

Condominiums: Deconversion (IL)

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A Practice Note discussing the key issues and requirements for deconverting a condominium in Illinois under the Illinois Condominium Property Act. This Note also discusses the right of a supermajority of unit owners to force a sale of all the condominium units in a condominium association under Section 15 of the Illinois Condominium Property Act to allow a deconversion, the rights of objecting unit owners, the fiduciary duties of the board of managers, and local municipal considerations.

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In Illinois, **condominiums** are created under the Illinois Condominium Property Act (Act) ([765 ILCS 605/1](#) to [605/35](#)). The rights and authority of a condominium association and its board of managers (sometimes also called board) are derived solely from:

- The Act.
- The terms and provisions of the condominium declaration and the bylaws that are not inconsistent with the Act.
- Specific authority granted by the unit owners.

On occasion, circumstances may exist making it desirable to discontinue the condominium form of ownership. This is done by removing the property from the provisions of the Act through Section 16 (765 ILCS 605/16). This process is frequently referred to as a condominium deconversion. Deconversion is not a legal term but is used informally in Illinois to describe the process of removing property from the provisions of the Act.

In the case of a typical residential condominium, the legal effect of a deconversion is that:

- The Act, the condominium declaration, and the bylaws no longer apply.
- The individual condominium units (also called units) are no longer subject to ownership or transfer.
- The property reverts to a residential apartment building.

The current popularity of deconverting residential condominiums is market driven. The aggregate **fair market value** of all the units in a condominium project is often less than the fair market value of the same project as a unified multifamily rental apartment project. Multifamily rental apartment buildings, especially in Chicago, are currently sought after by investors as highly desirable investment properties due in part to:

- Rising rental rates.
- Attractive long-term financing options available for multifamily rental apartments.
- The low supply of available apartment buildings for sale compared to residential condominium projects with high concentrations of unit owners willing to sell.
- The marketplace prices for:
 - apartment buildings are currently high; and
 - the demand for individual residential condominiums is fairly flat.

Financial Factors

The market for many condominiums has still not fully recovered from the economic effects of the last recession. This is especially true in financially distressed condominium associations that have:

- High levels of deferred maintenance.
- Depleted reserves.
- Special **assessments**.

- High monthly assessments.

The ability to sell or finance the purchase of a condominium unit is sometimes hindered due to condominium distress issues, such as:

- **Foreclosures** and short sales of units.
- Units with **mortgage** balances exceeding unit value.
- High concentrations of investor owned units.
- Ineffective management of the condominium.
- Deferred maintenance on aging buildings that can result in:
 - increased monthly assessments;
 - the imposition of special assessments; and
 - building code violations.
- Reserve shortages.

As a result, the fair market value for individual condominium units may be depressed.

In the current marketplace, it is not unusual for the aggregate fair market value of all condominium units in a condominium building to be as much as 30% to 40% less than the fair market value of the same building if it were owned and operated as an apartment building. Sometimes the value difference can be even greater. Because of this spread in values, the deconversion market is currently popular. The spread in values may provide an opportunity for both:

- The investor seeking to acquire and deconvert the condominium project.
- The selling unit owners.

Because of the value spread, unit owners acting together to sell the project as a whole may:

- Be in a favorable position to negotiate an aggregate sale price for their units that can be higher than the aggregate fair market value of the condominium units being sold individually.
- Achieve a price point per unit that is several percentage points higher than the fair market value of the individual units.

Investor Issues

An investor seeking to deconvert a condominium often agrees to pay more if the investor is assured of acquiring all the condominium units in the project because the value of the property as a whole following deconversion is often significantly greater than the collective value of the individual units.

However, in addition to the cost of acquiring the units, the investor must account for all post-acquisition **capital improvements** the investor must make to place the property in a suitable condition that is attractive to the investor's target rental market, including:

- Performing any needed deferred maintenance.
- Correcting existing building violations.
- Renovating and updating:
 - the dwelling units; and
 - the common areas.

