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CORPORATE REPORT

NO: R247 COUNCIL DATE: December 2, 2024

REGULAR COUNCIL

TO: **Mayor & Council** DATE: **November 28, 2024**

FROM: **Acting General Manager, Planning & Development** FILE: **0550-20-06**
General Manager, Finance

SUBJECT: **Proposed City Centre Office and Density Bonus Policy Amendments**

RECOMMENDATION

The Planning & Development Department and Finance Department recommend that Council:

1. Receive this report for information;

2. Endorse, in principle, the proposed set of actions on changes to the City's office development and density bonus policies in the City Centre, as outlined in this report; and

3. Direct staff to bring back amendments for Council's consideration to *Surrey Official Community Plan Bylaw, 2013, No. 18020*, *Surrey Zoning By-law, 1993, No. 12000*, and any other City bylaws, policies, and regulations as required to implement these changes.

INTENT

The intent of this report is to seek Council's endorsement in principle for proposed changes to the City's policies related to office development in the Central Business District, along with related density bonus policies that apply more generally to high-density development, in order to respond to changing market conditions and new Provincial legislation.

BACKGROUND

<u>Provincial Legislative Changes Related to Density Bonus</u>

The Local Government Act ("LGA") s. 482 allows for the granting of "bonus" density to development projects, above the nominal or "base" density prescribed in a zoning bylaw, in exchange for the provision of amenities that benefit the community. LGA s. 482.3 allows the payment of cash ("density bonus contribution") by a developer to the local government as an option, instead of providing the amenity directly. Recent changes to the LGA effected through Provincial legislation, mainly Bill 46-2023 and Bill 16-2024, require the City to make some changes to the way density bonus is implemented in Surrey.

The City uses the density bonus provision in the LGA to support its capital plan for amenities that are necessary to meet the demands of a growing population, such as recreation centres, libraries, and affordable housing. Density bonus contributions are a significant part of the funding for such amenities; over the past three years density bonus contributions from high-density development (mostly in City Centre) have averaged $24 million per year.

Surrey's current density bonus system sets out several categories of development contributions that are detailed in Schedule G of *Surrey Zoning By-law, 1993, No. 12000* (the "Zoning By-law"). Staff is working on a package of amendments that will harmonize *Surrey Official Community Plan Bylaw, 2013, No. 18020* (the "OCP"), Zoning By-law, and supporting bylaws with the changes to Provincial legislation, and will bring these proposed amendments forward for Council's consideration well in advance of the June 30, 2025 deadline established by the Province in Bill 16-2024.

While this staff work proceeds, staff have identified a need to advance a number of policy components specific to density bonusing for high-density development in the City Centre that are pressing and time sensitive. These components include:

- Clarifying the City's minimum requirements for office, entertainment and office-supportive retail uses in the Central Business District ("CBD") area of City Centre;
- Establishing a maximum amount of market residential density that counts as base density within the CBD, and above which density bonus contributions are expected;
- Changing the timing of collecting density bonus contribution payments, to align with the new Provincial legislation;
- Clarifying the procedures for allocating and collecting density bonus payments on large, multi-phase projects; and
- Clarifying exemptions to density bonus contributions including non-residential floorspace, non-market housing, and rental housing.

These proposed changes are more time sensitive as there are several large, multi-phase development projects that are nearing final adoption of rezoning and building permit application, and where density bonus contributions need to be determined.

<u>Office and Employment Policy in the CBD</u>

In March 2022, through Corporate Report No. R063; 2022 (Appendix "I") Council endorsed the Office and Employment Strategy and amended the City Centre Plan to incorporate the CBD in the core of downtown, centred around the Surrey Central SkyTrain Station, the City Hall complex, and SFU Surrey campus. The CBD was subdivided into two sub-districts (CBD 1 and CBD 2), and Council endorsed the principle of establishing a minimum expectation for office development within these areas; however, these minimum office and employment densities have not been confirmed by bylaw, which has created ambiguity around development requirements and has implications for density bonus payments that apply to development applications in the CBD.

DISCUSSION

<u>Proposed Office and Employment Requirements in the CBD</u>

One of the key policy goals in the OCP and City Centre Plan is fostering the growth of employment in the City Centre area, and in particular a regionally significant office district that anchors the "second downtown" of the region.

In Corporate Report No. R063; 2022 (Appendix "I"), the CBD 1 area with a Floor Area Ratio ("FAR") of 7.5 was proposed as entirely non-residential, while the minimum office and employment expectation in the CBD 2 area was suggested as 3.5 FAR. This amount of office and employment density was intended to encourage the development of an office district and to ensure that single-use market residential developments did not occupy key central sites and prevent the emergence of a core office district. A robust office district supports a diversified tax base for the City and brings other benefits along with local employment: entertainment and hospitality uses such as restaurants, hotels, cultural and sports facilities benefit from the daytime population of workers and commuters, creating a "virtuous circle" that builds a true downtown. A market study commissioned by the City in 2021 indicated a strong demand for office space and low vacancy rates in Surrey City Centre; this study informed the proposed policy set out in Corporate Report No. R063; 2022.

Since 2022, it has become apparent that the market demand for office development, both regionally and internationally, has adjusted, along with the economic viability of large office developments. This adjustment was noted by developers active in the region and further confirmed by a second market study commissioned by the City in 2023 by the consulting firm nblc (Appendix "II"). This study confirmed that the demand for office space has adjusted as firms have responded to the post-COVID environment of remote and hybrid work arrangements by reducing their office space footprint and leased space. While the future of workspace is uncertain, it is apparent that the near-term and medium-term demand for office is reduced from what it was prior to 2021. It follows that the City's requirements for office space in new developments within the CBD may be adjusted to ensure financial viability while retaining the opportunity to create an employment and entertainment district in the heart of Surrey City Centre.

To balance the objective of developing an office and entertainment district in the CBD area with financial viability, staff is proposing a revised minimum requirement of 3.5 FAR of office and "office-supporting" non-residential uses (such as hotels, restaurants, groceries, and cultural space) in the CBD 1 area, and a revised minimum of 2.0 FAR of these uses in the CBD 2 area. Staff is also proposing to adjust the area boundaries of the CBD 1 and CBD 2 areas, as shown in Appendix "III".

Office space is typically delivered in two formats in high-density mixed-use developments. The first type is "podium" office space, where the second through fourth floors of a mixed-use tower is non-residential space, with residential towers built above these podium levels. These offices tend to favour smaller leasable occupancies and, therefore, smaller firms, since the elevator shafts and tower building cores break up the podium space. The second type is a "stand-alone" office tower, either on its own parcel or as one of several towers above a common parkade and podium. This type of office building typically allows for larger floorplates, larger and more flexible leasable occupancies, and arrangements that attracts larger firms seeking longer leases or outright ownership. As a way of encouraging stand-alone office buildings, staff is proposing to allow for a further reduction in the minimum office and office-supporting requirement to 3.0 FAR in CBD 1 and to 1.5 in CBD 2 if the office space is delivered in a stand-alone form at a scale of 200,000 sq. ft. in CBD 1 and 100,000 sq. ft. in CBD 2.

<u>Proposed Density Bonus Calculations in the CBD</u>

Without Council-approved bylaw provisions on the minimum amount of office and employment density required of developments in the CBD, it is not possible to establish a firm base residential density above which bonus density contributions (known as "Tier 2 CACs") may apply. On a large high-density project, this ambiguity can result in a difference of several million dollars in Tier 2 CAC revenue to support community amenities, resulting in protracted negotiations between staff and the developer.

For example, in the core of the City Centre, the base density allowed is 7.50 FAR. If the minimum office and employment "base density" is set at 2.5 FAR, the resulting residential base density would be 5.0 FAR and any additional residential density would be "bonus" and result in a density bonus payment. If, on the other hand the minimum office and employment base density is set at 1.0 FAR, the residential base density would be 6.5 FAR, and density bonus would only apply above this threshold. On a large development proposing 7.0 FAR / 700,000 sq. ft. of residential floor area, this difference of 1.5 FAR in bonus density would result in a variance of $6M ($8M vs. $2M) in payments to the City.

As discussed above, the staff proposal is to set the minimum office requirement at 3.5 FAR in CBD 1 (reducible to 3.0 FAR for stand-alone office larger than 200,000 sq. ft. and 15 storeys) and 2.0 FAR in CBD 2 (reducible to 1.5 FAR with stand-alone office larger than 100,000 sq. ft. and 10 storeys). Therefore, the maximum market residential base density would be 4.0 FAR in CBD 1 (increasable to 4.5 FAR) and 5.5 FAR in CBD 2 (increasable to 6.0 FAR). Market residential floor area above these densities would be subject to Tier 2 CACs, which are currently $44.56/sq. ft.

These proposals were presented at the November 21, 2024 Development Advisory Committee meeting and were well-received by the members of the committee, including a number of major developers active in City Centre.

<u>Proposed Timing of Density Bonus Payments</u>

Recent provincial legislation (Bill 16-2024) amending the LGA requires local governments to collect density bonus contributions from development at the time of subdivision or building permit ("BP") issuance. This differs from the City's current practice of collecting Tier 2 CACs at the time of rezoning. Aligning the City's practice with the new provincial legislation will defer collection of these contributions by up to several years for some projects and will align with the collection of Development Cost Charges ("DCCs").

The issue of timing is particularly significant on large, multi-phased projects, where BPs for later phases of a project may not be issued for many years after the rezoning of the overall project site. In the case of density bonus contribution payments on multi-phase projects, clarity in the form of a Council-approved policy will reduce uncertainty for developers and allow the City to prepare more accurate revenue projections for capital planning purposes.

The staff proposal is for the City to provide an option to the developer of a multi-phase project, to either:

- Pay the full amount of the Tier 2 (density bonus) CAC for the entire project at the time of the first full BP issuance, calculated at the rate prevailing on that date; or
- Pay the proportion of the full Tier 2 (density bonus) CAC applicable to each phase of the project, calculated on the portion of the site being developed and at the rate prevailing on the date that the first full BP is issued for each phase.

For example, if the total Tier 2 CAC for a four-phase project is calculated at $8M, the developer would have the option of paying the full $8M on the date of the full BP issuance for phase 1, or of paying $2M on the date of the first full BP issuance for each equal phase. The benefit to the developer of the second option is clear, but there is some risk that the rate of the Tier 2 CAC is increased during the build-out of the project. This risk can be managed by allowing a 12-month "in-stream" rate protection for projects that have submitted a complete BP application before the date of a rate increase. This approach aligns with the City's practice for DCC collection, as well.

Exemptions from Density Bonus CACs

The City's current practice is to calculate density bonus CACs only on market residential floorspace in a strata or fee-simple form of ownership. The City exempts below-market rental floorspace along with office, commercial, institutional, and other non-residential floorspace from density bonus calculations.

The City has also exempted market rental residential floorspace from Tier 2 CACs, where the developer has entered into a Housing Agreement with the City, restricting the tenure of the units to rental for a certain period of time. Once a Housing Agreement expires and rental units are offered for sale, the City would levy CACs on bonus density; however, tracking the expiry of Housing Agreements and sale transactions is challenging.

The exemption of market rental residential floorspace from density bonus payments is controversial. On the one hand, bonus density (above the OCP) available on a rental development has real value to a developer, although this value is realized over a longer period of time, either through rents, the sale of a rental building, or the future sale of strata units once rental restrictions expire. On the other hand, market rental development is typically seen as less profitable than market condo development, and CACs or other fees may make "purpose-built" rental uncompetitive or not financially viable. The issue is further complicated by the fact that many market condo units are rented out by investor-owners, creating an equity imbalance as the tenants of these units are "contributing" to the amenities of the community differently than the tenants of rental units held by a developer or institutional investor.

New development—whether owner-occupied condos, rented condos or secured market-rate rentals—places a burden on the City's existing amenities and facilities. Determining whether it is equitable and financially viable to establish a Tier 2 density bonus CAC applied to market rental is a key decision for the City. The complexity of this issue requires a careful review that is beyond staff's expertise. Staff propose a market assessment by a qualified consultant, along with consultation with knowledgeable industry partners to determine if market rental development should continue to be exempted from density bonus calculation, or whether a unique CAC rate may be equitable and financially viable.

Proposed Approach

Based on the preceding discussion, staff is proposing a set of actions that includes:

1. Establishing minimum office and employment density expectations in the CBD 1 and CBD 2 designations in the City Centre Plan, as outlined above;
2. Establishing maximum market residential base densities for developments in the CBD designations, as outlined above;
3. Amending the boundaries of the CBD 1 and CBD 2 designations in the City Centre Plan, as outlined in Appendix "III";

4. Establishing a policy with options for the allocation and collection timing of density bonus CAC payments for multi-phase development projects; and
5. Retaining a market consultant to develop recommendations on whether to establish an equitable and viable CAC rate on density bonus market rental development.

This proposed set of actions are part of a larger review of the City's CAC policies to align with Provincial requirements which must be completed before June 30, 2025. The proposed actions outlined in this report are time sensitive as they affect active developments under application and are being accelerated in advance of the larger review.

In addition to the consultation with the DAC held on November 21, 2024 staff propose to consult with the Mayor's Development Approval Process Improvement Task Force. Following this consultation, proposed bylaw and policy amendments will be brought forward for Council's consideration over the next few months, with the goal of completing this work before Spring 2025.

Legal Services Review

This report has been reviewed by Legal Services.

CONCLUSION

Recent provincial housing legislation has a significant impact on how the City is able to finance community infrastructure and amenities that are needed to support population growth. This will require changes to the City's current system of CACs and density bonus, along with changes in the way funds are collected, held, and reported. There is a need to accelerate parts of this larger review of the City's policies and procedures that are time sensitive. This report sets out a proposed approach for Council's consideration and endorsement, to be implemented through subsequent amendments to the OCP, the Zoning By-law, other related bylaws, and policies.

Original signed by
Ron Gill, MA, MCIP, RPP
Acting General Manager, Planning & Development

Original signed by
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Appendix "I" Corporate Report No. R063; 2022
Appendix "II" Surrey City Centre Office Developer Market Insight Study (April 2023)
Appendix "III" Proposed Amendments to the Central Business District Designations

https://surreybc.sharepoint.com/sites/pdgmadministration/document library/corporate reports/future/city centre office policy amendments/cr proposed city centre office policy amendments.docx

APPENDIX "I"

CITY MANAGER'S DEPARTMENT

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CORPORATE REPORT

NO: R063 COUNCIL DATE: March 28, 2022

REGULAR COUNCIL

TO: **Mayor & Council** DATE: **March 25, 2022**

FROM: **Acting General Manager, Planning & Development**
General Manager, Investment & Intergovernmental Relations FILE: **6520-20 (City Centre)**

SUBJECT: **Update on Delivering the City Centre Plan Vision – Central Business District**

RECOMMENDATION

The Planning & Development Department and Investment & Intergovernmental Relations Department recommend that Council:

1. Receive this report for information;

2. Approve the proposed Office and Employment Strategy, as described in this report, including amendments to the City Centre Plan, attached as Appendix "I";

3. Approve the proposed City Centre Plan boundary extensions, as described in this report and attached as Appendix "II";

4. Authorize staff to amend *Surrey Official Community Plan Bylaw, 2014, No. 18020, as amended*, as documented in Appendix "III", in order to ensure consistency between related figures and land use designations within the City Centre Plan and those in the Official Community Plan, and authorize the City Clerk to bring forward the necessary Amendment Bylaw for the required readings and to set a date for Public Hearing; and

5. Authorize staff to amend *Surrey Zoning By-Law, 1993, No. 12000, as amended* (the "Zoning Bylaw"), as documented in Appendix "IV", in order to provide clarity on the impact of employment space requirements on the calculation of Capital Projects Community Amenity Contributions, and authorize the City Clerk to bring forward the necessary Amendment Bylaw for the required readings and to set a date for Public Hearing.

INTENT

The purpose of this report is to provide an update on the ongoing review of the City Centre Plan and to seek Council approval of new policies and land use designations intended to support office and employment growth in City Centre.

BACKGROUND

Surrey City Centre is undergoing a bold transformation from a suburban town centre into the region's second metropolitan centre. In 2017, Council approved the City Centre Plan (the "Plan") to realize this vision and guide high-density, mixed-use, transit-oriented growth. Integral to this vision is the emergence of City Centre as a major regional office and employment centre.

The Plan includes a framework to support office and employment growth, including a Guiding Principle to "Encourage Office & Employment". Office jobs contribute to a healthy local economy and expand the non-residential tax base. They allow Surrey residents to live close to work, reducing commute times and traffic congestion. In turn, office workers support commercial, entertainment, and cultural businesses and contribute to a vibrant downtown atmosphere.

The Plan envisions the highest concentration of employment in the core area surrounding Surrey Central SkyTrain Station. The areas surrounding Gateway Station, King George Station and Surrey Memorial Hospital are also identified for employment growth.

City Centre Office Demand

Since the Plan's completion, City Centre has experienced sustained investment and development, including numerous mixed-use and institutional projects. High-density residential growth has accelerated, and City Centre is experiencing rapid population growth. Office growth has been steady, although predominantly integrated within comprehensive mixed-use development. Between 2011 and 2019, leading up to the COVID-19 pandemic, City Centre added an average of 7,500 square metres of office space per year. During that period, office vacancy declined and has remained low, even with the onset of the pandemic. Currently there is approximately 200,000 square metres of office space in the City Centre, whereas by comparison there is approximately 2.5 million square metres of office space in downtown Vancouver.

There is a latent demand for office space in City Centre that is not being met due to the limited supply of vacant office space. For this reason, when new supply has come online, it has been absorbed relatively quickly, forcing prospective tenants that miss out to look elsewhere in the region.

Notwithstanding the healthy demand for office space in City Centre, large standalone speculative office construction remains challenging due to high pre-lease requirements needed to secure construction financing. This is not unique to the City Centre market. The current developers in City Centre are also predominantly residential developers, with few interested in the standalone office development business model.

The same factors that make Surrey City Centre a strategic office location are also driving unprecedented growth and demand for residential development, thus requiring a strategy to protect space for future office. Therefore, it is important that City Centre strengthens its profile as a downtown office location. This will improve its ability to attract the type of tenants needed to develop large scale office sites. City Centre already has key attributes that support the marketability of an office location, such as rapid transit connectivity, parking availability, and a strong institutional presence. As such, the City's efforts should strategically focus on the following objectives:

- Building a critical mass through continued incremental growth. This could be in the form of smaller and medium scale office in mixed-use developments.
- Making City Centre more attractive as an office centre by encouraging the delivery of office-supportive amenities and services, with a focus on dining, entertainment, and culture.

Based on existing conditions and market intelligence, there is an opportunity to reinforce City Centre as the second Central Business District ("CBD") for the Metro Vancouver region.

Interim Central Business District Requirement

While the existing Plan provides a strong framework to support employment growth, targeted amendments are required to provide stronger policy tools for requiring office space. On October 21, 2019, Council authorized staff to undertake an update to the Plan. Along with authorization to initiate the Plan update, Council also endorsed the establishment of an interim CBD area, along with a provisional policy requirement that new development therein provide at least 50% of its floor area for office and/or institutional uses. The interim boundary of the CBD is illustrated in Appendix "V".

The objectives of these requirements were to establish interim expectations regarding new development in the core of City Centre while staff undertake additional analysis and consultation related to a more permanent office and employment strategy. Through this approach, the City has been effective in establishing the intent and framework to build a critical mass of employment and establish City Centre as a major employment centre.

Staff have completed analysis and stakeholder consultation related to a long-term office and employment strategy, including refinements to land use policies and designations. Proposed refinements are described in this report.

DISCUSSION

Office and Employment Strategy Planning Process

The Plan update began with a market study, which was undertaken in spring of 2020. Upon completion of the market study, staff began the exploration of land use refinements and the preparation of draft policy. This process was accompanied by a comprehensive program of stakeholder consultation to ensure that diverse development and business interests were represented. Details of the consultation activities, along with key findings, are described in the following sections, as well as in a consolidated engagement summary attached as Appendix "VI".

<u>City Centre Market Study</u>

In spring 2020, Coriolis Consulting Corp. was retained to conduct a market analysis study for City Centre. The purpose of this analysis was to inform the development of policies to support office and employment growth. The study included the following elements:

- A review of regional and City Centre-specific office trends, including office floor space growth, vacancy, and tenant types;
- Interviews with developers and leasing agents on the prospects for office development in City Centre;

- A comparison of City Centre with competing Metro Vancouver office centres; and
- Commercial floor space forecasts for office, retail, and hotel development.

The market study found that between 2011 and 2019, average annual office construction in City Centre was approximately 7,500 square metres. During this period office vacancy in Surrey declined from 50,000 square metres in 2011 to 15,000 square metres in 2019. Based on local and regional trends, office growth to the year 2050 was forecast to average between 8,000 and 14,000 square metres per year for City Centre.

Surrey's large and growing population and its relatively affordable housing were counted among City Centre's advantages for attracting office development; however, most important were the presence of Simon Fraser University at the Surrey Campus and rapid transit connectivity to the rest of the region.

City Centre's main disadvantages with respect to attracting office development include a lack of a critical mass of existing office space, limited office-supportive amenities and services, and a lack of street front retail space.

The study noted that the future development of additional transit infrastructure, health and education institutions, and entertainment and cultural amenities will have positive impacts on forecasted office growth.

<u>Stakeholder Consultation</u>

Consultation was informed by the Public Engagement Strategy which was endorsed by Council during the planning process. Consultation with the public and key stakeholders was conducted via an online engagement platform with a public survey, presentations to community and business associations, and workshops with development industry stakeholders. Key learnings include the following:

- Office growth should be prioritized in the CBD;
- In addition to the CBD, office growth should continue to be encouraged in other City Centre locations, especially near Surrey Memorial Hospital;
- SkyTrain access and proximity to major institutions, including Simon Fraser University, the new UBC campus, and Surrey Memorial Hospital, are important factors for office growth in City Centre; and
- Availability of amenities and services such as shopping, entertainment, hospitality, and cultural facilities are important to workers and employers.

Stakeholders also expressed that residential development in City Centre supports employment growth as it provides a nearby supply of workforce housing. It was also conveyed that the residential component of a mixed-use development may support the delivery of office space by improving the overall financial viability of the project.

There were also concerns raised around the amount of office space that might be required, especially considering significant office projects that have already been approved and not yet constructed. It was felt that these developments will compete with future projects, impacting their ability to meet pre-lease requirements.

Economic Development Intelligence

Demand for office space continues to be present despite the impact of the COVID-19 pandemic. This reflects Metro Vancouver's attractiveness for office space, and the on-going global competition to attract the talent to support innovation and growth.

