

# Office conversion continues unabated

The trend of office space conversion to alternative uses is still strong, with another 92,000 m<sup>2</sup> of office space being reconverted in 2015.

A well-established trend is the conversion of offices to alternative uses, particularly in Brussels, which has the most substantial office stock in the country at 12.7 million m<sup>2</sup>. Typically, older, out-dated office properties abutting residential districts have been redeveloped over the last decade, though office space in traditional business districts has also garnered interest. Over the last three years, more than 340,000 m<sup>2</sup> of office space has been converted to alternative uses such as housing, elderly homes, hotels, schools, and student housing more recently. Since 2008, almost 800,000 m<sup>2</sup> of office space has been converted.



Michael Niego,

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“Even without changing the structure and shell of the building, redevelopment costs quickly exceed 1,100 euro/m<sup>2</sup> excluding soft costs and VAT”

In 2015, 92,016 m<sup>2</sup> of office space was announced for conversion, down from the year before and the 2013 high of 145,000 m<sup>2</sup>, but well above the long-term average.

Office conversion has gained the most traction in Brussels, with strong support from local urban planning authorities. Major ongoing projects include the redevelopment of the 70,000 m<sup>2</sup> former CGER headquarters in the city centre (**Chambon project**) and the redevelopment of the 50,000 m<sup>2</sup> former **Solvay headquarters** just off of Chaussée d'Ixelles. Both projects are undertaken by Allfin. Also in the city centre, the QPT Office Tower will become a new residential tower called the **Cosmopolitan** (by Besix). In the suburban districts east of Brussels, conversion has been the most dramatic, with former office districts like Marcel Thiry, Colonel Bourg and Rue de Genève gradually being transformed into mixed or pure residential districts.

Office conversion is also taking place in other cities. In Antwerp, Cores has redeveloped the former **Douanegebouw** ('t Eilandje) into a 40,000 m<sup>2</sup> residential development. Other notable examples are the **Antwerp Tower** (24,000 m<sup>2</sup>) from Wilma Project Development, which will be partly redeveloped into apartments, and the **Tolhuis** (23,800 m<sup>2</sup>) from Immogra, which will likely end up as a residential complex. In Ghent, the **RTT-toren** will be redeveloped into a mixed-use residential complex in 2020.

## Housing provides better exit values

The motivation for the conversion of office space has been a colliding trend of economic factors. While population growth in cities is high and residential prices have increased substantially, the office market has been less fortunate over recent years. In times of economic uncertainty, corporate downsizing and costs savings have resulted in a surge of office voids all over the city. Structural voids in some office districts have contributed to

vacancy rates as high as 30% in out-of-town districts. Once an older office building is vacated by its previous occupant, the costs to modernize and enhance the marketability is often prohibitive, and does not guarantee a successful commercialisation. With office rents under pressure in an ever more competitive market battling for the same but limited corporate demand, offices are no longer the preferred exit strategy of developers or landlords. This trend is new, and could dramatically change the balance of power in urban planning towards housing.

The redevelopment of an office building in apartments is most often a better and safer exit strategy for a developer or landlord, especially when taking into account exit risk. As apartment prices have almost doubled over the last decade, residential prices exceed those of offices in most locations. If there is a choice between housing and offices, housing has become the logical choice in most parts of Brussels. Another advantage of residential development is the phased sales process, which starts well before the actual construction.

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It is not uncommon to see 20% to 30% of units already being sold “on plan”. Subject to the Breyne regulation, which allows the buyer a gradual payment over the construction process, the developer already enjoys some incoming cash flow. The customer base is also very diverse and large in the residential market, with both private investors and end-users being targeted.

The exit strategy for an office development is significantly different. The commercialisation almost always happens at the end of the construction process, once the occupant has been able to visit.

The Cosmopolitan project by Besix RED is set to be a new landmark residential development right in the heart of Brussels old town. Architects Bogdan & Van Broeck will convert the 60s office tower into 156 apartments.



It is therefore not uncommon to see new office buildings with voids well after delivery. And once largely let, the building still needs to be sold to an investor to secure the full exit for the developer. Nonetheless we see again core investors looking forward to acquiring uncommitted office projects before delivery and without rental guarantee but only in AAA locations where the letting risk is minimized.

Pre-sales and lower exit risks make residential projects more attractive to developers. The intense competition in that segment has led many developers to reconsider their margins in order to be able to secure new projects. Feasibility studies showing gross margins between 15% and 20% are quite common.

**Conversion is not always feasible or possible**

Converting office space into residential uses is not always economically feasible. A typical office building differs strongly from a typical residential building. These differences are sometimes hard to overcome. Moreover, most office space is well located, and therefore simply too expensive to acquire for conversion purposes.

In a lot of cases, only the concrete structure of the buildings, the stairways and the lifts can be maintained. Interior walls, floors, technical installations, electricity and plumbing typically have to be completely renewed.

Also, factors such as neighbourhood, accessibility, visibility, building proportions, depth, free height, orientation, interior daylight and parking space do not always favour alternative uses. Even without changing the structure and shell of the building, redevelopment costs quickly exceed 1,100 euro/m<sup>2</sup> excluding soft costs and VAT. It is worthwhile noting that these costs apply to the gross areas whereas only the net areas are priced in residential.

Zoning plans must also be carefully analysed. Depending on the location, the local authorities may be more or less in favour of changes of use. Eventually, the mere interest of maintaining an existing structure lies in the volumes that were permitted for the previous use, whereas new construction could be limited in certain ways. A trade-off is sometimes required when the features of an existing structure are not ideal: square meters vs. quality standards.

Finally, the high exit prices of residential units that make a project feasible are not always what the market needs. Housing affordability is quickly deteriorating at the bottom-end of the market, leaving first-time homebuyers and low-income households out in the cold.

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