Final Report

Peer Review of NBLC "Evaluation of Potential Impacts of an Inclusionary Zoning Policy"

The Economics of Land Use

Prepared for:
City of Toronto

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EPS #213055

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1. Executive Summary

Objectives

The objectives of the peer review are to:

- Meet the provincial regulation (O. Reg. 232/18) requirements for an independent written opinion on the inclusionary zoning financial impact analysis
- Determine if NBLC's financial impact analysis approach and methodology are appropriate for determining feasibility and informing the City of Toronto's inclusionary zoning policy framework
- Determine whether any additional limitations or matters should be considered in relying on NBLC's financial impact analysis to inform an inclusionary zoning framework for the City of Toronto
- Determine whether any edits or updates to NBLC's financial impact analysis are recommended prior to finalizing the City's inclusionary zoning (IZ) policies

EPS also recognizes that the ultimate purpose of this process is to ensure that a well-grounded policy is advanced that will help the City move forward in addressing its affordable housing needs.

Understanding and Approach

Just as developers use a variety of metrics to gauge the financial performance of a development project, consultants approach the process of evaluating different circumstances with different methodologies. There are commonly accepted techniques for evaluating development feasibility, but in a policy feasibility context such as is the case with NBLC's "Evaluation of Potential Impacts of an Inclusionary Zoning Policy", Economic & Planning Systems (EPS) acknowledges that the methodology must be tailored to the client questions. As such, EPS's approach to peer reviewing NBLC's analysis is focused on the following core methodological elements:

- Use of Prototypes and Geographic Variability
- Land Value Assumptions
- Construction Costs and Revenue Assumptions
- Pro Forma Modeling
- Findings and Recommendations

About the Reviewer

Economic & Planning Systems' (EPS) review is rooted in experiences advising a diversity of governments on a broad spectrum of land use economic issues, including the feasibility, implementation, and modification of inclusionary zoning policies in market contexts.

EPS was founded on the principle that real estate development and land use-related public policy should be built on realistic assessment of market forces and economic trends, feasible implementation measures, and recognition of public policy objectives, including provisions for required public facilities and services.

For nearly four decades, EPS has provided clear, objective expertise on real estate development and land use issues and public policy in all phases of the urban life cycle for public and private sector clients throughout North America. More information on EPS's experience is provided on page 35 of the Appendix.

Key Findings

These findings are organized to align with several key methodological categories (as discussed later). They also summarize EPS's findings as they relate to Provincial guidance and the objectives mentioned previously.

Overview. Based on materials provided for review, EPS believes that NBLC's study generally satisfies two of the central considerations in a financial impact analysis.

- ***Provincial Requirements***. NBLC's study meets the Provincial regulation requirements for a financial impact analysis in that it applies an appropriate analytical framework incorporating requisite features, such as land costs, cost of construction, market prices, market rents, as well as Provincial plans and policies, and official plan policies.
- ***Methodology***. NBLC's use of a static pro forma with residual land value (RLV) outputs is an appropriate methodology (with minor modifications as recommended below) for the assessment of IZ viability and for informing the creation of a policy.

Specific Findings. Also based on materials provided for review, EPS believes that NBLC's methodology generally satisfies the requirement that is "appropriate for determining feasibility and informing the City of Toronto's inclusionary zoning policy framework."

- ***Use of Prototypes and Geographic Variability***. For the purpose of exploring IZ feasibility at PMTSAs only, a sufficient diversity of markets is represented in the analysis. Given also that the City is only exploring IZ feasibility for projects of 100 units[1] or more, prototypical site assumptions were developed collaboratively with staff that adequately represent this scale.

[1] At the time of this review, the City had been contemplating a threshold IZ applicability of 80 units or more.

- ***Application of Regulatory Scenarios and Land Value Assumptions***. Central to the methodology is that the residual land value (RLV) reflecting "as-is" densities is compared against "base case" reflecting redevelopment densities to determine IZ viability. EPS believes that the report contains justifications for and against the use of the "as-is" RLV from which IZ viability is determined.
- ***Construction Costs and Revenue Assumptions***. NBLC's pro forma modeling contains sufficient detail for an IZ feasibility study. It is also clear NBLC brings necessary familiarity with market and financial feasibility research to the effort. For the sake of transparency, however, EPS believes the report could further lay out all the inputs and assumptions.
- ***Pro Forma Modeling*** – NBLC applied a hybrid model approach, incorporating elements of discounted cash flow (DCF) analysis into a static (i.e., strictly vertical orientation of revenues and costs) structure, such as absorption of unit sales, lease-up, carrying costs of conventional financing during construction period, and the net present value of other variables as appropriate. Most IZ feasibility studies apply a static modeling structure.
- ***Findings and Recommendations***. Much of the qualitative recommendations regarding phasing, implementation, program administration, and the coordination of PMTSA planning give the City good guidance. EPS disagrees, however, with the recommendation regarding exemptions, the caveat concerning diminished need for incentives over time, and the caveat concerning the supportability of increased set-asides under sustained current market trajectory. Related to the discussion of land value as central to NBLC's methodology, EPS believes that the analysis makes the relevant calculations to understand IZ viability, but only highlights one in the findings.

Recommendations

Based on the review of NBLC's study, EPS recommends the following additional matters could be undertaken to strengthen NBLC's analysis, conclusions, and guidance to the City.

- ***Viability Metric*** – EPS does not believe that additional analysis needs to be completed, but that an additional "viability" decision criterion should be included, in a manner similar to what is referred to throughout this peer review as the 'at least greater than 10 percent rule', such that the City is provided with further valuable insight as to a conservative to optimistic range of value capture potential for IZ viability.
- ***Sensitivity Analysis*** – Regarding a few pieces of additional guidance NBLC has given the City regarding possible policy considerations for the future, EPS believes that NBLC's guidance to the City could be strengthened, and ultimately the City's development of an IZ policy bolstered by the addition of sensitivity analyses. Such sensitivity analyses could test out considerations for the possible adjustment of set-asides and possible need for incentives over time.
- ***Source Documentation*** – EPS believes that NBLC's presentation of their work could be augmented by 1) a technical appendix of all underlying inputs, assumptions, and sources such that another researcher would need to reproduce the same results using their own modeling, 2) a summary of the land sales transactions information, and 3) documentation or summary of market data and trend information that was used in the development of any underlying inputs and assumptions.
- ***Phasing and Implementation*** – In addition to the guidance to the City on implementing IZ, it could be helpful if the report illustrates what an implementation schedule might look like and provide case studies (lessons learned) of the successes and failures of implementing IZ too quickly versus phasing.
- ***Terminology and Labeling*** – EPS recommends defining terminology up front, such as identifying that "existing" can be interpreted synonymously with "as-is". EPS also believes including a column-by-column explanation of Table 7, 8, and 9 in the report would be helpful.

2. Introduction

Background

Regulatory Framework

This peer review satisfies the Provincial requirement for "a written opinion on the analysis described above from a qualified entity independent of the municipality." Under the Ontario Planning Act, municipalities have the authority to develop and implement an inclusionary zoning framework subject to provincial inclusionary zoning regulations O. Reg. 232/18 and O. Reg. 300/19. Under this framework, an assessment report is required by subsection 16 (9) of the Act and shall include information to be considered in the development of official plan policies described in subsection 16 (4) of the Act, including the following:

- An analysis of demographics and population in the municipality.
- An analysis of household incomes in the municipality.
- An analysis of housing supply by housing type currently in the municipality and planned for in the official plan.
- An analysis of housing types and sizes of units that may be needed to meet anticipated demand for affordable housing.
- An analysis of the current average market price and the current average market rent for each housing type, taking into account location in the municipality.

Furthermore, the framework requires that an analysis be undertaken to assess the potential impacts on the housing market and on the financial viability of development or redevelopment in the municipality from inclusionary zoning by-laws, including requirements in the by-laws related to the matters mentioned in clauses 35.2 (2) (a), (b), (e) and (g) of the Act, taking into account: value of land, cost of construction, market prices, market rents, and housing demand and supply. Furthermore, Clause 2(2) requires that the analysis described in paragraph 6 of subsection (1) shall take into account the following related to growth and development in the municipality: Provincial policies and plans, and official plan policies.

As such, the City of Toronto Planning Department engaged N. Barry Lyon Consultants (NBLC) in 2018 to undertake a financial impact analysis. A draft financial impact analysis report was released in May 2019. An update to this analysis was completed in May 2020, and targeted analysis updates were completed during Spring 2021 to incorporate newly-available market data, feedback received through stakeholder and public consultations, as well as recent changes to provincial land use planning legislation and regulations.

Materials Provided for Review

Completion of this peer review was made possible by the review of materials provided by the Province of Ontario, City of Toronto, NBLC, as well as External Stakeholders.

Materials from the Province. The following information was provided to ensure this peer review would meet Provincial requirements.

- Ontario Regulation 232/18 regarding Inclusionary Zoning

Materials from the City of Toronto. The City of Toronto Planning Department provided the following materials for EPS's review.

- Agenda Item History – 2019.PH6.2, May 28, 2019
- Agenda Item History – 2019.PH10.3, November 13, 2019
- Growth Plan Conformity and Municipal Comprehensive Review – Work Plan, May 2020
- IZ Assessment Report: Housing Need and Demand Analysis, September 2020.
- Agenda Item History – 2020.PH16.7, September 22, 2020
- Attachment 1: Draft IZ Official Plan Amendment (PH16.7), September 22, 2020
- Attachment 2: Draft IZ By-Law (PH16.7), September 22, 2020
- Draft Delineations for the Protected Major Transit Station Areas within the Downtown Secondary Plan and Draft Citywide MTSA Policy Directions, March 30, 2021

Materials from NBLC. The following information was transmitted to EPS or provided per EPS request.

- Evaluation of Potential Impacts of an IZ Policy, May 2019
- Update: Evaluation of Potential Impacts of an IZ Policy, May 2020
- Update: Evaluation of Potential Impacts of an IZ Policy, May 2021
- [By request] Draft Results Complete Pro Forma – May 26, 2021 [pdf version]
- [By request] Land Comps – 2021, May 28, 2021

Materials from External Stakeholders. The following information was provided by external stakeholders as context to the process and peer review.

- Steve Pomeroy, Focus Consulting "Examining the feasibility and options for an inclusionary zoning policy in Toronto", July 2019
- BILD Letter to Deputy Mayor "RE: Inclusionary Zoning Draft Official Plan Amendment and Zoning By-Law Amendment", November 6, 2020
- Finnegan Marshall "Inclusionary Zoning Feasibility Analysis", February 18, 2021

IZ Methodology

Feasibility Study Best Practices

In addition to EPS's experience in the field of IZ feasibility and housing policy formation, this peer review is based on an understanding and the themes of the economics literature on the subject, debates around its impacts, its advantages and disadvantages (refer to the ***Survey of Literature*** section on page 31 for a brief overview of several key contributions on the subject).

Building further on this foundation of understanding, a white paper from Grounded Solutions Network, the Terner Center for Housing Innovation at UC Berkeley, and the Lincoln Institute of Land Policy titled "Strengthening Inclusionary Housing Feasibility Studies" (2018) was published that encapsulated what EPS believes to highlight the central issues of conducting IZ feasibility studies. Among the many valuable insights into feasibility study best practices, the most salient conclusion is that "there is no single best methodology appropriate for all circumstances."[2] Rather, the paper suggests that consultants should be given latitude in tailoring methodologies to particular circumstances while providing guidance on which high-level elements an analysis should contain, and a discussion of their merits (as noted earlier, these categories of methodological consideration served as an additional framework in which this peer review was completed):

- ***Use of Prototypes and Geographic Variability*** – studies should include hypothetical prototypes that reflect the range of possible development scenarios in the market. They should also include sufficient representation geographically such that different market contexts (weak, mixed, or strong markets, for example) are represented, accounting primarily for variations in land values.
- ***Application of Regulatory Scenarios*** – that the feasibility of a hypothetical development is evaluated under more than one set of contexts, such as without inclusionary zoning applied, with various affordability levels, various set-asides, various alternative satisfaction options (such as cash in-lieu, offsite affordable housing construction, land dedication, etc.), and various incentives.
- ***Project Feasibility Metrics and Outputs of Modeling*** – while acknowledging there is no single appropriate metric, metrics of feasibility should suitably reflect minimum project hurdle rates or profitability, such as return on cost (ROC) or internal rate of return (IRR). These metrics should be chosen such that they answer the specific questions being asked. In most cases, output metrics of inclusionary zoning feasibility models take the form of an ROC or IRR, but a residual land value (RLV), though often "harder for many stakeholders to intuitively understand" and "particularly challenging to get

[2] https://inclusionaryhousing.org/wp-content/uploads/2018/11/ih-feasibility-studies-convening-report.pdf

good data on land values [for the analyst]"[3], is an appropriate metric because land value impacts are always at the center of regulatory change.

- ***Static vs Dynamic Modeling*** – that the technical modeling be tailored for the degree to which detailed and credible information on assumptions and inputs can be incorporated. It should be noted, however, that this white paper concludes that the static pro forma as opposed to discounted cash flow (DCF) was the preferred method. The publication observed that DCF models require making assumptions appropriate only to real projects where refined and calibrated cost and revenue inputs are available from the developer, contractors, and other professionals involved in a project. The guidance notes that making such detailed assumptions for a hypothetical development prototype is both far more difficult and subject to debate.
- ***Assumptions Over Time*** – that the analysis should approach trending and variation in assumptions over time with caution, depending on the circumstances and questions being asked.
- ***Transparency*** – that a study should disclose inputs and assumptions that another researcher would need to produce the same results using their own modeling.

In addition to these categories capturing the essence of the core methodological considerations of IZ feasibility studies, the publication encapsulates the fine balance that must be achieved in crafting solutions between the technical analysis, needs and circumstances of the community (dynamics of the market), client questions and purview, and political will in saying "feasibility studies do not provide the single correct policy answer; in fact, successful adopted policies do not always exactly mirror the results of the feasibility study."

[3] "Strengthening Inclusionary Housing Feasibility Studies" (2018)

Evaluation Context

The following is an encapsulation of EPS's understanding of the context in which NBLC completed its financial impact analysis.

Local Zoning

The City of Toronto's zoning context is unique. Development industry and property owners understand that existing entitlements (zoning) are out of date, underrepresent (particularly within the city's strongest submarkets) the scale of redevelopment potential, and as such, understand that redevelopment requires rezoning approvals. It is within this context that the task of identifying an appropriate methodology to assess the feasibility IZ is similarly unique.

NBLC Analysis Objectives

Programmatic. Based on materials transmitted for review as well as conversations with City Planning staff, EPS understands that the following programmatic parameters defined NBLC's approach to the financial impact evaluation:

- Test locations limited to Protected Major Transit Station Areas (PMTSA)
- Provincial regulation stipulates that IZ cannot apply to developments with fewer than 10 units
- Modeling would be reflective of the City's current considerations with regard to an IZ applicability threshold, i.e., projects generally with 100 units or more[4]
- Cash in-lieu of providing onsite affordable housing is not permitted
- Tenure of affordable units to be provided cannot be specified
- IZ should be tested on condominium and purpose-built rental projects
- Set-asides should be tested at 5, 10, and 20 percent of total density or gross floor area (GFA)
- Affordability levels were based on draft income-based definitions and corresponding rents and ownership prices provided by the City
- Affordability must be maintained for 99 years
- No financial incentives should be included, except for the elimination of parking requirements for affordable units
- Affordable unit mix must mirror the market-rate unit mix
- Finishes of affordable units are equivalent to the market-rate units

[4] As noted previously, the City of Toronto had been contemplating lowering the threshold of applicability to projects with 80 units or more at the time of this review. It should also be noted that NBLC's Toronto East test site assumed a 32-unit development based on market research.

Analytical. Based on additional conversations with City Planning staff and NBLC team members, EPS understands that the following analytical questions and requests guided NBLC's approach:

- Test IZ different set-aside levels in prototypical developments
- The outputs of the analysis should identify the viability of a redevelopment with IZ set-asides at different affordability levels
- The outputs of the analysis should identify the impact different percentage set-asides for affordable housing have on the RLV

NBLC Approach

Working within the given parameters and answering specific City Planning questions, EPS understands that NBLC used the following technical and methodological approach:

- ***Use of Prototypes and Geographic Variability***– single prototypes per test location were used tailored to specific development scales, which were developed with City staff based on a "built form that could reasonably be approved for a rezoning application" (page iii). NBLC also evaluated 11 locations around existing or planned PMTSAs, which reflect a diversity of strong and emerging markets across Toronto.
- ***"As-Is" Regulatory Scenario*** – the "as-is" scenario, discussed in greater detail in Chapter 3, defines the conditions in which the first RLV estimates are made, i.e., based on the site's "current use and the density permitted by the 'as-of-right' zoning" (page iii). With a second set of RLV estimates called "base case" RLV with IZ, discussed next, this RLV is also foundational to NBLC's determination of IZ viability, referred to as Perspective 1 (see the discussion of **Figure 1** on page 26). It is also at the center of questioning in this peer review as to whether this RLV is a reasonable "floor" against which the value capture potential for IZ is determined (see the discussion in Chapter 4).
- ***"Base Case" Redevelopment Regulatory Scenarios*** – NBLC used two "base case" regulatory scenarios: 1) the "base case" RLV of a redevelopment "that could reasonably be approved in a rezoning application" (page iii) with no inclusionary zoning requirements, and 2) the "base case" RLV of a redevelopment with inclusionary zoning requirements as mentioned above. In the latter RLV is used in juxtaposition with the "as-is" RLV to determine IZ viability, referred to as "Perspective 1" (refer also to the discussion of **Figure 1** on page 26).

