Staff Report

Development Services Department

www.kitchener.ca

REPORT TO:	**Planning & Strategic Initiatives Committee**
DATE OF MEETING:	**September 28, 2020**
SUBMITTED BY:	**Justin Readman, General Manager of Development Services 519-741-2200 ext. 7646**
PREPARED BY:	**Tim Donegani, Senior Planner 519-741-2200 ext. 7067**
WARD(S) INVOLVED:	**3, 9, 10**
DATE OF REPORT:	**September 14, 2020**
REPORT NO.:	**DSD-20-150**
SUBJECT:	**Inclusionary Zoning for Affordable Housing: Background and Fiscal Impact Analysis**

RECOMMENDATION:

THAT Council Report DSD-20-150 (Inclusionary Zoning for Affordable Housing: Background and Fiscal Impact Analysis) be received.

BACKGROUND:

The City's Housing Needs Assessment prepared as part of Phase 2 of the Affordable Housing Strategy demonstrated unserved needs for affordable housing across the housing continuum for low, moderate and middle income households. Municipalities have a range of planning and financial tools to support and enable the creation of affordable housing. Inclusionary Zoning (IZ) is a new tool that allows municipalities to require residential developments to include affordable housing units. When used alongside federal, provincial, regional and local initiatives, IZ can be effective in increasing the supply of affordable housing. Inclusionary zoning is one of the actions included in the draft Affordable Housing Strategy that was received by Council in August.

The provincial requirements for developing and adopting an IZ program are summarized in Appendix A. IZ can only apply to multi-residential developments with 10 or more units within Major Transit Station Areas (generally within 500-800 metres of ION stops). Prior to approving an inclusionary zoning by-law, municipalities must first prepare a housing assessment report to understand local demographics and housing supply and demand. Kitchener has largely addressed this requirement through the completion of its Housing Needs Assessment presented to Council in January 2020. Municipalities must also conduct a financial impact study to evaluate the viability of development under an inclusionary zoning framework. The City, in partnership with City of Waterloo, City of Cambridge and Region of Waterloo contracted consulting firm N. Barry Lyon Consultants Limited to carry out a financial impact study included as Appendix B. This work is being undertaken through the Kitchener-Waterloo Joint Services Initiative. Staff at all four municipalities continue to collaborate on data sharing, analysis, stakeholder engagement, policy development and action planning towards common affordable housing objectives.

*** This information is available in accessible formats upon request. ***
Please call 519-741-2345 or TTY 1-866-969-9994 for assistance.

Inclusionary Zoning has been used extensively in the United States and some Canadian cities. While several other Ontario municipalities are working to advance inclusionary zoning, no IZ policies have been adopted yet.

How Does Inclusionary Zoning Work?

Inclusionary zoning works by leveraging increases in density and value achieved through development approvals, investment in LRT and increasing demand for centrally-located housing to provide affordable housing. In this way inclusionary zoning programs can be designed to work without government subsidies.

Because inclusionary zoning programs result in lower revenues for developers through lower rents or sales prices than would otherwise be the case, the provincial legislation requires that IZ programs be designed to ensure that residential development continues to be financially viable for private market housing providers. Key considerations that affect the achievement of affordable housing objectives and influence development feasibility include:

- The "set aside" rate (proportion of units required to be affordable),
- the duration of affordability, range of household incomes addressed by the affordable units, and
- the tenure of affordable units (rental vs. ownership).

Where the economics of site development cannot support inclusionary zoning on its own, programs can include measures to offset the financial impact so that the development projects become financially viable. They can also be used to deepen the degree of affordability to serve a broader range of household incomes. Measures could include the phasing in of the program, increased height or density permissions, or financial incentives.

REPORT:

Financial Impact Analysis Approach and Key Findings

NBLC's financial impact study uses an approach called residual land value (RLV) analysis to test if prototypical residential projects in 10 Major Transit Station Areas across the Region are financially viable under four scenarios:

1. No IZ policy
2. 10% of units are required to be priced at the affordable benchmark[1]
3. 5% of units are required to be priced at 60% of the affordable benchmark
4. Determine the maximum viable set aside rate that could be supported at the affordable benchmark

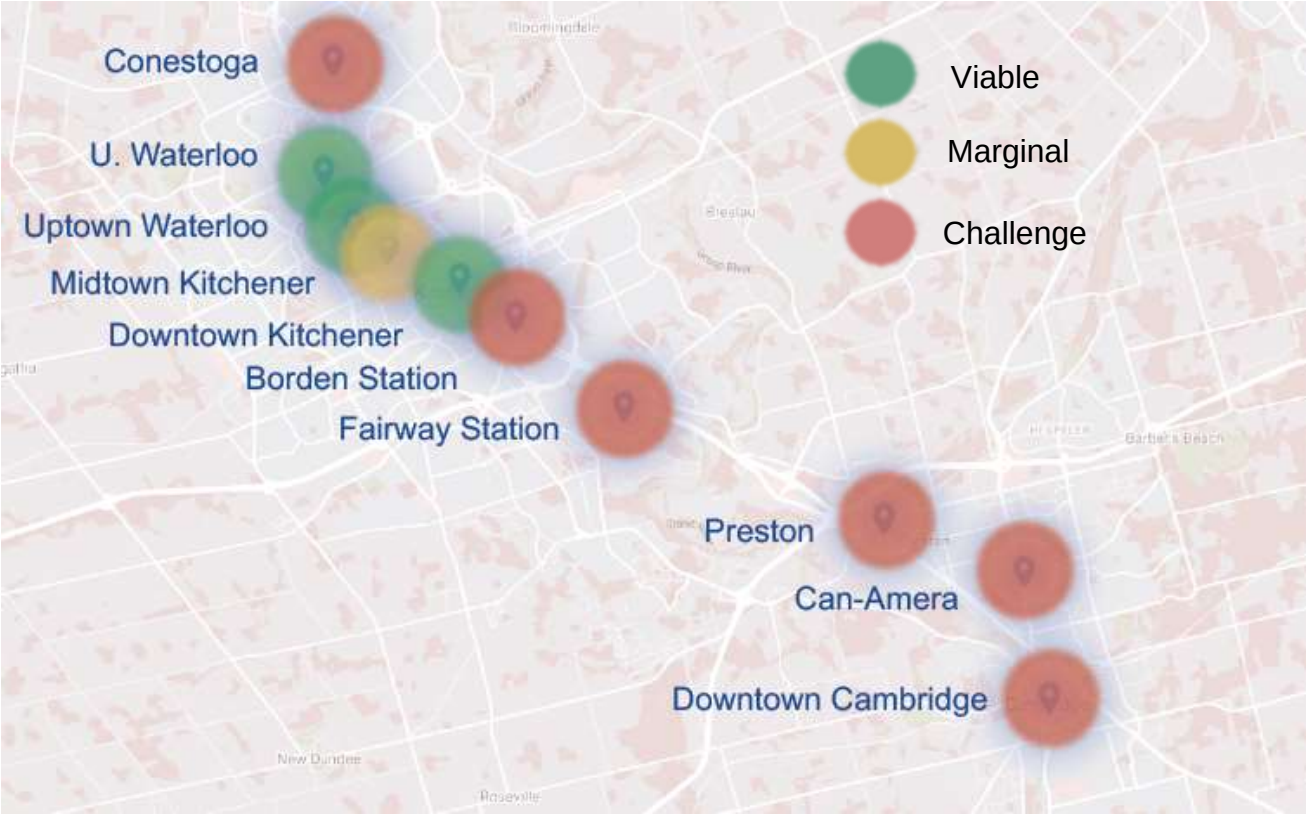
Fiscal Impact Analysis Highlights

- The costs of inclusionary zoning cannot be passed onto the market rate units in a building through higher prices/rents because developers are already pricing units as high as the market will bear.
- Developer profits are not reduced under IZ. Without the prospect for sufficient profit, developers will not be motivated to build.
- Instead, an inclusionary zoning policy will put downward pressure on land value.
- If an inclusionary zoning policy is too onerous, land value will be reduced by too much, so a residential redevelopment project cannot displace the existing land use and will not be viable.

[1] Affordable Rental Benchmark: Bachelor $810/mo; 1 Bedroom $1,045/mo; 2 Bedroom $1,231/mo; 3 Bedroom $1,300/mo
Affordable Ownership Benchmark: $350/square foot

- A modest and carefully designed inclusionary zoning policy is financially viable in the near term in some Major Transit Station Areas with the strongest residential market conditions.
- Major Transit Station Areas are not all equally capable of delivering new units through IZ as illustrated in Figure 1, and in more detail on pg 54-59 of Appendix B. Currently, IZ policy is viable in a few MTSAs but not others. A geographically uniform approach to IZ is not recommended. Instead, the initial focus of Inclusionary Zoning should be on MTSAs with strong residential markets.
- The analysis does not include any new municipal incentives. NBLC's model can be used to quantify how incentives could help achieve more affordable units, deeper levels of affordability, or longer duration than policy alone.
- In weaker submarkets, the policy framework should be set up now, with very low affordability requirements in the near term. These requirements can increase gradually as weak submarkets improve. IZ can deliver a modest but meaningful number of affordable units in the near term. There is significant value however in setting up an IZ framework to prepare for a more ambitious policy as development economics improve in the future. Frequent monitoring and adjustment of an IZ policy is critical.
- Cities should provide an early signal to residential developers and MTSA landowners that an inclusionary zoning policy is coming. When coupled with transition policies, this approach provides time for the market to adjust to an inclusionary zoning policy and minimize land market disruption.
- This analysis is limited to a point in time. Residential development economics are dynamic due to changing construction costs, changes in the real estate market due to COVID-19, the introduction of Bill 108, Bill 197 and its impacts on Development Charges, Community Benefit Charges, Density Bonusing and Parkland dedication.

Figure 1 - Financial Viability of Inclusionary Zoning – Condominium with 10% of units as permanently affordable rental units - 100% of Average Market Rent



Peer Review

Per provincial regulations, the Cities retained the consulting firm urbanMetrics to provide a peer review of NBLC's study. Their review, included as Appendix E, confirms that NBLC's study meets the statutory requirements, confirms the appropriateness of the methodology, key assumptions, findings, their interpretation and recommendations. urbanMetrics' suggestions surrounding the complexity of monitoring and maintaining affordability in perpetuity will require consideration in the next phase of this project.

What We Heard

Engagement to date has focused on key stakeholders from the development and affordable housing advocacy communities. These conversations are further detailed in Appendix B. Highlights include:

- In person meetings with key MTSA residential developers to introduce the project and learn about their concerns
- Zoom meeting with 49 key development industry and affordability advocate stakeholders regarding preliminary study findings
- One-on-one follow up meetings with key developers to verify study pro formas with real world examples
- Project webpage https://www.engagewr.ca/inclusionary-zoning launched on April 1
- Presentation to Affordable Housing Strategy Advisory Committee
- Council Strategy Session
- Meetings with Yes in My Backyard Waterloo Region (affordability advocates)

Conclusions and Next Steps

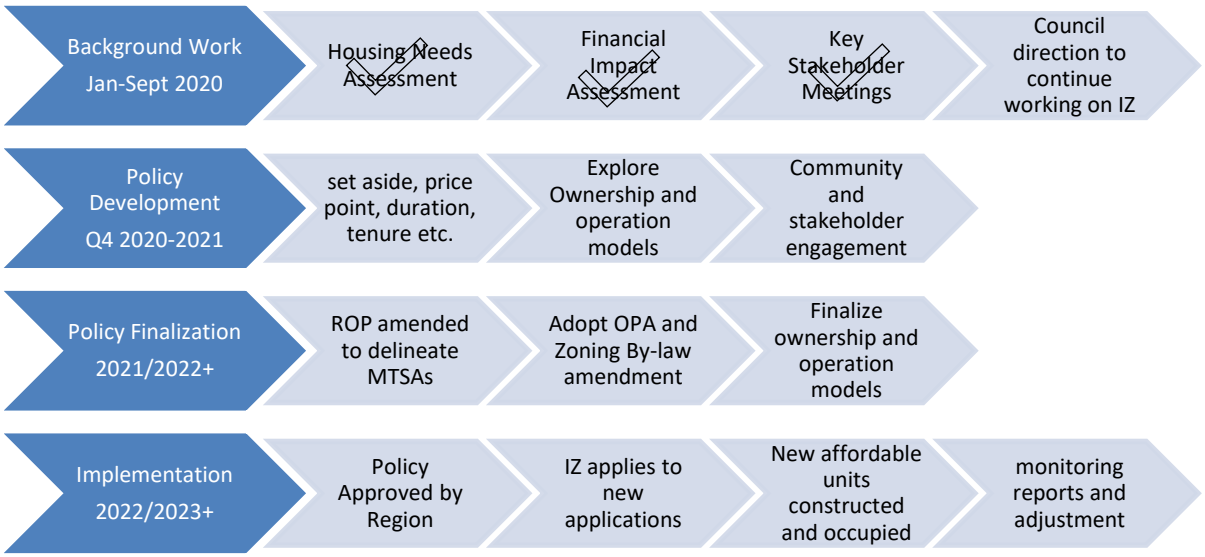
Inclusionary Zoning policy has potential to deliver a modest but meaningful number of affordable units within market developments. The study shows that under today's development economics, IZ is fiscally viable in Downtown and Midtown. Using Kitchener's standard growth management assumption that half of the total number of units currently allowed in zoning will be constructed, there is potential for up to 1,500 affordable rental units in the long term. If residential development economics improve, the IZ policy could be expanded to other MTSAs to deliver more affordable units.

IZ is one tool that can be used alongside policy and investment by Local, Regional, Provincial and Federal governments together with the suite of actions identified in Kitchener's Affordable Housing Strategy to achieve affordability objectives. Staff recommend that Inclusionary Zoning warrants further research, policy and program development and broader community consultation. Staff recommend that these principles guide this next step.

1. **Affordability -** Secure affordable housing that is not otherwise being provided by the market.
2. **Partner with development community–** To achieve housing targets the City needs developers to build new affordable units under IZ. Residential development projects must continue to be viable.
3. **Minimize land market disruption –** Provide early signals and transition time for the land market to adjust to IZ
4. **Long term sustainability –** IZ policy should be viable without financial incentives. Incentives may be used to achieve affordability objective beyond what is supported by land economics

Appendix C is an initial list of policy and program questions to be considered in the next phase. Staff plan to continue to collaborate with the Cities and Region. The integrated nature of our residential real estate markets would make it challenging for any one municipality to implement this kind of policy in isolation. Furthermore, collaboration provides more staff resources, opportunities to cost share, economies of scale in program delivery, and ultimately better policy. Staff at the municipalities intend to continue to work together on policy and program development and report back to Council.

Key milestones



ALIGNMENT WITH CITY OF KITCHENER STRATEGIC PLAN:
2019-2022 Strategic Plan – Caring Community Theme
Strategic Plan Goal: Enhance people's sense of belonging… by helping to make housing affordable.
Strategic Plan Action: Create an Affordable Housing Strategy for Kitchener by 2020 in collaboration with Waterloo Region, community groups and the development industry.

FINANCIAL IMPLICATIONS:
Most of the work in developing an IZ policy, regulations and program will be completed by staff, and are included in departmental work plans. However, the consultant's report and peer review both recommend frequent monitoring and adjustment of an IZ policy to ensure its success. An update or addendum to the fiscal impact model report is likely required, prior to implementation to account for COVID-related changes to development economics, market conditions and changes in legislation that affect soft cost. This required update will likely have resource implications that are currently unbudgeted. Staff are exploring opportunities to build capacity to undertake monitoring and financial modeling in-house, potentially in collaboration with the partner municipalities.

Staff are proposing to develop an inclusionary zoning framework that is sustainable without municipal financial contribution or subsidies towards providing affordable units. Should Council wish to achieve additional affordability objectives above what is supported by land economics, financial incentives may be required. The cost of implementing an IZ policy and program will be considered in a subsequent report. Staff have identified a potential for the non-profit housing sector (e.g. Kitchener Housing) to provide mutually beneficial assistance with ownership and operation of affordable units long-term.

COMMUNITY ENGAGEMENT:
Given the technical nature of this stage of the project, community engagement was primarily addressed to key stakeholders, informing them about this tool and the fiscal impact study and receiving feedback.

- In person meetings with key MTSA residential developers to introduce the project and learn about their concerns
- Zoom meeting with 49 key development industry and affordability advocate stakeholders regarding preliminary study findings
- One-on-one follow up meetings with key developers to verify study pro formas with real world examples
- Project webpage https://www.engagewr.ca/inclusionary-zoning launched on April 1
- Presentation to Affordable Housing Strategy Advisory Committee
- Council Strategy Session
- Meetings with Yes in My Backyard Waterloo Region (affordability advocates)

The next phase of the project will include broad based community engagement, including but not limited to the questions included in Appendix C.

PREVIOUS CONSIDERATION OF THIS MATTER:
DSD-19-134 – Affordable Housing Strategy – Work Program Overview
DSD-20-006 - Affordable Housing Strategy Phase 2: Housing Needs Assessment
DSD-20-034 - Council Strategy Session – Affordable Housing Issues and Options
DSD-20-108 – Draft Housing Strategy

REVIEWED BY: Karen Cooper, Manager, Strategic and Business Planning, City of Kitchener
Michelle Lee, Senior Policy Planner, City of Waterloo
Valerie Spring, Senior Planer - Reurbanization, City of Cambridge

Judy Maan Miedema, Principal Planner, Region of Waterloo

ACKNOWLEDGED BY: Justin Readman, General Manager of Development Services
APPENDICES:

Appendix A: Provincial Requirements for an Inclusionary Zoning Study
Appendix B: Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning Policy
Appendix C: Key Questions to be answered in next phase
Appendix D: What we heard
Appendix E: Peer Review Letter of Opinion on Inclusionary Zoning Financial Impact Analysis Report

Appendix A - Inclusionary Housing Assessment Information Requirements

Inclusionary Housing Assessment and Monitoring Requirements - (From Ontario Regs)

An assessment report required by subsection 16 (9) of the Act shall include information to be considered in the development of official plan policies described in subsection 16 (4) of the Act, including the following:

1. An analysis of demographics and population in the municipality.
2. An analysis of household incomes in the municipality.
3. An analysis of housing supply by housing type currently and planned for in the municipality.
4. An analysis of housing types and sizes of units that may be needed to meet anticipated demand for affordable housing.
5. 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.
6. An analysis of 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:
    - i. value of land,
    - ii. cost of construction,
    - iii. market price,
    - iv. market rent, and
    - v. housing demand and supply.
    - Provincial policies and plans and Official plan policies

A written opinion on the analysis from a person independent of the municipality and who, in the opinion of the council of the municipality, is qualified to review the analysis.

Monitoring reports to include:

1. The number of affordable housing units.
2. The types of affordable housing units.
3. The location of the affordable housing units.
4. The range of household incomes for which the affordable housing units were provided.
5. The number of affordable housing units that were converted to units at market value.
6. The proceeds that were received by the municipality from the sale of affordable housing units.

Appendix B

The Cities of Cambridge, Kitchener, Waterloo & Region of Waterloo

Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning Policy

April 2020

nblc
N. Barry Lyon Consultants Ltd.

nblc
Trusted advisors since 1976.

The Cities of Cambridge, Kitchener, Waterloo & Region of Waterloo

Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning Policy

Table of Contents

Executive Summary ii

1.0 Introduction 1

2.0 Housing Prices and Costs – Fundamental Factors 3

3.0 Market Context 10

4.0 The Conceptual Inclusionary Zoning Policy 23

5.0 Approach to Assessing Impacts 29

6.0 Analysis 38

7.0 Conclusions 51

Appendix A –Financial Result Mapping 54

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 Province of Ontario has adopted legislation that will allow the creation of affordable housing through inclusionary zoning (IZ) by-laws. The Province defines Inclusionary Zoning as a land-use planning tool that a local municipality may use to require affordable housing units (IZ units) to be included in residential developments of 10 units or more in accordance with the Planning Act of Ontario. Prior to adopting policies or enacting zoning by-laws that require affordable housing to be included in new developments the Province requires a comprehensive study (Municipal Assessment) to be undertaken to justify the need for affordable housing and to ensure the inclusion of affordable housing is economically feasible for a developer.

The Cities of Cambridge, Kitchener, Waterloo, and the Region of Waterloo are in the process of evaluating the feasibility of inclusionary zoning in their respective municipalities, and commissioned NBLC to examine the economic feasibility of adopting an IZ policy in transit-oriented submarkets across these municipalities. However, before a municipality can adopt an IZ policy/by-law, they must complete a Municipal Assessment Report to understand local demographics and housing supply and demand. An important component of this report is the undertaking of an analysis of the potential impacts that may arise from an IZ policy/by-law. As per regulation 232/18, the Province requires that municipalities analyze potential impacts on the housing market and on the financial viability of development by taking into account: the value of land; cost of construction; market price; market rents; and, housing demand and supply.

Most of the policy experience with IZ has been in the United States. In most jurisdictions where IZ has been successfully implemented, the central principle is that development density is increased to offset the requirement for some affordable housing. In certain instances, there are also financial programs utilized (tax incentives, etc.), but it is the exchange of density in strong market areas for affordable units that has underpinned the success of these policies. The Province appears to have acknowledged this reality by mandating that the application of IZ be limited to Protected Major Transit Station Areas (MTSA), where municipalities are required to adopt Official Plan policies and zoning by-laws in order to come in conformity to the Growth Plan. There are many areas across the municipalities of Cambridge, Kitchener and Waterloo where high-density planning permissions are already in place, which could influence the feasibility of Inclusionary Zoning in MTSAs. As such, the municipalities have directed NBLC to test impacts from IZ when the policy is applied to a percentage of total development yield, as opposed to a percentage of units as a result of an uplift in development density. This analysis demonstrates where there are signals that an IZ approach of this nature could be successful.

Of note, this analysis was completed without the benefit of a finalized regulatory framework pursuant to the More Homes, More Choice Act, 2019 (Bill 108 & Bill 197). With direction from Municipal and Regional staff we have therefore made certain assumptions with respect to municipal fees and charges in this work. Further review may be required once the regulations have been implemented, along with any emerging Community Benefits Charge by-laws.

Approach

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

- The policy framework is forward looking. It considers the implications for development if a developer were to pursue land acquisition and development under current market conditions.
- A range of affordable unit requirements are tested, starting with a requirement (or, "set-aside rate") of 10% of all residential Gross Floor Area (GFA) in a building, then testing for the maximum amount of inclusion for each test area under a base land value assumption ("as-is, where-is").
- No new incentives or offsets such as tax incentives or bonus development density were considered in this testing. However, existing development incentives in each municipality were captured.

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

Key Variables:	Base Case Tests		Sensitivity Tests	
	Limited Timeline	Permanent Affordability	Deeper Affordability	Higher Set-Aside Rate
Set-Aside Rate % of Total GFA	10%	10%	5%	Max % viable (cap at 20%)
Depth of Affordability for IZ Units	100% AMR, $350 psf Ownership	100% AMR, $350 psf Ownership	60% AMR, $210 psf Ownership	100% AMR, $350 psf Ownership
Period of Affordability*	25-years	Permanent	25-year/ Permanent	25-year/ Permanent

** Period of affordability applies only to rental scenarios*

The municipalities of Cambridge, Kitchener and Waterloo make up a diverse marketplace. Our study explores how an IZ policy approach would impact the feasibility of residential development in 10 submarkets along existing/ planned higher order transit. The following summarizes our methodology:

- Submarket areas were selected around existing higher order transit, or emerging market areas with existing and/ or planned transit infrastructure investments.
- In each of the 10 submarkets we developed prototypical development concepts based on emerging development trends in consultation with City staff. Concepts envision a development that might be achievable based on current policies, or, through a future development application.

- At each location we first estimated the base land value of a typical development site given the nature of existing land uses. The "as-is, where-is" value.
- For each submarket we undertook research to assess local pricing which was 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 and the developer's profit. What remains is land value.
- We tested a prototypical purpose-built rental and condominium project in each submarket based on the development concepts developed with staff. Our first test of development land value was with market revenue estimates and no affordable housing requirement.
- We then estimated land value based on the same development scenarios with the IZ policy options noted earlier.
- If the land value supported by the high-density development opportunity, with IZ requirements included, falls below, or is not 10% greater than the as-is, where-is value of the property, we assume the IZ policy would not be feasible. (Under this circumstance we assume that the owner of the land would not be motivated to sell for high density residential purposes). However, if the resulting land value, with IZ policies considered, remains at least 10% greater, there is a viable economic opportunity for affordable housing to be required in a development.

