

THE SPONSORS OF CONDOMINIUMS IN LARGE U.S. CITIES

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ABSTRACT

Many large cities in the U.S. have witnessed a proliferation of condominiums since 1970. At first, the condominiums were predominantly newly constructed, but subsequently most additions to the condominium stock were converted from existing rental units. The condos vary according to type of structure, location within the metropolitan area, price, and submarket. They have been promoted under changing housing market conditions, and have been influenced by a variety of changing external factors.

This paper explores the emergence of the condominiums in large U.S. cities and notes their varying characteristics. Subsequently, my argument for the study of the sponsors of the condominiums is presented. Based on a number of in-depth interviews with developers, real-estate consultants, and financiers, the background of the decision making process of the sponsors is sketched. Finally, a few possible effects of the emergence of the condominiums for the social structure of the urban area are discussed.

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Introduction

Condominiums are a relatively new phenomenon in the housing markets of large U.S. cities. As recently as 1970, the entire stock of primary-residence condos in the U.S. amounted to only 60,000 units, and these were strongly concentrated in only a few locations.¹ But since 1970 the production of condos soared: in 1975 the stock was estimated to number 1.25 million units; the 1980 Census of Population and Housing will likely register over two million units; and in a recent report, the Department of Housing and Urban Development predicted that the total number of condominiums may very well amount to over three million by 1985!²

These numbers in themselves, although testifying to a phenomenal increase, do not make the condominiums of great importance to the study of the urban housing markets in the U.S. Even if three million units would be in existence by 1985, the condos would still account for only approximately five percent of the total housing stock. More interesting than the increasing number of units, however, is the relative concentration of the condos in a limited - but expanding - number of housing markets and the changing spatial distribution of the condos. Furthermore, the recent proliferation of the condos and their rapidly increasing share in recent completions imply that they constitute a rapidly increasing share of all units currently available to home-buying households. An additional reason to study the condominiums in their effect on other housing submarkets; this effect has become of prime concern since the majority of new condos now result from the conversion of

existing rental housing, which has helped to worsen the rental housing crisis.

The introduction and proliferation of condominiums have been accompanied by an increasingly heated public debate on alleged advantages and disadvantages of the condos. To some, the condos provide new opportunities for home-ownership at a time when single-family homes are priced beyond the means of the average household and in locations where no other types of home-ownership units could be provided. Such supporters of the condominiums frequently point out that this type of housing can thus aid the ailing central cities: by attracting new investment, by preventing further flight to the suburbs, and even by stimulating the return of suburbanites to the city. To others, the condos signify a threat to stable communities by eroding the rental market. These opponents generally demand more government intervention to protect the population that is being displaced and to save the remaining rental housing from extinction. They see such government regulation as the only alternative to an otherwise unavoidable expansion of government involvement in the provision and maintenance of housing.

The study of condominiums must incorporate the wide range of aspects characteristic of this form of housing and of its impacts. In this paper, however, a limited perspective will be taken; other aspects will be studied in subsequent papers. After a brief review of some of the varying and changing characteristics of the condominium structures with respect to location, structure types, price, and market position, the discussion will focus on the sponsors of the condominiums. At first, I

will present my arguments for studying the supply side of the housing market. I will subsequently outline the role of the condominium developer, the options he has, and the conditions that influence his choice of option. Finally, I will make some tentative observations on the probable impact of the condominiums on the changing social structure of metropolitan areas.

Changing Characteristics of the Condominiums

The 60,000 primary-residence condominium units that existed in 1970 were concentrated in only a few SMSA's; SMSA locations accounted for 92% of all units. Most condos were concentrated in the South and West, where they were to be found predominantly in retirement communities. In several SMSA's - such as Fort Lauderdale/Hollywood and West Palm Beach in Florida, and Anaheim/Santa Ana/Garden Grove in California - they accounted for five percent or more of the total housing stock.³ At the time most condominiums were part of townhouse complexes, with only 35% in multi-family structures. High-rise structures accounted for only 13.4% of all condominiums. The majority of the condos were inexpensive, according to a limited survey:⁴ 48.7% were offered for sale at a price between \$20,000 and \$35,000, and an additional 15% of the units were priced below \$20,000.

