5 Condos and Common Interest Communities in Illinois — A Look Back and Suggestions for Going Forward

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I. BACKGROUND/HISTORY

A. [5.1] National Housing Act §234(c)

In 1961, §234(c) of the National Housing Act, ch. 847, 48 Stat. 1246 (1934), codified at 12 U.S.C. §1701, *et seq.,* became law. It provides in relevant part as follows:

> **The Secretary is authorized, in his discretion and under such terms and conditions as he may prescribe (including the minimum number of family units in the project which shall be offered for sale and provisions for the protection of the consumer and the public interest), to insure any mortgage covering a one-family unit in a multifamily project and an undivided interest in the common areas and facilities which serve the project, if [**certain conditions set forth in the section or adopted by the Secretary of Housing and Urban Development are satisfied**].** 12 U.S.C. §1715y(c).

B. [5.2] Illinois Condominium Property Act

Virtually all states adopted some form of a condominium enabling statute within a few years after the adoption of §234(c) of the National Housing Act. Illinois adopted the Condominium Property Act, 765 ILCS 605/1, *et seq.,* in 1963. It is what is referred to as a first-generation condo enabling statute. Many states updated and upgraded their condominium acts with second and third generation acts, but Illinois did not. Instead, Illinois made multiple amendments to the original Condominium Property Act, resulting, in the authors' opinion, in a piecemeal statute that works, in the sense that it permits condos to be created, but does not adequately address many issues that have arisen and evolved over the years.

C. [5.3] Condomania

In the 1960s, condo conversions took off, leading to a phenomenon in the 1970s that was dubbed "Condomania." Many longtime renters were forced to decide between buying the apartment that they had rented for years, often decades, or having the apartment sold out from under them and being required to move out. In the early years of conversions, the monthly cost to own a unit (including mortgage payments, real estate taxes, and assessments) was often less than the monthly rent on a comparable unit. Longtime renters who were faced with the "buy or move out" option found the economics to be favorable, but condos were new; people did not understand them and were wary of buying them. As time passed and the condo concept became better understood and accepted, the prices for condos increased to the point that the monthly cost to own equaled, then exceeded, the monthly rent for the same or a comparable unit. At first, converters compared the after-tax cost to own to monthly rent, taking into account the deductions for real estate taxes and mortgage interest. Eventually, when condomania was in full swing, the cost to own far exceeded the cost to rent, even after taking into account tax savings.

D. [5.4] Common Interest Communities

Even before the condo concept was introduced in the United States, it was not uncommon for subdivisions to be made subject to restrictive covenants. Many of these subdivisions were governed

by declarations of covenants, conditions, restrictions, and easements, and some of these declarations provided that the subdivision be administered by an association of the owners of the lots in the subdivision, especially when the subdivision included out-lots or common areas that needed to be owned and maintained by an association. This type of community came to be known as a common interest community (CIC). A CIC could be either a condo or a non-condo community. In Illinois, until 2010, when the Common Interest Community Association Act (CICAA), 765 ILCS 160/1-1, *et seq.,* was adopted, non-condo CICs were governed by common-law declarations with very limited statutory regulation.

E. [5.5] Fannie Mae and Freddie Mac

During the 1960s and early 1970s, Federal Housing Administration (FHA) insured condo unit loans were the most commonly used loans, although some lenders made portfolio loans on condo units. Around 1973 the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) got into the market for condo unit loans and common interest community unit loans. Their programs were different from the FHA program. While the FHA insured loans on condo units approved by the FHA, which were usually placed in Government National Mortgage Association (Ginnie Mae) mortgage-backed securities by mortgage bankers, Fannie Mae and Freddie Mac purchased loans and put them in mortgage-backed securities that they issued. Fannie Mae and Freddie Mac had a different approach to project approval. Instead of prescribing forms that had to be used, as did the FHA, Fannie Mae and Freddie Mac issued guidelines that needed to be followed and required those who sold mortgages to them to make certain warranties. The entrance of Fannie Mae and Freddie Mac into the condo/CIC market added to the acceptance of condos and units in CICs, especially for loans that were too big for FHA insurance. Fannie Mae and Freddie Mac permitted attorneys to draft documents that made sense and fit the market and local laws, and they were willing to give waivers to their requirements when they felt a waiver was warranted.

In 1974 there was still a usury law in Illinois and mortgage loans could not exceed 8 percent. The prevailing mortgage rate climbed above 8 percent, shutting off mortgage lending in Illinois. Fannie Mae came out with a program under which it would buy loans at 7.75 percent on homes (not condos) in CICs approved by Fannie Mae. The program helped revive the housing market in the mid-1970s. From the mid-1970s until the early 2000s, Fannie Mae and Freddie Mac were the dominant players in the condo and CIC secondary mortgage market.

F. [5.6] Chicago Condominium Ordinance

In 1978, at the height of condomania, the City of Chicago adopted the Chicago Condominium Ordinance, Chicago Municipal Code §13-72-010, *et seq*. Unlike ordinances or laws adopted in other jurisdictions, the Chicago ordinance was a disclosure ordinance. It required that the condo developer give a property report containing various disclosures to prospective buyers and, in the case of conversions, contained some safeguards for tenants, including a first right to purchase, a right of first refusal, and the right to extend their tenancy if the tenancy was expiring. The Chicago ordinance has been amended to also require a condominium disclosure summary with additional disclosures such as appliances, warranties, roof, windows, budgets, and contractors working on the

project. Chicago Municipal Code §13-72-025. A number of Chicago suburbs followed the lead of Chicago and adopted similar ordinances. A discussion of these ordinances is beyond the scope of this chapter.

G. [5.7] High Interest Rates

In the late 1970s interest rates were in the high teens, making it difficult for buyers to afford a mortgage and putting the brakes on condomania and the housing market in general, resulting in numerous failed or stalled "for sale" housing developments. In response to the downturn of the mid-1970s, attorneys for builders, developers, and converters began to modify their documents in order to give developers the flexibility to change their development plans, modify the documents, and otherwise make adjustments in order to react to changes in the market. It was during this downturn that the authors and other developer attorneys came to appreciate the significance of rights reserved to the developer/declarant.

H. [5.8] Savings and Loan Crisis

The savings and loan crisis of the late 1980s caused another significant downturn in the housing market, resulting in a large number of failed or stalled "for sale" housing developments. This time around, more so than in the mid-1970s, lenders ended up taking ownership of failed or stalled developments, and attorneys representing lenders learned the importance of a lender's need to obtain or control developer/declarant rights in order for their lender clients to effectively transfer a failed or stalled development to a new developer. Coming out of this crisis, the authors advised our lender clients to get collateral assignments of declarant rights when they made construction loans. We also learned additional lessons about maintaining flexibility for developer-builders in their project declarations.

I. [5.9] Bubble Burst

Throughout the 1990s and into the 2000s, the housing and condo market in new construction and conversions was strong, and developers, builders, converters, and lenders were making a lot of easy money. Unfortunately, many of the players in the market forgot what had happened in the mid-1970s, late 1970s, and late 1980s and became careless. The subprime lending market pushed Fannie Mae, Freddie Mac, and the FHA to the sidelines, took a huge share of the mortgage market, and even induced Fannie Mae and Freddie Mac to get into the subprime market.

Eventually, the subprime mortgage crisis led to a huge crash in the housing market. Entire developments stalled and failed, resulting in widespread foreclosures and bankruptcies for homeowners and developers alike. Fannie Mae and Freddie Mac were still significant players in the mortgage market, but subprime lenders who issued their own private mortgage-backed securities claimed a significant segment of the mortgage market. However, once the subprime crash occurred, widespread economic failures quickly followed.

Unfortunately, many attorneys for lenders also had forgotten the lessons learned in previous downturns and had failed to obtain collateral assignments of the developer/declarant rights for their lender clients.

J. [5.10] Illinois Common Interest Community Association Act

In 2010, the Common Interest Community Association Act became law in Illinois. By then, the various versions of the Uniform Condominium Act (UCA), none of which had been adopted by Illinois, had evolved into the Uniform Common Interest Ownership Act (UCIOA), which covers condos, cooperatives, and non-condo communities. Illinois passed up multiple opportunities to adopt a variation of the UCIOA, opting instead to pattern the CICAA on the Condominium Property Act. The CICAA incorporates many of the flawed provisions and concepts that are in the Condominium Property Act (even some that did not translate to non-condo projects) and added new and different flawed provisions. On the assumption that there is little likelihood that Illinois will replace the Condominium Property Act and the CICAA with a version of the UCIOA, this chapter primarily deals with how to operate within (and sometimes outside of) the coverage of the Condominium Property Act and the CICAA.

For property to be made subject to the Condominium Property Act, the owner of the property (the "declarant" or "developer") must affirmatively make the property subject to the Condominium Property Act. By contrast, the CICAA is not intended to operate in the same manner as the Condominium Property Act. The CICAA attempts to cover all non-condo and noncooperative developments, regardless of the intentions of the owner/declarant/developer of the development. There may be instances in which the owner/developer/declarant will not want its development to become subject to the CICAA, and there are ways to accomplish this result.

K. [5.11] Out-of-Date Model

The condo concept arrived in the United States (and Illinois) about the same time that Ford introduced the Edsel and Fidel Castro came to power in Cuba. Since then, except for a few old Edsels (some of which are still found in Cuba), the Edsel has disappeared. In the meantime, the number of residents who live in common interest communities, both nationwide and in Illinois, has grown exponentially, to the point that approximately 29.7 percent of Illinois residents live in a common interest community. Community Associations Institute, *Illinois State Summary: Community Association Fact Book* (2019), https://foundation.caionline.org/wp-content/uploads/2020/08/IL2019.pdf (case sensitive) Unlike Cuba, Illinois has had ample opportunity to modernize and upgrade its Edsel-like Condominium Property Act and the Common Interest Community Association Act. However, like the Cuban mechanics (who had no choice), the Illinois legislators (who did have a choice) opted instead to tinker with the Condominium Property Act like the Cuban mechanics tinker with a 1956 Chevy. To make matters worse, in 2010, again with ample options available, the Illinois legislators chose to produce a new and flawed model of the old Condominium Property Act, called the CICAA. To continue the analogy in car terms, the CICAA, which is a crude copy of the outdated Condominium Property Act, is probably comparable to the car that would be produced today if Cuba tried to build new Chevys by copying the 1956 Chevy, with none of the technological advances, safety features, environmental sensitivity, and comforts of today's cars. Like an old Chevy, the archaic Condominium Property Act and its progeny, the CICAA, do not address the multiple issues that have emerged since 1963, many of which could be effectively addressed by a more modern statutory scheme.

II. BASIC PROJECT DOCUMENTATION

A. [5.12] In General

Generally, in a common interest community the developer sells dwelling units and grants nonexclusive transferable rights and easements to the purchasers so that they may use and enjoy the common areas and facilities. The different forms of unit ownership generally found in a residential CIC are listed in §5.13 below.

B. [5.13] Forms of Unit Ownership

In order for units in a common interest community to be sold, they must fall into one of the following categories:

1. a condo unit (*i.e.,* a unit in a building that has been made subject to the Condominium Property Act);

2. a co-op unit (*i.e.,* a unit in a building that is owned by a co-op association, which is generally a business corporation whose member-shareholders have the exclusive right to occupy the units, usually under a proprietary lease with the association); or

3. a lot (*i.e.,* a subdivided area of land, or a portion of a subdivided lot, that is improved with a single-family residential unit in the form of a detached or attached home such as a townhome or duplex home) that is not made subject to the Condominium Property Act and may or may not be subject to the Common Interest Community Association Act.

C. [5.14] Single-Product Common Interest Community

A single-product planned unit development is a common interest community that is planned to be built over a relatively short period of time with units of substantially the same design and construction. This type of CIC may be developed using only one of the forms of unit ownership listed in §5.13 above. For example, the entire CIC may be developed as one condo, in which case a condo declaration will be recorded against the condo property and the common areas of the CIC generally will be made part of the common elements of the condo. When one unit does not encroach into the airspace above another unit, the CIC may be subdivided into lots, and a homeowners' declaration may be recorded against the entire CIC. Under this approach, each unit owner will own his or her lot, a homeowners' association or the developer/declarant will own the common areas, and the development may or may not be governed by the Common Interest Community Association Act.

D. [5.15] Multiproduct Common Interest Community

A multiproduct planned unit development is a common interest community that is planned to be built over a relatively long period of time (greater than three years), will contain different styles of units, and will include substantial common areas and facilities. In this case, the use of an "umbrella" or "community" declaration is suggested. See §5.36 below for a more detailed discussion of the suggested structure for this type of CIC.

III. [5.16] CHOICE OF FORM OF UNIT OWNERSHIP

The developer should choose the form of unit ownership that will best suit the physical aspects of a particular product and will appeal to the targeted marketing base. When a unit is located above another unit, the most common approach is to market the units as condo units, although another alternative is to market them as co-op units. When units do not overlap each other at various elevations, the developer has the additional option of marketing the units as lots. Several issues that should be considered in choosing the form of unit ownership are discussed in §§5.17 – 5.23 below.

A. [5.17] Governmental Regulation

A number of municipalities have adopted ordinances regulating condo developments, particularly condo conversions. Because compliance with the Condominium Property Act and local ordinances often adds to the costs of development, many builders prefer to use a form of ownership other than condo. In addition, since the crash of 2007, it is more difficult to obtain a mortgage loan on a unit in a condo than it is to get a loan on the same unit if it is part of a non-condo development (*i.e.,* a fee simple townhome development).

Until 2010, non-condo homeowners' associations were relatively free from regulation in Illinois, except for those that fell within the definition of "master association" in §18.5(a) of the Act (765 ILCS 605/18.5(a)), the definition of "community association" in §18.7(a) of the Act (765 ILCS 605/18.7(a)), or the definition of "common interest community association" in the forcible detainer provisions of the Code of Civil Procedure (735 ILCS 5/9-102(b), 5/9-102(c)(1)). A "master association" is a not-for-profit corporation or an unincorporated association created pursuant to a non-condo declaration that is authorized to exercise, or is delegated, powers to act on behalf of one or more condo associations for the benefit of owners of the condo units in the condos. 765 ILCS 605/18.5(a). Section 18.5 of the Condominium Property Act imposes certain procedural requirements on a master association that are similar to those imposed on condo associations, including procedures for the adoption of annual budgets, record-keeping, and the conduct of meetings and a requirement that the master association be turned over to the owners within three years after the declaration providing for the creation of the master association is recorded.

As mentioned in §5.10 above, the Common Interest Community Association Act is patterned after the Condominium Property Act in many respects and was intended to regulate non-condo and non-master association CICs. The CICAA, like the Condominium Property Act, requires that control of the association be turned over to the owners within three years after the declaration for the CICAA is recorded. 765 ILCS 160/1-50.

For a number of reasons, not the least of which is the timing of turnover, developers would prefer to not be governed by the CICAA. See §5.31 below for a discussion of under what circumstances the turnover requirements of the CICAA may not apply.

