October 2022

## **HOT TOPIC ALERT**

# **Adaptive Reuse**





Before and After: Rendition of the Michigan Central Station in Detroit, MI

### **Definition of adaptive reuse**

Adaptive reuse refers to "recycling" an existing building for a purpose that is different from which it was originally built or designed for. Adaptive reuse can optimize the useful life of existing assets by repurposing them for new uses while maintaining their historic features and presence in the community. Key features of adaptive reuse are prevention of demolition of existing structures allowing for greater integration into the revitalization of decaying neighborhoods, while at the same time offering an attractive alternative to new construction in terms of sustainability. These types of projects are not restricted to buildings of historic significance, however, and can be a strategy adopted in the case of any obsolete building or structure. As with any project, the architects, developers, builders, and entrepreneurs looking to rejuvenate and reconstruct a building still must perform adequate due diligence to make sure that upon completion, the project will serve the need of the market and can be competitively priced for the new intended use.

## The benefits of adaptive reuse

Adapts residential/commercial/industrial building inventory to current market condition A significant benefit of adaptive reuse, is that it adds to the available inventory of residential and commercial properties through the use of existing structures. The reuse of obsolete and vacant buildings for other purposes forms a very important aspect of any urban regeneration scheme. Adopting the adaptive reuse approach for the redevelopment of older vacant buildings provides added benefits to the regeneration of an urban area in a sustainable way, by transforming these buildings into usable and accessible units. The adaptive reuse strategy enables the local authority and owners of older vacant buildings in urban areas to minimize the economic, social and environmental costs of redevelopment while promoting urban expansion and development.

One of the consequences of the COVID-19 pandemic was that many businesses adopted remote or hybrid work strategies for their employees. This is at least one reason for a rising inventory of vacant office space. Other businesses, such as restaurants and retail stores, found it harder to meet their rent as a result of prolonged shutdowns, staffing shortages, and changes in consumer behavior that is seeing "brick and mortar" retail replaced with online shopping, and dining out replaced with home deliveries of restaurant food. As a consequence, many cities are embracing the adaptive reuse of this inventory for residential purposes. That reuse strategy is a potential way to help address the affordable housing crisis. The District of Columbia is a leader in this downtown office conversion trend. The District has, for several years, faced the twin issues of excessive office space and a lack of affordable housing. Converting empty or underutilized office buildings into residential units presents a win-win. Pittsburgh is another city that is looking to capitalize on this trend. City leaders have proposed reappropriating \$2.1 million in American Rescue Plan Act funds to give a boost to state and county efforts aimed at converting office buildings to affordable workforce housing. These two cities are among the many that are welcoming this trend of converting under-utilized office buildings to affordable housing. And, as compelling and powerful as this story may be, it is just one example of the positive outcomes of adaptive reuse.

Positive environmental impacts of building reuse

The average life spans of buildings in the developed world are <u>declining</u>, to around 70 years in the United States and as few as 30 years in Japan. Further, it has been reported that the building sector accounts for about a third of <u>global fuel consumption</u>. Meanwhile, old buildings represent an investment of energy and labor made at a time when the costs of such investments were significantly lower. Demolition of these buildings requires new expenditures of energy and resources to generate new building materials and to assemble them on a cleared site.

Modern building systems have high life-cycle costs and operational energy costs associated with them, whereas traditional masonry and stone buildings are more climate responsive. Therefore, one environmental benefit of reusing built assets is identified to be the retention of the original buildings <u>"embodied energy"</u>. When considering the definition of <u>"rehabilitation"</u> as "the act or process of making possible a compatible use for a property through repair, alterations, and additions while preserving those portions or features which convey its historical, cultural, or architectural values" it becomes clear that the reuse of building materials can provide substantial savings in embodied energy that would otherwise be wasted should the vacant structure be demolished.

Of course, the ancillary benefit to the developers and investors is that they can reduce expenditures for building materials by refurbishing existing building materials rather than purchase and install new materials.

Stimulating economic activity by providing building density with a mix of uses Vacant buildings tend to have a <u>negative economic impact</u> on communities. They generate little, if any, tax revenue from either property taxes or taxes on economic activity conducted in the building, such as sales taxes or franchise taxes. In addition, vacant buildings tend to discourage investment into nearby areas because of the perceived safety risk.

