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LEASEHOLD CONDOMINIUMS: THE FURTHER FLIGHT OF THE FEE

By BRIAN BUCKNALL*

The concept of condominium ownership of real property is a relatively recent innovation in land holding systems which have their roots in the English common law. From its first adoption in America less than twenty years ago, it has spread virtually throughout the common law world, and as experience with condominium statutes and projects expanded, new approaches to condominium schemes began to appear. Currently, a great deal of interest is being directed toward the possibility of creating condominium projects on land that is held under a long term lease. If the standard condominium scheme creates 'freeholds in the sky' (some writers refer to the interest as a "flying fee"¹), the leasehold variant results in 'leaseholds in the sky': the rights of the unit holders become even more remote from the fee simple interest in the real estate. While leasehold condominiums have been built in various parts of the world they have not been fully analysed and are not well understood.² Indeed, it is suggested that the problems and limitations inherent in a leasehold condominium regime are so serious as to make it a dangerous and unacceptable variation on the condominium concept.

Condominiums spring from civil law roots. It is sometimes suggested that condominium ownership was known to the Roman law, but it is generally agreed that recognizable condominium regimes were common in Europe in the Middle Ages. In Germany from the twelfth century on, there was wide spread use of the horizontal division of buildings into separate legal interests with community ownership of the underlying land and common areas.³ A concept of freehold ownership of strata did develop at common law also, but

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Professor Bucknall is Associate Professor of Law, Osgoode Hall Law School, York University. This paper draws heavily upon, and quotes extensively from, *The Leasehold Condominium: Problems and Prospects*, a report prepared for the Ministry of Housing of the Province of Ontario by the Ontario Task Force on Leasehold Condominiums. The Task Force consisted of the author as Chairman, Mr. Colin Connor as Financial Consultant, Mr. Leonard Fine as Legal Consultant and Ms. Marilyn Ginsburg as Research Assistant. The report was drafted by the author with the assistance of Ms. Ginsburg.

¹ See J. R. Shiff, *Condominium, The Flying Fee*, [1970] Special Lectures of the Law Society of Upper Canada, Recent Developments in Real Estate Law (Toronto: DeBoo, 1970) at 81.

² The best discussion of leasehold condominiums can be found in D. Clurman and E. Hebard, *Condominiums and Cooperatives* (New York: Wiley Inter-Science, 1970) Chapter XI and Rohan P.J. and Reskin M.A., *Condominium Law and Practice* (New York: Matthew Bender, 1965 with supplements) Chapter 19.

³ J. E. Cribbet, *Condominium — Home Ownership for Megalopolis* (1963), 61 Mich. Law Rev. 1027 at 1210. See also C. J. Berger, *Condominium — Housing on a Statutory Foundation* (1963), Columbia Law Rev. 987.

it never achieved the sophistication of the civil law schemes. It was recognized at an early date that a separate freehold estate could exist in strata either above or below the surface of the land.⁴ Interests of this sort did not, however, evolve into condominium schemes, since no common law device provided for the creation of an exclusive strata estate inseparably coupled with a common estate in related property. It was therefore necessary for the essential elements in common law condominium regimes to be created by statute. Puerto Rico, a territory of the United States with some civil law roots, was the first North American jurisdiction to enact a condominium statute.⁵ The state of Hawaii enacted similar legislation shortly thereafter,⁶ and today all fifty American jurisdictions and all provinces of Canada have condominium regimes. Condominiums are also found in the common law jurisdictions of the Commonwealth, but no condominium regime has ever been adopted in England.

A brief description of the general features of the modern freehold condominium is necessary in order to fully appreciate the problems inherent in a leasehold condominium scheme. Although condominium statutes vary from jurisdiction to jurisdiction, all regimes include the following ingredients. The developer of the condominium, having taken the appropriate planning and financing steps, constructs a building and then registers with appropriate officials a physical description of the project and a declaration that he intends the land to be governed henceforth by the relevant condominium statute. These documents establish the basic nature of the project (for example, a high-rise building with 150 units) and define the divisions of interest within it. The registration of these documents establishes a corporation without share capital which will serve the interests of the units owners from time to time. Each unit owner has a voting right in the governance of the corporation proportionate to his interest in the property. All of the property in the condominium project is divided among the unit owners, either as individual units, to which they have sole and exclusive rights, or as common areas, which they all hold as tenants in common. The corporation itself does not initially own any property although it does have the power to acquire and hold property on behalf of the unit owners. Upon purchasing a unit in a condominium, the new owners receive a unit deed conveying to them their units in fee simple and (tenant) undivided interests in the common areas. Each month the unit owners must pay their estimated proportionate share of the maintenance costs for the upkeep of the project. The unit holders bear individually their costs of acquisition, property taxes and, where possible, their individual utility charges.

In the freehold condominium, the participants in the development of a project are typically the developer and the financier. As the units are sold off, the developer's interest in the project declines until he has entirely divested

⁴ Lord Coke is reported to have said, "A man may have an inheritance in an upper chamber, though the lower buildings and soile be in another, and seeing it is an inheritance corporeall it shall pass by livery." Quoted in S. S. Ball, *Division into Horizontal Strata of the Landscape Above the Surface*, (1929-30), 39 Yale Law J. 616 at 621.

⁵ 1958 Laws of P. R. Title 31, C. 150.

⁶ R. S. H. Title 28, C. 514.

himself of any rights in the property. The financier allows the blanket mortgage against the entire building (by means of which construction of the project was financed) to be replaced by individual mortgages against the units in the condominium.⁷ While the mortgages are outstanding, the mortgagee typically protects his security by taking from the unit holders a right to vote in the affairs of the corporation. Eventually, of course, only the unit holders and the condominium corporation, which they control, have any rights in the project.

