2021 | Virginia REALTORS®

Commercial Connections

Converting Office Buildings Into Housing

Commercial Connections:
Converting Office Buildings Into Housing

October 2021

2021 Virginia REALTORS® Leadership Team

Beth Dalton, CRB
President

Denise Ramey, ABR, GRI
President-Elect

Katrina M. Smith, ABR, GRI, ePRO, SFR
Vice President

Tom Campbell, ABR, GRI
Treasurer

Kemper Funkhouser
Immediate Past President

Heather Placer, CCIM
Chair, Economic Advisory Board

Terrie Suit, MBA, CAE, CIPS
Chief Executive Officer

Study Author

Lisa Sturtevant, PhD
Chief Economist, Virginia REALTORS®

Commercial Connections

Converting Office Buildings Into Housing

Rising commercial vacancy rates and growing housing affordability and supply challenges have led to growing interest in the potential for converting office buildings into residential space. If office-to-residential conversions were feasible, these re-purposed properties could meet the two goals of addressing a weakening commercial market and providing much needed housing.

This report describes the concept of office-to-residential conversions, discusses challenges and opportunities for this type of redevelopment, and presents examples of successful projects in Virginia that have turned office space into new housing opportunities.

What is a Commercial-to-Residential Conversion?

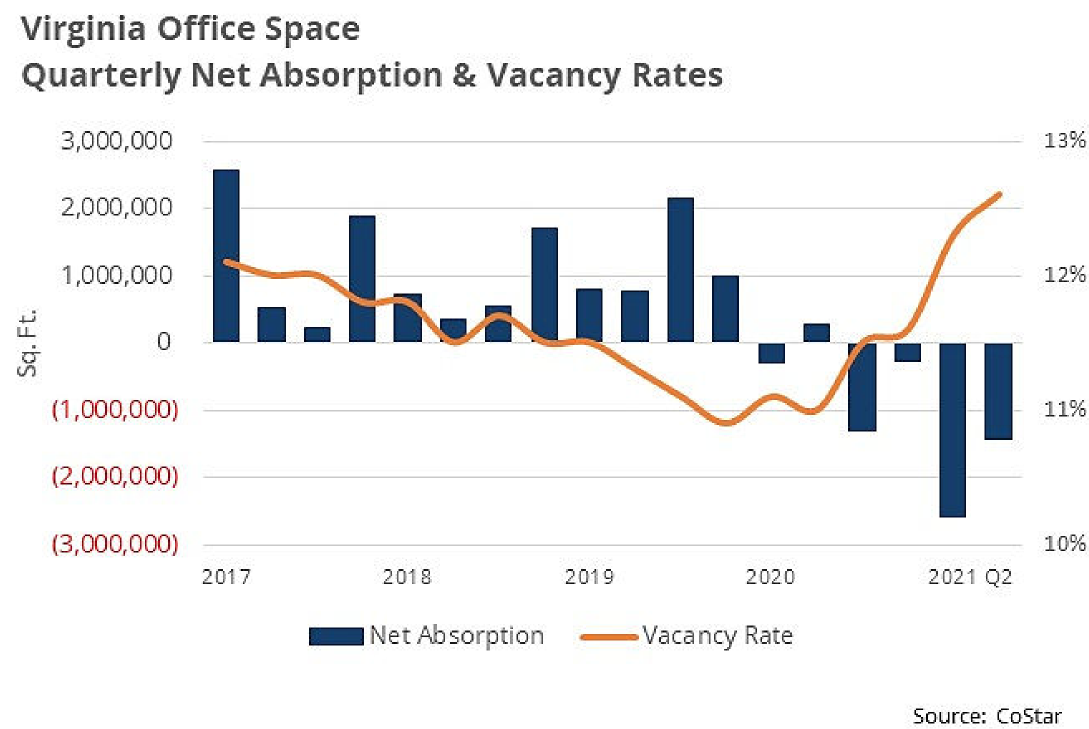
A commercial-to-residential conversion retains an existing commercial building and reuses the structure to create housing units, typically through a major gut rehab. Building reuse and conversion has often been associated with historic preservation, with the goal of protecting and improving buildings with historic or architectural significance. However, existing buildings can be converted to different uses more generally when they are vacant, have become obsolete, or when a change in use would bring greater financial returns to the property owner.

Office, retail, and warehouse spaces all have been converted into residential or mixed-use buildings, although the number of conversion projects remains relatively small. Despite the potential benefits associated with redeveloping office properties as housing, there can also be significant hurdles to these types of projects.

