COUNCIL REPORT

Edmonton

OFFICE TOWER CONVERSIONS

Recommendation

That the October 31, 2023, Urban Planning and Economy report UPE01864, be received for information.

Requested Action		Information only	
ConnectEdmonton's Guiding Principle		**ConnectEdmonton Strategic Goals**	
CONNECTED This unifies our work to achieve our strategic goals.		**Urban Places**	
City Plan Values	LIVE		
City Plan Big City Move(s)	A Rebuildable City	**Relationship to Council's Strategic Priorities**	Economic Growth 15-Minute Districts
Corporate Business Plan	Transforming for the Future		
Council Policy, Program or Project Relationships	• Bylaw 15200 - Capital City Downtown Area Redevelopment Plan		
Related Council Discussions	• July 11, 2023, UPE01577, Cost Sharing Partnerships with Organizations to Increase Small-Scale Community Amenities, Recreation and Leisure Spots in the Downtown Area, Community and Public Services Committee. • October 31, 2023, UPE01836, Downtown Community Revitalization Levy (CRL) Financial Incentives, Urban Planning Committee.		

Previous Council/Committee Action

At the April 4, 2023, City Council meeting, the following motion was passed:

> That Administration work with external stakeholders (e.g. UDI, BOMA, CHBA-ER, DBA, DRC, NAIOP, Chamber of Commerce, etc.) to discuss recommendations for increasing the number of new residential and/or hotel units in downtown Edmonton, focusing on:

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1. Refurbishment of existing residential or conversion of existing office spaces
2. Potential for legislative changes or financial incentives to better achieve this goal

Executive Summary

- The conversion of existing office spaces to residential is beneficial to core areas but can be challenging to accomplish.
- The majority of stakeholders have indicated that conversions are not currently financially viable. A financial incentive of $75-$100 per square foot would encourage conversions.
- Regulatory or legislative changes are not required for office conversions.
- Several Community Revitalization Levy (CRL) projects are nearing completion and others are committed. These are fulfilling their intended effect of encouraging development (one highrise is being built on the edge of Warehouse Park and others are planned).
- More incentive information is provided in the Urban Planning and Economy report, UPE01836 Downtown Community Revitalization (CRL) Financial Incentives Funding Program, also on the October 31, 2023, Urban Planning Committee meeting agenda.
- Industry stakeholders stated that there are enough hotel rooms for the current market.
- Building refurbishment into non-market housing is currently financially supported by the City through the Affordable Housing Incentive Program.

REPORT

Increasing the number of people living in the Downtown neighbourhood is a key component of the Capital City Downtown Plan, Downtown Vibrancy Strategy and The City Plan. The goal of these plans is to establish a thriving and active downtown, with workers, visitors and residents. When enough people live, work and visit downtown, it creates the critical mass needed to support not only office buildings but retail, hospitality, tourism, art and food services. Additionally, more people living downtown improves safety and security by putting more eyes, and activities, on the street.

The City has several tools that can influence the pace and volume of new residential development, including regulatory measures, infrastructure investments and financial incentives.

Administration conducted interviews with eight industry organizations, including all those listed in the original motion, and 17 individual companies involved in downtown development, office conversions and real estate. The list of stakeholders and the What We Heard report are available in Attachment 4.

These stakeholder discussions have informed this report as well as the October 31, 2023, Urban Planning and Economy report UPE01836, Downtown Community Revitalization Levy (CRL) Financial Incentives Funding Program.

Background

Downtown office buildings reached a peak valuation in 2014 and since then have seen a reduction of $3 billion in assessed value (or approximately half of the total value). This reduction redistributes the tax burden to other non-residential properties throughout the city. This has been partially offset by the construction of the new buildings, Edmonton Tower, Enbridge Centre and Stantec Tower, which has added $0.9 billion for a net reduction of $2.1 billion.

These three major office buildings built in Downtown Edmonton delivered more than 1.8 million square feet of new office space to the market. This, coupled with slow or negative absorption of office space, has resulted in an elevated vacancy rate which, as of Q2 2023, ranged between 21-24 per cent in the downtown submarket. This represents 3.6 to 3.9 million square feet of available space[1].

