

Condo Conversion: Setting the Record Straight

A recent Playboy article presented a grossly unbalanced view of the social and economic effects of conversion of rental units to condominiums. This article seeks to correct some of the misrepresentation.



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IN THE NOVEMBER 1979 issue of *Playboy* Magazine, free-lance writer Asa Barber calls the advent of condominiums and the conversion of rental housing one of the bigger scams of the century. Barber suggests that conversion of rental property to condominiums is some sinister plot between developers and the banking community to reap vast profits at the expense of the rental public who enjoy few options in the residential marketplace.

The rental public who purchase their condo units are reluctant to do so, according to Barber, and once they do they face the threat of rapidly rising shelter expense and possibly catastrophic risks when repairs are required of a building. Furthermore, he adds, unit owners have little voice over repairs and changes.

The bottom line for Barber is that tax laws favor converters over land-

lords; and what this country needs, according to him, is a tax climate which favors production and retention of rental dwellings.

Positive Development

Far from a conspiracy, the condominium boom represents one of the important developments which has taken place in the domestic housing market during the last ten years. Because of an increased demand for home ownership, a renewed interest in inner-city living, and the rapidly declining profitability of rental property, the condominium form of ownership has become increasingly popular as an alternative housing source.

Without the demand, the market for condominiums wouldn't exist. The surge in condominium conversions has occurred in a number of large cities, notably Chicago, not because developers have made it happen but because the movement is beneficial to many—unit owners included.

Conversion becomes an issue for people like Barber because it tends to aggravate the rental housing shortage situation. An adequate supply of rental housing is considered essential in meeting national housing goals because of the extent to which low-income and minority groups rely on such housing. Admittedly, condominium conversion is drawing on this supply to meet demand.

At the same time, the landlord business is deteriorating. Landlords are now finding themselves in the middle of a cost-rent squeeze. As measured by the consumer price index, the cost

of owning and operating rental property has more than doubled over the last ten years, while rents have increased, on the average, by about 60%. It is unlikely in today's rental market that an apartment building will generate cash flow, even with the advantage of modest mortgage financing. Despite the fact that rents have lagged behind increases in ownership costs, the rent burden is increasing for rental households feeling the pinch of inflation.

Not Just Tax Reform

Barber has suggested that income tax reform favoring the landlord is the panacea that would curb conversion. But income tax reform will not alter the basic cash-flow position of most properties. Clearly, this city and others are in need of national housing policy incentives to encourage the construction and retention of rental accommodations for moderate- and low-income groups.

The Department of Housing and Urban Development has recognized that condominium conversion has caused displacement of some tenants. In the opinion of HUD, "tenant displacement is the most serious and prevalent problem of conversion." A study conducted by HUD revealed that, on the average, about 80% of tenants involved in conversion are displaced. "However, the seriousness of the problem should not be measured by this number," explained HUD. "Rather, the seriousness of the displacement problem must be judged by the difficulty that a displaced tenant

has in finding comparable alternative housing within the same community."

The study further concluded: About three out of every four households displaced by condominium conversion could be described as middle- and upper-income households, who when asked why they didn't purchase their units cited other than financial considerations. Despite a tight rental situation, a majority of displaced households were able to locate alternative housing in one or two months. And in the majority of cases, the alternative housing was located close to or in the original neighborhood.

While available evidence suggests that most displaced tenants are moderate and upper income and that they can find alternative housing, this is an incomplete picture. HUD has also shown that 25% of the displaced are lower-income households with 15% to 20% having at least one elderly member. For such households, displacement from conversion can be a financial and psychological burden.

National Policy Needed

The answer lies in a national housing policy aimed at encouraging rental housing production. Conversion is not about to stop while effective demand is unfilled. In fact, HUD predicts that by the end of the century, 50% of the population will be living in condominiums. Clearly, we must either subsidize these needy groups adversely affected by displacement or offer incentives to encourage rental production. The private sector must be lured with a promise for moderate profit, in the case of subsidized housing programs, or it will not participate.

Barber focused his article on developer abuse of the conversion process, which according to him produces unprecedented profits. In the earlier stages of the conversion movement, such abuse regrettably did occur. However, the existing disclosure provisions of both the Chicago Condominium Ordinance and the State of Illinois statutes have substantially reduced opportunities for exploitation.

The profit picture for developers is often overstated by anticondominium interests. The difference between gross sell-out prices and the initial cost of purchase is usually an impressive figure. However, this margin is substantially eroded by costs such as vacancy loss, marketing expenses, repairs and rehabilitation, legal costs, the cost of borrowed money and many

other direct conversion expenses.

It is not uncommon, especially in the current market, for a developer to break even on conversion. A generally accepted return is 10% to 12% of gross sales. This certainly is not an unusually handsome profit when one considers the risks involved.

Here To Stay

The 1970s witnessed the emergence of the condominium movement. Despite the railings of critics, the condominium is here to stay, and conversions will continue as long as the market demands them. Several signifi-

cant factors have contributed to this growth. The primary advantage of conversion to unit buyers is that a condominium is an investment as well as a shelter. In recent years, real estate has proven to be an important hedge against inflation. Condominiums are also the most affordable alternative for a growing number of buyers, such as the first-time homebuyer. Mortgage lenders, too, are becoming more accustomed to the specifics of condominium ownership and have shown a willingness to service such mortgages.

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Today's most modern building. Tomorrow's landmark.

