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# CONDOMINIUM RENOVATION

Amy R. Piro\*

## I. Introduction

A condominium is a form of joint ownership of real property which has gained wide popularity in recent years.<sup>1</sup> It has been defined as "a system of separate ownership of individual units in multi-unit projects."<sup>2</sup> Each unit owner<sup>3</sup> has title to his unit in fee simple, and owns the underlying fee and common elements as a tenant in common with other unit owners. Ownership of the units in fee simple permits financing tailored to individual needs,<sup>4</sup> and minimizes the economic dependence of neighbors.<sup>5</sup> Nonetheless, many problems arise due to the physical interdependence of the fees. As a result, for a condominium arrangement to be feasible, the right and duties of unit owners with respect to the common elements must be clearly defined. Generally, an association consisting of unit owners is organ-

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1. 1 P. ROHAN & M. RESKIN, *REAL ESTATE TRANSACTIONS: CONDOMINIUM LAW & PRACTICE* § 9.02 (1974) [hereinafter cited as ROHAN]; Cribbet, *Condominium—Home Ownership for Megalopolis?*, 61 MICH. L. REV. 1207, 1210 (1963). This interest is primarily due to the Housing Act of 1961, which permits the Federal Housing Administration to insure condominium mortgages. Housing Act of 1961, Pub. L. No. 87-70, § 104, 75 Stat. 160.

2. 1 ROHAN § 1.01[1] (footnote omitted). "The term 'condominium' is sometimes used to denote the system of ownership, sometimes to denote the whole building committed to that system of ownership, and at other times to denote the individual unit with its appurtenant interest in the common elements. The context in which the term is used will denote which of the meanings is intended." *Id.* § 1.01 n.1 (emphasis omitted).

3. *Id.* See also *id.* § 1.01. Condominiums are usually apartment buildings in which the apartments ("units") are owned by their respective tenants ("unit owners"). Although condominium townhouses and commercial condominiums are becoming increasingly popular, this article is directed at renovation problems associated with residential apartment buildings organized as condominiums.

4. See *id.* § 9.01.

5. *Id.*; see Berger, *The Condominium-Cooperative Comparison*, 11 PRAC. LAW. 37, 38-39 (Jan. 1965).

ized to tend to administrative matters, maintenance, and allocation of common expenses.<sup>6</sup>

Although a condominium could probably be organized at common law,<sup>7</sup> all states, Puerto Rico, and the Virgin Islands have enacted enabling legislation.<sup>8</sup> These statutes authorize, and to varying degrees regulate, condominiums.<sup>9</sup> In addition, condominiums are also subject to the general property laws of the states.<sup>10</sup>

Moreover, condominiums are governed by contractual arrangements. Each unit owner has an individual deed to his unit,<sup>11</sup> which is subject to the "declaration," or master deed, an instrument which commits real estate to the condominium form of ownership.<sup>12</sup> It generally includes a description of the condominium,<sup>13</sup> and may also establish the method of sharing common expenses, set up an association of unit owners, and apportion voting strength among units.<sup>14</sup> A condominium is also subject to its bylaws—the set of rules and regulations which govern its internal administration.<sup>15</sup>

6. Cf. 1 ROHAN § 5.04.

7. *Id.* § 4.01; Cribbet, *supra* note 1, at 1212, 1216-18. "[T]he common law developed no aversion to separate floor or room ownership, and hence no special legislation is required to allow the creation of condominia in countries whose legal system is based on English law." *Id.* at 1212.

8. King, *Problems of Financing Condominiums*, 24 BUS. LAW. 445 (1969); see, e.g., CAL. CIV. CODE §§ 1350-70 (West Supp. 1974); CONN. GEN. STAT. REV. §§ 47-67 to -90 (1974).

9. See, e.g., N.Y. REAL PROP. LAW § 339-d-ii (McKinney Supp. 1974); 1A ROHAN apps. B-1-2.

10. See, e.g., N.Y. REAL PROP. LAW § 339-e(15); (McKinney Supp. 1974); CAL. CIV. CODE § 783 (West Supp. 1974); cf. 1 ROHAN § 1.01[2].

11. 1 ROHAN § 1.01[2].

12. See, e.g., CAL. CIV. CODE § 1355 (West Supp. 1974).

13. See, e.g., S.C. CODE ANN. § 57-504 (Supp. 1973).

14. See Rohan, *Drafting Condominium Instruments: Provisions for Destruction, Obsolescence and Eminent Domain*, 65 COLUM. L. REV. 593, 594 (1965).

15. 1 ROHAN § 7.03. The bylaws generally provide for the maintenance, repair, and replacement of common areas, use and maintenance of units, and requirements for modification of bylaws. *Id.* Many statutes enumerate certain items which must be contained in the bylaws. *Id.* at nn.22-23; see, e.g., OKLA. STAT. ANN. tit. 60, § 508 (1971); N.C. GEN. STAT. § 47A-18 (Cum. Supp. 1973). In addition to the above documents, some states also require that an offering plan be filed. See, e.g., N.Y. GEN. BUS. LAW § 352-e (McKinney 1968), as amended (Supp. 1974); 1 ROHAN § 7.02[2][c].

As a result of deterioration or obsolescence of premises, unit owners often decide to renovate. Their decision may raise questions significantly different from those encountered in dealing with ordinary condominium expenses. These include matters such as the required authorization, protection of dissenters' rights, and financing. This article will explore some of these problems and suggest possible solutions.

