TORONTO

STAFF REPORT
ACTION REQUIRED

Proposed Incentives to Support the Replacement of Office Space in New Mixed Use Developments

Date:	July 23, 2014
To:	Planning and Growth Management Committee
From:	Chief Planner and Executive Director, City Planning Division General Manager, Economic Development & Culture Director, Corporate Finance
Wards:	All
Reference Number:	P:\2014\Cluster B\PLN\PGMC\PG14130

SUMMARY

This report proposes that City staff consult with the public and the development industry on incentives to support the replacement of office space proposed to be demolished or repurposed to make way for residential development in areas near transit stations that are designated Mixed Use Areas or Regeneration Areas. The proposed consultation would take place over the course of the fall and winter 2014-2015. The report responds to a request from Council when it approved Official Plan Amendment 231, the Official Plan's economic and employment policies, in December 2013.

This report presents some incentives for discussion, including:

- Financial incentives that would be payable as grants equivalent to all or a portion of the municipal property taxes on existing space that is being replaced and/or the new replacement office space ;
- Planning incentives including reduced parking requirements and exemptions from the density calculations for the replacement space;
- Priority processing under Goldstar for the development application.

Full details of the incentives proposed for discussion are presented in Attachment 1.

The incentives address the 'gap' between, on one hand, the value of the land for residential towers rather than office buildings, along with the cost of building new space, and, on the other, the value of the rents that the existing or new office space can command in the market. Their goal is to keep office jobs in the City.

The current IMIT program also provides incentives for new office development, through TIEGs (grants equivalent to the municipal property tax increment yielded by the new development). The present IMIT program will be reviewed in 2016, and the consultation for the proposals presented in this report will inform that fuller review.

RECOMMENDATIONS

The Chief Planner and Executive Director, City Planning, the General Manager of Economic Development and Culture and the Director of Corporate Finance recommend that:

1. City Council direct staff to consult with the public and stakeholders on financial and planning incentives to support replacement of office space, based on the proposals shown in Attachment 1;

2. City Council direct staff to report further to Planning and Growth Management Committee in the first quarter of 2015 on the results of the consultation.

Financial Impact

Despite the construction of new office towers in the Downtown, the City has also been losing substantial amounts of office space through demolition or conversion to other uses over the past 20 years.

The purpose of the financial incentives proposed for discussion is to retain and potentially add to the supply of office space in the City. This would enlarge the tax base associated with such space since new space generally has a greater Current Value Assessment (CVA) than existing space. The basis of the grants that are equivalent to taxes on existing space is that if the financial incentives were not provided, the City would lose the space and the existing taxes it pays. It should be noted that new residential development that replaces the demolished space would pay property taxes, as a matter of course.

Based on the observed loss of office space since 1999 about 9,000 sq.m. of space per year may be eligible for incentives. The taxes payable by such lost space could be upwards of $250,000 per year, which would add up to $2.5 million over 10 years. An estimate of the financial impact of the incentives that will be proposed after the public consultations will be provided in the report targeted for the first quarter of 2015.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

On December 16, 2013, Council adopted OPA 231, which contains policies for the economic health of the City and policies, designations and mapping for employment areas. When it adopted OPA 231, Council also directed staff to 'report to the Planning

and Growth Management Committee in the first half of 2014 on additional incentives that the City may consider to promote the development of and maintenance of office space in the Downtown, Centres and within walking distance of rapid transit stations.'
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.PG28.2

ISSUE BACKGROUND

New Policies for Economic Health

The policies in OPA 231 represent a comprehensive approach to planning for employment in the City. As a large amount of the City's employment is in offices and a correspondingly large amount of its employment growth will also be in offices, a key element is the long term importance of maintaining and increasing the supply of office space in the City. The policies also recognize the importance of locating offices across the City and not just in Downtown, and on rapid transit, because of the limited capacity of the regional road network to support office growth.

Increasing office supply

With a view to increasing supply, OPA 231 includes a new policy (3.5.1.6) promoting the construction of office space on rapid transit lines – specifically in Downtown, the Centres and other areas within 500 metres of a rapid transit station.

