Mixed-Income, Purpose-Built Rental

A practical and scalable, evidence-based option that leverages government incentives and shifts the Canadian housing narrative.

EY Canada Housing Research

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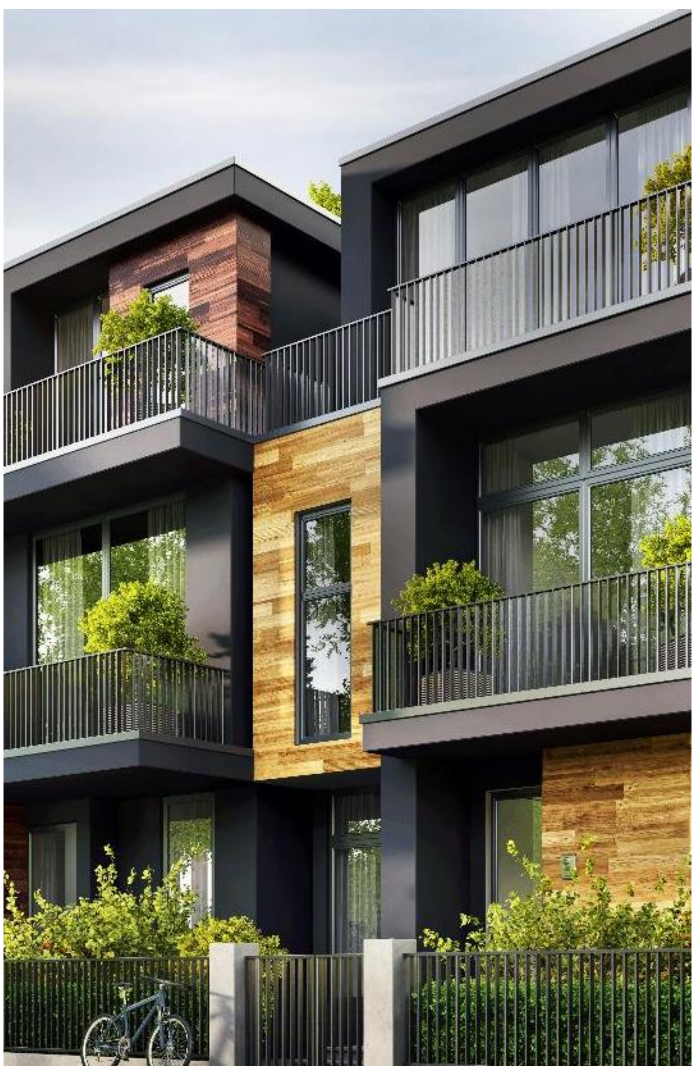
By leveraging a multitude of policy levers, we can deliver new affordable rental housing for Canadians

- **Canada is grappling with a well-documented housing shortage. An important component of any solution to this issue will be purpose-built rental housing, specifically mixed-income purpose-built rental housing, secured through long-term ground leases with private and non-profit sector developers on surplus government land. These mixed-income projects can help deliver new market and non-market housing simultaneously.**
- **Recent structural shifts in development economics have increased the challenges facing new housing production across Canada. These challenges are particularly pronounced for purpose-built rental development.**
- **All three levels of government in Canada have at their disposal a variety of policy levers they can pull to help improve the viability of rental development, including mixed-income rental housing projects.**
- **These levers need to be considered simultaneously, since none of them on their own is sufficient to positively impact the viability of new mixed-income purpose-built rental housing development.**



It is widely acknowledged that Canadians are grappling with a structural shortage of housing. Since the peak of new housing supply in the 1970s, there has been a lack of concerted efforts to expand the market's ability to produce new housing. Consequently, imperfect market conditions have led to a situation where the **excess demand for housing is not adequately matched by the supply of units.**

This shortfall in meeting record-high demand has led to friction across various aspects of the housing ecosystem and constrained the delivery of new housing supply**. Ultimately, this imbalance has contributed to severe declines in housing affordability**.

