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## Special Declarant Rights and Obligations Following Mortgage Foreclosure on Condominium Developments

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# NOTES

## SPECIAL DECLARANT RIGHTS AND OBLIGATIONS FOLLOWING MORTGAGE FORECLOSURE ON CONDOMINIUM DEVELOPMENTS

Condominium sales have slowed in recent years after experiencing sustained growth in the 1960's and early 1970's.<sup>1</sup> This decline apparently has caused construction lenders to foreclose more frequently on the mortgages of uncompleted condominium projects,<sup>2</sup> raising issues over the nature and extent of special declarant rights and obligations.

A declarant is the creator, promoter, marketer, or developer of a condominium project.<sup>3</sup> The declarant records a master deed, or declaration, identifying the rights and obligations of the declarant.<sup>4</sup> "Declarant" also may include the original declarant's successors in interest,<sup>5</sup> who usually must perform the obligations of the original declarant. If the successor in interest is a mortgagee or a secured party, however, the successor may not incur the original declarant's obligations unless the successor also has exercised special declarant rights.<sup>6</sup>

The Uniform Condominium Act's definition of special declarant rights "seeks to isolate those [ownership and development] rights reserved for the benefit of a declarant which are unique to the declarant and not shared in common with other unit owners."<sup>7</sup> These rights allow the declarant to manage and control the condominium

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1. See Teeley, *Condominium Laws Under Scrutiny Following Foreclosures*, Wash. Post, July 10, 1982, at E1, col. 1.

2. *Id.* See also Thomas, *The New Uniform Condominium Act*, 64 A.B.A. J. 1370, 1372 (1978).

3. Garfinkel, *The Uniform Condominium Act*, in CONDOMINIUM CONVERSIONS 153, 157 (1981).

4. 2 H. TIFFANY, *THE LAW OF REAL PROPERTY* § 483.55 (3d ed. Supp. 1983).

5. R. GLAZER, *PENNSYLVANIA CONDOMINIUM LAW AND PRACTICE* § 6.01 (1981).

6. *Id.*

7. *Id.* § 6.02.

complex in a manner unavailable to the owner of any single unit.<sup>8</sup> Special declarant rights are consistent with the declarant's role as a promoter and developer of the entire complex who is interested in full tenancy and in the improvements and management necessary to reach that end.

As a consequence of exercising special declarant rights, the declarant also incurs special obligations.<sup>9</sup> These obligations, owed to unit purchasers, include contractual duties and warranties of construction and habitability arising from the declaration documents.<sup>10</sup> Purchasers who bought condominium units before a foreclosure, as well as subsequent purchasers, may be uncertain whether the original developer or the foreclosing lender is responsible for special declarant obligations. The foreclosing lender faces the similar problem of determining the declarant rights and obligations that it acquired upon foreclosure.

In the absence of definitive state statutes, the courts have struggled to find satisfactory solutions to these problems.<sup>11</sup> State court decisions, however, have not delineated consistently or clearly the bounds of special declarant rights and obligations.<sup>12</sup> To resolve this problem, the National Conference of Commissioners on Uniform State Laws drafted and approved section 3-104 of the Uniform Condominium Act, entitled "Transfer of Special Declarant Rights."<sup>13</sup> Six states have adopted section 3-104 as proposed or

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8. Special declarant rights include:

[R]ights reserved for the benefit of a declarant to (i) complete improvements indicated on plats and plans filed with the declaration; (ii) to exercise any development right; (iii) to maintain sales offices, management offices, signs advertising the condominium, and models; (iv) to use easements through the common elements for the purpose of making improvements within the condominium or within real estate which may be added to the condominium; (v) to make the condominium part of a larger condominium or a planned community; (vi) to make the condominium subject to a master association; (vii) or to appoint or remove any officer of the association or any executive board member during any period of declarant control.

UNIF. CONDOMINIUM ACT § 1-103(23), 7 U.L.A. 132 (Supp. 1983) (cross-references omitted).

9. See *id.* comment 13. "[T]he concept of special declarant rights triggers the imposition of obligations on those who possess the rights." *Id.*

10. See *infra* text accompanying notes 36-41.

11. See Thomas, *supra* note 2, at 1372.

12. See *infra* text accompanying notes 69-94.

13. UNIF. CONDOMINIUM ACT § 3-104.

with slight modifications.<sup>14</sup> Michigan and Oregon have developed alternative statutes which delegate the rights and obligations after foreclosure.<sup>15</sup> Most state legislatures, however, have ignored the problem.

This Note will examine the Uniform Condominium Act's provisions dealing with special declarant rights and obligations and the measures that the various states have adopted. The Note will compare the Uniform Condominium Act to the Michigan and Oregon statutes and to judicial solutions in jurisdictions without a statute. The Note concludes that some form of statutory delegation is necessary to allocate equitably the loss that results from the original declarant's default. Section 3-104 of the Uniform Condominium Act is the preferable method for allocating those rights and obligations between innocent unit owners and innocent lenders.

### THE DEVELOPMENT OF CONDOMINIUMS

The condominium concept<sup>16</sup> of a horizontal and vertical division of airspace as alienable property existed at least as early as the Middle Ages<sup>17</sup> and, some commentators argue, even in ancient

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14. See ME. REV. STAT. ANN. tit. 33, § 1603-104 (Supp. 1983); MINN. STAT. ANN. § 515A.3-104 (West Supp. 1983); N.M. STAT. ANN. § 47-7C-4 (Supp. 1982); 68 PA. CONS. STAT. ANN. § 3304 (Purdon Supp. 1983-1984); VA. CODE § 55-79.74:3 (Supp. 1983); W. VA. CODE § 36B-3-104 (Supp. 1983).

15. See MICH. COMP. LAWS ANN. §§ 559.235, 559.237 (Supp. 1982); OR. REV. STAT. §§ 94.097, 94.103 (1981).

16. "Condominium" refers to more than one concept. Usually, the term identifies a form of property ownership in which a person owns both an individual dwelling unit in a multi-unit housing development and an undivided interest in the common elements. See J. KUSNET, HOW TO SET UP A NEW FIRST-HOME CONDOMINIUM 2 (Real Est. Rev. Portfolios No. 19, 1979); C. SMITH & R. BOYER, SURVEY OF THE LAW OF PROPERTY 451 (2d ed. 1971). The common elements include lobbies, grounds, electrical and mechanical equipment and systems, swimming pools, and tennis courts. Proxmire, *Introduction to Symposium on the Law of Condominiums*, 48 ST. JOHN'S L. REV. xi (1974).

