

# URBAN REVITALIZATION & RENT CONTROL IN THE DISTRICT OF COLUMBIA

by Chester C. McGuire

Two current themes in urban development are the spontaneous, private revitalization of central city neighborhoods and the renewed interest in rent control in some urban areas. These phenomena are not seemingly related, although some overlap arises from unintentional side effects of revitalization such as dislocation of poor residents, higher rents and condominium conversions.

Washington, D.C. has rent control and is also in the vanguard among cities in private neighborhood revitalization. Rent control in the District has existed only since 1974, so there is no long history from which to make definitive judgments.<sup>1</sup> However, a variety of noteworthy urban revitalization activities have occurred at the same time that rent controls have been institutionalized. What is the actual or likely impact of an active rent control program on the revitalization process? Can central city revitalization be sustained under the restrictive climate of rent control?

To determine the effects of rent control on revitalization activities, a sample of rent-controlled buildings was drawn from the files of the Rental Accommodations Office (RAO) of the District of Columbia. The sample was divided into buildings that had applied for certificates of eligibility to convert to condominiums (Table 1) and those that had not made such application (Table 2). The condo-eligibility

group was gathered from a list made available by the Condominium Office of the Housing and Community Development Department and the control group was selected at random from the files.<sup>2</sup>

## RENT CONTROL IN THE DISTRICT

Rent control in the District of Columbia dates from 1974. Current authorization is contained in the Rental Housing Act of 1977 which includes not only rent control provisions that affect the security of tenants and the sale, conversion and substantial rehabilitation of rental housing, but also a provision for relocation assistance and a rent supplement program.

The Rental Housing Act of 1977 requires that owners of all eligible property file an annual statement with the RAO. Buildings with four or less units or owners who have fewer than four rental units are exempt from the law. Other exemptions are for:

- All publicly-owned or publicly-subsidized housing.
- All new rental housing built after January 1, 1977.
- Dormitories, hospitals, and homes for the elderly.

The RAO determines rent ceilings, which are the highest legal rents that can be charged for a unit covered under the law. The base rent is essentially the rent that was chargeable on October 31, 1977, plus any authorized rent increases since then. Certain options are open to the landlord in raising rents based on operating costs. Landlords may file a hardship petition if the rate of return is lower than 8 percent or if the cash flow is negative.

## Rate Of Return Formula

The D.C. rent control law allows 8 percent return on investment, computed by allowing deductions of operating expenses, taxes and management

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**TABLE 1**

Selected Characteristics of  
a Sample of Rent-Controlled  
Apartment Buildings That Have Applied  
for Eligibility to Convert to Condominiums

Building Characteristics	Total	Condominiums		
		Conn./Mass. Wisc. Ave. Corridor	Capitol Hill	Adams-Morgan Shaw 16th St. Area
Units	90.3	102.1	63.8	93.6
Years owned	7.6	10.8	3.5	6.7
Percent owning other property	46%	60%	33%	39%
Percent filing petitions for				
a. ownership hardship	6%	4%	0	7%
b. tenant grievance	20%	16%	17%	22%
c. substantial rehab	16%	0	0	17%
<b>Operating Characteristics</b>				
Gross income	\$278,719	\$376,301	\$214,470	\$263,112
Operating expenses	134,624	176,480	97,616	128,592
% of gross income	48.3	46.9	45.5	48.8
Property tax	23,468	31,464	18,663	22,286
% of gross income	8.4	8.4	8.7	8.4
Management fee	12,477	17,401	4,619	12,066
% of gross income	4.5	4.6	2.1	4.6
Depreciation	19,453	25,682	14,992	18,654
% of gross income	6.9	6.8	6.9	7.1
Net income	88,694	125,274	78,579	81,513
% of gross income	31.8	33.9	36.6	30.9
Available % for debt service	108,148	150,956	93,571	100,166
% of gross income	38.8	40.1	43.6	38.1
Assessed value	1,290,937	1,628,979	1,088,667	1,261,724
Return on investment (%)	5.1	7.2	5.6	4.8
Gross income multiplier	4.63	4.32	5.07	4.80
Average monthly rent	257.22	307.13	280.13	234.25
<b>Number of cases</b>	90	25	6	59

fees plus 2 percent depreciation from gross rent. To arrive at the return the net rent is divided by the assessed valuation. District assessments are at full market value, and the rate of return formula has not been popular since it does not allow for debt service in the computation.

