

FAQs | Condominium Conversion in San Francisco

May 22, 2006 Edition,
by David R. Gellman

Breaking News **Bad News!**

In May, the San Francisco Board of Supervisors passed new legislation permanently blocking condominium conversions of properties where “protected” (elderly, disabled, or catastrophically ill) tenants are displaced. The new law is retroactive to evictions noticed on or after May 1, 2005. A further provision of the new law blocks conversions if *two or more* recent evictions of non-“protected” tenants have occurred. Earlier legislation, passed last December, tightened other rules for condominium conversions in buildings where “protected” tenants have been displaced.

Good News!

The City is implementing a major change in conversion rules, eliminating the requirement that mortgage lenders sign condominium “mylar” maps for conversions of 4 units or less. This change helps simplify the conversion process for smaller properties when a lender refuses to consent, as is often the case.

More Good News!

The City's performance in processing condo conversions is improving. Based on current experience, and with new staffing levels in City departments coming online following an application fee increase last November, we estimate that processing of 2–4 unit properties will now take 14–20 months. Processing of 5–6 unit properties, which require additional City and State approvals, will take about 4 additional months.

Further details on these topics may be found within.

This article summarizes the rules understood to be in effect on its publication date. Buyers and Owners should check with the author for recent developments before making commitments based on information in this article. Updated versions of this article may appear on the firm's website at www.g3mb.com.

What is a Condominium?

A condominium consists of an individually owned “Unit”, including the space within the walls, floors and ceilings of a dwelling, plus shared ownership of the remainder of the property, known as “Common Areas”. Owners pay monthly dues to their Homeowners’ Association to cover common repair and insurance expenses, but pay separately their individual mortgages, property taxes and utilities. The relationship between owners is governed by a document called the “Covenants, Conditions and Restrictions”, or “CC&Rs”.

Why Should I Convert My Property to Condominiums?

Most real estate professionals agree that conversion generally increases a property’s value. Conversion allows co-owners of multi-unit buildings to eliminate many of the risks of co-ownership, and to facilitate sale of individual units, by replacing shared financing with individual mortgages. Certain condominium units also will be exempt from San Francisco Rent Control limits on annual rent increases.

Is My Property Eligible for Conversion?

San Francisco limits **all** condo conversions to buildings of **no more than 6 residential units**. A mixed-use building may include any number of commercial units, but the number of residential units cannot be greater than 6. A 2-6 unit building will qualify to convert only when it (1) meets occupancy requirements; (2) wins or bypasses the annual conversion lottery; (3) for lottery conversions only, satisfies Tenant’s Rights rules; and, (4) does not run afoul of the City’s new Tenant Protection Legislation.

What is the San Francisco Condominium Conversion Lottery?

San Francisco severely restricts residential condominium conversions. All 2-6 unit buildings (other than the owner-occupied 2-unit properties described below) must compete in an annual lottery for the right to convert. A maximum of residential 200 units can win the right to convert each year through the lottery.

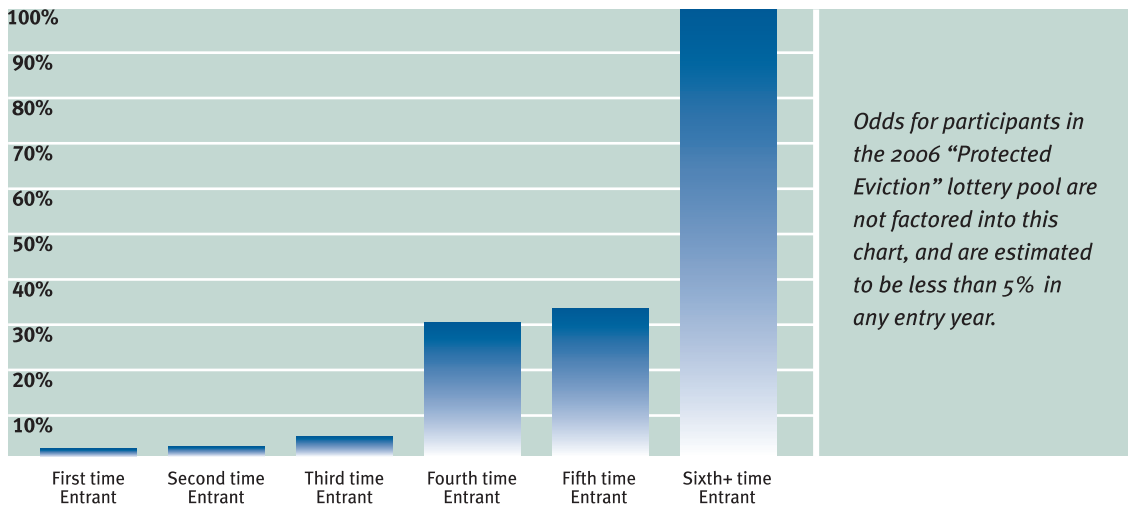
Which Properties Bypass the Conversion Lottery?

