CONDOMINIUM AND COOPERATIVE CONVERSION: THE FEDERAL RESPONSE (Part I---Overview Hearings)

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON

GO VERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

FIRST *SESSION*

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The Congress should reconsider Section 606 of Pt 96-399 to determine bother it should provide more specific guidance as to "adequate notice" o tenants or other required action, in buildings to be converted, in ocalities where an adequate supply of rental units may not be available, and whether to provide for Federal intervention if adequate state or local action is not taken.

Mr. ROSENTHAL. Our next witness is Mr. Daniel Lauber of Evanston, Ill. Mr. Lauber.

STATEMENT OF DANIEL LAUBER, PRINCIPAL CONSULTANT AND PRESIDENT, PLANNING/COMMUNICATIONS

Mr. LAUBER. My name is Daniel Lauber.

Mr. ROSENTHAL. Mr. Lauber, how do you pronounce it?

Mr. LAUBER. Lauber.

Mr. ROSENTHAL. Lauber. We shall, without objection, include your entire 33-page statement in the record, and we would be very appreciative if you could touch on the highlights.

Mr. LAUBER. My name is Daniel Lauber. I am president of Planning/Communications, a city planning and housing consulting firm based in Evanston, Ill. I have furnished a copy of my résumé to all of you so you can go through my credentials.

My work in condominium conversions includes service as a consultant to Montgomery County, Md.; Woodridge, Ill.; and Philadelphia, Pa. I conducted studies of the effect of conversions on the tax base in Oak Park, Ill., and the effects of conversion on displacement and housing costs in Evanston. I provide technical assistance to officials around the country. I have been coauthor of the monograph, "Condominium Conversion Regulations: Protecting Tenants," authored the first column in the country exclusively devoted to condominium conversion for the Chicago Sun-Times, and have written extensively for Planning magazine, the Journal of Housing, Builders magazine, the Washington Star and the Chicago Daily News. I have a masters of urban planning degree from the University of Illinois, a bachelor of arts degree from the University of Chicago, and have served on the board of directors of the American Society of Planning Officials, the American Planning Association, and am a member of the American Institutue of Certified Planners.

Condominium conversions are increasing the monthly housing costs of American consumers roughly somewhere between $1 billion and $3 billion. It is probably the most inflationary factor in America today. It is threatening the ability of this country to provide affordable and secure housing to a large segment of America's middle class.

We are all aware of the increasing rate of conversions nationally. I am sure you are aware of the HUD figure of 1.3 percent of the rental stock being converted to condominiums. However, this national figure masks the effects of conversion in local markets.

It is very important that we realize that we are dealing with a local phenomenon, because housing is supplied on a local market basis, that is spreading on a national scope. What is happening in one city may not be happening in another. In some cities we have 20 percent of the rental stock converted to condos; Boulder, Colo.. 18 percent; Walnut Creek, Calif., 15 percent; Evanston, Ill., 14 percent; Oak Park, Ill., 15 percent.

It has been very wise of this committee to call these hearings at this time before condominium conversion changes 20 percent of this Nation's rental housing. This will mean that in some communities there will be virtually no rental housing left at all.

Of course, we have the question before us of why there are conversions. Profit is the main motivation, and there is absolutely nothing in the world wrong with making a profit. Even though every State had created this form of ownership by 1968, conversions didn't take off until the midseventies.

Let me very briefly summarize the reason. In the midseventies, we had a collision of inadequate supply met by growing demand resulting from rapid household formation due to the baby boom coming of age, a rising divorce rate, and other factors. The housing shortage is so severe that HUD estimates that during this decade, we will need 600,000 more units of multifamily housing each year. Prior to the interest rates rising last year observers estimated that only 300,000 of these units will be built and half of those would have to be subsidized.

A third factor is the advent of double-digit inflation which has led people to speculate in housing. It has turned us into what some researchers call the "post-shelter society" where housing is no longer shelter just for your body, but also from taxes and inflation.

The key ingredient that acted as the catalyst was the decline in rental vacancy which has been alluded to earlier. Nationally, we are down to a 4.8-percent level, but in cities where conversions are occurring, vacancy rates are much lower. Evanston, Ill., one-half of 1 percent; Oak Park, 0.9 percent; San Francisco, less than 3 percent. In Atlanta, San Diego, Orange County, Phoenix, Chicago, and other cities where conversions have taken hold, the rental vacancy rates are all low in the neighborhoods where conversions are occurring.

This has created part of what is the artificial market of condominium conversion; the reluctant tenant purchaser. Studies in Chicago and Palo Alto estimate they make up more than 70 percent of the tenants who buy. Even the HUD study found that at least half of the tenants who buy are reluctant purchasers. They are not purchasing for the sake of ownership or tax deductions, they are purchasing for residential security. They are afraid that if they do not buy, they will be unable to find replacement housing in the community. If they do find replacement housing, it too will be converted. That is one segment of the artificial market for converted condominiums.

The other segment is speculators, nonresident investors. According to Home Data Corp., they have bought between 30 and 50 percent of the converted units in Chicago. According to the Montgomery County, Md., Housing Task Force, they have bought 17 percent of the converted units there.

The third segment of the condo market is, of course, natural demand. By itself, it would not be able to support the volume of conversions in many cities. Natural demand can probably be met by new construction in many jurisdictions. Interestingly enough, rent control has not been a cause of condominium conversion. Cities such as Chicago, Denver, and Houston have no rent controls at all but have a higher rate of conversion than most cities with rent control.

I would like to make it clear, though, that condominium conversion is neutral and I do own a condominium and live in it. Conversions, by themselves, are neither good nor bad. When I was first contacted by Palo Alto in 1974 about condo conversions and their concern that they were losing their low and moderate housing to conversion, I thought that conversion was the greatest idea in the world. It could do no wrong. Since then *we* have heard all sorts of claims both for and against conversion.

We have heard about effects of conversion on the municipal tax base, on housing costs, and on city revitalization. The validity of these claims are discussed in the written testimony in greater depth. These are not the real issues before this committee. The real issue is the effect condominium conversion will have on the ability of this Nation to provide affordable housing for large segments of its middle class. Studies by nonindustry researchers show that conversions place this ability in jeopardy by inflating the cost of housing at a rate that would make an OPEC oil minister blush.

If you would refer to the table on page 4 which lists quite a few of the studies that have been done by nonindustry investigators, you will find that the average cost of living in a unit increases 60 to 100 percent after conversion to condominium.

You will also find that the displacement rates are 75 to 95 percent. Let me emphasize that these are not transients, contrary to industry spokemen's claims. In Evanston, the tenants caught in conversions have lived in their units 7.2 years on the average and lived in Evanston an average of 20.57 years. In Oak Park, they have lived in their units an average of 5.7 years and in Oak Park an average of 18.5 years.

A 1975 Washington, D.C., study found that 54 percent of the tenants caught in conversions had lived in their units 5 or more years, and only 14 percent had lived in them less than 1 year. The reason that they are being displaced is that they can't afford to buy. You have already heard testimony about the fact that HUD found only 42 percent could even afford to buy.

Immediate displacement is not the only effect of conversion and not the only concern. There are longer range effects that are of greater concern, I think, to this committee and to this country. First, there is the effect of conversions increasing the cost of housing and tying up mortgage money that could be more productively spent on new construction.

In your own preliminary reports you have the example of the Promenade Apartments tying up an extra $50 million of mortgage money. This is a universal phenomenon with condo conversion. This helps force up interest rates and service costs and tightens the mortgage market for all home buyers.

Second, by forcing homeowners, condo tenants, people who buy condos to spend more money on housing, on their mortgage, conversion is tying up money that could be spent on durable goods. As a study by Chase Econometrics told us last week, housing costs in the 1980's are rising to such a level that people are spending 40 percent of their income on housing. It will crowd out other expenditures such as furniture, appliances, automobiles, and other discretionary purchases. Money invested in mortgages doesn't go to work. It doesn't create jobs. What creates jobs is money invested in durable goods. Tell the autoworkers that we should spend 40 percent of our income on housing; people just won't be able to buy cars. That doesn't help_ The ripple effects on the economy are potentially disastrous.

Third, by depleting the available rental stock, conversions have helped to fuel inflation in remaining rental units. We were first warned of this inflationary effect in a 1976 report by the Metropolitan Washington Council of Governments_ It has since been confirmed by other studies.

The threat of conversion is serious. it threatens a wide spectrum of our affordable housing_ Oak Park's 1979 condominium survey questionnaire on page 8 of my testimony notes that Oak Park's supply of middle-, moderate-, and low-income housing is being depleted directly and, perhaps indirectly, by condominium conversions. Clearly, condominium conversions are not restricted to higher rent units in Oak Park.

In Evanston, Ill., the "Human Relations Report" which has since been confirmed by two independent studies, one by the housing division and one that I did, concludes that in this traditionally socioeconomically and racially mixed community, the city must act to prevent condominium conversion from erecting an economic wall that forecloses the entry into the Evanston community of upwardly mobile young families of diverse backgrounds and displacement of present low- and moderate-income families and fixed-income elderly.

New rental construction which the industry seems to say is the only solution doesn't do the job. As Henry Schechter said so well in the Journal of Housing in April 1980, the proportion of income that renters are paying for their housing is increased as newly completed units have replaced units taken out of the rental market. Median rents from 1973 to 1977 have increased 9.6 percent a year while the average renter income increased only 5.6 percent a year. By 1977 over 30 percent of renters paid more than 35 percent of their income for rent and over 18 percent paid between 25 and 34 percent.

