FINAL REPORT

Business Competitiveness in the GTA: Why Toronto is Losing Ground

SUBMITTED TO

The Toronto Office Coalition

June 2005

PREPARED BY

Canadian Urban Institute
100 Lombard St., Suite 400
Toronto, ON M5C 1M3 Canada
416-365-0816
416-365-0650/0647
cui@canurb.com
www.canurb.com

RESEARCH TEAM

Canadian Urban Institute:

Glenn R. Miller, FCIP, RPP
Brent Gilmour, M.Sc.Pl.
Philippa Campsie, M.Sc.Pl., Hammersmith Communications
Aaron Heppleston, BA (Hon.), University of Toronto

Harris Consulting Inc:

Gordon Harris, MCIP, Principal
Jonathan Tinney, M.Sc.Pl.

ACKNOWLEDGEMENTS

Michael Brooks, Executive Director, CIPPREC
Luis Correia, Sr. Market Analyst, Royal LePage Commercial Inc.
Dan Cowin, Executive Director, Municipal Finance Officers' Association of Ontario
Jim Helik, Sr. Planner, Policy & Research, City of Toronto
Russell Mathew, Associate Partner, Hemson Consulting Ltd.
Sandy McNair, President, InSite Real Estate Information Systems
Dr. Eric Miller, University of Toronto
Paul N. Morse, Sr. Vice President, Royal LePage Commercial Inc.
Christine Raissis, Dir. Econ. Research & Business Information, City of Toronto
Garry Stamm, President, Stamm Economic Research
Raymond Wong, National Director of Research, CB Richard Ellis Ltd.
Justin Aitcheson, Layout & Design

PHOTO CREDITS

Michael S. Manett Photography 2006/Cover
Brent Gilmour 2005/pgs 10, 41, 44
© iStockphoto.com/Arpad Benedek 2005 pg 20
© iStockphoto.com/Vladmir Kondrachov 2005 pg 28
© iStockphoto.com/Timothy Babasabe 2004 pg 38
© iStockphoto.com/Aaron Kohn 2004 pg 52

Canadian Urban Institute
100 Lombard St., Suite 400
Toronto, ON M5C 1M3 Canada
416-365-0816
416-365-0650/0647
cui@canurb.com
www.canurb.com

June 7, 2005

Mr. Philip C.Gillin
Vice President, Real Estate
Sun Life Financial
225 King St. W, 11th Fl.
Toronto ON M5V 3C5

Dear Mr. Gillin:

Business Competitiveness in the GTA: Why Toronto is Losing Ground

On behalf of Gordon Harris and everyone who worked on this study, I am very pleased to provide the Toronto Office Coalition with our final report. As requested, we have studied the effect on business competitiveness of current property tax inequities between Toronto and the surrounding jurisdictions. We have also examined the longer-term consequences of development patterns in the region.

We conclude that the tax inequities make it more difficult for Toronto offices to retain or compete for new tenants. Interviews carried out for this study indicate that the combination of high occupancy costs and increasing concerns about congestion represent a major deterrent for companies renewing leases in Toronto. There are also concerns about congestion in the 905, fueled in part by a pattern of dispersed office development in locations that require commuters to rely on their cars for access.

A vibrant commercial sector is the hallmark of a great city, and is an attribute that cannot be left to chance. We see signs that Toronto is losing ground in this regard, and therefore hope that this report will help stimulate a debate about these critical issues.

Sincerely,

Glenn R Miller

Glenn R. Miller, FCIP, RPP
Vice President, Education and Research

c.c. G. Harris

Executive Summary

There are many wonderful things happening in Toronto, but commercial office development is not one of them. Tourism has bounced back after the SARS scare, cultural facilities are being created or expanded, condominium development is booming. The "night-time" (residential) population is increasing but the same cannot be said of the "day-time" population of people who work in the City. This conclusion may surprise people who assume that business is booming in Toronto.

Our report, commissioned by the Toronto Office Coalition, which represents the interests of owners and tenants that account for the majority of Class A office space in the City, provides an analysis of the impact that current tax inequities between Toronto and the surrounding 905 have on the competitiveness of offices in Toronto. There are three key issues:

- Commercial properties inside Toronto pay more education tax than commercial properties outside Toronto.
- The municipal tax load is weighted against commercial properties in Toronto relative to residential properties in Toronto. The commercial to residential ratio in Toronto is as much as three times higher than the ratios in the surrounding GTA municipalities.
- Capping and clawbacks create inequities among similar properties within the commercial property class of Toronto. Effective tax rates range enormously, from at least 2% (or lower) to at least 7% (or higher).

The City of Toronto has the largest inventory of office space in Canada: The City of Toronto is the hub of the largest, most significant concentration of commercial office development in the country. The City's stock of office space generates more than $500 million annually in property tax revenue for the municipality. More than 500,000 office workers commute to jobs in Toronto from within the City and throughout the Greater Toronto Area.

The long-term viability of Toronto's office inventory is at risk: Commercial office development in Toronto has virtually ground to a halt. Between 1998 and 2005, only seven buildings were developed in downtown Toronto, while 102 have been built in the 905. Tax inequities not only deter new construction but reduce the potential for reinvestment in existing office buildings. The cost of building upgrades cannot readily be recovered through rent increases because total occupancy costs – driven higher by the tax rate - cannot exceed what the market will bear. If a commercial core is not growing, it runs the risk of atrophying. Even though other sectors of Toronto's economy are still doing well, the role of the new office construction as a catalyst for new investment and a magnet for high-order employment is such that, without new Class A development, the City's economy will stagnate.

Tax inequities between 416 and 905 make it more difficult for Toronto offices to retain or compete for new tenants: One key reason for the lack of development is the well-known differential in commercial tax rates between Toronto and adjacent jurisdictions. This makes office space in the City significantly more costly than suburban space – and comparatively less attractive to potential tenants. Because land values are already higher in Toronto, higher tax rates compound the problem, driving up occupancy costs for tenants throughout the City and rendering the buildings they occupy less competitive in the GTA marketplace. This is particularly true in locations where only the municipal boundary between Toronto and the 905 separates competing projects. In these locations, owners of office buildings have been forced to keep net rents low to compensate for higher occupancy costs.

Toronto is losing tenancies and jobs to the 905: These inequities also pose a dilemma for companies when leases come up for renewal, because occupancy costs that incorporate a disproportionately high tax rate will obviously be higher than comparable space in the 905. Employers are already choosing to relocate to the 905 suburbs in order to reduce their occupancy costs. Office employment accounts for almost half the City's jobs and is therefore central to the vitality of the economy. Although the numbers fluctuate from year to year, Toronto still has 40,000 fewer office jobs than the peak in 1991.

New office developments in the 905 are auto-dependent: Relocation of jobs to the 905 places Toronto residents at a disadvantage when it comes to commuting to jobs in the 905 because transit connections between 416 and 905 are poor, and few of the new buildings constructed in the 905 have adequate transit service. Our investigation suggests that only six percent of commuters in 905 office locations use transit (versus more than 60% in the Financial District) -- this inevitably puts more cars on the road, increasing traffic congestion, reinforces long-term trends towards longer commuting times and frustrates the ambitions of 905 municipalities to create transit-oriented, mixed use centres of their own.

Commercial development is an important economic stimulus that helps define a city's relevance: The dispersal of office employment robs Toronto of potential assessment value and also removes significant numbers of jobs – with their associated spin-offs in terms of spending – from the Toronto economy. The Toronto central area, including the Financial District, will continue to serve its role as a centre of provincial government, culture, tourism, and entertainment, but without continued stimulus resulting from commercial growth, may become increasingly insignificant as an office employment centre. Our interviews suggest that many firms are content – for the time being, at least – to remain in the City because it makes sense to do so from a business perspective but this may not always be the case if the core continues to lose firms to less costly locations. A vibrant commercial sector is the hallmark of a great city and is an attribute that cannot be left to chance.

The combination of high taxes and increasing congestion is a major deterrent for companies renewing leases in Toronto: Although high taxes are a principal reason for the lack of new office development in the City, they are only one of many factors in the decision by individual companies to stay in the City or move elsewhere. Access is an equally important factor. Unfortunately, transportation access into the City centre has not improved in decades – the GO transit system faces barriers to expansion, and the rapid transit link to the airport, so long discussed, has yet to materialize. The TTC is preoccupied with maintaining a "state of good repair" and is in no position to expand or improve service levels. In interviews with companies that have already relocated or which are considering their options, the clear message is that the combination of high property taxes and severe traffic congestion is leading companies to choose locations outside Toronto. At the same time, there are concerns about congestion and poor air quality in the 905, where the number of trips per person, car ownership and trip length is increasing.

The City of Toronto needs to do more to support growth in the office sector: Finally, City policy appears to favour residential development over office development. The cranes on the downtown skyline are all building condominiums, not office towers. The City is doing relatively little to promote office employment, or to retain companies within the City. Other cities, such as Chicago, have realized that office employment is essential to economic health, and have developed multi-faceted strategies to foster that employment.

Toronto is neglecting the care and feeding of the "goose that lays the golden egg": For years, Toronto offices have been the goose that lays the golden egg for the City in the form of high property taxes that support many of the amenities that Toronto residents take for granted. Yet the health of the goose has been ignored to the point at which it may die of neglect. A strong, growing office market is well down on the list of municipal priorities, below such things as housing, urban design, air quality, waste management, and public safety. Although promised improvements in these areas, as well as ongoing repairs to roads, streetcar lines, and water pipes, will no doubt benefit offices at least indirectly, little is being done to directly address the needs of office owners and tenants.

Is Toronto's destiny to become a bedroom community for the 905 region? This is surely not the intention of any level of government, although it may be the unintended consequence of years of neglect.

The alternative is to create and implement policies that explicitly favour new development and job creation in the office sector and that support the economic health of the City. The Greater Toronto Area functions as a single, integrated economy, and its future competitiveness depends on maintaining a healthy, vibrant core. This report makes the following recommendations to promote offices in the City towards that end.

1. The province should impose a single uniform commercial tax rate across the region in order to reduce current inequities that are distorting the office market in the GTA.
2. The province should adjust the distribution of the educational portion of the commercial tax in order to reduce the impact on commercial property owners in the City of Toronto.
3. In the interim, the City of Toronto should take immediate steps to accelerate the rollback of commercial property taxes in order to improve the viability of the Toronto office market.
4. The City and the province should follow through on a commitment to redevelop thousands of acres of underutilized brownfield sites in the City of Toronto to help the City recover its employment base and to increase the availability of employment land.
5. The City should identify priority areas for office employment in order to give effect to its stated goal of "protecting Employment Districts from incursion of non-economic activity."
6. All levels of government should work together to accelerate planned improvements to Union Station and to enhance GO service linking Toronto with the rest of the region.
7. All levels of government should continue with plans to construct a rapid link between the airport and downtown Toronto as soon as possible.
8. The province should streamline environmental and other approvals for these and other transit initiatives that will reduce traffic congestion.
9. The province should work with regional, local governments and other stakeholders in the 905 to support their efforts to create higher density employment nodes in locations with adequate transit service or which have the potential to be served by higher order transit.

Contents

List of Tables

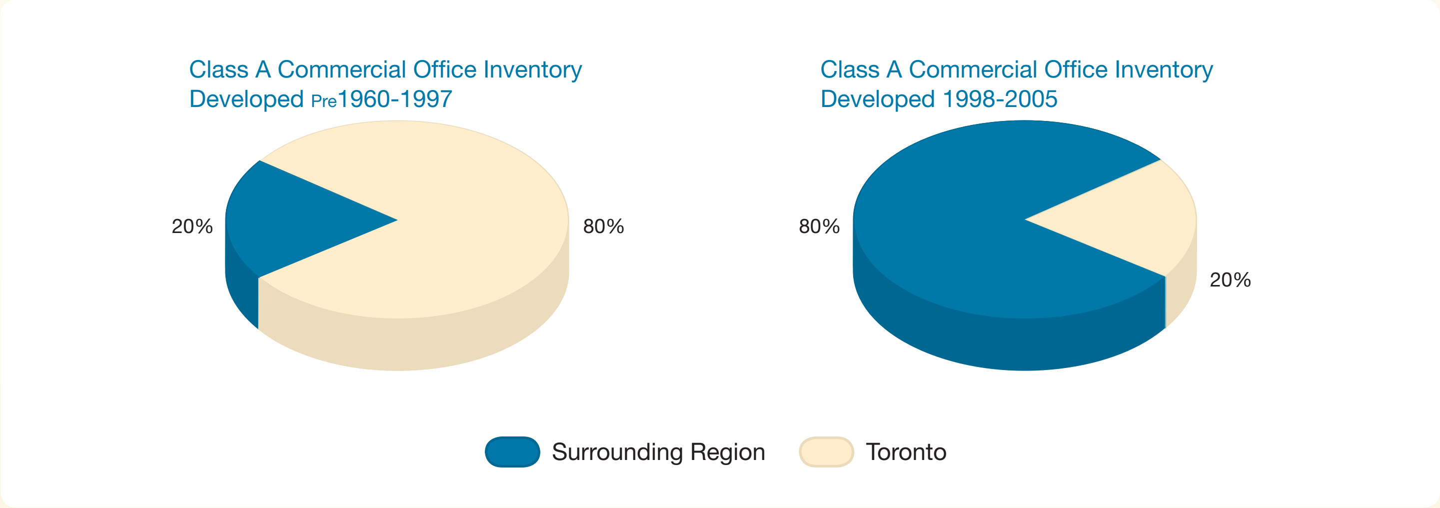
List of Figures

1.0 Introduction

With more than 100 million square feet of office space, 60% of which is Class A space, the City of Toronto is the hub of the largest, most significant concentration of commercial office development in the country.[1] Toronto houses the headquarters of 150 companies, and the City's stock of office space generates more than $500 million annually in property tax revenue for the municipality.[2] More than 500,000 office workers commute to jobs in Toronto from within the City and throughout the Greater Toronto Area.[3]

But since 1998, 80% of all Class A office space built in the GTA has been developed in the "905 area" – the regions surrounding Toronto. Commercial office development in Toronto has all but stalled.

Figure 1-1: Shift in Growth of Class A Office Space to 905



Source: InSite Real Estate Information Systems Inc.

The focus of this study, which has been commissioned by the Toronto Office Coalition,[4] is to understand the reasons for the sudden drop-off in demand for new office space in the City. To what extent do Toronto's higher property taxes discourage companies from renewing leases in Toronto? When consolidating corporate activities in a single location in the GTA, what factors do companies take into account? If most new office buildings in the GTA are being constructed in locations that cannot realistically be served by public transit, what is the resulting impact on traffic congestion and air quality if the majority of commuters have to drive? What is the penalty to the taxpayer overall if existing investments in costly infrastructure have to be duplicated to serve a region spreading over a larger and larger area?

[1] Based on figures provided by Royal LePage and InSite Real Estate Systems Inc., Net Leasable Area for Competitive Office Space for buildings larger than 20,000 sq ft. Estimates for the GTA put the total GLA of offices in all classes in the region at 160,000,000 sq. ft.

[2] Report prepared for CIPPREC by Hemson Consulting.

[3] 2005 report by Hemson Consulting for Province of Ontario. The City of Toronto employment survey identifies a grand total of 572,000 office jobs in 2003, including full and part-time employment.

[4] The Toronto Office Coalition consists of 16 owners and tenants occupying 55 million square feet of prime office space in the City of Toronto.

Perhaps the biggest concern in the investment community is over the long-term future of the Toronto office market. If no new buildings are being built, what effect will this have over time on the vibrancy and viability of that market? Does it serve the interests of the GTA as a whole if differentials in the commercial property tax system are allowed to continue to distort the natural workings of the marketplace?

This study addresses these and many other questions related to the region's ability to compete for jobs and investment while maintaining a high quality of life. Given the importance of the GTA as Ontario's economic engine, answers to these questions should concern us all.

2.0 Office Development in the Toronto Area Since 1967

2.1 DOWNTOWN BOOM AND BUST

In 1967, the year of Canada's Centennial, the TD Centre opened in downtown Toronto. It was the first of the big bank skyscrapers. It was followed by Commerce Court (1968-72), First Canadian Place (1972-75), and the Royal Bank Plaza (1973-77). These buildings, and others like them, established the model for competitive office space that simultaneously created a classic investment vehicle and supported the emergence of a burgeoning service-sector economy.

After a brief hiatus in the early 1980s, construction began on a new crop of high-rise office towers, including the Sun Life Centre (1984), Scotia Plaza (1988), and BCE Place (1991). The City encouraged this growth, and allowed developers to use options such as density bonusing and the transfer of development rights to make their towers much higher than they would otherwise be under the prevailing Official Plan and zoning by-laws. By the early 1990s, the Toronto skyline had assumed its present profile.[5]

[5] The skyline of the Financial District is quite compact. Only 8 office buildings rise higher than 40 storeys and another 14 have between 30 and 39 storeys.