The amount an investor must invest in the project in addition to its purchase price:

- Impacts the investor's profitability.
- Affects the margin over the fair market value an investor may be willing to pay to acquire the condominium units for deconversion.

Deconversion with Consent of All Owners and Lien Holders

The Act provides for a voluntary process to deconvert the condominium with the consent of all the unit owners and the lien holders. If at the time of the deconversion there is more than one-unit owner:

- The entire property is owned by the former unit owners as **tenants in common** with each other.
- Each owner has an undivided tenancy in common interest in the whole property proportionate to their previously owned percentage interest in the **common elements**.
- Each holder of a **lien** has a lien on an undivided tenancy in common interest in the whole property in proportion to the percentage interest in the common elements of the previously existing unit.

(765 ILCS 605/16.)

While it is legally permissible, a multi-owner deconversion is unusual. In most circumstances, a multi-owner deconversion creates legal and practical problems due to the former unit owners owning a multifamily property as tenants in common.

One of the biggest obstacles to a multi-owner deconversion is that ownership as a tenant in common grants each owner an equal right of possession and enjoyment of the entire property (*Westerdale v. Grossman*, 312 Ill. App. 3d 884, 886 (2000)). Although there may be solutions in special circumstances, a multi-owner deconversion resulting in ownership of the entire property by multiple tenants in common can:

- Create practical operating and legal issues in a multifamily building occupied by the former unit owners each legally entitled to possess the entire property.
- Present unfavorable issues for any lender with a loan secured by a previously existing individual unit that, after the deconversion, then has a lien on an undivided fractional interest in the property as a whole.
- Present obstacles to refinancing the property as a whole due to the existence of multiple owners with unequal fractional interests in the entire property.

Sale of Units to a Single Purchaser

The typical solution to avoid the tenant in common issue resulting from a multi-owner deconversion is for all the unit owners to sell their units to a single purchaser. When all the units are owned by a single unit owner, the sole owner of all the units can sign and **record** a notice of removal withdrawing the entire property from the Act (notice of removal) with the consent of its lender. Recording a notice of removal results in:

- The termination of the status of the property as a condominium.
- The property reverting to a unified apartment building with only one owner.

The units may be sold by separately negotiated contracts between each of the unit owners and the purchaser. This approach can be time-consuming and creates logistical problems and risks, such as:

- Not all the unit owners reaching an agreement with the investor resulting in the investor:
 - not being able to withdraw the property from the Act;
 - becoming an owner of several condominium units but not the owner of the entire building; and
 - failing to satisfy loan funding conditions of the investor's lender which commonly require acquisition of all or a minimum percentage of all units.
- Each unit owner may engage its own attorney to handle its unit closing causing:
 - the investor's attorney to negotiate multiple versions of purchase and sale agreements and closing documents; and

- practical challenges for coordination of closings for all the units.
- Residential seller's attorneys are often title agents motivated to use their preferred **title company** or title agency of choice, which may result in title clearance issues and closing coordination problems for the investor and its lender.

Many attorneys for individual unit owners may resist being required to use a title company selected by the investor for which the unit owner's attorney may not be a title agent. Attorneys in Illinois typically:

- Charge relatively small amounts as attorneys' fees for representing a seller of residential property.
- Derive substantial revenue from each closing by being a title agent and receiving a sizable portion of the title insurance premium in that capacity.

Most investors with a plan to deconvert, and their lenders, do not wish to acquire any unit unless they are assured that they can acquire all the units. The practical way for the investor to accomplish this outcome is for the investor to:

- Acquire all the units simultaneously in a single bulk closing.
- Require all sellers to use a single title company selected by the investor.
- Include a simultaneous closing condition in each unit's purchase and sale agreement providing that the investor is not obligated to acquire any unit unless it can simultaneously acquire all of the units.