The D.C. formula is not the common method real estate investors use to calculate return since it does not consider leverage, which is common to real estate. The formula tends to underestimate the return by a factor of three or four since the actual investment (equity) is a fraction of the sale price. Offsetting this, however, is the omission of debt service. In the early years almost all the debt service is interest, which should be allowed as a proper business expense. If this were done, the profit margin would be considerably lower than that computed by the

D.C. formula.

The deficiencies in the D.C. rate of return formula are offsetting. The degree of bias is dependent on the relative weight of the cost of financing. For older properties with low interest loans and low debt service the formula would appear adequate, but would penalize properties with large mortgages at high interest.

Analysis of data from the building sample reveals that the allowed 8 percent return is not being earned. The return on the control group was only 3.9 percent and the return on the condo group was only 5.1 percent.<sup>3</sup> Regardless of deficiencies in the formula, the properties should be earning at least the allowed level. Earning at rates lower than allowed appears at odds with the profit-maximizing behavior assumed of real estate investors.

**TABLE 2**

Selected Characteristics of  
a Sample of Rent-Controlled  
Apartment Buildings in  
the District of Columbia

Building Characteristics	Selected Areas				
	Total	Conn./Mass. Wisc. Ave. Corridor	Capitol Hill	Adams-Morgan Shaw 16th St. Area	Rest of City
Units	19.6	13.8	9.2	28.0	17.7
Years owned	9.7	16.9	8.1	9.0	9.2
Percent owning other property	59%	20%	70%	51%	68%
Percent filing petitions for					
a. ownership hardship	8%	10%	10%	18%	2%
b. tenant grievance	13%	10%	0	18%	14%
c. substantial rehab	1%	0	0	3%	0
<b>Operating Characteristics</b>					
Gross income	\$ 43,402	\$ 29,567	\$ 15,275	\$ 51,614	\$ 45,921
Operating expenses	25,746	16,286	7,185	32,722	26,594
% of gross income	59.3	55.1	47.0	63.4	57.9
Property tax	3,419	3,214	1,247	3,904	3,551
% of gross income	7.9	10.9	8.2	7.5	7.7
Management fee	2,283	1,633	911	2,858	2,304
% of gross income	5.3	5.5	5.9	5.5	5.0
Depreciation	2,879	2,093	1,212	3,064	3,193
% of gross income	6.6	7.1	7.9	5.9	6.9
Net income	9,073	6,342	4,718	9,065	10,278
% of gross income	20.9	21.4	30.9	17.5	22.4
Available % for debt service	11,953	8,434	5,931	12,130	13,470
% of gross income	27.5	28.5	38.8	23.5	29.3
Assessed value	192,893	173,295	81,965	254,819	185,415
Return on investment (%)	3.9	3.1	6.6	2.8	4.2
Gross income multiplier	4.4	5.9	5.4	4.9	4.0
Average monthly rent	184.50	178.54	138.36	153.61	216.20
<b>Number of cases</b>	112	10	10	33	59

Source: District of Columbia, Rental Accommodations Office

To attain the 8 percent rate of return, rents would have to be raised in the condo-eligible group by 5.2 percent and in the control group by 14.6 percent. These increases would have to come on top of any inflationary increases in operating costs and taxes.

Four factors are likely to explain the low rates of return:

*High transaction costs* — Although owners may file a hardship petition when rent is below the allowed rate, they claim that the procedure is cumbersome and biased. Only prosperous owners can undertake the necessary and costly services of accountants and lawyers. Even when the process is

successful, no guarantee exists that prompt rent increases will be granted.

