

1964

Condominiums in South Carolina: Possibilities and Pitfalls

Colin E. Harley

Follow this and additional works at: <https://scholarcommons.sc.edu/sclr>



Part of the [Law Commons](#)

Recommended Citation

Harley, Colin E. (1964) "Condominiums in South Carolina: Possibilities and Pitfalls," *South Carolina Law Review*. Vol. 17 : Iss. 3 , Article 2.

Available at: <https://scholarcommons.sc.edu/sclr/vol17/iss3/2>

This Article is brought to you by the Law Reviews and Journals at Scholar Commons. It has been accepted for inclusion in South Carolina Law Review by an authorized editor of Scholar Commons. For more information, please contact digres@mailbox.sc.edu.

NOTES

CONDOMINIUMS IN SOUTH CAROLINA: POSSIBILITIES AND PITFALLS

I. INTRODUCTION

A new property concept has swept the country. It is called the condominium. In its simplest form condominium may be characterized as "ownership of individual apartments" as an interest in realty.¹ The major features of ownership in a condominium apartment are: (1) individual fee simple ownership of a unit or apartment in a multi-unit dwelling; (2) an undivided interest in designated common elements of the building, such as land, halls, stairways, and elevators; (3) an agreement among all the apartment owners, in the form of bylaws, regulating the administration and maintenance of the common elements.²

Modern civilization and urbanization have caused increasing numbers of people to live in multi-unit buildings in order to be reasonably near the centers of employment, commerce, culture and entertainment.³ Many people who choose to reside in apartment-type buildings on a long-term or permanent basis may find renting to be unsatisfactory for a variety of reasons. The person who rents forfeits the emotional satisfaction of owning his home and accepts the sometimes disagreeable process of dealing with a landlord.

There are financial disadvantages to renting. The landlord, being in the business of renting, will take his profit. Interim vacancies between one tenant and the next also must be recouped in the rental fees. Simple logic indicates that these two cost factors inherent in renting would not be present, or at least would be minimized, in condominium apartment ownership. In addition the real estate taxes⁴ and mortgage interest⁵ could be deducted from income for tax purposes by a condominium apartment owner, whereas in the rental situation the landlord, and not the apartment tenant, gets the deduction.

Condominiums came to South Carolina with the 1962 Horizontal Property Act.⁶ The writer is aware of only one condomin-

1. 15 AM. JUR. 2d *Condominiums* §1, p. 978 (1964).

2. *Ibid.*

3. Kerr, *Condominium—Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 7 (1963); Berger, *Condominium: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987, 990 (1963).

4. INT. REV. CODE OF 1954, § 164(a).

5. INT. REV. CODE OF 1954, § 163(a).

6. S. C. CODE ANN. §§ 57-471 through 57-493 (1962). The use of the word "horizontal" to describe an apartment building is intended apparently to

ium in existence and in operation in the state at this writing, but the likelihood is that it will develop rapidly in the near future as it has in many other states. Even though South Carolina has no vast metropolis, the value of land is soaring in several areas, and some trend toward real urbanization is already visible.

The purpose of this article is dual: (1) to describe the condominium and its mechanics, and (2) to delineate possible problems which may arise. No real attempt is made to "sell" the idea. That is left to the natural laws of supply and demand.

II. BACKGROUND OF THE CONDOMINIUM

A. Ancient History

It is reassuring to note that the condominium concept is not altogether new. The ownership of a single room or part of a building as an interest in real estate was probably recognized at common law.⁷ Lord Coke once stated that

A man may have an inheritance in an upper chamber, though the lower buildings and the soile be in another, and seeing it is an inheritance corporeall, it shall passe by livery.⁸

Indeed, some writers have tagged condominium statutes as "enabling acts," indicating that they merely complement the common law.⁹

In the South Carolina case of *Pearson v. Matheson*¹⁰ the court held valid the ownership of specific airspace in a building. There a grantor conveyed land and the first fourteen feet of airspace to the grantee, who wanted to construct a one-story building. The grantor reserved to himself all the airspace above the grantee's fourteen feet for the purpose of building a hotel above the grantee's one story. The court stated

Therefore, "a man entitled to land * * * may grant the mines underneath * * * and other rights in or over the property." 3 Washburn 340; *Massot v. Moses*, 3 S.C. 195.¹¹

indicate that the building is divided into horizontal layers. This is ambiguous if not incorrect. Arguably a "Vertical Property Act" would convey the concept more clearly. See Cribbet, *Condominium—Home Ownership for Megalopolis*, 61 MICH. L. REV. 1207, 1218 (1963); 15 AM. JUR. 2d *Condominiums* § 1, n. 11, p. 979 (1964).

7. Ball, *Division Into Horizontal Strata of the Landspace Above the Surface*, 39 YALE L. J. 616, 620 (1930).

8. Coke on Littleton, quoted by Ball, *Division Into Horizontal Strata of the Landspace Above the Surface*, 39 YALE L. J. 616, 621 (1930).

9. See 77 HARV. L. REV. 777 (1963).

10. 102 S.C. 377, 86 S.E. 1063 (1915).

11. *Id.* at 382, 86 S.E. at 1065.

In England and Scotland the condominium concept has been accepted without the aid of statutes.¹² Scholars agree that condominium-type ownership was well known in Europe in the Middle Ages and in Germany beginning in the twelfth century.¹³ Some writers have claimed that it may have existed in the Roman Empire¹⁴ or among the Biblical Hebrews,¹⁵ although the contentions with respect to Rome have been disproven or at least questioned.¹⁶ At any rate the relevant history of individual apartment ownership has occurred in the last forty years. Condominiums have been popular in Europe for a number of years, and as a result they reached South America before coming to North America.¹⁷

B. Modern Developments

The condominium is truly modern to the United States. Between 1961 and the end of 1964, 41 states and the District of Columbia enacted statutes.¹⁸ Only Alabama, Delaware, Idaho, Maine, Montana, New Hampshire, North Dakota, Vermont, and Wyoming lacked legislation at that time,¹⁹ and it is likely that some of these states have statutes by now. Actually the territory of Puerto Rico was the first to enact the concept with its 1951 Horizontal Property Act,²⁰ which was amended to its final form in 1958.²¹

The obvious challenge of the condominium is its newness. Statutes have not been interpreted by case law. Problems undoubtedly lie below the water line hidden from view like the

12. GEORGE, *THE SALE OF FLATS* (2d ed. 1959); Berger, *Condominium: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987, 1001-02 (1963).

13. Leyser, *The Ownership of Flats—A Comparative Study*, 7 INT'L & COMP. L. Q. 31, 33-37 (1958); Cribbet, *Condominium—Home Ownership for Megalopolis*, 61 MICH. L. REV. 1207, 1210 (1963).

14. RAMSEY, *CONDOMINIUM: THE NEW LOOK IN Co-OPS* (1961); Borgwardt, *The Condominium*, 36 CAL. S.B.J. 603 (1961).

15. See letter from Louis H. Samuels to the New York Law Journal offering a translation of an old Hebrew deed written on papyrus and conveying part of a building, the deed now being located in the Brooklyn Museum, 150 N.Y.L.J. 4 (1963).

16. BUCKLAND & McNAIR, *ROMAN LAW AND COMMON LAW* 101-02 (2d ed. 1952).

17. Kerr, *Condominium—Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 4 (1963).

18. Rohan, *Disruption of the Condominium Venture: The Problems of Casualty Loss and Insurance*, 64 COLUM. L. REV. 1045 (1964).

19. *Ibid.*

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

21. P. R. LAWS ANN. tit. 31, §§ 1291-1293k (Supp. 1961).

bulk of an iceberg. However, its newness is not so ominous. The South Carolina statute is clearly written and is quite detailed in many of the problem areas. And where gaps in the Act exist, other areas of law may be employed. The ordinary laws, concepts, and incidents of real property generally apply to the interests of the condominium apartment owners. The maintenance of the common elements of the building by agreement among the co-owners, pursuant to a set of bylaws, resembles the operation of a corporation or an unincorporated association. Thus principles of corporation, contract, and agency law may govern.