Conversely, when obsolete structures are revitalized, they stimulate economic activity. In particular, when included as a part of a mixed-use development plan, the revitalization can enhance entire neighborhoods. Mixed-use development promotes local economic growth and environmental sustainability, and is also good for the physical and mental health of the residents. The Metropolitan Area Planning Council, the regional planning agency serving metropolitan Boston, lists the following benefits of mixed-use development:

- Spurs revitalization;
- Encourages high quality design by providing both greater flexibility and more control:
- Preserves and enhances traditional village centers;

- Promotes a village-style mix of retail, restaurants, offices, civic uses, and multifamily housing;
- Provides more housing opportunities and choices;
- May increase affordable housing opportunities;
- Enhances an area's unique identity and development potential (e.g., village centers, locations near bike paths, or "gateway" areas that announce a community's strengths);
- Promotes pedestrian & bicycle travel;
- Reduces auto dependency, roadway congestion, and air pollution by co-locating multiple destinations;
- · Promotes a sense of community;
- Promotes a sense of place;
- Encourages economic investment;
- Promotes efficient use of land and infrastructure;
- Guides development toward established areas, protecting outlying rural areas and environmentally sensitive resources;
- Enhances vitality;
- Embodies "Smart Growth;" and
- Increases revenues.

Other benefits include preserving undeveloped or environmentally sensitive land elsewhere in the community, providing opportunities for more or different housing, bicycle and pedestrian-friendly destinations, and fostering an enhanced sense of place or sense of community. Adaptive reuse, when incorporated into a comprehensive <u>urban</u> redevelopment scheme, can transform a decaying urban district into a vibrant community.

#### Case studies

### National and local REALTOR® associations

Denver Metro Area REALTORS® participated in efforts with City Council and a partnership of GBX Group and the longtime owner of the business in having <a href="Tom">Tom</a>'s <a href="Diner">Diner</a> in Denver, CO listed on the National Register of Historic Places as of December 2019. This status makes the building eligible for state and federal tax credits, preservation grants, low-cost construction loans and protection through preservation easements.

Denver Metro Area REALTORS ® also served as an interested party and assisted Denver City Council with a landmark designation application for the <a href="Howard Berkely Park Chapel">Howard Berkely Park Chapel</a>. The designation was made on July 27, 2021, making the 1960 chapel the city's 349th individual Landmark following a unanimous vote of City Council. The midcentury mortuary was built by Howard Mortuary Company, a business established in the city in 1917. The new owners have pledged to preserve the building and adapt it for reuse.

#### Other case studies

The list of case studies that demonstrate the benefits of adaptive reuse is extensive, and exhibit the versatility for the use of repurposed structures. A short list of case studies includes:

- The Refinery, a luxury hotel in Manhattan, was once a Garment District millinery;
- Chapman University in Orange, California has created <u>student housing</u> by converting the Villa Park Orchards Association Packing House, which was built in 1918 for the Santiago Orange Growers Association;
- The oldest fire station in Michigan was converted into a 100-room boutique hotel known as the <u>Foundation Hotel</u> in Detroit. Many of the original firehouse features, including exterior ornamentation, have been preserved; and
- A historic <u>airplane hangar</u> once owned by Howard Hughes to build the famous "<u>Spruce</u> Goose" flying boat is now Google's campus in Los Angeles.

This brief list, and the other projects noted within each of the related links, helps to showcase the limitless possibilities that adaptive reuse may offer to the many obsolete buildings everywhere.

### Significant legislation/court cases

### Legislative developments

Santa Ana, California has enacted what has been called a <u>strong adaptive reuse</u> <u>ordinance</u> (ARO). The ordinance allows for the adaptive reuse of nonresidential buildings to residential units in 4 designated "project incentive areas." A building may be adapted if the building either "was constructed in accordance with building and zoning codes in effect prior to July 1, 1974" or if it "has been determined to be a historically significant building." <u>St. Petersburg, Florida</u> has adopted a similar ARO.

#### Court cases

In a New York case decided in 2020, the court held that condemnation of a property is valid where the property is blighted and the condemnation serves a valid public purpose. In that case (*Matter of Court St. Dev. Project, LLC v Utica Urban Renewal Agency*), the property owner contesting the condemnation owned two of four parcels on which a building was situated. The building had been vacant for approximately 5 years. Redevelopment and reuse of the building would not be feasible unless all four parcels were under common ownership. Condemnation of the parcel would allow the Urban Renewal Agency to hold complete title to the building, thus permitting the redevelopment of the building.

