Government Regulation of Condominium in California

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In the past few years California has seen rapidly increasing interest in the construction and ownership of community apartment developments engendered by enormous population growth, concern for land conservation, and the exactions of modern day living. Major attention has centered on condominium which, for the United States, is a new concept of community ownership of real property.1

There is general agreement that the 1963 California Legislature should be asked to enact legislation to give recognition to this new concept of ownership and to establish machinery for the regulation of sales of condominium units in the interest of the public and the California building industry.2

It is the purpose of this article to discuss the present methods of regulation of condominium and community apartment house projects and the need for a new and more effective statute regulating all forms of community real property developments.3

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The views expressed herein are solely those of the authors and are not to be construed as representing any position or opinion of any agency of the State of California.

1 In the Northern California Regulatory Area, during the period beginning June 15, 1961, and ending October 1, 1962, the Division of Real Estate issued public reports for 18 condominium projects. There have been 7 filings in the Southern California Regulatory Area; three public reports issued during 1962.

Several condominium conferences have been held under the sponsorship of the Associated Home Builders of the Greater Eastbay, Inc., resulting in the publication of a guidebook for developers entitled, LEONARD, CONDO'MIN'TUM ABECEDARIUM (1961).

2 See Gregory, The California Condominium Bill, this issue.

3 “The staple question after demolition should be: What now?”

“What now” may well lead to legislative proposals. If ever we needed the law reviews, it is in this area. It is an area that most of them have sadly neglected. They could if they would take the lead on many timely problems with well-drafted proposals for legislative consideration.” Traynor, To The Right Honorable Law Reviews, 10 U.C.L.A. L. REV. 3, 9 (1962).
“Condominium” has been defined as follows:

A condominium is an estate in real property consisting of an undivided interest in common in portions of a parcel of real property together with a separate interest in space in an apartment, industrial or commercial building on such real property, such as an apartment, office or store. A condominium may include in addition a separate interest in other portions of such 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.

It can readily be seen that the condominium form of ownership of real property is readily adaptable to several types of projects. Besides apartment houses, it is already in use in office buildings. It is adaptable to mobile home parks and small boat harbors. However, its greatest present use is in apartment houses. Because there has been little regulatory experience with other than apartment house projects, most references to condominium projects in this article will be to condominium apartment house projects.

A large amount of structural variation is possible even among apartment house projects. In San Francisco condominium apartment houses have been mostly of the “high rise” variety. In Alameda, Contra Costa, and Marin Counties one and two story “horizontal condominium” structures have been built. In Southern California, a

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4 Taken from proposed statute drafted by representatives of the home building industry. The section quoted would add § 783 to the Civil Code. Some recognition of condominium as a legal mode of conveyance is needed. All public reports issued by the Division of Real Estate for condominium projects contain the phrase: “This division has no knowledge of any statutory or judicial precedent in California for the method of conveyance proposed to be used in this community apartment subdivision.” A similar statement appears in permits issued by the Division of Corporations.

5 Oakland Central Medical Building, Twinbrook Medical-Dental Center, Novato, California; First Federal Savings and Loan Association Building in San Juan, Puerto Rico, built in 1958. Such projects are being built in Utah. Remarks of Keith Romey, Second Condominium Conference, November 8, 1962, San Francisco, California.

6 Remarks of William T. Leonard, Second Condominium Conference. The concept of fee conveyance of cubes of water space for boat storage together with tenancy in common ownership of the pilings, ramps, walkways, service area, clubhouse, parking area, etc., is referred to as the “wet condominium.”

7 The Division of Real Estate filings in the Northern California Regulatory Area show a total of 750 condominium units as of October 1, 1962. Of these 718 represented apartments.

8 “The Hamilton” has a total of 211 units. “Green Hill Tower” has 53 units and “1818 Broadway” has 20 units.

9 E.g., “Everglade Townhouse” in San Rafael (36 units); “Fuchsia Terrace” in Berkeley (7 units); “Ha-Le-Kai Apartments” in San Rafael (22 units); “Wherritt House” in Berkeley (16 units); “Terrace at Peacock Gap” in San Rafael (16 units); “Ha-Le-Kai # 2” in San Rafael (20 units); “Creekside North” in Walnut Creek (46 units); “Ka Ha Le Manor” in San Rafael (51 units). “Golden Marina” in San Mateo, San Mateo County, has 27 units. “Hacienda Carmel,” a retirement center in Monterey County, has 125 units.
variation on the horizontal condominium is in use. Several one or two story buildings are constructed on a single plot of land. The houses, duplexes, etc. are grouped about a central courtyard or swimming pool. Such projects are referred to by the Division of Real Estate as “cluster condominium” projects. Obviously, the regulatory problems, especially local land use regulatory problems, will vary a great deal depending on the type of structure involved.

Community apartments are of three basic forms, although many other variations are possible:

(1) The condominium project in which the land and improvements are owned by the occupants as tenants in common. The airspace of the individual apartments is owned in fee by each apartment tenant. Management of the building and assessment of shares of operating expenses are governed by a management agreement which imposes equitable servitudes, conditions and restrictions on the interest conveyed to the tenants.

