

A building with 40 residential units is owned by a corporation and operated as a cooperative. Each resident is a shareholder in the corporation as well as its tenant pursuant to a lease that is subject to the mortgage on the building. Each tenant is assessed an annual fee to cover part of the corporation's taxes, maintenance expenses, and mortgage obligation. Through poor management by the corporation's board of directors, the corporation failed to raise sufficient funds to pay the mortgage obligation. The bank that holds the mortgage on the building has begun foreclosure proceedings. A resident of the building who paid the annual assessment fee and is not a member of the board of directors has sought a declaratory judgment that a buyer at the foreclosure sale takes the building subject to her lease.

The applicable jurisdiction has not adopted a statute that addresses this situation.

How should the court rule?

- A. Against the resident, because she is personally liable for the mortgage obligation as a shareholder of the corporation.
- B. Against the resident, because the lease is subject to the mortgage on the building.
- C. For the resident, because she is not a member of the corporation's board of directors.
- D. For the resident, because she paid her annual assessment fee.

## Explanation:

### Main types of common-interest communities

<b>Property owners' association</b>	Property owners must, as consequence of property ownership, belong to association & pay dues to it <i>or</i> Property owners in real-estate development must pay for use/maintenance of property held in common by individual owners, but association membership is optional
<b>Condominium</b>	Created by state statutes by filing declaration (or master deed) & plat with recording office in condominium's locality Declaration & bylaws set out rights & obligations of unit owners & fix shares for allocating expenses, taxes, voting rights Each owner is responsible for his/her own mortgage
<b>Cooperative</b>	Typically consists of land & one or more buildings owned by corporation that leases individual residential units to shareholders Resident is tenant who also owns one or more shares of stock in corporation & is prohibited from transferring interest separately from lease Cooperative has blanket mortgage

A **cooperative** is a common-interest community that typically consists of land and one or more buildings owned by a corporation that leases individual residential units to its shareholders. Unlike a condominium, in which each unit owner is responsible for his/her own mortgage, a cooperative has a **blanket mortgage** that generally has **priority over occupancy leases**.

Since the leases are subject to the mortgage on the cooperative, a **default on the blanket mortgage** can result in **foreclosure proceedings** on the property, which in turn can **terminate all leases**. Therefore, the buyer at a foreclosure sale will *not* take the building subject to a resident's lease.

**(Choice A)** A shareholder in a cooperative is *not* personally liable for the cooperative's debts.

**(Choice C)** Members of a corporation's board of directors may incur liability for the board's poor management of the corporation.\* However, this does not prevent the resident from suffering the consequences of the corporation's default on its mortgage obligation.

\*However, many courts apply the business-judgment rule to insulate a director or an officer from liability for an honest but mistaken business decision.

**(Choice D)** Although the resident has paid her annual assessment fee, which includes her share of the mortgage obligation on the building, she can nevertheless lose her right to occupy her residential unit if the bank forecloses on that mortgage.

**Educational objective:**

Unlike a condominium, in which each unit owner is responsible for his/her own mortgage, a cooperative has a blanket mortgage that generally has priority over occupancy leases. A default on that mortgage can therefore result in foreclosure proceedings on the property, which in turn can terminate all leases.

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