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How a Zombie Condo Board Can Ruin Your Day: The Case for Rewriting Section 15 of the Illinois Condominium Property Act, 52 UIC J. Marshall L. Rev. 1 (2018)

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**HOW A ZOMBIE CONDO BOARD CAN RUIN
YOUR DAY: THE CASE FOR REWRITING
SECTION 15 OF THE ILLINOIS
CONDOMINIUM PROPERTY ACT**

JOSEPH C. ALFE, J.D.*

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Abstract

By exploiting the highly ambiguous Section 15 of the Illinois Condominium Property Act,¹ developers and their zombie Homeowner Association boards of directors can easily oust unwitting unit owners—and it's all legal. In analyzing just such a case that was before the DuPage County Circuit Court, *Huntington Condo. Ass'n v. Grimm*,² and viewed through the clarifying twin lenses of Eminent Domain and notions of fair play and justice, one cannot help but conclude that Section 15 of the Act is desperately in need of a dramatic rewrite. I propose one here. But more so, in the quest for clarity of the Act, we must also carefully consider that Section 15's purpose is a delicate balance between the necessity of a defined way to dispose of distressed property, and the property rights of individual unit owners—and one of just compensation.

In this article, we will first delve into the history of the Act in Illinois and its origins and purpose. Next, we discuss the types of properties subject to the Act, and how distressed condominium projects trigger Section 15 of the Act. Then, the deconversion process is explained. A comparison of valuation schemes is made. The Act is then examined to identify its ambiguity and how this ambiguity impacts the practical application of Section 15 of the Act to the deconversion process. Lastly, new Section 15 language is proposed.

I. INTRODUCTION

In a move that surprises no one, a failed condominium developer having sold only a fraction of its units, stacks the development's board of directors with its own officers. Having been offered a below-market deal by a corporate buyer, the developer invokes Section 15 of the Illinois Condominium Property Act secure in the knowledge that its captive board can oust any unit owner with a sham vote, no meaningful appraisal for value, and little or no meaningful due process. This cannot be what the legislation intended Section 15 to allow, but here we are.

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1. 765 ILL. COMP. STAT. 605/15 (1963).

2. *Huntington Condo. Ass'n v. Grimm*, 2018CH000210 (Feb. 14, 2018).

II. HISTORY AND BACKGROUND OF DECONVERSIONS

Mention the word “condominium,” and one is sure to get a hazy definition. “In its modern legal sense, condominium means ownership in fee simple of a one-family unit in a multi-family structure, coupled with ownership of an undivided interest in the land and all other parts of the structure as a tenant in common with the other unit owners.”³ This modern form of ownership grew out of the cooperative schemes prevalent on the East Coast, especially New York City. An early proponent, Illinois adopted the Illinois Condominium Property Act on July 1, 1963.⁴

A. *National*

On a national level, Puerto Rico was the first to introduce the concept of the condominium in 1959.⁵ The model became viable nationwide when “Congress added Section 234 to the National Housing Act in 1961 authorizing the Federal Housing Administration to insure mortgages of individually owned units in multi-family structures in states where condominium is established by law.”⁶

In other words, unlike a co-op, a condo owner owns in fee simple, enabling the unit to be subject to a mortgage. Today, condominiums make up nearly 75% of housing units in some areas of Chicago, namely The Loop and Near North Side.⁷

1. *The National Housing Act - HUD*

In 1961, Congress added Section 234(d) to the National Housing Act.⁸ “Section 234(d) insures blanket mortgages for the construction or substantial rehabilitation of multifamily projects to be sold upon completion as individual condominium units.”⁹ This enabled the 1958 Condominium Act of Puerto Rico,¹⁰ the nation’s

³. C. Bernstein, *Condominium - Illinois Condominium Property Act: An Analysis*, 13 DEPAUL L. REV. 117, 118 (1963).

⁴. *Id.*

⁵. P.R. LAWS ANN. tit. 31, §§ 1291-93k (Supp. 1961).

⁶. Bernstein, *supra* note 3, at 118; see 12 U.S.C. § 1715y (amended by Sect. 431(b) of Pub. L. 98-181, Title IV (1983)) (authorizing the Federal Housing Administration to insure units that had been converted from rental properties).

⁷. *The Composition of Cook County's Housing Market*, INST. HOUS. STUDIES DEPAUL (June 6, 2014), www.housingstudies.org/research-publications/publications/composition-cook-countys-housing-market/.

⁸. 12 U.S.C. § 1715y (1934) (amended 1983).

⁹. *Mortgage Insurance For Construction or Substantial Rehabilitation of Condominium Projects: Section 234(D)*, U.S. DEPT HOUS., www.hud.gov/program_offices/housing/mfh/progdesc/subrehabcondo234d (last visited Aug. 19, 2018).

¹⁰. P.R. LAWS ANN. tit. 31, §§1291-93k (supp. 1961).

first, to be implemented on a national scale.¹¹ What it did was comfort lenders who were nervous to lend to developers by insuring against defaults.¹² This allowed developers to construct condominium projects, and sell the units to end buyers. Essentially, HUD's blessing sparked a condominium construction boom as newly flush young urban professional clamored for inexpensive urban residential units.

2. Bulk Sales

Traditionally, bulk sales were a way for developers who were overextended, or lenders who took back condominium projects from developers, to sell blocks of units *en masse*. This allowed struggling developers to raise much needed capital, or for lenders to sell a project instead of attempting to lease out a project themselves. In other words, "banks sell condominium units in bulk to avoid the potential successor developer liability, carrying costs and the other general liabilities associated with the maintenance of a condominium project and the operation of a condominium association."¹³

The catch here is simple: bulk sale buyers demand a hefty discount. This can be agreeable to a developer or lender for several reasons. Namely, "the buyer of the project (or the mortgage encumbering the project) is able to reduce the debt per unit and possibly allow for a positive cash flow for the project when the units are leased (and the upside of the appreciated value of the units when they are sold after the market conditions improve)."¹⁴ While a struggling developer's aim in courting a bulk sale is simply to raise much needed capital, a lender has several exit strategies. In addition to bulk sales, a lender can recoup its investment and discount by finishing the construction (if needed) and leasing out the units themselves. This creates a "turn-key" buying opportunity for a Real Estate Investment Trust ("REIT") or other entity. Additionally, a lender could engage a broker to sell the units off individually to open market consumers, often financing prospective buyers themselves.¹⁵ This would provide the greatest profits, but also the highest risks, time, and carrying costs.

11. Bernstein, *supra* note 3, at 118.

12. *Id.*

13. Alex Finkelstein, *Will Bulk Sales Stabilize Miami's Luxury Condo Market?*, WORLD PROP. J. (Aug. 31, 2009), www.worldpropertyjournal.com/us-markets/residential-real-estate-1/miami-condo-market-sales-the-icon-jorge-perez-cityplace-the-related-group-related-cos-of-new-york-corus-bank-starwood-capital-group-donald-trump-1330.php (quoting Jay A. Steinman, Esq.).

