The Weekly Take

Second Chance: Conversions give new life to old office buildings

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Spencer Levy
Everything old is new again. Versions of that adage have been featured in song and literature many times over the years, and now it's a major theme in commercial real estate. The conversion of older office buildings into multifamily or other new uses, in fact, may be the hottest trend in the industry today. On this episode, we traveled to CBRE'S New York office for a meeting with the principals of a company that's all-in on adaptive reuse.

Anoop Dave
It turns into a symbiotic situation. You do help the office market get a little stronger, you know, takes away some of that excess supply and create a more vibrant downtown.

Spencer Levy
That's Anoop Dave, founder and CEO of Victrix LLC, a private investment and development firm that specializes in adaptive reuse projects and is betting big on turning unused office space into new residential stock.

Tim Gordon
It's either going to be a virtuous circle or a vicious cycle. It's one or the other.

Spencer Levy
And that's Tim Gordon, a partner in Victrix and the Aria Development Group, a ground-up developer. Tim also serves as managing director of the Gordon Property Group, a family real estate company based in Manhattan, and as it happens, the nephew of legendary broker and entrepreneur Edward S. Gordon, whose name graces the CBRE conference room where we recorded our conversation. And for broader context on the scope of the conversions trend, we're also joined by CBRE's own Steve Timmel.

Steve Timmel
The projects we're on the marketplace with in Cincinnati – six seriously interested groups – four of the six were adaptive reuse.

Spencer Levy
Steve is a Senior Vice President based in Cincinnati, where he and his Midwest team specialize in the sale and marketing of investments in office retail centers and industrial properties for national institutions, regional developers and local investors. Coming up, office conversions, multifamily and more – fresh perspectives on properties that have seen better days. I'm Spencer Levy and that's right now on The Weekly Take.

Spencer Levy

Welcome to The Weekly Take. And this week we're joined by Anoop Dave, the CEO of Victrix. Anoop, thanks for joining us.

Anoop Dave
Thank you, great to be here.

Spencer Levy
Great to have you. And we're joined by his partner in the business, Tim Gordon, also of Victrix. And I say with pride, we are in the conference room, the Edward S. Gordon conference room, which is Tim's uncle. Tim, Thanks for joining the show.

Tim Gordon
Thank you very much. Great to be here.

Spencer Levy
Great to have you. And then last and certainly not least, our colleagues, Steve Timmel, Senior Vice President, CBRE based in Cincinnati.

Steve Timmel
Great to be here, Spencer. Looking forward to it.

Spencer Levy
You bet. So let's get right down to it. There's a lot of office buildings out there that people are concerned about because of the challenges of work-from-home, return-to-office, and then, of course, the capital markets environment has gotten really tough recently. But it's not so easy to convert an office building to multifamily or other use. So big picture, very big picture. You see an office building. What are you thinking about ifyou're thinking about converting it to multifamily or another use, Anoop?

Anoop Dave
Well, I think the first part is do you have a seller that really wants to sell? There's a lot of these buildings that people want to hold on to and hope for a better day. We're seeing less of that now, and this has been a niche business for 20 years and since COVID, it started to get a lot more scale. So first thing is, is it actually in a state to have a transaction?

Spencer Levy
Tim, same question to you. And talking about the willing seller, willing buyer. I guess everything has a price in the commercial real estate business. One of the challenges of adaptive reuse is getting the basis down in the buildings that's being sold to where it needs to be. What's your point of view?

Tim Gordon
I mean, basis is critical. And to Anoop’s point, I mean, oftentimes in the strategy, especially in the current environment where you have higher rates, offices dealing with increasing vacancy, the basis can be very attractive and you can have sellers particularly facing higher carrying costs, higher interest rates who are more than willing or eager to part with the asset. But part of the point is it's the basis. This is really an execution heavy strategy. And I think one of the key parts of this, it's not just the business which can often be very attractive when you're doing these kinds of transactions. But how much is the actual conversion itself going to cost? How difficult is that? Which is, I think probably the more difficult thing to analyze.

Anoop Dave
To add to what Tim said, usually you're spending five to 10 times your initial price to get it into something that will be a stable asset.