Findings

- This review has demonstrated that IZ policies may be economically feasible in certain, strong market areas. In these specific MTSA areas, the current and anticipated future market is likely to have the capacity to absorb the decrease in revenue that results from an IZ policy.
- However, the Region's market areas are highly variable. Applying the same policy in a weaker market area could discourage new investment. As this report will show, there is a large degree of variability between municipalities and market areas. Moreover, a product of this analysis is a model that can be used to test various scenarios and future changes in these markets.
- From a land economics perspective, the impact of an IZ policy is to cap a development's revenue (a price ceiling). Assuming that developers will always price their market units at the maximum the market will bear. That is, the costs of IZ cannot passed on to market rate purchasers or renters. If units could be still sold or rented at higher prices, developers would do that in order to maximize profits, irrespective of an IZ policy being in place. Therefore, the impact of the revenue decrease is to reduce the value that can be paid for land. When land value is reduced below that of the existing use of the land, the motivation for the land to be redeveloped is seriously reduced and investment potential lowered.
- Since 2001 high density residential condominium pricing has accelerated a rate greater than costs. This has allowed land values to continue to climb despite significant increases in

construction costs and municipal fees. However, if pricing were to stabilize – or decline – while costs continued to rise, developers would naturally pay less for land

- If IZ were to be applied uniformly without acknowledgement of market nuance, the downward impact on land values could discourage residential investment. However, the downward pressure IZ puts on the land value for residential projects could make non-residential uses such as office or retail development better able to compete for land in key intensification areas such as major transit station area locations.
- In instances where the supported land value of a development falls below the base (as-is, where-is) value of a property, development could be discouraged or delayed until the market demand for housing in the area supports higher pricing.
- A long-term IZ policy approach will allow land markets to adjust and developer expertise to grow. As the high-density residential markets in Waterloo Region continue to mature, there is the potential to create new affordable housing units over time. However, it will be important to gradually introduce and 'ramp up' IZ expectations as the markets adjust so that there is not an unintended shock to market activity that might otherwise impact new housing supply.
- In weaker market areas where intensified residential development and affordable housing are an objective, targeted financial incentives – potentially through a local Community Improvement Plan(s) – may be required to off-set the reduction in revenue caused by affordable unit requirements.
- If a policy was applied in weaker market areas without offsets such as density increases or tax incentives, IZ policies could have negative impacts on affordability in two inter-related ways:
    - By eroding the feasibility of projects, thus reducing the supply of housing, which at a macro level can put upward pressure on net demand (and pricing) of available units; and,
    - Assuming land values cannot be reduced below the base land value and that profit margins are fixed, the cost of delivering the least expensive entry-level apartment units within a project could also increase. This specifically relates to what are typically the smallest and lowest priced suites in high density projects; commonly a small percentage of the overall suite mix.
- The modeling demonstrates a need to strike a balance with policy direction that allows for developers to remain attracted to market development opportunities and advance affordable housing objectives. The continued redevelopment of key market areas helps increase the supply of housing, achieving other planning and economic objectives. And, through continued development activity, the outcomes of IZ can begin to be realized.

Recommendations

The municipalities have a range of implementation options that have the potential to yield a steady supply of affordable housing units using Inclusionary Zoning. The financial testing in this analysis demonstrates that this may be especially true in the strongest market areas of the cities. As Waterloo, Kitchener and Cambridge consider their potential IZ policies, we offer the following recommendations:

1. **Ensure clarity in development entitlements.**

- Develop the IZ framework alongside clear development entitlements in each MTSA. A successful IZ policy requires a measure of clarity in as-of-right zoning to form the basis by which land values are established. If there is no clarity around development potential in station area planning, developers will be forced to pay what they view to be approvable through rezoning in combination with market demand, and less about what might be legally permissible as-of-right.

- There are market locations today (e.g. Downtown Kitchener) where a significant degree of forward-looking planning work has already been put in place. If developers have already paid for anticipated density in advance, the ability to fund affordable housing, without a transition policy, could be undermined in the near term. This notion was reinforced through changes resulting from Bill 108 which would require that zoning be updated prior to IZ applying in Protected Major Transit Station Areas. Implementing IZ provisions should limit the speculative nature of land purchases through increased certainty.

2. **Consider transition and offsetting policies and incentives.**

- IZ policies must acknowledge the varied and nuanced characteristics of the local market area. Within current market conditions, high density market residential development is not ubiquitous, therefore IZ is not achievable in a uniform fashion without offsetting measures and/ or a transition framework from municipalities to support development in weaker markets.

- Consider implementing IZ policies in parallel with a framework to support development in weaker market zones. This could include Community Improvement Plans

- In working to calibrate each municipality's policy responses with market realities, the municipalities should also consider a phase in period starting with a low IZ percentage target (set-aside rate) with annual increases; and, an announcement to the market that the IZ policy will come into force in a certain period of time. Both approaches would allow markets to adjust and for sites which are currently in pre-development stages to proceed and allow land to be priced accordingly.

- Municipal financial incentives could be offered as a measure to 'top-up' to improve on level of affordability. While the provision of additional density as an approach to offset IZ costs is preferable from a municipal finance perspective, unless expectations around development

densities in the selected market areas are subject to significant revision, it is possible that the opportunity to use as of right density as an offsetting measure may be limited in some areas. However, this should be explored through future MTSA work and considered where feasible from a planning perspective.

3. **Balance IZ goals with broader development objectives.**

- Avoid implementing high levels of inclusion in market areas where new development investment is being encouraged and the market for new residential investment is currently weak. Moreover, outside of the Galt and University of Waterloo market areas, there is limited evidence to support a viable policy outcome for inclusionary zoning policies which are applied to purpose-built rental housing.
- For an IZ program to have an enduring impact on affordability in the region, the municipalities should seek affordability for units created through IZ in perpetuity, where possible. The use of municipal financial tools could also be considered to facilitate an extended period, increase the number of affordable units produced, or deepen the level of affordability, in some instances.

4. **Consider a framework for implementation and evaluation.**

- The regional marketplace is competitive, where possible it is encouraged that the Municipalities continue to work on developing IZ frameworks in tandem so that investment activity is not influenced simply by the absence of an IZ policy.
- IZ policies need to be paired with program details regarding who owns and operates the units and the types of agreements that would be registered on title to ensure that the policy is implemented. This represents a next step for the municipalities as they consult with council and stakeholders and begin to frame a preferred policy approach in each community.
- Update the IZ policy at regular intervals to ensure that the policy is nimble and able to adjust to the economic realities of the day; namely land values, residential unit pricing and construction costs. Of note, this analysis was completed without fully phased in Community Benefits Charge policies relating to Bill 108/197. Moreover, at the time of drafting this report considerations relating to novel coronavirus COVID-19 are impacting global markets. Illustrations of policy and market fluctuations like this emphasize the need for flexibility and regular monitoring of potential IZ policies throughout the municipalities.

This analysis cannot account for 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 from the perspective of each municipality once MTSA plans are advanced.

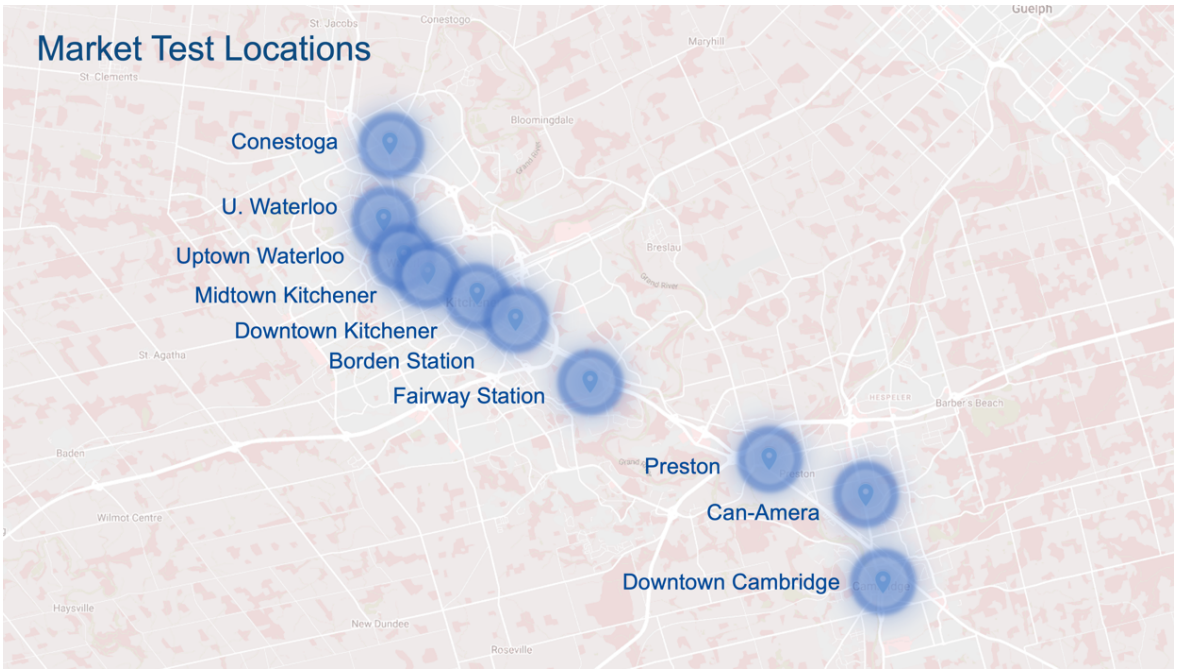
1.0 Introduction

The Cities of Cambridge, Kitchener and Waterloo retained N. Barry Lyon Consultants Limited (NBLC) to assess the feasibility of Inclusionary Zoning in residential development in select Major Transit Station Areas as a result of potential implementation of Inclusionary Zoning (IZ) policies. This analysis considers impacts across prototypical development forms in various transit station area locations, three in Waterloo, four in Kitchener, and three in Cambridge.

The Province of Ontario has adopted legislation that will allow the creation of affordable housing through Inclusionary Zoning techniques. The Cities of Cambridge, Kitchener and Waterloo are in varying stages of developing strategies to address housing affordability; part of this work includes evaluating the potential market feasibility and long tern benefits of Inclusionary Zoning. As part of this review, the Municipalities are required to evaluate the potential impacts of an IZ policy on development viability.

This study reviews the possible impact of a potential IZ policy using market research and a financial model to consider the land value implications for developers that would need to acquire land in today's market in order to proceed with a development. Achievable development density and market dynamics are established for a range of market locations throughout the municipalities in order to consider the nuance of varying market dynamics. Through an understanding of the subtleties between various markets, we examine how the costs of requiring affordable housing could impact the viability of a typical development.

Figure 1



Of note, this analysis was completed without the benefit of a detailed regulatory framework related to Community Benefits Charges (CBCs) pursuant to the More Homes, More Choice Act, 2019 (formerly Bill 108) and Bill 197, The COVID-19 Economic Recovery Act, 2020. At the time of writing, a proposed Community Benefits Charge approach had been tabled and was subject to ongoing consultation and pending regulation. Further review or consideration could be warranted once final regulations are implemented. This analysis assumes that existing development charge and parkland acquisition policies remain unchanged.

Furthermore, this analysis is timely in that it contributes to the identification of potential Protected Major Transit Station Areas to allow for the preparation of implementing IZ policies and zoning to meet the Province's "A Place to Grow: Growth Plan for the Greater Golden Horseshoe, 2019" ("Growth Plan") conformity timeline (2022) requirements.

2.0 Housing Prices and Costs – Fundamental Factors

This section reviews how housing prices and costs are established and the connection between these two fundamental factors that impact real estate development. The effect of an IZ policy would be to exchange the additional density achieved on a site through a planning application process (assuming most development is not built to as-of-right permissions) for affordable housing units. This would reallocate a portion of a residential development's yield to affordable housing, decreasing available project revenue.

2.1 Factors Influencing the Price of Housing

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

Figure 2

Demand	Supply
○ Population growth and projections	○ Sale values & absorptions of other marketing projects "the competition"
○ Demographics and incomes	○ Project positioning, interior features & finishes & amenities at competitive projects
○ Target purchaser groups	
○ Purchaser preferences	○ Review of development applications to understand future supply/ competition
○ Local employment opportunities	
○ Site/ market strengths & weaknesses	○ Sale values & market performance of the resale market "secondary competition"
○ Location & neighbourhood amenities	○ Review of development applications to understand future supply/ competition
○ Lending rates & regulations	○ Growth and land use policies affecting future development patterns
○ Future/ planned transit investments	

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

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

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

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

Unlike market units, prices for affordable units are fixed at a rate below what the market will bear. Since IZ policies require developers to include a certain proportion of affordable units in their development, the IZ policy has the effect of reducing the total potential revenue of a development due to the reduced revenue associated with the affordable units. The loss of revenue is proportional to the number of affordable units.

2.2 Factors that Influence the Cost of Housing

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

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

5. Hard Construction Costs
6. Soft Development Costs
7. Developer Profit
8. Land Costs

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

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

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

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

2.2.2 *Soft Development Costs*

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

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

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 shift depending on the approvals required, size of the property, value of the land (cash in lieu of parkland), the Section 37 agreement negotiated, changes to development charges, and others. Increases to development related charges therefore directly increase the soft development costs of delivering new homes.

Of note, refinements to the Planning Act through the implementation of a Community Benefits Charge (CBC) framework may further impact the types and amounts of fees that municipalities are permitted to collect for a development, which in turn could increase or decrease a developer's total soft costs. Further updates to this analysis should be considered once final regulations are implemented and municipalities begin to develop CBC By-laws.

2.2.3 *Developer Profit*

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

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

2.2.4 *Land Acquisition Cost*

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

2.3 Increased Costs Primarily Impact Land Values

Understanding that sales prices/ rental rates (revenue) are largely independent from costs, developers must seek to transfer additional costs to others in order to mitigate risk and maintain appropriate returns. Developers are investing their skills, time and equity to make a profit. If an acceptable profit level cannot be achieved by passing on costs, they will either invest in a new community, delay development or select another investment vehicle. Therefore, where costs increase – or revenues decrease, in the case of IZ – a proportional increase in revenue, or decrease in land value, must occur to keep a project viable assuming developer margins remain the same.

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

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

favourable; or, cancels the project. Though our discussions with local developers it is apparent that there have been recent instances where local developers have had to compress their profit margins in order to make projects work in light of unforeseen hard cost increases occurring after land has been purchased. In our view, significant profit margin compression is not sustainable for the industry over the long term. To the extent possible at this order of magnitude, this analysis reflects up-to-date cost expectations for high-density development in the Waterloo Region.

Since 2001 high density residential condominium pricing has accelerated a rate greater than costs. This has allowed land values to continue to climb despite significant increases in construction costs and municipal fees. However, if pricing were to stabilize – or decline – while costs continued to rise, developers would naturally pay less for land.

2.4 Understanding Land Values for High Density Projects

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

Project revenues are driven by the sale value of homes as well as other sources such as parking spaces, storage lockers, and ground-floor commercial space within an apartment building. Once project revenues have been estimated, developers will then begin to calculate all anticipated hard and soft project costs. As illustrated by **Figure 3**, 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, is referred to as the Residual Land Value (RLV). The RLV represents the maximum price a developer could pay for the land to construct the housing project while maintaining a desired profit margin.

The RLV will result in one of two scenarios:

- **RLV is equal to or higher than the asking price of land in the market:** If the RLV of a proposed development is greater than the asking price of the land in the market, a developer can, in theory, purchase the land and build the project while meeting their profit expectation.
- **RLV is below the asking price of land in the market:** In this situation, the housing development would not be considered viable because a developer could not pay the asking price of land and still maintain their minimum profit margin.

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 residential development is depressed due to the impact of an IZ policy to $2.0M, then we assume the owner would continue to use the property for its current use. The owner would not be motivated to sell.

Figure 3

Understanding Residual Land Value

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

If revenue decreases, costs increase on a percentage basis compared to revenue, as is true in the case of an IZ scenario. Therefore, the amount subtracted from the project's revenue will also increase, which results in a lower RLV. In other words, the developer would pay less for the development site because costs have increased.

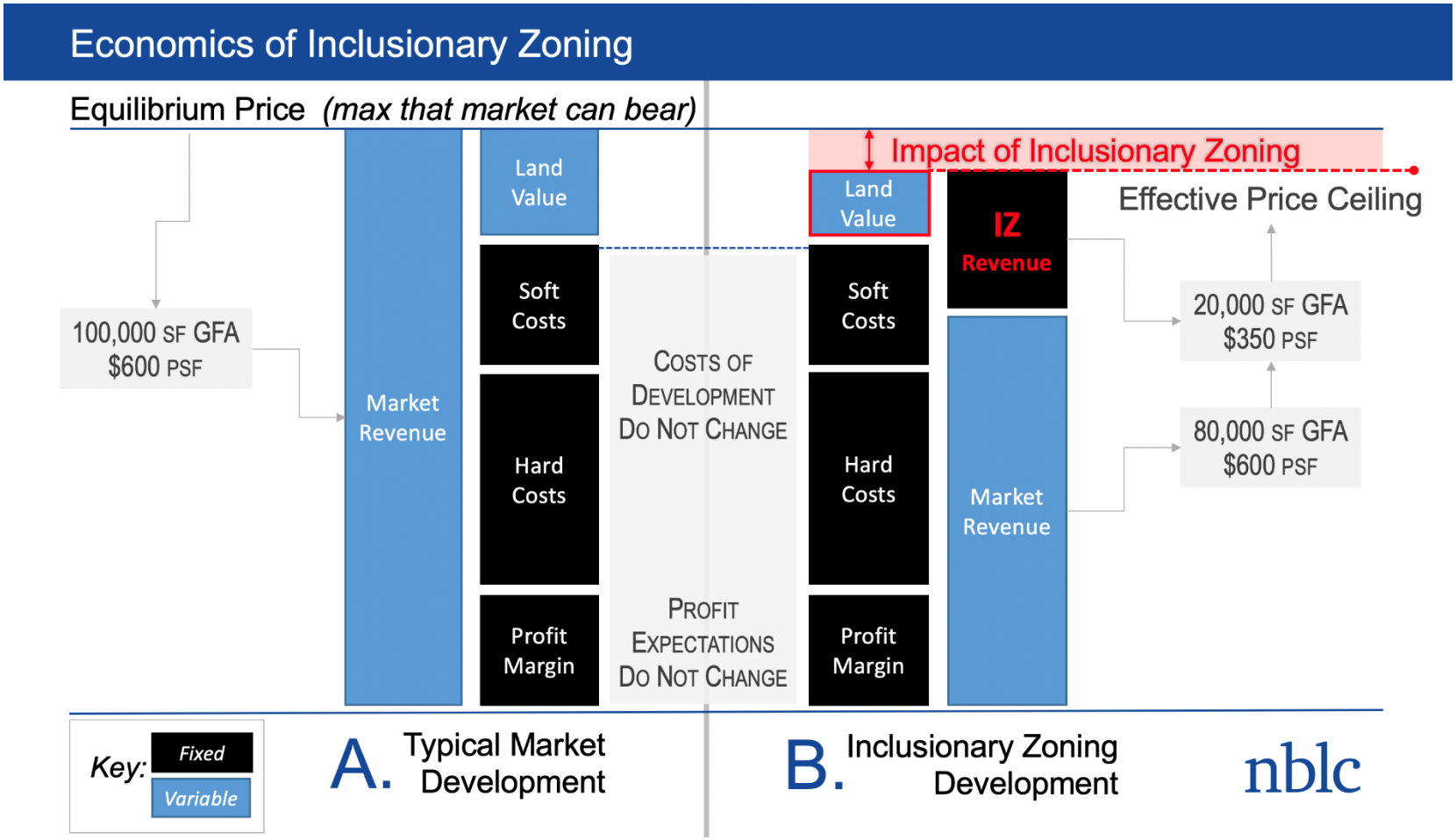
The RLV is impacted because the other elements of the equation (**Figures 3 & 4** are generally fixed. Developers are not likely to reduce their profit expectation as discussed earlier in this report. Developers also cannot simply increase the price of homes beyond what the market will support. If the market does support an increase in the price of new homes, developers are likely to increase pricing regardless of any change in costs.

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 by increasing the sale value of homes at pricing beyond what is supported in the market. Rather, if soil remediation works were to require $1.0M in added project costs, the developer should seek to pay $1.0M less for the property.

The following analysis uses this premise to estimate the potential impacts of an IZ policy across various market locations in Cambridge, Kitchener and Waterloo. The model estimates the impact to residual land value resulting from the IZ approach (relative to the amount that a developer might have paid for a market development prior to IZ), and compares that to the base value of land (based on the value of a typical underutilized land use, i.e. the value of a 'soft site' as-is, where-is).

If the land value supported by redevelopment after IZ is still greater than the base (as-is, where-is) land value, development would be viable. If the redevelopment's land value is lower than the base land value, development would be infeasible. **Figure 4** illustrates the key differences between a typical redevelopment proforma, and one with IZ.

Figure 4


Economics of Inclusionary Zoning
Equilibrium Price (max that market can bear)
100,000 SF GFA
$600 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
$600 PSF
Key:
Fixed
Variable
A. Typical Market Development
B. Inclusionary Zoning Development
nblc

3.0 Market Context

The tri-city area is one of the fastest growing urban centres in the Province. These positive conditions are driven by a combination of intra-provincial migration and growing number of non-permanent residents. This growth is likely a result of families seeking relatively affordable housing outside of the GTA, coupled with attractive job opportunities, as well increasing enrollment and a desire to attract a greater share of international students at any of the region's top-ranked universities and colleges. These market forces, combined with a program of public and private investment in the region (e.g. improvements to transit) and attractive lifestyle offerings (e.g. jobs, recreation opportunities and lifestyle amenities) make the region particularly appealing for a broad range of buyer/ renter households, across age cohorts, whether Canadians, temporary residents or newcomers.

These positive market attributes will continue to drive demand for new housing. As the supply of grade-related housing options reduce and affordability concerns intensify, there will naturally be a shift towards higher density housing formats. This shift will continue as congestion worsens across the region and more residents rely on higher-order transit service for daily travel, resulting in stronger demand for transit-supportive locations, and market acceptance of reduced parking ratios. This assumes development sites are walkable to existing LRT or BRT service and/ or Phase 2 LRT or expanded GO service once operational in Cambridge.

At the time of writing this report, global markets are beginning to adjust as a result of the public health implications related to a novel coronavirus pandemic. The degree to which COVID-19 will have long term implications on real estate markets is currently unknown. However, the underlying fundamentals of these local real estate markets, particularly throughout central market locations, have been positive. We expect that over time, the market will rebound. Although, near-term implications could impact the financial considerations in this evaluation.

3.1 Relative Affordability will Contribute to Demand for Condominium Apartments

Housing affordability in the Region has eroded in dramatic fashion over the past five years, driven by job growth in the area and spillover demand from higher-priced municipalities closer to the centre of the Greater Toronto Area. As of the fourth quarter (Q4) of 2015, the median price of a two-storey detached home in the tri-city area was $363,000, and by Q4 2019, the median price increased by 52% to $553,000. While appreciating in value at a similar rate (47%), the median price of a condominium apartment is generally more attainable as of Q4 2019 at $326,000.

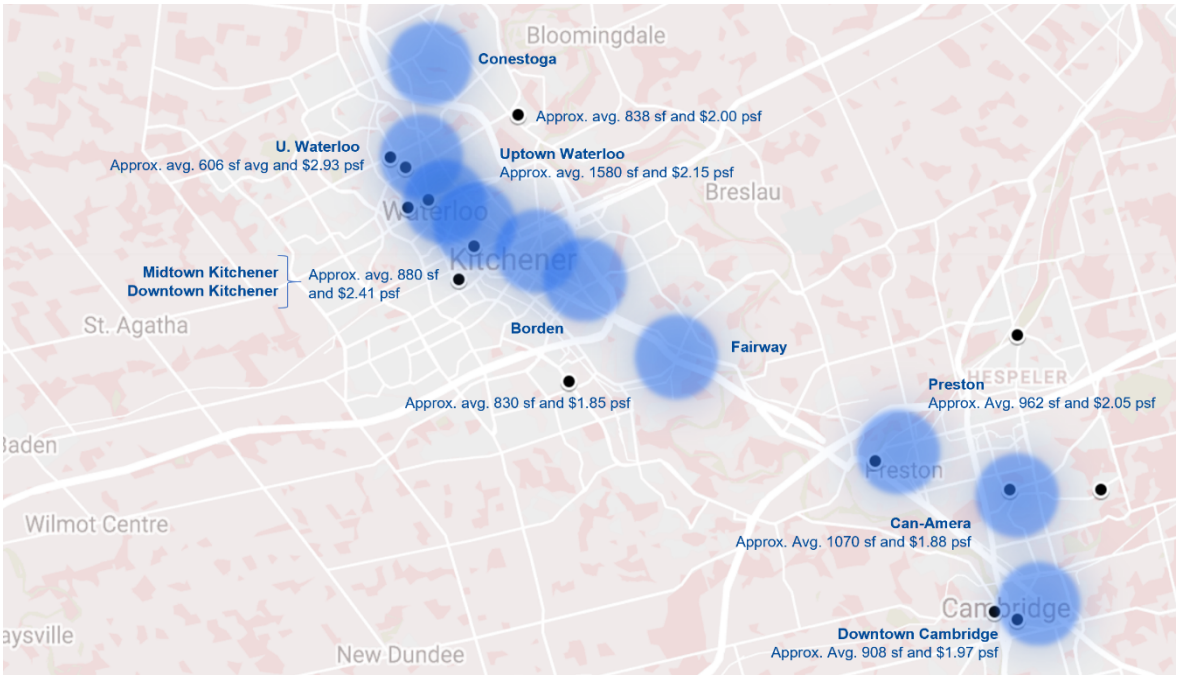
By comparison, the median after-tax income of an economic family rose at a much slower pace, from $72,790 to $81,598 between 2010 and 2015, representing a total increase of just 12.1% or an annualized increase in income slightly over 2.0%. When income statistics and housing prices are held in comparison, it becomes clear that incomes are not keeping pace with the price appreciation of the most popular housing format of 12% to 13% per year, on average. This points to eroding housing affordability across the region. Kitchener's Housing Needs Assessment (2020) shows similar, but more acute issues in that City.