*Lag in rents* — Leases are arranged a year or more in advance. During an inflationary period costs usually will rise faster than the owner's ability to raise rents, since rents can only be adjusted upward at the end of the term.

*Turnover minimization* — Small landlords are prone to use the strategy of turnover minimization rather than profit maximization. In a small building one vacancy can take a terrific toll on cash flow. Landlords will try to keep established, dependable tenants, since it is better to get less

rent from a stable tenant than to have a period of vacancy at higher rent.

*Low equilibrium rent level in the city* — Returns may be low because the true market rent in the District may be low. Many low-income families in the District are renters, and low-rent units serve this market. The amount that tenants can afford to pay is independent of the rent-setting formula. The discrepancy between allowed and actual rent differs among buildings. For example, among the higher-rent buildings in the condo-eligible group, the discrepancy between allowed and actual rent is only 5.2 percent, but among the lower-rent buildings the discrepancy is 14.6 percent (Table 3). The latter have a much larger gap to overcome — a discrepancy not easily explained by the first three propositions.

Some truth exists to all four reasons for the shortfall in rents. Unfortunately, the data do not allow firm conclusions and the subject deserves more analysis. The fourth reason — low equilibrium rents — is most consistent with the profit-maximizing model of real estate investor behavior and is buttressed by the discrepancy in profitability along the lines of rent level.

**TABLE 3**

Return on Investment Deficit  
for Apartment Buildings in the  
District of Columbia

	Condominium Applicants	Other Buildings
Theoretically allowed 8% return on investment	\$103,274	\$15,431
Actual return	88,694	9,073
Deficit (total)	14,580	6,358
Deficit (per unit monthly)	13.45	27.03
Deficit as % of rent	5.2%	14.6%

Based upon the average return for the two samples

**Reduction Of Maintenance Under Rent Control**

Data substantiating reduction of maintenance are sketchy. Information from the Apartment and Office Building Association of Metropolitan Washington indicates that operating expenses as a percentage of income have increased.<sup>4</sup> Much of this increase is due to rises in costs such as utilities. Because of these complications, it is very difficult to make determinations revealing such operating experience before and after rent control.

The two groups of buildings — those applying for condominium conversion and those that have not — reveal some differences between them. The condo group had only 48 percent of the gross income going toward operating expenses, as opposed to 59 percent for the control group. The differences in absolute dollars on a per unit basis are not that great: the condo group spent an average of \$1,495 per unit, as opposed to \$1,313 per unit in the control group. On this account the buildings requesting permission to convert to condominium were more favorably endowed than the average apartment buildings in the District.

With the imposition of controls through 1979, the maximum allowed rent increases since 1972 have been 39.2 percent in the aggregate, which comes to less than 5 percent per year.<sup>5</sup> During this same time the Consumer Price Index increased by 88 percent or more than double the allowed rate of rent increases. If one looks at specific items, the picture is even more grim with:

- heating oil increases over 300 percent;
- electricity by 150 percent;
- natural gas by 90 percent; and
- sewer and water charges by 92 percent.

Since the imposition of controls, the classic situation of “squeeze” has been put on D.C. apartment owners. Although rent increases subject to justification by the landlord have been allowed, they have not made up for the general increases in operating costs.

Again in reference to the profit-maximizing model, it would appear that the likeliest impact of a revenue shortfall would be first on profits and then on operating expenses. The deficit cannot be made up entirely by reducing maintenance because that would reduce the level of housing services below optimum. To defer too much maintenance takes a toll on the structure, reducing its value and salability. But the deficit cannot be financed entirely by reduced profits, because this lowers the return on investment and, hence, the value of the building. The owner is in a difficult situation; the likely outcome is both reduced profits and reduced property value resulting from a lower level of housing services being offered. Tenants are also less well off since they continue to pay the same nominal rent for reduced services.

