

To: **COUNCIL**

Meeting Date: **05/11/2021**

Subject: **Inclusionary Zoning for Affordable Housing and Financial Impact Assessment**

Submitted By: **Elaine Brunn Shaw, Chief Planner, MCIP, RPP**

Prepared By: **Valerie Spring, former Senior Planner – Reurbanization, MCIP, RPP and Elaine Brunn Shaw, Chief Planner**

Report No.: **21-130(CD)**

File No.: **D001.01.08.03**

Recommendations

THAT Cambridge Council receive Report 21-130(CD) – Inclusionary Zoning for Affordable Housing and Financial Impact Assessment as information;

AND THAT staff be directed to undertake a Housing Needs Assessment and prepare an inclusionary zoning work plan and stakeholder engagement strategy in 2022;

AND THAT collaboration with the Region of Waterloo, Cities of Kitchener and Waterloo continue in future on the development of Inclusionary Zoning policies and regulations in consultation with the public and stakeholders;

AND THAT the City of Cambridge supports the September 2020 resolution passed by the City of Kitchener as set out in Attachment 3 to Report 21-130(CD);

AND THAT, IT BE RESOLVED that City Council also requests the Province to reinstate the Planning Act provisions enabling a municipality apply Inclusionary Zoning provisions within its entire jurisdiction, or at minimum, also enable Inclusionary Zoning along Major Transit bus routes throughout the City;

AND THAT, IT BE FURTHER RESOLVED that a copy of this resolution be sent to the Ontario Minister of Municipal Affairs, to the local MPs and MPPs, to the Federation of Canadian Municipalities, to the Association of Municipalities Ontario, and to the Region of Waterloo and local area municipalities.

Executive Summary

Purpose

- Before a municipality can adopt an Inclusionary Zoning official plan policy and by-law with regulations, they must complete a Municipal Assessment Report to understand local demographics and housing supply and demand. 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.
- This report is a follow up to the Information Report provided to Council on October 6, 2020 regarding the work of the Inter-municipal Inclusionary Zoning Working Group on the financial viability assessment and the potential of implementing inclusionary zoning as a tool to address the affordable housing crisis.
- The required next steps for establishing Inclusionary Zoning are to prepare a: Housing Needs Assessment; inclusionary zoning work plan; and a stakeholder engagement strategy. This work is included as a proposed capital project in the City's 2022 capital budget.

Key Findings

- Inclusionary zoning (IZ) is a new tool under the Planning Act that allows municipalities to require some portion of the units in a new private market residential development of 10 units or more, to be affordable within Major Transit Station Areas (MTSAs).
- MTSAs include lands within 500-800 m (1640 – 2625 ft) of the planned stations along the Light Rail Stage 2 ION route in Cambridge.
- Staff from the Region and City of Cambridge has identified potential locations of Major Transit Station Areas (MTSAs) in Cambridge. Through the Regional Official Plan review, MTSAs for Cambridge will be delineated and included into the City's Official Plan through the scheduled update in 2022.
- An IZ by-law cannot be passed until the MTSAs are designated in the City's Official Plan. Therefore the City still has time to carry out the required additional analysis and public consultation.
- Provincial regulation requires a financial impact study be conducted to evaluate the viability of introducing an inclusionary zoning (IZ) framework. This combined study between Kitchener, Waterloo and Cambridge was completed and peer

reviewed to satisfy the requirement of Ontario Regulation 232/18. The study concluded IZ policy may be viable in strong markets using a phased-in approach.

- The recommendations in the Financial Impact Assessment evaluated the potential impacts of an affordable housing IZ policy and include:
 - providing clarity to developers regarding the policies around IZ;
 - phasing-in the transition to IZ and offering incentives to the weaker markets;
 - encouraging new development investment while avoiding high levels of inclusion;
 - seeking the affordability of new units in perpetuity;
 - working in tandem with the neighbouring municipalities to ensure there is no unfair advantage;
 - providing program details of who will own and operate the units; and, updating the IZ policy at regular intervals to ensure the policy remains relevant to current market conditions.
- At the present time, none of the sample development concepts used in the test markets in the Analysis found Cambridge to currently be financially strong enough to support inclusionary zoning policies, with the cautionary exception of Downtown Cambridge. As land values increase and higher density, mixed use development along the LRT route in Cambridge occurs, the feasibility of applying IZ also increases.
- City Staff believes IZ is one tool available to the municipality to use in addressing the affordable housing crisis and merits further study, policy and program research and broader community consultation.