The region's overall appeal, low interest rates and a positive economic environment (stable and diverse job opportunities) and spillover demand will continue to underpin future housing demand and support price growth. Moving forward, a lack of supply and limited range of choice in the resale market is likely to be a challenge for buyers trying to buy their first home, move-up from their current residence, or downsize. Pricing appreciation will support a shift in market demand toward more affordable and higher density housing formats. This trend is generally observed across other central areas of the GTA.

3.2 Rental Demand is Strong

Rental demand appears to be strong from a cursory scan of vacant and available supply across the station areas selected as test locations in this review. All station areas surveyed have at least one new purpose built rental project completed since 2013, with a total of 14 projects across the 10 station areas. Rental demand is generally fueled by a greater proportion of non-permanent (student) residents, and affordability issues related to the high cost of home ownership and changing preferences. This is particularly true among millennials who look towards rental tenure as an alternative to ownership forms in the tri-city area; rental opportunities remove the down payment barrier. This barrier to entry is skewed upwards given a greater supply of detached homes throughout the market (typically representing about 60% to 70% of resale activity). Downsizers are also playing a role here; demand at projects like the Barrelyards and Drewlo's buildings at the south end of Kitchener – among others – has been driven largely by this market segment.

Figure 5 – Location of New Purpose-Built Rental Apartment Projects (completed in the past 10 years) Pricing and Sizing by Station Area, based on Available Inventory as of January 2020



Source: N. Barry Lyon Consultants Limited; Marketing Materials; Listing Agent Phone Calls.

While there was limited choice (vacant or available) at the time of survey, new purpose-built projects in more suburban station areas typically offer greater value, through a combination of larger suite sizing and/ or lower index pricing. In comparison, rental projects in Kitchener's Midtown and Central station areas and Uptown Waterloo have higher index-pricing.

3.3 Majority of New High-Rise Supply falls within Central Areas

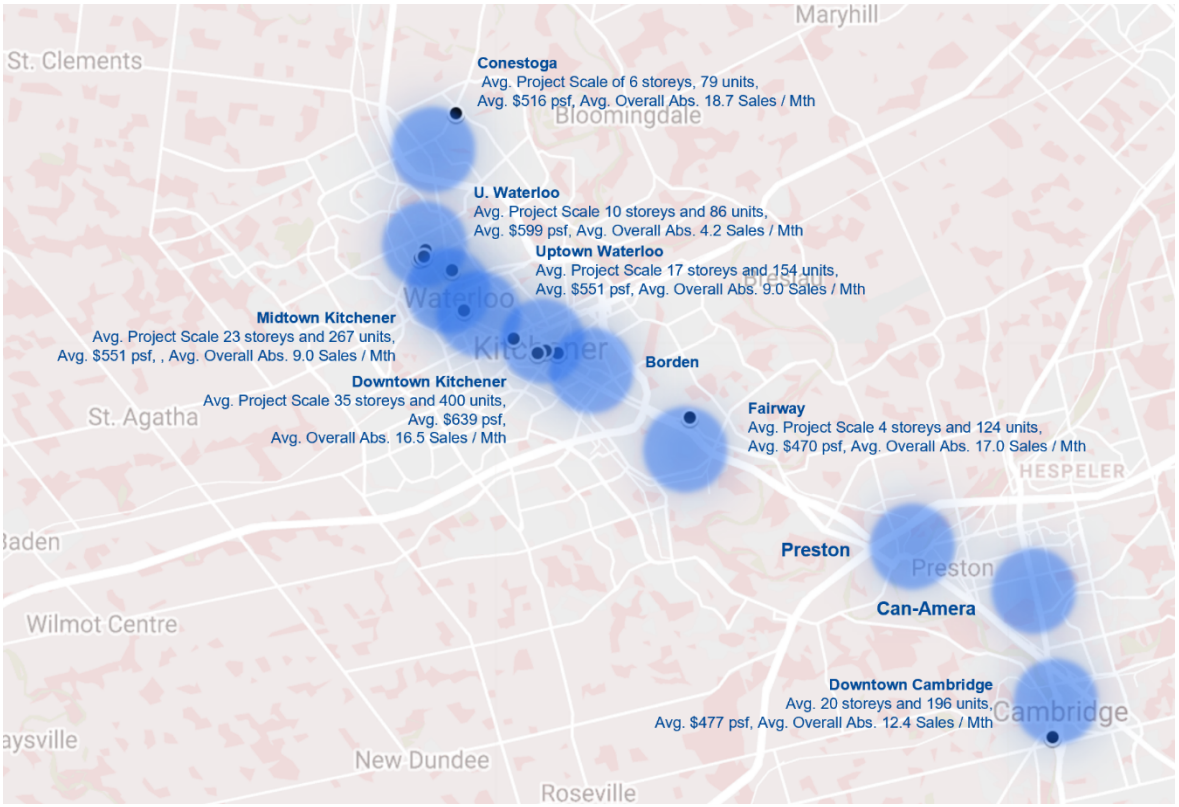
In terms of actively marketing (new) condominium apartment high rise projects within the tri-city area, most supply is located within central areas / in and around the region's larger downtown areas (e.g. Uptown Waterloo, Downtown Kitchener, and Downtown (Galt) Cambridge). These areas can market themselves as being within walking distance to a richer mix of retail, dining and entertainment amenities, as well as having LRT stops – BRT in the case of Downtown Cambridge. This locational advantage generally allows for a greater range of potential buyer groups, stronger pricing and absorption pace. These factors contribute towards the feasibility of larger scale projects.

Amongst central areas, Kitchener's Midtown and Central station areas and Uptown Waterloo have the greatest wealth of lifestyle amenities, coupled with job opportunities. The only high-rise projects actively marketing in Cambridge are in Downtown Cambridge (Galt City Centre).

Overall, there are fewer new high-rise offerings outside of these downtown areas. There are currently only two actively marketing projects across the more suburban station areas – one in Conestoga and one in the Rockway (Mill / Borden) station areas. Neither of these projects are within a short walking distance to an LRT stop. These suburban condominium apartment projects are primarily attractive for affordable pricing and/or offering good value (e.g. larger suite sizing). As pricing in more popular station areas increases, so too will demand for high rise living opportunities in these suburban areas that also offer access to higher-order transit.

One exception to the downtown development focus is the University of Waterloo station area with multiple condominium apartment projects exclusively targeting investors and adding de facto purpose-built rental product to the region via guaranteed rental terms and professional leasing and management services to investor-buyers. The number and scale of projects in this station area is linked more so to distance to classes and student/faculty engagement opportunities and University enrollment forecasts among others. This is as opposed to typical drivers of residential demand, such as population growth, employment opportunities, a downtown / mixed use context and transit improvements.

Figure 6 – Location and Characteristics of Actively Marketing Condominium Apartment Projects by Station Area Based on Available Inventory as of January 2020









Left to Right: Downtown Cambridge Farmers Market, Uptown Waterloo Shopping, Downtown Kitchen Community Event.

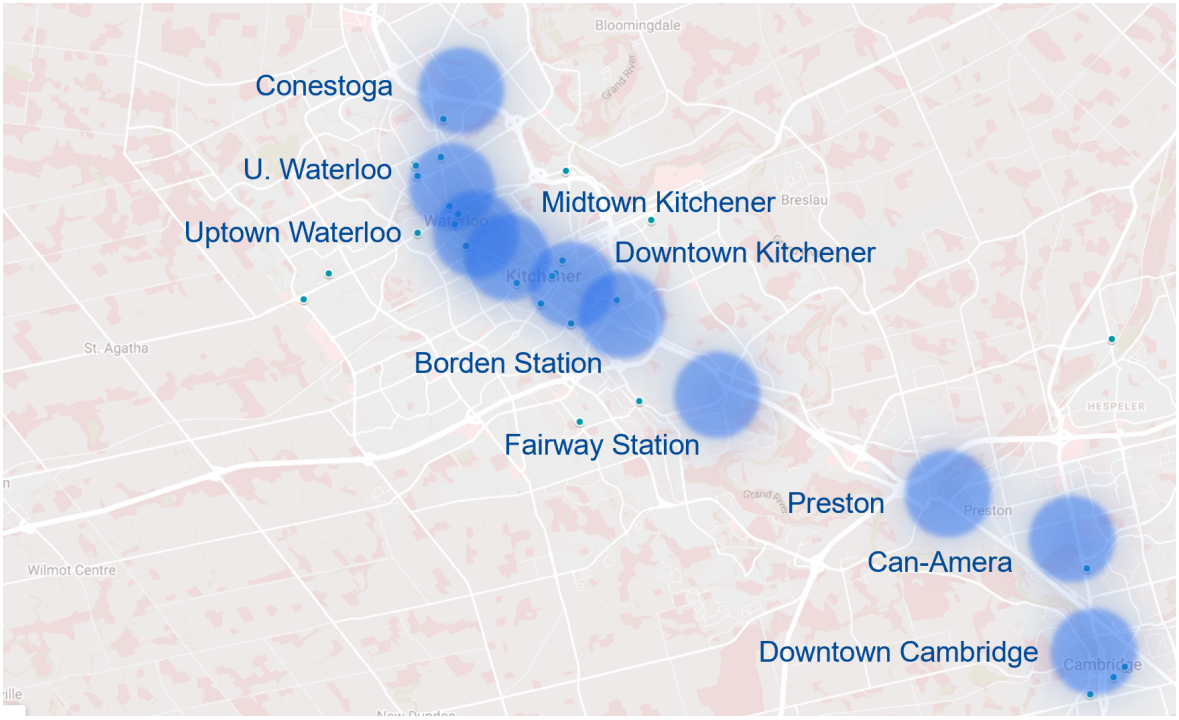
Source: N. Barry Lyon Consultants Limited; Realnet; BIA and Explore Waterloo Region Marketing Materials.

3.4 Development Applications Point to Demand for Transit Supportive Locations and Reduced Parking Ratios

NBLC has scanned high density residential development application activity across the three municipalities, focusing on projects located within walking distance of existing or future higher-order transit service. While there continues to be demand for larger scale projects in the more central areas and apparent acceptance of lower parking ratios, there is also some emergence of multi-phased projects outside of these established areas but within walking distance to existing LRT stops. Notable examples of such activity are the Auburn/Schneiders redevelopment proposal near the Borden LRT stop and the Viridis/Virerra Village proposal near the Fairview LRT stop. We generally expect such proposal activity to only increase over time, particularly towards the northern terminus of Phase 1 of

the LRT at Conestoga and as funding / timing of Phase 2 of the LRT to Cambridge is secured. However, until these areas become more urban, projects in suburban nodes are likely to continue to seek higher parking ratios, which significantly impacts the cost of development, particularly in structured or underground formats.

Figure 7 – Location of Residential Apartment Development Applications by Station Area



3.5 Pricing Increasing Faster than Development Costs

From a cost perspective, residential construction costs are increasing, but not at the same rate of residential unit pricing or land pricing appreciation. While a detailed analysis of construction cost trends was not conducted as part of this research, we have referenced the Altus Canadian Cost Guide which is commonly used in the industry as an initial point of reference when considering development. Looking back at the 2017 report and comparing it to the 2018 benchmarks, it appears that residential unit pricing increased 6% to 8%, while between 2018 and 2019, benchmark residential construction costs appear to have increased by over 10%. Between 2019 and 2020, costs again rose, with increases in the order of 6% to 9% across most categories (rates of cost inflation were higher for tall buildings over 40-storeys, as per Altus). This is consistent with findings from NBLC's informal dialogue with developers throughout the GTHA.

Of note, as part of this analysis, NBLC and staff from the municipalities of Waterloo, Kitchener and Cambridge also held discussions with prominent local development groups to engage in dialogue regarding key assumptions and the methodology used to assess IZ impacts. Feedback regarding the methodology used in this analysis was largely confirmatory. Developers helped to corroborate and substantiate current development economics as it relates to rising costs, and compressed margins.

In comparison, the average resale price of an apartment as reported by the Kitchener Waterloo Association of Realtors increased 17.9% in March 2020 compared to the year prior. The year-over-year pricing increase across all reselling housing forms between March 2019 and 2020 was 15.3% in the Kitchener Waterloo market area.

3.6 Housing Demand and Supply

This section includes a high level Regional and Tri-city overview in order to meet the minimum requirements for a peer reviewed study outlined in provincial regulations. More detailed supply and demand analyses are being conducted by each of the Cities as part of their examinations of inclusionary zoning regulations or policies as a means to provide affordable housing. Kitchener's study was completed in January 2020, the Waterloo study is expected to be released by the end of 2020 and Cambridge's study sometime in 2021.

3.6.1 *Policy Context*

Provincial Policy Statement (2020)

The Provincial Policy Statement (PPS, 2020) builds on earlier versions of the PPS with a renewed emphasis on increasing housing supply, supporting job creation and reducing red tape. The PPS directs municipalities to support housing affordability across the housing continuum by planning for a supply of land to develop a full range of housing types through both intensification and greenfield development. Specifically, the PPS requires and enables municipalities to maintain a supply of designated, available and serviced lands for residential development to ensure that housing supply can come online to meet demand. Municipalities are to use market-based approaches to plan for the appropriate range and mix of housing types, options and densities, including affordable housing, to meet the needs of existing and future residents.

The PPS defines affordability according to the ability of low and moderate income households to pay for housing. It requires upper tier municipalities to establish and implement targets for new affordable units. The PPS aims to ensure there is adequate land supply and that land use planning is connected to the needs of citizens and the market. However, Inclusionary Zoning is the only planning tool that can require affordable housing to be delivered by the private sector, supporting the affordability objectives of the PPS.

This study tests the implications of Inclusionary Zoning for units set at the affordable rental and homeownership price benchmarks established by the PPS.

A Place to Grow: Growth Plan for the Greater Golden Horseshoe (2019)

A Place to Grow: Growth Plan for the Great Golden Horseshoe (P2G) provides additional provincial vision and policy for the Greater Golden Horseshoe. Key principles that affect housing affordability include:

- Building complete communities;

- Supporting economic and employment opportunities;
- Supporting a range and mix of housing options, including additional units and affordable housing, to serve all sizes, incomes, and ages of households by increasing housing diversity
- Integrating land use and infrastructure planning; and,
- Providing for different approaches to manage growth that recognize the diversity of communities in the GGH.

Key polices in service of affordability objectives include:

- Minimum intensification and density targets;
- Requiring municipal affordability targets as in the PPS, and the identification of planning and financial tools to achieve these targets; and,
- Aligning land use planning with Housing and Homelessness Plans.

P2G forecasts population within Waterloo Region to increase to 835,000 by 2041. The municipalities' plans to accommodate this increasing need for housing are outlined in Regional and local Official Plans.

Regional Official Plan

The Waterloo Regional Official Plan (ROP, 2015) sets out a vision and high-level planning framework for the Cities of Cambridge, Kitchener and Waterloo as well as the surrounding townships. It translates the population and employment forecasts of P2G into municipal forecasts. The development of the ROP included a detailed analysis forecasting the number, type and location of new units required by 2031 taking into account population growth, past trends, demographic changes, changing household formation rates, affordability considerations, the role of the existing housing stock in meeting new needs, and the PPS and P2G policies in effect at the time. This translated into a requirement for new urban greenfield lands, and an urban structure to support Light Rail Transit (LRT) within the built up area. The forecasted housing range and mix is not included in policy, instead area municipalities are directed to provide an appropriate range of housing in terms of form, tenure, density and affordability to satisfy the various physical, social, economic and personal support needs of current and future residents.

Affordability is encouraged through condominium conversion policies, requiring medium and high density housing forms on large sites, and the consideration of financial tools. Density targets for the Urban Growth Centres and Urban Designated Greenfield Area lands require higher density housing forms that can be more affordable.

The ROP allocates the majority of growth to the Cities. It forecasts populations of 319,500 for Kitchener, 140,000 for Waterloo and 176,000 for Cambridge by 2031. It sets a 45% minimum intensification target and directs intensification to Urban Growth Centres, Major Transit Station Areas in the Central Transit Corridor, Reurbanization Corridors and Major Local Nodes.

The significant growth forecasted for the Central Transit Corridor provides for the opportunity for increased transit use, efficient use of infrastructure and economic development. Affordability within the Central Transit Corridor is a priority.

The ROP is currently under review. This update will bring forward a plan for 2041 and/or 2051 planning horizon including a Regional structure. Importantly, it will precisely delineate MTSA boundaries – a precondition to the implementation of Inclusionary Zoning.

City of Cambridge Official Plan

Cambridge's Official Plan (OP) was approved, in part with modifications, by the Region of Waterloo in 2012. A number of appeals were filed, some of which have been subsequently scoped or decided upon while some policies remain under appeal. The policies in the OP are intended to plan and manage growth in accordance with the complete community concept. The policies aim to maintain a balance between land supply including: residential; employment; and commercial uses; along with mixed use and transit oriented development.

Intensification within the built-up area is to be planned and designed to generally achieve higher densities than surrounding areas. The City's built-up area include: the Urban Growth Centre; Core Areas; Nodes; Regeneration Areas; Reurbanization Corridors and Major Transit Station Areas. A range and mix of housing is to be provided which take into account affordable housing needs and provide opportunities for affordable housing.

The City will ensure the creation of 45% of new housing units through infill, conversion, intensification and the redevelopment of built-up areas in the city and will allow compatible higher density residential development in these areas. The City also encourages the inclusion of a residential component in commercial development in the built-up areas and the development of community housing and affordable private sector housing aimed at meeting the needs of lower income residents.

City of Kitchener Official Plan

Kitchener's Official Plan was adopted in 2014 and approved by the Local Planning Appeals Tribunal in 2019. It supports affordability by permitting a wide range of housing types and densities throughout the City. Density is focused on the urban structure elements like the Downtown Urban Growth Centre; Major Transit Station Areas; City, Community and Neighborhood scale nodes; and Urban and Arterial Corridors. Downtown is planning to double its population and achieve a minimum of 225 people and jobs per hectare by 2031. Density targets are also set for greenfield communities. Higher density targets provide for a mix of housing forms, which can assist with affordability, it also supports transit usage and the cost savings associated with it. The OP requires 50% of new residential development through intensification starting in 2016 and increasing to 60% by 2026.

A range of housing types are permitted within Residential, Mixed use, Downtown, Institutional and even Commercial and Agricultural land use designations. The full range and mix is encouraged at the neighborhood scale to allow residents to age in place. For example, the Official Plan was recently

amended to allow for detached additional dwelling units and up to three units on a lot in the low rise residential land use designation without the need for a zoning by-law amendment.

The biennial Kitchener Growth Management Plan (KGMP) is used to stage development to achieve objectives surrounding complete communities; alignment of infrastructure and land use planning; and staff resources. Housing range and mix as well as opportunities for affordable housing are among the criteria for prioritizing plans of subdivision. The KGMP is also a vehicle to ensure there is sufficient supply to meet community needs.

City of Waterloo Official Plan

Like the Official Plans for both Cambridge and Kitchener, the City of Waterloo's Official Plan (2012) encourages the creation of affordable housing by planning for a sufficient supply of land for residential development and establishing a planning framework that supports a range of housing types and densities. The Official Plan sets out specific heights and densities, including minimum densities in some cases, for different residential land use categories. Higher residential densities are directed to areas designated for intensification, including the Uptown Waterloo Urban Growth Centre, Major Transit Station Areas and other Nodes and Corridors. In these areas, residential land uses categories encourage mixed-use, transit-oriented developments and a mix of housing types ranging from townhouses to apartments. Density in the Official Plan is calculated in terms of bedrooms per hectare rather than units per hectare. This approach was adopted, in part, to eliminate the financial disincentive for builders to construct smaller, more affordable units.

Affordable housing through small scale infill development is also encouraged through policies that enable the construction of second units within a primary dwelling units or ancillary structures, and policies that contemplate context-sensitive intensification in low density residential areas.

Finally, Waterloo's Official Plan requires staff and council to give regard to an adequate mix of rental and ownership units for a wide variety of household sizes when considering development applications and creating new or amending existing District Plans. Waterloo continues to implement Section 37 of the Planning Act through a set of bonusing policies in the Official Plan. These policies enable the City to authorize increases in height and/or density in return for the provision of community facilities, services and/or matters, such as affordable housing. While the bonusing provisions enabled through Section 37 are expected to be replaced shortly by a Community Benefit Charge system, they are still in effect and the City continues to use them to secure funding to support the creation of affordable housing, where appropriate.

Policy Context Conclusion

While the PPS, P2G, Regional and local Official Plans all set vision and objectives for housing affordability and include policies that do much to enable and encourage housing affordability, and mitigate the loss of existing affordable housing stock, there are no routine and actionable policies that effectively require affordable housing or a particular tenure to be developed as part of private

market development. The provincial framework for Inclusionary zoning provides this regulatory opportunity for the first time.

3.6.2 *Housing Supply*

The Region is forecast to grow from 556,000 people in 2016 to 835,000 by 2041. A slight decline in the number of people per household means 103,000 more units (a 50% increase) are required to accommodate growth. The allocation of this will be determined as part of the ROP review currently underway, but we know at least half of this will be in the form of intensification. And much of that intensification will be directed to Major Transit Station Areas and the Urban Growth Centres. The population will also be older with 16.9% of the population being 65+ compared to 13.9% in 2016. This may change the types of units that are in demand.

The 2016 Census shows that within the Cities:

- 68% of households own their homes and 32% rent;
- 53% of dwellings are single detached, one quarter are apartments and townhouses represent 12% of the stock;
- 75% of owners live in single detached dwellings;
- 65% of renters live in apartments buildings and 16% are in townhouses;
- The housing supply is in good condition with 95% requiring only regular maintenance or minor repairs; and,
- Half of all units were built since 1980.

In the three cities, ownership tenue and single detached dwelling types predominate. Efforts to diversify the housing stock will help meet the needs of current and future residents, their smaller households, and advance affordability objectives. These trends are being demonstrated through current development activity, where the types of housing being built are changing.

According to the Region's annual building permit monitoring report 66% of new units in 2019 were apartments and just 13% here single detached. This is the culmination of gradual reversal of tends in the early 2000s when approximately 70% the units built each year were single detached.

According to CMHC, approximately 5,400 new units started construction region wide in 2019. 2,100 were intended to be condominium and 2,100 were freehold. The remining 1,200 were rental. 3,500 of there were apartments (both rental and condominium).

CMHC's survey of intended tenure for recently constructed units shows that Regional rental construction in the last decade has represented 31% of completions. This compares to 16% in the 2000s and 19% in the 1990s. This is positive because of the rental market's propensity for reaching deeper affordability needs than freehold or condominium tenures. Condominiums completions have also increased to 31% of completions over the last decade. Despite the pace of rental construction,

the formation of rental households is even greater. As a result, condominium apartments commonly serve as de facto rental supply, with many households finding housing within the secondary rental market in rented condos or single detached dwellings.

3.6.3 *Rents, prices and vacancies*

Notable 2019 Region-wide, statistics according to CMHC and the KW Association of Realtors:

- The 2019 region-wide vacancy rate was 2% and has been under the 3% healthy and balanced rate of 3% for the last 10 years.
- Average market rent across all rental stock and unit types in the Region is $1,161 per month. On average, average bachelor units rents for $804, $1,041 for a 1-bedroom, $1,223 for a 2-bedroom, and $1,285 for a 3+ bedroom unit.
- According to the KW Association of Realtors, the average resale price of an ownership unit (across all housing forms) was $540,000 in 2019.
- In the last 10 years, rents have increase by 42%, home prices have increase by 104%, but incomes as represented by the Consumer Price Index rose just 18%.
- The average resale price of a single detached dwelling is $595,000. The average resale condominium price is $340,000.

CMHC only provides the price of new units for single and semi-detached dwellings. This does not provide a useful measure given the changes in demand and construction completions which have been experienced in the market. No information is available for rental rates in newly constructed developments.

To support this evaluation, NBLC conducted a high-level market scan of new high-density residential product types that are being actively sold or rented in MTSA market locations. The following table summarizes the average unit price of new condominium apartment projects actively marketing in January 2020 in each MTSA, as well as the average rental rates[1] in recently constructed purpose-built rental apartments in January 2020.

[1] Based on units that are vacant or available (move-out notice given) at the time of survey.

