CITY OF VICTORIA

Committee of the Whole Report

For the Meeting of October 5, 2023

To:	Committee of the Whole	**Date:**	September 14, 2023
From:	Karen Hoese, Director, Sustainable Planning and Community Development		
Subject:	**Rental Housing Incentives**		

RECOMMENDATION

That Council direct staff to:

1. Prepare a Revitalization Tax Exemption Bylaw to incentivize the inclusion of units affordable to median income households in new market rate rental developments and to encourage additional investment in non-market rental housing projects.
2. Report back on the results of the Revitalization Tax Exemption program after two years of the Revitalization Tax Exemption Program Bylaw being in effect for rental housing projects.
3. Consider a 50% reduction in Development Cost Charges for non-market rental housing projects through the Development Cost Charge Program Review.
4. Update the Victoria Housing Reserve Fund Guidelines to align with senior government programs, remove the maximum grant cap, increase up front grant payments, support larger family friendly units and equity deserving groups, and fund below-market housing units as described in the report.
5. Prepare a Rental Housing Policy and Incentives Handbook, as described in the report.

EXECUTIVE SUMMARY

The purpose of this report is to provide Council with a recommended approach for establishing new rental housing incentives. The Rental Incentives project addresses actions from the *Victoria Housing Strategy* (VHS) *Phase Two: 2019-2022*, the calls to action from the Vancouver Island Housing Leadership Network, and a Council motion from July 2022 relating to offering the Right of First Refusal (RoFR) to displaced tenants at their previous rents.

The City already has a number of measures in place to encourage the development of non-market and market purpose-built rental housing, and to support tenants when the redevelopment of an existing rental home does occur. This report considers additional incentives to support non-market rental housing developments and the inclusion of units affordable for households with median incomes in market rental projects.

Renters in Victoria continue to deal with an extremely tight rental market with the vacancy rate remaining around 1%. For many renters, the monthly rents in new purpose-built rental buildings are requiring much more than 30% of household incomes. Accordingly, the City is looking for ways to encourage rental housing investment and respond to the affordability challenges.

The proposed rental incentives would introduce a Revitalization Tax Exemption (RTE) Bylaw for 100% of the incremental increase in land and improvements values associated with redevelopment for ten years – the full exemption permitted under the provincial legislation (for greater detail see Attachment C). Staff recommend that non-market rental projects, owned and operated by public housing bodies, be provided a 100% RTE and a 50% reduction in Development Cost Charges (DCC). For market rental projects, the RTE would incentivize the inclusion of 10% of units that are affordable to median income households and offer the right of first refusal (RoFR) at Victoria's median rent rate for tenants displaced by redevelopment. In recognition of the current challenging market conditions for new construction, an alternate recommendation is identified describing how the RTE Bylaw could be structured to provide a 50% exemption for secured market rental projects without requiring on-site affordability for the next two years.

There are also recommended updates to the Victoria Housing Reserve Fund (VHRF) guidelines to provide additional support to non-market rental housing projects. The updates would bring the VHRF program into alignment with CMHC programs, further support the creation of family friendly units, and remove the funding cap to provide greater support to non-market housing providers during a challenging time for affordable housing development. It is recommended that a below-market rental funding stream be created to acknowledge the reliance on below-market rental units in non-market projects to enhance viability and align with other affordable housing programs.

Overall, Victoria has shown leadership in supporting the development of purpose-built rental housing. However, the City is falling behind its targets in the creation of low- and median-income housing. At the same time, the rising construction costs and high interest rates are making it more challenging to deliver rental housing. The proposed recommendation would provide additional support for non-profit housing providers in recognition that they are seeking assistance from all levels of government and encourage the inclusion of rental housing affordable to median-income households in new market rental housing projects, building on the existing suite of incentives from all levels of government.

PURPOSE

The purpose of this report is to present Council with a recommended approach for providing additional supports for non-profit rental projects and incentivizing the inclusion of units affordable to median-income households in new market rental developments.

