



Condominium Obsolescence

The Final Act or a New Beginning?

BY RONALD GARFIELD

Aging condominiums approaching obsolescence eventually require major upgrades or wholesale redevelopment. This article discusses practical considerations for condominium owners and their attorneys as they take steps to upgrade, redevelop, or sell an aging project.

Many condominium projects in Colorado were constructed in the 1960s and 1970s or earlier. Even with proper maintenance, the structures, systems, and other elements of these buildings will have degraded over time due to use and exposure to the elements.¹ In some projects, less rigorous building codes in place 40 or 50 years ago have contributed to accelerated condominium deterioration. And in mountain communities, additional physical stress due to greater snowloads, extreme temperatures, erosion, grade changes, and unstable soils may require special structural considerations.² Compounding matters, a project's architecture may be dated and out of step with current design features, rendering it less attractive to prospective renters or buyers. For example, older projects may lack certain amenities considered important today, such as fitness centers.

Even though condominiums can rely on reserve studies to establish sinking funds for the repair or replacement of common elements,³ sinking funds are typically not established for or adequate to cover the cost of complete demolition and replacement of physical structures.⁴ Despite such issues, many condominium projects have appreciated dramatically in value, and for some, the current value of the land alone greatly exceeds the project's original acquisition and construction costs. Where the land's value has significantly appreciated, it might make sense to sell the entire project rather than redevelop it. But redevelopment might create an opportunity to add additional units that could provide a welcome source of funds to offset some redevelopment costs.⁵

This article addresses options and practical considerations condominium owners and their

attorneys should consider when condominiums are at or near the end of their useful life and have reached obsolescence or are in need of major capital improvements. These considerations apply primarily to properties located in Colorado's mountain regions; condominium projects in urban settings may present different or additional considerations that are not addressed here.

Obsolescence

The Colorado Common Interest Ownership Act (CCIOA) does not define when a project or physical structures become obsolete.⁶ CRS § 38-33.3-217(1)(a)(I) provides that for condominiums created after July 1, 1992, a project is obsolete if at least 67% of the votes allocated to units of any project decide it has become obsolete.⁷ Condominium declarations often address obsolescence. But the term "obsolete" may not be the most accurate term to describe a condominium project at the end of its useful life, whether due to the potential failure of structural elements, market conditions, or other reasons, because using obsolescence and other defined terms may limit options available to owners when they might want to de-convert or redevelop. Declarations may better plan for a condominium project's future by addressing de-conversion and redevelopment (discussed below) and eschewing terms such as "obsolete" and "obsolescence."

What CCIOA Tells Us

CRS § 38-33.3-218 describes processes for owners who want to sell an entire project to a developer (de-convert) and how proceeds of the sale will be distributed by the homeowners association (HOA).⁸ Even though CCIOA does not address how owners can go about demol-

ishing an entire project and redeveloping a new project in its place, it can serve as a useful first step insofar as it contemplates a vote to terminate the condominium and a sale by the HOA to a third party or a redevelopment entity that consists of the pre-termination owners.

Planning for Obsolescence in Governing Documents

Some community documents do not address obsolescence. Condominium declarations that do address obsolescence typically require owners to formally approve a plan that includes a finding of obsolescence along with details of the owners intended design for the project's future (Plan). Navigating through the condominium documents and obtaining owner approvals may be the easiest part of implementing the Plan. When formulating the Plan, the HOA should first obtain a cost-benefit study comparing the expected costs and expected benefits of major upgrades, complete demolition and redevelopment, and de-conversion.

Major upgrades might be more cost-effective than complete demolition and redevelopment, especially in light of current construction costs and building code requirements. Preliminary architectural plans are often necessary to obtain even a rough estimate of construction costs. In the case of demolition, the HOA should plan on owners being unable to occupy their units for at least two years. Any cost-benefit study for a Plan that contemplates adding units to the project should also consider the time and expense involved in obtaining land use entitlements. A title company should be included in early planning to provide requirements for insurable title for new units when redevelopment is complete.⁹ Finally, the study should consider additional costs such as exactions that local governmental

authorities may require (e.g., green construction, employee housing mitigation, improvements to public infrastructure), especially where the Plan includes additional density. In many communities it may be possible to have a pre-application meeting with planning staff to learn about concerns the local governmental authority may have regarding redevelopment, especially where there is an interest in added density. Informal discussions about redevelopment might initially sound promising, but a rigorous analysis may show redevelopment to be cost-prohibitive or to involve other major unforeseen obstacles.¹⁰

If a declaration contemplates de-conversion or redevelopment, the Plan allowing for de-conversion and redevelopment should allow for approval by owners without requiring lienholders' consent. Lienholders should not be able to block the Plan's adoption because liens will be satisfied or moved to encumber other collateral as part of the de-conversion or redevelopment process.