**Extending Loans Under Rent Control**

The reluctance of lenders to lend under rent control is a difficult allegation to test empirically. In a study that explored this hypothesis through a canvass of lenders in New Jersey, Gruen showed that some reluctance existed on the part of lenders to become involved in new projects after the imposition of rent control.<sup>6</sup> The experience, however, was not unanimous, and the results do not entirely support the hypothesis.

One problem in trying to gain a clear-cut answer is the fact that the amount of multifamily housing constructed in the District of Columbia since the imposition of rent control has declined, which is not entirely the result of rent control.<sup>7</sup>

Questioning the motivations of lenders is not as instructive as analyzing the amount of money available for debt service — one of the key ratios in apartment building operation. The maximum amount available is that left over after payment of expenses, which includes the profit margin plus the allowance for depreciation. This determines the absolute amount that is available for payment of mortgage debt or the ability to incur additional debt. Equally critical is the level of interest rates. The higher the interest rate, the less the amount that can be borrowed with a fixed amount available for debt service. At low interest rates a given amount available for debt service can support a much higher level of indebtedness than at high interest rates. This is illustrated in Table 4, which shows the debt-carrying capacity of the amount available for debt service in both the condo group and control group.

**TABLE 4**

Maximum Value of Loan Supportable by the Amount Available for Debt Service under Alternative Rates of Interest

	Interest Rates				
	5	8	10	12	15
Condominium applicants	104	82	71	63	52
Other buildings	77	61	53	46	39

Figures expressed as the loan-to-value ratio of the maximum amount that could be supported at those interest rates.

Debt service is not an allowed expense in the setting of rents. The amount available for debt service at any given time is fixed and this affects significantly the ability to sell or refinance a building. In the case of a sale the potential purchaser faces a limited amount of rent revenue, which cannot be changed regardless of his interest expense. The cash available for debt service may not support a significant loan if the building were to be sold. For example, the maximum loan available for the average control group building would be 46 percent of the building value when the rate of interest is 12 percent. At a 15 percent rate, which was common in the latter half of 1979, the loan-to-value ratio would be less than 40 percent. The situation is a little better in the building which

seeks eligibility for condominium conversion. Table 4 shows that at very low interest rates, which were common in the 1950s, the amount available for debt service is adequate. But based on the levels of interest rates common in the late 1970s, the amount available for debt service is grossly inadequate.

The principal consequence of the low amount available for debt service is that it affects the ability to sell and refinance properties. For example, there are three likely outcomes when D.C. rental property is put on the market:

1. A well-heeled buyer might purchase the property and put down more than half of the sale price as equity, since the amount available for debt service from the property will not support a loan of more than half its value. Considering the low rate of return on rental property, however, such buyers are likely to be in short supply.

2. The seller might take back a purchase money mortgage for a substantial portion of the selling price, which will effectively exhaust what normally would be the owner's capital gain in the building. The ability of the seller eventually to obtain full payment of the purchase money mortgage depends on the ability of the building's rents to pay off all indebtedness after expenses.

3. The sale might be consummated at a deep discount. Buyers will calculate their bid prices based on current yields, which will tend to depress the sale price. Evidence from the building sample demonstrates that the value is already low as a percentage of income based on normal rules of thumb.

### Erosion Of Tax Base

New York City frequently has been cited as an example of the fiscal consequences of rent control.<sup>8</sup> One reason for its fiscal crisis was that rent control had suppressed the value of real estate. Since more than 70 percent of the city's housing stock was in apartments, depressing the value of rental property through rent control had disastrous fiscal consequences. Also, a study of Cambridge, Massachusetts, showed that rent control caused a reduction in the city's tax base.<sup>9</sup>

For Washington, D.C., the subject of the shift in tax from apartment owners to homeowners (as the buildings were converted) is worthy of some consideration although no definitive study of the shifting tax incidence has been made. The evidence is sketchy and inferences can be made only from bits and pieces of information. The data from the two groups in the sample do provide some insight, however.