The court held that areas of economic underdevelopment and stagnation may be considered blighted and serve as an adequate basis for the condemnation to acquire real property in order to eliminate blighting influences. Further, the public use, benefit, or purpose of the acquisition was to facilitate the rehabilitation and reuse of the building, with an intention of securing investment in the building and creating jobs and encouraging economic development. Redevelopment was deemed a valid public purpose.

Note that many states and municipalities have adopted restrictive laws relating to the definition of "blight" for purposes of condemnation. For example, <u>Virginia law</u> defines a "blighted property" as a property "that endangers the public health or safety in its condition at the time of the filing of the petition for condemnation and is (i) a public nuisance or (ii) an individual commercial, industrial, or residential structure or improvement that is beyond repair or unfit for human occupancy or use".

## Obstacles/implications and strategies to overcome them

### Zoning designation changes

One significant challenge that adaptive reuse projects may encounter is that the building may previously have been zoned for a use completely different than the new intended use. This may require a demonstration that the old zoning is <u>no longer viable</u>, and that a new zoning designation would benefit the community by having a positive economic impact (e.g., by generating new or additional taxes) and that it can be part of an <u>urban regeneration scheme</u>.

Changing zoning can be <u>costly and time consuming</u>. The proposed change must be approved by the local zoning and planning commission, and may also require approval from the local city council or county board, all of whom must be convinced of the merits of the project. In addition, in some communities, civic groups and other interested parties are given the opportunity to weigh in on the proposed change. Depending on the jurisdiction, changing the zoning designation can take <u>six months to a year</u>.

#### Impacts on local revenue

The potential impact on local revenues is almost certainly to be a positive factor by the community because it involves taking an abandoned site and turning it into a <u>revenue</u> <u>generating parcel</u>. Vacant buildings generate very little tax revenue and may serve as a drain on local resources due to public safety and other concerns.

## Adapting to new building codes/fire safety requirements

Addressing building code issues on large adaptive reuse projects may be <u>less of an obstacle</u> than on projects that are smaller in scale. This is because major adaptive reuse projects generally require that the entire interior of a building be gutted. Therefore, when reconstructing the interior, it is easier for the work to be built in accordance with current building code and fire safety requirements. The incremental costs are thus already incorporated into the overall project budget in a manner similar to a new construction project.

Conversely, on smaller scale adaptive reuse projects addressing building code issues can prove to be an obstacle that may not be overcome, because many local building codes are the same whether the project is for new construction or for retrofitting an existing structure. The result is that due to the increased cost of compliance with these building regulations, some smaller projects become cost prohibitive.

### Project impact on area infrastructure

One view is that because the structures targeted for adaptive reuse are located in already developed urban areas, the need for <a href="new infrastructure">new infrastructure</a> such as roads, water and sewer may be minimized. Of course, this would tend to be a project specific determination. It may be the case that there is significant infrastructure (e.g., broadband, mass transportation, roads, parking, water/sewer, etc.) needs associated with any given project. In these cases, it is critical to work with the local community to integrate the project into a comprehensive <a href="urban regeneration scheme">urban regeneration scheme</a> that incorporates the infrastructure need of the new revitalization project with the planned or ongoing economic development in the area.

## Case studies: overcoming obstacles

One project that perhaps symbolizes the rebirth of a community like no other is the adaptive reuse of the <u>Michigan Central Station</u> in Detroit. Michigan Central Station, or MCS as it is often called, consists of a three-story train depot and an eighteen-story office tower, When the building opened on December 26, 1913, it was the tallest railroad station in the world, and the fourth tallest building in Detroit. Due to decreasing demand for rail travel, however, the station was forced to close in 1988 after years of decay.

After numerous failed plans for demolition by the City, the building was sold to Ford Motor Company in 2018. Virtually every window in the building was gone due to weather or looters, and the roof was almost completely missing. The project had to be completed in three phases. First, workers had to dry out the property, pumping approximately <a href="2.5">2.5</a> million gallons of water out of the building. Second, workers had to stabilize the structure. Then, finally, restoration could begin. The challenges of the project were enormous.

