Introduction

The City of Toronto (City) engaged Real Estate Search Corporation (RESC) to develop policy proposals to support the replacement of office space located in buildings being demolished to make way for other forms of development usually residential; and in particular to identify the threshold GFA at which replacement is required; and to identify policy and implementation requirements for the policy to yield economically feasible new space.

In carrying out the study, RESC addressed the following questions:

- What impact does the replacement of office space have on the health of the office market?
- How much office space has been demolished?
- What policies could be adopted to allow for the development of other uses while retaining the employment space economically?
- What is the definition of office space for the purposes of the study based on evidence?
- What type of office space could be removed without substantial impact?
- Under what conditions should the City require the retention of office space?

RESC also considered the following objectives while researching the data and evidence assembled for this study;

- Create policies which would provide the economic conditions for market driven retention of office space.
- Consider mixed use policies – The desirability for Employment and Residential development within proximity of each other.
- Retention criteria to include heritage or significant regeneration considerations
- Interview and test the recommendations with both office owners and residential developers.

The Report was prepared during the summer of 2013 using both unique data from the Real Estate Search corporation database and data assembled from the City of Toronto including historical building permit applications and employment survey data.

Nine interviews were conducted between August 19th and Sept 12th. The interviews were done in hour long meetings. Interviewees were assured confidentiality. City staff was advised of who may be interviewed but anonymity was provided to those selected. Prior to the meetings a draft of the recommended polices were circulated. In some cases the drafts were distributed to a group of senior executives. In other cases, groups of senior executives met for the interviews. In one case written comments were returned and no interview occurred.

The interviews are considered to be of high quality because interviewees;

- Represent three residential development companies who have built a majority of the multi-residential buildings in excess of 100 suite condominium residential projects in the last 5 years.
- Represent development companies who have applied for and demolished office buildings.
- Include those who have replaced office space as part of the redevelopment of the site.
- Include persons who act for or are involved with associations in the business of representing developer interests.

All interviewees were unaware of the total impact of the demolition of office space and its impact on the employment market place. Some did not fully agree with the policies being recommended and indicated that no policy could apply to all situations.

The results of the interviews have been embedded in this report as part of the recommendations. In general, however, there was agreement that;

- Collectively the removal of uneconomic “C” class space made sense from an investment perspective.
- No owner should be restricted from removing buildings which were uneconomic.
- Greater clarity on exactly where the policy which makes the replacement of office space a requirement should be made.
- The demolition of office space normally occurs in areas where the office space market is weak and the residential market is strong making replacement economically harsh. Replacement in or exchange with stronger office markets should be encouraged.
- Incentives should be available to developers to replace office space economically, where feasible.
- Clearly define “balanced supply of both residential and employment capacity” When balanced supply of both is reached the policy could be eliminated.
- Replacing office space with non-employment uses in historical or heritage structures would also apply.

- Preserving existing structures in a regeneration node was desirable where the economics made sense.

The following is the full report with the comments of the interviews embedded where the consulting team agreed that the comments fulfilled to objectives of the assignment and complied with existing policy and planning practice.

Background

Office Buildings for the purpose of this study are defined as:

- Buildings used predominately (over 80%) for conducting business not associated with manufacturing.
- Buildings built specifically for office use may have limited uses other than office such as printing, shipping, packaging and computer related facilities.
- Buildings not originally built as office buildings such as manufacturing, residential or institutional buildings which have been converted to office space are considered office buildings.
- Retail spaces on the ground or on a second level are not calculated in the determination of how big an office building is.
- Office buildings which are predominantly used for medical or teaching purposes and are attached to or part of properties where medical or teaching is the predominant activity are not included as office buildings for the purpose of this study.
- Buildings of 2 stories or 3 stories of street retail and office/residential functionality above grade, commonly known as strip malls or commercial strips are not included as office buildings
- Buildings used by governments for predominantly government office purposes (over 80%) are not included as office buildings.[1]

The transition from industrial jobs located mostly in industrial only zoning of the early 20th Century to employment located in office buildings in largely mixed use is changing where people work. This change puts

[1] For further clarity please refer to the Real Estate Search Corporation's (RESC) website. The data for this study was assembled in accordance with the buildings used in the office building portion of the RESC database which includes 2,541 buildings as of September 31st 2013.

pressure on the need for policy that specifically addresses a balanced approach to the supply of both places for office workers to live and work.