Office Market Trends

The COVID-19 pandemic and economic recession have had significant impacts on the commercial real estate market in Virginia. While the industry was more resilient than many had expected at the onset of the pandemic, there have been rising vacancy rates and declining absorption rates in many markets. Some of the softening demand in the office market is directly tied to economic conditions brought about by the public health crisis, as employees moved to remote work and businesses looked to downsize their physical office space. The pandemic also may have accelerated other trends that were already underway prior to 2020, including shifts more shared office space and mixed-use buildings. Finally, office markets in Virginia have also responded to longer-term trends in the economy. For example, the Base Realignment and Closure (BRAC) processes had a major impact on Northern Virginia's office market over the past two decades, leading to a rise in vacant commercial space.

In most markets in Virginia, office vacancy rates have been rising since early 2020. In Northern Virginia, the office vacancy rate was over 16% in the second quarter of 2021. Office vacancy rates were about 8% in the Richmond region and 8.5% in the Hampton Roads market. Statewide, net absorption of office space has been negative for four consecutive months.



Many employers had been set to call employees back into the office during the summer and fall of 2021, but the coronavirus delta variant has put many of those plans on hold. Even when the public health crisis is resolved and the economy stabilizes, it is likely that work and office space usage will look different. Recent surveys suggest that employees want to retain flexibility in their work schedule. Hybrid in-person/virtual models will become more common. That shift could further reduce the overall demand for office space and open up opportunities to use former office space for other purposes.

Housing Needs

Home prices and rents have been escalating in Virginia, making housing affordability a growing challenge for individuals and families. Over the past five years, the median home price in Virginia has risen by about 30%. Apartment rents have increased by about 28%. Over the same time, the median household income in Virginia has increased by just 5%.

A major reason for the fast rise in housing costs has been a long-running lack of supply. Based on recent estimates, there is a housing gap of more than 240,000 housing units in the Commonwealth of Virginia. In order to close this housing gap and to continue to meet future demand, localities across Virginia would have to permit the construction of more than 74,000 annually for the next decade, which is more than double the amount of housing production that has been typical over the past 20 years.

There are many reasons why there is not sufficient housing being built to keep up with demand. Builders and developers face rising materials costs and persistent challenges finding construction workers. A lack of buildable lots and community opposition to new construction can also be roadblocks to new housing construction.

Converting Office Buildings to New Residential Units

Redeveloping vacant or underutilized office buildings into housing can be one important strategy for expanding the housing supply without increasing the overall amount of developed land in a community. It can also be a way to spur economic development activities in declining commercial areas.

Opportunities

Office-to-residential conversions can sometimes produce benefits not available with new construction projects:

- Older commercial buildings targeted for conversion often have **unique features** that home buyers and renters highly value. Examples include taller ceilings, attractive architectural details, and expansive lobbies. Office buildings also tend to have abundant parking.
- Conversion projects can sometimes be **less controversial** than new residential construction. Community opposition to new housing may be lessened since the buildings and infrastructure are already in place. Less opposition could save significant time and costs during the planning and approval process.
- Because office buildings tend to be in more densely developed parts of a community, an office-to-residential conversion can result in new housing options that are **well-connected to transit, jobs, and other services**.
- There are often **sustainability benefits** associated with conversions as these projects reuse much of the existing core building materials rather than demolishing and disposing materials and using newly produced materials for the construction.

Challenges

There are obstacles to converting office space into residential space than can make these types of projects unworkable in some cases:

- Office building **floorplates are often too large and deep** to enable appropriate layout of residential units. Because so much of an office floor is away from exterior walls, it can often require major modifications so that residential units can be situated with rooms abutting exterior windows.
- In some cases, **existing zoning and prohibits residential uses** on the site, which means the developer has to petition for a zoning change. Building codes related to fire and smoke protection, access to light and ventilation, and occupancy, among others, differ for residential and office uses and could require major interior changes to comply with code.
- Office buildings might be located in parts of the city that are “too” commercial. While they might have good access to jobs and transit, they may be **less accessible to other amenities and services**, such as schools, parks, and grocery stores.
- Even if office market conditions are weak, **building owners will often want to wait it out**, hoping that conditions will improve. In the short-run, converting the property to residential uses may not make financial sense for the owner.
- In all but the densest places, **building new is usually less expensive**. Savings that can accompany reusing an existing building can evaporate if the conversion requires significant rehabilitation or structural changes.