Spencer Levy
Steve, Anoop and Tim did a couple of deals in your market. Tell us about what was done and why.

Steve Timmel
Yeah, I met Anoop back in August of 2020, coming out of COVID 19 lockdown. And since then I'd like to say I've been involved with two-and-a-half transactions with Anoop. The first deal that I worked with on Anoop was an auction deal. Our team's been involved with about 15 of these auction deals and they are rapid fire. It was up in Columbus, about 477,000 feet, 26 stories, and the market had just gone through civil unrest. So it was the first building that I actually walked up to that had the windows boarded up on the ground floor. Anoop came to town with a team of seven people, and I said, this is, this guy's got a little bit of a different plan and was able to put the project under contract, had the foresight to view it as an adaptive reuse and was the winning bidder. That is not the normal, I would say, Anoop, for you to perform under that type of timeframe and stress. But everybody for all of us, his MEP team, his architect, his HVAC group, his electrician, you know, I call them the Mod Squad. They all worked for him and they had a long standing relationship with him and they were going to bat for him.

Spencer Levy
So, Tim, back to your comment that you made before regarding basis is just one piece of the puzzle, maybe the smallest piece of the puzzle. Let's start at the very basics. What goes into that process of determining is this building viable and what does it cost?

Tim Gordon
Well, I think it's, you know, Steve alluded to it, we have a big team at Victrix that we work with to assess these buildings. So I think it is going in, really estimating how much is it going to cost to work on these systems to make it into a viable building, which takes quite a bit of due diligence. I know you said you're surprised by the Legion as Anoop calls this team of guys that we've worked with on many projects. So I think it's going in there looking at it from that perspective. It takes a lot of upfront due diligence, far more so than buying any kind of stabilized building and then also working with the architect, because a lot of these were not built to be residential. So you have to work into an architectural plan that makes sense. How many units can you get? And from there you start to really estimate the cost. Part of the execution here is really also the due diligence of getting those kinds of quick estimates.

Anoop Dave
When you're serious about a deal, you start realizing the broker in the transaction, even if it's an auction deal, is your partner. And the seller is actually your partner as well, because the carrying cost on these deals, even without debt, can be one to five hundred grand a month and the broker is generally dealing with a deal that is wide open for trade. And on the deals we've done with Steve, we didn't read trade even though we could have. That's how we get the call. That's how we get the deal, the early look, the more serious take. When they see us dropping the amount of work and money in for a deal, they know we're serious.

Spencer Levy

So what prevents a lot of people from buying these more intensive assets is the upfront cost of due diligence that you're walking in with an army of seven people. That's expensive. I’m not going to ask you to tell me the number, but it could cost hundreds of thousands of dollars of diligence for some of these people.

Anoop Dave
It does.This–

Spencer Levy
So now I'm asking, what does it cost?

Anoop Dave
No, it goes into the six-figures and sometimes we will spend that amount before we were awarded the deal. And because that's why we'll be awarded the deal. We'll send the team out. And our due diligence costs are five to six figures. Easy, but it's cheaper. No upfront. Our calling card is we've done our homework and therefore it's going to be smoother than it will be with another party.

Spencer Levy
So in a traditional land development deal, you very often have options. We sign it up. We have 60 to 90 days. That's term number one. And then you have a much longer period once you get all of the entitlements and those done. Is that how these deals work, Steve, or is it different than that about how the deal itself is structured?

Steve Timmel
I would say that buying a building that's an adaptive reuse of an auction is a bit of an anomaly. It's a much more protracted process than something that's a little bit more commodity driven, like a retail center, an industrial building or underwriting an office building. Everything has to work in unison to get it done. I would tell you the traditional transaction schedule would be a normal 60- to 90-day due diligence period with the opportunities to extend in order to secure incentives, tax credits, historical tax credits if applicable. It's just a significantly longer process and the margin for misses is much more dramatic than some things that are more commoditized.

Spencer Levy
Let's talk about the physical structure for a second. And I think that the general talk about converting from X to Y is often hotels to multifamily and office is much different because the floor plates are much wider. And for most multifamily, you need windows for ingress and egress out of the units. So what is an optimal office building look like to you, starting with you, Tim?

