NATIONAL ASSOCIATION of COUNTIES NACo

June 2024

Revitalizing Main Street and Urban Corridors

Exploring the Potential of Commercial to Residential Conversion Projects

About the National Association of Counties

The National Association of Counties (NACo) strengthens America's counties, serving nearly 40,000 county elected officials and 3.6 million county employees. Founded in 1935, NACo unites county officials to:

- Advocate county priorities in federal policymaking
- Promote exemplary county policies and practices
- Nurture leadership skills and expand knowledge networks
- Optimize county and taxpayer resources and cost savings, and
- Enrich the public understanding of county government

NACo's Mission

Strengthen America's Counties.

NACo's Vision

Healthy, safe and vibrant counties across America.

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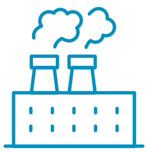
FOR ALL YOUR
GIFT GIVING NEEDS

Understanding the Scope and Scale of Commercial to Residential Conversions

TRADITIONAL BUILDING CONVERSIONS

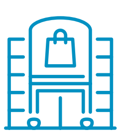
Warehouse



Industrial Facility

Church

Retail Storefronts



Shopping Malls

The phrase 'commercial to residential conversion' conveys an image of the high-rise office building that adorns many urban districts in counties across the country. With the recent declines in commercial property occupancy since the pandemic and the long-standing need for housing affordability,[A] many now-vacant properties seem ideal for redevelopment to community advocates and urban planners alike.[1, 2] However, very specific and limited economic conditions must exist for these types of projects to succeed. For instance, nearly every conversion will require the relocation of plumbing and heating, ventilation and air condition (HVAC); expanding or installing new safety systems (e.g., fire alarms); modernization of electrical and telecommunications wiring and a redesign of the physical layout.[3] Older buildings, in particular, likely also need lead paint or asbestos remediation.[4] In all cases, the land must be re-zoned to allow housing as an intended use.[5] Obstacles notwithstanding, when a good candidate for a conversion presents itself, the upside can be significant for community residents, the developer and the county.[6]

Developers and individuals, however, have long been converting smaller commercial properties into homes. From older warehouses and industrial facilities to churches, retail storefronts, shopping mall facilities and low-rise structures, commercial to residential conversions have breathed new life into urban business districts and rural main streets.[7] As county policymakers consider new strategies to increase housing supply – and thus, affordability – a creative approach that transforms the understanding of what constitutes a home unlocks the potential for revitalizing underutilized spaces.

[A] *Estimate suggest a supply deficit of 2.5 million units in 2023 due to more than a decade of under-building relative to population growth.*

Many Commercial Office Properties are Under-Equipped For Modern Business Needs

Upwards of **70%** of the nation's office stock was built before 1990

Buildings with more than **50%** vacancy make up just over **7%** of total inventory in the United States today

The U.S. is on track to have **1.1 billion** square feet of vacant office space by the end of the decade, one-third **(330 million square feet)** of which is excess space attributable to the increase in hybrid and remote work strategies

Source: Corbett, A., Thrope, K. and Smith, D. (2023). Obsolescence equals opportunity – Cushman & Wakefield. https://www.cushmanwakefield.com/en/united-states/insights/obsolescence-equals-opportunity

Office vacancy rates ebb and flow based on market conditions. After a period of rapid speculation building in New York City in the 1980s, the office market faced oversaturation, which, compounded with the early 1990s recession, drove vacancy rates to a then-record high of 17 percent.[8] In response, the city and state introduced a suite of new reforms aimed at revitalizing areas with a high concentration of commercial office vacancy, including the 421-g program, which created a real property tax exemption on any increase in assessment resulting from conversations as well as an abatement on pre-existing tax liabilities.[9] The 421-g program is one of the first attempts to incentivize commercial to residential conversions in the United States, and ultimately achieved more than six times the impact projected (2,000 units projected vs. 12,865 created), with particular success in converting older, pre-war buildings that had become unable to compete with newer builds.[10]

