Office Space Needs Study

Needs Assessment & Policy Options

November 18, 2024

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Cover Image: CoStar Realty Information Inc.

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Acknowledgements

Project Consulting Team

The project consulting team responsible for completing this study included a range of industry-leading professionals offering expertise spanning the full breadth of land economics, land use planning and municipal strategy / policy implementation. Parcel Economics Inc. ("Parcel") has served as the project lead for this study, with additional project support provided by Gladki Planning Associates ("Gladki", "GPA").

Parcel

Project Lead & Land Economics

gladki planning associates

Land Use Planning & Policy

City of Toronto Project Team

Our study process has involved extensive collaboration with staff from the City of Toronto. Consisting of a core working group from the City Planning and Economic Development and Culture Divisions, these additional personnel continue to provide input, advice and direction through the entire study process on matters primarily relating to land use policy, municipal strategies and engagement with local stakeholders.

Other Participants

Our detailed research program and "ground-testing" of study recommendations has also involved engaging with a range of stakeholders, including external industry participants active in the development—or use—of commercial real estate in Toronto and beyond. This involved soliciting feedback form a diverse group of developers, asset managers, businesses / employers, industry groups and other individuals familiar with the delivery—and management—of office commercial uses, as well as stakeholders with experience in office conversions.

Executive Summary

Background

Context

- Parcel Economics Inc. ("**Parcel**")—in cooperation with project partners Gladki Planning Associates ("**GPA**")—has been retained by the City of Toronto to review office space needs across the City, including validation of current and anticipated market conditions to gain an improved understanding of potential policy directions that could help yield the ideal type and scale of office uses in preferred locations.
- An extensive and detailed research program was undertaken as part of an early phase of work under this study, which culminated in the production and release of a **Background Report**, dated March 5, 2024.

See **Background Report** of March 2024 available under separate cover.

Scope

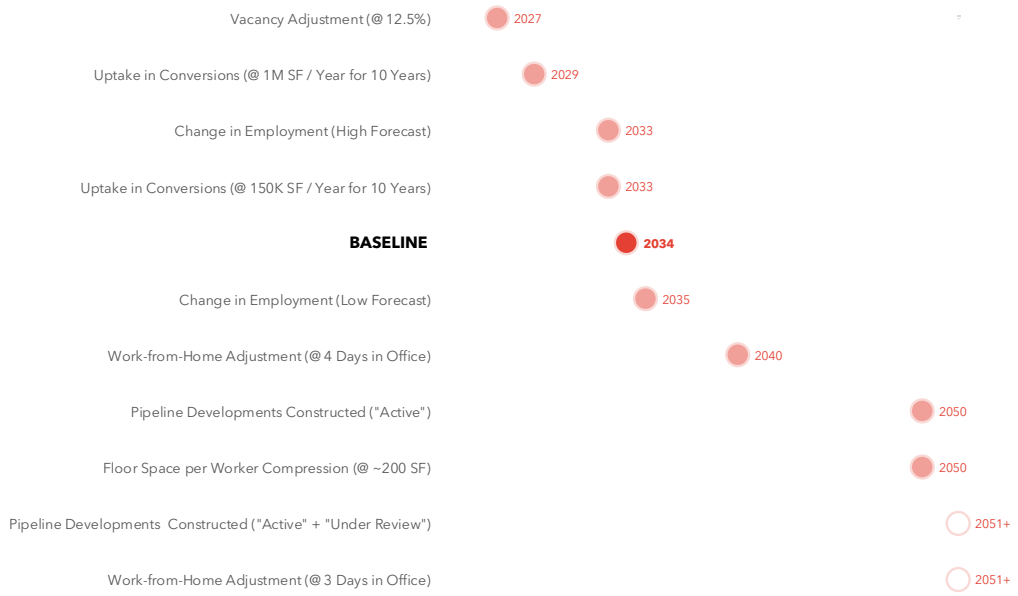
- Relative to the findings of the Background Report, the scope of work included under this second phase of work is intended to be **more "forward-looking" in nature**.
- Relying on research collected to date and summarized as part of our earlier reporting, the focus of this latest portion of our study has been as follows:
  - Preparing a **comprehensive needs assessment** that considers both the short-term and anticipated longer-term market demand for various classes / locations / formats of office space across the City;
  - Consideration for the **economics of new real estate developments**, including nuances across a range of development types and building typologies; and,
  - Developing **principles for policy options** that balance a range of municipal priorities, including—but not limited to—ensuring an adequate supply of office space to meet future needs long-term, as well as to ultimately protect the City's role as a major centre for economic activity on a global scale.
- The results of this study may inform future changes to the City's Official Plan, Zoning By-laws and Economic Development / Culture programs, in due course.

Findings

Part 1: Office Space Needs

- **Interrupted Demand:** The City is unlikely to experience a need for "net new" space for ~10+ years, at minimum. The exact timing will be subject to future work trends and the delivery of new supply proposed in the development pipeline.
- **Location-Dependent Demand:** Demand profiles vary significantly by submarket. Whereas demand for space (new and existing) is likely to be greatest in key employment nodes like the Financial District, this is where the expansion of supply may be least warranted shorter-term given the amount of recently completed and under construction space that is being delivered to market.
- **Longer-Term Prospects:** There will be need for new supply over the forecast planning horizon to 2051. Expansion could ultimately return to annual rates comparable to historical / pre-pandemic levels.
- There are **several factors that could ultimately impact future need for office space** across Toronto. Changes to some of these conditions could alter the timing or need for office space across the City, with several projecting timelines beyond 2051 (i.e., the end of the forecast period examined in this study):

The Effect of Factors on the Timing of Need for New Office Space is Significant

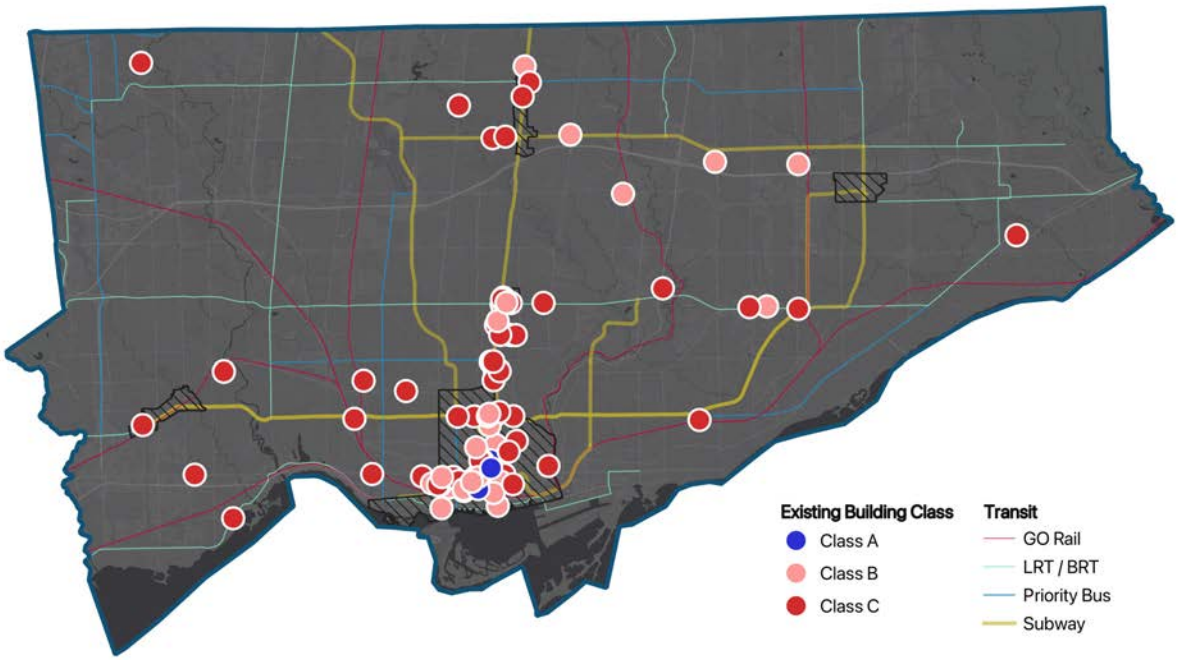


Source: Parcel

Part 2: Profile of Office Conversions

- Between 2013 and 2023, office conversions (primarily demo and rebuild) have included a range of proposals that plan to **increase, decrease or maintain** the existing amount of office space on-site.
- Most proposals are tied to lower-quality **Class B and C buildings**. Influenced by a "flight-to-quality", these office buildings are increasingly less desirable and make better candidates for other non-office uses.

95% of Existing Conversions are Tied to Existing Class B & C Office Buildings



Source: Parcel based on City of Toronto development application data.

- Most conversion applications propose to reduce the amount of office space provided. **Nearly all (75%)** of those that do propose to maintain or increase the existing office GFA, are in the Downtown.
- Existing conversion applications range in size and scale but on average propose to introduce **approximately 531 residential units**. Almost all applications also propose to increase the scale of development on-site, with total GFA expected to increase by some 35,000 square metres on average.
- In place of existing office GFA, many conversion applications are proposing to **introduce other uses**, including affordable housing, senior's housing, purpose-built rental units, and / or community space.

- Based on this profiling of recent office conversion projects in Toronto, we have also identified several distinct office conversion typologies, including: (i) **Existing Envelope**; (ii) **Overbuild**; and (iii) **Demo + Rebuild** contexts. These have formed—at least in part—the basis for the prototypical development concepts identified for testing as part of the accompanying financial feasibility analysis (the results of which are presented herein).

Part 3: Financial Feasibility

- The development of **new standalone office space is currently infeasible** in Toronto, even under ideal development conditions (e.g., for a AAA office building in the Financial District).

- Although some types of office conversion projects appear to be "profitable", most—regardless of location—**do not achieve sufficient investment returns** to be pursued by the development industry, regardless of location.

- Conversions involving the re-use of existing building envelopes without expansion are generally not feasible. **Demolition and rebuild formats are most viable**, with only selected overbuilds "penciling out" from an economic perspective.

- Replacement policies inherently hamper feasibility. Generally, projects become unviable when more than **25% of existing office space** is required to be replaced. While the exact replacement percentage able to maintain financial viability varies significantly by building size and location, the best results are generally achieved when at least some combination of the following conditions are met:

    - Development projects are **located in strong market areas** (i.e., able to command sufficiently high revenues / sales per square foot thresholds)

    - Development projects are located in areas accommodating **sufficiently high densities** (e.g., Financial District / Other Downtown / Yonge Eglinton, etc.)

    - The amount of **existing office space on-site is relatively limited**

    - The **existing office space is currently under-performing** (e.g., Class B, high vacancies, etc.)

    - The "conversion typology" allows for a full **demolition and redevelopment** of the site

- **Affordable ownership and rental housing** represent an ideal alternative replacement use relative to other office / commercial (non-residential) uses, which may require additional incentivization.

Existing Building Size: A Critical Factor in Determining a Feasible Replacement Percentage

Our analysis has focused on evaluating a range of replacement rates across different geographic contexts (i.e., Downtown, Yonge-Eglinton and North York Centre), as well as for different sizes of existing office buildings (40,000 / 60,000 / 80,000 / 100,000 / 150,000 square feet floor area). Across all geographies:

- **Small office buildings** (<40,000 square feet) have the potential to generate strong financial returns and accommodate up to 100% replacement, provided redevelopment parameters are consistent with those analyzed herein (e.g., significant residential density is added, lands were acquired at/near the submarket average price, among other conditions).
- **Medium office buildings** (~60,000 / 80,000 square feet) also show the potential to retain / rebuild some office space (e.g., with many buildings within this range able to redevelop with 25% replacement), albeit with potential declining for sites further from the Downtown.
- **Large office buildings** (~100,000 square feet or above) are particularly challenging to redevelop and in most cases are unlikely to generate sufficient returns to support a significant amount of office replacement. Consequently, the likelihood of redevelopment for most larger office buildings in the Financial Core is also limited.

It is also important to note that small office buildings account for nearly two thirds of the City's office buildings located outside of *Areas of Employment* yet only 10% of total supply on a floor area basis. Equivalently, these types of small office buildings represent **nearly 60% of buildings and 6% of space within the key geographies** (i.e., Downtown, Yonge-Eglinton Centre Secondary Plan, North York Centre Secondary Plan). It is therefore recommended that redevelopment of these sites be encouraged, as larger buildings are less likely to achieve financial feasibility.

As a hypothetical scenario (for demonstration purposes only), if just **10% of these sites redeveloped for mixed-use residential uses, it would have the potential to yield some 27,000 to 35,000 new residential units** while reducing the office space supply by—at most—2.3 million square feet, or less than 1.3% of the City's total existing supply. The space replaced would result in either: (i) 313 to 901 affordable housing units; or, (ii) 200,000 to 600,000 square feet of maintained non-residential / employment-generating space.

Part 4: Policy Options

- A range of policy options are available to respond to the City's economic context, projected demand, and financial feasibility issues. As part of our due diligence, a **range of policy options available to the City of Toronto have been assessed**.
- **Various policy objectives**, including the City's desire to maintain a thriving local economy, provide for complete communities in all areas of the city, and to respond meaningfully to the housing crisis, have been considered in formulating policy options.
- **Relaxing and adding flexibility in the office replacement policy** was identified as integral to sustaining and supporting development in Toronto going forward.
- **Flexibility**, including to substitute affordable housing and/or non-residential uses for required office space replacement, responds to changing market conditions while supporting a range of city-building objectives that are equal in priority.
- Changes to the office replacement policy should have the **capacity to be turned on or off in response to market conditions** to mitigate the loss of too much office space and the associated negative impacts on the city's economy.

Recommendations

1

Understand the Challenge

The development of new office space will continue to be challenged for the foreseeable future, yet the risk of a significant portion of the City's existing high-performing office supply being converted is also quite limited.

2

Make It Happen (Boldness)

Now is the time to consider a marked policy response that enables an appropriate amount / type of conversion activity in response to a wholesale shift in the market, with a focus on providing flexibility and relaxation of the City's policy structure.

3

Sense of Urgency (Timing)

In the face of what many continue to deem a housing crisis and simultaneously facing a major softening of the office market in Toronto, it is time for bold action. The City should avoid indecision—or "analysis paralysis"—in an attempt to satisfy all stakeholders.

4

Provide Clarity

The City should clearly define and communicate the parameters of any remaining conversion-related policies applicable within select areas of the city. This will help to avoid confusion and/or disagreement among stakeholders.

5

Prioritize Objectives

It is incumbent upon the City to prioritize competing municipal strategic objectives. Consideration will need to be given to balancing current development pressures (predominantly focused on residential uses) with longer-term goals (relating to growth in office / employment activity).

6

Consideration of Alternative Uses

Both affordable housing and other non-residential uses should be considered as part of City policies requiring the replacement of office GFA.

7

Support Choice in Replacement

The City should enable developments to "mix and match" the types of uses integrated in place of office space to help support the create of mixed-use buildings.

8

Monitor & Respond

There will be an inherent need to regularly monitor and update the City's rationale for updating its policies in response to ever-changing market conditions. Opportunity to activate or deactivate the policy could help ensure the City's appropriate response to these fluctuations.

See Section 6.0 (Conclusions) for detailed **Recommendations**.

1.0

Introduction

1.1 Background

Context

In response to evolving office market conditions and the fundamental shift that has occurred since the onset of the COVID-19 pandemic, the City has retained Parcel Economics Inc. ("Parcel")—in collaboration with project partners Gladki Planning Associates ("GPA")—to review office space needs across the City.

This work has involved validation of current and anticipated future market conditions, re-evaluating current and longer-term office space needs in Toronto, as well as gaining an improved understanding of potential policy directions that could help yield the ideal type and scale of commercial/employment uses in preferred locations. Throughout this research exercise there has also been a focus on effectively prioritizing and balancing supply requirements across both residential and non-residential use types.

The results of this study are specifically focused on informing future changes to the City's Official Plan, Zoning By-laws as well as Economic Development and Culture programs.

Recap

To arrive at the preferred outcomes identified, our project team has considered a variety of factors, including those established through an extensive supporting research program that culminated in the production of a **Background Report**, dated March 5, 2024.

This study included a number of distinct components, including but not necessarily limited to: (i) an overview of the current inventory and performance of office-based commercial real estate across the City; (ii) identification of relevant macroeconomic / employment / business trends that could influence future office market dynamics in

Toronto; (iii) a summary of the current policy context in Toronto; (iv) case study research inspired by policies / initiatives implemented in other major municipalities globally; as well as, (v) feedback from local stakeholders.

The following provides a brief summary of some of the key takeaways from our previous reporting:

- **Softening of the Market** – The office market in Toronto has undoubtedly softened and even key employment centres have been hit by continued changes in the wake of the COVID-19 pandemic. This includes heightened vacancies, increased available space and poor absorption, among other relevant performance indicators.

- **Signs of Resilience** – Higher-quality, well located office spaces continue to fare well and remain favourable in periods of reduced demand such as this. This highlights the resilience of Toronto's Financial Core and broader Downtown, including its continued role as the City's key employment centre and hub of office activity.

- **Uncertainty in Future Supply** – An abundance of active and longer-term pipeline office developments are proposed to enter the market, to the extent that future supply could already be exceeding established forecasts (if built, as currently proposed).

- **Not All Space is Equal** – Significant differentiation in the market for office uses has been observed across all key reporting metrics, including as a function of location, class of space, age of buildings, and industry positioning / tenanting, among other factors. This distinction continues to emphasize a need to maintain and enhance the supply of Class A space in Toronto and potentially re-evaluate future prospects for Class B and C level spaces.

- **Downtown Focus** – While recognizing the important equity outcomes of jobs distributed broadly across the City of Toronto, preliminary findings reinforce the continued strength of the Toronto East York District– and more specifically the Downtown and Financial District. This dynamic has increased in recent years as tenants have sought and relocated to higher quality spaces in more accessible locations of Toronto. Due to a variety of factors, including proximity to regional transit, office uses in Toronto's Downtown provide the city with a nationally significant economic advantage. Opportunities associated with this strategic advantage should be embraced and leveraged by the municipality.

- **Multi-Faceted Approach** - It is challenging to consider office uses in isolation from other macroeconomic factors and municipal strategic objectives, which inherently go "hand-in-hand" with other facets of healthy community building. This includes equal consideration of the ongoing housing crisis and a need for an expansion in the supply of local residential uses.

See **Background Report** of March 2024 available under separate cover.

Relationship with Background Report (March 5, 2024)

Whereas the Background Report was inherently focused on evaluating past and present conditions in Toronto, the findings presented throughout this second and final report are more **"forward-looking" in nature**.

It is important that both reports be reviewed in conjunction with one another for a comprehensive overview of our key study conclusions and recommendations. Similarly, we note that our original reporting includes a more detailed overview of the overall context, purpose and scope of the study as a whole, in addition to describing in more detail a range of key study parameters (e.g., key geographies, reporting elements, etc.), which are important to interpreting the results herein.

1.2 Scope

Relying on research collected and summarized as part of our earlier Background Report, the balance of our study process has primarily focused on the following core analytical elements:

- Preparing a **comprehensive needs assessment** that considers both the short-term and anticipated longer-term market demand for various classes / locations / formats of office space across the City;
- Continued evaluation and monitoring of **office conversion precedents** in Toronto, including consideration of trends relating to the typical format, scale and location of recent development proposals;
- Evaluation of the **economics of new real estate developments**, including nuances across a range of development types and building typologies; and,
- Developing **princples for policy directions and recommendations** that effectively balance a range of municipal strategic priorities, including—but not necessarily limited to—ensuring an adequate supply of office space to meet future needs long-term, as well as to ultimately protect the City's role as a major centre for economic activity on a global scale.

The results of this research and analysis have also been regularly communicated to key stakeholders, including parties already engaged through preliminary phases of work, among other local business interests and the public at

large (e.g., via a community consultation meeting and dedicated industry-focused stakeholder session held in mid-May 2024).

Parallel Policy Considerations

As a parallel consideration to this study, we heard from the public and stakeholders that embodied carbon and heritage were important factors to address – specifically in the context of potential conversions of existing office buildings. Although these two issues are not addressed directly through this report, they are nonetheless important considerations to be weighed by the City of Toronto as part of the ultimate policy amendments resulting from this research.

