

PROPERTY CONVERSION AND ADAPTIVE REUSE

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Evaluating property, not on what it is today but rather its long-term potential, has long been a pillar of commercial real estate investing and development. Consider the vast changes in commercial real estate sectors that we've seen in recent years. Industrial, multi-family, and hospitality sectors have seen unprecedented growth from where they were just three years ago, while the impact of COVID-19 has created turmoil and uncertainty in the office market. These changes have created both a need and an opportunity to assess conversions and adaptive reuses, to best position a property to meet market demands, maximize revenues, and create long-term value and stability. Conversion and adaptive reuse is by no means a new topic in the commercial real estate industry, but it has certainly become a significant discussion point, given the recent market shifts.

With increasing vacancy rates for office space and the ongoing housing shortage, converting office buildings into multi-family housing is an increasing temptation. But although opportunities can be found with properties of the right configuration and financial positioning, several challenges hinder the potential for this type of conversion. The most notable is the economics of these projects: office buildings carry a high cost basis, combined with the increasing cost of construction. Many office buildings are carrying a cost basis of \$150–\$200/SF, depending on the market and building class. When you add in construction costs of over \$300/SF for the infrastructure needs, upgraded code requirements, and finishes for residential use, the economics don't pencil out. In addition, the floor plates of many larger office buildings do not support residential conversions. With large, open, deep floor plates designed to house a single office tenant all on one floor, these layouts often do not sub-divide well, resulting in even higher construction costs and interior spaces with no windows.

With that said, we are seeing developers who have been able to navigate these obstacles and unlock opportunities, namely, Redfern Properties converting 45 Forest Avenue in Portland into 81 residential apartments. This 75,000± SF building was purchased fully vacant and not encumbered by varying tenant leases, which is often the case with office buildings. Redfern

purchased the property for \$32/SF and is also utilizing historic tax credits to support this capital-intensive project.

East Brown Cow is also finding success with the conversion of Class B office space into luxury hospitality rentals, branded The Docent's Collection. The Collection is comprised of the upper floors of 115 Middle Street, 121 Middle Street, and 178–184 Middle Street, consisting of 21 completed units and another 27 in the pipeline. These smaller Class B buildings have floor plates that are more favorable to sub-division. Additionally, short-term hospitality rentals can generate higher revenues per square foot than long-term apartment rentals, which helps support the large capital investment for conversion.

Along with multi-family and hospitality conversions, we also see adaptive reuses to meet the demand for industrial/flex space. Lease rates for industrial space have historically lagged those of office space. However, over the past 24 months, we have seen the delta between the two diminish, with increasing lease rates for industrial product, driven by increased demand by industrial users, limited existing inventory, and increased costs for new construction. This has opened the door for the conversion of office buildings and even retail properties into industrial/flex uses.

Fork Food Lab is currently in the process of converting 95–97 Darling Avenue in South Portland into a commercial kitchen and food manufacturing facility. The 42,000± SF single-story office building was formerly owned by WEX.

Another example is JB Brown & Son's purchase of One Davis Farm Road in Portland, with plans to convert the 48,000± SF two-story office building into a self-storage facility. Although challenged by lower ceiling height, these suburban office buildings can lend themselves well to lighter industrial and manufacturing-type uses. For higher clear heights and true warehouse space, former retail boxes can be an ideal opportunity, as shown by the repurposing of the Promenade Mall at 855 Lisbon Street in Lewiston. Formerly a 262,000± SF retail center, the Promenade has been converted into a high-bay industrial warehouse and expanded by an additional

65,000± SF. The large parking fields for retail and office buildings can provide a unique opportunity for potential additional development as they did at the Promenade Mall, or they can provide truck circulation and parking for users that may be limited at existing industrial properties.

Although we are seeing owners and users unlock opportunities with these conversions, it is important to note that many properties are challenged with restrictive zoning that does not allow industrial uses. Before embarking on a project of this nature, it is crucial to confirm that current zoning allows your planned end-use or that the property is located in a municipality that will support a change to the current zoning.

Whether it be industrial, multi-family, hospitality, or any alternative use, adaptive repurposing of spaces will forever be a part of strategic planning in commercial real estate as a hedge against the ever-changing ebb and flow of industry sectors and property life cycles. Looking ahead to 2023, as we continue to see the residual impact of COVID-19 on the office market, I suspect adaptive reuses will remain a hot topic. I anticipate seeing further repositioning of suburban office properties to support industrial and manufacturing demand, while conversions to multi-family residential will be limited and focused on smaller Class B buildings.

RECENT SIGNIFICANT PROPERTY CONVERSIONS

DEVELOPER	PROPERTY	NEW USE
Redfern Properties	45 Forest Ave, Portland	Apartments
East Brown Cow	115 Middle St, Portland	Hospitality
East Brown Cow	121 Middle St, Portland	Hospitality
East Brown Cow	178-184 Middle St, Portland	Hospitality
Fork Food Lab (Tenant)	95-97 Darling Ave, South Portland	Food Processing/Commercial Kitchen
JB Brown & Son's	1 Davis Farm Rd, Portland	Self Storage
Gendron Real Estate	855 Lisbon St, Lewiston	Warehouse

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