"Condominium" also may refer to the estate that an owner receives under the condominium form of ownership, consisting of a fee simple interest in the individual unit and an undivided interest in the common elements. 2 H. TIFFANY, *supra* note 4, § 483.52. Finally, "condominium" may refer to a specific building within the development, or to the development itself. *Id.* See *Condominium Workshop*, 48 ST. JOHN'S L. REV. 677, 716 (1974) (remarks of Mr. Parry).

17. 2 H. TIFFANY, *supra* note 4, § 483.51. See also Garfinkel, *supra* note 3, at 155; Leyser, *The Ownership of Flats—A Comparative Study*, 7 INT'L & COMP. L.Q. 31, 33 (1958).

Rome.<sup>18</sup> Although the condominium system of property ownership has existed for some time, it did not gain wide acceptance until the middle of this century when nations gave legal recognition to a phenomenon that had become a growing practice among property owners.<sup>19</sup>

Condominiums became popular in the United States after Congress enacted section 234 of the National Housing Act (NHA) in 1961.<sup>20</sup> The NHA facilitated the creation of condominiums by providing Federal Housing Administration insurance for condominium mortgages if state law permitted condominium ownership.<sup>21</sup> Following the adoption of the NHA, individual states quickly enacted condominium enabling statutes.<sup>22</sup>

Before the enactment of these statutes, condominiums were virtually unknown in the United States.<sup>23</sup> In the late 1960's and early 1970's, however, several factors contributed to the growth and popularity of condominium sales.<sup>24</sup> Condominiums were less expensive

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18. The existence of condominiums in ancient Rome is disputed. 2 H. TIFFANY, *supra* note 4, § 483.51. Some commentators have stated in absolute terms that condominiums originated in ancient Rome. See, e.g., Garfinkel, *supra* note 3, at 155; Ramsey, *Condominium*, PRAC. LAW., Mar. 1963, at 21. Other commentators, however, doubt these assertions on the grounds that "Roman Law followed the principle *superficies solo cedit*—whatever is attached to the land forms part of it—and did not visualize separate ownership of floors in a dwelling." Cribbet, *Condominium—Home Ownership for Megalopolis?*, 61 MICH. L. REV. 1207, 1210 (1963). See also Leyser, *supra* note 17, at 33.

19. The first condominium legislation was article 664 of the Code Napoleon of 1804, which divided responsibility for common areas—such as staircases—among property owners. Leyser, *supra* note 17, at 33-34; Comment, *A Comparison of United States and Foreign Condominiums*, 48 ST. JOHN'S L. REV. 1011 (1974). The French enacted the first modern condominium enabling statutes and regulations in 1938. *Id.* at 1012. Italy, Spain, and the Netherlands quickly followed France's example by passing their own condominium laws, and Germany, Austria, and Switzerland enacted condominium laws after World War II. *Id.* During this period Brazil, Cuba, Mexico, and Venezuela also adopted condominium laws. *Id.* Puerto Rico adopted condominium enabling laws in the 1950's that became the basis for § 234 of the National Housing Act in the United States. *Id.* at 1012-13.

20. 12 U.S.C. § 1715y(d) (1976).

21. Proxmire, *supra* note 16, at xiv.

22. *Id.* All fifty states had adopted condominium laws by 1968. See 125 CONG. REC. 23,117 (1979) (statement of Rep. Rosenthal).

23. See Rohan & Berger, *Foreward to Symposium on the Law of Condominiums*, 48 ST. JOHN'S L. REV. ix (1974).

24. Proxmire, *supra* note 16, at xi; Rohan & Berger, *supra* note 23. The number of condominiums in the United States grew from 85,000 in 1970 to 1,340,000 in 1975. 125 CONG. REC. 23,117 (1979) (statement of Rep. Rosenthal). Today, the number is estimated to be more than 1,500,000. K. ROMNEY & B. ROMNEY, CONDOMINIUM DEVELOPMENT GUIDE: PROCEDURE,

to purchase<sup>25</sup> and required less maintenance than traditional detached single-family dwellings,<sup>26</sup> yet they offered the same tax benefits as home ownership.<sup>27</sup> The desire of homeowners to be close to cities, and the scarcity of land in urban areas<sup>28</sup> also encouraged the use of multifamily housing. Additionally, home buyers often sought property that included recreational facilities.<sup>29</sup> Finally, the home-buying market changed because single, divorced, childless, elderly, and geographically mobile consumers entered the home-buying market and found that condominiums met their special housing needs.<sup>30</sup> The condominium sales boom caused some observers to predict that condominiums would become the most popular form of housing in the United States.<sup>31</sup>

In the late 1970's, however, condominium developers began to have difficulty selling units in their planned projects. A stagnant economy and high interest rates reduced the number of potential home buyers.<sup>32</sup> Although completed condominium units and projects were readily available in the housing market, the rate of sales did not match the rate of development.<sup>33</sup> Developers were un-

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ANALYSIS, FORMS ¶ 1.01[3] (rev. ed. 1983). For a more detailed discussion of the reasons for the increased popularity of condominiums, see *id.* at ¶¶ 1.01[3], 1.01[4], 1.04[3], 3.04.

25. See 125 CONG. REC. 23,117 (1979) (statement of Rep. Rosenthal); Garrigan, *Multifamily Properties: An Attractive Investment for the 1980s*, REAL EST. REV., Summer 1982, at 103, 109; Proxmire, *supra* note 16, at xi-xii; Rohan & Berger, *supra* note 23, at ix.

26. 125 CONG. REC. 23,117 (1979) (statement of Rep. Rosenthal); Proxmire, *supra* note 16, at xii.

27. 125 CONG. REC. 23,117 (1979) (statement of Rep. Rosenthal).

28. See *id.*; Rohan & Berger, *supra* note 23, at ix.

29. Proxmire, *supra* note 16, at xii.

30. *Id.* See also Rohan & Berger, *supra* note 23, at ix.

31. See 125 CONG. REC. 23,117 (1979) (statement of Rep. Rosenthal); Rohan & Berger, *supra* note 23, at ix.

32. See Teeley, *supra* note 1. In the early 1970's, when interest rates remained between 7% and 9%, consumers were willing to enter the housing market. When interest rates rose to 15% or more in the late 1970's, however, "[w]ould-be home buyers were largely frozen out of the housing market." Garrigan, *supra* note 25, at 109.

33. See generally Teeley, *supra* note 1. This phenomenon affected not only the condominium market, but the entire housing market. One commentator noted:

There is no shortage of housing today. There are currently over 300,000 new single-family homes, 80,000 new condos, and 90,000 converted condos in standing inventory across the country. Add to that the thousands of existing housing units which are listed for sale, and it is obvious that there is no shortage of housing. There is plenty to buy, and there are still some builders to supply more.

able to satisfy their mortgage obligations or to complete the development of projects.<sup>34</sup> As a result, lenders who had made construction loans to the condominium developers foreclosed on the developments to satisfy the developers' debts.<sup>35</sup> This scenario will continue as long as the condominium market falters and developers are unable to sell units.

