

AN EXAMINATION OF THE CURRENT OHIO CONDOMINIUM LAW

INTRODUCTION

THE CONDOMINIUM concept of housing was almost unknown twenty-five years ago in the United States. Today, condominiums have become prevalent and housing economists predict that more than fifty percent of the population will be living in a condominium type housing unit¹ by the turn of the century.²

Market indicators suggest that prospective condominium purchasers fall into three major categories: (1) young couples forming their first household (age 25-30); (2) actual and potential "empty nesters" whose children no longer live with them (age 45-65); and, (3) senior citizens (age 65-plus).³ This primary group of potential home purchasers comprises more than fifty percent of our total population.⁴ There is also a secondary market (age 35-45) which is comprised of confirmed urbanites and people buying second homes. This secondary market is generally composed of the middle class.⁵

A condominium buyer purchases two types of property: (1) an individual dwelling unit to which he has sole title; and, (2) a joint title to land (which includes both that upon which his unit rests and that intended for the use of all owners).⁶ Thus, a condominium dweller has the advantages of apartment living plus the advantage of accumulating investment equity as though he had purchased a house.⁷

¹ P. KEHOE, *COOPERATIVES AND CONDOMINIUMS* 5 (1974) distinguishes a condominium from a cooperative:

A cooperator does not have a free ownership of land. In reality his unit is owned by the cooperative organization and the cooperator occupies it under a lease from the cooperative. What the cooperator actually does own is a portion of the cooperative organization itself. The cooperative can itself be a lessee, each cooperator is in effect a sublessee. The cooperative is set up as a non-profit corporation, in which case each cooperator is a shareholder. In the corporate cooperative, each cooperator solely by virtue of his ownership of stock is automatically entitled to obtain a lease, called a proprietary lease, to a designated apartment or other dwelling and to occupy and use that specified unit in return for the payment of a monthly maintenance charge.

² B. JONES, *STATE REGULATION OF CONDOMINIUMS* 1 (1975).

³ A. ARNOLD & C. LAUNER, *DEVELOPING A CONDOMINIUM: FEASIBILITY, FINANCING AND MARKETING* 9 (1973).

⁴ KEHOE, *supra* note 1, at 1.

⁵ ARNOLD & LAUNER, *supra* note 3, at 9-10.

⁶ JONES, *supra* note 2, at 3.

⁷ ARNOLD & LAUNER, *supra* note 3, at 4. There are many logical reasons for the heavy demand for multifamily condominium housing. The chief reasons are: (1) the important economic benefits of home ownership; (2) the economic squeeze that is forcing both builders and buyers to search for less conventional housing opportunities; and, (3) the flexibility of condominium size and design. The few market failures reported have been attributable to poor market analysis in location or architectural design. Neither problem is peculiar to condominiums; either could spell failure for any form of housing.

When Puerto Rico enacted the Horizontal Property Act of 1958, it was the first American jurisdiction to specifically authorize the condominium.⁸ In 1961, Congress recognizing the need for more efficient use of urban land, authorized the Federal Housing Administration to insure mortgages on condominiums where their existence was lawful.⁹ This opened the door for extensive state condominium legislation. By the end of 1963, thirty-nine states had passed condominium enabling laws and by 1969, when Vermont finally did so, condominiums were legal in every jurisdiction.¹⁰

Ohio sanctioned condominiums in 1963 by enacting the Condominium Property Act.¹¹ The act addresses five issues: (1) the creation of the condominium form of ownership;¹² (2) the respective interests each unit owner possesses in the common area;¹³ (3) the administration of the condominium;¹⁴ (4) the rights of the lienors;¹⁵ and, (5) the removal of the property from the Act's provisions.¹⁶ The Act was amended in 1978 to facilitate consumer protection.¹⁷ This comment will examine the 1978 amendment and evaluate its effectiveness. It will then examine the tax considerations involved in the purchase of a condominium unit.

I. THE LEGAL STRUCTURE OF THE CONDOMINIUM

The legal structure of the condominium is basically established by two documents: the declaration,¹⁸ and the bylaws of the unit owners association.¹⁹ Both documents are framed by the developer in the context of state law.²⁰ Therefore, the developer exercises enormous influence on the condominium organization and this influence extends beyond the period during which he retains ownership of any of the units. The only restraints placed on the developer are the restrictions of state law.²¹

The declaration creates the condominium concept, its method of gov-

⁸ KEHOE, *supra* note 1, at 8; P.R. LAWS ANN. tit. 31, §§ 1291-1293(k) (1968).

