# Real Property, Probate and Trust Law Newsletter

Summer 2013

The Newsletter of the Pennsylvania Bar Association Real Property, Probate and Trust Law Section • Issue No. 73

## SECTION REPORT:
## From the Chair

*By Louis M. Kodumal*

As the new chair of the PBA Real Property, Probate and Trust Law Section (RPPT), I would like to take this opportunity to thank my colleagues for their vote of confidence in electing me to this position. I would also like to thank my predecessor, Aubrey Glover, for her leadership and significant work this past year in leading our section. During my term as chair, I intend to focus on the following priorities: (1) working with the Legislature to shape relevant legislation, using the resources available through the PBA legislative department, governance process and administration; (2) advising our members of developments in the fields of real estate, probate and trust law; and (3) increasing section membership, by demonstrating how membership in the RPPT Section adds great value to PBA membership and through related efforts.

Please join me in congratulating and thanking Nancy Glidden, Linda Enion and Ron Friedman, who have completed their current terms on RPPT Council. Our newest members of the RPPT Council are Karen Kinney (Probate and Trust Law), John Metzger (Probate and Trust Law), David Weixel (Real Property) and Neil Stein (Real Property). Additionally, Past Chair Bridget Whitley will serve as the RPPT delegate to the PBA House of Delegates for a two-year term. We are fortunate that the RPPT Council continues to feature an experienced and skilled group of practitioners, and we look forward to the contributions of our newest members to the RPPT Council.

I strongly believe that the progress that we have made as a group is reflected in our section's efforts to work cooperatively with other PBA sections in matters of mutual concern. For example, at the 2013 PBA Annual Meeting recently held in Pittsburgh, the Joint Recommendation and Report on Senate Bill 258, P.N. 143 (relating to actions to quiet title to severed subsurface rights to real property) prepared by the RPPT Section and the Environmental and Energy Law Section (EELS) was approved by the PBA Board of Governors and House of Delegates. We continue to work with the PBA Municipal Law Section to monitor proposed legislation affecting real estate tax sales throughout the commonwealth. Informal comments from practitioners within RPPT and other PBA sections regarding the new proposed Orphans' Court rules have been submitted to the Orphans' Court Procedural Rules Committee of the Pennsylvania Supreme Court.

These are just a few examples of the projects that your section's leadership has been undertaking in recent months. With your assistance, we can continue to grow as a section and enhance the practice of law for our members. I encourage you to become more involved with section programs and initiatives, and I welcome any suggestions and comments that the readers of our newsletter may have for improving the RPPT Section. ■

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*Louis M. Kodumal of the Law Offices of Vincent B. Mancini & Associates in Media is chair of the section.*

## Inside the Summer 2013 issue

Interested in contributing to the next RPPT Section Newsletter? ............ 2
REPORTS:
Probate and Trust Law Division ............ 3
Real Property Division ............ 4
ARTICLES:
U.S. Supreme Court Issues Important Land Use Decision in *Koontz v. St. Johns River Water Management District* ............ 8
Converting an Existing Condominium into a Planned Community ............ 11
'Sole Use' Trusts and Disclaimers ............ 12
Joint State's Amazing Record and Report ............ 14
The New Pa. Inheritance Tax Exemption for Qualified Family-owned Business Interests ............ 18
Scenes from the 2013 RPPT Section Annual Meeting. ............ 22
Section Leadership List. ............ 23

## ARTICLE:

# Converting an Existing Condominium into a Planned Community

*By Marshal Granor*

So simple, a child can do it.

How hard could it possibly be to follow the step-by-step instructions in a statute? It seemed like an easy assignment. My client created a townhouse condominium community a few years ago and, because of the real estate economy doldrums, chose (or, perhaps, was forced) to retain half of the units as rentals.

The owner-occupants tried to refinance when rates fell to historic lows, which is when they encountered the discriminatory policy the mortgage lenders have toward condominiums. Admittedly, condos led the fall in real estate values in states like Florida and Arizona. One reaction was limitations on the number of loans the Federal Housing Administration (FHA) will insure in any one condominium community. Additionally, there continue to be major issues in obtaining favorable appraisals of condos to allow for sales and refinances.

But the big story in residential condominium sales and finance continues to be the limit the Federal National Mortgage Association (FNMA) and FHA place on the number of investor-owned units in a condominium community. While this is not a new phenomenon, builders (and lenders in possession) were stuck with built inventory, and some owners were forced to become landlords because they simply could not sell at a price high enough to pay off their mortgage. Thus, some condominiums saw their investor rate exceed lender limits, making their condominium "non-conforming." To obtain a loan on a non-conforming condo unit requires finding a portfolio lender, and these typically charge higher fees and interest rates than a conforming loan.

As of this writing, FHA, FNMA and Federal Home Loan Mortgage Corporation (FHLMC) have raised their limit temporarily to 50 percent investor units. This means if any one of the sold homes in my client's community is rented, and the developer owns an even 50 percent, a buyer cannot obtain an FHA-insured loan or a FNMA/FHLMC-compliant loan, even if it is for a sale from an investor to a resident owner, thus curing the "over half" prohibition.