Table 1

High Density Residential in MTSAs and Vicinity				
MTSA	Average New Condominium Apartment Sales Price		Average Rents in Recently Constructed Purpose-Built Rental Apartment	
	End Price	$PSF	Monthly Rent	$PSF/mo.
Conestoga	$305,000	$515	$1,675	$2.00
University of Waterloo	$360,000	$600	$1,750	$2.95
Uptown Waterloo	$388.000	$550	$3,385	$2.15
Midtown Kitchener	$410,000	$550	$1,590	$2.40
Downtown Kitchener	$435,000	$640	$1,590	$2.40
Rockway	$316,000	$470	$1,535	$1.85
Fairway	$316,000	$470	$1,535	$1.85
Preston	N/A		$1,965	$2.05
Can-Amera	N/A		$2,015	$1.90
Downtown Cambridge	$430,000	$475	$1,265	$2.00

3.6.4 *Incomes and affordability*

Housing is generally considered affordable if it represents less than 30% of a household's pre-tax income. 23% of the region's households spend more than that. 42% of renters and 15% of owners spend more than 30% of their income on housing.

The concept of income deciles is helpful in understanding how affordability challenges affect people in different income categories. It splits the regional households into 10 equal sized groups according to their income.

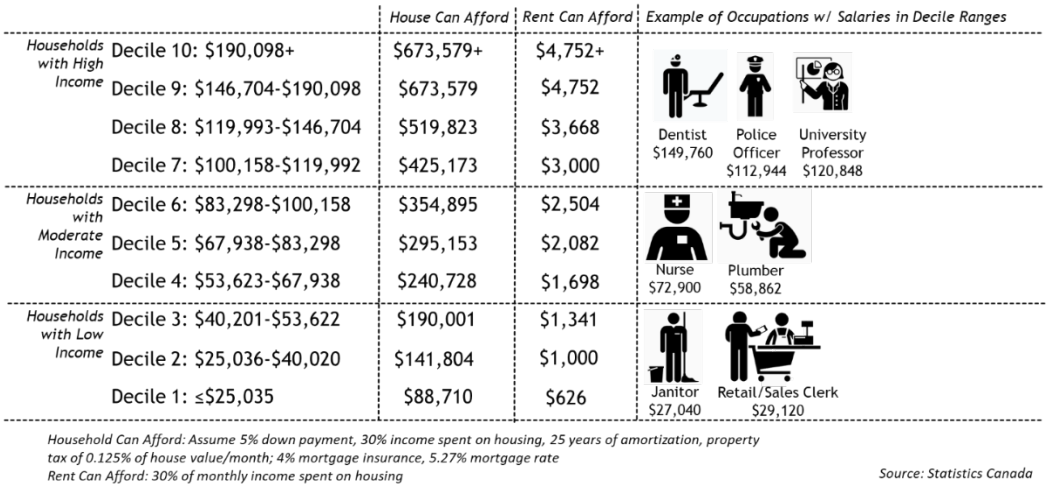
Regional incomes have increased gradually over time, but available housing is not well aligned to need from an affordability perspective, particularly those in low to moderate income deciles.

Core Housing Need is a powerful indicator of critical unmet housing requirements. A household is considered to be in Core Housing Need if its current housing is either unaffordable, in a poor state of repair or overcrowded and the household cannot afford suitable accommodation elsewhere. Unlike shelter-to-income ratio households, those that choose to pay more than 30% of income on housing are excluded from the calculation if a suitable affordable alternative is available. 11.3% of households are in Core Housing Need. The situation is more severe for renter households, 27% of which are in core housing need compared to just 4.5% of owners.

Income deciles are a helpful concept to understand how affordability challenges affect people in different income ranges. The chart below shows the most expensive rental and ownership unit each income decile can afford using standard assumptions adjusted to 2019 dollars.

Figure 8

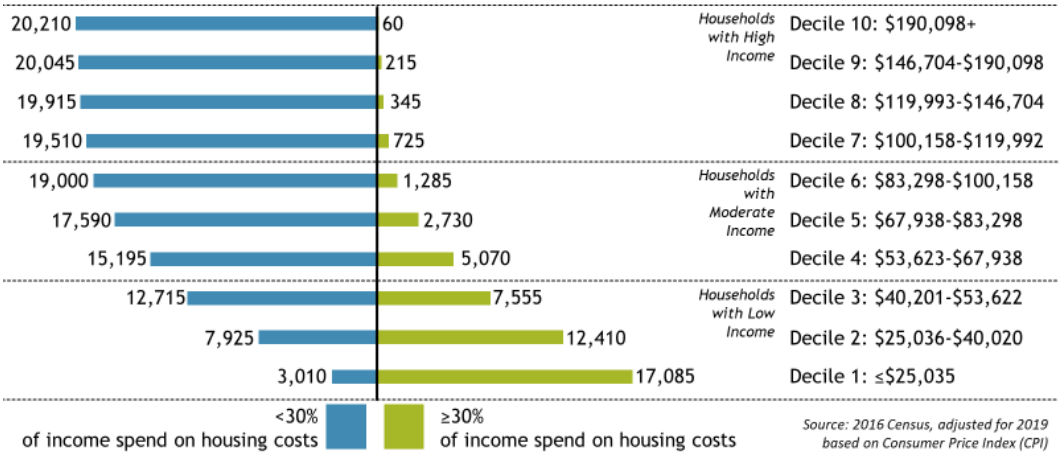
Example Occupations within Income Deciles



Prepared by City of Kitchener staff using KWAR and Census custom tabulation.

Figure 9

% of Income Spent on Housing Costs by Income Decile



Prepared by City of Kitchener staff using KWAR and Census custom tabulation.

The two previous charts show that while affordability needs are most acute among low income households earning up to 53,000 per year, there are also affordability challenges for moderate income households earning up to $100,000.

The new supply that is coming online, especially within MTSA market locations, is at prices and rents that are generally unaffordable to most low income and many moderate income households. Strong market demand has meant that there has been no sign of housing price reduction in response to the rapid increase in supply the Region was experienced over the last several years. New Inclusionary Zoning regulations now mean that municipalities can choose to adopt a policy response to address the affordability challenges of low and moderate income households within the private development sector.

4.0 The Conceptual Inclusionary Zoning Policy

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

4.1 Considering Offsets in the Design of an IZ Policy

In most jurisdictions where IZ has been successfully implemented, the underlying principle is that additional development density is traded to offset the costs of delivering affordable housing. In some instances, there are also financial programs utilized (tax incentives, etc.), but it is this density exchange that is often critical to an enduring and sustainable approach. Incentivising projects with financial tools can also be effective in emerging market locations where inclusionary zoning makes development financially unviable, and/ or where additional development density is less valuable.

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

- Not offer any financial offsets to developers, requiring that projects absorb the affordable housing requirement (i.e. without any municipal tools used to offset the affordable housing requirement);
- Apply additional density above the current approved zoning to offset the costs of an affordable housing component;
- Apply municipal financial incentives to the project to offset some of the costs of the affordable housing contribution; or,
- A combination of the two previous bullets above.

Determining the most appropriate approach is complicated by the fact that each municipality's housing market is diverse. In addition, each municipality has varying approaches to development planning and municipal finance.

Within the context of this assessment, it is possible that the ultimate approach to an IZ policy will vary in each of the three cities. Across the three municipalities and test locations as part of this research, there are a variety of market conditions that impact the nature of demand; including the type and cost of housing, and level of transit service. This diversity also extends to the relationship between as-of-right planning permissions and achievable density, which can impact land transaction activity and the process for extracting community benefits as part of a development application process. However, there is sound rationale for the municipalities to evaluating and pursuing IZ policy implementation simultaneously and collaboratively.

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 municipality to calibrate its IZ approach so that the density increase offsets the impact of the affordable housing requirements. Of note, future planning

work may be completed around Protected Major Transit Station Areas where considerations regarding transit supportive densities are warranted (and, in some locations, proactive planning permissions are already in place). However, to calibrate an approach of this nature, a City would need to consider the amount of additional density that could be reconciled from a planning and built form perspective, and then tailoring the IZ percentage to that context and market. Although, as results will show, there is also some opportunity to apply IZ to all density, within the context of as-of-right density.

Example: The approach to Inclusionary Zoning in NYC

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

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

Important lessons from NYC's experience with IZ are:

- That the expectations and development entitlements need to be clear, ambiguity introduces risk and speculation which undermines the policy opportunity. It is the forward looking nature of the policy, which anticipates future market demand (and value) and pre-emptively up-zones those locations, that is fundamental.
- The NYC approach also provides an allowance for appeal in some circumstances. The burden of proof is on the developer to demonstrate that the IZ policy makes a project unviable. As of January 2020, no developer had been successful in an appeal.
- Encourage on-site affordable housing 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 market areas, whereas 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.

If any of the three Cities chose to provide offsets as part of an IZ strategy, 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, or, as part of a limited term basis as a means to transition to a new IZ policy. 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.

Notwithstanding the above, this analysis is structured to test the impact of potential inclusionary zoning parameters absent any density offsets or financial incentives (other than those which are currently available today). The objective is to test the potential impacts of policy absent these tools, in order to provide a basis of evidence for municipalities to use as they consider 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 offsets in this review is that over time, the need for offsets will change. If the market sustains upward trajectory, the need for incentives may diminish over time. Notwithstanding this long term potential, we are also mindful of economic considerations related to the ongoing coronavirus crisis.

Although the extent and length of COVID-19's impact remains unknown, it is likely temporary. We are aware of developers pushing back launch dates for new projects and that the pace of construction has slowed – if not stopped completely, putting a further strain on supply in an already constrained market. With launches delayed and prospective buyers – domestic and foreign – continuing to self-isolate and social distance, sales in the active and resale markets have slowed and are expected to continue to do so in the coming months. Within the rental market, many landlords have begun to defer rents for tenants who are experiencing financial difficulties, which will keep vacancy rates low.

Though we have not lived through a pandemic similar to the current crisis, we can look to the 2008 financial crisis to gain some understanding of how COVID-19 may impact the market. At the time, the local new high-rise real estate market was shut down for all intents and purposes. Launches were delayed, some projects were cancelled, and buyers, for the most part, stayed away. However, pricing in both the ownership and rental housing markets were not measurably impacted. Very little new

rental product was in the market and vacancy rates remained incredibly tight. By the spring of 2009 confidence had been restored in the banking system and, driven by strong market fundamentals, the new sale and resale market regained its pre-recession strength. The following two years – 2010 and 2011 – set two of the three highest marks for new high-density residential sales on record at that time, along with steadily increasing pricing, while the purpose-built rental market continued to see declining vacancy rates and increasing pricing, spurring on new development interest.

Like with the recession a decade ago, the economy will eventually shed the effects of the pandemic. During this period there will naturally be softness, as all market participants including buyers/tenants, government staff and lenders all recuperate, re-assess their positions and adjust strategies. As the post COVID-19 economy emerges, we expect that the fundamentals that underpinned the strong housing market will similarly underpin the market's recovery. COVID-19 impacts may cause some buyers to delay or defer home purchases which should divert demand to the already strong rental sector.

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

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 the MTSAs in the three municipalities are quite varied and high-density residential development is not viable everywhere. This creates an opportunity for IZ over the long term, as a policy now can 'plant a seed', signaling the new policy framework to the market and introducing a new reality for development that will occur over the longer term, so that development economics can adjust accordingly.

4.2 Establishing an Initial IZ Requirement for Testing

This analysis is intended for information purposes as the municipalities consider a policy response to Provincial IZ regulations permitting this new tool which could support the creation of affordable housing. So, while the ultimate policy has yet to be determined, this analysis establishes conceptual approaches to test as a starting point, without offsets. This analysis tests the financial feasibility of inclusionary zoning under the current policy framework and without offsets (e.g. existing zoning, development fees and charges, and financial incentives).

To undertake our assessment, we assume, as a base case, the following potential IZ response:

- IZ requirements are calculated as a percentage total gross floor area (GFA) in a development. In the base case tests the percentage of IZ units required in a development (called, the "set-aside rate), is 10%.

- IZ units provided in rental tenure would have rents set to 100% of CMHC's average market rent (AMR) for the Kitchener-Cambridge-Waterloo Census Metropolitan Area (CMA). This is assumed to be the case whether the market development component is in ownership (condominium), or purpose-built rental tenure.
- IZ units provided in affordable ownership format are priced at an index value of $350 per square foot.[2] However within this testing, affordable ownership units are only considered as a potential delivery format within market ownership buildings.
- We test two lengths of affordability of rental units in the base case scenarios. First, affordability over a limited 25-year timeline. To simulate this, and quantify the eventual transition to market rental rates, the model estimates the value of affordable rental rates by calculating the present value of the affordable rental cash flow over the 25-year period of affordability, adding that to the value of those units as market rental suites after 25-years of discounting.
- Then, we replicate the same set-aside rate and depth of affordability assuming affordable rental units are permanently affordable.
- Given that the model is from a developer's perspective, in affordable ownership tests, units are assumed to be affordable to their initial purchasers. Any policies to ensure affordability for subsequent purchasers would not affect a developers' proforma However, there may be implementation approaches that ensure units remain affordable in perpetuity (i.e. an approach similar to the Whistler Housing Authority).
- The model assumes current municipal fees and that where applicable, current incentives remain in place. No other financial or planning incentives are included in the model.

The following table outlines the base case IZ parameters, as well as additional sensitivity tests that will be addressed later in this report.

[2] The City of Kitchener's Housing Needs Assessment provided a pricing threshold of $350,200 for affordable ownership housing. The $350 psf index pricing is derived assuming that a family sized unit of 1,000 square feet represents the maximum price and largest unit size which would meet this threshold.

Table 2

Key Variables:	Base Case Tests		Sensitivity Tests	
	Limited Timeline	Permanent Affordability	Deeper Affordability	Higher Set-Aside Rate
Set-Aside Rate % of Total GFA	10%	10%	5%	Max % viable (cap at 20%)
Depth of Affordability for Affordable Units	100% AMR, $350 psf Ownership	100% AMR, $350 psf Ownership	60% AMR, $210 psf Ownership	100% AMR, $350 psf Ownership
Period of Affordability*	25-years	Permanent	25-year/ Permanent	25-year/ Permanent

** Period of affordability applies only to rental scenarios*

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

5.1 Introduction

Waterloo Region's real estate submarkets are diverse. Our study therefore explores how this policy approach would impact the feasibility of residential development in ten station areas throughout Waterloo, Kitchener and Cambridge, all of which illustrate different levels of market demand. The submarket areas were selected around existing transit stations and include both strong and emerging market areas with existing and/ or planned transit infrastructure improvements. Following are key points that frame the approach for testing.

- In each of the test sites we worked with municipal staff to develop prototypical development concepts based on a view of potential development density. That is, the scale of development which might be reasonable to anticipate through a planning application.
- NBLC tested a rental and a condominium tenure project in each test location.
- In this assignment, proforma modeling is focused on assessing the impacts of residential uses only; this is to allow for testing results to reflect residential market conditions and to develop an evidence base that can be compared across transit station areas. We do however acknowledge that in some areas, prevailing planning policy would require developments to be mixed-use, incorporating some commercial uses within the same development. This modeling effectively assumes that these spaces would have a break-even financial position. However, variances in this regard could affect results.
- For each test location we undertake research to assess local pricing characteristics which are used to develop a financial proforma, structured as 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 and what remains is the value of the land.
- We evaluate the value of a property given the conditions of typical existing uses in each station area to benchmark current values. This is primarily informed by a review of recent commercial leasing activity and land transactions. This is referred to as the 'base value' of the property, i.e. its value on an as-is, where-is basis. Of course, there will be variations in the underlying valuation of typical development sites, however it is typical that lower scale commercial uses are commonly 'soft sites' relative to the emerging potential for residential development. Higher valued existing uses are less commonly sites that emerge as a viable redevelopment opportunity.
- We then evaluate land value based on the redevelopment concept at each test location (reasonable development potential) and the conceptual IZ policy discussed earlier.

Example: Establishing Base (As-is, Where-is) Land Value

In determining an estimate of typical "as-is, where-is" value in each test location, we reviewed prevalent low-density (under-utilized) non-residential uses in each station area in order to estimate the potential value of those sites. This work involved the review of parcel sizes, building floor areas, and net rents of local under-utilized commercial properties that are considered comparable to recent development sites, and estimated their value based on a capitalization rate.

For example, retail uses are common along King Street in the Preston market area of Cambridge. On a potential property that could make up a development site is a 3,500-square-foot single storey retail building on a 0.42-acre lot. Net rents on the property (utilizing data from Costar) are $20 per square foot per year. Based on a capitalization rate of 5.5%, the property would support an as-is value of $1.25 M. We extrapolate this to a one-acre site area; roughly $3.0 M per acre. The as-is, where-is values for each MTSA are estimated using aggregate values across multiple comparable properties in each MTSA.

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 market 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, a developer's profit margins are not adjusted. Because there is a ceiling on revenue, a developer could not afford to pay as much for land if it also must maintain its profit margin. We compare these land values to those of base value (of the underutilized site).

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

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

Based on the above analysis, we look to see where the financial model creates challenging or unviable outcomes. These will be the areas where we would expect to see development interest weaken or

delayed as a result of IZ until the market can support higher pricing, allowing residential land values to rise.

5.3 Financial Model Methodology

A redevelopment scenario was developed in each test location to compare to base land value. The redevelopment scenarios test ownership and rental tenures across each of ten market locations which were selected in consultation with staff at each municipality. The market areas selected reflect those which are either well established locations with transit connections, or emerging market areas with existing and/ or planned transit infrastructure improvements. The following summarizes our financial model methodology:

- The test sites include areas where development is viable and occurring currently, as well as others that are less marketable but anticipated to emerge as new high-density market areas given planned investments in transit infrastructure and other local planning initiatives.
- The development scenarios selected are high density residential forms, reflective of the types of development that have been recently completed, approved or planned for in the test areas. NBLC has conferred with municipal city staff in order to confirm the appropriate height and densities which can be expected.
- Assumptions around base land values for comparison to the value resulting from residential redevelopment rely on commercial leasing activity and sales to approximate the value of an existing land use. In practice, there will be variations in value amongst base-case test sites in any market area. These variations will have an impact on viability and land value impact, particularly in scenarios where a recent speculative land acquisition has occurred, or where a newer or denser (i.e. less underutilized) commercial property exists.
- The following table outlines the density and built form assumptions for each test site as assumed by NBLC, developed in conjunction with the staff in each municipality.
- A Residual Land Value (RLV) model establishes the site's land value (without IZ) according to the development parameters described in Table 2. This land value assumes the application of existing development charges and other municipal fees. We then repeat the RLV analysis to determine the value of the development site with the conceptual IZ policy included within the financial model.
- If the estimated land value of the redevelopment opportunity with IZ on the site exceeds the base value of the site, by at least 10%, redevelopment is considered to be viable. That is, within that test permutation, there is evidence supporting the potential of a viable IZ policy outcome.
- If the estimated land value of the redevelopment opportunity with IZ on the site is within 10% of the base land value, the redevelopment opportunity is considered "marginal" in the area.

- If the land value falls below the base land value by more than 10%, it signals that the policy could negatively impact the viability of new residential development. This is because underlying base land values would likely exceed the purchasing power of most residential developers.

Table 3

Summary of Prototypical Site Assumptions				
Market Location	Site Area (Acre)	Tested Built Form		
		Storeys	GFA (Sq. ft.)	Density (FSI)
Conestoga	1.00	25	300,000	6.9
University of Waterloo	1.00	12	150,000	3.4
Uptown	0.75	25	300,000	9.2
Grand River Hospital	1.00	25-30	300,000	6.9
Central/ Victoria Park/ Queen/ Kitchener City Hall/ Frederick	0.75	25-30	392,040	12.0
Borden/ Mill	1.00	20-25	250,000	5.7
Fairway	1.00	15-20	200,000	4.6
Preston (No BRT/ Future LRT)	1.00	5	80,000	1.8
Can-Amera/ Cambridge Centre Mall (Existing BRT/ Future LRT)	1.00	15-20	200,000	4.6
Downtown Cambridge/ Main (Existing BRT/ Future LRT)	0.50	20-25	275,000	12.6
Source: City Staff and NBLC				

5.4 Financial Model Assumptions

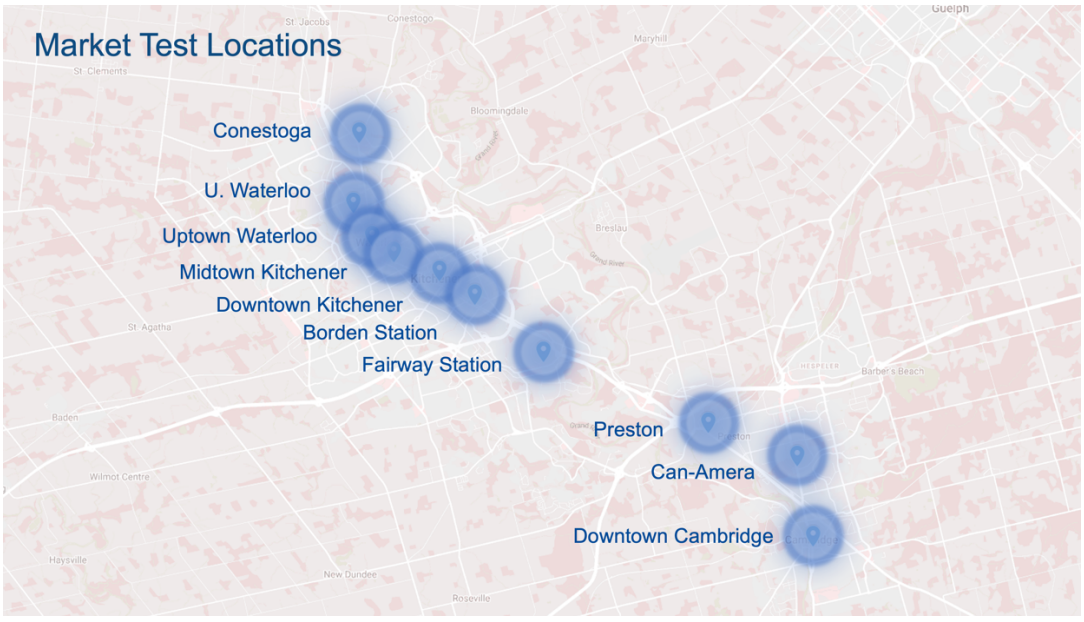
The following assumptions are applied in all scenarios:

- The average market rent (AMR) of $1,163 per month for the Kitchener-Cambridge-Waterloo CMA reported by CMHC in Fall 2019 is used to benchmark affordability. No additional revenue is assumed for parking spaces used by the tenants of affordable units.
- Unit sizes of the affordable units are assumed to be consistent with market units.
- Hard construction costs are estimated from the Altus Construction Cost Guide 2020 and are indexed for Waterloo Region, using 99% of GTA costs. This rationale was included in the 2019

Altus Construction Cost Guide. Costing assumptions were discussed and generally confirmed through our discussions with local development groups. However, costs will always vary across sites and developers.

- Current applicable property tax rates, planning application fees and development charges are included in the model and vary based on the location of the subject site.
- The models incorporate planning policy parameters which are reflective of the regulatory context prior to Provincial Bill 108/ 197 and associated regulations. Therefore, cash-in-lieu of parkland is calculated at current prevailing rates:
  - In the cities of Kitchener and Cambridge, cash-in-lieu of parkland is calculated at a value equivalent to 1 hectare of land per 500 units, or 5% of land value, whichever is greater. In Downtown Kitchener, no parkland dedication is assumed.
  - In the City of Waterloo, cash-in-lieu of parkland is calculated at 0.10 hectare per 300 units for the Uptown Waterloo site, and 0.15 hectare per 300 units for other sites.
- Other soft costs including consultants (engineering, architectural, etc.), project management, legal, insurance and marketing fees are accounted for.
- For construction financing in all scenarios, it is assumed the developer can borrow 75% of construction costs at an interest rate of 4.5% per annum. This assumption is also used for rental developments which in some cases may require a higher developer equity contribution.
- Pre-development timelines and construction timelines are estimates based on anticipated absorption rates and an estimated pace of construction for each prototypical development concept.

