

ARCHITECTURE OF COMMUNITY GOVERNANCE

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CHAPTER 8

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ARCHITECTURE OF COMMUNITY GOVERNANCE¹

I. INTRODUCTION.

The term “Architecture” is usually used in conjunction with the design of physical improvements; that is, exterior or interior building design or programming, as well as site landscaping planning and design. The legal definition of the practice of architecture in Texas is “a service or creative work applying the art and science of developing design concepts, planning for functional relationships and intended uses, and establishing the form, appearance, aesthetics, and construction details for the construction, enlargement, or alteration of *a building or environs intended for human use or occupancy...*”². This definition, and many of the words used – “creative”, “applying art and science”, “planning for relationships”, and establishing form and direction for construction for the purpose of human occupancy – can just as well be used to describe the role, function and purpose of creating a community governance system.

Community governance is a system – a system composed of rules, procedures, policies, and practices which are developed to administer a planned community. Deed restrictions, often taking the form of a single unifying instrument or sometimes separate and connected instruments; bylaws for the community association (whether one or more); separate rules related to construction of improvements; rules for the use of those improvements by owners, the board and committees of the members; and management policies all must be drafted and recorded or adopted. These are multiple and interconnected documents with the principal goal of creating a unified, sensible, coordinated system that can be explained, enforced, modified, and managed effectively. The various documents needed to achieve this goal are a system that should have a thoughtful architectural framework. Which architectural framework to employ will depend on a myriad of factors, including location, regulatory environment, timeline for the project, and product type. In addition to the legal requirements and legal judgments that must be satisfied or made as these instruments are prepared, how all the pieces, i.e., documents, fit together can and should provide guidance on the content and structure of each document and the relationship of each document to one another. This marriage between legal, business, and conceptual considerations, and how those considerations are combined by the practitioner to create the governance documents for a particular project, is the architecture of community governance.

¹ I would like to thank my Winstead colleagues Jenny Forgey and Jeff Thompson for their contributions to this article.

² Tex. Occ. Code, Section 1051.001(7) (emphasis supplied).

Over the past 30 years, my practice has principally dealt with the preparation and structure of community governance documents for horizontal and vertical³ planned communities across Texas and the United States. These planned communities have been of all types, and each are different in certain respects, whether that be the product mix, the client, the geographic location, and/or the existing or changing regulatory environment. Whether it be a single residential community with one or multiple builders, a true mixed-use project with a dominant residential or commercial use, pure commercial, resort dominant, age-qualified, rental dominant, or membership as opposed to ownership based, all these projects share a few conceptual underpinnings and ultimately fit into a type of governance architectural model.

Admittedly, this will not be your typical conference article, and those of you reading this may have different opinions on the ideas and models described below, other ideas you find important, or models you have used that are conspicuous by their absence. This article includes several graphic representations of types of governance systems. I have found that pictures are a better means to communicate these systems when explaining a proposed governance structure to a client or other project stakeholders. As will become soon apparent, this article is not intended to address operation or administration of the planned community or the enforcement or implementation of community rules. Rather, my goal is to illustrate the necessity of a thoughtful architecture as you go about preparing the documents that will comprise the governance system.

II. DESIGNING FOR CONSTITUENCIES: TO EACH THEIR OWN

It is possible to draft a governance system consisting of a single instrument, or declaration of covenants, that includes enabling language for the community association and assessments, end-user restrictions, design criteria/guidelines, and other various policies and procedures related to the operation of the governance system. A simplistic architecture would include a declaration and the organizational documents needed to create and administer the community association, i.e., a certificate of formation and corporate bylaws. There are many examples of

³ I use the term horizontal to refer to non-condominium governance systems and vertical to mean systems that utilize the condominium form of ownership for separate uses. There are blended systems wherein a horizontal (non-condominium) system is used to establish an overarching regulatory scheme whereupon a portion of the land subject to the horizontal system is then submitted to a vertical (condominium) system. By way of full disclosure, there are also blended systems that use the condominium form of ownership to separate horizontal land uses wherein one of those separate horizontal land uses is then submitted to a condominium system to further separate horizontally or vertically. Since submission to a condominium system is usually seen as creating a three-dimensional component of real estate with a conspicuous vertical dimension, I use the term vertical to mean any system that uses the condominium form of ownership. For a discussion of horizontal separation using the condominium form of ownership, see Burton, *Texas Site Condominiums*, 31st Annual Advanced Real Estate Drafting Course, Chapter 6 (March 2020).

this architecture all over Texas and throughout the United States, some old, some new, some being drafted right this minute. However, even for a straight-forward homogenous project⁴, this simple system does not consider how the various constituencies will use different parts of the governance system.

