

Chapter 14

CLTs and Condominiums

Since the condominium model is a relatively new form of real estate, and many people are not familiar with the details of how it works, this chapter begins with an overview of the model. Following the overview, the planning issues raised for CLTs that are dealing with condominiums in one way or another are discussed.¹

CONDOMINIUM OVERVIEW

Residential condominiums are a unique form of homeownership. While traditional homeownership includes the house as well as the front yard, the garden in the back, and the fence around it all, such is not the case with condominiums. Condominiums are a hybrid between individual and communal ownership. The living spaces, which are called “units,” are owned individually, and the remaining portions of the property, referred to as the “common elements,” are owned in common with other unit owners.

Condominiums can take many physical forms, but are typically characterized by multiple living units under one roof. This familiar style of condominium looks and feels very similar to an apartment building, except that the residents are owners rather than renters. In this arrangement, the unit owner wholly owns the airspace and surfaces within the unit, but the remainder of the property, including the building shell (walls, windows, roof, stairs, utility lines, etc.) as well as areas outside the buildings (yards, parking lots, etc., and, most importantly, the ground itself) is owned in common with other unit owners.

The condominium form of ownership is a statutorily created real property interest, defined and regulated by state statute. Because condominium units are, in many cases, nothing more than airspace, with only an accompanying fractional interest in the underlying land, it is no surprise that condominiums are highly regulated by state statute in order to protect unit owners. These regulations vary from state to state, but can generally be classified as relating to formation, operation, and sales.

Formation. Condominiums are created upon the recording of a “declaration” in the land records of the jurisdiction in which the property is located. As the central document in the formation process, the declaration “declares” how the condominium is intended to operate. The person or entity responsible for the creation of this document, and in turn responsible for the condominium, is known as the “declarant.” In most instances, the declarant is also the owner of the property upon which the condominium is to be located. The contents of the declaration are controlled by state statute, but generally include the following:

- *A legal description of the boundaries of the property being submitted to condominium ownership.*
- *The name of the condominium, which must be unique within the state.*
- *A statement as to whether the condominium is newly constructed or is a conversion of existing rental housing to condominium ownership.*

- *A description of the size and boundaries of each “unit.”* The unit boundaries are dependent upon the type of condominium created by the declarant, and may or may not include the exterior structure of the building. (In situations where the declarant wants to sell detached housing but is unable to subdivide the land, or wants to retain control of the land, a condominium commonly referred to as a “shoebox” is created, with unit boundaries defined as the exterior of the buildings.) In any case, the condominium units are treated as real property that may be conveyed and encumbered just like more traditional parcels of real property.
- *A description of all of the “common elements.”* By definition, a condominium must include common elements – those parts of the condominium that are jointly owned by each unit owner on a percentage basis. Most often the percentage owned by a particular unit owner is determined on the basis of the square footage of that owner’s unit, but other ways of determining the percentage are possible. For example, if the condominium includes a swimming pool, each unit owner would probably own an equal percentage of the pool regardless of the square footage of their apartments.
- *A description of the “limited common elements.”* Limited common elements are those common elements that are reserved for the exclusive use of certain unit owners, whereas general common elements can be used by all unit owners. Decks and parking spaces are typically designated as limited common elements. *All* of the components of the condominium must be designated as either units, general common elements, or limited common elements.
- *The allocation of voting rights to each unit.* As with the allocation of interest in the common elements, the method of allocating voting rights is subject to the will of the declarant.
- *The allowed and/or prohibited uses for each unit.*
- *The requirements for amending the declaration.*

In addition to the declaration, there are two other key documents necessary to form a condominium – the plat and the association bylaws. The plat is a graphic depiction of the condominium. Its representation of the unit boundaries/square footage measurements and designation of common elements must be entirely consistent with the declaration. The association bylaws are the rules and regulations for the operation of the association of unit owners. They are discussed in the next section.

Operation. The ongoing operation of the condominium is controlled by the association of unit owners, which is organized as a non-profit corporation. The bylaws that will govern the operation of the corporation are recorded along with the declaration. They control the allocation of voting interests to unit owners, the manner in which the board of directors is to be elected and removed, the powers to be held by the board, and the manner in which meetings are to be conducted. The bylaws also define certain operational requirements, including those relating to insurance, maintenance and replacement of the common elements, and the employment of property managers. The money needed to operate and maintain the common elements in the condominium is collected from the unit owners as a monthly assessment. A portion of the money

collected is placed in a reserve account so that, when it comes time to replace the roof or resurface the parking lot, the money is available.

