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Property - Multiple Ownership of Apartment Buildings - Establishment of Horizontal Property Regimes

Larry W. Waggoner
University of Michigan Law School

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RECENT LEGISLATION

PROPERTY — MULTIPLE OWNERSHIP OF APARTMENT BUILDINGS — ESTABLISHMENT OF HORIZONTAL PROPERTY REGIMES — The states of Arkansas and Hawaii¹ have enacted legislation allowing the owner² of a building, upon recordation of a master deed, to establish that building as a horizontal property regime,³ thereby permitting the owner to convey individual apartments⁴ in the building as if each were entirely independent of the remainder of the building. The purchaser of one of these apartments is constituted a "co-owner" and may record his deed.⁵ Each co-owner has an exclusive right to possession of his apartment and a right to a share,⁶ with the other co-owners, in those parts of the building that the statutes designate as "common elements."⁷ The administration of the building is to be governed by the by-laws adopted by a council of co-owners.⁸ The expense of administration and of maintenance and repair of the common elements is to be borne by the co-owners equally under the Hawaii Act, but pro-rata according to the value of the co-

¹ Arizona, Kentucky, South Carolina and Virginia have recently passed similar statutes. See ARIZ. REV. STAT. ANN. §§ 33-551 to 33-561 (1962); Ky. S. Bill No. 31 (1962); S.C. H. Bill No. 2121 (1962); Va. H. Bill No. 602 (1962). A preliminary draft of a Horizontal Property Act has been made for New York. Letter to writer from W. K. Kerr, Associate Counsel, The Equitable Life Assurance Society of the United States, Jan. 10, 1962.

² This is the phrase chosen by the legislature to describe "condominium" ownership, which means "joint dominion or sovereignty" or "joint ownership." Vogel and Zucker, *Condominium Ownership—A New Concept*, Real Estate F., Oct. 1961, p. 6.

³ The Hawaii act provides that a "developer" also may establish a proposed building as a horizontal property regime. Hawaii Sess. Laws, Reg. Sess. 1961, at 7 (H.B. No. 1142, § 3).

⁴ "Apartment" is defined in the Arkansas act as "an enclosed space consisting of one or more rooms occupying all or part of a floor . . ." Ark. Acts 1961, No. 60, § 2(a). The same term is defined in the Hawaii act as "an enclosed room . . ." Hawaii Sess. Laws, Reg. Sess. 1961, at 7 [H.B. No. 1142, § 2(a)]. The use intended for the apartment is not controlling. For example, offices or retail stores fit both definitions.

⁵ Ark. Acts 1961, No. 60, § 4; Hawaii Sess. Laws, Reg. Sess. 1961, at 7 (H.B. No. 1142, § 4).

⁶ The "share" each co-owner is to receive under the Arkansas act is to be equivalent to the percentage representing the value of his apartment in relation to the value of the whole property. These values are to be fixed at the time the building is constituted a horizontal property regime and cannot thereafter be changed. Ark. Acts 1961, No. 60, § 6. Under the Hawaii act, each co-owner is to have an equal share. Hawaii Sess. Laws, Reg. Sess. 1961, at 7 (H.B. No. 1142, § 6). Under both statutes, the co-owner's share is not subject to partition proceedings.

⁷ The parts of the building designated as common elements include generally the walls, roof, lobbies, stairways, halls, elevators and "other elements of the building rationally of common use or necessary to its existence, upkeep and safety" as well as the land. Ark. Acts 1961, No. 60, § 2(d); Hawaii Sess. Laws, Reg. Sess. 1961, at 7 [H.B. No. 1142, § 2(h)].

⁸ Under both statutes the council of co-owners is defined as all the co-owners. Under the Arkansas act a majority of the co-owners constitutes a quorum. Ark. Acts 1961, No. 60, § 2(c).

owner's apartment in relation to the value of the whole building under the Arkansas Act. *Ark. Acts 1961, No. 60; Hawaii Sess. Laws, Reg. Sess. 1961, at 267.*

The idea that one may "own" an individual apartment is not a new one.⁹ Cooperative apartment buildings first appeared on the American scene during the late nineteenth century.¹⁰ However, they did not become highly popular until after the close of World War II. Since that time their popularity has continued to increase¹¹ for two principal reasons. From the buyer's point of view, they offer an answer to the housing problem in highly urbanized areas and give the buyer the same sense of security that can be had only by owning his own home.¹² Second, the seller can obtain a higher price for the building by selling it in individual parts rather than as a complete unit.¹³ However, the problems attending the creation of individual ownership of apartments were not easily solved. A difficult problem was that of finding a method to provide an enforceable relationship between each buyer and the other apartment owners with respect to the common elements of the building. For example, it was necessary to assure that each owner would have use of the entrance-ways free of interference from the other owners, that the common elements would be kept in good condition, and that the cost of maintenance and administration of these parts would be apportioned among the owners. Further, it was difficult for a buyer to obtain financing, since bankers were reluctant to approve loans for the purchase of a part of a building. Because of the complexity of the agreements necessary to establish the desired relationship among the owners,¹⁴ because of the financing difficulties, and because under the common law¹⁵ it was not clear whether a freehold interest in a part of a building could be validly conveyed and recorded,¹⁶ no attempt was made to establish individual apartment ownership by the multiple agreement method.¹⁷ It was thought that the objectives could better be attained by the rather ingenious method of reposing title to the

⁹ See generally Leyser, *The Ownership of Flats—A Comparative Study*, 7 INT'L & COMP. L.Q. 31, 33 (1958).