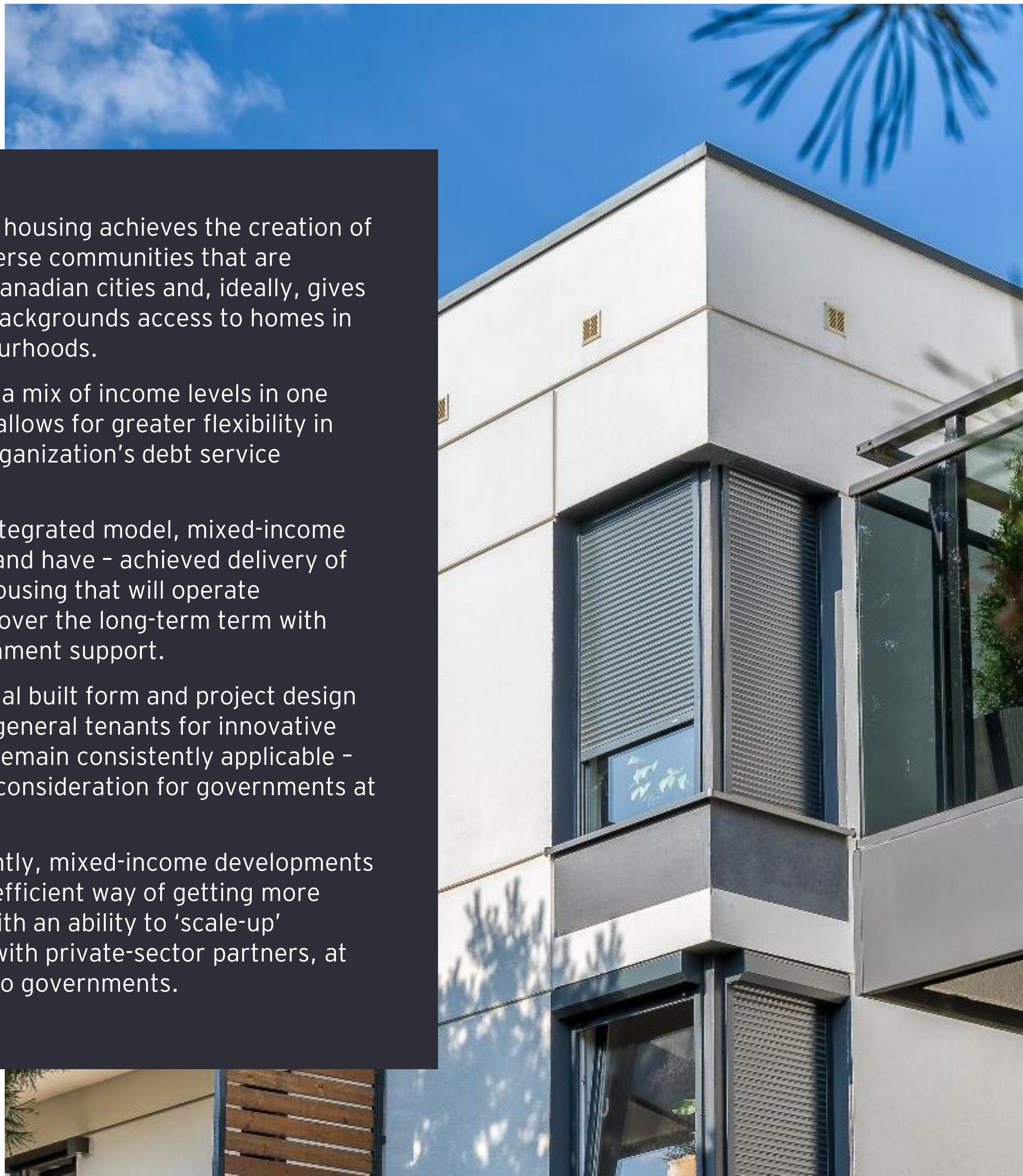
Overcoming these barriers and delivering new housing supply will require not only creative thinking and innovative strategies, but also an all-hands-on-deck approach that sees collaboration between the private sector and all levels of government.

EY teams believe one of the most scalable and evidenced-based solutions governments can pursue is the use of a number of policy levers to help encourage the private sector to develop mixed-income purpose-built rental housing. We believe if governments appropriately apply these available policy levers, both market and non-market housing can be delivered at minimal cost to governments.

