PLANNED COMMUNITY GOVERNANCE MODELS: SERIAL, EXPANDABLE, NESTED AND BUSTED

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I. INTRODUCTION

For the purpose of this article, a planned community model refers to the general structure chosen by the developer and its counsel to encumber the planned community with covenants and restrictions. The governance model is, in effect, the superstructure of the covenants. The model usually sets the expected pattern of annexation, amendment, association control and administration. The governance model communicates current plans and expectations for development and administration of the community

The governance model for a planned community should be carefully chosen based on the size and characteristics of the planned development. A poorly chosen model can increase developer exposure to claims, reduce market flexibility, and increase development and community administrative costs. The proper model takes into consideration local regulatory factors (e.g., plat approval process and timeline and other regulatory approval and review requirements), projected community amenities, the developer's specific needs and administrative capacity, the projected market segment and anticipated end-users, and the life-cycle of expected development activities.

This article segregates governance models into three (3) basic categories: (i) serial; (ii) expandable; and (iii) nested. As discussed in more detail below, while serial governance is sometimes used as a model, the model has significant deficiencies and is not recommended for use. Serial governance is discussed principally to identify problems inherent in the model. The last section of this article addresses the circumstance where initial expectations change and it becomes necessary to break the model into two or more separate components. This can occur due to political, administrative, or development factors.

II. SERIAL GOVERANCE

Serial governance refers to a structure where separate portions of the community are encumbered with separate and independent covenants[1]. In essence, each portion of the community is its own island, but the developer's intention is to administer all islands as a single planned community. A set of serial covenants includes the same named community association and identical or similar use and construction restrictions.

The model is implemented by developing a form set of stand-alone independent covenants. As platted portions of the community are developed, the form is revised to include a description of the land to be encumbered and the document is recorded. Once the community is fully developed, the model consists of separate and independent covenants, one for each developed or platted section of the project.

The principal deficiency with serial governance is maintaining consistency between separate independent covenants filed over time. Slight changes to use restrictions from one set of covenants to another can make it difficult, and often impossible, to develop consistent enforcement procedures. Even slight changes in the assessment provisions (e.g., assessment caps, owner approval requirements, penalty mechanisms, etc.), can make financial administration costly and complicated. Amendments to specific covenant provisions that would benefit the entire community are also made more difficult since each separate covenant requires amendment in accordance with the specific amendment procedures set forth in the separate covenant. A slight change in the approval process for amendment from one covenant to another can frustrate an otherwise important and necessary change to the documents. Failure to carry forward consistent developer control provisions, can raise thorny interpretation issues, and otherwise complicate administration of the association during the developer-control period.

The simple solution to most of the problems posed by serial governance is to insure that the same form covenant is used throughout the project. However, you have to get it right the first time and hope that the original conception of the project never varies. With long development life cycles, unavoidable market and economic changes, and the likelihood of regulatory changes, getting it right the first time, and for all time, is not a goal you should reasonably expect to achieve.

III. EXPANDABLE GOVERNANCE

Expandable governance refers to a structure where a certain portion of the community is encumbered with an independent covenant with the capacity to add future sections of the community or land to the same covenant.[2] Under the expandable model, and in contrast to the serial model, separate and independent covenants are not used to establish governance for further developed portions of the community. Under the expandable model, as land is developed, that land is annexed into the previously recorded covenant and is governed in accordance with the system previously established.

Expandable governance should also be contrasted with nested governance described in Section IV below.

[1] See Attachment 1 for a visual depiction of the serial model.

[2] See Attachment 2 for a visual depiction of the expandable model.

For purposes of describing the expandable model, it is assumed that a single association will administer the project, the project consists of a single use (e.g., residential or commercial, but not both), the process of development and land use is generally predictable based on regulatory requirements, and the land to be ultimately included within the planned community is under the developer's control.

For residential product, as a general rule of thumb, the expandable model should be considered for projects with: (i) 4 or less phased components; (ii) product with similar price points (e.g., homes from 250K to 400K, and not homes from 250K to 1MM); and (iii) a similar builder class (production or custom builders, but not both). In addition, the expandable model is probably not the preferred method for community governance where the project will include both residential lots and condominium product.