How anybody expects these renters to be able to afford traditional ownership opportunities when they are paying this much money for rent is beyond me. However, I am sure there is some magical solution. Such hardships are borne by the renters simply because there isn't much of an alternative.

We seem to be going on a suicidal path in our policy toward housing. We are allowing rental units which are affordable to the middle class and provided by the private sector at a profit without Government subsidies, at a profit to be converted to higher cost condominiums at a time when you can't build new, affordable rental housing without Government subsidies. However, you can build new condominiums at a profit without Government subsidies. The net result of this very poorly thought-out policy is higher housing costs for all Americans and very unproductive use of our capital. The result is inefficient, wasteful, and a very taxing experience for America's taxpayers.

A very good example of what this is doing and how it is costing the taxpayers is what has happened in Chicago where we have the conversion of Sandburg Village which was built on urban renewal land with HUD-insured mortgages. Prior to conversion, tenants there tell me the rent for a 1-bedroom was $300 a month. After the conversion of this 2,700 unit complex the cost of living in these units doubled and in some cases tripled. As many tax experts will tell you, when they are not being paid by the real estate industry to testify, that the tax benefits do not make up this difference.

To replace this rental housing, some developers are proposing building 3,246 rental units west of Chicago's Loop, called Presidential Towers, using a $200 million tax-free revenue bond.

Mr. DAUB. That is what I want to ask you about. One of your proposals is, as I read your prepared testimony, your fifth or sixth point, that we are actually contributing to this problem by virtue of HUD loan availability?

Mr. LAUBER. HUD's practices are contributing to this problem. I would appreciate it if perhaps you would let me finish the prepared statement, and then we could get into that specific area. This all ties together.

Mr. DAUB. What you are getting at, though, is there are entities at the local and Federal level that use money for loan purposes that actually reinforce the problem?

Mr. LAUBER. I believe Mr. Bradford will explain that in even more depth.

Mr. DAUB. OK, thank you. Go right ahead.

Mr. ROSENTHAL. Mr. Lauber, we don't have time to go through the prepared statement, really. I wish you could sum it up in about 2 minutes. Make the points that would be most useful for our purposes.

Mr. LAUBER. OK, certainly. You can read all the testimony in here.

The conclusion I have come to is illustrated by this ad offering a free Pinto if you buy a condominium and this ad from the Chicago Tribune for an auction of luxury condominiums from Phoenix, Ariz. This is appealing to speculators, not to purchasers who would live in them. We are getting conversions even if there is a lack of natural demand for them. As I explained, we are in this crazy housing policy allowing conversions when they are taking away housing the private sector is providing at a profit that people can afford and creating a need for new subsidized housing.

Mr. ROSENTHAL. Let me ask a question. What should the Federal Government do, if anything, and why? Can you answer that?

Mr. LAUBER. What I would suggest?

Mr. ROSENTHAL. Can you answer that one, two, three, four?

Mr. LAUBER. Yes. What I would suggest is that the Federal Government work to create a homeownership opportunity that takes housing out of the inflationary cycle, and that is limited equity cooperatives.

Mr. ROSENTHAL. Translate that into English. What does that mean?

Mr. LAUBER. What that means is a limited equity cooperative. Please, Congressman, let me explain. I am trying to answer your question.

Mr. ROSENTHAL. If you lose me, then you are wasting everybody's time.

Mr. LAUBER. I am trying to answer your question.

Mr. ROSENTHAL. What should the Federal Government do, one, two, three, four?

Mr. LAUBER. OK. We will get into explaining limited equity co-ops later.

One, have a 3-year moratorium on conversions to give us the time to develop the necessary programs and laws. Allow conversions only if they meet natural demand; namely, if two-thirds of the tenants agree to buy their units.

Two, adopt a policy encouraging the development and conversion of rental housing to limited equity co-ops. They are the same as any other cooperative, except they limit how much the cost of shares can increase each year. Before President Nixon terminated the program, it was the most successful housing program in this country's history. There was not a single default under it, and they returned $42 million to the co-op owners.

Three, enact legislation to require lending institutions to provide mortgage funds for limited equity cooperatives on terms no worse than those offered to buyers of conventional homes. In fact, no lending institution with any Federal involvement of any sort should be allowed to give loans to a condominium conversion unless the tenants have been given the opportunity to buy the building themselves and convert to limited equity co-ops. The Government should provide technical and financial assistance to do this.

Four, retain the National Consumer Cooperative Bank with greater funding than it has today.

Five, immediately terminate HUD's practice of converting federally insured or financed buildings threatened with default into condominiums. They should instead be converted to low equity co-ops.

Mr. DAUB. I will slow you down right there and ask that you explain that one, because I think that idea has some merit.

Mr. LAUBER. HUD has, unfortunately, a number of cases where buildings that, were HUD-insured where the developer has completely fumbled the ball and gone into default. It started converting the buildings to condominiums. That is just keeping the housing in the higher cost market and putting it into the speculative cycle. This is housing the taxpayer has already subsidized.

Instead, by converting to low equity co-op you are taking it out of the speculative cycle. The reason it goes out of the speculative cycle is because you have one mortgage on this building now as a co-op. Debt service makes up between 30 and 50 percent of the cost of owning a unit or building. If you keep that mortgage the same for 30 or 40 years, you have kept 30 to 50 percent of the cost constant.

Mr. DAUB. Who is HUD letting do this?

Mr. LAUBER. The conversions to condo?

Mr. DAUB. Yes, in the case of the practice you are talking about, which is the conversion to federally insured? Do you have a couple)f examples you could give us real quick?

Mr. LAUBER. There is a firm doing two buildings in the Chicago area. These buildings are constructed under 221(d)(4). There is an Oak Brook firm. Those are examples I have right now.

Mr. DAUB. OK, thank you. You can go on to your next solution. I will pursue this later.

Mr. LAUBER. Tenants should be given the right of first refusal to Hatch any contracted offer to buy a building.

The Federal Government should restrict the mortgage interest and property tax deductions on residence property to your principal residents and not allow these deductions for nonresidential, not home, buildings or condo units that you buy but don't live in. In other words, take that incentive away from the speculators.

Mr. ROSENTHAL. Do you think we could get that through this Congress?

Mr. LAUBER. Lord only knows. Actually most people are not involved in this second home purchase deal. There just happens to be this very large lobbying group that will do its best to prevent anything that might restrict conversion practices in this country.

Mr. ROSENTHAL. It is a very interesting idea. I never actually heard of it before. In other words, you could take the interest deduction for the first or the principal home. Beyond that you cannot do it.

Mr. LAUBER. Actually, I believe the Reagan administration in its earlier discussions were talking about something vaguely similar and also putting a cap on how much you could deduct.

Mr. ROSENTHAL. That is an interesting idea.

Mr. Neal.

Mr. NEAL. I am very much aware of the problems that are being discussed here in these hearings. But are there any benefits to condominium conversion? I have been led to believe that there were some benefits to, for instance, young people trying to get into their first home, that in some cases there was the opportunity to get an affordable home through a condominium conversion.

I am just curious if you have any idea of the ratio of detrimental conversions to those conversions that might be of some benefit.

Mr. LAUBER. As a condominium owner, I car, tell you the major benefit of living in a condominium is not having a landlord breathing over my back.

As the treasurer of my condominium and having worked with condo associations in the Chicago area, I can tell you that we may be heading toward slumdominiums in many cases. Alderman David Orr has pointed this out in Chicago.

We have cities using community development block grant money to bail out people who have bought condominiums who can't afford special assessments. Oak Park, for example, used $1,800 of CD money to give an interest-free loan to one low-income person who, as the result of a divorce settlement, was able to buy a condominium and couldn't afford the special assessment. Park Forest has used $240,000 of CD money to provide an escrow account to enable a condo association of 300 units to get $400,000 in loan money so they could bring their buildings up to code.

Mr. NEAL. I guess I did not make my question very clear. Are there any examples of condominium conversions that have been beneficial to people? I have been told, for instance, that young people often cannot afford conventional housing because the prices are too high, and they might be able to afford condominiums, the unit price being lower. Condominiums are smaller units of housing. The cost per unit is lower. They might be available to young people and elderly people, for instance, who couldn't afford conventional housing.

Mr. LAUBER. As long as the price of condominiums wouldn't inflate, it would do that. However, inflation in the cost of condominiums has produced a situation. For example, in a neighborhood in Evanston condominiums cost more than some single-family homes. This is not a poor neighborhood.

I think that Mr. Masotti will speak about benefits.

Mr. NEAL. Is the cost per square foot somehow higher in condominiums than it is in conventional housing?

Mr. LAUBER. It has gotten to that point in many areas.

Mr. NEAL. Why would a person then want to buy a condominium instead of a conventional house?

Mr. LAUBER. Let me make it clear. Some houses will cost more than a condominium; some condominiums will cost more than a house. It varies.

Mr. NEAL. Per square foot?

Mr. LAUBER. Yes.

Mr. NEAL. Depending on the quality.

Mr. LAUBER. In areas of immediate in-town, gold coast residences in cities, for example, condominiums are the chance for ownership.

What I am concerned about, and what I think you should be concerned about too is conversions being forced on people when they don't want to buy and people buying reluctantly and tying up money that could be spent on more productive entities. Many cities could probably meet the natural demand for condominiums.