The valuation of buildings as rental property appears to be low in terms of their income. The gross income multiplier, expressed in terms of assessed valuation, is relatively low: only 4.4 for the control group and 5.1

for the condo group. Generally the gross income multiplier should be somewhat higher, in the range of 6 or 7.<sup>10</sup> One caveat is that assessed values used may not always match actual market values, so that there may be some bias.

Considerable room for error exists in appraising properties for tax assessment purposes. In a rising market assessed values may tend to lag behind market values; in a falling market, the reverse is true. The direction of bias can be estimated if the direction of the market is known. For example, in the District the direction of market values in the single-family sector is up, with most properties appreciating in value. This trend has been substantiated by the D.C. assessor. However, there has been no comparable systematic study of property values in the multi-family stock and many opinions are offered as to whether apartment houses are rising or falling in value. Conversations with appraisers in the assessor's office give the impression that any bias in the estimation of value among apartments is toward the low side, that is, assessed value is below market, but this has not been proved.

In this analysis the issue of the degree of bias in assessed value is important but not critical. If assessed values are below market values, the return calculated is too high. Conversely, if assessed values are higher than market value, then calculated returns are too low, which is the most critical. If assessed values are 20 percent above market, then the average return on investment rises from 3.9 percent to 5.8 percent, still well below the allowed 8 percent. Therefore, the conclusions are not sensitive to substantial errors in the assessment of value for property tax purposes.

One would have to conclude that valuation of rental property as a percentage of its income is on the low side compared with real estate investment in general. These are low rates of return compared with what real estate investors normally desire. Based on this evidence it would appear that multifamily values in the District are lower than what they would be in the absence of rent control.

Without the ability to raise rents as warranted by increases in operating expenses, many property owners have applied for reductions in their assessments. Many reductions have been sustained because of the diminished income capacity of the buildings. In these specific instances the decline in value of apartment buildings does lower the tax roll.

### **Inhibition Of Rehabilitation**

All housing at some time or another requires major renovation to sustain a certain level of housing services. Certain subsystems, such as the heating plant, electrical wiring, roof and other features, will need periodic replacement.

A landlord contemplating a major investment in an existing apartment building does so on the basis that

the investment will yield a return commensurate with other investment opportunities. Substantial rehabilitation of a building will probably require raising rents to compensate for the increased investment. If the required increases can be passed on to tenants in the form of higher rent, the investment will make economic sense.

Substantial rehabilitation is defined in the Rent Control Act as improvements or renovations that cost 50 percent or more of the assessed value. To engage in substantial rehabilitation the landlord must first petition the RAO for approval, a process which consists of examining the proposed rehabilitation plans so the RAO can determine the appropriate rental ceiling after the rehabilitation has been done. After permission has been obtained the new rent can be a maximum of 125 percent above the pre-rehab rent.

Of those properties seeking certificates of eligibility for conversion, 16 percent had also submitted petitions for substantial rehabilitation. Among the control group, where the rate of return is lower, only 1 percent — an extremely low percentage — had submitted petitions for substantial rehab. Substantial private rehabilitation among rent-controlled buildings is not occurring.

## **CONDOMINIUM CONVERSION**

### **Issues**

In the area of multifamily revitalization the most contentious issue is condominium conversion, which raises the ire of renters, politicians, and owners. Statistics on condominium conversion show that although substantial, it is not the widespread phenomenon portrayed. For the nation as a whole the number of multifamily units built as condominiums averages approximately 10 percent to 20 percent of the total.<sup>11</sup> Conversion of the existing rental stock to condominiums is a localized issue that varies from city to city.

One reason often stated for the conversion to condominiums is the deteriorating economic situation of apartment buildings under rent control. It cannot be the only reason because in some cities without rent control the conversion is proceeding as rapidly as in D.C. Chicago leads in the number of condominium conversions with an estimated 35,000.<sup>12</sup> However, the conversion of condominiums in Chicago has tended to be localized in large buildings near the lakefront. Condominiums are not generally found at random throughout the city, although apartment buildings are certainly in every area.