#### SPECIAL DECLARANT RIGHTS AND OBLIGATIONS

A developer who sells units in a partially or fully completed condominium project is exposed to a broad range of potential liability to the individual owners.<sup>36</sup> The developer may be liable to owners for deficiencies in the construction of common elements,<sup>37</sup> such as parking lots and recreational facilities, or for deviations from construction specifications contained in the condominium declaration documents.<sup>38</sup> The developer also may be liable for negligence in the design or construction of the condominium, for breach of express or implied warranties of construction and habitability with respect to individual units,<sup>39</sup> or for breach of promise relating to the development of the entire project or the use of land within the project.<sup>40</sup> Finally, fraud and misrepresentation during the sale of units are additional sources of liability.<sup>41</sup>

The condominium unit owner confronted with any of these problems is likely to seek redress in the courts. If the developer has continued to exercise special declarant rights, he remains liable to the unit owners.<sup>42</sup> A problem arises, however, if the developer is

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Lesser, *The Future of Housing Depends on Adaptable Builders*, REAL EST. REV., Summer 1982, at 112, 115.

34. Teeley, *supra* note 1.

35. *Id.* See also Thomas, *supra* note 2, at 1372.

36. See generally M. LEVINE, REALTORS' LIABILITY (1979); Hyatt & Rhoads, *Concepts of Liability in the Development and Administration of Condominium and Home Owner Associations*, 12 WAKE FOREST L. REV. 915 (1976); Comment, *Products Liability and the Sale of a New Dwelling*, 17 GONZ. L. REV. 39 (1981).

37. See Hyatt & Rhoads, *supra* note 36, at 951.

38. *Id.* at 953-54.

39. See generally *id.* at 954-62.

40. See generally *id.* at 963-70.

41. See generally *id.* at 970-72.

42. See generally *id.* at 953. Neither the Uniform Condominium Act nor the state statutes relieve a condominium developer of liability for its own wrongdoing. Moreover, the developer will be liable if it has retained any special declarant right. See UNIF. CONDOMIN-

insolvent and the mortgagee has foreclosed on the project. The owner may be unsure whether to sue the developer, the mortgagee, or both.

Because the defaulting developer is likely to be judgment-proof, the unit owner often must turn to the lender as the potential source of recovery.<sup>43</sup> Complications can arise, however, when the unit owner sues the lender. The expectations of the innocent purchaser conflict with the financial considerations of the lender. Both the unit owners and the lender have legitimate claims to legal protection. The courts seek to protect the owner's contractual rights and the value of his investment in the property.<sup>44</sup> The courts also attempt to protect lenders to ensure the continued availability of condominium construction loans. If the declarant's liability is imposed on lenders, condominium construction loans at affordable interest rates may become unavailable. The lenders would face the uncomfortable dilemma of either absorbing a substantial loss by not foreclosing on an insolvent developer or assuming significant potential liability to unit owners by foreclosing.<sup>45</sup> Courts and legislatures have adopted varying approaches to resolve this dilemma.

### *The Great Western Rule*

In addressing the imposition of liability in the condominium mortgage foreclosure situation, many commentators and courts have focused on the *Great Western* rule, although the rule emerged in a setting that did not involve condominiums. In *Connor v. Great Western Savings & Loan Association*,<sup>46</sup> the California

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IUM ACT § 3-104(b)(1), (3); MICH. COMP. LAWS ANN. § 559.237 (Supp. 1982); OR. REV. STAT. § 94.097(2)(a), (b) (1981).

43. Builders and developers typically operate on the brink of insolvency. The industry is comprised of "thousands of small, undercapitalized firms which can easily enter and depart from the industry in accordance with fluctuations in housing demand." Comment, *Liability of the Institutional Lender for Structural Defects in New Housing*, 35 U. CHI. L. REV. 739, 740-41 (1968). Often, builders "obtain almost total financing from lending institutions" for planned projects. *Id.* at 741. Because builders seldom have any assets against which to enforce a judgment, disappointed owners view the construction lender as the only source of recoverable funds. *Id.*

44. Cf. *Connor v. Great W. Sav. & Loan Ass'n*, 69 Cal. 2d 850, \_\_\_, 447 P.2d 609, 618-19, 73 Cal. Rptr. 369, 378-79 (1968) ("the losses of family savings invested in seriously defective homes would be devastating economic blows if no redress were available").

45. See *infra* notes 65-66 and accompanying text.

46. 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968).



Supreme Court imposed liability on Great Western, the construction lender of a development consisting of detached single-family dwellings.<sup>47</sup> The lender loaned purchase money and construction money to the developer, and obtained a right of first refusal to make purchase loans to buyers in the development.<sup>48</sup> Additionally, the developer paid loan fees to the lender regardless of whether buyers borrowed from the lender.<sup>49</sup> The lender required the developer to submit construction plans, specifications, and work and cost breakdowns to the lender for approval, although "[i]t did not examine the foundation plans and did not make any recommendations as to the design or construction of the houses."<sup>50</sup> The lender did suggest that the developer increase sales prices, and the developer followed this advice.<sup>51</sup> As the work proceeded, the lender periodically inspected the construction site to ensure that the developer followed the submitted plans and that the developer spent construction money only for the intended purposes.<sup>52</sup> The lender, however, did not perform any of the actual construction work.<sup>53</sup>

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47. See *id.* at \_\_\_, 447 P.2d at 621, 73 Cal. Rptr. at 381. This was the first time that a court addressed the issue of lender liability to home buyers for construction defects. Gutierrez, *Liability of a Construction Lender Under Civil Code Section 3434: An Amorphous Epitaph to Connor v. Great Western Savings & Loan Association*, 8 PAC. L.J. 1, 1 (1977). Apparently, the California legislature disapproved of the court's handling of the lender liability issue. In 1969, the legislature enacted the following statute:

A lender who makes a loan of money, the proceeds of which are used or may be used by the borrower to finance the design, manufacture, construction, repair, modification or improvement of real or personal property for sale or lease to others, shall not be liable to third persons for any loss or damage occasioned by any defect in the real or personal property so designed, manufactured, constructed, repaired, modified or improved or for any loss or damage resulting from the failure of the borrower to use due care in the design, manufacture, construction, repair, modification or improvement of such real or personal property, unless such loss or damage is a result of an act of the lender outside the scope of the activities of a lender of money or unless the lender has been a party to misrepresentation with respect to such real or personal property.