Tim Gordon
I would say oftentimes you don't get the optimal I mean, to your point. Office buildings are often quite deep. You would prefer it to not have that degree of depth, to not have to rely on borrowed light or bedrooms without windows. That being said, we have done those kinds of deals which do work in certain areas. I mean, as a New Yorker, the first time you see them, you're a bit “you-can’t-do-this”, but in many jurisdictions you can. And it has worked quite well. That being said, yes, the preference would not be to have those kinds of very deep structures, or to have cores which are making it maybe ideal for an office, but not necessarily ideal from a residential perspective.

Anoop Dave

So I think one of the parts is not all square footage is the same and some of it is worth zero and some of it's worth negative because it's still going to cost you something to deal with it. And you have to go in and say, well, you know, we have a “Five P” process. So the first is the Price Paradox. The buildings that look like they're easiest to convert, like hotels, they're often the ones we have a harder time winning the bid on because everyone can see it and they bid it up and they may miss things that building code or other issues that blow them off budget. So it's actually the ones that are a little trickier that are viable because even though you're going to spend all this money after you buy the building, you still need to have a good basis at the beginning. We could go through the other Ps later, but focusing more on just the physical structure of it is what condition is the structure of the building, and then how can you drill through it? Because you're going to be plugging a lot of holes into that thing.

Spencer Levy
For purposes of our listeners, I've just read the Five Ps and we'll come back to some of the others. Sure.

Anoop Dave
So one is the Price Paradox. The second is the Place. The third are Partners. That includes your professionals that you bring in your capital partners and your lenders. These deals just generally have a bad story, and that creates a lot of humility. The next is the Process. How are you going to mix all these ingredients together to create something wonderful? And what is the Product you're going to hit to? Like what Tim said, Are you going for a top eight product? Are you going a little bit below that? There's things you can compromise on if you understand where you think your ultimate rents are going to be and your customer is going to be.

Tim Gordon
One of the first deals I worked on with Anoop in Hyattsville, Maryland. It was a 400,000 square foot office building. Very large floor plates. We ended up doing a lot of bedrooms where, you know, bedrooms were in back, so basically borrowed. Like you don't have a window in the bedroom. Again, a lot of people react to that initially saying you can't do that in that product. You know, there's a price difference in that product as rent did extremely well. So it may not be the ideal. But that doesn't mean you can't work with it. And I think in some ways, As Anoop was saying, it's less obvious to others, it can often be one of the more attractively priced. So you just have to be a little more creative and adjust rent expectations and so forth.

Spencer Levy
So when you're pursuing a building, you have the highest and best use. That's what you're looking for. And the highest and best use of any physical structure is its existing use, a different use or and we're sitting here literally three blocks from where JP Morgan's building their new headquarters, knocking it down on Park Avenue and building from scratch. How does that thought process go into your analysis of the building you're going to pursue?

Anoop Dave
I remember you did a podcast earlier this year where you had, I think Linda Fogie from Citi, and you're talking about what does the office dweller want? And you've got to build them the right product because, hey, it's all about supply and demand and the tenants are and the better end of that spectrum. So you got to build them something perfect. There's a housing shortage. And so if you have things that you can say, I'm going to give you this,

but you may have to compromise on that. You can make something work. So we use an algorithm called FLASH to determine what type of building and product we're going to design. So F is for Finishes. L is Location. A is for Amenities. S is for Specialness and size of the unit. And H is for Height, the ceiling height and the floor height you are. So we look at these buildings and we say, well, if this looks like it could be a viable office again, we're probably not going to be the winner. But I don't think a lot of people are seeing great demand for office today. If it's a teardown, that's generally not something we'd like to do. We've done it, but that's a secondary option. And then you have to decide like it's a convertible at all. And at what price does it make sense to be convertible?

Spencer Levy
So notwithstanding the macro issue that we're all too keenly aware of, the shortage of housing, there's competition out there, there's adaptive reuse or ground up. Do you ever feel any competition from the ground up, folks?