The leasehold condominium complicates this pattern of development by superimposing the entire scheme upon a leasehold rather than a freehold estate. The change is fundamental and has implications throughout the entire term of the lease. The landlord, the holder of the reversionary interest (who may or may not be the developer) retains rights over the property throughout the life of the project — indeed his interest in and concern for the land increase as the end of the term approaches. The financier faces an entirely new set of problems with regard to both the construction financing and the unit financing when the security for his loan is a leasehold interest. While he will place a mortgage against the original lease of the property and then allow individual unit lease mortgages to be substituted for it, the marketability, and, therefore, security, of his interest in the property is highly questionable. Freehold condominiums very quickly captured a share of the housing market in the jurisdictions in which they were introduced. They did so because of the fact that the purchaser of a freehold condominium unit is individually responsible for the debts and obligations incurred by, or secured by, his own interest in the project. He has no collective responsibility and should other unit owners default on their obligations he is not directly liable for their debts. This factor alone made condominiums much more acceptable and successful than co-operative housing projects, in which the unit holders share responsibility for the entire debt on the project. In leasehold condominiums, the problem of collectively shared responsibility arises again, but in another form. The following passage discusses this problem from the point of view of the condominium financier, but the difficulties it highlights are equally acute for the unit holder:

Fundamental to leasehold mortgages is the problem of guarding against the defeasance, or wiping out of the lease by the landlord landowner or the immediate lessee who subleases. Where an overall leasehold that is fragmented with respect to unit-owner obligation exists, defeasance of the lease may be occasioned by acts or failures beyond the control of individual unit-sublessees or lessee-assignees who are governed by a blanket lessee

The occasional practice of sandwiching leases between landowner and condominium-unit sublessee, or of otherwise fragmenting obligations under a single lease, presents a substantial danger to condominium purchasers as well as to lending institutions and, consequently, necessitates maximum safeguards by statute in order to avoid excessive speculation, to provide for full disclosure to purchasers,

⁷ The term 'mortgage' is used to indicate funds advanced upon security of an interest in property. In Ontario condominiums must, where possible, be registered under *The Land Titles Act* and the proper description of a secured interest in the property is a 'charge'. However, the term mortgage will be used throughout this paper to avoid confusion.

and to assure adequate protection against wiping out the purchaser or lending position upon defeasance of the lease.⁸

As the foregoing passage suggests, there are, in fact, a number of ways in which leasehold condominiums can be organized. The basic question is whether the leasehold interests in the individual units will run directly from the owner of the freehold or will come through the developer as holder of a head lease. The organizational model chosen will, of course, have enormous impact on the rights and security of the unit holders.

In all leasehold condominium schemes, a ground lease is made by the fee owner of the land to the developer, who is required to construct a building within a specified period of time. After this has been accomplished, any one of several courses may be followed:

Model One:

When the building has been completed the lessor and the lessee (developer) enter into and record a declaration of condominium after which the ground lease is cancelled and separate leases of the apartments are substituted, all in pursuance of provisions in the ground lease. The individual leases, issued by the owner of the ground lease who then also owns the building, may run to the developer, to be assigned by him to the respective apartment purchasers, or they may run directly to the respective apartment purchasers.⁹

Under this scheme, the developer is independent of the landowner and a ground lease is used to give the developer a mortgageable interest with which to finance construction of the project. Under the terms of the ground lease, the land owner may grant individual long term unit leases to the developer upon completion of the building and will accept the surrender of the ground lease. The rent reserved on the unit leases would represent the individual unit's proportion of the total ground rent, reserved in the original lease. As mentioned earlier, the mortgage on the ground leases would be substituted for it as the units were purchased.

Model Two:

The ground lease persists after completion of construction, and the developer assigns partial interests in the lease to the individual apartment purchasers.¹⁰

This second model is very similar in its organization to freehold condominiums. The theory behind it is that the transfer of an exclusive right to use a part of a leasehold interest for the entire balance of the lease is an assignment of a part of the lease and not a sublease. (If no reversion is retained by the transferor of an interest, no leasehold relationship can exist between the transferor and the transferee.¹¹) The units are then held directly by the landowner and the developer is removed entirely from the relationship. If the documents have been properly drafted, this model will preserve the essential advantage of a freehold project by ensuring that the units are individually

⁸ Clurman, *supra*, note 2 at 151.

⁹ *The Leasehold Condominium* (1967), 2 Real Property Probate and Trust J. 349.

¹⁰ *Id.*

¹¹ See *Thompson on Real Property* Vol. 3A (Indianapolis: Bobbs Merrill, 1959 replacement at 111-13. There is very little Canadian or English authority on this point.

responsible for debts and leasehold covenants, and thus the entire leasehold interest in the project cannot be endangered by individual forfeitures.

Model Three:

The ground lease also persists after completion of construction, but the developer issues subleases to the apartment purchasers. This enables the developer to take out a profit in the form of increased rent on the land.¹²

This situation involves what is commonly referred to as a 'sandwich' lease — the developer is 'sandwiched' between the landowner and unit purchasers and is able to reap long term profits because he can require greater ground rent in his subleases than the owner requires in the master lease. A project with a unified ground lease where the purchasers take by way of sub-lease from the developer is financially a fragile one, as each owner can be in jeopardy when others default or when the developer does not live up to his obligations under the master lease.

There is a fourth possible model. Where the landowner acts as a developer, he can after building the condominium simply transfer long term leaseholds rather than freeholds in the units. While a species of leasehold condominium could be created in this fashion, it differs from the typical system in that no ground lease is used during construction of the project. Construction financing is thereby simplified.

This type of arrangement would also create difficulties under the standard condominium legislation. The landowner would remain the owner of all condominium units and would thus control the condominium corporation. Furthermore, he would probably be treated as a residential landlord in the usual sense of the term and would thus have all the obligations inherent in that status.

It should be noted that freehold condominiums sometimes have leasehold interests associated with them. From time to time condominium corporations hold recreation facilities, for example, on long term leases. These leasehold interests thus become part of the common elements available to unit holders. Problems have arisen with this type of arrangement and these problems have sometimes been confused with the problems associated with leasehold condominiums.¹³ These two types of condominiums are, however, fundamentally different and should be kept distinct.

