INFORMATION REPORT

TO:	Chair and Members Emergency & Community Services Committee
COMMITTEE DATE:	December 7, 2017
SUBJECT/REPORT NO:	Incentives for Affordable Rental Housing Development (CES17013) (City Wide) (Outstanding Business List Item)
WARD(S) AFFECTED:	City Wide
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SUBMITTED BY: **SIGNATURE:**	Dave Brodati Acting Director, Housing Services Community and Emergency Services Department

Council Direction:

On June 12, Azim Kassam, Ekasa Hospitality Inc., made a delegation to Emergency and Community Services Committee (Item 6.1) asking the City to provide incentives for his proposed 224 unit rental housing development project at 210 Main Street East.

The Committee received the delegation and directed staff to "investigate the requests respecting incentives for affordable housing by Azim Kassam, along with any other possible local options, that may assist this and other private investment in the creation of affordable housing." This motion was approved by Council June 14, 2017.

Information:

Report CES17013 responds to the Council direction above. It provides an overview of:

- Key dynamics in the rental market in Hamilton;
- The City's Housing and Homelessness Action Plan's direction to address those market realities through various strategies;
- Analysis of the financial feasibility of rental housing development in Hamilton;
- The role incentives could play to stimulate rental housing development; and
- Analysis of the request for incentives for affordable housing at 210 Main Street East.
- Staff will report back to the Emergency and Community Services Committee early in 2018 with a detailed program framework for incentives for affordable rental housing development, including costs and funding considerations from future City budgets (tax supported and rate supported).

The Rental Market in Hamilton:

Market rents in Hamilton are increasing quickly. The average market rent increased 7.8% from $835 in 2015 to $900 in 2016.

There are a number of factors putting increasing pressure on the Hamilton rental market:

- Increasing mortgage rates, mortgage insurance rates, and high home prices (average resale value in Hamilton of $474,311 a 6.3% annual increase) are leading to fewer first-time home buyers and buyers staying in the rental market longer.

- There is a trend for affordable housing rental units to be renovated and rented at much higher rents. Canada Mortgage and Housing Corporation (CMHC) data shows lower vacancy rates for more affordable units than higher end units.

- There is an ongoing influx of renters to Hamilton priced out of the Greater Toronto Area (GTA) rental market. Rents for purpose-built rental stock in the GTA increased 3.1% between 2015 and 2016, to an average of $1,240, and rents for condominiums in Toronto increased 11.7%. GTA vacancy rates are also low with an average of 1.2%. The flow of renters priced out of the GTA to Hamilton will continue as the rents in Toronto and the GTA continue to increase, and with little new rental housing development, making it more difficult for people to find affordable rental housing.

Together these factors are increasing the demand for affordable rental housing and rapidly increasing rents. Unfortunately there is insufficient affordable stock to moderate rapid rent increases.

Hamilton's 10-year Housing and Homelessness Action Plan:

Hamilton's 10-year Housing and Homelessness Action Plan (HHAP) established a goal of creating 300 new units of affordable rental housing per year. The first Outcome Area of the HHAP is to increase the supply of affordable housing. Specific strategies in the Plan that address increased affordable supply are to:

Strategy 1.2
Explore the potential for **new incentive and funding programs** and expand and promote more broadly existing City incentive programs to increase the supply of affordable housing (e.g., **capital grants/loans, tax deferrals, waived development and other charges, etc.**)

Strategy 1.5
Explore the feasibility/further promote opportunities that exist in the Urban Hamilton Official Plan for density bonusing and use of Community Improvement Plans to **offer other incentives for affordable housing**.

Since the Plan was endorsed by Council in 2013, there have been 47 units of affordable rental housing built and 149 units under development, principally with funding available through federal/provincial affordable housing programs. On September 27, 2017, Council passed Item 8.1 of General Issues Committee Report 17-019, establishing the Poverty Reduction Investment Plan which includes up to $20M for the construction of new affordable rental housing. It is expected to yield approximately 134 additional units over five years. Even with these critical investments, the City is not meeting the target of 300 new affordable rental units annually.

Providing incentive options outside of established federal/provincial affordable housing funding programs presents additional opportunities to encourage the development sector to participate in the creation of new affordable rental housing and would contribute to implementation of key components of the HHAP.

Financial Analyses of New Rental Housing Development:

Neither the private sector nor the non-profit sector will build rental housing, affordable or otherwise, unless it is financially viable. Pro forma (financial) analyses completed for the City show clearly that developing new affordable rental housing is not currently financially viable. However, with financial incentives, rental housing becomes viable at varying rent levels depending on the amount of the incentive. The greater the incentive, the more affordable the units.

