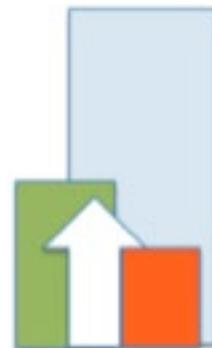


Exploring the need for an Inclusionary Zoning Bylaw and Additional Residential Unit Policy in the Town of Perth

Prepared for the Town of Perth

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Introduction

The Town of Perth, like many communities faces an affordability challenge: In the 2016 Census, over one in every two renter households (55%) renter households were identified as paying in excess of 30% of their gross income to secure safe and appropriate housing the national benchmark of affordability. Using CMHC's more narrowly defined core need measure, one in three renter households (34%) of renters are in need and over 95% of these face primarily an affordability problem.

The County of Lanark, which functions as the Consolidated Service Manager for Perth and other townships in the County maintains a wait list of households seeking assistance to address their affordability challenge. This exceeds 500 and most will wait over three years to access social housing due to a small stock and low turnover. This number continues to increase, including in Perth.

The County has prepared a Housing and Homeless Plan (2014) which was reviewed and updated in late 2019. The HHP identifies a range of options to address housing need, including expanding the supply of affordable housing through both non-profit and market developments.

Inclusionary Zoning is a potential mechanism that can contribute to new affordable housing development. Recent Provincial legislation creates the option for a municipality to adopt an inclusionary policy as part of the Provincial Policy Statement on Affordable Housing. The PPS also requires municipalities to permit additional residential units (secondary suites).

The purpose of this brief is to determine if inclusionary zoning is appropriate for both small infill projects and for larger apartments ranging from 10-100+ units, as well as for new lower density subdivisions within the Town of Perth. Secondly it examines opportunities to incent and encourage construction of additional residential units (secondary suites)

How an inclusionary zoning policy can contribute

In Perth, consistent with provincial policy and similar to many other municipalities, the Official Plan policy states that 25% of new units should be affordable housing and specifies rent and price targets, based on median income benchmarks.

But the Town has no mechanism to incent or enforce this policy requirement (beyond a modest incentive of a 10% reduction in Development Charges). Without explicit policies including both regulation (like IZ) and incentives (e.g. waived fees and charges) there is no capacity to meet these targets – the actual development and associated prices and rents are set in the market and there is no rationale for market developers to build at sub-market rents or prices.

This is typically characterized as market failure – a phenomenon in which there is an insufficient allocation of resources creating externalities such as unaffordable housing and homelessness. Many low-income households lack the income to have effective demand, and thus are overlooked in market pricing mechanisms.

Inclusionary policy can help to fill this affordable supply gap by imposing a specific pre-condition, such that new development cannot proceed without including some benefit, in this

case the provision of homes at sub-market rents or prices (in case of an affordable homeownership program).

A rational developer would not build and price the product at sub-market rents or prices, without incentives or compensation. If a municipality imposes this by regulation, the development industry contests this policy, usually arguing that this is an unfair tax directed solely to developers (as distinct from a general tax). In order to overcome this opposition it is necessary to consider potential offsets to fully compensate (and ideally exceed) for the cost of including sub-market units.

Offsets can come in variety of ways. One is to reduce or waive municipal fees and charges on the development (or on the affordable component). Another is to reduce the property tax rate for new multi-unit rental development (a provision made available by the province in 2002). Another is to increase the potential profit from development by permitting a higher density (more units convert to more sales or rental income), which has the least fiscal impact of the municipality.

Creating value uplift

Increasing density is the primary mechanism underpinning a win-win scenario. A municipal decision to permit rezoning to a higher density generates higher yield from the development. A portion of the increased density and yield is allocated to the developer while a portion is allocated to the municipality, in-kind in the form of units at submarket rent or price. Effectively this is a process of enlarging the pie (adding value) with the developer and municipality each taking a slice of the incremental increase in yield. In larger urban markets this is often lined to large scale public investment in transit and transit oriented development (TOD, with is the focus of Ontario bill 184).

Density bonusing is not a new concept and has been authorized in Ontario since 1990 under section 37 of the Planning Act. Under section 37 a fee is negotiated and the associated revenues direct to a Sec 37 fund that can be used for a variety of amenities (park amenities, day care space etc.), not exclusively for affordable housing. An IZ bylaw can be more specific and use the increased density and yield solely to generate some affordable housing. A well designed and calibrated bylaw can also reduce or remove uncertainty associated with a negotiated process.¹

The “growing the pie” concept is associated with a change in land use regulation such as a rezoning. Where land is already zoned, but not yet developed to the specified higher density (e.g. R4 zones in Perth) the potential value uplift associated with the higher density may already be capitalized into land prices, such that there is no extra pie. It can be enlarged only via further increase in density (and again easier in larger centres, associated with TOD).

