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Economy makes condo deconversion process something to consider

If you follow the local commercial real estate markets, you've likely heard quite a bit about the deconversion of condominiums through the sale of condominium buildings.

The sale of a particular condominium property and the removal of that property from the provisions of the Illinois Condominium Property Act (765 ILCS 605 et seq.) can be accomplished in various ways.

Although the mechanisms for accomplishing such a transaction have always existed under the act, the last two of years have presented substantial opportunities for both developers and condominium associations to avail themselves of the rights to proceed with such a transaction.

In short, the way sales of condominium buildings are structured usually involves a two-step process, which includes both Sections 15 and 16 of the act.

Section 15 outlines the steps by which a sale of the building to a single purchaser can be accomplished via a minimum of 75 percent consent of the building ownership (although the condominium's declaration can allow for a greater percentage).

In general, a bona fide offer to purchase the entire building is made, with the proceeds of the purchase divided among the unit owners according to their percentage interest of the common elements as set forth in the condominium declaration.

Market conditions have allowed that successful Section 15 sales provide unit owners with a higher sale price than they would obtain by trying to sell the unit on their own. Once the developer controls 100 percent of the building, it can proceed with deconverting the condominium association pursuant to Section 16 of the Condominium Property Act.

Often, what can make these transactions complicated is the negotiation of an appropriate purchase and sale agreement and other conveyance documents which adhere to the statutory requirements, preserve the condominium board's fiduciary duty to its owners throughout the entire process and ultimately successfully close the transaction to the mutual satisfaction of all involved.

Below are just a few of the common obstacles which need to be carefully reviewed and assessed in each transaction.

Underwater units

Even if 75 percent of the unit owners consent and agree to a sale pursuant to Section 15, some owners may find themselves in a situation where their allocated net proceeds are insufficient to repay the current outstanding balance owed on their existing mortgage.

As the existing mortgage lenders will need to provide payoff statements (and ultimately a release of their respective mortgage) to close the sale of these particular units, this creates a situation that may be difficult to timely resolve, especially since Section 15 is silent as to the effect of a Section 15 sale on existing liens.

Market conditions have allowed that successful Section 15 sales provide unit owners with a higher sale price than they would obtain by trying to sell the unit on their own.

In larger buildings which may have been particularly hit hard during the recent recession, there may be dozens of such underwater units. Not only does this present a timing issue, but also a practicality issue. The association and purchasers alike should con-

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sider the status and number of underwater mortgages as early as possible in the process.

Valuation of substantially improved units

Frequently, there are unit owners in the building whose units are much more valuable than comparable units and the price they are to receive as a result of the above structure is simply not reasonable.

Although such owners are still obligated to cooperate with such

negotiated, will result in proportionately less received by other unit owners. This difference is often negligible and will not materially impact the price received by other unit owners — particularly in large buildings.

However, if there are several dissenting unit owners availing themselves of this appraisal process, it can adversely affect the overall compensation received by the other owners if not taken into consideration during the contract process. This situation, too, needs to be contemplated and addressed early on in the transaction.

Timing considerations

Although unit owners involved in a transaction such as the above are required by statute to fully cooperate with such sale, obtaining all necessary conveyance documents for all units, cooperation from lienholders and otherwise complying with all other statutory requirements in order to get to the closing table can possibly become a time-consuming and costly endeavor — particularly for very large buildings.

When voting on such a contemplated sale, unit owners should be made fully aware of what is involved in such a transaction so everyone is voting with eyes wide open.

Sales under Section 15 of the Condominium Property Act can be great opportunities for condo associations, owners and developers alike. Although there are often hurdles which need to be overcome to successfully complete such a transaction, a carefully contemplated and executed plan from the beginning stages of the transaction can result in a winning deal on both sides of the table.

— *Special thanks to Chuhak & Tecson P.C. principal David J. Bloomberg for his contributions to this column.*