(2) The stock cooperative in which the land and improvements are owned by a corporation or trust. Each tenant owns stock in the corporation or certificates of beneficial interest in the trust, along with a long-term proprietary lease to a specific apartment or unit of space. Each shareholder may vote his stock to elect the managers of the building and is assessed for operating costs allocable to his shareholder interest.

(3) The tenancy in common or “deed plan” community apartment house in which the tenants own the land and improvements as tenants in common together with exclusive rights of occupancy of specific apartments. A management agreement similar to that in use in condominium projects controls management of the building and assessment of costs. The tenants elect the managing body. Operating costs are assessed in proportion to the value of each apartment.

The regulatory problems, at the state level, vary less with the form of ownership than with the design of the structure or the method of construction financing. The administrative officers concerned with community apartment regulation of each of the three forms of owner-

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10 Interview with Arthur J. Dermody, Senior Deputy Real Estate Commissioner, State of California.
11 See Friedman and Herbert, Community Apartments: Condominium or Stock Cooperative?, 50 CALIF. L. REV. 299 (1962).
13 See Barber, Co-op—The Deed Plan Community Apartment Project, 36 CAL. S. BAR J. 310 (1961).
ship consider the regulatory problems to be identical as to each type of interest.\footnote{14} Yet the scheme of regulation which has developed along with innovations in the form of ownership of community apartment projects treats each of the three types of developments in a different way.

**The Existing Regulatory System**

The major part of state government regulation of all forms of community apartment developments in California falls under three statutes: the Subdivision Map Act\footnote{15}, the California Real Estate Law (the relevant portion of which is often referred to as the "Subdivided Lands Act"),\footnote{16} and the Corporate Securities Law.\footnote{17}

**The Subdivision Map Act**

The purpose of the Subdivision Map Act is to provide for the regulation and control of the *design* and *improvement* of subdivided property with proper consideration given to the relationship of the property to adjoining areas.\footnote{18} "Design", as used in the act, "refers to street alignment, grades and widths, alignment and widths of easements and right of ways [sic] for drainage and sanitary sewers and minimum lot area and width."\footnote{19} The term "improvement" "refers to only such street work and utilities to be installed, or agreed to be installed by the subdivider on the land to be used for public or private streets, highways, ways, and easements, as are necessary for the general use of the lot owners in the subdivision and local neighborhood traffic and drainage needs as a condition precedent to the approval and acceptance of the final map thereof."\footnote{20}

Control of the design and improvement of subdivisions is vested in the governing bodies of cities and of counties.\footnote{21} The act applies alike to chartered and unchartered cities and counties.\footnote{22} The local governing bodies may pass regulations reasonably required by the

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\footnote{14} Interviews with Donald A. Pearce, Assistant Commissioner of Corporations, State of California; J. P. Mahoney, Administrative Advisor, Division of Real Estate; Arthur J. Dermody, Senior Deputy Real Estate Commissioner; John E. Hempel, Assistant Real Estate Commissioner; Michael J. Masiach, Counsel, Division of Real Estate, State of California.

\footnote{15} CAL. BUS. & PROF. CODE §§ 11500-658.

\footnote{16} CAL. BUS. & PROF. CODE §§ 11000-202.

\footnote{17} CAL. CORP. CODE §§ 25000-26104.


\footnote{19} CAL. BUS. & PROF. CODE § 11510.

\footnote{20} CAL. BUS. & PROF. CODE § 11511.

\footnote{21} CAL. BUS. & PROF. CODE § 11525.

\footnote{22} 29 CAL. OPS. ATT'Y GEN. 49, 50 (1957).
nature of the subdivision.\textsuperscript{22} The act does not deprive local governing bodies of jurisdiction to regulate the division of land which is not a "subdivision".\textsuperscript{24}

Local ordinances relating to subdivision design and improvement must be complied with as a condition precedent to approval of a final subdivision map.\textsuperscript{25} It is unlawful to sell or lease or contract to sell or lease subdivided property until a final map has been approved and recorded.\textsuperscript{26} Any conveyances and contracts made contrary to the act are voidable at the option of the buyer.\textsuperscript{27} Any offer to sell, contract to sell, sale or deed which does not comply with the act is a misdemeanor.\textsuperscript{28}

The Subdivision Map Act applies to:\textsuperscript{29}

any real property, improved or unimproved . . . which is divided for the purpose of sale or lease, whether immediate or future, by any subdivider into five or more parcels within any one-year period; provided, that [the act] shall not apply to the leasing of apartments, offices, stores, or similar space within an apartment building, industrial building, commercial building, or trailer park. . . .

A tenancy in common or "deed plan" community apartment house project of five or more units with exclusive rights of occupancy is subject to the provisions of the Subdivision Map Act.\textsuperscript{30} Likewise, since ownership of an apartment unit in fee encompasses the "right of exclusive occupancy"\textsuperscript{39}, a condominium project is subject to the Subdivision Map Act.\textsuperscript{31} The act has never been applied to stock coopera-

\textsuperscript{22} Ayres v. City Council of Los Angeles, 34 Cal. 2d 31, 307 P.2d 1 (1949).

\textsuperscript{24} CAL. BUS. & PROF. CODE § 11540.1.

\textsuperscript{25} CAL. BUS. & PROF. CODE §§ 11510, 11511, 11525.