B. [5.18] Surveying Requirements

To sell lots, the real estate must be subdivided and a surveyor must prepare a plat of subdivision. Under the Condominium Property Act, to create condo units, a surveyor must prepare a three-

dimensional survey of the condo property and each unit. 765 ILCS 605/5. To create co-op units, a surveyor may not be needed at all. Generally, the surveying cost for condo units is greater than the surveying cost for lots. It is not necessary to subdivide real estate that will be made subject to a condo declaration, but it is necessary to subdivide land that will be sold as lots. Subdividing land often requires the approval of one or more public bodies or agencies. See 55 ILCS 5/3-5029. Obtaining these approvals may not be simply or quickly accomplished and is often politically difficult.

C. [5.19] Real Estate Taxes

Under §10 of the Condominium Property Act, each condo unit owner will receive a real estate tax bill for his or her unit. The condo unit's assessed valuation will include the value of the undivided interest in the common elements of the condo that are appurtenant to the unit. 765 ILCS 605/10(a). The owner of a lot will receive a separate real estate tax bill for his or her lot. The failure of a condo unit or lot owner to pay real estate taxes on his or her unit or lot may result in the tax sale of the unit or lot but will not affect the interests of other unit or lot owners in the common interest community. A co-op association will receive the real estate tax bill for the entire building, and the bill will be paid from assessments collected from the owners. If some of the co-op unit owners are delinquent in the payment of assessments and, as a result, real estate taxes are not paid, then the entire building may be sold for unpaid taxes unless the nondelinquent owners make up the deficit.

Section 10(a) of the Condominium Property Act provides that real property owned by a condo association or a master association that is used exclusively for recreational or other residential purposes for the benefit of the unit owners shall be assessed for real estate tax purposes at $1 per year, and the balance of the value of the property shall be included in the taxes assessed to the condo unit owners. Thus, the tax bills that are sent to the unit owners will include the value of the condo unit, the value attributed to a percentage ownership in the common elements, and the value attributed to the right to use a common area owned by the condo or master association. Pursuant to §10(a), in counties of one million or more inhabitants, a person desiring to establish a $1-per-year assessment for real property owned by an association must submit an application to the assessor's office. A similar provision is found in the Property Tax Code, 35 ILCS 200/1-1, *et seq.,* and covers situations in which real estate used for recreational or other residential purposes is owned by a non-condo homeowners' association for the benefit of its unit owners. 35 ILCS 200/10-35. Pursuant to §10-35(b), in counties of three million or more inhabitants, a person desiring to establish a $1-per-year assessment must submit an application to the assessor's office.

Thus, the real estate tax treatment of property in all residential CICs should be the same regardless of whether the common areas are part of the common elements of a condo or real property owned by a non-condo homeowners' association.

D. [5.20] Owner Financing

An owner of a lot can mortgage his or her lot separately. Likewise, under the Condominium Property Act, each condo unit owner may mortgage his or her unit separately. 765 ILCS 605/6. However, as is discussed more fully in §5.47 below, as of late 2009 it is significantly more difficult to obtain a mortgage loan on a condo unit than on a similar unit that is not part of a condo.

Because all of the real estate in a co-op is owned by the co-op association, a co-op unit owner cannot give a lender a first mortgage on a fee-simple interest in real estate. Instead, a co-op unit owner may grant a leasehold mortgage on his or her proprietary lease and pledge the stock that he or she holds in the co-op association as collateral for a loan on his or her co-op unit.

E. [5.21] Insurance

Fire and casualty insurance on co-op and condo buildings is obtained by the condo association. This procedure has the administrative advantage of avoiding potential disputes between multiple insurance companies in the event of a loss that affects more than one unit. Also, the board of a condo association may require unit owners to obtain insurance covering their personal liability and compensatory damages to another unit owner caused by the negligence of an owner or his or her invitees or (regardless of negligence) originating from his or her unit. Responsibility for obtaining fire and casualty insurance on lot improvements usually falls on the individual owners, potentially creating administrative confusion. The documentation for a non-condo townhome-style development often will require the association to obtain fire and casualty insurance for the entire development, thus resulting in insurance coverage similar to that which is obtained by a condo association.

F. [5.22] Financial Interdependence

Each common interest community association will be responsible for paying various "common expenses" incurred by it on behalf of its unit owner-members. The greater the common expenses of a CIC association, the greater the financial interdependence of the unit owners. In general, the level of common expenses is highest in the co-op because the co-op association is generally responsible for the payment of mortgage service on the blanket mortgage (if any), real estate taxes, insurance, and maintenance costs for the building. The condo usually will generate the next highest level of common expenses because the condo association is responsible for the payment of insurance costs for the building and maintenance costs for the common elements but not real estate taxes. A non-condo homeowners' association generally will have the lowest level of common expenses because

1. it will not pay mortgage service or real estate taxes;

2. it may not pay fire insurance premiums (except in the case of a non-condo townhome development, as mentioned in §5.21 above); and

3. its maintenance costs usually will be limited to the maintenance of common areas and, sometimes, exterior maintenance of the buildings rather than maintenance of the building interiors or of operating systems that serve the building.

G. [5.23] Marketing Considerations

The choice between lots, condo units, and co-op units is often based on marketing considerations. Many marketing consultants believe that townhome-style dwellings marketed as lots will sell better than the same units marketed as condo units because a purchaser understands

ownership of real property in the form of a subdivided lot more easily than ownership of airspace in the form of a condo unit. This perception has changed over the years as the condo concept has gained broader market acceptance. However, as mentioned in §5.20 above, if the developer-builder has the option to make a particular type of unit (generally a townhome-style unit) part of a condo or subject to a non-condo declaration, it will be much easier to obtain end-loan financing on the unit if it is not a condo unit.

IV. [5.24] PROJECT DOCUMENTATION — ISSUES TO BE COVERED

Sections 5.25 – 5.34 below briefly discuss the basic issues that should be covered in drafting the documentation for a common interest community.

A. [5.25] Access Easements

Unless each unit is adjacent to a dedicated road, it is necessary to grant an access easement to the owner of each unit to permit the owner and his or her tenants, invitees, and guests to gain access from a public way to the unit over and across the common area. In a phased common interest community, an access easement also should be reserved or granted for the benefit of the owners of portions of the development that are not yet subject to the project documentation. This is necessary in order to preserve the marketability of the balance of the development so that, if the CIC is not developed as originally anticipated or a different developer acquires the balance of the project, the balance of the project can be developed separate and apart from the original development, with appropriate provisions for sharing the cost of maintaining the shared access roads.

B. [5.26] Use Restrictions

Although the local zoning ordinance or the planned unit development ordinance that applies to the development usually will establish the permitted uses, it is often advisable to include certain additional use restrictions in the project documentation. The most common use restrictions relate to such matters as the keeping of pets in the units, fencing, signs, leasing, parking, limitations on use of a unit for business purposes, adoption of solar policies, and other matters that generally affect the quality of life within the development. Newer issues that are environmentally focused include the adoption of a solar energy policy (see the Homeowners' Energy Policy Statement Act, 765 ILCS 165/1, *et seq.*) and providing car charging stations for electric cars (as of the publication of this handbook legislation on this matter is pending, see H.B. 4148, 101st Gen.Assem. (2020)). Some categories of restrictions, such as architectural controls (see §5.28 below) and leasing restrictions (see §5.32 below), are particularly sensitive.

C. [5.27] Maintenance Covenants

The documentation should specify who is responsible for what types of maintenance. In a development that will be administered by a homeowners' association, the association is generally responsible for maintaining the common areas and facilities in the development, such as private roads, detention areas, and recreational facilities. Also, in developments that include attached units,

the association is usually responsible for at least the exterior maintenance of the buildings. If the development is a condo, then the condo association will be responsible for maintaining all of the common elements of the condo, which generally consist of structural portions of the building, interior corridors, elevators, roofs, and other common elements.

In both condo and non-condo developments, there are certain areas that serve less than all the units and often only one unit. In a condo situation, these areas are referred to as "limited common elements." In non-condo situations, these areas often are referred to as "limited common areas" or "limited community areas." Examples of limited common elements or areas include balconies, patios, tennis courts, or swimming pools that serve only a portion of the units in the development; courtyards that serve several buildings within a complex; and other similar areas. The drafter has several options in dealing with the maintenance responsibility for limited common elements or areas. One approach is to have the owner or owners who use the limited common elements or areas furnish the maintenance at their own expense. Another approach is to have the homeowners' association or condo association furnish the maintenance but charge the owners who use the limited common elements or areas on some basis. Under the Condominium Property Act, the cost of maintaining limited common elements may be allocated on any reasonable basis. 765 ILCS 605/9. Most often, in both the condo and non-condo situation, the costs of maintaining limited common elements or areas are allocated in equal shares to the units that use these areas.

When the individual owners are made responsible for maintaining their units and limited common elements or areas that they use exclusively, the association often is given the right and power to furnish appropriate maintenance if an owner fails to do so and to charge the cost to the delinquent owner and lien the unit if such cost is not paid timely.

D. [5.28] Architectural Controls

Often the documentation for a planned unit development will contain architectural control provisions governing the construction of a home or the alteration, addition, improvement, or renovation of an existing home. There are several ways to approach architectural controls. One approach is to enumerate certain basic standards in the documentation, such as floor area ratios, minimum square footage requirements, and limitations on the types of materials or colors that may be used in connection with the construction or alteration of the exterior of the home. Alternatively or additionally, the documentation may include a procedure by which proposed plans must be submitted to an entity (which could be the developer/declarant or the association's board or a committee of the board) that will review the plans with the power to approve or disapprove them. Often, the entity is given the power to make judgments based on aesthetic considerations in addition to specific basic standards. Architectural control is an important developer right that is discussed more fully in §§5.31 and 5.58 below.

E. [5.29] Assessment Procedure

In a development that will be administered by an association, the association will need money to fulfill its obligations. In order to raise this money, the association must have the power to levy assessments against units within the development. Generally, the documentation will require the

association to establish an annual budget of its anticipated expenses and the buildup of reserves for anticipated periodic repairs and replacements that will have to be made by the association with respect to improvements maintained by the association. The amount of the annual budget is then divided among the units based on some rational basis.

If the association is a condo association, the assessments must be allocated among the units based on the percentage interests assigned to the units. See 765 ILCS 605/4(e).

In a non-condo situation, including under the Common Interest Community Association Act, any reasonable approach may be used to allocate the assessments, but most often in a residential development the assessments are levied equally among the dwelling units. A common approach that is used in non-condo common interest communities (and that is not inconsistent with the CICAA) is for the declaration to provide that during the period of the declarant's control of the association (declarant control period), the budget will be what is commonly referred to as a "stabilized budget," which is a budget based on the assumption that the development administered by the association is fully built out and occupied and all the planned amenities have been constructed and are fully operational. Under a stabilized budget, each owner of a unit that is subject to assessment (other than those still owned by the declarant and/or not yet built) will pay a portion of the stabilized budget determined by dividing the budget by the number of units planned for the development so that each owner is paying an assessment that approximates what he or she will be paying when full build out and occupancy is achieved. Under such an arrangement, the declarant is not responsible for paying assessments, but instead obligates itself to pay the difference, if any, between the assessments payable by the unit owners for operating expenses (not including reserve contributions) during the declarant control period and the actual operating expenses incurred during the declarant control period (the shortfall). The shortfall calculation can be made cumulative over the entire declarant control period or year by year during the declarant control period. In any event, the declarant should provide that the obligation to pay assessments for a unit will not begin until such time as a certificate of occupancy has been issued for the unit.

In a phased non-condo development, attention should be given to the establishment of the stabilized budget and whether expenses are front-loaded onto early phases. Back-loading expenses into later phasing poses some risks for a developer. Without the establishment of a stabilized budget, assessments could spike, which may lead to friction between the developer and early buyers.

The association needs a mechanism for enforcing the failure of a unit owner to pay assessments. The Condominium Property Act establishes a statutory lien in favor of the condo association for the failure to pay assessments. 765 ILCS 605/9(g). In a non-condo situation, including developments covered by the CICAA, the documentation must create a common-law lien against each unit.

F. [5.30] Mortgagee Rights

The documentation for a common interest community should include provisions dealing with the rights of the holders of mortgages or trust deeds on individual units. This subject is dealt with more fully in §5.54 below. Basically, however, the documentation should give each mortgagee who

so desires the right to receive notices or other information of interest with respect to the development and its mortgagor's unit. Also, mortgagees should be given certain rights with respect to cash distributions made by the association to the unit owners in connection with insurance, settlements, or condemnation awards. In addition, the lien of a first mortgage on a unit should be given priority over the association's assessment lien.

G. [5.31] Developer Rights

There are certain rights and powers the developer/declarant of a common interest community should reserve to itself, including the following:

1. The developer should reserve to itself the right to maintain model units and to erect signs or other advertising and sales material on the CIC, including the right to use the model units to sell units at other sites being developed by the developer.

2. The developer should retain absolute power of architectural control over what is built in the development and the right, at the developer's discretion, to assign this right to another entity, another developer-builder, or the association.

3. The developer should reserve to itself the right to permit prospective purchasers or lessees of units to come onto the CIC and to use the common areas and parking areas without the requirement that any fee be paid to the association.

4. The developer should reserve to itself the right to sell or lease units to whomever the developer desires on such terms as it deems appropriate.

5. The developer should reserve to itself the right to come onto the CIC in order to construct improvements to the CIC and to store necessary equipment on the CIC common areas while construction continues.

6. If the CIC is to be administered by one or more associations, the developer should retain the right and power to control the associations, at least during the initial stages of the development, by reserving the right to designate all members of the board of directors of the association and/or the right to caste all votes.

Under the Condominium Property Act, a condo association may be controlled by the developer only for a period of three years after the condo is first created or until the conveyance of 75 percent of the units in the project, whichever occurs first. 765 ILCS 605/18.2(a), 605/18.2(b)(i). The same rule applies to master associations (see 765 ILCS 605/18.5) and to associations subject to the Common Interest Community Association Act (765 ILCS 160/1-50(b)).

The timing of the turnover of control of an association is a significant issue for a developer. There are several ways to deal with this issue. One is to avoid the application of the CICAA entirely in a non-condo situation by not creating an association. See §5.35 below. Another option in a non-condo situation is to give the declarant multiple votes for each unit it owns so that the declarant can exercise those votes to retain control of the association.

7. The developer should reserve to itself (a) a limited right to amend the documentation for a CIC unilaterally, in order to bring the documentation into compliance with applicable law and to correct errors or omissions in the documentation; (b) the right to add or withdraw property from the terms of the documentation; (c) the right to bring the documentation into compliance with the requirements of the secondary mortgage market; and, generally, (d) the right to make changes to the documentation when the type of change is adequately disclosed to all owners and the change does not unduly burden the existing owners. RESTATEMENT (SECOND) OF PROPERTY: SERVITUDES §6.21 (1998); *North Country Villas Homeowners Ass'n v. Kokenge,* 38 Kan.App.2d 254, 163 P.3d 1247 (2007); *Flescher v. Oak Run Associates, Ltd.,* 111 So.3d 929 (5th Dist. 2013). In addition, the documents should provide that any provisions relating to the rights of the developer may be amended only with the prior written consent of the developer.