Current shifts in working conditions ushered in by the pandemic have created a revised push to explore programs like the 421-g. While many organizations look to bring employees back to at least a hybrid environment – if not fully in-person – the landscape of work environments has meaningfully shifted towards smaller organizational footprints.[11] As organizations continue to right-size lease requirements, the decrease in demand for offices creates increased competition for those with supply to offer premium experiences. Of the available office space, roughly 46 percent will require an upgrade or repurposing to remain competitive in the next ten years, including 25 percent, which is functionally obsolete.[12] In general, the hardest-hit office buildings share characteristics like location in a high-crime area with limited community assets (e.g., coffee shops, restaurants, etc.) – the same features important to a successful residential conversion.[13]

While not every property would be a good candidate for a commercial to residential conversion, some could fit the bill. Smaller buildings with adequate natural light and functioning windows have important features that make their conversion cheaper and more efficient.[14] As demonstrated in 1990s New York, when the incentives are appropriately aligned, commercial to residential-conversion can add a significant amount of much-needed housing stock to a community.

Several Types of Non-Office Commercial Properties Offer Good Candidates for Residential Adaptive Reuse

TOP TEN MOST POPULAR TYPES OF CONVERSIONS
(NUMBER OF CONVERSIONS NATIONALLY)

1. **Factory** (442)
2. **Hotel** (434)
3. **Office Building** (313)
4. **School** (199)
5. **Warehouse** (130)
6. **Healthcare Building** (80)
7. **Retail Store** (64)
8. **Financial Building** (49)
9. **Residential** (24)
10. **Military** (24)

Source: Yardi Matrix; Commercial to residential conversions since the '50s

Multiple types of commercial spaces possess characteristics that contribute to a successful commercial-to-residential conversion project. The two most common types of commercial properties converted between 1950 and 2020 are factories and hotels, which accounted for about 47 percent of all adaptive reuse projects.[B] [15] These spaces can be of particular interest due to their high ceilings, open floorplans and basic structure, which operate effectively as a shell within which housing is constructed. Some of these properties, however, occupy what is considered a "brownfield" property and require additional steps for conversion, which are usually related to environmental concerns or hazard remediation.[C] While urban areas are more likely to have office buildings suited for office-to-residential conversion, rural areas can also benefit from converting these other commercial real estate types, including low-rise buildings on the main street.

Regardless of location, nearly all residential conversion projects will become multifamily housing.[D, 16] The costs associated with renovation often do not cover the required return on investment that single-family would provide. Similarly, building owners will need to assess whether mixed-use, partial conversion or some other hybrid approach is appropriate for the market, allowing some commercial activity to continue.

