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National Office Report

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Conversions Become a Reality

- With housing in short supply and many office buildings sitting vacant, conversions appear to be an attractive opportunity for many owners and investors. While conversions have become more common as of late, though, they will likely not be the answer to the nation's housing shortage.
- Conversion projects are underway in an array of markets. In Dallas, five buildings are currently being converted, bringing an estimated 1,500 units to the market within the next few years. The McGraw-Hill building in midtown Manhattan will convert more than 20 floors into apartments beginning this summer. Washington, D.C., has been the most active conversion market, with a reported 2.5 million square feet earmarked. Yet D.C. added only 1,147 units from office conversions between 2020 and 2021, according to a recent analysis by RentCafe.
- Many challenges arise in converting an office building to residential. For one, the building needs to be well located, not only in an area zoned for residential but within a neighborhood where people want to live. The configuration of the building is also important—floor plates can be too large, ceilings can be too high or HVAC systems can be ill suited for residential. Some developers have looked to add amenities, such as storage units or gyms, in the center of the building to solve floor plate issues, but that reduces rentable space. Even when an office can check all of these boxes, conversions are expensive, and for an investor to profit, a majority of converted units have become luxury multifamily or condos. Distressed offices selling at bargain prices may allow previously unfeasible projects to pencil out, but many projects will still need further support to become reality.
- For office-to-residential conversions to be more than just a niche opportunity, government incentives will be needed to make more projects viable. Some places have already begun to address this. California's 2023 budget allocates \$400 million in grants for conversions, and the governor signed a new law that will help ease zoning issues. Baltimore recently reauthorized a tax credit that incentivizes conversions. Chicago solicited bids from developers to convert office in the city's LaSalle Street Corridor into housing, and has recently begun selecting proposals. While it can be expensive to provide incentives for developers to convert vacant offices into housing, doing nothing while property values fall could also be costly. A large share of many local governments' budgets comes from property taxes on commercial real estate, and declining office building values could wreak havoc on collections.