Maintaining office supply

OPA 231 also includes a new policy (3.5.1.9) requiring the replacement and increase of office space where over 1,000 sq.m. of existing office space is proposed to be demolished to make way for new residential development. The full wording of the policy is:

> "New development that includes residential units on a property with at least 1,000 square metres of existing non-residential gross floor area used for offices is required to increase the non-residential gross floor area used for office purposes where the property is located in a *Mixed Use Area* or *Regeneration Area* within:
>
> a) the *Downtown and Central Waterfront;*
> b) a *Centre; or*
> c) 500 metres of an existing or an approved and funded subway, light rapid transit or GO train station.
>
> Where site conditions and context do not permit an increase in non-residential office gross floor area on the same site, the required replacement of office floor space may be constructed on a second site, prior to or concurrent with the residential development. The second site will be within a *Mixed Use Area* or *Regeneration Area* in the *Downtown and Central Waterfront*; the same *Centre*, or within 500 metres of the same existing or approved and funded subway, light rapid transit or GO train station."

The underlying objectives of the policy are to:

- Ensure adequate ongoing job opportunities for the city's residents that can be reached by public transit;
- Support transit ridership;
- Support a strong civic economy.

When the policy was being considered, submissions to Planning and Growth Management Committee and Council indicated that the city should consider possible incentives for office development before the policy was adopted.

The Ministry of Municipal Affairs and Housing issued its decision on OPA 231 on July 9, 2014. The decision approved all of the office promotion and retention policies. It is anticipated that the Minister's decision will be appealed to the OMB. A commitment to provide incentives will match the City's requirement to replace and increase office space on rapid transit with incentives to do so.

Existing Incentives for Office Development

Financial Incentives through the IMIT Program
Currently, the City's IMIT program provides the following incentives for office development:

Tax Increment Equivalent Grants (TIEGs) are incentives provided in the form of grants that are equivalent to the increment in property taxes resulting from the development of the new office space. The grants are available for 10 years after the space is developed. In the first year, the grant is equal to 100% of the incremental tax, and this declines in subsequent years, so that over the 10 year period the grant equals a total of 60% of the incremental taxes (or 70% for locations in Employment Districts).

Transit corridors In transit corridors (within 800m of a transit station and not within the Financial District), all office buildings over 5,000 sq.m, are eligible to receive TIEGs, as well as contiguous office space over 5,000 sq.m. in a mixed use building.

Outside transit corridors (except in the Financial District as shown on Map 6 of the Official Plan) all corporate office buildings over 5,000 sq.m are eligible for TIEGs. In addition, contiguous office space over 5,000 sq.m. in a mixed use building is eligible to receive TIEGs, provided that at least 2,500 sq.m. or 25% of the office space, whichever is greater, is devoted for corporate office space.

Corporate office buildings must have at least 2,500 sq.m. or 25% of the GFA of the office building (whichever is greater) occupied by the corporate offices of a firm in an eligible sector. The eligible sectors include:
- biomedical operations
- computer systems design and services
- creative industries
- financial services
- food and beverage wholesaling
- information and communications technology
- information services and data processing
- manufacturing

- scientific research and development
- software development

Corporate Headquarters In the Downtown (including the Financial District) the program provides incentives for the space occupied by the Canadian or global corporate headquarters of a company. They must occupy a minimum of 10,000 sq.m. of office space within office buildings or other multi-tenant buildings.

Development Charges exemption
Office space is exempt from paying development charges if it is above or below the ground floor of a new building. The current charge would be $160.62 per square metre if payable. On a new 5-storey building of 25,000 sq metres this would amount to about $3.2 million.

In addition, office space that has been approved to receive IMIT grants is exempt from paying Development Charges. This would include the ground floor space of eligible office buildings. In the example of the 5-storey office building, this could be a further $800,000 in development charge exemptions.

Reduced tax ratio
The City has progressively lowered the tax rate for non-residential uses over the past 10 years, with a target of a ratio of 2.5 times the residential rate for office space by 2020.

Parking policies
The Official Plan also provides that for sites well serviced by transit, consideration will be given to minimum and maximum parking requirements.