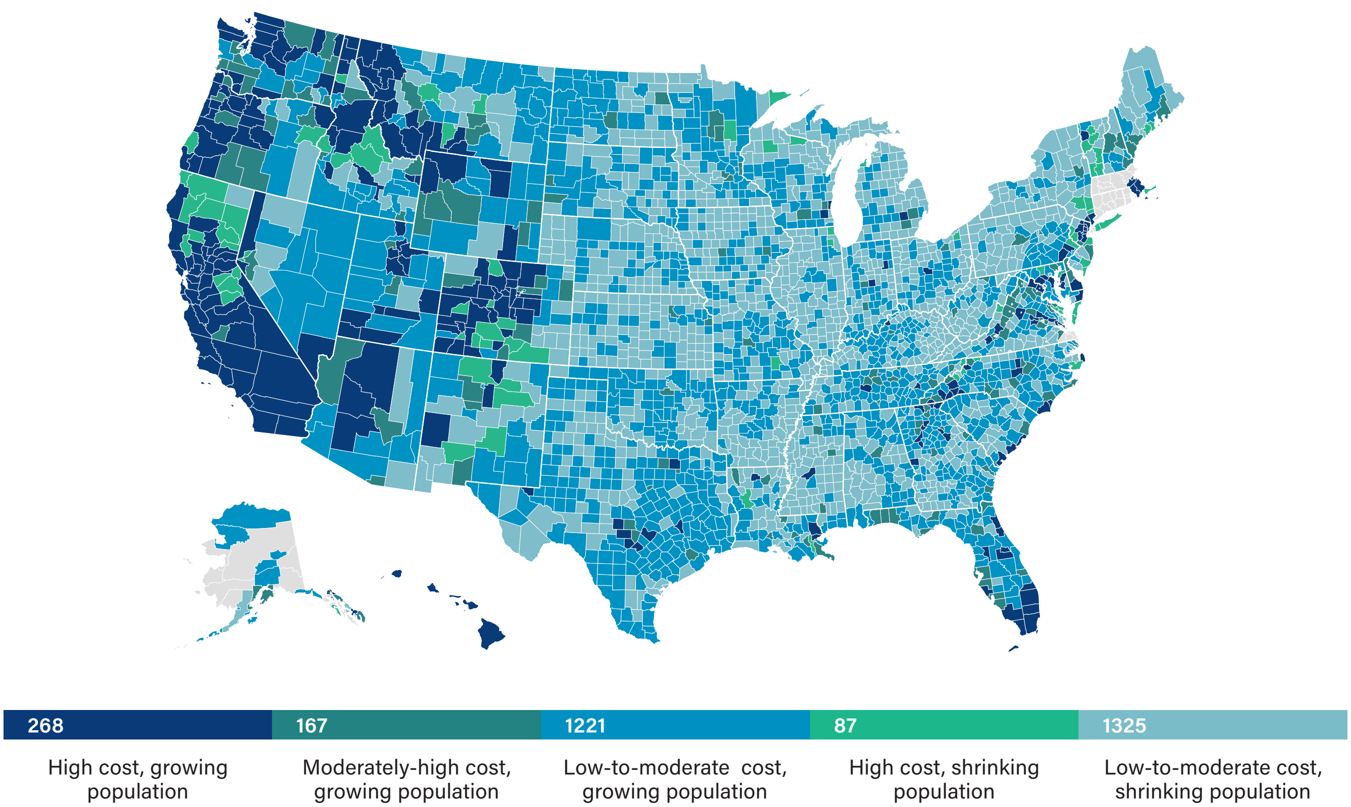
For the projects that are not good candidates for housing, additional options for conversion can be considered that create economic opportunity or services within the community. Some common alternatives are conversion to life sciences uses like laboratories for healthcare research and development and hotels.[17]

[B] *The RentCafe study focuses on buildings containing 50 or more units.*
[C] *For more information on brownfields revitalization, see NACo's report Revitalizing Communities Through Redevelopment: County Brownfields Primer, 2024.*
[D] *Multifamily structures are buildings with more than one housing unit, such as duplexes and apartment complexes.*

Residential Adaptive Reuse Will Not Solve the Housing Affordability Crisis

Housing affordability is a supply problem. In most communities, the primary constraint on affordability is the lack of available, quality homes built or renovated since the Great Recession.[18] Despite recent efforts to increase the capacity for development, the nation currently has an estimated inventory shortfall of about 7.2 million homes – particularly concentrated in the south and west.[19] Regional demand for housing is driven by long-run population growth and migration trends, leading to exponential housing cost increases due to market speculation in the highest growth areas and marginal or net negative home appreciation (a key component of wealth building) due to oversupply in others.[20]

HOUSING AFFORDABILITY IS DRIVEN BY ACCESS TO QUALITY UNITS THAT ARE PRICED RELATIVE TO REGIONAL INCOMES.



Source: NACo Housing Solutions Matchmaker Tool, 2024.

Not only is there a lack of supply, but the COVID-19 pandemic has shifted the nature and utility of housing. Some individuals are now seeking larger homes on larger lots to accommodate things like a dedicated office space for remote work.[21] Other individuals found a renewed emphasis on walkability and neighborhood amenities – including proximity to work.[22] This dichotomy presents challenges in urban, suburban and rural environments but couches the reality that not all vacant office space should be adapted for housing reuse, and demand for commercial space has not (and will not) cease to exist – it just needs to be right-sized to the current market conditions.[23]

Neither housing affordability nor office vacancy rates will be solved through adaptive reuse solutions alone. Housing affordability is complex and multifaceted, requiring a whole of government approach using policy solutions including land use, finance and lending, infrastructure planning and expansion, community engagement and education and leveraging federal resources.[E]

[E] *For more information on county strategies to advance housing affordability, see the NACo Housing Task Force final report and recommendations toolkit.*

The two most common types of commercial properties converted between 1950 and 2020 are factories and hotels, which accounted for about 47 percent of all adaptive reuse projects.