14. *Id.*

15. *Id.*

B. Illinois

1. The Illinois Condominium Property Act

The Illinois Condominium Property Act (“Act”), codified as 765 ILCS 605/1 *et seq.*, was passed in 1963. Recognizing the opportunity pioneered by Puerto Rico and encouraged by Section 234(d) of the National Housing Act, Illinois became an early devotee of condominiums as a solution to Chicago’s rapidly expanding need for affordable vertical housing schemes.¹⁶ What the Act did for Illinois was to “establish recording procedures, provide procedures for dissolving the condominium or disposing of the property after its destruction, and provide for separate taxation for each unit.”¹⁷

“Before the act will apply to a condominium, the co-owners must voluntarily submit the property to the provisions of the act by means of the ‘Declaration.’ This is a public deed, i.e. a recorded instrument which, in accordance with §4 of the act, must contain:”¹⁸

- (a) The legal description of the parcel.
- (b) The legal description of each unit, which may consist of the identifying number or symbol of such unit as shown on the plat.
- (e) The percentage of ownership interest in the common elements allocated to each unit. Such percentages shall be computed by taking as a basis the value of each unit in relation to the value of the property as a whole, and having once been determined and set forth as herein provided, such percentages shall remain constant unless thereafter changed by agreement of all owners.
- (i) Such other lawful provisions not inconsistent with the provisions of this Act as the owner or owners may deem desirable in order to promote and preserve the cooperative aspect of ownership of the property and to facilitate the proper administration thereof.¹⁹

It is the disposition provision of Section 15, that this article now turns to.

2. Section 15 Sale Provision

Section 15 of the act provides:

- (a) Unless a greater percentage is provided for in the declaration or bylaws, and notwithstanding the provisions of Sections 13 and 14 hereof, a majority of the unit owners where the property contains 2 units, or not less than 66 2/3% where the property contains three units, and not less than 75% where the property contains 4 or more units may, by affirmative vote at a meeting of unit owners duly called for such purpose, elect to sell the property. Such action shall be

16. Bernstein, *supra* note 3, at 118.

17. *Id.*

18. *Id.* at 119.

19. 765 ILL. COMP. STAT. 605/4 (2018).

binding upon all unit owners, and it shall thereupon become the duty of every unit owner to execute and deliver such instruments and to perform all acts as in manner and form may be necessary to effect such sale, provided, however, that any unit owner who did not vote in favor of such action and who has filed written objection thereto with the manager or board of managers within 20 days after the date of the meeting at which such sale was approved shall be entitled to receive from the proceeds of such sale an amount equivalent to the greater of: (i) the value of his or her interest, as determined by a fair appraisal, less the amount of any unpaid assessments or charges due and owing from such unit owner or (ii) the outstanding balance of any bona fide debt secured by the objecting unit owner's interest which was incurred by such unit owner in connection with the acquisition or refinancing of the unit owner's interest, less the amount of any unpaid assessments or charges due and owing from such unit owner. The objecting unit owner is also entitled to receive from the proceeds of a sale under this Section reimbursement for reasonable relocation costs, determined in the same manner as under the federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended from time to time, and as implemented by regulations promulgated under that Act.

(b) If there is a disagreement as to the value of the interest of a unit owner who did not vote in favor of the sale of the property, that unit owner shall have a right to designate an expert in appraisal or property valuation to represent him, in which case, the prospective purchaser of the property shall designate an expert in appraisal or property valuation to represent him, and both of these experts shall mutually designate a third expert in appraisal or property valuation. The 3 experts shall constitute a panel to determine by vote of at least 2 of the members of the panel, the value of that unit owner's interest in the property. The changes made by this amendatory Act of the 100th General Assembly apply to sales under this Section that are pending or commenced on and after the effective date of this amendatory Act of the 100th General Assembly.²⁰

It is important to view the Act in its entirety for two reasons: 1) to demonstrate its brevity and ambiguity; and 2) to help us deconstruct the Act into its vital parts for this discussion. Thus, we break down the Act to isolate the issues we focus on as follows:

a. The Majority Threshold Required for sale of the entire property

Unless a greater percentage is provided for in the declaration or bylaws . . . a majority of the unit owners where . . . not less than 75% where the property contains 4 or more units may, by affirmative vote at a meeting of unit owners duly called for such purpose, elect to sell the property.²¹

20. 765 ILL. COMP. STAT. 605/15 (2018).

21. 765 ILL. COMP. STAT. 605/15(a) (2018).

An extremely important detail is found in the very first line, “Unless a greater percentage is provided for in the declaration or bylaws...”²² What this means is that, like most statutes, the Act establishes a floor, not a ceiling. The Act establishes the minimum majority vote needed to approve a sale at 75%.²³ A Homeowner’s Association (“Condo”) may designate a higher percentage in its declaration or bylaws.²⁴ For example, if the declaration establishes the majority needed for approval at 100%, and the vote fails, the parties may not fall back on the Act’s 75% minimum without amending the declaration or bylaws.

b. The consequences of an approved sale

Once a majority vote has approved the sale of the property, “such action shall be binding upon all unit owners, and it shall thereupon become the duty of every unit owner to execute and deliver such instruments and to perform all acts as in manner and form may be necessary to effect such sale”²⁵ This is where the rubber meets the road. This provision is the focus of the majority of Section 15 litigation, and it is easy to see why it reeks of fundamental unfairness. Once the statutory or declaration majority is met, and the sale is approved, *all unit owners are bound to sell their units whether they want to or not*. In other words, once the vote is passed and the board approves the sale, all unit owners must execute the appropriate instruments and documents to convey their interest in their units owned.

3. *Section 15 2018 Revisions*

Updated Section 15 provisions became effective in Illinois on January 1, 2018.²⁶ Previously, one of the most litigated aspects of the sale provision centered around two issues: 1) owners who were “under water” and owed mortgages and liens in excess of the owners’ unit percentage realized through the sale; and 2) valuation disputes. First, we examine the lien in excess of value issue.

a. Short Sales:

One of the new horrors revealed by the great real estate collapse of 2008-2009 is the short sale. In its simplest explanation, a short sale is when a seller owes more in mortgages and other liens than the property is worth. Traditionally, an owner who owes \$100,000 and sells her property for a net realization of \$80,000

22. *Id.*

23. *Id.*

24. *Id.*

25. 765 ILL. COMP. STAT. 605/15(a) (2018).

26. *Id.*

would have to come to the closing table with \$20,000 in cash in order to successfully convey the property.²⁷ While an unpleasant result in any market, financially distressed sellers cannot or will not come up with the cash. Enter the short sale. The process is a complex and a convoluted morass of layers of approvals, valuations, and document collection between the seller, the buyer, and the seller's lenders and lien holders.²⁸ After months (and sometimes years) of underwriting, the lien holders must approve the sale and the net loss is absorbed by the lien holders in order to effectuate the transaction. Additionally, the "gap" between what the seller owes versus what they sell for is called a *deficiency*. Once the transaction closes, the lien holder will net less than what they are owed – but the seller still owes the money.²⁹

Naturally, this makes obtaining a successful vote to sell difficult if a deconversion buyer/developer's offer is too low to cover the unit owner's mortgage and lien obligations. Before 2018, unit owners who found themselves being forced to sell their units under Section 15 pursuant to offers that do not cover those obligations oftentimes faced financial ruin. This practice reeks of fundamental bad faith and unfairness, but unit owners were powerless to object. To complicate things further, the onerous short sale approval process can grind an entire deconversion deal to a halt while recalcitrant lenders delay short sale approval on a single unit out of hundreds that had already conveyed to the end buyer.³⁰

In response to the rising volume of consumer complaints, the Illinois legislature moved to amend Section 15 to address this issue.³¹ The new language provides for an objection process.³² Now,

27. Hypothetical created by author to demonstrate a deficiency balance created by a short sale.

28. Joseph C. Alfe, *Short Sale Road Rules: Getting the Buyer and Seller on the Same Page*, CHI. AGENT MAG. (Sept. 13, 2012), www.chicagoagentmagazine.com/2012/09/13/short-sale-road-rules-getting-buyer-and-seller-on-same-page/.