C. Condominium Compared with Co-operative

During the 1920s and 1930s the so-called co-operative became popular.²² Some people may confuse the co-operative with the condominium, but there are several real distinctions between the two. Generally a co-operative is set up as follows: (1) a corporation owns the entire apartment building; (2) the individual receives shares in the corporation and a long-term lease on a certain apartment; (3) the corporation pays the mortgage, real estate tax, and maintenance expenses from the proceeds of the lease agreements.²³

Several differences between co-operatives and condominiums should be observed:²⁴

(a) *individual ownership*—the condominium apartment owner has fee simple title to his own apartment, whereas the co-operator owns stock in a corporation, with a lease on his apartment;

(b) *individual responsibility*—the condominium apartment owner handles his own mortgage payments and real estate taxes separately, whereas the co-operative mortgage and taxes cover the entire building and a lien resulting from delinquent payments affects everyone in the building;

(c) *voice in management*—the condominium owner has a vote in proportion to the value of his apartment, whereas the co-operator has one vote, regardless of the relative value of his interest;

(d) *Blue Sky laws*—since a co-operative is a corporation, it may be subject to securities regulation, whereas a condominium owner may escape this problem entirely;

22. 15 AM. JUR. 2d *Condominiums* § 4, p. 984 (1964).

23. 15 AM. JUR. 2d *Condominiums* § 5, p. 986 (1964).

24. *Ibid.*

(e) *probate expenses*—the condominium is realty and should pass directly to the heirs or devisees, whereas stock in a co-operative, being personalty, must go to the administrator or executor, thus incurring probate expenses;

(f) *homestead exemption*—the condominium should receive the homestead exemption for realty, whereas the co-operative shares will come under the exemption for personalty in those jurisdictions where homestead extends to personalty.²⁵

The above comparisons demonstrate that condominiums and co-operatives are quite different. The distinction can be dramatized by the fact that during the Depression 75% of the co-operatives went bankrupt.²⁶ Presumably a similar disaster could not occur with the condominium, because each apartment owner is responsible only for his own tax assessments²⁷ and mortgage payments.²⁸ Liens against an insolvent neighbor do not attach to a solvent owner's apartment. The condominium owner is like a homeowner in a subdivision and is generally independent financially from the project as a whole. The only common obligation he incurs is for maintenance of the common elements. For these and other reasons the condominium should be a much more appealing arrangement than the co-operative.

III. DESCRIPTION: HOW IT WORKS

The South Carolina Horizontal Property Act never uses the word "condominium". The entire project is called a "horizontal property regime";²⁹ the individual units are "apartments";³⁰ and the owner of an apartment is referred to as a "co-owner".³¹ South Carolina and several other states followed Puerto Rico's Horizontal Property Act in omitting the word "condominium". Since the basic features are similar in all 43 statutes, the terminology is of minor concern. The device is still commonly referred to as a condominium.

25. Therefore, in South Carolina where the exemption differentiates between realty and personalty for the homestead exemption, the condominium exemption would be \$1,000 as realty, and that for the co-operative would be only \$500 as personalty. S.C. CONSTITUTION art. 3, § 28.

26. Note, *Co-operative Apartment Housing*, 61 HARV. L. REV. 1407, 1410 (1948).

27. S.C. CODE ANN. § 57-493 (1962).

28. S.C. CODE ANN. § 57-474 (1962).

29. S.C. CODE ANN. § 57-473 (1962).

30. S.C. CODE ANN. § 57-472(a) (1962).

31. S.C. CODE ANN. § 57-472(b) (1962).

Technically the word condominium means "control or ownership together". Ballentine's Law Dictionary refers to it as a form of joint ownership of real estate.³² However, neither of these definitions is nearly adequate, because the condominium has become a term of art as a result of all the legislation centered around the concept.

... "condominium" has come to refer specifically to a multiunit dwelling each of whose residents (unit owners) enjoys exclusive ownership of his individual apartment or unit, holding a fee simple title thereto, while retaining an individual interest, as a tenant in common, in the common facilities and areas of the building and grounds which are used by all residents of the condominium.³³

A. Characteristics of Ownership

1. *The apartment.* The basic element owned is, of course, the apartment. The apartment can occupy one or more floors and can constitute a residence, office, industry, or business.³⁴ It may be owned by an individual, partnership, firm, association, trust, or corporation or by any combination of these entities.³⁵ In other words the South Carolina statute places no restrictions at all on the physical arrangement, the purpose, or the ownership qualifications of condominiums. The only limitation imposed by law will be the applicable municipal zoning laws.

The kind of estate that may be held by a "co-owner" is also apparently unrestricted. Presumably most condominium purchasers will be interested in the fee simple. However, the statute permits the condominium apartment to be "the subject of ownership, possession or sale, and of all types of juridic acts inter vivos or mortis causa, as if it were sole and entirely independent of the other apartments in the building".³⁶ Leases, terms for years, life estates, fee simple absolutes, and all the various kinds of terminable estates would seem to be permissible just as with any other form of real property.

Technical questions may arise over exactly where the apartment begins and ends. This may be relevant in the recovery of insurance proceeds in the event a co-owner insures only his own

32. BALLENTINE, LAW DICTIONARY (rev. ed. 1948).

33. 15 AM. JUR. 2d *Condominiums* §1, p. 978 (1964).

34. S.C. CODE ANN. § 57-492(a) (1962).

35. S.C. CODE ANN. § 57-492(b) (1962).

36. S.C. CODE ANN. § 57-474 (1962).

apartment or the council of co-owners insures only the common elements, since common elements and the apartments are mutually exclusive. Does the apartment include the enclosing walls? Or does the apartment space begin with the first coat of paint on the walls? The statute is silent as to what the apartment includes.

Some indication of apartment boundaries may be found in the statutory definition of "general common elements". These include "main walls" and "all other elements of the building rationally of common use or necessary to its existence, upkeep and safety".³⁷ If main walls means "main supporting walls", there would be a question as to whether that includes walls which merely partition rooms without supporting other parts of the building. And the phrase "all other elements . . . rationally of common use" is classic litigation language; thus the answer does not appear to reside in the statute. It is suggested that the precise line between apartments and common elements may be set out in the master deed, because the Act requires a description of both in the master deed anyway.³⁸ Most statutes set the boundaries of apartments at the inner surfaces of the walls, floors, ceilings, windows, and doors.³⁹ This would be consistent with the definition in the South Carolina Act of an apartment as "an enclosed space".

2. *The common elements.* Everything outside the individual apartment constitutes the common elements of the condominium project. The Act specifies the following as "general common elements":⁴⁰ the land, building foundations, main walls, roofs, halls, lobbies, stairways, all entrance, exit or communication ways, basements, flat roofs, yards, gardens, lodging for janitors or other persons in charge of maintenance, all central installations of power, light, gas, cold and hot water, refrigeration, reservoirs, water tanks and pumps, elevators, and garbage incinerators. Then the statute uses catch-all phrases, the broadest of which is "all other elements of the building rationally of common use or necessary to its existence, upkeep and safety". It seems the first sentence of this paragraph is the most accurate description. The common elements include everything outside the individual apartments once a precise definition of the apartment is set out.

37. S.C. CODE ANN. § 57-472(d) (1962).

38. S.C. CODE ANN. § 57-479 (1962).

39. 15 AM. JUR. 2d *Condominiums* § 1, p. 980 (1964).

40. S.C. CODE ANN. § 57-472(d) (1962).

It should be observed that there may be a class of "limited common elements",⁴¹ the use of which is restricted to certain designated apartments to the exclusion of others. This could include any special corridors, elevators, sanitary services, or the like. For any common elements to be declared "limited", there must be an agreement by "all the co-owners", i.e. a unanimous agreement, to that effect. Limited common elements will present a problem of assessing those who have the use of them, unless everyone in the building has the same type and amount of limited common elements allotted to him.