Priority processing of applications
Development applications for office buildings and mixed use buildings with a large office component receive priority processing under the Gold Star program.

COMMENTS

Process

City staff engaged Real Estate Search Corporation (RESC) to assist staff with the development of incentives to support the replacement of office space located in buildings being demolished to make way for other forms of development. The RESC report (December 2013) is attached to this report as Attachment 2 and is available on the Official Plan Review webpage.

RESC's recommendations were based on analysis of its own database, the City's employment survey data, and interviews with office owners and residential developers to test possible incentives.

The proposed incentives are based on the RESC report along with further input from staff in Economic Development and Culture, Corporate Finance, and Legal Services.

Loss of office space

Since the onset of the recession in 1990, the City has seen many office buildings demolished, often to make way for new residential developments. It is not possible to estimate the total amount of office floor space lost, but employment survey data indicate that in 1990 there were about 40,000 jobs in office floor space that has been lost since then. Well-known examples include the Imperial Oil building on St Clair Avenue West, the provincial government offices on Yonge St south of Eglinton Ave, and one of the large buildings in Consumers Road at 2025 Sheppard Ave East.

In areas near subway stations (excluding the Financial District) since 1999, staff estimate that we have lost about 105,000 sq. m. or just under 9,000 sq.m. per year.

There are current applications to demolish the Foresters Towers near Don Mills and Eglinton (34,600 sq.m.) and an 18 storey office building at Bloor and Bay (24,445 sq.m) to be replaced by condo towers with no office component.

The basis for the incentives

The RESC report (Attachment 2) provides a full discussion of the basis for the proposed incentives. This discussion draws heavily on the RESC report.

Need for a continuing supply of office space

In order to provide accessible job opportunities for Toronto's growing population, it is important to balance the supply of residential development with new office development. The consultant's study which laid the foundation for the revised employment policies in OPA 231 concluded that :

- well over 50% of future employment growth in the City would be in office space,
- that the GTA would need up to 11 million sq.m. (120 million sq.ft.) of additional space by 2041, and
- that, about 5.5 to 7.5 million sq.m. (60 to 80 million sq.ft.) of that space should be in the City in order to retain its share of the region's space.

A variety of space

The City has seen a renewal of office construction in the Downtown Core with around 70,000 to 75,000 sq.m. (750,000 to 800,000 sq.ft.) of new 'AAA' office space per year in buildings suitable for the financial services sector.

This high end supply has not been matched by new mid-sized, mid-priced space in the City. Demand for this space has largely been met in the '905' area around Toronto in industrial parks serviced by highways and isolated from other uses.

Over the past 20 years a significant amount of the growth in office space in the City has been provided in former industrial buildings that have been converted to offices, particularly in the 'Kings.' This space has supported businesses in the 'new economy', but this type of space is becoming harder and harder to find in the City. It is now under increasing pressure from residential development and several buildings have been demolished to make way for the construction of residential towers.

It is important to provide a range of office space to meet the full range of office affordability needs – many businesses cannot afford to rent in a new Class 'A' office tower.

Impact of the loss of space

The space that has been lost over the past 25 years has primarily been space that supports a wide range of businesses and organizations that generally require lower cost accommodation or that meet their changing needs by moving to existing space. The RESC report notes that much of the space lost has been 'C' class space, and that the vacancy rate for 'C' class space in the City is only 2.7% and has not been above 4% for 7 years. Balanced markets operate well at 5% vacancy.

The continuing supply of this space is threatened because much of this space is 'undervalued' in real estate terms. It would yield greater returns if it were redeveloped for condominiums than it does in its present use for office buildings. Furthermore, the current rent levels for the space are often not high enough to support the cost of new space within the City. When space is lost the businesses may close down or move out of the City

The consultant's report summarizes the need for incentives: 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 (p11). The incentives address the 'gap' between, on one hand, the value of the land for residential towers rather than office buildings, along with the cost of building new space, and, on the other, the value of the rents that the existing or new office space can command in the market. Their goal is to keep office jobs in the City.

