



I.3. UNDERSTANDING BERKELEY'S CONDOMINIUM CONVERSION HOUSING MITIGATION FEE

Housing Department
Community Services and Administration Division

About the Mitigation Fee and City of Berkeley Housing Policy

Condominium conversion is the process of subdividing a multi-unit property into separately owned housing units. Subdivisions are regulated under the California Subdivision Map Act and Subdivided Lands Act. State law also allows local government to impose additional requirements. In Berkeley, these additional requirements are found in the Condominium Conversion Ordinance (CCO, Berkeley Municipal Code [BMC] Chapter 21.28 *et seq.*). Until 2005, the CCO prohibited conversion of rental units to Tenancy in Common (TIC) ownership. Because condominium units typically have a higher market value than rental units or TICs, it has an overall effect on the affordability of the City's housing stock. To mitigate this impact, since 1992, the City of Berkeley has imposed a housing mitigation fee. Revenues from the fee accrue to the Berkeley Housing Trust Fund to help finance construction and rehabilitation of permanently affordable housing in Berkeley. Between 1992 and 2005, this mitigation fee recaptured the entire difference in affordability that resulted from conversion. This had the effect of discouraging conversions.

In 2005, the state Court of Appeal held that cities could not prohibit conversion of rental units to TICs. Since then, the City has sought to encourage conversion of rental units to condominiums rather than TICs because of difficulties that can arise for people who invest in TIC properties. It has done so by imposing a cap on the affordable housing mitigation fee charged for conversion to condominiums.

In addition, Berkeley's affordable housing mitigation fee is designed to encourage property owners to extend protections to their tenants. Owners providing additional tenant protections specified in the CCO receive a substantial decrease in the amount of the affordable housing mitigation fee.

Exemptions from the Mitigation Fee

There is only one exemption under the Berkeley CCO.

- ✓ **Inclusionary housing units provided on site in multi-unit properties built since 1987** are exempt from the affordable housing mitigation fee, because these units provide permanently affordable housing opportunities. However only the inclusionary units are exempt from the affordable housing mitigation fee.

All other multi-unit properties are subject to the CCO's affordable housing mitigation fee provisions.

Two Mitigation Fee Formulæ

There are two mitigation fee formulæ in the CCO.

- ✓ **Nexus-Based Affordable Housing Mitigation Fee** (BMC 21.28.070.A) is intended to mitigate the entire loss of affordability that results from conversion of rental units to condominium units. The fee is calculated by dividing the difference between the

costs of owning the unit as a condominium less the rental costs by the current fixed mortgage rate. If a unit is an owner-occupied TIC unit, the CCO specifies how rental costs are to be calculated.

- ✓ **Affordable Housing Mitigation Fee Cap** (BMC 12.28.080) provides fee reductions to converters who agree to limit future rent increases for the life of the property to any resident tenant at the time of conversion to no more than 65% of the increase in the Consumer Price Index for all Bay Area Consumers. If a converter commits to that rent limitation, the affordable housing mitigation fee is capped at 8% of the sale price, or 4% for 2-unit properties.

Example of first formula:

Rental Costs = \$1,500 per month x 12 months/year = \$18,000 annually

Ownership Cost (including principal, interest, taxes, insurance, and homeowners' association dues) = \$2,700 per month x 12 = \$32,400

Assume a mortgage rate of 6.5 percent.

Increased housing cost due to ownership conversion of the unit = \$32,400 - \$18,000 = \$14,400

Mitigation Fee = \$14,400/0.065 = \$221,538

Example of second formula:

Assume a condominium unit you created through conversion has sold for \$400,000, and you've agreed to limit rents to existing or future tenants.

Mitigation fee = 8% x \$400,000 = \$32,000.

Understanding Mitigation Fee Reductions

The 8% cap is subject to the following additional reductions::

- ✓ **Duplex units** are subject to a cap of 4% of the sales price for each unit.
- ✓ **An owner occupant** in a property containing three or more units who has occupied the unit as his or her principal place of residence, including as a tenant, for at least 5 consecutive years immediately prior to the date of sale is eligible for a 50% fee reduction, **but only if the owner owned and resided in the unit as of June 30, 2010.** This reduction applies to both the full fee or the 8% cap, whichever is otherwise applicable.
- ✓ **An additional 25% fee reduction** is available to converters who pay the fee no later than the date of conversion. This reduction also applies to both the full fee or the 8% cap, whichever is otherwise applicable, and is in addition to any other reduction.