Not all condominiums are controlled by a single association, and not all condominiums are solely residential. In more complex condominium structures, the development may proceed through a series of phases and may provide for a mix of residential and commercial uses. It is not uncommon to see a mixed-use condominium with commercial units at the street level and residential units above. In such structures, the developer will often create an association for each phase or use, with a master association that controls the entire development. Each association would have its own bylaws and each unit would be subject to the bylaws for both the immediate association of which it is a part and the master association.

Sales requirements. The sale of condominium units carries with it certain disclosure requirements regarding the status of the condominium and the unit. In most states condominium developers are required to provide potential purchasers with a disclosure statement (also called a public offering statement) containing an estimate of the initial monthly assessments, a reserve study that details the capital improvements anticipated over the next thirty years, and, for condominium conversions, an inspection report that details the current state of the units and common elements, along with any suggested repairs. Sales of units cannot be closed until the disclosure statement is approved by the state and is delivered to the prospective buyer.

Financing. Although not regulated by statute, financing is another important consideration. The market for condominiums is often more volatile than for other forms of real estate. Condominium sale prices are often the first to drop in an economic downturn and the last to recover when the economy improves. This fact is closely related – perhaps both as cause and effect – to lenders’ reluctance to finance condominium units as compared with other forms of residential development.

Lenders perceive greater risk associated with communal ownership. Although each unit is separately owned and financed, the value of each individual unit is influenced by the actions of the community. If unit owners default on their monthly assessments, the burden of keeping up with needed expenses is then left up to the remaining unit owners. Over the long run, if assessments are not paid, there will not be enough money to fund necessary capital improvements. If those improvements are not completed when needed, the overall value of the condominium is negatively affected, and lenders face a greater risk of not being able to recoup the value of the loan if the property is foreclosed.

In order to offset these risks, the Federal Housing Administration (FHA), a division of the U.S. Department of Housing and Urban Development (HUD), offers mortgage insurance for condominiums, as for other owner-occupied homes. However, FHA will only insure loans for those condominium projects that have been approved by HUD. The requirements for HUD approval are set forth in HUD Handbook 4150.1. These include, for example, the requirement that at least 50% of the units must be sold before approval can be granted, and the requirement that at least 50% of the units must be occupied by the unit owner, among other requirements. Upon approval by HUD, the condominium is then included on a list of approved projects, which is available on the HUD website.

CONDOMINIUM PLANNING ISSUES FOR CLTS

The condominium-related issues that a CLT must address depend, first of all, on whether the CLT's goal is (1) to develop an entire condominium project on its own (involving either new housing or the conversion of existing rental housing), or (2) to promote and preserve affordable owner-occupancy for certain (but not all) units in condominium projects that have been or are being developed by other entities. We will discuss these two sets of circumstances separately.

CLT-Initiated Condominium Projects: New Development

Before considering – or *as* you consider – the questions related to condominium development, you should of course address the fundamental question of whether the condominium model is the best ownership structure for what you want to accomplish. If you are beginning with the basic goal of developing a certain number of homeownership units for households in a certain income range in a certain geographical area, the possible ownership models may include, in addition to the condominium model, traditional houses on separately leased plots of land, or townhouses on separately leased lots (with common wall agreements between adjacent units), or some form of limited equity cooperative (including the possibility of a cooperatively owned manufactured housing park). Your choice among such options will depend on a number of factors, including the following.

- The cost of developable land.
- The size and type of sites available.
- The number of sub-dividable lots and the number of homes that can be created on available sites under local zoning regulations.
- The number of units your CLT has the capacity to develop.
- The amount of time over which development and marketing can be, or must be, spread.
- The requirements of state and municipal laws permitting the various ownership models, and the relative complexity and cost of complying with these laws.
- The relative total costs of developing projects of different sizes involving the different ownership models.
- The relative marketability of different models for the intended clientele in the local market.
- The relative advantages and disadvantages of common interest ownership models (including condominium and coop models) for the intended clientele.
- The capacity of the CLT to provide appropriate training for stand-alone homeownership vs. its capacity to provide appropriate training for common interest ownership.
- The long-term support and stewardship responsibility entailed for the CLT by different models.
- The mix of ownership models in the CLTs existing portfolio, and the extent to which a preponderance of condominiums could pose a long-term risk for the CLT (the future marketability of condos, as noted above, being generally less predictable than that of conventional single-family homes).

Legal framework. Since the first state condominium law was adopted in 1960 (in Utah), more or less similar laws have been passed in all fifty states. The basic nature of the model established by these laws, as described above in the “Condominium Overview,” does not differ significantly from state to state, but the details – regarding the exact nature of the ownership structure, the process for creating that structure, and the legal responsibilities of the organization that creates it – these do differ. If your CLT is considering undertaking a condominium project, you should expect to work closely with an attorney who has experience in establishing condominiums under the law of your state.

