The Case for Office Conversion

UBP Headlines | February 2025

Author

Geoffroy Troesch
Head of Investments Management PMG

MARKETING COMMUNICATION | For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws

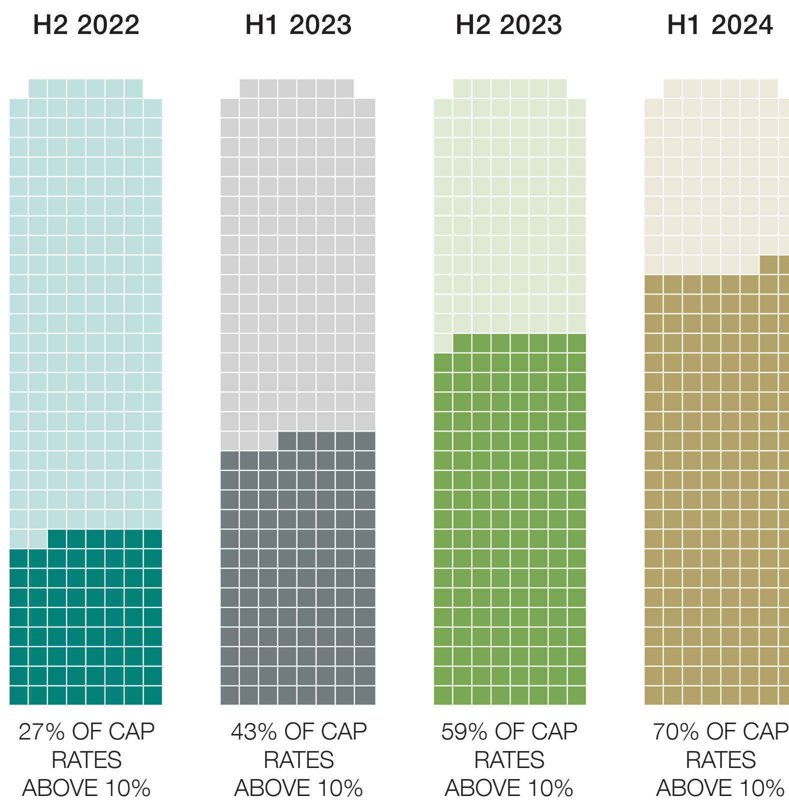
UBP
Union Bancaire Privée

Key points

- The US office property market has seen a significant shift in demand, impacting the non-prime segment.
- Scarcity of housing supply has continued, especially in major, high-density metro areas.
- New York City combines a tight housing supply with high levels of office vacancies – the ideal dynamic to deploy office-to-residential conversions.
- This provides investors with a unique opportunity to reposition major assets while enjoying structural tailwinds.