An alternative approach is to use Section 15 of the Act to simultaneously acquire all the units in a single transaction using a single purchase and sale agreement. Section 15 also provides a mechanism for forcing holdout unit owners to participate in the sale.

Section 15 Sale

If done correctly, Section 15 of the Act provides unit owners with a powerful tool to carry out the will of a supermajority of unit owners to sell the entire property despite efforts by a small minority of unit owners to stop the sale. Approval of a sale of the entire property under Section 15 of the Act (Section 15 sale) must be obtained from a supermajority of unit owners at a special meeting specifically called for that purpose (Section 15 special meeting).

Unless the condominium declaration and the bylaws or a local municipal **ordinance** adopted by a **home rule** unit of government require a greater percentage (see [Local Municipal Ordinances](#)), the percentage of all the units required for a supermajority to affirmatively approve a Section 15 sale is:

- Both units for a condominium containing two units.
- Two units for a condominium containing three units.
- Units owning 75% of the common elements for a condominium containing four or more units.

(765 ILCS 605/15(a).)

Section 18(b)(13) Special Meeting for the Board to Pursue a Section 15 Sale

Before a condominium association takes action to pursue a sale of the property on behalf of all the unit owners, Section 18(b)(13)(iii) of the Act requires that a special meeting of unit owners must be called and held for that specific purpose (Section 18(b)(13) special meeting). This step, however, is often overlooked by condominium associations and their attorneys even though it is mandated by the Act, the condominium declaration, and the bylaws. Failure of the board of managers to strictly comply with the Act, the condominium declaration, and the bylaws is a breach of fiduciary duty that may result in each participating board member being held personally liable (see [Breach of Fiduciary Duty](#)).

Ordinary rules of statutory construction require:

- The intent of the legislature to be determined and given effect. The most reliable indicator of legislative intent generally is the statutory language itself given its plain and ordinary meaning.
- That a reasonable interpretation be given to each word, clause, and sentence of a statute.
- That no term should be rendered superfluous.

(*Lake Shore Ass'n v. Deutsche Bank Nat'l. Tr. Co.*, 2015 IL 118372 ¶ 21.)

Considering together Section 15, Section 18(b)(13), and Section 18.4 of the Act, a sale of the entire property under Section 15 is a power reserved by the Act to the unit owners and is therefore excluded from the powers, duties, and authority vested in the board of managers on behalf of the condominium association. To obtain authority to act on behalf of the unit owners to pursue a Section 15 sale, the board of managers must obtain special authority to do so from the unit owners. That special authority is obtained by holding a Section 18(b)(13) special meeting.

Section 18(b)(13)(iii) requires the affirmative vote of not less than 2/3 of the votes of unit owners at a meeting duly called for that purpose to approve the purchase or sale of land or units on behalf of all the unit owners (Section 18(b)(13) special meeting).

At the Section 18(b)(13) special meeting, the unit owners may either:

- Decline to authorize any action to pursue a sale of the property on behalf of all the unit owners.
- Authorize the board, the president of the condominium association, a committee of unit owners, or other designated person (authorized representative) to take affirmative action to explore or pursue a Section 15 sale. This authorization may include granting an authorized representative authority to:
 - engage in negotiations on behalf of the condominium association within the bounds of authority granted by the unit owners at the Section 18(b)(13) special meeting (Section 18(b)(13) authority); and
 - hire on behalf of the unit owners experts to explore or pursue a sale of the property as a whole, including a real estate broker, an appraiser, legal counsel, and any other professionals as may be appropriate.

- The authority of the board of managers to act regarding a sale of the property on behalf of all the unit owners is derived solely from express authority granted to the board of managers at the Section 18(b)(13) special meeting. Without authority granted by the unit owners at a Section 18(b)(13) special meeting, the board has no authority to take any action to pursue a Section 15 sale, including:
- Marketing the property for sale as a whole.
- Hiring a broker to solicit offers for the property as a whole.
- Negotiating a sale contract on behalf of all the unit owners.