BACKGROUND

More than 60% of Victoria's residents rent their home. Currently, the City's rental vacancy rate is hovering around 1% highlighting the urgent need for more rental housing. At the same time, the City's housing targets identify the need for greater rental housing supply to catch up with existing demand in the community and keep up with future needs. But because of high construction costs and rising interest rates it is increasingly challenging for housing developers to build rental housing. As it becomes more difficult to secure financing, many rental projects are at risk of being sidelined or shifted to strata ownership. As a result, the City is exploring ways to build upon existing supports for rental housing to meet the City's rental housing targets.

The Victoria Housing Strategy, Vancouver Island Housing Leadership Network and Council Strategic Plan have identified that financial incentives and other supports could be used to encourage non-market rental housing projects and the development of market rental housing with affordability. Also, in 2022, Council directed that opportunities be explored to use tax exemptions as a tool to support developers in offering displaced tenants the right of first refusal (RoFR) at previous rents to limit displacement associated with the redevelopment of aging rental buildings.

This report reviews potential for new incentives for non-market rental projects and market rental projects with on-site affordable housing.

In summary, the need for affordable housing in Victoria has never been higher. The need to catch up on the City's affordable housing targets combined with a challenging economic climate mean that the City must explore every tool available to help address the affordability gap for renters in the community.

ISSUES & ANALYSIS

Existing Incentives

The City of Victoria has a number of incentives and supports in place to encourage the development of market and non-market rental housing.

Current incentives for non-market rental projects:

- Delegated development permits and exclusion from rezoning through the Rapid Deployment of Affordable Housing (RDAH) process for qualifying projects.
- Fee waivers for development application and building permit application fees.
- Capital grants from the Victoria Housing Reserve Fund (VHRF).
- Land partnerships for affordable housing projects on city-owned lands.
- Supportive land use policies for additional height and density (OCP Policies 6.5 A & B).

Current Incentives for non-market rental and market rental projects:

- Priority processing for rental housing applications.
- Exemptions from the City's Inclusionary Housing and Community Amenity Policy.
- Lower off-street parking requirements (on-going work to review Schedule C).[1]
- Bonus density above the base density for rental projects.

The existing suite of incentives has encouraged a significant amount of rental housing over the last six years. However, rising construction costs and increased interest rates are making it more challenging to deliver new rental projects, and especially difficult for projects with affordable units.

New Incentives for Consideration

Based on a jurisdictional review of the incentives used in other communities, two potential incentives were identified (see table below) for consideration.

Potential Incentive	Description of the Impact
Revitalization Tax Exemption (RTE)	Municipality provides 10-year exemption on incremental increase in assessed value of land and improvements through municipal property tax exemptions.
Development Cost Charge Waivers (DCCs)	Waiver or reduction in the amount of residential DCCs required to be paid to the municipality at the time of building permit application.

[1] Council provided direction to staff in May 2023 to explore options to further reduce off-street parking requirements for all forms of rental housing through the Schedule C Zoning Bylaw off-street parking review.

Both incentives improve the financial viability of new rental housing projects. A revitalization tax exemption (RTE) bylaw provides reduced municipal property taxes for a period of up to ten years on new developments. In addition to the reduced municipal property taxes there are reduced taxes related to the provincial share of property taxes (i.e., School Tax) which is borne by the Provincial Government. The cost savings from the tax exemption reduce the operating costs and allow for more of the rental revenue to service the debt. It is important to note however, that for non-market rental housing the RTE would have less financial benefit than it does for market rental projects because land and improvements for this type of housing are assessed by BC Assessment at lower rates than market developments. In contrast, a development cost charge (DCC) waiver allows for a new project to have lower upfront soft costs as developers have lower DCCs on a per unit basis at the time of building permit application.

Local governments are limited under Section 25 of the Community Charter in their ability to provide assistance to businesses and therefore there are limitations around how a DCC waiver or reduction could be provided to market rental housing providers (see Attachment C). For example, DCCs could be provided to market rental housing projects where the rental rates were secured at below market rates. In summary, both incentives provide financial benefits that could be used to encourage the development of new rental housing.

Economic Analysis

An urban land economist was retained to analyze the financial impact of these potential incentives on a range of rental development scenarios (Attachment B). The analysis looked at both a base case without the proposed incentives and then also determined the incremental financial benefit where a DCC waiver or RTE was provided. Also, the analysis considered the costs of requiring housing objectives such as affordable rental units or family units as a condition of the incentives. The analysis helps to assess if the financial benefits associated with the incentive (i.e., 10-year tax exemption) offsets the costs of the requirements (i.e.,10% of units as affordable at median income rates).