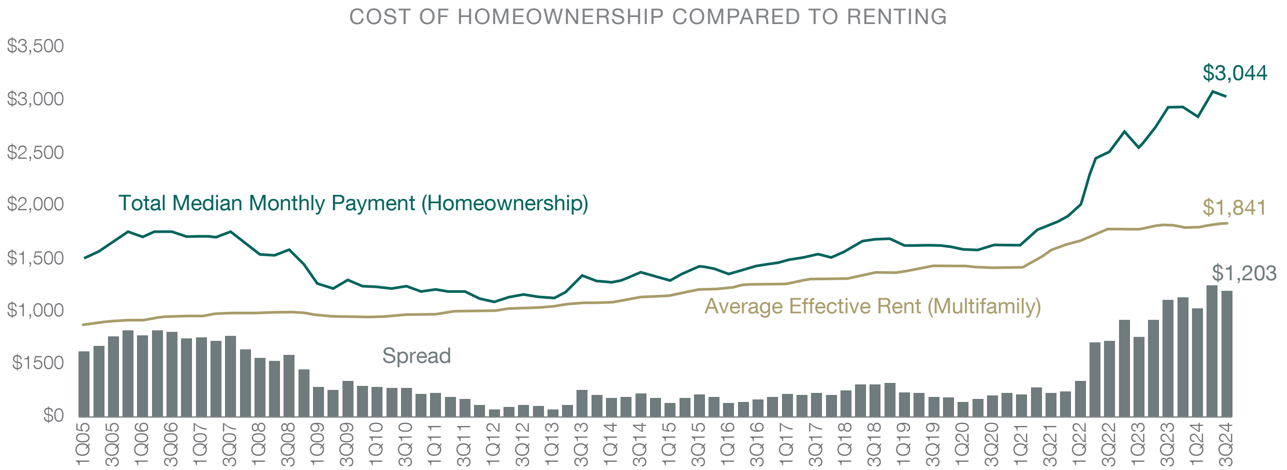
Introduction

The US office market has faced a major demand shock since the pandemic on the back of the rapid adoption of remote working. What was initially thought to be a temporary measure has morphed into a long-term preference on the part of employees. The absence of productivity decline has prompted companies to embark on a reduction of their office space footprint. According to Moody's, office demand across the United States could decrease by 14% over the next five years, with vacancy rates peaking in 2026. In the meantime, Class B and C (older offices) office yields have reached new highs, with 70% of the inventory priced at a cap rate above 10% as at H1 2024.



Note: Dark shaded blocks represent cap rate estimates above 10%.
Source: CBRE Econometric Advisors.

This contrasts significantly with the dynamics observed in the residential sector. Rising homeownership costs have fuelled multifamily rental demand, particularly as US mortgage rates have more than doubled since 2021. Despite these rate hikes, house prices have remained resilient, reinforcing rental demand. Low interest rates and the strong performance of multifamily led to a surge in multifamily developments between 2021 and 2022. As an illustration, in the Mountain West and the Sun Belt areas, new supply represents respectively 5.5% and 4.3% of the existing inventory, while the national average stands at 3.1% – twice as high as its pre-pandemic level. However, the slowdown in construction starts provides strong support for rental growth in the coming years.

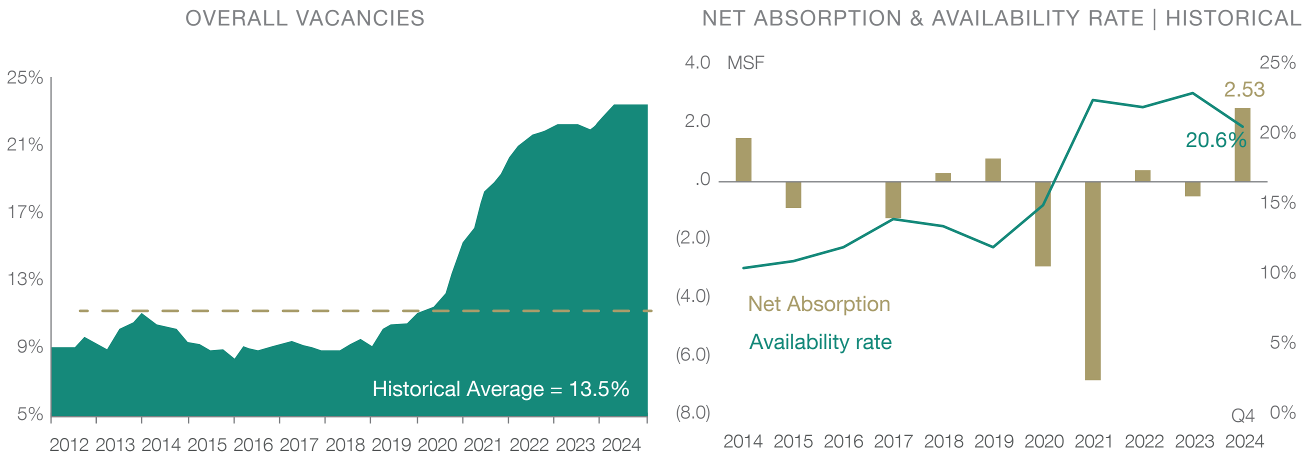


Sources: Newmark Research, Atlanta Federal Reserve (17.10.2024), RealPage.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

In major metropolitan areas, high replacement costs constrain new housing supply. Ground-up residential developments are often uneconomical, while the volume of highly vacated office buildings in downtown areas – now available at steep discounts – is catching the interest of developers. Meanwhile, public authorities see office conversions as an ideal solution to address housing shortages.

