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PREPARING FOR RESIDENTIAL CONDOMINIUM DEVELOPMENT

From Land Acquisition to Closing: What Developers Need to Know

Part One

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The Maryland Condominium Act— Title 11 of the Real Property Article of the Annotated Code of Maryland—is the statutory source of all law relating to the creation, management and operation of condominium ownership in Maryland, whether residential or non-residential. Not surprisingly, then, frequent reference to this body of law—the "Act"—is unavoidable.

These notes and thoughts on condominium development are not intended as a law journal article or legal treatise on the subject. Rather, it is offered as a practical guide of thought processes, steps and time lines, for developers and their counsel, from land acquisition to closings on out-sales.

Finding, Zoning and Buying the Land. Land is the chicken-egg conundrum of all real estate development: Do we start with a site and figure out what to do with it? Or do we start with an idea and find the land to accommodate the development of the idea? Whichever direction is taken, "condominium development" may have a role. But it is not a "zoning classification" nor is it a land-use format. Although popular parlance finds "condo" often used to connote high density, multi-family development, the condominium concept is a form of property ownership, entailing community or common ownership of land, structures and facilities used by all common owners, with the subdivision of a "unit" as the conveyable real estate. Thus, whether the style of property development—office building, warehouse complex, high-rise apartment, townhomes—the condominium form of ownership can be employed. The condominium form of ownership is mandated by the Act to have all of the aspects of real property. Whether "condominium" is the

answer or not depends upon the question posed. The "zoning" speaks to the land-use itself; the condominium form of ownership and property subdivision can find a place in virtually any "zone."

Choosing the Vehicle. Whatever other factors may be involved in the developer's choice of a piece of land and what to do with it, the profit motive is central. If a piece of real estate is zoned for residential use, the developer's analysis will lead him to a plan of land use and development which will bring to market the greatest number of readily saleable dwelling units—if sale is his goal— possible of delivery upon the site. If the zoning mandate is anything other than a traditional "single-family-lot" directive, the question is: How do we achieve the maximum saleable density potential of the site? And the answer must be: "Condominium." For it is only by the subdivision on a vertical plane, as permitted by the Act, that the realization of density can be achieved. The condominium, then, becomes the vehicle of choice.

"Condominium" should not be the answer unless the question is: "How best to achieve the realization of density and marketing"?— and it cannot be otherwise achieved by standard development, for the condominium form of ownership is complex and intricately document and statute-dependent. Moreover, for often invalid or non-existent reasons, the market place (and the lending community) very often is fearful of "condominium fees." Thus, if a given site can be built out with zero-lot-line town homes and achieve its maximum yield, more often than not the developer will be better off eschewing the condominium form and conveying town houses in the embrace of a homeowners' association holding title to the common areas and amenities.

Planning the Trip in the Condominium Vehicle. When the answer is "condominium," there are a variety of steps and procedures attending the trip which are not always accessories to the journey to sell-out of a plain-vanilla, non-condominium development.

First, the detailed plans of the buildings to be constructed must be carefully studied to determine the allocation of the "space" or "cubage" to be constructed between condominium units and common elements. The boundaries of the units become lines of title and must be precisely determined; do lines of title run from center line of studs? From the unfinished side of the drywall fasted to the studs? To the finished surface" Or the unfinished surface? And the same measurement issues attend the vertical dimensions of the unit. These determinations establish what is the "unit" of real property being created under the Act; how much is unit—and what is "common element"? Under the Act, the recording of the Declaration and By-Laws, accompanied by the recording of the plat and plans of condominium subdivision, establishes the regime and results in their being only two species of property—everything upon which the regime is declared is *either* **unit** or **common element.**

The common element property can include, if declared in the Declaration or depicted on the plat, a sub-set of common element styled **limited common element** ("LCE") Title to *all* common elements is vested in the community of all unit owners as tenants in common (the "co"

of condominium). The "limited" aspect of the LCE is determined by the Declaration or plat. A patio or terrace on a ground level unit, for example, may be declared an LCE, thereby establishing title in the community, but the right of use in one or more abutting units. Further, that "declaring" can also direct responsibilities of maintenance, repairing or replacement and reserve funding, as the declaring developer deems appropriate.

Establishing the Percentages of Interest; Who Sits Where for the Trip. The condominium regime to be established by the recording of the Declaration and By-Laws and the plat and plan must, under the Act, determine and posit the percentage of interest of common elements attributed to each unit. Although §11-107 of the Act does not direct the developer *how* to assign these percentages, the underpinning and unspoken standards are that, altogether, they must add up to 100% and ought to be based upon some rational basis. In the real world of condominium operation, the greatest significance of this percentage is that it equates to the share of expenses—condominium fees—borne by each unit. More about this pungent subject will be addressed below.

