City of Burlington CIP Financial Analysis Memo

To:	City of Burlington
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1.0 Executive Summary

urbanMetrics ("we", "us") was retained alongside Nethery Planning to provide a financial analysis of rental housing in the City of Burlington to aid in the development of the proposed Housing-Focused CIP.

We conducted a residual land value analysis for each of five development scenarios to assess how large the CIP subsidies should be in order to either render each one viable, or to incentivize the creation of affordable units and additional 3-bedroom units by making their profitability equal to those of the baseline scenario.

This analysis calculates the net present value of revenues that would be generated by a development, then subtracts hard and soft construction costs and a required profit margin for the developer. The leftover amount is the residual land value. The calculated residual land values were compared against standardized benchmarks to assess the amount of subsidies needed for the project to be feasible.

The analysis considered five different development scenarios:

- Accessory Additional Residential Unit ("ARU"): a newly-built accessory building with 1 bedroom.
- Converted ARU: a conversion of a portion of an existing home into an accessory rental unit with 1 bedroom.

- Missing Middle Fourplex: a 2-storey multiplex with four 2-bedroom units.
- 6-Storey Apartment: a 6-storey apartment with 101 units.
- 30-Storey Apartment: a 30-storey apartment with 354 units.

Under Current Market Conditions

We calculated the following subsidies would be needed for each of these rental scenarios to be feasible at market rents:

- Accessory ARU (i.e. housing unit separate from main house): $12,000 per unit
- Converted ARU (i.e. constructed within existing dwelling, such as a basement apartment): no subsidy needed for feasibility.
- Missing Middle Fourplex: $72,000 per unit (Total $288,000 for the project)
- Apartments: at $164,000 per unit for a 6-Storey apartment building and $230,000 per unit for a 30-Storey apartment building, the subsidies would be far in excess of what would be reasonable in a CIP program.

The following additional subsidies would be required to incentivize the creation of affordable units (in addition to the above subsidies):

- Accessory ARU: $96,000 per affordable unit
- Converted ARU: $71,000 per affordable unit
- Missing Middle Fourplex: $135,000 per affordable unit

Improved Market Conditions

We have also considered the incentives required for multi-unit projects under improved market conditions, including the following:

- Reduction of 1.5% interest for the construction loan;
- Reduction of 1.0% interest for the mortgage; and,
- Reduction of 5% to 8% in construction costs.

These assumptions were similar to the “high” scenario from the NBLC May 2024 Community Planning Permit System Financial and Market Analysis.

These improved market conditions scenarios were primarily used to calculate the incentives needed for affordable units and 3-bedroom units, as the gap in profitability between these units and the baseline market-rate units would increase as these market conditions improve. If subsidies were set on the lower gap in

profitability based on current conditions, they may not be sufficient for when these apartments become more feasible to develop.

Based on these improved market conditions, the following incentives would be required to make the project feasible at market rents:

- Missing Middle Fourplex: No incentives required.
- 6-Storey Apartment Building: Although the analysis indicates that a small subsidy per unit would be required (i.e. $27,000), this amount is within the range at which a developer might be able to design a project to make it feasible without incentives. Incentivising the entire project at $27,000 per unit may be beyond the reasonable limits of a CIP program.
- A 30-Storey Apartment building would still be beyond the reasonable limits of a CIP program to incentivise.

In order to incentivise the creation of affordable units, the following subsidies would be required:

- Missing Middle Fourplex: $227,000 per affordable unit.
- Apartments: $143,000 per affordable unit.

We have also considered the subsidies that would be required to incentivise the creation of additional 3-bedroom units at market rents, which would include the cost to the developer of reducing the total number of units. This scenario would only apply to the 6-storey apartment scenario. In this case, in order to incentivize a project to include approximately 20% additional 3-bedroom units, from a benchmark 5% or lower, the subsidy would be approximately $36,000 per unit. This scenario is more challenging to provide a definitive amount. This is because the price or rent for 3-bedroom units in apartments can be higher than those for townhome units, which are often more desirable for families. As such, the reason apartment developers include fewer 3-bedroom units is because of more desirable alternatives in the marketplace.

