The Massachusetts Homeownership Collaborative

HOMEBUYER COUNSELING CORE CURRICULUM

SECTION XI: CONDOMINIUM OWNERSHIP

Section Objectives:

- **To inform participants about the legal and ownership structure of condominiums**
- **To assist participants in shopping for a condominium**
- **To inform participants about condominium expenses and financing**

A. What is a Condominium?

Condominiums and cooperatives offer unique forms of homeownership – different from single-family homes. By definition, a condominium is a type of ownership in which the owner purchases a unit and then has a vote in the condominium association, which owns and operates the common areas. In a time when real estate prices are prohibitive for certain buyers, condominiums serve as an option for many first-time homebuyers.

Condominium associations can look like a small village of single-family homes or a twenty-story high-rise. A condominium association can include new construction, a converted schoolhouse, or a former apartment building. Condominium associations vary a great deal. Therefore, it is important that buyers know enough about the association they choose so that they will be informed about the impact of their purchase on their lifestyle and finances.

B. Ownership Structure

In a single-family home, the owner owns the home *and* the land underneath the home, and is generally free (although local zoning and health laws set some boundaries) to do as he/she wishes with the property. In contrast, in a condominium, each unit is part of a larger condominium association. This usually includes just the building with your unit. In some cases, the condominium will include your building and adjacent buildings.

The areas that are not part of individual units are called "common elements" or "common areas." "General common areas" can include building systems (plumbing, electrical, etc.), hallways, lobbies, central laundry facilities, community rooms, landscaped grounds, and other such features. In most cases, the unit is understood to be the "insides" of the unit and excludes exterior building features and the systems that serve the entire condominium. Some features, such as windows, may be part of the individual unit or a part of the condominium as a whole. Balconies are often "limited common areas." An individual unit owner may have exclusive access to the balcony, but is unable to make changes to the balcony (even a flower box) without approval of the association.

The condominium association is something like a corporation. It exists as an independent entity over and above individual unit owners but, at the same time, the association consists of all of the owners. Each unit owner has a vote in the association, but the value of his/her vote will vary. In the Master Deed (the document that establishes the condominium association), the value of this vote ("Percentage Interest") is stated. By law, the percentage interest is based on the value of the unit at the time of the Master Deed, in relation to other units.

Although unit owners have a vote in the association, an individual owner may not vote on every issue. Most associations have a Board of Trustees that is elected by the association to take care of day-to-day decisions. This decision making power is spelled out in the By-Laws. Trustees have the power to hire the management company, sign contracts, and make other decisions for the association. As an owner, if you choose not to serve as a Trustee, you can participate through the yearly election of Trustees and comment periods held at some board meetings. The rights and obligations of unit owners, including voting rights, are contained in the By-Laws.

Participation

Participation in the condominium association is restricted to those who own the units. In most associations, the day-to-day management of the building is taken care of by the Board of Trustees, either alone, or in conjunction with hired staff or a professional property manager.

It is very important that you participate in the association. Just as participation in your local elections assures you a vote in how local services are managed, your participation in the condominium association assures you a voice in how the condominium association is managed. Serving as a Trustee can be a thankless job. However, even if you do not wish to serve in this capacity, many very large associations have committees or social events, and all associations should have formal opportunities for input from unit owners, either at an annual meeting or at regular board meetings. In associations with six or fewer units, all unit owners may serve as Trustees, and all owners meet on a regular basis to manage the property.

C. FINDING THE ASSOCIATION THAT'S RIGHT FOR YOU

All condominium associations consist of a community of owners. Like any community, there is a diversity of backgrounds, experiences and desires. Your vision of what living in a condominium is like may differ from another owner-occupant, and it certainly differs from the condominium owner who lives elsewhere and rents his/her unit.

While condominium associations are “communities,” they are also businesses with monthly income and expenses, all of which must be handled carefully by the association, its Board of Trustees and its management company. You should keep in mind that you want to find a community that will be acceptable for you as it effects both your lifestyle and your financial security. The Rules and Regulations, the overall health of the association, the character of the residents and the costs are important considerations that will be discussed below.

