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ELEVEN YEARS UNDER THE INDIANA HORIZONTAL PROPERTY ACT

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BACKGROUND

Twenty years ago there were virtually no condominiums in this country. Today the condominium concept has found great favor among real estate developers throughout the United States. In fact, there are now condominium enabling statutes in all states, the District of Columbia, Puerto Rico and Guam.¹ In most of these jurisdictions, even the less populous ones, developers have been unable to resist the temptation of trying this Promethean approach to real estate ownership in practice.

Hoosiers followed this trend albeit somewhat belatedly. Although the Indiana Horizontal Property Act was enacted in 1963,² it was not until the 1970's that condominiums became popular with real estate developers in this state. Within the last four years the condominium market in Indiana, particularly in and around Indianapolis, has blossomed.³ Consequently, it is now appropriate to scru-

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1. See generally 4A R. POWELL & P. ROHAN, *POWELL ON REAL PROPERTY* §§ 633.5 - 633.6 (1973) for a historical development of the condominium concept. See also Berger, *Condominiums: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987, 1001-04 (1963).

2. Indiana Horizontal Property Act, IND. ANN. STAT. §§ 56-1201 *et seq.* (Cum. Supp. 1972), IND. CODE §§ 32-1-6-1 *et seq.* (1971) [hereinafter referred to as the "Act"]. It is interesting to note that the Act, which is based on the Federal Housing Administration's "Model Statute for Creation of Apartment Ownership," FHA Form No. 3285, does not contain the term "condominium." However, it clearly contemplates a condominium development as commonly defined; that is, a community in which the individual owners acquire fee simple title to the space of a unit bounded by the horizontal and vertical planes thereof together with an undivided percentage interest in the common areas and facilities of the development. See IND. ANN. STAT. § 56-1205 (Cum. Supp. 1972), IND. CODE § 32-1-6-5 (1971) which specifically permits each condominium apartment to be conveyed and encumbered as if entirely independent of the building of which it forms a part.

3. The present popularity of the condominium in Indiana is due in no small measure

tinize the effect of this "boom" and reassess the statute from which it originated. And with the recent drastic decline in the amount of funds available for construction of any kind,⁴ it seems crucial that home builders, lenders and consumers take a second look at the position of the condominium in the Indiana housing market.

It is now clear, however, that the superstructure of the condominium concept as embodied in the Act has developed fissures in some unexpected areas such as project expansion and tax status of homeowners' associations. The purpose of this article, therefore, is to examine the various types of condominium developments in this state, the difficulties developers have encountered in the creation of condominiums, and the sections of the Act which have proven cumbersome or in need of amendment.⁵ Although a number of these subjects have been touched upon generally and prophetically by other commentators,⁶ this article will specifically identify the potential legal pitfalls found in the documentation of condominium projects to date.

to the acceptance of the condominium concept by Indiana lending institutions. An equally important factor may be that such developments have met a housing need fulfilled in other states by traditional townhouse projects. See generally D. S. BERMAN, *HOW TO ORGANIZE AND SELL A PROFITABLE REAL ESTATE CONDOMINIUM* (1966). Still another reason for the rapid growth in the number of condominiums in Indiana and throughout the country may be the somewhat mysterious and magical quality the concept commanded in the housing marketplace. Initially, the concept received a major national boost when in 1961 Congress authorized the Federal Housing Administration to insure mortgages on individual condominium apartments. National Housing Act of 1961 § 234, 12 U.S.C. § 1715(y) (1969), *as amended*, (Supp. 1974).

4. B. Paul, *Balancing Act, Tight Money Forces Bank Loan Officer to Walk Tightrope*, *Wall Street Journal*, Aug. 20, 1974, at 1, col. 1.

5. Although it is well recognized that a condominium may be developed as commercial property, generally for professional offices, this article focuses upon the residential condominium for two basic reasons. First, commercial condominiums are exceedingly rare in Indiana. Presumably most developers will refine their approach to residential condominiums before attempting to cultivate a new market. (However, one commercial condominium is under development in northeast Indianapolis at the writing of this article.) Second, such developments will face many of the same problems that their residential brethren have encountered. Consequently, any comments solely applicable to commercial condominiums have been incorporated merely as supplemental footnote material.

6. See Rohan, *Second Generation Condominium Problems: Construction of Enabling Legislation and Project Documents*, 1 VAL. U.L. REV. 77 (1966); Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57 (1965). These articles contain interesting and sometimes exceedingly accurate predictions regarding implementational problems that might develop from construction of condominiums under the auspices of the Act.

The condominium concept is open to varying interpretations and uses, each of which has its advantages and drawbacks. This article will suggest some solutions and preventative action which will hopefully provide a basis upon which practicing attorneys can formulate informed opinions regarding condominium development in Indiana in the future.

BASIC APPROACHES TO PROJECT EXPANSION

The developer who desires to construct a condominium community in Indiana is initially faced with the problem of conforming with the statutory requirement that no apartment unit can be conveyed until a registered architect's verified statement that the floor plans being filed with the declaration accurately depict the project "as built" is recorded.⁷ Consequently, a developer who owns a rather large tract of land and contemplates a multi-building condominium project is confronted with the financial disability and practical problem of completing all units at the same time.

In order to avoid the drawbacks inherent in developing one massive condominium project there are several options available. The alternatives include creation of the following:

1. A number of separate condominiums with optional provisions for cooperation in the maintenance of common areas and facilities of each condominium.
2. Separate condominiums which share recreational common areas and whose maintenance assessments are collected on a hierarchical structure.
3. A multilateral consent type of expandable condominium where the original declaration is amended by consent of all co-owners.
4. A unilateral expandable condominium where the developer reserves in the declaration the right to add additional phases.⁸

In Indiana, the expansion question has been primarily dealt with in terms of the unilateral expandable condominium technique. This approach has been utilized in two significantly different ways.

7. IND. ANN. STAT. § 56-1213 (Cum. Supp. 1972), IND. CODE § 32-1-6-13 (1971).

8. Joliet, *The Expandable Condominium: A Technical Analysis*, 9 ABA LAW NOTES 19 (Fall 1974).

The most prevalent variation is the "Power of Attorney" method whereby the purchasers of condominium apartments in the first phase grant the declarant a power of attorney to amend the declaration to provide for varying and decreasing common area percentage interests appertaining to each apartment as additional phases are added to the project.⁹ This can be said to marginally comply with the Act's requirement that the co-owners must unanimously consent to amend the declaration to change the common area percentage appurtenant to each apartment.¹⁰ There is, however, considerable question as to the validity of the "Power of Attorney" approach to expansion.¹¹ First, the developer may find a power of attorney automatically revoked by the death or incompetency of the homeowner who granted the power. Second, the binding effect of the power of attorney on an uninformed subsequent apartment purchaser is suspect. Third, a possibility yet unlitigated is that where the developer reserves the right to change the percentage interest in the common areas appertaining to each apartment, a prospective purchaser may be able to void a contract of sale on the ground that the property to be sold is not ascertainable with certainty.¹² Consequently, it is suggested that the "Power of Attorney" method of unilateral condominium expansion be avoided, since it is an alternative with serious inherent disadvantages.

Another variation of the unilateral expansion approach is the "Chinese Menu" technique whereby the declaration sets forth what the percentage interest of each apartment in the common areas and

9. A provision setting unit density limits on these additional phases and an outside date for their inclusion in the condominium property should be inserted in the declaration to satisfy the mortgage lenders and also to serve as a point in rebuttal to the criticism of this approach. See note 11 *infra* and accompanying text.