Embodied Carbon

Embodied carbon is the greenhouse gas emissions associated with the materials and construction of buildings and infrastructure, including the emissions produced by the demolition and disposal of building materials at its end of life. The calculation of embodied carbon is complicated. Sometimes emissions are reduced by maintaining the building (existing envelope conversions and/or overbuild). Other times, new-construction offers energy savings over the long term. To further understand the impact of this embodied carbon further study by qualified experts is needed.

Heritage

Some office buildings, particularly those located in Downtown, have notable built form or cultural heritage features. Our review found that the City already has adequate tools to protect heritage office buildings, including Official Plan policies and the Heritage Register (under Section 27 of the *Ontario Heritage Act*).

2.0
Office Space Needs

Key Findings

- The City is **unlikely to experience a need for "net new" space for ~10+ years**, at minimum. The exact timing will be subject to future work trends and the delivery of new supply proposed in the development pipeline.
- Demand profiles vary significantly by submarket. Whereas demand for space (new and existing) is likely to be greatest in key nodes like the Financial District, this is where the expansion of supply may be least warranted shorter-term.
- There will be need for new supply over the forecast planning horizon to 2051. Expansion could ultimately return to annual rates comparable to historical / pre-pandemic levels City-wide.
- There are several factors that could impact future need for office space across Toronto. This includes changes in work from home, office vacancy, forecast employment and changes in office supply (including new office space & conversion activity).
- Changes to some of these conditions could alter the timing or need for office space across the City of Toronto, with several conditions projecting beyond 2051 (i.e., beyond the end of the forecast period examined in this study).

2.1 Overview

The background research and other supplementary analysis completed to date have been used as input to the baseline needs projections detailed herein.

Assumptions & Limitations

Building upon the overarching assumptions and limitations presented in Section 1.0 of the Background Report, it is important to acknowledge the following key parameters that are specific to our office space needs analysis:

- The **employment growth trajectories** considered as key inputs to our assessment are predicated on independent projections established by the City of Toronto. They include allocations of total employment by North American Industry Classification System (NAICS) at the "2-digit" level, as well as a more simplified 6-sector summary categorization, consistent with other parallel and related reporting prepared by the municipality (e.g., annual Toronto Employment Survey data, etc.). These projections also include "low", "medium", "high" and "max" growth scenarios.

- Historical **trends and baseline data** relating to floor space per worker estimates, proposed new office supply and other research has been informed by data collected as input the Background report. This includes a combination of statistics available via CoStar, the Toronto Employment Survey, a well as other validation through research interviews and other engagement activities.

- The **key geographies** identified herein—including the City's "Districts", "Centres", "Downtown", "Financial District", among other key policy areas are all consistent with those identified with research prepared earlier in the study process.

- The needs assessment is also predicated on a number of **other key input assumptions**, which have been fundamental in informing the short-and long-term office space needs analysis across the City. While we recognize that changes to the various factors listed below could materially influence future space needs, the establishment of a reasonable "base case" was essential as an initial point of reference or "starting point". This baseline was also subsequently relied upon to better understand the impact of potential alternative outcomes via accompanying scenario testing, where applicable.

- Healthy Vacancy Levels: Irrespective of current market conditions, our analysis assumes office vacancy will gradually return to a healthy rate (i.e., between 5-10%) over the forecast period.

- Employment Projections: As referenced above, the City of Toronto has prepared city-wide employment projections by Traffic Zone and NAICS, including a maximum, high, medium (reference) and low scenarios. Parcel has consolidated these projections by key geography or area (e.g., Districts, Centres, Employment Areas etc.), from which we have calculated potential office space needs. To be conservative, and unless explicitly stated otherwise as part of related sensitivity / scenario testing, we have generally relied upon the "medium" (reference) forecast as the baseline assumption.

- Change in Supply: For the purposes of this analysis, our characterization of the city's office supply assumes that existing space will be maintained, and that growth in supply will be based only on space that is actively under construction. Put another way, it does not include potential growth associated with office space in the "active" and "under review" stages of the **development pipeline**, nor the potential reduction of office space affiliated with **conversion applications**. Both of these factors have been layered on separately, once the base case supply/demand reconciliation had been established City-wide.

- Floor Space per Worker: There is no compression of office space considered as part of our baseline analysis. Rather, forecasted office need is based on maintaining and applying existing trends in floor space per worker (i.e., historical density or use of space).

- Work from Home: Consistent with historical trends, we have assumed demand for existing and new space is based on a 5-day in office trajectory as part of our baseline assessment. To be conservative, recent trends in work-from-home and the amounting impact on office space needs are not included by default but considered as part of the sensitivity analysis.

See **Alternative Outcomes** for adjustments to these baseline parameters.

Note About Different Measurements of Office Space

It is critical at the outset of this section of our reporting that a common understanding be established with respect to the unique measurements—or "expressions"—of office floor area, which are easily misunderstood. Each of these are inter-related and are important for different applications (including based on the purview of different professional disciplines interfacing with commercial real estate, like architects / engineers, land use planners, land economists, interior designers, property management, development, etc.).

Gross Floor Area (GFA)

This is typically the most common **policy-based measurement** relied upon by municipalities to establish permissions and approvals for specific buildings (existing and new). Accordingly, we have also focused the results of our needs assessment primarily on this basis, which we caution may cause confusion / misunderstanding by other industry professionals that are more familiar with other measurements identified below (e.g., interior designers who are more familiar with floor space per worker factors associated with net leasable space and/or "useable" office footprints, rather than building-wide totals).

Gross Leasable Area (GLA) / "Rentable" Space

This includes only the portion of total GFA that can be made available for lease to tenants and therefore represents the main source of floor area that can generate revenue for property managers / landlords (i.e., notwithstanding any building-wide costs that are effectively captured through net rents and TMI). For the purposes of this assessment, we have assumed that office buildings could achieve an overall **efficiency of 90%** (GLA:GFA), consistent with stats for the current inventory in Toronto. We do, however, note, that this can vary significantly across buildings (e.g., prominent office towers with large lobbies and common spaces / amenities vs. smaller buildings with minimum circulation only).

Vacant & Occupied Space

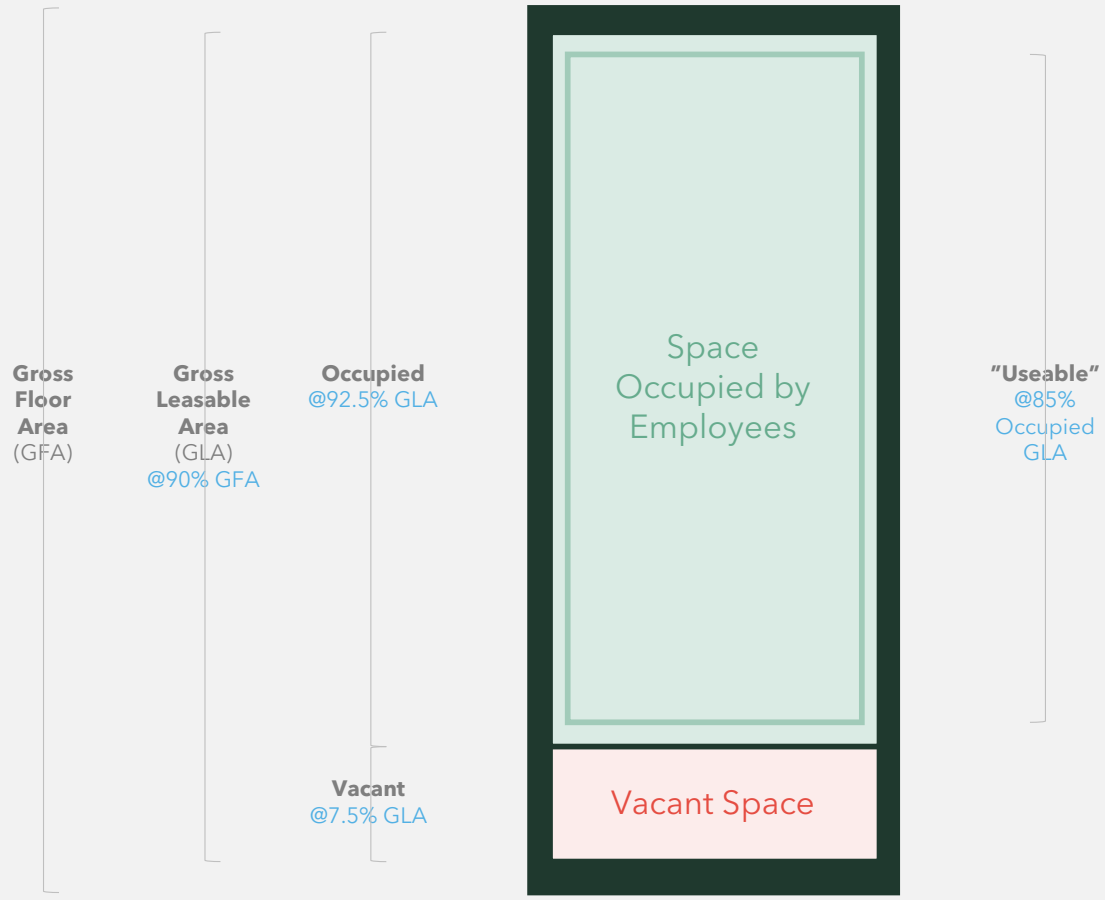
It is also important to distinguish between vacant and occupied space, through a relevant subdivision of total GLA. Our base-year evaluation considers vacancy levels more in-line with current market conditions (i.e., above average), though we have built into our modelling a vacant space "uptake" factor to return these numbers to more healthy, balanced levels (estimated at 7.5% as a baseline).

"Useable" Space

In conjunction with above, it is also important to consider that not all occupied space is truly "useable" for tenants in accommodating employment activity. As a baseline, we have assumed that some 85% of total occupied GLA will be useable.

Figure 2.1

Relationship Among & Between Different Measurements of Office Space



Source: Parcel

2.2 City-Wide Results (Macro "Lens")

The City of Toronto is unlikely to experience a need for "net new office space" in the next decade, if not longer.

Baseline

Demand Profile

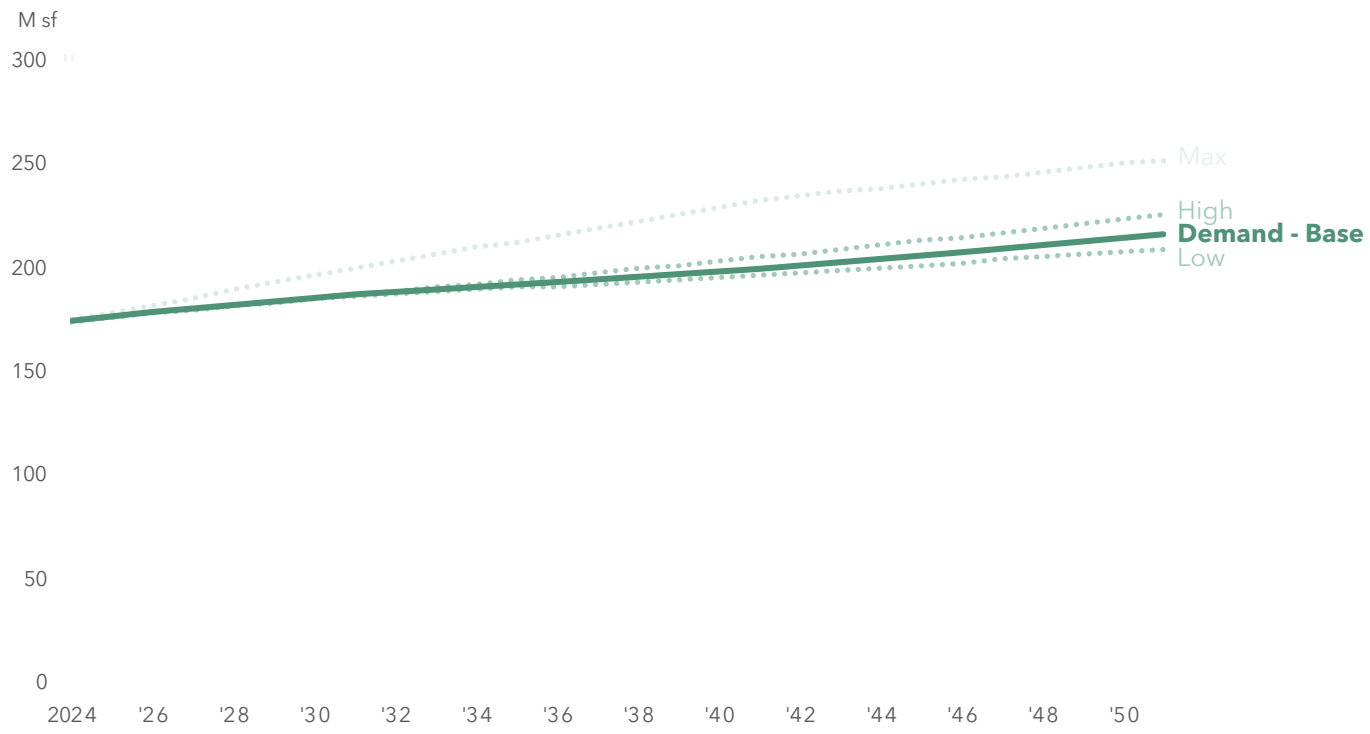
Future demand is based on the City's existing office supply and any new space presently under construction. Current and forthcoming office space has then been evaluated in the context of **historical floor space per worker (FSW) estimates**, to determine the amount of office space required to keep pace with anticipated employment growth over the forecast period to 2051. As mentioned above, absorption—or "uptake"—of existing office space and a return to healthy vacancy has also been considered as part of this analysis.

Short-term demand for office space generated by growth in the number of office employees will be partly addressed as heightened current office vacancy begins to return to a healthier level. Simultaneously, near-term office demand will also be satisfied—at least in part—by new office space entering the market (i.e., space presently under construction), which will increase the City's office supply.

Capacity across existing and forthcoming office supply is anticipated to delay the effects of employment growth on the need for new office space.

Figure 2.2

Current and Future Employment Levels Influence the Need for New Office Space



Source: Parcel.

Supply Profile

As noted in our background report, the City of Toronto currently contains approximately 188.2 million square feet of space in office buildings, as expressed on a "net" (GLA) basis. This includes some 162.3 million square feet occupied specifically by office uses (i.e., excluding retail at grade or other similar non-office uses), which translates to some **180.3 million square feet** of GFA.

In the near-term, the total office supply in the city is anticipated to increase as office buildings which are at various stages of construction continue to enter the market.

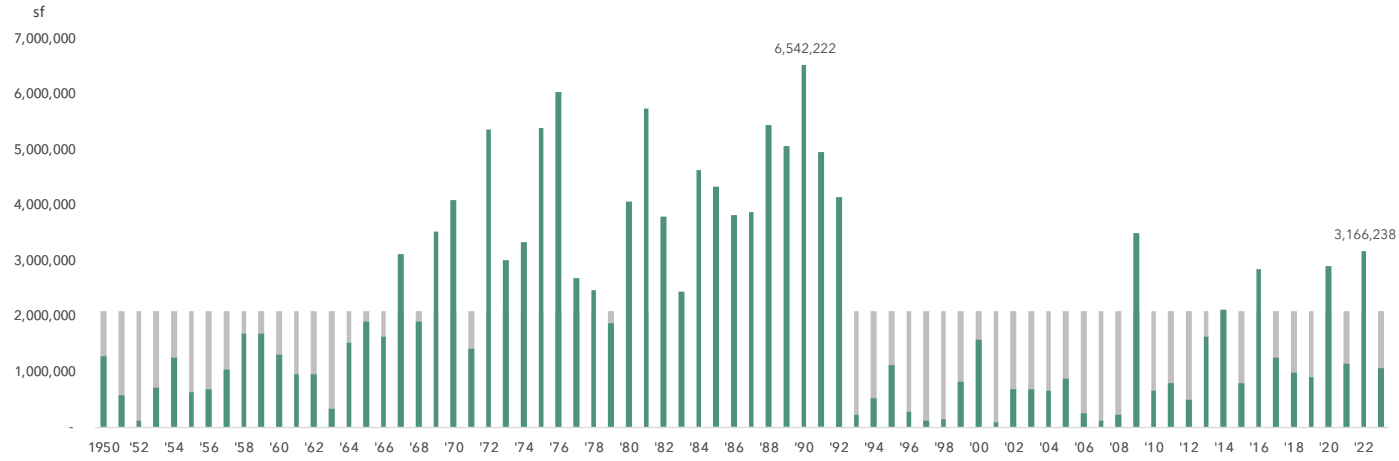
The City's office supply will be enhanced by the 8.8 million square feet of space currently under construction.

The likely integration and occupancy of this space has been estimated based on historical development trends and the individual status of buildings currently being constructed.

Figure 2.3 shows that while office development has been more moderate recently—**averaging approximately 1.2 million square feet per year—**the City has historically averaged growth of nearly 2.1 million square feet per year dating back to the 1950's.

Figure 2.3

Since 2000, Office Development has Lagged Behind Historical Trends



Source: Parcel based on year of construction for office buildings available via CoStar Realty data.

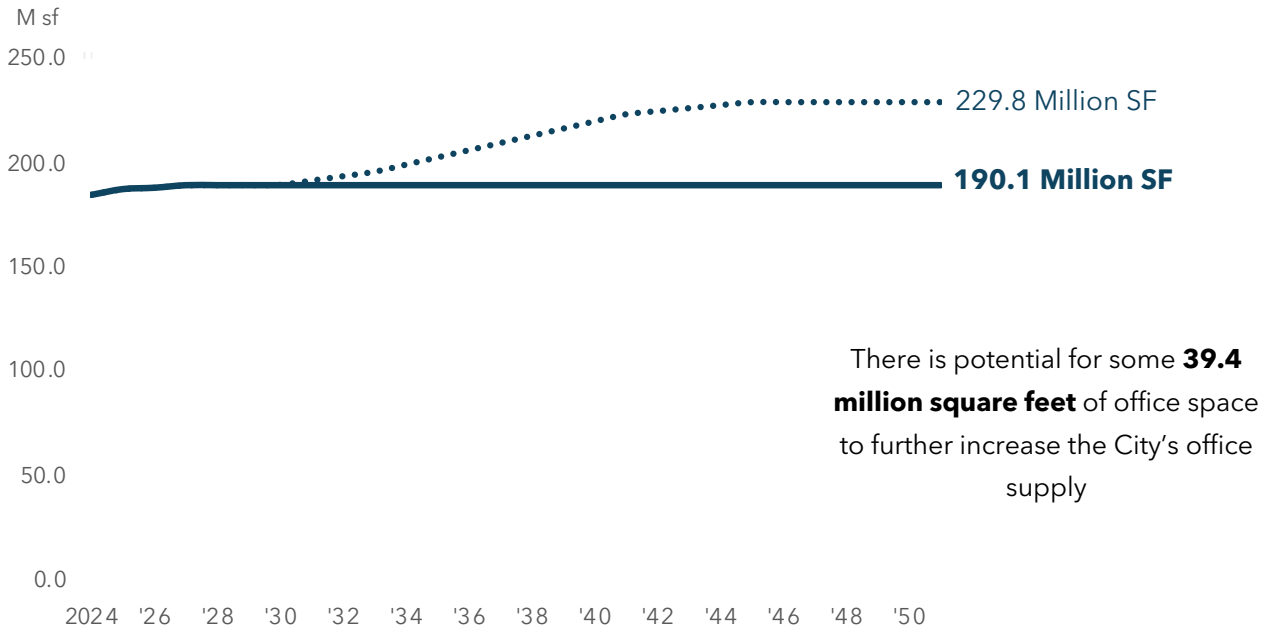
Development and occupancy of new spaces currently under construction will create an immediate boost in the City's office supply, and upon development, increase the total supply of office space in the City to **over 190 million square feet by 2027**.

There is also a substantial amount of office space in the City's development pipeline, including a significant **39.4 million square feet of office space** that could come to fruition over the forecast period to 2051. Figure 2.4 details that the development of this space could increase the City's total office supply to some **229.8 million square feet by 2051**.

Recognizing that it is unclear how much or when this space could develop—if at all—existing space under application has been excluded from our baseline analysis. That said, it is important to recognize this space has the potential to significantly influence the future supply of office space in the City going forward.