Between 1970 and 1975 over a million new units were constructed. The production clearly accelerated until 1973, but the ensuing economic recession of 1973/74 diminished the number of housing starts in general and also negatively affected the construction of condominium projects.

In 1974, the production dropped by 100,000 units below the 318,000 units constructed in the previous year; in 1975, only 40,000 units were completed. Even though the production of new condominiums rebounded somewhat around 1977 (production: 150,000 units), the record outputs of the early years of the seventies was not matched in a single year during the second half of the decade.⁵ Overproduction in the early years of the decade, sharp increases in construction costs, increasing government controls, and a very tight housing market which rapidly inflated housing prices are generally considered to be the dominant factors in moving the newly constructed condominiums out of reach of most first-time homebuyers and retired people on fixed incomes.

While the condominium starts in new construction projects showed a marked decline, the conversion of rental units to condos gained momentum. Between 1970 and 1975 only approximately 85,000 conversions took place, but in 1976 20,000 units were converted, and from then on the number grew rapidly. Both in 1979 and 1980, 145,000 units were reportedly converted.⁶ The rapid proliferation increased the overall market segment of the condos, but of far greater importance was the altered spatial distribution of the condos. While most condos are still to be found within (the largest) SMSA's, they are no longer restricted to those of the South and West: all now have significant numbers of condos, both in their central city areas and in the suburban zones. The conversion phenomenon, especially, has reinforced the concentration in urban areas, since structures and complexes suitable for conversion are mostly confined to such areas. An indication of the dispersion of condominiums to all major metropolitan areas can be found in the recent HUD study of the conversion of rental housing to

condominiums: the twelve most active SMSA's with regard to condominium conversions (which together account for 54% of all converted units) not only include areas that witnessed an early emergence of condos, such as Miami, Tampa, Los Angeles and San Francisco, but also SMSA's in other parts of the country: Boston, Chicago, Denver, Minneapolis, New York, Seattle, and Washington, D.C.⁷ In several of these cities practically all of the most desirable buildings have already been converted, and the conversion is currently spreading to smaller, older, and less expensive complexes that frequently need more rehabilitation. At the same time, developers who concentrate on rapid conversion of luxury buildings have shifted their activities to other cities.

Most condos are part of townhouse complexes or of garden apartment complexes. They are attractive to buyers for several reasons: their lower price when compared to single-family homes; the joint recreational facilities often included; more attractive designs and lay-out than in the standard subdivision; and finally, the transfer of maintenance responsibilities from the individual owner to the homeowners association. To sponsors, such complexes allow greater flexibility in development and thus carry less risk than high-rise complexes. The low percentage of high-rise complexes is also due to the fact that approximately 50% of all condos are found in suburban locations.

Also by price the condos are differentiated in a number of submarkets. A large proportion of condos is low to moderate in price, but examples of very expensive units abound. Recently constructed condos tend to be more expensive, due to the rapidly inflating construction costs. The number of expensive condos is further augmented by the conversions; at

first the most luxurious apartment buildings tend to be converted when developers move in on the conversion trend. But in general, the conversions are cheaper than newly constructed units, which has helped to keep the condos affordable.

Finally, in the characteristics of the occupants, the condos are distinguished in some respects from other housing: the elderly are clearly overrepresented (partly due to the large number of condos in retirement communities), and so are singles, newly started families, and 'empty-nesters'.

