

What We Heard Report

UPE01864 Office Tower
Conversions and
UPE01836 Downtown
Revitalization Levy (CRL) Financial
Incentives Funding Program

October 2023

Urban Planning and Economy,
Economic Investment Strategies

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SHAPE OUR CITY

Edmonton

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Land Acknowledgement

We respectfully acknowledge that we are located on Treaty 6 territory and the traditional Metis homelands of Region 4. Edmonton owes its strength and vibrancy to these lands, and the diverse Indigenous peoples whose ancestors' footsteps have marked this territory, as well as settlers from around the world who continue to be welcomed here and call Edmonton home.

1 Introduction

This report reflects the stakeholder engagement that was conducted to support the writing of two motions. Since both motions would require engagement with the development industry, Administration decided that in the interests of efficiency engagement would be conducted simultaneously.

UPE01864 Office Tower Conversions

That Administration work with external stakeholders (eg. 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:

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

UPE01836: Downtown CRL Financial Incentives Funding Program

That Administration return to Committee with a report outlining:

1. Options for a program of financial incentives funded by the Downtown Community Revitalization Levy (CRL) to support new mixed-market residential development in the Downtown neighbourhood, including options for payment structure (e.g. tax incentives or per door incentive) and funding options; and
2. Opportunities and potential uplift of prioritizing drainage infrastructure in the Downtown Community Revitalization Levy (CRL)

2. What We Heard

Major Themes

Although engagement with industry stakeholders was not entirely uniform, some common themes emerged. Note that this report represents the opinions and perspectives of the stakeholders. These have not been validated or confirmed by empirical evidence or further research.

Current Residential Rental Market

- The condo market is not expected to rebound for at least five years.
- There was steady leasing activity throughout 2022, nearing full occupancy by the end of the year. Universities, international students likely contributing.
- The work from home trend will continue. Tenants will renew for less space, and vacancy will go up.
- In 2018 there was a premium for rentals Downtown. Now it's a discount.
- Rent gets set by what the tenants are willing to pay, based on hundreds of people making decisions. Right now people will pay more to live elsewhere in the city.
- We haven't returned to pre-Covid activity levels Downtown.
- Land value prices haven't softened, but there haven't been many sales.
- Oliver feels more like a community than Downtown. City needs to bring the same momentum to Downtown.
- Student housing is a growing opportunity.
- Not a question of if units will get absorbed but how long it will take and what rents will be.
- Lots of rental products are currently being built Downtown. Cautious to see how lease-up goes.
- Downtown rents are lower, possibly due to safety concerns.

Construction Costs are Increasing

- Construction costs have increased due to supply chain challenges and skilled labour/trade shortages.
- Financing costs and debt financing have increased due to rising interest rates.
- Operating costs have also increased (utilities, property taxes, insurance).
- Building downtown is more complex:
 - Road closures
 - Crane access
 - Laydown is more difficult
 - Parkades add cost
 - More neighbours
 - Added step of Edmonton Design Committee

Investment Climate

- The “math” for building does not make financial sense at this time.
- Most large developments are built with institutional investors in mind. Investors in particular have a perception/concern about vibrancy/safety in Downtown Edmonton.
- Edmonton is less attractive to institutional capital than other centres at the moment.
- Without intervention, Edmonton’s growth is going to focus on developing areas.
- Money will go where it gets a return. Edmonton is known as a tough place to develop.

Incentives for Affordable/Mixed Market Housing

- Stakeholders support providing affordable housing and would like the City to do it in the most efficient way possible.
- Some stakeholders were not interested in providing mixed-market housing. Others would consider it if the incentives were sufficient.
- More of an incentive would be required to get affordable housing than market housing.
- There is interest from institutional investors in affordable housing - ESG perspective and low risk, predictable revenue stream.
- There are examples of mixed markets working well, but it can be hard to lease market units if there’s a five to eight per cent vacancy overall.
- Success requires non-profit housing providers to partner with experienced developers, combining their expertise.
 - Pairing groups up is complicated - is there a role for the City?
 - The Resolve Campaign in Calgary was cited as a successful example.
- MLI Select is a popular program but hard to make it work Downtown and with high-rises.
- AHIP is hard to use, with requirements for bonding, surety on your project.
- AHIP Downtown requires a financial commitment to acquire land and you have to spend hundreds of thousands on design and rezoning just to be in position to apply for a grant that you might not receive.
- Some stakeholders felt that CMHC’s MLI Select program is successful in providing affordable units and the City doesn’t need to intervene.
- If you build new units, people move up, and older projects end up cheaper.

Office Conversion - Current Office Market

- People aren’t returning to work Downtown. Converting office space helps with property tax distribution and public safety/vibrancy.

- Flight-to-quality investment in the office market has been happening since 2015.
- Several office buildings are becoming functionally obsolete. Rents can't cover mortgages, and owners are being forced to sell.
- Buildings getting sold for 20 cents on the dollar will set an unwanted precedent for appraisals, lenders.