Financial Implications

- The consulting firm N. Barry Lyon Consultants Limited (NBLC) was hired to evaluate the potential impacts of an affordable housing IZ policy. The Cities of Kitchener, Waterloo and Cambridge each contributed \$30,000 to pay for the professional services of NBLC and urbanMetrics who completed a peer review. The Region of Waterloo made a \$5,000 contribution to the study.
- NBLC is recommending regular monitoring of current market conditions to ensure IZ policies are not negatively impacting the economic feasibility of adding affordable residential units into the market.

- The Financial Impact Assessment can only address a certain point in time. Development costs can be impacted 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.
- Work has not commenced on the next stage of required work - Cambridge's housing needs assessment and it has been recommended as part of a 2022 capital project A/01055-20 for \$50,000.
- Continuing the collaboration already established with the Region of Waterloo and the Cities of Kitchener and Waterloo can be used to share the expense of monitoring the impact of IZ policy. The costs of that future monitoring is not known at this time and will need to be addressed in a future report to Council.

Background

Inclusionary zoning (IZ) is a new tool under the Planning Act that allows municipalities to require some portion of the units in a new private market residential development to be affordable. IZ is applicable to Major Transit Station Areas (MTSAs) only and applies to multi-residential development with 10 or more units. As part of the Region of Waterloo's Official Plan review currently underway, staff from the Region and City of Cambridge has identified potential locations of MTSAs in Cambridge. The City's Official Plan update is currently scheduled to start in 2022.

The benefits of implementing IZ are:

- increasing the supply of affordable housing;
- encouraging market housing development by supporting a diverse range of housing supply;
- and, creating more inclusive and complete communities.

IZ policy can complement other tools available to the city including those available through the City's Affordable Housing Community Improvement Plan and the Affordable Housing Reserve Fund.

Financial Impact Assessment

The final report is posted on Engage Waterloo Region website <https://www.engagewr.ca/inclusionary-zoning>. The executive summary of the report is included as **Attachment 1** to this report. A complete copy of the report is available upon request.

As a first step, Provincial regulation 232/18 requires a financial impact study be conducted to evaluate the viability of introducing an inclusionary zoning (IZ) framework. Staff from the Region of Waterloo and cities of Kitchener, Waterloo and Cambridge worked collaboratively to examine the economic feasibility of using IZ to add more affordable residential units into the market. By establishing the Inter-municipal Inclusionary Zoning Working Group, staff from the Region of Waterloo and cities of Kitchener, Waterloo and Cambridge have been able to share information and resources. It would be beneficial for this collaboration to continue as the need for regular monitoring of any IZ policy will be required in the future.

The Inter-municipal Zoning Working Group hired N. Barry Lyon Consultants Limited (NBLC) to undertake the financial impact assessment. The Province also requires a written opinion on the analysis: “from a person who is independent of the municipality and who, in the opinion of the council of the municipality, is qualified to review the analysis.” Christopher White, Professional Land Economist, and partner at urbanMetrics inc, has provided a written opinion supporting the methodology used by N. Barry Lyon Consultants Limited (NBLC) to draw their conclusions (**Attachment 2**).

This assessment was completed prior to Regulation 232/18 Inclusionary Zoning coming into effect on September 18, 2020 along with any emerging Community Benefits Charge by-laws.

As part of the financial impact analysis, NBLC considered the: value of land; cost of construction; market price; and market rent. While this methodology is considered by the municipalities and consultants to be sound, the analysis is challenged by the fact that no two development projects are the same and each developer will have different expectations when considering the potential profitability of a project. NBLC is confident; however, their conclusions are indicative of where IZ policy may be financially viable.

