

CONDOMINIUM CONVERSION IN SAN FRANCISCO

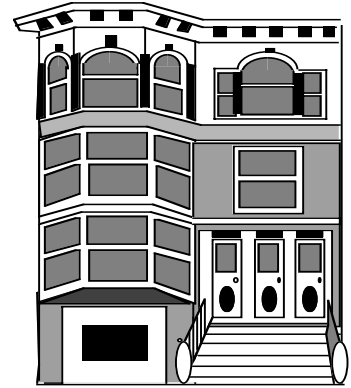
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HAVE CONDOMINIUM CONVERSION RULES CHANGED?

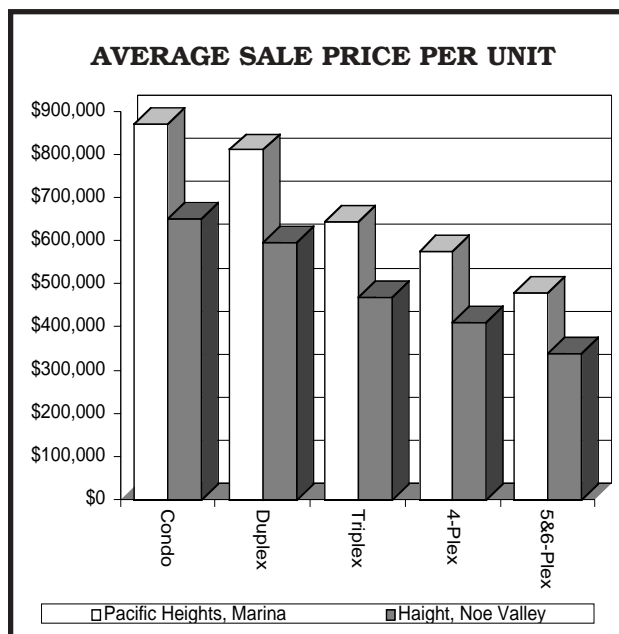
On January 10, 2003, a court ruling struck down the "McGoldrick" law which had significantly changed condominium conversion requirements. The effect of this decision was to reinstate the conversion rules which had been in effect before August 2001. This article summarizes the rules we understand to be in effect on the publication date. The January 10 court decision has been appealed, and new laws may be enacted. Buyers and owners should check with the authors for recent developments before making commitments based on information in this article. An updated version of this article may be available at our website "G3MH.com". Owners who qualify for conversion under current rules should file applications immediately.

WHY CONVERT A PROPERTY TO CONDOMINIUMS?

Conversion usually raises a property's value. The amount of appreciation increases with building size (see chart). Conversion allows co-owners of multi-unit buildings to eliminate many of the risks of co-ownership by obtaining separate financing. Under some circumstances, condominiums may also be exempt from limits on annual allowable rent increases.

WHAT IS A CONDOMINIUM?

A condominium consists of an individually-owned "Unit" and a share of group-owned "Common Area". The "Unit" is the space within the walls, floors and ceilings of a dwelling, and the "Common Area" is the remainder of the property. Owners pay their own mortgages, property taxes, and utilities, plus monthly "Homeowners' Association Dues" to cover repair and insurance of the Common Area. A lengthy document called the "Covenants, Conditions and Restrictions" or "CC&Rs" establishes the rights and duties of the condominium owners.



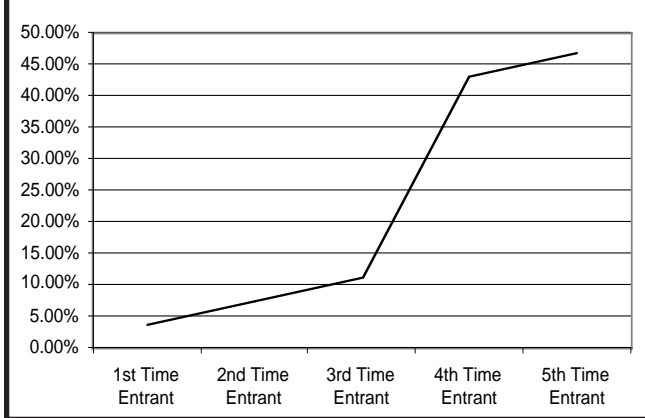
WHAT PROPERTIES QUALIFY FOR CONVERSION?