⁹ Housing Act of 1961, Pub. L. No. 87-70, 75 Stat. 149 (codified at 12 U.S.C. 1715y (1976)). Section 234 authorizes the Federal Housing Administration to issue mortgage insurance for "individually owned units in multifamily structures."

¹⁰ KEHOE, *supra* note 1, at 8; VT. STAT. ANN. tit. 27, §§ 1301-1329 (Supp. 1973).

¹¹ OHIO REV. CODE ANN. §§ 5311.01-.22 (Page 1970).

¹² *Id.* §§ 5311.02, 5311.06.

¹³ *Id.* § 5311.04.

¹⁴ *Id.* §§ 5311.08, 5311.19.

¹⁵ *Id.* §§ 5311.13, 5311.18.

¹⁶ *Id.* § 5311.17.

¹⁷ Am. Sub. H.B. 404, 112th Gen. Assem., Reg. Sess. (1977-1978) (codified at OHIO REV. CODE ANN. §§ 5311.01-.09, 5311.11, 5311.13, 5311.18, 5311.21-27 (Page Supp. 1979)).

¹⁸ *Id.* § 5311.01(C).

¹⁹ *Id.* § 5311.08(A).

²⁰ *Id.* §§ 5311.01-.27.

²¹ JONES, *supra* note 2, at 4.

ernance, and the obligations of the developer and unit owners.²² It must be signed and acknowledged by the owner in the presence of two witnesses and before a suitable official.²³ The declaration must contain a legal description of the land being submitted²⁴ and the name by which the condominium property shall be known.²⁵ The declaration must also contain the purpose of the condominium property and the units and commercial facilities situated therein, and the restrictions, if any upon their use or uses.²⁶ A general description of the building or buildings being submitted with the particular data necessary to identify each unit need also be included.²⁷ It is also necessary to describe the common areas and facilities and limited common areas and facilities, the percentage of interest therein appertaining to each unit, and the methods for allocating and amending the percentages.²⁸ In addition, there must be a statement that each unit owner shall be a member of a unit owners association established for the administration of the condominium property.²⁹ The name and address of a person to receive service of process for the association is also required in the declaration.³⁰ The method by which the declaration may be amended (the statute requires the affirmative vote of unit owners exercising not less than seventy-five percent of the voting power³¹) and any other provisions deemed desirable should be stated.³²

All condominium declarations must be filed and recorded in the office of the recorder of the county in which the land is situated.³³ When filed, all original declarations must be accompanied by a set of drawings of the condominium property³⁴ and a true copy of the bylaws of the unit owners association.³⁵

²² *Id.* at 5.

²³ OHIO REV. CODE ANN. § 5311.05(A) (Page Supp. 1979).

²⁴ *Id.* § 5311.05(B)(1).

²⁵ *Id.* § 5311.05(B)(2).

²⁶ *Id.* § 5311.05(B)(3).

²⁷ *Id.* §§ 5311.05(B)(4), 5311.05(B)(5).

²⁸ *Id.* § 5311.05(B)(6).

²⁹ *Id.* § 5311.05(B)(7).

³⁰ *Id.* § 5311.05(B)(8).

³¹ *Id.* § 5311.05(B)(9).

³² *Id.* § 5311.05(B)(10).

³³ *Id.* § 5311.06(A).

³⁴ *Id.* § 5311.07. The section provides:

A set of drawings shall be prepared for every condominium property which show graphically, insofar as is possible, all the particulars of the land or water slips, buildings, and other improvements, including, but not limited to, the layout, location, designation, and dimensions of each unit, the layout, location, and dimensions of the common areas and facilities and limited common areas and facilities, the location and dimensions of all appurtenant easements or encroachments, and, if the condominium property is not contiguous, the distances between any parcels of land or any water slips. The drawings shall bear the certified statement of a registered surveyor and registered architect or registered surveyor and licensed professional engineer that the drawings accurately show the building or buildings, or water slips, as constructed.

³⁵ *Id.* § 5311.06(A).

