New York Law Journal
Real Estate Trends
WWW.NYLJ.COM
ALM.
VOLUME 269—NO. 44
WEDNESDAY, MARCH 8, 2023

CONSTRUCTION LAW

Is There New Life for Underutilized Office Buildings?

By **Kenneth M. Block**
And **Melissa T. Billig**

There's a buzz in the real estate industry about converting commercial office space in business districts to residential use—and it's only getting louder. The pandemic has changed the way we use office space in New York City, among other cities. Hybrid work remains strong, office tenants want to occupy modern Class A spaces with amenities (albeit less of it), layoffs continue to roll out and construction financing interest rates are at their highest (nearly double from a year ago).

New York City has a significant amount of under-occupied or vacant Class B and Class C office real estate. Converting these commercial spaces to residential could help to solve the housing affordability crisis, where limited inventory has caused rents to soar. Landlords are trying to adapt to this post-pandemic world, but not every building is a viable candidate for a residential conversion—it's expensive to renovate, there are no tax breaks, and the commercial districts have not been re-zoned to permit these conversions—*so how can they do it*?

The consensus seems to be that Albany and City Hall need to take more action to incentivize these conversions. Legislation is required to loosen restrictions on the density of residential buildings, natural light and air requirements, re-zoning of commercial districts (providing more flexibility for mixed use as-of-right projects), and offering tax breaks like the expired 421-g and 421-a abatements.

In addition, these conversions need to be economically viable. An office building owner already has a substantial investment in its building. The additional investment required to convert the building may not actually increase the building's value.

In addition, the building owner will have carrying costs during the renovation without income from that asset. This type of redevelopment will not be easy or cheap. A conversion would therefore only seem to be economically viable if the converted housing is worth more than the existing building (with the help of tax abatements and incentives, of course).

The transformation of lower Manhattan in the early 1990s (which introduced the 421-g tax abatement) and in the early 2000s (following the 9/11 terrorist attacks) proved to be successful in repurposing office stock and adding residential supply—transforming the area. That transformation, with the help of tax incentives, should be a model for the re-imagining of the older building stock in Manhattan, including those in the Flatiron, Midtown East and Garment districts.

Governor Kathy Hochul and Mayor Eric Adams, who are aligned in making New York great again, fully support these conversions. In fact, their *New* New York Panel

KENNETH M. BLOCK *and* MELISSA T. BILLIG *are partners of Tannenbaum Helpern Syracuse & Hirschtritt LLP and co-chairs of the firm's construction & design practice group.*

is pushing for the revitalization of New York's business districts and the tackling of, among other things, the housing shortage. They are pushing for single-use business districts, where people can live, work and play, and are advancing initiatives to redevelop outdated office buildings and increase the housing stock. However, affordable housing will not be economically viable for the building owner without government aid (funding or financing the renovation costs).

Buildings most ripe for conversion appear to be those with smaller floorplates, which are easier to re-design and can give more light and air throughout. Buildings with wider floorplates and deep floors can have less light and air throughout and may not have the building systems in place necessary for residential use (i.e., bathrooms could be configured in the core of the building). Residential space requires, among other things, plumbing and electric in every unit.

One would argue that all of the vacant hotels would be prime candidates for these conversions since hotels have bathrooms, plumbing and lighting in each unit, but hotel owners will likely be unwilling to devalue their investment in the hotels to make the conversions economically feasible for developers.

We should also be mindful that successful conversions are subject to the buildings not being (overly) encumbered by existing commercial tenants. The cost to buy out or relocate existing tenants will undoubtedly add to the bottom line of these conversions and could prove to be cost prohibitive.

One would guess that the cost to renovate a building, as opposed to constructing it anew, would be less expensive. However, conversions in New York City (which will also have to factor in compliance with the carbon emission requirements of Local Law 97) will require the same planning and logistics, and may ultimately be just as expensive as ground up construction without the benefit of significantly higher commercial rental income to outweigh those costs.

Governor Kathy Hochul and Mayor Eric Adams, who are aligned in making New York great again, fully support these conversions. In fact, their New New York Panel is pushing for the revitalization of New York's business districts and the tackling of, among other things, the housing shortage.

Note that Local Law 97, which takes effect in 2024, requires non-city owned properties that are larger than 25,000 square feet to report, starting in 2025, utility consumption and carbon emissions. This requires building owners to start planning now for compliance (and ways to reduce consumption) as properties that exceed the City's emission limits will face penalties.

Converting underused office space can be a viable option to reinvigorate the city (creating new life for its office towers) and to produce the much needed housing supply, provided the right governmental investments (tax abatements and incentives) are in place.

The buzz about office to residential conversions is also being heard in many other cities such as Chicago, San Francisco, Philadelphia and Washington, DC, where commercial properties are similarly under-occupied and affordable housing is in demand. New York should be the model of proper adaptive re-use of office buildings to not only solve housing needs, but to create a transformative jolt to the "new normal."