Zoning makes development financially unviable, and/ or where additional development density is less valuable.

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

- Not offer any financial offsets to developers, requiring that projects absorb the affordable housing requirement (i.e. without any municipal tools used to offset the affordable housing requirement);
- Apply additional density above the current approved zoning to offset the costs 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 the most appropriate approach is complicated by the fact that Toronto's housing submarkets are diverse and ever evolving. Recent changes to Provincial regulations with respect to the Planning Act will also need to be considered by the City if financial offsets are considered.

In strong market locations, additional density can be highly valuable. Therefore, an eventual policy framework that trades additional density for affordable housing is likely to be more viable in these areas. In some instances, this might allow a City to calibrate its IZ approach so that the density increase offsets the impact of the affordable housing requirements. Of note, future planning work is likely to be completed around Protected Major Station Areas where considerations regarding transit supportive densities are warranted. However, to calibrate an approach of this nature, 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 and submarket.

#### Example: The approach to Inclusionary Zoning in NYC

New York City started using Inclusionary Zoning in 1987. Acknowledging that it was infeasible to spend its way out of a housing crisis with financial incentives, NYC determined that there was a need to engage the private market in a solution. At first the program was voluntary, offering additional "bonus" density to developers who elected to include affordable units in their projects. However, the City moved to adopt a more permanent program beginning with a financial assessment study in 2014.

The new mandatory program adopted in 2016 delivers permanently affordable units, using proactive up zoning as the mechanism to create new value which can be exchanged for IZ units. The City conducts detailed planning studies to identify areas with growth potential and "soft" development sites. Five studies of this nature have been completed to date in order to introduce new IZ policies. And, developers can request that the City study areas where new upcoming IZ policies could be applied (e.g. areas that might shift from manufacturing to mixed use).

Important lessons from NYC's experience with IZ are:

- That the expectations and development entitlements need to be clear, ambiguity introduces risk and speculation which undermines the policy opportunity. It is the forward looking nature of the policy, which anticipates future market demand (and value) and pre emptively up zones those locations, that is fundamental.
- The NYC approach also provides an allowance for appeal in some circumstances. The burden of proof is on the developer to demonstrate that the IZ policy makes a project unviable. As of January 2020, no developer had been successful in an appeal.
- Encourage on site delivery through high in lieu fees and onerous off site policies. Delivery off site in NYC (but within one half mile) triggers an additional 5% IZ requirement.
- Compliance and monitoring cannot be overlooked. IZ units in NYC are marketed through a single portal, "Housing Connect". Developers must hire not for profit housing administrators to coordinate marketing, income qualification and unit registration. They are also responsible for re rentals on turnover. The City has also established a Compliance and Enforcement unit where residents can report suspicions of non compliance.

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In market locations where current demand is weaker, density will have less value. In fact, there are instances where added density would detract from the viability of a project by adding market risk, time and/ or costs. Therefore, a policy that exchanges density for housing is less viable outside high demand submarket areas, where financial incentives (i.e. CIP tools) may be more effective as an interim solution. However, as the market evolves and demand improves, the need for these incentive tools diminish, because development density becomes more powerful.

From a municipal finance perspective, the provision of density as an offset approach is likely to be the most sustainable and enduring opportunity to pursue. This is because it would not require that a City forego development levies or property taxes which are required to fund 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. As noted, in American jurisdictions where Inclusionary Zoning is more common, it is this trade-off of new (bonus) density in exchange for affordable units which has been proven successful. The ultimate policy approach for Toronto should be considered relative to market and planning considerations in MTSA areas, as well as overarching municipal finance conditions.

Notwithstanding the above, this analysis is structured to test the impact of potential Inclusionary Zoning parameters absent any density offsets or financial incentives. The objective is to test the potential impacts of policy absent these tools, in order provide a basis of evidence for the City to use in its consideration of potential approaches moving forward. In some cases, it may be possible to right-size an IZ policy to current market dynamics, and in other cases, this testing may demonstrate that some form of approach to offsets is required in order to support viable development outcomes.

Another important consideration and rationale for not including any new financial incentives or density offset assumptions in this review is that over time, the need for offsets will change. If the market sustains upward trajectory, the need for incentives should diminish over time.

Notwithstanding this long term potential, we are also mindful of economic considerations related to the ongoing novel coronavirus crisis. As noted earlier, we expect a period of softness in the high density market as sales in the active and resale markets and the pace of new construction activity slows. However, our post-coronavirus economy will emerge in time, with strong underpinning through a continued low interest rate environment, highly diversified workforce, high levels of pent up demand, and international recognition for Canada's management of the pandemic.