The bylaws constitute the condominium rules and regulations within the declaration.³⁶ The Ohio Act requires the establishment of a unit owners association to be governed by the bylaws and stipulates that any amendment to the bylaws must be set forth in an amendment to the declaration and recorded.³⁷ Unless the declaration indicates otherwise, the bylaws must provide for the election of a board of managers³⁸ and its officers.³⁹ The bylaws must also delineate the powers of the board⁴⁰ and set out procedures for calling and conducting the owners association meeting.⁴¹ They must also describe the procedure for assessing and collecting common expenses,⁴² distributing common profits⁴³ and adopting administrative rules.⁴⁴ In addition, they must include a quorum requirement in terms of the percentage of interest in the common areas for a meeting of the owners association.⁴⁵ The association determines what percentage will constitute a quorum. Full disclosure of the bylaws is important because a unit owner is potentially liable for damages caused by noncompliance with the bylaws.⁴⁶

Despite the numerous items required to be in the declaration and the bylaws, the Ohio Act accords the unit owner and developer considerable flexibility in the actual details. The function of Ohio's statute and other state condominium statutes is to: (1) recognize the division of ownership and the necessity of a conveyance instrument that adequately and clearly demonstrates ownership and transferability; (2) establish a binding contract among the participants which cannot be avoided or altered to the detriment of others without their consent; (3) eliminate the uncontrollable legal means for partitioning property intended for common use; (4) require that government officials recognize the necessity to file documents in official places and to assess units separately and fairly for real property taxes; and, (5) provide safety and security for institutional lenders to issue mortgage loans secured by the separate units and their respective interests in common areas.⁴⁷

³⁶ JONES, *supra* note 2, at 4.

³⁷ OHIO REV. CODE ANN. § 5311.08(A) (Page Supp. 1979).

³⁸ *Id.* § 5311.08(B)(1).

³⁹ *Id.* § 5311.08(B)(3).

⁴⁰ *Id.* § 5311.08(B)(1).

⁴¹ *Id.* § 5311.08(B)(2).

⁴² *Id.* § 5311.08(B)(5).

⁴³ *Id.* § 5311.08(B)(6).

⁴⁴ *Id.* § 5311.08(B)(7).

⁴⁵ *Id.* § 5311.08(B)(2).

⁴⁶ *Id.* § 5311.25.

⁴⁷ D. CLURMAN & E. HEBARD, *CONDOMINIUMS AND COOPERATIVES* 13 (1970).

If the construction loan of the developer is insured by the Federal Housing Administration, documents must be filed and approved by the Department of Housing and Urban Development. No solicitation of purchases may be undertaken before approval. In addition to the declaration and bylaws, a subscription and purchase agreement and a regulatory agreement must be filed. The subscription and purchase agreement acts as a prospectus and contract of sale, although it may be expanded to include other provisions. The regulatory agreement provides for the establishment and maintenance of a reserve fund to replace structural items and mechanical equipment and provides for a general operating fund to provide a financial cushion in the event that monthly maintenance charges do not coincide with expenses. These funds tend to minimize the mortgage insurance risk.⁴⁸

II. PRESALE DISCLOSURE

The nature of the condominium interest and the complexities of the documents may mislead or confuse a prospective buyer who is about to make the single largest purchase of his lifetime.⁴⁹ Thus, Ohio has joined the ranks of a growing number of states which extend presale disclosure protection by statute.⁵⁰ The essence of disclosure is the full revelation of the terms of sale and operation so that all the consequences of ownership are clear.⁵¹ The assumption is that disclosure will force developers to proceed more carefully in planning and selling units and enable buyers to make an informed decision before entering into a purchase.⁵²

The Ohio Act requires that disclosure be made in the declaration and in the written offering statement which must be given to all prospective and actual purchasers.⁵³ It further provides that a developer or his agent may not offer to sell or sell a condominium ownership interest unless the condominium instrument provides detailed information concerning the rights of both parties.⁵⁴

Violation of the statute has been defined as an intentional omission or misstatement of a material fact. If the purchaser discovers that a purchase agreement is in violation of the statute, he has a right to void the agreement.

⁴⁸ ARNOLD & LAUNER, *supra* note 3, at 23-24.

⁴⁹ Rohan, *Condominiums and the Consumer: A Checklist for Counseling the Unit Purchaser*, 48 ST. JOHN'S L. REV. 1028, 1034 (1974).

⁵⁰ See ILL. ANN. STAT. ch. 30, § 322 (Smith-Hurd Supp. 1975); CONN. GEN. STAT. ANN. § 47-71b (West 1978); FLA. STAT. ANN. § 718.504 (West Supp. 1978); GA. CODE ANN. § 85-1643 (1978).

⁵¹ JONES, *supra* note 2, at 6.

⁵² Note, *New York Regulation of Condominiums*, 48 ST. JOHN'S L. REV. 964, 965 (1974).

⁵³ OHIO REV. CODE ANN. § 5311.26 (Page Supp. 1979).