Counties Interested in Adaptive Reuse Can Pursue Various Resources to Offset Costs

Commercial to residential reuse projects often incur significant renovation costs, sometimes reaching hundreds of dollars per square foot in addition to acquisition expenses. As a result, the overall net benefit of such projects has historically been low. However, within this challenge lies an opportunity for county and other governmental bodies to incentivize, support or catalyze conversion initiatives that yield positive net community benefits.

Federal Resources

Existing federal opportunities, such as the HOME Investment Partnership (HOME), the Section 108 Loan Guarantee Program (Section 108) for Community Development Block Grant (CDBG) recipients and the Low-Income Housing Tax Credit (LIHTC) have long been used by communities in adaptive reuse projects.[F]

Recent federal funding from the Bipartisan Infrastructure Law (BIL) and American Rescue Plan Act (ARPA) also offer potential resources for local governments interested in supporting commercial to-residential conversion. While ARPA programs provide direct, flexible funding that can be used as a match or cash on hand for these projects, funds are limited, and, in many circumstances, other priorities have greater precedence. BIL funding is limited to the Transportation Infrastructure Finance and Innovation Act (TIFIA), Railroad Rehabilitation & Improvement Financing (RRIF) and Thriving Communities Program (TCP). While these programs present great opportunities, they often convey complex requirements – particularly with the National Environmental Policy Act (NEPA) standards – that aren't usually found or relevant to housing-related programs.[G]

Local Resources

Locally, counties can consider various strategies to support commercial to residential projects. As a property tax-based government, there are opportunities (depending on state law and county authority) to provide tax credits or abatements to conversation projects. Counties can also act as partners in a Public-Private-Partnership (P3) solution, working with a developer or community group to combine resources, including the ability to apply for certain opportunities only available to public entities.

Some counties also have the authority to create land banks, housing trusts or other quasi-governmental entities that can support land transfers, bond issuance, credit enhancements or low-interest loans for conversion projects. These entities may also have access to state-level resources (or federal pass-through resources) not available directly to county governments.

One important facet of the county role in these projects is often related to zoning and community engagement. Any construction disrupts neighbors, and changing a previously commercial building to a residential one frequently requires review by the zoning board in coordination with local government planners and community partners. In this sense, counties seeking to support developers in pursuing these projects can act as conveners, gathering the appropriate stakeholders to engage the community in the process.

F *For more detailed information on these programs, see NACo's report The Federal-County Intergovernmental Nexus: An Introduction to Federal Housing Assistance Programs*

G *For a full list of federal programs that could support these projects, see The White House Commercial to Residential Conversions: A Guidebook to Available Federal Resources (2023).*

Navigating the Legal, Environmental, Economic and Social Frontiers of Conversion Projects

Seemingly complementary challenges of a lack of housing supply and increasing office and commercial space vacancies make residential adaptive reuse a compelling solution. County leaders must weigh the potential of each project.

Legal And Regulatory Considerations

Legal and regulatory considerations are among the most important factors in redevelopment. Commercial conversions in all but extremely limited cases must contend with zoning changes to allow residential use.[24] A change in zoning may also convey a change in the requirements specifying building height, setback, parking and open space allotment.[25]

Buildings in Harris County, Texas (Houston), for instance, are required to have 2.5 parking spaces for every 1,000 square feet of gross floor area (GFA) for offices and between 2 and 8 parking spaces for every 1,000 square feet of GFA in retail, depending on the type. Residential apartments require between 1.25 and 2 parking spaces for residential apartments depending on the number of bedrooms.[26] If the modal apartment size for the conversion is one bedroom[H] with an average of 750 square feet,[I] then an office with 250,000 square feet would need 377 parking spaces[J] to meet residential requirements. Because it was initially constructed for office purposes, the original building would only have been required to have 250 parking spaces. As such, any conversion project would likely require an additional exception to the conditional use permit (CUP) that allows for reduced parking requirements. For counties that oversee land use and zoning, however, this presents an opportunity to incentivize redevelopment by modifying local code to allow exemptions.

Parking requirements are one obstacle in a complex web of regulatory requirements that adaptable reuse projects must navigate. Other challenges may be encountered, including historically designated properties, differences in the inspection and code requirements and the need to permit necessary work. Some counties may have the authority[K] to remove barriers in one or more of these areas, but most zoning and land use regulations lie at the state or city level.