Only 2-6 unit properties may convert. They qualify only when they (i) meet occupancy requirements, (ii) win or bypass the conversion lottery, and (iii) for lottery conversions, satisfy "tenant rights" rules.

HOW DO YOU BYPASS THE CONVERSION LOTTERY?

Two-unit buildings bypass the conversion lottery if both units are occupied for one year by separate individuals who each own at least a 25% interest in the property during the entire occupancy period. Occupancy is proven by electric and telephone service. No other building types can by-pass the lottery.

CHANCE OF WINNING 2004 CONDO LOTTERY



HOW DOES THE CONVERSION LOTTERY WORK?

The conversion lottery is held annually during the first quarter of the calendar year. Tickets cost \$150 and are available for a two-month period ending about two weeks before the drawing. (In 2004, the lottery date was February 4 and the entry deadline was January 22). You may purchase a ticket without showing that your building qualifies for conversion. Up to 200 units may be converted through the lottery each year.

The lottery system is designed to favor buildings that have previously lost. This means your chances of winning are low the first time you enter but increase in successive years (see chart).

The lottery is divided into two drawings. The "Pool A" drawing selects up to 100 units from buildings which have lost at least three times. Two of the losses must be after 1994. Each qualifying building gets one Pool A ticket. Losing Pool A buildings are automatically entered in Pool B.

The "Pool B" drawing selects the remaining winners from all applicants but is also weighted to favor previous losers. First-time entrants get only one Pool B ticket. Other entrants get one Pool B ticket for each loss after 1994, and one more for any loss in 1990-94. (Note that only one Pool B ticket is issued for losses in 1990-94 even if a building lost multiple lotteries during this period.) Buildings may accumulate up to five Pool B tickets.

Winning buildings must submit a conversion application by a summer deadline. Losing buildings go on a waiting list in case winners fail to submit applications or are rejected for failure to qualify.

WHAT ARE THE LOTTERY OWNER-OCCUPANCY REQUIREMENTS?

For 2-4 unit lottery winners, one unit must be owner-occupied for three years; for 5-6 unit lottery winners, three units must be owner-occupied for three years. The term "owner-occupied" is actually a misnomer as applied in the lottery system; the occupant can be a tenant for three years so long as he/she is an owner at the time of application. Occupancy is proven by electric and telephone service. The three-year period is measured backwards from the lottery entry deadline. So to qualify in 2005, the required number of owners must have occupied continuously since January 2002.

MUST THE OWNER-OCCUPANTS REMAIN THE SAME?

This question is confusing because the occupancy requirements for conversion are different than the occupancy requirements for lottery priority. Conversion requires that the same owner-occupant(s) (one for 2-4 unit buildings, three for 5-6 unit buildings) reside in the property continuously from three years before the lottery entry deadline until the conversion application is submitted. The identity of the qualifying owner-occupants cannot change during those years. Lottery priority requires that one of the qualifying owner-occupants has been an owner (but not necessarily an occupant) during each of the previous lottery losses.

WHAT ARE THE "TENANT INTENT TO PURCHASE" REQUIREMENTS?

Lottery winners must submit "tenant intent to purchase" forms signed by residents of at least 40% of the units. These forms state that the signer intends to buy his/her unit as a condominium, but may later decide not to buy. The signers may be renters or owner-occupants. Under this system, only 3-4 unit buildings with a solitary owner-occupant need renter cooperation to satisfy the requirement.

WHAT ARE THE "TENANT RIGHTS" RULES?

All renters (including those who do not sign a "tenant intent to purchase" form) get an opportunity to purchase after conversion at a price established by the owner, all non-purchasing renters get one-year rent-controlled leases, and all disabled and senior (over 62) renters get lifetime rent-

controlled leases. At the conclusion of a lease period, renters may be evicted in connection with the sale of a unit. All tenants must be notified of their rights before a lottery conversion application is filed.

WHAT BUILDING CODE REQUIREMENTS APPLY TO CONVERSION?