⁵⁴ *Id.* § 5311.25.

The right must be exercised within fifteen days from the date of execution of the agreement or receipt of the written statement, whichever is later. When the purchaser exercises his rights, the developer must refund the monies paid by the buyer and pay all closing costs. The purchaser may also obtain damages and collect no less than \$500 for each violation plus attorney's fees and costs.⁵⁵ If the purchaser brings an action he knows to be groundless or in bad faith and the developer prevails, the court may require the purchaser to pay the developer's attorney's fees.⁵⁶

In addition to these private remedies, the attorney general is empowered to provide public enforcement if he has reason to believe that substantial numbers of persons are affected or substantial harm is occurring.⁵⁷ He may: (1) seek a declaratory judgment that an act or practice of a developer is violative of the Code; (2) pray for an injunction to prevent a threatened action;⁵⁸ (3) institute a class action for damages on behalf of the persons injured; or, (4) request the court to appoint a receiver or master.⁵⁹

Section 5311.26 is basically an antifraud provision placing affirmative duties of disclosure on the developer and warning that the written statement "shall not intentionally omit any material fact."⁶⁰ This section seems to forgive a negligent misstatement or omission of the information.⁶¹ On the other hand, section 5311.25 imposes an absolute liability upon the developer. This difference is probably due to the fact that providing the detailed information regarding the rights of the parties (section 5311.25) requires no exercise of discretion by the developers whereas section 5311.26 (the offering statement requirement) affords a great deal of discretion.⁶²

III. PARTICULAR CONSUMER PROBLEMS AND ATTEMPTED SOLUTIONS

Condominium buyers become involved in a novel interdependence with the developer and other unit owners. As a result, there is ample opportunity for consumer dissatisfaction and developer overreaching. The problems of the consumer generally fall into five categories:

A. *Loss of Purchaser Deposits*

The consumer usually makes a down payment or deposit to secure his unit with the developer. He may later discover that the developer has failed

⁵⁵ *Id.* § 5311.27.

⁵⁶ *Id.* § 5311.27(B)(3).

⁵⁷ *Id.* § 5311.27(C).

⁵⁸ *Id.* § 5311.27(C)(1).

⁵⁹ *Id.* § 5311.27(C)(2).

⁶⁰ *Id.* § 5311.26.

⁶¹ This disclosure provision is patterned after the Securities Act of 1933 § 11, 15 U.S.C. 77 (k)(a) (1976) and the Securities Exchange Act of 1934 § 10, 15 U.S.C. 78(j)(b) (1976).

⁶² Comment, *Ohio Condominium Law Reform: A Comparative Critique*, 29 CASE W. RES. L. REV. 147, 161 (1978) [hereinafter cited as *A Comparative Critique*].

financially and that the condominium will never be completed. The financial failure is generally due to developer misuse or bankruptcy. The developer often uses deposit money to pay further construction costs and such on-going expenses as payroll and advertising.⁶³ When a developer declares bankruptcy, the buyer may lose his deposit if mechanic's and materialman's liens or other creditors' claims consume the developer's remaining funds. The buyer's claim might also be subordinated to a construction lender's preferred blanket mortgage.⁶⁴ On the other hand, there are legitimate policy justifications for the developer's use of these deposits. Developers, especially small-scale construction enterprises, may need the purchaser's deposits to finance the development. In addition, the construction lender may mandate that a certain percentage of the units be presold and deposits be taken.⁶⁵

The Ohio Act requires that the deposit or downpayment be held in trust or placed in escrow until the settlement of the transaction, its return to the buyer, or forfeiture to the developer. If a deposit of \$2,000 or more is held for more than ninety days, interest must be paid at an annual rate of four percent to the purchaser upon the settlement or return of the deposit, or to the developer upon forfeiture. The Act further provides that such frozen deposits are not subject to attachment by the developer's or purchaser's creditors.⁶⁶ Section 5311.26 provides that the statute's requirement for the escrow deposits be disclosed to each prospective purchaser in writing.⁶⁷

When an escrow account is established, the depository must be a third party who shall act as the agent of both the developer and purchaser.⁶⁸ Therefore, the developer may not act as an escrow agent. The usual depository is a real estate broker, bank, or savings and loan association.

Since section 5311.25 also permits deposits to be held in trust, a developer may become the depository by having the purchaser appoint him as trustee. Where a single beneficiary is the sole trustee, the legal title and equitable interests merge to defeat the trust and confer a fee simple interest.⁶⁹ This problem can be solved when one of several beneficiaries is the sole trustee.⁷⁰

⁶³ Note, *Recent Innovations in State Condominium Legislation*, 48 ST. JOHN'S L. REV. 994, 999 (1974) [hereinafter cited as *Recent Innovations*].

