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Buyers Scarce, Many Condos Are for Rent

By VIKAS BAJAJ

Correction Appended

WASHINGTON — David Franco's illuminated model of a proposed 10-story condominium tower dominates a sales center that, in spite of the "Now Selling" banner still fluttering outside, is conspicuously closed for business.

"We could have waited it out and kept pushing and pushing," Mr. Franco said about the decision to abandon plans to sell 180 luxury condominiums with floor-to-ceiling windows offering views of the Washington Monument and Capitol Hill. "But it would have taken significantly longer."

After six weeks of failing to lure more than a couple of dozen buyers, Mr. Franco and his partner, Jeff Blum, joined the builders of nearly 6,000 condominium units in the Washington metropolitan area who have decided in the last three months to recast their projects as rental apartment buildings.

Since the middle of 2006, the frenzied condominium market here and in several other big cities like Las Vegas, Miami and Boston has collapsed. Once roaring sales have slowed to a trickle, sparse inventory has mushroomed into a glut and soaring prices have flattened out and started falling.

In many cities, banks have significantly scaled back loans to condominium builders. Some have demanded that developers sell half or more of the units in a building before even beginning construction.

In hopes of salvaging something from their costly plans, hundreds of developers like Mr. Franco are looking to the strong market for apartments, planning to rent their units for at least a couple of years while waiting for today's condo surplus to shrink. Mr. Franco and Mr. Blum hope to break ground on what will be a somewhat less expensive building this spring.

In some cases, developers are even turning older buildings back to rentals after a brief or

aborted attempt at condo conversion. Meanwhile, another 2,500 proposed condominiums in the Washington area have been scrapped altogether, according to Delta Associates, a real estate research firm.

The latest salvage operation on the part of condo developers is far from a sure bet, however. Condominium buildings generally cost more to build and operate than those built for apartments from scratch. And while rents are high and rising in most cities, in many cases they still are not sufficient to turn a profit.

Industry analysts also point out that rents may start sagging if too many condos are converted into apartments too quickly. While rents were rising at a robust 6.1 percent annual pace in the Washington area late last year, according to the Bureau of Labor Statistics, some buildings in the suburbs have recently started promoting move-in specials and other incentives to lure renters.

“You can do it, but it isn’t as attractive,” Tom Meagher, a Boston real estate consultant, said about converting condos into apartments. “You are not going to get enough rent to cover the cost. You might have to go back and redesign the floor plans.”

In the Boston area, Mr. Meagher is tracking 600 condo projects representing about 49,000 units in various stages, from applying for permits to active construction. While the recent slowdown is forcing developers to consider converting their projects to apartments and offices, he expects as many as a third of them will never be built at all.

Mr. Franco said that he and Mr. Blum were able to cut 10 percent from the costs of their planned building, on land in the trendy U Street corridor. That should be enough to make a profit, he said. Beyond switching to some less expensive materials, they also decided to subdivide some larger units into smaller apartments.

The partners are now going through a similar financial exercise on another proposed building across the street, which was to house 225 condominiums but now could be recast as a rental building as well.

Lenders started tightening the purse strings for the condominium market in early 2006 as sales weakened first in cities like Miami and Las Vegas.

“Did the lenders pull back soon enough?” asked Robert Brennan, managing director of real estate finance at Credit Suisse in New York. “I don’t think we know yet.”

Real estate experts say condos are more susceptible to booms and busts than single-family homes are because they attract more investors who do not intend to live in them and are easier to build than a new subdivision in many cities.

And while there are tentative signs that the worst of the overall housing slump may be easing as builders cut back and interest rates remain relatively modest, condo markets continue to suffer.

Take the owner trying to sell a spacious two-bedroom condo for \$879,000 in the former Columbia Hospital for Women, which closed in 2002, in the Foggy Bottom neighborhood of Washington. In 2004, the investor was so confident that he would make a handsome resale profit that he told his agent, Thomas P. Murphy, he wanted to buy five condos. Mr. Murphy said he flatly told his client he would only assist him in purchasing one unit in any one building.

