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CONDOMINIUM PRACTICE: A SECOND LOOK

J. Philip Johnson*

Over seven years ago, the author examined the recently adopted North Dakota Condominium Act and attempted to suggest some methods of practice for the real estate lawyer commissioned to establish a condominium project.¹ It appears that now may be an appropriate time to examine how condominium law and practice has developed in that interim. Some suggestions for improvement in the present law and practice may also be in order. While North Dakota has not seen the massive condominium projects developed in the sunny climes of Florida and California, we have seen a considerable number of smaller projects erected in our larger cities. The rising costs of residential construction and urban land have forced developers to search for alternative forms of dwelling units. While there has been recent public focus on certain unsavory developers and their practices, the condominium has lived up to most of its advance billing as a flexible form of multi-unit residential development.

I. DEEDS AND DESCRIPTIONS

A form of condominium deed for use in North Dakota was suggested in the previous article, and that form has seen a substantial amount of use.² Since that time, the Real Property Probate and Trust Law Section of the State Bar Association of North Dakota has developed and put into use modernized deed forms which are both shorter and simpler. Utilizing this base, an updated condominium deed appears in order and a suggested form is included as Appendix A to this article.³ Whatever the form of the deed, the matter of a correct legal description for individual condominium units remains the chief problem of the title examiner. Given the number of additional elements required for such descriptions, there is a multiplicity of opportunities for omissions or variances. Though

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1. Johnson, *Condominium: The Theory and the North Dakota Practice*, 44 N.D.L. Rev. 345 (1968).

2. *Id.* at 354-55.

3. See Appendix A, *infra*.

there are variances in statutory requirements among the various states most require the following elements in a unit description: (1) The legal description of the real estate upon which the total project is situated; (2) Reference to the declaration creating the condominium project, including recording data; (3) The individual unit designation, whether by number or letter; (4) The percentage of common elements appurtenant to such unit; and (5) Any restrictions upon use.⁴ North Dakota has somewhat abbreviated statutory requirements and a specific statement of the common elements percentage and restrictions upon use is not required.⁵ An incorporation by reference of the declaration and bylaw provisions may resolve these questions.⁶

By comparison, Minnesota has a more detailed list of requirements for condominium unit descriptions and, in addition to the five common requirements, Minnesota unit deeds must contain a post office address for the property.⁷

II. TITLE EXAMINATION

In our area the abstract of title-attorney's opinion system of title examination, remains the predominant approach. The condominium title examination presents a few unique features. The recording of a condominium declaration has substantially the same effect as the recording of a subdivision plat; it creates a number of new real estate units from one plot of ground.⁸ Given the voluminous character of the condominium documents, they cannot be effectively abstracted. The practice in our area has been to reflect in the abstract the essential recording data regarding the declaration and bylaws but exclude the substance. The examiner would then examine the original documents or copies of the original documents to determine their compliance with statutory requirements and whether they contain any objectionable items. Minnesota has adopted a title standard requiring the abstracter to include a verbatim copy of the documents as part of the abstract.⁹ This approach seems advisable to sustain the integrity of the abstract system. A title standard covering condominium abstracts and examinations is much needed in North Dakota.

The attorney's opinion should reflect his examination of the condominium documents and his finding of legal sufficiency. Special

4. See, e.g., S.D. COMPILED LAWS ANN. § 43-15-13 (1967); WIS. STAT. ANN. § 703-12 (Supp. 1974).

5. N.D. CENT. CODE § 47-04.1-05 (Supp. 1974).

6. See Appendix A, for a suggested form of North Dakota condominium unit description.

7. MINN. STAT. ANN. § 515.12 (Supp. 1974).

8. N.D. CENT. CODE § 47-04.1-01 (Supp. 1974).

9. Minn. Title Stand. No. 94 (June 18, 1971).

restrictions upon use and provisions affecting the estate of the client should be noted. On those situations involving a resale of a condominium unit, the provisions regarding right of first refusal should be kept in mind. The board of managers of the condominium ordinarily has a right to purchase the unit on the same terms as the proposed purchaser, if they find the purchaser objectionable. A careful examiner will require some evidence that this right has been waived. Ordinarily the bylaws of the project should provide that a certificate of an officer will be provided and will bind the unit owners. Such a certificate would not ordinarily be recorded.

