JUNE 2024

RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

Parcel

KEY FINDINGS

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RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

1

CHALLENGING MARKET CONDITIONS

Current macroeconomic conditions necessitate **trade-offs and prioritization among multiple municipal priorities** (e.g., preservation of rental supply, enabling missing middle typologies, increasing total housing supply, etc.)

2

BASELINE UPDATES (2023 – 2024)

The findings and key takeaways from our 2023 analysis remain relevant in the context of **updated inputs and assumptions** as a baseline condition (i.e., 2024 costs, revenues, etc.).

3

TYPOLOGY & TENURE

Mid-rise typologies and rental tenures cannot feasibly accommodate rental replacement units. However, feasibility of these developments are constrained by multiple factors independent of rental replacement requirements.

4

"LEVERS" AVAILABLE

There are multiple "levers" available to the City to **improve feasibility**, including adopting flexibility in density calculations (e.g., exempting replacement units from FSI), adjustments to parking, among others.

5

LIMITATIONS

Among these other "levers", however, many do not directly support identified policy objectives – particularly those relating to preserving rental housing supply (e.g., reduced duration of replacement requirements, increased unit replacement thresholds, etc.). These will need to be **carefully balanced with the underlying intent and desired outcomes of the bylaw**.

INTRODUCTION

RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

BACKGROUND

RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

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Original Research Program(s)

- Parcel Economics Inc. ("Parcel") was originally retained by the City of Kitchener in 2023 to prepare a more comprehensive **Rental Replacement By-law Financial Feasibility Study** (dated November 22, 2023)
- This work also built upon the analytical foundation and supporting research program established as part of an earlier **Enabling Missing Middle & Affordable Housing Feasibility Study** (dated April 11, 2023), which serves as a "companion" document to the above.

Purpose

- Since delivery of our original reporting, the City has continued to advance a draft Rental Replacement By-law. Parcel has since been asked to prepare **selected updates and additions to our original analyses to further test and refine the proposed by-law for implementation**.

CONTEXT

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Research Tasks

1. **Updated Baseline Financial Analysis** – Selected updates to establish more relevant models reflecting ongoing changes in market conditions since previous reporting, among other factors.
2. **Response to Supplementary Research Questions:**
   - *What is the minimum density at which a development can feasibly accommodate replacement units (@ 6-unit minimum threshold)? How will this impact "Missing Middle" development proposals?*
   - *What other "levers" are available to improve feasibility? Do they effectively satisfy identified policy objectives?*

ASSUMPTIONS & MODEL PARAMETERS

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Notes About Modelling (Caution & Limitations)

- The financial feasibility results presented herein represent an updated **"base case" only** to show the general relationships among / between different options identified.
- The results of this analysis will undoubtedly change as a function of both: (a) broader shifts in macroeconomic conditions that are beyond the immediate control of the City; and (b) on a site-by-site basis, where **conditions could deviate from those modelled in this type of prototypical analysis**.
- Feasibility modelling is designed to be dynamic / "evergreen" and will **continue to evolve with other parallel housing initiatives by the City** (e.g., other financial, policy and process-based incentives to encourage preferred housing outcomes).

ASSUMPTIONS & MODEL PARAMETERS

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Key Updated Inputs

- **Affordable Rents** – Updated CMHC 100% AMR (October 2023)
- **Hard Construction Costs** – Updated Altus Construction Cost Guide (2024) + Annual Growth reduced from 7.5% to 5.0%
- **Planning Fees, Building Permits, Development Charges + Property Taxes** – Updated to current rates

Other Parameters (Baseline Analysis)

- Replacement units delivered on-site only (i.e., no off-site, cash-in-lieu options)
- Assumed 10-year period for maintaining pre-development rental rates
- Additional waivers / subsidies identified for tenant relocation during construction

ASSUMPTIONS & MODEL PARAMETERS

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Typology & Baseline Models for Updating

- As confirmed with City staff, we have focused our updated models for the **20-Storey High-Rise** typology in the **Central** neighbourhood, including for both condo and rental tenures.
- All concept information and assumptions relating to built-form parameters are consistent with previous reporting based on **preliminary concepts prepared by Smart Density** and parallel market-based inputs provided by Parcel.
- The **four (4) baseline models** selected for updating are:
  - **Model 1.1** – 20-Storey High-Rise Condo Central (No Replacement)
  - **Model 1.2** – 20-Storey High-Rise Condo Central (Replacement @ 15 Rental Units)
  - **Model 2.1** – 20-Storey High-Rise Rental Central (No Replacement)
  - **Model 2.2** – 20-Storey High-Rise Rental Central (Replacement @ 15 Rental Units)

TASK #1 RESULTS:
UPDATED BASELINE

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TASK #1: UPDATED BASELINE

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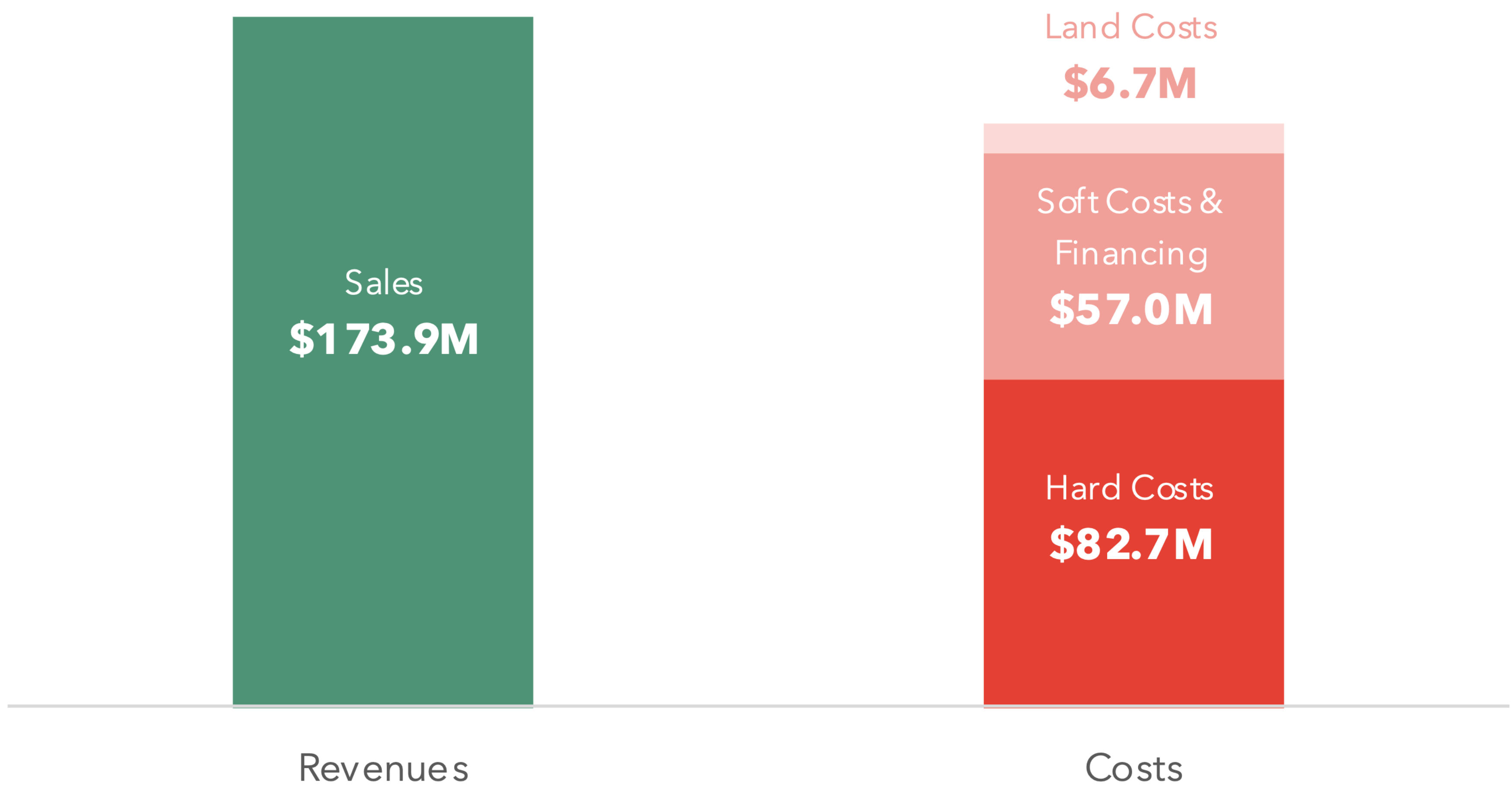
Condo Tenure

