

Residential Infill Opportunities

Financial Feasibility Assessment

October 19, 2022

Parcel



MISSISSAUGA

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Executive Summary

Context

- The purpose of this study has been to provide Smart Density and the City of Mississauga with insight into the **financial feasibility of four identified residential infill housing development typologies** (garden suites, laneway suites, garage conversions and multi-plexes), from the perspective of **typical homeowners and/or developers**.
- The insights provided through this reporting are meant to inform the City in making thoughtful policy decisions, which address Mississauga's **missing middle and affordable housing inventory**.

Key Findings


Baseline Analysis

- We have tested infill typologies based on a combination of affordable / market rents and typical development costs, among other relevant financial assumptions intended to establish an appropriate baseline conditions for evaluating feasibility. This baseline was predicated on the **goal of achieving at least a "break even" outcome**.
- As highlighted in the table below, financial performance varied significantly across each of the four typologies identified, with the **most promise exhibited by garage conversions and garden suites**. These presented a desirable mix of: (i) relatively low initial cash equity requirements; (ii) quick construction timelines; and (iii) decent revenue-generating opportunities relative to upfront construction costs.


Legend: ● Promising ● Possible ● Unlikely ● Infeasible

Typology	Observation	@ Affordable Rates	@ Market Rates
Garden Suites	<p>If the homeowner is able to invest at least 50% of the development costs in cash, both 1- and 2-storey garden suites can produce positive monthly cash flow. However, only 1-storey garden suites, which are less expensive to construct, will result in a positive return on investment to the homeowner if sold after 10 years of rental income.</p>	<p>1-storey: ●</p> <p>2-storey: ●</p>	<p>1-storey: ●</p> <p>2-storey: ●</p>
Laneway Suites	<p>With a similar overall gross floor area to the 2-storey, 2-bedroom garden suite option, albeit less rentable area associated with just 1-bedroom, laneway suites will struggle to generate positive cash flow, even with 50% cash equity. This type of accessory dwelling unit is less likely to prevail unless undertaken more for its social benefits (e.g., opportunities to enable aging in place, supporting other temporary or semi-permanent family members within a given household, etc.).</p>	●	●

Garage Conversions Representing the “low hanging fruit” among the identified options, these 1-bedroom suites can be constructed quickly, with little to no upfront cash required from the homeowner. Upon completion, they could generate strong positive cash flow, even at affordable rents.



Multi-plexes Even at prices and rents well above what is considered affordable, triplexes and fourplexes struggle to break even, let alone generate reasonable investment returns.



Challenges

Through our baseline and sensitivity analyses, we have identified a number of key challenges that all the infill typologies will need to overcome:

- **Escalating costs**—particularly for construction materials and labour—negatively affect the financial viability of all four infill typologies and are unlikely to return to pre-pandemic levels in absolute terms. This cost component will take some time to return to more typical pre-pandemic annual growth rates.
- Larger and **more complex accessory dwelling units limit the pool of potential homeowners** able to undertake such a project, as more owner’s equity (i.e., cash) will be required to allow for positive cash flow upon completion.

- Larger **multi-plexes come with additional costs, such as land acquisition and development charges**, which simply require more revenue to cover. Additionally, the small-scale developers likely to undertake such a project will be focused on investment return metrics and not necessarily the social benefits of this housing type alone.

Sensitivity Analysis

Following our baseline analyses, we have also undertaken targeted sensitivity analyses with the goal of overcoming some of the challenges identified above, as well as “stress-testing” some of the already-positive outcomes identified for selected typologies. Highlights include:

- To lower the upfront equity requirement for garden and laneway suites, market rents must be achieved in the \$1,850 to \$2,350 per month range, depending on typology.
- Garage conversions remain financially viable even if they cannot be financed entirely through debt.
- Multi-plex condo building viability could be improved through a combination of developer adjustments and City incentives.
- Multi-plex rental buildings are financially challenged and unlikely to materialize across the City in the near future.

Conclusions

- Accessory dwelling units represent a unique market segment where decisions to construct new buildings of this type are **not always profit-motivated**. Whereas the results highlighted above have been presented from a purely financial perspective, there are a multitude of other factors and preferred outcomes that inform the desirability of each typology. These simply cannot be measured in dollars and cents, including:

- opportunities to generate social benefits such as aging in place or supporting family members across other life stages;
 - enabling improved urban design / architectural concepts that deliver higher quality living spaces; and
 - the ability to replicate concepts at a more significant scale longer-term.
- The four infill housing typologies are unlikely to represent a “silver-bullet” solution to housing affordably in Mississauga. Nonetheless, they **present an ideal, low-barrier opportunity to improve housing choice** and could ultimately contribute—at least in part—to over-arching issues of housing supply and diversity in the community.
 - Regardless of the ultimate profitability or exact return on investment associated with each of the typologies evaluated, associated spending will nonetheless represents an **overall improvement and re-investment in the existing housing stock of Mississauga**. This type of spending, in and of itself, can generate economic value beyond the purview of the individual homeowner and/or developer.

1.0

Introduction

1.1 Background

Context

Smart Density is leading a study on behalf of the City of Mississauga, which is focused on evaluating residential infill opportunities in existing neighbourhoods.

As part of this assignment, Smart Density has identified four infill development typologies (garden suites, laneway suites, garage conversions and multi-plexes), in addition to the creation of seven prototypical buildings associated with these typologies. These prototypical building designs account for existing conditions across Mississauga, including lot sizes and current policy conditions, as well as trends emerging elsewhere across the Greater Toronto and Hamilton Area (GTHA).

Purpose

Even the best architectural designs and thoughtful planning policy initiatives are unlikely to achieve intended outcomes if they cannot be completed in a financially feasible manner (i.e., allowing for some level of profitability and/or return on investment). For example, the average homeowner is less likely to invest the time and resources required to add a garden suite to their property in the absence of some sort of resulting financial benefit (e.g., additional income to supplement their mortgage).

The purpose of this report has therefore been to provide Smart Density and the City of Mississauga with additional insight as to the financial feasibility of four main infill

development typologies from the perspective of typical homeowners or developers.

The information presented herein will ultimately empower the City to make decisions that effectively result in an increase to the local housing stock, with a particular focus on residential diversity and options for the delivery of affordable housing¹.

1.2 Scope

Baseline Analysis

Parcel first tested the infill typologies based on a combination of affordable rents / prices, market rents / prices, and typical development costs and assumptions to establish a baseline condition of feasibility, with the goal of at least generating a reasonable “break even”. Section 2.2 of this report details the baseline results and reveals how challenging it can be for some of these infill typologies to achieve this benchmark.

Options Analysis & Strategic Direction

Based on the results of our baseline analyses, we subsequently undertook targeted sensitivity analyses aimed at improving financial viability. This was done to explore possible solutions to the challenged typologies and stress test those typologies which appeared feasible under the baseline assumptions.

¹ Generally defined as housing costing 30% or less of household income.

1.3 Assumptions and Limitations

Identification of Options / Concepts

- The four (4) infill building typologies and resulting seven (7) prototypical development concepts reviewed and analyzed by Parcel were prepared by Smart Density. These included: interior and corner lot **garden suites**; **laneway suites**; interior and corner lot **garage conversions**; interior lot **triplexes**; and a corner lot **fourplexes**. The Smart Density plans and associated development statistics are assumed to be both reasonable and accurate.