Current Conditions

Edmonton's Downtown office vacancy rate of 21 to 24 per cent is the third highest among major centres in Canada, (behind London and Calgary). Nationally, the vacancy rate is 18.1 per cent[2]. Stakeholders (industry organizations and individual companies, detailed in the Community Insight section) considered a balanced office market to have a vacancy rate of between five and 10 per cent. To reach 10 per cent vacancy in Downtown Edmonton, 1.8 to 2.3 million square feet of office space would need to be occupied, demolished or converted to other uses.

High vacancy rates in the office market tend to lead to lower office rental rates. Higher office vacancy rates and lower office rental rates combine to reduce the values of office buildings. Should the trend to remote/hybrid work continue, office vacancy rates may continue to increase as businesses reduce the amount of space required.

Potential for Office Conversions

Converting office space to residential has the potential to reduce the amount of vacant office space, increase the number of people living Downtown and provides an opportunity to upgrade energy efficiency measures. More people living Downtown will result in increased demand for retail and food services. More activity and vibrancy will also improve perceptions of safety.

Stakeholders identified several additional benefits unique to office conversion that do not apply to newly built residential:

- The reuse of existing building structures, and their embodied carbon, are considered to be more sustainable.
- Conversion projects usually deliver new housing stock faster than new builds.
- Rents in converted buildings are often lower than in newly built buildings (from stakeholder observations).
- Reduced office vacancy supports the viability and valuations of the remaining office buildings.
- Conversions typically introduce a variety of styles and unit sizes to the market, offering greater choice to residents.

However, converting offices to residential units does not contribute as much to tax base growth as does new construction, nor do they directly contribute to the development of vacant land or

[1] Office market figures are drawn from publicly available Market Reports published by Avison Young, CBRE, Colliers, Cushman & Wakefield, and JLL.
[2] *Vacancy Rates and Sublease Listings Rise in Second Quarter as Canadian Office Markets Grapple with a Perfect Storm*. CBRE Canada. July 4, 2023.

surface parking lots - priorities for Downtown as described in the Capital City Downtown Plan, Downtown Vibrancy Strategy and The City Plan.

Edmonton's Office Conversions

Since the late 1990s, at least 16 buildings in Edmonton's downtown have been converted from offices to other uses, including four since 2017, see Attachment 1. Before conversion, these buildings experienced a high vacancy rate or were functionally obsolete. These buildings and hotels make a positive contribution to downtown vibrancy.

Several factors are needed to ensure an office building is convertible to residential. The most significant factor is the size of the floor plate, which is the square footage and size and shape of floors within a building. Generally, a large floor plate will result in long, skinny apartments. Floor plate size and shape determine the utilization rate (the amount of office space that can be converted to residential). Hallways, service areas, elevators and lobbies can influence the percentage of space that gets used. Building location, the condition of building systems and parking availability also contribute to making a building more or less suitable for conversion.

Discussions with stakeholders and a high-level study of the existing office building stock suggest that there are between two and ten buildings that could be converted to residential. These buildings could add 350 to 1,400 residential units, which would reduce the Downtown office vacancy rate by two to seven per cent (290,000 to 1.1 million square feet). Stakeholders indicated that the current economic climate makes converting office buildings challenging. The high costs of acquiring property, unprecedented construction costs and the increased cost of borrowing due to higher interest rates make their financial feasibility extremely difficult. As well, since rental rates are still lower in Edmonton when compared to other major cities, stakeholders stated the cost to build outweighs the expected return on investment. The majority of stakeholders were in favour of a financial incentive to overcome the current financial obstacles to office conversions.

Fiscal Impact of Conversions

The impact to property assessments and taxation of converting office space to residential units is complex. At the individual building level, a converted and fully-occupied residential building has a higher assessment than the building would as vacant office space. However, converting the use to residential also entails switching from non-residential tax rates to residential tax rates, which are approximately three times lower. Therefore, any tax uplift from these properties is less than for new builds and, in some cases, could be negative, depending on relative assessed values. An illustrative example of a potential conversion is included in Attachment 2.