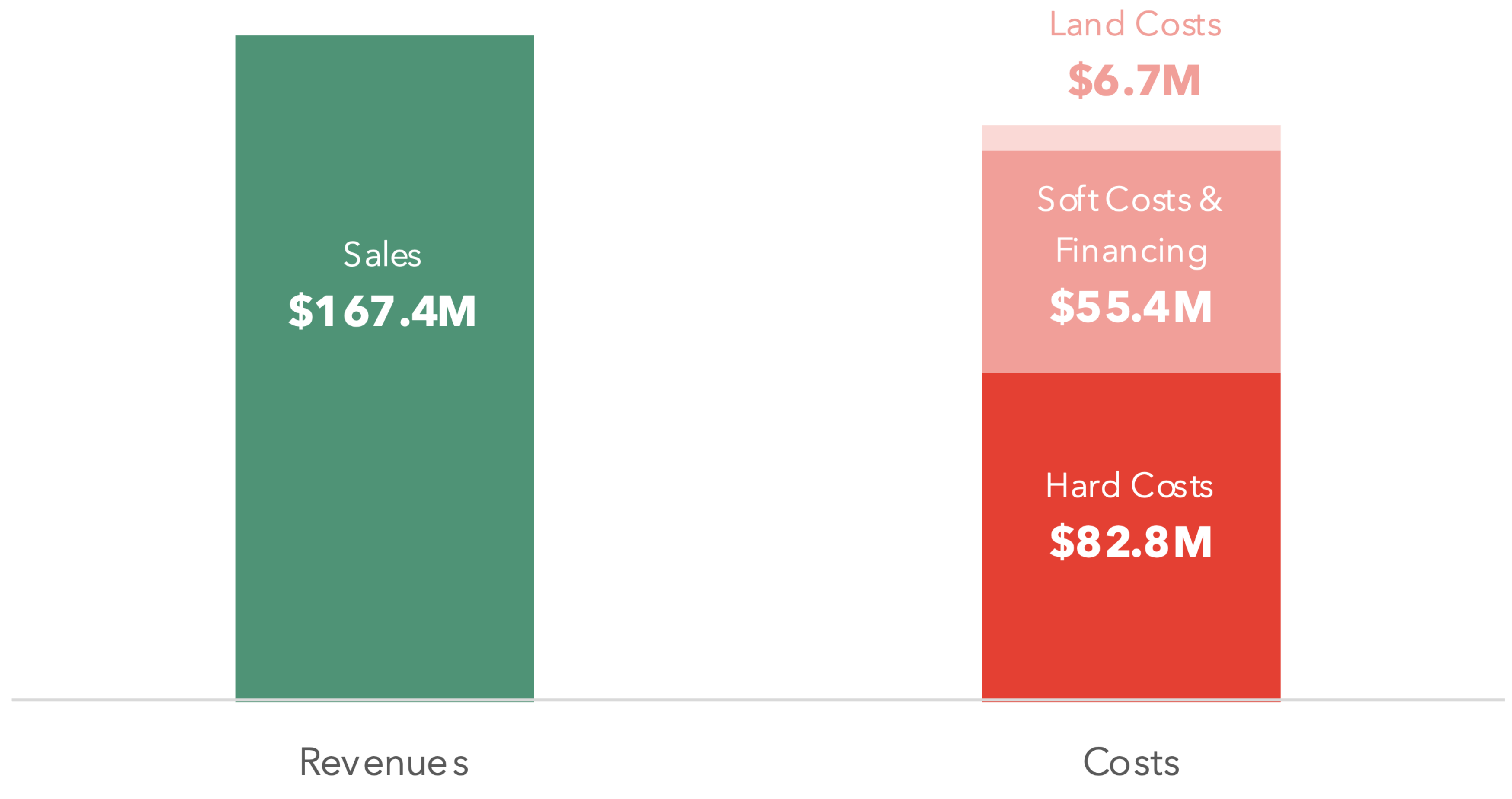
- Rental replacement of **up to 15 units** remains viable for a condo development in the Central Neighbourhood, though it does reduce developer profit and other return metrics