CAL. CIV. CODE § 3434 (West 1970). For an interesting discussion of *Great Western* and the judicial and legislative responses to the decision, see Gutierrez, *supra*; Comment, *A New Tenant Remedy: Lender Liability for Structural Defects*, 3 U.C.D. L. REV. 167 (1971).

48. 69 Cal. 2d at \_\_\_, 447 P.2d at 612-14, 73 Cal. Rptr. at 372-74.

49. *Id.* at \_\_\_, 447 P.2d at 614, 73 Cal. Rptr. at 374.

50. *Id.* at \_\_\_, 447 P.2d at 613-14, 73 Cal. Rptr. at 373-74.

51. *Id.* at \_\_\_, 447 P.2d at 614, 73 Cal. Rptr. at 374.

52. See *id.* at \_\_\_, 447 P.2d at 615, 73 Cal. Rptr. at 375. In fact, the lender wanted to be certain that the builder disbursed construction money only for completed work. *Id.*

53. See *id.* at \_\_\_, 447 P.2d at 611, 73 Cal. Rptr. at 371.

Two years after completion of the development, expansion and contraction of the adobe soil severely damaged the foundations of houses in the development.<sup>54</sup> Homeowners in the development sued both the lender and the developer, asserting two theories of liability. They argued that the lender was a partner of the developer in a joint venture and, as such, was vicariously liable for the developer's negligence.<sup>55</sup> The homeowners also argued that the lender had breached an independent duty to use reasonable care to prevent major defects.<sup>56</sup>

Although the California Supreme Court did not find a joint venture,<sup>57</sup> the court imposed liability on the lender because the lender owed an independent "duty to the buyers of the homes to exercise reasonable care to protect them from damages caused by major structural defects."<sup>58</sup> The court considered several factors in reaching this conclusion:

The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are [1] the extent to which the transaction was intended to affect the plaintiff, [2] the foreseeability of harm to him, [3] the degree of certainty that the plaintiff suffered injury, [4] the closeness of the connection between the defendant's conduct and the injury suffered, [5] the moral blame attached to the defendant's conduct, and [6] the policy of preventing future harm.<sup>59</sup>

After examining these factors, the court concluded that Great Western intended that its transactions affect the home buyers significantly,<sup>60</sup> that Great Western knew or should have known of the risk of harm to the home buyers,<sup>61</sup> and that the home buyers undeniably suffered injury.<sup>62</sup> Moreover, the court decided that Great

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54. *Id.*

55. *Id.*

56. *Id.*

57. *See id.* at \_\_\_\_, 447 P.2d at 616, 73 Cal. Rptr. at 376.

58. *Id.* at \_\_\_\_, 447 P.2d at 617, 73 Cal. Rptr. at 377.

59. *Id.* (quoting *Biakanja v. Irving*, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958)).

60. 69 Cal. 2d at \_\_\_\_, 447 P.2d at 617, 73 Cal. Rptr. at 377.

61. *Id.*

62. *Id.* at \_\_\_\_, 447 P.2d at 617-18, 73 Cal. Rptr. at 377-78.

Western's conduct was connected closely with the injury suffered by the home buyers, that substantial moral blame attached to Great Western's conduct, and that the admonitory policy of tort law required imposing liability for negligence on Great Western.<sup>63</sup>

The California court dismissed concerns about imposing liability on the lender by reasoning that "[i]f reliable construction is the norm, the recognition of a duty on the part of tract financiers to home buyers should not materially increase the cost of housing or drive small builders out of business."<sup>64</sup> The majority, however, did not address adequately the effect that lender liability would have on lending practices.

The dissent argued that imposing liability on the lender could have an extensive impact on lending practices, the housing market, and the economy.<sup>65</sup> The dissent feared that imposing liability might discourage lenders from making construction loans, thereby destroying the housing and construction industries. Alternatively, the additional liability might cause construction lenders to raise interest rates to unaffordable levels, or to levels that would increase significantly construction costs for new homes.<sup>66</sup>

Although some courts have adopted the *Great Western* rule, most courts have not imposed liability for negligent construction on lenders who have foreclosed on condominium developments.<sup>67</sup> Several courts have refused to impose liability because the lender's only involvement with the development has been financial.<sup>68</sup> The

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63. *Id.* at \_\_\_\_, 447 P.2d at 618, 73 Cal. Rptr. at 378.

64. *Id.*

65. *Id.* at \_\_\_\_, 447 P.2d at 622, 73 Cal. Rptr. at 382 (Mosk, J., dissenting). Justice Mosk argued that

[b]y imposing the entrepreneur's risks upon the supplier of capital, even though the latter has bargained away the opportunity of participating in the entrepreneurial gain on his capital by lending it at a fixed fee, the majority have effected a drastic restructuring of traditional economic relationships. The results may reverberate throughout the economy of our state, and may seriously affect the money and investment market, the construction industry, and regulatory schemes of financial institutions, all without the faintest hint in either statutory or case authority that such a draconian result is compelled.

*Id.* He further noted that liability for negligence could not be imposed if no duty of care existed, and that this duty did not exist in the lender-borrower relationship. *Id.*

66. *Id.* at \_\_\_\_, 447 P.2d at 625, 73 Cal. Rptr. at 385.

67. See *infra* notes 69-94 and accompanying text.

68. See, e.g., *First Wis. Nat'l Bank v. Roose*, 348 So. 2d 610 (Fla. Dist. Ct. App. 1977); *1000 Grandview Ass'n v. Mt. Washington Assocs.*, 290 Pa. Super. 365, 434 A.2d 796 (1981).

decisions do not preclude the possibility that these courts would impose liability in future cases, however, if the lender is involved closely with the developer before or after foreclosure. Rather than requiring courts to impose liability on an ad hoc basis, legislatures should establish statutory guidelines that enable unit purchasers and lenders to determine the effects of a potential foreclosure.

### *Judicial Approaches to Condominium Mortgage Foreclosures*

Courts in jurisdictions without applicable statutes have struggled with the conflicting policy goals of protecting buyers' expectancy interests and lenders' security interests. As a result, these jurisdictions have not developed a consistent approach for allocating special declarant rights and obligations following mortgage foreclosures on condominium developments. A series of cases decided by the Florida District Courts of Appeal illustrates the difficulties encountered by the courts.

