

**MIXED-USE AS A TOOL FOR SUBURBAN TOWN CENTRE OFFICE SPACE
DEVELOPMENT IN METRO VANCOUVER: A CASE STUDY IN PORT MOODY, BC**

EXECUTIVE SUMMARY

by

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Executive Summary

The central question explored in this report is: How can mixed-use development be used as a tool of cross-subsidization, allowing for the creation of office space in Metro Vancouver suburban town centres where it would not otherwise be economically viable? The central hypothesis is that mixed-use development, focused primarily on residential uses, allows for office space to be ‘carried’ or subsidized on the development pro forma, making development of office space viable where it would not otherwise be so.

Patterns of suburban office development across Metro Vancouver have largely focused on peripheral business parks and fringe development, despite planning interest and intent to cluster much of the suburban office market in designated town centres. Business parks have thrived due to their combination of zoning flexibility and low cost to build, while town centre space has suffered in part from lack of market demand, but also due to an apparent incongruence between the market rents payable by the majority of suburban office tenants and the cost of bringing such town centre office space online. The central hypothesis being tested is that mixed-use development can make otherwise economically unviable town centre office space viable by creating a system of ‘cross-subsidization’, whereby economically viable uses such as residential subsidize economically unviable office space within a project, creating overall project viability.

Methods

The methodology employed in this report is a combination of pro forma financial analysis and semi-structured interviews. Pro forma analysis is conducted for a single development site in the community of Port Moody, British Columbia. This is a city that has struggled to attract office space to its town centre, and which contains many well-located, underutilized sites that have potential to be redeveloped

as mixed-use. A case study site was selected in the town centre through consideration of a variety of criterion: location vis-a-vis transit, value of site improvements vs. land value, and ability to accommodate an office floor plate. Pro forma analyses were conducted at this site as follows:

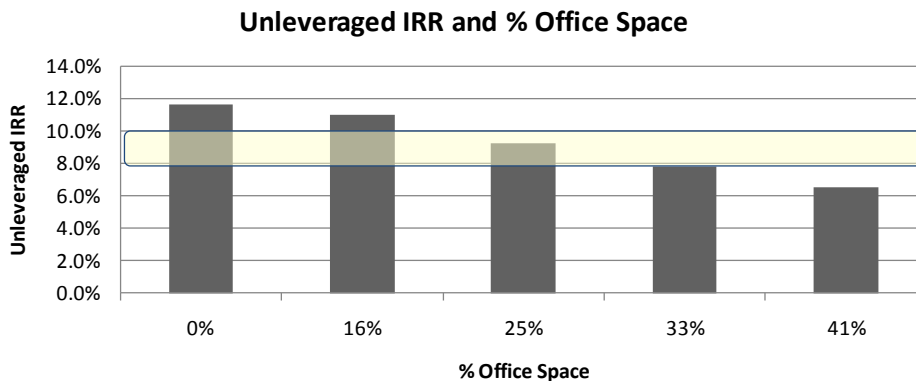
- A test of potential development viability under current zoning was conducted to examine whether existing site entitlements are sufficient to trigger redevelopment;
- This was followed by a test of development viability at a likely approved density (FSR) and mix of uses, based on OCP policy, recent history of OCP amendments on comparable lots near the subject site, and development undertaken nearby;
- The main thrust of financial testing involved multiple pro formas examining project feasibility under a fixed density (FSR), with incremental variations in the mix of uses (i.e. more or less office space and more or less residential space). This series of tests was used to find whether project viability decreases as office space increases (as hypothesized), but simultaneously allows for office space to be built through the creation of a project that is viable overall;
- Finally, sensitivity analysis was undertaken to examine how the viability picture changes as market-dependent variables are altered (e.g. sales prices of homes, office lease rates and development costs). This is used to find whether the relationships between office space and other uses in the mixed-use project are likely to change.

Semi-structured interviews were used to both gather data for the pro forma analysis and to test the analytical generalizability of the case study findings to other areas of Port Moody and town centre beyond. Interview topics included: market demand for suburban office space; size of the market for town centres vs. business parks; pro forma hurdle rates and return measures for mixed-use

development and office development; projects costs and ratios. Interviewees were selected using a basic non-probability snowball sampling method, and were conducted with planners, economists and developers.