Figure 2.4

Existing & Impending Office Space Influences the Need for Net New Supply



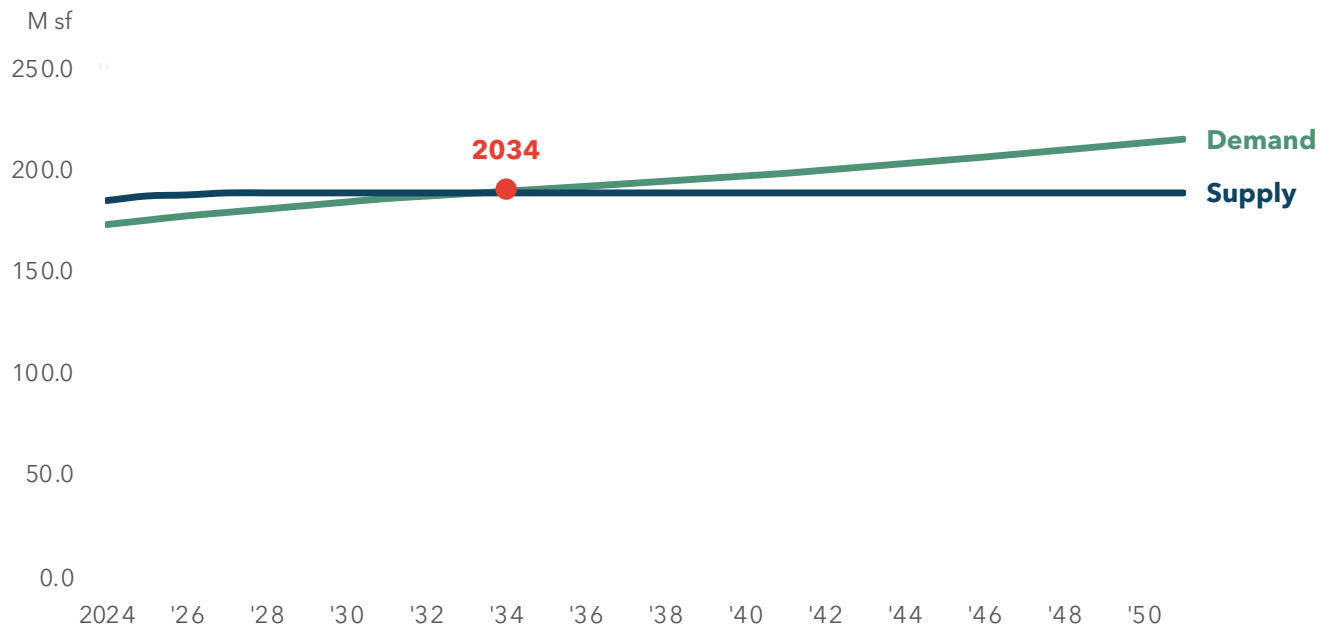
Source: Parcel.

Reconciliation

A reconciliation of the baseline supply and demand characteristics prevailing across the City of Toronto as summarized above have been shown in Figure 2.5. This suggests that—as a whole—the City **will not require new office space before 2034**.

Figure 2.5

The City is Forecast to Require Net New Office Space in 2034



Source: Parcel based on supply data from CoStar Realty & employment forecasts from the City of Toronto.

Alternative Outcomes

Given that this analysis is forward-looking, we have conducted scenario analyses to consider the impact of various deviations from our baseline assumptions.

Section 2.1 identified the key parameters used to establish and forecast future office space needs in the City of Toronto at a high-level. Recognizing that office supply and demand characteristics are influenced by a range of market conditions, Parcel has also analyzed how changes to several of these factors could impact the City's need for office space over the forecast horizon to 2051. As detailed herein, this ultimately has the effect of either shifting this inflection point of 2034 city-wide "sooner" or "later", depending on the variable in question.

To this end, we undertook sensitivity analyses to estimate the impact of the following variables. It is important to note that the various sensitivity analysis summarized **do not reflect all possible outcomes or scenarios**. Rather, each demonstration intends to identify how different conditions could impact the future office needs of the City in terms of broad relationships, including the amount and timing of anticipated demand.

Higher Vacancy (Reduced Uptake of Vacant Space)

Test: Vacancy @ 12.5%

If office vacancies were instead assumed to be 12.5% (rather than a healthier level of 7.5% captured in our baseline), additional "net new" office space would be needed sooner, as less office demand would be met through an uptake of existing office space available in the market today. While higher vacancy is possible, the likelihood that heightened vacancy results in new office space being required sooner is very unrealistic (and somewhat counterintuitive). In the situation that vacancy increased, there is no incentive for people to add new supply other than to create more contemporary and/or higher-performing buildings through new construction methods. This dynamic also becomes more extreme as vacancy increases.

Floor Space per Worker (FSW) Compression

Test: 200 sq ft / employee (GFA)

Historically, the FSW across Toronto office buildings has declined by approximately 1.6% per year. Recognizing a push for quality over quantity, Parcel has conservatively tested the impact of reducing the FSW across existing and new office space in Toronto. Specifically, we have tested reduction to the FSW across existing space by 0.5% per year to 2034 and assuming a 10% reduction in the FSW of new office space.

Employment Projections

Test #1: Low employment scenario
Test #2: High employment scenario

Parcel has considered how deviation from the City of Toronto's *Reference* scenario could impact office space needs. For this scenario, we have considered both the "low" and "high" scenarios, though deliberately excluded the "max" scenario identified.

Increased Supply

Test #1: Introduction of "active" applications only
Test #2: Introduction of all ("active" + "under review") applications

With substantial office and mixed-use developments currently in the City's development pipeline, Parcel has tested the impact that this space could have if it were to be built over the forecast period. Current market conditions make it unlikely that all development applications will develop

	as currently envisioned but this is nonetheless an important test to understand the potential impact that new supply could have.
Increase in Conversion Activity **Test #1**: 150,000 square feet of conversions per year for 10-years **Test #2**: 1 Million square feet of conversions per year for 10-years	On average, recent office-to-residential conversion projects propose to reduce existing office supply by some 50,000 square feet (per building). On the low end, Parcel has examined the impact of a few of these proposals developing per year at this rate. On the high end, a separate analysis has also been completed to test the quantum of office space that would need to be converted per year to require new office space in the coming years (i.e., within the 2020's).
Increased Work-From-Home Activity **Test #1**: 4-days in office **Test #2**: 3-days in office	Baseline analysis is calculated based on a full 5-day in-office work week. Recognizing ongoing mandates and changing employer / employee preferences, Parcel has tested the impact of employees working at home more often.

Work-from-Home Trends: Actual Impact on Office Space Footprints

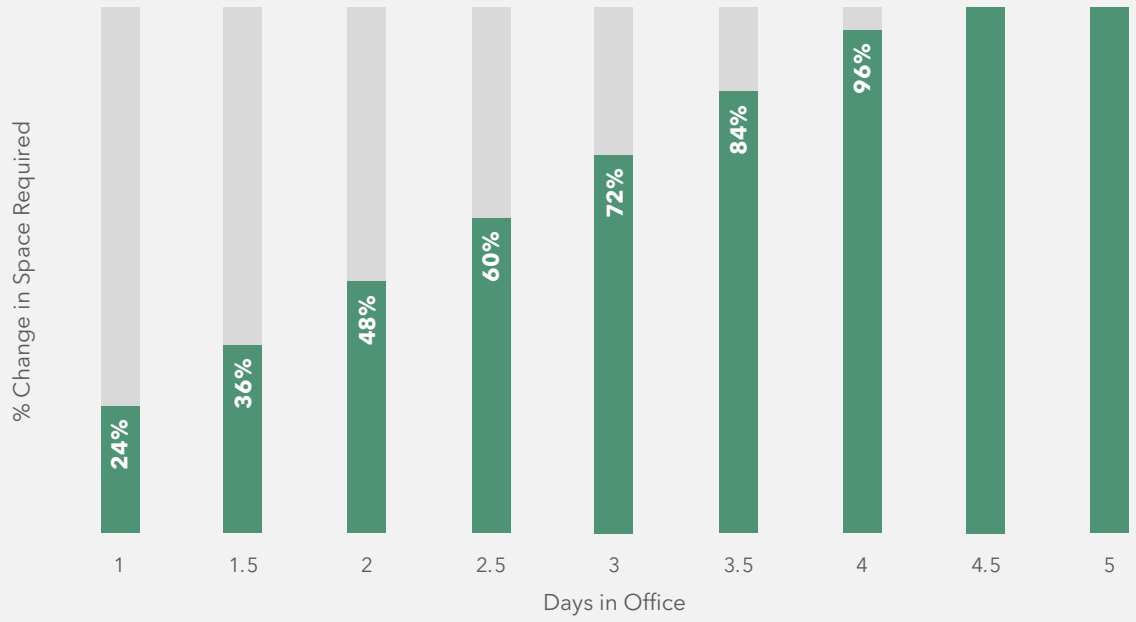
When considering the impacts of WFH trends on physical office space footprints—whether those required by individual organizations on a unit / portfolio-specific basis or at a much larger scale (e.g., City-wide, as is the case for the modelling presented in this report)—it is important to recognize that there is not necessarily a linear, one-to-one relationship between: (a) the proportion of employees working from home; and (b) the reduction in space that can be achieved for efficiency and cost savings purposes. In practice, there is often a "buffer" needed to accommodate employees coming and going from the office at different times and frequencies, as well as to account for "peak" periods. Similarly, the amount of space required by employees with different job functions can vary, in addition to the propensity for employees holding each of those job functions to work from home vs. in the office.

To appropriately capture this dynamic, some office space planners will consider a "buffer" or "wiggle room" of some 20-30% (i.e., rather than 3-days in the office per week representing 60% of the space required of a 5-day week, this would actually translate to some 72%). By extending these same calculations to other assumed splits between work-from-home and in-person activity by employees, we can see that even a 4-day

week in the office results in total space needs commensurate with a traditional 5-day pattern that was more common before the COVID-19 pandemic set in.

Figure 2.6

WFH Still Requires Some "Buffer" Room for Hybrid Companies



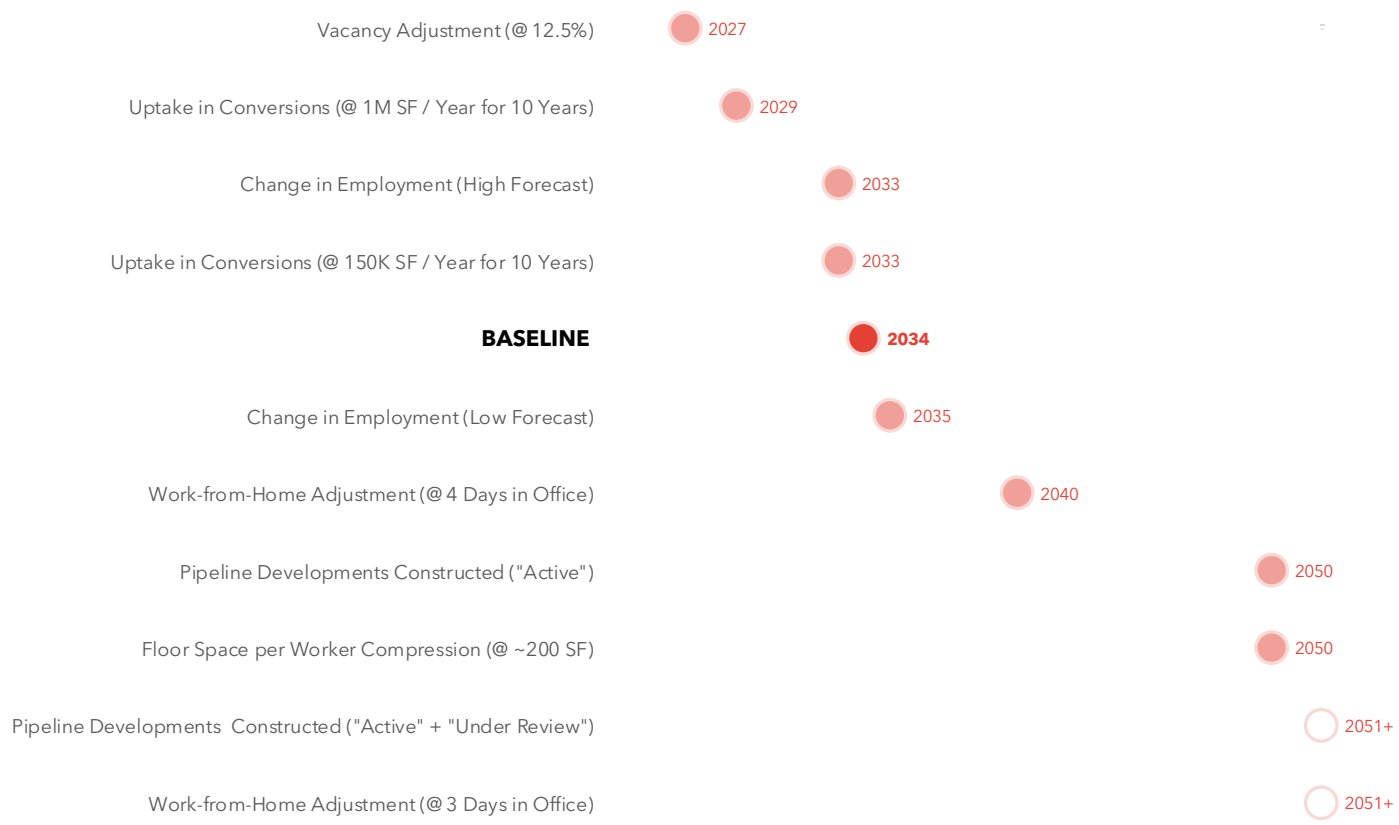
Source: Parcel, based on an assumed 20% "buffer" in office space required.

Figure 2.7 shows the impact that each sensitivity detailed above has on the timing of need office space in the city. Most of these evidently delay the timing or need for new office space across the City of Toronto, including **some which suggest that new supply will not be required until sometime beyond 2051** (i.e., beyond the end of the forecast period examined in this study).

Focusing on these scenarios, it is clear that a range of factors could delay the City's office space needs.

Figure 2.7

The Effect of Factors on the Timing of Need for New Office Space is Significant



Source: Parcel.

Scenario Analysis: Combined Impacts

When interpreting the date ranges summarized in Figure 2.1 for different scenarios, it is important to understand that these only represent the **effect of individual factors in isolation**, with all other variables held constant. In reality, however, there may be outcomes that involve a combination of these factors playing out, effectively "netting out" in different ways (both positively and negatively as it relates to the timing of when new office space may be required in Toronto.

2.3 **Area-Specific** (Micro "Lens")

Office space needs vary significantly by location, including the scale and timing of demand.

A similar exercise to above has been completed for a range of more specific geographies and office nodes across the Toronto, including key Districts, the City's identified Centres, Secondary Plan Areas and the Downtown (including the Financial Core).

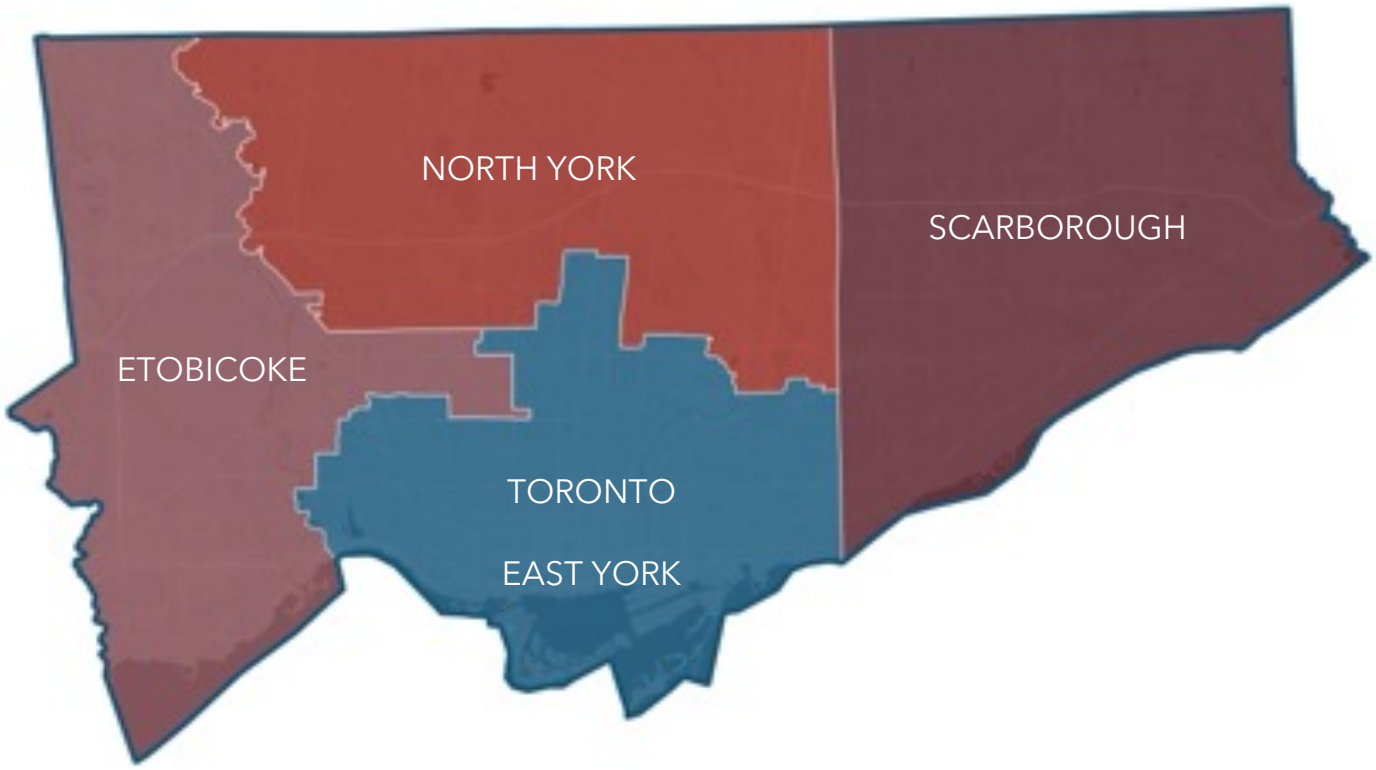
Whereas the City-wide exercise completed above is key to understand the range of factors that could influence office needs in the city going forward at a high-level, the analysis included herein has been conducted to identify how demand for office space—**including timing and quantity**—could differ across individual areas of the City due to unique market conditions (e.g., existing office supplies, performance / health indicators, locational characteristics, transit access, volume of residential and non-residential construction activity, etc.).

Districts

Differences in the amount of current and forthcoming office space is anticipated to shape office supply and demand characteristics across **Toronto-East York, Scarborough, North York and Etobicoke-York**. Furthermore, employment and the propensity for people to seek office space in each area will further influence when and how much space is required over the forecast period.