Anoop Dave
Well, what I'll tell you is when you do adaptive re-use, you have a different location that you start with. Usually you're in the middle of things because all of the buildings were converting. We're in the center of something and that's why they started as offices there. Often when you're doing new construction, in most cities you're seeing three- or four-story podium built type stuff. They need a lot more land and they're a bit further away because it's generally tough to build and very expensive to build new construction, high rises. So of course in a market, once you have your property, you don't want to have a lot of competition, but you do want that place to grow because it's going to get better and it's going to attract better people and good things for everybody.

Spencer Levy
Steve, let's go back to some of the local considerations here from your base in Cincinnati. But you cover the Midwest and this is not Cincinnati, but something I mentioned a lot. There's a Third Ward in Milwaukee. I mentioned the Third Ward in Milwaukee because it's an old industrial area and it's got these beautiful old industrial buildings that were converted into beautiful new multifamily. So the community likes adaptive reuse. In fact, they like the mix of adaptive reuse and new. How do you see it?

Steve Timmel
I wholeheartedly agree. Certainly the municipalities are definitely behind it. It is a bit of a political football at times and you're really kind of dealing with the third dimension with politicians, economic development groups, concerned citizens groups. So there's certainly takes a lot of finesse to get through one of these transactions. The traditional office buyers are very, very skeptical right now. They're waiting for some signals of the market coming back. Absorption guys right now are trading rents for decreased sizes as well as drops in rents on some projects. I'm on the market currently with a building in downtown Cincinnati, 200,000 square feet. And it's a unique project because the sky lobby starts on the 15th floor. It's called 36 East 7th Street. And of the most interested parties, five of them are adaptive reuse. So, yeah, I think it definitely continues to have broad appeal to the market. In the marketplace in Cincinnati, specifically, 4.2 million square feet since 2012 has been converted or slated for conversion to multifamily or hotels. So it's definitely a trend that we're seeing. And it's really helped the denominator effect in the marketplace and get rid of some buildings that really were never going to be competitive office buildings.

Spencer Levy

I think all of this discussion starts with a macro problem and we'll see if there is a micro solution to macro problems. There's just not enough housing out there, particularly at the affordable end of the range. So, Tim, let's go back to the math for just a moment. What are we seeing now from local municipalities to try to make it more affordable for developers to build an adaptive reuse rather than building a new someplace else?

Tim Gordon
One of the things you see is that oftentimes when you're doing a new development, you're just building from the ground up there can be opposition. Is this just building more market rate units? Are you blocking people's view? What does it look like? Why should it be there? I mean, the great part of adaptive reuse is oftentimes communities are very supportive because you're building housing that they need. It's a building that is sort of a white elephant, not contributing anything. You're preserving the history of the building. And from an environmental perspective, you're basically recycling an entire building. So you get a lot of support often for these projects, and that support is shown by the approvals. But also, to your point, their incentives they can offer In terms of real estate tax incentives, There are other kinds of credits that they can support you on. But what we've found is there is a great deal of support for this because precisely – probably mainly – because they really want housing and this is a great way to do it.

Spencer Levy
And a lot of these downtown areas have, let's just say, underutilized office – particularly some of these taller towers. This can play an important role to revitalize the office stock, couldn't it?

Anoop Dave
You know what? You're exactly right. And I can give you a case study of Pittsburgh, earlier in my career, fell into Pittsburgh and started doing conversions there with the guy who was my mentor and probably the biggest adaptive reuse developer in the country, Ron Caplan. And he was over 50%, I think, of the apartment supply in Pittsburgh. I think all of it were conversions. We just bought a building in Pittsburgh as well, and after 2013 or 2014, there really weren't any conversions to be done in downtown because people started buying office to keep as office.The Davis Companies did a great project down there and a few other people did that as well. So it turns into a symbiotic situation. You do help the office market get a little stronger, you know, take away some of that excess supply and create a more vibrant downtown.

Spencer Levy
So, Steve, how do you factor in infrastructure, walkability and other factors when you're looking at the attractiveness of a potential deal?