The ownership of the common elements has unique characteristics. Although writers have referred to it as a tenancy-in-common,⁴² this is inaccurate. It is a form of joint ownership, but neither the traditional tenancy-in-common nor the joint tenancy has the same features as the interest in the common elements of a condominium. The Act gives each apartment owner "a common right to a share, with the other co-owners, in the common elements of the property".⁴³ However, unlike a tenant-in-common, a disgruntled condominium co-owner is prohibited by the statute from separating his interest in the common elements in any way, by partition or otherwise.⁴⁴ Any contractual attempt to circumvent the statute on this point is void. His only protection lies in the general requirement that the co-owners respect each others' rights to the common elements.⁴⁵ This right is enforceable by an injunction or an action for money damages, it would appear. Also, contrary to the joint tenancy, the interest in the common elements does not have to be created in a single instrument, and there is no right of survivorship in the co-owners. Thus this form of concurrent ownership, it is submitted, is peculiar to the condominium and is a creature of the statute.

The ownership of the common elements appears to be an incident to ownership of an apartment and is included in the title to the apartment.⁴⁶ No separate deed is required for the interest in common elements. The Act provides specifically that "conveyance of an individual apartment shall be deemed to also convey the undivided interest of the owner in the common elements, both

41. S.C. CODE ANN. § 57-472(e) (1962).

42. 15 AM. JUR. 2d *Condominiums* § 1, p. 978 (1964).

43. S.C. CODE ANN. § 57-476 (1962).

44. S.C. CODE ANN. § 57-477 (1962).

45. S.C. CODE ANN. § 57-478 (1962).

46. S.C. CODE ANN. § 57-476 (1962).

general and limited, appertaining to the apartment without specifically or particularly referring to same."⁴⁷

The common elements are managed and maintained pursuant to a set of bylaws,⁴⁸ subject to the voting rights vested in all the apartment co-owners. The weight of a co-owner's vote depends on the *original value* of his apartment in relation to the value of the whole project.⁴⁹ Each apartment has a computed percentage of voting power and of obligation for common expenses, which percentage must be set out in the master deed before any apartments are sold.⁵⁰ The voting percentage of each apartment cannot be varied except by unanimous consent—the Act says "acquiescence"—of the co-owners.⁵¹ However, this does not prevent a co-owner from selling his apartment at a premium as the value of real estate appreciates. The purchaser merely must be willing to accept the original voting percentage held by his vendor.

B. Establishment—Three Documents

1. *The master deed.* The first procedural step required is the execution and recordation of a master deed covering the entire project.⁵² The purpose of the master deed is to create and establish the horizontal property regime, to give an apartment building status as a condominium before any individual conveyances are made. Its purpose also appears to be to lodge every detail of the project and its subsequent administration in a comprehensive instrument. The bulk of the attorneys' work is done at this preliminary stage.

The master deed must contain the following:⁵³ (1) a legal description of the land and building; (2) a description and number designation of each apartment; (3) a description of all common elements, including the details of any limited common elements; (4) the value of the project and of each apartment and the computed percentage of voting rights and responsibilities for common expenses assigned to each apartment.

47. *Ibid.*

48. S.C. CODE ANN. § 57-484 (1962).

49. S.C. CODE ANN. § 57-476 (1962).

50. S.C. CODE ANN. §§ 57-476 and 57-479(d) (1962).

51. S.C. CODE ANN. § 57-476 (1962).

52. S.C. CODE ANN. § 57-473 (1962).

53. S.C. CODE ANN. § 57-479 (1962).

An accurate and detailed set of building plans must be attached to the master deed before recordation.⁵⁴ The plans must be certified by an architect or engineer authorized or licensed to practice in South Carolina. Presumably he might certify that the plans meet acceptable standards of engineering and that the building was constructed according to the plans, although the Act does not specify just what is to be certified.

Finally the master deed must also include an attached copy of the bylaws.⁵⁵ This is probably the most important instrument in the condominium.

2. *The bylaws.* The administration and maintenance of the project as a whole are outlined in the bylaws. The Act requires that certain matters be provided for in the bylaws.

(a) Form of administration, indicating whether this shall be in charge of an administrator or of a board of administration, or otherwise, and specifying the powers, manner of removal, and where proper, the compensation thereof;

(b) Method of calling or summoning the co-owners to assemble; that a majority of at least fifty-one per cent is required to adopt decisions; who is to preside over the meeting and who will keep the minute book wherein the resolutions shall be recorded;

(c) Care, upkeep and surveillance of the building and its general or limited common elements and services;

(d) Manner of collecting from the co-owners for the payment of the common expenses;

(e) Designation and dismissal of the personnel necessary for the works and the general or limited common services of the building.⁵⁶

Any modification or amendment in the system of administration must be made by at least two thirds of the total vote of the horizontal property regime and must be recorded to be effective.⁵⁷

Obviously the system of administration required to be put in the bylaws vitally concerns each individual co-owner, as it may affect both his residence and his pocketbook. What to put in the bylaws will be considered in some detail in the subsequent discussion titled "Administration and Maintenance".

54. S.C. CODE ANN. § 57-480 (1962).

55. S.C. CODE ANN. § 57-484 (1962).

56. S.C. CODE ANN. § 57-485 (1962).

57. *Ibid.*

3. *Individual deeds.* Having recorded the master deed with certified building plans and bylaws appended, the developer may convey apartments to individuals. The statute makes this a streamlined process by allowing each apartment to be described by reference to the letter or number designation in the recorded building plans and to the name of the enterprise.⁵⁸ A conveyance of "apartment 5-X in the Dreamhouse Horizontal Property Regime" should constitute a sufficient legal description. In addition the same section states that conveyance of an apartment is deemed to convey the proportionate interest in the common elements without the necessity of specifying it. Except for these particular aspects of the condominiums, it should be presumed that the individual deeds must contain all the clauses, words of inheritance, and provisions ordinarily employed in deeds of real estate.

IV. POTENTIAL PROBLEM AREAS

There are several important fields which are fertile ground for some early planning in order to avoid serious problems after the condominium project has been constructed. The bylaws and the master deed must be drafted so as to close any gaps in the Act and to solidify a smoothly functioning plan of administration.

A. Administration and Maintenance

There must be an administrative scheme in the bylaws for implementing the decisions of the council of co-owners. This plan will be concerned with maintaining and repairing the common elements, obtaining and paying for janitorial and maintenance services, and collecting from the apartment owners the assessments for the common expenses incurred in such maintenance. The administration may also be empowered to procure various kinds of insurance for the building⁵⁹ and to perform whatever additional operations the council of co-owners may decide to undertake.

A form of administration must be chosen. Administration may be delegated to a single professional manager chosen by a vote of the council of co-owners, just as a municipality may hire a professional city manager. Or it could be performed by a board of administrators consisting of several of the apartment owners elected by the other co-owners. This arrangement resembles the board of directors of a corporation. Finally administration could

58. S.C. CODE ANN. § 57-481 (1962).

59. S.C. CODE ANN. § 57-490 (1962).

be left to the entire council of co-owners, although this method would seem to be the most cumbersome and inefficient of the three. Actually the South Carolina Act allows any form of administration to be adopted.⁶⁰ Having specified a form, the by-laws must define the administrative body's powers, compensation if any, and manner of removal.

How far the administrative powers extend is a matter of choice to some degree. In order to have a convenient and smooth-running organization, the condominium owners may want to consider delegating the following authority to the administration: (1) to set the time for meetings of the council of co-owners and to serve notice thereof; (2) to obtain and pay for janitorial services and maintenance operations for the common elements; (3) to bond the management; (4) to procure fire, casualty, and liability insurance for the entire horizontal property regime; (5) to discharge any liens which attach to the entire project; (6) to contract for reconstruction of portions of the building in the event of fire or casualty loss; (7) to assess and collect the common expenses from the co-owners in the manner prescribed in the bylaws; (8) to keep complete records of receipts and expenditures as required by the statute. Thus the bylaws will define the scope of their powers and will set out the other matters required by the section on bylaws that was quoted previously in this article. Of course, exercise of the various powers of administration will depend upon what resolutions the council of co-owners should adopt.