Converting buildings need not meet current building codes, be seismically upgraded, or have parking. But the City does require a building inspection. The inspection process has six steps: (i) submittal of the inspection request form and fee, (ii) a site visit by City building, plumbing and electrical inspectors, (iii) issuance of a written inspection report, (iv) receipt of a building permit for corrective work, (v) completion of all required work, and (vi) City inspection of the work and issuance of a completion certificate.

It is neither necessary nor advisable to start the inspection process prior to submitting a conversion application. Applicants must request inspection and pay the fee before submitting a conversion application, but need not have the inspection or complete the corrective work until after the application is submitted.

Inspection reports typically cover three types of problems: (i) work which was completed without required permits (including everything from kitchen renovations to decks to in-law units), (ii) conditions which present safety hazards (like poor fire egress or dangerous electrical wiring), and (iii) energy and water conservation violations. Once you request a City inspection, you must perform the cited work whether or not you complete the conversion. Consequently, City pre-inspections are not advisable. But pre-inspection by a private consultant familiar with conversion requirements may be beneficial. Such a consultant can provide advance warning of likely inspection issues, recommend prophylactic measures to minimize work requirements, establish the legality of preexisting improvements, and obtain building permits.

HOW DO QUALIFYING PROPERTIES BEGIN CONVERSION?

Owners of qualifying buildings (either lottery winners or lottery bypassers) must submit an application package to the City. The major components of the package are:

Inspection: Before submitting a conversion application, you must request a City inspection by mailing in a form and the required fee. The receipt for the inspection fee is part of the conversion application, but you need not have had your inspection in order to submit the conversion application.

Survey: Conversion requires a survey or “map” prepared by a licensed surveyor which locates the boundaries of the property and the condominium units. The survey takes 3-6 weeks to complete.

Occupancy: Owners or renters needing to prove occupancy must have bills or letters from PG&E and Pac Bell confirming service. Owners must also sign a sworn statement and provide evidence of a homeowner’s property tax exemption.

The package must also include a variety of other items which an attorney can help you compile.

HOW LONG DOES APPLICATION PROCESSING TAKE?

The application is processed by both the Department of Public Works and the Planning Department. During 2003, processing of 2-4 unit properties has taken 15-24 months; processing of 5-6 unit properties, which requires additional City approvals and a State approval, has taken about four additional months. A professional with knowledge of the process and the processors, and the ability to focus on the progress of the application, can accelerate approval.

WHAT OTHER DOCUMENTATION IS REQUIRED?

All condominiums must have CC&Rs which describe the rights and duties of the owners. CC&Rs should be prepared by an attorney and include:

- Homeowners' Association decision making
- Operating budget and maintenance reserve
- Division of financial responsibilities
- Management and record keeping systems
- Maintenance, alteration and usage rules

Properties of 5-6 units must also obtain a “Final Report” from the California Department of Real Estate by submitting a separate application.

WHAT STEPS REMAIN AFTER AN APPLICATION IS APPROVED?

The approved survey must have a notarized signature from all recorded owners and lenders. It is then returned to the City with an updated title report, a certificate of completion of the inspection work, and a Tax Certificate showing property taxes are paid current. The building officially becomes condominiums when the survey and CC&Rs are recorded.

Final recordation does not alter the ownership or financing of the property. All of the condominiums in the building remain owned by the same individual or group, and all remain subject to the same mortgage. Thus if two owners each own 50% of a duplex before conversion, they will each own 50% of both condominiums after conversion. Separation of the condominiums so that particular owners have title to particular units generally requires refinancing with separate mortgages for each unit.

WHAT ARE THE COSTS OF CONVERSION?

City Fees: The City charges an inspection fee ranging from \$511 for two units to \$852 for six units, an application fee of \$4,625 for 2-4 units or \$7,975 for 5-6 units, a \$150 lottery fee, and a recording fee of about \$110.

State Fees: The State application is required only for 5-6 units, and the fee is currently about \$1,700. The State also requires a formal budget which is best prepared by a professional budget preparer at a cost of about \$2,500.

Surveyor: Surveys start at about \$4,500 and increase with building size.

Attorney: Goldstein, Gellman, Melbostad, Gibson & Harris, LLP provides a complete, flat-fee package including preparation of the City Application, monitoring/troubleshooting, advice on space assignment, CC&Rs, and assistance in lender signing and recordation. Call for current pricing.