Figure 2-1: Class Office Locations 1961-1971

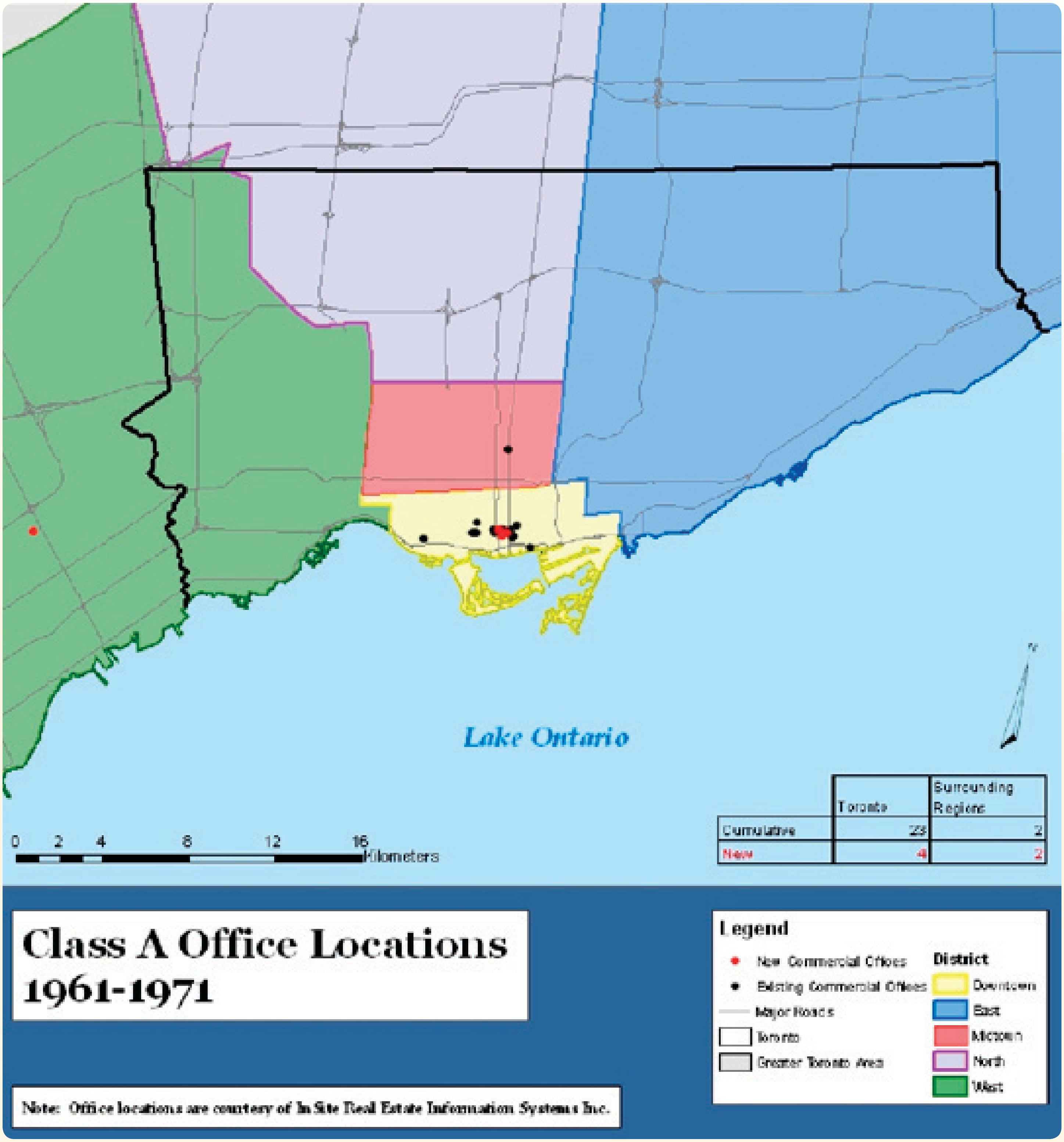
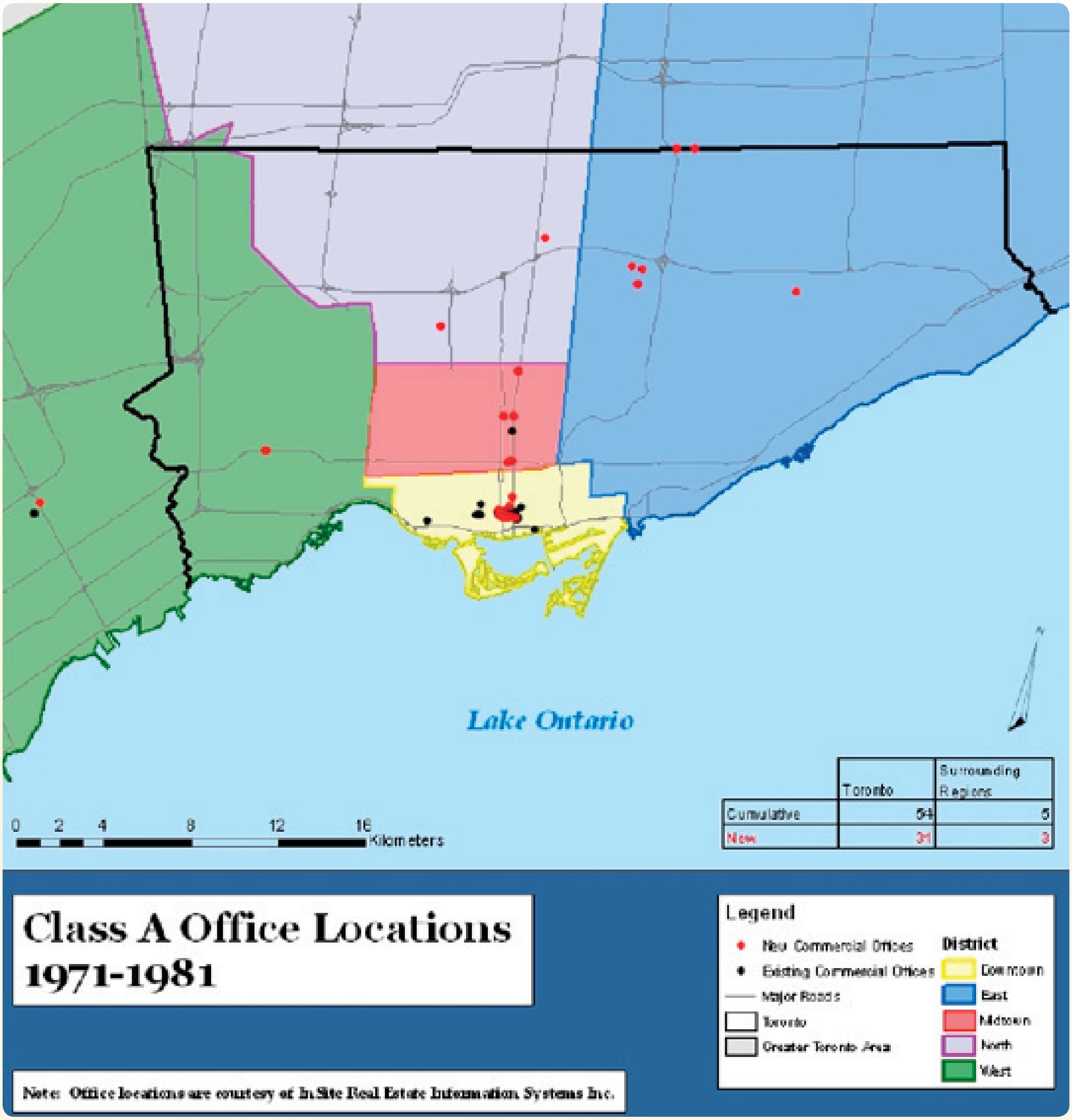


Figure 2-2: Class A Office Locations 1971-1981



Meanwhile, manufacturing was losing ground as a form of employment in what is now the City of Toronto. During the recession of the early 1980s, many factories closed, including many of the branch plants that had sprung up in the 1950s and 1960s. Demand for office space was so strong in the 1970s that some owners of relatively new industrial buildings replaced them with office projects. Just as today property owners and investors express concern over tax differentials that distort the market for commercial office space between 416 and 905, this period represented a watershed for developers of industrial space: a tax differential per square foot equal to rental rates proved to be the tipping point. Older space became obsolete and was demolished; uncompetitive space was converted to retail.[6]

Outside downtown, office growth expanded north along the Yonge subway corridor and up the Don Valley Parkway towards the 401, in high-profile locations easily accessible from the highway. But the heart of the office market continued to be dominated by growth in the Financial District, which had been formally designated as such in the 1976 Central Area Plan.

And then, in the early 1990s, it all ground to a halt. Plans to expand the Financial District south into the Railway Lands were abandoned. Construction on the Bay-Adelaide Centre, begun in 1990, stopped after the construction of an underground parking lot, a seven-storey elevator core and a park required as part of the development deal.

Construction stopped because the demand for office space plummeted after the recession. The jobless recovery that followed the recession turned out to be a largely office-less recovery for Toronto. In 2005, the Bay-Adelaide Centre remains a concrete stump in the middle of the financial district, a symbol of changes in the demand for office space and the changing role of the downtown core.[7] In the last decade, few major office towers have been built in the centre of Toronto. The Maritime Life Tower (completed 2002), is one of the only ones to feature commercial tenancies.

Less visible, but no less significant, are the changes in the ownership of the towers. Over the past few years, ownership of four of the six major properties has been transferred from the banks and development companies that built the towers to large pension funds and real estate investment trusts (REITs).[8] These institutions are well-funded, but risk-averse. They own and maintain assets, but have not to date undertaken new development.

2.2 OFFICES IN THE SUBURBS

As noted by the Brookings Institute, “Office buildings were the last major element of central cities to suburbanize, following people and retail.”[9] Today, the Financial District represents about a third of the Toronto office market. During the boom years of the 1970s and the 1980s, office buildings were constructed throughout the City and its inner suburbs, as well as the “905” region surrounding Toronto.

The midtown buildings and those of North York City Centre were largely similar to the downtown office towers, although on a smaller scale. In most cases, developers created office space on spec for rental tenants. By contrast, many suburban offices were purpose-built for specific companies on former industrial areas. These buildings, some grouped into campuses or parks, others free-standing, tended to be in areas well served by highways,

[6] G. Miller, Canadian Urban Institute, “Industrial Sector Study: Warehousing and Distribution,” 2000.

[7] Technically, the Bay-Adelaide Centre, owned by Brookfield Properties, is not dead but dormant. Architectural plans and renderings for the building have been prepared and modified over time, and the building is listed in statistics on downtown office space as being in the “pre-leasing” stage. (“Comparing Downtown and Suburban Office Market Performance in Canada,” GWL Realty Advisors, January 2005, p. 8.) At the time of writing, there is a possibility two major tenancies may come together to finally rekindle this development.

[8] The TD Centre is the property of the Ontario Teachers’ Pension Fund Board (which owns all Cadillac Fairview Properties). Commerce Court is owned by the British Columbia Investment Management Corporation (the pension fund of the B.C. government), and the Royal Bank Plaza and part of BCE Place by OMERS (Ontario Municipal Employees Retirement System). First Canadian Place is managed by O&Y Properties Corporation and as of February 2005, O&Y’s real estate portfolio is for sale. Scotia Plaza is still owned by the Bank of Nova Scotia, which purchased the property following the bankruptcy of O&Y (which had previously acquired the property from the bankrupt Campeau Development Corporation).

[9] Robert E. Lang, “Office Sprawl: The Evolving Geography of Business,” Brookings Institute, October 2000, p. 2.

where parking was plentiful. They met the demand for a new breed of office building with very large floor plates designed to meet the requirement for a sharply different ratio of executive offices to clerical staff.

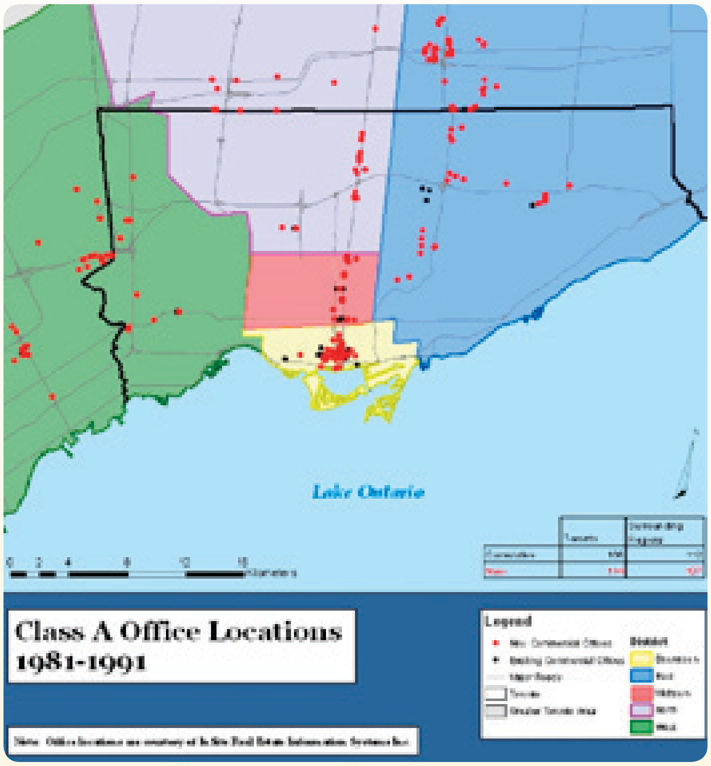
When construction slowed in the Financial District and the suburban downtowns, it continued in the office parks. In the late 1990s, highway-oriented[10] sites were almost the only areas of office development in the Toronto region.

The balance of office space between Toronto and the rest of the region has clearly shifted since the 1960s. One study found that in 2004, 1.8 million square feet of office space was under construction in the suburban parts of the Toronto CMA, compared to less than 500,000 in downtown Toronto. Another study noted that between 1986 and 2003, the number of head offices of companies in the Financial Post 500 in Toronto fell from 171 to 136, while the number in the rest of the Greater Toronto Area rose from 32 to 62.[11]

Today, Mississauga City Centre has 3.4 million square feet of office space, with a further 3.3 million square feet of office space dispersed along the Hurontario Corridor.

Mississauga is the sixth largest City in Canada and home to the head offices of 52 major corporations,[12] with about 25 Class A buildings. Markham to the northeast of Toronto calls itself the "high-tech capital of Canada," and is in the process of developing a downtown that will include office space.[13] Vaughan has proposed a "corporate centre" in an area largely occupied at present by big box stores. The bulk of current commercial development is focused in two concentrations along the Highway 7 corridor at highways 400 and 404; a third major focus for commercial growth is located west of the airport on the 401.

Figure 2-3: Class A Office Locations 1981-1991



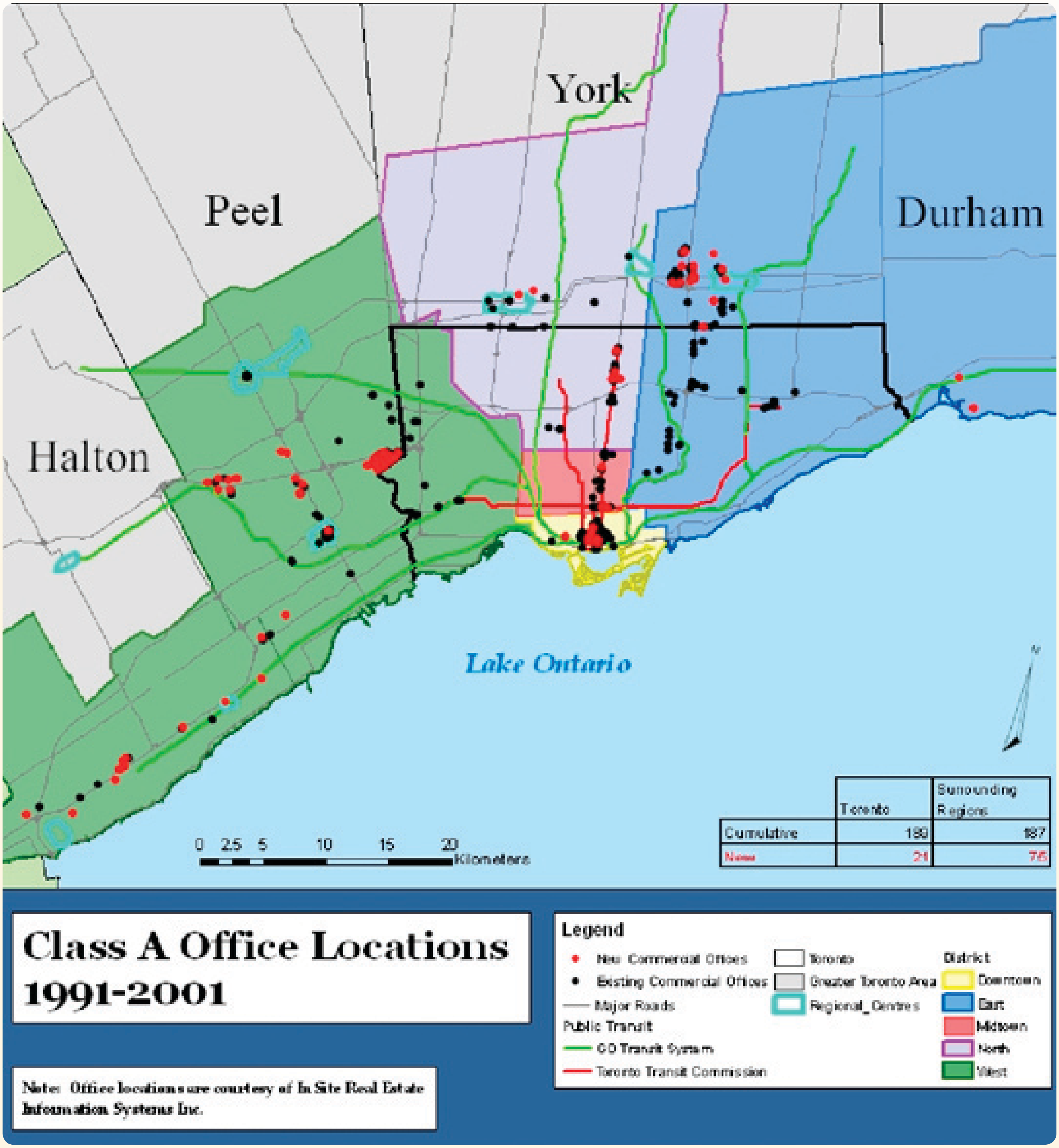
[10] A market study for undertaken at this time Marathon Realty by Stamm Economic Research determined that more than 90% of all commercial office sites in the 905 suburbs were within one arterial block of a major highway.

[11] "The Greater Toronto Area: Canada's Primary Economic Locomotive in Need of Repairs," TD Economics, 2002, pp. 13-14.

[12] http://www.Cityofmississauga.ca

[13] See Canadian Urban Institute, "Putting the Urban in Suburban: The Modern Art and Business of Placemaking," conference report, February 2003.

Figure 2-4: Class A Office Locations 1991-2001



The following table shows additions of new office space (in millions of square feet) in the Toronto CMA between 1954 and 1999:

Table 2-1: Commercial Office Space For Greater Toronto Area 1954-2005

	1954-1970	1971-1981	1982-1992	1993-2005	Commercial Space***	Total sq. ft.
Financial District	10,312,065	10,467,484	10,862,253	555,740	274,712	32,472,254
Midtown Toronto	5,478,480	5,749,853	4,268,660	398,096	470,090	16,365,179
Toronto Outside Financial and Midtown	10,473,415	4,618,045	11,696,388	1,884,671	1,936,142	30,608,661
Office Parks*	84,400	9,002,252	16,998,104	11,795,032	2,028,016	39,907,804
Office Commercial Subcentres**	196,513	4,116,031	11,201,945	1,118,807	213,084	16,846,380
Dispersed Locations***	2,585,728	4,573,186	8,129,192	3,168,591	1,757,355	20,214,052

Note: Class G (government) buildings were not included.

*Airport, Highway 404 and Steeles, Highway 407 and Highway 7, Consumers Road, Don Mills

**Meadowvale, Highway 427, Heartland Centre and Duncan Mills, North York City Centre, Scarborough Town Centre, Etobicoke Six Points and Mississauga City Centre

***Additional commercial office space with unknown completion date

It is important to distinguish between the suburbanization of the office market and office sprawl. Suburban offices may be clustered into nodes, or scattered in isolated spots. They may be close to a rapid transit interchange, or accessible only by car. The existence of offices in suburbs can reduce commuting and its associated costs and environmental problems, by providing jobs for suburban residents, or it may foster increased commuting by drawing residents from a wide area.