## II. Defining Renovation

Condominium legislation generally fails to differentiate between renovation and ordinary operating expenses. Due to the financial burden renovation places on unit owners, its impact on the quality of the condominium, and the conflict among unit owners which may result, renovation should be distinguished from ordinary repairs. In essence, renovation corrects obsolescence of a structure. A building may become obsolete through physical deterioration or functional obsolescence.<sup>16</sup> Physical deterioration includes normal wear and tear (1) to the structure due to the elements and traffic; (2) to internal mechanical equipment such as heating, plumbing, and electrical systems; and (3) to any other part of the condominium.<sup>17</sup> Functional obsolescence occurs where, due to advances in technology and changing concepts in building design and materials, a building or parts of it become outmoded. Examples may include a building without air conditioning or with an outmoded elevator.<sup>18</sup>

Another situation which may call for renovation is where a structural or mechanical feature does not operate as well as anticipated.<sup>19</sup> This occurs where "[s]torage spaces, laundry rooms, garage

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16. See 1 ROHAN § 12.03[1]; Comment, *The South Dakota Condominium Act: Problems of Termination, Obsolescence, Eminent Domain, and Repair*, 15 S.D.L. REV. 423, 431 (1970) [hereinafter cited as Comment, *Condominium Act*]. Depreciation of neighboring property values has been suggested as a third form of obsolescence.

17. See Knight, *Incorporation of Condominium Common Areas? An Alternative*, 50 N.C.L. REV. 1, 6-7 (1971) [hereinafter cited as Knight].

18. 1 ROHAN § 12.03[1]; Comment, *Condominium Act* 431.

19. Hennessey, *Practical Problems of Residential Condominium Operation*, 2 CONN. L. REV. 12, 25 (1969). Unit owners may have a cause of action against the developer for defects in the condominium. See *Gable v. Silver*, 258 So. 2d 11 (Dist. Ct. App.), *aff'd*, 264 So. 2d 418 (Fla. 1972) (implied warranty of fitness and merchantability extended to condomi-

spaces, recreation areas, pool areas and their related equipment . . . have inconvenient features or . . . [are] physically inadequate,"<sup>20</sup> or where the building's mechanical or electrical systems are defective.<sup>21</sup>

Even though a building is not functionally obsolete, defective, or suffering from physical deterioration, unit owners may nevertheless desire improvements or additions. While this type of major capital outlay is usually not regarded as renovation, it presents the same problems. It is often difficult to differentiate between a luxury expense and obsolescence. Those in favor of the proposed change will maintain that the building is obsolete, while those opposed will argue that the proposal is a frivolous luxury. Because of these problems, luxuries, improvements, and additions should be treated in much the same way as renovation.

Despite the inevitability of obsolescence and deterioration of the condominium structure, and the likelihood of conflict among unit owners, there is a surprising dearth of legal guidance as to how renovation problems should be resolved.<sup>22</sup> Notwithstanding a prolif-

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niums, permitting unit owners to recover for defects in air conditioning and heating systems); *Franzen v. Dunbar Builders Corp.*, 132 Ill. App. 2d 701; 270 N.E.2d 118 (App. Ct. 1971) (breach of contract action against builder for installing doors of inferior quality); *Edenfield v. Woodlawn Manor, Inc.*, 62 Tenn. App. 280, 462 S.W.2d 237 (Ct. App. 1970)(unit purchasers' recovery in breach of contract action against developer for defective air conditioning system). See also VA. CODE ANN. § 55-79.79(b) (Supp. 1974)(one year warranty for structural defects).

20. Hennessey, *supra* note 19, at 25.

21. *Id.*

22. In *Susskind v. 1136 Tenants Corp.*, 43 Misc. 2d 588, 251 N.Y.S.2d 321 (Civ. Ct. 1964), the only case uncovered by this author's research which had any bearing on the subject of condominium repairs, a tenant in a cooperative was held to have no obligation to repair the rotted underflooring and sleepers of his bedroom. It has been suggested that the court "intimated . . . that a contrary holding would result if a condominium unit owner were involved" since the court would not apply the condominium statute to the situation. 1 ROHAN § 12.03[2][b]. However, this seems to be grabbing at straws. The court merely recognized the distinction between cooperatives and condominiums and did not want to set a precedent whereby a condominium statute would influence the law on cooperatives. In Scotland, where flat ownership is common, each tenant owns the walls bounding his apartment, with the upper and lower occu-

eration of state condominium legislation, only four such statutes deal specifically with renovation.<sup>23</sup> Describing the remaining statutes, one authority has written:

[F]ew provisions detail rights and obligations where the entire project is in need of reconditioning. A similar though less complete gap appears in the treatment of additions and improvement; unit holders must piece together the probable legislative intentment from oblique references scattered throughout the applicable statute.<sup>24</sup>

Although renovation typically creates problems quite different in kind and degree from ordinary maintenance, most statutes fail to differentiate between the two. Many fail to mention renovation at all. Typical is the Federal Housing Administration Model Statute, after which numerous state statutes are patterned. It merely requires that bylaws provide for the "[m]aintenance, repair and replacement of the common areas and facilities . . . ."<sup>25</sup> Other statutes use such terms as "care, upkeep,"<sup>26</sup> "maintenance,"<sup>27</sup> "additions,"<sup>28</sup> and "improvements."<sup>29</sup> Despite the importance of renovation, and the special treatment it deserves, it is left to statutory interpretation whether authorization for renovation falls within the provisions dealing with ordinary maintenance.

