Critique of the Ontario Proposed IZ Regulations

The following is a critical assessment of the proposed regulations released by Ministry of Municipal Affairs & Housing on 18 December 2017 for the *Promoting Affordable Housing Act, 2016* – the Ontario legislation authorizing the use of inclusionary zoning (IZ) in the province. It first looks at the problems associated with the overall approach, and then with certain specific regulations.

Overall Approach

In these draft regulations, the Ministry has taken a heavy-handed approach that will severely limit what the municipalities can do. That approach is both unnecessary and will only serve to stifle the provision of affordable housing.

Overly Rigid and Unnecessary Regulations

The regulations contain a number of remarkably ill-considered provisions. One particularly damaging regulation is without precedent anywhere in IZ. Still others are extraordinarily restrictive. All of these appear to have been set without any apparent understanding of their impact. None of them certainly have been based on the well-tested IZ "best practices" that have evolved over many years in the US.

These regulations reveal that the government is far more concerned about catering to the exaggerated and unfounded concerns of the development industry rather than providing affordable housing. The regulations do not represent a reasonable compromise but rather an indefensible capitulation to those concerns.

Let's be clear about this: IZ does not damage the developers. They do not shoulder the cost burden associated with the affordable housing. It is shifted back to the land market that is able to adjust to the demands for affordable housing. Authoritative US studies show that IZ has virtually no impact on overall development activity.

Municipalities in the US have been solely responsible for designing these programs without any similar intervention from the states. The programs, and all of the regulations therein, are entirely the invention of the municipalities developed by them and then modified over time to reflect emerging lessons.

Despite this lack of oversight, municipalities there have acted reasonably and responsibly in these programs. Fears that they will overreach are unfounded; in general, they have proceeded cautiously. In any case, there are effective safeguards if the municipalities were ever to act inappropriately. The Ministry retains the authority to intervene with regulations at a later date, and nothing can force the developers to build.

If the Ministry really wanted to facilitate the provision of affordable housing, it would have kept the regulations at a minimum, and given municipalities the maximum scope to determine what rules and procedures are appropriate to their particular

conditions and priorities. Instead, the current one-size-fits-all approach treats all municipalities – whether big or small and high-growth or slow-growth – as the same.

In this regard, it is relevant to note what the previous Minister said before the Legislative Assembly on 28 September 2016: "throughout the consultations, we heard a common view that municipalities should be given the flexibility to tailor inclusionary zoning to local social and economic conditions. We want to ensure that they have this flexibility."

Furthermore, rather than focussing on fixed and hard rules, the Ministry should be relying more on preparing guidelines that can be used for pointing the municipalities in the right direction rather than dictating what they must do. Guidelines are a much better tool than rules for identifying and evaluating best practices, and for assessing more generally the pros and cons of taking alternative approaches. At the same time, they leave greater scope for municipalities to innovate and explore new practices.

Little Production of Affordable Housing

In addition to being unnecessarily intrusive, these regulations will have the effect of ensuring that very little affordable housing is produced.

The regulations contain a number of impediments. Some are minor and others more significant, but when taken together, they will be very stifling. These impediments include the following:

- the limits on the size of developments to which IZ can be applied;
- the limits to the percentage of affordable units that can be taken;
- the exclusion of rental housing developments;
- the potential for limiting IZ only to certain places and areas; and
- the requirement for municipal contributions.

The last of these is the most insidious. The requirement for municipal contributions will effectively set a limit to the price reduction that can be achieved in the affordable housing, and this in turn will ensure that affordable housing cannot be provided in upmarket developments (see more later).

These restrictions go well beyond those typically used in the US, and will significantly reduce affordable housing output in comparison with programs there. For example, if the City of Toronto adopted an IZ program based on best practices in the US, it could be expected to secure roughly 2000-2500 new affordable units per year. On the other hand, if it adopted a program based on these regulations, it would be lucky to get 100-200 units per year. Of course, other municipalities with less growth would receive even less.

