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UNIT OWNERSHIP

CONDOMINIUMS AND THE CONSUMER: A CHECKLIST FOR COUNSELING THE UNIT PURCHASER†

PATRICK J. ROHAN*

Consumer complaints, coupled with the ever-increasing presence of the condominium, have prompted media attention to the problems accompanying the sale of this type of shelter. A certain degree of dissatisfaction has been aired concerning new constructions, as well as conversions from rental status. Of necessity, these presentations have focused upon the most serious traps for the unwary purchaser. This heightened public awareness has, however, resulted in a greater number of prospective purchasers consulting counsel prior to acquiring their unit. Thus, it is incumbent upon the attorney to possess the requisite knowledge regarding this relatively new form of ownership. In the pages that follow, the author seeks to set forth some of the conclusions he has reached during a decade spent in drafting condominium documents, state statutes, regulations, and in carrying on daily correspondence with developers, lenders, condominium associations and disgruntled unit owners. It is hoped that this material may aid the attorney in guiding his client through the condominium maze. Caution should be observed, since no article or checklist, no matter how complete, can cover every relevant consideration, or anticipate all of the devices that the mind of man may invent for the purpose of separating the unwary from their savings.

ARE ALL CONDOMINIUMS TAINTED AND SHOULD I ADVISE MY CLIENTS TO AVOID THEM ALTOGETHER AS A MATTER OF PRUDENCE?

There are several reasons why condominiums represent a sound investment and should be considered by a prospective home owner. Knowledgeable observers in the housing industry are in general agreement that the homes of the future will be condominiums. A number of factors point in this direction, among them the scarcity of land in major urban areas, the spiraling cost of construction, the changing character

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of the population (with a marked trend toward smaller families and a growing senior citizen group), the public's loss of interest in detached homes on large plots, the mobility of the population and the growing emphasis upon recreation-oriented facilities.¹ In a sense, the condominium represents a viable compromise for those who do not want to live in either an apartment or a single family home. For better or worse, condominiums appear to be well suited for the emerging life style of many segments of society. Accordingly, it is safe to conclude that condominiums will constitute an increasing share of all new housing starts (currently one out of seven), and hence must be seriously considered by the home buyer.

Attorneys experienced in representing institutional lenders, title companies and unit purchasers would tend to agree that condominium projects per se are sound investments and that the construction industry has received a bad reputation in this area because of the machinations of a comparatively few avaricious operators and speculators.² Apart from the integrity of most developers and the need to protect their reputation with the public and institutional lenders, several factors operate to cause condominium projects to be marketed at a realistic price. Institutional lenders will not finance them unless they are structurally sound and priced within reason. The public will reject the proposed offering if it is not competitive with the traditional tract house as well as comparable rental accommodations. Indeed, most lenders require the developer to pre-sell fifty percent of the units from a model before construction funds are provided, and to demonstrate that the project can survive as a rental situation in the event that it fails to materialize as a condominium.

This is not to say that all condominiums in a given locality, marketed at a uniform price, are alike and that comparison shopping is futile or unnecessary. As in the new home field generally, the price of the product is the result of many variables; the following are among them: the size of the land acquired for the project and per acre cost to the developer; the density of the development; whether the project is making use of cluster zoning; the type and quality of construction, such as brick versus frame; the developer's purchasing power, as, for example, in purchasing fixtures and appliances in bulk; the amenities included within the unit and as part of the recreation package; the

¹ See generally Main, *Inflation Closes in on the One-family House*, MONEY, Sept. 1974, at 28; 1 CONDOMINIUM REP., May 1973, at 3-4.

² Some of these practices, and the proposed remedies for abuses, are discussed in the text accompanying note 100 *infra*.

amount allocated by the developer for extrinsic items, such as advertising, sales personnel, the cost of carrying unsold units, etc.; and last, but not least, the cost of financing construction of the project.

A knowledgeable individual will not restrict his inquiry to the initial cost of the unit, but will also investigate potential maintenance costs. Such costs can vary drastically even among projects that otherwise appear to be all but identical. Among these maintenance expenses are costs incurred in the operation of the recreational facilities and in the employment of maintenance personnel. Other variables to be considered include the length and terms of the management agreement, the type of fuel and heating plant involved, and the fees exacted for automobile parking spaces. The following table depicts the range of variable costs found in a recent survey of condominium projects offered in the New York metropolitan area.

	No. Acres	No. Units	Facilities	MONTHLY COST BREAKDOWN				
				Price Range	Main- te- nance	Recreation (If not included)	Other (If not in- cluded) Tax	
Heritage Village Southbury (Conn.)	1005	1800	Recreation	30,900	51	6	33	12 for sewers
			Buildings Tennis, Golf, 4 pools Over 46 Clubs	53,700	76		76	
Jonathan Hall Hewlett (Nassau)	2½	36	Recreation	60,000	128		171	
			Room	102,000	218		285	
Woodgate Village Holbrook (Suffolk)	48	504	Recreation	28,990	28		55	
			Building Tennis, Pool	32,990	41		80	
High Point Hartsdale (Westchester)	12	500	Club House	36,750	46		83	
			including Tennis, Pool	57,100	72		128	
Village Mall Bayside (Queens)	15	141	LeClub Riviera:	39,990	41	25 optional	4	
			Club House including Pool, Paddle Tennis	72,990	67		6	
Takara Yonkers (Westchester)	1	33		46,250	49		83	1,350*
				49,250	52		95	

* For garage space. Price for one or two car space. Owner must buy.
All figures rounded off to nearest dollar.

The prudent individual should collect the available data from all of the condominium projects in the price range and locality he has in

mind and then analyze the cost of purchasing and of carrying each unit. These figures should then be compared with the projected cost of single family homes and rental apartments. One is then in a position to make an intelligent decision on a sound economic basis.³

At this juncture, it should be recognized that some condominium developers have sought to make unconscionable profits, usually through the device of leasing recreational facilities back to the condominium at exorbitant rates, or by retaining a lucrative, long-term management agreement, or by combining the two. In the writer's judgment, prospective purchasers would be well-advised to scrutinize the length and cost of every management contract, and to avoid entirely any project that involves a long-term lease of any kind.⁴ Fortunately, the

³ As a rule of thumb, the prospective unit purchaser should add 25% to the developer's estimate of what the first year's budget and common charges will be. Even if the developer is scrupulous about these matters, the spiraling cost of fuel, maintenance supplies and labor will almost certainly cause an unanticipated increase in common charges in the immediate future. Again, where the development will take years to complete or contains extensive recreational facilities, it is necessary to scrutinize the plan in order to make sure that the first few purchasers will not have to carry the entire cost of maintenance until such time as the project is sold out. In such situations, this excess cost should be borne by the developer in the start-up phase of the project.

⁴ A purchaser recently signed a contract to buy a unit in a Florida luxury condominium. At \$49,000 for a two bedroom apartment, he thought he was paying a fair price. What he failed to consider, as part of the true cost, was the monthly rental for the "recreational" area, which the developer had leased for 99 years to the condominium association. For this proportionate share he will pay a net monthly rental of \$70 with adjustments upward to reflect increases in the cost of living.

Had this buyer capitalized his rental charge, the unit might have seemed less of a bargain. His capitalization rate would determine the hidden cost. Buyers should choose a rate based upon the earnings they would expect for the use of money, which, for most condominium buyers, ranges from five percent (the return on savings) to 10 percent. Within this range, the concealed cost for each \$10 monthly rental (and for this buyer's \$70 monthly rental) would be as follows:

Investment Yield	Capitalization Rate	Each \$10	\$70 monthly
5%	20	\$2,400	\$16,800
6%	16 2/3	\$2,000	\$14,000
7%	14 2/7	\$1,714.28	\$12,000
8%	12 1/2	\$1,500	\$10,500
9%	11 1/9	\$1,333.33	\$ 9,333
10%	10	\$1,200	

The figures show that the condominium purchaser would have to keep \$16,800 invested at five percent to throw off enough income to pay the rental charge for the recreation area. Put another way, paying the rental charge of \$70 per month would tie up \$16,800 of the purchaser's capital if not paid out of income. This factor must be considered in arriving at the actual cost of the unit.

This shows the hidden cost of a long-term recreational lease on a net rental basis—the condominium paying all taxes, insurance, and other charges on the leased site. The concealed cost would drop if the lease were fairly short (five to ten years, for example),

vast majority of condominium projects do not contain these troublesome elements.

Every jurisdiction would be well advised to regulate offerings by at least requiring disclosure of all relevant data. As a by-product of reviewing each and every condominium plan offered to the public, the agency involved (usually the Attorney General's office or Department of Real Estate) will quickly gain expertise in dissecting these plans and soon discover the major areas of consumer dissatisfaction and of economic overreaching. This expertise, in turn, can be channeled into legislation and administrative regulations outlawing the most flagrant abuses. It is a sad commentary that most condominium unit purchasers do not read the prospectus or offering plan before signing a contract and closing title, even where state law makes such plans mandatory. It is an even sorer commentary to note that a sizeable number of attorneys do not read these documents before permitting their clients to sign a condominium purchase agreement. This, in turn, has led the writer to conclude from long experience that the true value of condominium regulation lies in the expertise that the administrative agency acquires, coupled with an attempt on the part of the regulator to eliminate major abuses from the proposed plan before it ever sees the light of day. It should be noted, however, that the quality of review will differ markedly from state to state, ranging from no review in most jurisdictions to the thorough line-by-line review by the Bureau of Securities and Public Financing in the New York Attorney General's office.⁵ In view of this fact, and in light of the tendency of each locality to develop its own condominium quirks (such as widespread use of the recreational lease in Florida), counsel for a prospective unit buyer should seek the assistance of an attorney practicing in the jurisdiction wherein the project is located, or, if necessary, to step out of the transaction entirely in favor of such counsel. The best possible combination, of course, would be a dual review of the documents, since the nonresident attorney may have more time and motivation in attending to the matter than does the attorney practicing at the project site.

or if the developer paid some or all of the operating charges. Also, if the lease has a buy out clause, the purchase price and terms can change the hidden cost.

Where the lease contains a rent escalator, as it did here, the hidden cost will rise as the buying power of the dollar falls. By contrast, the stated cost of the unit is measured in fixed dollars, so that any rise in the unit's value due to inflation will benefit the owner and not the developer.

⁵ For a discussion of the procedures followed by the New York Attorney General's office, see D. CLURMAN & E. HEBARD, *CONDOMINIUMS AND COOPERATIVES* (1970) [hereinafter cited as CLURMAN & HEBARD]; Levine, *Registering a Condominium Offering in New York*, 19 N.Y.L.F. 493 (1974).