It is a breach of fiduciary duty by the board to act in a manner beyond the scope of authority expressly granted by:

- The Act.
- The condominium declaration and the bylaws.
- The express authority granted by the unit owners at a Section 18(b)(13) special meeting.

(See [Breach of Fiduciary Duty](#).)

Section 15 Sale Procedure

Whether or not the unit owners designate an authorized representative to pursue a Section 15 sale, the unit owners acting directly for themselves always have the authority to call a special meeting of unit owners under Section 18(b)(5) of the Act to consider or approve a sale of the property as a whole pursuant to Section 15.

The Section 18(b)(13) special meeting is necessary to designate an authorized representative to act on behalf of all the unit owners to market the property and negotiate a proposed sale of all the units. The authorized representation can help streamline the acquisition process instead of having all the unit owners directly negotiate the terms of sale for the entire property.

If authority has been granted to an authorized representative under a Section 18(b)(13) special meeting to act on behalf of all the unit owners and the authorized representative successfully negotiates the terms of sale with a purchaser, final approval of the Section 15 sale by the required supermajority is still required under Section 15 of the Act. Absent approval by the required supermajority, non-consenting unit owners are not bound to proceed with the sale.

Section 15 Special Meeting

At the Section 15 special meeting, the terms and conditions of a proposed sale of the property must be submitted for approval by the unit owners. This is typically done by submitting to the unit owners a fully negotiated and final form of the purchase and sale agreement detailing all the material terms of the sale, including:

- The purchase price for each unit either with:

- a schedule of the specific prices assigned to each unit; or
- a formula for determining the purchase price for each unit.

- The deadline for each unit owner to deposit the executed closing documents for its unit in escrow with the purchaser's title company.
- The amount of any broker's commissions to be paid by each unit owner.
- Any rights the unit owners may have to lease back their unit after the sale.
- The assignment of third-party leases to the purchaser at closing.
- The treatment of:
 - **security deposits** for any third-party leases; and
 - condominium association reserves.
- Provisions regarding the allocation of the costs and the expenses of closing.
- Whether any adjustment to the sale price of a unit owned by an objecting unit owner (see [Rights of an Objecting Unit Owner](#)) results in an adjustment to the sale price of all other units.
- The time and place for the closing.
- Other material terms of sale.

If approval is obtained from the required supermajority at a Section 15 special meeting, all the unit owners are bound to proceed with the sale and each unit owner is then required to:

- Execute and deliver the instruments and closing documents required to complete the Section 15 sale.
- Perform all other acts as may be necessary to cause the Section 15 sale to occur.

(765 ILCS 605/15(a).)

Rights of an Objecting Unit Owner

A unit owner not voting in favor of the Section 15 sale may file a written objection to the Section 15 sale (notice of objection) with the manager or board of managers within 20 days after the date of the Section 15 special meeting at which the Section 15 sale was approved (objecting unit owner). The objecting unit owner that properly files its notice of objection is then entitled to:

- Receive from the proceeds of the Section 15 sale an amount equal to the greater of:
 - the value of the unit owner's interest in the unit as determined by a fair appraisal less the amount of any unpaid assessments or charges due and owing from the objecting unit owner; or
 - the outstanding balance of any bona fide debt secured by the objecting unit owner's interest in the unit that was incurred by the objecting unit owner in the acquisition or refinance of the unit owner's interest in the unit less the amount of any unpaid assessments or charges due and owing from the objecting unit owner.
- Be reimbursed for reasonable relocation costs determined in the same manner as available under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (42 U.S.C. §§ 4601 to 4605).

(765 ILCS 605/15(a).)