All of the leasehold condominium models outlined can be varied in a number of ways. These variations — with regard to covenants, the term of the lease, rent recalculations, rights of transfer and so forth — involve important decisions concerning the objectives that are to be achieved through

¹² *Supra*, note 9 at 349.

¹³ In Florida, freehold condominium units were frequently sold with leasehold rights in common areas attached thereto. The holder of the reversion in the leasehold areas covenanted that any unpaid rent would become a lien against the debtor's freehold unit. Rents often proved to be excessive. See *Proposed Amendments to The Condominium Statute Submitted by The Florida Condominium Commission* (M.P., M.P., 1973) at 4.

the use of the leasehold condominium scheme. They also have a profound impact on the nature of the unit holder's interest. Unfortunately, as will be demonstrated hereafter, both the leasehold condominium model and the details that flesh it out tend to be chosen by the people who originate the condominium projects to suit the convenience of the landowner and developer. The implications that their choices may have for unit holders remain unconsidered.

Leasehold condominiums and analogous interests are permissible in a number of jurisdictions. They are, however, rarely used. Three provinces in Canada currently allow the registration of condominiums founded upon leasehold estates. Both Manitoba¹⁴ and Alberta¹⁵ have made rather general amendments to their condominium statutes allowing for projects built on leasehold land. Apparently the changes, in Alberta at least, were brought about by the desire to build vacation condominiums in the resort areas of Banff, Lake Louise and Jasper. Since these resorts are within national parks, no freehold interest can be put in private hands.¹⁶ British Columbia has recently made extensive amendments to its *Condominium Act* which includes detailed provisions on leasehold condominiums¹⁷ in an attempt to limit the use of leasehold condominium schemes to projects built on land leased from the Crown or a Crown agency.¹⁸ It has also made novel provisions protecting the interests of unit holders upon the termination of the lease on the project.¹⁹

Ontario is the latest province to give consideration to the adoption of a leasehold condominium regime. In 1975, *The Condominium Act* was extensively amended and a new section governing leasehold condominiums was added to it.²⁰ This section permitted the creation of leasehold condominiums on "land owned by and leased from the Crown or any agency of the Crown . . . for a term not less than 99 years". While the amending Act was given legislative approval, the section governing leasehold condominiums was never proclaimed.²¹

The legislation in British Columbia, Alberta and Manitoba, has never been used. Therefore, although leasehold condominiums are a potential addition to our real estate market, there is, as yet, no practical experience with this type of interest in Canada.

The situation in the United States is somewhat similar. Although nearly two-thirds of its jurisdictions now include provision for leasehold projects in

¹⁴ R.S.M. 1970, c. 170.

¹⁵ R.S.A. 1970, c. 62 as amended.

¹⁶ Correspondence from C. R. Hilborn, Solicitor, Alberta Housing Corporation, June 17, 1975.

¹⁷ *The Strata Titles Act*, S.B.C. 1974, c. 89.

¹⁸ *Id.*, s. 52.

¹⁹ *Id.*, s. 54.

²⁰ S.O. 1975 (2nd session) c. 5, s. 18.

²¹ The Ontario Task Force on Leasehold Condominiums, referred to *supra*, was appointed in April, 1975 to review the amendments to *The Condominium Act* R.S.O. 1970, c. 77 which had by that time received third reading. The Task Force recommended that the new s. 26 dealing with leasehold condominiums not be proclaimed and that a leasehold condominium regime not be introduced into the province.

their condominium statutes, very little use has been made of these enabling provisions;²² only Florida, California and Hawaii have had leasehold condominiums placed on the market.²³

Hawaii has by far the largest number of leasehold condominiums anywhere in America. It has also had the longest history of experience with leasehold condominium schemes. As was pointed out earlier, Hawaii was very quick to follow the lead of Puerto Rico in adopting a statutory condominium regime, and, given the constraints of the customs in property transfer, leasehold condominiums followed shortly thereafter. The situation in Hawaii is, however, atypical. Much of the land in the state is owned by large trusts and native families who cannot or will not transfer away freehold interest. Furthermore, since the state is a set of islands, land is a scarce and valuable commodity; therefore, the market in property and housing is subject to unusual pressures.

It is characteristic of much of the enabling legislation in both Canada and the United States that the statutory provisions with regard to leasehold condominiums are minimal. In many cases, the legislation simply provides that condominiums may be created on either freehold or leasehold estates.²⁴

²² The following is a list of the States and territories of the United States which permit the establishment of leasehold condominiums for residential use: Alaska, Arizona, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Iowa, Kentucky, Maine, Maryland, Minnesota, Mississippi, New Jersey, New Mexico, North Dakota, Nevada, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Virginia, Washington, Wisconsin, Washington D.C. and the Virgin Islands. New York State allows the establishment of commercial leasehold condominiums.

Marilyn Ginsburg conducted an extensive survey of these jurisdictions by mail and telephone in the summer of 1975 in order to find out how extensively leasehold condominiums were being used. Lawyers, officials of Bar Associations and relevant officials in State Governments were contacted. Very few of the people with whom Ms. Ginsburg talked were familiar with leasehold condominiums or knew of the existence of leasehold condominium projects.

²³ The relevant condominium legislation is Fla. Stat. Anno. C. 711, Cal. c.v. Code Ann. s. 783 (Supp. 1974) and H.R.S. Title 28 C. 514. One can only speculate why leasehold condominiums are found primarily in the 'resort' states. This type of holding may be of greatest interest to relatively wealthy people who desire convenient vacation homes and are not primarily concerned with the investment potential of their property holdings.