29. Joseph C. Alfe, *5 Important Short Sale Road Rules on Settling Deficiency*, CHI. AGENT MAG. (Aug. 28, 2013), www.chicagoagentmagazine.com/2013/08/28/5-important-short-sale-road-rules-settling-deficiency/.

30. See generally, *SPNA Acquires Grays Pointe Apartments*, STRATEGIC PROP. OF N. AM. (Jan. 19, 2016), www.spofna.com/news/spna-generates-value-added-returns-through-acquisition-of-grays-pointe-apartments) (referring to the role of loss mitigation in a condo deconversion, the author was in charge of loss mitigation/short sales for the deconversion at the 396 unit Grays Point project in Grays Lake, Illinois, which closed in 2016). This project was delayed over one year because of a short sale on the last unit to convey to the buyers, Strategic Properties of North America. The unit owner's lender, Bank of America, simply refused to make accommodations for the fact that the unit owner was deceased and therefore could not be financially underwritten for deficiency loss. To complicate things further, Bank of America insisted on probate, which is not required in Illinois for estates less than \$150,000. The buyer eventually paid the full mortgage balance just to close the deal.

31. 765 ILL. COMP. STAT. 605/15(a) (2018).

32. 765 ILL. COMP. STAT. 605/15(a)(ii) (2018).

unit owners have 20 days to object to the sale, in writing, to address any potential deficiency.³³ The new language provides:

[T]he outstanding balance of any bona fide debt secured by the objecting unit owner's interest which was incurred by such unit owner in connection with the acquisition or refinance of the unit owner's interest, less the amount of any unpaid assessments or charges due and owing from such unit owner.³⁴

The implications of these provisions are immense because it virtually eliminates short sales. Under the new language, regardless of the amount of the unit owner's lien obligations, the project buyer must pay them off – less any obligations owed to the association.³⁵ Sub-section (ii) ends with:

The objecting unit owner is also entitled to receive from the proceeds of a sale under this Section reimbursement for reasonable relocation costs, determined in the same manner as under the federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended from time to time, and as implemented by regulations promulgated under that Act.³⁶

This further incentivizes a distressed seller to take the deal and walk away. A savvy developer will waive those costs as well to quickly close this problem transaction. While buyers may balk at increased acquisition costs, the elimination of significant time delays incentivizes a prompt payoff, and the unit owner walks away without owing any money. Of course, they also walk away without realization of a profit, which leads us to valuation.

b. Valuation:

The 2018 amendments go further. Sub-Section (b) provides:

If there is a disagreement as to the value of the interest of a unit owner who did not vote in favor of the sale of the property, that unit owner shall have a right to designate an expert in appraisal or property valuation to represent him, in which case, the prospective purchaser of the property shall designate an expert in appraisal or property valuation to represent him, and both of these experts shall mutually designate a third expert in appraisal or property valuation. The 3 experts shall constitute a panel to determine by vote of at least 2 of the members of the panel, the value of that unit owner's interest in the property.³⁷

This provision provides a method of settling a unit owner's objection to valuation – to a point.³⁸ Under this language, a unit

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. 765 ILL. COMP. STAT. 605/15(b) (2018).

38. *Id.*

owner dissatisfied with the valuation of her percentage of ownership, translating to realized compensation from sale, can timely object within 20 days, and trigger the valuation panel provision. As constructed, this provision allows both sides to designate a valuation expert who then, in turn, designates a disinterested third-party expert. These three valuation experts then decide what the unit value actually is. This does not, however, address the ambiguity lurking in the body of the Section 15 valuation language, as we shall see later.

c. 1980's-2000's Rise of the Condo Conversion

During the condominium heyday for most large cities, with Chicago leading the way, developers' appetites were insatiable. Opposite of today, developers engaged in combat style competition to find and acquire large rental properties and turn them into condos. The undisputed king of Chicago condo conversions was Nicholas S. Gouletas, now chairman and chief executive of the Chicago-based American Invsco.³⁹ American Invsco repurposed rental properties in "coveted or up-and-coming- neighborhoods, convert[ed] them to condos, load[ed] them with amenities buyers want and market[ed] them" to newly wealthy young professionals and empty nesters flocking in from the suburbs.⁴⁰ New good times made millionaires of many investors, and even a few billionaires, but it was not to last.

d. Post-2008 Real Estate Crash

A perfect storm of rising defaults fueled by resetting of adjustable rate mortgages, falling property values that prevented borrowers from refinancing out of risky loans, and a contracting of mortgage credit markets combined to burst the mortgage/housing bubble in late 2006. Virtually overnight, investors were no longer willing to buy mortgage backed securities (MBSs) from Wall Street, who then cut off the cash to lenders. Since lenders were relying on these funds to lend instead of their own cash, they in turn stopped funding loans. The first to go were the Sub Prime and 'Alt-A' lenders, who had no actual assets and relied entirely on investors to fund loans. Without money to lend, these multi-billion dollar funding machines went out of business literally overnight. The collapse of these 'Pass Through' lenders such as New Century and Argent, started a media blitz that proclaimed that the sky was falling on the mortgage markets. This caused investors to start re-examining the MBSs that they had already bought, and they

39. Leslie Mann, *At Invsco, Condo Conversions Rule*, CHI. TRIB. (Nov. 28, 2008), www.articles.chicagotribune.com/2008-11-28/entertainment/0811260881_1_condo-conversions-condo-market-buyers.

40. *Id.*

discovered, to their horror, that they were exposed to a lot more risk than they realized. These larger lenders then disclosed this information, and the panic that this revelation set off caused these bigger banks to fail. These failures in turn worked like a reverse domino effect, and roared up the money ladder like an avalanche to bury the big Wall Street brokerage houses that had bought and sold the MBSs. When it was disclosed just how much risk these big investment banks were on the hook for, they too, either failed, were absorbed for pennies on the dollar by other banks, or were forced out of business by the Fed. This is what happened to Lehman Brothers, Indymac, and Countrywide. Ultimately, those left holding the bag – the pension funds, local, state, and foreign governments, and insurance companies are finding their balance sheets battered by these defaults, and more failures [were] expected.⁴¹

As a consequence, the real estate market along with values, plummeted as much as 26%.⁴² In Chicago, condominium values were hit especially hard. Condominium values in Chicago still lag behind 2006 numbers by 7%.⁴³ The stage is set, then, for a reversal of condominium fortune in Chicago.

According to the 2017 Case-Shiller Index, Chicago condominium sale prices are nearing 2006 peak levels.⁴⁴ “The Index bottomed in March of 2012 and saw incredible gains in May and June of that year.”⁴⁵ “Prices were up 4.5% and 4.6% from April and May respectively . . . Even after adjusting for seasonality these were the largest one month increases in 24 years.”⁴⁶ The big push, however, is condominium deconversions. Developers eager to avoid skyrocketing construction costs and the lengthy build time have settled on deconverting existing condominium developments into rental apartments. The craze started soon after the 2008 crash as developers bought failed condominium project units at bulk sales and then rented the units out.⁴⁷

“For investors, buying an older condo property and reconverting it is an avenue for gaining entry into coveted

41. Joseph C. Alfe, *The Credit Collapse-What Went Wrong, and How it Pertains to Short Sales*, ACTIVE RAIN (January 2009), www.activerain.com/blog/view/881844/the-credit-collapse-what-went-wrong--and-how-it-pertains-to-short-sales.

