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Comparing Condominiums and Cooperatives

by Bobbi McCarthy

During the past twenty years the term condominium has become synonymous with multi-unit home ownership. Housing cooperatives represent a distinctly different approach to the legal problems of creating part ownership in a larger property. The difference in approaches results in different impacts on the problems of buying, owning and operating these properties. Attorneys who advise developers, property managers or individual owners should be aware of these differences and some of the advantages and disadvantages which they present.

The Legal Framework

In a cooperative, the members essentially join together as a whole to own the housing development. A variety of types of organizations under which the members can organize are possible, including a trust, partnership or unincorporated association, but the most common form is that of a corporation. The cooperative corporation takes and retains title to the entire property as a whole and the members hold shares in the corporation. These shares evidence the right to occupy a unit of the corporate property. The members' power to control the corporation and the corporation's powers and duties to the members are set forth in the corporate charter. The individual member's right to occupy the particular unit is set forth in a document variously termed as an occupancy agreement, a mutual ownership contract or a proprietary lease. The member's right to occupy is thus a *contractual* one, which amounts to a lease hold interest, and his relationship to the corporation is both that of a tenant and a shareholder. 2 Rohan, *Cooperative Housing Law and Practice* § 2.01 (1979).

Maryland does not have a statute regulating the creation or operation of housing cooperatives. Therefore, in actions involving cooperatives, the courts look to contract, corporation and landlord-tenant law to resolve conflicts. See *Green v. Greenbelt Homes, Inc.*, 232 Md. 496, 194 A.2d 273 (1963). As a result, cooperatives are simple to establish, but subject to great variation in their organization and operation. In contrast, the Maryland Condominium Act, Md. Real Prop. Code Ann. § 11-101 to -142 (1981 & Supp. 1982), provides extensive and detailed statutory requirements for developing and operating condominiums. It may be possible to establish a condominium without reliance upon the statute. See *Macht v. Department of Assessments for Baltimore City*, 266 Md. 602, 296 A.2d 162 (1972); 52 Op. Att'y Gen. 425, 426 (1967). However, developers, title companies and their attorneys have preferred to minimize risk by utilizing the safe harbor provided by the Act. Enactment of the statute has resulted in rapid and widespread development of condominium home ownership in Maryland during the past decade.

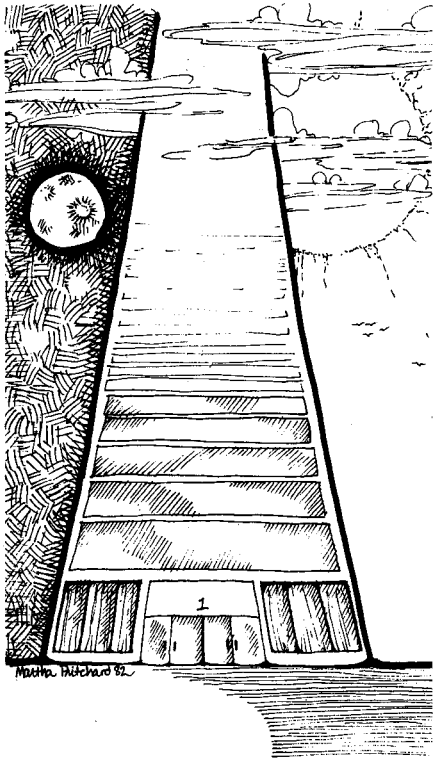
Under the Condominium Act, the overall project is designated by a recorded declaration and a condominium plat, and the owners of the units are given individual legal title to their portion of the property. The owners hold indivisible interests in the common structural and operations elements as tenants in common. Control over the common elements and areas of the condominium is vested in a council consisting of all the unit owners. The powers and duties of the council relating to the individual owners are provided in the by-laws in accordance with detailed requirements contained in the statute. The statute thus begins with the concept

that each unit is a separate and independent piece of property, and then significantly restricts the concept in order to recognize the common interests and responsibilities the units have toward the whole.