10. IND. ANN. STAT. § 56-1207(b) (Cum. Supp. 1972), IND. CODE § 32-1-6-7(b) (1971).

11. See Joliet, *The Expandable Condominium: A Technical Analysis*, 9 ABA LAW NOTES 19 (Fall 1974).

12. There is a paucity of litigation in the area of enforceability of condominium sales contracts. However, one reported case indicates that the courts may take a fresh look at traditional principles of property law when a condominium is involved. In *Centrex Homes Corp. v. Boaz*, 42 U.S.L.W. 2651 (N.J. June 5, 1974) it was held that a developer vendor of a condominium project unit cannot obtain specific performance of a contract for the sale of a condominium apartment. The court found that the equitable reason for granting specific performance for breach of a contract for sale of land was not applicable in the fact situation under consideration. The "real estate" involved was not unique, but, in fact one of hundreds of identical condominium units. Damages at law were, therefore, considered adequate.

facilities will be as additional phases are added.¹³ This method, which has been utilized in only a few Indiana condominium developments, is one of the better means to increase the size of the project. Since it informs the owners of the exact amount of their percentage interests in the common areas as expansion progresses, the "Chinese Menu" approach is not subject to all the criticisms leveled at the "Power of Attorney" method. Nevertheless, it is still subject to the unanswered general query presented by all unilateral expansion techniques: Does it meet the statutory requirement of unanimous consent of all co-owners?¹⁴

There are also a number of Indiana condominium projects that have incorporated the idea of mandatory sharing of recreational common areas. In some instances the recreation areas are conveyed to two owners' associations as tenants in common. The difficulty with this approach is that either condominium owners' association might seek partition of its ownership interest in the common area. Since each association owns an undivided one-half interest in the recreation areas, as opposed to common ownership being vested in the condominium owners, these areas are not technically part of the condominium property. Therefore, the associations are not subject to the Act's prohibition against partition.¹⁵

Other developments have involved the construction of a "community" comprised of a number of separate condominiums or condominiums combined with other types of housing. The condominium owners automatically become members of a central homeowners' association which owns and maintains the recreational areas for the entire "community." This planned unit development type of mandatory sharing method certainly runs into no statutory difficulty and, in fact, has been highly recommended as a workable solution to the condominium expansion problem.¹⁶ If this approach

13. See Bohan, *A Lawyer Looks at Residential Condominiums*, 7 ABA REAL PROPERTY, PROBATE AND TRUST JOURNAL 7, 14 (1972).

14. At least one Indiana developer has adopted a third variety of unilateral expansion by merely relying upon the bare provision in the declaration that the co-owners agree to additional phases and the automatic decrease in their percentage interests in the common area as such phases are added. This practice should be avoided. Even the "Power of Attorney" concept provides an additional element evidencing unanimous consent.

15. IND. ANN. STAT. § 56-1207(c) (Cum. Supp. 1972), IND. CODE § 32-1-6-7(c) (1971).

16. Krasnowiecki, *Townhouse Condominiums Compared to Conventional Subdivision with Homes Association*, 1 REAL ESTATE L.J. 323 (1973). The central homes association ap-

is utilized, care must be taken to record the declaration of covenants, restrictions and easements which creates the central homeowners' association prior to the recording of the first phase condominium declaration. In addition, the developer must be sure to reserve the right to make additions to the central homeowners' association declaration.¹⁷ The major drawback of this approach for the purchaser and his mortgage lender is that the value of the recreational areas depends to a great extent upon how many property owners or tenants will be members of the central association. Consequently, the developer should be limited to making only those additions that are reflected on a general plan of development shown to each prospective purchaser.

Still another variety of mandatory sharing of the common recreational areas contemplates the developer retaining ownership of the recreational areas and enters into a lease for use of such area with each condominium association or a corporation comprised of the owners of the apartments in each phase. Because of its frequent abuses, this technique has not been favorably accepted by the courts or state regulatory agencies.¹⁸ Although the author is aware

proach to expansion involves a two tier arrangement of homeowners' associations. On the top level is the central homeowners' association to which the developer will deed the recreational area and such other areas as will be used by all members of the community, much the same as in the traditional townhouse development. Each owner of a dwelling unit, be it a townhouse, condominium or detached residence, is an automatic member of the central association with a right to use the facilities owned by the association. Generally, the community homeowners are made automatic members in stages as the housing complex in which they live is constructed and added to the property covered by the covenants and restrictions creating the central association. Thereby, the developer can stop development of the "community" after the completion of any phase without doing violence to the central association.

On the second organizational level are the separate individual condominium owners' associations created as if each were a single phase condominium, *i.e.*, without provision for expansion. These associations, of course, do not own any property and are merely an instrument of management for each condominium in accordance with the requirements of the Act.

Since the covenants and restrictions creating the central association are recorded prior to the recordation of any condominium declaration, the result is that each condominium owner has a percentage interest in the common elements of his condominium plus an easement for use of the central recreational areas.

17. *Id.* at 362. If the developer fails to reserve such right, he will be unable to add additional condominium projects to the property covered by the covenants and restrictions creating the central association. The homeowners in these additional condominiums consequently would not have the right to use the central recreational facilities.

18. *Id.* at 359-61. The lease of the recreational areas by the developer to the condominium homeowners' association is sometimes referred to as a "Sweetheart Lease" because it is negotiated with the association before any condominiums are sold and while the developer is in total control of the association.

of a small number of Indiana condominium developers which have used the lease approach, some apparently did not intend it to be a first step toward expansion, but merely a one-time income producing device.

As an attempted combination of both the unilateral and mandatory sharing expandable condominium techniques, some condominium developers have merely reserved in the declaration the right to grant easements through the condominium common areas for the benefit of any future apartments located adjacent to the project. This procedure eliminates the problem of amending the declaration when additional phases are constructed, but still leaves the difficulty of determining the real value of the individual common area percentages. In addition, a lender might naturally be hesitant to make a loan on a project where the declarant has unlimited power to declare easements through the common areas. For all the lender may know, the declarant may decide to route the Indy "500" Festival Parade through the project at some future date. Nonetheless, a well-defined easement limited in location, use and duration, for the purpose of permitting development of additional identified phases should not result in any legal controversies.¹⁹

From the above discussion, it is apparent that the development of a condominium in phases is no mean feat. The primary reason that the drafters of condominium documents in Indiana have had a considerable amount of difficulty with expansion lies in the fact that the Indiana Horizontal Property Act is primarily aimed at the "vertical" development of property. Unfortunately, the Act does not adequately consider the purpose for which it is almost exclusively being used, that is, the development of multi-unit, one and two story buildings.²⁰

Under the present status of the law, the method of expansion

19. The easement, of course, should create rights only over the streets, sidewalks, recreational areas and other areas of the condominium normally used by all co-owners. In addition, the easement should be limited in duration to allow only reasonable time for further development.

20. See generally Rohan, *Second Generation Condominium Problems: Construction of Enabling Legislation and Project Documents*, 1 VAL. U.L. REV. 77, 83-84 (1966). The author is unaware of a single Indiana condominium which is a high-rise or medium-rise apartment building. There, however, is one being planned for the Indianapolis area. Its marketability will probably determine whether or not additional condominiums of this type are developed.

least likely to generate litigation is the creation of a central homeowners' association to own and maintain the recreational areas and facilities and to maintain the common areas and facilities of each separate condominium. Although more thought and documentation may be necessary to create such a development than to give birth to any other type of expandable condominium, many of the problems enumerated above are avoided. If, however, such a central homeowners' association approach is not considered appropriate, the "Chinese Menu" technique provides a more risky, but still relatively acceptable means of dealing with the expansion issue.

FORM OF HOMEOWNERS' ASSOCIATION

Under the Act, all purchasers of apartments in a condominium project are automatically members of an association of co-owners.²¹ This association may be incorporated under the Indiana Not-for-Profit Corporation Act²² or remain an unincorporated association.²³ Several factors ought to be considered when determining whether or not to incorporate the association.

The major drawback of an unincorporated association is that it has only marginal legal existence.²⁴ The officers are agents of the members and, therefore, contract in their behalf rather than in behalf of the association. Consequently, the individual members run

21. IND. ANN. STAT. § 56-1202(d) (Cum. Supp. 1972), IND. CODE § 32-1-6-2(d) (1971). The Act does not bestow complete corporate status on the association, even though it does grant it some characteristics of a corporation. See Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57, 66, 68 (1965).