What we have is this crazy situation where affordable units being provided by the private market at a profit are being converted into high-income housing. The only way to replace it is with subsidized housing. Therefore, we are being told, "Taxpayer, you bail us out. We create a situation; taxpayer, you subsidize the middle class."

Mr. NEAL. What you are saying is that in the majority of the cases you are familiar with there is not a common benefit to be gained. In most instances there are more people being forced out of housing than there are opportunities for people to buy housing who didn't have the opportunity?

Mr. LAUBER. The overall picture is substantial displacement, not many people buying because they want to buy, and speculators helping to prop up a market that wouldn't survive without them. Real estate is a market where you can do speculation and where you can control it and manipulate it.

Mr. NEAL. Do we have some figures on that? Do we know the kinds of conversions that have been made? Do we know how many have been made where the tenants are pleased with the conversions and are glad that it happened?

Mr. ROSENTHAL. We have the next witness who has that kind of information in addition to the HUD study which covers this.

Thank you very, very much for your very useful testimony. You realize that my aggressiveness is only because I am controlled by the clock.

Mr. LAUBER. I am fully aware of that. I just hope that each member of the committee will take the time to read through the testimony.

Mr. ROSENTHAL. It is very significant, very important testimony, and I am hopeful that they will.

[Mr. Lauber's prepared statement follows:]

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Testimony presented on March 31, 1981, *to the U.S. House* of Representatives, *Commerce, Consumer, and Monetary Affairs* Subcommittee *of* the Committe on *Government Operations*

TOWARDS A RATIONAL HOUSING POLICY: THE ROLE OF CONDOMINIUM CONVERSIONS

March 31, 1981 by Daniel Lauber

America's housing crisis is deepening at a frightening pace. Affordable ownership homes are priced beyond the reach of the vast majority of the population. And now, largely thanks to condominium conversion, a growing segment of America's households finds affordable rental housing to be a disappearing commodity. But unlike many of the other factors causing the astronomical inflation in the cost of housing over the past decade, condominium conversion is a totally artificially created form of ownership (each state legislature had to create this form of ownership through passage of a horizontal property act or condominium conversion act) over which we can exercise considerable control.

These hearings offer an opportunity to examine the effects of condominium conversion on our nation's housing stock and the ability of Americans to afford their housing. In the testimony that follows, I will review the pace of conversions in many municipalities and the conditions under which conversions occur; the effects of conversions on inflation; displacement, and our nation's ability to provide affordable housing to the middle class; the effects of voluntary developer efforts to mitigate adverse effects of conversions; how local laws have attempted to deal with the conversion problem; how the Uniform Condominium Act is being used to prevent local governments from mitigating the adverse effects of conversion; the shortcomings of the U.S. Department of

Housing and Urban Development's study The Conversion of Rental Housing to Condominums and Cooperatives; and appropriate responses the federal government would be prudent to take to prevent condominium conversion from eliminating much of our affordable housing stock now available to America's middle class.

THE HOW AND WHY OF CONVERSIONS

Even though the condominium form of ownership was created in some states as early as 1963, condominium conversion did not become widespread until the last half of the 1970s when the key ingredients for conversion came together:

a baby boom that grew up and reached the homeowning age;

an extremely rapid rate of new household formation due to increases in the divorce rate, the baby boom coming of age, a desire of older persons (who were living longer than ever before) to live on their own rather than move in which their children or be committed to nursing homes at an early age, a delay by the baby boomers in getting married;

a housing shortage due to insufficient new construction to meet demand— a shortage continuing to this very day— in both ownership and rentals;

the advent of double-digit inflation which led people to speculate in housing - the result of which is what George Sternlieb calls the "post shelter society" in which housing is not just shelter for one's body, but also a shelter from taxes and inflation. (This post-shelter society mindset resulted in "the general public . . buying properties at an unprecedented pace in an effort to combat inflation or to become overnight millionaires. One of the consequences of over-demand is that, without reason, property values escalate at a rate that is inflationary in and by itself. Buyers believe that it doesn't make any difference what they pay for a piece of property, as the price escalation can't stop." That's what Kenneth L. Kidwell, chairman of the board and president of Eureka Federal Savings and Loan Association wrote in the San Francisco Examiner on May 4, 1980.)

One ingredient was missing, and by the end of the 1974-75 recession it appeared. Rental vacancy rates fell to the lowest levels in decades. In 1961, the national rental vacancy rate was 8.9 percent; in 1965, 8.1 percent; in 1970,

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6.1 percent. By 1978 it had fallen to 5 percent and in 1979 to 4.8 percent.

Housing experts have felt that a vacancy rate of less than 5 percent makes it difficult for low- and moderate-income households to find replacement housing. Once it falls below 3 percent, this task is difficult for any but the most wealthy households.

National figures mask the more significant rental vacancy rates in local markets. The one thread that winds throughout the condominium conversion phenomenon is very low rental vacancy rates in cities or neighborhoods in which conversions take hold. Evanston, Illinois, where over-15 percent of the rentals have been converted to condominium, has a rental vacancy rate of ½ of 1 percent; Oak Park, Illinois, where over 14 percent of the rentals have been converted has a rental vacancy rate of just under 1 percent. The pattern is the same throughout the country. An extremely tight rental market is essential for any significant number of rentals to be converted to condominium. In an age of supply and demand one would think that the enormous demand represented by these low vacancy rates would lead to the construction of more rentals and retaining existing rentals as rentals. That has not been the case.

Instead, entrepreneurs have chosen to inflate the cost of our affordable rental stock by converting it to more expensive condominiums. As HUD noted in its 1975 study of conversions, the key reason for conversions is a relatively high profit that can be made in a short period of time with relatively little risk. Experience has borne out this observation. Profits in conversion are so high that one developer in Marin County, California, agreed to keep 40 percent of the units in his proposed conversion for moderate income households (initial sale and resale prices are controlled) in order to win permission to convert.

It would be redundant to simply repeat all the reports of profitability of conversions. Forbes ("Condomania in Chicago," by Bob Tamarkin, Nov. 13, 1978, pp. 54-59) and Playboy ("The Condominium Conspiracy," by Asa Baber, Nov. 1979) give numerous examples that illustrate that condominium conversions are forcing the cost of housing to astronomical heights. One Chicago attorney, Julius Yacker, estimates that consumers of multi-family housing in the Chicago area are spending billions of dollars more for housing than they would have had they been able to convert to low-equity cooperatives beginning in the late 1960s instead of this housing being converted to condominiums or kept in the speculative and inflationary rental market.

These low rental vacancy rates enabled developers to start converting rentals to condominium. Ideally, a developer hopes to sell at least 35 percent of a building's units to resident tenants in order to minimize advertising costs and generate a quick return on investment.

But in general, there just aren't that many tenants who want to purchase. The table below shows that in general, the vast majority of tenants do not purchase when their building is converted to condominium ownership. Many long-term residents of the community, in fact, are forced to leave the community because they cannot find affordable replacement housing there. Many tenants simply cannot buy because, as the last column of the table illustrates, the costs of remaining in their converted apartments increase by 60 to 100 percent, on the average.

Of those who do buy, most do so reluctantly. A study by the Palo Alto Planning Department first identified this phenomenon in 1974 when it found that 72 percent of the tenants who did purchase did not buy voluntarily. Instead, they purchased to achieve residential security. They feared that they could not find affordable replacement housing in Palo Alto, and if they did, it too would be converted to condominium. This finding was replicated in Peter

Findings of Studies on the Effects of Condominium Conversions

Study	Proportion of Tenants Not Purchasing Converted Units, Displacement Rate	Proportion of Displaced Tenants **Who** Move From Municipality	Increase in Monthly Carrying Costs *of* Unit When Converted from Rental to Condominium Ownership, Average'
Condominium Survey Questionnaire Report, Oak Park, Illinois, 1979	90%	Not available	60%
Effects of Condominium Conversions on Tenants, Tenants Organization of Evanston, Illinois, 1978	95%	55-73%	60-100%
Condominium Conversions in the City of Evanston, Illinois, Evanston Human Relations Commission, 1978	80-88%	*Not* available	100%
Condominium Conversions in Cambridge, Massachusetts, 1978	80%	29+%	Not available
Condominium Conversions in San Francisco. California. 1978	75%	Not available	60%
Condominum Housing: A New Home Ownership Alternative *for* Metropolitan Washington, WASHCOG. 1976	82.3%	Not available	Not available
District of Columbia Housing Market Analysis, 1976	78%	Not available	Not available
HUD Condominium/Cooperative Study, 1975	75-65%	Not available	30-35%
Palo Alto. California, Condominium Conversion Study, 1974	82%	Not available	Not available

Rent versus condominium ownership payments {mortgage, property tax, monthly assessment)
Lower figure *does* not include property tax; higher figure includes property tax

Adels' most thorough study of the Hyde Park community in Chicago Condominium Conversion in Hyde Park, 1965-1979 (A Thesis Presented in Partial Fulfillment of the Requirements for the Degree of Bachelor of Arts in Geography, University of Chicago, 1979, 130 pp.). Indeed, HUD's own study last year found that half the tenant purchasers who expressed an opinion said they would rather be renting than buying their unit (p. 23, Appendix 1-IV). It's these reluctant tenant purchasers who form a significant part of the artificial market for converted condominiums.