Transit focus

Given the existing congestion in the City and regional road system, it is essential to locate as much new office space as possible on rapid transit. The policy encouraging office space in OPA 231 focuses on transit supportive space – in Downtown, the Centres and other areas within 500 metres of a transit station. Office space provides about double the ridership as the same amount of residential space. It is consistent with the existing and emerging transportation policy and transit extension to focus further economic incentives on transit –related office space.

Proposed incentives

These proposals are based on the recommendations in the consultant's report. They are offered as the basis for consultation with the public and the development industry.

Proposed incentives: eligible development

Eligible space
The proposed incentives would target new office space being built to replace office space being demolished or repurposed to make way for residential development. They would apply to office space greater than 1,000 sq.m. in office buildings and mixed use buildings. The policy in OPA 231 that the incentives are supporting, targets the replacement of office space greater than 1,000 sq.m. The RESC report indicates that the 300 Class 'C' office buildings below 1,000 sq.m. make up less than 6% of the City's Class 'C' space, and that their protection from removal will not have a significant impact on the supply of office space in the market.

Eligible locations
The proposed incentives would apply to office space in Downtown, except within the Financial District, the Centres, and other areas within 500 metres of a transit station.

The Financial District boundaries for the purposes of these incentives should be enlarged from the area shown on Map 6 of the Official Plan, in order to reflect current strong office development in this area. The precise boundaries will be determined through the consultation process, but it is envisaged they will include areas south of the Gardiner Expressway to the Lakefront and also to the east, west and north of the current boundaries of Victoria Street, Simcoe Street and Queen Street.

Relocated space
In order to be eligible for incentives, new replacement space may be provided on another site than its existing location, under the following conditions:

- space between 1,000 and 1,999 sq. m. may be replaced with new or converted space in other eligible locations with comparable access to rapid transit – this would require a modification to the policy in OPA 231 which would currently limit replacement space to the same area as the demolished building;
- space over 1,999 sq.m. must be retained within the same area; that is, within Downtown, the same Centre, or within 500 metres of the same rapid transit station;
- off-site replacement space must be completed before the old space is removed; and
- replacement space on the same site must be built at the same time as the residential space is built.

Proposed financial incentives

The proposed financial incentives would be provided as grants, with the grant amount based on existing and future municipal property taxes associated with the existing space and the replacement space. This recognizes that if the incentives were not provided, the office space would be lost, along with the property tax that they pay.

The grants would be provided through a Community Improvement Plan. Three types of grants are proposed:

1. a grant to support continuing occupancy of existing space while replacement space is constructed;
2. a grant to support new space for a period after its completion; and
3. a grant to support vacant space in a new building until it is first occupied.

The grant to support vacant space would be paid concurrently with the grant for new space, such that the total grants payable in any year would not exceed the total municipal property taxes payable for the space in that year.

After the grants cease, the City will reap the full property tax benefit. By foregoing some of this benefit in the short run, the City benefits in the long run through the provision of competitive office space for jobs and support for transit.

1. Tax equivalent grant to support occupancy of existing space while off-site replacement space is being constructed

The proposed incentive would be a grant equivalent to all or a portion of the total municipal property tax on existing occupied space that is being replaced by new space on a different site than the existing space. The grant would be available while the new space is under construction. It would only be payable if the existing space were occupied for office purposes. It would be available until the new space was ready for occupancy, or the existing space is demolished or converted to residential uses, whichever is earlier. At that point the other incentives would be available for the new space.

The consultant's report recommended that the grant be equivalent to 100% of the property taxes for the existing space. This recognizes that without the incentives, the space would likely be demolished, with the consequent loss of its property taxes. Staff suggest that this be the basis for consultation.

It may also be appropriate to limit the period for which the grant is available. Staff are proposing 3 years as the basis for consultation.

2. Tax Increment Equivalent Grant (TIEG) for new office space

The proposed incentive is a grant equivalent to a portion of the municipal property tax increment for a limited period of time for new office space that is replacing existing office space being demolished or converted to residential uses.

The consultant recommended that the grant should be equivalent to 100% of the tax increment over a ten-year period. The existing IMIT program provides grants equivalent to 60% of the tax increment over a ten year period (or 70% in Employment Districts), beginning with 100% in the first year and declining thereafter. This recognizes the importance of greater support in the building's early years, and also of providing a 'soft landing' so there will be a lesser impact when the grants cease.