RECENT CONSUMER-ORIENTED PROPOSALS IN THE CONDOMINIUM FIELD

A number of condominium associations in Westchester and Rockland counties in New York are pooling their efforts toward refinement of New York's condominium law, which is already the toughest in the nation. This loosely-knit "Council of Condominiums" is made up of representatives of 15 separate developments that have a total market value of \$80 million and a combined population of two thousand unit owners. The legislative package advocated by the Council would afford the condominium unit purchaser greater protection than is usually given to the purchaser of a comparable one-family home in a tract development. The specific proposals include the following:

1. The legislature should impose a limitation upon the ultimate size of any condominium, so that no project would be comprised of more than 250 units. A project of this size would be large enough to afford the cost of the required management services and yet remain small enough to make it possible for everyone to know one another.
2. All condominium developers should be required to post performance bonds, as well as subcontractor payment bonds. Such bonding would lead to sounder construction practices at the outset and greater attention to repair requests during the break-in period immediately following completion of construction.
3. Local government agencies should be required to inspect the work in progress in order to insure that condominiums conform to standards set by prevailing multiple-dwelling codes.
4. Developers should pay full common charges on all unsold and unoccupied units, from and after the date the first unit is conveyed to a condominium purchaser. Under current practice, developers usually pay a fractional amount of the full common charge on such units.
5. The down payment on an unbuilt condominium unit should be held in escrow until closing of title to the unit. This would increase the cost of the developer's construction financing by making it illegal to use the buyer's down payment to defray construction costs.
6. Control of the condominium's board of managers should be given to the unit owners within one year after closing of title to the first unit, or when forty percent of the units had been sold, whichever occurs first.
7. Developers should be prohibited from renting unsold condominiums, pending their ultimate sale to unit purchasers, unless the developer has obtained approval of 75 percent of the unit owners in occupancy. This, in turn, would increase development costs.
8. The developer should be required to file more detailed con-

struction plans than are presently required, including documents indicating how the project "as built" differs from the original blueprints, site map, etc. In addition, the developer should be required to furnish a copy of all such documents to the condominium's first board of managers.

Other interested parties have suggested a requirement that both the board of managers and managing agent be bonded, in order to guarantee the safety of condominium funds.

A review of current proposals in the various state legislatures indicates a growing trend toward adoption of full disclosure statutes in the condominium field. Where adopted, such measures give the condominium unit purchaser more basic information and greater protection than is currently afforded the tract home buyer.

The consumer protection measures advocated by the "Council of Condominiums," discussed above, would take up where disclosure statutes leave off, and would strengthen the condominium unit purchaser's position in the trying days of initial occupancy of the project. It should be noted that the cost of such additional protection, whether in the form of offering plans, performance bonds, fidelity bonds, or some combination of the three, will necessarily be built into the cost of the condominium unit. Nevertheless, a strong argument can be made that this should be done, since the cost of a home represents the largest single purchase that the average individual makes in his lifetime. Moreover, eighty or ninety percent of the cost of the unit, including the increment in cost that would be traceable to consumer protection measures, would be borne initially by the unit mortgagee, and would not have to be shouldered by the unit purchaser at the moment of purchase. The cost of holding the down payment in escrow could be considerably lessened by legislation which would authorize the developer to invest such funds in United States Treasury notes or certificates of deposit and keep any interest earned, provided, that the unit under contract was completed and title ultimately conveyed to the purchaser free and clear. Income earned by the developer in this manner would go a long way toward offsetting the increase in construction loan costs caused by the escrow requirements. Another acceptable approach would be to permit the developer to obtain a bond covering potential loss of the down payment and to charge the cost of the bond to the unit purchaser. It is probable that the direction that condominium regulation is currently taking foreshadows the day when all residential construction, including tract homes sold as conventional one-family units, will be brought under similar controls. It is also probable that dissatisfaction with construc-

tion defects throughout the industry will accelerate the spread of express warranties and policies of insurance against such defects. Such policies are now being offered on an experimental basis by several home builder associations.

Since Florida has been one of the leading states in the development of condominiums and condominium law, its activities will be closely scrutinized and possibly followed. Recently, the Florida Condominium Commission was established to investigate measures and practices which might be necessary in regulating condominiums. It recently filed its report to the Florida legislature and its recommendations deserve consideration from anyone interested in condominium development, since they will certainly be considered by other states that are contemplating changes in their own condominium laws.⁶

Highlights from the report include these recommendations:

1. Further study should precede any decision to create a permanent agency to regulate condominiums.
2. It would be desirable for condominium projects to own their common areas outright. The commission refused, however, to propose an end to the developers' widespread practice of leasing the recreational facilities to the condominium. Such a "controversial" recommendation, the commission feared, might jeopardize other features of the report. Instead, the commission offered measures that would include the following strict controls on the content of any lease on which the condominium or a unit owner is obligated:
 - (a) The lease shall state the minimum and maximum number of units to be served by the leased facility;
 - (b) The lease shall not be terminated as to any unit owner who has paid his share of the rent;
 - (c) Where rent is paid for recreational facilities not yet completed, the rent shall be prorated and paid only for the completed facilities;
 - (d) The rental of recreation facilities for a residential unit shall be a fixed sum and may be adjusted only at ten-year intervals. Moreover, any upward rent adjustment must reflect actual changes in the cost of living;
 - (e) A lease of recreational facilities shall grant the lessee the option to purchase after ten years either at a fixed sum or in an amount set by arbitration. A 75 percent vote of the unit owners would be needed to exercise the option.
3. Leasehold condominiums would be expressly permitted if the underlying lease has an unexpired term of fifty years or more.

⁶ See AMENDED REPORT OF THE FLORIDA CONDOMINIUM COMMISSION TO THE 1973 SESSION OF THE FLORIDA STATE LEGISLATURE (1973).

4. Assessments would be made against the unit owners no less frequently than quarterly.
5. Associations would be given the power to operate more than one condominium.
6. The association would be able to maintain a class action on behalf of unit owners with respect to the common elements and the structural and mechanical components of the building. This would facilitate suits against the builder for construction defects.
7. Unit owners would receive written summaries of the project finances at least semiannually. (Annual summaries are presently required.)
8. Where a staged development is planned, the developer cannot prepare more than three alternative plans, which should be revealed to first-stage purchasers.
9. Buyers would receive a warranty of fitness and habitability. The roof and structural parts of a building would carry a three-year warranty (extended to five years in some cases). Everything else would be warranted for one year from completion for claims against contractors or suppliers, and for one year from the sale or first occupancy of a unit for claims against the developer. This provision would replace the implied warranty doctrine of recent court decisions.⁷
10. The developer's management control would be curtailed under a formula that would let the unit owners elect members of the board of administration when 15 percent of the units were sold and would give unit owners control of the board within three years after 75 percent of the units were sold, or within three months after 90 percent of the units were sold, or at once after all of the units were sold, whichever came first. However, the provision would protect the developer against prejudicial action by the board while he still held unsold units.
11. To insure completion of the project, the developer would either furnish a performance and payment bond or place in escrow five percent of the sales price of each unit sold prior to completion.
12. Conversions of existing rental buildings could not occur until tenants with expired leases were given ninety days to vacate. (However, the commission resisted measures that would further protect the status of tenants in buildings subject to conversion.)
13. A detailed prospectus would accompany the offering of any condominium containing more than twenty units. The prospectus requirements occupy eight pages.
14. Buyers would have fifteen days to cancel their contracts after receiving copies of the legal documents.

⁷ See text accompanying notes 95-99 *infra*.

A number of recent developments indicate that the absolute control currently exercised by developers over the board of managers in the first few years of a condominium's existence may be coming to an end. In the past, it was not uncommon for the developer to retain control of the board for a prolonged period of time in order to initiate the project on a sound basis, to maintain the common areas in a satisfactory manner, to facilitate marketing of the unsold units, and to protect against increased common charges or other forms of harassment by the purchasers that took possession of their units in the project's early stages. Such control also served to minimize the risk of a court challenge to a management agreement entered into between the condominium and a designee or subsidiary of the developer. As originally enacted, none of the condominium statutes contained provisions specifically regulating this sphere of developer activity. FHA regulations and those of some state administrative agencies, such as the New York Attorney General's office, did curtail the developer's role by mandating that control of the board of managers be turned over to the unit owners at an early date. Now it appears that a number of states are about to adopt these reforms by statutory amendment or administrative rule.

Illustrative is House Resolution No. 421 passed in Hawaii in 1974, which cites the growing outcry of condominium unit purchasers against practices such as the following:

1. Developers have kept control of the board indefinitely by retaining ownership of just over fifty percent of the units.
2. Control has been retained by selling a significant number of units to straw buyers or employees of the sponsor.
3. The documentation authorizes third parties who are not unit owners to be elected, and the developer packs the initial board with friends and associates who have no stake in the project insofar as they do not reside there or own units. Under the staggered election system found in most condominium bylaws, such persons could hold office for up to three years before coming before the unit owners for reelection.
4. The documentation sanctions voting by proxy and the developer has systematically obtained a large number of proxies.

The Hawaii House resolution takes note of the impact of these practices on the unit owners' control of their project, as well as the relationship of control to preservation of management contracts and other profit opportunities. It directs the Real Estate Commission of the State of Hawaii to study the area and to promulgate remedial regulations, including directives to the effect that: (1) no licensed real estate broker,

salesman, agent, or developer, nor any agent or employee of any of these, shall accept election to the board of an association of a condominium in which he participated in any way in its development, construction, or sale; (2) no licensed real estate broker, salesman, agent, or developer shall suffer any of his agents, employees, or subsidiaries, to accept election to membership on the board of the association of a condominium in which he participated in any way in its development, construction, or sale, nor to bid for nor to accept a contract of employment as manager or as managing agent; and (3) no licensed real estate broker, salesman, agent, or developer shall himself or itself, nor through any agent, employee, or subsidiary, accept employment as manager or as managing agent of any board of a condominium association of which such licensed broker, salesman, agent, or developer may otherwise lawfully be a member.

It should be noted that initial control of the condominium board of managers by the developer is frequently both a legal and practical necessity. This is particularly true in large lateral projects where the early purchasers will take possession several months or even years before the project is physically completed and marketed. In such cases, it is to the mutual advantage of both buyer and seller to have the project properly maintained and placed on a sound financial footing. Consumer-oriented regulation in this area should take cognizance of this factor.