Figure 10



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

Table 4

Area Specific Model Assumptions – Market Units					
Market Location	Avg. Unit Size	Parking Ratio	Condo Price $PSF	Condo Parking	Condo Sales Abs. Rate /Mo.
Conestoga	850	0.75	$550	Included	10
University of Waterloo	600	0.38	$675	$40,000	10
Uptown	750	0.70	$600	$40,000	20
Grand River Hospital	750	0.70	$600	$45,000	15
Central/ Victoria Park/ Queen/ Kitchener City Hall/ Frederick	700	0.70	$600	$45,000	20
Borden/ Mill	850	0.99	$550	Included	10
Fairway	850	1.10	$550	Included	10
Preston (No BRT/ Future LRT)	800	1.10	$480	Included	5
Can-Amera/ Cambridge Centre Mall (Existing BRT/ Future LRT)	800	1.10	$500	Included	5
Downtown Cambridge/ Main (Existing BRT/ Future LRT)	800	0.90	$520	$12,500	12.5
Source: NBLC Market Scan					

Table 5

Financial Model Assumptions			
Variables			
Revenue Inflator, per annum - New Residential		2.00%	
Capitalization Rate - New Residential		4.25%	
Vacancy & Bad Debt		2.00%	
Operating Expense Ratio (Affordable)		45.00%	
Operating Expense Ratio (Market)		35.00%	
Revenue Inflator, per annum - Commercial		2.00%	
Capitalization Rate - Commercial		6.50%	
Hard Costs			
Hybrid Construction up to 6 storeys ($psf)		$199	
Apartment up to 12 storeys ($psf)		$217	
Apartment 13 to 39 Storeys ($psf)		$224	
Freestanding Parking Garage ($psf)		$89	
Underground Parking ($psf)		$146	
Underground Parking Garages (Single Level, Open Cut Excavation)		$109	
Surface-Level Parking Construction		$15	
Servicing Connection Cost (per unit)		$500	
Landscaping & Hardscaping (per unit)		$500	
Demolition & Site Prep ($psf of site area)		$10	
Contingency Factor (% of hard costs)		5.00%	
Cost Inflator, per annum		2.00%	
Soft Costs			
Planning Application Fees	Waterloo	Kitchener	Cambridge
OPA and ZBA			
Regional OPA	$5,750	$5,750	$5,750
Regional ZBA	$1,852	$1,852	$1,852
Local OPA and ZBL - base fee	$32,285	$22,803	$26,725
Plan of Subdivision			
Regional Subdivision Plans	$13,275	$13,275	$13,275
Additional (per ha)	$250.00	$250	$250
Max Fee	$15,525	$15,525	$15,525
Local Plan of Subdivision	$45,160	$21,047	$9,550
Additional (per ha)	-	$190	$125
Max	-	$18,340	$19,101
SPA			
Regional SPA	$805	$805	$805
Local Site Plan Application - base fee	$10,622	$6,122	$11,000
Local Site Plan Application - additional fee (per unit)	-	$96	-
Condominium Approval			
Regional Condominium Plans			
Base Fee	$9,625	$9,625	$9,625
Additional Fee (per unit)	$100	$100	$100
Max Fee	$6,150	$6,150	$6,150
Local Plan of Condominium - base fee	$22,515	$8,464	$6,400

Other	Waterloo	Kitchener	Cambridge
Regional Other (Review of Full Environmental Impact Statement, Noise Study Review)	$4,850	$4,850	$4,850
Building Permit Fees			
Townhouse, duplex, triplex ($psf)	$0.80	$1.19	$1.43
Apartment Building	$0.80	$1.19	$1.38
Min Fee	-	$106	$120
Staff Time (Hr)	$100	$30	$100
Municipal Development Charges			
Regional Development Charges (Full)			
Apartment Dwelling (Per Unit)	$15,461	$15,461	$15,461
Townhouse Dwelling (Per Unit)	$21,220	$21,220	$21,220
Local Development Charges and Educational Development Charges (WRDSB and WCDSB)			
Apartments 3 Bedrooms or Less	$8,684	$6,418	$11,104
Apartments 4+ Bedrooms	$19,453	$6,418	$11,104
Multiples (TH, Stacks)	$10,377	$8,917	$15,595
Kitchener Suburban Multiple/Apt (Full Service)	-	$9,582	-
Kitchener Suburban TH (Full Service)	-	$13,310	-
EDC, per unit	$2,601	$2,601	$2,601
Cash-in-lieu of Parkland Contribution	*In Uptown Waterloo: 0.10 ha/300 units, 15% LV cap; Other Areas: 0.15 ha per 300 units (Density exceeding 100 unit/ha)*	*5% of land or 1 ha/500 units, whichever is greater*	*5% of land or one ha/500 units, whichever is greater*
Property Tax Rate (Residential, new multi-residential)	1.088%	1.111%	0.888%
Consultants (of Hard Cost)		5.00%	
Const Management (of Hard Cost)		3.00%	
Dev Management (of Hard Cost)		3.00%	
Insurance (of Hard Cost)		1.00%	
Marketing (of Hard Cost)		2.50%	
Sales Commission Fee (of Revenue)		2.50%	
Lender's Administrative Fee (of Total Cost)		0.80%	
Construction Loan Interest Rate (Annual)		4.50%	
HST Rate		13.00%	
Other Rates and Timing			
Profit Margin (Ownership Tenure)	15.00%		
Discount Rate	6.00%		

5.5 Limitations of this Analysis

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

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

This analysis isolates evaluations to one single development phase. However, in some MTSAs, the nature of redeveloping areas is such that larger underutilized lot areas will result in 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 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.

Finally, there will also be instances where land vendors, developers or operators have operating assumptions or methodological approaches that differ from those in this report. For this reason, it is possible that development may or may not occur in practice, at times these instances may be contrary to the results of this work. Again, this analysis is intended to provide the municipalities with a high level view with respect to the opportunities or barriers related to a forward looking IZ approach in scenarios which are thought to be reasonable prototypes for development occurring under current market conditions within the premise of 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 Analysis

Table 6 illustrates the results of financial testing for the base IZ scenario (a 10% set-aside rate with affordable unit pricing at 100% AMR for affordable rental, or $350 psf for ownership). There are three key pieces of information included in the table:

- Base land value for each hypothetical test site, estimated based on prevalent existing (under-utilized) uses in each station area;
- Results based on the land value supported by a redevelopment under the current policy (no IZ); and,
- Results based on the residual land value supported by a redevelopment with IZ.

The summary tables display green ('Viable') results in instances where the land values supported by residential redevelopment are more than 10% above base land values and could therefore incentivize their sale and redevelopment. Yellow ('Marginal') results are shown when the land value supported by a redevelopment is within 10% of the base land value. Development scenarios that result in a residential land values that are more than 10% below base land values are identified in orange ('Challenge'). In addition, the tables demonstrate the magnitude of change that is demonstrated in IZ scenarios when compared to the estimated land value of a development in the current policy context (i.e. without IZ applied). For instance, if the land value of a redevelopment opportunity in the current policy context is $10M, and with IZ applied, the land value is estimated to be $8M, a 20% impact has occurred.

6.1 IZ Policies Impact Land Values, but at Different Rates

The impact of the tested IZ approach (10% of a development's total GFA) would reduce the revenue of each project while holding costs relatively stable (i.e. increasing costs as a proportion of revenue). Therefore, the shortfall is absorbed as a reduction to the land value.

Generally, large reductions in land value are observed in areas where the anticipated building size is relatively large, and/ or where the market pricing is relatively high (which results in a larger gap between market and affordable price/rents). For instance, the inclusion of 10% affordable ownership units in Downtown Kitchener reduces the land value by about $3.8M from the "current policy no IZ" scenario, as the built form tested is nearly 400,000 square feet in floor area, and the market condominium revenue is $250 higher per square foot than an affordable condominium. By comparison, the building tested in Preston has a GFA of 80,000 square feet, and the market condominium pricing is only $130 per square foot higher than the affordable threshold. In this scenario, a 10% inclusion of affordable ownership units was estimated to depress land value by about $400,000.

Table 6

Estimate of Land Value Impact - 10% Set-aside Rate, 100%AMR/$350 psf											
MTSA	Municipality	Base Land Value Supported by Existing Use	Test Scenarios								
			Proposed Built Form			Tenure	Current Policy (No IZ)	With IZ			
			Site Area (Acre)	Storeys	GFA (sf)			IZ with Aff Condo	IZ with Aff Rental (25 Yrs)	IZ with Aff Rental in Perpetuity
Conestoga	Waterloo	$2,490,000	1.00	25	300,000	Condo	Viable	80%-100% Impact, Challenge	60%-80% Impact, Challenge	>100% Impact, Challenge
						Rental	Challenge	-	>100% Impact, Challenge	>100% Impact, Challenge
University of Waterloo	Waterloo	$8,700,000	1.00	12	150,000	Condo	Viable	<20% Impact, Viable	<20% Impact, Viable	<20% Impact, Viable
						Rental	Viable	-	<20% Impact, Viable	<20% Impact, Marginal
Uptown	Waterloo	$7,470,000	0.75	25	300,000	Condo	Viable	20%-40% Impact, Viable	<20% Impact, Viable	20%-40% Impact, Viable
						Rental	Viable	-	<20% Impact, Viable	20%-40% Impact, Marginal
Midtown (rail corridor northwest to City of Waterloo)	Kitchener	$4,220,000	1.00	25-30	300,000	Condo	Viable	20%-40% Impact, Viable	20%-40% Impact, Viable	40%-60% Impact , Marginal
						Rental	Challenge	-	40%-60% Impact , Challenge	>100% Impact, Challenge
Downtown Kitchener	Kitchener	$8,460,000	0.75	25-30	392,040	Condo	Viable	20%-40% Impact, Viable	<20% Impact, Viable	20%-40% Impact, Viable
						Rental	Challenge	-	20%-40% Impact, Challenge	60%-80% Impact, Challenge
Rockway	Kitchener	$3,390,000	1.00	20-25	250,000	Condo	Challenge	80%-100% Impact, Challenge	80%-100% Impact, Challenge	>100% Impact, Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	40%-60% Impact , Challenge
Fairway	Kitchener	$2,240,000	1.00	15-20	200,000	Condo	Challenge	>100% Impact, Challenge	>100% Impact, Challenge	>100% Impact, Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	40%-60% Impact , Challenge
Preston (No BRT/ Future LRT)	Cambridge	$2,880,000	1.00	5	80,000	Condo	Challenge	20%-40% Impact, Challenge	20%-40% Impact, Challenge	40%-60% Impact , Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	40%-60% Impact , Challenge
Hespeler Road (Can-Amera north to Cambridge Centre Mall)	Cambridge	$2,240,000	1.00	15-20	200,000	Condo	Challenge	20%-40% Impact, Challenge	<20% Impact, Challenge	20%-40% Impact, Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	60%-80% Impact, Challenge
Downtown Cambridge/ Main (Existing BRT/ Future LRT)	Cambridge	$4,020,000	0.50	20-25	275,000	Condo	Challenge	>100% Impact, Challenge	80%-100% Impact, Challenge	>100% Impact, Challenge
						Rental	Viable	-	20%-40% Impact, Marginal	60%-80% Impact, Challenge

6.2 Stronger Market Areas Show Potential to Generate Affordable Units through IZ

The impact on viability should be distinguished from impact on land value. As previously noted, in this analysis we compare a redevelopment's potential land value to the land value supported by an existing use (base land value) to determine "viability". In areas where residential land value is much higher than under-utilized commercial land value, the project could stay viable even if the inclusion of affordable units depresses the land value by a significant amount. This dynamic is demonstrated by the testing scenarios in Uptown Waterloo. In some instances, the tests demonstrate a $2.4M reduction in development land value when IZ is included for 25-years. Nonetheless, the residual land value still exceeds the value supported by the existing use plus the 10% threshold premium. So, based on our assumptions, a residential developer could still afford to acquire land, despite the sizable impact on land value brought about by IZ.

Our analysis illustrates that in strong market areas including University of Waterloo and Uptown Waterloo, a condominium or rental redevelopment could yield land values that exceed the base land value by a large margin, therefore can remain viable with the inclusion of 10% affordable units at the parameters described earlier.

Similarly, in Midtown and Downtown Kitchener, condominium redevelopments appear to have the capacity to include 10% of their GFA as affordable units and remain viable. However, rental developments in these two areas are not currently viable even without IZ requirements.

In viable market areas, where land values are significantly impacted, it is possible that the reduction in land value might 'shock' the market, notwithstanding the fact that the 10% premium over typical as-is where-is value is maintained. A range of project and site-specific factors would become relevant, including the motivations of the landowner and developer interests involved.

6.3 Impacts on Emerging Markets

There are locations in the Region of Waterloo that are still maturing. Conestoga in Waterloo and Downtown Cambridge appear to be two of such emerging marketplaces in terms of higher density residential redevelopment activity. New condominium developments have started to appear in the Conestoga market area, and our results shows that without IZ, a condominium development is likely to yield a higher land value than a prevailing existing use, but not by a large margin. So, in these locations, continued market appreciation would be required to support viable IZ outcomes in the longer term.

The inclusion of 10% affordable units would push the land value supported by redevelopment below the base values, creating challenging results for IZ if it were to be implemented today. Moreover, our tests demonstrate that purpose-built rental developments would be challenging economically in Conestoga even without an IZ requirement.

In Downtown Cambridge, purpose-built rental development is exempt from costly parkland requirements which puts them in an advantageous position financially compared to new condominium development. While rental developments appear to be viable within current market dynamics, the inclusion of 10% affordable rental GFA will likely yield marginal or challenging economic results. These results show that IZ policies may have a significant impact on the viability of projects in these emerging market areas as they introduce new costs into the development process which cannot be appropriately absorbed or accounted for through land values.

Thus, it is critical that an inclusionary zoning policy be developed with an understanding of the market nuances at play in each market. Seeking high set-aside rates, deep affordability levels or permanent affordability in emerging markets may discourage new development – developers will look for other opportunities.

Our tests indicate that in relative terms, the Rockway and Fairway in Kitchener, Preston and Hespeler corridor in Cambridge fall behind in terms of near-term market readiness for high density development. Therefore, development economics become even more challenging with an IZ requirement, although the gap in base value and redevelopment land values are smaller in some areas than others. Developers are frequently apprehensive of taking large risks in emerging markets and will often reduce what they are willing to pay for land in these markets as a form of "risk premium". As such, low-density commercial uses (e.g. pad retail, strip mall) still represent the highest and best use (i.e. yield the highest land value).

Land value impacts vary between each prototype and market area. This analysis illustrates an IZ policy could be successful in stronger areas at a 10% set-aside rate. However, this is held in contrast to weaker market areas in which the implementation of the same IZ approach would be challenging. The different results between stronger and weaker market areas within the Region highlight the necessity of a nuanced approach for IZ.

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

6.4 Impacts on Rental Projects

As previously noted, IZ units affect project viability primarily through revenue reduction due to units being rented at affordable rents instead of 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. For example:

- In the Uptown Waterloo market area, the inclusion of 10% affordable (in perpetuity) within a condominium development reduces the estimated land value from $12.3M (no IZ) to $8.5M (with 10% IZ), a reduction of $3.7M.
- The inclusion of 10% affordable GFA (in perpetuity) in a new purpose-built rental development reduces the land value from $10.6M (no IZ) to $6.9M (with IZ), a reduction of $3.7M.

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

With other things being equal, condominium apartment developments typically support a higher land value than rental developments, and therefore are more likely to stay viable with IZ requirements. This is common across Ontario, however, an exception to this is that in the City of Cambridge, parkland CIL is not charged for rental developments which gives them an advantage over condominium developments.

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. The typical equity requirement for rental building can be as high as 50% of the total costs compared to a condominium where the requirement typically falls within a 20% to 30% range.
- **Revenue:** Related to the above, a rental development requires the developer to go many years into the development process without any revenue. Even once the building is constructed it can take many months for the building to become fully occupied and 'stabilize'. In a condominium development, subject to obtaining deposit insurance, purchasers' deposits can form an inexpensive source of project financing. When the development is ready to be occupied, the developer can immediately charge all purchasers interim occupancy charges (effectively rent) until the project is registered and purchasers begin to pay their mortgages.

- **Market and Risk:** For many developers the market opportunity for condominium development offers much less risk and relatively quick returns compared to purpose-built rental development where returns are earned over a longer period.
- **Land Acquisition Competition:** For the reasons identified above, rental developers must attribute greater discounting to their projects to reflect risk and time-value-of-money. This often means that a rental developer cannot pay the same land price that a condominium developer can. Often, new rental development occurs on land which has been historically inventoried or capitalized through another productive land use (i.e. large format retail).

Across the ten test sites, market rental developments appear to be viable in some locations (particularly in the University of Waterloo, Uptown Waterloo, and Downtown Cambridge MTSA scenarios). Rental development in the two Waterloo areas yield a much higher land value than the base land value, whereas a rental development in Downtown Cambridge is likely to support a lower spread.

In other market areas, rental developments appear to be unviable even without IZ requirements, as the land value supported by rental development is outcompeted by the land value supported by many low-density non-residential uses. In many of these markets, the value of high-density residential uses (including rental) is escalating more rapidly than low-density non-residential uses, and at some point in the future, these forms of development could become viable. The impact of IZ requirements in these market areas would be a prolonged market maturation process.

Notwithstanding the above, and as noted earlier in this report, this analysis assumes that a rental developer would also need to acquire land from low-density non-residential landowners prior to redevelopment. Many rental developers may already own (surplus) land, and they may proceed to development if total expected development revenues exceed costs.

Examples like this include Conestoga, Downtown Kitchener, and Preston in Cambridge. In these areas, rental land value is below the low-density non-residential base land value (hence marked as "challenge"). However, since they do yield some positive land value, a development could happen if a developer already owns land. Among the three, a rental development in Downtown Kitchener or Preston is shown to continue to support a positive land value with IZ, but in Conestoga the land value will be negative (meaning costs exceed revenue).

6.5 Affordability Period

To analyze the inclusion of affordable rental units, we have tested two affordable periods; 25-year affordability and permanent affordability. Overall, the model suggests that the perpetuity requirement could have a noticeably larger impact on land value compared to the 25-year scenario. However, individual developer perspectives and other factors would impact the degree to which this is rationalized from site to site. This order-of-magnitude estimate suggests that perpetuity requirement could suppress land value by an additional $300,000 versus a 25-year affordability

scenario in a small-scale mid-rise development in Preston, and up to an additional $1.7M in land value at larger projects in Downtown Kitchener or Uptown Waterloo.

Additional findings related to rental affordability timelines across the test sites:

- Both rental and condominium developments in the University of Waterloo and Uptown Waterloo market areas remain viable with the inclusion of 10% affordable rental units for 25 years. In these two areas, condominium developments remain viable when affordable units are delivered in perpetuity, but new purpose-built rental developments are pushed to the "marginal" category when perpetuity is imposed.
- Condominium developments in Downtown Kitchener appear to be viable and can remain viable with 10% affordable rental units for 25 years, as well as in perpetuity. Meanwhile new condominium developments in Midtown Kitchener illustrate the potential to support 10% of GFA dedicated to 25-year affordable rental, but a perpetuity requirement might push the development to the "marginal" category. Of note, in Midtown and Downtown Kitchener, rental developments do not appear to be viable in typical market conditions.
- A perpetuity requirement could also make a difference in the emerging areas. Rental developments in Downtown Cambridge currently appear to be viable without IZ units. The inclusion of 10% 25-year affordable units can make the project marginally viable, and a perpetuity requirement will hinder the viability of the project. In the Conestoga area, condominium developments are currently viable, but the inclusion of 10% affordable rental units, either with 25-year or permanent affordability, appears to be challenging based on our modeling assumptions.
- In other areas, market rate developments are not currently available, and the inclusion of affordable rental units could delay the market maturation process. With permanent affordability requirements depressing the land value to a greater extent than 25-year affordability, it will further delay this process. However, these are not areas currently experiencing a large volume of new development activity anyway. So, in order to accelerate development activity, a policy like this could be paired with municipal or regional incentives, if possible, given other municipal finance constraints.

6.6 Impacts on Affordability

As discussed in prior sections, an impact of an IZ policy would be to cap a portion of project revenue, (increasing costs as a proportion of total revenue) placing downward pressure on residential land value. If land prices decline significantly, landowners may be less likely to sell or redevelop property. This could result in reducing the supply of housing entering the marketplace until demand increases pricing sufficiently to trigger development.

6.7 Impacts on Other Land Uses

If IZ is applied in a manner that creates a significant impact to residential land values, an unintended consequence could be an improvement in the ability for other productive non-residential uses such as retail or office development to compete for land in prime locations, or a slowing of development interest overall. This should be considered relative to other growth objectives that the Region and local municipalities have at emerging transit nodes and other locations.

6.8 Markets need Time to Adjust

Developers typically acquire land on a speculative basis, based on their understanding of the maximum approvable and market supportable built form. Given this, it will be important that the local municipalities design an IZ approach that is phased to allow for some development to proceed in the near term. This is important 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 adjustments in other market segments. Such development also achieves many other policy objectives, including design, economic development and promoting better live-work relationships. Likewise, the cities must clearly signal an emerging policy in order to ensure that future speculative land market activity can adjust to new cost considerations.

On the other hand, this means that emerging market areas, where speculative land purchasing has yet to ramp up, could also be desirable locations to implement IZ policies. While the implementation of IZ could slow down/ delay the market maturation process, it would condition the development community about future expectations and be could offset by other financial incentive programs in the interim. Overall, near term implementation of IZ, even if enacted at first with a token (nominal) requirement, will create far less hardship if implemented prior to the maturation of the marketplace.

6.9 Sensitivity Testing

Two sensitivity tests have been generated through discussions with the cities of Waterloo, Kitchener, and Cambridge. The following sections will summarize each of the sensitivity tests and their results.

6.9.1 *Calculating IZ at 5% Set-Aside Rate, with Deeper Affordability*

NBLC was asked to test the effect of an alternative IZ approach which would require a lower set-aside rate of 5% with a deeper affordability level. For affordable rental the level was set to be 60% of AMR (as opposed to 100% of AMR in the base scenario). And, for affordable ownership tests, the level is set to be $210 per square foot in sale value (60% of the $350 psf used in the base scenario). Key findings are as follows:

- The alternative scenario (5% set-aside rate with deeper affordability) generally yields a higher land value compared to the base scenario (10% set-aside rate at 100% of AMR in rental, or $350 psf in ownership).
    - Of note, the alternative scenario yields noticeably stronger land value results when compared to base scenarios for larger projects where market rates are higher, such as Downtown/Midtown Kitchener, Uptown Waterloo, and University of Waterloo. In these cases, land values are improved by $0.7 to $1.0 M.
    - The Hespeler Road market area is the only one tested with an inferior result in the alternative scenario relative to the base scenario. This is because the alternative scenario yields fewer affordable units, which are eligible for the incentives offered under Cambridge's Community Improvement Plan.
- In other areas a small improvement in land value is observed in this alternative sensitivity scenario, compared to the base scenario. This is because the lower set-aside rate is more impactful than the depth of affordability. That is, the model allows for more market units to be included, and the delta between market pricing and AMR is greater than moving from 100% of AMR to 60% of AMR.
- The impact on viability is generally consistent with the base case scenario, the only difference is that condominium developments with permanently affordable rental units in University of Waterloo and Midtown Kitchener areas produced 'marginal' results in the base scenario, while in this alternative sensitivity scenario the test results improve such that they now appear to be viable.

These results are summarized in Table 7.

Table 7

Estimate of Land Value Impact - Sensitivity 1 - 5% Inclusion @ 60%AMR/$210 psf										
MTSA	Municipality	Base Land Value Supported by Existing Use	Test Scenarios							
			Proposed Built Form			Tenure	Current Policy	With IZ		
			Site Area (Acre)	Storeys	GFA (sf)			IZ with Aff Condo	IZ with Aff Rental (25 Yrs)	IZ with Aff Rental in Perpetuity
Conestoga	Waterloo	$2,490,000	1.00	25	300,000	Condo	Viable	60%-80% Impact, Challenge	40%-60% Impact , Challenge	80%-100% Impact, Challenge
						Rental	Challenge	-	>100% Impact, Challenge	>100% Impact, Challenge
University of Waterloo	Waterloo	$8,700,000	1.00	12	150,000	Condo	Viable	<20% Impact, Viable	<20% Impact, Viable	<20% Impact, Viable
						Rental	Viable	-	<20% Impact, Viable	<20% Impact, Viable
Uptown	Waterloo	$7,470,000	0.75	25	300,000	Condo	Viable	<20% Impact, Viable	<20% Impact, Viable	20%-40% Impact, Viable
						Rental	Viable	-	<20% Impact, Viable	20%-40% Impact, Marginal
Midtown (rail corridor northwest to City of Waterloo)	Kitchener	$4,220,000	1.00	25-30	300,000	Condo	Viable	<20% Impact, Viable	20%-40% Impact, Viable	20%-40% Impact, Viable
						Rental	Challenge	-	40%-60% Impact , Challenge	80%-100% Impact, Challenge
Downtown Kitchener	Kitchener	$8,460,000	0.75	25-30	392,040	Condo	Viable	<20% Impact, Viable	<20% Impact, Viable	20%-40% Impact, Viable
						Rental	Challenge	-	20%-40% Impact, Challenge	40%-60% Impact , Challenge
Rockway	Kitchener	$3,390,000	1.00	20-25	250,000	Condo	Challenge	80%-100% Impact, Challenge	60%-80% Impact, Challenge	>100% Impact, Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	20%-40% Impact, Challenge
Fairway	Kitchener	$2,240,000	1.00	15-20	200,000	Condo	Challenge	>100% Impact, Challenge	60%-80% Impact, Challenge	>100% Impact, Challenge
						Rental	Challenge	-	<20% Impact, Challenge	20%-40% Impact, Challenge
Preston (No BRT/ Future LRT)	Cambridge	$2,880,000	1.00	5	80,000	Condo	Challenge	20%-40% Impact, Challenge	<20% Impact, Challenge	20%-40% Impact, Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	40%-60% Impact , Challenge
Hespeler Road (Can-Amera north to Cambridge Centre Mall)	Cambridge	$2,240,000	1.00	15-20	200,000	Condo	Challenge	20%-40% Impact, Challenge	<20% Impact, Challenge	20%-40% Impact, Challenge
						Rental	Challenge	-	20%-40% Impact, Challenge	40%-60% Impact , Challenge
Downtown Cambridge/ Main (Existing BRT/ Future LRT)	Cambridge	$4,020,000	0.50	20-25	275,000	Condo	Challenge	>100% Impact, Challenge	60%-80% Impact, Challenge	>100% Impact, Challenge
						Rental	Viable	-	20%-40% Impact, Marginal	40%-60% Impact , Challenge

6.9.2 *Calculating IZ at Maximum Set-Aside Rate*

In the following sensitivity test, the affordability level is reset to 100% of AMR for affordable rental and $350 psf for affordable ownership units. In this test, NBLC was asked to "stress-test" the model, seeking to understand the maximum sustainable rate of inclusion, capped at a maximum of 20%. Results are presented in Table 8; the table shows in coloured columns the magnitude of impact to land value that is estimated when IZ is introduced when compared to a market development without IZ. Then, the column that follows shows the percentage of IZ units that could be sustained notwithstanding the land value impact. Key findings from this sensitivity analysis are as follows:

- In areas where high density market residential developments are not currently feasible today based on the assumptions used in this analysis, there is no maximum set-aside rate that could be supported within current market dynamics. Further market maturation is required in order to support economically viable conditions for these development forms.
- In stronger market areas, it is possible that some projects could potentially remain viable with an affordable set-aside rate that is greater than the 10% rate established for the base scenario. However, as the following results reinforce, each market location is unique.
    - In the University of Waterloo market area, a condominium apartment development could remain viable with up to 15% affordable ownership units, up to 20% affordable rental units for 25 years, or up to 17% affordable rental units in perpetuity. A new purpose-built rental development could remain viable with up to 17% affordable rental units for 25 years, or up to 9% affordable rental units in perpetuity (with affordable rents at 100% of AMR).
    - In the Uptown Waterloo area, a condominium development could remain viable with up to 12% affordable ownership units, up to 20% affordable rental units for 25 years, or up to 10% affordable rental units in perpetuity. A rental development could remain viable with up to 11% affordable rental units for 25 years, or up to 6% affordable rental units in perpetuity.
    - In the Midtown Kitchener area, a market condominium development could remain viable with up to 10% affordable ownership units, up to 14% affordable rental units for 25 years, or up to 9% affordable rental units in perpetuity. A new purpose-built rental development does not appear to be viable at this location.
    - In the Downtown Kitchener area, a market condominium development could remain viable with up to 13% affordable ownership units, up to 20% affordable rental units for 25 years, or up to 12% affordable rental units in perpetuity. A new purpose-built rental development does not appear to be viable at this location.