Financing the Purchase of the Unit

The first and most crucial factor in purchasing a home today is locating mortgage money. The effect of the legal differences between condominiums and cooperatives is most evident in this area. The Maryland Condominium Act clearly establishes that condominium units are real property which can be conveyed in fee simple. Md. Real Prop. Code Ann. § 11-106(a) (1981 & Supp. 1982). Lenders are thus able to convey first mortgages at favorable rates in exchange for the well-known security of a deed of trust. Equally important, if the condominium has been organized in accordance with the regulations of the Federal Home Loan Mortgage Corporation (Freddie Mac), mortgage brokers will be able to package and sell the unit mortgages in the secondary mortgage market. See *Federal Home Loan Mortgage Corporation, Seller's Guide*, § 3.101.

Cooperative units on the other hand are only leasehold interests in property, and in Maryland these units are considered personal rather than real property. See *Green*, 232 Md. at 501, 194 A.2d at 275. Under state law, they must meet different lending requirements than those with which condominiums must comply. Cooperatives are also apt to be subject to higher interest rates on shorter term notes. See Md. Com. Law Code Ann. § 12-103(b) and (c) (1975 & Supp. 1982). The cooperative retains title to the unit and may have given a first mortgage on the property. The interest of the unit lender will be subordinate to both the rights of the first mortgagee and the cooperative corporation. This minimal security can be bolstered by agreements with the cooperative by which a default by the unit owner will give the bank the right to take



over the unit or the right to the proceeds of its sale. However, this agreement requires that the cooperative establish an on-going relationship with a lender and develop mutually acceptable loan documents and unit contracts.

Federal as well as state savings and loan institutions now have the authority to lend on cooperative units. However, few institutions have done so because the co-op loans cannot be resold to the major institutions involved in the secondary mortgage market. One such institution, the Federal National Mortgage Association (Fannie Mae), has drafted a proposal to purchase packages of cooperative share loans, but has yet to implement the program. Until it does, cooperative unit loan packages will at the most be salable only to private investor groups. Consequently, if the current market conditions continue and lenders are unable to commit funds on a long-term basis, these institutions will be unwilling to make loans on cooperative units.

The combined effect of these problems is that co-op owners desiring to sell their units usually can-

not find outside financing. As a result, co-op owners may have to finance some or all of the sale themselves, or the cooperative units may appreciate more slowly and be sold for significantly less than the cost of comparable condominium units. Such a result may prove a boon for those concerned only in purchasing a home, however, those concerned about their home's resale value may find cooperatives less desirable.

Even so, if the present market conditions continue the differences in financing co-ops and condos may become less significant. Not all condos can participate in the secondary contracts with the cooperative, and these contracts are not recorded.

Some developers have converted to cooperatives rather than condominiums in order to avoid legal restrictions, such as a moratorium on condominium conversions or special zoning requirements. However, establishing cooperatives for this purpose may prove self-defeating as it may result in anger and confusion among purchasers or the general public, thus making the project less viable. See *Washington Post*, p. E-1, Saturday, September 25, 1982.

Cooperatives may also find it easier to obtain financing in later years for major maintenance and rehabilitation. As the owner of the entire property, a co-op may be able to remortgage the project at more favorable, long-term rates. When faced with a similar need for financing, condominiums must rely on their reserves which may prove insufficient because of inflation. They must also rely on assessments of the unit owners. Although the condo council has the power to mortgage its property, the assets which it can use for security are limited. The council can help arrange second mortgages for condo unit owners who need to finance their assessments, but the process will be more costly.

In the past, some cooperatives have also been able to benefit from federal government housing programs, including mortgage market, and little financing is available for

any type of housing. Most sellers are now finding it necessary to provide some of their own financing in order to secure a buyer. Overall, housing prices are levelling out. Given these conditions, neither condos nor co-ops may appreciate significantly in the coming years, and owners of both may find resale troublesome.

Financing the Overall Property

Cooperatives have some potential advantages over condominium in matters involving the financing of the whole property. In construction or conversion of the project the cooperative will be able to assume an existing mortgage if it is assumable. With condominiums, lenders can insist that the existing mortgage, even if assumable, be paid off before the property is subjected to a condominium regime. This difference exists because in Maryland a lender receives a deed of trust as security, and thus the lender may be considered the owner for the purpose of recording the declaration under Md. Real Prop. Code Ann. § 11-102 (1981 & Supp. 1982). Thus assuming an existing mortgage can mean much lower costs for both the cooperative developer and the individual purchaser. Recording and settlement costs for cooperative projects are also far lower than those for a condominium, because only a single deed is involved. Individual purchasers actually only execute mortgage insurance, lower interest mortgages or subsidy payments to lower income members. Whether such programs will be available in the future, of course, is problematical.