Developers can aid their own cause in a number of ways. Long-term management contracts or agreements that call for excessive compensation should be avoided at all costs. The common charges allocable to completed, but as yet unsold, units should be fair and equitable. The developer's right, if any, to lease unsold units pending their sale, or to otherwise modify the character of the development, should be clearly spelled out in the offering literature. Thought should be given to turning over control of the board after the expiration of a reasonable period of time, even though the developer might still be left with enough unsold units to outvote the purchasers that have already taken title. Where a project will take several years to complete and market, consideration should be given to a staged or phased development, with parallel condominiums. It is thereby possible to turn over control of successive completed sections of the project as they are marketed. Specific areas of concern to the developer, such as retention of the right to continue advertising signs on the property until all units are sold, may be spelled out in the condominium documents and accom-

panied by a provision requiring unanimous consent of all unit owners, as well as that of the developer, for amendment or repeal of such provisions. As many areas of legitimate concern as practicable should be entrusted to the good judgment of the unit mortgagees by requiring the lender's approval in all cases of special assessments for improvements and modification of project documents.

EVALUATING CONDOMINIUM OFFERINGS AND CLOSING UNIT TITLES

*Safeguarding the Purchaser's Investment*⁸

As in any real estate transaction in which a building is to be erected, acquisition of a unit in a proposed condominium involves several risk-bearing features. The buyer stands to suffer a financial loss if the developer is unscrupulous, inadequately financed, or ill-advised in planning and executing the venture. Even with these hurdles surmounted, a poor bargain may be struck if the ownership, voting and assessment ratio assigned to the purchaser's interest do not proportionably reflect his investment. Each of these areas of exposure will be considered in turn.

Condominium enabling statutes are currently found in the District of Columbia and fifty states; of these, comparatively few jurisdictions have issued regulations governing initial sale of units. Further, where such control is exercised, the safety factor lies principally in the requirement of disclosure of all relevant data to the public.⁹ Although an attempt is made to discourage overreaching and contingent promises on the part of developers,¹⁰ reviewing authorities cannot be expected to guarantee that any particular condominium is a good, or even safe, investment. In most states, however, the field has been relatively free of complaint from irate purchasers. Although it has been asserted that

⁸ It may be anticipated that advising clients in connection with acquisition of a condominium unit will require extensive preparation on the part of counsel. Moreover, each condominium project will vary significantly from its predecessors, necessitating a fresh inquiry into each offering. This will have ramifications in the area of attorneys' fees. A modified form of time billing may be required in lieu of the usual flat fee charged for conveyancing.

⁹ In *Fountainview Ass'n, Inc. v. Bell*, 203 So. 2d 657 (Fla. Ct. App. 1967), it was held that the developer owes no duty to future condominium unit purchasers to refrain from making excess profits on the condominium venture. See also *Wechsler v. Goldman*, 214 So. 2d 741 (Fla. Ct. App. 1968). It is noteworthy, however, that the court indicated that a different result might follow if the question were an open one. Moreover, lower court litigation in other states indicates a trend toward imposing a fiduciary obligation upon condominium developers. See generally *State Sav. & Loan Ass'n v. Kauaian Dev. Co.*, 50 Hawaii 540, 445 P.2d 109 (1968); 10 WM. & MARY L. REV. 760 (1969).

¹⁰ Thus, for example, builders have been discouraged from promising facilities which would not be supplied unless a specified number of units were sold. See generally *Miller, Cooperative Apartments: Real Estate or Securities?*, 45 B.U.L. REV. 465 (1965).

builders seek excessive profits on condominium housing,¹¹ it generally appears that condominium units are priced lower than comparable conventional homes. A spokesman for one institutional lender has estimated that condominium interests will also have a higher resale value than cooperative apartments with the same square footage, because flexible means of condominium financing enlarge the number of potential buyers.¹² Review of the past few years' experience (spanning, of course, a period of generally rising real estate prices) reveals that most owners have realized a profit in disposing of their units.

While most projects have turned out to be a sound investment, some condominiums have proved unsuccessful. In the main, these ventures appear to have been poorly planned or merchandised. After one such collapse, a study disclosed that the market aimed at simply did not exist in the particular community.¹³ Excessive land costs,¹⁴ an over-supply of rental apartments in the vicinity,¹⁵ and failure to provide modern conveniences,¹⁶ have also proved damaging. Institutional lenders, anticipating possible marketing difficulties, frequently insist upon contingency plans for conversion to a rental property. Failure of a development to come to fruition as a condominium is not too tragic an occurrence, provided the builder is stable or has not made use of the purchasers' money to finance construction. But where the building corporation is a mere shell and buyers' funds have been utilized, their investment may be lost to mechanics' liens and a construction loan foreclosure. This danger must be flagged at the public offering stage in some states. Thus, if the purchasers' investment is not held inviolate, the Bureau of Securities and Public Financing of the New York Attorney General's office requires the developer to insert the

¹¹ Remarks of Reece H. Dorr, President, Hayward Founders Savings, *quoted in* Comment, *Condominium*, 19 SAV. & LOAN NEWS, Jan., 1964, at 38, 47.

¹² See Wagner, *Amenities of Living Determine if a Condominium Will Succeed*, 13 N.Y. SAV. ASS'N NEWS, Apr. 1964, at 2, 8 [hereinafter cited as Wagner].

¹³ See Leonard, *The Condominium that Flopped*, 2 AHB CONFERENCE 47 (1962).

¹⁴ See Meyer, *Case Study: The High-Rise Condominium*, 2 AHB CONFERENCE 16, 18 (1962) [hereinafter cited as Meyer]. See also Marks & Marks, *Coercive Aspects of Housing Cooperatives*, 42 ILL. B.J. 728, 730-35 (1948), for monetary risks stemming from the practices of cooperative promoters.

¹⁵ See Meyer, *supra* note 14, at 20-21; Comment, *Professional Approach to Apartment Lending*, 18 SAV. & LOAN NEWS, Apr. 1964, at 47.

¹⁶ See Wagner, *supra* note 12, at 2. The New York Attorney General's office has devised a procedure whereby condominium developers may solicit refundable deposits from would-be purchasers in order to test the market for the proposed condominium project before instruments and other costly items are prepared. Should a demand fail to materialize, the builder's loss is minimal. See N.Y. DEP'T OF LAW, BUREAU OF SECURITIES AND PUBLIC FINANCING, COOPERATIVE POLICY STATEMENT No. 1 (also applicable to condominiums) (available by writing 2 World Trade Center, New York, N.Y. 10047).

following warning in his literature: "If this offering is not consummated for any reason you may lose all or part of your investment."¹⁷ The shadow cast over the entire prospectus by such a statement may prompt builders to seek full financing elsewhere. Yet if the developer is inadequately capitalized, or seeks to save the interest otherwise payable on a construction loan, he may persist. In this event, some degree of protection may still be gained by requiring that he obtain a bond guaranteeing completion of construction.¹⁸

Even when a project is sound and well located, the ownership, assessment, and voting rights attached to the unit under consideration should receive close scrutiny. In most early condominiums the ratio governing all three incidents was arrived at by computing the value (or square footage) of the unit, in relation to that of the entire project.¹⁹ But builders of late have been demanding greater marketing freedom, including the right to raise unit prices if the development is selling well and lower them when sales fail to materialize as rapidly as anticipated. Protests have also been voiced against the requirement that all unit prices be determined before any are sold, on the ground that this unduly complicates the furnishing of intra-apartment improvements and fixtures. Accordingly, the view that varying percentages might be employed in fixing the three incidents (and that these need not be tied to a unit's price) is gaining ascendancy. It is nonetheless essential that the purchaser receive an undivided fractional interest in the project which approximates the value of his investment. Without this parity, he would receive less than he paid for his interest if the property were suddenly destroyed by fire, taken under eminent domain, or voluntarily deregistered and sold by the association of unit owners.

This concern is not limited merely to the sale of new units; it is relevant also in any resale where the price exceeds that paid by the original owner. If, for example, X paid ten thousand dollars for a unit possessing an undivided one-tenth interest in the project, later reselling

¹⁷ 13 N.Y.C.R.R. 19.2(a) (1964) (New York Attorney General's condominium regulations).

¹⁸ Unless the down payment is held in escrow as an inviolate trust fund, mechanics liens and the building loan mortgage will have priority, as in conventional real estate construction.

¹⁹ Under California practice, however, unit owners are given equal rights in the common elements and bear an equal share of assessments, absent an agreement to the contrary. See Gregory, *The California Condominium Bill*, 14 HASTINGS L.J. 189, 201 (1963) [hereinafter cited as Gregory]. New York recently amended its condominium act to provide for an additional method of allocation based on equal percentage interests. Furthermore, interests may be allocated on the basis of floor space, taking into account such factors as relative value of the location, uniqueness and accessibility to the common facilities. N.Y. Sess. LAWS [1974], ch. 1056, § 2 (McKinney).

it to *Y* for fifteen thousand, the undivided fractional interest attached to the unit would remain one-tenth. Institutional mortgagees have taken this into account when appraising condominium properties; the lender's loan to value ratio is applied against the unit's fair market value, or undivided fractional interest in the project, whichever produces the smaller valuation.²⁰ This aspect of the transaction should also be borne in mind if the seller is seeking additional compensation because of intra-apartment improvements (*e.g.*, wood panelling) or fixtures. If these items became part of the common elements upon affixation, the buyer might not receive compensation for them in the event of the building's demise.²¹

Statutory Compliance

Since it is possible that a project may be denied recognition as a condominium under a state enabling act, it is incumbent upon the purchaser's attorney to ascertain whether the instrumentation he is reviewing actually creates a condominium. A detailed acquaintance with local law is essential for an informed judgment because the enabling statutes vary significantly from state to state. Some are fashioned along "space lot" lines, some embody the "part of a building" theory; still others permit either approach to be employed.²² Several measures authorize units bottomed on a leasehold,²³ while some expressly or impliedly proscribe leasehold condominiums.²⁴ Again, state officials and builders active in the field have been plagued with such theoretical, but vital, questions, as whether there are minimum requirements, such as a building²⁵ or commonly-owned surface beneath a

²⁰ Address by William Kerr, May 11, 1964, in SYMPOSIUM ON THE PRACTICAL PROBLEMS OF CONDOMINIUM 19 (Transcript, Ass'n of the Bar of the City of New York 1964) [hereinafter cited as Kerr Transcript].

