

December 23, 2015

Mr. Peter Moore
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Dear Peter,

Introduction and Purpose

The purpose of this **Addendum Letter** is to supplement the Peer Review of Development Analysis for the SmartTrack Project – 2015. The Peer Review report itself was focused on the Commercial and Multi-Residential Forecasts for the Review of SmartTrack (November 25, 2015), prepared by Strategic Regional Research Associates (“SRRA”). This Addendum Letter serves as a review of additional elements that have been provided by SRRA subsequent to the Peer Review.

Item 1 – Conversion of Employment to GFA/Density

SRRA provided an additional section of its updated report that deals with the conversion of office employment to physical demand for office space. SRRA recommends that to assess the amount of Gross Floor Area (GFA) (also commonly referred to as Gross Leasable Area – GLA) which will result from office employment growth, the calculation needs to consider two elements:

1. The amount of space actually required for each employee in their day-to-day tasks (including desk space (example: a cubicle), the employee’s proportionate share of common area space (examples: meeting rooms, lunchroom), and the employee’s proportionate share of circulation space (examples: interior hallways, lobby).
2. The amount of additional space in office buildings that is not directly occupied by office workers, which has three separate aspects.
 - a. Vacant space in the overall office market that is available for lease by landlords.
 - b. Spaces within the existing office building inventory which are under construction/renovation for future use – such as remodeling preparations for occupancy by a future tenant.
 - c. Surplus (unoccupied, or under-occupied) spaces within existing tenant premises which the tenant has leased today, with the intent of accommodating future employment growth/expansion in years to come.

As acknowledged by SRRA, research studies and anecdotal evidence point to a continuing trend with respect to shrinking office space allocations on a per-employee basis. Workplace trends such as telecommuting and hoteling – terms that relate to the ability of an office worker to work remotely part of the time – are a driving factor behind this trend. As well, a desire to control occupancy costs (rent) is another factor. This latter trend is more pronounced in Central Business Districts versus suburban business parks, given the differential in occupancy costs.



Cushman & Wakefield – in our Peer Review – suggest that a range of 150-175 sf of occupied space per employee is reflective of the current dynamic in the regional marketplace (blended downtown and suburban environments) for new office occupancies. We also suggest that this reduction from observed historic occupancy levels per employee could be phased in over time in the modeling prepared by SRRA.

The following are Cushman & Wakefield's comments with respect to the amount of additional space in office buildings that is not directly occupied by office workers:

- SRRA has modeled an average vacancy rate of 7.0%. Cushman & Wakefield agrees with this assumption, as it aligns with our market survey data.
- SRRA has modeled an average figure for spaces within the existing office building inventory which are under construction/renovation for future use – such as remodeling preparations for occupancy by a future tenant – of 4.0%. Cushman & Wakefield considers the typical office lease to be 5 or 10 years, with an average of 7.5 years, for modeling purposes. A renewal probability of 75% is typically utilized in our modeling, reflecting the observed ratio of office tenants that stay in the same premises upon lease expiry, versus those that relocate. Using these two figures together, a total of 3.3% of the overall inventory therefore relocates on an annual basis.¹ If the typical renovation/remodeling of a tenant space takes 3 months to complete, the figure is adjusted to roughly 0.8% (or, say, 1.0%).² In addition to this, landlords are regularly renovating vacant spaces for preparation for future leasing (such as improving the HVAC, power supply, removing demising walls, etc.), and these spaces will not be captured in the market “vacancy rate” in the Cushman & Wakefield surveys, since they are not technically available “for lease” at the time of the survey. An additional overall factor of 3.0% to 5.0% would appear reasonable in modeling for the space that cannot be occupied by office employees within the marketplace of existing buildings as a result of construction/renovation work. In conclusion, SRRA's factor of 4.0% is considered to be on the conservative side, but supportable.
- SRRA has modeled the average surplus (unoccupied or under-occupied) space within buildings at an average of 5.0%. Most large firms have multi-year business plans which incorporate real estate needs. Approximately two-thirds of the Class A office space across the Greater Toronto Area is occupied by businesses that lease 50,000 sf or more (the figure grows to 72% for firms larger than 25,000 sf). If these firms on average lease an additional 10% more space than is needed in the initial year of a lease term the intention of “growing into” their premises over time, the average over the entire term is in the range of 5.0%. If this 5.0% figure is applied to 70% of the office users (the largest occupiers), then a factor of 3.5% should be added to the office demand modeling per employee. An argument can be made to add the 10% surplus space factor to the entire office inventory (averaged to 5.0% throughout the term of a lease/occupancy). In conclusion, Cushman & Wakefield considers the 5.0% figure utilized by SRRA to be appropriate.

¹ In a scenario having a hypothetical inventory of 75 million sf and an average lease term of 7.5 years, an average of 10 million sf of leased space in the inventory expires annually. If 75% of the space is renewed by tenants, and 25% of the space is vacated by tenants that move to new premises, then 2.5 million sf is renovated by landlords in preparation for a new tenant (typical for Class A space; less common for Class B/C space). 2.5 million sf of renovated space divided into the inventory of 75 million sf = 3.3%.

² 3 months of the year = 25%. 25% of 3.3% (the figure cited above) is 0.8% (or rounded to 1.0%).



CONCLUSION: SRRA states that the existing inventory of office buildings throughout the GTA currently has an unadjusted density factor of 209 sf per employee (which does not include vacancy, space under renovation, or surplus space). SRRA states that the adjusted sf per employee is equivalent to 220-235 sf per office employee (which is a growth factor of only 5.2%-12.4%). Cushman & Wakefield therefore concludes that there is an aspect of the overall analysis that is missing in the commentary.

