Appendix 1

Affordable Housing Program

UNDERSTANDING THE COST OF INCENTIVES

October 2016

nblc

Region of Peel
Working for you

MISSISSAUGA

City of Mississauga
Affordable Housing Program

Understanding the Cost of Incentives

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Executive Summary

On February 10th 2016, City of Mississauga Council endorsed a work plan to develop an affordable housing program for the City. As part of this work plan, with Peel Region as a partner, N. Barry Lyon Consultants Limited was retained to evaluate what and how financial incentives may be required to incent the development of new affordable housing supply. This report presents the findings of an economic analysis which is intended to inform Council's future decision making with respect to the development of the City of Mississauga's Affordable Housing Program.

The purpose of this analysis was to:

- Identify the financial drivers for creating new rental housing and factors affecting the preservation of existing rental stock;
- Prepare detailed pro formas to quantify the potential cost of financial incentives for new affordable housing and to assess sensitivity across varying levels of affordability, tenure, building types and market variables;
- Advise on the effectiveness of varying financial incentive tools in supporting the creation of affordable rental and ownership housing;
- Analyse the cost of creating new and upgrading existing second units and the financial implications for homeowners; and,
- Outline preliminary considerations in the development of a financial incentive strategy for new affordable housing, including an evaluation of the cost effectiveness of varying incentive approaches.

This report, *Understanding the Cost of Incentives,* is intended for information purposes in order to educate staff, decision makers and the public about the magnitude and types of potential incentives that could be considered to support new affordable housing development if Council were to choose to offer them. This discussion around the potential provision of financial incentives for affordable housing is only a starting point. It should be acknowledged that there could be pressure on municipal finances when providing these incentives.

Without a dedicated revenue stream for affordable housing, the provision of financial incentives, in any form (loans, grants, deferrals or waivers) would all ultimately affect the City's budget and this could have an affect the broader tax base. A next step in this process would be to assess the real fiscal impacts that might result through the provision of financial incentives.

Rental Housing Drivers

The vast majority of rental housing in the GTA was built prior to 1972. Leading up to that period, favourable tax rules incented rental housing construction. These tax advantages were withdrawn in 1972 and very little rental investment has occurred since this time. While little supply has been added to the inventory, demand has been unabated. Despite the aging of these buildings and the lack of modern design features and amenities, vacancy rates throughout the GTA have remained extremely tight.

These older rental apartment towers make up the majority of affordable rental housing supply in Mississauga.

Until recently there has been very little new rental housing investment. This is largely due to the following:

- Condominium development is less risky and offers a higher return;
- Relatively high rents are required to achieve a financially viable project;
- Limited market demand at these high rent thresholds; and,
- There are lingering concerns that rent control legislation could be amended and undermine the viability of a rental project.

The shortage of new purpose-built rental apartment supply, coupled with continued rental demand has resulted in investor-owned condominium apartments functioning as the de facto rental market. CMHC reported in 2014 that almost 30% of all condominiums in the GTA are investor owned.

While there has been a recent surge in interest in building new rental housing, this is only at the mid to higher end of the market. While this added supply offers some benefit by allowing those that can afford it to move out of rent controlled units, freeing up those homes for others, the limited amount of new supply will have only a modest impact on the overall picture.

As affordability in the ownership market diminishes, demand for rental housing will only increase in the City of Mississauga. Protection and enhancement of the rental housing stock at both affordable and market rates will be critical to ensuring the spectrum of housing needs for all community members are met.

Pro Forma Model Results

The results of our pro forma analysis indicate that the market is unlikely to support the development of new affordable ownership or rental development in Mississauga without external financial investment. This analysis considers the impact of both financial incentives and the cost of land on an array of development scenarios across Mississauga.

Specifically, the analysis shows that the amount of financial assistance required to support affordable housing can vary widely depending on the targeted level of affordability, project location, building form, tenure, mix of unit sizes and individual developer perspectives on project return and market risk. For example, the level of incentive required to support the development of an apartment building will be different depending on whether the building is constructed with reinforced concrete or wood-frame technology.

The provision of affordable rental or ownership housing, especially at the third income decile, is likely to require a significant amount of financial investment from public sources.

Effectiveness of Varying Financial Incentive Tools

The cost effectiveness of individual financial incentive tools is likely to vary widely based on specific considerations and objectives in individual development scenarios. Market factors like the return expectations of a developer and the cost of land need to be considered within the context of development tenure, type and scale, as well as objectives like the depth and duration of affordability.

The financial incentive tools considered in this report generally fall into two categories; grants or loans. The approaches that are likely to be most effective in incenting affordable housing are largely a function of the value of the incentive. The financial assistance must offset any capital deficits incurred in the project pro forma and satisfy typical return expectations for its developer. As an example, when comparing the waiver or deferral of development charges a waiver is likely to be seen as more valuable and incent the construction of new affordable housing stock relative to a comparable deferral, where funds are eventually recovered.

The effectiveness of providing financial incentives as a tool towards stimulating new affordable residential development will also be determined to a significant degree by the manner in which these incentives are administered. Future programming must be offered at regular and predictable intervals, be flexible to individual developer needs and partnership opportunities, and must recognize the realities of real estate development in the GTA.

Second Units in Mississauga

Subject to site specific considerations, our analysis and discussions with industry experts indicates that the typical cost of renovating an existing second unit is typically in the order of $25,000 to $30,000, while the costs of creating a new second unit are typically in the order of $40,000 to $50,000, or more.

However, there is a positive financial result in terms of net household income for homeowners who operate a second unit. Based on the assumptions in this analysis, the financial benefit is likely to be in the order of $6,000 per year. For homeowners, the largest potential negative financial implication resulting from the operating a legal second unit is the potential increase to income taxes. Other less impactful implications include potential increases to property tax payments, home insurance costs and other proportionate increases in utility and maintenance costs.

The City and Region should continue to encourage and simplify the process for creating legal second units in Mississauga. The current market for rental housing accommodation in second units is relatively affordable throughout Mississauga. Therefore, promoting and simplifying the process of creating new second units could be an effective means of increasing the supply of affordable rental housing in the City. While second units can create some financial benefit for homeowners, those seeking to develop a second unit are likely doing so, in part, for other reasons (to lower the cost of home-ownership, to age-in-place, etc.). The provision of financial incentives for individual homeowners to upgrade or create new second units in existing low density housing stock may be an effective measure to support the creation of safe and affordable rental supply and lower the cost of home ownership in existing communities. A coordinated communication and education program is likely required to support this investment and encourage the registration of legal units.

Financial Incentives for New Affordable Housing Development

There are steps that the City of Mississauga and Peel Region can begin to take in order to create a framework of financial incentives to support new affordable housing development in the future. Key recommendations stemming from this analysis include:

- **Address complications of the two-tier municipal structure through a shared set of objectives.** In order to package together a meaningful financial incentive program to support the development of affordable housing, it will be important to align the objectives of the Region of Peel and City of Mississauga. In addition to objectives supporting social equality, it will be important to articulate the economic case in support of affordable housing.
- **Create a selection process that encourages competition in terms of affordability levels and construction approaches.** As public funds become available it will be important to have an incentive program in place that recognizes that financial need varies based on location, construction type, developer expertise and other factors. The process should create a competitive environment that motivates developers to offer the maximum value for money based on performance criteria.
- **Provide financial incentive tools in a manner that is flexible and repetitive.** Any future incentive program needs to be predictable and enduring so that the development community can anticipate and prepare for proposal calls. Recognizing the many individual variations in each individual developer's pro forma, it may be beneficial to seek approval for a variety of financial incentive tools. By offering flexibility in this regard, the incentive program can offer a combination of tools that adapt to unique project characteristics.
- **Leverage or partner using Regional and Municipal public land assets as a tool in support of new affordable housing development.** The Region and City of Mississauga should evaluate their portfolio of land holdings to evaluate opportunities to leverage publicly owned lands towards lowering the overall cost of delivering affordable housing and creating opportunities for affordable housing development in locations which might not otherwise experience it.
- **Work to develop financial incentive programs for affordable housing which are enduring.** While grants can be necessary to support deep levels of affordability (especially for rental), the Region and City of Mississauga should work to develop and encourage a program for financial incentives which can endure over time. An alternative to providing grants, or a waiver/ rebate of fees could be to bundle the value of these potential incentives and apply them as second mortgage available to the purchasers of new affordable condominium units, paid back when the unit is sold or the initial mortgage ends or is refinanced. This approach could be somewhat similar to the Home in Peel program and other second mortgage programs in the market, but by adding flexibility and applying the model to purpose-built affordable ownership developments, the tool could support a broader range of projects and may create a growing pool of funds for reinvestment over time.

Financial incentives for new affordable housing should just be one part of a comprehensive housing strategy. This report discusses the possible use of emerging tools which should be considered within the discussion of financial incentives. Other strategies and tools to consider could include:

- considerations relating to new inclusionary zoning legislation;
- The efficiency of purchasing of built units from developers;
- Financial support and encouragement of mixing affordable units within market rental units; and,
- Financial supports and expansion of the not for profit sector.

1.0 Introduction

Mississauga City Council endorsed a work plan to develop an affordable housing program for the City. As part of this work plan, with Peel Region as a partner, The City of Mississauga (the City) has retained N. Barry Lyon Consultants Limited (NBLC) to evaluate the potential costs of financial incentives which might be required to incent the development of affordable housing. This report presents the findings of an economic analysis which is intended to inform Council's future decision making with respect to the development of the City of Mississauga's Affordable Housing Program.

The purpose of this analysis was to:

- Identify the financial drivers for creating new rental housing and factors affecting the preservation of existing rental stock;
- Prepare detailed pro formas to quantify the potential cost of financial incentives for new affordable housing and to assess sensitivity across varying levels of affordability, tenure, building types and market variables;
- Advise on the effectiveness of varying financial incentive tools in supporting the creation of affordable rental and ownership housing;
- Understanding the cost of creating new and upgrading existing second units and the financial implications for homeowners; and,
- Outline preliminary considerations in the development of a financial incentive strategy for affordable housing, including an evaluation of the cost effectiveness of varying incentive approaches.

This report, *Understanding the Cost of Incentives,* is intended for information purposes in order to educate staff, decision makers and the public about the magnitude and types of potential incentives that could be considered to support new affordable housing development if Council were to choose to offer them. This discussion around the potential provision of financial incentives for affordable housing is only a starting point. It should be acknowledged that there could be pressure on municipal finances when providing these incentives.

Without a dedicated revenue stream for affordable housing, the provision of financial incentives, in any form (loans, grants, deferrals or waivers) would all ultimately affect the City's budget and this could have an affect the broader tax base. A next step in this process would be to assess the real fiscal impacts that might result through the provision of financial incentives.

Residential demand in the City of Mississauga is strong and growing, with current projections indicating that over 2,000 new housing units per year will be required to 2041 to meet Provincial population projections. With the City at the end of its greenfield growth phase, this residential demand will be housed in higher density formats and on infill or repurposed properties.

With continued population growth and limited supply in lower density housing forms, average home pricing has increased substantially. For example, the average price of a detached home was $984,500 in Mississauga as of July 2016, an increase of about 40% over the past four years. Incomes have not kept pace with this pricing, eroding affordability. Diminishing affordability is expected to be a key factor driving demand for higher density housing forms in both ownership and rental tenures.

While there is demand for higher density residential forms in Mississauga, the market is unable to provide it at affordable rates due to the gap between affordable pricing and the costs of construction.

The following discussion summarizes the challenges the market faces in providing affordable housing in both rental and ownership tenures. From this we assess the financial shortfall and subsidy requirement necessary to incent development. Section 5 also takes a specific look at the economics surrounding secondary units and their role in addressing affordable housing needs. The report concludes with commentary on the role financial incentives could play as part of a broader affordable housing program.

2.0 The Challenge of Providing Affordable Rental Housing

2.1 Background

The vast majority of rental housing in the GTA was built prior to 1972. After 1972, the federal government imposed new tax rules that altered the treatment of depreciation on a building via capital cost allowances (CCA), upfront soft cost deductions and the practice of pooling which allowed rental owners to avoid recapture of CCA when disposing of an asset if another property was purchased with the proceeds. These reforms were intended to close a 'loop hole' in response to concerns that the existing systems was encouraging speculation. In addition, prior to 1972, capital gains on rental properties were not taxable, subsequent tax reform introduced 50 percent of capital gains as income for tax purposes. Changes to the tax treatment of soft costs further reduced the appeal of rental housing investment in Canada. Since 1972 very little rental investment has occurred but demand has been unabated. Despite the aging of these buildings and the lack of modern design features and amenities, vacancy rates throughout the GTA have remained extremely tight. As of fall 2015 in the City of Mississauga, the combined vacancy for rental townhomes and apartments was 1.6%.[1]

Between 1972 and leading up to the current period, rental housing has received limited interest in the private sector for the following additional reasons:

- The very strong market demand and higher rates of return associated with condominium development;
- The relatively high rents that are required to achieve a financially viable project;
- Limited market demand at these rent thresholds; and
- Lingering concerns that rent control rules will be changed to include new rental housing stock. To mitigate this concern and to provide flexibility in future asset management, many developers opt to register new purpose-built rental developments as condominiums.