The project was estimated to be a cost of \$750 million when Ford originally purchased the building in 2018. To help offset the cost of the project, the company received approximately \$250 million in tax and other incentives. Included in this total incentive package is nearly \$210 million of tax benefit from the project's location in a MI Renaissance Zone, abating or exempting the project from virtually all federal and state taxes. Additional incentives received for the project included benefits from the Commercial Rehabilitation Act (\$8 million); the Obsolete Property Rehabilitation Act (\$18.7 million); and the Neighborhood Enterprise Zone Act (\$3 million). The variety of incentives given to this project my help to serve as a guide to the creativity that can be brought to an important adaptive reuse project.

In a demonstration that Ford would use all resources available to it, engineers in Ford's additive manufacturing unit used 3D printers to replace hundreds of <u>cast iron rosettes</u> that had been ripped out by scrappers over the decades. This project is expected to be completed in 2023. The project is part of a 30-acre, <u>walkable district</u> that includes "1.2 million square feet of commercial real estate, modern workspaces for 5,000 workers, maker labs, high-tech connected infrastructure, open spaces, and a state-of-the-art testing environment. A fully restored, technology-enabled Michigan Central Station will be the heart of the district and a must-see destination for visitors from the region and the

world, featuring locally inspired restaurants, world-class public art, and vibrant community gathering spaces."

### Strategies for successful reuse projects

## **Partnerships**

One way to ensure success of your adaptive reuse project is to partner with other professionals familiar with the practice and who share your passion for the project. One suggestion is to find a <u>design partner</u> that shares a common vision for the project. It is also important to ensure they are familiar with the Secretary of the Interior's <u>10 Standards and Guidelines</u> for rehabilitating historic buildings.

Another recommendation is to find an experienced <u>construction management partner</u>. As with the design partner, you'll want to be sure that your construction partner also shares your vision for the project so that you work together to advance them throughout the construction process.

Finally, to the extent a project calls for development outside of your area of expertise, consider finding a project partner that has the skillset you are lacking and consider forming a joint venture.

Seek assistance from organizations/coalitions helping to develop policy

There are a number of resources available to help with the development of adaptive development project. Some of them focus on the <a href="https://housing.aspect">housing.aspect</a> of potential projects. In addition, partnering with local economic development organizations can help bring a project to fruition because they offer assistance with identifying and securing potential funding and incentives for the project. They also are familiar with the dynamics of local politics and how best to proceed with securing approvals from local authorities. For example, even a company as powerful as Ford Motor Company utilized the services of the <a href="Detroit Economic Growth Corporation">Detroit Economic Growth Corporation</a> in securing incentives and approvals on the Michigan Central Station project.

## Federal, state and local financing support available

#### Funding programs

Financing an adaptive reuse project may pose many challenges. Some <u>strategies for addressing financing issues</u> include finding an experienced first mortgage lender, helping to smooth the barriers throughout the funding process. In addition, consider non-recourse lenders (e.g., debt funds and mortgage REITs) and other alternative lenders who may be more flexible with their terms and agreements. Public financing may be an option in certain states but often the approval times are much longer.

Some financing options may be specific to the intended use of the project. For example, where the project is designed to provide <u>senior housing</u>, financing sources may include construction loans, low income housing tax credit equity investments, local housing

authorities, and HUD programs. Of course, this list is not all inclusive. Potential financing options will often depend on the location of the adaptive reuse project.

#### Tax incentives

As demonstrated in the discussion of the <u>Michigan Central Station</u> project, above, numerous incentives programs may be available in connection with an adaptive reuse project. That project also demonstrates the need for creativity when identifying potential incentives for any given project. With that said, some of the more generally available incentives benefits for adaptive reuse projects may include, but are not limited to:

- <u>Federal Historic Preservation Tax Credits</u>. Some <u>states</u> also offer historic preservation tax credits as well;
- Property tax abatement;
- Tax increment financing;
- <u>Brownfield tax credits</u> are available in some state and local jurisdictions for the redevelopment of land that was previously developed. In addition some <u>states</u> also offer other brownfield benefits, such as grants, loans, enhanced tax increment financing and free environmental site assessments;
- Community Development Block Grants;
- New Markets Tax Credits; and
- Green infrastructure tax benefits and state green incentives benefits.

Additionally, in the wake of the COVID-19 pandemic and its impact on commercial real estate trends, Congress has begun to seriously discuss creating new tax incentives or building upon existing incentives and grant programs to further incentivize and ease adaptive reuse projects.

Initiating discussions regarding these types of incentives benefits with a <u>local economic</u> <u>development agency</u> can help ensure that any available incentives benefits are identified and secured.

