REVIEW OF LAW NO. CLVII/1997:

THE CONDOMINIUM LAW OF HUNGARY

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INTRODUCTION

A new Law on Condominium took effect in Hungary on March 1, 1998.[1] The new law represents a substantial improvement over its predecessor, Law No.11/1977. The principles propounded in the new law should increase the likelihood of success of both privatized condominiums and new development in the multifamily housing sector. Among the most substantial improvements in the new law are the following:

- The owners' association is given explicit authority to undertake major repairs or renovation of the commonly owned property upon approval by a simple majority of this owners. This should resolve long-standing uncertainty about what approval is needed. The old law did not specifically define the scope of renovation projects that could be undertaken with less than unanimous consent; consequently, many people believed 100 percent approval was needed for any renovation.

- With 2/3 approval, the association may sell a portion of the commonly owned property that can be made into a separate unit, as long as the Foundation Deed so provides. With majority approval, an owner can petition the court to eliminate joint ownership over a portion of the common property and use it either to create an independent unit or extend individually owned property.

- Although not a full legal entity, the owners' association has been given new powers to enter into contracts and for most purposes to act with legal authority on behalf of the individual owners.

- The association may file a lien on the property of an owner who is more than 6 months delinquent in payment of condominium fees.

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[1] For the past two years, USAID has provided assistance to the Ministry of Justice with the preparation of a new Condominium Law. Assistance has included the presentation of an ongoing series of informal tutorials on condominium law for János Pesta, the principal drafter of the law, and his colleagues at the Ministry, sponsorship of a seminar on condominium law in Budapest in January 1997 and a series of workshops on specific issues addressed in the new law, and arranging for Mr. Pesta to visit the United States in May 1997 under the co-sponsorship of USAID and the Community Associations Institute (CAI). While in the US, Mr. Pesta visited condominiums and a property management firm, and attended CAI's national conference on condominiums.

- The scope of the foundation deed, the document that establishes the condominium, has been changed to encompass only the most fundamental principles of governance; the day-to-day operations of the condominium are to be carried out under rules and procedures established in bylaws, which can adopted and amended with 2/3 approval.

- Procedures are included in the law for the first time for construction and foundation of new condominium development, and for development of a condominium on leased land.

EFFECT ON EXISTING CONDOMINIUMS

As a result of both private development and mass privatization of the state-owned housing stock in Hungary, there are approximately 1 million housing units in existing condominiums that were established and have been governed under the 1977 Condominium Law. In cases where provisions of the new law are in conflict with the foundation deed of an existing condominium, the new law supersedes the old provisions automatically. *Ch. IV, Article 41(2).* An existing condominium can amend its foundation deed and adopt bylaws in accordance with the new law with 2/3 approval of the owners. *Ch. I, Article 6*.

The new law governs all condominiums developed or converted after its passage. Condominium-related claims arising before the act takes effect will be decided on the basis of regulations in effect at the time the claim arose. *Ch. IV, Article 41(1)*.

The law defines a condominium as any building comprised of two or more parcels of real estate. *Ch. I, Article 1(1)*.

KEY PROVISIONS IN THE PROPOSED LAW

Authority of the Owners' Association

The owners' association has more legal and decision-making authority under the new law. The association may undertake obligations in its own name, including those relating to renovation or management of the common property or ownership of a unit in the building. *Ch. I, Article 3(1)*. The law also provides that an association may exercise ownership rights over the common property and

"bear the encumbrances on the common property." *Ch. IV, Article 43, amending Civil Code Section 578/I.* This allows the association to borrow in its own name, using the assets of the association for this purpose.

The intention of the law is for the owners' association to have the same legal authority as a limited or unlimited partnership. While the association is not a full legal entity, the only explicit limitation on the association's legal authority is that owners are not protected from liability for obligations incurred by the association. The liability is limited, however, to each owner's pro rata share of ownership; the owners are not jointly and severally liable. In addition, claims of third parties against individual owners take precedence over claims of the owners' association against individual owners, but both can be settled within the same procedure, in accordance with the civil laws on simple (serial) guarantees. *Ch. I, Article 3 (3)*.

Sale or rental of common property is permitted with a 2/3 vote of the ownership interests, as long as this is permitted in the foundation deed and the portion of the common property to be sold or rented can be formulated as a separate property. *Ch. I, Article 3(2)*. Thus, while all of the owners share in the ownership of the common property, part of it can be sold without the consent of all. The theory underlying this provision, according to the drafters, is that the owners consent to it when approving the foundation deed and thus contractually assign certain of their ownership rights to the owners' association.

The general assembly can also decide to eliminate joint ownership of parts of the common property by a simple majority vote, either to create a new unit or to extend the property of an individually owned unit. Such a change in ownership structure is made by petition to the court, and involves changing the foundation deed. This can be done by order of the court, as long as the change does not violate the equitable rights of the minority. *Ch. II, Article 19(1)*.

Renovation of the Common Property

The law allows the general assembly of the owners to make decisions about the use, operation, and rehabilitation of the common property by majority vote. *Ch. III, Article 22*. Rehabilitation and modernization are defined in the law to include such activities as overhaul of main systems or the whole structure, restoration of original technical conditions, and replacement of systems or equipment, including conversion or replacement of central heating and hot water supply. *Ch. IV, Article 39(4)*.

With regard to management of the common property, the only exception to the rule of simple majority vote is for decisions on "expenditures which exceed the range of ordinary management expenditure," which require a unanimous vote. *Ch. III, Article 23(1)*. The law provides an explicit definition of such expenses:

- Expenses not included in the scope of maintenance, rehabilitation, or modernization—typically involving the extension of the building or the construction of a new building. *Ch. IV, Article 39(5)*.