As a member of the Consider Canada City Alliance, the City is now participating in a number of national efforts to attract major multinational companies to Surrey. Currently, staff are supporting investment leads totalling over 18,000 square metres of office space, representing approximately 800 jobs. While demand is anticipated to grow, Surrey will need to consider the following factors to support future large-scale office investment:

1) There is a lack of vacant office space in the City Centre, specifically large floorplates, the type of open office space desired by tech companies. The floorplate of a typical mixed-use buildings is not conducive to current office demand and will only attract smaller office users;

2) The timelines for 'move-in ready' companies are typically less than 18 months. Pre-leasing and waiting for a three to four-year construction timeline does not meet typical office demand requirements; and

3) There is a very limited number of standalone office developers, including Real Estate Investment Trusts and Pension Fund developers, operating in City Centre. Most developers active in the City Centre area are focused on residential development and have limited experience developing and leasing office space.

While existing developers are prioritizing high demand residential developments, few are exploring solutions to deliver more office space. This is despite Vancouver's downtown core continuing to build new office space to meet current demand. Other major regional transit hubs, such as Brentwood Town Centre, Coquitlam Centre, and Metrotown, are also pursuing growth in office space. An increasing number of office developers are offsetting pre-lease requirements by entering the pre-sale strata office market in order to greenlight potential projects.

For City Centre to advance its role as the region's second metropolitan centre, the City needs to prioritize the attraction of office development partners, while continuing to attract prospective tenants. More focused and applied measures are needed to protect transit-oriented sites for office development, particularly within the CBD. Office space protection needs to consider the type of office space that is conducive to modern tech companies and corporate offices. Office supportive uses and amenities also need to be prioritized in these areas.

Office and Employment Strategy

The proposed strategy is a comprehensive approach to ensure that transit-oriented sites are protected for office and employment space in City Centre. It addresses both short and long-term growth, considering the current and projected demand within City Centre, as well as existing constraints on office development and financing. The strategy draws from demand analysis and market evidence, with input and direction from industry and market experts.

To support this new approach, the Plan will define "employment uses" to include office, commercial and institutional uses. This provides flexibility for commercial developers while continuing to support office growth. It also reflects the City's objectives around expanding cultural and institutional uses and opportunities to secure key ancillary uses through development. The availability of supportive amenities and services is an increasingly important locational criterion for businesses, particularly technology and professional services.

The proposed strategy identifies a hierarchy of office growth areas within City Centre. It acknowledges the strategic value of key transit-served and hospital-adjacent locations, as well as the supporting role of other mixed-use areas, especially along King George Boulevard. This strategy is described in greater detail in the following sections.

Central Business District

The CBD will be the principal focus of office and employment growth. This will include high-density, Class A (highest calibre) office space in standalone office buildings, as well as significant floor area within mixed-use buildings. Employment growth will also be achieved through institutional expansion and additional commercial space. Development within the CBD will prioritize office and employment uses.

The entirety of the CBD is currently designated *Mixed Use 7.5 Floor Area Ratio ("FAR")* in the Plan. While this land use designation is intended to accommodate office and institutional uses, it also permits development that is predominantly residential (with minimal ground floor commercial).

To formalize the CBD, the area's land use designation is proposed to be amended to a new *Central Business District* designation. This will protect against the loss of strategically located sites to development that does not contribute significant employment space. Such sites are needed to ensure sufficient capacity for long-term employment growth and to provide opportunity for the development of larger floorplates that attract modern tech and corporate offices. Two sub-areas of the CBD are proposed as follows:

- *Central Business District Area 1 ("CBD Area 1")* – This area includes the lands currently controlled by the City and Simon Fraser University, as well as a majority of the Central City Shopping Centre site, as illustrated in Appendix "I". The intent within this area is to support high-density office and employment uses up to 7.5 FAR. Additional density, including residential density, may be considered in accordance with density bonus provisions and within the Zoning Bylaw, and subject to meeting urban design, transportation, and servicing criteria. These areas are expected to develop with standalone office and institutional buildings over the long-term, providing sufficient capacity to meet City Centre's future employment space needs. Residential may be considered subject to the provision of 7.5 FAR of employment uses.

  Central Business District Area 2 ("CBD Area 2") – This area includes properties east of City Parkway to King George Boulevard, as well as the portion of the Central City Shopping Centre facing Holland Park, as illustrated in Appendix "I". The intent within this area is to support high density employment uses, as well as to allow high density mixed-use development, providing at minimum 3.5 FAR of office and employment space. An overall permitted density of 7.5 FAR is supported. Additional density may be considered in accordance with density bonus provisions within the Zoning Bylaw, and subject to meeting urban design, transportation, and servicing criteria. Development may take the form of a standalone office or institutional buildings or an office/commercial podium with residential or additional employment uses above. On larger/phased sites with multiple buildings, significant office space must be provided and prioritized with the initial phase of the development. Additionally, employment space satisfying the FAR requirements will be clearly identified in the General Development Permit and Comprehensive Development Zone.

Within *CBD* Area 2, the 3.5 FAR employment space requirement is reflective of the amount of office/commercial floor space proposed by some recently approved mixed-use developments in City Centre. Projects may potentially qualify for a reduction to the required employment space by providing uses that improve the conditions to support office growth and attract office employers. In such cases, it is proposed that the following provisions apply:

- The employment space requirement may be reduced by no more than 0.75 FAR for a development providing a significant amount of floor area for purpose-built office supporting uses. To justify a reduction, office supporting uses must occupy at least 2,000 square metres of floor area. Such uses may include dining, cafes, bars, cinemas, performance venues, cultural facilities, artists space, galleries, and hotels. Childcare and fitness space may also qualify if located above street-level. The amount of the reduction will depend on the mix of office supporting uses proposed. The base employment space FAR requirement can be reduced by 1 square metre for every 1 square metre of purpose-built office supporting uses provided.

- A reduction to the requirement may also be considered for a development conveying land and/or an air space parcel and improvements to the City for a plan identified civic purpose.

In addition to this new land use designation, it is proposed that an Entertainment and Cultural District be identified within the CBD. The purpose of this would be to encourage the concentration of entertainment and cultural businesses in locations proximate to high-density office, mixed-use, and retail developments. Post-pandemic, downtowns must offer a compelling reason for workers to return to the office. Outside of the workplace, this means providing a range of social opportunities including dining and entertainment (i.e., music, dancing, etc.) options in addition to high quality retail offerings.

Establishing an Entertainment and Cultural District creates a vision that entertainment and hospitality businesses can buy into and improves the marketability of commercial space. Additional work will be undertaken through the next steps of the planning process to elaborate this vision and ensure an active and engaging public realm.

<u>Health and Technology District</u>

The emerging Health and Technology District encompasses Surrey Memorial Hospital and adjacent areas generally between King George Boulevard and the BC Hydro Transmission Corridor as far north as Fraser Highway. It will be an additional focus of high-density employment in City Centre. Sustained office development in recent years has met the need for medical offices near the hospital, as well as space for the growing technology sector (including the HealthTech Innovation Hub). Recently, the University of British Columbia has announced their intent to locate new academic facilities in the area.

The proposed strategy reinforces this as an area for continued institutional and office growth. It is proposed that a portion of the district, as illustrated in Appendix "I", be amended to a new *High Density Employment* land use designation.

This designation will apply to Surrey Memorial Hospital and several adjacent blocks north of 96 Avenue. The intent of this designation is to provide high-density employment uses, including office, institutional, and ancillary commercial, in locations outside of the CBD. This designation will also allow for supportive housing and residential care facilities. The permitted density within this designation will support development up to 7.5 FAR. Additional employment density may be considered subject to meeting urban design, transportation, and servicing criteria.

Mixed-Use Areas

In addition to the CBD and the Health and Technology District, existing mixed-use areas will contribute to employment growth by providing supplemental, typically small-scale office space. This is needed to meet existing demand, including ancillary office uses, as well as to ensure sufficient long-term employment capacity within City Centre.

Currently, many mixed-use developments are predominantly residential, providing limited employment space, usually one floor of commercial at ground level. In key transit-served locations and adjacent to the proposed employment districts, additional employment floor space above ground level is appropriate. This may be in the form of office or additional commercial space.

To achieve this, it is proposed that the *Mixed Use 3.5 FAR, Mixed Use 5.5 FAR and Mixed Use 7.5 FAR* designations be modified to require a minimum of two floors of employment uses (with three to four floors encouraged). This requirement would be strictly form-based, with no associated density target, and would apply only to the following locations:

- In proximity to the Gateway and King George SkyTrain Stations;
- Along King George Boulevard between 104 Avenue and 96 Avenue; and
- Adjacent to the CBD and the Health and Technology District.

These areas are identified by map in Appendix "I".

As previously noted, there is approximately 200,000 square metres of office space in the City Centre. In the absence of the proposed requirements, space for employment uses is expected to grow to 400,000 square metres by 2050. With the establishment of the Central Business District, Health and Technology District, and the Mixed-Use Areas, it is expected that office growth will accelerate, with approximately twice as much office space added by 2050, for a total of approximately 600,000 square metres. With this enhanced growth and continued residential growth, the City Centre will solidify itself as the region's second metropolitan centre.

Proposed City Centre Plan Boundary Extension

In addition to the Office and Employment Strategy, the plan update includes work to review land use designations within the Bolivar Heights and Green Timbers neighbourhoods of City Centre. In undertaking this work, two potential plan boundary extensions have been identified. Staff propose minor boundary adjustments at the north and south ends of the City Centre Plan area, as illustrated in Appendix "II". These boundary extensions will allow these areas to be planned in conjunction with the land use review being undertaken for Bolivar Heights and Green Timbers. In each case, the extensions will also facilitate the conveyance of riparian lands for watercourse protection.

Proposed OCP Amendments

The OCP currently includes a *Central Business District* land use designation that covers the extensive high-density areas within City Centre. This area does not correlate to the CBD boundary proposed in this report which is intended to prioritize employment uses. In order to provide clarity on the intent and the extent of the CBD, several OCP amendments are proposed that will ensure consistency and strengthen alignment between the OCP and the City Centre Plan. The changes, attached as Appendix "III", are as follows:

- Rename the existing *Central Business District* designation as the *Downtown* designation to avoid confusion with the proposed City Centre Plan designation of the same name, but different extent. The successor *Downtown* designation will continue to encompass all high density residential and employment areas.
- Replace all references to *Central Business District* with references to *Downtown* including within the *Multiple Residential*, *Commercial*, and *Mixed Employment* designations.
- Amend Figure 3: *General Land Use Designations* to reflect the renaming of the *Central Business District* designation, described above, and to ensure alignment with City Centre Plan land uses.
- Amend Figure 4: *Secondary Plan Areas* to reflect the proposed update to the City Centre Plan boundary.
- Amend the renamed *Central Business District* Section to include the employment space (non-residential) requirements.
- Amend Figure 16: *Central Business District Densities* to rename as "Figure 16: *Downtown Densities*" and to reflect the densities identified within the City Centre Plan.
- Insert Figure 16a: *Required Non-Residential* to reflect the proposed employment space requirements.
- Amend Figure 42: *Major Employment Areas* to reflect the changes to Figure 3, as described above.
- Amend Figure 63: *Secondary Plan Areas* to reflect the proposed update to the City Centre Plan boundary.

Proposed Zoning Bylaw Amendments

Zoning Bylaw amendments are needed related to the proposed employment space requirements for mixed-use development. The Zoning Bylaw regulates the collection of Capital Projects Community Amenity Contributions ("CPCAC"). CPCACs are payable only on the residential component of a mixed-use development. "Tier 1" CPCAC rates are applicable to that portion of the development up to the density prescribed in the OCP or an approved secondary plan, such as the City Centre Plan. "Tier 2" rates are applicable to the portion above the prescribed density. Zoning Bylaw amendments, attached as Appendix IV", will clarify that any required employment space will be deducted from the plan density for the purpose of determining the amount of residential density subject to Tier 1 rates. The amendments will also replace references to the *Central Business District* OCP designation with references to the *Downtown* designation, as described above.

Next Steps

Subject to Council approval of the City Centre Office and Employment Strategy, staff will amend the City Centre Plan accordingly, and undertake the following related work items:

- Undertake additional analysis regarding office supply and demand and explore opportunities to further expand CBD areas and supportive land use designations;
- Establish a vision, development parameters, and supportive policies to support an Entertainment and Cultural District within the CBD;
- In coordination with the Parks, Recreation & Culture Department, review and update the Plan, as needed, to ensure the appropriate provision of cultural facilities, services, and amenities to support the Office and Employment Strategy;
- In coordination with the Parks, Recreation & Culture Department, review and update the Parks and Open Space Network as needed to ensure the appropriate provision of parks and plaza spaces to support the Office and Employment Strategy;
- Review and update the Secondary Plan Community Amenity Contributions to ensure appropriate funding to support updates to the plan, including parkland amenities and cultural facilities and services;
- Update City Centre's Urban Design Guidelines in relation to employment areas and to support the above-mentioned vision for an Entertainment and Cultural District;
- In collaboration with the Engineering Department, review non-residential off-street parking rates based on parking utilization data, and update the City Centre road network as needed;
- Complete supplementary housekeeping amendments to the Plan as needed; and
- Explore additional amendments to the OCP, as needed, in order to align related policies, figures, terms, and land use designations within the OCP to those advanced through the City Centre Plan update.

Staff will continue to work on the Plan update with additional updates for Council consideration in 2022. The final updated Plan is anticipated for Council consideration in 2023.

SUSTAINABILITY CONSIDERATIONS

The Office and Employment Strategy proposed as part of the City Centre Plan Update supports the objectives of the City's Sustainability Charter 2.0. In particular, this plan update supports the Sustainability Charter 2.0 themes of Built Environment and Neighbourhoods, and Economic Prosperity and Livelihoods. Specifically, this strategy supports the following Desired Outcomes ("DO"):

- Neighbourhoods and Urban Design DO3: The City Centre is a dynamic, attractive and complete metropolitan area and important international destination, and is one of North America's most livable and desirable downtowns;
- Jobs and Skills Training DO1: Diverse and meaningful employment and business opportunities are available close to where people live, and provide incomes that can support a high quality of life;
- Economy DO7: The City's strong revenue base includes a balance of commercial and residential property taxes; and
- Innovation DO14: Surrey is the region's innovation hub, focusing on health and clean technologies, and creating significant local and regional economic impacts.

CONCLUSION

The proposed update to the Plan is the culmination of work undertaken over the last two years. It is reflective of comprehensive consultation with office and institutional developers, key office tenants, and business stakeholders, and intelligence gathered through independent market analysis. The Plan update represents a clear strategy to protect for and advance office space and employment in City Centre. It prioritizes employment and office growth within a designated Urban Centre in alignment with the City's OCP and the Metro Vancouver Regional Growth Strategy.

The proposed Plan update will further support a compact, sustainable, and transit-oriented City Centre with a diverse offering of employment opportunities. Based on the above discussion, it is recommended that Council approve the proposed Office and Employment Strategy for City Centre, and amend the City Centre Plan, OCP and Zoning Bylaw as described in this report.

Jeff Arason, P.Eng. Acting General Manager, Planning & Development	Donna Jones General Manager, Investment & Intergovernmental Relations

PK/AD/cc

Appendix "I" – Proposed City Centre Plan Land Use Amendments
Appendix "II" – Proposed City Centre Plan Boundary Extensions
Appendix "III" – Proposed Amendments to *Surrey Official Community Plan Bylaw, 2014, No. 18020*
Appendix "IV" – Proposed Amendments to Zoning Bylaw
Appendix "V" – Interim Central Business District
Appendix "VI" – Office and Employment Strategy Engagement Summary

Appendices Available Upon Request

APPENDIX "II"

City of Surrey

Surrey City Centre Office Developer Market Insights Study

April 2023

nblc

Trusted advisors since 1976.

City of Surrey

Office Developer Market Insights Study
Surrey, British Columbia

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The conclusions contained in this report have been prepared based on both primary and secondary data sources. NBLC makes every effort to ensure the data is correct but cannot guarantee its accuracy. It is also important to note that it is not possible to fully document all factors or account for all changes that may occur in the future and influence the viability of any development. NBLC, therefore, assumes no responsibility for losses sustained as a result of implementing any recommendation provided in this report.

Summary of Findings

N. Barry Lyon Consultants Ltd. was retained by the City of Surrey to help the City understand the Canadian office development landscape, the impact of various development incentives, and the policies/strategies that could be pursued to encourage new office investment in Surrey. The following are our key findings:

- Over the long-term office investment is expected to be attracted to transit-connected, urban environments that offer a range of live/work opportunities. Centres that have offered an interesting mix of residential, retail, entertainment, and workplaces have outperformed traditional suburban office markets across North America.

- In this regard, the City of Surrey is well positioned to capture long-term demand. Surrey City Centre has already outperformed many suburban communities across Canada. Access to the Canada Line, a large and skilled work force, along with a broad range of commercial and cultural amenities are the structural elements necessary to attract office investment in the future.

- However, across North America, the pandemic has created near-term market issues and perhaps more importantly longer-term structural issues on how, and where, we work.

- It is clear that a greater number of people will work from home in the future. However, rates of people returning to work vary widely across the County but show slow signs of slow recovery – but full recovery to pre-pandemic conditions is not expected. Its also clear that the office will continue to be an important element of how we conduct work.

- The financial feasibility of suburban office development is further complicated in Surrey by the demand for significant amounts of parking, rising interest rates, and supply side issues. In particular, the market demand for underground parking can be so expensive that a project's construction cost would exceed the market value of the office space.

- Despite these headwinds, the City has been able to attract new standalone office towers that are part of master-planned communities with residential uses (i.e. King George Hub). In these types of communities, the weak land value that is associated with standalone office development is offset by expanded residential permissions. In our opinion, this is a positive outcome for the City and is a model that could be replicated if the conditions are appropriate.

- It will take time to adjust to post-pandemic market demand and office needs. In the meantime, the City should continue its efforts to enhance the City Centre from both a physical and policy perspective to be ready for when demand returns. To this end, we offer some thoughts for consideration that could help the City achieve their objective of attracting new office investment over the long-term.

- The City should continue to invest in Surrey City Centre, enhancing its market appeal for new office investment. This includes investments in the public realm, pedestrian environment, public art, green space, transit, community amenities, and more. These types of investments enhance the attractiveness of Surrey City Centre to both residents and workers alike, which ultimately will be key in establishing the type of community that is attractive to developers should an office opportunity arise.

- The continued expansion of residential uses within Surrey City Centre encourages the continued growth and diversification of retail, restaurants, commercial services, and amenities. As these uses grow, so does the walkability of the City Centre. Together, these influences result in an increasingly attractive community that will attract office demand as opportunities emerge.

- Local developers have shown, to varying degrees, that they have the capacity and ability to deliver new standalone office uses in Surrey, assuming they are adequately supported with appropriate residential densities. This approach will be most effective on large sites that can appropriately accommodate this model. Larger sites can accommodate multiple residential towers which would be needed to offset weak land values associated with standalone office.

- Consideration can also be given to identifying prime sites within Surrey City Centre that could be designated for standalone office development should future market conditions warrant it.

- Other jurisdictions have also pursued planning policies that require the integration of commercial office space within a mixed-use building. These types of policies, as opposed to the requirement to build a standalone office tower adjacent to residential uses, are best suited for smaller sites where it is physically infeasible to construct multiple towers. Often this policy sees commercial office space built into a podium level.

    - In our opinion, these types of policies would not be desirable for the City of Surrey if the long-term goal remains the attraction of standalone office investment. These types of policies will result in lower-quality office space with much more limited market demand coming primarily from population-serving office uses (health services, accounting, legal, etc). By flooding the market with lower-quality and cheaper office space, these policies may hinder the feasibility of higher-quality standalone office development in the future, as it could suppress commercial lease rates, making new standalone development much more challenging.

    - Should Surrey opt to pursue these policies, it will be important to accurately gauge market demand. From a design perspective, there are significant challenges with building podium office space owing to the spacing of construction columns and the lack of exterior window space.

    - In addition, the development of commercial office space in a podium is often an afterthought for developers, particularly developers with limited experience in building office spaces. Given this, there is likely a role for collaboration between Economic Development and Planning staff to help design space that is more functional and more desirable by the market. Economic Development, in speaking with prospective tenants, will have a better idea as to how this type of space should be built to satisfy market demand. This knowledge could be useful for Planning in producing design guidelines for commercial office space, or at the very least providing this feedback through the development review process, to ensure that the office space that is being produced aligns with market demand.

- We do not recommend the use of financial incentives to encourage development at this time. Financial incentives such as tax increment grants and development charge rebates are broadly used in Ontario in similar urban contexts to Surrey. However, they have not resulted in any material new office investments. They can also trigger a "race to the bottom" with other competing municipalities.

- The City of Surrey should periodically reassess the use of financial incentives. There may be market or policy changes that might warrant there use especially if they are employed by a competing community.

They might also be considered as part of a broader market strategy to highlight Surrey City Centre – especially if post-pandemic market conditions do not improve.

- There may be a role for the Surrey City Development Corporation to facilitate the preleasing of new standalone office projects, guaranteeing a portion of the space (e.g., 10%) if the developer can hit the remainder of their preleasing requirement. This approach could help improve the feasibility of new office projects.

- The presence of institutional and government tenants in Surrey is a positive aspect that should be acknowledged. These tenants can provide valuable support for the development of new major office spaces by assisting developers in meeting preleasing requirements. In our professional opinion, the SCDC should play a role in this process by facilitating connections between these tenants and potential developer partners.

- Given the challenges associated with underground parking requirements in suburban markets, creative solutions could be explored. This could include the development of a municipal parking structure or even surface parking as an interim measure. The City might also consider acquiring parking spaces in private developments for public use.

1.0 Introduction

N. Barry Lyon Consultants Ltd. ('NBLC') has been retained by the City of Surrey to conduct a study that helps the City understand the Canadian office development landscape, the factors affecting the investment decision making of major office developers (e.g., pension funds, RIETS), the impact of various development incentives, and the strategies that could be pursued to encourage new office development in Surrey. Specifically, the City is interested in understanding whether the current market-driven approach around office development is realistic in attracting standalone office developers to build in Surrey City Centre.

The following study provides a review of the national office investment landscape in Canada, looking at the key factors that are shaping and influencing new office development. A further review of existing market dynamics is then provided, with the Vancouver Metro region and the City of Surrey being assessed in more detail. Part of our work has also been influenced by interviews conducted by NBLC with office developers, REITS, pension funds, commercial brokers, and other major players in the sector. A summary of our findings from these interviews is attached as an appendix.

The goal of this study is to identify the challenges currently facing new office development in Surrey City Centre and to determine the factors that need to be in place if Surrey wishes to attract greater office investment. Our work is forward-looking, attempting to align attraction strategies and policies with the market expectations to build a competitive downtown core for Surrey.