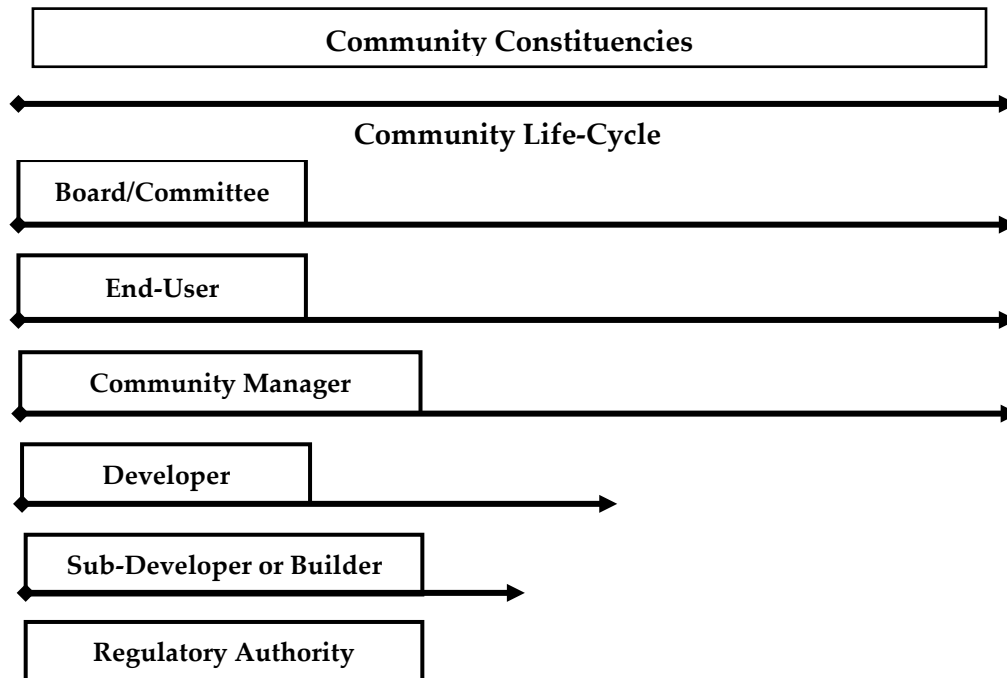
Constituencies include the master developer⁵, builders or sub-developers of product that will be sold to end-users, the end-users of the product, the community manager, community board or committee leadership, lenders (construction loans or mortgages), utility service providers (private or public), and often local entitlement agencies. Each of these current or future stakeholders have different needs and will interact with the system differently. The master developer needs to retain some controls over the system to ensure its development plan is realized and to further preserve its ability to obtain a return on investment. The builder or sub-developer is primarily concerned with ensuring that its product can be built in the community and the process required for approval of the product. End-users should understand what they can and cannot do on their property as well as the assessments they are required to pay for common area maintenance and community administration. Board and committee members need to understand their responsibilities. The community manager will manage the system and should be able to easily and quickly identify parts of the system that are relevant to the issue being confronted or the specific task that must be performed.

Constituencies are transitory or permanent. The master developer will control and administer the system during development and sale but will ultimately exit. The builder and sub-developer will interact with the system for a finite period (during their take down contract and/or completion and sale of their product) and then leave the system. A local entitlement authority has limited interaction with the governance system, and then usually only to confirm that the governance system incorporates applicable development requirements.⁶ End-users, the management company, and board and committee leadership are permanent users.

⁴ An example of a simple and homogenous project would be a project that includes only traditional platted lots being sold and constructed by one or more builders for re-sale to consumers with customary amenities, e.g., pool, open space, etc.

⁵ In this article, the master developer is synonymous with the initial developer (upon creation) who is the controlling authority of the governance system, i.e., the declarant.

⁶ A local regulatory authority may require that a community association be formed for the purpose of maintaining common areas; that specific common area be identified in the governance documents; and/or that the governance system include long-term development and product requirements, e.g., minimum home size, required setbacks, etc.