\textsuperscript{26} CAL. BUS. & PROF. CODE § 11538.

\textsuperscript{27} CAL. BUS. & PROF. CODE § 11540.

\textsuperscript{28} CAL. BUS. & PROF. CODE § 11541.

\textsuperscript{29} CAL. BUS. & PROF. CODE § 11535.

\textsuperscript{30} CAL. BUS. & PROF. CODE § 11004 provides:

"A community apartment project in which an undivided interest in the land is coupled with the right of exclusive occupancy of any apartment located thereon is subject to the provisions of this part.""This part" refers to Part 2 of Division 4 of the code. Part 2 includes both the Subdivided Lands Act and the Subdivision Map Act.

\textsuperscript{31} 39 CAL. OPS. ATT'Y GEN. 25 (1962). The opinion also indicates that unless each parcel of airspace in a project abuts on a public street, the exception in CAL. BUS. & PROF. CODE § 11535(b) (1) for parcels of less than five acres which abut upon dedicated streets in which street opening or widening is not required by the governing body in dividing the land into lots or parcels and in which lot design meets the approval of the governing body, is unavailable. It is readily apparent that no high rise project could meet these requirements.
Building industry representatives have objected to application of certain local design and improvement ordinances to high rise developments. Such objections are justified in certain situations in which the regulations involved are designed for single story conventional subdivisions. For example, the application of minimum lot size requirements in such a way that the minimum lot is required for each unit in the high rise condominium project serves no useful purpose and defeats the development of what may be a highly efficient use of land in a congested area. Another highly inappropriate requirement is the conventional subdivision map which, when applied to high rise buildings, requires the filing of a difficult three dimensional map when a record of survey map would be sufficient.

Changes in the Subdivision Map Act which would except high rise developments from certain design regulations would be desirable. However, care should be taken to insure local design control over horizontal developments, especially those which include considerable land which is not covered by buildings. A low level, cluster type of development can resemble a conventional subdivision of one family dwellings in all respects except form of ownership. Such a development could utilize either the condominium, tenancy in common or stock cooperative form of ownership. Such a project should not be exempt from any local design or improvement regulations since the problems of land use regulation do not vary with the interests conveyed in structures. It is the type of structure which is important.

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82 CAL. BUS. & PROF. CODE § 11535 covers all "real property" which is divided for the purpose of sale or lease by a subdivider into five or more parcels within any one year period. The section does not apply to the leasing of apartments in apartment buildings. The term "real property" is not to be read as limited to the dividing of interests in the land, in the sense of the solid material of the earth. "Real property" includes all the interests in the real property. The interest of a stockholder-lessee in a stock cooperative apartment house, with a voice in the management of the property and the right to a proportionate share of the sales price upon sale of the property, has been held by the California Supreme Court to be an interest in real property. Estate of Pitts, 218 Cal. 184, 22 P.2d 694 (1933). See also 17 CAL. OPN. ATT'Y GEN. 79 (1951). The exception in CAL. BUS. & PROF. CODE § 11535 for the leasing of apartments in an apartment house would seem to be intended to cover only conventional leases without the other interests which accompany the purchase of a stock cooperative apartment.

83 Friedman and Herbert, supra note 11, at 337.


85 Like the buyer of a subdivision lot, the purchaser of a community apartment is interested in acquiring a home. Like the buyer of a subdivision lot, he is equally subject to imposition or to the legal entanglements which sometimes arise from the financial operations of the property developer; see, for example, Ten Winkel v. Anglo California
It may be true, as some commentators have noted, that the application of specific zoning ordinances and the power to charge the cost of streets and sewers to the benefited property owners can accomplish many of the objectives of the Subdivision Map Act.

If the land on which the project is built is subject to a special assessment or bond for street or other improvements, the assessment or bond must be paid in full or a bond filed with the board of supervisors, as trustees for the bondholders, prior to approval of the final subdivision map. The governing body of a city or county may disapprove a tentative map because of flood hazard or inundation and require protective improvements to be constructed as a condition precedent to approval of the map. Whenever any part of a subdivision is subject to a lien for taxes or special assessments which are not yet payable, the final map may not be recorded until the subdivider files a bond with the county to insure payment of all state, county, municipal and local taxes and current installments of principal and interest of special assessments which are liens against the property but not yet payable at the time of recording the final map.

The Subdivided Lands Act

The Subdivided Lands Act regulates the sale and leasing of subdivided lands. The first step in the regulatory procedure is the filing of a written notice of intention to sell or lease subdivided land with the real estate commissioner. This notice must include such statements as the state of title to the land and the terms and conditions on which the land is to be sold or leased, together with copies of any contracts to be used. The commissioner may investigate any subdivision

Securities Co., 11 Cal. 2d 707, 81 P.2d 958 (1938). It is the objective of the subdivision law to protect such purchasers. 17 Cal. Ops. Att'y Gen. 79, 81 (1951).


See Friedman and Herbert, supra note 11, at 338. Cal. Const. art. XI, § 11 provides in part that "any county . . . may make and enforce within its limits all such local, police, sanitary and other regulations as are not in conflict with general laws." An analysis of a county’s power over the division of land must be directed to the scope of the police power and the question of whether or not the contemplated regulations would conflict with the general law. If a regulation is reasonably calculated to promote the economic welfare, public convenience and general well being of the community, it is a valid exercise of the police power. Miller v. Board of Public Works, 195 Cal. 477, 234 Pac. 381 (1925).