The condos still don't dominate the housing stock numerically. They constitute, however, a large share of the units offered for sale at any one time. In the early seventies they accounted for 15%-30% of all recently completed dwelling units, and this proportion was much higher in those market areas where they were concentrated. Toward the end of the seventies, the share of condominiums in private multi-family construction - without government subsidies - increased to above 50%.⁸ At the same time, the conversion of rental units increased dramatically. By 1980, 1.3% of all rental units in the U.S. was converted; the percentage was found to be 2.2% for the 37 largest SMSA's, and an impressive 2.7% for the twelve most active SMSA's combined. Individual large cities have, however, witnessed even higher conversion rates: HUD reported that in Washington, D.C. 8% of the rental stock has been converted, in Denver 7%, in Chicago 6.8% and in Houston 5.4%.⁹ Many smaller communities and specific areas within large cities have been plagued by even higher rates. The effects of this wholesale shift of units from one submarket to another has fueled the public debate, and prompts us to look at the production side of the housing market.

The Study of the Residential Development Process

To understand the changes in the character of residential areas and consequently in the social structure of cities, geographers have given attention to the functioning of housing markets. Housing markets tend to be complex, due to the combined characteristics of dwellings, locations, and households. Regularity is observed in that specific types of dwellings tend to dominate certain areas, and given types of households tend to occupy similar dwellings. Consequently, the introduction of a new form of housing in an area would affect its social composition. The most direct approach to account for changes in the housing market is practised in micro-level studies: such studies generally aim to identify the actors involved and account for their respective roles.

Classical economists tend to stress the demand side of markets. From this perspective, they might account for the increasing number of condos by emphasizing the increasing number of household formations; by observing that the post-war 'baby boom' has now reached prime home-buying age; by an increasing demand for tax-shelters because of inflating incomes; by noting that many people buy now - even at unreasonable costs - because of the fear that inflating prices will move the home ownership market out of reach within one or two years. The general decrease in family size, the increasing number of adult-only households, changes in lifestyle, and more emphasis on security promote the demand for apartments and units in fenced-in complexes.

Studies of the functioning of housing markets, however, have closely established that these factors in and by themselves cannot account for

the changes in the housing market. The consumers are compartmentalized in housing classes, groups with different positions in the housing market, determined by a system of formal and informal controls wielded by the various actors on the supply side of the market.¹⁰ Harvey's study of the role of financial institutions¹¹ showed how owners, managers, and various agents utilize existing social and economic status stratification to allocate consumers to specific submarkets. Other researchers studied the production process of housing and focused on the analysis of the decisions underlying this process to account for the functioning of the housing market, its reinforcing mechanisms, and the vehicles for change.¹² Their analyses are based on the observations that most housing units are speculatively built for the market, and thus, that housing consumers can only choose among the alternatives provided by the developers. The developers' decisions are guided by the profit motive and constrained by a number of limitations; consumer preferences are only taken into account if they are recognized by the developers and in as far as they run parallel to their interests.¹³ Therefore, a proper analysis of the supply of dwellings in a market economy requires an analysis of the decisions made by developers. Among the various actors on the supply side of the market, the developers take the central position, because it is their role to take the initiative: to initiate the production process and to bring the other actors together. Although many significant differences exist among the developers, as reflected in their activities, in essence their role in the supply process is similar, and this process can be described in a general format.

The Development Process¹⁴

The developer formulates the project objectives, he combines the various production factors, manages the production process, and sells the product. His specific contributions to the production process are: an intimate knowledge of the market (actually of three markets, e.g., the housing market, the capital market, and the market of the (other) production factors); familiarity with regulations; access to other agents on the supply side; and a willingness to take risks. The other key actors (owners, financiers, builders, and consumers) have to take positive action for the development process to succeed. In addition, the production process is helped along and to a certain extent influenced by a medley of specialists and intermediaries (attorneys, accountants, consultants, architects, title searchers, realtors, appraisers, government officials, etc.). The fact that the production of dwellings is such a long, complex chain of decisions forms the basis for the important role of the developers as initiator and mediator.