22. IND. ANN. STAT. §§ 25-507 *et seq.* (Cum. Supp. 1972), IND. CODE §§ 23-7-1 *et seq.* (1971).

23. The Act arguably does not permit an association to be incorporated under the Indiana General Corporation Act. But even if this course of action were considered available, there is little to recommend it. The homeowner members want to avoid profit and the taxation thereof, not to engage in a business for profit. Also, the possibility that the association of condominium apartments owners could be considered to be a partnership is not a very likely one. See Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57, 67-68 (1965). Finally, an alternative available in townhouse developments but not condominiums is to organize the association as a Massachusetts Trust whereby a trustee holds title to the common areas with the homeowners as the beneficiaries. See IND. ANN. STAT. §§ 25-4801 *et seq.* (Cum. Supp. 1972), IND. CODE §§ 23-5-1-1 *et seq.* (1971).

24. See Kratovil, *Building Restrictions Draftsmanship*, THE GUARANTOR, Lawyers Supp. (Spring 1973); Note, *Organizing the Townhouse in Indiana*, 40 IND. L.J. 419, 426-28 (1965); Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57, 65-68 (1965).

the risk of unlimited liability for these contracts as well as for torts committed within the scope of the officers' employment.²⁵ Furthermore, an unincorporated association is incapable of holding title to real estate in the absence of an enabling statute.²⁶

The non-profit corporation is an advantageous form of homeowners' association for several reasons. First, the members personally enjoy limited liability.²⁷ Second, the management and employees are not personally liable on obligations made on behalf of the corporation.²⁸ Third, there is no question of the legal ability of the corporation to hold title to real estate.²⁹ Thus, the best approach would appear to be to incorporate under the Indiana Not-for-Profit Act.³⁰ The vast majority of Indiana condominium homeowners' associations have done so.

25. This risk can effectively be eliminated if the association purchases sufficient liability insurance to cover all contingencies with the members named as co-insureds. See generally Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57, 77-80 (1965) for a detailed discussion of the potential liability of members of the association.

The only reported litigation in this area also does not bode well for the unincorporated associations. The decision in the California case of *White v. Cox*, 17 Cal. App. 3d 824, 94 Cal. Rptr. 259 (1971), has the effect of increasing the individual condominium homeowner's potential tort liability over that existing at common law, at least where an unincorporated association has been created to manage the condominium property. In *White* it was held that a member of an unincorporated condominium homeowners' association could sue the association for damages for injuries suffered due to negligent maintenance of the condominium grounds. (On his way to the pool, White tripped over a garden sprinkler hidden from view.) This is directly contrary to the common law rule which prohibits such action on the ground that all co-owners are engaged in a joint enterprise. See Lawrence, *Tort Liability of a Condominium Unit Owner*, 2 REAL ESTATE L.J. 789, 792-94 (1974) for a detailed discussion of the *White* case. Of particular interest is the possibility that the effect of *White* might be avoided by an appropriate provision in the by-laws of the association. *Id.* at 799-800.

26. See *Popovich v. Yugoslavia National Home Society*, 106 Ind. App. 195, 18 N.E.2d 948 (1939). See generally THE HOMES ASSOCIATION HANDBOOK, Urban Land Inst. Tech. Bull. 50, § 25.3 (1970) [hereinafter referred to as THE HOMES ASSOCIATION HANDBOOK]. This problem is quite real since the association may well want to become the owner of one or more of the apartments.

27. See IND. ANN. STAT. § 25-513 (Cum. Supp. 1972), IND. CODE § 23-7-1.1 (1972) in which the liability of individual members is limited to the extent of unpaid dues and assessments.

28. *Id.*

29. A drawback of a not-for-profit corporation is the possibility that upon involuntary dissolution all property would escheat to the state. Such proceeding could be commenced for mere failure to file an annual report. See IND. ANN. STAT. § 25-566 (Cum. Supp. 1972), IND. CODE § 23-7-1.1 (1971).

30. But see Ind. State Bar Association, *I Real Estate for the General Practitioner* § 7.02 (1973).

In order to eliminate the significance attached to the choice of the form of the condominium homeowners' association, it is suggested that the Indiana legislature adopt an amendment to the Act which specifically limits personal liability of the individual condominium owners.³¹ This amendment should require that the plaintiffs first sue the association and collect any judgment from the association's assets. Any deficiency in excess of the assets of the association then could be recovered by suits against individual apartment owners whose liability would be limited to their respective percentage interests in the common areas and facilities multiplied by the amount of the deficiency.³²

The enactment of a statute of this nature would eradicate two potential injustices. First, it would eliminate the situation where suit is filed and judgment obtained against an individual apartment owner for the negligent act of one of the association's agents. The fact that the individual owner may seek contribution from the other owners does not necessarily mean that he will be reimbursed. Second, amendment of the Act as suggested would not permit the condominium owners to merely absolve themselves of personal liability for management of their own residential property by incorporating the association. Since the association generally owns nothing, it certainly does not provide a very "deep pocket" from which a judgment could be collected.

TAX STATUS OF HOMEOWNERS' ASSOCIATIONS

At the present time, the status of the condominium homeowners' association for purposes of both federal and state income tax is somewhat unsettled. Because both the federal and state tax statutes are broad enough to include unincorporated associations within their definitions of "corporation,"³³ this state of uncertainty is not

31. See Lawrence, *Tort Liability of a Condominium Unit Owner*, 2 REAL ESTATE L.J. 789, 803-04 (1974).

32. Massachusetts has adopted this approach. MASS. ANN. LAWS Ch. 183A, (Supp. 1972). See Lawrence, *Tort Liability of a Condominium Unit Owner*, 2 REAL ESTATE L.J. 789 at 798-99 (1974) for a survey of the views of other state legislatures on the subject.

33. INT. REV. CODE OF 1954, § 7701(3); IND. ANN. STAT. §§ 64-2601, -3210 (Cum. Supp. 1972), IND. CODE §§ 6-2-1-1(a), -3-1-10 (1971). It could be argued that a condominium homeowners' association qualifies under Subchapter T. INT. REV. CODE OF 1954, §§ 1381-88, for treatment as a cooperative. Cf. *Park Place, Inc.*, 57 T.C. 767 (1972). However, the better view is that a condominium homeowners' association is not a cooperative for federal tax purposes, because it is not operated on a cooperative basis and does not allocate amounts to

due to the form of the association. Therefore, it makes little difference in this area whether the homeowners' association is incorporated under the Indiana Not-for-Profit Corporation Act or remains in an unincorporated form. In either case, the primary tax question of whether or not the homeowners' association will be granted tax exempt status remains.³⁴

Federal

Federal income tax exemption may be sought under the various subsections of Internal Revenue Code Section 501(c). On the face of the statute there are three feasible alternatives:

1. Qualification under Section 501(c)(3) as an organization operated exclusively for charitable purposes.
2. Qualification under Section 501(c)(4) as an organization not-for-profit operated exclusively for the promotion of social welfare.
3. Qualification under Section 502(c)(7) as a club organized and operated exclusively for pleasure, recreation and other non-profitable purposes, no part of the net earnings of which accrue to the benefit of any private shareholder.³⁵

The probability of obtaining an exemption under Section 501(c)(3) is nil. There is little authority for finding that a condominium homeowners' association could qualify as a charitable organization. The major stumbling block for the association in this area is presented by the emphasis placed by the IRS on the presence of some traditional element of charity — relief of the poor, advancement of religion or promotion of education.³⁶

The most likely possibility for qualification for an exemption

patrons on the basis of the business done for such patrons as required by Treas. Reg. § 1.1381-1(a) (1963). Furthermore, there is really no benefit of such status not already given the condominium homeowners' association under Rev. Rul. 70-604, 1970-2 CUM. BULL. 9. See note 45 *infra* and accompanying text. Under Indiana law, there is no special treatment afforded cooperatives. The Indiana Department of Revenue, consequently, holds that cooperatives are subject to gross income tax as are condominium homeowners' associations. See generally note 46 *infra*.

34. Although the association may be a not-for-profit corporation, this does not automatically entitle it to either federal or state tax exempt status. The tax authorities make an independent inquiry to determine whether or not a not-for-profit corporation meets the "purpose" standards found in both the federal and state tax statutes.