In 2016, N. Barry Lyon Consultants Limited and DKGI Inc. were retained by the Evergreen Housing Action Lab to conduct pro forma analysis work for Hamilton. They analysed the financial viability of a variety of affordable rental housing development scenarios in three areas of the city. They concluded that new affordable rental housing development is not financially viable in Hamilton. A "*private developer is unlikely to participate in the development of new affordable rental housing without financial support from the public sector*."

The results of the analysis are shown in Appendix A to Report CES17013. Overall, depending on the type of building (wood or concrete), the unit size mix, and the site, a capital incentive of between $43,000 and $145,000 per unit is needed to make the development of new housing with rents of 125% of average market rent financially viable. To reach greater levels of affordability, significantly higher capital incentives are needed. Appendix A to Report CES17013 shows the incentives required to reach 125%, 100%, and 80% of CMHC average market rent for each development scenario.

These findings are corroborated by the work of Steve Pomeroy of Focus Consulting, a recognized expert in affordable housing development financing. In 2016, Pomeroy presented generalized Ontario development scenarios that show similar findings to the N. Barry Lyons and DKGI Inc. pro forma analysis done for Hamilton. Even with rents at 150% of CMHC average market rent for Ontario ($1,600/month), for a mix of one and two-bedroom units, a per unit equity/grant contribution of $65,000 was needed to make the average affordable rental housing project viable. In Year 1, this scenario provided a 3.6% return. By Year 10, it provided an 8.5% return. His analysis showed that to achieve 100% of average market rent ($1,075), equity of $146,270 is required and there is a very low rate of return. At 80% of average market rent ($834), equity of $178,996 is required and the rate of return is minimal.

As rents decrease, operating revenues for rental projects decrease. Because financial institutions will only lend on the lesser of construction costs or operating revenues, and the revenues for affordable housing are always less than the construction costs, this means that the more affordable the rents, the smaller the mortgage that can be obtained, and the larger the gap between construction costs and available financing. Thus, the more affordable the rents the more equity is required up front. This equity can come from developer funds or incentives/government grants. Incentives on the operating side, such as property tax waivers, also increase the financial viability of a project.

Incentives for the Development of Affordable Housing:

Staff consulted with the development sector, financial sector and reviewed incentive programs of other municipalities (attached as Appendix B to Report CES17013). Through these discussions the following messages emerged:

- A range of incentives is required to make the development of new rental housing financially viable.

- For new rental housing to be financially viable with rents at or below the CMHC average market rents, development charge, parkland dedication fee, and tax waivers, are needed as well as capital grants. At 125% of CMHC average market rent, development charge, parkland dedication, and tax exemptions may in some cases be sufficient to make projects financially viable.

The pro forma analysis summary confirmed that, in some situations, rents of 125% of CMHC average market rent are also achievable in Hamilton with development charge, parkland dedication fee, and tax waivers.

The following table estimates the cost of various potential incentives for rental housing.

Table 1: Affordable Rental Housing Incentives: Estimated Foregone Municipal Revenue or Cost per Unit ($)

Incentive	One-Bedroom Apartment	Two-bedroom Apartment	Townhouse
Exemption of Municipal Development Charges	15,790	22,692	26,865
Exemption of Parkland Dedication	6,000	8,000	8,000
Subtotal	*21,790*	*30,692*	*34,865*
Waiver of Property Taxes Net Present Value 20 years, 3%, net of education taxes	23,692	27,460	65,600
TOTAL	45,482	58,152	100,465

The cost to the City of incenting 100 apartment units per year would be approximately $2.5 million (excluding the cost of waiving property taxes) depending on the unit types, and the cost of 200 apartment units would be approximately $5 million. If an offset funding source for waived property taxes was included these figures would double.

Exempting the above development fees reduces revenue that the City requires to fund growth infrastructure. Over the last 5 years (2012 – 2016) approximately $55M in City-wide development charge exemptions have gone unfunded. Staff recommend that any exemptions from growth development fees be funded. Funding would have to come from reserves and/or future levy and rate increases from existing (not growth) taxpayers. The Poverty Reduction Fund is intended for projects yielding deep affordability, so staff do not recommend that the Poverty Reduction Fund be used to fund development fee exemptions unless rents for the housing produced are 80% of average market rent or less.

