Condo Mania

Across the country, it's pay up or move out

Peter Dreier and John Atlas

Marie Abbott was frightened. The seventy-two-year-old Boston woman, living on a fixed income and partially paralyzed by a stroke, had just received a letter from her landlord informing her that the building in which she had spent the last thirteen years was being converted to condominiums.

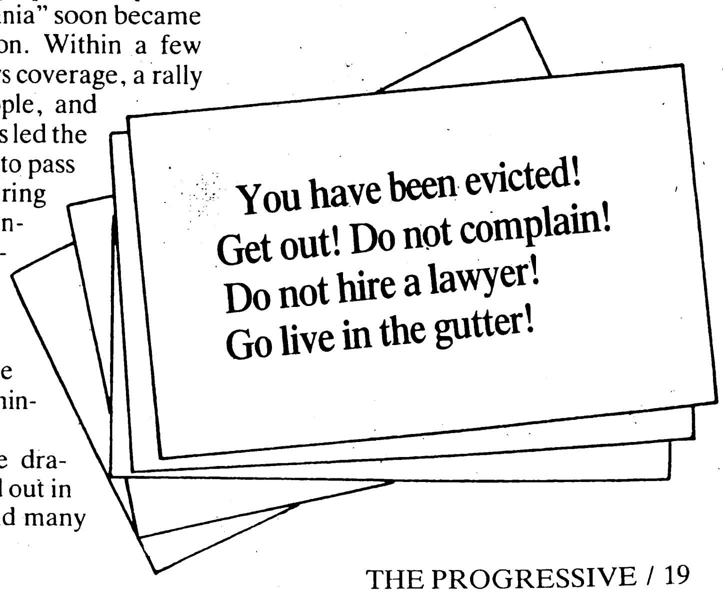
"I don't know how I can move," she said. "I'm crippled on one side. I can't walk—I can't even get on a bus. My doctor told me I could have another stroke. I'd just as soon die. I hope I do soon."

In Fort Lee, New Jersey, sixty-nine-year-old Phyllis Hoffman was anxiously debating her choices. The two-bedroom apartment she shared with her sister was to become a cooperative, its $491 rent increasing to a monthly payment of $850. "I don't have that kind of money to invest," she said. "I moved here from New York for peace and quiet. Where are we going to go?"

The 800 tenants of the Towne Estates apartment complex in Boston were asking themselves the same question not long ago. They had received the unexpected news that their complex had been sold to American Snacks, Inc., which operates vending machines, doughnut shops, and hamburger restaurants. The new owner wanted to turn the units into condominiums and had given the tenants thirty days to buy or move. The tenants, who paid monthly rents of $350 to $450, would be saddled with monthly payments of $700 to $800 for the same units as condominiums.

A few tenants, young professionals and senior citizens alike, contacted the media and several sympathetic politicians, and "condomania" soon became a hot issue in Boston. Within a few weeks the heavy news coverage, a rally of almost 1,000 people, and pressure from tenants led the Boston City Council to pass an ordinance requiring landlords and converters to give tenants one year's notice (two years for seniors and the handicapped) before evicting for condominium conversion.

Versions of these dramas are being played out in most major cities and many suburbs across the country as the trend spreads to convert rental property to condominiums and cooperatives. The boom in condominiums (in which each unit is individually owned) and cooperatives (in which each owner buys a share in the entire complex) is so new that the U.S. Census counted them separately for the first time in 1980. But it has quickly become a major factor in the nationwide decline of rental housing available to low- and moderate-income people. In November 1979, the U.S. General Accounting Office estimated the country's vacancy rate at 4.8 per cent—the lowest on record—and added that the number



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of rental units lost through conversion will outstrip the number of new units being built. In most large cities, the vacancy rate is much lower.

Condominium ownership in this country first took hold in vacation areas in the early 1970s. Between 1970 and 1975, the number of condos increased fifteen-fold to 1.25 million units, and by 1980, to more than 3 million. Indeed, condominium construction is the strongest sector of today's housing market, surpassing construction of both single-family homes and non-subsidized rental apartments for the first time in 1979.

But in the late 1970s the conversion phenomenon developed. According to a study released last summer by the Department of Housing and Urban Development (HUD), about 366,000 units have been converted to condominiums since 1970, with 71 per cent of the conversions taking place since 1977. Experts estimate that about 150,000 conversions took place in 1980 alone. According to HUD projections, half the population will live in condos by the end of the century if the trend of conversions and new construction continues unrestricted.

But like Marie Abbott and Phyllis Hoffman, most renters cannot afford to follow the trend. Studies estimate that one-half to three-quarters of tenants are unable to buy their converted apartments. Those who are forced out usually find inferior housing and higher prices awaiting them elsewhere in the tight rental market. And once they resettle, there is no guarantee that their new apartments will not be sold out from under them again.

