

HOA 101: Agenda

1. Introduction to Common Interest Developments
 - A. Types of Common Interest Developments
 - B. The Governing Documents
 1. Articles of Incorporation
 2. Bylaws
 3. The Declaration
 4. Rules and Regulations
 5. Architectural Guidelines
 5. Condominium Plan
 - C. Laws Governing Common Interest Developments
 1. Davis Sterling Common Interest Development Act
 2. California Corporations Code
 3. Subdivided Lands Act and the California Code of Regulations
 4. Subdivision Map Act
 5. Case law
 6. Lender guidelines (not law, but important)
2. The 'master' association and master planned community – what it is and how it is different.
3. How associations are formed and structured
 - Local agency input in regard to land use
 - DRE input in connection with the subdivision offering
 - Developer governance planning
4. Compare a governmental entity with an association.

Speaking Outline

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I. Characteristics of Common Interest Developments.

A. *Introduction to Common Interest Developments.*

Essentially, common interest developments are residential or commercial developments that are governed by an association pursuant to a declaration. Common interest developments are composed of "common area" and "separate interests" (Defined in Cal. Civ. Code Sections 1351(b) and (l)). California recognizes four types of common interest developments: community apartment, stock cooperative, condominium project and planned development.

In a community apartment project (defined in Cal. Civ. Code Section 1351(d)), each purchaser of a separate interest receives an exclusive right to use or occupy a specified unit along with an undivided interest in the common area. The association may be an unincorporated association. It does not own any interest in the common area. These rights are usually transferred by a grant deed. Most community apartments were formed in the late 50's to early '60's. The declaration can be nothing more than restrictions spelled out in the grant deed of the community apartment unit. Generally, very little financing is available for community apartment units; Fannie Mae and Freddie Mac do not purchase loans secured by community apartment units. Community apartments are occasionally mistaken for condominiums.

In a stock cooperative (defined in Cal. Civ. Code Section 1351(m)), the entire project is owned by the cooperative corporation and the 'owners' are actually tenants under long term leases. The tenants also own shares of stock in the cooperative corporation. Although, under California law, an interest in a stock cooperative is an interest in real property (see Cal Civ. Code Section 783.1), documentation for some stock cooperatives is all unrecorded. Stock cooperatives were formed mostly in the 1970's as a way to convert and sell apartments without obtaining approvals from local governmental agencies. Converters took advantage of a loophole in the Map Act which was eliminated in September 1979, when Government Code Section 66424 was amended to include stock cooperatives within the definition of a "subdivision" under the Subdivision Map Act. E.g., ***Shelter Creek Development Corp. v. City of Oxnard***, 34 Cal. 3d 733; 669 P.2d 948; 195 Cal. Rptr. 361.

Generally stock cooperatives are not formed in California today. Some financing is available through specific entities such as the National Cooperative Bank. Fannie Mae has rather detailed guidelines for purchase of loans secured by stock cooperatives; however, finding a lender willing to make

the initial loan can be difficult. Both stock cooperatives and community apartment projects can be converted to condominium projects if appropriate approvals are obtained. See Cal. Civ. Code Section 1351(e) and Cal. Govt. Code Section 66452.10. The Department of Real Estate also exerts jurisdiction over conversion of stock cooperatives and community apartments to condominiums. See DRE form RE 627A.

Condominiums are composed of a separate, three dimensional interest in space defined on a condominium plan along with an undivided interest in common area. In the past, the common area typically was the entire common interest development. More often today, the common area is a cube of air located above the units with the remainder of the common interest development being property owned in fee simple by the association. The traditional condominium unit is defined by the interior, unfinished surfaces of a residence within a building, which usually is several stories tall. More frequently today, site condominiums are also created. In a site condominium, the unit is a cube of airspace that can encompass a yard and single family dwelling. Condominiums are used as an alternative to lots because they are not subject to the same setback requirements and so can be placed closer together. Although development of the traditional stacked-attached condominium had slowed greatly, over recent years, and particularly now, we see a surge in creation of high-rise condominiums, often with ground floor retail, in specific urban areas. There is also more interest in continuing life care communities, which are often developed as condominiums. Conversion of apartments to condominiums also has picked up greatly in the past few years.