The *Municipal Act, 2001*, prohibits municipalities from “bonusing” commercial enterprises, including private sector developers, with financial incentives. However, there are enabling legislative frameworks available to provide incentives for specific purposes, without constituting “bonusing”:

- The Municipal Housing Facilities By-law 16-233 was passed by Council on August 12, 2016. This is enabling legislation that allows Council to adopt a site specific municipal housing facilities by-law to deem private sector projects to be a municipal housing facility, in exchange for affordability that complies with the Municipal Housing Facilities By-law.

- Under the Planning Act, Council may establish a community improvement plan through which it can provide financial incentives to the private sector. A community improvement plan is more flexible and is geographically specific so it could apply to the whole of the urban area of the city or more targeted areas such as with the Downtown and Community Renewal Community Improvement Plan.

The City's Development Charges By-laws and Parkland Dedication By-law currently grant exemptions from development charges and parkland dedication fees for affordable housing projects participating in a senior government or municipal affordable housing program.

The City has the authority, through the *Municipal Act, 2001* and its Municipal Housing Facility By-law 16-233, to deem a property a municipal housing facility and exempt a property from both municipal and education property taxes. Deeming a property a municipal housing capital facility requires Council approval on a site specific basis and requires the development proponent to enter into a municipal housing facilities agreement with the City. Currently, the legislation does not require approval of the education tax exemption from the Province, although it must be notified.

Incentives and Rental Housing Affordability:

Rents at 125% of CMHC average market rent are moderately affordable, providing housing to households with modest incomes.

The CMHC average market rent is not necessarily a good indicator of the rents for newly available units. Vacant units that are offered for rent may have been subject to rent controls for a long period of time, keeping the rents low. As units turn over, landlords are permitted to increase the rents as much as the market will bear. In a "hot" rental market the newly available units will generally rent for a higher amount than the overall average market rent. Given this reality and given the economics of new rental housing financial viability, Council approved Report CES16031, which amended the Municipal Housing Facilities By-law definition of affordable housing to be up to 125% of average market rent, as an upper threshold for providing incentives for the creation of new rental housing supply.

Housing with rents at 125% of CMHC average market rent is only one part of the housing continuum. In order to achieve deeper affordability, either greater capital incentives/grants or the addition of rent subsidy programs are needed. Appendix B to

Report CES17013 shows various rent levels, the income needed to afford those rents, the occupations that create that income level, and the program approach to address that rent level. A single person on Ontario Works can afford only 42% of average market rent. From these rent levels to 66% of average market rent, approximately $200,000 per unit in capital, as well as waived development charges and parkland dedication fees, is required to make development for this income group financially viable.

To achieve 80 to 100% of average market rent approximately $120,000 to $150,000 per unit in capital grants, as well as waived development charges and parkland dedication fees, is required. Federally/provincially funded housing programs, in conjunction with municipal waivers of development charges and parkland dedication fees, typically create housing in the 70% to 80% of average market rent range.

Incentives for 210 Main Street East – Ekasa Hospitality Inc., Rental Housing Project:

On June 12, 2017, Azim Kassam, Ekasa Hospitality Inc., made a delegation to the Emergency and Community Services Committee asking for incentives for his 224 unit rental housing development project in exchange for providing rents at approximately 125% of CMHC average market rent for 15 years.

Mr. Kassam's proposed project is located on the Day's Inn site at 210 Main Street East, near the corner of Main Street East and Wellington Street. He is proposing 224 rental units in a 15 storey building, as well as 3,572 square feet of retail space at ground level. The construction value is approximately $36 million. 37 units will be accessible, which is three more than the minimum requirements. The project qualifies for incentives under the Downtown and Community Renewal Community Improvement Plan.

At the June 12, 2017 Emergency and Community Services Committee meeting, Mr. Kassam requested the incentives of full development charge and parkland dedication fee waivers, and property tax waivers for a 15 year period of affordability. In exchange, Mr. Kassam would set the rents at 125% of CMHC average market rent for 15 years and target the units to tenants with moderate income. In addition, he requested waivers of education property taxes for the affordability period of 15 years, at no cost to the City.

Through this proposal Mr. Kassam was prepared to accept $7.33 million less profit over the 15 year period in comparison to the option of charging rents based on what the market can bear (significantly higher than 125% of average market rent). This is inclusive of incentives he already qualifies for under the Downtown and Community Renewal Community Improvement Plan.