¹ A negotiated process to “confiscate” some portion of the profit gain leaves uncertainty for the developer. Conversely a specific requirement, published in advance sets a known condition. The develop and the market can price this requirement into their pro forma, with much clearer certainty. This also avoids planners (who may lack knowledge and skills) becoming negotiators.

In pre-zoned sites, the potential offsets may be limited only to existing municipal fees and charges. And any extensive use of waiving fees and charges may have implications for the Town's budget as it reduces revenues typically used to cover the cost of delivering municipal services (planning, building inspection etc.)

It is necessary to calibrate any inclusionary requirement (and associated cost to the developer) against the value of potential offsets. A larger IZ requirement may be possible in cases of up zoning compared to land that is pre-zoned (i.e. either zoning to allow higher density signaled in an Official Plan, or to a density above the current zoning bylaw maximum).

Imposing an excessive requirement (where value uplift or compensating fee reductions are insufficient to fully offset the cost) can act as a deterrent to development, so again careful calibration of the inclusion rate and phasing is important.

Density bonusing is quite common across Canada, inclusionary zoning less so (mainly in Quebec and BC). Inclusionary zoning is more extensive across the US. And while often associated with higher density multiple unit development, many suburban US jurisdictions have applied and inclusionary requirement at lower densities, imposing these as part of sub-division approvals, rather than rezoning.²

In these suburban subdivision cases this produces detached or attached homes and sometimes townhomes, with a specific percentage required to be affordable. In many cases these are used in affordable ownership programs as well as for rental use. The pre-eminent inclusionary policy in the US is the Montgomery County (Maryland) Moderately Priced Unit Development program. The MPDU was introduced in 1973 and in its first 30 years (to 2004) generated over 11,000 affordable homes.³ In some cases title is transferred to a county housing agency and the units enter a rental pool managed by the county; in other cases units are directed to an affordable homeownership program targeting marginal home buyers.

The appropriate focus of an IZ policy in Perth should be premised on the type (detached subdivisions or multiple unit apartments) and scale of development anticipated over the next decade.⁴

² Subdividing to enable construction of more detached homes has the same effect as up-zoning to multi-unit apartment use – both add new units, generating new revenues, and both are facilitated by a public decision process.

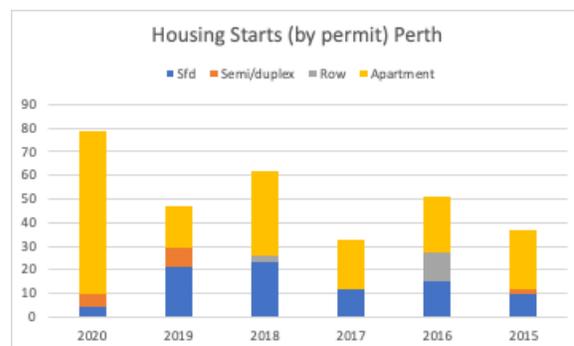
³ To put this in context this is a rapidly growing large suburban community within commuting distance of Washington DC. In 2016 it reached a population of over 1 million, with 372,000 households so the 11,000 MDPU homes represent roughly 3% of all homes.

⁴ Between 2012 and 2017 only a single land subdivision plan was approved creating 16 lots in 2016 (County Lannark Housing Homeless Plan 2019; P 91). This low volume implies limited potential to achieve affordable homes via the land sub-division process.

Recent new home construction trends and IZ capacity

As a community of 6,000 people, Perth is not enumerated in the CMHC Survey of Housing Starts, so it is necessary to utilize building permit data. Breaking down permits for new residential construction for the past five years reveals a relatively small volume of new housing construction.

Total starts have averaged 52 homes per year with the high of 79 occurring in 2020 (ytd to November). Roughly one-third are single or semi-detached and two-thirds multiple unit row or apartment structures. Most detached starts appear to be infill homes, rather than in new residential subdivision and the multiple unit properties are typically quite small structures averaging only 14 units per project.



While permit data do not reveal with the multiple units are designated as condominium versus rental, the data on registration of condominium plans suggests few are condos.⁵ Typically where home purchase prices are more affordable, there is less demand and market pressure for condominiums as a way to access ownership, and this appears to be the case in Perth.