A new Virginia statute specifically mentions "renovation," but treats it exactly like maintenance and repairs.<sup>30</sup> However, the stat-

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pants owning the roof and ground respectively. A cumbersome system of cross easements has resulted, with expenses such as roof repairs inequitably apportioned. Furthermore, control of the building is sacrificed. Welfeld, *The Condominium and Median-Income Housing*, 31 *FORDHAM L. REV.* 457, 462 (1963).

23. MASS. ANN. LAWS ch. 183A, § 18 (1969); OHIO REV. CODE ANN. § 5311.15 (Page 1970); OKLA. STAT. ANN. tit. 60, § 528 (1971); ORE. REV. STAT. § 91.660 (1) (1974); see 1 ROHAN § 12.03[2]; Comment, *Condominium Act* 423.

24. 1 ROHAN § 12.03[2][a].

25. FHA MODEL STATUTE FOR THE CREATION OF APARTMENT OWNERSHIP § 19(f), in 1A ROHAN app. B-3. Some statutes permit such provisions to be made in the declaration rather than bylaws. See CAL. CIV. CODE § 1355(b)(3) (West Supp. 1974).

26. D.C. CODE ENCYCL. ANN. § 5-914(a)(3) (1966).

27. CAL. CIV. CODE § 1355(b)(3) (West Supp. 1974).

28. PA. STAT. ANN. tit. 68, § 700.308 (1965).

29. *Id.*

30. VA. CODE ANN. §§ 55-79.79, -79.83 (Supp. 1974).

ute permits the condominium instruments to provide otherwise.<sup>31</sup> Other statutes, such as Puerto Rico's,<sup>32</sup> do not deal specifically with renovation but have mandatory provisions with regard to maintenance. Puerto Rico requires a majority of the owners to approve "necessary works for the maintenance of the property and for the adequate use of the elements . . . ."<sup>33</sup> Any work not falling within this provision must be approved by the unanimous consent of all unit owners.<sup>34</sup> It is unclear whether renovation would have to be approved unanimously or only by a majority vote.<sup>35</sup>

Most declarations and bylaws distinguish renovation costs from other expenses on the basis of the dollar amounts involved.<sup>36</sup> The greater the expenditure, the higher the percentage of votes required for approval.<sup>37</sup> As a result, treatment depends on the cost, rather than the nature of the expenditure. Clearly, this is not a helpful distinction. Repairs and renovation costing the same amount require the same number of votes. A series of minor renovation costs which are easier to get approved could result in a substantial increase in common expenses.<sup>38</sup> Even where the cost of a minor renovation is slight, it still may be regarded as unfair to burden a large minority with the added expense.

A more useful means by which regularly recurring expenses can be distinguished from extraordinary ones is by providing that expenses normally recurring within a stipulated period of time are ordinary repairs. All others would be treated as renovations. It would be appropriate to couple such a provision with a dollar minimum excluding certain minor, albeit unusual, expenses from the stricter renovation provisions.

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31. *Id.*

32. P.R. LAWS ANN. tit. 31, §§ 1291(n)-(p) (1967).

33. *Id.* § 1291(n).

34. *Id.*

35. The situation is complicated by section 1291(o), which permits an owner to undertake "urgent or necessary works of repair, safety or maintenance" for which he is entitled to contribution by co-owners. *Id.* § 1291(o). However, an owner does so at his own risk: section 1291(p) prohibits construction on a condominium that may affect the building's safety, solidity, or maintenance unless all co-owners consent. *Id.* § 1291(p).

36. 1 ROHAN § 12.03[2][b].

37. *See, e.g.*, 1A ROHAN apps. C-1, C-3.

38. To prevent this, a ceiling could be set on common expenses, but adjustments would have to be made for rising costs.

Renovation might also be defined as the correction of major physical deterioration and functional obsolescence of the condominium structure. Such a definition would be appropriate in statutes, and might be desirable in the bylaws or declarations of condominiums with only a few units. Condominiums with many units might well prefer as much precision as possible in defining renovation, using all or some of the foregoing provisions, in order to eliminate disputes and litigation.

### III. Authorizing Renovation

#### A. Conflicting Interests of Unit Owners

Whether renovation is needed, and what improvements should be made, are questions likely to cause disagreement among unit owners. Critical to whether a condominium will be renovated is the cost which ultimately must be borne by unit owners. In every condominium, due to the economic positions and personal preferences of unit owners, there will be some who are reluctant to bear the costs of renovation though others are willing to do so.<sup>39</sup> Some of the more affluent unit owners may have a preference for opulence; others may prefer to spend their money elsewhere or may be unable to afford the additional expenditures.

The possibility of neighbors materially increasing a unit owner's expenses by approving renovation is contrary to the condominium's purported advantage of permitting financing similar to private home ownership. The timing of renovation may also have important bearing upon the financial status of unit owners. As one authority has noted, "[w]hereas the ordinary home owner 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."<sup>40</sup>

At common law, when premises were jointly owned, a tenant could not be compelled to contribute toward improvements made on the property by his cotenant.<sup>41</sup> This prevented a cotenant from

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39. Wisner, *Financing the Condominium in New York: The Conventional Mortgage*, 31 ALBANY L. REV. 32, 42 (1967) [hereinafter cited as Wisner].

40. 1 ROHAN § 13.03[2].