- ***Pro Forma Modeling*** – based on the materials provided to EPS, NBLC appeared to use a hybrid model, incorporating certain DCF elements into a static (that is, strictly vertical orientation of revenues and costs) structure, such as absorption of unit sales, lease-up, carrying costs of conventional financing during construction period, and the net present value of other variables as appropriate. By contrast, a dynamic or DCF model in the conventional practice, would be oriented both vertically (revenues less costs, etc.) and horizontally (by month and/or year).
- ***Project Metrics and Outputs*** – among the possible metrics of project feasibility, such as IRR, ROC, and RLV, NBLC selected RLV as the metric from which impacts (and thus, IZ viability) would be assessed. For the most part, this required NBLC to apply a uniform 15 percent profit margin on condominium projects and a cap rate spread to purpose-built rental projects. As such, outputs were estimates of RLV for the regulatory scenarios described above.
- ***IZ Viability Determination*** – selecting the RLV as the output metric from which IZ viability would be determined meant that NBLC needed to identify a decision rubric – that is, a point at which the RLV under the "base case" redevelopment with IZ was sufficiently higher than the "as-is" RLV to ascertain IZ policy viability. To do this, NBLC established a threshold rule stating that IZ would be viable if the "base case" redevelopment RLV with IZ requirements was at least 10 percent greater than the "as-is" RLV. NBLC notes that they "consider [this threshold] necessary for a landowner to sell the property for redevelopment" (page 24). When discussed in this review, EPS refers to this threshold rule as the "at least 10 percent greater than rule". Above all, examining the use of these specific RLV calculations is central to EPS's review, commentary, and recommendations.

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3. Review

This chapter details EPS's review of NBLC's financial impact analysis, methodology, and conclusions. The chapter is organized, using the categories outlined in the previous section, to sequentially address the following layers of analysis and findings.

Use of Prototypes and Geographic Variability

To capture the diversity of the Toronto market, NBLC utilized 11 submarkets across the city and tested both purpose built rental and condominium developments.

- ***Locations***. Eleven submarket areas were selected. As noted on page 16, these areas were around transit stations or growth centers, and both strong and emerging market areas were included. Within the submarkets, prototype test locations were chosen in consultation with City staff.

  EPS Commentary. The choice of locations is less a methodological decision and more a limitation of Provincial regulation[5]. From the U.S. perspective, IZ is typically tested and/or applied on a citywide basis, and as such, feasibility studies typically include development scenarios representative of strong to weak markets, within and outside of transit areas.

- ***Prototypes*** – Within each submarket, City staff provided prototypical development site and established assumptions for the built form that could be approved in a rezoning application. In Table 6 on page 20 of the May 2021 report, NBLC outlines the model assumptions for each test location. Prototypical developments are defined by the number of stories (ranging from 6 to 47), the Gross Floor Area, number of units (ranging from 32 to 564), and average unit size. The average unit size varies only slightly (either 650 or 700 square feet). Other parameters that vary by test location or prototype, as outlined in Table 6, include absorption rate, unit pricing (condominium/rental and parking), parking ratio, and affordable unit pricing (sale or rental).

  EPS Commentary. EPS recognizes that NBLC worked collaboratively with City staff to identify single prototypical development site assumptions of built form that could be reasonable approved in a rezoning application. From the U.S. perspective, it is common for IZ feasibility studies to assess the impacts a range of development prototypes per location – that is, to be reflective of different market dynamics and the various building forms and scale that could be built within a market or subarea, e.g., low-, mid-, and high-rise building forms. While there is no single best practice, studies that do include this degree of variation in prototypes do so for the sake of adding elements of

[5] The implementation of inclusionary zoning is limited to PMTSAs (or where a Development Permit System by-law is in place) under Section 16(5) of the *Planning Act*.

sensitivity testing. NBLC does, however, caveat its methodology to the point: "variations in any of its modeled assumptions…will influence the degree to which IZ impacts the viability of development on a particular site" (pg. 22), that "the results…should be considered at a high level", and that "further review or consideration could be warranted once PMTSA plans are advanced" (pg. 34).

- ***Mixed Use Contexts*** – As noted in the final bullet on page 19, the pro forma modeling undertaken as part of NBLC's analysis focused only on residential uses. In areas where mixed-use development would be required (based on prevailing planning policy), "[this] modeling assumes that these spaces would have a break-even financial position."

  EPS Commentary. EPS believes that it may be better to frame the exclusion of mixed-use development prototypes as a methodological choice, rather than categorically weighing in on the economics of non-residential space.

Application of Regulatory Scenarios and Land Value Assumptions

Because NBLC's analysis utilizes the RLV, underlying valuation and entitlement assumptions are critical to the model and its viability outputs. As noted previously, NBLC utilizes three regulatory scenarios to structure RLV metrics for each test location and prototype: 1) the "as-is" value, reflecting the current use and density permitted by "as-of-right" zoning, 2) the "base case" redevelopment RLV with no inclusionary zoning requirements, and 3) the "base case" redevelopment RLV with inclusionary zoning requirements (page iii-iv). The RLVs for each scenario (by test location) are summarized in Table 7 (page 25), Table 8 (page 25), and Table 9 (page 26) of NBLC's report.

- ***"As-Is" RLV.*** The report notes that the "as-is" value of each test site was established "based on typical existing uses and as-of-right zoning … primarily informed by a review of recent commercial leasing activity and high-density residential land transaction activity" (page 16). To demarcate the bounds of this "as-is" definition, NBLC notes that they "do not consider the "as-is" land value to be what developers speculate the City of Toronto might approve through a rezoning or Official Plan amendment process" (page 16). This definition is central to NBLC's methodology, from which viability is determined.

- ***"Base Case" Redevelopment RLV with No IZ Requirements.*** This scenario represents land use and density assumptions in a redevelopment "that could reasonably be approved in a rezoning application" (page iii). The "density and built form assumptions for each test site [were] provided by City staff" (page 16). Additionally, NBLC undertook "research to assess local pricing and absorption dynamics which [were] used to develop a financial pro forma…" (page 17). NBLC also notes that the RLV resulting from the modeling "represent[s] the potential land value that …reflects the price a developer could reasonably pay for the site absent the IZ policy" (page 17). EPS requested and received supplementary material summarizing land sales transactions that NBLC used in the identification of RLVs for "base case" redevelopment RLV. However, the information did not confirm how the information was interpreted or the extent to which those sales did or did not represent land sales transactions that occurred in the process of immediate or near-term redevelopment versus land sales transactions that occurred without a foreseeable redevelopment. As is discussed in Chapter 4, NBLC does not use this RLV in its determination of IZ viability, referred to as "Perspective 1". Rather, NBLC merely uses it as a reference point to identify how much "base case" RLV is impacted by the IZ requirements (see the discussion in Chapter 4 on Perspective 2 and Column E of **Figure 2** on page 27, which EPS designated as Column E).
- ***"Base Case" Redevelopment RLV with IZ Requirements.*** This scenario reflects the same density and built form assumptions for each test site as used in the scenario above, except that inclusionary zoning requirements are applied. As noted above, this is the "base case" redevelopment RLV that is compared against the "as-is" RLV to determine IZ viability. Applicable to both "base case" RLV scenarios, NBLC notes that "this analysis cannot […] contemplate the acquisition of land at speculative values, not fully appreciating the magnitude of impacts from future policy adjustments" (page 22). EPS interprets this as a reflection of NBLC's comment that the "base case" RLV "represent[s] the potential land value that …reflects the price a developer could reasonably pay for the site *absent the IZ policy*" (page 17).

  EPS Commentary. With regards to NBLC's core viability determination (i.e., that the "base case" RLV with IZ must be at least 10 percent greater than the "as-is" RLV in order that IZ is determined to be viable), EPS believes that NBLC applied its methodology consistently, i.e., that no errors in the application of the chosen methodology were made such the viability determinations would be called into question. Yet, EPS believes that NBLC's justifications and caveats (as discussed in Chapter 4) could be construed as detracting from this selected methodology and be leveraged to support an additional policy feasibility metric, also as discussed in Chapter 4.

Construction Cost Assumptions

NBLC has included an appendix to the report summarizing the model assumptions (Table 10, page 35). EPS also received a pdf version of NBLC's pro forma. While we could not ascertain any formulaic/calculation errors from this material, it did provide a more detailed set of inputs and assumptions than were presented or summarized in the written report. Some of the following review pulls from both the written report and a PDF of NBLC's pro forma.

- ***Hard Costs*** – Hard costs are sourced from Altus Group 2021 "Canadian Cost Guide" and summarized in Table 10 on page 35. Seven categories of hard costs are included: (1) above grade construction costs range from $230 to $333 per square foot, varying by the height of the building (consistent with the Cost Guide, the assumption is that as buildings get taller they are more expensive to build). Costs used are the midpoint of the range provided in the Cost Guide, and buildings are assumed to be cast-in-place concrete. (2) Below grade construction costs, estimated at $180 per square foot (midpoint of the range provided in the Cost Guide). (3) a hard cost premium is used for constrained sites, i.e., a 10 percent of hard costs factor applied to development in the TO Core and Yonge Eglinton submarkets to reflect development constraints in those areas (the 10 percent figure is not sourced, however). (4) Servicing connection cost, estimated at $500 per unit (unsourced). (5) Landscaping and hardscaping, estimated at $1,000 per unit (unsourced). (6) Demolition and site preparation, estimated at $15 per square foot of site area (unsourced). (7) Contingency factor, estimated at 10 percent of hard costs (excluding cost inflation). A cost inflation factor of 2.0 percent per year was also used (Table 10, page 37).
- ***Soft Costs (excluding fees)*** – Outside of fees, there are 8 categories of soft costs included in the modeling, summarized in Table 10 (page 36): (1) Property taxes, calculated at 0.6 percent of project value (reflecting May 2021 rates); (2) Provincial and municipal land transfer tax, calculated at 4.0 percent of land value at acquisition (reflecting May 2021 rates); (3) Consultants, project management, legal, insurance, and marketing, estimated at 14.5 percent of hard costs (unsourced); (4) sales commission fee, estimated at 4.0 percent of revenue (unsourced); (5) Lender's administrative fee, estimated at 0.8 percent of loan value (unsourced – note that in the pro forma provided, this is noted to be 0.8 percent of total costs); (6) Construction loan interest, estimated at 4.5 percent per year (unsourced); (7) HST, calculated at 13.0 percent (reflecting May 2021 rates). Within the pro forma document there is an additional line item for the Tarion enrolment fee, ranging from approximately $1,100 to $1,500 per unit and varying by submarket and development (sourced from Tarion). The pro forma also shows that construction loan financing costs are calculated assuming 75 percent average draw schedule and a 75 percent loan-to-cost ratio across all scenarios. In the report, however, NBLC notes that "equity requirements are

typically greater in purpose-built rental projects" (page 30), but does not change the loan-to-cost ratio for those prototypes.

- ***Fees*** – NBLC included a relevant range of development fees in the modeling. These are all outlined in Table 10 (page 35) and are based on May 2021 rates. Fees included planning application fees (OPA and ZBL base and additional fees, site plan application base and additional fees, plan of condominium base and additional fees, and building permit fees) as well as development charges/other exactions (general development charges, educational development charges) and cash-in-lieu of parkland and Community Benefit Charges (CBC). This updated version of the analysis incorporates the updated municipal CBCs and assumes that the developer pays Cash-in-Lieu of Parkland Dedication (10 percent of land value) and CBC (4 percent of land value) at time of building permit issuance (page 18). NBLC has noted that the analysis "assumes that the City of Toronto will implement a CBC pursuant to recent Provincial legislative changes. At the time of writing, a CBC approach was subject to ongoing analysis and consultation. … this analysis assumes the continued application of existing development charge and parkland policies in place today. Any substantial near-term adjustments to these fees or other municipal rates and charges could have an impact on the findings of this review" (page 1).

  EPS Commentary. NBLC's pro forma contains sufficient detail for an IZ financial impact study. It is clear NBLC brings familiarity with market and financial feasibility research necessary to the effort. For the sake of transparency, however, EPS believes the report and its readers could benefit from a presentation of the underlying inputs and assumptions, as mentioned previously, such that another researcher would need to produce the same results using their own modeling. The most recent version of NBLC's report contains more robust presentation of these details than earlier versions. EPS believes, however, that some (though not all) of the criticisms made by external stakeholders could have been addressed or potentially avoided. The "Strengthening Inclusionary Housing Feasibility Studies" white paper referenced earlier (page 7) suggests that "greater transparency and accountability can be achieved through a public working group or technical advisory group". It further notes that such groups are convened "to advise consultants…and to help identify key local market data to use as inputs in the model." While not every study or process can follow the same prescription, given that every study is conducted under unique circumstances, such a process component could have offered external stakeholders the opportunity to review inputs and assumptions before the study was made public.

Revenue and Operating Assumptions

Revenue and operating assumptions, outlined below, are key factors in determining development viability.

- ***Cap Rates and Profit*** – As outlined in the Financial Model Assumptions section (page 19) and summarized in Table 10 (page 36), developer profit for condominium units is assumed to be 15 percent of gross revenue, while profit for purpose built rental and rented condominium units is assumed to be a 50 basis point spread to market capitalization rates. For affordable (below market) rental units, the capitalization rate is assumed to be 100 basis points greater than the market rental units, "a high level estimate used to capture the risks associated with operating rent restricted units, namely the risk introduced by restriction on rent increases at vacancy and the increased exposure to operating expense increased which are not similarly restricted" (page 19). As noted in the report appendix, the "strong market rental capitalization rate" of 3.00 percent reflects the lower bound for Multifamily in CBRE Q1 2021 and Colliers Q4 2020 Cap Rate Reports (page 37), and cap rates for other development types are benchmarked to this figure. Moderate and other markets are assumed to be 25 basis points greater, affordable rental is assumed to be 100 basis points greater, and the rental profit margin is assumed to be 50 basis points greater than the market capitalization rate. As noted in the PDF of NBLC's pro forma, profit for market and affordable rental is included in the capitalized value, and cap rates also vary by submarket and prototype.
- ***Rental Rates*** – Rental rates are summarized in Table 4 (affordable rents - page 14) and Table 6 (all rents - page 20). As noted in Table 6, affordable rents are modeled at $1.95 per square foot, while market rents range from $2.75 (Weston) to $4.25 (TO Core) per square foot depending on submarket (reflecting the average value per unit mix). NBLC notes that "for each submarket [they] undertake research to assess local pricing dynamics" however the source of this research is not noted (page iii, page 17). As noted in Table 10 (page 37), market rental rates are inflated at 2.0 percent per year, and affordable rents are inflated at 1.5 percent per year.
- ***Rental Operations and Maintenance*** – Operations and maintenance costs (including property taxes) are assumed at 36 percent of Gross Potential Income for purpose built rental units, and $0.85 per square foot per month for rented condominium units (page 37).

- ***Condominium Price Points*** – Condominium sales prices are summarized in Table 4 (affordable prices – page 14) and Table 6 (all prices – page 20). As noted in Table 6, affordable prices are modeled at $418 per square foot, while market prices range from $850 (in Weston (NIA) and Finch West) to $1,450 (in TO Core) per square foot depending on submarket (reflecting the average value per unit mix). As with rents, NBLC noted they undertook research to assess local pricing dynamics, but no source of information or summary of that research is provided. As noted in Table 10 (page 37), market prices are inflated at 2.0 percent per year, and affordable prices are inflated at 1.5 percent per year. As also noted in Table 10, other condominium factors include initial and final deposit (20 percent of sale price), price increase at start and end of construction (2 percent of sale price), units sold during pre-construction/presales (70 percent), during construction (20 percent), and at completion (10 percent). These factors do not vary across submarkets. Sales commission (4.0 percent of sales revenue) was factored in as a soft cost (Table 10, page 36).
- ***Additional Revenue Factors*** – Additional revenue factors are summarized in Table 6 (page 20). Sources of additional revenue are parking and storage lockers (note that Table 6 identifies only parking prices, however the PDF of NBLC's pro forma shows that this revenue accounts for both parking and storage). As noted on page ii, parking is only provided for market units (the elimination of minimum parking requirements for affordable units was the only incentive considered in the analysis), with parking ratios varied by submarket ranging from 0.25 in TO Core to 0.90 in Etobicoke Center, Golden Mile, and Scarborough Center. Parking revenue also varies by submarket and development type, with condo prices ranging from $40,000 (Scarborough Center) to $125,000 (TO Core) per stall and rental rates ranging from $90 (Weston, Finch West, Scarborough Center) to $200 (Yonge Eglinton Center, North York Center, TO Core) per stall per month (Table 6, page 20). These factors are not sourced.
- ***Timing and Net Present Value (NPV) of Revenues*** – Timing assumptions for both rental and condominium development are summarized in Table 10 (page 36-37). Rental absorption is assumed at 8.0 percent of units leased per month and that 25 percent of the building is preleased at occupancy, and sales absorption is assumed at 15 sales per month; these do not vary by submarket (note: the rental absorption rate is included in Table 10, the sales figure of units per month is included in the pro forma document). Additional condominium timing factors, summarized in Table 10, include time prior to land sale (0.5 years), time to begin marketing after land purchase (1.5 years), and occupancy period prior to registration (0.5 years). The analysis assumes a discount rate of 6.0 percent (Table 10, page 37); this factor does not vary by submarket or prototype. A major caveat on project timing involves the potential for multi-phase development. As noted on page 22, "This analysis isolates evaluations to one single development phase."

