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CONDOMINIUM: AN INTRODUCTION TO THE HORIZONTAL PROPERTY SYSTEM

Throughout the history of property law, there have been various approaches to the problems involved in dividing the ownership of real property into horizontal layers. In the United States, these problems have been partially resolved with such devices as the simple lease, the stock-lease cooperative and the co-ownership cooperative. These devices, however, have proved far from satisfactory. Because of the inadequacies of these devices, a new system of horizontal property law was needed. Such a system is now available for the states to incorporate into their laws. Two states have already enacted legislation establishing the system,¹ and the remaining states will probably follow suit in the near future.²

The system is known as a "Condominium." Interpreted literally, "Condominium" means "in common ownership."³ Briefly defined, a Condominium is a statutory system of horizontal ownership in fee of single units (apartments) in a multi-unit structure, with the common elements, such as the land, halls, stairs, heating plant, etc., being owned in common by all the single unit owners. Expenses incurred in maintaining the common elements are paid proportionately by the co-owners.⁴ The deed for each unit is recorded separately. In it are contained covenants providing for administration, repair, and maintenance of the Condominium; these are binding upon both original and subsequent owners. The unit-owner may separately convey and mortgage his apartment. Each unit is also separately taxed.

While new to the United States,⁵ the Condominium is an ancient form of ownership, originating in Roman law centuries ago. Condominiums

¹ ARK. STAT. ANN., § 50-1001 (Supp. 1961); HAWAII SESS. LAWS, 1961, Act 180.

² This view is reinforced by the passage of Federal legislation providing for mortgage insurance on the Condominium projects. This aspect will be further developed during the course of the discussion.

³ *Hearings on Various Bills to Amend the Federal Housing Laws before a Subcommittee of the Senate Committee on Banking and Currency*, 86th Cong., 2d Sess., 585, 594 (1960) [hereinafter cited as *1960 Hearings*].

⁴ These expenses are analogous to the payment of taxes in a suburban subdivision: (a) in the case of payment to the Condominium administration, the money is used for upkeep of the building, land and utilities; (b) similarly, money paid in the form of taxes to a subdivision is used for the upkeep of parks, roads, sewers, etc. See *1960 Hearings*.

⁵ Note, however, that three separate Condominium projects sponsored by the Veterans' Administration, have been in existence since 1947 in New York, Connecticut, and Washington, D.C. See *1960 Hearings*; Kerr, *Condominium*, LAW TITLE NEWS, Aug., 1961, p. 2.

have long been recognized and looked upon with favor in many European and Latin American countries.⁶

The Condominium is based entirely upon statutory provisions.⁷ A comparison of the Condominium with the stock-lease cooperative and the co-ownership cooperative reveals the distinctive features and advantages which are found in the Condominium. In the co-ownership cooperative, each apartment owner holds an undivided fractional interest in the land and buildings. This interest confers upon each apartment owner the right to exclusive possession of his own apartment. The common areas and facilities are shared by the co-owners of the building. Covenants to maintain and repair the cooperative are set forth in the deeds to the apartments. These purport to run with the land, but the states vary in holding such covenants to be binding upon successors and assigns. If they do not run with the land, then doubt is cast upon the entire project. Conditions for forfeiture and reversion of title may be attached to these covenants. If the covenants cannot be enforced without the necessity of forfeiture or reversion, then the apartments will be unacceptable as security for most institutional mortgages. This is also true if there are covenants which limits ownership to those who are acceptable; (*e.g.*, as a member of a club) or if committee approval is necessary to become an owner. In many states, the interests in each apartment are incapable of being separately owned, conveyed and mortgaged; and the related instruments are not legally entitled to be recorded. None of these objections are to be found in the Condominium system.

In the stock-lease cooperative, title to the land and building is vested in the owning corporation. Each apartment "owner" is a stockholder in the corporation and holds his apartment under a lease. The corporate by-laws and the leases provide for a division of expenses among the tenants, with payment to be made to the corporation. If any tenant fails to pay his proportionate share, he is subject to being dispossessed and having his stock cancelled.

The individual apartments cannot be separately mortgaged or taxed. If the mortgage on the entire land and building is foreclosed, the individual tenant may lose his apartment even though he has fulfilled his individual financial obligation. An individual cannot "own" his own apartment

⁶ 1960 Hearings.