41. *Id.* § 12.03[2]. This rule has been relaxed to the extent that a cotenant may get a lien for essential repair expenditures that he made. *Id.*



being "improved" out of his interest in the property.<sup>42</sup> Absent application of this common law rule, such a result is exactly what may happen to a condominium owner—he may be renovated out of his interest.<sup>43</sup>

On the other hand, failure to renovate may leave many of the unit owners dissatisfied with their apartments. Moreover, the value of the units is likely to decrease significantly while unit owners preferring renovation are forced to stand helplessly as their investments decline. They will be in the frustrating position of having the necessary money for their share of the desired improvement, but nevertheless being unable to make it—a dilemma private homeowners would not face. Thus, renovation may become a matter of bitter dispute in the absence of a manageable and equitable method of authorization.

### **B. Percentage of Votes Required to Authorize Renovation**

Statutes which specifically deal with the problem of renovation typically require a high percentage of votes for approval. For example, Oklahoma and Oregon require that ninety percent of the unit owners agree that a building is obsolete in order to authorize renovation,<sup>44</sup> and Ohio requires seventy-five percent.<sup>45</sup> Under Massachusetts law, seventy-five percent of the unit owners must agree to renovate in order for all owners to be liable for the expense;<sup>46</sup> if between fifty and seventy-five percent agree, they may do so at their own expense.<sup>47</sup>

When fixing the percentage of votes required to authorize renovation, whether in a statute, declaration, or bylaw, a number of factors should be considered. First, the more the requisite percentage de-

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42. *Id.*

43. Arguably, in the absence of a statutory or contractual provision to the contrary, this common law rule could still apply to common elements jointly owned by unit owners. *Id.* § 12.03[2]. However, provisions in statutes and bylaws authorizing the management or association of unit owners to make repairs and assess owners would supersede the common law in most cases.

44. OKLA. STAT. ANN. tit. 60, § 528 (1971); ORE. REV. STAT. § 91.660(1) (1974).

45. OHIO REV. CODE ANN. § 5311.15 (Page 1970).

46. MASS. ANN. LAWS ch. 183A, § 18(b) (1969).

47. *Id.* § 18(a).

viates from unanimity, the greater the likelihood is that expenses will exceed the financial resources of less affluent owners;<sup>48</sup> the closer to unanimity, the greater the danger that the renovation decision is being made by the least affluent and most irrational owners.<sup>49</sup> Thus, a balance must be reached.

The percentage of votes required should depend to some extent on the size of the condominium involved. If the condominium consists of a small number of units, then unanimity—or something close to it—may be desirable. Where the condominium consists of numerous units, a unanimous—or close to unanimous—vote might be difficult or even impossible to obtain.

The percentage of votes required should also be a function of the type of renovation involved. The strongest argument can be made for renovation to correct physical deterioration. Due to the nature of condominium ownership each unit owner's fee depends on the existence of the building. When the building's structure is seriously declining, those opposing renovation could effect the destruction of the fee interests of other unit owners, as well as their own.

Even if the physical existence of the building is not threatened, unit owners will find their fees valueless if certain essential systems such as plumbing and electricity are not functioning. Furthermore, the facility is something everyone bargained for and expected, but a physical defect may render it less useful than originally anticipated. For example, fees will be less desirable if existing amenities such as air conditioning or swimming pools are inoperative. When authorization for such renovations is withheld, the value of all unit owners' interests is reduced. Therefore, it is not unfair to burden unit owners with these reasonably anticipated expenses. It follows that a low percentage of votes should be required for approval in such situations.

If certain features of a condominium have become functionally obsolete, as in the case of a building without air conditioning or with outmoded elevators, pro-renovation unit owners may argue that their apartments had a particular competitive advantage which they have a right to maintain. Anti-renovation unit owners, on the other hand, may feel that the building need not reflect changing

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48. See 1 ROHAN § 12.03[3].

49. *Id.*

standards of living, and since pro-renovation unit owners could move into other condominiums with the desired features, they should not be allowed to renovate the condominium at the expense of anti-renovation owners. As a result, a higher percentage of votes may be desirable to authorize correction of functional obsolescence than to correct physical deterioration or defects.

A high percentage of votes is also justifiable where a luxury expense is being proposed. The proponents would be changing the character of the condominium to one of greater affluence rather than remedying any deterioration in the facilities. As a result, dissenters should be protected.

When a building is being renovated, luxury expenses often may be less expensive if included in the renovation, rather than being done separately. If their inclusion is considered, a vote should first be taken on whether to renovate (presumably requiring a lower percentage), and then a second vote taken to determine if the luxury should be included (presumably requiring a greater percentage of votes than for the renovation decision). The same two part voting scheme can be used if correction of functional obsolescence could be achieved in conjunction with remedying physical deterioration.

The type of condominium and the economic status of its owners should also be considered in fixing the exact percentage of votes required in each instance. In a luxury condominium, where unit owners are affluent, the percentage may be relatively low because the expense is unlikely to cause hardship, and owners could reasonably expect the luxury quality of the building to be maintained. On the other hand, higher percentages are reasonable with low and middle income condominiums.

Since differing percentages may be desired depending on the type of condominium and the type of renovation involved, statutes should not freeze the percentage to any fixed number. They must be flexible, so that percentages can be tailored to the needs of individual condominiums and particular renovation proposals. In the absence of a governing clause in the declaration or bylaws, an appropriately flexible formula which takes into account the above considerations should be provided by statute.