2.0 Assumptions

Approach/Methodology

A pro forma residual land value analysis was conducted for each housing scenario to assist the City in understanding the value of grants/forgivable loans that might be required within a Housing CIP.

The residual land value was calculated by estimating projected revenues and subtracting hard and soft construction costs and an industry-standard 15% pre-tax profit margin. The leftover amount is the residual land value, which is the maximum value that would be paid for land for that development. Residual land values are often expressed in terms of dollars per buildable/built square foot. If the residual land value exceeds the cost of land (assumed to be $50 per buildable square foot), then that type of development is considered feasible.

The residual land value has a natural interpretation for the multiplex and apartment scenarios. For ARU scenarios, the cost of land may be interpreted as the value the homeowner loses from converting a portion of their home or yard to the ARU. Here, the "land cost" would represent the loss of enjoyment of a portion of their property. As this is more personal in nature, the value a landowner may place on this loss of enjoyment could be more or less than the benchmark land costs assumed in the analysis, which may impact the level of subsidies required to incentivize the development of ARUs.

Two types of scenarios were considered: ground-related housing and multi-storey apartments.

The ground-related housing scenarios include:

- An additional residential unit (ARU) in a newly built accessory building with 1 bedroom.
- An ARU converting a portion of an existing home into a 1-bedroom home, such as a garage or basement.
- A 2-storey multiplex with four 2-bedroom units.

The multi-storey apartment scenarios included two scenarios considered by NBLC in their May 2024 Community Planning Permit System Financial and Market Analysis. These scenarios included:

- A 6-storey apartment.

- A 30-storey apartment.

Baseline Pro-Forma Assumptions (Current Market Conditions)

The following table describes the assumptions used in the pro-forma analysis for the ground-related housing scenarios:

Figure 1: Assumptions for Ground Related Housing Scenarios

	Scenario 1: Accessory ARU	Scenario 2: Conversion ARU	Scenario 3: 4-Unit Multiplex
# of Units	1	1	4
Unit Type	1 BR	1 BR	2 BR
Unit Size (SF)	800	800	1,200
Market Rent	$2,125	$1,850	$2,900
Affordable Rent	$1,621	$1,621	$1,831

The average unit size for conversion ARUs is based on CMHC June 2021 Housing Market Insight Report on Secondary Units in Ontario. The average unit size for a basement apartment across the province was 825 square feet, ranging from an average of 700 square feet in Sudbury to 1,200 square feet in Vaughan. The average for Burlington was 1,029 square feet.

For accessory ARUs, we reviewed recently constructed laneway homes in generally in Toronto, which ranged from 800 to 1,200 square feet. We assumed 800 square feet for both types of accessory units to provide for greater affordability. There are very few examples of newly built four-plexes and the average size of 1,200 square feet is based on a review of available unit models being offered by builders.

Market rents were obtained from a review of MLS data for Burlington. The affordable rents are based on the Province's "Affordable Residential Units for the Purposes of the *Development Charges Act, 1997* Bulletin", June 2024. This uses the definition of "affordable" found in the Provincial Planning Statement.

For each ground-related scenario, the following cases were assessed:

- The general feasibility of each type of development, assuming they are rented out at market rates.

- The general feasibility of each type of development assuming they are rented at affordable rates for 25 years, after which they revert to market rates.
- The loss in revenues from an affordable development compared to a market-rate development, which can be interpreted as the subsidy needed to encourage a private developer to build an affordable rental compared to a market-rate rental. This is the subsidy above statutory exemptions for development charges, community benefits charges and parkland dedication.