²⁴ See, the Alberta *Condominium Property Act*, *supra*, note 15. Section 3(4) reads as follows:

Notwithstanding subsection (3), where land is held under lease and a certificate of title has been issued under the *Land Titles Act* in respect of the lease, this Act applies to the land described in the certificate of title

See, also, the legislation in California (*West's Calif. Codes Annotated*, 1975, Supp. Vol. 7) which appears to be typical. Section 783 entitled "Condominium Defined" provides that:

A condominium is an estate in real property Such estate may, with respect to the duration of its enjoyment be either (1) an estate of inheritance or perpetual estate, (2) an estate for life, or (3) an estate for years such as a leasehold or a sub-leasehold.

Texas also deals with the matter by statutory definitions: (*Civil Statutes of the State of Texas* Vol. 3 Art. 1301a.) Section 2(a) of the *Condominium Act* states: 'Property' means and includes the land whether leasehold or in fee simple and the building . . . thereon

The assumptions underlying this approach are clearly that leasehold condominiums are different only in detail and can be governed and administered under standard condominium doctrines, and that market pressures will be sufficient to discourage any abusive schemes. Both of these assumptions have proved unsound and in few jurisdictions slightly more detailed provisions with regard to leasehold condominiums have been added.²⁵

It is perhaps worthwhile to offer a few words on the English situation in this brief review of experience with leasehold condominiums. While condominium schemes are found in many Commonwealth countries, England has never adopted condominium legislation.²⁶ Instead of using a statutory condominium regime, the English have devised novel conveyancing methods which draw upon the common law doctrine of co-tenancy in order to create interests in land remarkably similar to leasehold condominiums.

The English practice is to divide buildings horizontally into 'flats'. The flats are separate legal interests which can be conveyed at common law either in freehold or leasehold.²⁷ The problem that arises is that at common law, the use of positive covenants to govern the acts of owners in fee simple is severely limited. (Negative or restrictive covenants are, of course, binding in equity and run with the land — restrictive covenants are simply insufficient in this situation.) Consequently, in the absence of modern legislation on condominium ownership and the use of owners' associations, it is very difficult in England to enforce positive obligations, for example to repair common areas, in a building where flats have been transferred on a freehold basis. Because of this difficulty, there are very few freehold flats in England today; the vast majority of flats are of the leasehold variety. By the use of identical long term leases from the owner of the land to the tenants of each unit, positive covenants are enforceable. A further complication arises because at common law these covenants are enforceable between the holder of the reversion and the tenants, but not among the tenants themselves. Various devices are used to circumvent this difficulty. After a project has been constructed and the leases are granted, the tenants of the block will form a tenants' association. The association may then purchase the reversion of the building for a nominal amount. If the association is a legal entity in its own right, the estates do not merge and the association can enforce the positive covenants as long as the leases last.²⁸

Flats transferred under long term leases are marketed in England in very

²⁵ The provisions of the Virginia legislation quoted *infra*, note 39 are typical of the most recent amendments. The British Columbia legislation, *supra*, note 17, is the most extensive statutory treatment of leasehold condominiums.

²⁶ The term 'England' is used to cover England, Wales and Northern Ireland. Scotland's law is built on Civil Law foundations and condominiums have been in existence there for many years.

²⁷ See generally E. F. and A. George, *The Sale of Flats* (3rd ed. London: Sweet & Maxwell, 1970). The authors of this treatise favour the creation of freehold flats and give the impression that freehold flats are more commonly used in England than they in fact are.

²⁸ *Id.* at 142, see, also, 83-85.

much the same way as leasehold condominium units are marketed in the United States. The purchaser pays a premium, the market value of the lease, to the vendor and acquires the leasehold interest together with the obligation to make regular rental payments to the landlord. The purchaser of the leasehold flat of course acquires easements over any of the common areas in the project. While leasehold flats comprise a relatively small proportion of the housing market in England,²⁹ they do provide parallels to leasehold condominiums and they will face the same problems.

Though leasehold condominiums, and analagous schemes are, as yet, rarely used, considerable interest has been expressed in the concept and, obviously, the potential for expanded use is enormous. As has already been suggested, leasehold condominiums are appropriate in circumstances where a freehold transfer of the land is either impossible or undesirable or where the owner of the land does not wish to undertake the long term management responsibilities entailed in a standard residential development.³⁰ This is the apparent rationale for the development of leasehold condominiums in Hawaii and for the passing of the leasehold condominium legislation in Alberta. The same reasoning seems to have been used in California where leasehold condominiums have been developed in recreational areas on land which is held by either government agencies or large land-owning companies which do not wish to transfer a freehold estate.

Leasehold condominiums, like all leaseholds, offer the owner of the land very significant long term advantages. The leasehold arrangement, if not specifically limited by statute, can give the landlord control of the property over the period of the lease through carefully drafted covenants. Landlords have the further advantage of repossessing the property at the termination of the lease and guiding its redevelopment thereafter. From this point of view, leasehold condominiums might be particularly attractive to government agencies participating in housing and land development programmes. A government agency might use a leasehold condominium as a type of planning device which would give it both immediate and long term control over the land while putting the administration of the property into other hands.

It is frequently thought that the principal justification for leasehold condominiums is that they can provide unit holders with rights that are more substantial than those in the standard residential leases, but less expensive than

²⁹ In 1973, a study indicated that 54 per cent of the residences in England were owner occupied. Approximately 12 per cent were privately owned rental accommodation. Government owned rental accommodation made up about 30 per cent of the residences and leasehold flats fell into the miscellaneous category which took up the remaining 4 per cent. See D. Caplan, *People and Homes* (London: The British Property Federation, 1975) at 5.