EPS Commentary. As EPS's summary of NBLC's cost- and revenue-side inputs and assumptions illustrates, NBLC's pro forma modeling contains sufficient detail for an IZ feasibility study. Moreover, NBLC has modified underlying cost and revenue factors through revisions to its first impact analysis in May 2019 using available sources to reflect and update current market conditions. However, EPS believes there are still opportunities for NBLC to strengthen its presentation of analysis and research through consistent documentation of all inputs and assumptions, sources, as well as summaries of trends research which informed the calibration of their modeling inputs, such as new rental unit pricing trends, new condominium sales price trends, or cap rate trends by property type.

Findings and Recommendations

- ***Market Viability*** –In qualitative terms, NBLC's analysis addresses viability of redevelopment both with and without IZ. Further discussion and commentary on NBLC's viability determination is provided in Chapter 4. NBLC caveats these findings in the Executive Summary (page iv) and in Chapter 6.0 (page 24): 1) "the primary impact of an IZ policy as conceptually defined is to reduce the development revenue from a project", 2) "in weaker market areas…an IZ policy could have a negative impact", 3) "the feasibility of residential development after an IZ policy…will vary depending on market strength". In quantitative terms, NBLC's analysis indicates that a 10 percent set-aside could likely be absorbed into condominium projects, while a 20 percent set-aside might only apply to stronger markets. Furthermore, NBLC notes that IZ for purpose-built rental becomes largely unviable beyond a 5 percent set-aside, discouraging investment (page v).
- ***Affordability Levels*** – After initially testing different affordability terms (25 and 99 years), the City directed NBLC to test only a 99-year affordability term. NBLC does note that a more limited term can "mitigate the land value impacts of IZ to some degree" (page 31).
- ***Phasing*** – In terms of timing, NBLC recommends 1) "it is crucial that the policy be introduced at a modest level…", 2) "the City should clearly communicate when the policy will come into force and how the policy parameters may change over time.", 3) "the City should consider a transition period", and 4) "following the transition period, the City should introduce the policy gradually over a phase-in period starting with a low IZ set-aside rate…" NBLC also notes that "in Toronto, developers typically acquire land on a speculative basis, based on their estimate of the maximum approvable (and market supportable) built form" (page 28).

EPS Commentary. EPS believes that NBLC's recommendations regarding phasing and timing gives the City good guidance on incrementally adopting this policy in such ways as to minimize the impacts that would otherwise be felt immediately by the market.

- ***Coordination of PMTSA Planning*** – NBLC acknowledges the connection between the planning work to identify density minimums around PMTSAs and the need to calibrate the IZ approach "so that the density increase offsets the impact of the affordable housing requirements" (page 11). As such, NBLC recommends that the City coordinate the planning of PMTSAs with the development of the IZ policy.

  EPS Commentary. The City should follow this guidance as much as possible. From experience and observation, EPS believes that one of the primary failings of IZ policies in the U.S. context is a situation in which planning processes, e.g., zoning code updates and comprehensive plans (decoupled from affordable housing policy development, such as incentive policies, density bonus tools, or IZ), result in increases to maximum allowable densities to reflect or respond to changing markets. The lesson-learned from a housing policy best practices perspective, however, is that such outcomes do so at the expense of a value capture opportunity for affordable housing goals. A better planning approach is to calibrate allowable densities only to the point that the value capture potential for IZ is not lost.

- ***Set-Asides*** – NBLC recommends that the City consider different set-aside rates to allow for market variances. NBLC also recommends that the City consider different set-asides applied to affordable ownership or rental units "to acknowledge the varying economic performance and land value capacity of those projects" (page vii). NBLC states, in alignment with the previous recommendation on "Coordination of PMTSA Planning" that "… 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" (page 10). The report notes that "generally speaking, set-asides can increase with allowable densities" (page 33).

  EPS Commentary. Again, the city should follow this guidance as much as possible. However, EPS offers a word of caution on interpreting NBLC's last caveat regarding set-asides increasing with allowable density. Within the methodological confines of NBLC's viability determination (i.e., the "base case" RLV with IZ must be at least 10 percent greater than the "as-is" RLV in order that IZ is determined to be viable), this is correct because the increased density applies to the "base case" RLV with IZ side of the RLV estimation, implying an expansion of the value capture opportunity. However, within the methodological confines of "Perspective 2" (such that IZ is viable if the "base case" RLV with IZ is no more than X percent lower than the "base case" RLV without IZ), this may not be correct because increased density would apply to

both sides of the RLV estimation, implying a contraction of the value capture opportunity. NBLC even notes that "as buildings get taller, they become more costly to construct" (page 18), which confirms the point that from the point of view of "Perspective 2", as density increases, the value capture opportunity for greater set-asides can diminish because of these increased costs to build.

- ***Incentives*** – The study does not include financial incentives, such as CMHC financing tools or bonus density. NBLC does suggest, however, that "in weaker markets, or for purpose-built rental development in most areas of the City,…interventions such as bonus density or financial incentives would be required [to] offset the impacts of the policy and maintain development viability" (page v). Later, NBLC states that "… as the market evolves and demand improves, the need for these incentive tools diminish, because development density becomes more powerful" (page 13) and "if the market sustains upward trajectory, the need for incentives should diminish over time" (page 12).

  EPS Commentary. EPS believes that the City should apply NBLC's guidance regarding the consideration of financial incentives or bonus density in exchange for meeting IZ requirements, especially in weaker markets. However, EPS offers a word of caution on interpreting NBLC's last remark regarding the need for incentives diminishing over time if the market sustains its upward trajectory. This is generally correct within the methodological confines of NBLC's viability determination. That is, as the difference in RLV between the "as-is" RLV and "base case" RLV with IZ requirements becomes larger through upward market trajectories (which EPS interprets as: 1) a market in which greater and greater densities are supportable, and 2) a market in which sales prices and rents continue to escalate), the value capture opportunity expands and the need for incentives diminishes. But in the context of NBLC's remark on buildings getting costlier to construct as they get taller, page 18 (which, as mentioned above, EPS believes can characterize an "upward" market in which greater and greater densities are supportable), EPS believes that such cost-side considerations could offset NBLC's comment on the diminished need for incentives. Furthermore, if, for example, construction costs themselves ("…residential construction costs are increasing, [though] not…at the same rate of unit or land pricing appreciation in strong market locations", page 9), cap rates, the cost of borrowing, or any other cost-side input change over time, such cost-side considerations might further dampen the conclusion that the need for incentives diminishes over time in an upward market trajectory.

- ***Exemptions*** – NBLC recommends an exemption like New York's in which developers may apply for the IZ requirements to be amended or waived where they can "demonstrate a lack of feasibility and/or other significant community benefits are being provided" (page vii). NBLC points out that no developer has been granted such an exemption and comments that this must be an indication "that the policy had been well calibrated to local economics" (page 12)

  EPS Commentary. EPS is concerned that NYC's exemption may not make for the best policy in Toronto. First, NYC's mandatory IZ policy applies citywide, and the exemption, from EPS's perspective, was an attempt to mitigate against weak development economics in areas more equivalent to Toronto's non-PMTSA areas. Second, making the case for an exemption early in the planning process may be problematic for developers as well as the City because targeted price points, rents, and construction costs can shift during the planning process. On one hand, it is difficult for developers to confidently convey actual development costs (i.e., final contractor bids) early in the planning process or actual sales prices or rental rates in advance of project completion. The concern is that a situation for a developer could arise in which what initially looks like a viable project with IZ (such that the developer does not apply for an exemption) becomes unviable as significantly higher-than-anticipated contractor bids are finalized. On the other hand, the concern is that a situation could arise in which what initially was determined to be a project unviable with IZ becomes viable with IZ because either a) lower-than-anticipated contractor bids are finalized or b) higher-than-anticipated sales prices or rental rates are achievable. Additionally, even if an unbiased arbiter (not the municipality) of such a determination could be identified, the determination of such an exemption would need to occur so late in the planning and development process as to open up the potential for process delays, which could in turn increase the cost of development itself. Best practice research indicates that other alternatives are preferrable, such as 1) land dedication in-lieu of onsite affordable housing, 2) offsite affordable housing construction, or 3) the payment of a fee in-lieu of affordable housing that is used by a municipality elsewhere to subsidize the affordability of units in other projects.

- ***Program Administration*** – NBLC recommends that "IZ policies need to be paired with program details regarding who owns and operates units…[and] develop a framework to maintain oversight…" (page vii).

  EPS Commentary. The City should follow NBLC's guidance here as well. The ownership or management, operations, marketing, and maintenance of affordable housing within a market-rate development require expertise and compliance support that developers often do not have. As such, program details that give developers guidance on how to partner with organizations that specialize in affordable housing management, etc., should be developed.

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4. Conclusions

This chapter focuses on a topic EPS believes to be central to this peer review – that is, the methodological perspective from which NBLC determines IZ viability. Throughout, EPS has referenced this chapter's discussion, the conceptual distinctions between Perspective 1 and Perspective 2 (illustrated below), and the central question as to whether the "as-is" RLV estimation represents a reasonable "floor" against which the value capture potential for the purpose of IZ viability is determined – that is, from the point of view of Perspective 1.

Viability

The following is a characterization of the two perspectives from which EPS believes viability can be examined and why it might be important to consider both. This discussion also highlights that NBLC has made calculations from both perspectives, using Perspective 1 as the primary viability determinant, while calculating and offering discussion in support of Perspective 2.

Perspectives

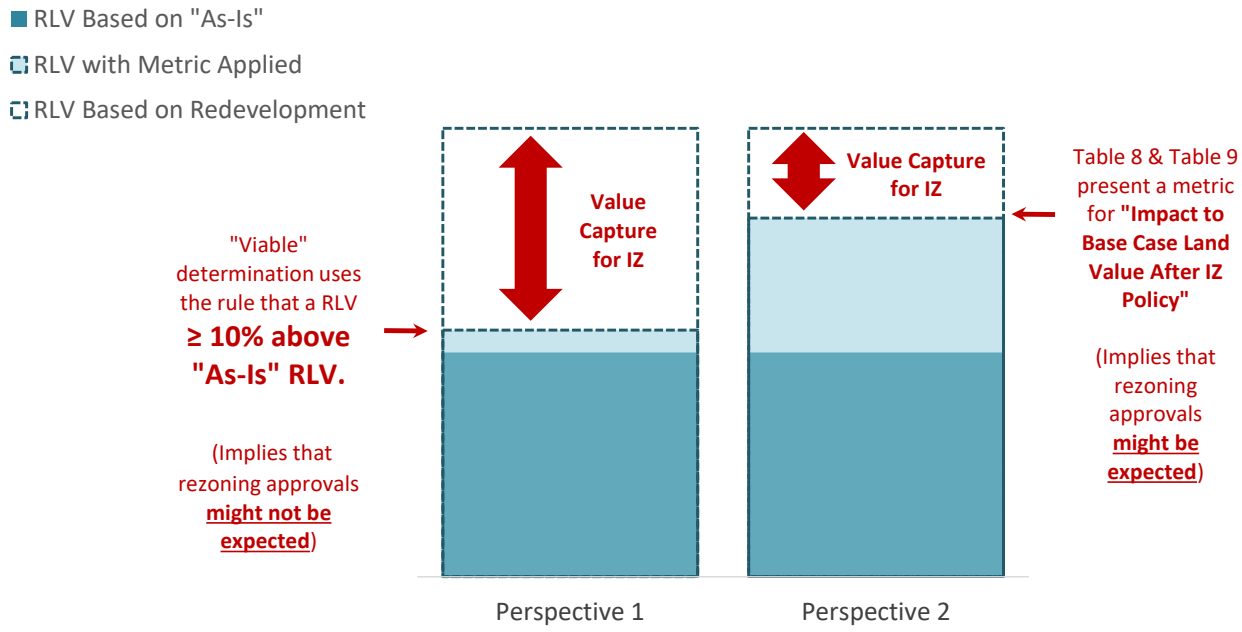
Defining how to calculate viability from each perspective relies on the different RLVs from each regulatory scenario, but another way to view them is through the lens of their outputs. That is, Perspective 1 can be characterized as an "optimistic" estimate of value capture potential because of its output, and Perspective 2 can be characterized as a "conservative" also because of its output. **Figure 1** illustrates these perspectives.

- ***Perspective 1 (Optimistic)***. On the surface, Perspective 1 views IZ as viable when the RLV in a redevelopment with IZ is at least 10 percent greater than the RLV of the "as-is" RLV. With this as the decision criterion, the value capture potential for IZ set-asides is the difference between the "base case" RLV with and without IZ – an order of magnitude in value capture potential proportional to the order of magnitude difference between the density allowed under the "as-is" and the "base case" redevelopment scenarios. It implies that, for IZ to be viable, a land sales transaction does not need reflect the scale of redevelopment possible through a rezoning. Rather, a land sales transaction must merely be at least 10 percent greater than the "as-is" RLV. As such, this value capture opportunity accounts for an *optimistic* portion the difference between the "as-is" and the "base case" redevelopment scenarios.

- ***Perspective 2 (Conservative).*** From this perspective, IZ is viable if the "base case" RLV with IZ is no more than some percent below the "base case" RLV without IZ that "could reasonably be approved in a rezoning" (page 16). NBLC does calculate this percent reduction from the "base case" RLV without IZ but does not apply it in the determination of IZ viability[6], so the application of this perspective would require NBLC to structure an additional decision criterion (similar to the 'at least 10 percent greater than rule'). This perspective implies that, for IZ to be viable, a land sales transaction does need to reflect a redevelopment that could reasonably be approved in the market. As such, this value capture opportunity accounts for a *conservative* portion the difference between the "as-is" and the "base case" redevelopment scenarios.

EPS believes it is important to view IZ viability from both perspectives because of the risk inherent to relying on just Perspective 1. Relying solely on Perspective 1 risks an IZ policy being introduced with overly aggressive set-aside requirements. Perspective 2 assists by demonstrating how a policy could be introduced in a phasing plan, recognizing the competing interests of multiple stakeholders.

Figure 1 Viability Metric from Two Perspectives



Source: Economic & Planning Systems

Z:\Shared\Projects\DEN\213055-Toronto Inclusionary Zoning Financial Analysis Peer Review\Data\[213055-EPS Analysis of NBLC Draft Results - May 26 2021.xlsx]Illustration Data

[6] Note that the discussion of **Figure 2** illustrates that NBLC shows this magnitude impact as a range of percent change, but does not indicate whether it is a positive or negative impact.

To illustrate where and how NBLC calculated both perspectives, **Figure 2** highlights five columns of information from Table 7 (layouts in Table 8 and 9 are the same) in the report (page 24-25). Columns D and E represent Perspectives 1 and 2, respectively. As noted previously, NBLC presents the estimation of this percent impact to the "base case" redevelopment RLV with IZ as a range, e.g., "10 to 20 percent impact", "20 to 30 percent impact", etc.

- ***Perspective 1 (Column D)***. NBLC's "viable/challenge" determination is calculated as: if **[(C – A) / A]** is greater than or equal to 10 percent, then Column D reads "viable". If it is not, then Column D reads "challenge".
- ***Perspective 2 (Column E)***. This column is calculated as **[(C – B) / B]** and represents a second possible "floor" against which to determine IZ viability, but is treated as miscellaneous, leaving its interpretation to the City.

