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TOWNHOUSES WITH HOMES ASSOCIATIONS: A NEW PERSPECTIVE

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INTRODUCTION

In an earlier article, I have explored various reasons why the homes association might provide a better approach to the maintenance of common areas and facilities than a condominium—especially in the case of townhouse developments for sale.¹ That article suggests that the condominium provides only two significant advantages for townhouse developers: (1) in communities that have no express zoning for this use, townhouses can usually be developed under the apartment district regulations so long as the land itself is not subdivided into lots. This means that townhouses must either be rented or sold in condominium form;² (2) in many areas the word “condominium” has become associated with luxury living and has acquired a certain magic appeal on the market.

These advantages, however, are fast disappearing. There is a wind blowing from Florida that has chilled the condomin-

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¹ Krasnowiecki, *Townhouse Condominiums Compared to Conventional Subdivision with Homes Association*, 1 REAL ESTATE L.J. 323 (1973).

² For a possible response to this problem, see text accompanying notes 68-73 *infra*.

ium market.³ Reports of fraud and overreaching by condominium developers, whether merited or not, have spread throughout the country. The hue and cry has been taken up by a number of federal agencies, the FTC,⁴ the OILSR,⁵ even the IRS.⁶ Legislation is pending in Congress to bring condominiums under specific federal controls.⁷

Many developers feel that they would do well to look for some other way to market the townhouse concept. There is renewed interest in the homes association approach to townhouse development—where each townhouse is sold with its own individual lot in fee and where the common areas are conveyed in fee to a separate organization for the benefit of the residents. The common expenses and the common rights and obligations of the residents are then controlled through recorded covenants running with the land.

It has therefore occurred to me that it might be useful to review how one puts a homes association together, and how it can be used in open space community development. The leading work on this subject is still the Urban Land Institute's *Homes Association Handbook*.⁸ Although the *Handbook* was published in 1964, I believe that the legal analysis and the Model Forms for which I am responsible⁹ remain essentially sound. The Forms, of course, were never intended to be more than guidelines for local counsel to shape and improve. A number of improvements could and will be proposed in this Article. But there was a central purpose behind the old Forms—to strike a reasonable balance between the interests of the developer and the interests of the housing consumer. My feeling then was that the courts would not enforce covenants which tend to take unfair advantage of the housing consumer, and nothing has happened since

³ For an excellent discussion of the abusive consumer practices in Florida and other jurisdictions, as well as the federal and state responses, see Comment, *Condominium Regulation: Beyond Disclosure*, 123 U. PA. L. REV. 639 (1975).

⁴ The FTC is engaged presently in an investigation of condominium developer practices. [2 Current Developments] BNA Hous. & Dev. REP. 88 (1974).

⁵ See text accompanying notes 121-31 *infra*.

⁶ See Emanuel, *Condominium Developers and the Internal Revenue Service—The Florida Story*, 2 REAL ESTATE L.J. 760 (1974).

⁷ S. 4047, 93d Cong., 2d Sess. (1974); S. 3658, 93d Cong., 2d Sess. (1974). See Comment, *supra* note 3, at 662.

⁸ URBAN LAND INSTITUTE, THE HOMES ASSOCIATION HANDBOOK, (Tech. Bul. 50, 1964) [hereinafter cited as HANDBOOK].

⁹ See *id.* vii; J. KRASNOWIECKI, LEGAL PRINCIPLES AND FORMS FOR HOMES ASSOCIATIONS (1963).

1964 that would lead me to change my position. On the contrary, I am convinced that if developers do not voluntarily police the homes association approach, the legislatures and regulatory agencies will do it for them.¹⁰

I. TOWNHOUSE CLUSTER: SINGLE PHASE

Usually the developer of a large townhouse project will try to submit final plans for approval by the local authorities in phases. This approach to the larger development is dictated by several considerations: Most local subdivision ordinances require that basic site improvements—such as streets, drainage, and grading—shown on a subdivision plan be completed or guaranteed (by bond or cash escrow) when the plan is finally submitted for record. In other words, submission of final record plans is the event that triggers this expense. Under such ordinances, the only way in which a developer can defer expenditures on basic site improvements is to present final record plans for approval in phases.

In addition, the typical subdivision ordinance also requires that streets and other facilities which are intended for public maintenance must be dedicated at the time final record plans are filed. Once a street or other public area has been dedicated it is a step which is frequently hard to undo, especially when lots have been sold out of the record plan.¹¹ Thus, premature recordation has the effect of freezing the land use pattern for the entire project.

Indeed, there is a long standing doctrine that persons who buy lots in a recorded subdivision may acquire rights by implication to areas that *appear*, on the plan, to be intended for common use.¹² In this era of consumer protection, the courts have shown some disposition to expand that doctrine.¹³ These are

¹⁰ The California and New York experiences are illustrative. Regulatory approaches today apply equally to condominiums and homes associations. CAL. BUS. & PROF. CODE §§ 11003, 11004.5 (West Supp. 1974) (applies to any "planned development" which is defined by the presence of common areas supported by assessments which may become liens on the individual units); N.Y. GEN. BUS. LAW § 352-e(1)(a) (McKinney 1968). The New York Bureau of Securities and Public Financing has taken the position that homes association developments are "cooperative interests in realty" covered by the registration provisions of § 352-e. Letter from David Clurman, Director of the Bureau, to the author, Sept. 5, 1973.

¹¹ See notes 15-18 *infra* & accompanying text.

¹² See notes 20-23 *infra* & accompanying text.

¹³ See text accompanying note 20 *infra*.

some of the basic reasons why developers prefer to proceed to the development of larger projects by phases.¹⁴

I will speak of phased development at greater length in Part II of this Article. For purposes of this Part, I assume that the development will consist of only one phase. This assumption allows me to concentrate on the basic elements of the homes association approach without introducing the added complications that are connected with phasing.

A. *The Basic Property Scheme*

1. Role of Subdivision Plan

A recorded subdivision plan has two consequences that can affect the scheme:

a. *Dedication to the Public*

In the absence of an express provision to the contrary, a recorded subdivision plan may impliedly dedicate to the public all those areas shown on the plan that are usually owned and maintained by the public. Certainly this is true of streets,¹⁵ and the rule has been extended to parks and playgrounds.¹⁶ The courts usually hold that the implied dedication occurs when the first lot is sold out of the recorded subdivision.

The implied dedication may occur even though the area in question is not labelled on the plan as a "street,"¹⁷ "park," or "playground"¹⁸ if its shape suggests that it is such a public area. Obviously, steps must be taken to assure that the common areas shown on the recorded plan intended to be conveyed to and maintained by the association are saved against a possible implied dedication to the public. For this reason, I recommended in the *Homes Association Handbook* that a notation be inserted on

¹⁴ By way of contrast, this is precisely the problem that condominium statutes do not solve. Most of the statutes are based on an FHA model law that was drafted for a development consisting of a single building. As a result, they do not recognize the need for phased development nor do they accommodate it. See Krasnowiecki, *supra* note 1, at 353-65.

¹⁵ *Stanfield v. Brewton*, 228 Ga. 92, 184 S.E.2d 352 (1971); *Adams v. Rowles*, 149 Tex. 52, 228 S.W.2d 849 (1950); *Harris v. South Portland*, 118 Me. 356, 108 A. 326 (1919); *Brighton Constr., Inc. v. L. & J. Enterprises, Inc.*, 121 N.J. Super. 152, 296 A.2d 335 (1972).

¹⁶ *Whilden v. Richie*, 42 Del. Ch. 62, 203 A.2d 617 (1964); *Picconi v. Carlin*, 40 N.J. Super. 393, 123 A.2d 87 (1956).

¹⁷ *City of Indianapolis v. Kingsbury*, 101 Ind. 200 (1884).

¹⁸ See *Picconi v. Carlin*, 40 N.J. Super. 393, 123 A.2d 87 (1956).

the face of the recorded plan identifying the areas which are not to be dedicated to the public and stating that these areas will be conveyed to a homes association as more fully provided in a Declaration of Covenants and Easements executed and recorded on the same date.¹⁹

b. *Implied Private Protective Easements*

Running parallel to the doctrine which implies a public dedication of seemingly public areas shown on the plan, is a doctrine that implies that each purchaser of a lot acquires a private easement of use and enjoyment over such areas in common with the other lot purchasers in the subdivision. So far, the easements have been confined to common activity areas such as streets,²⁰ playgrounds,²¹ and lakes²² shown on the face of the recorded portions of a subdivision plan.²³ If this limitation prevails, a developer can protect his open space and street plan from being frozen through such implied easements by simply recording his plan in smaller sections (local government permitting). This, it will be recalled, is one of the reasons for phased development. One might question, however, whether the courts will hold the line between recorded and unrecorded plans, especially if the latter are actively employed in the sales promotion. This question as well as others that relate to phased development will be discussed at length in Part II.²⁴ Here I have assumed that we are dealing with a single phase and that the developer is willing to commit himself fully to all of the representations made in that phase.

Nevertheless, the doctrine of implied easements is significant for the single phase because developers may wish expressly to limit or enlarge its scope. If the rights of the lot purchasers in the common areas are left simply to implication, it may become impossible to modify the arrangement without the con-

¹⁹ HANDBOOK, *supra* note 8, at 197, 382 (Appendix E, Model Form: Dedication of Common Areas).

²⁰ See note 15, *supra*; Highway Holding Co. v. Yara Eng'r Corp., 22 N.J. 119, 123 A.2d 511 (1956); Rahn v. Hess, 378 Pa. 264, 106 A.2d 461 (1954).

²¹ See Picconi v. Carlin, 40 N.J. Super. 393, 123 A.2d 87 (1956).

²² Klein v. Dove, 205 Md. 285, 107 A.2d 82 (Ct. App. 1954).

²³ See notes 15-22 *supra*. Apparently New York takes the position that the implied rights arise only in favor of those purchasers whose deeds refer to the plan. Weil v. Atlantic Beach Holding Corp., 131 N.Y.S.2d 225 (Sup. Ct. 1954), *modified*, 285 App. Div. 1080, 139 N.Y.S.2d 799, *aff'd as modified*, 309 N.Y. 772, 128 N.E.2d 813 (1955).

