

# **REGIONAL HOUSING TASK FORCE CONDOMINIUM CONVERSION WORKSHOP**

## **ISSUE PAPER: CONDOMINIUM CONVERSIONS IN THE SAN DIEGO REGION**

June 24, 2004

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# **SANDAG's CONDOMINIUM CONVERSION WORKSHOP**

## **ISSUE PAPER: CONDOMINIUM CONVERSIONS IN THE SAN DIEGO REGION June 24, 2004**

The conversion of apartments to condominiums is a phenomenon that has been occurring over the last few decades in the San Diego region and continues to present local governments with complex challenges. As local governments encourage condominium conversions in order to increase more affordable for-sale housing, these units also often take away from the existing rental housing stock. As a result, local governments are faced with the difficulty of creating a harmonious balance between affordable home ownership and affordable rental opportunities.

SANDAG first analyzed this phenomenon in 1978 when the Board of Directors of the Comprehensive Planning Organization (SANDAG) authorized a study of rent control and condominium conversion issues within the San Diego region. This issue paper describes the recent surge in condominium conversions, common positive and negative effects and existing policies implemented in various jurisdictions.

### **CONDOMINIUM CONVERSIONS IN THE SAN DIEGO REGION:**

#### ***Tracking condominium conversions:***

It is difficult to ascertain exactly how many multifamily rental units have been converted to condominiums due to the way in which many jurisdictions track conversions. Some apartments converted to condominiums are tracked while others are not.

Rental units, that have been converted to condominiums but were not originally mapped as condominiums, are required to obtain an approved condominium map. This process allows jurisdictions the ability to track how many apartments are converted. However, many of the converted rental units were originally mapped as condominiums and therefore do not require discretionary action.<sup>1</sup> As a result, many jurisdictions do not and/or cannot track these types of conversions.

#### ***Are condominium conversions a growing trend in the region?***

Over the last several years, the supply of affordable for-sale housing has quickly become increasingly insufficient to meet the region's needs. In January 2004, California Association of Realtors (CAR) reported an affordability index of 16 percent for the region which stood as the second lowest ranking in the state.<sup>2</sup> During this period, a historically large number of conversions have occurred in the San Diego region as well.

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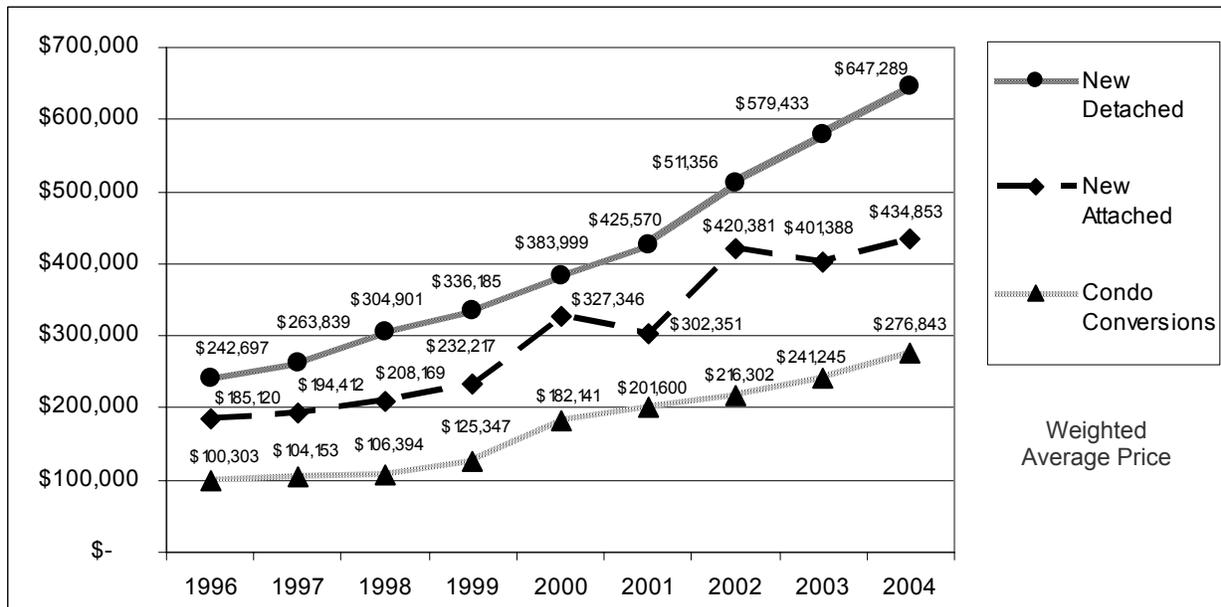
<sup>1</sup> City of San Diego. Revision to Condominium Conversion Regulations. Report NO. P-03-369. December 5, 2003.