35. See generally INT. REV. CODE OF 1954, § 501(c).

36. Isabel Peters, 21 T.C. 55 (1953).

appears to be under Section 501(c)(4). One Indiana condominium association has pursued an application under this section through the IRS procedural maze to IRS National Office conference. The ultimate IRS decision was adverse to the association on the ground that the association was engaged in maintaining residential structures, an activity which had a direct benefit to its members and only an indirect bearing on the social welfare of the community.³⁷

The IRS reasoned that the benefit was direct because the members of the association owned, as tenants in common, the common areas being maintained. Somewhat ignored by the IRS in this entire procedure was the principle that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in *some way* the common good and general welfare of the people of the community.³⁸ Along this line, the association argued that the condominium project itself constituted a community much the same as does a precinct, neighborhood or school district.³⁹ It contended that, at the very least, a condominium is part of a community much smaller than the city of Indianapolis. Therefore, the fact that the association maintains areas normally maintained by a municipality (streets, parking areas, sidewalks, street lights, parks and swimming pools) should be given considerable weight. Unfortunately, the IRS seemingly failed to look beyond the direct benefit standard.

Since the date of this IRS National Office conference, a formal ruling has been issued which embodies the position set forth above. It provided:

Since the organization's [condominium homeowners' association] activities are for the private benefit of its members, it cannot be said to be operated exclusively for the promotion of social welfare. Accordingly, it does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.⁴⁰

37. See Rev. Rul. 69-208, 1969-1 CUM. BULL. 283; Commissioner v. Lake Forest, Inc., 305 F.2d 814 (5th Cir. 1962).

38. Treas. Reg. § 1.20(c)(4)-1 (1959).

39. See Rev. Rul. 72-102, 1972 INT. REV. BULL. No. 10, at 11, wherein it was determined that a non-profit organization formed to preserve the appearance of a housing development and to maintain its streets, sidewalks and common areas for the use of its residents was tax exempt under Code Section 501(c)(4).

40. Rev. Rul. 74-17, 1974 INT. REV. BULL. No. 2, at 11.

Although the ruling concerned a non-Indiana condominium project, the condominium statute described in the ruling so closely parallels the Act that there is no reason to believe a different result would have been reached if an Indiana condominium homeowners' association had been considered.

The IRS has also indicated that it will unfavorably view application under Section 501(c)(7) for the reason that the net earnings of the association would adhere to the benefit of its members.⁴¹ The IRS points out that a condominium homeowners' association is not organized purely for pleasure and recreational purposes, but for maintenance of the common areas including the buildings which house the individual apartments of the members of the association.

Notwithstanding the general IRS position, the association could attempt to receive some tax benefit under Section 501(c)(7) by creating a separate corporation to own and operate the swimming pool, clubhouse and other purely recreational facilities. Although the success of such venture is not yet known, this type of dual corporate membership may prove to be unwise for two reasons. First, the homeowners' association might well receive virtually the same federal tax benefits as the separate corporation by utilization of its business expense deductions.⁴² Second, the costs of operating two corporations would be considerably greater than the operation expenses of a single corporation.⁴³ This is especially important to the individual owners who are trying to keep the assessments to a minimum.

Even though a condominium homeowners' association probably cannot obtain a federal tax exemption without litigation of that

41. See note 44 *infra*. But see THE HOMES ASSOCIATION HANDBOOK § 28.31 for the view that an exemption might be granted under Section 501(c)(7).

42. If the association is not given tax exempt status on the ground that it is in the business of managing and operating a condominium, it is arguably entitled to deduct the cost of operating and maintaining the recreational areas from gross income as a business expense. However, the IRS is virtually certain to balk at allowing such a deduction on the basis of an analogy to the ordinary homeowner who is unable to deduct such costs as a business expense without a further showing of the business character of the expense. In other words, the IRS may try to place the condominium apartment owners in the same tax position occupied by owners of detached residences. See Rev. Rul. 64-31, 1964-2 CUM. BULL. 947.

43. Some of the obvious duplication of costs would be for incorporation, maintenance of corporate records and filing of tax returns and annual reports.

issue,⁴⁴ there is an alternative that will at least minimize federal tax liability. Revenue Ruling 70-604 permits condominium homeowners' associations to deduct the amount of the excess assessments left at the end of the taxable year if such amounts are applied to assessments for the next year or are refunded to the homeowners.⁴⁵

Notwithstanding this alternative for minimizing federal income tax, the application for exemption from federal income taxes is important for state tax purposes. This is because the state income tax authorities frequently look to federal rulings for guidance in regard to exemption applications. Therefore, in light of the discussion which follows, an association may desire to litigate the issue of federal tax exemption.

State

At first glance, state taxation might be considered of secondary importance. However, when the onerous and infamous Indiana gross receipts tax on corporations is remembered, it becomes apparent that the amount of state income tax assessed could be a critical factor in determining the financial success of condominium homeowners' associations.⁴⁶ Unfortunately, the two associations who were

44. The IRS Exempt Organization Section has informally advised the author that condominium homeowners' associations have applied for and been denied exemptions under virtually all sub-sections of Section 501(c), including subsections (c)(3), (c)(4) and (c)(7). This position has aroused sufficient interest in Congress that the House Ways and Means Committee has listed the tax exempt status of condominium homeowners' associations as an item to consider for inclusion in a 1974 tax revision bill. TAX MANAGEMENT MEMORANDUM 74-11 at 10 (May 27, 1974).

45. Rev. Rul. 70-604, 1970-2 CUM. BULL. 9. The major drawback with this approach is that the association may want to accumulate a relatively large reserve from year to year for major expenses to avoid relying solely on a special assessment. A possible solution would be to apply the reserve remaining at the end of the taxable year to the assessments for the next year, but at the same time increase the total of such assessments in an amount equal to the reserve accumulated. There is, however, some indication that the IRS is considering issuing another ruling addressing the question of whether or not the periodic assessments paid by the condominium homeowners are deemed taxable income to the association. TAX MANAGEMENT MEMORANDUM 74-11 at 10 (May 27, 1974).

46. IND. ANN. STAT. § 64-2606(i) (Cum. Supp. 1972), IND. CODE § 6-2-1-7(i) (1971) sets forth the requirements for obtaining exemption from the Indiana Gross Income Tax Act of 1933, IND. ANN. STAT. §§ 64-2601 *et seq.* (Cum. Supp. 1972), IND. CODE §§ 6-2-1-1 *et seq.* (1971). See also IND. ANN. STAT. § 64-3249 (Cum. Supp. 1972), IND. CODE § 6-3-7-1 (1971) for additional exemption provisions and IND. ANN. STAT. § 64-3219(a) (Cum. Supp. 1972), IND. CODE § 6-3-2-3 (1971) exemptions from the Adjusted Gross Income Tax Act of 1963, IND. ANN. STAT. §§ 64-3201 *et seq.* (Cum. Supp. 1972), IND. CODE §§ 6-3-11 *et seq.* (1971) including by incorporation all exemptions granted by the IRS under INT. REV. CODE OF 1954, § 501(a).

the first to file for Indiana income tax exemptions met considerable resistance from state authorities.⁴⁷

After negotiation with the Not-for-Profit Organization Division of the Indiana Department of Revenue, it appeared as if each of the condominium homeowners' associations would get a partial exemption as a social organization with permission to deduct membership assessments from total receipts.⁴⁸ This procedure would have put the state in harmony with the position taken by the federal authorities — no exemption, but minimal tax. However, after further consideration, the Indiana Department of Revenue issued a letter determination denying any exemption, whole or partial, essentially on the ground that if the association cannot qualify on the federal level, it cannot on the state level either.

One final possibility was then explored. Since all funds held in an agency capacity for another are exempt from gross income under Indiana tax statutes,⁴⁹ an association could request a ruling as to whether or not it holds membership dues in an agency capacity for its members. Although the state officials could hold that no true agency relationship exists, it is most likely that the exemption will be denied because the association's members receive too much direct benefit from the association's activities. However, if the assessment money was used directly for the benefit of individual members via home maintenance and repair, it would appear that the association, at least under the tax statutes, was acting merely as an agent for its members in having such work accomplished.