A successful policy is one that strikes a balance with market conditions today; and, is nimble enough to evolve over time as market conditions evolve. Moreover, as this testing will demonstrate, the residential market conditions throughout Toronto's submarkets are quite varied, with varying degrees of strength. This creates some opportunity for IZ over the long term, as a policy now can 'plant a seed', introducing a new reality for development that will occur over the longer term.

#### 4.2 Establishing an Initial IZ Requirement for Testing

This analysis builds upon previous testing and is intended for information purposes as the City considers a response to Provincial IZ regulations supporting the creation of affordable housing. As the ultimate policy has yet to be determined, this analysis reflects one conceptual approach, building evidence as a starting point, without offsets.

City staff have provided NBLC with the following parameters for testing within the context of this updated analysis:

- IZ requirements are calculated as a percentage of total residential GFA in a development.
- The percentage of IZ units required in a development (called, the "set-aside rate) in this testing is either 10% or 20%.
- IZ units are provided in rental tenure with rents set to 80% of CMHC's average market rent (AMR) for City of Toronto. This is assumed to be the case whether the market development component is in ownership (condominium), or purpose-built rental tenure. This depth of affordability was directed from staff in response to public consultation feedback.
- IZ units are assumed to be permanently affordable, secured for 99-years.
- The model assumes current municipal fees and charges. No other financial or planning incentives are included in the model.
- Then, we repeat the analysis with a simulated Community Benefits Charge, where 15% of land value is contributed (established the day before building permit) as a soft cost in the proforma. This replaces cash-in-lieu of parkland and Section 37 contributions in the model. Of note, no adjustment to current development charges have been assumed as part of this analysis.

The following table outlines the IZ parameters evaluated as part of this report.

	Current Pla	nning Policy	Emerging CBC Framework		
Key Variables:	Lower Set- Aside	Higher Set- Aside	Lower Set- Aside	Higher Set- Aside	
Set-Aside Rate % of Total GFA	10%	20%	10%	20%	
Depth of Affordability for IZ Units	80% AMR	80% AMR	80% AMR	80% AMR	
Period of Affordability	99-Years	99-Years	99-Years	99-Years	

Table 1

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## 5.0 Approach to Assessing Impacts

The 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 Modeling Methodology

Toronto is a very diverse marketplace. Our study therefore explores how the noted 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 test sites we worked with municipal staff to develop prototypical development concepts based on a view of potential development density. That is, the scale of development which might be reasonable to anticipate through a planning application.
- NBLC has tested a market rental and market condominium tenure project in each test location.
- In this assignment, proforma modeling is focused on assessing the impacts of residential uses only; this is to allow for test results to reflect residential market conditions and to develop an evidence base that can be compared across transit station areas. We do however acknowledge that in some areas, prevailing planning policy would require developments to be mixed-use, incorporating some commercial uses within the same development. This modeling effectively assumes that these spaces would have a break-even financial position. However, variances in this regard could affect results.
- For each test location we undertake research to assess local pricing and absorption dynamics which are used to develop a financial proforma, structured as a residual land value model. The RLV model assesses all the project revenues. From these revenues, we subtract the costs of development including the developer's profit and what remains is the value of the land.
- We evaluate the value of a property given the conditions of typical existing uses and as-of-right zoning in each station area to benchmark current land values. This is primarily informed by a review of recent commercial leasing activity and high density residential land transaction activity. This is referred to as the 'base value' of the property, i.e. its value on an as-is, where-is basis.
- 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.

- We then evaluate land value based the redevelopment concept at each test location (assuming this reflects reasonable development potential) and the conceptual IZ policy framework discussed earlier.
- The following table outlines the density and built form assumptions for each test site.

Summary of Prototypical Test Site Parameters									
		Tost Sito	As-of-right	Tested Residential Built Form					
Site No.	Market Location	Area (sm)	Residential FSI	No. Storeys	No. Units	FSI			
1	Etobicoke Centre	3,800	3.5	28	241	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	2,800	1.0	8	197	5.8			
5	Yonge Eglinton Centre	2,000	3.0	22	222	11.5			
6	North York Centre	3,500	4.5	35	283	8.6			
7	Downtown	2,600	5.0	47	640	15.7			
8	Toronto West	3,700	2.0	22	241	7.3			
9	Toronto East	700	2.0	6	16	3.7			
10	Golden Mile	7,000	2.0	39	227	3.0			
11	Scarborough Centre	4,500	2.0	41	398	7.0			

#### Table 2

#### 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. For each of the prototypical developments across the submarket areas, the RLV model is developed using local market inputs.

