

The process of selling real estate to tenant-owned associations

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Seven steps for conversion from tenancy to tenant-ownership from the tenants' point of view.

The question of conversion is raised and a Board is formed.

The question of conversion can start in three different ways. Normally it is the property owner who offers the tenants the opportunity of buying the property. That can be done in two ways. Either the property owner contacts the tenants directly, or uses a broker to contact the tenants. The third way is that the tenants themselves contact the property owner and announce their interest in buying the property.

The continuation process looks quite the same for the three different ways. It starts with a meeting to inform to all the tenants. That meeting will choose a working team which will have one significant assignment, to choose and form a Board. The Board will adopt statutes, decide a name for the tenant-owned association and register the tenant owned association at the Swedish Companies Registration Office. The Board will also choose an agent who will support the tenant-owned association through the different steps in the discussion.

Technical survey.

A technical survey of the property is carried out by an independent surveyor. The purpose of the survey is to assess the cost of maintenance of the property over the next 10 years after the tenant-owned association has acquired the property and it will be used as a basis in the economic planning.

The survey contains a description of the property, the buildings and all noted deficiencies in every part of the building. Since the result of the technical inspection has a large impact on the price of the property, it is usually a discussion point in the forthcoming negotiations.

Preliminary calculation for the tenant-owned association.

The agent makes a preliminary calculation based on the assumed price of the property, and the technical survey. An estimation of the number of tenants that are interested in buying their apartments is made. The costs for running the property must also be estimated. The agent investigates the present cost for interest rate and decides a level that feels realistic in the long run and all of the different running costs for the property to be used in the calculation. The preliminary calculation shows the acquisition price for every apartment and the change in the monthly cost for the tenant.

Assessment of interest.

A preliminary non-binding expression of interest is sent to the tenants to assess the interest in buying their apartments based on the preliminary calculation. Some agents prefer to check the assessment of interest at an earlier stage, before the technical survey, and in that case they will not have a preliminary calculation as a base for the tenants' decision about interest.

Establishment of economic plan.

For the tenant-owned association to be able to vote for a purchase of the property, an economic plan that states the economy for the tenant-owned association must have been established.

The economic plan contains of three parts.

The first part is a general text part which describes the buildings design, formation and condition.

The second part is a calculation that describes the economy for the tenant-owned association for the coming eleven years.

The third part is the technical survey.

The economic plan must be signed by the agent and the Board of the tenant-owned association and reviewed and approved by two certifying officers appointed from the Swedish Companies Registration Office. This is done to ensure that the economic forecasts in the plan are realistic.

Meeting to vote for acquisition.

When the economic plan is approved the tenant-owned association has a meeting where the tenants vote for acquisition. Every apartment will have one vote and to be able to vote the tenant must be registered on the address. The law states that at least 2/3 of all the tenants in the building must vote for an acquisition to make the decision valid. Voting refers only to giving the tenant-owned association mandate to acquire the

property, each tenant who has voted is not obligated to buy the apartment that the tenant lives in. If the tenants vote for acquisition the economic plan shall be registered at the Swedish Companies Registration Office.

The tenant-owned association's access to the property.

About two to four weeks after the meeting where the tenants voted for acquisition, the tenant-owned association accesses the property. Today when there is a recession, it takes longer than four weeks. The purchase price is paid and the tenant-owned association becomes the new owner of the property. At the same time, the tenants buy their apartments (actually they buy a share in the tenant-owned association) from the tenant-owned association. The tenants which have chosen not to buy their apartments will still have the same rental agreement as before, and the only difference for them is that they will have a new landlord.

Process of selling real estate to tenant-owned associations from Akelius point of view.

Deciding which properties to sell to tenant – owned associations.

The question is how the selection of properties we want to convert into tenant-owned associations is made, and which criteria we use in that decision?

The regional manager decides which properties should be suggested for conversion to the Board of Akelius. The different criteria that are used are a combination of the following;

The location of the property, must be a location with a market for tenant-owned associations.