If justified by the circumstances, the expandable model is relatively simple to implement and administer. Obviously, the annexation process must be monitored to insure that additional phases are made subject to the covenant prior to conveyance. In addition, it is possible, and appropriate, to provide some flexibility with respect to modifying use and construction restrictions applicable to further phases. In most cases this is implemented in conjunction with annexation by amending specific provisions of the covenant applicable to the annexed phase. However, too many changes can create the same problems inherent in the serial governance model.

IV. NESTED GOVERNANCE

Nested governance refers to a structure where a separate "foundational" covenant (usually referred to as a "master covenant") is recorded which addresses association control and administration, architectural control, the annexation process, and fiscal issues (i.e., assessments)[3]. In general, the foundational covenant establishes systems and procedures for administrative aspects of the project that are unlikely to change based on future circumstances. Specific restrictions and requirements associated with construction and use (e.g., minimum square footage, specific use prohibitions, etc.) are purposefully excluded from the foundational covenant.

Under the nested model, phases of the community are annexed into the foundational covenant and a separate covenant (sometimes referred to as a "development area covenant") is recorded with specific use and construction restrictions applicable to the annexed phase. Once a phase has been added to the foundational covenant and separate development area covenant has been filed, future phases may be annexed into the foundational covenant and a previously recorded development area covenant, if appropriate. Alternatively, a separate and unique development area covenant can be recorded for the new phase[4].

The nested governance model may ultimately include a single community association charged with administration of the entire project (i.e., a "master association"), or a single master association and one or more subordinate associations. Formation and administration of the subordinate association is addressed in the development area covenant.

The principal benefit of the nested model is the flexibility it affords the developer. The nested model permits the developer to promulgate specific restrictions and requirements applicable to a particular phase in close proximity to the market conditions and requirements then applicable to the phase. Since specific assumptions are not made in the foundational covenant regarding development and use, the developer has the ability to respond to unforeseen circumstances, take advantage of new opportunities, and postpone establishing specific product standards for the development.

In general, the nested model should be considered for: (i) mixed-use projects (residential and commercial) with common administration; (ii) projects with significant variation in residential product style and price point; and (iii) projects with fee simple lots and an integrated condominium component.

It should be noted that the nested model can be more expensive to design and implement principally as a result of the flexibility inherent in the system. The fact that the developer is able to postpone many decisions under the model means that the developer, and counsel, will be designing the system throughout the development process and will often need to take into account, or at least consider, the expectations of non-developer owners when making these decisions.

V. SEPARATING GOVERNANCE POST-CREATION- BUSTED

What if in the middle of development the developer, or its successor, discovers that the governance model is no longer workable due to improper selection or changed circumstances? Even a thoughtfully designed governance system may no longer be workable due to political issues, changed market conditions, or other factors. Perhaps the developer filed a foundational covenant anticipating a mixed-use project, but the first prospective commercial

[3] See Attachment 3 for a visual depiction of nested governance.

[4] The development area covenant can serve as a condominium declaration filed pursuant to Chapter 82 of the Texas Property Code if the particular phase is to be developed under the condominium form of ownership.

user refuses to purchase property subject to a governance system that will ultimately be administered by a predominant residential component. Maybe a residential project is suffering from "declarant control fatigue", i.e., the existing residents are agitating for control of the community association, but the project is nowhere near completion. In such cases and others, and assuming the recorded governance documents so allow, it may make sense to implement a new governance system for undeveloped portions of the community. There are obviously political and fiscal issues associated with a decision to "bust" an existing governance system, but if the existing documents include appropriate withdrawal provisions (assuming the new system will include property then subject to the existing system), or if the land was never annexed into the existing system, these issues can often be addressed.

For those projects with amenities that will be shared between the existing and new system, joint use can be addressed through a common amenity sharing agreement. The sharing agreement can address the allocation of operational and maintenance costs, reserve easements in favor of the non-owning party, and implement common rule and enforcement procedures. For projects with newly bifurcated residential and commercial components, to the extent the commercial component benefits from maintenance provided by the residential association, the commercial governance system can provide that a portion of the costs incurred by the residential association be collected through commercial assessments.

Excluding undeveloped positions of the planned community from the existing governance model can also raise regulatory issues. In certain circumstances, the approval documents issued by a city or county for undeveloped components of the project may include requirements or conditions premised on the existing governance system. For example, the plat for an undeveloped section with a water quality pond may include a plat note, which requires that the pond be maintained upon completion by the association created under the existing model.