The administrative system can, of course, be changed by a vote of co-owners representing two-thirds of the value of the building, so long as the adopted modifications are recorded.⁶¹ But because of the two-thirds requirement, the bylaws should be drafted with the realization that the system may tend to become permanent.

The basic decisions on administrative policies of the condominium regime are made by the council of co-owners and implemented by the administrative body. A majority of at least 51% of the *value of the building* must vote for adoption of a decision before it becomes effective;⁶² thus quorum requirements appear

60. S.C. CODE ANN. § 57-485(a) (1962).

61. S.C. CODE ANN. § 57-485 (1962).

62. The statute states that "a majority of at least fifty-one percent is required to adopt decisions". S.C. CODE ANN. § 57-485(b) (1962). It does *not* say a majority of those present at the meeting. And the statute defines "majority of co-owners" as "fifty-one percent or more of the basic value of the property as a whole". S.C. CODE ANN. § 57-472(f) (1962).

to be irrelevant under the South Carolina Act. Also, the Act is silent as to whether proxies may be used, so possibly this could be decided in the bylaws. Clearly the co-owners still have command over the management in decision-making.

A final consideration in the area of management is whether to incorporate the administrative body. The statute does not specifically authorize incorporation, but presumptively its silence on the matter would allow incorporation. Lawyers and laymen alike are more familiar with, and confident about, corporations than they are about unincorporated associations,⁶³ and this may prompt some developers to incorporate the management. The strongest motivation to incorporate stems from the desire to limit liability. A member of an unincorporated association is jointly and severally liable for the contracts and torts of the association,⁶⁴ and most people will want to avoid this risk. Incorporation probably provides the answer. It should be pointed out, though, that incorporation is not an absolute guarantee.⁶⁵ There is an argument that the managing corporation could be treated as an agent⁶⁶ or alter ego⁶⁷ of the apartment owners and that the owners are liable personally as principals. Or the courts might pierce the corporate veil if the co-owners have some dishonest motive for incorporating.⁶⁸ On balance, incorporation should effect limited liability, and in no event should a co-owner be held liable for more than his proportionate share.⁶⁹ And as a practical matter apartment owners will probably feel more secure if the management of common elements is incorporated.

B. Collection of Assessments

One of the largest gaps in the South Carolina Act concerns the collection by the management of assessments for common expenses. The statute states that "co-owners of the apartments

63. Strictly speaking, the council of co-owners of a condominium is not in every respect like an unincorporated association, since no co-owner may avoid the common expenses by dissenting from the decision or withdrawing from the use of the common elements. S.C. CODE ANN. § 57-487 (1962).

64. FORD, UNINCORPORATED NON-PROFIT ASSOCIATIONS 51-69 (1959).

65. Berger, *Condominium: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987, 1007 (1963).

66. See *Shamlian v. Wells*, 197 Cal. 716, 242 Pac. 483 (1925).

67. See *Minton v. Cavaney*, 56 Cal.2d 576, 364 P.2d 473 (1961); BALLANTINE, CORPORATIONS § 122, at 292-93 (rev. ed. 1946); LATTIN, CORPORATIONS 66 (1959).

68. BALLANTINE, CORPORATIONS §§ 127, 130, 339 (rev. ed. 1946).

69. Berger, *Condominium: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987, 1008 (1963).

are bound to contribute pro rata . . . toward the expenses of administration and of maintenance and repair of the general common elements".⁷⁰ Unlike dissenters in an ordinary unincorporated association, condominium apartment owners may not avoid participation in common expenses.

No co-owner may exempt himself from contributing toward such expenses by waiver of the use or enjoyment of the common elements or by abandonment of the apartment belonging to him.⁷¹

The problem in South Carolina is that the statute fails to provide for a lien against an apartment owner who cannot or will not pay his assessments. Thus the obligation to pay appears to be a mere debt, and no remedy may be had until the debt is reduced to a general judgment lien, which then could be levied upon. Possibly the absence of a lien for unpaid assessments reflects legislative concern for mortgagees. But it would seem that a lien for assessments subordinate to prior recorded mortgages could have been created by the Act to facilitate collection of assessments.

Stronger provisions are found in a number of statutes. In California there is a lien on the apartment as soon as the management records a notice of deficiency, and this lien includes interest, costs, and attorneys' fees.⁷² In the District of Columbia a lien arises when expenses are assessed.⁷³ The absence of a lien similar to these probably constitutes a weakness in the Act.

The attorney could attempt to create the lien for unpaid assessments by contract, drafting it into his master deed, bylaws, and individual deeds. Whether this would be successful would be difficult to predict as an absolute. There is respectable support for the general proposition that an equitable lien may be created by express contract under certain conditions.⁷⁴

The South Carolina case of *Dow v. Ker* held that a contract to mortgage personalty created an equitable lien with a preference over general creditors.⁷⁵ In that case the defendant, being unable to pay a due debt, secured an extension of the time for

70. S.C. CODE ANN. § 57-487 (1962).

71. *Ibid.*

72. CAL. CIV. CODE § 1356 (1963).

73. D.C. CODE § 5-916(d) (1963).

74. See *Stanley v. Cox*, 253 N.C. 620, 117 S.E.2d 826 (1961); 33 AM. JUR. LIENS § 19, pp. 428-29 (1941).

75. *Dow v. Ker*, Speers Eq. 413 (1844)

payment from Carter. In consideration of the extension, Ker agreed on April 7, 1840, that he would give to Carter a mortgage on certain of his negro slaves and other personal property if the debt were not paid by April 7, 1843. This constituted the contract to mortgage personalty to Carter. Two years later, in 1842, Dow and other general creditors brought an action in an attempt to levy on the negro slaves, asserting that the 1840 agreement to mortgage them did not create a lien. The court upheld the lien over the general creditors and adopted *per curia* the decree of Chancellor Johnston, who stated

Now, I do not perceive on what ground the complainants have a right to complain, for Ker, who was in debt to Carter, might think proper to give him a lien on his property; and what right have they to complain?⁷⁶

The court, therefore, upheld the creation of a lien by express contract and since that time has continued to do so.⁷⁷

The abstract legal principle of *Dow v. Ker* appears favorable to an attempt to create by contract a lien for unpaid assessments against a condominium apartment owner. In *Dow* the promisor created a lien by saying, "I'll mortgage my property to you if I don't pay my debts by a certain date", and the lien existed from the day of the agreement and before any mortgage was executed. It would be quite similar for the purchaser of a condominium apartment to agree that a lien would attach to his apartment upon his failure to pay assessments. The only possible distinguishing factor is that, whereas in *Dow v. Ker* the lien was created on an existing debt, the apartment owner will be contracting a lien for future debts. It is doubtful that this distinction would prevent a contractual lien for unpaid assessments, but the draftsman should take pains to see that his document creating the lien is strongly stated and unambiguous. In spite of the favorable cases, this area should be regarded as somewhat uncharted. Also, it is extremely important that any attempt to create a lien for unpaid assessments should be made subject to a mortgagee's prior lien in order to reassure lenders.

Subsequent purchasers of condominium apartments have a real caveat to observe. The strongest provision in the Act concerning unpaid assessments is aimed at purchasers from delin-

⁷⁶ *Id.* at 419.