Where Obsolescence Issues Arise

Planning for a project's future must take into account various factors related to the condominium's physical structure and age and the regulatory environment.

Multiple Buildings

Condominium projects may consist of a single freestanding building or multiple buildings that operate as a single condominium regime.¹¹ Sometimes buildings are added in phases over time, which can cause earlier phases to reach obsolescence sooner than later phases. With some projects, only a single building or fewer than all buildings might want to adopt a Plan, which requires consideration of how to implement a Plan for fewer than all of the projects' buildings. In such case, the condominium declaration may provide some guidance. Some declarations allow individual buildings within the condominium regime to separate or "de-annex" to carry out a Plan and then "re-annex" after the work is complete. If the declaration does not offer a clear path to de-annexation, the declaration may allow owners of one building to carry out major upgrades for their building. Even where de-annexation is allowed, the declaration might

present other potential problems, such as rights of first refusal.

If a Plan contemplates demolition, existing mortgages on condominium units should not trigger the need to obtain lienholder consents as long as the lenders will be paid off at the time of demolition. If the lenders will not be paid off, it may be necessary to substitute other collateral for security of their liens.

Major Upgrades

Where a development's complete demolition and reconstruction is not feasible or appropriate, condominium owners may take a more limited approach by approving upgrades or replacements that are both structural and cosmetic in nature. Examples include new roofing, new elevators, lobby upgrades, parking structure additions, new exterior siding, windows or balconies, fitness or business centers, bike and ski storage lockers, swimming pool additions or upgrades, new exterior lighting or landscaping, or other improvements intended to make the project more attractive to owners, prospective renters, and purchasers. Financing the cost of major upgrades is beyond the scope of this article but has been addressed previously by this author.¹²

Land Use Approvals

Over any period of years, the local land use regulations governing a condominium project typically become more and more onerous.¹³ For example, the land on which the project is located may have been downzoned, or the building(s) otherwise rendered nonconforming.¹⁴ Land use approvals for projects constructed 40 to 50 years ago may have been simple one-step affairs where the developer did not have to mitigate for perceived impacts like employee housing or parking or provide open space, green construction, or pedestrian amenities. And de-annexation might be considered a "subdivision" under current land use regulations, which could require additional compliance.

De-converting

As discussed earlier, de-conversion is an end-of-life scenario where owners agree to sell the entire project to a developer, take the money, and have

nothing further to do with the property.¹⁵ Without regard to CCIOA, owners could individually agree to sell all their units to a developer. But CCIOA allows the HOA to serve as a vehicle for the sale, which can be beneficial because it avoids exposing individual unit owners to seller liability and provides a mechanism to establish each owner's share of the proceeds based on relative market values.

Pre-CCIOA Regimes

Demolishing a pre-CCIOA project (i.e., created prior to July 1, 1992) and replacing it with a new building or buildings may jeopardize the redeveloped project's status as a pre-CCIOA regime.¹⁶ This is because when a project is demolished, no units remain that typify the condominium form of ownership and its attendant common expense structure, and when the new building is constructed and divided into units, a new declaration and map would be required.¹⁷ Thus, the project likely would not retain its pre-CCIOA status. But failure to retain pre-CCIOA status should not be a deterrent to implementing a Plan for demolition and redevelopment because CCIOA is well established and there are few, if any, meaningful benefits to pre-CCIOA status. Further, the initial apprehensions about CCIOA being unduly onerous have for the most part proven to be unfounded.

Typical Players

Developers and owners are major players in implementing plans for obsolescence. Their roles in the process must be contemplated carefully.

Developers

When owners of a condominium project want to completely redevelop the project with new units, they must decide on a developer and consider the merits of forming a new development entity. If a sufficient number of owners want to remain in the project and buy back new units, a new development entity can be formed. Owners can agree to contribute their existing units to the new development entity in exchange for interests in the new development entity coupled with contracts to buy the new units upon project completion. The new development entity would be used to obtain entitlements,

secure construction financing, and procure contracts with builders, architects, and other construction professionals.

