September 27, 2021

Members of the Zoning Commission
Mr. Andrew Trueblood, Director
DC Office of Planning
1100 4th St SW, Washington, DC 20024

via email: zcsubmissions@dc.gov

RE: Case No. 21-05: Support for Amendment to Subtitle C – Inclusionary Zoning XL, Phase #2 – Applying Inclusionary Zoning to Conversions of Non-Residential Gross Floor Area to Residential Use

Comments by Leslie A. Steen

Please accept this letter as comments to be provided to the Zoning Commission on the above referenced case.

I am a resident of the Ward 3 in the District of Columbia. Professionally, I have spent most of my career as a housing developer/owner/asset manager of affordable housing after 7 years as a market rate housing developer, served as the District's first Housing Chief under Mayor Fenty, and engage in housing policy advocacy.

I appreciate the opportunity to comment on the proposed Amendment. I support the concept of applying Inclusionary Zoning to commercial conversions to residential use. Having listened to the Zoning Commission's last hearing on this matter, I would like to make the following observations.

- Markets shift and pendulums swing. This is all part of investing in real estate.
    - Long before COVID, the suburban office market was shrinking. Five years ago I considered purchasing a suburban office building in need of renovation to convert it to housing. I did not pursue it because there were other more attractive opportunities.
    - At the same time, pre-COVID, the downtown office market started to shrink because tenants were seeking less space per employee.
    - Next came COVID causing shifts. The suburban office market is recuperating.
    - Before COVID in the Washington metro area market rate housing started to experience higher vacancies, in large part because we had overbuilt the high end. I know because the company I work with owns one, in joint venture with Bozzuto.
    - The market absorption is showing us that developers need to find ways to provide housing at more moderate rents. Maybe it is time to end the arms race for which project can provide the most glamourous, high end amenities.

- Now COVID has hit and all of the markets are disrupted.

- Fewer people are going to the office. Yet, national trade papers now report that office occupancy is recuperating. There is more leasing activity.
- In high income residential tenants have been able to pay their rent because they are still employed remotely.
- However, many low income tenants are not employed. They are getting help in paying the rent so that they do not get evicted. The rent collections at the firm I work are at 92%. The trade press reports that rents are escalating.
- Markets are disrupted and will continue to be disrupted for a while. The local markets are shifting and will continue to shift.

- Costs have skyrocketed. They were escalating prior to COVID. Then the supply chains got disrupted. First, we heard about the problem with lumber. Then lumber prices stabilized and now there are other problems. Supply chain problems exist in many sectors. One can't buy refrigerators due to the shortage in chips. Tanks are anchored off shore waiting to unload. There is great uncertainly that makes all development very difficult and risky.

- It is hard to say what the enduring impact of COVID will be. Are people going to return to the city for both office and residential? Are young people leaving the District for less expensive cities? What is the impact of demographic changes? Marcus & Millichap had a webcast worth reviewing: Marcus & Millichap and IPA's Real Estate Investment Roadmap: Demographics Drive Transformation https://event.on24.com/wcc/r/3357967/84A84148830D92A34CE2B187D6D3C205.

  The webcast showed the fluctuations in the number of people from the Baby Boomers (78.2M) decrease to Gen X (69.6M average age 46 now) and then the increase to Gen Y (88M average age 26 now). The Gen Y population can't afford the rent that the Gen X can afford.

  - No one has the answer of where the COVID impact will end up. Where will local shifts in the market end and when and what will the next cycle be. Have we tapped out the top of the market residential just as the cost of construction has skyrocketed?

- Developers deal with these risks. It is part of what is considered when making a real estate investment. There are no guaranteed returns, although in Washington for the past couple of decades, the returns have been stable.
  - This is changing, and the District's owners/developers will adjust. If a product type diminishes in value, this change is part of the risk an owner/developer takes.
  - The government is not responsible to make an owner whole.

- Conversions: I have done conversions of schools and warehouses to residential. What's entailed?
  - The first thing to remember is that the formulas don't work well. Every conversion is unique. Every rehab is unique. Conversions are more complex.