III. FINANCING THE CONDOMINIUM

One party to any condominium transaction will have a point of view which must be taken into consideration.¹⁰ A purchaser is often trusting, naive and willing to accept whatever is offered in the way of legal documentation. A lender seldom is so easily satisfied. A mortgage lender is likely to be involved in financing the construction of the project and a mortgage lender is also likely to be involved in the sale of individual units. While lenders have financed condominium construction based upon individual unit mortgages, the advisability of this appears very questionable. North Dakota allows creation of a condominium project prior to completion of improvements, unlike other states, such as Minnesota.¹¹ However, a good rule of thumb is to record the declaration and bylaws as late as possible after completion of construction. Invariably there arise changes in the way the project was constructed from the way it was planned. Amendments to reflect such changes can be a substantial problem, particularly after a number of units have been sold. A single construction mortgage upon land and improvements, with later recording of the condominium documents, is preferable.

Lender's counsel will want to assure himself that the documents are legally sufficient and that they adequately protect the mortgagee's interests. Amendments which may affect the basic structure of the condominium, significant obligations of the unit owners, or rights of the mortgagee should require mortgagee consent.¹² The mortgagee will want specific clauses governing his rights and position upon foreclosure as it relates to common expenses and liens for unpaid common expenses. Provisions unduly restricting market-

10. See generally King, *Problems of Financing Condominiums*, 24 BUS. LAW 445 (1969) (relating primarily to federal programs and requirements for federally insured institutions); Pfeller, *Condominium Financing: Some Legal Basics*, 38 U.S. SAV. & LOAN LEAGUE LEG. BULL. 249 (1972).

11. This is based upon a requirement that a registered architect, licensed engineer, or registered surveyor certify that the floor plans depict the structures "as built." MINN. STAT. ANN. § 615.13 (Supp. 1974).

12. See Pfeller, *supra* note 9.

ability of units—limited categories of ownership, complicated board approval or right of first refusal provisions—will not be acceptable to an informed lender.

The condominium act requires that all "owners" join in the declaration creating the project.¹³ If there exists a mortgage on the land, the mortgagee should join in the declaration. It may be argued that the mortgagee is not an "owner" under the statute,¹⁴ but there is no question as to his ownership of a substantial interest affecting the real estate. If the declaration is to become effective without his approval, it would have the effect of substantially changing the nature of his security. At best it could be said that the condominium established without the mortgagee's consent would be subject to the lien of that mortgagee, which would jeopardize the condominium in the event of foreclosure.

IV. INSURANCE

There are several aspects of insurance coverage upon the condominium project—fire and other casualty loss upon the buildings, improvements and common equipment, liability for injuries and losses occurring in or about the project, casualty losses for furnishings and personal property of each unit owner. There are two basic approaches to insurance upon such a project: (1) Coordinated unit owner policies; and (2) An association master policy.¹⁵ If coordinated individual policies are desired, the declaration must set forth the required coverage and the manner in which an individual owner proves compliance. A more satisfactory approach, one in more general use, is the master policy format. The declaration establishes this requirement for implementation by the board of the condominium. The individual owners would be restricted to policies for liability on their premises and losses to their personal property and fixtures. The problems of maintaining and enforcing total insurance coverage through individual unit owner policies appear too formidable for satisfactory solution. It remains to be seen whether existing policies of insurance, many simply forms of apartment ownership coverage, adequately deal with condominium problems. Some companies are developing policies specifically for such projects but their availability appears limited.

Another factor to be incorporated into the condominium documents—ordinarily the bylaws—is the use of an insurance trustee. In the event of damage to the structure, the whole proceeds must be

13. N.D. CENT. CODE § 47-04.1-02 (Supp. 1974).

14. A North Dakota mortgagee takes a lien and not title. N.D. CENT. CODE § 35-03-01.2 (Repl. 1972).

15. See Kenyon, *Insuring the Condominium*, 19 PRAC. LAW. 13 (1973); P. ROHAN & M. RESKIN, *CONDOMINIUM LAW AND PRACTICE*, ch. 11 (1972).

made available for application upon repairs and reconstruction. Even those unit owners whose apartments are undamaged suffer from a damaged building that continues unrepaired. An insurance trustee also appears to be in the best position to protect the proceeds against claims of creditors. The bylaws should provide directions as to the handling and application of insurance proceeds by the trustee.

V. EXPANDABLE CONDOMINIUMS

In the drafting of the original condominium statutes, the drafters contemplated essentially a single building, single stage development. However, the size and scope of condominium projects grew from 12 and 24 unit apartment buildings to mixtures of building types extending over many acres and including hundreds of individual units. At the same time substantial economic pressures brought a legal search for a satisfactory method of allowing condominium expansion.