⁷⁷ See *Moore v. Bynum*, 10 S.C. 452 (1877); *Davis v. Childers*, 45 S.C. 133, 22 S.E. 784 (1895); *Avery v. Wilson*, 47 S.C. 78, 25 S.E. 286 (1896); *Creech v. Long*, 72 S.C. 25, 51 S.E. 614 (1905).

quent co-owners. If a purchaser buys an apartment from a vendor who has been delinquent in paying for assessments, the purchaser "shall be jointly and severally liable with the seller for the amounts owing by the latter . . . without prejudice to the purchaser's right to recover from the other party the amounts paid by him as such joint debtor."⁷⁸ The debt runs with the apartment, so in a very subtle form, there is something that resembles a lien in the statute. In addition when a delinquent co-owner sells his apartment, the Act provides that unpaid assessments "shall first be paid out of the sales price",⁷⁹ thus allowing the administration to go against the proceeds of the sale. This right to pursue the proceeds of a sale in the hands of a delinquent co-owner is, however, subject to and preceded by accrued taxes and payments due under a prior recorded mortgage.

C. Mechanics' Liens

Mechanics' liens represent another area where the silence of the Act raises questions. This topic will be considered only briefly to illuminate problems which may arise. No extensive discussion will be attempted.

When work has been performed on the common elements at the request of the administration, may the person furnishing the services have a mechanic's lien on those common elements? The South Carolina Act does not specify that he does not. In contrast the Model Act expressly prohibits liens against the entire property once it has been submitted to condominium status.⁸⁰ Lacking such a provision, the South Carolina Act does not forbid liens. But a lien on the common elements would be hampered, if not completely nullified, by the statute's prohibition against any partition or division of the common elements.⁸¹ This provision should prevent any sale of the common elements to enforce a mechanic's lien. Therefore the lien would be emasculated. At any rate there is uncertainty, and the practitioner should be aware that there is a problem in this area.

D. Restraints on Alienation

In rental property the landlord has some discretion in accepting and rejecting tenants. He may be motivated to seek tenants

78. S.C. CODE ANN. § 57-489 (1962).

79. S.C. CODE ANN. § 57-488 (1962).

80. FHA MODEL ACT § 9.

81. S.C. CODE ANN. § 57-477 (1962).

that will be at least generally acceptable to his other tenants. But in a condominium the apartment owner has a fee simple, and he may be willing to sell unselectively when he decides to change his residence. Possibly it would be wise and desirable to provide some limitations on alienation.

Restraints on alienation must be reasonable to be valid.⁸² Covenants or contracts that require discrimination on a racial or religious basis are not enforceable in a court of law for constitutional reasons.⁸³ However, it is generally agreed that a right of first refusal, i.e. an option to purchase, is a reasonable restraint.⁸⁴ It could be provided in the bylaws and deeds or in a recorded side agreement that the council of co-owners will have the first option to purchase any apartment to be sold, such option to be exercised at the market price. Although stricter restraints could probably be imposed, it is suggested (1) that the strict restraints would destroy one of the best qualities of the condominium, namely, free alienability, and (2) that a first refusal option is sufficient protection for the co-owners anyway.

Any restraint imposed should expressly protect and not encroach upon the rights of mortgagees. If the council's option to purchase has a preference over a subsequent mortgagee's right to foreclose and sell, lenders may become disenchanted with the condominium.

E. The Viewpoint of Lenders

How the financial world will accept the condominium is of major concern to the developer. At least two phases of financing are required, the first being the original construction costs of the entire project, the second being the individual purchases of apartments.

Even if the condominium developer has good financial standing, he could face the practical problem that lenders may be conservatively nervous about financing a new idea in ownership. The lender may wonder how successful the developer will be in selling the apartments, even though he would have been willing to finance the same building as rental property. This caution probably is unjustified, because if no apartments are sold, the

82. See 6 AMERICAN LAW OF PROPERTY §§ 26.64-26.67 (Casner ed. 1952); RESTATEMENT, PROPERTY § 413 (1944); Schnebly, *Restraints Upon the Alienation of Legal Interests*: I, 44 YALE L. J. 961, 989 (1935).

83. *Shelley v. Kraemer*, 334 U.S. 1 (1948).

84. 15 AM. JUR. 2d *Condominiums* § 17 (1964).

horizontal property regime may be waived and converted to rental property.⁸⁵ Or if the developer were able to sell only some of the apartments, presumably the remaining ones could be leased rather than sold.

There may be another way to satisfy wary lenders. The developer could solicit contracts to purchase apartments before he begins construction. If 50-75% of the apartments could be sold in advance, the lenders' risk would be substantially reduced. Naturally the developer's attorney should draw purchase agreements which provide for adequate liquidated damages in the event of breach by the buyer or which would support an estoppel theory if an action for specific performance were necessary.

The next problem, then, is to convince prospective apartment purchasers to sign binding purchase agreements prior to construction of the building. The obvious difficulty is that the prospective buyer will want to see an apartment before committing himself. The writer has it, on information and belief, that developers in Florida have successfully used the technique of building one sample apartment purely for persuading prospective buyers to sign purchase agreements. This could well solve the problem of obtaining financing.

Once construction of the building has been accomplished, lenders should receive the condominium with a warm embrace. Instead of one large mortgage on the entire building, there will be 25, 50, or possibly 100 mortgages. This will increase the lenders' service charges, of course. On the other hand, there are a great many advantageous aspects from which lenders may benefit. There is only one piece of property and one building to inspect. The building will have uniform maintenance by professional services. Whereas some lenders are too small to finance an entire apartment building at once, the condominium gives these smaller institutions, such as federal savings and loan associations, an opportunity to serve the apartment owners individually. This automatically means that the lender will have the chance to offer all its other services to the individual apartment owners through direct contact. Finally the condominium will spread the lenders' risk in that instead of a single landlord's solvency, there will be a large group of individual mortgagors to depend upon for satisfaction of the mortgages on the apartments.

Lenders have a special interest in fire and casualty insurance to protect their interests in mortgaged property. Most mortgages

85. S.C. CODE ANN. § 57-482 (1962).

contain a "standard mortgagee" clause which gives the mortgagee in event of a catastrophe the option of taking the insurance proceeds or allowing the mortgagor to use them to rebuild.⁸⁶

The Horizontal Property Act clashes with the traditional rights of the mortgagee under the "standard mortgagee" clauses. The Act states, "In case of fire or any other disaster the insurance indemnity shall . . . be applied to reconstruct the building."⁸⁷ The only time reconstruction is not mandatory is when the building is more than two-thirds destroyed. It requires unanimous consent of the co-owners to rebuild if two-thirds or more of the building is destroyed, and unless reconstruction is agreed upon unanimously, insurance proceeds will be distributed to the co-owners pro rata, subject to the liens of mortgagees. But in the usual situation insurance proceeds *must* be applied to rebuilding under the Act. The provision would seem to overrule the mortgagee's right to the proceeds under a "standard mortgagee" clause. As a purely practical matter this may be inconsequential, because in nearly every case mortgagees allow proceeds to go for reconstruction anyway. However, until it can be proven that mortgagees are willing to forego a "standard mortgagee" clause, this remains at least a theoretical problem. A possible solution will be discussed in the section below on "Insuring the Condominium".

F. Insuring the Condominium

The most vital consideration for the condominium may well be adequate insurance.⁸⁸ This can hardly be overemphasized. A single fire or catastrophe could destroy a large number of "homes" in a condominium at once. Rebuilding is mandatory under the Act if the building is less than two-thirds destroyed,⁸⁹ and the cost of rebuilding must be paid pro rata by those co-owners "directly affected by the damage".⁹⁰ If some of the affected co-owners are unable, because of inadequate insurance, to pay for reconstruction, the value and living atmosphere of the entire building would be adversely affected. The apartments untouched by the catastrophe have a definite interest, it would

86. RATH, GRIMES & MOORE, STRATA TITLES 45 (1962).

87. S.C. CODE ANN. § 57-491 (1962).

88. Rohan, *Disruption of the Condominium Venture: The Problems of Casualty Loss and Insurance*, 64 COLUM. L. REV. 1045, 1046 (1964).

89. S.C. CODE ANN. § 57-491 (1962).

90. S.C. CODE ANN. § 57-492 (1962).

seem, in having all parts of the building, including other apartments, repaired and livable.