Rules and Regulations

The rules and regulations of a condominium association can make a substantial difference in how happy you are in the association and in your home. Some rules are found within the Master Deed, and others are found within the Rules and Regulations.

Rules found in the Master Deed can only be changed by amending this Deed. The Rules and Regulations can usually be changed by the Trustees, and unit owners generally do not have a vote in this situation. The Master Deed and the Rules and Regulations were created by the original developer and the past and current Trustees to meet the needs of the condominium as a whole. There may be rules that seem perfectly reasonable to those already living in the association that may not be reasonable for your needs or lifestyle.

The most common rules that create tension are those concerning pets. There are many associations that do not allow pets or only allow certain kinds and/or sizes of pets. If you are a dog or cat lover and the association does not allow them, do not purchase in the association. Do not expect to purchase your condominium and then change the rules. Changing the rules and regulations can be time-consuming and divisive at best, impossible at worst, as you may not have the support of other owners. It is very important that you ask to review the condominium documents, including the Rules and Regulations, before you sign a Purchase and Sale Agreement. The Master Deed and the Rules and Regulations commonly cover the operation of the common areas, including the following:

- Pets
- Decoration of doors, windows (anything outside of the unit, including flags, air conditioners, etc.)
- Number of people who can live in a unit
- Ability to rent unit
- Parking
- Activities in the common areas

Amenities, Location

As in any home purchase, the location and amenities included in the home are an important consideration. In the purchase of a condominium, this takes on an added dimension, as many of the amenities are part of the association's common areas rather than the condominium unit. You may not be able to afford your own swimming pool if you purchase a single-family home, but a condominium association may provide a swimming pool accessible to all residents. By spreading the costs of the pool among many unit owners, it becomes affordable. The drawback is that the cost of these amenities is included in the condominium fee, and if the association has many amenities you never use, you may prefer to buy in an association that has only the amenities you need.

Location within the condominium association is also an important consideration. You may prefer the front of the building over the back, or you may prefer a particular floor due to privacy, security or accessibility. In addition you will be able to hear your neighbors more easily than in most single-family homes, so you may want to pay special attention to the thickness of walls and the general level of noise. Finding the unit with the right amenities and location can be a challenge, but it is possible!

<u>Size of the Association</u>

The size of the association has a dramatic impact on its character and management. There are suburban condominium associations (mostly in the Sunbelt) that function as small towns with a couple of thousand units. Like a small town, the association provides a large number of services. On the other hand, owners in a large association may not know each other, creating a less cohesive community. In smaller associations (fewer than 50-100 units), owners are better able to get to know one another (for better or worse) and each owner has to take a more active role in the functions of the association. In very small associations (fewer than 6-10 units), owners may have to take on all management/maintenance functions themselves, requiring a very high level of participation. Even in small associations though, costs and work are spread among unit owners, reducing the costs that you might have spent on an individual home.

<u>Management</u>

All condominium associations must have some level of management. Condominium fees must be collected, bills must be paid, and the common areas maintained. Depending on the size and the level of participation in an association, the association and/or its trustees may decide to either “self-manage” or hire a professional property manager. There are trade-offs in either of these arrangements of which you, as a buyer should be aware.

Under self-management, the Trustees oversee the maintenance of the property and its finances. One Trustee may serve as treasurer and another may complete small repairs around the property. Being self-managed does not mean that others are not hired to complete work around the property. In fact, many self-managed associations hire a cleaning service and contractors for large jobs. There are many pitfalls of self-management. Trustees experience a burn-out, aspects of building upkeep can be overlooked, and conflicts between owners easily disrupt the day-to-day functions of the association.

Many associations hire a professional property manager, and lenders prefer associations to be professionally managed. Although almost anyone can call themselves a manager, there are accreditation programs under the Institute of Real Estate Management, the Community Associations Institute, and other trade associations.