Office Conversion - Potential Scope and Challenges

- Office conversions are more complex than they seem at first. Retrofitting can be costly and tricky but sometimes get to market faster than a new build.
- There is a risk to not knowing what safety codes upgrades will be required. It could be helpful to have dedicated safety codes staff to provide guidance for potential conversions.
- Older buildings might not have parking, and it's hard to market a residential building with no parking.
- There are only a few good candidates in the core (2 to 10).
- Some stakeholders noted that there are more if you expand the boundary beyond downtown (eg. to 124 Street), but other stakeholders felt the program should be targeted to Downtown to create a critical mass.
- Institutional office owners probably won't be doing many conversions.

Office Conversion - Benefits of Conversion

- Office conversions can result in new units quickly.
- According to the developer, rent is sometimes less expensive than in a new building.
- The City could also consider conversions to university housing, which would bring additional residential demand to Downtown.
 - Arts spaces were also mentioned as a conversion use that would bring vibrancy.

Office Conversion - Financial Incentives

- There is developer interest in conversions (especially with an incentive).
- The Calgary grant program made developers prioritize conversion projects.
- People who have the ability to do conversions are getting attracted to other cities (Calgary).
- If the City offers a grant, the price of acquiring older office buildings might go up.
 - Other stakeholders did not expect this to be an issue.
- There's more opportunity to get more out of a grant program if it includes new builds.
- Mixed opinions on whether a grant should be:
 - Only for office conversions
 - Only for new builds
 - Open to both

Comments on Hotel Market and Value of an Incentive

- Demand for Downtown hotels is largely business trade driven. With work from home there's less business.
- Hotels are great for vibrancy, tourism and economic development.
- Hotels have no feasibility right now. Edmonton is oversupplied with hotels for at least five to seven years.
- During major events, our hotels are at capacity and visitors have to seek rooms outside the City.
- COVID has hit the hospitality industry hard.
 - Another year of recovery may give a clearer picture.
 - Super unstable demand because you can't build your business around peak times.

- We're in a cycle where hotels aren't worth much. It would have to be a very heavy subsidy, and it would just increase vacancy.
- No harm in including options for hotels - if the goal is vibrancy, why not include hotels?

Financial Incentives - Amount

- During interviews, \$75 sq foot (as per Calgary's program) was considered to be effective.
 - This would represent one-third to one-half of conversion costs.
- Conversion costs would be similar between Edmonton and Calgary. Calgary would see higher rents.
- Following our interviews, multiple stakeholders suggested \$100 sq foot would be more effective, at a suggested commitment of \$100 million by the City.
- Other developers suggested that an amount smaller, such as \$60 sq ft, would still be useful or even smaller amounts to just cover concrete and rebar (\$40 sq ft).
- A higher incentive will make more conversions happen.
- Office conversions have more risks, and \$75 covers those risks.
- One developer indicated \$15,000 to \$20,000 per unit would make a difference.
- Per door subsidies would skew developers to provide smaller units to maximize the grants.

Financial Incentives - Structure

- Generally, a financial incentive was considered more effective than a tax rebate; however, some developers would be happy with a tax rebate.
- Grants are more useful the earlier they can be accessed in the development process.
- Tax grants don't help with upfront costs.
- Any grant program needs to be accountable and have a reporting mechanism.
- Developers who have recently completed conversion projects expressed annoyance at not being able to participate in a future incentive.
- A tax freeze incentive would need to be 10-15 years in length.
- Lenders/underwriters won't be moved by tax freeze incentives.
- One stakeholder proposed a stabilization/occupancy guarantee where the City would guarantee revenue for up to X per cent occupied. Support would taper off as the units lease up.
- Consider focusing an incentive on a smaller area to build a critical mass.
- Several stakeholders suggested that any funds should be spread across multiple projects, not consumed by one or two large ones.
- Ensure that milestones are built into the incentive, that the developers have to meet and/or pay the incentive only on completion of the building

Non-Financial Actions the City could take

- Needs to be a push to bring people Downtown.
- Incentivizing employers to bring their workers back downtown helps retail, which helps residential.
- Address crime and safety concerns, cleanliness.
- More people Downtown will help with feelings of security.
- City needs to take leadership on safety and security. People can't enjoy amenities without safety.
- Sidewalks are crumbling Downtown. Why is there no neighbourhood renewal? The pedestrian experience makes a difference to enjoyment and perception of safety.
- Amenities need to run parallel to any incentive.
- We need parks, rec centres, basketball courts, family-friendly amenities, public washrooms, dog parks, grocery stores and other retail. Downtown isn't a 15-minute community yet.
- More support for vibrancy, festivals, etc.
- Market Downtown as a good place to live.

Regulations and Legislation

- Requirements for ground floor commercial should be re-evaluated or the City could “de-risk” it (i.e. tax write off for commercial/retail ground floor) or be more flexible on short-term uses on the ground level.
- Generally, the permit process was not a problem. However, some zoning can be a hindrance (i.e. certain DC zones).
- Regulatory/permitting process has been smooth. Edmonton offers an advantage in this regard compared to other markets.