In the initial stage of the production process a prediction has to be made of the demand for the dwellings the developer contemplates producing, or even of a number of alternative options. The prediction does not only require accurate knowledge of the consumer demand, but also a good assessment of the activities of the competition. The highly fragmented production of housing has frequently led to over production and, in general, to severe oscillation in output. In 1975, approximately 20% of the total condominium stock in the U.S. was unsold, the single most important reasons for the spectacular drop in condo starts in that

year! The percentage of unsold units fluctuated from one year to the next, and often even within shorter periods. HUD concluded that these fluctuations were supply related: producers in market areas with a stable output did not encounter substantial problems with unsold units, but producers in strongly fluctuating markets (e.g. Fort Lauderdale!) suffered major losses. By and large, the demand for condos increased steadily, yet was not able to absorb rapidly increasing rates of output.¹⁵ The observation made earlier that the production of newly built condos dropped significantly during the second half of the seventies does not contradict this: the decline is explained by the rapidly increasing construction costs (e.g. in Denver: average \$12 per sq. ft. in 1970 to \$26 per sq. ft. in 1980) and by the availability of the converted units at lower prices.

In reality, the developer does not sell to the consumer but to an investor, either a mortgage bank or an equity investor. The developer thus has to create a product that meets their (investment) requirements. Before the development can start, financing arrangements must be made. The commercial banks that provide the construction loans and other short-term loans require security in the form of escrow money, pre-sales commitments, refinancing contracts, or liens on property. Mortgage lenders are interested in long-term worth as a guarantee against having to foreclose on property with little resale value. Equity investors are primarily interested in rapid appreciation. By and large, once horizontal property acts had been adopted by the states upon the instigation of the real estate and construction industries, to provide the necessary legal protection, the condos have satisfied the requirements of all these lenders. Only during the period of overproduction in the early seventies

was the confidence temporarily shocked. The current high interest rates have also tended to make lenders more cautious, but developers with good personal contacts and a good track record have little difficulty in finding money - but they have to pay more for it. In fact, increasing interest rates have, to a certain extent, stimulated the production of condos, because they forced to market toward cheaper units which the consumers could still afford. Only when the mortgage interest rates reached 18% was the production of condos also negatively affected, and during 1980 many new projects (both construction and conversion) were temporarily halted.

The financial plan has to be adopted before the development can be carried out; the developer has to seek commitment from the investors. To get favorable terms for qualified buyers, the developer pays points to the bank; sometimes he takes back a mortgage himself, if buyers are finding it hard to meet downpayment requirements. While such actions on the part of the developer might promote sales and could lead to more advantageous tax-planning by spreading the income over a number of years, the developer runs a high risk of losing his money if the buyer defaults. Tax-planning, greater flexibility, and less dependency on expensive outside financing are also important in the choice of the type of project the developer anticipates. Such factors, along with greater market appeal and restrictions on high rise structures, explain the popularity of townhouse and garden-type apartments among condominium developers.

The conversion of rental housing to condominiums is a development process that is very similar to new construction; only the selection of the structure to be converted and the sales program differ. Initially,

the conversions were limited to prestigious buildings and to structures in higher status areas. Often such conversions have a captive market, since tenants can not easily find an equivalent substitute for their present residence. High-income households can afford to buy their units and often can reap significant tax benefits. Conversions provide outsiders with an opportunity to buy into attractive neighborhoods relatively cheaply. Such projects, however, have already become unavailable in those cities where the conversions were introduced early. Developers who specialize in rapid conversion of luxury apartment buildings have shifted their activities to other cities. Other developers working on a smaller scale and more involved in rehabilitation have concentrated on smaller, lower-priced complexes. Thus, conversions have spread to more cities and have been promoted in various parts of cities and suburbs.

