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Bylaw for a Diverse Metropolis

Response to Municipal Consultation Document

The Real Property Association of Canada (REALPAC)

October 2019

The Real Property Association of Canada ("REALPAC") is Canada's senior industry association for owners and managers of investment real estate. Our members include publicly traded real estate companies, real estate investment trusts ("REIT"s), private companies, pension funds, fund managers, banks, and life insurance companies, with cumulative real estate assets under management between $600 Billion a $1 Trillion CAD. The association is further supported by large owner/occupiers and pension fund advisors as well as individually selected investment dealers and real estate brokerages.

We are encouraged to see that the municipality of Montreal is undertaking a thorough review of the city's development policies to improve housing affordability and choice for all of Montreal's residents. It is our hope that through the consultation process, the government will recognize that there is widespread agreement on many of the policy proposals from the real estate and housing sectors with respect to how to effectively and more affordably increase Montreal's housing supply without stifling investment in the city. We equally hope that the government will enact changes proposed through this process with the support of, and in partnership with, the industry.

REALPAC and its membership believe that the *Bylaw for a Diverse Metropolis* too highly regulates the Montreal housing and real estate market, to the detriment of the City of Montreal's business competitiveness and affordability for families and those looking to buy homes and grow businesses. REALPAC is always supportive of government taking an active role in working with the development industry to address problems affecting our cities. However, this needs to be done in partnership with the community. The industry's initial reaction to the 20-20-20 initiative has been tempered, with initial communications from the City of Montreal suggesting that the draft bylaw has been updated to address industry concerns.

In this submission, we outline our industry's views on some of the most critical issues impacting Montreal's new bylaw and suggest key actions for the government's consideration. These recommendations are offered respectfully, based on inner-industry consultations with senior-ranking members who routinely evaluate Montreal's investment attractiveness, and develop the homes, offices, and infrastructure that Montreal's economy depends on. The following is an outline of major subjects covered in this submission;

1. **Defining affordability**
2. **Owner-Occupied vs. Rental Policy Issues**
3. **Paris 2020 – Affordable Housing Strategy**
4. **Inclusionary Zoning in Ontario – REALPAC's Research**
5. **Collective Policy Issues**

REALPAC's commentary on the above four issues contain a variety of recommendations, which in our view, will meaningfully improve the bylaw's goal of increasing diversity of housing choices and costs in Montreal.

1. Defining Affordability

Montreal's new *Bylaw for a Diverse Metropolis* lacks clear definitions for defining affordability. Affordable housing can have many different definitions as, left undefined, affordable becomes predicated on the individual's budgeting decisions as opposed to a policy direction. There is also a clear distinction between "affordable housing" and housing affordability. The former speaks to a certain class of housing which generally prices units at a discount in relation to the local market pricing of housing. The latter refers to the relationship between the local housing market and area median income, which would price housing according to local wages.

Many municipalities choose to defer to the Canadian Mortgage and Housing Corporation's (the "CMHC") market rate for the region to define a floating price measure of affordability in relation to the average price of housing in the city, such as in the case of Toronto's Housing Now initiative. Measures like this give a clear rationale between the price of affordable housing and the broader housing market. Toronto defines affordable as 100% of area average rent. Other qualifiers may bring this down to 80% or even 30% to serve deep housing need. This model uses market pricing as a benchmark to ensure that the subsidies being contributed by market-rate purchasers are not disproportionately benefitting occupants of affordable units.

An alternative approach, as was used in many HOPE VI program projects (United States *Department of Housing and Urban Development*) was to define affordable as a proxy of area median income, ensuring that those below the area's 50th percentile of earners could still access housing. This model accepts that, in some markets, externalities have detached housing prices from the local economy, especially with the rise of 'not for housing' housing investment. There are two well-documented models for pricing affordable housing: against the market or against local wages. Both ensure a balanced approach to pricing affordable housing such that it does not disproportionately improve affordability for one group of residents while increasing the cost of housing for all other residents. In the draft *Bylaw for a Diverse Metropolis* the City of Montreal has used neither model.

The *Bylaw for a Diverse Metropolis* detaches the prices of units from both the housing and labour markets while entrenching such pricing in the bylaw. Within the English language summary document, under a text box labelled "A few definitions" affordable housing is defined as,

> "Under the bylaw, housing is considered affordable if its price or rent is situated below the limits defined by the bylaw. These ceiling prices are equal to or slightly lower than market prices for modestly designed housing units" (Pg. 7).