Utilities

- Working with EPCOR to upgrade water servicing is a challenge. No cost-share program. As EPCOR began work, issues were found with the existing infrastructure, failing because of old age. Led to increased costs. Creates burden on contingency - all costs to the developer.
- Challenge with Waste Services in conversion. Separate rooms are required for commercial and residential waste. With a conversion, it's hard to find space for a second garbage room in an existing building. Would rather contract private collection for residential waste.
- Current situation where the first developer pays all the bills for utility upgrades can be a big issue.
- It's a site-by-site conversation. You don't know until you get there what the issues will be. Could be that there are no costs or could be a million dollars.
- EPCOR policy for sub-meters add significant costs.

Other Comments

- Smaller, wood frame buildings are less risky and less costly than high-rises, but many developers are holding out for a high-rise.
- Wood frames are quicker to market. High-rises are slow, and you might see multiple business cycles by the time it opens.
- Agreement that more people living downtown would create vibrancy and improve the commercial viability.
- Any barrier to people coming Downtown (eg. parking rates) is not going to help recovery.
- General acknowledgment that Oliver is doing well and responding to the market.
- Skeptical that there would be much uptake from families for three bedroom units. More likely to be three students sharing the unit if the building is near a post-secondary or easy transit.
- Don't see why the City would have a role in refurbishment. If it's about energy efficiency, that's more a federal/provincial issue. Any refurbished product is going to be top of market.

The findings from these interviews were used to provide content for UPE01864 Office Tower Conversions, UPE01836: Downtown CRL Financial Incentives Funding Program and, to a lesser extent, UPE01557 Options To Address Surface Parking Lots In Centre City And The Quarters.

3 Engagement Approach/Overview

Engagement was conducted to gather feedback from development industry representatives to help inform the writing of the two Committee reports. Engagement occurred between May and September of 2023. Opportunities to provide feedback included interviews, emails, correspondence and a tour of converted office buildings.

Level of Influence

The level of influence for this project was at the ADVISE level of the City's Public Engagement Spectrum.



How We Engaged

Most of the industry stakeholders were engaged by inviting them to either a face-to-face or virtual one-hour interview. Most of the interviews consisted of at least two of the City of Edmonton staff and one stakeholder, although on occasion there were more than one interviewee at a time.

Administration created an interview guide, which was a series of questions to be covered. However, the interviews were sometimes wide-ranging, and stakeholders were invited to explore the topics that were of the most interest to them.

Who Was Engaged

Representatives of the following industry organizations were engaged in the development of this report (those marked with an * were mentioned in the original motion):

- Building Owners and Managers Association (BOMA) - Edmonton*
- Canadian Home Builders' Association - Edmonton Region (CHBA-ER)*
- Commercial Real Estate Development Association (NAIOP)*
- Downtown Business Association*
- Downtown Recovery Coalition*
- Edmonton Chamber of Commerce*
- Infill Development in Edmonton Association (IDEA)
- Urban Development Institute - Edmonton Region (UDI)*

Administration also engaged with representatives from a number of other corporations or organizations. These stakeholders were identified based on known interest or experience in office conversions, mixed-market housing, and Downtown residential development. Some conversations were initiated by the City. Others were recommended by other stakeholders, and several stakeholders reached out to the City to share their perspectives.

Representatives of the following corporations were formally engaged in the development of this report:

- Anu Development
- Autograph Developments
- Avison Young
- Beljan
- Canada ICI
- Cantiro
- CBRE
- Cidex
- Independent planning consultant
- Josan Properties
- Leston Holdings
- Lighthouse Hospitality
- Lumia Real Estate
- MacLab
- One Properties
- Procura
- Strategic Group
- Stromiga
- Westcorp

Members of the City of Calgary's Administration and staff from Canada Mortgage and Housing Corporation (CMHC) were also engaged.

What We Asked

Administration created an interview guide so that all interviews covered the same topics. However, the interviewees were given leave to discuss the topics that most interested them, and the conversations were broad and wide-ranging. The questions from the guide were:

1. What is your impression of the current market for new residential development in Downtown and/or the Quarters?
2. Are there hindrances in the short to medium term to investing/developing within the Downtown and/or the Quarters?
3. What would you recommend to increase the number of new residential/hotel units in Downtown?
4. What is your perspective on the 2021 Construction Grant?
5. Mixed-market housing refers to developments which include a mix of market units and non-market units. Most often those are 'near market' housing where rents are capped at 80 per cent of market rates but could include deeper subsidy units with rent geared to income and ongoing subsidy. Do you have any experience with, or have you ever considered, mixed-market housing developments?
6. What are the challenges associated with converting office buildings to residential/hotel?
7. How frequently does stormwater drainage servicing requirements affect the developability of Downtown projects?