The analysis tested the financial impact of the following incentives:

- 10-year Revitalization Tax Exemption on 100% of the incremental increase in the land and improvement value (100% of the revitalization amount)
- 100% Development Cost Charge Waiver on the residential development cost charges.

The analysis tested the economic impacts of the following requirements:

- requiring 10% of units at rents affordable to households with median incomes
- requiring 30% of units as ‘family friendly’ (two- and three- plus bedroom units)
- examining the impacts of offering tenants displaced from redevelopment the Right of First Refusal at CMHC median rents or their previous rental rate[2].

<u>Findings from Economic Analysis for Revitalization Tax Exemption Tool</u>

For a typical market rental housing project to obtain financing, a lender requires the developer to show an expected profit margin of 10% to 12% or higher. However, developers use a range of metrics to assess the financial viability of a project based on risk tolerance, land costs, profit and cash flow expectations, and capital appreciation. While the market conditions for rental housing are currently very challenging (high land costs, rising construction and borrowing costs etc.) the

[2] The analysis tested 25% of existing tenants returning for an average of seven years based on CMHC data related to unit turnover. Also, the CMHC median rate was used as a proxy for the existing rent rate of the tenants.

economic analysis shows that where a project can reduce off-street parking and build to the maximum density levels of the Urban Place Designation identified in the Official Community Plan (OCP) that many rental projects are on the edge of being financially viable. Accordingly, as the City looks to support rental housing investment it is important to balance the cost-savings associated with any new incentives with any reduction in revenue associated with proposed requirements in a way that complements and builds on the City's existing suite of incentives.

Financial Benefit to Housing Provider

When applied to its fullest extent, the revitalization tax exemption (RTE) tool provides a significant financial benefit to a project with a savings of approximately $9,000 per unit over a ten-year period. The lower property taxes increase the profit margin by roughly 3 to 4%. The considerable financial benefit associated with the tax exemption means that there is potential to require that certain housing objectives be delivered as a condition of the incentive. For example, the requirement of 10% of units at rental rates affordable for households with median incomes is estimated to result in a decrease in the profit margin of roughly 4 to 5%.The analysis shows that the RTE could offset the cost of requiring affordable rental units when combined with other incentives from municipal and higher levels of government (e.g., reduced parking rates and bonus density with new federal GST exemptions and favourable financing rates), helping to ensure a rental project's viability.

Value to Market vs Non-Market Rental Projects

Generally, this tool was identified to be most beneficial to wood-frame (four to six storey) market rental housing projects. Given the higher costs associated with concrete construction the financial benefit is lower for tower projects and as a result less opportunity for the benefit to offset the assessed requirements (affordable units). Also, the tool would have a lower financial impact on non-market rental housing projects as BC Assessment typically assesses land and improvements at discounted rates in recognition of the lower rental revenue that non-market rental projects generate. However, many non-market rental projects are struggling to cover operating costs given rising costs (borrowing costs, insurance, staffing, etc.) and therefore any savings are invaluable in supporting the delivery of deeper affordability in non-market projects. A RTE is valuable to both rental and non-market projects with the greatest opportunity to offset costs of identified housing objectives (i.e., affordable units) in wood-frame construction projects.

Findings from Economic Analysis DCC Waiver

Financial Benefit to Housing Provider

The benefit of a DCC waiver for a market rental project is minor as DCCs represent a small portion of total project costs. For example, the economic analysis indicates that a 100% DCC waiver improves the profit margin of a market rental project by 0.5 to 1.0%. As a result, DCC waivers are likely to have a limited impact as an incentive for market rental housing projects. If the City were to provide this incentive the costs of a DCC waiver would still need to be covered by some other funding strategy (e.g., taxation) as DCCs are required to fund City infrastructure. Generally, this incentive would provide a minor financial benefit to market rental housing providers with greater potential to negatively impact the City's long-term infrastructure planning.

