



# Research on Condominium Ownership Based on Information Asymmetry - A Case Study of American Law

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## Abstract

Condominium ownership is an important content of real property right. Based on the theory of information asymmetry, the author discussed the information asymmetry of exclusive parts and common parts in the process of transaction of real property right, and then took Uniform Condominium Act of America as a reference in order to provide solution ways for eliminating the information asymmetry of exclusive parts and common parts under the current transaction situation in China.

**Keywords:** Information asymmetry, Condominium ownership, Common ownership

## 1. Introduction

Condominium ownership is an important content of real property right, the article 70 of Property Right Law of PRC that issued by 2007 defined it as "owners have ownership for exclusive parts such as residential and commercial room in the buildings, and have common ownership and rights of co-management for common parts except exclusive parts." Namely condominium ownership is made of exclusive right, common right and membership right, among them exclusive right and common right are property right, membership right is not a property right (liu, 2006, p.38). Therefore, three parts determine jointly that condominium ownership is a composite ownership, which is different from the general ownership.

Ownership is transacted in the process of transaction of real estate, which is actually the process of transaction of exclusive right and common right. Because of the features of uniqueness of transaction object of real estate, complexity of formation process and territoriality of transaction market of real estate, it easily makes exclusive right and common right lead to information asymmetry in the transaction process. Generally speaking, developers are in information superiority, exclusive right and common right of consumers are difficult to guarantee efficiently. Especially now at the imperfect law situation of condominium ownership in China, it more easily leads to information asymmetry. In view of this, the author intends to discuss how to protect exclusive rights and common rights of the consumers better in the transaction process based on the theory of information asymmetry, and makes the American law - Uniform Condominium Act (issued by 1977) as a reference, in order to be further beneficial to standardize market order of real estate in China.

## 2. Related concepts

### 2.1 Information Asymmetry

The theory of information asymmetry is the core content of Information Economics, it specifically refers to that the information shows uneven and asymmetric distribution between the economic entities of mutually responding in the

market, all parties that have economic relations do not all know the relevant information of subject matter(zhang, 1996, p.397). It can be summarized two points, one is that the distribution of transaction information is asymmetric between transaction parties, namely one has more relevant information than the other, and one is that transaction parties are clear about the relative position in their respective possession of information.

Information asymmetry can cause adverse selection and moral hazard. Adverse selection means that one who is carrying on a market transaction has possessed some information which the counterpart did not have before signing the contract, but these information may affect the interests of the latter, thereupon one who has occupied the advantage of information may be possible to use this advantage of information do things that are better for himself but not better for the counterpart, thus the efficiency of market and economic will be reduced (xin, 2001, p.36-40). Moral hazard means that one part who is engaged in economic activities goes against the utility of the counterpart while is promoting his own in the maximum after reaching the contract (wang, 2008, p. 14).

Both adverse selection and moral hazard will lead to market failure or inefficient operation of market, the problem of information asymmetry is not be solved fundamentally by using market mechanism singly, so government regulations of seeking is an important measure to remedy inadequacy of market, government regulations have mandatory, it can directly order the two transaction sides revealing some significant information, thus the level of information asymmetry can be decreased in the maximal degree(zhou, 2006, p.25).

### *2.2 Information asymmetry analysis on the transaction process of condominium ownership*

Information asymmetry of condominium ownership in the process of transaction means that buyers do not wholly master all effective information of developers about exclusive parts and common parts. this information inferiority is information asymmetry. Concretely speaking, developers not only master the public information which includes information of geographical position, terrain, traffic, house type of exclusive part, allocation area of common parts and so on, but also master the hidden information which includes the information of cost of exclusive parts, allocation cost of common parts, allocation scope of common parts and calculation method of allocation area of common parts, quality, appreciation potential and so on. Thus house buyers do not have this information superiority, which may lead to the following: ① Developers embezzle the common parts of house owners, which means developers embezzle the common parts that should belong to the house owners originally before signing the housing contract, or developers let common parts lease or sale to the third party. This phenomenon is adverse selection. ② Developers change the common parts without authorization, which means developers change the primary planning and design without authorization under unwitting condition of house buyers after signing the housing contract, which makes a change in scope or location or share of common parts of housing buyers. This phenomenon is moral hazard.