⁶⁴ Crockett, *Protecting the Deposit of the Consumer Who Purchases a New Condominium Apartment*, 8 HAWAII B.J. 103, 104-05 (1972).

⁶⁵ *Id.*

⁶⁶ OHIO REV. CODE ANN. § 5311.25(A) (Page Supp. 1979).

⁶⁷ *Id.* § 5311.26(M).

⁶⁸ *Squire v. Branciforti*, 131 Ohio St. 344, 2 N.E.2d 878 (1930); *McGriff v. McGriff*, 48 Ohio L. Abs. 218, 74 N.E.2d 619 (Ct. App. Ohio 1947).

⁶⁹ *Hill v. Iron*, 160 Ohio St. 21, 113 N.E.2d 243 (1953).

⁷⁰ *Burbach v. Burbach*, 217 Ill. 547, 75 N.E.519 (1905).

A practical approach would be to permit deposits to be held by developers under bond.⁷¹ The use of a surety bond would provide a purchaser with protection and yet not restrict the developer's use of the deposit.

The release of the entire deposit upon settlement has been criticized for failing to protect the purchaser of a unit that has not been completed, equipped or landscaped, or in which construction of the common elements has not been finished.⁷² It has been suggested that a two-step release would provide more protection by releasing part of the deposit upon closing and the remainder upon completion.⁷³

B. *Burdensome Maintenance, Management and Recreational Facility Contracts*

The developer may promise to (or engage a third party to) provide long-term maintenance and management services to the condominium complex.⁷⁴ A unit purchaser may discover that he has actually purchased only a part of the complex and has in fact entered into a long-term lease for the remainder. A developer may retain ownership of the land or recreational facility which the unit owner must lease. These leases sometimes provide for exorbitant fees⁷⁵ and may even include escalator clauses allowing for future rate increases.⁷⁶

These arrangements are commonly called "sweetheart contracts." The Ohio Act has provided some protection against sweetheart contracts by mandating that a written statement be provided to each prospective purchaser disclosing the existence of any contracts made with the unit owners association.⁷⁷ To aid in this disclosure, a facsimile of any contract must also be provided with a narrative statement describing its effect on the buyer. This statement must include the services to be rendered, the charges to be assessed and the relationship, if any, between the developer and any agent.⁷⁸

A unit owner's share of the joint expense or assessment may increase beyond the amount originally anticipated. The cause could be poor management, increasing costs of developer contracts and leases, or a decision of the unit owners. A purchaser of a condominium may find himself out-

⁷¹ MODEL CONDOMINIUM ACT § 14 (1977).

⁷² *A Comparative Critique*, *supra* note 62, at 157.

⁷³ See CONN. GEN. STAT. ANN. §§ 47-74(d)(b) (West 1978).

⁷⁴ JONES, *supra* note 2, at 7.

⁷⁵ *Id.* It has been suggested that the cost be tied to a nationally recognized price index in order to prevent excessive rate increases.

⁷⁶ *Recent Innovations*, *supra* note 63, at 1001.

⁷⁷ OHIO REV. CODE ANN. § 5311.26(H)(3) (Page Supp. 1979).

⁷⁸ *Id.* § 5311.26(I).

voted and forced to pay his share of unwanted additional facilities, services or improvements.

The Ohio Act requires a written statement that must provide a two year projection, revised and updated at least every six months, of the costs of such contracts.⁷⁹ An additional degree of protection is afforded by requiring that recreation and management contracts be renewed by the unit owners association after unit owners other than the developer have gained control of the association.⁸⁰ This approach is flexible in that it retains an option to renew rather than automatically cancelling all prior contracts.

C. *Tenant Displacement Upon Conversion of Rental Projects Into Condominiums*

Until the real estate depression of 1973-75, condominium activity was almost entirely limited to new construction. A transition from new construction to conversion of existing multi-family buildings began in 1973 for a number of reasons,⁸¹ one of which was that most new construction was grinding to a halt.⁸²

The conversion of a rental unit can create difficulties for both the former tenant and the prospective purchaser. The conversion of a rental unit into a condominium may cause displacement of the former tenants. In urban areas this most often affects the middle, lower, and fixed (e.g. elderly) income tenants.⁸³

The Ohio Act requires that a tenant be given an option to purchase an interest in the condominium and be given written notice 120 days before being required⁸⁴ to vacate.⁸⁵ The nature of the notice is unclear. A Senate Judiciary Committee report suggests, however, that the legislature intended that the notice be notice "of the conversion."⁸⁶

The Judiciary Committee⁸⁷ has been criticized for this interpretation

⁷⁹ *Id.* § 5311.26(F).

