

REAL ESTATE

Phoenix building conversion projects can be an opportunity, but comes with challenges

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Arizona Republic

Published 5:01 a.m. MT Dec. 12, 2023 | Updated 5:02 a.m. MT Dec. 12, 2023

A shift in the office market after the COVID-19 pandemic may have created opportunities for the adaptive reuse of former office buildings but converting them into apartments or other kinds of spaces is easier on paper than in practice.

According to research from Colliers International, Phoenix's office vacancy rate in the third quarter of 2023 was 14.7%, an increase from the previous quarter, and up from the same time last year. Office vacancies were the highest they've been since the fourth quarter of 2013. While not all of the vacant office is suitable for reuse, the vacancy level does have developers thinking of a next life for some buildings.

Phoenix development leaders who have worked on such conversions said those types of projects can be very rewarding, but also difficult to pull off.

One former office building on Camelback Road and Central Avenue that has been under construction for years as part of a conversion into apartments stands as a clear example of the difficulties developers can face.

After the project's general contractor went bankrupt and the site suffered other setbacks, including supply and labor shortages driven by the pandemic, the owners defaulted on the loan, even though the construction was about 85% complete, according to court documents in the case. The lender bought the building back in the foreclosure in November.

The building, called One Camelback, is still in the process of being converted from offices for BMO Harris Bank into apartments, but it is unclear what the timeline will be for the building's completion.

Building must be the right fit

In real estate, developers and adaptive reuse advocates often repeat the adage that the greenest building is one that is already built, meaning repurposing an old building is much more sustainable than building a new one.

According to research done by the National Bureau of Economic Research, done by authors Arpit Gupta, Candy Martinez, and Stijn Van Nieuwerburgh, about 36 office buildings in the Phoenix metro could be potential candidates for conversion into apartments. However, it is unlikely most of those will actually be converted and it's unclear how many developers have sought permission for such projects.

Finding a building suitable for a conversion is use can be one of the hardest parts of the conversion process, even before construction can begin, real estate leaders said.

“The bottom line is, the building has to be the right building, it has to be the right opportunity and the right jurisdiction,” said Jason Morris, an attorney with Withey Morris Baugh who has worked on getting zoning and other permitting approval for adaptive reuse cases.

Morris was involved in the process of converting an office building on Central and Lexington avenues in midtown Phoenix into residential uses. The building is now condominiums and apartment units, but the process took years, Morris said.

The building conversion attempt began before the Great Recession of 2008.

“The end result was a beautiful building,” he said. “But what happened in the interim was we had to deal with the city of Phoenix, which did not have any experience with conversions like this.”

In the case of the Lexington building, the office already had floor designs that were divisible and convertible into apartment units, Morris said.

“The single biggest question is, can you divide the floorplates into usable, efficient and profitable multifamily units?” he said. “The answer to that is often no.”

Changing the use also means adapting all other building systems too, like fire safety, stairwells, elevators and water. Those changes can take time, and can be different than what a developer originally had in mind, which can lead to a project taking longer and costing more.

“Banks won’t wait forever,” Morris said.

Apartments often have less traffic than offices, and can be a “better neighbor,” Morris said, making some conversions attractive to the surrounding area, but the logistics can still be the barrier that halts a plan.

Other conversions permitted, some buildings seem good candidates

Morris said he has gotten rezoning approval on other conversions, but it will be up to the market to determine if those ever take place.

Whether a building is a good candidate for a conversion is likely going to remain a case-by-case basis, he said, but despite the potential pitfalls, he said he would choose to be involved in another.

“I absolutely would do it again,” he said. “It’s great to be part of having a building get a second life.”

A conversion may be a viable option for a functionally obsolete or smaller office building. In Phoenix, near 31st and Northern avenues, a vacant office building is under construction to be converted into apartments, with an additional residential development to be built in the parking lot.

The approach could be a possibility for addressing vacancies in large office buildings as well.

In downtown Phoenix, the former Chase Tower, the state’s tallest building, has been vacant for years since the banking giant moved out in 2021.

No plans have yet been announced for the 50-year-old tower, but a change in use could be likely. JDM Partners, the asset manager for Chase Tower, did not respond to an inquiry about the tower’s future.

Developer: Reuse preserves history, community

Despite the difficulty, some developers say adaptive reuse should be top of mind.

“The existing building is the greenest building,” Walter Crutchfield, partner at Vintage Partners, said. Vintage Partners has done adaptive reuse projects in central Phoenix and northern Arizona. “If we are concerned about climate and we are concerned about our carbon footprint, adaptive reuse should be our first idea.”

Across the street from One Camelback, Uptown Plaza, a retail and restaurant center that was built in the 1950s, underwent a major renovation in 2015, shifting the focus of the center from soft goods retail to restaurants and services.

Crutchfield, the developer of the Uptown Plaza project, said the renovation without the change in use included rediscovering the original look of the building, and then adapting it to modern standards.

Vintage Partners was also involved in a project in Flagstaff that converted a former Harkins Theatre building into an office for the Arizona Department of Transportation, which Crutchfield called “incredibly difficult.”

“There is no manual for that, you have to figure it out on the fly,” he said.

Any delays or additional costs can sink an adaptive reuse project, Crutchfield said. A contractor bankruptcy, like what happened at One Camelback, can completely upend a project.

“You can’t take big hits on an adaptive reuse,” he said.

Vintage Partners was also involved in the Rise Uptown Hotel on Fourth Avenue and Camelback Road, a conversion project that took two office buildings and made them into a boutique hotel.

“Rise was probably the most difficult,” he said. “In old buildings, things show up that you weren’t prepared for, and that leads to delays, and leads to changes to your cost model and revenue model.”

Both buildings at Rise had structural issues that needed to be fixed, he said.

“When you start, you’ve got to finish,” he said. “In the end, you know you’ve created the greenest possible development, and you preserved history, you preserved community.”

'A weird spot': Economy is on solid footing despite widespread anxiety, experts say

Reuse project sparks reinvestment

In midtown Phoenix, one of the most prominent additions to the area has been the adaptive reuse of Park Central, a former mall on Central Avenue that was converted from department stores to office space. The conversion, done by a partnership between Plaza Cos. and Holualoa Cos., has been touted as a catalyst for growth in the area.

Repurposing the mall meant demolishing work done in the past two or three renovations to get down to the skeleton of the buildings, said Jon Stelzer, executive managing director of development, design and construction for Plaza.

“We discovered the structure itself was in very good shape, we could use it and not have to reinvent the wheel,” he said. “We didn’t really know until we took off the layers, we got lucky that we didn’t have many downfalls.”

The former department stores are now almost fully leased by companies that have been attracted to the renovated former mall. By using the old stores, the office buildings have taller ceilings and open floor plans, and the renovation included adding patios and roll-up garage doors to give businesses indoor and outdoor working space.

While converting a building might be trickier than building one from scratch, Crutchfield said he expects to see creative developers try it more in the future.

“I think it’s one of the best ways to deliver good development,” he said. “As it relates to any asset, it takes creative, persevering developers to not just see the next use, but devise a plan, a path and financing to deliver the adaptive reuse.”

Crutchfield said he thinks the city’s existing stock of office buildings will “give tremendous opportunities on the residential side” for developers who want to take on the challenge.

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