2.2 Financial Issues

Developers of multi-family housing projects in the GTA have a choice to build in rental or ownership tenure. In either case, they are seeking the highest rate of return from the time and resources they invest into a project. Virtually all developers in the multi-family sector have focused on the condominium ownership side of the market. This is due to the very strong demand and limited exposure to risk (relative to rental housing).

Relative to rental development, a multi-family condominium development generally offers the following financial advantages:

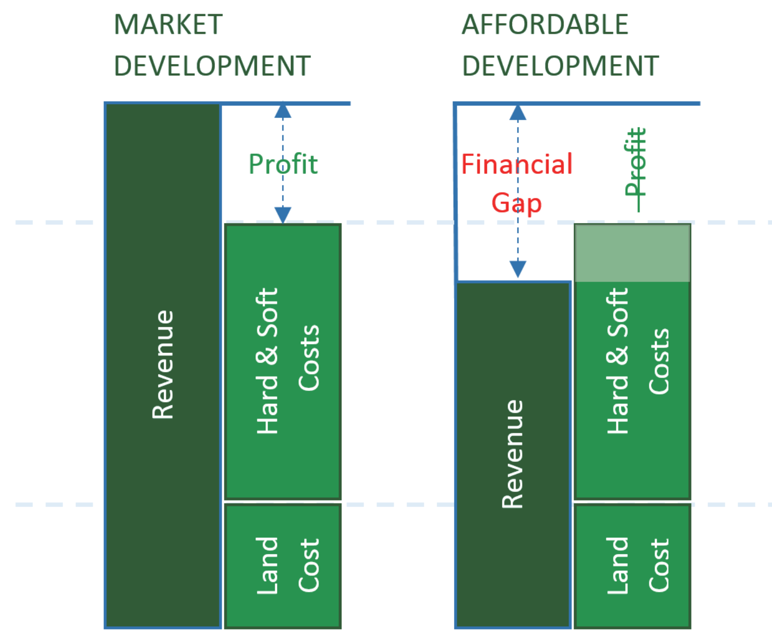
- Project revenues can increase with market;
- Equity requirements can be smaller;
- Financing is typically only offered when presale requirements have been achieved. This makes managing risks easier;
- Subject to meeting presale requirements, there is a broader range of institutional and private financing mechanisms;
- Projects can typically be completed in 3 to 6 years; and,
- Returns on equity are typically superior.

[1] Vacancy rate for purpose-built rental apartments and townhomes as per CMHC's Fall 2015 GTA Rental Market Report.

Understanding that the costs of construction are similar to those of condominium projects, an affordable rental project presents several major challenges:

- Rental revenues are fixed and suppressed below market rates. This creates a significant financial gap (see Figure 1) against the project costs;
- Lenders can require a much higher equity contribution;
- Assuming a project was viable with affordable rents, returns on equity are achieved at a much slower pace, typically over 15 to 20 years;
- A developer must have the capacity to manage the project over the long term; and,
- The low rental revenues make projects either unfeasible or leave little room for project error.

Figure 1



2.3 Outlook

A common feature in successful cities is a strong real estate market. As demand grows, so does pricing and pressure on affordability results. In cities such as New York, London and Paris, the response to affordability issues is a shift in demand towards the rental market. In these cities households living in rental tenure far exceed those in ownership tenure. In New York, over 70% of households live in rental housing compared to 25% in the City of Mississauga. If incomes do not rise in parallel with housing prices, a growing number of people will be left unable to afford the financing costs of ownership. This is the situation across the GTA and in Mississauga. As affordability in the ownership market diminishes, demand will continue to shift to rental housing.

Protection and enhancement of the rental housing stock at both affordable and market rates will therefore be critical to ensuring the spectrum of housing needs for all community members are met.

While the production of rental housing has been modest, there is evidence of renewed interest in investment in this sector. While all investment has been at the higher end of the market, these trends still bode well for the production of new supply which has the potential to, at a minimum, relieve some of the demand pressures.

2.3.1 Private Investors Showing the Way

The shortage of new purpose-built rental apartment supply coupled with continued rental demand has resulted in condominium apartments functioning as de facto rental accommodation. CMHC estimates that about 26% of condominium apartment units in the City of Mississauga are used as rental units, with the percentage even higher across the GTA (over 30%).

The supply of private rental units in condominium apartment buildings is estimated to have increased by nearly 3,500 units between October 2011 and October 2015 in the Region of Peel, from approximately 7,500 to about 11,000 units, according to CMHC. Despite this increase in supply, vacancy rates have remained low for condominium apartment rentals in Peel Region in 2015 at 2.1%, per CMHC.[2]

This demand has not gone unnoticed by the development community. While the low rates of return are still an issue, developers and institutional investors, especially those with underutilized land, are now considering rental housing as an approach to maximizing the asset value. In particular, there is significant interest from existing apartment operators, REITs and pension funds. As such, the GTA's purpose-built rental apartment construction starts hit a 25-year high in 2015.

Daniels' recent 'Skyrise' project in Erin Mills is the first new rental building completed in Mississauga in over 20 years, the result of a financial partnership with a large institutional investor.

2.3.2 Institutional Investment

Real estate investment trusts, pension funds and other institutional investors are growing and hungry for products that can offer secure returns over the long term. Particularly with the changes in the retail sectors, these investors are seeking ways to beef up the performance of shopping centres by adding infill rental projects. Several large scale

[2] Vacancy rate for private condominium apartment units that have been entered in to the rental market as reported in CMHC's Fall 2015 GTA Rental Market Report.

management firms are looking at standalone rental buildings that offer low, but stable rates of return as a good option to diversify their holdings.

2.3.3 Aging Building Stock

Many experienced rental housing developers are acutely aware that the age of the buildings will become increasingly challenging to manage and at some point will require replacement. With the average age of a rental building in the GTA at over 40 years old, rental housing developers are looking at ways to renew and modernize their stock before being faced with unmanageable expenses

2.3.4 Flight to Quality

Developers of new purpose-built rental apartment development are likely to experience demand from renters who are currently being housed in older purpose-built rental supply. This is because there is very little modern and high quality rental apartment supply in the market and because some households living in rent controlled buildings can actually afford to pay more for their accommodation. Often, renter households who can afford to pay more rent will transition into newer buildings to take advantage of modern amenities and conveniences like in suite laundry, dishwashers and condominium-quality finishes.

This transition, or "flight to quality", opens up vacancy within older, more affordable rental stock. Therefore, the development of new market rate purpose-built rental supply can also have some positive impacts on increasing supply of affordable housing.

2.3.5 Professional Management & Security of Tenure

Another factor contributing to market demand for new purpose-built rental apartment development, especially relative to private rentals within condominium apartment, is the added certainty and level of service that professional management offers to prospective renters. Savvy rental apartment developers will use these attributes to their advantage when marketing a new purpose-built apartment development.

In rented condominiums, tenants have very little security of tenure. Owners can decide to sell or house family members in the unit with little notice. Moreover, rental rate increases are largely uncontrolled. Another benefit to professional management is the fact that any maintenance issues can be addressed quickly by on-site staff. This is often not the case in private condominium rentals where the landlord could live offsite, or even in another country.

While these factors do not directly impact the supply of affordable rental housing they do signal the potential for positive growth in the rental supply which in turn could relieve some demand pressure over time.

2.4 The Advantage of Registering as a Condominium

In Mississauga, it has becoming increasingly common for rental apartments to apply for condominium conversions, and newly completed purpose-built rental development is being registered in condominium tenure, with the developer/ operator owning all of the units in the project.

This is occurring for two primary reasons:

- The tax rate applied to condominium apartment buildings is lower than the multi-residential rate applied to rental apartment buildings. Therefore, registration as a condominium (even though it is operated as a rental building) lowers the ongoing operating expenses of the project, improving profitability[3]; and,
- Registering as a condominium allows the developer more flexibility in terms of asset management. In a potential disposition of the property down the road, units can be sold individually or in bulk to multiple purchasers, rather than disposing of the building as a whole.

[3] The Region currently funds the difference between the tax rate applied to purpose-built rental development and the single-family rate in their applications of IAH funding for the duration of their agreements (20-years).

3.0 The Challenge of Providing Affordable Ownership Housing

Affordable ownership housing shares the same financial advantages as market condominium development. The only challenge is the limit of revenues to affordable levels. In the City of Mississauga, the threshold for affordable ownership follows Provincial Policy and is established by the Region as service manager based on Mississauga incomes and housing prices. The maximum affordable house price is currently $398,012. This is the price that a household at the sixth income decile in Peel can afford to pay for a home (currently an annual income of less than $100,000). In Mississauga, some forms of new market housing are currently available at prices that are below this affordable ownership pricing. Currently, there are about 1,375 new unsold condominium apartment units available in Mississauga, with an average price of about $364,000. However, the average size of these units is just 738 square feet, meaning that these units are not suitable for all households, particularly families. Therefore, the delivery of family oriented housing can be significantly more expensive.

Another key issue and criticism with affordable ownership housing development is the difficulty in keeping units affordable over a long period of time. Trillium Housing, Options for Homes, as well as the Daniels "Boost" program all help make ownership more affordable by offering variations of a low-cost second mortgage, typically payable when the home is resold. However, at resale they can be sold at market rates and the affordability of the unit is potentially lost.

4.0 The Costs of Financial Incentives for Affordable Housing

4.1 Methodology

NBLC approached this analysis from the perspective of a private developer who is considering whether to build market-rate or affordable housing. The premise of this analysis is that a developer needs to earn a minimum financial return (or profit) to undertake a project, and that a developer would only participate in building affordable housing if it offered a similar return as a market-rate development. We assume that the cost of land, the cost of construction, and the developer's target return are the same regardless of whether the units are sold or leased at market or affordable rates. For the purposes of this analysis, we assume there are no material differences in the development of market-rate or affordable housing aside from project revenue.

As discussed in earlier in this report, the revenue generated from affordable units is typically insufficient to cover the cost of construction, let alone to acquire the land and compensate the developer. The gap between costs and revenues is the required incentive.

The quantification of this financial gap is the focus of this analysis.

The methodology for this analysis is to model a developer's financial pro forma for an array of market-rate development scenarios and adjust the revenue assumptions to reflect the project revenue of the same development but at varying levels of affordability. The difference (or shortfall) in revenues between the affordable and market-rate development scenarios creates a financial gap which represents the amount of financial incentive which might be necessary to make the project financially feasible.

Simply put, the model quantifies the incentive required by the developer to build the same project, but to sell or rent it at affordable rates. The incentive is considered as a one-time capital grant used to bridge the financial gap, however, incentives can be applied using numerous tools, as discussed in **Appendix A** of this report.

Together with City of Mississauga and Region of Peel staff, market areas, built forms, affordability levels, and other project assumptions were established for the purposes of this analysis. Ultimately, the model simulates a wide variety of development scenarios across Mississauga, giving the City and Region an understanding of the range of subsidy that might be required to produce affordable housing in a variety of market locations and building forms.

4.2 Model Variables & Test Scenarios

The following tables summarize the key variables and development scenarios tested in the financial pro forma analysis.

Of note, two levels of affordability are tested for in affordable ownership housing scenarios, the 3rd and also the 5th or 6th income decile subject to comparable market pricing. The current Peel Term of Council priorities focus on removing households from the wait list (generally less than 3rd decile). There is a significant number of moderate income households (approximately 30% of total households) who would not qualify for Peel programs yet they continue to face challenges when trying to address their needs in the market. Therefore, understanding this need to plan for affordable workforce housing, an upper affordable pricing threshold was also included in this analysis.