Ownership structure and enforcement of long-term restrictions. Under some state condominium laws, it is possible for a CLT to lease an undivided interest in the land beneath a condominium to each individual unit owner. Such leases can then serve as the vehicle for establishing and enforcing the long-term restrictions that are the particular concern of the CLT – restrictions on occupancy, resale, and permitted financing for individual units – and such leases need not differ substantially from other CLT ground leases based on the Model CLT Residential Ground Lease.

However, in states where unit owners cannot hold an undivided individual ownership interest in the land – where they can have only shared interests as members of a condominium association that controls the land – the CLT cannot use a ground lease as a direct means of establishing restrictions on individual units. In some such situations, if the law does not require the association to own the land on a fee simple basis, the CLT may be able to lease the land to the association, and it may be possible to include in the lease a requirement that the association enforce restrictions regarding the resale, occupancy and financing of individual units. But, even where a CLT does enter into a lease agreement with the association, the usual practice, in the absence of unit-by-unit ground leases, is to rely on restrictive covenants on the individual units as a means of enforcing restrictions on those units.

In most states, however, deed covenants are not as enforceable as ground leases over long periods of time. A few states (currently Massachusetts, Vermont, Maine, Rhode Island, and Oregon) have adopted statutes that specifically permit perpetual affordability covenants. In other states the period of enforceability for all covenant-based restrictions is limited, either by statute or by the common law “rule against perpetuities” (see Chapter 8, “Implementing Restrictions on Ownership”). CLTs considering the use of deed covenants should consult with an attorney regarding this aspect of the law in their own states, and should explore the possibility of pursuing legislation similar to that enacted in the five states mentioned above. The statute recently enacted in Oregon – ORS 456.270 et seq – can be viewed at <http://landru.leg.state.or.us/ors/456.html>.

The CLT’s responsibilities and concerns as “declarant.” If a CLT is to be the entity that records the “declaration” that brings the condominium into being and describes its essential features, it should be sure that it has a clear understanding of the legal requirements that must guide it in preparing the declaration and in carrying out its responsibilities as “declarant” – that is, its responsibilities up until the time when an elected board of directors assumes responsibility for governing the condominium. The basic types of information that must be included in the declaration are outlined in the “Condominium Overview” above, but, again, it will be important to work with an

attorney who is familiar with the responsibilities specifically assigned to the declarant by your state's condominium law.

It is also important, however, for the CLT to understand not only the *legal* issues entailed in developing the declaration but also the *practical* issues involved in implementing the plans embodied in the declaration. For this reason, it is advisable to seek advice not only from attorneys but from people who have professional property management experience with condominiums. Before you file a declaration it is a good idea to ask such a person to review the document with an eye for any management problems that it might present.

As a provider of affordable homeownership opportunities, a CLT has a particular concern both with establishing condominium systems that will work effectively, over the long term, for its intended lower income clientele, and with preparing these lower income homeowners to work effectively within these systems. The CLT's role in drafting bylaws – and, to varying degrees, in drafting the declaration itself – will be crucial in shaping these systems. The practical considerations involved in drafting bylaws are discussed later in this chapter.

Responsibilities as developer. In addition to the responsibilities specific to the role of the condominium declarant, a CLT that is creating a new condominium will have all of the considerable responsibilities specific to the role of the developer of a multi-unit housing project – unless this role can be assigned to or shared with another entity (and even then the CLT must oversee construction closely enough to ensure that purchasers of the units will get the quality that they pay for and that the law requires).

Permitted uses and income levels. Among the essential questions to be addressed in planning a condominium project is the question of whether all of the units will be subject to the same kinds of restrictions. If the project will include units intended for commercial or other nonresidential uses, they will necessarily be treated differently from the residential units. The specific uses of nonresidential units will normally be restricted in certain ways – at least for the purpose of ensuring that their use will not negatively affect the residential use of other units, and perhaps for other purposes as well – but the specific nature of these use restrictions will be different from one situation to another. The *resale* of these units may also be restricted, or may not be restricted at all. You may want to allow for-profit businesses to sell their units to whomever they choose, for a market price; or – if your goal is to provide affordable space for nonprofit facilities or for business ventures by local people – you may want to restrict both price and buyer eligibility (but not in the same terms as the residential units). You may also want to consider the possibility of creating separate condominium associations for residential and nonresidential units, since the concerns of these two types of owners will be quite different. (See Chapter 16, Non-Residential Ground Leases,” for discussion of CLT restrictions on non-residential use.)

With regard to residential units, the first question will be whether buyer income requirements for all units will be the same (for instance, requiring all buyers to have household incomes below 80% of AMI) or whether different units will be designated for different income levels. If different income levels are to be accommodated, the question then will be whether all units will be subject to the same resale formula (though with differing prices and buyer-eligibility requirements), or whether there will be some “market-rate” units that have no resale restrictions at all. If there are to be market-rate

units, and if they are physically separate from the “affordable” units, then some CLTs may want to consider creating separate associations for the two types. Generally, however, the creation of multiple associations entails practical disadvantages – including greater initial cost and greater management complexity over time. Furthermore, there are reasons to avoid formal distinctions that would tend to separate members of the community on the basis of their incomes.