Three parties have an insurable interest in every condominium apartment. Naturally, there is the owner of the apartment. Secondly, the mortgagee may insure to protect his lien interest. Thirdly, the administrative body of the condominium has an insurable interest granted by the Act.⁹¹ There is no statutory requirement as to who should procure insurance. Arguably all three can do so. The Act states that the council of co-owners may "insure the building against risks, without prejudice to the right of each co-owner to insure his own apartment on his own account and for his own benefit."⁹² It should be evident that a helter-skelter insurance program could be disastrous.

Insurance planning should be concerned with at least six basic questions: (1) who should procure insurance; (2) how much insurance will be adequate to allow reconstruction; (3) how to avoid overlapping coverage and payment of excess premiums; (4) what insurance plan will satisfy mortgagees; (5) what is the best way to administer the proceeds; (6) whether to take advantage of group policy rates. There are some extremely complex legal questions on insuring the condominiums, and this article of necessity attempts to block out only the broader considerations.⁹³

The most persuasive arguments found among legal writers call for a single master policy on the entire building for several compelling reasons.⁹⁴ Each apartment is inseparably connected to the condition of the whole structure. Reconstruction can be most conveniently effected if conducted and paid for by the administration rather than in a piecemeal fashion by each co-owner. With one master policy there would be no possibility of overlapping the insurable interests of co-owners, mortgagees, and administration and of duplicating premiums. In addition a group fire and casualty policy could be obtained at lower premium rates. Another consideration is that FHA administrators will probably prefer a master policy if they are to approve FHA-

91. S.C. CODE ANN. §57-490 (1962).

92. *Ibid.*

93. For a comprehensive and scholarly treatment of condominium insurance, see Rohan, *Disruption of the Condominium Venture: The Problems of Casualty Loss and Insurance*, 64 COLUM. L. REV. 1045 (1964).

94. For the strongest arguments in favor of the master policy, see RATH, GRIMES & MOORE, *STRATA TITLES* 45-46 (1962). Also, see analogy of interdependent merchants in a shopping center, Pollack, *Shopping Center Leases*, 9 KAN. L. REV. 379 (1961).

insured mortgages. For administrative convenience it may be desirable to stipulate in the master policy that the insurance proceeds may be paid directly to an apartment owner if the damage were limited to a single apartment, thereby eliminating an unnecessary administrative step in the limited damage situation. A final argument in favor of the master policy is that the statute expressly permits co-owners to insure their interests concurrently with a master policy,⁹⁵ so if a master policy were procured by the administration, an apartment owner would still have the option of insuring his personal property and any improvements he has made on his apartment. Unless an unforeseen strong objection to the master policy appears, it seems to offer every possible advantage that could be gained by an insurance program.

If the planner rejects the master policy arguments in favor of individual apartment policies, he should at least co-ordinate the individual policies to avoid duplication of premiums.⁹⁶ This can be done by an agreement among co-owners specifying what amount of insurance each apartment owner will carry. Providing for individual policies will forfeit the advantage of group rates and will require the administrative inconvenience of collecting the costs of reconstruction from the co-owners one by one. Also there would be a problem about damage that affected only common elements and no apartments. It is not clear that individual policies would cover that at all, since the interest in common elements is undivided. This problem may force the co-owners to procure a master policy for at least the common elements. Again all reason seems to be against individual policies.

The amount of insurance is a prime concern regardless of who buys it. Since construction costs are likely to continue rising at least as fast as the cost of living, insurance based on original cost will be inadequate to cover reconstruction completely. Therefore, it is recommended that the amount of insurance be based on appreciated value of the building or, even better, on estimated cost of reconstruction. Besides fire and casualty, liability insurance should be considered to guard against suits by invitees who are injured while on the condominium property.⁹⁷

95. S.C. CODE ANN. § 57-490 (1962).

96. Rohan, *Disruption of the Condominium Venture: The Problems of Casualty Loss and Insurance*, 64 COLUM. L. REV. 1045, 1060 (1964).

97. Kerr, *Condominium—Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 43 (1963).

It goes without saying that lenders who take mortgages on individual apartments will demand that insurance be adequate. As has already been discussed in "The Viewpoint of Lenders", the mandatory application of insurance proceeds to reconstruction may nullify the lenders' traditional right to the proceeds under a "standard mortgagee" clause. Even if the lender accepts this limitation upon his interest, he will be more concerned than usual about the insurance arrangements. It is suggested that the lender may be made to feel more secure if the insurance program includes two safety features: (1) comprehensive fire, casualty, and liability coverage for the maximum amount required for reconstruction;⁹⁸ (2) a reliable corporate trustee to receive and administer all the proceeds pursuant to the plan of reconstruction.⁹⁹ This should give a lender considerable security, and the only problem remaining would be the ability of the apartment co-owners, the individual mortgagors, to continue their mortgage payments while paying rent for a temporary residence during reconstruction. This last problem exists anyway, whether the mortgagor owns a house or a condominium apartment.

If the mortgagee insists on separate insurance coverage for his interest, possibly the apartment mortgagor would be willing to pay for an individual policy *in addition to* the master policy in order to satisfy his mortgagee. In spite of traditional notions of insurable interest, the Act seems to permit full insurance by both the administration and the individual co-owner.¹⁰⁰ In reference to the insurance provisions of condominium statutes, one writer has concluded, "If any theme is revealed, it appears to be one of permissive duplication of coverage."¹⁰¹ Startling though it may seem, then, dual insurance of the condominium apartment seems permissible.

There may be another route to obtaining dual coverage in order to placate the mortgagee. This is the so-called "valued policy" whereby the insurer agrees to pay a face amount regardless of

98. Fire and casualty insurance should be considered in terms of reconstruction cost to prevent the insurance company from deducting building depreciation in arriving at a loss figure. For guidelines on valuation problems, see McWilliams, *Valuation of Buildings For Insurance Purposes*, 1952 INS. L. J. 525, and Taylor, *Element of Depreciation on Partial Building Losses*, 1956 INS. L. J. 295.

99. Use of a corporate trustee for holding insurance proceeds has become popular in some jurisdictions. See Ellman, *Fundamentals of Condominium and Some Insurance Problems*, 1963 INS. L. J. 733, 737.

100. S.C. CODE ANN. § 57-490 (1962).

101. Rohan, *Disruption of the Condominium Venture: The Problems of Casualty Loss and Insurance*, 64 COLUM. L. REV. 1045, 1055 (1964).

insurable interest. This is authorized in some situations by a South Carolina statute.¹⁰² The purpose of the statute is to protect the insured from uncertainty as to the valuation of his interest¹⁰³ by allowing him to contract for a specific amount, up to the full value of the property, and the insurer cannot at a later time attempt to show that the insured's interest was less than the face amount of the policy.¹⁰⁴ But the "valued policy" route is not free of difficulties. The insurer may be entitled to prorate his risk if the insured has another policy on the same property.¹⁰⁵ It is arguable, though, that the right to prorate can be estopped. In *Hunt v. General Ins. Co.*,¹⁰⁶ the life tenant of a building insured the structure for its full value, and the insurer issued a policy knowing of the insured's limited interest. The court held that the knowledge of the limited interest of the insured, along with issuance of the policy and collection of the premiums for the full value, amounted to an estoppel. The insurer had to pay the life tenant the full amount of the damage even though the remainderman had also collected for his interest in the building. Thus the "valued policy" and an estoppel combined to allow dual coverage.¹⁰⁷ Whether the *Hunt* doctrine would apply to the condominium facts cannot be predicted conclusively. Probably the dual coverage permitted in the Act is the clearest route to duplicate insurance.

The suggestions made in this discussion of insurance only raise the issues in a general way. This area merits a great deal of thought and detailed planning, and the attorney will have to incorporate a variety of practical considerations into his insurance planning. There is room for a good deal of imagination on the part of the planner in these areas left unsettled by the Act.

