



Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

MEMORANDUM

TO: The Honorable Supervisor Farrell
FROM: Ben Rosenfield, Controller *BR*
DATE: March 9, 2012
SUBJECT: Estimated Condominium Conversion Fee and Associated Property Tax and Property Transfer Tax

Per your request, the Controller’s Office has estimated the range of potential revenues that may be generated by the proposed Condominium Conversion Impact Fee Ordinance as currently drafted. As shown in Table 1, the estimated revenues range from \$7.4 million to \$24.6 million in fee revenues plus approximately \$0.1 million in additional property tax and real property transfer tax revenues. These estimates are highly sensitive to several key assumptions outlined below.

Table 1 Projected Single Year Fee Revenue, Property Tax, and Property Transfer Tax at Different Participation Rates

	100% take up rate 1,857 Units	50% take up rate 929 Units	50% take up rate 557 Units
Fee Revenue (one-time)	\$ 24,644,000	\$ 12,322,000	\$ 7,393,200
Property Tax	\$ 40,000	\$ 20,000	\$ 10,000
Transfer Tax	\$ 50,000	\$ 30,000	\$ 20,000
Total	\$ 24,734,000	\$ 12,372,000	\$ 7,423,200

Estimated Condominium Conversion Impact Fee Revenue

Our projections are based on Keyser Marsten Associates’ (KMA) January 2011 Condominium Conversion Nexus Analysis. We have reviewed this report and believe the market data and other assumptions are sufficiently current to provide a reliable estimate of the nexus amount attributable to condominium conversion, and that an updated report is not necessary for fee discussions at this time.

The Condominium Conversion Fee contemplated by the ordinance ranges from \$20,000 to \$4,000 per unit, with the fee reduced the longer the property has been in the condo conversion lottery. The proposed fees are less than the maximum per unit fee to convert a tenancy-in-common (TIC) to a condominium supported by the KMA nexus study, summarized below:

1. \$300,000 TIC value; \$21,787 maximum conversion fee,
2. \$400,000 TIC value; \$30,117 maximum conversion fee, and
3. \$500,000 TIC value; \$34,603 maximum conversion fee.

The first step in our analysis was to estimate the participation rate of TIC owners willing to pay the conversion fee rather than taking a chance on winning in subsequent rounds of the condo lottery. Our assumption is that the alternative to paying the fee is that the TIC owner borrows an amount equal to the net increase in value from converting from a TIC to a condo for the projected number of years to win the lottery without paying a fee (based on the increased probability of winning the lottery each subsequent year). If the net benefit from paying the fee is greater than the alternative described above, it is assumed that the TIC owner would opt to pay the fee.

For purposes of the analysis, we have assumed an average TIC value of \$500,000, based on the range of values in the KMA nexus study, and average recent TIC sales prices of approximately \$600,000 in the past two years.

The potential revenue generated by the proposed fee is dependent on several key variables summarized below, which also include the assumptions used in the analysis:

1. TIC Value (\$500,000 per unit assumed in this analysis)
2. Value Premium from converting TIC to Condo (15%, per the KMA study)
3. Conversion Impact Fee level (based on proposed ordinance, initially \$20,000)
4. Percent of owners willing to pay the fee, or the “take up rate” (to account for uncertainty, a range is presented, assuming 100%, 50%, and 30% of owners opt to pay the fee)
5. Cost to convert from TIC to Condo (\$10,900 per unit for permits and code compliance corrections, per the KMA study)

Exhibit A presents a summary of the potential revenue generated by the proposed Condominium Conversion Impact Fee, based on the above key assumptions. As indicated, the fee is estimated to generate from **\$7.4 million to \$24.6 million**, depending on the participation rate. The bottom of Exhibit A includes an estimate of the fee revenue for a range of TIC values, as well as the revenue generated assuming fees were set at a rate to maximize participation.

Estimated Property Tax and Property Transfer Tax

The incremental value from converting a TIC to a condominium is not realized until the property is sold. In other words, the conversion process itself is not an “assessable event” and will not generate any increased property taxes or property transfer taxes. Only when the property is transferred will tax revenue be generated, based on the value enhancement from converting a TIC to a condominium (again, assumed to be 15% for purposes of this analysis).

Exhibit B presents an estimate of potential tax revenue generated from conversion. The analysis makes the simplifying assumption that the market value of the TIC is equal to the current assessed value. The key assumption in this analysis is the percent of units sold after conversion (which triggers re-assessment and transfer taxes). The turnover rate of residential properties in San Francisco averaged about 5% per year, based on the average annual units sold from 1994 to 2011 divided by the owner-occupied housing inventory.