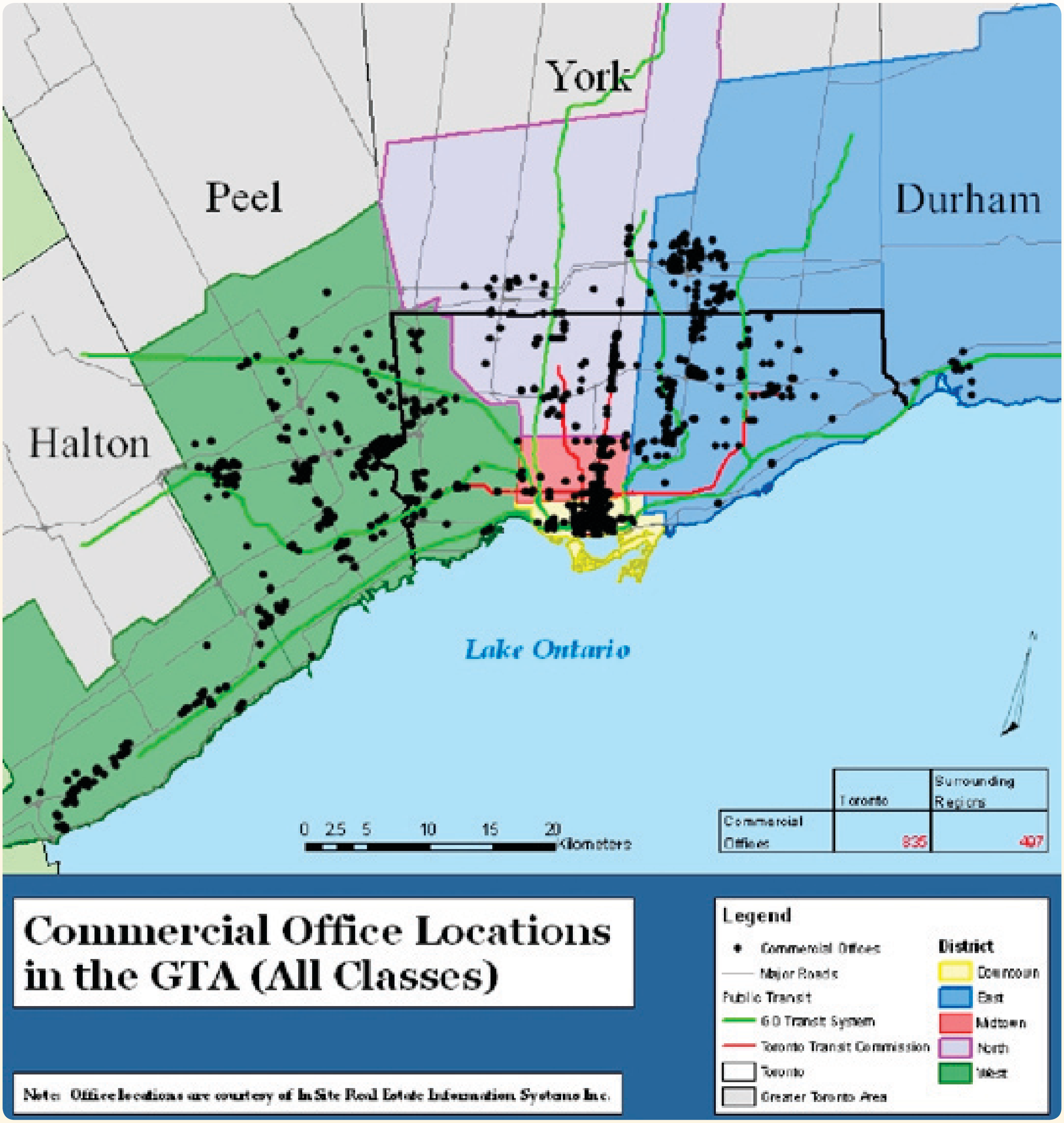
If most new office space is constructed at the regional edge, it may extend commuter sheds into undeveloped rural areas and thereby fuel sprawl…. If most new space is built in areas with no public transit access, then reliance on automobiles will continue to grow.[14]

The Greater Toronto Area has both suburban office nodes and office sprawl. This is apparent in Figure 2-5, which illustrates the current office market in the GTA (All classes). In the 416 area (Toronto) office development is concentrated in numerous designated nodes (North Yonge, Scarborough City Centre) as well as in scattered locations in the 905, offices are in one "official" node (Mississauga City Centre) and several office parks (e.g. Airport Corporation Centre) which function as nodes. The majority of development is located in opportunistic fashion along major highways. The recent Smart Growth initiative in Ontario documented some of the economic and environmental problems caused by the rapid and largely uncoordinated expansion of low-density, automobile-oriented development around Toronto. For example, the study highlighted the costs of congestion in the Toronto area, which were estimated to cost the economy about $1.8 billion annually in delays.[15]

[14] Lang, "Office Sprawl: The Evolving Geography of Business," Brookings Institute, October 2000, p. 2

[15] Shape the Future, Final Report of the Central Ontario Smart Growth Panel, April 2003, p. 8.

Figure 2-5: Commercial Office Locations in the GTA (All Classes)



Much of the literature on sprawl focuses on the outward march of residential subdivisions. However, transportation experts have suggested that employment sprawl may contribute to automobile dependency even more than residential sprawl, since people are generally willing to make the trip from home to a rapid transit station or stop, provided that the trip takes them directly to work.[16] But although the GO system does a good job of bringing people from across the region into downtown Toronto, it is largely unable to deliver people to jobs scattered in Oakville, Vaughan or Markham. As well, although the GO trains and buses are well used, the system as a whole accounts for a relatively small share of all transit trips.

2.3 Stagnation or Prosperity?

The GTA economy has largely recovered from the combined effects of post-NAFTA economic restructuring and the severe recession of the early 1990s, largely because the region possesses "a degree of sectoral balance and diversity that is virtually unmatched by any other major metropolitan areas in North America."[17] According to the Institute for Competitiveness and Prosperity, the GTA also hosts many of the key wealth-producing economic clusters such as business services, financial services, knowledge creation, hospitality, and tourism. These sectors create jobs and attract the investment that keeps the region's economy dynamic.[18] The GTA generates about one-fifth of Canada's GDP.[19]

Although economists rate the performance of the GTA's economic clusters among the best in North America, this does not mean that the region is meeting its full potential or that there are not serious concerns about the region's ability to maintain the conditions that support these sectors. A constant theme in studies released over the past 15 years is that although the transformation of the GTA's economy has been remarkable and unprecedented, current growth patterns may well be unsustainable.

One of the first to issue a warning regarding the competitiveness of the Greater Toronto Area was University of Toronto geographer, Meric Gertler. Writing in 1990, he identified "signs of economic distress within the region."[20] Gertler's analysis of regional strengths and weaknesses highlighted the historic "underappreciation" of Toronto's role in the provincial (and national) economy, the lack of centralized decision making to advance essential investments in infrastructure and the emergence of what is now a familiar trend for companies to relocate and restructure their businesses to better meet their requirements. With respect to the latter, his report cited examples of companies "transferring employment (that might have remained in the Toronto region) to sites well beyond its borders." He also drew attention to the issue of congestion, commenting on the importance of preserving mobility and access for both goods and services.

This was followed by a series of reports commissioned by the Office for the Greater Toronto Area for the Greater Toronto Coordinating Committee. Key among these reports was a study by IBI Group[21] that evaluated the land consumption implied by three alternative development patterns (Spread, Central and Nodal).[22] It suggested that an urban structure of nodes

[16] Eric Miller, "Making transit more attractive," Toronto Star, October 19, 2004, p. A21.

[17] David Pecaut, "The Fourth Era," background report for the GTA Task Force, 1996

[18] Institute for Competitiveness and Prosperity, "A View of Ontario: Ontario's Clusters of Innovation." 2004.

[19] "The GTA: Canada's Economic Locomotive in Need of Repairs," TD Economics, 2002.

[20] "Toronto: the State of the Regional Economy," Meric Gertler, University of Toronto, 1990, based on proceedings from a workshop organized by the Royal Commission on the Future of the Waterfront et al.

[21] GTA Urban Structure Concepts Study: Background report No.1, IBI Group, 1990.

[22] "GTA Infrastructure Requirements", IBI Group, report to the OGTA, 1992.

and corridors might reduce traffic congestion and its harmful effects on the environment and the economy. But it was evident that it would be difficult to avoid the spread – or status quo – pattern of growth, because at any given time, the pattern of urban development is "essentially set for the next 20 years."[23] Companion reports voiced concern over high property taxes in downtown Toronto – "the second highest in North America"[24] – and the economic damage that would be inflicted on the GTA if improvements were not made in regional transportation.

By the mid-1990s, many more voices had joined the chorus of those who were worried about the City's ability to attract and retain investment. The provincial government established the Greater Toronto Area Task Force in 1995 to recommend action on a number of related issues.[25] The task force report emphasized that the region's core and suburbs function in "lockstep," and that failure to protect the conditions that attract and retain head offices in Toronto would lead to the decline of the region as a whole.

The key message from this work was that the City-region operates as a single, integrated economy. The task force placed special emphasis on the damage to the region's competitiveness caused by "inequities in the taxes paid by (what is now the City of Toronto) businesses compared to those in surrounding municipalities." In highlighting the need to create "a level playing field for Greater Toronto businesses" the task force urged the provincial government to take action in order to "avert a downward spiral of reduced assessment, higher taxes and reduced services."

In 2002, TD Economics issued another "warning" about the need to take concerted action in the interests of preserving the economic prosperity of the region.[26] This was not the first time that macro level issues such as labour productivity, earnings per capita and corporate income tax practices had been given a geographic interpretation but the credibility of the bank clearly had an impact on the way the report was received.

The last few years have seen a flurry of proposals and plans and some new legislation to address a host of urban and regional issues: urban sprawl, traffic congestion, decaying infrastructure, and environmental problems. Improvements in these areas will no doubt indirectly benefit employment of all kinds, including office employment. But will they help stabilize office employment in the City of Toronto? To answer this question, we need to look at the dynamics that produce the current pattern of office development.

[23] "Urban Form in the GTA: Bringing the Vision into Focus," report of the urban form working group to the urban form working group, 1992.

[24] "Sustainable Economic Growth, "report of the economic vitality working group, 1992.

[25] The Report of the GTA Task Force, January 1996. (The Golden Commission)

[26] TD Economics, "The GTA: Canada's Economic Locomotive in Need of Repairs," 2002.

3.0 What Has Created the Current Pattern of Office Development?

The pattern of office development in the Toronto region is largely the product of three interlocking factors:

- economic trends, including business cycles, free trade, and economic restructuring;
- public policy, including planning and zoning, property taxes, and transportation investment;
- the decisions of individual businesses, based on their budgets, work force, need for space, locational requirements, and so forth.

A look at how these three factors have evolved in the Toronto area provides some insight into the current pattern.

3.1 ECONOMIC RESTRUCTURING: GOOD AND BAD NEWS FOR OFFICES

The recession of the early 1980s caused no more than a brief pause in the creation of office space in Toronto. However, in the recession of 1989 to 1994, almost 190,000 jobs were lost in Toronto. And when the economy improved starting in 1994, it was a jobless recovery – the job losses continued until 1996.[27] By 1999, office employment in Toronto was still below 1990 levels.[28] Furthermore, after a rebound in 2001-2, the numbers dipped again in 2003.[29]

Demand for office space plummeted. And given the inevitable time lag between changes in demand for office space and the actual creation of new office space, new space was still being made available as demand was decreasing. This so-called "supply overhang" led to vacancy rates of more than 20 percent in downtown Toronto in the early 1990s.[30] With firms caught out by the collapse in value of their capital assets, prime real estate changed hands at fire sale prices.

The jobless recovery in the office sector[31] was the result of restructuring brought about by information technology, free trade, and globalization, among other things.

The restructurings that had occurred during the recession had eliminated tens of thousands of clerical jobs in Toronto.[32] By the time business began to improve again in the mid 1990s, the remaining employees had learned to work with less support staff. Word processors on every desk had replaced the typing pool, and data management was conducted by small numbers of computer technicians rather than armies of filing clerks. Some traditional forms of doing business disappeared entirely; for example, the Toronto Stock Exchange closed its trading floor in 1997, to become a virtual market.

Information technology had a particularly dramatic affect on the financial sector. Among other things, these transformations affected who did what and where they did it. Many routine data-handling jobs in banking and insurance were grouped together as "back office" functions. Since these jobs involved no face-to-face contact with clients, and the information was stored and transmitted electronically, jobs were moved out of the City centre to suburban locations, where real estate was cheaper and large new buildings that were wired for computers could be built less expensively.

At the same time, information technology made possible new financial products and services. Trading in derivatives, day trading, round-the-clock currency trading, and the creation of new kinds of investment vehicles were all made possible by massive increases in computing power, and the ability to transmit information instantly around the world. Even as routine operations were being moved to suburban locations, new jobs in the financial sector were being created in downtown Toronto.

Another trend that affected the office sector was the move to "outsourcing," a term that has at least three meanings: (1) the privatization of formerly public-sector functions, (2) the tendency of companies to hire contract or freelance workers as needed rather than maintaining a large in-house staff, (3) the option of moving work to distant locations, such as consolidating call centres in Sault Ste. Marie or New Brunswick – or Alabama or India, in which case, it is known as "offshoring."

The effects of the various types of outsourcing on downtown employment varied. Government and some corporate offices emptied out; consulting offices filled up. Call centres and back office created employment elsewhere, but supported the operations of central locations.[33]

[27] Employment in Toronto 1999, Toronto Urban Development Services, June 2000, p. 3.

[28] Employment in Toronto 1999, p. 4.

[29] Toronto Employment Survey 2003, Toronto Urban Development Services, January 2004. Although unpublished, the latest data suggest a small improvement in 2004.

[30] Colin Lizieri, "The Office Market in Downtown Toronto," in The Future of Downtown Toronto, GHK International, Background Study 2, 2000, p. 62.

[31] In the manufacturing sector, it was largely attributed to automation and the closure of branch plants after the signing of the Free Trade Agreement in 1988.

[32] The Fourth Era: The Economic Challenges Facing the GTA, Boston Consulting Group, 1995, p. 9.

[33] "A relocation of retail, batch, and back office functions to suburban areas of the Toronto region…is not a symptom of decline. Indeed, the presence of back office functions in the region has a stabilising effect." Lizieri, "The Office Market in Downtown Toronto," in The Future of Downtown Toronto, GHK International, Background Study 2, 2000p. 63.

The signing of the Free Trade agreement in 1988 saw a retrenchment of "branch plant" offices representing U.S. interests from a base in the Toronto area. All of a sudden, it became feasible to service the Canadian market from a base in Cleveland or any other American headquarters City.

Finally, the globalization of industry and markets also affected employment and the economy. Canada certainly lost manufacturing and lower-skilled jobs to other countries. The effects of globalization on office jobs in central cities, however, is less clear. A Canada-wide study of head offices by researchers at Statistics Canada, for example, found that the number of head offices in the country actually rose between 1999 and 2002, employment in those offices increased slightly, and the Toronto area (which includes its suburbs) consolidated its position as the top location for head offices in Canada.[34] Another study noted:

> The evidence available suggests that, despite expressed fears of competition from the US and decentralisation, Toronto has maintained its role over the last decade [1990-2000]. Above average growth in FIRE [finance, insurance, real estate] and business service employment in the downtown has been accompanied by a shift to higher value added activities.[35]

Global competition in the financial industry has also raised the prospect of bank mergers, which are sometimes seen as a threat to downtown office employment.[36] However, bank mergers in the United States between 1988 and 1998 led to a net increase in bank employment.[37] Consolidations in the United Kingdom showed a similar tendency to increase employment over the long-term, after short-term employment losses. And in Toronto, "the merger of Burns Fry and Nesbitt Thompson in 1995 led to an increase in employment of around 20% three years after the merger, rather than the predicted fall."[38] The main threat to employment, not just in Toronto, but in Canada as a whole, is not mergers so much as foreign takeovers, if operations are consolidated in the country of the acquiring firm.

The economic upheavals continued throughout the high-tech boom of the late 1990s, and the dot-bomb of 1999-2000. The destruction of the World Trade Center in New York on September 11, 2001, led to fears that concentrated financial centres were too vulnerable to terrorist attack, and that all office work would have to be decentralized, but these fears gradually faded.

The economic changes since 1980 have altered the office landscape, yet in themselves, they do not spell the death of central city office employment, and they have even created some new kinds of employment that has the potential to benefit central cities. Whether or not that potential is realized depends on public policy and the decisions of individual companies.

3.2 PUBLIC POLICY DOES NOT FAVOUR OFFICE DEVELOPMENT IN THE CITY OF TORONTO

3.2.1 Planning Failures and the Fixation on Residential Development

In the 1970s, the growth of offices beyond downtown Toronto to midtown and the "suburban downtowns," was partly the result of deliberate planning policy. Official and district plans included the designation of employment nodes at Yonge and Bloor, Yonge and St. Clair, and Yonge and Eglinton, and around the City halls of North York and Scarborough (and, to a lesser extent, that of Etobicoke). See Figure 3-1. These nodes were designed to support thousands of office jobs, along with shops, housing, and transit connections and to serve as focal points for outlying parts of the City.

[34] John R. Baldwin, Desmond Beckstead and Mark Brown, "Hollowing-out, trimming-down or scaling-up? An analysis of head offices in Canada, 1999-2002," Statistics Canada, December 2003, Catalogue no. 11F0027MIE, No. 019.

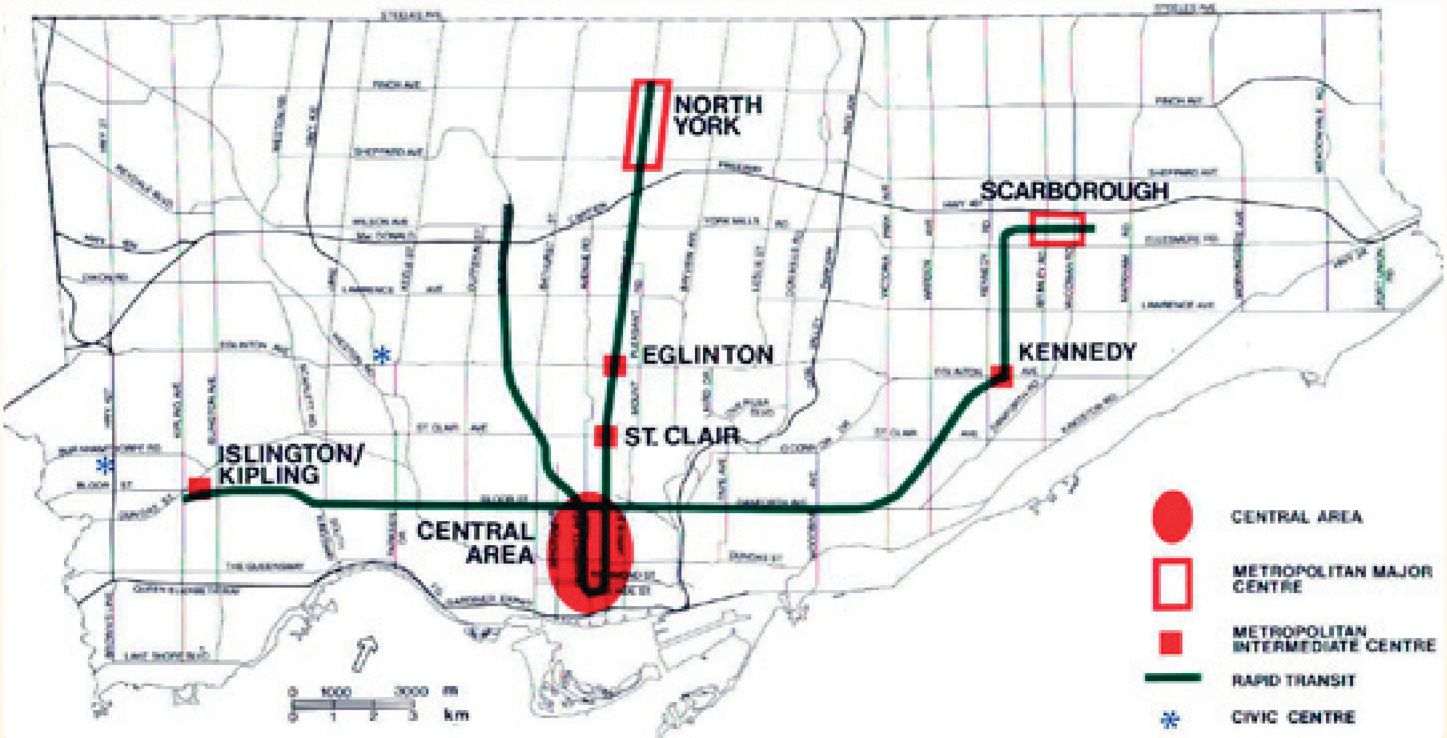
[35] Lizieri, "The Office Market in Downtown Toronto," in The Future of Downtown Toronto, GHK International, Background Study 2, 2000," p. 63.