Issues surrounding the use of a new development entity include whether the new development entity will be recognized as a separate legal entity or treated as the HOA's alter ego, and whether the new entity should be treated as the developer, declarant, or both for the purpose of allowing certain claims and enforcing specific rights by purchasers of the new units. As long as corporate formalities are adhered to, the new development entity should be recognized as a separate legal entity and treated as an unrelated third party; purchasers of new units (even those with an equity interest in the new entity who owned a pre-demolition unit) should have all rights that an unrelated buyer would have against an unrelated third party developer; and the new development entity should be treated as the declarant under the new condominium documents.

Dissenting Owners

Some existing declarations allow owners to dissent from a plan for obsolescence, which triggers a required buy-out of their condominium unit at fair market value. Such provisions may present additional challenges to implementing a Plan for obsolescence because they require dissenting owners to be paid off up-front before demolition can begin, and the HOA may lack sufficient funds for the buyout. In such cases, assuming at least 67% of the owners are in favor of the Plan, a solution might be to first amend the declaration to remove any dissenting owners' rights.¹⁸ Pre-CCIOA declarations that have higher voting requirements have been upheld by Colorado courts where common elements are affected.¹⁹ But it would also be valid for the 67% to pass an amendment allowing the HOA to buyout the dissenting owners.²⁰ Other Colorado cases have upheld a higher than 67% voting requirement to amend a declaration as long as such voting requirement (even if unanimous) did not violate existing law at the time the declaration was recorded.²¹ Alternatively, the HOA could use reserve study sinking funds to fund the buyout, though non-dissenting owners might object.

“
But failure
to retain pre-
CCIOA status
should not be
a deterrent to
implementing
a Plan for
demolition and
redevelopment
because CCIOA
is well established
and there are few,
if any, meaningful
benefits to pre-
CCIOA status.
”

Specific Obsolescence Issues

Plans for obsolescence must routinely consider issues relating to taxes, financing, due diligence, and construction defects.

Tax Issues

When a condominium is demolished, the individual condominium units cease to exist and should be removed from the local county assessor's records.²² The entire post-demolition footprint of a demolished building should be revalued as a single vacant parcel with a valuation considerably less than the pre-demolition value of the individual units.

Real property in Colorado is automatically revalued every two years. Valuations are based on

comparable sales in the prior two years or, absent comparable sales, other relevant data. Where real property is overvalued, owners should file a timely written protest to the county assessor.²³ The assessor must issue a determination on the protest, and if the initial determination is not satisfactory, taxpayers have further recourse to the county Board of Equalization and, if necessary, yet another appeal to Colorado's Board of Assessment Appeals. In any sale to a developer for de-converting, the parties might agree to readjust closing tax proration when the county assessor's reevaluation takes place.

Another consideration is whether any real estate transfer tax (RETT) may be applied by a local government authority that imposes such a tax.²⁴ Under CCIOA, when a termination occurs “title . . . vests in the Association as trustee for the holders of all interests in the units.”²⁵ This presents the question of whether such a vesting or transfer would trigger a RETT payment, and, if the RETT is triggered, whether an exemption would be available. If the RETT is triggered and an exemption is not available, it is unclear how the parties would determine the amount of the consideration that would be subject to the RETT.

Financing Concerns

Construction financing will most likely be necessary when a new condominium building is to be built. Typically, the collateral for the construction loan is the land, and ultimately, the finished new condominium units. But plans for obsolescence often involve many years of appreciation on the value of the land, and the lender's as-built appraisal should consider the prices at which the new condominiums would sell,²⁶ which may constitute sufficient collateral to obtain the new loan. Because the existing units will be demolished, they cannot serve as collateral, and a lender may insist on a first-and-only lien on the land underlying the former condominium building as well as all necessary access, utility, and other easements or rights-of-way.

As soon as possible, the HOA should commence discussions with potential lenders to resolve issues to obtain construction financing and to address issues in the redevelopment plans. For example, some or all of the units may

have liens that must be paid off (or collateral substituted) and released before units can be demolished. In such cases, the construction lender might agree to finance the cost of paying off existing loans and roll the payoff amount into a new purchase money loan based on the presumably more valuable new units.

The construction loan will also likely finance some or all of the soft costs and all hard costs associated with the demolition of the existing buildings and construction of the new buildings. Existing owners should expect to pay upfront some of the seed money for the project. Owners and the HOA would almost always prefer the loan to be a non-recourse loan based on the value of the collateral. To make the loan more attractive to a lender and to increase the likelihood of a lender approving a non-recourse loan, the owners and HOA should consider providing the lender with binding resale contracts, where existing owners have committed to buy back the new units and paid earnest money deposits that could serve as additional collateral; limited guarantees from purchasers of new units; and/or evidence that the redeveloped project will include the construction of additional units that can be sold to third parties.