Apart from location and prestige, the age of the building, its amenities and appliances, its construction quality (and consequently the rehabilitation and remodeling costs), and the unit-differentiation are influential to the decision whether or not to convert it. When the necessary outlays for rehabilitation and remodeling are high, it is less likely that the building will be converted early. The construction and engineering reports are major inputs for the feasibility study. This will be made at an early stage in the conversion process, generally after the developer buys an option on a particular building and before he will commit himself. Older buildings generally require a higher investment than newer buildings, but this need not deter the conversion if the higher costs are compensated for by a superior location. New

projects are often converted "as is"; this is facilitated by the fact that rental buildings are nowadays designed with eventual conversion in mind. The differentiation of units by size and number determines the best market: singles and beginning families tend to prefer small apartments, while empty-nesters look for units with at least two or three bedrooms. Finally, an analysis of the present tenant profile is of increasing importance, on the one hand to estimate the number of potential buyers, and on the other hand because an increasing number of local governments have adopted protective measures by which certain groups have to be offered relocation assistance, alternative housing, or life-long leases on their present units.

An important aspect of conversion is compliance with government regulations; an increasing number of states and local jurisdictions have adopted regulating mechanisms. Such protective and regulatory statutes vary strongly from place to place. All states have adopted procedures for conversion and for registering new or converted condominiums; approximately 50% of all states have passed additional legislation. Numerous municipalities and countries have elaborated upon these to protect the housing market in general or to give special protection to specific groups of renters. Developers who spread their activities into new market areas are therefore generally obliged to hire the services of local real estate attorneys or consultants.

Finally, the developer has to develop a sales strategy which will guarantee a successful sell-out of the units. The sales strategies differ depending on local market conditions (including local government regulation), the characteristics of the complex being converted, the tenant profile, and the characteristics of the developer. Yet, most

strategies aim at maximizing the sale to present tenants both to attain the desired quick turn-over and to comply with increasing government regulations. In addition, many lenders nowadays require a 60%-80% pre-sale rate as a guarantee for successful conversion. A carefully designed sales strategy can also benefit the converter through minimal vacancies due to short-term leases on unsold units, especially when little or no rehabilitation is necessary. Thus, the developer can obtain income to supplement expensive short-term financing. Tenant discounts are often used as a powerful sales argument. Sales are often promoted by an open and correct relationship with tenants, but other developers attempt to get the same results through misrepresentation, aggressive sales procedures, or even harassment.

The conversion generally brings the developers a substantial reward for his activities and an attractive return on his equity investment, if he contributed any funds at all. The recent HUD conversion study¹⁶ quotes several sources that mention an average gross profit of some 30%. This yield is much higher when not related to the purchase price (plus rehabilitation costs) but to the developer's investment. Reportedly, prices are generally set at such a level that renters in low and moderately priced units would pay prices \$50-\$100 per month more for the ownership costs of their units than they would previously pay in rent. In expensive buildings the monthly outlays often double. Private equity investors who speculate on rapid appreciation to make capital gains are generally willing to pay a price so high that a negative cash-flow of up to \$100 per month results when they rent their unit on a short term lease.¹⁷

In spite of the very attractive profits that can be made by converting a rental complex to condominiums, owners of (larger) rental properties have not tended to undertake the conversions themselves, either independently or a joint venture with a developer/converter. The major reason for this is to be found in the different tax rates on ordinary income and on capital gains. If an owner sells a structure in its entirety, then, irrespective of the intent of the purchaser, his profits will be taxed as capital gain. If, however, the owner would be involved in selling the individual units, the IRS would consider him to be a real estate dealer, and any profits from such activities would be taxable at the ordinary income tax rate.¹⁸ Even though new schemes are continuously attempted, including conversions by tenants, it seems that the developer/converter will continue to enjoy a beneficial position, as long as the external conditions that govern the market allow condos to remain feasible.