The other portion of the artificial market for converted condominiums is the speculator or nonresident investor. Home Data Corporation estimates that between 30 and 50 percent of Chicago area condominiums are owned by nonresident investors. A 1979 survey in Montgomery County, Maryland, found that speculators had purchased 17 percent of the converted condominiums there. These speculators either rent their units out (studies find the rent is typically 175 percent of the preconversion rent) or keep them vacant until they appreciate enough to sell at a profit.

The natural segment of the condominium conversion market is too small to generate the conversions that have occured in most jurisdictions. There just are not that many households that want to live in and own a condominium. Hence, the artificial markets have been used to create "demand" for converted condomininiums. Where communities have enacted ordinances that limit conversion to satisfy natural demand (these ordinances typically impose an automatic moratorium on conversions when the rental vacancy rate is below 3 percent and allow exceptions to the moratorium only if a certain percentage of tenant agree to buy their units or agree to exempt their building from the moratorium), conversions have ground to a halt, in general, or developers have turned to bribery of tenants to get them to agree to the conversion. Bribes in excess of 53000 have not been uncommon in the District of Columbia - again pointing to the profitability of conversion.

INFLATIONARY EFFECT. The conversion of rentals to condominium is perhaps the most inflationary phenomenon in America today. It would make an oil sheik turn green with envy. How else can you double the cost of housing with the flick of a Bic?

As noted in the table on the preceding page, conversion tends to increase the cost of living in a unit by 60 to 100 percent, on the average. For example, the Sheridan South condominiums in Evanston, Illinois, rented for $275/month in 1978 (2 bedrooms). A year later the rent escalated to $375/month when a speculator bought the building. P. year later the speculator completed a tax-free trade with a condominium converter who then sold these units for over $65,000 each. The monthly cost, at the available 9.5 percent interest rate, came to over $660. Even with tax deductions (which don't do anyone any good until they receive their tax refund), the cost of living in a 2-bedroom apartment at Sheridan South rose over 100 percent thanks to speculation and conversion. Only 5 of 50 tenants bought their units. -Note that the cost of living there has not remained static since monthly assessments (which are not tax deductible) have risen substantially since conversion.

This is not an isolated example. This subcommittee has already uncovered other similar instances of inflation due to conversion. Unfortunately, this inflation in housing costs has significant adverse effects.

First, by increasing the cost of housing, conversion increases the amount of mortgage money required to finance a building. Instead of there being a single mortgage for a rental building, there is now a mortgage for each unit with the grand total of mortgage money being far greater than that invested in the building when it was rental. That ties up mortgage money that could be more productively used for new construction. It also ties up mortgage money for all homebuyers - and helps force up interest rates and service charges.

Second, by forcing households to spend more money on housing, conversion poses ominous implications for the rest of the economy. Instead of spending money on durable goods - automobiles, appliances, furniture - or travel, food, or entertainment, or putting money into savings institutions as savings, households are spending it on a mortgage. As more households spend more than 25 to 30 percent of their income on housing, they must reduce expenditures elsewhere; their discretionary buying power is reduced. Money invested in mortgages do not put people to work! Money invested in durable goods, etc. creates jobs.

Third, by depleting the available rental stock, conversions have helped fuel inflation in rents in the remaining rental units. Chicago Realtor Dempsey Travis notes that increasing condominium conversions are a prime reason for the shrinking supply of starter apartments throughout Chicago. Recent articles in Chicago papers quote apartment managers as blaming condominium conversions for the high rent increases: "Further pushing up the price is the continuing high demand in a shrinking market as more and more buildings are converted to condominium." (Chicago Sun-Times, July 13, 1978, p. 1) - New household formations continue to outstrip new construction. Many of these households require rental housing for affordability and mobility. Conversions simply restrict this supply while demand for rentals remains high. As one local apartment manager told me, "With this tight rental market, we can raise rents almost as high as we want since people have nowhere else to move."

The Metropolitan Washington Council of Governments was the first to identify inflationary effects of conversions in its April 1976 report, "Condominium Housing: A New Homeownership Alternative for Metropolitan Washington" (p. 204).

EFFECTS OF CONVERSION: DISPLACEMENT.

An obvious corollary of the inflationary effect of conversion is displacement. As noted in the table on page 3, the vast majority of tenants tend to move out of their converted buildings. The move is usually a result of inability to pay the higher cost of living there. HUD's 1975 study notes that displacement is an unavoidable by-product of the conversion process. . . . In a city where rental [vacancy] rates are low and where rental units are occupied by the elderly, who are often on fixed incomes, and by low- and moderate-income families, the displacement potential of this conversion process appeared awesome." And as the table on page 3 illustrates, it has indeed proven awesome.

It is important to note that conversions generally occur in relatively stable neighborhoods contrary to propaganda circulated by the conversion industry. In Evanston, Illinois, surveyed tenants caught in conversions had lived in their units an average of 7.2 years and in Evanston an average of 20.57 years. Surveyed Oak Park, Illinois, residents had lived in their apartments an average of 5.5 years and in Oak Park an average of 18.5 years. Only in Mountain View, California, have tenants caught in conversion been found to be relatively short-term residents: 1 to 1.5 years, on the average. Homeowners in Mountain View, though, live in their homes an average of only a to 7 years.

Industry spokesmen wil often claim that tenants have a turnover rate of 25 or 33 percent annually and that these displacement figures should be reduced by these amounts to accurately reflect the number of tenants who are moving out only due to conversion. However, this is again poor technique and distortion. You cannot apply such general rates to specific buildings being converted because the turnover rates in those buildings are generally very low. For example, in Sheridan South, only 2 to 6 units would change hands each year prior to the conversion in which only 5 of 50 tenants purchased. It really doesn't matter whether you assign a displacement rate of 90 percent or, say 78 percent (assumes 6 tenants would have moved out anyway) -- either way this is a significantly high displacement rate.

EFFECTS OF CONVERSION: MEETING MIDDLE-CLASS HOUSING NEEDS

A broad spectrum of tenants are being displaced by conversions. Oak Park's 1979 Condominium Survey Questionnaire Report concludes:

> Oak Park's supply of middle-, moderate-, and low-income housing is being depleted directly, and perhaps indirectly, due to condominium conversions. Rentals found in this study ranged from $200 a month to $375, definitely within the range of low- to middle-income housing. Clearly condominium conversion is not restricted to higher rent units in Oak Park.

Similarly, Evanston's Human Relations Commission reached the following conclusion about the traditionally racially and socioeconomically diverse community:

> The continued availability of housing affordable, on a rental basis, by low- and moderate-income families and the fixed income elderly cannot be assured by operation of the real estate market place. Thus the city must act . . . to prevent condominium conversion from erecting an economic wall that forecloses the entry into the Evanston community of upwardly mobile young families of diverse backgrounds and displacement of present low- and moderate-income families and the fixed-income elderly.

Even without condominium conversions making units, provided at a profit by the private sector without government subsidy which are affordable to low-, moderate-, and middle-income households, unaffordable to them by substantially inflating their cost, we seem to be fighting a losing battle to meet the demand for affordable housing. According to one widely-used government estimate, our nation will need 600,000 new multifamily units annually this decade to meet the needs of just low- and moderate-income families and to replace substandard apartments. Even before the past year's mortgage-rate increases, projections predicted that only about 300,000 units a year would actually be built, and half of those would require government subsidy. These figures do not include the units needed to replace converted units. Small wonder the General Accounting Office reported to Congress in November 1979 that "the rental housing problem is so severe that it requires the immediate attention of and action by the Congress and the Administration."

And even if new rental housing were built in sufficient quantities, would the displaced due to condominium conversions be much better off? Statistics suggest they would not. As Henry Schechter noted in the Journal of Housing ("Economic squeeze pinches the future of housing," April 1980 pp. 192-196):

> "The proportion of renters paying a high percentage of their income for rent has increased as newly completed units carried high rents while older low-rent units were removed from the [housing] supply. Median rents increased an average of 9.6 per cent annually from 1973 to 1977; average renter income increased 5.6 percent per year. By 1977, over 30 percent of renters paid more than 35 percent of their income for rent and over 18 percent paid between 25 and 34 percent.
>
> "Such hardship is borne because there isn't much of an alternative. In the fourth quarter of 1979, almost one-half of the units vacant for rent had zero or one bedroom, obviously not for families with children; 11 percent of the vacant rental units were lacking in some or all plumbing facilities; and 43 percent of them were more than 40 years old. . . . the size and rents of many vacant units did not match the housing needs of their geographic locations."

In fact, we may be on a suicidal path in our housing policy toward condominium conversions. We have a situation in which the private sector is able to provide housing affordable to low-, moderate-, and particularly middle-income households at a profit without government subsidy. (As Jonathan J. Stein, assistant vice-president of Inland Real Estate Corp. told the Chicago Sun-Times, "Our investors are happy with the return on most of the 50 rental project we own." The condominium conversion industry insists that it is not profitable to own rentals anymore. However, the burden of proof rests on them. This subcommittee should be given free access to the financial records of any apartment buildings it chooses to determine their profitability as rental. It is ludricrous to simply accept industry assertions like this one without proof - the excess profit provided by condominium conversions can make industry spokesmen less than honest.)

Yet we cannot provide enough rental housing with new construction to meet demand — and even then it generally requires some subsidy to be affordable to low- or moderate-income households, and even many middle-income households.

Yet we allow these affordable units to be converted to higher cost condominiums which the preconversion residents generally cannot afford to buy.