Both Fannie Mae and Freddie Mac purchase loans secured by condominiums; however, Freddie Mac's earthquake insurance requirements may be difficult, if not impossible, to satisfy in certain areas of California. Fannie Mae has separate rules for site condominiums, which essentially allow them to be treated like units in planned developments.

Although we list them last, planned developments make up well over the majority of new common interest developments. Generally, at the Department of Real Estate, about seventy percent of the filings are for planned developments. (Of the remainder, about sixty percent are site condominiums). A planned development is composed of lots and common area. The common area can be easements or a separate lot owned in fee simple. Most lenders are familiar with planned developments.

B. *General Outline of Relevant Law:*

1. Davis-Stirling Common Interest Development Act located at Civil Code §§ 1350 to 1376.

2. The Subdivision Map Act (“Map Act”) (Government Code Section 66410 to 66499.58).

The Map Act gives the locality the right to control design of subdivisions through the mapping process. Typically, the mapping process involves two steps: applying for and obtaining a tentative tract map with conditions of approval, then complying with the conditions of approval and obtaining and recording a final tract map. Generally, a tract map must be obtained when land is divided into five or more condominiums or lots. When land is divided into less than five parcels, subdividers can obtain a parcel map.

3. The Subdivided Lands Act (Bus. & Prof. Code Section 11000, *et seq.* and Cal. Code of Reg., Title 10, Article 12 Section 2790, *et seq.*).

- The Subdivided Lands Act gives the Department of Real Estate (“DRE”) jurisdiction and defines the scope of DRE jurisdiction.
- Section 11001 authorizes the DRE commissioner to issue regulations, which are contained in Title 10 of the California Code of Regulations.
- Note: the regulations set out reasonable arrangements for such things as transfer of common area, assessments, members meetings and voting, governing body elections, meetings and voting, declarant control and other matters. These regulations set maximum limits on the amount of control a subdivider can retain. The regulations are only examples of reasonable arrangements; other arrangements may also be approved if they can be justified for a particular subdivision.
- The regulations also identify a separate type of planned development as “Master Planned Development.” Generally these developments are composed of 500 or more homes divided into smaller subdivisions. The DRE recognizes that the developer of a Master Planned Development needs to retain control over operation of the community longer than the developer of a typical planned development. Cal. Code of Regs. Section 2792.32 sets different limits on developer control of Master Planned Developments.

4. The California Corporations Code.

The Corporations Code sets rules for operation of corporations and unincorporated associations. Most associations are formed as nonprofit mutual benefit corporations governed by Corporations Code Section 7710 through 8910. Some associations that are responsible for amenities of a

more public nature are formed as nonprofit public benefit corporations governed by Corporations Code Section 5110 through 6910. Unincorporated associations are subject to Corporations Code Section 20000 through 21401. Older associations may be unincorporated. Associations for condominium projects composed of two or three units may also be formed as unincorporated associations.

II. **Overview of the DRE's Jurisdiction.**

A public report is required for the sale of subdivided lands, defined as a division of improved or unimproved land into **5 or more** parcels for the purpose of sale or lease now or in the future. B&P Code Section 11000. **A public report is not required for the sale of commercial property**; however, commercial property can be included in a subdivision that will include residential property that is subject to DRE jurisdiction. B&P Code Section 11010.3. For example, ground floor retail areas can be included in the residential condominium association. Planned developments, condominium projects, stock cooperatives and community apartment projects containing 5 or more separate interests are subject to DRE jurisdiction. B&P Code Section 11004.5. Apartment to condominium conversions will also be subject to DRE jurisdiction because project has to be subdivided to be sold.

Projects composed of less than 5 separate interests are not subject to DRE jurisdiction.

Standard subdivisions (those without associations) in cities that meet specified requirements are not subject to DRE jurisdiction. B&P Code Section 11010.4.