²¹ Fixtures and intra-apartment improvements may well generate disputes, unless their ownership is clearly delineated in the declaration or bylaws. See Address by A. Carleton Dukess, May 11, 1964, in SYMPOSIUM ON THE PRACTICAL PROBLEMS OF CONDOMINIUM 9 (Transcript, Ass'n of the Bar of the City of New York 1964) [hereinafter cited as Dukess Transcript]; Armstrong & Collins, *Condominium — The Magic in a Word*, 16 S. CAL. TAX INST. 667, 683 n.61, 684-85 (1964) [hereinafter cited as Armstrong & Collins].

²² See Gregory, *supra* note 19, at 190-96; Kerr, *Condominium — Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 25 (1963) [hereinafter cited as *Statutory Implementation*].

²³ See, *e.g.*, CAL. CIV. CODE ANN. § 783 (West Supp. 1974); S.C. CODE ANN. § 57-495(e)(i) (Cum. Supp. 1974); VT. STAT. ANN. tit. 27 § 1302(2) (Supp. 1973). New York allows leasehold condominiums only for nonresidential purposes. N.Y. SESS. LAWS [1974], ch. 1056, § 1 (McKinney), amending N.Y. REAL PROP. LAW § 339-e(11) (McKinney 1968).

²⁴ See CLURMAN & HEBARD, *supra* note 5, at 147; 4A R. POWELL, REAL PROPERTY ¶ 633.19 (rev. ed. 1974) [hereinafter cited as POWELL].

²⁵ Some developers have projected condominium ventures for special purposes, such as land holding, dock moorings (marinas) and similar projects. However, many enabling statutes appear to contemplate a residential or commercial structure. See, *e.g.*, N.Y. REAL PROP. LAW § 339-e (McKinney 1968) (building means a multi-unit building or buildings

structure, which must be met before a development qualifies as a statutory condominium. Thus, may a project be sold as a condominium if isolated segments of the property are owned in common, but the land and buildings separately held? Would town houses or detached homes qualify if the only commonly-held areas were a swimming pool and park?²⁶

Substantial difficulties may arise if units are belatedly denied condominium classification, with the consequent loss of benefits which would normally accompany such status. For example, the enforceability of covenants contained in the declaration and bylaws would rest merely upon classical principles of equitable servitudes together with covenants running with the land at law.²⁷ Statutory exemption of the association's right of first refusal or restraints upon alienation from operation of the Rule Against Perpetuities,²⁸ and the right to separate taxation of units,²⁹ would also be jeopardized. Perhaps most serious of all, unit titles could prove unmarketable if there were any question in the jurisdiction whether air space constituted real property.³⁰ Again, might not the condominium statute preempt the field, barring "common law" condominiums and hybrid projects which conform only in part to the enabling legislation? In view of the foregoing hazards, counsel should

comprising a part of the property). These statutes would appear to require a building before a complex would qualify for condominium status.

²⁶ A related issue is whether traditional community associations would qualify for condominium status. See, e.g., *Neponsit Property Owners' Ass'n v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938); 2 AMERICAN LAW OF PROPERTY §§ 9.13-9.20 (A. Casner ed. 1952). It has been stated that some southern California projects closely resemble town houses with only a common pool. See *Armstrong & Collins*, *supra* note 21, at 689; McCaughan, *The Florida Condominium Act Applied*, 17 U. FLA. L. REV. 1, 11 (1964).

²⁷ See *Berger, Condominium: Shelter On A Statutory Foundation*, 63 COLUM. L. REV. 987, 1016 (1963) [hereinafter cited as *Berger*]; *Johnson, Legal Problems of Cooperative Housing In Illinois*, 50 ILL. B.J. 940, 943-44 (1962). Whether affirmative covenants and mere promises to pay a sum of money annually for extrinsic services, such as pool maintenance, may be enforced against successors of the original unit owners might prove a difficult question in some jurisdictions.

²⁸ See *Friedman & Herbert, Community Apartments: Condominium Or Stock Cooperatives?*, 50 CALIF. L. REV. 299, 314-19 (1962). It should also be noted that absent statutory protection, freehold restraints upon alienation are presumptively invalid. *Bernhard, The Minority Doctrine Concerning Direct Restraints On Alienation*, 57 MICH. L. REV. 1173, 1174 (1959).

²⁹ Prior to passage of condominium enabling legislation, many jurisdictions had ruled that there was no requirement that assessors must separately assess multiple interests in a single building. See *Comment, Separate Assessment Of Condominiums*, 14 HASTINGS L.J. 289, 290-94 (1963).

³⁰ While this fear sparked much debate during the early years of condominium development, more recent authorities have argued that air space does, in fact, constitute real property. See *Liebman, Development of Air Rights*, N.Y.L.J., Nov. 12, 13, 14 & 15, 1968 (printed in four installments), at 1. See also *Model Airspace Act*, in 8 REAL PROP. PROB. & TR. J. 504 (1973).

proceed with caution in approving any offering which does not fall squarely within the enabling legislation.

It is also advisable to make certain the project meets with the local zoning board's approval,³¹ and, if a lateral condominium, that it complies with subdivision regulations. Zoning will not prove worrisome for high-rise projects, inasmuch as they should qualify in zones where apartment house construction is permitted. However, when a town house or cluster development is planned, minimum lot, set-back and other typical restrictions could cause difficulty,³² especially if the builder seizes upon the condominium concept as a means of circumventing standards governing traditional housing construction. Some observers take the position that uncertainty will reign as long as local boards must make ad hoc decisions under zoning codes drafted with no thought of condominiums in mind.³³ An opposing viewpoint is reflected in condominium statutes which stipulate that each structure is to be treated like any other building; that is, a project's status as a condominium should have no bearing one way or the other on its zoning classification.³⁴

Rights Reserved by the Developer

Far-reaching powers, ranging from a right to alter unit prices to an option to cancel the offering if a specified number of units are not "pre-sold", are frequently retained by the builder in the "purchase agreement" or form contract tendered to a unit purchaser. The developer, doubtless, will refuse to negotiate with purchasers' counsel concerning these prerogatives. Nevertheless, their import should be conveyed to the prospective buyer to assist him in evaluating the offering.

Promoters frequently retain the right to unilaterally amend the

³¹ Although zoning is most often passed upon by the architect, in the case of a condominium, zoning should be reviewed by the lawyer for such problems as may exist in ordinances dealing with single family residences and other terms which, when applied to the condominium, may create ambiguities. Dukess Transcript, *supra* note 21, at 11.

³² Zoning and planning authorities have attempted to create specialized, and sometimes onerous, requirements for condominium construction. Armstrong & Collins, *supra* note 21, at 677-78. For litigation involving an attempt by a municipality to zone out condominiums, see Lancaster Dev., Ltd. v. Village of River Forest, 84 Ill. App. 2d 395, 228 N.E.2d 526 (1967); Bridge Park Co. v. Borough of Highland Park, 113 N.J. Super. 219, 273 A.2d 397 (1971).

³³ See, e.g., Armstrong & Collins, *supra* note 21.

³⁴ Compare N.C. GEN. STAT. § 47A-27 (1966) and TENN. CODE ANN. § 64-2721 (Supp. 1973) with FLA. STAT. ANN. § 711.08 (1969) and TEX. REV. CIV. STAT. 1301a § 23 (Supp. 1974). Local communities cannot discriminate against condominiums which otherwise meet all the qualifications of the then existing zoning law. See, e.g., Lancaster Dev., Ltd. v. Village of River Forest, 84 Ill. App. 2d 395, 228 N.E.2d 526 (1967).

condominium's declaration and bylaws, in order to facilitate marketing of units or comply with requirements of title companies, institutional lenders or local civic authorities. Such provisions are of little consequence if future amendments cannot shrink the builder's obligations or alter the liabilities, ownership fraction and voting rights of units already purchased. Accordingly, the developer's amending power should be circumscribed by a caveat that no revision may: (1) diminish the undivided interest and voting rights of units already sold; (2) increase earlier purchasers' share of common expenses; (3) alter the builder's responsibilities and warranties as set forth in the offering; or (4) diminish assessments against apartments unsold when the condominium plan becomes effective.³⁵

In one project, the developer was empowered to raise and lower prices on unsold units and to alter their physical layout, even to the extent of combining apartments or severing rooms from one unit and adding them to another. The integrity of interests previously sold was preserved by a stipulation that price changes could not alter the fractional interests originally allocated to sold units, and that boundary shifts between apartments would merely effect reallocation of the ownership percentages of the revised suites.

As long as two or more units remain unsold, the developer will occupy an influential position as multiple-unit owner. Consequently, it is essential that any limitations upon the exercise of his rights as a unit holder, as well as his exemptions from obligations usually inherent in such status, should be spelled out in detail. Thus, sale of remaining units by the builder is invariably exempted from the right of first refusal or other restraint upon alienation. Less frequently, he is given a degree of control over common expenses which may be assessed against units still held by him; this reprieve should not be excessive in duration or amount. Finally, the developer will be in a position to elect the entire board of managers until most units have been sold. Since cumulative voting is seldom, if ever, prescribed for association meetings, purchasers will be unable to elect a single member of the board of managers when an opposition slate is supported by the builder in possession of several votes.³⁶ In recognition of this fact, some developers

³⁵ See Dukess Transcript, *supra* note 21, at 17.

³⁶ Recent legislation in Connecticut, however, limits the ability of the developer to monopolize the board by giving the unit owners the right to petition, under specified circumstances, for an election at which only unit owners shall be elected. See CONN. GEN. STAT. ANN. § 47-80(b)(1) (Supp. 1973).

have consented in advance to vote for a number of candidates nominated by unit purchasers.

Condominium Unit Financing

Condominium offerings frequently stipulate that all purchasers must place their mortgages with a designated institutional lender, or contain provisions designed to discourage resort to any other mortgagee. Several factors contributed to the emergence of this restrictive practice. Some lenders condition the making of construction loans upon receipt of all or a specified share of the unit mortgage applications.³⁷ Builders, in turn, prefer dealing with a single institution, especially one already conversant with condominium concepts and the project's documentation. Also, employment of the same lender on both construction and permanent financing enables the parties to avoid a second mortgage tax (in jurisdictions where a levy is made each time property is mortgaged) by splintering the building loan into individual unit liens as sales occur.³⁸ Consequently, it may be generalized that the narrowing of one's choice of mortgagee is not a serious objection to acquisition of a unit, provided, of course, the favored lender's terms are comparable to those prevailing in the local mortgage market.