Chicago architect, Stanley Tigerman, credits Mies van der Rohe with influencing his design of the Boardwalk. Lovers of the classic Mies' "less is more" school admire the clean lines of the exterior. The sparkling curtain of windows. And residents enjoy dynamic views from these floor to ceiling windows.

Popular features in this ultra-modern building are the recreational facilities including a swimming pool and tennis court, 24 hour security, the food mart, apparel boutique and an indoor heated garage. The meticulous maintenance of the Boardwalk is a reflection of the pride the owners take in living in this majestic building.

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are the Taft Hotel in New Haven and the Opera and Benjamin Franklin hotels on the upper west side of New York. Three troubled hotels on the South Michigan Ave. strip in Chicago (Pick-Congress, Blackstone and Conrad Hilton) might appropriately be considered candidates for conversion to residential properties as part of a master plan to revitalize the South Loop.

Many Neighborhoods

Although most of the discussion concerning condominium conversion in Chicago has focused on the luxury buildings along North Lake Shore Drive and several in Hyde Park, the condominium phenomenon has clearly moved away from the lake and into structurally sound and usually smaller buildings in neighborhoods undergoing rehabilitation and revitalization. Rogers Park and some sections of Uptown, as well as neighborhoods in the near Northwest area, are undergoing significant rehabilitation, most often by a growing number of small-scale indigenous firms which have discovered the condominium process as a way of making a reasonable profit by restoring valuable buildings and simultaneously enhancing the viability of neighborhoods. This process of neighborhood revitalization bodes well for city and community alike if it can be accomplished without unnecessary displacement and disruption. It is important to preserve the social fabric of lower-income and ethnic neighborhoods where possible through creative financing schemes involving both the public and private sectors, and by providing suitable and acceptable rental housing as necessary and appropriate. Options and equity must be guiding principles in this process.

It is my judgment that the process of converting multifamily buildings from single ownership to multiple ownership, either through condominium or cooperative arrangements, has the potential for filling a growing housing need for a changing urban population, while simultaneously offering a mechanism for salvaging a significant proportion of our valuable built environment and sustaining or rebuilding viable urban neighborhoods. The condominium concept has proven itself for several thousand years and its contemporary rediscovery as a viable tool for redevelopment at this juncture in our national history should not be underestimated or over-regulated. □

Setting the Record Straight

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In addition to the economic advantages of condominium ownership for the unit buyer, cultural changes have insured a favorable opinion of condominium ownership for many families. A recent survey conducted by the National Association of Homebuilders, for example, revealed that consumer preference for maintenance-free dwellings has shifted from interest in the single-family home, which requires lawn gardening and exterior maintenance, to the condominium which allows maximum free time for owners.

Finally, conversion is beneficial to municipal governments. Condo conversion may increase the tax base of the city because the market value of a building is always higher after conversion. This slows the shift of investment from the city to the suburbs. In addition, conversion is looked upon as a stabilizing effect on the neighborhood which suffers from the transiency inherent in the rental market. Homeowners, in general, who hold a greater stake in the community are less likely to turn a deaf ear to neighborhood issues.

Responsible Support

Studies conducted by Harvard University, the Northwestern Urban Studies Department, and other reliable sources such as the Institute of Real Estate Management, have come to the conclusion that the emergence of the condominium movement is one of the most beneficial developments for unit owners, neighborhoods in general, and the city as a whole which has occurred in the last three decades.

Barber's reporting of condominium conversion is loaded with shocking descriptions of fraud by the developer, tenant victimization and high risk for the unit owner. All of this highlights the worst in condominium conversion and fortunately represents the small minority of cases. In failing to portray fairly the overwhelming majority of instances in which the unit owner is satisfied with his purchase, he has given us a slanted picture of the situation. If he were to poll a cross-section of typical unit owners, and not depend on interviewing the mysterious and few developers who came to him with a heavy conscience, surely his story would not have resulted in such a disservice to the reading public. □

New Condo or Conversion?

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pleases them. They want to put their dishes in brand-new cabinets and hang their clothes in closets smelling of new wood.

And there is a group of persons to whom the term "conspicuous consumption" still holds true. There is status to moving into a brand-new building, especially if that brand-new building has a clubhouse, a swimming pool and all other modern and delightful amenities.

A new building has another positive factor. *Everything* is brand new. There are minimal construction problems and almost everything is under warranty. Any problem? The warranty takes care of it for a certain amount of time. That is security which can be very comforting.

Waiting Not All Bad

As for the distinct possibility that a purchaser may have to wait a year to move into new construction, this is not a negative to some families. Perhaps they have a home or another condominium they must sell. The year between purchasing and moving in will give them ample time to sell their old property and prepare to occupy the new.

Whether you purchase a new or a converted condominium, it is most likely there will be professional management if you are buying into a building of more than 12 units. This management will supervise the day-to-day operations of the property and will insure harmonious living and proper upkeep and maintenance of common areas on a continuing basis.

Before you buy, check on the management firm. Determine how effective it is. Take a walk around the building (if you can) and see if the property is well-tended. The management company also is responsible for record keeping, helping with financial matters, organizing committees and securing proper insurance coverage.

And finally, Mr. Prospective Buyer, know yourself also. Know what appeals to you the most. Determine how your living arrangements will fit into your way of life. Again, look into yourself. There are the answers.

Buying, building, converting are rewarding investments for everyone. With a little care and concern, they can be rewarding for you, too. □