The foregoing discussion has assumed that only unit owners will have the opportunity to approve renovation. However, it may be desirable to permit others with an interest in the condominium, such as first lienholders and mortgagees, to have a voice in the

matter. This has been done in at least one condominium, where improvements costing more than \$50,000 must be approved by "more than 50% of total authorized votes of those [voting] . . . and by all mortgagees holding mortgages constituting first liens upon 25 or more apartment units . . . ."<sup>50</sup>

#### IV. Financial Aspects of Renovation

##### A. Liability for Costs of Renovation

Once a renovation project is authorized, its cost is usually included in the common expenses which are paid by the unit owners.<sup>51</sup> There are various methods of allocation. Some statutes permit the method to be set forth in the declaration or bylaws,<sup>52</sup> while others provide for proportionate liability. Generally, these latter statutes provide that a unit owner's liability be based on his interest in the common elements.<sup>53</sup> This interest is based on the value of his unit as a percentage of the value of the entire condominium.<sup>54</sup> Under some statutes, unit owners may be required to contribute equally.<sup>55</sup>

When expenses are borne on the basis of the unit as a percentage of the value of the entire condominium (the sum of the values of all units), a definition of value must be determined. The easiest way is to state the value of each unit in the declaration, generally the unit's purchase price. However, since relative values of individual apartments may fluctuate, *e.g.*, due to changing tastes, original prices do not necessarily reflect the subsequent relative values of units. As a result, provision for periodic reappraisals should be made.<sup>56</sup>

Moreover, while units with better views or locations may cost

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50. See 1A ROHAN app. C-1.

51. MASS. ANN. LAWS ch. 183A, § 18(b) (1969); ORE. REV. STAT. § 91.660(1) (1974).

52. See, *e.g.*, FLA. STAT. § 711.08(g) (Supp. 1974); R.I. GEN. LAWS ANN. § 34-36.20 (1969).

53. See, *e.g.*, CONN. GEN. STAT. ANN. § 47-76 (Supp. 1974); IND. ANN. STAT. § 32-1-6-11 (Burns 1973); 1 ROHAN § 6.03[1] nn.2 & 4.

54. 1 ROHAN 6.03 [1] nn.4 & 5; see, *e.g.*, CONN. GEN. STAT. ANN. 47-76 (Supp. 1974); MASS. ANN. LAWS ch. 183A, § 6(b) (1969); PA. STAT. ANN. tit. 68, § 700.311 (1965).

55. See 1 ROHAN § 6:01[3]; *cf.*, *e.g.*, CONN. GEN. STAT. ANN. § 47-74 (b)(1) (Supp. 1974); ILL. ANN. STAT. ch. 30, § 309 (Smith-Hurd 1969); MASS. ANN. LAWS ch. 183A, § 5(a) (1969).

56. See, *e.g.*, CAL. CIV. CODE § 1353 (b) (West Supp. 1974).

more, they are no more expensive to maintain. As a result, it may be fairer to allocate renovation expenses on the basis of proportionate floor space.<sup>57</sup> However, many aspects of renovation (such as a new lobby or swimming pool) do not benefit the owner of a larger or more expensive unit more than others. It would therefore appear more equitable to divide such expenses equally, rather than on a pro rata basis.<sup>58</sup> Consideration also should be given to charging common expenses only to those unit owners benefiting from the undertaking in situations where it benefits less than all.<sup>59</sup> Thus, depending on the type of renovation involved, expenses could be allocated according to floor space, benefits received, or equally.

Generally, once renovation costs are included among the common expenses, anti-renovation unit owners are liable for their share of the expense.<sup>60</sup> Both Oregon and Oklahoma, in provisions dealing specifically with obsolescence, provide that upon proper authorization to renew and restore the property all unit owners must pay the cost as a common expense.<sup>61</sup> Ohio and Massachusetts are notable in that they give dissenters certain rights and protections. Under Ohio law, the declaration may permit a dissenting unit owner to elect to have his unit purchased by the association.<sup>62</sup>

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57. See 1 ROHAN § 6.01[4] for a discussion of statutory approaches toward reappraisal.

58. Gregory, *The California Condominium Bill*, 14 HASTINGS L.J. 189, 201 n.25 (1963). This approach has been adopted in Virginia. VA. CODE ANN. § 55-79.83(c) (Supp. 1974) provides that common expenses be apportioned in accordance with the voting strength of a unit. Under the statute, voting strength is proportionate to the size of a unit. *Id.* § 55-79.77. See also N.Y. REAL PROP. LAW § 339-i(1) (McKinney 1968).

59. This approach is permitted by the Virginia statute. See VA. CODE ANN. § 55-79.83(b) (Supp. 1974).

60. 1 ROHAN § 6.02[2]. Generally, statutes provide that payment of common expenses cannot be avoided by waiving a right to use the common elements. *Id.*; see, e.g., ARK. STAT. ANN. § 50-1017 (1971); CONN. GEN. STAT. ANN. § 47-78 (Supp. 1974).

61. OKLA. STAT. ANN. tit. 60, § 528 (1971); ORE. REV. STAT. § 91.660(1) (1971).

62. When a dissenter's unit is sold, his interest in the common area should be included as well, so that ownership of the unit and common areas is not divided. Kreider, *The Ohio Condominium Act*, 33 U. CIN. L. REV. 463, 479-80 (1964).