²⁴ See text accompanying note 97 *infra*.

sent of every one of the lot owners. Furthermore, the association should have the power to suspend members from the enjoyment of these areas for infraction of its rules and for non-payment of assessments. An implied easement might not be subject to such limitations. Consequently the *Homes Association Handbook* urges that the enjoyment rights of the residents in the common areas and facilities should be expressly spelled out, so that appropriate limitations can also be imposed. This is best done in the Declaration of Covenants and Easements with an appropriate reference made on the face of the subdivision plan.²⁵

The question is often asked whether the enjoyment rights should be extended automatically to tenants as well as owners. I have always felt that the membership rights should be given to the owners in the first instance with the proviso that the owner may extend his enjoyment rights to his tenants and to any member of his family who resides with him. I am aware that this is an era when failure to champion the cause of tenants is looked upon with some distaste. But I think that the idea that tenants automatically get a vote²⁶ in the association or that they automatically get a right of enjoyment to the common areas and facilities is troublesome, not because tenants should be denied these rights but because it seems unwise to separate control over these rights from the interest in the property that will bear the long range gain or loss attributable to the use or abuse of those areas. Obviously I am talking only about who is given control, not about how it should be exercised.

2. The Declaration of Covenants and Easements

a. *Protective Covenants: Architectural Review*

There are many restrictive or "protective" covenants that a developer might wish to include in the Declaration for the purpose of regulating the use and appearance of the community. Protective covenants of this sort are not unique to a homes association scheme. Nor do they involve any difficult legal questions. Attorneys drafting such covenants should consult the

²⁵ HANDBOOK, *supra* note 8, at 197, 382 (Appendix E, Model Form: Dedication of Common Areas); *id.* 387 (Appendix F, Model Form: Declaration of Covenants and Restrictions, Article IV).

²⁶ This is the one small modification which Community Management Corporation has made in my original HANDBOOK forms. See COMMUNITY MANAGEMENT CORP., MODEL LEGAL DOCUMENTS FOR COMMUNITY SERVICE ASSOCIATIONS (1972).

planners and architects involved in the project and rely heavily on their advice concerning the use or design features to be covered. Ordinarily, it is a good idea to create an architectural review committee within the association to administer the protective covenants. The committee can serve as an important buffer against the dissension that can easily result when there is a dispute that involves matters of taste. Unless the developer is certain that he can control the committee, the draftsman should take care to exempt original construction by the developer from the architectural review. The term "developer" should be defined to include the name of the individual or company and any person or corporation to whom the named developer assigns his rights in writing.

b. *Covenants for Maintenance Assessments*

Unlike restrictive covenants, covenants for maintenance assessment call upon the landowner to do something affirmative—to pay money. Unfortunately, the law that relates to affirmative covenants presents the ordinary mortal with one of the most confounding intellectual experiences he can suffer. There seem to be two schools of thought in this field: one follows the mysteries of "privity" and "touching and concerning" through every turn only to confound itself and its readers; the other simply tells us that all of this knowledge is irrelevant because affirmative covenants will always run as equitable servitudes in equity.²⁷ Most of the writings in the latter group imply that equity will enforce the obligations by some form of personal judgment—and that is simply untrue.²⁸ But I am tired of en-

²⁷ For an informative review of the existing theories and cases, see 5 R. POWELL, *REAL PROPERTY* 670-86, at 139-344.9 (1971). Other recent writings include, C. CLARK, *REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH LAND"* (2d ed. 1947); Berger, *A Policy Analysis of Promises Respecting the Use of Land*, 55 MINN. L. REV. 167 (1971); Newman and Losey, *Covenants Running with the Land, and Equitable Servitudes: Two Concepts, or One?*, 21 HASTINGS L.J. 1319 (1970). Compare Dunham, *Promises Respecting the Use of Land*, 8 J. LAW & ECON. 133 (1965), with HANDBOOK, *supra* note 8, at 309-37.

²⁸ 2 AMERICAN LAW OF PROPERTY § 9.36 (A. Casner ed. 1952), explicitly states that affirmative covenants will run with the land as equitable servitudes and will be enforced by mandatory injunction. I have not been able to find a single case which supports that last proposition. Of the two cases cited, the first, *Murphy v. Kerr*, 5 F.2d 908 (8th Cir. 1925), expressly refused to reach the question, and the second, *Whittenton Mfg. Co. v. Staples*, 164 Mass. 319, 41 N.E.441 (1895), expressly limited the judgment so that execution could issue only against the land in question, *id.* at 331, 41 N.E. at 446. For other cases, see J. KRASNOWIECKI, *CASES AND MATERIALS ON OWNERSHIP AND DEVELOPMENT OF LAND* 408-11 (1965); HANDBOOK, *supra* note 8, at 315-20.

gaging in fruitless polemics and so, I am sure, are my readers. So I am going to state what I think the rules are, and why:

Rule 1. Courts do not like to enforce affirmative obligations against successors in interest to real property—an affirmative covenant will not run—unless they are satisfied that (a) assuming each successor knew of the covenant,²⁹ he would naturally expect to be bound when taking title to the property, and (b) the nature of the covenant is such that the purchaser can generally predict what the burden will be at the time of his purchase (enabling him to adjust the purchase price up or down for its presence).

The first part of this proposition—the purchaser must expect to be bound—is really what the courts are concerned with when they talk about whether the covenant “touches and concerns the land.” The covenant must relate to the land in such a way that the ordinary mortal would expect that if he takes the land, the covenant will come with it.³⁰ That is why a covenant to fly to the moon will not run with the land.³¹ But a covenant to pay for the maintenance of common areas and facilities will run³²—if the other rules I am about to discuss are also met.

²⁹ 5 R. POWELL, *REAL PROPERTY* ¶ 680 (1971).

³⁰ Professor Bigelow suggested some years ago that a covenant “touches and concerns the land” whenever the defendant’s legal interest in the land will become less valuable through its enforcement. Bigelow, *The Content of Covenants in Leases*, 12 MICH. L. REV. 639, 646 (1914). Most commentators agree with Professor Bigelow’s suggestion, see, e.g., 5 R. POWELL, *REAL PROPERTY* ¶ 675 (1971). But to apply that theory, one must be able to identify what is part of the bundle that is called one’s “legal interest in the land.” These writers have not furnished us with any satisfactory method of doing this. I think that the best way of identifying the contents is to examine the reasonable expectation of most buyers. Similarly, with respect to the running of the *benefit* of a covenant, Professor Bigelow used the same formula—in his view the covenant would “touch and concern” the benefited land if the plaintiff’s legal interest in the land would become more valuable through its enforcement. One is presented with the same problems of identification here as well.

Professor Bigelow did not, however, address himself to the question whether a covenant which “touches and concerns” a defendant’s land can run even though it does not touch and concern plaintiff’s land (because the latter has no land), and vice versa. See note 43 *infra*.

³¹ Unfortunately, I cannot find a case that involves these facts, but cases that say that the covenant to pay taxes runs, *Post v. Kearney*, 2 N.Y. 394 (1849), or that the covenant to maintain insurance runs, *Masury v. Southworth*, 9 Ohio 340 (1859), really cannot be explained unless one is prepared to admit that the expectations of “reasonable” persons is not as elusive a principle as most real property experts think. Indeed, basic theory of the law of torts and of contracts relies, in large measure, on this principle.

³² *Neponsit Property Owners’ Ass’n, Inc. v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938), is the leading case. See *Mendrop v. Harrell*, 233 Miss. 679, 103 So. 2d 418 (1958); *Rodruck v. Sand Point Maintenance Comm’n*, 48 Wash. 2d 565, 295 P.2d 714 (1956); *Phillips v. Smith*, 240 Iowa 863, 38 N.W.2d 87 (1949); *Queen City Park Ass’n v. Gale*, 110 Vt. 110, 3 A.2d 529 (1939). See also notes 35-38 *infra*.

The above rule of normal expectation also serves to explain why a subsequent taker is bound by a covenant when he takes the *same* interest as the original covenantor, but is not if he takes a *lesser* interest.³³ If the rule were otherwise, a tenant would automatically be bound by the covenants of his landlord—hardly a normal expectation. Similarly, it is clear that a mortgage lender is not obligated on an assessment covenant until he takes possession of the property upon default. Indeed most jurisdictions hold that he is not obligated until he has acquired title through foreclosure or through some similar proceeding.³⁴ That result is hard to explain in a “title” theory jurisdiction (where the mortgage lender takes title to the property on the date when the mortgage is given). But it is not hard to explain under my rule. An ordinarily prudent businessman would not *expect* to be personally liable on covenants affecting the mortgaged real property until he takes over control of that property. Until such time he thinks of himself only as a secured interest holder and not as an owner, no matter what the legal doctrines say.

The second part of the above proposition (that the burden of the covenant must be generally predictable) is best illustrated by the cases that have frowned upon covenants which require an owner to supply steam heat to a neighboring property perpetually.³⁵ There is no way one can confidently predict the burden of such a covenant over an indefinite period.

³³ 2 AMERICAN LAW OF PROPERTY § 9.15 (A. Casner ed. 1952); RESTATEMENT OF PROPERTY § 535 (1944).

³⁴ Sources cited note 33 *supra*; see cases collected in *Amco Trust, Inc. v. Naylor*, 159 Tex. 146, 317 S.W.2d 47 (1958). The case states, incorrectly, that in “title” theory jurisdictions, the mortgagee is bound even before he takes possession, citing *Williams v. Safe Deposit & Trust Co.*, 167 Md. 499, 175 A. 331 (1934). *Williams*, however, clearly holds that the mortgagee is not obligated on the covenant when the possession of the mortgaged premises is left with the mortgagor.

³⁵ See, e.g., *Miller v. Clary*, 210 N.Y. 127, 103 N.E. 1114 (1913). Some believe that *Miller* was, in effect, overruled by *Nicholson v. 300 Broadway Realty Corp.*, 7 N.Y.2d 240, 164 N.E.2d 832 (1959) (involving a suit in damages covering a short period during which defendant had stopped supplying steam heat to plaintiff’s property just prior to the sale and conveyance that terminated the covenant forever). But if my theory is correct, *Nicholson* would never have been decided favorably to the plaintiff had the plaintiff not sold his benefited land to the defendant, thus terminating all future enforcement. When most commentators expressed the view that *Furness v. Sinquett*, 60 N.J. Super. 410, 159 A.2d 455 (1960), closed off all possibilities of affirmative covenants running in New Jersey, it seemed to me that the case merely stood for the proposition that a covenant cannot be enforced when its enforcement was not expected by the purchaser. *Furness* involved events that happened in 1893 when every purchaser bought a lot in a subdivision and covenanted “to construct a sidewalk” on his lot. The covenant was never enforced until 1960 when someone in the subdivision decided that it would be nice to have sidewalks. The case should have been decided against enforcement because it is clear that

Applying these two rules to the maintenance assessment, it is clear that the assessment will run with the land, provided the formula for the assessment is such that its burden is generally predictable. That is why I have counselled that the covenant should establish definite maximums for the assessment with a carefully designed procedure for increasing this maximum.³⁶ I do not think that a formula which simply says that the home purchaser must pay "his pro-rata share" of the assessments will suffice, especially where the number of units sharing in the expense is not determined.