Table 1

Model Variables Tested	
Market Areas	**Built Forms**
• City Centre • Cooksville • Erin Mills • Lakeview • Malton	• Concrete Apartments (Typical suite sizes and family-oriented suite sizes) • Wood-frame Apartments (Typical suite sizes and family-oriented suite sizes) • Stacked Townhomes • Traditional Townhomes • Semi-Detached Homes
Development Variables	**Tenure & Depth of Affordability**
• For-profit developer • For-profit without land cost • Non-profit developer • Non-profit without land cost	• Ownership affordable to the 3rd and 5th *or* 6th income decile *(depending on location and building typology)* • Rental at 100% AMR for Peel Region

Table 2

Location / Testing Matrix						
Built Form:	Concrete Apartments	Wood-frame Apartments	Stacked Townhomes	Traditional Townhomes	Semi-detached	**Context / Site-Specific Features**
City Centre	X	X				Vacant land in a downtown location. No Sec. 37 payable.
Erin Mills	X	X				Intensification area, vacant land.
Cooksville	X	X				Infill on existing apartment site, requires demolition of 112,000 sq. ft. building.
Lakeview		X	X	X	X	Neighbourhood, requires demolition of existing 36,000 sq. ft. building.
Malton		X	X	X	X	Neighbourhood, requires demolition of existing 32,000 sq. ft. building.

Built Form Assumptions							
Assumptions	Concrete Apartments		Wood-frame Apartments		Stacked Townhomes	Traditional Townhomes	Semi-detached
	Typical Suite Mix	Family-Sized Units	Typical Suite Mix	Family-Sized Units			
Residential Unit and Area Statistics							
Number of Units	180	150	60	50	50	17	12
Average Net Unit Size (SF)	750	900	750	900	1,000	1,300	1,800
Net to Gross Efficiency (NGE, %)	85%	85%	85%	85%	95%	100%	100%
Gross Floor Area (SF)	168,824	168,824	52,941	52,941	50,000	22,100	21,600
Building Height (Storeys)	18	18	6	6	3	3	3
Required Parking Stalls (per residential unit)	1.00	1.25	1.00	1.25	1.00	0.00	0.00
Below Grade Parking	Yes	Yes	Yes	Yes	Yes	No	No
Hard (Construction) Costs							
Above Grade GLA Construction Cost (PSF)	$190	$190	$176	$176	$130	$120	$115
Below Grade Parking Garage Cost (PSF)	$90	$90	$90	$90	$90	$0	$0

4.3 Financial Model Assumptions

4.3.1 General Assumptions

The following assumptions apply to all development scenarios unless noted otherwise.

- The models are scaled to a 0.4 hectare (1-acre) site.
- Project costs are consistent between ownership and rental scenarios.
- In scenarios where land cost is included, the developer must acquire the site at the market rate.
- NBLC has reviewed land transaction data and market sale data to establish assumptions regarding land costs and developer profit targets in each built form scenario and market location.
- Hard construction costs are informed by NBLC's experience and the 2016 Altus Cost Guide and a contingency of 5% of total hard costs has been assumed.
- Soft construction costs incorporate government fees and taxes, and NBLC has estimated servicing costs, consultant's fees, marketing costs, and lender's fees based on prior experience.
- Costs and revenues are inflated at 1.75% per year during the construction period.
- Development application fees including rezoning, site plan, and plan of subdivision or condominium have been included. A Section 37 payment of $1,500 per unit has been included in the concrete apartment scenarios in Erin Mills and Cooksville.
- A cash-in-lieu of parkland dedication payment has been included.
- A 7% discount rate is assumed for all built forms except concrete apartments, where an 8% discount rate is used to reflect the risk premium associated with this built form.
- Some site demolition costs are assumed in Cooksville, Lakeview, and Malton.

4.3.2 Tenure-Specific Assumptions

The following assumptions are specific to the type of tenure:

- Ownership
    - A target return of 15% of gross revenue is used for the for-profit scenarios, while a target return of 0% is used in the non-profit scenarios.
    - An absorption rate of 10 units per month.
    - 70% of units must be sold prior to the start of construction.
- Rental
    - Affordable in perpetuity, with rates set at 100% AMR for the Region of Peel and inflated by 2% annually.
    - Modeled with a 20-year cash flow.
    - A 3-year lease-up period with a stabilized vacancy rate of 2%.
    - A 7% leveraged Internal Rate of Return is used as the target return for the for-profit development scenarios and a 5% leveraged IRR is used for the non-profit scenarios.
    - Operating expenses are assumed at 35% of gross revenue.
    - A 5% capitalization rate.

4.4 Financial Results & Discussion

The results of this analysis are shown in the summary matrix on the following pages. These financial results illustrate an estimate of the range of financial incentive required on a per-unit basis, to produce different types of affordable housing at varying levels of affordability across Mississauga.

While the following results illustrate the range of financial incentive that might be required in varying development scenarios across multiple locations in Mississauga, not all developers are exposed to the same costs, nor do they take consistent approaches in evaluating returns and project risk. For this reason, it is likely that the level of incentive would vary between different developers on the same site.

It is important to note that while this analysis models conceptual developments where the whole project is offered at affordable rates, the per unit results presented here are thought to be relatively scalable to projects where only a portion of the units are made affordable, or units at different affordability thresholds are mixed together.

4.4.1 Affordable Ownership

Key findings from this financial analysis follow:

- The difference in revenue has the biggest influence on the amount of incentive that is required to bridge the financial gap between market and affordable residential development. Our analysis indicates that concrete apartments, wood-frame apartments, and stacked townhomes require the least amount of incentive on a per unit basis. This is partly because in some market areas, the current market pricing is not significantly below the high end of the target affordability threshold. These three built forms were tested at the 5th income decile because in many cases units available in the market are already affordable (according to the Region's definition) to the 6th income decile in some areas of Mississauga.
    - Based on the assumptions used in this analysis, the level of incentive required to support the private sector's development of new affordable apartments with a typical suite mix or stacked townhomes is expected to range between \$86,000 and \$195,000 per unit at the 5th income decile, and between \$189,000 and \$298,000 per unit at the 3rd income decile.
    - Market rates for the traditional townhomes and semi-detached homes have well exceeded what is considered to be affordable in Mississauga and the financial gap quantified in this analysis clearly reflects this. In the two areas where traditional townhomes and semi-detached homes were tested, the total financial gap was between \$144,000 and \$333,000 per unit at the 6th decile, and between \$302,000 and \$482,000 per unit at the 3rd income decile.
- Recognizing that the financial gap is primarily a function of the difference in market and affordable rates, this is likely to have a significant bearing on future decision making around the provision of incentives to support affordable housing, specifically when considering which income band to target and where to locate affordable housing. While an investment in apartments and stacked townhomes may be more economical, not every built form is appropriate in all areas or planning contexts, nor may they be appropriate for a particular group's need. Therefore, cost is just one factor to consider alongside broader policy objectives when investing in affordable housing.
- Built form has the second largest impact on the amount of incentive required. In absolute terms, the apartments and stacked townhomes are likely to require more incentive because they often produce

higher development yields with higher total development costs. However, these projects require less incentive on a per unit basis because they benefit from certain economies of scale not realized by the low density developments. Some of the fixed costs, in particular, the cost of land, can have a large impact on the financial viability of a project. By spreading these costs over many units, the higher-density built forms achieve lower per-unit costs and therefore require less incentive per unit.

- The opposite is true of townhomes and semi-detached homes. Land makes up a greater portion of the development costs in these scenarios because there are fewer units and these product types can command higher sale prices. Removing the cost of land, therefore, has a greater impact on the financial gap in the traditional townhomes and semi-detached homes compared to the apartments and stacked townhomes.
    - For example, the total land cost for concrete apartment scenarios tested in this prototypical analysis was between about \$2.0 and \$2.3 million, but only about \$11,000 to \$16,000 per unit. Compare this to townhomes and semi-detached homes, where the total land cost was lower at \$1.3 to \$1.7 million, but about \$90,000 to \$140,000 on a per-unit basis. Removing the cost of land in the traditional townhomes and semi-detached homes scenarios reduces the financial gap, or level of incentive, by over \$100,000 per unit in most cases.

The following table highlights the range of financial incentive required on a per unit basis to support a viable financial result according to the assumptions used in this analysis across varying development scenarios.

Table 3

Financial Results - Required Incentive, Per Residential Unit Affordable Ownerhip at 3rd and 5th/6th Income Decile										
Built Form/ Suite Mix		***Affordable Purchase Price***	**Total Financial Gap (Capital Deficit + Developer Profit + Market Land Value)**		**Development on Free Land (Capital Deficit + Developer Profit)**		**Non-Profit Development (Capital Deficit + Market Land Value)**		**Non-Profit Development on Free Land (Capital Deficit Only)**	
			Low	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**
Affordable Ownership at the 3rd Income Decile										
Concrete Apartments	Typical Mix	*$221,000*	$214,000	$227,000	$203,000	$214,000	$145,000	$153,000		
	Family Mix	*$221,000*	$282,000	$298,000	$268,000	$282,000	$132,000	$153,000		
Wood Frame Apartments	Typical Mix	*$221,000*	$189,000	$214,000	$169,000	$203,000	$130,000	$151,000	$108,000	$129,000
	Family Mix	*$221,000*	$255,000	$284,000	$230,000	$268,000	$186,000	$211,000	$160,000	$185,000
Stacked Townhomes		*$221,000*	$210,000	$219,000	$168,000	$172,000	$148,000	$155,000	$106,000	$108,000
Traditional Townhomes		*$221,000*	$302,000	$331,000	$212,000	$231,000	$226,000	$241,000	$136,000	$141,000
Semi-Detached		*$221,000*	$435,000	$482,000	$325,000	$342,000	$340,000	$379,000	$230,000	$239,000
Affordable Ownership at the 5th* or 6th Income Decile										
Concrete Apartments*	Typical Mix	*$334,000*	$111,000	$124,000	$99,000	$110,000	$41,000	$50,000		
	Family Mix	*$334,000*	$179,000	$195,000	$165,000	$179,000	$100,000	$110,000		
Wood Frame Apartments*	Typical Mix	*$334,000*	$86,000	$110,000	$64,000	$88,000	$27,000	$48,000	$5,000	$26,000
	Family Mix	*$334,000*	$152,000	$181,000	$126,000	$154,000	$83,000	$108,000	$57,000	$82,000
Stacked Townhomes*		*$334,000*	$107,000	$116,000	$65,000	$69,000	$45,000	$45,000	$3,000	$3,000
Traditional Townhomes		*$398,000*	$144,000	$173,000	$54,000	$73,000	$68,000	$83,000	Potential Viability	Potential Viability
Semi-Detached		*$398,000*	$286,000	$333,000	$176,000	$193,000	$191,000	$231,000	$81,000	$91,000
"*" Indicates scenarios where affordable residential sale revenue is tested at the 5th income decile										

Disclaimer:
Every reasonable effort has been taken to ensure that the information, analysis, conclusions, and recommendations in this analysis are accurate and timely.
No responsibility for the information, analysis, conclusions, or recommendations is assumed by N. Barry Lyon Consultants Limited or any of its employees or associates.

4.4.2 Affordable Rental

The results of this analysis for affordable rental housing are developed using a model that tests for the amount of incentive required to make the units affordable in perpetuity, with the affordable rate set at 100% of current average market rent (AMR). These rents are marginally inflated with costs over the life of the building. Key findings from this financial analysis follow:

- The results again show that concrete apartments with a typical suite mix, wood-frame apartments with a typical suite mix, and stacked townhomes produce the smallest financial gap, on a per unit basis. Based on the assumptions in this analysis, our analysis illustrates that in high-density wood-frame construction forms, it may cost less than $100,000 per unit for a for-profit developer/operator to offer these unit types at affordable rates, in perpetuity. In buildings with a larger average unit size positioned as family-oriented units, the amount of incentive required is roughly 20% more, at between $107,000 and $125,000 per unit.
- When operated by a non-profit developer (assumed to be accepting of a lower rate of return), the subsidy required falls by roughly 20% for all unit types. Traditional townhomes and semi-detached homes require more incentive (between $115,000 and $191,000 per unit). Again, these costs may be justified if the built form helps to meet other policy objectives or need.
- Note that the affordable rental analysis models the incentive required to fill the financial gap as a one-time capital grant to improve the project's cash flow (similar to the current Investment in Affordable Housing or "IAH" model which supports development with rents at 80% of AMR). While a realistic form of incentive, it is possible that these results may vary if other longer term incentives (e.g. a loan with repayment terms, or property tax waivers) were offered instead, or in combination. As modeled, the municipality could consider adding incentives on top of this capital grant to target deeper levels of affordability, consistent with the Region's current IAH model which also offers a 20-year property tax incentive.
- The level of incentive required to support the development of concrete and wood-frame apartments with a family suite mix, that is, an average unit size of 900 sq. ft., cost between $66,000 and $71,000 more per unit than an identical building with a typical suite mix (750 sq. ft. per unit). This is primarily due to the fact that the development yield is reduced because the units are 20% larger but rental rates do not increase proportionately. This increases the fixed development costs on a per unit basis.
- Wood-frame apartments and stacked townhomes can be effective in striking a balance between value for money and context appropriate scale. At six-storeys, wood-frame apartments can function as a form of intensification that is contextually appropriate for both existing apartment neighbourhoods, mid-rise avenues, and transitions toward existing neighbourhoods. Similarly, stacked townhomes can fit well in low-rise neighbourhoods where underutilized sites can accommodate sensitive intensification, or in locations where grade related housing may improve the character of the area.