G. FHA-Insured Mortgages

The FHA encourages condominium development. The stated purpose of the Housing Act of 1961 is "to provide an additional

102. S.C. CODE ANN. § 37-154 (1962). For a detailed discussion of this statute, see Tate, *The South Carolina Valued Policy Statute and the Apportionment of Proceeds from the Insurance of Limited Interests in Real Estate*, 10 S.C.L.Q. 248 (1958).

103. *Aetna Ins. Co. v. Norris Bros.*, 109 F.2d 172 (4th Cir. 1940).

104. *Holden v. Hanover Fire Ins. Co.*, 128 F. Supp. 527 (W.D.S.C. 1957).

105. Procuring additional insurance without the insurer's consent and against the provisions of the policy allowed the insurer to avoid the policy. *Wynn v. Caledonian Ins. Co.*, 100 S.C. 47, 84 S.E. 306 (1915).

106. 227 S.C. 125, 87 S.E.2d 34 (1955).

107. For a more recent case estopping an insurer from prorating its liability, see *Edwards v. Great American Ins. Co.*, 234 S.C. 404, 108 S.E.2d 582 (1959).

means of increasing the supply of privately owned dwelling units where . . . real property title and ownership are established with respect to a one-family unit which is part of a multifamily project."¹⁰⁸ That Act provided for FHA insurance on condominium apartment mortgages up to a ceiling of \$25,000.¹⁰⁹ In 1964 Congress further demonstrated its benevolent attitude by raising the ceiling to \$30,000 and adjusting other limitations upward.¹¹⁰

If the apartment purchasers are to obtain FHA-insured mortgages, the entire building must have been previously covered by some kind of FHA-insured mortgage, other than a co-operative mortgage.¹¹¹ The purpose of this is to make sure that the condominium apartments are in a building that meets FHA property and construction standards.¹¹² Therefore, the developer must decide at the outset whether to FHA the building during construction so that apartment purchasers may get FHA financing. It may well be a good selling point for the seller to have FHA insurance available.

The FHA commissioner's regulations require a public deed¹¹³ that is essentially the same as the master deed under the South Carolina Act. The land and building, the units, and the common elements must be described. The valuation of the individual apartments must be shown and may not be in excess of the FHA appraisal. Each unit owner must have a vote in accordance with his percentage of ownership. And there must be a plan of administration.

The FHA imposes other limitations of its own. The plan of administration may not be changed without FHA approval.¹¹⁴ In addition the regulations *require* a master, or "blanket", insurance policy on the project, unless the commissioner approves some other plan,¹¹⁵ and indications are that the master policy

108. 75 Stat. 160 (1961), 12 U.S.C.A. § 1715y(a) (Supp. III 1961).

109. 24 C.F.R. § 234.27(a)(1) (Supp. 1964); 75 Stat. 160 (1961), 12 U.S.C.A. § 1715y(c) (Supp. III 1961), as amended, 78 Stat. 780-782 (1964).

110. 78 Stat. 780-782 (1964), 12 U.S.C.A. § 1715y(c) (Supp. 1964) amending 75 Stat. 160 (1961).

111. 75 Stat. 160 (1961), 12 U.S.C.A. § 1715y(c) (Supp. III 1961); see 24 C.F.R. § 234.1k (Supp. 1963).

112. Kerr, *Condominium—Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 19 (1963).

113. 24 C.F.R. § 234.26(b) (1962).

114. 24 C.F.R. § 234.26(b)(7) (1962).

115. 24 C.F.R. § 234.26(b)(9) (Supp. 1964).

is preferred by the FHA. There must be a plan to convert or terminate the FHA coverage carried by the developer as he sells each individual apartment.¹¹⁶

When the developer begins to sell apartments, he must prepare a form known as the "Schedule of Units".¹¹⁷ With this form the developer applies for a "Blanket Commitment for Insurance of Individual Mortgages" to be issued by the FHA. This "commitment" appears to be a promise or offer by the FHA to insure the mortgages on the individual units if the project is completed and if the FHA approves 80% of all apartment purchasers. Although it does not seem to matter how many of the apartment owners choose to FHA their mortgages, the FHA won't insure any mortgages at all unless it "approves" the purchasers of 80% of the value of the project.¹¹⁸ Then the developer must apprise all prospective purchasers of the FHA appraisal value when he offers apartments for sale.¹¹⁹

If a purchaser desires to have FHA insurance on his mortgage, he must accept some FHA limitations. He must occupy at least one of the units he buys, and altogether he may own no more than four FHA units in the condominium project.¹²⁰ The amount of an apartment purchaser's FHA-insured mortgage may not exceed \$30,000 in any case.¹²¹ The purchaser may borrow (1) 97% of the first \$15,000 of the value of his apartment, (2) 90% of amounts between \$15,000 and \$20,000, and (3) 75% of amounts in excess of \$20,000.¹²² In other words, the mortgage may cover all but \$450 of a \$15,000 apartment, all but \$950 of a \$20,000 one, and all but \$3,450 of a \$30,000 one. The mortgage is limited to 35 years or three-fourths of the remaining life of the project, whichever is less.

Possibly a more stringent limitation is the per room dollar provision. In a small building there would probably be a limit of \$2,500 per room for the mortgage.¹²³ Also, if the apartment were less than four rooms, there would be an over-all limit of

116. 24 C.F.R. § 234.26(c) (1962).

117. Note, *The FHA Condominium: A Basic Comparison with the FHA Co-operative*, 31 GEO. WASH. L. REV. 1014, 1022 (1963), citing an interview with Tom L. Davis, Office of General Counsel, FHA, February 20, 1963.

118. 24 C.F.R. § 234.26(c) (3) (1962).

119. 24 C.F.R. § 234.26(b) (1962).

120. 24 C.F.R. § 234.26(e) (1962).

121. 78 Stat. 780-782 (1964), 12 U.S.C.A. § 1715y(c) (Supp. 1964) amending 75 Stat. 160 (1961).

122. *Ibid.*

123. 24 C.F.R. § 234.27(a) (3) (1962).

\$9,000 instead of the \$30,000 ceiling. In a larger structure, one that required an elevator and other expensive common elements, the per room limitations are somewhat higher, namely \$3,000 per room and \$9,400 over-all for apartments of less than four rooms.¹²⁴ In addition, in areas the commissioner finds to have "high cost levels", the per room limitation may be extended another \$1,250, to a total of \$4,250 per room.¹²⁵ The per room limitations will tend to constrict the \$30,000 ceiling, as the mortgage must be for the *lower* of the \$30,000 and per room limitations. These various regulations as to time and dollar amounts change frequently, and the purchaser's attorney must be certain to update his information before advising his client on specifics.

The lender-mortgagee must certify to the FHA that the following conditions exist:¹²⁶ (1) that the individual deed on the apartment complies with the laws of the jurisdiction; (2) that the apartment is subject to an approved condominium plan; (3) that the mortgagor has good title and that the lien of the FHA-insured mortgage is a valid first lien; (4) that property taxes are required to be assessed and levied separately upon each apartment in the local jurisdiction's condominium law; (5) that there are no recorded racial restrictions on the property. These are not at all burdensome requirements, since they amount only to recognition of the accepted legal situation surrounding ordinary home ownership.

The final aspect of FHA financing that the developer and the apartment owners must consider is the problem of dealing with the government. Admittedly this may not actually be a problem. To be sure, however, the commissioner will have his thumb, and if he sees fit, both hands, in the pie. There is a provision in the regulations that allows the commissioner to require any kind of agreement that he deems necessary for the regulation and administration of condominiums.

(f) *FHA controls for consumer and public interest.* The Commissioner may require such conditions and provisions as he deems necessary for the protection of the consumer and

124. 24 C.F.R. § 234.27(b) (1962).

125. 24 C.F.R. § 234.27(c) (1962).