Purpose-built rental housing is an important component of Canada's Housing Ecosystem. Through the use of surplus public lands, governments have one of the best opportunities to deliver truly mixed-income rental housing options at minimal costs.

In any approach seeking to address Canada's affordability crisis, purpose-built rental housing will play a critically important role. Rental housing is itself a form of attainable housing, providing an alternative for the increasing number of Canadians who are struggling to enter the ownership market, due to escalating home values and barriers to obtaining mortgages. Understanding this, governments of all levels should be looking to develop policies that encourage the development of new purpose-built rental housing.

Moreover, new rental housing development offers an avenue to introduce non-market rental units within mixed-income purpose-built rental projects. We believe mixed-income, purpose-built rental housing is one of the most effective delivery options that capitalizes on partnerships between the public and private sector to deliver both market and non-market housing. This is a scalable and reliable solution that can minimize the cost to governments, while helping them achieve a variety of policy objectives.



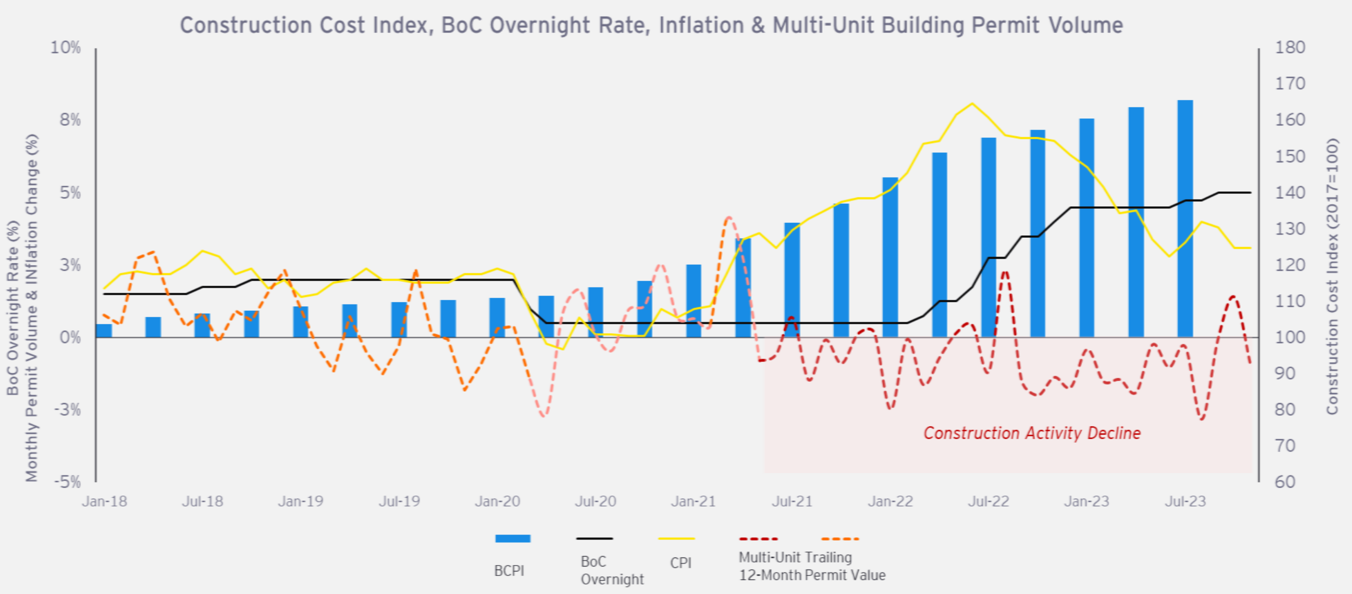
- ✓ Mixed-income housing achieves the creation of complete, diverse communities that are reflective of Canadian cities and, ideally, gives people of all backgrounds access to homes in more neighbourhoods.
- ✓ Incorporating a mix of income levels in one development allows for greater flexibility in meeting an organization's debt service covenants.
- ✓ Through an integrated model, mixed-income models can – and have – achieved delivery of non-market housing that will operate sustainability over the long-term term with limited government support.
- ✓ While the actual built form and project design will vary, the general tenants for innovative partnerships remain consistently applicable – an important consideration for governments at all levels.
- ✓ Most importantly, mixed-income developments are the most efficient way of getting more homes built with an ability to 'scale-up' construction with private-sector partners, at minimal cost to governments.