Conditions that Stimulate Condos

Since 1970, the housing supply in the United States has seen some significant changes due to variations in total output, in characteristics and mix of types of newly completed units, and because of a decrease in mobility toward the end of the decade, which brought fewer older dwellings onto the market. The total number of newly constructed dwelling units amounted to almost 18 million between 1970 and 1980; during the first six years of this period, more dwellings were produced than in any previous decade. In each one of the years 1971-1973, the output topped two million units, only to fall back to less than 1.2 million

units in the wake of the 1973/74 recession.¹⁹ Following an initial recovery, the production dropped once more toward the end of the decade, mainly because of cost increases in all production factors. The new residential developments tend to show a higher density than before, houses and lots are downsized in an effort to keep the costs down, and an increasing number of units are completed in multi-family structures. A decreasing percentage of these are built as private rental complexes without government subsidies. The production is kept up only because of expanding government outlays and because of condominiums.

A number of explanations have been advanced to account for these changes. The higher densities and the increasing proportion of multi-family units have been related to steep increases in land prices and construction costs, which inflate the cost of the standard single-family home. Between 1972 and 1976, land prices rose 13% per year; the annual construction cost increases amounted to 8%, and the price for the average new single-family home increased 12.5% per year. (The price of existing homes inflated annually at the rate of 9.3%.) Since 1976, these price increases have continued, fueled by an increasing inflation rate and interest rates that reached record highs. The increase of the cost of borrowed capital was certainly a major factor and one neither the housing industry nor the consumers were used to. Since the Second World War, the interest rates have tended to become higher, but very slowly. In 1963 the rate was 5.89%, in 1972 it stood at 7.6%, and in 1976 at 9%, but in 1980 the prime rate had moved to over 20%, and mortgage loans were offered at 18%. These interest increases

influenced the return on invested capital and the total construction costs. The construction costs have been forced up by increasing government regulation of the development process, which has extended the length of time between the first design and the completion of the structure, entailing interest loss. Construction costs have also been raised by front-loading more of the development costs. (Formerly the development was slowly brought up to normal standards during the period of occupancy, but increasingly it is required to have the development completed before the first inhabitants move in.) The average construction costs increased substantially; because of these increases, fewer families can afford to buy a new home as first-time buyers. The average family income has increased far more slowly than the cost of housing (between 1972 and 1976, only by an annual 7%), and thus, while in 1963 53% of American families could still afford to purchase a home (at \leq 25% of the gross family income), this percentage had decreased to 41% in 1975 and has since dropped further. In the early seventies, two-thirds of the completed homes were bought by first-time buyers; by the end of the decade, only one-third of these homes went to this group.²⁰

Because of their higher density, their relatively small size, and the economies achieved by mass production and rational construction methods, the condos are cheap in comparison with the standard single-family homes. But recently, also their market has been eroded by price increases, which led to the relative decline in output of new condo units. Their price now compared unfavorably with the competing converted rental units.

The conversion of rental housing to condominiums has rapidly increased, not only as a reaction to the increasing construction costs of new construction, but also because of the predicament of the rental market. The annual production of privately financed rental units has decreased from an annual average of 478,000 units during the 1972-74 period to approximately 50,000 units in 1980. This production falls short of the demand by approximately 200,000 units annually. During the most recent years the stock of rental units has witnessed a decline of 20,000-50,000 units annually,²¹ because of conversion and abandonment.

The private rental market suffers from a number of difficulties. Most of the rental stock is old (41% was built before 1941) and in disrepair; this results in high maintenance costs if the manager/owner intends to maintain his possessions properly. The yields are generally (too) low but cannot be raised substantially, due to the low average income of the renters. (One third of all American families are renters. Their average family income amounted to \$8,800 in 1977, which compares with an average family income for homeowners of \$16,000. The gap between the incomes of the two groups is growing, partly because the renters include the hard-core poor and partly because anyone with an increasing income joins the ranks of the homeowners if at all possible.) The proportion of income spent on housing costs is high among the rental population: 30% of renting families pay over 35% of their before-tax income for rent, 48.7% pay more than the generally accepted maximum of 25%.²² The number of units subsidized through one of the various HUD programs increased rapidly. (The total number of subsidized housing

