OTTEN JOHNSON ALERT

Adaptive Reuse Update: New Federal Incentives and Emerging Trends

November 2023 • Emily L. Maino and Chelsea M. Marx

Introduction

The changes to the office space landscape spurred by the COVID-19 pandemic led to deserted downtown areas and abandoned business districts throughout the nation. In second quarter of 2023, office vacancies across the country hit a 30-year high at over 18%, while residential rents continued to remain near record highs across U.S. cities, perpetuating the ongoing housing affordability crisis. Many policymakers and private sector leaders, like the American Planning Association and U.S. Green Building Council, have been studying ways to reinvigorate our cities by repurposing vacant commercial buildings into residential projects to increase housing affordability and offer the added bonus of reduced emissions.

Over the past year, we have reported on national trends regarding adaptive reuse, the process of such conversions, including the City of Denver's efforts to identify buildings that would be good candidates for conversion. However, as we discussed, these conversions can be challenging and costly, which means that policymakers must provide financial and regulatory incentives to increase this type of development.

On October 27, 2023, the Biden-Harris Administration announced a series of federal actions to incentivize the conversion of commercial properties to residential space across the country. Through these new federal actions, the White House seeks to ease these challenges and advance adaptive reuse efforts across the country. This alert provides an overview of the new federal efforts to encourage adaptive reuse projects and an update on national trends in this area.

New Federal Actions Incentivize Commercial-to-Residential Conversions

New Federal Grants, Below-Market Loans and Tax Incentives

First, the Department of Housing and Urban Development (HUD) and the Department of Transportation (DOT) each released new guidance on using existing federal financing programs in the context of converting commercial properties for residential use. HUD's Community Development Block Grant Program, which has provided $10 billion in grants to states and local governments to develop urban communities since 2021, will allow such governments to access up to five times their annual allocation to fund residential and mixed-use conversion projects. HUD also announced a new $85 million Pathways to Removing Obstacles to Housing program that will provide grants to states and local governments to develop adaptive reuse strategies and finance conversions. Additionally, the DOT released new guidance to developers, states and local governments highlighting its lending capacity of over $35 billion in below market interest rate loans for transit-oriented development projects, including conversion projects near transportation. In conjunction with this guidance, the DOT released a policy statement to reflect its support for pursuing transportation projects that seek to decrease emissions while increasing the affordable housing supply.

Disposition of Federal Properties

Second, the DOT and the General Services Administration (GSA) are each making efforts to offset the costs of conversion projects through the disposition of federal properties. The DOT is issuing new guidance allowing transit agencies to transfer properties to local governments, nonprofit, and for-profit developers at no cost for transit-oriented affordable housing developments. Furthermore, the GSA will work with the Office of Management and Budget to promote the sale of surplus federal properties that buyers could redevelop for residential use. These efforts will include maintaining a public list of current sale opportunities and affirmatively marketing available resources to support housing development in connection with those properties.

Commercial-to-Residential Federal Resources Guidebook, Trainings and Technical Assistance

Third, the White House released a guidebook on available federal resources for commercial to residential conversions and announced additional training workshops and technical assistance that the administration is undertaking to promote these conversions. The Commercial to Residential Conversions Guidebook, which can be found here, provides an overview of the new federal actions discussed above. It also provides detailed descriptions of over 20 federal programs administered by six federal agencies that can be used to support conversion projects. These programs include low-interest loans, loan guarantees, grants and various tax incentives, many of which may be combined as a means to improve the financial practicability of commercial to residential conversions. The White House will announce a series of training workshops for state and local governments, real estate developers, owners, builders and lenders on how to leverage these federal programs for commercial to residential conversion projects. The DOT, Department of Environment and Treasury will support these efforts through new technical assistance programs, toolkits, and other online resources that will educate and support developers seeking to finance these conversion projects.

Emerging Trends

Nationwide

While the federal programs offer additional incentives for building owners in many cities that are struggling with high vacancy rates in office buildings across the Country, many states and municipalities have implemented their own programs and policy changes to assist developers and business owners in potential conversions, primarily in aspects that the federal government cannot provide assistance with, such as building permit processes and zoning changes. Many cities and states are starting to offer a mix of financial or tax incentives with streamlined permitting and other regulatory changes for qualifying projects. For example, Boston recently adopted a “Downtown Residential Conversion Incentive Pilot Program” which offers tax incentives for developers, fast tracked permitting, and assistance with rezoning where needed. This program requires developers to sign a “PILOT” agreement with the City of Boston, an incentive generally available only to tax-exempt entities, which reduces property taxes up to 75% of the standard tax rate for qualifying conversions.

Similarly, in August of this year, New York City announced it was allocating over $24 billion for affordable housing and adaptive reuse programs. As part of this program, it launched an “Office Conversion Accelerator” to assist building owners in assessing the feasibility of conversion projects, particularly in buildings that are not as easily suited for conversion as others in the city might be. While New York City is not new to incentivizing office to residential conversions, it again has adopted new programs and policies to address the post pandemic landscape by increasing the housing stock in areas that faced significant losses in office building tenants.

Statewide, California has allocated $400 million of state funds to incentivize adaptive reuse and adopted Assembly Bill No. 529, which seeks to facilitate the redevelopment of commercial properties into housing by adopting adaptive reuse ordinances to reduce barriers for potential conversions. The bill also requires the Department of Housing and Community Development in California to convene a working group to identify challenges to adaptive reuse and propose potential amendments to building standards to enable conversion projects in the State. Several municipalities in California, such as San Francisco and Los Angeles, have taken further action to promote conversions in their cities. San Francisco has asked property owners what kinds of support they would need for adaptive reuse conversions and indicated it would adopt policies and programs to address these needs. Los Angeles is in the process of updating its existing Adaptive Reuse Ordinance to streamline the permit review processes, expand the adaptive reuse program to other parts of the city, and increase the number of buildings that are eligible for conversion.

Moving forward, developers and building owners will likely be able to combine the state and local targeted support and process streamlining with the federal funding programs to make these projects more feasible. As more cities identify their own specific challenges and needs, they can implement programs that complement the new federal resources available and address the individual needs of each potential project.

Local Adaptive Reuse Updates

As we noted above, the City of Denver recently completed its study to identify buildings in downtown Denver that might be suitable for adaptive reuse and launched a pilot program for interested business owners. Like many of the other cities discussed above, the pilot program in Denver will provide building owners with assistance in navigating a potential conversion project by assigning them a specific project coordinator who will assist with the permitting process. The City is still accepting applications for its Adaptive Reuse Pilot Program. The program specifically supports conversions of buildings located in the upper Downtown area of Denver that are currently configured for office space, were constructed more than 30 years ago, currently have 50% or higher vacancy, and will be converted to multi-use residential in part or in whole. Applicants must describe any anticipated challenges in the conversion and what other incentives are being pursued. Additionally, applicants must address the “project vision” and how the project will meet the Expanding Housing Affordability requirements. It is unclear whether Denver will offer any financial incentives in addition to the administrative support in navigating the permitting process as the program is only in its application stage at this time.

Conclusion

As we discussed in our original alert, adaptive reuse projects present several challenges for those seeking to convert office space to residential but offer the unique potential to address both office vacancy and housing affordability issues at once. As cities continue to combat these increased vacancy rates and search for ways to provide additional affordable housing for their residents, the additional federal support and ongoing development of state and city programs will provide essential resources to help building owners and developers overcome the cost burdens and administrative hurdles often posed by office to residential conversions.

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