RREEF Real Estate Minute
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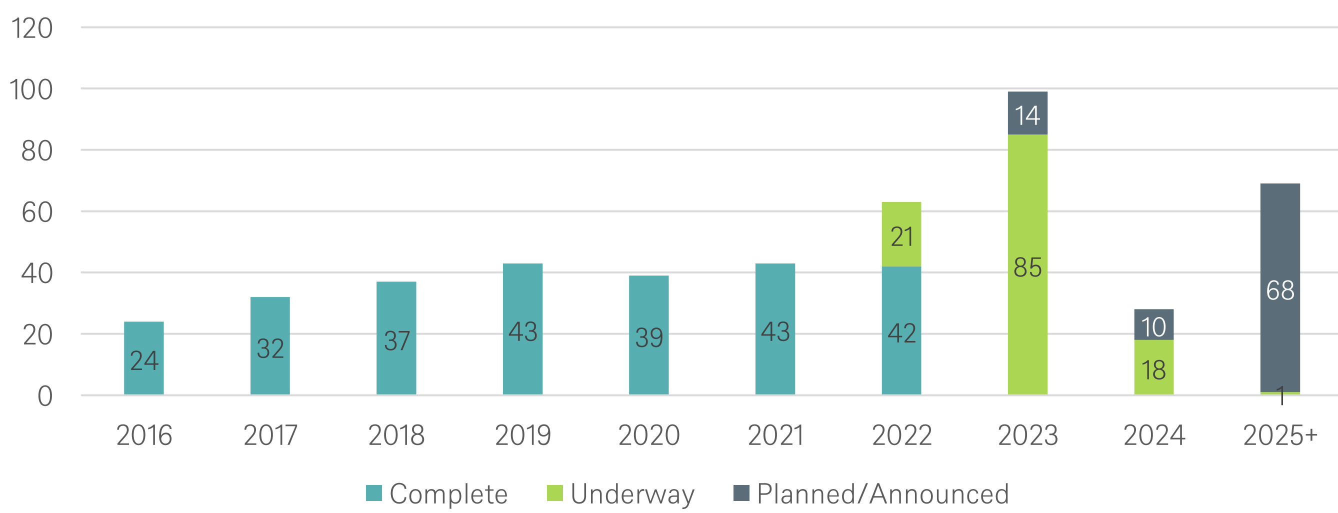
Office Conversions: One Size Does Not Fit All

Converting undesirable office space to residential uses has arisen as a popular repurposing solution, given the tailwinds supporting the demand for residential housing. The pandemic induced rise of remote work has lowered office demand and occupancy. The national office vacancy rate reached a nearly 30-year-high of 17.8% in 2Q 2023[1] and sublease availabilities are rising as tenants attempt to shed underutilized office space. Moreover, record-low apartment vacancies and sustained, elevated rent growth have made office to residential conversions attractive to opportunistic developers.

While office conversions have become increasingly attractive options for older, less competitive buildings, completed projects have not significantly increased since the pandemic. According to CBRE, an average of 39 conversions completed annually between 2017 and 2021.[2] Conversions are especially attractive in dense markets with limited available land, including downtown areas in walkable neighborhoods with abundant amenities. From a building characteristics perspective, candidates for repositioning include CBD buildings with historical charm, a slender shape, high ceilings, and punched windows. These kinds of buildings, often dating to the early 20th century, make for simpler conversions because the same logic that shaped how they were designed as offices a century ago determines how apartments are planned today.

Some 42 office conversions have been completed in 2022 and 217 are either under way or planned. Conversions are concentrated in coastal and northeast markets with relatively older office stock. San Diego, Boston, Manhattan, Cleveland, and Philadelphia have the most completed conversions since 2016. Boston and San Francisco Peninsula have the most underway. The average age of the 89 properties converted is 80 years old and the average size is 184,400 square feet. About 90% of the conversions were constructed before 1980. Buildings delivered before 1980 account for 30% of U.S. office stock and have vacancies above 17%, making them prime candidates for future conversions.[3]

Office Conversions by Construction Status and Estimated Year of Completion
# of Conversions



Source: CBRE Research, Q4 2022.

1. Source: CBRE-EA
2. Source: CBRE
3. Source: CBRE

While building-level specifications are key to evaluating conversion candidates, market-level cost analyses come into play as well. Costs to retrofit office buildings for residential use vary widely and are often the biggest hurdle in identifying sensible conversions. Estimates from $100 per square foot up to nearly $700 per square foot are common and vary based on the scope of work. In addition, if the basis for buying office space is low enough, conversions can remain competitive with ground-up construction. Per C&W data, the average price per square foot paid for a high-rise office building to be converted since 2020 has been about 50% of the overall office market average ($234/sf) and 65% below the average multifamily high-rise price per square foot.[4]

Conversion of obsolete offices to residential use could be a solution that will support the recovery of the U.S. office fundamentals. Yet, despite the robust pipeline, conversions alone will not measurably decrease the surplus of office stock. Moreover, only 20 to 25 percent of North American office buildings are viable candidates, according to Paynter. Even if every planned office conversion is completed, together with the conversions completed since 2016, only an estimated 91.1 million square feet would be removed from the market, roughly 2% of total U.S. office inventory.[5]

4. Source: Cushman & Wakefield
5. Source: CBRE-EA

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