Repairs: Building permit fees and repair costs depend on the extent of needed work.

Title: Some title companies will provide required title reports free of charge if the owner promises to use the same company for a post-conversion sale or refinance of the property.

Lender: Most lenders charge \$200-350 to sign the survey.

IS IT HARD TO GET THE PRE-CONVERSION LENDER'S CONSENT?

Conversion cannot be completed unless the pre-conversion lender signs the survey indicating consent to the conversion. This requirement applies even if you intend to refinance the condominiums separately after conversion. Most but not all lenders are willing to sign the survey, but some charge signing fees of \$200-1,000. If your lender refuses to sign, you will need a new mortgage for the entire building in order to complete the conversion. Check your lender's signing policy early.

DO I NEED TO REFINANCE AFTER CONVERSION?

Refinancing is not required by most lenders but is necessary prior to transferring any of the condominiums individually. Most owners refinance for the following reasons: (i) to allow the condominiums to be transferred to individual owners or sold separately, (ii) to eliminate the default risk associated with sharing a loan obligation with other owners, (iii) to eliminate the risk that a future job loss, illness, or credit blemish will make refinancing difficult or impossible, (iv) to qualify a unit for eventual exemption from San Francisco's limitation on rent increases, or (v) to replace one large loan on the entire building with several smaller and lower-interest loans on individual condominiums.

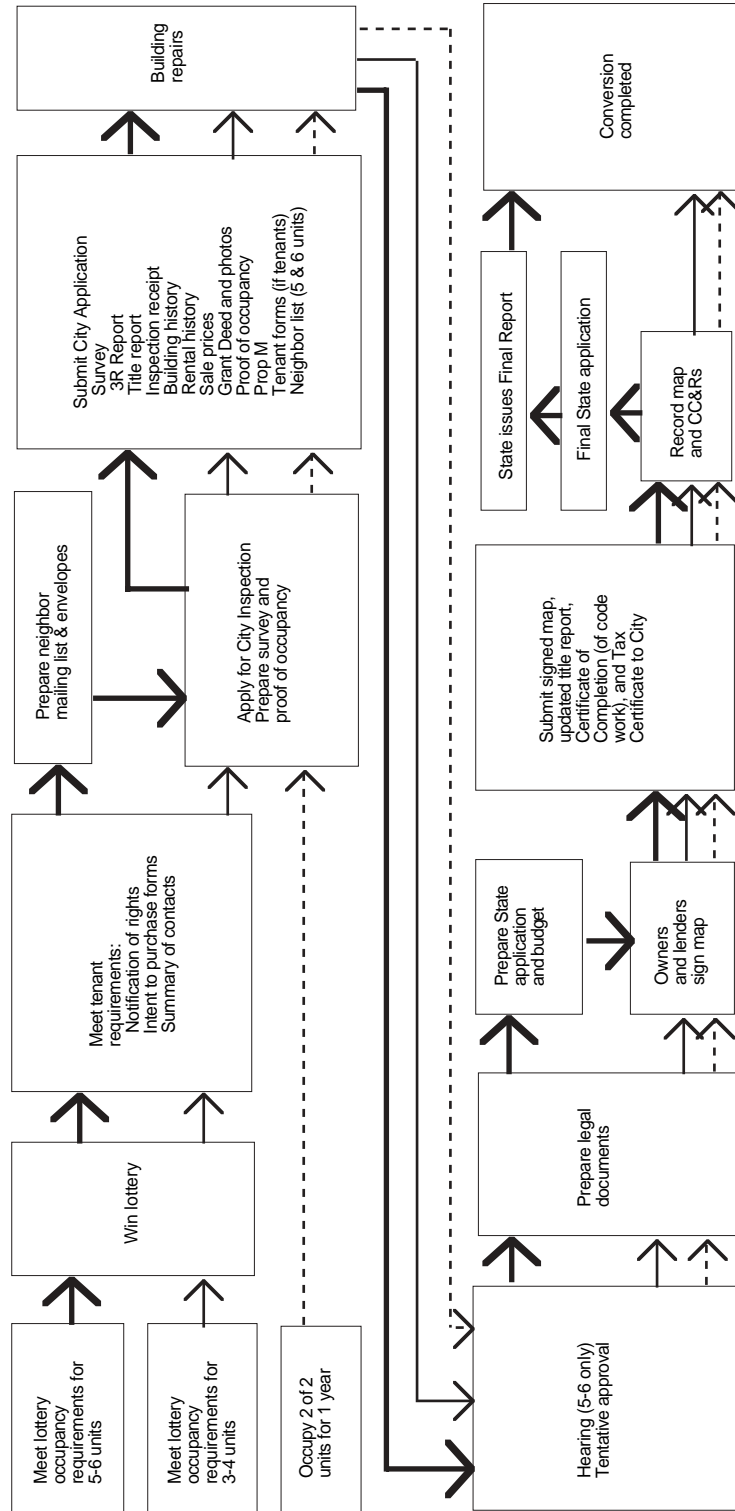
WILL CONVERSION INCREASE MY PROPERTY TAX?