That said, given the age profile of Perth households with the number of persons over 65 years of age double (39.7% vs 18.9%) that of the province overall, there may be latent pent-up demand from senior empty nesters seeking to downsize, remain in Perth and retain equity (vs renting). And others migrating from markets such as Ottawa may also seek this downsizing option. This may create some market demand for condo product specially for age restricted buildings.

Typically inclusion rates range from 10% to 20% based on number of units of gross floor area and apply to developments above a minimal size. In Langford BC the minimum benchmark is 10 units and an inclusion rate of 10%; in Montreal the minimum was 200 units, subsequently reduced to 100 units, with 15% of units to meet social-affordable rents.

Both the low overall number of annual starts and small project size in recent years suggest limited potential to utilize an inclusionary zoning mechanism in Perth. Even at the low minimum project size of 10 units or homes, few of the developments undertaken in Perth would be captured by such a bylaw (based on last 5 years, at most 5 units/year).

The existing availability of pre-zoned R4 land limits potential land value uplift and capture through additional rezoning and it is doubtful that a sufficient amount of other offsets (waiving municipal fees and charges) could be accumulated to deliver necessary contributions to avoid disincenting new construction.

⁵ Data reported in the Lannark Housing and Homeless Plan 2019 identifies only 1 project with 25 condo units registered between 2012-2017. Perth Planning staff have also confirmed that very few of multiple unit developments are condominiums, most targeting the rental market.

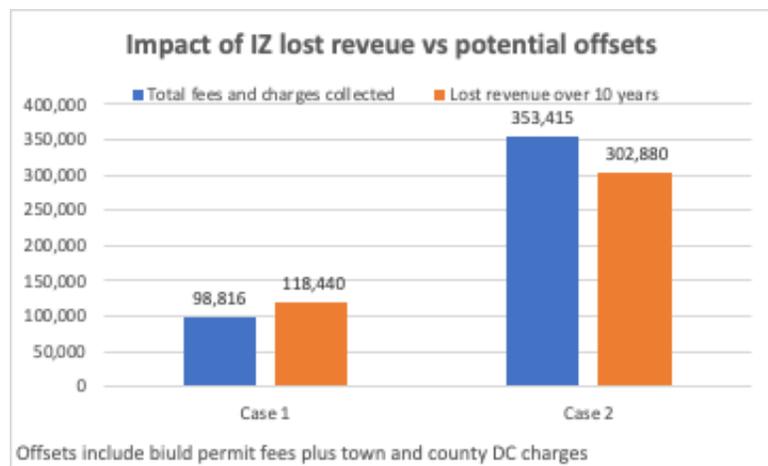
Assessing the quantum of offsets required

Two simple case studies have been used to examine the potential impact of an IZ requirement. This involves cases of new rental properties with 24 and 57 units respectively. It assumes that 10% of the units be affordable with rents set below the median market rent. This results in 2 of 24 and 5 of 57 being designed. The financial impact on the developer is calculated by taking the difference between the full potential market rent and this median rent benchmark on each IZ-affordable unit, aggregating this over a 10 year affordable compliance period and summing for total IZ units in each project.

This “loss” (foregone revenue) is then compared to the quantum of fees and charges levied on the project by the Town of Perth. Note that the IZ loss is calculated only for the IZ units; the amount of fees and charges is the total, for all market and the IZ-affordable units. Details of this calculations are shown in Appendix A.

These two illustrative cases reveal that in order to fund these relatively few affordable units, the municipality will have to waive between 86% and 120% of the total fees and charges collected.

In fact in case 1 waiving 100% of these public charges remains insufficient to fully offset the loss incurred. Clearly, this significantly impacts municipal revenues.



Looking to the future

Officials have identified a number of new planning applications and inquiries that may involve larger scale development, and a break from the scale of development up to now. These include a large parcel on the eastern side of the Town proposed a subdivision to create 65 detached and attached homes together with a 10 ha parcel being considered as an apartment structure (requiring rezoning from R1-R4); and a parcel north of Hwy 7 with potentially 100 lots, with a mix of single family and higher density R4 areas. Should similar applications continue to come forward this could potentially increase targeted development for inclusion.

Officials also suggest that the Town is planning to update the economic development strategy and the existing sewage treatment facility with the view to attracting growth such that the total population could increase from the current 6,000 to between 8,000 and 10,500 people over the next 20 years. This implies new residential construction in the order of 100-200 homes annually, with a mix of low density detached and semi-detached as well as multiple unit developments.