Most professional property managers work for several condominium associations and are able to negotiate better prices for services based on this larger grouping of properties. A professional manager stays abreast of legal, zoning and health code requirements that may affect the property and stays in tune with the new or cheaper services that will increase the quality of life and value of the condominium association. Property managers take many of the day-to-day burdens off the shoulders of the Board of Trustees, though Trustees still have ultimate responsibility for the management of the property. As the manager is seeking a particular level of profit (the "management fee"), hiring a property manager can be more expensive than self-management. On the flip side, a property manager typically saves properties a great deal of money through advantageous contracts and the knowledge that they bring to the property.

In a very large association, the association may be able to get the benefits of a professional property manager, without the extra overhead of the management fee by hiring an individual property manager to mange that property exclusively.

D. CONDOMINIUM FEES

Condominium fees pay for all the upkeep of the common areas. They do not pay for the upkeep of your unit or your property taxes. Depending on the age and style of the building, the condominium fee may pay for heat and hot water. Condominium fees do cover insurance costs for the association, but not for your individual unit. Even if a mortgage lender does not require a separate unit insurance policy, it is in your best interest to have such a policy. A unit owner's insurance policy is similar to renter's insurance in that it protects you against certain types of damages and theft. A unit owner's policy also offers protection in cases where activities in your unit affect an adjacent unit owner, such as a large spill that creates a leak. In other words, there are instances where the overall condominium insurance policy does not cover all claims and, as such, you should have your own protection.

Condominium fees vary dramatically from one condominium association to another. The inclusion or exclusion of heat and hot water makes a substantial difference, but differences also arise because of the level of services provided. In central city condominiums that were converted from apartment buildings, many are now completing projects to repair, replace or upgrade aspects of the buildings that may not have been taken care of at the time of conversion. This work can include new roofs, new heating systems, new windows, and upgrading of lobbies and other common areas. While this is a good sign that the long-term value of the condominium association is being maintained and increased, these costs do increase condominium fees and may make it financially more difficult for first-time homebuyers to purchase in these associations.

In conclusion, condominium fees vary, but what is most important for the condominium buyer to know is why the condominium fees are set at a particular level, and whether the condominium association is getting value for the money it is spending. You may decide to say “yes” to an association with high fees provided the fees are paying for upgrades and amenities you like and the work is being done at a fair price.

E. FINANCING YOUR CONDOMINIUM

Underwriting: Lending Guidelines

Underwriting is a term that refers to the process by which the lender determines the risk it is taking by giving you a loan. Underwriting guidelines are created by individual lenders for loans that they keep (“portfolio”), but most lenders rely exclusively on Fannie Mae and Freddie Mac guidelines.

As you may be aware, Fannie Mae and Freddie Mac are federally chartered, for-profit corporations that purchase mortgages from lenders and package them into securities. By doing so, Fannie Mae and Freddie Mac increase the availability of money by recycling money through the system more quickly than would occur if lenders had to wait the entire life of the loan to have money to lend again. As a result, Fannie Mae and Freddie Mac take on most of the risk of the loan and set guidelines for lenders.

In all mortgages, the lender’s risk is based upon two factors: the capability of the borrower to repay the loan and the value of the property. Lenders look at the credit, debt, income and savings of the borrower. In a single-family home, they will also look at the appraisal (determination of market value) of the property. In the case of a condominium, lenders obtain an appraisal of the unit. The borrower should make a written request to the lender for a copy of the appraisal. The lender will also want to know about the general health and stability of the condominium association as a whole. For this reason, Fannie Mae and Freddie Mac have set guidelines for assessing the health of associations. These guidelines vary depending on the size of the association and pilot programs exist for some area, including the Fenway, Allston-Brighton, Jamaica Plain, South Boston and South End neighborhoods of Boston, but they all consider the number of units owned by owner-occupants versus those owned by investors, the health of monthly collections, the number of units owned by a single investor, and the amount of reserves.

