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Pre-planning for condominium conversions - Samantha McDonald

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Every time the housing market booms, owners or purchasers of multi-family housing contemplate whether they should keep the steady stream of rental income or whether they should cash in by converting the property into condominium units and selling the units individually. We saw this in the 1980s and in the early 2000s, and it's happening again. Mortgage rates are still generally low, people are eager to buy, and a condo is typically priced more affordably than a single-family home. Undoubtedly, there are pros and cons to a conversion. From a developer's point of view, you'll generally realize a higher sale price for condominiums than for multi-family houses. However, there are certain things you should think about when considering a conversion of a multi-family home into condominium units.

The pre-planning stage: Know your costs and timing.

Get a good real estate agent to do some fair-market-value price evaluations. What is the property worth right now as a multi-family? What would each condo unit be worth? The difference, less your profit, is the maximum you should spend on the conversion.

Obvious costs include the construction or renovation work, materials and permits. Remember that a conversion requires that the building and all units be brought up to current codes, and different utility requirements may be brought into play. Other, less obvious costs to factor in include legal fees, which will likely range between $5,000 and $20,000, depending on the locality and complexity; brokers' commissions on selling the units; recording fees and excise taxes; and engineers' and architects' fees, likely exceeding $5,000, for drawing the necessary plans.

Additional costs and lengthy delays must be factored in if the property contains four or more units and the units are occupied. Tenants in such buildings are afforded greater protections by a patchwork of condominium conversion statutes. The laws vary by location, but the state statute applicable to all communities in the Commonwealth mandates the following:

• A moratorium against evictions until notice is afforded to each tenant. Most tenants must be provided with notice of the developer's intent to convert one year before the developer can terminate their tenancy, but elderly, handicapped, and low- or moderate-income tenants must be provided two years' (or in some cases up to four years') notice.

• A cap on annual rent increases at CPI or 10%, whichever is less.

• A 90-day right of first refusal giving the tenant the right to purchase the unit on terms that are the same as or more favorable than those to be offered to the general public.

• A relocation payment of $750 to $1,000 per tenant, depending on whether the tenant is a member of a protected class. Elderly, handicapped, and low- or moderate-income tenants must also be provided with relocation assistance to help them find new housing in the same municipality at the same or a lower rental rate.

In addition, some municipalities have enacted stricter protections for tenants. For example, in the city of Boston, the notice period for elderly, disabled, and low- or moderate-income tenants is five years. Moving-cost reimbursement in Boston is now up to $6,000, or $10,000 for elderly, disabled, and low- or moderate-income tenants. In Somerville, the protections apply to two- and three-unit homes. At least 11 Massachusetts communities have specialized protections.

Investigate the zoning. The condominium conversion process might reveal issues with current zoning compliance (such as illegal basement units). The current use may have more units than are legally permitted under the zoning ordinance or may be a grandfathered use. A condo conversion preserving the same number of units may require zoning relief, adding to the time and cost of the conversion.

Once you've completed the conversion, there will be still more costs. The developer must obtain and pay for the master insurance policy — usually more expensive than individual building insurance — until the units are sold. The developer is also required to pay the monthly condominium fees for any unsold units from the time of recording the master deed until all the units are sold.

Consult with an experienced attorney before putting together your cost analysis to ensure you do not encounter any expensive or time-consuming surprises in your conversion.

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