Manhattan offices

By the end of 2024, Manhattan's office vacancies climbed to around 23%, the highest level since 1986, with Lower Manhattan being the most impacted, with vacancies well above 30% in some areas, according to Cushman & Wakefield. While net absorption showed signs of recovery in the fourth quarter, the bulk of it can be attributed to a significant large-scale conversion project, suggesting prolonged weaknesses in the leasing market.

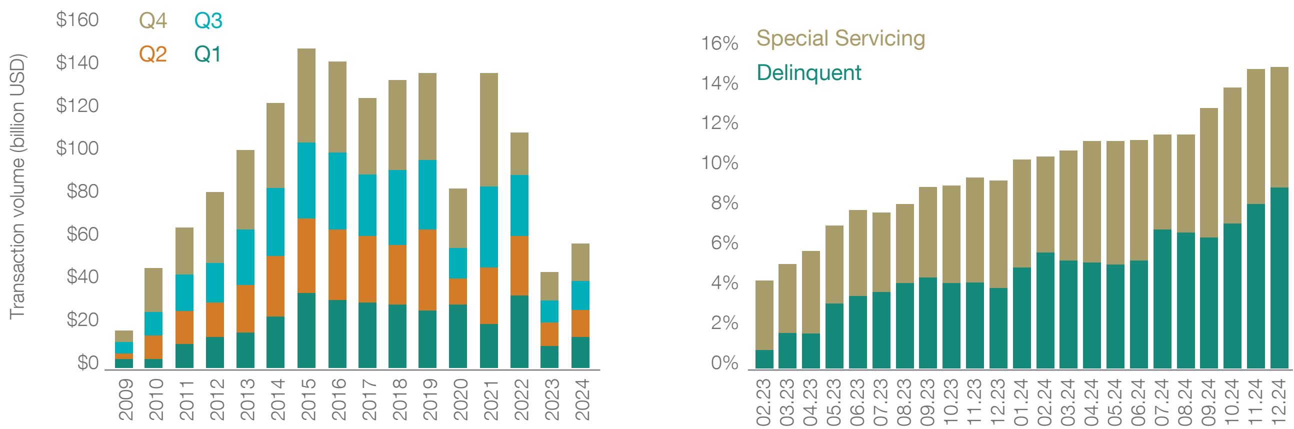


Source: Left Cushman & Wakefield; Right: CBRE Research, Q4 2024.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

Despite these challenges, signs of stabilisation are emerging. Office construction starts in the past six quarters have reached an historical low, limiting the new office supply until at least 2028. Demand is also stabilising, as the vast majority of tenants appear to have stabilised their office usage or are considering expanding it due to higher office attendance, according to data compiled by CBRE.

Prime new builds will continue to drive the bulk of the demand going forward, especially Class A or renovated assets offering superior amenities and easy access to transport. Technology and creative industries are increasingly drawn to mixed-use neighbourhoods, often relocating to urban peripheries away from traditional CBD areas. As a result, the non-prime segment of the Manhattan office market will probably continue to suffer from weak demand, and rising delinquencies on office commercial mortgage-backed securities (CMBS) suggest more financially distressed assets will enter the market in the coming months.

