

**MEMORANDUM**

**TO:** District of Columbia Zoning Commission

**FROM:** Jonathan Kirschenbaum, AICP  
Development Review Specialist

Art Rodgers  
Senior Housing Planner  
JLS  
Jennifer Steingasser, AICP  
Deputy Director, Development Review & Historic Preservation

**DATE:** October 4, 2021

**SUBJECT:** ZC Case 21-05 – Supplemental Report #2 for a Proposed Text Amendment: IZ-XL Phase #2 – Applying Inclusionary Zoning to Conversions of Non-residential Buildings to Residential Use<sup>1</sup>.

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**I. BACKGROUND**

At its June 28, 2021 public hearing, the Zoning Commission (“Commission”) considered text amendments for Case No. 21-05 and heard public testimony about applying the existing Inclusionary Zoning (“IZ”) program to conversions of non-residential buildings to residential use (“conversion”). The IZ requirement would apply to conversions regardless of whether the size of the building is retained or enlarged and only in zones where IZ already applies.

Prior to taking proposed action, the Commission requested that the Office of Planning (“OP”) respond to comments submitted to the case record, review prior conversions to understand why they were financially feasible, and contact all Advisory Neighborhood Commissions (“ANC”) to provide another opportunity for their review and comment on the case.

OP continues to recommend **approval** of this case based on the text amendments in the OP public hearing report (Exhibit 9).

**II. ANALYSIS OF COMMENTS**

**ANC Notices**

The Office of Zoning sent out the initial notice of public hearing on May 4, 2021 (Exhibit 6) ([View Exhibits 21-05](#)). OP contacted all ANCs on August 18, 2021 by email (Exhibit 7) to serve as a reminder that the case was heard at a public hearing and that the Commission would like to provide an additional opportunity for their comment on the case. No ANC comments were submitted to the case record at the time this report was filed.

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<sup>1</sup> Other than Downtown (“D”) zones that are exempt from the IZ program.

## **Public Comments**

The Commission requested all individuals and organizations that testified at the public hearing to upload their testimony to the case file. To date, testimony and comments have been received from several individuals and organizations at Exhibit 10 and Exhibits 12 through 16. Below, OP has summarized and responded to the comments provided at both the public hearing and submitted to the case file. They are also addressed through the broader discussion in Section III of this report.

## **Financing and Housing Production Comments**

1. IZ regulations should be flexible and clear and simple.
2. Applying IZ to conversions would act as a disincentive for conversions by making it difficult for conversions to obtain financing and it could increase the likelihood that a property owner would not pursue a conversion.
3. There should be financial structuring to help incentivize conversions, i.e., tax abatements or land only tax assessments.
4. How will the text amendments impact the changing office market?
5. Will the text amendment meet the goal of creating more affordable housing?

OP Response: The conversion regulations should be as clear and simple as possible. Building in flexibility to cover the diversity of potential scenarios can create complexity that makes clarity and proper enforcement more difficult. The Zoning Regulations do offer flexibility through Planned Unit Developments (“PUDs”) and relief through Subtitle C §1007.1.<sup>2</sup>

There is potential for a small number of hotels to remain non-residential uses. However, OP believes there will be a net gain in IZ units when IZ is applied to existing structures compared to the hypothetical loss of conversion projects that choose to stay non-residential. This is discussed in greater detail in Section III.

Only the DC Council has the ability to authorize tax abatements. The Council did recently pass the Tax Abatement for Affordable Housing in High-Needs Areas, which targets Rock Creek West where OP’s conversion report identified an increased likelihood of conversions.

The office market has been geographically shifting away from Rock Creek West, but OP’s analysis suggests that due to the limits on office floor-area-ratio (“FAR”) in mixed-use (MU) zones, other than Downtown zones (“D zones”), there is usually additional residential FAR available for redevelopment. Therefore, the proposed amendments will not have an impact on the supply or demand of office uses in these areas. This is discussed in greater detail in Section III.

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<sup>2</sup> §1007.1 permits an applicant to demonstrate that IZ “would deny an inclusionary development owner economically viable use of its land.”