Both lenders and developers soon noted that it was very expensive and quite risky to complete a major multi-building condominium project before recording the condominium documents and selling the individual units. A staged development would allow the project to be completed in manageable portions and the remainder delayed if the existing sales market did not warrant completion. Few state statutes deal specifically with this question, and North Dakota is included among those states whose condominium acts neither proscribe nor authorize expansion of an existing condominium.¹⁶

One method of staged condominium development is to plan for a series of self-contained condominium projects which might be constructed and sold at different times but which would be adjacent and compatible. Such a development might have separately owned recreational facilities which could be leased to the condominium owners association.¹⁷ This approach has the advantage of establishing legally self-contained projects which might stand on their own if no further development transpired. However, it ordinarily requires development in very substantial blocks and does not allow great flexibility in adding smaller numbers of units. It also results in a series of owner associations and governing boards, though there may be a second level board coordinating the the boards of the separate owner associations.

16. N.D. CENT. CODE ch. 47-04.1 (Supp. 1974). See also S.D. COMPILED LAWS ch. 43-15 (1967); MINN. STAT. ANN. ch. 515 (Supp. 1974).

17. See P. ROHAN & M. RESKIN, *supra* note 15, at § 16.03; Garfinkel, *Problems of Incremental Condominiums*, VI MOD. REAL ESTATE TRANS. (ALI-ABA 1974).

Another method, which allows greater flexibility, is to provide in the condominium declaration for future amendment to add land and buildings to the original project.¹⁸ While such is not specifically authorized by most states' acts, neither is it proscribed. Barring some unusual provision of state law, the concept of amendment to enlarge the project appears accepted by most authorities. In jurisdictions utilizing primarily or exclusively title insurance, the question has been, "What is acceptable to the title insurance company?" In our area we must ordinarily satisfy the attorney title examiner. The right to amend for purposes of adding additional units must be retained in the developer, without the necessity of joinder by subsequent condominium owners. A careful review of real property principles reveals that we are here creating a future interest in the developer, a limited right to change the nature of the real estate interest held by the unit owners.¹⁹ For this reason, the interest should be specifically limited. The minimum limitations of the expansion clause should include: (1) A legal description of the tract which may be added to the project; (2) Joinder of the fee title holder of the tract to be added if other than the developer; (3) A time limit for addition of the final phase, not exceeding the rule against perpetuities; (4) A limit as to the units to be added, including number and architectural compatibility; and (5) A description of the manner in which the percentage of common elements will be adjusted.²⁰

The expandable condominium should, however, be used with great caution and only if no other alternative is available. The potential for title problems and errors in connection with added real estate is great. A cavalier addition to an existing project may cloud the title on all units and create a quagmire for the unwary.

VI. SECURITY QUESTIONS

In our earlier analysis of the North Dakota Condominium Act, we questioned whether state securities law applied to condominium unit sales.²¹ While the statutes have not changed and the theoretical question remains, there has arisen no propensity to treat the ordinary condominium unit as a security under state law. In part, this may be attributable to the specialized registration requirements for condominium projects that have been adopted in states such as New York, Florida and California. On the federal level there has

18. See Joliet, *The Expandable Condominium: A Technical Analysis*, 9 LAW NOTES 19 (1972); Outin, *Condominiums That Can Grow*, 11 LAW TITLE NEWS (Oct. 1971).

19. This is in the nature of a reversionary interest. See R. POWELL, *POWELL ON REAL PROPERTY* § 270 *et seq.* See also N.D. CENT. CODE § 47-04-09 (1960); Outin, *supra* note 18.

20. This may be described in general terms or the so-called "Chinese menu" approach may be utilized. See Joliet, *supra* note 18; P. ROHAN & M. RESKIN, *supra* note 15.

21. Johnson, *supra* note 1, at 352.

arisen a developing concern with the promotion and sale of the recreational condominium unit which is to be rented out most of the year. The unit is often sold as an investment which will "cost the purchaser nothing" since his rental income will exceed all expenses, including that of his own use. In addition, the purchaser is to claim the tax shelter of interest, real estate tax, insurance and maintenance expense deductions. The purchaser may avoid operating responsibility by a rental pooling arrangement through a managing agent.

In an official release as of January 4, 1973, the Securities and Exchange Commission set forth its position on these sales programs.²² The offering of condominium units for sale or lease is considered the offering of a security if it includes any one of the following: (1) The units are offered or sold with emphasis on the economic benefits to be derived from the managerial efforts of the party handling rental of the units; (2) The offering includes participation in a rental pool arrangement; or (3) The offering requires the purchaser to keep his unit available for rental a portion of the year, or requires the use of an exclusive rental agent, or materially restricts the purchaser in his use of the unit. Since many states have similar definitions of a "security" or "investment contract" to that of the Securities Act of 1934, a like interpretation under state law is quite possible.²³ In our area this rental-income sales approach has not developed any substantial steam, we apparently have too few resort areas. However, it should be a concern for the lawyer counseling a would-be condominium developer.