8. The documentation should provide specifically that any of the rights reserved to the developer are assignable by the developer. This gives the developer the option to sell the balance of the project together with the developer rights that are necessary to complete the development. These rights are critical to a lender, investor, or developer acquiring a partially completed project. The documentation should permit the developer to collaterally assign its developer rights to a lender. In Illinois there is caselaw holding that developer/declarant rights are personal rights that must be transferred by assignment and do not run with the land. *Board of Managers of Medina on Lake Homeowners Ass'n v. Bank of Ravenswood,* 295 Ill.App.3d 131, 692 N.E.2d 402, 229 Ill.Dec. 629 (3d Dist. 1998). Certain developer rights are specifically mentioned in the Condominium Property Act and the CICAA, the most significant of which is the right to control the association until the mandated turnover date. See 765 ILCS 605/18.2 (condos), 605/18.5(f) (master associations); 160/1-50 (CIC associations). The Condominium Property Act also permits the creation of a developer's right to add property to a condo for a period of up to ten years after the declaration is recorded. 765 ILCS 605/25. Most other rights, however, are created by the declaration. In somewhat odd language that is found in both the Condominium Property Act and the CICAA, a successor in title to the units owned by the developer, as that term is defined in the Condominium Property Act (765 ILCS 605/2(q)) and the CICAA (765 ILCS 160/1-5), arguably becomes the developer under the Condominium Property Act or the CICAA, as applicable, at least with respect to the developer rights provided for in the applicable Act. It appears to be an open question, which to the authors' knowledge has not yet been answered in a reported opinion in Illinois, whether developer rights provided for in the declaration that governs a development (but not specifically provided for or created under the Condominium Property Act or the CICAA) will travel with those developer rights that are specifically provided for in the applicable Act when the balance of the property is conveyed to the "successor developer." The authors believe that the rights created in the declaration that are not created under one of the Acts do not necessarily follow the rights created under the Act in the event that the balance of the property is conveyed to a "successor developer" unless those rights are specifically assigned to the successor developer in an assignment. Those developer rights that are not specifically created under the applicable Act and are not specifically assigned to the successor developer would remain with the original developer unless the declaration provides otherwise. In 2017 both the Condominium Property Act and the CICAA were revised to provide that an assignment of a developer's interest in the property under the declaration was not effective until the successor developer (a) obtained the assignment in writing and (b) recorded the assignment instrument. 765 ILCS 605/9.5, 160/1-47.

9. Declarations often include provisions that make it difficult for the association to bring a lawsuit, especially a lawsuit that would be heard by a jury. The primary reason for these types of provisions is basically twofold. One is that an ill-conceived lawsuit that can be brought by a board without the knowledge of the members, an open discussion, and a vote at a meeting of the members can often be harmful to the association and its members by putting financial stress on the association that could lead to a depletion of the cash reserves, a special assessment, or, worse, jeopardize the ability of owners or prospective buyers to obtain unit loans. A second reason is that an association will often bring a costly and divisive lawsuit against the developer. To this end, the documentation frequently includes a provision requiring a supermajority of the owners to vote affirmatively in favor of instituting a lawsuit for any purpose other than collecting delinquent assessments or enforcing provisions of the documentation. Such a provision has been invalidated in a condo declaration (765 ILCS 605/18.9) but has not yet been invalidated under the CICAA or other non-condo situations. Some documentation contains provisions requiring that any dispute between the association and the declarant be resolved by mandatory mediation and, if mediation is not successful, mandatory binding arbitration.

10. Although it is not technically a developer right, a developer should consider seriously setting up associations that will administer the CIC as limited liability companies (LLCS) instead of not-for-profit corporations. There are several reasons to do this, not the least of which is that prior to turnover a limited liability homeowners' or condo association can be managed by the developer entity. Prior to turnover, a not-for-profit association needs to be managed by a board of directors consisting of at least three individuals appointed by the developer, who later can be sued individually for alleged breaches of fiduciary duties to the owners, when the real target is the developer entity (which is also usually named unless it is insolvent or no longer in existence), not the individuals.

H. [5.32] Municipality Rights

Occasionally, the municipality in which the development is located will require that certain rights and powers be granted to it in the project documentation. Generally, a municipality will be concerned about maintenance of stormwater runoff facilities, private utility lines located on the development, and private roads. However, more and more frequently, a municipality wants the right to come onto a development to cause other types of maintenance or repairs to be furnished if the association or an individual unit owner fails to do so. Often, a municipality requires the developer to include in the documentation a provision that gives the municipality the right to charge the association or an individual unit owner for the cost of doing any work the municipality believes is necessary and to impose a lien on portions of the development if any such amounts are not paid when due. The drafter should be careful, however, to make any such lien subordinate to the lien in favor of holders of first mortgages or first trust deeds on the units.

Some municipalities require that the documentation for a common interest community be subject to the review and approval by the municipality. Occasionally, as a condition to approval, a municipality will attempt to require the developer to impose restrictions that cannot be imposed legally or politically by the municipality by ordinance. In particular, a municipality occasionally asks that a developer prohibit or restrict the leasing of dwelling units, presumably on the theory that owner-occupants will take better care of their property, although other motivations may be at

work. A developer should be wary of agreeing to these requests because they could adversely affect marketability of the dwelling units or the ability to obtain mortgage loans on the dwelling units. An entity that is considering acquiring a partially completed project needs to review the project documentation to determine whether there are any government-imposed restrictions (*e.g.,* limitations on the leasing of units) that could interfere with the ability of the developer of the project to complete the project successfully.

I. [5.33] Enforcement by Association

In a common interest community, which is administered by an association, the association generally has the primary responsibility for enforcing the covenants. Enforcement may take the form of levying fines, an action for specific performance, or an action for eviction. The documentation should provide that if the association does bring enforcement action and prevails, it also shall be entitled to recover its costs, including attorneys' fees.

J. [5.34] Enforcement by Owners

The documentation also should provide for a private cause of action by one owner against another owner for a violation of the documentation. This is particularly important in a common interest community when there is no association. However, the secondary mortgage market generally requires that each owner be given a private right of action, even in a CIC that is administered by an association.

V. [5.35] NEED FOR AN ASSOCIATION; ALTERNATIVES

A homeowners' association that administers a common interest community has the power to levy assessments and act on behalf of the unit owners. A well-run homeowners' association can enhance the appearance of the CIC and the value of the units. However, a disturbing trend has developed — homeowners' associations have become, in some cases, the battleground for old-time "fence fights" and local political battles. A homeowners' association often is controlled easily by a small group of proactive individuals whose arrogant use or abuse of power can lead to divisive disputes within the CIC that occasionally lead to costly and debilitating litigation. See §5.31 above.

Partly because of these developments, developers have increasingly attempted to avoid the creation of homeowners' associations, minimize the number of homeowners' associations that are created in connection with the development of CICs, or at least minimize the likelihood that an association will initiate litigation against the developer.

The type of development in which it is easiest to avoid the use of a homeowners' association is one in which the units are single-family, detached homes. In this situation, each owner can be made responsible for the maintenance of his or her own home and lot. However, in these developments, occasionally there are common areas that may consist of private roads, detention areas, wetlands, or recreational areas. In years past, developers were reasonably successful in causing the municipality to accept the dedication of the roads or in causing the municipality or a park district to accept a dedication or conveyance of detention areas, wetlands, or other types of

open space. However, governmental agencies have become increasingly reluctant to accept dedications of common areas, preferring instead to require the developer to establish a homeowners' association to own common areas and maintain them at the expense of the owners of the homes.

One approach that has met with some success in this area is the use of a special service area (SSA). SSAs are authorized under the Special Service Area Tax Law, 35 ILCS 200/27-5, *et seq.* Basically, a "special service area" is an area that is subject to a real estate tax, the proceeds of which are used for a specific purpose that generally relates to the area that is being taxed. In the context of a CIC, an SSA can be established for the purpose of maintaining roads, detention areas, or wetlands located within a CIC. The roadways, detention areas, or wetlands would be dedicated or conveyed to the municipality, but the cost of maintaining these areas would not be paid out of the general funds of the municipality; instead, the cost would be paid with the tax revenues generated from the SSA. The preferred approach with respect to the use of SSAs, however, is (a) to require an association to be primarily responsible for providing the service in question, and at the same time (b) to adopt an ordinance that provides for a "backup" SSA to be activated if the association fails to fulfill its obligation. The municipality will often require that the SSA (whether pending or adopted at the time the declaration is recorded) be disclosed in the declaration.

Occasionally, a CIC may be served by a detention area or a monument sign area that needs to be maintained. If the detention area is relatively small, a developer may include the detention area as part of one or more subdivided residential lots when platting the subdivision and impose the obligation to maintain it on the owners of the lot or lots. Similarly, a monument sign can be included on a subdivided residential lot and the obligation to maintain it imposed on the owner of the lot.

There is another situation in which it may be advisable not to create a homeowners' association. As mentioned in §5.10 above, a development being subject to the Common Interest Community Association Act is not elective on the part of the declarant. The CICAA is drafted so that it applies to all developments that fall within the definition of developments that are covered by the CICAA. Specifically, in order to be subject to the CICAA, the development must be governed by an "association" or "common interest community association." Until recently, an "association" was defined to be either a not-for-profit corporation or an unincorporated association. Amended by P.A. 99-41 (eff. July 14,2015), the list was expanded to include limited liability companies. 765 ILCS 160/1-5.

The authors believe that if no association is required to be created when the declaration for a non-condo CIC is recorded, the CIC will not be subject to the CICAA. Developer/declarant rights are personal and do not run with the land. A declarant that reserves to itself the power to administer and operate a development would have the power to assign those rights to any entity it chooses, including an entity that does not have an ownership interest in the development. The declarant could reserve the right that could be exercised at a later time (which it need not exercise) to create a not-for-profit corporation or LLC and require that all owners of units in the development be members of the corporation or LLC, to which the declarant could assign some or all of the developer/declarant rights under the declaration. The authors believe that if (and only if) this occurs, the association would be a CIC association and the CICAA would apply to it.

VI. [5.36] USE OF MULTIPLE ASSOCIATIONS

Large common interest communities, which may include several different types of buildings and active recreational facilities that will be available to all residents, may need to be administered by more than one association. An example of the type of project that might require multiple associations is a large new construction project that is planned to include buildings containing units where the airspace of one unit is above the airspace of another unit, a number of townhome-style or duplex-style buildings, a number of single-family detached homes, a clubhouse or recreational facility that will serve all residents of the development, green space, park areas, and private roads. In this situation, it is recommended that (a) one or more condo associations be created for the purpose of administering the buildings with units with overlapping airspace, (b) one or more non-condo townhome associations be created to administer the townhome-style and duplex style buildings, and (c) an "umbrella" or "community" association be established for the purpose of owning and maintaining the common areas and recreational facilities that serve all of the residents, as well as administering architectural controls. It may not be necessary to set up a separate association to administer the single-family detached homes, unless for some reason it is desirable to have an association to furnish exterior maintenance to the homes, landscape maintenance, or snow removal.

There are benefits to using multiple associations. For example, through the use of a community association to furnish maintenance of common areas throughout the project, there is a greater likelihood that the development will be maintained in a uniform and consistent manner and that economies of scale will be realized because the community association will be buying certain essential services, such as snow removal and landscaping, for the entire development. However, this approach does have its drawbacks and disadvantages. The existence of multiple associations makes the management and administration of the development more complicated and costly. This approach also tends to create political factions within the development based on the division of responsibilities among the various associations.

From the developer's point of view, in a large CIC in which multiple associations must be used, it is advisable to centralize control of the development in a community association and maintain control of the community association as long as possible.

Unfortunately, the current state of the law in Illinois discourages this type of approach. In particular, under the Condominium Property Act, any association that is delegated the powers of a condo association is defined as a "master association," and control of a master association must be turned over to the unit owners within three years after the declaration that provides for the creation of the master association has been recorded. 765 ILCS 605/18.5(a), 605/18.5(f). In order to avoid a community association being deemed a master association, the drafter must structure the documentation in such a way that the community association is not delegated any powers of a condo association. For example, a community association should not be given the power to maintain the common elements of a condo or even exercise architectural control over a condo within the development. If, however, there is no condo association planned for the development, then the community association can exercise powers that otherwise would be exercised by non-condo homeowners' associations without falling under the definition of "master association."

Even if a community association can be structured to avoid being deemed a master association under the Condominium Property Act, it is still possible that it may be deemed a CIC association under the Common Interest Community Association Act and subject to turnover in three years after the declaration is recorded or upon the conveyance of 75 percent of the units, whichever occurs first. 765 ILCS 160/1-50. The definition of "developer" under the CICAA mimics the Condominium Property Act and defines the developer as "any person who submits property legally or equitably owned in fee simple by the person to the provisions of this Act." 765 ILCS 160/1-5. This would suggest that property must be intentionally submitted to the CICAA in order for it to be subject to the CICAA and that a declarant that chooses not to "submit" its property to the CICAA can avoid the application of the CICAA by so providing in the declaration. However, §1-10 of the CICAA provides that "[u]nless expressly provided otherwise herein, the provisions of this Act are applicable to all common interest community associations in this State." 765 ILCS 160/1-10. Note that the provision refers to CIC associations, not CICs. The definition of "common interest community" refers to real estate that is administered by an "association." 765 ILCS 160/1-5. Thus, under a fair reading of §1-10 of the CICAA, the CICAA applies only to an association that administers a CIC and does not apply to the real estate that makes up the community. This is another example of the inconsistent drafting of the CICAA. The authors believe that if a declaration does not provide for the creation of an "association" to administer a CIC and instead provides that the CIC will be administered by the declarant, then the CIC would not be subject to the CICAA, at least not until the declarant exercises a reserved power (which it need not exercise) to create an association and require each owner of a home to be a member of the association and assigns some or all of the declarant rights to the association.

VII. [5.37] CONVERSION CONDOMINIUM PROJECTS

Conversion of an apartment project to individually owned condo units has been an option available to apartment project owners since 1963, when the Condominium Property Act was first adopted. Condo conversions were most popular in the mid-1970s, at which time concerns about the treatment of tenants and the shrinking rental stock caused a number of municipalities, including the City of Chicago, to pass ordinances governing condo conversions. With the high interest rates of the 1980s, condo conversions were not a significant factor in the marketplace. In the late 1990s and early 2000s, with home loans available at lower interest rates, the buy-versus-rent comparison once again favored buying, and condo conversions returned. The housing crash of 2007 caused many conversions then in process to stall or fail. Most multifamily buildings constructed after the crash have been rental buildings. However, many of these newer buildings were designed and constructed in contemplation of conversion to condos when market conditions for conversions once again became favorable.

The conversion plan for an existing apartment project differs in a number of respects from a development plan for a new construction condo or a planned unit development project. The discussion in §§5.38 – 5.40 below covers some of the issues that should be considered when formulating a conversion plan.