Since the June 12, 2017 Emergency and Community Services Committee meeting, staff has met with Mr. Kassam. Subsequent to those discussions with staff, Mr. Kassam is willing to revise his request to:

- increase the affordability of the units by dropping the rents to 120% of average market rent; and,

- extend the affordability period from 15 to 20 years.

A 20 year affordability period is consistent with federal/provincial affordable housing programs. This is a concession on Mr. Kassam`s part because it means an increased loss of $2.44 million.

Table 2 details the costs and benefits of providing these incentives to Ekasa Hospitality, Inc. for this project. While it is a significant amount of money that would have to be funded through the levy, given that the project already qualifies for the Downtown and Community Renewal Community Improvement Plan incentives, the costs are significantly less than would be required for a project that does not qualify for that program, i.e. $23,114 per unit rather than $44,002 per unit.

The property in 2017 will yield $72,515 in municipal taxes. The development is worth $36 million. The one time cost to the levy to offset the development charge and parkland fee exemptions would be $1,161,556. The annual cost to the levy in terms of municipal property tax exemptions would be $407,940 each year until 2038, with a net present value of $5,660,284. Education tax exemptions would represent a further annual incentive of $64,440 until 2038, but at no cost to the City.

Table 2: City Incentives requested my Mr. Kassam

Incentives	**Total Value**	**Less Downtown Renewal Incentives**	**Net Incentives Requested**
Development charges	$4,046,224	$3,034,630	$1,011,556
Parkland dedication fee	$150,000	0	$150,000
Municipal Property Taxes (NPV)	$407,940 annual (Total $5,660,284 20 years)	(5 years increment grant) $1,644,235	$4,016,049
TOTAL	**$9,856,508**	**$4,678,865**	**$5,177,605**
Per Unit	**$44,002**	**$20,888**	**$23,114**

Based on a recent appraisal of what the market can bear for the proposed project, market rents are as follows, compared to rent of 125% and 120% of CMHC average market rent for the area:

Table 3: Rent Comparison

Unit Type	Number of Units	Market Rents	125% CMHC Average Market Rent (Central Area)	120% CMHC Average Market Rent (Central Area)
Bachelor	14	$950	$858	$823
One-bedroom	140	$1,250	$1,041	$1,000
Two-bedroom	66	$1,450	$1,288	$1,236
Three-bedroom	4	$1,800	$1,542	$1,481

Mr. Kassam provided details of his projected revenues for the full market rent which enables us to calculate the reduction in his income if he were to reduce the rents. If he charged a rent of 120% CMHC average market rent rather than the full market rents as determined by an appraisal, his revenues would be $498,448 less annually, with a net present value over 15 years of $7.33 million. Over 20 years the difference would be $9.77 million. These calculations assume a 3% vacancy rate.

Mr. Kassam`s project is entitled to receive Downtown and Community Renewal incentives of a 5 year increment tax grant estimated at $1,644,235 and a 75% municipal development charge waiver of $3,472,570. He would receive these incentives regardless of the rents he chooses to charge, and, if he chose, he could build condominiums rather than rental units. If he receives the additional incentives he is requesting, his revenue loss would be a 20 year net present value of $4.59 million compared to a project with full market rents.

Mr. Kassam’s request represents an additional per unit incentive cost of $23,114 above and beyond what the project already qualifies for under the Downtown and Community Renewal Community Improvement Plan incentives. This is considerably less than the average per unit incentive costs for an average project outside of the Community Improvement Plan boundary.

Given that Mr. Kassam’s proposal for new rental housing at moderate levels of affordability is only an incremental additional cost compared to the cost of incentives he already qualifies for through the Downtown CIP, this may be considered a good investment opportunity for the City to achieve much needed new affordable rental housing. However, the incremental cost is not budgeted and approval of the proposal would be outside of a comprehensive incentive program framework. Such a framework would provide Council with parameters and information to make fully informed decisions on affordable housing development proposals requesting incentives as they come forward.

To that end, staff are of the view that Mr. Kassam's proposal should be held in abeyance pending Council's consideration of the comprehensive incentive program framework and its budget implications.

Next Steps:

Staff will report back to the Emergency and Community Services Committee with a detailed program framework for incentives for affordable rental housing development, including costs and funding considerations from future City budgets (tax supported and rate supported).

Appendices and Schedules Attached

Appendix A to Report CES17013: Summary of Pro Forma Analysis Results

Appendix B to Report CES17013: Affordable Rental Housing Incentives in Other Municipalities

Appendix C to Report CES17013: Rental Housing Continuum Infographic