Prohibitions against second mortgages and noninstitutional lenders, found on a lesser scale, are designed to reduce assessment defaults, disruptive mortgage foreclosures and evasion of condominium obligations. Thus, second mortgages are sometimes prohibited in order to prevent overextension of one's credit in acquiring or carrying a unit. The bar against noninstitutional mortgagees³⁹ is prompted by fear that private lenders will not be greatly concerned with the project's welfare and that of fellow mortgagees. Thus, a foreclosure action might be instituted by a private mortgagee as soon as possible after default. Moreover, collusion between mortgagor and mortgagee could underlie

³⁷ See Kerr, *Condominium, A Preview*, 16 ASS'N OF LIFE INS. COUNSEL PROC. 231, 286-87 (1962). This is a practice frequently employed by lenders in both the high-rise and lateral condominium project. Prospective purchasers sometimes are influenced not to resort to other lenders though such practices as accepting smaller down payments where the favored lender is employed.

³⁸ See Dukess Transcript, *supra* note 21, at 11.

³⁹ Thought should be given to the desirability of limiting the amount or type of mortgage on a unit. Some people in the field are of the opinion that one of the great benefits of a condominium is the preservation of the rule that each owner has a substantial equity investment which would thus tend to motivate the owner to act for the benefit of the building and further would tend to increase the financial stability of each unit owner by reducing the monthly carrying charges on his apartment. Some have suggested limiting mortgages to institutional first mortgages.

Id. at 14.

such a move, because forced sales are not subject to the restraints upon alienation and the purchaser on the sale receives the unit free of the obligation to pay past due association assessments.⁴⁰ While the two restrictions under discussion operate to circumscribe the unit purchaser's financing activities, the added protection they afford against detrimental activities of fellow owners may well be worth the price.

In order to gain a complete picture of the unit mortgagor-mortgagee relationship, counsel must consult the enabling legislation and project documents, in addition to the debt and security instruments.⁴¹ By way of illustration, several enabling statutes require concurrence of all lien holders for such major steps as dissolution of the venture.⁴² Similarly, the declaration and bylaws frequently confer additional powers upon unit mortgagees — for example, capacity to act as insurance trustee or hold office as a member of the board of managers. A common variant is found in projects wherein approval of lenders holding a specified fraction of all outstanding mortgages is required before important decisions may be implemented.⁴³ Also, there is no barrier to a lender exacting concessions from the borrower in the unit mortgage itself. Thus, the lender may insist that the mortgagor obtain its approval before voting on certain issues and surrender his vote to the mortgagee when behind in his mortgage payments. These provisions should not prove too burdensome, unless their cumulative effect is to vest decision-making power in the mortgagees, not the condominium's occupants.⁴⁴

While most unit purchasers will deal with knowledgeable lenders, some will labor under mortgage provisions which all but ignore the fact that the real property security is an integral part of a condominium venture. Lenders entering the field for the first time frequently employ forms intended for use in apartment house financing. Of necessity, such mortgages fail to cover several condominium features and occasionally contradict the declaration, bylaws or enabling statute. Accordingly, the lender's instruments should be reviewed to ascertain:

1. the rights of mortgagor, mortgagee and association of unit owners with respect to all aspects of casualty insurance, including mechanics of premium payment, adequacy of coverage,

⁴⁰ See 4 POWELL, *supra* note 24, at ¶ 633; Armstrong & Collins, *supra* note 21, at 694-95.

⁴¹ See Berger, *Condominium Primer for Fiduciaries*, 104 TR. & ESTATES 21 (1965).

⁴² See, e.g., ARIZ. REV. STAT. ANN. § 33-556 (Supp. 1973); MASS. GEN. LAWS ch. 183A, § 19 (Supp. 1974-75).

⁴³ Such provisions are treated at length in Kerr Transcript, *supra* note 20, at 24-26.

⁴⁴ See Mixon, *Apartment Ownership in Texas: Cooperative and Condominium*, 1 HOUSTON L. REV. 226, 254 (1964) [hereinafter cited as Mixon].

- mortgagee designation on policies, loss adjustment, and the lender's role in determining the use to be made of policy proceeds following a loss;
2. the mortgagee's right, if any, to control alteration and improvement of the mortgaged unit or other portions of the condominium;⁴⁵
 3. the effect of acts of waste committed by individuals other than the mortgagor;⁴⁶
 4. whether a prepayment penalty will be exacted if the project is terminated on a casualty loss, condemnation or voluntary dissolution;⁴⁷
 5. the effect of the mortgagor's breach of covenants contained in the declaration or by-laws but not found in the mortgage;⁴⁸ and
 6. the lender's rights in the mortgaged unit in the event of a default, as, for example, whether a power to appoint a receiver and collect rent pending sale on foreclosure will be applicable.⁴⁹

Surprisingly, many otherwise meticulous institutional lenders have left one or more of these areas uncovered in their condominium mortgage forms.

Title Insurance Coverage

Condominium offerings frequently contain a provision to the effect that a named title company will provide a fee policy at unit

⁴⁵ It would appear that this traditional prerogative of the mortgagee must give way to the statutory right of the association to direct improvement and repair of the property.

⁴⁶ The mortgagee of a cooperative enjoys some leverage over building maintenance, but a unit mortgagee has only a derivative control through the apartment owner. Although the lender might provide in the mortgage for acceleration of payments if waste is committed in the common areas, such a provision would be harsh on an otherwise current unit owner who, singlehandedly, could not have prevented the waste. Moreover, this drastic sanction would be unlikely, by itself, to improve maintenance.

Berger, *supra* note 27, at 1000. *But see* Kerr Transcript, *supra* note 20, at 25.

⁴⁷ A difficult problem of contract construction may be presented if the customary prepayment penalty clause, worded in terms of voluntary prepayment, is employed. The destruction of the building, taking under eminent domain, or dissolution by the vote of fellow owners may not constitute a voluntary termination and prepayment. Further, would the lender want the loan outstanding after the security has been eliminated?

⁴⁸ Condominium unit mortgages frequently contain a clause making breach of the provisions of the declaration or bylaws a default under the mortgage.

On the special relation which may exist between the lending institution and the individual unit owner, and the effect of that relationship on priorities, see *State Sav. & Loan Ass'n v. Kauaian Dev. Co.*, 50 Hawaii 540, 445 P.2d 109 (1968); 10 WM. & MARY L. REV. 760 (1969).

⁴⁹ See G. F. OSBORNE, HANDBOOK ON THE HOW OF MORTGAGES §§ 141-63 (1951).

closings, subject to exceptions listed in an appendix to the offering.⁵⁰ In some jurisdictions the cost of the title policy, borne by the purchaser, is equivalent to the "bulk rate" available on development homes after the insurer certifies title to the entire tract to the developer or construction loan mortgagee.⁵¹ In other states, the premium may equal or exceed that charged for title insurance on a comparable one family home, either because of tariff regulations or the additional work connected with approving condominium instruments.⁵²

The protection afforded by the title policy consists primarily of a guarantee that the insured will acquire fee title to his unit.⁵³ A survey of companies insuring condominiums reveals that policies except the declaration and bylaws from coverage. This, of course, is necessitated by the fact that the unit purchased is fully subject to them. Also, with this exception in the policy, the company does not warrant that provisions contained in the cited documents, for example, restrictions upon alienation, are valid and enforceable. It is an open question whether issuance of a unit fee policy is equivalent to certification that the project is a legally constituted condominium. Although title insurers thoroughly examine the declaration and bylaws prior to their recordation and make every effort to assist the developer in complying with the local statute, it would be a bold company which would warrant how a comparatively new enabling act will be interpreted by administrative agencies and the courts. It would appear that no cause of action

⁵⁰ In the offerings reviewed, the following constituted the typical exceptions:

- (1) zoning regulations and any future amendments thereto;
- (2) the terms, covenants and conditions of the declaration and bylaws;
- (3) any state of facts which an accurate survey of the apartment would show, provided such facts do not render the title unmarketable;
- (4) leases and license agreements of portions of the common elements (where the structure included one or more commercial units or facilities which formed part of the common elements);
- (5) easements in favor of owners of other units to use the pipes, wires, conduits, public utility lines and other common elements including those located in the insured's unit, and serving such other units, and easements of necessity in favor of other units or the common elements; and
- (6) easements in favor of adjacent units or the common elements for continuance of all encroachments resulting from the erection or settling of the building, or resulting from repairs, postcasualty reconstruction or alteration of the common elements, in that such encroachments may remain as long as the building remains standing.

⁵¹ For a projected savings to the unit owner, see Address by Carl D. Schlitt, May 11, 1964, in SYMPOSIUM ON THE PRACTICAL PROBLEMS OF CONDOMINIUM 27 (Transcript, Ass'n of the Bar of the City of New York 1964) [hereinafter cited as Schlitt Transcript].

⁵² See Kerr Transcript, *supra* note 20, at 21; Eagan, *Title Insurance for Condominiums*, 14 HASTINGS L.J. 210 (1963) [hereinafter cited as Eagan].

⁵³ See Eagan, *supra* note 52; Groszold, *The Modern Concept of Condominiums*, 47 LAW TITLE NEWS, Jan. 1968, at 83. However, New York title companies are also insuring compliance with the enabling act in their unit policies.

would accrue under a title policy as presently worded in the event the project failed to qualify as a condominium, provided, of course, that the insured was still recognized as having fee title to his unit.

As resales occur, some difficulties will stem from the fact that unfulfilled obligations may be traceable to three different sources: the unit vendor, the association and other unit owners. Title companies will certify that the seller is not delinquent in his taxes and condominium assessments, provided the necessary estoppel letter is furnished by the association or board of managers.⁵⁴ It is unlikely, however, that any guarantee will be given that the association is fully current in all its obligations. When the possessor of a cooperative apartment sells his stock and accompanying lease, it is not uncommon for the buyer to request a continuation search against the cooperative corporation owning record title.⁵⁵ But the condominium association does not own any portion of the realty, hence a search would be unavailing, except insofar as it disclosed judgments docketed against the association and delinquent franchise taxes (if the group were incorporated).⁵⁶ The association or board of managers may also have projected special assessments or incurred debts which have not as yet resulted in a lien. Not being of record, these items would be beyond the purview of the title policy.⁵⁷ Unit owners other than the seller will probably be regarded as adjoining landowners and therefore no search will be made against their properties.⁵⁸ Thus, an individual may purchase a unit in a condominium in which one or more fellow owners are delinquent in their taxes, mortgage payments or association assessments.⁵⁹ It should

⁵⁴ See Schlitt Transcript, *supra* note 51, at 32-33.