Condominium conversion became a political issue in D.C. because of the large number of landlords who expressed intention to convert their buildings. In an attempt to deal with a perceived problem, the city has had moratoria, which have been on-again-off-

again. As of December 1978 the District had approximately 8,000 apartments that had been built as or converted to condominiums.<sup>13</sup> In addition, landlords had applied for eligibility to convert an additional 14,642 apartment units. The potential for condominiums in the District was approximately 12 percent of the existing multifamily units.<sup>14</sup> Many citizens became alarmed and felt this might be a trend leading to a significant reduction in the rental stock in the District.

To convert rental units to condominiums the District's Condominium Act of 1976 requires that:

- The unit being converted is a high-rent accommodation;
- A majority of the tenants agrees to the conversion; or
- The vacancy rate in the District for non-high rent accommodations is above 3 percent.

Prior to conversion landlords are required to give 120 days written notice to tenants, who must be given right of first refusal to purchase. Relocation assistance as required by the law must be made available to displaced tenants.

### **Condo Locations**

Although there are concentrations of apartment buildings throughout the city, since 70 percent of all the households in the District rent, condominium conversions are not scattered at random across the city. Rather, more than 90 percent of all actual conversions and requests for eligibility to convert are concentrated in three relatively well-defined sections of the city, in the northwest quadrant radiating out along major arteries. The first major concentration of condominium conversions is the area along Wisconsin and Connecticut Avenue, characterized by many large apartment buildings in a relatively affluent part of the city. The second area occurs in what is loosely defined as the Capitol Hill area, a neighborhood that surrounds the Capitol, the Library of Congress, and the Supreme Court. Its boundaries are undefined but seem to enlarge every year due to its popularity. In the Capitol Hill neighborhood, buildings tend to be the smaller, walk-up variety. The third area of concentration is loosely referred to as the Shaw-Adams-Morgan-16th Street area, which emanates from the central business district in a northward direction and is characterized by many large apartment complexes.

### **Economics Of Condo Conversion**

Are the condo group buildings different from other apartment buildings in the city? When the condo group sample is compared with the control group, it becomes apparent that those seeking to convert are significantly different from the ordinary apartment buildings in the District. One outstanding characteristic is that they are the largest of the apartment

buildings, with an average size of more than 90 units, compared with a citywide average of less than 20 units per complex. They also have significantly higher rentals, with an average monthly rent of \$257 versus \$184 for the control group. In terms of assessed valuation the condo group was assessed at more than six times the average of buildings in the control group.

The condo group buildings are also more profitable than other apartment buildings in the city. The average rate of return on investment was 5.1 percent for the condominium sample as opposed to 3.9 percent for the control group. Among the condo group the highest returns were found among the large apartment buildings in the Wisconsin-Connecticut Avenue corridor.

The Apartment and Office Building Association of Metropolitan Washington maintains an experience exchange of apartments in the city. The condominium buildings in northwest Washington compared favorably with the AOBA sample and appeared to be more profitable.<sup>15</sup> Thus, the condominium conversion cannot rest entirely on a lack of profitability since these buildings tend to be more profitable on the whole than all of the other apartment buildings scattered throughout the city. Factors other than lack of profitability are at work as incentives in condominium conversion. Were the sole incentive the squeeze between income and expenses brought on by rent control, then one would expect that more buildings that had lower rates of return in other parts of the city would be seeking to convert.

A better understanding of the incentive for owners to convert from rentals to condominiums and the desire for tenants to have the building remain rental, can be gained from looking at the basic economics of the situation. There is a change both in value and in ownership and tenure once a rental building is converted to condominium.

The basic economic framework in a conversion is shown in Table 5. In 1978 the average assessed valuation per unit was \$14,296 in those buildings seeking to change their status. When such a building changes hands to a condominium converter, the price is likely to be higher than the assessed valuation if the building is otherwise eligible for condominium conversion. The exchange value is likely to be in the neighborhood of \$25,000 per unit. The converter will face expenses for recording, settlement costs and sale commissions, which historically have been on the average of \$5,000 per unit. Depending on the state of the building, the conversion process is usually accompanied by some amount of rehabilitation. Minimum rehabilitation usually will include putting in new appliances and floor coverings, repainting and refurbishing the landscape and common areas. Such refurbishment usually will run from \$5,000 to \$10,000, most likely tending toward the high

side. The converter must add in his own markup to cover his costs including interest and payment for his own time.