#### Addressing financing obstacles

As with any construction project, there are <u>considerations before seeking financing</u> that should be resolved before starting. These considerations include items such as estimated construction/redevelopment costs, ascertaining the demand for the project, zoning, licensing, and analyzing how the project fits within the overall development plan for the community. After assessing the potential for project incentives, the financing gap will be identified. Then, as noted above, develop <u>strategies for addressing financing issues</u> for the project.

## State and local REALTOR® association advocacy efforts

Below are several examples of advocacy efforts by state and local realtor associations.

Virgin Islands Territorial Association of REALTORS®, US Virgin Islands:

The US Virgin Islands has some of the oldest, and culturally significant buildings in the Western Hemisphere. For years, properties have fallen into decay, and some have been lost forever, resulting in the creation of areas on the islands with crime and safety concerns. The Association intends to be a resource for the <a href="State Historic Preservation">State Historic Preservation</a> Office and the legislature to enact legislation that will encourage property owners to maintain their historic structures.

## **Central Oregon Association of REALTORS®:**

The Central Oregon REALTORS Association assisted in the efforts of Deschutes County to work on a program that would provide more local control in re-classifying lands designated for Exclusive Farm Use (EFU) or Forest Use (F-2) but that are not actually viable for these purposes due to poor soil conditions, a lack of irrigation, climate conditions or other factors. The proposed amendments were intended to provide a foundation for establishing a process for property owners to pursue a re-designation of lands deemed not farmable, but that may represent opportunities for other uses, such as housing. In 2020, the Board of County Commissioners decided to review additional testimony and conduct deliberations during subsequent public meetings. According to Central Oregon Land Watch, re-designating land use <u>failed</u> in 2020 and in 2021.

#### Nebraska REALTORS®:

The Nebraska Association worked with legislators to develop a Land Bank bill designed to help revitalize problem properties in metropolitan and first-class cities across Nebraska. Governor Ricketts signed the bill into law in August 2021.

#### Conclusion

Adaptive reuse can be an important tool for the regeneration of urban areas. It saves resources and promotes economic revitalization when incorporated into a redevelopment plan for a designated neighborhood or area. The benefits of saving an existing structure can go well beyond the scope of the single building, Adaptive reuse can even help solve many societal issues as well, such as a lack of affordable housing in urban areas. Although the revitalization of an obsolete or vacant building poses many challenges, there are many resources available to assist in a project, such as project partners, incentives, and local economic development agencies. Of course, as with any development project, due diligence must be performed to ensure that the project is feasible and economically viable.

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Questions or concerns contact Melissa Horn Email: MHorn@nar.realtor Phone: 202-383-1026

#### ADDITIONAL STATE & LOCAL RESOURCES

White Papers: Comprehensive reports prepared for NAR on issues directly impacting the real estate industry. Examples include: Rental Restrictions, Land Banks, Sales Tax on Services, State & Local Taxation, Building Codes, Hydraulic Fracturing, Foreclosure Property Maintenance, Climate Change, Private Transfer Fees.

**Growth Management Fact Book:** Analysis of issues related to land use and modern growth management topics include density — rate of growth, public facilities and infrastructure, protection of natural resources, preservation of community character, and affordable housing.

# NAR Research: Case Studies on Repurposing Vacant Hotels/Motels into Multifamily Housing

Recognizing that the conversion of vacant hotels/motels is a win-win solution to address the underutilization of hotels/motels and help alleviate the housing shortage, NAR's Commercial Real Estate Research Advisory Board conducted research on the conversion of vacant hotels/motels into multifamily housing to draw some insights and best practices.

# On Common Ground: Repurposed Buildings: Helping Solve America's Housing Crisis

Some developers and housing advocates have had success repurposing office buildings, schools and libraries and even such unique buildings as former New England textile mills, a Los Angeles funeral home and a Wichita parking garage into apartments that don't cost a fortune to rent. Using historic and affordable housing tax credits from state and federal agencies can significantly reduce the cost of financing these projects.

#### **Tackle Adaptive Reuse Strategies with a Smart Growth Grant**

Local and State REALTOR associations can apply for a grant to address adaptive reuse strategies. Funding can cover meeting or forum costs, studies or consultants to ignite interest or change legislation to support repurposing key commercial assets.

All resources are available on REALTOR® Party webpage under the State & Local Issues tab.