Steve Timmel
Great question. Most of the adaptive reuse, as we've seen in all the Midwestern markets, are older and architecturally appealing office buildings. They've got a story, they've got a history to them. There's a certain cool factor that can be done and created within the building that was going to attract tenants and renters to the buildings. The interesting part will be is this adaptive reuse going to leapfrog out into the suburbs and into markets that are not walkable? We do have an investor in Ohio right now that has recently purchased two 90,000 square foot suburban office buildings. His plan is to convert those to residential use. He's got some excess land, he doesn't need the parking. And so he's kind of going down that path. Will be interesting to see if that holds true. The other trend, though, that we are seeing is that B-minus, ‘78 to 1987 build construction, the pricing on those

buildings is getting to the point now where they make sense for adaptive reuse. The second building that Anoop and I worked on was a headquarters building called 7 West 7th down in Cincinnati, 345,000 square feet building was a headquarters was built in 1978 or ‘79. And then 36 East 7th, a 200,000 square foot building. We're on the market marketplace with that building’s a 1987 build. So it's not only the old architectural, appealing buildings that are getting converted. I think we're at that point now where we're getting into that next level of buildings.

Spencer Levy
So for people who worry historian of real estate, they should know that there was a major tax law change in 1986, and pre-1986 there was probably too much building. And we're seeing some of those buildings now being recycled into some form of adaptive reuse. So let's get back to the math for just a moment. And I hate to get super wonky here, but I want to get down to the bottom line. When you take a look at your options for your capital dollars, I always say the same thing: Money and people are mobile, but your city isn't. You have to go with what you got because you can't pick up and move someplace else. So how do you pick a city? Because many of the cities we talked about aren't necessarily Midtown Manhattan. They are smaller cities like Cincinnati. I mentioned Milwaukee. What is an optimal city for you for conversion? Hyattsville’s not exactly Main and Main.

Anoop Dave
Well, one, we do like the Third Ward in Milwaukee. We were there for a colleague's wedding and it is cool. A lot of great stuff going on there. You know, I grew up in Richmond, Virginia. I was born in New York. I live in New York. So I have an appreciation for big and small cities. And what you really want, I think today are what we call the three F's. And if they have the three Fs, we're pretty excited, which are Fun, Food and Feel-safe because I think that's where the longer term trajectory is going. And when you have those things, you create a lot of pride. I'm seeing a lot of cities that were called secondary cities that have terrific pride with them now. Pittsburgh, everyone wears black and gold. And in Cincinnati, I have a t shirt that says “Cincinnati invented hustle”. And Richmond has “Our VA” slogan. So there's a lot of primary and secondary cities that we feel are very good.

Tim Gordon
I agree with the. There's also really a correction in terms of price. Some of these secondary cities also, you know, the basis can get in at is materially below some of the primary cities. And just in terms of building, you perform the models, you're going to vary the rent growth by different cities. But if you believe it's a stable market or growing market and you're getting into lower basis, even if it's not a primary city, I think it can work quite well. There's oftentimes a slightly obviously less competition there. So we'll look at many different kinds of cities. We have to like the underlying fundamentals, but we're also really being led by the tactic of adaptive reuse. One, those type of opportunities have to be available in that city then, two do we like the underlying market?

Spencer Levy
So I was at a presentation the other day, Steve, from one of our colleagues in the Denver area, and showed a case study at two buildings that were only three quarters of a mile apart, sold one recently for 750 bucks a foot, sold the other one for 100 bucks a foot. And similar buildings. And he's like, well, why? Wrong submarket, and the basis in the hundred dollar one was for conversion. So I'm not going to ask you what you're selling your assets for, but where is the price point have to come in in a midwestern market for adaptive reuse to begin to make sense.

Steve Timmel
It can range obviously Anoop talked about the physical structure and what you're getting yourself into. But it feels like that these buildings are shaking out if it's going to be full adaptive reuse of apartments versus ground floor retail of like in the high thirties to mid-forties afoot is where it seems to shake out. But you mentioned earlier developing ground up. This is a development project. Yes, the structures there, the facade is there, the floors are there, but it is a development project. And from a brokers perspective, I mean, candidly, very few, if any, of the capital markets brokers have the ability to fully underwrite and perform an adaptive reuse without doing a complete development, perform it. It's just a skill set that is not completely developed across the markets.

