

# As Demand for Office Remains Sluggish, Investors Look to Industrial and Logistics Conversions on Long Island

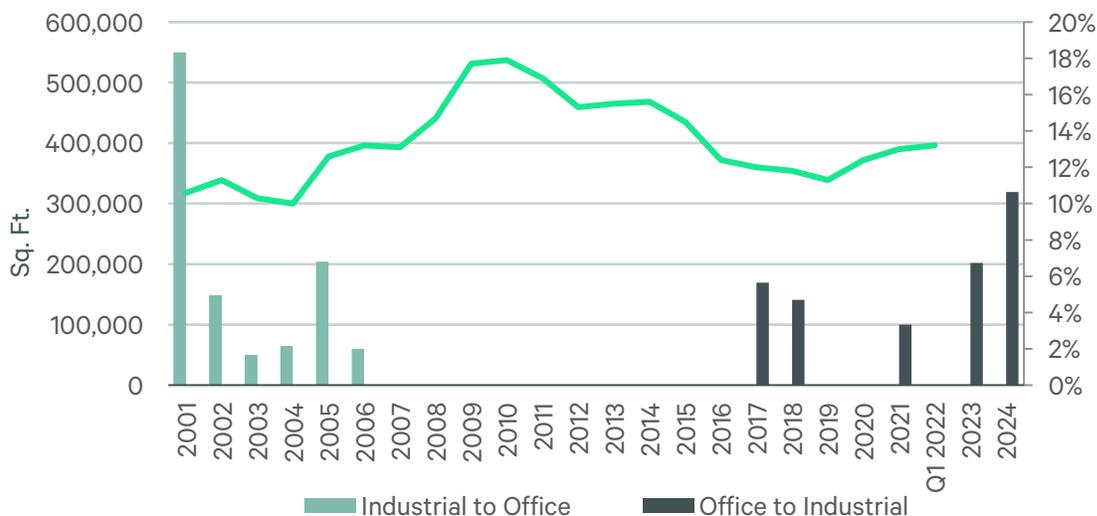
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On Long Island, where retail sales increased 13.2% from Q4 2020 to Q4 2021, e-commerce driven demand for warehouse and distribution space has sparked the conversion from office to industrial uses. This conversion wave is all the more notable as it marks the reversal of a prior trend from the early 2000s, when growing demand for office space spurred industrial conversions to office.

## History of Long Island Conversions

In the early 2000s, the office market’s availability rate hit 9.5%, its lowest point ever. Long Island’s demand for office space far outweighed interest in industrial leasing. The shortage of developable land and a diminishing supply of available office space attracted industrial owners, who found conversion to office both financially attractive and physically feasible. From 2001 to 2006 approximately 1.1 million sq. ft. of industrial space was converted to office, adding 3% to the Long Island office inventory.

FIGURE 1: Conversion Volume (SF) vs Office Availability Rate



Source: CBRE Research

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## Reversal of Fortunes: Industrial Again on the Rise

As consumers continue to shift toward more online purchasing, the demand for warehouse and distribution space has surged across the U.S. and in the local market. The Long Island industrial vacancy rate currently stands near historic lows at 3.4%, a 140-basis point decline year-over-year. With a shortage of modern, efficient industrial properties for last-mile delivery, and the availability rate for older underutilized Class B office buildings at 13.2%, these properties are being considered by investors and developers for industrial redevelopment. Since 2017, there has been at least 320,000 sq. ft. converted from office to industrial, accounting for 2% of existing office inventory. One notable example was Arrow Electronics' former headquarters at 50 Marcus Drive in Melville, the 169,000-sq.-ft. office building was acquired by logistics firm Stellae International to convert back to industrial and add two 50,000-sq.-ft. additions. Originally built as an industrial building in the 1960's, 50 Marcus Drive was converted to office in 2001.

With the continuing growth of e-commerce, demand for warehouse and distribution space is likely to persist for years to come. However, not all office buildings are prime candidates for conversion. Office properties currently pegged for conversion share similar characteristics, such as having high vacancy, locations close to major highways and in industrial zones. Class B office buildings repurposed to industrial can potentially achieve higher net rents than the office buildings. A new state-of-the-art distribution facility on Long Island could have asking rents of \$19.00-\$22.00 per sq. ft. NNN compared to \$23.00 per sq. ft. gross for an underperforming Class B office building. Despite the costs to demolish and rebuild, owners and developers are seeing the upside opportunity.

Looking forward, the office-to-industrial conversion trend appears to be picking up speed especially in the wake of the pandemic, with office demand below long-term averages. CBRE is tracking five office-to-industrial conversion projects, totaling at least 521,000 sq. ft. There is 202,000 sq. ft. projected for completion in 2023 and an additional 319,000 sq. ft. in the pipeline, with completion dates not yet announced. One project slated for 2023 completion is 107 Charles Lindbergh Boulevard in Garden City. The 98,000-sq.-ft. office building on 6.6 acres, formerly occupied by the IRS, was purchased by Brookfield Properties and demolished to make way for a new 102,000-sq.-ft. state-of-the-art warehouse distribution facility.

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