Although cooperatives have some advantages in dealing with financial matters affecting the overall property, they are not advantages which cooperatives will always be able to realize. In the end, the scale may tip in favor of condominiums due to advantages which condos have regarding the individual units.

Restrictions on Ownership and Use

Undoubtedly, the idea that in a condominium one actually owns his own home is one of the most appealing aspects of this type of multi-owner arrangements. However, this distinction from cooperative organizations becomes more illusory than real when one examines how the Maryland Condominium Act circumscribes the individual owner's rights. The Act places broad powers in the hands of the condominium council to control the common elements of the property and also to regulate and to restrict the use and occupancy of the individual unit for the greater good of the condominium. Md. Real Prop. Code Ann. § 11-111 (1981 & Supp. 1982). In *Dulaney Towers Maintenance Corp. v. O'Brey*, 46 Md. App. 464, 418 A.2d 1233 (1980), the Maryland court upheld the right of the condo council to restrict the owner's use of his own unit as long as the restrictions are reasonable and are enacted in accordance with the condominium by-laws. The statute also provides that the rule of law against restricting alienability of property cannot be used to defeat the declaration or by-laws of a condominium. Md. Real Prop. Code Ann. § 11-124(a) (1981 & Supp. 1982). Thus, apparently, condo owners can be prevented from selling to individuals who do not meet the requirements established in the by-laws, as in "adults only" condominiums. As long as the restrictions do not involve prohibited discrimination (race, religion, sex) and are not *per se* unreasonable or unreasonable in application, they will be upheld. See *Ritchey v. Villa Nueva Condominium Ass'n.*, 81 Cal. App. 3d 688, 146 Cal. Rptr. 695 (1978); 100 A.L.R. 3d 241.

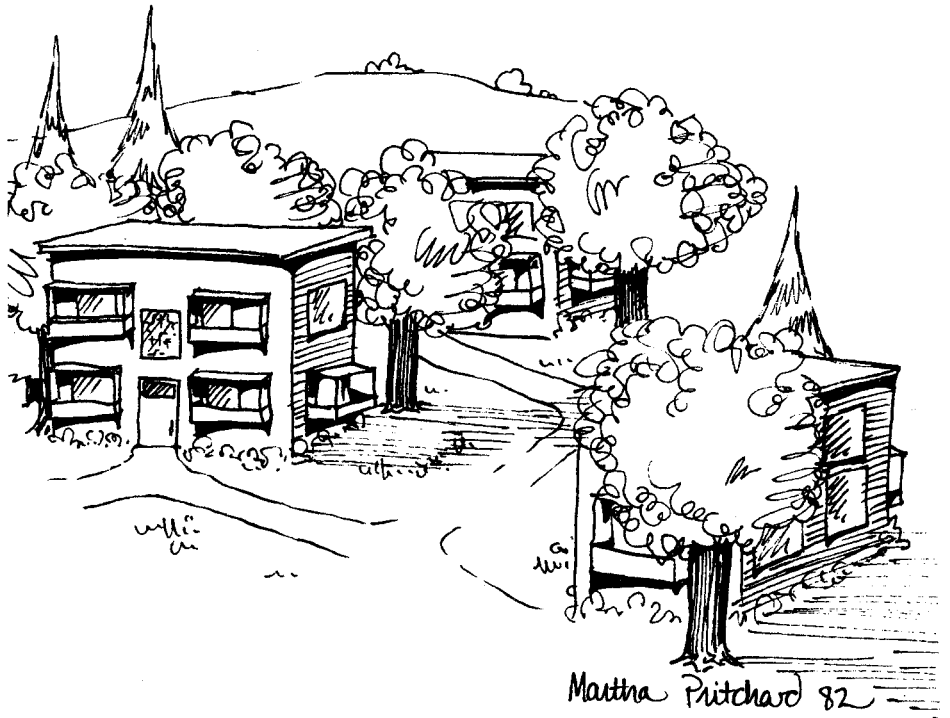
Cooperatives may have clauses in their by-laws and occupancy agreements which prohibit members from transferring their membership without prior approval from the Board of Directors. The cooperative may also reserve the first option to repurchase the unit when the mem-