A. [5.38] Statutory Constraints

Section 30 of the Condominium Property Act deals with the procedures for making an apartment project subject to the Act. Basically, the owner of the property must give written notice of its intention to make the property subject to the Act (and thereby convert the property to a condo) to all tenants of units in the property. 765 ILCS 605/30(a). The notice must be accompanied by an offer to sell to each tenant the unit in which the tenant resides and the price at which the offer is being made. The tenant then will have 30 days in which to accept the offer. 765 ILCS 605/30(b). If the tenant does not accept the offer and within 120 days after the date of the notice of intent a contract is entered into to sell the tenant's unit to someone else, then the tenant must be given notice of the contract and must be given the right to buy the unit at the price and terms set forth in the contract. 765 ILCS 605/30(c). The tenant then may exercise this right to purchase by notifying the converter within 30 days after the tenant has been given notice of the contract. 765 ILCS 605/30(e). This is commonly known as a right of first refusal. 765 ILCS 605/30(a)(2) provides that, in the event that an owner fails to provide notice of its intention to convert, when a tenant vacates the premises as a result of his or her lease not being renewed and the tenant's unit is later converted to a condo, the owner is liable to the tenant for actual moving expenses (not to exceed $1,500), three months' rent, and reasonable attorneys' fees and costs. 765 ILCS 605/30(a)(2).

In addition, any tenant whose tenancy expires within 120 days after the date on which the notice of intent is given has the right to extend his or her tenancy to the end of the 120-day period by giving written notice to the owner of the building within 30 days after he or she receives a notice of intent. If the tenancy is so extended, it shall be extended at the same rent the tenant is currently paying. 765 ILCS 605/30(c).

Furthermore, the Condominium Property Act requires certain disclosures to be made to the first purchaser of a unit. 765 ILCS 605/22. Section 22 provides that the purchaser has the right to cancel his or her contract until five days after the last of the designated documents has been delivered to the purchaser or the closing of the sale of the unit, whichever occurs first. 765 ILCS 605/22(e). In the case of a condo conversion, these documents include the condo declaration, the bylaws of the condo association, a floor plan of the unit, a budget for the condo association, an engineer's report concerning the condition of the property in a form prescribed by the Condominium Property Act, and, if available, an operating history of the property.

Effective July 29, 2005, P.A. 94-386 amended the Condominium Property Act to authorize a municipality to inspect units in a proposed condo conversion and require that the units comply with current codes. 765 ILCS 605/30.5. Although municipalities arguably had this right without the amendment and, in fact, some had already imposed such a requirement, the likely result of this amendment is that more municipalities will adopt ordinances that require inspections and evidence of current code compliance as a condition to conversion to condo status. The most common impact has been on life safety issues such as sprinkler installation. Municipalities have passed ordinances that, regardless of the status of a building's current code compliance, require an owner to install a sprinkler system that previously was not required when the building was a rental structure. See §5.35 above regarding possible funding for sprinkler improvements under the Special Service Area Tax Law.

In 1978, at the height of condo conversions, Chicago adopted the Chicago Condominium Ordinance, the purpose of which is to give additional protection to purchasers of units in condo conversions, with an emphasis on protecting tenants, particularly elderly and handicapped tenants.

The notice requirements of the Condominium Property Act and the Chicago Condominium Ordinance generally apply to the conversion of an existing apartment project. In a loft conversion in which the building is vacated, gutted, and rebuilt or expanded, there are usually no tenants who would be entitled to receive notices or rights under the Act or the Chicago ordinance due to the extension time needed to complete the interior construction. The 2011 amendments to the Chicago ordinance added additional tenant protections. Among these changes are that (1) tenant notice of conversion was increased from 120 to 180 days (210 days in cases in which the tenant is over 65 or deaf, blind, or unable to walk); (2) the tenant's right to extend his or her lease was increased from an additional 120 days to 180 days (210 days in cases in which the tenant is over 65 or deaf, blind, or unable to walk) if the lease expires during the notice period; and (3) required relocation assistance was increased from $1,500 to $2,500 to any qualified tenant, provided that the tenant's one month rent is greater than $1,500. Chicago Municipal Code §§13-72-060, 13-72-065.

The Chicago Condominium Ordinance is primarily a disclosure ordinance. It requires — before the offering for sale of a unit in a newly constructed, newly rehabbed, or newly converted condo project of more than six units — certain specific disclosures be made in the form of a property report. The property report must follow a prescribed format that includes, among other things,

1. copies of all the condo documentation required to be given to prospective purchasers pursuant to §22 of the Condominium Property Act;

2. a survey of the condo property;

3. a statement as to the condition of title;

4. a disclosure of any and all building code violations over the past 10 years;

5. estimates of monthly assessments and real estate taxes;

6. information concerning any financing that will be furnished by the developer;

7. certain basic information concerning the identity of the developer and certain professionals working with the developer; and

8. disclosures concerning contracts and other obligations that will bind the condo association (*e.g.,* management agreements, laundry leases, and insurance contracts). 765 ILCS 605/22.

In the case of a conversion, the property report also must include an engineer's report covering the structures and operating systems. The property report must be available no later than the commencement of the sale and marketing program for the condo. Violations of the ordinance are punishable by fines. Additionally, the developer of every residential condominium project (regardless of size) in the City of Chicago must complete a condominium disclosure summary and

file it with the Department of Business Affairs and Consumer Protection no later than 90 days prior to the first offering for sale of any unit and file any material changes or amendments to the disclosure summary within 30 days of the change or amendment. Chicago Municipal Code §13-72-025(B). After filing the condominium disclosure summary, the developer shall (1) make the summary available with its marketing materials, (2) distribute the summary at all open houses and any showings, (3) furnish the summary to each prospective buyer prior to the execution of a contract for the initial sale of a residential condominium unit, and (4) keep a receipt signed by each purchaser acknowledging that the purchaser has received and has had an opportunity to review the summary. Chicago Municipal Code §13-72-050(B).

In addition, a number of municipalities in the Chicago metropolitan area have adopted condo conversion ordinances patterned after the Chicago ordinance. Some, however, include additional substantive requirements that tend to make it more costly or risky for a developer to convert a property in the municipality to condos. Anyone who is contemplating the conversion to condos of property located within a municipality should check with municipal authorities to see if the municipality has adopted ordinances that would have an impact on a condo conversion.

B. [5.39] Single Building Conversions

When an apartment project consists of a single building, the building usually is converted at one time to the condo form of ownership. Occasionally, large buildings have been converted in phases in order to facilitate the satisfaction of presale requirements that may be imposed by lenders. Such phasing, however, may have an impact on the ability of purchasers to qualify for mortgages to be sold or insured in the secondary mortgage market. When the building contains commercial space in the form of stores or offices, it is often advisable to carve the commercial space out of the condo. This can be done in one of two ways. One approach is to record what is commonly known as a “vertical subdivision” plat that divides the building into a number of three-dimensional lots. The lot or lots that contain the residential portion of the building then are made into a residential condo, and the lots that contain commercial space are either made into a commercial condo or owned and operated as commercial property separate from the residential condo portion of the building. Another approach is to exclude the commercial space from the legal description of the real estate that is being made part of the condo. The commercial space then is owned and operated as commercial property separate and apart from the condo. In these cases, the relationship between the residential condo and the commercial condo space is addressed in a party wall agreement or in a reciprocal easement agreement that provides for cost sharing, structural support, utility easements, and other mutual benefits. See §5.45 below. In those buildings in which the value of the commercial space is relatively small compared to the value of the residential portion of the building, it may not be necessary to separate the commercial and residential portions of the building. In such a situation, the commercial portion of the building may be made into one or more condo units in the same condo as the residential units. Of course, the commercial units would have to be made subject to different use restrictions than those imposed on the residential units. It is also advisable to include in the condominium declaration that such commercial use restrictions and other terms that benefit the commercial units cannot be modified without the consent of the commercial unit owners. Generally, the secondary mortgage market will limit the amount of space in a mixed-use building that may be designated as commercial to 20 to 25 percent of the total floor area.

C. [5.40] Multibuilding Conversions

In an apartment project that consists of multiple buildings, care must be taken to establish a phasing plan that gives the converter maximum access to end-loan financing. Generally, the secondary mortgage market will require that between 50 and 70 percent of the units in the portion of a conversion development that will make up the condo be subject to sale contracts before loans on units in the condo may be sold in the secondary mortgage market. Thus, for example, in a 500-unit apartment project that consists of ten 50-unit buildings, instead of attempting to convert the entire project to condo at one time, the converter should phase the conversion building by building. Thus, the first phase of the conversion can be made part of a condo, and unit loans may be sold in the secondary mortgage market when 50 – 70 percent of the units in the first building (25 – 35 units out of 50) are subject to sale contracts. Generally, the presale requirement operates on a cumulative basis. Thus, if the presale requirement is 50 percent, then loans in the first phase will be saleable in the secondary mortgage market when 26 units in the first building have been sold. When the second building is added to the condo, the presale requirement will be 50 percent of 100 units, or 50 units, but instead of being required once again to satisfy a 50-percent presale for the second building, units in both the first and second buildings can be used to satisfy the presale requirement for the first two buildings. This approach works only if the condo is what is commonly referred to as an "add-on" condo. See 765 ILCS 605/25.

If the apartment project has significant amenities, such as a clubhouse, swimming pool, and tennis courts, the converter must pay attention to when and how the amenities are made part of the condo. The secondary mortgage market may not approve a conversion if a large amenity package is made part of the condo before there are sufficient units in the condo to pay for the cost of maintaining the amenity package. However, if the condo unit owners do not have a perpetual right to use and enjoy the amenity package, the amenity package may not be advertised as being available to the unit owners, and no portion of the value of the amenity package may be included in the value of units for appraisal purposes.

VIII. [5.41] LARGE CONDOMINIUM DEVELOPMENTS

A condominium can involve multiple buildings or multiple phases in a single building or a combination of the two. Formulating a development plan for a phased condo presents certain issues that are not normally found in the construction of a single-phase condo.

A. [5.42] Phased Condominiums

In a new construction condo project, once a condominium unit exists, the owner of the unit (including the developer as an owner) must pay assessments on the same basis as the owner of every other unit, regardless of whether the unit is occupied. In multi-floor buildings, units on the lower floors of the building are often ready for occupancy before the units on the higher floors. Also, in multibuilding projects, one building may be ready for occupancy before another building. One way to deal with these issues is to add portions of the project to the condo in phases (*e.g.,* floor by floor, building by building, or floor by floor within each building). The Condominium Property Act specifically provides for and permits property to be added to a condo in phases. 765 ILCS

605/25. When P.A. 80-1110 (eff. Jan. 1, 1978) was enacted to permit phasing, the particular type of phasing that was generally occurring was the addition of entire buildings in new construction or apartment project conversion projects, primarily located in the suburbs. The phasing of a large, new construction building or multiple buildings can be done legally under the provisions of the Condominium Property Act. This type of phasing, however, does present some unique issues. Sections 5.43 and 5.44 below discuss some of the issues that commonly arise in connection with a phased development.

B. [5.43] Cross Easements

When portions of a building are added in phases, it is necessary to provide for various support and access easements in the declaration so that, until all of the building is part of a condominium, the condo association and the owner of the portion of the building that is not yet part of the condo have the right to maintain the portions of the building that they are responsible for maintaining. Also, to the extent that the condo property and the non-condo property share a common wall or floor divider, the use and maintenance of the common wall or floor divider should be covered by what are commonly known as "party wall" covenants.

C. [5.44] Assessments/Reserves

If a project is phased, then only the owners of units that are part of the condo property are obligated to pay assessments to the condo association from time to time. The Condominium Property Act provides that each owner must pay his or her proportionate share of the common expenses for each unit owned. 765 ILCS 605/9(a). Until all proposed units in a phased building are made part of the condo, the developer needs to determine how the budget for the condo should be prepared and what level of assessments should be payable by owners of units. For example, in a high-rise building that is being phased, it is unlikely that the roof will be made part of the condo property until the last phase, and until the entire building is made part of the condo, portions of the operating systems (*e.g.,* elevators, heating, air conditioning, and hot water) will be both within and outside of the condo property. Also, because the building will be only partially occupied, the cost of certain services, such as maintenance of hallways, may be less because of the lower occupancy. On the other hand, certain overhead costs, such as the cost of a 24-hour doorman or security service, may not be affected by the level of occupancy.

There are basically two ways to deal with this issue. One approach is to reduce the budgeted expenses to reflect reduced costs because of the reduced occupancy. Another approach would be to levy assessments based on what is commonly referred to as a "stabilized budget," which is a budget based on the assumption that all portions of the property that are intended to eventually become part of the condo are part of the condo and that all units are fully occupied and all services are being furnished. Under a stabilized budget approach, each owner of a unit that is part of the condo, including the developer for units owned by the developer (regardless of whether they are occupied) will pay full assessments from time to time under the stabilized budget for each unit owned. Depending on the costs that are actually being incurred, the assessments payable with respect to the existing units may not be sufficient to pay the actual operating expenses of the condo as it then exists. If the assessments levied to pay operating expenses under the stabilized budget are not sufficient to cover these expenses, the developer should pay the shortfall. If the assessments

levied to pay operating expenses exceed the operating expenses, the developer could reduce the budget to come closer to actual costs, thus reducing the assessments payable by all owners, including the developer. The benefit to the developer of phasing is that the developer will not be required to pay assessments for a unit until the unit is added to the condo. Although the use of a stabilized budget does not technically comply with the Condominium Property Act (another flaw in the Act), it is a reasonable approach that benefits the early buyers because (1) instead of requiring them to pay a disproportionately high assessment until enough units are in the condo to justify a more reasonable assessment, it tells them what the assessments will likely be when the building is sold out and (2) obligates the developer/declarant to subsidize the operating shortfalls until equilibrium is reached. Thus, it does not disadvantage the early buyers and is a reasonable approach that should be permitted under the Condominium Property Act. The stabilized budget approach is the approach the authors use in non-condo situations, including those communities covered under the Common Interest Community Association Act, in which there is broad flexibility to establish in the declaration how assessments are allocated among the owners and what share of the expenses the developer will pay. See §5.29 above.

D. [5.45] Commercial Space

Many mid-rise, high-rise, and conversion buildings contain commercial space that, generally, is located on the ground level and sometimes on the second or third levels. Commercial space can be made part of the condo property as common elements, made into nonresidential units, or carved out of the condo property. If the commercial space is made part of the common elements, then the condo association will have control over how the commercial space is used and will apply any rent received with respect to the commercial space to pay common expenses. If the commercial space is made into one or more nonresidential units, the commercial units can be used for nonresidential purposes, will have a percentage interest, and will pay assessments based on the percentage interest assigned to each commercial unit. The most significant difference between nonresidential units and residential units will be the use restrictions. However, because the nonresidential units are units within the condo, they will be subject to rules and regulations adopted from time to time by the condo association.

One potential problem with making commercial space into units is that, generally, the commercial space represents a small amount of the space in the building, which means that its owners would have little voting power. A board dominated by residential unit owners could pass rules and regulations or institute procedures that could make things difficult for the owners of the nonresidential units and adversely affect the marketability of these units.