See also 7 Cal. Ops. Att'y Gen. 319 (1946).

See also 7 Cal. Bus. & Prof. Code § 11551.5.

See also 7 Cal. Bus. & Prof. Code § 11601.


See also 7 Cal. Bus. & Prof. Code § 111010.

Ibid.
being offered for sale or lease in this state. Following examination of a subdivision, the commissioner makes a public report of his findings. Lots or parcels in a subdivision may not be sold or leased or offered for sale or lease until the commissioner has issued a final public report. Reservations to purchase or lease may be taken if a preliminary public report has been issued. The prospective purchaser must be given an opportunity to read the public report and must sign a receipt for it. Any reservation agreement signed by a prospective purchaser together with any valuable consideration received must be placed in a neutral escrow depository. The proposed purchaser must be given the option to cancel his reservation without cost or penalty.

The Subdivided Lands Act is designed to prevent fraud and is a “full disclosure” type of statute, carrying criminal sanctions for misrepresentations. The public report is designed to provide the prospective purchaser with a complete picture of the risks he is assuming in the purchase of a subdivision unit.

All tenancy in common or “deed plan” community apartment projects, whether high rise or horizontal, are subject to the Subdivided Lands Act. Likewise, all condominium projects are subdivisions for purposes of the act. Stock cooperatives have never been thought to fall within the scope of the act. However, as in the case of the Subdivision Map Act definition of “subdivision”, the stock cooperative

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48 Ibid.
49 Ibid.
50 Ibid.

51 In re Sidebotham, 12 Cal. 2d 434, 85 P.2d 453 (1938); Cal. Bus. & Prof. Code § 11020.
52 17 Cal. Op. Att’y Gen. 79 (1951); Cal. Bus. & Prof. Code § 11000 provides: “Subdivided lands” and “subdivision” refer to improved or unimproved land or lands divided or proposed to be divided for the purpose of sale or lease or financing, whether immediate or future, into five or more lots or parcels... the leasing of apartments in a community apartment project, as defined in Section 11004, shall be subject to the provisions of this chapter.” Cal. Bus. & Prof. Code § 11004 provides: “A community apartment project in which an undivided interest in the land is coupled with the right of exclusive occupancy of any apartment located thereon is subject to the provisions of this part.”
seems to be within the scope of the definition of "subdivision" in the Subdivided Lands Act.\textsuperscript{64}

The Subdivided Lands Act not only prevents misrepresentations of fact in the sale of subdivided property but also insures the purchaser that he will be able to receive legal title free and clear of any existing blanket encumbrance and other encumbrances upon payment of the purchase price or get his deposit or purchase money back.\textsuperscript{59} The importance of the blanket encumbrance provisions is not to be underestimated inasmuch as they cover not only liens of record, such as trust deeds and mortgages, but all blanket liens which might be foreclosed against the purchaser's interest.\textsuperscript{56} A subdivision becomes subject to a blanket encumbrance from the moment materials are delivered or work of improvement is performed affecting more than one lot of the subdivision.\textsuperscript{57} The danger toward which the act was directed, namely, that the subdivider will not be able to deliver clear title, is particularly inherent in the situation where subdivision parcels are sold under long-term conditional land sale contracts.\textsuperscript{58}

\textsuperscript{64} See note 52, \textit{supra}. As used in the Subdivided Lands Act, the words "lot" and "parcel" (CAL. BUS. \& PROF. CODE § 11000) are not limited to physical parcels of the earth's surface, but include all estates in real property. \textit{17 CAL. OPS. ATT'Y GEN.} 79, 82 (1951).

The word "land" embraces all titles, legal or equitable, perfect or imperfect, including such rights as lie in contract. \textit{In re Pitts' Estate}, 218 Cal. 184, 192, 22 P.2d 694, 698 (1933).

The interest of a stockholder-lessee in a stock cooperative apartment house, with a voice in the management of the property and the right to a proportionate share of the sales price upon sale of the property, is an interest in real property. \textit{Id.} at 191, 22 P.2d at 697.


The stock cooperative also seems to fit the definition of "community apartment" in CAL. BUS. \& PROF. CODE § 11004. See note 52, \textit{supra}. The stock cooperative tenant has the right of "exclusive occupancy" of his apartment, as that term is used in CAL. BUS. \& PROF. CODE § 11004, by virtue of his proprietary lease.\textsuperscript{55}


\textsuperscript{54} CAL. BUS. \& PROF. CODE § 11013.

\textsuperscript{56} 37 CAL. OPS. ATT'Y GEN. 180 (1961).

\textsuperscript{57} Among the title hazards to the conditional sale buyer are the following:

(1) The subdivider fails to make payments on an encumbrance on the individual parcel existing at the time the contract is executed. Although the buyer is current in his payments, the holder of the encumbrance starts foreclosure proceedings and the contract buyer is faced not only with the loss of his home but with loss of his payments as well.

(2) After delivery of the contract, the title holder-subdivider may place subsequent liens on the subdivision lot or may suffer mechanics' liens for both on-site and off-site improvements.