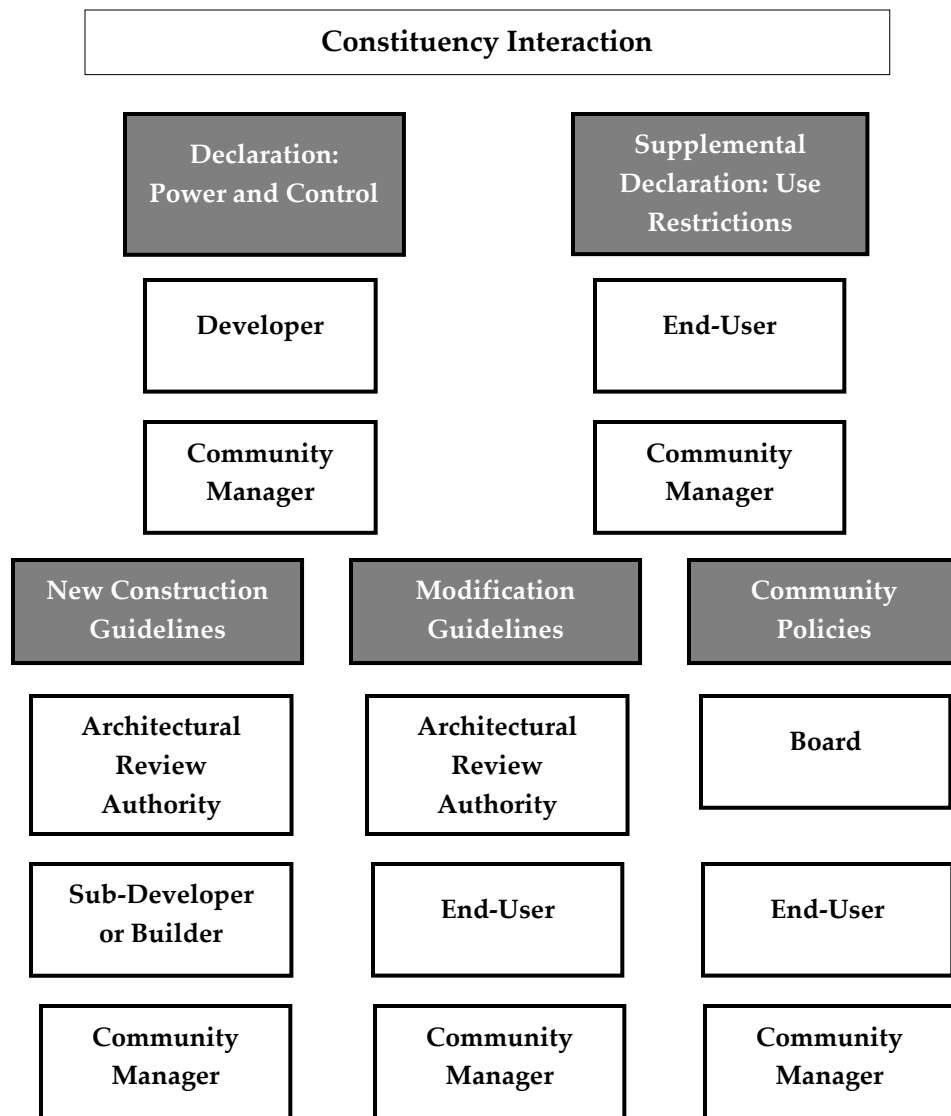


Another facet to design, and the differing constituent interactions with the system, is particularly relevant for the master developer. A sensible governance organizing principal can help ease understanding and provide direction and focus to aspects of the system that matter to a particular stakeholder. This means determining whether specific subject matter that is important to a class of stakeholders can be separated into a component of the system. An organized system is a system that is easier for the master developer to explain, modify as to a specific stakeholder, and administer during developer-control. For the builder or sub-developer, that may mean removing all construction restrictions or design criteria from the declaration and placing them in a separate document so that its focus is on the design document as opposed to the entire system. For administration of the community association, that means assembling all operational policies and community rules into a separate component of the governance system, so the manager has a better understanding of its role and can focus on making suggestions to improve operational efficiency.

One simple analogy is to how we, as a people, organize our government. I often refer to the declaration as the “constitution” of the community. Though it may be necessary at some point during the life-cycle of the system, the declaration should be amendment stable, i.e., sustainable. The declaration, without amendment, should be able to accommodate a change in product or technology, or a new and unexpected stakeholder, e.g., an age-qualified sub-developer, etc. A declaration is more likely to become unstable when construction requirements, or provisions that deal primarily with operation and administration of the

community association, are included. Similar to a constitution, the declaration may be thought of as the power and control document. The declaration allocates authority, control, and rights as opposed to incorporating specific details regarding product or process, which are more likely to change over time. Obviously, the risk of instability rises with the size and complexity of the project. However, even the relatively simple homogenous project will likely change over the coming decades. To secure sustainability requires that some thought be given to the likelihood of change and requires organizing the components of the governance system in a manner that it may more easily respond to change...even for the simple project.

The graphic below illustrates how each document in a governance system interacts with various constituencies in the system.



While the function and purpose of the documents listed above are probably self-explanatory to those of you who create community governance systems, some explanation of the community policies “document” may be helpful. Section 202.001(1) of the Texas Property Code requires that most policies which the community association seeks to enforce must be recorded. Many of these polices are adopted by the board or the developer outside of the recorded declaration and sometimes later in the project life-cycle, e.g., amenity rules. In addition, over the last several years the Texas Legislature has required that certain polices be adopted.⁷ As noted, to the extent the policy is of a nature that is intended to regulate behavior and be enforced against a member of the community association the policy must be recorded. Policies, whether required by law or best management practices, can be numerous. Recording these policies separately, which is a practice we have seen in Texas, is not ideal. Disparate and separate policies, recorded over time and from time to time, can create confusion. Time separated single subject polices are more prone to be adopted in a vacuum without reference to the content or context of other components of the governance system. Different terms, for example, may be used to refer to the same enforcing authority and different notice, fine, or enforcement standards may be used between polices when a single approach may work. The careful attorney may overcome these problems but polices are not always drafted by attorneys. Some are drafted by community managers or community members, and sometimes they are based on other forms used or other projects with different governance systems. Separate policies disconnected from the governance system erode sustainability of the system.

One means to counteract this risk is to prepare and adopt a community manual and establish the manual as an integrated part of the system. That means the architect of the system prepares the community manual at the same time as the other governance components, not as an afterthought but as part of the system. Defined terms are more conveniently confirmed, conflicts between components are more easily resolved, and the purpose of each part of the governance system is more easily understood. A community manual establishes one integrated document for policies and procedures and a means by supplement to change or add policies over time as needed to respond to changed circumstances. Yes, there is more art than science here, but art is part of the architecture of governance.

⁷ Chapter 202 of the Texas Property Code has become the de facto legislative dumping ground for several polices which can be characterized as use restrictions and design guidelines in reverse. In other words, the Texas Legislature has identified certain improvements or behavior that an association may not prohibit or regulate or may prohibit or regulate only within certain parameters. This list includes xeriscaping, rain barrels, solar facilities, flags, roofing, religious displays, generators, firearms, selling lemonade, swimming pools, and security improvements. To enforce, in most circumstances the community association has to adopt specific policies which then must be recorded.

III. STAND-ALONE AND SEQUENTIAL GOVERNANCE SYSTEMS

A. Stand-Alone Governance.

Stand-alone governance refers to a single declaration that when first recorded subjects land to the declaration. Additional land may be added to the declaration over time. You may think that describes all governance systems, but that is not the case. What distinguishes the stand-alone system from the more complicated, “sequential system”, described in Section III. B below is that the stand-alone declaration will include use restrictions and may include construction restrictions. Thus, there is less separation of the system into component parts to address separate stakeholders. However, components of the stand-alone system may still be designed to preserve sustainability. The stand-alone declaration may exclude construction restrictions, which may be addressed in separate design guidelines, and a community manual may be used to address association policies and best practices. What is missing is the flexibility to adjust for product type and more easily negotiate special arrangements with sub-developers without having to amend the declaration (see the discussion on “amendment stacking” below). However, the assumptions underlying the stand-alone system are that flexibility regarding product type or development is not necessary. The development is simple and homogenous, i.e., detached homes or commercial buildings on separately owned and platted plats, and the development time horizon is short (reducing the risk of changed economic circumstances, culture and/or building technology). These communities have a developer, that is often the builder, or a handful of builders all with similar expectations.