The price level per sqm on the tenant to tenant property market should not be too low.

A comparison is made between the total price Akelius can get for the property if it were sold to a tenant-owned association, and the book value as well as the market value of the property. The price should be higher than both the book value and the market value.

To find out a possible price, we use our own calculation sheet for tenant-owned associations (appendix A).

We also have to take into consideration the age structure of the residents and the number of social contracts.

The property normalized yield of market value should not exceed 4%. By market value, in this case it means the market value when selling to tenant-owned associations.

In summary when the regional manager chooses which properties to convert, the main criteria are;

- There must be a market for conversion.
- We must make a good profit compared both to property's book value and market value.
- And, not to forget, common sense should be used combining the different facts in the selection process.

Deciding how to sell the property.

In 2006 when we started up our IDA project, we did it in a large scale and to be able to handle that amount of properties we used different brokers to help us out.

The broker's assignment was to start up the conversion process through building up an interest for conversion by the tenants. To create an interest, the broker first invited and held an information meeting for the tenants. Then the broker put together a working group which should form a Board. The Board should then choose and contract an agent which will work for the tenant-owned association in the conversion process. The agent and the broker will then be in contact with each other in the conversion process.

The broker informs and gets directives from their client (the property owner) and the agent works for and informs their client (the tenant-owned association).

This arrangement sometimes slow up the process and all relevant information is not always brought up to us as a property owner. Therefore, we have decided to try a different approach in 2009.

One way is that we ourselves contact the tenant-owned association and suggest them two different agents that we would like them to choose between. We have in these cases already contacted and had a discussion with the agent about the specific property.

The process then continues as described in the seven steps for conversion, the only differences that we will not have a broker who works for us; instead we will have a direct contact with the agent. This will hopefully speed up the process and avoid that relevant information is kept away from us and save us some money since we do not have to pay any fee to the broker.

Another method, similar to the one above, is that we give the agent, which we want the tenant-owned association to choose,

the task of taking the first contact with the tenants in the property.

There is one risk in this new way, and that is that the Board of the tenant-owned association will choose another agent than the agents we propose. That has not been the case so far, and if it happens we only have to consider if we want to continue the process with that other agent or not.

In summary, if we manage to reduce the parts involved in the conversion by one, the broker;

- It will speed up the process.
- We will minimize the risk that we miss relevant information.
- We will save on the broker's fee.
- We will have a larger impact over which agents the tenant-owned association choose.

Akelius market price calculation.

To allow us to work coherently over all of the Akelius regions, we use the same excel sheet for determining the possible market price when selling real estates to tenant-owned associations.

The excel sheet works as follows.

First we download a list from ADW that shows the buildings, all contracts, area of the contracts and current rent.

We have to determine a possible distribution among the contracts, how many we believe are going to buy their apartment. Normally in our calculations we expect 70% are going to buy their apartments. This is not true day one, but a possible outcome in the long run.

Next we have the income ready from the tenants who prefer not to buy their apartment, and from all commercial contracts and parking. To determine the annual fee from the tenants who prefer to buy their apartment, we make a calculation, (operational cost of the property + rental cost = income from rent + X). Where X = annual fee.

To determine the operational cost we use the budget for the following costs, property tax, heating, water, electricity and refuse collection. For caretaking, running maintenance and reparation fund, we use standardized figures.

The rental cost is determined by two parts.

Part one is the distribution between how much the purchase price for all of the apartments when the tenant-owned association sells the apartments to the tenants, and the amount of loans that the tenant-owned association shall carry. The sum of

these two must cover the total cost for the tenant-owned association to acquire the property. By changing the distribution between them you affect the over value in the apartment and the annual fee. You need to come up with an over value of 25 % and a decrease between the previous rent of the apartment and the new cost (annual fee + rental cost) for the tenant who bought their apartment by approximately 10 %. These are not fixed numbers; they depend a lot on the location of the property. Part two that determines the rental cost is the interest rate. We put together a basket of different maturity of the loans together with the current interest rate. This can however lead to some difficulties in the forthcoming negotiations with the agent, which will be described later.