Recent structural shifts in development economics have caused residential permit activity to fall across Canada, including for new rental housing development, where project viability tends to be much more tenuous.

Developers today are responding to a perfect storm that's formed over the last three years in Canada. Construction costs are up by more than 50%, conventional lending rates have more than doubled and government fees in markets such as Vancouver and Toronto have increased to more than 25% of construction budget costs.

At the same time, planning and approvals continue to be very lengthy, especially in Toronto and Vancouver. Limited developers' returns due to increasing financing, construction and development costs have challenged the viability of new multifamily construction projects, leading many developers to pause or even cancel new projects, an undesirable outcome that only deepens the structural shortage of new housing.

For rental projects, the challenges are even further pronounced with lending requirements necessitating greater upfront equity contributions from developers since rental projects do not realize any revenues until many years after the land is initially acquired. Layering in affordable housing requirements in mixed-income projects only further exacerbates these viability challenges.



A range of policy levers is available to all three levels of government. To get the most out of these levers, many will need to be pulled at once.

Overcoming the development viability challenges that face new rental housing development will require collaboration and commitment from all levels of government, which have a variety of policy levers at their disposal that can help incentivize the private sector to develop mixed-income rental projects.

Recently, governments have begun to signal their support for these objectives through major policy shifts. However, to truly address the rental housing viability challenges and get the most out of the potential of each policy levers, governments will need to pull many of these levers simultaneously. By stacking these levers, governments have the potential to substantially increase the level of public sector support for new mixed-income rental housing projects, thereby increasing the supply of not only market-rate rental housing, but also non-market rate rental housing at a minimal cost to themselves.

To understand that impact of policy levers that could be pulled, we can examine how each of them will hit a private sector developer's proforma. While it's not possible to cover the wide breadth of levers that are currently and potentially available to governments, we believe the following are most critical to increasing public sector support for both market-rate rental projects and mixed-income rental housing projects:

01

GROUND-LEASE ON GOVERNMENT LAND

Governments of all levels have extensive real estate holdings, including many underused or surplus lands that could be employed for affordable housing purposes. Instead of disposing of these sites through a fee-simple sale, many governments are now pursuing long-term land leases (99 years) when taking these sites to market, allowing them to maintain public ownership of the asset. In these situations, governments are including affordable housing program requirements, effectively offering the land at minimal land lease cost to a developer partner in exchange for the provision of new affordable housing.

02

CMHC LOW-COST FUNDING / LOAN INSURANCE

Canada Mortgage and Housing Corporation (CMHC) offers two primary programs to support the development of new purpose-built rental housing: Apartment Construction Loan Program (ACLP) and MLI select multi-unit loan insurance. While these programs differ in their applications, at a high level they offer developers more favourable loan terms, including lower borrowing rates, higher LTCs, lower DSCRs and up to 50-year amortization periods.

Until recently, rental projects could qualify for MLI Select by meeting environmental and accessibility criteria alone, enabling purely market rental projects to secure lower-cost financing and enhance their feasibility. However, recent changes to the program have reduced the scoring attributed to the environmental component, meaning projects now require the inclusion of some affordable housing to qualify. This change has limited the program's reach, hindering the viability of many projects.

03

CMHC FEE WAIVER

CMHC's funding programs all have administrative costs. While these costs are relatively minor in comparison to project budgets, by waiving them CMHC would be able further increase the viability of many rental projects.

04

THE REMOVAL OF THE GST AND HST

Until recently, new purpose-built rental development was subject to both federal and provincial sales tax. New federal legislation introduced in September 2023 aimed to incentivize the construction of new rental housing by removing the GST on new rental housing construction. Concurrently, some provinces have followed suit, waiving the HST on new purpose-built rental construction.