Model 1.1: No Replacement



Profit	IRR	EMx
$27.5M	26.2%	2.00x

Model 1.2: With Replacement



Profit	IRR	EMx
$22.5M	19.3%	1.81x

TASK #1: UPDATED BASELINE

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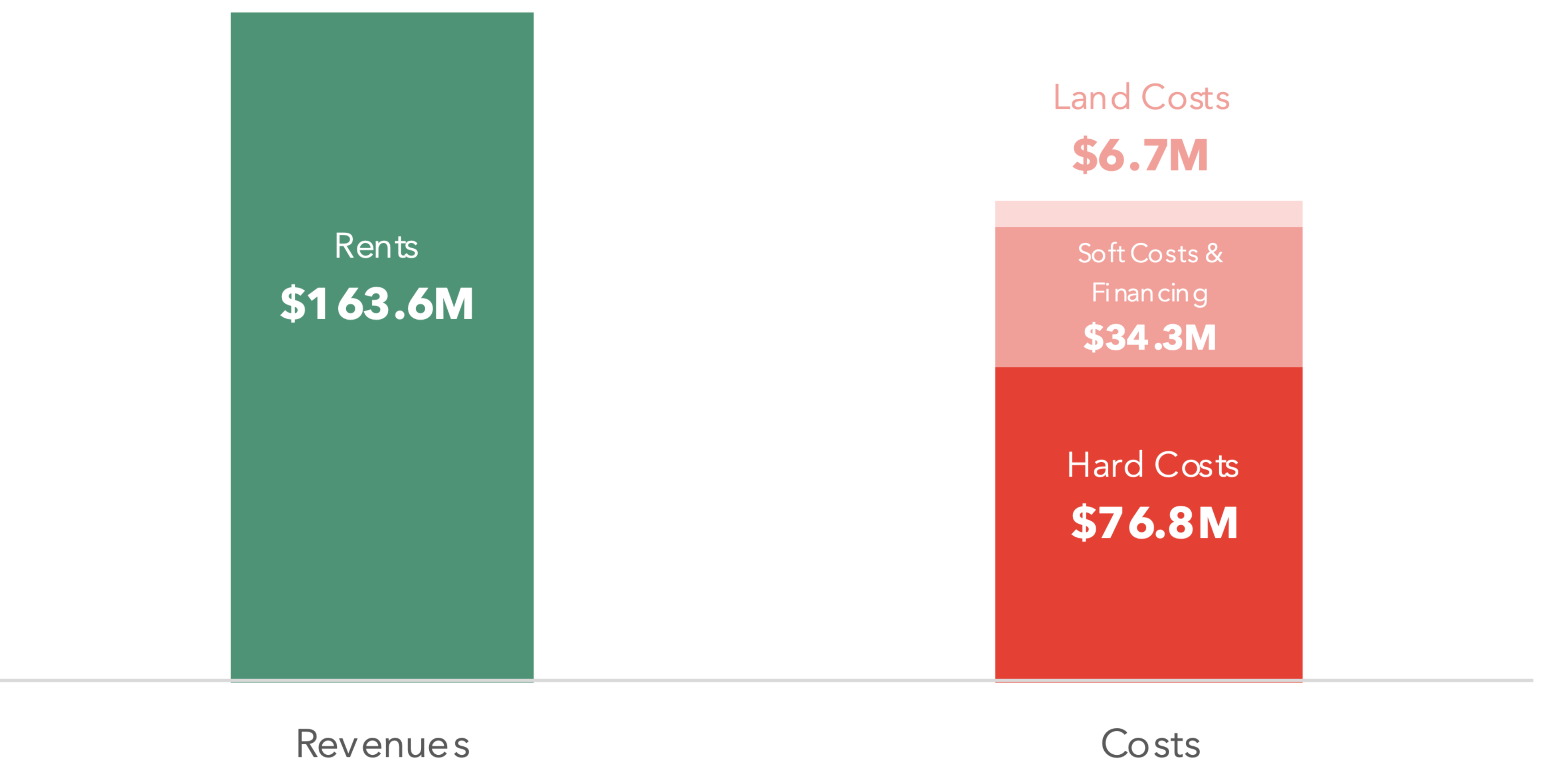
Rental Tenure

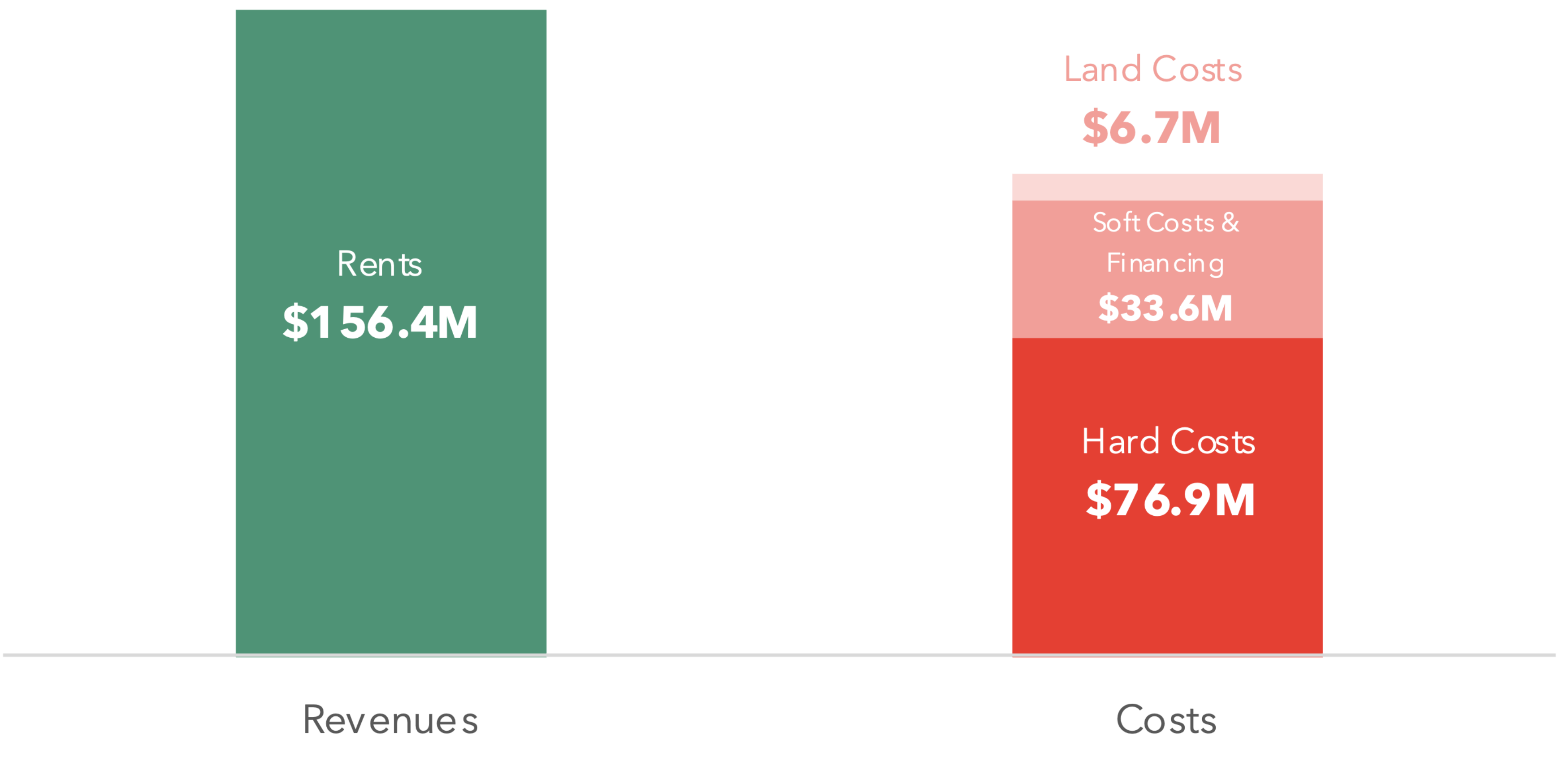
- Return metrics are **insufficient to encourage development** for rental tenures (with and without rental replacement policies)

Model 2.1: No Replacement



Profit	IRR	EMx
$45.7M	4.8%	1.78x

Model 2.2: With Replacement



Profit	IRR	EMx
$39.2M	4.3%	1.67x

TASK #1: UPDATED BASELINE

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Summary

- Overall, the **results of our original 2023 analysis remain accurate and relevant** in the context of current market conditions and prevailing rate / fee structures in Kitchener.
- Specifically, we can confirm that a rental replacement by-law is likely to deter all types and tenures of intensification of existing rental buildings across the city (especially while alternative, non-rental apartment redevelopment sites remain available and viable, as highlighted in our previous reporting).