Figure 2 Excerpt from NBLC's Table 7

Estimate of Land Value Impact of Inclusionary Zoning Policy
Purpose Built Rental Apartment Building With Inclusionary Zoning Units Rented at Below Market Rates

	Test Site	Pre Inclusionary Zoning			Post Inclusionary Zoning - % GFA Rented at Below Market Rates		
		Estimated Total Value of Property "As-Is"	Base Case Market Land Value Before IZ Policy		5% of GFA Rented at Below Market Rates		
			Total	Development Viable Before IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ
1	Etobicoke Centre	$8,000,000	$1,400,000	Challenge	-$500,000	Challenge	> 50% Impact
2	Stockyards / Junction	$10,800,000	$17,800,000	Viable	$15,000,000	Viable	10% to 20% Impact
3	Weston	$6,400,000	-$7,900,000	Challenge	-$9,200,000	Challenge	<10% Impact
4	Finch West	$5,400,000	$7,000,000	Viable	$5,400,000	Challenge	20% to 30% Impact
5	Yonge Eglinton Centre	$18,700,000	$25,200,000	Viable	$21,700,000	Viable	10% to 20% Impact
6	North York Centre	$21,500,000	$22,700,000	Challenge	$18,200,000	Challenge	10% to 20% Impact
7	TO Core	$35,800,000	$58,200,000	Viable	$49,700,000	Viable	10% to 20% Impact
8	Toronto West	$17,900,000	$41,600,000	Viable	$36,600,000	Viable	10% to 20% Impact
9	Toronto East	$3,200,000	$4,200,000	Viable	$3,800,000	Viable	<10% Impact
10	Golden Mile	$9,000,000	$1,600,000	Challenge	-$1,600,000	Challenge	> 50% Impact
11	Scarborough Centre	$4,500,000	$6,800,000	Viable	$2,900,000	Challenge	> 50% Impact

The report states that NBLC does "not consider the 'as-is' land value based on what developers speculate the City of Toronto might approve through a rezoning" (page 17), a methodological justification for using Perspective 1 to inform IZ viability. But EPS believes there are many caveats within the report that give even greater justification for using Perspective 2 to inform IZ viability:

- The "base case" redevelopment scenario is defined used assumptions for built form that could reasonably be approved in a rezoning." (page 16)
- "In Toronto, developers typically acquire land on a speculative basis, based on their estimate of the maximum approvable (and market supportable) built form." (page 28)

These statements point to the reality that developers and landowners are viewing RLV from Perspective 2. At a minimum, it points to the appropriateness of elevating Perspective 2 (Column E) to another viability metric, such as NBLC's use of Column D. The case for using a Perspective 2 metric is also bolstered by NBLC's following statements:

- "Developers who already own land must be able to maintain a reasonable profit margin not just to make a return, but also to ensure that lenders will finance their projects." (page 8)
- "The City must account for developers who already own land and have purchased their property without accounting for IZ…"

EPS believes these statements further acknowledge that such a set of circumstances is worth considering in the determination of IZ viability.

Recommendations

- ***Viability Metric*** – Additional analysis does not need to be completed but adding a viability metric that represents Perspective 2 (Column E) would provide the City with valuable insight into the "bookends" of IZ viability. Taking the same approach to the creation of the "at least 10 percent greater than 'as-is' RLV" rule, NBLC could create a rule that determines viability if the "base case after IZ" RLV is reduced "no more than X percent below 'base case before IZ' RLV".
- ***Sensitivity Analysis*** – EPS's discussion of NBLC's commentary on 1) set-asides increasing with allowable densities, and 2) the need for incentives diminishing over time within a market that is sustaining an upward trajectory illustrates the difficulty in offering policy-oriented caveats in the absence of sensitivity modeling. That is, making statements that hold true for unknown future circumstances is a difficult task, such as when development patterns, market trajectories, costs, and revenue inputs continue to evolve. Making statements that hold true for only specific trajectories or specific viability metric methodologies means that the shelf-life of such guidance lasts only as long as those conditions hold true. EPS believes that NBLC's guidance to the City could be strengthened, and ultimately the City's development of an IZ policy bolstered by the addition of sensitivity analyses. Such sensitivity analyses could test out the above-mentioned set-aside and incentive commentaries under each of the viability metrics proposed (Perspective 1 and Perspective 2), as well as a range of market trajectories that lay out possible cost- and revenue-side shifts.
- ***Source Documentation*** – EPS recommends that the report include 1) a technical appendix with all underlying inputs, assumptions, and sources, 2) a summary of the land sales transactions information it utilized in calibrating "as-is" RLVs for the modeling which might include number of transactions assessed per PMTSA location, average, median, and/or minimums/maximums, land use densities, and other notes regarding whether the purchase was made for the purpose of redevelopment or not, and 3) any additional documentation of market data and trend information used to inform and calibrate revenue inputs.
- ***Phasing and Implementation*** – In addition to NBLC's good guidance to the City on implementing IZ, it could be helpful if the report illustrates what an implementation schedule might look like and provide case studies (lessons learned) of the successes and failures of implementing IZ too quickly versus phasing.
- ***Terminology and Labeling*** – EPS recommends defining terminology up front, such as identifying that "existing" can be interpreted synonymously with "as-is". EPS also believes including a column-by-column explanation of Table 7, 8, and 9 in the report would be helpful.

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Appendix

Survey of Literature

Inclusionary zoning (IZ) has been a topic of many peer-reviewed research papers and law journal articles in the United States. Among the scores published over the last 30 years, EPS has chosen a few representative publications, which are also among the more frequently cited, to illuminate the breadth of academic debate around the topic. As with many topics of debate, there is no lack of opposition or support regarding this land use control. On one hand, we have selected what we believe present rigorous analyses and well-constructed arguments of the issues. On the other hand, we also believe these publications represent critical turning points in the evolution of debate regarding how to national housing affordability challenges through land use controls.

- ***"Reflections on Inclusionary Housing and a Renewed Look at its Viability," (Padilla, 1995)*** This journal article was written at a time when the State of California was considering the adoption of a statewide inclusionary zoning mandate to respond to the ever-expanding affordable housing crisis. The article is primarily a legal review but has been among one of the more frequently cited sources of principle considerations of the positive versus negative impacts of this regulatory mechanism. The author notes that the policy is not problem-free: it places "the onus of solving a society-wide problem on a small group, namely developers" and that "the group primarily responsible for solving the problem is not primarily responsible for causing the problem." The author suggests, though not through quantitative analysis, that the policy may lead to a decrease in the production of housing generally, but that a balancing of public and private interests can be achieved to "equitably share any of its burdens and benefits."[7]
- ***"Why is Manhattan So Expensive? Regulation and the Rise in House Prices" (Glaeser and Gyourko, 2003)*** This journal article for the National Bureau of Economic Research debates the justifiability of gaps between construction costs and housing prices in Manhattan against data from other markets throughout the US. It argues that land use restrictions are the natural explanation of this gap and presents present evidence toward the widely-accepted notion that a constraint in the supply of housing leads to much higher prices and fewer units in many markets across the country. Glaeser and Gyourko are careful to note that "regulations limiting building

[7] Padilla, Laura M. (1995) "Reflections on Inclusionary Housing and a Renewed Look at its Viability," Hofstra Law Review: Vol. 23: Iss. 3, Article 1. Available at: http://scholarlycommons.law.hofstra.edu/hlr/vol23/iss3/1

need not be economically inefficient" – i.e., that their findings do not recommend eliminating regulation.[8]

- ***"Economics of Inclusionary Zoning Reclaimed" (Powell and Stringham, 2005)*** The authors summarize their work with the following statement: "Although authors such as Dietrich, Padilla, and Kautz provide the most sophisticated defense of inclusionary zoning to date, they make some fundamental economic errors and, thus, advocate misguided policy proposals." They provide a review of the literature, an examination of the economic errors made in those studies, and conclude that many of the arguments "seem to be based more on egalitarian ideology rather than sound economic logic." For example, they illustrate that unless affordability is subsidized by government, inclusionary zoning functions like a price control (a tax on development), in which the impacts are felt by builders, market-rate home buyers, and owners of undeveloped land. They also address various other arguments made, including: 1) that builders do not absorb the cost of providing affordability as a cost of doing business; and 2) that typical programs do not offer incentives that sufficiently offset these costs. The authors conclude that "evidence demonstrate[s] that imposing price controls and taxes on housing is one of the worst ways of encouraging the production of housing." [9]
- ***"Housing Market Effects of Inclusionary Zoning" (Bento, et al, 2008)*** Through statistical analysis of California communities between 1988 and 2005, these authors found that inclusionary zoning policies had measurable effects on housing markets such as increasing the share of multifamily housing starts by seven percent; increasing the rate of single-family housing price appreciation by two (2) to three (3) percent per year; and a decrease in the size of single family houses. [10]

[8] Glaeser, Edward L., Joseph Gyourko, and Raven Saks. "Why is Manhattan So Expensive?: Regulation and the Rise in House Prices." Journal of Law and Economics 48, 2 (2005): 331-370.
[9] Benjamin Powell & Edward Stringham, "The Economics of Inclusionary Zoning Reclaimed": How Effective are Price Controls?, 33FLA.ST.U.L.REV.471(2005).
[10] Antonio Bento, Scott Lowe, Gerrit-Jan Knaap and Arnab Chakraborty *Cityscape* Vol. 11, No. 2, Regulatory Innovation and Affordable Housing (2009), pp. 7-26

- ***"Silver Bullet or Trojan Horse? The Effects of Inclusionary Zoning on Local Housing Markets in Greater Boston" (Schuetz, Meltzer, and Been, 2009)*** Although the focus of this article was on the Greater Boston area, its analytical conclusions were broadly applicable (and in alignment with other literature) in that "prices in jurisdictions with inclusionary zoning programs in place for 5 to 14 years [were] 3.75 to 3.95 percent higher than prices in similar jurisdictions with very recent or no inclusionary zoning programs."[11]
- ***"Unintended or intended consequences? The effect of below-market housing mandates on housing markets in California" (Means and Stringham, 2012)*** These authors present rigorous quantitative analysis to conclude that "cities adopting below-market housing mandates end up with higher prices and fewer homes." They provide findings from their analysis that demonstrates cities that had adopted such policies ended up with housing prices 9 percent higher prices and production volumes 8 percent lower than cities without those policies (between 1980 and 1990). They also concluded that during the next decade, cities with the same regulation saw housing prices increase 20 percent higher and production decrease 7 percent overall.[12]
- ***"Inclusionary Zoning in the US: Prevalence, Impact, and Practices" (Thaden, 2017)*** The article in the Lincoln Institute for Land Policy broadly assesses the production yield (units and fees in-lieu) of inclusionary zoning policies across the US and identifies the number of jurisdictions nationwide (886) that have an inclusionary zoning policy. The study documents that of the jurisdictions with inclusionary zoning policies, 45 percent are in New Jersey, 27 percent in Massachusetts, 17 percent in California, and 11 percent scattered throughout the rest of the U.S. There are 12 IHO policies in Colorado (1 percent of programs nationwide). The study finds that 373 of them reported a total of $1.7 billion in impact or in-lieu fees generated and the production of 173,707 units. Although the authors note that "these numbers substantially underestimate the total fees and units created", the numbers suggest that jurisdictions have created an average of 190 units per program since adoption, whereas most programs have been in effect for at least 15 years.

[11] Silver Bullet or Trojan Horse? The Effects of Inclusionary Zoning on Local Housing Markets in the United States Jenny Schuetz, Rachel Meltzer and Vicki Been Urban Studies Vol. 48, No. 2 (February 2011), pp. 297-329

[12] Means, Tom, and Edward Peter Stringham, 2012. "Unintended or Intended Consequences? The Effect of Below-Market Housing Mandates on Housing Markets in California" Journal of Public Finance and Public Choice, 30(1-3): 39-64.

- ***"Can More Housing Supply Solve the Affordability Crisis?" (Anenburg and Kung, 2018)*** Responding to the growing suggestion that land use regulation itself is the source of unnecessarily high housing price or rent escalation, some began turning to the broader debate over the fundamental proposition that relaxing constraints on housing production supply might mitigate against housing price escalation. The authors use a Neighborhood Choice Model with nationwide 2014 American Community Survey public-use microdata to simulate how rental rates would respond to an increase housing supply in a neighborhood. The findings demonstrate that "rent elasticity is low", i.e., that rents are not likely to shift (up or down) as a result of an increase in supply, and that "marginal reductions in supply constraints alone are unlikely to meaningfully reduce rent burdens."[13]
- ***"Fewer Players, Fewer Homes: Concentration and the New Dynamics of Housing Supply" (Cosman and Quintero, 2019)*** A more recent contribution to the literature examines an observed trend in the production capacity and yield of the nation's builders. The authors analyze nationwide data and determine that in the 10 years following the end of the Great Recession, that the number of developers and home-builders has declined, resulting in a "lower production, volume, fewer units in the production pipeline, and greater unit price volatility."[14]

[13] Elliot Anenberg & Edward Kung, 2018. "Can More Housing Supply Solve the Affordability Crisis? Evidence from a Neighborhood Choice Model," Finance and Economics Discussion Series 2018-035, Board of Governors of the Federal Reserve System (U.S.).
[14] Cosman, J. and Quintero, L. (2018), Fewer players, fewer homes: concentration and the new dynamics of housing supply. Carey Business School. Johns Hopkins University

Peer Reviewer Experience

EPS provides a range of services related to housing, regulation, development finance, and policy. The following briefly describes EPS's core services in this area:

- ***Equity-Focused Needs and Strategy***- EPS helps communities identify and address a broad spectrum of issues and solutions related to equity, vulnerability, and inclusion. An important part of that work is helping communities understand the seen and unseen dynamics of market forces and barriers that have exacerbated vulnerabilities and disparities for populations. Within an evaluation framework that incorporates a community's unique values, EPS helps to identify proactive strategies that protect and improve community character, identity, and social networks, and orient future policy to sustained equity.

- ***Housing Market and Needs Assessments***— EPS works with public- and private-sector clients to assess the dynamics of housing markets and prepare broad-based strategies to address the full spectrum of housing needs. Our work involves detailed analysis of market supply (based on competition, land availability, financing, etc.) and demand (based on demographic trends, income, preferences, etc.) to provide actionable recommendations that target short- and longer-term implementation, as well as structural reforms for direct and indirect impact.

- ***Financial Feasibility Studies***—EPS conducts pro forma-based financial analyses of residential projects, including both market-rate and mixed-income developments. These analyses are used to evaluate the viability of new construction and redevelopment, as well as the financial implications of public policies designed support housing for targeted groups and locations. This work supports our clients seeking to use public financing, Low-Income Housing Tax Credits, New Market Tax Credits, HUD Section 108 loans, HUD Section 221d4 financing, among other conventional or permanent financing vehicles.

- ***Federal and State Compliance Planning***—EPS supports jurisdictions in completing their state-mandated Housing Element updates and federally mandated Consolidated Plans. EPS prepares housing needs analyses and assists with program evaluation and new program development.

- ***Affordable Housing Development Plans and Negotiations***—EPS works for public- and private-sector clients on plans and negotiations to design and implement affordable housing programs that meet community goals for housing and income diversity, while also maintaining appropriate financial returns for developers. Solutions encompass land disposition, ground leases and land trusts, equity participation programs, homebuyer assistance programs, tax increment financing and other public subsidies.

- ***Inclusionary Zoning and Linkage Studies***—Mixed-income, or inclusionary, housing ordinances have become a common tool for ensuring a diverse housing supply within a given community. EPS works with jurisdictions to develop and retool their programs to meet changing markets and performs the calculations and analysis to establish fees in lieu of building homes on site. In addition, EPS develops fee programs and legally-required nexus studies to support affordable housing by assessing the impact of new, nonresidential construction on the existing housing supply of low-cost housing.