The third alternative, carving commercial space out of the condo, is often the best choice from the point of view of the developer. By carving the commercial space out of the condo property, the commercial space will not be subject to rules and regulations adopted by the condo association. The commercial space will not participate in the condo association in that it will not have a percentage interest and, therefore, will not have any right to attend meetings or vote. Similarly, the commercial space will not be required to pay assessments (including a reserve build-up) based on a percentage interest. Instead, the declaration should be drafted so that it contains provisions that require the owner or owners of the commercial space to pay a designated share of certain expenses, such as maintenance of the roof, the exterior of the building, and any common access areas, loading

docks, or other areas or systems that serve both the condo property and the commercial space. Under this approach, the commercial space owners will not be required to pay a percentage interest of all costs that include costs for services that the commercial space will never use, such as elevator maintenance or the cost of maintaining residential areas of the building. This method of expense allocation should result in the commercial space owners paying substantially less for maintenance costs than they would pay if they owned condo units. Since the commercial space will not become part of the condo property, unless the developer reserves the right to add commercial space to the condo property at a later date, the declaration will need to include cross-easements of support and access between the commercial space and the condo property. Also, there will need to be party wall provisions dealing with the walls or floor dividers that separate the commercial space from the condo property.

E. [5.46] Parking

Most large buildings have parking as part of the project. Because most large buildings are located in areas where parking is at a premium, the developer generally sells parking spaces. There are several ways to approach parking. They include

1. creating each parking space as a separate condo unit that is then sold and conveyed to a purchaser;

2. setting up each parking space as a limited common element that is then assigned to a unit;

3. setting up the parking spaces as part of the general common elements that are then assigned to the owners by the condo association board; or

4. creating a valet parking facility within the condo whereby each owner of a unit who desires to park a car will purchase a parking right that will be the right to park his or her car at any time in the parking garage, using the valet system.

Since a purchaser who is asked to pay for parking will want to know that he or she will have a specific assigned parking space, the most commonly used approaches are to either create the parking spaces as condo units or assign the parking spaces as limited common elements. The valet parking approach has been used in situations in which it is possible to park a larger number of cars in the garage but, because of the way the garage is configured, the only way to be able to get cars in and out when they are needed is to set up the garage as a valet parking facility.

When a specific parking space is to be assigned to a unit, the typical choice is between parking spaces that are units and parking spaces that are limited common elements. If a parking space is set up as a unit, it will have a percentage interest assigned to it; this means that an assessment will be payable with respect to the unit, the unit will have a vote equal to its percentage interest, and, in addition, because it is a condo unit, a real estate tax bill will be issued with respect to the unit. If, on the other hand, a parking space is set up as a limited common element, it will not necessarily have a percentage interest assigned to it (although it could be required to pay a share of the cost of maintaining the garage) and it will not be issued a separate real estate tax bill (although the value of the parking space may be picked up and included in the real estate tax bill for the unit to which

it is assigned). Lenders prefer that parking spaces be limited common elements because a limited common element parking space will be covered automatically by the mortgage on the unit to which it is assigned, whereas a parking space unit would have to be made specifically subject to the lender's mortgage. Also, a limited common element parking space may be assigned only from one unit to another, usually requiring mortgagee consent, whereas a parking space unit can be conveyed separate from a residential unit without the mortgagee's consent, although to do so may be a default under the mortgage or a breach of the terms of the declaration.

IX. [5.47] DE-CONVERSIONS

The housing market crash that led to the Great Recession of 2007 – 2009 put enormous stress on the housing market in general and the condominium form of ownership in particular. Issues unique to condominiums that were exposed by the Great Recession include the following:

- Presale requirements, restrictions on the percentage of units that could be owned by investors, limits on the number of delinquencies, and other restrictions that lenders applied to condominium projects made it much more difficult to obtain a mortgage on a condominium unit than on a single-family home or a non-condominium townhome unit.

- The rise in assessment delinquencies created serious financial issues for condominiums and their nondelinquent unit owners. Lenders required that condominium declarations make the lien for unpaid assessments subordinate to the lien of the first mortgage on the unit. When the first mortgage on a unit was foreclosed, the foreclosure sale would result in the extinguishment of the lien for unpaid assessments, depriving the association of much-needed income. Nondelinquent owners were faced with rising assessments and/or special assessments to cover the shortfalls created by delinquencies and extinguished assessment liens.

- Many condominiums were unwilling or unable to accumulate sufficient reserves for major repairs or replacements when needed, resulting in the association borrowing and/or levying a special assessment to pay for needed work. In the absence of a source of funds for repairs, many condominium associations chose to defer necessary repair work, resulting in the deterioration of the property and a decline in unit values that made it difficult for owners to sell or refinance their units.

- Restrictions or prohibitions on the leasing of condominium units made it difficult for an owner no longer in occupancy of the owner's unit to rent the unit to generate income to help pay the unit's ownership costs until the unit could be sold.

- Large numbers of potential home buyers were shut out of the housing market because of damaged credit or large student loans. Many people who could afford to buy and who could qualify for a mortgage chose to rent rather than buy in order to keep their options open and not risk a potential diminution in, or loss of, their equity in the event of a decline in housing values. Alternatively, they were concerned that they might be stuck owning a unit they no longer were able or desired to live in. In addition, many Millennials delayed marriage and family formation, and the need or desire to purchase a home. As a result, homeownership in the United States significantly declined.

As the demand for owner-occupied condominium units declined, demand for rental apartments increased, as did rental rates. As a result, demand for rental buildings that could be leased for moderate rents increased.

In recent years, investors began to look to condominiums as a source of rental units. At first, investors “went after low-hanging fruit” in the form of recently constructed or converted condominium buildings that had stalled or failed due to lack of sales. The investor would acquire a significant percentage of the units in a troubled building from the failing developer or the lender that had repossessed the units and then would, over time, acquire the balance of the units through short sales or foreclosure sales until it owned all of the units and was able to withdraw the condominium from the terms of the Condominium Property Act and make it into a single-owner apartment building.

As the availability of failed condominium projects decreased, investors began to focus on condominiums in which no single party owned a significant percentage of the units. However, investors found that acquiring all of the units in a condominium with multiple unit owners was much more difficult than buying the bulk of the units in one transaction and picking up the stragglers one at a time. Investors began to approach condominiums that were candidates for de-conversion — well-located buildings with studio, one-bedroom, or two-bedroom units that were experiencing some of the problems referred to above — with an offer to buy the entire building. Investors learned, often the hard way, that acquiring a condominium building for de-conversion in Illinois is problematic, especially when there are multiple unit owners, a significant number of owner-occupants, and/or “underwater” mortgages.

A. [5.48] Statutory Basis

There is only one way to voluntarily de-convert a condominium in Illinois: 100 percent of the unit owners and 100 percent of the holders of liens on units must consent to do so under 765 ILCS 605/16. When there are multiple owners of units, the most common way to de-convert is for one buyer to acquire 100 percent of the units pursuant to §15 of the Act, which provides for the sale of 100 percent of the units upon the affirmative vote of owners owning not less than 75 percent of the percentage interests in the condominium. Upon such a vote, all unit owners, even those who did not vote in favor of the sale, are obligated to “deliver such instruments and to perform all acts as in manner and form may be necessary to effect such sale.” 765 ILCS 605/15. Once a buyer acquires title to 100 percent of the units, it can terminate the condominium by withdrawing the condominium from the Act.

NOTE: In 2019 the City of Chicago revised its condominium ordinance in a reaction to the number of de-conversions happening in the city and the increasing objections by long-term homeowners feeling forced from their homes. The revised provision in Chicago Municipal Code §13-72-085 requires a vote of not less than 85 percent of the unit owners to approve a sale of the condominium property. It remains to be seen if other municipalities will follow suit and require a higher voting threshold, as Chicago has, than the 75 percent as required by the Condominium Property Act. 765 ILCS 605/15.

Although §§15 and 16 of the Act are brief and relatively straightforward, the implementation of a sale/de-conversion is not easy, especially when there are owners who do not desire to sell, owners who will not cooperate with the sale, issues concerning the ownership of units, relative values of units that do not correspond to the percentage interests, or liens on units that exceed the value of the units (*i.e.,* the units are "underwater"). The presence of one or more of these issues can scuttle a proposed sale or complicate and extend the process to the point at which a prospective buyer may be deterred from pursuing the sale or will need to reduce the purchase price to compensate for the time and effort required to negotiate and consummate the transaction.

The recommended plan of action for a condominium that is a candidate for sale or de-conversion is for the association to first deal with and resolve as many of the anticipated issues as possible and then offer the building for sale pursuant to a request for proposals, which lays out the terms and conditions of the sale and requires the prospective buyer only to make a proposal based on price. It may take some time to resolve the issues, and it may turn out that one or more significant issues cannot be effectively resolved, in which case it may not be possible to sell the building. However, if the association can resolve as many of the significant issues as possible up front, it would be in a position to offer a "turnkey" sale that would maximize the sale price and the return to the owners.

B. [5.49] Identify the Issues

The following are some of the issues that may need to be resolved by an association that is considering selling itself:

Basic information. The first step is for the association to gather some basic information about the condominium, including the following:

1. information on units being leased (including rent term, renewal options, security deposits) and whether there are any delinquencies, defaults, or alleged defaults by the tenant or any complaints or claims by the tenant;

2. copies of all contracts between the association and third parties and any permits and licenses held by the association;

3. a copy of the recorded declaration and condominium plat;

4. a current commitment for title insurance with respect to all units and copies of all documents listed in Schedule B;

5. to the extent possible, the purchase price paid for each unit and the cost of significant rehab work done on the unit;

6. the amount outstanding on mortgage liens and other liens with respect to each unit;

7. the real estate taxes levied with respect to each unit and the status of any efforts to obtain reductions in the taxes;

8. a current report showing the status of assessment payments from each unit owner, any delinquencies and the status of any collection efforts;

9. balance sheets and financial statements for the association for the last two fiscal years;

10. an inspection of the building and all units to determine what work will be required immediately and the remaining useful life and the cost to replace systems and facilities within the building (such as HVAC, roofing, windows, building exteriors, plumbing, electrical, etc.); and

11. information concerning any litigation, disputes, or issues between the association and a third party or between the association and a unit owner or between unit owners of which the association is aware.

It is recommended that the association accumulate the above information for three reasons: first, to permit the board to make a determination of what a buyer should be willing to pay for the building; second, to assist the board in determining how the net sale proceeds should be allocated in order to maximize the vote in favor of the sale; and third, because any prospective buyer will need to review some of the information during its due diligence period.

Allocation of sale proceeds. Although it is generally assumed that the default formula for allocating the net proceeds of a sale is by applying the percentage interests to the purchase price, 765 ILCS 605/15 does not require that percentage interests or any other formula be used to allocate the proceeds of sale among the unit owners. Agreeing on how the net proceeds of the sale will be distributed is a significant issue. If it cannot be resolved, there may be no point in continuing to pursue a sale unless a potential buyer is willing to underwrite the cost of what could be a long-drawn-out and costly process.

To attain the 75-percent vote (or 85-percent vote in Chicago; see §5.48 above) and secure the cooperation of 100 percent of the owners will require an approach that seems fair, or at least reasonable, enough to get as many of the owners as possible to support the approach in order to permit the sale to occur in a timely manner. There may not be a simple formulaic solution to allocating the sale proceeds. For instance, owners may have different investments in comparable units (purchase price and/or cost of rehab or upgrades) and/or different amounts of mortgage or other liens on the units. Also, owners will often have conflicting views on the relative values of their units. With respect to those units that are underwater, it may be necessary to negotiate with the lender to accept less than the outstanding debt or else allocate enough proceeds to the unit to pay off the debt.

Rights of objecting owners. 765 ILCS 605/15 provides that an owner who does not vote in favor of a sale and files a written objection to the sale is entitled to receive from the "proceeds of sale" an amount equivalent to greater of (1) the "value" of the owner's unit, as determined by a "fair appraisal," or (2) the "outstanding balance of any bona fide debt secured by the objecting owner's interest" (*i.e.,* an underwater mortgage), less unpaid assessments and charges owned from the unit owner. In addition, a dissenting owner would be entitled to be paid "reasonable relocation costs" determined with reference to the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. *Id.*

Section 15 gives no guidance of on what basis "value" is to be determined. There appears to be at least three possible ways to approach a determination of value: (1) as an owner-occupied unit in a functioning condominium; (2) as a rental unit in a functioning condominium; or (3) as a rental unit in a non-condominium apartment building. Except for an owner who would benefit from the underwater mortgage provision referred to above, a dissenting owner would need to be confident that the appraisal process would result in a "value" for the unit that is higher than the portion of the sale proceeds allocated to the unit, lest the owner end up with a reduced share of the sale proceeds.

Dealing with owner-occupant issues. There may be owner-occupants who desire to remain in their unit as tenants after the sale or de-conversion. If the expectation is that the building will be de-converted into a conventional rental building, the terms of sale could require the buyer to permit former owner-occupants to remain as tenants, either short term or long term, in order to obtain the owner-occupants' consent to the sale. Alternatively, a portion of the proceeds of the sale could be set aside to assist former owner-occupants to relocate regardless of whether they become objecting owners.

Difficulty identifying or contacting owners. There could be deceased, incapacitated, or unresponsive owners, such as lenders who have taken title through foreclosure or foreclosures in process. The association will need to identify and resolve these issues before it can deliver clear title to all of the units. The first step is to obtain a current commitment for title insurance to determine the identity of each unit owner.

Prorations. Since each unit receives its own real estate tax bill, the real estate tax prorations need to be done unit by unit. This is an issue that can be dealt with in the "sale plan" described in §5.50 below and implemented in the closing escrow. The same applies to any other prorations, such as rent on units that are being leased.

C. [5.50] Preparing for the Sale

If the issues described in §5.49 above, as well as any other issues that arise, can be effectively dealt with, it is recommended that the association present to the owners, at one or more informational meetings, the terms on which the building would be sold and how the proceeds of sale would be distributed, along with a proposed form of sale agreement that will be used to effectuate the transaction with the selected buyer (sale plan).

Since, under 765 ILCS 605/18 and at common law, the board has a fiduciary duty to the owners, the board must be careful to provide transparency and full disclosure of all relevant facts surrounding the proposed sale to the owners. The reason for this is so that, when a vote on the proposed sale is held, each owner can make an informed decision as to whether to vote in favor of the proposed sale or, if not, whether to file an objection to the sale and go through the appraisal procedure provided for in 765 ILCS 605/15.

It is suggested that the sale plan state the minimum net sales proceeds that the association will require after all costs, fees, and transfer taxes have been paid (minimum net proceeds) and, correspondingly, the minimum amount of money that each owner will receive for the owner's unit when the sale is completed, plus or minus prorations. The sale plan should also include provisions

for how any excess proceeds over the minimum net proceeds will be distributed and how any reserves being held by the association will be used or distributed. The excess over the minimum net proceeds could be distributed in any number of ways, but two logical approaches are (1) pro rata based on the allocation of the minimum net proceeds (which may or may not be based on percentage interests) and (2) by percentage interests. Since the reserves were built up from assessments based on percentage interests, any reserves remaining after the transaction is completed should be distributed based on percentage interests. Alternatively, the sale plan could provide that the reserves will become the property of the buyer after the sale, which could support a higher minimum net proceeds requirement.

