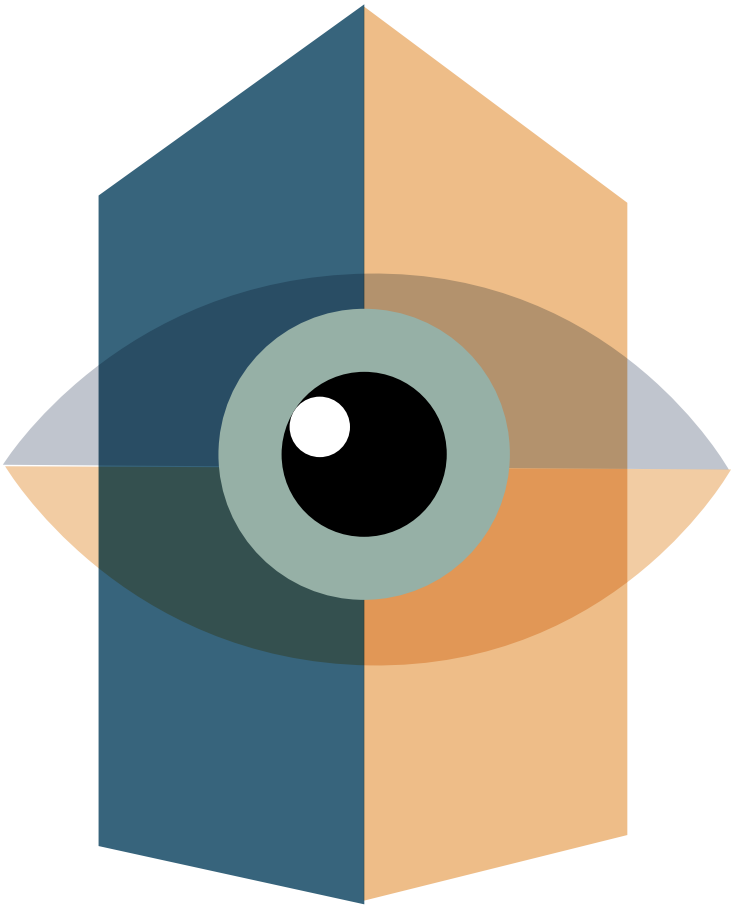
ARBITRAGE IN PLAIN SIGHT



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Despite clear opportunity, adaptive reuse arbitrage that could help restore market equilibrium has been slow to materialize, and that was before the most recent episode at the former Pfizer building in New York.

The US office market remains in structural reset. Vacancies hover at record highs, office values in many gateway markets have fallen by up to 80%, while residential values remain at or near record highs.

Despite clear opportunity, adaptive reuse arbitrage that could help restore market equilibrium has been slow to materialize, and that was before the most recent episode at the former Pfizer building in New York.

This slow materialization could be partially due to how rigid institutional capital mandates, combined with two decades of private equity-driven product specialization, have eroded both the market imperative and critical industry skills required to spur value maximization at scale through use transformation.

The results of these forces include significant and avoidable losses for institutional investors, higher housing costs for consumers, and declining urban centers throughout the US. Drawing on current data and policy sources, the paper quantifies the scale of the loss, explains its regulatory and incentive roots, and offers practical steps to regain asset and portfolio profitability by reconnecting capital and knowledge with prudent risk.

THE MISSED ARBITRAGE

By the second quarter of 2025, US office vacancy had reached 20.7%—an all-time high, according to Moody's Analytics.[1] S&P Global Ratings, citing Green Street's Commercial Property Price Index, reports that US office real-estate prices have fallen roughly 36% from their 2022 peak, while McKinsey Global Institute estimates that $800 billion, in real terms, of office-space value is at stake by 2030 across the nine cities it studied under its moderate scenario.[2]

The aggregate scale of the impairment is difficult to measure precisely, but available estimates place it on the order of $1 trillion. Estimates of the US office stock near the 2022 market peak range from approximately $2.64 trillion to $2.9 trillion. Applying the approximately 36% decline in US office real-estate prices reported by S&P Global Ratings, citing Green Street's Commercial Property Price Index, implies aggregate value impairment of approximately $950 billion to $1.04 trillion. Independent academic work provides a useful, more narrowly defined benchmark: Gupta, Mittal, and Van Nieuwerburgh estimate $556.8 billion in value destruction across US office markets attributable to the remote-work shock. Their estimate measures a more specific source of value destruction than the broader market-price impairment calculated here. Taken together, the evidence supports approximately $1 trillion as a reasonable order-of-magnitude estimate of aggregate office-value impairment rather than a precise measure of realized losses.[3]

In a functioning market, such deep discounting and value reversal would unleash creative arbitrage: incentivizing the transformation of lower value office uses into higher value strategies.