In *First Wisconsin National Bank v. Roose*,<sup>69</sup> the Florida Court of Appeal for the Fourth District held that no greater duty could be imposed on the construction lender than it had assumed as a lender and security holder.<sup>70</sup> The developer, in selling units in a recreational condominium complex, had promised buyers that it would maintain the recreational areas.<sup>71</sup> Following the sale of the units to individual purchasers, the developer became insolvent and failed to provide the promised maintenance.<sup>72</sup> In the event of a foreclosure, the construction lender would have had an interest in maintaining the recreational areas. The lender did not foreclose on the development, however, and did not maintain the recreational areas. When the recreational areas began to deteriorate, the unit owners sued to force the lender to provide maintenance funds or to foreclose on the development.<sup>73</sup>

Based on the financing arrangement, the unit owners sought to establish a joint-venture relationship between the developer and the lender so that the court might hold the lender liable for failing

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69. 348 So. 2d 610 (Fla. Dist. Ct. App. 1977).

70. *See id.* at 611.

71. *Id.*

72. *Id.*

73. *Id.*

to maintain the recreational areas.<sup>74</sup> Alternatively, the owners requested that the court impose a duty on the lender to use reasonable care in supervising the construction work and in maintaining the recreational areas.<sup>75</sup> The court refused to impose liability on the lender on a joint-venture basis because the community of interest necessary to create a joint-venture relationship did not exist.<sup>76</sup> In contrast to the California court's decision in *Great Western*, the Florida court also rejected the unit owners' claim that the lender owed a duty to use reasonable care to supervise the developer.<sup>77</sup> Thus, the court found no legal or logical basis for ordering the lender to foreclose, and denied the requested relief.<sup>78</sup>

Three years later, in *Chotka v. Fidelco Growth Investors*,<sup>79</sup> the Florida Court of Appeal for the Second District did impose liability on a foreclosing lender for construction defects. In *Chotka*, the developer had completed most of the complex before defaulting on the construction loan.<sup>80</sup> The lender foreclosed, completed the recreational areas and lobbies, and finished individual units as the unit purchasers requested.<sup>81</sup> The lender, however, did not perform any major construction work.<sup>82</sup> The unit owners sued the lender, requesting damages for defects and omissions in the original construction of the condominium and common elements.<sup>83</sup> The lender denied any knowledge of construction or design defects at the time of foreclosure, and denied that it was liable as a developer of the project.<sup>84</sup>

Looking beyond the lender's characterization of itself as merely a construction money lender, the court reasoned that the defendant became more than a lender when it took title to the condominium.

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74. *Id.*

75. *Id.* The plaintiffs' arguments were identical to the arguments raised in *Great Western*. See *supra* text accompanying notes 55-56.

76. 348 So. 2d at 611.

77. *Id.* The court noted that the owners did not allege sufficient facts to establish any duty of supervision on the part of the lender. *Id.*

78. *Id.*

79. 383 So. 2d 1169 (Fla. Dist. Ct. App. 1980).

80. *Id.* at 1170. According to the court, "the project had been completed except for the swimming pool, tennis court, lobby, game room, elevator lobbies, and two sauna baths." *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

ium project and completed construction. At that point, the lender held itself out as the developer by advertising and selling units in the project.<sup>85</sup> The court held that the lender became a developer "to the extent that [it] may be held liable for performance of express representations made to the buyer, for patent construction defects in the entire condominium project and for any breach of any applicable warranties due to defects in the portions of the project [it] completed. . . ."<sup>86</sup> Adopting reasoning similar to the analysis in *Great Western*, the court decided that if a construction lender becomes involved with a condominium development other than as a mere lender and security holder, the lender becomes liable for the results of its own acts and promises and for the obvious or discoverable construction defects caused by the original developer.

In a more recent case, the Florida Court of Appeal for the Third District refused to impose liability on a construction lender. In *Riverview Condominium Corp. v. Campagna Construction Co.*,<sup>87</sup> the developer had promised to repair a defective roof on a condominium if the lender would postpone foreclosure actions.<sup>88</sup> When the developer did not make the promised repairs, the unit owners sued the developer on a variety of theories, and also sued the lender, claiming third-party beneficiary status under the contract between the developer and the lender.<sup>89</sup> The court dismissed the claim against the lender, noting that a third party could not sue the promisee of a contract for damages after the promisor breached the contract.<sup>90</sup> The court implied, however, that the beneficiaries of the agreement could bring third-party claims against the developer.<sup>91</sup>

The unit owners in *Riverview*, unlike those in *Roose*, *Chotka*, and *Great Western*, did not argue that the lender's involvement in

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85. *Id.*

86. *Id.*

87. 406 So. 2d 101 (Fla. Dist. Ct. App. 1981).

88. *Id.* at 102.

89. *Id.*

90. *Id.*

91. *See id.* The unit owners already had a cause of action against the developer because the developer owed the unit owners a duty to repair improperly constructed facilities. Thus, a third-party beneficiary claim against the developer would not provide the unit owners with any additional relief.

the project made it independently liable as a developer. If the owners had made this argument, the court might have found that the lender had become a developer of the project by requiring the developer to engage in particular construction practices, thus making the lender liable for the developer's obligations. Another factor distinguishing both *Riverview* and *Roose* from *Chotka* was the absence of foreclosure proceedings. Only in *Chotka* had the lender foreclosed on the development.

The most important factor in the Florida cases, however, was the degree of the lender's involvement in the project. In this respect, the decisions are similar to *Great Western*. The more extensive the lender's involvement in the development, the higher the probability that it will be liable for construction flaws and other problems involving the condominium development. The courts have failed to state clearly, however, the extent of the involvement necessary to trigger the lender's liability.

A survey of cases in other jurisdictions does not clarify the threshold at which the lender's involvement gives rise to liability. In *1000 Grandview Association v. Mt. Washington Associates*,<sup>92</sup> for example, the Pennsylvania Superior Court dismissed without explanation the complaint of a unit owners' association. The complaint alleged that the lender was a joint venturer liable as a developer for construction defects and, alternatively, that the lender had failed to use reasonable care in supervising construction and was therefore liable for the resulting damage. The court stated that "a mere lender of construction money" could not be liable for the quality of construction,<sup>93</sup> but the court did not indicate the types of activity that might give rise to liability.<sup>94</sup>

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92. 290 Pa. Super. 365, —, 434 A.2d 796, 797 (1981).

93. *Id.* at —, 434 A.2d at 798.