The consultants looked at 10 smaller market areas (submarkets) in the Region shown in **Figure One** below along existing or planned high order transit routes which included both strong and emerging residential and mixed use markets. The consultant then prepared prototypical (sample) development concepts and tested both rental and condominium tenure in each submarket. Each sample concept was evaluated using the percentage of units required to be affordable (referred to as set aside rate) and the length of affordability (25 years for rental or in perpetuity for owned units). The development concepts were then analysed to determine the financial viability of each market.

The residual land value is the amount of revenue remaining from the sale of the completed project once all the expenses associated with developing the land and profit margin have been deducted. The financial viability was calculated by using the residual land value to estimate the maximum land value a developer was willing to pay for a development site.

The N. Barry Lyon Consultants Ltd. (NBLC) report concluded that IZ policies may be economically feasible in certain, strong market areas. However; due to current land values along the Light Rail Transit route, the Cambridge test markets are not as strong as some of those found in Kitchener and Waterloo and would not support the introduction of IZ policies at this time. The viability of applying IZ will change over time as new high-density market areas emerge and investments in the LRT occur.

While there were 11 recommendations in the NBLC report, the following four best highlight the conclusions:

1. Ensure clarity in development entitlements (the planning framework) which requires an update to the municipal zoning prior to applying inclusionary zoning (IZ) in Major Transit Station Areas. Developers will then know what is legally permissible as-of-right when contemplating a site to purchase.
2. Consider transition and offsetting policies and incentives so IZ is phased-in starting with a low percentage target for a predetermined period of time. IZ cannot be achieved in a uniform fashion across the region as the markets varying from one area to the next requiring a transition period to help support development in weaker markets.
3. Balance IZ goals with broader development objectives to avoid high levels of inclusion where new development is being encouraged or the investment in new residential construction is weak; and
4. Consider a framework for implementation and evaluation to ensure the IZ framework can be adjusted depending on the current market realities.

NBLC is encouraging the municipalities to continue their collaboration as the regional market is competitive and municipalities should not be disadvantaged because of IZ.

NBLC concluded IZ policies may be viable in some of the submarkets studied and not, at this time, in others. Most of the LRT route in Cambridge, with the potential exception of Downtown Cambridge, is considered to have land values that are not currently viable for Inclusionary Zoning. This is anticipated to change over time as land values increase.

A phased-in approach to applying IZ policies will be necessary in order to avoid shocking the housing market. NBLC advised that as part of the policy approach to IZ, Council and stakeholders will need to identify a preferred policy approach as to whom will own and operate the units and what type of agreements will need to be registered on title.

These recommendations still provide time for the required Major Transit Station Area boundaries to be established through the Regional Official Plan and City Official Plans and then further required work on the housing needs assessment to be completed.

