



SUMMARY OF FINDINGS

Office-to-Residential Conversion in San Francisco's Changing Real Estate Market

San Francisco's downtown recovery is hindered by a lack of economic diversity and a shortage of workforce housing. Could converting vacant office space to residential use be a financially viable solution to both problems?

Flexible work has transformed San Francisco, changing how companies and employees use office space. Increasingly, firms are reducing their physical footprint in San Francisco, abandoning sub-par Class B and Class C spaces, and instead leasing higher-quality Class A buildings. Older buildings are at risk of becoming obsolete. And the decrease in people and activity downtown has negatively impacted small businesses, cultural institutions, and the hospitality industry.

Restoring the economic and social health of downtown San Francisco will require many types of efforts, including improving transit, diversifying the business mix, and introducing more entertainment. But converting underperforming office buildings to residential use could go some way toward two revitalization efforts: creating workforce housing and increasing foot traffic to support small businesses downtown. Other cities, including Calgary, Chicago, New York, and Washington, D.C., are pursuing a similar strategy.

In a first-of-its-kind study, SPUR and [ULI San Francisco](#), in partnership with [Gensler](#) and [HR&A Advisors](#), explored not just the physical suitability of office buildings for redevelopment as housing (as other research has done) but also tested the financial feasibility of conversion projects under different economic conditions and policy scenarios. The analysis focused on San Francisco's central business district, which includes the North and South Financial District areas. Together they contain 63% of the office space in downtown San Francisco.¹ However, the findings can be extrapolated to the greater downtown area, which includes the SoMa, Yerba Buena, Mission Bay, and Jackson Square/Northern Waterfront areas. A report presenting our full analysis and expanding on our findings will be released later this year.

Findings

1. Because of their physical characteristics, office buildings in San Francisco are stronger candidates for conversion than office buildings in other cities in North America.

Using a proprietary tool, Gensler evaluated the physical factors that make for a good residential building, including the building shape and size, ceiling heights, availability of elevators, neighborhood context, proximity to transit, and other criteria. It found that only 20% of the buildings it evaluated across North America scored high for conversion. In downtown San Francisco, Gensler deemed 40% of the evaluated buildings to be good candidates. The best candidates were high-rise buildings with floor plates of between 12,000 and 20,000 square feet.

How the Study Rated Buildings

Gensler rated office buildings on their suitability for conversion to housing based on physical factors such as their location, shape, size, and layout. Buildings that score higher on suitability generally have lower construction costs per housing unit and therefore are more financially feasible to redevelop.

Source: Gensler



SITE CONTEXT

- Walkability
- Transit
- Natural light
- View obstruction
- Allows for south facing windows



BUILDING FORM

- Shape of building
- How easy is it to plan units?



FLOOR PLATE

- Window to core distance
- Number of existing elevators



ENVELOPE

- Existing window to wall ratio
- Ease of window replacement



SERVICING

- Loading
- Parking
- Structure
- Mechanical, electrical, and plumbing

¹ CBRE, *San Francisco Office Figures Q4 2022*, January 2023, <https://www.cbre.com/insights/figures/san-francisco-office-figures-q4-2022> (accessed February 26, 2023).

2. Conversion of vacant office buildings could physically accommodate 11,200 housing units in downtown San Francisco, including the central business district, SoMa, Yerba Buena, Mission Bay, and Jackson Square/Northern Waterfront areas.

At the end of 2022, the vacancy rate for downtown office buildings was nearly 28%, or almost 23 million square feet of unleased space.² Office vacancy in the city is projected to remain high through 2026 as more leases expire and tenants reduce their footprints.³ If 40% of the currently unleased space could be physically converted to housing, 11,235 units could be created. (Unit counts are based on an assumption that 80% of the building could become livable space and that the average unit size would be 650 gross square feet.) If only the vacant Class B and Class C buildings were converted, approximately 4,200 units could be accommodated downtown. But the actual construction of housing depends on financial viability from the perspective of a developer or investor.

3. The city's planning and building code requirements represent a major challenge for conversions.

The studied properties are all in the core downtown areas that allow residential development “by right,” that is, without the need for case-by-case local approvals.⁴ However, many planning code and building code requirements make it difficult to redevelop an office building into housing. For example, none of the studied buildings would meet the open space requirements in the planning code. Because of the challenges of adapting an office layout for residential uses, most conversion projects could not adhere to the city's requirement that at least 25% of units in any given building have at least two bedrooms.