In our analysis, the IZ policy reduces a project's revenue, thereby reducing the land value – again, the developer profit margins are not adjusted. Because there is a ceiling on revenue, a developer could not afford to pay as much for land if it also must maintain its profit margin. We compare these land values to the land value of the underutilized site.

If the land value of any redevelopment scenario approaches (within 10%) or falls below the base value of a site (i.e. the value that might be supported as-is, were-is), we assume that the viability of the development project is in question. In this instance, a residential developer would not likely be able to purchase the site because the value the developer can afford to pay does not present enough upside to motivate a landowner to close their business. And, it might become possible for other economically competitive uses to outperform (i.e. new office).

Further, if the impact from IZ on land value is too extreme, residential developers who already own land may not be able to recuperate appropriate expected returns, and may choose not to develop the site, or the site's highest and best use may change to another form of non-residential or residential development which does not require Inclusionary Zoning.

Based on the above analysis, we look to see where the financial model creates challenging or 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, allowing residential land values to rise.

If the estimated land value of the redevelopment opportunity with IZ on the site exceeds the base value of the site, by at least 10%, redevelopment is considered to be viable. That is, within that test premutation, there is a viable policy outcome.

#### 5.3 Financial Model Assumptions

The following assumptions are applied in all scenarios:

- The city-wide average affordable rental rate of \$1,178 per month (80% of CMHC Average Market Rate as of Fall 2019) is used for IZ units in this analysis.
- Hard construction costs are estimated from the Altus Construction Cost Guide 2020, 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, development charges, and current cash-in-lieu (CIL) rate for parkland dedication are included in the model. Other soft costs including consultants (engineering, architectural, etc.), project management, legal, insurance and marketing fees are accounted for.
- Where applicable, Section 37 assumptions have been developed based on information provided by the City of Toronto, using recent agreements in each submarket as precedent.
- In the Community Benefit Charges (CBC) scenarios, CBC is assumed to replace parkland dedication CIL and Section 37 and is calculated at 15% of land value at the time of permit issuance.
- 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.

• 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 3						
Financial Model Assumptions						
Variables						
Revenue Inflator, per annum	2.00%					
Capitalization Rate	4.00%					
Vacancy & Bad Debt	2.00%					
Operating Expense Ratio (Affordable)	50.00%					
Operating Expense Ratio (Market)	36.00%					
Hard Costs						
High Density Office (Class A)	\$278					
Hybrid Construction up to 6 storeys (\$psf)	\$218					
Apartment up to 12 storeys (\$psf)	\$238					
Apartment 13 to 39 Storeys (\$psf)	\$243					
Apartment 40 to 60 Storeys (\$psf)	\$268					
Apartment over 60 storeys (\$psf)	\$300					
Underground Parking (\$psf)	\$148					
Underground Parking (Single Level, \$psf)	\$110					
Surface-Level Parking Construction	\$15					
Servicing Connection Cost (per unit)	\$500					
Landscaping & Hardscaping (per unit)	\$1,000					
Demolition & Site Prep (\$psf of site area)	\$15					
Contingency Factor (% of hard costs)	10.00%					
Cost Inflator, per annum	2.00%					
Soft Costs						
Planning and Building Application Fees						
Planning Application Fees						
OPA and ZBL - base fee	\$41,383					
OPA and ZBL - additional fee (psm)	\$8.14					
Site Plan Application - base fee	\$22,225					
Site Plan Application - additional fee (psm)						
500-700 sm	\$15.67					
700-1400 sm	\$12.11					
1400-4400 sm	\$7.86					
Over 4400 sm	\$3.91					
Plan of Condominium - base fee	\$9,801					
Plan of Condominium - additional fee (unit)	\$27.11					
Building Application Fees						
Residential Unit Fee (per unit)	\$52.08					

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Multiple Unit Building Index (per sm)	\$17.16
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 (% of Land Value)	10.00%
Community Benefits Charge (% of Land Value)	15.00%
Property Tax Rate	1.193%
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
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 Charge	\$1,793
Section 37 Contribution (where applicable)	*Variable
Cash-in-lieu of Parkland Contribution (where applicable)	10.00%
Property Tax Rate	1.193%
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 4