RATE CUTS DRIVING SOME IMPROVEMENT IN LIQUIDITY, BUT CAPITAL MARKETS' RECOVERY IS UNFOLDING SLOWLY

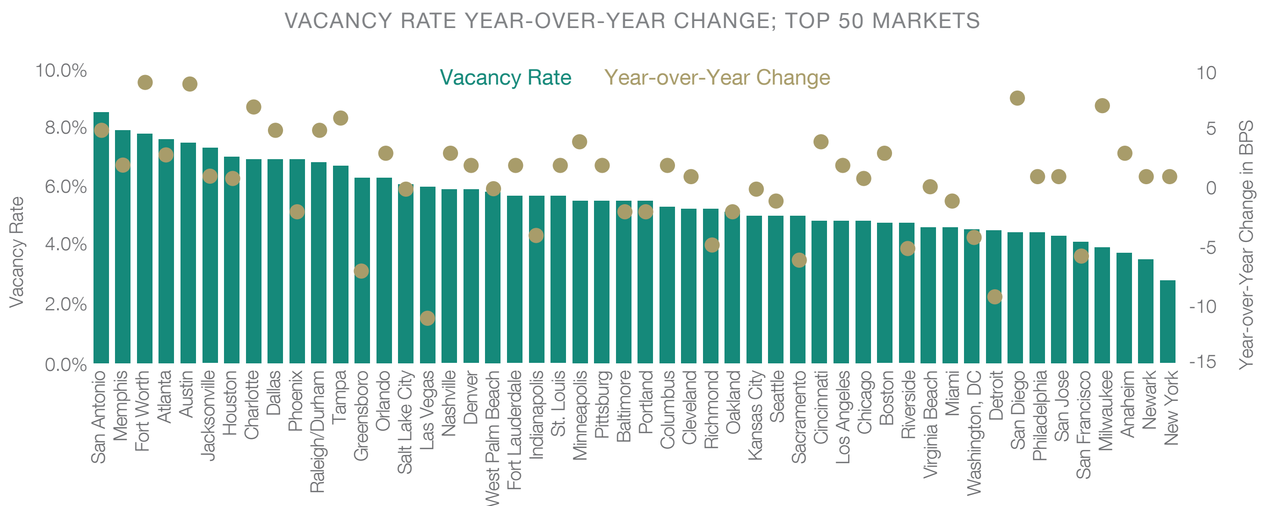


Left: Historical office sales volume; Right: Office CMBS delinquency and special servicing rates.
Sources: JLL Research, Real Capital Analytics, Trepp.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

New York multifamily

At the other end of the spectrum, the Manhattan rental housing market is continuing to experience a different set of challenges.

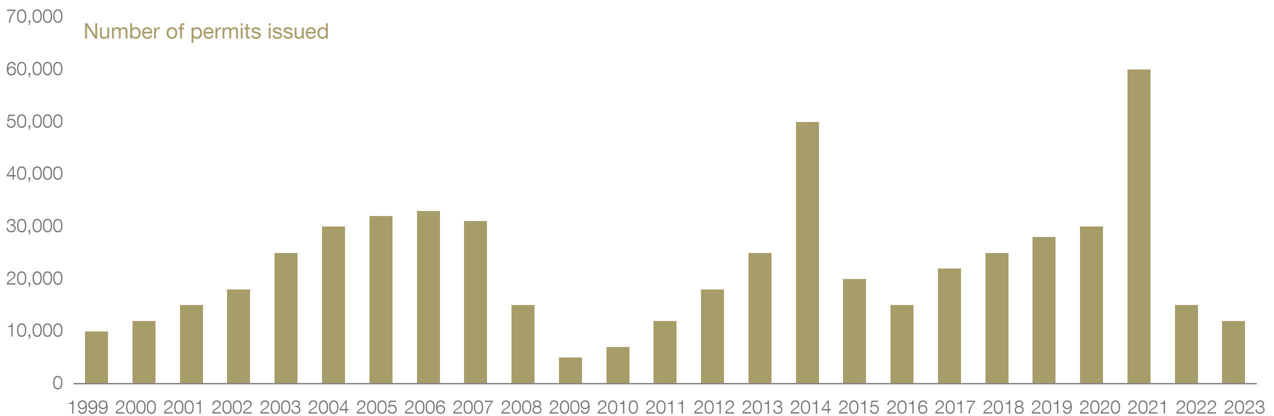
With only 1.1 million market-rate rental units in a city of 3.7 million residential properties, restrictive zoning laws, rising construction costs, and limited land availability have constrained new development. The *City of Yes for Housing Opportunity* initiative aims to add 82,000 homes over the next 15 years, yet this remains a drop in the ocean compared with the estimated 500,000-unit shortage.



