

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /  
Or Sponsoring Organization Is Missing

3. Development Topics

- j. "Condominium Principles and Practice",  
no date

## CONDOMINIUM PRINCIPLES AND PRACTICE

- I. 1. The condominium is another form of cooperative ownership of real estate. We have talked earlier of its differences from a strict cooperative. The cooperative has had a number of defects in operation which have limited its popularity:
  - A. In the depression many were lost because the failure of some owners to pay their fees jeopardize the mortgage of all.
  - B. The cooperative control resale and resale price so that the tenant-owner could not realize appreciation in the property due to an improving location value or inflation.
  - C. With amortization of the cooperative mortgage, purchase of the owner book value interest required an ever growing down payment, thus reducing marketability still further.
  - D. To avoid these pitfalls, variations in the coop plan have been devised to avoid these objections, principally control of involuntary loss of investment due to default of some members on common charges.
    1. Provision in the proprietary lease that upon default by the lessee on a monthly assessment, the coop shall have a lien upon the interest of the defaulting lessee and may therefore sell his stock and lease or sublet his apartment to raise the necessary money.
    2. In New York City a complicated <sup>concept</sup> ~~concept~~ appeared in 1947 by which a purchaser acquires an undivided interest in land and building together with exclusive right of occupancy.
    3. More recently the Chicago Title Company devised a method by which the tenant-owner in a conventional cooperative can mortgage his own leasehold interest and obtain title insurance for such interest.
    4. Nevertheless there is a public resistance to cooperatives. At the same time there is a growing interest in high density urban home ownership.
    5. Hence the condominium has appeared
- II. The reason for the appearance of condominium in Puerto Rico after a long history in Europe is twofold:
  - A. Rapidly growing population and the scarcity of building sites in urban areas in Puerto Rico has created an acute housing shortage in the cities.
  - B. According to one author the average Puerto Rican has a fanatical desire for home or property ownership. He must either acquire a house far from the urban center or remain in the city, buying or renting at an exorbitant rate.
  - C. Hence Puerto Rico developed the condominium plan for buildings called condominios. Each occupant gets a fee title with one qualification. If he wishes to sell he must first offer ~~an~~ apartment to the other co-owners who must accept within 10 days. This is called right of first refusal.

Should the owner sell without such an offer or lose the property for a debt, the co-owners may exercise what is known as the right of redemption. Within nine days of the deed a registry or in the absence of this of knowledge of the sale, the others must purchase the property at the price to which it was sold.

- D. Enabling legislation in Puerto Rico was called the Horizontal Property Act and it establishes the horizontal property regime. Owners of a building must express their intention to submit to these rules by means of recording with the Registry of Property (i.e. Deeds)

In this Act the word "apartment" is defined as meaning not only a residential unit but also any structure occupying all or part of a floor in a building which may be independently utilized as a place of residence or office for any kind of industry or business provided it has either direct or indirect exit to a thoroughfare.

The exit further provides that real estate taxes will be charged to individual apartments having their individual tax assessments.

- E. Now it is the opinion of one legal authority, general counsel for Chicago Title Co. that most of these features could be or had been incorporated into the coop form as is presently found in the United States. The major stimulus to condominium in this country is therefore due to the 1961 amendment of the Housing Act authorizing FHA insurance for condominium mortgages and ...to depreciation tax privileges for the title owner of real estate.

The National Housing Act does not mention condominiums by name but rather authorizes insurance of first mortgages "given to secure the unpaid purchase price of a fee interest in, or a long term leasehold interest in, a one-family unit in a multi-family structure and an undivided interest in the common areas and the facilities which serve the structure."

It should be noted that the long term leasehold refers to a ground lease and not the proprietary lease of a coop, which do not come under the provisions of the act.

To be eligible for insurance the mortgage will not exceed the per room and per family units in Section 207 or the loan ratios created in 234.

1. Dollar limits under 207 are \$2500 per room or \$3000 for elevator type structures: \$9000 per unit in less than 4-room units or \$9400 for elevator type structures. The Commissioner may increase these limits up to \$1250 per room in high cost areas.
  2. Loan ratios are 97% up to \$13500 including common areas and facilities, 90% of the balance up to \$18000, and 70% in excess of \$18000. Maximum maturity is 30 years
- F. Insurance is available for older structures which are or have been covered by an FHA mortgage previously insured under another provision of the act. It gives the FHA Commissioner power to release from the lien of such a mortgage the various one-family units and interests. Finally it states this is only available where the laws of a state establish the relationship of a one-family unit in a multi-family structure.

Horizontal ownership is possible in the common law of most states. The trick is to give it marketability and administrative simplicity. This interest has meant state legislation.