Rule 2. When several landowners expect to share equally in the benefits and burdens of a covenant and that expectation is disappointed, so that some have the benefits but not the burdens whereas others have to carry an extra burden, the courts are apt to find that the covenants are not enforceable,³⁷ at least if the majority of those who have the unexpected burdens so desire.

An example of this rule is suggested by *Peterson v. Beekmere, Inc.*³⁸ In this case, although all of the lots were entitled to the use and benefit of a lake, only some of the lots were subject to assessment. Those who were burdened by the assessment successfully brought an action to have it declared unenforceable. It is sad that the court felt compelled to distinguish, synthesize and blend all of the separate doctrines of covenant law to reach this perfectly sensible conclusion,³⁹ but that has been the tradition in this field of the law.

purchasers could not have suspected that the sidewalks would be built 67 years after it would have made sense. Instead, the court held that affirmative covenants do not run with the land in New Jersey. I knew that view was not going to prevail for long, and it did not. See note 38 *infra*.

³⁶ HANDBOOK, *supra* note 8, at 201-08, 326-27.

³⁷ Note that I have changed the formulation of this rule. Instead of saying that the covenant will not run with the land, I say that the covenant is unenforceable. It is generally believed that the doctrines that control the running of covenants with the land have nothing to say about enforcement between the original contracting parties. I believe, on the other hand, that if these doctrines are worth anything, they represent policies designed to prevent overreaching in real estate transactions and are equally applicable to the original contracting parties. For a broader discussion of this point, see note 39 *infra*.

³⁸ 117 N.J. Super. 155, 283 A.2d 911 (1971).

³⁹ The court had considerable difficulty overcoming the prior holding in *Furness v. Sinquett*, 60 N.J. Super. 410, 159 A.2d 455 (1960), to the effect that affirmative covenants will not run in New Jersey. It did so, essentially, by reference to changing times concluding that today there should be no difference between affirmative and restrictive covenants. It then grafted the doctrine of the "common scheme" from the restric-

In any event, the case supports the advice given in the *Homes Association Handbook* that the obligation to pay the assessment should be imposed against all of the residential lots in the subdivision, including the lots that the developer retains unsold.⁴⁰ The *Handbook* points out that the developer can control his exposure by limiting the number of lots platted of record at any one time.⁴¹

Rule 3. A covenant will not run with an interest in land unless the person seeking to enforce it has another interest in the same or in nearby land which is intended to be benefited by the covenant. By "intended to be benefited" what is meant is that the giver of the covenant must have reasonably expected that the right to enforce the covenant would extend to the owner of the interest in question. An association can act in a representative capacity to enforce a covenant on behalf of members who have that requisite interest.⁴²

It has been the practice of some academic writers to deride this rule.⁴³ I fail to understand the force of this criticism. The rule ensures that covenants will not run to protect the idiosyncratic desires of a former owner (a covenant, for example, that the present owner erect a monument to the Emperor Nero), or to confer a windfall on a former owner (when the covenant acquires an unexpected nuisance or "hold-out" value due to

tive covenant field onto affirmative covenants and held that the assessments were unenforceable in the absence of uniform application. Unfortunately, the law of restrictive covenants was not clear on this point either—failure of a common scheme will terminate enforcement between the lot owners *inter se*, but there is no case that holds that the covenant becomes unenforceable as between the original parties. For dictum to the contrary, see *Stanton v. Gulf Oil Corp.*, 232 S.C. 148, 101 S.E.2d 250 (1957). For a collection of other cases, see *HANDBOOK*, *supra* note 8, at 310-13.

⁴⁰ *HANDBOOK*, *supra* note 8, at 203-04.

⁴¹ The efficacy of this advice depends, of course, on whether the courts will continue to draw the line at the *recorded* plan when determining what expectations of the lot purchasers are entitled to recognition. That question will be considered in Part II of this article dealing with phased development. See text accompanying note 97 *infra*. We need not reach it here because we have assumed a single phase project where one record plan will be filed for the whole project.

⁴² See *Neponsit Property Owners' Ass'n, Inc. v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938).

⁴³ See, e.g., *C. CLARK*, *supra* note 27, at 110. Nevertheless, I have not been able to find more than two cases where a covenant was enforced at the instance of a plaintiff who had no benefited land. See *Pratte v. Balatsos*, 99 N.H. 430, 113 A.2d 492 (1955); *Van Sant v. Rose*, 260 Ill. 401, 103 N.E. 194 (1913). There are, on the other hand, many cases that have refused to enforce covenants on the grounds that the plaintiff has no benefited land. See, e.g., *Los Angeles Univ. v. Swarth*, 107 F. 798 (9th Cir. 1901); *Forman v. Safe Deposit & Trust Co.*, 114 Md. 574, 80 A. 298 (1911); *Minch v. Saymon*, 96 N.J. Super. 464, 233 A.2d 385 (1967).

change in circumstances.)⁴⁴

Under this rule, a homes association would have no trouble qualifying. If it owns or leases the facilities supported by the assessments, it clearly has the requisite interest in the benefited land. Even when it has no interest in the facilities, if its members have such an interest (for example, a tenancy in common or easement rights in the facilities) the association will qualify in a representative capacity.⁴⁵

Indeed, I believe that purchasers in a residential development who agree to pay assessments do not intend to benefit the association as such but rather intend to benefit each other. Therefore, the real test is whether *the members*, not the association, have the requisite interests in the common areas and facilities.

There are two parts to the rule I have stated. First, the person seeking to enforce the covenant must have a property interest that is benefited. Second, the person making the covenant must have reasonably expected that the right to enforce would extend to the owner of the interest in question. If the test is whether the association has the requisite characteristics, it will satisfy both tests when it obtains a property interest in the common areas and facilities and when it is expressly mentioned in the covenants. But if the characteristics of the members are important, the association will lose its right to enforce the covenants whenever, (a) its members do not have a sufficient property interest in the common areas and facilities, or (b) the membership expands to include a significant number of persons who were not expected to have the right to enforce the covenant. I believe that the characteristics of the members are the important consideration and that a court faced with situation (a) or (b)⁴⁶ will be inclined to deny enforcement.⁴⁷

⁴⁴ I would have preferred a rule which required the enforcer to show a "legitimate economic interest" (rather than limiting the interest to land). Such a reformation would present, however, the problem of determining which interests are legitimate. See *Pratte v. Balatsos*, 99 N.H. 430, 113 A.2d 492 (1955) (holding that the plaintiff had an urgent economic interest—to avoid competition in his trade). Who is to say, however, whether this is a "legitimate" interest and, if so, under what circumstances? While it is true that shopping center exclusives have generally been approved, some courts have resisted the notion that such covenants should run. Compare *Shell Oil Co. v. Henry Ouellette & Sons Co.*, 352 Mass. 725, 227 N.E.2d 509 (1967), with *Gulf Oil Corp. v. Fall River Housing Authority*, 306 N.E.2d 257 (Mass. 1974).

⁴⁵ See note 42 *supra*.

⁴⁶ Situation (b) is especially significant in a phased development where new sections and new members are added to the association.

⁴⁷ I have consistently argued that the right of the association to enforce covenants rests on the reciprocal right vesting in its members. *HANDBOOK*, *supra* note 8, at 310-11,

I feel diffident about stating the next rule, my last, because it is so obvious that it appears banal. Yet a higher court in Maryland recently wandered far afield to find a rationale for its decision when this one was so obviously available:

Rule 4. A covenant that requires a homebuyer to pay for the cost of recreational areas, or of certain common facilities, will not be enforced if the circumstances show that the cost has already been capitalized into the price of the home. In other words, courts do not like arrangements in which the housing consumer may be misled into paying for something twice.

In *Sanitary Facilities II, Inc. v. Blum*,⁴⁸ a developer conveyed all of the land planned for a residential community to Sanitary Facilities II, Inc., a sister corporation. Sanitary reconveyed to the developer. In the deed of reconveyance, Sanitary covenanted to construct certain water and sewer facilities on the site and the developer covenanted that all of the lots created within the property would be subject to an annual assessment in favor of Sanitary in an amount sufficient to retire the capital cost of the facilities over thirty years. The assessments were to "commence on January 1 of the second year following conveyance by the Developer[,] its successors or assigns as to each lot conveyed for the construction of a dwelling unit thereon. . . ."⁴⁹ The developer then sold and conveyed the entire property to Levitt and Sons, Inc. The agreement between the original developer and Levitt apparently required Levitt to pay the entire principal cost of the sewer and water facilities to Sanitary and Sanitary to release the covenants. Although Levitt paid Sanitary, for reasons which are totally obscure the covenants were not released. Levitt then sold all of the lots to home purchasers with record notice of the covenants. Sanitary subsequently claimed the right to collect the assessments.

333-35; cf. *Wald v. West MacGregor Protective Ass'n*, 332 S.W.2d 338 (Tex. App. 1960). There is strong support for the proposition that reciprocal enforcement rights can exist only between lot owners who could have anticipated that they would be mutually joined under one scheme. See, e.g., *Snow v. Van Dam*, 291 Mass. 477, 197 N.E. 224 (1935); *Rodgers v. Reimann*, 227 Ore. 62, 361 P.2d 101 (1961).

In addition, situations (a) & (b) suggest an answer to the often raised question whether it is possible to combine a discretionary membership association (where membership is extended only at the discretion of a membership committee) with a mandatory assessment against those members who are admitted. If I am right, the answer is no. The residents must have a permanent, alienable, and quantifiable property interest in the common areas and facilities to support a mandatory assessment. Since the size of a discretionary membership is never entirely predictable, the quality of the interest obtained cannot be readily determined. Cf. text accompanying notes 35-36 *supra*.

⁴⁸ 22 Md. App. 90, 322 A.2d 228 (1974).

⁴⁹ 322 A.2d at 236.