³⁰ Some landowners look to leasehold condominium arrangements as a method of redeveloping property for residential use without suffering an excessive liability for capital gains tax on the land or undertaking long term commitments to property management. Whether there is, in fact, any tax saving in this sort of arrangement depends, of course, on the tax laws of the jurisdiction in question.

comparable rights in a freehold condominium. The evidence on this point is, to say the least, ambiguous:

A long-term leasehold involves 100 per cent financing of the cost of the land. If the technique substantially reduces the cost of acquiring a condominium unit, the argument of economy has substance. In the 1950's leasehold cooperatives in Florida sold for prices averaging one-third less than comparable apartments in fee cooperatives. On the other hand, many leasehold cooperatives have sold for prices nearly equal to those for comparable fee cooperatives. The authors believe that in a buyer's market the leasehold condominium technique might bring to the market units below the cost of fee units and at the same time would be economically feasible. Amid the pressures of a seller's market danger exists from the tendency to disregard the lower development cost of the leasehold condominium, and to charge prices that have little relationship to the distinction between leasehold and fee ownership.³¹

The theory is that when a condominium is built on a leasehold estate, the purchaser of a unit will pay only for the improvements to the land and not for the land itself. The purchaser would thus have a lower down payment and a smaller secured debt to discharge. The obligation to pay rent on the land would, however, diminish this advantage. Ground rent would likely be calculated by the landowner with reference to the existing mortgage and investment market in the jurisdiction. Landlords would try to obtain in rent an amount equal to that which they could realize by selling the land outright and investing the proceeds. The right of the reversionary interest is, as a general rule, a matter of little consequence at the commencement of a long term lease. Thus, the rent on the property was at the market level for ground rents, the unit owner's proportion of it would probably be only slightly lower than the proportionate payment of interest and principal on a mortgage of the land itself. At present in Ontario, long term ground leases reserve about ten per cent of the value of the land as annual rent. The rent reserved is one to two per cent below the prime lending rate.³² This initial advantage might also be offset by the higher legal and financing costs which, at least at the outset, could be expected to be incurred where so novel an interest is being purchased. The lease would, of course, exceed the amortization period of the mortgage so that the carrying costs (rent, maintenance and taxes) for a leasehold condominium unit would be higher over the long run. One other factor to remember is that the rent reserved by the lease could remain fixed over a long period. In an inflationary market, the rent would represent a diminishing percentage of the land value and could fall well below the lending rate. The reverse would be true, of course, in a depressed market.

³¹ Clurman, *supra*, note 2 at 147-48.

³² Research by Marilyn Ginsburg in the summer of 1975 indicated that ground rents are somewhat lower in Hawaii than in other jurisdictions. Ground leases of 55 to 60 years in length reserve rent at a percentage of the value of the land $2\frac{1}{2}$ to $3\frac{1}{2}$ per cent below the prime lending rate. This fact may reflect the greater frequency of leasehold transfers in the State.

In Table A, the unit price of a recently constructed freehold condominium is compared to the unit price of a similar building hypothetically built on a ground lease. As the figures show, the difference in down payment is small and the difference in annual carrying cost is negligible. Only a substantial drop in the ground rent would make such a unit significantly more economical. Therefore, in the absence of some form of assistance, leasehold condominiums might have difficulty competing in the housing market.

TABLE A

COMPARISON OF LEASEHOLD & FREEHOLD CONDOMINIUM
FINANCING³³

This table is loosely based on a 133 unit high rise condominium. The sale price of freehold units in the building was \$48,000, of which \$8,000 was the proportionate cost of the land. Leasehold units could thus be sold for the proportionate cost of construction of the building, or \$40,000. If fully insured mortgages for 95 per cent of the purchase price were available at 11 per cent interest for either type of unit, the following calculations can be made:

	<i>Freehold</i>	<i>Leasehold</i>
	\$	\$
Purchase price per unit	48,000	40,000
Mortgage loan	45,600	38,000
Cash down payment	2,400	2,000
Annual mortgage payment, principal and interest at 11%	5,111	4,260
Ground rents	nil	800
	<hr/>	<hr/>
Total annual principal and interest payment and ground rent	5,111	5,060
Annual difference in carrying cost = \$51.00		

The comparison in purchase price and carrying cost may not, in fact, tell the whole story. The difference in annual carrying costs, while slight, does have an impact on the debt service ratio (D.S.R.) of housing cost to income. Since the D.S.R. is a significant factor in judging the eligibility of prospective purchasers for mortgage financing, this small change in annual costs might broaden the range of people for whom condominium housing could be appropriate. Table B explores the relationship between D.S.R.s and income requirements for mortgage financing.

³³ This and the following table were drawn up by Colin Connor, Executive Vice President of Morguard Trust Company. The table is based upon a freehold condominium constructed in Canada in 1975.

TABLE BINCOME REQUIREMENTS IN CONDOMINIUM
FINANCING

<i>Housing Debt</i>	<i>(27% D.S.R.)</i>	<i>Income Required</i> <i>(30% D.S.R.)</i>
\$5,111 (annual principal and interest \$18,929 on freehold mortgage)	\$18,929	\$17,036
\$4,250 (annual principal and interest on leasehold mortgage)	\$15,777	\$14,200
\$5,060 (annual principal and interest on leasehold mortgage together with annual ground rent)	\$18,740	\$16,866

Again the difference between the two condominium schemes is negligible unless the ground rent is taken out of the calculation of the housing debt. While these figures suggest that the economic advantages in leasehold condominiums are marginal, they also illustrate some of the ways in which leasehold condominiums might be used by governments and government agencies in order to increase the stock of low income housing. If the government acted as landlord, the ground rent on the project might be forgiven in whole or in part to unit holders meeting relevant criteria of need. Such a programme, coupled, perhaps, with subsidized mortgages, could put these units into the hands of people whose incomes could not support the purchase of freehold condominiums.

Nevertheless, it is clear that the advantages to be gained by adopting a leasehold condominium regime are somewhat remote. The presumed advantage of greater economy in the purchase of condominium units depends heavily on the state of the property and land finance markets at the time a project is completed. Economies will be realized only insofar as the ground rent on long term leases is significantly less than the interest that would be paid on a mortgage of the same land.