05

IMPROVED DEVELOPMENT APPROVALS TIMELINES

Delays in development approvals are costly for all projects, but especially so for purpose-built rental projects. They both require a greater amount of upfront equity, and they don't realize any project revenue until occupancy.

Red tape and bureaucracy have long been a barrier to supply. One of the most impactful levers provincial and municipal governments could use would be to find strategies to fast-track the approvals process. Ontario recently made legislative attempts to expedite the approvals process by imposing mandatory decision timelines once an application has been submitted to a municipality (Bill 108). However, without collaboration with municipal planning departments, the impact of this legislation has been minimal on actual approval timelines.

06

ALTERNATIVE CONSTRUCTION TECHNIQUES (I.E. MASS TIMBER)

Over the past three years, the cost of traditional construction materials has escalated rapidly. This cost escalation, coupled with continued pressure for the construction industry to reduce its environmental impact, has contributed to an increased interest in alternative construction materials and techniques that bring down overall project costs.

Provincial governments have an important role here as they can adjust building codes to allow new and alternative construction techniques. This includes permitting alternative materials such as mass timber, which Ontario recently approved for construction of up to 12 storeys, as well as expanding the use of alternative construction techniques such as modular construction.

07

REDUCED PROPERTY TAX FOR NEW RENTAL HOUSING

The most recent Ontario budget proposed providing municipalities with the ability to offer a reduced municipal property tax rate on new multifamily housing. As municipal property taxes are often one of the largest operating costs for purpose-built rental operators, particularly for new projects, a reduction in the new multiresidential rental tax rate could help improve the viability of new purpose-built rental development.

08

DENSITY BONUSING FOR RENTAL PROJECTS

In some provinces, municipalities have the ability to introduce rental housing zoning that permits greater as-of-right density for purpose-built rental projects than condominium apartment projects. The City of Vancouver, for instance, recently passed zoning that allows for as-of-right six-storey rental projects fronting on select major roads, whereas only four-storey condominium apartments would be permitted as-of-right. While this example is minor in scale, the same logic could be applied to much larger projects. As municipalities are creatures of the provinces, though, this would allow some degree of collaboration between the two levels of government.

09

WAIVING DEVELOPMENT CHARGES AND PROPERTY TAXES ONAFFORDABLE UNITS

The most common incentives are for municipal property tax abatement or the waiver of development charges on affordable housing units. For example, the City of Toronto's Open Doors program and the City of Vancouver's Rental Incentive Program both offer this type of development incentive to promote the creation of housing. This type of fee reduction impacts both the upfront development cost for these projects and the ongoing operating costs.

10

REDUCED DEVELOPMENT CHARGES ON MARKET UNITS

In addition to waiving municipal development levies for affordable housing units, municipalities can further incentivize the development of mixed-income rental housing by including reduced development charges for market-rate units. Lower upfront development costs can allow for mixed-income projects to include a greater number of non-market units while still maintaining project viability.

Market opportunity?

With an illustrative concept for a 300-unit project in Toronto, a customized pro forma tool allows a better understanding of the impact of these levers on the development of new mixed-income purpose-built rental housing.