Figure 2.8

Office Space in Toronto is Distributed Across Four Historic Districts



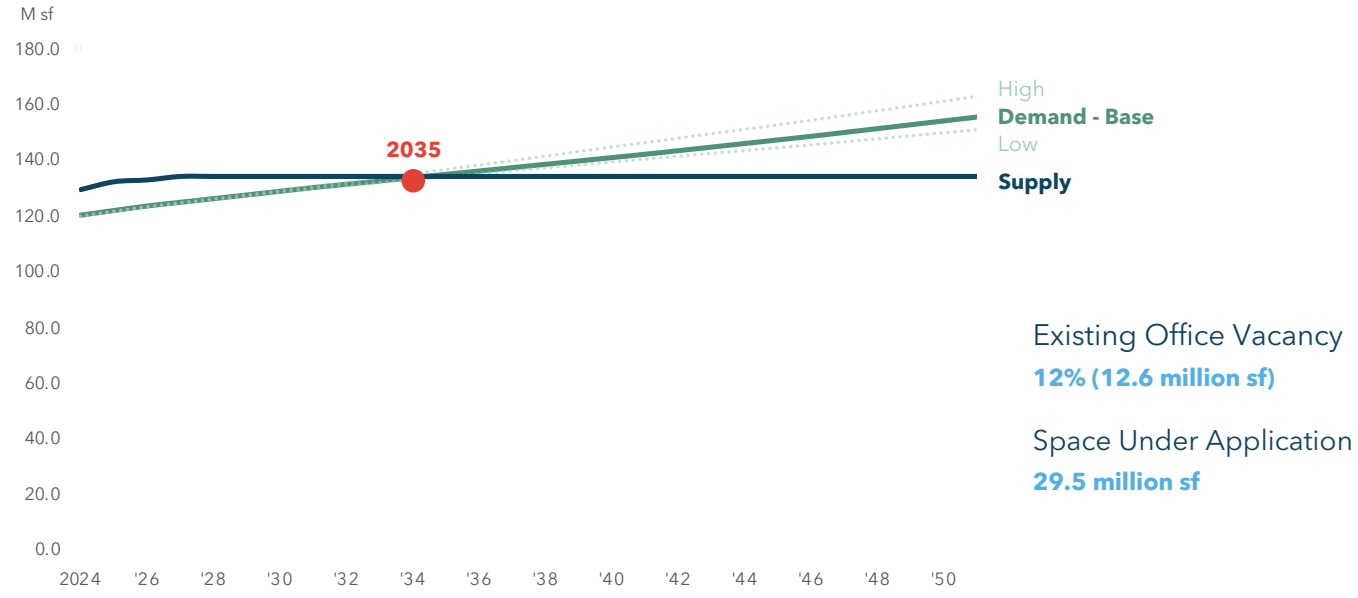
Source: Parcel.

Toronto-East York (TEY)

Existing office inventories together with a range of new supply being constructed eliminates the short-term need for new office space in TEY.

Figure 2.9

2035 Represents an Inflection Point for Office Space Demand Across TEY



Source: Parcel.

Demand Drivers

- Approximately **55% of employment** in TEY occurs in office space, less than the share across the city where office employees comprise 65% of employment.
- Demand will be delayed as heightened vacancy returns to a healthier level.

Supply Drivers

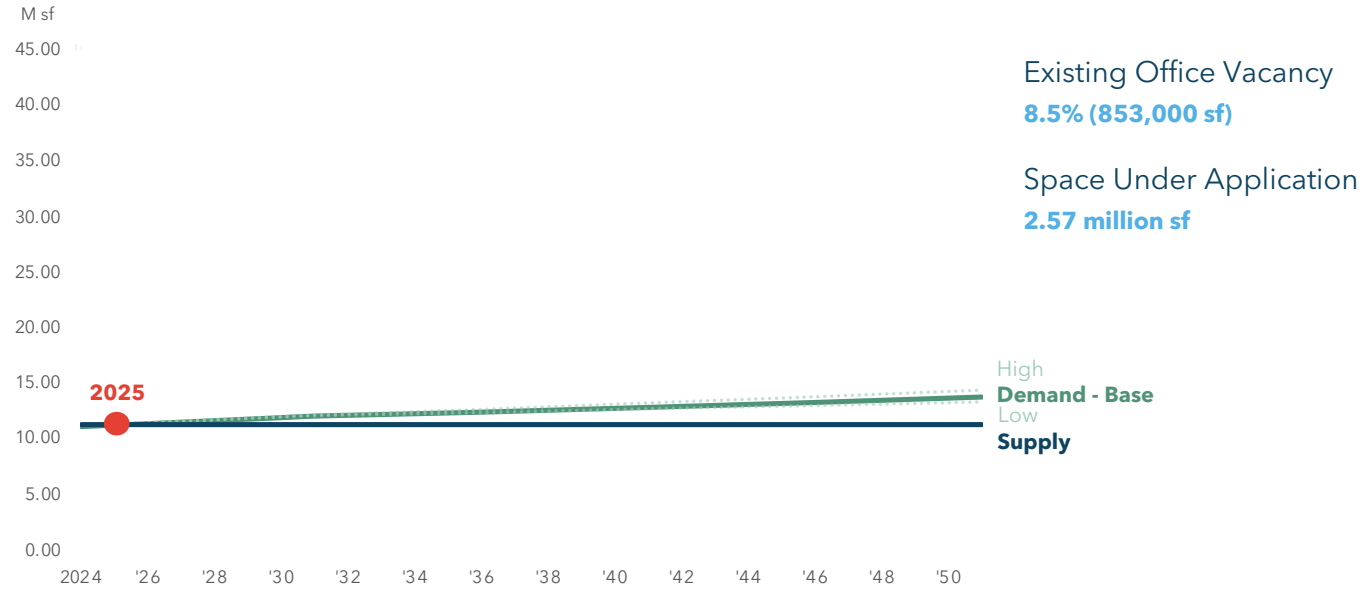
- A significant amount of new office space already under construction, including **8.4 million** square feet.
- Office space under construction in TEY comprises **95% of the City's under construction office inventory**.

Etobicoke-York

Driven by the absence of new supply and a limited stock of existing office space, a small amount of demand for new office space is anticipated in the near-term.

Figure 2.10

By 2025, Additional Office Space Will Be Warranted in Etobicoke-York



Source: Parcel.

Demand Drivers

- Forecast growth in the number of office-based employees, most prominently over the period to 2031.
- Office vacancy is currently low, limiting opportunity for demand to be consumed through the absorption of existing office space.

Supply Drivers

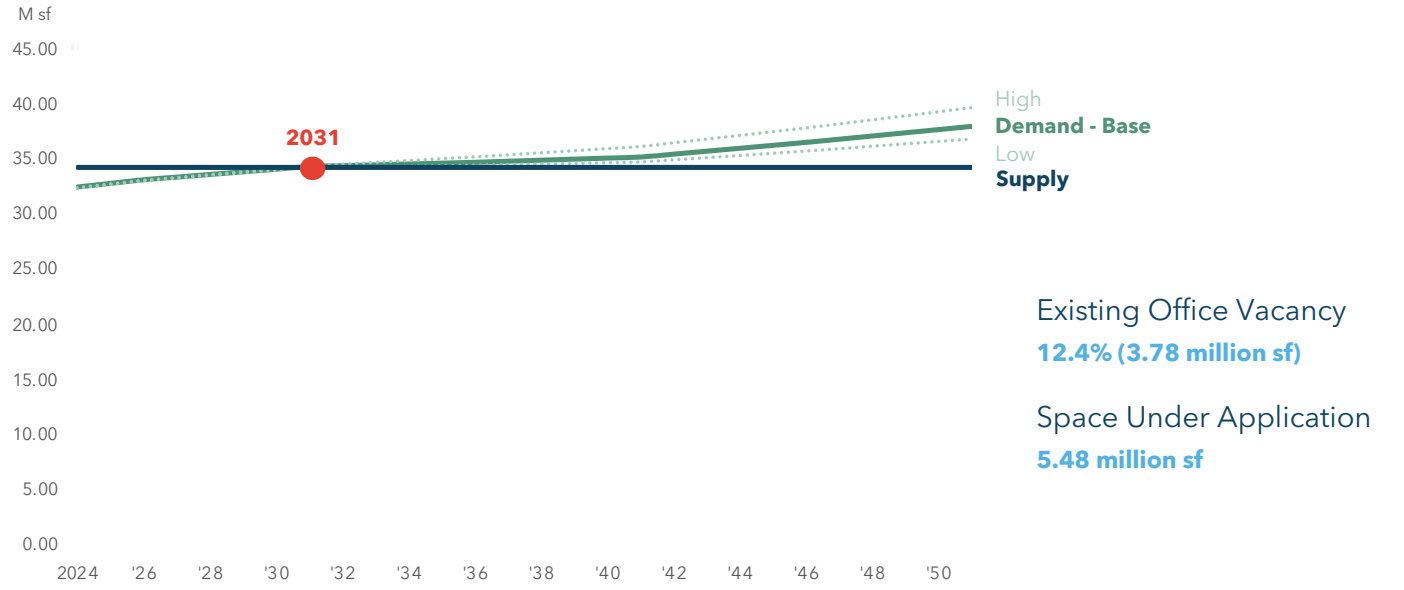
- Only **115,000 square feet of new office space** is under construction currently, representing a marginal 1.1% increase above the current office supply.
- Etobicoke-York contains a limited share (6%) of Toronto's office space. New supply follows this trajectory, accounting for only 7% of office space under construction.

North York

While opportunity to absorb vacant space will delay demand, a lack of new development could drive demand for new office supply longer-term.

Figure 2.11

There Will Be Demand for New Office Space in North York by 2031



Source: Parcel.

Demand Drivers

- Some **42% of employment** in North York is in office space.
- A lack of immediate supply to support new and growing office employment.
- Near term demand is anticipated to be met through the gradual absorption of existing **vacant space which consumes some 12%** of the existing supply.

Supply Drivers

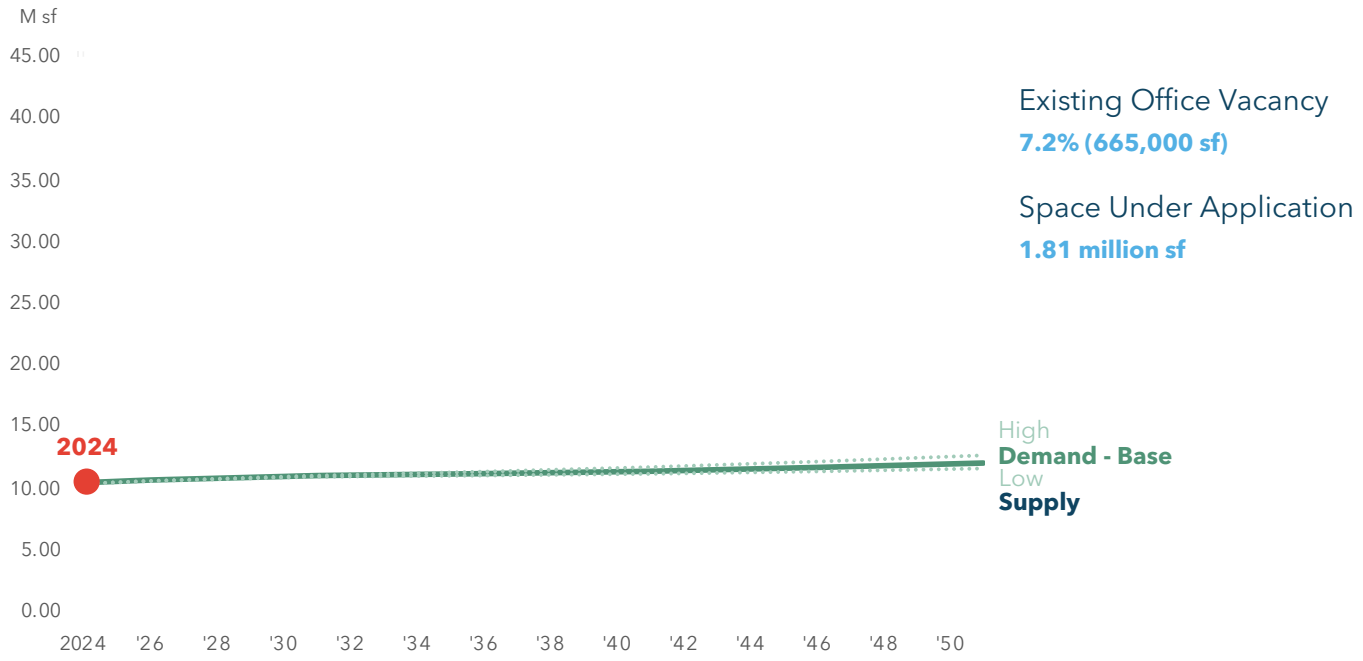
- This area contains a significant **30.5 million** square feet of office space, or 19% of Toronto's total office space.
- There is limited development of new office space, with only some 291,000 square feet of space under construction. New development will increase the existing supply of space by only 1%.

Scarborough

Employment growth will generate demand for a limited amount of new space due to low vacancy / existing supply and a lack of new development.

Figure 2.12

There is Already Demand for a Limited Amount of Office Space in Scarborough



Source: Parcel.

Demand Drivers

- Office employment does not represent a significant share of employment (some 25%), reducing the overall need for office space.
- Existing **office vacancy is low**, minimizing opportunity for new demand to be absorbed by existing space.

Supply Drivers

- There is no office development under construction currently, eliminating opportunity for near-term demand to be accommodated by new space.
- The area does not represent a significant location for office space, accounting for only 8% of the City's office inventory.

Other Areas

In conjunction with our consideration of broader District-wide trends, we have evaluated potential office space needs across several sub-municipal areas of interest. A few of these areas—shown in Figure 2.13—have been highlighted to showcase differences in potential supply and demand characteristics.

The demand profiles included herein vary significantly by submarket due to differences in a range of factors, including existing supply, location, office employment and anticipated new development.

Figure 2.13

There are Nuances in the Office Dynamics Present in Different Parts of the City

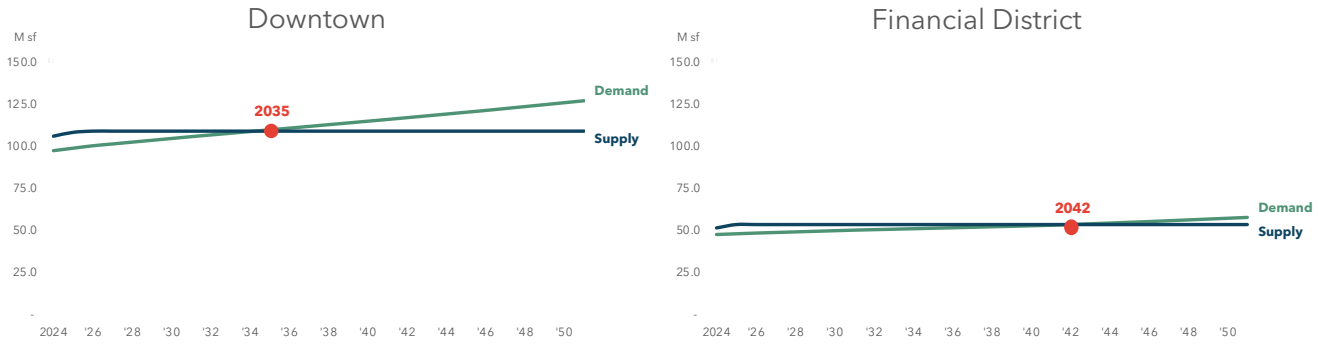
Source: Parcel.

Downtown & Financial District

Whereas the amount of office space required in key nodes like the Downtown (Financial District) is likely to be greatest overtime, this is where the expansion of supply may be least warranted in the shorter-term.

Figure 2.14

The Need for Office Space Expansion is Deferred by Significant Supply



Source: Parcel.

Downtown Toronto contains a significant 56% of the City's existing office space, meaning that there is a **more meaningful supply of office space to support current and new demand** generated by employment growth. This coincides with a significant share of new space being constructed currently (nearly 6.4 M square feet). Furthermore, there is a significant 11.7 million square feet of vacant space (nearly 13% of all space) available for lease in the Downtown. This space has the potential to absorb some of the area's existing market demand, further reducing the need for expanded space in the interim.

This dynamic is heightened in the Financial District, which contains nearly 57% of the Downtown's office supply and some 41% of its new office construction activity. Like the Downtown, the Financial District has an even greater ability to absorb demand generated by employment growth, further delaying the need for supply expansion.

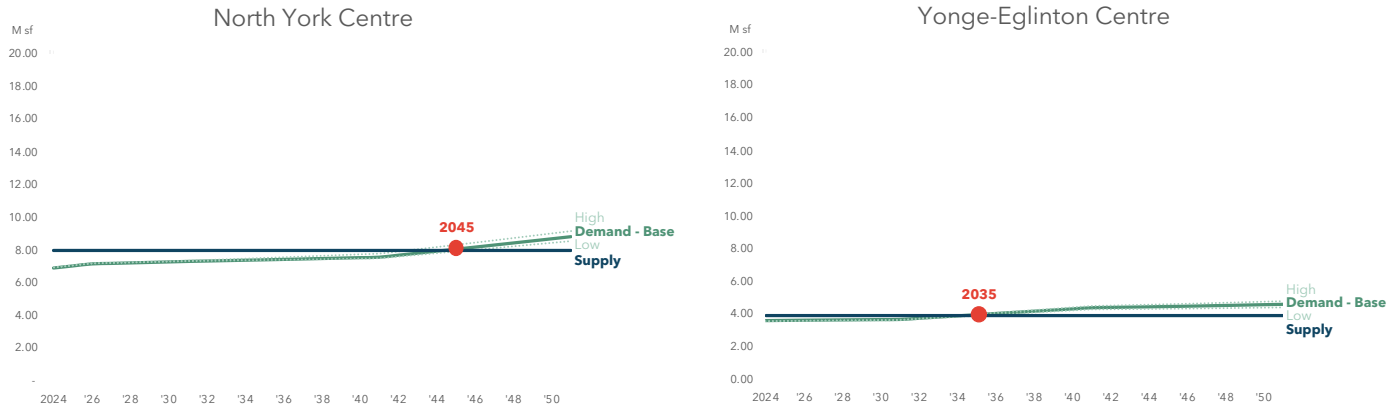
Demand for a sizeable amount of new office space is anticipated to come to fruition over the longer term due to the significance of office-based employment in this area of the City. While the Downtown contains only 37% of the City's total employment it hosts a significant 53% of Toronto's office-based employment. Due to this dynamic, as office-based employment across the Downtown grows, demand for new office space will be generated.

Centres

Relative to other Centres, the **North York Centre** and the **Yonge-Eglinton Centre** host a larger share of the City's office space. They also continue to experience new office activity, with new office construction presently underway. Notwithstanding their role relative to other Centres, the small amount of existing office space in combination with more tempered employment growth still limits the overall need for new office space.

Figure 2.15

Demand for New Office Space Across City Centres is Limited & Delayed



Source: Parcel.

North York Centre

- Less than 30% of employment is tied to office space, mitigating future need for new space.
- Relative to other areas, North York Centre contains a small share of office space (<1%). This, combined with heightened vacancy across existing space, reduces near-term demand for new supply.
- Demand is limited by existing opportunity to absorb significant current availability. There is also some 150,000 square feet of additional space under construction currently.

Yonge-Eglinton Centre

- Office employment represents a significant share of employment in this area (60%). Moderate growth in employment overall is anticipated to maintain office space needs.
- There is nearly 100,000 square feet of new space under construction. Recognizing office vacancy is currently relatively high, there is opportunity to absorb existing demand across existing and forthcoming supply.
- The Yonge-Eglington Centre comprises only 3% of the City's existing office supply.

3.0

Office Conversion Profiles

Key Findings

- Office to residential conversions include several proposals that plan to **increase, decrease or maintain** the existing amount of office space on-site.
- Most proposals are tied to lower-quality **Class B and C buildings**. Influenced by a flight-to-quality, these office buildings are increasingly less desirable and make better candidates for other non-office-based uses.
- Most conversion applications propose to reduce the amount of office space provided. **Nearly all (75%)** of those that do propose to maintain or increase the existing office GFA, are in the Downtown.
- Existing conversion applications range in size and scale but on average propose to introduce **approximately 531 residential units**. Almost all applications also propose to increase the scale of development at existing sites, with total GFA expected to increase by some 35,000 square metres on average.
- In place of existing office GFA, many conversion applications are proposing to **introduce other uses**, including residential (rental and condominium tenure), senior's housing and / or community space.

3.1 Context

Building upon preliminary monitoring and featured office conversion profiles identified as part of the *Background Report*, Parcel has since completed a more detailed examination of conversion activity across the City of Toronto.

This broader cross-section has been key in identifying trends across existing conversion applications, and more broadly in informing potential future policy recommendations.

The following provides a brief overview of the key parameters of this more extensive sample of conversion projects:

- References and details included below are based on **100+ examples of conversion activity** that have been proposed or are being proposed across the City of Toronto between 2013 and 2023. While they may not represent a comprehensive sample, they are sufficiently extensive and representative of recent development activity across the city.
- Data and information availability has made the information and findings from this sample **inherently "rear-view" looking**. Landowners, developers and the city may not be willing to accept the same or similar conditions today and/or in the future.
- Conversion applications are—and continue to be—**influenced by fluctuating market and economic conditions**.