The following table describes the assumptions used in the pro-forma analysis for the multi-storey apartment scenarios:

Figure 2: Assumptions for Multi Storey Residential Scenarios

	Scenario 4: 6-Storey	Scenario 5: 30-Storey
Site Area (SF)	21,528	64,583
Building Height	6	30
Residential Units	101	355
Gross Floor Area (SF)	92,709	324,316
Unit Mix:		
Studio	5%	5%
1 Bedroom	50%	50%
2 Bedroom	40%	40%
3 Bedroom	5%	5%
Unit Sizes (SF):		
Studio	450	450
1 Bedroom	650	650
2 Bedroom	875	875
3 Bedroom	1050	1050

For each multi-storey apartment scenario, the following cases were assessed:

- The general feasibility of each type of development, assuming they are rented out at market rates.
- The general feasibility of each type of development assuming they are rented at affordable rates for 25 years, after which they revert to market rates.

- The loss in revenues from an affordable development compared to a market-rate development, which can be interpreted as the subsidy needed to encourage a private developer to build an affordable rental compared to a market-rate rental.
- The loss in revenues from an additional 3-bedroom unit, compared to the benchmark unit mix. This can be interpreted as the subsidy needed to encourage a private developer to build an additional 3-bedroom unit.

Rental units offered for rent in the City of Burlington were examined on MLS to provide reasonable assumptions on average unit sizes and market rental rates. Affordable rents for the City of Burlington were taken from the Province of Ontario's Development Charge bulletin noted above.

For the ground-related housing scenarios, one-bedroom rentals in single-detached houses, semi-detached houses, or townhomes were almost all basement apartments. Due to the lack of data, we assumed that separated ground-related 1-bedroom units would rent at a 15% premium.

Figure 3: Market Rent and Unit Size Assumptions

	Ground-Related	Multi-Storey Apartment
Rent: Studio/Basement	$1,850	$1,600
Rent: 1BR	$2,218	$2,150
Rent: 2BR	$2,900	$2,500
Rent: 3BR	$3,500	$2,800
Size: Studio/Basement	800 SF	450 SF
Size: 1BR	800 SF	650 SF
Size: 2BR	1,200 SF	875 SF
Size: 3BR	1,500 SF	1,050 SF

For all scenarios, the average hard costs from the 2024 Altus Cost Guide for the GTA were used. These costs were $227.5 per square foot for ground-related housing, $287.5 per square foot for the 6-storey apartment, and $337.5 per square foot for the 30-storey apartment. For a conversion ARU, we assume costs are half of the cost of building a new building, or $113.75 per square foot.

Building permit fees as of 2024 were taken from the City of Burlington website. We further assumed a 10% contingency as a percentage of hard costs.

For the 4-unit multiplex with market-rate units, we further assume development charges of $8,612.48 per unit (80% of $10,765.60), while ARUs are exempt from development charges. We additionally include Parkland Dedication charges equal to 10% of the land value based on $50 per buildable square foot. Affordable units are exempted from these charges.

For multi-storey apartments, we assume Official Plan Amendments and Zoning By-law Amendments are required, with the associated fees. We assume the ground-related developments will not require these or other planning submissions or fees.

We assume a Gross Leasable Area to Gross Floor Area ratio of 95% for ground-related housing and 82% for multi-storey apartments.

We further assumed a parking ratio of 0.7 spaces per unit for residential and 0.1 stalls per unit for visitors, following the NBLC CPPS Report. Residential parking was assumed to be underground while visitor parking spaces were assumed to be surface parking. We assumed that residential parking spaces were rentable for $100 per month.

Operating expenses excluding property taxes were assumed at 20% for market-rate ARUs, 17.5% of revenues for other market-rate housing, and 35% for affordable housing. A higher operating expense rate was assumed for affordable housing as it is likely a portion of these costs are fixed per unit. We further assumed 5% selling costs and agent fees, 2% bad debt, and a 2% vacancy rate for market-rate units and 1% for affordable units.

The construction loan rate was assumed to be 6.95%, which was the prime rate plus 1%. The mortgage rate was assumed to be 4.75% based on discussions with developers in the City of Burlington. In addition, for each scenario, we further consider a scenario where an affordable development can gain access to a lower-cost lending program with a rate of 4.25% for both the construction and the mortgage components. Finally, we assume a discount rate of 8% for cash flows.

The capitalization rate was 4.25%, the average of low-rise multi-family apartment cap rates in the Colliers Q3 2024 Canada Cap Rate Report.