On top of this, it also remains uncertain that this so-called affordable housing produced under these provisions will be actually affordable housing under any rigorous and defensible definition of affordable housing. In the US, to be considered

affordable housing, it must be “below-market” housing. In other words, it must be for households not being served by new private market development.

Under the IZ legislation, the so-called affordable housing produced in these programs will be required to meet the looser definition of affordable housing as set out the Provincial Policy Statement (PPS). This definition has never been shown to set a “below-market” standard. Instead, it would seem to allow in many markets for the provision of lower-priced market housing for households already able to purchase a new market house. Using IZ to provide more market housing – albeit, low-end-of-market housing – is not a responsible use of this tool.

Considering lack of production, and the time and effort needed to develop and administer these programs, why would municipalities want to take on IZ under such restrictive regulations.

Specific Regulations

The following addresses the key specific aspects of the regulations that needed to be changed.

Municipal Contributions

The regulations will require the municipalities to provide financial contributions amounting to 40% of the price reduction for the affordable units, while the developers will make up the remaining 60%. The required contributions must be made through, and only through, waivers to parking requirements and various specified regulatory charges already being collected from the developers.

Making the provision of affordable housing dependent on municipality contributions is entirely without precedent. Nothing like this has ever been done in IZ in the US has taken this approach. This fact, by itself, should be enough to raise doubts about the appropriateness and necessity of this type of provision.

It is granted that many (but not all) municipalities in the US offer similar regulatory concessions, but the type and level of these concessions are determined solely by the municipalities themselves based upon what is necessary, appropriate and practical in their particular circumstances. Nevertheless, even where they offer no or little compensation, there is no evidence that these programs cause economic harm to the developers. Indeed, there are two authoritative studies that have shown the developers in comparable municipalities with IZ and without IZ at virtually the same rate.

To require municipal contributions reflects a poor understanding of how IZ programs work. In these programs the developers do not, nor are they expected to, shoulder any cost burden associated with delivering the affordable units. Instead, as it is widely recognized, this cost burden is “passed back to the land”. In other words, the developers will make up for these costs by paying commensurately less for the land.

In addition to being quite unnecessary, these contributions will have a very negative impact on the provision of affordable housing because the price reduction that can be achieved though these contributions will be relatively limited. To wit, while the maximum value of the municipal contributions will vary from place to place, it is unlikely to amount to much more (and likely to be much less) than roughly $50,000 per affordable unit. So, when development contributions are factored in, the maximum price reduction will be roughly about $125,000 per affordable unit.

The above assumes that all of these fees and charges will be redirected to affordable housing, although they are now being collected to pay for other municipal services and infrastructure improvements. It is more reasonable to expect that municipalities will be very selective in how and when they are used for IZ, even further reducing the financial support available.

In any case, the limited price reduction that can be achieved is unlikely to secure affordable housing in many developments even under the loose PPS definition. Only in developments at the low end of the market will the price reduction be likely able to meet this standard. On the other hand, in developments at the upper end of the market the gap between the market price and affordable price will be too wide to be bridged, unless the municipality pours in more supports. The likely consequence is that many developments – perhaps even a majority – will escape providing any affordable housing at all.

This consequence goes against the basic tenets of inclusionary zoning, which is to provide affordable housing in every new development, and to have all developers participate on an equitable basis.

Summary

The requirement that the municipalities must financially contribute toward the provision of affordable housing must be deleted in its entirety. IZ just cannot work under these provisions. Municipalities should have the flexibility to decide what concessions (if any) are suitable in their particular circumstances.

Maximum Setaside

The regulations will limit the IZ programs to taking no more than 5% of the housing as affordable housing on most sites, and 10% in areas around “high-density transit stations”.

In the US, while this figure varies, a setaside of 20% is a widely-used best practice. The experience there abundantly shows that this housing take can be used without adversely impacting the development industry.
The 5% limit is particularly restrictive. Through this single act alone, the regulations will cut the potential affordable housing output by 75%.