Environmental Sustainability

Redevelopment must also contend with environmental considerations. Because most conversions have been occurring in buildings that are decades old, certain environmental and remediation efforts must be considered – and budgeted.[27] Asbestos remediation, in particular, can be costly and necessary due to its popularity as a building material before its nearly global ban in the 1980s due to health concerns.[28] On the other hand, renovation of existing properties can have net positive environmental benefits compared to

[H] *The most common apartment size in a multifamily building nationally is one bedroom https://www.nmhc.org/research-insight/quick-facts-figures/quick-facts-apartment-stock/characteristics-of-apartment-stock/.*

[I] *One-bedroom apartments generally range from 700 to 800 square feet https://www.apartments.com/blog/studio-apartments-vs-one-bedroom-apartments.*

[J] *Calculation assumes a core factor of 85 percent of the square footage due to loss of space from floorplan reconfiguration https://ggwash.org/view/92306/why-affordable-housing-cant-pay-for-itself.*

[K] *For more information on county housing authorities and solutions, see the NACo Housing Task Force final report and recommendation toolkit https://www.naco.org/program/naco-housing-task-force.*

a full teardown and new build because of the ability to preserve existing carbon, reduce energy and carbon-intensive building activities and use fewer building materials.[29]

Economic Feasibility and Market Risks

Each regulatory and legal consideration adds costs to the redevelopment effort before the work has begun. For projects that can find an easy pathway to meeting these requirements, there are other economic factors to consider, including the "hard" and "soft" costs of architecture or design, reconfiguring HVAC and other systems and construction costs. For these types of projects to be successful, the costs – including land acquisition, hard costs and administrative costs for financing and development – must outweigh the potential return from rents or sale of condominium units.

The average acquisition cost for office space in New York City is $542 psf, with average conversion costs between $100 and $200 psf and average profit margins of $23 psf, which totals between $665 and $765 psf – significantly higher than the average apartment cost of $434 psf.[30] Though these figures represent an expensive market, the sentiment remains: residential adaptive reuse does not pencil in many situations without government involvement or a significant decline in commercial valuations.

There are also market risks associated with conversion. The interest rate environment is continually variable, supply chain disruptions can have significant impacts delaying project sites and costing money on construction loans and disruptions from technology, insurance markets and private investment will always present challenges. However, the ability to attract residents willing to sign leases is unlikely to be one of them.[31]

Community Impact

Another important consideration for local leaders when assessing the viability of commercial to residential conversion in counties is the impact on residents. Construction can be disruptive to residents, a hurdle that public leaders may contend with during community meetings or stakeholder engagement activities related to adaptive reuse.[32] However, community benefits – particularly when these conversions involve mixed-use development that creates additional neighborhood amenities and housing – can help mitigate the temporary negative factors.[33] Mixed-use conversions can also be an important consideration because existing commercial stock may be located in a central business district or other community area lacking traditional residential priorities like schools, healthcare, parks, grocery stores or other facilities. There are many strategies county leaders can use to help facilitate community engagement, from partnering with advocacy groups to holding open meetings and conducting surveys.[L]

Project Viability, Long-Term Needs and Outlook

A combination of these factors must be weighed together to determine the best form of adaptable reuse or revitalization for each community. In some cases, residential reuse developments will make the most sense, while others could be better suited to renovation or reuse into specialized commercial product. Some developments will make more sense to tear down and rebuild rather than attempting to convert into a different use. No matter the best path forward, addressing the vacant and underutilized commercial product within communities provides social and economic benefits for the community and its residents.[34]

[L] *For more information on county community engagement solutions, see the NACo Housing Task Force final report and recommendation toolkit https://www.naco.org/program/naco-housing-task-force.*

Endnotes

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Notes

All analyses are based on 3,069 counties with active county governments. Thus, Connecticut, Rhode Island and portions of Alaska and Massachusetts are excluded since they do not have active county governments. Independent cities in Virginia are also excluded from the analysis.

New York City is a consolidation of the five boroughs of the city of New York:

- Manhattan (New York County)
- The Bronx (Bronx County)
- Brooklyn (Kings County)
- Queens (Queens County)
- Staten Island (Richmond County)

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