



Pretend and Extend: A Deep Dive into Commercial Real Estate Lending's Hidden Crisis

CHAPTER 21:

A PUBLIC-PRIVATE CONVERSION CORPS

DECEMBER 29, 2025 | REAGAN SCHWARZLOSE, FRICS | MAI | CRE | CCIM

The United States confronts a paradoxical crisis in its built environment. Obsolete commercial buildings, particularly office properties rendered economically unviable by remote work adoption and changing space requirements, sit vacant in urban cores across the country. Simultaneously, the nation faces a severe shortage of affordable and workforce housing that constrains economic mobility, exacerbates inequality, and limits metropolitan growth. These challenges are not separate problems but interconnected components of a single opportunity.

A coordinated public-private strategy could address both by unlocking underutilized assets through incentivized conversion of commercial space to residential use. However, this transformation will not occur through market forces alone. High retrofit costs, zoning constraints, financing gaps, and valuation uncertainty create barriers that prevent private actors from pursuing conversions at the scale necessary to make meaningful impact. What is required is policy infrastructure: a systematic approach that aligns government resources, private capital, regulatory flexibility, and technical expertise to accelerate adaptive reuse.

This article proposes the creation of a national conversion corps, a collaborative mechanism bringing together federal agencies, state and local governments, private developers, housing advocates, and valuation professionals to systematically convert stranded commercial assets into productive housing stock.

The Stranded Asset Challenge

Research from the Federal Reserve Bank of New York and commercial real estate data providers documents the scale of office obsolescence. Vacancy rates in many markets exceed 20 percent, with Class B and C properties facing particularly severe distress. Many of these buildings are economically dead in the sense that operating income cannot support debt service at current market financing costs, yet they remain on lender balance sheets at valuations that reflect outdated assumptions.

The extend-and-pretend phenomenon has prevented efficient reallocation of these assets. Banks avoid foreclosure because realized losses would trigger capital impacts and regulatory scrutiny. Borrowers lack incentives to surrender properties voluntarily when debt exceeds value. The result is stasis, with buildings deteriorating physically while ownership structure remains frozen. This delay imposes costs that extend beyond individual lenders and borrowers.

Urban blight accelerates when prominent buildings sit vacant, signaling decline to residents, businesses, and potential investors. Tax base erosion follows as assessed values decline and municipalities lose revenue needed for services and infrastructure. Housing shortages intensify as developable sites remain locked in unproductive uses while residential demand goes unmet. The opportunity cost of this paralysis compounds with each passing quarter.

Private actors cannot overcome these barriers independently. Individual developers lack the capital scale to acquire and convert multiple properties simultaneously. They face regulatory uncertainty about whether zoning changes will be approved and how long entitlement processes will take. Financing remains difficult because lenders view conversions as higher risk than ground-up construction or traditional office repositioning. Valuation challenges persist because comparable sales for converted properties are limited, creating uncertainty about end values that financing requires.

Why a National Conversion Corps Is Needed

Addressing stranded asset conversion at meaningful scale requires a coordinated mechanism that the private sector cannot create alone and government cannot effectively implement without private expertise. A national conversion corps would establish the institutional framework for systematic collaboration.

The corps would bring together complementary capabilities from multiple sectors. Government-backed capital through loan guarantees, tax credits, and subordinated debt would reduce financing costs and absorb downside risk that prevents private capital deployment. Private sector developers and equity sponsors would contribute deal execution expertise, construction management, and market knowledge about residential product types and tenant demand.

Local housing authorities and planning departments would provide regulatory flexibility, expedited permitting, and connection to affordable housing programs and tenant populations. Independent valuation firms and feasibility experts would establish credible baselines for property condition, conversion costs, and achievable residential values, removing the valuation fog that currently prevents transaction clarity. Workforce development partners would align labor training programs with construction demand created by conversion activity, addressing skilled trades shortages while creating employment pathways.

This collaborative structure addresses market failures that prevent conversion activity from occurring efficiently. Information asymmetry about conversion feasibility would be reduced through standardized assessment protocols. Regulatory uncertainty would be minimized through pre-approved entitlement frameworks. Financing gaps would be filled through layered capital structures combining public and private sources. Transaction costs would be reduced through streamlined processes developed specifically for conversion scenarios.

Components of a Successful Conversion Program

A functional conversion corps requires several essential tools and structures working in coordination. Predevelopment grants or feasibility funding would provide early-stage capital to assess conversion viability before major commitments occur. Converting office buildings to residential use requires detailed analysis of structural capacity, mechanical systems, floor plate dimensions, egress requirements, and unit layout possibilities. These assessments cost hundreds of thousands of dollars per property, creating barriers to evaluating multiple potential conversions. Federal or state grant programs covering 75 percent of predevelopment costs would enable systematic screening of conversion candidates.

Tax incentives or depreciation adjustments similar to Low Income Housing Tax Credits or Opportunity

Zone programs would improve project economics. Conversion projects face higher per-unit costs than ground-up construction due to structural constraints and building system upgrades. Tax credit structures that recognize these incremental costs while delivering affordable housing would attract private equity capital. Accelerated depreciation schedules for conversion-specific improvements would enhance cash-on-cash returns during early operating years.

Zoning flexibility and streamlined permitting represent essential regulatory contributions. Many urban office districts prohibit residential use or impose requirements designed for ground-up residential construction that are inappropriate for conversions. Fast-track entitlement processes with pre-approved design standards would reduce approval timelines from years to months. Adaptive building code provisions addressing issues such as unit sizes, natural light requirements, and parking ratios would enable feasible conversions that current codes prevent.