Though perhaps counter-initiative since they presume a single owner, long-term projects, whether they be build-to-rent⁸ or single owner commercial, sometimes use stand-alone governance systems to provide a ready means to administer community policies and allocate expenses, to satisfy local regulatory requirements, to provide an option to transition to diversity of ownership, and to limit liability for the maintenance of amenities or shared features. With a single-owner project, the governance system (if there is one) is usually simpler. These systems vary in detail and documentation based on the project and operator. In certain cases, a declaration is recorded authorizing the formation of an association and assessments, but the association is never formed. If the system is required by a regulatory authority, for example to own and maintain common areas such as a pond or an integrated drainage system, the association is formed, but assessments may never be levied, at least so long as the project is

⁸ For a discussion of issues often confronted when introducing a build-to-rent project into an existing planned community primarily composed of residential for-sale product, see Burton and Grobmyer, *Build-to-Rent and Planned Communities: Making the Match*, Texas Builder Magazine (February 2021).

owned by a single owner. For pure commercial or industrial projects with long-term leases, an association may be formed to maintain shared drives or monumentation and assessments levied to provide a convenient means to substantiate lease pass-throughs. Even without any regulatory requirement to do so, a stand-alone declaration may be recorded, and an association formed to secure more favorable insurance or to provide some protection from claims against the owner and operator of the project.

B. Sequential Governance.

1. “Just In Time” Model.

Sequential governance is a system where flexibility is critical. A means to address divergent product, sub-developers, and different rules and requirements for different parts of the community must be addressed in order to create sustainability. Sequential governance should be considered for: (i) mixed commercial and residential; (ii) mixed residential (detached, attached, age-qualified), where there may be various classification of common area with different benefitted parties (and payors); (iii) developments with long, sometimes multi-generational development timelines; and (iv) any other project where use and users are uncertain and may change over time. In the sequential system, the declaration more squarely fits into the analogy made in Section II of this article in that the declaration is only devoted to the fundamental principles of governance, essentially a constitution, as opposed to specific use or construction restrictions. In a sense, the declaration may be viewed as a launch pad where the actual regulation of successive land areas, phases, or products is deferred.

An important feature of sequential governance annexation is “just in time” annexation. “Just In Time” means subjecting portions, as opposed to all, of the land to the governance system in close proximity to when use and user are known. There are tensions and risk in this approach, which are described below, but for the large mixed-use project with multiple and uncertain potential uses, and a long development life-cycle, annexation over time, just in time, supports system sustainability. Just In Time presumes “declaration as constitution” with no use, construction, or product restrictions in the declaration. The declaration is devoted only to the process of governance, authority of the association, reservation of right to levy assessments, and preservation of developer rights during development of the project.

The sequential governance system uses supplement covenants to allow for different regulations for different products or sub-developers. A single supplemental covenant with appropriate use restrictions will likely accommodate all traditional, single-family, detached, residential lot product without regard to the builder or home architectural style. An age-qualified, 55 and over product, would require a separate supplemental covenant to incorporate

provisions required by the Housing for Older Persons Act⁹. An attached product might use a supplemental covenant to also serve the purpose of a condominium declaration under Chapter 82 of the Texas Property Code.¹⁰ A commercial multi-family project will have a separate supplemental covenant to address use restrictions unique to multi-family rental use.

Supplemental covenant practice will often differ depending on whether the land area of the project to be encumbered is residential or commercial. A supplemental covenant for single family detached residential lot product is usually agnostic despite various lots sizes. The supplemental covenant has traditional use restrictions appropriate for all detached residential use, and there is usually no reason to file separate supplemental covenants for each separate phase of the same product type. In effect, the supplemental covenant for detached residential is like the stand-alone covenant in that newly developed residential phases are annexed into the supplemental at the same time those areas are annexed into the principal declaration. If the use of what was thought to be a standard residential phase changes to residential use that requires different use restrictions, e.g., age-qualified or attached townhome, a separate supplemental covenant addressing the changed circumstance may be recorded. This is one of the inherent benefits of the sequential/Just In Time system. There is no need to withdraw land from a previously recorded supplemental covenant if the covenant is determined to be unsuitable to the new phase, and there is no need to amend a prior supplemental covenant to incorporate the new use.

Supplemental covenant practice differs for commercial product in a planned community. In almost all cases, it is inadvisable to record a supplemental covenant for all multi-family, office, or retail uses since the users, i.e., purchasers, will each be different and have different requirements and expectations, whether through their own operational experience or imposed by lenders or the purchaser's investors.

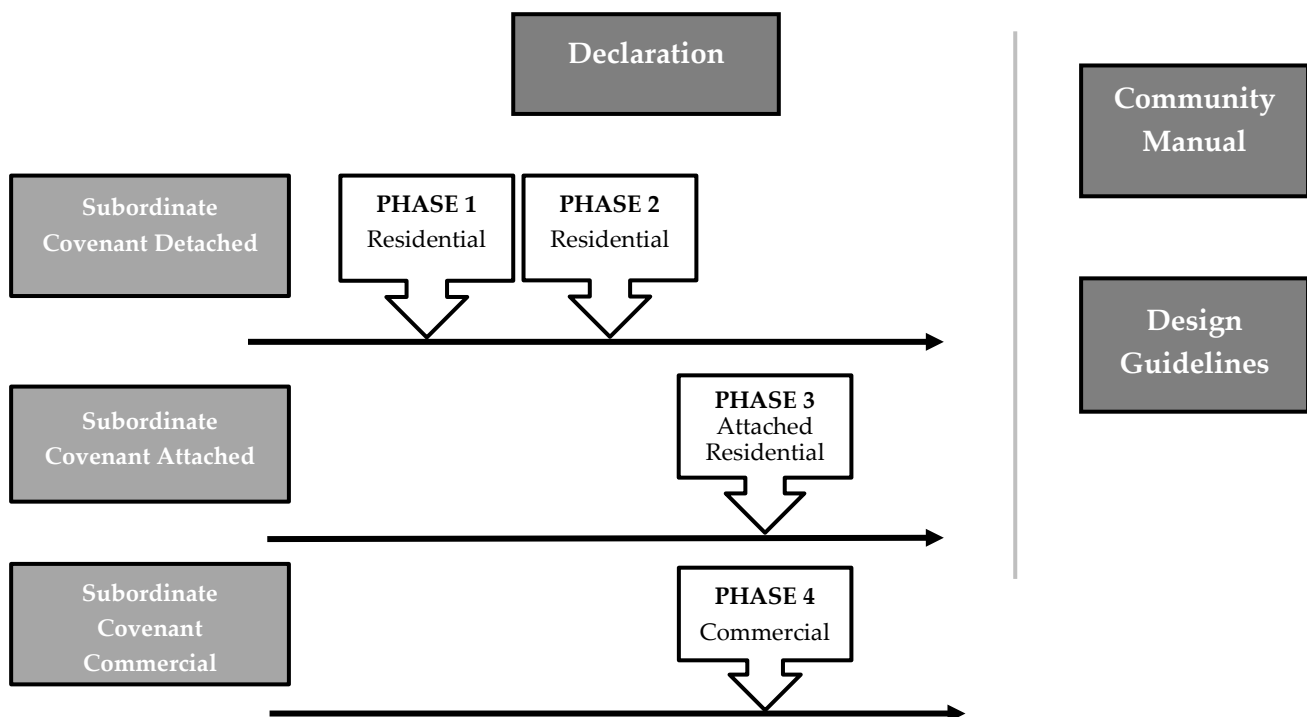
For the large and long timeline development, a sequential model with Just In Time governance incorporating supplemental covenant practice avoids amendment stacking. Amendment stacking occurs where a single declaration initially encumbers all or most of the planned development, and the declaration includes specific use, and sometimes construction restrictions. It is inevitable that there will be changes in the development plan, the projected uses, and needs of users. As the project develops and changes occur, the declaration is amended to change a use, a construction restriction, a prohibition, or add a right or feature not otherwise