III. There are some problems to the condominium form which arise with or without enabling legislation.

- A. Separate assessment of individual units in a multi-unit structure has some subtle implications. Co-ops are given one assessed value and one tax bill. The problem of parcel numbers on a tax assessors plat is a minor one.
- B. How do you determine individuals values is a major question. Presently in Puerto Rico and in the U.S. structure and land are valued as a whole and then divided among individual owners by the same percentage as each shares in the common element, in voting, and so on. Initially this method seems fair enough.
- C. However with time individual apartments will change their relative values because of changes in view, market preferences for number of rooms, design defects, and so on. Still each tax payer would be recognized as an individual with the right of appeal. He would appeal an assessment based on a share of the total value of the building, and so would be challenging everybody's assessments.
- D. Sale of condominium shares may come within the purview of the corporate securities act. There is delegation of managerial duties and functions to third persons and a business form which will affect the financial interests of the purchaser. The investors right to control management depends upon a voting arrangement. For this reason lawyers feel it is possible condominiums are in the scope of blue sky laws. For that matter so may be tenancy in common co-operatives, conventional tracts with local improvement associations, and syndicates.
- E. Most lenders require that the builder of a condominium receive a permit from the division of corporations as a condition to a loan commitment. You may seek this permit by submitting basic documents, an income and expense sheet, and a resume of sponsor or developer experience on forms required for a corporate co-op. There is no requirement that you have recorded the project according to sub-division plats at that time.  
  
Failure to do so exposes the developer to the penalties of retroactive application of the act.
- F. In the event of a blanket assessment for lack of legislation requiring individual assessment, the organization should provide for the proportionate assessment of each unit owner by the governing body secured by a right of lien secured by a power of sale clause. The governing body can put itself in the position to remove a delinquent owner for non-payment of taxes in 120 days where the taxing authority must wait for a period of up to five years.

A blanket lien by the taxing power against a group of owners for taxes due by some of them would be invalid except that the assessor would have a valid lien against the common area in proportion to the units in default. A purchaser at a tax sale would receive no greater rights than the original owner, and as a practical matter the owners in common may wish a redemption clause which gives them the power to purchase the tax lien for resale.

- IV. The State of Wisconsin legislated and the governor approved this summer a Unit Ownership Act. (Statutes 230.70 - 230.97 were created)
- A. Unit is given the same definition has the word apartment in the Puerto Rico bill. It means any part of a property for independent use, "Including one or more rooms or enclosed spaces located on one or more floors or parts thereof in a building and with a direct exit to a public street or highway or to a common area leading to such a street or highway."
- B. Among other definitions common areas and facilities, unless otherwise defined in the project declarations, include:
1. The land on which the building is located;
  2. The foundations, columns, girders, beams, supports, main walls, roofs, halls, corridors, lobbies, stairs, stairways, fire escapes and entrances and exists of the building;
  3. The basements, yards, gardens, parking areas and storage spaces;
  4. The premises for the lodging of janitors or persons in charge of the property;
  5. Installations of central services such as power, light, gas, hot and cold water, heating, refrigeration, air conditioning and incinerating;
  6. The elevators, tanks, pumps, motors, fans, compressors, ducts and in general all apparatus and installations existing for common use;
  7. Such community and commercial facilities as may be provided for in the declaration; and
  8. All other parts of the property necessary or convenient to its existence, maintenance and safety, or normally in common use.
- C. The act also makes provision for "Limited common areas and facilities" which are designated in the declarations as reserve for use of certain units to the exclusion of others.
- D. Common area ownership cannot be separated from the units to which it appertains and shall be deemed leased, conveyed, or encumbered even though the unit is not described in any instrument of conveyance. The percentage of undivided interest is to be computed by taking as a basis the value of a unit in relation to the value of the whole property.
- E. The statutes gives the association of unit owners as represented by the manager or the board of directors irrevocable right of entry during reasonable hours to repair or replace items incidental to the common areas or other units.
- F. The statutes require each owner to comply strictly with the by-laws and rules of the association or be subject to damages and injunctions in a suit brought by the manager or board of directors or both. By the same token unit owners are prohibited from doing anything which would impair soundness, safety, value, or right of the other unit owners.
- G. Any action of the board of directors or manager within their powers is deemed to have universal approval and give rise to a mechanics against the entire project, which can be removed by each owner to the extent of his share. Common expenses and income are a portion by the usual percentage basis.
- H. Contents of declaration are to include:
1. Land description
  2. Building description, stating number of stories, basements, and units
  3. Description of each unit by number, location, area, number of rooms, and adjacent common area with immediate access.

4. Description of common areas
5. Description of limited common areas
6. Value of property and of each unit and percentage of each unit for purposes of voting, assessment, and other purposes.
7. Statement of purposes for which building and units are intended and use restrictions.
8. Name of person to receive service of process
9. Percentage of votes to determine to rebuild, scrap, or sell property in the event of its damage or destruction.
10. Additional details felt appropriate
11. Method for amending declarations.

