Mayor's Office of Housing and Community Development
City and County of San Francisco

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TO: Angela Calvillo, Clerk of the Board of Supervisors and Honorable Members of the Board of Supervisors

FROM: Gigi Whitley, Deputy Director, Mayor's Office of Housing and Community Development

CC: Anne Michele Smart and Jasmine Oberste, Appellants, and Property Owners of 273 29th Street and 275 29th Street

SUBJECT: Appeal Requesting Reduction, Adjustment or Waiver of Condominium Conversion Fee for a Property Located at 273A 29th Street

DATE: November 15, 2013

On June 18, 2013, the Board of Supervisors passed Ordinance No. 117-13 amending the City's Subdivision Code to create an expedited and reliable option for tenancy-in-common (TIC) owners and other property owners to convert their TICs or buildings in to condominiums. By paying a one-time fee to the City, these owners could bypass the annual condominium conversion lottery and receive subdivision map approval as required for a condominium unit. As part of the law's legislative findings, the Board relied on a 2011 economic nexus study that demonstrated and quantified the impact of condominium conversion on the demand for affordable housing in San Francisco and the cost of mitigating the impact. The ordinance set the condominium conversion fee at $20,000 per unit—below the fee level justified in the nexus study—and further reduced the fee for TIC owners based on the number of years of participation in the annual lottery. Fee revenue to the City is designated for the development of new affordable housing units for low- to moderate-income individuals and families.

This memo summarizes key findings of the nexus study, describes the law's requirements for granting an appeal, and analyzes the request for a fee waiver from Anne Michele Smart and Jasmine Oberste, the property owners of 273A 29th Street, (part of a tenancy-in-common with 273 and 275 29th Street). The law's standard for granting the appeal requires the appellants to successfully challenge the economic analysis in nexus study. A hardship exemption is not an allowable reason to grant an appeal. Based on an analysis of this case, the Mayor's Office of Housing and Community Development (MOHCD) contends that the economic nexus study justifies the payment of this fee, already reduced to $16,000 per unit in this case, and that the appellants have not met the standard for a successful appeal. As such, MOHCD recommends that the Board of Supervisors deny this appeal.

Background.

Prior to the law's enactment, the City and County of San Francisco limited the number of rental or TIC units that could be converted to condominiums to 200 per year, in order to preserve affordable rental units in the City. Through a lottery process, TIC owners and other property owners could apply to receive approval for a condominium conversion subdivision map, the first step in a two-step process for creating a condominium unit in San Francisco. Condominium conversion is an option for owners in buildings with two to six units, under certain conditions. TICs are owned jointly as entire buildings in percentage shares. In contrast, a condominium is owned as a separate, divided legal real estate interest from the other condominium units in a building, and each individual condominium owner may separately sell, lease, or finance his or her condominium unit. TIC ownership can be more complex and risky due to this joint-ownership relationship. TIC owners may buy and sell shares equivalent to a single unit but that does not mean they own their unit outright with the ability to separately sell or finance the unit. Because of this risk, mortgage financing and transaction costs are significantly higher for TIC ownership share than condominium ownership. The benefits of condominium conversion include a more advantageous form of title and ownership and better mortgage loan terms that reduce homeownership costs and help owners remain in their homes. As such, there is a demonstrable financial incentive to convert jointly-owned, multi-unit property to individually owned condominiums.

Given pent up demand to convert to condominium and a backlog of approximately 2,000 units waiting to convert, the City began considering an alternative to its condominium lottery process. The City commissioned a 2011 nexus study to evaluate the economic impacts to the City of condominium conversion and whether those impacts justified an impact fee, similar to other development impact fees that mitigate the City's costs to provide additional affordable housing, such as the Jobs Housing Linkage Fee and inclusionary housing fees.

The 2011 nexus study conducted by Keyser Marston Associates (KMA)[1] determined that the conversion of a TIC or rental unit to a condominium would result in a net increase in household income in San Francisco, through the replacement of a TIC owner with a higher income condominium purchaser. Given the higher income of condominium purchasers, the condominium owner would have higher consumer spending and increased demands for goods and services such as banking and retail services, leading to increased job creation. Among the jobs created would be additional low- and moderate-income jobs. The workforce performing these additional lower income jobs create a greater demand for affordable housing, as these households cannot afford market-rate housing in San Francisco. The cost to the City to subsidize this increased need for additional affordable housing creates the nexus between the condominium conversion and justification for a conversion fee.