<sup>2</sup> Wire Services. "San Diego Home Affordability Index Holds at 16 Percent." The North County Times. January 8, 2004. [online article: [http://www.nctimes.com/articles/2004/01/09/news/breaking/1\\_7\\_0411\\_58\\_25.txt](http://www.nctimes.com/articles/2004/01/09/news/breaking/1_7_0411_58_25.txt)]

With historically low interest rates and rapid rates of appreciation, many who can afford rents in the San Diego region can also afford and desire the relatively affordable condominium conversions. As a result, many apartment owners have decided to convert their apartment units to condominiums or sell them to converters in order to meet this demand.<sup>3</sup>

Throughout the region, condominium conversions are one of the most affordable for-sale housing options. For the first ten months of 2003, according to the San Diego Association of Realtors (SDAR), the average cost of a converted condominium was \$229,000 whereas the average cost of an attached home was about \$329,000.<sup>4</sup> As depicted in Figure 1, there are even larger cost differences between condominium conversions, new attached homes, and new detached homes.

**Figure 1**  
**San Diego County Annual Pricing Trends Among New Detached,**  
**New Attached, and Condominium Conversions**  
**1996 - 1st Quarter 2004**



Source: San Diego Metropolitan/MarketPointe Realty Advisors<sup>5</sup>

As a result of these factors, the rate of appreciation of condominium conversions and the number of converted apartment units sold have increased rapidly over the last couple of years. As shown in Table 1, more condominium conversions were sold in the San Diego region in 2003 than between 1996 and 2002. Condominium conversions in our region have been increasing much faster relative to Southern California as well. In Southern California, the majority (90 percent) of condominium conversions, within the last four years since 2004, have occurred in SD County.<sup>6</sup>

<sup>3</sup> Freeman, Mike. "Welcome Homes: With Housing Prices Soaring, Condo and Apartment Complexes are Rising Again in San Diego." *San Diego Union-Tribune*. August 3, 2003. [online article: <http://pqasb.pqarchiver.com/sandiego-sub/doc/380032741.html?mac=2759a154470dd8abc205dcb488ce6>]

<sup>4</sup> Vallera, Robert. "What Trends Will Drive San Diego's Apartment Market in 2004?" *The Daily Transcript*. January 7, 2004. [online article: <http://www.sddt.com/reports/2004/01/residentialreport/tj.cfm>]

<sup>5</sup> Nevin, Alan. "All is Well in Lotus Land: Will It Stay That Way When Interest Rates Begin to Rise?" *San Diego Metropolitan*. May 2004. [online article: <http://www.sandiegometro.com/2004/may/property.php>]

<sup>6</sup> Vallera.

**Table 1**  
**Condominium Conversions Totals**  
**San Diego County, 1996 – 2003**

Year	1996	1997	1998	1999	2000	2001	2002	2003
Weighted Avg. Price	\$103,303	\$106,158	\$106,394	\$125,347	\$182,141	\$201,600	\$216,302	\$241,245
Weighted Avg. \$/Sq.ft.	\$96.17	\$105.08	\$115.98	\$126.72	\$172.13	\$197.10	\$224.54	\$271.93
Sold	285	343	187	97	282	261	619	2,338

Source: MarketPointe Realty Advisors/Multi-Housing News<sup>7</sup>

According to Table 1, converted apartments have increased in weighted average price between 1996 and 2003 by about 134 percent. This rate of appreciation has been much faster relative to the region’s cost increase in the average two-bedroom apartment regionwide since 1996 of about 30 percent.<sup>8</sup>

The demand for condominium conversions, in addition to other types of for-sale attached housing, has helped create a new trend in the region. For the first time ever, more attached (2,123) versus detached (2,071) housing units throughout the region were sold in the first quarter of 2004. Of the total housing units sold, 714 units, or 33.6 percent, were condominium conversions.

