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Condominium mortgages and collateral assignments of phasing rights - by Saul Feldman

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The Massachusetts Condominium Statute, Chapter 183A, was adopted in 1963. Since that date, those of us who draft condominium documents have drafted phased condominiums for numerous developments or conversions. In the 1960s and early 1970s, there was a lot of truth to the expression “In the land of the blind, the one eyed man is king.” I was fortunate enough to be one of the seven or eight lawyers drafting condominium documents in the decade from 1963 through 1972. We were struggling to learn a new sub-specialty to real estate law – condominium law. Although we became better at it eventually, we still need to improve when it comes to representing lenders who are making loans for condominium developments to be developed in phases.

Phasing rights are sometimes called “development rights” or “expansion rights.”

While most real estate lawyers know how to draft a master deed for a phased condominium, there is much confusion on how to draft a construction mortgage for a phased condominium.

Some lawyers still believe that phasing rights are interests in personal property and treat phasing rights as personal property in drafting a mortgage. One lawyer insisted that phasing rights, being personal property, should be transferred by a separate bill of sale. This is incorrect, as phasing rights are interests in real estate and must be treated as interests in real estate in any construction mortgage.

This means that the mortgage must include the phasing rights in the description of the mortgaged premises.

This can be stated very succinctly: “together with the phasing rights provided in the Master Deed.”

In my opinion, it is not enough to include all of the land described in the Master Deed with the exception of the units which have already been conveyed to unit purchasers.

Real estate is a bundle of rights. One of these rights is the phasing rights in a phased condominium. Phasing is done for financing and marketing considerations. A lender will only fund based on the market. The developer believes that the annual absorption rate for his 50 units is one year. The lender may believe the annual absorption rate is 10 units a year for five years. The lender insists on a phased condominium. The golden rule states that he who has the gold makes the rules. The lender has the gold. Therefore, there will be a phased condominium.

Lawyers for lenders must learn to draft condominium construction mortgages properly. Failure to do so will adversely affect the value of the lender’s collateral and may lead to a legal malpractice claim. Some lenders require both a conveyance of the phasing rights in both a mortgage and a collateral assignment of development rights. This is a belt and suspenders approach but it is a reasonable requirement.

Of course, there are many other concerns for a lawyer representing a lender. For example, the

business deal for the payment to the lender when the lender is asked for a partial release. In the interest of privacy, this and other business points should be put in the loan agreement, which is not recorded. It should not be put in the mortgage, which is recorded.

I believe we are in a bubble, that the real estate market has plateaued. I have witnessed the downturns of the mid-1970s, late 1980s, early 1990s and 2005-2010. When we are in the next decline, lenders will have to consider workouts, foreclosures, and deeds in lieu of foreclosure. At that point, our documents become very important!

Lawyers representing lenders who have failed to draft the loan documents properly will be in trouble. Also, lawyers representing lenders who fail to review the condominium documents carefully will be in trouble. For example, if the master deed states the phasing rights expire in seven years, the lender needs to know this as it will affect the value of the collateral.

Our lender clients rely on us to protect them by drafting correct mortgage descriptions of the property which contain assignments of phasing rights as well as assignments of phasing rights as a separate but also important document to be recorded.

In the event our condominium construction mortgages and assignments of phasing rights fail to protect our lender clients, there will be chaos.

We real estate lawyers must do our job and draft loan documents correctly.

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