Conversion will not increase the assessed value of your property. The current value will be allocated among the condominiums, and each condominium will get a separate tax bill based on the allocation.

WILL CONVERSION INCREASE MY INSURANCE PREMIUMS?

Conversion often increases insurance costs, particularly in 3-6 unit buildings, and you may be

CONDOMINIUM CONVERSION FLOW CHART



required to switch insurance carriers. Consulting your insurance agent early in the conversion process will help eliminate unpleasant surprises once the conversion is complete.

WHAT CONDOMINIUM CONVERSION LAW CHANGES ARE ON THE HORIZON?

The ongoing litigation regarding existing conversion law could result in significant changes to that law either through court decisions or through new legislation created in response to court decisions. These changes could involve owner-occupancy requirements, waiting periods, renter participation requirements, or lottery procedures. The changes could impact owners waiting to qualify for conversion and owners who have already qualified and submitted applications but have not yet been approved.

A new state law (A.B.728) which became effective on January 1, 2004, should significantly reduce the amount of information which cities like San Francisco require for condominium conversion. Although we hope City processing will be quicker, the effect of this new law remains to be seen.

ABOUT THE FIRM AND THE AUTHORS

The firm of Goldstein, Gellman, Melbostad, Gibson & Harris, LLP, formed in 1986, has extensive experience in real estate litigation and transactions. The firm's practice includes real property sales and exchanges, general land use, buyer/seller disputes, landlord/tenant disputes, estate planning and probate. Attorneys Andrew Sirkin, David Gellman, and Boyd McSparran work together to handle condominium conversions for the firm.

D. Andrew Sirkin, of counsel to the firm, is a recognized expert in co-ownership forms including condominiums, TICs, equity sharing and co-housing. He is an accredited instructor with the California Department of Real Estate, and frequently conducts co-ownership workshops for attorneys, real estate agents, corporations, and prospective home buyers. His first book, *The Equity Sharing Manual*, was published by John Wiley and Sons in November 1994, and the annual edition of his most recent book, *The Condominium Bluebook*, was published by Piedmont Press in January 2004. Mr. Sirkin has converted over 2,000 condominiums in

San Francisco. He has written three companion articles to this one. They are entitled "Owner-Occupancy and Ellis Evictions", "Questions and Answers on Tenancy In Common", and "Unmarried Couples and Property Ownership". Copies are available from the firm free of charge. Mr. Sirkin can be contacted via email at DASirkin@earthlink.net.

David R. Gellman, a partner in the firm, has extensive experience in TICs, condominium conversion, landlord/tenant (rent control), real estate litigation, commercial leasing, like-kind exchanges, multifamily housing finance, construction, and estate planning. This broad base of experience allows him to offer real estate clients added insight and a full range of services. Mr. Gellman manages the firm's condominium conversion practice. He can be contacted via email at DGellman@g3mh.com.

Boyd McSparran is an associate with the firm. His practice areas include condominium conversion, tenancies in common, commercial and residential real property transactions, and landlord-tenant disputes. He can be contacted via email at BMcSparran@g3mh.com.

Should you have any further questions or wish to set up an appointment, please call us at (415) 621-5600.