Despite a clear market need, accretive use transformations have been relatively slow to materialize. Transaction volumes, in most markets, remain a fraction of ground-up competition, as institutional capital has been reticent to move with proactive purpose. The arbitrage opportunity is visible, but few seem to possess the skills, the mandate, or the institutional permission to act. Why?

HOW THE SKILL BASE DISAPPEARED

Over the past two decades, real estate development and finance have increasingly industrialized and institutionalized. Capital markets seeking scalability and perceived safety have rewarded repeatable, low-variance product types—multifamily podiums, last-mile logistics warehouses, self-storage facilities—whose perceived execution, product quality, and market risks were believed to be understood and quantifiable. Underwriting conventions, lender requirements, and appraisal methodology likewise favored conformance and direct physical comparability over potential product uniqueness. In response, developers and design consultants learned defined and highly repeatable execution models to drive fee income and profitability through speed and replication. One casualty of this institutional preference for product similarity and replication has been the rational diminution of skill sets required for building adaptation and market differentiation.

Regulation further reinforced product standardization. As zoning codes, building requirements, and entitlement processes grew in complexity, developers rationally sought strategies that lessened perceived execution risk and that could be replicated across multiple jurisdictions; while elected officials likewise encouraged, what they believe were, known commodities. Converting an office building to another use, especially in high-quality commercial shells for a higher revenue producing and lower cap rate use, does not appear to align with either developer or municipal standardization goals.

The asset acquisition process for building conversion also requires rethinking established market protocols. Where the finance and development community have normalized "land closing" for ground-up executions upon receipt of zoning approval or building permit issuance, office building owners typically execute "asset sales" within thirty days following the completion of physical due diligence; a much shorter process. As both industries are optimized for their own internal logic, the acquisition of an existing asset "as land" lacks a natural buyer and seller.

Fiduciary governance designed to protect capital further compounds the challenge. Under ERISA and similar frameworks, plan sponsors face heightened scrutiny for thesis drift. Investment consultants and oversight committees divide real-estate capital into rigid buckets: core, core-plus, value-add, and opportunistic, each further segmented by asset type and geography. Deviating from their stated mandate—even to pursue a financially accretive use transition—often violates established investment parameters, enhancing career risk for managers who stray from the herd. Fee structures further entrench stasis by tying compensation to assets under management and in-place revenue, rather than one-off, redevelopment gains.

In the face of this friction, developers and design consultants rationally optimize for the known; replicable ground-up development strategies that align with regulatory frameworks, and the acquisition, development, and capital structures they encourage and support. Losing the economic incentive to innovate has meant losing the knowledge and skills required to maximize value through adaptive arbitrage, trapping the highest quality assets and their investors in an avoidable cycle of decline.

Demand for apartments and offices, and their resulting cap rates, had effectively flipped.

THE BLACK SWAN

The institutional structures and guardrails erected to protect capital worked well when asset demand was steady to increasing, interest rates were steady to declining, and capital flows were directed to the assets that managers had been encouraged to pursue. But over the last twenty years, technological and societal changes altered the value landscape dramatically. In 2000, predictable information-based employment growth resulted in office values being among the highest in commercial real estate. By 2020, however, as mobile telecommunications allowed information to be processed anywhere, and changes in household formation rates saw many postpone marriage and childbearing, apartment use had gained primacy.

The result? Demand for apartments and offices, and their resulting cap rates, had effectively flipped.

Today, economically impaired Class-A, B, and C office assets, made from the highest quality materials and often in the best locations, are available at steep discounts, even below historic raw land value, yet few developers, design consultants, advisors, or investors possess the cross-disciplinary competence to execute a conversion arbitrage strategy at scale. The resulting skills gap exacerbates asset value erosion by limiting the universe of potential sponsors and investors with proven ability to transform assets into their highest and best use.

A system initially designed to protect investment capital through standardization has evolved into a system that effectively prevents profitable self-correction.