Spencer Levy
The I.R.A., the Inflation Reduction Act, which is something that allows you to put in HVAC equipment and other things that aren't always getting the headlines much cheaper than you could have done before you get federal tax incentives to do that. Tim, starting with you, what are some of the incentives out there that you've seen and do you think we'll see more of given some of the challenges in the office sector?

Tim Gordon
Sure. I mean, some of the tax incentives that we've seen are historic tax credits. New market tax credits oftentimes are dealing with historic buildings. And so you can be eligible for these historic tax credits, which can be a direct reduction to your hard cost. And to your point, these incentives can be quite large.

Anoop Dave
The reason why these incentives are offered is because these projects are very, very difficult. And one of the things that we've seen as a miss Tim and I are partners on a deal where a group procured a huge amount of incentives, but they didn't realize the restrictions that come with those incentives. And sometimes the incentives don't play well with each other. So you can't just layer one on top of another. And there's a lot of leakage with the incentives. We've seen that as a double edged sword, where we've seen in high times people like, Oh, you get these incentives and they're over-bid for it and then they get into trouble. Or in low times we're able to have that as a competitive advantage on our bid and be the winning bidder.

Spencer Levy
So, Steve, back to the brokerage of these deals. Are we seeing more people enter this market or are we seeing people step back given some of the capital markets concerns that we have right now? It's tough to get money out there, certainly on the debt side.

Steve Timmel
No, I would tell you that this is definitely a growth area, probably a little bit to a dismay that some additional groups are getting into the pool. As I mentioned earlier, the project we're on the marketplace with in Cincinnati – six seriously interested groups, four of the six were adaptive reuse. The age of that building would theoretically preclude them from historic tax credits, so they would all be pursuing tax credits and incentives to do the deal. But it's definitely getting more popular.

Anoop Dave
Well, I do want to say, Steve, one of the things that to my dismay is when people win a building and they don't do anything with it, right. That's what I think is the worst, because you really bring down not just your own deal, but you impact several blocks around you

because these are often very big buildings. And if you don't get them turning into something viable, a lot of bad things happen in the immediate area.

Steve Timmel
Yeah, there's a building in greater Cincinnati right now that traded. They won incentives. They lost incentives in it. And again, to Anoop’s point, it's a bit of an eyesore. And I remember when you were pursuing Carew Tower, your message was the city wants something done with this building. This is too big of a building, too important of a centerpiece for your city not to have something done. But it is interesting as other groups and maybe it's jealousy or otherwise, but I think to a certain extent there's some folks in Cincinnati that were betting against him, which is unfortunate, but it's a great project. And one of the neat things about working with Anoop is that he definitely had a mission that this is a really a great corner. Your city wants something good to happen here and something positive in that there's a lot of city fathers that are behind getting this thing turned around.

Spencer Levy
Seems to me you're killing two birds with one stone here. If the city gives incentives for your project, because what you're doing is you're creating more units. And number two, you're getting off the market, a bad asset, an asset that could be a blight on the community. So, Tim, let's go to you first on just the mixed use aspect of this and the choice of use. Better stated. And sticking with multifamily go all the way from luxury down to capital-A affordable, but you can also add mixed use components, which could include retail, could include a piece of office. And I know that Anoop has a whole formula on this. Hey, we'll start with you and go to Anoop.

Tim Gordon
No, absolutely. I mean, our focus is on multifamily, but many of them contain retail at the ground floor, which is common in some of the buildings, which the bigger buildings will incorporate some office, usually on the lower floors. This is one of those, I think, rare strategies where it truly is a win win for the investors, for the community as well, because to your point, they have an asset in the middle of the city which is really not doing anything. It's bringing down the city and all of a sudden they'll take some office off the market, helps the existing office, but really create housing, which almost all cities now need. The demand is there, but the supply really isn't. And this is a way to do that, which I think is one of the reasons why many communities are behind it, because it is a genuine win win.

Spencer Levy
And the other aspect of it, of course, again, not to get very bottom line is if an office building comes off line, it doesn't pay property taxes. What's your point of view?