The following table highlights the range of financial incentive required on a per unit basis to support a viable financial result in the development of affordable rental housing, at 100% AMR for either a private or non-profit developer.

Table 4

Financial Results - Required Incentive, Per Residential Unit Affordable Rental at 100% AMR (Region of Peel Rates)								
Built Form/ Suite Mix		*Affordable Monthly Rental Rate*	Est. Financial Gap (Private Developer/ Operator)			Est. Financial Gap (Non-profit Developer/ Operator)		
			Low	-	High	Low	-	High
Concrete Apartments	Typical Mix	*$1,137*	$94,000	-	$101,000	$74,000	-	$79,000
	Family Mix	*$1,220*	$117,000	-	$125,000	$95,000	-	$101,000
Wood Frame Apartments	Typical Mix	*$1,137*	$84,000	-	$94,000	$64,000	-	$74,000
	Family Mix	*$1,220*	$105,000	-	$118,000	$83,000	-	$96,000
Stacked Townhomes		*$1,220*	$86,000	-	$89,000	$64,000	-	$68,000
Traditional Townhomes		*$1,357*	$115,000	-	$122,000	$91,000	-	$99,000
Semi-Detached		*$1,357*	$172,000	-	$191,000	$148,000	-	$168,000

5.0 Second Units

5.1 Overview of Second Units in Mississauga

Second units, typically known as basement apartment or in-law suites, make up a key segment in Mississauga's affordable rental housing stock. A second unit is a self-contained living unit within a detached, semi-detached house or townhouse.[4] Between August 1, 2015, and July 31, 2016, rents of basement apartments in Mississauga ranged between $800 and $1,350 per month, averaging $1,024 per month.[5] Comparatively, rents of purpose-built rental apartments in Mississauga averaged about $1,182 per month in 2015.[6]

Second units have mostly been illegal in Mississauga prior to 2009. Notwithstanding this, in 1994, the Provincial government passed the Residents Rights Act (Bill 120) which permitted second units in houses as of July 14, 1994, regardless of municipal zoning. Under this legislation, second units created before July 14, 1994, were considered legal non-conforming uses. On November 26, 1995 and shortly after a change in provincial government, second units were again banned in Mississauga under Bill 20 which restored the municipalities' rights to determine where second units could be permitted through their zoning by-laws. The City estimates that during this short window (July 14, 1994, to November 26, 1995), approximately 400 second units were created legally in Mississauga with building permits.

In 2009, the City of Mississauga passed Official Plan Amendment 95 which permitted second units in detached dwellings. This provision was extended to permit second units in townhomes, semi-detached homes, and detached homes following the passage of the *Strong Communities Through Affordable Housing Act, 2010* (Bill 140), which required the City to bring its policies in conformity with this Bill.

Subsequently, Mississauga passed the Second Unit Licensing By-law, which came into effect on January 1, 2014, facilitating the creation of legal second units through a licensing process. In June 2016, a less onerous registration process was introduced to replace the licensing process, with the intention of encouraging more homeowners to legalize existing second units and to create new legal second units.

Prior to the introduction of these licensing and registration by-laws, the City of Mississauga was aware of 3,500 illegal second units through information from residents (i.e. complaints). However, the actual number of illegal second units across the City could be much larger. The Canadian Mortgage and Housing Corporation (CMHC) estimated that the number of second units in municipalities can range from 5% to 10% of the housing stock.[7] In 2011, Mississauga reported a total of 151,250 ground-oriented homes. Using CMHC's rate, there could be 7,500 to 15,000 second units in Mississauga, of which the vast majority are not currently registered.

5.2 Benefits of Legal Second Units

Despite being illegal for some time, second units have been filling the gap between growing rental demand in the City and a lack of new purpose-built rental units. Second unit rentals are often relatively spacious and many could be considered family sized units. Encouraging the

[4] City of Mississauga (2016). www.mississauga.ca/portal/residents/housingchoicessecondsuites
[5] Based on listings from Toronto Real Estate Board's (TREB's) Multiple Listing Services (MLS).
[6] Canadian Mortgage and Housing Corporation, Rental Market Report (Fall 2015).
[7] Canadian Mortgage and Housing Corporation, Accessory Apartments: Characteristics, Issues and Opportunities (1991).

legalization of these second units could help increase the supply of higher quality, safe and relatively affordable rental units that meet the housing needs of a wide range of renters in Mississauga. From the perspective of a municipality, encouraging second units throughout existing housing stock supports:

- A form of low impact intensification already permitted under current zoning, which can enhance and support the utilization of public transit, local businesses and make more efficient use of public infrastructure;
- An increase in relatively affordable rental housing supply;
- Opportunities for home ownership through increased borrowing capacity;
- Relatively hands-off operation of rental housing supply;
- An alternative neighbourhood lifestyle for renters (compared to high density housing forms); and,
- Opportunities to age in place, and housing for adult children.

From the homeowners' perspective, a legal second unit could:

- Provide additional income which might help prospective homeowners qualify for a mortgage;
- Provide housing options for extended family or a live-in caregiver;
- Command higher rents than an illegal unit;
- Lower the ongoing costs of homeownership; and,
- Improve property value.

5.3 Overview of Registration Process

The second unit registration process in Mississauga is divided into three streams, each of which could require varying costs and processes for registration. At a high level, these streams are categorized as:

- Units created on or before July 14, 1994.
    - Considered legal non-conforming uses, applicants are required to prove the existence of the unit on or before that date, and arrange for an inspection and clearance from the Fire and Emergency Department. Orders could be issued to remedy deficiencies, triggering a building permit process.
- Units legally created after July 14, 1994.
    - An original building permit is required to register the unit. Illegal units created after July 14, 1994, would need to enter into a building permit process to be registered.
- A new second unit in an existing home.
    - New units must be created and registered through a building permit process. In some cases, a Minor Variance application could be required.

Second units can also be included in new housing developments. However, these second units, created at the same time as the principal unit, are subject to additional development charges (DC) as high as $37,000 per unit, on top of the applicable DC for the principal unit.[8] Because of this additional cost, it is rare for developers to include second units in new developments. We understand that the Province is currently considering an amendment to this policy.

[8] 2016 Development Charge rate for small units.

5.4 Order of Magnitude Costs

Typically, the costs of renovating or creating a new second unit will involve both hard costs (e.g. labour, materials) and soft costs (e.g. designer/ consultants' fees, application fees). In Mississauga, a building permit process is required for most registration cases, which would require professional architectural and HVAC drawings demonstrating Zoning and Building Code compliance. The application timeline could vary from two weeks to several months. In some other municipalities, the process for legalizing existing units is less onerous. For instance, in the City of Oshawa, the registration process for existing second units only requires the compliance to building and fire codes, and professionally prepared drawings are not mandatory in all circumstances. This can translate into significant savings in both time and costs for a homeowner.

In interviews with industry professionals involved in the second unit renovation/ creation business, it was estimated that the hard costs for creating a new second unit in Mississauga is typically in the range of $40,000 to $50,000, and soft costs are estimated around $5,000.

Hard costs for renovating an existing second unit can vary greatly depending on the condition of the existing second unit. Overall the average renovation cost is estimated to be in the range of $20,000 to $30,000, subject so site-specific variances. The most common renovation projects required for registration purposes are related to health and safety. Often these renovations involve alterations to windows and access, fire rated features, flooring, smoke and carbon monoxide detectors, and ventilation. Soft costs associated with the renovation of existing second units are estimated to be approximately $3,000 in Mississauga.

5.5 Existing Financial Assistance Program

Following the policies permitting second units in Peel, the Region launched the Peel Renovates Second Units program in 2015 to offer eligible applicants up to $25,000 per household for use in renovating existing second units in order to meet registration requirements. The first $3,500 is in the form of a grant, with the remainder issued as a forgivable loan so long as the homeowner does not sell within 10 years. Eligible applicants must own their home, have a maximum gross household income of $87,800, have drawings of work to be completed, and a building permit (if required) to commence renovations. The types of renovations covered by the program are also largely related to health and safety and include renovation works on accessibility, fire safety, structural, electrical, plumbing, and HVAC systems.

As of July 2016, a total of 11 households in Peel had qualified for Peel Renovates Second Unit Program, including two in Mississauga and nine in Brampton. The limited take-up in Mississauga is likely attributable to the following factors:

- A potential knowledge gap:
    - Program information is available on the Region's website and at the service counter, but is not widely advertised. Many homeowners with the intention of upgrading second units may not be aware of the program. Others may not fully understand the process of registration.
- Few eligible applicants in Mississauga.
    - Grade related homes are expensive in Mississauga when compared to the overall average price throughout Peel Region (an average price of $755,580 versus $686,880).[9]

[9] Toronto Real Estate Board, Market Watch, June 2016

Homeowners who can afford a grade-related home in Mississauga are likely to have incomes that exceed the maximum threshold for this program. Of note, the average income of an ownership household in Mississauga as of the 2011 Census was $108,000. This is likely to have increased since that time.

- Eligible applicants are required to have professional drawings and a building permit in hand when applying for the Peel Renovates program. The upfront time and costs associated with this condition may be limiting the attractiveness of the program.
- Inflexible payment procedures/coverage:
    - Payments from the Peel Renovates program are made once the project is completed. However, it is common for contractors to require partial payments at project milestones, especially in larger projects with lengthy timelines.
    - The Peel Renovates program does not cover any soft costs associated with the renovation (e.g. architecture or building permit fees). However, unlike Brampton, most streams of the second unit registration process in Mississauga require professionally prepared drawings. This triggers additional soft costs that may be impacting the uptake of Peel Renovates program in Mississauga.

5.6 Financial Implications for Homeowners

In addition to the upfront hard and soft costs associated with upgrading existing or creating new second units, operating a legal second unit might expose the homeowner to additional costs when compared to instances where the home does not have a second unit, or instances where a homeowner might be operating an illegal unit.. In order to understand the financial implications of having a legal second unit from homeowners' perspective, NBLC has prepared an order-of-magnitude financial analysis to reconcile the costs and revenues associated with upgrading an existing second unit, or creating a new second unit. The results of our analysis compare the annual after-tax household disposable income in the following four scenarios:

- The base case, a do-nothing scenario with no second unit;
- The operation of a legal second unit; and
- Operating a legal second unit, with a grant from the City that covers the upfront hard and soft costs associated with renovating or creating a new unit.

5.6.1 General Assumptions

In order to simulate the financial implications for a typical household in Mississauga, NBLC has made the following assumptions:

- The homeowner has an annual household income of $108,715 from employment, the average annual household income of owner households in Mississauga, as per the 2011 Census;
- The home value is about $700,000;
- Mortgage payment calculations assume a down payment of 30%, an annual interest rate of 3.5%, and a 25-year amortization;

- Residential Property Tax Rate in 2016 is 0.87%, as per the City of Mississauga;
- Annual insurance premiums (without second unit) are $850;
- Annual utility costs (without second unit) are $2,000;
- Monthly phone, cable, internet costs (without second unit) are $150;
- Annual home maintenance cost (without second unit) are $7,500;
- The floor area of the second unit is 1/3 of the total floor area of the house; and,
- Achievable monthly rent, including utilities, is $1,000.

5.6.2 Income Tax Implications

For homeowners, rental income can supplement to the cost of ownership. However, any additional rental income received from tenants who are not family members is taxable. Certain housing related expenses can be used as deductions, including utilities, phone/cable/internet costs, mortgage interest, property taxes, and maintenance cost, etc.

With additional net rental income, our analysis illustrates that the increase in total taxable income for owners with a second unit could push a household into a higher income tax bracket. However, the magnitude of this income tax impact will vary based on individual household finances and applicable tax rates.

