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The office apocalypse will see a wave of buildings demolished or converted to residential, New York City real estate exec says

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Marianne Ayala/Insider

The office apocalypse is real and it's happening in small increments that will eventually lead to a wave of demolished or converted properties, according to JLL senior managing director Bob Knakal.

The New York City property exec and veteran real estate broker pointed to potential trouble heading for the US office space, thanks to the plunging demand for office buildings since the pandemic, and poor lending conditions across the commercial real estate sector.

That means empty office properties could soon see their last days, Knakal warned, as owners will choose to repurpose their buildings or, if it's more cost-efficient, tear them down.

"I think what we're going to see is a combination of conversions to residential and demolitions to make way for new construction, that's going to help get rid of a lot of this overhang of vacant office space that we have," he said in an interview with CNBC on Thursday.

Experts have been warning of trouble in the commercial real estate sector for the last year as credit conditions in the economy tighten. Banks are now less willing to lend on risky commercial real estate loans, or will only do so at higher interest rates than they have in the past.

Many commercial real estate mortgages are financed at interest rates around 3.5%-4%. Refinancing today would mean borrowing costs for property owners would about double, Knakal estimated, something experts have warned could lead to a wave of distressed CRE debt and forced property sales.

Lending pressures will be exacerbated by the fact that office buildings have become less profitable since the pandemic. Persistent work-from-home trends have pushed office vacancy rates to their highest levels ever, according to the National Association of Realtors. New York City alone has around 100 million square feet of empty office space, Knakal estimated.

The office sector is probably the most challenged type of commercial real estate, Knakal said, especially for older, second-tier office buildings, which are in lower demand than newer properties.

Older buildings will need to have "something happen" to revive interest, Knakal said. Conversion into residential properties is a likely possibility, he predicted, given the severe shortage in housing inventory across the US.

"We need housing across the income spectrum in almost every city in the country. And if you look at the solutions to all our problems ... all the solutions to housing problems are on the supply side," he said.

Some buildings, though, can't be remodeled due to physical constraints. And for some properties, demolishing would actually be more cost-effective, given that commercial real estate values have plunged around 11% in the past year.

"If you take the price of the building plus the price of demolishing, some of those values are less than land value," he said.

Other experts have warned of a major restructuring to America's office building supply. Class B or lower-grade office buildings could become obsolete, one property exec warned. Office buildings, meanwhile, could soon double the price decline they saw in 2023, the real estate firm Cohen & Steers estimated.