The restriction also has another adverse impact. It would rule out the use of higher setasides on off-site developments as a way of facilitating the development of affordable rental housing (see Off-Site Provisions).

The 10% limit for areas around "high-density transit stations" is also egregious for another reason. The strong demand for housing, and hence the significant increase in land values, around these stations is due in very large part to the massive public investment in transit. None of that increased land value is due to the actions of the development industry nor local landowners. Nevertheless, they have been able, and will be allowed to continue under this provision, to grab most of this public-generated value for their own unearned gain.

The municipalities should be enabled to recover some significant part of that gain, either to help pay for those facilities and/or ensure that ample affordable housing (not just a paltry 10%) is built around these stations. This can be done by imposing a much higher setaside around these stations – at least as high as 50%, if not 75%.

Summary

This regulation should be removed so that municipalities are allowed to set their own setaside thresholds relating to their local conditions and housing needs. Failing that, the prescribed cap should be set at least at 20% generally, and 50% for lands around fixed-rail transit stations.

Rental Housing

The regulations do not include any measures that would require or even facilitate in any way the provision of affordable rental housing. Considering the very critical need for affordable rental housing everywhere, this omission is hard to justify.

Most notably, the regulations do not apply to developments providing of affordable rental housing. In contrast, all IZ programs across the US apply to both rental and ownership housing.

The regulations also overlook an important opportunity for creating affordable rental housing through the off-site provisions. These provisions should be framed in a way that encourage private developers to construct purpose-built rental housing off-site that would be owned and operated by the non-profits (see next).

Summary

The regulations should be altered so that they:
1) apply to rental developments as well as ownership developments; and
2) incorporate the provisions facilitating off-site rental development noted next.

Off-Site Provisions

The regulations appropriately allow for the affordable housing obligation under certain conditions to be satisfied by constructing the affordable units on another site.

Similar off-site provisions are widely used in the US, but with an important additional condition. Where off-site provisions are allowed, the developers are typically required to provide more units – generally 25 or 50% more – or the same units at a correspondingly deeper level of affordability. This is justified because these developers are fully satisfying the purpose of the IZ programs, which is to provide affordable housing integrated within all market developments.

Using this approach could also secure another benefit – the provision of affordable rental housing. The surcharge would apply whenever the developers built affordable ownership housing off-site, but it could be waived when they build affordable rental off-site. In this way, this provision could be used to leverage the provision of affordable rental, and especially in partnership with the non-profit sector.

Unfortunately, requiring the developers to meet a higher setaside for building off-site would be prohibited under the current regulations. This is yet another reason why the municipalities should be given more flexibility in what provisions they use.

The existing regulations also limit the off-site affordable housing to be no more than 50% of the total housing on that site. It is not clear whether this restriction would hinder the development of non-profit housing. To be safe, the regulations should explicitly waive this provision for non-profit developments when built under these off-site provisions.

Summary

The regulations should be modified so that they:
1) allow the municipalities to require developers to provide additional affordable housing when they build affordable ownership housing off-site; and
2) waive the 50% limit for affordable housing off-site when that housing is affordable rental.

Minimum Development Size

Under the draft regulations, the municipalities will be able to apply the inclusionary requirements only to developments of 20 units or more in size.

In the US, while this size threshold varies from place to place, a threshold of 10 or more units is widely and successfully used. (Many programs actually go down to developments of 2 or more units, but this relies on the use of cash-in-lieu for the small developments, which unfortunately has been ruled out by the legislation.)

These thresholds are kept as low as possible in order to maximize affordable housing output because a significant proportion of the total housing production typically comes from small developments.

Summary

This regulation should be deleted, or failing that, lowered to 10 or more units.

Income Eligibility

Under these regulations, to protect the affordability of the units, he municipalities will be required to do the following:
1) set annually the initial permitted sale price for the affordable units;
2) set the household income limits for the eligible households;
3) set a way for determining permitted resale price during 20-30-year control period.