Because of this, the conversion trend is meeting resistance from tenants and senior citizen groups. At first, most tenants are confused and unaware of their political and legal options. But receipt of a "buy up or move" letter—or even the anticipation of one—often prompts them to start talking to their neighbors for the first time. As a result, tenant organizations have mushroomed around the country.

Some tenant groups confront the converters directly. Tenants picketed the eighteen-story Promenade Apartments in suburban Bethesda, Maryland, for five months, frightening off potential buyers and forcing the converter to negotiate the terms of the conversion.

In most cases, however, tenants exert pressure on elected officials for protection. Some cities, including Philadelphia, Chicago, and Washington, D.C., enacted temporary bans on all condominium conversions. Sixteen states and several dozen cities have passed various laws to protect tenants and preserve the rental housing stock. Some prohibit conversions until the vacancy rate increases to an acceptable level so tenants have somewhere to move; others require six months' notice or more before eviction, and still others require landlords to let tenants approve the conversion or to pay their moving expenses.

Some well-intentioned laws may actually backfire, however. Senior citizens claim that in a tight rental market, landlords discriminate against the elderly if they know city laws will make them harder to evict. And in some communities, developers have circumvented tough condo conversion laws by turning apartments into luxury cooperatives. In response, cities have included cooperatives in their laws.

At the Federal level, New York Representative Benjamin S. Rosenthal introduced a bill to impose a three-year moratorium on condo and co-op conversion, to withhold Federal funds from communities that do not provide adequate rental housing, and to establish a Presidential commission to study the topic.

What is behind the condo phenomenon? Why would landlords want to sell their property, a source of income and power? The answer was summed up in a 1976 HUD report: "The large potential profits which can be made in a relatively short time when compared to new construction make conversion so inviting for investors."

According to *Forbes* magazine, a developer can usually turn a substantial profit in three to six months. The nation's biggest converter, American Invesco of Chicago, bought a thirty-story apartment building now called Outer Drive East Condominiums for $10 million in 1973, spent $250,000 on superficial remodeling, and sold the apartments for more than $14 million—a hefty 44 per cent return on investment. It was also American Invesco that purchased the Promenade Apartments for $50 million, made cosmetic improvements, and despite tenant picketing, put the co-ops on the market for a total of $100 million.

The profits are so large and so immediate that banks are happy to finance conversions at 13 per cent, 14 per cent, and on up to 20 per cent interest. An official for Continental Illinois Bank, which financed most of Chicago's big conversions, says, "We love them. The turnover is quick and we're making a lot of money." Consumer groups complain that the banks' love affair with conversion ties up mortgage money that could otherwise be spent on new construction.

Behind the dollar signs are the same investment incentives found throughout the housing industry—an industry built around tax benefits for the most affluent. One such incentive is a measure actually established as a tax reform in 1976: It eliminated rapid tax depreciation for old apartment buildings, which had allowed land owners to shelter large amounts of their rental income. While the measure discouraged the once-common practice of buying old apartments as tax shelters, holding them for a few years, and then reselling them to another high-income investor who would do the same thing, it ultimately prompted apartment owners to leave the rental market entirely—by selling out to condo converters.

In general, the rental market has not brought apartment owners the profits it once did. Their tenants are, for the most part, those left behind by the rush toward single-family home ownership of the 1950s and 1960s. In 1977, for example, while the median income of homeowners was $16,000, it was only $8,800 for renters. Landlords' operating costs have risen, but renters' incomes have not kept pace. As this gulf widens, many landlords feel they must bail out.

The first wave of condominium conversions usually takes place in the more profitable buildings in affluent neighborhoods. The recent HUD study found that most converted buildings had been generating substantial profits as apartments. It is only after this supply has been exhausted that converters go after more marginal buildings.