It is important to note that the pro-forma analysis will only provide a general idea for which types of development may be broadly feasible or not. Each individual development would likely face different costs and potential revenues. Different developers may also have different discount rates due to differences in access to financing and risk preferences. Market conditions would also change over time.

Favourable Pro-Forma Assumptions

Because current market conditions are challenging for rental developments, we also considered a set of more favourable assumptions where rental development may become more feasible. These assumptions were similar to the "high" scenarios considered by the NBLC May 2024 Community Planning Permit System Financial and Market Analysis. These scenarios were only run for the 4-unit multiplex, 6-storey apartment, and 30-storey apartment developments.

The favourable scenarios were most important for determining the level of incentives for affordable housing and for additional 3-bedroom units. The concern with using the baseline scenarios for determining the values of these incentives is that the unfavourable market conditions may compress the difference in net earnings from a normal unit compared to an affordable or 3-bedroom unit. If market conditions improve where these rental developments become more feasible, that gap could widen. In that case, if incentives for affordable and 3-bedroom units were set based on the compressed differences, the incentives would not be sufficient to incentivize the creation of such units.

For construction costs, we used the 25-percentile of the range in the 2024 Altus Cost Guide. These costs were $216.25 per square foot for the 4-unit multiplex, $266.25 per square foot for the 6-storey apartment, and $311.25 per square foot for the 30-storey apartment.

Additionally, the favourable scenarios used lower interest rates. These scenarios assumed a construction loan interest rate of 5.45% and a mortgage loan interest rate of 3.75%.

Finally, the favourable scenarios used a slightly lower capitalization rate of 4%.

3.0 Results

The calculation of required incentives has been provided in Figure 4 for the baseline scenarios under current market conditions and Figure 5 for the favourable scenarios. The favourable scenarios were used to determine the level of incentives the multi-residential unit projects, assuming that improved market conditions permitted them to be viable.

Converting space within an existing dwelling does not require incentives to be rented at current market rates.

We found that conversion ARUs (i.e. converting space within an existing dwelling, such as a basement apartment) are the most feasible type of missing middle development. Due to their low construction costs, these projects have a residual land value exceeding $50. In other words, they are already profitable to construct and rent out at market rents without any incentives.

However, in order for conversion ARUs be rented out at affordable rents, an incentive of approximately $71,000 per unit would be required, which would represent the difference between the residual land value at market rents and the residual land value at affordable rents.

Unattached accessory units only require a small incentive to be rented at current market rents

ARU Accessory Buildings (i.e. unattached units, such as a laneway unit) have higher construction costs than conversion ARUs. As a result, they are just slightly short of being feasible. These types of developments would require approximately $12,000 to be feasible. This amount is within a reasonable contingency range and it is not inconceivable that these units can be tailored to minimize costs and bring them into a feasible position without any subsidies.

Because accessory building ARUs are assumed to command higher rental rates in the market, it would be more expensive to convert them to affordable units. A subsidy of around $96,000 per unit would be required, assuming that the base unit was financially viable.

Its important to recognize that the conversion of part of a home or lot to an accessory unit has personal space implications for the owner. As such, the decision to convert will involve personal considerations (e.g. giving up personal space, becoming a landlord, avoiding conflicts between tenants and family members, etc.). In addition, the unit may be occupied by a family member/friend and the rent may not reflect market rents. Due to these factors, the decision to convert may not be made on purely financial terms and may require an incentive more or less than those above.

Multi-plexes are much more expensive to construct than and would require an incentive of approximately $72,000 per unit to make a rental unit viable.

Finally, the multiplexes were not feasible due to relatively high construction costs combined with lower rent per square foot levels. An incentive of approximately $227,000 per unit would be required to make these units affordable assuming that the units could be developed at financially feasible costs.

Mid-rise and high-rise rental buildings would require substantial subsidies for units to be offered at market rents, and more to allow units in these buildings to be offered at affordable rents and/or to create additional 3-bedroom units.

At $164,000 per unit for a 6-Storey apartment building, the subsidies to make the entire building viable would be far in excess of what would be reasonable in a CIP program.