Sources: Newmark Research, RealPage.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

UNITS ISSUED NEW HOUSING PERMITS, 1999-2023

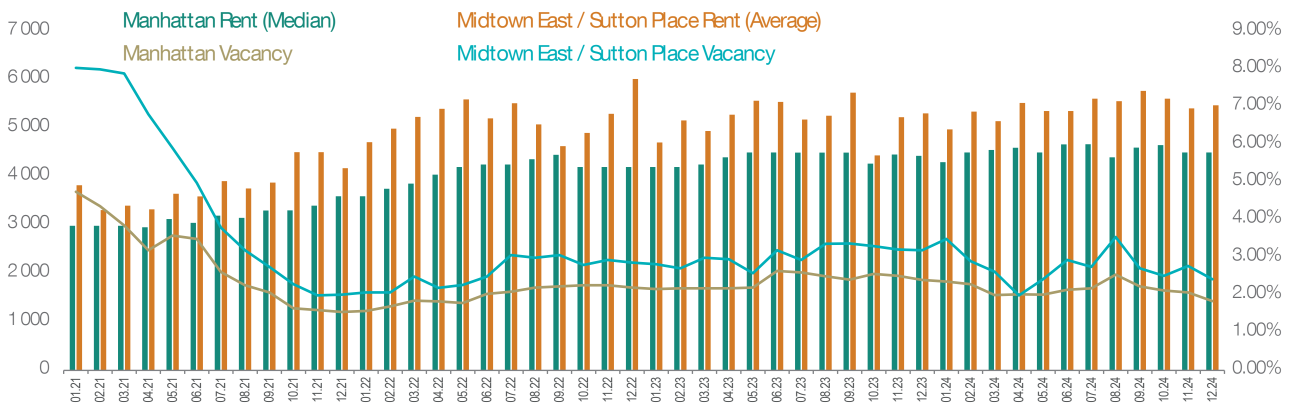
Number of permits issued for new construction of housing decreases by 76% in 2023



Sources: 1999-2009 – U.S. Census Bureau, Building Permits Survey; 2010-2023 – NYC Department of City Planning.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

Tight supply conditions have pushed rents to record highs, with median Manhattan rents ranging from USD 3,410 for studios to USD 10,950 for three-bedroom apartments in 2024, according to a study from Corcoran. Rental growth in the city is expected to outpace the national average in 2025, further reinforcing the need for additional housing stock.

NEW YORK RENT & VACANCY RATES (CBRE)



Source: https://inhabit.corcoran.com/nyc-residential-rental-market-report-december-2024/
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

The case for conversion

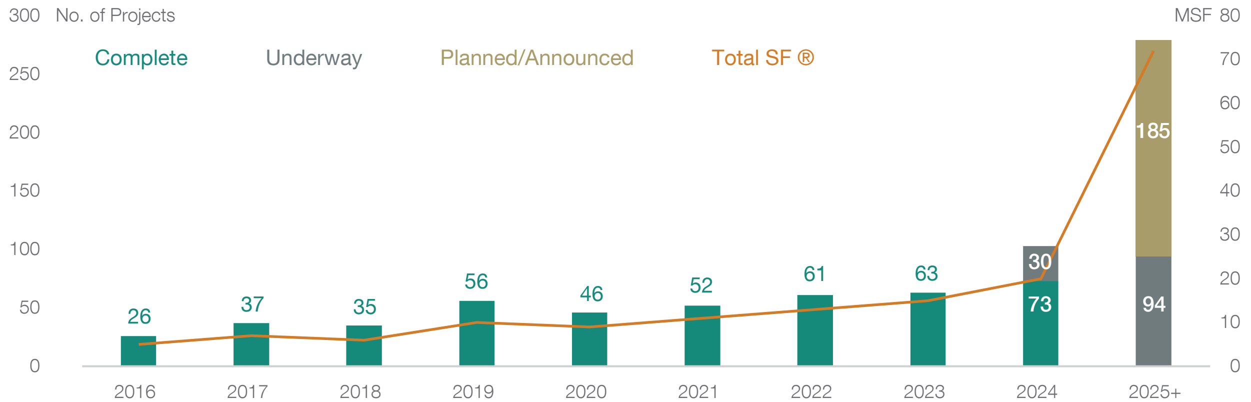
A 2023 study by Columbia University estimated that 600 office properties in New York City were eligible for conversion, yet only 35 buildings have been repurposed since 2016, according to New York State data. While conversions are gaining momentum, they remain highly complex and require thorough execution.