### **Density Comments**

6. Some conversions are already built to their maximum zoning envelope and do not have the ability to achieve additional bonus density to offset the cost of providing affordable units.
7. The text amendments should only apply IZ to conversions when that building is in a zone where bonus height and density are available. The IZ requirement should only be attached to the additional density gained.

OP Response: Due to the limits on non-residential FAR in mixed-use (MU) zones there is likely additional density available for redevelopment. For properties where there is not additional residential FAR available, the decision about conversion becomes a business decision by the property owner as to how they will maximize land value given potential costs, revenues, and profit requirements. As discussed in greater detail in Section III there are several options available for property owners when considering a conversion.

### **Vesting Comments**

8. There should be a delayed effective date for IZ to apply to conversions in D zones to allow existing conversion deals to proceed under current economic assumptions.

OP Response: As stated in the OP public hearing report and at the public hearing, there is no proposal to apply the IZ program to conversions located in any D zone where IZ does not already apply.

OP does not recommend an extended effective date. This case was set down on March 11, 2021.

### **Set-Aside Requirements Comments**

9. Consider an alternative set-aside requirement for conversions that is lower than the existing IZ program requirement.

OP Response: OP recommends keeping the set-aside consistent with existing IZ requirements, which also helps to keep the regulations “clear and simple.”

## **III. ANALYSIS OF CONVERSIONS**

### **Background**

The Commission requested OP review prior conversions and provide more information about why they were financially feasible as they relate to the public comments above. First, it’s important to briefly summarize how the proposed text amendments will apply the IZ program to conversions:

- The proposal applies IZ only to conversions of non-residential buildings to residential use in zones that permit mixed-uses. D zones, which are generally located in Central Washington, would not be effected by the proposed text amendments because they are zones already exempt from the IZ program.

- The proposed text amendments would apply to conversions regardless of whether the size of the building is retained or enlarged. The 50 percent expansion threshold before IZ applies to units in the existing structure (§C-1001.4) would not apply to conversion from non-residential to residential. The 50 percent expansion is in part to address the complexity of IZ applying to already occupied residential buildings. This is not the case when the existing space is converted from non-residential to residential.<sup>3</sup>

Properties likely to convert and that would be subject to the proposed text amendments are located in areas generally zoned mixed-use (MU). MU zones that permit mixed-uses tend to significantly restrict non-residential uses compared to residential uses. Mixed-use zones, on average, permit 80 percent more residential FAR than non-residential FAR. For example, in the MU-4 zone, which is the most commonly mapped mixed-use zone, residential use is permitted 100 percent more FAR when the IZ bonus density is used<sup>4</sup> than non-residential use FAR.

In the majority of conversion cases there is significant expansion potential because there is FAR available to construct additional residential floor area. The IZ affordability requirements are also accompanied by a permitted 20 percent increase in density regardless of the form the residential development takes. There is likely to be few conversions that are already built to the maximum residential FAR permitted by the MU zones.

### **Completed, Under Construction, and Planned Conversions**

There are 22 conversions that are either completed, under construction, or planned where there was a significant change in existing uses and Attachment I illustrates the development patterns of these conversions. There is a wide range of diversity between sub-markets, site conditions, processes, and other variables for conversions, but the main difference is between those projects that increased existing FAR and those that did not.

The majority of projects (12 out of 22) represent a significant expansion of the existing building envelope, either through horizontal or vertical additions, or through demolition of the existing structures and construction of a new development. Five were PUDs and seven were matter-of-right or BZA cases. IZ applied to all these, but the set-aside requirement was often limited to the construction of new floor area only.

Ten projects represented a conversion where there was no substantial change in FAR. Two were in the D zones not subject to IZ and one was an institutional use. The remaining seven appear to follow certain patterns or circumstances, including:

- Office buildings in limited office sub-markets that were either non-conforming due to zoning restrictions on use or FAR, and/or with narrow floor plates that made them highly suitable for conversion to residential; and
- Hotels, including some that had previously been housing, in zones where differences in permitted FAR between hotel and residential use are minimal.

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<sup>3</sup> The proposed rules retain the delay until a 50 percent expansion for pre-existing residential due to complications caused by applying affordability requirements on potentially occupied units and other factors.