Figure One

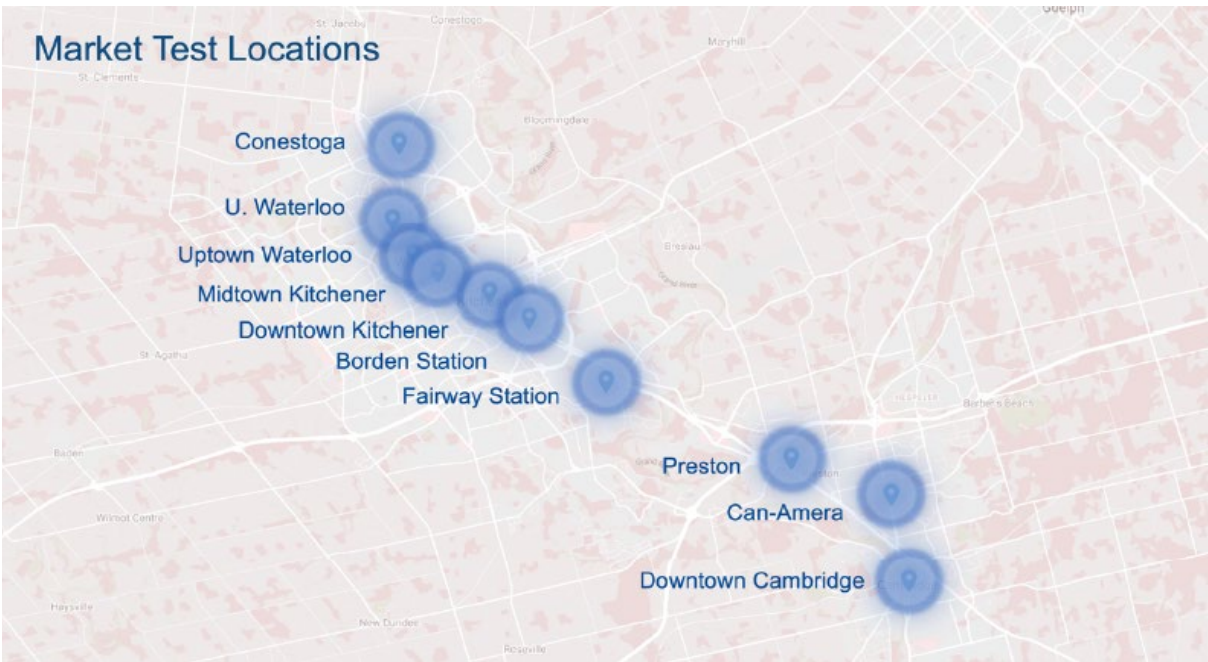


Figure One shows the ten geographical areas within the region considered by the consultants when analysing the financial feasibility of inclusionary zoning.

Figure Two

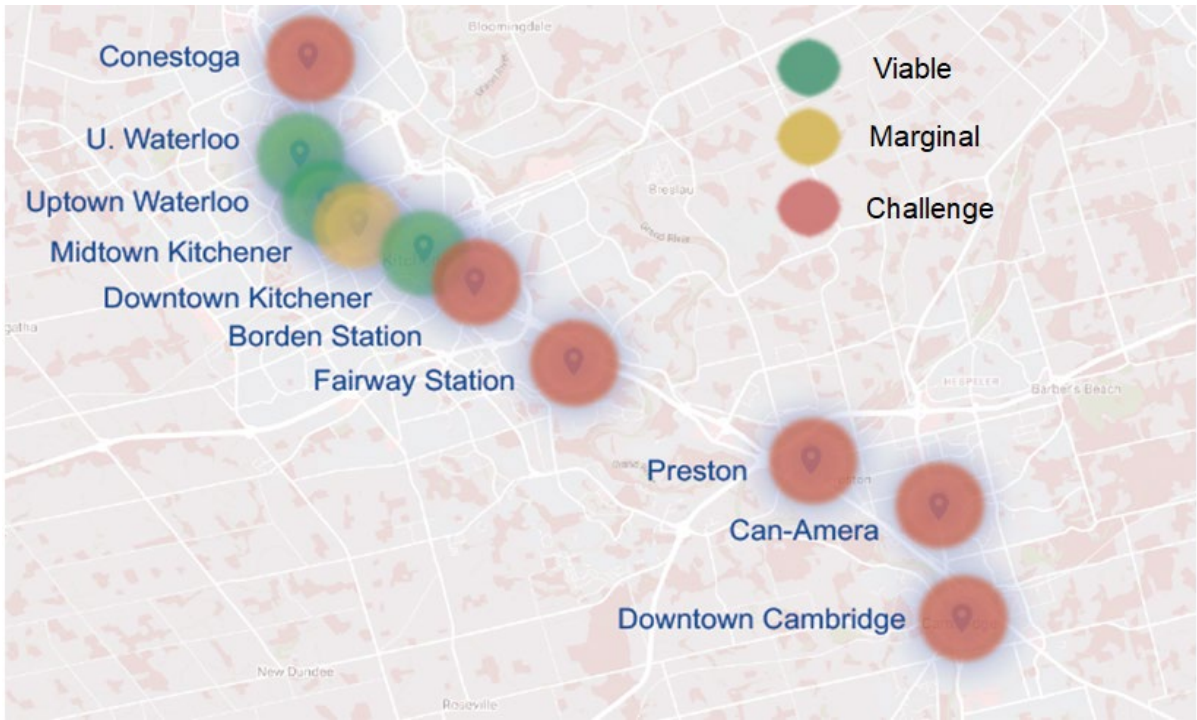


Figure Two shows the ten geographical areas within the Region rated by the consultant for their financial viability

Figure Three



Figure Three shows which submarkets are financially viable should IZ policy be implemented at 10% Average Rental Housing (ARH) for a 25 year period.