If this growth is pursued and approached there may be a stronger case to design and implement a modest inclusionary policy to capture some of the value uplift from growth as a contribution to address a backlog and future growth in housing need. That said a population projection of this order (i.e. 100-200 homes per year) remains at the lower bounds of feasibility for an inclusionary policy.⁶

Given the amount of offsets that would be necessary to create an effective IZ policy i.e. waiving permit application fees and development charges on IZ properties, the municipality would potentially see a substantial reduction in such revenues.

If the Town is prepared to forego such revenues, it may be more effective to explore alternatives, such as selective grants to incent addition of secondary apartments and garden suites (as now enabled under the PPS May 2020), and providing municipal land to non-profit developers, rather than pursuing inclusionary zoning that at best can have a minimal impact.

At the same time an IZ bylaw could be designed and implemented in the event that growth and larger scale rezonings and sub-divisions materialize to generating land value uplift. The IZ bylaw can establish explicit requirements such that prospective developers are aware of any inclusionary requirement and can capitalize the cost into the project (i.e. not overbid land prices). Sharing the value uplift created by the public decision to permit higher density can avoid or minimize the undesirable impact of waiving municipal fees and charges.

Exploring policies to encourage additional secondary units.

The Provincial Policy Statement, May 2020 (PPS, 2020) has replaced the term ‘second residential unit’ with ‘additional residential unit’. Municipalities were previously able to specify that a second residential unit would be permitted within either a dwelling or an accessory structure. The recent modifications now require planning authorities to allow an additional residential unit within the dwelling and with an accessory structure, for a total of three (3) dwelling units per parcel.

With almost three quarters (73%) of the existing homes in Perth constructed before 1980, and many on larger lots there may be considerable potential to add additional units either as separate accessory dwellings or as additions to the existing dwelling.

And in comparison to an inclusionary policy that at best might create 10 units per year, it appears that exceeding this level of activity is quite possible.

Over the past decade permit data indicated that very few additional residential units have been legally added. So some incentives may be required. In addition to simply *permitting* additional

⁶ It is also noted these expectations substantially exceed projections developed by the County of Lannark (as reported in the Housing and Homeless Plan 2019 update). Perth has experienced one of the lowest population growth rates in the County since 2011 (only 1.5%) and in developing its projection to 2038 the County anticipates continued slow growth, with a 2038 population projection for Perth of only 6,085. This is an increase of only 105 from the 2016 population. If this projections holds, there will be much less new housing and no potential to use IZ policy to add affordable units.

units this form of affordable housing can be incented *and explicitly encouraged*. Such incentives are especially useful if the intent is not solely to increase supply of rental options, but to ensure that these additional units achieve affordable rent levels (i.e. at or below the local average market rent⁷).

A number of municipalities and/or provinces have established such incentive programs. For example:

- Manitoba Housing offers municipalities a secondary suite program funding a forgivable loan that covers 50% of cost up to a maximum of \$35,000. The loan is incrementally forgiven over 10 years (so effectively a grant) provided the unit remains a rental, tenants are selected from a eligibility list and rents remain below the average market rent. Failure to remain in compliance, terminates the forgiveness and the loans becomes repayable immediately.
- Edmonton offers a grant of up to 20,000 covering 50% of the cost to create the additional unit, and requires the homeowner to sign an agreement committing to retain rents below an affordable threshold (also linked to the CMHC average rent).
- Simcoe county offers a forgivable loan on a 15 year term of up to \$25,000 cover 50% of the cost to create the additional unit. In this case there is no maximum rent criteria;
- Kingston has an incentive with two funding options, aimed at helping all homeowners create secondary suites so the community has more affordable housing. The only requirements on renting the suite is that it be rented to those with a low income for an agreed-upon period (at least 5 years. One funding stream is for those in locations that require planning applications. This funding will help with required municipal application fees of up to a maximum \$7,000 in the form of a forgivable loan. The second source of funding is a forgivable loan that ends up being the lesser of \$15,000 or 75% of the costs associated with developing a second residential unit.

These programs achieve two objectives. First ensuring that the unit meets affordability criteria and thus contribute to municipal OP affordability targets; and second, by restricting to use as permanent affordable rents preclude use for short-term (e.g. Airbnb use). This approach negates the additional step of creating a regulation for short-term rentals as a number of larger municipalities have done. It is now a common practice to restrict short-term rentals to additional bedrooms with an owner occupied home; and to preclude the use of self-contained apartments, such as additional units, from being used as short-term rentals (and thus removed from the permanent long term rental stock).

