

TOP STORIES IN U.S.

- 1 of 12 **Obama Lays Out Vision on Foreign Policy**
- 2 of 12 **Poet, Author Maya Angelou Dies at 86**
- 3 of 12 **Report Faults Conditions at Phoenix VA**
- Hagel Orders Review of Military Health ...**

U.S. NEWS  
**Developers Turn Former Office Buildings Into High-End Apartments**  
 In Cleveland and Other U.S. Cities, Rents for Residential Units Rise Amid Sluggish Office Demand

Email Print 0 Comments

ARTICLE FREE PASS  
 Enjoy your free sample of exclusive subscriber content.

50% off SUBSCRIBE NOW >

By ELIOT BROWN CONNECT  
 Updated May 7, 2014 12:05 a.m. ET



There's a realignment taking place in U.S. cities as landlords repurpose their buildings from office spaces to living spaces, bowing to a historic anomaly that's turning residential and commercial real estate upside down. Eliot Brown reports. Photo: Billy Delfs for The Wall Street Journal.

CLEVELAND—During its heyday, the East Ohio Gas building was home to some of the most well-respected companies in the state, from the utility company that bears its name to national accounting firm Deloitte & Touche LLP.

But now the downtown 21-story tower, which has been vacant for five years, is set for a summer reopening as a luxury apartment building.

The property, named Residences at 1717.

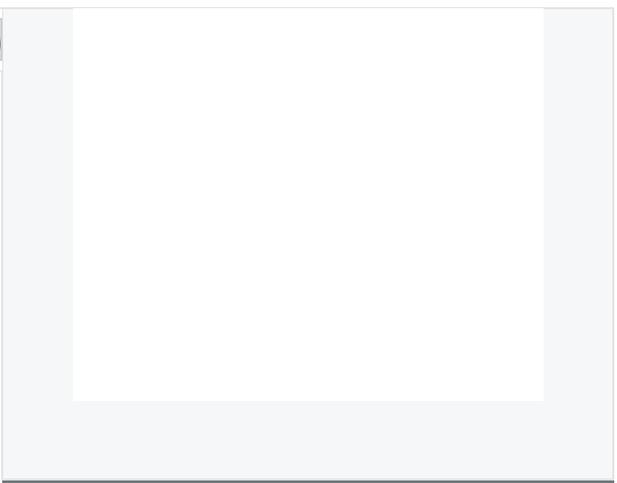
RECOMMENDED STORIES



High office vacancy rates are prompting developers to convert buildings to residential use. Above, an old Cleveland property gets a makeover. *Billy Delfs for The Wall Street Journal*

center. For the privilege, the landlord plans to charge as much as \$2,575 a month for a two-bedroom unit—or more than \$17 a square foot annually. That's about 20% higher than what businesses were paying for space in the building when it still operated as an office tower.

The Residences are in the vanguard of a major realignment taking place in cities across the U.S. as landlords repurpose their buildings from spaces where people



Popular Now What's This?

ARTICLES

- 1 Little Children and Already Acting Mean**
- 2 The Shawshank Residuals**
- 3 Breaking the Five-Minute 'Beer Mile' Brews Controversy**

OPEN ^

- 4 Hope Fades in Brazil for World Cup Boost**
- 5 CEO Pay Rises Moderately; a Few Reap Huge Rewards**

VIDEO **Beer-Chugging**

work to spaces where they sleep. In the process, the traditional economic relationship between residential and commercial real estate is turning upside down.

"The rental market is very tight, with lots of demand," says Christopher Thornberg, an economist with Beacon Economics in Los Angeles. "The pace of absorption you're seeing in the office market is just so slow compared to past cycles," he says. "We just have too much office space out there."

### Converting Downtown USA

Several urban areas are seeing a reverse trend in real estate, where rents for residential units are rising amid sluggish office demand. In Cleveland, for example, developers are turning some former office buildings and warehouses into high-end apartments.



Historically, office space has commanded substantially higher rent than residential space. But that is starting to change, especially for older buildings that have lots of architectural charm—often located in urban downtowns—but are no longer desirable as top-notch office space.

