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Forms of Housing Ownership

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# Forms of Housing Ownership

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Once you have decided to purchase a home you forego one of the four forms of holding or owning property available to Michigan residents. The four choices you have are 1) renting (leasehold), 2) fee simple ownership, 3) cooperative ownership, and 4) condominium ownership. When you decide to purchase a home, your main concern then becomes which of the last three will best satisfy your or your family's situation, needs, and financial resources.

An important point to keep in mind when you invest in real estate is that, in a legal sense, you never completely own that home or the property on which the home is located. What you do own when you purchase a home is the right to use that property, subject to the rights of any others who may have an interest in the property. The form of ownership you decide upon, fee simple, condominium, or cooperative, will determine what rights you possess.

In legal terms, the home you will buy is usually referred to as real estate or real property. These terms refer to a specific, well-defined portion of the earth's surface (land or water or both) together with the air above the surface and the matter below the surface. In addition, they refer to things growing on the land, such as trees or crops, and any structures that are permanently affixed to the land such as dwelling units or other forms of buildings.

## Fee Simple

The oldest and the most popular form of ownership in Michigan is fee simple ownership. Under this form of ownership, the property owner is entitled to all of the rights and privileges to use the property as he or she sees fit for an indefinite period of time. These rights and privileges, however, are not absolute.

Through restrictions such as zoning laws, deed restrictions or building codes established by local governing bodies, absolute ownership of rights to property is curtailed. The state, as well, restricts your rights to full ownership by such policies as eminent domain, under which the government has the right to claim your property or portions of your property for the common good of the citizenry. Despite these restrictions, however, fee simple ownership does grant the owner the most substantial rights to use, maintain, improve and dispose of or pass on the property to others.

Proof of ownership in fee simple rests in the **title** to the property. This document specifies the totality of rights in the property held by the party in possession of a piece of land. If some rights to the use of land have been divided, for instance, or given to others at some point in time, this should be specified in the title. Examples of how this could happen are numerous. Mineral rights, for example, could be relinquished, or the property could be passed to two children of elderly parents instead of to one. To prevent problems which can result from this type of division of rights, each county in Michigan has a recorder's office which has responsibility for keeping records regarding the transactions on property in the county. Needless to say, some transactions or subdivisions, or relinquishment of rights to property may have been overlooked as property has changed hands in the past 200 years. Thus, securing legal advice when you purchase the rights to a piece of property becomes almost mandatory. Lawyers can search the records of title or an abstract of title and give you a somewhat clear picture as to the totality of your rights regarding the property you wish to purchase.

A second form of protection available to you is **title insurance**. In this instance, a company specializing in the business of searching titles conducts a study

of the title to the property you are considering. If satisfied that the title is clear of rights having been passed to others the company will insure the title for a one-time premium. If problems arise in the future, such as the long-lost son of a previous owner or an ex-spouse appear and claim an interest in the property rights, the company will pay for any financial costs resulting from covered defects in title as well as pay any legal costs necessary to clear the title.

In Michigan, the seller can legally be required to provide an owner's title insurance policy, which pays for legal costs and claims resulting from covered defects in title. A purchaser should require the seller to provide an owner's title policy to provide protection against defects in title.

A second special document, the **deed**, is used by the seller of the property to convey his ownership rights to you, the buyer. There are three basic types of deeds used in Michigan: Warranty Deeds, Limited Warranty Deeds, and Quit Claim Deeds.

A Warranty Deed conveys all of the seller's interest in the land, under the provision that the seller guarantees that he is the owner of the title, and that the title is free of all defects other than those he has specified in the deed. If defects later become known, under this form of deed conveyance, the seller is liable and is supposed to protect the buyer's interests.

The Limited Warranty Deed, on the other hand, does not contain a general warranty of title. It limits the seller to only offering a warranty on acts concerning the property which the seller took part in. Thus, the seller is making fewer promises regarding his clear ownership of the property.

The Quit Claim Deed offers the buyer the least assurance that the title is good. Under this form of property conveyance the seller passes to the buyer only those interests, if any, he may have in the property, and the seller offers no guarantee that the title to the property is free of defects.