When residential supply capacity substantially exceeds employment supply capacity there is a need to have policy which helps to restore balance. This includes the preservation of existing office space as well as a policy which encourages the creation of new supply of office space of all types and in all markets in order to keep pace with residential development. There was a period in the late 1980s where office capacity out performed residential capacity and this may occur again, but for now and as the data shows residential capacity has outperformed commercial capacity from at least 2000.[2]

This policy recommendation specifically addresses the issue of preserving office where feasible and/or replacing it. It is the opinion of the authors that these policies should only apply while there is an imbalance of supply.

Presently, 55% of all jobs in the City are located in office buildings. This ratio is expected to continue to grow as manufacturing jobs do not grow substantially. The Region is expected to grow from 6 to 9 million people over the next 30 years and that will create demand for office jobs and the creation of between 100 and 125 million sq. ft. of office space to accommodate those jobs[3]. This will bring the total in the Region to more than 300 million sq. ft. of office space.

As of December 31st 2013, there is over 206,000,000 sq ft of office space in the Greater Toronto Area including buildings under construction. The City of Toronto has 140 million sq. ft. of office space and 66 million is located in the rest of the Greater Toronto Area (GTA)[4]. In order to maintain its current share of the region's office space, the City of Toronto is expected to grow by at least 60 to 80 million sq. ft. of office space. The City of Toronto must maintain or exceed its share to balance the extraordinary growth of residential capacity. Without a comparable growth of employment space the strain on mobility infrastructure will be too great. The Region is already experiencing “reverse commute” where people are forced to travel from the City into the 905 by car alone.

To achieve this potential growth, changes will be necessary to planning, economic and transportation policy. The capacity to house office job growth may be at risk without policy change. One major challenge to meeting future demands is the creation of new mid-sized, mid-price

---

[2] See Appendix 1
[3] 'Sustainable Competitive Advantage and Prosperity – Planning for Employment Uses in the City of Toronto', MGP 2012 (The Employment Uses Study)
[4] Real Estate Search Corporation (RESC) data

buildings and a declining supply of buildings which can be repurposed from other uses to office space. Recent trends suggest that the market is producing only large scale high-end office buildings and not enough of the other two types to provide for the residential growth.

The City of Toronto's staff has proposed, as part of the overall strategy to increase office space capacity, that there should be 'no net loss' of office space through the redevelopment process. Any space demolished must be replaced. The objective of this report is to suggest policy alternatives and tools that will help preserve or create office space while at the same time permitting further economically viable property development of other uses on those sites.

Preserving office capacity in this business cycle is strategically important for the City. Until markets and policy are creating a balanced supply of residential and employment capacity, the City can no longer permit the erosion of low cost alternatives for business. To be sustainable, the market for office space should provide a reasonable range of options for employers in terms of location as well as cost.

Current Supply of Office Space

The current supply of new office space in the City has averaged between 750,000 sq. ft. and 800,000 sq. ft. per annum over the last 10 years[5]. 96% of that has been built in the Financial Core (FC).[6] The expected growth of new office space in the City and the Region will require that the average supply of office space in the City of Toronto alone must increase to at least 1.5 million sq. ft. /annum for the City to maintain its share of the region's office space. The projections for this amount of space include all types of office space from major projects in the financial district, to midsized projects in nodes throughout the City and the retention of low cost conversion of other types to affordable early stage "incubator' type office space.

The last 15 years has seen new supply of office space in only two types of buildings and most of all that has been created in the Downtown area. New buildings in the Financial Core have been built recently suitable for the growth of the Financial Services Sector (FSS). There has also been the conversion/regeneration of many buildings from manufacturing to office space in the Kings and other older industrial areas. These two types of office buildings have created most of the capacity for the last 25 years. In order to meet the demands of the future the city will have to incent new

[5] See Appendix 1
[6] The Financial Core includes nodes on the Waterfront and immediately to the West of University.

development opportunities and reach out into broader markets both from a building type and from a geographic perspective.

New supply required to match growth will have to be housed in three types of buildings

1. New “AAA” class space in the Financial Core.
2. New mid-sized buildings in accessible lower cost clusters
3. Regeneration of other forms of buildings.

Without increasing the capacity in the 2nd and 3rd types the City is at risk of losing employment space and opportunity. When the space doesn’t exist the growth may not occur at all or may end up outside of Toronto or even in other cities.

New “AAA” class space

The Financial Core is experiencing a renewal of construction. The appearance of several high profile “AAA” buildings in the Financial Core after a long absence of building represents a shift in focus but this alone will not manage the expected need for more office space in the City. The Financial Services Sector has enjoyed steady growth of between 500,000 sq. ft. and 600,000 sq. ft. per annum for the past 15 years[7].