What are the key elements for a successful conversion?

- Suitability. Eligible buildings must have an appropriate structure which meets residential specifications, including plumbing, and heating, ventilation and air conditioning (HVAC). Ideal floor plates have a rectangular shape but should not be too large, while three or more unobstructed facades maximises the number of buildable units. These characteristics are typically found in older buildings, which explains why properties undergoing conversion are, on average, 65 years old.
- Vacancy status. Candidates for conversions are not always fully vacant, but there should be a clear path towards full vacancy to avoid any project delay. In some cases, developers may even consider financially incentivising the remaining tenants to vacate the premises before the end of the lease.
- Cost of the project. The acquisition cost plays a critical role, explaining why so few conversions were realised in the last decade. An entry price in the USD 200–300 per square foot range or lower is ideal; adding the conversion costs estimated at between USD 300 and USD 500 per square foot, means that repurposing an office for residential use would cost up to 25–30% less than ground-up projects.

- Ancillary costs. Trade tariffs on aluminium and steel imposed by the new Trump administration could inflate construction costs, although such an impact would likely affect more full-scale developments than conversions.

OFFICE CONVERSIONS BY CONSTRUCTION STATUS & ESTIMATED YEAR OF COMPLETION



Sources: CBRE Research, Q3 2024. Totals only include conversion projects (excluding demolitions).
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

Conversion projects typically have a shorter delivery time, thanks to a lighter – and sometimes an absence of – permitting process. The scope of work is limited, as most of the building structure is kept while additional floors, which command higher rents, can be added thanks to air rights. Recent deliveries, such as the former JPMorgan building at 25 Water Street, are evidence that conversions can reach the rental market after 24 months of transformation work. For comparison, it is not uncommon to see 48–60 months delivery time for residential projects.

In a classic New York efficiency move, the city has created an *Office Conversion Accelerator* programme to help building owners efficiently navigate the administrative process, thanks to a single point of contact within the city's government. Tax incentives have also been introduced, allowing for a 90% property tax abatement over 35 years on the condition that 25% of the units are allocated to lower-income households.

Conclusion

Office-to-residential conversions offer a compelling opportunity in today's real estate landscape by addressing a dual challenge: on the one hand, the strategy takes on the repurposing of office assets on the back of declining demand, while, on the other hand, it addresses a societal need given the chronic housing shortage. The favourable market conditions, coupled with supportive policies and fiscal incentives, create an ideal environment for this sort of investment to succeed.

As always, the thorough selection of assets, pristine execution, and a keen awareness of market dynamics are the essential keys to success. Tenant buyouts and structural modifications are part of the challenges that investors will face, but the trade-off will materialise through reduced costs and shorter execution time compared with new builds.

Last, this environment offers an opportunity that could be limited in time. The stock of available assets to be converted is limited and the most viable and attractive assets are in short supply, creating a form of scarcity. Reshaping cities and repurposing assets are at investors' fingertips.