Keep in mind that the warranty deed, although superior to the other two forms of deed conveyance, is only as good as the person conveying the deed. If for example, the seller is not financially capable of meeting the warranty, or if the seller cannot be located so he can be forced to honor the warranty, the deed has little security.

## Advantages and Disadvantages of Fee Simple Ownership

For many families, exclusive ownership of the rights to property has been one of the safest financial investments and best hedges against inflation available. Over the years, the value of residential property has generally increased at a rate similar to or greater than

inflation, while the costs of the mortgage remain constant once the mortgage is secured (the newer variable rate mortgages and graduated payment mortgages are exceptions). The owner also has a form of forced savings with a mortgage due to the equity built up through payments on the principal amount of the mortgage loan. In addition, over the years the cost of a home mortgage (interest on the mortgage) has generally been less than other forms of credit, thus providing a somewhat inexpensive way to use someone else's money. This form of property possession may allow the home buyer tax savings as well because property tax and interest payments on the mortgage are deductible for federal income tax purposes if you have enough deductions to itemize rather than take the standard deduction (zero bracket amount). The final advantage is the freedom to use, maintain and improve the property at will.

Fee simple ownership does involve disadvantages, however. Transfer (selling costs) and initial costs (down payment and closing costs) are not insignificant. Investment potential for the buyer is limited due to the fact that a large down payment is required, continued monthly payments must be made and the commitment to this type of investment is long term. The belief that the value of a property will increase and thus return a financial reward is a risk that may not pay. Some monthly outlays such as maintenance, repair, and utilities are quite unpredictable and are becoming increasingly costly. Large amounts of time, energy, and "how to do it" skills are usually necessary to keep the property in good condition, and it is usually quite difficult and more time consuming for an owner to sell property than it is for a renter to change dwelling units.

## Cooperative Ownership

A second and relatively new form of ownership is the cooperative. Under this form, you become a member of a non-profit corporation. The corporation, once formed, purchases and builds an apartment building or townhouses, and using the land and buildings as security, obtains a mortgage. Each apartment in the building is then occupied by a member of the cooperative, and that member has the right to use the apartment as long as he/she meets their obligations to the corporation (other members). In addition, each member receives ownership of a percentage of the corporation stock. This percentage of stock usually represents the price of the particular unit occupied (dependent upon size, location, and arrangements). As a member of the corporation, each family or individual is responsible for a monthly payment to the membership. This payment includes maintenance, repair, debt retirement (principal and interest on the mortgage), taxes, insurance,

and reserve fund. The size of the monthly payment depends upon the size of stock held, i.e., unit held. In essence, cooperative ownership represents a co-operative venture by a group of people to buy property with each member co-operatively responsible for payments and upkeep. The fact that the property is financed by a single loan to a corporation rather than direct loans to individual owners is the most unique characteristic of the cooperative.

## **Advantages and Disadvantages of Cooperative Ownership**

Cooperative living offers several advantages: it is a form of forced savings in which payments on the principal of the mortgage will provide a good return if the property increases in value. Thus the investment can provide a hedge against inflation. Cooperative ownership offers income tax savings similar to fee simple ownership and in comparison to renting, can be cheaper, because the cooperative owner is not paying for vacancies or landlord profit (both are automatically built into monthly rent in typical rental agreements). Finally, cooperative ownership allows the individual stockholders joint control over their individual dwellings as well as joint control over the immediate area. This joint management of the complex is beneficial if all members are similar in attitudes regarding property upkeep.

Joint ownership and management responsibility can also be one of the major disadvantages of cooperative ownership. For each individual stockholder's freedom to use (including renting to a non-member), maintain, and improve the dwelling unit may be restricted by the cooperative's by-laws and declarations as well as being controlled by the cooperative's board of directors. Thus, how pleasant cooperative living becomes depends largely upon the ability of the individual stockholders to make wise, collective decisions to manage and maintain the property, something not always easily done unless much forethought goes into the initial agreement.