Rather than fight to find a lender willing, for higher returns and fees, to hold a non-compliant loan in their portfolio, my client and the resident owners had a brilliant (?) idea. Let's terminate our condominium regime and replace it with a planned community. After all, these were townhouse-shaped condo units which should have been in a "PUD[1]" planned community format from the outset.

Now how hard could that be?

Being unable to find a colleague who had done this type of conversion before – after all, who wants to be the first to venture into the dark woods of this topic all alone – I invented my own procedure. What follows is my conclusion of the process for converting a Pennsylvania Uniform Condominium Act[2] (UCA) condominium to a Uniform Planned Community Act[3] (UPCA) format. I do not present myself as the ultimate authority on this subject. I would be pleased to hear from other practitioners with their experiences and views on the subject. Perhaps we can continue the dialogue on the Real Property, Probate and Trust Law Section listserv.

To start, we need to combine the rules for termination of a condominium set forth in the UCA with the direction, if any, in the existing declaration of condominium.

**§3220. Termination of Condominium** sets out the process, which I summarize as follows:

1. Obtain a termination agreement executed by at least 80 percent of all unit owners (or a greater number, if required by the declaration). In our scenario, the declaration required "at least 90 percent" owner approval.

2. The termination agreement must be recorded within one year of its adoption or first execution by a unit owner. (In fact, this association attempted to terminate once before, and they did record the termination agreement. But it was recorded 14 months after the first signature was affixed, so it was void from the start.)

3. If the condominium is not being sold off in bulk (and our units were not such a bulk sale), the unit owners become tenants in common with each other, maintaining the exclusive right to occupy their former home. Liens "shift" to remain in force on the new ownership unit.

4. Lenders must be notified of the termination, but the law is silent regarding approval of the new documentation. Do the lenders have to consent to the recordation of the new planned community declaration? What if lender rights are significantly changed or reduced in the new regime's declaration? Nothing in the law requires the language protecting existing secured lenders in the condominium declaration to be maintained in the planned community documents.

The above – obtaining the affirmative approval of 90 percent or more of the unit owners – may sound daunting enough. Add to that the right of secured lenders to approve or veto this process. The statute permits mortgagees to have certain rights. FNMA and other agency requirements have insisted lenders have the right to approve any dissolution of the condo regime. Looking to our declaration, "Permitted Mortgagees" – those who file a request for notifications with the association – must affirmatively approve a major amendment to the

*(Continued on Page 16)*

**ARTICLE:**
**Converting an Existing Condominium into a Planned Community**

*(Continued from Page 11)*

documents by a 51 percent vote. One assumes complete annihilation of the condo regime would constitute a "major amendment."

But our condominium, as most across the country, has no Permitted Mortgagees. Not one lender has come forth to request notification of association actions. Thus, we have lender apathy. How can we obtain their approval for this termination?

Fortunately, UCA **§ 3221. Rights of Secured Lenders** provides a deemed approval from lenders after 45 days, if the process therein is followed strictly. This requires: notice "...at the address of the secured lender endorsed on any mortgage or deed of trust of record **and** at the address to which the unit owner mails any periodic payment paid to the secured lender. The notice to the secured lender shall include a statement of the specified action and a copy of the full text of any proposed amendment and a form prepared by the association upon which the secured lender may indicate its approval or rejection of the specified action or amendment..."

Thus, to properly notify each lender, we needed to obtain a copy of the recorded mortgage (for the official address on the recorded form) as well as the lender's current mailing address for payments. This second notice address proved impossible in some cases because we learned many owners make mortgage payments electronically and thus have no postal "mailing address" for their lender.

There is a list of items to be sent to the lenders, found in this UCA section. Therefore, to get to the point of an up or down vote, we needed the following documents drafted and information obtained:

a. Confirm ownership names and addresses of unit owners;
b. Agreement of owners to terminate the condominium;
c. List of all lenders and their two relevant addresses;
d. Letter of explanation to lenders, including proposed new declaration and bylaws;
e. Return letter of approval/disapproval from lender;
f. Current title search, showing any liens and judgments against the condominium association, as well as all recorded restrictions and agreements; and
g. The standard requirements to start a new Planned Community, being:
    i. Declaration of Planned Community (with Plats and Plans);
    ii. Legal description of the outbounds of the property;
    iii. Legal description of newly-created common elements to be owned by the Planned Community Association;
    iv. Bylaws of the new association corporation;
    v. Deed of common open space from all owners (who are momentarily to be tenants in common) to the Planned Community Association;
    vi. Budget for the new Planned Community Association; and
    vii. Public Offering Statement for declarant, if needed for the remaining homes to be sold.

That is a huge amount of work and especially daunting if one is unsure of the result of the owner vote. In our case, we had 100 percent approval of the concept before drafting began. The wildcard was lender approval. They had 45 days to approve, reject or, as expected, say nothing. In fact, if they understood the process, they knew many loans would be refinanced and paid off to obtain lower rates once the termination was accomplished. Would that constitute a reason for a lender to disapprove of the termination? Would lenders withhold approval to retain higher yielding loans, or would they be relieved to be rid of a mortgage on a hard-to-sell condominium unit?