AUTHOR

Geoffroy Troesch

Head of Investments Management PMG

25 Water Street: From 'Punch Card' building to high-end rentals

25 Water Street has become the new poster child for the efforts across Manhattan to repurpose old, deserted office buildings as prime residential properties. Nicknamed the 'Punch Card' for its recognisable vertical straight windows resembling computer punch cards, 25 Water Street was a 55-year-old building that was nearly impossible to reposition in the current market. Now, it has become the largest office-to-residential conversion in the country.

Recently leased by JPMorgan for its back-office operations, the building saw its occupancy shrink to just 10% just before it was acquired for USD 251 million by a group of developers in 2022. According to Bloomberg, the project was financed through a USD 536 million loan, which would likely bring the total costs of the project to USD 700–750 million, including equity. In comparison, a full ground-up development of this size would typically run to nearly USD 1,000 per square foot, or USD 1 billion in total.

Due to be delivered in November 2025, the building will be totally unrecognisable and home to more than 1,300 high-end residential units which will be rented out for between USD 3,000 and USD 12,000 a month, plus amenity fees which cover, for example, pickleball, a pool, gym, spa and other perks. To benefit from the newly introduced 35-year property tax break, a quarter of the units will be leased through an affordable housing programme.

As office vacancies rise in the financial district, the area is in urgent need of rejuvenation. Repurposing deserted offices into prime residential units offers a new life to once-dynamic neighbourhoods. Should the conversion of 25 Water Street set the tone, this strategy is only in its infancy and will offer appealing metrics to investors.

Source: Bloomberg.

Disclaimer

This document is a marketing communication containing GENERAL INFORMATION on financial services reflecting the sole opinion of Union Bancaire Privée, UBP SA and/or any entity of the UBP Group (hereinafter "UBP") as of the date of issue. It is not and does not purport to be considered as an offer nor a solicitation to enter into any transaction with UBP, buy, subscribe to, or sell any currency, product, or financial instrument, make any investment, or participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation. This document is meant only to provide a broad overview for discussion purposes, in order to determine clients' interest. It does not replace a prospectus, KID, KIID or any other legal document relating to any specific financial instrument, which may be obtained upon request free of charge from UBP or from the registered office of the issuer of the instrument concerned, where applicable. The opinions herein do not take into account individual clients' circumstances, objectives, or needs.

UBP performs analysis on the financial instruments based on market offer and may maintain and/or seek to develop business affiliations with third parties for that purpose; furthermore, UBP may create its own financial instruments. This generic information is therefore not independent from the proprietary interests of UBP or connected parties, which may conflict with the client's interests. UBP has policies governing cases of conflicts of interest and takes appropriate organisational measures to prevent potential conflicts of interest.

The information contained in this document is the result neither of financial analysis within the meaning of the Swiss Banking Association's "Directives on the Independence of Financial Research" nor of independent investment research as per the EU's regulation on MiFID provisions. EU regulation does not govern relationships entered into with UBP entities located outside the EU.

When providing investment advice or portfolio management services, UBP considers and assesses all relevant financial risks, including sustainability risks. Sustainability risks are defined by the EU's Sustainable Finance Disclosure Regulation (2019/2088) as "an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment". For further information on our sustainability risk management approach please visit [www.ubp.com].

Reasonable efforts have been made to ensure that the content of this document is based on objective information and data obtained from reliable sources. However, UBP cannot guarantee that the information contained herein and gathered by the Bank in good faith is accurate and complete, nor does it accept any liability for any loss or damage resulting from its use. Circumstances may change and affect the data collected and the opinions expressed at the time of publication. Therefore, information contained herein is subject to change at any time without prior notice. UBP makes no representations, provides no warranty and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein nor does it accept any liability whatsoever for any errors, omissions or misstatements in the document. UBP does not undertake to update this document or to correct any inaccuracies which may have become apparent after its publication.

This document may refer to past performance which is not a guide to current or future results. All statements in this document, other than statements of past performance and historical fact, are "forward-looking statements". Forward-looking statements do not guarantee future performances.

The tax treatment of any investment depends on the client's individual circumstances and may be subject to change in the future. This document does not contain any tax advice issued by UBP and does not reflect the client's individual circumstances.