(3) Delinquent tax liens, both federal and state, may be suffered on the property by the seller.

(4) Upon completion of his payments, the buyer may have extensive and expensive litigation to secure title if the subdivider has been adjudicated bankrupt, or the property has passed to his heirs. \textit{39 CAL. OPS. ATT'Y GEN.} 16, 22 (1962). These hazards have been brought under control by \textit{10 CAL. ADMIN. CODE} §§ 2814.1-14.5, issued pursuant to the opinion in \textit{39 CAL. OPS. ATT'Y GEN., supra}.\textsuperscript{58}
The Corporate Securities Law

The California Corporate Securities Law, to the extent of its securities qualification provisions, is a specific permit act. It is designed to prevent deception, the exploitation of ignorance, and all unfair dealings in the issuance of securities.

No company may sell any security of its own issue, or offer for sale, negotiate for the sale of, or take subscriptions for any such security until it has first secured a permit from the Commissioner of Corporations authorizing such sales.

If the commissioner finds that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just, and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities that it proposes to issue and the method to be used by it in issuing or disposing of them are not such as, in his opinion, will work a fraud upon the purchaser thereof, the commissioner shall issue to the applicant a permit authorizing it to issue and dispose of securities, as therein provided, in this State, in such amounts and for such considerations and upon such terms and conditions as the commissioner may provide in the permit.

The Commissioner of Corporations has the authority under the Corporate Securities Law to impose conditions requiring the deposit in escrow of securities, the impoundment of the proceeds from the sale thereof, “and such other conditions as he deems reasonable and necessary or advisable for the protection of the public and the purchasers of the securities.”

The statutory definition of a “security” is broad enough to include almost every conceivable kind of commercial transaction. Section 25008 of the Corporations Code provides:

“Security” includes all of the following:

(a) Any stock including treasury stock; any certificate of interest or participation; any certificate of interest in a profit-sharing agreement; any certificate of interest in an oil, gas, or mining title or lease; any transferable share, investment contract, or beneficial interest in title to property, profits, or earnings.

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60 CAL. CORP. CODE §§ 25000-26104.
61 Dahlquist, Regulation and Civil Liability Under the California Corporate Securities Act, 33 CALIF. L. REV. 343, 348 (1945).
62 Ibid.
63 Ibid.
64 CAL. CORP. CODE § 25500.
65 CAL. CORP. CODE § 25507.
66 CAL. CORP. CODE § 25508.
(b) Any bond; any debenture; any collateral trust certificate; any note; any evidence of indebtedness, whether interest-bearing or not.
(c) Any guarantee of a security.
(d) Any certificate of deposit for a security.

[Emphasis added.]

In one sense every contract is a security because it guarantees to the parties thereto something of value. Obviously, however, no universal guardianship over all commercial transactions was intended by the Legislature in enacting the Corporate Securities Law. The courts have limited the application of section 25008 of the Corporations Code to transactions contemplated by the legislature. Thus, it is not every "note" or "evidence of indebtedness" which, regardless of its nature and of the circumstances surrounding its execution, is included within the meaning and purpose of the act. Likewise, although "beneficial interest in title to property" includes, in its literal meaning, every species of interest in or title to property, inchoate or complete, it is limited in its application to interests which come within the regulatory purpose of the act.

The courts have generally been loath to attempt to define with any degree of finality the term "security." About all that can be said with certainty in an unsettled area is that, for a security to exist, the

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67 Id. at 685, 91 P.2d at 895.
68 Id. at 686, 91 P.2d at 895.
69 Silver Hills Country Club v. Sobieski, 55 Cal. 2d 681, 814, 13 Cal. Rptr. 186, 188, 361 P.2d 906, 908 (1961). "The purchaser of a membership in the present case has a contractual right to use the club facilities that cannot be revoked except for his own misbehavior or failure to pay dues. Such an irrevocable right qualifies as a beneficial interest in title to property within the literal language of subsection (a) of section 25008. (See Yuba River Power Co. v. Nevada Irr. Dist., 207 Cal. 521, 523, 279 Pac. 128; cf. Civ. Code, § 654; Govt. Code, § 54030.)"

The Yuba River Power opinion at 523 quotes 22 R.C.L. 43 (1918) for a definition of "property" as follows: "The term 'property' is sufficiently comprehensive to include every species of estate, real and personal, and everything which one person can own and transfer to another. It extends to every species of right and interest capable of being enjoyed as such upon which it is practicable to place a money value. As applied to lands the term comprehends every species of title, inchoate or complete. It is supposed to embrace those rights which lie in contract—those which are executory as well as those which are executed." (Emphasis added.) CAL. CIVIL CODE § 654, referred to in the Silver Hills opinion, states: "The ownership of a thing is the right of one or more persons to possess and use it to the exclusion of others. In this Code, the thing of which there may be ownership is called property." The final reference in the Silver Hills opinion, CAL. GOVT. CODE § 54030, provides, in subsection (b): "Property" means real or personal property, easement, license, or other right in property.

71 Dahlquist, supra note 60, at 357.
interest offered or conveyed must fit within the literal language of one of the categories in section 25008 of the Corporations Code, and the offer or sale of the interest must amount to the solicitation of risk capital for the development or operation of a business for profit. The latter point of inquiry concerns the type of risk assumed by the purchaser; the expectation of material benefits is unnecessary.