A second major disadvantage to cooperative ownership is the fact that each stockholder is jointly liable for the other stockholder's actions. Thus each can usually be assessed a portion of another stockholder's pro-rata share of monthly payments if that stockholder defaults on payments. This is usually not a problem in cooperatives that have an adequate reserve fund, which is important if the cooperative is to be a wise investment.

Finally, under cooperative ownership, the individual shareholder may find it quite difficult, and costly to sell his interest (stock) in the cooperative, as the prospective buyer must make a down payment large

enough to finance the purchase under the original mortgage. This initial down payment requirement for the prospective buyer may be especially large if the property has increased in value greatly or if the original stockholder has built a sizable amount of equity in the cooperative. An additional limitation is the fact that in many cases the prospective buyer must also be approved by the board of directors before the sale can be completed. This right of approval is greatly restricted today and prospective purchasers cannot be turned down based on race, sex or national origin.

## **Condominium**

Condominium ownership is a third, distinct form of property possession, sharing features with both fee simple and cooperative ownership. The term "condominium" means individual ownership of one-family units (actually the air space between the four walls, the floor, and the ceiling) within a multifamily structure (i.e., apartment or high rise) or complex (i.e., subdivision or planned unit development). Fee simple ownership of the unit is coupled with an individual ownership interest in the land and common areas (i.e., halls, service facilities, and recreation facilities) which are part of the development. In essence the owner owns his unit and has undivided ownership interest in all common areas. Ownership interest in the common areas is usually determined by 1) the ratio of the value of an owner's unit to the total project value or 2) the ratio of the owner's square footage to the total square footage in the project. Ownership interest also determines the amount of the monthly fee which must be paid to the owner's association, the legal entity created to manage, operate and maintain the common areas in the development.

Condominium ownership in Michigan is created and defined by certain legal documents, the most important of which is the master deed. This document creates condominium ownership of the property. In addition, the master deed contains the subdivision plan which graphically describes the individual units and common areas, and it contains the by-laws which create the association administration and regulations. Knowledge of the contents of the master deed is necessary to insure that you are buying a "type of living" and a "cost of living" suitable to your needs. Consultation with a lawyer knowledgeable in the area of condominium ownership is urged.

## **Advantages and Disadvantages to Condominium Living**

Under condominium ownership, individual owners are responsible for financing their own dwelling units, and thus they may find it easier to sell their property than cooperative owners. In addition, the condo-

minium owner enjoys greater freedom to use (including renting) or improve the dwelling unit than either the renter or the cooperative owner. Some of these freedoms, however, may be restricted by the association. Major structural changes, for example, may be prohibited, as well as any changes to the exterior of the unit.

A second major advantage of condominium ownership is the fact that the owner's financial risk and liability are not involved with other owners to the degree seen in cooperative ownership. Usually only maintenance and management costs and building insurance are shared in a condominium situation and thus the owner would only be responsible for absorbing these costs if another individual owner defaulted.

A third major advantage of condominium ownership is the fact that exterior maintenance and upkeep of the common areas and facilities are generally the responsibility of the association rather than individual owners. The owner, however, does pay for these services through association fees.

Finally, the condominium owner enjoys the typical advantages common to ownership: a form of forced saving, a hedge against inflation, and income tax savings.

The major disadvantages of condominium ownership concern the shared interest in the common areas and facilities. As pointed out above, there may be restrictions on individual freedoms involved in condominium ownership. While each individual owner has input into the maintenance and management of the project, one's desires are subject to the collective decisions of the association and may not be reflected in some actions taken by the group such as level of upkeep, exterior look of the property, operation of budgets and assessments.

In Michigan, condominium units may be sold on a leasehold basis. This is a form of ownership in which a third party such as a management company or the developer retains ownership of the land and/or recreation facilities and leases these to the unit owners. Initial cost of the unit thus may be greatly reduced below that found in regular condominium ownership. The

savings may be lost over time however, as monthly lease payments may be costly and can increase at the owner's discretion. Leasehold condominiums have been a major source of concern in recent years because of management-tenant disagreements. Legal advice, if this form of ownership is being considered, is especially necessary.

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