Area	Area Specific Model Assumptions										
		Area Specific	Cost Variables	Area Specific Market Assumptions							
Site	Market Location	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	700	12.0	\$840	\$50,000	\$3.25	\$120	0.90	
2	Stockyards / Junction	-	\$2,600	700	15.0	\$925	\$50,000	\$3.40	\$120	0.65	
3	Weston (NIA)	-	\$2,400	725	10.0	\$750	\$50,000	\$2.75	\$85	0.80	
4	Finch West	-	\$1,800	700	12.0	\$800	\$50,000	\$3.10	\$85	0.70	
5	Yonge Eglinton Centre	10%	\$3,200	700	20.0	\$1,250	\$85,000	\$4.00	\$150	0.35	
6	North York Centre	-	\$5,600	700	18.0	\$1,200	\$70,000	\$3.90	\$125	0.80	
7	Downtown	10%	\$4,800	650	25.0	\$1,400	\$125,000	\$4.50	\$180	0.25	
8	Toronto West	-	\$3,000	700	15.0	\$1,100	\$75,000	\$4.25	\$150	0.50	
9	Toronto East	-	\$3,400	725	10.0	\$1,150	\$65,000	\$3.80	\$150	0.60	
10	Golden Mile	-	\$2,600	725	10.0	\$950	\$50,000	\$3.10	\$85	0.90	
11	Scarborough Centre	-	\$2,000	725	15.0	\$875	\$40,000	\$3.25	\$85	0.90	

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



#### Figure 4 – Locations of the Test Sites

#### 5.4 Limitations of this Analysis

This analysis uses available data at a point in time in order to develop a basis of evidence for policymakers to consider and engage with stakeholders as strategies to address affordable housing needs are developed. However, given the nature of free markets, this analysis cannot account for future unexpected shifts in economic conditions which may directly impact development viability. At the time of writing this report, global markets are adjusting in light of the public health implications related to COVID-19. The degree to which these considerations have long term implications on real estate markets is currently unknown. The underlying fundamentals of the market had been positive prior to this, and the market data and assumptions used in proforma analyses herein are reflective of pre COVID-19 dynamics. Sustained impacts to the macro-economic health of Ontario and Canada may warrant the reassessment of any emerging Inclusionary Zoning policy.

Moreover, imminent Provincial policy changes as a result of Bill 108 and Bill 197 and resulting regulations will likely warrant further consideration of IZ impacts within a revised framework of municipal charges, planning entitlements and geographical considerations related to IZ.

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. 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 Protected Major Transit Station Area (MTSA) work. The PMTSA process will require a planning study be undertaken for that MTSA to identify the number of residents and jobs per hectare, permitted uses and minimum densities. 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 limited near-term opportunities for affordable housing.

This analysis isolates evaluations to one single development phase. However, in some MTSAs, the nature of redeveloping areas is such that larger underutilized lot areas will result in multiphase developments. Larger sites may have an improved ability to absorb affordable housing requirements through added efficiency and often lower land values on an index basis. This analysis pro rates the valuation of base land uses to the area required to support a single phase of redevelopment.

This analysis cannot capture certain nuances 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.

This analysis does not include financial incentives for affordable units or any of the notable CMHC financing tools that exist today for rental projects (through competitive intake programs). Rental apartment testing results could improve when these programs are considered. Given that duration of these programs are not known, they have not been considered in this analysis.

Finally, there will also be instances where land vendors, developers or operators have operating assumptions or methodological approaches that differ from those in this report. For this reason, it is possible that development may or may not occur in practice, at times these instances may 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 forward looking IZ approach in scenarios which are thought to be reasonable prototypes 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

Table 5 illustrates the results of financial testing across all permutations considered as part of this updated testing. This includes either a 10% or 20% set-aside rate, permanently affordable at pricing equivalent to 80% of CMHC AMR. These parameters are applied to the existing Planning Act framework (which includes cash-in-lieu of parkland and a payment for community benefits and infrastructure through Section 37), or assumptions meant to simulate an emerging Community Benefits Charge (CBC) framework.

There are three key pieces of information included in the table:

- An estimate of base land value for each hypothetical test site, estimated through review of existing (under-utilized) uses and as-of-right density parameters;
- Results based on the land value supported by a redevelopment under current policy parameters (i.e. with no IZ), this is the "Base Case Market Development Land Value"; and,
- Results based on the residual land value supported by a redevelopment with IZ, including the magnitude of land value change in percentage terms versus a market development.

The summary table displays green ('Viable') results in instances where the land values supported by residential redevelopment are more than 10% above existing land value. Development scenarios that result in a residential land values that are less than 10% above existing as-is-where is land values are identified in orange ('Challenge'). The analysis also demonstrates the magnitude (percentage) of change in land value that is estimated to result from a particular IZ approach when compared to development within base case parameters.

A notable finding through this analysis is that a CBC rate at 15% creates relatively little change to the viability of IZ versus the existing Planning Act framework given our assumptions around cash in lieu of parkland and likely S.37 costs. However, this should be reviewed again if final regulations amend the 15% rate, or if development charges are also impacted (for the purposes of this analysis, it is assumed that development charges remain unchanged).