Feasibility Approach

- To assess the financial feasibility of five (5) of the prototypical development concepts most likely to be undertaken by **existing homeowners**, we have compared their potential rental revenue streams over a 10-year hold period and the potential value of the units upon sale of the property in year 11 to the total costs to develop and maintain the units.
- For the large multi-plex concepts most likely undertaken by **small-scale professional developers**, we have taken a similar approach, while also introducing a discounted cash flow (“DCF”) to better understand investment return metrics commonly targeted by the development industry.

Other Assumptions

- The various other statistical inputs relied upon in our analysis are considered sufficiently accurate for the purposes of this high-level analysis. These statistical sources—including available municipal information, datasets and previous reporting, as well as third-party industry data—have ultimately informed a number of the key underlying assumptions and inputs utilized in our analysis.

- It is assumed that a reasonable degree of economic stability will prevail in the Province of Ontario, and specifically in the context of the City of Mississauga market, over the course of the development planning horizon identified in this study.
- It is important to recognize that the lingering effects of the COVID-19 pandemic will continue to result in a significant amount of uncertainty as it relates to current and potential future market conditions. At the time of reporting, there is not a complete understanding of the potential longer-term implications of the pandemic on economic conditions nor real estate development patterns across the City of Mississauga and beyond.

In the event that material changes occur that could influence the foregoing assumptions, the analysis, research findings and recommendations contained in this report should be reviewed or updated, accordingly.

2.0

Baseline Financial Analysis

Key Findings

- Our baseline analyses considered the revenue generating potential of each infill typology against the development costs associated with their construction.
- These infill typologies included a variety of unit types and sizes, spanning from 420 square foot 1-bedroom units to 1,356 square foot 3-bedroom units.
- Wherever possible, our baseline scenarios were tested using affordable rental rates, at least as a starting point.
- At **affordable rents**: (i) garage conversions require little to no cash investment and generate strong positive cash flow to homeowners; and, (ii) garden suites / laneway suites are likely to result in positive cashflow, albeit 2-storey suites are more expensive to construct (resulting in lower net income and higher initial expenses).
- Multi-plex condo and rental buildings require **market prices** to break even, while multi-plex rental buildings are unlikely to satisfy developers' investment criteria.

2.1 Basic Parameters

The following section details the important assumptions that were required to conduct our baseline analyses of financial viability across the four main infill housing typologies prepared by Smart Density. This included assumptions relating to: building design, layouts and statistics; revenue assumptions (e.g., sale prices and monthly rents); and cost assumptions (e.g., construction costs, government taxes and fees and financing related costs).

Options / Design Concepts

As summarized under separate cover, Smart Density has developed four main infill housing typologies, including:

1. **garden suites;**
2. **laneway suites;**
3. **garage conversions;** and
4. **multi-plexes.**

Most of these typologies can be described as taking one of the following two forms:

- **accessory dwelling units (“ADUs”)**, which contemplate the addition of an extra residential unit to an existing and maintained single-detached home; or,
- the multi-plexes, which require the **redevelopment of a single-detached home to be replace with a multi-unit building.**

Figure 2.1 provides rendering of the seven prototypical buildings designed by Smart Density.

Figure 2.1

Infill Building Typologies

Garden Suite (Corner Lot)



Garden Suite (Interior Lot)



Laneway Suite



Garage Conversion (Corner Lot)



Garage Conversion (Interior Lot)



Fourplex (Corner Lot)



Triplex (Interior Lot)



Source: Smart Density

As detailed in Figure 2.2, these infill typologies can include a variety of unit types and sizes, spanning from 420 square foot 1-bedroom units in a converted garage to a 1,356 square foot 3-bedroom unit in a triplex.

Figure 2.2

Summary of Development Statistics

Typology	Height	Units			Avg Unit	Gross	Net
		1 Bed	2 Bed	3 Bed		Floor Area	Floor Area
Garden Suites							
Corner Lot	1 Storeys	1			851 sq ft	851 sq ft	851 sq ft
Interior Lot	2 Storeys		1		490 sq ft	490 sq ft	490 sq ft
Laneway Suite	2 Storeys	1			645 sq ft	839 sq ft	645 sq ft
Garage Conversion							
Corner Lot	1 Storeys	1			420 sq ft	420 sq ft	420 sq ft
Interior Lot	1 Storeys	1			455 sq ft	455 sq ft	455 sq ft
Multi-plexes							
Corner Lot Fourplex	2 Storeys			4	1,018 sq ft	4,209 sq ft	4,073 sq ft
Interior Lot Triplex	2 Storeys			3	1,356 sq ft	4,067 sq ft	4,067 sq ft

Source: Parcel, based on development statistics provided by Smart Density.

Revenue Assumptions

To conduct our baseline analyses, we have made assumptions about the timing and scale of revenues available from both monthly rental flows and the sale of units under the multi-plex scenarios. Overall, we have assumed the prototypical buildings will require between 9 and 36 months to construct and each will be held for 10 years before being sold. Wherever possible, affordable rental rates have been considered, unless they resulted in losses too great to be

overcome with subsidies and incentives, at which point more market-based rates were considered.

Figure 2.3

Revenue Assumptions

Assumption	Garden + Laneway Suites	Garage Conversions	Multi-Plexes
Development Timeline	12.0 yrs	11.5 yrs	13.5 yrs
Entitlement & Design	8 mths	6 mths	12 mths
Unit Sales	-	-	6 mths
Construction	8 mths	3 mths	18 mths
Hold Period	10.0 yrs	10.0 yrs	10.0 yrs
Sale	2034	2033	2023 / 2036
Sales Revenue			
Sales Year	-	-	2023
Per Unit	-	-	\$0.94 M - \$1.24 M
Per Sq Ft	-	-	\$920 PSF
Sales Commission	-	-	5.0%
Rental Revenue			
Beginning ...	2024	2023	2025
Per Unit	\$1,550 - \$1,750 / mth	\$1,095 / mth	\$3,200 - \$3,725 / mth
Per Sq Ft	\$2.05 - \$3.15 PSF	\$2.30 - \$2.60 PSF	\$2.50 - \$3.25 PSF
Avg Annual Rent Growth	1.5%	1.5%	1.5%
Vacancy + Bad Debt	5.0%	5.0%	5.0%

Source: Parcel

Cost Assumptions

Similarly, we have also made assumptions relating to land, hard costs, and soft costs for each of the typologies identified. In addition to the assumptions outlined in Figure 2.4, we make special mention of the following:

- Garage conversions, garden and laneway suites include no land acquisition costs as they are expected to take place on an existing homeowner's excess land, however, we assume the land required to build a multi-plex will be acquired in the form of a below-market value, single-detached house (i.e., a "fixer upper"). Applying a roughly 30% discount to the Mississauga resale average detached home value of \$1.58 million², **we have assumed roughly \$1.1 million in land acquisition costs per multi-plex site.**
- **Hard Costs** are based on the 2022 Altus Construction Cost Guide and assumed to increase at an average annual rate of 10%. This is based on the Statistics Canada Construction Cost Index, which suggests that residential construction costs have risen between 10% and 18% annually over the past 5 years, depending on the residential building type.
- Other assumptions relating to **soft costs**—such as financing, municipal charges and fees, etc.—are based on a combination of available municipal data, standard industry benchmarks, as well as our own professional judgement.

² Toronto Real Estate Board, July 2022.