WHO LOSES

Institutional investors, lenders, municipalities, and consumers bear the highest cost for rigid industry conformity. Within the universe of core open-end real-estate funds, office exposure fell from roughly 33% in 2020 to 15% in 2024. Yet even as allocations lessen, markdowns sting. Average office valuations have declined by about 43%, nationwide, from peak to trough; a paper loss of more than $1 trillion. These impairments translate directly into weaker funding ratios for retirement beneficiaries, higher write-offs for lenders and institutional investors, higher interest rates and liquidity requirements for borrowers, lower property, and sales tax revenues for municipalities, and ultimately, reduced residential options for consumers.

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WHY INSTITUTIONAL CAPITAL HAS BEEN SLOW TO REACT

In functioning markets, inefficiencies attract capital until the inefficiencies disappear. The persistence of today's real-estate arbitrage—hundreds of billions in unrealized value that could be recaptured—shows that the issue is not just pricing but structure. The inefficiency survives because the institutions that control the capital and/or the assets have chosen not to arbitrage it.

One impediment is this arbitrage requires both information and execution ability. The value spread between an obsolete office use and its potential residential value cannot simply be captured via trade; it must be engineered through zoning, design, and construction—risks that the capital provider may not feel qualified to evaluate or skills they do not believe a sponsor can demonstrate.

Another constraint is fiduciary law itself. Within this system, institutional investors are not passive victims; but constrained participants. Under ERISA and similar state pension statutes, trustees are judged more by perceived procedural prudence, than past performance. Deviation from a benchmark can expose participants to litigation or loss of consultant rating. Investment Policy Statements lock each portfolio into fixed style boxes that define acceptable risk and asset type.

To execute a conversion, a manager must demonstrate that any proposal meets a prescribed level of acceptable risk or require an amendment to governing documents. These processes can take months to complete, require multiple layers of board approval, and can create perceived career risks for managers.

Liquidity requirements also play a role. Core and core-plus open-end funds must meet quarterly redemptions and maintain appraisal-based NAVs. Adaptive reuse projects, by contrast, lock-up capital for several years. The structural liquidity mismatch makes it difficult to allocate a meaningful portion of portfolios to temporally illiquid conversions. Lenders exacerbate the challenge by often requiring borrowers to maintain a 10% liquidity balance during the term of a construction loan. Sequestration of such a large amount of equity can reduce potential equity returns by over 50%.

The advisory ecosystem further encourages stasis. Consultants often privilege income producing assets, in part, because the consultancies lack internal entitlement, design, and construction expertise that could bolster their advocacy for strategic repurposing. By advancing the perception of conversion execution risk as insupportably high relative to other strategies, potentially due to a misperception of relative risks, the advisory system heightens systemic rigidity.

Finally, a deep principal–agent problem pervades the system. The persistence of unrealized arbitrage lies not in the absence of opportunity but in the asymmetry between incentives that govern real estate decision-making and the lack of industry clarity surrounding potential conversion risks and rewards. By incentivizing conformity and stasis, real estate "best practices" ensure that the realities of use conversions remain, for many, unknown, unknowns.

WHAT IS THE SCOPE OF WORK?

In an industry known for rewarding standardization, one challenge for conversion strategies remains the relatively wide aperture that defines adaptive reuse scopes of work, and by extension, the cost, risk, time, execution quality, and market viability of the potential end product. As the known universe of adaptive executions range from nearly complete redevelopments requiring full skin removal, addition of new floors, and large structural reconfiguration (The New York City, Pfizer Building Model), to others that more closely resemble simple interior tenant improvement retrofits, the wide breadth of executions increases difficulty for capital allocators in understanding the risk of "conversions" broadly defined and, by extension, which capital bucket they require.

Are conversions more akin to new construction, core, opportunistic, or value-add strategies?

Potentially all of the above.

Therein lies both the challenge and the opportunity for the industry.

CONVERSION MATH REMAINS COMPELLING

Talent pools should adjust to capital incentives. Graduate real estate programs and firm training curricula that emphasize financial modeling of stabilized projects over entitlements, engineering, or adaptive-reuse design limit the number of future leaders with the skills required to both prevent the next value crisis and/or to profit from its subsequent arbitrage opportunity.

For those with the correct knowledge, however, the cross-category innovation reward of use conversions can be dramatic: the same per-square-foot rent in apartments and office buildings translates into as much as a sevenfold difference in asset value, or more, in certain high-value markets.