Currently, the only area in Cambridge with cautionary potential is Downtown Cambridge when considering Market Rental, at 10% of Affordable Rental Housing, for an affordability period of 25 years.

Analysis

Strategic Alignment

PEOPLE To actively engage, inform and create opportunities for people to participate in community building – making Cambridge a better place to live, work, play and learn for all.

Goal #1 - Community Wellbeing

Objective 1.4 Promote, facilitate and participate in the development of affordable, welcoming and vibrant neighbourhoods.

Goal #2 – Governance and Leadership

Objective 2.4 Work collaboratively with other government agencies and partners to achieve common goals and ensure representation of community interests.

Objective 2.5 Focus on the responsible management of financial resources, ensuring transparency and accountability.

Staff from the Region of Waterloo and the Cities of Kitchener, Waterloo and Cambridge is working collaboratively to determine if an inclusionary zoning (IZ) policy will be financially feasible in MTSAs. Staff is of the opinion that a shared policy framework, which includes the three cities, will be more effective in creating affordable residential units in the Region in the longer term. Public consultation will be required for that future policy creation.

Comments

Inclusionary Zoning is relatively new to municipalities in Canada. Municipalities interested in implementing IZ are required through Provincial legislation to consider the potential impacts to the economic viability of adopting IZ. The economic viability of Inclusionary Zoning is based upon municipalities leveraging the additional land value achieved through public investment such as Stage 2 ION for light rail transit and transit-supportive housing development approvals. Through this, a portion of the enhanced land value is used to finance the creation of affordable units.

Because Inclusionary Zoning programs can reduce revenues for developers as a result of lower rents and sale prices for the affordable units, the programs must be carefully designed to ensure that the overall residential development continues to be financially viable for private market housing providers. Areas with strong housing markets have been found to be best suited for Inclusionary Zoning programs. Key considerations that affect the financial viability of Inclusionary Zoning include:

- “set aside rate” (proportion of units required to be affordable);
- degree of affordability;
- duration of affordability;
- tenure of affordable units (rental vs. ownership)

Where the economics of site development cannot support Inclusionary Zoning on its own, a municipality can establish financial and planning measures to assist in the financial viability of the project. These measures can also assist in increasing the set aside rate, the degree of affordability, or the duration of affordability. Measures can include financial incentives such as reducing or deferring development charges, waiving various application and/or permit fees, increased height or density, and/or reduced parking requirements. The gradual phase-in of Inclusionary Zoning policies and/or the use of financial incentives can also be used to offset a developer’s financial impacts until the market adjusts to the new policy framework.

As noted in the Background section above, the Financial Impact Assessment calculated financial viability by using the residual land value to estimate the maximum land value a developer was willing to pay for a development site. This approach was peer reviewed

by urbanMetrics and considered a reasonable approach for municipalities to use. Recent preliminary feedback from some representatives of the Waterloo Region Homebuilders' Association indicates that building a model based upon an estimated value of land as a key indicator of the appropriate time to implement Inclusionary Zoning may not work. Other costs increase as development proceeds. The representatives also noted that there are too many variables to predict what will happen with costs and the real estate market. The representatives also agreed that a slow, measured, collaborative approach is needed between municipalities, landowners, developers and the public going forward.

Future Required Work

IZ is limited to Major Transit Station Areas (MTSAs), the boundaries of which need to be confirmed through the Regional Official Plan Review process. Staff from the Region and City of Cambridge has identified potential locations of MTSAs in Cambridge. Through the Regional Official Plan review, MTSAs for Cambridge will be delineated and included into the City's Official Plan through the scheduled update in 2022. An IZ by-law cannot be passed until the MTSAs are designated in the City's Official Plan. Therefore this City still has time to carry out the required additional analysis and public consultation.