Other creative financing structures may emerge as time goes by. Additional financing details are outside the scope of this article but should be a consideration in any plan for the redevelopment of an obsolete project.

Due Diligence

Redevelopment of older condominiums may require significant due diligence before construction plans can be finalized.²⁷ For example, in older projects, asbestos or lead dating back to the original construction may be present. If a project was constructed many years ago, it is possible that no testing was performed for environmental conditions such as mine tailings or groundwater contamination. In addition to environmental conditions, soil testing for any new foundation system will also be required.

Construction Defects

In Colorado, negligence by construction professionals gives rise to an independent tort claim in favor of an initial buyer, and even a

“
 Given the passage of time, unforeseen market conditions, and the changing tastes of 21st-century owners, renters, and purchasers, real estate practitioners will deal with obsolescence more and more frequently.
 ”

subsequent owner, as to latent defects.²⁸ The question thus arises about the duty owed by a development entity comprising owners of the pre-demolition units where the same owners buy back new units. Such a developer likely still owes an independent duty to the purchasers of new units. Further, this independent duty would be owed by the developer, to the extent additional units are developed and sold off to buyers that were not original owners; and all other construction professionals, to purchasers of units, whether or not they were original owners.²⁹ The developer entity should obtain insurance covering construction defect claims and review policy exclusions carefully to make sure coverage exists where the developer entity and purchasers of the new units are so closely related.³⁰

Practitioner Concerns

Condominium projects seeking to redevelop or de-convert need legal counsel to draft and adopt documents, perform due diligence, handle de-annexing buildings from multi-building projects, obtain entitlements from governmental authorities, organize development entities, contract for pre-sales, draft agreements with construction professionals, negotiate financing, prepare a condominium map, and close on the sale of the new units. Real estate practitioners must consider issues such as what representations to make in pre-sale contracts and how statutory or implied new home warranties could be enforced where the buyer and seller are interrelated.

Real estate practitioners should also be mindful of potential conflicts of interest in dealing with obsolescence. Different legal counsel may be required for the various parties involved. For example, the HOA's interests may not be aligned with redevelopment of only one building in a multi-building project. In that case, if the owners create a separate development entity for their building, such entity will need legal counsel separate from the HOA's legal counsel.

Conclusion

Given the passage of time, unforeseen market conditions, and the changing tastes of 21st-century owners, renters, and purchasers, real estate practitioners will deal with obsolescence more and more frequently. Stakeholders in older projects will be forced to take a hard look at major upgrades, redevelopment, or de-conversion. Practitioners should assist in all phases of project development to ensure smooth transitions throughout a condominium's life cycle. **CL**



Ronald Garfield has practiced banking and real estate law in the Aspen office of Garfield & Hecht, P.C. for over 40 years. He is a cofounder and the managing shareholder of the firm—(970) 925-1936, garfield@garfieldhecht.com.