Figure 1 – Surrey City Centre

Source: City of Surrey

2.0 Factors Driving Office Investment Trends

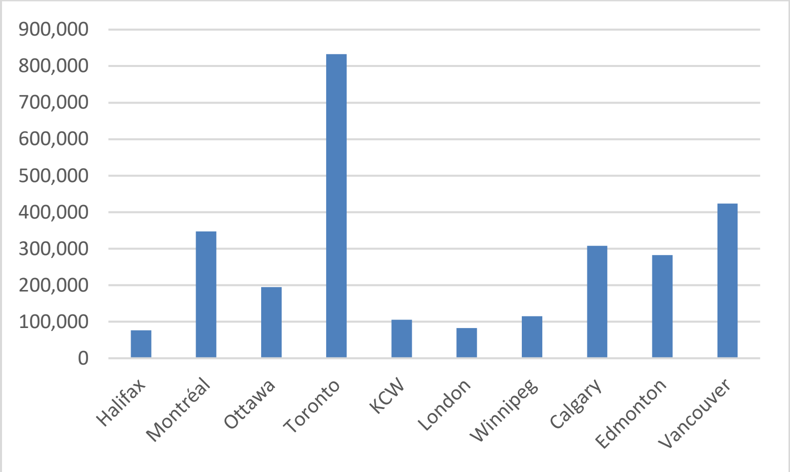
To better understand the locational decisions that many office developers and tenants make, on both a national and local level, it is important to understand the key factors that influence these decisions. As part of this project, NBLC has conducted first-person interviews with a variety of players in the office market to inform our opinion, in addition to our experience in the office market on other similar assignments. These interviews include national and local office developers, commercial brokers, REITs, pension funds, and asset managers, amongst others. A more fulsome description of these interviews is included as an Appendix.

Population & Employment Growth

As a starting point, office investment locates in markets that are experiencing strong population and employment growth. Typically, market areas that are experiencing strong population growth are thriving economically, attracting new residents and businesses alike, as well as creating new jobs. A growing population and employment base are linked to demand for new office space, making market conditions favourable for new investment.

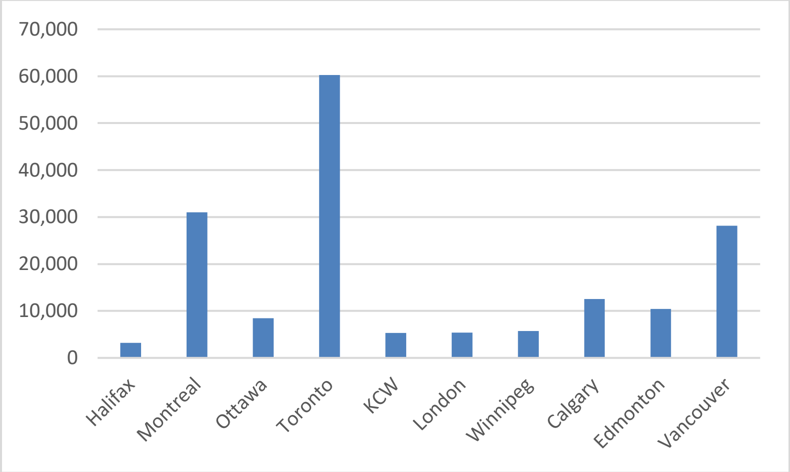
Not surprisingly, Canada's three largest cities, which continue to see the bulk of new office investment, are also Canada's three largest CMAs in terms of both population and employment levels. Moreover, all three of these market areas are seeing the highest levels of both population and employment growth in Canada over the past decade (**Figure 2 & Figure 3**).

Figure 2 – Net Population Growth by CMA, 2012 to 2022



Source: Statistics Canada

Figure 3 – Net Employment Growth by CMA, 2012 to 2022



Source Statistics Canada

Access to Deep and Qualified Pool of Labour

More precisely than just population growth, office investment is attracted to markets that have access to a deep pool of qualified labour. Specifically, for Canada's knowledge-based economy, access to highly educated and highly skilled employees is one of the most critical factors of success. These employees are increasingly opting to locate in Canada's three largest cities (i.e., Toronto, Montreal, and Vancouver), which in turn, has played a significant role in these three cities attracting the largest share of Canada's office investment.

At the local level, office investment is equally as attracted to areas that have an abundance of highly skilled and qualified employees. This is especially true for many of the high-value sectors (FIRE, technology, etc.), where human capital is often critical to the success of the firm. In Metro Vancouver, this partially explains the abundance of high-value tenants that are located either in the downtown or in the Mount Pleasant area. It is important to note, however, that this pattern has been somewhat changing in recent years, as many talented young workers are moving eastwards in the GVA, owing to housing affordability concerns. This shift could partially explain the growing number of technology companies choosing to locate in Burnaby, but the longer-term implications of this shift are not yet fully known.

Our interviews highlighted how important this factor was on a local level. Many interviewees, for example, highlighted how prior to the COVID-19 pandemic, many firms were opting to locate in downtown market areas to remain as competitive in the labour market as possible. This was especially true for high-value tenants. While the pandemic has somewhat undermined this trend, many of our interviewees still highlighted that over the long-term, this would remain a critically important factor, as the competition for highly skilled labour remains.

Agglomeration Economics

Many higher-skilled employment uses gain efficiencies by locating near one another, often improving economies of scale, knowledge spillover, and networking effects. These agglomeration impacts are particularly notable in several high-value industries that rely heavily on knowledge workers. This includes industries such as financial services, creative and technology, and business/professional services, all of which continue to cluster in Canada's three largest office markets, particularly, in these market's downtown areas. The presence of these high-value sectors is a key driver of office investment as they will pay the highest rents that can financially support new office development.

Agglomeration economics also reduce the risk for office developers as there is more certainty that space can be filled within a building if a major tenant vacates. Many interviewees explicitly stated this as a significant factor influencing their decision to locate almost exclusively in prime downtown markets, which has only increased since the COVID-19 pandemic has resulted in increased remote work and vacancy risk.

Labour Preference for Amenity-Rich Mixed-Use Environments

Amongst young, highly educated professionals, there is a growing preference for amenity-rich communities that offer truly walkable opportunities to both live and work. These communities align with the emerging profile of young professionals who place a high value on living in environments that offer creative outlets, a broad range of cultural and social pursuits, and allows them to reduce their reliance on private automobiles. Not surprisingly, given this preference and the fierce competition for labour, most high-value tenants are opting to locate in these types of communities, which are almost always located in downtown market areas.

This factor was stressed repeatedly by all interviewees who operated on a national/international scale. For many interviewees, the neighbourhood context was often considered one of the most important considerations when opting for new investments. Some factors that were listed as contributing to neighbourhood character include public art, public open space, recreational amenities, cultural amenities, retail amenities, and a broad range of hospitality venues. The underlying idea is that until a vibrant, desirable community has been established, demand for new office space is typically insufficient to justify development.

These interviewees also expressed that while these environmental factors often drove them to focus primarily on downtown market areas, they did not reject the idea that such environmental conditions could be present outside of the downtown. Many believed that once suburban market areas had reached a 'critical mass' of amenities and people, the conditions for new office development may be favourable enough to support new investment that could compete with downtown market areas. While not traditionally suburban, many interviews had this sentiment about the Mount Pleasant submarket in Vancouver, as well as locations like Liberty Village and the Vaughan Metropolitan Centre in Ontario.

Proximity to Higher-Order Transit

Many interviewees highlighted the presence of higher-order transit as an important factor in their investment decisions, especially as congestion worsens. Interviewees often spoke about the financial constraints that were associated with providing sufficient parking at new office projects, and as such, they viewed higher-order transit favourably as it eased this burden. Equally important was higher order transit's ability to expand the labour pool that could access a project, particularly as reliance on private automobile usage continues to decline amongst younger generations.[1] Even with the expansion of work-from-home, the costs and time associated with commuting are expected to persist, underpinning the demand for convenient, reliable, and affordable transit service.

However, a key caveat here is that simply being located adjacent to a transit stop is not enough on its own to produce dense, mixed-use communities.[2] Many of the other factors that drive employment locational decisions, as noted throughout this report, must also be present. It is also important to recognize that the ability of higher-order transit to attract employment investment declines significantly in a more suburban context, with highway access becoming a much greater indicator. Transit is also not as appealing if it is not frequent, reliable and easily connected to a larger transit network.

For example, Union Station in downtown Toronto is the central transit node in the Greater Toronto Area. It is the location where all local TTC routes as well as the GO commuter rail system connects and is therefore the central transportation hub for the over 6.2 million people across the Region. Office investment has been heavily concentrated in this area, whereas one-way transit routes extending into the suburbs that have limited connections to other high-order transit (i.e., fewer people being connected to the station and lower ridership) has seen very little investment. This situation is similar in the GVA.

[1] Brookings. Why are young people driving less? Evidence points to economics, not preferences

[2] Farber & Grandez (2017). Transit accessibility, land development and socioeconomic priority. Journal of Transport and Land Use

Vehicular Accessibility and Parking

Even with the growing preference for transit access, many suburban office workers in Metro Vancouver still rely heavily on private automobiles. Nearly all interviewees from the local Vancouver office market noted that inadequate parking in a suburban office development would present a substantial marketing challenge when it came to leasing. Even tenants in Surrey's newest office projects immediately adjacent to the Skytrain stations had sizable, market-driven parking requirements. This high parking requirement in suburban locations creates challenges related to land needs (surface parking) and/or cost (underground parking). This is why new office development is often attracted to central cities, where parking requirements tend to be much lower.

Not surprisingly then, proximity to a highway network is often a more marketable feature to tenants than proximity to higher-order transit in communities such as Surrey, at least until a critical mass of population, amenities, transit improvements, and services have been established that allows for parking requirements to be reduced without impacting leasing. Many of the new suburban office buildings in Vancouver's suburbs have been modest in size (e.g., 3-storey and wood frame) surrounded by surface parking.

Proximity to Post-Secondary Education

While it was not expressed by any of our interviewees, the long-term benefits of post-secondary institutions are well documented, with many having a positive impact on office demand/investment. Post-secondary institutions often can be a key source of highly skilled and qualified employees. This is particularly common in the technology and creative sectors where post-secondary education is critically important and where the workforce tends to skew towards younger populations.

Post-secondary institutions with strong technology-based programs also produce economic spin-offs. The effects of these spin-offs are clear in locations such as Waterloo Region, where the presence of three major post-secondary institutions has heavily contributed to the burgeoning technology-based industry in that region. However, the presence of post-secondary institutions alone is not enough. Many other factors discussed in this section must also be in place. Additionally, these spin-off effects function much like agglomeration economics in that it is a slow process and takes time to build momentum.

Capital Costs and Operating Competitiveness

A variety of upfront capital costs (development charges, land costs, etc.), as well as ongoing operating costs (e.g. property taxes), are also important considerations for many office investors. Naturally, investors look to markets that have the lowest development and operating costs, relative to achievable market rents. The more favourable the cost environment, the more likely a new office project would be financially feasible. However, it is important to remember that costs are just one side of the equation for office investors. None of our interviewees noted capital or operating costs as a major consideration in their investment strategies, which also included incentives that might lower operating or capital costs, which will be explored further later in this report.

Market Rents

More important than low upfront capital costs and operating costs are the achievable market rents. If a new office project can not achieve sufficient market rents to overcome the upfront capital costs and ongoing operating costs, it remains financially unfeasible. This is why Canada's three largest office markets – Vancouver, Toronto, and Montreal – continue to see the highest amount of office investment despite being locations with above-average development costs, particularly land costs.

On a local level, this underscores why new office development is heavily concentrated in a small number of submarkets, almost always the submarkets with the greatest level of office demand from high-value tenants, as these submarkets produce the highest achievable lease rates as well as low vacancy.

Existing Supply of New High-Quality Space

As will be discussed later in this report, there has been a bifurcation of the office sector in Canada with new, well-located class A office space continuing to attract significant amounts of demand at the highest rents from high-value tenants. Conversely, older office space continues to experience significant challenges attracting tenants. Interviewees identified markets that lacked this high-quality and new class A office space was often viewed favourably from an investment perspective (i.e., the opportunity to cannibalize existing tenants in older buildings). However, this also creates challenges for municipalities as the office vacancy and sustainability of older office buildings suffer, which has led communities such as Calgary and Edmonton to explore incentives for converting these buildings to residential or outright demolition.

3.0 Office Investment Trends

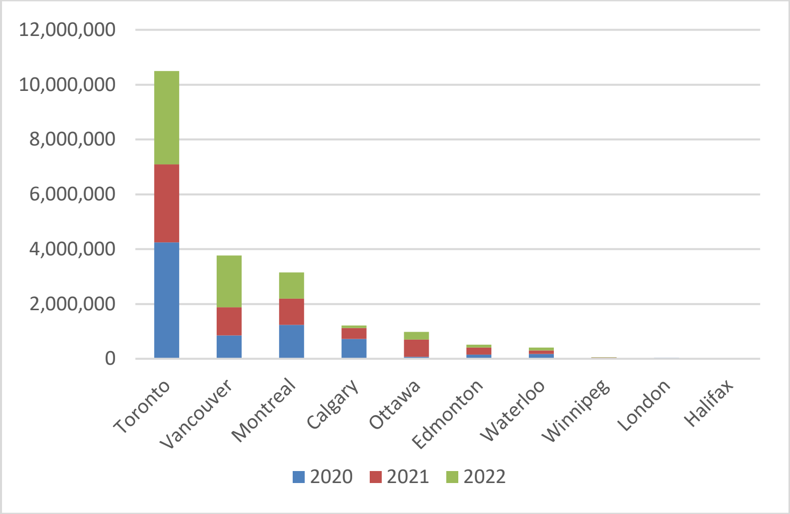
The following explores office investment trends across Canada, which builds off the findings of the previous section of this report.

Investment is Heavily Concentrated in Canada's Largest Markets

Canada's largest and most economically diverse metropolitan areas continue to attract, by far, the largest amount of new office investment in the country. **Figure 4** shows new office floor space deliveries over the past three years, highlighting just how concentrated this investment has been in markets such as Toronto, Vancouver, and to a lesser extent Montreal. These three markets alone have accounted for 84% of new office space deliveries over the past three years.

These markets are the primary hubs of industries such as FIRE, technology, business services, and professional services, all of which generate the largest amount of office demand and the highest lease rates in the country. Owing to the presence of these sectors, new office projects in these markets are typically able to prelease a significant amount of space prior to construction, bolstering the feasibility of new office developments. In Vancouver, for example, 57.4% of its 3.7 million square feet of under-construction office space has already been pre-leased. Nationally, approximately 47.6% of under-construction office space is pre-leased, however, this figure is heavily skewed by Toronto and Vancouver.[3]

Figure 4 – Office Space Deliveries (sf), 2020-2022

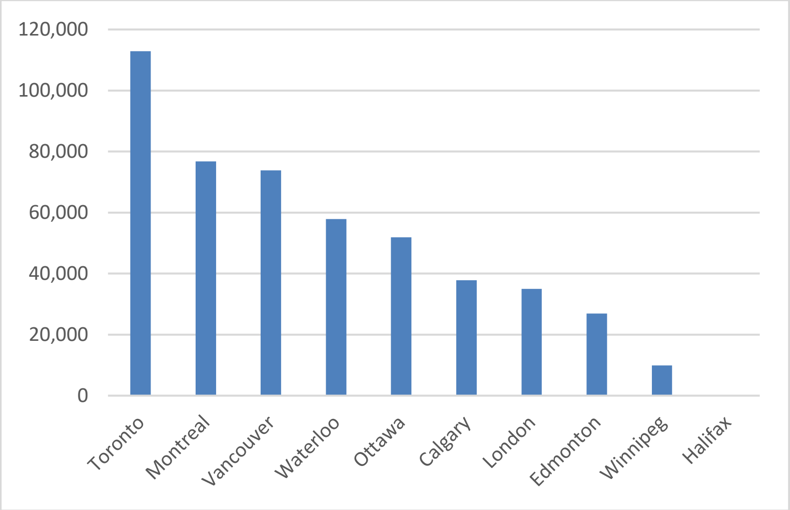


Source: CoStar Realty

Further underscoring the sizable level of demand in Canada's primary office markets, **Figure 5** shows the average size of new office space deliveries over the past three years. The average size of a newly delivered office building is largest in Toronto, followed by Montreal and Vancouver. In these markets, demand is so substantial that developers can hit preleasing requirements on larger-scaled buildings in shorter time frames, rendering them feasible. Opposite to these markets, Canada's smaller office markets have primarily seen much smaller deliveries, reflective of the more limited demand and more traditional office tenant base. In markets that require significant parking requirements, modestly scaled projects also help reduce development costs.

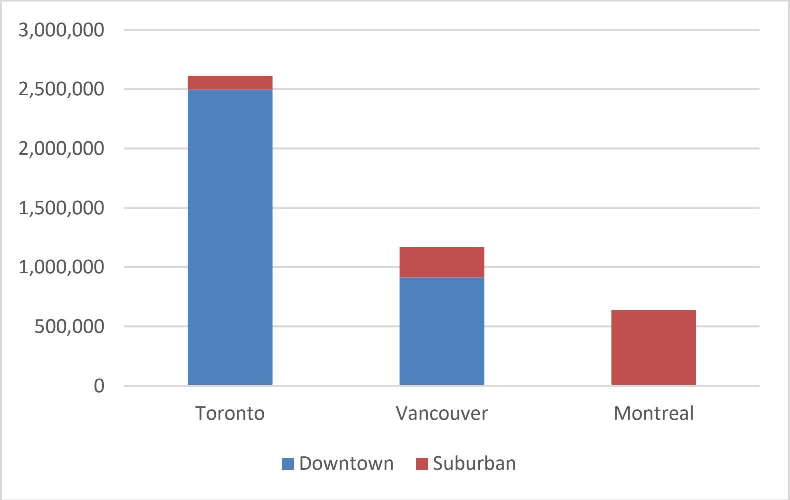
[3] CBRE Office Market Report. Q4-2022

Figure 5 – Average Size (sf) of New Office Building Delivery, 2020-2022



Source: CoStar Realty

Figure 6 – New Office Deliveries in Canada's Three Largest Markets, 2022



Source: CBRE

Major Standalone Office Investment is Almost Entirely Happening in Central Cities

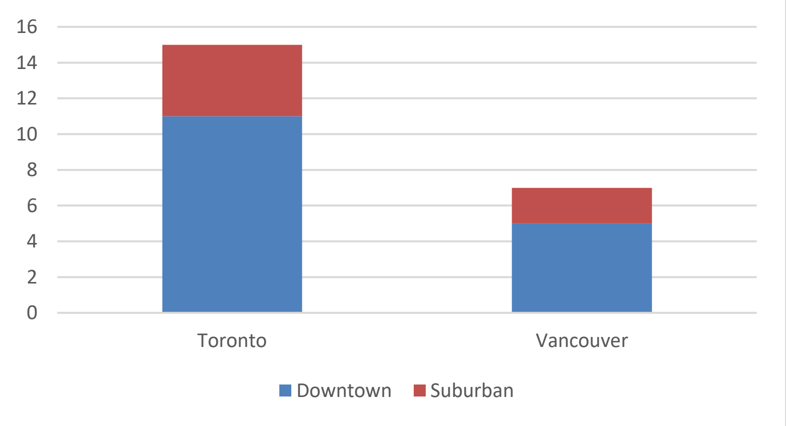
As the cost associated with major standalone office development continues to grow, as does the time and complexity of these projects, investment is increasingly concentrating in downtown markets where the highest-value tenants are opting to locate. Approximately 74% of Canada's new office supply in 2022 was in a downtown market with nearly all of this (92%) being in either downtown Toronto or Vancouver (**Figure 6**). Similarly, 73% of Canada's total under construction office space is in a downtown market. This concentration is not surprising given the factors previously discussed. This includes:

- The preference for walkable mixed-use communities amongst highly educated knowledge sector workers has resulted in their concentration in downtown areas.
- The diversity of economic activity in downtown areas, particularly the presence of high-value tenants, who have opted to locate close to their labour force.
- The substantial amount of demand from these high-value tenants for new high-quality class A space, which has resulted in significantly faster preleasing periods, high rents, and low vacancy.
- The attractiveness and strong accessibility allow a project to pull from a very wide net of potential tenants and workers.
- The transit connectivity and centrality of downtown areas, which allows developers to provide very little parking and minimize their construction costs.

This preference for downtown market areas was heavily noted during our interviews with players in Canada's office sector. Many interviewees noted that their organization's investment thesis was to focus almost entirely on downtown market areas as these areas were the most desirable location for high-value tenants.

At the same time, many interviewees highlighted that downtown market areas were generally regarded as the safest investment location given their historical stability. Many of Canada's largest office investors were tied to conservative funds such as pension funds. For these investors, downtown office investment represents the most conservative investment opportunity given the historical precedent, whereas suburban markets such as Surrey were viewed as very risky in the current environment.

Figure 7 – Standalone Office Building Completions Since 2018 Over 200k SF



Source: CoStar Realty Data

Suburban Areas not Attracting Major Standalone Office Investment

Outside of downtown market areas, modest amounts of new office investment is occurring, however, this investment is rarely the traditional standalone office towers we are seeing in downtown areas. Suburban office investment tends to be much smaller, with very few buildings over 200,000 square feet and often of lower quality than downtown office buildings. For example, in the City of Vancouver, there has been only two standalone office projects over 200,000 square feet completed outside the downtown in the last five years, while in Toronto there has been only four (**Figure 7**). Driving this trend are the following:

- The absence of high-value tenants in suburban market areas, as many have opted to locate in downtown markets close to their employees.
- The lack of economic diversity in many suburban markets, meaning slower prelease periods and a greater level of turnover risk for large office spaces.
- Lower lease rates stemming from the absence of high-value tenants.
- Lack of transit connectivity and centrality, meaning a greater number of employees rely on private automobiles, resulting in higher parking requirements which come with additional construction costs.

Combined, all these factors have made it very challenging to develop large urban-style standalone office buildings in suburban contexts, owing to significant feasibility concerns. The potential revenues are often insufficient to cover the costs of construction including the cost of land, lower levels of demand result in risky pre-lease periods, it is difficult to compete with residential developers on land value, and financing is difficult to secure given these market challenges.

To illustrate this point, we have completed a high-level (i.e., order of magnitude) development proforma for a hypothetical office project in the City of Surrey based on current market parameters and costing inputs. This example assumes that the developer would build and then sell the project upon completion. As shown, in **Table 1**, the potential revenues associated with the development of a new 500,000 square foot office project in Surrey are less than the total cost of development. In fact, this example shows a negative land budget, meaning that not only would this hypothetical development not generate enough revenue to purchase land, but it would also not even be able to construct the project if land were provided to the developer at no cost.

Assuming a situation where a developer is intending to build the same hypothetical development with the intention of holding the project on completion produces similarly negative results, even with no land costs. The net operating income ('NOI')[4] that would be associated with this hypothetical development is only equal to a development yield of 4.16%.[5] As this yield is below prevailing market cap rates (5.25%), it is highly unlikely that a developer would pursue this opportunity as they could theoretically purchase an existing asset that produces a higher return, without the risks associated with development. Rising interest rates and cap rates were specifically identified by interviewees as a major challenge in this regard, as the development yield they require is increasing within this market context (most stating a yield of 10%-15% being necessary). Rising construction costs and softness in the sector are reducing achievable yields at a time when required return thresholds are increasing.