#### Table 5

Estima	Estimate of Land Value Impact / Viability of Inclusionary Zoning applied to All Density																								
			Pro	oposed Built Fo	rm		Land Value Result & Percent	tage Change from Base Case	Land Value Results & Percen	tage Change from Base Case															
Site & Market Location		Estimate of Existing	Estimate of Existing	Estimate of Existing				Base Case	Current	S.37/42	15%	CBC													
		Site Land Value*	No. Storeys	No. Units	Tenure	Market Development Land Value Result	10% Inclusion 80% AMR 99-Year Affordability	20% Inclusion 80% AMR 99-Year Affordability	10% Inclusion 80% AMR 99-Year Affordability	20% Inclusion 80% AMR 99-Year Affordability															
					Condo	Viable	Viable, 20% to 30% impact	Challenge, > 50% impact	Viable, 20% to 30% impact	Challenge, > 50% impact															
1	Etobicoke Centre	\$10,070,000	28	214	Rental	Challenge	Challenge, 30% to 50% impact	Challenge, > 50% impact	Challenge, 30% to 50% impact	Challenge, > 50% impact															
2	Stockvards / Junction	\$11 350 000	12	269	Condo	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 20% to 30% impact	Viable, 30% to 50% impact															
	Stockyards / Sunction	\$11,550,000	12	205	Rental	Viable	Viable, 20% to 30% impact	Challenge, 30% to 50% impact	Viable, 20% to 30% impact	Challenge, 30% to 50% impact															
3	Weston	\$5 330 000	25	218	Condo	Viable	Viable, 30% to 50% impact	Challenge, > 50% impact	Viable, 30% to 50% impact	Challenge, > 50% impact															
	Weston	\$3,330,000	25	210	Rental	Challenge	Challenge, > 50% impact																		
Δ	Finch West \$	\$6,850,000	8	210	Condo	Viable	Viable, 20% to 30% impact	Challenge, > 50% impact	Viable, 20% to 30% impact	Challenge, > 50% impact															
-	T inch west		0	210	Rental	Viable	Challenge, 30% to 50% impact	Challenge, > 50% impact	Challenge, 30% to 50% impact	Challenge, > 50% impact															
5	Vonge Eglipton Centre	\$19,310,000	\$19,310,000	\$19,310,000	\$19,310,000	\$19,310,000	\$19,310,000	\$19,210,000	\$19,210,000	\$19,210,000	\$19,210,000	\$19,210,000	\$19,210,000	\$19,210,000	\$19,210,000	¢10,210,000	¢10,210,000	22	239	Condo	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 10% to 20% impact	Viable, 30% to 50% impact
5	Tonge Eginton centre							22		Rental	Viable	Challenge, 20% to 30% impact	Challenge, 30% to 50% impact	Challenge, 20% to 30% impact	Challenge, 30% to 50% impact										
6	North York Centre	\$27,170,000	25	297	Condo	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 10% to 20% impact	Viable, 30% to 50% impact															
	North Fork Centre	\$27,170,000	33	387	Rental	Viable	Challenge, 10% to 20% impact	Challenge, 30% to 50% impact	Challenge, 10% to 20% impact	Challenge, 30% to 50% impact															
7	TO Coro	\$28 270 000	47	570	Condo	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 10% to 20% impact	Viable, 30% to 50% impact															
, ,		\$20,270,000		570	Rental	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 10% to 20% impact	Viable, 30% to 50% impact															
	Toronto West	\$19,880,000	22	249	Condo	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 10% to 20% impact	Viable, 30% to 50% impact															
°	Toronto west	\$19,660,000	22	546	Rental	Viable	Viable, 10% to 20% impact	Viable, 30% to 50% impact	Viable, 10% to 20% impact	Viable, 30% to 50% impact															
0	Toronto Fact	£2,420,000	6	21	Condo	Viable	Viable, 10% to 20% impact	Viable, 20% to 30% impact	Viable, 10% to 20% impact	Viable, 20% to 30% impact															
9	Toronto East	\$2,450,000	0	51	Rental	Viable	Viable, 10% to 20% impact	Challenge, 20% to 30% impact	Viable, 10% to 20% impact	Challenge, 20% to 30% impact															
10	Golden Mile		262	Condo	Viable	Viable, 20% to 30% impact	Viable, 30% to 50% impact	Viable, 20% to 30% impact	Viable, 30% to 50% impact																
10	Goiden Whie	\$12,200,000	39	202	Rental	Challenge	Challenge, 30% to 50% impact	Challenge, > 50% impact	Challenge, 30% to 50% impact	Challenge, > 50% impact															
11	Scorborough Contro	ÉE 700.000	41	202	Condo	Viable	Viable, 30% to 50% impact	Viable, > 50% impact	Viable, 30% to 50% impact	Viable, > 50% impact															
"	Scarborougn centre	\$2,790,000	41	392	Rental	Viable	Challenge, > 50% impact																		