⁷ But see Thuma, *The Condominium—A New Form for the Cooperative*, 41 TITLE NEWS 126 (1962).

It is the contention of Mr. Thuma, Vice-President of the Title-Legal Department of the Chicago Title & Trust Co., that Condominiums can be established in most states, including Illinois, without legislative action, upon the common law theory that all superadjacent air space to the skies [subject to the laws of navigation] is capable of being subdivided and conveyed by the surface owner.

so long as there is a mortgage on the entire land and building. Unlike the Condominium in which there is only a right of first refusal in the other apartment owners, the tenant in a stock-lease cooperative cannot assign his lease without the approval of the corporate board of directors.

In the Condominium there is no separate entity which owns the land and building—there are only the sole owners of apartments who are also the co-owners of undivided interests in the common elements. In the stock-lease cooperative the owning corporation stands between the apartment owners and the title to the land and building. Thus the apartment owners are in fact one step removed from ownership. This supports the claim made by advocates of the Condominium in Puerto Rico that it affords a sense of ownership not enjoyed by the owner of a cooperative apartment.

In the Condominium the estate conveyed to the apartment owner is such that the sales of apartments should not logically be subject to Federal or State Securities Laws. In the stock-lease cooperative such laws must be complied with or exemption ascertained.⁸

The need for the Condominium is becoming quite evident; it grows out of a pressing necessity to provide adequate housing in large urban areas where the high cost of land, coupled with construction and financing expenses, practicably precludes the erection of single family homes and where rentals on available apartments are prohibitively high for the masses.

The Condominiums would create an additional means of increasing the supply of low-cost, decent, private housing. Supporting such expectations, James Barnes, the head of one of the nation's largest mortgage banking concerns,⁹ has stated "that the Condominium can be expected to provide adequate housing for the increasing number of elderly families and individuals, one of the most pressing problems confronting this country."¹⁰ He also contends that such projects can be expected to revolutionize the building industry in the United States.

Included among the advantages of Condominiums which Barnes cites are: (1) the economic utilization of costly urban land and (2) a reduction in necessary services and in the workers supplying such services; such as street maintenance, public lighting, garbage collection, police and fire, schools and transportation. Thus large savings would result and a benefit would accrue to society as a whole.¹¹

The Condominium concept is perhaps best exemplified by the statute

⁸ Kerr, *Supra* note 5, at 4.

⁹ Mr. Barnes is president of J. T. Barnes & Co., Detroit. The company, with branches in the United States and Puerto Rico, has a portfolio of \$350,000,000 in government insured and guaranteed loans; \$100,000,000 of that amount is for developments in Puerto Rico.

¹⁰ Barnes, *Accelerated Growth of Condominiums Expected from New Housing Bill Law*, LAW TITLE NEWS, Aug., 1961, p. 5.

¹¹ *Ibid.*

embodying its principles as found in Puerto Rico.¹² Originating in the Spanish civil law,¹³ legislation of this type was first enacted in Puerto Rico in 1902.¹⁴ Progressing towards a more complete and modern form, a similar act was passed in 1951.¹⁵ The last stage of development occurred in 1958, giving Puerto Rico the Horizontal Property Act,¹⁶ a comprehensive statute, enhanced by its clear and unambiguous language.

The Horizontal Property system, although extremely popular in Puerto Rico, has not grown as rapidly as expected due to the difficulty of obtaining financing in that country.¹⁷ Puerto Rico has embodied the Condominium concept into both small units and high-rise buildings. The estimated construction of Condominiums, completed or under way in Puerto Rico, is in excess of \$22.5 million.¹⁸

THE PUERTO RICO HORIZONTAL PROPERTY ACT

I. Basic Provisions

The Act¹⁹ applies only to buildings whose sole owner or co-owners expressly declare their desire to submit it to the system by means of a recorded public deed. Once the building is submitted to the system the apartments may be individually conveyed and encumbered and may be the object of ownership, possession, and all types of juristic acts, *inter vivos* and *causa mortis*, entirely irrespective of the building of which they form part. The title to such apartments is recordable.

The owner has an exclusive right to his apartment and to a share, with the other co-owners, in the common elements equivalent to the percentage his apartment represents in the total value of the building. This percentage is computed at the time the building is submitted to the system; it cannot be altered without the consent of all the co-owners. The basic value is for the purpose of the system only and does not prevent the owner from fixing a different value to his apartment in all other types of acts and contracts.