[36] The likelihood of bank mergers moved a step closer in February 2005. Sinclair Stewart, "Goodale to address bank mergers," Globe and Mail, February 24, 2005, p. B7.

[37] Lizieri, "The Office Market in Downtown Toronto," in The Future of Downtown Toronto, GHK International, Background Study 2, 2000," p. 50.

[38] Lizieri, "The Office Market in Downtown Toronto," in The Future of Downtown Toronto, GHK International, Background Study 2, 2000," p. 55.

Figure 3-1: Designated Metropolitan Centres



In some cases, the centres developed much as the planners had hoped – with a little help from “mayors who saw suburban office towers not only as a means to fill the tax coffers but also, together with new City halls, as symbols of public acknowledgement of prestige.”[39] This was certainly the case with Mel Lastman and North York City Centre, which by 1995 had 6.9 million square feet of office space and 27,800 jobs, of which 82% were office jobs.

North York had the benefit of the subway and the central spine of Yonge Street. Attempts to build suburban centres around shopping malls, as in Scarborough, were less successful: by 1995, Scarborough Town Centre, despite having secured the first suburban Class A office building in the early 1980s (The Consilium), had only 2.7 million square feet of office space and 19,500 jobs, of which only 52% were office jobs.[40]

[39] Gunter Gad and Malcolm Matthew, “Central and Suburban Downtowns,” in Canadian Cities in Transition, Trudi Bunting and Pierre Filion, editors, Toronto: Oxford University Press, 2000, p. 262.

[40] Gad and Matthew, “Central and Suburban Downtowns,” pp. 262-64.

The building boom in these areas ended at the same time as the downtown building boom. "The 1980s were the 'golden decade' of office development in the suburban downtowns… Their share of Toronto's office stock increased from 2.5 percent in 1976 to 9 percent in 1991. In the 1990s, (commercial office) growth in suburban downtowns literally came to a halt."[41] Once the buildings that had been approved in the 1980s were finished, few new commercial buildings were added in the 1990s.

The growth of scattered office parks presented something of a problem for planners, who wanted to promote the suburban downtowns, which were accessible by transit. Meanwhile, offices were still moving outwards. At first, much of the development was led by corporations and developers seeking out relatively cheap land for "groundscrapers" (one- and two-storey buildings with large floorplates that allow employers to consolidate operations on a single level), but as the development boom of the late 1980s continued, suburban municipalities began to plan for and develop their own suburban downtowns and office nodes.

In the 1980s, some of the municipalities surrounding what was then Metropolitan Toronto outgrew their status as bedroom communities, and became cities with a full range of employment opportunities. This process was facilitated by the regional governments established in the 1970s – Halton, Peel, York and Durham.

The creation of these regional governments was partly a result of the success of the two-tier Metro model in Toronto itself. Metro had done a reasonably good job of planning for and controlling growth in the City's outward expansion. However, managing the relationship between continuous improvement of trunk services, regional scale infrastructure and fiscal capacity worked best when applied as a centralized model. To have the concept applied by five regional scale governments in the same economic geography led to conflict and competition among the regions and between the regions and the central city.

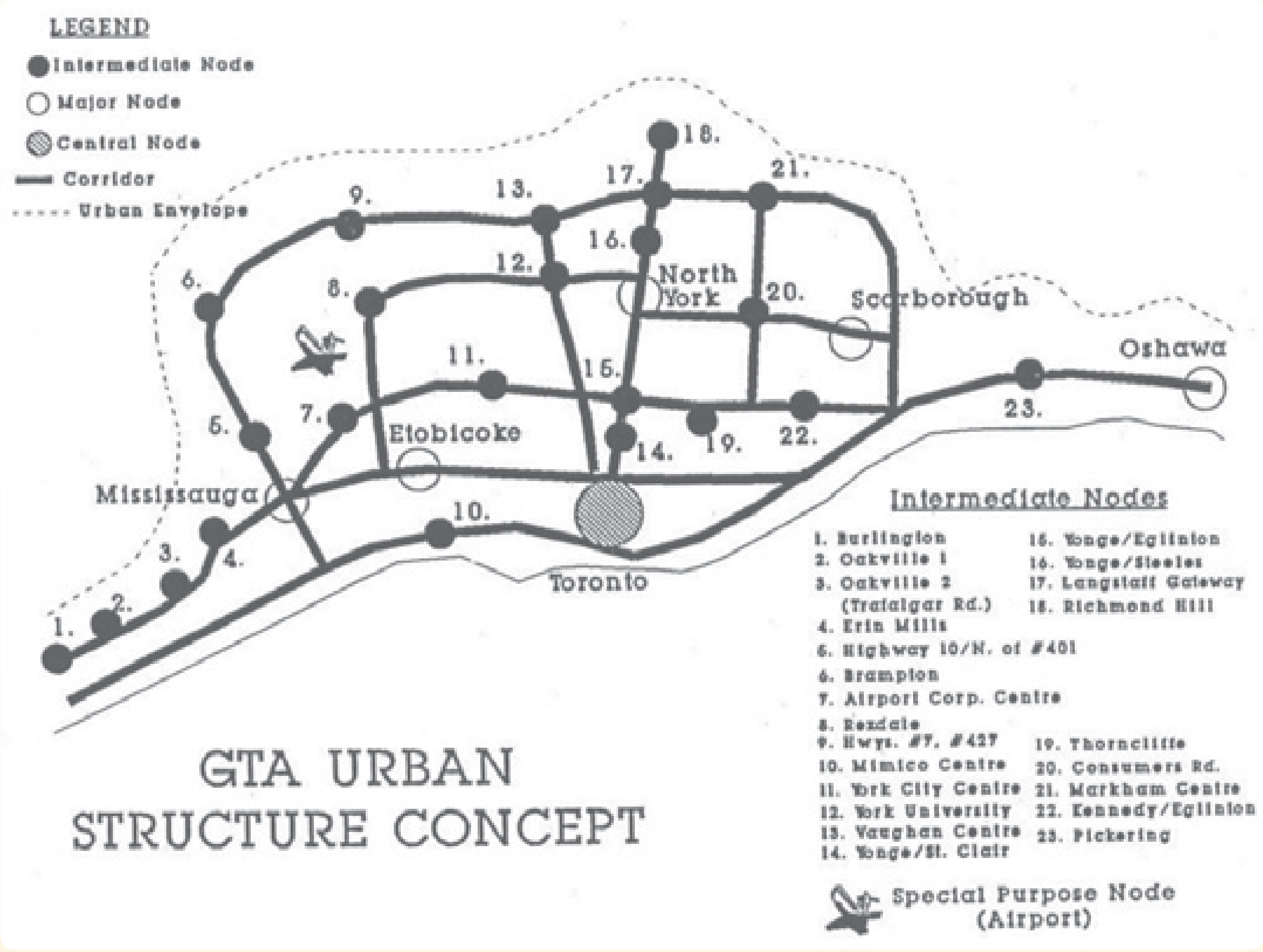
The pace of development rang alarm bells throughout the region, in part because growth was exceeding the ability of municipalities to provide – or pay for – essential piped services, leading to the threat of development freezes. Driven by this concern and a realization that both commercial and residential development in the 905 was being built at densities too low to attract or sustain transit usage, the provincial government set up the Office for the Greater Toronto Area to search for solutions to these problems.

The OGTA commissioned reports that documented the impact of continued low-density development as well as options for mitigating the effects of such development. Following an extensive consultation process, the province and its municipal partners announced a vision for a new kind of regional urban structure, built around a series of mixed-use centres linked by transit corridors. The expectation was that replicating the Metro experience of a balance between a strong core and a series of high-density "nodes" in the surrounding region would create a sufficient critical mass of development to support better transit usage, and slow the trend towards increasing congestion and poor air quality. See Figure 3-2.

[41] Igal Charney, "The Conditions for Capital Investment in the Real Estate Sector: The Case of Office Development in Toronto," PhD thesis, Department of Geography, University of Toronto, 2000, p. 183.

[42] "GTA Urban Structure: An Analysis of Progress Towards the Vision", Canadian Urban Institute, 1997.

Figure 3-2: GTA Urban Structure Concept



Unfortunately, by the time agreement was reached on this vision in 1990, the development bubble had burst. Employment projections in 1993 forecast much lower than anticipated office jobs as a proportion of total future employment.[43] This trend severely undercut the potential to achieve a new urban structure that was supposed to maintain Toronto as the commercial hub of the region while simultaneously steering the demand for commercial office space to high-density sub-centres.

In 1997, the Canadian Urban Institute prepared a report for the province that assessed the degree to which the GTA vision agreed to in 1992 was being realized.[44] The report found that development was not occurring as desired, and pointed out that too many “nodes” had been designated by the regions and municipalities to reach the necessary critical mass of development. Without significant investment in public transit, the CUI indicated that the concept of nodes and corridors would not achieve its objective. One of the principal recommendations was that infrastructure investment should be focused on a small number of nodes and that ways be found to discourage commercial development in particular from occurring in scattered locations outside the designated nodes. The Regional Planning Commissioners of Ontario subsequently reviewed the concept and are preparing to reduce the number of designated nodes.

The policies remain in place today, even though the economic drivers that would have supported a concentration of high-density office space in suburban locations no longer exist and the promised government financial support for investments in public transit never materialized.[45]

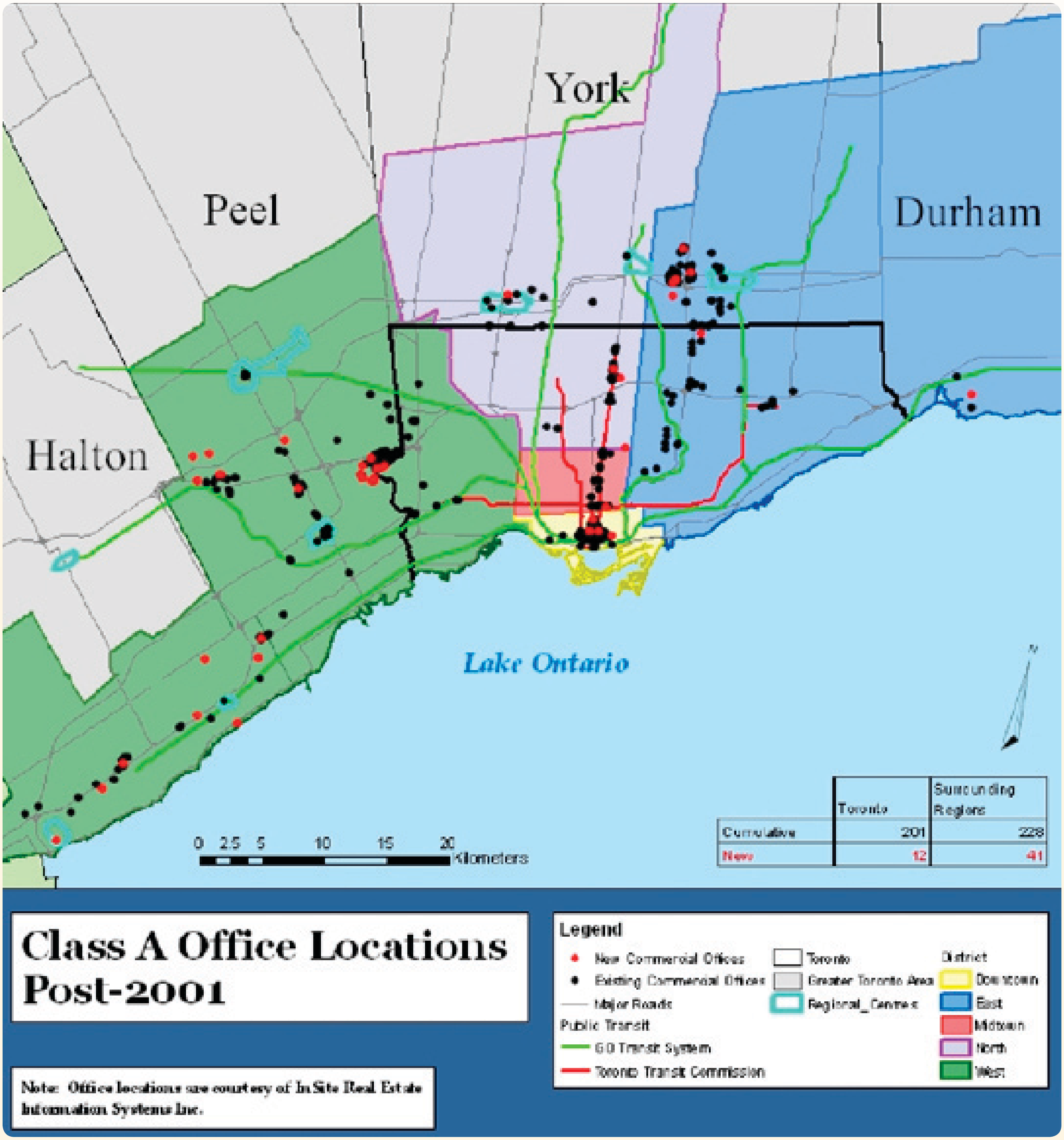
As illustrated in Figure 3-3, the only designated node outside of Toronto with significant amounts of office space is Mississauga City Centre. Commercial development (offices) in that area has been flat for some time although residential and retail growth is proceeding apace.

[43] Hemson/Coopers & Lybrand Consulting Group

[44] “GTA Urban Structure: An Analysis of Progress Towards the Vision”, Canadian Urban Institute, 1997.

[45] MAH/MTO, “GTA Urban Structure: Progress Towards the Vision,” Canadian Urban Institute, 1997. This review noted that although the original vision had proposed 29 “nodes,” by the time that the regions and area municipalities implemented the vision through their official plans, the number had increased to 44.

Figure 3-3: Class A Office Locations Post-2001



With progress stalled on regional governance, the province chose to impose amalgamation on the City of Toronto in 1998. Because this was carried out at the same time as the imposition of current value assessment in the amalgamated City and as local services realignment (popularly known as downloading), the next few years were somewhat chaotic, as local politicians and bureaucrats struggled to cope with all of these changes at once.

Within the City of Toronto, it now seems that interest has shifted from maintaining and creating jobs to maintaining and increasing the residential population. Toronto has long prided itself on the fact that, unlike many American cities, it has never lost its middle-class population, and that its central low-rise residential neighbourhoods are, for the most part, thriving. The protection of these neighbourhoods is one of the main principles of the City's Official Plan. The City has also moved to promote new residential development in formerly non-residential areas in a variety of ways.

Beginning in 1993, the City allowed owners of empty office buildings – mostly B class space – to convert them to condos. By 1995, 16 conversion projects were under way or in awaiting approval, representing the removal of 1.4 million square feet of office space from the inventory.[46] This process was particularly evident in the Yonge and Eglinton, and Yonge and St Clair areas but it also affected office parks, such as Flemingdon Park in Don Mills.

[46] Charney, The Conditions for Capital Investment in the Real Estate Sector, p. 188.

At about the same time, the City amended its industrial policies to allow the "deregulation" of the areas known as the Kings (King–Spadina to the west, and King–Parliament to the east). This deregulation freed up space in older industrial buildings; some of it was converted to office space – resulting in the coining of the term "post and beam" -- some to residential. However, new construction tended to be largely residential condos. In 2005, condominium construction continues apace, including on the former railway lands south of Front Street, an area that had once been intended as an extension of the Financial District.

The most recent Official Plan for the City of Toronto heavily emphasizes the need to find space for more residents, without disrupting the lives of those in well-established residential districts. If existing residential land cannot absorb the newcomers, more employment land will have to be converted for residential use. One of the drawbacks of encouraging residential development on employment lands is that residential values per square foot are typically much higher than commercial, which tends to discourage employment-related development.

Despite a statement in the Official Plan that its policies support the City's "economic foundations" by "protecting Employment Districts from incursion of non-economic activity,"[47] it is not clear exactly which policies do this, or how. There are more specifics on protecting residential districts from the incursion of non-residential activity.

These changes are eating away at the space available for offices and other commercial development. Moreover, as residents begin to predominate in formerly commercial or even industrial space, they have a tendency to complain about the noise and traffic generated by businesses, and to oppose the creation of new businesses. Unwittingly, perhaps, the City may have made the creation of new office developments in some areas of the City, including many areas close to downtown, less likely.

3.2.1 Tax Inequities: The Old, Old Saga

The current property assessment and taxation regime has, for commercial properties in Toronto, three separate forms of institutionalized inequity.

First, commercial properties inside Toronto pay more education tax than commercial properties outside Toronto.

Second, the municipal tax load is weighted against commercial properties in Toronto relative to residential properties in Toronto. The commercial to residential ratio in Toronto is much higher than the ratios in the surrounding GTA municipalities.

Third, capping and clawbacks create inequities among similar properties within the commercial property class of Toronto. Effective tax rates range enormously, from at least 2% (or lower) to at least 7% (or higher).

The higher provincial education rate was described in the following way by John Barber:

> The province… charges Toronto business a punitive rate on its own property tax – the one it levies to finance education – that removes more than four times as much money from the City as Queen's Park proposes to restore with its supposedly business-friendly $25 million [one-time assistance package]… Currently, Toronto businesses pay 2.22 per cent of their annual assessments to support Ontario schools, whereas those in other municipalities in the urban region pay between 1.53 per cent and 1.74 per cent… If the government equalized rates within Greater Toronto alone, according to City bureaucrats, local businesses would save $120 million annually.[48]

[47] Official Plan, Chapter Three, p. 63.

[48] John Barber, "Province's tax on business historically unfair," Globe and Mail, February 22, 2005, p. A12.

The inequities between residential and commercial tax rates have been in place for years. In 1998, the provincial government brought in a new system called Current Value Assessment, which was intended to simplify property taxes and remove inequities from the former system. Under Current Value Assessment, the tax paid by a business depends on three factors: the current value of the property, the municipal tax rate set by the municipality, and the education rate set by the province. At the same time, the province established a "fairness ratio," which meant the municipal tax rate on multi-residential, industrial or commercial properties was expected to be no more than 100% of that on single-household residential properties.