When the board believes that it has reached a consensus, or at least has enough support from the owners to justify going forward, the association should prepare a request for proposals, which will lay out the terms of the sale plan.

D. [5.51] Find a Buyer

The request for proposals would be sent to prospective buyers who have expressed an interest in buying the building, or it might be disseminated by a broker. Once a qualified buyer is obtained and a formal contract negotiated and executed, the final, executed contract and the sale plan would be submitted to the owners for a vote to approve the contract under §15 of the Condominium Property Act, 765 ILCS 605/15, and to approve the allocation of proceeds as provided in the sale plan.

E. [5.52] Preparing for Closing

The buyer will want to acquire all units free of liens at one time. The best way to accomplish this is for the association and the buyer to set up a closing escrow into which each owner will be required to deposit a deed to his or her unit, a payoff letter or release from his or her lender (if any), and any other lienholders and any other closing documents required under the sale contract or by the title insurance company. In anticipation of closing and in order to expedite the process, the association may want to begin collecting closing documents from owners as soon as the sale has been approved (even before all the conditions to closing have been satisfied) and deposit them in the closing escrow. When the conditions have been satisfied, all owners' deposits are in the escrow and the buyer's money is in the escrow; the transaction will close and the condominium will be de-converted by the withdrawal of the property from the Act and the condominium declaration. The act of de-converting the property will also cause the property tax parcel numbers eventually to be reconsolidated by the assessor into a non-condominium parcel designation.

F. [5.53] Liquidate Association and Distribute Funds

After the closing, the net proceeds of the sale would be distributed per the sale plan. The balance of the funds held by the association, including reserves (if not turned over to the buyer), should, after all expenses are paid and delinquent assessments are collected or deducted, be distributed based on the percentage interests. After all funds have been distributed, the association would be terminated.

In conclusion, a condominium association that desires to sell its building needs to spend some time, effort, and money to prepare itself for sale. Following the procedure suggested above will help facilitate a sale and maximize the return to the owners, while minimizing conflicts and delays.

X. [5.54] SECONDARY MORTGAGE MARKET

At several points in this chapter, reference is made to the requirements of the secondary mortgage market and how it influences the formulation of the development plan. See, *e.g.,* §5.40 above. A brief description of the secondary mortgage market and its requirements follows.

The secondary mortgage market is a shifting complex of governmental and quasi-governmental agencies and entities as well as institutional investors. Currently, the major investors in the secondary mortgage market are Fannie Mae, a government-sponsored enterprise; Freddie Mac, a federally chartered corporation under the oversight of the U.S. Department of Housing and Urban Development (HUD); and various mortgage banking operations, insurance company pension funds, and other institutional investors that buy and sell home mortgages or securities backed by pools of home mortgages.

Lenders generally have regarded loans on units in condos and planned unit developments as more risky, if not simply more trouble, than loans on detached, single-family homes that are not part of a condo or common interest community. One way to maximize the availability of end-loan financing is to conform the condo or CIC documentation to the requirements of the secondary mortgage market. This enables the end lender to sell the mortgage loans it originates, rather than to hold them in its portfolio, or to shift some of the risk of the loans to entities that insure or guarantee loans.

Usually, investors in the secondary mortgage market purchase only mortgages that satisfy certain specific requirements. Since homeownership is a goal that the federal government actively supports and encourages, a number of federal or federally related programs have been developed to encourage the purchase of home mortgages by investors:

a. The Federal Housing Administration, a part of HUD, insures home loans that satisfy its requirements. An investor is encouraged to purchase FHA-insured home loans or securities backed by a pool of loans that includes FHA-insured loans because if an FHA-insured loan goes into default, it can be assigned to the FHA in return for cash or debentures of the federal government, thus substantially reducing the investor's risk.

b. The U.S. Department of Veterans Affairs (VA) is a federal agency that guarantees a substantial portion of home loans to veterans who satisfy its requirements. An investor is encouraged to purchase VA-guaranteed loans or securities backed by a pool of loans that includes VA-guaranteed loans because if a VA-guaranteed loan goes into default, the VA will stand behind its guaranty and, in many cases, will purchase a defaulted loan for cash. The VA will guarantee loans secured by lots in a CIC and condo units. The VA does not guarantee co-op share loans.

c. Freddie Mac purchases conventional loans (other than those that are FHA-insured or VA-guaranteed) that satisfy its requirements. Freddie Mac purchases loans from savings and loan associations, banks, and certain mortgage bankers. Freddie Mac will purchase long-term, fixed-rate loans, and various adjustable rate mortgages (ARMs) on lots in a CIC and condo units. Freddie Mac does not purchase co-op share loans.

d. Fannie Mae purchases from qualified sellers/servicers FHA-insured loans, VA-guaranteed loans, and conventional loans that satisfy its requirements. Conventional loans purchased by Fannie Mae include long-term fixed-rate loans, growing-equity mortgages (GEMs), and various ARMs. Fannie Mae will purchase loans secured by lots in a CIC and condo units. Fannie Mae will purchase co-op share loans.

e. As part of the Housing and Economic Recovery Act of 2008, Pub.L. No. 110-289, 122 Stat. 2654, the Federal Housing Finance Agency (FHFA) was created on July 30, 2008, in an effort to provide "an independent regulatory agency [responsible for the oversight of] vital components of the secondary mortgage markets including Fannie Mae, Freddie Mac and the Federal Home Loan Banks." Federal Housing Finance Agency, *FHFA AT-A-GLANCE,* www.fhfa.gov/aboutus. However, the FHFA has delegated certain day-to-day business operations to Fannie Mae and Freddie Mac, including matters involving individual mortgages, property sales or transfers, and foreclosures.

FHA, VA, Fannie Mae, and Freddie Mac all have requirements that must be satisfied before they will insure, guarantee, or purchase a loan, as the case may be, on a condo unit. Although all of these entities previously had similar requirements that needed to be satisfied before they would insure, guarantee, or purchase loans on non-condo units, they currently do not have such requirements, but it is possible that such requirements may be reinstated in the future.

It is possible to draft a set of condo documents that satisfies the legal requirements of the FHA, VA, Fannie Mae, and Freddie Mac. Although the FHA, VA, Fannie Mae, and Freddie Mac currently do not have a uniform set of standards for condo projects, there are several basic issues that concern them all, including the following:

Workability. The documentation must establish a workable project and, in particular, must set forth clearly responsibility for maintaining all portions of the project. The documentation must provide a logical and workable means of allocating expenses incurred by the association and collecting assessments from unit owners.

Budgeting. The budgeting procedure must be clear, and the budget must include adequate reserves (usually a minimum of 10 percent of the overall budget) for the replacement and major repair of the common areas of the project and funding for insurance coverage and deductibles.

Assessments. Assessments must be mandatory, and nonpayment of an assessment must result in a lien against the defaulting owner's unit. No more than 15 percent of the total units may be more that 30 days in arrears in the payment of assessments. This threshold has been temporarily increased to 60 days.

Priority of mortgage lien. With only a few exceptions, the lien of the holder of a first mortgage on a unit must have priority over the association's lien for unpaid assessments.

Developer's reserved rights. The reserved rights of the developer must be reasonable and must relate to the legitimate interests of the developer in constructing the project and selling the units. A long-term recreational facility lease is generally not acceptable to the secondary mortgage market. Also, a long-term management agreement or any contract that appears to involve self-dealing by the developer will be scrutinized closely. The developer will not be permitted to retain control of the association beyond a reasonable period of time, which is generally not later than when 75 percent of the units have been sold or five (and in some cases seven) years after the declaration is first recorded, whichever comes first.

Add-on rights. If the developer reserves the right to add additional property to a residential association, the improvements on the added property should be of the same style, construction, and quality as the property currently being administered by the association. This requirement is intended to ensure that the maintenance costs of all units will be similar and that no one unit owner will be required to subsidize the cost of maintaining other units that may require a greater amount of maintenance than his or her unit. Also, the developer may have to limit its power to add property to the condo to a reasonable period of time, which may vary depending on the character and size of the project. Further, the method the developer chooses to implement its add-on rights may affect its quota for the owner-occupancy rate or the limits on FHA concentration levels.

Phasing a single structure. Building-by-building add-on phasing is not typically a problem for the secondary mortgage market. Difficulties arise when a developer phases a single building structure into several phases in which a floor or groups of floors are added in as a legal phase. Although this type of vertical phasing is permitted under the Condominium Property Act, as discussed at §§5.39 – 5.42 above, it is not favored in the secondary mortgage market. Particularly, Fannie Mae has determined that one building equals one legal phase. There may be some flexibility if a project is approved through its Project Eligibility Review Service (PERS) but not through the traditional lender-delegated review processes. Fannie Mae, SELLING GUIDE: FANNIE MAE SINGLE FAMILY §B4-2.2 (Oct. 7, 2020) (Fannie Mae SELLING GUIDE), https://selling-guide.fanniemae.com. Vertical phasing is acceptable under FHA guidelines if certain criteria are met, such as issuance of a (temporary) certificate of occupancy for the legal phase, independent sustainability from future phases, and units in the phase having been built out. FHA SINGLE FAMILY HOUSING POLICY HANDBOOK, p. 510 (2019) (HUD Handbook 4000.1), www.hud.gov/sites/dfiles/OCHCO/documents/4000.1hsgh_Update7.5.pdf (case sensitive).

Right of first refusal. Originally, a declaration containing a right of first refusal in favor of the association upon the sale of a unit was not generally acceptable to the secondary mortgage market. These rights, rarely exercised by an association, created a problem just by their mere presence in the declaration. Effective January 1, 2010, P.A. 96-228 added §22.2 to the Condominium Property Act as a possible solution to the problem. Section 22.2 provides: "[i]n the event of a sale of a condominium unit by a unit owner, no condominium association shall exercise any right of refusal, option to purchase, or right to disapprove the sale, on the basis that the purchaser's financing is guaranteed by the Federal Housing Administration." 765 ILCS 605/22.2. In addition, FHA

guidelines permit a right of first refusal unless it "violate[s] discriminatory conduct prohibitions under the Fair Housing Act regulations at 24 CFR part 100." HUD Handbook 4000.1, pp. 528 – 529.

Amenities. The amenities of a project, such as recreational facilities, must not be a financial burden to the existing units in the project. If the project documentation permits later annexation of additional property and if the existing units cannot support the amenities, then a secondary mortgage market entity may approve the project but require the developer to post adequate security to guarantee that the cost of maintaining the amenities will be paid until a sufficient number of units exist.

Presale requirement. Generally, between 50 percent and 70 percent of the units in a project must be under contract for sale before a mortgage on a unit will qualify for insurance or guarantee by or sale to an entity in the secondary mortgage market. The harsh effect of the presale requirement may be mitigated by breaking a large project into phases. Also, if the project is an add-on project, the presale requirement may be applied on a cumulative basis as phases are added to the project.

On June 30, 2011, the FHA issued Mortgagee Letter 2011-22 and the *Condominium Project Approval and Processing Guide* (*Condominium Guide*) for the purpose of consolidating the information from Mortgagee Letters 2009-46a, 2009-46b, and 2011-03. See www.hud.gov/program_offices/administration/hudclips/letters/mortgagee. The *Condominium Guide* amended the presale requirement to 30 percent for a new construction and gut rehabilitation conversion projects. (This requirement is not applicable to existing projects or non-gut rehabilitation conversions.) See *Condominium Guide* §3.4. Section 3.4 states that valid presales require (a) copies of sales contracts and evidence of a mortgagee willing to lend, (b) evidence a unit has closed and is occupied, or (c) a builder's certificate and spreadsheet evidencing that (a) or (b) is true.

Mortgagee Letter 2012-18 temporarily provided for a sliding scale of presale requirements and investor percentage of ownership limitations, such that as the number of presales and owner occupants increased so could the percentage of investor ownership — starting at 30 percent and peaking at 50 percent. Mortgagee Letter 2012-18. Such treatment was continued pursuant to Mortgagee Letter 2016-15. Note, however, that Mortgagee Letters 2012-18 and 2016-15 have been superseded by HUD Handbook 4000.1.

Owner occupancy requirements. The secondary mortgage market will not approve a project if too many units are owned by nonresidents or investors. Generally, if more than 49 percent of the units are owned by nonresidents, the secondary mortgage market entities will not insure, guarantee, or purchase loans in the project. There are some exceptions for second homes and bank-owned units. Owner-occupancy limits are also affected by the type of phasing chosen by a developer. For example, under FHA guidelines, the owner-occupancy ratio applies to the number of presold units only when the development is in its initial marketing phase, proposed, or still under construction. The FHA will allow a minimum owner-occupancy ratio equal to 30 percent of the declared units for a new construction project. After the initial 12 months and for any existing project, the presale requirement increases to 50 percent. See *Condominium Guide* §3.5. Section 3.5 states that proof of

owner-occupancy may be provided in the form of (a) a copy of a sales contract and evidence of a mortgagee willing to lend, (b) evidence that a unit has closed and is occupied, or (c) a builder's certificate and spreadsheet evidencing that (a) or (b) is true.

Mortgage Letter 2015-27 temporarily provided an alternate calculation for the owner-occupancy percentage by allowing units that were not investor owned to be considered owner occupied for the purpose of project approval. See Mortgage Letter 2015-27. Such treatment was continued pursuant to Mortgagee Letter 2016-15. Again, note that Mortgage Letters 2015-27 and 2016-15 have been superseded by HUD Handbook 4000.1.

FHA concentration levels. The FHA's 2019 final rule made no change to the 25 – 75 percent range proposed for the maximum FHA insurance concentration requirement. The FHA will not insure any mortgages in an approved project if 75 percent or more of the units are FHA insured. The FHA will not issue new case numbers once the 75-percent concentration level (plus a small tolerance to accommodate for some fallout) has been reached in any particular development. With the issuance of guidance in 2019, the FHA refused to increase the FHA concentration level to 100 percent for new or established projects. 84 Fed.Reg. 41,846 (Aug. 15, 2019). See also Press Release, HUD Public Affairs, *FHA Issues New Condominium Proposal Rule,* HUD No. 19-121. (Aug. 14, 2019), www.hud.gov/press/press_releases_media_advisories/hud_no_19_121.

Commercial space. Generally, the secondary mortgage market will limit the amount of space in a mixed-use building that may be designated as commercial to 25 to 35 percent of the total floor area. See Fannie Mae SELLING GUIDE §B4-2.1-03. However, the FHA will allow upwards of 49 percent of the project to be allocated to commercial space. HUD Handbook 4000.1, p. 151.

Investor/single-entity ownership. No single entity may own more than 10 to 20 percent of the units in the project. The 10-percent limitation on single ownership applies to all owners except the developer during the initial marketing of a new condo. HUD Handbook 4000.1, p. 478. However, Fannie Mae permits 20 percent single-investor ownership in a project of 21 units or greater. Fannie Mae SELLING GUIDE §B4-2.1-03. Certain units may be excluded from the calculation, such as units owned by the developer that are vacant and being actively marketed for sale.