	No Replacement (Baseline)	**With Replacement**
Ownership	🟢	🟡
Rental	🔴	🔴

🔴 Infeasible 🟡 Unlikely 🟢 Possible

TASK #2 RESULTS: SENSITIVITY ANALYSES

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TASK #2: SENSITIVITY ANALYSES

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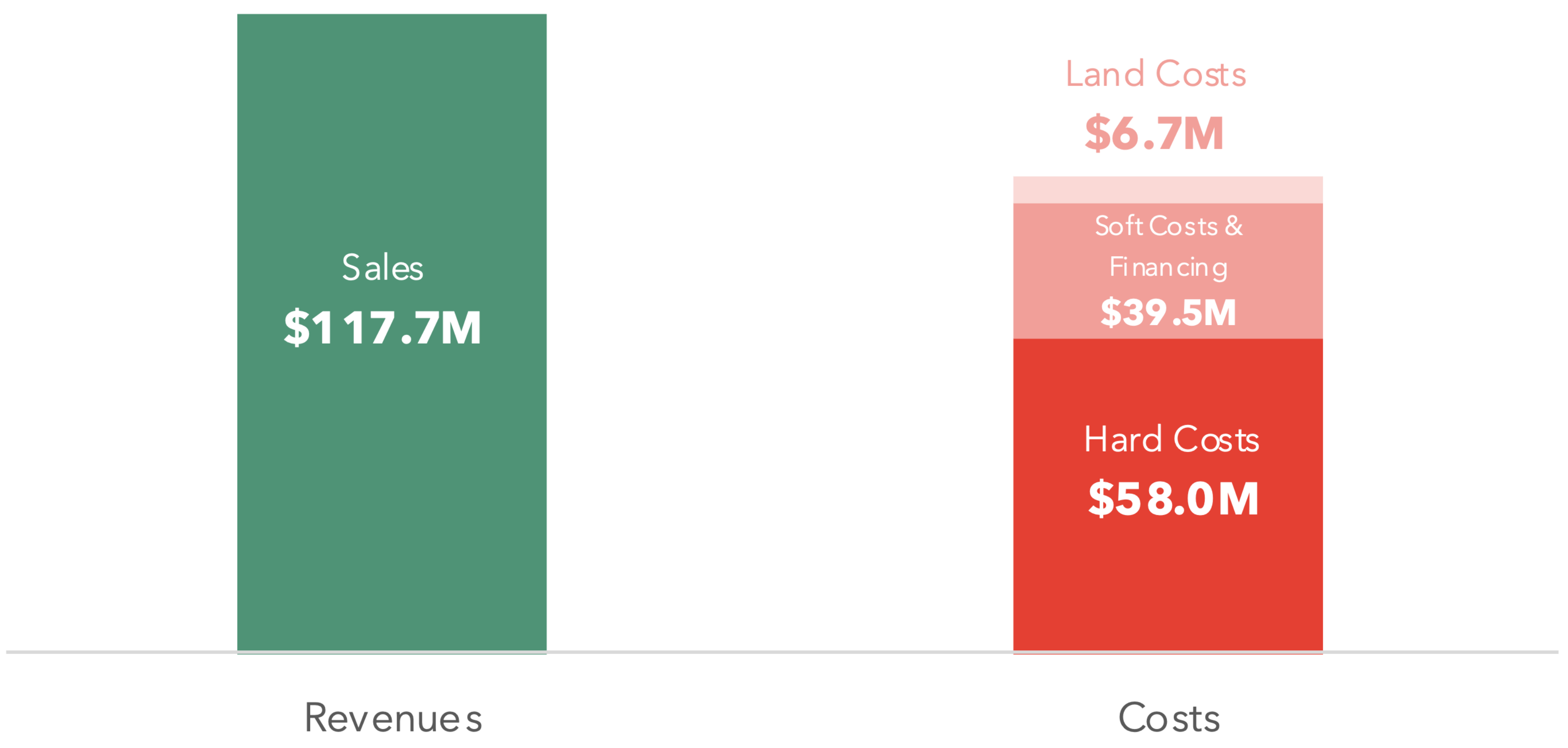
Sensitivity: Reducing Density from 20-Storeys…How Low is Still Feasible?

- A minimum density of **145 units** is required to accommodate rental replacement units while achieving a target IRR of 15%.
- At approximately 11 units per floor (consistent with the original building typologies established for testing as part of our original 2023 and updated 2024 baseline analyses, this translates to a **14-storey building**.



Profit	IRR	EMx
$13.2M	15.4%	1.66x

TASK #2: SENSITIVITY ANALYSES

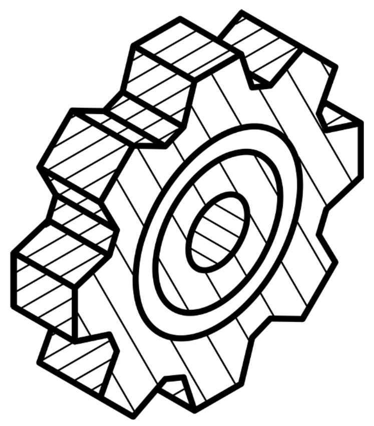
RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

- At 14 storeys, we note that this amount of height and density would exceed categories relating to "Missing Middle"–and specifically "Mid-Rise"–developments in the Kitchener context altogether (regardless of the exact definition used*). That said, per previous reporting by Parcel, many of the developments in this typology range are already infeasible as a function of broader market conditions and macroeconomic factors. The **introduction of a rental replacement bylaw is not expected to–in and of itself–render Missing Middle projects infeasible**.

