In The News

The Time To Reinvent The Commercial Real Estate Spaces Of The Future Is Now

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Commercial real estate brokers and market experts believe the coronavirus has fundamentally shifted the leasing market to unfamiliar territory, and it is time to begin thinking about creative ways to reposition retail, restaurant, hotel and office properties that are at risk of losing tenants permanently.

"I think, generally speaking, the market is not quite ready to face the fact that things are changing more than we care to admit," Dominus Commercial Inc. Vice President Aaliyah Haqq told Bisnow. "I think we are going to find ourselves a little bit behind in being forward-thinking about what we can do to repurpose spaces as we come out of whatever is on the other side of ... COVID."

Courtesy of Aaliyah Haqq Dominus Commercial Vice President Aaliyah Haqq is brainstorming ways to transform abandoned commercial real estate. Haqq, who operates in both brokerage and development, is advocating for the CRE industry to start thinking creatively about how to reinvent spaces to remain revenue-generating after a mass exodus of traditional tenants and little to no leasing activity expected in the near future. She believes the only way to do this is to bring end users, developers, architects and brokers together.

Real estate attorney and Farella Braun + Martel partner Charles "C.J." Higley has made a living advising developers and other stakeholders on how to repurpose existing properties, including the transformation of a suburban mall to an office campus. He's preparing for an increase in repurposing efforts.

Hotels are particularly ripe for repurposing to other uses, Haqq said. More than half of 600 respondents to a survey from the American Hotel & Lodging Association published July 29 said their hotels are in danger of falling into foreclosure. Occupancy plummeted to less than 10% in some facilities early in the pandemic, and only 37% of AHLA's respondents said they have enough business to bring back at least half of their employees.

"In my reimagining hat, if I were to put one on, I think about hospitality," Haqq said. "You think about all of the plumbing that is there, you think about all of the rooms that are there. Is there a way we can repurpose it into some type of healthcare facility if needed?"

Haqq said hotels and office buildings may work well as housing for veterans and long-term care facilities since they have so many individual rooms and complex plumbing inside.

Retail will also likely have a plethora of opportunities for repurposing. The sector could lose up to 25,000 stores in 2020 alone, according to Coresight Research.

"From the retail perspective, I definitely would expect to see an uptick in the ways that owners are thinking about repurposing those properties," Higley said.

Younger Partners retail acquisition platform leader Micah Ashford said boutique retail spaces will definitely come back with new tenants in place, but big-box retail or larger assets face the prospect of having to reposition their spaces. On the plus side, those larger spaces have an appealing availability of square footage for social distancing purposes.

Haqq notes large retail spaces like old Toys R Us locations can be reactivated by creating office collaboration centers featuring conference rooms large enough for people to social distance effectively in the future.

In the past, such a measure would be considered wasted space, but now, Haqq said, "it is safer to have a conference room that's three times the size it used to be with the same [number] of occupants." Her other idea would be to use emptied big-box spaces to serve as central kitchens and delivery points for multiple restaurants — many of which will need less independent and dining room space in the future and more centralized hubs for their delivery services.

"As far as big-box as a whole, I can see us taking the front [of the stores] and making them retail, and then having the back part of the space for e-commerce while trying to get an average rental rate that makes sense for us to remain shopping center owners," Ashford said. Retail-to-industrial conversions are accelerating, according to CBRE. Thirty-five such projects have been proposed, started or completed nationwide since January 2019, a sharp increase from 24 in 2017 and 2018. In the last three years, 13.8M SF of retail has been converted to 15.5M SF of industrial, CBRE said, and it expects the trend to pick up the pace because of the coronavirus pandemic, as people have more fully embraced shopping online.

"Underperforming retail sites have become an ideal location for last-mile warehouse developers," the firm said in a July 23 research report. "They are often located within population centers, connected to utilities and have large parking lots with multiple points of ingress and egress. Many are also freestanding big-box stores with existing dock doors and clear heights compatible with industrial use."

Retailers and restaurants also are going to have to brainstorm ways to create social distancing with more guests waiting outside to get into stores, while also taking up the challenge that comes with increased curbside pickup and drop-off services, Ashford noted. One of the more common conversion efforts Higley has experienced during his career in San Francisco has been the transformation of warehouse industrial space into office.

"The insatiable appetite for office space during the recent tech boom has driven the conversion of many such spaces, valued for their large, open-floor plates," he said. "This phenomenon has made the South of Market area the locus of the city’s vaunted tech industry. At the same time, as traditional office buildings with smaller floor plates have become less desirable, we’ve seen former office buildings converted to residential use."

But Higley isn't yet predicting a large wave of office properties converted to other uses — it is yet to be seen if tenants will return to their business sites to keep office assets at pre-crisis levels of occupancy or if that sector, too, will start to get an increase in empty properties.

"I think office is a trickier question, and I think the jury is still a little bit out on that, to be honest," he said. "In my mind, the question is [whether] what we are experiencing right now is going to lead to a true diminishment of people working in traditional offices, or is it really just going to lead to a reallocation of those offices?"

Envisioning all of these changes is one thing, but putting them into effect takes time, so the process of brainstorming reinvention begins now, Higley said. Depending on the regulatory structure of a city, the process can take months or even years, with highly regulated environments creating challenges along the way.

Higley faced these challenges when helping developers convert a mall into an office campus, noting that oftentimes the use in place is completely different from the developer's new vision. Shopping centers also may have existing tenants with long leases or tenants that own their spaces outright. The process of negotiating with these tenants can draw out an adaptive reuse project and create barriers to obtaining approvals or moving forward if existing tenants or store owners push back against the new plans.

For this reason, Higley recommends establishing strong community ties before a project launches.

"I think the first step ought to be sitting down with the planning agency of a local jurisdiction and also the economic development agency," Higley said. "Two things are really happening here: One is the realignment of a physical space, the other is the realignment of the economy."

Higley also advises clients to look for hidden surprises like "anomalies in subfloor conditions" and structural challenges before jumping headfirst into a building conversion.

"One example we've seen are older buildings with 'wavy' floor plates that require unanticipated work to get them back to level," he said. "The problem can be especially acute in a place like San Francisco with lots of old buildings that may carry additional restrictions on alterations due to historic preservation concerns. This can result in major revisions to the drawings — and therefore significant change orders and cost increases — during construction, when the developer has relatively little leverage or control of the project."

To ward off these threats, Higley encourages developers to work alongside architects and contractors during the due diligence phase of any project to determine what structural issues are hidden from plain view.

"We've seen projects that suffered significant cost overruns due to unforeseen anomalies in subfloor conditions and basic structural conditions. These problems are amplified where the architect's drawings assume certain baseline conditions that prove unreliable," Higley said.

Converting a property from one use to another doesn't always require a zoning change, said Angela Hunt, who leads Munsch Hardt's Zoning and Land Use practice group.

When it does require zoning adjustments in Dallas, it can take anywhere from two months to a year, but developers have one thing on their side: cities that are more open to ensuring the CRE economy gets back to normal.

"In this uncertain environment, cities may be more open to supporting zoning changes that would allow adaptive reuse rather than seeing buildings remain vacant," Hunt said. "Keep in mind, though, that cities are facing their own belt-tightening and are looking for ways to maintain the tax base, shore up their local economy and support job growth."

The full article can also be viewed by clicking here.

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