There is approximately 12 million sq. ft. of remaining building capacity in the financial core. This figure was determined by interviewing 4 major commercial real estate firms and using the data prepared by RESC. While new opportunities may be created through the re-zoning process, it is believed that this should be enough new office space for the growth of the financial services sector over the next 15 years. (5 million sq. ft. is under construction at the time of writing and is scheduled to be completed in the next 5 years). However, the supply of AAA buildings in the financial core is only expected to meet a third of the demand needed to meet growth targets in the City of Toronto.

New Mid-sized Mid-priced Office Space

The construction of new mid-sized, mid-priced office space in the Region has been largely met outside the City of Toronto with over 360 properties of this type being built since 2000 and less than a dozen comparable sites in the 416. During the last 25 years the “sprawl” of office accommodation in mid-sized, mid-priced markets has largely occurred outside the City in industrial parks serviced by highways and isolated from other uses. This

[7] RESC schedule of FSS growth

trend may be wavering but there is still a real risk to the City of Toronto that this trend will continue.

Emerging Economy

Space for emerging businesses in the New Economy was largely satisfied during the past 20 years by the regeneration of the “Kings”. Zoning policy was amended in the mid-90s to permit office employment and other uses in former industrial buildings, resulting in a complete regeneration of these buildings The transformation of mostly industrial buildings, in the brick and beam districts including the Kings on both the east and west sides of the downtown core to good quality but affordable office space has led to the creation of over 15 million sq. ft. of office space without the construction of a new building. One of the key arguments in support of “deregulation” in the Kings was that by focusing on urban form rather than the land use, investors (be they commercial office investors or condo builders) could get to market in a very short timeframe. This building type is becoming harder and harder to find and new conversions are fewer and fewer. Some estimates put the remaining supply of convertible buildings below 2 million sq feet.[8]

Impact of Demolition of Office Space.

The removal of 3 million sq. ft. since 2000 and 5 million since 1990 of largely “C” class buildings as a result of conversions to housing and other uses is creating even tighter market for affordable office space than before. The impression created in the City recently that the new “AAA” class space construction is a sign of resurgence, can be misleading because office space isn’t being built *anywhere else* in the City and only “AAA” class space is being created.

Current vacancies in “C” Class of all sizes are 2.7%[9]. Most of the space being removed is considered undervalued in real estate terms, but from an employment perspective the removal of space is creating a lack of space for companies who cannot afford to occupy new “A” or “AAA” class space.

Policy has been used to incent employment spaces in the past and this study recommends incentives to balance the economic disparity between new construction and the cost of retaining existing office space. There is precedent for this. The City induced the growth of the creative classes in

[8] . The figure 2 million is the result of 2 interviews with commercial builders in that market and the assessment of building supply by RESC.
[9] Vacancies in All “C” Class space since 2008 have never been higher than 4%. Balanced markets operate well at 5% vacancy.

repurposed and generally less expensive buildings in the Kings…..[10] Preserving job capacity in the City is the objective of the "no Net Loss" policy provision but achieving this objective will require tools to level the disparity between the values of spaces in these buildings.

Residential Out Building Jobs Space In office Buildings

The overall creation of new office space is not keeping up to the creation of new residential capacity[11]. The residential capacity of the City and the collateral jobs required to sustain that growth has outstripped the new supply of office space considerably. The growth of over 100,000 residential condominium units in recent years has outpaced the development of new office space capacity (See Appendix 1). This trend is not slowing down with the recent completion of office towers in the Financial Core. On current practices every 1,000,000 sq. ft. of rentable area provides capacity for approximately 5,000 jobs. To keep pace with the anticipated population growth, office space would have to be built at a rate of 1,500,000 sq. ft. /annum. Providing policy changes which do not inhibit redevelopment and repurposing of buildings is an essential part of the new intensification of the City. Encouraging mixed use policies and providing employment and residential spaces together in areas outside of Employment Areas is an objective of planning policy.

Mixed Use

Arguments have been put forward for NOT obliging builders to put multiple uses in one building because market conditions for multiple uses may be very different[12], however, in this case where office space already exists and recognizing that market conditions are most likely not favourable to office space, policy ought to recognize and address this imbalance. Policy tools to mitigate or subsidize the economic imbalance are in the public interest and represent good planning policy. The situation varies in scale depending on the market but the policy tools as recommended below enable the builder to reasonably and economically retain or replace existing office space as a condition of redevelopment.