In planning mixed-income projects, CLTs should also be mindful of how the particular mix of incomes might affect the organization’s 501(c)(3) charitable status under the terms of the “safe harbor guidelines” or related “facts and circumstances” as published by the IRS. (Projects developed through an acknowledged relationship with a local government agency to serve a higher range of incomes may qualify as charitable on the basis that they “lessen the burdens of government.” In any case, see Chapter 6, “Tax Exemption.”)

Governance . As noted above, one of the important concerns for a condominium declarant will be the task of drafting the bylaws that will determine how the condominium association will govern its affairs. The specific content of the bylaws will vary depending on a number of factors – including the particular mix of uses and income levels, as discussed above, the overall number of unit-owners involved, and the particular nature of the general common elements and limited common elements that must be overseen collectively. In any case, however, the bylaws should facilitate effective, stable operation of the condominium under a governance system that is inclusive and democratic. To this end, a CLT should pay particular attention to the following basic concerns.

- *Keeping the governance process as simple as possible.* Complex layers of requirements and restrictions deriving from different associations and stated in different documents can greatly increase the difficulty of self-governance for condominium residents – especially lower-income residents who are likely to have relatively little experience with, or little time to deal with, such matters. Bylaws should not be so simplistic that they fail to provide guidance on important questions, but neither should they be so complicated that just a few members achieve undue power by virtue of being the only ones who understand them.
- *Weighting of votes.* In electing board members, it is common for the vote of individual unit-owners to be weighted according to the size or other differences among their units. For instance, if the home of Owner A is 20% larger than the home of Owner B, Owner A’s vote might have 1.2 times the weight of Owner B’s. Before establishing any such system in the bylaws, however, a CLT should consider the extent to which it may concentrate power in a particular sub-group within the association.
- *Possible direct role of the CLT in governance.* Some CLTs have developed condominium bylaws that give the CLT itself an ex-officio seat on the association board of directors. Also, some CLTs retain permanent ownership of certain units in order to make them available as rental housing for people with special needs or for other specialized uses – which gives the CLT a right to vote as a member of the association, though not necessarily a seat on the board. These opportunities to participate in the affairs of the association give the CLT an opportunity to

- monitor, and perhaps to influence, the decisions of the membership and the board. However, the advantages of this potential influence should be balanced against the possible disadvantage of the board becoming over-reliant on the CLT for guidance.
- *Representation of owners of price-restricted units.* In mixed-income projects where lower income residents own units that are subject to occupancy and resale restrictions while higher income residents own “market-rate” units, the CLT has reason to be concerned with the relative influence of the two groups within the board of directors. You may want the bylaws to provide for a certain minimum number of directors to be elected by and from each of these categories, to ensure that the differing interests of the two are both represented on the board. However, you should balance the potential benefits of such representation with the potential disadvantages of the emphasis it places on the differences between the two groups of residents.
 - *Affordability of assessments.* The condominium association’s board of directors will have the authority to assess fees to pay for the maintenance, repair and replacement of common elements, and perhaps also to pay for additions and improvements to the common elements. In mixed-income condominiums, fees that are affordable for higher income residents may not be affordable for lower-income residents. A CLT should be sure that the more affluent will not have the power to impose unaffordable fees on the less affluent. This is of particular concern when there are just a few affordable units within a predominantly market-rate condominium project. One way to protect the less affluent is by seeing that they are adequately represented within the board, as noted above, but other measures may accomplish the same purpose. For instance, you may require that replacements and repairs be accomplished with materials of comparable quality to the original materials rather than allowing more expensive materials to be substituted. You may also consider requiring a super-majority vote for improvements that will increase monthly fees by more than a specified percentage, or that would be considered luxuries. And in any case you should do everything possible to ensure that adequate reserves are maintained so that there will not need to be a sharp increase in fees as replacements and repairs eventually become necessary.
 - *Access to information.* All association members should have full access to information about the condominium’s financial condition and about all board decisions. The bylaws should require that financial reports be distributed to association members periodically, and that minutes of board meetings also be distributed.
 - *Approach to management.* If a contract with a professional property management company can be affordable for all of the unit-owners, a CLT may draft bylaws that require the association to contract for such services in order to assure sound management practices (see the following discussion of management issues).

Ongoing management concerns. For the long term, the successful management of a condominium project depends not only on the ability of individual households to manage the practical and financial concerns related to their units but also on the ability of the

association to manage the shared concerns of the community. Central to these concerns is the maintenance of the condominium's common elements. Effective maintenance of these elements is dependent on effective financial management.