## **3. Uniform Condominium Act of American**

In U.S., the information disclosure system of Real Estate market and the legal system of condominium ownership are comparatively sound, so the author chooses U.S. as an example. Uniform Condominium Act in U.S. was constituted by National Conference of Commissioners on Uniform State Laws and announced in 1977. By 1980, this act had been adopted by 12 states basically overall, such as Pennsylvania, Virginia, Washington, New Mexico, Texas, and so on. Although legislative amendments of other states did not have adopted this law wholly from the structure or content, the content of this act was absorbed substantially.

### *3.1 Relevant regulations of Uniform Condominium Act*

According to the article 2.5.1 of Uniform Condominium Act the condominium declaration should include the following: Full description in law about all buildings and other structures in the situation of the property district; Description about the maximal amount of housing units that developers have rights to build; Description about boundary and number of each housing units; Description about other common parts which will be appointed for the special common parts in addition to this act; Description about the common parts else designated for special in future; Description about the development rights reserved by developers, and the necessary legal description about the construction land that developers have reserved the development rights, and description about the period when developers can exercise these development rights; If developers can have the development rights of different block at different times, this should be definite in the condominium declaration, and description about the specific location, boundary or four boundaries, and the specific time when developers exercise the development rights of each block; If developers exercise the development rights of any part of a block, they should express the development rights which will be exercised partially or wholly; Other conditions or restrictions to the development rights of developers above-mentioned; Description about the share of the common property allocated for each housing unit in the common parts of the property district under the provisions of this act.

### *3.2 Provisions analysis*

By analyzing article 2.5.1 in Uniform Condominium Act it can conclude that it has been regulated in law that ownership of apartment of the entire property district should be affirmed in the condominium declaration, including range of

exclusive parts (boundary), range of common parts, and common parts for special. With the phased development adopted, the condominium declaration should explain further about the content of the common parts and exclusive parts involved in the phased development.

Among that the condominium declaration is drawn up by the developer in accordance with the law, and delivered Real Estate Register Institution to register after natural completion of buildings, and then buildings can be transacted after registration. While sale-building, developers should provide housing-consumers the condominium declaration and its accessories (Accessories refer to floor arch plan and profiles). The housing-consumers who certificate (accept) the article in the condominium declaration and sign a sales contract with developers, will be contracting parties or signing parties of the condominium declaration and its accessories in law. Thereupon the condominium declaration and its accessories produce legal binding force to the sellers and the buyers. After the finish of the sales of the housing units in the property district, the condominium declaration and its accessories will be main agreement or contract (correspond to Owner Management Protocol) between all owners of the property district.

### *3.3 Brief summary*

Through summarizing the above content, we can conclude that Uniform Condominium Act demand developers to draw up a paper of condominium declaration by law before sales, the condominium declaration must includes compulsory contents which are regulated by this law, which is that the condominium declaration must illustrates the information about exclusive parts and common parts of condominium ownership in detail, then the commercial houses can be transacted after registration of the condominium declaration. Developers must express the condominium declaration to the housing buyer in the transaction, if the housing buyer accepts the condominium declaration and signs the transaction contract with the developer, he (or she) will be the contracting party of the condominium declaration and its accessories in law. Thus America has eliminated the information asymmetry of condominium ownership that exists in the developer and the housing buyers in the maximum through the law, whether adverse selection or moral hazard.