As a basis for consultation, staff propose a total grant equivalent to 85% of the municipal tax increment over 10 years. This would recognize that the consultant's recommendation is for a significantly larger grant than the present IMIT grant, but also provide for a lower grant in the latter years to provide a 'soft landing.',

3. Tax equivalent grant for vacant space

The proposed incentive is a grant equivalent to all or a portion of the total municipal property tax on vacant new office space until first occupancy. The grant would be available once the building is ready for occupancy and would be provided for new space that is replacing old space to be demolished or converted to residential uses. This incentive would supplement the existing vacancy rebate of 30% of the municipal property tax until first occupancy. It should not result in a 'double payment' for vacancy. In addition to this, any commercial space vacant for more than 90 consecutive days will continue to receive a 30% education tax rebate, as required by legislation.

The consultant's report recommended that this grant be equivalent to 100% of the municipal property tax. This recognizes that without the incentives, the space would likely not be built, and consequently would not pay property taxes. The consultant also recommended that this vacancy incentive be available for up to 10 years. Staff are concerned that this is too long. A recent report on the vacancy rebate program expressed concern that payments to owners for vacant space may provide a disincentive to property owners leasing out the space.

As a basis for consultation, staff propose that this grant would be based on the portion of property taxes for the new space that are not subject to TIEGs (the 'non-increment' portion), and that it would only be available for up to 3 years.

Differences with the Current IMIT Incentives for Offices

The existing IMIT program supports replacement space to some extent, by providing TIEGs of 60% over 10 years for space over 5,000 sq.m.

These proposals differ from the current IMIT incentives for offices:

- The 1,000 sq.m. minimum space requirement is lower than the existing requirement of 5,000 sq.m. The lower limit is intended to target the replacement of smaller buildings threatened by demolition.
- The tax equivalent grants for existing space and the tax equivalent grant for vacant space would be new incentives, but only available in situations where new space is replacing existing space.
- The total TIEG may be greater than the present 60% over ten years.
- The eligible area around transit stations would be reduced from an area with 800 m of the station to one within 500 m to be consistent with Provincial policy.
- Other areas of Downtown presently more than 800 m from a transit station would also be eligible.

The 'richer' incentives proposed here reflect the primary importance of retaining or replacing existing office space in the City in areas outside of the Financial District. The present IMIT program will be reviewed in 2016, and the consultation for the proposals presented in this report will inform this fuller review.

Parking Reduction Incentive

The costs of structured parking may inhibit office development. They are a notable addition to the construction costs for a new office building. Reduced parking requirements could make a significant difference to the rents that would need to be charged for new space.

The proposed incentive is that no more parking should be required for replacement office space than was provided for the original office space. This will also support transit use. Many older buildings have little or no parking and the workers within them are reliant on public transit. Maintaining this situation will reduce the cost of replacing the office space and support transit ridership.

Density Incentive

Even with the financial incentives and reduced parking requirements the cost of new office space may not always be supported by rental levels in the local market. The proposed incentive is to consider including the office component as additional density beyond maximum permitted zoned density, except for locations adjacent to lands designated as 'Neighbourhood Areas'.

Priority Processing of Applications

As part of the incentive package, development applications for replacement office space over 1,000 sq.m. would also be eligible for priority processing under the Gold Star program provided it accounted for at least 25% of the project's total GFA. Through the Gold Star program, staff in City Planning, Economic Development and Toronto Buildings help expedite eligible industrial, commercial office and institutional developments.

Further Review

The consultant (RESC) recommended that these policies should be reviewed regularly, and at least as often as every Five-year review of the Official Plan. The RESC report suggests that '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.' The reviews may also consider other matters related to support for transit and other goals of the Official Plan. The existing IMIT Program is required to be reviewed every four years. Consideration should be given to including the replacement office incentives in that review.

Next Steps

The proposed incentives in Attachment 1 respond to Council's December 2013 direction to report on 'additional incentives that the City may consider to promote the development of and maintenance of office space in the Downtown, Centres and within walking distance of rapid transit stations.'