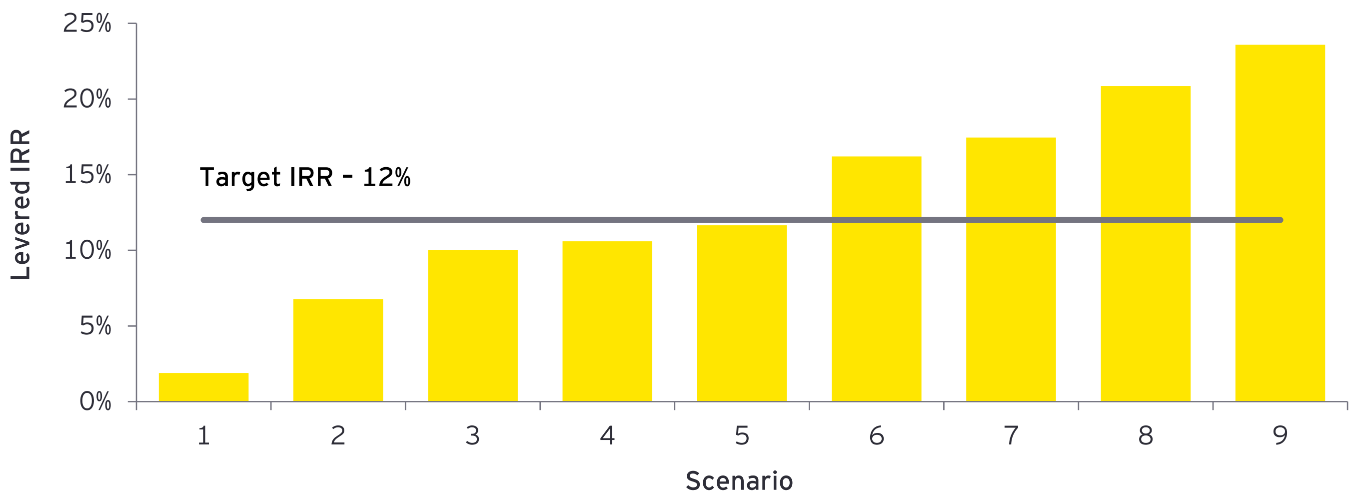
Each developer considers different metrics when assessing rental construction projects and sets distinct return thresholds that must be met for a project to be deemed viable. Should a developer determine that they cannot achieve their desired return threshold, they may opt to either cancel or postpone projects until market conditions become more favourable.

One of the most common metrics for project evaluation is the internal rate of return (IRR), which serves as a key indicator of project profitability. While the specific IRR threshold required by developers varies, the industry average typically hovers around 12% to 15%.[1] If a prospective project demonstrates its capability to meet this target, it is deemed feasible.

With this understanding, we can demonstrate how the aforementioned levers impact a developer's financial projections and consequently influence project viability. Below is an analysis of a 100% market rental building under different scenarios.

As depicted, even projects operating at full market rental rates are unable to exceed typical viability thresholds without the implementation of any government interventions. Even with an HST/GST wavier, low-cost CMHC financing with no administration fees, an accelerated approvals timeline and alternative construction methods, our hypothetical project would still be viewed as unfeasible in the eyes of a private sector developer. **It is only when a multitude of levers are pulled are that our hypothetical market project could attain its target return threshold, thus rendering it financially viable.**[2]

Viability of Market Rental Project Under Various Policy Scenarios



Scenario	1	2	3	4	5	6	7	8	9
Government Levers									
GST/HST Waived	N	Y	Y	Y	Y	Y	Y	Y	Y
MLI Select	N	N	Y	Y	Y	Y	Y	Y	Y
CMHC Fees Waived	N	N	N	Y	Y	Y	Y	Y	Y
Accelerated Approvals	N	N	N	N	Y	Y	Y	Y	Y
Alternative Construction	N	N	N	N	N	Y	Y	Y	Y
Reduced Rental Ptax	N	N	N	N	N	N	Y	Y	Y
Density Bonusing (+25%)	N	N	N	N	N	N	N	Y	Y
DCs Reduced on Market (50%)	N	N	N	N	N	N	N	N	Y

1= Based on EY's survey of Canadian Rental Developers conducted in conjunction with CMHC – (link to be provided)

For mixed-income purpose-built projects, the need for government support is even greater. But by pulling on multiple policy levers simultaneously, governments are able to incentivize the delivery of both market and non-market housing at minimal cost to themselves.

