Vermont Association of Realtors®

Testimony on Commercial Conversion

Senate Economic, Housing and General Affairs

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KW …

Why should Commercial Conversion be feasible?

As of Q-2, 2021 office space down by 115 Million Sq Ft. compared to 2020 Q-1

Conversion is feasible if apartment rent (Class A) is higher than current office rents (Class B/C)

Commercial Conversion especially suitable for multifamily rental housing

What are the challenges?

Cost of construction rising at a 17% annual rate

Availability

Low market driven incentives make conversion less attractive

Conversions are risky and expensive.

Factors like Economic, Legal and Practical must be considered

Cap rate, vacancy rate and annual rent increases must be part of the equation

Permitting, toxic contamination and code conformity add to complexity

Physical characteristics of building and building systems (elevators) and residential permitting requirements (light, air, fire alarms, sprinklers, and egress) will determine conversion costs.

Commercial zoning may not allow residential use.

Residential rental is risky with Landlord-Tenant laws restrictive for landlords.

When are commercial conversions to residential housing successful?

Works when Local Developers and Investors are committed to project

Clear Project Objectives Identifying target market to determine location aesthetics and functional design

Community buy in

Works where residential rents are trending higher than commercial rental rates

Older buildings have more potential for redevelopment, depreciated and will need remodeling anyways.

Wedge shaped or cubed buildings offer easier conversions that rectangular buildings where a significant volume of space is far from exterior walls and natural lighting.

How can government faclilitate commercial conversion:

Commercial Conversion needs subsidy from federal, state or local policy to be effective

Our National Association of Realtors (NAR) are advocating for the Revitalizing Downtowns Act HR 4759, S.2511. We suggest that a similar State based program be considered to encourage conversion.

The act provides a 20% Tax Credit for qualified property conversion expenditures

Modeled on current law historic property rehabilitation tax credit for buildings older than 25 years.

NAR Recommends, and VAR encourages state regulations be expanded to include:

Shopping centers, industrial buildings, and hotels

Extend Tax credit to Real Estate Investment Trusts (REIT)

Bonus credits for projects in economically distressed areas

Use state tax exempt bonds

Rule based or “by right” zoning that is quick and objective can encourage conversion.

Introduced in House (07/28/2021)

Revitalizing Downtowns Act

This bill expands the investment tax credit to add a qualified office conversion credit. The amount of such credit is 20% of the qualified conversion expenditures with respect to a qualified converted building. The bill defines *qualified converted building* as any building if (1) prior to conversion, the building was nonresidential real property which was leased, or available for lease, to office tenants; (2) the building has been substantially converted from an office use to a residential, retail, or other commercial use; (3) the building was initially placed in service at least 25 years prior to the beginning of the conversion, and (4) straight line depreciation is allowable with respect to the building.

Current Market Stats

Chittenden – Absorption Rate Residential 1 Month

B – C Rate $12 to $15 Annual or $1000 to $1,250/month per 1000sqft

A Rate $16 to $22 Annual or $1300 to $1830/month per 1000sqft

1 Bedrooms - $1200 to $1500 Affordability $48K (26) to $60K(33)

2 Bedrooms - $1750 to $2000 Affordability $70k(38) to $80K(44)

Area vacancy rates have held steadily at 2% since 2018. Comparably, a healthy vacancy rate is 3% to 5%

Annual growth rate .8% and healthy 2.5% 1980 – 1990