⁸⁰ *Id.* §§ 5311.25(B), 5311.25(D).

⁸¹ Cox & Pritchett, *A Converter's Guide to Condominiums*, REAL ESTATE TODAY, Nov. 1979, at 4.

⁸² ARNOLD & LAUNER, *supra* note 3, at 32. The exchange of future rental income for immediate gain coupled with the threat of rent controls and the gradual narrowing of tax incentives for owners of income property has intensified the desirability of conversion.

⁸³ Note, *Tenant Protection in Condominium Conversions: The New York Experience*, 48 ST. JOHN'S L. REV. 984 (1974).

⁸⁴ If the tenant does not vacate, the developer must resort to the Ohio forcible entry and detainer statute. OHIO REV. CODE ANN. § 1923 (Page Supp. 1979).

⁸⁵ *Id.* § 5311.25(G).

⁸⁶ SENATE JUDICIARY COMM., REPORT ON AM. SUB. H.B. 404, 112th Gen. Assem., Reg. Sess. 3 (1977-78).

⁸⁷ *Id.* "In the case of a conversion condominium development, all tenants have been given an option to purchase an interest within 90 days after notice of conversion." This interpretation requires the developer only to offer the tenant an option to purchase sometime during the 90 day period following notice of conversion.

because, under it, the developer could still be in compliance with the statute if he notified a tenant of the conversion and provided the tenant with an option eighty-nine days later. A one day option would certainly not protect a tenant against displacement.⁸⁸

A practical approach is suggested by the Model Act.⁸⁹ It permits the tenant to remain until the end of any written lease and avoids hardship for the developer by imposing a two year limitation on the time a tenant may remain.

There are problems inherent in converting. Even buildings that otherwise offer condominium potential may lack amenities commonly associated with newly designed units. Practically speaking, it may be neither physically nor economically feasible to attempt installation of these amenities. Many older properties were built when building codes, zoning ordinances and market conditions did not make great demands. Also, undesirable features may be acceptable to a renter but extremely difficult to sell.⁹⁰

In order to protect the prospective purchaser in Ohio, the developer must disclose the age and condition of the property and give his opinion of the useful life of the structure and the mechanical and support systems.⁹¹ The developer must also project repair and replacement cost for five years into the future. Since an intentional failure to comply would subject the developer to penalties, he must make a reasonable effort to ascertain the required information.⁹² This disclosure requirement has been criticized for failing to require an independent expert opinion or a report of termite infestation. Another perceived shortcoming is the failure to require disclosure of the installation and construction dates of the structural system and a report of repairs.⁹³

D. *Physical Defects in the Condominium*

Before the enactment of section 5311.25,⁹⁴ the only recourse of an owner was an action in fraud,⁹⁵ breach of contract,⁹⁶ breach of an express warranty⁹⁷ or tort.⁹⁸ The Ohio statute grants warranty protection to the purchasers of residential condominiums.

⁸⁸ *A Comparative Critique*, *supra* note 62, at 165.

⁸⁹ MODEL CONDOMINIUM ACT, § 11(b) (1977).

⁹⁰ ARNOLD & LAUNER, *supra* note 3, at 33-34.

⁹¹ OHIO REV. CODE ANN. § 5311.26(G) (Page Supp. 1979).

⁹² *Id.* § 5311.27.

⁹³ *A Comparative Critique*, *supra* note 62, at 169-170.

⁹⁴ OHIO REV. CODE ANN. § 5311.25 (Page Supp. 1979).

⁹⁵ *Pumphrey v. Quillen*, 165 Ohio St. 343, 135 N.E.2d 328 (1956).

⁹⁶ *Rapp v. Murray*, 112 Ohio App. 344, 171 N.E.2d 374 (1960).

⁹⁷ *Tibbs v. National Homes Constr. Corp.* 52 Ohio App. 2d 281, 369 N.E.2d 1218 (1977).

⁹⁸ *Lloyd v. William Fanin Builders, Inc.*, 40 Ohio App. 2d 507, 320 N.E.2d 738 (1973).

