EXCERPT

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Debt and Equity Market Updates

Outside Forces Slow OZ Investment, but Economy, Extension Could Spur Increase

A looming expiration date and a decrease in capital gains events are combining to put a damper on OZ investing, but many advocates are confident that things could change quickly.

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Affordable Housing Debt and Equity Outlook: What Affordable Housing Developers Should Know

Affordable housing developers are navigating myriad challenges, including the oversubscription of private-activity bond volume cap, high interest rates and increasing insurance premiums.

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NMTC Investor Market Remains Strong in 2024, But Questions are on the Horizon

Demand for NMTC investment is robust. How might NMTC permanence or a combined allocation round affect appetite and pricing?

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The ABCs of NMTC Source Leverage Lending

The leverage loan structure has evolved substantially from the early days of the NMTC incentive, including ways to mitigate certain risks.

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Insights on Affordable Housing, Community Development, Historic Preservation and Renewable Energy

Living at the Office: How a Scoring System Developed by Design Firm Gensler Can Find New Life for Vacant Office Buildings

CINDY HAMILTON, HERITAGE CONSULTING GROUP

At 160 Water Street in Lower Manhattan, a 29-story tower called Pearl House offers a remarkable range of amenities to residents of its 588 apartments, including a gym, golf simulator, bowling alley and (when tenants are done exerting themselves) a spa. Even more remarkable is that as recently as 2020, this building was an office tower, catering to the commercial foot traffic of the surrounding Financial District.

When the COVID-19 pandemic emptied out this and countless other downtown office buildings around the country and as the rate of remote work increased, 160 Water Street became symptomatic of a much larger problem: What should property owners and developers do with all these vacant downtown office buildings? The solution may be found in an innovative algorithm developed by design firm Gensler, which has scored more than 1,300 office buildings to date to identify the best candidates for new life in the post-pandemic world.

Problems on Two Fronts

Although many of the industries hit hardest by the pandemic rebounded, office real estate is not among them. Many downtowns still have higher vacancies in office real estate than in 2019, with JLL reporting the U.S. office vacancy rate at 21.9% in the first quarter of 2024. City centers have experienced similar declines in the past, typically alongside major economic downturns, but this slump appears to be more persistent—and possibly permanent, as businesses of all sizes shift to hybrid or remote arrangements. The issue has cascading effects, impacting not just the building owners but also other businesses—from restaurants to retail—that relied on the foot traffic from commercial offices for their own bottom lines.

Meanwhile, the country faces a critical shortage of affordable housing. For half of renters, their housing costs eat up more than a third of their salary. Homeowners (and those who wish to become one) face high interest rates and low inventory. With land prices and construction costs up, new construction alone cannot address the shortage.

Scoring the Solutions

Gensler's scorecard tackles both problems at once. Its algorithm offers a data-driven solution, scanning the glut of vacant office buildings and identifying targets for conversion to residential or hospitality uses. The scoring system begins with the premise that many office buildings are obsolete in their current form but could be repurposed as housing or hotels. But the criteria also takes into account that not all commercial buildings are suitable candidates for conversion. A complex range of determining factors affect the viability of a rehabilitation, making the difference between whether a scheme pencils out or not. Gensler's calculations aim to anticipate those margins, offering clarity to a developer more efficiently than a traditional pro forma.

The scorecard accounts for the real estate mantra of "location, location, location," calculating the building's

Gensler

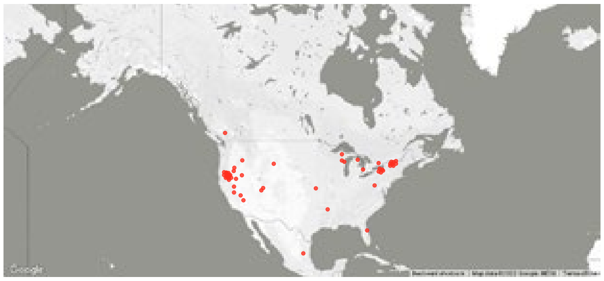
OFFICE TO RESIDENTIAL

All Project Summary City

Pick landlord name to filter by landlord. Uncheck to view all.

Name of landlord/developer

Map of Properties



Ranked Compatibility by Project

	Project Name	Compatibility	Floor Plate	Form	Services	Context	Envelope
1.	Confidential	95%	9	10	10	10	9
2.	Confidential	93%	9	10	10	9	9
3.	Confidential	93%	9	10	10	9	9
4.	Confidential	92%	10	10	5	10	9
5.	Confidential	91%	9	10	5	10	9
6.	Confidential	91%	8	10	10	10	9
7.	Confidential	90%	7	10	10	10	9
8.	Confidential	90%	7	10	10	10	9
9.	Confidential	90%	8	10	10	9	9
10.	Confidential	89%	9	10	10	9	7

Project Scorecard

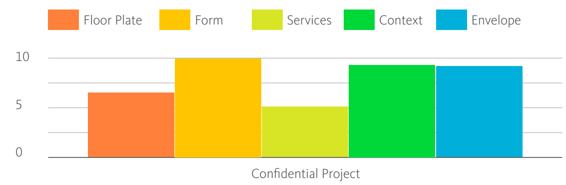
Project Name: Confidential

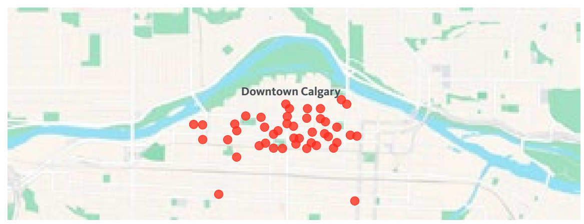
Compatibility

81%

Name of landlord/developer	GHG Savings (kgCO2e)	
Confidential	2,229,322	
Vacancy Rate	**Convertible Area**	**# of Units***
0%	79,904	88

*based on 80% efficiency





proximity to public transportation networks and other services; indeed, many older office buildings are in prime downtown areas that are well-connected to mass transit. Beyond those contextual factors, the criteria evaluate a host of physical characteristics for each building, including the envelope design, structural massing, floor plate shape and scale, placement of the service core and whether the ground floor has sufficient space for residential lobbies and amenities. These metrics zero in on the most adaptable buildings.