If the advantages of leasehold condominiums are problematic, the difficulties that they raise are quite apparent and, by some standards, almost insuperable. One can only speculate why these problems have not prevented the creation and sale of leasehold condominiums in places such as Hawaii and California. It should be pointed out that the greatest difficulties with this type of condominium arise as the project matures and the end of the lease on the land approaches. Since even in Hawaii there are no leasehold condominiums more than twenty years old, most of these problems have not yet been faced. It would appear that in many jurisdictions leasehold condominiums (and the analogous English flats held on long term leases) have been allowed to enter

the real estate market with no real appreciation of the dangers which they pose.

The problems associated with leasehold condominiums are of two kinds. Some are incidental and can be remedied; these arise when leasehold condominium regimes are introduced into a jurisdiction without sufficient legislative control. They also arise when condominium developers are allowed too much freedom in the creation of leasehold condominium projects. Other problems are inherent in this type of regime and can never be successfully avoided, though their impact can be minimized. The most serious of these inherent problems are related to the fact that the estate in land on which the condominium is founded must terminate at a specified time. This progress toward the effluxion of the term of the lease makes the financing of the project and the unit purchases, and the repair and maintenance of the units quite different in leasehold condominiums than it is in freehold condominiums.

The major financing problems in leasehold condominiums are related to the sale and resale of the unit interests. These problems can crop up at various points throughout the term of the lease. Leases are, in theory, fully as mortgageable as freehold interests. The only question with regard to the mortgaging of leases is the value of the security that the mortgagee is able to obtain for the money loaned. Leasehold unit interests might be seen as doubtful security when they are first introduced into the market. Financial institutions have a fairly well understood ranking of interests in property which are desirable as mortgage security. All other factors being equal, detached and semi-detached homes are considered more attractive and marketable (and hence, better security) than condominiums. This hierarchy of preference guides financiers in the allocation of their investment portfolios. Novelty alone would place a leasehold condominium project at the foot of any list of desirable investments.³⁴ Similarly, the units themselves may be unattractive to mortgagees on sale or resale transactions. Until mortgagees can be assured that the leasehold condominium units are a marketable commodity, they are unlikely to want to advance money on them. It seems, however, that leases of flats in England and condominium unit leases in the United States have weathered this period of uncertainty and achieved a respectable place in the mortgage market.

Another factor in modern mortgaging practice which must be considered is the availability of mortgage insurance. Where mortgagees are asked to advance more than 75 per cent of the value of the secured interest, they will demand that the mortgage be insured by a mortgage insurance company. The insuring body may be either a public agency, such as Central Mortgage

³⁴ Colin Connor held a series of interviews with Canadian lending institutions with regard to the introduction of leasehold condominiums into the Ontario housing market in the summer of 1975. The view that leasehold condominium units would be the least attractive investments in the field of housing was widespread. It was universally acknowledged that mortgage insurance from Central Mortgage and Housing Corporation, the federal government's chief funding agency for housing, would be a prerequisite to granting any mortgage on such an interest. Even with an offer of CMHC insurance, interest in such projects would be limited if other investments were available.

and Housing Corporation, or a private corporation. Mortgage insurance presents a second hurdle to the introduction of leasehold condominiums into the real estate market since mortgage insurance companies must also be convinced of the marketability of this type of holding before institutional mortgagees are likely to become interested in investing.

Both lenders and mortgage insurers will test the desirability of their investments by criteria other than the marketability of the secured interest. A major element in the mortgagee's security is his ability to predict the expenses which the secured property will bear throughout the term of the mortgage. This prediction is important on two grounds. The mortgagee will want to be certain that the housing expenses of the mortgagor do not eat up a disproportionate share of the mortgagor's income (which is to say that the D.S.R. will be kept at an acceptable level). Secondly, the expenses which must be borne by a unit interest are important in establishing the value of that interest. Any uncertainty concerning expenses leads to an uncertainty in valuation which would again lead mortgagees to avoid investing. Condominium unit holders may be caught in a trap if regular re-evaluations of the rent are provided for in the condominium lease. There is some evidence to indicate that, under such circumstances, mortgagees will not grant mortgages with amortization periods going beyond a date of rent recalculation. A rent recalculation date in a condominium lease might, therefore, 'freeze' unit holders and make their interests unmarketable.³⁵

These financial problems arise in a more serious form toward the termination date of the lease. Mortgagees will not be satisfied with a leasehold as security unless its term extends significantly beyond the amortization period of the loan. Some mortgagees require ten years in excess of the amortization period. Others suggest that a term twice the length of the amortization period of the loan is the appropriate security in a leasehold interest. Under any test, a mortgage would be difficult to obtain on a leasehold condominium unit in the last thirty years of the term of the lease and would be almost impossible to secure in the last twenty years.

The lack of mortgageability in the interest will, of course, itself diminish the value of the interest. The interest would, however, have some value right up to the end of the term. In the final years of the lease, the unit would be appraised at the capitalized value of the rent on a comparable rental unit for the balance of the term with some adjustment to reflect the obligation to contribute to the common expenses. Unit holders could transfer their rights in a cash market or could themselves hold mortgages on the interests transferred. But either of these expedients is highly inconvenient among low and moderate income unit holders. The units might also, at the very end of the term, be transferred by means of sublease by the unit holders, but this too is unsatisfactory.

The effluxion of the term of the lease creates a whole set of problems in addition to the financing difficulties already discussed. What happens to the

³⁵ In the summer of 1975, Marilyn Ginsburg was told of a leasehold condominium in Hawaii which was nine years away from its first rent recalculation. No mortgage institution would accept the units as security and they were consequently unmarketable.

condominium regime when the lease terminates? In theory, if the estate on which the regime is founded is lost, the regime must also be lost. The land would be held in fee simple by the reversioner. Would the condominium corporation terminate at the same time? Presumably the corporation should be allowed to continue until its members wind it up: the corporation may have obligations to discharge, and assets to administer even after the lease is ended. What is the status of the unit holders at the end of the lease? In theory, they cease to have any interest in the property and should vacate the premises on or before the termination date. Whether unit holders will in practice be ready to undertake a mass evacuation is another question. Should unit holders become periodic tenants if they stay in possession beyond the termination of the lease? If they do become tenants in the usual sense of the term, what becomes of their obligations with regard to maintenance and repair under the condominium regime? There is a curious, almost inexplicable, silence in the statutes which permit the creation of leasehold condominiums on all of these points.