**TABLE 5**

Economic Factors in a  
Typical Condominium Conversion

<b>Landlord's view:</b>	
Value as rental property (per unit)	\$15,000
<b>Developer's view:</b>	
Sales price to condominium developer	\$25,000
Expenses to refurbish/rehabilitate	10,000
Settlement costs and commission	5,000
Developer's markup	20,000
Sales price as condominium	60,000
Interest expense to developer	6,000
Margin to developer	14,000
Less taxes	7,000
Net margin to developer	7,000
<b>Tenant's view:</b>	
Current apartment rent (per month)	\$250-300
Price as condominium	60,000
Downpayment on condominium (20%)	12,000
Monthly mortgage payment (20 years, 80% of value, 12% rate)	\$ 450
Property taxes (per month)	100
Condominium fee (per month)	150
Total occupancy cost (per month)	700

The most significant cost is interest expense. In the hypothetical conversion as described and shown in Table 5, the converter would have invested approximately \$40,000 per unit. At an interest rate of 15 percent per annum, holding cost would amount to \$6,000. If the holding period lasts longer than one year, the interest expense would go up accordingly. In this example the converter is left with a margin of \$14,000 after payment of interest costs. Assuming that the converter is in the 50 percent tax bracket, his profit on the conversion would be \$7,000. Given the risk involved in these kinds of transactions, this does not appear unreasonable.

Because of the high interest costs involved the converter will desire as many existing tenants as possible to stay on as condominium owners. Since he will do well if 50 percent stay on, he will usually offer them substantial incentives including discounts on the sale price.<sup>16</sup>

The incentives for existing tenants to remain after a building has become a condominium are often difficult for the tenant to see. Consider again the hypothetical example: the rent in the average building that is likely to be converted is in the range of \$250 to \$300 per month. The economics of condominium conversion as outlined would result in a selling price for the finished unit in the neighborhood of \$60,000.<sup>17</sup> From the standpoint of the purchaser a mortgage for 80 percent of value at an interest rate of 12 percent with terms of 20 years would result in a monthly payment of \$450. To this must be added the property tax which would be approximately \$100 per month. The property tax would be based upon the current sale price of \$60,000 rather than the average value as a rental which is approximately \$15,000. As a result property taxes would increase three- to four-fold. In addition, there is the condominium fee in the range of \$150 per month which covers the common areas, some utilities and services.

The conversion has increased the occupancy cost to a condominium owner to more than double the former rent of \$250 to \$300. The unit is essentially the same as a condominium as it was as a rental. Although there will probably be some upgrading, the address is the same.

Even with an increase through conversion in the price of the accommodations, it may be attractive as a condominium to some of the existing tenants. Those in high tax brackets can enjoy the benefit of writing off a considerable portion of the monthly cost by deducting interest and property taxes. In addition, there is the possibility of appreciation offering a substantial return. If property is appreciating at 5 percent to 15 percent per annum, the combination of tax deductibility and price appreciation may make the decision to remain as a condominium owner a sound one.

Consider again the hypothetical example in Table 5. A condominium owner in the 50 percent tax bracket would have after-tax expenses of \$420 per month as opposed to pretax expenses of \$700. The after-tax difference between owning and renting is approximately \$120 to \$170 per month. However, the condominium probably would be appreciating and in this case, would have to appreciate at the rate of 8 percent per annum to recover the initial outlay of \$12,000 plus the monthly deficit in five years. During the 1970s, condominiums and other properties in the District appreciated at rates above 8 percent. Given these assumptions, the step from renter to condominium owner would be sound.