The common elements include a number of things that call for ongoing, month-to-month maintenance: lawns that need to be mowed, driveways and parking areas that need to be maintained and, in many locations, kept free of snow, heating systems that need to be fueled and serviced, lighting that must be kept functioning, and so on. All of these activities involve financial obligations that must be anticipated and paid for through monthly fees. The board of directors is ultimately responsible for setting these fees, but should do so based on accurate information and calculations provided by managers.

It should be noted that not all unit owners should necessarily be assessed the same amount. It is appropriate for unit owners to share some expenses equally (such as the cost of lawn mowing or heat for common areas to which all have access), but other expenses may be more fairly charged to unit owners on a different basis. For example, if heating costs for living units are included in the assessment, owners of larger units should pay a larger share of the cost. Similarly, owners of units with 3 bedrooms and 2 bathrooms should pay a larger share of a water bill paid out of the assessment than owners of units with only a single bedroom and bathroom. And, in a multi-building development, the expenses of maintaining common space in a particular building may be charged only to the owners of units in that building.

Long-term financial management. There will also be long-term costs that will not require monthly, or even annual payments but that will require payment of substantial sums at a future time. These include such eventual necessities as painting the exteriors of buildings, replacement of roofing, and the repair or replacement of major components of heating, cooling and ventilation systems – all of which are the responsibility not of individual unit-owners but of the association. It may be tempting to ignore the fact that such costs are out there in the future – especially for a new condominium with brand new facilities – but it is extremely important that they *not* be ignored.

Sound management requires that both the probable timing and the probable amounts of long-term costs be anticipated, and that reserve funds be established and funded at a level sufficient to cover the costs when they must eventually be paid, without need for large increases in monthly fees at that time. Maintaining sufficient reserves is *especially* important when the goal is to preserve the affordability of units for future lower income owners. The failure to assess current owners sufficiently to cover long-term costs (which accrue for both initial and later residents) will shift the burden of these costs to future owners – including lower income households for whom that burden may be unaffordable.

To the extent that reserves can be funded at the outset as a subsidized part of the CLT's overall development cost, the financial burden for both present and future owners may be lessened. Over the long term, however, the reserves must be funded primarily through the fees paid by the members from month to month.

Essential financial management tasks. If all costs – both short- and long-term – are to be covered systematically, a number of essential tasks must be completed.

- All basic operating expenses must be identified and total annual operating expense projected.
- Any debt service obligations must be identified month by month and year by year.

- Capital needs assessments must be conducted to determine the likely amounts and timing of future capital costs, and the amounts that will need to be reserved in order to cover these costs.
- The monthly fees necessary to cover all operating expenses, debt service, and the funding of reserves, must be calculated and allocated fairly to the members.
- Systems should be established for the collection of monthly fees and for consistent follow-up regarding late payment.
- Realistic annual budgets must be developed for board approval.
- Month-by-month cash flow projections must be made to evaluate the likelihood that enough cash will be available *when* it is needed.
- Bank accounts must be established; procedures must be established for deposit of all receipts without delay and for making all necessary disbursements before penalties are incurred.
- A proper bookkeeping system should be established and implemented consistently.

All of these tasks should be carried out in the context of a fully developed accounting system that will yield verifiable financial reports to the board and the membership of the association at regular intervals.

Who will carry out management tasks? As the governing body of a condominium association, the board of directors is responsible for seeing that the association is well managed, but it should be emphasized that governance and management are not the same function. It is the board's job to set policies, approve budgets, and (except in the case of some small condominiums, as noted below) to hire managers. It is then the managers' job to implement policies on a day-to-day basis and see that the association's duly established policies are consistently implemented and that its financial transactions are carried out in accordance with its duly approved budget. In general, the board of directors should not try to micromanage the association's day-to-day business, and the professional managers should not intervene in the policy-making functions of the board of directors.

The preferred way of ensuring that essential management tasks are carried out satisfactorily is for the association to contract with a professional property management company (either for-profit or not-for-profit). For smaller projects, however, the per-unit cost of professional management services may be more than is affordable for lower income households. In such situations, self-management is an option to be considered, at least if adequate management training can be provided to the association's board of directors, or to a committee of the board that will be charged with day-to-day management responsibilities. At least one CLT – Champlain Housing Trust – has developed smaller condominium projects that have successfully managed their own common property (with the help of a paid bookkeeper).