The common elements of the property are:

¹² P.R. LAWS ANN., Tit. 31, § 1291 (Supp. 1910).

¹³ SPAN. CIV. CODE, T. III, Art. 396.

¹⁴ P.R. CIV. CODE § 403 (1902).

¹⁵ P.R. LAWS ANN., tit. 31, § 1275 (1955).

¹⁶ P.R. LAWS ANN., tit. 31, § 1291 (Supp. 1960).

¹⁷ 1960 *Hearings*, but note: with the incentive added by the FHA insurance of mortgages on Condominiums, construction should increase rapidly.

¹⁸ Barnes, *supra* note 10.

¹⁹ P.R. LAWS ANN., tit. 31, § 1291 (Supp. 1960).

- (a) the land,
- (b) foundations, roofs, halls, lobbies, stairways, entrance, exit and communication ways,
- (c) basement, flat roofs, yards and gardens,
- (d) lodgings of janitors and other maintenance people,
- (e) heating, electricity, gas, refrigeration and water installations,
- (f) elevators and garbage incinerators,
- (g) and all other elements of common use or those necessary to its upkeep and safety.

These common elements cannot be the object of a partition action and cannot be mortgaged without the unanimous consent of all the co-owners. Each co-owner has the use of the common elements in accordance with their purpose, provided that they do not interfere with the other co-owners' legal rights in so doing.

Should any co-owner wish to sell his apartment he must first offer it to the other co-owners who, by virtue of the system, have a right of first refusal.

The use and enjoyment of each apartment is subject to various rules:

- (a) it must be used solely in accordance with the use prescribed by its deed,
- (b) no tenant may disturb the peace of the other co-owners or tenants,
- (c) it cannot be used for immoral, unlawful or abnormal purposes,
- (d) each co-owner may decorate, repair, clean or improve his apartment at his own expense provided that in so doing he does not modify the exterior portions of the building as to form or color,
- (e) all tenant and co-owners must comply with the administrative rules.

Violation of any of the above rules gives rise to a cause of action for damages in the injured tenant or co-owner. Necessary maintenance of the common elements is carried out by an agreement of a majority of the co-owners. Whenever the common elements require urgent and necessary work for repair, safety or maintenance, any co-owner may have it done at his own expense and recover the cost from the other co-owners. No co-owner may build new floors, make excavations or do any other work which will affect the safety of the building without the unanimous consent of the others. The common profits and expenses of the building are distributed among the co-owners according to their percentage portion in the building.

II. The Public Deed and Its Recording

The deed must contain:

- (a) the description of the land, the building and the building materials,
- (b) the description and number of each apartment,
- (c) the description of the common elements,
- (d) the purpose for which the building and the apartments are to be used,

- (e) the value of the property and the percentage value of each apartment along with the percentage value each apartment receives in the common elements,
- (f) the administrative rules, and
- (g) certified plans of the building.

The deed of each individual apartment must also set out a description of the land, the building, the materials, the apartment itself and must also state the percentage accorded to the apartment in the common elements. Each apartment is recorded as a separate piece of property upon an individual record. The common elements are recorded under the public deed. The percentage share of each apartment in the common elements is deemed to have been conveyed or encumbered with the apartment, without need of recording such conveyance or encumbrance of the share under the public deed. However, new floors added, or portions of adjacent land acquired, so as to form part of the common elements, must be recorded under the public deed. Similarly, any conveyance by all the co-owners of the common land must be recorded under the public deed to show the description of the land as it stands after the conveyance. The co-owners may, by unanimous vote, waive the Horizontal Property System; such a waiver does not, however, bar a subsequent return of the building to the system.

III. Administration and Insurance

The building administration is governed in accordance with by-laws which are recorded under the public deed. The by-laws must contain:

- (a) the form of administration *i.e.* whether controlled by an administrator or board of administration, specifying the powers, method of removal and compensation thereof,
- (b) the method of calling a co-owners meeting; the presiding officer and recording secretary,
- (c) a statement that fifty-one per cent of the co-owners constitutes a decision adopting majority,
- (d) the manner in which the common expenses are to be collected from the co-owners,
- (e) provisions for the care, upkeep and surveillance of the building, and
- (f) enumeration and manner of dismissal of maintenance personnel.