Figure 2.4

Cost Assumptions

Assumption	Garden + Laneway Suites	Garage Conversions	Multi-Plexes
Land Acquisition	None	None	\$1.1 M
Hard Costs			
Demolition	\$10 PSF	None	\$10 PSF
Building	\$325 - \$350 PSF	\$125 PSF	\$240 PSF
Parking	\$6,000 per space	\$6,000 per space	\$6,000 per space
Avg Annual Growth	10%	10%	10%
Soft Costs			
Development Application Fees	None	None	OPA + ZBA + SPA @ 2022 Rates
Legal Fees	2% of Hard Costs	2% of Hard Costs	2% of Hard Costs
A & E	5% of Hard Costs	5% of Hard Costs	5% of Hard Costs
Building Permit	2022 Rates	2022 Rates	2022 Rates
Development Charges	None	None	2022 Rates
Property Taxes During Development	2022 Rates	2022 Rates	2022 Rates
Sales & Marketing	0.5% of Hard Costs	0.5% of Hard Costs	0.5% of Hard Costs
Construction Management	5% of Hard Costs	5% of Hard Costs	5% of Hard Costs
Contingency	5% of Total Costs	5% of Total Costs	5% of Total Costs
HST	Based on 13% HST (less Applicable Rebates)	Based on 13% HST (less Applicable Rebates)	Based on 13% HST (less Applicable Rebates)
Financing			
Debt	50%	100%	75%
Equity	50%	-	25%
Interest Rate	6.7% (Prime + 200 bps)	6.7% (Prime + 200 bps)	6.7% (Prime + 200 bps)

Source: Parcel. All 2022 Rates adjusted based on Non-Residential Construction Price Index to future year of payment.

The Importance of Construction Costs

Deviation from the assumed construction costs in future years can have a dramatic impact on financial feasibility. We believe that the building cost assumptions in Figure 2.4—which rely upon the 2022 Altus Construction Cost Guide, additional research specific to laneway and garden suites, as well as the incorporation of a 10% average annual escalation—are reasonable and conservative, if anything. However, the future is uncertain, especially post-pandemic.

If actual construction costs are ultimately higher, cash flow and overall viability will be negatively impacted - particularly for the ADU typologies where construction costs already account for 67 - 78% of development costs. There is also the possibility that future annual cost escalation is below 10%, improving viability.

We further note that the relative speed at which we have assumed these typologies can be entitled and constructed (i.e., 9 to 18 months) suggests that they are more closely tied to the costs of today than those unknown costs of the future. That said, it will be important to re-visit this analysis in future years to ensure the fundamentals remain valid.

2.2 Summary of Findings

Our baseline analyses detail the financial feasibility of each typology based on the assumptions itemized in Figure 2.2 through Figure 2.4.

Garden Suites

Overview

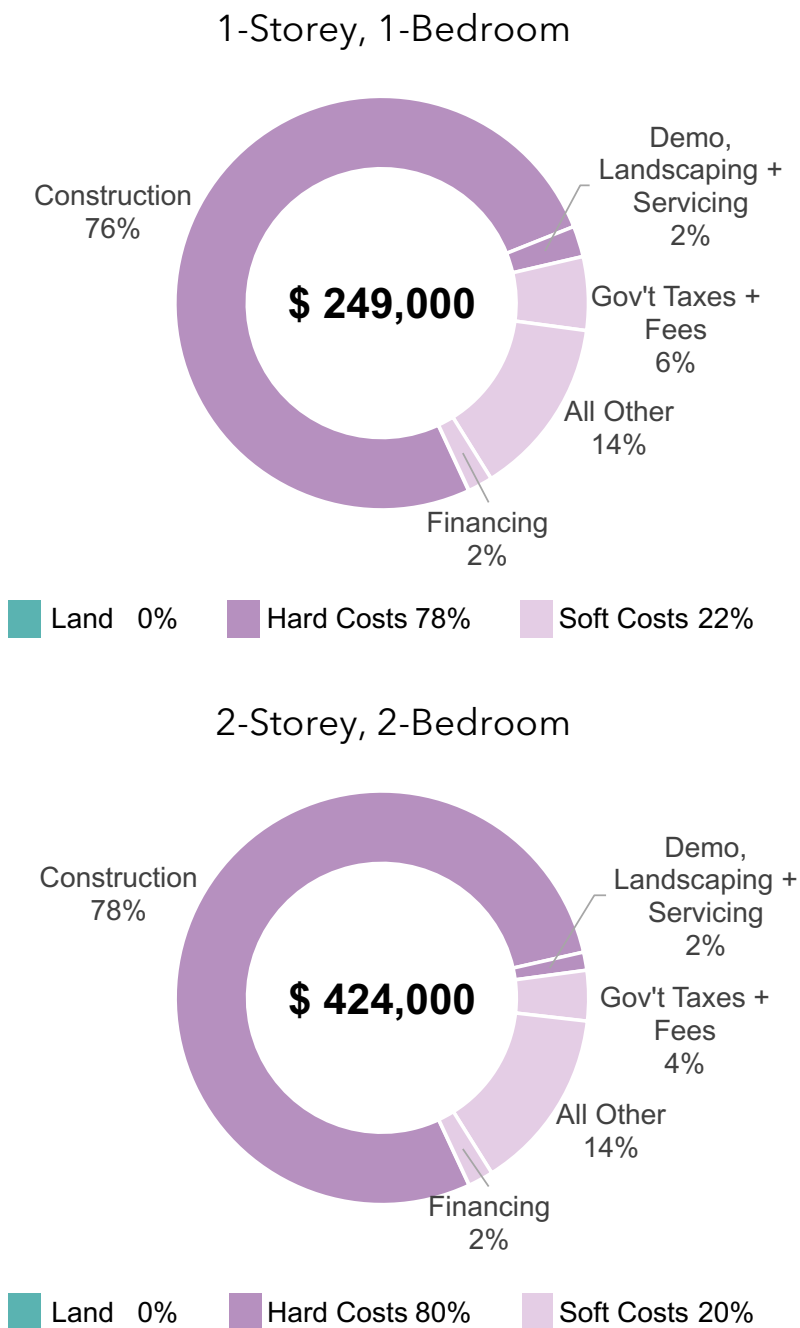
As noted in Section 2.1, we have reviewed the financial feasibility of both the corner lot (1-storey) and interior lot (2-storey) garden suite prototypes prepared by Smart Density. In both configurations, we have assumed that the buildings would be commissioned by single-detached homeowners and then added to the City's rental inventory.

Furthermore, to optimize cash flow to the homeowners once the garden suites are leased, we have assumed 50% of the construction costs would be funded through equity (i.e., cash available directly from the homeowner) and 50% debt to be rolled into the existing mortgage of the primary residence upon completion. If more debt is utilized, rental revenues at the assumed affordable rents would no longer cover debt service payments, rendering the addition of a garden suite less likely.

Figure 2.5 provide a breakdown of development costs relating to the garden suite prototypes, illustrating the increase in costs associated with the 2-bedroom, 2-storey garden suite.

Figure 2.5

Garden Suite Development Costs



Source: Parcel, based on the assumptions in Figure 2.4.

Findings

Based on a monthly rent of \$1,450³, grown by 1.5% annually into the future, revenues generated by the 1-storey garden suite typology are likely to exceed the additional mortgage payments required to construct the building. This results in positive monthly cash flow to the homeowner.

Similarly, based on a monthly rent of \$1,625⁴, grown by 1.5% annually into the future, revenues generated by the 2-storey garden suite typology are also likely to exceed the additional mortgage payments required to construct the building, resulting in positive monthly cash flow to the homeowner.