However, whenever a tax system changes, there are winners and losers. Some property owners will pay less tax than they did before; some will pay more. To protect the potential "losers," the province included caps on the amount by which taxes could increase in the years following the implementation of Current Value Assessment. It covered the cost of these caps "by delaying the full decreases owed to [previously] overtaxed businesses, many of which are located in Toronto's core"[49] – in other words, clawbacks. At the same time, the province did not make the "fairness ratio" compulsory, so there was no penalty for disregarding it.

As noted by Enid Slack, "Instead of capping of the amount of the tax increase arising from a reassessment, the tax itself was capped."[50] This effectively froze commercial tax rates. For Toronto-based companies whose properties have been reassessed at a lower value, this means that the amount of taxes paid is still based on the previous higher assessment. This creates inequities within the commercial property tax class.

The original problem of inequities between commercial and residential property taxes remains. A 2003 study for the Canadian Institute of Public and Private Real Estate Companies found the following tax ratios for commercial property compared to residential property (which is defined as 1.0).[51] In theory, none should be greater than one.

The disproportion between the assessment base of the City of Toronto and the actual taxes raised is shown in Figure 3-1.[52] The commercial sector is shown in white. The pie chart on the left shows its contribution to assessment.

Table 3-1: Tax Ratio in the GTA

Municipality	Tax ratio
Toronto	3.5206
Markham	1.1000
Mississauga	1.2971
Oakville	1.4565

Source: Toronto Office Buildings: Analysis of Municipal Revenue and Costs, October 2003

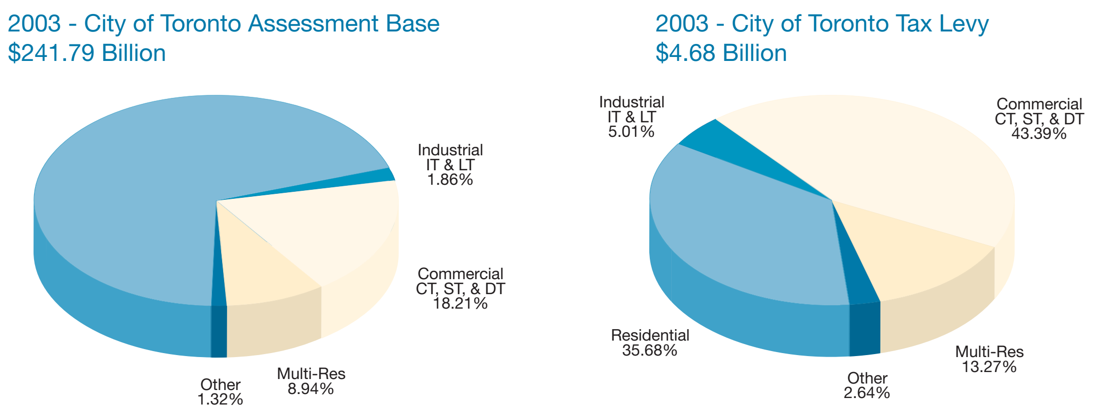
[49] Why Grow Elsewhere? Reforming Property Taxes in the City of Toronto, Toronto Board of Trade, February 2000, p. 7.

[50] Enid Slack, "Property Tax in Ontario: What have we learned?" 2002.

[51] "Toronto Office Buildings: Analysis of Municipal Revenue and Costs," prepared for the Canadian Institute of Public and Private Real Estate Companies by Hemson Consulting, October 2003.

[52] Canadian Institute of Public and Private Real Estate Companies, 2003 CIPPREC Property Tax Assessment/Tax Analysis, Executive Summary, prepared by Derbyshire Viceroy Consultants, September 2004.

Figure 3-4: City of Toronto Assessment Base and Tax Levy 2003



Source: Canadian Institute of Public and Private Estate Companies, 2003

These inequities in the property tax system contribute to higher occupancy costs for businesses in the City. The Toronto Board of Trade has suggested that higher occupancy costs in the City of Toronto, "threaten the health of Toronto's core and main streets. [That] tenants in Toronto's office towers will leave the core if quick action is not taken to reduce their share of taxes."[53]

The differential in occupancy costs across the region are described in detail in Appendix A. Figures 3-5 and 3-6 illustrate the relatively small spread in rental rates and the sharp differences in taxes paid.

Overall, our analysis shows that total occupancy costs are much higher in the central core area, partly because of higher average rents and partly because of higher tax rates on more valuable property. Outside the core, however, the spread between average rent levels is relatively small, with rents in the North Yonge area only between one and two dollars higher than those in areas as far out Mississauga or Oakville. The outlying areas of 416 (i.e. in the City of Toronto) suffer from higher occupancy costs than comparable buildings located on the other side of the municipal boundary in the 905.

But tax inequities are not news. They have been the subject of countless reports by real estate groups, business lobbies, and public finance experts. Each report has recommended that the inequities be removed as quickly as possible. And the City of Toronto is moving slowly in that direction. However, any reduction in commercial property tax will doubtless increase residential taxes, and

[53] Toronto Board of Trade (February 2000) "Why Grow Elsewhere? Reforming Property Taxes in the City of Toronto."

Figure 3-5: Class A Commercial Office Net Rent by Municipality

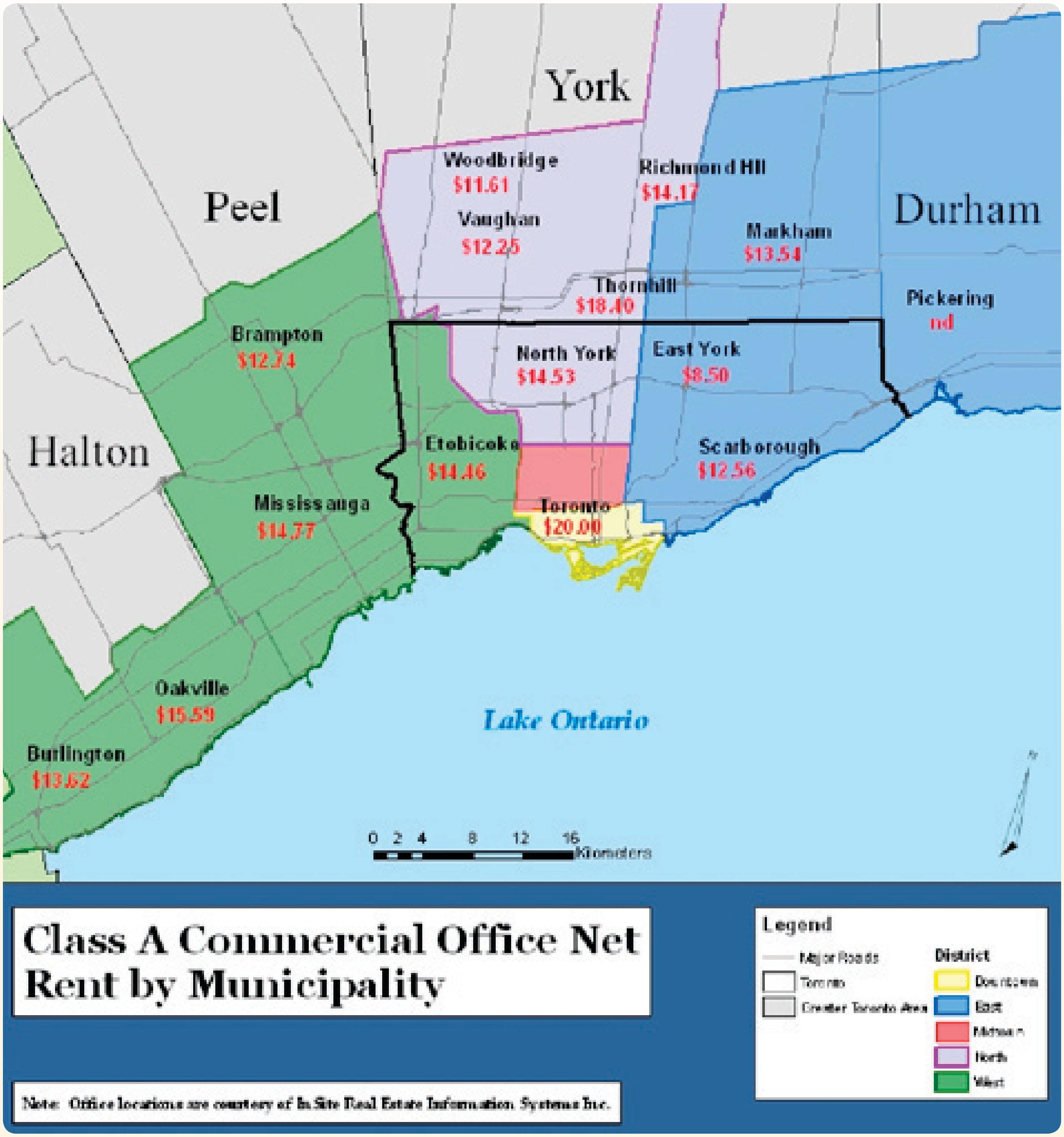
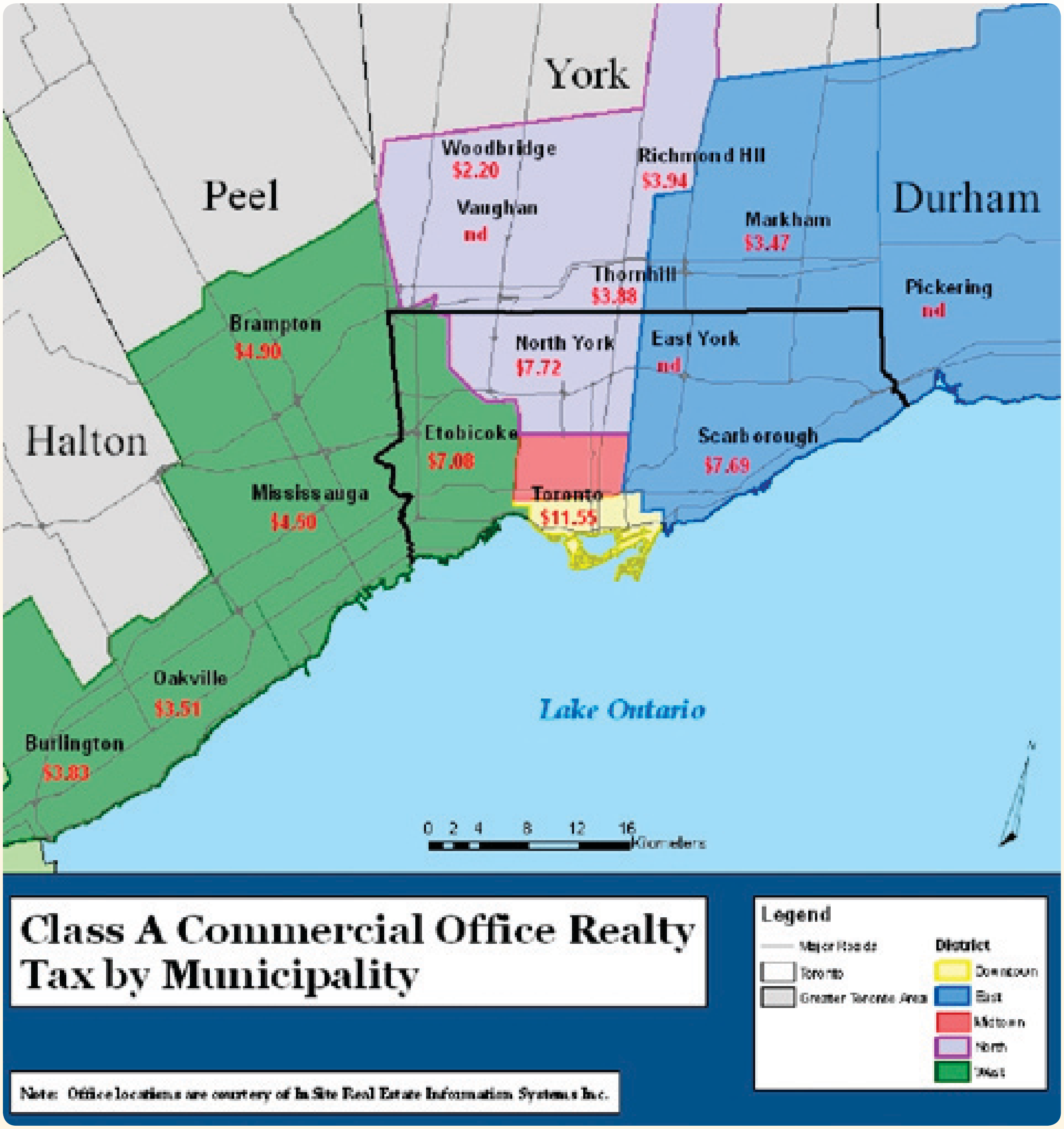


Figure 3-6: Class A Commercial Office Realty Tax by Municipality



N.B. Average rental rate for “Toronto” reflects Financial District & Midtown that is a huge stumbling block to real progress. Just as the City's planning documents seem to suggest a bias in favour of residential development, so too does the City's tax policy. Toronto homeowners would most likely fight any dramatic increase in taxes to counter the reduction in corporate taxes, and very few municipal politicians have the stomach for such a fight. Even though the long-term prosperity of Toronto depends on employment, in the short-term, business is allowed to suffer to keep residents happy.

The Financial District is particularly hard-hit. For years, the Financial District and its stock of "trophy" Class A office space, has provided a sizable proportion of the revenues that flow into City Hall. And despite protests from business owners, despite high vacancy rates, despite the outflow of companies to the cheaper suburbs, the City takes this source of revenue for granted. Just as the Province of Ontario has complained to the federal government that it pays more in taxes than it receives in government services, so the Financial District pays more in taxes than it receives in amenities or infrastructure improvements. But the situation has been in place so long that it is easy to assume it will continue forever.

Policy makers do not appear to think that the downtown is seriously threatened. The downtown restaurants appear to be full at lunchtime, the usual tide of office workers streams to and from Union Station during the rush hour, there are construction cranes everywhere (even thought they are building condominiums or opera houses, it makes the City centre look busy). Any cries of alarm are drowned in the usual downtown hubbub.

As for the future of offices elsewhere in the City, the question does not appear to be a priority within city hall.

3.2.2 Transportation: Expect Congestion on All Routes

Finally, there is a baffling reluctance on the part of the City to invest in better access to the downtown. "The 1981 Metropolitan Official Plan stated that no new office centres should be built; however, the 1991 Toronto Official Plan designated a number of suburban clusters for office development in order to reduce the flight of development to the outer suburbs of the CMA."[54] Significantly, approval of the plans to expand the financial district south of the rail corridor was only given on the understanding that no new transportation capacity (other than GO) was required. This astonishingly short-sighted bias against reinvestment in the transportation capacity of the core has proved to be a costly policy.

Even GO rail capacity is tightly constrained, as the system runs on tracks that it does not own. The GO system depends on CN tracks and CN drivers. A threatened CN strike in May 2005 that would have crippled commuter transit was averted only at the last minute. And for years, transportation planners have considered options for a rapid link to the airport, but the proposal to construct the line has only now entered the environmental assessment phase.

As a result, transportation researchers who make projections for the future of the region are beginning to sound like radio traffic reporters in rush hour: Expect congestion on all routes. "The

[54] Charney, "The Conditions for Capital Investment in the Real Estate Sector…," p. 187.

growth in transportation demand will…outstrip transportation capacity. By 2031, the number of vehicles (on the roads in the study area) will have increased by 43%, from 3.7 million to 5.6 million, the number of vehicle kilometers traveled each day by residents in the area will increase by 64%" (far outstripping the provision of new facilities) and "the number of hours of delay experienced by auto drivers…are projected to rise to 1.2 million hours a day." The resulting increase in carbon dioxide emissions per capita "are estimated to increase by 42%." [55]

The transportation deficit is partly the result of the failure to implement the nodes-and-corridors growth concept. With the exception of Markham Centre, which is achieving its goals by following a different strategy, the designated centres have attracted remarkably few commercial office buildings. Mississauga City Centre, after a promising start, has lost momentum in its bid to create a commercial office focus. New development is occurring on greenfields scattered throughout the region, close to highways, on large parcels where surface parking can be provided. Many of these locations are difficult to impossible to serve economically with transit.

The following table illustrates current levels of transit and auto usage in selected areas of the GTA. The areas modelled are illustrated on Figure 3-7.

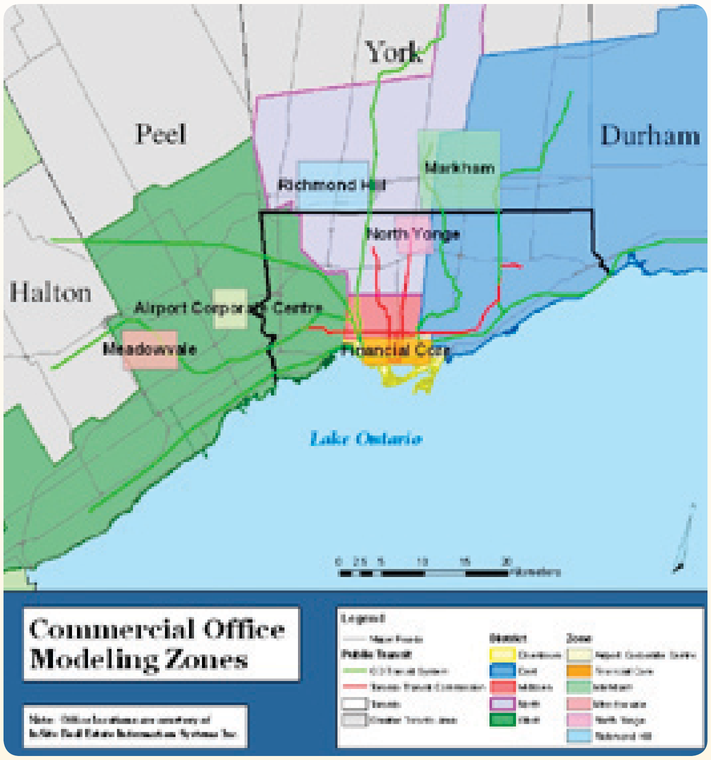
Table 3-2: Modal Split for Selected Market Areas (morning peak, TTS survey data)

	Employment	% of trips by auto	% transit, walk, cycle
Financial Core	249,667	31	69
North Yonge	26,209	68	32
Markham	56,401	94	6
Richmond Hill	10,868	93	7
Airport Corporate Centre	34,016	93	7
Meadowvale	21,929	95	5

Source: Based on analysis of Transportation Tomorrow Survey data by Dr. Eric Miller.

[55] "Business as Usual," Neptis Foundation, 2004

Figure 3-7: Commercial Office Modelling Zones



Attempts to create a regional authority to coordinate transportation across the region as a whole also fell apart, as the ill-fated Greater Toronto Services Board sought to move ahead on much-needed transportation infrastructure decisions with no funding and a requirement to proceed on the basis of consensus. The long-awaited Greater Toronto Area Transportation Authority appears to be stalled in bureaucratic wrangling.

For more than 15 years, there have been alarm bells concerning the lack of new transit infrastructure in the 905. The development patterns (see Figure 3-3) are clearly in conflict with the policies being pursued by regional, municipal and provincial government.

