



Good Neighbors

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## REPORT

**DATE ISSUED:** December 5, 2003

**ITEM 108**

**REPORT NO.:** HCR03-073 For the Agenda of December 12, 2003

**SUBJECT:** Condominium Conversions Draft Regulations

### SUMMARY

Issue: Should the Housing Commission recommend that the City institute regulations to govern conversion of condominiums?

Recommendations: Recommend adoption of the proposed condominium conversion regulations (Attachment 2) that would amend Municipal Code Chapter 12, Article 5, Division 4 and Chapter 14, Article 4 as follows:

1. Require that condominium conversion applicants provide a relocation/down payment assistance payment of three months current rent to residents of units being converted who earn less than the area median income (AMI) when the rental vacancy rate is below 7%.
2. Amend the Inclusionary Housing Ordinance to apply inclusionary housing requirements to converted units that will sell for more than 150% of Area Median Income.
3. Assure that units undergoing conversion meet all applicable local and State building and zoning standards.

Land Use and Housing Committee Recommendation: On September 17, 2003 the Land Use and Housing Committee voted 4 to 0 to forward the Manager's Recommendations described above to other reviewing bodies prior to their consideration by the full City Council.

Community Planners Committee Recommendation: On November 25, 2003, the Community Planners Committee voted 16-7 to support the Manager's Recommendation. The dissenters were concerned that the proposed regulatory changes would increase the purchase price for converted condominiums.

Affordable Housing Task Force Recommendations:



1. Provide relocation assistance for seniors, disabled, and low income households displaced by condominium conversions and provide down payment assistance to encourage homeownership.
2. Apply the recently adopted inclusionary housing requirement to condominium conversions.
3. Require that converted properties must meet building and zoning requirements in effect at the time of construction. Plumbing, mechanical, electrical systems must be in good working order. Roof systems must be inspected by a licensed contractor or home inspector. Walls and roof should have insulation or meet Title 24 at the time of construction.

Fiscal Impact: Collecting and distributing relocation/down payment assistance and expanding the Inclusionary Housing program to include some condominium conversions would result in increased administrative costs to the Housing Commission. These costs would be dependent on the level of conversion activity and are proposed to be reimbursed by applicant for conversion.

## **BACKGROUND**

In recent years the City of San Diego has seen a dramatic increase in the number of residential rental units that have been converted or are proposed to be converted to condominiums. Applications to convert 2,113 units in 161 projects have been received since 1999 including 668 units in the past four months. A summary of conversion activity is included as Attachment 1. It should be noted that these figures only include units that were not initially mapped as condominiums and, therefore, require approval of a condominium map in order to convert. Many other units were initially mapped as condominiums but have been operated as rental projects for a number of years before undergoing conversion. The City does not track these units due to the fact that there is no discretionary action required for the units to begin operating as condominiums.

The recent increase in condominium conversions is a market reaction to the severe shortage of affordable for sale housing in San Diego coupled with some softening in the rental market. During the past few years home prices have increased by 15-20% per year in San Diego, one of the fastest appreciation rates in the United States. In many cases condominiums have appreciated even more rapidly. Residential rents, by contrast, had been increasing locally at about 5-6% per year but recently the rate of increase has been slowing. High prices, high rates of appreciation for condominiums and low interest rates have fueled the recent interest in condominium conversions. The Union Tribune reports that the average price of a converted condominium unit in San Diego during the first half of 2003 was \$230,364 compared to \$378,215 for a new condominium unit. New units tend to be larger, more luxurious and contain more amenities than converted units.

State law requires that condominium projects receive a subdivision map in order to establish individual ownership interests. Further, it establishes a number of conditions to protect both the tenants and prospective buyers. These include a number of noticing requirements, such as 60 days written notice to tenants of intent to file an application for a tentative condominium map

and 180 days written notice of intention to convert prior to termination of tenancy due to proposed conversion. In addition, State law requires that units being converted be offered for sale first to the renters currently occupying the units.

Previously, the City of San Diego had condominium conversions regulations in place that required applicants for condominium conversions to pay two months relocation assistance to low income, disabled and elderly tenants when the rental vacancy rates were below 5%. This requirement was excluded when revisions to the Land Development Code took effect on January 1, 2000. The regulations were eliminated due to changes in market conditions. At that time, rents and home prices were moving up at roughly the same rate and few if any condominium conversions were taking place. In addition, State laws on conversions, which were enacted after the original City regulations were adopted, were thought to be adequate to regulate condominium conversions at that time.