2-unit properties bypass the conversion lottery only if *each unit* has been *separately occupied* for the past 12 months by *separate individuals* who have each owned at least a 25% interest in the property during the entire occupancy period. Occupancy must be proven by electric and telephone service. There is no annual limit on the number of owner-occupied 2-unit buildings which can convert via the lottery bypass. However, no other buildings can bypass the conversion lottery. Owners who have evicted “protected” (elderly, disabled, or catastrophically ill) tenants between November 16, 2004, and May 1, 2005, are **denied a lottery bypass**, and may only enter a restricted “Protected Eviction” lottery pool (see below). Owners who evict a protected tenant after May 1, 2005, are subject to new Tenant Protection Legislation discussed below. Evictions prior to November 16, 2004 do *not* affect conversion.

What are the Odds of Winning the Conversion Lottery?

The lottery system is designed to favor buildings that have previously lost. This means the odds of your winning are very low the first time you enter but increase in successive years. A rule *effective only in 2006* guaranteed winning slots to 6th and 7th time lottery entrants, dramatically skewing the odds:

Estimated Odds of Winning 2006 Lottery



How does the Conversion Lottery Work (Pool A & Pool B)?

In addition to eligible owner-occupied 2-unit buildings, San Francisco allows only **200** units to condo convert each year. The "Pool A" drawing selects 100 units from buildings which have previously lost at least three times. Each building meeting this criteria gets one Pool A ticket. After the first 100 units are awarded, all remaining buildings are automatically entered in Pool B for the remaining 100 units. Buildings where protected tenants have been evicted between November 16, 2004, and May 1, 2005, are barred from Pool A, and restricted to a "Protected Eviction", lottery pool of the last 25 units drawn in Pool B. (Under a special rule effective for the 2006 lottery **only**, all buildings participating in the lottery for the 6th or 7th time **automatically qualified** for conversion, using up most of the 100 Pool A units. It is unknown whether this procedure will be repeated in 2007.)

The "Pool B" drawing selects the remaining winners from all applicants, but is also weighted to favor previous losers. First-time entrants receive one Pool B ticket. All others get one extra Pool B ticket for each prior loss. However, the slight advantage of acquiring additional tickets is largely offset by the increasing number of buildings entering the lottery each year.

Winning buildings must submit a conversion application by a July deadline. Losing buildings go on a waiting list and each year a lucky few take the place of the handful of lottery winners who fail to submit, or submit applications which are rejected.

How does New Tenant Protection Legislation Affect Conversions?

A new ordinance, enacted on May 16, 2006, temporarily blocks conversions if *two or more evictions* of non-protected tenants have occurred in the property on or after *May 1, 2005*, restoring conversion rights to these properties only following *10 years* of owner-occupancy. The new law **permanently** blocks condominium conversions of properties where *even one* "protected" tenant (age 60+ and living in the property for at least 10 years; disabled; or catastrophically ill) has been evicted on or after *May 1, 2005*. **Grandfathering provisions exempt properties that were 100% owner-occupied on April 4, 2006, from these new restrictions.** Legislation enacted in late 2005 created a special category for buildings where protected tenants were evicted after **November 16, 2004**. These buildings, even if

not knocked out of the running by the May 16 ordinance, will be deemed ineligible for the first 175 units awarded through the lottery, meaning that these buildings will be barred from Pool A, and left to compete with all other applicants for in a “Protected Eviction” lottery pool of the last 25 units drawn from Pool B. *Evictions based on tenant fault (e.g., non-payment of rent, nuisance) do not trigger any Tenant Protection Legislation.*

How do I Apply for the Conversion Lottery?

The conversion lottery is held annually in February (in 2006, the lottery date was February 8, and the entry deadline was January 26). The lottery fee is a flat \$150 per building. After having won the lottery, applicants must still satisfy the City’s “Owner-Occupancy” and “Tenant Intent to Purchase” requirements:

OWNER-OCCUPANCY

Applicants will need to establish that their buildings have met the City’s “Owner-Occupancy” requirements. For 2-4 unit lottery winners, one unit must have been owner-occupied for three years; for 5-6 unit lottery winners, three units must each have been owner-occupied for three years. During those three years, the same owner-occupant(s) must reside in the property continuously; the identities of the qualifying owner-occupants cannot change (although they can move about within the building). Occupancy must be proven by electric and telephone service. The three-year occupancy period is measured backward from the lottery entry deadline (i.e., to qualify in 2007, the required number of owner-occupants must have occupied continuously since January 2004). The term “owner-occupant” is a misnomer, as the City actually allows the occupant to be a renter for three years as long as he or she has also become an owner by the time the lottery ticket is purchased.