Best Practices

While there have been relatively few office-to-residential conversion projects, there have been enough examples to suggest some best practices for local officials, developers, and other real estate professionals interested in promoting these types of repurposing projects.

- **Building Size and Age Matter**. Smaller, older office buildings typically are better candidates for residential conversion. Older buildings not only tend to have more unique architectural features that are valued by owners and renters, but they also often have smaller floor plates, which makes retrofitting the building easier and less costly. In addition, these buildings may be more likely to be vacant or nearing the end of their financially viable life as an office building.
- **Land Use and Zoning Are Critical.** It is important to assess the underlying land use and zoning of the office building property. If the site is planned or zoned for mixed-use rather than strictly for office/commercial use, it may make the process of gaining approval for the office-to-residential conversion easier. A community may have an overlay district that allows for flexibility in building uses, which would also be a plus for these types of projects. Finally, buildings located in Opportunity Zones have the added benefit that they may allow the developer to take advantage of federal funding designed to support redevelopment in the area.
- **Partnerships Are Necessary.** Office-to-residential projects may provide opportunities for commercial developers to collaborate with their residential colleagues. The private sector can also work to gain support from local elected officials and advocate for land use and zoning changes to better facilitate projects that repurpose commercial buildings as housing.

Case Study #1

The Oronoco Condominiums
601 North Fairfax Street
Alexandria, Virginia

Completed in 2014, the Oronoco Condominiums is an example of a successful office-to-residential conversion in the north end of Old Town, Alexandria. Developer EYA converted the former office building of the Sheet Metal Workers' International Association (SMWIA) into the six-story, 60-unit high-end condominium building, with river views, high ceilings, and floor-to-ceiling windows.

The SMWIA building represented an ideal candidate office building for re-purposing. The relatively smaller size of the building (155,000 square feet), awkward "U" shape of the building, and the small windows made the property unattractive to office tenants who were looking for newer and more modern office space. Although the building was not that old—it had been constructed in 1985—the SMWIA was only occupying one floor and the other tenant, the General Services Administration, decided to re-locate. EYA purchased the building in 2011.

Some of the characteristics that made the building relatively unattractive to office tenants were the same ones that made an office-to-residential conversion appealing. For example, smaller floor plates made the interior rehab less intensive. The terraced height allowed for unique rooftop terraces and the "U" shape created an opportune place for a resident courtyard.

The building's height also was an advantage during the project. The City of Alexandria had limited new construction in that part of the city to 50 feet. The SMWIA office building was 70 feet tall, which meant that the developer got more square footage with a conversion that they would have with a new construction project.

Oronoco Condominiums: Key Takeaways

- Smaller office building with features that limited office occupancy
- One major building tenant that was also the building owner
- Strong demand for luxury condos in the region
- Developer experienced with conversions and working in the City of Alexandria

The conversion process involved demolition and replacement of the exterior skin and removal of some interior walls. Stairs and elevators were replaced to meet building codes, and small windows were replaced with floor-to-ceiling windows. EYA retained the existing underground parking garage but reduced the number of parking spaces from 350 to 150.

Oronoco Waterfront Residences
Alexandria, Virginia

The timing and partners were right for the Oronoco Condominiums project. EYA had had experience doing other office-to-residential projects in other parts of the region. The north end of Old Town Alexandria was undergoing a revitalization of its industrial and commercial areas, but no condominiums had been proposed when EYA purchased the SMWIA building. Finally, EYA saw growing demand for luxury condos by empty nesters downsizing and looking for something new.

City zoning would have allowed the developer to build 110 residential units, but instead EYA created 60 larger, high-end condominiums to target the luxury, empty-nester buyer. Units ranged in size from 1,600 to 3,500 square feet. When the project was completed 2014, condominiums were selling for between $1.6 and $4.5 million.

Case Study #2

Deco at CNB Apartments
219 East Broad Street
Richmond, Virginia

A historic property and a jewel of Richmond's skyline was transformed into 200 apartments in 2016. In 2013, Douglas Development Corporation began work on what would be one of the largest historical rehabilitation projects in the state. The developer purchased the Central National Bank building in 2005 but did not begin redevelopment until 2013, holding onto the property through the Great Recession and ultimately finding a market for apartments.

The Central National Bank building was a 23-story building built in 1929 and generally considered the best example of Art Deco architecture in the City of Richmond. The building was once referred to as Central Fidelity Bank and had most recently been occupied by Wachovia (now Wells Fargo). The building had been unoccupied since 2000, with the bank tenants moving to other locations.