Election of Fee Regulations

Applicants with applications pending before the City as of March 24, 2009, may elect to pay the affordable housing mitigation fee in effect as of March 24, 2009, or as it was between August 16, 2007 and March 23, 2009 so long as the City has not taken final action approving a parcel map or final subdivision map no later than December 31, 2012. An application is considered

“pending” if the applicant has submitted and paid fees for either Local Law Compliance or the main Condominium Conversion Application/Map Application prior to March 24, 2009.

How will the City collect the mitigation fee?

In drafting the three mitigation fee documents (promissory note, deed of trust, and conversion agreement), the City will prepare an estimated fee that is based on either a prorated value for each unit based on the price at which you originally purchased the entire property as reported by the Alameda County Assessor's office, an analysis of sales price for comparable units, or some other mutually agreed upon basis for estimating the fee.

The fee estimate is done for three reasons.

- ✓ To determine whether you are exempt from the fee
- ✓ To determine whether you are eligible for fee reductions
- ✓ To generate an estimate of the entire mitigation fee for the property for inclusion in the promissory note and the deed of trust.

It is only at the time of sale of each that your actual mitigation fee is finally calculated for determining your fee payment, unless you elect to pay the fee up front (see below).

To complete your condominium conversion, the City will issue escrow instructions to your title company that will accompany your new subdivision map, condominium plan and CC&Rs, along with three documents that implement the City's mitigation fee: a promissory note, a deed of trust, and a conversion agreement. You will sign these documents through your title company. City escrow instructions will tell your title company the order in which to record your Subdivision Map, followed by its plan, CC&Rs, and your deed of trust and conversion agreement. You will execute the promissory note also through the title company, but the note will be returned to the City directly. Once recorded, the City will receive a copy of the deed of trust and conversion agreement from the County and will retain them in your property file in the Housing Department.

At the time you sell your unit, your realtor, or the realtor for your buyer will obtain a title report that discloses the conversion agreement and as part of your escrow process, you will be in touch with the City of Berkeley to arrange final calculation of your fee based on the sale price. The fee should be paid to the “City of Berkeley Housing Department” as part of any and all disbursements from escrow. Payment of the fee is **not** triggered by transfer of an owner-occupied TIC unit from the TIC to that owner-occupant.

Paying the Mitigation Fee Up Front

You may choose to take advantage of the additional 25% prepayment reduction by paying the affordable housing mitigation fee no later than the date of conversion (BMC Section 21.28.080.D). To pursue this alternative, you must obtain an appraisal from a Certified Residential Appraiser licensed by the California Office of Real Estate Appraisers, who will be instructed to appraise your property as a condominium. The affordable housing fee will be based on the appraised value of the unit, subject to the 25% reduction.

How do I document that I owned and occupied my property for purposes of claiming a fee reduction?

The City of Berkeley Housing Department will recognize a variety of personal and public records in making a determination of your eligibility to claim the owner/occupant fee reduction.

Record Keeping for Demonstrating Occupancy of the Converting Unit	
Tax Records	<ul style="list-style-type: none">• Property tax records, especially bills from Alameda County indicating you claimed the homeowner's exemption for the property.• Records indicating you filed your income taxes from the unit you own and live in.
Utility Records	<ul style="list-style-type: none">• Phone bills from as far back as you have retained.• PG&E bills from as far back as you have retained.• City of Berkeley refuse collection bills from as far back as you have retained.
Other Records	<ul style="list-style-type: none">• Rent Board information indicating you were a tenant in the unit.• Other evidence that reasonably proves you used the unit as your principal place of residence during the time in question.• Rent Board information indicating your property had been owner-occupied and/or occupied rent-free.

For More Information

You may consult the Berkeley Planning and Development Department web site at <http://www.cityofberkeley.info/ContentDisplay.aspx?id=794>.