The administration of the building may be modified at any time by the sole owner or co-owners representing three-fourths of the building's value. The modification is not operative until recorded under the public deed. Detailed records and books of account must be kept by the administration; these must be made available for examination by the co-owners at convenient hours on working days.

All co-owners are bound to contribute pro rata towards the expenses of administration, maintenance and repair of the common elements. Waiver

of the use and enjoyment of the common elements or abandonment of the apartment will not exempt the co-owner from contributing. The claim against the co-owner for his share of these expenses has preference over all other claims, except: (1) taxes for the past three years, (2) insurance premiums on the apartment for the last two years, and, (3) recorded mortgages. One who acquires an apartment is jointly and severally liable with the conveyer for the conveyer's obligations as regards administrative and common element expenses incurred prior to the conveyance, but such a person has a cause of action against the conveyer to recover any amounts paid out for such expenses.

If the administration fails to abide by the by-laws or if, after proper notice of a meeting a quorum necessary for decision-making cannot be had, an interested co-owner may seek a court ruling as to the course of action most appropriate for the efficient management of the building.

The co-owners can, by a majority vote, insure the building against risks. Each co-owner may also insure his own apartment for his own benefit. In case of a fire or other disaster, the insurance indemnity is applied to reconstruction of the building. Reconstruction is not compulsory where it comprises more than three-fourths of the building. In such a case, the indemnity is given pro rata to the co-owners entitled to it. Where the building is not insured, or where the insurance is insufficient to cover the cost of rebuilding, the costs are paid by the co-owners directly affected by the damage, in proportion to the value of their apartments. If any affected co-owner refuses to pay, the majority may proceed with reconstruction at the expense of the co-owners benefited thereby.

THE STATE ACTS

Hawaii is the first state to have adopted a Horizontal Property Act.²⁰ The Act, though patterned very closely after the Puerto Rican statute, is distinctive in several ways.

First, conspicuously absent from the Hawaiian Act is the right of first refusal in the co-owners as is found in the Puerto Rican statute. This provision was eliminated as possibly constituting an unlawful restraint on alienation.²¹

Secondly, the Act provides for the regulation of the Condominium activities by a Commission having broad powers. In order to comply with these provisions, a developer must file a notice of his intention to build and sell Condominiums with the Commission. The Commission, after inspecting the plans of the project, then issues a public report of its findings. Thereafter, the developer cannot enter into a binding contract or

²⁰ HAWAII SESS. LAWS 1961 Act 180; ARK. STAT. ANN., § 50-1001 (Supp. 1961).

²¹ Kerr, *supra* note 5.

agreement for the sale of any unit in the project, until the prospective purchaser has read the public report and acknowledged such fact in writing.²² The Commission has the power to bring suit to enjoin any building activity which contravenes its rules and regulations.

Thirdly, the land upon which the Condominium stands may be owned in fee simple or may be leased.²³

The Arkansas Act is patterned, in substance, directly after the Puerto Rican statute.

NATIONAL HOUSING ACT—1961 AMENDMENT

Congress, recognizing the tremendous potential of the Condominium, and desiring to provide incentive for investments in their construction, enacted legislation in 1961 authorizing the insurance of mortgages on individually owned units in multi-unit structures.²⁴

Stating that its purpose is to "provide an additional means of increasing the supply of privately owned dwelling units, where under the laws of the state in which the property is located, real property title and ownership are established with respect to a one-family unit which is part of a multi-family structure,"²⁵ the Act then goes on to enumerate the mortgagor's rights and duties. Included among the mortgagor's rights are the exclusive right to the use of the apartment covered by the mortgage and the right to use the common areas and facilities serving the structure along with the other co-owners in the building. In addition, the mortgagor has the obligation of paying his proportional share of the expenses incurred by reason of maintaining the common areas and facilities. The individual mortgagor's rights and obligations are subject to such controls as the Federal Housing Authority Commissioner deems necessary for the protection of the Condominium and its occupants.

As defined by the Act, a mortgage "may include a first mortgage given

²² These stringent provisions were inserted to protect the Hawaiian public which had recently lost several millions of dollars through fraudulent schemes involving projects of this type. Kerr, *supra* note 5.