Another type of problem might arise should the unit holders in a leasehold condominium desire, or be forced, to consider rebuilding or terminating their project. Condominiums on freehold land can be faced with such choices under a number of circumstances. The building may have suffered partial or complete destruction and the unit owners may decide not to make repairs, or the building may be found to be obsolete, so that the redevelopment of the property would be financially advantageous to the unit owners. In either case, the owners can jointly decide to end the condominium regime and assert co-tenancy interests in the freehold. Presumably, holders of leasehold interests could also assert a co-tenancy right in the ground lease of the project. The balance of the term of such a lease might not, however, be sufficient to make either rebuilding or redevelopment economically feasible. Furthermore, the ground lease might specify that the landlord is entitled to receive the condominium buildings in a good state of repair at the end of the lease. Many of these problems can, of course, be met by expertly drafted insurance programmes. It would be much more satisfactory, however, if they were covered by explicit statutory provisions.

Even in the absence of damage to or destruction of the project, the maintenance and repair of a leasehold condominium is likely to create serious difficulties toward the termination date of the lease. During the last twenty years of the unit interest, there will be some tendency on the part of unit holders to delay or avoid major repairs to their own units or to the structure and common areas of the building. Certainly, every decision to repair made during that period will be judged with regard to whether the unit holders will be able to get full value for the money invested.

The problem of disrepair in leaseholds is a very old one and is dealt with by some very well-established common law doctrines. A lessee is at all times under an obligation to return the leased premises to the lessor at the end of the lease term in roughly the same condition in which they were received from the lessor at the commencement of the term.³⁶ The lessee is not

³⁶ R. E. Megarry and H. W. A. Wade, *The Law of Real Property*, (3rd ed. London: Stevens, 1966) at 689.

entitled to exploit or destroy the premises ("commissive waste") or to fall into decay ("permissive waste").³⁷ Though there is some controversy on the matter, there is probably a common law obligation on the tenant to keep premises held on a long term lease in good repair although he is not, as a general rule, required to prevent deterioration by "reasonable wear and tear".³⁸ These common law doctrines are typically augmented by special covenants in modern leases. A tenant will, almost invariably, specifically agree in his lease not to damage the premises and to make necessary repairs.

Evidently people currently concerned with the sale of flats and leasehold condominiums view these common law doctrines as sufficient to govern the rights of the parties throughout the term of the unit interests. In both England and Hawaii, landlords retain in their leases rights to order repairs to the premises, and in both jurisdictions the expectation is that landlords will supervise tenants closely to ensure that their buildings are returned to them in a good state of repair. These expectations may be unrealistic. The common law doctrines evolved at a time when landlords and tenants stood in a one-to-one relationship. The tenant was aware of his individual responsibility from the outset and could govern himself accordingly. One might speculate that tenants in a leasehold condominium project there would see their relationship to the landlord and their responsibilities in a different light, and would be extremely reluctant to discharge their responsibilities for repair and maintenance toward the end of the term, regardless of whether these responsibilities arose through common law or covenant. The British Columbia legislation permitting the creation of leasehold condominiums tries to meet this problem by forcing the landlord to pay the unit holders the market value of the improvements to the land upon the termination of the lease.³⁹ The unit holders thus do not entirely lose the value of their investments in maintenance and repairs. British Columbia is, however, the only jurisdiction to address this problem and it can do so, it is suggested only because it restricts leasehold condominiums to leases on Crown lands.

The difficulties discussed above are inherent in the leasehold condominium concept; no amount of legal ingenuity will avoid them completely. However, some of the other difficulties that have arisen with regard to leasehold condominiums can be overcome. In some cases, for example, leases between developers and unit holders are extremely restrictive in their terms.

Even though the leases run for long terms, landlords restrict tenants in the same manner in which they would be restricted in a two or three year lease. Tenants thus find themselves with none of the advantages of freehold ownership, and without the short term tenant's right to escape his obligations by moving elsewhere. This problem has been particularly acute in Hawaii where landlords have shown little restraint in the covenants they include in unit leases. One landlord is reported to have refused a condominium corporation on his property the right to erect a sign giving the name and address of

³⁷ *Id.* at 106, and 689.

³⁸ *Id.* at 689.

³⁹ *Supra*, note 17, s. 54.

the project. Abuses of this sort with regard to long term residential leases have lead to a popular movement to pass a *Land Reform Act* which would allow the state to purchase, through condemnation (expropriation) proceedings, parcels of land on which leasehold residences are built, and then sell the fee to the tenants.⁴⁰

The inclusion of covenants of any suit in condominium leases raises an additional problem. In a traditional residential leasehold, the landlord will enforce his rights under the lease by threatening to re-enter and terminate the tenancy. While statutory protection against forfeiture of leases under these circumstances is now common, the availability of such a remedy in situations in which the tenant has made a major investment in the premises is, to say the least, undesirable. A meticulous landlord armed with a restrictive lease and a right of re-entry could make life in a condominium very uncomfortable. Probably a landlord's right of re-entry should be statutorily limited to the enforcement of a very few rights — pre-eminently the right to rental payments. Furthermore, re-entry should be allowed only after extensive notice is given to the tenant as well as to any parties holding secured or other interests in the tenant's unit.

Another problem with regard to landlord's remedies might be mentioned. Where landlords re-enter under traditional leases, the lease is terminated and the leasehold estate is lost. Could this be allowed to happen in a leasehold condominium? That is, would a leasehold condominium unit become a freehold in the landlord's hands upon re-entry through the merger of the leasehold and reversionary estates? If it did so, would the unit continue to be governed by the condominium regime which was founded on the lease? What interest would the landlord transfer when he put the unit into other hands? Again, the existing statutes give little or no guidance on these most perplexing problems.