When all classes of office development are considered (see Figure 2-5), it is obvious that the GTA is locked into a pattern of employment sprawl, with poor prospects for reversal or recovery. As can be seen from this table, the actual mode splits in favour of transit (averaging 6%) are a very long way from the targets identified in official plans of 20%.

Transportation is only one aspect of infrastructure investment. Years of under-funding for all kinds of infrastructure have taken their toll on Toronto: potholes, burst pipes, power outages, transit stoppages, and other problems disrupt business with growing frequency. The infrastructure deficit is not unique to Toronto,[56] but its effects are more obvious in an older city than in a newer one.

In 1999, the CUI published “Reinvesting in Toronto: What the Competition is Doing”[57] by Joe Berridge. This report provided strong evidence that Toronto was lagging behind its competition – that is, other City regions in North America – in terms not just of essential transportation infrastructure, but also the level of investment in new attractions, civic amenities, and development financing.

As of 2005, investment in cultural attractions is on the upswing, with the creation of a new opera house, expansions to the Royal Ontario Museum and the Art Gallery of Ontario, and other improvements. The City is soliciting ideas for ensuring better urban design in civic spaces, and even for improvements to Nathan Phillips Square. Clearly tourists are a priority, along with residents. However, development financing arrangements remain unchanged, the plans for the waterfront have been stalled for years, and Toronto is not making as much progress on brownfield and greyfield redevelopment as smaller cities in Ontario.

[56] The Federation of Canadian Municipalities maintains “Canada’s Infrastructure Deficit Counter,” which, as of 6 p.m. on March 3, stood at $60,963,771,800. In the time it took to type this footnote, the counter increased by about $7,000.

[57] “Reinvesting in Toronto: What the Competition is Doing,” Canadian Urban Institute, 1999.

3.2.3 Ignoring the Needs of Offices

Overall, provincial and municipal policy decisions have not favoured office employment in the City of Toronto. The province has failed to implement its own ideas for the orderly development of commercial space throughout the region, thereby allowing office sprawl, inhibiting the expansion of transit networks, and increasing traffic congestion. The City largely ignores the needs of offices in favour of residential development and other interests. Little or no progress has been made in eliminating property tax inequities that burden offices in the City. Offices continue to pay and pay and pay, and get few new benefits in return. Transportation access to the centre of the City has not improved significantly since the GO network was put in place, and GO is a hostage to the railway companies. The TTC meanwhile is preoccupied with the financial challenges of maintaining a "state of good repair" and is not able to pursue expansion of rapid transit.

Of particular concern is the fact that a growing proportion of City of Toronto residents are now employed in the 905 and cannot commute to these jobs by transit.

The offices that remain in the City do so presumably in spite of public policy, not because of it. Their location decisions, however, depend not only on the economic and political climate for business, but also on company structure and culture, and their own unique requirements for space.

3.3 BUSINESS LOCATION DECISIONS: NOT JUST THE BOTTOM LINE

3.3.1 Downtown vs. Suburban Space

Each business weighs a variety of factors in the decision on where to locate, and whether to relocate (given that moving offices represents a major cost in itself). These include the local labour market and labour costs, access to clients, visibility, the regulatory regime, taxation, land costs, transport and accessibility, business culture, and quality of life.

Labour costs and access to skilled labour, although they are important, generally do not affect the choice between an urban or suburban location in the same region, although they do affect the choice among competing City-regions. The Greater Toronto Area is considered one large labour market, and workers commute to where the jobs are. The exception is when firms wish to access specific pools of labour such as semi-skilled female clerical workers. In the 1970s, companies located in suburban Toronto in order to be able to access a labour force resident in northeastern Scarborough; companies with a similar requirement today are choosing to locate in Markham, Vaughan and similar locations.

Similarly, quality of life differentials may determine the choice of a region, but not necessarily the choice of a site within a region. And studies that suggest that certain companies choose trendy urban environments in order to attract creative workers generally apply to high-tech or media companies, rather than the financial industries and business services that form the backbone of the office market.

Businesses do consider proximity to related or ancillary businesses in making location decisions – the clustering effect.[58] This may affect not only the choice of a region, but of a place within the region. For example, now that so many high-tech businesses have already settled in Markham, other, newer high-tech businesses are likely to follow them. In terms of the demand for office space, this phenomenon is known as "the making of the market." Companies that have already left downtown for Toronto

[58] "Clusters…include end-product or service companies; suppliers of specialized inputs, components, machinery, and services; financial institutions; and firms in related industries….firms in downstream industries… [and] institutions, governmental and otherwise, that provide specialized training, education, information, research, and technical support." Michael Porter, quoted in Meric Gertler, "Smart Growth and the Regional Economy," Toronto: Neptis Foundation, 2003.

"suburbs" of North York, Western Etobicoke and Scarborough are also predisposed to relocation to the 905 in part because their business networks are already there.

Once a business has made the decision to locate in the GTA, it faces the choice of downtown Toronto, midtown, the inner suburbs within the City of Toronto, or a location in the 905 region.

Toronto's downtown office towers are now several decades old, and were built before the days of electronic communications. Although they have been extensively refurbished to accommodate information technology, companies may still find them too dated or too constricted for their needs. The suburbs offer newer office spaces, up-to-date public facilities, and infrastructure that is, by and large, in a better state of repair.

At the same time, some companies prefer to own their own building, clearly marked with their own name, than to rent several floors in someone else's building, where their presence is less visible and where they must pay for common spaces shared with other tenants. The suburbs offer the option of creating brand-new, customized, Class A space for individual companies. Companies that want to make an architectural statement with their head offices generally do so in the suburbs. By comparison, creating new office buildings in the City is a more complicated process than building on a greenfield site in the suburbs. Rezonings in the City tend to lead to opposition from neighbouring businesses and residents, often leading to an Ontario Municipal Board hearing over issues such as parking, traffic, wind, shadowing, and so forth. Suburban office developments tend to be much less contentious and protracted. And since delays cost money, quicker development is better for the bottom line.

Another factor - much harder to document because the market is dynamic – is the willingness of developers in the 905 to build offices "on spec." Because taxes are so much lower it is far less risky to build new space in the 905. So when potential tenancies arise, deals can be struck more readily in the 905 because construction is either well on the way or complete. In contrast, the time lag from lease signing, to completed construction to meet the needs of a Toronto-based tenant - without "spec" building - is prohibitive. The carrying costs of unleased, completed space are significant because of the tax burden and a major deterrent to proceeding with new construction in Toronto.

Space in the 905 area is not only more plentiful, it is also cheaper, both in terms of buying land or renting space. The cheapness of suburban land allows companies to be fairly prodigal with space. Many corporate campuses in Mississauga and Markham include acres of free parking, wide sweeps of attractive but unusable landscaped grounds, and low-rise buildings with very large floorplates.[59]

The 905 area and some of the inner suburbs also offer "free" parking.[60] In a study of the dynamics of the Greater Toronto Office Market, completed for Metro Toronto in 1990 by Hemson, adequate, affordable parking was cited in every case study of every office node – that is, either the lack of it was considered a disadvantage or the presence of it was considered an advantage, depending on the company and the location. One respondent, when asked about the factors that were important in choosing a particular office location, said simply, "Parking, parking, parking."[61]

Toronto's downtown offices are accessible by transit, and parking is necessarily priced high enough to cover the cost of providing underground parking as well as higher land values. Although this encourages office workers to use the TTC and GO systems, this can render downtown office locations inconvenient for visitors to the office buildings who drive.

Many office developments in the 905 area are close to highways, which allows office workers to commute from locations spread throughout the region. At a time of two-career families and greater job mobility, living close to work is not a luxury everyone can afford or arrange. It is not even something that everyone wants. Office locations close to highways are also convenient for deliveries, shipping, and visits from clients who drive.

Location decisions also factor in costs, such as land costs and development costs. In the central city, there are no greenfield sites available for development. Land costs may include the cost of assembling a parcel in areas where ownership is fragmented, or, in the case of formerly industrial lands (brownfields), decontamination costs. Previously undeveloped suburban land is undoubtedly cheaper to buy than land in the central business district.

Development costs include carrying costs during the process of obtaining planning permission, construction costs, and servicing costs, which include development charges. In the City, the process of securing planning permission is often prolonged by objections from businesses and residents near the proposed site, which increases carrying costs. Construction may also be more expensive in the City, since the site may be hemmed in on all sides by other buildings.

Development costs, however, are only a minor differential. Central cities offer land that is already serviced, and development charges are low or non-existent. Although in theory, servicing and development charges should be more expensive in the suburbs, where the land may not have full services, and where watermains, sewers, and roads must be created or extended to accommodate a new office building or campus on a greenfield site, in practice, suburban development charges rarely reflect the true costs of servicing, but are based on average costs, and do not vary

[59] Although statistics indicate decreasing amounts of floor space per employee, an estimate of land consumed per employee suggests a different pattern. A typical office building in downtown Toronto, built on an acre of land at an FSI of 8x, accommodates approximately 1200 employees (assuming a generous 250 sq ft per person). To accommodate the same number of workers in the 905 would require approximately 10 times as much land (assuming a maximum FSI of 0.7 – the maximum that can be built with surface parking using normal parking requirements of five spaces per 1000 sq ft of leasable area).

[60] For employees commuting to suburban locations – typically by car – the trade off between convenience and "free" parking with having to pay $100 or more for a transit pass on a monthly basis is psychologically appealing. Operating costs for a car related to commuter travel tend to be blended with other activities.

[61] Dynamics of the Greater Toronto Office Market, Hemson Consulting, March 1990. Appendices, unpaged, section III.C.

according to the location or the development's likely demand for infrastructure (such as development that has a higher-than-usual need for water or roads).[62]

Finally, costs include property taxes, discussed in the previous section. There is no question that commercial properties in the City of Toronto bear a disproportionate tax burden. What is less clear is the effect of this burden on office location decisions.

In a 2002 paper on municipal finance and its relationship to the pattern of urban growth, Enid Slack noted, "Other things being equal, property taxes not matched by service benefits have the potential to discourage development, reduce property improvements, building size and the number of buildings, reduce the density of development, and likely affect business location decisions within metropolitan areas. What is not clear, however, is how much the property tax actually influences land use decisions. As [Frederick] Stocker notes [in a 1973 article on property tax and land use], there is a fair bit of agreement on the direction of the impact, but 'not much evidence on the strength'.[63]

It should also be noted that although the impact of tax inequities on development patterns or market viability has not been widely reported in the literature, there are few jurisdictions with the kind of blatant inequities that exist between 416 and 905, which may explain why the impacts have not been studied in depth.

3.3.2 What the Decision Makers Say

To better understand the factors considered by companies when making locational decisions, we undertook a series of in-depth interviews with decision-makers through a combination of face-face interviews and telephone surveys. The companies are grouped under four main categories:

- Companies that have recently renewed or made major commitments to new office space in Toronto.
- Firms that have moved all or a major part of their operations from Toronto to the 905, outside the GTA or elsewhere in Canada.
- Companies that have come to Toronto or the 905 from other jurisdictions.
- Firms that have recently renewed their commitment to the 905.

Our questions covered the costs of office space in different locations, and the amenities required to satisfy corporate objectives and the needs of employees. We were also interested in the corporate structure of the company being interviewed: are there multiple locations, a single location? Is it a head office or a back-office function? What were the circumstances that triggered the location decision? Was it a lease renewal; the desire to consolidate several locations under one roof; or was the motivation to reduce overhead, keep costs stable during an expansion phase? We present the results of these interviews in a way that protects the confidentiality of the participants. (The questionnaire is provided in Appendix B.)

[62] Pamela Blais, "Smart Development for Smart Growth," Toronto: Neptis Foundation, 2003, p. 16.

[63] Enid Slack, "Municipal Finance and the Pattern of Urban Growth," Toronto: C.D. Howe Institute, February 2002, p. 13.

The following is a summary of insights gleaned from more than 30 interviews:

Lease renewals and/or corporate consolidations are the principal reasons for reviewing office location. The most common triggers for reconsidering office location are lease renewal and/or corporate consolidations. Although “lease renewal” was cited as the motivating factor for initiating a review of space in nearly every interview, we were struck by the large number of companies that needed to address issues related to acquisitions, restructuring, and other matters related to corporate changes. This reflects the volatility of the current business environment, and a preoccupation with managing operating costs.

Business practices continue to evolve, resulting in a desire by companies to retain as much flexibility as possible. The rapid pace of change affects businesses of all sizes and types, regardless of the sector or niche occupied by the company. As a result, companies are drawn to office space that will remain affordable if business decreases (resulting in layoffs) yet capable of absorbing more employees if the business expands.

Since newer space is perceived to be more easily reconfigured than older space, the desire to retain flexibility favours locations in the 905. One executive expressed concern that although his firm was at present committed to maintaining its presence in downtown Toronto, the stock of buildings is aging, and unless new buildings are constructed, the prestige of a downtown address may wane.

Certain firms value downtown and other transit-oriented locations in the City for providing access to essential professional services, transit, and other amenities, but these qualities will not always be unique to Toronto. For companies committed to maintaining their office location in Toronto, some executives place a premium on access to "top-quality advice" available from nearby professional service firms. Others cite the quality of the working environment in downtown as an essential quality for attracting and retaining high-calibre professional staff. Companies that attract employees from throughout the GTA may prefer a downtown Toronto location – at present – because it offers access to the TTC and GO systems, as well as highway access from the Gardiner Expressway. These companies accept the higher costs of conducting business in Toronto, because they can meet employee accessibility requirements. But one company indicated that if a 905 location could be found that offered similar transit accessibility, the opportunity to reduce operating costs in a lower tax environment would likely prove "irresistible."

Several executives mentioned the paradox of paying a premium to locate a business unit in "post-and-beam" space near downtown Toronto, which, after taking into account communications upgrades, is more costly than Class A space in the core.

One interviewee noted that the qualities that make Toronto attractive require constant reinvestment. Others expressed concern that if essential public infrastructure such as the subway and other visible assets such as public spaces, sidewalks, and street furniture are not kept in a state of good repair that this could affect how companies view their "investment" in premium space. Several firms noted that as the 905 locations increase the kinds of goods and services they offer, the differential between Toronto and neighbouring jurisdictions is becoming less noticeable. One individual predicted that as the markets mature in suburban 905 locations, there will be a shift in priorities. The old adage of "location, location, location" is less relevant today than in the past for many firms.

Some companies that operate premises in both Toronto and neighbouring suburbs are concerned about the differential in occupancy costs between jurisdictions. If there are operational differences – for example, downtown is the executive branch and the suburban location is the back office – occupancy costs per employee are less of an issue. But as suburban locations acquire a greater mix of activities, and become better able to support tasks that were formerly the sole purview of downtown locations, the cost differential becomes more of an issue.

On a more positive note, one Toronto-based company that recently relocated to different premises in the same general area in which it has operated for many years commented that it had originally moved out of downtown to a location near the DVP and Eglinton in order to reduce costs. With the passage of time, the company has seen much of its day-to-day client contacts shift to the 905. Having decided to stay in its present location (albeit in different premises), the company now finds that its sales force can cover both the 905 and central Toronto, although rising congestion levels in both locations remain a concern. Time lost to highway congestion outweighs property costs, because the firm does not occupy a lot of space. Although sales staff try to plan their sales calls to avoid the worst congestion, there are limits to what can be achieved in this regard. Another executive based in Markham added that she tries to avoid business meetings in the central area at all costs in order not to lose time to congestion.

Some interviewees were very concerned about discrepancies between assessed values and taxes paid. The tax cap instituted by the Province of Ontario has caused hardship to a number of companies. One interviewee from a company that owns its premises told us that following reassessment, annual taxes should have been reduced by approximately two-thirds, but the company has not been able to benefit from this reduction because their taxes are locked in to the original assessed amount. Although the ratable value is adjusted downwards by 2% annually, the cumulative "penalty" amounts to several million dollars over time. Since this amount cannot be recouped, the company is highly "motivated" to find new space in the 905 when its lease becomes due.

When companies consolidate, they tend to choose 905 locations. A large number of firms interviewed have been through "serial acquisitions," leading to the consolidation of operations. In several instances, companies used the relocation process to meld the corporate cultures of former competitors. In such cases, firms typically select a "neutral" venue. Having established a budget to accommodate consolidated operations, companies typically worked with brokers to review options. Since brokers tend to work with the familiar, choosing a broker located in the suburbs will almost always result in selection of a suburban location. We heard from several companies that when locations in Toronto were included in the list of potential sites, there tended to be too few options to choose from. By and large there is a greater range of options in 905 locations at any given time.

Vacancy rates also influence decisions, as well as the availability of sublets. In one case, however, a major financial services firm was able to consolidate in downtown Toronto because the right property was available at a "bargain rate." In this example, the client stated up front that the company would have been prepared to pay a small premium to consolidate its operations in a location close to public transit in the downtown.

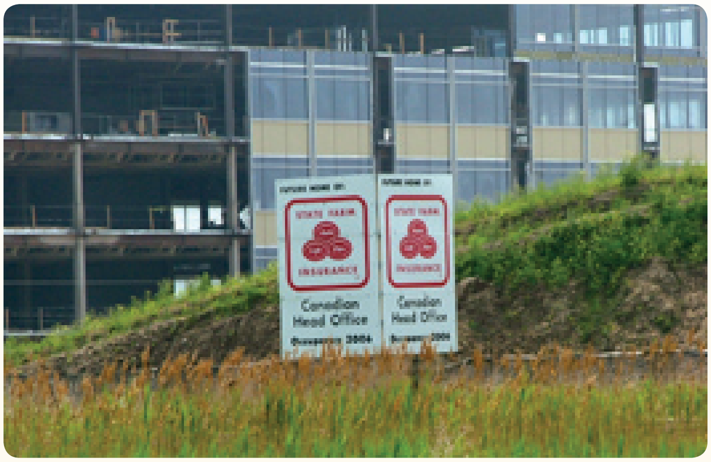
We also interviewed companies going through a process of consolidation that see ownership as a reasonable alternative to leasing so they can "control their own destiny." Companies with several thousand employees indicate that ownership is sometimes preferred over leasing, depending on the company's tax structure and operating procedures. Others, however, preferred to rent because "real estate management is not a core competency."

High occupancy costs in Toronto are a critical consideration, but are seldom the sole determinant of office location. In almost all cases, companies were concerned with overall or total occupancy costs, a major component of which in the case of Toronto-based companies is property tax. One large company with a long-term lease commitment in downtown Toronto cited the need to understand market cycles in order to be able to negotiate "suburban rents" for higher-value locations at the appropriate time. This works both ways, however. We spoke to representatives of firms that during the overheated market of the late 1980s had anticipated significant rises in rental rates by locking in to what proved to be above-market rates. This occurred in Toronto as well as the surrounding 905. Once burned, twice shy: this situation is unlikely to recur. We also encountered one company that, having left the Toronto market, continues to pay for space in Toronto that it no longer occupies rather than paying the penalties to be released from their commitment.

A by-product of consolidation in the financial services and management consulting fields is that the surviving firms have become increasingly cost-conscious. Several firms indicated that they maintain offices in downtown Toronto to "maintain a presence" or to "service a few large clients," but that they had moved large numbers of employees to suburban locations to keep costs down.