Standardized valuation and underwriting frameworks supported by independent data providers would address the valuation uncertainty that currently inhibits financing. As-is office valuations, conversion cost estimates, and as-converted residential values need consistent methodologies that lenders can rely upon. Registry systems tracking conversion projects would build comparable databases that reduce valuation disputes and enable more confident underwriting.

Public-private matching capital structures would layer different funding sources to achieve risk-adjusted returns for all participants. A typical structure might include senior debt from conventional lenders at 50 percent loan-to-cost, mezzanine financing from state housing finance authorities at 20 percent, federal loan guarantees covering another 15 percent, and private equity contributing 15 percent. This structure distributes risk appropriately while making projects feasible that cannot proceed with conventional 65 percent senior debt alone.

Example Scenarios and Precedents

Several cities have begun experimenting with conversion incentives, providing early evidence of what systematic programs could achieve. Calgary developed an office conversion program offering grants and tax incentives following energy sector decline that left downtown buildings vacant. By 2024, the program had facilitated conversion of over one million square feet of office space to residential use, demonstrating feasibility in a challenging market.

Chicago and New York have offered regulatory relief and financial incentives for office-to-residential conversions, though programs remain limited in scale. These early efforts confirm that conversions are technically feasible and can produce viable housing when supported appropriately, but also demonstrate that piecemeal local initiatives cannot address the national scale of stranded assets.

Historical programs provide models for effective public-private collaboration. HOPE VI transformed distressed public housing through partnerships between housing authorities and private developers, demonstrating that government capital combined with private execution can deliver results. New Markets Tax Credits have channeled billions in private investment to underserved communities by reducing risk through tax benefits and technical assistance.

Consider a practical example of how the conversion corps model would function. A 300,000 square foot Class B office building in a secondary market sits 60 percent vacant with debt approaching maturity. The building is fundamentally sound structurally but economically obsolete as office space. Local housing authority analysis indicates strong demand for workforce housing near transit. Under the conversion corps framework, predevelopment funding supports feasibility assessment confirming the building can yield 250 residential units at costs of \$200,000 per unit including acquisition. State housing finance authority provides subordinated debt and federal tax credits.

The existing lender agrees to discounted payoff based on credible as-is valuation. A regional developer experienced in multifamily construction executes conversion. The result is needed housing supply, removal of a distressed asset from the lender's books, increased tax base for the municipality, and returns for private investors.

Legislative and Policy Pathways

Converting this vision into operational reality requires specific legislative and administrative actions at federal and state levels.

Congress should establish a dedicated Adaptive Reuse Conversion Fund within the Department of Housing and Urban Development with initial authorization of five billion dollars over five years. This fund would provide the predevelopment grants, loan guarantees, and subordinated financing that make conversion projects feasible. Legislation should specify performance metrics including units created, cost per unit, and affordability levels achieved.

Treasury should modify tax code provisions to create conversion-specific incentives modeled on Low Income Housing Tax Credits but tailored to the unique economics of adaptive reuse. These credits should recognize higher per-unit costs while requiring long-term affordability commitments that justify public subsidy.

The Department of Housing and Urban Development and state housing finance agencies should pilot regional conversion programs pairing local developers with identified stranded assets. Pilots in five diverse markets over 24 months would demonstrate model structures and identify necessary adjustments before national expansion.

An interagency working group including HUD, General Services Administration, Treasury, and FDIC should identify top conversion candidates nationally by analyzing commercial real estate loan data,

vacancy patterns, and housing need indicators. This analysis would prioritize resources toward markets and properties where conversion offers greatest impact. The GSA should evaluate its own portfolio for conversion candidates, demonstrating federal leadership.

State legislatures should authorize housing finance agencies to issue bonds specifically for conversion financing and update building codes to facilitate adaptive reuse. Municipal governments should develop pre-approved conversion frameworks that streamline entitlements for projects meeting specified criteria.

Conclusion: From Crisis to Community

The stranded asset challenge in commercial real estate and the affordable housing shortage represent failures of market coordination that government intervention can address efficiently. Neither problem will resolve through laissez-faire approaches. The question is whether public and private sectors will collaborate systematically or allow these interconnected crises to deepen.

The call to action for federal housing and infrastructure agencies, state and local housing authorities, adaptive reuse investors, development firms, and policy think tanks is to pursue legislation and targeted incentive programs establishing a national conversion corps. This initiative would transform the extend-and-pretend crisis into a generative opportunity that creates housing, revitalizes urban cores, removes distressed assets from financial system balance sheets, and demonstrates effective public-private collaboration.

Four Corners Valuations stands ready to support this vision through asset-level feasibility analysis, highest and best use studies, and post-conversion valuation services. As a firm grounded in market data and redevelopment insight, we recognize that converting stranded assets requires honest

assessment of current conditions, realistic projection of conversion costs, and credible valuation of end products. Our work would support public and private partners in accelerating the conversion pipeline by providing the valuation clarity that enables confident capital deployment. The transformation of obsolete commercial space into productive housing begins with accurate understanding of what exists and clear vision of what is possible.



Reagan R. Schwarzlose

FRICS | MAI | CRE | CCIM

CEO | Principal

+1-480-440-2842 Ext. 06

rschwarzlose@fourcv.com

www.fourcv.com



FOUR CORNERS VALUATIONS
REAL ESTATE ADVISORY SERVICES

Four Corners Valuations delivers exceptional valuation and advisory services across the US and globally, offering a unique blend of local expertise and international experience. Utilizing advanced technology and superior data sources, we ensure accurate and comprehensive valuations for developers, investors, lenders, and other stakeholders. With licensed professionals across the United States and experienced in more than 60 countries, we are dedicated to excellence and committed to guiding our clients towards informed and successful decisions.

+1.480.440.2842 www.fourcv.com