The common areas are to be warranted under the condominium instrument for two years. This warranty must cover the full cost of the labor and materials needed for repair and replacement of the roof and structural components as well as the mechanical, electrical, plumbing and common service elements. This warranty begins to run on the date the deed is recorded for the sale of the first condominium ownership interest in the development to a good faith purchaser for value.⁹⁹

The developer must also warrant the individual unit for one year. This warranty also covers the cost of labor and materials required to repair or replace structural, mechanical or other elements that are damaged because of a defect in materials or workmanship. This one year warranty begins to run on the date the deed is recorded following the first sale of a condominium ownership interest to a good faith purchaser for value.¹⁰⁰ If the developer assigns to the purchaser any express or implied warranty that the manufacturer has given him on appliances, he is not required to extend his own one year warranty. He is, however, liable for the installation of the appliances.¹⁰¹ If the developer receives a warranty that exceeds the one year time period, he must assign it to the purchaser.¹⁰²

The protection afforded by the statute may not be strong enough to be meaningful to the purchaser.¹⁰³ The warranty covers only the cost of repairs and replacement and does not cover any resulting losses. Any consequential damage must be recovered through a common law remedy. Also, since the warranty commences upon the first recording of a deed, a subsequent purchaser may not receive warranty protection.¹⁰⁴

E. *Conflicting Interests of Owner-Resident and Owner-Developer*

Since units sell gradually over a period of time, the developers may own many or a majority of units for some time after the project starts. The Ohio Act has balanced the developer's and owner's interests by establishing a time requirement for the initial owners meeting and a timetable for the gradual transfer of control from the developer to the other unit owners.¹⁰⁵

According to section 5311.08,¹⁰⁶ the developer may act in the place

⁹⁹ OHIO REV. CODE ANN. § 5311.25(E)(1) (Page Supp. 1979).

¹⁰⁰ *Id.* § 5311.25(E)(3).

¹⁰¹ *Id.* § 5311.25(E)(4).

¹⁰² *Id.* § 5311.24(E)(5).

¹⁰³ Note, *Ohio Amends Its Condominium Act*, 4 U. DAY. L. REV. 503, 518 (1979).

¹⁰⁴ *A Comparative Critique*, *supra* note 62, at 184.

¹⁰⁵ *Id.*

¹⁰⁶ OHIO REV. CODE ANN. § 5311.08(C) (Page Supp. 1979).

of the association until one is established. The association, however, may be established no later than the time of the filing of the deed for the first unit sold. To avoid the developer "packing" the board, the section provides that only owners may be members. At that time, the owners other than the developer, must elect at least twenty-five percent of the board of managers. By the time fifty percent of the interest has been sold, thirty-three percent of the board must be elected.

In addition, section 5311.08¹⁰⁷ permits the declaration to authorize the developer or his designee to appoint and remove members of the management board or other association officers and to exercise the powers otherwise assigned to the association. This authorization may extend only for three years after the establishment of the association or thirty days after the sale of seventy-five percent of the interests to bona fide purchasers, whichever is earlier. This section further provides that if there is a unit owner other than the developer, the declaration cannot be amended to extend the scope or the period of the originally authorized developer control. Within thirty days after the developer's powers have expired the association must meet and elect all of the management's board and officers. At this time the developer must turn over the records that the statute required him to maintain. Failure to do so renders the developer liable for damages.¹⁰⁸

IV. TAX CONSEQUENCES OF CONDOMINIUM OWNERSHIP

Most condominium advertising emphasizes the tax savings advantage of condominium ownership. Like a single family homeowner,¹⁰⁹ the owner of a condominium unit may, for income tax purposes, deduct both real estate property taxes assessed against his unit¹¹⁰ and interest paid on any mortgage debt he incurred to purchase the unit.¹¹¹ These expenses can be expected to represent fifty to seventy percent¹¹² of the condominium carrying charges.¹¹³ The higher the tax bracket the more attractive is the deductibility of expenditures.

¹⁰⁷ *Id.* § 5311.08(D).

¹⁰⁸ *Id.* § 5311.09(B).

¹⁰⁹ Rev. Rul. 64-31, 1964-1 C.B. 300 specifically states:

[A] taxpayer may deduct, under sections 163 and 164 of the Code, respectively, the interest in the mortgage indebtedness and the taxes assessed in his interest in the property which he pays each year, provided he itemizes his deductions in filing his Federal income tax returns.

¹¹⁰ I.R.C. § 164 permits an itemizing taxpayer to deduct real property taxes.

¹¹¹ I.R.C. § 163 permits an itemizing taxpayer to deduct interest on home mortgage indebtedness.