94. Recently, a court in the District of Columbia ordered a lender who merely had foreclosed on a development to prepare new condominium documents and to provide security and maintenance for the development. See Teeley, *supra* note 1, at E20, col. 3. Before foreclosure, only one person had purchased a unit and moved into the complex. *Id.* The lender refused to perform the promises that the developer made to the sole unit owner, and the owner sued to have the promises enforced. *Id.* Although the unit owner filed a motion for a new trial, the trial court indicated that the unit owner should address most of her claims to the developer rather than to the lender. *Id.* This resolution left the owner without a remedy, however, because the developer had no funds with which to pay damages. See *id.*

*Special Declarant Rights*

The previous discussion has focused on the lender's special declarant obligations and liabilities upon the insolvency of the developer or foreclosure by the lender. Confusion concerning the lender's exercise of special declarant rights also may arise under these circumstances. The foreclosing lender may be uncertain about its right to complete the project and about the liabilities that it may incur by acting or failing to act. The lender may wish to maintain, sell, or continue development of the project, or change the development from a condominium complex to an apartment complex. Additionally, the lender may be uncertain about its right to manage, advertise, and sell units in the project, maintain offices in the complex, and use the common areas. Only a clear statutory delineation of the rights and obligations of a foreclosing lender will alleviate these uncertainties.

#### THE STATUTORY RESPONSE

In response to the problems of transferring special declarant rights and obligations from condominium developers to foreclosing construction lenders, the National Conference of Commissioners on Uniform State Laws developed section 3-104 of the Uniform Condominium Act.<sup>95</sup> Six states have adopted section 3-104 without significant changes.<sup>96</sup> Oregon and Michigan have adopted alternative statutes that also respond to the problem of transferring special declarant rights and obligations.<sup>97</sup>

*The Uniform Condominium Act Approach*

The Uniform Condominium Act does not affect the developer's liability for contract and warranty obligations. Section 3-104 places liability for the breach of any warranties, as well as for any construction problems arising before transfer or foreclosure, on the developer.<sup>98</sup> Additionally, the developer remains liable for the subse-

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95. See Thomas, *supra* note 2, at 1370.

96. See *supra* note 14.

97. See *supra* note 15.

98. UNIF. CONDOMINIUM ACT § 3-104(b)(1). "Upon transfer of any special declarant right, the liability of a transferor declarant is as follows: (1) A transferor is not relieved of any obligation or liability arising before the transfer and remains liable for warranty obligations



quent declarant obligations and liabilities of the successor if the transferee or foreclosing lender is an affiliate of the developer.<sup>99</sup> Any entity that controls or is controlled by the developer, or that exercises joint control with the developer over the condominium project is an affiliate.<sup>100</sup> Presumably, a lender would be an affiliate if it became closely involved in the project, as the lenders did in *Great Western* and *Chotka*. Even if the developer and its successor are not affiliated, the developer is responsible for subsequent obligations arising from any special declarant rights that the developer might have retained.<sup>101</sup> If the developer is not affiliated with the lender and the developer has not retained any special declarant rights, however, the developer is not responsible for any problems arising after a foreclosure or transfer that terminates its interest in the project.<sup>102</sup>

Under section 3-104, the lender, unlike the developer, may choose the special declarant rights that it wishes to acquire and thereby determine the extent of its liability to condominium owners.<sup>103</sup> The foreclosing lender has three alternatives: the lender may succeed to all special declarant rights,<sup>104</sup> thus assuming all obligations associated with the possession or exercise of those rights;<sup>105</sup> the lender may succeed only to certain special declarant rights related to maintaining models, sales offices, and signs,<sup>106</sup> thus limit-

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imposed upon him by this Act." *Id.*

99. *Id.* § 3-104(b)(2). "If a successor to any special declarant right is an affiliate of a declarant . . . the transferor is jointly and severally liable with the successor for any obligations or liabilities of the successor relating to the condominium." *Id.*

100. *Id.* § 1-103(1).

101. *Id.* § 3-104(b)(3). "If a transferor retains any special declarant right . . . the transferor is liable for any obligations or liabilities . . . relating to the retained special declarant rights and arising after the transfer." *Id.*

102. *Id.* § 3-104(b)(4). "A transferor has no liability for any act or omission or any breach of a contractual or warranty obligation arising from the exercise of a special declarant right by a successor declarant who is not an affiliate of the transferor." *Id.*

103. *Id.* § 3-104(c). The last sentence of this section provides that "[t]he judgment or instrument conveying title [following foreclosure] shall provide for transfer of only the special declarant rights requested." *Id.*

104. *Id.* § 3-104(c). "[A] person acquiring title to all the real estate being foreclosed . . . upon his request, succeeds to all special declarant rights related to that real estate. . . ." *Id.*

105. *See id.* § 3-104(e)(2)(ii).

106. *Id.* § 3-104(c). "[A] person acquiring title to all the real estate being foreclosed or sold, but only upon his request, succeeds . . . only to any rights reserved in the declaration . . . to maintain models, sales offices and signs." *Id.*

ing its liability; or the lender may succeed to all special declarant rights, but declare that it holds those rights solely for transfer to another.<sup>107</sup> The third option minimizes the lender's exposure to liability.<sup>108</sup> None of these options exposes the lender to liability for the developer's declarant obligations unless the lender assumes the obligations<sup>109</sup> or is an affiliate of the developer.<sup>110</sup>

A lender that succeeds to all special declarant rights is exposed to a broad range of potential liability. Essentially, the lender becomes liable to unit owners for everything except the developer's misrepresentations, breaches of warranty, breaches of fiduciary duty, and obligations resulting from the developer's acts after the transfer.<sup>111</sup> Although the risk of liability is greater under this option, the lender acquires the right to complete construction, expand or contract the project, sell units, and control the homeowners association.<sup>112</sup> This alternative may appeal to a lender who has foreclosed on a substantially completed project, because the lender may finish construction, quickly sell the units, and recover a large portion of its investment. For example, if only four units and the recreational areas remained unfinished in a large condominium de-

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107. *Id.* § 3-104(e)(4). "A successor to all special declarant rights . . . may declare his intention in a recorded instrument to hold those rights solely for transfer to another person." *Id.*

108. This provision is designed to deal with the typical problem of a foreclosing mortgage lender who opts to bid in and obtain the project at the foreclosure sale solely for the purpose of subsequent resale. It permits such a foreclosing lender to undertake such a transaction without incurring the full burden of declarant obligations and liabilities.

*Id.* comment 7.

109. *Id.* § 3-104(c). The lender may assume the developer's declarant obligations in order to maintain good relations with the unit owners or to strengthen his ability to complete the development. See Teeley, *supra* note 1, at E21, col. 3.

110. UNIF. CONDOMINIUM ACT § 3-104(e)(1). "A successor to any special declarant right who is an affiliate of a declarant is subject to all obligations and liabilities imposed on the transferor by this Act or by the declaration." *Id.*

111. A successor . . . is subject to all obligations and liabilities imposed . . . (ii) on his transferor, other than: (A) misrepresentations by any previous declarant; (B) warranty obligations on improvements made by any previous declarant, or made before the condominium was created; (C) breach of any fiduciary obligation by any previous declarant or his appointees to the executive board; or (D) any liability or obligation imposed on the transferor as a result of the transferor's acts or omissions after the transfer.