With a large down payment, lenders have determined that the borrower has taken a big enough stake in the property that the buyer also assumes some of the risk. As a result, lenders' guidelines are less strict for these purchases. Lenders do not consider this to be true with low down payment programs (less than 20-25%) and, therefore, lending guidelines are more strict for low down payment buyers.

Traditionally, Fannie Mae, Freddie Mac and lenders (including MassHousing) have only accepted low down payment loans in associations where the owner-occupancy rate is greater than 60% or 70%. The risk is perceived to be higher in associations where investors make up a majority of the association, as these investors may not choose to spend the money necessary to maintain the common areas, thus lowering the value of the association and the sales prices for individual units. This guideline has proven problematic for first-time homebuyers, as most affordable condominium associations in Boston, and many other areas, have owner-occupancy rates closer to 30%. For this reason, the Fenway and Allston-Brighton Community Development Corporations and the City of Boston advocated with Fannie Mae to change these guidelines for the Boston neighborhoods of Fenway/Kenmore and Allston-Brighton. Homebuyers with down payments of 3-5% can now access Fannie Mae backed loans in condominium associations with as few as 25% of the units owner-occupied. This program has been extended to include Jamaica Plain, South Boston, and the South End neighborhoods of Boston, and buyers have found it easier to get loans in similar associations in other parts of Boston. Owner-occupancy and the overall health of the condominium are still considerations for both the buyer and the lender, but it has become easier to get a mortgage.

Purchase/Rehab Financing

Many condominium buyers discover that they want to renovate their unit once they decide to buy it. For some, this is purely a matter of taste. For others, renovations are necessary to bring a unit up to today's standards. Although the condominium may not need the level of renovation of a single-family house, the renovation of a kitchen is usually an expensive proposition. Local programs, such as Boston HomeWorks, provide some grant assistance to help these expenses, but for some buyers, more renovation is required.

The best time to complete major renovations is at the time of purchase, but most buyers do not have the cash to complete the work. For this reason, many buyers consider purchase/rehabilitation mortgage products. Under these programs, money is included in the mortgage to cover the cost of the purchase and the cost of renovations. In most cases, the lender will base the mortgage on an appraisal that bases the value of the property on its worth after the renovations are complete. Be careful that the appraisal of after-renovation value is not too high, otherwise the borrower could face a situation in which the mortgage is higher than the market value of the property ("negative equity"). This is not different from how such a mortgage is written for single-family homes. Due to the underwriting standards discussed above, there are fewer mortgage products available to the condominium buyer than to the buyer of a single-family home, but they are available!

Qualifying for a Mortgage

Obtaining a mortgage for a condominium is similar to the process for obtaining a mortgage for a single-family home. Just as with a single-family home, your ability to pay monthly housing costs including principle and interest (the mortgage), property taxes, and private mortgage insurance (on down payments of less than 20%), determines the size of the mortgage.

Unlike a single-family home, however, monthly housing expenses do not include homeowner's insurance. Instead, condominium fees are considered as part of the monthly housing expenses. The condominium fees include insurance on the buildings. This insurance is all that the mortgage lender requires, but it does not include coverage of your personal property. Therefore, buyers are qualified based on the following:

Housing Debt Ratio=PITIC
P=Principal
I=Interest
T=Property taxes
I=Private mortgage insurance
C=Condominium fees

As it concerns the qualifications for a loan, condominium fees sometimes include heat and hot water, and sometimes they do not include these utilities. Since heat and how water are not considered in pre-qualifying a borrower for a single-family home, some lenders will make some allowance for calculating the final amount you are able to borrow.

Let's look at an example:

Qualification for a Mortgage: Example

Buyers: J. Doe and J. Deere
Annual Income (joint): $44,000
Monthly Income: $3,667
Housing Debt Ratio: 33%
Total Debt Ratio: 38%

Assuming that the buyer's debt is low (less than 5% of income), they are eligible to take up to the full 33% of this income for housing.

