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Decision Time for Boston's Office Landlords

As Vacancies Rise, Housing Conversions Enter the Picture

By Steve Adams | Banker & Tradesman Staff | Jul 31, 2022

Boston's class B office market is feeling the brunt of leasing declines in the hybrid work model era, with availabilities topping 22 percent. Photo courtesy of the BPDA

With over 3.8 million square feet of available space as remote and hybrid work entrench themselves, Boston's class B office market looks like potentially fertile ground for conversion into thousands of new housing units.

But will developers take the plunge? City officials will take a closer look at multifamily conversions to address the dual specters of a declining central business district and the housing affordability crisis. The Boston Planning & Development Agency will commission a feasibility study on the topic this fall, as a downtown zoning study resumes discussions on potentially taller building heights.

For now, interest in office-to-residential projects remains lower in Boston than most similar cities, said Todd Dundon, a principal at architects Gensler.

"The most significant reason is everybody is more interested in developing labs, where the money is, than residential," he said.

Beyond the life science alternative, developers and architects remain wary of the hurdles associated with residential conversions. Complications include difficult layout of older buildings and parcels, costly surprises during construction, timelines for office lease expirations and additional parking requirements associated with residential use.

Using a proprietary dashboard, Gensler has analyzed more than 300 buildings in 25 cities and found that only 30 percent met its requirements for a housing conversion.

The program analyzes building forms, floor plate characteristics such as distance between building cores and the exterior, building skin characteristics such as size and operability of windows, and service use requirements including loading areas and parking.

"It's where you get into the older heritage buildings where it becomes more of a challenge," Dundon said. "A lot of these are not full block buildings. They've got party walls on either side, and that makes it very difficult to maximize the units and make it pencil out."

Other Cities Offer Conversion Subsidies

Major office-to-housing conversions already announced by developers elsewhere include One Wall Street and 55 Broad St. in Manhattan and the South Temple Tower in Salt Lake City. California's budget for fiscal 2023 and 2024 includes $400 million for conversions of office buildings into affordable housing. In June, Pittsburgh Mayor Ed Gainey proposed $2.1 million in American Rescue Plan Act funding toward downtown office-to-housing conversions.

Cliff Kensington, director of acquisitions for Brookline-based City Realty, said landlords need to consider lengthy timelines related to office lease expirations.

"It's never so clean that you've got a perfectly vacant building. There's still these one or two tenants sprinkled throughout who have years left on the lease," Kensington said.

Oleg Uritsky, CEO of Boston-based Helge Capital Real Estate, points to additional parking requirements for multifamily uses as another roadblock for conversions.

In January, Boston eliminated on-site parking requirements for 100 percent affordable housing developments, but hasn't changed the rules for market-rate and mixed-income projects.

And housing conversions can bring unpleasant surprises even following approvals and securing financing.

"Most of the office buildings are old and once you start opening up the walls, you never know what you're going to find there. You may find something very difficult that isn't anticipated," Uritsky said.

Office Leasing Momentum Stalls in 2022

Rising office vacancy rates in the first half of 2022 indicate that leasing momentum from commercial tenants has sputtered after a recovery last fall. The citywide office market has so far recorded 777,000 square feet of negative absorption in 2022, according to Colliers data. And Boston's class B office properties are feeling the brunt of the downturn, with vacancies hitting a near-record 22.3 percent availability rate in the second quarter.

The BPDA will put the issue on the front burner when it commissions a feasibility study on the topic this fall, a spokeswoman said. And resumption of a downtown planning study could lead to taller zoning heights making multifamily projects more attractive to developers in commercial districts.

The downtown study covers some of the city's most densely developed neighborhoods from the Financial District to the Massachusetts Turnpike. Put on hold during COVID and scheduled to resume following the hiring of a BPDA downtown planner, it has studied potential rezoning for taller baseline building heights.

But merely allowing taller buildings won't necessarily prompt a wave of expansion projects, architects and developers say. Existing buildings' vertical expansion potential is limited by structural issues. Residential conversions require potential costly upgrades to utilities, elevator banks and building envelopes to install operable windows as required by building codes.

Physical upgrades can bring the cost of conversions within 15 percent of new construction, City Realty's Kensington estimated.

"It's not as easy as just keeping [office tenants] in place and building on top," he said.

Time Advantage Over Ground-up Construction

But many of those same obstacles exist in New York City, where architects are seeing rising interest from office landlords. The Real Estate Board of New York estimates that office conversions could generate approximately 14,000 residential units in neighborhoods such as Midtown East, the Garment District and Flatiron.

Developers are cutting courtyards into the middle of floor plates to create usable housing units, said Eugene Flotteron, director of architecture and a partner at New York architects CetraRuddy. Condominium conversions comprise the bulk of the activity, because they typically include larger units that lay out more easily. Some developers have added additional elevator and utility cores, said Flotteron, who estimated such projects as costing $150 to $250 per square foot.

Conversions offer a timeline advantage, with a typical project taking 12 to 18 months compared to two years for new construction, he said. A widening spread between class A and B office rents in New York City has forced many landlords' hands.

"Right now [residential conversions] are all penciling out. It comes down to the highest and best use, and if they're not getting the rents of the new office buildings, it's worth it," he said.

Steve Adams