This case could have been disposed of on a number of theories. The lower court, for example, held that the developer had agreed to release the covenant if Sanitary was paid and that Sanitary was bound by the developer's agreement because it was a sister corporation. The matter also could have been resolved under Rule No. 3⁵⁰ because Sanitary had no further interest in any land. I think it should have been disposed of under Rule No. 4, because it was a clear case of gouging. The higher court held, instead, that the covenant did not run because the assessment was to commence in the future. That position is simply untenable⁵¹ and is a good example of what happens when a field of law suffers from an intellectual *rigor mortis*.

In light of the experience which supports Rule No. 4, I would recommend strongly that developers not plan on recovering the capital cost of any improvement through long term assessment against the residents. Whether this be done through a loan to the association secured by a mortgage on the common areas and facilities, or by leasing the common areas and facilities to the association,⁵² the dangers of double recovery and gouging are such that if the courts do not invalidate these arrangements, the legislatures will.⁵³

c. *Party Wall Covenants*

The *Homes Association Handbook* notes that the rules of law applicable to party walls in general do not solve a number of problems that may arise between adjacent unit owners. It therefore urges that such matters as the obligation to maintain and repair and the right to construct be expressly covered by covenants in the Declaration.⁵⁴ Most of these suggestions are based

⁵⁰ See text accompanying notes 42-47 *supra*.

⁵¹ Most commentators have agreed that the distinction between things "*in esse*" and things not "*in esse*" mentioned in Spencer's Case, 5 Co. Rep. 16a, 77 Eng. Rep. 72 (1583), went out with the spats. 5 R. POWELL, REAL PROPERTY ¶ 673 (1971). Most homes association covenants provide that assessments will not begin until the first month following the date when the common areas and facilities are conveyed to the association. Indeed, that is the approach taken in article IV, § 7 of the model Declaration of Covenants, Conditions and Restrictions published by HUD. U.S. DEP'T OF HOUSING & URBAN DEVELOPMENT, LAND PLANNING PROCEDURES AND DATA FOR INSURANCE FOR HOME MORTGAGE PROGRAMS App. 2, at 5 (Handbook No. 4140.2, 1973). Would the court in *Sanitary Facilities* wish to conclude that such homes association assessments are not enforceable in Maryland? I think not.

⁵² For further discussion, see text accompanying notes 75-90 *infra*.

⁵³ For an extended analysis of how the courts' reluctance to act has resulted in legislative activism in the condominium area, see Comment, *supra* note 3.

⁵⁴ HANDBOOK, *supra* note 8, at 329-31.

on the assumption that no one has an affirmative obligation to rebuild if any unit is destroyed by fire or other casualty. Thus, for example, the suggestion that the owner whose unit is destroyed must weatherproof the exposed party wall assumes that he may decide not to rebuild his unit. I am convinced that this is not a desirable situation. Developers of fee ownership townhouse projects should, by covenant and other arrangements, establish a proper insurance and replacement scheme, similar to the schemes required by statute in condominiums. I made this point in my prior article.⁵⁵ Now I should explain the mechanics in greater detail.

B. *A Replacement and Insurance Scheme for
Townhouse Development*

1. The Need for Community-Wide Decisionmaking

The general practice in fee ownership townhouse developments has been to sell and convey the townhouse like a single family detached home. The purchaser has no obligation to rebuild his unit in case of fire or other casualty loss. He is expected to obtain individual insurance. The standard homeowner policy provides that if a unit is destroyed the insurer may either replace the unit or pay the proceeds over to the owner.⁵⁶ The insured then has the option to rebuild. If there is a mortgage, the mortgagee will require that the insurance policy be endorsed to him. The endorsement does not waive the insurance company's right to rebuild, but if the company elects not to do so the proceeds will become payable to the mortgagee to the extent of its interest.⁵⁷ The mortgagee, in turn, reserves the right to apply the proceeds to the balance of the loan outstanding at the time of the loss or to make them available to the owner for reconstruction, at its election. This reservation appears in all home mortgage instruments.

Thus, in effect, the decision whether to rebuild the unit will be made in a hierarchical fashion first by the insurance company, then by the mortgage lender, and finally by the owner. In an inflationary era, the insurance company will usually not choose to rebuild. Similarly, the mortgage lender may decide to

⁵⁵ See Krasnowiecki, *supra* note 1, at 351-53.

⁵⁶ See N.Y. Ins. Information Inst., Sample Ins. Policies Form No. 49, Standard Fire Policy, line 141 (std. ed. 1968).

⁵⁷ *Id.* Broad Form HO-2, Homeowner's Policy Additional Conditions ¶ 4 (1970).

terminate its exposure by applying the proceeds to the balance of the loan—especially if it has no mortgages outstanding on the adjacent units. It seems to me that this is a very poor arrangement. It exposes all unit purchasers and their lenders to the possibility that they will end up with a unit in or next to a townhouse building that looks like a toothless monster.

In addition, under the present arrangement unit owners are exposed to unnecessary liability. Obviously, when units are attached, as they are in the townhouse design, it is possible that a negligently caused fire in one unit may damage or destroy several other units. If each unit is separately insured by its owner, as it is under the conventional system, the insurance companies holding policies on the damaged units will have an action over against the negligent owner. A typical homeowner's policy provides only negligible coverage for this kind of liability.

I therefore urge that developers of fee ownership townhouse projects establish, by covenant, a replacement and insurance scheme similar to those available in the condominium. Indeed, the arrangement established by covenant can be superior to the arrangement that is dictated by the condominium statutes, since those are often ill designed to solve the problems of a townhouse development.

2. The Covenant to Rebuild

As in the condominium, the covenants should place the obligation to rebuild the units on the homes association rather than on each individual owner and the association should be required to carry a blanket insurance policy in an amount sufficient to cover one hundred percent of the cost of replacement. The insurance arrangement should mirror the arrangement recommended for the condominium.⁵⁸ The blanket policy should waive the company's subrogation rights against other unit owners and those who reside with them, relinquish the other-insurance clause, and modify the pro-rata clause so that sufficient proceeds will be immediately available to the association for rebuilding even if unit owners carry other insurance. The policy should also modify the increased hazard clause so that

⁵⁸ For an excellent summary of the condominium insurance arrangement, see Takabuki, *Condominium Insurance: A Case History*, in PROCEEDINGS, ABA INSURANCE, NEGLIGENCE & COMPENSATION LAW SECTION 206 (1967).

only those special risks that are within the association's exclusive control are material. The insurance proceeds should be made payable to an insurance trustee, and mortgage lenders should be required to modify the provisions reserving to the mortgagee the right to apply the proceeds of the blanket policy to the balance of the loan. I would additionally recommend that this provision be included in the covenants so that second and subsequent generation mortgages will likewise be suitably limited.⁵⁹

a. *Will These Covenants Run?*

I think they obviously will. A simplistic way of looking at the covenant to rebuild would be to say that the burden of it is on the association and the benefit is with the townhouse unit owners and their mortgagees. There is never any problem with the running of the benefit of an affirmative covenant. But, as I have said earlier, the benefits and burdens that I think are material in the homes association context are those that exist *between the unit owners*.⁶⁰ For those townhouse unit owners (and their mortgagees) whose units are damaged or destroyed, the covenant may be considered a burden in the sense that it forecloses the alternative of doing nothing; for those whose units remain, the covenant may be considered a benefit in the sense that rebuilding will serve to protect the value of their interest. Since no one can predict whose unit will go and whose will be spared, the benefits and burdens are entirely reciprocal. That is always the ideal situation so far as running of covenants is concerned.

Furthermore, the covenant to rebuild and to maintain the insurance necessary to fund such rebuilding meets all of the four rules that I have stated earlier. First, one who buys a house would surely expect to be bound by a covenant which requires the owner to rebuild the unit, either directly or through the association, and to maintain insurance for this purpose—Rule 1(a).⁶¹ The burden of the covenant is readily predictable, whether it is considered to rest in the payment of the insurance premiums or in the owner's forfeiture of the right to pocket the proceeds in lieu of rebuilding—Rule 1(b).⁶² Rule 2 will be met if

⁵⁹ A recorded covenant limiting future mortgages will run with the land. *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

⁶⁰ See note 47 *supra* & accompanying text.

⁶¹ See text accompanying notes 29-36 *supra*.

⁶² *Id.*

all of the townhouse owners in the development are required to participate in the scheme without exception.⁶³ The unit owners, the potential plaintiffs in any attempt to enforce the covenant, clearly have an interest in land that was intended to be benefited—Rule 3.⁶⁴ The covenant does not involve double recovery—Rule 4.⁶⁵ What is true of the unit owners is also true of their mortgage lenders.

b. *When Should the Duty to Rebuild Terminate?*

One of the advantages of the homes association approach is that it leaves one free to rethink this question instead of being forced to follow a pattern established by statute as is the case in condominiums. It has often been noted that the condominium statutes of most jurisdictions are based on an FHA model which assumed that it was dealing with a single building. Some of the state statutes were modified slightly to recognize that a condominium may consist of several buildings. On the whole, however, the solution for the casualty loss problem that is proposed in those modified statutes is less desirable than the solution that obtains under the original model.

The condominium statutes that assume a single building usually provide that the obligation to rebuild terminates if there is a substantial destruction of "the building" and if seventy-five percent of the unit owners vote not to rebuild.⁶⁶ In an effort to recognize condominiums involving several buildings a number of states provide that the obligation to rebuild terminates when there is substantial destruction of "one or more of several buildings" or if seventy-five percent of the unit owners "directly affected" by the damage or destruction vote not to rebuild.⁶⁷ Superficially, this seems like a good solution. But it loses most if not all of its sense when one realizes that, according to these statutory provisions, the events which result in a termination of the duty to rebuild also result in a termination of the condominium regime as to the buildings involved. These statutes go on to say that the unit owners affected can partition out their portion

⁶³ See text accompanying notes 37-41 *supra*.

⁶⁴ See text accompanying notes 42-47 *supra*.

⁶⁵ See text accompanying notes 48-52 *supra*.

⁶⁶ See, e.g., CONN. GEN. STAT. ANN. § 47-84 (Supp. 1974); ME. REV. STAT. ANN. tit. 33, § 584 (Supp. 1973); N.Y. REAL PROP. LAW § 339-cc (McKinney 1968).

⁶⁷ See, e.g., N.J. STAT. ANN. § 46:8B-24(b) (Supp. 1974); PA. STAT. ANN. tit. 68, § 700.802 (1965).

of the property. If the buildings are grouped around extensive common areas and recreational facilities, how can a court rationally separate the interests of those unit owners whose building was destroyed from the rest of the condominium? The idea is nonsensical.