Several interviewees also noted that relocation from downtown to "suburban" locations is nothing new. For firms that made the move to North York, Western Etobicoke or Scarborough a decade ago, a move to the 905 presents relatively minor "dislocation effects" and the decision to relocate is made easier by the relatively high costs (i.e. high taxes) of occupancy in Toronto's "suburban" locations.

Head office functions in downtown Toronto require smaller amounts of space nowadays. For financial services companies that have multiple locations to serve Canada and the United States, specialized business operations are typically split up on a geographic basis. Selection of an office location in the Toronto area is determined by thenature of the function carried out here. In cases that warrant a "head office presence" in downtown Toronto, for example, the functions carried out in the financial core are "high value" but typically do not occupy large amounts of space. If, however, the office is not the head office, locations are selected that can accommodate executive and support staff in one place. The number of employees to be accommodated is clearly a key consideration, since this affects not only the cost per employee per square foot but also the nature of the space required. There is also an important relationship between occupancy costs and employee status: professional staff who generate high fees can be supported in more expensive space; the less "productive" (in dollar terms) the employee, the stronger the pressure to locate that employee in less expensive space.



When companies have locations in several countries, international experience can influence expectations. One company with offices in other large cities in Europe and North America suggested that their management is used to having choice when it comes to selecting office space. As a result, even though the GTA is one of the largest markets in North America, these managers consider that Toronto offers a limited range of options. One complaint (unsubstantiated by the facts) is that Toronto office space is either "premium" or "cheap," with nothing in the middle.

On the other hand, international comparisons can work in Toronto's favour, as the quality and diversity of the labour market available in the GTA is viewed favourably by global companies. U.S.-based site selection experts say that for global firms looking at different jurisdictions, property taxes are almost never taken into account in deciding on which City-region to choose. Companies consider local property taxes only after a decision has been made to locate somewhere in the region.

For companies with a high proportion of professional staff, the choice of location reflects company culture. The ratio between executive and support staff is a critical variable. If the latter is dominant, the location decision depends more on the cost of accommodating large numbers of employees. If the proportion of executive staff is higher, their preferences tend to prevail. Thus, for companies where image and access to professional services and clients is important, higher occupancy costs associated with downtown Toronto will be tolerated, although one executive commented that "nothing is forever," and that if the company's clients leave downtown in sufficient numbers, that rationale might no longer be valid.

Some companies see themselves as being "downtown" companies (citing the benefits of public transit and the perception that female employees will be safer in a busy downtown environment), while others are content to select suburban campus-type locations. When a company's roots are in the United States, and its head office is located in a campus-type location, this tends to influence the choices made by the local office.

Suburban locations are selected for many reasons other than cost. For the most part, companies that have relocated or decided to consolidate operations in suburban locations outside the City of Toronto suggest that they are satisfied with their choices. Although most firms conducted employee surveys before relocation, few have done formal follow-up surveys. Anecdotal evidence points to a high degree of pragmatism, however.

In some cases, firms hinted that "grumblings" over a move to the suburbs have been dealt with by bringing in health facilities or special catering arrangements (or contracting to have such services available close by), to counter the lack of such amenities in the area. Such solutions are considered to be cost-effective, because employee productivity is a priority. In other cases, companies are willing to lose and then replace some employees, although most firms indicate that relatively few staff give up a good job for a poor location. "They get used to it," said one human resources specialist.

Some interviewees noted that employee productivity can improve in suburban 905 locations where there are "fewer distractions" ("They take shorter lunch breaks") and that interaction around the only available coffee station can stimulate better employee morale. On the other hand, a few firms provided amenities in their downtown Toronto offices, even though the area was rich with alternatives, as a way to encourage their employees to stay late and work longer hours.

A number of firms have made special arrangements to help employees adjust, at least for a transitional period. These arrangements include the provision of shuttle buses, facilitated car-pooling, and even assistance with relocation costs. We also heard that several suburban municipalities improved local bus service from GO stations, where large numbers of employees are involved.

Several firms with experience in suburban locations have invested in retrofits of their "parklike" settings to enhance the perception of employee safety, particularly at night when female employees are crossing deserted parking lots.

One company that relocated a business unit to a suburban Toronto location more than a decade ago has seen employees gradually shift their place of residence to accommodate the move. Because the company owns the building, employees felt confident that the move was long-term, justifying the decision to move their place of residence.

A number of firms opting to relocate to the 905 from Toronto cited employee satisfaction as a key goal. Several interviewees said, “We employ young professionals who can’t afford house prices in Toronto and who want to be close to their families.” Others indicated that their choices were influenced by the location of employee residences (already in the suburbs).

Toronto companies that conducted polls found that employees strongly preferred to remain in downtown Toronto and viewed commuting to suburban locations as “time lost to congestion,” or “psychological torture,” even though their staff for the most part currently live elsewhere in the suburbs. There were also divergent opinions on the efficiency of space. Although some companies suggest that greater efficiencies come from large floorplates, others argue in favour of smaller floorplates found downtown and other transit-accessible locations in Toronto.

We conclude from answers to this question that company culture is a strong determinant in decision-making: also, few companies claim that their decisions are democratic!

For the most part, the larger the company, the higher degree of importance placed on the symbolic aspects of a location decision. For example, one high-profile company indicated that in addition to the practical benefits flowing from consolidation following a series of acquisitions, maintaining “scattered” locations was inconsistent with the company’s desired image. Another firm cited the need to be able to provide free parking for visitors (a function of its business model). A number of companies either relocated or chose to consolidate their operations close to the airport. In such cases, the bulk of the office location options available are on the 905 side of the municipal border. Two firms commented that occupancy costs (including property taxes) were noticeably lower in Mississauga. We were struck by the number of times that interviewees cited the need to get to the airport quickly as an influence in their location decisions.

Several firms that have either moved to or consolidated their operations in the Airport Corporate Centre (or comparable locations) cited the fact that as much as half their staff spend more than 60% of their time visiting clients in other cities. Not only do these firms need easy access to the airport, but they are able to lease less space than they would otherwise need because they practice “hotdesking” or “hotelling” (the practice of providing staff with office space only when it is needed, supporting staff to be “mobile” and/or relatively more reliant on home offices).

In sum, we conclude that—like the death of a thousand cuts—it is the combined effect of different concerns that add up to decisions to leave the City. For example, concerns about high tax rates, traffic congestion and the difficulty of getting to the airport collectively add up to a powerful set of barriers to be overcome.

3.4 PUTTING IT ALL TOGETHER

What does all this mean for offices in the City of Toronto? Our review of the factors that have led to the current pattern of office development in the City and its surrounding regions leads us to the following conclusions:

- The trend to the suburbanization of offices is not unique to Toronto, but is the result of large-scale economic changes, including economic restructuring and the increasing use of information technology.
- Planning policy in the Toronto region has been ineffective in imposing an orderly pattern on commercial development, and has allowed the creation of employment sprawl. Despite years of talk about the need to establish and maintain a pattern of "nodes" and "corridors," this pattern has never been enforced. Continuation of current development trends will inevitably add to congestion and perpetuate the spread of the region at densities that cannot support public transit. This does not bode well for the future competitiveness of the region.
- The City of Toronto's current planning policies appear to favour residential development over office and other commercial development.
- Property taxes for office buildings in Toronto are high relative to other classes of buildings within the City and to office buildings in other parts of the region. Property tax reform in the 1990s failed to address this situation, and may have made it worse, because of the way the education tax is imposed, and because of clawbacks that prevent businesses from getting the tax break the system was designed to offer.
- Transportation access to the central City has remained essentially unchanged for decades. In part, this is the result of deliberate policy decision by the City, in part it is the result of repeated failures to coordinate transportation throughout the region as a whole.
- Business owners who make location decisions for many reasons, and cost is only one. Their decisions reflect the company structure and culture. However, most of them want flexibility, in order to avoid getting locked in to certain amounts or configurations of space.
- Downtown head offices are getting smaller.
- Consolidation of operations is a key reason why companies move from Toronto to the 905 region.
- Although companies cite employee satisfaction as a factor in location, different companies have different employee profiles: for some, access to affordable suburban housing may be a priority, for others, the preference is a location close to downtown amenities.
- Employee satisfaction must be weighed against employee productivity, and some companies find that employee productivity increases in 905 locations, because of the lack of "distractions."
- Proximity to the airport is important for many businesses, and since costs are lower in Peel and York regions, these businesses generally choose the 905 area over northwest Toronto.

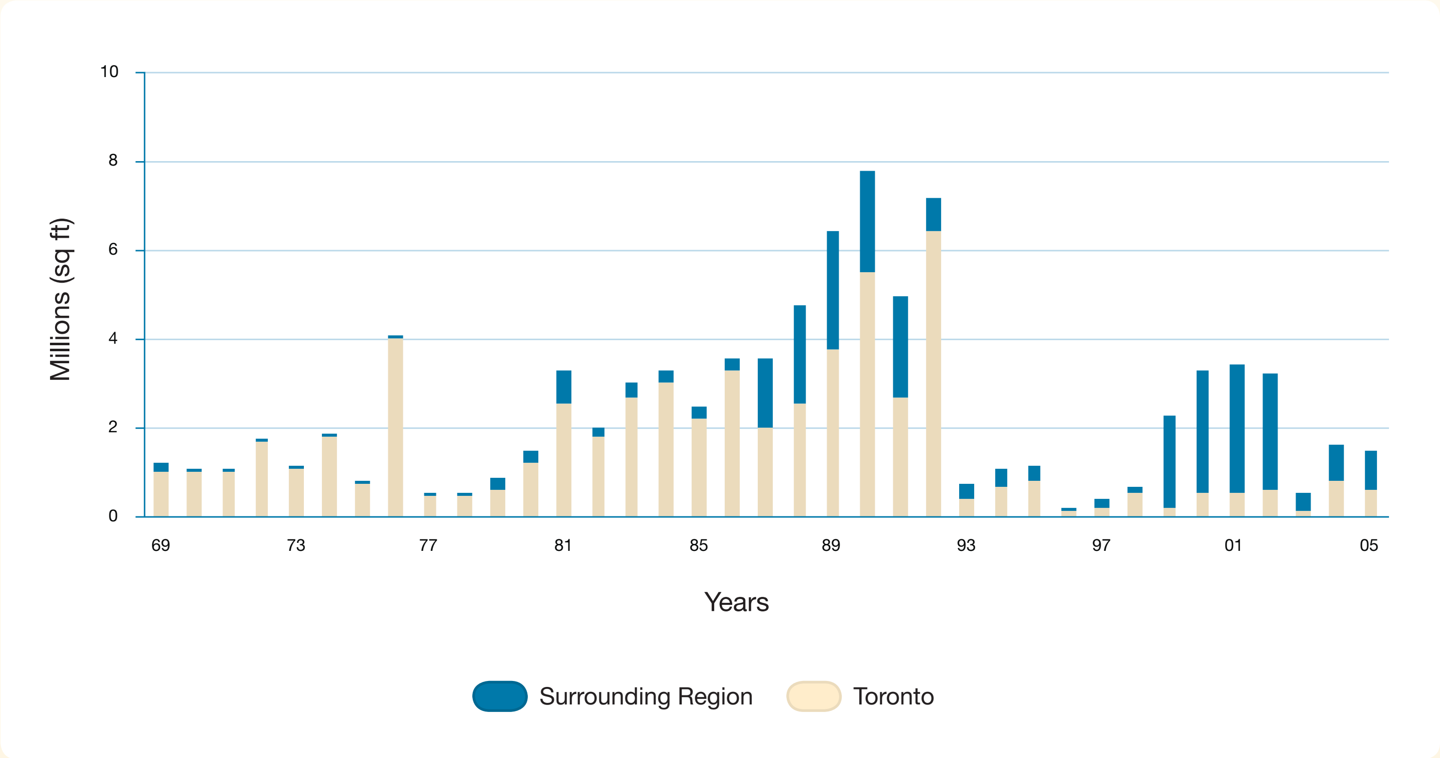
4.0 Killing the goose that lays the golden egg

4.1 THE UNINTENDED CONSEQUENCES OF NEGLECT

There are many wonderful things happening in Toronto, but commercial office development is not one of them. Tourism has bounced back after the SARS scare, cultural facilities are being created or expanded, condominium development is booming. The "night-time" (residential) population is increasing but the same cannot be said of the "day-time" population of people who work in the City.

Companies are moving and will continue to move from 416 to 905. This robs Toronto of potential assessment value and also removes significant numbers of jobs – with their associated spin-offs in terms of spending – from the Toronto economy. The Toronto central area, including the Financial District, will continue to serve its role as a centre of provincial government, culture, tourism, and entertainment, but without continued stimulus resulting from commercial growth, will become increasingly insignificant as an office employment centre.

Figure 4-1: Class A Commercial Office Space Growth in Toronto and Surrounding Region Year by Year 1969-2005



Source: InSite Real Estate Systems Inc.

Comparatively higher taxes make it increasingly difficult for developers to undertake the construction of new office buildings in Toronto; over time the viability of the Toronto market for office space will begin to decline as the stock gets older, choices for prime users become fewer, and companies continue to move out to suburban locations. If current tax inequities continue, office buildings located outside of the financial core and in other places without regional transit will find it increasingly challenging to maintain the quality and upkeep of their buildings if the market proves unwilling to pay for upgrades and building improvements.

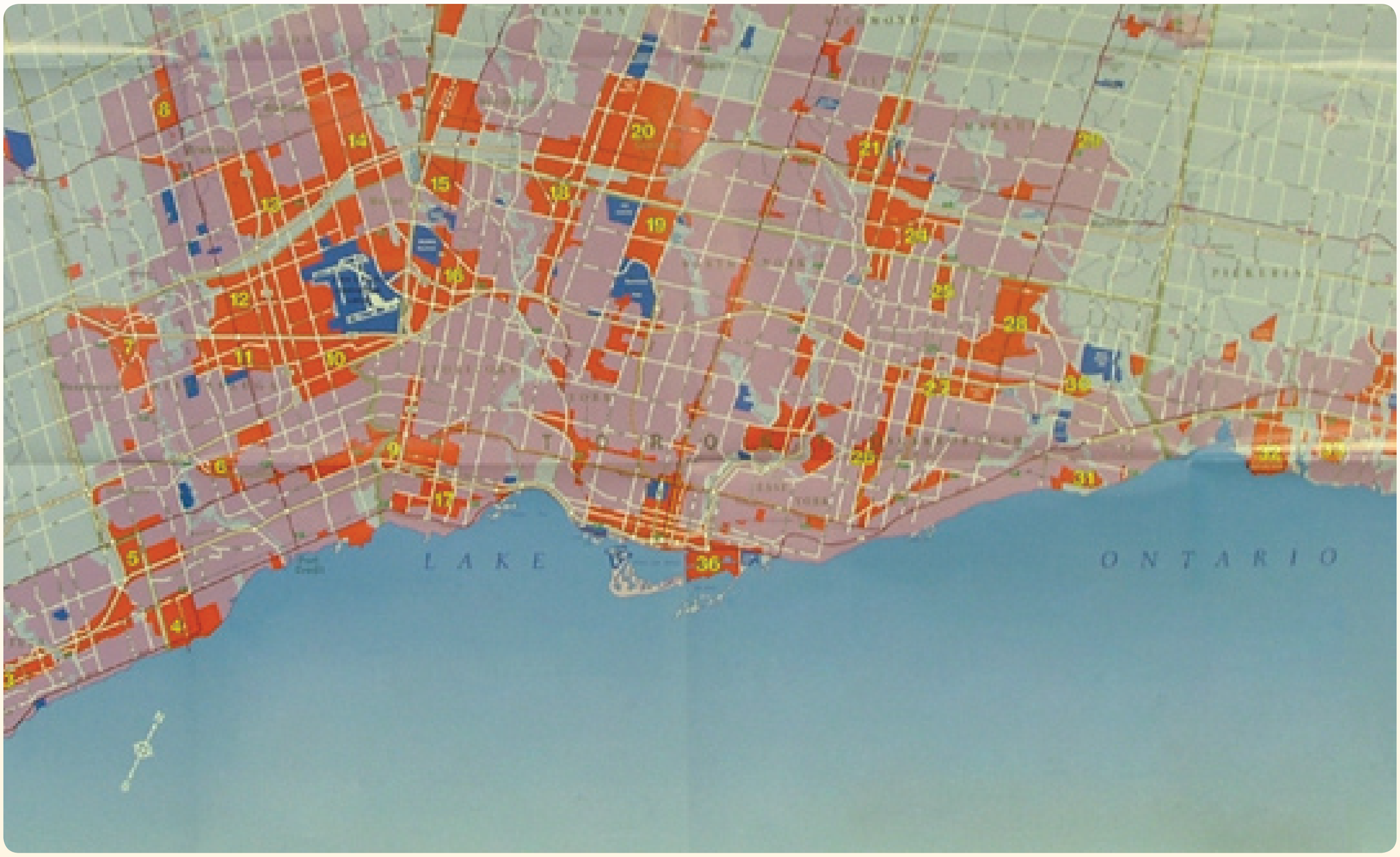
For years, Toronto offices have been the goose that lays the golden egg for the City in the form of high property taxes that support many of the amenities that Toronto residents take for granted. Yet the health of the goose has been ignored and the goose may end up dying of neglect. Offices are well down on the list of municipal priorities, below such things as housing, urban design, air quality, waste management, and public safety. Although promised improvements in these areas, as well as ongoing repairs to roads, streetcar lines, and water pipes, will no doubt benefit office tenants at least indirectly, little is being done to directly address the needs of office owners and tenants.

The situation bears some similarity with the situation of industrial space occupants in the 1980s. In this period in Toronto's development, property taxes in the former Metro Toronto were not only uncompetitive (with what we now refer to as) the 905 areas surrounding Toronto but were calculated on a different basis. Developers and owners of industrial space had to compete with thousands of acres of newly accessible industrially zoned land (thanks to the construction of 400 series highways by the province). The result was a sustained period of development of industrial space. The GTA now has more industrial space than the next 10 largest metropolitan areas in Canada combined, but the role played by the City's industrial space in that total is much less important than it once was. If current conditions continue unabated, history may yet repeat itself, with the City's office inventory getting older and less competitive.

Is Toronto's destiny to become a bedroom community for the 905 region? This is surely not the intention of any level of government, although it may be the unintended consequence of years of neglect.

The alternative is to create policy that explicitly favours new development and job creation in the office sector and that addresses the economic health of the City. Before considering recommendations for the City and the province, it is useful to consider Chicago, which has a policy that favours business in the City.

Figure 4-2: Industrial Areas in the GTA



Source: Toronto Real Estate Board 2004 Greater Toronto Area Industrial Areas and Values

4.2 CHICAGO'S CENTRAL AREA PLAN: STRIVING FOR "URBAN GREATNESS"

Chicago is actively addressing the correlation between a vital downtown office sector and a healthy regional economy. The city's 2003 Central Area Plan outlines a strategy designed to strengthen downtown Chicago's economic base, expand its parks and open spaces, and improve its transit and roadway networks. Chicago recognizes the inherent value and promise of its downtown, and reflects this in its "plan for urban greatness." By focusing on the interdependent themes of development, transportation, and open spaces, the city is effectively addressing the need for a coordinated and comprehensive commitment to achieve the long-term success of its downtown, the city, and the region.