The language of this statement does draw a connection to market prices of 'modestly designed housing units', but that is not a clearly defined nexus. Further to this, Section IV of the draft bylaw, entitled *Requirements for Affordable Housing*, contains subsection 22(1) and 22(2) which outline how government is planning to entrench fixed unit prices for all subject developments:

22. For the purposes of the definition of "affordable housing":
(1) the maximum selling price is established in the table below, for each territory defined in Appendix A and according to the typology, including any storage space residential, taxes and rebates and excluding any parking space:

	Centre-ville	Quartiers	Périphérie	Extrémités
Studio	$225,000	$225,000	$200,000	$180,000
One Bedroom	$280,000	$280,000	$250,000	$200,000
Two bedroom	$325,000	$325,000	$280,000	$240,000
Three Bedroom	$450,000	$450,000	$400,000	$350,000
Affordable Family Unit	$450,000	$450,000	$400,000	$350,000

(2) the maximum rent is established in the table below according to the territory defined in Annex A and according to the typology, including, where appropriate, all services offered with the rent:

	Centre-ville	Quartiers	Périphérie	Extrémités
Studio	$880	$880	$675	$585
One Bedroom	$1040	$1040	$810	$720

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Two bedroom	$1440	$1440	$990	$810
Three Bedroom	$2000	$2000	$1170	$927
Affordable Family Unit	$2000	$2000	$1170	$927

Subsection 23 outlines additional requirements for such units stating:

> 23. Where affordable housing referred to in section 19 is offered on the rental market, the agreement must include an obligation to include an appendix to the lease to provide for the rent payable for the 5 years following the date on which the building will be ready for the use for which it is intended will not be increased by more than 2% per year and that it will not be able to be amended by the court.

Separation of market pricing vis-à-vis static pricing with no clear and ongoing calculation nexus stratifies supply and creates a two-tiered supply market. As the costs of development and market-rate housing continue to climb, static pricing will continuously fall further and further below market pricing and increase upward pricing pressure on all other unit types.

While supportive of any policy that seeks to improve the cost of living and quality of life for residents, REALPAC does not believe that this strategy for securing affordable housing as part of an inclusionary zoning regime contributes towards a fair and affordable market for all.

Montreal is still considered to be one of the more affordable major urban centres in Canada. Detaching unit prices from markets effectively ignores the factors that continue to contribute towards market-wide affordable housing in Montreal. Rather it carries the potential to hand select residents an affordability windfall while increasing costs for everyone else.

Recommendations:
- *Define affordability by using a nexus reflective of either local household income or local housing markets and allow unit prices to reflect area market rents or median household incomes*
- *In combination with the above, increase or remove the 2% rent escalation clause to permit unit pricing and operators to reflect changes in the local market, increased operating costs, and cost-recovery*
- *Enact policy measures to protect market-wide housing affordability*

2. Owner-Occupied vs. Rental Policy Issues

The *Bylaw for a Diverse Metropolis* treats purpose-built rental development and for-sale condominium development as almost identical. The two are separate forms of real estate with different financing and operation models. Specifically, purpose-built rental development is hampered by a long-tail business model with limited cost-recovery options.

A 2017 CMCH analysis of rental housing within six of Canada's major housing markets found that cash-on-cash returns on purpose-built rental developments were typically negative. In the case of Montreal, average annual 10-year returns ranged from -5% to -1% with an average of -4%. When the model was modified to assume no-land costs (assuming the owner was re-using land or received 'free' land) returns still ranged from -3% to +1% with an average of -2% over a 10-year period. This metric accomplishes two things;

1. It communicates how unattractive purpose-built rental is becoming as an asset class to developers and investors.

2. It also demonstrates how unsustainable a real property rental asset is over a 10-year period under development regimes across the country.

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The long-term goal of most housing policy is to encourage supply that could affordably be maintained in perpetuity; that is the rents being paid to the building's operators cover the operations, capital improvements, and debts. The CMHC research shows that for this to be achievable for purpose-built rental developments in Montreal the average apartment would need to be leased for between 14%-38% more than the current market average.

Rental Housing Service Providers are unable to immediately pass on increases in the costs of operating a building unlike how a condominium developer can recoup all costs at the time of the sale. In comparison to freehold housing development, purpose-built rental development is not a competitive asset class. However, it is an attractive housing option for lower-income households and people requiring flexible housing options. As such, it is incumbent upon government to address the unique challenges in purpose-built rental development and help to make it a more viable development option in major urban centres like Montreal. A bylaw which acts to set the rents on some units in an identical fashion to how the policy seeks to regulate condominium pricing would not be helpful in this scenario. Any change that pushes rents down on some units will have an elastic effect on other units by pushing rents higher or making development unfeasible for a greater number of development scenarios.