In summary, the state income tax exemption is probably of more financial significance than the federal exemption. But since

47. The Indiana Department of Revenue initially responded to these exemption requests with a form letter indicating merely that "Your organization should not file this form (Form IT-35A Application To File As Not-for-Profit Organization) because there is no provision for organizations such as yours under this particular Act." Was this a denial or grant of an exemption? The Department verbally indicated that it was a denial, but tentatively agreed that it might be more appropriate to issue a formal and explicit letter ruling.

The state is naturally quite hesitant to grant a total exemption to any organization even remotely connected with real estate developments because the exemption from income tax also exempts the corporation from Indiana sales tax and might, therefore, permit it to avoid paying sales tax on materials used in the construction of additions to its property. See Ind. Dept. of Rev. Circular ST-14 (Rev. May 1, 1973).

48. See Ind. Dept. of Rev. Circular IT-35 (Rev. Dec. 1, 1972).

49. See Ind. Dept. of Rev. Circular IT-49 (Issued Jan. 1, 1971).

the state income tax authorities look to determinations made by the IRS, the federal tax exemption should be pursued with diligence—through court action if financially feasible.

The form and taxation of the condominium homeowners' association are only two of the more apparent legal issues that arise during the development of a condominium. Other questions often arise with regard to even the most basic conceptual aspects.

COMMON AREAS

One extremely trying problem for the developers of condominiums in Indiana has been with common areas and facilities. The difficulties have ranged from a total misunderstanding of the condominium concept to minor confusion with the ownership of these common areas. The issue of the percentage ownership of common areas and facilities appertaining to each apartment has been mentioned previously, but will be explored in more detail here.

The Act provides that the term "common areas and facilities," *unless* otherwise provided in the declaration, shall mean and include land upon which the building is located, structural support of the building, the recreational facilities, premises for the lodging of janitors or other maintenance personnel, installations of all general utilities services, installations of other items of equipment existing for common use and such other facilities that may be provided for in the declaration.⁵⁰ In order to fully understand this provision, it must be read in conjunction with the definitions of an "apartment" and of "limited common areas and facilities." An apartment is simply an enclosed living *space* within the building.⁵¹ Limited common areas and facilities are those common areas and facilities designated in the declaration as reserved for use of those owning a certain apartment or apartments to the exclusion of the owners of all other apartments.⁵²

When these definitions are read together the condominium concept becomes clear. Each owner individually holds title to a particular space in a building and also owns the building or buildings and

50. IND. ANN. STAT. § 56-1202(f) (Cum. Supp. 1971), IND. CODE § 32-1-6-2(f) (1971).

51. IND. ANN. STAT. § 56-1202(a) (Cum. Supp. 1971), IND. CODE § 32-1-6-2(a) (1971). This "space" may also include non-supporting internal walls without doing violence to the basic concept embodied in the Act.

52. IND. ANN. STAT. § 56-1202(j) (Cum. Supp. 1971), IND. CODE § 32-1-6-2(j) (1971).

other common areas and facilities in common with all other apartment owners. An owner also has exclusive use of those common areas necessary for the enjoyment of his particular apartment, e.g., adjacent patio, adjacent balcony, parking space, storage area and the interior surface area of the walls bounding the apartment.

Notwithstanding its basic simplicity, several condominium declarations reflect a gross misunderstanding of this concept and a lingering desire to provide for individual ownership of something more than space. An almost infinite variety of approaches to condominium ownership has resulted. Certain declarations have been drafted to provide specifically that the owner of an apartment owns the structure surrounding and supporting his apartment.⁵³ This type of development is somewhere between the condominium and the traditional townhouse (where the owner actually owns the land upon which his house is located together with the structural aspects of the house), a virtual no-man's-land unexplored by either the courts or real estate authorities. Such developments, therefore, could be found to be outside the ambit of the Act creating untold legal complications. The common law regarding the support, duration and location of freehold interests in space is not sufficiently settled to comfort anyone who might be compelled to rely thereon. Some of the specific difficulties which could be encountered if a project were found to be without the purview of the Act include the identification of the units, the creation of cross-easements and co-ownership in areas of common use, the establishment of joint management, the protection against partition and the preservation rights of the parties in case of destruction of the property.⁵⁴ Even if these obstacles could be overcome by the wise use of common law principles, there is also the unwelcome possibility that the Act preempts the field, thereby eliminating the opportunity to create a

53. It has been stated that the definitions of "apartment," "common areas and facilities," "building" and "property" are broad enough to cover projects consisting of row houses and flexible enough to permit rearrangement of items generally considered to be common areas and facilities so they become part of an apartment. Cf. N. PENNEY & R. BROUDE, *LAND FINANCING* 151 (1970). Unfortunately, the result has been that some attorneys have merely attempted to force a traditional townhouse project into the mold of a condominium rather than simply making minor adjustments in this area to compensate for the move from a high-rise project to garden apartment or row house developments. See note 56 *infra*.

54. See P. ROHAN AND M. RESKIN, *CONDOMINIUM LAW AND PRACTICE* § 4.01 (1973) [hereinafter cited as 1 ROHAN AND RESKIN]. See generally Note, *Proprietary Interests and Proprietary Interests in Space*, 42 *IND. L.J.* 225 (1967).

common law condominium.⁵⁵ Obviously, the "creative" draftsman-ship approach to condominium documentation does nothing but invite legal disaster, regardless of the outcome of any resulting litigation.

There are some condominium projects in Indiana in which the declaration is quite ambiguous as to the extent and nature of the common areas and facilities. The declarations in these cases indicate that the individual apartments consist of space alone. However, there are numerous indications throughout each declaration that the common areas do not include the structural aspects of the buildings.⁵⁶ This approach, of course, could lead to difficulties similar to but less severe than those discussed immediately above.

A special problem in this area involves the ownership of the portion of the common areas and facilities used for recreational purposes. Occasionally a developer desires to retain an ownership interest in recreational property and either lease it to the association or operate some type of a private club in which membership is voluntary and expensive. The motives of these developers notwithstanding, ownership of the recreational facilities by the declarant or a third party is not particularly desirable from either an owner's or lender's point of view. This is because of the possibility that the benefit of the recreational areas could be lost to the owners by reason of the unilateral act of a third party or a default under the lease.

A related issue arises where, for tax reasons previously considered, the recreational areas and facilities are owned and operated by a not-for-profit corporation separate from the association. In such instance, the mortgage lenders on individual apartments will be concerned that the recreational areas and facilities may be alienated, mortgaged or otherwise burdened by that corporation thus diminishing the value of each apartment as well as the value of the entire project.⁵⁷

55. 1 ROHAN AND RESKIN § 4.01 n.1.

56. There are also several other declarations which bring some minor structural components (surface of interior walls, doors and windows) into the definition of "apartment." These slight variations are not significant and are made within the limited flexibility provided in the definitions of "apartment" and "common areas and facilities" as set forth in the Act. IND. ANN. STAT. § 56-1202(a), (f) (Cum. Supp. 1971), IND. CODE § 32-1-6.2(a), (f) (1971).

57. In one condominium project under development at the time of this writing, the recreational facilities are to be owned by the association. There is no apparent reason for this

The drawbacks of unilateral expandable condominiums already have been mentioned.⁵⁸ An additional problem where the undivided percentage interest in the common areas appertaining to each apartment will fluctuate as additional phases are added is that the amount of common area property covered by the mortgage on individual apartments will also fluctuate. Although it is considered that Sections 7(b) and 14 of the Act would cover this situation and subject the revised percentage interest appertaining to each apartment in the expanded common area to the various mortgages,⁵⁹ it is wise to include in each mortgage a specific provision for release of the lien of the mortgage on the applicable percentage interest in the original common areas and automatic and simultaneous reattachment to the new percentage interest in the expanded common areas.⁶⁰ In fact, some title insurance companies have required this type of clause as a condition to issuing a mortgagee's title insurance policy on unilateral expandable condominiums. It could be contended that the mortgage on the percentage interest in common areas loses priority and begins to run anew whenever it is adjusted by expansion of the project. However, the recommended clause is designed to rebut that argument.

procedure, since additional tax advantages or expansion flexibility are not available thereby. In addition, if the association owns the recreational areas and facilities, then mortgages on the individual apartments will not cover these areas and facilities. Thus, they could be readily alienated or burdened by the association.