Paradoxically, the condominium statutes that assume a single building provide a better solution precisely because the several buildings must be treated as one. "Substantial destruction" then is measured by looking at all of the buildings in the aggregate. Moreover, it takes seventy-five percent of all of the unit owners in the entire project to vote for a termination, which is certainly better than allowing a few owners to do it.

The homes association approach, by way of contrast, avoids one of the basic elements of the condominium tangle. The decision whether to rebuild any particular units can be divorced from the decision whether the homes association arrangement should continue to apply to and bind all of the lots. My own feeling is that units should always be rebuilt unless a substantial majority of all of the townhouse owners in the association vote against it. I would also require a substantial majority of those whose units were damaged and destroyed, as well as a substantial majority of all of the other owners, to terminate the duty to rebuild. A termination of the duty to rebuild, however, should not extinguish the underlying homes association arrangement.

C. *The Zoning Question*

Zoning has been a hurdle for fee simple townhouse development, much more so than for the condominium. The courts have held that a zoning ordinance cannot exclude condominiums from an apartment district if the units meet the use and other physical requirements of the district.⁶⁸ These cases rest on the proposition that the power to zone is confined to matters of land use (including physical improvements on the land) and that the form of ownership is not within that power. I agree, of course, that condominiums cannot be excluded from apartment districts. But the statement that matters of title are not within the land use control power is misleading. Obviously, matters of

⁶⁸ *Maplewood Village Tenants Ass'n v. Maplewood Village*, 116 N.J. Super. 372, 282 A.2d 428 (Ch. 1971); *Bridge Park Co. v. Borough of Highland Park*, 113 N.J. Super. 219, 273 A.2d 397 (App. Div. 1971); *Borough of Brookhaven v. Iacobucci*, 61 Del. County 628 (Pa. C.P. 1974).

title are subject to control if they have a direct bearing on land use. Subdivision control was invented because local authorities realized that when a parcel is divided among a number of individual owners, certain land use matters are irrevocably compromised: namely access, minimum area requirements, and the location of buildings in relation to each other.

The division of a larger site into smaller parcels involves both short range and long range zoning interests of the community. The short range concern is to secure the proper improvement of the site as a whole and a proper disposition of the buildings upon it. But the land use concern does not stop at original construction; the possibility of destruction and reconstruction or renewal must be considered. Furthermore, continued maintenance, if not of the buildings themselves then of the common areas, is also a legitimate land use concern and within the land use control power. On both scores, however, the condominium cannot be legitimately distinguished from the rental apartment.

Although the title to the units is divided, the land itself remains under undivided ownership. As a result, both the original development and any future renewal or redevelopment of the site remains under unified sponsorship and control. In fact, the original development of a condominium is normally in the hands of a single developer. The division of title does not occur until the buildings are completed. Indeed, the definition of "unit" in some statutes presupposes completed construction.⁶⁹ Even if the applicable statute permits the sale of unimproved land in condominium units, no improvements can be made unless the unit owners act in unison through the central condominium organization. Similarly, if the original improvements are destroyed, reconstruction must be undertaken in unison unless the regime is terminated and there is a partition of the land. Partition, ordinarily, will result in the sale of the site as a whole. In the unlikely event that partition in kind (into separate lots) is decreed, this will trigger whatever site planning and subdivision controls are then applicable.⁷⁰ In other words, by per-

⁶⁹ *But see* Comment, *supra* note 3, at 660.

⁷⁰ New Jersey appears to be the only state which expressly exempts "divisions of property upon court order" from the reach of its subdivision control law. N.J. STAT. ANN. § 40:55-1.2 (Supp. 1974). It is ironic that that state was also the first to hold that condominiums are not subdivisions.

mitting division of the buildings into condominium units, the local government does not compromise its future ability to apply proper site planning measures to the site as a whole. In all these respects, therefore, the condominium has characteristics that are no different from those of a rental apartment. Nor is there any difference in capacity to maintain the common areas. Indeed, the condominium is superior because its central management has a statutory duty to provide proper maintenance for its common elements, whereas the management of a rental apartment does not.

The above analysis shows why conventional townhouse developments that involve individual lots cannot qualify under the typical apartment district regulations as readily as the condominium. Although the original development and improvement of the site is usually in the hands of a single developer, the fact that each purchaser acquires his own individual lot in fee affects the long range interests of the local government concerning proper maintenance and proper re-use of the site in the event of destruction. The standard apartment district regulations do not address themselves to these concerns because they assume that the site will remain in undivided ownership. The answer to the above concerns, however, is not to banish the fee ownership townhouse from the community,⁷¹ but rather to draft an ordinance that answers these concerns—one that requires the developer to establish a satisfactory organization for the maintenance of the common areas, and provides that after division of the land into lots, the original project area will continue to be treated as a unit for land use control purposes.

Furthermore, if my recommendations for an insurance and replacement scheme are followed,⁷² the fee ownership townhouse project can be made more desirable from a land use point of view than a condominium. As already noted, many condominium statutes terminate the duty to rebuild and allow for partition as soon as one building is destroyed.⁷³ The covenants in a fee ownership townhouse development can provide for a much more desirable solution.

⁷¹ Two recent cases have suggested by implication that townships cannot exclude fee ownership townhouse developments from every portion of the township. *Ellick v. Board of Supervisors*, No. 201 C.D. 1974 (Pa. Commonwealth Ct., Feb. 11, 1975); *Camp Hill Dev. Co. v. Zoning Bd. of Adjustment*, 13 Pa. Commonwealth 519, 319 A.2d 197 (1974).

⁷² See text accompanying notes 56-67 *supra*.

⁷³ See text accompanying notes 66-67 *supra*.

II. DEVELOPMENT BY PHASES: THE CONSUMER MOVEMENT

It is clear that the purpose of development by phases is to avoid irrevocable commitment to a particular plan of development and premature expenditures on land and improvements.⁷⁴ Therefore, development by phases often conflicts with the interests of the housing consumer—at least as he perceives them.

A. *Premature Commitment and Expenditures on the Common Areas and Facilities*

1. Statement of the Problem

In strict economic profile the capital cost of the common areas and facilities of most open space community development is gradually recovered out of the sales proceeds of the units. Indeed, that is the proper treatment of the cost for federal income tax purposes.⁷⁵

Some developers, especially some condominium developers in Florida, have attempted to recover the capital cost of the amenities through assessments against the residents. This is done by leasing the facilities to the association, or by conveying the facilities to the association subject to a mortgage back to the developer or to some third party, and requiring the association to assess the residents either for the payments to principal and interest on the mortgage or for the rental payments (a portion of which represents recovery of principal).

In theory, these alternative approaches could benefit the consumer in two ways. First, the expense of paying for capital cost of the common land and facilities could be spread over a longer term than might be possible if the cost were capitalized into the price of the unit and financed through a regular home mortgage. Second, this way of financing the common areas and facilities might result in lower downpayments. These benefits could follow if the price of the unit were reduced by the present worth of that portion of association assessments which is applied to the capital cost of the improvements or return on capital (as opposed to current operating expenses). Unfortunately, that has not been the case. Developers have taken advantage of a market that is not too sophisticated. Some have even gone so

⁷⁴ See text accompanying notes 15-25 *supra*.

⁷⁵ *Country Club Estates, Inc.*, 22 T.C. 1283 (1954); *cf.* *Jordon Perlmutter*, 45 T.C. 311 (1965).

far as to set the rental or mortgage payments very low during an initial period with massive escalation clauses to follow, thus confusing the consumer further.

As a result, all arrangements where the common areas and facilities are leased to the association or are encumbered by a mortgage have become suspect. In some quarters the suspicion has approached hysteria, with the result that sensible solutions are no longer considered. The principal objections against leasing the common areas and facilities or maintaining them encumbered by a mortgage are the fear that the consumer is being confused into paying for the capital cost of the improvements several times over, and the danger that the consumer will lose the enjoyment of the common areas and facilities through forfeiture of the lease or foreclosure of the mortgage.

I think it is improper to consider the lease and the mortgage situation together as if they represented the same evil. In my opinion, the lease is always objectionable whereas the mortgage is not. If the mortgage is not in excess of the cost of the improvements, and specifically provides for a retirement of the principal out of the proceeds of sale of each unit; and further if the association has no power to assess the unit owners for mortgage debt service, the possibility that the consumer will be required to pay for the facilities twice is precluded. The only remaining problem is the risk of losing the facilities if the developer fails to sell a sufficient number of units.

2. The HUD-FHA Solution

It is hard to say that HUD has a solution to this problem. Rather it seems that HUD slowly backed itself into confusion. Shortly after the publication of the *Homes Association Handbook*,⁷⁶ the FHA and VA jointly published a set of model homes association documents.⁷⁷ The FHA-VA forms were practically identical to the forms prepared for the *Handbook*. The major difference was that the *Handbook* forms allowed the developer to

⁷⁶ HANDBOOK, *supra* note 8.

⁷⁷ FEDERAL HOUSING ADMINISTRATION & VETERANS ADMINISTRATION, SUGGESTED LEGAL DOCUMENTS FOR PLANNED-UNIT DEVELOPMENTS, (1965). The original forms were revised in Aug., 1968, without significant changes relevant to this discussion. The 1968 revised forms have now been republished in U.S. DEP'T OF HOUSING & URBAN DEVELOPMENT, LAND PLANNING PROCEDURES AND DATA FOR INSURANCE FOR HOME MORTGAGE PROGRAMS apps. 1-4 (Handbook No. 4140.2, 1973) [hereinafter cited as HUD No. 4140.2].

mortgage the common areas to cover the cost of related improvements and to retain title pending completion and marketing of the homes (subject to a definite obligation to convey them at a fixed time), whereas the FHA-VA forms required the developer to convey the "common area" to the homes association free and clear of all liens and encumbrances prior to sale of the first home.⁷⁸ The FHA-VA also required that all proposed improvements on the "common area" be completed before the first sale, or that completion be guaranteed by proper bond or cash escrow.⁷⁹ I criticized this approach at the time because it seemed to me to be impractical.⁸⁰ Developers were unlikely to find any lenders willing to release the common areas and improvements from blanket land acquisition and construction mortgages without a substantial cash payment. I also thought that imposing this extra front end expense on open space community development would only discourage it. I still think that I was generally right.