42. S&P Case-Shiller Index (2017), see *infra* Table 1.

43. Dennis Rodkin, *10 Years After the Bust: For Condos, a Lost Decade*, CRAIN’S CHI. BUS. (Oct. 10, 2016), www.chicagobusiness.com/static/section/housing-crash-condos.html.

44. Wolf Richter, *The US Cities with the Biggest Housing Bubbles*, WOLF STREET (Aug. 29, 2017) www.wolfstreet.com/2017/08/29/the-us-cities-with-the-biggest-housing-bubbles/.

45. *Id.*

46. *Case-Shiller Home Price Index For Chicago Metro Area*, LUCID REALTY www.blog.lucidrealty.com/chicago_real_estate_statistics/ (last visited Dec. 19, 2018) (quoting Case-Shiller Index April 2018).

47. This represents the author’s observations as a participant in the Chicago deconversion market.

neighborhoods that are otherwise hard to enter.”⁴⁸ The trick for investors is finding the right properties then getting a foot in the door to present an offer.

III. TYPES OF PROPERTIES SUBJECT TO SECTION 15 OF THE ILLINOIS CONDOMINIUM PROPERTY ACT

The range of coveted properties is broad. From high-rise developments consisting of hundreds of units, to vintage neighborhood properties with as little as two or three, developers and investors are seeking anything they can deconvert into rental units. Certain types of property require different approaches. Here, I divide properties by their financial stability and ownership.

A. Failed Projects

This is where deconversions first came into being. Investors originally looked for failed projects. Especially during the market free-fall period of 2008-2012, condominium projects that were under construction or completed but not yet marketed were especially vulnerable. Developers found themselves scrambling for funds to complete construction projects just as lenders were rolling up their carpets and barring the doors. One by one, developers fell into default and lenders were faced with taking back uncompleted, or completed but not yet sold out, condominium projects. “Once a lender has invested material dollars to fund construction, there is no turning back because a partially completed building is worth less than the investment already made.”⁴⁹

B. Completed, Sold-Out & Troubled Projects

Oftentimes during this period, lenders were forced to take back projects from developers and either complete them, or sell them out. When projects were completed, lenders often turned to bulk buyers to quickly get these assets off their books when values were still declining. A bulk sale is when an investor buys more than one unit of a larger development in one transaction. Like most purchases in bulk, the investor usually negotiates a discounted price per unit. This allows troubled sellers to get distressed assets off their books, while investors and developers acquire assets at a discount.

Beginning in 2013, rising condo values prompted lenders to partner with brokers to sell the distressed units retail to end use

48. Dees Stribling, *Condo Deconversion Wave Hits Chicago*, BISNOW (Aug. 22, 2018), www.bisnow.com/chicago/news/multifamily/condo-deconversion-wave-hits-chicago-92086.

49. Joel C. Solomon, *Condominium Lending: Lessons From the Bust*, 1 REAL EST. FIN., 1, 2 n. 3 (Winter 2015).

buyers. This involved certifying the building as a condominium pursuant to the Act and establishing a Homeowner's Association with a board of directors. Once this process was done, the lender exited and the Condo controlled.

1. *Failed Condos*

As the association takes over, its management must maintain financial prudence, establish cash reserves, pay property taxes, and maintain the property. Mismanagement or dereliction of any of these can quickly hamstring even a well-funded Condo.

2. *Special Assessments*

To make matters worse, if there are maintenance issues or structural repairs that exceed the budget or threaten reserves, the board may levy a special assessment against unit owners over and above their monthly dues. This can cause hardship or even unit owner default if the assessment is large – leading to default. “When someone stops paying their maintenance, they stop paying [the association’s] taxes, too. Even if the guy next door was paying their mortgage like clockwork, it won’t matter. If enough people go down, the whole building’s going to go down.”⁵⁰ Due to shoddy new construction or deferred maintenance, it is not unheard of for Condos to levy special assessments topping \$30,000 per unit, or more.

3. *Eviction and Eminent Domain*

Under the Act, a unit owner in default of association dues can be foreclosed upon and evicted.⁵¹ Illinois is a judicial foreclosure state, but Condos need only turn to the provisions of the Forcible Entry and Detainer Act.⁵² By adhering to this Act’s notice process, a Condo can file suit for collection of dues and evict a delinquent unit owner. The Act provides that, “[i]f suit is filed under the Forcible Act the association will be asking a court to award it all past due assessments, attorney’s fees and court costs. Additionally, the association will be asking a court to award it possession of the owner’s unit.”⁵³ Using this process, the Condo has no duty to compensate the unit owner.

50. Lisa, Iannucci, *Managing Distressed Properties*, COOPERATOR N.J. (Apr. 2018), www.njcooperator.com/article/managing-distressed-properties/full (quoting Linda D’Amico, a real estate agent licensed in New York).

51. 765 ILL. COMP. STAT. 605/9.2(a) (2018).

52. 735 ILL. COMP. STAT. 5/9-101 (2018).

53. Douglas J. Sury, *Trauma Evictions Collections of Assessments and Other Sordid Tales*, KEAY & COSTELLO, www.keaycostello.com/collections/assessment-collection (last visited Dec. 19, 2018).

Compare this with Section 15(a) which provides that the unit owner is “entitled to receive from the proceeds of such sale an amount equivalent to the greater of: (i) the value of his or her interest, as determined by a fair appraisal, less the amount of any unpaid assessments or charges due and owing from such unit owner . . .”⁵⁴ In other words, the unit owner receives compensation determined by a “fair appraisal,” a muddy term as we shall see later.

Now contrast this with Illinois Eminent Domain Act.⁵⁵ Under this Act, property may be subject to a taking “primarily for the benefit, use, or enjoyment of the public and . . . necessary for a public purpose.”⁵⁶ The glaring difference is this: under the Illinois Eminent Domain Act, the landowner is owed *just compensation*. Further, the Act provides:

Private property shall not be taken or damaged for public use without just compensation and, in all cases in which compensation is not made by the condemning authority, compensation shall be ascertained by a jury, as provided in this Act. When compensation is so made by the condemning authority, any party, upon application, may have a trial by jury to ascertain the just compensation to be paid.⁵⁷

Comparing and contrasting these “takings”—because let’s face it, that is what they all are — reveals vastly differing ideas of compensation (or not) to rightful land owners, and how that compensation is valued and justified. Illinois landowners, no matter what type of land they own, no longer ought to be subject to these onerously conflicting models of compensation (or not).

IV. THE DECONVERSION PROCESS

In the simplest terms, a condominium deconversion is when the Condo, under Section 15 of the Act, votes to sell the entire property to a third party, who will then turn the property into rental units.⁵⁸ In the current market, rental units are more valuable to investors.⁵⁹ Deconversion is a lengthy process. Here are the steps in simplified form.

54. 765 Ill. Comp. Stat. 605/15(a) (1963) (citing to the original language contained in the statute).

55. 735 ILL. COMP. STAT. 30/1-99 (2018).