PROTECTED EVICTION CERTIFICATE

Applicants will need to certify under penalty of perjury that since November 16, 2004, no evictions of any protected tenants have taken place in the building. Applicants who evicted a protected tenant between November 16, 2004, and May 1, 2005, can still purchase lottery tickets, but their tickets will be eligible only for the last 25 units selected in the lottery. Applicants who have evicted even one protected tenant, or more than one non-protected tenant, after May 1, 2005, will not be allowed to purchase lottery tickets unless each unit in the building was owner-occupied on April 4, 2006.

What are the Post-Lottery Requirements?

After having won the lottery, applicants must still satisfy the City’s “Owner-Occupancy” and “Tenant Intent to Purchase” requirements:

OWNER-OCCUPANCY

The Owner-Occupancy requirements for lottery winners are identical to the Owner-Occupancy requirements for lottery applicants (see above).

TENANT INTENT TO PURCHASE

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 or her unit as a condominium, while reserving the right later to decline to buy. Because signers may be either renters or owner-occupants, only 3-4 unit buildings with a single owner-occupant need renter cooperation to satisfy this particular rule.

What Building Code Work Will I Need to do to Convert?

Your building need not be upgraded to meet current building codes, be seismically retrofitted, or even have parking. However, the City does require a building inspection as part of the conversion process, which involves: (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 building permits for corrective work, (v) completion of all required work, (vi) City inspection of the work; and, (vii) issuance of a Certificate of Final Completion and Occupancy.

Inspection reports typically cover three types of problems: (i) work which was done without required permits (including everything from 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. In some cases, pre-inspection by a *private* consultant familiar with conversion requirements may be beneficial. A consultant can provide advance warning of likely inspection issues, recommend advance steps to minimize remediation requirements, establish the legality of preexisting improvements, and help you obtain building permits. We can provide a list of knowledgeable inspectors to our clients when needed.

What are the “Tenants Rights” Rules?

A renter living in a dwelling unit at the time a lottery conversion is completed gets an opportunity to purchase the condominium unit at a price established by the owner. Renters who decline to purchase may request a one-year rent-controlled lease or moving assistance; disabled and senior (over 62) renters are entitled to lifetime rent-controlled leases. These rules apply *only to lottery conversions*, not to lottery bypass conversions. San Francisco Rent Control rules allow for the eviction of a renter at the conclusion of the lease term (for lottery conversions) or upon completion of the conversion (for lottery bypassers) to facilitate the sale of a newly converted unit.

How do Qualifying Properties Begin Conversion?

In February of 2006, the City completely revamped its condominium conversion application forms and procedures. Owners of qualifying buildings (either lottery winners or 2-unit lottery bypassers) must submit the latest multi-part application package to the City. The major components of the new package are:

Inspection: Before submitting a conversion application, you must request a City inspection by mailing in a form and 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. Counsel on the choice of a qualified surveyor is essential. We monitor the performance of local surveyors, and can help you select a surveyor who is knowledgeable of the City's ever-changing requirements.

History: Your application must include a detailed five-year occupancy history of each unit in the building to allow the City to monitor compliance with the City's latest tenant protection rules.

Occupancy: Owners needing to prove occupancy must submit letters from PG&E and a land-line telephone company confirming service. Owners must also sign a sworn statement and submit evidence of a homeowner's property tax exemption.

Photos: As part of the 2006 application changes, the City has tightened its requirements for submission of site photos (to help identify sidewalk encroachments requiring a special permit). We can provide you with a diagram showing exactly where you must stand when you take photos of your property.

The application package must also include a variety of other items which we can help you compile. ***An incomplete or improperly organized package will be rejected by the City, with a service charge of \$250 assessed for each resubmission.*** Because several months can pass each time before the City reviews your efforts, getting it right the first time can prevent substantial delays.

How Long does the Conversion Process Take?

Happily, the City's performance in completing condo conversions is improving. Based on projected new staffing levels in the City departments involved and the backlog of existing applications, we estimate that processing of 2-4 unit properties will take 14-20 months if the initial application package is correct and complete. Processing of 5-6 unit properties, which require additional City and State approvals, will take about 4 additional months.

What Other Documentation is Needed?

