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'05 condo conversion boom offers buyers more variety than '70s wave

by Gail Lissner 10/16/05 | Updated 3/21/06

During 1979, the height of condomania in the Windy City, nearly 4,800 rental apartments were converted to condominiums in downtown Chicago. That was double the number of conversions recorded in any year before or since – until now.

While Chicago won't break the record it set in 1979 this year, Appraisal Research Counselors expects that more than 4,000 rental units – most already announced and in marketing programs – will convert to condos downtown during 2005.

This year will be another peak for a trend that began here in the '60s but didn't really take off until the mid-'70s. It was during that decade that developers found a ready market of renters opting to purchase their units at the time of conversion.

Back then, virtually all downtown conversions were located in the Gold Coast. Though the early days of Chicago conversions may not seem so long ago, submarkets such as River North, the Loop, the South Loop and the West Loop had yet to develop as residential locations.

River North is one of the best examples. During the '70s, the sparse blocks just north of the Loop and west of the Magnificent Mile showed no hint of becoming a residential neighborhood. Today, massive residential development has been added to the area's mix of restaurants, offices and art galleries, and River North is home to the great bulk of downtown Chicago's 2005 conversion activity.

In the 1970s, the best conversion candidates were well located, well maintained and well occupied, with a large number of long-term residents. Of course, high rents and an affluent resident profile were the icing on the cake. As the market matured and the best buildings converted, though, developers moved on to the second and then third tier buildings. Their criteria for what was "convertible" quickly morphed when these lesser quality buildings proved successful.

How times have changed. Today, it's often the newest and most luxurious rental buildings that are tapped for conversion. In the latest crop of conversions, buyers aren't facing towers that are 10, 20 or more than 30 years old. Instead, they're perusing the likes of 400 North LaSalle, Grand Plaza West Tower, Park Millennium and 2 East Erie – all

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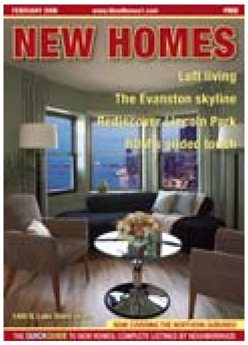

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fewer than five years old.

The conversion of such luxury, "Class A" rental buildings in the downtown market means two things: a possible shortage of luxury rental product in 2005 and prices for converted units that are similar to those for new-construction condominiums.

At the other end of the price spectrum, very small, modest units also are being converted. Both 1400 N. Lake Shore Drive and 1140 N. LaSalle are vintage buildings with extremely small units, and are appealing to buyers who want these locations at competitive price points.

Renters in these and other conversions who don't want to buy have more options than their counterparts 30 years ago. As condo conversions accelerated in the '70s, a growing number of renters bought their units, spurred by a shrinking number of good alternatives in the rental market. Resident retention rates (the number of tenants in a building that developers turn into owners during conversion) had hovered around 20 percent of units. It began to climb in the '70s and reached a record high near the end of the decade when the 1000 N. Lake Shore Plaza conversion saw an astounding retention rate of 88 percent.

Why so high? Renters truly did not have any comparable alternatives to the large condo-like units in which they lived. Too many of the best rental buildings already had gone condo, shrinking the supply of downtown apartments. Residents who wanted to stay in the area had to buy – or move to a rental that would almost certainly be a step down on the housing ladder.

The 88 percent retention rate at 1000 N. Lake Shore Plaza remains a record and is unlikely to be broken in the current conversion wave. During recent years, around 10 to 25 percent of the tenants in a given conversion typically purchase units in the building.

Next month, I'll discuss trends in pricing and renovation and discuss what's ahead for the condo conversion market in 2006.

Gail Lissner is co-author of Appraisal Research Counselors' quarterly Downtown Chicago Residential Benchmark Report, an in-depth analysis of the downtown Chicago housing market, focused on the area between North (1600 N.), Cermak (2200 S.), the lake and Ashland (1600 W.) The report tracks development activity and helps people investing in residential real estate make informed decisions.www.AppraisalResearch.com.

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