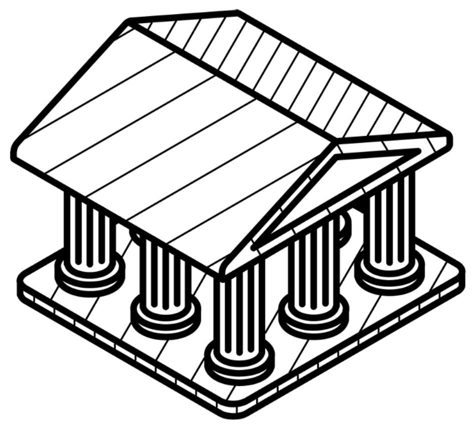
  **As-of-right @ 6-storeys / latest municipal policy direction @ 8-storeys / Parcel recommendation via 2023 Enabling Missing Middle & Affordable Housing work @ ~12-storeys.*

- More specifically, it is likely that **additional incentives and/or supports will be required** to encourage the development of Missing Middle projects in other development contexts across the City (i.e., sites without existing rental units). As identified through previous work undertaken by Parcel on behalf of the City, this could include a mix of Financial, Process and Policy-based incentives, as applicable.

Financial



Process



Policy

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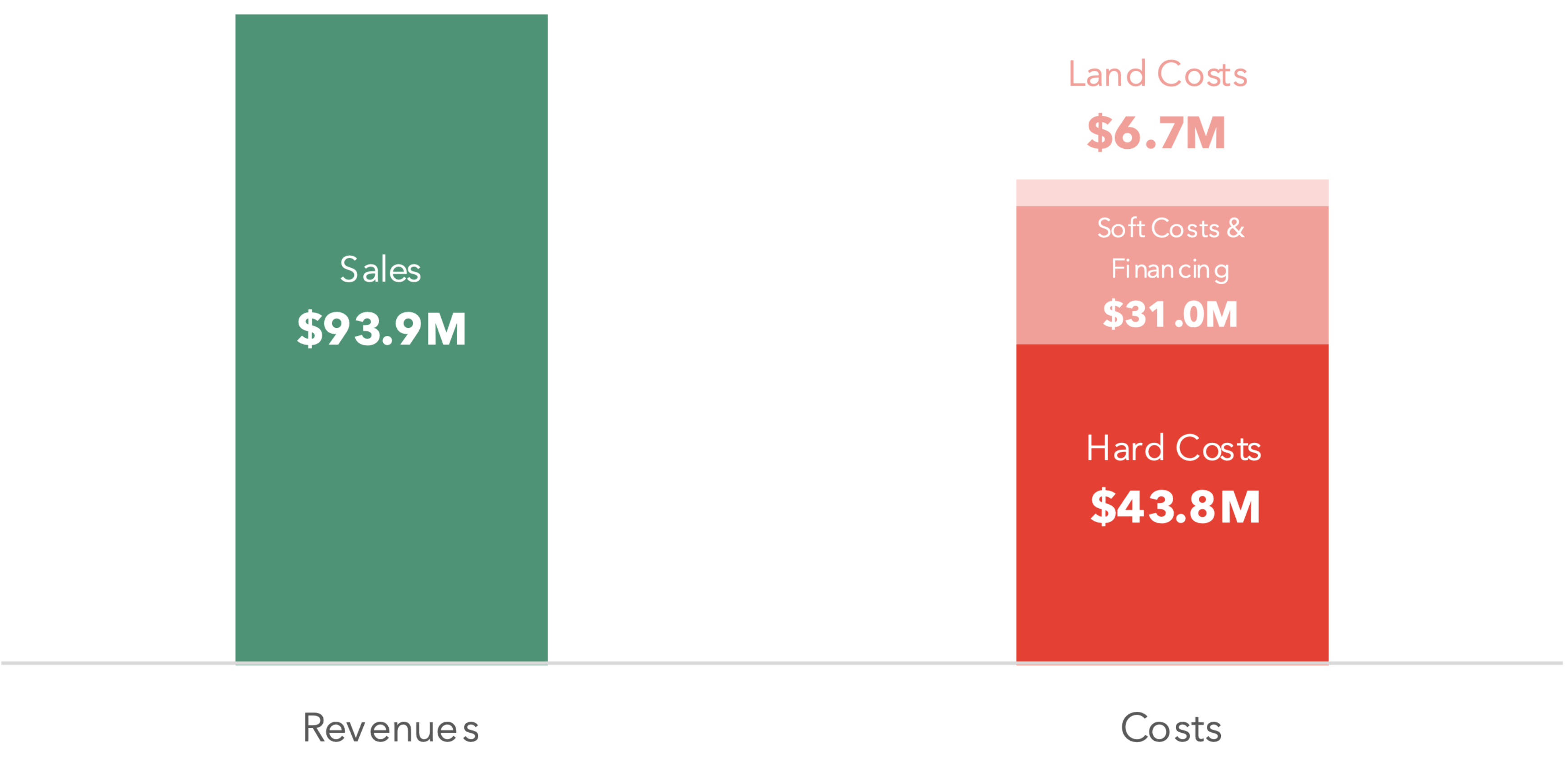
RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

Sensitivity: Parking Adjustments

- A development could feasibly replace 6 units in a **12-storey building** if **50% of parking is provided as surface parking**. However, site dimensions and density may constrain the ability of a site to accommodate surface parking.

12-Storey Building w/ 50% Surface Parking



Profit	IRR	EMx
$12.4M	15.4%	1.80x

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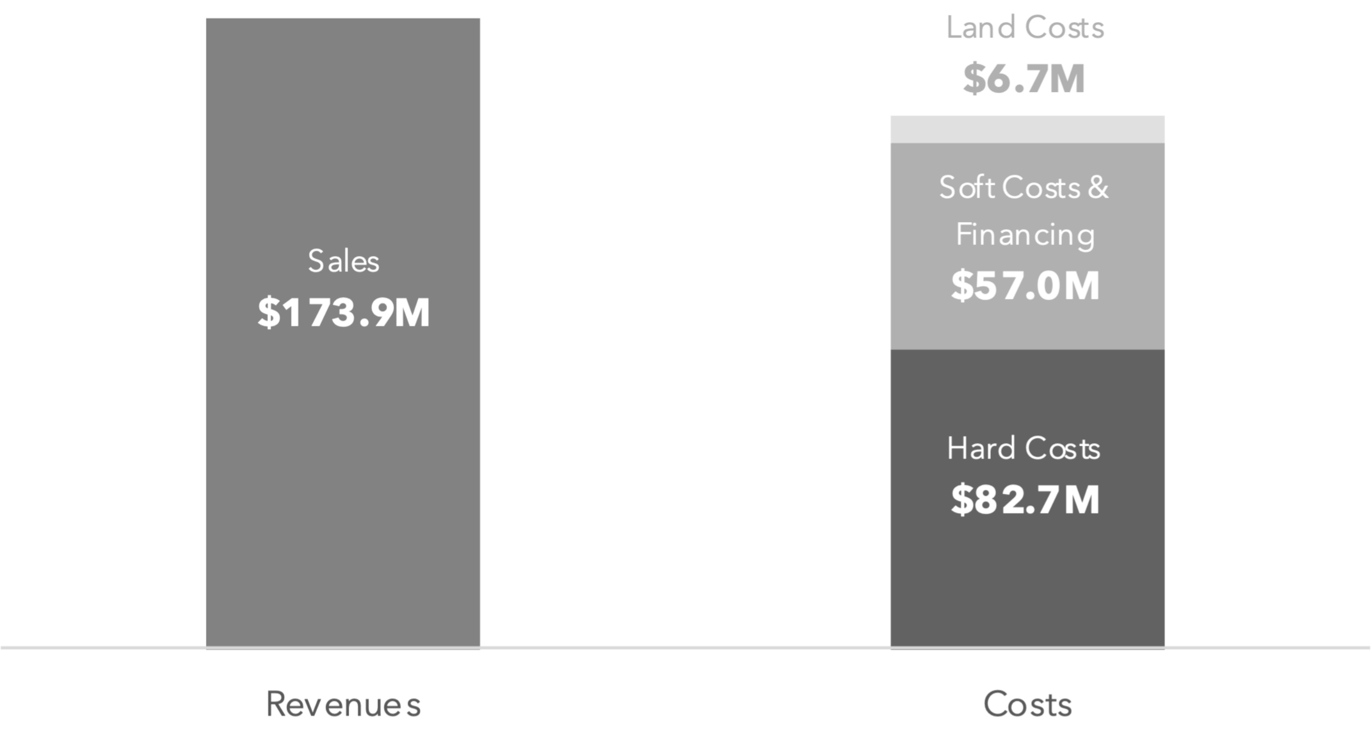
Sensitivity: Exempting Replacement Units from Density Calculations