starts in multi-family structures in 1975 was approximately 50,000 units; both in 1979 and 1980, the number of subsidized housing starts was approximately 200,000. Due to a decreasing output of multi-family construction, this production represented a growing proportion, 46.5% and 66.7% respectively.²³) But in spite of this increased government effort, the rental market diminished and the nationwide vacancy rate dropped to below 5% for the first time in 30 years; in many places the rate dropped significantly below this.

The main problem for the struggling rental market is the diminishing returns on invested capital, as costs increase much more rapidly than income. While rents increased on the average by 79% between 1970 and 1979, all expenses increased by an average of 123%, and energy costs more than quadrupled.²⁴

The increasing pressure on the rental market and the tendency of the rents to increase have contributed to the emergence of active and vocal renters' organizations, which organized rent strikes and exerted political pressure to have protective measures adopted. Rent control measures have been adopted by an increasing number of local jurisdictions; these regulations, or the threat thereof, have negatively affected the willingness of investors to put their money into rental housing.

A small or even a negative income is in itself no deterrent to investment in rental housing, as long as other potential income is available: loss compensation by other income (tax shelter) and/or an attractive capital gain at the end of the exploitation period. A favorable tax regime stimulated private investment in rental housing until the end of the sixties: accelerated depreciation allowances,

compensation of (artificial) losses by other income, and a low capital-gains tax rate (20%). The Tax Reform Act of 1969 and later changes in the tax regulations (1972, 1973 and 1976), however, decreased the market value of rental property, and subsequent studies of and proposals for additional tax changes further undermined the propensity to invest (Smith & Shulman, 1974; Tucker, 1977). The rapidly increasing interest rates after 1973 made the situation even worse, and for many owners it has become unattractive to keep their investment money tied up in rental housing, especially if and when major new investments are required for maintenance or rehabilitation.

The value of the rental project is determined by the amount of future income expected from this source, while the value of the condos is determined by the sale price of comparable units. As a rule of thumb, a complex can be sold to an investor for rental exploitation at the rate of six or seven times the annual gross rent, but it can be sold to someone who intends to convert the complex to condominiums at nine or ten times the annual rent.

The "condo fever" spread rapidly from a small number of very active market areas such as Boston, Chicago, Denver, Houston, Los Angeles, New York, San Francisco, and Washington, D.C., to an ever-increasing number of other places. Not only large cities, but also medium-sized and small urban places are now being affected. It is generally believed that condo conversions blossom in places with a tight rental housing market (few vacancies) and in places having a strong demand for homeownership but a short supply of affordable homes. Rapid price

increases could be one of the factors, because an increasing number of households will tend to climb on the bandwagon before the aspired homeownership has moved out of reach. There is a positive correlation between conversion and a condition of low rental vacancy rate and high rent level. But the question of cause and effect is highly controversial. The viewpoints in this controversy strongly resemble the standpoints regarding the necessity of government control of the conversions: to some, the conversions provide homeownership opportunities for households hard hit by high rents and the shortage of rental units at comparable prices; to others, the correlation proves the effects of conversion on the functioning of the rental market.

The standpoints in the debate also depend on the priorities with regard to the functioning of the housing market in general, and on the viewpoints taken with respect to the solution of the urban problems. This has been concisely summed up by former HUD secretary Moon Landrieu in his testimony for the Senate Subcommittee on Housing:

"Conversions remove units from the rental market; yet ironically, by encouraging investment, conversion may be the best hope of preserving much of our existing housing stock. Conversions displace some lower income people, yet they also provide ownership opportunities for others priced out of the single-family market. As conversions contribute to the problem of urban displacement and the lack of rental housing, so do they contribute to neighborhood revitalization and increase local tax revenues. Thus, conversions present a complex picture."²⁵

The Effects of Condominiums on the Social Structure of the Cities

When the condos were first introduced in the U.S., the promoters emphasized the possible contribution to retaining inhabitants in the city or attracting suburbanites back. The notion that the condos can aid

the ailing cities by attracting re-investment is still very much alive. Homeowners generally find themselves in a different stage of life and tend to enjoy higher incomes than renters. By virtue of the fact that condos are homeownership units, one may expect them to be inhabited by a specific selection of occupants; but the group is internally differentiated because different structures and different units - and other locations - attract different types of households.