In Arlington, Virginia, a gateway office and apartment submarket, the same $40 per-square-foot base rent in a 200,000-square-foot Class A, concrete-frame, high-rise building, when analyzed for both office and apartment use, shows the power of use arbitrage for restoring lost value.

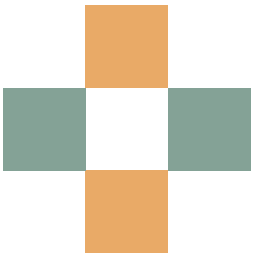
The effective economics of multifamily use dramatically exceed those of office use through higher occupancy, reduced tenant concessions, the absence of required short term (10-year) tenant improvement and leasing commission cost amortization, lower operating expenses, and meaningfully tighter cap rates. When these operational and capital-market differences are applied to a $40 per square foot gross rent, multifamily use generates approximately $28.40 per square foot of NOI compared to only $8.00 for office.

Capitalized at market-appropriate rates, this produces a nearly seven-fold difference in asset value within the same building, simply by transitioning use: $568 per square foot for apartment use v $80 per square foot for office use. This economic reality is mirrored across many gateway office and residential submarkets.

If the cost to create this additional $488 value is only $300 per square foot, and can be realized in 18-24 months, that translates to a 62% gross margin on total new capital in less than two years. Very few ground-up, opportunistic strategies offer similar return profiles or comparable speed to market. The key to success, however, is smart design that capitalizes upon and retains existing building attributes while also controlling conversion cost and scope.

While not every building can or should be converted, when physical feasibility combines with market demand and correct knowledge, the economic opportunity is clear, substantial, and scalable.

The key to success, however, is smart design that capitalizes upon and retains existing building attributes while also controlling conversion cost and scope.



REACQUAINTING CAPITAL AND KNOWLEDGE WITH DEMAND

Reversing a trajectory that favors slow decline over productive action requires revising the institutional incentives and perception of execution risk relative to use arbitrage.

Real-estate investment vehicles and practitioners should be incentivized to seek better uses when clear arbitrage conditions arise, rather than remaining constrained by legacy buckets. Investment boards, acting as fiduciaries, should require special-situation or reuse mandates that encourage conversions from office to housing, education, life-science, or other highest and best use cases, under defined feasibility, value creation, and risk criteria.

Performance incentives must also evolve. Instead of paying managers solely for stable quarterly IRRs and total AUM, compensation should reward realized value creation—the net income and NAV delta achieved through successful repositioning. Such incentives would encourage managers to seek maximum value while reinvigorating underutilized industry skill sets.

Developers and funds should seek strategic advantage by partnering with proven "conversion teams" staffed with industry experts in cross functional redevelopment who have the knowledge and track record to generate outsized economic returns at scale. Where many still believe that conversion projects result in higher cost, higher risk and lower quality than ground up strategies, the truth is often the diametric opposite. Successful conversions demystify perceived risks, broadening their appeal within the investment community. The more that conversion risks, costs, and benefits can be quantified, managed and optimized, the more widespread conversions will become.

Apartment developers and investors should likewise actively seek the discrete value enhancing attributes of high-quality office product to realize a competitive advantage over their institutionally similar, predominantly wood-framed, competition. With working from home emerging as a significant cultural, economic, and demographic phenomenon, and Gen-Z consumers privileging individuality and authenticity, assets initially designed for commercial use have specific physical advantages over purpose built residential products (taller ceilings, bigger windows, more elevators, more parking, wider stairs, concrete frames, main and main locations, greater sustainability) to support this evolving demand.

Public policy can also support industry efforts by standardizing code-relief mechanisms and making existing financing and tax incentives easier to combine. The White House's *Commercial to Residential Conversions* guidebook, developed in partnership with HUD and other federal agencies, identifies federal resources available to support conversion projects, while more recent Brookings Institution research, conducted in cooperation with HUD, identifies regulatory reforms, historic-preservation tax credits, loan programs, and other financial tools that can reduce conversion costs and improve project feasibility.[4]

Above all, governance culture must shift from punishing deviation to rewarding informed flexibility. Fiduciaries should treat style drift not as moral failure but as a moral imperative and evidence of responsive and responsible management in a transformed market. Until governance mechanisms evolve to encourage adaptive behavior, in a world where the fiduciary, legal, and operational checks governing institutional capital move slower than arbitrage market cycles, today's market inefficiency will remain visible, acknowledged, and unexploited, even as the value creating opportunity remains generational.