⁹ The Housing for Older Persons Act of 1995 (HOPA) (Pub. L. 104-76), 109 Stat. 787 (1995).

¹⁰ If the master developer conveys a tract to a sub-developer that intends to establish a condominium on its tract, a supplemental covenant could be filed to address negotiated restrictions between the master declaration and the sub-developer as part of the sale. The sub-developer would file the condominium declaration which would then be subordinate to the declaration and the supplement covenant.

contemplated. The longer the life cycle of the development the more likely amendments to the declaration will be required. Multiple amendments to the principal declaration create system erosion and operational confusion. Entrants into the system prior to the amendment may have expectations supported by the original declaration which can increase the risk of disputes and/or affect project marketability; drafters and language used in the amendments may change over time; and the time spent stitching together multiple amendments and how those amendments work in tandem with the declaration can lead to mistakes and confusion in the administration and management of the community.

There are tensions related to Just In Time annexation, which tension arises in proportion to the amount of non-residential product in the planned community. Filing a declaration without encumbering all the land when the declaration is filed will likely be scrutinized by sophisticated commercial entrants who will be concerned that the developer will not add sufficient land to economically absorb projected common area and community administration costs. Referred to as the “pioneer problem”, since this issue is most often raised by early system entrants, it may be overcome by special side agreements with commercial purchasers whereby the developer promises to add a minimum portion of the land over a specified time and agrees to hold assessments at a certain level for a certain period of time. Even if the circumstances of a particular planned community require that all land be added when the declaration is recorded, the declaration should retain the right for the declarant to withdraw land based on certain criteria, and the supplemental covenant system should be used to regulate different components of the project.



2. Bifurcated Governance: Residential and Commercial.

Another way to reduce system tension, where the community includes meaningful non-residential components, is bifurcation. Bifurcation involves separation, of what would be a single governance system accommodating both residential and non-residential uses, into two systems: one for the residential areas and one for the commercial areas. Bifurcation allows each system to be adjusted and refined to better meet end-user expectations. A residential dominant system, meaning a system where the community association, rule-making authority, and the architectural approval process will ultimately be controlled by residential owners, may not appeal to sophisticated commercial users. Commercial users may be concerned about the risk of later changes to the system that affect commercial use generally, or targeted changes to the system that affect or prohibit a particular commercial use. This can be a real problem for marketability of the commercial areas.

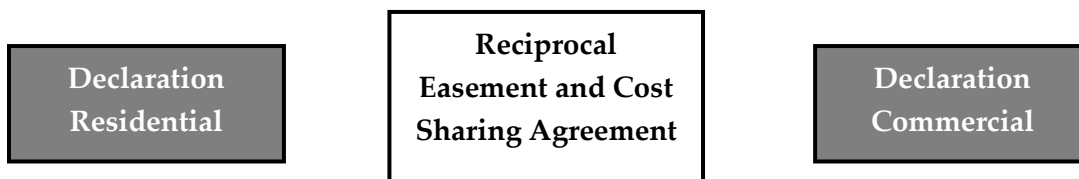
The problem may be addressed in a single system by implementing protections for the commercial use (and purchaser) into the supplemental covenant, or by establishing a blended residential/commercial control system in the declaration. However, these tools may impact system stability since they are sometimes complex and confusing. The alternative is to bifurcate.

One system is created for the predominant residential areas, and a separate system is established for the predominant commercial areas. Predominant in the sense that modern planning conventions may not conveniently separate residential and commercial areas into specific areas of the overall project. Often some commercial areas may be integrated or surrounded by residential uses, e.g., community-based commercial¹¹ or a town center, or there may be residential within a predominate commercial zone, e.g., condominium or dense residential either horizontally adjacent to commercial or built above the spaces set aside for a commercial use. For these integrated areas it can be a challenge to determine what areas should be assigned to each system, but in most cases a balance may be struck that at least reduces marketability and control concerns for the commercial areas.¹²

¹¹ If a bifurcated system is used, and if there is community-based commercial integrated within the residential areas, and if its spatial relation to residential counsels for inclusion within the residential system, the supplemental covenant system can be used to incorporate protections for the commercial use. In my experience, there is less transactional tension with small commercial uses and much more with major retailers or commercial uses, e.g., Home Depot, Costco, and major grocers.

