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Introduction

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In the last few years, the condominium has moved from relative obscurity to center stage in the overall picture of the housing market in the United States. Once largely confined to second homes in vacation spots, condominiums now make up an increasingly large proportion of the residential housing market, especially in urban areas. Business and commercial condominiums also enjoy a growing popularity.

From 1970 to the present time, condominium ownership has risen fivefold, from 416,000 units to approximately 2 million units. Condominiums already account for 50 percent or more of the new construction in metropolitan areas, and thousands of rental units in existing structures are converted to condominiums each year, further swelling the condominium market while cutting into the supply of rental housing. The Department of Housing and Urban Development (HUD) has predicted that half of the United States population will be living in condominiums within the next 20 years.

At this time, there is growing interest in the "condominium boom," as evidenced by numerous articles in the news media and action in Congress on condominium legislation. Thus, the publication of this *Symposium on the Law of Condominiums* is a timely and valuable contribution to the store of information on condominiums and to the debate on further action in the field of condominium law.

What is a condominium? A condominium is an individually owned unit in a multi-unit complex, which may be a high-rise or low-rise structure or a collection of townhouses. The condominium buyer acquires full title to his unit plus an undivided interest in common areas and facilities, which can range from the lobby, grounds and electrical and mechanical systems to extensive recreational facilities such as swimming pools and tennis courts. The owners are jointly responsible for the maintenance and operation of commonly held areas and facilities.

Economic factors are the main motivating force behind the condominium boom of the 1970's. Inflation in real estate prices has pushed the price of the standard single-family house beyond the reach of many

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potential home buyers. Soaring land and construction costs, often combined with sewer moratoriums and other anti-growth policies, have placed further pressures on the supply and price of housing, leading to speculation that the single-family detached house is becoming obsolete. A report released in October 1974 by HUD, the Environmental Protection Agency, and the Council on Environmental Quality lends support to this view, pointing out that the sprawling single-family housing development is far more costly than clustered, higher density housing, by a number of economic and environmental quality measures.

Another side of the picture is that rental housing — the traditional alternative to the single-family home — has become an increasingly less attractive investment. Costs of maintenance and utilities have risen rapidly, as have real estate taxes, and imposition of rent controls in many cities has cut into landlords' profit margins. Thus, the incentive is to turn the building over to a developer, who takes his tax breaks, does some renovation, then sells the units at an often inflated price and gets his money out fast with a handsome profit. As for building new rental housing, costs of construction make projected rents prohibitively high, and here again, the advantage to the developer lies in getting his money out quickly and turning responsibility for running the building over to the resident owners.

Changes in the make-up of the United States population also add to the condominium trend. Family size is declining, and the number of one and two person households is growing rapidly due to certain demographic factors — increases in the elderly population and in the single and divorced population. Generally higher income levels make condominium ownership a viable concept for a larger proportion of the population.

From the perspective of the buyer, the condominium can be an attractive housing choice. Condominiums are usually priced below single-family homes in the same area, and they often include recreational and other facilities beyond the reach of most individual homeowners. Condominium owners are free of many of the maintenance chores of single-family homeowners, while they share the same financial advantages — tax deductions and an opportunity to build up equity in the property.

While there are many benefits accruing to condominium ownership, there are also many problems and abuses which have come to light as the condominium boom has progressed. Some of these are problems of the individual owner, stemming from a failure to realize that condominium living is multi-family living and involves constraints

not encountered by the single-family homedweller. The new owner may be disturbed to find that he cannot decorate his apartment in certain ways because the bylaws prohibit it, or that he cannot play his stereo at the highest sound level because his neighbor objects. Or, if he is used to apartment living, he may not realize that he alone is responsible for maintenance in his own unit, while his condominium fee goes only for upkeep of the common areas.

But more often, the problems involve misrepresentations, self-dealing, and other abuses on the part of the condominium developer. These abuses have received much publicity in recent months.

There is "low-balling" — the practice of understating the monthly condominium fee charged for maintenance of common areas and other building expenses, so that the owner finds his fee doubles or triples a year after he bought the unit.

There is the "sweetheart" contract — a long-term contract entered into with a management company, generally one in which the developer has an interest, which locks the owners into higher-cost and often lower quality management services than they could get if they were free to choose their own company, and assures the developer a continuing financial interest in the property even after control is turned over to the owners association.

There is the 99-year recreational lease — in which the owners find they do not own the swimming pool or whatever but in fact are leasing them from the developer at a steep rental fee, sometimes with a built-in cost-of-living escalator designed to return over time a profit many times higher than the original cost of the facilities.