All condominiums must have Covenants, Conditions & Restrictions ("CC&Rs") describing the rights and duties of the owners. CC&Rs are prepared by an attorney, and typically include:

- A Condominium Plan
- Rules for group decision making
- Allocation of financial responsibilities
- Maintenance, repair and alteration rules
- Dues and maintenance reserve requirements
- Usage policies governing noise, pets, parking, etc.
- Requirements for management and record keeping systems

Properties of 5-6 units must also obtain a "Public Report" from the California Department of Real Estate by submitting a separate application, including a professionally prepared preliminary Operating Budget. A self-prepared preliminary Operating Budget is suggested for smaller properties; we can assist you in preparation.

Does My Lender have to Approve My Conversion?

Following final approval by the City, the survey map is copied onto plastic "mylar" sheets, to be signed by all record owners. If your building has 5-6 units, your current mortgage lender(s) also must sign the mylar map, indicating consent to the conversion. For smaller properties, the City now allows recording of the mylar map *without* lender signatures. Nevertheless, lenders are entitled by law to be offered a Consent & Subordination Agreement, which the lender may choose to sign, or not. Some lenders sign willingly, charging a small fee. When a lender refuses to sign, we can offer alternative strategies.

We maintain an up-to-the-minute database of lenders' conversion policies, backed up by years of experience interpreting and satisfying lender signing requirements, and we have an unequalled track record working with lenders to change their policies.

When is Conversion Complete?

After all owners and lenders have signed the mylar survey map, it is returned to the City with an updated title report, a certificate of completion of the inspection work, and a Tax Certificate showing property taxes have been paid. The building officially becomes condominiums when the survey map and CC&Rs are recorded. For lottery conversions, notices to tenants in possession are given at this time (or for 5-6 unit buildings, when the State's Public Report is issued), setting forth the tenants' special purchase and occupancy rights.

Must I Refinance After Conversion?

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 three owners each own 1/3 of a 3-unit building before conversion, they will each own 1/3 of all three condominium units after conversion. Refinancing is a necessary step to separate ownership of the individual units, so that particular owners can acquire title to particular units, and involves replacing the existing loan(s) on the entire building with separate loans on individual condominium units. Most owners will refinance: (i) to allow the condominium units 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; or (iv) to qualify a unit for eventual exemption from San Francisco Rent Control limitations on rent increases.

Can I Sell Before Conversion is Complete?

For properties converted through the lottery, a sale of the property is permissible at any time, although we recommend that the conversion application be filed prior to any title transfers. For owner-occupied lottery bypass properties, the City prefers that the original owners continue to own and occupy the property until the conversion has been completed.

Will Conversion Increase My Property Taxes and Insurance Premiums?

Conversion will not increase the assessed value of your property. The current assessed value will be allocated among the condominium units, and each unit will get a separate tax bill based on the allocation. Conversion often increases insurance costs, particularly in 3-6 unit buildings, and you may be obliged to switch insurance companies. Consulting your insurance agent early in the conversion process will help eliminate unpleasant surprises once the conversion is complete.

Will My Unit Remain Subject to Rent Control After Conversion?

The State's "Costa-Hawkins" law exempts many single-family residences from local restrictions on annual rent increases, such as those found under the San Francisco Residential Rent Stabilization and Arbitration Ordinance. The landlord of a single-family residence which is subject to the Costa Hawkins law can increase rent annually without restriction; however, other Rent Control rules continue to apply. Condominiums are considered single-family residences, and Costa-Hawkins privileges will apply to a newly converted unit, but only *after* the unit has been sold to bona fide purchaser for value, or in the case of a building where all

of the converted units but one have been sold, to the remaining unsold unit after the owner has resided there 1 year. Note that tenants who moved into their units *before January 1, 1996*, are exempt from the Costa-Hawkins law, and retain all of their Rent Control rights.

What Will My Conversion Cost?

City Fees: San Francisco charges a building inspection fee ranging from \$480 for two units to \$800 for six units, an application fee of \$8,336 and recording fees of about \$50.

State Fees: A State application is required *only* for 5-6 unit buildings; the fee is about \$1,700. For these buildings, California also requires a formal budget which should be prepared by a professional service at a cost of about \$2,500.

Surveyor: Survey maps start at about \$6,000, and increase with building size and complexity.

Attorney: Goldstein, Gellman, Melbostad, Gibson & Harris, LLP (“G3MH”) offers a complete, flat-fee package, including: preparation of the multi-part City Application; counsel on building inspection issues; assistance in selection of surveyor and title company; advice on space assignment; status reports, monitoring and troubleshooting; CC&R preparation; and assistance in lender signing and recordation. Our fees vary depending on property size, and are competitively priced; please call for details.