"Since the act does not make profit to the supplier of capital the test of what is a security, it seems all the more clear that its objective is to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another."

Proprietary leases in stock cooperative apartment projects which are sold coupled with shares of stock in the property owning corporation have long been treated as securities. But the question of whether or not condominium units are securities is as yet unanswered.

Each purchaser of a condominium unit receives a tenancy in common interest in the land and all undivided improvements. He also receives a fee simple deed to the airspace within an apartment and may receive additional fee simple interests in the airspace of a parking, storage or balcony area. The interests in air space are usually made determinable upon destruction of the building and a decision of a majority of tenants not to rebuild. Each purchaser may also receive an undivided interest in the reversion which may arise upon destruction of all or a part of the building.

Condominium conveyances all include extensive management pro-

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72 Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 815, 361 P.2d 906, 908 (1961). People v. Davenport, 13 Cal. 2d 681, 688, 91 P.2d 892, 897 (1939): "Those instruments, however, secured or unsecured, which are used for the purpose of financing enterprises and promoting a distribution of rights in or obligations of such enterprises, and which are designed as a means of investment, are termed securities." (Emphasis added.)

74 "It bears noting that the act extends even to transactions where capital is placed without expectation of any material benefits." Silver Hills Country Club v. Sobieski, supra note 72 at 815, 13 Cal. Rptr. at 188, 361 P.2d at 908.

75 Ibid.

76 CAL. CORP. CODE § 25008 provides: "‘Security’ includes all of the following:
(a) Any stock . . . ."


A real property title interest is a “beneficial interest in title to property.” See authorities cited note 69, supra. Such interests may also be “certificates of interest or participation,” “investment contracts,” “certificates of interest in a profit sharing agreement.” Domestic & Foreign Pet. Co., Ltd. v. Long, 4 Cal. 2d 547, 555-6, 51 P.2d 73, 76 (1935).

77 See Friedman and Herbert, supra note 11, at 303.
visions in the declaration of covenants in order to enable a centralized authority to maintain the common facilities and provide common services. Each purchaser agrees that the building will be managed by a board of governors who are elected by the tenants. These elected managers are delegated the authority to enter into all contracts necessary for the efficient operation of the project, including the employment of servants. To provide the funds needed for management of the building and grounds, assessments of individual owners are made. Such assessments are based on estimates and are paid in advance of the actual cost experience in equal monthly installments. If the estimates prove inadequate the board may levy a further assessment. A lien with a power of sale is created on each ownership to secure payments of assessments.

Silver Hills Country Club v. Sobieski seems to be a sufficient precedent to support the conclusion that condominium units which are sold in advance of construction of the building and other facilities conveyed are securities if the proceeds of the advance sales are needed to insure completion of the facilities as represented. The interest which is offered for sale is a “beneficial interest in title to property,” within the literal language of section 25008 of the Corporations Code. What is solicited is the risk capital necessary to carry on the business of developing and selling real property for profit.

However, under the Subdivided Lands Act, the purchasers’ funds are impounded and in most cases cannot be used by the developer until a notice of completion has been filed and marketable title can be conveyed to the purchaser. It may be possible to use the proceeds of advance sales to complete common facilities. At any rate, the application of Silver Hills on the basis of advance sales is limited.

Whether the supreme court would hold that the sale of condominium interests in completed facilities constitutes the sale of a security rather than an ordinary commercial transaction is an open question.

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78 The Declaration of Covenants, Conditions and Restrictions and Power of Attorney of the Green Hill Tower in San Francisco, for example, is an 18 page document providing for such things as the annual meeting, voting by tenants, a maintenance fund, authorized expenditures, bonding of the board of governors and manager, assessments of estimated costs, liens to secure payment of assessments, leasing of areas constructed for commercial operations, limitations on use and occupancy, right of first refusal prior to sale, lease or renting of any unit, right to audit or inspect books and records, etc.


The interest offered for sale to the public is still a “beneficial interest in title to property.” If the board of managers or governors leases certain areas of the building to nonresidents for commercial purposes and distributes the proceeds as income to the tenants, or applies the proceeds in reduction of assessments, the condominium may also be a “certificate of interest,” or fit another category in section 25008.83

The point which is open to speculation is whether or not the transaction comes within the legislative purpose of the Corporate Securities Law. Do condominium purchasers in all cases risk capital so that the act affords them “at least a fair chance of realizing their objectives” in a legitimate venture?84

The Commissioner of Corporations, by administrative interpretation, today treats condominium interests as securities in every case and several permits have been issued for such projects.85 This interpretation is based on an assessment of the risks assumed by the purchaser. He often is faced with the risk that the sales effort will not be entirely successful, with the result that his interest will not achieve its full promised value, and his assessments for operation of the project will be higher than originally estimated. The purchaser runs the risk that the builder’s original estimates are not reasonably accurate as to costs of operation and income from leased facilities, if any; in such event he may be subject to additional assessments which have no ceiling. He runs the risk that management of the facilities will not be efficient and that risks will not be properly insured. He may risk unlimited contract liability for contracts entered into by the management body.86 In some instances he takes the risk that promised services such as medical care for aged tenants or recreational services will not be provided for as represented. By making monthly payments on his assessment of estimated operating costs the purchaser is contributing the working capital necessary for operation of the plant. In short, operation of such a project is attended by all of the risks of a business organization. The condominium purchaser buys into such an organization. These factors would appear sufficient to sustain the Commissioner’s conclusion that the solicitation of risk capital is always involved in condominium sales.