5.6.3 Renovating an Existing Second Unit

Using the general assumptions described previously, NBLC tested the financial implications on a household choosing to upgrade an existing second unit. Following are assumptions used in the following model which estimates the order of magnitude financial implications associated with upgrading an existing second unit:

- Total hard costs are $25,000;
- Total soft costs are $3,000;
- Both hard and soft costs will be rolled into the homeowner's mortgage;
- The assessed home value will increase by $28,000, the same amount of the construction cost (hard cost and soft cost);
- Additional insurance premiums are $75 per year;
- Utility cost will increase by 1/3 as the result of a second; and,
- Phone, cable, and internet costs will increase by about $200 per year as the result of a second unit.

The following table summarizes the carrying costs of the home across the four scenarios previously described. Based on the noted assumptions in this chapter, it also compares the residual disposable household income after all revenue, estimated income taxes, and household costs are considered, under all three scenarios. The following points summarize the key findings:

- Based on our assumptions, having a legal second unit can increase a household's annual disposable income by about $6,000 versus not having a second unit.
- In a hypothetical scenario where the City also offered a grant to cover renovation costs, households with a legal second unit

supported by a renovation grant could gain approximately $2,000 more in annual disposable income over the base case.

While it is possible that the operation of an illegal unit might increase these potential returns, it is important to note that individual property owners with an illegal second unit may be fined up to $25,000 per offence if found to be in violation of the City by-laws. Additionally, landlords not disclosing rental incomes to the CRA could also be subject to penalties, not to mention the wide range of other of liabilities a homeowner is exposed to.

Table 5

Household Finance - Renovating Existing Second Unit			
	No Second Unit	Upgraded Existing Second Unit for Registration	Upgraded Existing Second Unit w/ Grant
Second Unit Cost Assumptions			
Second Suite Grant	-	-	$28,000
Renovation Cost (to be Mortgaged)	-	$25,000	$0
Soft Cost (Design, Permits etc.)	-	$3,000	$0
Order of Magnitude Income Tax Calculations			
Gross Rental Income Reported (Annual, all utilities incl.)	-	$12,000	$12,000
Deductible Expenses (1/3 of total expenses)	-	$6,269	$6,269
Net Rental Income Declared	-	$5,731	$5,731
Total Taxable Income (Employment+Net Rental)	**$108,715**	**$114,446**	**$114,446**
Estimate of Income Tax (Annual, est.)	**$28,987**	**$31,373**	**$31,373**
After-tax Income	**$79,728**	**$83,073**	**$83,073**
Mortgage Calculations			
Mortgage Amount (30% down)	$490,000	$509,600	$490,000
Monthly Mortgage PMT (interest@3.5%, 25 Years)	$2,439	$2,536	$2,439
Costs & PMTs (Annual)			
Mortgage	$29,264	$30,434	$29,264
Property Tax	$6,120	$6,339	$6,339
Insurance	$828	$898	$898
Utilities	$2,000	$2,667	$2,667
Phone, Cable, Internet	$1,800	$1,800	$1,800
Maintenance	$7,500	$8,000	$8,000
Total Cost & PMTs (Annual)	**$47,512**	**$50,138**	**$48,967**
Annual Household Finance Summary			
Gross Employment Income	$108,715	$108,715	$108,715
Gross Rental Income	-	$12,000	$12,000
Total Income Tax Due	-$28,987	-$31,373	-$31,373
Operating Cost & PMT	-$47,512	-$50,138	-$48,967
Residual Income after Housing Costs (Balance)	**$32,216**	**$39,204**	**$40,375**
Benefit over Doing Nothing		**$6,988**	**$8,159**

5.6.4 Creating a New Second Unit

NBLC also modeled the prototypical financial implications on a household choosing to construct a new second unit, using the same base assumptions outlined previously. Additional assumption associated with creating a new second unit include:

- Total hard costs are $50,000 for constructing a legal second unit;
- Total soft costs are $5,000 for constructing a legal second unit;
- Both hard and soft costs will be rolled into the homeowner's mortgage;
- The assessed home value will increase by $55,000, the same amount of the construction cost;
- Additional insurance premiums are $75 per year for second units;
- Utility cost will increase by 1/3 as a result of a new second; and,
- Phone, cable, and internet cost will increase by about $200 per year as a result of a second unit.

The following table summarizes the carrying costs of the home across the four scenarios previously described. It also compares the estimated residual disposable household income after all revenue, taxes, and household costs are considered, under all four scenarios. The following points summarize the key findings:

- Based on our assumptions, having a legal second unit can increase a household's annual disposable income by about $5,600 versus not having a second unit.
- Should the City offer a grant to cover the hard and soft construction costs, which relieves the homeowner from increasing mortgage costs, the annual gain over the base case scenario could be near $8,000 per annum.

Table 6

Household Finance - Creating New Second Unit			
	No Second Unit	New (Registered) Second Unit	New (Registered) Second Unit w/ Grant
Second Unit Cost Assumptions			
Second Suite Grant	-	-	$55,000
Construction Cost (to be Mortgaged)	-	$50,000	$0
Soft Cost (Design, Permits etc.)	-	$5,000	$0
Order of Magnitude Income Tax Calculations			
Gross Rental Income Reported (Annual, all utilities incl.)	-	$12,000	$12,000
Deductible Expenses (1/3 of total expenses)	-	$6,341	$6,341
Net Rental Income Declared	-	$5,659	$5,659
Total Taxable Income (Employment+Net Rental)	**$108,715**	**$114,374**	**$114,374**
Estimate of Income Tax (Annual, est.)	**$28,987**	**$31,373**	**$31,373**
After-tax Income	**$79,728**	**$83,001**	**$83,001**
Mortgage Calculations			
Mortgage Amount (30% down)	$490,000	$528,500	$490,000
Monthly Mortgage PMT (interest@3.5%, 25 Years)	$2,439	$2,630	$2,439
Costs & PMTs (Annual)			
Mortgage	$29,264	$31,563	$29,264
Property Tax	$6,120	$6,558	$6,558
Insurance	$828	$898	$898
Utilities	$2,000	$2,667	$2,667
Phone, Cable, Internet	$1,800	$1,800	$1,800
Maintenance	$7,500	$8,000	$8,000
Total Cost & PMTs (Annual)	**$47,512**	**$51,485**	**$49,186**
Annual Household Finance Summary			
Gross Employment Income	$108,715	$108,715	$108,715
Gross Rental Income	-	$12,000	$12,000
Total Income Tax Due	-$28,987	-$31,373	-$31,373
Operating Cost & PMT	-$47,512	-$51,485	-$49,186
Residual Income after Housing Costs (Balance)	**$32,216**	**$37,857**	**$40,156**
Benefit over Doing Nothing		**$5,641**	**$7,940**

5.7 Barriers and Opportunities

Barriers limiting the creation of legal second units

- Through research and interviews with industry professionals, it is our understanding that knowledge gaps widely exist for homeowners in:
  - Knowing where and how to get started in legally renovating or creating a new second unit and which registration stream they must follow;
  - Navigating cost effective ways to meet relevant requirements in building code and fire and electrical safety and zoning;
  - Awareness of financial assistance that is available; and
  - Knowing the rights and responsibilities of being a landlord.
- Many homeowners with existing illegal second units are genuinely interested in finding out what it would involve to legalize their rental units. However, many do not pursue detailed information for fear of triggering potential penalties.
- Upgrading or creating a new second unit requires an upfront investment of homeowner resources. In Mississauga, a building permit is required for virtually all second unit registration cases. This commonly triggers requirements for professional architectural drawings and creates a lengthier project timeline.
- Despite the risks, the additional disposable income and savings gained through the operation of illegal second units could be the most significant barrier dissuading homeowners from creating legal second units.
- Fear of NIMBYism from neighbours is also common as many take issue with potential impacts resulting from additional parking demand, noise, perceptions of crime, and property upkeep.

Opportunities to encourage legal second units

- Further simplify the registration process by loosening standards related to existing second units and zoning by-law compliance.
- Continue to improve the resources available at the City to bolster the registration process. This could include offering a direct contact to knowledgeable staff; an interactive web tool for homeowners with visualized guides highlighting relevant steps in the registration process as well as relevant Building Code, fire, electrical safety and zoning requirements where possible; and, providing a list of qualified architects and contractors.
- Increase the supply of financial aids by extending forgivable loans to households not eligible for the Peel Renovates program, as well as households planning to create new second units. Higher value forgivable loans could also be considered.
- Develop a comprehensive communication plan and engage with brokers and the building industry for distribution. A communication plan could convey the following key messages:
  - The fact that second units are legal in Mississauga and the new simplified process for registering units;
  - Outline the benefits of legal second units on individuals and communities;
  - Direction to resources available at the City, including staff contacts, registration process information and financial incentives that may be available.
  - The rights and responsibilities of being a landlord; and
  - The potential consequences of operating an illegal second unit.

5.8 Second Units as Affordable Housing

Our market scan of available second units in Mississauga indicates that the current market for this rental housing accommodation is relatively affordable. Therefore, promoting and simplifying the process of creating new second units could be an effective means towards increasing the supply of relatively affordable rental supply in the City. This analysis points to the fact that encouraging the creation of legal second units can create some financial benefit for homeowners (especially when financial assistance is provided). However, the magnitude of the potential financial benefit over not having a second unit is modest. Therefore, homeowners who are seeking to develop a second unit are likely doing so in part for other reasons (to help in qualifying for a mortgage, lower the cost of home-ownership, or to age-in-place, etc.).

The provision of financial incentives for individual homeowners to upgrade or create new second units in existing low density housing stock may be effective as a measure to support the creation of a safe and affordable rental supply and to lower the cost of home ownership in existing communities. However, a coordinated communication and education program is likely required to support this investment and encourage take-up.

Notwithstanding that a developer may be able to facilitate greater numbers of new affordable housing supply, encouraging and providing assistance (both logistical and monetary) to homeowners in the creation of second units provides an opportunity to support individual, rate-paying homeowners within the City, as opposed to developers. While take-up may be modest, this approach may help in alleviating perceived issues with subsidizing a private developer's bottom line.

We understand that the Region of Peel will be delivering a program where forgivable loans will be targeted for the creation of new second units with eligibility conditional on the homeowner housing an individual currently on the Region's central waiting list for affordable housing, with rents capped at the Regional AMR. Understanding that the market for second units is already relatively affordable and functioning as de facto affordable rental supply, following are some considerations with respect to a program of this nature:

- Our analysis demonstrates relatively marginal gains in disposable income when operating a legal second unit. Capping achievable rental rates in order to qualify for a financial incentive to support renovation costs may discourage the creation of legal second units, especially with low interest rates available elsewhere.
- A key consideration for individual homeowners as affordable housing providers would be the compatibility of the homeowner and tenant. To minimize potential conflict, the Region would likely need to develop and manage a program to pre-screen the waitlist and consider arranging carefully selected tenants from the waitlist to be accommodated in second unit rentals. Similarly, a screening process is likely necessary to identify suitable landlords.
- There are limitations in the ability for second units to function as stable long term affordable housing stock with security of tenure. The availability of the units is heavily dependent on individual owners' desire to continue operating the unit, as well as their financial and personal situations. The Region would need to consider how tenancy issues are dealt with if a homeowner decided to sell their home prior to the end of a rental agreement.
- Consideration should be given to the suitability of certain neighbourhoods as locations for affordable rental housing. Lower income households may be better housed in locations with close proximity to transit and employment opportunities.

6.0 Considering a Financial Incentive Program for New Affordable Housing Developments

The key finding from this analysis is that there is a financial shortfall experienced by the development community in pursuing the development of affordable ownership or rental housing in Mississauga. Therefore, the use of financial incentive tools could help to offset this shortfall and accelerate the interest of the private development community in the construction of new affordable housing opportunities in the City.

Again, this discussion around the potential provision of financial incentives for affordable housing is only a starting point. Without a dedicated revenue stream for affordable housing, the provision of financial incentives, in any form (loans, deferrals, grants, or waivers) would all ultimately affect the City's budget and this could have an affect the broader tax base.