ber desires to sell. Cooperatives possess strong powers under such clauses that allow the Board to screen new members and reject those they deem unsuitable. In fact, under their by-laws, some cooperatives can reject applicants for any reason and without explanation. As long as the requirements for membership approval do not on their face involve illegal discrimination, they will be enforceable. *Girard v. 94th Street and Fifth Avenue Corporation*, 530 F.2d 66 (2d Cir. 1976); *cert. den.* 425 U.S. 974 (1976). Recently, Maryland courts upheld the right of a cooperative to refuse membership to an unmarried couple based on a requirement in the by-laws and occupancy agreement that occupants of a unit be members of the same family. *Prince George's County v. Greenbelt Homes, Inc.*, 49 Md. App. 314, 431 A.2d 745 (1981).

Restrictions on use and disposition of a unit may be considered problematic for some individuals. Certainly developers would not want restrictions which interfere with the market ability of the units. However, as seen from the perspective of other unit owners or members

the power to restrict is a valuable protection of their investment in their homes. In actual practice, cooperatives usually require prior board approval of new members, mainly in order to be assured that the individual will be able to maintain his financial obligations and will not endanger the economic security of the development. Condominiums usually do not require prior approval of a new owner because the new owner will have to satisfy a lender's financial requirements.

Some cooperatives use restrictions on transfer as an opportunity to inform potential members about the type of interest they are purchasing and about the restrictions involved in multi-family housing. Cooperatives and condominiums comprise little democratic subsocieties which by necessity are more restrictive than that which exists outside the organizations. To promote the health, happiness and peace of mind of the majority, each owner must give up a certain degree of freedom of choice which he might otherwise enjoy in separate, privately-owned property. *Hidden Harbour Estates v. Norman*, 309 So.2d 180,



(Fla. Dist. Ct. 1975). Furthermore, those who live in such close proximity must combine a careful respect for the concerns of others with a tolerance for having others infringe on their rights. Owners who treat their units or the common areas with callous indifference will strain the effective functioning of the organization. On the other hand, owners who seek perfection in their living arrangements may make unreasonable demands on their neighbors or on the development and will invariably end up unhappy. In short, both the owners who care too much and the owners who care too little about the quality of their lives may prove unsuitable for either cooperative or condominium ownership.

Remedies for Member Violations

Inevitably, some cooperative or condominium owners are going to create problems in the housing development. The most common problem is nonpayment of monthly charges or assessments. Clearly, neither type of organization could survive long if it permitted deficiencies to mount unchecked. The actions which the two organizations can take against members who are unable or unwilling to pay, differ dramatically.

In the condominium, the council of unit owners may record condominium liens on the unit within two years after the assessment becomes due. If the owner fails to pay off the lien, the council can move to foreclose. The unit may then be sold at a public sale, subject to the prior mortgage. While the foreclosure procedures are clearly established, considerable time, expense and attention to detail is required to complete them. Md. Real Prop. Code Ann. § 11-110 (1981 & Supp. 1982); Md. Rules Proc., Rules W70-79

The remedy for the cooperative is much quicker and cheaper. A cooperative, as the landlord of the premises, may proceed under a

summary dispossession action in the district court and may regain possession within a matter of weeks. Md. Real Prop. Code Ann. § 8-401 (1981 & Supp. 1982). Although the member still retains his interest in the unit's equity, he is no longer entitled to possession. Depending upon how the cooperative is organized, it may repurchase the unit and give the ousted tenant the proceeds after deducting the outstanding charges, or it may arrange for the sale of the unit to a third party and after settlement convey the net proceeds to the dispossessed member. These remedies, of course, are extreme. The offending member is not only a tenant, but he is also an owner of the corporation, and the organization has a responsibility to assist him with his housing needs and to protect his investment. Therefore, the cooperative may choose, instead of eviction, either to arrange for repayment of a deficiency over an extended period, or to require the owner to sell but permit him to remain in the unit until it is sold. An advantage which a cooperative has with any of these alternatives is that it has final control over the proceeds of any sale. Because the co-op remains the titled owner of the premises and must approve and execute proprietary leases with new members, all sales must be processed through the cooperative. Therefore, a cooperative has not only a more effective remedy, but also a greater flexibility in dealing with a delinquent member.