Critically, conversions in San Francisco would be subject to earthquake-related codes. Significant seismic upgrades can be triggered when buildings change from commercial use to residential use. If conversions are required to include a substantial seismic retrofit, the ensuing cost could hinder many projects from moving forward.

To receive relief from any of these code requirements, builders would need to undertake an onerous and years-long process with no guarantee of success. Most developers are unlikely to undertake a complex conversion project under these circumstances.

4. Given current economic conditions and development costs, most conversions of underperforming office buildings to housing are not financially feasible.

For projects to be financially feasible, the value generated from rental income must exceed the cost of development. Since the onset of the pandemic, construction costs have escalated rapidly, while apartment rents have dropped by about 10%. The construction costs of conversion projects,

² CBRE, *San Francisco Office Figures Q4 2022*, January 2023, <https://www.cbre.com/insights/figures/san-francisco-office-figures-q4-2022> (accessed on February 26, 2023).

³ Office of the Controller, City and County of San Francisco, “Response to Letter of Inquiry Regarding Downtown Commercial Property,” October 19, 2022, <https://sfcontroller.org/sites/default/files/Documents/Economic%20Analysis/Controller%20final%20reponse%20to%20Letter%20of%20Inquiry.pdf>.

⁴ All properties studied are in C-3-R, C-3-O, or C-3-O(SD) zoning districts, which allow residential uses.

including labor and materials, are estimated to range from \$472,000 to \$633,000 per unit — without seismic upgrades.⁵ Soft costs, which include city fees, range from about 20% to 40% of total project development costs. Given today's costs and potential revenues, a residential conversion would generate less value for the property owner than maintaining the office use, even given high office vacancy. If residential rents rise to pre-pandemic levels, owners of the most distressed office buildings would likely have a viable pathway to convert to housing. However, the economics of redevelopment would still be challenging without further cost reductions.

5. The city's inclusionary housing requirement and impact fees are major barriers to conversion.

A January 2023 study found that San Francisco's inclusionary housing requirement that 21.5% of new rental housing be set aside at rents affordable to lower-income families is not financially feasible for new housing projects.⁶ A significant reduction in the inclusionary requirement would be necessary to make office-to-residential conversions more viable. The city's open space impact fee, which applies to housing in some zoning districts, can be a very significant cost for conversion projects. Its economic impact is nearly equivalent to that of the inclusionary requirement. Concurrently reducing city fees and inclusionary requirements would greatly increase the feasibility of conversions.

6. Case studies from other cities show that incentives are critical to office-to-residential conversions.

The cities of Calgary, Chicago, New York, and Washington, D.C., offer insights into the types of programs that can help accelerate redevelopment of vacant office buildings into much-needed housing. Each city implemented an incentive program that provided funding or property tax abatements for conversion projects. Calgary offered property owners up to \$75 per square foot in grants, resulting in redevelopment of five buildings and yielding more than 700 units in a one-year period. Chicago offered tax increment financing for conversion projects that make 30% of units affordable, resulting in six project applications. Washington, D.C., introduced a property tax abatement program targeted at conversion projects that make at least 15% of the units affordable. New York's governor has proposed a partial property tax abatement for office conversions that include affordable housing, and the State of New York and New York City are considering regulatory changes to enable conversions.

⁵ Order-of-magnitude cost estimates are provided by Turner Construction and do not include the cost of seismic upgrades.

⁶ Office of the Controller, City and County of San Francisco, "Inclusionary Housing Technical Advisory Committee Second Meeting," January 6, 2023, <https://sf.gov/sites/default/files/2022-12/TAC%20Meeting%20%232%20Presentation.pdf>.

One of few examples of office-to-housing conversion in San Francisco, 100 Van Ness was completed in 2015. Without incentives such as local funding or property tax abatements, office-to-residential conversions are not financially feasible in today's market.

Source: Emerald Fund



Policy Imperatives

The findings above suggest at least six policy imperatives for encouraging office-to-residential conversions in San Francisco.