Extreme care should be exercised on the question of the actual ownership of fixtures and appliances, any liens that may have attached to them, and the seller's right to transfer them, remove them, or receive compensation for them (especially in view of the fact that they may possibly be treated as common elements or be pledged to the unit mortgagee).

⁵⁵ *Jervis, Problems in the Purchase of a Co-operative Apartment*, PRAC. LAW, Nov. 1959, at 83. The author points out that it is often difficult to ascertain the financial condition of the cooperative corporation. *Id.* at 84.

⁵⁶ Attorneys have sought to obtain a statement from cooperative housing corporations attesting that they have been legally formed, that their taxes have been paid and that there are no outstanding unpaid obligations. Teitelbaum, *Representing the Purchaser of a Cooperative Apartment*, 45 ILL. B.J. 420, 424 (1957) [hereinafter cited as Teitelbaum]. If possible, a similar certification should be obtained from the board of managers or condominium association.

⁵⁷ The prospective purchaser's posture here is similar to that of the home buyer unexpectedly saddled with a street, sewer or other public assessment which, although made public years earlier, did not become a lien until after closing of title.

⁵⁸ A neighboring unit owner's default can only affect the purchaser indirectly, through an increased annual assessment or special levy to make up deficiencies stemming from the default.

⁵⁹ If the mortgagee of the defaulting owner forecloses, the new owner and all other

be noted, however, that most of the foregoing omissions from coverage are found in any title policy, and that the reasons prompting purchase of title protection by the ordinary home buyer apply with equal, if not greater, force when a condominium unit is acquired.

Risk of Loss

Condominium "risk of loss" factual patterns will be complicated by the physical interdependence of units and the prevailing practice of insuring the entire project under a single master policy in lieu of multiple individual insurance contracts.⁶⁰ When risk is on the buyer, for example, he will be required to complete the purchase despite a casualty loss, and to rely upon the association to restore the premises with the proceeds of the master policy.⁶¹ Nor will an equitable settlement be assured by statutory or contractual provisions authorizing an abatement in price or rescission when the property is materially damaged or destroyed.⁶² If an abatement were decreed and a master policy in effect, the buyer would receive a windfall.⁶³ Further, would rescission or an abatement be warranted where the particular apartment was rendered uninhabitable, or depreciated, solely by virtue of destruction of other units or remote common elements? An even more subtle danger lies in the possibility that an uninsured or inadequately insured loss may necessitate a post-casualty assessment to restore units other than the one under contract.⁶⁴ A substantial burden will rest upon attorneys for the parties to anticipate these situations. As a minimum, the contract of sale should specify the rights of buyer and seller with respect to an abatement, rescission and repair assessment, should a casualty loss occur anywhere in the building prior to closing of title. It would also be advisable for the party shouldering the risk of loss to procure an interim casualty policy as additional protection.

OPERATIONAL PROBLEMS OF THE CONDOMINIUM

Professional versus Occupier Management

Management disputes have proved a perennial source of strife in housing cooperatives. In the post-war era, cooperators rebelled against unit owners will ordinarily be assessed an amount sufficient to make up the lost condominium assessment.

⁶⁰ See *Statutory Implementation, supra* note 22, at 36.

⁶¹ See Ellman, *Fundamentals of Condominiums and Some Insurance Problems*, 1963 C.C.H. Ins. L.J. 733-35; Kerr Transcript, *supra* note 20, at 22-24.

⁶² Few states have sought to enlarge the buyer's protection through enactment of the Uniform Vendor and Purchaser Risk Act. See 9C UNIFORM LAWS ANN. 194 (Supp. 1973).

⁶³ For the adjustments required when both the association and unit owner insure, see *Statutory Implementation, supra* note 22, at 37.

⁶⁴ "If overall insurance coverage is inadequate, the owners of units left standing will lose by pooling." See *Mixon, supra* note 44, at 252.

management companies saddled upon the project under long-term contracts entered into by the promoter.⁶⁵ Fortunately, condominium builders have not repeated this practice; the average span of management contracts executed by them is in the neighborhood of three years or less. As has been the case with proprietary lessees, condominium unit owners have also divided into warring pro- and anti-management factions, because of differences relating to fiscal policy.⁶⁶ Typically, one group favors expenditures for improvements to the property such as installation of self-service elevators, central air conditioning, etc., as well as for nonessential services such as doormen and handymen on 24 hour call. The opposing camp seeks to keep carrying charges to a bare minimum by paring expenditures wherever possible. These differences are reflected in each group's evaluation of the existing management company and ultimately in disputes over its retention. However, the threshold question whether to employ professional management will frequently be academic, in view of the insistence of both conventional mortgagees and the Federal Housing Administration that specialists be employed.⁶⁷ Further, the level of opulence on which a project is maintained will be dictated, not by the managing agent, but by the wishes of the unit owners possessing enough votes to control the condominium association or board of managers.⁶⁸ Hence, whether the project's assessments will remain in line with a prospective purchaser's standard of living turns not on the issue of professional versus do-it-yourself management, but on the income level and propensities of the majority of unit owners. Some advance indication of the standard which will typify the project may be gleaned from its location, unit prices and the facilities installed by the developer.

When management specialists are not mandatory under the declaration and bylaws, as is sometimes the case in small lateral and cluster

⁶⁵ See, Note, *Federal Assistance in Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 541, 584-88 (1959). Half of the section 213 FHA cooperatives built in New York City were involved in lawsuits concerning alleged abuses on the part of sponsors. *Id.* at 586.

⁶⁶ See Armstrong & Collins, *supra* note 21, at 694. In the case of a condominium, these disputes may not be as heated, however, since the condominium units are separately owned and financed. Accordingly, the parties will have less of a common interest in the project.

⁶⁷ See Kerr Transcript, *supra* note 20, at 25.

⁶⁸ The board of managers in a number of projects reviewed by the author were given authority to spend amounts ranging from three hundred dollars to fifty thousand dollars for community purposes without prior unit owner approval. The smaller authorization was typical of lateral and cluster condominiums, whereas the authority was increased in the high-rise developments. Under the terms of most project instruments, expenditures which must receive prior unit owner approval can usually be sanctioned by a majority, or in some cases two-thirds, vote of the membership.

arrangements, the purchaser is exposed to a more uncertain danger — inexperienced personnel. Shortsighted economies and outright mismanagement may produce a decline in essential services, amenities and, eventually, property values. Special assessments may become necessary to balance an unduly optimistic budget and a no-man's land created by a hypercautious board uncompensated and possibly underinsured which refuses to assume jurisdiction over a segment of the property or community problem.⁶⁹

Special Assessments

Unlike privately financed cooperatives, which have generally been populated by high income families, condominiums will be sold to all income groups.⁷⁰ As a consequence, it is essential that prospective purchasers recognize that their annual real estate taxes and condominium assessments will not remain constant. Moreover, extraordinary assessments may be voted by the association at any time. While the ordinary homeowner can postpone major capital outlays until such times as his budget permits, the condominium dweller is subject to assessment whenever an appropriate vote of his neighbors dictates. Rarely, if ever, do the declaration and bylaws require unanimous consent for sizable expenditures. Payment, moreover, is normally due between ten and thirty days after notification. This short grace period would, in itself, cause no hardship, if the necessary funds were readily available.⁷¹ Where borrowing is required, however, the unit mortgage probably would have to be refinanced or a personal loan obtained since institutional lenders could not take a second mortgage.

Included among the more common items necessitating a special assessment are: (1) post-casualty or post-condemnation repairs, when available insurance or other proceeds prove insufficient to meet restoration costs in full; (2) renovation and improvement expenses, particularly where a building dated by lack of modern conveniences has been converted into a condominium; (3) acquisition of individual units by the association, either through exercise of the right of first refusal or pur-

⁶⁹ A hidden danger may lie in the fact that funds received by the condominium association from operating or leasing of common facilities, for example, a restaurant or store, may constitute income to the unit owners even if retained by the association. See generally Anderson, *Tax Aspects of Cooperative and Condominium Housing*, N.Y.U. 25TH INST. ON FED. TAX. 79 (1967).

⁷⁰ See Welfeld, *The Condominium and Median-Income Housing*, 31 *FORDHAM L. REV.* 457 (1963).

⁷¹ The ban on second mortgages and noninstitutional mortgagees previously discussed, see text accompanying notes 39-40 *supra*, may prove embarrassing to the unit owner met by a sudden demand in the form of a special assessment.

chase on a foreclosure; (4) annual assessments uncollected by virtue of the defaults of one or more individuals; and (5) budget deficits traceable to operation of common facilities (a restaurant, swimming pool or stores), or to nonrecurring items of expense (such as litigation costs).

In reviewing the project's financial background, purchaser's counsel should inquire whether its proposed annual budget includes reserves for contingencies. Although such reserves are required in FHA condominiums,⁷² they are sometimes omitted in others. Finally, attention should be directed to the unit owner's obligations, if any, in connection with other structures in a multi-building, high-rise project, or subsequent sections of a lateral condominium being built and sold piecemeal.⁷³

Liability Exposure and Insurance

In addition to projections concerning annual and special assessments, the buyer will be vitally interested in blocking out his legal exposure, in terms both of contract and tort. In jurisdictions where the association of unit owners assumes a recognized format such as a corporation, not-for-profit corporation, membership corporation, or unincorporated association, counsel will be able to construct a fairly accurate picture of his client's future contractual liability.⁷⁴ In other states, such as New York, where the statute merely calls for a "board of managers,"⁷⁵ if project draftsmen do not specify the board's organizational structure, prophesy may be more difficult. The worst should be assumed, namely that each individual will be fully responsible for contracts of the board within the scope of its authority. Whether a unit owner may free himself of this obligation merely by paying his aliquot share (as fixed by the ownership ratio in the declaration), will depend upon the contents of local enabling legislation.⁷⁶

In the tort area, the co-owners of the land and buildings will be expected to bear full responsibility for injuries resulting from negli-

⁷² FHA Regulatory Agreement form 3278, reprinted in 1 P. ROHAN & M. RESKIN, CONDOMINIUM LAW AND PRACTICE § 904[5][b]. The FHA agreement form is promulgated pursuant to 24 C.F.R. § 234.24(f) (1974).

⁷³ See DEL. CODE ANN. tit. 25, § 2239 (Supp. 1971-72); PA. STAT. ANN. tit. 68, § 700.802 (1965); W. VA. CODE ANN. § 36A-8-1 (1966).