Whether an incentive is provided as grant of a forgivable loan, a source of funding or financing is required. In Manitoba and Ontario, this can come from the local allocation under the federal-provincial Provincial priorities program. In other cases, such as Edmonton it is funded from municipal revenues.

⁷ As a small community under 10,000 population Perth is not covered by the annual CMHC rent survey. However CMHC does undertake a Rural Rental Market Survey here every 5 years and this was conducted in October 2020, with results to be published in mid-January so a current average market rent is forthcoming as the AM

If the town of Perth is unable to access funding/financing via the province (or Service Manager, Lanark County) it may be limited in capacity to fund such incentives, and more modest incentives such as waiving any permit application fee or a freeze on property taxes (vs capturing increase in value due to the additional suite) might be considered. It is likely, however that the cost of such incentives will be substantially lower than those needed to provide offsets to compensate developers for forgone profit revenue under an inclusionary bylaw, as reviewed above and in Appendix A.

An affordable additional residential unit program can also be extended to new developments and by providing a financial incentive can emulate the effect of an inclusionary policy to encourage developers of new homes to install additional units within the new development.

Conclusions and recommendations

This review has found that over the past 5 years the volume of new housing construction is quite small and dominated by smaller structures. With a minimum project (or subdivision) size of 10 units few properties would be captured by an inclusionary policy. Further, at an inclusion rate of 10% very few affordable options would be generated.

In addition, the cost to the Town (and County) to waive fees and charges as an offset on inclusionary zoning is substantial and will erode municipal revenues used to fund development and planning services. A potential option, and better use of municipal funding resources would be to implement an incentive program to encourage creation of affordable additional units, versus simply permitting the creation of additional residential units (accessory and secondary apartments on existing residential lots).

The opportunities to compensate developers via enhanced density (growing the pie) currently appear quite constrained as Perth already has a good supply of R4 multiple unit apartment sites. Additional analysis is required to identify the potential density increase in pre-zoned but not yet developed R4 zones and potential for any density increases in other zones reflecting intensification designations in the Official Plan.

If larger scale development and associated rezoning and subdivisions are anticipated in an updated growth strategy, the opportunity to grow the pie and fund the IZ requirement from new value revenue would be more viable and could reduce or eliminate the cost of fee waiver offsets. It is advisable to design and implement an IZ bylaw well ahead of any Official Plan update. Any OP intensification sends a signal to market that higher densities will be accepted and this leads to land value speculation. Publishing conditions well in advance of potential applications ensures that any value uplift is more effectively shared and avoids excessive land speculation.

Recommend that the Town of Perth

1. Within an updated growth strategy and if mid-to-large applications for rezoning or subdivision are anticipated and suggest there is realistic opportunity to create value uplift via rezoning the Town should proceed to design and implement an inclusionary bylaw.

2. Undertake further exploration of options and design or update to recently adopted affordable additional residential unit program and policy to incentivize construction and renovation to create new accessory and secondary rental units.

Appendix A: assessing cost of offsets and potential to fund via waiving fees and charges.

Illustrative cases to quantify cost of offsets

Case 1: 24 unit rental

Unit size	#	assume market	median rent (2015)*	Diff per month	Diff per year	Loss over 10 years	IZ units	Loss
1-bed	16	1,200	730	470	5,640	56,400	1	56,400
2-bed	4	1,400	883	517	6,204	62,040	1	62,040
3-bed	<u>4</u>	1,600	1,096	504	6,048	60,480		
Total	24						8%	118,440

Fees and levies collected (2018 fee schedule)

	Total	Per unit
Building Permit Fees	20,002	833
Development Charges (Perth)	63,814	2,659
Development Charges (Lanark County)	15,000	625
Total fees and charges	98,816	

Case 2: 57 unit apartment (2019/20 fee schedule)

Unit size	#	assume market	median rent (2015)*	Diff per month	Diff per year	Loss over 10 years	IZ units	Loss
1-bed	8	1,200	730	470	5,640	56,400	2	112,800
1+den	17	1,350	822	528	6,336	63,360	3	190,080
2-bed	<u>32</u>	1,400	883	517	6,204	62,040		
Total	57						9%	302,880

Fees and levies collected (2019/20 fee schedule)

	Total	Per unit
Building Permit Fees	108,990	1,912
Development Charges (Perth)	204,143	3,581
Development Charges (Lanark County)	40,283	707
Total fees and charges	353,415	

*Median rents from CMHC purpose built survey - only carried out every 5 years - 2020 survey in Oct 2020, results to be available Mid-January

Here the 2016 medians have been inflated by the cumulative Ontario rent guideline since 2015 (9.65%)

