



David Bloomberg

Turning condos into apartments can make good money for developers, investors ... if they avoid the pitfalls

By Dan Rafter

David Bloomberg has seen the trend: Developers and investors are eagerly seeking to acquire condo buildings and turn them into apartments. This de-conversion trend is taking hold across the Midwest, and developers and investors stand to earn plenty of dollars from it. But Bloomberg, principal at Chicago law firm Chuhak & Tecson, says that converting condos to apartments isn't always an easy task. There are plenty of potential pitfalls.

Here's the advice Bloomberg shared during a recent interview with Midwest Real Estate News.

The big challenge: We are seeing a lot of developers and investors interested in converting condominium buildings into rental apartments. We are getting calls about this on a regular basis, from both developers and the owners of existing condo buildings. These people are asking us a lot of procedural questions, logistics questions. They want to know how the process works. This isn't surprising. This is a unique deal structure. In a conversion, we are talking about unit owners and developers. You are not just buying a building. You have to first get title to all of the units in a condominium building to do these deals. That is the challenging part.

Approvals needed: According to the Illinois Condominium Property Act's Section 15, when there is a building with four or more units, you need the approval of 75 percent of the unit owners to convert their building to rental apartments. If 75 percent of the unit owners do agree to the conversion, then all the unit owners in the building, even those who didn't vote to approve the move, have a duty to take all the actions necessary to make the sale happen. Once you get that 75 percent, everyone has to go along with it. That is always the question, though. It sounds like a simple concept. But then you get into a host of issues when you talk to the condo board that administers the building. Who is going to negotiate the deal? How is it going to be presented to the unit owners?

Who gets what? One of the big issues is always about the price that individual unit owners get. How are the dollars from the sale going to be allocated among the unit owners? The way it is supposed to work is that every unit owner gets a percentage interest in the common elements of a building. The bigger the unit, the greater a percentage of interest they get. That is the easy way to do it. But say a condo building was developed in 1980. Say the owner of one unit hasn't

made any renovations at all. The market value of that unit as it sits now is much less than the market value of other units that have been renovated. Some unit owners might say that they don't want to take a lesser price than the owners of a larger unit who have made no renovations since buying their unit. They might argue that they have invested more money in their unit, and that they deserve more money after the sale. If you are the developer or investor, you have to deal with those issues. Sometimes you divide the price by the actual market value of the condo units.

Right to fight: Unit owners who vote "no" to a sale that is then approved anyway do have the right to ask for an appraisal of their unit if they are unhappy with the price they are getting. If you are unhappy with the sale and with the value assigned to the unit, you can get it appraised. You will then get the amount determined by your new appraisal. That is your option if you are unhappy with what is proposed.

A difficult task? There are certain buildings in which it is easier to get that 75 percent approval. The best candidates are those buildings in which a majority of the units are already owned by investors who are renting out the units. These owners will be more likely to approve a de-conversion to rental units. Or maybe there is a building that has the need for expensive capital improvements that the unit owners might have to pay for. The unit owners can now avoid that expense by approving a sale. Or a developer might want a building so much that it is offering a premium above what the owners would be able to get on the market.

It usually makes the most sense in the city when you have 10 to 35 units in a building, maybe 40. There are few de-conversions in the pipeline of properties that have more units than that. It gets very complicated when you have too many unit owners involved.

The underwater problem: Deals also get complicated when you have a lot of unit owners who are underwater on their mortgage. Let's say that you have a developer who wants to give a lump-sum purchase price for the building and everyone gets a share. What do you do with a unit in which the owners owe more on their mortgage than what the unit is worth? What if the lump-sum payment isn't enough to satisfy the outstanding mortgage lien on the property? That is a major hurdle. If you bought your unit in the middle part of the last decade, you are likely still underwater. That is the case with a large number of condo units in the city.