Anoop Dave
Yeah, I agree with you. I think one of the things when you're dealing with the city is it's very tough to govern a city. They have many, many priorities that they're trying to balance and you try to work with them. So one is not asking for things that they can't give or expecting it because sometimes they have regulatory reasons, legal reasons. They just can't do certain things, but they can always be helpful. They can expedite things or just listen to you and tell you what they will or will not approve if you just ask them. And that's often a big part. And the city's a big you know, they're big organizations. So it could be the building department, it could be economic development. And we've been fortunate. We've seen some cities like Cincinnati, Pittsburgh, Phoenix, that have been unbelievably accommodating and responsive. They pick up your phone call. So I think when it comes to

how are you going to do this as mixed use, you know, it used to be everyone always wanted office and there was always the most incentives for office because they viewed that as a win on many fronts. It created jobs. Well, today, housing creates jobs. Remote work is here to stay. And those tenants that you have in your building, their workers, they're going to contribute to the neighborhood and they could be budding entrepreneurs. A lot of cities are getting that, and that's why they're also moving forward on conversions.

Spencer Levy
You know, it's interesting, one of the multipliers that I've traditionally quoted and I've quoted on this show, I believe, is that for every six new jobs in a market, we believe that it creates one more multifamily unit, demand demand for one more multi unit demand for two more retail jobs, demand for able hotel nights is this multiplier effect thing. But I was speaking with our head of multifamily research, Matt Vance. He said, you know what it might be reversed now. It might be that multifamily creates that demand. Tim you were nodding your head there.

Tim Gordon
I agree. I mean, you can go really both ways with the cause and effect there. I think by creating these vibrant areas with more people living there, that's more demand for retail, more people who want to have offices close to where they live now in terms of the commute. So I think it's either going to be a virtuous circle or a vicious cycle. It's one of the other. And I think when you can just get more activity, more housing, it's going to create that as opposed to just having basically an empty office building, not doing very much. So I think you really kind of reverse it.

Spencer Levy
Steve, we're in a capital markets issue right now. I mean, right now I think the number one issue in our whole business is the cost of debt, the ability to finance these projects, but also the cost of construction is going through the roof. Those parts of it have come down. Some of the commodity costs, lumber, steel, other things have come down. While labor stayed high enough. Of course, the course of interest stayed high. Coming out of this, whenever the inflation starts to come down, let's assume it's already coming down, but really starts to really come down mid-year next year. Are we about to see the golden era of adaptive reuse as the capital gets cheaper

Steve Timmel
Are we in a golden age? I think it comes in spurts, right? As Anoop said in 2013, 1415, there weren't really any deals, deals to buy. I would tell you that there's been a lot of the older buildings within the greater Cincinnati market and Columbus that have already been converted to hotel or multifamily, and I think it'll cool off a little bit, obviously. And it all comes down to math, as you like to put it. The economics have to work and there's economics for this type of project can work a variety of different ways via a tighter construction schedule, better economies of scale, doing multiple projects at the same time, cheaper debt whenever we see that again. And of course the incentives that the savvy investor is able to secure. But it's a very quick tipping point if those things are not aligned.

Anoop Dave
You know, like Dickinson wrote that book, A Tale of Two Buildings. And I think that's what this is. If you have a quality building that can be. Averted all of the increases you had Ken [Colao] on from CNY, But he was talking about the spiking in materials and labor costs and construction costs. Well, some of that is an advantage to you when you're doing it for use because you already have the steel, the concrete, the windows, what have you. But if it's a

building that cannot be converted, that's a problem because your carry costs are going to be much higher and your financing costs are going to be much higher. It's almost like leverage. It's going to double the pain on a bad deal, but it's really going to help you as a discount to replacement cost of your good deals.

Spencer Levy
Let's talk about final thoughts now, but I also want you to put on, if you could for just a moment, your green hat, because I think there's nothing greener than reusing an existing building because you don't have to use new materials. You may have to do it in the interior, but certainly you have that efficiency. Tim, starting with you, what are your final thoughts on the present and future of adaptive reuse?