Value to Market vs Non-Market Projects

The impact of a DCC waiver is likely different for market rental projects and non-market projects. For market rental projects even a 100% waiver would have a minor impact on the proforma of a project. However, for non-market rental housing the savings would help increase affordability; non-profit housing providers often struggle to find the funding needed to cover a project's soft costs and therefore the cost of DCCs (approximately $3,000 per unit) are added to the debt of the project and recouped via higher rents. Over the last five years the City has seen on average two non-market rental projects apply for building permits each year. Therefore, the financial impact of providing a reduction in DCCs for non-market projects would be much lower than if it was available to all market rental projects.

Key Takeaways of Economic Analysis

- In cases where a wood-frame market rental project can reduce parking and achieve the maximum density of the OCP urban place designation, a project may be viable despite challenging market conditions.
- The Revitalization Tax Exemption provides the greatest benefit to a project's viability, especially for market rental housing.
- On-site affordable housing and right of first refusal requirements have the greatest negative impact on the viability of a new rental project.
- Where a project is required to provide a minimum of 20% two-bedroom units and 10% three-bedroom units the project's profit margin is reduced by 0.6% to 1.3%.
- The incentives identified would be most impactful for wood-frame construction. Much higher densities would be required to incent the inclusion of affordable units in concrete construction rental projects.
- A Development Cost Charge waiver or reduction carries a direct cost to the City, and analysis shows that it would have a marginal impact on the viability of a market rental project.
- For non-market projects any financial savings typically translate into lower rental rates and greater affordability based on non-profit management of housing.
- Overall, the impact of individual incentives can be meaningful, but the greatest benefit comes from being able to layer multiple incentives across multiple levels of government (e.g., parking, density bonus & tax exemptions).
- The City would need to provide the full revitalization amount for 10 years in order to roughly offset the costs of the proposed affordability requirements (i.e., 10% of units affordable).

The economic analysis highlights that the impact of financial incentives (e.g., RTE) should not be viewed in isolation, but rather considered holistically alongside the city's (and other levels of government) existing suite of incentives. Furthermore, rental housing developers use multiple metrics to assess the financial viability of each unique project. For this reason, the trade-off between pursuing the tax exemption and the requirement of providing on-site affordability will need to be assessed on a project-by-project basis. However, where a project can access various City supports (e.g., reduced parking, bonus density, priority processing, etc.), the RTE may be an attractive tool to deliver on-site affordability. At the same time, there are also CMHC and BC Housing Programs that offer low interest financing and reduced mortgage insurance rates where projects provide on-site affordability, as per the policies of a local jurisdiction, that could further motivate an applicant to pursue the RTE offering. In summary, the analysis demonstrates that despite challenging market conditions for rental housing, the proposed incentives could complement existing incentives that the City provides to help achieve affordable housing targets.

Proposed Incentives Approach

The proposed approach summarized in tables 1.3 and 1.4 recognizes the City's commitment to use all available levers to encourage non-market housing as well as the need to engage market rental housing providers in providing units affordable to renters with median incomes. The proposed incentives would have the greatest potential to encourage housing in areas envisioned for low-rise (up to six storey) wood-frame residential apartments. This approach would support rental housing in the City's urban villages, urban residential areas as well as areas designated Housing Opportunity and Mixed Residential aligning with the City's growth strategy of encouraging housing near villages and corridors. Also, the proposed approach could help preserve on-site affordability where aging market rental housing buildings are redeveloped as they approach end of useful life. The proposed approach summarized in the tables below recognizes the City's objectives related to the development of non-market housing supply, while also providing a new incentive for market rental housing providers to develop units affordable for households with median incomes.

Table 1.3: Non-Market Rental - Proposed Incentives and requirements

Incentive	Benefit	Requirements
Revitalization Tax Exemption (RTE)	100% revitalization amount for 10 years (incremental increase in value of land and improvements).	• Owned and operated by Public Housing Body. • Legal agreement securing rental tenure and affordability for a minimum of 60 years. • ROFR for eligible displaced tenants to affordable units.
Development Cost Charge Waiver	Partial waiver (50%) to be explored via DCC program review of the City's residential development cost charges.	

Table 1.4: Market Rental - Proposed Incentives and Requirements[3]

Incentive	Benefit	Requirements
Revitalization Tax Exemption (RTE)	100% revitalization amount for 10 years (incremental increase in value of land and improvements).	• 10% of units secured via legal agreement as affordable to median income households as per City rates and rental tenure secured in perpetuity. • ROFR for eligible displaced tenants to affordable units (income tested) secured via a legal agreement.