The Affordable Housing Task Force (AHTF) devoted considerable attention to the condominium conversion issue. They made three recommendations on this issue that are listed in the Summary section of this report. The Manager's recommendations include a refinement of the first two AHTF recommendations (requiring relocation/down payment assistance for tenants of units undergoing conversion and application of the Inclusionary Housing requirement to condominium conversions). The third AHTF recommendation is for converted units to meet specific zoning and building standards and inspection requirements. The LU&H Committee agreed with staff that existing State and local regulations are adequate to ensure that units being converted meet appropriate building, zoning, health and safety standards. In addition, they noted that purchasers of converted units are required to have inspections prior to purchase. Therefore, no new regulations relating to inspections or quality standards were proposed by the LU&H Committee.

## **DISCUSSION**

Condominium conversions have often been described as "a double edged sword" with both positive and negative effects. The benefits of conversions are that they often provide home ownership opportunities at a price level significantly below that of new construction in San Diego. The relatively low prices of many converted condominiums make them particularly suitable for first time or affordable homebuyer subsidy programs. Other advantages of condominium conversions include an increased rate of homeownership and higher property taxes. A detrimental effect of condominium conversion is that many current renters of these units cannot afford to buy their unit and are, therefore, displaced from their units and forced back into a housing market which offers few affordable opportunities for rental or for sale housing. In addition, there are concerns that the rapid increase in condominium conversions is resulting in displacement of low-income residents. The proposed regulations described below attempt to address both the positive and negative issues associated with condominium conversions.

As noted above, the City previously imposed a relocation requirement of two months rent for qualifying residents. This requirement applied to applicants for condominium conversions when the rental vacancy rate was below 5%. A similar requirement has been proposed to be reinstated and would directly benefit lower income people displaced by condominium conversions during

periods of tight rental housing supply. To ease the burden on conversion applicants, it is recommended that the relocation assistance requirement be limited to renters who earn less than the area median income (AMI). This would benefit those individuals and families, including the elderly and disabled, who are most negatively impacted by condominium conversions. The money could be used for relocation or for down payment costs to purchase a unit. There would be no limitations on use of the relocation assistance.

An increase in the previous amount of relocation assistance, to the equivalent of three months of the tenant's current rent, is recommended because two months rental assistance is often inadequate to cover moving costs, rental application fees, prepayment of first and last months deposits and other costs associated with relocation. A vacancy rate threshold of 7% is recommended for the relocation/down payment assistance requirement because even when an overall vacancy rate of 5-7% exists (considered a moderate and healthy rate), there is a shortage of vacant units in San Diego affordable to lower income tenants. The median rent in San Diego of \$1,175 (Union Tribune, September 9, 2003) is unaffordable to a large segment of the population. There is a two-tier rental market in San Diego with older, smaller, less expensive units located primarily in older communities and newer, larger, more expensive units concentrated in newer communities. During the past decade most of the new apartments constructed have been higher cost luxury units. Although the market for the higher end units in San Diego has recently softened, units affordable by people earning less than area median income remain difficult to find. Unfortunately, the smaller less expensive apartment complexes are usually not included in rental and vacancy surveys.

In addition to relocation assistance for affected tenants, it has been recommended that inclusionary housing regulations apply when units are converted. The inclusionary housing provisions recommended by the LU&H Committee for condominium conversions would require applicants for conversions to either offer 10% of the converted units at a price affordable to residents earning 100% or less of area median income (AMI), provide the same number of affordable units at an off site location, or pay an in lieu fee. Units being sold at 150% of AMI or less would be exempt from any inclusionary requirement. This exemption criteria is intended to encourage relatively modest sales prices.

The AHTF recommendations regarding building and zoning code requirements and standards for mechanical, electrical, plumbing, roof and wall systems cover areas that are already comprehensively regulated by the City and/or governed by rules set forth by the State Department of Real Estate. All condominium conversion projects must have been constructed in accordance with City codes in effect at the time of initial construction. In addition, the State Department of Real Estate requires an inspection of the project's condition as a requirement of establishing a homeowners association. Therefore, additional requirements in these areas are unnecessary for conversions. Recently revised rules for processing condominium conversions will ensure that they will all be carefully scrutinized to assure that all applicable local and State building and zoning standards are being adhered to.

Administering the recommended relocation/down payment assistance would result in an increase in workload and staff time at the Housing Commission. A \$200 deposit for each unit

subject to a payment is proposed to cover these costs. The funds are equal to approximately three hours of staff time. The funds would be used to reimburse the Housing Commission for its costs incurred in ensuring compliance with the obligations set forth in the regulations and in providing technical assistance to assist eligible tenants in their relocation. If the costs incurred by the Housing Commission exceed the amount deposited by the applicant, an additional deposit could be required.

The proposed relocation and inclusionary requirements would modestly increase the costs of and potentially deter some conversions. However, the increased equity, protection of lower income renters and other benefits of these proposals, enumerated above, outweigh the costs. Therefore, the measures described in this report are recommended.

Respectfully submitted,

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ATTACHMENTS:

1. Condominium conversion statistics, Development Services Department
2. Draft revisions to condominium conversion regulations