Assuming market rents were to increase by 50%, we can see that this same hypothetical project would only just become feasible. An average lease rate of $53 psf per year would result in a development yield of 6.06%, assuming no land costs (**Table 2**). In this case, the project would be considered feasible as the development yield exceeds prevailing market cap rates. However, it is not realistic to assume that a new office project in Surrey would be able to achieve lease rates above $50 psf per year. Only a small handful of the newest and highest-quality office projects in Canada have been able to achieve lease rates above $50, with all these projects being located in either Downtown Vancouver or Downtown Toronto. Driving the infeasibility of suburban office is the much lower lease rates in suburban markets and the cost of underground parking that is necessary to attract tenants. Moreover, even if we are to assume that the parking requirements are half of what is currently being demanded by the market, the land budget remains negative, underscoring just how challenging major standalone office development is in suburban markets such as Surrey.

There are some instances where urban-style standalone office towers have been constructed in suburban nodes, however, these have been largely the result of planning policies and not market forces. In these cases, municipalities will require a certain amount of commercial space as part of a larger master-planned community, and the developers are willing to provide that space as it allows them to unlock additional residential densities. This additional residential density results in the community being profitable to the developer.

[4] Net operating income refers to the owners operating income after all expenses have been paid, but before taxes have been paid.

[5] A project's development yield is the NOI divided by the cost of construction. It represent the expected annual rate return to the developer upon occupancy.

Table 1

Standalone Office Proforma (500,000 sf) City of Surrey	
Revenue	
Net lease rate	$35
Market Cap Rate (Vancouver Suburban Class A)	5.75%
Net Operating Income	$16,132,231
Total Revenue from Sale of Office	**$280,561,000**
Costs	
Total Hard Costs	$316,602,000
Total Soft Costs	$52,081,000
Financing Costs	$18,225,000
Total Cost of Construction	**$387,469,000**
Development Yield	**4.16%**
Residual Land Budget	
Residual Land Budget (future$)	($106,347,000)
Residual Land Budget (present$)	($69,646,000)

Table 2

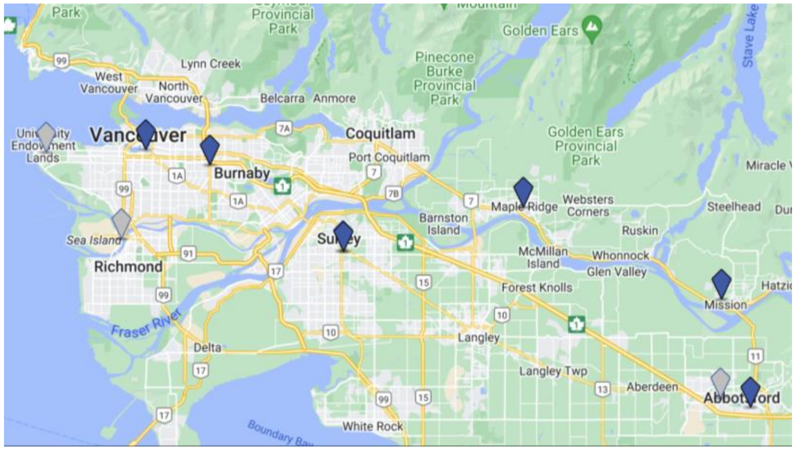
Standalone Office Proforma (500,000 sf) City of Surrey	
Revenue	
Net lease rate	$53
Market Cap Rate (Vancouver Suburban Class A)	5.75%
Net Operating Income	$23,596,211
Total Revenue from Sale of Office	**$410,369,000**
Costs	
Total Hard Costs	$316,602,000
Total Soft Costs	$54,678,000
Financing Costs	$18,353,000
Total Cost of Construction	**$389,633,000**
Development Yield	**6.06%**
Residual Land Budget	
Residual Land Budget (future$)	$20,737,000
Residual Land Budget (present$)	$13,580,000

Suburban Office Investment is Often Low-Rise With Surface Parking

The large majority of the office investment that is occurring in suburban areas is much different than the standalone major office towers we are seeing in central cities. Most commonly, market-driven office investment in suburban areas tends to be in the form of smaller (<100,000 square feet) buildings with a sizable amount of surface parking. Often, this investment is on greenfield lands, which allow for a lower cost of construction. Contrary to major standalone offices in the urban core, this type of space tends to attract population serving office users – accountants, personal law firms, realtors, medical offices, etc. The success of these firms is not heavily contingent on access to the most talented labour pool, but more so on their location next to the population centres that they serve.

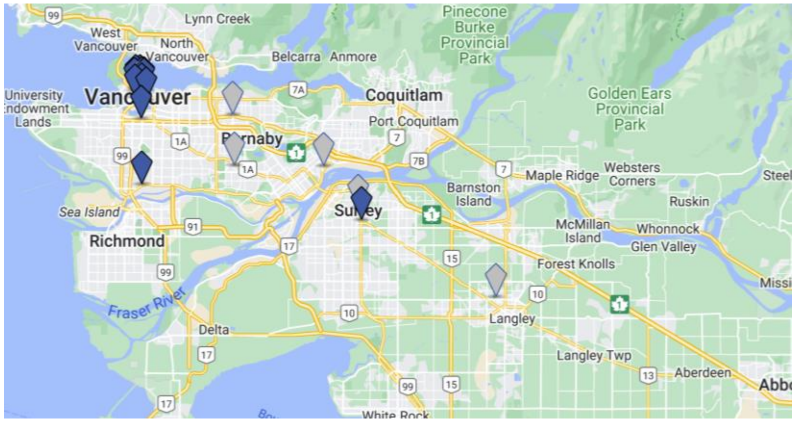
To illustrate this locational pattern, **Figure 8** shows the location of new medical office buildings completed in Metro Vancouver over the past decade, while **Figure 9** shows the location of new large (>200K square feet) standalone office towers completed in Metro Vancouver over the past decade. As illustrated, there appears to be no apparent geographical pattern for the medical office completions, which are scattered throughout the region. Conversely, the new major standalone office completions are much more centralized in and around downtown Vancouver. Further, many of the larger standalone office completions outside of the downtown are part of larger master-planned communities and were not market-driven investments.

Figure 8 – Medical Office Completions Since 2012



Source: CoStar Realty Data

Figure 9 – 200,000 sf+ Standalone Office Completions Since 2012



Source: CoStar Realty Data

Downtown Adjacent Areas Are Attractive Investment Options

Although many of our interviewees had a very negative outlook for office investment outside of downtown areas, several did mention unique downtown-adjacent submarkets where market conditions were still reasonably favourable for standalone office development – specifically, the Mount Pleasant submarket in Vancouver and the Liberty Village submarket in Toronto. Both areas are unique in that they are former industrial clusters located adjacent to downtown Vancouver and Toronto, respectively. Their unique character has helped them attract many firms in the technology and creative sectors who value these types of unique communities. The outlook for office investment in these submarkets was more positive than other non-downtown market areas for several reasons:

- They were still reasonably close to downtown, typically within walking or cycling distance;
- The former industrial character of the area made these neighbourhoods quite desirable for young knowledge sector workers. In both areas, there was an abundance of restaurants, cafes, bars, breweries, and other amenities that are important to knowledge sector employees.
- Transit connectivity was quite good, particularly in the Mount Pleasant submarket which already had a SkyTrain Station within walking distance (Broadway-City Hall) and a second under construction (Mount Pleasant on the Broadway Extension). This factor, coupled with the proximity to downtown allowed office projects in these submarkets to have very low parking ratios, thereby reducing construction costs.
- The industrial and commercial zoning in these submarkets kept land values much lower than lands that could accommodate residential uses.
- Both areas accommodated significant residential development and density, helping increase the population and amenities in the area.

Even with all these factors working in favour of new standalone office investment, the scale of new office projects is still quite modest relative to downtown markets. In Mount Pleasant, for example, most new standalone office projects are typically less than 60,000 square feet, with only two completions of more than 100,000 square feet in the last decade. Additionally, many of these smaller scale buildings are constructed using mass timber, a more affordable alternative to concrete. This lower cost of construction only further helps the feasibility of these projects.

REITS and Pension Funds are Disinvesting from Offices

Numerous interviewees expressed bearish sentiments regarding the office sector in general, not only over the short-term but also over the long term as the industry readjusts to a post-COVID equilibrium. Many of the pension funds and asset management firms we spoke to noted that their organizations had even begun a process of disinvesting from their office holdings, minimizing their portfolio's exposure to the sector. None of them indicated a desire to expand their office holdings. This is a trend that has been noted across North America and Global Markets. Oxford Properties, which is owned by the Ontario Municipal Employees Retirement System ('OMERS') has already decreased the office share of its portfolio to 25% from as high as 44% in 2016. Moreover, they have suggested that this share could be reduced further in the coming years.[6] Other groups have indicated they have no desire to include office investment in any of their suburban master plans moving forward.

The selling of assets has also not been limited to lower performing assets either, with some funds divesting from high-quality class A office assets located in prime market areas, such as the recent sale of Royal Bank Plaza in downtown Toronto.[7] Funds and asset management firms that are looking to purchase existing office assets are generally only willing to do so at very steep discounts with a very long-range outlook.

Prelease Contracts are Being Cancelled

Leading into the pandemic was a period of very high optimism for the office market, which saw the largest surge in office projects beginning construction in decades across Canada. Market optimism was so high that many projects were willing to go ahead on spec[8]. As the pandemic shattered this optimism, this is no longer the case. Projects that had begun construction before 2020 have continued and are now coming to market, although many are experiencing significant challenges with preleasing. For example, Allied Properties REIT and RioCan REIT's project in downtown Toronto called The Well, went ahead in 2019 with Shopify as a major anchor tenant for over 250,000 square feet of space preleased, approximately 25% of the total office space. As the project has now come to completion, Shopify has cancelled its lease.[9]

Most groups interviewed indicated it is no longer possible for projects to advance without significant pre-lease commitments.

Planned Projects Are Being Cancelled

Through our interviews, we have also heard from major office developers that most projects that were not past the point of return, are being cancelled or put on hold indefinitely. This is true even for projects in the most sought-after marketplaces. In Vancouver, a prominent example of this is The Crystal at Waterfront Square, a 500,000 square foot office tower proposed by Cadillac-Fairview at the intersection of West Cordova and Richards Street in downtown Vancouver. Despite the project's highly sought-after location, it is our understanding that Cadillac-Fairview has put this project on hold indefinitely due to the increasing challenges of making these types of projects financially feasible.

[6] Wall Street Journal. Pension Funds Are Selling Their Office Buildings
[7] Globe and Mail. Oxford Properties to sell Toronto's Royal Bank Plaza to Zara founder for more than $1.2-billion
[8] On spec means the project was speculative in nature and the builder was willing to begin the planning/construction process without a major tenant signed.
[9] BayStreet. Shopify Cancels Plans For New Toronto Office

New Land is Not Being Purchased for Office Investment

None of our interviewees indicated that their firms had any appetite for acquiring new land with the intention of office development, even in sought-after downtown markets. One of our developer interviewees even went as far as to say that their firm is not even considering acquiring mixed-use land in downtown market areas if planning policies dictate even a modest amount of office space in the podium level. This was particularly notable as this firm has pursued major standalone office projects in the past, including some that were still under construction as of the completion of this report.

Some of the REITs and pension funds that were interviewed stated that even prior to the pandemic, there was very little appetite to acquire land in suburban areas for the purpose of office development given that many already owner existing retail centres in these communities that offered the potential for intensification. They all stated that the intensification of these existing assets would take precedence, especially given that many of these assets were capitalized through existing retail uses. It is therefore unlikely that these groups would explore acquiring new land for suburban office investments in new locations like downtown Surrey in the near-term.

Construction Pipeline Continues to Decline

While vacancy rates remain elevated across the country, they are beginning to show signs of stabilizing as new deliveries are beginning to slow. The national office construction pipeline has continued its downward trajectory since 2021, with projects that were planned and under construction prior to the pandemic coming to completion in 2021 and 2022. Concurrently, many proposed office developments have been placed on hold or cancelled, owing to the depressed levels of demand and challenging market conditions, which will be explored to follow.

Its also important to recognize just how localized new office construction is in Canada. Of the 11 million square feet of space under construction in Canada as of Q4-2022, 86% is in either the Vancouver or Toronto marketplace. Even Canada's second largest office market, Montreal, has only 1 million square feet under construction, amounting to just 9% of the total national under construction inventory. This is reflective of all the factors discussed in Section 2.0.

3.1 Municipal Incentives

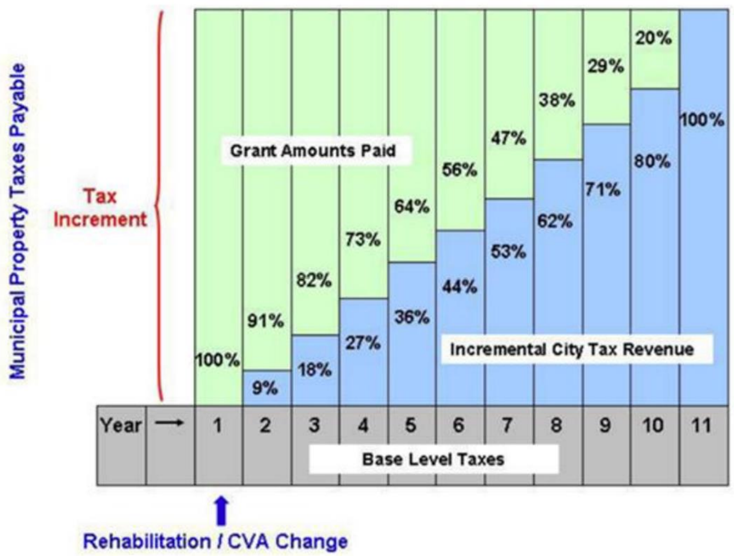
Understanding all the challenges with suburban office investment, many jurisdictions have established municipal incentives, both financial and non-financial, to encourage new office development. These incentives are not yet present in the Metro Vancouver region, but they are employed across nearly all municipalities in the GTA.[10] Despite their stated intention of trying to overcome market challenges, these incentive programs have largely been unsuccessful in the GTA, as they are not significant enough to overcome market risk/feasibility, and they do not impact the most important factors that are driving office investment (section 2.0 of this report). As a result, office investment in Ontario has continued to be concentrated in specific locations (i.e., downtown Toronto), despite the availability of incentives in other areas.

While a range of incentives are offered, the two most common are:

[10] Incentive programs are currently in place in Durham Region, Toronto, Markham, Richmond Hill, Vaughan, Brampton, Mississauga, Peel Region, York Region, and Hamilton.

- **Tax Increment Equivalent Grants ('TIEGs') –** This incentive program provides an annual refund of the incremental increase (i.e., the difference between the current assessed value and value after development) in property tax over a set period. The City still collects the full tax amount for the property, but a refund is issued for part of the incremental gain, with this refund typically decreasing over time. The main benefit of a TIEG is that it does not cost the City directly (i.e., capital grants do not have to be secured). It does, however, place a greater burden on the existing tax base, which will have to make up the foregone revenues. Additionally, in a typical triple net lease structure[11] the benefit is accrued to the tenants by reducing their gross rent, not the developer directly. Interviewees have therefore rightly noted that a TIEG does not necessarily impact their proforma, but it does help with leasing space through lowered rents.

Figure 10 – Sample TIEG Payment Schedule (Toronto)



[11] Typically, office tenants pay a base net rent to the property owner and are also responsible for additional costs such as property tax, maintenance, and insurance.

- **Development Charge Deferrals, Reductions, and Waivers –** One of the largest soft costs for a project is the municipal development charges that are intended to pay for new infrastructure supporting the development. To incent office development, many jurisdictions offer deferrals, reductions, or waivers for new office development with the intention of reducing the upfront capital costs and thereby improving the economic feasibility of the project.

Many jurisdictions in the GTA have offered a combination of both incentives, with varying degrees of depth, to incent new office development. However, few of these programs have been successful at attracting new office investment because the other factors necessary to attract new major office are not present and the incentives on their own do not overcome project feasibility challenges. Only Vaughan (explored in more detail to follow) and the City of Toronto have seen take-up in these programs. In Toronto's case, this program was put in place over 12 years ago at a time when the major office market was not as strong as it is today. Toronto has rightfully determined that the incentive package offered to office projects is no longer necessary and has amended the program to exclude the downtown and other strategic nodes.

All interviewees explicitly stated that the presence of these incentive programs has not affected their investment decision-making. It was repeatedly stressed that the depth of market demand and the achievable lease rate were first and foremost with regards to project feasibility. While the availability of incentives was still viewed favourably by participants, they were not enough, in isolation, to meaningfully affect the feasibility of investing. In addition to incentives, most participants noted that other strategies would have a more meaningful impact towards influencing office investment, such as transit improvements, public realm improvements, increased residential density to an area, improved walkable amenities and attractions, providing significant residential density if a mixed-use project was proposed, finding parking solutions, and other similar strategies. One interviewee even went as far as to say that no financial incentive would 'move the needle', indicating that they would invest in a location that does not offer incentives but accommodates the conditions identified in Section 2 of this report.

Take for example, the City of Vaughan and its package of incentives at Vaughan Metropolitan Centre ('VMC'). To encourage new office development adjacent to the new terminus station on the Spadina Subway Extension, the City brought forth one of the GTA's most extensive package of incentives in 2014. This package included development charge reductions and deferrals, cash-in-lieu of parkland fee reductions, and a TIEG. Even with this extensive package of incentives, the VMC has seen only two standalone office towers completed – the 365,000 square foot KPMG Centre and the 220,000 square foot SmartCentres Place. Moreover, the KPMG Centre had started construction prior to the City establishing its incentives program and only received the incentives retroactively, suggesting the incentives had no impact on its feasibility.

While the City of Vaughan likely views this modest amount of new office investment as a win, it is important to highlight that incentives were not the driving force behind these projects as there were several more important factors at play:

- The new TTC subway station that provided a direct connection to downtown Toronto opened the VMC to a much broader base of labour.

- The VMC consisted of several very large parcels with singular landowners. The City converted the property from employment land and granted significant residential permissions with a requirement to build some office space. This arrangement allowed the landowner to rationalize the construction of new office space given the magnitude of high-value residential density.

- The City allowed surface parking for the office projects as an interim measure. The intention was that as the VMC built-out, the surface parking lots would be converted to other uses and the office's lower underground parking ratios would be sufficient to meet future demand.

- Some of the high-value tenants that have leased space in these two buildings, specifically KPMG, already had space in Vaughan and were simply moving to improved space.

- There was significant strength in the GTA office market throughout the 2010s which bolstered the economic rationale for new office development.

This situation required the convergence of several factors at the same time to successfully result in new stand-alone office space. These findings indicate that while incentives are viewed favourably by the private sector, they do not, on their own, result in viable office investment. Once a municipality introduces incentives, it is also very common for other surrounding communities to follow suit, which is often referred to as a 'race to the bottom'.

Vaughan Metropolitan Centre

4.0 National Office Market Overview

While the Canadian office market was displaying extraordinary strength leading into the COVID-19 pandemic, the industry is currently facing significant market challenges. The following section reviews the state of Canada's office market.

Office Market Remains in State of Recovery

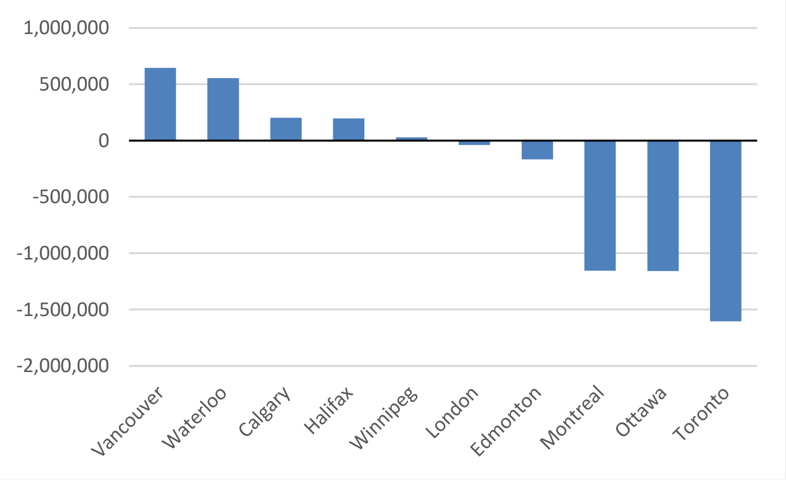
Canada's office market remains in a state of recovery, following unprecedented softness in 2020 and 2021 due to COVID-19. In Q4-2022, 2.1 million square feet of net negative absorptions[12] were recorded across Canada. Since the start of the pandemic, there have been only two quarters in which the national office market recorded positive net absorptions (**Figure 12**). However, it should also be noted that 2022 saw the highest annual level of absorption since the start of the pandemic, suggesting that the market is continuing to stabilize into a new state of equilibrium.

This national trend is heavily dictated by large net negative absorptions in Toronto, Ottawa, and Montreal (**Figure 11)**. Vancouver, on the other hand, has faired better throughout the pandemic including in 2022. The Vancouver office market recorded positive net absorptions of nearly 650,000 square feet in 2022, the most of any market in Canada. A similar trend occurred in 2021 with Vancouver recording net positive absorptions.

Vacancy Rates Remain Elevated

In the decade prior to the pandemic, national vacancy rates were steadily trending downwards as demand for office space grew, heavily driven by Canada's major markets. However, the onset of the pandemic and the shift to remote working models altered this long-term trend. In 2020, national vacancy rates increased from just 6.7% at the start of the year to 11.0% by the end of the year. Since then, national vacancy rates have continued to inch incrementally higher, reaching 17% by the end of 2022. The long-term nature of office lease contracts has contributed to this steady increase, with some tenants opting to hold on to their space until their lease comes up for renewal as opposed to immediately subleasing their space. This is coupled with a steady influx of newly completed space entering the market, all of which were planned and under construction before the pandemic.