Eligibility and ineligible projects. FHA, VA, Fannie Mae, and Freddie Mac each have their own lists of approved projects. Reciprocity between the agencies is common but not always given. Regardless of agency, the common thread behind the characteristics of projects that do not qualify for secondary mortgage financing is lack of control by individual owners. Some examples of ineligible projects are (a) ones requiring mandatory memberships in recreational facilities owned by third parties, (b) hotel/motel projects even if the unit is individually owned, (c) project based on something other than real estate (e.g. houseboats), (d) continuing care facilities, and (e) projects that include excessive seller financing and sale contributions. Fannie Mae SELLING GUIDE §B4-2.1-03; Freddie Mac, SINGLE-FAMILY SELLER/SERVICER GUIDE §5701.3 (Nov. 4, 2020), https://guide.freddiemac.com/app/guide/.

For the most up to date information on each of these categories you should refer to the following:

- Fannie Mae's legal requirements are found in its SELLING GUIDE §B4-2.1-01.

- FHA legal requirements are found in HUD Handbook 4000.1, p. 510

- Freddie Mac legal requirements are found in its SINGLE-FAMILY SELLER/SERVICER GUIDE, Ch. 5701.

- VA requirements are found in its LENDER'S HANDBOOK, VA Pamphlet 26-7, ch. 16, *Common Interest Communities, Condominiums and Planned Unit Development* (Oct. 22, 2019), www.benefits.va.gov/warms/pam26_7.asp.

Although unit loans secured by lots in CICs and condo units are widely traded in the secondary mortgage market, loans secured by the shares of a co-op unit owner in his or her co-op association have not yet gained wide acceptance in the secondary mortgage market. Fannie Mae has a program under which it will purchase loans made by lenders to owners of co-op units that are secured by a pledge of the owner's stock in a cooperative association and his or her leasehold interest in the unit. In addition, the FHA will insure loans secured by a pledge of a co-op unit owner's stock in his or her cooperative association.

The foregoing briefly outlines some of the major issues with which the secondary mortgage market is concerned. To obtain project approval of a CIC from a particular entity, it will be necessary to compare the documentation for the CIC to the legal requirements of the entity.

As of the date of this publication, FHA, VA, Fannie Mae, and Freddie Mac do not require project approval of non-condo projects. The secondary mortgage market is in a state of flux, and it is possible that this could change and, at some time in the future, the secondary market once again will require approval of documents for non-condo projects.

XI. CONSIDERATIONS WHEN ACQUIRING TITLE TO A PARTIALLY COMPLETED PROJECT

A. [5.55] In General

The housing crash caused a large number of projects to stall or fail. Many of these projects went through short sale, foreclosure, deed in lieu of foreclosure, or bankruptcy and ended up being owned by an entity other than the original developer, usually the lender or an investor that acquired the project from the lender. Now that the housing market is recovering, builders and developers are looking to acquire and restart and/or resume many of these projects. Unfortunately, the builders and developers who are considering acquiring a project with the intent of restarting or resuming the project are confronting a myriad of significant issues. A builder that is interested in acquiring a partially completed project (New Builder) needs to conduct a thorough due diligence investigation to determine the status of the project, including what rights may and should be assigned to the New Builder and what obligations the New Builder may be inheriting.

Sections 5.56 – 5.63 below provide a summary of documents that should be reviewed and issues that should be considered by the New Builder.

B. [5.56] Entitlements

A New Builder should review annexation and development agreements, applicable zoning and subdivision ordinances, recapture agreements, easements, cost-sharing agreements, and other recorded documents. Be aware that many rights and obligations may "run with the land." If certain rights and obligations do not run with the land, the New Builder should determine if it needs or wants to acquire such rights and, if so, what needs to be done to acquire them and what obligations come along with them.

C. [5.57] Bonds/Letters of Credit

Often surety bonds or letters of credit are posted by the developer as security for the completion of subdivision improvements required under the entitlement documents. It should be determined whether such bonds or letters of credit exist and, if so, whether they are sufficient to complete the required work. The New Builder needs to determine if it will be required to replace the security or if the municipality will call the security and complete the work. If the security is called, a determination needs to be made as to whether the party standing behind the security will have a defense to the call and, if it does the work, whether it will have recourse against the New Builder.

D. [5.58] Homeowner and Condominium Documents

The New Builder should review the declaration, bylaws, or operating agreement; articles of incorporation or articles of organization; other association corporate or LLC records, rules, and regulations; cost-sharing or other agreements that bind the association; budgets; bank records; financial statements; and real estate tax bills. These documents should be reviewed to determine the rights and obligations of the developer (or declarant), including, for example, architectural control, status of control of the association, subsidy issues, obligations to complete common areas and amenities, status of conveyance of common areas to the association or governmental bodies, real estate tax liabilities with respect to common areas, real estate tax issues including tax divisions, obtaining the $1 assessment treatment for common areas, and other exemptions available to the developer such as model home exemptions. As discussed in §5.29 above, non-condo declarations often are drafted so that the developer/declarant pays the shortfall between income and operating expenses instead of paying assessments for units owned by the developer/declarant.

E. [5.59] Developer/Declarant Rights

The New Builder may want to acquire some or all of the rights of the developer/declarant in order to effectively complete the development, even if it means that the New Builder must assume the obligations that go along with becoming a successor or assignee of developer/declarant rights. Consideration must be given to the economic situation of the association, particularly if control has been turned over to the owners. An important part of due diligence is meeting with the managing agent and board of directors for each association to determine if they have any claims against or issues with the original developer or subsequent owners of the project. The New Builder should attempt to resolve issues that the New Builder may discover during its due diligence, such as issues relating to architectural approvals and the right to market, sell, or lease the homes that it will be building, before it commits to acquire the balance of the project.

Before the New Builder commits to acquiring the balance of a stalled or failed project, it needs to consider who holds the developer/declarant rights. As mentioned in §5.31 above, the developer rights are personal rights that do not run with the land, although the Condominium Property Act and the Common Interest Community Association Act both provide that an entity that acquires the balance of the units owned by the developer becomes the "successor developer." 765 ILCS 605/2(q), 160/1-5. The authors believe that an entity that becomes the successor developer under the Condominium Property Act or the CICAA does not acquire those developer/declarant rights created under the declaration that are not mentioned in the applicable Act. Those rights must be assigned by the original developer/declarant.

Many lenders and their attorneys were not aware of the fact that developer rights are distinct personal rights that do not necessarily run with the land and failed to obtain a collateral assignment of such rights when the lender made a loan to the original developer. Even a lender that took a collateral assignment of the developer rights from the original developer often did not pursue and obtain such rights in a foreclosure or deed in lieu of foreclosure transaction. An investor that acquired the balance of a project from a lender that did obtain such rights often did not request that such rights be assigned to it.

If the lender does not acquire the developer rights necessary for a New Builder to successfully restart and complete a project, then such rights remain with the original developer/declarant unless the rights have been otherwise assigned to another entity or have expired by their terms. One way to acquire those rights is to have the original developer assign them to the New Builder. However, if the original developer was not treated well by the lender or has other issues, it may be reluctant to cooperate or downright hostile. It is strongly suggested that a potential New Builder use its due diligence period to determine who has the developer rights that it needs or wants and whether it is possible to obtain them.

Depending on whether and what developer rights can be obtained, the New Builder may still have some work to do to make sure that it has the rights and powers necessary to give it the best chance possible to make the project a success. Some developer rights are more important than others. For example:

1. The New Builder must be able to build the product that the New Builder desires to build. The easiest way to accomplish this is to receive an assignment of the power to approve what is built on the project. Some declarations create an architectural review committee to exercise this power, with the committee controlled by the declarant as long as the declarant is still building homes at the project. Other declarations reserve this power to the declarant and also reserve the right to assign this power to a subsequent developer/builder or to the association. The New Builder needs to determine who has this power, if the power still exists, and how it can get this power assigned to itself. If the power has been turned over, or passed, to the association, the New Builder will need to obtain the approval of the association or its architectural review committee for the proposed product. If this is the case, this issue should be made part of a global settlement with the association. This may include the payment of money or other concessions in order to obtain the necessary approvals from the association. Some declarations include specific construction and design restrictions, such as minimum square footage, façade finishes, and other architectural restrictions. To deviate from restrictions in the declaration may require approval from the architectural review

committee or may require an amendment to the declaration. Depending on how many lots or parcels the New Builder is acquiring, and whether those lots or parcels have voting rights sufficient to carry an amendment to the declaration, the New Builder may be able to cause the declaration to be amended to permit the construction of the product that the New Builder desires to build.

2. The New Builder must be able to market and sell homes, including the rights to build model homes and a sales center, install marketing signs, and bring potential buyers on the project to view the project, homes, and amenities. These are rights that the original developer reserves to itself and that the New Builder needs to obtain from the entity that holds them, which is usually not the association. However, if those rights no longer exist, it would be advisable for the New Builder to obtain such rights in the global settlement with the association discussed above, which may require an amendment to the declaration.

3. The right to control the association, including the right to set the budget and provide for the maintenance that is required to be provided by the association, is another important developer right. This right is specifically covered by the Condominium Property Act and the CICAA, both of which require that turnover of control occur upon the first to occur of the conveyance of 75 percent of the units or the expiration of three years from the recording of the declaration. 765 ILCS 605/18.2(b), 160/1-50(b). This is one of the most problematic issues because developers of larger projects usually need and want more than three years to effectively build, market, and sell the units in a project and would prefer to retain control until they are sold out.

See §§5.29 and 5.36 above for suggestions as to how to deal with this issue for the original declarant. To deal with this issue in an existing project — one that should have been turned over but was not, or one that must be turned over in the near future — is to deal with budgeting and maintenance issues in a global settlement with the association (preferably after turnover has occurred). In these situations, the association is often cash strapped, if not insolvent. An infusion of cash by the New Builder may help seal the agreement with the association. A financially stable association will make it easier for the New Builder to be able to sell units and for the buyers to obtain unit loans.

F. [5.60] Special Service Area Issues

In recent years, municipalities, at the request of developers, have established special service areas (SSAs) to finance the construction of certain public improvements that would serve a development, such as stormwater management facilities, sanitary sewer facilities, roads, streets, sidewalks, erosion control measures, wetland mitigation, public park improvements, etc. The municipality issues tax-exempt bonds to pay for the public improvements, with the bonds being repaid over a period of 27 – 30 years by way of a line item on the real estate tax bill (SSA tax) for each lot or unit in the development. A number of partially completed projects are subject to such SSA taxes. A typical annual SSA tax may range from $1,500 – $2,500 per lot or unit, regardless of whether the lot is improved with a dwelling unit, and this amount typically increases by 1.5 or 2 percent per year. This could be a significant burden for the New Builder and will affect the marketability of the unsold lots. As of the date of this publication, many SSA bonds are selling for significant discounts. The New Builder should consider purchasing SSA bonds at a discount,

retiring a portion of the bonds, and releasing the portions of the project that the New Builder owns from the annual real estate tax burden, thus improving the value and marketability of that property while leaving the bonds and the real estate tax obligation on the existing homes that were sold by the previous developer or developers.

G. [5.61] Interstate Land Sales Full Disclosure Act

U.S. Department of Housing and Urban Development issues should be considered, including whether the project was registered with HUD (and if so, whether the developer strictly complied with HUD's regulations concerning distribution of the HUD property report, including collecting signed acknowledgments from all purchasers) or qualifies for an exemption from registration under the Interstate Land Sales Full Disclosure Act (ILSFDA), Pub.L. No. 90-448, Title XIV, 82 Stat. 590 (1968), codified at 15 U.S.C. §1701, *et seq.* If the project was registered with HUD, then periodic filings are necessary to maintain the registration. As of March 25, 2015, the registration requirements of ILSFDA no longer apply to condominium unit sales. 15 U.S.C. §§1702(b)(9), 1702(d). Since this is only a partial exemption from the terms of ILSFDA, the antifraud provisions and other consumer protections still do apply, unless the condominium sales also qualify for a full exemption pursuant to 15 U.S.C. §1702(a).

H. [5.62] Financing Unit or Lot Sales

Other issues to consider are the availability of end-loan financing for the lot or unit purchasers and whether secondary mortgage market approvals been received. As discussed in §5.54 above, it has become significantly more difficult to obtain end loans on condo units. As a result, many builders avoid creating condos whenever possible.

I. [5.63] Environmental Issues

Environmental issues could have a significant impact on the ability to obtain financing and the cost of development and insurance and may create expensive and time-consuming obligations for the New Builder, such as obligations to create or mitigate wetlands, complete environmental remediation work, and obtain revisions to flood maps.

XII. [5.64] DISTRESSED CONDOMINIUM PROJECTS

P.A. 96-174 (eff. Jan. 1, 2010) amended the Illinois Condominium Property Act by adding §14.5, titled "Distressed condominium property." 765 ILCS 605/14.5. This legislation was passed in response to a multitude of problems, such as the blight and hazards of distressed condo projects, reduction in the values of the remaining units, lost tax revenues, and loss of apartments to the rental market. Customary municipal building code enforcement mechanisms cannot solve the problems of such projects. Distressed condos often lack a functioning board to enforce assessment collections and effectuate building repairs. As a result, such condo projects are at risk of being demolished.

Section 14.5 provides procedures for determining if a particular projected is distressed:

a. 50 percent or more of the units are not occupied by parties with legal rights;

b. the structure has serious building code violations;

c. 60 percent or more of the units are in foreclosure or have been in the last 18 months;

d. the recording is of more units on the parcel than physically exist;

e. essential utilities to the parcel or 40 percent of the units have been terminated (or have been threatened to be terminated); or

f. at least 60 percent of the units are delinquent in the payment of property taxes.

Section 14.5 provides further procedures for addressing these concerns, including the appointment of a receiver to manage and conserve the property or to sell the condo property. The court may appoint a receiver and, after notice and a hearing, may declare that the property is no longer viable as a condo. If such determination is made, the property shall be deemed owned by all of the unit owners as tenants in common based on their former undivided interest in the common elements; liens affecting any unit shall be deemed attached to each undivided interest in the property. An appointed receiver has broad powers, including securing the premises, executing leases, collecting rents, procuring insurance, employing third parties, paying taxes, maintaining or disconnecting utilities, making repairs, holding reserves, and other powers granted by the court.

XIII. [5.65] FLAWS AND SHORTCOMINGS OF CONDOMINIUMS IN ILLINOIS

In the early 1960s, the Condominium Property Act was quickly adopted in Illinois and other states in order to permit builders and developers to build multifamily unit buildings and sell the units to buyers who could obtain FHA insured mortgage loans. At that time, there was little experience with common interest communities and virtually no experience with condos. As the popularity of CICs and condos grew, various issues emerged. As more and more voters became owners and residents of CICs and condos, political pressure to address some of the issues grew. In response, some states adopted what are referred to as comprehensive second- and third-generation acts to replace the first-generation acts. Other states, including Illinois, opted instead to react in a piecemeal fashion as issues arose and often reached crisis proportions, such as the rise of "condomania" (see §5.3 above). The ups and downs in the housing market in the 1970s and 1980s exposed some of the shortcomings of the CIC and condo concepts and led to some legislative responses. The most recent crash put extreme pressure on CICs and condos and exposed flaws and shortcomings that had not previously been anticipated or dealt with.