In developing a program for the delivery of financial incentives for affordable housing in Mississauga, we identify the following guiding considerations:

- The results of our technical pro forma analysis indicate that the market is unlikely to support the development of new affordable ownership or rental development in Mississauga without financial support. The public sector would have to provide a direct subsidy in order to close the gap financial gap that exists between market and affordable housing development. This subsidy could come in the form of varying combinations of incentive tools.
- The financial results of this study point to the wide range in the amount of financial incentive that might be required to support new affordable housing development given variations in the market location, product type, construction method, tenure, and individual developer perspectives of costs, project risk, and profit thresholds.
- The provision of affordable rental or ownership housing, especially at the third income decile, is likely to require a significant amount of financial investment from public sources, requiring an alignment of priorities between the City of Mississauga and the Region of Peel.
- Together, the Region and the City of Mississauga should consider developing a clear set of objectives for any future affordable housing incentive programming to set a road map for coordination and accountability. This set of policy objectives should be developed in partnership and frame both the social and economic case in support of new affordable housing development.
- The outcome of this shared set of objectives could provide greater focus in terms of where incentives should be applied, the types of housing development that should be targeted and how incentives can be assessed in terms of value for money or other policy objectives. It could also direct and focus the resources of the Region and City to the area(s) in the most need and with the greatest potential to benefit from investments in affordable housing. Or, to areas where surplus regional or municipal land holdings can be leveraged for the creation of affordable housing.
- This coordinated set of objectives could also establish a path forward which streamlines incentive programming within the two-tiered municipality. A positive outcome would be to establish a clear, coordinated program for the delivery of incentive tools directed at the development of new affordable housing.
- Any future incentive program for the creation of new affordable housing development needs to be predictable and enduring over several years so that the development community can anticipate and

prepare for proposal calls. A key note with respect to existing incentive programs primarily available at the regional level (as the housing service manager) is that often the conditions tied to these tools are not reflective of development realities (e.g. timelines). This has limited the take-up and utility of existing programs. Future financial incentive programming must acknowledge this.

- Any financial incentive program should also be structured with a termination or program review date. An evaluation program should be established that provides a mechanism to assess the cost effectiveness of the program relative to the identified goals of the affordable housing incentive program.

6.1 The Effectiveness of Financial Incentives

The current IAH program offered through the Region in support of affordable rental development is a relatively blunt instrument which offers a grant of up to $150,000 per unit. However, as this analysis has illustrated, location and development-specific factors can have a significant impact on the cost effectiveness of this grant. For example, a traditional private-sector developer building a high-rise rental apartment tower could well need an incentive of $150,000 per unit (or more) to make the development viable at 80% of AMR. However, a non-profit or co-operative building a smaller scale wood-frame apartment development may not need the full $150,000 per-unit subsidy.

Therefore, to be effective in the delivery of financial incentives for affordable housing – regardless of the specific financial incentive tools that are utilized to provide the incentive – a major overarching principle should be to administer incentive tools in a manner that is flexible, recognizing and adapting to the needs of unique developers on unique sites. From this base of understanding, the City and Region can measure value for money based on key criteria like development yield, depth of affordability and location.

The overall effectiveness of providing financial incentives to incent affordable housing development will largely be a function of the value of the total value of the incentive. To be meaningful, the financial assistance provided must offset any capital deficits incurred in the project pro forma and satisfy a reasonable return the developer.

The cost effectiveness of individual financial incentive tools, including those evaluated earlier in this report, are likely to vary widely based on specific considerations and objectives in individual development scenarios. Market factors like, the return expectations of a developer or non-profit, or the price of land, need to be considered within the context of development tenure, type and scale, in addition to objectives like the depth and duration of affordability.

The financial incentive tools considered in this report generally fall into two categories; grants (waivers) or loans (deferrals). From a municipal finance perspective, deferring the payment of fees, or lending capital to developers, is less costly. This is simply because the funds are required to be returned in time. However, when all other considerations are equal, the provision of financial incentives through a grant or waiver is likely to have a more substantial impact on development economics. A review of the opportunities and constraints associated with various financial incentive tools is provided in Appendix A.

The Region and City of Mississauga should consider the cost effectiveness of financial incentives for the development of new affordable housing alongside a range of other tools, partnership opportunities, and strategies that seek to increase the supply of affordable housing in Mississauga. This could include:

- Continuing to simplify the process for the legalization and registration of second units throughout Mississauga and the provision of forgivable loans to cover homeowner's renovation costs. While there may still be challenges to motivate large numbers of homeowners to participate, the costs of these potential incentives (based on typical renovation costs) appear to be relatively cost effective in comparison to the amount of financial incentive that is required to support the development affordable housing units in a new development.

- Purchasing new units from developers in market developments. The Region of Peel has purchased units in market buildings in the past. This is a strategy that the City could pursue on its own, or in partnership with the Region. By committing to purchase units in new developments, the City/ Region provide a benefit to the developer, lowering cost of construction financing and accelerating the development's sales process. In exchange for this, the City or Region may be able to command a significant discount over market pricing. This strategy also promotes the development of mixed-income communities.

- A similar approach could also be used in new purpose-built rental development. The City and/or Region could seek out partnerships with developers in order to invest in new purpose-built market rental developments, providing land and/or cash in exchange for a developer's commitment (via a funding agreement) to operate those units at affordable rents. Again, depending on the magnitude of the investment, this could accelerate the developer's lease-up timeline, lower the debt obligation of the project, and encourage the development of mixed-income communities.

- Investments in financial support for, and the expansion of, the private not-for-profit housing sector. Private non-profit housing corporations and co-operative housing providers can be effective and accountable in their delivery and operation of housing. There is a longstanding history of successful private not-for profit housing expertise in Ontario. These groups often function as an effective alternative to large scale government-run social housing.[10] Working to grow the organizational capacity and supply of affordable housing units within the private not-for-profit sector could be a cost-effective manner in which to invest potential financial incentive dollars.

- Another strategy towards ensuring a cost effective approach to the development of new affordable housing could be to leverage surplus municipal and regional land assets through partnerships with developers and private-not-for profit housing providers. Subject to the availability and location of developable land, this approach could be effective as a means of directing the development of new affordable housing (or mixed-income) development to locations in Mississauga which might not otherwise experience it.

6.2 Potential Funding Sources

Recognizing the many individual variations in each individual developer's pro forma and location-specific considerations, it will be important to seek approval for a wide variety of potential financial incentive tools. By offering flexibility in this regard, the incentive program can offer a combination of tools that adapt to unique project characteristics.

If incentives that waive development levies or taxes are deemed appropriate, it may be more suitable to acknowledge this through a grant

[10] Currently, there are 32 private non-profit housing providers in Peel, accounting for over 3,500 units of housing. Source: Region of Peel.

system that is funded and drawn from the tax base. This could resolve the problem of determining which charges to waive and could help to address potential municipal finance issues associated with a potential incentive program.

In order to package together a meaningful financial incentive program to support the development of affordable housing, it will be important to align the objectives of the City and Region to collectively establish a package of financial incentive tools.

6.3 Program Development and Delivery

It is a common error for local or regional municipalities to develop incentive programs that assume that all developers use the same metrics in assessing the feasibility of development projects and require the same level of incentives. In fact, the need for and type of incentives could vary between different developers on the same site. Program development and delivery must recognize this issue.

When providing grants or waivers, the City and Region should work to implement programming that ensures that incentives are not just supplementing a developer's bottom line. Opportunities to mitigate that concern include establishing a process whereby developers would compete for available incentives. Or, establishing programs where incentives might flow through a developer to potential purchasers in an affordable ownership model as down payment assistance, for example.

To address the unique perspectives of developers in the marketplace and ensure that the City and Region achieve value for money, proponents should be required to compete for incentives based on the objectives for the program established by the City and Region. Through a proposal call, the incentives could be awarded based on a developer's performance measured against key criteria. The evaluation could be structured to address specific priorities including, among others:

- The level of affordability, tenure of development and duration of affordability;
- The scale of development, number of affordable units;
- The provision of family-sized units;
- Satisfaction of other sustainability, urban design or architectural objectives;
- The provision of public facilities, open spaces or satisfaction of other regional or municipal planning objectives; and,
- Project location.

In a proposal call of this nature, the potential incentive tools considered previously, to the extent possible, should all be available to developers, or packaged together as a grant or loan.

With the Region and City of Mississauga coordinating at the outset, the program should be structured in a manner that reflects realistic development timelines and is simple to understand. We note that the current administration of Investment in Affordable Housing (IAH) funds for new affordable rental housing development ties funding to tight timelines requiring the start of construction within 120 days of an executed contribution agreement.

In a new or modified financial incentive program, developers could be asked to select from the "menu" of programs when they make their submission to the proposal call, or simply identify the level of incentive required. Given the competitiveness of the process, developers would be encouraged only to draw the financial incentives necessary to support a viable development and satisfy any of the other objectives identified by the City and Region. And, while development-ready projects could be scored highly in the evaluation process, the program should incorporate a greater degree of flexibility in this regard when compared to the current IAH model.

It may be unlikely that the private development community would choose to implement new purpose-built affordable housing in locations of the City where market housing is currently viable. To overcome this challenge, the Region and City of Mississauga should evaluate their portfolio of landholdings to evaluate opportunities to leverage publicly owned lands for this benefit, lowering the overall cost of delivering affordable housing and creating opportunities for affordable housing development in locations which might not otherwise experience it.

6.4 Program Duration

While it may be more palatable to initiate a program of this nature as a pilot program to gauge the market's response, our experience indicates that it may take several years to realize the impact of an incentive program. Part of this delay can be attributed to the time it can take to convince developers to invest in these types of developments. For this reason, it is key to provide a predictable incentive offering/ proposal call structure so that organizations can prepare for the technical RFP submission should they not submit in a given year. The other part to this is the time it takes from initiation to completion of a development project. A typical condominium development can often take at least two years to see completion, often the timeline is longer. Any future program should recognize these factors and provide sufficient time for uptake.

To ensure competitiveness in the process, the program should also be designed so that it can endure and be predictable. For example, the City and Region may consider a program that targets the delivery of a set number of affordable housing units each year and release an annual RFP seeking to attract this development. By creating a regular and predictable approach, the program can condition the market to understand the programming opportunities and objectives, encouraging a greater response and developer performance over time.

We would suggest that the initial program period be established for a minimum of five years with annual reviews. Within this period, evidence of the program's effectiveness should be apparent and decisions could be made with respect to program adjustment or continuation. It will also be important to continuously monitor the annual financial incentive offering. As construction costs evolve over time and the residential market continues to mature, the need for financial incentives supporting certain housing forms or levels of affordability may evolve. A financial limit should also be established for the program so both City and Regional Council can be certain of the total fiscal impact of the potential program.

6.5 An Alternative Approach for Affordable Home Ownership

An alternative to providing waivers and rebates of fees could be to bundle these potential Regional and Municipal incentives and apply them as second mortgage available to the purchaser of a condominium unit, paid back when the unit is sold or the initial mortgage ends or is refinanced. This approach could be similar to the Options for Homes, Trillium Housing or Daniels' Firsthome Boost program. However, by offering the program to any qualifying developer, the program could be applied to a broader range of projects in Mississauga.

The effectiveness of this program will depend on the value of the second mortgage that is made available and conditions of eligibility. The Region's current 'Home in Peel' affordable ownership program (now on hold) offered a down payment loan, registered as a second mortgage. However, the loan was not available to purchasers of new homes, only resale properties. The program offered a maximum of $20,000 (interest-free for 20-years) to households with incomes below $88,900 and restricted the purchase price of properties to $330,000. These restrictions in the program appear to have limited the utility of the program as relatively few properties are available at this price point, especially for families in Mississauga.

One of the key issues for most people making their initial entrance into homeownership is accumulating the required down payment. A program of this nature could significantly improve the accessibility of homeownership by easing the down payment requirements and effectively expanding the pool of qualified purchasers for developers in Mississauga. The program could also remove the subsidy to the developer and eliminate perceptions with respect to how much of the subsidy goes towards a developer's bottom line.

With this tool, the provision of municipal financial incentives could stimulate private sector development interest in a manner which has enduring qualities and might have an opportunity to directly affect the affordability of new development within Mississauga.

Following are the basic elements of this potential program:

- Developers could apply to enter their project into the program in order to have financial incentives applied directly to potential purchasers of condominium units;
- The City could have developers compete for the program based on project attributes including: depth of affordability; design; location within the City; and, public spaces, among other potential criteria;
- The City could provide a deferral of development charges and fees, along with other affordable housing funding. These municipal financial incentives would pass through the developer and would be provided as an interest and payment-free second mortgage to purchasers, which would be registered on title;
- Homeowners would assume responsibility to repay the full amount of the financial incentives in the form of a City Second Mortgage; and,
- Second mortgages would be repaid to the City when the term of the initial mortgage ends, when the unit is resold, or, when it is refinanced. In addition, the City could potentially access a proportionate share in any equity gain. This City might also consider a nominal interest charge.