Recommendations:

- *Enact incentives for developing purpose-built rental development in Montreal*
- *Evaluate the City of Montreal's surplus land portfolio for opportunities to partner with industry on affordable purpose-built rental housing projects*
- *Decouple utilities and maintenance from rent-controlled or rent-stabilized units*
- *Waive, exempt, or reduce affordable purpose-built rental units from development charge and property tax calculations (similar to the policy model in use in Ontario)*

3. Paris 2020 – Affordable Housing Strategy

The City of Paris, in 2014, unveiled plans that no doubt inspired Mayor Plante's 20-20-20 initiative. The Paris 2020 affordable housing plan is an initiative that redesigns how cities can offer and create affordable housing. Paris 2020 involves both the dedication of public funds towards new housing developments as well as a housing "buy-back" plan, with the City of Paris releasing a list of apartments that they have right of first refusal to buy and transform into affordable housing units. The strategy is similar to the City of Montreal's plan, however, four key components present in the Paris plan are lacking in the *Bylaw for a Diverse Metropolis*.

1. *Legal Authority*

The City of Paris has legal authority to place limitations on real property sales through requiring Right of First Refusal on a limited selection of named addresses.

2. *Public-Sector Investment*

The City of Paris is building 7,000 new public housing units annually between 2014 and 2020.

3. *Quiver of Solutions*

The City of Paris is not solely relying on inclusionary zoning requirements (or affordability set-asides) to meet their federally mandated 20% affordable housing targets. Rather, a quiver of policy solutions all combine to make meaningful affordability advances in both the public and private housing markets.

4. *National Mandate*

The City of Paris' 2020 plan is the result of the completion of a required conformity exercises with federally mandated affordability targets for municipalities over a certain size.

Montreal 20-20-20 transplants some of the most distortive pieces of the Paris plan without adapting some of the most supportive.

First, when setting unit rates, the *Bylaw for a Diverse Metropolis* is fixing the rates of all affordable housing units within the bylaw, with a limited annual rent escalation clause. This is counter to the Paris approach which implemented a right of first-refusal program that specifically designated addresses. The units are still to be sold at a rate based on the market, owners have the right to appeal the government's price to a judge, and they have the right to opt not to sell the unit or remove it from market. Montreal's policy direction instead requires social housing units to be included in new developments over 5 units and sets the rates for affordable housing units to be included in new developments of over 50 units. Paris has the legal authority to implement their program, Montreal does not. It is not known how the courts will allow Montreal to exert a similar authority over all required housing set asides within its civic boundary. The government is free to set the rates on their own public housing units but should be cautioned against setting fixed rates on privately owned and operated units. If one of the end goals of this new municipal policy is to create a prosperous, diverse, and vibrant city such pricing intervention will cause market distortions counter to this goal.

Decoupling units from the market rate only works if the building is fully paid off, owned-operated by the public sector, and has alternative revenue sources for covering maintenance cost increases and capital improvements.

Recommendations:

- *Leverage the municipal policy levers that Montreal does have to incent the provision of affordable housing units.*
- *Municipally invest in new housing developments either through public development or private-sector partnership.*
- *Consider inclusionary zoning and rent control policies as part of a bundle of tools that can be used to create new supply and maintain its affordability.*
- *Access funding and programs made available through the federal government's National Housing Strategy to augment existing municipal efforts to improve housing affordability.*

4. Inclusionary Zoning in Ontario – REALPAC's Research

REALPAC previously conducted research regarding the efficacy of inclusionary zoning ("IZ") policies when the Government of Ontario was drafting a similar policy frame-work initiative to promote affordability within the province. The *Bylaw for a Diverse Metropolis* repeats many of the policy issues that REALPAC's research found were ineffective and did not reflect best practice. To be successful, any IZ -style initiative must be accompanied by a comprehensive review of regulations impacting the cost of housing in Montreal. For an affordable housing initiative to be viable, government needs to collectively address regulatory and market-wide barriers to initiating a market-wide reduction in costs.

1. *Market & Resident Adaptability:*

One of the justifications for this new policy approach is that Montreal is now having to compete with outer-lying suburban municipalities that can provide larger housing units at more affordable price points. IZ set-asides are best implemented at a regional or provincial level. Research shows that defining IZ requirements and thresholds at the provincial level creates a more stable, consistent, and predictable development climate. The *Bylaw for a Diverse Metropolis* carries with it the propensity to create vastly different development environments between different municipalities and, with different prices for different areas in Montreal, even within different neighborhoods. Due to volatile cross-region set-aside policies, the *Bylaw for a Diverse Metropolis* may distort the regional housing market and act to increase demand outside of Montreal rather than quell it.