However, under more favourable market conditions, assuming that the buildings could be constructed in a financially viable manner, for each affordable unit, $143,000 per unit would be required to incentivize their creation. To increase the ratio of 3-bedroom apartments to 20% of total units from an expected 5%, an additional $36,000 per unit would be required.

A 30-storey rental project would be difficult to be viable even under more favourable market conditions.

Figure 4: Calculation of Required Incentives, Baseline Scenario

Scenario		Number of Units	Buildable SF	RLV ($)	RLV per SF ($)	Gap[1]	Gap/Unit	Incentive Required Per Unit	Explanation
ARU Accessory Building									
	Base Case	1	842	$30,429	$36.1	$11,677	$11,677	$11,677	To make a unit viable
	Affordable	1	842	-$65,544	-$77.8	$107,649	$107,649	$95,972	Top up to make unit affordable
ARU Conversion									
	Base Case	1	842	$103,708	$123.2	$0	$0	$0	No incentive required
	Affordable	1	842	$32,874	$39.0	$9,232	$9,232	$70,834	To make affordable unit equal to base case
4 Unit Multiplex									
	Base case	4	5,053	-$34,019	-$6.7	$286,651	$71,663	$71,663	To make a unit viable
	100% Affordable	4	5,053	-$574,490	-$113.7	$827,121	$206,780	$135,118	Top up to make unit affordable
6-Storey Apartment									
	Base case	101	92,709	-$12,034,544	-$129.8	$16,669,994	$164,460	$164,460	To make a unit viable
	5% Affordable	101	92,709	-$12,369,753	-$133.4	$17,005,203	$167,767	$66,141	Top up to make unit affordable
	Additional 3 Bedrooms (+18.5	94	92,709	-$12,128,752	-$130.8	$16,764,202	$178,070	$5,101	Top up to incentivise 3 bedroom at market rate
30-Storey Apartment									
	Base case	355	324,316	-$65,364,859	-$202	$81,580,659	$230,073	$230,073	To make a unit viable
	5% Affordable	355	324,316	-$66,468,254	-$205	$82,684,054	$233,185	$62,236	Top up to make unit affordable
	Additional 3 Bedrooms (+64.6	329	324,316	-$65,745,884	-$203	$81,961,684	$248,869	$5,898	Top up to incentivise 3 bedroom at market rate

1) Represents the difference between the residulal land value (RLV) and the base land value estimated at $50 per square foot x the buildable square footage.

Figure 5: Calculation of Required Incentives, Favourable Scenario

Scenario	Number of Units	Buildable SF	RLV ($)	RLV per SF ($)	Gap[1]	Gap/Unit	Incentive Required Per Unit	Explanation
4 Unit Multiplex								
Base Case	4	5,053	$629,882	$124.7	$0	$0	$0	To make a unit viable
100% Affordable	4	5,053	-$278,373	-$55.1	$531,004	$132,751	$227,064	Top up to make unit affordable
6-Storey Apartment								
Base Case	101	92,709	$1,894,103	$20.4	$2,741,347	$27,045	$27,045	To make a unit viable
5% Affordable	101	92,709	$1,167,062	$12.6	$3,468,388	$34,218	$143,455	Top up to make unit affordable
Additional 3 Bedrooms (+18.5)	94	92,709	$1,220,372	$13.2	$3,415,078	$36,275	$36,481	Top up to incentivise 3 bedroom at market rate
30-Storey Apartment								
Base Case	355	324,316	-$18,591,720	-$57	$34,807,520	$98,164	$98,164	To make a unit viable
5% Affordable	355	324,316	-$20,913,614	-$64	$37,129,414	$104,712	$130,964	Top up to make unit affordable
Additional 3 Bedrooms (+64.6 3BR)	329	324,316	-$20,572,646	-$63	$36,788,446	$111,705	$30,662	Top up to incentivise 3 bedroom at market rate

1) Represents the difference between the residulal land value (RLV) and the base land value estimated at $50 per square foot x the buildable square footage.