We also put in the estimated market value from actual sales in the area per sqm as a comparison to the sqm price that our calculation results in.

To come up with the total amount for the tenant-owned association to acquire the property, we have to add four posts to the purchase price.

Cost of land register, 1.5 % of the highest of tax assessment value or the transferred purchase price from the first transaction into the dormant company (if we make a company deal).

Repair fund, based on the posts in the technical survey.

Mortgage costs for the tenant-owned association.

Conversion cost, mainly the cost the tenant-owned association has to pay to the agent; approximately 10,000 SEK per apartment.

Now we are finished with our first calculation. We have a purchase price for the tenant-owned association that we believe is possible to come up to.

However, for the tenant-owned association to have the right to acquire the property they must have an economic plan that is approved. It is the agent who puts together the economic plan. There are some differences between the way we make our calculations and how the agents make theirs, and there are even differences between the different agents.

One of the major factors that affects the purchase price is the cost of rent. When we calculate the rental cost we use a basket of loans with different maturity dates, and we use the current rent rate. In the economic plan, the agent is much more cautious than we are about the rent rate. The agent must present a rent rate that is realistic over the next 10 years. Today you can put together a basket with an average rent of about 3.2%. For the economic plan the agent must use an average rent of about 4.2%.

The effect that has on the purchase price is about 10%. If in our calculations we use a rent rate that is much lower than the rent rate used by the agent in the economic plan, we will have too high expectations on the purchase price.

One other factor that might have a large effect on the purchase price is the repair fund. The tenant-owned association has to present financing of the total amount of assessed maintenance cost for the next 10 years in the economic plan. It is a good idea to investigate if we can present cheaper solutions to solve the noted deficiencies from the technical survey. Sometimes you can even present facts that show that the noted deficiencies according to a different surveyor are not necessary to bring up in the economic plan.

A comment about the market price when tenants sell apartments to other tenants; in our calculation sheet we present the market price per sqm for similar sales in the actual location. That gives us the upside for the tenant who buys their apartment in the conversion in percentage. We have a “rule” that says that the upside should be approximately 25 %. Not to forget in that discussion is that the apartments which we compare the market price from often have annual fees that are about 30% lower than the annual fees that we calculate. The effect that might have in the conversion is not crystal clear, but you have to take that fact into consideration. Some of the agents have a different approach when they are setting the annual fee. As you remember, we did that by calculating (operational cost of the property + rental cost = income from rent + X). Where X = annual fee. Some agents instead decide the annual fee should be similar to the actual annual fees in existing tenant-owned associations in the same location as the property we are trying to convert.

Another thing to keep in mind is that in the suburbs where we are converting our properties, the work, involvement and skill of the agent is very important. One of the most important things with our new way of trying to get the tenant-owned association to choose one of the agents we present for them is that the probability for a successful conversion increases. Today you have the situation that even if you have a successful vote for acquisition by the tenant-owned association, you might not be able to close the deal. You have one more important issue to fulfill and that is that you need a bank to give the loans to the tenant-owned association. The only bank in Sweden today which is positive to do that is SBAB. They have one absolute condition and that is that the tenant-owned association has a connection degree of at least 60%.

Even if the calculation shows that the tenants will have a good upside (on the value of the apartment) and a lower monthly cost for the apartment, it has been difficult to achieve 60%

connection degree. It is here the determined work of the agent and our ability to come up with new ideas to convince the tenants becomes essential.

In summary, to increase the possibility for a successful conversion the following points are important.

- Be careful in the preparation of choosing the right properties to try to convert.
- Decide a realistic purchase price.
- Work with dedicated and skillful agents.