58. See notes 11-14 *supra* and accompanying text.

59. IND. ANN. STAT. § 56-1207(b) (Cum. Supp. 1971), IND. CODE § 32-1-6-7(b) (1971), which provides in pertinent part: "The percentage of undivided interest in the common areas and facilities. . . shall be deemed to be. . . encumbered with the apartment even though such interest is not expressly mentioned or described in the [mortgage] instrument." See also IND. ANN. STAT. § 56-1214 (Cum. Supp. 1971), IND. CODE § 32-1-6-14 (1971) which contains a similar provision regarding the transfer of an interest in title in a condominium apartment.

60. Following is a suggested form for such a clause:

In the event additional common areas and facilities are added to the Regime by amendment of the Declaration recorded as Instrument No. _____, under the date of _____, 19____, in the office of the Recorder of _____ County, Indiana, in accordance with said Declaration, the lien of this mortgage on the common areas and facilities shall be automatically released as to the percentage interest in the then existing common areas and facilities appertaining to the mortgaged Apartment and shall automatically attach to the percentage interest in the common areas and facilities, as expanded, appertaining to the mortgaged Apartment, and the percentage interest in the common areas and facilities, as expanded, appertaining to the mortgaged Apartment set forth in any amendment to the Declaration is hereby mortgaged effective on the recording of such amendment to the Declaration as though mortgaged hereby.

SHORTCOMINGS OF THE ACT AND SUGGESTED AMENDMENTS

It should be noted at the outset that some of the conceptual and practical difficulties now existing occasionally spring from the practitioner's unconscious reluctance to comprehend the basic premise of the condominium concept—that an enclosed space can be treated as real property. In other words, the present confusion in some of these areas is not exclusively the result of the Act's less than perfect form. Nonetheless, after eleven years of use, it is apparent that the Act is in need of much clarification and amendment.

A fundamental flaw in the Act is that it is not tailored for use in the development of multi-unit one and two story buildings, precisely the type of housing projects which are now being constructed as condominiums in Indiana and throughout the country.⁶¹ Most sorely needed is express statutory authorization to expand the condominium project. Specific provision that additional phases may be added by either the "Power of Attorney" or "Chinese Menu" method are the obvious alternatives to be permitted. If the "Power of Attorney" method is authorized, the developer should also be required to add phases only in accordance with a detailed general plan of development prepared and made known to each purchaser prior to the sale of any apartment.⁶²

61. See Rohan, *Second Generation Condominium Problems: Construction of Enabling Legislation and Project Documents*, 1 VAL. U.L. REV. 77, 83-84 (1966).

62. The only approach presently used in Indiana which would not be improved by specific statutory approval is the central homeowners' association technique. See notes 14 and 16 *supra* and accompanying text.

It is, therefore, recommended that the Indiana legislature enact an amendment to the Act in the form of an additional section providing that the "Chinese Menu" approach to expansion be authorized. Following is a draft amendment designed to be consonant with Section 7(b) of the Act:

Property submitted to this act may be expanded by adding apartments and common areas and facilities thereto in accordance with provision in the declaration. Such provision authorizing expansion shall include the following particulars:

- (a) A general plan of development showing the property being submitted to this act and the phase areas and number of apartments in each phase area which may be later submitted to this act.
- (b) A list of the percentage of undivided interest in the common areas and facilities that will appertain to each apartment as each additional phase is added.
- (c) A time period, not to exceed five (5) years, within which the phase or phases set forth in the general plan of development may be added to the property.

Any owner of an apartment in a horizontal property regime created by a declaration

Section 2 of the Act contains numerous definitions crucial to proper interpretation and use of the Act.⁶³ As has been mentioned, the definition of an apartment as simply consisting of an enclosed space has caused some attorneys difficulty. The inclusion of major structural components in the definition of "apartment" in the declaration would of course cause the development to take on the trappings of a townhouse community and raise the question whether it even comes within the Act.

A look at the same issue from a different perspective also reveals drawbacks to this approach. If property is added to each apartment space, it must be eliminated from the scope of another condominium term — "common areas and facilities." As set forth above, common areas and facilities include the land, the actual structural aspects of the building, the recreational facilities and other common items *unless* otherwise provided in the declaration. This language leaves open what some attorneys apparently view as the possibility of creating a townhouse type development which would come within the provisions of the Act by merely drafting a declaration in which the structural aspects of the condominium buildings are excluded from the definition of "common areas and facilities" and included within the definition of "apartment." Notwithstanding this ingenious, but unsound reasoning, if the common areas do not include the structural aspects of the buildings, the definition of "apartment" is meaningless and the foundation of the condominium concept is destroyed.⁶⁴

There has also been some confusion with the concept of *limited* common areas and facilities.⁶⁵ Some draftsmen of declarations fail to realize that limited common areas can be designated. This tech-

containing an expansion provision which includes the information required by this section shall be conclusively presumed to have consented to the changes in the percentage of the undivided interest of his apartment in the common areas and facilities set forth in the declaration; provided, however, that any co-owner who contracted to purchase an apartment prior to the recordation of the declaration shall not be conclusively presumed to have consented to such changes unless such owner was provided a copy of the expansion provision and in writing acknowledged receipt thereof. Notwithstanding Section 7(b) of this Act a declaration containing an expansion provision which includes the information required by this section need not be amended upon the addition of any phase specified therein.

63. IND. ANN. STAT. § 56-1202(j) (Cum. Supp. 1971), IND. CODE § 32-1-6-2(j) (1971).

64. See notes 54 and 56 *supra* and accompanying text.

65. IND. ANN. STAT. § 56-1202(j) (Cum. Supp. 1971), IND. CODE § 32-1-6-2(j) (1971)

nique should be utilized to provide that patios, storage sheds and parking spaces adjacent to the apartments are common areas limited to the use of the owner of that apartment. Limited common areas can also include the surface of the walls, windows and the doors of each apartment, although the inclusion of these elements in the definition of "apartment" is not critical and is sometimes used as a method to insure maintenance of such property by the individual owner.

The definition of "common expenses" is usually not problematic.⁶⁶ However, an interesting aspect of that provision is that common expenses may include any expense declared a common expense in the declaration. One Indiana developer has used this provision to obtain a substantial amount of money in the form of "grounds fees" payable by each condominium owner at the rate of ten dollars per month for a period of thirty years. Fortunately this practice is not widespread in this state.⁶⁷

The ownership and maintenance of the common areas and facilities raise numerous questions. Section 7(a) of the Act provides that "each apartment owner shall be entitled to an undivided interest in the common areas and facilities in the percentage expressed in the declaration."⁶⁸ This presumably precludes the possibility of ownership of the common areas by the homeowners' association or by any other corporation. The fact that the percentage of undivided

defines "limited common areas and facilities" as "those common areas and facilities designed in the declaration as reserved for use of a certain apartment or apartments to the exclusion of the other apartments."

66. IND. ANN. STAT. § 56-1202(g) (Cum. Supp. 1971), IND. CODE § 32-1-6-2(g) (1971) indicates that "common expenses" mean and include: (1) all sums lawfully assessed against apartment owners by the association; (2) expenses of administration, maintenance, repair or replacement of the common areas and facilities; (3) expense agreed upon as common expenses by the association; and (4) expenses declared common expenses by the Act, the declaration or by-laws of the association.

67. In Florida, where the condominium market has been strong for the past decade, one of the most frequent sources of litigation centers around similar activities on the part of developers, *e.g.*, Riveria Condominium Apartments v. Weinberger, 231 So.2d 850 (Fla. 1970); Fountainview Ass'n., Ind. No. 4 v. Bell, 203 So.2d 657 (Fla. 1967). As a response to the tendency of some condominium developers to overreach, the Florida legislature enacted explicit disclosure standards to protect potential purchasers. FLA. STAT. ANN. § 711.24 (1971).