The proposed incentives for market rental housing providers as outlined in the table above seeks to balance the financial benefits to developers with the costs associated with requiring 10% of the units to be affordable for households with median income. In addition, an alternate recommendation is provided that identifies how the RTE Bylaw could be structured to support market rental projects without on-site affordability at 50% of the revitalization amount in recognition of the especially challenging market conditions for secured rental housing at this time.

Additional supports for non-market rental housing

High construction costs, coupled with rising interest rates, are making the delivery of non-market housing in Victoria extremely challenging. To address this issue, several minor updates are proposed to the Victoria Housing Reserve Fund (VHRF) Guidelines that would provide greater support to non-profit affordable housing providers.

[3] More detailed information regarding the proposed conditions or requirements for the various incentives is provided in Attachment C.

Proposed Updates to Victoria Housing Reserve Fund Guidelines

- Remove $500,000 cap for the maximum grant – With rising project costs, the removal of the funding cap would equalize grant support for larger projects and provide additional support at a time when many projects are struggling with funding shortfalls.
- Establish a new funding stream for below-market units – By offering grants for below-market units, the VHRF would support projects where deeply affordable units are subsidized by units rented at below-market rates (e.g., 10% below-market). The starting below-market rents would be determined using an appraisal at time of occupancy or based on an existing funding program (e.g., CRD or BC Housing) that includes below-market units. The grants would be set at roughly 70-80% of the median income VHRF grants. All units would be managed by non-profit housing providers ensuring that over time the below-market units would become more affordable.
- Allow CMHC Co-investment units to qualify as median income units – By recognizing median income units secured through CMHC programs as eligible for the City's median income grants there would be less misalignment between the City and CMHC programs. The CMHC Co-Investment Fund and VHRF both target rent rates affordable for households with median incomes.
- Adjust grant payment schedule – Increasing the initial City grant payment from 50% to 80% prior to construction, with a final 20% holdover payment at occupancy would provide greater liquidity to housing providers during a time when it is expensive to take on greater debt.
- Adjust VHRF project priorities to reflect updated data on priority populations – Update the project priority guidelines to reflect the City's Equity, Diversity and Inclusion work and priority populations analysis of the Housing Assessment and Resource Tools (HART) project.
- Establish a grant amount for four-bedroom units – An increased grant amount for four-bedroom units would reflect the higher construction costs to deliver these larger units. Currently, four-bedroom units are provided the same funding as three-bedroom units under VHRF guidelines.

Next Steps to Implement Incentives

To operationalize the recommended incentives and supports, various policies or bylaws would need to be prepared. The implementation of the rental incentives work is described below should Council approve the recommended approach.

Develop Revitalization Tax Exemption Bylaw for Rental Housing

To provide the proposed rental housing tax exemptions a new City Bylaw would need to be prepared and approved by Council. The RTE Bylaw would outline program objectives, exemption amounts, and any conditions or requirements. All RTE applications would be considered by Council.

Develop Victoria Rental Housing Policy and Incentives Handbook

Victoria has various supports and incentives (Attachment A) currently in place to encourage market and non-market rental housing. A new handbook would ensure clarity around the different policies available to rental housing providers and eligibility requirements to clarify expectations for housing providers.

Update VHRF Guidelines

With Council's direction, the VHRF Guidelines would be updated as described in this report.

DCC Bylaw and Program Review in 2023-24

If Council were to approve exploring a waiver or reduced DCC fees for non-market rental projects, this direction would be considered as part of the current review of the City's DCC program. The outcomes of the program review would result in updates to the City's DCC Bylaw that would be brought forward for Council consideration.