As part of the legislative findings for Ordinance No. 117-13, the Board determined that based on evidence presented in the nexus study, there is a reasonable relationship to the subdivision applicants' burdens on the City that result from the change in use and ownership status from a dwelling unit within an unsubdivided property to a separate interest in a condominium unit.[2]

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[1] *Condominium Conversion Nexus Analysis, San Francisco*, Keyser Marston Associates, January 2011

[2] Section 1(b) of Board Ordinance No. 117-13 (Subdivision Code – Condominium Conversion Fee) provides: "This Board finds that the condominium conversion fee as set forth in this legislation is an appropriate charge imposed as a condition of property development, which in this case is the City's

Basis for an Appeal.

In a September 26, 2013 request for a fee waiver, Ms. Smart and Ms. Oberste request a waiver or reduction of the condominium conversion fee, due to limited household income caused in part by medical issues. The request does not make any claims regarding the applicability of the nexus study on which the fee was based. The KMA nexus study was not based on a household having the ability to pay a fee, but rather that the TIC unit(s) would be sold, at some point, to a higher income household, creating the need to offset costs to the City from the impacts of the actual conversion. In the future, either the appellants or their estates will sell the unit to a condominium purchaser, rather than a separate TIC purchaser. That economic transaction creates the need for the impact fee, whether it occurs immediately or sometime in the future.

Acknowledging this reality, the Board decided to require fee payment at the time of application for the condominium conversion subdivision (when the TIC owner initiates the subdivision approval process that will result in the owner's benefit), rather than at another point in time, such as paying the fee at the sale of the condominium unit. While it is accurate that the nexus study focused on the converted condominium unit being purchased by a new buyer at some time, the study acknowledges that the units may not necessarily be purchased immediately.[3]

In the meantime, there are tangible financial advantages to the existing TIC owner who becomes a condominium owner. The KMA study quantified the gain of condominium conversion at 15 percent, or an estimated $45,000 to $75,000 gain after deducting standard City administrative fees. Property owners gain from the fact that financing costs are significantly lower for higher valued condominiums than TIC units (a 4.75% interest rate for TIC loans compared to 2.25% for condominium home loan at the time of the KMA study).

Ms. Smart and Ms. Oberste will reap immediate financial benefits through conversion to a condominium unit. After condominium conversion, the appellants could refinance an existing mortgage loan at a lower interest rate, thereby leaving more discretionary income for other uses. Ms. Smart and Ms. Oberste may also have the ability to obtain an individual home equity loan to enhance their current living conditions. This increase in value and opportunity to

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approval of a condominium conversion subdivision, a discretionary development approval pursuant to the San Francisco Subdivision Code and the California Subdivision Map Act. Based on data, information, and analysis in a Condominium Conversion Nexus Analysis report prepared by Keyser Marston Associates, Inc., dated January 2011, and the findings of Planning Code Section 415.1 concerning the City's inclusionary affordable housing program, this Board finds and determines that there is ample evidentiary support to charge the fee set forth herein as it relates to a subdivision map approval that allows the conversion of existing dwelling units into condominiums. Said charge also is lower than the fee amount supported in the abovementioned Nexus Analysis report. As a consequence the Board finds that the amount of this charge is no more than necessary to cover the reasonable costs of the governmental activity and programs related to condominium conversion. The Board further finds and determines, that based on this evidence, the manner in which this charge is allocated and assessed on a per unit cost for each unit converted to a condominium bears a reasonable relationship to the subdivision applicants' burdens on the City that result from the change in use and ownership status from a dwelling unit within an unsubdivided property to a separate interest in a condominium unit."

[3] The nexus study states: "The analysis assumes that the unit is sold upon conversion. Some existing owners will stay in the unit. Some of those who stay will refinance based on more favorable lending terms and higher unit value. **In any case, the conversion of the unit generates an increase in unit value and ultimately, a higher income occupant." (Highlight added.)**

refinance their existing mortgage would allow the owners to finance the condo conversion costs, including providing funds borrowed to pay the conversion fee. Obtaining and using such additional discretionary income in the local economy can have similar economic impacts on the City as those analyzed in the nexus study for new condominium purchasers.

Existing Fee Relief.