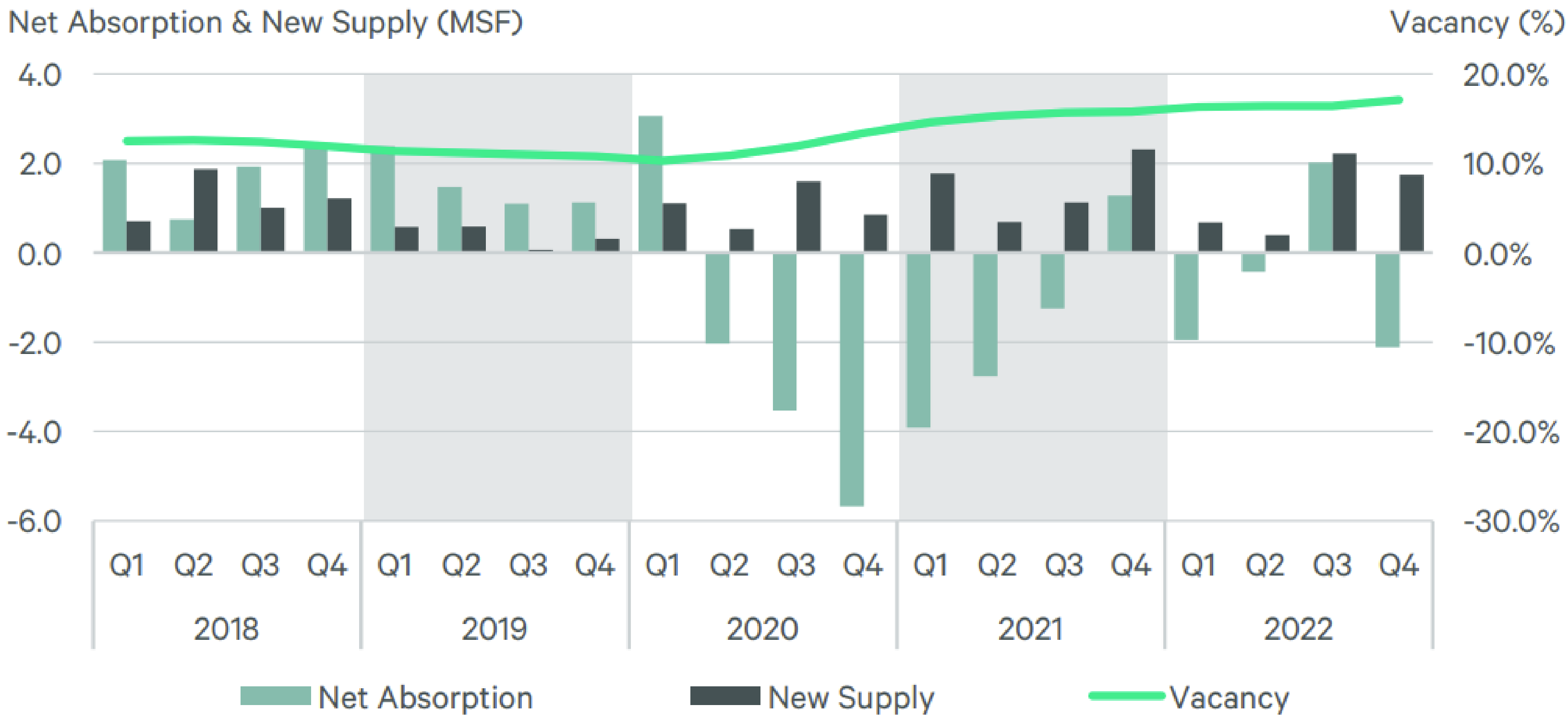
Figure 11 – Net Absorptions by Market, 2022



Source: CBRE

[12] Net absorptions are calculated by subtracting newly leased space from the newly available space. Net negative absorptions means more space became available than was leased, which would lead to increased vacancies.

Figure 12



Source: CBRE

Sublease Space is Driving Vacancies

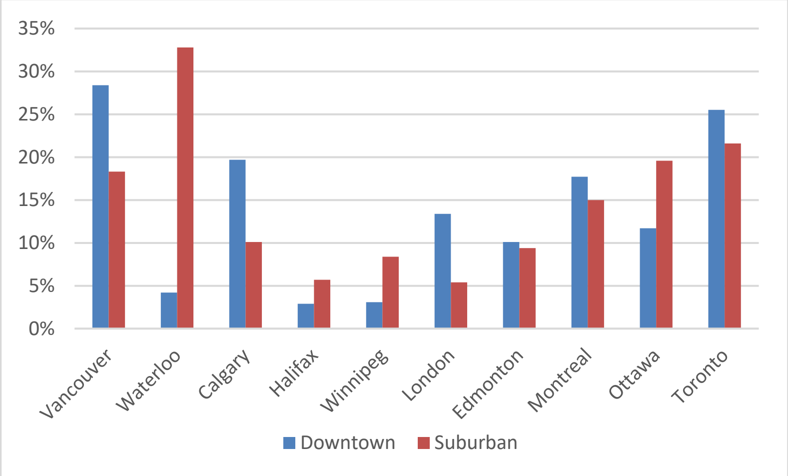
Across the country, the amount of office space that is available for sublease has steadily increased throughout the pandemic. The long-term nature of commercial lease contracts coupled with many tenants revaluating their floorspace requirements in the face of growing levels of work-from-home has led to a surge in office space that has been put on the sublease market. Nationally, sublease space accounts for 18.1% of total vacant space as of Q4-2022, approximately double the pre-COVID rate.

The amount of sublease space is particularly sizable in Canada's largest markets. For example, sublease space accounts for 25% of total vacant space in Vancouver, 23% in Toronto, and 17% in Montreal. These larger markets have greater economic diversity which has driven this trend. Toronto, Montreal, and Vancouver have sizable tech sectors, which was more flexible with remote work. Many tenants in this sector were quick to put space for sublease. Conversely, smaller office markets consist of a larger share of traditional office uses (government offices, banks, insurance, etc.) that were less flexible in their ability to work remotely.

It is also important to appreciate the role that new office supply has played in this national dynamic. Canada's largest markets have a lot more inventory in the pipeline that has typically been pre-leased in advance by large anchor tenants, many of whom have opted not to take the space and instead try to sublease it. In markets like Toronto and Vancouver, these companies would have a greater number of opportunities to downsize and upgrade, creating more turnover in the market and a greater amount of sublease space. These opportunities have simply not been existent in Canada's smaller office markets as the supply of office space in many of these markets has remained virtually unchanged in recent years.

Equally as important, there has been an extensive movement of tenants from class B to class A space in recent years as an above-average amount of class A space is becoming available. This movement has left a significant amount of class B space available for sublet with limited demand for this type of space for all the reasons discussed in this report.

Figure 13 – Sublease Space as % of Total Vacant Space, Q4-2022



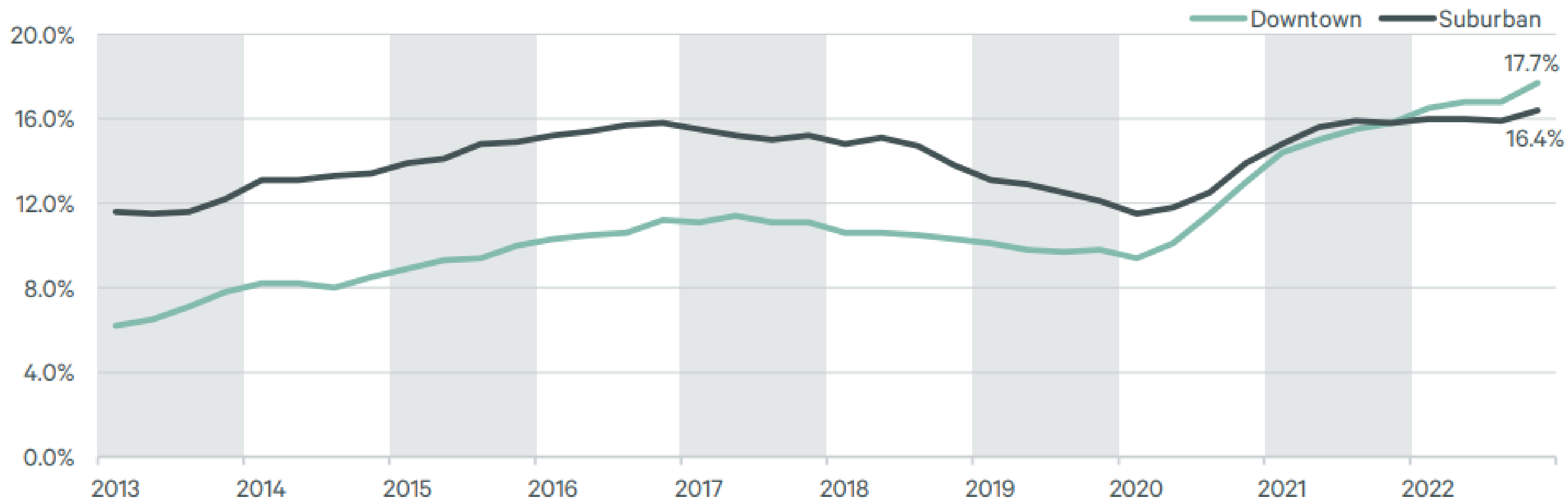
Source: CBRE

Suburban Markets are Outperforming Downtown Markets

For many of the reasons discussed in Section 2.0 of this report, downtown markets were some of the most popular places to both live and work, prior to 2020. Office space demand was highest in the downtown areas evidenced by lower vacancy rates and higher levels of absorptions. Over the past two years, this trend has shifted with downtown vacancy rates climbing across the country, surpassing suburban vacancy rates in Q4-2021 for the first time in over a decade (**Figure 14**). An increasing amount of space available for sublease in downtown markets has been key to the increasing vacancy rates relative to suburban marketplaces (**Figure 13**). This discrepancy has been driven by:

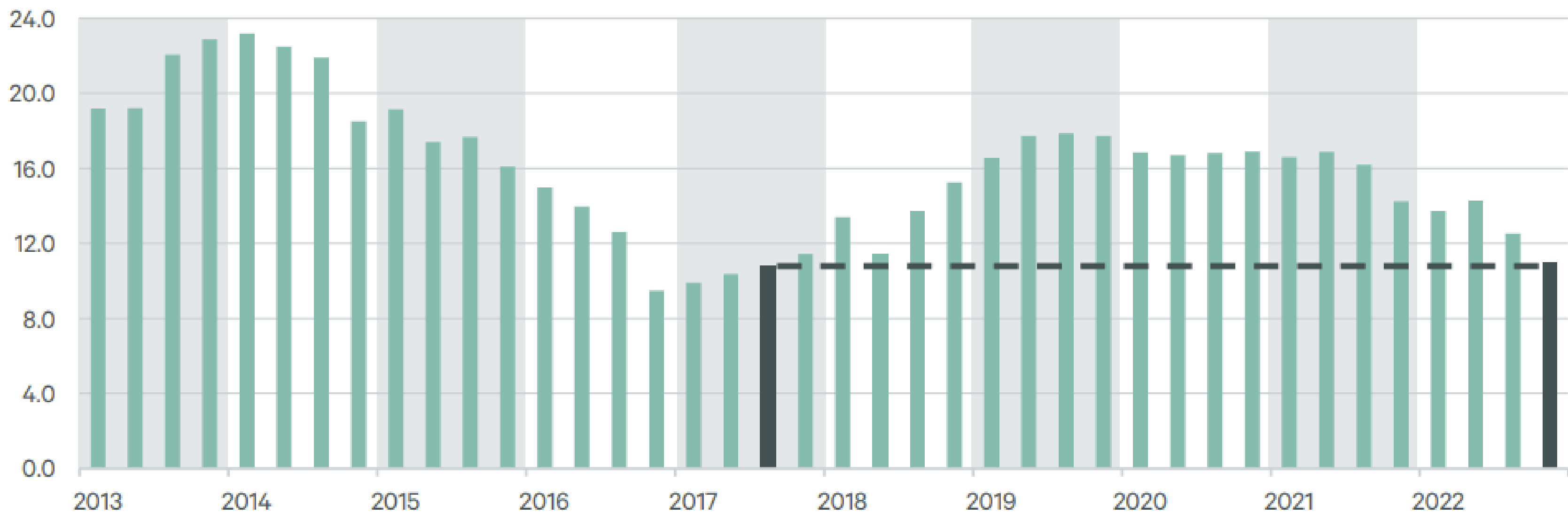
- Higher lease rates in downtown markets, making tenants quicker to act on subleasing unused space given the greater financial burdens; and,
- The completion of a many large standalone office projects in the downtown that were planned and under construction prior to the pandemic.
- A larger share of tenants in the downtown that were willing to adapt more permanent work from home policies.

Figure 14 – National Downtown vs. Suburban Vacancy Rate



Source: CBRE

Figure 15 - Figure 8 – National Office Under Construction Inventory (million of sf)



Source: CBRE

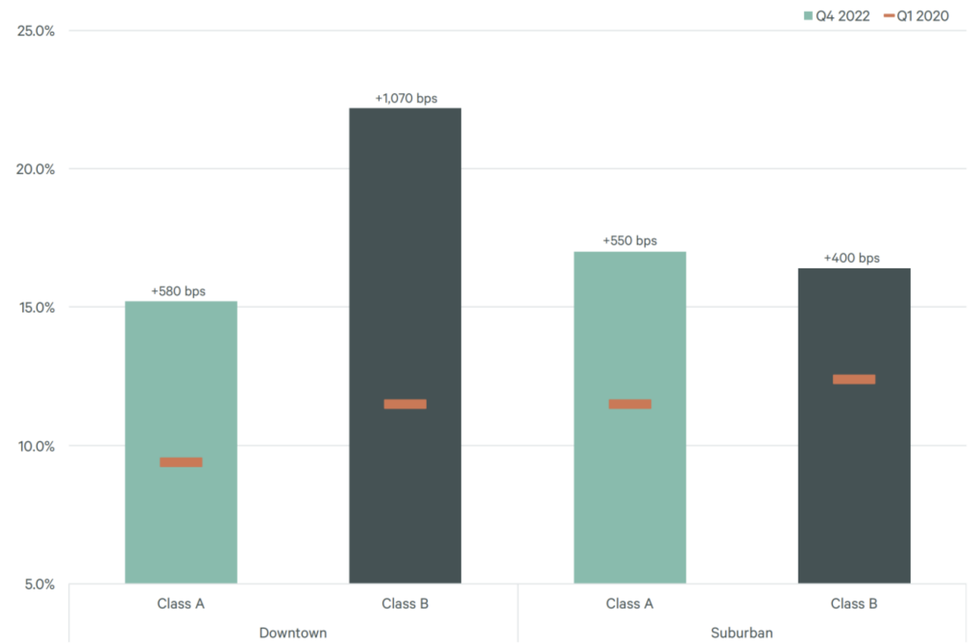
Bifurcation of Office Space

Despite increasing vacancy rates, Canada's major office markets have continued to successfully add new office space as demand for new class AAA office space persists. These cities, particularly Toronto and Vancouver, are home to some of Canada's highest-value tenants including financial services, major tech brands, and national headquarters. Many of these high-value tenants place significant value on occupying the highest quality spaces available for reputational and competitive purposes. They are willing to pay 'top dollar' for these spaces and will often sign sizable contracts during the pre-lease period. It is the presence of these high-value tenants that have allowed cities like Toronto and Vancouver to continue to add new office space despite increasing vacancy rates.

In downtown areas, where these types of tenants are most attracted, this has led to a sizable bifurcation of the office market. The national downtown class A vacancy rate was 15.2%, approximately 700 bps below the downtown Class B vacancy rate as of Q4-2022. Further, throughout the pandemic, the downtown Class A vacancy rate has increased by only 580bps compared to the downtown Class B vacancy rate which increased by 1,070bps.

The vacancy rate for class A space in suburban markets is higher than in downtown areas at 17.4%. This is also higher than the class B suburban vacancy rate of 16.8%. Moreover, class A space suburban vacancy rates increased by 550 bps during the pandemic, while class B suburban vacancy rates increased by 400 bps. This highlights that while there continues to be demand for quality class A office space, this demand is almost entirely centred in downtown areas. Suburban markets simply do not have the same level of demand for class A space.

Figure 16 – Class A vs Class B Vacancy – National Downtown and Suburban



Source: CBRE

A Period of Recovery and Adjustment

Looking ahead, the office sector in Canada is likely in for an extended period of market weakness as it rebalances from the current mismatch between supply and demand. This was a theme that came up repeatedly during our interviews with all major players in the market expressing reservations about the sector as it continues to adjust to a post-COVID environment. While it is beginning to appear that the large majority of office workers have returned to the office in some capacity, even a small reduction in office space demand can have an impact throughout the industry, especially as a glut of new supply comes online. This mismatch will take time to work itself out.

There are also growing concerns about a looming commercial real estate debt crisis, with a significant amount of debt set to become due over the next year.[13][14] Many landlords will need to refinance low-yield assets at much higher rates and there is speculation that there could be an even greater offloading of office holdings as they struggle to find financing.

Notwithstanding this ongoing softness and the restructuring of the office sector, it is clear as people return to work that the office will continue to be an important element of how we conduct work. We expect though that the fluidity between work and home will only increase the demand for transit-connected, urban environments that offer a range of live/work opportunities and an interesting mix of amenities. This includes suburban submarkets like Surrey City Centre, which is already well-positioned relative to many other suburban submarkets to compete for this demand when it returns.

Looking Forward for the Office Sector

The ongoing softness of the market is also contributing to several ongoing changes in the office market. A recent report entitled *Emerging Trends in Real Estate 2023* by PWC and ULI provides an outlook for the North American office sector. The report's analysis was based on interviews with industry experts from a variety of fields. Key findings from this report include the following:

- Between 10% to 20% of older stock will end up either being repurposed or removed from the market due to the bifurcation of demand and the ‘flight to quality’. However, it is suggested that even the repositioning of older office stock through extensive renovations may not be enough, as this has not been overly successful in most markets. Vacancy rates for class B and class C space are expected to remain very high.

- Workspace design is becoming more critical as many office workers are now demanding individual workspaces as opposed to open-concept office spaces.

- The softening of the office market has also led to increased interest in the conversion of office spaces to residential, although this comes with considerable viability issues and is largely dependent on the local market context.

- Medical office is the one subsector that continues to boom, owing to an ageing population and the increased moves toward ancillary health care providers across the industry.

[13] Commercial Mortgage News. Office Buildings Face Moment of Truth As $14 Billion in Debt Comes Due

[14] The Wall Street Journal March 2023. Commercial Property Debt Creates More Bank Worries: Large number of office defaults could force banks to mark down value of these and other loans

5.0 Vancouver Office Market Overview

The following section provides a market review of the office sector in the Greater Vancouver Area with a specific focus on the City of Surrey.

Major Office Investment Concentrated Downtown

Recent office investment in Metro Vancouver has followed nation-wide trends, with the largest share of new office space being in the downtown market area for all the reasons discussed in Section 2.0 of this report. Over the last three years, the downtown market has added 2.6 million square feet of new office space, equal to 51% of the entire Metro region's new office space over the same period. More notably, downtown Vancouver has accounted for 75% of Metro Vancouver's new class A office space over the past three years, adding 2.3 million square feet.

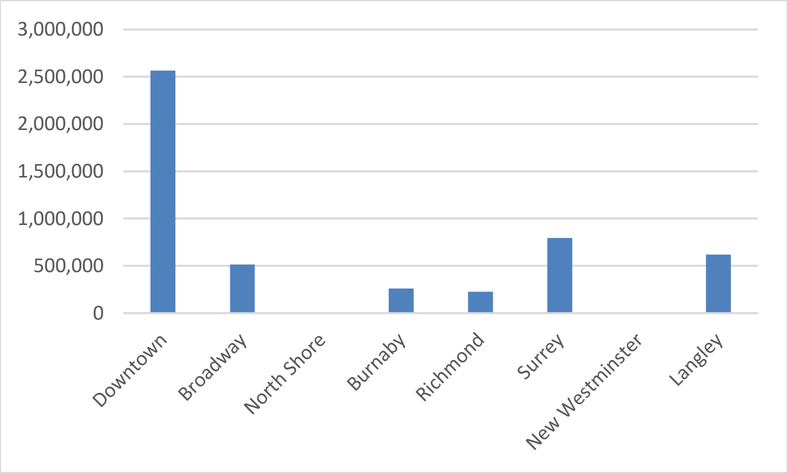
Vancouver's suburban market areas have added more modest amounts of office space in recent years, with much of this space being class B space (68%). New office investment in suburban Vancouver also tends to be much smaller, with an average building size of 64,000 square feet compared to 197,000 square feet in downtown Vancouver.

Figure 18 shows new office space by market area in Metro Vancouver. As shown, the City of Surrey has added nearly 800,000 square feet of new office space over the past three years, the most of any of the suburban municipalities. This still pales in comparison to downtown Vancouver though and most of this new space (83%) was class B.

Figure 17 – New Office (2020+) Space (sf) by Class and Location

Source: CoStar Realty Data

Figure 18 – New Office (2020+) Space (sf) by Market Area



Source: CoStar Realty Data

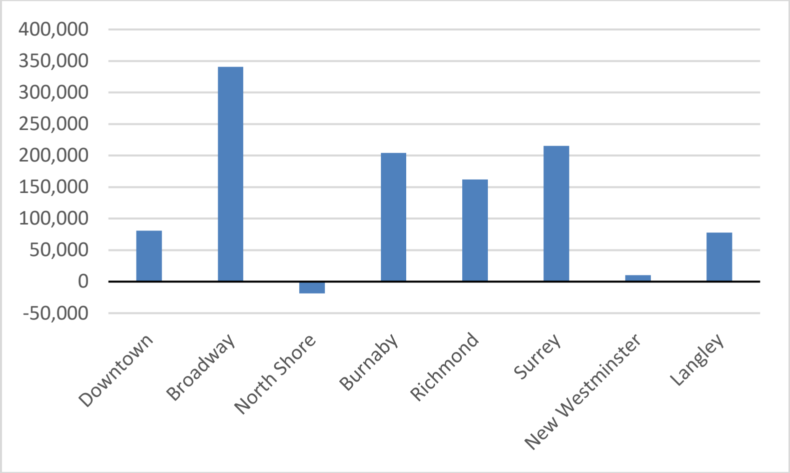
Highest Levels of Demand in Downtown Vancouver

As discussed earlier in this report, the Vancouver office market was one of the first in Canada to return to net positive absorptions following the COVID-19 pandemic. In 2022, it recorded net positive absorptions of approximately 1.2 million square feet. By market area, we see that the Broadway corridor saw the highest net absorptions with 340,000 square feet, followed by Surrey, Burnaby, and Richmond. The downtown market area recorded only modest net absorptions of just 80,000 square feet (**Figure 19**).

Net absorptions do not tell the whole picture though for the Metro Vancouver area. The largest amount of demand is still in the downtown market area, however, as the downtown also added the largest amount of new supply during 2022 (1.6 million square feet). If anything, the fact that downtown Vancouver still recorded positive net absorptions in 2022, despite such a large influx of new space, underscores just how concentrated office demand is in downtown Vancouver. This was largely due to significant preleasing occurring in many of these major downtown projects.

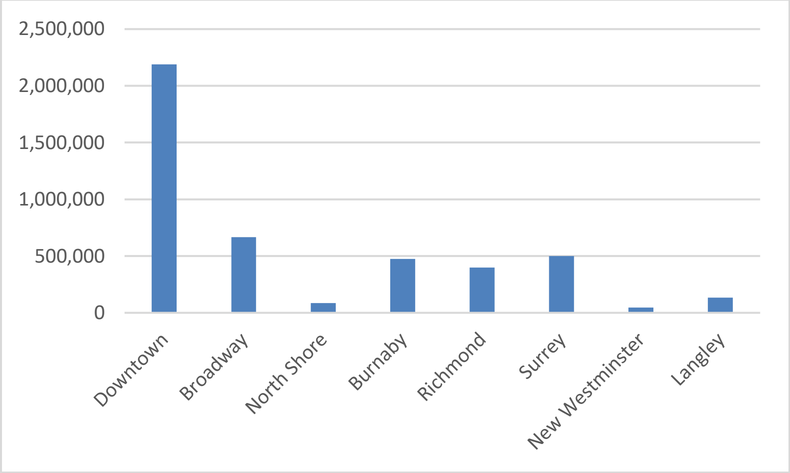
Figure 20 highlights this point, looking at gross absorptions during 2022. As shown, downtown Vancouver saw nearly 2.2 million square feet of office space leased during 2022, more than three times the amount of space that was leased in the next closest market area – the Broadway Corridor. The suburban market areas saw even lower levels of leasing activity, including Surrey which saw only 500,000 square feet of gross absorptions in 2022.