This document is confidential and is intended to be used only by the person to whom it was delivered. This document may not be reproduced, either in whole or in part. UBP specifically prohibits the redistribution of this document, in whole or in part, without its written permission and accepts no liability whatsoever for the actions of third parties in this respect. This document is not intended for distribution in the US and/or to US Persons or in jurisdictions where its distribution by UBP would be restricted.

Switzerland: UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority (FINMA).

UK: UBP is authorised in the United Kingdom by the Prudential Regulation Authority, and is subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the Prudential Regulation Authority.

Dubai: This marketing material has been communicated by Union Bancaire Privée (Middle East) Limited, a company regulated by the Dubai Financial Services Authority ("DFSA"). It is intended for professional clients and/or market counterparties only and no other person should act upon it. The financial products or services to which this material relates will only be made available to a client who meets the professional client and/or market counterparty requirements. This information is provided for information purposes only. It is not to be construed as an offer to buy or sell, or a solicitation for an offer to buy or sell any financial instruments, or to participate in any particular trading strategy in any jurisdiction.

Hong Kong: UBP is a licensed bank regulated by the Hong Kong Monetary Authority (HKMA) and a registered institution regulated by the Securities and Futures Commission (SFC) for Type 1, 4 & 9 activities only in Hong Kong. The securities may only be offered or sold in Hong Kong by means of documents that (i) are addressed to "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO"); or (ii) are defined as "prospectuses" within the meaning of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) (the "CO") or constitute offers to the public within the meaning of the CO. Unless permitted to do so under the laws of Hong Kong, no person may issue or have in their possession for the purpose of issuing, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the securities, directed at, or likely to be accessed or read by, the public in Hong Kong, except where the securities are intended to be disposed of only to persons outside Hong Kong, or only to "professional investors" within the meaning of the SFO.

Singapore: UBP is a bank regulated by the Monetary Authority of Singapore (MAS), is an exempt financial adviser under the Financial Advisers Act 2001 of Singapore to provide certain financial advisory services, and is exempt under section 99(1) of the Securities and Futures Act 2001 of Singapore to conduct certain regulated activities. This document has not been registered as a prospectus with the MAS. Accordingly, this document and any other document or material in connection with generic recommendations may not be circulated or distributed, whether directly or indirectly, to persons in Singapore other than (i) institutional investors; or (ii) accredited investors as defined under the Securities and Futures Act 2001 of Singapore. This advertisement has not been reviewed by the Monetary Authority of Singapore.

Luxembourg: UBP is registered by the Luxembourg supervisory authority the Commission de Surveillance du Secteur Financier (CSSF).

Italy: Union Bancaire Privée (Europe) S.A., Succursale di Milano, operates in Italy in accordance with the European passport – held by its parent company, Union Bancaire Privée (Europe) S.A. – which is valid across the entire European Union. The branch is therefore authorised to provide services and conduct business for which its parent company, Union Bancaire Privée (Europe) S.A., has been authorised in Luxembourg, where it is regulated by the Luxembourg financial supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF).

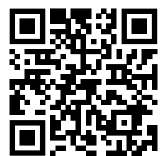
Monaco: This document is not intended to constitute a public offering or a comparable solicitation under the Principality of Monaco's laws, but might be made available for information purposes to clients of Union Bancaire Privée, UBP SA, Monaco Branch, a regulated bank under the supervision of the Autorité de Contrôle Prudentiel et de Résolution (ACPR) for banking activities and under the supervision of the Commission de Contrôle des Activités Financières for financial activities.

© UBP SA 2025. All rights reserved.

MORE ON UBP.COM

See additional UBP Headlines content on our Newsroom page

Receive UBP's newsletter by signing up on our website



Union Bancaire Privée, UBP SA | Head Office
Rue du Rhône 96-98 | P.O. Box 1320 | 1211 Geneva 1 | Switzerland
ubp@ubp.com | www.ubp.com

Signatory of: PRI Principles for Responsible Investment