56. 735 ILL. COMP. STAT. 30/ 5-5-5(c) (2018).

57. 735 ILL. COMP. STAT. 30/10-5-5(a) (2018).

58. Hypothetical created by author to demonstrate one purpose of a deconversion.

59. This represents the author’s observations as a participant in the Chicago deconversion market.

A. *Identifying the Property*

As discussed above, distressed Condos make good acquisition targets. According to Santo Rizzo, a Chicago deconversion broker responsible for some of the biggest recent Chicago deconversions, investors identify Condos troubled by large special assessments and other financial difficulties.⁶⁰ Scale is also important. Large corporate buyers, such as Strategic Properties of North America, tend to favor large projects consisting of hundreds of units.⁶¹

A new trend is towards smaller, vintage buildings in Northside neighborhoods such as Ravenswood and Uptown. These projects can be as small as three to twelve units, with some in the twelve to twenty-five unit range. “Analysis by KIG, a Chicago broker/developer, revealed neighborhood multifamily transactions increased by 175% in 2017 over 2016.”⁶²

B. *Buyer Due Diligence*

The savvy investor looking at deconversion candidate property completes exhaustive due diligence. On the expense side, investors must identify building insurance, maintenance, administration, environmental hazards, municipal and zoning issues, and other expenses.⁶³ On the revenue side, Condo dues, vending income, and other special income are considered. Deferred maintenance is an especially important topic.

1. *Investor Valuation Approaches*

Unlike residential appraisals, commercial valuation is a complex and varied process. Determining a property’s worth often depends on its highest and best use, or the buyer’s future use. Several valuation approaches are used and may reveal vastly different values.

a. Cost Approach: Value = Cost of land + Construction Cost

The cost approach is most often used with specific-use

60. Interview with Santo Rizzo, Chicago deconversion broker (August 2018).

61. *Id.* Strategic Partners of North America have closed on these Chicago deconversions in 2016-2018: Kenelly Square, 268 units for 78 million, Clark Place, 133 units, 35 million, and Bel Harbor (brokered by Santo Rizzo) 207 units, 51.5 million.

62. Chuck Sudo, *There Is No Market For One-Bedroom Condos, And Insatiable Appetite for Condo Deconversions*, BISNOW (Jan. 31, 2018), https://www.bisnow.com/chicago/news/multifamily/chicagos-condo-deconversion-trend-is-adding-scores-of-one-bedroom-apartments-to-neighborhoods-inventory-84413?utm_source=CopyShare&utm_medium=Browser.

63. Interview with Santo Rizzo, Chicago deconversion broker (August 2018).

property. “The cost approach assumes that the cost of a property is based on its highest and best use.”⁶⁴ In other words, if land is suited to gravel mining, the best use would not be residential housing. The method takes into consideration current land costs, rebuilding cost of any structures, and construction and other costs associated with replacement. The cost approach is “generally applied when appropriate comparables are difficult to locate, such as when the property contains relatively unique or specialized improvements, or when upgraded structures have added substantial value to the underlying land.”⁶⁵

The cost approach is often used in the valuation of a deconversion simply because finding comparables to unique projects, or similar deconversion projects may be difficult. Compared to other approaches, the cost approach may not yield true to market unit values necessary to reach the just compensation standard that Section 15 ought to be measured by. It does, however, meet the “fair appraisal” standard currently used.

b. Sales Comparison Approach: Value = Other Like Properties Sold in a Local Geographic Area

The comparison approach resembles the typical valuation scheme used to value residential property. Here, a valuator simply locates and compares the subject property with a similar property that has recently sold in a local geographic area. This produces a true market value because the subject is compared in real-time with another property that has recently sold in the same market. The issue here is finding other like condominium projects in the same local area.

c. Income Approach: Value = Net Operating Income (NOI)/Capitalization (CAP) Rate

The following three components are critical to the property valuation.⁶⁶

The net operating income is the biggest variable in the equation. Remember that because all the components of NOI vary from property to property, it can become subjective.

64. *How to Value Commercial Real Estate: Comparing Approaches*, VALUEPENGUIN (Jan. 2, 2019), www.valuepenguin.com/small-business/how-to-value-commercial-real-estate.

65. Rafael Rosenkranz, *Five Common Methods to Value a Commercial Property*, FIRST REPUBLIC (May 16, 2016), www.firstrepublic.com/articles-insights/life-money/grow-your-wealth/five-common-methods-to-value-a-commercial-property.

66. Richard C. Reimer, *3 Approaches to Valuing Commercial Real Estate*, SCOTSMAN GUIDE (Nov. 2006), www.scotsmanguide.com/Commercial/Articles/2006/11/3-Approaches-to-Valuing-Commercial-Real-Estate/.

The CAP rate is determined by the buyer's objectives. It is essentially the assumed annual return on an investment before mortgage payments and taxes.

The value varies, depending on whether the NOI is computing "as is" value or market value. If the valuation is as-is, then actual rents and actual operating expenses are used. If the valuation is market, then market rents, vacancy credit losses and operating expenses are used.⁶⁷

This is where buyer due diligence comes into play. Proper and detailed diligence assures that the data input into these calculations is complete, leading to a realistic valuation. Done properly, the income approach yields true comparable values to the condominium deconversion's end-product: a multi-unit rental property, i.e., apartment building. Because this approach compares the offer for purchase price tendered to the Condo with the values consistent with other local and like apartment buildings on an income-producing basis, the values generated tend to be the highest and best market value price. Thus, there is just compensation for individual unit owners.

C. *The Offer Process*

Once a property is identified, and all due diligence is done, a buyer will use one of the three approaches and come up with a project value. For the investor's purposes, the income approach makes most sense. When an end-value is determined, the investor can craft an offer. What the offer must come down to be successful is this: what will the individual unit owner receive in relation to his or her share of the property? In other words, *dollars per door*.

This is the metric unit owners will be comparing when the inevitable competitive offers start rolling in. In most cases, outside brokers and investors solicit Condos for the opportunity to present an offer. Increasingly though, Condo boards have become proactive and hire brokers or law firms to solicit offers from investors, especially if they are at the point of voting to levy costly special assessments. The sentiment being, *why spend the money if we can sell for a premium?*⁶⁸

67. *Id.*

68. Alby Gallun, *These Big Condo Towers Could Be Rentals Once Again*, CRAIN'S CHI. BUS. (May 31, 2017), www.chicagobusiness.com/article/20170531/CRED03/170539960/chicago-condos-consider-switch-to-rentals.