Breaking an existing governance model may be impossible based on existing agreements and/or the expectations of existing owners; however, in certain circumstances, the benefits of developing future portions of the planned community under a new model may justify a careful analysis of whether breaking the model is possible.

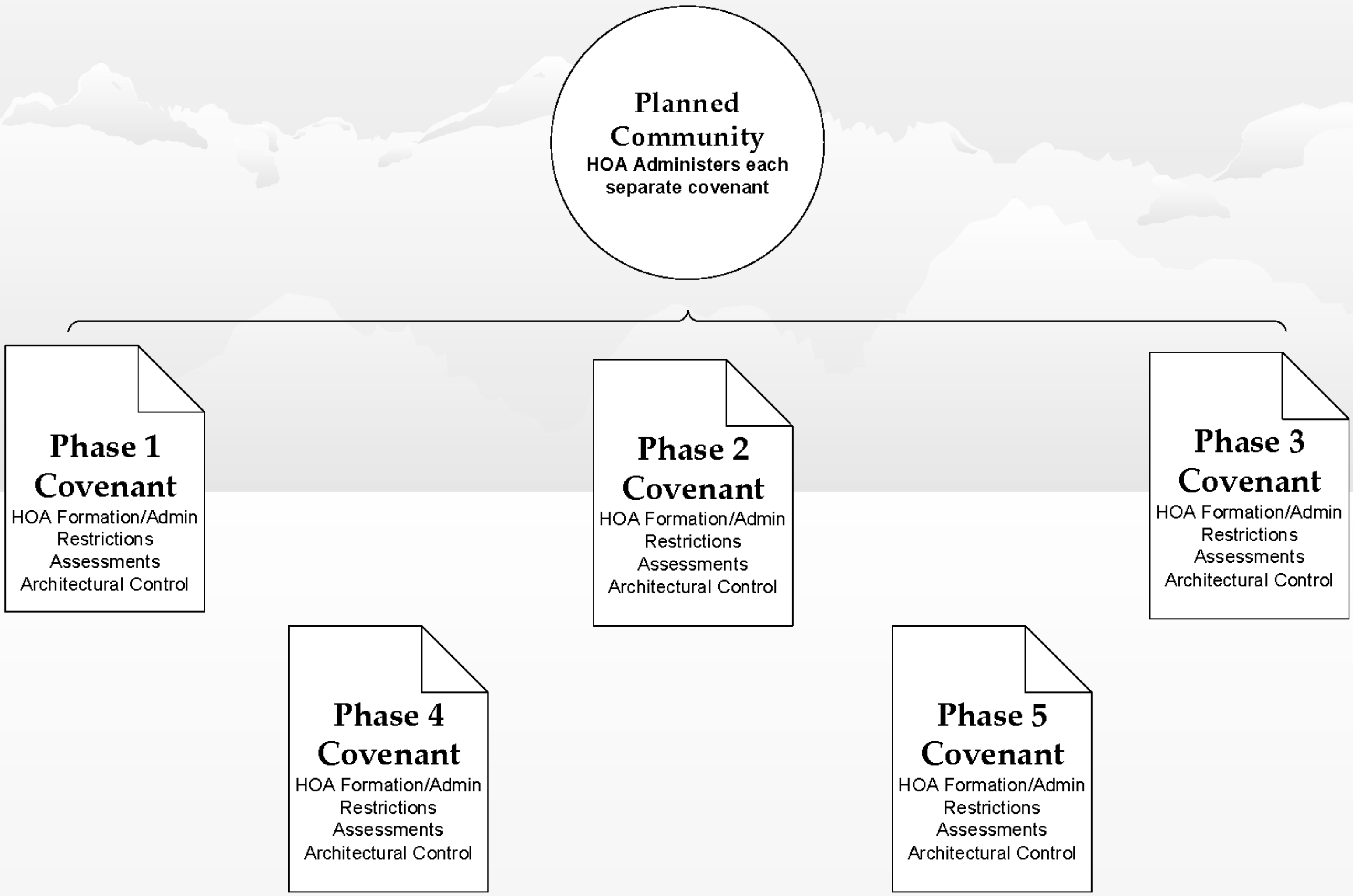
VI. CONCLUSION

In addition to the specific use and construction restrictions to be applied to a proposed development, the developer and their counsel should give careful consideration to the structure used to implement the restrictions. The structure, or model, of governance should be selected based on the size and unique characteristic of a particular project. A poorly chosen model can increase developer exposure to claims, reduce market flexibility, and increase development and community administrative costs. The serial model of governance should be avoided.