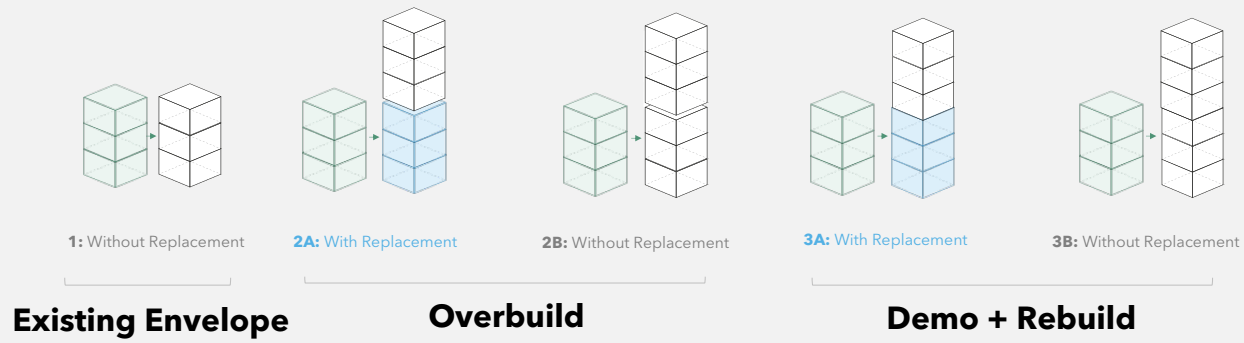
See **Background Report** for additional conversion profile information.

Spectrum of Office Space Conversion Typologies

Based on this profiling of recent office conversion projects in Toronto, our *Background Report* also included an identification of several distinct office conversion typologies, as illustrated again below for reference. We note that these have formed–at least in part–the basis for the prototypical development concepts identified for testing as part of the accompanying financial feasibility analysis presented in Section 4.0 of this report.

Figure 3.1

Multiple Types of Office Conversions That Vary in Cost & Complexity



Source: Parcel.

3.2 Summary of Findings

Theme #1: Location

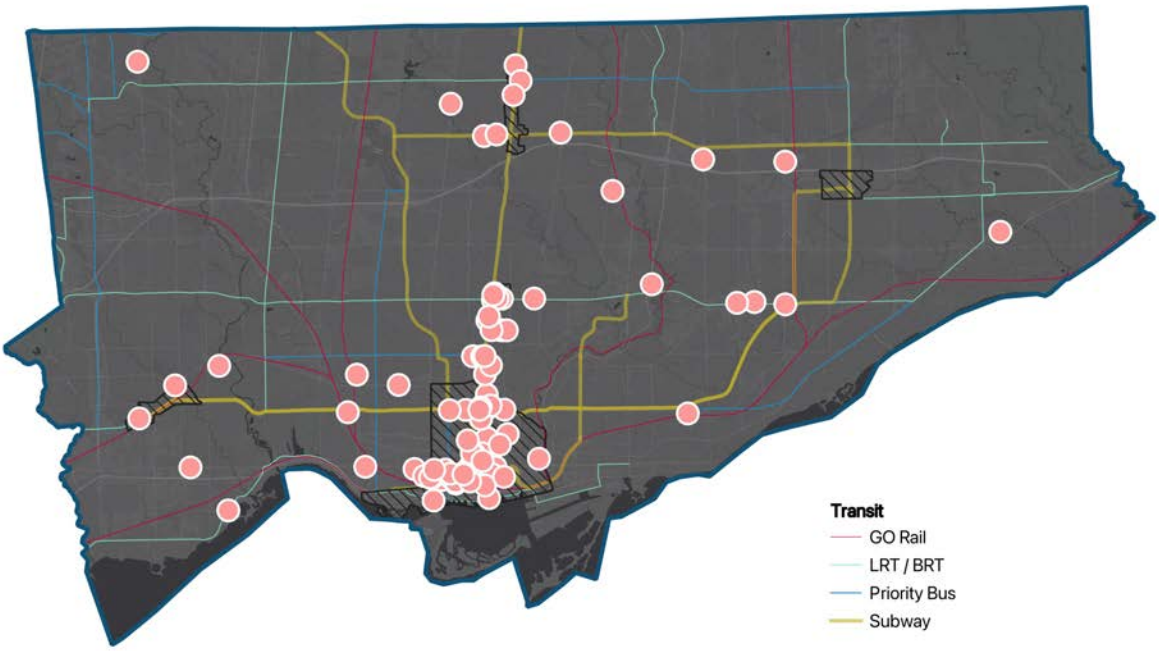
Downtown Toronto contains the largest share of applications which propose to convert existing office space. This includes applications that **propose to increase, decrease or maintain** the existing supply of office gross floor area (GFA) presently provided.

Nearly half (45%) of Toronto's existing conversion applications are in Downtown Toronto.

An additional 10% of current applications are in one of the City's Centres and meaning that these locations collectively contain some 55% of all existing conversion activity in Toronto.

Figure 3.2

A Significant 45% of Existing Conversion Applications are Located Downtown



Source: Parcel based on City of Toronto development application data.

Based on the existing size and format of conversion applications being brought forward, Downtown office space is generally proposed to represent only 18% of proposed GFA. However, while this is partly a function of many applications proposing a net reduction in office space, it is more generally due to the format of applications being proposed.

A reduction in total office GFA across the Downtown is largely due to the format of existing applications, which include office space as a component of much larger mixed-use projects.

Theme #2: Class

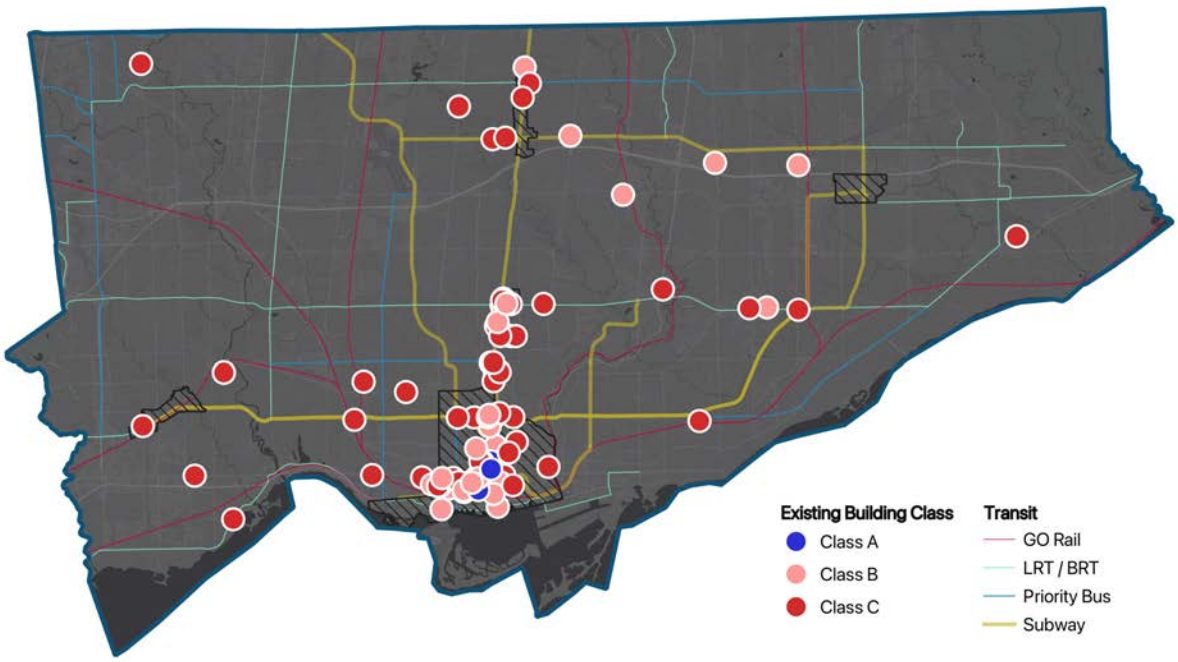
As discussed as part of our *Background Report*, different areas of Toronto—including Downtown—contain a disproportionate share of Class A office space, while others—including the North York District and the Scarborough District—contain a larger share of Class B and C buildings. That said, irrespective of location, a significant **95% of proposals** planning to convert existing office space are tied to existing **Class B and C buildings**.

As buildings which increasingly lack the amenities and features to attract and sustain tenants, most conversion applications are for Class B and C office buildings.

Figure 3.3 shows that the largest share (52%) of conversion applications are affiliated with Class C buildings, with Class B buildings similarly tied to a notable 43% of applications. Only 5% of existing conversion applications are affiliated with higher-quality, Class A buildings. As input to future policy recommendations, it is important to recognize that higher-quality, existing buildings are inherently less susceptible to conversion due to their quality and ongoing function.

Figure 3.3

95% of Existing Conversions are Tied to Existing Class B & C Office Buildings



Source: Parcel based on City of Toronto development application data.

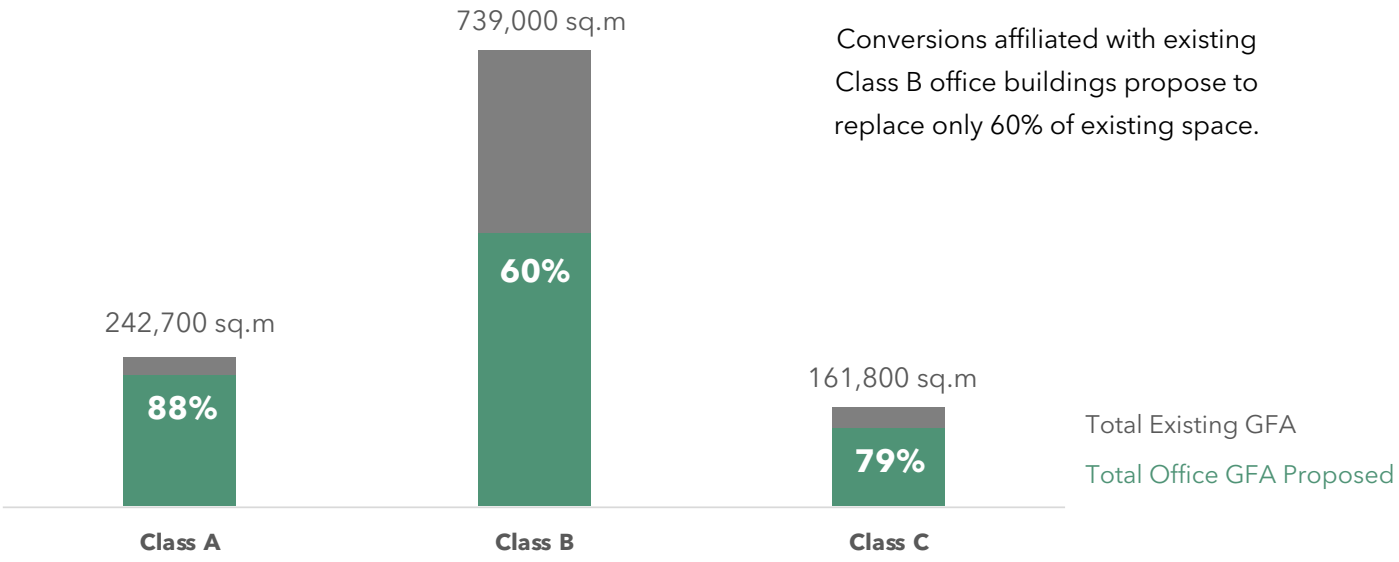
Existing office conversions are tied to older, obsolete office buildings. High-quality, well occupied office buildings are not at risk of being converted.

While the largest number of applications are tied to existing Class C buildings, Figure 3.4 shows that applications proposing to convert existing Class B buildings amount to the most significant reduction in total office GFA. In fact, of the 739,000 square metres of Class B office space that could be lost due to conversion, only 60% is proposed to be replaced. This is likely tied to the larger average size of existing Class B buildings—and as highlighted in our Background Report—the sheer volume of Class B space available in the market.

By comparison, conversion applications affiliated with Class A buildings are anticipated to collectively eliminate some 242,700 square metres of existing Class A office space. While already being less in volume, these applications also propose to replace 88% of existing office space as part of their application.

Figure 3.4

Class B Space Could See the Greatest Loss of Space (GFA)



Source: Parcel based on City of Toronto development application data.

Theme #4: Type

In buildings proposed for conversion, office uses make up an average of 96% of the building's total existing GFA. This compares to the developments planned as part of these conversion, where office space is estimated to comprise an average of only **13% of the total GFA envisioned**. While this is partly due to growth in the size and scale of development proposed (i.e., higher overall GFA), it is also influenced by a growing number of applications which propose a net loss or reduction in the amount of space included.

Across conversion applications identified, a **notable 52% propose to include no office space**. An additional 5% of existing conversion applications propose to replace between 1% and 50% of existing office space. By comparison, only 22% of existing applications propose to fully replace or exceed the current office GFA as part of the proposed development. This includes 6 applications that propose to maintain the existing office GFA and 14 which propose to exceed the existing office GFA.

Most conversion applications that propose to maintain or increase the existing office space provided are in the City's Downtown.

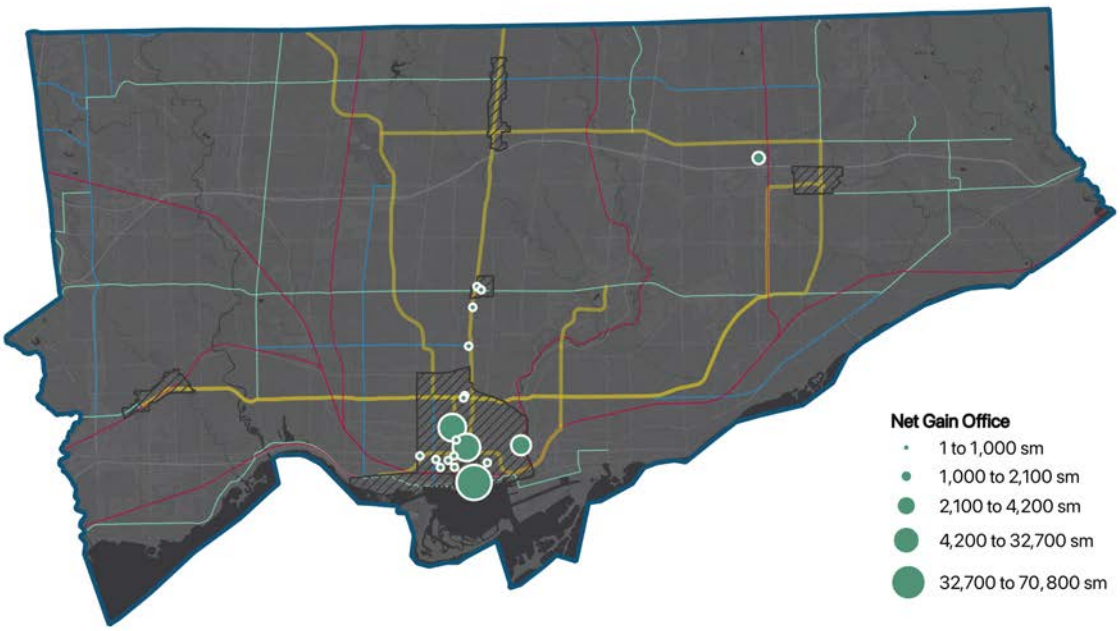
A significant 75% of existing applications that propose to **increase or maintain** the existing office GFA are in the Downtown.

Relative to other areas of the City, **transit-oriented lands in the core continue to draw and sustain office uses** (see Figure 3.5). The inverse is true across existing applications which propose to reduce or eliminate office GFA. Nearly 40% of these applications are located outside the Downtown, including 67% of the applications that propose no office replacement as part of their applications. This generally coincides with locations that are both less accessible and comprised of lower-quality office space.

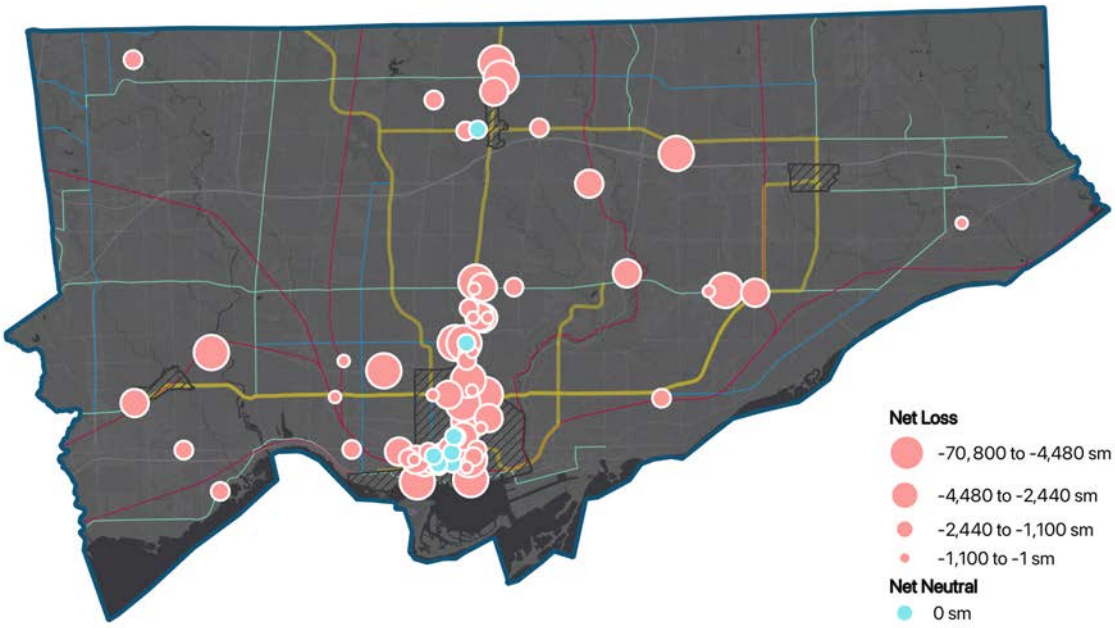
Figure 3.5

A Reduction in Office Space is Most Evident Outside the Downtown

Net Increase in Office GFA



Net Loss / No Change in Office GFA



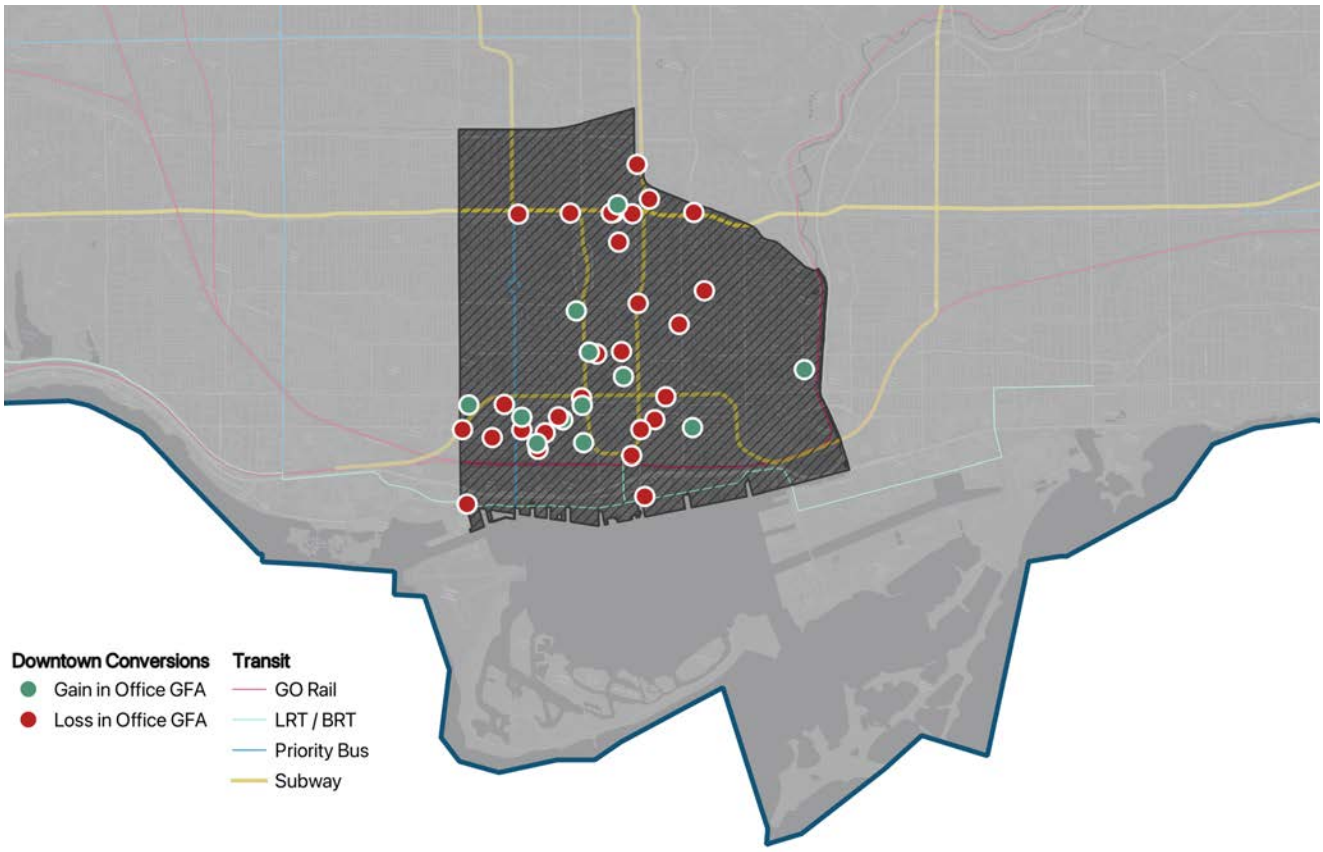
Source: Parcel based on City of Toronto development application data.