Whatever the result, it would seem to apply with equal force to most tenancy in common or “deed plan” community apartment proj-

83 Authorities cited note 76, supra.
85 Interview with Donald A. Pearce, Assistant Commissioner of Corporations, State of California.
86 Friedman and Herbert, supra note 11, at 311.
Since a tenancy in common interest in land coupled with an irrevocable license is conveyed, a "beneficial interest in title to property" is involved. If interests in the building are sold prior to completion of the facilities and the proceeds of sale are necessary to completion, the sales effort constitutes the solicitation of risk capital here as well as with condominium interests. If an existing building is being sold, the purchaser runs risks as to management and operating cost assessments identical to those assumed by the condominium purchaser. His cost assessments are also the working capital with which the project is operated.

**Conclusions and Suggestions for Legislation**

The above discussion demonstrates the need for a single regulatory statute which would treat all forms of community real property developments, whether stock cooperative, "deed plan," condominium or other variation, in the same manner. There is a need to recognize that the problems of government are substantially the same for all types of community developments.

In every case a use is made of land which has an effect on local land use planning, utility services, adequacy of streets, and lot design and improvement. The precise effect depends, not on the form of ownership, but on the size and design of buildings and other improvements.

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87 In 11 CAL. OPS. ATT'Y GEN. 81 (1948) the Attorney General ruled that where an apartment house owner sells the property to two or more purchasers as tenants in common and each purchaser is designated the owner of a particular apartment in the building, the transaction does not constitute a sale of securities within the meaning of the Corporate Securities Act. This opinion unquestionably conformed to the authorities as they existed in 1948, and is probably still viable today when limited to the facts on which it is based. However, broad reliance on it today as the basis for immunity of all tenancy in common projects is probably misplaced.

The opinion is based on a hypothetical transaction involving an existing building of six apartments. Conveyance to each purchaser of an undivided interest as tenant in common was made through an escrow transaction. No sales, therefore, were finalized until all six purchasers had been secured. No provisions for operation of the building or for income-producing leasing activities existed as an element of the solicitation or sales.

The opinion held that the interests conveyed were outside the legislative purpose of the Corporate Securities Law in that there was "no apparent element of investment in the sense that buyers purchase an interest in the property in the expectation or hope of securing capital gain or interest, the latter being characteristics of a security transaction under the act." (P. 83.) Under the doctrine of Silver Hills Country Club v. Sobieski, the expectation of material gain is not a necessary element of a security today.

The Division of Corporations relies on this opinion as to all "deed plan" community apartment projects and does not assert jurisdiction.

In every case, problems arise as to the ability of the developers to complete the improvements and convey clear title regardless of their own economic entanglements. These problems exist by virtue of the state of the risks involved in the real property development industry. They do not vary with the form of the interests conveyed to the ultimate purchasers.

Problems of enforcing ethical conduct in sales of community apartment interests, with particular regard to misrepresentations and failures in disclosure of essential information, vary with the complexity of the particular transaction. This complexity, however, is less a product of the legal form of the interest conveyed than of the size of the project and the number and kind of services sought to be furnished to residents of the development. The management agreement in a stock cooperative project can be as complicated as the statement of covenants and conditions in a condominium project. Likewise, the ability of laymen to understand the package that is offered to them, even given full disclosure, depends on the complexity of the particular project.

With this background in mind, we find that tenancy in common or "deed plan" community apartment projects are subject to the Subdivision Map Act and the Subdivided Lands Act, but sales of the apartments are not regulated by the Division of Corporations. Stock cooperative projects are not regulated under the Subdivision Map Act or the Subdivided Lands Act but are regulated by the Division of Corporations. Condominium projects are subject to the Subdivision Map Act and the Subdivided Lands Act, and the Division of Corporations asserts jurisdiction over all such interests. An apartment buyer in a cooperative or condominium project must buy from a licensed stockbroker, while a deed plan buyer deals only with a real estate broker. There is no utility in this kind of diverse treatment.

The problem is magnified by the fact that much of the regulation which does exist today is inappropriate to the interests involved. New forms of property developments have been forced into regulatory schemes which were developed for wholly different purposes. Thus, the Subdivision Map Act contains many provisions which were designed to cope with the problems of the conventional subdivision, but which are inappropriate to high rise apartment houses. Minimum lot size requirements, for example, should never be applied to each apartment in a high rise building which is subdivided in horizontal planes above the surface of the land. Neither should a developer have to file three dimensional maps which depict the various horizontal planes conveyed. A record of survey map should be sufficient.

Dual regulation of apartment sales under both the Subdivided
Lands Act and the Corporate Securities Law places an unnecessary burden on developers. The filing of two sets of fact statements, the payment of two fees, the necessity to deal with additional people, etc. are considered burdensome by the industry. In addition, the application to a real estate transaction of the requirement that securities be sold by licensed stockbrokers is objectionable.