I. Contents of the deed for a unit should include:

1. Description of the land consist with the declarations, post office address of the property, and recording identification by volume and page, reel and image of the declarations.
2. Unit number
3. Statement of unit use
4. Percentage of undivided interest
5. Grantor and grantee detail

J. Copy of the floor plan must be filed with the declarations

K. As a condition to the first transfer of title to each unit, all mortgage claims must be paid and satisfied, or a proportionate release file and duly recorded, or the mortgage lien shall provide for release of a unit or undivided in the common area upon payment of a certain sum.

L. There is provision for removal of property from condominium ownership, and a long list of by-laws, for keeping books of receipts or expenditures. Priority of lien is given to (1) assessments of the association, except for tax liens, mechanics liens, and mortgage liens.

M. Grantor and grantee in a voluntary conveyance become jointly and severally liable for all unpaid assessments at the time of transfer although the grantee is entitled to a statement from the board prior to closing.

N. The board of directors has the power to buy the insurance at the request of the majority of the units owners or at the request of a first mortgagee of one or more units. However, each unit owner may also secure his own insurance.

O. In the event of damage or destruction, if the association does not elect to repair or rebuild than:

1. Property is deemed owned in common by all
2. Tenuancy in common will be in proportion to percentage of previous interests
3. All liens will be transferred in accordance with existing priorities to the appropriate tenuancy in common
4. Property will be subject to a suit for partition, with sale proceeds, insurance proceeds, and other assets, considered as one fund divided proportionally among all units owners. Respective liens of all owners shall be paid first and the balance, if any, distributed to unit owners.

## V. Some comments on condominium by Casey

- A. First FHA insured condominium apartment in U.S. is in Hallandale, Florida. There is a second underway in Chicago.
- B. The financial risk of condominium verses co-op both contain limits of liability. The co-op owner was exposed to foreclosure of the corporation, but all he could lose was his stock interest and unit book value, which he could abandon in the face of assessment. However, the condominium owner is liable for his own mortgage and his own taxes until he sells his title, although his delinquency cannot burden those remaining.
- C. Destruction of the premises creates a problem, as a practical matter, only if owners disagree about rebuilding or when insurance proceeds are inadequate and owners will not make up the difference.
  1. The original Puerto Rico version required reconstruction if damage was 75% or less, including owner contribution if necessary. Damage of more than 75% required sale of property and liquidation. Either solution could be changed by unanimous agreement.
  2. The FHA version, has used in Wisconsin, is a more flexible approach.
- D. Common elements may be both general or limited as defined by the declaration, but disputes can be avoided by creating as many general areas as possible.
- E. Common areas leads to another problem--the delinquent or uncooperative owner.
  1. Three enforcement rights are given to the association. A lien enforceable by foreclosure but subordinated to first mortgage. Some states give the association the right of first payment out of sale proceeds, but this conflicts with state definition of first mortgages eligible for investment by various banks and insurance companies.
  2. Refusal to pay common expenses generally also means default on the conditions of the first mortgage.
  3. Liens have first claim on condominium income for store and laundry rental, etc.
  4. Rules for "Harmonious living" as the Puerto Ricans have it, are set forth in the enabling statute and the by-laws. Each unit is subject to the following rules:
    - a. Prescribed use in deed
    - b. No immoral or unlawful purpose
    - c. No disturbance of the peace
    - d. Decoration or improvement which does not change exterior
    - e. Compliance with all the administrative rules.
 Violation in the co-op means eviction since the owner is in the position of tenant. But Condominium owners have a fee not subject to cancellation so that a cumbersome process of injunction or suit for damages is necessary.
- F. Restriction of resale violates the rule against alienation of a fee simple and would probably be illegal. The lesser restriction of a right of refusal for a few days may be valid but has not been tested. There is some thought that if a condominium is on leased land, resale could control has the rules on alienation do not apply to lease holders. However, some attorneys feel that the owner has received a fee interest in his apartment unit so that a restriction would be illegal.
- G. Use of a lease hold may not be possible because most statutes require transfer of a ~~fee interest~~ simple interest which precludes use of leased land.

Other states such as Virginia, Arizona, and Hawaii permit lease hold condominiums as does the FHA program. As a practical problem ground rent increases common expenses which means default by one or more owners increases the burden on those remaining, creating a danger similar to that of the co-op without its escape feature. Individual leases for each unit owner would divide liability but create problems for blanket construction financing.

- H. A final problem is owners liability for injury suffered by third persons on or because of common elements. None of the statutes make provisions for this so presently each owner could be sued separately and have to satisfy the judgement himself with right of contribution co-owners. Statutes and by-laws should make provisions for this by requiring injured party to seek redress against association first.

Injuries suffered in a particular apartment would remain the liability of the apartment owner.