Repairs: Building permit fees and repair costs will vary, depending on the results of your building’s physical inspection.

Title: G3MH can obtain required title reports on your behalf free of charge if you agree to use the assisting title company in your post-conversion refinancing or sale.

Lender: Lenders typically charge from \$200-400 to approve conversions.

How do I Choose a Lawyer to Assist Me in My Conversion?

A Law Firm Specializing in Condominium Conversions Should Offer You:

- A choice of experienced attorneys knowledgeable in all aspects of the conversion process;
- A long history of successfully completing conversions in San Francisco;
- Ongoing guidance to help prevent you from making 1st timers’ mistakes;
- Counsel in all stages of the conversion process, including building inspection, selection of a competent surveyor, and lender issues;
- Representation before the City Planning commission when required;
- A single point of contact with City agencies;
- Expertise in landlord/tenant issues;
- Outstanding experience in mortgage lender consent requirements;
- Knowledge of the City’s rules and procedures – those on the books, as well as the unwritten rules learned only through experience.

**What Sets
Goldstein, Gellman,
Melbostad, Gibson
& Harris, LLP
("G3MH") Apart in
Condo Conversions?**

EXPERIENCE:

G3MH has been a respected member of San Francisco's real estate community for over twenty years. Our condominium conversion team initiated its first San Francisco condominium conversion in 1998. Since then, we have successfully completed over 2,200 San Francisco condominium conversions. Over the past four years, G3MH has handled the majority of conversion applications, including more than half of all lottery winners (over 400 units), plus an additional 543 duplex units exempt from lottery requirements. We worked integrally with City departments to fashion the City's latest conversion procedures, so we are very familiar with the nuances of the City's new application package.

EXPEDITING:

G3MH is not a conversion "expediter." No one in San Francisco is, and hiring anyone - including us - with the expectation that your application will receive "special" attention from City officials will leave you disappointed. However, the G3MH team has years of experience with the subtleties of the various City departments involved in condominium conversion. We work hard to insure that your application is complete and correct the first time it is submitted. We will meet with you personally throughout the conversion process; we are always available to answer your questions by phone and email, and we will keep you apprised of the status of your application, and changes in law or local procedures affecting same. We maintain an excellent and long-standing reputation with City officials to help insure that your conversion application receives the attention of the necessary parties in a timely fashion.

FLAT-FEE:

G3MH provides its condominium conversion services over the entire multi-year process on a flat-fee basis. We think you will find our fees both modest and appropriate to the services you will receive. The scope of our work is clearly explained up front, and the costs laid out for you, so that there will be no surprises or "extras" down the road. Any additional hourly services are incurred only at your specific request.

SERVICE:

G3MH is a full-service law firm, which means that our attorneys and paralegals are available to offer additional guidance in landlord/tenant issues, title transfer and vesting, trust and estate matters, easements, tenancies-in-common, property tax issues, and all other matters indirectly related to the conversion process. Although we hope you never need it, should you require representation in trial or arbitration, our team of litigators is at your disposal. No other firm in San Francisco offers the staffing and resources to meet your needs in every aspect of condominium conversion, and beyond.

About the Author and the G3MH Condo Conversion Team:

David R. Gellman, managing partner of G3MH, has extensive experience in tenancy-in-common (TIC) formation, condominium conversion, landlord/tenant (rent control), real estate litigation, commercial leasing, like-kind exchanges, multifamily housing finance, construction, and estate planning. Mr. Gellman 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. He has written a companion article to this one, entitled “Tenancies-In-Common in San Francisco” which can be found on the firm’s website at www.g3mh.com. Mr. Gellman can be contacted via email at DGellman@g3mh.com or by phone at (415) 673-5600.

Boyd McSparran is an associate of G3MH. His practice areas include condominium conversion, tenancies-in-common, commercial and residential real property transactions, and landlord-tenant disputes. He has written a companion article, entitled “Tenant Evictions in San Francisco” which can be found on the firm’s website at www.g3mh.com. He can be contacted via email at BMcSparran@g3mh.com or by phone at (415) 673-5600.

Pamela Wiget is a paralegal at G3MH. She is responsible for maintaining contact with the City departments and staff who process conversion applications. Pamela has special expertise in lender approvals of condominium conversions, and often consults with commercial lenders to help them administer their conversion approval policies.

This article is for informational purposes only, and should not be relied on as legal advice about specific situations. Readers should consult an attorney if they need help with legal matters. We invite readers seeking legal assistance to contact one of our attorneys to discuss their needs.

Notes

Condominium Conversion Process

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