⁷⁴ Many attorneys feel that the corporate form is unattractive because of possible hidden income tax consequences. See Anderson, *Some Tax Aspects of the Condominium*, 1970 U. ILL. L.F. 220. For an analysis of the merits of the various management forms available, see Berger, *supra* note 27, at 1004-11; Hennessey, *Co-operative Apartments and Town Houses*, 1956 U. ILL. L.F. 22, 26-32.

⁷⁵ N.Y. REAL PROP. LAW § 339-v(a) (McKinney 1968), as amended, N.Y. SESS. LAWS [1974], ch. 1056, § 6 (McKinney).

⁷⁶ See 4A POWELL, *supra* note 24, at ¶ 633.25.

gence in construction or maintenance of common elements.⁷⁷ Moreover, vicarious liability may arise from acts or omissions of the condominium's board of managers and employees. However, the tort problems are reducible to a question of adequacy of the condominium's insurance program. Here it should be noted that in many projects the master liability policy does not protect individual owners if a lawsuit stems from alleged negligence within the confines of a unit. When coverage is so restricted, or the group liability policy is inadequate in amount or breadth of coverage, purchase of a supplemental individual policy, if not essential, is warranted. The same holds true when the master policy does not include, in clear terms, a waiver of the insurer's right to subrogation against individual unit owners, their household and servants.

If the purchaser contemplates playing an active role in direction of the project, care should be exercised to guarantee that the project's instrumentation exonerates the board of managers for all actions save wilful misconduct.⁷⁸ Before agreeing to serve, indemnification should be provided for board members, including counsel fees in litigation commenced by individual unit owners or third parties.⁷⁹

Casualty Insurance

Protection against fire or other casualty losses will ordinarily be purchased in the form of a master policy by the board of managers, with premiums forming part of the unit owners' annual assessments.⁸⁰ The association should, of course, take the necessary steps to acquire a policy suited to the condominium's needs and to prevent disruption of the insurance program by activities of individual owners. A unit purchaser, in turn, should analyze the master policy in order to determine if gaps in coverage exist. Thus, for example, the declaration

⁷⁷ See Rohan, *Perfecting the Condominium as a Housing Tool: Innovations in Tort Liability and Insurance*, 32 LAW & CONTEMP. PROB. 305 (1967); Schreiber, *The Lateral Housing Development: Condominium or Home Owners Association?*, 117 U. PA. L. REV. 1104, 1143-45 (1969). See *White v. Cox*, 17 Cal. App. 3d 824, 95 Cal. Rptr. 259 (Dist. Ct. App. 1971), wherein the court sanctioned a negligence suit brought by a unit owner against his own condominium.

⁷⁸ It is possible that the condominium's board members may be held to be in a position of trust and confidence vis-à-vis fellow unit owners, and therefore held to a fiduciary's obligations. This suggests the advisability of having full liability insurance coverage, with the board named as an additional insured.

⁷⁹ The experience of corporate officers and directors in connection with suits lodged against them for malfunction in office dictates that this exposure should be specifically covered in the project's declaration and bylaws.

⁸⁰ See Ellman, *Fundamentals of Condominiums and Some Insurance Problems*, 1963 C.C.H. INS. L.J. 733, 737. However, many town house condominium projects have made use of multiple individual insurance policies, with proof of effective coverage to be filed with the association or board.

and bylaws do not exempt unit holders from liability for assessments during a period of forced vacancy resulting from a casualty loss.⁸¹ Hence, the owner will have to pay for emergency shelter, while keeping current in his carrying charges and mortgage payments. This drain upon his resources should be offset by an individual policy or appropriate rider to the master policy. Installation of intra-apartment improvements and fixtures may warrant similar action.⁸² When purchasing separate coverage, the insured should specify that the subject matter of the policy is a condominium unit, or appendages thereto, and not a cooperative apartment or leasehold interest. Failure to make this fact clear to the broker and insurer may result in issuance of unsuitable coverage, with the defect remaining undetected until after a loss occurs.

Restrictions Upon Occupancy and Alienation

Even if the prospective purchaser contemplates indefinite occupancy of his unit, unforeseen events may necessitate its immediate resale. By way of illustration, divorce has prompted premature disposition of several units, often at a distress price.⁸³ Resale may also be brought about through a death in the family, sudden downturn in one's income, or other problems personal in nature. Accordingly, it is advisable to acquaint the purchaser with provisions restricting alienation of the condominium unit, as well as limitations placed upon occupancy. The former may make it difficult to obtain approval for the resale, and the latter may shrink the available unit-buyer market. Where such is the case, the wisdom of acquiring the interest should be reviewed.

Many condominium statutes permit reasonable restraints upon alienation, at least when they are not intended as a vehicle for discrimination based on race, creed, color or national origin.⁸⁴ Commonplace in cooperatives, such restraints are highly valued, perhaps in ex-

⁸¹ Declarations generally do not contain such an exemption, although it is sometimes found in proprietary leases. This coverage should be purchased by the individual unit owner if the master policy does not provide it. Further, the association should also procure loss of rental income insurance if commercial units are leased to tenants.

⁸² If fixtures and intra-apartment improvements were installed, and only a master policy in effect, the insurance proceeds would be distributed according to the ownership ratio contained in the declaration. Thus, the unit owner in question would receive no direct benefit from the insurance. Hence, it is advisable to procure additional individual coverage, if the master policy makes no allowances for intra-apartment improvements. This point is also of significance in lateral condominiums, such as town house arrangements, wherein a great spread in value may occur over the years, between units with the same undivided ownership fraction. See Armstrong & Collins, *supra* note 21, at 689.

⁸³ See Remarks of Scott Chandler, 3 AHB CONFERENCE 31 (1963).

⁸⁴ See 4 POWELL, *supra* note 24, at ¶ 633.15.

cess of their actual utility.⁸⁵ They usually are viewed as necessary in order to safeguard the social and economic structure of the project.⁸⁶ Although it does not entirely disappear, the economic interdependence factor diminishes in importance in the condominium, while the community harmony rationale is applicable equally to both forms of housing.

Restraints commonly found in condominium declarations of by-laws include: (1) a requirement that the association or board of managers approve any prospective purchaser;⁸⁷ (2) right of first refusal, whereby bona fide offers received by a unit owner may be matched by the association within a relatively short period, usually ten to thirty days after notification is given to the board of managers; or (3) a right to supply another purchaser who will meet the terms agreed to by the unit owner's prospect. The latter two restraints do not appear to be unduly burdensome. In fact, the right of first refusal will, in all probability, be rarely exercised, since the purchase price would have to be raised by means of a rather large assessment against the remaining unit owners. Moreover, if the unit were acquired, further assessments would be necessary in order to maintain it and to meet payment of real estate taxes pending its disposition.

The problems posed by the first restraint—a right to reject prospective purchasers—are much more serious. Many courts have enforced restrictions upon alienation of stock and accompanying proprietary leases.⁸⁸ At least one tribunal has indicated that the exercise of discretion to approve or disapprove is nonreviewable in the courts.⁸⁹ Perhaps the largest single drawback to vesting such power in the association or board of managers lies in the fact that most condominium statutes lack a provision (commonly found in cooperative housing projects)⁹⁰ authorizing individuals to surrender their units in return

⁸⁵ "Restrictions on sale of a cooperative apartment usually consist of a lease requirement that prospective purchasers be approved by resolution of the board of directors, by a specified percentage of the members of the board or by the holders of a specified percentage of the stock." *Statutory Implementation, supra* note 22, at 45.

⁸⁶ "The condominium's power to veto the admission of a new member has two professed aims: first, to reduce the risk of financial interdependence by excluding the economically unreliable; second, to promote the project's inner harmony by striving for compatible members." Berger, *supra* note 27, at 1018.

⁸⁷ It is essential in any resale that the buyer's attorney obtain a certification from the condominium association that the seller has fully complied with the mechanics of the restraint placed on alienation and that the instant sale is approved. In some instances, it may be possible to endorse this approval on the bottom of the contract of purchase.

⁸⁸ See *Statutory Implementation, supra* note 22, at 45 n.112.

⁸⁹ *Weisner v. 791 Park Ave. Corp.*, 6 N.Y.2d 426, 160 N.E.2d 720 (1959).

⁹⁰ See H. VOGEL, *THE CO-OP APARTMENT* 40 (1960).

for release from all future liability in connection with the venture.⁹¹ In a period of general economic slump or individual loss of income, a unit owner, otherwise solvent, may face financial ruin if tied to a condominium unit. Nevertheless, without the option to surrender his interest, the only way out of the dilemma is to find a purchaser and obtain the necessary approval. At this juncture, unlimited discretion with respect to buyer approval may prove a formidable obstacle.⁹²

Where restraints are placed upon the leasing of one's unit, the considerations mentioned above become relevant, since such limitations restrict the unit owner's mobility and capacity to respond to economic setbacks. Also to be considered are restrictions designed to preserve project homogeneity and to insure leisurely, noise-free living. Although such provisions constitute a strong selling point for the developer, they also serve to drastically shrink the resale market. Thus, for example, individuals purchasing town houses and detached homes in retirement colonies have experienced great difficulty in finding a buyer on resale. In many of these developments, units are limited to individuals fifty years of age or older, and persons meeting this requirement frequently have no desire to relocate in a project populated exclusively by this age group. Again, some condominiums prohibit occupancy by individuals under the age of fourteen. This type of restriction, for all practical purposes, limits the available resale market to single individuals, childless couples and to couples whose children have been reared.⁹³ Accordingly, a unit should not be purchased unless the client can foresee a reasonable opportunity to resell the interest, should such a course of action become necessary or desirable.⁹⁴

⁹¹ The New York statute attempts to resolve this problem by providing that the unit owner may not release himself from liability for common charges by waiving his right to use of the common elements or by abandoning his unit. However, if the bylaws so provide, he may convey his unit to the board of managers and thereby be relieved of liability for subsequent common charges. N.Y. REAL PROP. LAW § 339-x (McKinney 1968).

⁹² See Note, *Federal Assistance In Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 542, 610-11 (1959). In another connection, the note writer asserts:

Safeguards are needed, however, to preclude a discriminatory exercise of the directors' power resulting in the dispossession of an unpopular cooperator who happens to violate a minor occupancy regulation. The courts cannot be relied on to correct such abuses, because a lawsuit would be too costly, time-consuming, and unlikely to succeed.

Id. at 608-09.

⁹³ *Query*: Would such restrictions be upheld in the event a condominium unit owner gave birth to offspring? For a discussion of early cases and public policy factors to be considered see 2 R. BOYER, *FLORIDA REAL ESTATE TRANSACTIONS* 1545 (1964).