What if individual owners refuse to abide by the "house rules?" Under Md. Real Prop. Code Ann. § 11-113 (1981 & Supp. 1982), a condominium may impose fines for violations after notice and hearing. The individual has a right to appeal to the Maryland courts. These fines can then constitute a lien on the condominium and, if not paid, could lead to foreclosure. Alternatively, the council may sue the unit owner for damages or injunctive relief. Continued violations could lead to a criminal contempt conviction, but at

best, the remedy is a limited one as far as the condominium is concerned.

In a cooperative, the house rules are usually incorporated directly or by reference into the occupancy agreement or the proprietary lease, and the cooperative may terminate the lease "for cause." Under Section 8-402.1 of the Real Property Article, the landlord may repossess if the tenant breaches the lease and fails to comply within thirty days after the landlord has given notice of the violation. The "stick" with which the cooperative may gain compliance is thus more direct and effective. As a result efforts which the cooperative makes to mediate and settle disputes may be more successful.

Management Concerns

Among those experienced in managing both cooperatives and condominiums there is some feeling that cooperatives are easier to manage. Not only are their controls over the members stronger and more direct, but the cooperative is able to function more effectively as a unit. In a cooperative the power to act is clearly centralized in the board of directors, and the tenant/shareholders are more immediately aware that their ability to control the organization must be accomplished through group action. A condominium may have greater difficulty imbuing its owners with the sense of community commitment and involvement which is necessary to enable the council to enforce its rules and regulations.

The possibility that a cooperative can be more easily managed does not mean that it will be better managed than a condominium. Under either type of development, the critical factor is the ability and dedication of its elected directors. Managing a housing development demands not only sound and far-sighted fiscal policies, but also demands an openness and sensitivity to the needs of its members. Those

considering purchase of either a cooperative or condominium unit should take time to examine the organization's leadership. Whether the investment in a unit will be secure will depend in large part on the experience, intelligence and commitment of the directors and on the management they oversee.

Conclusion

Condominiums and cooperatives represent different legal approaches and, to an extent, different conceptual orientations to the challenge of home ownership within a multi-unit dwelling. Condominium organization begins with the concept of independent individual ownership, but then significantly restricts traditional ownership rights in the interests of the group. Cooperatives focus initially on the larger entity and then provide in their by-laws and regulations for the rights and privileges of the members with regard to their individual homes and their participation in and control of the organization.

Each type of organization has advantages and disadvantages as far as development, purchase and occupancy. Condominium units are often easier to finance, but cooperative projects may be easier to develop and may be initially less costly. However, if financing continues to be as scarce as it is today, the differences in purchasing condominium versus cooperative units may become much less significant.

Cooperatives may impose somewhat greater restrictions on an individual's use and transfer than that of a condominium, but increasingly the two organizations have similar regulations in recognition of the need to balance the rights of the individual with the needs of the group. Cooperatives may enforce their regulations with more ease because they can utilize the landlord-tenant procedures, but successful management of either type of organization mostly depends on the ability and dedication of its leadership.

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A Review of Real Property Support Rights in Maryland

by Judith Ann Cross

Lawyers and law students should be aware of real property support rights in Maryland. It will arise in any type of practice, and one may encounter the problem of support rights even when undertaking a home improvement such as building a swimming pool. Set forth is an overview of the Maryland law on real property support rights.

Right to Lateral Support

Lateral support is an ancient principle of the common law that every landowner is entitled to receive the necessary physical support from adjoining soil. If earth is removed so near a neighbor's property that the neighbor's soil crumbles away under its own weight, there is liability for the damages proximately caused.

The leading Maryland case on lateral support rights is *Mullan v. Hacker*, 187 Md. 261, 49 A.2d 640 (1946).

In *Mullan*, the court traces the original theory of lateral support to England where the right was viewed as an easement subjecting the adjoining land to a natural servitude. It was not necessary to prove negligence to establish liability because the right was violated by removal of support. Over the years, a second theory developed that the right to lateral support was a right of property naturally attached to the soil. Under this second theory, it was necessary to show negligence or intention to cause injury.

In Maryland, both views have contributed to the present law. The right