D. The Voting Process

1. Section 2.1

Before we get into voting, it is important to remember the Declaration requirement. The Declaration is the governing instrument of the Condo. In it are rules regarding how a vote is required to take place. It must at least comply with the statutory minimums outlined in Section 15 of the Act but may impose greater requirements.⁶⁹ Lastly, “[a]ny provisions of a condominium instrument that contains provisions inconsistent with the provisions of th[e] Act are void as against public policy and ineffective.”⁷⁰ This will become important information as we shall see.

a. Section 15 Requirements

Section 15 of the Act requires that 75% of unit owners must vote in the affirmative to approve a sale of the entire property.⁷¹ The statute provides:

Unless a greater percentage is provided for in the declaration or bylaws, and notwithstanding the provisions of Sections 13 and 14 hereof, a majority of the unit owners where the property contains 2 units, or not less than 66 2/3% where the property contains three units, and not less than 75% where the property contains 4 or more units may, by affirmative vote at a meeting of unit owners duly called for such purpose, elect to sell the property.⁷²

Notice the first words, “Unless a greater percentage is provided for in the declaration or bylaws”⁷³ Also notice the next provision, which provides: “Such action shall be binding upon all unit owners, and it shall thereupon become the duty of every unit owner to execute and deliver such instruments and to perform all acts as in manner and form may be necessary to effect such sale”⁷⁴

There you have it: the crux of the statute regarding the rights of individual unit owners. Once the board accepts an investor’s offer, and once 75% of the unit owners vote to accept that offer, “*Every unit owners’ association must comply with the Condominium and Common Interest Community Ombudsperson Act.*”⁷⁵ The reasoning for this is basic corporations and partnership common law. For example, if a private corporation with eight shareholders voted on an important resolution, and a quorum was present, the dissenters

69. 765 ILL. COMP. STAT. 605/15 (2018).

70. 765 ILL. COMP. STAT. 605/2.1 (2018).

71. 765 ILL. COMP. STAT. 605/15 (2018).

72. 765 ILL. COMP. STAT. 605/15(a) (2018).

73. *Id.*

74. *Id.*

75. 765 ILL. COMP. STAT. 605/35 (2018).

must go along with the majority or nothing would ever get done. Unanimity for major decisions is preferred, but elusive. For the dissenting voters, however, options are extremely limited and fundamentally unfair.

E. The Holdouts

Those who dissented from voting in favor of sale, and who refuse to effectuate the sale of their units are the holdouts, and they can single-handedly hold up a Section 15 sale by making a written objection.⁷⁶ In *Huntington Condo. Ass'n v. Grimm*, “Grimm, and several owners in other condo deconversions [were] hiring attorneys, resisting pressure to sell their homes for a fraction of what they believe they’re worth.”⁷⁷ In order to trigger their rights of dissent, unit owners must first properly object under the new 2018 provisions of Section 15.⁷⁸

1. Objection Under Section 15

The 2018 amendments to Section 15 provide for an objection process, but not necessarily a remedy.⁷⁹ The 2018 amendments to the Act provide in pertinent part:

[H]owever, that any unit owner who did not vote in favor of such action and who has filed written objection thereto with the manager or board of managers within 20 days after the date of the meeting at which such sale was approved shall be entitled to receive from the proceeds of such sale an amount equivalent to the greater of: (i) the value of his or her interest, as determined by a fair appraisal, less the amount of any unpaid assessments or charges due and owing from such unit owner or (ii) the outstanding balance of any bona fide debt secured by the objecting unit owner's interest which was incurred by such unit owner in connection with the acquisition or refinance of the unit owner's interest, less the amount of any unpaid assessments or charges due and owing from such unit owner. The objecting unit owner is also entitled to receive from the proceeds of a sale under this Section reimbursement for reasonable relocation costs, determined in the same manner as under the federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended from time to time, and as implemented by regulations promulgated under that Act.⁸⁰

This amendment is significant for several reasons. Let us

76. 765 ILL. COMP. STAT. 605/15(a)(ii) (2018).

77. Deborah Goonan, *Condo to Apartment ‘Deconversions’ Continue in Chicago*, INDEP. AM. COMMUNITIES (May 19, 2018), www.independentamericancommunities.com/2018/05/19/condo-to-apartment-deconversions-continue-in-chicago/.

78. 765 ILL. COMP. STAT. 605/15(a)(ii) (2018).

79. 765 ILL. COMP. STAT. 605/15 (2018).

80. 765 ILL. COMP. STAT. 605/15 (2018).

unpack this provision and discuss in detail its components.

The 20-day written objection period begins on the day the vote was taken and the sale approved. The written objection must be filed with the Condo board.

Once filed, the objecting owner “shall be entitled to receive from the proceeds of such sale an amount equivalent to the greater of: (i) *the value of his or her interest*, as determined by a *fair appraisal*, less the amount of any unpaid assessments or charges due and owing from such unit owner . . . ”⁸¹

Here is where the ambiguity rears its ugly head. Questions such as: What does a fair appraisal mean? Who determines the fair value? Whose duty is it to provide a fair appraisal? What valuation approach should be used? Who pays for the appraisal? are important ones to ask. This last question is important because a commercial appraisal on a 300-unit property could run in the tens of thousands of dollars. All these questions are in play and the Act is completely silent. Also important is to note that the unit owner is to receive the value of his or her interest. This is not the per-unit appraisal now being used. A unit owner’s interest is his or her interest in the appraised value of the entire property. This is significant because it places the duty on the Condo to provide a valuation of the entire property. The amendment further provides:

If subject to liens,

- (ii) the outstanding balance of any bona fide debt secured by the objecting unit owner's interest which was incurred by such unit owner in connection with the acquisition or refinance of the unit owner's interest, less the amount of any unpaid assessments or charges due and owing from such unit owner.⁸²

This is a major improvement, no doubt brought on by screaming constituents pressuring lawmakers. This provision eliminates the responsibility of the unit owner to short sale their underwater unit to their financial detriment as discussed previously.⁸³ In addition,

Unit owner reimbursement for moving expenses is also a product of political pressure. “The objecting unit owner is also entitled to receive from the proceeds of a sale under this Section reimbursement for reasonable relocation costs, determined in the same manner as under the federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970...”⁸⁴

“If there is a disagreement as to the value of the interest of a unit owner who did not vote in favor of the sale of the property, that

81. 765 ILL. COMP. STAT. 605/15(i) (2018).

82. *Id.*

83. 765 ILL. COMP. STAT. 605/15(a)(ii) (2018).

84. *Id.*

unit owner shall have a right to designate an expert in appraisal or property valuation to represent him, in which case, the prospective purchaser of the property shall designate an expert in appraisal or property valuation to represent him, and both of these experts shall mutually designate a third expert in appraisal or property valuation. The 3 experts shall constitute a panel to determine by vote of at least 2 of the members of the panel, the value of that unit owner's interest in the property.”⁸⁵

In effect, once the investor has presented its contract and valuation to the Condo, and a vote based upon this valuation is successful, the Act provides a hazy, but logical process to object. This assumes that the board did their own due diligence and had their own valuation done, or otherwise underwrote the investors valuation to determine if it was commensurate with market value at a minimum. In this case, if a unit owner objects he or she then must hire their own appraiser, the investor brings in theirs, and a disinterested third-party appraiser mediates a value. The issue with this is that now, a unit owner either must shell out tens of thousands of dollars to get a whole project appraisal, or simply get an ordinary residential single unit appraisal, which is not equipped to provide an accurate value.

2. Remedies

There are none. This is the fundamental unfairness of the current Section 15 scheme. In theory, a holdout could negotiate for more money. This is a limited remedy because the ambiguity of the term *fair appraisal* hamstring any negotiation.⁸⁶ There is no benchmark to compare to such as is required under eminent domain. “While Section 15 spells out how the conversions can occur, the provision doesn’t spell out any penalties for violating its requirements or give any government agency authority to oversee and enforce it.”⁸⁷ For example, “[o]wners can be compelled to take a bath, if that’s what the other members decide.”⁸⁸ This is a true majority rules situation whereby a minority voter’s property rights can be extinguished upon a majority vote.