Following are some initial issues that will have to be addressed relating to this potential incentive tool:

- The City/ Region would have to determine the best vehicle to hold the second mortgages. This could be a third party, or the City itself, but would carry its own administrative costs and liabilities that would need to be assessed in greater detail;
- The City and Region may have to fund some component of the deferred development fee revenue for expenditures until the second mortgages are retired. This may put limits on the extent of the program depending on the capacity of the City. There may also be interest or administrative costs that would need to be identified;
- The tool would require the City to take on some market risk in a development. While there are methods available to mitigate market risk, this cannot be completely avoided; and,
- The deferral of development charges and fees requires a long-term outlook. This has financial implications for the city which would need to be understood in greater detail.

6.6 Summary Recommendations

Our study has illustrated that financial incentives will be required as part of a broad and comprehensive strategy to encourage investments in new affordable housing within the City of Mississauga. However, any financial incentive program must also recognize that each neighbourhood offers different market issues and every developer is unique.

The City and Region should consider incentive programming in a manner that recognizes the magnitude of the financial gap that currently exists between market and affordable housing, setting clear objectives for the affordable housing investment program and accommodating the unique perspectives and motivations of individual developers.

In any case, where financial incentives are offered, a performance-based delivery approach is suggested to target affordability as well as other design, tenure, community and economic objectives of the City and Region.

A next step in this process would be to evaluate the real fiscal impacts that might result through the provision of a financial incentive program for affordable housing.

Appendix A – Review of Incentive Tools

The following chapter presents a review of the opportunities and constraints of various financial incentive tools that might be available to the City of Mississauga in developing a financial incentive program for the development of new affordable housing.

The following discussion is a high-level starting point for further conversation and analysis which should consider funding sources, downstream municipal finance implications and the City/ Region's internal capacity for managing incentive programming.

The following tools are considered in this review:

- Capital loans & grants;
- Development charge waivers;
- Development charge deferrals;
- Planning and development fee waivers;
- Property tax waivers;
- Property tax deferral/ equivalency grant;
- Fast-tracking development approvals;
- Partnering in development of public land;
- Municipal Capital Facility Agreements; and,
- Considerations around potential Inclusionary Zoning legislation.

The financial incentive tools considered in this section of the report generally fall into two categories; grants (waivers) or loans (deferrals). The approaches that are likely to be most effective in incenting affordable housing are largely a function of the value of the incentive.

As illustrated earlier this report, the financial assistance must offset any capital deficits incurred in the project pro forma and satisfy typical return expectations for its developer.

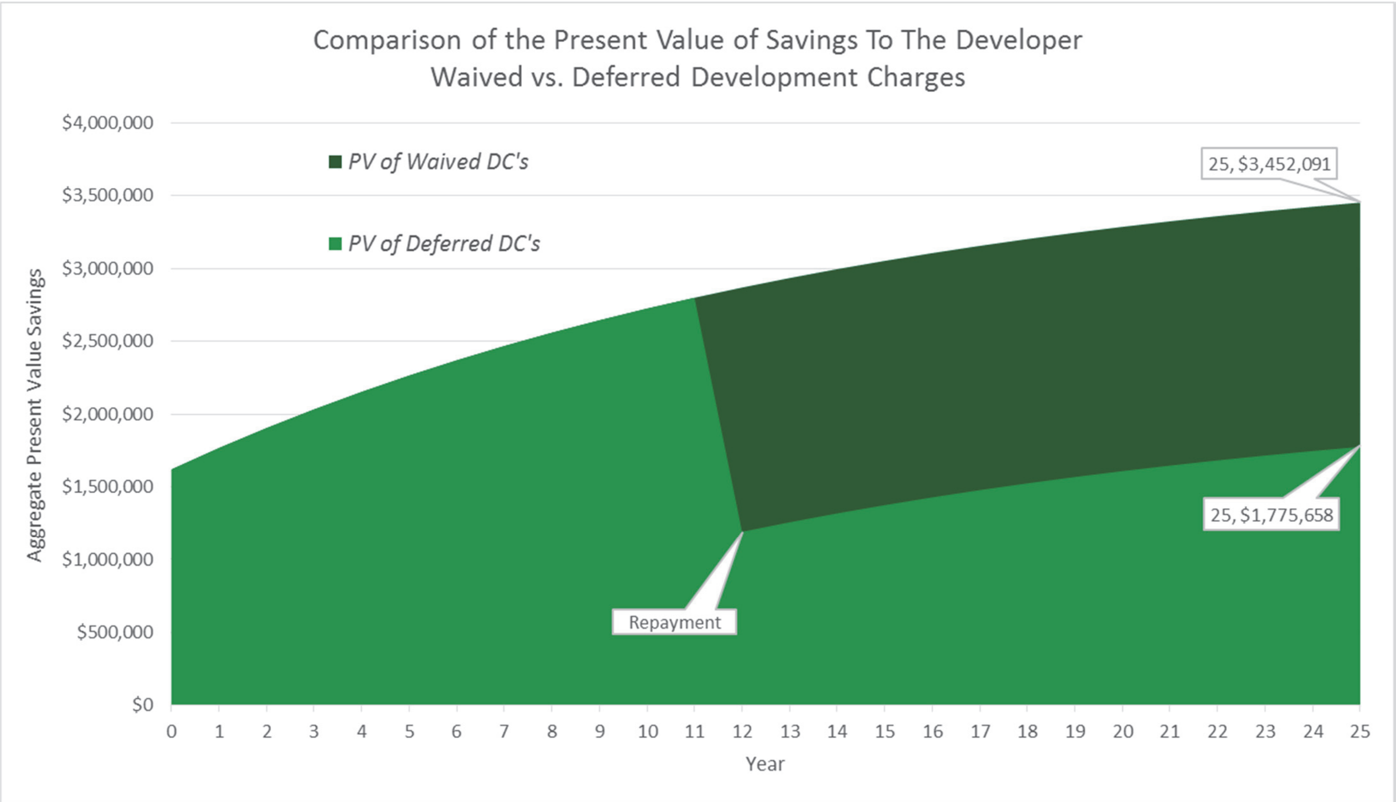
The effectiveness of individual financial tools will largely be a function of the value of incentive being offered. However, when comparing grants and waivers of the same fee (i.e. development charges, for example), waivers would represent a more significant benefit relative to a comparable loan or deferral where funds are reimbursed.

To illustrate this, NBLC compared the benefits that a developer is able to realize when development charges are either waived or deferred. To do so, we analyzed a hypothetical, 100-unit, purpose-built rental development and determined the upfront savings during construction as well as the financing implications over a 25-year period. To determine the net present value of the incentive tools, cash flows were discounted at a rate of 7% per year. In testing the deferral of development charges, it was assumed that the amount payable in the future reflects the City's development charges that would have been paid in 2016, unadjusted (i.e. not inflated and without accrual of interest). It was also assumed that the deferral would be for a 15-year period; with an assumed construction period of three years, the deferred charges would be payable at the end of the 12^{th} year of operation.

In the hypothetical development scenario, the net present value (to the developer) of waiving development charges is roughly $3.5 million while the net present value of the deferral is approximately $1.8 million. Figure 2 illustrates the comparative effectiveness in producing cost savings.

Another consideration affecting the effectiveness of financial incentives will also be determined to a significant degree by the manner in which these incentives are administered.

Figure 2



Capital Loans & Grants

Opportunities

- A low, or no interest, loan or grant can reduce a developer's lending requirements (and construction loan financing costs) in addition to helping projects in weaker market locations with slower sales absorptions reach pre-sales thresholds. The City of Hamilton's downtown multi-residential investment loan (primarily applied to ownership housing) is an example of this type of incentive tool and model worth considering in order to support the development of new affordable housing development.
- The administration of these investments could be structured through an annual request for proposals process with recipients selected based on tailored evaluation criteria to reward certain levels of affordability, the provision of community benefits, or other municipal priorities.
- A grant or loan offers a degree of flexibility for developers, allowing them to apply the funds to areas of their individual project pro formas where they need it most. In affordable ownership scenarios, these funds could also flow-through a developer to purchasers, packaged as equity (and potentially held as a second mortgage). This could represent an evolution or expansion of the Region's Home in Peel program.

Constraints

- The administration of this tool would require that the City or Region set aside dedicated staff resources and funds for investment into selected projects and to continually monitor their progress.
- The cost and effectiveness of these tools can vary widely depending on repayment terms (if any), the amount of funding available and the tenure of development, among other site and developer-specific factors.
- Another potential issue with this tool is that the City/ Region can be exposed to market risk through situations in which a project performs poorly and defaults on its loan. However, market risks can be mitigated by ensuring that the developer has adequate equity invested in the project and by ensuring that the loan is not issued until appropriate presale targets and/or construction milestones have been achieved. Loans could be structured to be repaid over time as the developer collects down-payments or begins to close on the sale of units. The loan could also be secured against the land.
    - In the case of Hamilton, repayment of loans occurs upon the sale of individual condominium units, the City is repaid upon securing 25% of the sale price of the unit until the total loan amount has been paid in full. For units that remain outstanding, repayment terms for those units are addressed in a Loan Agreement between the developer and municipality.[11]

[11] City of Hamilton, Planning and Economic Development Department.

Development Charge Waivers

Opportunities

- The waiver of development charges can have a significant positive impact on a developer's financial pro forma. In some near-viable circumstances where we have assessed the potnetial financial inmplications for non-profit developers, or where land costs are removed from the model, the waiver can sometimes represent enough of an offset to overcome financial shortcomings and produce positive results.
- Development charge waivers are commonly used by municipalities throughout Southern Ontario as the primary program towards incenting private sector investment, for varying motivations. For the development community, development charges are well understood and the application of a waiver is easy to model.
- In the Mississauga context, this waiver could provide an incentive valued at approximately $32,000 to $76,000 per residential unit, depending on the development typology and suite mix. The waiver could be administered through a CIP targeted towards specific locations targeted for affordable housing, or applied city-wide to developments meeting certain evaluation criteria.

Constraints

- The major issue with a development charge waiver is its cost to the City. In other municipalities, the magnitude of savings made available to a developer through this tool has made it popular. However, the cost to the City/ Region can make it difficult to sustain over a long period of time.
- These waivers must be financed through the tax base. Reducing development charge related revenues also impacts the funding available for services and community investments needed through intensification.
- The application of development charge waivers must be considered within the context of future downstream funding needs, with an understanding of how the compensated revenue will be funded.

Development Charge Deferrals

Opportunities

- Development charge deferrals until the time of registration in a condominium development or the duration of lease-up in a rental tenure project, can support investment by reducing upfront development costs and lending requirements.
- Costs in the early stages of a condominium development are significant. These costs are typically funded through developer equity and are at risk until a developer meets its presale targets for construction financing. In weaker market locations where land values are lower, the risk profile is even higher. The impact of a development charge deferral would vary depending on the scale of the project and level of affordability, but could be significant by limiting a developer's equity/ lending requirements and debt costs.
- For rental housing providers, a major risk is the lease-up period prior to stable occupancy, (typically around 98%). Until a development nears this occupancy level, revenues may not be balanced with costs, putting stress on the viability of the development. Even in affordable housing scenarios, developers face financial exposure throughout the lease-up the period. If the costs of development charges could be deferred until the project meets a pre-determined occupancy, these funds could be redirected in the development to potentially reduce project risk and improve viability.
- The costs of the deferral are relatively modest compared to waivers and as such are more sustainable. The program could be relatively straightforward for the City/ Region to administer, primarily requiring mortgage administration and monitoring development progress in order to trigger the time at which development charges are due to be paid in the development process.

Constraints

- As with many deferral programs, the effectiveness of the tool is limited versus an outright waiver. However, deferrals can be more sustainable from a municipal finance perspective over the long run and could be part of a comprehensive package of tools used to incent development.
- A key risk to the City is the verification of occupancy rates or presale progress in a development. The City also loses leverage in securing the payment of development charges by their deferral. Typically, development charges are paid at the issuance of the building permit. By deferring them to occupancy the City's leverage in the requirement of payment (through the ability to withhold permits) is diminished. Although it would require new administrative processes to secure and hold mortgages, the value of development charges could be secured on title as a second mortgage in favour of the City.
- Another possible risk would be the potential of a significant market downturn. However, this risk could be mitigated by requiring that developers provide an independent market feasibility opinion as part of an application process.
- Finally, this tool is less impactful on development viability than an outright waiver. However, from a municipal finance perspective, this approach is more sustainable. A development charge deferral could be effective alongside a suite of other potential incentive tools.