Association's Lien for Delinquent Condominium Fees

The association can encumber with a lien the property of an owner who is delinquent in payment of fees for more than 6 months. *Ch. III, Article 24(1).* The lien assures that the owner will pay the debt when the unit is sold, or to foreclose after obtaining a court order. (Theoretically, it would be possible for a condominium to foreclose without a court proceeding if the foundation deed so states and it is a notarized document. However, the law does not require that the foundation deed be notarized, *Ch. I, Article 11(1)*, and it is unlikely that this procedure will be widely followed.)

Dividing Condominiums with More than One Building

In a condominium that consists of more than one building or definable property, such as a stairwell, the owners of one portion (or more than one but less than all) can vote by a simple majority to petition the court to split off from the existing condominium and establish a new condominium. The standard for the court to approve the request is whether it will violate the equitable interests of the other owners. *Ch. I, Article 9 (2) and (3).* If all the owners agree unanimously to splitting an existing condominium into smaller entities, no court petition is necessary, since the property can be divided and the foundation deed amended with unanimous consent.

Governance Structure

In all condominiums with over 6 units, the owners' association is to be managed by a common representative, or by an executive committee if an executive committee is called for in the foundation deed or bylaws. *Ch. 1, Article 6(2); Ch. III, Article 21(2) and (3)*. The common representative, or the chairman of the executive committee, has the authority to represent the owners' association in court or before other authorities. *Ch. III, Article 37*.

An audit committee may be elected in any condominium, but it is mandatory in condominiums comprised of more than 50 units. *Ch. III, Article 21(2)*. This provision apparently is intended to eliminate problems of single-person control over larger, more complex buildings. The audit committee may inspect the activities of the common representative or the executive committee at any

time, opine on the budget, and generally review invoices, payments, and all the financial activities of the condominium. *Ch. III, Article 38*.

Governing Documents

Under the new law, governance of the condominium and decision making by owners is more flexible. The old law provides for governance under the provisions of a foundation deed that was registered when the condominium was established and could not be amended without the unanimous consent of the owners. The new law provides that there may be two documents guiding the management and operation of a condominium: the foundation document and, if provided for in the foundation deed, "organizational and operational procedures of the association," or bylaws. *Ch. 1, Article 6(1).* Bylaws are intended to deal with everyday operations of the condominium; the foundation deed is meant to control only the most fundamental issues of ownership.

The law still requires unanimous approval to amend the foundation deed (except for the opportunity for an existing condominium to amend its foundation deed and adopt bylaws in order in accordance with the new law), *Ch. I, Article 11(2)*, but only 2/3 approval to adopt or amend the bylaws. *Ch. III, Article 23(2)*. For new condominiums, the bylaws are to adopted at the first or foundation general assembly. *Ch. I, Article 6(2)*.

To be effective, both the foundation deed and bylaws must be registered in the property records. *Ch. I, Article 6(3)*.

Qualifications of Common Representative and Chairman of the Executive Committee

The law provides that a person may not serve as a common representative or chairman of the executive committee if he or she has been convicted of a crime, banned by a court from serving in such as capacity, or who is with a firm that has failed to pay applicable fees or other obligations. *Ch. III, Article 36.* An earlier draft of the law provided that if a common representative or member of the executive committee is not an owner or a resident of the building and is paid a fee, he or she must be qualified for this activity in accordance with a special regulation and training requirements to be adopted for this purpose by the Ministry of the Interior and the Ministry of Environmental Protection and Regional Development. This provision was eliminated in the version of the law that was adopted. The law now provides that by June 30, 1998, the Ministry of the Interior is to submit a proposal on vocational training and examination requirements for property managers to be implemented by Országos Szakképzési Tanác

(National Council of Vocational Training). *Ch. IV, Article 42*.

Calculation of Votes and Common Expenses

Proportionate or *pro rata* payment of common expenses and voting is required, unless the foundation deed or bylaws provide otherwise. *Ch. II, Article 17* and *Chapter III, Article 27(1)*. The right of owners in a particular condominium to approve bylaws that apportion costs on a different basis may be important. For example, in a case where on occupant of a unit uses substantially more heat or water or generates more trash than the average occupant because of the use of the unit, cost sharing on the basis of the size of the unit may not be fair.

"Partial" General Assemblies

The law permits "partial general assemblies," if the foundation deed or bylaws so provide. This allows owners to meet in sections, with identical agendas. The votes of the sections are aggregated to reach a final decision. It also allows sections of the building with business activities only in that part of the building to vote separately on matters relating to those activities. For example, a stairway that has common area commercial space accessible only from that part of the building could vote on how to allocate income from rental of the space. Ch. III, Article 30(3).

Co-Owners' Pre-Emptive Right to Purchase or Lease Units

If so stated in the foundation deed, the co-owners (in the aggregate, not the association *per se*) may have a pre-emptive right to purchase or rent a unit before it can be sold or leased to a third party. *Ch. II, Article 14*.

Changes to Nonresidential Use; Nonresidential Condominiums

A change in use of a unit from residential to nonresidential, or change in use of a nonresidential unit, can be prohibited by a 2/3 vote at a general assembly. *Ch. II, Article 12(3)*. A condominium can be established for all nonresidential purposes. *Ch. I, Article 4*.

Procedures for New Condominium Construction or Development

The law permits foundation of a condominium by one person as a developer or investor, with rights to transfer ownership as units are sold. Buyers are obliged to take on responsibility of ownership. This provision was designed to allow developers to use property as collateral for a loan for construction and to establish "preliminary foundation" that can be modified later. *Ch. I, Articles 5 and 8*.

Condominiums on Leased Land

A condominium can be established on land owned by an outside entity. *Ch. I, Article 1(2).*