\* Pro rated for multi-phase projects

#### 6.1 IZ Policies Impact Land Values, but at Different Rates

The impact of the tested IZ approaches would reduce the revenue of each project while holding costs relatively stable (i.e. increasing costs as a proportion of revenue). Therefore, the shortfall is absorbed as a reduction in land value. Generally, large reductions in land value are observed in areas where the anticipated building size is relatively large, and/ or where achievable market pricing is high (which results in a larger gap between market and affordable price/rents).

For instance, the inclusion of 10% affordable rental units in a condominium apartment project in Weston Village is estimated to reduce land value by about \$20 per square foot (PSF) buildable. By comparison, the TO Core (Downtown) test demonstrates an impact in the order of \$45 PSF.

#### 6.2 Stronger Market Areas Show More Potential for Affordable Units through IZ

The impact on viability should be distinguished from impact on land value. This analysis compares a redevelopment's potential land value to the land value supported by an existing use (base land value) to determine viability in terms of an IZ policy. In areas where residential development land value is much higher than as-is where-is land value, a project could stay viable even if the inclusion of affordable units depresses the land value by a significant amount. As the previous table outlines, in some instances an impact to land value in the order of 10% to 20% can be enough in some instances to erode development viability. Whereas, in some instances a 50% impact can be sustained while maintaining viability – that is, a residential developer could still afford to acquire land at as-is where-is value, despite the sizable impact on land value brought about by IZ.

Our analysis illustrates that a 10% set-aside rate could likely be absorbed in condominium apartment projects across all of the test locations in this analysis. In the City's strongest market areas, a condominium or rental redevelopment could yield land values that exceed the base land value by a large margin, therefore can remain viable with the inclusion of 10% affordable units at the parameters described earlier. In some instances, this is also true at a 20% set-aside rate.

In areas where viability is maintained, but where land values are significantly impacted, it is possible that this might 'shock' the market, notwithstanding the fact that the 10% premium over typical as-is where-is value is maintained. A range of project and site-specific factors would become relevant, including the motivations of the landowner and developer interests involved. This dynamic should be addressed through a transition policy if/ when the City implements a policy of this nature. A shock to the market could manifest in different ways; but would likely include a delay in the pace at which near term residential development activity occurs, or a shift in investment activity to more favourable locations or land uses.

#### 6.3 Impacts on Emerging Markets

There are high density residential submarket locations in Toronto that are less mature, including market areas where a new purpose-built rental project might be challenging in current market conditions, notwithstanding an IZ policy. While the market opportunity for new high density development is emerging across most submarkets city-wide, an IZ policy must acknowledge that the margins for new apartment (rental or condominium) development do not always support high land values when compared to other economically productive uses in weaker market locations.

Based on the built form and market assumptions used in this analysis, the testing demonstrates that the inclusion of 10% affordable rental units within condominium apartment projects is likely sustainable across each of the submarket locations. The results are more mixed when the same 10% IZ policy is applied to a purpose-built rental project.

The testing also demonstrates that moving to a 20% IZ requirement creates much greater strain on the economics of development in weaker submarkets (and on purpose-built rental projects in some stronger submarkets, also).

These results show that an ambitious IZ policy may have a significant impact on the viability of new apartment projects in emerging high density market areas as the policy would limit achievable revenue which cannot be appropriately absorbed or accounted for through land values. Thus, it is critical that an IZ policy be developed with an understanding of the market nuances at play in each submarket (and to monitor these markets over time). Seeking high set-aside rates, deep levels or permanent affordability in emerging markets may discourage new development – developers will look for other opportunities.

Our tests indicate that in relative terms, the City's stronger high-density submarket locations (Yonge-Eglinton, North York Centre, Downtown, Toronto West and Toronto East) demonstrate a greater degree of capacity to absorb the impacts of the tested IZ policies. In the weaker submarkets, development economics become even more challenging with an IZ requirement, although the gap in base value and redevelopment land values are smaller in some areas than others. Developers are frequently apprehensive of taking large risks in emerging markets and will often reduce what they are willing to pay for land in these markets as a form of "risk premium". As such, other non-residential uses may represent the highest and best use of land when IZ is applied without offsetting measures or gradual transition in accordance with market evidence.