Housing Policy

- California Forward Housing Supply & Policy Analysis (CA)
- Gentrification and Displacement Indicators (Los Angeles, CA)
- Consolidated Plan (Kane County, IL)
- Housing Element (Santa Barbara County, CA)
- Affordable Housing Policy (Palm Desert, CA)
- Affordable Housing Policy (Laguna Beach, CA)
- Affordable Housing Policy (Newport Beach, CA)
- Affordable Housing Policies (Gilroy, CA)
- Affordable Housing Program and Project Analysis (San Carlos, CA)
- Housing Community Benefits Analysis (Berkeley, CA)
- Housing Needs Study and Action Plan (Santa Rosa, CA)
- Affordable Housing Policy (San Mateo, CA)
- Consolidated Plan (Aurora, CO)
- Comprehensive Plan Housing Demand (Oklahoma City, OK)
- Housing Affordability Study and Strategy (Oklahoma City, OK)
- Housing Policy Framework (San Antonio, TX)
- Strategic Housing Implementation and Funding Plan (San Antonio, TX)
- Housing Study (Lakewood, CO)
- Multi-Dwelling Unit Zoning Density Bonus Update (Portland, OR)
- Housing Needs and Policy Assessment (Archuleta County, CO)
- Housing Needs Analysis (San Miguel County, CO)
- Sonoran Institute Housing Market Study (CO, ID, WY)
- Medical Center Workforce Housing Strategy (Summit County, CO)
- Housing Trends and Strategic Plan (Plano, TX)
- Housing Production and Funding Analysis (Denver, CO)
- Regional Housing Study (Aspen to Glenwood Springs, CO)
- Housing Needs (Summit County, CO)
- Demographics and Housing Opportunities (Windsor, CO)
- Housing Needs (Lake County, CO)
- Housing and Community Sustainability Study (Flagstaff, AZ)
- Housing and Community Benefits Feasibility (South San Francisco, CA)
- Saltillo District Affordable Housing and Gentrification Mitigation Strategy (Austin, TX)
- Housing Element (Sonoma County, CA)
- Ad Valorem Property Tax Comparative Analysis (TX)

Inclusionary Zoning, Incentives, and Nexus Studies

- IZ Calculator (Province of Ontario, Canada)
- IZ Feasibility and Linkage Fee Nexus (Ft. Collins, CO)
- IZ Ordinance Update (Denver, CO)
- IZ Feasibility and Policy Study (Nashville, TN)
- Affordable Housing Density Bonus Incentive Feasibility (Portland, OR)
- IZ for Rental Policy (Boulder, CO)
- IZ Feasibility (Longmont, CO)
- California IZ Ordinances and Fee Studies
- IZ and Nexus Studies (Mountain View, CA)
- IZ Study (San Mateo, CA)
- IZ Study (Sonoma County, CA)
- Density Bonus Feasibility (Santa Barbara, CA)
- IZ Study (Santa Rosa, CA)
- IZ Study (Sunnyvale, CA)
- IZ Study (Walnut Creek, CA)
- IZ Study (Palm Desert, CA)
- IZ Study (San Carlos, CA)
- IZ and In-Lieu Fee Studies (San Bruno, CA)
- IZ and In-Lieu Fee Studies (Newport Beach, CA)
- IZ Study (Gilroy, CA)
- Residential Linkage Nexus Study (Douglas County, CO)
- Residential Market Analysis Affordable Housing Fees (Burbank, CA)
- ADU Feasibility and Incentive Program Analysis (Oakland, CA)
- Workforce Housing Linkage Study (Sonoma County, CA)
- Financial Analysis of Density Bonus (Berkeley, CA)
- Downtown Commercial to Residential Zoning Changes (Duarte, CA)

Feasibility, Peer Review, and Negotiation Support

- Colorado Regional Tourism Act Third-Party Analyst (State of CO)
- Regional Transportation District Joint Development Services (Denver, CO)
- Apple Economic and Fiscal Impact Peer Review (Cupertino, CA)
- Peer Review of Facility Options (Point Lobos, CA)
- Affordable Housing Employee Generation Rate Peer Review (Summit County, CO)
- Bay Area Rapid Transit Joint Development Negotiations and Asset Management (San Francisco, CA)
- Mueller Airport Redevelopment (Austin, TX)
- Public Housing Reinvestment and Expansion Feasibility (Los Angeles, CA)
- Bear Valley Apartments Market Assessment (Denver, CO)
- Lowry Housing Operations Study (Denver, CO)
- Telluride Foundation Funding Model Development (CO)
- Downtown Housing Market Study (Loveland, CO)

- Green Water Treatment Plant Housing Analysis and Development Negotiations (Austin, TX)
- Development Economic Impact Study (Edwards, CO)
- Housing Authority Land Pricing Analysis (Boulder, CO)
- MTC Bay Area Housing Development Readiness Analysis
- MTC Bay Area Public Lands for Housing Study
- VTA Residential Market Studies and Affordable Housing Policy
- Development Review Process Support (Lakewood, CO)
- USPS Distribution Center Redevelopment Financial Analysis (Portland, OR)
- Campus Redevelopment Disposition Support (Portland, OR)
- Apartment Market Analysis (Portland OR)
- Economic and Fiscal Analysis of Stanford Mixed-Use Housing (Menlo Park, CA)
- Financial Analysis and Negotiation Support of Visitation Valley Mixed-use Housing (San Francisco, CA)
- Housing In-Fill Development Feasibility Study (Fresno, CA)
- VTA Student and Co-Housing Feasibility (Santa Clara, CA)
- Feasibility Analysis and Negotiations Support (Brisbane, CA)
- Senior Housing Feasibility Studies (Lafayette & Moraga, CA)
- Salt Works Residential Economic and Market Analysis (Redwood City, CA)
- Apartment Market Feasibility Analysis (Hercules, CA)
- Coliseum and Fruitvale BART Affordable Housing Analysis (Oakland, CA)
- Fruitvale Hispanic Home Ownership Feasibility Study (Oakland, CA)
- Specific Plan Residential Development Feasibility (East Pleasanton, CA)
- Peer Review of Updated Walnut Street Feasibility Study (San Carlos, CA)
- Peer Review of Fiscal and Economic Impact Analysis (Seaside, CA)
- University of California Feasibility Assessment and Negotiation Support, (San Francisco, CA)
- Child Care In-lieu Fee Peer Review and Analysis (Los Angeles, CA)
- Development Impact Fee Review (Mammoth Lakes, CA)
- Development Impact Fee Review (San Luis Obispo, CA)
- Development Impact Fee Review (Santa Rosa, CA)

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The City of Toronto

Update:
Evaluation of Potential Impacts of an Inclusionary Zoning Policy

May 2021

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N. Barry Lyon Consultants Ltd.

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Trusted advisors since 1976.

The City of Toronto

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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, originally completed in May of 2019. This document serves as an addendum to the 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 the total yield in a development project. This report should be read in conjunction with our original study.

Of note, key adjustments in this work include the incorporation of the updated municipal Community Benefit Charge, new proposed definitions of affordable purchase prices and rents as provided by City of Toronto staff, as well as updated development cost and revenue assumptions current to Spring 2021.

The Conceptual IZ Policy

To undertake our assessment of potential impacts, the City has prepared a conceptual IZ policy which would have the following key elements:

- The IZ policy applies to market condominium and purpose-built rental projects. Non-profit projects are not considered in the analysis.
- The IZ set-aside rate is based on a percentage of total residential gross floor area (GFA) in a residential development. This differs from the policy parameters in some other jurisdictions where IZ is only applied to the additional density achieved through rezoning.
- No incentives are considered in this analysis other than the elimination of minimum parking requirements for affordable units.
- The IZ units must be maintained as affordable for 99 years.
- The unit mix for IZ units must mirror the unit mix of the market units.
- The quality of finishes is equivalent to market units and residents have access to the same amenities. Similarly, condominium fees are assumed to be equivalent for IZ and market units.

The following tables summarize the policy permutations and affordable revenue assumptions provided to NBLC for use in this updated evaluation.

Table 1

Summary of Tenure & Set Aside Rates Tested				
Type of Development	Tenure of IZ Units	Set Aside Rates Tested		
Condominium Apartment Building	Affordable Ownership	10%	20%	30%
Condominium Apartment Building	Affordable Rental	10%	20%	30%
Purpose Built Rental Apartment Building	Affordable Rental	5%	10%	20%

Table 2

2021 Affordable Sale Prices and Rents Tested		
Unit Type	Affordable Sale Price	Affordable Rent
Studio	$197,900	$812
One Bedroom	$259,000	$1,090
Two Bedroom	$321,000	$1,661
Three Bedroom	$407,000	$1,858

Approach to Analysis

As described in our May 2019 analysis, the City of Toronto is comprised of diverse submarkets. This evaluation therefore considers the potential impacts to the feasibility of high-density residential development in 11 locations around existing or planned transit service. The following summarizes our methodology:

- Submarket areas were selected around existing higher order transit, or emerging market areas with existing or planned higher order transit infrastructure improvements.
- In each of the 11 submarkets, City staff provided NBLC with a prototypical development site and established assumptions for the built form that could reasonably be approved in a rezoning application.
- For each submarket we undertake research to assess local pricing dynamics that 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 current land value considering the site's current use and the density permitted by the "as-of-right" zoning. This estimate is referred to as the "as-is" land value and forms the basis upon which we measure development viability.
- We then model the conceptual development scenario without the IZ policy to establish a base case land value. This represents the potential land value that might be achieved through a rezoning. Where the redevelopment's land value exceeds the "as-is" land value by a 10% margin, we consider development to be viable prior to the introduction of an IZ policy.

- We then layer on the IZ policy under various set aside rates to determine whether the redevelopment project maintains a land value above the "as-is" land value plus a 10% margin. Where the land value meets or exceeds this test, we conclude that development could remain viable following the introduction of the policy.
- If the land value of the development parcel, with the IZ requirements, is not 10% greater than the "as-is" land value, we conclude the development is not feasible. Simply, the landowner would not be motivated to sell their property for less than it is worth under its existing use.
- We also quantify how the IZ policy impacts the base case land value (i.e., the redevelopment site's land value prior to IZ). Where an IZ policy creates significant impacts to the base case land value, it can be expected that these markets will require time to adjust.

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 test scenarios conducted throughout this study show evidence that these land markets are likely to have capacity to absorb the impact of a modest IZ policy without jeopardizing development viability. That is, the market pricing is high enough and there is enough density added through the rezoning process that development could generate a land value in excess of the as-is value of the property following the introduction of the policy. The following are other key findings from this evaluation:

- The primary impact of an IZ policy as conceptually defined is to reduce the development revenue from a project. Hard and soft construction costs do not change and so when revenues are decreased, the developer must reduce their budget to acquire a site if they are to maintain an acceptable profit margin. When a developer's budget for land is less than the "as-is" land value, the motivation for the land to be redeveloped, and for housing to be created, is similarly reduced and investment potential undermined.
- In weaker market areas, where revenues are lower, or in areas where development density is modest, an IZ policy could have a negative impact on investment and the production of housing. The analysis illustrates that stronger market areas have greater potential to absorb the cost of the policy as the opportunity for, and value of, additional density 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 of residential development after an IZ policy is introduced will vary depending on the market strength of the location, the existing use of the site, the density permitted through rezoning, and the tenure of residential units, among other factors. Condominium developments, for example, typically generate more revenue and thereby support higher land values than purpose-built rental developments. As such, condominium projects often have a greater ability to absorb the

impact of the policy. Similarly, applying the same policy that might be viable in downtown Toronto to a weaker market area could discourage new investment.

- The City has indicated that it wishes to prioritize the delivery of affordable rental units in condominium buildings as an outcome of an IZ policy. Our modeling demonstrates that the value of an affordable ownership unit, under the City's current definition, is considerably greater than the value of an affordable rental unit at the same set aside rate and would have less of a financial burden on the development community.
- A long-term approach to an IZ policy would allow land markets time to adjust and expertise in the development community to grow. As high-density residential submarkets in Toronto continue to mature, there may be potential to increase set aside rates. However, it will be important to introduce these rates gradually to allow the real estate market to adjust. Implementing an aggressive IZ policy in the near term could result in active projects becoming infeasible because developers may have already acquired land without accounting for the cost of an IZ policy.
- Discussions of an IZ policy have been ongoing for several years and final implementation will be tied to Provincial approval of Protected Major Transit Station Area (PMTSA) plans. PMTSA plans must introduce new minimum density parameters for future development. These plans create an opportunity to develop a parallel IZ policy which is responsive to the variations in market strength and existing conditions within a PMTSA. This planning work would provide the clarity necessary for developers and landowners to account for the impacts of an IZ policy when making future investment decisions.
- The analysis indicated that a 10% set-aside rate for affordable ownership or rental units could likely be absorbed in condominium apartment projects across most of the test locations. As we approached a set aside rate of 20% only the strongest markets areas retained project viability.
- The ability of purpose-built rental projects to accommodate an IZ policy illustrated weaker results. Only the strongest market areas could sustain any IZ policy requirement. The majority of these test sites became unviable above a 5% set aside rate.
- Introducing IZ in weaker markets, or for purpose-built rental development in most areas of the City, would likely discourage investment and housing supply. In these locations, interventions such as bonus density or financial incentives would be required offset the impacts of the policy and maintain development viability.
- This analysis cannot assume the wide variations of market factors and the interests of developers and landowners. The results therefore should be considered at a high level and used to provide general direction in developing IZ policies. Further review or consideration

may be warranted once PMTSA plans are advanced, a final implementation framework is in place, and as market conditions evolve.

Recommendations

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

- IZ should be viewed as a forward-looking policy that will be in-force over the long term. From a land economics perspective, implementing an overly aggressive IZ policy could result in negative consequences if land acquisition and development activity stalls. The impact of an aggressive policy will not become apparent for many years as there is a significant lag between when the decision is made to acquire land and begin the development process, and when new housing is finally delivered to end users. Should the City realize that the policy is too burdensome and need to later reduce the IZ requirement, the long-term policy goals and economic outcomes might be undermined. It is crucial that the policy be introduced at a modest level, which can be increased over time as market conditions permit.

- The City should clearly communicate when the policy will come into force and how the policy parameters such as the set aside rate may change over time. The City should consider a transition period before the policy is introduced to allow the market to clear any projects which are currently under development. The length of the transition period should reflect the time it takes for typical development to receive zoning and site plan approval, understanding complex and large projects may require special accommodation. Following the transition period, the City should introduce the policy gradually over a phase-in period starting with a low IZ set-aside rate with specified, periodic increases. Overall, the City's approach to implementation should ensure that markets are able to adjust, allowing new development lands to be priced accordingly and sites which are currently in pre-development stages to proceed.

- The IZ policy should be developed alongside development entitlements in each PMTSA. A successful IZ policy requires a measure of clarity in station area plans to form the basis by which future land values can be established.

- The high-density residential market is geographically diverse. Therefore, IZ is not achievable in a uniform fashion without offsetting measures and/ or a transition framework to support development in weaker submarkets. The City should consider whether PMTSA's could have different set-aside rates to allow for market variances, working to calibrate affordability requirements in tandem with new densities determined through future planning processes. Generally speaking, set-aside rates can increase with allowable densities, but market strength must be considered carefully when calibrating a rate.

- The IZ policy should initially focus on the PMSTA's in areas that show the greatest market strength. This could include areas not tested in this report such as new station areas associated with the Ontario Line and Scarborough Subway extension, where new PMSTA policies have the potential to significantly increase density and land values.
- The City could consider measures to offset weaker economic conditions in some market zones as a transitional or interim measure as markets evolve and strengthen with improvements to transit infrastructure. These might include Community Improvement Plans or other focused public investments including transit connectivity, parks, or community facilities that help improve the market appeal of the area.
- Further, the City should consider whether varying set aside rates should be applied to the delivery of affordable ownership and affordable rental units in order to prioritize the delivery of units that best suit the profile of affordable housing need in the City. This is premised on the assumption that developers, not the City, will have discretion in selecting the tenure of affordable units created through IZ. This consideration should also apply to the delivery of market ownership or purpose-built rental projects, to acknowledge the varying economic performance and land value capacity of those projects.
- In all cases, the calibration of set aside rates and definitions of affordability should be communicated clearly to the market so that developers, non-profits, and landowners can plan accordingly.
- The City should explore 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 through the project.
- IZ policies need to be paired with program details regarding who owns and operates units and the types of agreements that would be registered on title to ensure that the policy is implemented and sustainable through operation. The City should also develop a framework to maintain oversight of the depth and duration of affordability and unit types as necessary. The development of a clear framework remains an ongoing process for the City as it considers its role and capacity along with that of key stakeholders.
- The IZ policy should be revisited at regular intervals to ensure that the policy is responsive to the economic realities of the day. The Toronto real estate market evolves rapidly. The recent volatility caused by the COVID-19 pandemic emphasizes the need for flexibility and regular monitoring of potential IZ policies throughout the City.

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, initially completed in May of 2019 and updated again in May 2020. This report serves as an addendum to these analyses by updating key market and cost parameters, the definition of affordable prices and rents, and by adjusting potential policy scenarios.

The Province of Ontario has adopted legislation that will allow the creation of affordable housing through IZ policies. The City of Toronto is actively developing strategies to address housing affordability across a spectrum of need; part of this work includes evaluating the potential City-building benefits of IZ. Provincial IZ 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 and no financial incentives have been assumed.

This update to our previous studies reviews the possible impact of a potential IZ policy using market research and a financial model to consider the 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. In short, we examine how the impact of providing affordable housing in market development could impact the viability of prototypical high-density residential projects.

Of note, this analysis assumes that the City of Toronto will implement a Community Benefits Charge (CBCs) pursuant recent Provincial legislative changes. At the time of writing, a Community Benefits Charge approach was subject to ongoing analysis and consultation. Further, this analysis assumes the continued application of existing development charge and parkland policies in place today. Any substantial near term adjustments to these fees or other municipal rates and charges could have an impact on the findings of this review.

In addition, impacts flowing from the response to COVID-19 are affecting Toronto's housing market and will continue to influence market conditions in the near term. Market data and assumptions in this update were developed in February and March of 2021. With Ontario's vaccination rollout underway, 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 premise of a typical IZ policy would be to exchange some of the density achieved 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 overall project viability, including 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.

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. As a result, 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 cannot be 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.

Of note, since our last review of potential IZ parameters and impacts, there has been significant recent escalation in hard construction costs across varying materials and trades.

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, changes to development charges, and others.

Refinements to the Planning Act through the implementation of a Community Benefits Charge (CBC) framework will further impact the way soft costs are calculated in a developer's proforma. This analysis assumes that the City of Toronto will implement a CBC rate set at 4% of land value as outlined in Provincial regulation. In some high value market locations throughout the City, this might represent a reduction in costs versus the previous Section 37 approach.

Developers and their investors 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.

Moreover, a developer's lender will look to see adequate profit in a project to ensure that risk factors are accounted for in order to finance a project. If profit margins are inadequate, lenders will not advance funds to the project.

2.3 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 or other revenue-generating uses. 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 to acquire land to construct the housing project and achieve their required profit margin.

When a developer conducts an RLV analysis, the result will guide whether or not to proceed with the land acquisition and undertake the project. This results in one of the two following 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 satisfying 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 required profit margin.