The Central National Bank building truly is a unique and impressive building. The steel-frame, limestone-clad skyscraper was the tallest building in Richmond at one time and offers amazing views of the city. The three-story entrance, which served as the bank lobby, includes ornate architectural details and unique spaces. During the renovation, original plasterwork, decorative moldings, bronze windows, terrazzo flooring, light fixtures and the old letter-box mail system were retained. Five existing elevators also were preserved, with their original cabs with interior wooden paneling and Art Deco doors.

While the building's overall construction was generally good, there was major rehabilitation work that needed to be done within the building to repair water damage and replace interior walls. A major challenge was the need to carve out 100 square feet of flooring on 21 floors to put in a new steel staircase. The difficult and expensive renovation project was made possible with the use of Historic Tax Credits, which is an indirect federal subsidy designed to help finance the rehabilitation of historic buildings.

Deco at CNB Apartments:
Key Takeaways

- One-of-a-kind building with unique interior and exterior features
- Located in a part of Richmond that was redeveloping
- Building had been vacant for more than a decade
- Historic tax credits were available to help finance redevelopment

Deco at CNB
Richmond, Virginia

The redevelopment of the Central National Bank building was part of a larger transformation that was going on along Richmond's Broad Street corridor. Private and public sector investment in the city began to attract new residents and bring new life to downtown.

The developer of The Deco at CNB Apartments targeted graduate students and other young adults who wanted to live close to Richmond's burgeoning arts and entertainment district. Virginia Commonwealth University markets the building as off-campus housing to its students. Most of the 200 apartments were planned as one-bedroom units, and apartments range in size from 400 square feet to 1,180 square feet. Rents currently range from $1,110 to $1,680 per month.

Case Study #3

Mission Lofts
5600 Columbia Pike
Falls Church, Virginia

The Northern Virginia office market was hit hard in 2005 by the Department of Defense's Base Realignment and Closure (BRAC) process, which moved federal employees and contractors out of more than six million square feet of leased office space in Arlington, Alexandria, and Fairfax. Office vacancy rates shot up throughout Northern Virginia over the next decade.

The nine-story office building at 5600 Columbia Pike in the Bailey's Crossroads area of Fairfax County, built in 1960s, provided a good opportunity for conversion and reuse. The property was one of the buildings vacated by the Department of Defense as a result of BRAC and the building was left vacant in 2012.

Highland Squares Holdings LLC purchased the property in 2017 for "the cost of the parking alone," according to the developer. The property is located in an Opportunity Zone along an important east-west corridor in Northern Virginia, which created an opportunity to access additional federal funding sources for the redevelopment of the building.

Mission Lofts
Falls Church, Virginia (Fairfax County)

The office building had tall ceilings, large windows, an open floor plan, and ample parking. Fairfax County approved the redevelopment of the office building as a work/live property, the first of its kind in the County. Tenants can choose to use their units as a residence, office (for up to 10 employees), or both. The original intent of the project was to help make it easier and less costly for people to open small businesses in the county. Zoning was changed to accommodate both residential and commercial uses and each unit carries a business license. The developer had recently completed a similar property in Alexandria.

The office building had been equipped with significant cable and fiber infrastructure, which the developer retained during the redevelopment.

Because the building was to be used for both residential and commercial uses, the developer kept other features of the office building that would normally be removed in an office-to-residential conversion, including public restrooms on each floor, heavier floors to support more foot traffic, handicap access, and water fountains.

Each unit at Mission Lofts has rooms that could be flexibly used as living areas, bedrooms, or office space. All units have 50% more power than typical apartments. There is additional air space between units to reduce noise. Conference rooms and a community kitchen are available on the property's lower floors.

The redevelopment project came online in April 2020, just as the COVID-19 pandemic hit. The rise in remote work boosted the appeal of the property. Units range in size from between 650 and 1,050 square feet. Rents range from about $2,000 to $3,000 per month and are the same whether the tenant uses the unit as a residence or office.

More office-to-residential conversions could be on the way in Fairfax County. In light of the high office vacancy rates and the need for more housing, Fairfax County approved a change to the County's land use plan to make it easier to redevelop office buildings as residential. Most buildings still require a zoning change, but the developer does not have to go through a more intense land use change request.

Mission Lofts: Key Takeaways

- Unique product type, offering true "work/live" spaces
- Inexpensive property located in a very high-cost region
- Favorable land use and zoning environment
- Location in an Opportunity Zone brought additional resources

Virginia REALTORS®
10231 Telegraph Road
Glen Allen, Virginia 23059

virginiarealtors.org