

Vertically Separating Ownership to Create Value in Chicago

by Chad J. Richman

A FREEBORN & PETERS LLP CLIENT ALERT

ABOUT THIS CLIENT ALERT:

The sum of the parts can be greater than the whole. This maxim is especially true in real estate. Developers should consider whether an existing building or development project presents an opportunity to “spin-off” various layers of vertical space on the basis of distinct use components or otherwise. This client alert provides helpful information to consider, including the four steps in the vertical separation process in the city of Chicago for a mixed-use, mixed ownership project.

The sum of the parts can be greater than the whole. This maxim is especially true in real estate. Developers should consider whether an existing building or development project presents an opportunity to “spin-off” various layers of vertical space on the basis of distinct use components or otherwise. For example, the sale of the ground floor retail component of an office building or the broadcast rights associated with the roof of a tower. This is usually achieved in Chicago by dividing ownership of a (characteristically mixed-use) parcel via condominium, vertical subdivision or vertical separation.



A condominium regime may not be ideal because every condominium must comply with the Illinois Condominium Property Act-- which is generally geared toward residential use with governance by an association. Vertical subdivision is also less than ideal due to onerous subdivision platting and disclosure requirements, as well as extensive municipal approval procedures.

Vertical separation is similar to vertical subdivision, but much simpler and may not require City of Chicago approval. The vertical separation method is not available for every project but has quickly gained prominence because of its simplified process. Additionally, there is often no “underground” review or financial disclosure requirement for the separation. The more sophisticated title companies in Chicago are very familiar with this structure and regularly insure title to the various components of the vertical separation.

The vertical separation process in the City of Chicago for a mixed-use, mixed-ownership project consists of four steps:

- 1. Legal Descriptions for Parcels to be Separated.*
- 2. Reciprocal Easement and Operating Agreement.*
- 3. Conveyance Deeds to Sever Ownership.*
- 4. Petition for Division of Tax Parcels.*

The vertical separation process in the City of Chicago for a mixed-use, mixed-ownership project consists of four steps:

- 1. Legal Descriptions for Parcels to be Separated.** The first step in the vertical separation process is determining how the parcels are to be divided. Once the boundaries of the parcels have been established, a surveyor must prepare legal descriptions to create the three-dimensional air rights parcels to be subject to the separation. The surveyor will literally create a new legal description corresponding to the new geographic boundaries for each new tax parcel. Naturally, the total area represented by all the new legal descriptions must equal the total area represented by all of the original legal descriptions. Keep in mind that parcels may include the air rights above an existing structure (for example, for purposes of a broadcast/telecom parcel).
- 2. Reciprocal Easement and Operating Agreement.** A reciprocal easement and operating agreement (“REA”) is necessary in order to provide for the easement rights, maintenance obligations, cost sharing obligations, service obligations and use restrictions for the property to be operated and enjoyed in harmony. The REA will be executed by the parties thereto and recorded against title to the property immediately after the conveyance of the vesting deeds to the separate ownership entities. The drafter of the REA must anticipate potential areas of discord and craft management mechanisms to avoid the conflict.
- 3. Conveyance Deeds to Sever Ownership.** The current titleholder must convey the divided parcels by deeds to the various ownership entities that are established to hold title to those parcels. Upon conveyance and recording, the title company will issue an endorsement confirming the separation and the valid and legal nature of the parcels created by each applicable conveyance. There is a State of Illinois Plat Act which may be considered by the Cook County Recorder’s office when accepting deeds for recording. If considered, there are several exemptions which may be used to satisfy the Recorder and complete the conveyances.
- 4. Petition for Division of Tax Parcels.** Following conveyance of the various parcels, a separate petition for division of the real estate tax parcels must be filed with the Cook County Assessor. A lag will exist from the date the petition is filed and the date the split bills are issued because taxes are paid in arrears in Chicago. Therefore, care should be taken to allocate taxes during such temporary period.

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