Figure 1

Understanding Residual Land Value	
Project Revenue	A
Project Costs	- B
Developer Profit	- C
Residual Land Value	= D

2.3.1 *How Would IZ Impact this Dynamic?*

The introduction of IZ influences the variables noted in **Figure 1** in the following ways:

- **Project Revenue:** Will decrease as developers will be forced to charge below-market rates for some of the units in their development.
- **Project Costs:** The cost of building and delivering affordable and market rate homes are similar. IZ would therefore not impact development costs in a significant way.

- **Developer Profit:** Developers are investing their time, skill, and equity to build a housing project. Developers must therefore ensure, to the best of their ability, that IZ does not impact the minimum profit threshold that would motivate them to advance a housing project and satisfy their lenders. It is also in the public sector's interest to keep developers motivated to expand the supply of housing.

2.4 IZ will therefore Primarily Impact Land Value

If revenue decreases, while project costs and developer profit remain the same, the amount that is available to pay for land (RLV) will decrease. In other words, the developer would pay less for the development site because their revenue has decreased. **Figure 2** shows this nuance by illustrating the key differences between a typical redevelopment proforma and one with IZ.

The RLV is impacted because the other elements of the equation are generally fixed. Developers 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. This change in pricing is regularly observed in the market as supported by supply/demand conditions.

A cap on 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 of remediating the site 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.

If housing prices were to increase while construction costs remain stable or decline, a developer would have a larger budget to acquire a property and so the land value of development properties would increase. Conversely, if pricing were to stabilize or decline while costs increase, developers would need to reduce their budget to acquire land. As a result, the value of development parcels would fall.

The discussion in this section therefore concludes that reduced revenue potential will place downward pressure on land values (the same would be true with increasing costs). The only exception to this is where a developer has already acquired land, as a developer cannot pay less for land to account for rising costs / decreased revenue if they have already purchased land without accounting for this impact. In this situation, a developer must either: accept a lower return; delay the project until the market is more favourable; or cancel the project.

It is common for the introduction of a significant policy change, such as increased development charge rates, to be accompanied by a transition policy to allow for the market to clear these projects. However, through our discussions with developers across the GTHA, it is apparent that there have

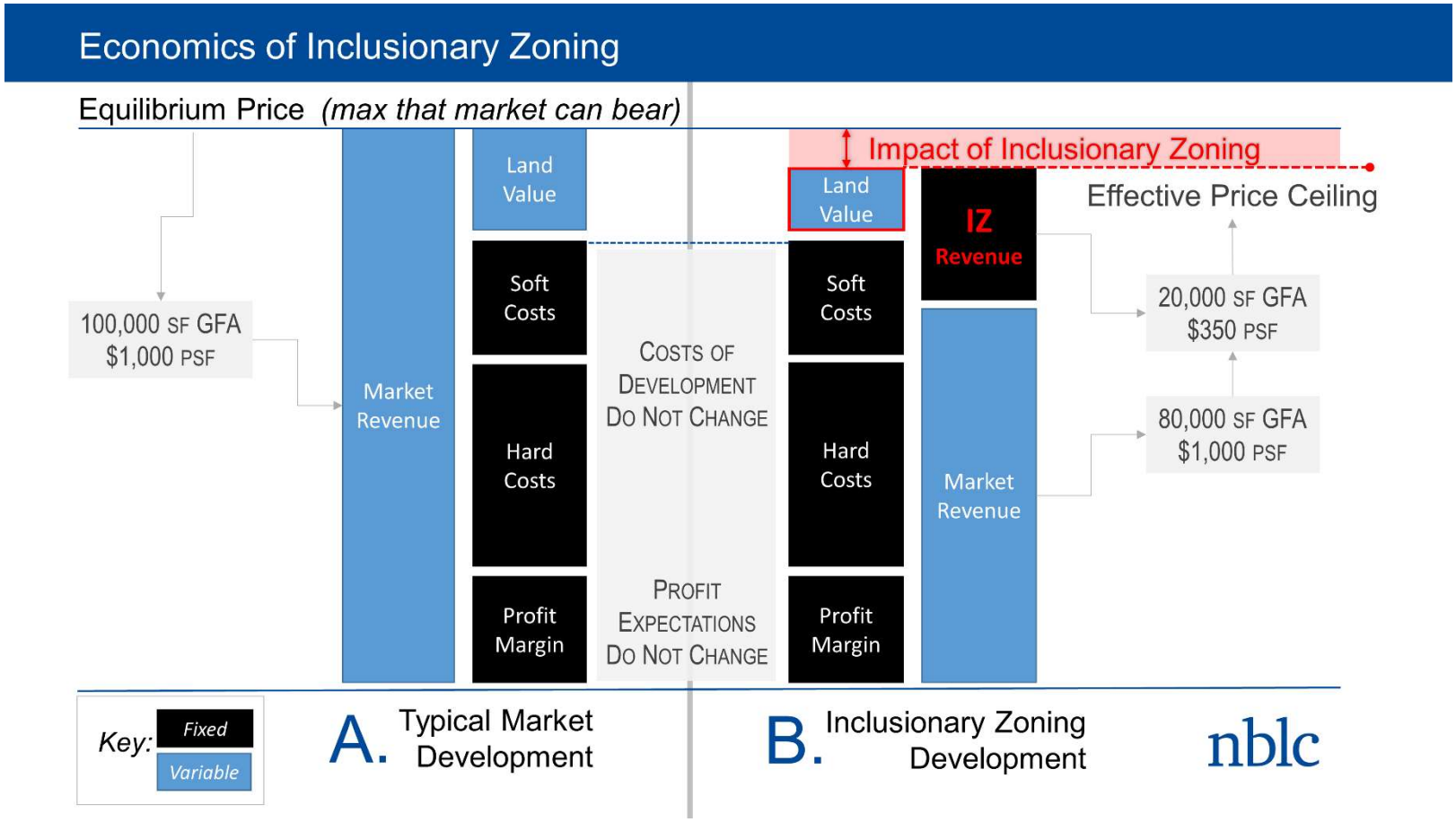
been instances where their profit margins have been negatively impacted by extraordinary changes to costs or revenues after land has been purchased. This is part of the risk developers take on through their projects. However, in our view, and in the eyes of banks financing new development projects, significant profit margin compression is not sustainable for the industry over the long-term. Developers will always enter into development projects seeking to achieve their required return on investment. They will not adjust this profit expectation in light of increasing costs or decreasing revenues. Instead, they will reduce their budget to acquire land so as to achieve this profit margin on every project they enter into.

The following analysis uses this premise – that the value of developable land is the dependent variable – to estimate the potential impacts of an IZ policy across various building forms and 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 "as-is" 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 "as-is" land value, development would be viable. If the redevelopment's land value is lower than the "as-is" land value, development would be infeasible. **Figure 2** illustrates the key differences between a typical redevelopment proforma, and one with IZ.

Example: Assume a site zoned and used for a gas station with an estimated land value of $2.5M. If the land value of the site for high density development is reduced to $2.0M as the result of an IZ policy, then we assume the owner would continue to use the property for its current use. The owner would not be motivated to sell to a residential developer.

Figure 2


Economics of Inclusionary Zoning
Equilibrium Price (max that market can bear)
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
A. Typical Market Development
B. Inclusionary Zoning Development
nblc

2.5 How Might IZ Impact Real Estate Development Activity and the Supply of Affordable Housing?

For IZ to be successful, market residential development must remain viable. The core premise of IZ is to have the private sector incorporate affordable housing into a market housing development. If development becomes unviable because of IZ, the private sector may not have the ability to build new housing in locations where IZ applies. This situation could result unintended negative consequences:

- Development will not occur where IZ applies, which will be within Toronto's PMTSAs, and new affordable housing will not be supplied as development impacted by IZ does not advance.
- Given the scale of PMTSA coverage in Toronto, larger impacts on the housing market as supply could occur, which would perpetuate affordability challenges as demand for housing in the GTA continues to increase.
- As IZ is a forward-looking policy, with the intention that developers will pay less for land to account for the reduced revenue potential as a result of IZ, the City of Toronto must account for developers who already own land and have purchased their property without accounting for IZ through adequate transition policies. Developers who already own land must be able to maintain a reasonable profit margin not just to make a return, but also to ensure that lenders will finance their projects.

This report therefore provides a basis of evidence to support the City in designing an IZ policy that can be implemented sensitively and in a nuanced way that accounts for the differing markets across Toronto. The core purpose of this report is to provide evidence of how IZ can be implemented without creating negative impacts across the housing market. If IZ is implemented in such a way, the negative consequences noted above can largely be avoided, resulting in the continued supply of market and affordable housing delivered by the private and non-profit sectors within the City's PMTSAs.

The findings in this evaluation of impacts use prototypical built form assumptions to illustrate how the conceptual approach to IZ might impact development viability across the City. The findings also demonstrate how site-specific conditions could impact the viability of an IZ approach from site to site. This aggregate information is intended to form a basis of evidence to inform the City' policy decision making.

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 fluctuating 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 has 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 and institutional 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 this has typically not occurred 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 continue to adjust as a result of the public health implications related to the novel coronavirus pandemic, COVID-19. The full impact on the economy from business closures and job losses is likely still months away from being fully assessed as business and income supports remain in place at the time of writing. While Canada has confirmed its intention to increase immigration beyond pre-pandemic levels, when this increased rate begins may be dependent on how long the pandemic persists.

The degree to which COVID-19 will have long term implications on real estate markets is currently unknown. However, the underlying fundamentals of Toronto's local real estate market, particularly throughout traditionally strong market locations, has remained strong to date through much of the pandemic.

In terms of the Toronto new condominium apartment market, after a slow spring, buyers returned in the second half of 2020, with monthly sales rates on par with historical trends and pricing spurred on by historically low interest rates. In the resale market, prices and transactions for low-density homes have reached record highs while demand in the resale condominium apartment market appears to be returning to pre-COVID levels in the first quarter of 2021 after softening through much of 2020.

The purpose-built rental market has experienced higher than typical vacancy rates which has meant that the price of market rental rates has remained mostly flat, or in some cases declined modestly. However, we expect that as offices begin to re-open, post-secondary students return to classes, and immigration increases, that demand for rental units will strengthen.

In our opinion, Canada is likely to remain an appealing place to do business. Demand to invest and migrate to Toronto is likely to only increase as we move forward. This, combined with a continued low-interest-rate environment, the GTA's highly diversified workforce, forecasts for increased immigration and a strong economic recovery, and the proven market appeal of Toronto all bode well for continued housing demand moving forward.

4.0 The Conceptual Inclusionary Zoning Policy

The following section summarizes the conceptual affordable housing approach evaluated as part of this update to the original 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 IZ 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);
- Permit additional density above the current approved zoning to offset the costs of an affordable housing component (i.e., a voluntary approach);
- Apply municipal financial incentives to the project to offset some of the costs of the affordable housing contribution; or,
- A combination of the previous two approaches above.

Determining the most appropriate approach is also complicated by the fact that Toronto's housing submarkets are diverse and ever evolving.

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. It is possible that future planning work could be completed around Protected Major Transit 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. Given the absence of emerging nature of PMTSA plans in Toronto, this reconciliation between future entitlement parameters and IZ requirements has not occurred but could be considered in future.

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; meaning that the policy had been well calibrated to local economics.
- 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.

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 as an incentive.

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. As PMTSA plans are introduced and approved, the ultimate policy approach for Toronto should be considered relative to market and planning considerations in PMTSA areas, as well as overarching municipal finance conditions.

4.2 The Overarching Framework of this IZ Testing

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 without these tools, in order to 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 pandemic. As noted earlier, we expect a period of softness in some market sectors. 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 diverse, 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.

4.3 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.

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

- The IZ policy applies to market condominium and purpose-built rental projects. Non-profit projects are not considered in the analysis.
- The IZ set-aside rate is based on a percentage of total residential GFA in any residential development. This differs from a policy which would only apply to the additional density achieved through rezoning.
- IZ units within a condominium building could be sold or rented for below market rates.
- There are no offsets or incentives provided in conjunction with the IZ set aside requirement.
- The IZ units must be maintained as affordable for 99 years.
- The unit mix for IZ units must mirror the unit mix of the market units.
- The quality of finishes is equivalent to market units and residents have access to the same amenities. By the same token, condominium fees are equivalent for IZ and market units.

Table 3

Summary of Tenure & Set Aside Rates Tested				
Type of Development	Tenure of IZ Units	Set Aside Rates Tested		
Condominium Apartment Building	Affordable Ownership	10%	20%	30%
Condominium Apartment Building	Affordable Rental	10%	20%	30%
Purpose Built Rental Apartment Building	Affordable Rental	5%	10%	20%

Table 4

Affordable Sale Prices and Rents Tested		
Unit Type	Affordable Sale Price	Affordable Rent
Studio	$197,900	$812
One Bedroom	$259,000	$1,090
Two Bedroom	$321,000	$1,661
Three Bedroom	$407,000	$1,858

Example: Permanent Affordable Ownership, the Whistler Housing Authority

The Whistler Housing Authority (WHA) was established to ensure that a large proportion of Whistler's current employees and retirees can live in that same community, where real estate values are high. The WHA owns units that can be either owned or rented, but the most outstanding success of the municipally owned corporation has been its ability to maintain permanent affordability throughout its ownership housing stock.

The key to the WHA program is maintaining a waitlist of qualified potential purchasers and the implementation of caps on resale values. The WHA ensures that at turnover, new buyers are taken from that same waitlist. The appreciation of resale value is linked to a preestablished index ensuring perpetual affordability. The WHA calculates the maximum resale value on these resale restricted units using either the Bank of Canada prime lending rates, the Greater Vancouver Housing Price Index, or most commonly, the Canadian Consumer Price Index.

The WHA model is one of the few affordable ownership housing models in Canada where units are held at below market rates in perpetuity. Most other programs offer one time affordability. The WHA owns more than 1,900 units.

5.0 Approach to Assessing Impacts

The following section describes the methodology for assessing the potential impacts of the policy, the parameters of the conceptual IZ policy, and the assumptions which underpin the analysis.

5.1 Modeling Methodology

Toronto is a very diverse marketplace. Our study therefore explores how the conceptual policy approach would impact the feasibility of a residential development in 11 submarkets across the City prior to, and following, the introduction of the conceptual IZ policy.

- The submarket areas were selected around transit stations or growth centres and included both strong and emerging market areas with existing or planned transit infrastructure improvements.
- Within each submarket, City staff provided NBLC with a prototypical development site and established assumptions of the built form that could reasonably be approved in a development application.
- We establish the value of the site prior to redevelopment based on typical existing uses and as-of-right zoning. 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 "as-is" or existing value of a site, (i.e., its value on an as-is, where-is basis) and forms the basis upon which we measure development viability. We do not consider the "as-is" land value to be what developers speculate the City of Toronto might approve through a rezoning or Official Plan amendment process.
- We then model the conceptual development scenario. The following table outlines the density and built form assumptions for each test site as provided by City staff.

Table 5

Summary of Prototypical Test Site Parameters						
Site No.	Market Location	Test Site Area (sm)	As-of-right Residential FSI	Density Parameters After Rezoning		
				No. Storeys	No. Units	FSI
1	Etobicoke Centre	3,800	3.5	28	212	4.4
2	Stockyard / Junction	4,400	3.0	12	266	4.8
3	Weston (NIA)	3,400	2.5	25	223	5.2
4	Finch West	2,800	1.0	8	207	5.8
5	Yonge Eglinton Centre	2,000	3.0	22	236	11.5
6	North York Centre	3,500	4.5	35	383	8.6
7	Downtown	2,600	5.0	47	564	15.7
8	Toronto West	3,700	2.0	22	370	7.3
9	Toronto East	700	2.0	6	32	3.8
10	Golden Mile	7,000	2.0	39	380	4.3
11	Scarborough Centre	4,500	2.0	41	401	7.0

- 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 (RLV) 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 first model the development scenario without the IZ policy to establish a base case land value. This represents the potential land value that might be achieved through a rezoning and reflects the price a developer could reasonably pay for the site absent the IZ policy. Where the redevelopment's land value exceeds the "as-is" land value by a 10% margin, we consider development to be viable prior to the introduction of an IZ policy.
- We test the viability of the development under both market purpose built rental and market condominium tenures.
- We then layer on the conceptual IZ policy under various set aside rates to determine whether the redevelopment project maintains a land value above the "as-is" land value plus a 10% margin. Where the land value meets or exceeds this test, we conclude that development can remain viable following the introduction of the policy.
- If the land value of the development scenario, with the IZ requirements, is not 10% greater than the "as-is" 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.

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 the land values supported through redevelopment to the land value of the site "as-is".

If the land value of any redevelopment scenario approaches (within 10%) or falls below the "as-is" value we conclude 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 land value the developer can afford to pay is not enough to motivate a landowner to close or relocate their business.

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 identify circumstances where the IZ policy creates challenging or unviable development outcomes. These will be the areas where we would expect to see development activity weaken or be delayed as a result of the IZ policy until the market can support higher pricing, density permissions are increased, or the IZ policy is amended to allow residential land values to rise above the "as-is" value of the property.