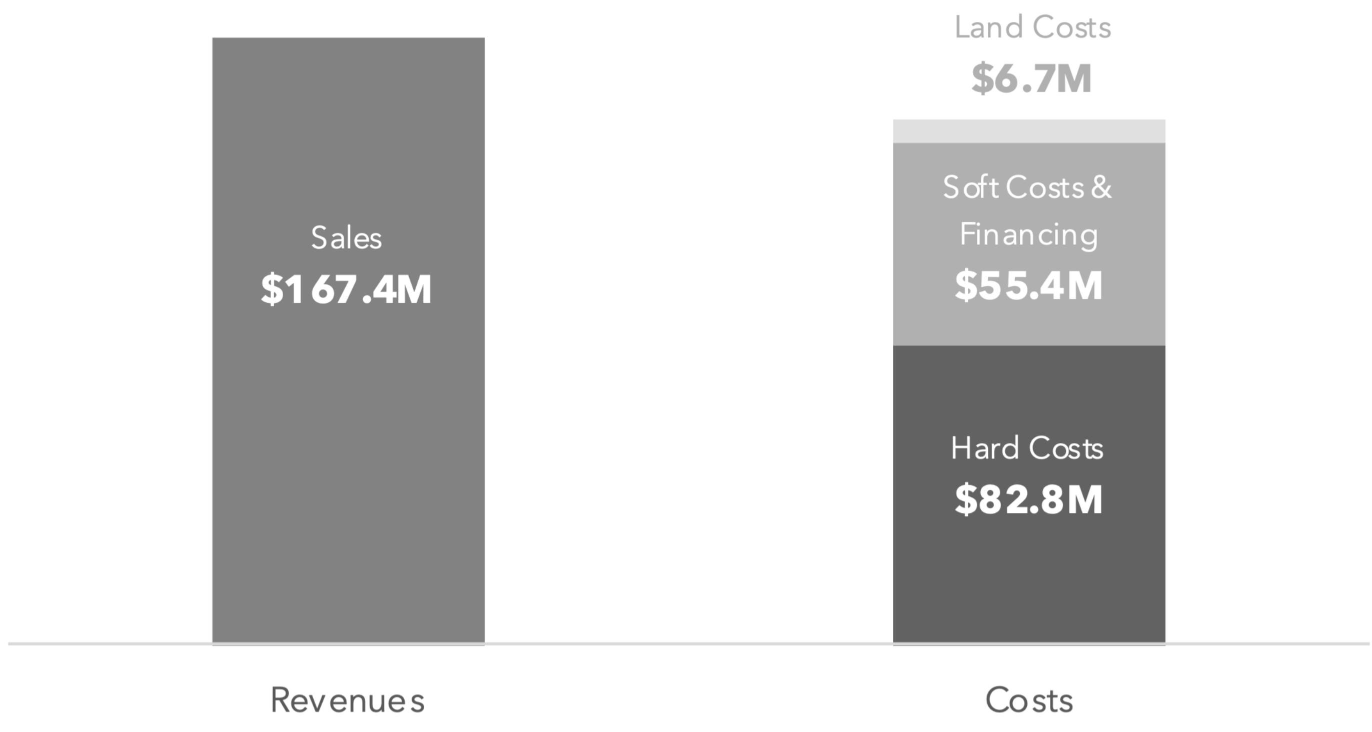
- Exempting replacement units from density calculations **improves return metrics**, but still not as strong as without rental replacement.

Model 1.1: 210 Units
(210 Net New)