III. **The Legal Management Documents.**

A. **Articles of Incorporation.**

The articles of incorporation are a creature of the Corporations Code, Civil Code and federal and state tax statutes applicable to nonprofit corporations. Generally, articles of incorporation for all types of developments are substantially similar. They must:

- ✓ give the name of the entity
- ✓ state the type of corporation and its purpose
- ✓ identify the general powers that the corporation has
- ✓ give the business or corporate address of the entity, if there is one
- ✓ identify classes of membership and rights and privileges of members
- ✓ identify the approvals required for amendment

- ✓ give the name and address of the manager if there is one
- ✓ identify the agent for service of process
- ✓ be signed by the incorporator

The articles of incorporation should also include any provisions required to obtain appropriate tax exempt status. Typically, an association is a homeowners association within the meaning of Section 23701t of the California Revenue and Taxation Code and Section 528 of the Internal Revenue Code. For some associations that take on more 'public' functions, they can qualify as exempt as a social welfare corporation (under IRC Section 501(c)(4), but they must be incorporated as public benefit (for state exemption, not federal) and the articles of incorporation must include a prohibition on lobbying and other activities. Also, funds on dissolution must go to another exempt entity, not the owners.

B. **Bylaws.**

The Bylaws are a creature of the Corporations Code and Civil Code. They outline how the entity is operated. The Bylaws should contain provisions addressing the following:

- ✓ **Board of directors** – number, qualifications, procedures for elections, filling vacancies, removals, procedures for making decisions – meetings, actions without meetings, quorum and adjournment. Boards of Directors are usually composed of 3 or 5 directors. Usually, directors must be owners but they do not have to live on site.
- ✓ **Officers** – most associations have a president, vice president, secretary and treasurer. The board elects and removes all officers.
- ✓ **Owners** – the bylaws must list the classes of membership, quorum, percentage required to approve things, how to call meetings, etc.

Classes of voting – Most associations usually start with two classes of voting membership: class A and class B, which is the subdivider, who gets three votes for every home owned and subject to assessment. In larger associations (such as master planned communities), the subdivider can have a class C right to appoint a majority of the directors.

Quorum for meetings – the larger the association, the lower the quorum requirement. Make the quorum requirement as low as allowed by statute to make it easy to call meetings.

In exceptionally large associations, such as in those with over 1,000 members, we will establish a delegate system of voting.

- ✓ **Notice and Hearing procedure** – this procedure must be established in the bylaws so that the association can impose penalties on its members. It must be procedurally fair, which usually means that you must give the offending owner notice, the right to respond, and the right to meet with the board of directors.
 - ✓ **Miscellaneous provisions** - authorization for signing documents, availability of association documents, establishment of a fiscal year
- C. **CC&Rs.** Unique aspects of some standard provisions are listed below:
- **Use Restrictions.** The use restrictions should conform to the type of development.
 - ✓ Some new developments include a home-business element of the residence so homes are used for more than just single family residences and exceptions must be made to the standard prohibition on business and commercial activity.
 - ✓ Parking and vehicle restrictions should reflect the type of development.
 - ✓ Animal regulations – in planned developments, two animals is usually fine. In stacked, attached products, the subdivider may want to limit the number, weight, and breeds of pets.
 - ✓ Views. This is important to establish up front. Also, the marketing for the community must be consistent with what is in the legal documents.
 - **Association Powers and Duties**
 - ✓ Association powers should be clearly identified.
 - ✓ The association should also be affirmatively authorized to perform unique functions. For example, subassociations should be authorized to comply with master association mandates.
 - ✓ The association should be obligated to complying with unique city requirements such as the obligation to administer a recycling program or maintain adjacent public areas.
 - **Maintenance Responsibilities.** The relative maintenance responsibilities of the association and the owners should be spelled out in easy to understand terms.

- **Architectural Control.** Architectural control can be exercised by the Board of Directors or by a committee, usually composed of 3 people appointed by the Board.
 - ✓ Usually the committee is deemed to approve a complete application of the committee does not act within a specified period of time.
 - ✓ Approvals can terminate if the owner does not take action within a certain period of time after the approval is issued.
 - ✓ After work is completed and inspected, the committee should be required to issue final confirmation that work is completed as approved.
 - ✓ California law requires that owners have a right to appeal decisions to the board.
 - ✓ Sometimes the committee is given the right to delegate powers to third party decision maker.
 - ✓ Usually the committee has the right to approve certain improvements in advance, without submission of an application.
- **Property easements and rights.**
- **Lender protections.** Typically CC&Rs comply with Fannie Mae and Freddie Mac guidelines in existence when the CC&Rs are drafted. Some CC&Rs may also be drafted to comply with VA and FHA requirements.
- D. Other Documents
 - **Form of Notice of Addition** – used to add additional phases.
 - **Supplemental Declarations of Restrictions.**
 - **Rules and regulations and architectural standards.**