The proposed incentives should be the basis of further consultation with the public and other stakeholders, including the development industry.

Staff will report further on the results of the consultation to Planning and Growth Management Committee in the first quarter of 2015.

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ATTACHMENTS

Attachment 1: Proposed Financial and Planning Incentives to Support Replacement of Office Space – For Discussion

Attachment 2: 'Office Replacement Analysis for OP Review,' report by Iain Dobson, Real Estate Search Corporation (December 2013)

Appendix 1

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Attachment 1: Proposed Financial and Planning Incentives to Support Replacement of Office Space – For Discussion

Eligible development

The proposed incentives would be available for new office space being built to replace office space being demolished or repurposed to make way for residential development.

Eligible size

The proposed incentives would apply to office space greater than 1,000 sq.m. in office buildings and mixed use buildings.

Eligible locations

The proposed incentives would apply to office space in Downtown, except within the Financial District, the Centres, and other areas within 500 metres of a transit station.

The Financial District boundaries for the purposes of these incentives should be enlarged to reflect current strong office development in this area. The precise boundaries will be determined through the consultation process, but it is envisaged they will include areas south of the Gardiner Expressway to the Lakefront and also to the east and west of the current boundaries of Victoria Street and Simcoe Street.

Relocated space

In order to be eligible for incentives, replacement space may be provided on another site than its existing location, under the following conditions:

- space between 1,000 and 1,999 sq. m. may be replaced with new or converted space in other eligible locations with comparable access to rapid transit – note that this would require a modification to the policy in OPA 231 which would currently limit replacement space to the same area as the demolished building;
- space over 1,999 sq.m. must be retained within the same area; that is, within Downtown, the same Centre, or within 500 metres of the same rapid transit station;
- off-site replacement space must be completed before the old space is removed; and
- replacement space on the same site must be built at the same time as the residential space is built.

Proposed financial incentives

The proposed financial incentives would be provided as grants, with the grant amount based on existing and future municipal property taxes associated with the existing space and the replacement space. This recognizes that if the incentives were not provided, the office space would be lost, along with the property tax that they pay.

The grants would be provided through Community Improvement Plan. Three types of grant are proposed:

1. a grant to support continuing occupancy of existing space while replacement space is constructed;
2. a grant to support new space for a period after its completion; and

3. a grant to support vacant space in a new building until it is first occupied.

The grant to support vacant space would be paid concurrently with the grant for new space, such that the total grants payable in any year would not exceed the total municipal property taxes payable for the space in that year.

1. Tax equivalent grant to support occupancy of existing space while off-site replacement space is being constructed

The proposed incentive would be a grant equivalent to all or a portion of the total municipal property tax on existing occupied space that is being replaced by new space on a different site than the existing space. The grant would be available while the new space is under construction. It would only be payable if the existing space were occupied for office purposes. It would be available until the new space was ready for occupancy, or the existing space is demolished or converted to residential uses, whichever is earlier. At that point the other incentives would be available for the new space.

As a basis for consultation, staff suggest that the grant be equivalent to the total municipal property tax on the existing space and that the grant be available for a maximum of 3 years.

2. Tax Increment Equivalent Grant (TIEG) for new office space

The proposed incentive is a grant equivalent to a portion of the municipal property tax increment for a limited period of time for new office space that is replacing existing office space being demolished or converted to residential uses.

As a basis for consultation, staff suggest a total grant equivalent to 85% of the municipal tax increment over 10 years

3. Tax equivalent grant for vacant space

The proposed incentive is a grant equivalent to all or a portion of the total municipal property tax on vacant new office space until first occupancy. The grant would be available once the building is ready for occupancy and would be provided for new space that is replacing old space to be demolished or converted to residential uses. This incentive would supplement the existing vacancy rebate of 30% of the municipal property tax until first occupancy. It should not result in a 'double payment' for vacancy. In addition to this, any commercial space vacant for more than 90 consecutive days will continue to receive a 30% education tax rebate, as required by legislation.