In the meantime, private industry can provide condominium units via new construction that would meet the natural demand for condominiums and do not require government subsidy to build.

It strikes me as slightly insane to allow these affordable rental units to be converted to condominium when the net result is a need for more subsidized housing and inflation in overall housing costs. Would it not make more sense to keep the affordable rentals as they are and meet the natural demand for condominium ownership through new construction which requires no government subsidy to be profitable?

This absurd public policy where we allow affordable units to be converted to higher cost condominiums made things difficult for low- and moderate-income households long ago. But today it is affecting the middle class as well. Last September the U.S. House of Representatives passed a bill to provide rent supplements to the middle-income households much like Section 8 has subsidized low- and moderate-income households. Former assistant secretary of HUD Chester McGuire recently wrote in Seller/Servicer magazine (Sept.-Oct. 1980, p. 24) noted that arguments are heard for more widely distributed rental housing subsidies here. "The reason is evident," McGuire writes, "not enough rental housing is being built, which is now affecting the middle class."

While the Administration and most of the Congress have chosen to ignore this situation in which a growing segment of our population can no longer afford housing without spending a disproportionately large share of their inflation-riddled income on housing, a growing number of local jurisdictions are acting to mitigate this adverse effect of condominium conversion.

LOCAL EFFORTS TO PRESERVE AFFORDABLE HOUSING IN THE FACE OF CONDOMINIUM CONVERSION

Most cities and counties which have enacted condominium conversion ordinances provide, in those ordinances, for consumer protections such as disclosure statements and inspection reports. Most provide some tenant "protections" as well, largely in terms of a notice of intent to convert. However, a growing number of communities across the country are finally willing to admit that the central issue in the condominium conversion controversy is not consumer or tenant protections. Rather, it is the effect conversions have on a community's ability to meet the housing needs of its residents, particularly middle-class residents.

But, some elected and appointed officials see condominium conversion's inflationary effect as desirable. It gives them a chance to raise housing costs and force out low- and moderate-income residents -- a view that seems to be quite prominent among officials in the Chicago area, for example. The conversion phenomenon is the central city's and inner-ring suburbs chance to play their own version of exclusionary zoning, that fun-filled game perfected by the outer-ring suburbs of making it impossible to build affordable housing through a series of restrictive zoning controls. Now the central city and inner-ring suburbs can force up the cost of their housing through condominium conversion and rid themselves of the poor, low-income, moderate-income, and even middle-income households. With this change they think property taxes will increase even though even HUD's 1980 study shows only a minimal increase, if any, in property tax receipts due to conversions.

Quite a few local officials, and I dare say national office holders as well, see conversion as a good thing because it enables renters to become homeowners. Afterall, doesn't the National Association of Realtors constantly remind us that the American Dream is homeownership? But what these officials ignore is that for many, if not most renters, homeownership is not their housing dream - at least not homeownership at any cost. Many require the mobility renting affords them. Many cannot afford ownership. Many simply do not want to own. <u>All renters really want is secure and affordable housing.</u> Condominium conversions certainly appear to work against achieving that aim.

Other officials seem to hear only the views of the condominium conversion industry. It's a powerful industry extending far beyond the membership of the National Association of Realtors. The number of middlemen involved in the conversion process -- each of which helps force the price of housing up even further -- is large. Ever wonder, for example why bar associations oppose restrictions on condominium conversions? It's really very simply self-interest. According to the American Bar Association the single largest portion of the general practitioner's practice is real estate transactions. Those 50,000+ conversions in Chicago alone, for example, provide a lot of transactions for the city's attorneys. Afterall, you need an attorney to draw up your conversion documents and each buyer and seller needs to hire an attorney.

The title insurance companies are similarly supporting conversions out of self-interest. A rental building of, say, 100 units, has only one title to be insured and searched each time the building is sold. And sales of rental buildings usually do not occur as frequently as houses or condos. Convert that building to condominium, and there are 100 titles to be drawn up, searched, and insured at the time of conversion and first unit sale. Then, as each unit is resold in later years, there is another title search and insurance policy to be issued for each unit. The business of the title company has been increased by thousands of times simply by turning the rental building into a condominium.

Banking institutions are quite pleased with conversions in their own short-sighted way. Conversion of a rental building has often meant termination of a low-interest mortgage the owner obtained years ago. Now the bank can provide a mortgage to each buyer at the going rate, or even through one of these new renegotiable rate mortgages which protect the banks from inflation and place more of the burden of inflation on the consumer. Since the condo units will change hands more frequently than the whole building did as a single commodity, the lending institutions will be able to replace old mortgages with new ones at presumably higher rates and will, of course, charge those service points on each resale. Conversions are-impossible without the cooperation of the lending industry. They've lent the money to the developers; they've lent the money to the nonresident speculators. They've let the amount of mortgage money tied up in a single structure skyrocket through condominium conversion. As this committee has noted before, the Promenade Apartments in Bethesda, Maryland, is a fine illustration of the effect of conversions on the availability of mortgage money. Bought by American Invsco for $49 million, it will sell out for between $95 and $100 million. That's about $50 million in mortgage money tied up in a building simply by converting it to condominium. That $50 million could have been more productively used to finance new construction. Instead, it was used to inflate the cost of housing.

It doesn't stop with the lending institutions. Real estate appraisers prefer conversions because they increase the number of dwelling units that require appraisals for financing at the same astronomical rate as the title companies enjoy. Similarly, we find land surveyors and engineers testifying against conversion controls out of the same self-interest.

To be complete, I should mention the really big winners in the condo conversion game. First there are the developers themselves who, as discussed earlier enjoy huge profits with usually little risk or investment. Second, there are the landlords who can receive an extra 30 percent when they sell their buildings to a converter. Third, there are the Realtors who earn commissions on the sale and resale of each unit. Like the title companies, conversion opens up a whole new world for real estate salespersons. And last, but certainly least, there are the speculators who have turned shelter into a spculative investment. Indeed, a condo may not be a home.

Combined, these professions form a formidable lobby against any restriction on condominium conversions. But a crowing number of communities recognize the destructive effect of conversions and have responded to the housing heeds of their residents by putting a limit on the privilege of conversion. (NOTE: Conversion is a privilege rather than a right. Each state legislature had to create this form of property ownership. Hence, each legislature, or localities acting through home rule powers, may limit further creations of the condominium form of ownership. What the government giveth, the government may taketh away.)

LIMITS ON CONVERSIONS TO PRESERVE AFFORDABLE HOUSING

A growing number of communities have placed a limit on condominium conversions as part of an effort to preserve affordable housing. I do not pretend that the list of communities I am about to present is complete. It is more complete than that provided by HUD in its 1980 study. But each week, it seems, another community is curtailing condominium conversions for the express purpose of preserving affordable housing.

There are six basic techniques used to preserve affordable housing in the face of condominium conversions. The first was pioneered by Palo Alto, California, in 1974. For seven years, Palo Alto has imposed what amounts to an automatic moratorium on conversions whenever the rental vacancy rate is below 3 percent. Since it has not risen above 2 percent in that time, conversions have essentially been halted with, according to the planning staff, none of the disastrous effects the real estate lobby insists will happen (deterioration of rental stock, fall in property values and taxes, abandonment). The only exemption to this automatic moratorium has been if 2/3 of the tenants agree in writing to exempt the building from it. This has happened twice. Once for a three-flat and last October for a major apartment complex comprising more than 10 percent of the city's rental housing. (An ex-Mayor essentially "bribed" tenants to agree to the conversion by offering long-term leases and other goodies.) At this moment Palo Alto has imposed a complete moratorium on conversions while its law is revised to prevent such wholesale conversions in the future.

Other cities using the same basic approach include: District of Columbia (3% vacancy rate; 51% tenant approval to exempt); Cambridge, MA (4%); Vail, CO (3%); and the California jurisdictions of Claremont (3%), Cupertino (5%), Fremont (3%), Gardena (3%), Hayward (5%), Marin County (5%), Los Angeles (5% by planning area), Montclair (3%), Newport Beach (5%; 67% to exempt), Orange County (5%), Palo Alto (3%; 67% to exempt), San Bernadino (6%; 67% to exempt), San Diego (5%), Santa Monica (5%; 80% must buy to exempt).

A second technique, not quite as effective but still useful, is to limit the number of conversions in any one year to a percentage of the rental stock or to a percentage of new rental units built during the preceding 2 years. Jurisdictions employing this technique include the California cities of Albany, La Mesa, Mountain View, Oakland, Riverside, San Francisco, and Walnut Creek.

A third technique, just as effective as the first, is to require some form of tenant approval, either in the form of a specified proportion of tenants voting to approve the conversion or a set percentage of tenants agreeing to purchase their units. This approach assumes that tenants voting to approve either plan to purchase or have someplace to move. California cities using this approach include San Francisco (40% must agree to purchase; city is trying to close loopholes), Newport Beach (30% vote), and Thousand Oaks (50% vote). New York City requires that 35% of the tenants agree to purchase for an eviction plan to be filed and 15% agree to purchase if no eviction plan is to be filed. The New York Attorney General has recommended that these figures be increased, partially because developers have abused the current system.

A fourth technique requires the city to consider the effect the proposed conversion would have on the balance of the community's housing stock. Lynnwood, WA; Cambridge, MA; and Vail, CO; employ this condition when considering conversion applications. These California jurisdictions also use this approach: Belmont, Concord, Gardena, Marin County, Mountain View, Oceanside, Thousand Oaks.