Conversion to residential would theoretically bolster the assessment of other buildings that remain offices, as they may experience reduced vacancy rates, which is part of an income approach to valuing the building for assessment purposes. All else being equal, this would result in higher assessments of buildings within the same class. However, many factors go into assessing office buildings, including rental rates, operating costs, and capitalization rates, so there is no guarantee that other office buildings' assessments would change, just because a nearby building was converted to residential.

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Similar to any incentive program, an analysis of the net fiscal impact to the City depends on the assumptions that the office conversion would not have taken place without the incentive and that the creation of additional housing supply does not disincentivize developers from moving forward on their development intentions downtown or elsewhere in the city.

Conversions to Hotels

Hotels are valuable contributors to downtown vibrancy. They provide accommodation for tourist and business travellers and they host a range of events that bring activity downtown. There is precedent for converting office buildings to hotels in Edmonton (e.g., Matrix Hotel, Courtyard by Marriott Downtown), demonstrating that hotels can be a viable option for reusing office buildings when market conditions are supportive.

Stakeholders familiar with the hotel development market in Edmonton indicated that outside of peak times (e.g., large conventions, high-profile concerts), there is more than enough hotel capacity. Overall, hotel occupancy in downtown Edmonton from January to May 2023 was 53.4 per cent[3]. In the previous year, January to May 2022, it was 40.9 per cent and for January to December 2022, it was 48.2 per cent.

Stakeholders indicated that the current demand for hotels, in combination with the ongoing difficulty of securing financing for hotel development, makes new hotel construction unlikely.

Financial Incentives for Office Conversion to Residential

Affordable Housing Investment Program (AHIP)

The City currently offers the Affordable Housing Investment Program (AHIP), which funds up to 25 per cent of the construction costs of the affordable housing component of a project. Since 2020, it has funded 1,159 affordable units across 16 projects throughout the city. Projects within the Downtown areas are eligible to apply to this program..

Canada Mortgage and Housing Corporation Programs

Canada Mortgage and Housing Corporation (CMHC) currently offers a financing program called “MLI Select,'' which offers preferential financing terms to projects that provide typically 25 per cent of units as affordable. Much of the rental development underway across Edmonton today is accessing this program and stakeholders indicated that new Downtown projects would likely access this program.

The CMHC also offers low-cost loans to eligible borrowers for building rental apartments through the Rental Construction Financing Initiative. The loans start at a minimum of $1 million and allow a maximum of up to 100 per cent of the Loan-to-Cost. This program does not support retirement homes, single-room occupancy or student housing, but otherwise provides funding during the most risky phases of development (that is, from construction to operations). These loans have 10-year terms with a locked-in fixed interest rate and a 50-year amortization period. There are criteria for affordability, accessibility and energy efficiency attached to this program.

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[3] Government of Alberta Accommodation occupancy rate dashboard: https://economicdashboard.alberta.ca/dashboard/accommodation-occupancy-rate/

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Community Revitalization Levy Incentives

Many Community Revitalization Levy (CRL) catalyst projects are nearly complete, such as Warehouse Park, the renewal of Beaver Hills and Michael Phair Parks and the public realm components of the Station Lands development. These catalyst projects are intended to stimulate new developments for the areas around these parks. Conversations with stakeholders indicated that the most effective use of municipal funding is to support the demand for living downtown by improving safety and security (stakeholders' primary concern), and providing new and enhanced amenities.

Administration will continue to support the development and renewal of Downtown community amenities through policy and zoning incentives, new infrastructure such as parks and improvements to amenities and the public realm, and community enhancement programs like those supported by the Downtown Vibrancy Strategy. These initiatives were described in the July 11, 2023, Urban Planning and Economy report Cost Sharing Partnerships with Organizations to Increase Small-Scale Community Amenities, Recreation and Leisure Spots in the Downtown Area.

Possible Incentive Structure

A financial incentive for residential development could be structured to benefit both office conversions and new construction. Administration continues to monitor the federal and provincial governments' responses to the housing crisis. Incentive or debt relief programs from other orders of government would be welcome, and Administration is open to cooperating in programs that address the housing crisis, for both affordable and market housing. The estimated costs and outcomes of an incentive grant for market residential are outlined in Attachment 2 of UPE01836.