Physical Indicators

Age turns out to be a factor, but perhaps not in the way one might expect. Although some might expect that older buildings are, by definition, obsolete, the opposite is actually true in many cases, according to Jack Paruta, a Senior Associate with Gensler. In fact, Paruta notes that pre-World War II buildings are often the best opportunities for adaptive reuse, as their designs typically score well according to many of Gensler's metrics. Since these buildings predate the widespread use of air conditioning, their floor plates are usually more efficient. Deeper buildings often incorporated lightwells through the core to improve circulation and introduce light on the interior. In many cases, the floor plate is shallow enough that there is less than 30 feet separating the exterior windows from the interior corridors and the structural column grid is often 20 feet on center. Those layouts and dimensions may require some design problem-solving, but they are ultimately conducive to apartment layouts, as the column spacing lends itself to interior demising walls and the exterior window spacing dictates reasonable widths of apartment units, according to Paruta.

Compare this with many postwar buildings, which were built in an era when both air conditioning and fluorescent lighting were ubiquitous. With those cooling and lighting systems in place, postwar buildings did not need to rely on the same design principles that dictated prewar floor plans. They typically featured much larger floor plates, uninterrupted by many (or any) structural columns. Office occupants were no longer reliant on natural air circulation or light, so there was no need to shorten the interior distances, break up the floor plate with lightwells or incorporate operable windows. In these buildings, the curtain walls might maximize the natural light at the perimeter of each floor, but those windows could be up to 100 feet away from the service cores. This arrangement was ideal for cubicles and conference rooms but is not suitable for contemporary apartments without major reconfigurations.

For these reasons, older buildings often perform well in Gensler's scorecard—even before historic tax credits (HTCs) are factored in (in general, financial cost and return on investment are natural byproducts of the scorecard's metrics, rather than direct inputs). But the same qualities that score well in Gensler's calculations are often the same characteristics that support a strong HTC opportunity, since they suggest that the character-defining features of the building's original design remain intact. Moreover, older office buildings in city centers are often already listed on the National Register of Historic Places, either on an individual basis or as part of downtown historic districts, thus clearing the first hurdle of HTC eligibility.

Putting the Scores into Action

If a building scores in the 70th percentile or above in its scorecard, Gensler considers it a suitable candidate for conversion, according to Paruta. At that point, the owner and design team can proceed to develop test fits and additional cost analysis. Often, this happens on a case-by-case basis, in partnership with individual developers. But Gensler has also collaborated with economic development organizations to evaluate entire cities' worth of downtown office buildings.

The firm first experimented with this approach in Calgary, Alberta, where the office vacancy rate was high (at 24%) even before the pandemic; by mid-2021, the rate had soared to 32%. For comparison, Detroit's office vacancy rate was half that when that city declared bankruptcy in 2014. Gensler partnered with Calgary Economic Development to evaluate 6 million square feet of buildings in downtown Calgary, identifying more than 15 candidates for conversion; not only would those rehabilitations reduce the amount of unused office space, but they would together increase the number of residential units in the city's core by 24%.

Gensler has gone on to work with the city of Tulsa, Oklahoma; the San Francisco Bay Area Planning and Urban Research Association; the Canadian Urban Institute and others. Such collaborations point to the fact that this problem is widespread, but the solution promises to have equally far-reaching results. The firm has scored buildings in more than 25 cities from coast to coast, many of which have advanced into development or development has been completed.

These conversions help to revitalize beleaguered downtowns, but they do so in a socially sustainable way. Because these buildings are in commercial city centers, rather than older residential neighborhoods, the introduction of housing does not contribute to the displacement of long-term residents or the gentrification of established communities. The social merits of these rehabilitations are matched only by their environmental sustainability, as rehabilitating a building avoids significant ecological costs associated with new construction.

Moving Forward and Moving In

Gensler continues to experiment with new scenarios for its scoring system.As downtowns continue to recover, the firm hopes to adapt the scorecard to evaluate industrial buildings beyond the urban core. Among the hundreds of office towers it has already evaluated, the firm has reached some surprising conclusions. Most notably that the less desirable the office space was (that is, if it could not claim to be Class A office space), the more suitable it is for residential conversion, Paruta said. Thus, older buildings that cannot offer top-tier amenities to office tenants can nevertheless be very marketable to future residents. As Gensler's scoring system recognizes the best opportunities for redevelopment, the Class B and C office buildings in our city centers can still earn top grades.

Cindy Hamilton is president of Heritage Consulting Group.

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NOVOGRADAC®

CONTACT

CORRESPONDENCE AND EDITORIAL SUBMISSIONS
Teresa Garcia
teresa.garcia@novoco.com
925.949.4232

ADVERTISING INQUIRIES
Christianna Cohen
christianna.cohen@novoco.com
925.949.4216

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