As illustrated in Figure 2.6, over a period of 10 years, the homeowner could expect more than \$63,000 in additional income from the inclusion of a 1-storey garden suite on their property. The more expensive 2-storey garden suite option, however, is likely to generate a positive cash flow of less than \$30,000 over the same period. This is because rent can only increase by \$175– or 12%–to remain consistent with the City's 2-bedroom average, while costs could be as much as double the estimate established for the 1-storey suite alternative.

Finally, we estimate that the 1-storey garden suite would add \$295,000 to the sale price of the property 12 years from now, whereas the 2-storey garden suite would add \$335,000 to the sale price of the property, based in their respective income-generating potential.

³ Based on the City's 2021 average market rent for a 1 bedroom, affordable to households with at least \$58,000 in annual income.

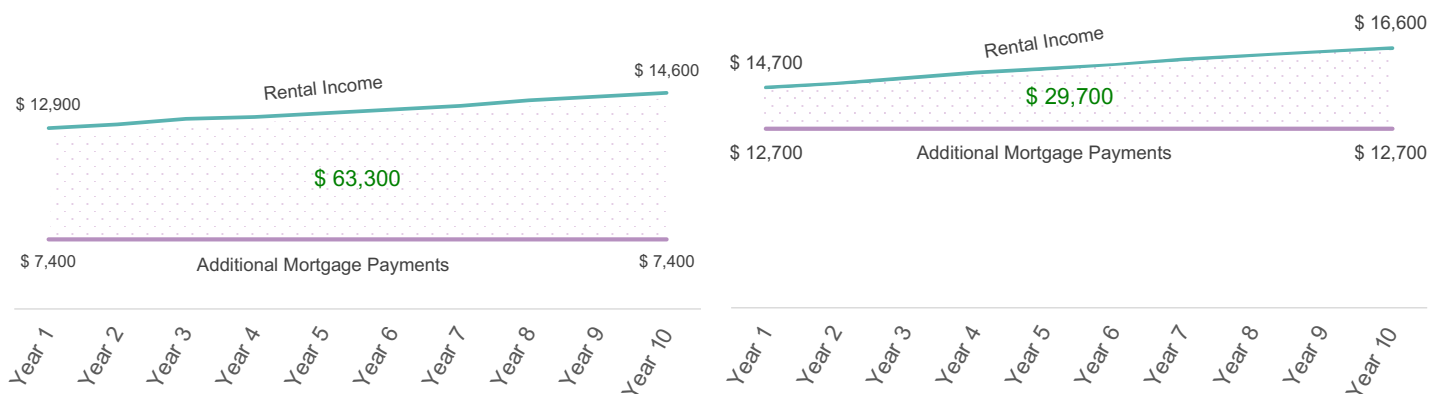
⁴ Based on the City's 2021 average market rent for a 2 bedroom, affordable to households with at least \$65,000 in annual income.

Figure 2.6

Garden Suite Cash Flow

1-Storey, 1-Bedroom

2-Storey, 2-Bedroom



Source: Parcel. Excludes some revenue during lease up.

Although homeowners are likely to focus heavily on the ADUs’ ability to generate positive cashflow, we have also calculated their overall return (or loss) as another sign of whether garden suites are a worthwhile investment in the fullness of time.

As detailed in the following tables, the 1-storey garden suite has the potential to generate \$134,000 in profit to the homeowner over 12 years, resulting in a 9% average annual return. We note this is likely a higher average annual return than the average investor could otherwise obtain through other types of non-real estate investments.

Homeowner Revenue vs Costs (1-Storey Corner Lot Garden Suite)

Net Rental Income 10 yrs	\$ 65,000
Net Proceeds at Sale of Primary Residence	\$ 193,000
Less: Equity Invested	\$ (124,000)
	Profit / (Loss) \$ 134,000
	<i>Total Return</i> 108.1%
	<i>Avg Annual Return</i> 9.0%

Conversely, the 2-storey garden suites are likely to result in a net loss to the homeowner over an equivalent time horizon, despite their ability to generate positive cash flow in the interim. This is in large part due to the larger equity requirement at the outset due to increased costs.

Homeowner Revenue vs Costs (2-Storey Interior Lot Garden Suite)

Net Rental Income 10 yrs	\$ 32,000
Net Proceeds at Sale of Primary Residence	\$ 168,000
Less: Equity Invested	\$ (212,000)
	Profit / (Loss) \$ (12,000)
	<i>Total Return</i> (5.7)%
	<i>Avg Annual Return</i> (0.5)%

Summary: Garden Suite Financial Viability

Garden suites can be financially viable at affordable rents if the homeowner is able to contribute at least 50% of the project costs, a potentially challenging hurdle of between \$125,000 and \$215,000.

Although both have the potential to generate positive cashflow upon completion, only the smaller 1-storey garden suite is likely to generate a profit, as well as an average annual return above many alternative investments.

Given the added costs of the 2-storey unit with minimal rental revenue increase, it is **likely that more 1-storey, 1-bedroom garden suites would be constructed if rents must remain affordable.**

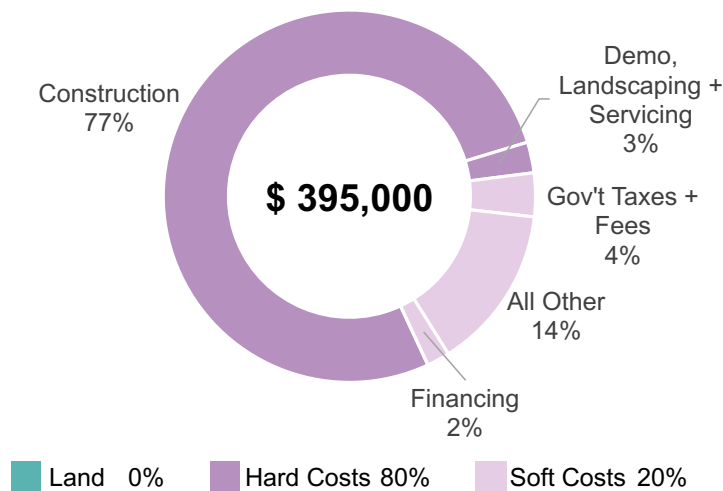
Laneway Suites

Overview

The prototypical laneway suite prepared by Smart Density is very similar to the 2-storey garden suite, with one notable difference: it is assumed that an existing detached garage must be demolished and re-incorporated into the newly constructed building, limiting it to 1 bedroom. This adds to the costs and reduces the amount of rentable space in the completed laneway suite.

As in the garden suites, we have assumed 50% of the construction costs would be funded through equity (i.e., owner's cash) and 50% debt to be rolled into the primary residence's mortgage upon completion. If more debt is utilized, rental revenues at the assumed affordable rents would no longer cover debt service payments, rendering the addition of a laneway suite less likely.

Figure 2.7

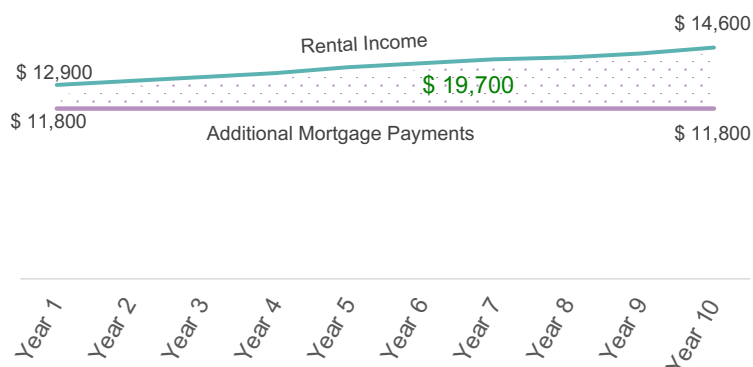
Laneway Suite Development Costs

Source: Parcel, based on the assumptions in Figure 2.4.