As has been previously noted,<sup>63</sup> Massachusetts provides that if between half and three-quarters of the unit owners authorize an improvement, they may do so at their own expense.<sup>64</sup> This provision:

may discourage unit owners from voting in favor of the improvement in the hope that a less-than-three-quarter majority will result which will bear the entire cost alone. But, since such a majority is not bound to proceed, it is doubtful whether improvements will be made without seventy-five per cent agreement.<sup>65</sup>

If three-quarters or more of the unit owners agree to make an improvement, then all must share the expense.<sup>66</sup> However, if the cost exceeds ten percent of the then value of the condominium, dissenting voters may require the association to purchase their units at their fair market value.<sup>67</sup> This is intended to prevent a unit owner from being improved out of his interest, although it may be possible to circumvent the statute by spreading the cost over the course of successive years.<sup>68</sup>

The basic drawbacks to a provision permitting dissenters to sell their units to the condominium are that the association must repurchase when it is seeking to raise funds, and the number of owners requesting appraisal is unknown until after the vote is taken.<sup>69</sup> In light of this, it is advisable to permit reconsideration of the improvement decision if the cost of buying dissenters' interests materially alters financing.<sup>70</sup> Since the extent to which dissenters should be protected depends upon the same factors discussed above with respect to voting requirements,<sup>71</sup> it is best to have statutorily imposed provisions only in the absence of formulas in bylaws or declarations.

## B. Financing the Cost of Renovation

The availability of adequate financing is critical to condominium renovation. Two basic approaches are group and individual

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63. See text accompanying note 47 *supra*.

64. MASS. ANN. LAWS ch. 183A, § 18(a) (1969).

65. Note, 77 HARV. L. REV. 777, 781-82 (1964).

66. MASS. ANN. LAWS ch. 183A, § 18(b) (1969).

67. *Id.*

68. PRACTISING LAW INSTITUTE, COOPERATIVES AND CONDOMINIUMS 303 (J. McCord ed. 1969).

69. 1 ROHAN § 12.02[4].

70. *Id.*

71. See text accompanying notes 48-50 *supra*.

financing: unit owners can obtain financing as a group, or each can be assessed his share of the expenses and arrange individual financing.

### 1. Individual Financing

While the possibility of individual financing of a unit's purchase price is one of the attractive features of condominium ownership, considerable problems are encountered in the case of renovation expenses. The chief problem is an inability to obtain a second mortgage. In many jurisdictions institutional lenders may not invest in a second mortgage on a condominium unit.<sup>72</sup> Since most units will already have a first mortgage for the purchase price, unit owners will be unable to raise additional mortgage funds for renovation. The reason for prohibition of a second mortgage is apparently to prevent the overextension of credit<sup>73</sup> and "ensure that each owner has a substantial investment in equity and pride of ownership, and to prevent private lenders from foreclosing without regard for the effect this might have on the project."<sup>74</sup>

The prohibition against institutions making second mortgages is often coupled with a ban on noninstitutional mortgagees.<sup>75</sup> This is because a private mortgagee, who is relatively unconcerned with the welfare of the building as a whole, is more likely to foreclose. There is also the danger of collusion between mortgagor and mortgagee, since a forced sale is not subject to restraints on alienation and the purchaser receives the unit free of past due association assessments.<sup>76</sup>

A contractor may renovate the condominium, relying for payment on the monthly or periodic assessments against unit owners. In such a situation he is dependent upon the financial responsibility of the condominium owners or their equity positions.<sup>77</sup> In many jurisdictions work performed on common elements can be the basis of a

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72. See, e.g., N.Y. REAL PROP. LAW § 339ff(b) (McKinney 1968); 1 ROHAN § 13.02[4][a].

73. 1 ROHAN § 13.02[4][a].

74. Wisner 42.

75. 1 ROHAN § 13.02[4][a].

76. *Id.*

77. Berger, *The Condominium-Cooperative Comparison*, 11 PRAC. LAW. 37, 41 (Jan. 1965).

mechanic's lien against the condominium so long as the work was duly authorized by the condominium's management.<sup>78</sup> Under some statutes a unit owner is permitted to remove the lien from his unit if he pays the proportionate amount due attributable to his unit.<sup>79</sup> In various other states, a mechanic's lien will not arise under these circumstances, but common charges due or received constitute a trust for payment of the expenses, provided the work was duly authorized.<sup>80</sup> This method of financing may be undesirable to the contractor, who may regard it as too risky or may be unwilling or unable to wait for periodic payments.

Where the contractor wants his money immediately and a second mortgage cannot be obtained, unit owners must either refinance their mortgages, get unsecured personal loans, or liquidate personal investments.<sup>81</sup> If the renovation cost is included in common expenses, unit owners often have only a short period in which to raise funds.<sup>82</sup>

## 2. Group Financing

In light of the burden renovation costs place on unit owners if personal financing is attempted, owners may consider group financing as an alternative. As with individual financing, mortgaging the property is an attractive method. However, a blanket mortgage, *i.e.*, one which covers the entire condominium project, faces statutory roadblocks in many jurisdictions.<sup>83</sup> In some, blanket mortgages

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78. See CAL. CIV. CODE § 1357 (West Supp. 1974); D.C. CODE ENCYCL. ANN. § 5-925 (1966); PA. STAT. ANN. tit. 68, § 700.704 (1965).