Condominiums may be expected to influence the social structure of their neighborhoods strongly when they are of a different type than the surrounding buildings. The construction of low-rise apartment buildings in an area of predominantly single-family homes will certainly attract a different group of residents to the area. These owners would have more in common with other apartment dwellers; one would not expect large differences in family status, but both income position and age might be different. The impact of the condominiums on the social structure of an area can thus be related to a number of decisions on the part of the developer. The same is true for conversions; the selection of the project to be converted and the way this is brought about influence the proportion of the tenants that choose to buy their unit, and this strongly affects the impact of the conversion on the social structure of the area.

Empirical evidence to check these expectations, however, is scarce and in some ways contradictory. While the condos are expected to provide an anchor for the redevelopment of cities, the displacement resulting from conversion is often refuted. Recent studies have suggested that an increasing number of tenants buy their apartments, perhaps due to the

scarcity of alternative housing. Speculative investment keeps part of the units available as short-term rentals. But other studies quote very high displacement rates. Apparently local situations differ strongly. One of the problems of the blurred relationship of housing and household characteristics seems to be that the housing market in many areas has become so tight and insecure that the frequently observed correlations between dwelling types and household characteristics have been disrupted. Predictions as to the long term impact of the condominiums on the social structure of the cities are, therefore, highly uncertain.

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The substance of this paper draws on a variety of published sources and in-depth interviews with representatives of developers, financiers, real estate consultants and attorneys, and policy makers. The interviews were used to check the observations on the condominiums derived from the many articles and notes in journals, newspapers, and newsletters of the various trade organizations. I would like to express my gratitude to those who made me aware of the various sources and above all to those who liberally donated their time to share their information and insights with me.

A complete list of sources and contacts will be provided in the final reports on this study.

NOTES

1. HUD Condominium Cooperative Study. Volume 1, National Evaluation. Washington, D.C.: U.S. Government Printing Office, July 1975. Table III-11.
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8. Data derived from U.S. Bureau of the Census, Construction Reports, Series C20 (Housing Starts).
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14. This section of the paper is based on observations from a large number of journals and newsletters of the construction and real estate industries which have subsequently been verified by in-depth interviews.
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16. The Conversion of Rental Housing, op. cit.
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19. Data derived from Bureau of The Census, Construction Reports, Series C20 (Housing Starts).
20. These figures were mentioned in a number of interviews with developers and consultants; some are confirmed in the Ninth Annual Report on the National Housing Goal, Message from the President of the United States, Washington, D.C., 1977, Table 6.
21. These figures were quoted by Senator H. A. Williams, Jr., Chairman of the Subcommittee on Housing, Committee on Banking, Housing, and Urban Affairs of the U.S. Senate, in his opening statement of The Hearing on Rental Housing (Rental Housing, Hearing before the Committee..., United States Senate, 96th Congress, 2nd Session. Washington, D.C.: U.S. Government Printing Office, 1980. Parts 1-3. Part 1, p. 1.
22. Data derived from The Annual Housing Survey, 1977. Washington, D.C.: U.S. Bureau of The Census and U.S. Department of HUD.
23. Data quoted by (former) HUD Secretary, Moon Landrieu in his testimony before The Senate Subcommittee on Housing, at their Hearing on Rental Housing (Rental Housing, op. cit., p. 3).
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