A number of jurisdictions consider the potential for displacement of tenants in general or members of specific classes such as the elderly or handicapped. These include Aspen, CO; and the California cities of Albany, Concord, Duarte, Gardena, Mountain View, San Francisco, and Thousand Oaks.

The sixth and final technique involves requiring a developer to retain units as low- or moderate-income. Marin County, CA, uses this approach with much success. As noted earlier, one developer agreed to keep 40 percent of one development low- and moderate-income in order to win approval for his conversion. San Francisco requires the retention of all low- and moderate-income units as such in _any conversion. In conversions of 50 or more units, at least 10 percent of the units must be made low- or moderate-income. These units are kept as low- or moderate-income either as rentals or through controlled initial sale and resales.

Washington, DC, and Montgomery County, Maryland, use a -seventh and

the most promising technique available. They give the tenants in a building the right of first refusal to purchase their buildings anytime they are for sale or sold. In the first 18 months of operation the Washington, DC, program has been a resounding success -- _so successful that developers are now suing. While 4300 units were still converted by condominium developers during this time, another 2700 were in buildings purchased by the tenants themselves.

Nearly 500 of these were converted to limited-equity cooperatives with technical and financial assistance provided by the District's Housing Business Resources Administration from a series of revolving loan funds which the tenants repay with the permanent financing they receive from the private sector.

Herein lies the most promising technique to preserve affordable housing: the use of low-equity or limited-equity cooperatives. This form of housing takes the building out of the inflationary speculative cycle of rentals and condominiums and keeps it affordable nearly forever.

A limited-equity cooperative is like any other cooperative in the sense that residents own shares in a cooperative association which actually owns the building. However, in a limited-equity cooperative, the resale value of the shares is controlled by the coop's articles of incorporation or by-laws. The limit can be most anything: 5% increase a year, $100 increase annually, $400 annually, 10% annually. The key factor is that the increase in the cost of shares is kept less than the general inflation rate. Shares cannot be the object of speculation. This approach recognizes housing as shelter for bodies, not income.

Under the cooperative form of ownership, each resident purchases shares that entitle him/her to occupy a unit. For low-equity coops, this cost is usually no greater than what a tenant must pay when he rents an apartment (first month's rent, last month's rent, security deposit). In the District, the initial cost of these shares has run from $500 (the most common figure) to $3500 (in one case).

The "owner" of a low-equity cooperative enjoys both the benefits of homeownership and renting. Each month he pays an assessment that covers the operating costs of the building and the ownership costs (mortgage payment, property tax, etc.). The portion of this monthly payment that goes toward the interest on the mortgage and the property tax are deductible on his federal income tax as for any homeowner. But since there is invariably a waiting list to join a low-equity cooperative and there are virtually no closing costs involved in the transfer of shares, all the middleman costs associated with the resale of condominium units are eliminated. There's no title to be searched or insured since there is still only one title for the building; no appraisal to be made, no attorney to hire for hours of work, no mortgage to be issued, etc. Small wonder spokespersons for these groups rarely have a good word to say for low-equity cooperatives. They've got no financial benefit to be realized from them.

However, the shareholder and the public derive considerable benefit from limited-equity cooperatives. First, as a cooperative there is but one mortgage on the building and, unless some disaster requires substantial injections of funds, it will not have to be mortgaged again. Hence, the debt service is constant and since that composes from 30 to 50 percent of the cost of ownership, increases in monthly assessments will be needed only to cover increases in actual operating costs (maintenance, utilities, property tax, insurance, etc.). There will be no increases in the monthly assessment for debt service unlike, say, an apartment building which is sold and the new owner must increase the rent simply to cover the higher debt service he must pay.

To put this in concrete terms, consider the low-equity cooperatives in Park Forest, Illinois. The village planner there paid $165/month when - he first moved in eight years ago. Today he pays $235/month. Not bad for a 2-bedroom townhouse. He has saved so much money that he could spend it on such items as a new car and better furnishings. He has saved enough that he could purchase a home if he so chose. And his experience is typical. All it takes is a decision to treat your housing as shelter rather than a speculative investment.

The success of low-equity cooperatives as a means of providing and preserving affordable housing is legendary. The FHA's 213 program (mortgage insurance for low-equity cooperatives for moderate-income households) was so successful that the Federal Government returned $41.5 million to the cooperatives as mortgage insurance dividends because there were no defaults. This repayment record is better than that of any other FHA or HUD program. Naturally, Richard Nixon nixed this program in 1971.

The public benefits because by taking units out of the inflationary speculative cycle, low-equity cooperatives help preserve badly needed affordable housing without using Section 8-type subsidies that only fuel inflation. As Chester McGuire reports, "Direct subsidies do not alter the economic rent, only who pays it." Section 8 and other direct subsidies have done nothing to deal with the major cause of inflation in housing: speculation, the repeated resale of properties to generate a profit. Officials in Montgomery County, Maryland, estimate that to replace existing rental units worth $8500 to $15,000 each with new construction will take $35,000 to $42,500. To make such new construction affordable to low- or moderate-income households, some subsidy is necessary. .However, even then the rents will be higher than in existing buildings.

Limited-equity cooperatives, though, avoid this inflationary pitfall.

The experience of Washington, DC, demonstrates that limited-equity cooperatives offer the best opportunity to preserve affordable housing in the face of speoulation and condominium conversion. And the sort of law that the District of Columbia has that gives tenants the right of first refusal to purchase their building (namely, if a third party makes an offer, the owner must sell to the tenants instead if they can match that offer), combined with revolving loan funds and technical assistance makes low-equity cooperatives a practicality.

Montgomery County, Maryland, recently enacted a similar law which has already been taken to court by developers fearful that such noninflationary and nonspeculative housing could shut them out. They had earlier overturned a similar Montgomery County law which applied only to buildings that were converting to condominium. The new law applies to the sale of any rental building. But thanks to state pre-emption of local municipalities on condominium conversions, the earlier Montgomery County law was discarded by the court.

THE UNIFORM CONDOMINIUM ACT: A THREAT TO PRESERVING AFFORDABLE HOUSING

Montgomery County's law was thrown out by the court because it violated a provision of state law based on the Uniform Condominium Act. This provision states:

> "A zoning, subdivision, building code, or other real estate law, ordinance, or regulation may not prohibit the condominium form of ownership or impose any requirement upon a condominium which it would not impose upon a physically identical development under a different form of ownership." (§1-106)

This provision would effectively prohibit the use of every technique that has been used to preserve affordable housing in the face of condominium conversions. There is no reason for this prohibition except to promote the financial interests of the condominium conversion industry. Rut that is hardly surprising since the 18 member committee that-wrote the UCA contained 17 persons involved in the conversion industry. It was approved by the National Conference of Commissioners on Uniform State Laws and has been supported by bar associations across the country.

Now, if the UCA was really a more responsible law than that enacted by municipalities, I suppose there would be little problem with it. However, as Massachusetts State Representative John Businger has said, "It's a four month notice to get out. It's a-sham."

Indeed, the UCA is even weaker in the area of consumer protection than some of the state laws it would replace. And it is certainly weaker on tenant protections and consumer protections offered by many of the municipal laws it would eliminate by pre-emption.

In fact, it appears that pre-emption of local laws is the main aim of proponents of the Uniform Condominium Act (UCA). It took just four months after Philadelphia adopted an 18-month moratorium on conversions for the condo conversion industry to ram the UCA through the Pennsylvania State Legislature despite heavy lobbying efforts by well-organized groups of housing consumers. The pre-emption provision of the UCA has, of course, made it difficult for Montgomery County, Maryland, to control the conversion tide. It has prevented Milwaukee, Wisconsin, from dealing with the new wave of conversions spearheaded by American Invsco. (With less than 30 percent of its housing stock rental, Milwaukee can ill-afford to lose any of it to conversion.) State Senator Jim Moody has introduced legislation to eliminate the pre-emption provision in Wisconsin's state law. He faces a difficult fight.

And now the Illinois Association of Realtors and Chicago Bar Association have the adoption of the UCA with its pre-emptive provision as a top priority for 1981 in Illinois. This just happens to come at a time when aldermen in Chicago and Evanston are giving serious consideration to restricting forced conversions and developing ordinances and programs based on those used in Washington, DC, to encourage conversion to limited-equity cooperatives.

The only argument of any apparent merit in support of a uniform state law, at first, seems to be that a single law would prevent developers from being confused by differing local requirements. Never mind that each municipality may have different housing needs and that conversions can have profoundly different impacts depending on the nature of a community. The older housing stock of one community may require stricter code compliance before conversion than the newer stock in another community.

But the argument for uniform treatment throughout a state is one of the most unfounded ever devised. If developers are confused by differing local condo conversion laws, would they not also be confused by differing local building codes or zoning ordinances? Maybe we should have a single building code in each state or a single zoning ordinance for each state. In fact, since so many developers are going national, we wouldn't want them to be confused by a different condominium law in each state, would we? Let's have a single condominium law nationally; a single building code nationally; a single zoning law nationally.

Just as a single building code or zoning law for a state, or the nation is unwarranted, so is a single uniform condominium law. The only reason the conversion industry wants such laws that pre-empt local jurisdictions, is because they can better control state legislatures and prevent enactment of laws that might restrict conversions in order to preserve affordable housing. With the UCA, the conversion industry can throw up an unbeatable roadblock to efforts to preserve affordable housing. The UCA ought to be a national scandal and the self-serving, selfish, and irresponsible proponents of the UCA ought to be exposed for what they are.