<sup>4</sup> A non-residential use in the MU-4 zone is limited to a 1.5 FAR compared to a residential use that is allowed a 3.0 FAR for providing IZ units.

Non-conforming office uses are very rare. One on Virginia Avenue, NW had been a residential building built in 1940, converted to office despite it being in a RA-5 zone and recently converted back to residential. Two in Buzzard Point were non-conforming structures as a result of the rezoning to CG/W-2 overlay,<sup>5</sup> which limited non-residential use to 2.0 FAR. Without federal leases, the existing structures rapidly declined in value in terms of office, which created market conditions that facilitated the conversion to residential uses.

Four conversions are hotel to residential. The most notable is the historic Marriott Wardman that converted to condominiums in 2016 and broke the record for the highest condominium price per square foot. One property converted in 2008, while another in Georgetown is currently under construction, and finally a hotel recently sold with the intended purpose of converting to senior assisted living.<sup>6</sup>

Most zones allow hotels the same FAR as residential uses, so in many cases there is less opportunity for expansion under zoning. However, OP's analysis determined that of the 94 hotel properties outside of the D zones, approximately 61 percent, including the remaining portions of the Woodley Park Marriott, have sufficient development potential under the recently adopted Future Land Use Map to make the properties suitable for conversion and/or redevelopment through map amendments or PUDs.

A hotel becomes a candidate for conversion when both the market for hotels has weakened, and the building has aged into lower quality. In this scenario, when the hotel's additional development capacity is limited to the bonus density that accompanies IZ requirements (because the hotel is already built to the same FAR permitted by matter-of-right residential) then OP acknowledges there is an increased chance that property owners may choose to retain the existing use due to the impact of an affordability requirement on the potential value of changing to residential.

Of the hotels without significant additional capacity, OP's [Assessment of Commercial to Residential Conversions in the District of Columbia](#) (Exhibit 8) concluded, "...a small number of hotels outside of Central Washington are more likely to include properties with lower building quality that may be more conducive to conversion." This means that many are in good condition and may stay as hotels and a few aging properties are likely conversions.

## **Conclusion**

The decision to pursue a conversion is a business decision by the property owner as to how they will maximize land value given potential costs, revenues, and profit requirements. Property owners have several options, including:

1. Retain existing non-residential uses (IZ would not apply);
2. Minimize costs of redevelopment and only convert the existing FAR from non-residential to residential (IZ is proposed to apply to the residential use);

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<sup>5</sup> CG/W-2 Overlay was part of the 1958 version of the Zoning Regulations.

<sup>6</sup> Older adult assisted living facilities are exempt from IZ under §1001.6 (b).

3. Expand vertically or horizontally to access the additional density as the existing structure and site conditions permit (IZ is proposed to apply to all existing and new residential uses); or
4. Raze the existing structure and redevelop the site to the full density permitted by the zone. In some cases, this could be supported through a rezoning or PUD (IZ would apply to new residential use).

OP's economic modeling in the past has demonstrated that the 20 percent IZ bonus density increase is an effective balance that retains a base value of land as determined by the market. In some cases, the 20 percent increase is subject to site conditions that limit a property owner's ability to access the full bonus density. In fiscal year 2020, approximately 81 percent of all IZ developments received an average 14 percent increase in density.<sup>7</sup>

However, the IZ pipeline includes another 19 percent of projects that did not access even matter-of-right density due to site conditions such as size of land, slope, or the historic nature of the property. There is little indication that the inability to achieve the bonus density impeded individual sites from being developed. There have been no requests for relief under Subtitle C §1007.1, which permits an applicant to demonstrate that IZ “would deny an inclusionary development owner economically viable use of its land.” And there have been no lawsuits claiming a taking.