33% (0.33) X $3,667 = $1,210 available for housing debt (PITIC)

Housing costs:	Real estate taxes	$140	
	Mortgage insurance	31	
	Condominium fee	200	(excluding heat and hot water)
	Total	$371	
	Not allowed for housing	$1,210	
	- Non-mortgage costs	371	

Amount available for mortgage = $839

Assuming an 8% interest rate, and a 5% down payment, the above buyer can afford $120,000 for a condominium. In the above example, we used a condominium fee of $200. This number can vary dramatically, and the enclosed chart should give you some idea to what you can afford, given varying condominium fees.

F. BUYING A CONDOMINIUM: SPECIAL CONCERNS

Condominium Documents

Potential buyers should always ask to examine the following records of the condominium association, commonly referred to as "condo docs," and make sure the offer allows for review and approval of the condo docs. These include:

- *The Master Deed.* The Master Deed is the document that establishes the condominium association. The Mater Deed is filed at the local Registry of Deeds. This document spells out the boundaries of the condominium association and designates what portions of the property are common and which are considered separate condominium units. The units are individually described, as is the percentage of interest that each unit owner has in the association as a whole.

- *The Declaration of Trust.* The Declaration of Trust creates the organizational group that runs the association.

- *By-Laws or Rules and Regulations. See section on Rules and Regulations.*

- *Minutes.* Minutes of Board meetings can be useful in determining how active the condominium association is, the level of participation by owners, and the issues that face the association.

- *Reserve Report.* Small associations (under 10 units) may not have either a reserve report or a separate reserve account. A reserve account consists of those funds set aside to meet long-term planned and emergency repairs and improvement. In Massachusetts, condominium associations are required to have separate reserve accounts, yet many small associations do not.

- *Annual Budget.* Although you may not know what standard costs are to manage residential properties, an experienced condominium attorney may be able to recognize if there are large problems with the budget. Just as important though, with little knowledge of property management, you should be able to determine if income and expenses are balanced and if the finance appear to be organized.

- *Insurance Policies.* Even the most experienced condominium Board members are unsure of the level of insurance needed to cover an association against unforeseen circumstances.

Home Inspections

The home inspection for a condominium unit may be more complicated than the home inspection for a single or multi-family home. Even though your condominium only includes the interior of your unit, as a part owner of the condominium association, you should also gather information about the physical health of the condominium association as a whole. A condominium home inspection should include the following:

- A thorough inspection of the unit, including plumbing and heating, as well as checking for cracks in walls or any other item that may need repair.

- Check the electrical system, both for your unit and the association as a whole. There could be problems with the safety of the system or the level of power needed to operate your appliances and electrical goods. For example, the central electrical system may be in good repair, but the outlets in your unit may not meet current safety standards.

- The roof should be checked, just as in a single-family home. If the association contains multiple buildings, the inspector should check a number of the roofs. Remember, you must pay a portion of upkeep, even if it is for the roof of another building in your association.

- Check all building systems, such as the heat and hot water systems. The inspector may be able to tell you the useful remaining life of the system, and you can determine if the condominium association will be prepared to meet this expense.

- If there is more than one building in the association, the inspector should check to insure that these buildings, as well as any amenities (such as a swimming pool) that may not be part of your building but, as part of the condominium, becomes a financial responsibility of all members of the condominium association.

Making an Offer

Making an offer on a condominium is similar to making one on a home. You will want to be aware of the selling price of other units that are similar in size, location, amenities and state of repair.

For the purchase of a condominium, finding a similar sale (a comparable sale, or "comp") is different than finding a comparable sale for a single-family home. With a single-family home, the goal is to find similar sales of homes in the same neighborhood. In a condominium, it is best to find recent (6 months-one year) sales in the same condominium association. Because of the varying health, stability, and amenities of condominium associations, even two associations that are adjacent to each other may have different sales prices. Data from *Banker and Tradesman* and other sales publications generally list the size of units sold. If this information is unavailable, sales in the same association can be compared by looking at the Master Deed to find out the size of the units. With this in hand, if you are unable to find a unit of the same size, but in the same association, determine the cost of the two units by square foot.