Applying this turnover rate to the incremental value added through conversion and the assumed “take up” rate provides an estimate of the total incremental value of condos sold each year. Applying the tax rates to this incremental value results in about \$40,000 in property taxes and

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\$50,000 in transfer taxes, assuming 100% take up rate and a \$500,000 base value, as indicated in Exhibit B.

If you have any questions, please contact me or you may call Kurt Fuchs on my staff, at 415-554-5369, or Kurt.Fuchs@sfgov.org.

Attachments

Exhibit A

1. Estimated Condominium Conversion Fee Revenue at \$500,000 Average TIC Value

Lottery Group	Proposed Fee	% Discount from B2 Fee	100% take up rate		50% take up rate		30% take up rate	
			# Units Participating	Potential Fee Revenue	# Units Participating	Potential Fee Revenue	# Units Participating	Potential Fee Revenue
A6	4,000	80%	253	1,012,000	127	506,000	76	303,600
A5	8,000	60%	324	2,592,000	162	1,296,000	97	777,600
A4	12,000	40%	350	4,200,000	175	2,100,000	105	1,260,000
B3	16,000	20%	440	7,040,000	220	3,520,000	132	2,112,000
B2	20,000		490	9,800,000	245	4,900,000	147	2,940,000
Total			1,857	24,644,000	929	12,322,000	557	7,393,200

Key Assumptions

\$500,000	Average TIC value
15%	Value premium from converting TIC to condo
\$10,900	Average cost of condo conversion per unit (code compliance, permitting)
7.99%	Annual interest rate

Note: 100% of units in each lottery group would participate if the net benefit from paying the fee is larger than net benefit of the alternative. The net benefit of paying the fee is a 15% increase in the value, minus the fee and average costs of condo conversion. The alternative to paying the fee is to borrow an amount equal to the increase in value that converting to a condo would provide for the number of years it would take to win the lottery without paying a fee (i.e. number of years until unit has been in lottery for seven years).

2. Estimated Condominium Conversion Fee Revenue and Participation at Range of Average TIC Values

Current TIC Value	B2 Fee	# Units Participating	Revenue assuming take up rates of			Note
			100%	50%	30%	
\$300,000	\$20,000	0	-	-	-	proposed B2 fee level
\$400,000	\$20,000	577	3,604,000	1,802,000	1,081,200	
\$500,000	\$20,000	1857	24,644,000	12,322,000	7,393,200	
\$300,000	\$12,200	1857	15,032,840	7,516,420	4,509,852	revenue-maximizing B2 fee level
\$400,000	\$17,700	1857	21,809,940	10,904,970	6,542,982	
\$500,000	\$23,200	1857	28,587,040	14,293,520	8,576,112	

Key Observations

Revenue are highly dependent on assumptions, particularly the assumed current value of TICs, the fee level, and participation rate.

Exhibit B

Property Tax and Transfer Tax Estimates to General Fund Based on Incremental Value of Converting TIC to Condo

Number of Units Participating	Market/ Assessed Value - TIC	New Assessed Value - Condo	Incremental AV/ unit	Take Up Rate (% paying fee)	% to Sell After Conversion	Total Incremental Value of Condos Sold	Estimated Property Tax 0.57%	Estimated Transfer Tax 0.75%
<u>\$500k TIC Value</u>								
1,857	\$500,000	\$575,000	\$75,000	100%	5%	\$6,963,750	\$40,000	\$50,000
1,857	\$500,000	\$575,000	\$75,000	50%	5%	\$3,481,875	\$20,000	\$30,000
1,857	\$500,000	\$575,000	\$75,000	30%	5%	\$2,089,125	\$10,000	\$20,000
<u>\$400k TIC Value</u>								
577	\$400,000	\$460,000	\$60,000	100%	5%	\$1,731,000	\$10,000	\$10,000
577	\$400,000	\$460,000	\$60,000	50%	5%	\$865,500	\$5,000	\$6,000
577	\$400,000	\$460,000	\$60,000	30%	5%	\$519,300	\$3,000	\$4,000

Key Assumptions

- 15% Value premium from converting TIC to condo; taxes estimated on this incremental value only.
- 5% Annual Residential Turnover rate (based on annual average residential units sold from 1994 to 2011 (6,000) divided by the City's owner-occupied housing inventory (125,000 units)). Source: Paragon Real Estate Group (based on MLS data); Dataquick; US Census, 2010.

Key Observations

Tax revenues will only be realized when converted units are sold, which are based on historic turnover for all property types. To the extent that newly converted condos turnover faster, the potential tax revenue will be realized sooner.