*Id.* § 3-104(e)(2)(ii).

112. *Id.* §§ 1-103(23), 3-104(c).

velopment at the time of foreclosure, the lender probably would elect the first alternative so that it could sell the finished units and complete the other units and recreational areas. Before requesting to succeed to all special declarant rights, however, the lender would want to verify that the original developer did not make any serious construction errors for which the lender might be held liable.

If the complex is complete, the second alternative would be more attractive to the foreclosing lender. This alternative allows the lender to maintain models, sales offices, and signs on the common elements, and to advertise and sell individual units. The lender's only potential liability would be for failure to issue a public offering statement.<sup>113</sup> Because a lender can avoid liability by simply filing the required papers,<sup>114</sup> the lender can eliminate virtually all liability. Thus, if the lender can sell the condominium units without additional construction, the lender should choose the second option.

The third alternative, involving succession to all special declarant rights solely for transfer to another, is attractive to lenders who have foreclosed on uncompleted condominium developments or on projects that have serious construction or design flaws. If the lender chooses this alternative, the only special declarant right that it can exercise is control over the condominium homeowners association.<sup>115</sup> The third option insulates the lender from any liability to the unit owners except for the liability that may arise

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113. *Id.* § 3-104(e)(3). "A successor to only a right reserved in the declaration to maintain models, sales offices, and signs . . . is not subject to any liability or obligation as a declarant, except the obligation to provide a public offering statement. . . ." *Id.*

114. Of course, if the lender makes misrepresentations in the public offering statement, it may be held liable to unit owners on contractual grounds or for securities fraud. In addition, the lender may be subject to other civil and criminal liability for violations of the securities laws. *See generally* M. LEVINE, *supra* note 36; J. MORRIS, *HOW SECURITIES LAWS AFFECT REAL ESTATE OFFERINGS* 15-18, 34-36 (Real Est. Rev. Portfolios No. 12, 1977).

115. Thereafter, until transferring all special declarant rights to any person acquiring title to any unit owned by the successor, or until recording an instrument permitting exercise of all those rights, that successor may not exercise any of those rights other than any right held by his transferor to control the executive board in accordance with the provisions of section 2-102(d) for the duration of any period of declarant control, and any attempted exercise of those rights is void.

UNIF. CONDOMINIUM ACT § 3-104(e)(4).

from his own acts and omissions in controlling the association.<sup>116</sup> If the lender merely holds the property until another developer assumes control, the lender will not be liable to unit owners for any contract or warranty obligations, structural defects, or obligations of either the original developer or the successor developer.<sup>117</sup>

The Commissioners designed section 3-104 to balance the interests of lenders and unit owners.<sup>118</sup> Section 3-104 preserves the unit owner's right to proceed against the original developer for structural defects, misrepresentations, breaches of warranty, and breaches of fiduciary duty.<sup>119</sup> This right probably will be worthless to many owners, however, because the developer usually is insolvent after a foreclosure. To resolve this problem, section 3-104 codifies the *Great Western* rule by imposing liability on lenders that become involved with the development before or after foreclosure, but negates liability if the lender merely loans money or acquires a security interest. Thus, a lender who has become an affiliate of the developer before foreclosure, or who elects to succeed to all of the developer's special declarant rights may be liable to unit owners for a variety of damages. If the lender does not elect to succeed to all of the developer's special declarant rights, however, the extent

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116. *Id.* §§ 3-104(e)(4), 3-103(d).

117. *See id.*

118. *Id.* § 3-104 comment 2. The Commissioners indicated that section [3-104] strikes a balance between the obvious need to protect the interests of unit owners and the equally important need to protect innocent successors to a declarant's rights, especially persons such as mortgagees whose only interest in the condominium project is to protect their debt security. The general scheme of the section is to impose upon a declarant continuing obligations and liabilities for promises, acts, or omissions undertaken during the period that he was in control of the condominium, while relieving a declarant who transfers all or part of his special declarant rights in a project of such responsibilities with respect to the promises, acts, or omissions of a successor over whom he has no control. Similarly, the section imposes obligations and liabilities arising after the transfer upon a non-affiliated successor to a declarant's interests, but absolves such a transferee of responsibility for the promises, acts, or omissions of a transferor declarant over which he had no control. Finally, the section makes special provision for the interests of certain successor declarants (e.g., a mortgagee who succeeds to the rights of the declarant pursuant to a "deed in lieu of foreclosure" and who holds the project solely for transfer to another person) by relieving such persons of virtually all of the obligations and liabilities imposed upon declarants by this Act.

*Id.*

119. *See id.* § 3-104(b)(1), (3).

of the lender's potential liability is significantly curtailed and the injured unit owner may be left without a meaningful remedy.

### *The Oregon Approach*

The Oregon statute<sup>120</sup> is similar to section 3-104 in many respects, but it exposes the lender to a broader range of potential liability. The statute imposes liability on the developer for any declarant obligations arising before the foreclosure and for any breach of warranty.<sup>121</sup> Additionally, if the developer retains special declarant rights or is affiliated with the lender, the developer becomes jointly and severally liable for all obligations and liabilities of the lender.<sup>122</sup> If the developer does not retain any rights after foreclosure and is not affiliated with the lender, however, the developer will not be liable for the lender's contractual or warranty obligations.<sup>123</sup>

A developer's successor is similarly liable for all the obligations of the developer, except for misrepresentations, breaches of warranty, and breaches of fiduciary duty.<sup>124</sup> If the lender and developer are affiliates, however, the lender will be liable for all the de-

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120. OR. REV. STAT. §§ 94.097, 94.103 (1981).

121. Upon the transfer of any special declarant right, the liabilities and obligations of a transferor are as follows: (a) A transferor is not relieved of any obligation or liability arising before the transfer and remains liable for warranty obligations imposed under ORS 94.017. Lack of privity does not deprive any unit owner of standing to bring an action to enforce any obligation of the transferor.

*Id.* § 94.097(2).

122. (b) If a transferor retains any special declarant right, or if a successor declarant is an affiliate of the transferor, the transferor is subject to liability for all obligations and liabilities imposed on a declarant by the provisions of ORS 94.004 to 94.480 and 94.991 or by the declaration or bylaws arising after the transfer and is jointly and severally liable with the successor declarant for the liabilities and obligations of the successor declarant which relate to the condominium.

*Id.* at § 94.097(2)(b).