While the Downtown contains most the City's conversion applications that propose to maintain or increase the amount of office space, the majority (67%) of conversion applications Downtown actually propose a reduction in the amount of office space GFA provided.

On average, conversion applications in the Downtown propose to reduce the existing office GFA by nearly 6,800 square metres.

Figure 3.6

Most Downtown Conversions (70%) Propose a Reduction in Office Space



Source: Parcel based on City of Toronto development application data.

Theme #5: Scale

Though there is significant variation in the scale, type and composition of conversion applications being put forward, they all generally propose a net increase in the total building GFA. In fact, buildings being proposed as part of existing conversions are anticipated to have an average GFA that is some 35,300 square metres larger than the existing building.

Necessary to be financially viable from a development perspective, the increased scale of buildings coincides with a range of uses being proposed in place—or in addition to—office space. This includes a range of non-office, non-residential uses or features such as childcare space, community space, privately owned public space (POPS),

affordable housing, heritage features and senior's housing. It also includes a significant scale and amount of residential GFA and new residential units.

On average, conversion applications propose to introduce some 531 residential units.

The scale of residential development anticipated is even higher across buildings that propose to reduce or eliminate the office GFA provided, including some 543 new residential units on average.

4.0

Financial Feasibility

Key Findings

- Financial feasibility (pro forma) analysis has been used as a tool to evaluate a range of desired outcomes that best support a range of City building goals.
- The development of new standalone office space is currently infeasible in Toronto, even under ideal development conditions (e.g., for a AAA office building in the Financial District).
- Although some types of conversions appear to be "profitable", most do not achieve sufficient investment returns to be pursued by the development industry, regardless of location.
- Conversions involving the re-use of existing building envelopes without expansion are not feasible. Demo + rebuild are most viable, with only selected overbuilds "penciling out".
- Replacement policies inherently hamper feasibility. Generally projects become unviable when more than **25% of existing office space** is required to be replaced (i.e., for predominantly condo-based projects in the Financial District).
- **Affordable ownership and rental housing** represent an ideal alternative replacement use relative to other office / commercial (non-residential) uses, which may require additional incentivization.
- While results vary by geography, project viability for conversion projects are best achieved in the **Downtown and key "Centres" along the Yonge Corridor** (i.e., where revenue-generating opportunities are greatest).

4.1 Overview

Pro forma analyses are important to all facets of urban development, with wide-ranging private and public sector applications.

Financial feasibility modelling is—at its core—a tool for evaluating potential future outcomes. Whether motivated purely by profit or driven by other city-building objectives and social purpose, this type of analysis can be applied to any number of different "use cases" to maximize opportunities to achieve preferred outcomes.

Broadly speaking, development pro forma analyses can be relied upon at various stages of the real estate development life cycle, including during the early stages of concept development (Pre-Development); throughout the entitlements and government approvals process (Approvals & Funding); as well as to inform the creation of sound land use policies that are mindful of the current—and anticipated future—conditions within a given market (Policy Development).

For this study, pro forma analysis—and financial feasibility in general—has been utilized mainly as a tool for comparison rather than profit maximization.

Furthermore, the analyses presented in this study have not been relied upon as an exact predictor of actual profits, nor profit maximization more broadly. It is more intended to help the City identify meaningful tools, policy directions and potential future incentives that result in desired outcomes, based on the range of key study objectives identified. We acknowledge that some typologies and scenarios which may appear unprofitable in the following section could very well be profitable under the right circumstances and conditions, which deviate from our broad baseline assumptions.

Key Determinants

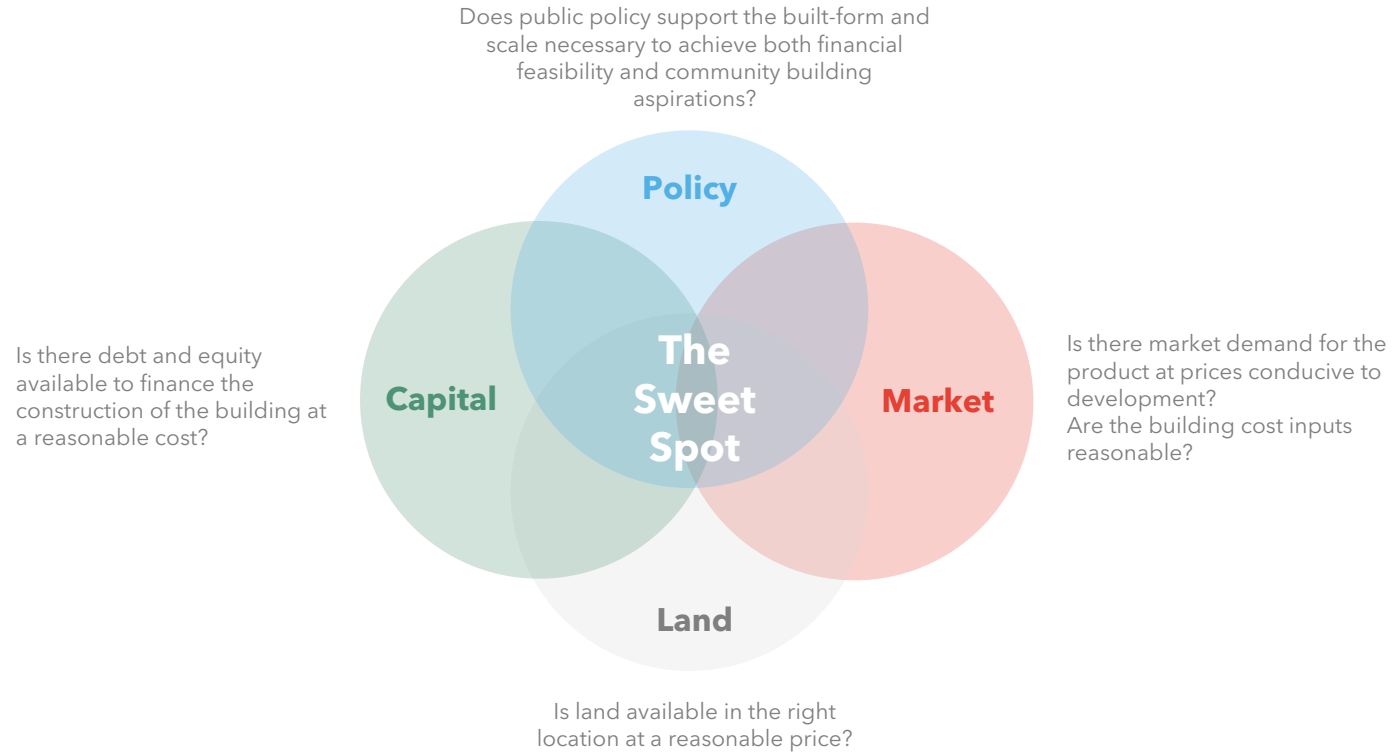
The development of new real estate can be extremely complex given that its success is dependent on a multitude of factors spanning countless industries and professional disciplines. Similarly, development can be heavily

influenced by both broader macroeconomic conditions and more site-specific factors; all of which are key determinants in the ultimate viability of a given project.

For simplicity, we often synthesize this to the identification of four key elements that can have some of the most significant impacts on financial feasibility: **Policy**, **Market**, **Land** and **Capital**. The successful integration of all of these factors is required to set the groundwork for viability.

Figure 4.1

The "Sweet Spot" for Successful Development Projects



Source: Parcel

General Structure

Notwithstanding variations across different organizations and use cases, it is helpful to keep in mind that the overall structure of any financial feasibility modelling is effectively the same.

Both streamlined and very detailed development pro forma analyses can always be simplified to their core elements: Revenues, Costs and Profits.

How certain revenue / cost and profit assumptions are applied can also vary when dealing with different tenures in the case of residential development (i.e., ownership vs. rental housing). The key difference being that most ownership (condo-based) residential developments are focused on relatively short-term investment horizons consisting of predominantly one-time cost / revenue streams, whereas purpose-built rental housing requires a much different investment "lens", that can span many years (i.e., including operation of the new asset, upon its completion and market entry).

Common Return Metrics

Not all developers are alike and there is no single return metric that signifies a financially viable project. Each participant looks at a unique subset of variables and return metrics under different conditions, based on their own requirements and/or expectations. Common measurement tools include:

- **Net Profit / (Loss)** – The total amount of money made (or lost) over the course of a project.
- **Internal Rate of Return (IRR)** – The expected compound annual return (%) over the course of the project.
- **Equity Multiplier (EMx)** – The number of times a project's original equity investment is returned to investors.
- **Cash-on-Cash Return (CoC)** – The cash flow after financing (%) generated by the equity invested to date. It does not take into account the value of the building or any appreciation of value over time.
- **Timing** – Opportunistic investors look for quick returns (e.g., condo apartments) while long-term investors value consistent returns over a longer period (e.g., rental apartments).
- **Measurements of Risk** – Loan to Value, Debt Service Coverage Ratio, Debt Yield, etc.

While our supporting financial modelling includes consideration of all of the above metrics, we have generally focused on IRR for the purposes of simplicity in this reporting.

Limitations & Assumptions

When considering this type of high-level financial feasibility modelling—which is not specific to any one site and/or landowners—it is important to identify the key assumptions and limitations inherent to our approach. Furthermore, consistent with other financial analyses focused on policy-level observations, we note that the modelling presented herein **should not be taken as a conclusive nor definitive representation of financial feasibility, or lack thereof, for individual properties**. Rather, it is intended to provide a more general and preliminary understanding of the relative feasibility of prototypical development concepts based on the assumptions provided, as well as to provide an indication as to the most important financial drivers of developing new office space in Toronto.

Development Concepts

- The prototypical development concepts established for testing as part of this assessment are not intended to be indicative of any specific property nor landholdings across Toronto. They are hypothetical development concepts, based on the general nature, scale and density of development being contemplated in this area currently, both from a market-based precedent perspective, as well in the context of reasonable land use policy permissions.

- Recognizing that each property and landowner will have different conditions as it relates to financial feasibility, we have attempted to capture the full range of possible outcomes through the related sensitivity analyses prepared by our team, which adjust selected input assumptions (including to reflect nuances across different pre-defined policy areas and geographies within Toronto).

Feasibility Approach

- Given the preliminary and conceptual nature of the development concepts being considered—as well as the level of statistical detail available at this early stage of the planning process—we have adopted a relatively simplified Discounted Cash Flow (DCF) approach to assess the financial feasibility of developing office space and other types of uses through conversion applications in Toronto. As such, our analysis simply considers a realistic "break-even" point that could ultimately yield a reasonable return on investment to the owners of each property while also maintaining (or enhancing) the value of their existing real estate assets. This has helped to identify the minimum type and amount of development that would likely be required to incentivise development while simultaneously ensuring the financial feasibility of projects over the longer-term planning horizon[1].

[1] The financial assessments presented in this report are not equivalent to more detailed and traditional pro forma financial analyses that are typical of most individual real estate development projects. Recognizing the scope and underlying nature of this assignment to evaluate

Approach: Discounted Cash Flow Analysis

Historically, many policy-based financial analyses prepared on behalf of public sector organizations like the City of Toronto are structured around a more simplified "Back-of-the-Envelope" (**BOTE)** approach. Although Parcel regularly relies upon this approach in the right context, based on the more extensive and nuanced scope of this study, we felt that it was necessary to complete a more rigorous **DCF** analysis. This type of analysis is capable of more appropriately capturing: (a) the time-value of money; (b) the full timeline of development projects; (c) the nuances of operating buildings like offices and/or purpose-built rental projects over many years; as well as, (d) a more comprehensive subset of common risk/return metrics.

Overall, although the analysis presented in this report has continued to be relied upon as more of a comparative tool than an explicit predictor of investment returns (i.e., all the same as a more simplified RLV), the DCF approach has allowed us to prepare a more defensible and flexible analysis that responds to the unique objectives of the study.

- Our analysis is further limited to evaluating the feasibility of the development concepts being constructed in isolation, including articulation for each of the distinct policy areas identified. As such, no specific infrastructure costs have been incorporated into this analysis. These costs would represent an additional construction cost at each site, which we have assumed would ultimately be determined based on future technical engineering work, site / block planning, as well as discussions with City of Toronto staff.

- The financial pro forma analyses included in this report have been undertaken at a very high-level and do not necessarily constitute advice to proceed with the conceptual developments identified. Rather, our financial analyses are intended to help determine whether the concepts—and related policy directions—appear show promise (or not) at first glance and are therefore worthy of further investigation. A more detailed and comprehensive development pro forma analysis would ultimately be required by the owners/operators of each property to consider the actual costing, phasing and refinement of development plans before proceeding with any new development (including determination of the optimal office component of any given project).

potential policy directions, these financial assessments are intended to provide additional context and advice from a more general financial / economic perspective only. As such, more focused and specific financial pro forma analyses will undoubtedly be required by the owners of each property in Toronto to properly evaluate the feasibility of any specific development concepts that may be advanced in the coming years.

- The financial pro forma analyses in this report are "un-trended", meaning that they exclude any growth assumptions for both revenues and costs. This has been deliberately chosen to focus on the fundamentals of the redevelopment opportunities without relying on forward looking assumptions which may not materialize to achieve satisfactory returns. In the future, if revenue growth outpaces cost growth, the results of our analyses would improve (and vice versa).

- Similarly, the findings presented as part of our analysis do not account for the unique financial expectations, strategic positioning and/or development capacities of current or future owners of real property in Toronto. As such, although each project may demonstrate a positive or negative preliminary finding as it relates to feasibility, it does not necessarily assert that such a finding—nor the related assumptions incorporated into this analysis—will ultimately be consistent with the perspectives or parallel analyses of each individual landowner. Ultimately, it is those organizations who will establish internal financial thresholds, development parameters and conditions which implicate the scope and scale of any new developments proposed.

- In conjunction with above, we note that any assessment of purpose-built rental housing deliberately excludes additional incentives or subsidies that may be available in support of this type of residential development. Specifically, although certain baseline conditions have been reflected that are within the purview of the City—including development charge reductions for new rental buildings—our analysis has not considered additional external sources of funding or financing (e.g., no consideration of programs available via the Canadian Mortgage and Housing Corporation, or similar). If these types of conditions or supports were to apply, it could help improve financial feasibility results in certain circumstances.

See **Background Report** for additional Assumptions & Limitations.

Parameters & Concepts

A range of development typologies were considered as part of our financial feasibility assessment, to capture nuances across **different locational contexts** (i.e., area-specific market conditions), as well as to capture **different elements of the conversion spectrum** presented earlier in the Background Study (and re-included in Section 3.1 of this report for reference). Additionally, consideration for a variety of residential replacement uses was considered, including ownership (condo) and rental tenures, as well as different proportions of affordable housing.

Broadly, this feasibility testing centred around 4 distinct baseline models, from which multiple scenarios were considered as part of supplementary scenario (or "sensitivity") testing:

- **Model #1 – Standalone AAA Office**

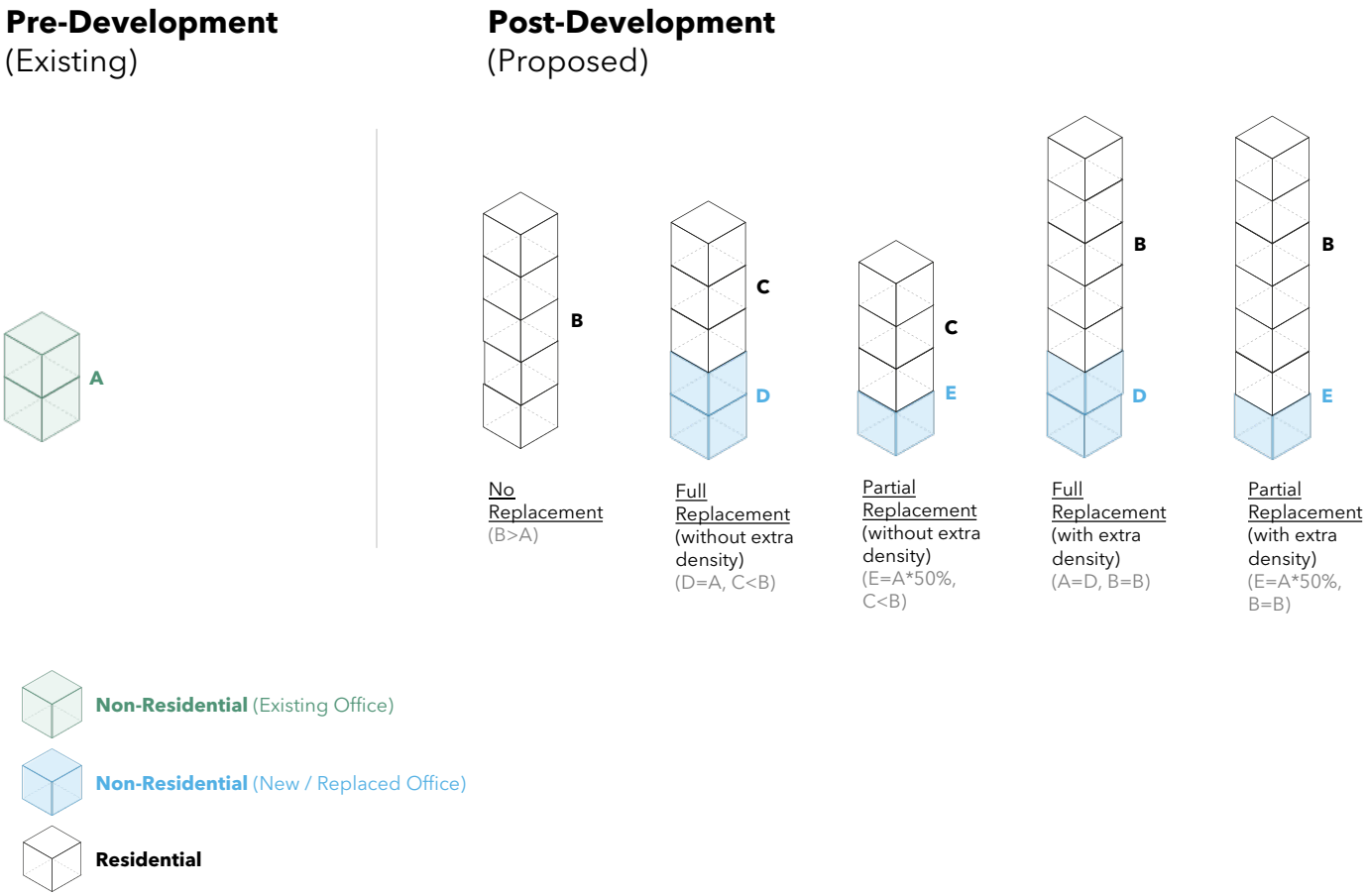
- **Model #2 – Basic Conversion** (Existing Envelope)

- **Model #3 – Complex Conversion** (Overbuild)
- **Model #4 – Simple Conversion** (Demo + Rebuild)

Additionally, we note that our baseline financial modelling does not inherently assume that any provision of additional density will be made through the development application process, though this would further improve feasibility as a general observation (i.e., thereby reducing the proportion of replacement space relative to total development floor areas). This assumption was made to provide for a more immediate "pound-for-pound" comparison of the effects of requiring more (or less) replacement space, while holding the total amount of market residential space constant. The graphic in Figure 4.2 provides a more detailed summary of this dynamic, for reference.