As a basis for consultation, staff suggest that this grant would be based on the portion of property taxes for the new space that are not subject to TIEGs (the 'non-increment' portion), and that it would only be available for up to 3 years.

Proposed Planning Incentives

Three types of planning incentive are proposed:

1. Reduced parking requirements
2. Density calculation exemption
3. Priority processing for development applications

1. Parking reduction incentive

The costs of structured parking may inhibit office development. They are a big addition to the construction costs for a new office building. Reduced parking requirements could make a significant difference to the rents that would need to be charged for new space. The proposed incentive is that no more parking should be required for replacement office space than was provided for the original office space. This will also support transit use. Many older buildings have little or no parking and the workers within them are reliant on public transit. Maintaining this situation will reduce the cost of replacing the office space and support transit ridership.

2. Density incentive

Even with the financial incentives and reduced parking requirements the cost of new office space may not always be supported by rental levels in the local market. The proposed incentive is to consider including the office component as additional density beyond maximum permitted zoned density, except for locations adjacent to lands designated as 'Neighbourhood Areas'.

3. Priority Processing of Applications

As part of the incentive package, development applications for replacement office space over 1,000 sq.m. would also be eligible for priority processing under the Gold Star program provided it accounted for at least 25% of the project's total GFA. Through the Gold Star program, staff in City Planning, Economic Development and Toronto Buildings help expedite eligible industrial, commercial office and institutional developments.

Attachment 2: 'Office Replacement Analysis for OP Review,' report by Iain Dobson, Real Estate Search Corporation (December 2013)

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 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]

[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.

[2] See Appendix 1

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 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.

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[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

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 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

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

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 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.

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[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.

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 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.

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[9] Vacancies in All “C” Class space since 2008 have never been higher than 4%. Balanced markets operate well at 5% vacancy.
[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

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 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.

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[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

[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.

What are "Businesses at Risk?"

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.

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

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

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.

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[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.

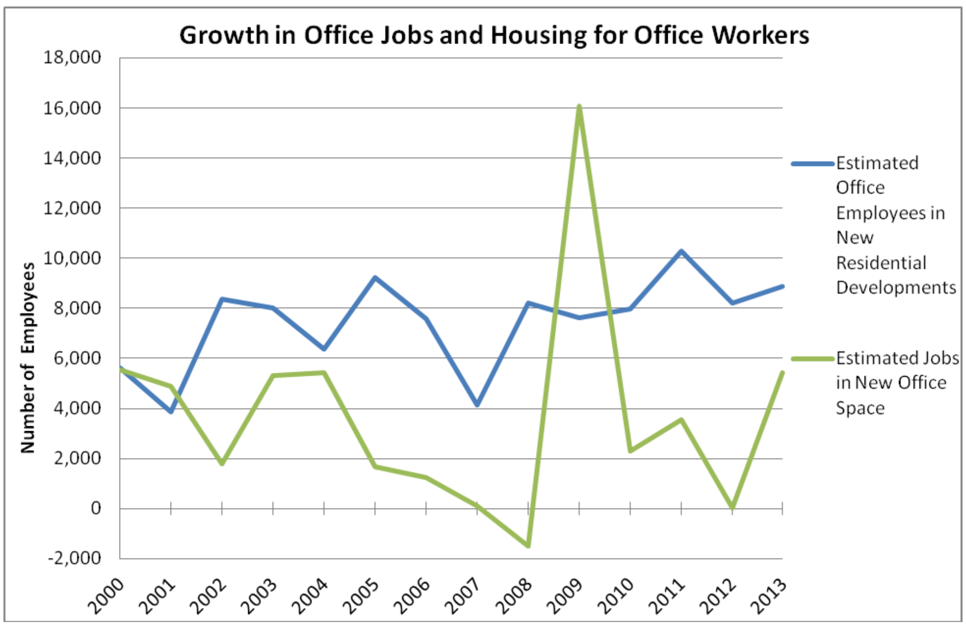
Growth in the industrial base will not be significant in the coming decades and the study showed that retail employment in shops and major retail outlets largely grows with residential capacity. Retail and service jobs tend to grow with residential growth whereas

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

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.