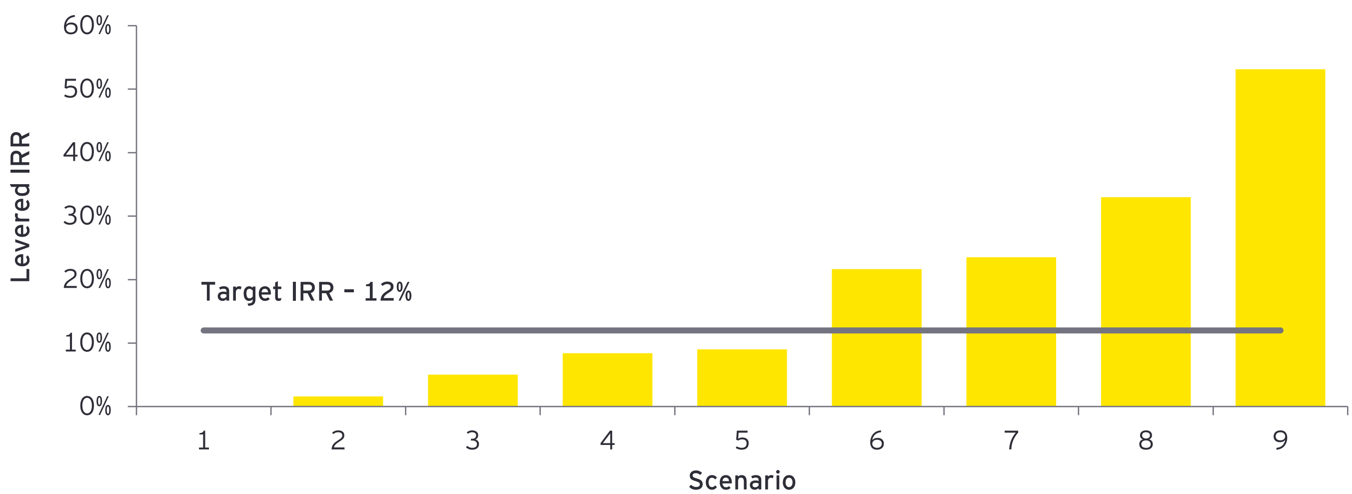
If governments aim to increase the supply of rental housing, particularly non-market rental units in mixed-income developments, they can facilitate this by providing surplus public land to developers through long-term ground lease arrangements. These agreements could stipulate specific requirements for affordable housing inclusion. Consequently, the cost of the land is effectively reduced to a nominal sum.

However, despite the reduced land expenses, mixed-income rental projects still encounter notable feasibility hurdles in the absence of supplementary government assistance. Yet, **by concurrently implementing multiple policy measures, governments can support these mixed-income projects, thereby improving their viability**.

Illustrating this point, let's consider a low-cost ground-lease scenario where 20% of the units are priced at affordable rents. In this example, we've assumed that affordable rates are fixed at 30% of the area median incomes. As depicted, even in a scenario where land costs are negligible, a private market developer struggles to achieve their target return thresholds without the implementation of several government incentives.

By requiring the integration of affordable housing in ground lease transactions, governments can augment the availability of non-market rental housing. However, this can only be accomplished if a substantial array of policy levers is enacted simultaneously.

Viability of Rental Project with 20% of Units at 80% AMI



	1	2	3	4	5	6	7	8	9
Government Levers									
Ground Lease	Y	Y	Y	Y	Y	Y	Y	Y	Y
GST/HST Waived	N	Y	Y	Y	Y	Y	Y	Y	Y
ACLP	N	N	Y	Y	Y	Y	Y	Y	Y
DCs & Ptax Waived (AH Units)	N	N	N	Y	Y	Y	Y	Y	Y
Accelerated Approvals	N	N	N	N	Y	Y	Y	Y	Y
Alternative Construction	N	N	N	N	N	Y	Y	Y	Y
Reduced Rental Ptax	N	N	N	N	N	N	Y	Y	Y
Density Bonus (+25%)	N	N	N	N	N	N	N	Y	Y
DCs Reduced on Market	N	N	N	N	N	N	N	N	Y