A per-square-foot grant (rather than a tax rebate) is the stakeholder-preferred structure for a residential development incentive. This incentive could apply to office conversions, new construction or both. A per-square-foot is easy to understand, is recognized by lenders and reduces upfront capital requirements for developers.

For the City, this type of incentive is relatively easy to administer, the grant amount is known upfront and, if paid at occupancy, there is no risk that grant payments would go to projects that do not reach completion. The costs of an incentive grant would be significant to the City. Most stakeholders indicated that $75 per square foot would be a meaningful incentive that would make new development viable. Different responses ranged between $40 and $100 per square foot.

Legislative Changes

Stakeholders provided feedback on the need for legislative or regulatory changes that would help to increase the number of office conversions. In general, zoning, permitting and other regulatory requirements were not seen to be a deterrent to conversion. Some stakeholders highlighted Edmonton's strengths in these areas. These comments are validated by the City of Edmonton ranking of number one out of twenty-one Canadian municipalities for speed of approvals, cost of development permits and the number of planning features available, according to the Canadian Home Builders Association's 2022 Municipal Benchmarking Study[4].

Stakeholders suggested greater support in resolving building code and space challenges with waste collection for residential vs. commercial would be helpful actions from the City.

Residential Refurbishment

In discussions with key stakeholders and industry, there was little mention or desire for an incentive for the refurbishment of residential units. Refurbishment of market housing occurs frequently without City intervention. It generally results in higher rents being charged.

Refurbishment of non-market housing, or transitioning from market housing to non-market housing, is already financially supported by the City through the Affordable Housing Investment Program (AHIP).

Budget/Financial Implications

The costs of an incentive program have not been included in the 2023-2026 Operating Budget. If Council wishes to advance a financial incentive program, Council should articulate the intended outcomes and direct that an unfunded service package be included in the 2024 Fall Supplemental Operating Budget Adjustment process. Depending on the scale of the program, the service package would contemplate resourcing requirements to administer the program.

Should Council wish to provide an incentive for mixed-market residential development, for conversions or new builds, report UPE01836 provides information on the potential effects of differing incentive amounts.

Community Insight

Administration conducted interviews with eight industry organizations (including all those listed in the original motion) and 17 individual companies involved in downtown development, office conversions and real estate. City of Calgary staff were also interviewed about their office conversion program (Attachment 3). Stakeholder insight has been supplemented by quantitative research into the downtown office market and a search of articles and news reports about office conversions. The list of stakeholders and the What We Heard report are available in Attachment 4.

Stakeholder insights have informed the discussion of current market conditions and the evaluation of options for residential development incentives as discussed throughout this report. This included both financial and non-financial incentives, options for grant structure and amounts.

GBA+

Edmonton's Housing Needs Assessment (included in the September 26, 2022, Community Services report CS01088, Updated Affordable Housing Strategy) explored available quantitative data supplemented with qualitative data from engagements with the housing sector and people

[4] Canadian Home Builders' Association. 2022 CHBA Municipal Benchmarking Study. 2022.

with lived and living experience to determine the overall need for affordable housing in Edmonton and how housing need disproportionately impacts different segments of Edmonton's population. Data that is disaggregated by gender, race, disability, age and other grounds can reveal patterns of structural inequality. The 13 priority population groups considered for the Housing Needs Assessment are as follows:

- Women and children fleeing domestic violence
- Female heads of households, especially single mothers
- Seniors aged 65+
- Young adults aged 18-29
- Indigenous peoples
- Racialized people
- Recent immigrants, especially refugees
- 2SLGBTQ+ (two-spirit, lesbian, gay, bisexual, transgender, queer/questioning and plus) community members
- People with physical health or mobility challenges
- People with developmental disabilities
- People dealing with mental health and addictions issues
- Veterans
- People experiencing homelessness

When considering housing options, each priority population group will have different needs and considerations. Most people do not fall into a single category; it is important to recognize that intersectional identities of multiple individuals within households can influence housing needs..

Attachments

1. List of Downtown Office Conversions
2. Conversion Impact on Assessment and Taxation
3. Calgary Office Conversion Incentive Program
4. What We Heard Report and Stakeholder List