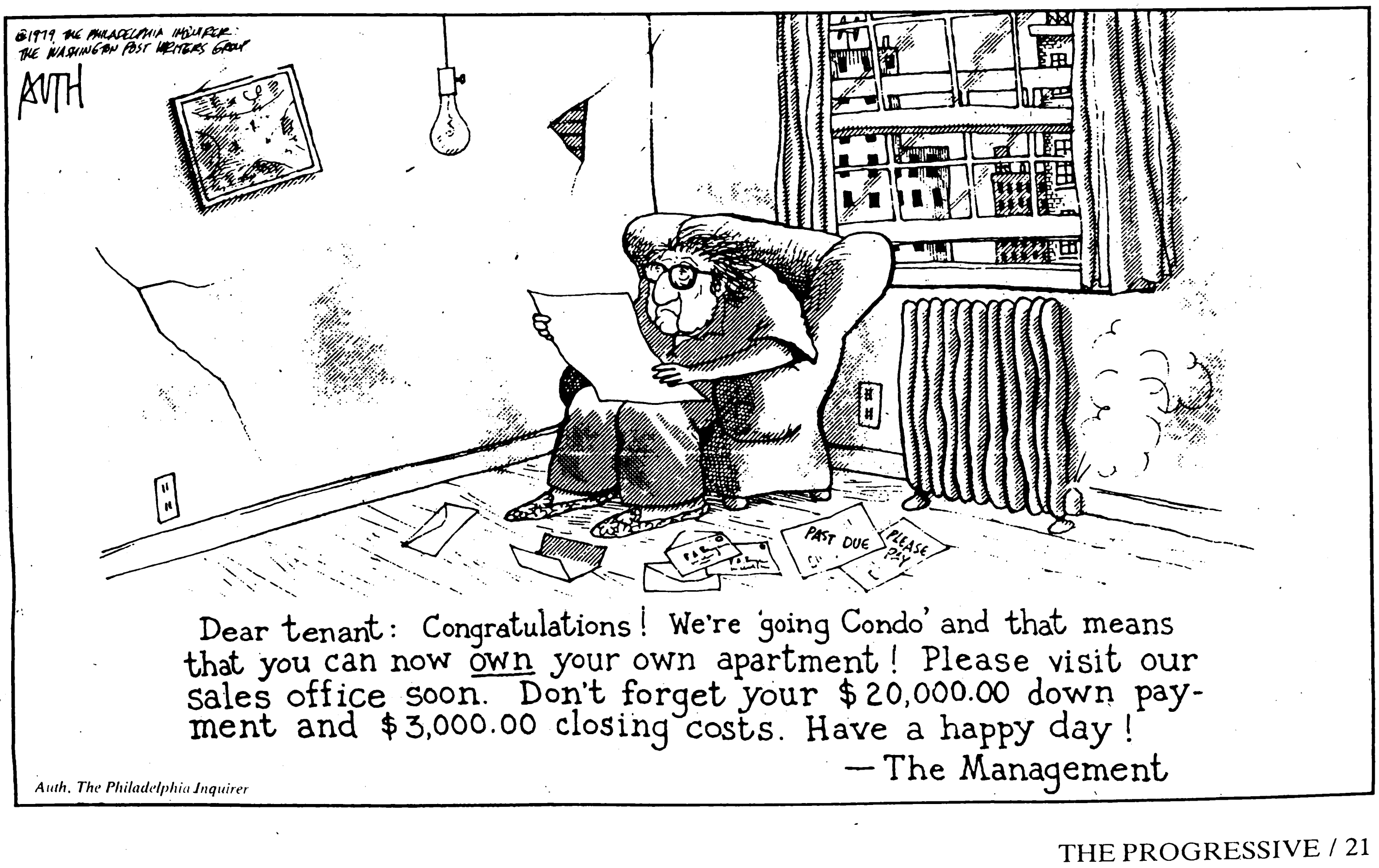
The effect of conversion is compounded by the failure of both the private and public sectors to build much new low- and moderate-income housing. New rental housing construction slowed to a virtual standstill in 1980, making it the worst year in two decades. The slowdown was due, in part, to the tight monetary policy established last year by President Jimmy Carter and the Federal Reserve Board, which dried up working capital needed to build new housing. But to convert existing housing to condominiums, rental income could still be used as working capital. Thus, conversion has been much safer than new construction.

Under these conditions, condo conversions offer building owners and speculators the quickest path to big profits with relatively little investment or risk. And where there are big profits, there is big business. Most conversions were initially undertaken by a mixture of small-time entrepreneurs and large local realty management firms, but now they are the work of far-flung enterprises. American Invesco alone has converted more than 15,000 units in sixty-three projects across the country. The company has bought up several large Chicago realty companies, a San Francisco firm, plus Colorado's largest commercial real estate enterprise. It has also entered the New York City market, buying a high-rise on Park Avenue.

The big money draws converters into politics. American Invesco, which has lobbied heavily to stop tenant protection laws, is now under investigation by Rosenthal's Subcommittee on Commerce, Consumer, and Monetary Affairs for possible violation of mortgage lending and campaign finance laws. According to one committee source, the firm spent $300,000 on lobbying just to keep its records out of the investigators' hands, and another $200,000 to defend itself in newspaper advertisements.

The profit motive is a logical explanation for the lust for condominium conversions on the part of owners, converters, and banks. But what about the condo purchasers? Why would anyone want to *buy* an apartment?

