REPORT OF THE
VIRGINIA BOARD OF COMMERCE ON

Residential Planned Community Development Study

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

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INTRODUCTION

The 1986 General Assembly adopted House Joint Resolution 122 to study the need for regulation of residential planned community developments. The Resolution was introduced by Delegates V. Earl Dickinson, Kenneth R. Plum and George P. Beard and Senator R. Edward Houck; and directs the Secretary of Economic Development to study the need for the regulation of sales and management of residential planned communities. The Virginia Board of Commerce conducted the study on behalf of the Secretary. This report is the result of that study.

A special three-member committee composed of members of the Board of Commerce was designated by the Board to work with Department of Commerce staff. Two public hearings were conducted on June 30 and July 1, 1986. These two hearings, one in Richmond and one in Arlington, were designed to elicit public comment so that the specific problems which gave impetus to the introduction of Resolution 122 might be identified.

The hearing conducted in Richmond was the better-attended of the two hearings. Approximately fifty persons were in attendance and fourteen persons spoke. In contrast, approximately fifteen persons attended the Arlington hearing and four persons spoke. Lot owners, association management and developers were represented at both hearings. In addition to oral testimony at the hearings, written comments were provided to the Board of Commerce by twenty-five persons.

Testimony at the hearings revealed the reasons which prompted the study. Lot owners in residential planned communities expressed concern about the manner in which these developments are organized and operated. Problems cited by lot owners include the maintenance of common areas, formulation of and adherence to an association budget, and conduct of association meetings. Community management and developer representatives concurred in identification of these problems. Disagreement exists, however, in defining the appropriate manner in which these problems should be resolved.

House Joint Resolution 122 clearly establishes the scope for review of the issues prevalent in residential planned communities. The Resolution suggests that sales and management of such communities should be examined as well as enforcement of deed and covenant restrictions through internal quasi-courts systems and the applicability of tax laws. This review is based upon and should therefore include comparison of the residential planned community to similar forms of property development which are presently regulated under Virginia law.

The report of the Board of Commerce addresses each of the specific problems identified in the public hearings and the specific areas of concern identified in the resolution and is based upon a more extensive research document prepared by Department of Commerce staff. In addition to discussing the background problems and application of existing laws, the Board of Commerce in this report outlines alternatives for appropriate action to resolve these problems.

BACKGROUND

The issues and problems identified by lot owners in residential communities have been the subject of earlier studies. These concerns were the basis of the enactment of the Subdivided Land Sales Act and the ongoing review of that law.

In 1978, the Virginia Real Estate Commission (now the Virginia Real Estate Board) issued a report on Recreational Land Development, House Document Number 5. This report, completed at the direction of the General Assembly, recommended the enactment of legislation to regulate recreational land sales and development. The Subdivided Land Sales Act was enacted as a result. Subsequent to the enactment of this law, problems remained in certain subdivisions. These problems continued to increase as evidenced by an increased number of complaints to the Real Estate Commission and increased interest in seeking revisions to the Subdivided Land Sales Act.

The Subdivided Land Sales Act enacted and effective in 1978, parallels its federal counterpart, the Federal Interstate Land Sales Full Disclosure Act. Application of the Subdivided Land Sales Act is and has been much more limited than application of its federal law model, however. Application has been limited because of the manner in which subdivision is defined by the Act. The definition of "subdivision" in the Act is two-part, with the first part focusing on subdivisions of one hundred or more lots of greater than five acres and sold by land sales installment contracts. The second part of the definition includes existing subdivisions in which the developer has concluded its sales efforts and in which the association now owns and is responsible for maintenance of common areas.

This definition has resulted in narrow application of the Subdivided Land Sales Act as it seems was the intent of the General Assembly in passing this legislation. The Subdivided Land Sales Act was introduced as the result of a study of problems experienced in the sale of recreational land developments rather than primary home developments. The first part of the definition of subdivision is clearly consistent with that intent, bringing a limited number of developments under the control of the law and regulation of the Real Estate Commission. The Act was intended to eliminate recreational land sales fraud prevalent in the 1970's by requiring the developer to register the project and make disclosures to purchasers.

It is the second part of the definition of subdivision which has been at the center of controversy. Although it has been determined that the registration requirements of the Act do not apply to existing subdivisions, the Act has been cited as authority for property owners' associations to increase the amount of assessments, impose penalties and enforce liens for non-payment of assessments. Property owners of lots for which their deeds establish a limited assessment have resisted that interpretation, asserting that the law is vague and does not clearly apply to all subdivisions. The position of these property owners is that their deeds are contracts, the terms of which have been negotiated and should not be affected by subsequently enacted law.