¹² As for residential integrated into a commercial area, if access to and use of common area developed and administered in the residential system is desirable, access via easement, license, or membership, with a corresponding use charge can be used, provided the residential declaration allows the developer or board to allow access and use to owners who are not also members of the residential association.

System bifurcation for the integrated mixed-use planned community will likely raise issues related to what common area should be shared between the two systems and which association, residential or commercial, should maintain. In most all cases there will be amenities designed and intended to be used exclusively by either the residential or commercial components, but trails, certain open space, ingress and egress corridors, and certain other facilities will be shared, if for no other reason than access to such facilities cannot be conveniently restricted to a specific system and it would be unfair to burden one system with all the costs of operation and maintenance. In such circumstances, a reciprocal use and cost sharing agreement should be used to connect the two systems. The agreement will provide for shared access and designate a maintaining party for the shared area. It may also include costs descriptions and allocations between the two systems¹³, specific maintenance standards, and self-help rights reserved to the non-maintaining party.¹⁴



IV. SINGLE STREAM AND NESTED CONDOMINIUMS

The creation of condominiums is governed by Chapter 82 of the Texas Property Code, known as the Texas Uniform Condominium Act (the “Act”). Setting aside the real estate differences between a project structured as a condominium versus a project governed by a non-condominium governance system¹⁵, the architecture of governance for the condominium project

¹³ Cost sharing may not always be necessary, e.g., if the areas to be maintained by each system association, and the costs associated therewith, are roughly equivalent.

¹⁴ A reciprocal use and cost sharing agreement is also sometimes used between residential systems. This occurs where new development, with a separate system and community association, is adjacent to or near an established development with existing amenities. This is beneficial where: (i) the legacy governance system is outdated, a new system must be implemented for the new development, and there are marketing or economic reasons to operate the two areas, legacy and new, as a single development; (ii) two different developers will administer the two areas, and control needs to be held by each developer over their own developments; or (iii) the developer plans distinct communities with different product type that counsels for different systems, yet each system has amenities that are planned to be used by all communities.

¹⁵ I have written extensively over the years on various legal aspects related to the structure and creation of condominiums. For a discussion of real estate and legal considerations affecting condominiums see *The Right Condo Governance Provisions Can Enhance Safety*, Law360 (August 2021); *Texas Site Condominiums*, Advanced Real Estate Drafting Course (August 2020); *TUCA at 25*, Advanced Real Estate Drafting Course (March 2019); *Leasehold Condominiums*, 40th Annual Advanced Real Estate Law Course (July 2018); *Risky Business: Avoiding Coverage Gaps*

differs since there is statutory guidance on the contents of the declaration.¹⁶

Despite the Act's requirements, there are still structural and organizational principles that should be considered when designing a condominium governance system. The constituency principles discussed in Section II of this article still have bearing on design though there are slight differences. For the traditional attached or stacked condominium development, the developer is the builder, or takes the role of the builder from the perspective of the consumer. That is, the developer contracts with the end user and conveys a completed unit. There are condominium structures where the developer creates unimproved site condominiums and conveys sites to builders, like a platted lot. Though relatively new (new, as in the last 20 years), the site-based condominium is prevalent in Texas.¹⁷ For the purpose of this article, we will set those structures aside.

A. Single Stream Condominium.

A single stream condominium is the most prevalent form of condominium governance in Texas. Single stream refers to a project governed by a single condominium declaration which creates the units, includes operating requirements for the condominium association; allocates maintenance responsibilities for units and common elements; includes common area cost allocations and appropriate use restrictions; and reserves certain developer rights. Compared to the declaration as constitution concept for non-condominium projects, described in Section II of this article, the condominium declaration cannot meet that standard since the Act requires more detail, and rightly so given the proximity of the separately owned units, extensive structural improvements that support and serve those units, and overall greater complexity in management and administration. There are similarities, to the extent required for the project, related to the annexation of additional land or the creation of additional units, but the process is more tightly controlled and constrained by the Act as compared to a non-condominium governance system.

Even so, there are still a few organizational principles that will help protect sustainability of the system. Behavioral rules associated with use or the interaction of owners; use rules for

and Overlaps When Insuring Mixed-Use Projects, sponsored by the American Bar Association RPTE and the American College of Real Estate Attorneys (February 2018); *Condominium Tort Reform in Texas*, Texas Lawyer (2016); *Using the Condominium Form of Ownership to Segregate (Plat) Land*, Advanced Real Estate Strategies, State Bar of Texas (December 2013); *Drafting Condominium Documents to Comply with FHA, FannieMae and VA Requirements*, Advanced Real Estate Drafting Course (March 2013); *Condominium Alternatives, Mixed and Non-Traditional Uses*, 34th Annual Advanced Real Estate Law Course (July 2012).

¹⁶ See Tex. Property Code § 82.055.

¹⁷ For a discussion of site-based condominiums, see Burton, *Texas Site Condominiums*, Advanced Real Estate Drafting Course (August 2020).

shared areas; management policies and processes affecting renovations or changes to units — all should be handled by separate instrument and should not be included in the declaration. Use rules, policies, and procedures, or any special instructions or guidance needed to manage or administer the project, but which may change over time, should be addressed outside the declaration. Addressing these issues external to the declaration preserves the ability to respond to change since the Act has stricter limitations, as compared to non-condominium systems, on amending the condominium declaration (whether by the developer or the owners) which may prove difficult to satisfy.¹⁸

A single stream condominium may include residential, commercial, or a mix of residential and commercial. To the extent the project includes both residential and commercial, system bifurcation is not an option since the condominium declaration is the instrument that creates both use units (residential and commercial). Where the project includes large commercial uses, vertical system bifurcation is often used, which I refer to as a “nested” condominium and discuss in more detail below. However, if one use, whether it be commercial or residential, is non-dominant¹⁹, in that the non-dominant use is smaller or if there are limited shared areas between the two uses, the declaration may utilize “minority protections” to reduce marketability tension for the non-dominant component and otherwise protect the unit(s) from system change initiated by the dominant use. Minority protections may include limitations on rule changes or amendments without advance consent, caps on controllable expenses²⁰, and/or specialized rights or easements for the benefit of the non-dominant use.²¹