- In emerging areas where new market residential developments are currently marginally viable, the maximum rates of inclusion are much lower:
  - Market condominium developments in Conestoga can support a 1% set-aside rate, in either affordable ownership or rental tenure.
  - Market rental developments in Downtown Cambridge are estimated to have the capacity to support a maximum 6% set-aside rate for affordable rental (at 25-years), or a 3% affordable rental set-aside rate in perpetuity.

Table 8

Estimate of Land Value Impact - Sensitivity 2, 100% AMR/$350 psf														
MTSA	Municipality	Base Land Value Supported by Existing Use	Test Scenarios											
			Proposed Built Form			Tenure	Current Policy	With IZ						
			Site Area (Acre)	Storeys	GFA (sf)			IZ with Aff Condo		IZ with Aff Rental (25 Yrs)		IZ with Aff Rental in Perpetuity		
Conestoga	Waterloo	$2,490,000	1.00	25	300,000	Condo	Viable	< 20% Impact	1%	< 20% Impact	1%	< 20% Impact	1%	
						Rental	Challenge	-	-	No Impact	0%	No Impact	0%	
University of Waterloo	Waterloo	$8,700,000	1.00	12	150,000	Condo	Viable	20%-40% Impact	15%	< 20% Impact	20%	20%-40% Impact	17%	
						Rental	Viable	-	-	< 20% Impact	17%	< 20% Impact	9%	
Uptown	Waterloo	$7,470,000	0.75	25	300,000	Condo	Viable	20%-40% Impact	12%	20%-40% Impact	20%	20%-40% Impact	10%	
						Rental	Viable	-	-	20%-40% Impact	11%	20%-40% Impact	6%	
Midtown (rail corridor northwest to City of Waterloo)	Kitchener	$4,220,000	1.00	25-30	300,000	Condo	Viable	20%-40% Impact	10%	20%-40% Impact	14%	20%-40% Impact	9%	
						Rental	Challenge	-	-	No Impact	0%	No Impact	0%	
Downtown Kitchener	Kitchener	$8,460,000	0.75	25-30	392,040	Condo	Viable	20%-40% Impact	13%	20%-40% Impact	20%	20%-40% Impact	12%	
						Rental	Challenge	-	-	< 20% Impact	0%	< 20% Impact	0%	
Rockway	Kitchener	$3,390,000	1.00	20-25	250,000	Condo	Challenge	No Impact	0%	No Impact	0%	No Impact	0%	
						Rental	Challenge	-	-	< 20% Impact	0%	< 20% Impact	0%	
Fairway	Kitchener	$2,240,000	1.00	15-20	200,000	Condo	Challenge	No Impact	0%	No Impact	0%	No Impact	0%	
						Rental	Challenge	-	-	No Impact	0%	No Impact	0%	
Preston (No BRT/ Future LRT)	Cambridge	$2,880,000	1.00	5	80,000	Condo	Challenge	No Impact	0%	No Impact	0%	No Impact	0%	
						Rental	Challenge	-	-	No Impact	0%	No Impact	0%	
Hespeler Road (Can-Amera north to Cambridge Centre Mall)	Cambridge	$2,240,000	1.00	15-20	200,000	Condo	Challenge	No Impact	0%	No Impact	0%	No Impact	0%	
						Rental	Challenge	-	-	No Impact	0%	No Impact	0%	
Downtown Cambridge/ Main (Existing BRT/ Future LRT)	Cambridge	$4,020,000	0.50	20-25	275,000	Condo	Challenge	No Impact	0%	No Impact	0%	No Impact	0%	
						Rental	Viable	-	-	< 20% Impact	6%	< 20% Impact	3%	

7.0 Conclusions

This review has demonstrated that there are some instances where the current market is likely to have capacity to absorb an IZ policy. However, without a corresponding density offset or financial incentive program, the overall impact of inclusionary zoning in all market locations would be a decrease in total development revenue. This in turn would be absorbed by reducing the land values.

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

Because of this, it will be important that the municipalities implement IZ through a phased approach, signalling the policy change to the market, and then gradually increasing requirements over time.

In the near term, and especially across market locations where development is occurring today, the municipalities should seek to strike a balance with a phased-in policy direction that allows for developers to remain attracted to market development opportunities. Thus, through continued development activity, the desired outcomes of IZ and other transit-oriented development policies can begin to flow.

There is also a longer-term opportunity from a policy perspective that must also be acknowledged. Introducing IZ now – even at low rates of inclusion – especially in weaker high-density markets, means that it may take longer for new development to occur (without counteractive intervention, in the form of financial incentives, for instance). However, with a longer-term policy vision in place, the early introduction of IZ is beneficial because it sets a standard for doing business that will be priced into future market activity (for example, in MTSAs that are employment areas, where mixed use is currently not permitted, pending a Municipal Comprehensive Review).

The municipalities have a range of implementation strategies that have the potential to yield a steady supply of affordable housing using Inclusionary Zoning. The financial testing in this analysis demonstrates that this may be especially true in the strongest market areas of the cities. As Waterloo, Kitchener and Cambridge consider their potential IZ policies, we offer the following recommendations:

- Develop the IZ framework alongside clear development entitlements in each MTSA. A successful IZ policy requires a measure of clarity in as-of-right zoning to form the basis by which land values are established. If there is not clarity around development potential in station area planning, developers will be forced to pay what they view to be approvable through

rezoning in combination with market demand, and less about what might be legally permissible as-of-right.

- There are market locations today where a significant degree of forward-looking planning work has already been put in place. If developers have already paid for anticipated density in advance, the ability to fund affordable housing without a transition policy could be undermined in the near term. This notion was reinforced through changes resulting from Bill 108/ 197 which would require that zoning be updated prior to IZ applying in Protected Major Transit Station Areas. Implementing IZ provisions should limit the speculative nature of land purchases through increased certainty.

- IZ policies must acknowledge the varied and nuanced characteristics of the local market area. Within current market conditions, high density market residential development is not ubiquitous, therefore IZ is not achievable in a uniform fashion without offsetting measures from the municipalities to support development in weaker markets.

- The three Cities should consider implementing IZ policies in parallel with a framework to support development in weaker market zones. This could include Community Improvement Plans or Municipal Capital Facilities By-laws that offer interim financial incentives or a framework to allow for the IZ policy to be amended or waived in instances where developers can demonstrate a lack of feasibility.

- In working to calibrate each municipality's policy responses with market realities, the municipalities should consider a phase in period starting with a low IZ percentage target (set-aside rate) with annual increases; and, an announcement to the market that the IZ policy will come into force in a certain period of time, e.g.in three to five years. Both approaches would allow markets to adjust and for sites which are currently in pre-development stages to proceed and allow land to be priced accordingly.

- Municipal financial incentives could be offered as a measure to 'top-up' on affordability. While the provision of additional density as an approach to offset IZ costs is preferable from a municipal finance perspective, unless expectations around development densities in the selected market areas are subject to significant revision, it is possible that the opportunity to use density as an incentive may be limited in some areas. However, this should be explored through future MTSA work and considered where feasible from a planning perspective.

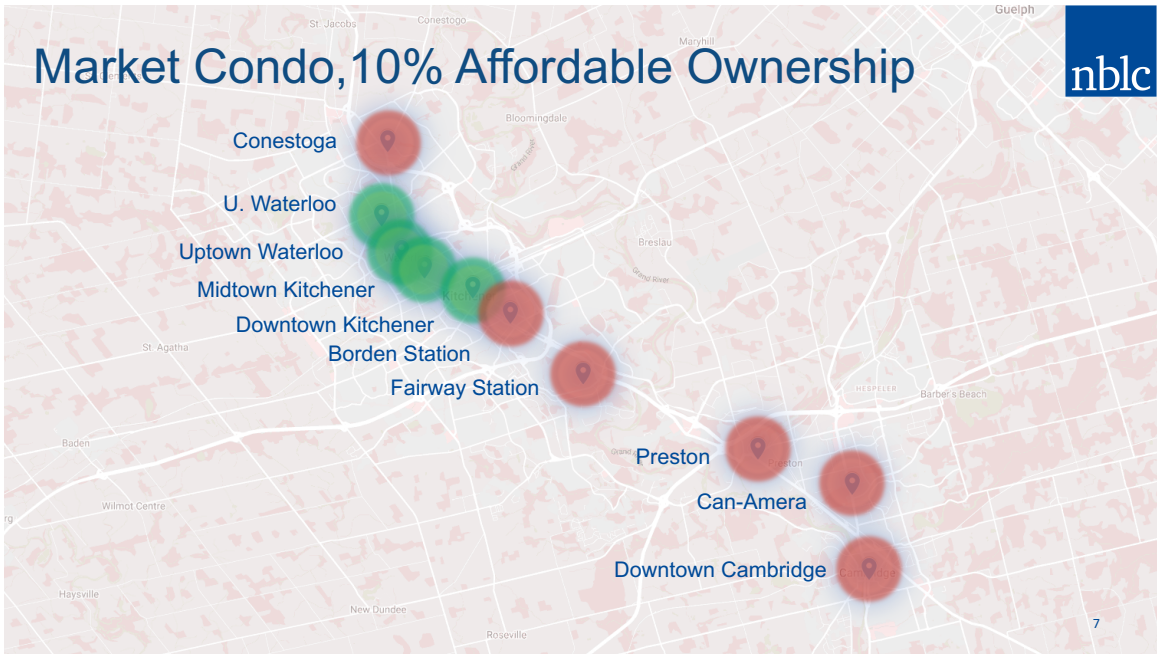
- Avoid implementing high levels of inclusion in market areas where new development investment is being encouraged and the market for new residential investment is currently weak. Moreover, there is limited evidence that the tested inclusionary zoning policy framework would be viable when applied to purpose-built rental housing, outside of the Galt and University of Waterloo market areas.

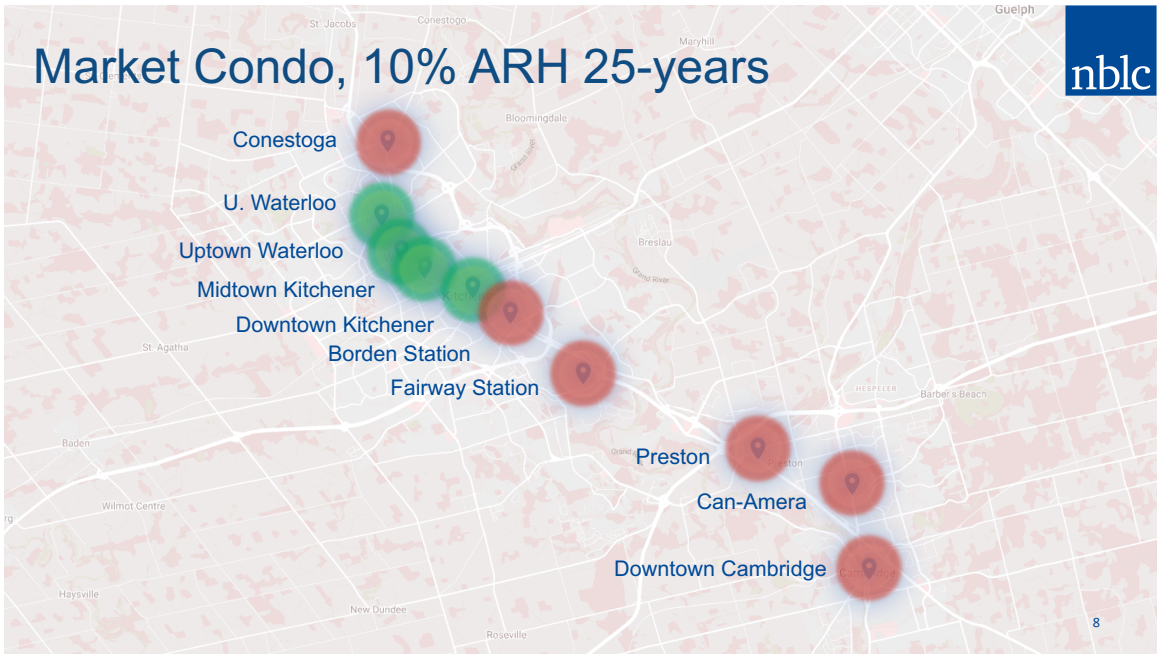
- For an IZ program to have an enduring impact on affordability in the region, the municipalities should seek affordability for units created through IZ in perpetuity, where possible. The use of municipal financial tools could also be considered to 'buy' an extended period, increase the number of affordable units produced, or deepen the level of affordability, in some instances.
- IZ policies need to be paired with clear rules about who owns and operates the units and the types of agreements that would be registered on title to ensure that the policy is implemented. This represents a next step for the municipalities as they consult with council and stakeholders and begin to frame a preferred policy approach in each community.
- Update the IZ policy at regular intervals to ensure that the policy is nimble and able to adjust to the economic realities of the day. Of note, this analysis was completed without fully phased in Community Benefits Charge policies relating to Bill 108/ 197. Moreover, at the time of drafting this report considerations relating to novel coronavirus COVID-19 are impacting global markets. Illustrations of policy and market fluctuations like this emphasize the need for flexibility and regular monitoring of potential IZ policies throughout the municipalities.
- 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 from the perspective of each municipality once MTSA plans are advanced.

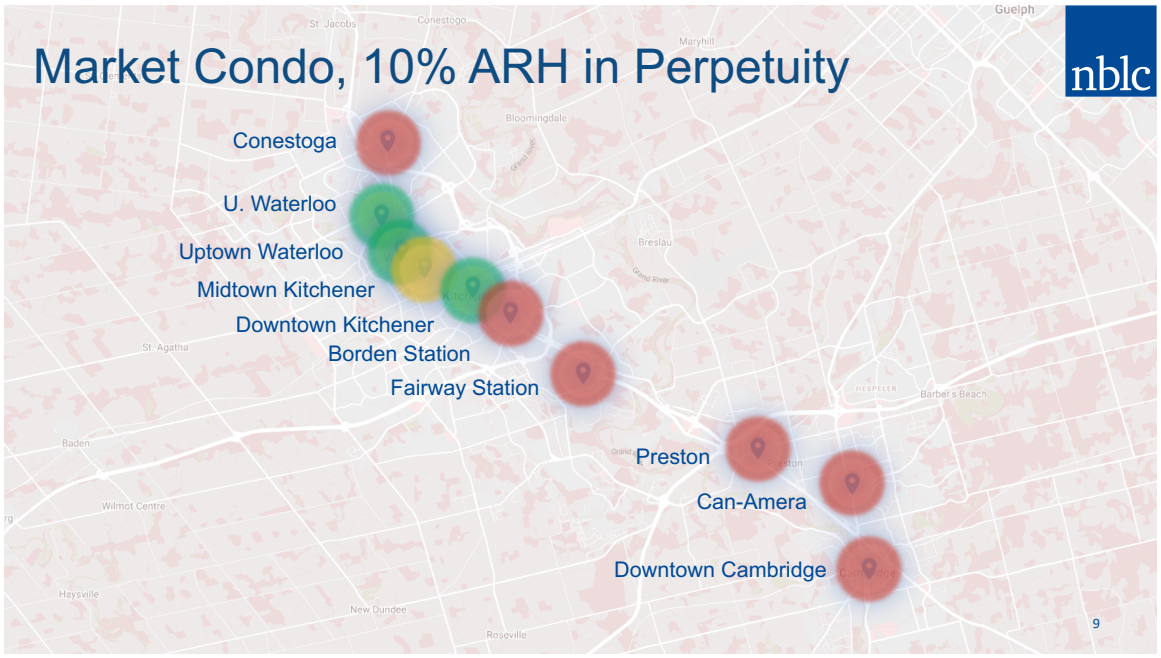
Appendix A –Financial Result Mapping

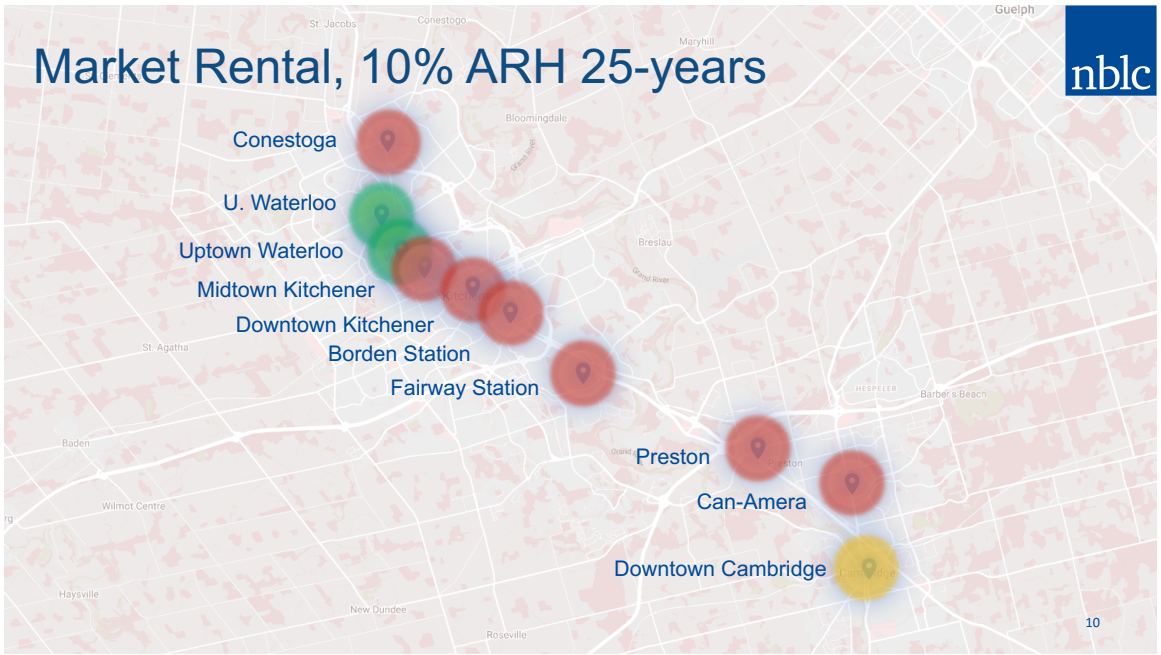


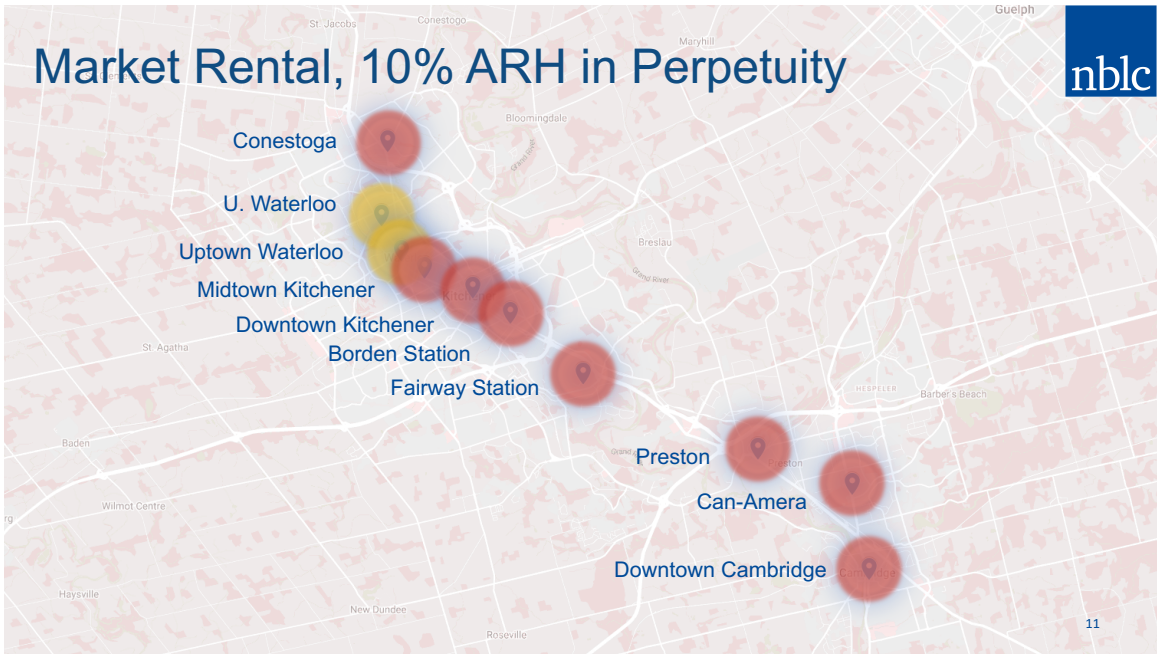



Market Condo,10% Affordable Ownership
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
7


Market Condo, 10% ARH 25-years
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
8

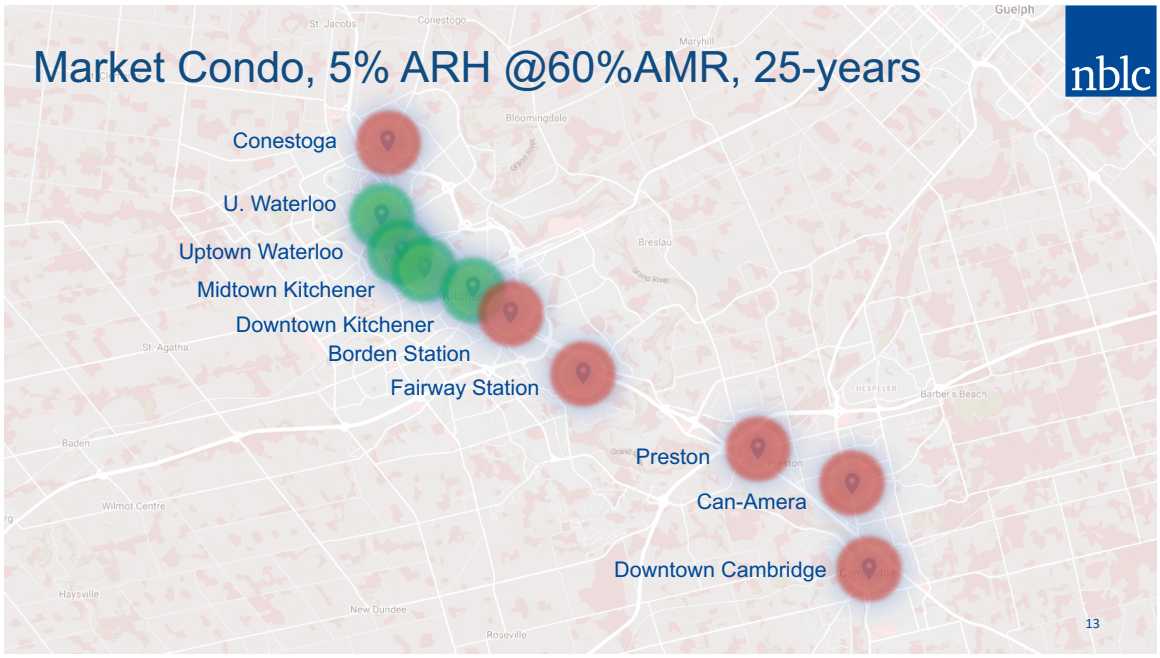

Market Condo, 10% ARH in Perpetuity
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
9