When Cushman & Wakefield's figure of 150-175 sf of "occupied" space per employee is adjusted to account for "unoccupied" space which also exists in the office market (an additional 16.0%, reflecting the analysis presented above), the revised sf per employee for modeling purposes falls in a range of 174-203 sf. If this figure is intended to also reflect the related retail space (on the ground floor) within some office buildings, it should be grossed up by the same factor SRRA has already employed in its earlier modeling, to account for the relatively lower employment density of retail space compared to office space.

It remains the opinion of Cushman & Wakefield that the figure modeled by SRRA is conservative, and will therefore result in a higher than required amount of new office space construction in the TIF modeling. Cushman & Wakefield advises that SRRA consider an additional scenario that utilizes a lower office space per worker figure, to test this sensitivity in the modeling. Also, the capacity of existing buildings to accommodate increased office density over time should be acknowledged. This would lessen the requirement for new construction to accommodate office employment growth over time.

With regard to the TIF analysis, SRRA states that these new buildings will become more valuable and attract higher assessments than lower office employment capacity buildings. Cushman & Wakefield agrees with this sentiment, but believes that this will become the "new normal" in new office construction, and that valuations will necessarily adapt to this. The potential (relative) devaluation of the existing older office buildings as a result of a lower performance standard (less office occupancy capacity, on a per employee basis) will act to counter the increasing valuations of the new stock.

SRRA states that employment growth of office users who repurpose exiting industrial buildings will offset the need for new office construction to accommodate this growth. This phenomenon would result in a considerable increase in the assessed value of those repurposed buildings (from an industrial assessment to an office or perhaps flex industrial assessment). Cushman & Wakefield agrees with this analysis, but cautions that this revised assessment would likely not be equivalent to a purpose-built new office building valuation.

Item 2 – Estimates of Value Uplift

SRRA provided an additional section of its updated report that focus on the estimates of property value uplift for existing properties resulting from the introduction of SmartTrack within the Primary TIF Zones. SRRA reviewed a sample of research on the subject to determine the applicability of other research to the proposed SmartTrack project, and to determine a range of incremental property value uplift.

Research on the impact of a new transit line on property values shows that property is more highly valued in neighbouring properties than in comparable properties that do not have the benefit of a new transit project.

The amount of increment depends on four general factors:

- scale and impact of the project;
- proximity to transit;
- property type; and,
- term of impact (amortization).

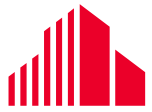
The assessment of the incremental value uplift takes into consideration that SmartTrack provides the following:

- Substantial improvements to transit access for employment over and above existing transit service in most areas served by SmartTrack;
- Substantial opportunities for new development to impact existing real estate values; and,
- A lesser degree of increment where neighbourhoods are already well serviced by transit.

The research indicates that when a new transit project such as SmartTrack reaches into communities with relatively low existing property values, the incremental value increase of those properties tends to raise property values considerably faster than in other higher valued parts of the same city.

According to the research, and SRRA's analysis, the property types most likely to be affected by SmartTrack in order of most increment are:

- Industrial lands – these properties will increase dramatically in value, because they represent the majority of the non-residential properties which surround the project, and will increase in value as their use and functionality change. For example, in Vaughan, the land values in Vaughan Metropolitan Centre have tripled since the initiation of construction of the TTC's Toronto-York Spadina Subway Extension.
- Existing single family homes – the impact of rapid population growth expected in the region over the next 25 years on the value of single family homes will reflect a shift to multi-residential new supply in the form of (and a proportionate increase in) the value of single family dwellings. Because much of the region in general – and the City of Toronto specifically – does not have vacant land to build new single family homes, the incremental impact on their values is anticipated to be substantial. The housing stock within the Primary TIF Zones of SmartTrack is predominantly single family dwellings, but the anticipated new supply of multi-residential homes in Primary Zones will have an incremental impact on value of single family homes.
- Retail properties – the limited amount of retail opportunities surrounding SmartTrack will cause existing retail properties to experience more rapid increases in value compared to other retail properties located outside the Primary Zones.



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- Commercial properties – the Downtown Core of the City of Toronto is well served by existing transit. Downtown office properties will increase in value, but not as much as the office properties located east of the Don Valley up to Markham, and those located west of Bathurst Street out to the Airport Corporate Centre.

In its projection, SRRA has utilized a 21 year horizon, which most often aligns with the nature of a city similar to Toronto that has established transit infrastructure. Cities such as London, New York, and Chicago are considered most comparable. Research indicates that there will likely be a sharp initial impact after the new transit line is approved and comes in to service. This impact will be sustained for a five year period, after which it is likely to lessen by the end of a 21 year period from the commencement of service.

On the basis of the precedent research, SRRA concludes that the range of incremental property uplift for SmartTrack over a 21 year period is between .065% and .09% per annum, and that those rates of increment decline beyond 21 years. This range is an average assessment broadly over all types of properties in the Primary Zones.

CONCLUSION: It is Cushman & Wakefield's opinion that the methodology and approach to the estimates of property value uplift is fundamentally sound. Relying on precedent research and selecting comparable cities is an appropriate means of gauging the prospective impacts of SmartTrack on properties in Toronto's Primary TIF Zones.

Although Cushman & Wakefield has not reviewed the property value uplift literature, it is our hypothesis that commercial properties would be more positively impacted by new transit infrastructure compared to retail properties. This is based on the thought that only the trade area of a community-scale or regional-scale shopping centre would be impacted by transit enhancements, since local-serving retail plazas have a limited trade area geographic draw. In time, this trade area population will be increased by the addition of new multi-family construction – although the magnitude of growth will vary from place to place. On the other hand, office properties would immediately benefit from greatly enhanced accessibility from a regional workforce, and thus migrate towards higher achievable rental rates (and thus, property values) compared to non-transit locations.

Yours sincerely,

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