Tenants' rights can also be abused where a 'sandwich' type of leasehold condominium is created. In a sandwich lease, the owner of a freehold may assert rights against the entire property through the covenants in the ground lease. If he does so, he could, at least in theory, terminate all of the interests created upon the ground lease — that is, he could evict the unit holders by exercising a right of re-entry against the developer who holds the ground lease. This possibility is avoided in England by having the owner of the freehold consent to all the unit interests granted by the developer of the block of flats. The problem is dealt with in some states of the United States by statutory provisions protecting unit interests against re-entry by the owner of the freehold.⁴¹

⁴⁰ This information was gathered by Marilyn Ginsburg in research during the summer of 1975.

⁴¹ See, for example, the new *Condominium Act* for the State of Virginia (Code of Virginia, Vol. 8, 1974 Supp. C. 4.2.) Title 55-79-54 (e)(3):

[N]o lessor who executed the same, and no successor in interest to such lessor, shall have any right or power to terminate any part of the leasehold interest of any unit owner who makes timely payment of his share of the rent to the person or persons designated in the declaration for the receipt of such rent and who otherwise complies with all covenants which, if violated, would entitle the lessor to terminate the lease. . . .

If leasehold condominiums do in practice create the grave difficulties outlined above, is there any way in which they can be successfully introduced into the housing market of a common law jurisdiction? It is quite possible that such a feat could be accomplished. The basic requirement for a successful leasehold condominium regime would be a statute which deals comprehensively and in detail with the many difficulties discussed. Certainly, it is both unsatisfactory and dangerous to proceed on the basis of a simple statutory amendment allowing condominiums to be built on leasehold estates. The pattern of legislative amendment along these lines that has developed in many of the states of the United States should not be followed. Similarly, any legislation on this matter should provide that leasehold condominiums and analogous interests can be created only pursuant to statutory authorization. The English situation in which conveyancers are allowed to develop their own leasehold condominiums should be avoided.

If a statutory leasehold condominium regime is to be established, a number of matters will be crucial to its success. The statute should establish a minimum term for the leasehold estate on which the condominium is to be built or for the unit interest in the condominium, depending on the organizational model adopted. The term should be long enough that the unit holders are able to build up some equity in their units. Presumably, in an expanding economy, leasehold units would have some market value until relatively close to the end of the term. A lease term of 90 to 100 years would allow a leasehold unit to have some investment potential and permit unit holders to consolidate their capital and participate in the non-leasehold housing market.⁴² In theory, the term of the lease should bear some relationship to the estimated life of the condominium building. As noted previously, it would be enormously inconvenient for unit holders to be faced with major structural repairs in the last decades of the lease. Unfortunately, there are no clear guidelines on the life expectancy of modern buildings.

A statutory condominium regime should also make specific provisions with regard to rent recalculation during the term of the lease. From the point of view of the interests of tenants and lending institutions, it would be most desirable not to have any rent recalculation whatsoever. Such a provision would not be realistic in normal property markets. In any event, rent recalculations should be limited. Rents should remain constant (that is, they should be neither recalculated nor subject to escalation) for at least several decades. If rents are to be recalculated during the term of the lease, they should be recalculated with regard to some fixed criteria, such as the market value from time to time of the unimproved property on which the condominium project sits. In this way, unit holders and mortgagees would have at least some point of reference with regard to their future rental obligations. Whether provisions

⁴² As noted previously, the Ontario legislation (*supra*, note 20) provided for a lease period of 99 years. The British Columbia legislation (*supra*, note 17) requires that there be an unexpired term of 50 years on the ground lease before a condominium can be registered. In the United States, the ground leases tend to be for 50 to 65 year terms. From an investment, marketing and mortgaging point of view, these relatively short leases are probably unwise.

of this sort would be sufficient to encourage mortgagees to invest in leasehold condominiums does, however, remain unclear.

A leasehold condominium statute should also provide guidelines which go as far as possible toward preserving the independence of leasehold units from interference by the holder of the reversion. If leasehold units are ever to be a useful element in the housing market, they will have to be made as analogous as possible to freehold condominium units. The statute should prohibit any arrangement whereby the unit holder takes by way of sub-lease from the developer of the condominium. 'Sandwich leases' must be avoided. The statute should insist that the holder of the reversion assert rights and responsibilities directly against the holders from time to time of the units in the project. Again, the common law doctrines with regard to the assignment of leasehold interests should be statutorily abrogated. Finally, the holder of the reversion should be prohibited from asserting the usual landlord's remedies against the holders of the unit. The assignors of unit interests from time to time should be freed of all responsibility to the holder of the reversion for obligations arising after the assignment is complete. The holder of the reversion should be entitled to terminate the interest of the unit holder only under extreme circumstances and after a lengthy period of notice has elapsed.

If leasehold condominiums can be introduced where sufficient statutory controls are present, the question remains whether they should be introduced at all. Leasehold condominiums and analogous forms of tenure appear to flourish only under special circumstances. Probably leasehold condominiums will be difficult to introduce into housing markets which do not exhibit the unique features found in, for example, Hawaii and England. Presumably, they will never compete on an equal footing with freehold condominium projects.

If leasehold condominiums are appropriate and valuable only in a very narrow range of circumstances, they probably should not be introduced at all. Projects of this nature might be valuable where land values make freehold development impractical or where fundamental restrictions (such as those existing in provincial and federal parks) make leasehold development mandatory. In either of these situations, the development of traditional rental accommodation is a presently available alternative. Allowing a condominium regime to be used in such circumstances would not add a great deal to the development of the property's potential. If the assumption that leasehold condominium schemes would be appropriate only under unusual conditions is correct, any such project would remain a unique and unfamiliar element in the land development industry. None of the advantages that might be expected to flow from a general familiarity with the concept would accrue. If an equitable leasehold condominium scheme can only be achieved through guidelines, the advantages to be achieved will not be worth the energies expended.