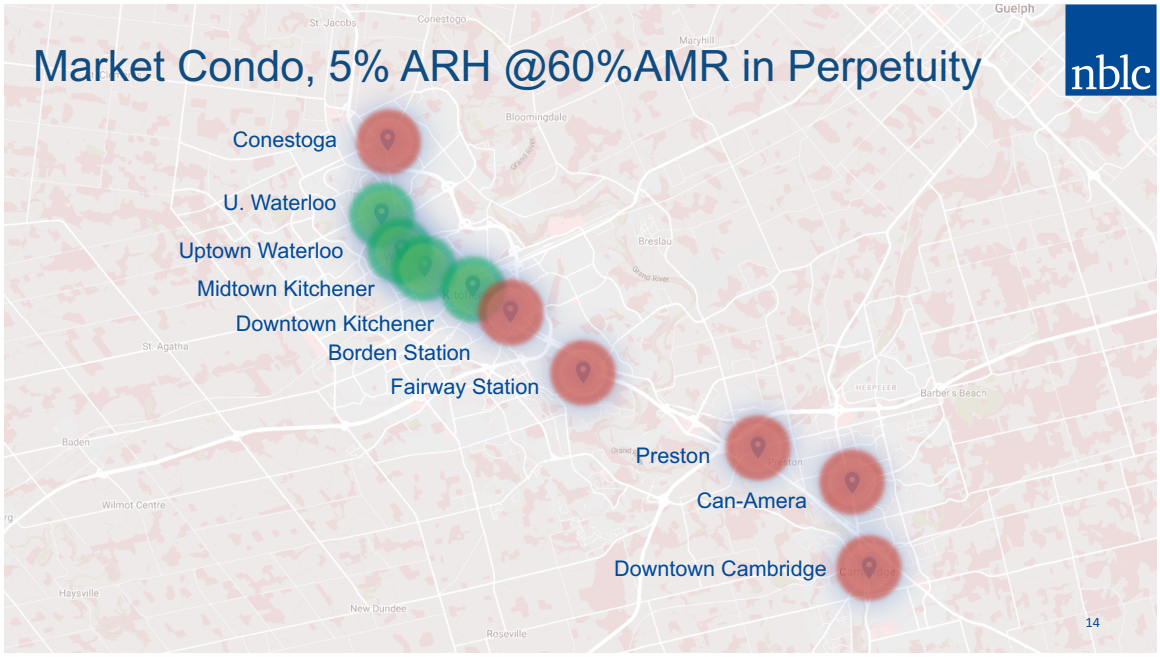

Market Rental, 10% ARH 25-years
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
10

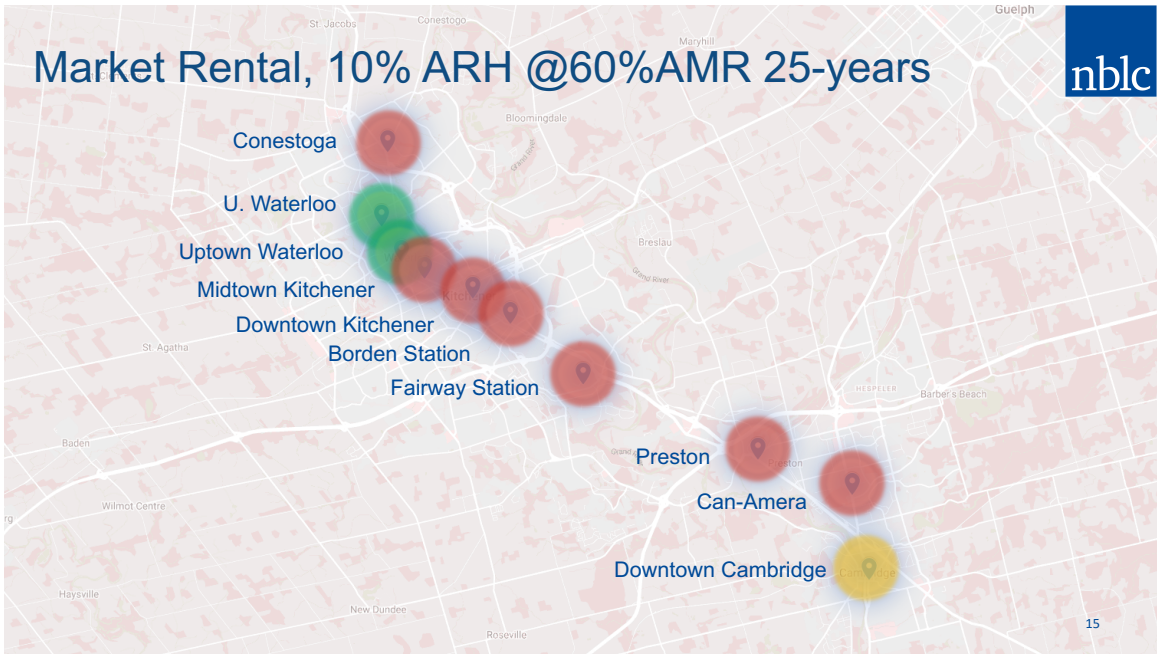


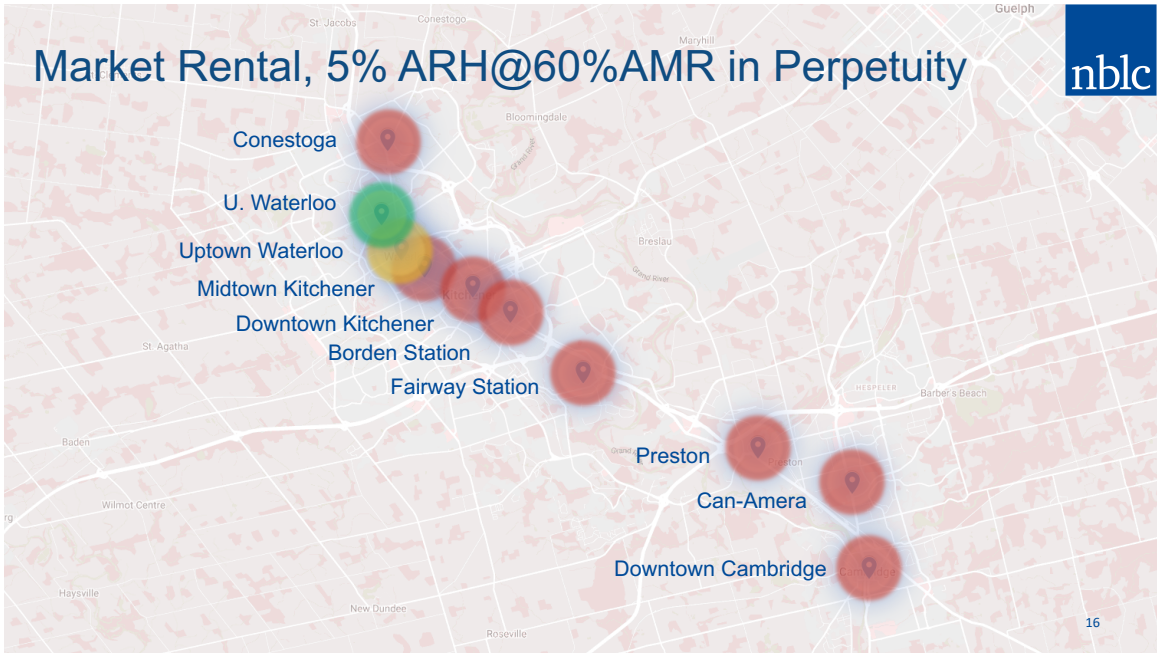
Sensitivity Results




Market Condo, 5% ARH @60%AMR, 25-years
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
13


Market Condo, 5% ARH @60%AMR in Perpetuity
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
14


Market Rental, 10% ARH @60%AMR 25-years
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
15


Market Rental, 5% ARH@60%AMR in Perpetuity
nblc
Conestoga
U. Waterloo
Uptown Waterloo
Midtown Kitchener
Downtown Kitchener
Borden Station
Fairway Station
Preston
Can-Amera
Downtown Cambridge
16



Trusted advisors since 1976.

Appendix C – Key questions to be considered through policy development and community engagement

Questions	Potential Answers
Set Aside Rate	
-What proportion of units should be affordable? -Should there be different set aside rates for different station areas? -Should set aside rates increase over time?	-A range of set aside rates from 1%-20% or more could be considered
Duration	
How long should the affordability of the units be maintained?	10 year, 25 year, or permanent affordability
How can ongoing affordability of ownership units be maintained?	Regulate resale prices eligibility criteria for second purchasers 50% of resale profits to be payed to the city and reinvested in affordable housing
Range of Incomes addressed (depth of affordability)	
Should IZ units target the affordable housing needs of low-income or moderate-income households?	Affordable rent set at: -100% CMHC average market rent[2] (AMR). -60% of AMR -120% AMR
	Rents/prices affordable to households in the: -3rd income decile ($40,000-$53,000) -4th income decile ($53,000-$68,000) -5th income decile ($67,000-$83,000)
Other policy considerations	
Should IZ apply to small projects?	-IZ applies to projects of 10 units or more -40 units or more
What types on units are required?	-Focus on bachelors and three bedroom units -Affordable unit mix similar to market units in the building -40% 1 bedrooms, 40% 2 Bedrooms; 20% 3 Bedrooms as in recent Regional housing program
How big should affordable units be?	-per Waterloo Region Affordable Housing Design Guidelines -Similar to market units
What should be the tenure in affordable units?	-Rental only -Rental and ownership

[2] [2] Affordable Rental Benchmark: Bachelor $810/mo; 1 Bedroom $1,045/mo; 2 Bedroom $1,231/mo; 3 Bedroom $1,300/mo
Affordable Ownership Benchmark: $350/square foot

-Can required IZ units be provided offsite? -How far away can the units be? -When should offsite units be completed?	-Offsite units allowed but with a higher set aside rate /Offsite units not allowed -<400m away, within the same MTSA, in any MTSA -Offsite unit delivered first, agreements to secure offsite units
Should inclusionary requirements apply to as-of-right development?	-IZ requirements apply to all residential projects that meet criteria -IZ requirements only applies via private zoning by-law amendments -A higher rate of inclusion required for increases in density
How should incentives work?	-No incentives -Non-financial incentives e.g. increases in permitted FSR, expedited approvals, reduced parking requirements possible for set aside rates higher than the minimum -Financial incentives such as City fee waivers, tax abatements, capital grants, tax increment grants, ongoing rent subsidies
Program Considerations	
How will affordable rental units in a condominium building be managed?	-Developer responsible for ownership and operation long term -Non-profit (e.g. Kitchener Housing) owns and operates -Region or City owns and operates
-Who decides who gets to live in the units? -Who ensures agreements are being upheld?	City, Region, non-profit, Developers
Who is eligible to live in an IZ unit?	-Minimum/maximum income requirements -Lottery -Waitlist -Priority for key workers, other criteria
-Can residents continue to live in IZ units if incomes increase? -What happens when household size changes?	-Resident can stay in affordable units for as long as they wish -Resident must find other housing if their income increases too much -Couple can stay in a 3 bedroom unit after their children move out.
How much can the rent increase?	-Rent is permanently frozen -rent increases by the provincial rent guideline -Cannot increase rents beyond the annual guidelines, even if major repairs are required

Appendix D - What We Heard From Stakeholders

Knowledge Shared

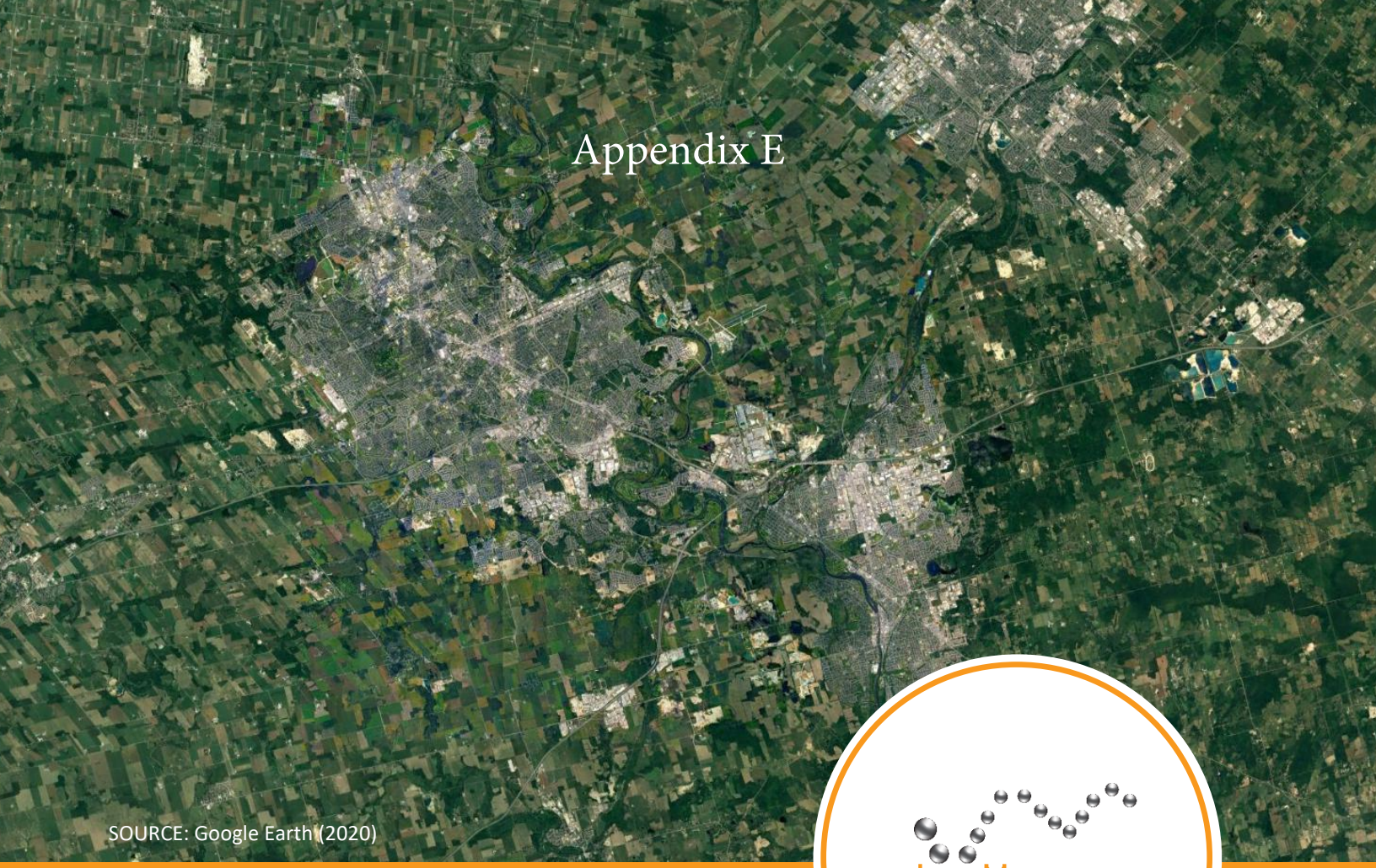
- The cost of land is not a currently a significant part of the cost of a development project
- The profit margin assumptions used in modeling reflect what developers target and what capital investors expect
- The cost of construction labour has significantly increased in recent years
- High rise building construction is more expensive than mid-rise construction
- More cost effective to build affordable housing units in non-core markets
- Having lower parking ratio requirements can be a huge cost savings. It is expensive to provide parking
- The developable land is in short supply. Not many motivated land sellers at this time. Challenging to assemble land for development.
- IZ requirements for affordable ownership units could present project financing challenges
- Have been building mostly 1 bedroom units in high rise buildings

Questions

- What is considered to be affordable unit price for ownership and rental?
- What need along the housing continuum is IZ intended to address?
- What percentage of units will be required to be affordable?
- How long will rental units be required to be affordable?
- Will the IZ requirements differ by geography?
- Who will administer/ manage the affordable rental units?
- Who will be eligible to buy/rent the affordable units?
- Can cash in lieu be provided instead of affordable units? Can units be provided onsite?
- Can units be provided onsite?
- What type of unit (bedroom size) and size would the affordable units be required to be?
- Can developments receive addition density in exchange for provision of affordable housing units?
- Who will ultimately bear the cost of the IZ zoning policy?
- How will the proposed Community Benefit Charges influence the viability of IZ?
- When would an IZ policy take effect?
- How will the IZ policy be monitored?

Feedback/ Suggestions

- Generally supportive of Residual Land Value (RLV) approach, but with concerns that land values may not actually decrease in the real world
- Would not want IZ policy to impact developments 'in process'
- IZ may not be viable in current markets but may be feasible over time. IZ policy should be introduced slowly over time and should be signaled in advance to land vendors and developers. Do not want IZ to halt development or disrupt the market.
- IZ could have a similar impact as expiration of Development Charge exception in Downtown Kitchener in 2019 where see a lot of development occur before IZ policy takes effect
- Agree there is affordable housing crisis. IZ should not be the only tool utilized to address it.
- Concern that IZ may cause the market unit prices to inflate to offset the cost of affordable housing units. Significant increases in market unit prices would be problematic.
- Encourage municipalities to make municipal owned land available for development
- Developers may want to have some influence in who resides in the affordable units



SOURCE: Google Earth (2020)

urbanMetrics inc.
market, economic and strategic advisors

EVALUATION OF IMPACTS OF INCLUSIONARY ZONING POLICY

Peer Review

Kitchener / Cambridge / Waterloo, Ontario

Prepared for the **Cities of Kitchener, Cambridge, Waterloo**

September 16, 2020

urbanMetrics inc.
market, economic and strategic advisors

KITCHENER

CANADA
CAMBRIDGE

THE CITY OF
Waterloo

This document is available in alternative formats upon request by contacting:

info@urbanMetrics.ca
416-351-8585 (1-800-505-8755)

September 16, 2020

Cities of Cambridge, Kitchener, Waterloo
c/o Tim Donegani
Senior Planner
City of Kitchener
200 King Street West
Kitchener, Ontario
N2G 4G7

Dear Tim:

RE: Evaluation of Impacts of Inclusionary Zoning Policy – Peer Review (Kitchener / Cambridge / Waterloo, Ontario)

urbanMetrics inc. ("urbanMetrics", "uMi") is pleased to submit the following peer review of the April 2020 draft report titled *Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning Policy*, prepared by N. Barry Lyon Consultants Ltd. ("NBLC") on behalf of the Cities of Cambridge, Kitchener, Waterloo and Waterloo Region.

Based on our review of the subject report and our own re-cast of selected elements of the associated financial analyses relied upon to inform the findings of the study, we ultimately support the work prepared by NBLC and are **confident that the study adequately addresses the requirements set out in Ontario Regulation 232/18** with respect to the implementation of new Inclusionary Zoning programs. In particular, **we have not identified any material deficiencies in the work prepared** by NBLC and generally note that they appear to have **completed a detailed, thorough and accurate financial analysis**. This analysis appropriately captures the required nuance and submarket-specific conditions across the various subject communities while also having regard for the inherently high-level nature of this type of analysis in informing municipal land use planning policy.

The following opinion letter provides a more detailed overview as to the underlying purpose and scope of our review, urbanMetrics commentary as to the appropriateness of the underlying methodology employed by NBLC—including associated analytical assumptions and statistical inputs—as well as our own professional opinions as to the interpretation of the research findings presented and final recommendations advanced by NBLC.

1.0 Introduction

1.1 Background

In 2018, the Provincial government passed Regulation 232/18, which allows municipalities to implement Inclusionary Zoning ("IZ") policies under certain predefined conditions and parameters. Simply put, IZ is essentially a housing policy approach that seeks to secure non-market housing as a biproduct of broader market developments. The policy tool has been implemented in many jurisdictions throughout the United States—to varying degrees of success—and the approach is now being actively studied and considered in many Canadian cities, including across Ontario.

In response to the above policy direction at the Provincial level, the Cities of Cambridge, Kitchener, Waterloo and Region of Waterloo collectively commissioned a study specifically targeted at preparing a more detailed investigation and testing of local development conditions; ultimately informing whether the adoption of an IZ policy framework is economically feasible in this jurisdictional and locational context. More specifically, the purpose of this study has been to explore how the implementation of a new IZ framework could impact development activity in these communities, with the objective of maximizing the creation of new affordable housing units and minimizing any unwanted impacts on investment interest, land values or overall market affordability.

To complete this study, the subject municipalities have retained the services of NBLC, a consulting practice specializing in housing, development feasibility analysis and real estate strategy. As outlined in more detail herein, the NBLC study has largely been completed at this stage, including an extensive supporting research program, the preparation of financial pro forma analyses for a number of different submarket areas (10), consideration for a range of alternative scenarios or potential outcomes by way of corresponding "sensitivity analyses", consultations with local real estate professionals active in the Waterloo Region market (i.e., the development community), and delivery of a complete draft report inclusive of all related research findings, conclusions and recommendations as of April 2020.

1.2 Purpose

The aforementioned introduction of new IZ policies by the Government of Ontario under the Planning Act resulted in Ontario Regulation 232/18, which was filed on April 11, 2018. The study commissioned by the subject municipalities and completed by NBLC is ultimately intended to satisfy the requirement for the "Assessment Report" identified under this regulation and as part of the

municipalities' consideration for developing new Official Plan policies. As noted in the NBLC report, this Assessment Report is required to provide an "analysis of potential impacts on the housing market and on the financial viability of development or redevelopment in the municipality from inclusionary zoning by-laws" and specifically taking into account the following factors:

- value of land;
- cost of construction;
- market price;
- market rent; and
- housing demand and supply.

Further to above, Ontario Regulation 232/18 also requires a "written opinion on the analysis" described above that is prepared by a "person independent of the municipality and who, in the opinion of the council of the municipality, is qualified to review the analysis". In satisfying this measure, the Cities of Cambridge, Kitchener and Waterloo have now retained the services of urbanMetrics to undertake this peer review and written opinion of the NBLC study.

Although the consideration for implementing IZ policies is a relatively new concept for Ontario municipalities and therefore very few of these peer reviews—if any—have been completed to date, we note that they are commonplace in various other areas of land use planning and the municipal development approvals process. In particular, they are perhaps most common as part of critiquing other types of land economics assignments, including market demand and impact studies and/or in support of dispute resolution (e.g., in preparation for OMB/LPAT hearings, etc.).

In our experience, these types of studies are typically intended to provide a municipality or other public sector organization with an **unbiased, third-party perspective and to further validate (or refute) the findings presented as part of an original research assignment**. To this end, urbanMetrics' role for this assignment has ultimately been to **ensure the underlying appropriateness, accuracy and suitability of the study prepared by NBLC**, thereby providing the subject municipalities with additional confidence in the findings presented.

1.3 Scope

It is important to make clear at the outset of this review the underlying extent and scope of our involvement with this assignment. As established in the original Terms of Reference with the City of Kitchener (and also on behalf of the City of Waterloo and City of Cambridge), this review has generally been intended to address a number of core elements of the NBLC study and ultimately to prepare the following key tasks/deliverables:

- Written opinion of NBLC draft report of April 2020 (as presented in this document).
- Determination as to whether the draft report meets the requirements in Ontario Regulation 232/18.
- A review of the: (i) appropriateness of the methodological structure of the analysis; and (ii) the validity of the key assumptions and inputs relied upon by NBLC.
- Review of 3-4 sample pro forma analyses prepared by NBLC (assumed to be sufficiently representative of the larger body of work undertaken).
- Commentary on the key findings and recommendations provided, including in the context of "real world" applications.

In addition to the specific tasks identified above, we have also engaged in ongoing and active discussions with municipal staff and appropriate representatives of NBLC at a number of occasions, including liaising with relevant technical/analytical staff to clarify our understanding of the analysis and key data inputs, as needed.

In light of the above scope of work, and as agreed upon with the subject municipalities before undertaking this review, we further note that there are a number of specific exclusions and/or limitations to our review, including but not necessarily limited to the following:

- We have not validated the calculation of relevant development-related municipal fees and charges (e.g., development charges, planning application fees, etc.), which are all assumed to be sufficiently accurate for the purposes of this review and have already been vetted by each of the lower tier municipalities involved.
- Beyond a high-level review of their general suitability and consistency with current development patterns, we have not provided a direct critique nor other commentary on the conceptual developments considered by NBLC within each of the ten submarket areas identified (e.g., with respect to overall scale of development, densities, consistency with municipal policy and development permissions, etc.). We assume that these have all been appropriately reviewed and accepted by municipal staff before being tested for viability.
- We have not prepared a detailed, line-by-line audit of the 140 financial pro forma analyses produced by NBLC and all corresponding spreadsheets, cell references, etc. Instead, and respecting the propriety nature of many of these elements of the study, we have undertaken a more high-level review and recast of sample pro forma analyses provided by NBLC in PDF format. Given that all of the distinct feasibility analyses and related sensitivities follow a similar/identical analytical structure and format, these are generally assumed to be appropriately representative of the entire body of work prepared by NBLC as part of this assignment.