123. "(c) A transferor who retains no special declarant right has no liability for any act or omission or any breach of a contractual or warranty obligation arising from the exercise of a special declarant right by a successor declarant who is not an affiliate of the transferor." *Id.* § 94.097(2)(c).

124. A successor declarant who is not an affiliate of the transferor is subject to all obligations and liabilities imposed upon a declarant . . . except for liability for misrepresentations or warranties made by the declarant or previous successor declarant or for a breach of fiduciary obligation by such person.

*Id.* § 94.097(3)(b).

veloper's obligations, including liability for misrepresentations and breaches of warranty or fiduciary duty.<sup>125</sup> The Oregon statute defines an affiliate as anyone who "has contributed more than twenty percent of the capital of the [developer]."<sup>126</sup> Generally, construction lenders provide far more than twenty percent of the capital for a condominium project, and thus would be considered affiliates exposed to the same liability as the developer.

### *The Michigan Approach*

Michigan has adopted an entirely different approach to the problem of delegating special declarant rights and obligations. The Michigan statute provides that the "obligations of the developer to condominium unit purchasers . . . shall not be affected by the transfer of the developer's interest in the condominium project," and that the mortgagee "shall not be required to assume and shall not otherwise be liable for any contractual obligations of its predecessor in title."<sup>127</sup> The developer remains fully liable after foreclosure, but the lender is immune from liability.

As a corollary, the statute restricts at least one of the special declarant rights that the lender may exercise.<sup>128</sup> After foreclosure, the lender may have to file disclosure documents and must obtain permission from the Michigan Department of Commerce before selling any condominium units.<sup>129</sup> These restrictions prevent the lender from defrauding potential buyers.<sup>130</sup> Although this statute appears to protect a lender from liability for the developer's obligations, restricting the lender's ability to sell the remaining units

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125. *See id.* § 94.097(3)(a).

126. *Id.* § 94.097(1)(d).

127. MICH. COMP. LAWS ANN. §§ 559.235, 559.237 (Supp. 1982).

128. A mortgagee . . . which acquires title to the lesser of 10 units or 75 percent of the units in the condominium project, by foreclosure, deed in lieu of foreclosure or similar transaction, shall obtain a permit to sell from the [Department of Commerce] administrator prior to selling any such units. The administrator may condition the issuance of a permit to sell upon compliance by such mortgagee . . . with the provisions of . . . this act, [relating to disclosure statements] and any other provisions of the act as may be required by rule in order to insure that the condominium project will not work or tend to work a fraud or deception on prospective co-owners.

*Id.* § 559.235.

129. *Id.*

130. *Id.*

may discourage lenders from funding condominium projects.

Although the foreclosing lender may be concerned by the impediments to selling remaining units, its position is vastly superior to the preforeclosure unit owner. The Michigan statute provides almost complete protection for the foreclosing lender, while leaving the unit owner without a meaningful remedy. Under the statute, the developer remains solely liable after foreclosure. The unit owner seeking judicial redress can sue only the developer, who is probably insolvent.

### *Evaluating the Statutory Approaches*

Of the three statutory approaches, section 3-104 of the Uniform Condominium Act strikes the fairest balance between the interests of lenders and the interests of condominium unit owners. Under section 3-104, the lender may control the extent of its liability. Depending on the rights exercised by the lender, its liability may be nonexistent, limited, or complete. Section 3-104 does not guarantee that the unit owner will recover from the lender for the developer's acts or omissions, but it preserves the possibility. Indeed, the owner's chance of recovering from the lender is good if the lender has finished the development and sold some of the units. If the lender has not become involved in the completion of the development, imposing liability on the lender for the developer's acts would be inequitable. The policy of imposing liability on the foreclosing lender based upon the extent of the lender's involvement with the development is preferable to an all-or-nothing approach. Section 3-104 allocates loss between lenders and unit owners on the basis of the preferable policy.

In contrast, Oregon and Michigan have taken a one-sided approach. The Oregon statute exposes the lender to full liability for the obligations of the developer, although the lender may have done nothing more than provide funds for the development. This approach probably will discourage lenders from making construction loans for condominium projects. Lenders are not likely to finance condominium developments if the loans involve a greater risk of liability than a secured lender would assume in any other situation. The Oregon statute, however, ensures that injured condominium unit owners will recover for any deficiencies in the condominium or for any breach of warranty. Thus, if lenders finance a

condominium development in Oregon, unit owners always should recover their losses even if a developer defaults on the construction loan.

Michigan, on the other hand, protects lenders completely and leaves unit owners without a remedy upon the developer's insolvency or bankruptcy. Although lenders deserve some protection from liability for a developer's breach of warranty or negligence, providing full protection may be unfair to unit owners. If the lender becomes involved in the development, it should be liable for its own negligence and for its own contractual obligations. Otherwise, lenders will have little incentive to act responsibly in approving or supervising construction plans.<sup>131</sup>

The Oregon and Michigan statutes are extreme approaches to the problem of equitably allocating losses from failed condominium developments. Both lenders and unit owners want and deserve protection, but both interests cannot be accommodated fully. Section 3-104 of the Uniform Condominium Act varies the protection according to the lender's activities and equitably allocates liability between the parties.

### CONCLUSION

Delegating special declarant rights and obligations equitably following mortgage foreclosures on condominium developments involves allocating a loss between two innocent parties. Because the problem has no easy solution, and because judicial decisions have not demonstrated a consistent approach, a statutory delegation of rights and obligations is desirable. Section 3-104 of the Uniform Condominium Act does not apportion the loss in all circumstances; the Act preserves the possibility that either the lender or the unit

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131. Of course, lenders will want to protect the value of their security interests. In *Connor v. Great W. Sav. & Loan Ass'n*, 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968), the court recognized a duty on the part of the lender to protect the value of a project for which it had providing funding:

Since the value of the security for the construction loans and thereafter the security for the permanent financing loans depended on the construction of sound homes, Great Western was clearly under a duty of care to its shareholders to exercise its powers of control over the enterprise to prevent the construction of defective homes.

*Id.* at \_\_\_\_, 447 P.2d at 616, 73 Cal. Rptr. at 376. The beneficiaries of this duty, however, are not condominium buyers, but shareholders of the lender.



owner will bear the entire loss generated by an insolvent developer. Section 3-104, however, allocates the loss between the innocent parties if the lender exercises certain special declarant rights or assumes certain obligations. In contrast, the Oregon and Michigan statutes fail to allocate the loss on the basis of the lender's involvement in the project. Of the three statutory approaches, section 3-104 strikes the fairest balance between the interests of unit owners and the interests of lenders. In jurisdictions without similar statutory guidelines, the courts should seek to effectuate the policy considerations underlying section 3-104.

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