What is missing is any clear directive that the permitted income thresholds must be consistent with the permitted price levels. From the above, it might be assumed that the income and price will be linked for the initial sale, but it would be safer to make this explicit. In any case, there is no reference whatsoever to controlling household incomes for the resales, nor tying them to the resale prices.

In absence of a clear directive, it is very possible that the affordable housing – especially when resold – could go to undeserving households – namely, ones earning enough to afford a market house. This would clearly defeat the purpose of the program.

Summary

The regulations should ensure that the affordable housing is available only to income- eligible households – that is, those earning an income appropriate to the reduced price of the affordable housing.

Affordability Controls

The regulations call upon the municipalities to control the affordability of the inclusionary housing for 20-30 years, and when doing so, determine the equity share going to the home seller whenever the affordable unit is sold within this period. Then, for the post-20-30-year period, the regulations also mandate the use of a specific set of complex equity-sharing provisions

The rationale behind using two different approaches is unclear. The municipalities are apparently considered competent to decide on equity sharing for the first 20-30 years, but then for some unknown reason, not for the succeeding resale.

In any case, the post-20-30-year provisions are capricious. At certain times, they are unfair to the home seller (in the early years, when they offer too little equity to them) and at other times, irresponsible about the public asset (in the later years, when take too little of the equity is recovered for the public).

Rather than prescribing the equity split in this complex and arbitrary way, the regulations should simply allow the municipalities to determine the equity split in both the 20-30-year period and afterwards. In doing so, they should be expected to meet these two principles: 1) that whenever affordable housing is sold on the open market, the at least present-day value of the initial price reduction should always be recovered and returned to the public sector; and 2) homeowner should be able to receive a reasonable and equitable part of the market value increase accruing during their period of ownership.

(There are two main ways for setting the equity split, but like many other aspects of these affordability controls, they are best handled through guidelines rather than regulations.)

As noted, the municipalities are required to control the affordability of the inclusionary units for at least 20 years and no more than 30 years. In the US, the programs are clearly moving to 30 years at least, if not in perpetuity. There is certainly no justification for using anything less than 30 years for affordable ownership housing (which is the sole focus of the current provisions). Even the arguments for using 20 years in the case of affordable rental housing are limited and questionable.

The regulations allow the municipalities to recover a share of the sale proceeds after the 20-30-year period, but say nothing about how these monies can or should be used. The regulations should require that these monies be devoted solely to affordable housing.

<u>Summary</u>

The regulations should be revised to:

1) extend the period of control at least to a minimum of 30 years, while leaving open the possibility of in perpetuity;
2) remove the arbitrary equity-sharing provisions for the post-control period, and allow the municipalities to determine the equity sharing for this period while adhering to the stated two principles;
3) require that the monies recovered by the municipality from the sale of the affordable units be used by the municipalities for affordable housing.

Price Levels

The municipalities will be required to set the affordable housing price levels every year for each type of inclusionary affordable unit expected in their jurisdiction. This will be critical to the successful operation of these programs, but at the present time the municipalities will be unable to complete the exercise in any rigorous way.

According to the legislation, the municipalities will be required to meet the lower of the two affordability standards – one income-based and the other price-based – set out in the PPS definition. Because the income standard is typically the lower of the two, it must be given precedence. In any case, once the income levels are set, it is relatively straightforward to establish the corresponding price levels.

Here is the problem: the municipalities lack the income data necessary to determine annually the income levels associated with the different household sizes for each their particular jurisdiction. So the best they can do is make guesstimates, which could raise various doubts about the program. On the other hand, there is market data available for setting the price levels directly, but as noted, the rules associated with the definition do not allow this.

The best way to deal with this is for the Ministry to develop a standard methodology together with the necessary income data base that can be used by all municipalities. Alternatively, it should reformulate the PPS definition which is flawed in various ways.

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