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Multi-use projects and master condominiums

At least until the recent economic 'adjustment,' many real estate developments,

particularly in urban areas, were being conceptualized and implemented as multi-use projects in order to maximize the development potential of a particular tract of land. Many of these projects were established as condominiums containing units dedicated to multiple uses. A basic model is a single condominium with a larger number of residential condominium units, a smaller number of retail or commercial units, and possibly parking space units.



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As the number of units and uses (or their complexity) increases, however, there are a number of reasons to consider creating a master condominium which consists of a limited number of units, sometimes called master units. Each of these units can itself be a separate condominium, or sub-condominium, dedicated to a particular use. As an example, a master condominium could have three master units, the first of which is a residential sub-condominium, the second, an office sub-condominium, and the third, a commercial or retail sub-condominium (the units of these sub-condominiums can be offered for sale or lease).

The reasons for a choosing a master condominium scheme vary but include:

- The management and administrative efficiencies which permit the managers of each sub-condominium to focus on issues important or local to it (e.g., responsibility for maintenance, repair and replacement of sub-condominium common elements, and the allocation of costs attributable to a particular use among those users), while the master condominium focuses on issues that cross the boundaries of the sub-condominium units (e.g., shared master condominium common elements).

- The willingness of some lenders to finance a single-use sub-condominium project, rather than a larger multi-use project. (Although dealing with multiple lenders may not be desirable, it is preferred to dealing with no lenders.)

- The possibility of bringing in different partners to develop and construct the different uses.

- The possibility of adding real estate (or airspace) to the condominium in the future through an alternative to a flexible condominium format¹.

- A tax benefit for the residential unit owners by exempting the homeowners' association from federal corporate taxes (if the square footage of the commercial units is more than ten or fifteen per percent of the total square footage of all units, the condominium association is subject to federal corporate income tax.²)

- Recent changes in the Fannie Mae guidelines for the financing of the purchase of residential condominium units which have caused some lenders to insist (or express a preference) that a residential condominium contains no commercial units or fewer such units than

previously would have been thought acceptable.³ (This can result in the use of a multi-tier condominium regime where one might not have been previously considered.)

Like any condominium in Pennsylvania, a master condominium is created by the recording of a declaration, together with plats and plans, in the real estate recording office of the county in which the project is being constructed.⁴ The declaration for the master condominium provides for a limited number of units, each of which can or will be a separate and distinct condominium regime, or sub-condominium, to be further subdivided into units. Declarations are then recorded for each of the units of the master condominium thereby creating multiple sub-condominiums.⁵

Some of the critical issues facing the drafter of any condominium documents are the allocation of control and decision-making and the creation of mechanisms dealing with control and decision-making as well as with dispute resolution in areas such as administration or governance, financial management, and the maintenance and repair of common areas. In a multi-use project, all these issues can be addressed within a single condominium with multiple use units.

However, as noted above, when the projects and the number of units grow, it is more efficient to have those units dedicated to a single use administer or address those issues relating specifically to the single use. From an operational perspective, it may also be desirable to provide as much autonomy as is

reasonable for each use and to isolate the uses as much as possible. This could also minimize disputes between the owners of the different use units.

Condominiums are governed by unit owner associations. When a master condominium with separate sub-condominium regimes is formed, there are typically multiple condominium associations, i.e., one for each use plus an association for the master condominium.⁶ The drafter is then charged with delineating the responsibilities and duties between the sub-condominiums' associations, which must also work in conjunction with the master condominium association to address the common issues.

However, in some jurisdictions like Pennsylvania, the declarant may (in the declarations) delegate all or some of the powers of the sub-condominium associations to a master or umbrella association.⁷ In such jurisdictions, the applicable law also provides for a variety of methods for the election of directors of the master association.⁸ The drafter is then better able to fine-tune the interplay between the multiple associations.

Finally, although multiple associations might be a better approach on larger complicated project, in other cases, it might simply result in multiple levels of unnecessary bureaucracy and administration. Consider a project where there may be no more than fifteen units of which four are commercial or retail (with a total of less than 15% of total area) and the remainder residential, but where circumstances have dictated that there should be two sub-

condominiums. Provided that the applicable law permits it, an appropriate approach might be single master association addressing all the issues of the three condominiums, i.e., the master condominium and the two sub-condominiums.⁹

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1. The Pennsylvania Uniform Condominium Act, 68 Pa.C.S.A. §§3101-3414 (the "Act"), allows a declarant to add real estate to a condominium or to convert common areas to additional units. If the provisions of the Act are too limiting or otherwise problematic in a particular case, creating a master unit for future development might be a solution.

2. A residential condominium or homeowners' association will be taxed as a corporation unless it is exempt under Section 528 of the Internal Revenue Code, in which case it will be subject to a flat tax of 30% but only on non-exempt activities. 26 U.S.C.A. §528. In order to qualify for this exemption, an association must meet a number of tests including whether or not "substantially all of the units... are used by individuals for residences." Id. at § 528(c)(2). Practitioners accept this requirement to mean that at least eighty-five (85%) percent of the square footage of all units must be dedicated to residential use.

3. For recent Fannie Mae changes see: Announcements 08-01, 07-18 and 07-07 available on line at www.efanniemae.com/sfl/refmaterials/approvedprojects/index.jsp (last visited Nov. 10, 2008).

4. 68 Pa.C.S.A. §3201.

5. The Act provides that any interest in real estate can be the subject of a declaration and made into a condominium, including leaseholds. Since a condominium unit is an interest in real estate, it can be the subject of a declaration. 68 Pa.C.S.A. §§3103 and 3201.

6. Section 3301 of the Act mandates that a unit owners' association shall be organized no later than the conveyance of the first unit.

7. Section 3222 of the Act provides that the powers of a sub-condominium association may be delegated in the declaration, in whole or in part, to a master association. 68 Pa.C.S.A. §3222(a), (b) and (g).

8. 68 Pa.C.S.A. §3222(e).

9. 68 Pa.C.S.A. §3222(b) and (g). ■