There are other aggravations — promised facilities which are never built, defects left unrepaired, developer's refusal to turn control over to the owners association, continued developer control of the association through holding of unsold units.

Some condominium buyers do not even get to become owners, because the developer goes broke and it turns out that he plowed the deposits into the construction and there is no way that the prospective owners can get their money back.

In buildings converted to condominiums, still more problems may arise. The owners find, after they take control, that they are saddled with expensive repairs, as long-neglected electrical and mechanical systems left untouched by cosmetic renovation fall apart and have to be replaced.

The owner may find himself paying as much or more for his condominium as for a comparable house. He feels he has been de-

frauded, and yet finds that he has no grounds on which to sue because the property laws in his state do not envision such subtleties as "low-balling" and "sweetheart" contracts. Willy-nilly he is the owner of his condominium castle, and the law holds that he is responsible for whatever befalls him in it. "Caveat emptor" is the only applicable doctrine.

Condominium conversions raise the spectre of still another problem — the displacement of rental tenants who are unable to buy their units and who cannot find suitable alternative housing at a price they can afford. Especially hard hit are elderly people, living on fixed incomes and unable to get mortgages, who often have deep attachments to apartments they have lived in for years. Other groups which are hard hit are lower income families, young people, and transients. Condominium conversions dry up the rental housing supply and drive up rents, further aggravating the housing problems these people face. This appears to be the most intractable of all the problems spawned by the condominium boom.

Given the rapid development of the condominium boom, and the problems accompanying it, it is not surprising that questions have arisen concerning laws affecting condominiums and condominium conversions and the legal rights and restrictions affecting condominium owners and developers. It is equally unsurprising that the legal situation in this area is complicated and confusing, because in a real sense the law has not caught up with reality.

Although the condominium concept dates from ancient times, it is only quite recently that condominiums have acquired a formal legal existence in the United States. Puerto Rico adopted its Horizontal Property Statute in 1958,[1] but the real impetus to development of condominium laws in the United States was the passage of section 234 of the National Housing Act of 1961,[2] which authorized the Federal Housing Authority (FHA) to insure mortgages for condominium units where condominium ownership was permitted under state law. By 1969, all fifty states, plus the District of Columbia and the Virgin Islands, had passed condominium enabling statutes.

Since that time, the states rather than the federal government have taken the initiative in the field of condominium law. With the surge of condominium development and its accompanying problems, several states have enacted so-called "second generation" condominium laws increasing protections for condominium buyers and tenants displaced by conversions. Jurisdictions which have adopted consumer protective

1 P.R. LAWS ANN. tit. 31, §§ 1291-1293(k) (1968).
2 12 U.S.C. § 1715y (1970).

condominium laws include New York, Florida, California, Hawaii, Michigan, Maryland, Virginia and the District of Columbia. All of these laws contain elements of disclosure of information and elements of regulation of condominium practices. Some lean more toward disclosure, and some more toward regulation, with recent amendments tending more toward regulation.

The disclosure approach is modelled on the securities laws and is at base a sophisticated refinement of the "caveat emptor" doctrine. The fundamental premise is that if the consumer is provided with full and complete information about the sale item, then he can make an enlightened decision whether to buy or not, and if he then finds his purchase not to his liking, he has only himself to blame. There is then nothing intrinsically wrong in selling, for example, a condominium unit with an exorbitant recreation lease fee that must be paid even before occupancy to avoid foreclosure, so long as this fact is disclosed in the condominium documents. The New York law leans heavily toward the disclosure approach, although detailed regulations and aggressive enforcement have made it an effective tool for broad consumer protection.

The regulatory approach assumes that the condominium buyer needs protection as well as information. The premise is that the consumer does not have adequate resources to protect himself against certain practices which an unscrupulous developer might engage in. In the case of condominium sales, the underlying assumption might be that this is the sale of a good — housing — which is consumed by all persons and is essential to every person's well-being, and thus the consumer should have some assurance that he is getting a quality product, as is the case under the food and drug laws or under laws forbidding false advertising. Thus, for example, the recently passed Virginia condominium law bars the developer's use of a purchaser's deposit money by requiring that such deposit be held in escrow until delivered at settlement.[3]

Disclosure and regulation represent two different approaches to condominium law, but they are not incompatible. In practice, existing laws contain a measure of both, but the matter of the mix of the two elements is often the subject of controversy.