126. 24 C.F.R. § 234.26(d) (1962) requires certificates discussed in (1)-(4). Number (5), concerning the absence of race restrictions, is required by 24 C.F.R. § 234.66(a) (Supp. 1964). However, 24 C.F.R. § 234.66(b) (Supp. 1964) allows the commissioner to waive the certificate concerning racial restrictions if he thinks the circumstances warrant dispensing with the requirement.

public interest, including but not limited to a regulatory agreement between the Owners and the Commissioner which shall be made applicable to the Association or Cooperative of Owners . . .¹²⁷

The likelihood is that the commissioner's agreement will require the usual monthly assessments for common expenses of administration, plus an additional sum to build up a reserve for replacing fixtures and to serve as working capital for the administration of the building.¹²⁸

H. Some Tax Considerations

The condominium apartment owner will be the only apartment dweller able to enjoy the tax advantages of home ownership. Local real estate taxes¹²⁹ and interest paid on the mortgage¹³⁰ will both be deductible from the apartment owner's income. Purchase or sale of an apartment should qualify for nonrecognition of gain on the sale of a residence,¹³¹ which is a real benefit to homeowners. Translated, this means that if the owner of either a house or a condominium apartment sells the residence for more than his investment in the property, the gain will not be considered income if it is plowed back into another residence (whether house or condominium apartment) within one year of the sale of the first residence.

There are some minor tax problems as well as tax advantages. The council of co-owners may be attributed with income if the administration over-assesses the co-owners for common expenses.¹³² This is an incredible ruling, since the assessments are paid by the co-owners for their own benefit. But if the management entity receives \$20,000 in assessments and spends only \$15,000 for common expenses, there is \$5,000 which the Commissioner *might* regard as income to the entity, even if the excess is to be applied to the expenses of the next year. Possibly the

127. 24 C.F.R. § 234.26(f) (1962).

128. Kerr, *Condominium—Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 20 (1963).

129. INT. REV. CODE OF 1954, § 164(a).

130. INT. REV. CODE OF 1954, § 163(a).

131. INT. REV. CODE OF 1954, § 1034(a).

132. Rev. Rul. 56-225, 1956-1 CUM. BULL. 58 states: "Where, in the case of a cooperative housing corporation . . . the excess of predetermined charges at the end of any year is not used to reduce carrying charges until a subsequent year or years, such excess constitutes income to the corporation subject to federal income taxes in the year in which received". The soundness has been questioned. See 1 CCH 1963 STAND. FED. TAX REP. ¶ 273.05.

commissioner will refrain from making such a bizarre contention, but some preventive medicine is recommended. The solution is to avoid the whole problem by providing in the bylaws that on or before December 31 of each year the management must return any excess assessments to the co-owners pro rata.

A real income tax situation will be encountered if the council of co-owners decides to lease any of the common areas. It would be possible for a condominium to have the ground floor or some other area as common elements and eligible for leasing as a drug-store, cafeteria, laundromat, or the like, for the convenience of the residents of the building. If this leasing creates income, how will the co-owners be taxed—as mere co-tenants, as a partnership, or as an association taxable as a corporation?

Generally the answer depends on whether a business objective is present. If it is, the council of co-owners may be taxed as a corporation.¹³³ It has been held under some cases that co-tenants of real estate who rent a portion of the land, even with a profit motive, do not *necessarily* have a business objective that will make them a corporation for tax purposes.¹³⁴ But if the purpose of the arrangement is to own, manage, lease, and sell real estate, there is such a business objective.¹³⁵ The commissioner may look to the condominium instruments in order to surmise the purpose of the organization.¹³⁶ If they give an insufficient indication, actual conduct may control the determination of purpose.¹³⁷ A comprehensive analysis of whether the managing entity is taxable on leased property as a corporation by virtue of business purpose is beyond the scope of this article, but the attorney must be aware of the potential problem.

Of course, corporate taxation will apply if the management is incorporated. If it is not, corporate taxation may still apply to the unincorporated association which acts like a corporation. Under Treasury regulations an association may be taxed as a corporation if it has the continuity, centralized management, limited liability, and free alienability of interests that are char-

133. INT. REV. CODE OF 1954, § 7701(a)(3), defines corporations: "CORPORATION.—the term "corporation" includes associations, joint stock companies, and insurance companies."

134. Daniel S. W. Kelly, 16 CCH Tax Ct. Mem. 34, 40 (1957); Meyers v. Commissioner, 89 F.2d 86 (7th Cir. 1937).

135. Helvering v. Coleman-Gilbert Associates, 296 U.S. 369 (1935); Helvering v. Combs, 296 U.S. 365 (1935).

136. Morrissey v. Commissioner, 296 U.S. 344 (1935) (held, business objective); Rohman v. United States, 275 F.2d 120 (9th Cir. 1960) (held, no business objective).

137. Treas. Reg. § 301.7701-1 (1960).

acteristic of a corporation.¹³⁸ The unincorporated condominium has all of the above qualities in some degree, except limited liability. It may be that the management entity will be taxed as an association-corporation. But this territory is quicksand, and the eventual trend could hardly be predicted accurately at the present time. If, as expected, most developers incorporate condominiums' management anyway, this issue will decline in importance.

If the management entity of the horizontal property regime were to make a profit by leasing common areas, the income may be attributed either to the entity or to the apartment owners. Initially it would be attributable to the entity. But the administration might decide to assess the co-owners less than is needed for common expenses and to apply the lease income to the common expenses of maintaining the building. In that way any income would be offset by expenses, and the books of the administration would show no profit. This procedure will probably raise some very nice tax questions and cause the commissioner to begin making noises.

The commissioner raised the exact question just mentioned in the case of *Anaheim Union Water Co. v. Commissioner*.¹³⁹ An incorporated irrigation company sold water to its shareholders at less than cost in order to offset profits from sales to outsiders. The tax court held that the losses on sales to shareholders could not be deducted and that the income from arm's length sales was still fully taxable to the company.¹⁴⁰ The tax court decision did not decide whether the shareholders might also have taxable imputed income in the form of a constructive dividend to the extent the purchases fell below cost. If this were true, double taxation would occur. However, on appeal the Ninth Circuit reversed the tax court. The court of appeals held that the companies could sell water to their shareholders at less than cost and still deduct the full costs of production, thus offsetting all income that would have been taxed to the corporation. But to the extent that the purchasing shareholders received water below cost, they might have had income on a constructive dividend theory.¹⁴¹ However, the tax consequence to the shareholders was not before the court.

138. Treas. Reg. § 301.7701-2(a)(2) (1960).

139. 321 F.2d 253 (9th Cir. 1963).

140. *Anaheim Union Water Co. v. Commissioner*, 35 T.C. 1072 (March 29, 1961).

141. See Jules C. Winkelman, 1 CCH Tax Ct. Mem. 640 (1943), for an example of a constructive dividend.

The analogy of the *Anaheim Union Water* decision should apply to condominiums in which assessments are set below the cost of maintenance and the difference is supplied by income from the common elements. If *Anaheim* is correct, the condominium management will have no income. Probably the individual co-owners will have personal income to the extent they receive free maintenance. Certainly the result reached by the court of appeals in *Anaheim* is more just than the double taxation that might follow from the position taken by the tax court. But the comparison of the two opinions will demonstrate that this is also an area of flux in taxation, and no theory is on bedrock.

V. CONCLUSION

The breadth of the topic defies any meaningful summary remarks. This article is only a survey of the condominium, its potentiality, and its problems. It seems to be a new departure with a great deal of room for imagination in planning. At the present, research materials are almost confined to statutes, regulations, law review articles, and one encyclopedia. In the near future a special report on condominiums will be available.¹⁴² The future of condominium in South Carolina depends upon its inherent appeal to the public and the ability of the bar to implement it properly.

COLIN E. HARLEY

142. Ten Harvard graduate business students are issuing a report called "CONDOMINIUM: Housing for Tomorrow", which may be obtained post-paid for \$15.00 from Management Reports, 38 Cummington Street, Boston 15, Massachusetts.