Meeting Growth Expectations

While other policy initiatives promote investment in new office building capacity[13], there remains the need to retain existing inventory of office

---

[10] Employment Uses Study
[11] Employment Uses Study.
[12] Strategic Regional Research, 'Region in Transition' (date); also Appendix 2.5 of the Employment Uses Study
[13] for example, the City's Imagination Manufacturing Innovation & Technology program which provides a grant equivalent to a tax rebate for 60% of the increased taxes over the first ten years after the space has been built

space because the overall capacity is not keeping pace with residential capacity. It is estimated that 18 million sq. ft. of office space is at risk of conversion to other uses. Much of that is on existing transit corridors and underdeveloped sites.

The Employment Uses Policy Study showed that there will be continuing strong need to create new office employment space and a need to accommodate that growth in existing office space as well. The Study also indicated that the market demand for office space in many of the existing locations outside of the Downtown and for small modules of new space is very soft. In those conditions leasing retained or replacement space may not be economically feasible for the developer.

The Employment Uses Policy Study recommended a policy that would require retention/replacement of office space if a site was to be converted to another use. The proposed policy was to apply to buildings with a net rentable area for replacement over 10,000 sq. ft. but the policy would need to be supported by incentives for developers to insure the economic viability of retaining existing office space while intensifying development.

What are “Buildings at Risk?”

In recent years the City has been experiencing the demolition of office buildings replaced by residential uses. This has been driven by market forces. Over 3 million sq. ft. of office space has been removed from the market in the last 10years. During the same period there was just over 6 million sq. ft. built of new space and 4 million of converted space from other uses. All but 3 buildings were replaced by residential buildings and all were “C” class buildings.

The data used to determine which buildings and how many there are was based on the number and distribution of “C” class office buildings. Real Estate Search Corporation has identified over 18 million sq. ft. of “C” Class buildings in the City, 15.5 million sq. ft. of which is greater than 20k[14]. This suggests that while there are over 300 buildings below 10,000 sq. ft. they only make up make up less than 6% of the “C” class space. Their protection from removal will not have a significant impact on the supply of office space in the market. By significant, we argue that there would have to be large numbers of these buildings demolished and there is no evidence that this has happened or is about to happen.

What are “Businesses at Risk?”

[14] There is 18,687,880 sq ft of “C” Class office space in Toronto and only 1.1 million is below 10,000 sq ft.

The buildings at risk of removal generally contain the widest variety of uses generally in low cost accommodation. Most companies satisfy their need for office space by moving into vacant space in existing buildings. In other words they go where the space is. These companies rely on a wide variety of options and a marketplace where vacancy is reasonable. These companies often could not exist in more costly space. The bulk of start-up companies start their businesses in these spaces and are vitally important to their growth.

The impact on businesses of losing office buildings in the “C” class rent market is significant. The demand for this space is borne out by the lowest vacancy rates of all classes. The vacancy rate for all “C” class space has not been above 4% in 7 years and is currently 2.7%. More telling is that there is virtually no space for sublease. The opportunity for those tenants to operate in the Toronto market is limited by a very small amount of opportunity space. Recognition of where those tenants can be re-located to should be a determining factor in which policy incentives are applied. There are several examples of tenants who successfully relocated in the node where their previous building was removed[15] Most businesses in the cases studied, however, closed down or move out of the City.

If vacancy is not available to small and medium sized companies at an affordable price then they cannot operate. Only about 350 companies[16] are big enough and strong enough to provoke the construction of new buildings. Those companies make up 30% of the size of employers in the market place. Over 250 of those companies are not big enough to justify building a building in excess of 150,000 sq ft. Fewer than 100 businesses have been in a position to manage growth on their own terms in the City of Toronto, the rest rely on vacancy and existing buildings.

[15] e.g. Royal Sun Alliance building formerly on Scott Street.
[16] Strategic Regional Research Associates research in progress.

What issues should policy address?

The sites and office space being converted all had some of the following characteristics:

- underdeveloped relative to the lot sizes
- undervalued compared to the converted use
- located in office employment nodes where no new supply had been built within 25 years
- located mostly in old transit friendly nodes
- leasing values were considerably below values needed to build new supply
- attracted allowable densities far greater than the commercial zoning permitted
- existing buildings were run down requiring major re-investment

New policy must recognize the economic reality of the existing buildings at risk and induce/mitigate the economic conditions which would allow for the preservation or enhancement of employment while at the same time allowing for redevelopment to include other uses.