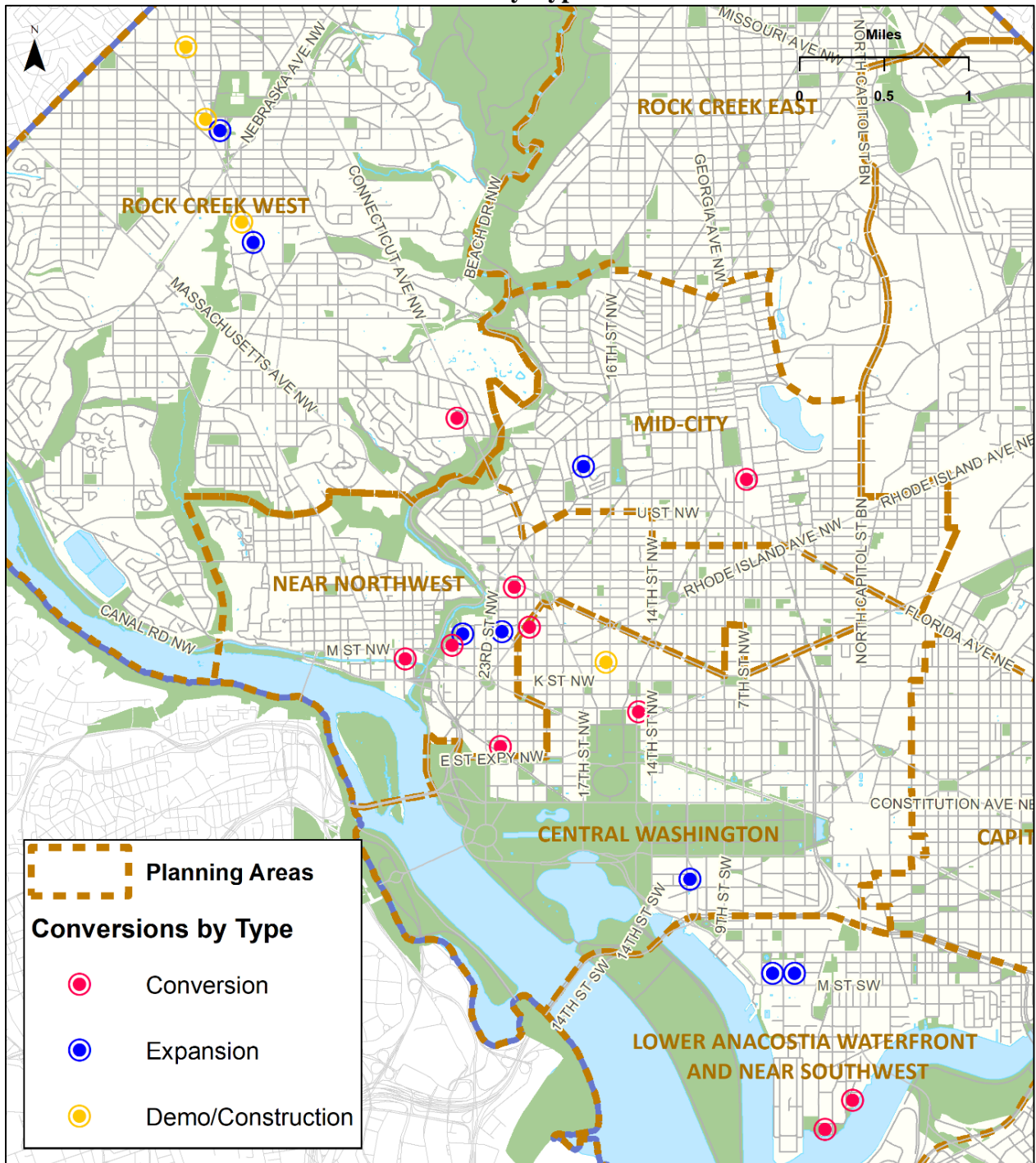
There are different factors that determine whether a property is suitable for conversion. As discussed above, when an existing non-residential use is no longer viable, a property owner has several options to ensure the best use of the land, including retaining existing non-residential uses or converting to residential uses.

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<sup>7</sup> Inclusionary Zoning Annual Report for Fiscal Year 2020, Department of Housing and Community Development.  
<https://dhcd.dc.gov/node/1554046>

### Attachment I

### Non-Residential to Residential Conversions by Type<sup>8</sup>: 2008 to 2021



Source: DC Office of Planning, October 2021.

<sup>8</sup> Conversion is defined as a change in use with little or no change in FAR. Demo/construction is defined as a site redevelopment involving the substantial demolition of existing structures and new construction. Expansion is defined as the existing structure is largely kept intact but there is either a vertical or horizontal addition to the building.