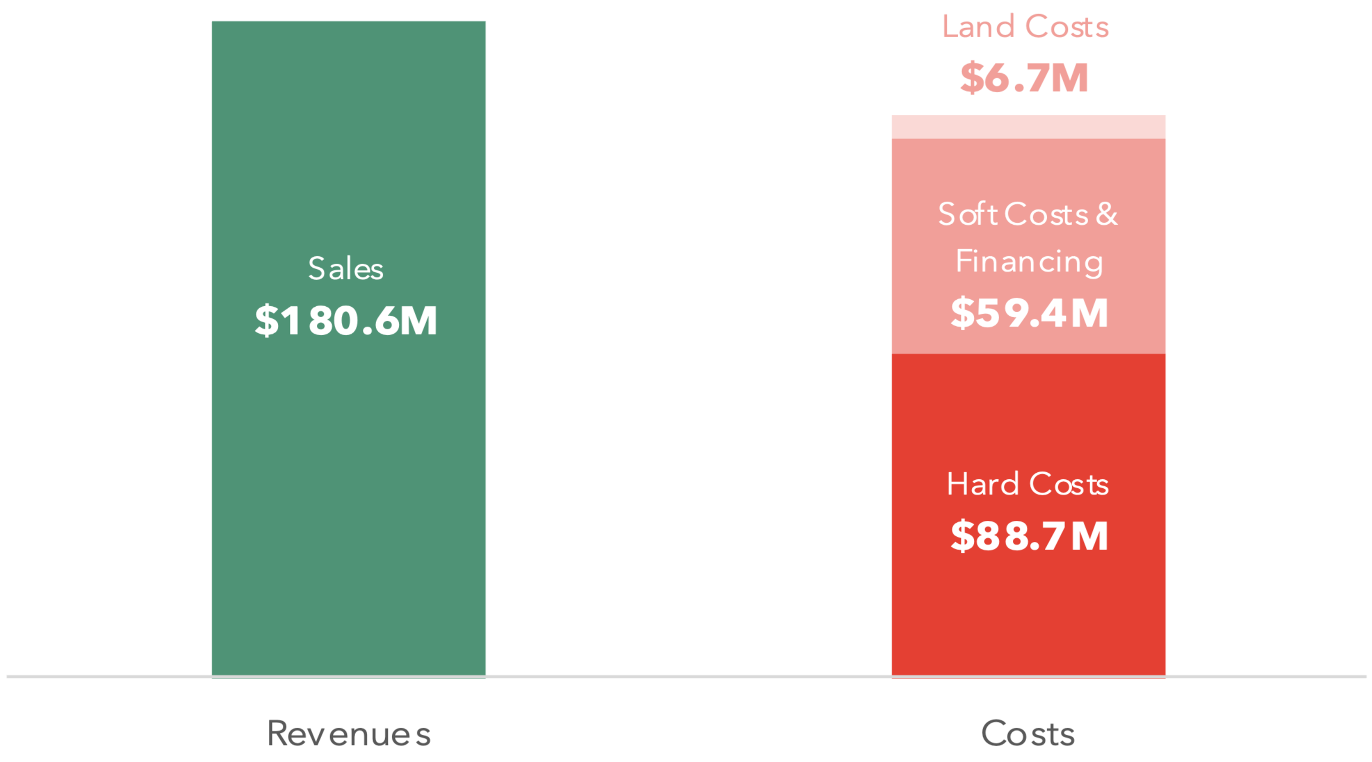
Profit	IRR	EMx
$27.5M	26.2%	2.00x

Model 1.2: 210 Units
(195 Net New + 15 Replacement)



Profit	IRR	EMx
$22.5M	19.3%	1.81x

225 Units
(210 Net New + 15 Replacement)



Profit	IRR	EMx
$25.8M	21.2%	1.87x

TASK #2: SENSITIVITY ANALYSES

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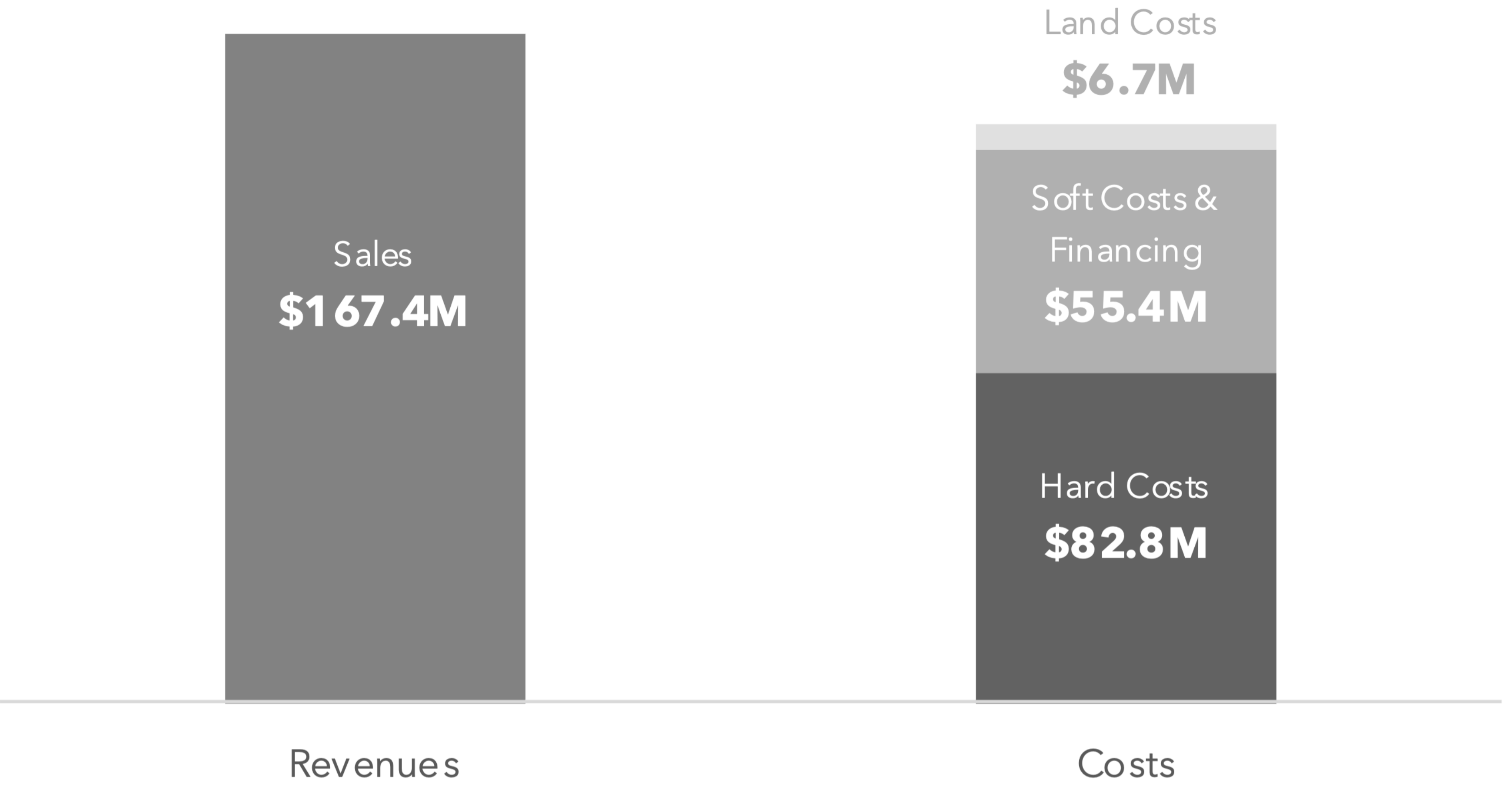
Sensitivity: 5-Year Affordability Period