But what if money is not the issue? In *Huntington Condo. Ass’n v. Grimm*, Jeffrey Grimm is the lone holdout in the 356-unit Huntington property.⁸⁹ In this case, Mr. Grimm can certainly walk away with more than the \$153,000 the other holdouts accepted (far

85. *Id.*

86. 765 ILL. COMP. STAT. 605/15(a) (2018).

87. Jonathan Bilyk, *Converting Values: Condo Owners on Wrong End of Deconversions Lament Lack of Legal Protections*, COOK COUNTY REC. (May 4, 2018), www.cookcountyrecord.com/stories/511404961-converting-values-condo-owners-on-wrong-end-of-deconversions-lament-lack-of-legal-protections.

88. *Id.* (quoting James Arrigo, an attorney specialized in condominium association and real estate law).

89. Interview with Damon Fisch, attorney for Jeffrey Grimm (Aug. 2018).

higher than the \$50,000 original investor offer).⁹⁰ However, Mr. Grimm is looking to object on the fundamental unfairness of the process itself.⁹¹

V. STATUTORY AMBIGUITY

As described above, Section 15 of the Act is deficient and ambiguous in key provisions at best, and fully incompetent at worst. Much of the issue stems from the fact that the original intention of the legislature when it drafted Section 15 is now mostly outdated. Modern market trends and industry changes demand that the section be re-written.

A. Section 15 – *What the Legislation Intended*

Condominiums in Illinois now have a greater than half-century history of use. “Many of the early condominium projects are old and in need of rehabilitation or cannot economically be rehabilitated and are candidates for demolition and redevelopment.”⁹² In a modern sense, that redevelopment is deconversion. To be sure, Section 15 serves an important purpose. With looming special assessments, deferred maintenance, and financially failed Condos, Section 15 provides an exit strategy. Today, however, savvy investors and crooked Condo boards exploit the ambiguity of Section 15 to the individual unit owner’s detriment.

1. *Compare to the UCIOA*

The Uniform Common Interest Ownership Act (“UCIOA”) was promulgated in 1982 and amended in 2008 and 2014.⁹³ It is adopted by Connecticut, Delaware, Vermont, and Washington state.⁹⁴ Planners sought to bring efficiency and uniformity to common interest legislation.⁹⁵ The UCIOA raises the minimum threshold to approve a sale to 80% of unit owners:⁹⁶ “The association, on behalf of the unit owners, may contract for the sale of real estate in a common interest community, but the contract is not binding on the

90. *Id.*

91. *Id.*

92. Brian Meltzer, Martin A. Schwartz & Matthew J. Leeds, *Time to Rehab the Aging Condominium Concept: Fixing Problems Uncovered by the Great Recession*, PRAC. REAL EST. L. 1, 1 (Sept. 2017).

93. Common Interest Ownership Act, UNIFORM L. COMMISSION, www.my.uniformlaws.org/committees/community-home?CommunityKey=587d74e1-ae08-48be-b3c1-a6eae168e965 (last visited Jan. 2, 2019).

94. *Id.*

95. *Id.*

96. Unif. Common Interest Ownership Act §2-118(a) (1982).

unit owners until approved”⁹⁷ Then, “an agreement to terminate must be evidenced by the execution of a termination agreement, or ratifications thereof, in the same manner as a deed”⁹⁸

This is significant. Once ratified, all unit owners execute an agreement, a *deed in fact*, to which the ownership of all units conveys to the Condo. In turn, the condo can convey in one transaction to an end buyer. After the sale is ratified, the “assets of the association must be distributed to all unit owners and all lien holders as their interests may appear in the order”⁹⁹

Most importantly:

*[T]he respective interests of unit owners are the fair market values of their units . . . as determined by one or more independent appraisers selected by the association. The decision of the independent appraisers must be distributed to the unit owners and becomes final unless disapproved within 30 days after distribution by unit owners of units to which 25 percent of the votes in the association are allocated. The proportion of any unit owner’s interest to that of all unit owners is determined by dividing the fair market value of that unit owner’s unit and its allocated interests by the total fair market values of all the units and their allocated interests.*¹⁰⁰ (emphasis added)

What a difference! All of Section 15’s haziness and ambiguous friction points are eliminated by clear, concise, and *fair* language. The UCIOA comes full circle to the constitutionally correct eminent domain standard of just compensation—*fair market value* (“FMV”). How does it get to FMV? By appraisers selected by the association—settling both the duty and the methodology question, though language should be added to specify *what* valuation methodology. Lastly, the FMV is imputed directly to the unit owner’s individual interests.

2. *How Buyers and Developers Exploit Section 15’s Ambiguity*

As of this writing, only four states have adopted the UCIOA model.¹⁰¹ Most rely on a hodgepodge of statutes loosely mirroring Illinois and New York. No uniform fair standard is applied, investors and boards can and do exploit ambiguity to unit owner’s detriment. One such example is the sordid tale of Jeffrey Grimm’s fight against the Residences at Huntington Condo.¹⁰²

97. Unif. Common Interest Ownership Act §2-118(e) (1982).

98. Unif. Common Interest Ownership Act §2-118(b) (1982).

99. Unif. Common Interest Ownership Act § 2-118(b)(i)(5) (1982).

100. Unif. Common Interest Ownership Act §2-118(j)(2) (2014).

101. Common Interest Ownership Act, UNIFORM L. COMMISSION, www.my.uniformlaws.org/committees/community-home?CommunityKey=587d74e1-ae08-48be-b3c1-a6eae168e965 (last visited Jan. 2, 2019).

102. Interview with Damon Fisch, attorney for Jeffrey Grimm (Aug. 2018).

a. Huntington Condo. Ass'n v. Grimm

Located in the affluent Southwest suburb of Chicago, Naperville's 356-unit Residences at Huntington was a failed condominium project.¹⁰³ Just prior to the crash, Huntington's developers had sold less than 50 units before the real estate market plummeted in 2008.¹⁰⁴ Faced with certain failure, Huntington's developers decided to retain the unsold units and instead rented them out in sort of a *de facto* deconversion.¹⁰⁵ Over the subsequent decade, the developer reclaimed all but sixteen units. Rockwell Partners, a Chicago based real estate management company, owned or controlled Huntington's retained units.¹⁰⁶ Rockwell also tendered the purchase offer as buyer to Huntington's board under the name HC Naper Investments, LLC.¹⁰⁷

b. Exposing the Captive (Zombie) Condo Board

There is one key peculiarity of the Huntington Homeowner's Association board – four out of the five directors are Rockwell employees.¹⁰⁸ This creates a fundamental conflict of interest. Private unit owner Jeffrey Grimm was the lone remaining director.¹⁰⁹ This created a board mindlessly beholden to the interests of Rockwell, not the Huntington Condo.¹¹⁰ To determine the extent of the conflict, we turn to the governing statute for Illinois Condos.

3. *The Illinois Not for Profit Act*

Illinois Condos are governed by the General Not for Profit Corporation Act of 1986 ("NFPA").¹¹¹ The Act provides the rules for Illinois Not for Profit entity corporate governance.¹¹² Article 8 of the Act governs directors and officers.¹¹³ Of interest here is Section 108.60 which provides for the conflict of interest rules for directors. In part, the statute provides: "If a transaction is fair to a corporation

103. *Id.*

104. *Id.*

105. *Id.*

106. Defendant's Motion to Dismiss at ¶ 16, Huntington Condo. Ass'n v. Grimm, 2018CH000210 (Jan. 10, 2019) (author obtained information about this case from his interview with Damon Fisch, attorney for Jeffrey Grimm (Aug. 2018)).