Regulation under a fair, just and equitable standard should not depend on whether or not the building which is being sold is completed at the time sales are first made to the public. Yet this may be the state of the law as to condominium and “deed plan” projects today.

A permit system of sales regulation is needed with a “fair, just and equitable” test such as that of the Corporate Securities Law. Whether all community apartment interests are securities or not, the complexity of the transaction and the degree of the risks assumed by purchasers of such interests demand that the entire transaction be subject to review by experts who are qualified to pass on its basic fairness.

So long as the purchaser was merely buying a house in a conventional subdivision, a full disclosure law had some hope of success. But it does not work as to community developments today. As the terms and conditions of the transaction become more complex and the risks to the purchaser are increased, the transaction eventually exceeds the understanding of the ordinary layman, and the full disclosure approach loses its effectiveness.

Today, the purchaser of a community apartment sold under a permit issued pursuant to the Corporate Securities Law has the protection that the Commissioner of Corporations has examined the operative feasibility, the adequacy of financing, insurance, and of the reserves for completion and maintenance of community facilities for medical, 

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90 CAL. CORP. CODE §§ 25005, 25006, 25700.
91 CAL. CORP. CODE § 25507.
92 The need for examination by experts of real estate promotions involving future costs to be borne by the purchasers of beneficial interests in real property is amply illustrated by the many failures of golf club promotions throughout the country, costing the purchasers of “life memberships” millions of dollars. See Changing Times, Sept. 1961, p. 41 and The Wall Street Journal, Dec. 28, 1961, p. 1, col. 1. One chief problem pointed out in these reports is that initial entry costs and estimates of future operating expenses are often kept unrealistically low in order to present an attractive deal. The result is often failure of the entire project because of underfinancing.
93 For example, the public report of the Division of Real Estate for “Hacienda Carmel” is almost two and one-half legal size typed pages in length. It summarizes many complex provisions concerning escrows, liens, securing assessments, terms and conditions of ownership, waiver of partition, etc.
recreational, restaurant, and other services. The buyer has the assurance that the conditions of the sale and the plan for management of the project have been analyzed and have been found to be fair, just and equitable, and that the builder will conduct the sale of the apartment units justly and honestly. On the other hand, the purchaser of an apartment under the Subdivided Lands Act (i.e., a tenancy in common or a condominium for which a builder did not secure a permit) has only the benefit of a public report which, at best, merely discloses the risks.

With the prospect of a much greater demand for community homes, the new statute should give the community home buyer the same type of protection which is now afforded investors in and purchasers of real estate securities.\(^4\)

There is a need for expert examination of estimated future operating expenses of the project to insure that purchasers of limited means are not presented with a rosy picture based on unrealistically low estimated assessment charges. Such charges could later turn out to be beyond the resources of the tenant. Such a person could lose his entire interest by exercise of the power of sale which accompanies all assessments of operating costs.

Many similar tragedies occurred in California during the early years of the great depression. Community apartment purchasers, many of whom were able to make the tax and mortgage payments allocable to their own apartments, lost their entire interest by the unexpected foreclosure of the master mortgage when they could not meet the increased assessments which resulted from the defaults of their fellow tenants.

If sales are to be made in advance of completion of the project the regulatory authority must have the power to escrow the proceeds of early sales until enough sales are made to insure completion of the project and the success of the sales effort.\(^5\) Such power now exists under the Corporate Securities Law.\(^6\)

Condominium and tenancy in common community apartment purchasers can face unlimited tort liability to third persons for injuries caused by unsafe conditions existing on the premises and for the acts of servants employed to provide common services.\(^7\) For this

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\(^4\) CAL. CORP. CODE § 25507; CAL. BUS. & PROF. CODE §§ 10238.2-38.4.


\(^6\) CAL. CORP. CODE § 25508.

\(^7\) Friedman and Herbert, supra note 11, at 313, 314.
reason, the regulatory agency should have the authority to set minimum standards of insurance coverage for the protection of tenant-owners.

Because the management board of condominium and tenancy in common community apartment projects can incur unlimited contract liability for the tenant-owners, it is important that annual elections of the board be assured. Inspection of financial records and periodic financial reports to the tenant-owners should be required. Some provision for auditing of the books should also be provided.

The regulatory agency should have the authority to issue regulations consistent with the "fair, just and equitable" standard, in order to take care of any other problems which may develop.

It would be desirable to regulate all condominium, stock cooperative and "deed plan" projects under a single community real estate development act, administered by a single agency. Such a law could insure that local land use regulations appropriate to community developments of various designs are complied with. The fairness of the sales program and the requirement that only clear title interests be conveyed in projects whose success is assured can be accomplished through a permit regulatory program in the same act. Under a permit program, the public report provisions of the Subdivided Lands Act would serve no further purpose and could be dispensed with as to community developments.

The adoption of such a community real property development law would have the effect of releasing builders from inappropriate and burdensome regulations, thereby promoting the construction of projects which present an efficient and desirable use of land in urban areas. At the same time the purchasing public would be adequately protected. The resulting increase in public confidence in community home ownership would be a boon to those developers who present feasible and attractive projects to the consumer public. Such developers undoubtedly account for the vast majority in the industry.

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98 Id. at 311, 312.
101 Ibid.