Another question that may come up – at least in the case of self-managed condominiums – is that of the CLT's long-term role in seeing that the condominium is properly managed. Should the CLT have a monitoring and advisory function? Should it have a right (if legally possible) to approve or disapprove major decisions affecting management? If it has management capacity in its own organization, should it perhaps provide management services (or some level of management oversight) to the

condominium? Or should it adopt a hands-off policy but be prepared to intervene if there appear to be management problems? CLTs have differed significantly in their approach to these questions.

Northern California Land Trust's condominium lease (leasing an undivided interest in the land to each Homeowner) calls for CLT approval of reserves and assessments, contracts with property managers, and rules enacted by the Association. At the other end of the spectrum, Champlain Housing Trust, an experienced property manager in its own right, has generally followed a hands-off approach, though it does provide training and technical assistance during the time when new condominium boards of directors are establishing management systems, and does maintain a certain level of contact through its role in collecting fees and overseeing resales of units.

Initial orientation and training of condominium purchasers. Whatever its ongoing role in relation to the condominium association and its board of directors, the CLT should normally play an active role in orienting and training the individual condominium purchasers – both at the time units are initially sold and as they are resold over time. The kind of training needed will include not only many of the elements that are important for first-time buyers of conventional homes, but also preparation for the role of association member. Among the things that are important for association members to understand are:

- The basic condominium ownership structure: who owns what – individual units, common elements, limited common elements, the fee interest in the land;
- the rights and responsibilities of members of the association;
- the process of electing the board of directors and the powers and responsibilities of the board as established by the bylaws of the association;
- basic financial management concepts needed to understand the management of the association's affairs by the board and/or management company (including an understanding of the purpose of reserves and a basic understanding of financial reports);
- the rules and regulations established for unit-owners by the board;
- the role of the CLT and the nature of the resale (and other) restrictions it is charged with enforcing.

The exact nature of the training will vary, depending on the specific features of the state condominium law and the terms of the declaration and bylaws as well as on the size and nature of the project. The PowerPoint presentation entitled Homeowners Association 101, developed by the City of Lakes CLT, provides an example of one kind of introductory training for condominium association members.

CLT-Initiated Condominium Projects: Conversions

Condominium conversion projects entail the conversion of rental housing to condominium ownership. The rental housing may have been originally developed by a CLT that later decides that owner-occupancy would now be desirable and possible, or it may be a rental project that the CLT has decided to acquire with the intention of converting it to condominium ownership, perhaps with plans to improve the quality of the housing in the process. In either case the CLT will not only need to deal with all of the important issues that it would face as the developer of a new condominium project, but will also need to deal with an additional layer of issues arising from the fact that the form

of ownership – and all that it entails – will be changed for *existing* residents of the housing.

In the for-profit world, a condominium conversion may happen when a landlord sees it as a way of liquidating a rental property on favorable terms (converting a stream of rental income into capital that could be invested more profitably elsewhere). Or it may happen when a developer sees an opportunity to acquire depreciated rental property, improve it, and sell it, unit by unit, for a profit as condominium property. For a CLT, however, the overriding concern will not be profit; it will be the question of what costs and benefits a conversion would yield for the residents (though the costs and benefits for the CLT itself are of course also relevant).

Critical preliminary questions. To assess both the costs and benefits for the residents and the workability of a condo conversion for everyone concerned, some important questions must be carefully explored.

- How many of the current tenants have an active (or at least potential) interest in owning their current home as a condominium unit?
- Does the property need rehabilitation? Is there interest among residents in seeing it rehabbed – or perhaps improved beyond its original condition?
- How much debt does the CLT already carry for the housing in question (or, if it does not already own it, how much debt would it have to assume to acquire the property). How much would the cost of conversion add to this existing debt – including potential rehab costs, legal and administrative costs, and the cost of organizing and training the residents?
- What are the incomes of current residents? How many could qualify for mortgage loans – and for what dollar amount? How many would qualify for public subsidies? Given the total cost of the project, how many resident households would be able to finance the purchase of their units with the help of any subsidies they may qualify for?
- For those who are either not interested or not financially able to purchase their unit, what are the alternatives? Additional subsidy for purchase? Continuing rental within a condominium? Relocation? How well would these alternatives work for the residents, and how would they affect the condominium if a conversion takes place?
- In your jurisdiction, what will be your CLT's specific obligations to the current residents (in addition to other obligations as declarant) during the conversion process? (For instance, in some states, existing residents in a rental property must be given the first opportunity to purchase their apartment if it is converted to a condominium.)
- Is there – or can there be – enough sense of community among the existing residents to foster the development of a successful common interest community?
- For both the short and long term, how marketable will units be to people who do not already live in them?

Initial outreach and organizing. Thorough exploration of most of the questions above will require a substantial amount of interaction with the residents, before as well as after a decision is made to proceed with a conversion. The needs and interests of the residents

will need to be surveyed, and should also be discussed in groups sessions, where residents will have an opportunity to respond to the asserted needs and interests of their peers and where CLT personnel will have an opportunity to assess the level of agreement among residents and the group's potential for cooperation.