If there is a disagreement regarding the value allocated to an objecting unit owner's interest:

- The objecting unit owner has the right to designate an expert in appraisal or property valuation (appraiser) to represent the objecting unit owner.
- If the objecting unit owner designates an appraiser, the purchaser of the property must designate an appraiser to represent the purchaser.
- Both the objecting unit owner's appraiser and the purchaser's appraiser then mutually designate a third appraiser.
- The three appraisers then form a panel of appraisers.
- The panel of appraisers must determine by a vote of at least two of the members of the panel the value of the objecting unit owner's interest in the property.

(765 ILCS 605/15(b).)

This appraisal process is the only remedy provided under the Act for an objecting unit owner.

Non-Compliant Unit Owner

If a Section 15 sale is approved by the required supermajority but a unit owner refuses to cooperate with the Section 15 sale (non-compliant unit owner), the non-compliant unit owner is in breach of its statutory duty expressed under Section 15(a) to:

- Execute and deliver documents and instruments necessary to effect this sale.
- Perform all other acts in a manner and form as may be necessary to effect this sale.

(765 ILCS 605/15(a).)

In addition to being in breach of the express statutory duties under Section 15(a), the non-compliant unit owner may be in breach of the purchase and sale agreement even though the unit owner may not have agreed to its terms. As provided in Section 15(a) of the Act, once the required supermajority of unit owners have approved the terms of sale, all unit owners are bound by this action (765 ILCS 605/15(a)).

A non-compliant unit owner may be sued for:

- A mandatory injunction requiring the non-compliant unit owner to comply with its statutory obligations.
- Specific performance.
- Damages that may include attorneys' fees and costs.

The pool of potential plaintiffs against any non-compliant unit owner includes:

- The condominium association.
- Each individual unit owner damaged by receiving less than the amount they would realize under the Section 15 sale.
- Any lender with a mortgage exceeding the value of a unit entitled to be paid in full under Section 15(a) of the Act.
- The purchaser.

Breach of Fiduciary Duty

Section 18.4 of the Act provides that in the performance of their duties, the officers and members of the board, whether appointed by the developer or elected by the unit owners, must exercise the care required of a fiduciary of the unit owners (765 ILCS 605/18.4).

Each member of the board and its officers:

- Has a fiduciary duty to the members of the condominium association.
- Must act in a manner that is reasonably related to the exercise of this fiduciary duty. Failure to comply with their fiduciary duty can result in liability for the condominium association and for the individuals themselves.

(*Bd. of Managers of Weathersfield Condo. Ass'n v. Schaumburg Ltd. P'ship*, 307 Ill. App. 3d 614, 622 (1999).)

As a fiduciary, each board member must:

- Strictly comply with the Act, the condominium declaration, and the bylaws.

- Implement the will of the members of the condominium association without exceeding its bounds.

(*Wolinsky v. Kadison*, 114 Ill. App. 3d 527, 533 (1983).)

When the condominium declaration and the bylaws provide procedures to govern board action, these procedures must be followed. Failure to comply with the requirements of the condominium declaration and the bylaws is **ultra vires** and therefore void.

The high degree of trust unit owners must place in the condominium association imposes on the members of the board strict fiduciary duties to treat unit owners with the utmost candor, rectitude, care, loyalty, and good faith (*Boucher v. 111 E. Chestnut Condo. Ass'n*, 2018 IL App (1st) 162233, ¶¶ 33-36).

As expressly provided in the opening sentence of Section 18 of the Act, Section 18(b)(13) is among the mandatory bylaws required to be adopted by every Illinois condominium association.

Resisting a Section 15 Sale

The board of some condominium associations may usurp the authority of unit owners by:

- Engaging in ultra vires actions.
- Breaching their fiduciary duties owed to all the unit owners by pursuing a Section 15 sale without first obtaining the required authorization to proceed at a Section 18(b)(13) special meeting (Section 18(b)(13) authority).

If a unit owner wishes to stop a Section 15 sale, the time to act is early in the process. Many unit owners wait too long to resist efforts by the board to promote a Section 15 sale. Once the Section 15 sale is approved by the required supermajority of unit owners, it is typically too late to stop the process. At that point, every unit owner must sell their unit in compliance with the approved terms of sale (765 ILCS 605/15(a)).