Figure 4.2

Delivery Options for Replacement Space can Materially Affect Financial Feasibility



Source: Parcel.

4.2 Macroeconomic Conditions

Development conditions across the country are extremely challenging at the time of this reporting, with only selected development opportunities being underwritten as "feasible".

As detailed herein, this dynamic can be attributed to record growth in construction costs and interest rates, as well as an ever-tightening lending environment as banks seek to limit their risks. This condition will be exacerbated for especially complex office space conversion projects (e.g., "overbuilds" / partial re-use of existing space / heritage features, etc.). Equivalently, other potential requirements relating to the City's replacement policies will directly impact feasibility, including alternative options for the delivery of affordable housing, other non-residential (non-office) uses and/or any other uses that ultimately deviate from the default "highest and best use" for many sites in Toronto of market-rate residential.

While the number of variables and specific input assumptions included in most development pro formas are far more extensive, the following is intended to highlight **just a few of the key macroeconomic factors currently affecting the viability of new real estate developments most significantly**. In many cases, these factors broadly apply to both standalone office projects, as well as residential and/or predominantly residential mixed use projects like conversions with some office replacement included.

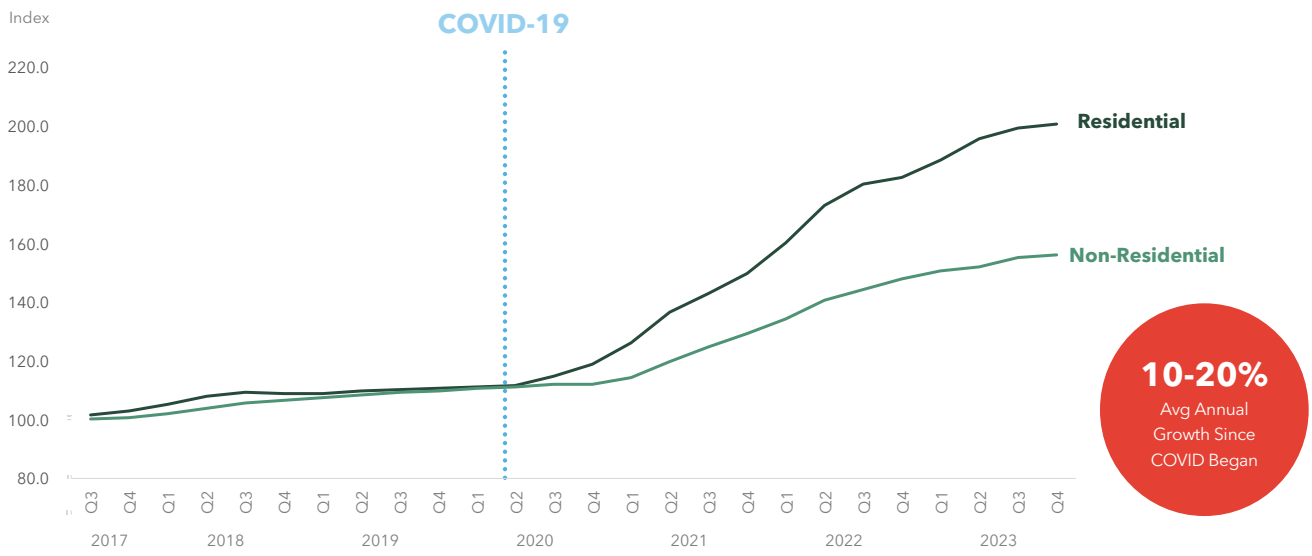
To best inform desired outcomes, it is important to: (a) identify the full range of these types of external factors that could influence the viability of development projects; and (b) isolate for factors that are either within or beyond the immediate control of the City.

Factor #1: Hard Building Cost Escalation

- As emphasized through recent media coverage and corresponding data releases (e.g., Statistics Canada Construction Price Index, Altus Construction Cost Guide, etc.), per square foot **cost ratios have risen sharply since the beginning of the COVID-19 pandemic**. Although there has certainly been variation across different real estate asset classes (land use categories) and submarket areas (geographies), this has been a consistent and common observation in communities across the country.

Figure 4.3

Construction Costs Have Grown Substantially but Are Starting to Calm



Source: Parcel, based on Statistics Canada Building Construction Index (BCPI) data. As of Q1 2024.

Return to "Normal"

Major office development tends to require a long-term investment view involving "patient" capital and a willingness to wait many years—even decades—to fully recoup initial capital investments in projects. Similarly, policy-based decisions inherently need to consider outcomes spanning a much longer-term planning horizon rather than focus exclusively on the short-term.

Notwithstanding this dynamic, we note that the construction cost index tracking new building activity illustrated above shows that year-over-year (YoY) changes appear to have peaked and are declining. While interest rates have flattened somewhat in recent months, timing is still unclear as to when they may retreat toward historical averages, or if further increases lie head.

Based on the foregoing, our baseline financial feasibility results have been deliberately left "un-trended" and do not necessarily consider the direct effects of future cost and/or revenue increases, which could ultimately occur at different rates of growth.

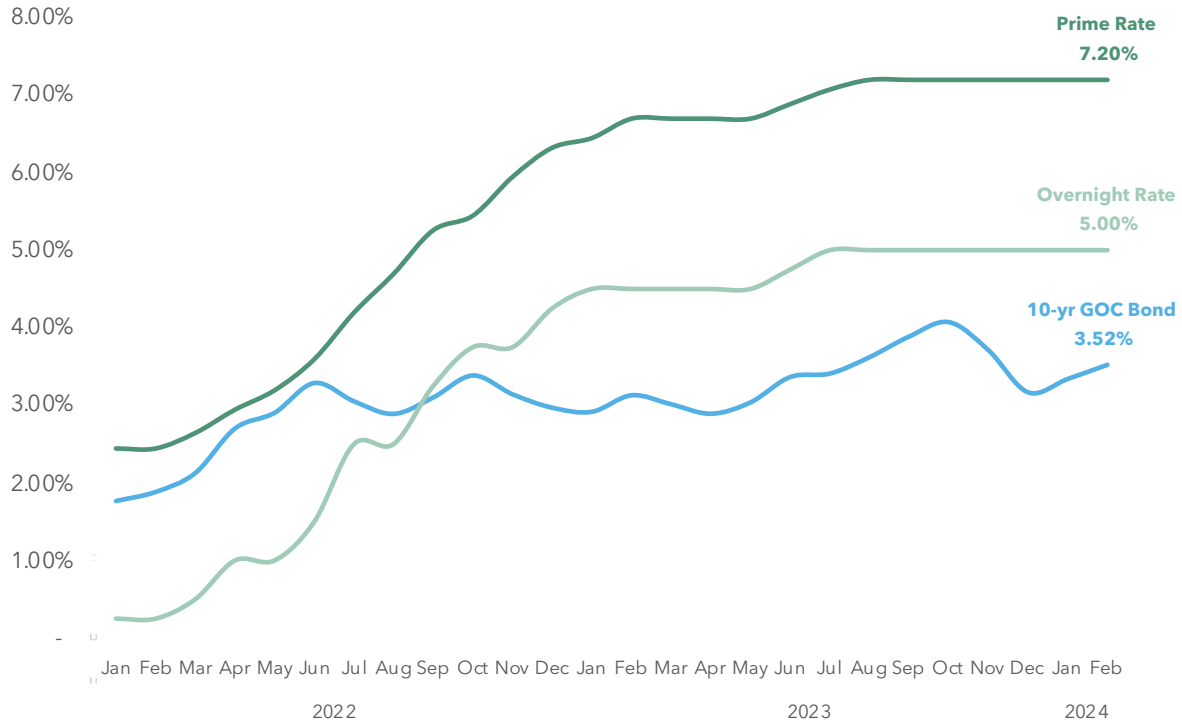
Factor #2: Interest Rates Increases

- Following an extended period of notably low interest rates leading up to the COVID-19 pandemic, 2022 through 2024 has **marked a period of notable adjustment**, as recent government announcements continue to plot rates back up to approximately 7.2% today (per the stated Prime Rate, as of late February 2024).

- In conjunction with the significant capital costs associated with developing new real estate, this can have **significant impacts on financing** (i.e., subject to the amount of equity available for a given project and/or the amount required to be financed via debt / loans).

Figure 4.4

Interest Rates Increases Have Flattened



Source: Parcel, based on the Bank of Canada. As of Q1 2024.

Factor #3: Land Use Policies & Fees

- In response to continued growth pressures and finite financial resources, municipalities across Ontario and beyond—including the City of Toronto—have been **steadily increasing the amounts levied against new developments** (e.g., one-time development charges, community benefits charges, parkland requirements / cash-in-lieu fees, etc.).

- Similarly, more structural policy changes continue to be implemented through new legislation in Ontario, including recent / ongoing announcements from the Province of Ontario, which will effectively alter the amount of these fees that can be charged across selected types of development (including affordable / below-market housing specifically, as considered as a component of our analysis of alternative replacement uses).

- Land use policy changes (e.g., land use permissions, urban design guidelines, etc.) can also directly impact the feasibility of a given project – particularly if the amount or scale of development required to achieve viability is **not permitted as-of-right**. Office conversions represent a change of use, which, depending on location, may not be permitted. The process of obtaining planning approvals is costly and lengthy, and may add risk the developer is unwilling to accept.

Factor #4: "Highest & Best Use" Inertia

- Unsurprisingly, **market residential (ownership) continues to represent the "highest and best use"** for most typical development sites across Ontario and beyond. With even purely market-based projects challenged by the various factors above, it has become increasingly difficult to achieve project feasibility for any types of developments (e.g., office uses, affordable housing, retail/service commercial spaces, etc.) that risk resulting in a reduced—or "discounted"—revenue stream. Furthermore, regardless of profit motivations, this continues to squeeze the gap between total project costs and available revenues to offset them.

- It is also important to note that highest and best use assessments are often informed by two distinct components within the purview of land economics: (1) **market opportunity or "demand"**; and, (2) **financial feasibility (development economics)**. While there is a direct relationship between these two factors, they do not always align. For example, there is plenty of demand—or "need"—for affordable housing presently, but that certainly does not allow for favourable conditions for financial viability. Equivalently, there could be demand—or "need"—for office uses, but that does not necessarily guarantee that new space will command rental rates that are sufficiently high to achieve project viability.

Factor #5: Non-Residential Uses

- Similar to above, even new market-rate residential projects in the Downtown and Midtown can often become challenged or overburdened by the cumulative effects of various other limiting factors affecting feasibility, including **the inclusion of a significant amount of non-residential space where demand may not be available**. As a general rule-of-thumb, we typically observe that any time a given development project is required to dedicate more than 5-10% of its total floor area to non-revenue (or limited revenue) generating uses, it begins to materially strain feasibility, thereby disincentivizing investment that begins to look elsewhere.

- That said, the inclusion of non-residential uses—including office uses, but also uses such as neighbourhood-serving retail/service commercial uses, institutional facilities and other community functions—**can serve as an important amenity to communities**.

4.3 Findings

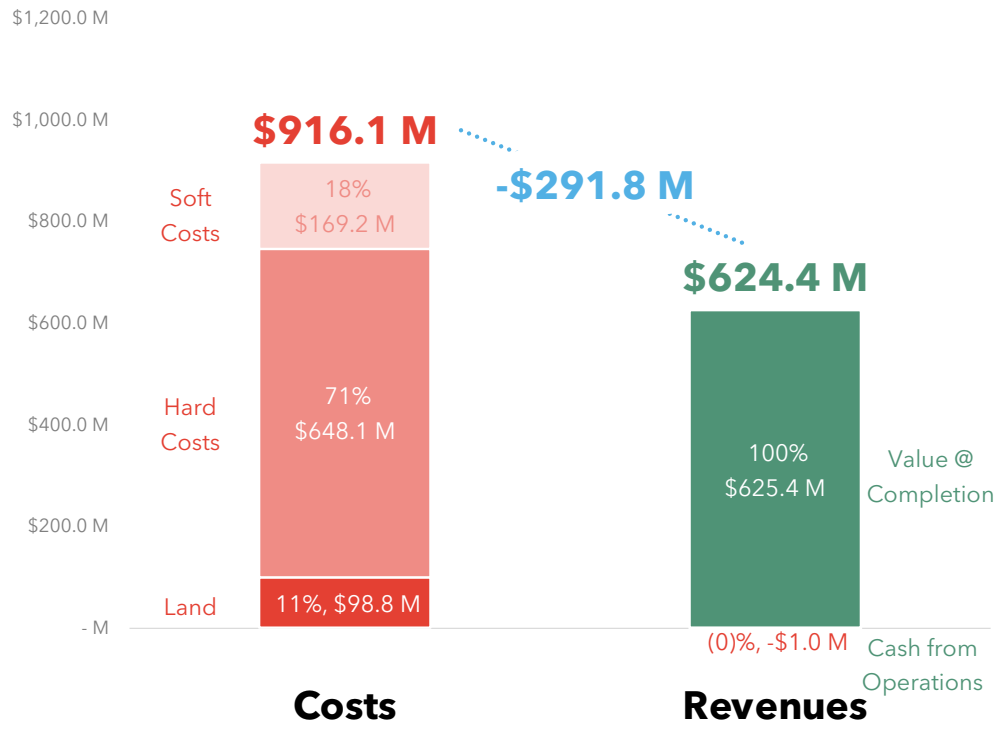
Takeaway #1: Standalone Office is Not Feasible

- The results of our preliminary pro forma modelling validate the observed challenges to developing "net new" office space in Toronto. Specifically, both "Large" and "Medium" sized AAA office buildings result in significant losses, even under ideal conditions in a place like the Financial District.

- For example, a standalone AAA office building in the Financial Core could ultimately be **worth $292M less than it costs to build**, based on current / prevailing market conditions.

Figure 4.5

Developing Class AAA Buildings in the Financial Core Could Result in Financial Losses



Source: Parcel. Based on analysis conducted in the Financial Core. Results could vary in other geographies.

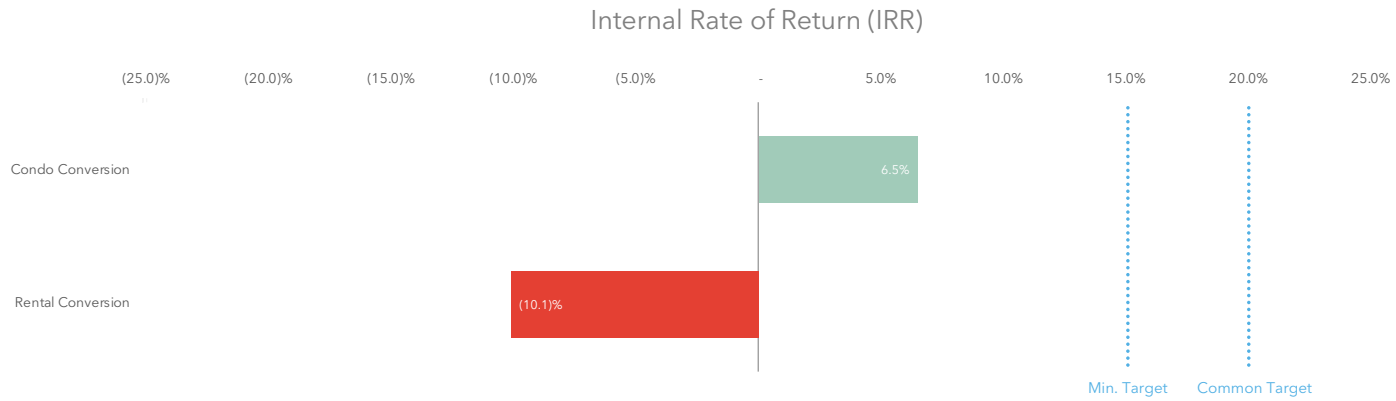
Takeaway #2: The Conversion of Existing Building Envelopes is Financially Challenging

- Conversions involving a repurposing of existing space (within the existing building envelope) are generally not feasible.
- Although condo (ownership) residential conversions of this type could technically be "profitable" (i.e., with revenues exceeding costs), they would not achieve sufficient investment returns to incentivize this type of development activity (i.e., with sufficient opportunity for reasonable investment returns, or "developer profit" of at least 15% IRR +).

- For an equivalent scenario involving a repurposing of the existing building envelope, **rental conversions result in significant losses**, which are indicative of the relationship between ownership / rental tenures across all financial modelling undertaken.

Figure 4.6

Existing Envelope Conversions are Challenged, Especially for Rental Projects



Source: Parcel. Based on a 50% vacant, 100,000 square foot B-Class office building Downtown.

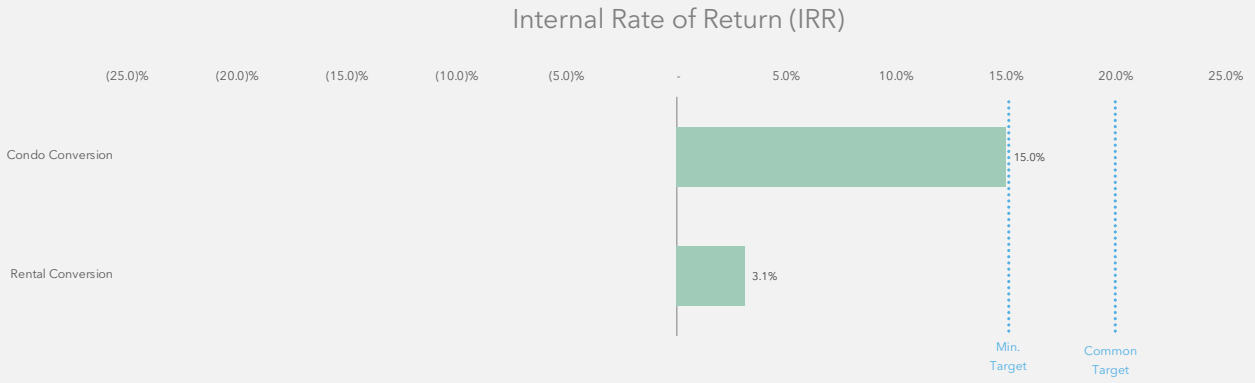
Possible Exception(s): Development in Ideal Conditions

Notwithstanding the baseline condition above, the conversion of existing office spaces to residential uses (i.e., within the existing building envelope) may be possible under ideal conditions. This includes: buildings with appropriate physical characteristics, location in a high-demand market area, heightened existing vacancies, acquisition price below market value, etc.

For example, an 85,000 square foot office building in Yonge-Eglinton acquired with 50% vacant space at a discount to the area average has the potential to achieve an IRR of 15%, if converted to condominiums. Furthermore, although conversion to rental apartments has lower IRR potential for "merchant developers" (i.e., a developer who sells the building shortly after lease-up), a "build-to-hold developer" could generate more than 4% return-on-costs from year 1 of operations, provided the property is debt free. This type of development opportunity may entice some longer-term investors.

Figure 4.7

Conversion Could Be Possible Under the Right Circumstances



Source: Parcel. Based on a 50% vacant, 85,000 square foot B-Class office building in Yonge-Eglinton.

Takeaway #3: Replacement Percentage Upset Limits Vary by Building Size

- Existing office buildings from 40,000 to 150,000 square feet[2] were analyzed for their ability to retain / rebuild the existing office space in both overbuild and demolition + rebuild scenarios across the Downtown, Yonge Eglinton and North York Centre.
- Across all three of these subject geographies, **small office buildings** of 40,000 square feet or less have the potential to generate strong returns as a mixed-use redevelopment retaining / rebuilding 100% of the

[2] For the purposes of this assessment, we have focused on buildings within this range as they represent a significant number of properties across the Downtown and other areas where office replacement policies apply (i.e., Yonge Eglinton, North York Centre). In this context, we have broadly characterized "small office buildings" as being in the range of 40,000 square feet, "medium office buildings" in the range of 60,000 or 80,000 square feet, and "large office buildings" closer to 100,000 square feet and above. These are not intended to represent categories that apply to the entire supply of office properties across the City, but rather those that are most likely to be candidates for conversion and therefore identified for analysis as part of this hypothetical demonstration. We also note that results will inherently vary on a site-by-site basis, as well as for buildings of specific floor areas within / between these identified ranges.

existing office space in all three areas, provided the buildings are acquired at or near the submarket average and significant residential density is added.