Findings

As office space displaces residential space within a fixed FSR development scenario, project viability as measured by unleveraged internal rate of return (IRR) decreases. In the case study analysis of a 3.0 FSR development scenario on the subject site, as office space increases from 16% to 41% (with an associated decrease in residential space), the overall project cost decreases by 0.8% while project revenues fall by 10.5%. The yellow bar in the figure below represented the unleveraged IRR hurdle rate range of 8-10%. As office space increases, the project becomes less viable.



Returns Comparison		
	Office/Retail	Residential
FSR	3.0	3.0
Saleable Residential sq.ft.	0	155,550
Leasable Retail sq.ft.	130,900	0
Leasable Office sq.ft.	24,650	0
Total Project Costs	\$60,678,290	\$53,137,489
Total Project Revenues	\$46,068,802	\$74,786,333
NPV @ 9%	-\$23,097,143	\$7,267,844
Unleveraged IRR	1.2%	16.3%

The decrease in unleveraged IRR with incremental replacement of residential space by office paints a picture of office being an overall drain on mixed-use project profitability. This is further illustrated by contrasting a 3.0 FSR development scenario with

two use mixes: (1) retail + office mix, and (2) 100% residential. The office/retail development accrues project costs 14% higher than the residential only development, while revenues are 38% lower. The unleveraged IRR drops from a very viable 16.3% to an unviable 1.2%.

Overall, the case study findings indicate that, provided there is sufficient residential space within the mixed-use development to make the overall project economically viable, office space can be included in the project and offered at rents congruent with what the market can pay. Residential end-users subsidize the office space component.

Sensitivity analyses indicate that, under most normal market circumstances, the key variables that would most affect the financial outcomes are likely to move in parallel – up or down (e.g. residential sales prices and office rental rates). While market shifts will change overall project viability and make some mixes that were borderline viable under current conditions possibly less or more viable under changed conditions, there would continue to be a mix of residential and office that could achieve the dual objectives of economic attractiveness for developers and planning policy attractiveness in terms of encouraging suburban town centre office space. Furthermore, residential sales are a necessary source of subsidization for office uses in mixed-use development at the subject site.

The case study findings are found to be applicable to other sites in Port Moody and town centres of other Metro Vancouver municipalities.

- At Port Moody's mixed-use Suter Brook Village, the office component is subsidized by residential end-users;
- At Port Moody's Newport Village, it was only due to a backlog of demand from users able to pay economic rents that the office component was not subsidized by residential end-users;

- Mixed-use developments in Coquitlam Town Centre indicate that residential density was required to make office components of the development financially feasible. Leasing office space requires lower than economic rents;
- A similar situation exists in North Vancouver, where residential components of a mixed-use project are required to subsidize both office and hotel components.

Overall, the analysis in this report has shown that through residential-primary mixed-use development, areas where market rents for office space cannot create viable office precincts can be made to include office space through cross-subsidization from residential product. If this strategy is used to bring office space to town centres at rates comparable to those found in suburban business parks, there may be an opportunity to attract small firms from those parks to town centres.

Policy Recommendations & Future Research

To attract mixed-use development with office space to strategic town center locations, Port Moody planners may wish to explore the following policies:

- An encouragement of office development as part of mixed-use projects on identified sites in the OCP;
- The inclusion of multi-family residential as a permitted use in the C-3 Zone (as currently), along with a higher base-density allowance (to ensure viable projects) and a bonus density system with community amenity contributions;
- The requirement for a fixed amount of office space (defined in FSR) as part of the base density of future mixed-use in the C-3 zone or in select areas of the C-3 zone.

Metro Vancouver municipalities should consider a number of strategies to incentivize mixed-use development with office space in their town centres. These include: city assisted land assembly; permitting stand-alone office components as part of mixed-use, phased developments; and detailed exploration of bonus density strategies with mandatory office space FSR as part of base density allowances.

Areas for future research should include: determining the motivations of suburban office park tenants to locate as they do, as part of an effort to determine whether some could be attracted to mixed-use town centre developments if rental rates were comparable; determining the extent and geographic distribution of the emerging market for transit-supportive office space in suburban town centres; and to engage with the Port Moody community to determine where additional mixed-use density is most acceptable as a precursor to policy development around mandatory office space inclusion and density bonusing provision.