If a board starts to initiate a sale of land or units on behalf of all the unit owners without the Section 18(b)(13) authority to do so, the board is acting in breach of its fiduciary duty owed to all the unit owners by:

- Exceeding its legal authority.
- Acting in breach of its fiduciary duty owed to all the unit owners to faithfully comply with the requirements of the Act, the condominium declaration, and the bylaws.
- If the board takes steps to initiate a sale of land or units on behalf of all the unit owners without disclosing this action to the unit owners, the board of managers, including each member, is breaching its fiduciary duty to be transparent in the conduct of condominium association business and to act toward the unit owners with the utmost candor, rectitude, care, loyalty, and good faith (*Boucher*, 2018 IL App (1st) 162233, ¶ 36).

Even if a board breaches its fiduciary duty, once the required Section 15 owner approval occurs, a court may find that any action for breach of fiduciary duty for failure to comply with Section 18(b)(13) of the Act is moot.

Actions to Discourage Deconversions

Due in large part to a perception that Section 15 sales are being used by predatory investors to force homeowners from their units, a variety of measures are being pursued by deconversion opponents to slow or stop their frequency, including:

- Limiting the number of units in the building that an investor can control. This restriction is an attempt to keep the investor from acquiring enough units to reach the ownership threshold of 75% for a Section 15 sale. However, this type of restriction may violate the requirement under Section 18(b)(2) of the Act that the condominium association can have only one class of member.
- Restricting the number of units in the building that can be rented. This restriction increases the holding cost to the investor by potentially limiting its ability to lease units while it continues to acquire a sufficient number of units to authorize a Section 15 sale. If the condominium declaration allows units to be leased, a restriction on leasing must be enacted by amendment to the declaration and not by the adoption of a rule or regulation (*Strobe v. 842-848 W. Bradley Place Condo. Ass'n*, 2016 IL App (1st) 141427, ¶ 15).
- Amending the condominium declaration to increase the percentage of unit owners that must agree to a Section 15 sale so it is greater than the 75% threshold required in the Act. However, if an investor gains control of at least 75% of the units, the investor may be able to amend the declaration to return the threshold to 75%, as permitted in Section 27(a)(i) of the Act (765 ILCS 605/27(a)(i)).
- Advocating for legislative amendments to Section 15 of the Act to:
 - increase the required supermajority required to approve the Section 15 sale; or
 - add other statutory obstacles to a sale of the property under Section 15.
- Working with local municipalities to enact ordinances requiring a larger majority of unit owners to agree to a Section 15 sale than is required under Section 15 of the Act.

Local Municipal Ordinances

In many cases, it may be more expedient for deconversion opponents to seek to modify local ordinances to restrict a Section 15 sale than to try to achieve the same result in the state legislature.

The Illinois Constitution provides for home rule jurisdiction. Unless expressly limited by statute, a home rule unit of government (county or municipality) has concurrent power with the State of Illinois to perform any function that applies to its government and affairs. This includes, but is not limited to, the power to regulate for the protection of the public health, safety, morals, and welfare. (Ill. Const. art. VII, § 6(a).) Home rule units have the same powers as the sovereign, except when those powers are limited by the Illinois General Assembly (*City of Chi. v. Roman*, 184 Ill.2d 504, 513 (1998)).

The Act does not preempt the authority of home rule municipalities to regulate and control condominiums (*Palm v. 2800 Lake Shore Drive Condo. Ass'n*, 2013 IL 110505, ¶¶ 42-44).

City of Chicago's Deconversion Ordinance

Exercising its home rule authority, the City of Chicago enacted an ordinance, effective October 16, 2019, mirroring Section 15 of the Act except that the ordinance increased the minimum required supermajority to authorize a Section 15 sale to 85% ([Chicago, Ill., Code § 13-72-085](#)).