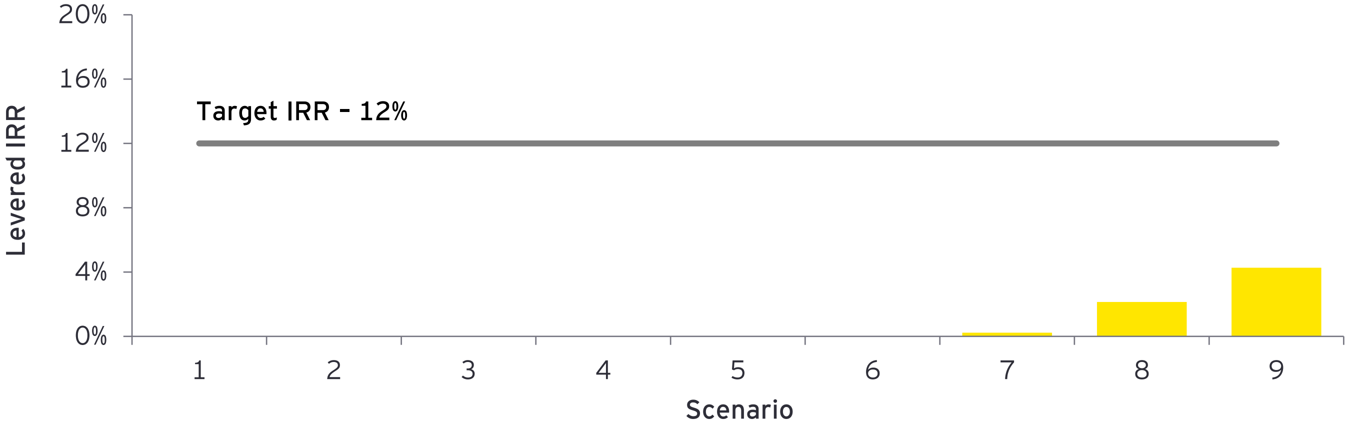
While governments can encourage the development of non-market rental housing through ground-lease transactions with private sector developers, there is a limit to how much affordable housing can be reasonably provided in one project

Despite the potential for governments to expand both market and non-market rental housing through ground-lease transactions with private sector developers on surplus land, there's a limit to the extent to which affordable housing can be mandated before a project becomes entirely unfeasible, regardless of the number of policy interventions employed.

If we were to examine the same hypothetical mixed-income project as previously discussed, but with 50% of units required to be priced at 30% area median incomes or less, we would find that no combination of government policy measures could make this project financially viable.[2] In such scenarios, there are simply not enough market-rate units to adequately subsidize the non-market units, resulting in project profitability falling short of the viability thresholds set by private developers, even with substantial government support.

For the private sector to perceive these types of projects as feasible, governments would need to offer additional capital or operational funding.

Viability of a Rental Project with 50% of Units at 80% AMI



	1	2	3	4	5	6	7	8	9
Government Levers									
Ground Lease	Y	Y	Y	Y	Y	Y	Y	Y	Y
GST/HST Waived	N	Y	Y	Y	Y	Y	Y	Y	Y
ACLP	N	N	Y	Y	Y	Y	Y	Y	Y
DCs & Ptax Waived (AH Units)	N	N	N	Y	Y	Y	Y	Y	Y
Accelerated Approvals	N	N	N	N	Y	Y	Y	Y	Y
Alternative Construction	N	N	N	N	N	Y	Y	Y	Y
Reduced Rental Ptax	N	N	N	N	N	N	Y	Y	Y
Density Bonus (+25%)	N	N	N	N	N	N	N	Y	Y
DCs Reduced on Market	N	N	N	N	N	N	N	N	Y

Key takeaways

01

Using long-term ground lease transactions with private and non-profit sector developers, governments at all levels can make use of surplus public land to deliver both market and non-market rental housing simultaneously to help with Canada's growing housing shortage.

02

To fully see the benefit these mixed-income rental projects, though, all three levels of government will need to work together, applying a variety of policy levers simultaneously to help these projects overcome the increasingly challenging development economics associated with new rental housing development.

03

Even with substantial support from all levels of government, there is a limit to how many affordable units can be required in mixed-income rental projects before additional capital or operating support is needed to make these projects viable.

1. Based on EY survey of Canadian rental developers conducted in conjunction with CMHC – (link to be provided)
2. Our simplified test of project viability only considers a developer's target IRR. However, to qualify for CMHC funding programs, projects must hit certain debt service coverage (DSCR) targets during the operational phase. In many of the scenarios with 50% of units at affordable rates, meeting these CMHC targets is difficult, further impacting project viability.

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