VOLUNTARY INDUSTRY MEASURES

Often we hear the hue and cry of an industry that the industry should be allowed to regulate itself. Unfortunately, this amounts to letting the fox guard the chicken as the UCA does.

Voluntary developer measures have frequently been failures in the sense that they do nothing to preserve affordable housing. Generally they are intended to ease the burden of conversion a little.

Chicago's Robert Sheridan, for example, offered two-year lease extensions to the elderly in his Edgewater Beach conversion. However, he was surprised at the low response rate. That is not the slightest bit surprising if you bother to talk to the elderly who are caught up in a condominium conversion.

A brief lease extension like that only prolongs the agony. In two years the elderly tenant is out anyway and in two years he or she may have an even more difficult time finding an apartment due to greater infirmity of old age or an even lower rental vacancy rate. One may almost get the feeling that developers hope the elderly will die off in this two-year period so the only relocation they will need is to a cemetery.

Nothing short of a life lease with restrictions on rent increases will do for the elderly caught in a building converting to condominium. The only catch is how to prevent discrimination against the elderly in the rental of apartments when such a law is in effect. Generally jurisdictions with such laws also have moderate rent control laws which make it very difficult to deny a rental to an elderly person on the basis of age.

But is there really any reason to expect condo converters to really care? Afterall these are the same folks who persist in conducting misleading advertising campaigns to sell their units. What developer has not run an advertisement showing how owning a condominium reduces your cost of living thanks to the income tax deductions afforded homeowners? (Admittedly this is the single largest government subsidy in the housing field. For the past fiscal year it will come to over $18 billion.)

Typically the converter will show your new monthly cost due to mortgage payments, property tax, and monthly condominium assessment. Then he will show how much of this you can deduct from your income taxes assuming you are in a certain tax bracket. That gives you the "real" "cost" of ownership. What the developer does not tell you is that you have a standard deduction coming anyway, whether or not you own. To be honest, the developer should subtract that standard deduction ($3400 for a married couple, $2300 for a single person, $1700 for a married person filing a separate return) from his estimate of tax savings since homeownership does not give you that first $3400/2300/1700 of deductions - everyone gets it. That will show that the actual tax benefits are minimal. For my condominium a developer's typical ad would show income tax savings of $3000 in homeownership deductions, or roughly a $1000 tax savings. Actually, I've got $2300 of that deduction coming to me anyway as does any taxpayer who takes a standard deduction. So my actual tax savings due to ownership comes to only one-third of $700, or $233, less than $20/month. My actual itemized deductions came to roughly $1400 after the standard deduction was subtracted; so my tax savings total came to $40/month, hardly the figure that would be advertised.

THE HUD CONDO STUDY: SLOPPY RESEARCH REWARDED

HUD's 1980 study, The Conversion of Rental Housing to Condominiums and Cooperatives: A National Study of Scope, Causes, and Impacts is certainly a massive work of art. Unfortunately, it is a work of deception, sloppy research technique, and misinformation as well. I think Congress should demand its money back!

The study's most glaring deficiencies include its concentration on national figures on the number of conversions. This is a sloppy and misleading approach since we do not have a single national housing market. Instead we have small regional and local housing markets in which a high rate of conversions is masked by national figures. Nationally, the HUD study found that "only" 1.3 percent of the country's occupied rental stock had been converted to condominiums (and cooperatives —not limited-equity) between 1970 and 1977. The study's authors persist in emphasizing this figure when they know full well that it is meaningless. We will not have a high national figure until conversions overwhelm more cities and by then it will be too late to do anything about them. We will have lost a staggering proportion of our affordable housing stock to higher cost condominiums and the only response will be more inflationary subsidies to get rentals built. The study does admit that conversions have affected a substantial proportion of rentals in many cities - although it would have been more "honest" to report on the number of conversions in terms of their proportion in individual housing markets.

For example, Evanston, Illinois, has seen over 15 percent of its rentals converted to condominium. But when buried in the national picture the significance of this figure is lost. Even when aggregated within the Chicago SMSA -- which consists of several separate housing markets – the Evanston figure is lost.

This attempt to minimize the impact of conversions is typical of the sloppy or misleading efforts of the HUD study. I still cannot understand, for example, the value of the study's model of the effects of conversion on the rental market. Like most models it assumes away reality and operates only in a hypothetical world. Never does the concept of reluctant tenant purchasers enter into the model. The study even warns that this is a hypothetical model and that "the effect of conversions is likely to differ from market to market and, therefore, the national aggregated effect may not adequately describe the results of conversion activity in any particular locality." (p. VII-2) That's a good warning. Too bad even HUD's publicists did not heed it. This model has been misused in HUD press releases and other publicity to show virtually no loss of rentals due to conversion. Yet even the study admits it does not reflect reality. So, why include it?

Rather than spend a few dozen pages criticizing the HUD study, I would refer you to the attached article in Appendix A, "HUD Blesses Condomania," by Peter Dreier which appeared in the Sept/Oct 1980 issue of Working Papers (pp. 53-58). Having worked with Professor Dreier in the preparation of the article, it would be redundant to repeat its criticisms. Just read the article for a thorough evaluation of HUD's study.

WHERE DO WE GO FROM HERE: A FEDERAL ROLE?

Housing is certainly a matter of national concern. Even if you ignore decades of federal involvement in the effort to provide affordable housing, there is still the fact that much of the nation's mortgage money is provided by federally-insured lending institutions operating under federal rules and regulations and the fact that conversion activity is hardly restricted to one or two states. Condominium converters today operate in many states not just one. The sale of converted units is an interstate commerce as clearly depicted by an advertisement in the March 17, 1981 issue of the Chicago Tribune (section 4, page 8) for an auction of 66 luxury condominiums . . . in Phoenix, Arizona. In addition, federal income tax laws provide the nation's single largest housing subsidy (more than $18 billion annually) to homeowners and any activity that would increase the size of that subsidy such as condominium conversion is certainly a matter for national public policy and action.

Today we have a most puzzling public policy toward housing, both nationally and in all but a few dozen municipalities. We allow existing rental housing affordable to middle, moderate, and low income households that is provided at a profit by the private sector, to be converted into higher cost condominiums that a growing number of persons in these income groups cannot afford -- unless they want to spend much more than 25 percent of their income on housing.

At this same time, we recognize that it is virtually impossible to build new rental housing for members of these income groups without using taxpayer subsidies to essentially guarantee profits for the builders.

Concommitantly, we are aware that it is certainly quite profitable to construct new condominiums, which, frankly, by themselves could meet the natural demand for condominium ownership in most communities.

This approach is clearly an inefficient waste of the taxpayers money and a chief contributor to inflation because it allows existing affordable housing to be replaced by more expensive housing and creates a need for more government subsidized housing to replace the converted units. If you don't think this is inflationary, consider the rents in the replacement housing. In San Francisco, Section 8 walkups call for as much as $804 in monthly rent. A three-bedroom walkup in Washington, DC. will cost $564/month; the allowable Section 8 rent in the District for a 3-bedroom apartment in a five-story elevator building is $978.

Perhaps one of the most dramatic examples of how this policy is wasteful, inefficient, and taxing on America's pocketbook, is the conversion of Sandburg Village in Chicago and the proposed subsidized construction of Presidential Towers to replace the loss of Sandburgs rental units.

Sandburg Village is a 2700-unit complex of HUD-insured buildings constructed on urban renewal land on the near north side of Chicago. Rent for a one-bedroom apartment just prior to conversion was less than $300/monthly according to several long-term tenants there. Conversion more than doubled, in some cases tripled, the monthly cost of living in Sandburg. To replace these rental units -- which have already enjoyed subsidies in terms of urban renewal and HUD insurance -- developers have proposed constructing 3246 rental units just west of Chicago's "Loop" using $200 million in tax-free mortgage revenue bonds to help finance the deal. These publicly-issued bonds, of course, won't generate much tax money - in fact they'll be used as a tax shelter by purchasers. Rent in the Presidential Towers, assuming occupancy within 5 years: over $600/month for a studio, over $700/month for a one-bedroom. Rents in Sandburg would never had risen that level in that time period. Overall, housing consumers wind up paying more and the taxpayers wind up subsidizing new construction to replace rentals that never should have been allowed to convert in the first place. Try to imagine how much cheaper it would have been to the taxpayer if Sandburg had been kept rental and Presidential Towers were built as condominium without any subsidy.

There appears no way to get the general rate of inflation under control without first limiting inflation in the components of that general rate. Condominium conversion spurs inflation in housing costs; in fact it is the single greatest inflation producer in this country today by viture of its ability to double monthly housing costs with the flick of a pen.