The *Homes Association Handbook* and subsequent ULI publications have always recommended that developers of larger projects be allowed to proceed to final record plan approval by smaller sections and provide clearly in the Declaration that the developer has no legal commitment to the purchasers to abide by the general plan applicable to future sections unless and until those sections are reduced to final record plan and are added to the scheme of covenants established in the first section.⁸¹

In its *Land Planning Bulletin No. 6*, originally published in 1963, FHA indicated that it was in agreement with the phasing concept.⁸² The FHA probably thought that the phasing concept would solve the developer's financial problems. In theory the developer could limit his front end expenses under the FHA

⁷⁸ U.S. DEP'T OF HOUSING & URBAN DEVELOPMENT, LAND PLANNING PRINCIPLES FOR HOME MORTGAGE INSURANCE ¶ 4-2 (Handbook No. 4140.1, 1973) [hereinafter cited as HUD No. 4140.1]. Oddly enough, the HUD model Declaration of Covenants (FHA Form 1401, VA Form 26-8201) defines "common area" as "property owned by the Association." HUD No. 4140.2, *supra* note 77, app. 2, at 2. It might seem, therefore, that the developer need convey nothing to the association since nothing is a "common area" unless conveyed. But, of course, HUD has not found this argument persuasive, or amusing.

⁷⁹ HUD No. 4140.1, *supra* note 78, at ¶ 4-3.

⁸⁰ URBAN LAND INSTITUTE, THE HOMES ASSOCIATION HANDBOOK 408 (rev. ed. 1966).

⁸¹ HANDBOOK, *supra* note 8, at 219.

⁸² FEDERAL HOUSING ADMINISTRATION, U.S. DEP'T OF HOUSING & URBAN DEVELOPMENT, PLANNED-UNIT DEVELOPMENT WITH A HOMES ASSOCIATION 20-21 (Land Planning Bull. No. 6, rev. ed. 1973).

"free and clear" requirement by including only a small portion of the common area and facilities in the first phase and then gradually adding the rest as subsequent phases are developed. The gradual approach, however, does not appeal to the consumer who is generally unwilling to postpone his enjoyment of an amenity until it is fully paid for. Developers have found that the amenities have to go in up front. They have found that lenders are not prepared to release the amenities from a blanket land acquisition and construction loan without repayment of the entire allocable cost. It seems to me that HUD-FHA is putting its head in the sand if it believes that developers will advance the necessary cash. Besides, it is not entirely clear to me that the consumer is benefited. I don't really believe that the blanket lender can walk away with the amenities after he has released a number of lots.⁸³ Money advanced by him for the construction of the common facilities is probably much cheaper than money advanced by the developer. It seems, therefore, that developers and consumer advocates (including HUD-FHA) must search for some intermediate solution to this problem.

3. A Suggested Solution

Large scale developments are usually planned in such a way that each phase has a certain independent integrity from an architectural and site planning point of view. Under such a plan, there will be some common land and some facilities that are integral to the phase. Integrity, in the sense that it is used here, would be determined by the location of the land itself (for example, open spaces immediately surrounding and separating the buildings) or by the proposed use of the land or facility in question. Parking designed for use by that group of buildings, or walkways providing access to and between the buildings would be an example of the latter. For want of a better word, I will refer to these as "neighborhood" common areas and facilities. On the other hand, much of the planned common land will not be integral to any particular phase but will, either by location or by proposed use, have a community-wide orientation. I will call these "community-wide" facilities.⁸⁴

⁸³ For a discussion of whether a lender would be estopped, see Krasnowiecki, *supra* note 1, at 333 n.14.

⁸⁴ I am grateful to Stephen W. Chamberlin, Director of Planning, Leon N. Weiner & Assoc., Wilmington, Del., for suggesting this distinction.

I believe that the developer should be required to convey the neighborhood common areas and facilities to the association free and clear of all liens prior to sale of the first home in that neighborhood. I believe that he should be allowed to maintain a mortgage on the community-wide facilities beyond the point of the first sale under certain specific conditions. First, the mortgage should be given and held by an institutional lender, preferably the same lender who is financing the construction or the permanent loan on the homes. Since access to these common elements is an important component of the value of each individual unit, such an arrangement would dissuade foreclosure on the facilities when mortgages are held by the same lenders on the units themselves.

The mortgage should also have an arrangement for payback out of the proceeds of the sale of each dwelling unit. The possibility of extending the payback schedule by adding new land and new units to the mortgage coverage should be expressly precluded.⁸⁵ Furthermore, the payback should be substantially accelerated—the mortgage should be cleared before all of the scheduled units are sold. If such an arrangement is not possible as to advances on construction of the homes, the developer should arrange for a separate allocation of the mortgage loan to the common areas and facilities and an accelerated payback as to that amount, so that the common areas will be released as early as practicable.

In addition, each sale should be accompanied by a complete release of the mortgage as a lien on the lot or as a personal obligation of the owner and there should remain no arrangement by which the lien or the personal obligation to pay the principal of the mortgage could re-attach to the released lot in the form of association assessments or otherwise.⁸⁶ Finally, the fact of the mortgage, its amount, and the payback arrangements should be disclosed to each purchaser before he enters into a binding agreement of purchase.

If the project is large enough and involves a substantial number of phases and neighborhoods, the developer should establish a two-tier system consisting of a central association to own and operate the community-wide areas and facilities and a

⁸⁵ See text accompanying notes 46-47 *supra*.

⁸⁶ See text accompanying notes 48-53 *supra*.

number of satellite associations, one for each neighborhood.⁸⁷ This approach is particularly advisable when the neighborhoods are distinguished by different housing types or different forms of ownership—one neighborhood is townhouses, the other is garden apartments; one is sales and the other is rental. Even if that is not the case and the development is relatively homogeneous, the creation of a central association serves to distinguish in the mind of the consumer those facilities which are “his” (the neighborhood association facilities) and those which belong to the entire community and depend upon the success of the project as a whole.

I think it is wrong to conclude, as HUD-FHA has done, that the developer should never retain the title to any area or facility that is shown on a record plan and designated a “common area” in the Declaration of Covenants.⁸⁸ Neighborhood areas and facilities, I have agreed, should be conveyed to the association before the first home is sold in the neighborhood in question. But I do not agree that all community-wide areas and facilities should be conveyed immediately.

Certainly, community-wide areas and facilities that are only projected in some future phase of the project and are not shown on any record plan or designated in any recorded Declaration need not be conveyed. Indeed, that is the whole purpose of the phasing concept. Even those that are shown on a record plan, however, need not necessarily be conveyed. On the contrary, if such an area or facility is allowed to remain subject to a mortgage, the developer should retain title to it until released from the mortgage in order to alert the consumer to the fact that the area or facility is not absolutely secure. If the developer conveyed the area or facility to the association subject to the mortgage, the risks of confusion are greater. Consequently, the *Homes Association Handbook* recommends that the developer should be allowed to retain the legal title to some of the common areas and facilities.⁸⁹ The *Handbook* forms, however, require that the record plan and Declaration contain a definite commitment to convey

⁸⁷ It will be recalled that I also urged the two-tier approach as a solution to the expandable condominium problem. See Krasnowiecki, *supra* note 1, at 361-65. The difference there was that each neighborhood association would be a condominium rather than a homes association.

⁸⁸ See note 78 *supra* & accompanying text.

⁸⁹ *HANDBOOK*, *supra* note 8, at 239-40.

when a stated number of the units have been sold, or, in any event, not later than a stated date.⁹⁰

In my conversations with FHA officials at that time, it was my understanding that FHA did not want to permit such an arrangement because of the fear that intervening bankruptcy of the developer might make it impossible to enforce the commitment. The *Handbook* approach, however, envisages that the lot purchasers would be granted express easements of enjoyment over the area immediately and that only the bare legal title would remain with the developer. Those easements might, of course, be subject to the mortgage (if the mortgagee does not join in the Declaration) but I fail to see how getting the fee title places the purchasers in any better position (either as to the mortgagee or as to the potential bankruptcy of the developer) than getting the easements, since the easements constitute the entire enjoyment of the property.⁹¹

B. *Advance Improvement: Risk of Undermaintenance and Overloading*

When major community-wide facilities are put in up front, the early purchasers face the risk that the project will fail before there are enough residents to support the facility. The HUD-FHA position that all such facilities must be cleared of debt before the first home is sold really does not solve this problem. If anything, involvement of a reputable lending institution suggests that someone other than the developer has assessed the risks and believes that the market will run strong enough to retire the debt out of the sales of the units within a reasonable period of time. But even if the lender's market analysis proves false, I do not think the lender will take the facilities away from the existing residents. I do not believe that the courts will

⁹⁰ HANDBOOK, *supra* note 8, app. F, art. IV, § 2 (Model Form: Declaration of Covenants and Restrictions) [hereinafter cited as *Declaration*].

⁹¹ I have already noted that I believe the mortgagee will become subject to the lot owners' easements by estoppel. Krasnowiecki, *supra* note 8, at 333 n.14. The commitment to convey the common area in the future might be an "executory contract" which the developer's trustee in bankruptcy might be entitled to disavow under § 70b of the Bankruptcy Act, 11 U.S.C. § 110(b) (1970). But according to the *Handbook* documents, the sale and conveyance of each lot and home would include a grant of a perpetual easement of enjoyment over the common areas shown on the recorded subdivision plan—a completed "transfer" which the trustee could not set aside unless made "without fair consideration." 11 U.S.C. § 107(d)(2) (1970). This may raise a question when only a few homes have been sold, but the same question would exist even if the common area were conveyed in fee.

permit it.⁹² The real risks are that the existing residents may be called upon to contribute substantially more to the maintenance of the facility than originally expected or that they may be forced to share the facility with additional and unexpected persons. The first risk is undermaintenance and the second is overloading.

1. The Risk of Undermaintenance

There is no perfect solution to this problem. I do not think that a presale requirement would be realistic. The fact is that the consumer does not want to buy until he has seen the improvement. The idea that one can presell four or five year's worth of individual homes in the suburbs is, therefore, a pipe dream. Fortunately, current HUD-FHA regulations do not require pre-sale for homes association developments.⁹³ I have the following suggestions.

First, the decision whether to increase assessments to absorb the slack created by a lag or failure in projected sales must be made by the existing residents and not by the developer or by the financial interests behind him. Consequently, provisions in the covenants which simply obligate the residents to pay a "pro-rata share of the expenses" of the facilities should be avoided. The exposure of each home must be limited in some way. The standard method is to establish a maximum assessment which is subject to increase only by scheduled inflationary increments or by the vote of a substantial number of the resident owners. Another possible approach is to provide that each unit is obligated for its pro-rata share of expenses but not in excess of a certain percentage of the total set by reference to the total number of units needed to support the facility.⁹⁴

Second, as Rule No. 3 indicates, all record lots should be subject to assessment, including those retained by the developer.⁹⁵ Since the developer can control his exposure by the number of lots recorded at one time, the question then is whether there should be some additional commitment to underwrite deficiencies in the total maintenance budget for a stated num-

⁹² See note 83 *supra*.

