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Breaking up a condo association contains lots of ins and outs

Some savvy investors and Daley Center regulars are aware that there is another type of condominium deconversion that may end the lifecycle of a condominium association.

Under Illinois Condominium Property Act Section 14.5, a municipality has the authority to seek the deconversion and sale of a troubled condominium association in court. This process only applies to troubled properties with at least two key risk factors present that include serious physical code violations, high foreclosure activity and a threatened or actual utility interruption.

More often than not, the municipality (usually the city of Chicago) will target a property with serious code violations and discover the other factors are also present. Normally, the court process involves an appointed receiver presenting a study on whether rehabilitation is possible or that the sale of the property is the most feasible result.

If the court opts for a sale, the property will be marketed and a buyer will present itself. Savvy investors often watch these properties in the hopes of obtaining a distress discount but are aware that they must come ready and able to address the code violations and are usually required to put forth a significant investment in the property to comply. The naive should dive in only with a very big (and very green) parachute.

During the closing of the transaction, the immediate above-the-line deduction will be payment of the receiver, after which all owners receive an amount attributed by their percentage ownership in the condominium before the deconversion.

There are, of course, other deductions and claims against the proceeds that must be treated to clear title and comply with the condo act. The jockeying begins then among lien and other claimants.

Unlike a voluntary deconversion, sales under Section 15 or a termination of the condominium under Section 16, Section 14.5 deconversions usually have other creditors and lienholders involved beyond the mortgagees. These lienholders may be contractors, utilities, vendors and adverse claims against the condominium as a corporation.

These claims are generally separated by type, secured liens versus claims for lien and then further down the line become the unpaid nonlienholders such as vendors and adverse claims.

The following excerpt from the act suggests a priority in the sale proceeds after the payment of the receiver: "(1) to pay taxes attributable to the unit owner; then (2) to pay other liens attributable to the unit owner; and then (3) to pay each unit owner any remaining sums from his or her respective share."

Lien becomes the operative word, as does its homophones. This is a distressed property sale so the funds are lean and lienholders may find themselves similarly shorted. Claimants will appear in court trying to impede distribution, leaning on the court while the owners await their funds.

THE REal DEAL

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However, the statute specifies that other liens attributable to the units shall be paid and then owners recoup the remainder, leaving nonliens very lean indeed.

In the condominium context, there are four major liens: Those super liens such as water, the mortgagees and those other "lien" claimants. Usually, super-priority liens such as water would be first in line for payment. Afterward, first mortgagees are next in line on a condominium property before all others, including the association assessment lien in most if not all cases.

In typical situations, the value of the proceeds after payment of the receiver, property taxes and super-liens leaves a sum that is most often eclipsed by the outstanding mortgage balance; further disbursement is rarely seen.

In unusual situations, regular priority lien claimants in this mesne category will now vie for the proceeds. The battle of perfection begins and normally mandates that claimants demonstrate their successful perfection in time.

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A properly perfected mechanic's lien, a clean lien, would attach to the individual units by percentage ownership per Section 9.1 of the act, with ample room to split hairs between a lien and a claim for lien. But, beware of the insulating effect of this same section in preventing owner liability for judgments against the association itself, which are limited only to the owner's proportionate share of the indebtedness, whether collection is sought through assessments or other means.

This might leave claimants and judgment holders with nothing to glean after addressing the actual liens.

An interesting conundrum arises when looking at perfection. Properly perfected liens depend on record notice for establishing their place in line. This would suggest a clean lien would have some success. The condominium association also has a lien under Section 9 for unpaid assessments which automatically becomes a lien per the statute as of the date of default in payment and it enjoys a special priority compared to all but taxes, municipal levies and penalties. Section 9(g)(1) (2018) of the act makes this a mean lien.

It is possible, therefore, if an owner fails to pay assessments before a mechanic's lien is filed, the assessment lien must be paid first. This can create funds for the association that can be used to address remaining claims against it that are not perfected against the owners, leading to a (potentially) tidy winding-up but from lean-lien pickings.

In short, and without further mincing of words, Section 14.5 deconversions can present a very interesting list of priority questions along with ample opportunities to litigate claims ad nauseam over a small pool of funds.

The good news is that most Section 14.5 deconversions with any complexity of claims result in a fairly orderly workout with a goal of maximizing owner proceeds if possible, without further words wasted over liens.