In addition to a financial feasibility analysis, as part of the process to eventually pass an IZ by-law, municipalities are required to complete a housing needs assessment to understand local demographics and housing supply and demand. Work has not commenced on Cambridge's housing needs assessment and is recommended as part of a 2022 capital project A/01055-20 for \$50,000. City staff is recommending collaboration with the Region of Waterloo, Cities of Kitchener and Waterloo continue in future on the development of Inclusionary Zoning policies and regulations in consultation with the public and stakeholders;

Although a housing needs assessment has not been initiated by Cambridge yet, recent data provided by the Region of Waterloo indicates over 3,700 individuals in Cambridge are on the wait list for housing.

The Housing Needs Assessment will consider: demographics, growth and employment; the current housing picture; the projected housing picture; housing for students and seniors and those experiencing homelessness. This review of current and emerging housing needs will be considered against the existing and projected housing supply in Cambridge will inform the strategy to address the housing gaps. The Public Engagement Strategy will identify how best to receive input into the drafting of the Housing Needs Assessment.

If Council does not support staff's recommendations, this report will remain as being provided for information.

Feedback to the Province about Inclusionary Zoning

Based upon the Financial Impact Assessment to date and resolutions passed by the City of Kitchener in September 2020 (**Attachment 3**), it is also recommended that:

City Council request the Province to reinstate the Planning Act provisions enabling a municipality apply Inclusionary Zoning provisions within its entire jurisdiction, or at minimum, also enable Inclusionary Zoning along Major Transit bus routes throughout the City;

That a copy of this resolution be sent to the Ontario Minister of Municipal Affairs, to the local MPs and MPPs, to the Federation of Canadian Municipalities, to the Association of Municipalities Ontario, and to the Region of Waterloo and local area municipalities.

Existing Policy/By-Law

Chapters 2, 8 and 10 all include policies relating to affordable housing as identified below:

Chapter 2 Growth Management

2.8. the City will encourage the development of a wide range of housing unit types to accommodate the needs, preferences and economic resources of the city's households.

2.8.2 Secondary units are permitted as a way to provide affordable units in existing neighbourhoods. Comment: Please note that the City cannot control the rent level that a homeowner chooses to charge for a rental apartment on their property.

Chapter 8 Land Use Policies and Designations

8.4.1.1 the City will encourage development of affordable housing and provide opportunities for the development of affordable housing by permitting mixed-use development in the Urban Growth Centre, Community Core Areas, Nodes, Regeneration Areas, Reurbanization Corridors and Major Transit Station Areas; promote the inclusion of a residential component in commercial development and encourage the development of community housing and affordable private sector housing that is aimed at meeting the needs of lower income residents.

8.4.1.2 the City will require, wherever appropriate, that when a development application proposing residential uses is submitted for a site containing two hectares or more of developable land, a minimum of 30% of new residential units to be planned in forms other than single-detached and semi-detached units, such as town homes and multi-unit residential buildings. Comment: This policy is commonly cited by staff when we are responding to pre-consultation proposals in

advance of an applicant submitting a formal planning application and requesting developers to include affordable housing in their proposals. As a result of this policy, several developers are required to make financial contributions to the City's Affordable Housing Reserve Fund at the time of issuance of building permits for their project.

8.4.1.3 new residential development will include a minimum number of affordable housing units based on the targets established in the Region's Community Action Plan for Housing. Comment: There are currently no specific numerical targets that apply to Cambridge. The wording of this policy will be reviewed when we undertake the review of the City's OP in 2022.

Chapter 10 Implementation

10.16 development standards may be incorporated into a Zoning By-law to permit bonusing through an increase in height and/or density of development where such increase provide public benefits including affordable housing. Comment: As a result of this section, developers have made financial contributions to the City's Affordable Housing Reserve Fund and have added affordable rental units to their developments.

It should be noted that through the recent changes to the Planning Act, bonusing opportunities are now limited and the City has the opportunity to consider whether a community benefits by-law should be pursued. Finance staff is looking into the community benefits by-law matter.

