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Good deals in condominium real estate? Ownership cost continues whether the property is rented or used

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With the collapse of the residential real estate market, there ought to be some terrific bargains for investors to pick up, particularly in hardest hit areas such as Florida and southern California. Many clients and friends of mine have been tempted, as I have been, if it were not for the hidden costs of these bargains. Condominium development, and condominium ownership, are great in up markets. But if the market turns down, the impact can be severe.

The first issue that comes to mind is the Condominium Association itself. I think condominium associations are difficult in general in such developments, but they turn really ugly in the down market. Although I stereotype here, many condo associations in Florida, for example, are made up of retired high-powered business people, now with nothing to do but manage the association. They can become a little officious in their retirement with this responsibility. In an economic downturn, if owners stop paying condo association fees, for example, the association officers can get really crazy. As they are the most involved, they want to maintain the quality of the buildings and development, at the same time that members are either voting against expenditures or refusing to pay fees. It can be a no-win situation.

Related to the condominium fees, if various owners stop paying because they are unable or have bigger problems with their mortgage, viable owners may have to pick-up the tab. Typically the condominium budget is trimmed, but it still may be that there are owners who can, and will, make higher payments to ensure that the quality of their environment remains high, particularly if they are interested in selling. The last thing that the financially able owners want is to project the image of the troubled condominium project.

The next issue with condominiums in a down market is the amenity package. Recently I have been getting reports from a large and well respected community in the southwest Florida area. This development was started almost 30 years, and it is both "healed in" and occupied by the well-heeled. However, it has five golf courses which the original developer had the prerogative of turning over to the members at a certain point. Despite the fact that the original developer has been extremely successful, they're having troubles like every other developer and are choosing to turn the golf courses over at this time. The homeowners, on the other hand, do not want the golf courses, as they just represent more red-ink. Thus, course members are trying to resign from the club, but cannot always get out any time they want. If they can't resign, they simply stop paying membership dues, and the same thing happens with the club facilities as happens with the homeowners associations. In this particular development, there are also a marina club and social club. Imagine the difficulties when everybody, including the condominium owners association, are vying for the same limited pool of home owners capital.

Those are problems from the owners' point of view. On the developer's side, there are many related risk factors in building this type of project. The most basic one is that, typically there are enormous up front costs, such as the amenity package. A developer needs these things to differentiate his or her development and attract the buyers. Additionally, as condominiums, they will typically be built in much larger structures, with a great deal more infrastructure as well as building cost necessary to be spent, before even the first unit can be sold. Further, the permitting efforts can be more complex in large condominium developments, adding to the time frame between the "glint" in the eye and first sale. Thus, permitting, infrastructure, construction, and amenities package may take years before there is a single actual sale, and the likelihood of a market change grows in every prolonged time frame.

Summarizing, it is very tempting to purchase real estate at half price such as one is able to in certain distressed resort areas. However, the cost of ownership continues, whether or not the property is rented or used. If some of those costs are hidden, it may be more difficult to make a profit than you think.

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