

The Late, Great Condo Conversion Boom

By Parke M. Chapman

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Last week looked like the official end of the single-family housing bubble. In back-to-back reports, the National Association of Realtors and National Association of Home Builders reported significant declines in both new and existing home sales — as well as falling median prices and swelling inventories in many parts of the U.S.

No surprise, then, that the air has also been sucked out of the condo-conversion market. With demand slipping — from both residents and speculators — underwriters are taking a harder look at conversion plans. Some lenders in over-supplied condo markets, such as Manhattan, are even shifting their attention to rental properties.

The pace of conversions has fallen sharply, according to Real Capital Analytics. In 2005, converters spent more than \$30 billion buying up apartment properties; in the first half of 2006, they spent \$7.5 billion vs. \$13.5 billion in the first six months of 2005. In the second quarter, the figure was \$2 billion, a far cry from almost \$7 billion for similar properties that converters spent in the year-ago quarter. Even though more deals were done toward the end of the year in 2005 and the prior two years, Real Capital Analytics expects full-year numbers to come in well short of 2005's \$30.5 billion.

"Conversion buyers are definitely slowing down because some of these markets are really oversupplied with new units," says Dan Fasulo, national director of market research at Real Capital Analytics.

Sales of existing condos and coops began to decline earlier this year. According to research released last Friday by the National Association of Home Builders, 896,000 existing condos were sold in 2005, which represented a 9% increase over 2004. But in June, the sale of existing condos fell to an annual rate of 805,000, a 10% decline from December 2005 and a 15% decline from June 2005.

Price appreciation has also flattened. Median condo resale prices jumped by 18%, 17% and 14% annually in 2003, 2004 and 2005 respectively. Through the first half of 2006, median condo prices have declined. The NAHB reports that by the end of June, the median resale price for a U.S. condo was \$226,900 (or just 1% higher than the December 2005 price, and several percentage points below the June 2005 record high of \$231,800 per unit).

Fasulo of Real Capital Analytics adds that the compounded effect of excessive condo supply and lackluster buyer demand for units has had the biggest impact in markets like Las Vegas and New York City.

It's easy to see why. Lenders have poured capital into the New York City condo market in recent years. Much of that money was earmarked to convert office and apartment buildings into condos. But this spurred an inventory glut, just when rising interest rates — and record sale prices — were chipping away at demand. Now some converters are quietly talking about reconverting condos into rentals — what market research Property Portfolio Research tartly calls "repartments."

"There are definitely fewer new condo projects being financed now than there were twelve months ago but we're seeing plenty of capital flow into the [rental conversion] market," says Andrew Singer, principal at Manhattan-based real estate finance firm Singer & Bassuk. His firm has arranged more than \$4 billion in construction loans for New York City rental projects and conversions over the past three years.

"Lenders realize that the New York City market needs more rental units. Plus, with such great demand to rent these units, landlords can boost rents," adds Singer.

In June, Singer arranged a \$100 million construction loan on 67 Wall Street. The 25-story, 325,000 sq. ft. Lower Manhattan office building will be converted into 211 rental units with ground-floor retail space. The owners of 67 Wall Street, private investors Nathan Berman and Ronny Bruckner, expect this apartment conversion to be completed early next year.

This doesn't mean that lenders have given up completely on financing condo conversions. But only seasoned borrowers need apply, says one Manhattan source.

"Condo lenders are really scrutinizing these deals before they commit any capital," says Steve Kohn, president of Manhattan-based real estate finance firm Sonnenblick-Goldman. "They want to see a condo converter with a solid track record, and they also want the borrower to have liquidity in case something goes wrong."

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