THE PATH FORWARD

The office market transformation has exposed not just a structural change in demand but a systemic flaw in real estate investment practice. In response to exogenous and internal forces, the financial and human institutions of real-estate investment have grown sclerotic; discouraging rational market participants from capitalizing upon the inefficiencies they were created, in part, to exploit.

One path to bridging this divide may be, paradoxically, the increased institutionalization of how use conversions are defined, categorized, and executed. In an industry that rewards systemization and conformity, it is far easier to succeed by aligning emerging value creation strategies with established industry practices than in hoping industry practices realign to a new approach.

Developers, building owners, and investors should, therefore, actively seek to establish and adopt institutional conversion standards that define use conversion scope, cost, and character. Industry standards and definitions reduce perceived execution risk (similar to industry definitions of "podium," "wrap," or "BTR") enabling greater alignment with the forces that currently restrict widespread conversion adoption. In clarifying what conversions both require and entail, market practitioners can transform what is perceived as "bespoke," "risky," and "one-off" into something more universal. Many of the most successful strategies and executions have already begun working towards this type of standardization.

With hundreds of billions in lost value waiting to be restored and harvested, the financial incentive is present, and the data remains unequivocal: office vacancies above 20%, office valuations down over a third, residential values that can far exceed comparable office values, and immediately realizable latent value locked in high quality, well located, and use impaired buildings. The obstacle is not capital scarcity, but the erosion of the expertise and mandate flexibility needed to act.

Rebuilding that capacity will determine whether the next decade's investment returns reflect continued impairment or outperformance. To restore value, capital must be allowed—and people must be incentivized and trained—to bridge categories once again. The greatest arbitrage available today is not in the buildings themselves but in reconnecting money that needs return with the opportunities, knowledge and incentives that can create it.

EXHIBIT 1: CASE STUDY: ARLINGTON, VA. OFFICE USE V RESIDENTIAL CONVERSION WITH THE SAME $40 PER SQUARE FOOT BASE RENTS IN THE SAME 200,000 SQUARE FOOT OFFICE BUILDING.

ARLINGTON, VA MULTI-FAMILY	ARLINGTON, VA OFFICE		MULTI-FAMILY USE
95.0%	80.0%	→	HIGHER MARKET OCCUPANCY
$38.40	$35.00*	→	HIGHER EFFECTIVE RENTS PER SF *($40 office rent with 15 months free on 10-year lease= $35 per sf Net Effective Rents. Apartments rents stabilized with ½ month concession)
$0.00	$15.00**	→	NO TI AND LC LEASE TERM AMORTIZATION **(Assumes $150 Office TILC Cost fully amortized over 10-year lease term. Residential conversion costs are 30 – 45- year improvements that do not require full lease term amortization)
$10.00	$13.50	→	LOWER OPERATING EXPENSES (apartment residents pay utilities)
$28.40	$6.50	→	HIGHER NOI/SF (not vacancy adjusted)
5.5%	9.0%	→	LOWER CAP RATES
$516.36 psf	$72.22 psf	→	7X VALUE DIFFERENCE

The Same Building with the Same $40 Per Year Base Rents Generates 7x More Net Asset Value with Multi-family Use Than Office Use Today in Arlington, VA

EXHIBIT 2: CASE STUDY: DOWNTOWN, WASHINGTON, DC. OFFICE USE V RESIDENTIAL CONVERSION WITH THE SAME $48 PER SQUARE FOOT BASE RENTS IN THE SAME 250,000 SQUARE FOOT OFFICE BUILDING.

Washington DC Multi-Family	Washington DC Office		MULTI-FAMILY USE
94.0%	75.0%	→	HIGHER MARKET OCCUPANCY
$46.08	$40.80*	→	HIGHER EFFECTIVE RENTS PER SF *($48 office rent with 18 months free on 10-year lease = $41 per sf Net Effective Rents. Apartments rents stabilized with ½ month concession)
$0.00	$18.00**	→	NO TI AND LC LEASE TERM AMORTIZATION **(Assumes $180 Office TILC Cost fully amortized over 10-year lease term. Typical market cost. Residential conversion costs are 30 – 45- year improvements that do not require full lease term amortization)
$11.00	$15.50	→	LOWER OPERATING EXPENSES (apartment residents pay utilities)
$35.08	$7.30	→	HIGHER NOI/SF (not vacancy adjusted)
5.0%	10.0%	→	LOWER CAP RATES
$701 psf	$73 psf	→	9.6X VALUE DIFFERENCE