¹⁰ The earliest reported case in the United States involving a cooperative apartment is *Barrington Apartment Ass'n v. Watson*, 38 Hun 545 (N.Y. Sup. Ct. 1886).

¹¹ See Anderson, *Cooperative Apartments in Florida: A Legal Analysis*, 12 U. MIAMI L. REV. 13, 14, 16 (1957).

¹² See Hennessey, *Co-operative Apartments and Town Houses*, 1956 ILL. L.F. 22, 23.

¹³ See *id.* at 23.

¹⁴ Castle, *Legal Phases of Co-operative Buildings*, 2 SO. CAL. L. REV. 1, 2 (1928).

¹⁵ For a thorough discussion of how this problem is handled under special statutes in the civil law countries, see generally Leyser, *supra* note 9.

¹⁶ "It is . . . impossible to own an apartment." Issacs, *History and Development of the Co-operative Apartment*, 5 Prac. Law., Nov. 1959, p. 62. *But see* Castle, *supra* note 14, at 3. "[T]here is nothing theoretically impossible about it."

¹⁷ See Issacs, *supra* note 16. Castle, *supra* note 14, at 2.

entire property in a separate legal entity such as a corporation or a trustee.¹⁸ The corporation or trustee had no problem in obtaining financing since it could mortgage the entire building. Briefly, under the more popular "corporation plan" each "owner"¹⁹ buys stock in the corporation and receives a proprietary lease to "his" apartment. Under the "trust plan" each "owner" receives a certificate of beneficial interest. The by-laws of the corporation and the owner's lease, or alternatively the trust certificate, contain the provisions necessary to effect the above objectives with respect to the common elements, and provide for payment of the financing charges as a part of the cost of maintenance.

The Arkansas and Hawaii statutes both provide that a freehold interest in an individual apartment may be conveyed and recorded, and detail legal relations among the co-owners with respect to the use, maintenance and operation of the building. Moreover, the purchaser of a freehold interest in one of these apartments can now qualify for a loan that is insured by the Federal Housing Administration.²⁰ Thus the individual owner is responsible only for the mortgage on his own apartment, and his annual maintenance charge is not affected by a default of one of the other tenants.

However, two notable differences between these statutes exist. First, although both statutes allow an owner of an existing building to establish it as a horizontal property regime, the Hawaii act further permits a developer of a *proposed* building to do so. Thus from a practical standpoint, it will be cheaper for a developer to finance the construction of a building in Hawaii.²¹ Second, the Arkansas act includes a provision permitting the co-owners to insure the entire building under a single policy against risks such as that of fire.²² And, if there is a fire, a standard is provided by which it is to be determined whether or not reconstruction of the building is to be compulsory,²³ and how the insurance proceeds are

¹⁸ For a complete discussion of both plans, see generally Castle, *supra* note 14; Yourman, *Some Legal Aspects of Cooperative Housing*, 12 LAW & CONTEMP. PROB. 126 (1947).

¹⁹ Castle, *supra* note 14, at 17, argues that the apartment purchaser is the real owner thereof, the corporation or trust merely being devices making such ownership possible.

²⁰ National Housing Act § 234, added by 75 Stat. 160, 12 U.S.C.A. § 1715y (Supp. 1961).

²¹ One of the advantages of a cooperative is that the builder can obtain money cheaper from prospective co-owners than from banks. Hennessey, *supra* note 12, at 22. See also Comment, 68 YALE L.J. 542, 597 (1959). See generally *id.* at 542. But a builder in Arkansas can still use the traditional corporation method. ARK. STAT. § 64-101 (1947).

²² Ark. Acts 1961, No. 60, § 20. This does not prejudice the right of each co-owner to insure his apartment on his own account and for his own benefit.

²³ If more than "two-thirds of the building" is destroyed, reconstruction is not compulsory. Ark. Acts 1961, No. 60, § 21. Does this mean two-thirds of the value of the building, or two-thirds of the area, or something else?

to be distributed if the building is not to be reconstructed.²⁴ The Hawaii act is silent as to all these problems, apparently leaving insurance up to each individual co-owner, and the problem of reconstruction in case of extensive damage up to the by-laws. Of course, the by-laws can just as adequately provide for the solution to this problem. But, in case the by-laws also are silent, bitter dispute is likely to arise among the co-owners with respect to whether or not to reconstruct, particularly if some of the co-owners were not insured and are otherwise financially unable to contribute toward reconstruction. The use of foresight when drafting the by-laws can avoid this problem.

Although the statutes differ in these respects, their significance is in the fact that they both enable the purchaser to obtain a federally-insured loan, and tend to make the establishment of cooperative apartments more standardized and more analogous to the ordinary purchase and sale of a house, with which lawyers, bankers and laymen are more familiar. In addition, the mere fact that this type of statute has been enacted by the legislatures of four states and is under consideration in others²⁵ indicates that there is both a continued need for such housing and a continued public interest in it.

Larry W. Waggoner

²⁴ Ark. Acts 1961, No. 60, § 22.

²⁵ See note 1 *supra*.