

Office Space Needs Study

Needs Analysis & Policy Directions (Accessible Version)

November 18, 2024

Parcel

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planning
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Cover Image: CoStar Realty Information Inc.

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”).

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 from 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

For the full report, please visit the following link: www.parceleconomics.com/torontooffice or contact the staff listed on the City of Toronto's **Office Space Need Study** page.

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.

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,

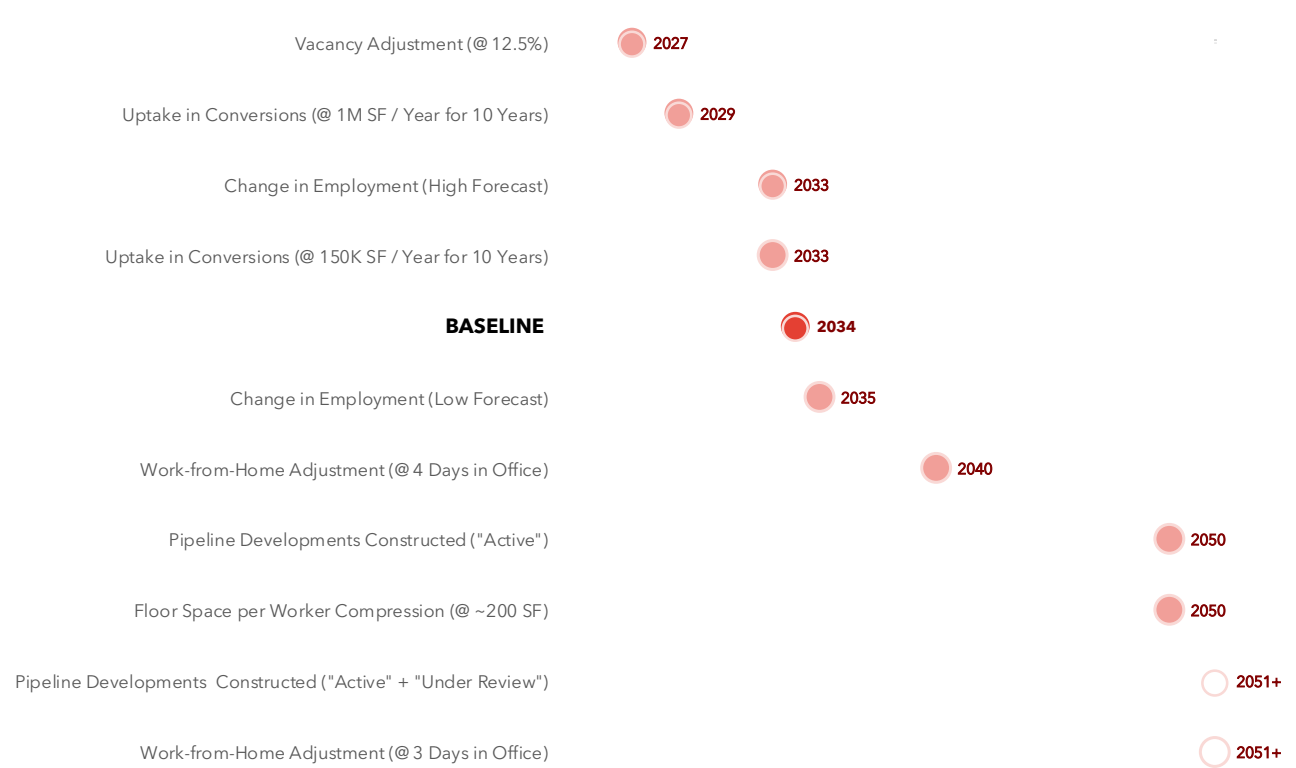
- Developing **principles for policy options** that balance a range of municipal priorities, including—but not limited to—ensuring an adequate supply of office space to meet future needs long-term, as well as to ultimately protect the City’s role as a major centre for economic activity on a global scale.
- 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

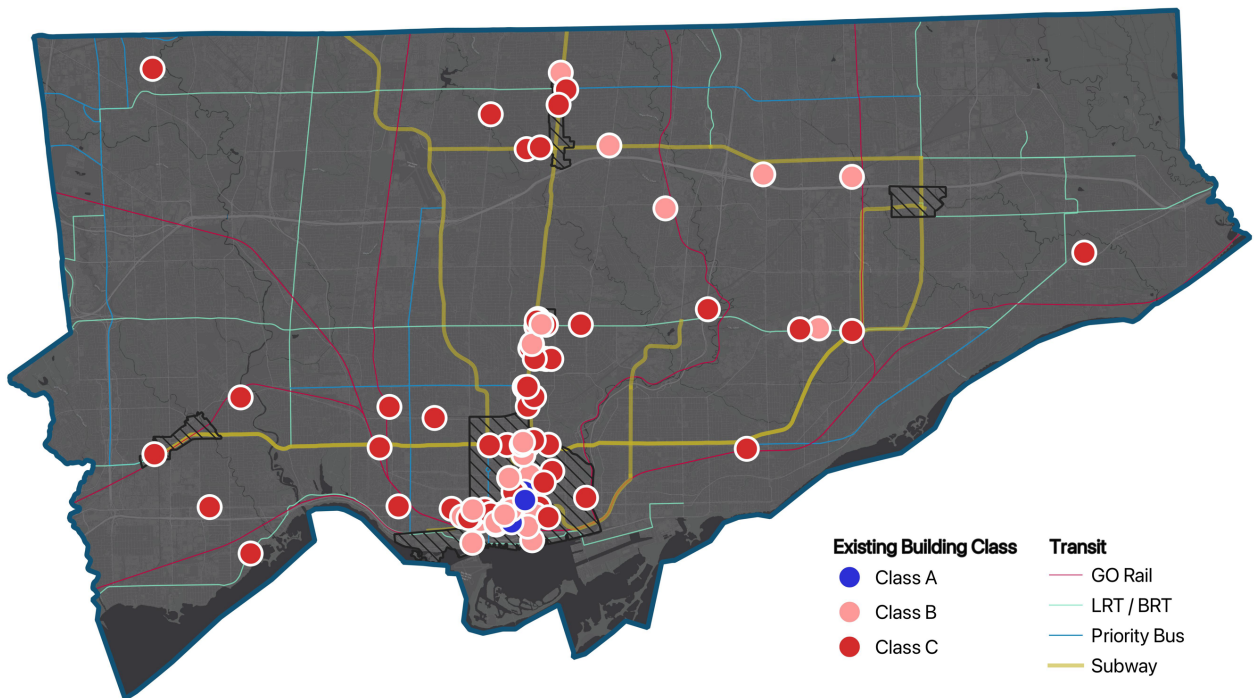


Source: Parcel

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

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.