Like the non-condominium structure, a community manual is used to assemble rules, policies, procedures, and best practices that may change over time, into one document. A maintenance manual is often developed which reflects best practices, and an allocation document is sometimes used to allocate expenses in a manner which is closer aligned to use than

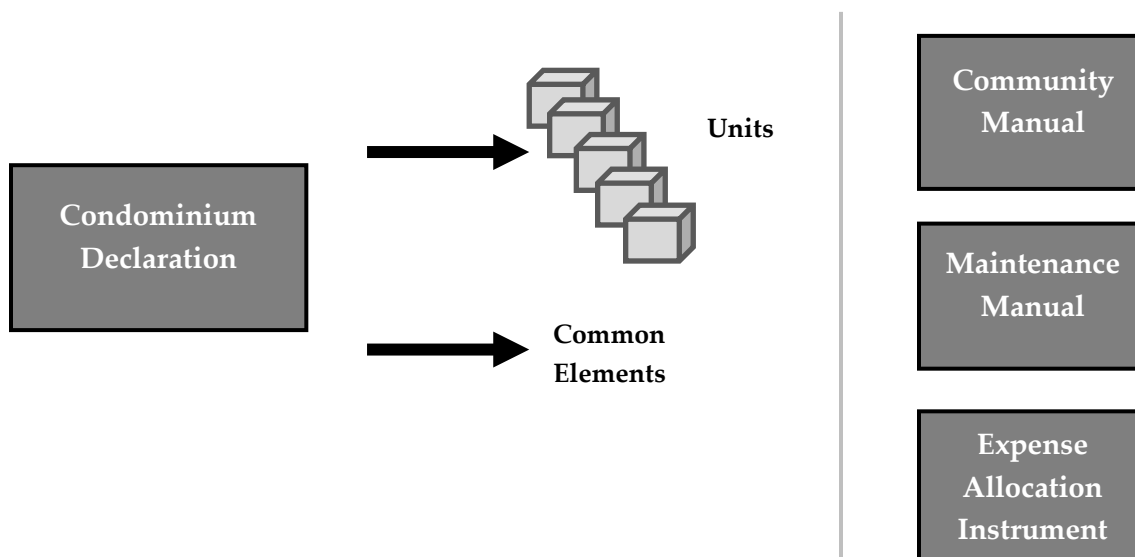
¹⁸ See § 82.067 of the Act. The developer can reserve rights to amend the declaration during the period specified in the condominium declaration for the purpose of exercising certain special rights related to the development, completion and sale of units. Some limited amendments may be prosecuted by the board of directors, some by 67% of the owners, and some changes must be made by 100% of the owners.

¹⁹ The most frequent configuration is a vertical development with first floor retail where the retail units require protection from changes to the system or rules which will ultimately be administered by a board controlled by residential unit owners.

²⁰ Caps on controllable expenses benefitting the non-dominant use will not work unless any actual expenses that exceed the cap are allocated to the dominant use. All expenses incurred by the condominium association must be paid by unit owners through assessments which are, in almost all cases, the only source to discharge such expenses.

²¹ Rights may include exclusive parking areas, use of specific shared areas during certain times, or the right to maintain a component of the project which is particularly important to operation of use. In some cases, such as parking or exclusive use areas, these rights may be characterized as limited common elements assigned to the non-dominant use.

size.²² The concept is just as true for condominiums as non-condominiums: the governance system should be structured in a manner that promotes sustainability by separating subject matter components with a high likelihood of change from the condominium declaration. The object is to reduce the risk of obsolescence and structural dissonance by allowing change without amending the founding declaration. Subject matter separation establishes an organizing principle which eases administration and makes it easier to understand the governance system.



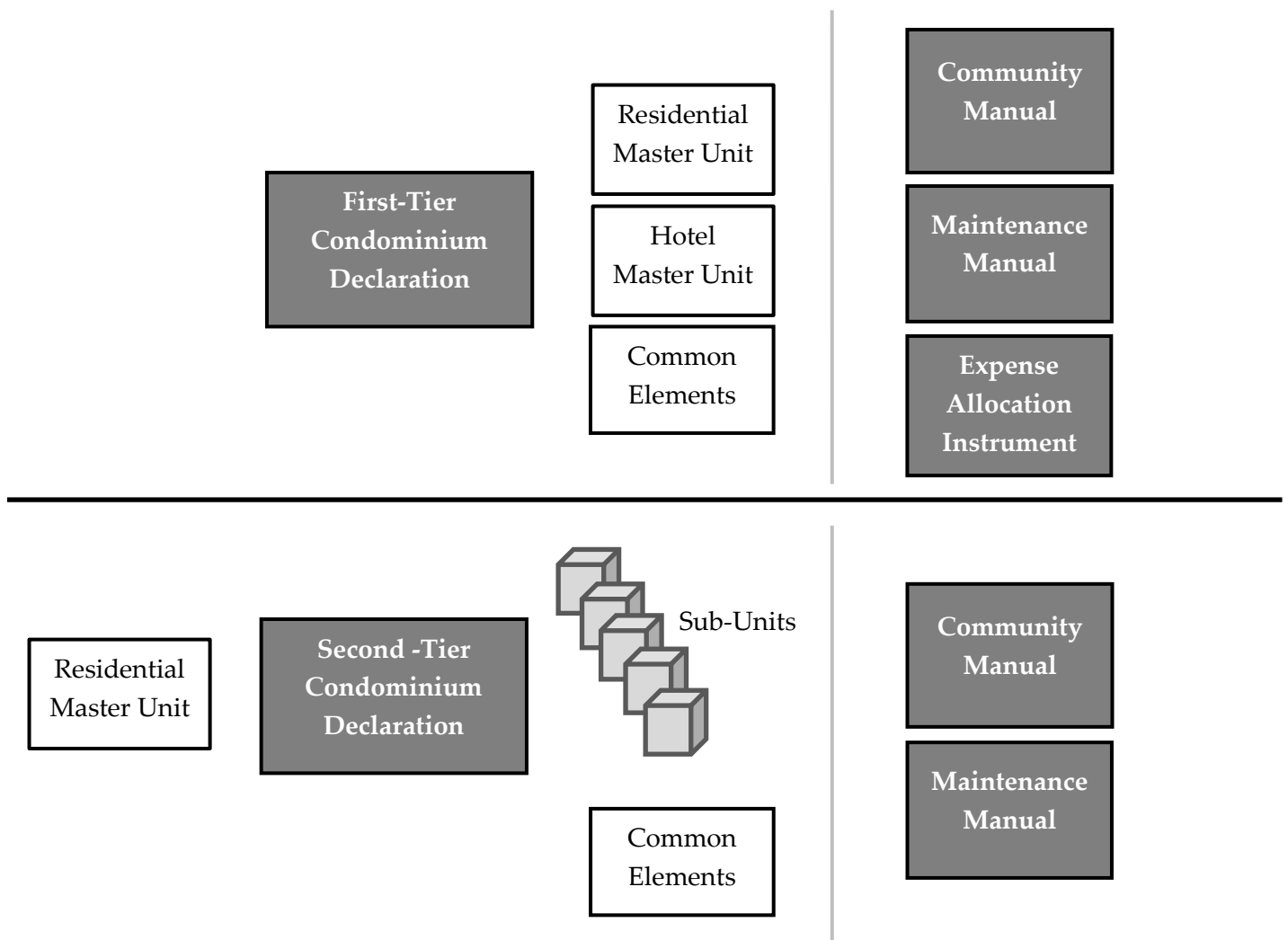
B. Nested Condominiums.