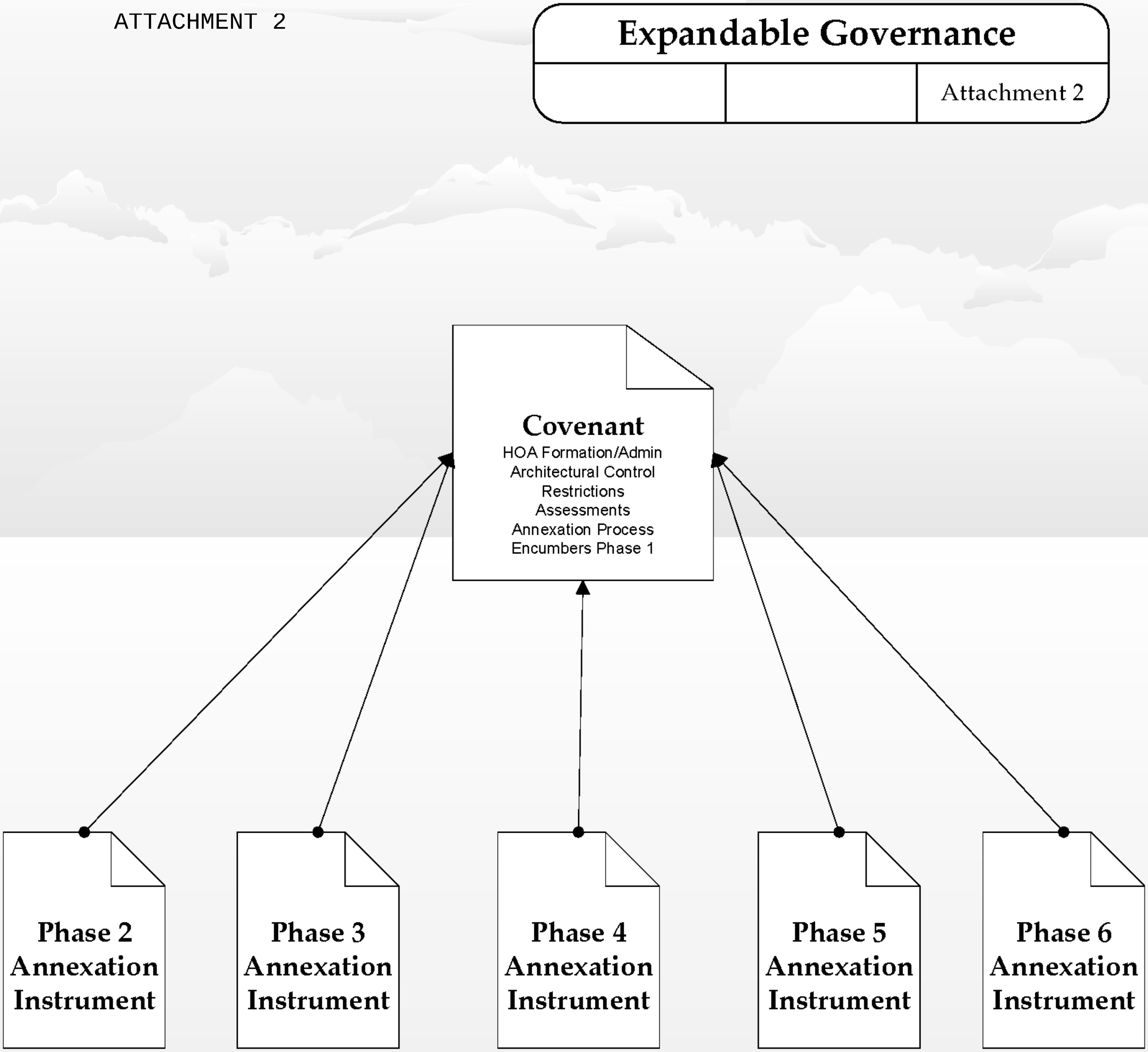
ATTACHMENT 1

Serial Governance

Attachment 1



ATTACHMENT 2



ATTACHMENT 3

Nested Governance

Attachment 3