## **4. Circumstance of China**

Commercial housing sales in China include commercial housing cash sales and commercial housing presales. So the stage of commercial housing presales is the start of the stage of sales. Information asymmetry seriously exist at the stage of commercial housing presales about condominium ownership in China according to investigation of relevant laws, such as City Immovable Administration Law (issued by 1995), Commercial Housing Sale Administration Law (issued by 2001), City Commercial Housing Presale Administration Law (issued by 2001), City Immovable Development and Management Administration Regulation (issued by 1998), Real Estate Management Regulation (issued by 2007) and so on. It is mainly shown in two aspects.

### *4.1 Housing buyers not know the scope of exclusive parts and common parts at the stage of presales*

According to City Commercial Housing Presale Administration Law and Real Estate Management Regulation, developers only present Commercial Housing Presale License and express Provisional Management Protocol to housing buyers at the stage of presales, and both sellers and buyers should reach a written contract of agreement on the Provisional Management Protocol when the sale contract is signed, in which the article 22 of Real Estate Management Regulation about the content of Provisional Management Protocol stipulates that the construction unit should draw up a paper of Provisional Management Protocol before the stage of property sales, and should make convention by law on items which include use, maintenance and management of the related property, common interests of owners, obligation which should be performed by owners, responsibility that should be undertaken by owners when they violate the provisional management protocol and so on. Provisional Management Protocol which is drawn up by the construction unit must not infringe the legal rights of property buyers. The other articles of Real Estate Management Regulation do not regulate anything about the content of the provisional management protocol, and other laws also do not have concrete regulations for this point.

So we can conclude that Real Estate Management Regulation and other laws lack of concrete regulations about explanation of scope of exclusive parts and common parts in the provisional management protocol, which makes practice lack of guidance seriously and also causes housing buyers difficult to know those information.

### *4.2 Transaction contract of commercial house lack of definite engagement for exclusive parts and common parts*

According to the article 10 of City Commercial Housing Presale Administration Law, the transaction contract of commercial housing should clarify these principal contents: appellation or name of the parties; address of the parties; basic situation of the commercial house; sale mode of the commercial house; determination mode of the price item of the commercial house; total price item and payment form and payment time of the commercial house; delivery conditions and date; commitment of decoration and equipment standards; delivery commitment of supporting infrastructure of water supply, power supply, heating supply, gas, communication, road, greening and so on; delivery commitment of public facilities and related rights and responsibilities; property ownership of public matching buildings; treatment method of area discrepancy; related matters of dealing with property right registration; methods of resolving

disputes; liability for breach; other matters which appointed by both parties.

According to analysis on the article 10 which is mentioned above, as for exclusive parts and common parts, the transaction contract only illustrates the property ownership of the public matching buildings, namely it only illustrates a part of condominium ownership. As to other parts it does not explain clearly such as scope of common parts of single building, boundary of exclusive parts, appointed common parts and so on. Because the contract does not reach an agreement about those, if the property district is developed in stages, developers may change the scope or location or share of common parts to a great extent from their own interests so as to damage the rights of owners finally.

### **5. Enlightenment of Uniform Condominium Act**

In conjunction with Uniform Condominium Act of American and circumstance of China, the author believes that China should demand developers clearly explain exclusive parts and common parts of the whole property district in the provisional statute before sales by law regulations, such as boundary of exclusive parts, scope of common parts and so on. If the property district is developed in stages, developers should explain the further development rights that may influence exclusive parts and common parts, such as adjustment of agreed common parts which will be built in the future, adjustment of location of common parts and so on. The provisional statute should be expressed to housing buyers before the sales, and both the sellers and the buyers should reach a written contract of agreement on the provisional statute when the sale contract is signed. At the same time, the content of exclusive parts and common parts would be agreed in the sales contract in order to produce the credit relationship between sellers and buyers. Anyone who changes it unilaterally will bear legal liability. Consequently, the behavior of developers of adverse selection and moral hazard in the transaction of exclusive parts and common parts will be eliminated by government regulations, which makes the consumer rights be protected better.

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