Affordable Housing Community Improvement Plan (CIP):

In 2016 Cambridge City Council directed staff to look at ways to facilitate the construction of affordable units by providing financial incentives; assessing the implications of passing a Development Permit System and deferring development charges and permit fees for affordable housing projects built within Regeneration and Node Areas of the City.

In response to that direction from Council, staff prepared the Affordable Housing Community Improvement Plan which was adopted by Council in October 2016. The CIP assists in the development of affordable housing in the city by providing incentive-based programs thereby encouraging the creation of affordable housing units. The CIP was initiated to complement the existing services and programs offered by the Region. By determining the primary barrier to providing affordable housing is financial, the City has exempted affordable housing projects from paying planning application and building permit fees, deferred the payment of development charges for 20 years and provides a Tax Increment Grant (TIG) provided the project remains affordable for the 20 year period.

Not-for-profits are exempt from municipal taxes but the (TIG) noted above is available to private developers. The Affordable Housing replicates the Brownfield TIG, but instead of remediation of a contaminated site, a grant is provided to site where affordable housing has been constructed. Eligible projects for the incentives through the CIP are those located in Regeneration, Node and Core Areas.

General

Official Plan policies would need to be amended at some future point to provide the policy framework for Inclusionary Zoning and include mapping and policies for the Major Transit Station Areas. An amendment to the existing Zoning By-law would be required in order to introduce IZ regulations.

Financial Impact

The consulting firm N. Barry Lyon Consultants Limited (NBLC) was hired to evaluate the potential impacts of an affordable housing IZ policy. The Cities of Kitchener, Waterloo and Cambridge each contributed \$30,000 to pay for the professional services of NBLC and urbanMetrics who completed a peer review. The Region of Waterloo made a \$5,000 contribution to the study.

NBLC is recommending regular monitoring of current market conditions to ensure IZ policies are not negatively impacting the economic feasibility of adding affordable residential units into the market.

The Financial Impact Assessment can only address a certain point in time. Development costs can be impacted 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.

Work has not commenced on the next stage of required work - Cambridge's housing needs assessment and it has been recommended as part of a 2022 capital project A/01055-20 for \$50,000.

Continuing the collaboration already established with the Region of Waterloo and the Cities of Kitchener and Waterloo can be used to share the expense of monitoring the impact of IZ policy. The costs of that future monitoring is not known at this time and will need to be addressed in a future report to Council.

Public Input

Representatives of the development industry and affordable housing advocates throughout Waterloo Region were consulted during an IZ Stakeholders engagement session held via a video meeting on March 27, 2020. Approximately 48 stakeholders participated. As well, members of the Working Group met with developers and

affordable housing advocates individually. A project webpage <https://www.engagewr.ca/inclusionary-zoning> was launched in April 2020. Further consultation was conducted in 2021 with members of the Waterloo Region Homebuilders' Association to discuss ownership and operation models; price point; duration of affordability; tenure and percentage of units required to be affordable (set aside) rates.

As noted in the Comments section above, recent preliminary feedback from some representatives of the Waterloo Region Homebuilders' Association indicates that building a model based upon an estimated value of land as a key indicator of the appropriate time to implement Inclusionary Zoning may not work. Other costs increase as development proceeds. The representatives also noted that there are too many variables to predict what will happen with costs and the real estate market. The representatives also agreed that a slow, measured, collaborative approach is needed between municipalities, landowners, developers and the public going forward.

Internal/External Consultation

The Inter-municipal Inclusionary Zoning Working Group is made up of staff from the Region of Waterloo and the Cities of Kitchener, Waterloo and Cambridge. Members of the Working Group met with senior staff from all municipalities and anticipate further collaboration as each municipality continues to consider inclusionary zoning (IZ) and work to develop policies. Input from Economic Development, Legal and the Planning Services Division will be sought as work continues on this subject.