Tim Gordon
Adaptive reuse, really. I mean, two or three years ago this would not be necessarily a topic that would be ripe to discuss. It was really a very niche, boutique segment. I think now it's really one of the flavors that everyone's thinking about precisely because office is under particular pressure, because there's interest rate issues, there's possible recession looming. But I do think this is structural. I think that once we pass this kind of cyclical episode, the truth is because of work from home, like people's habits have changed. And I think there are going to be offices that need to be converted. The highest, best used is then residential, and I think office is going to come back. My family owns some offices. I believe in that. I hope so, we all do. But I think there are certain office buildings in city centers which are just better off right now being converted, and I think this opportunity has legs. It's not just a temporary thing. I think the adaptive reuse ebb and flow, but I think it is something that is going to be a toolkit for developers for a long time to come. There's always going to be an allure to adaptive reuse business, classic value investing. You're buying materially below replacement cost. That being said, it's going back to the beginning. The trick is once you start actually doing the conversion process, what is the true all in cost? And I think this is really an execution heavy business where you really want to have the experience working with people who've done it before, who know how to do the due diligence well, have the vision of what the building could actually look like and what they could actually lay out, because the initial basis always looks attractive or generally speaking. And in fact, going back to when I walked these cities and you hear these prices of buildings like, oh my gosh, this compares to certain apartments in certain cities. I mean, it's incredible what you're getting, but can you really do the conversion at a price that makes sense?

Steve Timmel
Yeah. Tim, I can't tell you how many New York investors have come to the Midwestern cities and says, how can I lose at this price? Well, you can lose on interest carry. You can lose on not leasing up your building. And I think when you get out of some core markets, pricing does look a little bit cheap and attractive to do so. So I guess my last word on it is that the office sector is going to go through a rebirth. It's going have to reinvent itself, much like the retail sector has done every ten years or so. It's going to be fun to watch, and painful to some folks. But again, I think it's going to be a great opportunity to reposition assets that have exceeded their highest, best use as built.

Anoop Dave
I think the important part is also, you want to be part of the city. And the whole thing about adaptive reuse is not only you have to adapt to the building, you have to adapt to the city. You're going into a city that you already think is doing well for you and you're just going to help that path along. And that's something special. So we get really excited about these

great towns. And you said about ESG, you know, we've been ESG before. It was in vogue. What you're doing is you are rehabilitating something that often has emotional attachment to a neighborhood, to a person, to a community. And you're always green because you are reusing. It's kind of odd. Some of the typical standards don't acknowledge adaptive reuse, but obviously adaptive reuse is inherently very green, and you often do have incentives because you're doing something that's good for the community.

Spencer Levy
On behalf of The Weekly Take, I want to thank Anoop Dave, the CEO of Victrix. Thank you so much for coming out, Anoop.

Anoop Dave
It's great to be here. Thank you very much.

Spencer Levy
Great to have you. And then his partner in business, Tim Gordon.

Tim Gordon
Great to be here. Thank you.

Spencer Levy
And then last but certainly not least, our colleague Steve Tamil, senior vice president of CBRE based in Cincinnati. Thanks, Steve.

Steve Timmel
Thanks a lot. Spencer. It's been great.

Spencer Levy
For more on office conversions and on our show, check out our website, CBRE.com/The WeeklyTake. Next week, we hit the road again, traveling to Philadelphia for a wide ranging tour of a market with a lot going on. The Phillies just went to the World Series. The Eagles have been on the short list of Super Bowl favorites this season. And we'll look at how the real estate game is being played by one of the owners of the NBA's 76ers who’s a big time scorer and the student housing sector. So tune in for that and a lot more in the weeks to come. Meanwhile, we hope you'll give us some brotherly love – or sisterly love, of course – by sharing the show with folks in your network. And don't forget to subscribe, rate and review us wherever you listen. And before we go, a belated end of year shout out to the folks at Business Insider, which named The Weekly Take the Best Overall Podcast for Real Estate Investors for 2022. We're proud and grateful for the recognition and promise to keep earning it in 2023. I'm Spencer Levy. Be smart. Be safe. Be well.