- E.g., in doing residential rehab one learns that a garden apartment rehab is quite different from a high rise, similarly a historic rehab is quite different from a non-historic building.
- A conversion of a school to housing is especially tricky. For example, schools have much wider hallways and higher ceilings than typical residential buildings, so costs such as that for utility and cleaning are much harder to project.
- Developers love formulas that they can use repeatedly. Buy the land at $X per square foot, build the building at $Y per square foot, rents at $Z per square foot. What are the operating costs per square foot? What is the cap rate?
- Build something from the ground up in a stable market and the formulas work. When there is uncertainty, then you have do your homework, work with your instincts, and convince the lenders. It is much harder.
- For example, when ones takes an operating building and changes the use, one has to vacate the building. That's expensive.
    - Doing affordable housing preservation, I face these risks all of the time. Conversions are much like the process when one renovates and preserves an occupied building. When the buildings are young enough, with good logistics, one could renovate with the tenants in place. Today the buildings in our area are older, so during the renovation one has to vacate the tenants, relocate them to other affordable housing and then bring them back, all on strict schedules imposed by the government regulations for the funds that I use.

- I recently considered trying to buy and convert an underutilized commercial building to apartments in a Rock Creek West NW community. I know the building better than most because I was the largest tenant at one time. I backed off and didn't approach the owners because of the existing leases. Not only would I have to empty the building, loose that income stream, and carry it vacant, but the owner had recently leased to a new tenant – a bank. Banks typically get long term leases, and substantial improvements are made. The other tenants could probably be bought out, or the space was already vacant, but I knew it would be difficult to afford the buy-out of the bank. In my judgement the numbers would not work for my type of endeavor. Someone else might do it, or the owner will continue in ownership and clip coupons.

- There are many things to consider when converting an occupied or vacant building.
    - The purchase price of the building is one. When an owner sells to a new owner or to a new entity it controls, the land cost will reflect the diminishment of the value of the building as an office building.
    - This is where the rub is. No one wants the land/building value to diminish, but if the owner wants to convert it, it already has.
    - The cost of the land or land and building will factor in the value of the market rate and the IZ housing units.
        - With IZ in place, this will be a known and stable factor without risk for the developer.

        - The rents on the IZ units will be known. The IZ units will have higher occupancy rates. The operating costs will be the same for all of the units. The rehab costs will be the same for all of building. The capital deployed will look at the net operating costs and return on investment.

- The problem with conversions are all of the other unknowables. These unknowns do not follow the usual formulas. They entail risk that the developer wants to minimize.
    - Which nuances of a conversion costs the most? Certainly, not the affordable housing requirement imposed by zoning. To repeat, affordable housing/IZ housing is not an unknown. It is exceedingly stable.
- The unknown factors that will cause conversions to not happen include the tenant buy-outs, vacancy during development, changes in HVAC, plumbing, elevators, etc.
    - With the age of many of our buildings, replacing the old plumbing and HVAC lines might be more affordable than repairing old ones that are coated with asbestos insulation.
    - The impact of IZ requirements will be known and minimal.

- What should the Zoning Commission do?
    - The reality is that many owners are faced with having to go through major transitions, whether it is a transition from office to residential or the risks and disruptions associated with rehabbing an office.
        - They are going to have to take that risk at a time of uncertainty in the office market.
        - If an owner owns an office building, and the market shifts, which it was before COVID, owners will have to adjust. The market will play out. Some building owners will lose value and others might be fine.
    - The zoning commission establishes how an owner is allowed to use his/her property. It is a right bestowed by the government.
    - It is the government's role to intervene to address the broader and recognized needs of society when the market does not provide them, what economists refer to as "market failure."
    - The government zones properties to address the broader and recognized needs of society.
        - It is not the government's role to intervene in enabling transitions from commercial to residential unless and until the diminished properties become detrimental to the broader community.
        - Since the market fails to provide affordable housing, it is the government's role to enable it, just as the Zoning Commission imposed retail requirements in the downtown commercial zones in the 1990's.
        - At the time the market was producing all commercial and no retail because commercial rents were higher. Retail left the city for the suburbs.
        - Accordingly, the Zoning Commission required retail inclusion. Owners/developers were unhappy but complied. For the short term some lost revenue, but today these retail spaces are benefits these

owners by ensuring a vibrant downtown to the benefit of the property owners.

- The inclusion of affordable housing will benefit these owners as well because the District needs housing at all income spectrums to be a vibrant and economically robust.

o Today, we need affordable housing, especially in the higher cost areas of the District. The market is failing to produce it. The zoning commission can intervene and require it.

o One last point. The zoning commission should not settle for 80% of AMI housing. This is market housing is large parts of the District, including Ward 3.

▪ If new buildings in upper northwest are produced with apartments affordable to households with incomes of 80% of AMI, these tenants will be taken out of many of the existing apartment buildings throughout the upper northwest and back-filled by others with the same income profile.

- It will not increase the income diversity nor provide equity to those with lower incomes.

Thank you for your attention to this important matter.

Respectfully,

Leslie A. Steen