Figure 19 – Net Absorptions (sf) by Market Area, 2022



Source: CoStar Realty Data

Figure 20 – Gross Absorptions (sf) by Market Area, 2022



Source: CoStar Realty Data

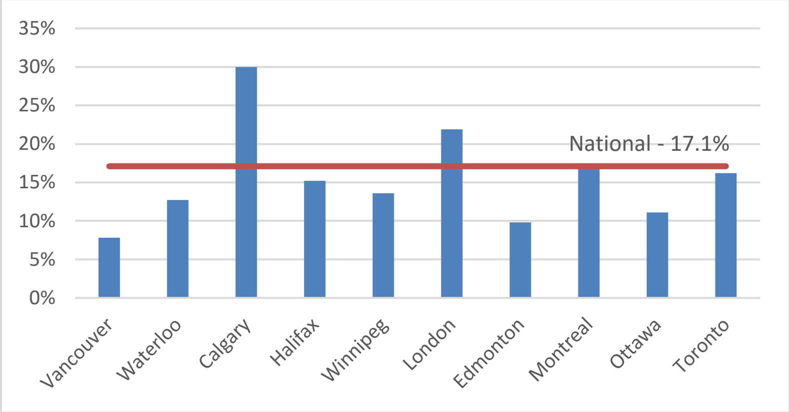
Vacancy Rates Have Trended Upwards

As noted previously in this report, the Greater Vancouver office market faired better than other Canadian markets during the COVID-19 pandemic, being one of the only office markets to see vacancy rates remain below 10% throughout. Even still, the effects of the pandemic were evident. By the end of 2022, office vacancy rates had reached 8.6%, which is nearly double what they were at the end of 2019 (4.4%). The weakening of office demand, coupled with the continuous inflow of new supply in Vancouver has driven this increase in vacancy rates.

The increase in vacancy rates has occurred across all market areas during the pandemic, although to varying degrees (**Figure 22**).[15] Vacancy rates in the downtown saw the largest increase reaching 6.8% by the end of 2022. This does not mean, however, that demand is softest in the downtown, but it is reflective of a substantial amount of new supply coming online during the pandemic in the downtown market area.

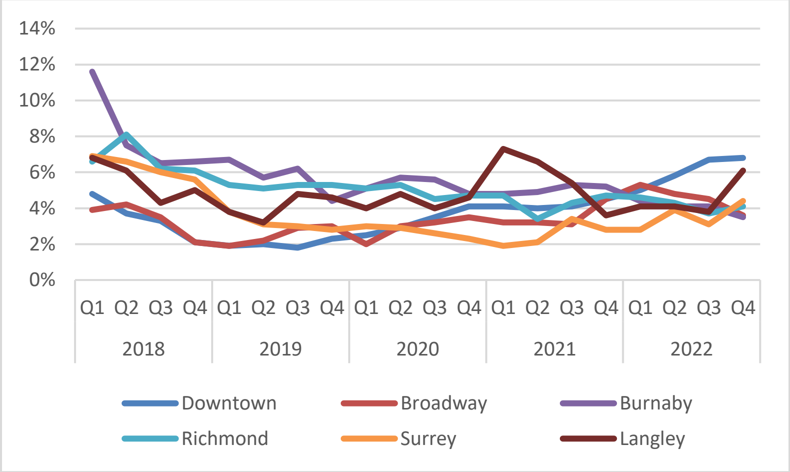
The City of Surrey has seen vacancy rates increase slightly since 2020, reaching 4.4% by the end of 2022. This is approximately inline with other suburban market areas such as Burnaby (3.5%), Richmond (4.1%), and Langley (6.1%).

Figure 21 – Office Vacancy Rates by Market, Q4-2022



Source: CBRE

Figure 22 – Vacancy Rate by Market Area



Source: CoStar Realty Data

[15] Of note, for localized market data, we have relied on CoStar data which uses a different methodology than CBRE data. As such the figures may not align, but this is intended to show trends in the market.

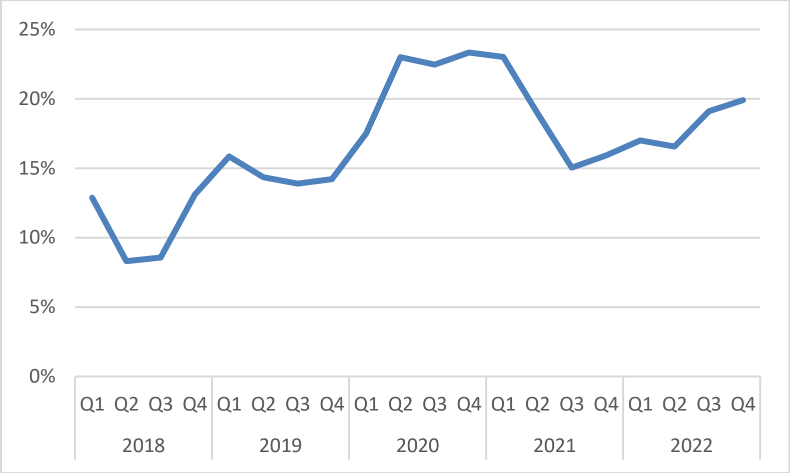
Sublease Space is Concentrated Downtown

Driving this increased vacancy has been a surge in sublet space, as many firms re-evaluated their working arrangements resulting in smaller footprints. As shown in **Figure 23**, sublease space accounts for 20% of the total vacant space in Metro Vancouver as of the end of 2022, up from less than 10% just five years ago.

As shown in **Figure 24**, sublease space accounts for 25% of total vacant space in the downtown, the highest of all the major market areas in Metro Vancouver. In suburban market areas, sublease space accounts for a much smaller share of total vacant space. In Surrey, it accounts for only 7% of the total vacant space. A big driver for this trend was a large amount of class A office space that has come online recently in downtown Vancouver. As this space becomes available and many of Vancouver's high-value tenants are moving into it, their former space being put up for sublease. This in turn is having a rippling effect throughout the market as other firms have also been shifting upwards from class B to class A space. In suburban market areas, there has been a more limited amount of movement, as there has only been a modest amount of new supply entering the market.

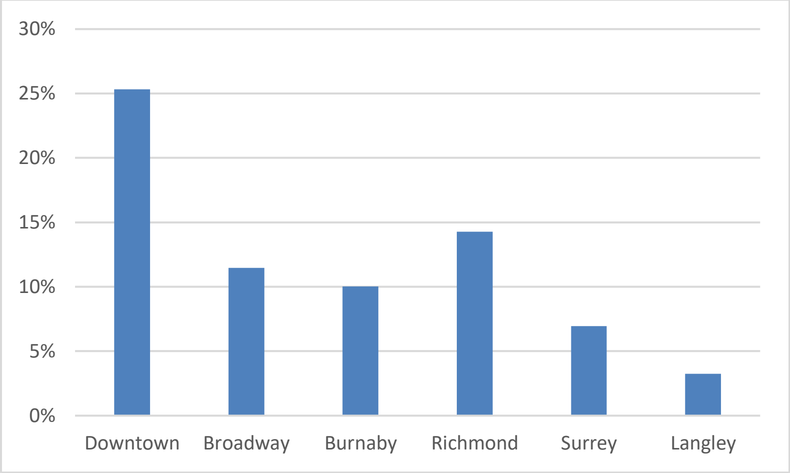
It should also be noted that the significantly higher lease rates in downtown Vancouver made tenants quicker to act when opting to sublease their unused space. In suburban market areas, lease rates were much lower which made the economic burden much smaller for firms, with many simply opting to hold onto their space until the lease runs out. This was noted by brokers in our interviews who suggested the vacancy rate in Surrey is probably not entirely accurate as there is a large amount of leased but unused space throughout the city.

Figure 23 – Sublease Space as Share of Total Vacant Space, Metro Vancouver



Source: CoStar Realty Data

Figure 24 – Sublease Space as Share of Total Vacant Space by Market Area

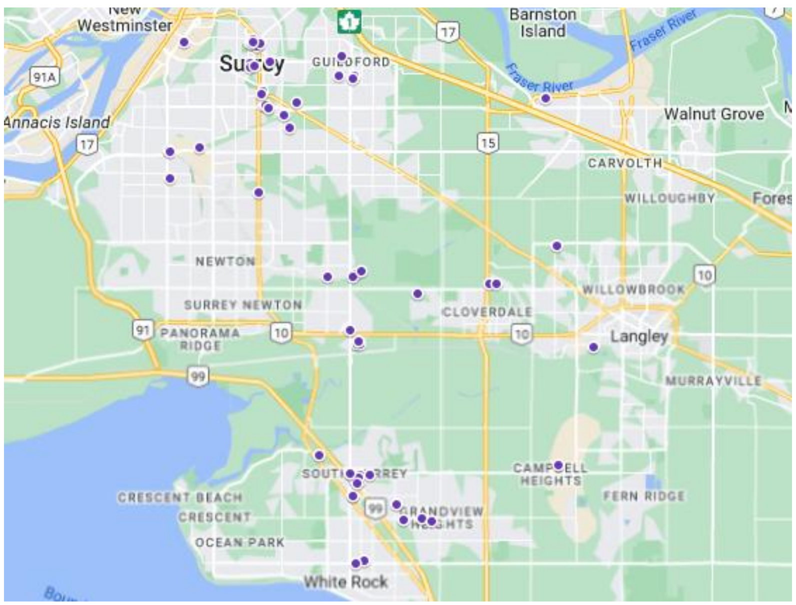


Source: CoStar Realty Data

5.2 City of Surrey / City Centre

As noted, the City of Surrey has seen a reasonable amount of office investment relative to other suburban communities. Since 2016, Surrey has added just under 2 million square feet of new office, equal to about 280,000 square feet per year. This far exceeds other suburban municipalities in Metro Vancouver such as Burnaby and Richmond, which only added 840,000 and 450,000 square feet of new office space, respectively, during the same period. Even on a national-scale, Surrey exceeds nearly all other suburban municipalities in terms of new office investment. In the GTA, for example, the City of Mississauga and the City of Vaughan, respectively, saw only 1.5 million and 1.0 million square feet of new office space added between 2016 and 2023. This is particularly noteworthy as both municipalities offered extensive incentives to encourage new office.

Figure 25 – Issued Office Building Permits, 2013 to 2022



Source: City of Surrey

The above-average investment in office spaces in Surrey can be attributed to its strong population growth. From 2011 to 2021, Surrey's population increased by over 100,000 individuals, surpassing the growth in the cities of Vancouver, Richmond, and Burnaby. This significant population expansion has resulted in a large customer base for office tenants in Surrey, thereby justifying the above-average investment levels. It is worth noting, however, that most recent office investments have been focused on serving the local population rather than major corporate needs. This includes medical office uses.

Figure 25 shows all building permits with office floor area issued in Surrey over the last ten years (2013 to 2022). As shown, investment in office uses in Surrey has primarily been in a small number of clusters. This includes clusters in and around Surrey City Centre, near Guildford Town Centre, and a small cluster near Highway 10 / 152nd Street. Looking closer, Surrey City Centre has seen the largest amount of Surrey's recent office investment, accounting for 43% of all permitted office floor space over the past decade.

Despite this positive investment for the City of Surrey, the majority has been either modest suburban style offices with surface parking or as part of a master-planned community where the residential uses effectively subsidize the office space. This is an important point, as like all suburban municipalities, the market forces are simply not supportive of major standalone office development. Our interviews stressed this point, with local developers suggesting that in the absence of increased residential permissions, they would not pursue new office development. This was also demonstrated in Section 3.0 with our hypothetical standalone office pro forma. Interviewees noted many factors for why they would not pursue new standalone office development in Surrey City Centre. This includes:

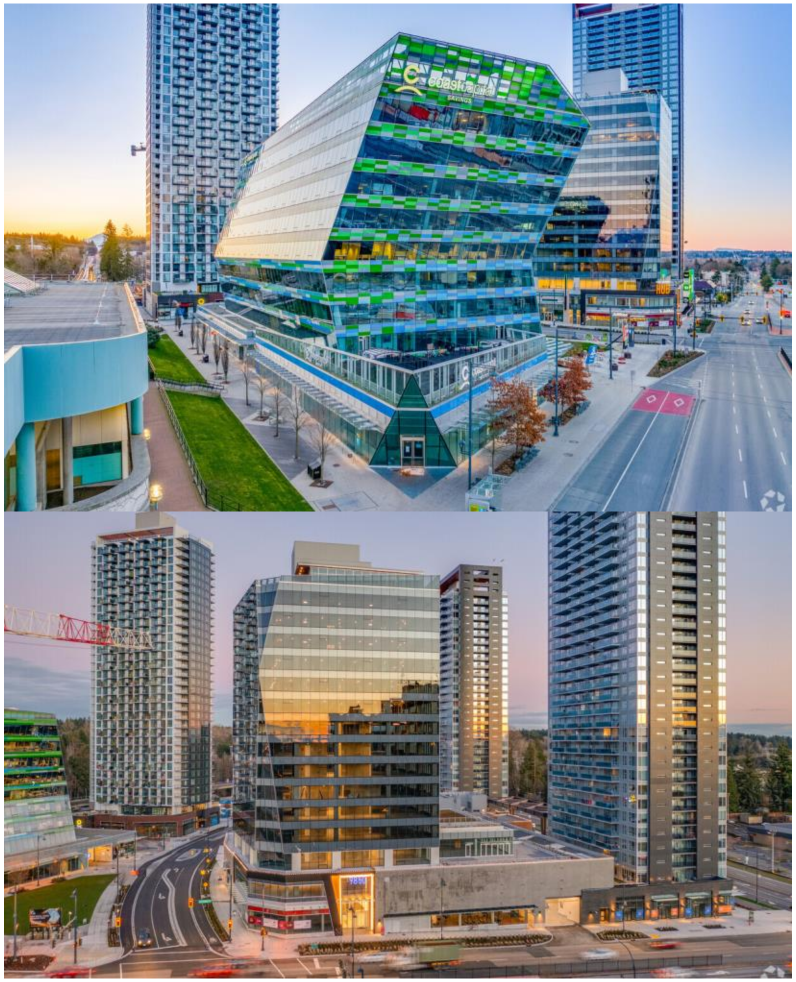
- Lack of market demand from high-value tenants who are willing to pay the highest lease rates which are needed to support the costs associated with major office development.
- Onerous parking requirements, as dictated by the market, which would significantly increase the cost of new office development.
- Challenges with preleasing a sizable amount of space, owing to most tenants only requiring small spaces (<10,000 square feet).
- Surrey City Centre does not yet have a critical mass of density, population, and walkable urban amenities.

Looking closer at the office development that has occurred in Surrey City Centre, there are two projects worth highlighting.

King George Hub – PCI Developments

Adjacent to King George Station, the King George Hub community, which was developed by PCI Developments Group, has two standalone office towers. The first tower was completed in 2015 and consists of 171,650 square feet of office space. The primary tenant in this project is Coast Capital Savings who leases approximately 106,500 square feet of space. The second office tower, known as The Hub, was completed in 2022 and is 260,000 square feet. Its primary tenant is Westland Insurance Group who leases 83,000 square feet. It is our understanding that the projects both include parking ratios of approximately 2 spaces per 1,000 square feet, which is quite high. Our broker interviews suggested that this was required from a market perspective and that any less would make leasing very challenging.

Figure 26 – King George Hub – Phase A (top) & Phase B (bottom)



Source: CoStar Realty Data

In speaking with representatives of PCI, it was indicated that the feasibility of this project hinged on the residential permissions, which provided sufficient uplift in land value to allow for standalone office. In total, the project is to include upwards of 1.2 million square feet of residential floor area. It was also indicated that the precursor to Phase 1 was the pre-leasing arrangement with Coast Capital, which provided significant support for the project to move forward. However, it was stated that the attraction of Coast Capital was somewhat of a positive anomaly, with Coast Capital Savings looking to consolidate all their Surrey offices at the time (i.e., new jobs were not created). Tenanting the rest of the space was quite challenging.

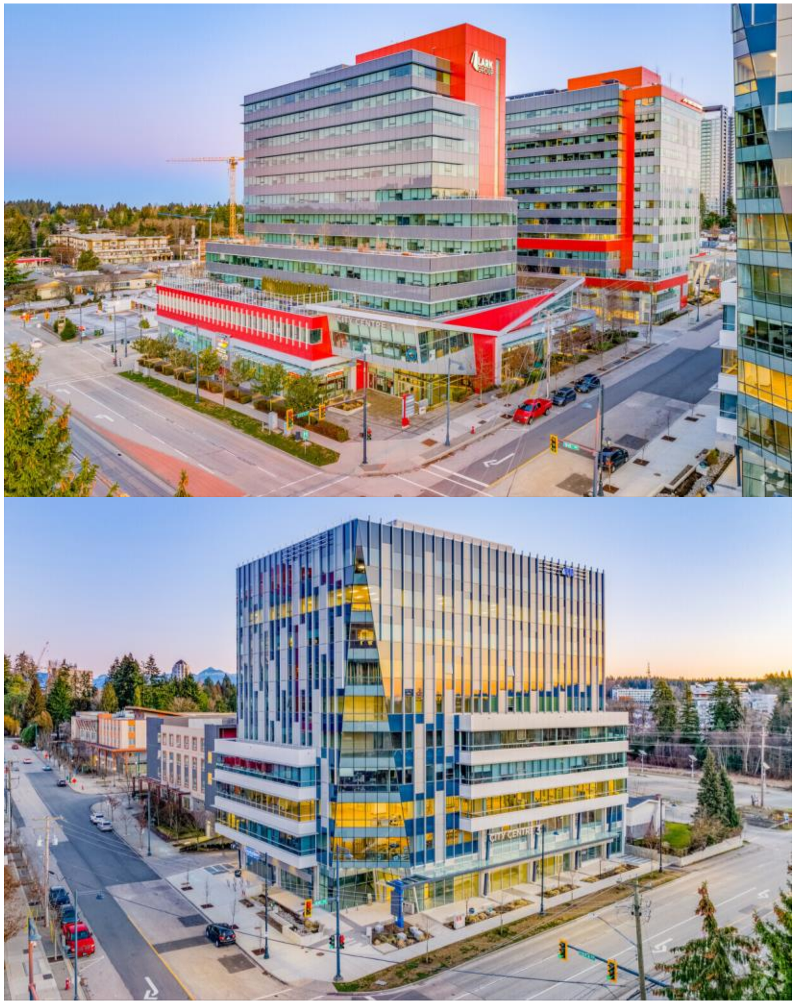
Phase 2 began construction on spec in 2018, at a time when the office sector was near its peak, just prior to the pandemic. However, it is unlikely that such a project would move ahead on spec in today's market given the increasing softness of the office market and hesitancy around financing new office space in suburban markets.

City Centre – Lark Developments

Located just south of King George Station and adjacent to Surrey Memorial Hospital is the three-phase City Centre office project, built by Lark Developments. This project consists of three standalone office towers with approximately 476,000 square feet of space. The first phase was completed in 2014 and the most recent phase was completed in 2021. Unlike most other office projects, this project was condominium in tenure, with smaller spaces being sold to end-users. The proximity of the office to Surrey Memorial Hospital has meant that much of this space has been occupied by medical-type tenants, although there have been some tech-based companies purchasing space as well as professional services firms.

Unlike King George Hub, this project's feasibility was not contingent on additional residential permissions. In speaking with a representative from Lark, it was indicated that the feasibility of this project was largely based on their ability to secure financing without major tenants due to the smaller scale of each building, and the much lower land costs as this project was started over a decade prior. It is our understanding that the land costs were minimal to Lark Developments.

Figure 27 – City Centre I & II (top) & City Centre III



Source: CoStar Realty

It is also important to highlight the uniqueness of the medical and life science office sector. Unlike the traditional office sector, which is heavily influenced by the locational factors discussed in Section 2.0, the medical office sector is primarily driven by proximity to medical facilities and population centres. Moreover, unlike traditional office uses, it is not as impacted by broader macroeconomic conditions. The pandemic, for example, had little to no impact on the strength of the medical office sector.

It is also important to highlight the uniqueness of the condominium office product, which is common for medical offices. Unlike traditional offices, condominium offices present a lower level of risk for developers, assuming they can sell the units promptly, as there is no hold period in which market risk can enter. Units are sold upfront before construction, and the developer can exit the project promptly, minimizing market exposure.

Other Key Findings from Interviews

Through our interviews with local developers and brokers, a few other key points were raised regarding the office market in Surrey and Surrey City Centre that are worth highlighting:

- **Vacancy Rates are Not Reflective of Market Conditions –** Local brokers mentioned that vacancy rates for Surrey do not accurately reflect the market conditions they are seeing on the ground. They noted that there were several tenants with large footprints in Surrey who have reduced their office needs due to work from home but have not put their space on the sublease market. This occurred either because lease rates were not financially burdensome enough to justify subleasing the space, or because the tenants were institutional and therefore not as concerned about the short-term financial considerations of leasing unused space.

- **Professional Services Have Been Attracted to Surrey –** One thing that was noted by brokers and developers is that the City of Surrey is reasonably appealing to business administration and professional service tenants owing to its large population base. However, it is the back-of-house positions that are located in Surrey, as these roles are not as reliant on access to high-quality labour. It was noted that this was partially what drove new office development in neighbouring Langley.

- **Modest Tenant Demands Presents Challenges –** Both brokers and developers in Surrey noted that the lack of large tenants made leasing significantly more challenging. Most tenants had space needs of less than 10,000 square feet, with many being smaller than 5,000 square feet. With such small spacing requirements, leasing new buildings was increasingly challenging and time-consuming. Large pre-lease requirements of 40%-60% were also noted as being required in the current environment, which is difficult to secure, particularly with larger stand-alone buildings.

6.0 Challenges Faced by Surrey in Attracting Major Office Investment

The City of Surrey's objective with this study is to determine the best strategies the City can pursue that would encourage a nationally competitive downtown core with the type of office space that is most in demand by major employers. In the context of the existing market conditions and investment patterns, there are several key challenges faced by Surrey, as well as most other major markets, that could hinder this objective, at least in the short term.