²³ Much of the land in Hawaii being subject to ground leases, the co-owners instead of having a fee simple estate would have a sub-leasehold estate. Both types are treated alike for taxation purposes. Note: "It would seem desirable from the apartment owner's point of view, to provide in the ground lease that it shall not be terminated as to any apartment with respect to which the proportionate part of the rent has been paid to the Condominium administration. Failing some arrangement of this sort, the apartment owner in a leasehold Condominium apartment is in much the same position to ground rent as the owner of an apartment in a stock-lease cooperative [is] with respect to both taxes and mortgage charges." Kerr, *supra* note 5, at 6.

²⁴ 12 U.S.C.A. § 1715y (Supp. 1961). "Multi-unit structure" is defined as a structure having five or more family units. 26 Fed. Reg. 7497 (1961).

²⁵ 12 U.S.C.A. § 1715y(a) (Supp. 1961).

to secure the unpaid purchase price of a fee interest in, or a long term leasehold interest in,²⁶ a one-family unit in a multi-family structure and an undivided interest in the common areas and facilities which serve the structure where the mortgage is determined by the Commissioner to be eligible for insurance.”²⁷

The FHA Commissioner is authorized to insure any mortgage if: (1) it meets the FHA requirements under § 1709(b),²⁸ (2) the structure is or has been covered by an FHA insured mortgage,²⁹ and (3) the mortgagor is acquiring a family unit covered by a mortgage issued under the act, for his own use and occupancy, and will not own more than four one-family units covered by mortgages insured under the act.

A mortgage, to be eligible for insurance, must not exceed the per room and per family unit limits of the section 207 rental housing program, or the loan to value ratios of the section 203 home mortgage program.³⁰ The maximum maturity of the mortgages is thirty years or three-fourths of the Commission's estimate of the remaining economic life of the structure whichever is the lesser.

The FHA Commissioner has issued regulations dealing with Condominium ownership.³¹ As in all FHA mortgage insurance regulations, it is provided that no racial restrictions are to be placed upon the building during the period in which the mortgage is insured. Although the regulations prescribe the method of establishing a Condominium in order for it to qualify for FHA mortgage insurance, the provisions so closely resemble those found in the Puerto Rican Act, that no appreciable difficulties are foreseen for the American conveyancer.³²

²⁶ *Supra*, note 23.

²⁷ 12 U.S.C.A. § 1715(b) (Supp. 1961).

²⁸ 12 U.S.C.A. § 1709(b) (Supp 1961).

²⁹ This provision insures that the structures would have been built or rehabilitated with the benefit of FHA minimum property requirements, inspections and appraisals. See S. Rep. No. 281, 87th Cong., 1st Sess. (1961).

³⁰ The dollar limits under section 207 are: \$2,500 per room (\$3,000 for elevator-type structures), and \$9,000 per family unit in less than 4-room units (\$9,400 for elevator-type structures). The Commissioner may increase these amounts up to \$1,250 per room in high cost areas. 26 Fed. Reg. 7430 (1961).

The loan to value ratios under section 203 are: (1) 97% of \$13,500 of the appraised value including the common elements, (2) 90% of such value in excess of \$13,500 but not in excess of \$18,000, (3) 70% of the value in excess of \$18,000. See S. Rep. No. 281, 87th Cong., 1st Sess. (1961); 26 Fed. Reg. 7410 (1961).

³¹ FHA Revised Regulations, part 234, Condominium Ownership, 26 Fed. Reg. 7377-7537 (1961).

³² However, as to any specific provision, reference should be made to the Regulations, there necessarily being technical requirements which must be complied with.

CONCLUSION

The sense of ownership which the Condominium affords to the apartment owner, coupled with its economic and legal advantages, leaves little room to doubt that the system of horizontal property ownership will become part of the law in every state in the Union. The Condominium has proven successful in countries all over the world; there is no reason why, with the added inducement furnished by FHA insured mortgages, such a proven system should not flourish in the United States.³³

Although theoretically, a Condominium system could be established in the majority of states without the necessity of legislative enactment, passage of statutes in the several states, modeled after the Puerto Rican Act, would facilitate the operation of the system and minimize the lengthy and expensive litigation, which would surely result if the system was left to evolve by court decision alone.

³³ Thuma, *The Condominium—A New Form for the Cooperative*, 41 TITLE NEWS 126 (1962).