Policy Recommendations

General

Recommendation 1 Policy Review– The policies recommended in this report should be reviewed regularly, and at least as often as every 5-year review of the Official Plan. The test for when the policy could be removed ought to be based on the market place reaching a supply balance between net new residential capacity and net new employment space capacity.

Recommendation 2 Minimum Size- Office Space in buildings as defined in the appendix "A" must be retained when it exceeds 10,000 sq. ft. in gross floor area in on a site under conversion to other uses.

Recommendation 3 Mid-Size - Space measuring in excess of 10,000 sq. ft. but less than 20,000 sq. ft. of office space may be replaced with new or converted space in other office clusters with comparable access to rapid transit..

Recommendation 4 Over 200 sq m – Space over 20,000 sq. ft. must be retained within the node.

Recommendation 5 Tenants are re-located in the same Node – The obligation to retain office space may be removed in extreme cases where the vacancy in the node exceeds 30% and as a result no amount of inducement will create a reasonable re-investment in office space.

Recommendation 6 Replace/Retain before Conversion- Office Space in buildings which qualify for relocation outside the node or are retained in the node but off site must be completed before the old space is removed. Office space retained on site must be built at the same time as the new mixed use is built.

Financial Incentive Tools[17]

Recommendation 7 Realty Tax Exemption Transition/Construction Period – no realty tax will be charged on office space during the construction of replacement office space as an inducement to replace or refurbish.

[17] Although these incentives are described as tax relief of one kind or another, the actual incentives would be provided as grants through a Community Improvement Plan and not as a reduction or rebate of taxes.

Recommendation 8 Never Occupied Space Tax Exemption – Retained or replaced office space under this policy may receive an exemption from realty tax for up to 10 years for new or regenerated office space which has never been occupied.

Recommendation 9 Tax freeze on replacement space at old rates - It is in the public interest to retain the opportunity to have a place to work. If the space is replaced under the conditions of policy requiring it to be replaced then the new space should be taxed at its pre-redevelopment rate for the transition period (10 yrs.).

The argument is that if there was 'no policy' to retain office space there would not be any tax once the building was demolished. As a result of this policy the city is already further ahead from a revenue perspective and holding the rate at pre retention levels makes the new space competitive, and it achieves other policy objectives such as providing space for jobs and support for transit.

Site Planning Tools

Recommendation 10 –Drop or reduce parking requirements in Transit or established office nodes. In order to mitigate against costs which would otherwise further inhibit re-development, no more parking should be required for the replaced space than was provided before the redevelopment. Parking requirements have changed. Many old buildings have no parking and those conditions should be preserved to reduce the cost of retention.

Recommendation 11 –Density bonus provisions above the existing zoning which permit the value of the building or site to increase beyond what the value would have been if the office space was not retained or replaced. Zone for new uses as if the old building didn't exist and then add the old massing of the office building to the coverage, providing the transition in scale and impact on adjacent neighbourhoods is satisfactory.

Appendix 1:

Measuring Residential and Commercial Office Job Capacity

Creating places to live and places to work in balanced amounts contributes to more complete communities. To measure this, the City of Toronto and Real Estate Search Corporation analysed residential building and commercial office space data to develop a tool to understand the balance between the capacity to house people who work in office jobs and the capacity to locate those jobs in office buildings.

The results of this work indicate that since the beginning of 2000 and up to the end of 2013, there were twice as many places to live for people with office based jobs than office space to accommodate them. The overall creation of new office space is not keeping up to the creation of new residential capacity in the City of Toronto. This trend contributes to the reverse commute from the City to the 905.

The research concluded that from 2000 to 2013, 105,000 people with office jobs lived in new housing in the 416, largely in multi-unit condominiums. At the same time the amount of net new office space accommodated for only 52,000 jobs in office space, a 2 to 1 ratio. The capacity ratio for the last five years was less but still unbalanced, 43,000 residential places for office workers were created while only 27,000 places for office workers to work were built.

The assumptions which lead to the development of this measuring tool include a better understanding of what type of buildings house jobs and how many people per household worked in jobs related to those buildings.

What is the reason office jobs were singled out for this study?
A previous study by Malone Given Parsons for the City of Toronto[18] indicated that over 55% of jobs in the City were housed in office space, 17% in industrial buildings and the balance distributed in all other forms of employment including retail medical, educational as well as non-place based jobs in the transportation sector.