But some might argue that conversion will always be pretty limited: that developers only want to convert the luxury buildings. Of course, municipal studies mentioned earlier demonstrate that buildings housing middle, low, and moderate income households are being converted. But let's not rely solely on municipal studies. Let's listen to what the condominium conversion industry says in its unguarded moments about the future of condominium conversions:

Harold Miller; converter of Sandburg Village: *"Everything's going to be converted and I'm right." (Interview with Daniel Lauber)*

Roberta Sellers of Gold Coast Residences (converters in Chicago): *The condominium conversion wave will endure "as long as there's anything left to convert." (Chicago Sun-Times, March 9, 1979, p. 76)*

The Marling Group, Ltd, Northfield, IL based national real estate consulting and development firm: '*The supply of desirable condominium conversion products will continue to dwindle until almost all of the desirable rental properties, which are free from conversion legislation, are converted." (Press release, "National Study Charts Luxury Condo Prices, Comments on* Future *Trends," Sept. 10, 1980)*

David Kaufman, condominium broker: *"You'd* have to *go* into a *really bad neighborhood* to *find a rental building that won't go condo.* You *could darn near condo a doghouse today." (Chicago Sun-Times, Feb. 12, 1978, p. 8)*

Samuel Zell, president of Equity & Financial Management Ca of Chicago: *"Not only highrise buildings lining* the lakefront *will go condo, but the two- and three-flat buildings of the North Side should also be converted* to *condos, says Zell. 'It's spreading there already. Where people have the* opportunity *and it's economically feasible, they'll convert to condos.'* [Zell] *predicts* there *will be no more* rental *apartment buildings in* the *United States in the next 10* to *15 years." (Chicago Tribune, "Renters* to *become extinct, investor says," June 24, 1979, Section 14, p. 1E)*

Bruce Steele, chief of housing, Washington Area Council of Governments: *"There is no such thing as a non-convertible building so long as* the *general locational aspects are* there." *(Washington Star, Jan. 25, 1981,* p. C-1)

There is no doubt about it: condominium conversion threatens the very existence of our nation's affordable rental housing stock.

America is caught between the proverbial rock and hard place. We are allowing our affordable rental housing to be converted to more expensive condominiums while at the same time we cannot replace it without government subsidies which have always been too few and too late. It's just too expensive to build affordable rental housing today without government assistance. As 70 year old Harry Helmsley, our nation's largest individual landlord (his firm Helmsley-Spear controls $3 billion worth of commercial and residential real estate developments) says the day is past when middle-income America can afford to rent a new apartment because there is no one left who can afford to build it. (Chicago Tribune, Nov. 15, 1979, Section 6, page 9)

Instead of limiting the very inflationary condominium conversion phenomenon, we have allowed it to continue. But can Americans continue to afford the kind of inflation conversion has brought us? I would roughly estimate that condominium conversion alone inflated the actual amount of money spent on housing in the 1970s by over S3 billion. That is money that could have been put to better use on durable goods which oreate jobs. And that figure does not include the additional money tied up in mortgages for the inflated price of condominium real estate.

What's a country to do? We could continue to allow the cost of housing rise beyond the reach of the middle-class. There are, afterall, many observers who feel we are heading into an "unaffordable" society in which there will be a small but wealthy upper class that can afford nearly anything it wants, and a massive lower class that can barely afford daily necessities and will require public subsidy to house itself. The middle-class, according to this scenario, will find its quality of life declining as discretionary income disappears. Housing, as Samuel Zell suggests, will cost 40, 50, or more percent of our incomes. Even so "establishment" a firm as Chase Econometrics is forcasting that in this decade the cost of housing will be so high that the purchase of homes will tend to "crowd out" the purchases of consumer durables, especially furniture. (Reported in Chicago Tribune, March 29, 1981, Section 5, page 1)

But it does not have to be this way. A little common sense and pragmatic public policies designed to serve America's population rather than the speculative forces of the housing industry can head it off at the pass. I would suggest that this subcommittee, the Congress, and the Administration pursue the following policies and undertake the following suggested actions to assure a sound supply of affordable housing for America's middle-class during the remainder of the twentieth century and beyond:

• Enact a three-year national moratorium on condominium conversions with exemptions only for buildings in which two-thirds of the tenants agree to purchase their units without coercion and threat of eviction of any sort.

This moratorium is essential to provide time for the Congress and the Administration to develop the other programs and policies recommended here to preserve our affordable housing. Allowing conversions to continue during this time would only setback the nation's efforts by allowing affordable housing to be converted into higher cost housing. Congressman Rosenthal has already introduced legislation of this type - nearly two years ago.

- Adopt a policy of encouraging the removal of rental stock from the inflationary speculative cycle through conversion to limited-equity cooperatives.

  As explained earlier, limited-equity cooperatives take housing out of the speculative cycle that is the major cause of inflation in housing costs today. Earlier illustrations have shown how low-equity cooperatives fight inflation by keeping a constant debt service until expiration of the mortgage (at which time a new mortgage is not necessary and monthly costs can either be reduced or kept constant and used for any needed rehabilitation).

  This policy would not contradict the national policy to encourage homeownership since low-equity cooperatives are a form of homeownership. As demonstrated by the FHA 213 program, low-equity cooperatives are one of the soundest forms of homeownership available. Their only "fault" is that they do not provide business for the inflationary middle-men of the condominium conversion industry.

- Enact legislation to require lending institutions to provide mortgage funds for limited-equity cooperatives on terms no worse than those offered buyers of conventional homes.

  Most lending institutions refuse to finance limited-equity cooperatives out of ignorance. Sometimes it requires federal action to overcome such ignorance. When business operations are unable to think beyond today's profits they lose track of long-term interests. Our automobile manufacturers are the perfect example of this failure. If the federal government had not mandated fuel economy goals years ago, our automobile companies would not have started planning to build fuel efficient vehicles until last year. They would be in even worse shape vis a vis foreign manufacturers than they are now.

  Similarly, our lending institutions are either unaware of the superb track record limited-equity cooperatives have established, or they are simply interested in pursuing the greater short-term profitability of condominium financing. Either way, any federally-insured lending institution should be required to provide financing to limited-equity cooperatives in order to qualify for any federal insurance.

- Provide technical and financial assistance to tenant associations to purchase their buildings and convert to low-equity cooperatives. This assistance should be available to middle-income as well as low- and moderate-income tenants.

  Revolving loan funds can be used to provide the financial assistance. Tenant associations can repay the borrowed money out of funds they receive for permanent financing from the private market. The First Purchase Loan Program in Washington, DC demonstrates that this technique is most feasible and successful.

  Municipal planning departments can provide the technical assistance tenants will need to convert to low-equity cooperatives. Again, the program in the District of Columbia shows this approach works as long as competent people administer it.

• Retain the National Consumer Cooperative Bank with greater funding than it has today.

This bank can provide loans for limited-equity cooperatives until the othermechanisms suggest here can be put into operation. The Coop Bank offers an opportunity to get the low-equity cooperative program off the ground and establish more examples of how successful these coops are. Even though there are plenty of excellent examples of these cooperatives today, the banking industry may need more examples before it recognizes their value.

• Immediately terminate HUD's practice of converting federally-insured or financed buildings into condominiums when threatened with default.

These conversions serve no purpose except to inflate housing costs. Even when prices are set so moderate-income families can afford them initially, speculation will soon price the moderate-income household out of the building. In addition, moderate-income households are often unable to afford steep special assessments to correct building faults. Oak Park, Illinois, for example, provided a $1800 interest-free loan to one moderate-income household to cover a $1800 special assessment. The village used Community Development Block Grant funds.

Park Forest had to place over $240,000 of community development funds in escrow before any bank would loan a local condominium association (over 300 units) over $400,000 so they could bring the common areas in the buildings up to village codes -- just three years after conversion. Residents were largely middle-income households that simply could not afford the $1000 to $1500 cost of a special assessment.

The key point is that condominium ownership is still inflationary. Instead of converting these buildings to condominium, HUD should be converting them to limited-equity cooperatives. At a bare minimum, the tenants in these buildings should be given a choice.

• Require that tenants be given the right of first refusal to match a contracted offer to buy a rental building.

The specific details of how this approach would work are already being implemented by the District of Columbia. There is no good reason why the timetables and rules governing this process in the District of Columbia cannot be used nationally.

This requirement can be implemented by prohibiting the use of the U.S. mails and any federally-insured lending institution for the sale of any rental property unless this requirement is met.

This requirement is essential to implementing a policy encouraging the conversion of rental housing to limited-equity cooperatives. It gives the housing consumer a choice between continued renting, condominium ownership, and ownership in a limited-equity cooperative. It would help stop the forced conversion of affordable rental housing to more expensive condominiums.

Adoption of these policies and implementing activities will help preserve America's dwindling supply of housing affordable to middle-income and low- and moderate-income households without the commitment of large inflationary amounts of taxpayer dollars.

We can no longer delay. Housing is too essential to allow it to remain an object of speculation. As the United State Supreme Court said in Block v. Hirsch, 256 U.S. 135 (1920):

> "Housing is a necessity of life. All the elements of a public interest justifying some degree of public control are present."

Local governments have generally failed to act to preserve our affordable housing. When they have, they have relied heavily on the support of federal dollars for inflationary housing subsidies. The failure of local government to act necessitates federal action, as is so often the case.

It would truly be a shame, five or ten years from now when America's middle-class can no longer afford housing, to have our politicians bemoan this situation and say, "Isn't it too bad nobody did anything about this housing crisis in 1981, before it got too big to handle?" I suspect the response will be to throw more good money after bad through inflationary government subsidies rather than decide to remove affordable housing from the inflationary speculative cycle through conversion to limited-equity cooperatives.

But unless the action and policies called for here are adopted and implemented within the next few years, America's middle class faces an otherwise unavoidable housing disaster, the likes of which we have not seen since the Great Depression.

If this Administration and Congress are serious about curbing inflation, they will pursue the policies suggested herein or, I fear, we can kiss affordable housing for the middle class good-bye by the end of this decade.