By 2010, according to MarketPointe Realty Advisors, approximately 96,000 housing units could be developed with about 40 percent being developed within the next two years and the rest by the end of the decade. The projection includes 44,748 detached homes, 30,923 attached homes, and 20,486 apartments units. The apartments, depending on market conditions, could be built as condos.<sup>9</sup>

## **WHAT ARE THE EFFECTS OF CONDOMINIUM CONVERSIONS ON THE REGION’S HOUSING CRISIS?**

### **Negative Effects:**

#### ***Loss of affordable multi-family rental units:***

The San Diego region’s housing stock includes approximately 350,000 apartments. Since 1996, 4,412 apartments have been converted in the region (Table 1). In addition, apartment developers increasingly must compete for available land. Most of the sites available for apartment

<sup>7</sup> Berton, Brad. “Sales of Converted Condos in San Diego County: Skyrocketing.” *Multi-Housing News*. May 6, 2004. [online article: [http://www.multi-housingnews.com/multihousing/reports\\_analysis/feature\\_display.jsp?vnu\\_content\\_id=2073427](http://www.multi-housingnews.com/multihousing/reports_analysis/feature_display.jsp?vnu_content_id=2073427)]

<sup>8</sup> San Diego Housing Commission. [online information: <http://www.sdhc.net/giaboutus2.shtml>]

<sup>9</sup> Showley, Roger. “Attached Home Sales Outpace Detached: Shift Is Occurring in New Housing Due to Escalating Prices.” *Union-Tribune*. April 20, 2004. [online article: <http://www.signonsandiego.com/news/business/20040420-9999-1b20housing.html>]

development are being acquired by developers interested in constructing for-sale housing<sup>10</sup> and most multifamily units being constructed are condos, not rental apartments.<sup>11</sup>

***Potential displacement of lower/moderate income renters:***

There is concern that lower/moderate income renters are increasingly being displaced due, in part, to the rapid increase in condominium conversions. Typically, only a relatively small percentage of existing renters actually buy their unit.<sup>12</sup> Many of the displaced renters are then forced back into the housing market which offers few affordable rental and for-sale housing opportunities.<sup>13</sup> As a result, these renters often face numerous financial and emotionally challenging situations.

***Potential for investors purchasing units, and then renting them out at higher rates:***

In many instances, developers have simply opted to purchase apartment units only to quickly resell them to other developers for a profit.<sup>14</sup> This speculation could lead to higher prices and higher rents as a result. According to MarketPointe Realty Advisors, investors first purchase and then immediately rent out about a third of converted apartments.<sup>15</sup>

***Higher maintenance costs of converted units:***

The region's average apartment project is relatively young when compared to other areas such as the East Coast. However, many of the materials used to build the apartments in the region often wear out much faster than those on the East Coast.<sup>16</sup> Many of the condominium conversions, especially those formerly used as rental units, have older internal components and require more maintenance.<sup>17</sup> If the condominium corporation does not create a sufficient reserve fund, the new homeowners could have to help pay for the increasingly necessary maintenance costs in the future. These unanticipated expenses can often pose serious financial burdens especially for lower-income households who already balance limited budgets.

***In lieu fees used to help people purchase converted units:***

In lieu fees and housing trust fund monies often used for the construction of new affordable housing units are being used in some jurisdictions to help qualified people purchase existing condominium conversion units rather than provide for new affordable rental units. In these instances, these fees are not helping to provide the much needed increase in the supply of affordable rental units.