Land value impacts vary between each prototype test and market area. This analysis illustrates an IZ policy could be successful in stronger areas at a 20% set-aside rate, particularly when applied in condominium apartment developments. However, this is held in contrast to weaker market

areas in which the implementation of the same IZ approach would yield challenging economic results. The different results between stronger and weaker submarket areas highlight the necessity of a nuanced approach for IZ.

The implementation of IZ must be cognisant of market dynamics. Phasing or transition policies are strongly encouraged in order to avoid a shock the market. However, this is not to signal that IZ polices shouldn't be considered in outside of MTSA locations where strong residential development economics are ubiquitous. In fact, early implementation of IZ policies in these emerging locations could set a market up for long term success, injecting the policy early on, before residential land values strengthen significantly. The trade-off would likely be a delay in the pace at which near term residential development activity occurs – effectively maintaining the status quo for longer. The benefit, however, is that once residential development economics do improve, IZ is already part of the economic and land pricing equation, producing affordable supply as a result of every new market residential project. In all cases, the policy should be monitored and adjusted as economics evolve.

#### 6.4 Impacts on Rental Projects

IZ units affect project viability primarily through a revenue reduction as units would be rented at affordable rents instead of sold or leased at market rates. In this analysis we tested the inclusion of affordable rental units in both market condominium and market rental buildings. Generally, the residual land value in the market condominium and market rental buildings are reduced by a relatively similar amount on a percentage basis (notwithstanding some exceptions). For example:

- In the North York Centre submarket test scenario, a 10% set-aside rate (affordable rental in perpetuity) within a condominium development is estimated to reduce land value by about 16%.
- In the same location, the inclusion of 10% affordable GFA (in perpetuity) in a new purposebuilt rental development reduces the land value by 19%.

Despite a similar reduction in land value, the impact on viability through an IZ policy could be different. Depending on the price of underutilized land in the market, it is possible that condominium projects could sustain the IZ policy, while new rental projects would be deterred.

With other things being equal, condominium apartment developments typically support a higher land value than rental developments, and therefore are more likely to stay viable with IZ requirements. This is common across Ontario; however, it should be noted that CMHC financing programming has not been assumed as part of this review. Where successful, some projects can benefit significantly from these tools.

Rental housing is typically at a disadvantage in Ontario for several 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. As a result, equity requirements are typically greater in purpose-built rental projects.
- **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 'stabilize'. In a condominium development, subject to obtaining deposit insurance, purchaser's deposits can act as an inexpensive source of project financing. When the development is ready to be occupied, the developer can charge purchasers off occupied units an interim occupancy charge until the project is registered and purchasers begin to pay their mortgages.
- Market and Risk: For many developers the market opportunity for condominium development offers much less risk and relatively quick returns compared to purpose-built rental development where returns are earned over a longer period.
- Land Acquisition Competition: 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. Often, new rental development occurs on land which has been historically inventoried or capitalized through another productive land use (i.e. large format retail).

Across the eleven test sites, new market rental developments are largely viable. However, it becomes apparent that due to the factors noted above, IZ would negatively affect new rental projects to a greater degree than condo. However, this is also the case now, where rental developers are competing for land in a free market with condominium apartment developers.

There are few instances where the tested IZ policies would reduce land values to zero, or negative values. Therefore, in instances where rental developers may already own (surplus) land, development may still proceed if total expected development revenues exceed costs.

#### 6.5 Affordability Period

In this updated evaluation, the City has opted to test only one period of affordability; 99-years. However, previous iterations of this analysis have demonstrated that limited affordability timelines can – depending on the perspectives of individual developers – mitigate the land value impacts of IZ to some degree by offering a reversionary value at some point in time. Notwithstanding, the policy implications with a limed period of affordability are not optimal; from an affordable housing policy perspective, longer affordability timelines are best.

#### 6.6 Impacts on Affordability

As discussed in prior sections and our previous reporting, an impact of an IZ policy would be to cap a portion of project revenue, (increasing costs as a proportion of total revenue) placing downward pressure on residential land value. If land prices decline significantly, landowners may be less likely to sell property for the purposes of redevelopment. This could result in reducing the supply of housing entering the marketplace until demand increases pricing sufficiently to trigger development. In broad terms, constraints on housing supply can affect affordability. The key to a successful IZ policy will be to strike a degree of balance so that the supply of new market housing does not contract.

#### 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 could be an improvement in the ability for other productive non-residential uses such as retail or office development to compete for land in prime locations, or a slowing of development interest overall. This should be considered relative to other growth objectives that the City has at existing and emerging transit station areas.