⁹³ HUD 4140.1, *supra* note 78, ¶ 4-4.

⁹⁴ Because the maximum exposure is not stated in a dollar amount, this latter alternative may open the door to bilking (e.g., through exorbitant management fees) as well as to misrepresentation (concerning expected maintenance costs). It also tends to conflict with my Rule No. 1 for covenants. See text accompanying notes 29-36 *supra*.

⁹⁵ See text accompanying note 40 *supra*.

ber of years. Developers claim that their own self-interest in seeing the project sell is a sufficient commitment. Although I think that is true of the better developers, I tend to agree with those who feel that there has to be some way of flushing out the shaky ones. I do not think that heavy escrow and bond requirements at the front end are desirable. I would prefer some form of a direct review of the developer's financial structure and his capacity to deliver.

2. Risk of Overloading: Future Additions

When community-wide facilities are committed with the early phases of a development, the practical opposite of under-maintenance may result. To salvage a failing project, or to maximize profits, the developer may decide to depart from the existing plan by adding more units than originally projected or adding units expected to make more intensive use of the common areas without making any offsetting adjustment in the amount and location of new facilities. This is the problem of overloading.

If the rules that I have stated concerning affirmative covenants have any validity, such overloading violates Rules 2⁹⁶ and 3⁹⁷ and could terminate the obligation to pay assessments. But that is not a realistic remedy. The existing residents will perceive that if they cut off the assessments, the condition of the common areas may deteriorate and result in further losses. Consequently, they are more likely to seek an injunction to prevent a departure from the original overall plan.

Although, except as to each phase, the overall plan will not be recorded in the land records, it will be on file with the local zoning and planning authorities. Moreover, it will probably be used extensively by the developer's sales force. Few developers make any effort to prevent or to control the representations made to the purchaser about the overall plan. There is a good chance that the courts will extend the doctrine of implied easements and covenants to hold the developer to such representations.⁹⁸

To avoid this result the problem of overloading must be dealt with explicitly in the Declaration of Covenants and Ease-

⁹⁶ See text accompanying notes 37-41 *supra*.

⁹⁷ See text accompanying notes 42-47 *supra*.

⁹⁸ *Burgess v. Putnam*, 464 S.W.2d 698 (Tex. Civ. App. 1971).

ments. The *Homes Association Handbook* suggested that the developer's right to bring additional land within the scheme of an existing association should be limited by a "general plan."⁹⁹ This plan was to be prepared independently from any other general plan for the purpose of establishing the basic ground rules for additions, such as how many units could be added at the maximum, how much more open space would be added at a minimum, and so forth. The sole function of the "general plan" was to control the developer's right to make an addition to an *existing association*. The developer, of course, would retain the right to develop any future phase in a different manner provided he did not add it to the existing association. The *Handbook* counselled that the plan should contain a conspicuous statement to this effect and should be made part of the package of information handed to every prospective purchaser.¹⁰⁰

Most developers are concerned that this approach might be unduly constraining. The *Handbook* seemed to require a physical plan—one that graphically depicts the future phases of the project and the general disposition of land uses. Since I agree that that is unduly constraining, I now have the following suggestions.

I have already observed that for the larger project a two-tier association system—central association for community-wide facilities coupled with local associations for neighborhood common areas—makes a lot of sense.¹⁰¹ I have also urged that the neighborhood common areas and facilities ought to be completed and conveyed free and clear to the association from the start.¹⁰² But that does not preclude the possibility that the development of the housing itself will be undertaken in phases, record plans being filed separately for each phase.

If such phasing is planned within a neighborhood association, I believe that the developer's right to add the neighborhood phases to each other should be controlled by a physical plan of the sort recommended in the *Handbook*. However, the right to add new phases to the central association should not be controlled by a physical plan. A physical plan would be unduly constraining, considering the period of development that

⁹⁹ *Declaration*, *supra* note 90, art. II, § 2.

¹⁰⁰ *HANDBOOK*, *supra* note 8, at 218-19.

¹⁰¹ See text accompanying note 84 *supra*.

¹⁰² *Id.*

is often involved and the changes that can occur on the market. A compromise may be a "policies plan" which pins down the matters that are of legitimate concern to the consumer—for example, the maximum number of units that can be added, the ratio of open space to number of units, and the ratio of square foot area of various facilities to the number of units. I know that many developers still believe that the courts will honor an unrestricted reservation to make additions. But I suspect that at the first sign of overreaching the courts will clamp down on the developer, probably restricting him to the original land use plan. I strongly believe that it is better to meet this problem face-on with a reasonable solution.

C. *Voting Control Over the Association*

The *Homes Association Handbook* proposed that the developer retain a 3 to 1 voting superiority over the residents until the total outstanding votes of the residents equal the total outstanding votes of the developer.¹⁰³ Since the votes were based on the number of lots, the developer would lose control when seventy-five percent had been sold. To prevent the developer from using his voting control to make changes adverse to the interests of the residents, the *Handbook* proposed that the developer votes be placed in a separate class.¹⁰⁴ This would enable the draftsman to specify in the covenants which issues would require the assent of the majority of both classes and which could be determined by a simple majority of the entire voting membership. In this way, some issues could not be decided by either the developer or the residents alone. On these issues, each class would, in effect, have a veto power over the proposed action of the other. The *Handbook* proposed that critical issues such as increases in the maximum assessment,¹⁰⁵ diversion of any existing common areas or facilities to some other use,¹⁰⁶ and additions that substantially depart from the "general plan" should require the assent of both classes of voters.¹⁰⁷ On the other hand, election of directors and daily operations would remain subject to the voting superiority of the developer.¹⁰⁸

¹⁰³ HANDBOOK, *supra* note 8, at 240-41; Declaration, *supra* note 90, art. III, § 2.

¹⁰⁴ HANDBOOK, *supra* note 8, at 240-41; Declaration, *supra* note 90, art. III, § 2.

¹⁰⁵ Declaration, *supra* note 90, art. V, § 5.

¹⁰⁶ *Id.* art. IV, § 3(f).

¹⁰⁷ HANDBOOK, *supra* note 8, at 394-95 (Model Forms: Articles of Incorporation, art. VI).

¹⁰⁸ *Id.* art. V.

I hold no brief for the 3 to 1 formula. On the contrary, in larger projects where a two-tier association system should be employed, I believe that the developer should be allowed to retain control over the central association until he completes the entire project. On the other hand, in the neighborhood association the developer may have less at stake and an earlier relinquishment of control makes some sense. When the developer retains a controlling vote, the two class voting system is imperative. It does not matter whether the distinction is expressed in terms of class A and class B votes¹⁰⁹ or in terms of "developer" and "homeowner" votes.¹¹⁰ If no distinction is made, the developer retains an overwhelming vote on all issues and may, in his own self-interest, increase the maximum assessment, absolve his lots from assessment, or divert the common areas to some other use.¹¹¹

Another problem arises if some of the units will be sold and others will be held for rent. A formula which allows one vote for each dwelling unit owned may have the undesirable result of transferring permanent control to one or more landlords within the development. Although such centralization of power can be avoided in part by placing the rental units in their own separate neighborhood associations, the problem persists within the central association which owns the community-wide facilities.

Some commentators have suggested that each dwelling unit should be given two votes and when a unit is rented the votes should be split, one to the tenant and one to the landlord.¹¹² As previously noted, I do not think this solves the problem.¹¹³ I believe that the total votes allowed to the rental units should be adjusted so that they remain substantially less than the votes of the owner occupants.

D. *The Federal Agencies*

1. HUD-FHA

HUD has recently reissued most of its prior publications and model documents relating to homes associations in handbook

¹⁰⁹ Declaration, *supra* note 90, art. III, § 2.

¹¹⁰ See COMMUNITY MANAGEMENT CORP., *supra* note 26.

¹¹¹ The problem of extended control is equally oppressive in the condominium context. See Comment, *supra* note 3, at 645-46.

¹¹² See COMMUNITY MANAGEMENT CORP., *supra* note 26, at 6-7.

¹¹³ See text accompanying note 26 *supra*.

form. There has been no change in its position.¹¹⁴

Thus HUD continues to require that all common areas be improved and conveyed to the association free and clear of liens prior to the first sale,¹¹⁵ without drawing any distinction between facilities that are an integral part of the neighborhood under development and other community-wide facilities.¹¹⁶ This inflexible approach extends to the other problem areas I have discussed above, namely the problem of voting control and the problem of overloading.

HUD has no regulation that specifically addresses the voting problem. Rather HUD personnel treat the model documents as law, ignoring the introductory statement that "[t]heir use is not mandatory but recommended."¹¹⁷ The model documents have simply adopted the ULI Handbook three-to-one formula, and area offices insist on that formula regardless whether they are dealing with neighborhood associations or a central association.¹¹⁸

A similar fate has befallen the problem of additions. The HUD Handbook and its Instructions for the model documents require that the developer prepare a general plan of the development and submit it to the relevant agency within HUD.¹¹⁹

¹¹⁴ HUD No. 4140.1, *supra* note 78; HUD No. 4140.2, *supra* note 77.

¹¹⁵ See notes 78-79 *supra* & accompanying text.

¹¹⁶ See text accompanying note 84 *supra*. A similar lack of sensitivity to the economic realities of open space community development is exhibited in recently announced regulations of the FNMA and FHLMC governing their participation in conventional condominium and planned unit development home mortgage loans. FNMA's regulations require that improvements to "the common areas" be completed before any individual home (or unit) mortgage is submitted for purchase by the Association and that all common areas must be conveyed to the homeowner's organization free and clear of all liens prior to that time. FNMA Conventional Selling Contract Supplement, § 502.03, Apr. 24, 1974. "Planned Unit Development" is defined as: "A real estate development which consists of separately owned lots with contiguous or non-contiguous areas or facilities usually owned by an Owners Association" *Id.* § 105. FHLMC's regulations contain similar requirements but apply them only to common areas which are "regarded as part of the value of the unit in a Planned Unit Development for purposes of the appraisal upon which the mortgage loan is predicated." FHLM Sellers' Guide to Conventional Whole Loans, § 2.204H, July 1, 1974. This modification is of interest because HUD has generally proved unwilling to trust its appraisal process to make a proper adjustment for incomplete common areas rather than require completion. The degree of a consumer's disappointment over losing promised amenities is not necessarily related to whether he has paid for them. HUD may simply be responding to the political realities of its job.