If the estimated land value of the redevelopment opportunity with IZ on the site exceeds the "as-is" 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.

It may also be true that where the test results demonstrate a viable policy outcome that land vendors would have to accept significantly lower land value than once anticipated. Where significant decreases in land value are shown as a result of IZ, it is possible that vendors of underutilized sites may be less willing to sell land in the near term. We strongly recommend that the City consider phasing and transition to mitigate this risk.

5.3 Financial Model Assumptions

The following is a list of assumptions which are common to all development scenarios tested:

- Every building is assumed to be a cast-in-place concrete apartment building. Hard construction cost estimates are sourced from the Altus Group *2021 Canadian Cost Guide*. The guide provides a range of costs based on building height. NBLC has graduated the cost assumptions to help smooth variations in results. Consistent with the *Cost Guide*, it is assumed that as buildings get taller, they become more costly to construct.
- An additional hard cost premium of 10% is assumed in the Downtown and Yonge-Eglinton test locations to acknowledge the common complexity of developing on a constrained site, often with heritage considerations or other extraordinary issues to manage.
- It is assumed that a developer must rezone the site, including an Official Plan Amendment, to permit the proposed project. The assumption regarding approved density was provided by the City.
- Municipal planning fees, development charges and taxes are calculated using the current rates as of May 2021.
- It is assumed the developer will pay Cash-In-Lieu of Parkland Dedication and a Community Benefit Charge equivalent to 10% and 4% of land value at time of building permit issuance, respectively.

- The model includes other soft costs such as consultants (architects, engineering, etc.), project management, legal, insurance and marketing fees.
- For construction financing, it is assumed the developer can borrow 75% of construction costs at 4.5% 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.
- Developer profit for condominium units is assumed to be 15% of gross revenue.
- Profit for purpose built rental and rented condominium units is assumed to be a 50 basis point spread to market capitalization rates. These profit margins are required for both market and below market units and form part of the residual land value equation.
- The capitalization rate for below market rental units is assumed to be 100 basis points greater than the market rental units. This spread to market cap rates is a high level estimate used to capture the risks associated with operating rent restricted units, namely the risk introduced by restriction on rent increases at vacancy and the increased exposure to operating expense increases which are not similarly restricted.
- The proforma modeling is focused on assessing the impacts of residential uses only and so commercial components of a project such as ground floor retail or office space has not been included in the analysis. 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 assumes that these spaces would have a break-even financial position.

The following table outlines key assumptions regarding the test site, prototypical development concept, and market inputs. A table appended to this report lists other key assumptions applied throughout the modeling exercise.

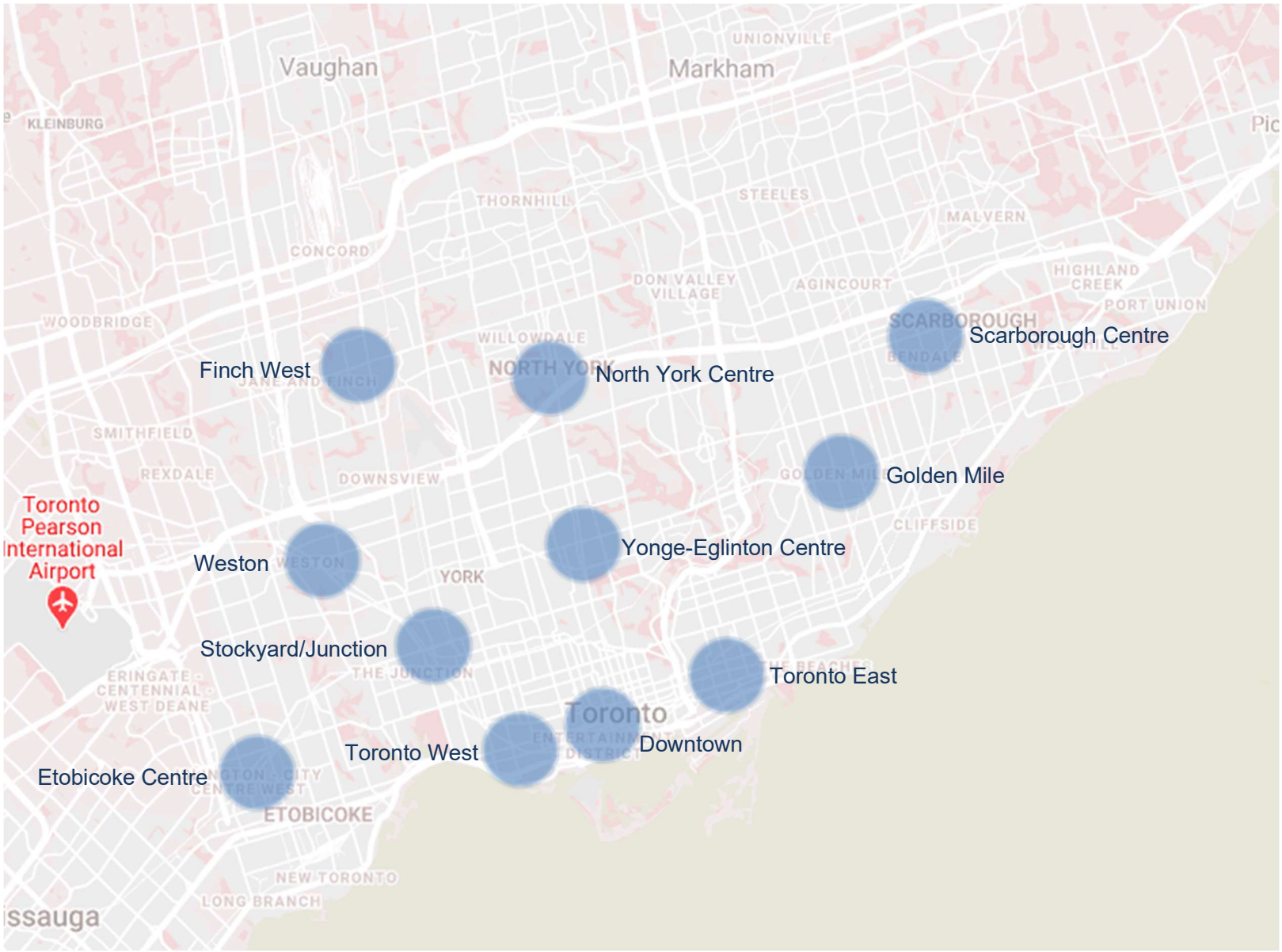
Table 6

Area Specific Model Assumptions													
	Building *		Units		Market Units						Affordable Units		
Market Location	Storeys	Gross Floor Area (sq. ft.)	Units	Avg. Unit Size (sq. ft.)	Condo Sales Absorption Rate (units per month)	Condo Pricing (per sq. ft.) **	Condo Parking Price (per stall)	Parking Ratio	Rental Pricing (per sq. ft.) **	Rental Parking Revenue (per stall per month)	Parking Ratio *	Affordable Sale Price (per sq. ft.) **	Affordable Rent (per sq. ft.) **
Etobicoke Centre	28	179,000	212	700	15	$925	$50,000	0.90	$3.25	$120	0.00	$418	$1.95
Stockyards / Junction	12	224,000	266	700	12	$975	$50,000	0.65	$3.40	$120	0.00	$418	$1.95
Weston (NIA)	25	188,000	223	700	10	$850	$50,000	0.80	$2.75	$90	0.00	$418	$1.95
Finch West	8	175,000	207	700	12	$850	$50,000	0.70	$3.10	$90	0.00	$418	$1.95
Yonge Eglinton Centre	22	199,000	236	700	20	$1,250	$85,000	0.35	$4.00	$200	0.00	$418	$1.95
North York Centre	35	323,000	383	700	20	$1,200	$70,000	0.80	$3.75	$200	0.00	$418	$1.95
TO Core	47	441,000	564	650	25	$1,450	$125,000	0.25	$4.25	$200	0.00	$440	$2.02
Toronto West	22	290,000	370	650	15	$1,200	$80,000	0.50	$4.00	$175	0.00	$440	$2.02
Toronto East	6	27,000	32	700	10	$1,250	$70,000	0.60	$3.80	$175	0.00	$418	$1.95
Golden Mile	39	320,000	380	700	15	$1,050	$50,000	0.90	$3.10	$100	0.00	$418	$1.95
Scarborough Centre	41	338,000	401	700	15	$950	$40,000	0.90	$3.25	$90	0.00	$418	$1.95

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

*** Average per unit mix*

Figure 3 – 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 policy makers to consider in the development of a potential IZ policy. However, this analysis cannot account for future unexpected shifts in economic conditions which may directly impact development viability, especially when the global pandemic is still current. The degree to which these considerations have long term implications on real estate markets is currently unknown. Sustained impacts to the macro-economic health of Ontario and Canada may warrant the reassessment of any emerging inclusionary zoning policy, especially in light of the current low-interest rate environment and public spending. Future cost and revenue increases in excess of the assumptions in our model are also possible.

This analysis assesses the impact of a conceptual IZ policy on prototypical developments in 11 Toronto submarkets to illustrate how the confluence of various development attributes may contribute to the success of a potential policy approach. A key feature of this analysis is that it incorporates a wide variety of site- and market-specific conditions. These variables include the as-of-right density permissions and existing land uses, density achieved through rezoning, market pricing, development costs, property constraints, and planning policy considerations, among others. This approach to assessing impacts is appropriate given the core features of the conceptual IZ policy tested in this work – that it is mandatory, applicable to all residential floor area, and does not include a mechanism to offset impacts. The results therefore present a spectrum of potential development outcomes in across the City's varying markets. However, variations in site-specific nuance will influence the degree to which IZ impacts the viability of development on a particular site.

This analysis also 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.

Any significant near term changes to Municipal charges (e.g., cash-in-lieu of parkland, development charges) may warrant further consideration of IZ impacts within a revised framework of municipal charges, planning entitlements and geographical considerations related to IZ.

This analysis isolates evaluations to one single development phase. However, in some transit areas, the nature of redeveloping areas is such that larger underutilized lot areas will result in multi-phase 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 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). Purpose-built rental apartment testing results could improve when these programs are considered. However, 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. Landowners may also have difficulty adjusting to the new market reality of IZ, potentially taking time for them to understand and appreciate why property values have been impacted. 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.

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 that are thought to be reasonable prototypes for development occurring under current market conditions within the premise of a willing buyer and a 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 Results

The results of the financial analysis are shown in the following tables. There are three key pieces of information included in each table:

- An estimate of the existing "as-is" value of each test site, estimated through a review of existing (under-utilized) uses and as-of-right density parameters;
- An estimate of the residual land value of the site if redeveloped absent the proposed Inclusionary Zoning policy. This has been labelled the "Base Case Market Land Value Before Inclusionary Zoning"; and,
- An estimate of the land value supported by the redevelopment with the Inclusionary Zoning policy in effect, including the magnitude of land value change in percentage terms versus a Base Case development.

The summary table displays green ('Viable') results in instances where the land values supported by residential redevelopment are more than 10% above "as-is" land value. Development scenarios that result in a residual land values that are less than 10% above "as-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 (i.e., redevelopment without IZ policies applied).

6.1 Density Matters

The amount of density that is anticipated to be approved through the rezoning is an important determinant as to whether a project is financially viable before an IZ policy is introduced and whether a site can remain viable for redevelopment after an IZ policy is applied.

The results of the Etobicoke test location provide a good illustration of this dynamic. The as-of-right density at this test site is 3.5 FSI and the rezoned density is 4.4 FSI, roughly a 25% increase in allowable building area. Prior to the introduction of the IZ policy and under the assumption the developer pursues a condominium development, this added density increases the land value from approximately $8 million to $9.6 million. This rezoned land value is approximately $1.6M, or roughly 20% greater than the "as-is" land value. This exceeds the 10% improvement to the "as-is" land value that we consider necessary for a landowner to sell the property for redevelopment, and so we conclude that the there is a viable opportunity to redevelop the property before an IZ policy is applied.

Table 7

Estimate of Land Value Impact of Inclusionary Zoning Policy
Purpose Built Rental Apartment Building with Affordable Rental IZ Units

	Test Site	Pre Inclusionary Zoning			Post Inclusionary Zoning - % GFA Rented at Below Market Rates								
		Estimated Total Value of Property "As-Is"	Base Case Market Land Value Before IZ Policy		5% of GFA Rented at Below Market Rates			10% of GFA Rented at Below Market Rates			20% of GFA Rented at Below Market Rates		
			Total	Development Viable Before IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy
1	Etobicoke Centre	$8,000,000	$1,400,000	Challenge	-$500,000	Challenge	> 50% Impact	-$2,400,000	Challenge	> 50% Impact	-$6,200,000	Challenge	> 50% Impact
2	Stockyards / Junction	$10,800,000	$17,800,000	Viable	$15,000,000	Viable	10% to 20% Impact	$12,300,000	Viable	30% to 50% Impact	$6,800,000	Challenge	> 50% Impact
3	Weston	$6,400,000	-$7,900,000	Challenge	-$9,200,000	Challenge	<10% Impact	-$10,400,000	Challenge	<10% Impact	-$13,000,000	Challenge	<10% Impact
4	Finch West	$5,400,000	$7,000,000	Viable	$5,400,000	Challenge	20% to 30% Impact	$3,800,000	Challenge	30% to 50% Impact	$500,000	Challenge	> 50% Impact
5	Yonge Eglinton Centre	$18,700,000	$25,200,000	Viable	$21,700,000	Viable	10% to 20% Impact	$18,200,000	Challenge	20% to 30% Impact	$11,100,000	Challenge	> 50% Impact
6	North York Centre	$21,500,000	$22,700,000	Challenge	$18,200,000	Challenge	10% to 20% Impact	$13,600,000	Challenge	30% to 50% Impact	$4,100,000	Challenge	> 50% Impact
7	TO Core	$35,800,000	$58,200,000	Viable	$49,700,000	Viable	10% to 20% Impact	$41,100,000	Viable	20% to 30% Impact	$23,900,000	Challenge	> 50% Impact
8	Toronto West	$17,900,000	$41,600,000	Viable	$36,600,000	Viable	10% to 20% Impact	$31,700,000	Viable	20% to 30% Impact	$21,800,000	Viable	30% to 50% Impact
9	Toronto East	$3,200,000	$4,200,000	Viable	$3,800,000	Viable	<10% Impact	$3,400,000	Challenge	10% to 20% Impact	$2,500,000	Challenge	30% to 50% Impact
10	Golden Mile	$9,000,000	$1,600,000	Challenge	-$1,600,000	Challenge	> 50% Impact	-$4,900,000	Challenge	> 50% Impact	-$11,400,000	Challenge	> 50% Impact
11	Scarborough Centre	$4,500,000	$6,800,000	Viable	$2,900,000	Challenge	> 50% Impact	-$900,000	Challenge	> 50% Impact	-$8,600,000	Challenge	> 50% Impact

Table 8

Estimate of Land Value Impact of Inclusionary Zoning Policy
Condominium Apartment Building with Affordable Rental IZ Units

	Test Site	Pre Inclusionary Zoning			Post Inclusionary Zoning - % GFA Rented at Below Market Rates								
		Estimated Total Value of Property "As-Is"	Base Case Market Land Value Before IZ Policy		10% of GFA Rented at Below Market Rates			20% of GFA Rented at Below Market Rates			30% of GFA Rented at Below Market Rates		
			Total	Development Viable Before IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy
1	Etobicoke Centre	$8,000,000	$9,600,000	Viable	$5,400,000	Challenge	30% to 50% Impact	$1,100,000	Challenge	> 50% Impact	-$3,300,000	Challenge	> 50% Impact
2	Stockyards / Junction	$10,800,000	$22,000,000	Viable	$16,200,000	Viable	20% to 30% Impact	$10,300,000	Challenge	> 50% Impact	$4,200,000	Challenge	> 50% Impact
3	Weston	$6,400,000	$6,100,000	Challenge	$2,200,000	Challenge	> 50% Impact	-$1,900,000	Challenge	> 50% Impact	-$6,000,000	Challenge	> 50% Impact
4	Finch West	$5,400,000	$12,500,000	Viable	$8,700,000	Viable	30% to 50% Impact	$4,900,000	Challenge	> 50% Impact	$1,100,000	Challenge	> 50% Impact
5	Yonge Eglinton Centre	$18,700,000	$37,100,000	Viable	$29,300,000	Viable	20% to 30% Impact	$21,300,000	Viable	30% to 50% Impact	$13,300,000	Challenge	> 50% Impact
6	North York Centre	$21,500,000	$51,100,000	Viable	$40,100,000	Viable	20% to 30% Impact	$28,800,000	Viable	30% to 50% Impact	$17,300,000	Challenge	> 50% Impact
7	TO Core	$35,800,000	$98,500,000	Viable	$79,700,000	Viable	10% to 20% Impact	$60,300,000	Viable	30% to 50% Impact	$40,400,000	Viable	> 50% Impact
8	Toronto West	$17,900,000	$52,200,000	Viable	$42,200,000	Viable	10% to 20% Impact	$32,000,000	Viable	30% to 50% Impact	$21,600,000	Viable	> 50% Impact
9	Toronto East	$3,200,000	$6,800,000	Viable	$5,700,000	Viable	10% to 20% Impact	$4,600,000	Viable	30% to 50% Impact	$3,400,000	Challenge	> 50% Impact
10	Golden Mile	$9,000,000	$27,900,000	Viable	$19,300,000	Viable	30% to 50% Impact	$10,500,000	Viable	> 50% Impact	$1,500,000	Challenge	> 50% Impact
11	Scarborough Centre	$4,500,000	$15,100,000	Viable	$7,500,000	Viable	> 50% Impact	-$300,000	Challenge	> 50% Impact	-$8,200,000	Challenge	> 50% Impact