68. IND. ANN. STAT. § 56-1207(a) (Cum. Supp. 1971), IND. CODE § 32-1-6-7(a) (1971). It is also provided therein that: "Such percentage, unless the declaration specifically provides otherwise, shall be computed by taking as a basis the value of the apartment in relation to the value of the property as a whole." *Id.*

interest in the common areas shall not be altered without the announced consent of all co-owners expressed in an amended declaration has created some problems for the expandable condominium projects.⁶⁹

Section 10 of the Act which deals with liens has not yet caused any great consternation in the legal community.⁷⁰ However, the provision therein that no lien can arise or be effective against the property as a whole may be tested some day when all the co-owners of a particular condominium desire to mortgage the entire property in order to undertake massive renovations or reconstruction. Another potential problem is inherent in that portion of Section 10 which states that labor performed or materials furnished for the common areas and facilities, if duly authorized by the board of directors of the association, provides the basis for filing a lien against each apartment. This creates the possibility that while the developer is in control of the board of directors, he could burden the apartment owners with mechanic's liens relating to improvements of the common areas and facilities.⁷¹

The form of conveyance of the apartments is set forth in Section 14 of the Act. Unfortunately it is internally inconsistent and in need of amendment.⁷² This section initially provides that any conveyance or transfer of title of an individual apartment shall also convey the undivided interest in the common area relevant to that apartment without specifically referring to the same in the conveyance. This is consistent with Section 7 of the Act which provides:

69. This complexity was discussed in the section relating to the basic approach to the condominium concept and will not be pursued further here.

70. IND. ANN. STAT. § 56-1210 (Cum. Supp. 1971), IND. CODE § 32-1-6-10 (1971). This section of the Act prohibits liens against the property as a whole after the declaration is filed and makes it clear that each apartment is to be treated as a separate piece of real estate for the purpose of recording liens except where mechanic's liens are filed on the basis of work on the common areas and facilities authorized by the association. In that event a lien may be filed against each apartment. However, an apartment owner can remove his apartment and undivided interest in the common areas and facilities from the lien by paying the proportional amount thereof attributable to his apartment. See also IND. ANN. STAT. § 56-1216 (Cum. Supp. 1971), IND. CODE § 32-1-6-16 (1971) for the requirement that at the time of the first conveyance of each apartment it be free from all liens and encumbrances.

71. See Krasnowiecki, *Townhouse Condominiums Compared to Conventional Subdivision with Homes Association*, 1 REAL ESTATE L.J. 323, 337-38 (1973); see also note 87 *infra* and accompanying text.

72. IND. ANN. STAT. § 56-1214 (Cum. Supp. 1971), IND. CODE § 32-1-6-14 (1971).

The percentage of the undivided interest of each apartment in the common areas and facilities shall not be separated from the apartment to which it appertains and shall be deemed to be conveyed or encumbered with the apartment even though such interest is not expressly mentioned or described in the conveyance or other instrument.⁷³

However, later in Section 14 there is a requirement that each deed of conveyance or instrument transferring an interest in title contain the specific percentage of the undivided interest in the common areas appertaining to the apartment in question.⁷⁴ This apparent conflict should be resolved. Is a deed or mortgage valid if it does not specify the percentage interest? It probably is, but only the drafters of the Act can state with accuracy the result intended. There is also a provision in Section 14 of the Act requiring any deed of conveyance or instrument transferring an interest in title to contain a statement of the use for which the apartment is intended and the restrictions on its use.⁷⁵ This seems to make little sense in view of the fact that the declaration is of record and the grantee would be taking subject to that declaration and the restrictions contained therein.⁷⁶

In order to eliminate the confusion in this area, the Indiana legislature should repeal that portion of Section 14 which requires statements in deeds or instruments transferring an interest in title regarding the use of the apartment and the amount of the percentage interest in the common areas appertaining thereto. If this cannot be accomplished, it is suggested that Section 14 be amended to provide that it is permissible and preferable to set forth in the deed or mortgage the percentage of undivided interest in the common areas and facilities appertaining to the apartment and any restric-

73. IND. ANN. STAT. § 56-1207(b) (Cum. Supp. 1971), IND. CODE § 32-1-6-7(b) (1971).

74. IND. ANN. STAT. § 56-1214 (Cum. Supp. 1971), IND. CODE § 32-1-6-14 (1971). Presumably, the legislature intended to insure that the potential apartment purchaser knew exactly the percentage interest in the common areas and facilities that appertained to his prospective apartment. This is an admirable goal, but it should be effectuated in a manner which would not do violence to other portions of the Act. A separate disclosure statement could be required and compliance enforced by imposing absolute civil liability for failure to provide such statement.

It is also possible that the legislature may desire to distinguish between deeds and mortgages in regard to the disclosure required. If this is so, that intent should also be clearly set forth.

75. IND. ANN. STAT. § 56-1212(b) (Cum. Supp. 1971), IND. CODE § 32-1-6-14 (1971).

76. See note 74 *supra*.

tions on its use, but that the failure to do so will not affect the validity or recording priority of the instrument in question.

An additional restriction on conveying apartments not specifically mentioned in the Act is found in many declarations in the form of a right of first refusal provision running in favor of the association.⁷⁷ While this method may be an adequate means for the association to exert some influence over the future condition of the condominium,⁷⁸ a mortgagee who takes by foreclosure or by deed in lieu thereof should be specifically exempt from such provision. Such mortgagee should also be excluded from any prohibition against leasing during the period when he has taken possession pending foreclosure as well as after he becomes record owner.⁷⁹

In addition to the problems mentioned above, the darkest cloud looming over Indiana condominium projects contains a flood of reconstruction and insurance issues to be dumped upon the first development experiencing significant destruction of its buildings. Although the Act provides that the co-owners may insure the buildings against casualty, most lenders prefer a mandatory requirement to this effect in the declaration.⁸⁰ The real problem, however, relates to the application of the insurance proceeds upon destruction of the property. Section 19 of the Act provides:

Reconstruction shall not be compulsory where it comprises

77. Such provision would be a permissible addition to the declaration under IND. ANN. STAT. § 56-1212(b) (Cum. Supp. 1971), IND. CODE § 32-1-5-12(b) (1971) and is not an unreasonable restraint on alienation. Although there is some question as to whether such provision violates the rule against perpetuities, the prevailing and better view is that it does not. See 1 ROHAN AND RESKIN § 10.03; see generally Note, *Right of First Refusal—Homogeneity in the Condominium*, 18 VAND. L. REV. 1810 (1965).

78. One Indiana condominium declaration contains a clause which would require each apartment owner to obtain the consent of the association to convey his apartment. This consent-to-sale type of restriction as distinguished from a right of first refusal is probably unenforceable as an unreasonable restraint against alienation. See Note, *Right of First Refusal—Homogeneity in the Condominium*, 18 VAND. L. REV. 1810, 1830 (1965); see generally HERSCHMAN, *THE PRACTICAL LAWYER'S MANUAL OF MODERN REAL ESTATE PRACTICE*, 123-35 (1969).

79. Often the declarant is also exempted from any prohibition against leasing in order to be protected against the possibility that the apartments cannot be sold. If this occurs and the declarant turns the property into a rental project, the individuals who have already purchased apartments will be sure to object strenuously and may seek to enjoin the declarant from such activity.

80. IND. ANN. STAT. § 46-1218 (Supp. 1965), IND. CODE § 32-1-6-18 (1971). This master policy should, of course, contain a waiver of the right of subrogation against the apartment owners.

the whole or more than two-thirds [2/3] of the building; in which case, and unless otherwise unanimously agreed upon by the co-owners, the indemnity shall be delivered prorata to the co-owners entitled to it in accordance with provision made in the by-laws or in accordance with the decision by three-fourths [3/4] of the co-owners if there is no by-law provision.⁸¹

This section is open to considerable interpretation. It is an example of how a statute intended for one purpose (high-rise apartment buildings) can be distorted by use for a different purpose (multi-unit, one and two story buildings). Some declaration draftsmen have construed this provision as applying separately to each of the buildings of a multi-building condominium. In that case, reconstruction of a particular building would not necessarily be compulsory even if more than two-thirds of the building was destroyed, unless the co-owners of apartments in that particular building unanimously agreed otherwise. Conversely, a majority of declarants view Section 19 as contemplating destruction of two-thirds or more of all the buildings comprising the condominium common area before reconstruction is compulsory.