The real estate industry claims that the demand for condominiums is rooted in the desire for home ownership. There is some truth to the claim. Most Americans *have* always wanted their own houses, associating ownership with security—the freedom from eviction or arbitrary rent increases;



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postwar policies turned this "American dream" into a reality for many. The Federal Housing Administration established guarantees for single-family home mortgages, stimulating banks to make credit widely available. Federal highway construction projects paved the way for massive suburban development. The Federal income tax law made interest and property tax payments deductible, permitting home owners to pay less tax than renters at the same level.

As a result, home ownership rates rose continually from 44 per cent in 1940 to 55 per cent in 1950, and ultimately to 65 per cent in 1977. Those who continued to rent were largely those who could not afford to buy—the poor, the elderly, the urban minorities.

But that picture began to change as the average cost of a single-family home rose from $23,000 in 1970 to $80,000 today. Former developer Jay Janis, who headed the Federal Home Loan Bank Board under Jimmy Carter, has said that only a "privileged few"—about 15 per cent—can still afford to buy a new home.

As a result, many younger renters who planned ultimately to buy a house—especially two-income professional couples—have hopped on the condominium bandwagon for fear that if they don't buy something quickly, they will never be able to make a first down payment. Rising gasoline prices and urban gentrification have also made city living more attractive. Those looking for a place of their own as a hedge against inflation, but unable to afford a single-family house, may see a condominium as the only choice. Condos selling from $60,000 to more than $100,000 are snapped up by panicked buyers as soon as they come on the market. Chicago realtors have called the situation "mass hysteria."

So while "demand" for condos exists, it is, at least in part, artificial. It is a creation of long-standing Federal policy favoring home ownership, landlord-tenant laws that make renters vulnerable and insecure, and extremely low vacancy rates that create panic buying. Recent Federal policy indicates a tolerance of the situation; the Government-sponsored Federal National Mortgage Association, dubbed Fannie Mae, has taken out large ads in general-circulation magazines promoting condominiums, for instance. And Moon Landrieu, HUD Secretary under Carter, called efforts to restrict condo conversions "an emotional response."

For some, condominiums seem to be the new American dream. But for many more, they have become a nightmare. Tenants faced with conversion must either move or dig deeper into their pockets simply to keep the same roof over their heads. And even those who initially believe they can afford to buy are often unaware of the long-terms costs of owning a condo—especially in buildings with structural defects—and of the management problems that may attend common ownership of the external features of a building. Developers argue that conversion improves the housing stock by providing incentives for maintenance and repair, but many purchasers in fact buy little more than cosmetic improvements, such as an extra coat of paint or a new rug.

A fake crisis in housing triggers panic

In general, condo conversions do nothing to increase the supply of housing, but simply increase the cost. More housing for those of low or moderate income is urgently needed—yet even the private housing industry admits that it cannot provide it, either for rental or ownership. It is simply not profitable enough.

Housing policy can thus go one of two ways:

The housing industry is calling for deeper and deeper subsidies—directly through Federal housing law and indirectly through the tax code—to provide an "incentive" for new construction. But with speculation driving up the cost of land and the Federal Reserve's tight money policy boosting mortgage interest rates, the subsidies would have to be so deep that the housing built could hardly be called "private" at all—except for the private profits it would generate.

On the other hand, the Government could recognize that the housing "crisis" is largely artificial—part of a housing system controlled by bankers, speculators, and land owners who have no incentive for cost containment. The response need not be more public housing where the Government serves as landlord, bankers and real estate interests control local housing authorities, and tenants get caught in a fiscal austerity pinch. Instead of reserving public housing for the poor and regulating the private housing interests, a more comprehensive and democratic approach must be taken.

Alternative institutions, such as non-profit and community-controlled housing cooperatives and housing development corporations, could be set up to construct new housing and rehabilitate old and abandoned buildings. "Sweat equity" and "urban homesteading" programs might be promoted for the same purpose. Mortgage money could be made available by creating state banks, investing Government and union pension funds at lower interest, and supporting the National Consumer Cooperative Bank, a new agency set up to lend money to consumer co-ops that mainstream lenders ignore. Or, to keep the price of land from skyrocketing, anti-speculation taxes and land banking (holding land off the speculative market) could be encouraged. By eliminating costly incentives and subsidies to powerful private interests, such programs would actually cost less and give residents more long-term security and financial control over their housing.

As the trend toward condominiums shows, traditional housing policy that frames the issues in terms of home ownership versus rental housing has become obsolete. It needs to be replaced with an equation that considers what people want out of the places where they live—affordability, security, and a sense of control. ■