Coordinating Editor: Christopher D. Bryan, cbryan@garfieldhecht.com

NOTES

1. CRS §§ 38-33.3-307 and -313(9) (the association is responsible for upkeep and maintenance of the common elements).
2. <https://seacolorado.org/docs/2016-Colorado-Design-Snow-Loads.pdf>.
3. CRS § 38-33.3-209.5(1)(b)(IX). See also Association Reserves, Reserve Study Laws & Legislation, <https://www.reservestudy.com/legislation/Colorado> (“Associations must have a ‘policy’ that addresses when a Reserve Study is going to be done, whether the financial analysis included a physical analysis, and a disclosure of any funding plan designed to pay for anticipated reserve expenses”).
4. Schuirmann, Reserve Studies—Lessons Learned (Feb. 17, 2019), <https://community.condoassociation.com/article/reserve-studies--lessons-learned.html> (a vital planning tool to assist associations in forecasting maintenance costs and to be updated regularly).
5. Williams, “Building answers to Colorado’s mountain housing crisis,” *Colorado Politics* (Feb. 26, 2019), https://www.coloradopolitics.com/news/premium/cover-story-building-answers-to-colorado-s-mountain-housing-crisis/article_40581dee-347d-11e9-ba3e-471229db926a.html (“The town recently pumped \$4.2 million into the teardown of 24 aging units at the Solar Vail condos owned by the Sonnenalp Hotel, allowing the ongoing reconstruction to increase capacity to 65 units of workforce housing”).
6. CRS § 38-33.3-103 (definitions of CCIOA).
7. CRS § 38-33.3-217(1)(a)(I) (amendment of association declaration may be accomplished by a vote or agreement of owners not to exceed 67% so as not to be declared void as contrary to public policy).
8. CRS § 38-33.3-218 (termination of common interest community).
9. Meltzer, “Time to Rehab the Aging Condominium Concept: Fixing Problems Uncovered by the Great Recession,” 33 no. 5 *Practical Real Estate Lawyer* 37, 44 (Sept. 2017).
10. Fenster, “Takings Formalism and Regulatory Formulas: Exactions and the Consequences of Clarity,” 92 *Cal. L. Rev.* 609, 615 (2004) (describing “exactions” as an “essential deal-making tool” for local land use regulators to keep the expense off of taxpayers).
11. CRS § 38-33.3-205(1)(e) (contents of declaration).
12. Garfield, “When Homeowner Associations Borrow—What Attorneys and Lenders Should Know,” 44 *Colo. Law.* 51 (Dec. 2015).
13. CRS § 31-12-107 (pertaining to petitions for annexation). An example of a municipal annexation process is at <https://www-static.bouldercolorado.gov/docs/PDS/forms/203.pdf>. An example of a municipal land use application packet is at <https://www.cityofaspen.com/DocumentCenter/View/1835/Land-Use-Application-Packet-2017>.
14. CRS § 30-28-111 (county zoning planning).
15. CRS § 38-33.3-218(10)(a) (determination of respective interests of unit owners).

16. CRS § 38-33.3-117 (applicability to preexisting common interest communities).
17. CRS §§ 38-33.3-201 (creation of common interest communities), -202 (defining unit boundaries), and -205 (contents of the declaration).
18. CRS § 38-33.3-217 (amendment of declaration).
19. *DA Mtn. Rentals, LLC v. Lodge at Lionshead Phase III Condo. Ass’n*, 409 P.3d 564, 573 (Colo. App. 2016).
20. *Id.* at 574.
21. *Giguere v. SJS Family Enters., Ltd.*, 155 P.3d 462, 468 (Colo.App. 2006).
22. CRS §§ 38-33-104 (tax assessment of condominium in county where unit is located) and 38-33.3-105(2) (“constitutes for all purposes a separate parcel of real estate and must be separately assessed and taxed”).
23. CRS § 39-5-122(2) (remedies to correct real property valuation).
24. See generally <https://www.cityofaspen.com/DocumentCenter/View/230/Title-23-Taxation-1-2-3-PDF> (RETT for City of Aspen).
25. CRS § 38-33.3-218(5) (following termination title vests in the association as trustee).
26. *Bly v. Story*, 241 P.3d 529, 537 (Colo. 2010) (“Generally, valuation evidence based on the cost of construction appraisal method is important in determining the market value of

- new or relatively new improvements.”) (quoting Appraisal Institute, *The Appraisal of Real Estate* at 382 (13th ed. 2008)).
27. Reichert and Rozansky, eds., *The Practitioner’s Guide to Colorado Business Organizations* §§ 43A, 43.3 (3d ed. CLE in Colo., Inc. Supp. 2019) (a comprehensive checklist could be useful, such as one that covers commercial buildings, to include unique and complex considerations).
 28. See Colo. Civ. Jury Instr. 30:54 (The elements for a claim of negligence are: (1) the homeowner incurred damages; (2) the builder breached an applicable duty of care; and (3) the builder’s breach of care was a cause of the homeowner’s damages).
 29. CRS § 13-20-802.5(4) (“‘Construction professional’ means an architect, contractor, subcontractor, developer, builder, builder vendor, engineer, or inspector performing or furnishing the design, supervision, inspection, construction, or observation of the construction of any improvement to real property.”).
 30. CRS § 13-20-808 (insurance policies issued to construction professionals); *Greystone Constr., Inc. v. Nat’l Fire and Marine Ins. Co.*, 661 F.3d 1272 (10th Cir. 2011) (because damage to property caused by poor workmanship is generally neither expected nor intended, it may qualify under state law as an occurrence, and liability coverage should apply).



Our Courts is a joint activity of the Colorado Judicial Institute and the Colorado Bar Association that provides nonpartisan information programs to adult audiences around the state to further public knowledge and understanding of the state and federal courts in Colorado.

For more information or to schedule a presentation, visit ourcourtscolorado.org.