107. *Id.*

108. *Id.*

109. Interview with Damon Fisch, attorney for Jeffrey Grimm (Aug. 2018).

110. *Id.*

111. 805 ILL. COMP. STAT.105 (2018).

112. *Id.*

113. *Id.*

at the time it is authorized, approved, or ratified, the fact that a director of the corporation is directly or indirectly a party to the transaction is not grounds for invalidating the transaction.”¹¹⁴

The term “corporation” is operative. In this case, the corporation is the Condo, not the seller. Therefore, any director of the board of any Condo must act in fairness to the Condo when voting on any transaction, such as voting on a purchase offer. This also means that a director voting in the interest of another entity, such as the selling entity, can invalidate the transaction unless full disclosure is made, or may not have his or her vote counted.¹¹⁵

Condo directors have a fiduciary duty to the Condo and may be personally liable in some cases for certain transactions.¹¹⁶ However, the Condo may indemnify directors acting in good faith on behalf of the Condo.¹¹⁷ Director duties mirror those of any corporate entity and include the duty of care and duty of loyalty.¹¹⁸ Ordinarily protected by the business judgment rule, a director may become liable if they make decisions in bad faith, or recklessness or imprudence to the fiduciary duty of the Condo.¹¹⁹

In cases such as *Huntington Condo. Ass’n*, duty of loyalty is directly implicated.¹²⁰ Because directors are employees of the selling entity, and stand to materially benefit from the sale, any decision by them to sell to the detriment of the Condo and unit owners

114. 805 ILL. COMP. STAT. 105/108.60(a) (2018).

115. 805 ILL. COMP. STAT. 105/108.60(c)(2018).

116. 805 ILL. COMP. STAT. 105/108.65; *see also* *Raven’s Cove v. Knappe Dev. Co.*, 114 Cal. App. 3d 783, 799 (1981) (opining, “it is well settled that directors of nonprofit corporations are fiduciaries.”); *Cohen v. Kite Hill Cmty. Assn.*, 142 Cal. App. 3d. 642, 650-651 (1983) (holding, “in recognition of the increasingly important role played by private homeowners’ associations...the courts have recognized that such associations owe a fiduciary duty to their members.”); *Frances T. v. Vill. Green Owners Ass’n*, 42 Cal. 3d 490, 513 (1986) (stating:

Directors of nonprofit corporations such as the Association are fiduciaries who are required to exercise their powers in accordance with the duties imposed by the Corporations Code The fiduciary relationship is governed by the statutory standard that requires directors to exercise due care and undivided loyalty for the interests of the corporation). *Id.*

117. 805 ILL. COMP. STAT. 105/108.75 (2012).

118. *Burt v. Irvine Co.*, 237 Cal. App. 2d 828, 852 (1965) (stating:

Directors are not merely bound to be honest; they must also be diligent and careful in performing the duties they have undertaken. They cannot excuse imprudence on the ground of their ignorance or inexperience, or the honesty of their intentions; and, if they commit an error of judgment through mere recklessness, or want of ordinary prudence and skill, the corporation may hold them responsible for the consequences). *Id.*

119. *Id.*

120. *Huntington Condo. Ass’n v. Grimm*, 2018CH000210 (Feb. 14, 2018) (author obtained information about case from Damon Fisch, attorney for Jeffrey Grimm (Aug. 2018)).

constitutes self-dealing.¹²¹

VI. PROPOSED CHANGES TO SECTION 15

I propose a selective merging of the UCIOA Section 2-118 termination provision with that of existing Section 15 language, to gain the best of both schemes. My proposed changes to the current Act's language are in italics:

(a) *a common interest community may be terminated only by agreement of unit owners of units to which at least 80 percent of the votes in the association are allocated, or any larger percentage the declaration specifies, and with any other approvals required by the declaration and may, by affirmative vote at a meeting of unit owners duly called for such purpose, elect to sell the property. Such action shall be binding upon all unit owners, and it shall thereupon become the duty of every unit owner to execute and deliver such instruments and to perform all acts as in manner and form may be necessary to effect such sale, provided, however, that any unit owner who did not vote in favor of such action and who has filed written objection thereto with the manager or board of managers within 20 days after the date of the meeting at which such sale was approved shall be entitled to receive as just compensation from the proceeds of such sale an amount equivalent to the greater of: (i) the value of his or her interest of the entire property, as determined by a fair market master appraisal using one or more of the following types of appraisals: 1) Cost approach; Sales comparison approach; or the Income approach, less the amount of any unpaid assessments or charges due and owing from such unit owner or (ii) the outstanding balance of any bona fide debt secured by the objecting unit owner's interest which was incurred by such unit owner in connection with the acquisition or refinance of the unit owner's interest, less the amount of any unpaid assessments or charges due and owing from such unit owner. The objecting unit owner is also entitled to receive from the proceeds of a sale under this Section reimbursement for reasonable relocation costs, determined in the same manner as under the federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended from time to time, and as implemented by regulations promulgated under that Act. It shall be the duty of the buyer to provide to the Condo the appraisal completed by a duly licensed appraiser, using one of the valuation methods described in sub-section (ii).*

(b) If there is a disagreement as to the value of the interest of a unit owner who did not vote in favor of the sale of the property, that unit

121. *Raven's Cove*, 114 Cal. App. 3d at 799 (stating:

[T]he duty of undivided loyalty . . . applies when the board of the directors of the Association considers maintenance and repair contracts, the operating budget, creation of reserve and operating accounts, etc. Thus, . . . directors of an association . . . may not make decisions for the Association that benefit their own interests at the expense of the association and its members . . .) *Id.*

owner shall have a right to designate an expert in appraisal or property valuation, *using a common residential sales comparison appraisal to represent him in establishing a value for the unit in question*, in which case, the prospective purchaser of the property shall designate an expert in appraisal or property valuation *as described above*, to represent him, and both of these experts shall mutually designate a third expert in appraisal or property valuation. The 3 experts shall constitute a panel to determine by vote of at least 2 of the members of the panel, the value of that unit owner's interest in the property, *to be compared to the master appraisal described in sub-section (i). The unit owner may then choose the greater of the two values, subjecting the objecting unit owner to all duties of Section (a).*

This merging of regulatory schemes preserves the purpose of the Act, which is to provide a Condo with an exit plan, means to remove an entire property from the Act, and still balance the property rights of individual unit owners. By removing the ambiguity of the current Section 15 language and establishing:

1. A flat 80% approval rate; and
2. Just compensation to unit owners by fair market master appraisal; and
3. Defining what an acceptable master appraisal is; and
4. Defining whose duty it is to acquire the master appraisal; and
5. Expanding the objection process to allow unit owner to choose which valuation method is acceptable; then the process of removing an entire common interest community property from the Act, a deconversion, is finally a level playing field, fair, and just.

VII. CONCLUSION

Section 15 of the Act, in its current form, is outdated, ambiguous, and invites abuse from investors and developers to the unit owner's detriment. The solution, however, is simple. By combining elements of the UCIOA and the current Section 15 language, Illinois can bring clarity to the haze of ambiguity and preserve notions of fair dealing, just compensation, and justice for Illinois unit owners subject to a condominium deconversion offer.