2.0 Review

2.1 Methodology

The following section details our high-level review of the methodology employed by NBLC to evaluate the effects of IZ on the financial feasibility of development in each MTSA considering a combination of tenures (i.e., condo and rental) and affordability types.

Analytical Structure & Approach

In completing this type of community-wide feasibility analysis and ultimately informing future municipal policies, it is important to emphasize that no two development sites are the same and individual developers will have varying motivations and return expectations (or requirements) to consider when investigating a new development project. This presents one of the single greatest challenges in assessing the impacts of IZ on the financial viability of development across broad market areas. With this in mind, the following provides a brief overview of our review, understanding and commentary on the fundamental methodologies and approach adopted by NBLC as part of this study.

- The approach taken by NBLC was to first develop prototypical development concepts for each of the ten submarkets identified based on emerging development trends, as well as consultations with City staff and the development community. These development concepts considered both purpose-built rental and condominium/ownership tenures in each submarket. In our experience, although not without its pitfalls in terms of appropriately reflecting the potential unique conditions or requirements of individual sites, this general approach is certainly most common and can generally be considered an emerging “best practice” for such high-level analysis. Similarly, we can confirm that urbanMetrics has regularly employed a similar methodology in other municipal jurisdictions where this type of high-level demonstrative or illustrative analysis was required.
- Utilising these prototypical developments, NBLC then assessed the financial viability of development using a residual land value (RLV) approach to estimate the maximum land value a developer may be willing—or able—to pay for a development site while also meeting their own internal development return requirements. Often utilized in the development community as a “first pass” when underwriting potential development site acquisitions, an RLV assessment requires less detail and specificity than a more comprehensive discounted cash flow (DCF) proforma modelling technique typically relied upon once a site has already been identified as having some underlying development potential. The latter DCF approach is

generally more appropriate when a detailed site-specific development concept is being tested and optimized to ensure returns will be met and financing can be secured. In our experience, if a development site is unable to pass the preliminary RLV test, it is unlikely to be feasible when modeled on a DCF basis. As such, while this general approach will not necessarily guarantee the future feasibility of a given development project, it typically provides an appropriate measure of viability and economic promise at a much earlier stage such as this (i.e., as part of a municipal policy exercise).

- Given the challenges of evaluating IZ policies across ten distinct submarkets and hundreds of unique sites, we believe that the RLV approach is appropriate for informing policy-based decisions such as this, whereas a DCF model is only appropriate for site-specific analysis when more detailed development plans are available (i.e., detailed design stage of development or immediately approaching market entry).
- Additionally, we note that the NBLC analysis involved the creation of some 140 unique proforma models, which would have otherwise required an unnecessarily burdensome amount of time and resources to complete as a DCF for each scenario. It is our opinion that this additional effort would have been of little to no value to the subject municipalities, yielding marginal—if any—benefit. Similarly, we note that—as a perquisite to undertaking any more detailed analysis than already prepared by NBLC—additional design conceptualization and site-specific considerations would have been required, which are not necessarily available from the three lower-tier municipalities at this time.
- In order to estimate the impact to land values associated with the implementation of IZ, NBLC undertook the following specific work steps:
    - Firstly, estimates of the base land value for each prototypical development were established based on prevalent existing under-utilized uses in each submarket area.
    - Next, redevelopment for both condo and rental residential uses were tested under the current policy (i.e., with no IZ) to understand if development is viable before an IZ policy is implemented.
    - Finally, various implementations of IZ were tested considering different levels of affordability (condo) and affordability periods (rental). If the land value of any redevelopment scenario approached (within 10%) or fell below the base value of a site, NBLC assumed that the viability of the development project would be in question. This assumes that if a residential developer cannot offer the existing landowner at least 10% higher than a site's base value, it will not be enough to motivate a landowner to close their business and sell their site to the developer.

> In executing this assessment, NBLC also notes that: "*The policy framework is forward looking. It considers the implications for development if a developer were to pursue land acquisition and development under current market conditions.*" Perhaps more accurately, we would suggest that it rather takes into account current market conditions to then forecast potential or likely future conditions (e.g., considering growth in both revenues and costs, etc.), which is a suitable approach in our opinion.

Overall, we find this to be a **reasonable approach for understanding the high-level implication of implementing IZ within each submarket**. We do, however, caution that it is unlikely that the prototypical base land values assigned to each submarket will be consistent with current landowners' actual or perceived values on a more site-by-site basis. NBLC also recognizes and acknowledges this limitation as part of the following note in Section 5.5 of their report:

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

To appropriately reflect this limitation, it will be important for the subject municipalities to provide sufficient flexibility in their IZ policies, even in areas where financial viability may appear strong with IZ, as presented in the analysis prepared by NBLC.

Application & Accuracy

As part of our methodological review, NBLC has provided us with detailed RLV models for four sample submarkets representing varying locational and market conditions across the Region. These include: the *University of Waterloo MTSA*, the *Central/ Victoria Park/ Queen/ Kitchener City Hall/ Frederick MTSA,* the *Fairway MTSA*, and the *Downtown Cambridge/ Main (Existing BRT/ Future LRT) MTSA*.

Although it is outside of the scope of this peer review to perform a line-by-line audit of each model, we have ensured that the mathematical approach to calculate the residual land value under each scenario is sound and that the general equations appear to be correctly formed. Furthermore, we have also conducted a high-level "spot check" across each of the RLV models to identify any obvious inconsistencies or analytical deficiencies.

Through our review of the sample models provided, we have co-ordinated directly with NBLC on numerous occasions to obtain further clarification in several areas. These topics and discussions included, but were not necessarily limited to, the following:

- the application of parking requirements and suitability of parking types;

- the use of market revenue assumptions which are higher than their market research reflected in Table 1;
- property tax assumptions;
- construction financing rates and construction draw schedules;
- the inclusion of HST in both the revenue and cost calculations;
- the methodology for valuing the affordable rental scenario with a 25-year term; and
- the appropriateness of the discount rate applied.

Based on the high-level scope of this peer review, we cannot be certain that the NBLC analysis is completely error free, however, based on our detailed discussions and NBLC's additional background research, combined with our own review and spot check, **we are sufficiently confident that the RLV approach described above has been applied correctly and accurately.**

2.2 Inputs & Data

Based on the general analytical structure set out in the previous section of this review, the following provides a more detailed overview of our findings with respect to a number of the more specific sub-elements of the NBLC study. This includes the range of specific inputs, assumptions and other statistical sources relied upon to complete the subject analyses.

Development Concepts

Table 3 of the NBLC report summarizes the prototypical site assumptions (e.g., site area, building height, Gross Floor Area) while Table 4 summarizes prototypical units and parking assumptions (e.g., average unit size, parking ratio, unit and parking pricing, absorption) for each of the ten submarkets.

In our opinion, these assumptions appear **reasonable and reflective of both existing policies and emerging development trends** present in each submarket. The general scale and nature of development contemplated is also consistent with our own professional experience in this part of the Province, including work directly on behalf of the local development community and/or other landowners and investors.

Market Information

- **"As is, where is" Base Land Values**

  The base land values upon which all development scenarios were judged have been calculated using land values of existing low-density commercial uses. While this may not be a perfect solution, it likely represents the most appropriate high-level and consistent assumption available to NBLC in this particular application (i.e., that which best reflects the current conditions on many of the properties located within the various submarkets or MTSA's identified). As noted earlier, there are some inherent and unavoidable limitations to this type of analysis in terms of potential disconnect between the land values modelled in the analysis versus the actual or perceived values for specific landowners throughout these areas.

  This is a distinct challenge of introducing any new IZ policy framework, whereby local landowners could be reluctant to acknowledge or accept downward pressures on land values. This reluctance to accept downward pressure on land values can be particularly strong for sites that currently may be worth more to the owners based on the existing income generating operations than the one-time payout of selling the site for re-development. NBLC provides an illustrative example of such a situation on page 6 of their report. Furthermore, we also note that land values do tend to be more resilient to change or market fluctuation and generally exhibit a certain level of "stickiness" relative to other forms of real estate pricing (e.g., price per square foot sales levels, which are more immediately responsive to changing market conditions or consumer preferences, land use policy amendments, infrastructure announcements, etc.). As highlighted by NBLC, the resulting risk of this dynamic is that overall development activity is thereby reduced given the weakened financial prospects resulting from the lower revenue-generating opportunities inherently presented by non-market/affordable housing options.

  As recommended by NBLC and discussed further herein, there are nonetheless a number of approaches that can potentially be utilized by the subject municipalities in addressing these risks, including gradual introduction of policy changes, continued monitoring of market impacts on a go-forward basis, as well as a broader commitment to frequent and direct communication with the local development community/landowners.

- **Revenue Assumptions**

  Table 1 in the NBLC report summarizes the results of their high-level scan of condominium sale prices and rents across the ten submarkets, while Table 2 details the affordability levels considered in the RLV models. Through discussions with NBLC, we note that the market sales assumption ultimately input into the RLV models (as contained in Table 4) are slightly higher as they are based on the most recently launched projects captured within the research sample and therefore most indicative of potential ongoing or future market conditions. Based on our

high-level review, **the revenue assumptions (including additional interim occupancy charges and various recoveries) appear reasonable**.

We will, however, **underscore the importance of updating these assumptions regularly on a go-forward basis**, especially considering the potential short/medium-term effects of the ongoing COVID-19 pandemic.

Ground Floor Commercial Uses in Mixed Use Developments

Although not directly related to the core housing focus of this analysis (i.e., including both market and non-market components), NBLC acknowledges that—in some areas—prevailing planning policy would require developments to be mixed-use, thereby incorporating some commercial uses within the development on a given site. It is our understanding, however, that the RLV models prepared by NBLC assume that these types of commercial spaces would be "revenue neutral" and therefore have been excluded from their analysis, accordingly.

Based on our experience across suburban and emerging urban markets across Ontario, we note that—while nonetheless important in achieving active and animated complete communities—these grade-related retail and service commercial spaces can, in many cases, remain vacant for many years and indeed reduce the profitability of broader mixed-use projects. We further note that, during underwriting, it has become increasingly common for developers to assume "zero" revenues from this portion of a given building, yet still consider the associated costs as a more conservative approach (i.e., appropriately reflecting the potential risks associated with investing in the construction of these non-residential spaces yet not necessarily realizing the corresponding revenues). Therefore, although we generally agree with the approach adopted by NBLC in this regard (particularly for the sake of simplicity), we would recommend that any requirements to include commercial spaces as part of future developments within the subject MTSA's should be carefully considered before or in parallel to the implementation of new IZ policy.

- **Hard Costs Assumptions**

  The RLV models rely on the hard cost estimates from the Altus Construction Cost Guide. It is our understanding that these costs per square foot ratios were also vetted and confirmed by representatives from the local development community as being appropriate in this application. Given the high-level nature of the development concepts considered and in the absence of more site or development-specific cost estimates from a quantity surveyor, **we consider the hard costs in the Altus Guide appropriate** for inclusion in this type of RLV analysis.

- **Soft Cost Assumptions**

  Municipal development fees (including planning application fees, building permit fees, development charges, parkland contributions, and property taxes), which make up a large portion of soft costs, have been included by NBLC as direct inputs from the Region and local lower-tier municipalities. Other soft costs have been estimated as a percentage of hard costs based on typical "rule of thumb" type ratios, a common technique across all real estate

proforma analysis. In our opinion, this is an appropriate level of detail to have included in this portion of the analysis and consistent with the approaches commonly utilized by urbanMetrics.

Other Assumptions

In addition to the more targeted market-based assumptions, the RLV models require several assumptions that must go beyond what today's market research reveals and therefore incorporate an element of professional judgement. These include:

- **Capitalization Rates (Cap Rates)**

  Combined with the net operating income (NOI) expected from the new buildings, cap rates are used to estimate an income-producing asset's value upon completion. Market cap rates across all asset classes are readily reported on for both current and historical periods, however, future cap rates are unknown and must be forecast based on the modeller's best estimate of future market conditions and expected investment returns. The cap rates utilized by NBLC are generally in-line with the current cap rates reported by CBRE in Kitchener–Waterloo as of Q2 2020 and in our opinion, are reasonable to assume over the short- to medium-term in the Region.

- **Revenue & Cost Growth**

  The RLV models utilized by NBLC involve consideration for market conditions over future periods and as such, current market revenue and cost assumptions were assumed to grow into the future. In particular, NBLC has conservatively assumed that both revenues and costs will grow by some 2% annually on a go-forward basis. We appreciate this conservative growth rate (by comparison to recent/historical patterns) and believe that by assuming revenues and costs will grow equally, the future value of development land is not reliant on growth in market demand (i.e., revenue growth) outpacing the corresponding growth of costs, which would then speculatively add value to land into the future.

  Moreover, based on follow-up discussions and responses to targeted questions posed by urbanMetrics, we understand that NBLC have not applied a unique growth rate to the future municipal fee portion of soft costs (e.g., development charges). This was an active decision on their part to hold the rate of growth for municipal fees directly in line with other hard and soft construction costs, with recognition and acknowledgement of the fact that these could ultimately fluctuate in time. While we note that this could ultimately understate the potential future costs associated with increased municipal fees—which could very likely increase at a rate of greater than 2% on average in the coming years—we appreciate that this is difficult to pinpoint based on uncertainty in the future cost recovery needs of the subject municipalities

in future periods. Regardless, we do not anticipate this will necessarily result in a material impact on feasibility, as characterized in the context of this study. In particular, as confirmed and noted by NBLC, these fees are typically levied relatively early on in the development process (upon issuance of building permits), so any impacts of applying a unique growth rate to these figures would only be marginal. That is, they are unlikely to deviate significantly from current rate structures in a relatively short period of time.

- **Developer's Profit**

  A key component of any RLV model is to account for, and preserve, a reasonable developers' profit. NBLC has set-aside a total of 15% of project revenues to reflect this opportunity for profit-generation. It is important to note that—although developers often do not achieve the targeted profit margin included in their RLV upon completion of a development project—assuming anything less at this early stage of the development process would not allow for the real world "wiggle room" that development projects often need to see them through more detailed site-specific planning process and execution. This, in effect, serves to reflect an appropriate contingency or "buffer" on any profit margins, thereby allowing for potential future fluctuations (increases) in costs, poor sales performance and/or other potential unforeseen circumstances. Furthermore, a healthy profit margin ensures that projects will secure financing in terms of presenting more favourably to prospective lenders.

  Overall, and in consideration for the above factors, developers typically underwrite their projects at a baseline or starting point of 15% (in our experience), although anywhere in the range of 10-20% is generally considered reasonable or an appropriate benchmark in this type of application. NBLC's decision to target the middle end of this range is appropriate both in terms of exercising reasonable conservatism, but also in terms of consistency with our own work and practices of the development community itself.

- **Discount Rate**

  The NBLC models assume that revenues, costs and developer's profit will occur more than 5 years after land acquisition and a 6.0% discount rate was applied to calculate their present value and the amount that the developer would be able to pay for land today. Through supplementary conversations with NBLC, we understand that this discount rate was chosen in large part through their previous consulting experience with the development community in comparable Ontario communities. Although it is impossible to know each individual developer's discount rate–which undoubtably will vary, typically somewhere in the range of 6% to 12%–we believe that 6% is an appropriate "blanketed" assumption in this case where there is a need for consistent and blended averages across multiple properties and geographies. If anything, however, we do note that this may be potentially optimistic.

Overall, we believe that the **assumptions requiring professional judgement have been reasonably considered by NBLC** and serve to ensure that land values across all scenarios and submarkets are comparable to their base values.

2.3 Interpretation of Findings

As is the case with any land economics assignment of this nature, it is important to not only ensure the quantitative methods and underlying calculations, assumptions and statistical inputs are sound and appropriately representative of potential real-world conditions, but also to validate the resulting interpretation of the analysis and any key takeaways and recommendations. That is, the analysis needs to go "beyond the numbers" and achieve some substance in more practical vs. theoretical applications.

Whereas the previous sections of this review substantiate the more technical aspects of the NBLC study, the following focuses on providing a secondary review of their end conclusions and recommendations to the subject municipalities from the perspective of future implementation. Overall, we **agree with the general advice and observations made by NBLC in light of the analysis presented**. There is a direct and immediate connection to the analytical findings established and the recommendations thereof.

Flexibility in Policy

As noted previously in this review—and as addressed directly by NBLC—it will be critical to ensure that appropriate flexibility is built in to any future IZ policy established by local area municipalities. In our opinion, this is generally two-fold:

- Firstly, given the hypothetical nature of this analysis for demonstrative parcels of land within each submarket, there will undoubtedly be unique development conditions, expectations and resulting land pricing for individual sites in practice versus theoretical development projects. Although it is impossible to truly capture all the distinct conditions on each of these sites, it is nonetheless important to accommodate the range of possibilities or potential outcomes in this regard. As such, a future policy implementation that avoids being overly prescriptive while also maintaining sufficient protection of the underlying objectives or strategic goals of the municipalities will be important.
- Secondly, and notwithstanding the above, NBLC highlights the obvious diversity of market conditions across the Region. In addition to general flexibility to bridge the gap between policy and the realities of the real estate market, it will also be important to encompass the full range of development conditions presented across the various submarkets—and/or individual sites—identified within each municipal jurisdiction. At its most basic manifestation, we agree

with NBLC's recommendations that targeted financial incentives may be required to compensate for the obvious reduction in revenues associated with affordable housing minimums; particularly in the context of poorer-performing or "weaker" market areas. In addition, however, we further note that there could be a myriad of other parameters or "levers" that can potentially be considered by the subject municipalities to improve feasibility conditions in more isolated cases, including:

- adjusting the quantum of affordable housing required (i.e., total % of units or floor areas required);
- modifying the "depth" of affordability in terms of targeting a different proportion or representation for low and moderate income households;
- considering reductions in parking requirements (although we do note that the rates assumed by NBLC are already relatively low); as well as
- offering opportunities for additional density permissions (i.e., simple exchange for additional market-based height or density).

Further to above, it could be important to consider appropriate policy mechanism(s) that allow for site-specific exemptions or other accommodations to achieve appropriate conditions on unique and/or strategic sites. For example, there will inevitably be sites that are particularly challenging from the perspective of viability (e.g., severe contamination and remediation costs, difficult or complex physical/location/access characteristics, awkward relationship with surrounding land uses, exceptionally large sites for which unique challenges are presented with respect to phasing and possible absorption timelines, etc.). Loosening of some of the IZ policies may be required in order to continue to incentivize and/or allow for development to occur for these types of sites. Similarly, there may be specific strategic sites for which the various lower-tier municipalities would like to secure additional development to achieve other planning or economic development-related objectives, which require discretionary relaxation of policy to alleviate constraints to develop relating to reduced opportunities for revenue generation.

Gradual Introduction

In their draft reporting, and based on our own discussions with relevant members of their team, NBLC appears to advocate for introducing any new IZ policies gradually or "turning the taps on slow", so as to provide appropriate advanced warning to landowners and the development community. Although in theory—and perhaps at face value—this could delay the delivery of new affordable housing supply to the Region, we ultimately agree with their assessment and believe that this is a necessary first step to ensure the longer-term sustainability of the new policy framework. This may also serve to avoid any unwanted immediate or short-term "shocks" in the local market area(s).

In addition to establishing a reasonable timeline for introduction of the new IZ policy, this initiative should also be accompanied by active and regular communication, education and outreach with the development community to ensure clarity of the intended direction and motivations of this policy, as well as the anticipated outcomes from the perspective of each of the municipalities.

Monitoring Framework

Consistent with the notion of a gradual introduction of new IZ policies, per above, a related and subsequent task for the municipalities will be to continuously monitor the market impacts of the new IZ policy and to actively adjust in response to any unwanted changes. This will also be required to simply update and reflect constant changes in a dynamic real estate market, including: evolving construction cost profiles and rates, changing revenue/demand prospects, adjustments to developer preferences, ongoing supply/demand relationships, broader macroeconomic trends, etc. Similarly, as alluded to in some of the case study examples identified by NBLC (e.g., New York City), there may be a need to hear appeals or challenges to the policy in circumstances for which a reasonable agreement cannot be established between municipal authorities and local landowners/developers.

With respect to future monitoring, however, we recognize that this will be particularly challenging in an environment of limited financial and/or staff resources and potential lack of in-house subject matter expertise within each of the subject municipalities. These challenges could also be further exacerbated by the fact that there likely will not be sufficient scale or magnitude of IZ-related development activity to justify the costs of monitoring in this manner (e.g., relative to other larger municipalities where there could be a critical mass of development to warrant such a framework).

One potential solution to this problem would be to simplify the analyses prepared by NBLC and effectively isolate or reduce to the model to its core principles (i.e., a “bare bones” version of the same modelling that follows the same general RLV structure but with fewer individual assumptions or statistical elements to be updated). This may facilitate any future updates by municipal staff and/or others involved that may not be able to offer the same level of expertise as external consultants.

Although we generally caution municipalities against updating or re-running these types of financial models in isolation and without an appropriate understanding of the underlying concepts and requirements for said inputs, this approach may nonetheless offer an interim or temporary solution that requires less significant time and effort (as well as reduced risk of inaccuracy or misinterpretation). For example, it is our opinion that—while the NBLC analysis may be appropriately detailed to inform the development of the new IZ policies under consideration as an initial baseline—the modelling structure may be overly or even unnecessarily detailed to be updated on an annual basis. That said, we would generally encourage the municipalities to leverage this additional rigour and specificity to best inform the introduction of the new IZ policies at the outset, but thereafter seek to prioritize the *frequency* of any monitoring or update schedules established rather than necessitate a similar level of *detail* in this monitoring process. Based on our earlier discussions, we believe that

NBLC shares the same sentiment with respect to the importance of frequent updating, wherever or however possible.

Perpetuity of Affordable Units

Another one of NBLC's targeted recommendations is to "seek affordability for units created through IZ in perpetuity, where possible". Based not only on the results of their financial analysis but also in support of ongoing municipal strategic objectives (e.g., increasing the supply and indeed the term of affordable housing supply), we certainly agree with this direction. As noted as part of previous discussions with representatives of each of the lower-tier municipalities, however, we will caution that this often places undue pressure and reliance on external sources of funding from other levels of government (i.e., depending on the depth of affordability being pursued and/or the specific parameters established as part of the resulting IZ policies and opportunities for exemptions, additional financial incentives, etc.). More broadly, we note that there will undoubtedly continue to be a finite source of provincial and federal funding available to support the creation of affordable housing and municipalities in Waterloo Region will continue to vie for these moneys in direct competition with other parts of the province and country.

As such, we would simply suggest that the subject municipalities carefully consider the extent to which they are willing, capable and prepared to support this type of housing over the longer-term planning horizon, if and where applicable.

3.0 Conclusions

Based on our review of the NBLC report and supporting financial analyses, we support their research conclusions and recommendations with respect to the feasibility of introducing new IZ policies in the Cities of Cambridge, Kitchener and Waterloo. The following provides a summary of our specific findings in this regard:

- We believe that **the RLV approach and analytical structure adopted by NBLC represents a reasonable and reliable methodology** for understanding the high-level implication of implementing IZ within each submarket.
- Although we cannot necessarily guarantee the full accuracy and completeness of the 140 proformas prepared by NBLC, we are sufficiently confident that the RLV approach and analysis described above has been **applied correctly, accurately and in a comprehensive manner**.

- The various **statistical inputs and other assumptions requiring professional judgement** relied upon by NBLC as part of their analysis appear to be **entirely reasonable** and consistent with our own research and experience in this market area.
- Although we have identified a number of potential alternative approaches, assumptions and/or considerations for selected elements of the NBLC study, these would **not result in a material impact to the end results of the study, nor any of the associated study conclusions** and recommendations provided to the municipalities.
- Based on our review of the NBLC findings and recommendations, including in the context of "real world" applications, we generally **agree with the advice and observations made by NBLC in light of the analyses presented**.

Overall, no fundamental deficiencies nor other issues were identified as part of our review, which need to be addressed as part of any future updates or re-issuing of the draft reporting prepared by NBLC to date. Consequently, and as identified at the outset of this opinion letter, it is the professional opinion of urbanMetrics that the study prepared by NBLC on behalf of the subject municipalities **adequately addresses the requirements set out in Ontario Regulation 232/18 with respect to the "Assessment Report" to be prepared in support of the implementation of new IZ policies**.

It has been a pleasure conducting this study on behalf of the Cities of Cambridge, Kitchener and Waterloo and we hope that you find this information helpful in your continued efforts to explore the appropriate application of new IZ policies across the Region. Please do not hesitate to contact the undersigned with any questions or comments that you may have, or if further discussion and coordination is required with relevant members of NBLC.

Yours truly,

urbanMetrics inc.

Christopher White, PLE
Partner
cwhite@urbanMetrics.ca

Matthew Paziuk
Senior Project Manager
mpaziuk@urbanMetrics.ca