Transparency is critical to establish trust. Clear information about the nature of a possible conversion should be made available to residents of all units, and group sessions should be scheduled to allow for discussion of the subject, and to answer any and all questions. As planning progresses, CLT personnel should meet individually with all resident households to address their concerns and to begin the process of assessing their ability to qualify for mortgage financing.

In so far as possible, resident input should be invited regarding rehabilitation and improvement of the property. Resident input can also be important regarding the drafting of the bylaws that will shape the condominium's governance structure.

Clearly all of this will require a substantial amount of time, and a substantial amount of staffing. Conversions of larger rental projects may call for the full-time efforts of at least one organizer for at least a year. The costs of such staffing should be realistically anticipated in developing a conversion budget

Counseling and training. Residents who want to purchase their units will need varying amounts of counseling to help them qualify for mortgage financing. Any residents who cannot or do not want to purchase their units will need varying amounts of counseling to help them make alternative arrangements.

Training to prepare residents for the role of association membership will be as important for conversions as for newly developed condominiums. The list of basic training topics that appears above in connection with newly developed condominiums can be applied to conversions as well. For conversions, however, this kind of training can begin sooner – perhaps at the same time that bylaws are being drafted and other aspects of planning are moving forward – since most of the residents will be present well before the condominium is actually created and units are actually purchased.

Condominium Units in Projects not Developed by the CLT

Two types of situations. CLT stewardship of condominium units located in projects that have not been developed by the CLT itself can be a product of two different kinds of situations:

1. *New condominium projects in which a limited number of the units will be offered for affordable prices with resale price restrictions.* Such projects may result from municipal inclusionary zoning ordinances – and/or project-by-project agreements between municipalities and developers – requiring that a certain percentage of new units be “permanently affordable.” Such projects may also result from an agreement between a CLT and a developer, with the CLT agreeing to contribute public subsidies available to it for a certain number of units (e.g., the condominium projects of the City of Lakes CLT and Kulshan CLT).
2. *Scattered-site “buyer-initiated programs.”* In these programs, a CLT applies available public subsidy to the purchase of a home (condominium or other) selected by the buyer from among units that are for sale in a designated market and that have been approved by the CLT.

In all of these situations, a CLT's relationship with a unit-owner is on a unit-by-unit basis – through a covenant attached to the deed to each unit – but this does not mean that the CLT can disregard the many issues that relate to the condominium as a whole. In the case of a new condominium that a CLT has not initiated but in which it will steward a certain number of units, the CLT will still have the same concerns discussed above in connection with CLT-initiated projects. It will still want to be sure not just that individual units are appropriate for the individual households but that the condominium as a whole will work – on an ongoing basis – for lower-income residents in terms of physical structure, governance structure, financial structure and management structure.

The same is true for condominiums in which a CLT may consider subsidizing and stewarding one or more units through a buyer-initiated program. When a CLT evaluates a single-family detached home for possible purchase through a buyer-initiated program, it can focus primarily on the home itself, independent of its neighbors, but when a CLT evaluates a condo unit for such a program it must look at the whole condominium project. If the condominium has been operating for some time, there will be a need – and opportunity – to look not only at the way the project was planned but at its actual performance. Are buildings and grounds well maintained? Are financial reports up-to-date? Are finances stable, with reserves being funded at appropriate levels? Has occupancy been stable, with limited vacancies?

Monitoring and stewardship fees. In the case of “inclusionary units” (whether as products of zoning ordinances or project-by-project agreements), it has been common for municipalities to record deed covenants restricting the occupancy and resale of the units for an extended period of time. In the past, these municipalities rarely provided for monitoring and enforcement of the restrictions. It was assumed that the covenants would be “self-enforcing” – i.e., when a resale was pending, the buyer's attorney (or an attorney for a lender or title company) would discover the recorded covenant and would avoid a violation that would undermine the buyer's title.

Over time, however, it became clear that affordability covenants were self-enforcing only to a limited extent (see Chapter 8, “Implementing Restrictions on Ownership”), and for this reason it is increasingly common for CLTs to be asked to take on a stewardship role for such units, with responsibility for monitoring compliance with the restrictions and assuring that when the units are sold they are sold to households in the designated income range for prices that do not exceed the limits established by the covenants – and assuring as well that a similar covenant is attached to each buyer's deed. Such covenants are normally framed as a transaction or agreement between the unit-owner and the CLT – with the CLT defined as the source of the benefits of affordability and the unit owner, in return for these benefits, agreeing to accept the restrictions and granting the CLT the right to enforce them.