#### 6.8 Markets Need Time to Adjust

Developers typically acquire land on a speculative basis, based on their understanding of the maximum approvable (and market supportable) built form. Given this, it will be important that the City design and implement an IZ approach that is phased in to allow for development to proceed in the near term – this is particularly important in weaker market locations. This is essential so that the policy can achieve its desired outcome; creating a new supply of affordable housing while also increasing the overall supply of housing to provide for more gradual pricing increases in other market segments.

Likewise, the City must clearly signal an emerging policy in order to ensure that future speculative land market activity can adjust to new cost considerations. This is not to signal that in weaker market locations, where speculative land purchasing has yet to ramp up, are not desirable locations to implement IZ policies. While the implementation of IZ could slow down/ delay the market maturation process, early implementation will in fact condition the development community about future expectations and be offset by other financial incentive programs in the interim. Overall, near term implementation of IZ, even if enacted at first with a token requirement, will create far less hardship if implemented prior to the maturation of the City's weaker submarket locations.

## 7.0 Conclusions

This review has demonstrated that there are locations across Toronto where the market is likely to have capacity to absorb an IZ policy. Without a corresponding density offset or financial incentive program, the overall impact of Inclusionary Zoning in all markets would be a decrease in total development revenue. This in turn would be absorbed by reducing residential land values.

In instances where the land value of a development opportunity falls below the as-is value of a property, development will be discouraged or delayed until the market demand for housing in the area supports higher pricing. If IZ were to be bluntly applied without acknowledgement of market nuance, an unintended consequence in the interim could be a relative improvement in the ability for other non-residential uses such as office or retail development to compete for land in Major Transit Station Areas.

The majority of Toronto's residential apartment development activity occurs within the Downtown, the Yonge Corridor and in North York along the Subway lines. Prior to market uncertainty brought about by COVID-19, these areas have had very strong market fundamentals. We assume that once the impacts of COVID-19 are shed, the housing market will return to normalcy. Within this framework of assumptions, this study generally demonstrates that the land market should have the ability to absorb the impact brought about by a modest IZ policy without jeopardizing development viability.

Inclusionary Zoning presents a long-term policy opportunity which could yield a new supply of affordable housing units for the City. Introducing IZ now – even at low set-aside rates – including in weaker high-density submarkets, may mean that it takes longer for new development to occur (without counteractive intervention, in the form of financial incentives, for instance). However, with a longer-term policy vision in place, the early introduction of IZ is beneficial because it sets a standard for doing business that will be priced into future market activity.

As the City of Toronto considers a potential IZ policy, we offer the following recommendations:

- Develop the IZ framework alongside clear development entitlements in each MTSA. A successful IZ policy requires a measure of clarity in station area plans to form the basis by which land values are established.
- The City should consider whether each MTSA could have different set-aside rates to allow for market variances as it relates to the percentage affordability and allowable densities determined through MTSA planning processes. Generally speaking, set-aside rates can increase with allowable densities.

- IZ policies must acknowledge the varied characteristics of local submarkets. These measures in weaker market zones could include Community Improvement Plans or other focused public investments such as new transit, parks or community facilities that help improve the market appeal of the area.
- The City could consider implementing a framework to allow for the IZ policy to be amended or waived in instances where developers can demonstrate a lack of feasibility (e.g. in purpose-built rental apartment scenarios) and/ or where other significant community benefits are being provided.
- The City should consider a phase in period starting with a low IZ set-aside rate with specified (e.g. annual) increases; and/ or an announcement to the market that the IZ policy will come into force in a certain period of time (e.g. as MTSA plans are implemented). Both approaches would allow markets to adjust and for sites which are currently in pre-development stages to proceed, allowing new development lands to be priced accordingly.
- IZ policies should consider whether rules about who owns and operates the units and maintains oversight of the depth and duration of affordable as well as the unit types are necessary. This represents a next step for the City as it consults with council and stakeholders, beginning to frame a preferred policy approach.
- The IZ policy should be revisited at regular intervals to ensure that the policy is nimble and able to adjust to the economic realities of the day. Of note, this analysis was completed without fully phased in Community Benefits Charge policies relating to Bill 108. Moreover, at the time of drafting this report considerations relating to novel coronavirus COVID-19 are impacting global markets. Illustrations of policy and market fluctuations like this emphasize the need for flexibility and regular monitoring of potential IZ policies throughout the City.
- This analysis cannot assume the wide variations of market factors and the interests of developers and landowners. 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 IZ policies. Further review or consideration could be warranted once MTSA plans are advanced and as market conditions evolve.

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