

Good growth observed in office to residential conversions in certain regions

Office space to residential conversions are gaining in popularity, particularly in CBD areas where there is a dearth of mid-market residential property for young professionals looking to live closer to work. According to Joel Rosen, MD at Prime Residential, who has himself been involved in a number of these conversions, there has been a strong interest from commercial property owners as the traditional deal flow has slowed due to tough economic conditions.



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“There are currently a large number of office vacancies, especially in some areas of Johannesburg. With fewer new commercial tenants entering the market, there is often no other option but to look at alternative ways to make these investments work for you,” Rosen explains.

More attractive asset class

According to Rosen, residential property has become a more attractive asset class as it is delivering better returns.

There is a growing number of young professionals who are looking to live closer to where they work. However, at the same time there has also been a drop in the supply of affordable units in some of the CBDs around the country. These two driving factors have created a healthy market for property conversions.

“The residential rental market in the middle market space has shown good occupancy, healthy collections and solid annual growth. High demand, low supply and good yields all combine to make property conversions an attractive option for many investors,” says Rosen.

Caveat emptor still applies

While the opportunities to convert existing office space into residential units is attractive, there are some factors which should be considered before rushing in.

“Not all CBDs offer the same opportunity. For instance, Cape Town has seen a number of new higher-end office to residential conversions come on stream in recent months, resulting in an oversupply. However, there has been a lack of new affordable rental supply as developers struggle to see solid financial returns in the lower-end rental market. What’s more, the cost of inner-city properties in Cape Town is far higher than in other metropolises like Durban and Johannesburg which, together with the costs of the conversions, makes the returns less attractive,” explains Gary Palmer, CEO of Paragon Lending Solutions.

When it comes to location, Rosen agrees that investors and developers should choose carefully.

“There are certainly fewer opportunities in Cape Town in the current circumstances. We believe that good urban nodes in Gauteng is where the focus should be. Randburg is a good example. There is a high vacancy in B-grade office space, a very high demand for residential rentals and it is ideally situated for those working in Randburg and Sandton, with excellent access to public transport. These sorts of areas are where the real opportunity lies,” explains Rosen.

Both Palmer and Rosen also caution that finding the right building is key to making the deal attractive.

“Developers need to look closely at the floorplans of the buildings. Not all office space is easily converted. Many offices have very deep spaces with little natural light. Or, they may have a structural floorplan which would require extensive renovations and building work to make it a suitable living space. This impacts the costs and ultimately the profitability of the exercise,” says Palmer.

Overenthusiasm can be a real danger. Rushing into an ill-thought through conversion can leave a developer on the hook for the debt and a building that is not attractive to tenants - frustrating sales opportunities and making rentals unlikely.

Despite the cautions, both agree that office conversions offer a means to capitalise on current trends. The trick, however, is to partner with companies who have the necessary experience.

“There are any number of creative ways to make money in the current climate. Working with people who have real experience in conversions, who know the markets, and who understand how to maximise investment returns with the right finance is the key to keep your money working for you,” Palmer concludes.

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