Thus, several states have passed condominium consumer protection laws, all differing in many ways in language and approach, but all having common aims. Many of these state laws also contain provisions pertaining to condominium conversions. New York, for example,

[3] VA. CODE ANN. § 55-77.95 (Supp. 1974).

recently passed a condominium conversion law which requires, among other things, approval of 35 percent of the tenants before conversion can take place.[4]

Recently, some local governments in areas strongly affected by condominium growth have also acted on condominium laws, giving particular attention to condominium conversions and their effect on the supply of rental housing. The District of Columbia recently passed a regulation setting requirements for conversions, including the furnishing of an independent engineer's report on structure and systems to all prospective purchasers. In addition, the District has passed and extended a moratorium on all conversions, pending further study of tenant relocation problems. Two ordinances adopted this year in California localities make an affirmative commitment to maintaining rental housing at a certain level. A Palo Alto ordinance prohibits conversions when the rental vacancy rate falls below 3 percent, and one passed in Marin County could bar conversions if they would reduce the supply of rental housing to less than 25 percent of the total number of dwelling units in the county.

Thus, at the state and local level, there has been action on condominium legislation in a number of places and along a variety of lines. At the federal level, on the contrary, there has been no legislative action at all until the latter part of 1974. There has, however, been federal activity in the condominium field under existing law, some of it rather creative.

Under its section 234 condominium mortgage insurance authority, HUD has produced extensive handbooks covering both condominium construction loans and mortgages on individual units. These handbooks provide model condominium organizational documents and, in their regulations, appear to bar the practices most widely criticized in the condominium industry and to protect the rights of the condominium owners. HUD officials claim that these requirements are designed to protect the interests of the FHA as the insurer rather than those of the buyer per se, and they point out that in fact less than 1 percent of all condominium units built in the country have been financed under FHA-insured mortgages — perhaps because the requirements are so stringent. Despite the good record achieved by FHA-insured condominiums, HUD officials refused, in a Senate hearing, to say that similar requirements should be extended to condominiums, or even to agree there is a need for any regulation on the federal level.

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4 N.Y. GEN. BUS. LAW § 352-e(2-a)(1)(i), *added by* N.Y. SESS. LAWS [1974], ch. 1021, § 2 (McKinney).

HUD's Office of Interstate Land Sales Registration (OILSR) has drawn up regulations[5] extending the definition of a "lot" covered by the Interstate Land Sales Act[6] to include a condominium unit erected on that lot, with exemptions for existing buildings and for buildings erected on the land within two years pursuant to a sales contract.[7] The Act, which employs a full disclosure approach, was designed to regulate sales of undeveloped land, and there is some question as to whether it is legitimate to stretch its application to condominium units erected on such land. The regulations drawn up by OILSR appear to be a creative response to an obvious and related problem in the absence of any other law dealing with the problem.

Similarly, the Securities and Exchange Commission (SEC) has been pulled into acting on a number of condominium complaints, so long as the condominium offering can be shown to be a security. This means, in SEC terms, that the offering must include some collateral arrangement such as a rental pool, which is quite common with resort condominiums, but not with basic residential units.[8] Once a condominium is shown to be a security, then the SEC can exercise its regulatory powers, and indications from recent court decisions are that the term "security" is being interpreted rather broadly.[9] This is still another example of extending the coverage of existing law in the absence of other laws more directly aimed at the problem. SEC officials freely admit that they are uncomfortable with condominium regulation and that their expertise is not particularly well suited to the special problems of real property interests.

From these and other examples, there is an evident need for federal consumer protection legislation in the condominium field. Some order must be brought to the "crazy quilt" of federal regulation, and probably some federal agencies which have stepped into the void created by the absence of such legislation should be relieved of any discomfort this may have caused them through the passage of specific condominium regulation laws providing for disclosure and regulation of condominium sales and conversions. In addition, there is a need to set some uniform national standards for condominium sales to avoid the many problems and distortions which can arise when some states have less stringent laws than others and to provide equal protection

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5 38 Fed. Reg. 23,874-909 (1973).

6 15 U.S.C. § 1701 *et seq.* (1971).

7 *See id.* § 1702(a)(3).

8 *See* SEC Securities Act Release No. 5347 (Jan. 4, 1973).

9 *See, e.g.*, 1050 Tenants Corp. v. Jakobson, 503 F.2d 1375 (2d Cir. 1974); Forman v. Community Services, Inc., 500 F.2d 1246 (2d Cir. 1974) (shares of stock in cooperative housing projects deemed securities).

for buyers and developers nationwide. Federal legislation does not necessarily have to bar states and localities from administering condominium laws, nor need it bar them from establishing more stringent standards where local problems appear to advise this. What it can do is set minimum standards to ensure a modicum of protection to all consumers.