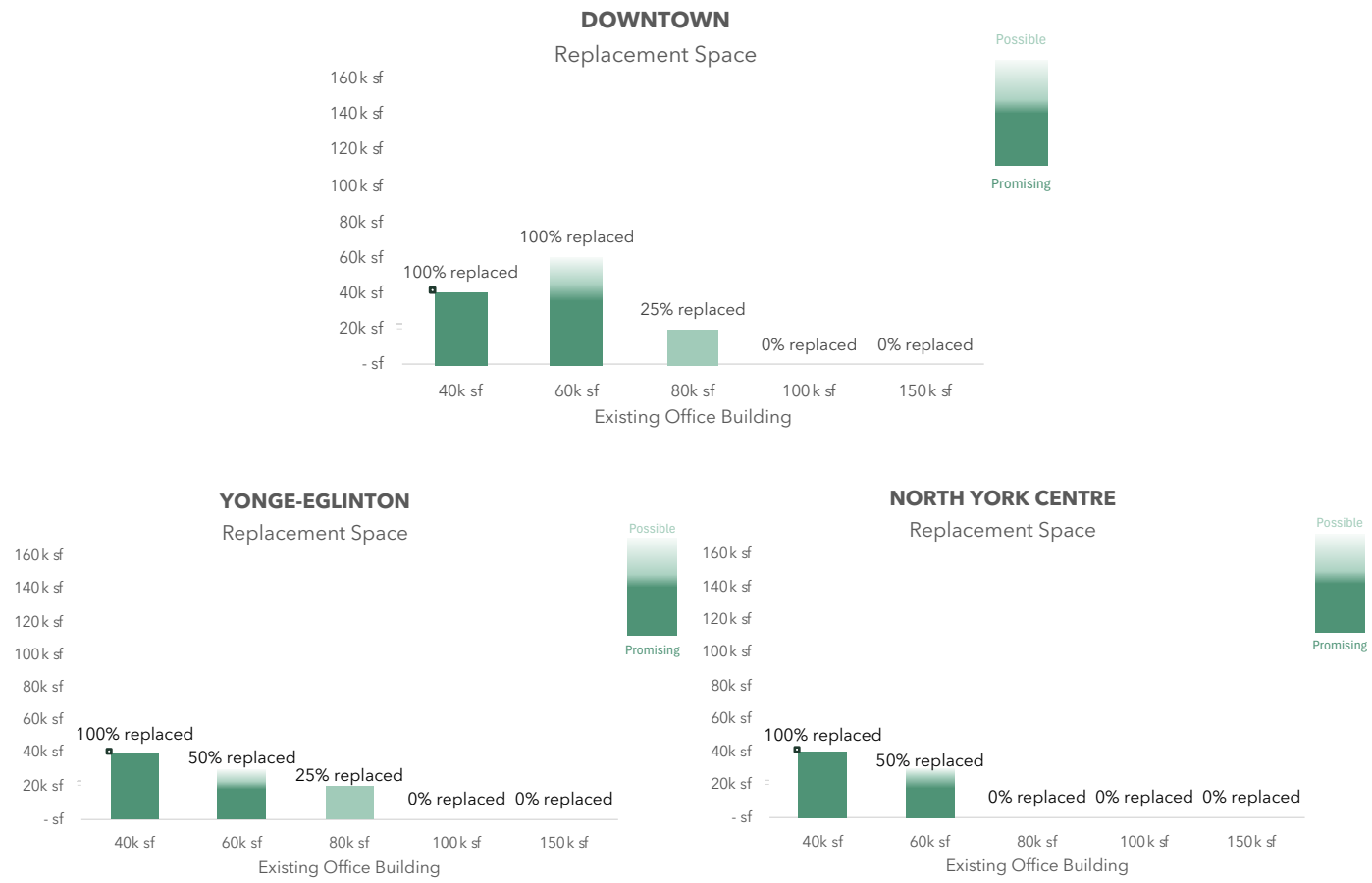
- It also appears possible to retain / rebuild some of the existing office space in **medium office buildings** of approximately 60,000 to 80,000 square feet within stronger market areas, however, this ability appears to decline the further the site from Downtown.

- Existing **large office buildings** of 100,000 square feet or more are challenged to generate strong returns as a mixed-use redevelopment based on residential market conditions and the average office building value per square foot in each area, even when no office space is included. Large buildings are too costly to purchase and yield too much poorly performing space in the new development, even at lower replacement rates or with additional residential density. This is another reason why larger existing office buildings in the Financial District (i.e., premier, Class A office space) is far less likely to redevelop and/or become converted to non-office uses.

- Further to the dynamic outlined above, it is also important to note that the larger the existing office building, the more **feasibility can be materially hampered by replacement requirements resulting in the retention of existing office space, even in part**.

Figure 4.8

Office Buildings < 80,000 sq ft Can Retain a Portion of the Existing Office Space



Source: Parcel. Based on average office building values and mixed-use redevelopment as an overbuild or demolition + rebuild. See Appendix for more detail.

- Additional **residential density**–beyond the 380 to 485 units considered as part of this assessment–may help to achieve higher replacement percentages, however, this is subject to market conditions.

Encourage the Redevelopment of Small Office Buildings

We note that small office buildings (i.e., 40,000 square feet or less) outside of the *Areas of Employment* account for nearly 2/3rds (65%+) of office buildings across the city but only contain 10% of the office space supply. Equivalently, these types of small office buildings represent nearly 60% of buildings and 6% of space within the key geographies where at least some form of replacement policy applies (i.e., Downtown, Yonge-Eglinton Centre Secondary Plan, North York Centre Secondary Plan). Their redevelopment should be encouraged, even at replacement rates of less than 100%, as the majority of the city's office space is within much larger buildings (i.e., > 100,000 square feet) and is less likely to redevelop, as shown above.

As a hypothetical scenario (for demonstration purposes only), if just **10% of these sites redeveloped for mixed-use residential uses, it would have the potential to yield some 27,000 to 35,000 new residential units**[3] while reducing the office space supply by–at most–2.3 million square feet[4] or less than 1.3% of the City's total existing supply. The space replaced would result in either: (i) 313 to 901 affordable housing units; or, (ii) 200,000 to 600,000 square feet of maintained non-residential / employment-generating space.

Large office buildings are particularly challenging to redevelop into mixed-use buildings.

Even if a functionally "tired" office building can be purchased and redeveloped for a lower price, achieving strong returns can still be challenging. For example, a 50% vacant B-Class office building of some 150,000 square feet Downtown, purchased at a discount and redeveloped into a market-rate condominium building at mid-level hard costs[5] and with no replacement of the existing office space could achieve an IRR of nearly 19% as an overbuild and nearly 21% as a demolition + rebuild (see Figure 4.9).

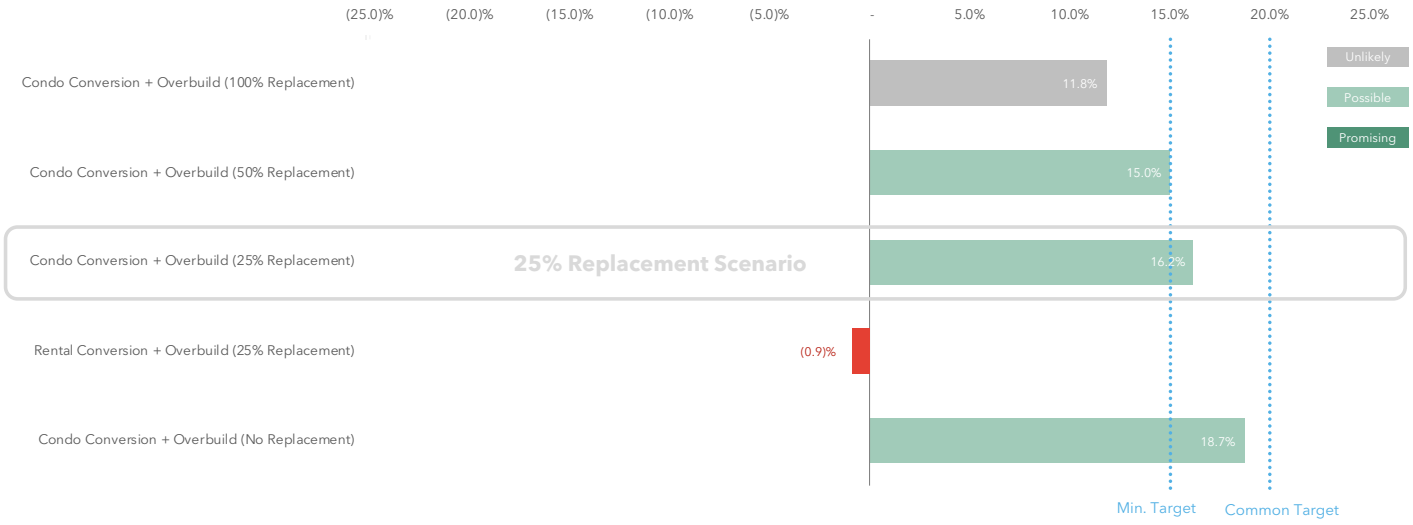
Assuming **anything more than 25% replacement renders this redevelopment challenged.**

[3] Based on the residential densities considered in our analysis of 380 – 485 units per project.
[4] Assumes each converted site contains 40,000 sq ft of office space.
[5] Consistent with the median of the 2024 Altus Cost Guide range.

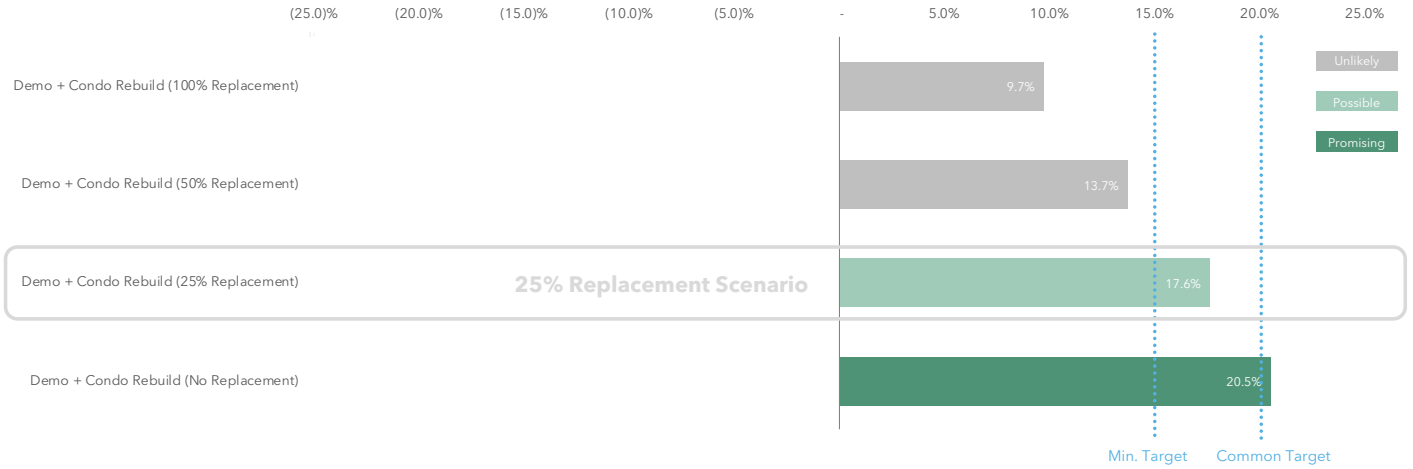
Figure 4.9

Replacement Requirements can Hamper Feasibility, Especially When > 25%

Overbuild of 50% Vacant, 150,000 sq ft Office Building Downtown



Demo + Rebuild of 50% Vacant, 150,000 sq ft Office Building Downtown



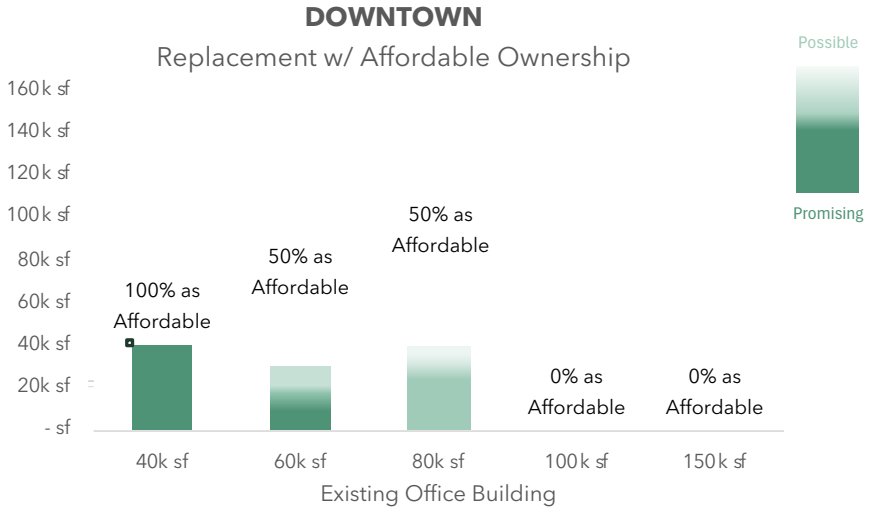
Source: Parcel. Based on a 50% vacant B-Class office building Downtown with 485 residential units and median hard costs.

Takeaway #4: Affordable Housing is a Possible Alternative Replacement Use

- Building upon the results above, our analysis has also considered the extent to which alternative replacement uses are feasible, including affordable housing across both ownership and rental tenures.
- Similar to the retention of office space, smaller buildings can support a higher proportion replaced as affordable housing while larger office buildings remain quite challenged.
- Focusing on the Downtown and using the same assumptions as our analysis of office retention by building size in Figure 4.8, we estimate that smaller office buildings could be replaced with up to 40,000 square feet of affordable ownership uses (or some 52 affordable units). This could increase slightly up to 60,000 square feet (or some 78 affordable rental apartments) if the affordable space is rental.

Figure 4.10

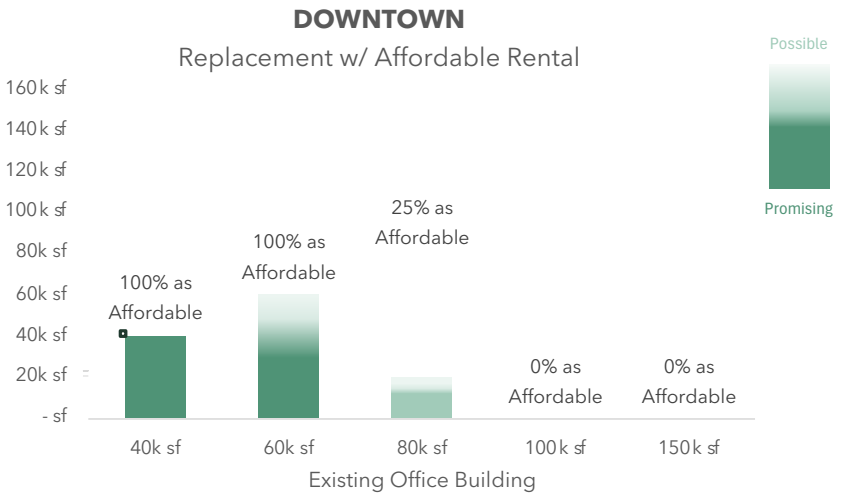
Up to 40,000 sq ft of Office GFA Could be Replaced as Affordable Ownership Housing



Source: Parcel. See Appendix for more detail.

Figure 4.11

Up to 60,000 sq ft of Office GFA Could be Replaced as Affordable Rental Housing



Source: Parcel. See Appendix for more detail.

See Appendix for detailed **Financial Feasibility Assumptions**.

5.0
Recommendations

Policy Principles & Findings

Research undertaken as input to the *Background Report* laid out the foundation for and summarized current / existing land use policies at the provincial and municipal levels. The following summarizes some of the underlying principles and key findings of this study from a policy perspective, which have directly informed the range of more targeted recommendations provided herein:

- A range of **policy options** are available to respond to the City's economic context, projected demand, and financial feasibility issues.
- Various **policy objectives**, including the City's desire to maintain a thriving local economy, provide for complete communities in all areas of the city, and to respond meaningfully to the housing crisis, have been considered in formulating policy recommendations.
- **Relaxing and adding flexibility in the office replacement policy** was identified as integral to sustaining and supporting development in Toronto going forward.
- **Flexibility**, including to substitute affordable housing and/or non-residential uses for required office space replacement, responds to changing market conditions while supporting a range of city-building objectives that are equal in priority.
- Changes to the office replacement policy should have the **capacity to be turned on or off** in response to market conditions to mitigate the loss of too much office space and the associated negative impacts on the city's economy.

1 Understand the Challenge

Based on current and anticipated future market / economic conditions, developing new office uses in Toronto will **continue to be challenging**, with few exceptions.

In particular, the inclusion of office space in new developments—whether in standalone buildings or mixed use development contexts—typically represents a burden to feasibility at present. These types of uses are not only less profitable than residential uses (i.e., consistently the "highest and best" use), but actually lead to net financial losses in many cases.

At the same time, however, the **risk of large, high-performing, Class A office buildings being converted to residential uses is limited**. This does not pose a major risk to key concentrations of office space in Toronto, including many buildings in the Financial Core.

2 Make It Happen (Boldness)

There has been a wholesale shift in the need for "net new" office space in Toronto. Now is the time to consider a **marked policy response** that enables an appropriate amount / type of conversion activity.

The focus of policy updates should be on providing flexibility. They should inherently consider a relaxation of the City's current policy structure relating to office uses, rather than layering additional complexity.

3 Sense of Urgency (Timing)

In the face of what many continue to deem a housing crisis and simultaneously facing a major softening of the office market in Toronto, it is **time for bold action**. The City should avoid indecision—or "analysis paralysis"—in an attempt to satisfy all stakeholders.

4 Provide Clarity

The City should **clearly define and communicate the parameters** of any remaining conversion-related policies applicable within selected areas of the city. This will help to avoid confusion and/or disagreement among stakeholders.

5 Prioritize Objectives

It is incumbent upon the City to **prioritize competing municipal strategic objectives** and the timelines associated with those preferred outcomes. That is, the desire for maintaining office space should be evaluated in conjunction with other goals and objectives that could be achieved more immediately, including: affordable housing delivery, securing retail/service commercial uses as an important amenity to growing communities, delivery of other non-residential / employment uses, etc.

Consideration will need to be given to balancing current development pressures that predominantly focus on residential uses with longer-term goals relating to growth in office and other forms of employment. The financial feasibility of projects requiring demolition and rebuild will also need to be set against City priorities on carbon abatement, waste generation, and water intensity.

6 Consideration of Alternative Uses

Both **affordable housing and other non-residential uses** should be considered as part of City policies requiring the replacement of office GFA. There is a growing need for affordable housing recognizing—among other things—City-wide issues of homelessness, rental housing and high interest rates. Including other non-residential uses helps achieve broader policy objectives including employment generation near transit, a diverse economic base, and a healthy municipal tax base.

7 Support Choice in Replacement

Enable developments to "mix and match" the types of uses integrated in place of office space to help support the create of mixed-use buildings.

Also, off-site provision of the alternative uses with similar locational criteria as the original policy should be permitted. Cash-in-lieu in place of affordable housing could also be considered, if these funds could help advance the HousingTO Plan targets for affordable housing.

8 Monitor & Respond

Similar to other policy-based financial and market analyses prepared by—or on behalf of—municipalities, there will be an inherent need to **regularly monitor and update** the City's rationale for updating its policies in response to ever-changing market conditions.

With the exact inflection point where demand could outstrip supply difficult to quantify, the City should advance a policy response that maintains the flexibility to pro-actively monitor market conditions as they improve / deteriorate. Opportunity to activate or deactivate the policy through a motion of Council could also help ensure the City's appropriate response to fluctuating market conditions.