1. Remove obstacles in the planning and building codes and simplify approvals for conversion projects.

The City of San Francisco should conduct a deeper assessment of planning and building code impediments to conversions and should establish clear requirements for seismic upgrades that are appropriate for conversion projects.

In addition, the city should create a ministerial process for permit approvals. Such a process expedites permitting by Planning, Department of Building Inspections, and other departments by limiting the approvals needed when the project complies with the city's building and planning codes. Unlike discretionary approvals that involve judgment or deliberation and that are often issued by an appointed or elected decision-making body, ministerial approvals involve the application of clear requirements and are often issued by municipal staff. Importantly, ministerial approvals are not subject to the California Environmental Quality Act.

Finally, the city should seek to provide exemptions from environmental review of proposed downtown conversion projects because the projects involve existing buildings and require no new construction of transit, infrastructure, or other public facilities.

2. Consider making the inclusionary housing requirement less stringent.

Since 1980, San Francisco has required commercial development to pay a jobs-housing linkage impact fee, which is intended to address the impact that adding new workers has on the need for more affordable housing. Because the fee has been in existence for so long, many office buildings in San Francisco have already paid it. Furthermore, office conversion projects, unlike new construction, cannot take advantage of California's density bonus law, which partially offsets the cost of providing affordable units by allowing additional height or density. Given this context, as well as the economic challenges of the existing policy, reducing the inclusionary requirement for conversion projects would be reasonable.

3. Consider reducing impact fees for conversion projects.

Downtown office conversions would not have the same impact on the city's infrastructure as new development projects, given that they involve existing buildings within a highly dense urban environment. A reduction of San Francisco's impact fees, which have escalated steeply over the past few years, would significantly lower the cost of conversions. In particular, a reduction of the open space fee would decrease this cost for some projects.

4. Explore tools to provide incentives for office conversion projects.

Many U.S. cities are implementing programs that encourage the conversion of office buildings to increase housing downtown. San Francisco could learn from these programs to pilot an incentive program that could reduce taxes like the real estate transfer tax or establish new infrastructure financing districts downtown to help fund the adaptive reuse of office buildings to residential or other uses. The city could require projects that receive incentives to provide some percentage of affordable housing, but that percentage should be determined after conducting further financial feasibility analysis.

5. Consider policies to create a "reserve" for the office space removed through conversions.

In 1986, San Francisco passed a voter measure, Proposition M, that caps the amount of office development that can be approved each year to 950,000 square feet. More recently, 2020's Proposition E tied approval of office development to the amount of affordable housing built. As a result of these policies, San Francisco has occasionally been unable to approve office development projects to accommodate a growing number of companies and jobs. To avoid further constraining the office supply in downtown San Francisco in the long term, the city could consider allocating any office space removed in a conversion to the Prop. M "reserve." This reserve could be tapped if project applications ever exceeded the maximum allowable amount of office development.

6. Explore state legislation that provides property tax incentives for conversion projects that produce affordable housing and workforce housing.

The state could explore the use of joint powers authorities or an expansion of the welfare property tax exemption to convert office buildings to housing affordable to middle-income workers. It also could study, as other cities and states have done, the long-term impacts and benefits of a property tax abatement program for conversion projects in downtowns. Because of the limitations of California's Proposition 13, implementation of a local tax abatement program would require changes in state law and likely a statewide ballot initiative.

Acknowledgments

Primary Author

Sujata Srivastava, SPUR

Contributing Authors

Stanford Caldera III and Anne Christie, SPUR

Natalie Sandoval, ULI San Francisco

Benedict Tranel and Duanne Render, Gensler

Kate Collignon and Christiana Whitcomb, HR&A Advisors

We thank Eric Tao, Jack Sylvan, Sarah Dennis Phillips, Marc Babsin, Strachan Forgan, and Alexander Quinn for their assistance.

We thank Jones Lang Lasalle and Avison Young for the custom real estate market analysis that informed this report.

We thank JPMorgan Chase for its generous support of this research.

Edited by Melissa Edeburn and Karen Steen

Design by Shawn Hazen

Cover photo by Sergio Ruiz



San Francisco | San José | Oakland

Ideas + action for a better city

spur.org

Gensler

HR&A

