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Underused office space could find new life as housing, Downtown L.A. advocates say

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With office vacancy rates still above 20% in Downtown Los Angeles, some landlords and their tenants are coaxing workers back to the office with elaborate renovations and highly amenitized Class A space.

But as a possibly permanent shift to hybrid work pushes companies to downsize their cubicle and conference areas, others, advocates argue, should consider other uses entirely, like housing.

“I really don't think there's any doubt that the demand for office space is now diminished significantly,” said Hal Bastian, former executive vice president and director of economic development of Downtown Center Business Improvement District (DCBID). “Which begs the question: What are we going to do with all this empty space?”



MARKUS HANKE VIA GETTY IMAGES

When Bastian discusses converting office space to residential units, the situation sounds mutually beneficial for the city, developers and owners paying mortgages on vacant buildings.

“There's probably 100 different reasons that it's difficult,” he said. “I'm not interested. That's what they said about this 22 years ago. We have a need for housing, we need to do something differently, and we need to make it easier. That's going to take political leadership to get it done, but the idea for the political leadership can be forced by the constituencies, the business community and the owners to make it happen.”

Part of the \$308 billion budget signed by Gov. Gavin Newsom last month allocates \$400 million to incentivize conversions of underused commercial buildings into housing across the state, signaling that the state expects a slow recovery for office buildings. The budget dedicates \$150 million in funding for conversions to be distributed this fiscal year and the remaining \$250 million in the 2023–2024 fiscal year.

Carol Schatz, founder and president emeritus of DCBID, who introduced office conversions in the late 1990s and 2000s, said she finds it exciting to see money in the state budget allocated for commercial to residential conversions.

“It was really transformational in our downtown revitalization,” she said. “Staples Center [now Crypto.com Arena] made a huge difference because it gave people a reason to come downtown, and [an] adaptive reuse ordinance gave people a reason to live downtown, to experience not only Staples Center but the restaurants that started to come. But the key is housing. If people just come in and out of downtown, you can't really revitalize it. It requires a population, living there and working there in many cases.”

Schatz said 75,000 people reside downtown, a number that was “unheard of” when she started DCBID.

The state of the downtown office market

Year-to-date net absorption for offices downtown rose from minus-319,000 in the first quarter of 2021 to minus-15,000 in the beginning of 2022, according to DCBID, with 2.7 million square feet

of office space under construction. But despite rising absorption, companies are expected to downsize as they return to office, leaving floors of previously leased buildings vacant.

CBRE reported 21% overall office vacancy in Downtown L.A. in Q1 2022, and 47% overall office vacancy in East Downtown.

Carl Muhlstein, executive managing director at JLL, said premier office space and Class A buildings are recovering and outperforming as return-to-office gains momentum. The buildings seeing issues are Class B and C buildings and vintage high-rise offices with little demand.

"We have too many Class B and C office buildings," he said.

"They're not going to be re-leased. They're not going to be able to maintain their financing and value as office buildings. They could be delivered quickly to the market, because they're sitting on fee land. They have a parking structure. Some of the floor plates may match."

Vintage high-rises offer another opportunity for development as companies looking for space show a preference for newer structures rather than buildings constructed in the '60s or '70s, such as the former Crocker Citizen's Bank Headquarters.

The 42-story, 700,000-square-foot office building in the heart of downtown at 611 W. 6th St., with cross-shaped floor plans completed in 1969, has been vacant for nearly a decade. Muhlstein said if the building could be converted to residential, it could add as many as 800 units and benefit the developer as well as the city.

What's old is new again

Converting office space to residential isn't a new concept in L.A., especially not downtown. In 1999, the city passed the Adaptive Reuse Ordinance — spearheaded by Schatz — to simplify the process of converting vacant and underused buildings downtown into housing and hotels.

Office buildings were popping up on Spring Street through the '60s, until development shifted to Bunker Hill and the Financial District. By the 1990s, offices on Spring Street and in the

surrounding area were functionally obsolete, with no demand and few remaining tenants.

When the recession hit Downtown L.A. in the '90s, some high-rise office buildings had hit a nearly 30% vacancy rate, Schatz said. She knew a change had to be made. Looking at Manhattan's tax abatement program in New York, she saw how city assistance in converting office buildings to housing was benefitting both developers and residents while revitalizing downtown. Los Angeles' Proposition 13 barred the city from copying New York's program, so Schatz came up with the Adaptive Reuse Ordinance, inadvertently starting Downtown L.A.'s renaissance.

The former United California Bank building built in the 1960s at 600 Spring St. was one of the first high-rises in the city before the bank moved its offices. When the city moved forward with the Adaptive Reuse Ordinance, the vacant building at 600 Spring St. was converted to residential lofts, as it has remained ever since.

Adaptive reuse changed the face of office development through the 2000s. The former Superior Oil Building was converted to the 207-room hotel The Standard in 2002, one of the first big adaptive reuse projects.

The former Mobile Oil headquarters became the Pegasus Apartments in 2003, adding 322 residential units to Flower Street and earning a Conservancy Preservation Award. More recently, the 1923 Neoclassical building once home to the Bank of Italy's L.A. headquarters was converted in 2018 to the NoMad Hotel, now reopening as Hotel Per La.

Obstacles and challenges

As floors of office space sit empty again, it seems an opportunity has arisen for adaptive reuse to make a comeback, eliminating obstacles created by zoning and permitting laws set by the city.

In the meantime, obstacles that would make conversions difficult, Muhlstein said, boil down to zoning and land use laws, plus the actions of city government. Considerations regarding parking ratios, floor plans, safety and construction limitations also must be taken into account, while developers may question whether the return on investment is high enough.

Cost of conversion is less of an issue than expected, according to Bastian.

“The miracle of adaptive reuse is it took fixed city resources like personnel to get stuff done, but there was no money involved,” Bastian said. “There were no bonds floated or anything else, just the ease of being able to redevelop these buildings and turn them into housing. We know it can be done and it has been done.”

With Gov. Newsom’s budget, funding should be even less of an issue in the future. Schatz said she’s curious how the money will be distributed.

“It will be interesting to see how that \$400 million will be spent statewide,” she said. “I think there will be an emphasis on low-income housing. That’s what I think may happen with some of that money.”

Adaptive reuse has been found to reduce vacant space while preserving the architectural and cultural past of downtown, while breathing new life into the residential community. While it has been executed mainly downtown, Muhlstein said adaptive reuse could be successful in other areas of L.A., such as West Hollywood or Santa Monica, but emphasized that downtown presents the most opportunity for conversion development.

“Downtown is the poster child of over 100 empty floors of office space with little velocity to re-tenant,” he said, though he added that he doubted whether local municipalities are flexible or progressive enough to re-embrace concepts like the Adaptive Reuse Ordinance that helped save downtown decades ago.

As long-term office leasing activity becomes clear, Schatz said she believes office conversions will become more pervasive around L.A., and said she’s surprised anyone would oppose adaptive reuse projects.

“It’s always been important to me to know what’s going on with something that has such tremendous benefits for the city and downtown in particular,” she said.

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