Major Office Investors Will Continue to Opt for Proven Markets Given Ongoing Market Softness

Many of Canada's largest real estate developers and investment funds (REITs, pension funds, asset managers) already own and operate extensive office portfolios across Canada and worldwide. The challenges currently being faced by the office sector have pushed many of these firms to shift funding towards alternative, more profitable sectors, as many no longer view the risks associated with office development as inherently worth it. Any ongoing office investment by these firms that are still occurring has typically followed one of two patterns:

- **Reinvestment in Existing Assets –** With shifting economic conditions and the changing nature of retail, many of Canada's largest real estate asset holders are looking to maximize their existing retail holdings, specifically through the development of mixed-use communities on suburban shopping centres. For these sites, residential permissions are the primary goal, with office uses typically included to obtain planning permissions. As the land value of these sites is often capitalized through existing retail uses, it is unlikely that these firms would purchase new land at market rates for the purpose of office development. For example, SmartCentres and Oxford Properties already owned the shopping centres at VMC and Downtown Mississauga, respectively.
- **Prime Market Areas** – In instances where Canada's largest real estate developers and investment funds have opted for new standalone office projects, it is almost always in the submarkets that provide the lowest level of risk. Many of these firms have conservative funding sources, such as pensions, and as such are unlikely to consider investing in less predictable office markets (i.e. suburban areas) when downtown submarkets tend to be much more stable and predictable. All groups interviewed indicated that the current market environment is resulting in an even more focused and narrow investment outlook concentrated on prime downtown locations.

Major Tenants Have No Appetite for Non-Central Market Areas

When considering the major tenant groups that Surrey would ideally like to attract to their Downtown, a very pronounced pattern emerges in their locational trends. These tenant groups have almost entirely opted to locate in central cities, despite the highest lease rates in the country, as it allows them to attract the high-quality talent which is integral to their success. Highly educated and talented knowledge sector workers have shown a very strong preference for the walkable mixed-use communities that central cities typically offer and given the overwhelming demand for this type of labour, companies are increasingly looking to remain as competitive in the job market as possible.

This point was continually stressed by commercial brokers, office investors, and developers during our interviews. The brokers in particularly stated that this was often considered the most important factor for tenants in the technology sector, the professional services sector, and the FIRE sector when choosing where to locate. To date, these types of tenants have simply shown limited desire to locate in locations like Surrey.

Development Economics Are Challenging for New Standalone Office Development

Recently, the development sector has undergone several broader macro-level changes that have negatively impacted the feasibility of new development for all sectors, especially office. Some of these changes include:

- **Rising Interest Rates** – Since the start of 2022, the Bank of Canada has increased its policy rate eight times, reaching 4.50% by January 2023. While rate hikes have now slowed, these substantial increases have made the economics of new development much more challenging. Increased borrowing costs are particularly challenging for new office development given the projects receive nearly no revenue during the construction phase, unlike new residential development.

- **Limited Capital** – It is also important to highlight that the increased rates from the BoC have also shifted the amount of capital that is available for new developments. Many investors are now able to achieve up to 5% annualized returns in the bond market or other fixed-income securities, meaning there is less of an incentive to deploy capital on riskier investments such as new office space, especially given that even the most successful office projects may only be achieving yields slightly above 5%. Most interviewees have therefore noted they are seeking returns above 10%, which is not achievable in the suburban office market.

- **Construction Costs** – Since the start of the pandemic, disruptions in global supply chains and labour shortages have exacerbated the costs of new high-rise construction. In Vancouver, for example, the hard costs associated with developing a 30+ storey class A office building increased by 8% between 2022 and 2023, with more substantial increases occurring since the COVID-19 pandemic began.[16]

- **Minimal Office Lease Rate Growth –** Owing to the softening of office demand that has occurred over the past three years, office lease rate growth has been flat to modest. This is particularly true in less-centralized submarkets such as Surrey. Average asking lease rates for class A office space in Surrey have remained unchanged over the past three years, ranging from $28 to $38 psf per year.[17]

These changes have had the effect of decreasing the financial feasibility of potential projects, with new standalone office development increasingly challenging as demonstrated in Section 3.0 of this report. Potential revenues are no longer sufficient to cover the increased costs of development including land and developer profit. This again confirms why new standalone office development is increasingly concentrated in the submarkets with the highest achievable lease rates. At the same time, residential pricing and demand have increased substantially in recent years, particularly in suburban markets such as Surrey. As such, market interest has shifted to high-density residential development, which is also driving land values beyond what office developers can afford to pay.

[16] Altus 2023 Canadian Cost Guide

[17] Avison & Young. Year End Market Report 2019 & 2020

Suburban Parking Requirements Further Challenge New Suburban Office Development

Further complicating the economics of new standalone office development, suburban submarkets such as Surrey have much more onerous parking requirements. This presents additional challenges as any possible revenue associated with parking is often minimal and not sufficient to cover the additional cost of parking development, especially if the parking is located underground.

Moreover, it was expressed during our interviews by brokers and developers that existing parking provisions are already dictated by market demand and that it is unlikely they could be decreased any further, even with the presence of the SkyTrain stations. Brokers explicitly stated that in a market like Surrey, most office tenants have sizable parking requirements, meaning that if sufficient parking was not available, they would simply opt to lease space elsewhere.

Development Timelines Are Impactful

Local developers discussed the impact that development timelines can have on the feasibility of new projects of all asset classes. However, many also expressed admiration for the speed and clarity with which City staff were able to process applications for commercial uses. Many noted that relative to other municipalities in Metro Vancouver, the City of Surrey was much more accommodating of new office proposals.

While this response from the development sector should undoubtedly be viewed as a positive for the City of Surrey, there are other factors, beyond the City's control, that have negatively impacted development timelines. As noted earlier, supply chain disruptions and labour shortages have led to a lengthening of construction timelines, which given the increased costs of borrowing, is putting a further dampening on the feasibility of new development projects. Gaining pre-lease commitments several years before construction is also challenging.

Critical Mass in Surrey City Centre has not Been Reached

Many local interviewees expressed that the City of Surrey and Surrey City Centre have been undergoing a rapid change, with perceptions in the marketplace positively changing. New residential uses, coupled with new institutional, retail, and community uses were all viewed as contributing to Surrey City Centre's improving sense of place. Despite this positive direction, many noted that the area has still not yet reached 'critical mass' as a truly vibrant and mixed-use community. Many expressed a desire for new cultural, community, and recreational uses that would continue to build on Surrey City Centre's identity. They also highlighted that continued residential development would positively impact the desirability of Surrey City Centre for new office investment.

Smaller Tenants Present Preleasing Challenge for Large Standalone Office Projects

As noted by brokers and developers alike, Surrey has been able to attract some tenants from the professional services sector, the business administration sector, the technology sector, and to a lesser degree the FIRE sector. However, these tenants are either much smaller players in the market, or their Surrey offices are intended to function as a secondary outpost for these firms who have larger spaces in Downton Vancouver. Their suburban offices are home to many of their administrative tasks. It was noted that these tenants typically have much smaller floor space requirements with most leases being for 30,000 square feet or less.

More commonly though, office tenants in Surrey have space requirements of 10,000 square feet or less. Such small spacing requirements pose significant challenges in terms of preleasing. It was expressed to us during our interviews that these smaller tenant space requirements in Surrey make the feasibility of larger office towers much more challenging, if not impossible. This is not uncommon in markets like Surrey, with most suburban office buildings being modest in scale because of this challenge.

Larger Tenants Are Not Attracted for Pure Market Reasons

Notwithstanding the above, Surrey does have some tenants with larger space demands (>30,000 square feet) in Surrey City Centre. These tenants have not, however, opted to locate in Surrey for pure market reasons as many are institutional-type tenants. Examples of this include the Fraser Health Authority, the Canadian Revenue Agency, and Simon Fraser University. While the presence of these tenants can be viewed favourably, it is important to highlight that these types of tenants do not produce the same level of economic spin-off as other sectors, nor are they driven by the same market forces as other sectors and their demand for space is also somewhat limited.

In any event, the presence of these tenants was still favourable for Surrey as they could, hypothetically, commit to a large amount of preleasing if a new standalone office tower was proposed. This arrangement could be beneficial as it could help overcome many of the preleasing challenges noted by developers and brokers.

Another similar concern that was raised by a developer was that should a new standalone office building in Surrey be designed with one of these institutional/government tenants in mind, there becomes a significant risk in the future that the tenant may one day decide to leave. In this scenario, there are likely to be significant challenges with preleasing this space given the lack of tenants in Surrey that would require such a large floorplate.

Local Developers May Not Be Capable of Delivering Large-Scale Projects

Like Surrey, other jurisdictions have pursued the development of new office space through planning policy requirements. Most commonly, residential permissions are given or expanded on a site contingent on the inclusion of non-residential uses, typically commercial office uses. The inclusion of office space in these mixed-use projects is often viewed as an extraction, given the negative land values typically associated with office uses.

One challenge with this approach that has been noted in other jurisdictions is that the local residential developers/landowners may not have the technical and professional experience to adequately bring new office space to the market (i.e., these are residential developers with no experience in the office sector). In instances where office space is included in the podium level of a residential tower, the office space can often be an afterthought, being inefficiently designed to meet current market demand. This is a situation that benefits neither the developer nor the municipality.

These challenges can also be present on a new major standalone office project that is part of a master-planned community. Many of the national office developers we interviewed spoke of the complexities of new standalone office development, with these challenges only being magnified by thinner margins compared to residential development. Local developers that are primarily experienced in residential or more modest office projects, may simply not have the experience to properly bring a new major standalone office project to market in Surrey.

Surrey Development Corp is Competing with Private Interests

It is our understanding that the City of Surrey is in the process of bringing the Surrey City Development Corporation ('SCDC') back, with the intention of developing a new multi-phase project with over 1 million square feet of class A space at a project known as Centre Block. The prospect of this development came up in many of our interviews, with many interviewees questioning the objectives of such a project. The reasons for this were varied:

- Such a large amount of new office space would result in an oversupply of office space for the Surrey market. An oversupply could challenge achievable lease rates in Surrey, which in turn could further undermine the feasibility of new office development.

- At 1 million square feet, the proposed project could effectively absorb Surrey's entire office market demand for multiple years. Private-sector office developments would be forced into competition with this project, which would slow absorptions and further challenge the feasibility of new office development.

- As noted earlier in this section, one of the biggest challenges that new standalone office development in Surrey faces is the lack of large tenants that would be willing to prelease a significant amount of space which is necessary to advance financing. It is our understanding that the Centre Block project is in discussions with several institutional tenants that have sizable floor space requirements. By removing these tenants from the market, the Centre Block project would further undercut the feasibility of any market-driven office project that is dependent on hitting certain preleasing requirements.

- On the other hand, given the analysis in this report and discussions with interviewees, it is unlikely that any of the developers in Surrey would consider delivering a project of this scale on their own. For example, one of the only major office proposals of the scale envisioned by the City of Surrey (Central City by Blackwood) was put on pause indefinitely after the pandemic began.

7.0 Key Findings and Direction

For all the reasons discussed throughout this report, Canada's largest office players (developers, REITs, pension funds, etc) are unlikely to choose to invest in Surrey over other markets while the broader sector continues to adjust to changes brought on by the pandemic. Stronger market conditions in central cities, coupled with office development becoming increasingly risky, means that new major standalone office investment is unlikely to happen in Surrey, at least until greater stability returns to the market.

Notwithstanding this, we still believed that, relative to other similar markets, Surrey is well-positioned relative to attract interest in the future when the market recovers. Understanding this, we offer the following concluding thoughts for the City of Surrey's consideration that could help achieve their objective of attracting new office investment over the long term, as well as attracting smaller outcomes in the near-term. This commentary is intended to be high-level, highlighting what we believe to be pursuable paths for the City, while also noting any risks/challenges.

Lack of Incentives is Not Impacting Office Investment

The absence of office development incentives, both financial and non-financial has not, in our view, impacted the ability of the City of Surrey to attract major standalone office investment, particularly from the major office developers active across North America.

. This was not only expressed by nearly all our interviewees but there is considerable evidence from across Canada that shows how little impact development incentives can have in attracting new office investment to suburban office locations. For example, the City of Mississauga has had office incentives in place for some time in the downtown that have not resulted in new investment, whereas smaller scale suburban office buildings continue to occur in other areas of the City where incentives are not available.

Although it is our opinion that financial incentives are not enough on their own to encourage standalone office development, they could play a role in promoting the City of Surrey through marketing and attraction efforts. One thing noted during our interviews was that, even though office developers did not factor financial incentives into their investment decisions, they were keenly aware of which municipalities offered incentives. In this sense, financial incentives could function as a marketing tool for the City of Surrey.

Further, as the Metro Vancouver region has no municipalities that currently offer office development incentives, the adoption of incentives by Surrey could likely begin a race to the bottom amongst all municipalities. Any advantage that the incentives may initially offer, will quickly be nullified when other municipalities pursue similar strategies. On the other hand, should neighbouring municipalities opt to introduce office development incentives, it is likely that the City of Surrey will be forced to follow suit to remain competitive.

Working With Local Developers is Vital

Understanding that large office developers and investors are unlikely to come to the City of Surrey during this period of market softness, working with local builders could be a more likely path to success in the shorter term. Local developers have already shown that they can deliver new standalone office projects at both PCI's King George Hub and Lark's City Centre. They have also shown a willingness to include a smaller amount of office space in the podium of new mixed-use buildings.

However, many of the builders in the local market appear to be exclusively residential developers. This is likely to pose challenges regarding getting these groups to provide office space, particularly space that is thoughtfully designed and aligned with market demand.

PCI Model is an Optimal Outcome in Today's Market

The best outcome to date for Surrey has been the King George Hub community developed by PCI Developments, and in our opinion, the City should be looking to replicate this where possible. To properly replicate this though, it is important to understand a few key points that made this development feasible. Most importantly, the inclusion of two standalone office towers only made financial sense as PCI was granted residential permissions that offset the loss in land value that is typically associated with standalone office development. PCI effectively completed the office towers despite lower financial returns, as it allowed them to unlock residential permissions that provided much higher returns for the entire project.

Additionally, the initial office phase did not begin construction until it had retained Coast Capital Insurance as a preleasing commitment – approximately 60% of the total space. It was expressed to us, by both brokers and PCI, that this commitment was unexpected and not at all typical for the market at that time. PCI expressed considerable reservations regarding the ability to attract another major tenant in such a timely manner in today's market and viewed the attraction of Coast Capital Insurance as simply a matter of good timing.

The second phase of this project did begin construction on spec, although this was just prior to the COVID-19 pandemic, a period in which the outlook for the office sector was at an all-time high. It was expressed to us that such an approach would not be pursued today and that a major preleasing commitment would be required to proceed with a similar phase.

Larger Site Policy Could Bring Standalone Office

A key takeaway from the PCI model is that larger development parcels allow for a greater degree of flexibility concerning land use planning policy. Larger sites allow for a greater diversity of uses, specifically, increased residential densities that are often necessary to offset the negative land value often associated with standalone office uses in suburban contexts. This increased residential floor space allows for the larger mixed-use project to make sense financially, even if the standalone office component would not be in isolation. These models also allow for shared parking in an underground format with residential uses.

However, to compensate for the decline in land value, the residential permissions would need to be significant. Determining the exact ratio of residential to office space is difficult due to the distinctive nature of each project. Nevertheless, considering the financial difficulties related to office development, it is probable that residential uses would need to greatly surpass office uses in scale. For example, even at King George Hub, which was planned and constructed during a period of robust office demand, residential floor area outnumbers office floor area by a ratio of more than 4 to 1. In today's market, it is likely that even greater residential permissions would be required to make this project feasible.

Understanding this, it is unlikely that a smaller site that could only accommodate two towers could support a single residential and a single office tower. In this instance, the single residential tower is unlikely to drive enough land value to support the inclusion of a standalone office tower. A larger site though, which could accommodate multiple residential towers would be better equipped to accommodate a standalone office tower. This suggests that there could be a role for land use policy with regards to large sites in Surrey City Centre as they are best able to accommodate new standalone office development in today's market.

In these larger mixed-use projects, consideration should also be given to the phasing requirements. Given the unprofitability of standalone office development, developers will look to push off the development of office space until later phases in the project, hoping that the market provides some relief in the interim while receiving revenues for residential components first.

The strategy of extracting office uses from large development sites in exchange for residential permissions is expected to yield the most significant outcomes for Surrey in the near to medium-term, as well as set Surrey up for even greater success in the future as the market recovers. However, it is crucial to implement this policy with flexibility, considering the prevailing market conditions at the time. If this approach is overly rigid, there is a risk that the City of Surrey may impede the development of residential uses by rendering sites unproductive. Therefore, a balanced and adaptable approach is necessary to ensure optimal outcomes.

Smaller Office Requirements – Podium Office Space

Other jurisdictions have also pursued planning policies that require the integration of commercial office space within a truly mixed-use building. These types of policies, as opposed to the requirement to build a standalone office tower adjacent to residential uses, are best suited for smaller sites where it is physically infeasible to construct multiple towers. Often this policy sees commercial office space built into a podium level.

In our opinion, these types of policies would not be desirable for the City of Surrey if the long-term goal remains the attraction of standalone office investment. These types of policies will result in lower-quality office space with much more limited market demand coming primarily from population-serving office uses (health services, accounting, legal, etc). By flooding the market with lower-quality and cheaper office space, these policies may even hinder the feasibility of higher-quality standalone office development in the future, as it could suppress commercial lease rates, making new standalone development much more challenging.

Should Surrey opt to pursue these policies, it will be important to accurately gauge market demand. From a design perspective, it was noted that there are significant challenges with building podium office space owing to the spacing of construction columns and the lack of exterior window space. In addition, the development of commercial office space in a podium is often an afterthought for developers, particularly developers with limited experience in building office spaces. Given this, there is likely a role for collaboration between Economic Development and Planning staff to help design space that is more functional and more desirable by the market. Economic Development, in speaking with prospective tenants, will have a better idea as to how this type of space should be built to satisfy market demand. This knowledge could be useful for Planning in producing design guidelines for commercial office space, or at the very least providing this feedback through the development review process, to ensure that the office space that is being produced aligns with market demand.

It will also be important to recognize that attention should be given to the amount of office space that would be required under such an approach. If the requirement is too onerous, it could completely sterilize new development, which is not a desirable outcome.

Identifying Standalone Sites for Future Development

While the discussion to this point has been centred on the idea of extracting office space from mixed-use projects, there is also an approach where prominent sites are identified within Surrey City Centre, with planning permissions limiting them to standalone office uses. Understanding the financial challenges associated with standalone office development, this approach may ultimately sterilize these sites in the short-term in the absence of any assistance from the City. However, such an approach could help lay the groundwork for future standalone office development at key sites once the market fundamentals have changed and Surrey City Centre continues to build out.

Ideally, these sites would need to be immediately adjacent to higher-order transit to minimize the parking requirements and maximize the appeal of the sites to developers. Consideration will also need to be given to the surrounding land use patterns, with sufficient residential uses to activate the immediate surrounding area. This approach should be considered much longer-term in nature.

Continued Investment in Public Realm

One subject that came up repeatedly during our interviews with brokers was the positive steps Surrey has made in recent years to improve the public realm in Surrey City Centre. Despite these improvements though, there remains room for improvement that would go a long way in helping create the necessary market conditions for standalone office investment. Effectively, investing in public realm improvements today would help lay the groundwork for the future, should market conditions shift enough to support new major standalone office development in Surrey.

As noted earlier, a large part of this public realm improvement would be the continued expansion of residential uses in Surrey. Increasing the population density of Surrey City Centre would provide demand for a greater number of community amenities such as retail uses, bars and restaurants, cafes, event space, etc. However, other approaches were suggested during our interviews that could further enhance the public realm improvements. This includes investments in pedestrian flows, public art, green space, recreational facilities, conference centres, etc.

The fundamental idea here is that as Surrey City Centre continues to expand as an attractive residential and commercial hub, the market conditions supporting new office investments will also grow in lockstep. While Surrey already offers an attractive location for investment relative to many other similar suburban market areas, by continuing to expand as an appealing community with ample amenities, it will only further establish the necessary prerequisites for potential office developers to consider investing in Surrey once the market recovers.

A notable illustration of this concept can be observed in Toronto's Liberty Village submarket. This formerly industrial area underwent a transition towards residential usage in the late 20th century as creative professionals sought affordable rents. As the residential development progressed and the population increased, an array of community amenities also emerged. As Liberty Village began to firmly establish itself as a desirable residential community with a wide range of amenities, new office development began to take place. Despite its strong reputation though, office investment has been modest, with the completion of only three standalone office towers: a 75,000 square foot project in 2006, a 97,000 square foot project in 2020, and a 141,000 square foot project in 2020.

The key lesson to learn from this example is that in non-traditional office markets, submarkets must reach a critical mass before office investment becomes likely. Although it is difficult to quantify this critical mass precisely, it appears that the necessary conditions are only met once an area is firmly established in the market as an attractive place to live, with an abundance of amenities to cater to residents' needs.

NBLC has also researched other North American case studies that show similar themes, specifically the importance of a vibrant public realm and a sizable residential population that supports commercial uses. These profiles have been included as an Appendix to this report.

Medical Office Investment Should be Viewed Positively

The City of Surrey has experienced significant investment in population-serving office spaces, including medical offices, as highlighted earlier in this report. Unlike larger-scale office investments, population-serving office uses are distinct in that their location is primarily determined by proximity to the population they serve. The growth of these office spaces in Surrey is directly linked to its rapidly expanding population. Moreover, it's worth noting that medical office uses are less susceptible to broader macroeconomic fluctuations compared to major office uses.

Given Surrey's increasing population, it is likely that population-serving office uses will continue to be attracted to the area. While this investment may be moderate in scale, it is a noteworthy strength for Surrey that should be encouraged. These office spaces will contribute to establishing and enhancing the appeal of Surrey, fostering the development of essential community amenities. As emphasized in this report, these amenities are crucial for creating an environment that is appealing to office developers.

The Roll of the Surrey City Development Corporation

One of the biggest challenges with new standalone office development in suburban communities is the preleasing of space. Owing to the risks involved, it is not unusual for lenders to require a certain level of preleasing commitments prior to issuing construction loans. This is often 40% of total leasable space. For a 500,000 square foot building, this challenge becomes even more onerous, given the limited depth of demand for preleasing class A space in suburban communities.

One strategy the City could pursue to minimize this preleasing risk would be to have the SCDC commit to preleasing a certain amount of space, provided that the developer can prelease the remainder of the required preleasing commitment. For example, if a developer can pre-lease 30% of the space, the SDCC would commit to taking on an additional 10% of the space, helping the developer hit their preleasing lending requirement. The SDCD could then operate the space as co-working space, community amenity space, or they could simply sublease the space to a high-value tenant of their choosing. This approach would shift part of the preleasing risk onto the City and at minimal cost should they be able to sublease the space at a reasonable rate.

Of course, this approach would come with a level of risk for the SCDC as they would be financially obligated to lease a certain amount of space, with no guarantees of returns. However, the arrangements could be structured in such a way as to limit the length of time the SCDC is tied to the lease, with the expectation being that their preleasing commitments would move to new proposed projects should they require similar help with preleasing. A cap could also be placed on the amount of space that SCDC is able to commit to, as opposed to a commitment to a certain percentage of floor space. This would help clarify the program from a financial planning perspective.