2. *Ownership Viability:*

By enabling homebuyers to build equity and sell their units at a profit, potential owners should be able to exit 'affordability' oriented ranges in the housing market and upgrade to market-rate housing. Entrenching unit prices in the bylaw would see homebuyers trapped in the inclusionary zoning market and require higher and higher numbers of units to be added to the market in this pricing tranche as opposed to the market-rate housing that helps to subsidize the cost of providing set-aside units.

3. *Unit De-control:*

Maintaining pricing control over a unit can severely impact an owner's upward mobility and the financial feasibility of them leaving the 'affordability' oriented spectrum of the housing market. Fixing both the rents and sale prices of units with an escalation clause only allowing an annual rent increase of 2% raises questions about the future sustainability of these units. The bylaw is unclear if units will reset to the entrenched prices after 5 years or if operators are allowed to modify the rents. REALPAC advances that allowing Rental Housing Service Providers to set rents such that they can cover maintenance expenses and recover costs will help to keep buildings in a state of good repair and affordable long-term.

4. *Exclusionary Zoning:*

Inclusionary Zoning advances a regulatory solution without addressing the crux of the problem it is attempting to solve. Diminishing housing affordability in Montreal is linked to a complex array of factors, some of which can be easily addressed by municipal policy interventions and some cannot. Updating zoning bylaws to reflect the policy goals of the City of Montreal would help to align development regulations with development goals and meaningfully contribute to improving market-wide housing affordability.

Recommendations:

- *Ensure the new bylaw does not further reduce Montreal's competitiveness with other municipalities.*
- *Modify affordability requirements to allow residents to use units as a tool for socio-economic mobility.*
- *Allow for unit decontrol to lessen stigma on the units and ensure increased operating and maintenance costs can be reflected in sale prices and rents.*
- *Address other barriers to affordability in zoning or municipal policy that make development difficult and expensive.*

5. Collective Policy Issues

The *Bylaw for a Diverse Metropolis* is a unique policy amongst its peers. It at once proposes both an IZ-style set aside rate as well as rent- *and* price-controlled units detached from both the housing market, local labour markets, and inflation-based increases reflective of costs. Both of these requirements are uniformly applied with no discretion given to the nuances of tenure types or how buildings are supposed to support these units long-term. This is a sweeping policy that paints the development and real property industries with broad strokes and leaves the building community with few, if any, options for delivering new housing within Montreal.

Rental Housing Service Providers ("RHSPs") and housing developers set their own prices, unit-type ratios, and unit sizes based on proforma calculations and what the market is willing to bear. The issue at hand is that of government overreach into a dynamic market, one in which ebbs and flows. It is REALPAC's opinion that affordability will only be further aggravated by the *Bylaw for a Diverse Metropolis*, an issue which is opposite to the goals of this policy intervention.

The Montreal 20-20-20 initiative needs to make it clear who or what it is serving.

The private development market cannot be solely relied upon to rebalance the housing market and overly regulating it is not the sole policy tool required to create mixed-income communities and improve housing affordability. Key components of the Paris plan are the precise tactical interventions, at market rates, that the City of Montreal could use to create opportunities to re-establish affordable housing supply in neighbourhoods with limited supply choice and affordability issues.

Recommendations:

- *Narrow direct interventions so that they are tactical and precise in nature.*
- *Implement policies to help support affordable units such that they are sustainable long-term*
- *Leverage government's surplus land supply to provide low-cost/no-cost land for purpose built rental development*
- *Engage industry in a partnership model to make fulfilling affordability requirements feasible and to promote development opportunities in Montreal*

On behalf of Canada's wider real estate and development community including many of the companies building in Montreal, we would like to commend the City of Montreal for addressing how to make the city more affordable as the issue emerges, rather than at the apex of a crisis. REALPAC is highly supportive of local politicians taking direct action with regards to front-running perceived supply issues within Montreal. We hope that municipal staff will carefully consider the suite of policy recommendations contained within this submission and look forward to working with the City of Montreal on the development of a more balanced and effective approach to housing development for years to come.

We invite you to contact us with any questions or concerns with this submission at the coordinates below.

Respectfully submitted,

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SCHEDULE 1

Executive Summary- REALPAC Policy Recommendations

Bylaw for a Diverse Metropolis

October 2019

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