A related problem concerns the apportioning of damage expenses not covered by insurance. The Act is also confusing in this area. Section 20 of the Act requires that if the insurance proceeds do not cover the cost of compulsory reconstruction or in the event there are no proceeds, then the apartment owners "directly affected" by the damage must pay for restoration in proportion to the value of their respective apartments or in any other proportion as provided by the by-laws.⁸² Unfortunately, the legislature neglected to define "directly affected." Consequently, varying definitions have developed. Some declarations define an affected owner as one owning an apartment "located within a building in which the fire or other casualty occurred." This type of provision leaves the possibility of controversy where four units in a building are completely destroyed and two other units are not damaged and remain inhabitable. Other declarations contain definitions of affected apartments somewhat

81. IND. ANN. STAT. § 56-1219 (Cum. Supp. 1971), IND. CODE § 32-1-6-19 (1971).

82. IND. ANN. STAT. § 56-1220 (Cum. Supp. 1971), IND. CODE § 32-1-6-20 (1971).

more consonant with the Act — an apartment which is damaged by fire or other casualty.⁸³

Yet another dilemma to be faced is the one created when, for example, one of the buildings of a multi-building project is destroyed and the association does not decide to reconstruct the building within one hundred twenty days from the date of the damage. This automatically would vest ownership of the property in the owners as tenants in common and make partition available to any of the co-owners.⁸⁴ This possibility would certainly decrease the value of each apartment and make obtaining additional financing a difficult task.⁸⁵

One provision that has been overlooked by some homeowners' associations is that found in Section 25 of the Act. It provides that no modification or amendment to the association's by-laws shall be valid unless duly set forth in an amendment to the declaration.⁸⁶ The natural assumption of the association would be that it could change its by-laws in a manner similar to that of other corporations. Ignorance of the fact that any changes in the by-laws not conforming to the statute are void usually arises because the attorneys who drafted the declaration for the developer have left the developer and are no longer available to advise the association about such nuances of the Act. Some developers, however, feel a continuing responsibility and have provided legal assistance to the association until it is functioning smoothly and efficiently with legal counsel of its own.

This leads to the question as to when the developer should release control of the association to the apartment owners who have purchased individual condominium units. Obviously the developer initially owns all the apartments and, therefore, retains voting con-

83. The drawback to the use of such a definition is that there is uncertainty as to what constitutes destruction or damage of an enclosed space. Must the building collapse? Probably not, since it would seem that an apartment could be considered destroyed if it were rendered uninhabitable by fire or other casualty. Therefore, in view of the confusion created by poor draftsmanship of Section 19 of the Act, the use of the concept of destruction of apartments is probably not inappropriate. See generally Note, *Proprietary Interests and Proprietary Estates in Space*, 42 IND. L.J. 225 (1967).

84. IND. ANN. STAT. § 56-1221 (Cum. Supp. 1971), IND. CODE § 32-1-6-21 (1971).

85. See Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57, 71-73 (1965) for comment on some of the problems inherent in Sections 19, 20 and 21 of the Act.

86. IND. ANN. STAT. § 56-1225 (Cum. Supp. 1971), IND. CODE § 32-1-6-25 (1971).

trol over the association until fifty per cent (50%) of the apartments are sold; assuming, of course, the percentage interests in the common areas appertaining to each unit are identical.⁸⁷ In addition to naming the initial board of directors, the developer may also provide that his hand-picked group will remain in that position until a specified date two to five years hence, often the date when the construction loan becomes due or when it is projected that all phases of the project will be completed and sold out. The use of individuals experienced in real estate management as members of the board of directors during the creation of the association is probably advantageous to all parties concerned. It is, however, undesirable from an owner's viewpoint for the term of the initial board of directors to extend beyond this period. In fact, Section 26 of the Act appears to prohibit the developer from controlling the board until all units are sold. It is provided therein that the terms of at least one-third of the directors shall expire annually.⁸⁸

Finally, Section 28 of the Act provides for voluntary removal of the property from the Act upon unanimous consent of all apartment owners.⁸⁹ The provision makes the removal of the property sound relatively simple. However, all parties should be aware of the barriers that must be surmounted in order to allow the community to function smoothly without the supportive provisions of the Act.⁹⁰

CONCLUSION

Although condominiums have achieved a favored position among Indiana real estate developers, questions remain concerning the utilization of the condominium concept in this state. First, since land is still relatively available, the need for high density housing may not be as great in Indiana as in some other states. Only rarely has an Indiana condominium been developed in a rapidly growing recreational area or an otherwise particularly desirable location.⁹¹

87. If the project does not sell, this situation could theoretically continue indefinitely.

88. IND. ANN. STAT. § 56-1226 (a) (Cum. Supp. 1971), IND. CODE § 32-1-6-26 (1971).

89. IND. ANN. STAT. § 56-1228 (Cum. Supp. 1971), IND. CODE § 32-1-6-28 (1971). See Note, *Observations on Condominiums in Indiana: The Horizontal Property Act of 1963*, 40 IND. L.J. 57, 69-71 (1965) for criticism of the requirement for unanimity.

90. See note 54 *supra* and accompanying text.

91. Recreational condominium developers in other states have often offered to perform certain rental services for the purchaser. The SEC has indicated that such offerings may constitute the offering of a security in the form of an investment contract or a profit-sharing

Second, the resale value of condominiums in Indiana is yet unknown. Once this factor begins to take shape, it will, of course, influence developers' decisions regarding construction of additional condominium developments. Third, the existing condominiums have not reached an age where major repairs have been needed. Consequently, it is difficult to determine what legal issues will develop when the homeowners' association makes major special assessments or seeks outside financing to make such repairs. Fourth, many insurance questions have not been resolved, because few, if any, Indiana condominiums have been significantly damaged or destroyed by fire or other casualty. Fifth, the expandable condominium concept has not been challenged in the courts. If litigation of this issue should develop, condominium construction could be expected to decelerate pending its outcome.

This certainly is not to imply that condominiums have no place in the Indiana housing picture now or in the future. In fact, the condominium may prove to be one answer to the current national crisis in lower to moderate cost housing.⁹² However, in many instances a traditional townhouse project may be more advantageous in terms of general flexibility and freedom for expansion.⁹³ Further, a major legal result arising from development of condominium projects in which the apartment spaces do not encroach upon each other vertically, *i.e.*, a typical townhouse community, is the creation of neoteric issues in a previously relatively well-settled area of the law.⁹⁴ Consequently, the current rush to construct row house type condominiums should slow once developers and their attorneys have

arrangement requiring registration of both the condominium offering and the salesmen. See Ellsworth, *Condominiums are Securities?*, 2 REAL ESTATE L.J. 694 (1974); Klein, *Preparation of SEC Registration Statement for an Offering of Condominium Units*, 2 REAL ESTATE L.J. 461 (1973).

92. See Berger, *Condominium: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987 (1963).

93. See generally Note, *Organizing the Townhouse in Indiana*, 40 IND. L.J. 417; THE HOMES ASSOCIATION HANDBOOK, *supra* note 26.

At the other end of the spectrum, the cooperative is an ownership alternative in medium-rise and high-rise apartment projects. However, the condominium is superior to the cooperative for financing purposes and is, therefore, preferred by most authorities. *E.g.*, Berger, *The Condominium-Cooperative Comparison*, THE PRACTICAL LAWYER'S MANUAL OF MODERN REAL ESTATE PRACTICE 87-94 (1969).

94. See generally, Krasnowiecki, *Townhouse Condominiums Compared to Conventional Subdivision with Homes Association*, 1 REAL ESTATE L.J. 323 (1973).

an opportunity to reflect upon some of the disadvantages inherent in such projects.

Regardless of the forms future Indiana condominium developments take, many of the issues analyzed will be presented to an attorney representing either the developer, lender, prospective purchaser or apartment owner. Whatever his client's perspective, the practitioner should be able to offer knowledgeable comments about these problems and suggest workable resolutions to many of them.