Often, but neither of necessity nor Act-required, the voting right attributed to each unit is weighted to be equal to the percentage interest in common elements. Equally often, we find the more egalitarian "one unit-one vote" approach, even though there are widely disparate assignments of percentages of interest. Whichever methodology is elected, it must find expression in the Declaration and is, typically, set forth in an exhibit scheduling the percentages and not infrequently carrying the expression of a number of decimal points in order to reach as nearly as reasonable a 100.000% total, since each tenth of a point can result in a very real dollar impact.

More About the "Vehicle." The trip planning in the condominium vehicle requires the developer to engage in some very detailed analysis. As noted above, the universe of the condominium regime is totally filled and divided between "units" and "common elements." Accordingly, the parcel of land upon which 125 garden apartment units were built in 1966, when converted to a condominium regime, will find *all* of that parcel of land owned by the unit owners as tenants in common, in accordance with their assigned percentages of interest in the common elements— the tot lots, the parking areas, the sidewalks, *everything* is a common element and owned by the unit owners as tenants in common—and. not surprisingly, is their collective responsibility to maintain, repair and operate.

The "unit" part of this universe is the quantum of defined real estate made to exist as a statutorily-established quantity. The bricks, boards and mortar which contain the units may be altogether common elements, partially parts of the units, or in some limited applications, *all* common elements. The Declaration's definition of the "Unit" is the determinant: A typical residential unit definition will be found as follows:

Each Condominium Unit is a three dimensional space having boundaries as follows: the lower boundary of the unit is a plane or planes coincident with the level and elevation of the surface of the structural floor underlying the finished floor surface of the Unit; the upper boundary of each Unit is a plane or planes, sometimes horizontal, sometimes inclined, but at all times coincident with the upper, unexposed surface of the ceiling drywall or ceiling material, to include that drywall or other surface material as a part of the Unit; the lateral or perimetrical boundaries of the unit shall be vertical planes coincident with the unexposed surfaces of the drywall on the perimeter walls, as depicted on the Plats, to include that drywall or other finishing material as a part of the Unit, extended vertically to intersect the upper and lower boundaries described above. Further, the unit includes all bays and projections.

The elevation above sea level of the floor surface of each Unit is shown on the Plats, together with reference to the datum plane upon which such measurement is based.

Equipment located within a Condominium Unit and designed or installed to serve only that Unit, including without limiting the generality of the foregoing, air-conditioning equipment, mechanical equipment, skylights, appliances, non-bearing partition walls, lath, furring, wallboard, plaster or plasterboard, paneling, tile, wallpaper, paint, finished flooring materials, carpets, outlets, electrical receptacles and outlets, fixtures, cabinets and the like, shall be considered a part of the Condominium Unit and not a part of the common elements. Equipment and appurtenances located outside the boundaries of any Condominium Unit and designed or installed to serve only one particular Condominium Unit, such as furnaces, air conditioning equipment, compressors, ducts, chutes, flues, wires, conduits, pipes, hoses, tubing and the like shall be considered a part of the Condominium Unit which they are designated or designed to serve and may not be considered a part of the common elements.

The allocation to the "unit" in this definition is such that the attributes of the unit very nearly resemble the attributes of a single family home, save that the land and the structure itself are within the common element realm. Consistent with the Act, it is also possible to designate items situated outside the unit as LCE and thereby, although allocating the title to the community, reposing repair responsibilities and replacement costs upon the unit owner. It can be seen that the possibilities as among unit, common element and limited common element are many, variable and consequential.

The particular significance of each judgment of allocation lies in the impact of costs deriving from that decision: for example, if the air conditioning compressor and heat pump sitting outside the building, but serving the unit, are considered part of the common elements, the condominium fees will have to encompass and budget reserve funding for replacement, servicing and operation. And to that extent, while condominium fees go *up*, the unit owner's worry factor goes *down.* But as the worry diminishes, and greater convenience and efficiency is achieved, the offsetting negative is market resistance to higher condo fees and loan qualification issues, since the projected condo fees will most likely be considered by the prospective lender.

The closed-circuit aspect of the costs of the building operation must be brought into sharp focus: this is not a profit center— it costs what it costs, but the allocation of those costs as between unit-owner individual responsibility and collective expense through the condominium fee assessment is critical, both for marketing purposes and, in particular, as we will touch upon below, required disclosures.

The Rules of the Road. The collection of unit owners, as the tenants in common owners of everything but the units, comprise an entity known as the **council of unit owners**, which may be organized as a corporation or operate as an unincorporated association under the Act. The operation of the council of unit owners—the tenants in common of the common elements—are to be governed by the By-Laws, mandated by the Act to be adopted and recorded with the Declaration. Like most by-laws, these are statutorily required to embrace a wide variety of matters of governance, with particular emphasis on the establishment of budgets and the implementation of a system of collection of the funds necessary to operate the condominium, potentially secured by lien on the units

Vetting the Road Map. In the instance of *residential* condominiums, **§11-126** of the Act requires, as a condition precedent to entering an enforceable contract for the sale of a condominium unit that the developer prepare and file with the Office of the Secretary of State in accord with the directives of §11-126(a) of the Act a Public Offering Statement ("POS") a statement precisely responsive to the sixteen (16) items required to be disclosed by the subsection of the Act. The POS is the critical disclosure medium for the sale of a residential condominium. Its filing with the Secretary of State, as required, does not give any assurance to the developer that what he has filed is *correct*; it is a catalogue of what is required to be disclosed and if not done correctly, all contracts entered thereafter are in jeopardy.