Table 9

Estimate of Land Value Impact of Inclusionary Zoning Policy
Condominium Apartment Building With Affordable Ownership IZ Units

Test Site		Pre Inclusionary Zoning			Post Inclusionary Zoning - % GFA Sold at Below Market Rates								
		Estimated Total Value of Property "As-Is"	Base Case Market Land Value Before IZ Policy		10% of GFA Sold at Below Market Rates			20% of GFA Sold at Below Market Rates			30% of GFA Sold at Below Market Rates		
			Total	Development Viable Before IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy	Total	Development Viable After IZ Policy	Impact to Base Case Land Value After IZ Policy
1	Etobicoke Centre	$8,000,000	$9,600,000	Viable	$7,100,000	Challenge	20% to 30% Impact	$4,500,000	Challenge	> 50% Impact	$1,900,000	Challenge	> 50% Impact
2	Stockyards / Junction	$10,800,000	$22,000,000	Viable	$18,200,000	Viable	10% to 20% Impact	$14,400,000	Viable	30% to 50% Impact	$10,500,000	Challenge	> 50% Impact
3	Weston	$6,400,000	$6,100,000	Challenge	$3,900,000	Challenge	30% to 50% Impact	$1,600,000	Challenge	> 50% Impact	-$700,000	Challenge	> 50% Impact
4	Finch West	$5,400,000	$12,500,000	Viable	$10,300,000	Viable	10% to 20% Impact	$8,100,000	Viable	30% to 50% Impact	$5,900,000	Challenge	> 50% Impact
5	Yonge Eglinton Centre	$18,700,000	$37,100,000	Viable	$31,400,000	Viable	10% to 20% Impact	$25,600,000	Viable	30% to 50% Impact	$19,800,000	Challenge	30% to 50% Impact
6	North York Centre	$21,500,000	$51,100,000	Viable	$43,400,000	Viable	10% to 20% Impact	$35,600,000	Viable	30% to 50% Impact	$27,600,000	Viable	30% to 50% Impact
7	TO Core	$35,800,000	$98,500,000	Viable	$84,500,000	Viable	10% to 20% Impact	$70,200,000	Viable	20% to 30% Impact	$55,500,000	Viable	30% to 50% Impact
8	Toronto West	$17,900,000	$52,200,000	Viable	$45,100,000	Viable	10% to 20% Impact	$38,000,000	Viable	20% to 30% Impact	$30,700,000	Viable	30% to 50% Impact
9	Toronto East	$3,200,000	$6,800,000	Viable	$6,000,000	Viable	10% to 20% Impact	$5,200,000	Viable	20% to 30% Impact	$4,400,000	Viable	30% to 50% Impact
10	Golden Mile	$9,000,000	$27,900,000	Viable	$22,300,000	Viable	20% to 30% Impact	$16,500,000	Viable	30% to 50% Impact	$10,700,000	Viable	> 50% Impact
11	Scarborough Centre	$4,500,000	$15,100,000	Viable	$10,400,000	Viable	30% to 50% Impact	$5,700,000	Viable	> 50% Impact	$900,000	Challenge	> 50% Impact

However, the value created though the rezoning at the Etobicoke site is relatively modest when we compare this result to that of other test locations. For example, the as-of-right density permitted at the Scarborough Centre test location is 2.0 FSI but it is assumed that the developer could achieve 7.0 FSI through a rezoning. Where the rezoning at the Etobicoke site adds an addition 25%, or 37,000 sq. ft. of developable building area, the Scarborough Centre site gains nearly 250%, or roughly 240,000 sq. ft. of additional building area. That rezoning improves the Scarborough Centre land value from approximately $4.5M to $15.1M, an increase of $10.6M or approximately 236%.

The amount of value created through the rezoning therefore becomes very important as we layer on the IZ policy and increase the set-aside rate. In the policy approaches tested in this review, the entire impact of the policy will need to be absorbed by the land value. In the instance of the Etobicoke site, the increased density achieved through the rezoning would be insufficient to offset the loss of revenue at the lowest set aside rate tested.

Allowable density therefore becomes a key consideration to determining how much affordable housing can be leveraged through an IZ policy. Future PMTSA planning work will afford the City the opportunity to introduce density expectations for sites in tandem with the application of the IZ policy. It will be important that the allowable density is sufficient to support a land value in excess of the "as-is" value, before and after the IZ policy is applied, for new residential development to occur in the areas.

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 "as-is" land value to determine whether redevelopment is viable before and after an IZ policy is introduced. In areas where development land value is much higher than the "as-is" land value, a project could remain viable even if the IZ policy depresses the land value by a significant amount. In some instances, a 30% to 50% impact might be sustained while maintaining viability. That is, a residential developer could still afford to acquire land at a price greater than "as-is" value, despite the sizable impact on land value brought about by IZ. However, in other instances an impact to land value in the order of 10% to 20% can be enough to erode development viability.

Our analysis illustrates that a 10% set-aside rate for affordable ownership or rental units could likely be absorbed in condominium apartment projects across most of the test locations. As we approached a set aside rate of 20% only the strongest markets areas retained project viability. However, at a high set-aside rate land value impacts are significant and would require time for markets to adjust.

The ability of purpose-built rental projects to accommodate an IZ policy illustrated weaker results. Only the strongest market areas could sustain any IZ policy requirement. Most of these test sites became unviable above a 5% set aside rate.

Strong market locations support land values that are more likely to exceed the "as-is" land value. This margin is significantly smaller in areas with weaker market demand, or where the density increase through rezoning is relatively modest.

6.3 Markets Need Time to Adjust

In Toronto, developers typically acquire land on a speculative basis, based on their estimate 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 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.

In areas where viability is maintained, but where land values are significantly reduced as a result of IZ (e.g., with a 20% IZ scenario applied to condominium projects in the City's strong market locations), it is possible that landowners might defer the sale of land to a developer for housing, hoping that land values will increase. For developers who have purchased land, 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 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 locations outside of where the policy applies.

The City must clearly signal an emerging policy in order to ensure that future speculative land market activity can adjust to new economic considerations. This is not to signal that 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.

6.4 Impacts through Affordable Ownership

This latest update to our analysis seeks to understand the impact of affordable ownership units on development viability. The analysis shows that providing affordable ownership units has less of

an impact on development viability when compared providing affordable rental units. This is due the fact that the City's proposed definition of affordable condominium sale prices are significantly greater than the capitalized value of the same unit if rented for below market rates.

Financial impact aside, it would also appear that delivering affordable ownership units would be an easier process to administer as developers could likely expect that qualifying purchasers would remit purchase deposits in the same fashion that a market purchaser would during the predevelopment sales period. In addition, owners of these units, not the developer would be responsible for the ongoing ownership costs, including property taxes and condo fees.

6.5 Impacts on Emerging Markets

There are high density residential submarket locations in Toronto that are less mature, and the viability of development is only now just emerging. While the market opportunity for new high density development is growing across most submarkets city-wide, an IZ policy must acknowledge that economics of apartment (rental or condominium) development do not always support high land values when compared to other allowable land uses such as gas stations or retail uses.

Our analysis illustrated that in Weston and Etobicoke Centre a, IZ policy, at even very low set aside rates, would impact development viability for most types of residential development. Its also probable that, except for the Keele and Finch test site, that the balance of the Finch market area would also encounter viability issues with an IZ policy, even with the new LRT service.

This is not to suggest that IZ polices should not be considered in weaker markets. The Scarborough Subway Extension and the Ontario Line will create new stations that will dramatically transform some market areas and could be good candidates for IZ policies. The intersection of McCowan and Sheppard, at the terminus of the Scarborough Subway is a possible example. The opportunity for significant shifts in land value in these areas is strong. As land use permissions are being reconsidered at these future station areas, so should the inclusion of IZ policies.

Other areas may also emerge in the future as suitable for IZ policies as demand and pricing improves. As the City monitors its IZ policies it should anticipate these market changes and opportunities for IZ expansion.

6.6 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 similar amount on a percentage basis (notwithstanding some exceptions).

Despite a similar reduction in land value, the impact on viability through an IZ policy could be different. Depending on the price of development 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.

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).

It becomes apparent that due to the factors noted above, IZ would negatively affect new rental projects to a greater degree than condominium projects. The economics of housing development already favour condominium projects in terms of their ability to compete for land and the

introduction of an IZ policy would worsen this dynamic. The results indicate that even a modest set aside rate could reduce land values to zero, or negative values.

6.7 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 public policy implications with a limed period of affordability are not optimal; from an affordable housing policy perspective, longer affordability timelines are best.

6.8 Impacts on Affordability

As discussed in prior sections and our previous reporting, an impact of an IZ policy would be to reduce 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.

6.9 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.

7.0 Conclusions

Inclusionary Zoning presents a long-term policy opportunity which could yield a continuous supply of affordable housing units for the City. This analysis demonstrates that there are locations across Toronto where market demand and the density achieved through a typical rezoning process may be sufficient to absorb the IZ policy as tested. The overall impact of the IZ policy in all markets would be a decrease in total development revenue. If we assume that pricing remains relatively stable, these impacts would be absorbed by reduced land values.

The majority of Toronto's residential apartment development activity occurs within the Downtown, the Yonge Corridor and in North York along the Subway lines. 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 in these areas without jeopardizing development viability.

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

- IZ should be viewed as a forward-looking policy that will be in-force over the long term. From a land economics perspective, implementing an overly aggressive IZ policy could result in negative consequences if land acquisition and development activity stalls. The impact of an aggressive policy will not become apparent for many years as there is a significant lag between when the decision is made to acquire land and begin the development process, and when new housing is finally delivered to end users. Should the City realize that the policy is too burdensome and need to later reduce the IZ requirement, the clarity and intentions for affecting long-term policy goals and economic outcomes might be undermined. It is crucial that the policy be introduced at a modest level, which can be increased over time as market conditions permit.
- The City should clearly communicate when the policy will come into force and how the policy parameters such as the set aside rate may change over time. The City should consider a transition period before the policy is introduced to allow the market to clear any projects which are currently under development. The length of the transition period should reflect the time it takes for typical development to receive zoning and site plan approval, understanding complex and large projects may require special accommodation. Following the transition period, the City should introduce the policy gradually over a phase-in period starting with a low IZ set-aside rate with specified, periodic increases. Overall, the City's approaches to implementation should ensure that markets are able to adjust, allowing new development lands to be priced accordingly and sites which are currently in pre-development stages to proceed.

- The IZ policy should be developed alongside development entitlements in each PMTSA. A successful IZ policy requires a measure of clarity in station area plans to form the basis by which future land values can be established. While not tested in our study, we also believe that the new station areas being created with the Scarborough Subway extension and the Ontario Line could also offer significant opportunities to consider for IZ policies.
- The high-density residential market is geographically diverse. Therefore, IZ is not achievable in a uniform fashion without offsetting measures and/ or a transition framework to support development in weaker submarkets. The City should consider whether PMTSA's could have different set-aside rates to allow for market variances, working to calibrate affordability requirements in tandem with allowable densities determined through future planning processes. Generally speaking, set-aside rates can increase with allowable densities, but market strength must be considered carefully when calibrating a rate.
- Further, the City should consider whether varying set aside rates should be applied to the delivery of affordable ownership and affordable rental units in order to prioritize the delivery of units that best suit the profile of affordable housing need in the City. This is premised on the assumption that developers, not the City, will have discretion in selecting the tenure of affordable units created through IZ. This consideration should also apply to the delivery of market ownership or purpose-built rental projects, to acknowledge the varying economic performance and land value capacity of those projects.
- In all cases, the calibration of set aside rates and definitions of affordability should be communicated clearly to the market so that developers, non-profits, and landowners can plan accordingly.
- The City should explore 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 through the project.
- IZ policies need to be paired with program details regarding who owns and operates units and the types of agreements that would be registered on title to ensure that the policy is implemented and sustainable through operation. The City should also develop a framework to maintain oversight of the depth and duration of affordability and unit types as necessary. The development of a clear framework remains an ongoing process for the City as it considers its role and capacity along with that of key stakeholders.
- The IZ policy should be revisited at regular intervals to ensure that the policy is responsive to the economic realities of the day. The Toronto real estate market evolves rapidly. The

recent volatility caused by the COVID-19 pandemic emphasizes 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 PMTSA plans are advanced, a final implementation framework is in place, and as market conditions evolve.

Appendix – Model Assumptions

Table 10

Financial Model Assumptions		Notes
Hard Costs		
Above Grade Construction Cost - Concrete Apartment	$230 to $333	*per sq. ft. Varies by height. Midpoint of range provided in Altus Group 2021 Canadian Cost Guide*
Below Grade Construction Cost	$180	*per sq. ft. Midpoint of range provided in Altus Group 2021 Canadian Cost Guide*
Hard Cost Premium for Constrained Sites	10.00%	*of hard costs. Applies to TO Core and Yonge Eglinton test location*
Servicing Connection Cost	$500	*per unit*
Landscaping & Hardscaping	$1,000	*per unit*
Demolition & Site Preparation	$15	*per sq. ft. of site area*
Contingency Factor	10.00%	*of Hard Costs excluding cost inflation*
Soft Costs		
Planning Application Fees		
OPA and ZBL - Base Fee	$42,152	*total*
OPA and ZBL - Additional Fee	$8.29	*per sq. m.*
Site Plan Application - Base Fee	$22,638	*total*
Site Plan Application - Additional Fee		
500-700 sq. m.	$15.96	*per sq. m.*
700-1,400 sq. m.	$12.34	*per sq. m.*
1,400-4,400 sq. m.	$8.01	*per sq. m.*
Over 4,400 sq. m.	$3.98	*per sq. m.*
Plan of Condominium - Base Fee	$9,983	*total*
Plan of Condominium - Additional Fee	$27.61	*per unit*
Building Permit Fees		

Hourly Examination Fee	$85.79	*per hour. Analysis assumes 1 hour of examination time per 1,000 sq. ft. GFA*
Residential Unit Fee	$52.08	*per unit*
Multiple Unit Building Index	$17.16	*per sq. m.*
Development Charges & Other Exactions		
Apartments 1 Bed and Bach.	$33,358	*per unit*
Apartments 2 + Bedrooms	$51,103	*per unit*
Educational Development Charges	$2,993	*per unit. May 2023 rate*
Cash-In-Lieu of Parkland & Community Benefit Charges	14.00%	*of land value at time of permit*
Property Tax Rate	0.60%	*of project value*
Ontario & Toronto Land Transfer Tax	4.00%	*of land value at acquisition*
Consultants, Project Management, Legal, Insurance, Marketing, Development & Construction Management	14.50%	*of hard costs*
Sales Commission Fee	4.00%	*of sales revenue*
Lender's Administrative Fee	0.80%	*of loan value*
Construction Loan Interest Rate	4.50%	*per year*
HST Rate	13.00%	
Condominium-Specific Assumptions		
Condominium Profit Margin	15.00%	*of gross revenue*
Initial and Final Deposit	20%	*of sale price*
Price Increase at Start and End of Construction	2%	*of sale price*
Sold During Pre-Construction / Presales	70%	*of units sold*
Sold During Construction	20%	*of units sold*
Sold at Completion	10%	*of units sold*
Time Prior to Land Sale	0.5	*years*
Time to Begin of Marketing after Land Purchase	1.5	*years*
Occupancy Period Prior to Registration	0.5	*years*

Rental-Specific Assumptions		
Vacancy & Bad Debt	2.00%	*of gross effective income. Applicable to all rental units*
Operating Expenses - Purpose Built Rental Buildings	36.00%	*of gross effective income, including property taxes.*
Operating Expenses - Rental Units in Condominium Building	$0.85	*Excluding property tax. Property tax variable per market value of unit*
Strong Market Rental Capitalization Rate	3.00%	*Lower bound for Multifamily in CBRE Q1 2021 & Colliers Q4 2020 Cap Rate Reports*
Moderate and Other Market Capitalization Rate	3.25%	*25 bps greater than strong markets*
Affordable Rental Capitalization Rate – Spread to Market	1.00%	*100 bps greater than market purpose-built rental units*
Rental Profit Margin	0.50%	*greater than market capitalization rate*
Rental Absorption Rate	8%	*of units per month*
Valuation Assumptions		
Market Revenue Inflator	2.00%	*per year. Applicable to market rental and ownership prices*
Affordable Revenue Inflator	1.50%	*per year. Applicable to affordable rental and ownership prices*
Cost Inflation	2.00%	*per year*
Discount Rate	6.00%	*per year*

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