Planning and Development Fee Waivers

Opportunities

- The waiver of planning and development fees relating to land use policy amendments and building permits can have a measurable positive impact on a developer's financial pro forma.
- In certain locations, the waiver of payments under Section 37 of the Planning Act in exchange for height and density can also be effective (i.e. outside of Mississauga City Centre where heights are currently not limited).
- Waiving the City's fee for cash-in-lieu of parkland can also have a measurable impact on development economics. For medium and high density development forms in Mississauga, a waiver produces savings in the order of $9,800 per residential unit.
- The administration of planning and development fee waivers is likely more simple than a development charge waiver as the revenue associated with these fees is not directly tied to the provision of community infrastructure, rather they represent the costs incurred in processing the application. The Planning Act provides general language supporting the waiver or reduction of planning fees in instances where a municipality is satisfied that it would be unreasonable to require payment.
- Understanding that the value of Section 37 contributions can vary throughout the City depending on a number of considerations, another variation of this incentive tool might be to cap these contributions at a nominal value (i.e. $500 per residential unit) to provide certainty and some financial relief to the developer, without completely forgoing the important contribution to community services which often comes along with new development.

Constraints

- The effectiveness of this tool in isolation is likely to be limited in the support of affordable housing development given the magnitude of the financial gap that typically exists between market and affordable housing. Depending on the market context, development form, and level of affordability, the savings provided can be relatively small and may not be enough to support a viable development. However, combined with other tools, this type of incentive can begin to have a meaningful impact on a developer's pro forma.
- The financial implications of forgoing this revenue, from a departmental perspective, should be understood in greater detail. Often, departmental budgets rely on planning and development fees as a major component to forecast future spending.
- While Section 37 and cash-in-lieu of parkland contributions are often a key revenue source for the City in its provision of community services, it could be argued that these potential waivers for new affordable housing developments are reasonable given that the development may not have occurred at all without the incentive.

Property Tax Waivers

Opportunities

Ownership:

- To limit a developer's exposure to upfront development costs, another potential tool would involve the waiver of property taxes until the development is occupied or registered and its residents assume the payment of property taxes.
- The real value of this incentive would vary depending on the assessed value of the property at the outset of development. However, the incentive may be effective when combined with other municipal tools, especially in instances where the existing land use is a productive, income-generating use.

Rental:

- Providing a waiver of property taxes to new purpose-built rental developments can have a significant positive effect on the development economics of purpose-built rental development by reducing manageable expenses and improving the development's ongoing cash flow.
- In the City of Toronto, its current package of incentives for affordable rental developments includes a 25-year waiver of school board and municipal property taxes for not-for-profit corporations or not-for-profit co-operatives. To date, this has been implemented through a Municipal Capital Facility Agreement.

Constraints

Ownership:

- Our experience in assessing property tax waivers during the development of ownership housing has shown to have limited effectiveness in isolation unless the developer is undertaking a large, multi-phase development program.
- The administration of a short term property tax waiver may be complicated from a legal point of view without the provision of a municipal capital facility agreement, brownfield remediation, heritage retention or other eligible exemption or reduction outlined under the Provincial Land Tax Act.

Rental:

- As with any waiver of municipal/ regional revenue sources, the issue with a property tax waiver is its cost. Waiving the collection of property taxes for new development can create strain from a municipal finance perspective in terms of funding community infrastructure and services.
- The costs and funding implications for future growth related expenses should be understood and may need to be accounted for throughout the broader tax base.

Property Tax Deferral/ Equivalency Grant

Opportunities

- In Ontario, property tax deferrals are commonly offered through a Tax Increment Equivalent Grant (TIEGs). This tool is mostly offered as an incentive for rental development, but can also be applied to ownership models.
- From a rental development perspective, a significant component of rental income goes toward property taxes. The rebates are designed to boost cash flow over the initial years of operation via a decreasing grant with each year, subsidizing effective net rents, and allowing a subsidization of the rent levels necessary to make an office project feasible. In these programs, developments typically pay the full effective tax rate after about ten years of diminishing rebates.
- For projects in ownership tenure, property tax rebates could be offered to either the developer or unit purchasers. Offering the rebate to homeowners could be a very effective way of reducing the cost of home ownership, while at the same time, providing a market advantage to the developer who is investing in affordable housing.
    - The City of Hamilton has a program in place that offers this incentive. In this program, only the original purchaser can apply for the rebate which has a duration of five years from the date of condominium registration and reassessment. The rebates are structured so to not exceed 100% of the municipal property tax increase during the first year, 80% in year two, 60% in year three, 40% in year four and 20% in year five.
    - It is our understanding that this tax incentive has not often applied to condominium purchasers in Hamilton. This could be strengthened in a future program for Mississauga by requiring that the tax incentive be administered to purchasers, improving the affordability of home ownership.

Constraints

- Limited timeline property tax deferrals/ equivalency grants can be problematic when tied to affordable housing development if the intention is to provide affordable housing over a long time horizon, or in perpetuity.
- In rental housing, the eventual increase in carrying costs must be considered alongside projected rental rate increases (likely to be minimal) and the planned duration of affordability. This eventual increase in costs is likely to limit the effectiveness of the tool versus an outright waiver of property taxes. However, if combined with other incentives, the approach might be a meaningful tool alongside other incentives.
- Again, the costs of the program of this nature could include a significant administrative component, as well as the tax the revenue loss and service requirement implications. However, the theory of these incentives is that without the incentive, the development would not otherwise be realized.

Fast-Tracking/ Streamlining of Development Approvals

Opportunities

- Timelines are critical in any real estate development. Once a developer purchases land for the purposes of development, the project is exposed to market risk and a wide variety of costs, many of which are time sensitive. Fast-tracking the development approval component of a project's timeline adds to the level of confidence in the project – and certainty has value.
- From the municipality's perspective, a fast-tracked or streamlined approvals process for affordable housing development means that the municipality can prioritize its allocation of resources to projects that have a meaningful impact on the quality of life for a cohort of residents who are typically not served in new real estate development.
- Moreover, the introduction of this type of program is generally an administrative policy, and there is likely minimal investment required from the municipal/ regional perspective.

Constraints

- Fast-tracking development approval timelines is often mentioned as a potential tool to incent development. However, a key issue constraining the effectiveness of this tool is the fact that some components of the development approval process occur outside of City Hall. Agencies like regional conservation authority and the ministry of transportation also have a role in development approvals and can negate any municipal measure to accelerate the timing of higher priority development applications. These constraints limit the effectiveness of the incentive.
- Subject to the volume of take-up, a program of this nature may put added pressure on internal staff resources and their capacity to process development applications; some of which could be complicated by the introduction of financial incentive tools, or other special considerations.
- There is also the potential for some resistance from the broader development community if development approval timelines for conventional development applications lengthen as a result of the prioritization of affordable housing development applications.

Partnering in the Development of Public Land

Opportunities

- One tool available to the City or Region would be to enter into partnerships and provide land to developers at no cost, or below market value through sale or a long-term lease agreement.
- Removing land costs from a residential pro forma can have a significant impact on development economics, especially in strong market locations where land costs are high.
- The pro forma model results across the five test sites in this analysis illustrate potential positive impact ranging between $11,000 & $110,000+ per unit when land is removed from the cost of development.
- Leveraging publicly owned lands for affordable housing development in strong market areas presents an opportunity to support the development of affordable housing options in locations which might not otherwise experience it.
- This may also represent a positive use of public lands in marginal market locations where the disposition of land for market uses may not yield strong returns.

Constraints

- In considering the provision of municipal/ regional land at little or no cost as part of a potential incentive program, it will be important to assess the City and Region's land portfolios to identify opportunities and an overall strategy for the use or disposition of surplus lands. Limitations in the availability of surplus property and any applicable repayment terms could limit the effectiveness of this tool.
- The impact of the incentive is site-specific and more impactful in certain development typologies. As such, the benefit is more complex to evaluate and can be subject to some debate.
- A potential risk to the City of Region would be the loss of control over development outcomes if transferring ownership. This could be mitigated through long term land lease agreements or through restrictive covenants, although this adds complexity to the project.
- Providing land at little or no cost for affordable housing precludes other revenue generating opportunities for the City or Region from that asset. However, there are also costs to inaction on affordable housing; these impacts are being considered by the City in a separate analysis.

Administrative Tools & Emerging Policy

Municipal Capital Facility Agreements

- Qualifying potential affordable housing assets as Municipal Capital Facilities allows for a relationship between the municipality and a non-profit or the private sector developer to deliver municipal housing projects.
- This administrative tool is used to facilitate a relationship between a housing service manager and developer where incentives can be provided. Available tools within a Municipal Capital Facility agreement can include:
  - Giving or lending money;
  - Giving, leasing or lending property;
  - Guaranteed borrowing;
  - Property tax exemptions/ reductions; and,
  - Development charge exemptions.
- As noted throughout this chapter, these tools can have a positive financial impact on development viability.
- Prior to a Municipal Capital Facility agreement, the municipality must pass a municipal housing facility by-law which must include:
  - A definition of "affordable housing";
  - Policies regarding public eligibility for housing units; and
  - A summary of provisions that agreements must contain for municipal housing facilities.
- Region of Peel By-law 41-2003 currently exists for this purpose.
- The designation of affordable housing projects as Municipal Capital Facilities may only be established by the municipality that is a housing service manager. In Mississauga's case, the housing service manager is the regional municipality (Peel). Therefore, this administrative tool is not currently available to the City of Mississauga. However, the City can use Community Improvement plans which allow the use of similar incentive tools.

Inclusionary Zoning Considerations

Inclusionary Zoning is a technique used to extract affordable housing benefits as part of development proposals. Typically, it works best where affordable housing requirements are offset by density increases, tax abatements or other incentives.

- In Canada there is limited experience with inclusionary zoning. In Ontario, the Planning Act does not currently provide for inclusionary zoning. However, the City of Toronto's large site policy does require that for sites over 5 hectares in size, 20% of any increase in residential density be provided in affordable housing.
- This policy has been unsuccessful for a range of reasons but chief among them has been:
  - The limited number of large sites;
  - Most large sites are industrial and the rezoning results in a very large and unsustainable amount of affordable housing; and,
  - The large sites are typically in weak suburban market areas-further reducing the economic viability of redevelopment.
- Current legislative framework outlining the potential Inclusionary Zoning tools for municipalities in Ontario Bill 204 is vague. It is currently unclear whether the Province will give specific direction regarding key components of a potential Inclusionary Zoning by-law, or whether the determination of the following items will be left up to municipalities to establish independently. Key unknown factors include:
  - The amount of affordable housing to be provided in development;
  - The length of time which a unit must remain affordable;
  - The types of units that are required to be affordable (this could include targets relating to unit size, number of bedrooms or other special accessibility considerations);
  - Other funding or financial incentive tools that might be applied in parallel with projects implemented with inclusionary zoning;
  - The ability to pay cash-in-lieu of affordable housing; and,
  - Measures which might ensure control over the resale and re-lease of units in order to maintain affordability.
- Another key issue in the current legislation is the use of Section 37. Bill 204, as currently drafted, requires that the use of inclusionary zoning and Section 37 be mutually exclusive.
- For the City of Mississauga, the most probable locations for the use of inclusionary zoning will be in the City Centre. However, the utility of inclusionary zoning tools will depend on how inclusionary zoning is applied in practice (to incremental increases over base density, or to entire developments). With height currently unlimited in Mississauga's City Centre, density offsets for inclusionary zoning may not be available.
- Other areas such as Port Credit and future transit stations may offer possibilities to apply inclusionary zoning tools.
- Inclusionary Zoning requirements will likely have to take into consideration subtleties within local market characteristics within a municipality. However, the legislation in its current forms does not appear to allow for a great deal of flexibility to applying the tool according to market and location-specific considerations.
- In any case, the introduction of Inclusionary Zoning legislation should be done gradually to allow the land market to adjust.

In order for future Inclusionary Zoning policies to be effective, the policy must recognize the economic realities of land development and strike a balance between public benefit and economic viability. Without acknowledging this, the policy could undermine investment and have a detrimental impact on other Provincial planning objectives relating to intensification. Again, the province's current articulation of Inclusionary Zoning policy states that it cannot be applied alongside payments pursuant to Section 37 of the Planning Act. This could put affordable housing objectives at odds with other community needs.

- Several key interconnected factors will have a significant bearing on the effectiveness of Inclusionary Zoning. Key questions to consider moving forward are:
    - What depth of affordability is required?
    - What percentage of units in a development are required to be affordable?
    - How deep is the market and what pricing is achievable for market-rate housing at locations where Inclusionary Zoning is being applied?
    - What other parallel public funding sources or incentive tools are available to the developer?
    - Will Inclusionary Zoning policies be applied to an entire development, or only the proportional increase in development density above base zoning? And, how might this take place in City Centre where heights are not currently limited?
- Any policy that considers the use of inclusionary zoning should carefully consider the implications on development through market and financial analysis.