"He needs \$890,000 to break even, but the offers are at \$800,000 to \$840,000," Mr. Murphy said. "He does remember that I told him he was not getting five of them."

Could he rent the condo? Yes, but that option is not appealing, either. Mr. Murphy estimates that the unit could rent for \$4,000 a month, far short of the \$6,800 a month the condo costs in mortgage interest, maintenance fees, insurance and taxes.

"They have a choice of how they want to lose it," Mr. Murphy said of investors and condo developers. "Drip by drip or in one slap."

Mr. Murphy said he believed condo sales had picked up somewhat lately and he even ran a four-way bidding contest on one well-priced condo in Foggy Bottom, near the State Department. But the supply of newly built condos is so large and so many of them are similar to each other that many sellers are having to sharply cut their asking price. Others have simply given up.

At the end of 2006, 24,200 units were on the market in the Washington area, up from 13,000 at the start of 2005. Sales have slowed to 663 in the fourth quarter of 2006 from 3,520 in the first quarter of 2005, according to Delta Associates. Recorded prices have been flat, which probably masks an effective decline since only the most attractive properties are selling and many owners throw in extra inducements that do not show up in official figures.

One of the few exceptions to the trend is in Manhattan, particularly at the high end. Condo and co-op sales increased to 2,441 in the fourth quarter, from 1,574 a year ago, and inventory was

relatively flat at 5,900, said Jonathan J. Miller, an appraiser. Much of the increase can be attributed to a legal change in how sales of co-ops are recorded, but Mr. Miller said a 5.5 percent drop in prices from the third quarter also helped.

Nationally, condominium sales have fallen further than those of single-family properties, 13.6 percent from November 2005 to the same month in 2006; free-standing homes showed a 10.7 percent decline in the same period. Inventories have risen 38.1 percent for condos and 29.6 percent for individual homes, according to the National Association of Realtors. The national median price — half the condos sold for more and half for less — was \$224,600 in November, unchanged from November 2005.

But there is no comprehensive, national source of data for new condominiums sales. The Realtors group only measures sales of existing units and the Commerce Department, which tracks sales of new single-family homes, does not collect data on condominiums.

In the recent housing boom, many cities welcomed condos, hoping the young, upper-income set they attract would help revitalize older neighborhoods. In some cities, condominium construction also gave municipal officials an opportunity to demand that developers set aside some units for affordable housing in exchange for zoning and building approvals.

In Washington, the area around 14th and U Streets was one of several formerly run-down neighborhoods to get a facelift largely from new condo projects. The area was once a hub of African-American civic and cultural life, but the neighborhood was ravaged by riots in 1968 after Martin Luther King Jr.'s assassination and fell into decades of neglect and disrepair.

The area has now become home to trendy cafes, a Whole Foods grocery and other stores. But signs of its hardscrabble past linger on in dilapidated apartment buildings and storefronts. The influx of transplants from nearby Dupont Circle and Adams Morgan has also raised the usual strains that accompany gentrification — rising rents, increased traffic and the displacement of local residents.

Mr. Franco, who lives in the neighborhood, said he was sensitive to those concerns. His company, Level 2 Development, contributed \$1 million to help a group of tenants in low-income apartments buy their building as part of a deal with the local government for the approval of his condo project.

He had hoped to take up residence in a 3,200-square-foot corner unit with an expansive terrace, which will now be cut up into smaller rental apartments.

But as he drove around the neighborhood recently pointing out rows of redeveloped buildings, he acknowledged that the market might have reached its limit for now. As an example, he pointed to a used car lot that seemed to be a vestige of a bygone era.

“The reality is not everything can make way for condos,” Mr. Franco said. “This guy may be doing so much business that it has far more value than what a real estate sale can fetch.”

Correction: January 19, 2007

A chart on Tuesday with the continuation of a front-page article about the slowdown in the condominium market mislabeled the top line of the scale showing the number of condos for sale. It is 25,000, not 30,000. A corrected graphic can be found online.

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