DEVELOPER LIABILITY FOR "BENEFITS DERIVED" AND REAL ESTATE TAXES FOR PHANTOM UNITS IN CONDOMINIUMS AND OTHER COMMON INTEREST COMMUNITIES

By: Wendell A. Smith, Esq.

On August 14, 2015, the Appellate Division of the New Jersey Superior Court rendered an opinion in the case of High Point at Lakewood Condominium Association, Inc. v. the Township of Lakewood, which concluded that 136 unbuilt or phantom units within a condominium were subject to real estate taxation. In addition, the decision recognized the potential for the imposition of common expense assessments against such units, both retroactively and on a prospective basis.

In reaching its decision, the Court stated that the liability of the owner(s) of unbuilt or paper units in a condominium for common expense assessments is consistent with liability for taxation. The Court also stated that phantom units could be assessed because N.J.S.A. 46:8B-17 of the Condominium Act did not include any limitation on the assessment of common expenses to be charged to owners of partially built or unbuilt units, and that the regulations promulgated under the Planned Real Estate Development Full Disclosure Act (PREDFDA) contemplated assessments on units "individually owned and under development, in proportion to the benefit derived by the unit from the items included in the budget."

Importantly, the Court might have reached a different conclusion if there were any provisions in the master deed or by-laws for the High Point at Lakewood Condominium which provided for other proportions for the sharing of common expenses to be charged against each unit as permitted by N.J.S.A. 46:8B-17 and by the New Jersey Department of Community Affairs (DCA) in the administration of PREDFDA registrations for common interest communities. Presumably no such provisions existed.

As most developers of common interest communities and their attorneys are well aware, the assessment and calculation of "benefits derived" is a pervasive and unsettled issue in New Jersey. No formal guidelines have been promulgated by DCA and such claims are usually fact sensitive and are resolved on an ad hoc basis between developers and the associations which administer and manage the common interest communities which have been developed. Unfortunately, the High Point Court remanded this aspect of the case to the trial court and therefore shed little light on these issues. It did, however, recite a litany of cases in other jurisdictions which found no distinction between built and unbuilt units with respect to the assessment of common expense charges. Moreover, the Court also identified an Oklahoma case which stated that under Oklahoma statutory law the establishment of a unit requires construction of a unit "rather than an idea expressed on paper." Without being presumptuous, a legislative or regulatory initiative by NJBA regarding the calculation of common expenses for unbuilt units for "benefits derived" should be considered in order to provide much needed and long overdue guidance.

The High Point case is a complex one which addressed a variety of other issues, such as the validity of the developer's reserved power of attorney, a partial revocation of the Condominium, the foreclosure of tax sales certificates for the phantom units, statutes of limitations and equitable defenses, issues that are beyond the scope of this article. Importantly, however, the Court did endorse the concept of phased development to help minimize liability for taxes and common expense assessments when it stated "if a developer is uncertain whether economic conditions will justify the complete build out of a planned condominium, the developer

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Wendell A. Smith is a Partner with Greenbaum, Rowe, Smith & Davis LLP. Mr. Smith has practiced real estate law for over fifty years, and is widely recognized as one of New Jersey's preeminent authorities on the legal issues impacting condominiums and common interest communities. Throughout his career he has provided practical and sophisticated representation to developers, lenders, and hundreds of condominium, cooperative and other common interest communities. Mr. Smith is a Charter Member of the College of Community Association Lawyers of the Community Associations Institute. He is General Counsel Emeritus and Founding President of the Community Associations Institute's New Jersey Chapter and Co-Author of New Jersey Condominium and Community Association Law (Smith, Estis & Li, Gann Law Books, 2015). He can be reached at (732) 476-2420 or wsmith@greenbaumlaw.com.

PRESIDENT'S MESSAGE

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plan and the many committees that bring welcome member volunteers to tackle the many tough issues facing our industry.

We know that construction has improved recently due to a growing economy and rising consumer confidence. This signals the start of many new projects coming on line over the next few years. Given this, I would like to have a team of subcontractors who have the best interests of our industry at heart, and I'm confident that you are one of them. Please read the information I've enclosed so you understand the value of membership and how joining can put money back in your pocket.

As an added point, the check you are receiving today for work performed for my company is, in large part, due to the efforts of the (local HBA) on behalf of the building industry.

Uniting together through the (local HBA) will only help improve all of our futures.

Sincerely,

Builder Member, Inc.

-----End Sample Letter-----

Consider adding to your signature any NJBA or Local Chapter leadership position, i.e. - President, State Director, Local Officer, Committee Chairmanship, etc. and perhaps the number of years you've been a member or the year you joined. This demonstrates your personal membership commitment.

In conclusion, the officers and I thank you for your commitment to NJBA and we ask that each one of you assist us in our goal to double our membership this year!

DEVELOPER LIABILITY

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may approach the project in phases, adding new sections to the master deed as conditions permit, rather than to attempt to withdraw unbuilt or unsold units from the condominium." The concept of phasing is not new and has also been used in other contexts, including compliance with the presale requirements of lenders and the preservation of flexibility of design and housing mix to meet the demands of the marketplace. In the absence of any statutory or regulatory amendments to eliminate or clarify "benefits derived" liability for unbuilt units, phasing of common interest communities remains a viable and prudent approach to limiting the common expense liability of developers for phantom units. The establishment of independent condominium regimes on a smaller scale with separate associations may also represent an effective alternative.

In conclusion, a developer of a common interest community of any magnitude, whether a condominium or fee simple development, would be well advised to subdivide the property into smaller independent parcels rather than to initially incorporate all of the buildings under a single master deed or declaration. This approach will help to minimize or avoid the liability of phantom units for "benefits derived" or real estate taxes because they do not exist under the legal documentation for the development until they are added to the community after they are completed.

WELCOMED SEQUEL

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coverage to builder-developers and the building industry state-wide where claims of faulty workmanship and property damages are alleged by aggrieved homeowners, homeowner's associations or other similarly situated parties, and where the work at issue was performed by subcontractors.

Each of these cases keyed into the subcontractor's exception to the "Your Work" exclusion (which exclusion, again, does not apply to the damaged work or the work from which the damage arises was performed on the contractor-builder insured's behalf by its subcontractor(s)). The "subcontractor's exception" is included in the more recent 1986 ISO standard form CGL policy that, presumably, most of NJBA members will have. NJBA members and associates should take note of these recent decisions, re-examine existing CGL policies they have, and further take the import of these decisions under advisement when looking to place or renew CGL policies for projects coming on line.

FN 1 – Belmont Condominium Association, Inc. v. Arrowpoint Capital Corporation, et al., No. A-4187-12T4, 2015 N.J.Super. Unpub. LEXIS 1749 (App. Div. July 21, 2015).

FN 2 – Bob Meyer Communities, Inc. v. James R. Slim Plastering, Inc., et al. v. The Ohio Casualty Insurance Company, et al., No. A-5581-12T1, 2015 N.J.Super. Unpub. LEXIS 1754 (App. Div. July 21, 2015).

FN 3 – Cypress Point Condominium Association, Inc. v. Adria Towers, LLC, et al., ___ N.J.Super. ___ (App. Div. 2015), 2015 N.J.Super. LEXIS 114 (App. Div. July 9, 2015).