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<sup>10</sup> Sheehan, John and Edward, Rosen. "The Outlook for San Diego's Apartment Market." The Daily Transcript. July 10, 2003. [online article: <http://www.sddt.com/reports/2003/07/urbanliving/td.cfm>]

<sup>11</sup> Christensen, Kevin. "Housing Permitted Through October the Highest in Three Years." The Daily Transcript, November 26, 2003.

<sup>12</sup> MarketPointe Realty Advisors. "Condominium Conversions: The Only Remaining Source of Reasonably Priced Sale Housing in San Diego." September 29, 2003.

<sup>13</sup> San Diego Housing Commission. Condominium Conversions Draft Regulations. Report Item 108. December 5, 2003.

<sup>14</sup> Neely, Liz. "Conversions Mean Cash, if not Homes: Developers Gain with Condo Projects." The San Diego Union-Tribune. April 29, 2004. [online article: [http://www.signonsandiego.com/uniontrib/20040429/news\\_2m29condo.html](http://www.signonsandiego.com/uniontrib/20040429/news_2m29condo.html)]

<sup>15</sup> MarketPointe Realty Advisors.

<sup>16</sup> Nevin, Alan. "A Condo Conversion Calling." San Diego Metropolitan. August, 2003. [online article: <http://www.sandiegometro.com/2003/aug/property.html>]

<sup>17</sup> Sichelman, Lew. "Condo Conversions Require Extra Care." Union-Tribune. April 20, 2003. [online article: <http://pqasb.pqarchiver.com/sandiego-sub/index.html?ts=1084468588&classchk=pass>]

## **Positive Effects:**

### ***Potential provision of more affordable homeownership opportunities:***

As already discussed, condominium conversions are one of the most affordable types of for-sale housing in the region. In 2003, there was a substantial difference of about \$100,000 between the average cost of a converted apartment and the average price of a condominium. As a result, many are suitable for first time or affordable homebuyer subsidy programs.<sup>18</sup> And, although most of the existing renters do not buy their own units, most of the buyers are former renters.<sup>19</sup>

### ***Personal equity:***

The vast majority (90 percent) of the American household's net worth is represented by the equity in their homes.<sup>20</sup> Owning a condominium conversion can improve one's net worth. Nationwide in 2002, the price appreciation of condos (15.6 percent increase from the prior year) surpassed the appreciation of single family homes (6.1 percent increase from the prior year).<sup>21</sup> With recent rapid increases in appreciation, much of cost of the original down payment could be similar to the equity achieved in the first few years.<sup>22</sup>

### ***Rehabilitation of rental apartments:***

Many older apartments are not well-maintained. As a result of the conversion process older units may be significantly rehabilitated, thereby helping to revitalize communities.<sup>23</sup>

### ***Increased tax revenue:***

Condominium conversions can provide additional revenue for local jurisdictions. Newly converted units have a higher property value and therefore generate more property tax revenue than they did as rental apartments.<sup>24</sup>

## **CONDOMINIUM CONVERSION POLICIES IN VARIOUS JURISDICTIONS:**

### ***City of La Mesa:***

A period of high numbers of condominium conversions and displaced residents in the 1970's and 1980's helped establish the City's existing ordinance regulating the conversion of apartments to condominiums. To discourage applications for conversions, the City's ordinance stipulates, in part, that the number of units allowed to be converted in any given year is limited to 50 percent of the yearly average of new apartment units constructed in the previous two years.

According to a City report in 2003, few new apartments in the City have been constructed during the past several years. As a result, no condominium conversions were permitted during this time. It

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<sup>18</sup> City of San Diego. Report NO. P-03-369.

<sup>19</sup> MarketPointe Realty Advisors.

<sup>20</sup> MarketPointe Realty Advisors.

<sup>21</sup> Muto, Sheila. "Apartments Go Condo as Rental Demand Falls." The Wall Street Journal Guide to Property. March 10, 2003. [online article: <http://homes.wsj.com/propertyreport/propertyreport/20030310-muto.html>]

<sup>22</sup> Market Pointe Realty Advisors.

<sup>23</sup> Nevin. "A Condo Conversion Calling."