Findings

As illustrated in Figure 2.8, based on the same relatively affordable monthly rent of \$1,450 as for the 1-storey garden suite option, grown by 1.5% annually into the future, revenues generated by a laneway suite typology are expected to barely exceed the additional mortgage payments required to construct the building.

Figure 2.8

Laneway Suite Cash Flow

Source: Parcel

As in the garden suites, we have also calculated the homeowner's overall return (or loss) as another sign of whether laneway suites are a worthwhile investment. Like the 2-storey garden suites, laneway suites are likely to result in a net loss to the homeowner, despite their ability to generate positive cash flow. Again, this is in large part due to the larger equity requirement to support the initial construction of the building.

Homeowner Revenue vs Costs (2-Storey Laneway Suite)

Net Rental Income 10 yrs	\$ 22,000
Net Proceeds at Sale of Primary Residence	\$ 143,000
Less: Equity Invested	\$ (197,000)
Profit / (Loss)	\$ (32,000)
<i>Total Return</i>	<i>(16.2)%</i>
<i>Avg Annual Return</i>	<i>(1.4)%</i>

Summary: Laneway Suite Financial Viability

With similar development costs to a 2-storey garden suite but less revenue generating potential, laneway suites become challenging at affordable rents in the Mississauga context. It is **more likely that these types of accessory dwelling units would be constructed for non-financially motivated reasons**, such as housing family members.

Garage Conversion

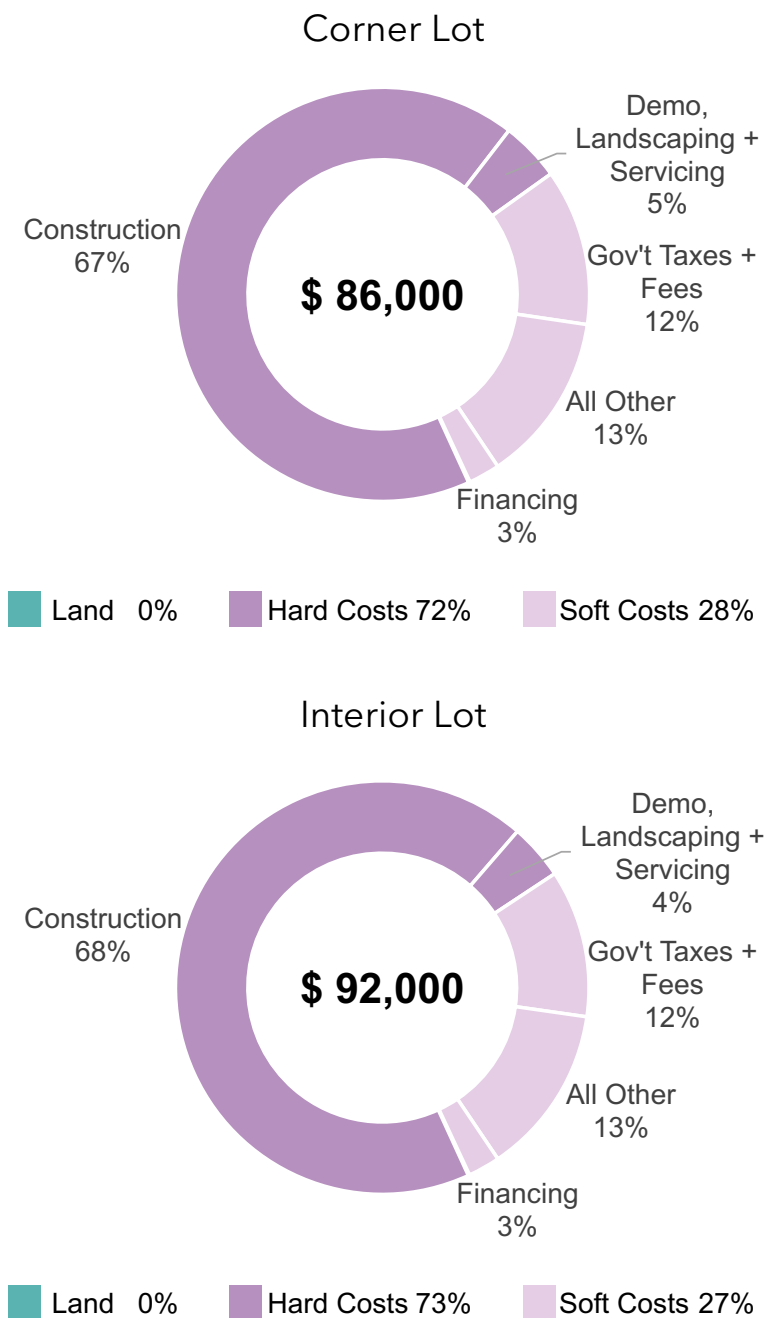
Overview

As noted in Section 2.1, we have reviewed the financial feasibility of both the corner lot and interior lot garage conversion prototypes prepared by Smart Density. In both configurations, we have assumed that existing attached garages would be converted by homeowners and then added to the City's rental inventory.

Furthermore, given the relatively low costs of converting the garage suites, we have assumed 100% of the construction costs would be funded through debt—likely as a home equity line of credit—to be rolled into the primary residence's mortgage upon completion. This would allow for a **relatively low barrier to conversion** as existing homeowners who have owned their homes for a reasonable amount of time can likely leverage the equity they have accumulated instead of turning to their cash savings.

Figure 2.9 provides the development costs of the garage conversion prototypes with the only difference being that the interior lot is assumed to accommodate a slightly larger suite.

Figure 2.9

Garage Conversion Costs

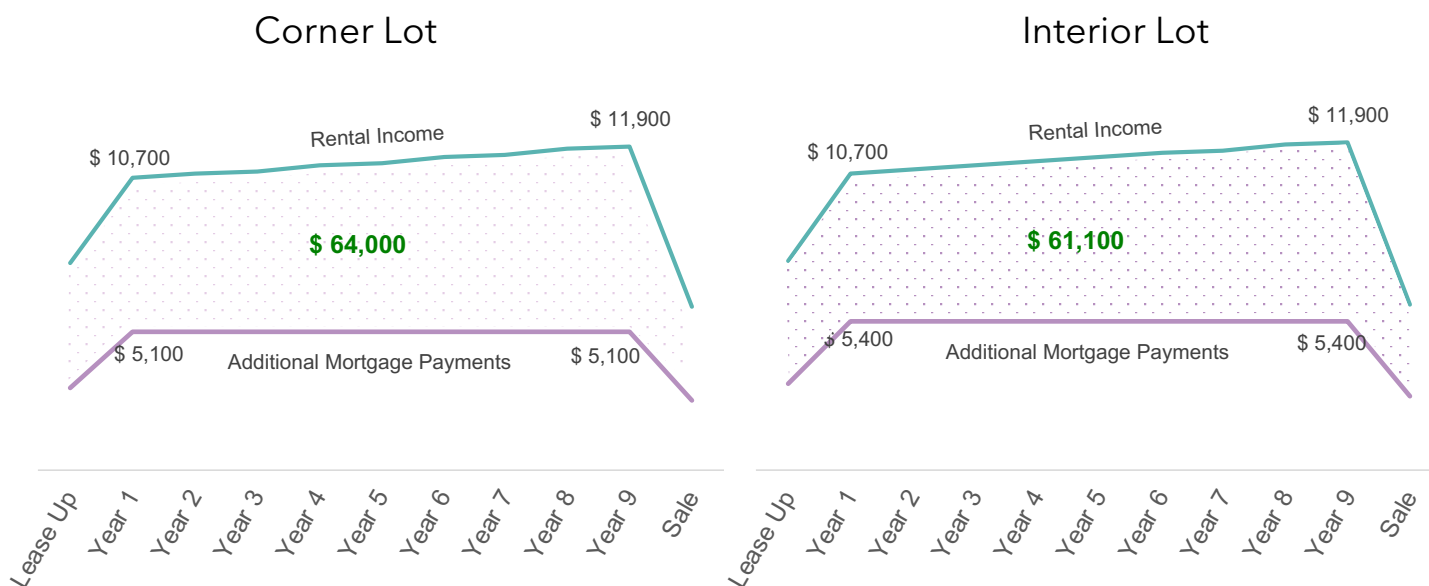
Source: Parcel, based on the assumptions in Figure 2.4.