The following example should give some idea of the items you may want to compare between units:

	Intended Purchase	Comparable Sale #1	Comparable Sale #2
Location	25 Main Street #5	25 Main Street #12	50 Main Street #4
Date of Sale		1/21/97	5/28/97
Bedrooms	One	One	One
Size of Unit	800 SF	900 SF	825 SF
Purchase Price		$98,000	$75,000
Price/SF		$109	$91
Location of Unit	Second floor, front	Top (fourth) floor, front	Second floor, rear
Amenities	Balconies, washer-dryer hookup in units	Balconies, washer-dryer hookup in units	All units alarmed, central laundry room
Condo Fee	$250	$300	$198
Includes heat	Yes	Yes	No

and hot water?			

You will also want to make sure that the condominium and its neighborhood is right for you. View the units or walk around the neighborhood at various time of the day and night, weekdays and weekends, to get a feeling of whether the location is right for you. Trustees, the management company, owners and tenants are other sources of information about the neighborhood and the association. You are making an investment and moving into a community and should have as much information as possible before making your decision.

The Closing: 6(d) Certificates

Under Massachusetts General Law, a lien exists on a condominium unit for unpaid common charges (condo fees). It is discharged upon payment. At the time that you complete the purchase of a condominium unit (the closing), your lender will require a 6(d) Certificate. This certificate is a statement from the condominium association that the seller of the unit does not owe any outstanding condominium fees or charges. If there are outstanding fees, you should request that the seller pay these fees before the closing. Generally, condominium associations do not charge for this certificate, but more and more are charging a small fee to complete this form, as well as any other documentation required for the closing.

After the closing, the 6(d) Certificate is filed at the Registry of Deeds, along with other documents relative to the purchase of the property.

G. WHAT IS A COOPERATIVE?

Cooperatives are not a common form of homeownership in the United States. New York City has the most cooperatives in the United States. There are also some cooperatives in Massachusetts (including in a couple of Boston's neighborhoods), however, such that they provide an option the homebuyer may want to consider.

In a cooperative, residents do not own their individual units. Instead, the building is owned by a corporation, and residents hold shares in this corporation. In other words, you are a member of the cooperative. As a member, you have a role in running the property. You do not own your own unit, however. Instead, you lease your unit from the cooperative. You have less control over changes that you can make to your unit and there may be more rules and regulations than in a condominium. But, as a group of owners, a cooperative has greater control over who moves into the association and a greater measure of control over the quality of life on the property. For example, most cooperatives have a membership committee. Membership committees have varying selection criteria. These criteria tend to focus on commitment to participating in the cooperative or the potential owner's need for housing. In addition, rules and regulations are easier to enforce than in a condominium association, because violation of the rules constitutes a violation of the lease that individual members have with the cooperative. A condominium association can fine a unit owner for rules violations, but a cooperative can evict a member for serious infractions of the rules.

Not all cooperatives are alike – in fact, there can be major differences. Some cooperatives are “market” cooperatives. In these cooperatives, the price of membership (the “share price”) is set by the market and this would be very similar to a condominium sales price. Someone joining such a cooperative could see a profit upon selling their share.

In a “limited equity” cooperative, the price of a share is limited, and can run anywhere from a few hundred dollars to about $25,000. In these cooperatives, the new member could expect to get some appreciation on their initial investment, but it is based on a formula, and does not yield a high profit to the member.

When the resident decides to leave the cooperative, he/she commonly sells the share back to the cooperative, who then re-sells it to a new member. Limited-equity cooperatives can take several forms, and share prices may vary by income, by unit size, or both.

Since you will not own your particular unit, you may be unable to obtain a mortgage. Instead, a personal loan will be required.

In conclusion, the advantages of a cooperative include the opportunity to build some equity, resident control of the property, and there is no landlord waiting to extract a profit from rents. Cooperatives differ in their financial structure, but a share holder may to able to take the federal income tax mortgage interest deduction, either based on the share loan, or the members share of the mortgage interest and property taxes for the entire cooperative.