<sup>24</sup> Nevin. "A Condo Conversion Calling."

can be argued that this policy does not allow enough flexibility and limits the potential for homeownership. However, it can also be argued, according to the same report, that these regulations are more relevant today than ever before due to the City's low vacancy rates, high increases in rental costs, and lack of new affordable apartments over the last several years.<sup>25</sup>

### ***City of El Cajon:***

Currently, more than 50 percent of the City's housing units consist of apartments.<sup>26</sup> In an effort to boost homeownership rates and provide more affordable ownership housing, the City, according to a recent report, has revised its ordinance over the last few years by "deleting the minimum parking requirement, deleting the requirement for separate water meters, and more recently reducing the tenant relocation assistance obligation."<sup>27</sup>

Even though the City's ordinance regulating conversions has become less stringent, condominium conversions have not greatly increased as a result. Many recent converters have purchased apartment complexes and gained the City's approval to convert them but have decided to sell the apartments (with the approval) to another developer for a profit. Over the last few years, only 96 of the 1,116 apartment units approved for conversion have actually been sold.<sup>28</sup> Rising property values and the potential for quick profits have increased speculation.

The City's condominium conversion ordinance is currently being evaluated in an effort to help bring more units to market.<sup>29</sup>

### ***City of San Diego:***

A large number of the region's condominium conversions have occurred in the City of San Diego. Before this recent surge, conversions were much less common, and for years, the City required only two months of relocation assistance, primarily used in the 1980's, for qualifying residents whenever the vacancy rate dropped below 5 percent. As rents and home prices increased at similar rates during the late 1990's, the City determined as a result, in 2000, to not include this requirement in its new Land Development Code. The City felt that the state's less stringent law relating to condominium conversions would be sufficient to regulate conversions at that time. However, due to the recent and rapid increase in conversions, the City has recently adopted a more stringent condominium conversion ordinance.<sup>30</sup>

Although not a full description, the City's revised ordinance now includes the following requirements:

- Converters must provide three months of relocation assistance for qualified renters when the rental vacancy rate falls below 7 percent.
- All condominium conversion projects of two or more units that contain units sold to households earning 150 percent AMI or more are subject to the City's Inclusionary Affordable Housing Ordinance. This ordinance requires that at least 10 percent of the total dwelling units within a proposed conversion be set aside for households earning no more than 100 percent AMI.

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<sup>25</sup> City of La Mesa. A Proposed Amendment to the La Mesa Municipal Code to Eliminate Restrictions on the Number of Condominium Conversions that Are Allowed Annually. Report NO. ZOA 03-06. October 15, 2003.

<sup>26</sup> Neely.

<sup>27</sup> City of El Cajon. Status Report on Apartment Conversions to Condominiums. Agenda Report Item 3.3. April 21, 2004.

<sup>28</sup> Neely.

<sup>29</sup> City of El Cajon. Agenda Report Item 3.3.

<sup>30</sup> City of San Diego. Report NO. P-03-369.

- Condominium conversions sold to households earning 150 percent AMI or less, pursuant to an agreement entered into with the San Diego Housing Commission, shall not be included in the dwelling unit totals for purposes of applying the inclusionary housing requirements.<sup>31</sup>

### **POTENTIAL POLICIES JURISDICTIONS COULD CONSIDER TO ADDRESS ISSUES RELATED TO THE CONVERSION OF RENTAL APARTMENTS TO CONDOMINIUMS:**

- Adopt inclusionary housing requirements
- Provide relocation assistance to renters
- Allow the conversion of only higher end or more luxury type apartments
- Restrict the number of condominium conversions relative to the number of new rental units constructed
- Require a physical elements/conditions report to determine needed improvements and conditions of approval

### **CONCLUSION/NEXT STEPS**

The purpose of this issue paper is to shed light on the recent surge of condominium conversions in our region and their impacts. SANDAG will post this issue paper and a summary of the workshop proceedings on its Web site.

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<sup>31</sup> City of San Diego. Regulations Governing Condominium Conversions. Information Bulletin 539. May 2004.



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