Findings

As illustrated in Figure 2.10, based on a monthly rent of \$1,050⁵, grown by 1.5% annually into the future, revenues generated by a corner lot garage conversion typology are likely to exceed the additional mortgage payments required to convert the space. As illustrated, the slightly higher costs associated with the additional space in the interior lot conversion squeeze the income potential slightly.

Figure 2.10

Garage Conversion Cash Flow



Source: Parcel

Given that no upfront equity is required by the homeowner under this scenario, this investment is assured to have a very healthy overall return for the homeowner undertaking the conversion.

⁵ Below the City’s 2021 average market rent for a bachelor apartment, affordable to households with at least \$42,000 in annual income

Summary: Garage Conversion Financial Viability

Potentially requiring no upfront costs, 1-bedroom suites within **garage spaces would add affordable rental options that are also profitable** to the primary homeowner. Even at affordable rents, the primary homeowner could generate \$60,000 to \$65,000 in rental income over a 10-year hold period, as well as a premium on the sale of their home if they choose to sell in the future. This typology has the potential to also increase the affordability of the primary residence, supplementing the homeowner's mortgage payments.

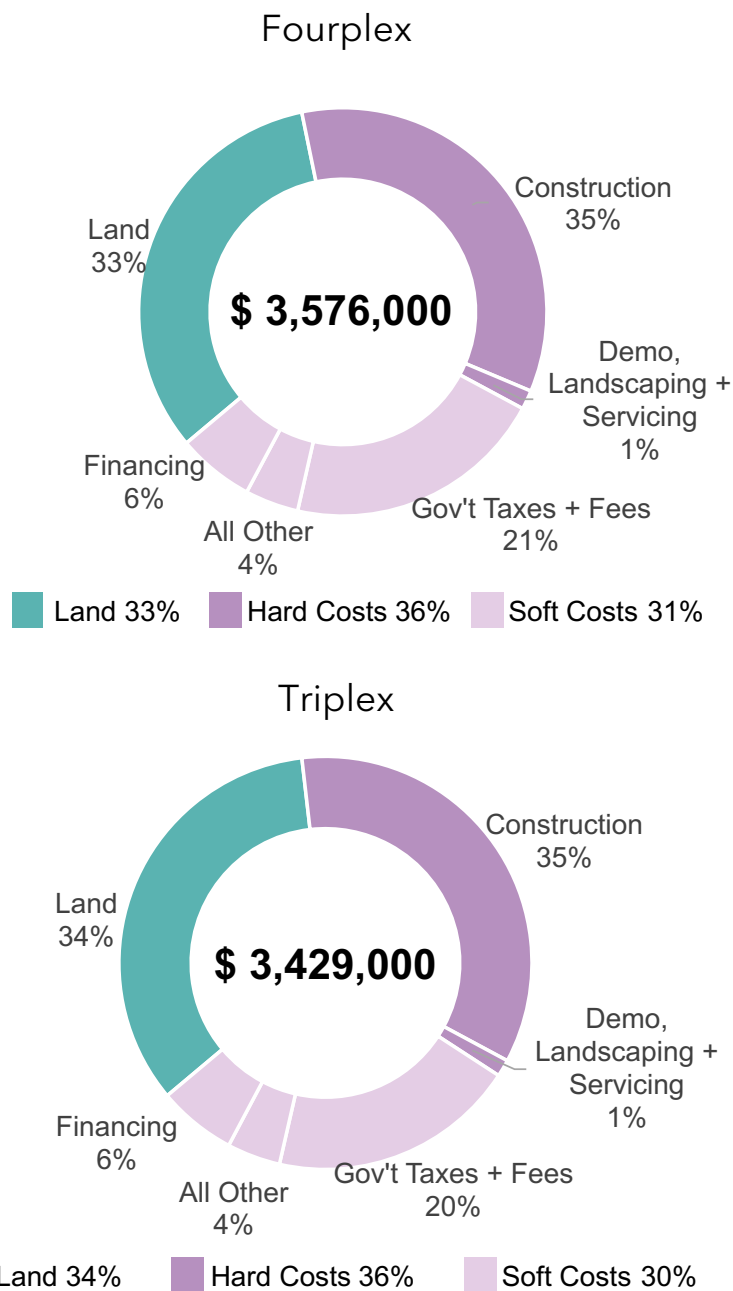
Multi-Plexes

Overview

As noted in Section 2.1, we have reviewed both the corner lot fourplex and interior lot triplex prototypes prepared, including both condominium ownership and rental tenures for each. In both configurations, we have assumed that an existing single-detached home of approximately 2,000 square feet would be purchased for redevelopment at some 30% below average market value to reflect a relative state of disrepair (e.g., a "tear down"). Furthermore, for condo ownership, we have assumed 25% of the development costs would be funded through equity (i.e., cash equity) and 75% through debt as a construction loan. The rental scenarios are assumed to require at least 50% equity with the remaining 50% funded via a construction loan, which would later be converted to permanent debt. Figure 2.11 breaks down the development costs, including land acquisition.

The scale of the multi-plex projects means that they are less likely to be undertaken by typical homeowners and more likely to be undertaken by small-scale developers with more aggressive investment return expectations than the typical Mississauga household looking to generate additional monthly cash flow and/or to support other non-financial objectives.