As the various required disclosures are reviewed, it is immediately apparent that considerable consumer sensitivity is largely centered on budgetary matters and the determination and prediction of condominium fees. The intricacies and interplay of costs and ownership arising from the allocation among *unit, common element and LCE is critical.* In this regard, the careful developer will spend significant time and attention with an experienced condominium property manager to study and adjudge the appropriate allocations of interests and the costs resulting.

The Finish Line; How to Get to the POS, Closing and Profit

The ordering of the steps leading to the filing of the POS runs like this:

1. The identification of the product and its amenities is the true beginning point. In the case of, let us say, a multi-story, with stacked titles, many of our common element/limited common element questions are thereby answered. The quantum of condominium fees is always sensitive and must be carefully weighed when considering the housing market-segment sought to be addressed. In the case of a higher-end product, the developer is enabled to market a more all-inclusive product; for example, balconies and terraces can be maintained by the condo and made the subject of reserves, rather than left to the condo owner's expense—and other aspects of maintenance and operation can be styled more along the lines of a high-end rental and the costs packaged into the condo fees.

2. The nature and extent of amenities can have a significant impact on condo fees—as well as marketing allure. Therein lies the challenge; many a condo developer has overrated the attraction of grand swimming pools, large meeting rooms, on-site restaurants, etc., only to find before the project is fully sold and closed-out that the grandiosity of the amenity package is not really worth what it costs the owners—and the developer— to get into operation.
3. At this point, the conceptual product ought to be far enough along to begin to find expression in architects' drawings, on their way to becoming the plat and plan of condominium subdivision, one of the legal essentials of the creation. Interaction among the developer, the architect and the drafting lawyer should fairly quickly conclude what the project is that needs expression in the Declaration and ByLaws. In almost all situations, the ByLaws need to be cast in a direction where more of the control and decision-making is reposed in professional management rather than in "town-hall meetings."
4. The contract of sale for the condominium units is, of course, a necessary component of the POS and needs to be the product of a collaborative effort of the developer, the professional management team, the sales force and the attorney drafting. The contract should be the product of that collaboration and NOT the standard form sales agreement out of the broker's kit. The crossing of the legal T's and dotting of the appropriate I's is certainly critical; but that contract needs to be as short, readable and enforceable as the Act permits—and requires. The form of agreement often thrust at consumers—at whatever price level—is generally over-lawyered, too long and requires too many exceptions, exemptions, addenda and signatures. The careful developer does not spend great sums of time and money on design and décor, only to let the most important legal document—the contract of sale—get torn off of a pad.
5. When the product, its design, amenities and budget are done, and the contract by means of which to sell it confirmed, it is compacted into the POS for filing. Until that POS is vetted, we cannot write enforceable contracts.

An overarching consideration in all of this preparation is, of course, **accuracy**; if it is all accurately done, there is little need for amendment. If dollars and dimensions are well thought through, there is no need to condition every number as "approximate." The "materiality" of amendments only arises when there have to be amendments[1]. Most often, the quagmire of amendments results from trying to get the marketing cart out in front of the horse of details. Even

[1] *Herlson v. RTS Residential Block 5, LLC*, a decision of Maryland's Court of Special Appeal, reported in 191 Md.App. 719 (2010), has caused considerable consternation in the condominium developer and management community on the subject of "amendments" and the "materiality" thereof, to the point of engendering talk of legislative clarification—which as of this writing has not occurred

in a concrete and steel building, it is the carpenter who is often the most important trade—and his motto needs to guide the POS process—**measure twice, cut once**.

And, finally, the culmination of the process is accomplished by the sale and closing or settlement on each unit. A Maryland statute accords to the purchaser of residential real property—including condominium units—the right to select the title lawyer, settlement company and place of closing.[2] If the developer's counsel entrusted with the preparation of the condominium documents and the POS does not have the capacity to handle the closings on the sale of the condominium units—the preferred and most efficient arrangement—it is important that the developer make appropriate arrangements and contractual provisions so that all settlements will take place through and by the same agency and office.

The subject of condominium settlements will be treated in greater depth in a later paper.

Further, another paper—*Part Two*—is planned in the near future to consider some of the intricacies of the subdivision of condominium units and its applicability to non-residential condominium projects.

[2] MD Code, Business Occupations & Professions, § 17-524