We were able to reduce costs to our clients by having the original engineer redo the condominium declaration plat as a planned community declaration plat. Other than a few changes to dates and titles and adding unit boundaries around each townhome, the plat remained basically the same.

The engineer prepared a legal description of the common elements since, in a planned community, the association must take title to common elements.

Who is the grantor? Because the former condominium unit owners are temporarily tenants in common, we concluded all owners had to join in the conveyance of common elements to the new association. But, the statutory minimum to terminate requires only 80 percent of the condominium owners, and our documents required 90 percent. What happens if someone objects and refuses to sign the deed conveying the open space? The UCA and UPCA do not address this dilemma.

While we waited for the result of our notification to the lenders (required to be via regular U.S. mail, with "Certification of Mailing"), we contemplated a few academic questions:

1. If you can terminate the condominium with an 80 percent vote, what happens when there is opposition by a minority of owners? If they refuse to sign the deed to the common elements or the new declaration, can they effectively secede from the regime? What happens to their use of the common road or clubhouse?

2. What do we do if lenders object? Is there a way to appeal their decision? Is there even a person in most national lenders who would understand what we are trying to accomplish?

3. How do title companies deal with the priority of liens after the conversion takes place?

4. Does a foreclosure on a loan dated 2006 dislodge the declaration recorded in 2013?

While waiting out the 45-day lender approval, we began work on the remaining formation issues:

*(Continued on Page 17)*

## ARTICLE: Converting an Existing Condominium into a Planned Community

(Continued from Page 16)

1. Incorporate new association and hope the name we checked in Harrisburg is still available;
2. Obtain the employer identification number (EIN) for the new association;
3. Open bank accounts for the new association;
4. Obtain insurance for the new association:
   a. Public liability
   b. Fidelity coverage for board members and officers
   c. Directors' and officers' insurance
   d. Errors and omissions insurance
   e. Property coverage for common elements; and
5. Remind unit owners they will need primary homeowners' insurance coverage on the date of recording the new declaration.

Our checklist for action after the termination of condominium is recorded and the new association is in place is:

1. Hold elections for new executive board members (unless the termination agreement positions condo board members as the new Planned Community Association board);
2. Final accounting of old association, and tax filings;
3. Dissolve or terminate old condo association corporation; and
4. Close checking account and transfer funds into new association name.

In fact, our lenders cooperated by not replying, and we were able to proceed with our plans. One owner had been out of the country, so we had to wait for his return to execute the termination agreement, common element deed and new declaration.

It could have been anticlimactic. And it should have been. The title company sent our documents, in proper order, to be recorded electronically:

1. Termination Agreement;
2. New Declaration of Planned Community with Declaration Plats and Plans as exhibits;
3. Deed to Common Elements.

And that is when the open space deed was rejected for lack of a tax parcel number and lack of a transfer tax affidavit of value. In fact, the open space in a planned community may not have an assessed value, since its intrinsic value is included in the purchase price paid for each home in the community. (See § 5105 (b) – Separate titles and taxation). Nevertheless, the City of Philadelphia, as some other counties, requires the non-assessable land to have a parcel identification number, so we waited while the city supplied a number. It took three attempts for the title company to successfully record the new declaration, and then we were done.

Was it as complex as it seemed while we were in the midst of the process? Yes and no. I was able to write out the steps to be taken, but many homeowners were confused by the details. It did require having someone well-versed in the procedure to watch over it and prod owners and board members to act quickly and completely. A notary public close by was a major plus.

The process is complete as I write this article. Other condominium associations have asked if they, too, could benefit from a conversion to planned community association form. In one case, the condo contains stacked units. If they become a planned community, will lenders continue to state, "You only have two choices, PUD or condo. If it stacks, it's a condo."

This puzzle is being promoted by the appraisal community. But that is a conversation for another day. ■

[1] PUD is not a term of art. It can mean "Planned Unit Development" or "Planned Urban Development." The City of Philadelphia's Office of Property Assessment seems to use PUD to mean a set of attached homes, perhaps where there is an association to own and control open space or storm water features. But PUD is not a zoning classification, and in many locations, a PUD must have both residential and commercial components. We prefer the precision of Planned Community, per the UPCA.

[2] Uniform Condominium Act (UCA) 68 Pa.C.S. § 3101, et. seq.

[3] Uniform Planned Community Act (UPCA) 68 Pa.C.S. § 5101, et. seq.

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## ARTICLE: 'Sole Use' Trusts and Disclaimers

(Continued from Page 15)

**Summary**

**The decision whether to pay inheritance tax at the death of a married decedent or postpone the payment of the tax until the death of the surviving spouse through the use of a "sole use" trust can be a difficult one. For a testator who wishes to have a trust for the surviving spouse but also wishes to include children and grandchildren as discretionary beneficiaries during the lifetime of the surviving spouse, drafting a will with disclaimer provisions may allow the trust to be converted to a "sole use" trust through post-mortem disclaimers by the children of their discretionary interests, as well as disclaimers of similar interests of their own children. While court approval of the disclaimers may still be necessary, the disclaimer provisions in the will should do no harm and could facilitate the approval of the disclaimers.** ■

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