Figure 2.11

Multi-plex Development Costs

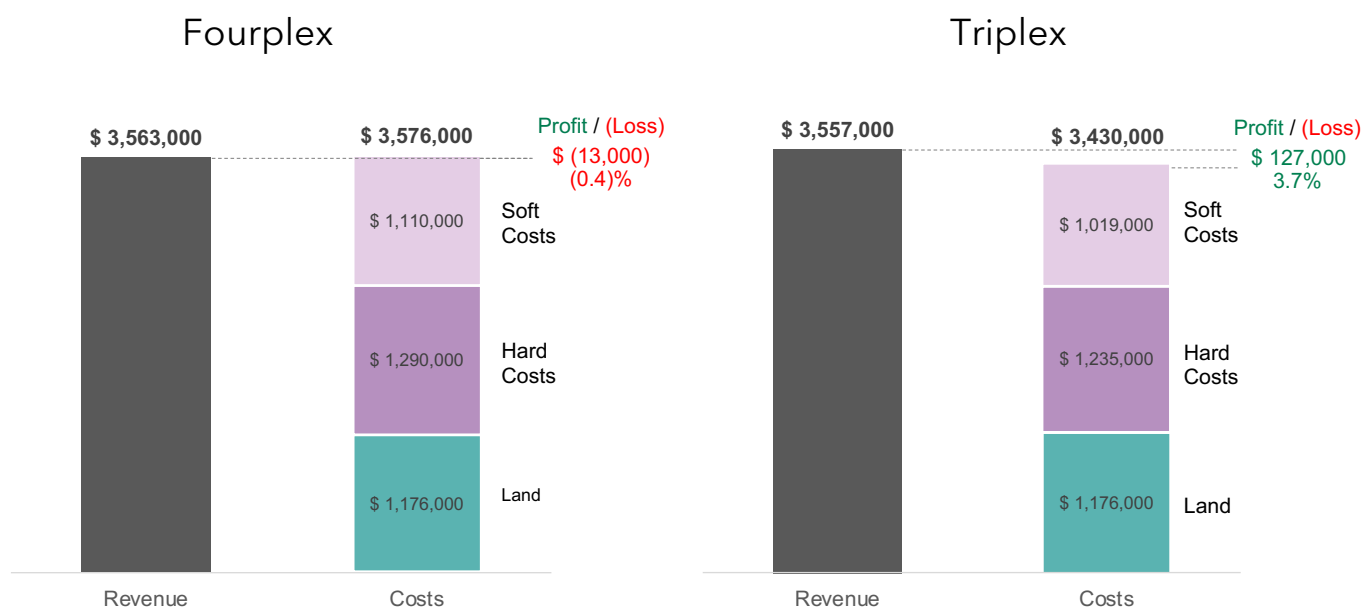
Source: Parcel, based on the assumptions in Figure 2.4. Rental scenarios include slightly lower Government Fees & Taxes.

Findings

Based on the assumptions in Section 2.1, a corner lot fourplex selling four condo ownership 3-bedroom units at an average of nearly \$940,000 per unit (i.e., well above affordable ownership levels in the City) nearly breaks even, as illustrated in Figure 2.12. Similarly, an interior lot triplex selling three condo ownership 3-bedroom units at an average of nearly \$1.25 million per unit (i.e., well above affordable ownership levels in the City) is likely to make a small profit, albeit not enough to entice investment.

Figure 2.12

Revenues vs. Costs (Ownership)



Source: Parcel

Instead of comparing total revenue to total costs (i.e., project level profit), we've focused on the net revenues to the builder / owner in relation to the equity investment required (i.e., developer profit) for the rental scenarios as this is more appropriate for a build-to-hold income producing asset.

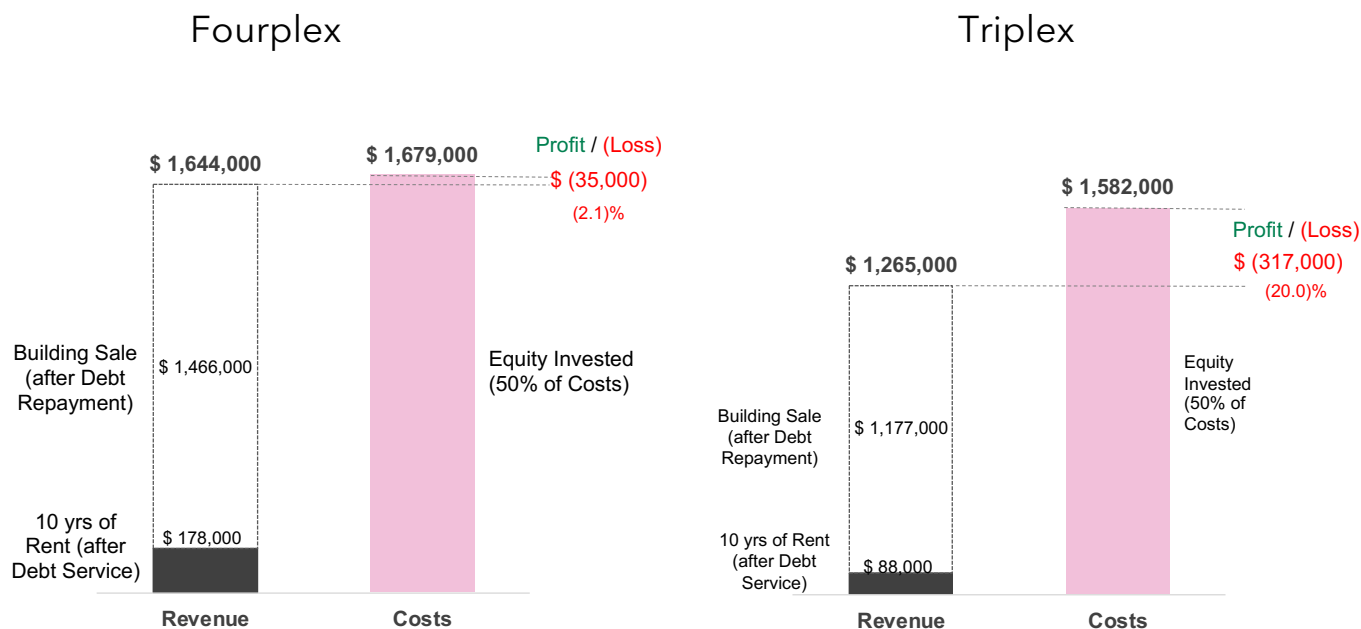
Figure 2.13 illustrates that even if the 3-bedroom fourplex units achieve rents starting at almost \$3,000 per unit (\$3.00 per square foot), grown at 1.5% each year, the developer equity invested

will slightly exceed revenues to the building owner over the 13.5 years of construction and operation by some \$35,000.

Similarly, if the larger triplex 3-bedroom units were to achieve rents starting at almost \$3,400 (\$2.50 per square foot) per month, also grown at 1.5% annually, the developer equity required will likely exceed revenues over the 13.5 years of construction and operation by some \$317,000.

Figure 2.13

Revenues vs. Costs (Rental)



Source: Parcel

Summary: Multi-plex Financial Viability

Even at prices and rents well above what is considered affordable, triplexes and fourplexes struggle to break even, let alone generate reasonable investment returns. As such, based on our baseline analysis, both multi-plex typologies are unlikely to attract significant developer interest across the City for the time being.

3.0

Strategic Direction

Key Findings

Through accompanying sensitivity analyses, we note the following:

- To lower the upfront equity requirement for garden and laneway suites, market rents must be achieved in the range of \$1,850 to \$2,350 per month, depending on typology.
- Garage conversions remain financially viable even if they cannot be financed entirely through debt.
- Multi-plex condo building viability could be improved through a combination of developer adjustments and City incentives.

- Multi-plex rental buildings are quite financially challenged and unlikely to materialize across the City in the near future.

Other important considerations when dealing with the feasibility of infill projects include:

- Continued high construction cost growth, which will further hamper the feasibility of these infill typologies.
- Not all infill developments are motivated by financial investment, but rather for social reasons such as multigenerational housing.

3.1 Options Analysis

In addition to our baseline financial feasibility assessment, we have also identified some potential adjustments to each of the typologies through more targeted sensitivity analyses.

Garden Suites

Although we recognize that the 50% equity requirement for these typologies is a substantial hurdle for many homeowners (e.g., \$125,000 - \$215,000 depending on building size), we note that it is necessary factor if relatively affordable rents are to be maintained. Given that construction costs account for 76 - 78% of the development costs and are unlikely to be reduced in the current inflationary environment (see Section 3.2), the only way to lower the amount of upfront equity required would be through additional revenue (i.e., approaching or even exceeding market averages).