Conclusion

Inclusionary Zoning (IZ) has the potential to create a modest number of affordable units and is one of several tools available to municipalities to address the affordable housing crisis. In accordance with Provincial requirements, City Staff believes IZ merits further study, policy and program research and broader community consultation. Prior to adopting IZ policies or enacting zoning by-laws, a comprehensive study must be undertaken to justify the need for affordable housing and to ensure IZ is economically feasible for a developer. IZ needs to be phased-in and capable of responding to changes in the market to ensure developers will be motivated to build affordable units. As well, IZ signals to the community the municipal commitment to facilitate the creation of affordable units.

In alignment with the City's Strategic Plan, City Staff is of the opinion that a shared policy framework, which includes the three cities, will be more effective in creating affordable residential units in the Region in the longer term. Public consultation will be required for that future policy creation.

Signature

Division Approval



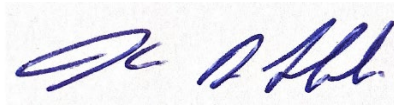
Name: Elaine Brunn Shaw

Title: Chief Planner

Reviewed by the CFO

Reviewed by Legal Services

Departmental Approval



Name: Kevin De Leebeeck for Hardy Bromberg

Title: Deputy City Manager, Community Development

City Manager Approval



Name: David Calder

Title: City Manager

Attachments

1. Executive Summary - Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning, prepared by N. Barry Lyon Consultants Ltd. (NBLC) for the Cities of Kitchener, Waterloo and Cambridge.
2. Peer Review of the Evaluation of Potential Impacts of an Affordable Housing IZ, conducted by urbanMetrics Inc., dated September 2020
3. Resolution by Kitchener City Council on October 5, 2020 regarding Inclusionary Zoning and Affordable Housing

Attachment 1:

Executive Summary - Evaluation of Potential Impacts of an Affordable Housing
Inclusionary Zoning

Complete report can be found at: <https://www.engagewr.ca/inclusionary-zoning>

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

Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning Policy

April 2020



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

Evaluation of Potential Impacts of an Affordable Housing Inclusionary Zoning Policy

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Disclaimer:

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

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

Executive Summary

The 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 MTSA's. 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 be 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 at 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.

SOURCE: Google Earth (2020)



EVALUATION OF IMPACTS OF INCLUSIONARY ZONING POLICY

Peer Review

Kitchener / Cambridge / Waterloo, Ontario

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

September 16, 2020



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 byproduct 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 prerequisite 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 “wobble 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

Attachment 3

September 2020 resolution passed by the City of Kitchener:

WHEREAS The City of Kitchener recognizes the importance of strong and diverse neighbourhoods where residents can grow and thrive;

WHEREAS a key action in the City of Kitchener Strategic Plan is to create a caring community through the development of a Housing Strategy, aimed at addressing challenges to housing affordability in Kitchener across the housing continuum;

WHEREAS Kitchener's Housing Need assessment found that rapid price and rent increases are making housing unaffordable all along the housing continuum, including middle income households;

WHEREAS the City of Kitchener has identified affordable housing as a priority in the City and has adopted Council Policies to encourage development of new affordable rental housing units, which provide exemptions and deferrals of development to fees/charges;

WHEREAS the City of Kitchener continues to seek options to encourage a broader range of housing options and increase the supply of affordable housing opportunities available;

WHEREAS Inclusionary zoning is one important, cost effective tool that can be used to deliver more affordable units to help address growing affordable housing needs;

WHEREAS Bill 108 restricted the use of inclusionary zoning to areas around major transit stations providing rail or bus rapid transit, and provincially mandated community planning permit system areas; and,

WHEREAS there are city-wide opportunities to achieve affordable housing through inclusionary zoning in a manner that is financially sustainable for both municipalities and developers;

THEREFORE IT BE RESOLVED that the City Council request the Province to reinstate the Planning Act provisions enabling a municipality apply Inclusionary Zoning provisions within its entire jurisdiction, or at minimum, enable Inclusionary Zoning along Major Transit bus routes throughout the City;

THEREFORE IT BE FURTHER RESOLVED that a copy of this resolution be sent to the Ontario Minister of Municipal Affairs, to the local MP's and MPP's, to the Federation of Canadian Municipalities, to the Association of Municipalities Ontario, and to the Region of Waterloo and local area municipalities.