

Downtown Office Conversion

Description

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“Your success in life isn’t based on your ability to simply change. It is based on your ability to change faster than your competition, customers and business.” — Mark Sanborn.

This past July, Boston Mayor Michelle Wu, following the lead of several other major cities around the country and world, announced the Downtown Office to Residential Conversion Pilot Program (the “Program”). The Program is focused on attacking the dual issues of (i) increased commercial office vacancy rates post-pandemic in the downtown Boston market (with a focus area on the district bounded by Tremont/Cambridge Street, Essex Street, and the Greenway along with select portions of the West End) and (ii) ever-increasing housing costs. The Program will not only provide financial incentives for converting existing office space to residential housing, but also streamline and reform the outdated zoning codes and procedures to enable such conversions.

The Program, among other things, allows the Boston Planning & Development Agency (“BPDA”), the City of Boston, and developers to enter into payment in lieu of tax agreements providing for much needed tax incentives and tax breaks for downtown conversion projects. Additionally, the permitting process, including Article 80 review, will be fast tracked for projects participating in the Program in order to make it easier for downtown conversion projects to be approved.

The BPDA has recently begun accepting applications and will continue to accept applications through June 2024, with any approved projects required to start construction no later than October 2025. Given these tight timelines, developers must act quickly to take advantage of this Program. Those who delay may find themselves holding vacant assets and unable to meet their financial obligations.

The Data

The Covid-19 pandemic resulted in a drastic shift in office demand. As of 2023 Q2, the commercial office availability rate in Boston has increased to 13.7%, up from 8.4% in 2019. There is 44.8 million square feet of commercial office space available in Boston, which is the highest on record. Of that, 34.7 million square feet is directly available and 10.3 million square feet is listed for sublease (also the highest on record).

In 2022, it appeared for a short time that commercial office demand might be rebounding. That year saw the first positive net absorption rate for office occupancy since the start of the pandemic (though the rate was still well below pre-pandemic levels) and office occupancy reached a post-pandemic high of 31% signaling that businesses were beginning to gradually end remote work and bring workers back to the office. However, that trend did not take hold. Net absorption has cratered so far in 2023 and is on pace to rival the record low in 2020. Office occupancy is back on a downward trend.

Workers have demonstrated over the past three years that remote work is not only possible, but successful. Productivity has largely rebounded from the pandemic. Numbers published in May 2023 show that in 2021 Boston’s Gross City Product reached record levels after a pandemic-induced dip in 2020. The 2022 and 2023 numbers are expected to be roughly in line with pre-pandemic levels. Further, workers have made their preference clear. A poll conducted by the Boston Globe earlier this year showed that 46% of respondents prefer a hybrid work model, 39% prefer to work fully remote, and only 15% prefer a full return to the office.

It appears unlikely that commercial office demand will rebound to pre-pandemic levels anytime soon. As a result, the data shows, and we expect, that many companies either are (or will be) looking to downsize their

office footprint. With 11.7% of Boston office leases expiring in 2023, and over 40% of Boston office leases expiring over the next 5 years, occupancy rates are expected to continue a downward trend.

Residential Housing Demand

At the same time as commercial office demand has dropped, the demand for residential housing in Boston has been on a meteoric rise. In July, the median price of a single-family home in the Greater Boston Area reached a record \$910,000, the median price of a condominium reached \$735,000, and median rent rose to \$3,124, rivaling Bay Area cities and New York nationally.

The supply of housing in Boston is not nearly sufficient to meet the increased demand, which phenomenon is even more pronounced in downtown Boston. Downtown Boston contains only 2.3% of the total residential units available in the city. Downtown residential vacancy rates are 3.5%, the lowest of any neighborhood besides Back Bay and Fenway, which is down from 5.4% in 2019. That -1.9% change in residential vacancy rates is the greatest decrease in vacancy rate of any Boston neighborhood, which suggests that residents are increasingly desirous to live downtown.

Despite the lack of supply of residential units in downtown Boston, and the increased demand for them, only 28% of upcoming downtown development projects are for residential builds, as compared to approximately 50% throughout the city generally.

The Program

Cities such as New York, Chicago, Los Angeles, Washington, D.C., London, Paris, and San Francisco, among others, have recently announced or adopted programs to provide incentives and relax zoning regulations to encourage conversion of downtown office space to residential units. In July, Mayor Wu announced the Program to encourage that same type of conversion in Boston.

In addition to tax incentives, zoning and Article 80 review will be expedited for projects participating in the Program to help ease the process for converting office space and developing residential units in the downtown area.

The Program will be administered by the BPDA, the Mayor's Office of Housing, and the City of Boston Finance Cabinet. Any project will be required to comply with the recently updated Inclusionary Development Policy (i.e. 17% of units at 60% of Area Median Income and 3% at Fair Market Value for those with housing vouchers). The viability of a building for conversion will be case specific and depend on the size, build, and location of the building. The BPDA has identified mid-size Type 2 and Type 3 buildings in the financial district, with floorplates of 50 to 70 or 70 to 100 feet, as the most economically viable candidates for conversion, though smaller Type 1 buildings may be economically viable if they have a significantly high vacancy rate.

The post-pandemic era of worker flexibility is a leading contributor to the current trend of decreasing demand for commercial office space nationally and in Boston in particular. While the demand for commercial office space is on the decline, the demand for residential space has skyrocketed and has shown little signs of slowing.

Contact [Partridge Snow & Hahn](#) if you are interested in exploring the Program. [Loren F. Sutton](#) or [Jay R. Peabody](#) of the [Commercial & Real Estate Finance Group](#) are ready to assist businesses with these issues.

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