VII. ALTERNATIVE FORMS OF OWNERSHIP

In the previous review of condominium ownership, we compared it with the cooperative.²⁴ The cooperative involves corporate ownership of the building or real estate, with individual apartment dwellers having long term leases and stock ownership in the corporation. Outside of New York state, the cooperative has seen little utilization. A form of ownership which shows greater potential for use and development in our area is the townhouse association, sometimes known as the planned area development (PAD), or as the planned unit development (PUD). Inspired by cluster development, planning concepts and supported by the long history of urban townhouses, the townhouse association has seen substantial use in such areas as suburban Minneapolis-St. Paul. The Federal Hous-

22. S.E.C. RELEASE No. 5347 (Jan. 4, 1973).

23. 66 HAWAII OP. ATT'Y GEN. 12 (Mar. 29, 1966); P. ROHAN & M. RESKIN, *supra* note 15, at §§ 18.01-.05.

24. Johnson, *supra* note 1, at 350-51.

ing Administration has contributed to the rise of this form of ownership through the development of suggested and approved forms of documentation.²⁵

The townhouse association can be used only with the townhouse architectural form—side by side independent housing units sharing common walls but located upon their own parcel of real estate. The owner is sold the parcel upon which his townhouse sits and membership or ownership in a non-profit corporation which owns the common ground around the townhouses. A declaration of restrictions and conditions is recorded covering the common areas. This grants common easements to the townhouse owners and restricts development and use on the common areas. In addition the declaration sets up party wall agreements and a means for assessing townhouse owners for the cost of maintaining the common area. Though substantially similar to the condominium concept, the townhouse association is ordinarily developed without specific statutory authority, based upon general real estate principles.

VIII. STATUTORY AMENDMENT

The North Dakota Condominium Act is, to a large degree, a "bare bones" statute, containing the basic framework for establishment of a condominium project, but without detailed provisions answering the variety of problems that have arisen in practice. There are many questions arising under this statute for which a statutory answer would be helpful to the lawyer. The matter of authority for expandable projects, the handling of leasehold condominiums, the application of insurance proceeds—all these are significant questions unanswered by the statute. However, there is still much to be said for the English common law method of resolving matters through development of informed practices based upon experience. We have not yet developed the legislative foresight to legally resolve all problems in advance of their occurrence.

North Dakota and its neighboring states have not developed a condominium registration procedure, similar to securities registration, such as has been established in a number of the states having large scale developments of this type. It has been suggested by some in the field that intensive regulation of this type may likely result from any attempt at substantial amendment of these acts. Given the size of our area projects and the experience within our region, this would seem a good example of legislative over-kill. Some abuses in development may yet bring it about. However, unless an exemption is provided for small projects, a complex regis-

25. FHA Form 1400, VA Form 26-8200 (Aug. 1968).

tration procedure would push small condominium developments over the edge of economic feasibility.

APPENDIX A

CONDOMINIUM WARRANTY DEED

THIS INDENTURE, Made this _____ day of _____, 1975, between SUNSHINE COMPANY, a corporation under the laws of the State of North Dakota, grantor, and HARRY HOUSEHOLDER and HERMIONE HOUSEHOLDER, grantee, whether one or more, whose post office address is Fargo, North Dakota.

WITNESSETH, For and in consideration of the sum of Ten Dollars and other valuable consideration, grantor does hereby GRANT to the grantee, as joint tenants and not as tenants in common, all of the following real property lying and being in the County of Cass, and State of North Dakota, and described as follows, to-wit:

Unit 8, in Sun Terrace Condominium, created under a Declaration of Condominium recorded in Book D-6 of Misc., page 156, et seq., erected upon Lots Two (2) and Three (3), Block 8, Sunny Dale Addition, City of Fargo, Cass County, North Dakota, according to the certified plat thereof on file and of record in the office of the Register of Deeds in and for said County and State, together with the undivided interest in the common elements declared appurtenant to such unit.

Grantee by acceptance hereof expressly assumes and agrees to be bound by and to comply with the covenants, and conditions set forth in such Declaration of Condominium including, but not limited to, the obligation to make payment of assessments for the maintenance and operation of the condominium which may be levied against such unit.

And the grantor, for itself, its successors and assigns, does covenant with the grantee that it is well seized in fee of the land and premises aforesaid and has good right to sell and convey the same in manner and form aforesaid; that the same are free from all incumbrances, except installments of special assessments or assessments for special improvements which have not been certified to the County Treasurer for collection, applicable zoning ordinances and regulations; all of the terms, conditions, rights, privileges, obligations, easements and liens set forth in the Declaration of Condominium, Bylaws, and Declaration of Restrictions; such covenants, restrictions and easements of record, if any, as may now affect the described property; and the above granted lands and premises in the quiet and peaceable possession of the grantee, against all per-