The Same Building with the Same $48 Per Year Base Rents Generates 9.6x More Net Asset Value with Multi-family Use Than Office Use in Downtown Washington, DC Today

EXHIBIT 3: CASE STUDY: CASE STUDY: CHICAGO CBD/LOOP, IL. OFFICE USE V RESIDENTIAL CONVERSION WITH THE SAME 36 PER SQUARE FOOT BASE RENTS IN THE SAME 300,000 SQUARE FOOT OFFICE BUILDING.

CHICAGO, IL MULTI-FAMILY	CHICAGO, IL OFFICE		MULTI-FAMILY USE
93.0%	65%	→	HIGHER MARKET OCCUPANCY
$34.56	$31.50*	→	HIGHER EFFECTIVE RENTS PER SF *($36 office rent with 15 months free on 10-year lease = $35 per sf Net Effective Rents. Apartments rents stabilized with ½ month concession)
$0.00	$15.00**	→	NO TI AND LC LEASE TERM AMORTIZATION **(Assumes $150 Office TILC Cost fully amortized over 10-year lease term – Typical market cost. Residential conversion costs are 30 – 45-year improvements that do not require full lease term amortization)
$10.50	$14.50	→	LOWER OPERATING EXPENSES (apartment residents pay utilities)
$24.06	$2	→	HIGHER NOI/SF (not vacancy adjusted)
5.75%	12.0%	→	LOWER CAP RATES
$418psf	$16.67psf	→	25X VALUE DIFFERENCE

The Same Building with the Same $36 Per Year Base Rents Generates 25x More Net Asset Value with Multi-family Use Than Office Use in the Chicago CBD Today

ABOUT THE AUTHORS

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NOTES

[1] Moody's CRE, "The Office Sector's Double Whammy," July 8, 2025 (reporting that the US office vacancy rate reached an all-time high of 20.7% in the second quarter of 2025).

[2] S&P Global Ratings, "US Banks Are Better Positioned to Manage Commercial Real Estate Risks," February 19, 2025 (citing the Green Street Commercial Property Price Index and reporting that US office real-estate prices had fallen roughly 36% from their 2022 peak); McKinsey Global Institute, Empty Spaces and Hybrid Places: The Pandemic's Lasting Impact on Real Estate, July 13, 2023 (estimating that $800 billion, in real terms, of office-space value across the nine cities studied is at stake by 2030 under its moderate scenario).

[3] Author calculation and synthesis. Bramshill Investments, "A Closer Look at Office Commercial Real Estate & Investment Opportunities within Securitized Products," July 2023, citing Morgan Stanley, "Spring Training—CRE & REITs," May 11, 2023, reports an estimated year-end 2022 US office-market value of approximately $2.639 trillion; RMI, Financing US Building Decarbonization: Leveraging a Sector-Wide Emissions Model to Prioritize Capital Flows (2024), estimates the US office building stock at approximately $2.9 trillion. S&P Global Ratings, citing Green Street's Commercial Property Price Index, reports that US office real-estate prices declined roughly 36% from their 2022 peak. Applying that decline to the foregoing estimates of US office-stock value implies aggregate value impairment of approximately $950 billion to $1.04 trillion. See S&P Global Ratings, "US Banks Are Better Positioned to Manage Commercial Real Estate Risks," February 19, 2025. As an independent and more narrowly defined benchmark, Arpit Gupta, Vrinda Mittal, and Stijn Van Nieuwerburgh, "Work from Home and the Office Real Estate Apocalypse," American Economic Review 116, no. 2 (February 2026): 674–709, doi:10.1257/aer.20231619, estimate $556.8 billion in value destruction across all US office markets in their analysis of the effects of remote work.`

[4] The White House, Commercial to Residential Conversions: A Guidebook to Available Federal Resources, October 2023, developed in partnership with the US Department of Housing and Urban Development and other federal agencies; Cara Eckholm, Tracy Hadden Loh, Jonathan Meyers, and Steven Paynter, "A Community Guide to Office-to-Residential Conversion: Part 2, Policy Levers," Brookings Institution, July 17, 2025. The Brookings research was conducted as part of a cooperative agreement with the US Department of Housing and Urban Development.