For example, to maintain similar levels of positive cash flow with just 25% equity—likely a more important metric than overall return to the average homeowner—the 1-storey garden suite would need to achieve \$1,850 per month rent and the 2-storey garden suite would need to achieve \$2,325 per month. These rents are in-line with market rents in amenity filled purpose-built rental apartment buildings. For additional context, at market rents, the 2-storey garden suite would generate a similar average annual return as the 1-storey garden suite at affordable rents.

Laneway Suites

Laneway suites present a similar dynamic as 2-storey interior garden suites. To reduce the equity requirement to 25% of development costs, market rents of \$2,100 would need to be achieved, however, this may be even more challenging as the leasable area is smaller due to the reconstruction of the parking space on the first floor. Similar to the baseline analysis, this assumes a condition that is only slightly better than “breakeven”, which is not likely to be sufficient in enticing much investment of this nature. Furthermore, even at market rents, the present value of 10 years of cash flows and the future sale of the suite would be only slightly higher than the equity required.

Garage Conversion

Our baseline analysis for the garage conversions found that they are financially feasible, even at affordable rental rates. This remains true, even if the homeowner cannot finance the construction with 100% debt. In fact, reducing the amount of debt improves cash flow upon completion, albeit lowering overall returns.

Multi-Plexes

Condo Ownership

From a financial feasibility perspective, the multi-plexes show the most promise when sold as condo ownership, however, even the baseline analyses under this scenario did not break even, or generated only negligible returns unlikely to entice investment. Feasibility could be improved to the point of profitability through the following conditions:

Developer

- Use more of their own money (less debt) to finance construction (e.g., only 50% debt = \$107,000 savings on the fourplex).

City

- Waive City Development Charges (approximately \$58,000 - \$96,000, depending on building typology).
- Pre-amend the Official Plan and Zoning to reduce entitlement costs (approximately \$47,000 - \$50,000).

Taken together (i.e., combining the elements noted above), this would increase potential profit to between 7.5 - 10.5% of total costs, making this building type more viable, albeit still below many developers' typical underwriting standards.

Other changes that could yield a substantial improvement to feasibility include: (i) spending less for land; and, (ii) selling the units for higher prices; both of which could be quite challenging in some areas of Mississauga.

Rental

As shown in our baseline analyses, triplex and fourplex rental infill buildings are not financially feasible at affordable rents. Furthermore, municipal incentives alone will not be enough to alter this relationship and would still require the consideration of higher rents.

For example, even if the City were to waive development charges and pre-amend the Official Plan and Zoning By-law, the triplex Developer would need to achieve rents of at least \$3,650 per month or \$2.69 per square foot just to break even. A single or semi-detached house could be rented at this monthly rent in several areas of the City. Furthermore, reducing these fees for the fourplex developer would tip the project into profitability, however, at just over 9% total return over 14 years, the project is still unlikely to entice any investment. **As such, infill multi-plex rental buildings are unlikely to be developed across the City in the near future.**

3.2 Other Considerations

Non-Financial Goals

Financial viability is certainly not the only hurdle to consider when it comes to infill housing. This is especially true for ADU's like the garden suites, laneway suites and garage conversions.

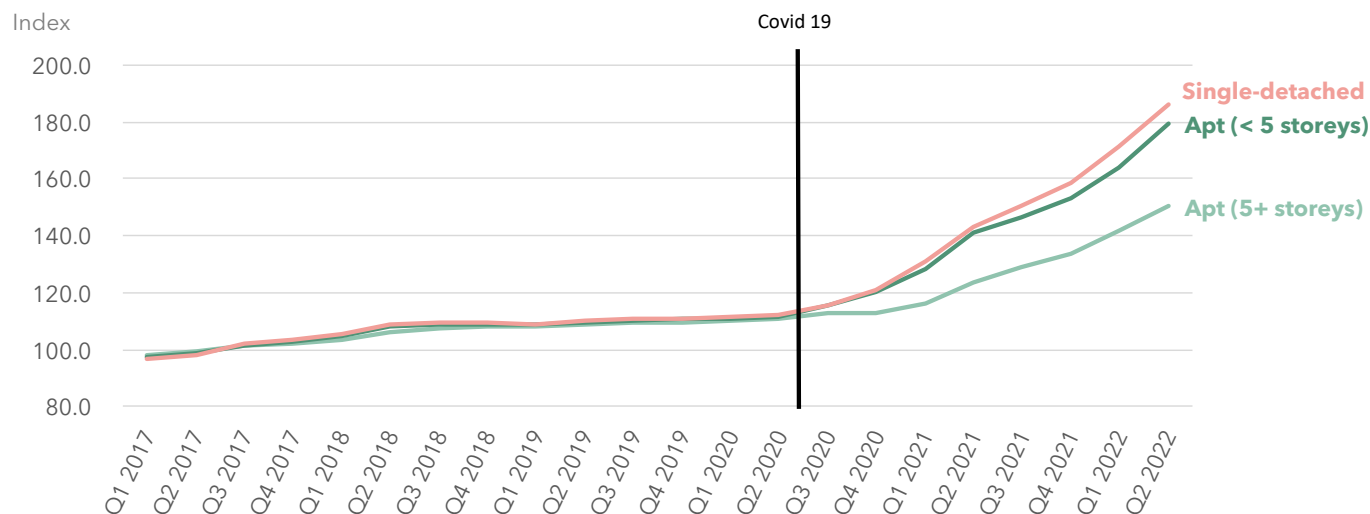
As previously mentioned, ADU's are introduced by existing homeowners to their existing housing lot. This is **not always a profit-motivated financial investment**. For example, converting a garage to a 1-bedroom apartment so that an aging parent can be close by family members can provide quality of life improvements and social well-being not measurable through dollars and cents. Similarly, a homeowner may be content to breakeven or even endure some negative cashflow from a garden suite over a given period of time while they wait for their children or other family members to grow and inhabit the unit in the future.

Escalating Cost Environment

Hard Construction Costs account for 67% – 78% of development costs in the ADU's, making them the most important factor on the cost side of the equation. **Error! Reference source not found.** illustrates the general trending in construction prices over the past 5 years, including the impact of the recent COVID-19 pandemic.

Figure 3.1

Residential Building Construction Price Index



Source: Parcel, based on the Statistics Canada Building Construction Price Index.

Over the first 3 years of the period, single detached and apartment buildings construction prices were tightly knit, growing at the same steady rate of approximately 4% - 5% annually. As illustrated, the pandemic has accelerated this overall rate tremendously since Q1 2020. It is also important to note that the ADU infill typologies considered in our analysis are most similar to *single-detached* homes, which grew nearly 34% annually, while the multi-plexes would fall within the *apartments under 5 storeys* category), which grew 31% annually since Q1 2020.

Moving forward, there are a multitude of factors that will influence cost growth, including the cost of key inputs such as lumber or the availability of tradespeople. Over time, it is likely that average annual cost growth will move back toward the three-year average leading up to the pandemic, however, this is unlikely to stabilize overnight. As such, our assumption of 10% annually over the next 3 to 4 years considers this range from over 30% down to 5%.

Other Factors

In a more general sense, the following key factors have emerged from our analyses of the identified infill housing typologies:

Cost-Equity Relationship

The more expensive a typology is to build (due to size or building design) the more likely the owner will be required to contribute additional cash equity. Otherwise, the resulting cash flow upon completion may be negative (i.e., the owner will lose money each month).

Affordable vs. Market Rental Rates

The smaller, less complex typologies are the most likely to still be 'profitable' at relatively affordable rental rates, whereas the multi-plexes require strong market rental rates just to break even.



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