Presence of Large Institutional Tenants Could be Leveraged

The presence of institutional and government tenants in Surrey should be recognized as an existing advantage that can be strategically utilized to achieve the City's objectives. It's important to note that these tenants often select locations for non-market driven reasons, distinguishing them from high-value tenants. Due to various factors, such as Surrey's substantial and expanding population, the city has already attracted a considerable number of institutional tenants, who typically have significant space requirements. This is advantageous for large-scale independent office developments, as it can assist them in meeting preleasing requirements that may not be achieved solely through market forces.

In our professional opinion, the SCDC could potentially play a valuable role in this context. Acting as a facilitator or intermediary, the SCDC could foster connections between developers and prospective institutional tenants, thereby promoting the advancement of projects. This would necessitate ongoing coordination with both planning and economic development staff to ensure effective collaboration.

Parking Will Remain Onerous and Solutions Should be Explored

As noted throughout this report, one of the biggest challenges facing suburban office development is the sizable parking requirements demanded by the market. Even with the presence of higher-order transit, most tenants still have sizable parking needs. An office project that can not accommodate these needs is often left at a significant disadvantage. At the same time, the costs of constructing parking are very high with nearly no revenue generated from their uses. This mismatch can often make suburban office projects unfeasible. Understanding this challenge, alternative and creative solutions should be considered by the City of Surrey to provide sufficient parking without challenging the feasibility of standalone office development.

One alternative that could be considered is to pursue a strategy like the City of Vaughan at the VMC. To encourage office development at the VMC, the City allowed the initial office towers to construct part of their parking above-ground as surface parking. As surface parking is significantly cheaper than underground parking, this helped the feasibility of these projects. The intention, however, was that over time as the VMC continued to build out, these surface parking lots would be redeveloped for other uses, either residential or commercial. This solution acknowledges that while there is significant demand for parking in today’s context, as the area continues to build out and fewer residents rely on private automobiles, there would be the ability to reduce parking requirements.

An alternative approach would be for the City or the SCDC to either build or own a municipal standalone parking structure in Surrey City Centre that could help offset project parking requirements and provide parking at a reduced cost. Similarly, the City could own parking space as part of a private development. While it has not yet pursued this strategy, the City of Mississauga has passed a Community Improvement Plan that allows for them to commit funding/equity towards this type of project. While this approach could be feasible, the location of the parking structure would be critical. It would need to be as close to new office development as possible, otherwise, its impact could be marginal.

Appendix – Interview Summaries

As part of this report, NBLC conducted first-person interviews with several major players in the Canadian office market. Below, we have listed the organizations that we were able to speak with, however, these interviews were conducted on the basis of individual anonymity.

- Blackwood Asset Management
- PCI Developments
- Lark Developments
- Ivanhoe Cambridge
- Hines
- Cadillac Fairview
- Northcrest Developments
- Oxford Properties
- First Capital RIET
- North American Development Group
- CBRE
- Colliers
- Carterra Developments
- Michael Heely – Former CEO of Surrey City Development Corporation

From these interviews, a few key points and suggestions were raised. Many of these have been brought up throughout this report, however, many bear repeating in shortened form. In our opinion, the most important points from our interviews are as follows, grouped by theme:

Office Market & Investment Outlook

- General sentiment and outlook for the office sector are grim due to the significant shift to work from home. The longer-term nature of the development process has also meant that new office supply is continuing to come to market, despite demand being at record lows.
- A significant amount of rightsizing going on in the marketplace, which is resulting in a lot of movement. The result is a bifurcation of space, with class B facing more significant challenges than class A space.
- Many players are looking to divest from their office assets, both high-quality and low-quality assets. Very few are looking to purchase existing assets, but those who are, are buying at a very high cap and taking on risk with a longer-term outlook on the market.
- Suburban office is likely to be the most challenged by these negative trends, as the money that is looking to invest in office is only looking for class A space in the most desirable locations.
- The only place that is likely to continue to see new office investment is dense urban communities that have already reached critical mass with population, employment, and amenities. One interview noted

many American markets they are continuing to invest in because they met all these characteristics.

- Even for some of the big, experienced firms, it is challenging to enter new office markets due to a lack of experience.

Office Development

- Job function can determine the type of office space that needs to be built. This can make development challenging in markets with less dynamic employment markets should tenants eventually leave.

- Office space in the podium level often comes with significant challenges due to columns, lack of exterior walls, and additional elevator shafts. Moreover, many developers are not experienced in the development of office space, which results in podium offices being of quite poor quality. In turn, this space can be very challenging to market.

- Parking inclusion often kills the development proforma for any standalone office project. This is a big reason why most office development is centred in downtown areas, where parking ratios can be very low and there is some revenue associated with the parking.

- In larger master-planned communities, the inclusion of single office projects is only feasible because increased residential permissions on the site provides an uplift in land value to offset the negative land value that is typically associated with office development.

- Proceeding with office buildings without significant pre-lease commitments is no longer possible in the market, particularly as financing for these projects has dried up.

City of Surrey / Surrey City Centre

- The reputation of Surrey is improving and continued residential investment is leading toward a more favourable development climate, but all interviewees noted it was still a long way away.

- The office development that has been developed in Surrey should be viewed favourably. Relative to many other suburban communities, this is a good outcome.

- It is likely that Surrey will continue to attract lower-level employees, or back-of-house employees from larger firms, similar to what has chosen to locate in Surrey or Langley recently. Many viewed Surrey as an optimal location for this type of employment given the large population base.

- While transit access should be viewed favourably, Surrey remains an auto-driven market. It is unlikely this changes in the near future.

- The Centre Block project was viewed very negatively as it effectively cannibalized years of Surrey's office demand. It would make private-sector office development even more challenging.

Opportunities to Promote Office / Development Incentives

- Most importantly, Surrey is going to need to continue to build towards a critical mass for Surrey City Centre. The recent residential additions are good, but more needs to happen if the City wishes to attract office investment.

- Community amenities such as public art, green space, community/recreational facilities, event space, etc. will all go a very long way in helping to make Surrey City Centre a more desirable place for new office investment.

- Developers are typically aware of municipal development incentives, but they do not affect development decision making in a significant way.
- Many developers will base their investment decisions around modelling that does not include office incentives, even if they are in place. In their eyes, they are viewed as a bonus. Some incentives, such as TIEGs, help attract tenants with lower rents but do not 'hit' the proforma in a meaningful way.
- Developers will follow the high-value tenants. Incentives don't change this. City should be finding strategies to entice these tenants as developers will build to suit anywhere these tenants locate.

Appendix – North American Mixed-Use Case Studies

NBLC has evaluated master-planned mixed-use redevelopment projects in North America that incorporate a significant employment component. These case studies emphasize the importance of a strong public realm, good transit connectivity, and a significant residential population if the goal is to attract employment uses.

Mueller Redevelopment – Austin, TX

The Mueller redevelopment is a public-private partnership between the City of Austin and Catellus Development Group to redevelop the 711-acre former Robert Mueller Municipal Airport into a mixed-use urban village. The site is located about five kilometres from downtown Austin and three kilometres from the University of Texas at Austin.

In 1996, a Council-appointed 16-member task force called for the creation of a compact, pedestrian-oriented, mixed-use community. A master plan was adopted in 2000 that subsequently led to the selection of Catellus Development Group as the master developer in 2002. For two years following their selection, Catellus and the City of Austin worked to refine the plan and establish the specific terms for the disposition of the airport property within an overall Master Development Agreement.

The Mueller redevelopment broke ground in 2007 and will be home to approximately 6,200 residential units with at least 25% of the units being affordable to households earning less than 80% of the city's median family income. The redevelopment is planning to support roughly 14,500 jobs in medical, office and retail industries, resulting in a ratio of 2.3 jobs per residential unit. The redevelopment will include a total 4.0 million square feet of office and retail space and 140 acres of public open space.

The plan is divided into various districts that include a Town Centre District, comprised of high density residential and commercial office buildings, which will provide a social, cultural and commercial focus for the new community and surrounding neighbourhoods. The plan also calls for the creation of four mixed-use residential districts surrounding the Town Centre that will see the majority of the residential development.

Figure 28 – Mueller Redevelopment Site

In addition to the Town Centre District, the plan designated approximately 120 acres for additional employment uses that promote the City's broader economic development goals, which includes the Dell Children's Medical Centre of Central Texas (the first LEED Platinum hospital in the world), an academic health research campus for the University of Texas at Austin, a grocery-anchored retail centre and the converted hangar buildings that are now used as film production facilities for the Austin Studios.

The first project to begin construction was the Dell Children's Medical Centre of Central Texas. It was built through a partnership with the Seton Healthcare Family (a network of hospitals in the Austin area). This led to another partnership with the University of Texas at Austin to build a new children's health and biomedical research centre. These partnerships helped change the perception of the area and allowed prospective commercial tenants to envision the area's potential as a future economic hub.

Cottle Transit Village – San Jose, CA

Cottle Transit Village is a mixed-use and transit-oriented infill development in San Jose, California. The 332-acre site is located 24 kilometres south of the city centre and is surrounded by three rail transit stations (one commuter rail station and two light rail stations). It was originally developed by IBM in 1956 as its first west coast manufacturing campus. However, in 2002, Hitachi Global Storage Technology (HGST) acquired the site and concluded that the site was too large for its needs, and that consolidating operations on 160 acres would be the best approach for their operations.

In 2003, HGST retained urban planning consultants to evaluate the property and identify value-creating uses for the remaining 172 acres of land. A master plan for the remaining land was created through a collaborative process with the City, civic organizations and local residents. The plan's objectives were to take advantage of the site's proximity to transit and convert an industrial park into a livable workplace and urban village.

In 2005, San Jose's city council approved the master plan that would create a walkable village with three residential districts and two mixed-use commercial centres surrounding the HGST campus. The plan called for 2,930 homes with as many as 3,000 jobs at a ratio of approximately 1.0 job per residential unit. The plan includes a total of 460,000 square feet of retail and commercial space and 17 acres of parks and open spaces. Municipal zoning was converted from industrial to mixed-use/residential to allow for the redevelopment of the site. HGST then took on the role of master developer by evaluating proposals for the sale of development-ready mixed-use parcels.

San Jose was initially averse to converting designated employment lands. As such, it was important to demonstrate to the City the shift in office space demand (and the challenges associated with attracting new office development to a single-use suburban location) and that incorporating residential development would provide ridership for public transit and support job retention, which would result in increased tax revenue for the city.

HGST also funded the construction of a $2.0 million pedestrian bridge linking the village and campus to the adjacent commuter rail station. The construction of the village's green infrastructure – which includes walkable streetscapes, multiuse paths and greenways that wrap around the campus – were also completed prior to any residential development, providing 10-minute pedestrian and five-minute bicycle connections to transit stations.

Lastly, to take advantage of the site's proximity to transit, the master plan included residential densities ranging from 20 to 60 units per acre, with areas closest to transit being built out at TOD densities of 60 units per acre. At the time, this was far greater than typical 12 units per acre seen outside of downtown San Jose.

Figure 29 – Aerial Photo of Former Campus / Cottle Transit Village

Lincoln Yards – Chicago, Illinois

Lincoln Yards is a proposed master-planned, mixed-use development project that will transform 55 acres of former industrial land along the North Branch of the Chicago River into a vibrant riverfront community. The site was home to Chicago's oldest steel mill operating from 1902 until it was demolished in 2012. It also comprises the former City-owned Fleet Management site, as well as other industrial and manufacturing lands.

In 2017, the City of Chicago adopted the North Branch Framework Plan and subsequently rezoned the Lincoln Yards site to facilitate the creation of a mixed-use neighbourhood that promotes economic growth and transit-oriented development. The goal is to maintain the Lincoln Yards site and the larger North Branch Industrial Corridor as an important economic contributor and vital job centre within the city of Chicago.

Real estate developer Sterling Bay began acquiring the Lincoln Yards in 2016 and unveiled its initial vision for the site in 2018. The Lincoln Yards master plan was then created through a community-driven development process and was approved by Chicago City Council in March 2019. The plan calls approximately 6,000 residential units. Of these units, 10% will be affordable. Approximately 21 acres, or roughly 40% of the site, will be developed as publicly accessible open space.

Lincoln Yards is located about a five-minute walk from a commuter rail station and a 10-minute walk from a subway station. While these rapid transit stations surround the site, the connectivity through and to the site is restricted by existing infrastructure barriers. In order to make the site a truly transit-oriented development, Sterling Bay will be investing in significant improvements to the surrounding infrastructure that will see an expansion to the dedicated bike lane network, improved access to the two transit stations and adding new water taxi stops.

The Lincoln Yards master plan also includes several unique districts for the distribution of density, built form and use. This includes a riverfront edge, a vibrant commercial corridor, a large central park and a transitional neighbourhood edge. The majority of office development will primarily be located along the commercial corridor. The plan places great emphasis on the importance of human-scale and an activated ground floor throughout these different character zones by developing smaller-scaled blocks allowing for a pleasant walking experience.

In terms of phasing, commercial development along with infrastructure improvements are expected to occur prior to any residential development. Two new office buildings and a shared parking garage are currently proposed as the initial phase of Lincoln Yards.

Figure 30 – Lincoln Yards Redevelopment Master Plan

Playa Vista – Los Angeles, CA

Playa Vista is a master-planned community that includes a mix of residential, commercial and retail uses located at the western edge of Los Angeles, California. Prior to the development of Playa Vista, the area was home to the former Hughes Aircraft Company manufacturing plant from 1941 to 1985. After its closure, the Summa Corporation (heirs to Howard Hughes' business interests) planned a massive redevelopment for the 1,087 acres of lands. The plan would include high-rise office buildings and hotels, with a major shopping mall and a new road connection that would divide existing wetlands. This led to strong political and community opposition backed by trends in new urbanism which were emerging around the same time. Part of the backlash was driven by the proposed residential uses that were expected to significantly increase traffic congestion in the area.

Summa eventually sold the lands and a revised plan was developed through negotiations with the City and the new land owners. Traffic congestion was a key issue in securing entitlements, which resulted in a revised plan that contained a balance of residential and employment uses in order to keep the traffic impacts somewhat consistent with the former manufacturing use. The revised plan also preserved the designated wetlands.

Playa Vista began redevelopment in 2002 and is now a thriving live-work-play community. Located within an area referred to as Silicon Beach, Playa Vista has evolved into one of the high-tech hubs of Los Angeles which includes companies such as Google, Yahoo, Microsoft, Facebook, YouTube, IMAX and many others. The area is expected to be home to 6,500 residents.

The key takeaway from the Playa Vista development is that the area was planned for a mix of uses at the outset. Incorporating residential uses not only helped mitigate potential traffic issues, it also helped create a thriving employment hub where approximately 50% of employees live within five miles. Although only about 10% of Playa Vista residents work in the area, this is still a significant amount in comparison to the rest of Los Angeles where the majority of people commute to work.

The fine-grain, vertical mixing of residential and commercial uses was challenging. As such, the residential and commercial uses were horizontally separated in Playa Vista. This approach to separate office buildings from residential homes was successful due to an inviting public realm that allowed for a walkable community. The mix of housing types and built forms at different market points was also important for absorption rates and build out time.

Interviews with Playa Vista developers revealed that the front ending of retail should have been completed before any of the residential or commercial development to ensure that services were in place for new employees and residents. If done again, Playa Vista developers would have subsidized retail uses at the outset to stimulate investment.

Figure 31

Key Themes from Case Studies

The following summarizes the key strategies that emerged from the precedent analysis

Housing is Important for Attracting Businesses

Areas that seek to attract high density employment uses need to offer housing within close proximity. Each of the examples that NBLC reviewed had a significant portion of land dedicated to residential development in order to create live-work environments that help attract a workforce. This trend is also evident for established business parks such as Hauppauge Industrial Park in Long Island and Tysons Corner in Virginia. Both of these suburban office parks are seeking to add residential density in order to become regional economic hubs.

Transit is a Catalyst for Redevelopment

Transit is viewed as a critical amenity to attracting the broadest possible labour force. As seen in the Cottle Transit Village example, the presence of multiple transit stations, with connections to an established downtown, were critical in unlocking opportunity and helping create a vision for the area as a future economic hub.

The Importance of the Public Realm

A major component for the success of transit-oriented development is the ability to walk and cycle to transit stations. As such, many of the transit-oriented precedents illustrate the importance of investing in pedestrian and bicycle connections to transit stations prior to any office or residential development to ensure easy accessibility in and around the community.

Office and Retail Uses Should Come First

Along with infrastructure improvements, commercial uses such as office and retail tend to be developed prior to residential uses. As seen in the Mueller Airport redevelopment, a regional retail centre and large medical centre where among the first buildings to begin construction in order to stimulate investment at the outset. This approach is also being used in the Lincoln Yards redevelopment where two office buildings will be part of the initial phase of the project. Although this was not done at Playa Vista, interviews with the developers revealed that, in hindsight, they would have subsidized retail uses at the outset to stimulate investment.

Residential and Commercial Uses can be Separated into Different Districts

A theme that emerged from all of the precedents is the separation of residential and employment uses into different districts. The research found that many of the master plans had a central commercial district that would be the primary area for office development. These districts tend to be closest to transit stations and would accommodate high density office and residential development. Surrounding these districts are areas designated for mixed-use residential development. However, this is only successful if the entire project is developed through smaller-scaled blocks with animated streetscapes to create a walkable community.

Partnerships with Post-Secondary and Medical Institutions

Partnerships with post-secondary and medical institutions were a key strategy for many of the precedents in attracting modern jobs in medical research, technology and innovation. As seen in the Mueller Airport redevelopment, a partnership with a local healthcare network was established to build the Dell Children's Medical Centre of Central Texas, which led to another partnership with the University of Texas at Austin to build a children's health and biomedical research centre. Both of these initial partnerships helped drive residential development and the overall character of employment development at Mueller.

Similar partnerships have been established in other communities to transform underutilized industrial areas into innovation districts where educational institutions, medical centres, start-ups, incubators and entrepreneurs can align and coexist. Some examples of innovation districts include the Cortex Innovation Community in St. Louis, Missouri, SkySong Innovation District in Scottsdale, Arizona, I.D.E.A. District in San Diego, California and University City in Philadelphia, Pennsylvania.

Post-secondary institutions typically play one of two roles in the development of innovation districts. The first model is when an innovation district that is under development is looking for a strong post-secondary institution to be an important anchor in the development. This typically requires the university to build a satellite campus which serves as a helpful driver for growth in the creative, innovation and technology sectors. The second model is when a university is looking to build an innovation district on its premises and utilizes its land holdings (or acquires land) for commercial/residential development to attract start-ups and entrepreneurs.

However, the objective of both is the same: to leverage the presence of a research university to attract young talent to the area. That talent is developed by the university and then connected with outside businesses and networks that help lead to entrepreneurship within the district. Ultimately, partnerships with post-secondary institutions help stimulate residential and commercial development that will create a live-work community for the local area's growing creative and technology workforce nblc

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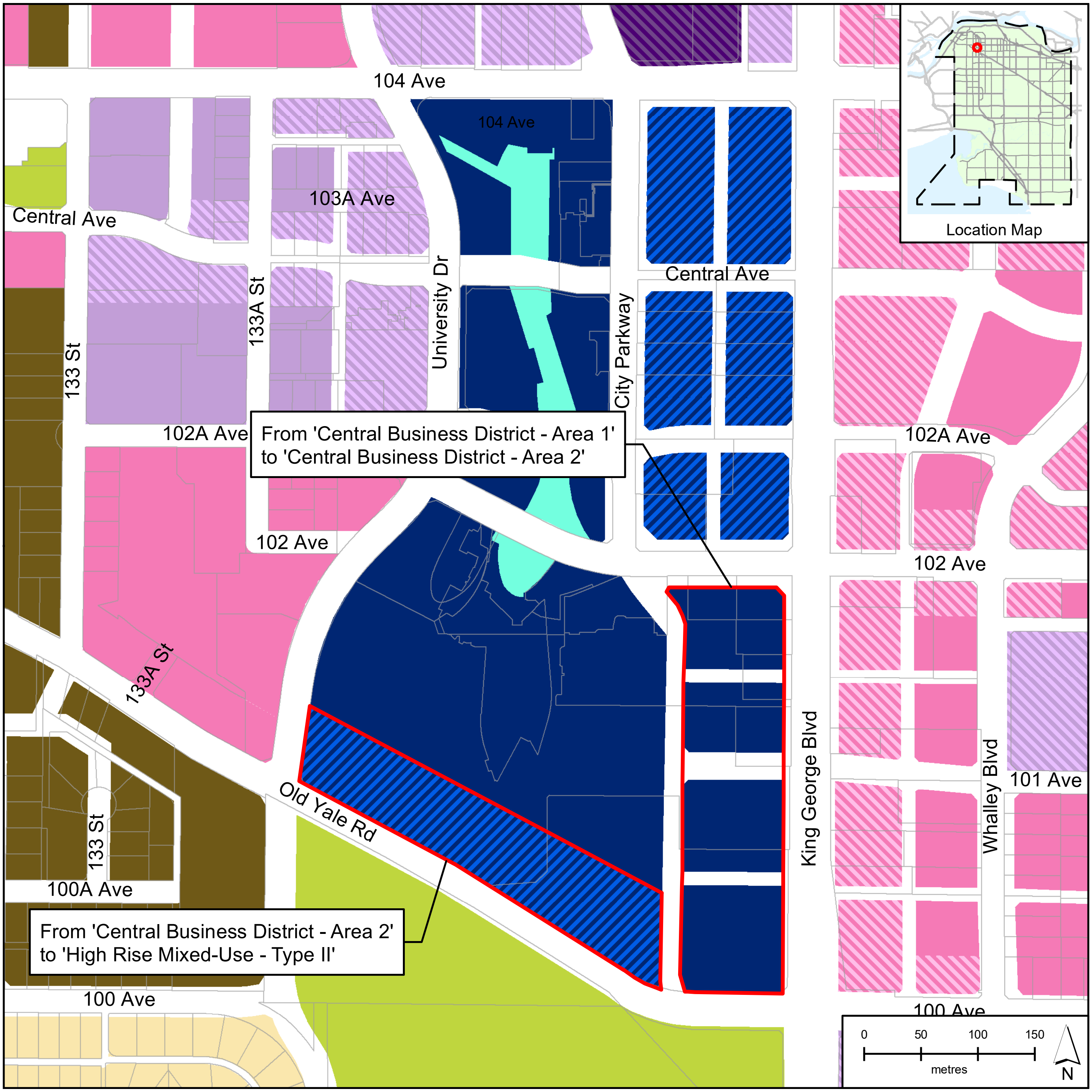
Proposed Amendments to the Central Business District Designations



LEGEND

- Central Business District - Area 1
- Central Business District - Area 2
- High Rise Residential - Type I
- High Rise Mixed-Use - Type I
- High Rise Mixed-Use - Type II
- Mid to High Rise Residential
- Mid to High Rise Mixed-Use
- Low to Mid Rise Residential
- Urban Residential
- Park
- Plaza
- Proposed Land Use Amendments

CITY OF SURREY

Planning & Development Department

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