The CLT usually charges a monthly “stewardship fee” to the unit-owner, which helps to cover the cost of monitoring and provides for month-to-month contact with the owner as a basis for monitoring continued occupancy. The fee is not a lease fee like that which may be charged when a CLT owns the land beneath a home, but is justified as part of the bargain that includes subsidized affordability for the owner. Typical fees range from \$25 to \$50 per month.

Marketing and buyer-orientation. The extent to which a CLT controls the marketing of inclusionary units varies from program to program. In some cases the CLT may be *the*

entity that markets the units; in other cases it may have limited control or may share control with the developer and/or the subsidy source and/or professional realtors. In the case of scattered-site buyer-initiated programs, the CLT normally will not be actively involved in marketing condominium units but, as emphasized above, can and should screen the available units *and* the condominium projects in which they are located, and should communicate its assessment clearly to potential buyers. In any case, the CLT should play an active role in orienting, qualifying, and training buyers with regard to the terms of the covenant and the relationship with the CLT.

Matching buyers with appropriate condominiums. A municipality that creates inclusionary units may, in the process, influence the structure and policies of a particular condominium project, and a CLT, as the municipality's partner in preserving the affordability of these units, may have a degree of influence on the project. But this influence is likely to be limited at best. In its unit-by-unit condominium work, the CLT will be involved, as a general rule, not with shaping the projects in which the units are located, but with seeing that the homebuyers buy units in existing condominiums that will meet their needs and allow them to succeed as homeowners and as members of the community. This "matching" function is especially important with buyer-driven programs, where a variety of different condominiums may offer possibilities for CLT homebuyers.

In addition to the questions that CLTs must consider when matching buyers with any type of housing (affordability of initial price, number of bedrooms, location and availability of services, etc.), CLTs matching buyers with condominium units must also consider the affordability of monthly fees, the sufficiency and maintenance of common areas, the sufficiency of financial reserves and financial management practices, and the appropriateness of governance structures for inexperienced lower income unit-owners.

Assessing long-term affordability and marketability. An immediate concern will of course be the overall affordability of the unit – not only in terms of the purchase price but in terms of the ongoing monthly fees that must be paid to support the costs of maintaining the common elements of the condominium. It should also be recognized, however, that these monthly fees will increase over time to the extent that the association's operating costs increase.

In a condominium project where low-income households are a minority of the condo owners, there is a particular concern that the members of the association may vote to approve expensive improvements that would increase members' monthly costs beyond what the low-income members can afford. Before helping low-income people to buy units in a particular condominium, a CLT should review financial management practices, including actual reserve levels, and bylaws provisions in an effort to determine the likelihood and possible timing of fee increases, and should be sure that the incomes of purchasers will provide enough "cushion" to absorb possible increases.

Regarding resale, the CLT must concern itself not only with the future affordability of the unit for the intended income level but with its marketability in a range of different market conditions. (See the discussion of affordability and marketability in Chapter 18, "Project Planning and Pricing.")

If the CLT's involvement is through a "buyer-initiated program," then, before designating units as eligible for the program, the CLT should screen them to be sure they are appropriate in all respects – including probable future as well as present affordability

and marketability – for a reasonable range of households in the targeted income range. In the realm of “permanently affordable” homeownership, it is not enough simply to make the present match between a unit and one particular household.

Finally, as noted in the “Condominium Overview” above, the market values of condominium units tend to be more volatile than the values of single-family detached homes. When demand for condominium units slackens in a particular market, their value may drop significantly – perhaps eliminating much of the market advantage originally created by a subsidy. If a high percentage of a CLT’s holdings consists of condominium units, the organization can face serious problems in such a market situation. For CLTs working in very expensive markets, there may be little alternative to the condominium model as a means of providing affordable homeownership opportunities for lower income people, but CLTs that do have some choice regarding the ratio of condo to non-condo units in their portfolios may want to limit this ratio – or at least keep an eye on it – in order to limit their exposure to weak market conditions.

A Note on FHA-Insured Financing for Condominium Units

As is emphasized in the “Condominium Overview” above, the availability of FHA mortgage insurance for loans to condominium purchasers has played an important part in assuring lenders that loans for this new form of property are not unduly risky – even though the collateral is, physically, just a “box of air.” CLTs should be aware, however, that there have been some serious problems regarding the use of FHA-insured loans for the purchase of resale-restricted homes (as discussed in Chapter 20, “Financing CLT Homes”), both for conventional single-family homes and for condominiums. Possible solutions to these problems are currently being discussed between CLT Network personnel and FHA officials. For up-to-date information contact NCLTN.

ⁱ This chapter was drafted based on extensive input – through a number of conference calls – from a group of attorneys and practitioners working with CLTs that have experience with condominiums. The section entitled “Condominium Overview” was drafted by attorney Jeff Evans, a member of the group.