OPTIONS & IMPACTS

Option 1 (Recommended)

1. Prepare a Revitalization Tax Exemption Bylaw to incentivize the inclusion of units affordable to median income households in new market rate rental developments and to encourage additional investment in non-market rental housing projects.
2. Report back on the results of the Revitalization Tax Exemption program after two years of the Revitalization Tax Exemption Program Bylaw being in effect for rental housing projects.
3. Consider a 50% reduction in Development Cost Charges for non-market rental housing projects through the Development Cost Charge Program Review.
4. Update the Victoria Housing Reserve Fund Guidelines to align with senior government programs, remove the maximum grant cap, increase up front grant payments, support larger family friendly units and equity deserving groups, and fund below-market housing units as described in the report.
5. Prepare a Rental Housing Policy and Incentives Handbook, as described in the report.

Option 2

Option two includes the same structure as option one but recognizes the challenging conditions for market rental housing construction by recommending an RTE Bylaw with a 50% revitalization amount for 10 years for secured market rental projects, without the requirement for affordable units. For non-market rental housing providers, the 100% revitalization amount is recommended. Also, option two recommends a lower DCC reduction (25%) for non-market rental housing projects in order to reduce the financial impact to the City. Option two identifies a less stringent approach for market rental housing providers to access the RTE in recognition of the challenging conditions facing rental housing providers.

1. Prepare a Revitalization Tax Exemption Bylaw that provides 50% of the revitalization amount for secured market rental projects without affordability and 100% of the revitalization amount for non-market rental housing projects.
2. Report back on the financial impacts and benefits associated with the Revitalization Tax Exemption program after two years of the Revitalization Tax Exemption Bylaw being in effect.
3. Consider a 25% waiver for non-market rental housing projects through the current Development Cost Charge Review.
4. Update the Victoria Housing Reserve Fund Guidelines to align with senior government programs, remove the funding cap and increase up front grant payments, support larger family friendly units and equity deserving groups and fund below-market housing units as described in the report.
5. Prepare a Rental Housing Policy and Incentives Handbook, as described in the report.
6. Report back on the financial impacts and benefits associated with the Revitalization Tax Exemption program after two years of the bylaws being in effect.

Accessibility Impact Statement

Core Housing Need and the need for more affordable housing options is felt most acutely by priority populations in the city. The outcomes of the Rental Incentives Project will add more rental homes affordable to median-income households.

2023 – 2026 Strategic Plan

The proposed project will support multiple objectives outlined in the City's Strategic Plan, including:

<u>Housing</u>

- Enable more market and non-market housing and diversify housing types and distribution
- Simplify City processes to accelerate housing development
- Increase tenant protections within the City's authority and in partnership with other governments and agencies.

<u>Transportation</u>

- Explore the future of parking norms and policies.

Impacts to Financial Plan

There will be no impacts to the financial plan, however, should Council direct preparation of a new revitalization tax exemption bylaw for rental housing and/or exploring DCC waivers for affordable housing projects, property taxes would shift to non-exempt properties and an alternate funding source for the DCC reserves for any DCCs waived would be required for qualifying projects in the future.

Official Community Plan Consistency Statement

The proposed rental housing incentives are consistent with policies in the OCP and support objectives and policies in Section 13: Housing and Homelessness.

CONCLUSIONS

The City of Victoria has a strong foundation of policy to support rental housing development. to the City has prioritized rental and affordable housing initiatives since the introduction of the Victoria Housing Strategy in 2016. The rental incentives proposed in this report, guided by policy direction and technical analysis build on the City's commitment to encouraging affordable housing. Through the proposed updates, the City can continue to show leadership in this area, and together with provincial and federal levels of government, implement tools to help create more affordable rental housing stock in the community.

There are several other projects and initiatives being advanced concurrently and or identified in workplans over the next two years including the OCP 10-year review and zoning modernization work, development of a Family Housing Policy, Rapid Deployment of Affordable Housing monitoring review, the Residential Rental Tenure Zoning Pilot, and the Schedule C Off-Street Parking update which will all play a role in further supporting and enabling both market and non-market rental housing development.

Respectfully submitted,

Andrew Cusack
Senior Planner, Housing Policy

Karen Hoese
Director, Sustainable Planning and Community Development

Report accepted and recommended by the City Manager: ______________________________

Date: ______________________________

List of Attachments

- Attachment A: Existing Incentives for Rental Housing in Victoria
- Attachment B: Consultant's Report: *Evaluation of the Financial Impact on New Rental Projects of Potential New Housing Requirements and Development Incentives*
- Attachment C: Rental Housing Incentives Backgrounder