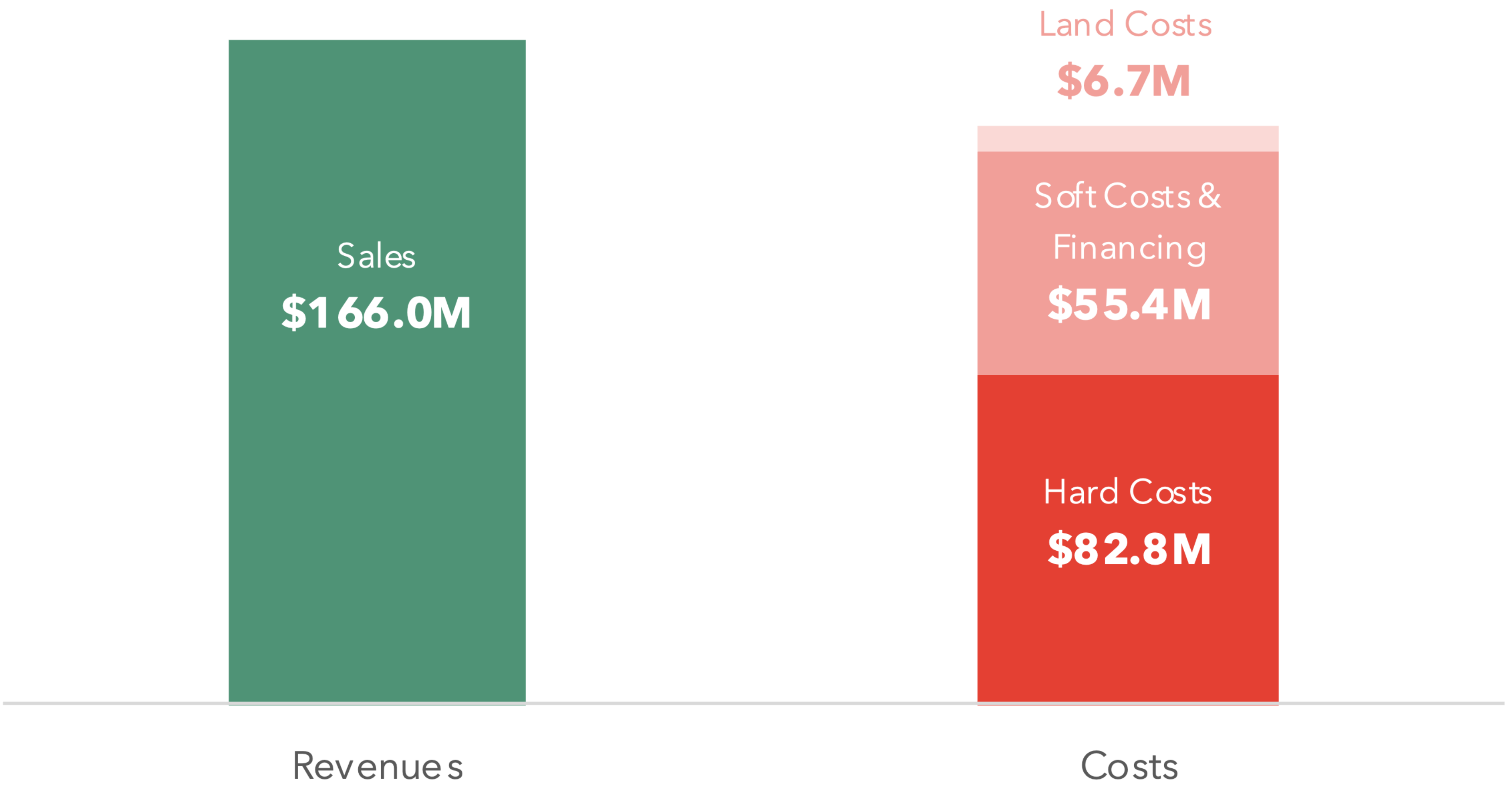
- Shortening the affordability period from 10 years to 5 years **improves project viability, though not meaningfully enough** to encourage redevelopment that otherwise would not occur.

Model 1.2: With Rental Replacement
(10-Year Affordability)



Profit	IRR	EMx
$22.5M	19.3%	1.81x

With Rental Replacement
(5-Year Affordability)



Profit	IRR	EMx
$21.1M	19.7%	1.76x

TASK #2: SENSITIVITY ANALYSES

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Sensitivity Summary (Financial Feasibility "Lens")

	Condo					
	Model 1.1	**Model 1.2**				
	No Replacement	With Replacement	Minimum Density	Minimum Density w/ Surface Parking	Additional Density	5-Year Affordability
Profit	$27.5M	$22.5M	$13.2M	$12.4M	$25.8M	$21.1M
IRR	26.2%	19.3%	15.4%	15.4%	21.2%	19.7%
EMx	2.00x	1.81x	1.66x	1.80x	1.87x	1.76x

Improves Return Metrics

Marginal Impact on Return Metrics

FEASIBILITY SUMMARY

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FEASIBILITY SUMMARY

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Key Observations (Financial Feasibility "Lens")

- Projects of all types and sizes are **currently challenged from a financial feasibility perspective**. This is a function of factors that are both within and beyond the immediate control of the City of Kitchener.

- New purpose-built rental projects in particular are **strained to achieve feasibility as a baseline condition**, both in the local Kitchener context, but also most other jurisdictions across Canada (i.e., short of selected high-value neighbourhoods where new units command a sufficient premium to offset significant upfront capital requirements).

- **A rental replacement bylaw in Kitchener risks further exacerbating this underlying condition, but is not necessarily the sole factor contributing to poor feasibility**.

Note: Financial feasibility represents just one "lens" through which policy-related decisions need to be made, albeit an important one to ensure realistic implementation. In addition, a range of other economic and social factors need to be addressed – including the adequate provision of housing for a full range of income levels and household types to ensure local economies are supported longer-term (e.g., support labour force, etc.).

FEASIBILITY SUMMARY

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“Levers” to Improve Feasibility (Rental Replacement-Specific)

- Limit / waive requirements to replace existing rental units (either in whole or as part of specific development conditions)
- Increase the threshold for which rental replacement applies to enable smaller scale developments (e.g., remove as a barrier for sites with 6-12 existing rental units only)
- Exempt replacement units from density calculations
- Shorten the duration for which replacement units are required to maintain pre-development rental rates (e.g., from 10-years to 5-years)
- Reduce parking requirements and/or consider alternative delivery methods (e.g., surface and/or interim parking solutions, etc.)

Note: Although many / all of these factors could improve conditions for financial feasibility, they <u>may be ineffective in terms of achieving other identified housing-related policy objectives</u>. They all come with <u>trade-offs</u> that need to be weighed by the City.

FEASIBILITY SUMMARY

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RENTAL REPLACEMENT: FINANCIAL FEASIBILITY UPDATES

"Levers" to Improve Feasibility (General)

Density

- Greater density permissions generally makes it more feasible to absorb a smaller proportion of rental replacement units, *in theory*. However, larger redevelopment projects will likely only be viable on sites that currently house larger rental buildings / via lot assembly involving multiple rental properties. As such, density alone, though necessary, does not guarantee increased financial viability.

- Expanding the definition of Mid-Rise developments to at least 12-storeys+ as-of-right could also aid feasibility via time efficiencies in the entitlements / approvals phase.

Government Fees as a Component of Total Development Costs

- Municipal and regional fees are a relatively small component of project costs, constituting between 6% and 7% of total development costs. Approximately 85% to 90% of these fees are development charges.

- Given DCs are already waived on replacement units (and discounted in the case of rental units), there may be limited ability for the municipality to further reduce fees to meaningfully improve financial viability of rental replacement.

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THANKS
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