⁹⁴ On the possibility of entering into special contractual arrangements as to severance of parts of units, occupancy by others, etc., which agreements cannot later be rescinded by majority vote, see *Crossman v. Pease & Ellman, Inc.*, 29 App. Div. 2d 4, 284 N.Y.S.2d 751 (1st Dep't 1967).

MISCELLANEOUS CONSUMER PROTECTION CONSIDERATIONS

Implied Warranties of Fitness and Merchantability on New Condominium Units

Caveat emptor, let the purchaser beware, was a sacred cow of the common law. Unless there was fraud or deceit, or an express warranty of fitness, which the seller rarely gave, the homebuyer took the premises as he found them. If the roof leaked or the foundation crumbled, the seller could not be held accountable. But this is all changing rapidly. Since 1963, the common law rule has been abandoned and a number of courts have extended an implied warranty of fitness and merchantability to the purchaser of a new home.⁹⁵

In the Florida case of *Gable v. Silver*,⁹⁶ the implied warranty doctrine was applied in a suit against the builder of condominium apartments. The plaintiffs purchased new units in late 1966 and early 1967. Almost from the start, the air conditioning system failed to work properly, but when suit began in 1968, a one-year express warranty covering the system had already expired. So plaintiffs had to depend on an implied warranty of fitness. The trial court held that an implied warranty did exist as to the realty, and every integral part thereof, including the air conditioning. Even though the express warranty had already lapsed, the appellate court considered whether the homebuyer could sue on an implied warranty if he held an express warranty that carried the disclaimer: "This warranty is in lieu of all other implied and express warranties." Citing earlier cases involving the sale of chattels, the court concluded that the disclaimer would not be enforced.⁹⁷

There is some difficulty with that position, as the court itself acknowledged, since the Uniform Commercial Code permits a seller to exclude or modify the implied warranty of merchantability if he does so by a conspicuous writing.⁹⁸ However, the court avoided that difficulty by treating the air conditioning as realty, to which the Code does not apply. The court made sure, however, that homebuyers would enjoy the implied warranty, even as to fixtures, by stating that any disclaimer sanctioned by the Code would not cover sales of new housing, since a homebuilder is not a "merchant" or a dealer in goods to whom the Code's disclaimer of warranty provision would

⁹⁵ See McNamara, *The Implied Warranty in New-House Construction*, 1 REAL ESTATE L.J. 43 (1972), and *The Implied Warranty in New-House Construction Revisited*, 3 REAL ESTATE L.J. 136 (1974).

⁹⁶ 258 So. 2d 11 (Fla. Dist. Ct. App.), *aff'd*, 264 So. 2d 418 (Fla. 1972).

⁹⁷ *Id.* at 13-14.

⁹⁸ UNIFORM COMMERCIAL CODE § 2-316.

apply.⁹⁹ No distinction was drawn between the condominium developer and any other homebuilder with respect to duties owed to the unit purchasers.

Although the Florida case appears to be the first reported decision in which a condominium developer was held to have given an implied warranty of fitness, it is probable that in every state where the homebuilder carries that duty, so, too, does the condominium developer. Other states, however, may not follow Florida in barring a disclaimer of implied warranties when the buyer receives proper notice.

Questionable Building and Marketing Practices

Addressing the Third Annual Building Exposition and Congress, Ralph Nader recently predicted an upsurge in lawsuits against residential developers, including a sharp increase in class actions instituted by condominium boards and homeowner associations. A recent flurry of such class actions in New York would tend to support this view.¹⁰⁰ One area singled out for close scrutiny has been the unfair marketing tactic of understating projected operating expenses and carrying charges in order to make the project more attractive to potential purchasers. Other developers have separately metered water and utilities, as well as electric heat, in order to make such items personal expenses, thereby reducing the common charges. In some cases, this fact appears only in fine print, if it appears at all, in the promotional literature describing the condominium. Practices such as these recently caused a jury in Illinois to award damages against a developer whose understatement of common charges was found to be deliberate.

Condominium developers should be encouraged to obtain a projected budget and allocation of common charges from an independent expert prior to formulating advertising brochures. Preferably such an opinion should be sought from a management company with long experience in operating the type of property being marketed. Experienced developers in this area make due allowance for inflation in the cost of both goods and services, and then add an arbitrary ten percent to the budget for unforeseen contingencies, in order to provide an additional margin of safety. As an alternative, some developers guarantee the accuracy of the budget and monthly common charges for a period ranging from one to three years. While this approach may mani-

⁹⁹ 258 So. 2d at 17-18.

¹⁰⁰ See, e.g., *Richards v. Kaskel*, 32 N.Y.2d 524, 300 N.E.2d 388, 347 N.Y.S.2d (1973); *Tuvim v. 10 East 30 Corp.*, 32 N.Y.2d 541, 300 N.E.2d 397, 347 N.Y.S.2d 13 (1973); *Whalen v. Lefkowitz*, 44 App. Div. 2d 442, 335 N.Y.S.2d 592 (1st Dep't 1974).

fest good faith on the part of the sponsor, it would not constitute a complete defense if the first year's common charges turned out to be far in excess of his projections.

In fashioning promotional literature, developers should include common charges, debt service, real estate taxes, utilities, and heat and water charges in any overall estimate of monthly expenses, irrespective of whether any one or more of these items technically constitutes an individual expense. On a broader scale, each purchaser should be furnished a full-fledged offering plan, even in jurisdictions that do not require complete and adequate disclosure by statutory mandate or administrative regulations.

Several experienced developers have begun to experiment with specific warranties and "call back" procedures in order to avoid the inconvenience and expense associated with interminable and outdated construction complaints. In some instances these efforts have taken the form of a stipulated cutoff date for complaints and a contractual agreement that common area complaints may only be processed by the board of managers and not individual unit owners. This arrangement is sometimes coupled with an agreement to arbitrate differences between the developer and the board as to the responsibility for defects and how to go about repairing them. From the developer's viewpoint, by limiting the "call back" period to a reasonable time frame, he is in a better position to call upon the subcontractor responsible for the defect to make appropriate repairs. This is especially true where the complaint is received and processed before the developer has paid the final installment due the subcontractor under his contract.

The sponsor may also avoid unnecessary expense and criticism by requiring subcontractors and fixture suppliers to furnish a warranty that runs to the unit purchasers (or board of managers) as well as to the developer. Similarly, appliance warranties should begin to run from the date the purchaser acquires title to his unit, and not from the date the appliances are delivered in bulk to the construction site.

Developer's Compliance with Truth-in-Lending Regulations

If the developer becomes involved in the procurement of financing for the unit purchasers, he must contend with the disclosure requirements of the federal Truth-in-Lending Act.¹⁰¹ Charged with the responsibility of implementing the Act, the Federal Reserve Board formulated Regulation Z,¹⁰² which contains both disclosure requirements

¹⁰¹ 15 U.S.C. § 1601 *et seq.* (1970).

¹⁰² 12 C.F.R. § 226 *et seq.* (1973).

designed to give customers meaningful information about the cost of credit and cancellation features that give customers the right in certain instances to cancel the transaction.¹⁰³

The Board has recently explained some of the applications of Regulation Z to condominium sales.¹⁰⁴ There are primarily three fact situations which will bring the sponsor within the Act's coverage: (1) if he personally extends credit to the purchaser, *e.g.*, by providing a purchase-money mortgage, imposing a finance charge for the credit; (2) if he negotiates an installment sale contract in which the purchase price is payable in more than four installments; or (3) if he "arranges for the extension of credit," such as obtaining a commitment from a mortgage lender to provide the buyer's financing.¹⁰⁵

Although credit sales of condominiums will require full disclosure of credit terms, the consumer's "right of rescission" would not appear to be applicable. Section 125(a) of the Act gives the consumer the unqualified right to rescind a credit transaction within three business days if "a security interest is retained or acquired in any real property which is used or is expected to be used as the [consumer's] residence"¹⁰⁶ However, specifically excluded from the three-day cancellation provision is any sale involving "a *first lien* or equivalent security interest" on a residential dwelling.¹⁰⁷ Thus, first mortgages to finance the initial acquisition of a dwelling unit would not subject the sale to the buyer's right of cancellation.

Extensions of credit for business or commercial purposes are exempt from all provisions of the Act,¹⁰⁸ so Truth-in-Lending problems will arise most often in connection with residential condominiums. The presence of a few commercial buyers or lessees in a residential condominium probably would not be sufficient to exempt the project from coverage, hence the need for disclosure.

CONCLUSION

Traditionally, conveyancing has been considered an exacting task, whether viewed from the vantage point of representing the buyer

¹⁰³ For a thorough discussion of the Truth-in-Lending disclosure requirements and penalties for noncompliance, see Bowmar, *Truth-in-Lending: A Look at Some Real Estate Ramifications*, 34 ALBANY L. REV. 231 (1970).

¹⁰⁴ See Excerpts from Federal Reserve Board Public Position Letter No. 676 (Mar. 8, 1973), in 4 CCH CONSUMER CREDIT GUIDE ¶ 30,954 (1973).

¹⁰⁵ *Id.* Some of the situations in which a condominium developer might be found to be "arranging for the extension of credit" are suggested in Federal Reserve Board Public Position Letter of Dec. 8, 1970, in 4 CCH CONSUMER CREDIT GUIDE ¶ 30,619 (1973), and Federal Reserve Board Public Position Letter of Sept. 5, 1969, in 4 CCH CONSUMER CREDIT GUIDE ¶ 30,154 (1973).

¹⁰⁶ 15 U.S.C. § 1635(a) (1970).

¹⁰⁷ *Id.* § 1635(e) (emphasis added).

¹⁰⁸ *Id.* § 1603(l).

or seller. In the condominium context, counseling the unit buyer embraces still broader responsibilities. The purchaser's attorney will be dealing with a developer who is disinclined, if not prevented by law, from changing basic provisions of the offering to suit individual purchasers. Hence, the negotiation phase is narrowed, if not eliminated, and the decision becomes basically one of whether to go to contract. If the purchaser requires a remedy after he has taken title to his unit, his counsel should be aware that the field of condominium regulation has entered a new level of sophistication. State blue sky provisions, as well as a developing body of case law, must be considered. Furthermore, various federal regulatory provisions, applicable to condominium sales, add new dimensions to the responsibilities of the buyer's attorney. Counsel versed in the entire picture of condominium regulation and practice will be an invaluable asset to his present clients and much sought after by other prospective buyers.