At the end of 2013, the U.S. apartment vacancy rate stood at 4.1%—the lowest since the end of the dot-com boom in the early 2000s, and below its 5.7% average rate since 1980, according to an analysis of 50 top markets by property-data firm Reis Inc. Meanwhile, the office vacancy rate was 16.7%—only a nudge down from the 17.6% post-economic crisis high reached in 2010 and well above its average of 14.9% since 1980.

That residential rents are surpassing office rents reflects the path of the U.S. economic recovery as well as demographic and lifestyle shifts. During a typical cycle, demand for office space picks up within a year or two after the recovery begins, allowing office landlords to fill their vacancies and charge higher rents.

But in this recovery, office vacancies have remained stubbornly high as employers have been slow to expand, leaving hundreds of millions of square feet vacant. While prime-quality office space still commands top dollar, the economy has been especially harsh on many older buildings, which can't compete with newer office space for tenants and never fully recovered from earlier economic downturns.

At the same time, demand for rental apartments is so strong that landlords in many cities—including here in Cleveland—report monthslong waiting lists from people eager for places to live, especially downtown properties near employment centers.

The economic recovery has "been the kind of one that gets people renting...but not a lot of people back to work using office jobs," says Ryan Severino, an economist at Reis. "Normally you wouldn't expect to see this kind of divergence where apartment vacancies are plummeting and office vacancies are stuck."

### 1 Runners Gut it Out



### 2 Why the Price of Gold is Falling



### 3 Women React to Isla Vista Shooter Elliot Rodger



### 4 Microsoft Surface Pro 3 Review



### 5 World Cup 2014 Losing Support in Brazil





Doug Price, CEO of K&D Management, is bullish on conversions. *Billy Delfs for The Wall Street Journal*

While conversions in New York City have been occurring for years, the trend is now spreading to cities around the country where older buildings and empty offices are in plentiful supply. The promise of federal tax credits for rehabbing historic properties is another incentive to focus buildings with a past.

Places like Cincinnati, Baltimore, Richmond, Va., and Rochester, N.Y., all have record numbers of conversions under way. In Buffalo, N.Y., and Providence, R.I., officials have been discussing turning the tallest buildings in town—once home to some of the cities' largest employers—into apartments. Billionaire investor Dan Gilbert has said he is considering conversions for some of his office buildings as part of his efforts to revitalize downtown Detroit.

In Pittsburgh, developer Millcraft Industries Inc. last year converted a 16-story office building once occupied by the state of Pennsylvania to luxury apartments that rent for about \$22 a square foot annually. The building now has 100% occupancy. The company considered leaving it an office building, but estimated that it would potentially get just \$20 a square foot, with the uncertain prospects for full occupancy.

"It's a matter of supply and demand and people want to be downtown," says Lucas Piatt, the company's chief operating officer. "I think we've hit a tipping point."

Indeed, even where apartment rents are similar to office rents, owners stand to take in more income from apartments given that apartments are often fully rented while office buildings aren't.

The same principles apply in Cleveland, where many of the largest employers have shrunk or consolidated space and downtown office vacancy has hovered around 19%.

While the gritty city center had for decades struggled to revitalize, now a surge in demand from a generation of 20-somethings wary of owning a home and interested in urban living has pushed apartment vacancy down to about 5%, with rents rising.

By 2015, the Downtown Cleveland Alliance projects that the area will have 7,071 residential units, up from 2,881 in 2000. That includes nearly 600 units in seven office-to-apartment conversions that are under way—the most ever at one time for the city.



After five years of sitting empty, the East Ohio Gas building is being converted into apartments. During its heyday, the Cleveland property had served as home to a host of large companies, including Deloitte & Touche LLP. *Billy Delfs for The Wall Street Journal*

One real-estate concern taking an aggressive stance amid the changes is K&D Management LLC, a privately-held company headed by Douglas Price and his ex-wife Karen Paganini.

The business partners started the company in 1984—when they were still married—buying an eight-unit apartment building after watching a real estate focused infomercial on TV. They gradually built up a portfolio that included more than 12,000 units to become the largest apartment owner and manager in northeast Ohio with more than \$100 million in annual revenue, according to Mr. Price.