¹¹⁷ HUD No. 4140.2, *supra* note 77, app. 1, at 1.

¹¹⁸ Memorandum from HUD Regional Office III, June 10, 1974, reviewing documentation for a large-scale project located in the Philadelphia area, on file with the author.

¹¹⁹ HUD No. 4140.2, *supra* note 77, app. 1, at 3.

There is no requirement that the plan be communicated to the consumer in some way. This is fortunate, because the plan is the old physical plan of the ULI Handbook, which is much too constraining when used to control additions to a community-wide association. However, HUD itself may hold the developer to the strictures of that plan. The model documents expressly grant that power to HUD.¹²⁰

I am convinced that these inflexible policies will do a great deal of harm to the planned unit development movement, if they have not done so already. At best, they will drive developers of open space housing away from the HUD programs, thus neutralizing any influence which HUD may have had in establishing better practices in this field.

2. OILSR

Since I wrote the comparison of condominiums and homes associations,¹²¹ the Office of Interstate Land Sales Registration has entered this field. The OILSR has recently revised its regulations under the Interstate Land Sales Full Disclosure Act¹²² to provide that sales of "lots" include sales of condominium "units."¹²³ This change did not present any new problems for homes association developments since these always involved lots in the conventional sense. However, the condominium industry was so outraged by the expansion of the conventional meaning of the word "lot," that it failed to address itself to the real problem. In my opinion, there was nothing wrong with the OILSR's view that condominium units are "lots" within the meaning of the Act. What was wrong was the confusion which appears to prevail in that agency concerning the scope and meaning of the

¹²⁰ Although HUD does not appear to require that the plan be communicated to the consumer directly, the documents do contain an anomalous provision which requires the developer to provide the consumer with the deed description of the parcels that may be added. *Id.* 6 (Form No. 5). This is nonsense. It does nothing for the consumer and assumes that the developer already has a legal or equitable interest in the proposed addition, elevating this assumption into a requirement. When applied to a small project or to a phase of a larger project, I have no objection to the requirement that the developer have control over the land area involved, but it makes little sense to apply the requirement to all of the land area that may ultimately be included in a larger development. That is why I now feel that a better way to protect the interests of the consumer is to require that the developer establish a policies plan that would focus primarily on the common areas and facilities.

¹²¹ Krasnowiecki, *supra* note 1.

¹²² 15 U.S.C. §§ 1701-20 (1970).

¹²³ 24 C.F.R. § 1710.1(h) (1974). For an extended discussion of this new activism, see Comment, *supra* note 3, at 658-62.

"homebuilder exemption" in the Interstate Land Sales Act. The exemption states that the Act does not apply to "the sale or lease of any improved land on which there is a residential, commercial, or industrial building, or to the sale or lease of land under a contract obligating the seller to erect such a building thereon within a period of two years."¹²⁴

The primary purpose of the Act was to control fraudulent offerings of unimproved lots or parcels of ground. I believe that the purpose of the second clause was to prevent subdividers from avoiding the thrust of the Act by luring the consumer into a binding agreement to purchase the lot through some wholly unenforceable promise to build a home on it. I believe that the Act was never intended to apply to the case where the agreement to purchase does not become binding unless a home is completed.¹²⁵ Such an agreement is not a sale of the lot, it is a sale of the home. The lot is sold only if the home is there. I do not think that the Act was supposed to cover it.

I have never seen a standard contract for the sale of a home in a new subdivision that says that the builder will build a home. What it says is that the builder will sell and the buyer will buy a home if it is completed on a certain date, and if it is not completed the contract is at an end and the buyer's deposit will be returned to him. I cannot believe that the Interstate Land Sales Act intended to change this age old practice.

Once it is conceded that the Act applies to an ordinary home purchase if the contract does not affirmatively bind the builder to build and to complete the home within two years, Pandora's box is open. Practically every homebuilder in the country is violating the Act if he is building fifty homes or more and using the mails or other instrumentalities of commerce to advertise.

OILSR did indeed open Pandora's box. In an introduction to its regulations,¹²⁶ the OILSR observed that the *bona fide* condominium homebuilder need not be concerned about the change in definition of "lot" since the obligation to complete the units in two years is not onerous. To emphasize this point, the OILSR informed the condominium builders that "if a condominium dwelling unit is merely incidental to the common facilities (as in the case of recreational developments), all common facil-

¹²⁴ 15 U.S.C. § 1702(a)(3) (1970).

¹²⁵ The OILSR, however, may not agree. See Comment, *supra* note 3, at 660-62.

¹²⁶ 38 Fed. Reg. 23866 (1973).

ities must be completed within the two-year period to qualify for the exemption since frequently vacation sites are sold without assurances that such facilities will be completed."¹²⁷ There was an uproar among condominium builders. Obviously the idea that all common facilities would have to be completed within two years of the first sale was an impossible suggestion in larger developments.¹²⁸

OILSR's recent attempt to clarify its position has only made matters worse.¹²⁹ Some condominium builders could live with the distinction which says that the common areas must be completed if the units are merely incidental to the facilities. But the OILSR clarification published in the form of Guidelines draws the distinction in terms of whether the facilities are "the primary inducement to the sale."¹³⁰ Obviously most common facilities are an inducement, and, as such, they are always "primary" with the disappointed consumer. The applicability of the act should not be left to such a vague standard.

Furthermore, the OILSR seems to have ignored the implications beyond the condominium. All requirements applicable to condominiums must apply a fortiori to ordinary home sales. After all, the OILSR discussion and Guidelines were triggered by its conclusion that sales of condominium units involve sales of "lots." The sale of a home on its lot always involves the sale of a "lot." Thus unless the OILSR reverses its position or the courts agree that it is untenable, ordinary homebuilders may have to rewrite their contracts of sale to include an affirmative obligation to complete the home within two years.

What if, however, the homes are offered with common areas on the homes association pattern? Can the developer avoid registration under that act without undertaking to complete all of the areas within two years? Considering only OILSR's intention—to give the consumer extra protection—I am bound to say that homes associations and condominiums are indistinguishable. But good intentions do not control the meaning of statutes. When the Act states that the existence of, or an agreement to build, residential, commercial, or industrial structures is sufficient to exempt the sale from its scope, the Act clearly refers to

¹²⁷ *Id.*

¹²⁸ See Comment, *supra* note 3, at 661 n.111.

¹²⁹ 39 Fed. Reg. 7824 (1974).

¹³⁰ *Id.* 7825.

structures that are *on the lot in question*.¹³¹ OILSR may arguably require completion of the common facilities in a condominium because they are an indivisible part of the "unit" by statute—assuming OILSR is right that a "lot" and a "unit" are the same thing. But OILSR has no power to require completion of improvements outside the lot in question, on someone else's lot.

3. SEC

I have discussed SEC's Release 5347 in my previous article.¹³² Although it focuses on condominiums, I believe that it states the SEC position for homes associations as well. If I am right in this conclusion, a developer should not plan to have the homes association supplement its operating budget by outside income producing activities unless he is prepared to go through a registration. The SEC could take the position that there is a sufficient profit motive and a sufficient reliance on the skills of the association management to classify such an offering as an investment contract.¹³³ However, it seems clear that the SEC would not find an investment contract if the association amenities are maintained on a nonprofit basis out of assessments or user fees collected from members.¹³⁴

Unfortunately, a recent Second Circuit decision has thrown doubt on the traditional distinction between profit motivated ventures on the one hand and ordinary home purchases on the other. In *Forman v. Community Services, Inc.*,¹³⁵ the court suggested that cooperative housing offerings may be treated as investment contracts because the residents have an equity at risk. The court suggested that it is a sufficient profit motive if the unit owners expect to save some operating expenses through a communal effort and expect to benefit from deductions for interest and local taxes not generally available to rental apartment dwellers.¹³⁶ Obviously, if these are sufficient profit motives, then all housing that combines communal maintenance with the normal homeownership tax benefits are securities offerings. I cannot believe that is right. The cooperative involved

¹³¹ See text accompanying note 124 *supra*.

¹³² Krasnowiecki, *supra* note 1, at 349-51.

¹³³ See, e.g., SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

¹³⁴ SEC Securities Act Release No. 33-5347 (Jan. 4, 1973), 38 Fed. Reg. 1735 (1973).

¹³⁵ 500 F.2d 1246 (2d Cir. 1974), *cert. granted sub nom.* United Housing Foundation, Inc. v. Forman, 43 U.S.L.W. 3399 (U.S. Jan 20, 1975) (No. 74-157).

¹³⁶ *Id.* at 1254.

in the *Forman* case owned substantial commercial space which was expected to generate some \$1,106,000 in gross rentals. It seems that this alone would have sufficed to provide the necessary profit motive, and it is unfortunate that the court went on to mention the others. So long as the *Forman* decision stands, however, it will create serious doubt about the scope of the securities laws.

CONCLUSION

Because of the energy problem and increasing concern for the environment, housing will have to learn to consume less of the countryside. It will have to learn to cluster around public transportation nodes in higher densities.¹³⁷ American housing consumers, however, still want to own their individual home and they want outdoor recreation close at hand. These needs and desires lead me to believe that the townhouse will become the predominant housing type in the years to come. Recent experiences with new towns suggest that most of this development will be in small or medium-size projects. Absent significant government funding and involvement, the arrangements for maintenance of the common areas and facilities will continue to be private in nature.

In an earlier article, I have compared two such private approaches, the condominium¹³⁸ and the homes association. In this Article, I have explored the homes association in more detail. Obviously, I think it is a sound alternative. Its greatest virtue, however, is also its greatest vice. Because it is not controlled by statute, it is a flexible device in the hands of the draftsman which can be molded to protect both the needs of the industry and the interests of the housing consumer. In the hands of a thoughtless developer it can be bent to abuse the consumer. A proper understanding of the problems special to this form of ownership is, therefore, a practical necessity.

¹³⁷ A recently published study (sponsored jointly by CEQ, EPA & HUD) indicates that townhouse development may have the smallest adverse environmental impact and involve the least energy consumption per unit as compared with other forms of housing. REAL ESTATE RESEARCH CORP., *THE COSTS OF SPRAWL* 3-24 (1974).

¹³⁸ The condominium, however, is subject to substantial public control. See Comment, *supra* note 3.