The plan reflects the vital importance of the city's central area, stating that business success depends on a high quality of life. Chicago's changing economy has also shifted away from its industrial heritage: even though 70 million square feet of office space was constructed between 1960 and the present, total employment increased only slightly during that period as a result of losses in blue-collar employment. The city's office sector, its "economic engine," is projected to grow by 1.6 million square feet yearly over the next 20 years in the central area of the city.

To encourage and accommodate this growth in the office sector, the city has recognized that a holistic approach is necessary, building on its existing strengths and prior successes. To avoid crippling traffic congestion, substantial investment will be made in its transit and transportation networks. Open space is being improved and expanded, and additional places to live in the central area will be provided. These improvements are paid for from funds generated through Tax Increment Financing. There is also provision for the City of Chicago and the State of Illinois to selectively intervene to "land" or "retain" major employers. In special cases, the city is able to "buy down" land costs for specific sites through a process known as "development notes." Building upon the City's historic role as a transportation hub, a dedicated group made up of Chicago's academia, business, and government are investing heavily in what has become one of the world's largest and fastest information networks; this has already been a vital factor in attracting large businesses to the central area.

Regional competitiveness is dependent upon the success of the core. By concentrating office development in its dense and diverse central area, Chicago will make maximum use of its existing infrastructure and reduce the pace of regional sprawl. Additional development will be reorganized to major corridors that are presently served by, or conducive to service by, rapid transit.

Jobs will be created, the plan asserts, if and only if these potential workers are provided with efficient transportation, high-quality work environments, and places to live in the central core. The Central Area Plan constitutes a committed and earnest effort on behalf of the City to realize these essential goals.

5.0 Recommendations

The City of Toronto is the heart of the largest and most important economic region of Canada. The GTA accounts for nearly one-fifth of Canada's GDP. Despite competition between the 416 and 905 areas, the region needs to function as an integrated whole in order to compete internationally with other City-regions. The health of the City affects not just the well-being of those who live and work inside the City limits; it affects the whole region. Yet for years, the City has neglected one of its most important assets: the office sector. Offices are overtaxed and under-supported. It is time to reverse this trend.

1. The province should impose a single uniform commercial tax rate across the region in order to reduce current inequities that are distorting the office market in the GTA.
2. The province should adjust the distribution of the educational portion of the commercial tax in order to reduce the impact on commercial property owners in the City of Toronto.
3. In the interim, the City of Toronto should take immediate steps to accelerate the rollback of commercial property taxes in order to improve the viability of the Toronto office market.
4. The City and the province should follow through on a commitment to redevelop thousands of acres of underutilized brownfield sites in the City of Toronto to help the City recover its employment base and to increase the availability of employment land.
5. The City should identify priority areas for office employment in order to give effect to its stated goal of "protecting Employment Districts from incursion of non-economic activity."
6. All levels of government should work together to accelerate planned improvements to Union Station and to enhance GO service linking Toronto with the rest of the region.
7. All levels of government should continue with plans to construct a rapid link between the airport and downtown Toronto as soon as possible.
8. The province should streamline environmental and other approvals for these and other transit initiatives that will reduce traffic congestion.
9. The province should work with regional, local governments and other stakeholders in the 905 to support their efforts to create higher density employment nodes in locations with adequate transit service or which have the potential to be served by higher order transit.

APPENDIX A

Data provided by InSite Real Estate Information Systems Inc (RealInsite) illustrates the differences between average occupancy costs within the three main office areas within the City of Toronto (the Financial Core, the North Yonge area surrounding North York City Centre, and in Toronto West around Burnhampthorpe Rd. and the 427), and a selection of office commercial nodes within the suburban 905 region (the Airport Commercial Centre, the junction of Highway 404 and 407).

Total occupancy costs for Grade A office space were disaggregated to show average net rents, average property taxes and operating costs (common area, utilities, maintenance etc.) on a per square foot basis. These costs were compared across a selection of building sizes to test for differences across a selection of facility types.

Figure A-2 shows the total occupancy costs in a selection of office regions within the GTA broken down by component costs. In this graph, the relative parity between average rental rates in outlying areas of the central City (North Yonge and Toronto West) and suburban locations can be seen along with the relative disparity between total office space costs on either side of the suburban boundary.

This is evidenced by the significantly higher average rents paid for downtown office space. The financial core area has average rents that are consistently five to eight dollars per sq. ft. higher than elsewhere in the region. There is also a limit to what the market can bear. Since the only variable in total occupancy costs is rent, the effect of the relatively high tax rate is to limit the potential for rental increases.

A report prepared as background for the City of Toronto's new plan[64] suggested that the impact of the tax differential is felt by owners of Toronto office buildings outside the core. The GHK report emphasizes that commercial tax rates apply to all areas of the City and suggests that outlying locations within the City are in much more direct competition with office clusters elsewhere in the region. High commercial property tax rates are therefore much more likely to be shifted back onto owners in these outer City areas, reducing the incentive to develop new properties or to reinvest in existing ones.

Our analysis also examined the relative size of buildings in each sub-market to determine the effect that building size has on average occupancy costs. Because buildings in the financial core tend to have larger amounts of common area space than suburban buildings, we selected buildings that were physically similar. Even so, operating costs tend to be higher than comparable larger buildings in the 905.

Although the Toronto West and North Yonge sub-markets have accessibility and location characteristics similar to sub-markets in Mississauga and the 404-407 areas in Vaughan, the high property taxes in the Toronto sub-markets place these areas at a cost disadvantage. Rent levels are quite similar, as are operating costs. The major difference is the property tax. Figure A-3 shows that while Toronto West features lower average net rents, total occupancy costs for office space are significantly higher than the cost of similar space in Mississauga. (Note that for a certain size of building (100-200,000 sq.ft.), total operating costs are slightly higher that in the comparable Toronto West location. The rest is significantly higher in Mississauga for this size building, reflecting other factors such as building age.) These findings help explain the impact that higher commercial tax rates appear to be having on demand for office space in these outlying areas of Toronto.

[64] GHK International – Canada (2003) "The Future of Downtown Toronto: A Note on Commercial Property Taxes." Prepared for GHK by Dr. David Nowlan, University of Toronto.

Figure A-1: Average Occupancy Costs for Select Commercial Markets

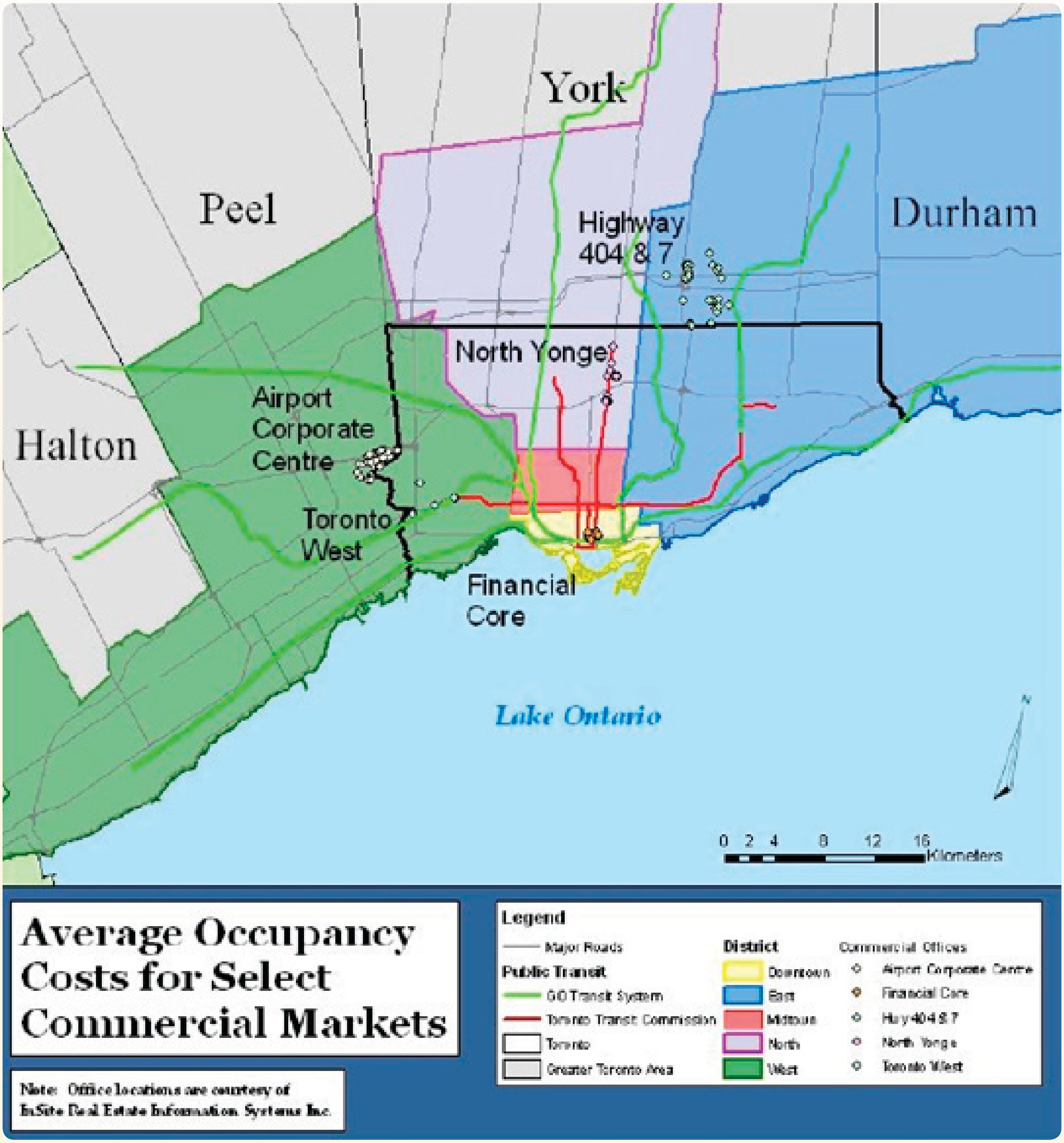


Figure A-2: Average Total Cost (Disaggregated) by Region: Buildings <100,000 Sq. Ft.

Figure A-3: Average Total Cost (Disaggregated) by Region: Buildings 100,000-200,000 Sq. Ft.

Figure A-4: Average Total Cost (Disaggregated) by Region: Buildings 200,000-300,000 Sq. Ft.

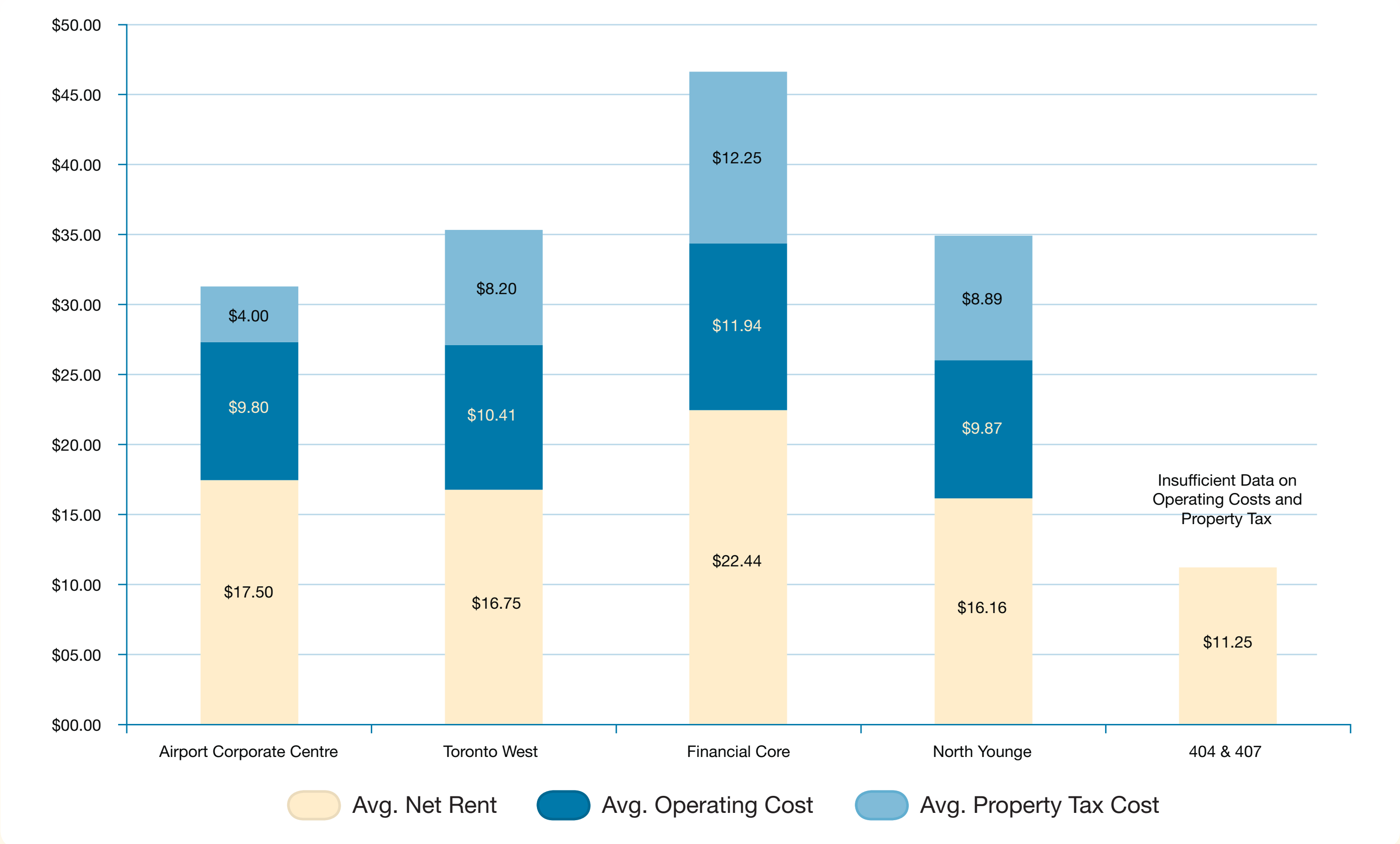
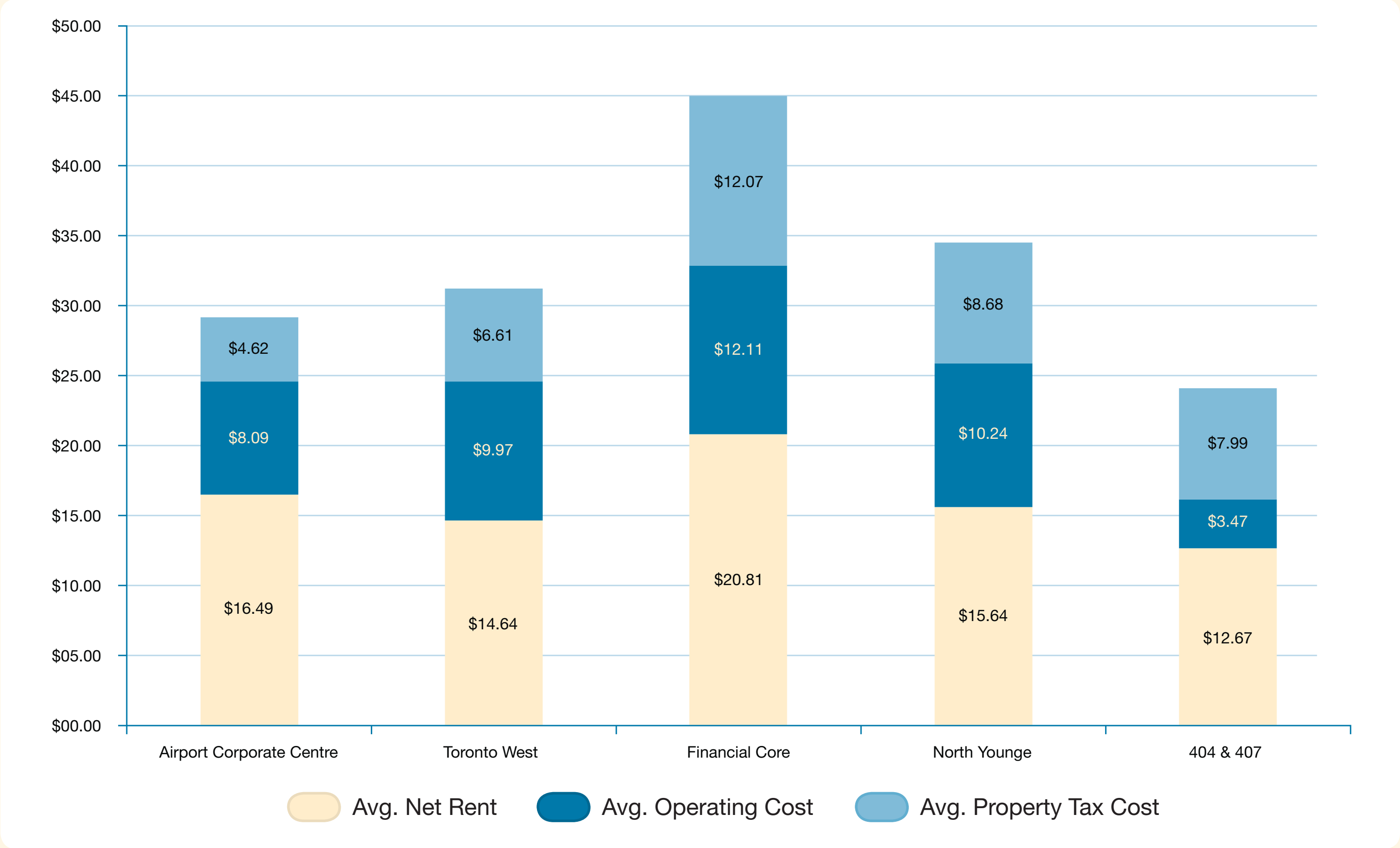


Figure A-5: Average Total Cost (Disaggregated) by Region



APPENDIX B

INTERVIEW QUESTIONNAIRE

1. Name of firm
2. Contact (N.B. the identity of individual firms or their representatives will not be disclosed in the study)
3. Current location
4. Previous location and date of relocation
5. Nature of business activity
   - Approximate ratio between professional or executive personnel versus support staff
   - Corporately owned or tenant in competitive space
   - Single or multiple locations
   - Head office, back office, regional office
   - If in the 905 now, can the needs of Toronto market be met from that location?
6. What was the single biggest issue behind the decision to commit to your current location?
   - Corporate objectives
   - Financial (occupancy costs)
   - Employee needs
   - Other
7. What was the trigger?
   - Lease renewal
   - Company reorganization
   - Consolidation of properties and/or functions
   - How many employees were there before and after the relocation?
   - Did your company commit to more space or less space?
8. What was the process followed?
   - Was a broker retained?
   - If so, location of broker
   - How were the needs of employees addressed?
   - Have employees been canvassed since the relocation?
   - Is there any information on how employees get to work (before and after relocation)?
9. Has your company's relocation influenced decisions by other companies, suppliers?
10. Were there any financial incentives to relocate to your present place of business?
11. Has your firm identified any cost savings or cost penalties associated with the move?
12. Will the amenities and other qualities of this present location serve your company over the longer term (beyond the next lease renewal)?