Additionally, the Board set the fee at $20,000 per unit, lower than the maximum mitigation cost of $21,600 to $34,900 supported by the KMA nexus analysis. The fee level also decreases from $20,000, to as low as $4,000 per unit, depending on the number of years the TIC has participated in the lottery. In the case of Ms. Smart and Ms. Oberste, the fee is calculated at $16,000 per unit or $48,000 for the 3-unit property.

It is important to note that while this building's TIC owners apparently have chosen to each pay the per-unit cost ($16,000 each), it is not necessary that each owner pay an equal share of the TIC's $48,000 fee. In other words, co-owners that place a higher value on the condominium conversion than Ms. Smart and Ms. Oberste could pay more than an equal share to reduce their fee payment. For example, Ms. Smart and Ms. Oberste's co-owners could decide to loan them funds for the fee and structure it as a loan from the new condominium homeowners association (HOA). The loan could be repayable to the HOA upon sale of the unit sometime in the future.

Moreover, the TIC owners of the building presumably were not forced to convert and pay the fee now. As long as this building remains eligible for the conversion program, the TIC owners in this building could elect not to convert at this time and remain a TIC until the annual condominium lottery resumes in the future when the conversion fee will not be assessed.

Law Does Not Allow for Hardship Waiver.

The only basis of this appeal is financial hardship. However, the legislation does not allow for a waiver based on financial hardship, and granting the waiver based on this rationale is problematic. Under the Subdivision Code requirements, the appellants need to demonstrate that there is an "absence of any reasonable relationship or nexus between the impact of development and the amount of fee." The appellants bear "the burden of presenting substantial evidence to support the appeal, including comparable technical information to support the appellant's position." The legislation provided an appeal process to allow a challenge to the impact fee analysis itself. For the Board to waive, reduce, or adjust the fee, the appellants must demonstrate that the economic nexus is somehow faulty.

Ms. Smart and Ms. Oberste's appeal does not meet this definition. Ms. Smart and Ms. Oberste have not provided any economic or technical analysis to dispute the basic findings of the nexus study. Their appeal has not demonstrated that the nexus between condominium conversion and the need for additional affordable housing does not exist in their case.

Fee Deferral Process.

The law does allow for a TIC owner to request a fee deferral based on demonstrated economic hardship. Applicants demonstrating income for the last 12 months at less than 120 percent of area median income (AMI) can request a fee deferral while the Department of Public Works' (DPW) completes its application review. According to DPW, Ms. Smart and Ms. Oberste did not pursue this option.

Other Relevant Property Information

The three-unit building is assessed at $1,844,354 per the 2013-14 property tax bill. The City Attorney's Office has confirmed with DPW and the Rent Board that there were no evictions from this building since 2000.

Recommendation:

While the appellants' circumstances may be sympathetic, their case does not meet the standard for appeal stated in the law. Given that the property owner has not presented substantial evidence and technical analysis to dispute the City's nexus study, the Board should reject this appeal. The Board has already provided fee relief by: a) setting the fee level below the maximum fee levels justified by the nexus study and 2) reducing the fee to credit the TIC owners based on number of years in the lottery. Based on the $16,000 fee for their unit, Ms. Smart and Ms. Oberste are already receiving a $4,000 per unit fee reduction based on prior years of participation in the lottery. As noted above, Ms. Smart and Ms. Oberste also did not take advantage of the hardship remedy available, to request a fee deferral until final subdivision approval.

Furthermore, there is no requirement for Ms. Smart and Ms. Oberste to pay an equal share of the TIC building fee. The fee applies to the entire building, which allows Ms. Smart and Ms. Oberste to negotiate with their co-owners on a lower payment or possible loan from the HOA prior to resale of the unit if the ownership group voluntarily elects to pursue a condominium conversion at this time.

Finally, the legislation did not establish a fee waiver or reduction based solely on financial hardship. As such, there is no objective criteria upon which the Board can make such a determination. If the Board waives or reduces the fee based on this claim, it likely would create a precedent for any other applicant who is on a fixed income. Such a result could significantly jeopardize the amount of affordable housing fees available to the City that the Board specifically determined were needed to offset the economic impact on the City from condominium conversion.

The Mayor's Office of Housing and Community Development stands behind the Board's decision to offset the impact of additional market-rate condominiums to impose this fee. Based on the rationale presented, the appeal does not meet the threshold for a fee waiver. As such, MOHCD recommends that the Board deny this appeal.