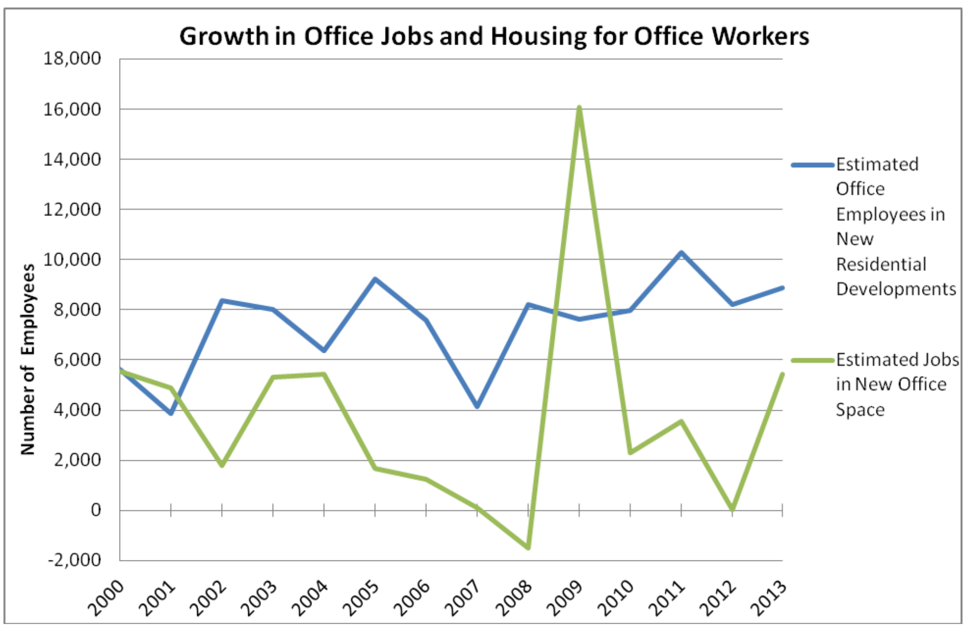
Growth in the office sector has outpaced all other building forms and there is every indication that this trend will continue. Office space houses both traditional business and many of the new economy businesses which are driving growth of the region. Intensification of the region will occur and there is limited growth for employment spaces other than office space.

[18] Sustainable Competitive Advantage and Prosperity – Planning for Employment Uses in the City of Toronto', MGP 2012

Growth in the industrial base will not be significant in the coming decades and the study showed that retail employment in shops and major retail outlets largely grows with residential capacity. Retail and service jobs tend to grow with residential growth whereas office space development is far less likely to be driven by residential development leading to imbalances of supply as we are seeing in the City of Toronto.

Even more important to city building is the close relationship between the higher order transit and office jobs due to the high concentration of jobs in a relatively intense and small amount of land. Office space if connected to residential capacity feeds ridership and sustainability more than other forms of non-residential space.

The following graph plots the estimated number of office employees in both new residential space and new office space. With the exception of 2009 residential capacity has outstripped the creation of office space. The table below provides a summary of the estimates used in the graph.



Graph 1, New housing is out growing the capacity to house office jobs at the rate of 2:1, 2000-2013

	2000 - 2006	2007 - 2013	2000 - 2013	Average p.a. 2000-2013
New residential units	80,300	90,700	171,000	12,200
Estimated Office Employees in New Residential Developments*	49,000	55,300	104,300	7,500
New office space (sq. ft.)	6,913,300	6,827,600	13,740,800	981,500
Jobs in New Office Space**	32,900	32,500	65,400	4,700
Office loss (sq. ft.)	1,439,600	1,321,600	2,761,200	197,000
Job capacity of lost space	7,000	6,500	13,500	1,000
Net increase in Office Space (sq. ft.)	5,473,600	5,505,959	10,979,600	784,300
Net increase in jobs in office space	25,900	26,000	52,000	3,700
Estimated New Office Jobs per Newly Housed Office Worker	0.53	0.47	0.50	0.49

All figures rounded to the nearest hundred.
* based on an estimated 0.61 office workers per residential unit
** based on an estimated 210 sq. ft. per office employee

The building of over 170,000 residential units in recent years has outpaced the development of new office space capacity. This trend is not slowing down with the recent completion of office towers in the Financial Core. To keep pace with the anticipated population growth, office space would have to be built at a rate of 1,500,000 sq. ft. /annum. Providing policy changes which do not inhibit redevelopment and repurposing of buildings is an essential part of the new intensification of the City. A balanced approach to mixed use policies and providing employment and residential spaces together is critical to the regions success.