Those tenants who do not have the high income to take advantage of the tax shelter, the downpayment required, and/or the faith in the continued price appreciation in condominiums may find that it is not a good deal to remain once the building is converted. They may be better off paying \$250 to \$300 per month rent elsewhere rather than facing a \$700 monthly payment on a condominium, regardless of tax benefits. They have a tremendous incentive to delay or thwart such a conversion. In this case the economics of the situation are straightforward and so are the politics.

#### NOTES

1. The rent control law is administered by the Rental Accommodations Office (RAO), which has a board and a staff.

2. The data were gathered from the files of the Rental Accommodations Office (RAO). A list of all apartment buildings in which the owner has applied to convert to condominium is maintained by the Department of Housing and Community Development. The condo sample contains most of the buildings on that list. Some of the buildings on the list were not included because the most current statement was not in the RAO files at the time, since they were in use, being processed or being refiled; or the information in the file was incomplete at that time, contained ambiguous entries, or was otherwise difficult to interpret clearly. The control group sample was obtained by selecting at random one or more properties in each file of the individual file drawers, which are maintained by the quadrant of the city and street address. This assured coverage of the entire city.

3. The difference in the mean values for the return on investment between the two samples is significant at the .05 level using a one-tailed test for the distribution of  $t$ .

4. Apartment and Office Building Association of Metropolitan Washington, *AOBA Information: Experience Exchange*, 1976.

5. Rent controls were imposed nationwide in 1971 as part of the Nixon Administration's wage and price controls and were lifted in 1973. The D.C. rent control went into effect in 1974 but rents were rolled back to their 1973 level.

6. Gruen, Gruen Associates, *Rent Control in New Jersey: The Beginnings*, consultant report prepared for the California Housing Council, Sacramento, California, 1977.

7. U.S. General Accounting Office, *Rental Housing: A National Problem that Needs Immediate Attention*, Washington, D.C., November 8, 1979.

8. Frank S. Kristof, Temporary Commission on City Finance, *The Effects of Rent Control and Assessed Valuations for Ad Valorem Taxation*, Fifteenth Interim Report to the Mayor by the Temporary Commission on City Finance, June 1977.

9. Charles R. Lavery, Jr., *Rent Control Highlights: Effect on Property Valuations and Assessed Valuations for Ad Valorem Taxation, or a Probable Predicament*, mimeographed, Cambridge, Massachusetts, October 1976.

10. The concept of the gross income multiplier is common in real estate as a handy valuation device. However, there is no rigorous definition of the appropriate level for the GIM. Because of the current uncertainty in the rental market, a consensus is not easy to obtain. But during this research it became evident that knowledgeable appraisers believe that a GIM of 6 is adequate for well-situated properties of good quality. At the other end of the spectrum, Sternlieb found that the GIM for slum properties was in the range of 1 to 2. Refer to: George Sternlieb, *The Tenement Landlord* (East Brunswick, N.J.: Rutgers University Press, 1966).

11. Between 1975 and 1978 condominium and cooperative apartments accounted for 18 percent of all housing of five or more units. U.S. Department of Commerce, *Current Housing Reports, Market Absorption of Apartments*, H-130-79-Q1, June 1979.

12. Shlaes & Co., *Condominium Conversions in Chicago: Facts and Issues*, Chicago, 1979.

13. Development Economics Group, *Condominium and Cooperative Conversions in the District of Columbia*, Washington, D.C., 1979.

14. According to the D.C. Housing and Community Development Department, there were approximately 8,000 condominiums in the city as of year-end 1979. Data from the *Annual Housing Survey: 1974* (U.S. Bureau of the Census, *Current Housing Reports*, Series H-170-74-18, Housing Characteristics for Selected Metropolitan Areas: Washington, D.C. — Maryland — Virginia SMSA) show a total of 134,900 housing units in buildings of five or more units.

15. AOBA, *loc. cit.*

16. Specific data on condominiums in D.C. are contained in the Development Economics Group study already referenced.

17. Development Economics Group, *loc. cit.*