Following is a summary of some of the more serious flaws and shortcomings that have plagued CICs and condos in Illinois:

Financial interdependence. All CICs necessarily involve a certain degree of financial interdependence because of the necessity of levying assessments on the owners of units in the CIC in order to pay whatever common expenses are incurred by the association that administers the CIC. Condo and cooperative associations that administer multifamily buildings have the highest assessments because of all the systems that serve the building and the cost of insurance for the building. After the crash, when owners could not pay or stopped paying their mortgage service, they often stopped paying assessments and real estate taxes, putting the burden on the paying owners to make up the difference in higher assessments. A significant number of delinquencies in a condo will disqualify the units from secondary market financing, resulting in more stress on the unit owners.

Reserves. Although it is shortsighted, owners who expect to sell their unit in a few years are often reluctant to fund reserves for replacements that may not be needed until after the owners are long gone. After the crash, associations often used reserves to cover shortfalls in revenue and failed to replenish the reserves. An absence of adequate reserves will often force an association to levy a large special assessment or to borrow money and pledge future assessments as collateral for the loan. Either approach will result in greater assessments payable by the current owners.

Personal liability. Most unit owners do not realize that a large judgment against the association may result in each unit owner being held liable, at least for their proportionate share of the judgment, and that bankruptcy of the association may not insulate the owners from this liability.

Transparency. It is often difficult for a unit owner or potential buyer of a unit to obtain information necessary to evaluate the financial condition of the association.

Financing. Owners or potential buyers of units in a CIC that is under financial stress, especially those in a condo, may not be able to obtain a mortgage on a unit in the CIC, even if the borrower's FICO score (a score created by the Fair Isaac Corporation used to assess credit risk and determine whether to extend credit) is high and the borrower has funds for a down payment.

Leadership. Apathy is a serious problem in many CICs, especially smaller CICs. Often this leads to a shortage of qualified persons who are willing to serve on the board of directors. This can result in incompetent leadership and opens the board to undue influence by an egomaniac or even a criminal. Often a weak board will allow itself to be influenced by an unscrupulous managing agent or greedy attorney.

Legislation may effectively address some of these issues. A good template for a legislative solution is found in the Uniform Common Interest Ownership Act, a model act promulgated by the National Conference of Commissioners on Uniform State Laws, which covers CICs condos and cooperatives. The UCIOA was first adopted in 1982 and has been amended and updated periodically since then, with the latest amendments being made in 2014. Illinois should consider replacing both the Condominium Property Act and the Common Interest Community Association Act with the UCIOA. However, even the UCIOA will not solve many of the most serious issues.

The impetus behind the passage of §234(c) of the National Housing Act (see §5.1 above) and the introduction of the condo concept in the United States was to make homeownership more

affordable and bring it within the reach of low- and moderate-income (LMI) households by making FHA insured mortgages available to condo unit owners, particularly LMI households. As CICs and condos grew in popularity and became a dominant factor in the housing market, LMI households were often left behind. The subprime phenomena resulted in many LMI households becoming owners of units and homes in CICs and condos, with little counseling to prepare them for what they were getting into. When the crash came, it was the LMI households that suffered the most harm.

Affordable condo units remain a good option for LMI households to become homeowners, build up equity, and have the opportunity to participate in the governance of the community in which they live. Unfortunately, for some of the reasons discussed above, including the difficulty to obtain mortgage loans, LMI households are being denied the option of becoming condo unit owners. Section 5.67 below puts forth a proposal for using a modified version of the condo concept to permit LMI households to become condo unit owners in a structure that, the authors believe, would be responsive to many of the pitfalls and traps that emerged to devastate LMI households after the crash.

XIV. [5.66] SUGGESTED LEGAL STRUCTURE FOR OWNER-OCCUPIED AFFORDABLE HOUSING DEVELOPMENTS USING THE CHICAGO AFFORDABLE REQUIREMENTS ORDINANCE

The cost of acquiring land, preparing the land for construction, and constructing affordable homes is a threshold issue. Today, the cost to construct a home far exceeds the price that the home can be sold for in order to be "affordable" (*i.e.,* monthly cost of ownership is less than 30 percent of the income of a household earning not more than 100 percent of the median family income (MFI) (about $2,000/month for a family of four in Chicago earning about $79,000/year)). For purposes of this section, we will assume that (a) sufficient land on which to build a "community" consisting of several "neighborhoods" of homes on the south or west side of Chicago will be supplied by the City of Chicago, the Cook County Land Bank, or another source; (b) the land will be "cleaned up" and made ready for construction by a not-for-profit using available tax increment financing funds; and (c) the cost of the construction of the homes will be furnished by the investment of funds by developers that are required under Chicago's 2015 Affordable Requirements Ordinance (ARO), Chicago Municipal Code §2-44-80, to provide off-site affordable homes (currently, this is approximately $183,000 per home). The homes would then be sold to households earning not more than 120 percent of the MFI at a price that is affordable at a monthly cost of not more than 30 percent of the income of a household earning not more than 100 percent of MFI (as high as $210,000 under current ARO rules, but realistically more likely around $140,000). Financing for the buyer would be provided by a lender approved by the city under the ARO, which most likely would receive Community Reinvestment Act of 1977 (CRA), Pub.L. No. 95-128, Title VIII, 91 Stat. 1147, credit. (However, see the discussion in §5.68 below of the blanket mortgage approach.)

A. [5.67] Suggested Legal Structure

Each neighborhood in the owner-occupied affordable housing development would be made subject to a condominium or non-condominium declaration (neighborhood declaration) that would provide for the administration of the neighborhood by a "neighborhood homeowners' association" whose members are the owners of the homes in the neighborhood.

The entire community, and each neighborhood, would be made subject to a "community declaration." The community declaration would reserve to an entity identified in the community declaration (which may be a not-for-profit corporation with experience in administering affordable communities) a number of rights and powers with respect to the management and operation of the community and the neighborhoods. This "administrative entity" would act in place of a community homeowners' association, which, under applicable Illinois law, would be required to be turned over to the owners after the first to occur of either (1) a75-percent sell out of the homes in the community or (2) three years from recording of the community declaration. Among other things, the administrative entity would have the right and power (1) to provide certain designated maintenance and other services to portions, or all, of the community and charge the cost thereof to the homeowners' associations whose members benefit from the services and (2) to establish, modify, and enforce rules and regulations designed to promote and maintain the viability and sustainability of the community and each neighborhood homeowners' association. Thus, the several neighborhood homeowners' associations would be governed by their owners and subject to the guidance of the administrative entity whose mission and purpose would be to help the community effectively deal with issues, including those discussed in §5.66 above.

In a deviation from the typical condominium or homeowners' association setup, each neighborhood declaration would provide that each owner of a home would be required to pay monthly to the neighborhood homeowners' association the following with respect to the owner's home: (a) the monthly assessment; (b) monthly deposits of real estate taxes; and (c) the monthly mortgage service applicable to the home. The neighborhood homeowners' association would then administer the neighborhood and pay necessary expenses and would also make mortgage service and real estate tax payments as they became due on behalf of each owner. The payment of mortgage service and real estate taxes is something that housing co-ops ordinarily do but condominiums and homeowners' associations have not done in the past. By centralizing this function in the neighborhood homeowners' association, the neighborhood homeowners' association would get an early warning when an owner was experiencing financial difficulties so it could effectively deal with the issue.

Each neighborhood homeowners' association's budget would include line items for reserves to cover delinquencies as well as to build up sinking funds to pay the cost of the inevitable major repairs and replacements to the improvements that are maintained by the neighborhood homeowners' association. If properly funded, the reserves could help cover the hopefully brief periods when assessments with respect to a home were disrupted, avoid delinquencies on mortgages or real estate taxes, and permit the neighborhood homeowners' association to avoid borrowing or levying special assessments to pay for major repairs or replacements.

The administrative entity would oversee and regulate each neighborhood homeowners' association to make sure that it was adequately administering its neighborhood and complying with its neighborhood declaration. The administrative entity would be a resource and guide to (as well as regulator of) the boards of the neighborhood homeowners' associations.

B. [5.68] The Blanket Mortgage Approach

Under Chicago's 2015 Affordable Requirements Ordinance, a developer is required to spend funds (currently about $183,000) for the acquisition and/or construction of each required ARO off-site home. Chicago Municipal Code §2-44-80. If the developer spends $183,000 to build an off-site home on donated land and then sells it for net proceeds of, say, $140,000, the transaction would cost the developer about $45,000 – $50,000, which is preferable to paying the "in lieu" amount (currently $235,000 or $183,000) to the city with no return.

As mentioned on §5.65 above, a major issue that faces a moderate-income household is obtaining a mortgage loan. One possible approach that may help a development of newly constructed ARO off-site homes be more likely to fulfill its intended purpose of providing a source of affordable owner-occupied housing is for the developer of each neighborhood to have the option of providing "seller" financing by subjecting the homes in the neighborhood to what is commonly known as a "blanket mortgage." The blanket mortgage would be a nonrecourse (*i.e.,* no personal liability to a homeowner), long-term, fixed-rate, self-amortizing mortgage. This type of mortgage is common in a housing co-op structure. The amount of the blanket mortgage would be set based on what the monthly ownership cost of the ARO off-site homes in the neighborhood would be (*i.e.,* assessments, insurance, real-estate taxes, and mortgage service) so that the ownership costs would be less than 30 percent of 100 percent of MFI (as of 2018, about $2,000 per month or less). Using this approach would result in the portion of the blanket mortgage attributable to each ARO off-site home being less than the approximately $183,000 cost of constructing the home and would support an initial net sale price of around $140,000 per home. (The monthly cost of owning a home that costs around $140,000 would be closer to $1,500 than $2,000.)

Each buyer/owner of a home that was subject to the blanket mortgage would be obligated to pay to the neighborhood homeowners' association its proportionate share of the mortgage service under the blanket mortgage based on the ratio of (1) the monthly assessment payable by the owner to (2) the monthly assessments payable by all owners of homes subject to the blanket mortgage. In a neighborhood of same-size single-family homes, each owner of a home would pay an equal amount of the mortgage service each month. An owner's equity in the owner's home would increase over time as a function of (1) the rising market value (and increase in the permitted resale price), if any, of the home and (2) the reduction of the portion of the blanket mortgage attributable to the home as periodic payments of principal were made.

In a neighborhood of ARO off-site homes in which the market values of homes was not increasing (and even if they were increasing, the resale price is restricted under the ARO) and in which a buyer was able to pay cash for the portion of the sale price that was above the portion of the blanket mortgage attributable to the home, the fact that the blanket mortgage is nonrecourse to the individual owners would make it much easier to transfer ownership of a home subject to the blanket mortgage. (This is a feature of a limited equity co-op.) If the buyer's credit rating and income permitted the buyer to carry a greater monthly ownership cost than what was being paid by the seller, the holder of the blanket mortgage may permit a second or junior mortgage to be placed on the home by the buyer to facilitate the sale. (This feature is not available in a limited equity co-op.)

The developer would make a home subject to the neighborhood declaration and the blanket mortgage when the home was sold and conveyed to the first buyer. When all of the homes in the neighborhood have been built, sold, and conveyed and the neighborhood was stabilized, the developer should be able to sell the blanket mortgage to a bank that desired to promote affordable housing and could use Community Reinvestment Act credit. What the developer received for the blanket mortgage when and if it sold it would likely be much less than the cost of construction. However, even if a developer received back only a portion of the funds invested, it would still be a better return than if the developer had made the "in lieu" payment and received nothing back. In addition, the developer would be able to be part of a commendable effort to rebuild communities that were devastated by the crash by providing new affordable owner-occupied housing to moderate-income households.

Until a significant percentage of the homes have been refinanced and released from the blanket mortgage, the holder of the blanket mortgage and the administrative entity should have a significant role in the administration of the neighborhood homeowners' association. In particular, the mortgage holder and the administrative entity would want a system in place that screened each potential owner to maximize the likelihood that the owner would meet his or her financial obligations to the neighborhood homeowners' association.

If the blanket mortgage model is used, at some point in time the difference between the portion of the blanket mortgage attributable to a home and the resale price of a home (even with the resale price restrictions of the ARO) will become high enough that paying cash for the difference or financing the difference with a second mortgage may not be feasible for a moderate-income buyer. At that point, the then-holder of the blanket mortgage should be willing to permit home-by-home releases (partial releases) from the blanket mortgage. The ability to either refinance a home or sell the home to a buyer who can finance the purchase with a first mortgage on the home, when the proceeds are used to obtain a release from the blanket mortgage, will greatly enhance the marketability of homes in the neighborhood. The holder of the blanket mortgage likely will not permit partial releases unless and until the neighborhood homeowners' association satisfies the then applicable requirements of the secondary mortgage market for the insurance or purchase by the secondary mortgage market of loans on homes in the homeowners' association.

The blanket mortgage would permit and provide for the release of a home from the lien of the blanket mortgage upon payment to the holder of the blanket mortgage of a sum equal to the portion of the mortgage debt that is attributable to the home. This amount, commonly referred to as the "release price," is determined by multiplying the outstanding principal balance of the blanket mortgage loan by a fraction, the numerator of which is the home's share of assessment payments to the homeowners' association and the denominator of which is the share of assessments payable to the homeowners' association by all homes then subject to the lien of the blanket mortgage. The release price will decline as amortizing payments under the blanket mortgage are made and the principal outstanding under the blanket mortgage decreases.

The legal structure suggested above is designed to facilitate the creation of affordable owner-occupied communities of ARO off-site homes in areas of the city that need them most and allow the communities to be sustainable and flexible in order to avoid the pitfalls that have hampered such communities in the past.

In order to give the above plan the greatest chance of success, a few changes need to be made to the ARO. Specifically, a developer should be permitted to build for-sale owner-occupant ARO off-site homes anywhere in the city (or at least in certain designated areas of the city where there is a need for affordable homeownership) to meet its ARO obligation when building a rental or for-sale project *anywhere* in the city and eliminate the "two-mile rule."

XV. [5.69] CONCLUSION

As of late 2020, the homebuilding industry in portions of the Chicago area was showing signs of recovery after having been adversely affected by the COVID-19 pandemic. For developers, the process of entitlements within municipalities slowed almost to a halt. Developers looked to excuse performance under doctrines of commercial frustration and force majeure. Purchasers who lost their jobs during the economic downturn could not obtain financing and defaulted on contracts. It remains to be seen how the lack of development for much of 2020 will affect demand and deliveries for 2021 as the pandemic continues and the economic recovery stalls. To effectively develop new projects or restart and reinvigorate many stalled common interest communities requires a thorough understanding of the issues discussed in this chapter and how they affect the particular CIC in question.

A lender, investor, or developer that considers the issues raised in this chapter before committing to acquire or to provide funds to develop a project should be better able to make an informed decision as to whether it wants to acquire the project and how it will deal with these issues if it does acquire the project.