In the latter part of 1974, Congress began to act on condominium legislation. The Senate Banking, Housing and Urban Affairs Committee held hearings on October 9 and 10 on two bills, S. 4047, introduced by myself and Senator Brooke of Massachusetts, and S. 3658, introduced by Senator Biden of Delaware. Other bills have been introduced on the House side by Representative Collins of Illinois in the first instance, and by Representatives Rosenthal of New York and Aspin of Wisconsin. Previous to this, Congress included in the omnibus Housing and Community Development Act, passed in August, a provision requiring HUD to report to the Congress within one year on problems and abuses in the field of condominium and cooperative housing.

Work on condominium legislation will continue in the next Congress. Both the House and Senate Banking committees have agreed to hold hearings on this subject early in the session. I am convinced that Congress can and must act swiftly, because of the pressing need for federal condominium legislation.

Since the bills which have been introduced are undergoing extensive revision in the light of further information drawn from the hearings and other sources, it is impossible to state exactly what form that legislation will take. I can, however, discuss briefly the major concerns to be dealt with in developing condominium legislation.

First, there is the question of disclosure — how much and for what purpose. Both Senate bills require extensive disclosure of information relevant to the purchase of a condominium, including such things as identity of the developer, legal description of the property, estimated operating and maintenance costs, and declaration and bylaws of the condominium project. However, previous experience with full disclosure laws, notably the Interstate Land Sales Act, suggests that they are inadequate to protect the interests of all but the most sophisticated of purchasers. Many of the condominium projects which have been most sharply criticized did, in fact, have detailed descriptive documents available to prospective purchasers upon request, and yet these people — and often their lawyers as well — were unable to wade through hundreds of pages of complicated legal language to extract the essential information.

Coupled with the question of the efficacy of disclosure is the question of the ratio of cost to benefit. Given that there is undoubtedly a cost attached to preparing disclosure documents — a cost which will be passed on to the consumer in the price of his unit — the question becomes how much disclosure is needed to provide essential information without incurring excessive and needless costs? The Proxmire-Brooke bill does contain a requirement that HUD draw up uniform disclosure forms, to facilitate both preparation and examination of such information.

If disclosure is not enough, then how much regulation is advisable? Is it enough to provide assurances on specific points, such as the right of owners to form an owners association and take over operation of the project by a certain date, or should there also be prohibitions of specific practices, such as the leasing of recreational facilities? To extend the argument further, should HUD simply register condominium projects and determine whether there is compliance with disclosure requirements, or should it take a more active role and certify or reject projects according to whether or not they comply with a whole range of standards? The registration requirement and assurances on a number of points are already laid out in the bills which have been introduced, but future drafts may include additional consumer protection measures.

Another basic question is how much enforcement should be provided at the federal level and how much should state and, in some cases, local governments be encouraged to administer the law on their own? The Proxmire-Brooke bill authorizes state and local governments to administer their own condominium laws so long as these are consistent with the federal law, and states and localities would be free to adopt more stringent laws as well. A number of witnesses at the Senate hearings testified that effective administration was possible only at the local level. At the same time, many states and localities have shown no interest to date in enacting or administering condominium laws, and it is also possible that local regulatory bodies would be more susceptible to pressure from vested real estate interests. The response will have to be some judicious blend of federal and state/local enforcement, but the details have yet to be worked out.

Any federal legislation must have a carefully drafted civil liability provision, giving condominium owners full rights to sue in their own behalf, and probably establishing minimum penalties.

Finally, the knottiest question once again is how to deal with the problem of condominium conversions and dislocation of tenants. There should certainly be provisions to ensure that the buyer of a converted

unit knows what he is getting, and that that unit meets at least some minimum quality standards before it can be sold. As for the plight of tenants affected by condominium conversions, there are a variety of remedies to be considered, including tenant notification requirements, tenant approval provisions, moratoriums on conversions under certain conditions, and relocation assistance of various types. None of these remedies are infallible, and there are a number of questions as to how they should be treated in federal law.

Once again, I applaud the effort put forth in this *Symposium on the Law of Condominiums* to pull together information and comments on all aspects of condominium law and practice. My only hope is that action in the 94th Congress will render some of the articles obsolete, to the ultimate benefit of all of us.