Until recently, K&D focused on the suburbs around Cleveland, eschewing the downtown because rents were low. But in 2008, after seeing some growing demand from young renters, the company bought 668 Euclid, a mostly-vacant office building that had once been a department store. K&D converted the building to 236 luxury apartments aimed at young professionals who work downtown. At the time, the economy was reeling and Mr. Price braced for a slow reception. Instead, the building leased up quickly. "We were moving people in as fast as we could finish the units," he says. "We built it—they came."

In 2011, the partners turned their sights on the Hanna Building Annex, a modest eight-story office building on the east end of downtown that they converted to 102 apartments. That, too, leased up rapidly and now has a waiting list of six to nine months.

While working on the Hanna project, K&D became intrigued by the East Ohio Gas building, which had lost its largest tenants more than a decade earlier. Mr. Price liked the configuration: Its small floors with large windows make for good apartment layouts. In 2012, he agreed to buy the 1950s-era building for \$12 million. Crews worked three shifts during the winter to complete the conversion and the building



Cleveland's downtown demographics have changed, with more young people moving to the urban center to rent upscale apartments. *Billy Delfs for The Wall Street Journal*

is scheduled to open in July.

K&D says the federal tax-credits for historic preservation, as well as other incentives, can cover as much as half of the cost of a job. The conversions have been so profitable, says Mr. Price, that K&D is now selling properties in the

suburbs to focus on downtown and is in talks to buy at least two additional office buildings that it plans to convert.

The growing demand for apartments has a potential downside to Mr. Price and other developers: The days of scooping up deals on the cheap may be coming to an end.

"It's pushed the price of the buildings up," says Mr. Price. "We've been a victim of our own success."

Write to Eliot Brown at [eliot.brown@wsj.com](mailto:eliot.brown@wsj.com)

Email Print 0 Comments Order Reprints [Social Media Icons]

WSJ In-Depth



Hope Fades in Brazil for World Cup Boost



Sherpas, Fate and the Dangerous Business of Everest



Ex-Governor Auditions as Clinton's Populist Challenger



Amazon Murder Raises Brazil Tensions



Tragedy Worsens Malaysia Airlines' Woes



Deathbed Deal That Returned Nazi-Looted Art

SPONSORED RESULTS

- 10 Stocks To Own, Stock Picks For 2014, Top 10 Stocks For 2014, Top Income Funds

- [Fixed Income Investments](#)
- [Stocks To Trade](#)
- [2014 Crossover SUVs](#)
- [10 Best Dividend Stocks](#)
- [Best Investment Funds](#)
- [Best Investments For 2014](#)





**SUBSCRIBE NOW** ▶

DIGITAL + PRINT



THE WALL ST



[Subscribe](#) / [Login](#)

[Back to Top](#) ↗

**Customer Service**

[Customer Center](#)

[New! Live Help](#)

[Contact Us](#)

[WSJ Weekend](#)

[Contact Directory](#)

[Corrections](#)

**Policy**

[Privacy Policy](#)

[Cookie Policy](#)

[Data Policy](#)

[Copyright Policy](#)

[Subscriber Agreement & Terms of Use](#)

[Your Ad Choices](#)

**Ads**

[Advertise](#)

[Place a Classified Ad](#)

[Sell Your Home](#)

[Sell Your Business](#)

[Commercial Real Estate Ads](#)

[Recruitment & Career Ads](#)

[Franchising](#)

[Advertise Locally](#)

**Tools & Features**

[Apps](#)

[Emails & Alerts](#)

[Graphics & Photos](#)

[Columns](#)

[Topics](#)

[Guides](#)

[Portfolio](#)

[Old Portfolio](#)

**More**

[Register for Free](#)

[Reprints](#)

[Content Partnerships](#)

[Conferences](#)

[SafeHouse](#)

[Mobile Site](#)

[News Archive](#)

[Jobs at WSJ](#)

Copyright ©2014 Dow Jones & Company, Inc. All Rights Reserved.