¹¹² CLURMAN & HEBARD, *supra* note 47, at 139.

¹¹³ *Id.* at 141. "Even though the constant charges on long-term mortgages include a disproportionately high percentage of interest payments during the first six or seven years, increases in the market value of the unit serves as a hedge against inflation without the need to sell."

A lessee can claim none of these deductions.¹¹⁴ The residential tenant stockholder in a cooperative that accommodates both commercial and residential units may lose property tax and mortgage interest deductions if more than twenty percent of the cooperative corporate gross income is derived from commercial leases.¹¹⁵

If the condominium unit owner rents his unit, a deduction for repairs and maintenance is permitted by section 162 of the Internal Revenue Code for those expenditures applicable to such period of time.¹¹⁶ A depreciation allowance under section 167 should also be within the entitlement of such unit owner for the period of rental use.¹¹⁷ Should the unit owner suffer a casualty loss to his condominium property, he can deduct the amount in excess of the \$100 floor.¹¹⁸

A taxpayer who sells or exchanges a condominium unit that was his principal residence may defer any taxable gain.¹¹⁹ The tax on the profit may be postponed by buying a new principal residence within eighteen months of the date of sale.¹²⁰ Purchase of either another condominium unit, a single family home, or stock in a cooperative corporation would suffice.¹²¹ To defer all gain, the taxpayer would have to pay as much for the new home as he realized on the sale of the unit. The portion of the profit not reinvested in a new principal residence would be taxable income.¹²² Of course, as in the case of the sale of an individual dwelling used as a residence by the seller, no loss incurred on the transaction is deductible because the property was not used in a trade or business.¹²³

If the condominium owner does realize a gain on the sale of his unit, it is taxable as a long-term capital gain if the unit has been held more than one year.¹²⁴ As a long-term capital gain, sixty percent of the profit on the sale of the unit is excluded from income. The other forty percent is taxed as ordinary income.¹²⁵ The condominium owner may sell his unit on the

¹¹⁴ I.R.C. § 262. Under I.R.C. § 162(a)(3), rental expense for purposes of a trade or business is deductible as an ordinary and necessary expense.

¹¹⁵ I.R.C. § 216. This rule does not apply to condominiums.

¹¹⁶ I.R.C. § 165(c)(3) defines a "casualty loss as a loss which arises from fire, storm, shipwreck or other casualty, or from theft."

¹¹⁷ I.R.C. § 162.

¹¹⁸ I.R.C. § 167.

¹¹⁹ I.R.C. § 1034.

¹²⁰ I.R.C. § 1034(a).

¹²¹ KEHOE, *supra* note 1, at 38.

¹²² ARNOLD & LAUNER, *supra* note 3, at 6.

¹²³ CLURMAN & HEBARD, *supra* note 47, at 142.

¹²⁴ I.R.C. § 1223.

¹²⁵ I.R.C. § 1202.

installment method provided he meets certain requirements.¹²⁶ An installment sale will permit him to avoid reporting his entire gain in the year of the sale and allow him to spread his profit over the length of the installment payment period.

If the condominium owner's unit is condemned or sold under a threat of condemnation, he may defer any profit realized by treating the disposition as an involuntary conversion.¹²⁷ To qualify, the unit owner must replace the converted residence unit within two taxable years following the end of the tax year in which the conversion occurs.¹²⁸ Any excess of the condemnation proceeds over the cost of the new home is currently taxable.¹²⁹

A gift tax advantage lies in the fact that a condominium unit owner can transfer his interest in the unit to himself and his spouse as tenants by the entirety for no consideration and not incur a gift tax.¹³⁰ This is so because the creation of a tenancy by the entirety in real estate is not considered a transfer for purposes of the gift tax unless the donor elects to have it treated as a taxable gift.¹³¹

CONCLUSION

The amendments to the Ohio Condominium Act have been successful in mitigating many of the major consumer problems while at the same time providing developers with the opportunity to make profits and the flexibility to try innovative techniques. Further responsive and responsible legislation (including favorable tax treatment) will provide the climate for the continued growth of the condominium alternative.

PATRICIA MCQUILLEN BILLOW

¹²⁶ I.R.C. § 453(b)(2).

¹²⁷ I.R.C. § 1033.

¹²⁸ I.R.C. § 1033(a)(2)(B)(i).

¹²⁹ I.R.C. § 1033(a)(2)(A).

¹³⁰ ARNOLD & LAUNER, *supra* note 3, at 7.

¹³¹ I.R.C. § 2515(a).