A nested condominium is a governance structure that approximates non-condominium bifurcation described in Section II of this article, i.e., separation of the residential and commercial areas of a project into two separate systems, but does so vertically by using tiered condominium declarations recorded for the same project. The nested regime is primarily used where the project includes residential for-sale units and one or more significant commercial units. The most common example is a project with a hotel use and residential for-sale condominiums, but any project with large and/or significant commercial uses along with residential is a candidate.

The purpose of vertical segregation into two regimes is to allow the superior condominium regime to manage areas shared throughout the entire project, e.g., loading docks, building structural components, mechanical rooms, garages, etc., with the superior regime controlled and administered by a board to which at least a majority of members are appointed or elected by the non-residential component, or on which the commercial component owners

²² For an extensive discussion on the use of allocations in a mixed-use development, see Leeds, Peterson, and Van Atta, *Cost Allocations in Mixed-Use, Mixed-Ownership Developments*, American College of Real Estate Lawyers (2014).

have meaningful representation. The subordinate condominium declaration, the second tier, is usually recorded for the residential use which further subdivides the residential area into for-sale residential sub-units and exclusive residential common area. Under the second-tier condominium declaration, a separate condominium association is created which manages and administers common area exclusive to the residential areas through a board ultimately elected by the residential owners, usually with no commercial unit representation. There are variations on the theme. The nested approach may be used for projects with no commercial use if there is a need to further subdivide units created under the superior declaration and there is common area exclusive to the created sub-units that should be managed and administered by a separate condominium association.



The first-tier condominium declaration separates the project into areas of the building that correspond to a use and that are intended to be owned separately. Alternatively, the first-tier condominium declaration may separate the project into areas to be further subdivided using a second-tier condominium declaration. Any first-tier declaration, also known as a “master

condominium declaration”, will also identify shared components, i.e., common elements, that will be used by all units or otherwise administered by the condominium association created under the first-tier condominium declaration. Units created by the first-tier condominium declaration are usually referred to as master units.

As noted in the exhibit above, subject matter separation still exists for the same reasons discussed for the stand-alone condominium governance systems. Separation by subject matter is even more important in a nested structure since it is more complicated. Each declaration is independent in that each declaration creates specific units and common elements and has a separate condominium association, and perhaps different community managers, but there will be integration between the systems and associations especially in a single structure mixed-use project. Shared oversight or communication, renovations and repairs that must be coordinated, joint enforcement of rules, cooperative assessment collection, organized move-in/move-out procedures, and other shared management and administration matters will naturally occur. However, each system should clearly communicate, through its document organization, where ultimate responsibility and decision-making authority lies. There is a risk, especially related to insurance claims, utility allocations, and repairs, that one system and its manager and leadership will not understand the balance of rights and duties between the two systems.

A nested system includes a ready means, through the second-tier condominium declaration, to create common area exclusive to the units created by that declaration and to allow sub-unit owners a means to manage those components through a separate condominium association. A separate association, with the right and obligation to manage common area exclusive to its members, ultimately controlled by those members, can reduce tension between use classifications, e.g., residential and commercial, which would otherwise occur if a single stand-alone declaration were used.

V. CONCLUSION

The architecture of community governance is principally a creative effort, constrained to a degree by a few legal and historical parameters, with a heavy dose of lived and learned experience. Most drafters of community systems will represent the sponsor or developer of the project, but the drafter should be mindful that a governance system is created for the life-cycle of the community. Some systems are relatively simple, some more complex. In either case, there are underlying themes to consider when thinking about how to structure a system. Organize governance, to the extent possible, with short, medium, and long-term stakeholders in mind. Thinking about these constituencies and their needs, in particular what parts of the system they are most interested in, will help determine what goes where and if a separate document or component, other than the declaration, would best serve the need. For long and medium term

life-cycle projects there will be changes in use, users, building material, community technology, and recreational needs. How will these changes be accommodated by the system? Will the system framework remain intact with change? A governance system should preserve its core purpose; that is, creating a community that continues to support *human use or occupancy*, but at the same time is able to absorb change. In short, system design matters.