Capitalizing on the Changing Office Landscape in Canada

The Changing Office Landscape

The nature of work, how we work and where we work is constantly changing. The traditional model of commuting to the urban core to work, and then retreating to the suburbs to live and play has been supplanted by the live-work-play ethos of the millennial generation, fueling urban renewal and the creative repositioning of previously under-utilized core assets.

Where the rule of thumb used to be 250 sq. ft. (sq. ft.) per employee, the average has been reduced to 150 sq. ft., and the Federal Government of Canada has mandated 140 sq. ft. as their target. CoreNet Global predicts that within five years, 100 sq. ft. per employee will be the standard. Technological advances have made working from home, work sharing and hoteling common practices rather than exceptions, and this trend is prevalent among the largest employers as well as small, flexible organizations.

Some of the fastest growing tenants in North America are not traditional employers, but instead aggregators of small office users such as Regus and WeWork. Many start-ups and new market entrants no longer look to lease as their first priority. Rather their employees are distributed amongst these co-working alternatives, deferring the acquisition of office space until it becomes imperative.

None of this is to say that the old rules do not apply anymore, rather those rules are being reinterpreted in new and innovative ways.

Shrinking Offices

The trend became noticeable on a large scale in downtown Toronto in 2013: 5.4 million sq. ft. of new office space was under construction in the financial core, anchored by 10 leases representing 2.2 million sq. ft. Typically new office construction is the result of employees outgrowing their previous spaces; however this instance was different. Seven out of the ten major leases featured tenants downsizing. In fact, according to CBRE Research, 2.7 million sq. ft. was vacated but only 2.2 million sq. ft. was absorbed.

This downsizing trend is driven by different factors: gains through efficient space planning, new work arrangements (Canadian bank RBC-Dexia moved to a hot-desking arrangement in Downtown Toronto), and replacing physical documents with digital (law firms made the largest gains in terms of square footage per employee: law firm Miller Thomson’s office in Downtown Vancouver went from four floors to one).

Paramount among these reinterpreted rules is the importance of transit connectivity, which has become more salient with the shift in how people work. For example, many companies require a presence in high-rent submarkets, but for practical business reasons, the client-facing minority could be located in high-cost office space in the urban core, while the majority back-office support could be located in a lower cost location that is a 30-minute train ride away.

Similarly, high growth companies who are quickly outgrowing their space may purchase extra time and value by ‘de-officing’ their workforces: allowing some employees to share desks in a flex-schedule arrangement, while others work remotely from co-working spaces, all in the context of maintaining the headquarters as the corporate focal point.
Job Growth Driving Demand

In addition to changing **how people work**, the growth of the Canadian office market has drastically changed **where people work** as well. According to Statistics Canada, the number of ‘office using employees’ in Canada has grown by 9.8% over the past decade, or 1.65 million jobs. The space demand of this growth has lead to a record construction boom (66.5 million sq. ft.), which has necessitated landlords finding new markets to build in, especially in already dense markets like Toronto and Vancouver.

Stretching The Geography

Over the past decade there has been a pronounced sprawl in major Canadian markets in terms of neighbourhoods that tenants will consider for office space, particularly traditional users. Using Toronto as an example, the traditional Central Business District (CBD) was historically bounded to the south by railway tracks, beyond which was undeveloped land. It was unheard of for a company to move ‘south of the tracks’. In the past decade however, 4,054,267 sq. ft. of new office space has been built, and 4,050,697 sq. ft. absorbed by tenants who previously would never have considered this location.

Similarly, to the West of the CBD, repurposing of warehouses has resulted in a vibrant new office market of over 3,822,931 sq. ft. of brick-and-beam space, favoured by Toronto’s growing technology and media sector. Almost all major Canadian markets have experienced this stretching of the geography, offering landlords and investors new opportunities to find value in previously un-considered markets.

Tenants are Changing, Assets Must Change Too

As the nature of the tenants change, so too must the assets they occupy. It is not simple to change a fixed asset such as an office tower, however if the asset is strategically located along established or future transportation corridors, there are ‘downtown amenities’ which can be provided to non-downtown assets to attract tenants. These amenities include functional shared common areas such as shared boardrooms which allow tenants more flexibility in their own space requirements, fitness and shower facilities, healthy and innovative food options, tenant lounges with collaboration areas, and building specific ride sharing options such as Uber or Lyft. The critical first issue for assets though remains the primacy of multi-node transportation connectivity.
Starlight Investments has identified an alternative option to the traditional urban-suburban investment opportunities, which we describe as ‘near-urban’ office nodes. These are locations which share the following features:

➢ Located on the outer fringes of the traditional urban node, but not deemed ‘suburban’;
➢ On, or easily accessible by, traditional urban transit systems
➢ Easily accessible by major highway networks;
➢ Lower rental rates than most urban or suburban nodes;
➢ High quality assets with comparable amenities to downtown locations;
➢ Assets which have not seen the capital upgrades that more traditionally located buildings have; and
➢ Appeal to both urban (transit connected) and suburban (driving) employees.

These opportunities offer employers Class “A” office space with urban amenities at a lower rental rate than urban locations, and several suburban locations as well. They offer employees a work option which is easily accessible by all demographics, allowing the live-work-play model to be experienced by all employees, not just those who happen to live near where they work.
Unlocking Value

These are not easy assets to unlock their potential. They require creative visioning, prudent allocation of resources to generate superior returns, patience, and the right team to execute on the vision.

These assets are also difficult to acquire. By taking advantage of it’s extensive industry network, Starlight Investments and True North Commercial REIT have been able to execute on a number of off-market opportunities to acquire assets which fit the parameters above at an attractive capitalization rate.

The two biggest expenses of most employers are wages and rent. By creatively repositioning overlooked assets, Starlight Investments can offer employers an opportunity to maximize the benefits on both items and above average returns for investors.

Case Study #2 – 301-303 Moodie, Ottawa, Ontario

301-303 Moodie demonstrates a prime opportunity to take advantage of developing trends in an office submarket. The conversion of the former Nortel Carling Campus into the Department of National Defense’s headquarters will bring approximately 25,000 jobs to the area, with ancillary growth expected. Additionally, OC Transpo is building a light rail link to downtown adjacent to the property bridging the urban-suburban divide for commuters.

Combined with initiatives such as converting under-utilized common areas into shared work environments, food options and a fitness centre, it is expected that this property will be well positioned to take advantage of these developments.

About Starlight Investments

Starlight is a Toronto-based, privately held, full service, real estate investment and asset management company driven by an experienced team comprised of over 120 professionals. Starlight currently manages $7.5 billion of multi-family and commercial properties through funds, JV’s and club deals. Starlight’s portfolio consists of approximately 35,000 multi-family units across Canada and the U.S. and over 4.6 million sq. ft. of commercial properties. For more information visit www.starlightinvest.com and connect at www.linkedin.com/company/starlight-investments-ltd-.

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