Condominium community: Unwinding under duress - by Daniel Calano

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Over the last several years, I have personally witnessed, and in one case, participated in, the "unwinding" of a residential condominium structure. The reason for, and process of, has often been recent climatic destruction such a hurricane or fire. But, as in the case of the tragic southeast Florida building collapse, it can simply be old age deterioration, outdated building codes, and/or a slack in periodic upkeep.

The physical demise of structure is typically not the only problem, since condo living is also community, friendship, interaction, and the inter-reliance of one another. The Florida hurricane related events, three in a row over four years, did not only cause significant physical building damage, but also emotional and financial duress, as periodic and redundant capital assessments were needed to keep up with the re-building. Further, the process of moving out, and moving back in, or leaving completely, can cause unanticipated and continuous stress, as well as a loss of market value, despite improved structural improvements. Simply put, the condominium can lose its otherwise excellent "reputation", which is very hard to restore.

In the process of re-building, several areas of uncertainty can grow as unanticipated consequences.

First, there is the overall decision to restore, or simply demolish. This obviously not only involves a structural engineer decision, but also a condominium ownership decision, be it a majority, or unanimous. Within the condominium, typically all owners will have to agree. Even the threat of non approval, ie. "hold-outs" can slow or stop the process, especially in large projects.

Also, and critical In the decision process, Insurance companies can be cooperative, or not. Claims and subsequent litigation are perfunctory, causing delays or stoppage. In the Florida cases, many insurance companies simply left the State. New insurance companies were scarce, and/or much more expensive. This slow process impacted bank lending, which was clearly difficult, as condominium lending was mainly needed for the overall structure, as individual lending relates to unit interiors, liability etc.

On an individual basis, each owner normally would have some existing bank loans, which typically needs to be paid off in advance, and/or re-blended with new bank financing. In the best case, this takes time, and in the worst, is based on dissimilar individual capacity, and could lead to foreclosure of the project.

Given the complexity of the issues above, some owners will want to leave. They will want to be bought out, but the question is "how" and how soon?

Having addressed the insurance issue, there will eventually be a payment made to the overall condo, which typically will not be sufficient to cover an owners cost, which owner will either value the investment as what was originally paid to buy a unit, or what the open market would indicate as value.

The valuation process is the most perplexing facet. Assuming the building value, due to building demise, is nil, and thus based purely on the land, value will be determined on the basis of a typical developer pro-forma. To simplify, the value will likely be derived on market value of the newly built unit, minus construction cost, soft costs, financing etc, based on an acceptable rate of return over time. It is also reasonable to view the proposed current unit value, as a “lot”, ie individual land value. As in any project, values will change with size, locations, views, etc. In any case, the site may be paid for in advance, allowing individuals to be “bought out”. It is also possible an owner may want keep the “land” and stay in the process, preferring to move back in, after the new construction.

The permutations of how this can go are many, as developers, lenders, current unit owners, and prospective future buyers ponder the project. In any case, as you can see, the process is complicated at best, lengthy for sure, and emotional for many as the condo community considers the future.

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