

DRAFTING EXERCISE 10

Drafting a Buy-out Provision to be Included When the Entire Condominium Project is to be Rebuilt or Sold

Assume that you are representing the developer of a new condominium project and have been asked to draw up an appropriate set of declarations for the condominium. Having reviewed the declarations drawn up by your firm several years ago for the same client, when the client built another condominium project, you have decided that most of the changes to be done can be made by one of your bright, young associates.

There is one provision in the new declarations, however, that will require your expert drafting skills.

When the previous declarations were drafted (before you joined the firm), no provision was made for rebuilding or selling the condominium project as a whole. During the years that have passed since condominium projects first became popular, it has gradually become evident that some provision must be made for allowing the rebuilding or sale of the entire condominium project.

As a lawyer active in the real estate field, you are aware that some of the early condominiums have fallen into such a state of disrepair that it is simply necessary to rebuild the entire project. Other condominium projects, initially built on relatively inexpensive land on the edge of town, are now surrounded by new developments, which make the underlying land so valuable that it

is no longer financially prudent to continue to use the land for the original condominiums.

Because of the fact that each unit owner in a condominium also owns an undivided interest in all of the common elements, it would be impossible to sell the whole condominium project without the consent of each unit owner - unless the declarations contain appropriate provisions for sale.

Clearly, it is necessary to protect the interests of each unit owner. However, over the years it has become clear that it is also necessary to provide some way in which the entire condominium project could be rebuilt, or sold, when that is the appropriate course.

Keeping in mind the necessity of protecting the individual unit owner, as well as the need to be able to rebuild or sell the entire project when necessary, draft an appropriate buy-out provision (or "obsolescence clause") to be included in new condominium declarations.

As you begin drafting an appropriate provision, you may want to look at the Pointers for Drafting that follow.

POINTERS FOR DRAFTING A BUY-OUT PROVISION TO BE INCLUDED IN CONDOMINIUM DECLARATIONS

There are at least seven things to consider when drafting a buy-out provision to be included in

condominium declarations.

1. Under what conditions should the entire project be rebuilt, or sold?

The most important decision to be made is what circumstances should be sufficient to trigger the buy-out provision.

There are two major times when it would seem appropriate to rebuild or sell the entire condominium project as a whole. First, it would seem appropriate to REBUILD the project when age, poor original construction, or extensive damage to the project has made it economically preferable to rebuild the project, rather than making piecemeal repairs.

Second, it would seem appropriate to SELL the entire project either when economic times have become so hard that it is no longer feasible to operate the project as a condominium or when economic times have become so good that the land is worth far more when used for something other than a condominium.

In other words, there are several different situations in which it should be possible to rebuild or sell the project as a whole. It is important to spell out these situations carefully.

2. Who decides whether the circumstances alleged actually meet the requirements specified in the declarations for rebuilding or sale?

This is usually neglected in condominium declarations. But if you have specified certain conditions under which the project is to be rebuilt or sold in its entirety, then you should provide some means for ascertaining when those conditions have been met. Perhaps a provision for arbitration, by an outside entity, is appropriate here.

3. How many of the unit owners must agree with the plan before rebuilding or sale can take place?

Remember, the reason for the buy-out provision in the declarations is to prevent one unit owner, or a few, unit owners, from unreasonably preventing appropriate rebuilding or sale. So set the percentage of unit owners realistically. And decide whether the larger units are to have more votes than the smaller units - if all the units are not of equal size.

Also consider what provisions you should make for the mortgagees involved with the individual units. Are they also entitled to vote on this decision? If so, are the votes of the mortgagees to be weighted according to how much remains unpaid on their respective loans? Or are all the mortgagees to have an equal vote? Are all the mortgagees to vote - or only the first mortgagees? What about mortgagees who are family members of unit owners?

4. Who has authority to rebuild or sell the entire project?

Usually, this is handled by giving the condominium association a power of attorney to deal with

all of the property in the project - when the requirements for rebuilding or sale have been met. (But be aware of point 7, involving the Rule Against Perpetuities, when you are drafting this power.)

5. How much notice is to be given to individual unit owners before the project as a whole is rebuilt or sold?

Keep in mind that individual unit owners may have just undertaken extensive redecorating or furnishing of their individual units. Should they be given some time to amortize their investment, and to find a new place to live, if the project will be uninhabitable while it is being remodeled, or if the project is to be sold? Remember that retired people, on limited incomes, may have difficulty in securing a loan for new housing. Or the local housing market may be very tight. In any case, it is usually a significant emotional matter for anyone to be told that he or she must leave his or her home involuntarily. So provide appropriate adjustment time by reasonable advance notice.

Also keep in mind, however, that once it has been announced that an entire project is to be rebuilt or sold, that may destroy the resale market for all units in the project - so that people who must sell their individual units early, because of a transfer to another city, for example, may be greatly inconvenienced by an appreciable time between the decision to rebuild or sell and the actual implementation of that decision.

6. How is payment to be made to the unit owners?

As indicated above, it is probably very important that prompt payment be made so that the unit owners can find new housing. In addition to that, however, it is important to specify who is to be paid how much if the project is to be sold. Is each unit to be treated equally? Are the larger units to be given a larger share of the proceeds? Are the well-kept, newly decorated units to be given more of the proceeds than the run-down units? Should the tax assessments on the individual units be used as a basis for distribution of the proceeds? In any case, be sure to provide that past due assessments and the like can be withheld from the proceeds for any particular unit for which the assessments have not been paid when due.

7. Be sure that the power of attorney does not violate the Rule Against Perpetuities.

In essence, this power of attorney may be considered to be similar to a general inter vivos power of appointment. Remember that any power of appointment must be exercised no later than a life and twenty-one years after it is created, or it is void under the common law Rule Against Perpetuities.* So draft around this. A corporation cannot be used as a measuring life. The

* When a general inter vivos power is given to a person (who is the donee of the power), there will be no RAP problem on the exercise of the power because a person who is a donee will exercise the power, if at all, within the lifetime of the donee. But when a corporation (or other entity that is not a natural person) is made the donee of a power, there will be a RAP problem unless there has been careful drafting. Remember that when you are dealing with a power of appointment, you must be sure both that the power will be exercised within the time allowed by the RAP and that the interest created by using the power will vest in time to comply with the RAP.

measuring life must be a human life. There are no relevant human lives available for a provision such as this UNLESS SPECIFIC HUMAN LIVES ARE SPECIFIED. So if you want to make sure that the provision you draft does not violate the Rule Against Perpetuities, and if you want the provision to last for more than twenty-one years after it is created, then simply select and name a reasonable number of people to be used as measuring lives. The lives selected might be those of the developers, or the young children of the developers, or any other reasonably ascertainable group of people. Then, the provision should be drafted to be effective only for those lives, plus twenty-one years. In fact, this will probably get you about ninety years of protection, which is probably enough.

If desired, however, you could provide that all the unit owners could adopt a NEW provision, after fifty years or so, to obtain ANOTHER ninety years or so of protection.

Remember, if you simply draft the power, without considering the Rule Against Perpetuities, then the whole provision will be void in a jurisdiction that enforces the common law rule. So do draft appropriately.