79. See CAL. CIV. CODE § 1357 (West Supp. 1974); D.C. CODE ENCYCL. ANN. § 5-925 (1966).

80. See, *e.g.*, N.Y. REAL PROP. LAW § 339-1 (McKinney 1968).

81. 1 ROHAN § 12.03[4][a].

82. Wisner 42. In reference to the New York law, it has been stated that "it appears clear that the statute contemplates that 'additions and improvements' to the common elements would be financed as common expenses of the condominium." Kerr, *Problem of the Mortgage Lender*, 11 PRAC. LAW. 55, 63 (Jan. 1965).

83. "The condominium statutes generally severely restrict blanket mortgages on the condominium." Zinman, *Condominium, A Re-View*, 23 ASS'N LIFE INS. COUNSEL PROC. 205, 233 (1973) [hereinafter cited as Zinman].



must be first liens.<sup>84</sup> New York achieves a similar result by limiting institutional lenders to first mortgages,<sup>85</sup> and adds a further barrier to this method by prohibiting any lien against common elements unless unit owners unanimously consent.<sup>86</sup> In Pennsylvania, a management association does not have the power to execute a mortgage.<sup>87</sup> Such restrictions help prevent foreclosure on a unit owner's interest for acts or defaults of others.

Numerous suggestions have been made to circumvent these prohibitions and restrictions. The most direct solution is statutory change. It has been suggested with respect to the statutes that they

might be amended to permit blanket mortgages upon a vote of say, 80% of the unit owners, with an overall limitation on the amount of such mortgages, expressed in terms of actual dollars or a percentage of the cost or assessed valuation of the condominium.<sup>88</sup>

The high percentage is presumably designed to protect dissenters. If that is so, the votes necessary to approve the renovation should be the same as that required for approval of the blanket mortgage. A further reason for identical percentage requirements is that the financial burden is likely to be greater without the blanket mortgage than with it.<sup>89</sup> In order to protect an owner from being cut off by foreclosure of the blanket mortgage due to acts and defaults of others, the statute can provide that a unit may be released from the lien upon payment of the appropriate fractional share.<sup>90</sup>

One way to obtain a group mortgage is to incorporate the common elements.<sup>91</sup> Under such a plan, unit owners would own shares in the corporation in proportion to their interests in the common elements.

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84. See, e.g., N.J. STAT. ANN. § 46:8B-23 (Supp. 1974).

85. N.Y. REAL PROP. LAW § 339-ff(b) (McKinney 1968). See also *id.* § 339-r.

86. *Id.* § 339-l.

87. Comment, 8 VILL. L. REV. 538, 548 (1963). The council can only raise money through assessments. PA. STAT. ANN. tit. 68, § 700.306 (1965).

88. Zinman 234.

89. The arguments against fixed statutory percentages set forth with respect to authorization for renovation apply with regard to authorizing blanket mortgages as well.

90. See N.J. STAT. ANN. § 46:8B-23 (Supp. 1974).

91. See Note, *Condominium: Incorporation of the Common Elements—A Proposal*, 23 VAND. L. REV. 321 (1970).

The corporation could then obtain a mortgage.<sup>92</sup> However, before this could be attempted, numerous statutory changes would have to be made.<sup>93</sup> A further drawback is that the maximum amount of mortgage money an owner could get for his unit (to finance its purchase) would be substantially lower, since the mortgage would be secured only by the unit, and not by any interest in the common elements.<sup>94</sup> Still another drawback is that under this financing scheme a condominium would become more like a cooperative, with accompanying difficulties in refinancing upon resale.<sup>95</sup>

Rather than having a corporation own the common elements, it has been suggested that a corporation be formed to administer the affairs of the condominium.<sup>96</sup> Each unit owner would have shares in proportion to his interest in the common elements. The common areas would then be leased to the corporation on a long term basis. The corporation could make lease payments to the individual unit owners, and would charge each owner for maintenance costs. The corporation would then be able to obtain a leasehold mortgage. The advantage of this method is that it could probably be accomplished within existing statutory frameworks.<sup>97</sup> Since a unit owner would retain title to common areas, his own mortgage could be secured by the common areas as well as his own unit, so long as the lease were subject to the mortgage.<sup>98</sup>

Another method to obtain the advantages of a mortgage is through a sale leaseback arrangement.<sup>99</sup> To do this, the institutional

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92. However, a mortgagee would only lend upon the common areas in proportion to their value, normally determined by capitalizing rental income. In order to do this, common areas would have to be leased to the condominium association at substantial rent, producing possibly adverse tax consequences.

93. For example, statutory changes might have to be made to (1) permit conveyance of common areas to the corporation; (2) permit common element corporation shares to be characterized as real property; and (3) allow property tax assessments on common areas to qualify as corporate liabilities. See Knight 8-9.

94. *Id.* at 10. The common elements can equal twenty-five to fifty percent of the value of a project. *Id.* Theoretically, a loan could be secured by the shares, but this is apparently impractical. See *id.*

95. *Id.*

96. *Id.* at 11.

97. *Id.* But see note 92 *supra*.

98. Knight 11-12, 14.

99. Zinman 234.

lender must own the land before units are sold, and lease it to the condominium association. Unit owners would get a leasehold interest in the land, and use this interest to secure a mortgage. One problem with this solution is that unit owners are probably unable to deduct real estate taxes.<sup>100</sup> Another more serious problem is that a leasehold condominium is probably not permitted in numerous jurisdictions.<sup>101</sup> Also, this method can be used only when a condominium is first organized. Once the condominium regime has commenced, a leaseback arrangement would be difficult to implement, because all unit owners must consent to the conveyance of their interests in the land to the lender, and most statutes prohibit the separation of interests in units from common elements.<sup>102</sup>

Still another approach is to separate only some of the common elements, such as recreational facilities, and lease them to the condominium owners.<sup>103</sup> The utility of this solution is uncertain, since it raises additional questions:

[T]here are problems, such as whether any resulting break in the contiguity of condominium property is permitted; whether rent payable under property leased to the condominium is a common charge subject to being enforced by the association's lien; and whether local regulatory agencies will permit the long term lease.<sup>104</sup>

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100. *Id.*

101. *Id.* In Florida a leasehold condominium is expressly permitted, provided the term of the lease is in excess of ninety-eight years. FLA. STAT. ANN. § 711.08 (Supp. 1974).

102. D.C. CODE ENCYCL. ANN. § 5-907 (1966).

103. Zinman 235.

104. *Id.* (footnotes omitted). One suggestion (made with respect to Pennsylvania law) to facilitate financing where the council does not have the power to execute a mortgage is to temporarily terminate the condominium regime. Comment, 8 VILL. L. REV. 538, 545 (1963). Upon termination, unit owners become tenants in common. See PA. STAT. ANN. tit. 68, § 700.602 (1965). A problem arises since a majority of unit owners may provide for renovation, *id.* § 700.302, whereas termination requires unanimity. *Id.* § 700.601. It has been suggested that "[a] court might be able to find that the need to maintain the condominium for the benefit of all the unit owners implies a power to mortgage and to subordinate other liens." Comment, 8 VILL. L. REV. 538, 549 (1963). The danger of such termination is that under various statutes a unit owner could demand sale of the property and unit mortgagees could call their loans. 1 ROHAN § 12.03[4][a]. Also, any subsequent unit mortgage would be a second mortgage. *Id.*

Due to the difficulties of securing a mortgage to finance renovation costs, a condominium venture must raise funds through reserves, special assessments, or short term unsecured borrowing, or contractors must depend on the financial responsibility of the condominium owners or their equity positions.<sup>105</sup> Of these solutions, setting up reserves is perhaps the most effective.

Under the reserve method, a portion of the common expenses, payable by each unit owner on a periodic basis, would be set aside and used to cover future renovation costs. Assessments for renovation could be decreased or eliminated once a sufficient reserve has accumulated.<sup>106</sup> There appear to be no statutory barriers to this arrangement. Indeed, reserves for deterioration and obsolescence are expressly permitted by some state laws.<sup>107</sup>

The drawback of a reserve requirement is that periodic assessments are increased.<sup>108</sup> Since this will tend to make the condominium less marketable, developers may be reluctant to provide for reserves in the original declaration or bylaws. While reserves may be set up once the condominium is in operation, unit owners may not have the foresight or may be unwilling to spend the money to do so. A further shortcoming is that reserve funds must be invested pending disbursement, and how they are invested may cause dissent and place a greater fiduciary responsibility upon management.

## V. Conclusion

For condominiums to continue to be a popular and desirable form

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105. Berger, *The Condominium-Cooperative Comparison*, 11 PRAC. LAW. 37, 41 (Jan. 1965).

106. 1 ROHAN § 12.03[4][a].

107. CONN. GEN. STAT. ANN. § 47-80(b)(12) (Supp. 1974); N.Y. REAL PROP. LAW § 339-v(2)(b) (McKinney 1968). One of the requirements to be met in order for a condominium to qualify for Federal Housing Administration insurance is that certain reserves be set up. See 1 ROHAN § 9.04[5]; cf. 12 U.S.C. § 1715Y (1970). The FHA requires that two funds be established. One is for replacement of structural elements and mechanical equipment. Disbursements can be made from this fund only upon the written consent of the FHA Commissioner. The second fund is an operating reserve which is maintained by monthly allocations, the amounts to be determined from a stipulated formula. See generally 1 ROHAN § 9.04[5].

108. Drawbacks involving reserve requirements in condominiums are briefly discussed in 1 ROHAN § 12.03[4][a] n.13.

of ownership, satisfactory ways must be found for dealing with the inevitable problems of deterioration and obsolescence. Present law does not adequately distinguish between renovation expenses and those arising from ordinary maintenance and repairs. Renovation deserves separate treatment because of the magnitude of the impact it will have on condominium life and its significant effect on the finances of the unit owners. Renovation will change the quality of the condominium in terms of convenience, utility, and appearance. Furthermore, if the building is old enough, failure to renovate may threaten its very existence. As a result, statutes and bylaws should differentiate between renovation expenses and those arising from ordinary maintenance and repairs, and should permit special authorization and financing arrangements for renovations.

The percentage of votes appropriate to authorize renovation should depend on (1) the number or units; (2) the type of condominium; (3) the kind of renovation proposed; and (4) the rights, if any, afforded dissenters. Statutes should not freeze the number of votes to a fixed percentage. They should be flexible to permit declarations or bylaws to set forth a percentage tailored to the particular needs of each condominium. It would be appropriate for statutes to set forth a formula in the absence of a provision in the declaration or bylaw.

Financing renovations presents serious problems due to difficulties in obtaining mortgages. Removal of the many statutory roadblocks to group and individual financing is necessary and desirable if renovation is to be allowed to further the interests of unit owners, rather than exposing them to serious and unanticipated problems. Only through such reform can condominium owners be adequately protected.