The controversy in applying the Subdivided Land Sales Act has repeatedly produced legislation to amend the law. In 1983, two bills to amend the Subdivided Land Sales Act were introduced in the General Assembly. Because of the debate generated by the two bills, the sponsors of these bills agreed to withdraw them and seek the assistance of the Real Estate Commission to study the Subdivided Land Sales Act in light of the proposed statutory amendments. A study committee was formed by the Commission and under the coordinative efforts of Department of Commerce staff, this committee conducted a review of the law and the two proposals to amend the law.

Two public hearings were conducted by the Subdivided Land Sales Study Committee in Middleton and Norfolk, Virginia. Public response to the two legislative proposals was mixed. One faction favored increased authority to the property owners' association. The other faction vehemently opposed that additional authority, basing their stance on constitutional arguments.

In summary, the hearings indicated that there exist established communities with severe problems, resulting from either mismanagement or assessment techniques which incorporated fixed rates at their inception. Without statutory amendments applying in an arguably retroactive fashion, these subdivisions faced deteriorating common areas and facilities and bankrupt owners' associations. The problems which these established communities confront are further exacerbated by the concern that the counties or cities in which these subdivisions are located had refused or would refuse to assume responsibility for maintenance of roads, parks, utilities, and other common facilities in the developments.

Concurrent with that concern, however, was the position of certain lot owners that they should be no further obligated than the amount of the assessment stated in the deed for their property or in the restrictive covenants for the subdivision. Property owners in a number of Virginia subdivisions purchased and received general warranty deeds containing no mention of a property owners' association or assessments for maintenance of common property. Others may have received deeds which permanently limited assessments to a nominal amount. Those property owners argued that the effect of requiring new or increased assessments would be to alter existing and valid contracts, thereby impairing contract rights.

The Real Estate Commission's Subdivided Land Sales Study Committee met several times after these public hearings and ultimately recommended legislation representing a compromise position of these two factions. Even though the completed product was considered a compromise, opposition to any proposal to extend owners' association authority continued. The Committee recommendation was presented to the Real Estate Commission in December, 1983. Although the Commission received the report prior to the beginning of the 1984 session of the General Assembly, the Commission was not in a posture to recommend legislation because of time constraints.

However, some members of the Commission's study committee who were also members and representatives of the Property Owners Association of Virginia (POAVA) requested that Delegate Vincent F. Callahan, Jr. introduce amendments identical to those recommended to the Commission by the Subdivided

Land Sales Study Committee. The Property Owners' Association of Virginia has long advocated legislation to extend the authority of property owners' associations. Delegate Callahan introduced the amendments as House Bill 1628 in response to that request.

During the House General Laws Committee's consideration of Delegate Callahan's bill, the Department of Commerce on behalf of the Virginia Real Estate Commission, articulated the concerns of the Commission that the amendments were not responsive to issues raised in the public hearings and study committee discussions. The Department also expressed concern that certain of the amendments could be construed broadly to affect existing subdivisions and to conflict adversely with local government and constitutional laws. The Department concluded that although the Commission did not necessarily oppose the bill, there were a number of questions which remained unresolved. Based upon that testimony and concerns expressed by other speakers at the committee meeting, the General Laws Committee voted not to report the bill. The Committee asked that Department of Commerce staff again research the issues surrounding the subdivided land sales controversy.

In preparation for the 1985 legislative session, and in conjunction with the commitment made to the General Laws Committee by the Department, on June 25, 1985, the Virginia Real Estate Commission again reviewed the work of the study committee and examined the last offered legislation to amend the Act. As a result of this work, the Commission found that the public interest would not be benefitted by changes to the existing Act. The Commission questioned the effect of the proposed legislation on the property rights of lot owners in Virginia. The Commission further concluded that the legislation raised concerns about constitutional protections. For these reasons the Commission did not recommend the amendments for introduction.

Because the Real Estate Commission had taken the position that the proposal developed by its study committee did not resolve the problems as identified and articulated by lot owners, the Property Owners' Association of Virginia again asked Delegate Callahan to introduce legislation to amend the Subdivided Land Sales Act. In the 1986 session of the General Assembly, Delegate Callahan introduced House Bill 316. The bill, substantially the same as House Bill 1628 introduced the year before, was carried over at the request of its patron, apparently because of House Joint Resolution 122 and the study which that Resolution mandates.

SPECIFIC ISSUES

House Joint Resolution 122 identifies four general areas which are contentious for lot owners in residential planned community developments: administration, regulation, enforcement, taxation. Testimony at the public hearings conducted by the Board of Commerce reaffirmed the concern of the General Assembly as stated in the resolution; members of the public voiced concerns which may be categorized in the same manner. The most frequently expressed problems appear to be in the area of administration. The consen-

sus of participants in the public hearings is that the problems experienced in residential planned communities generally occur after the developer is no longer involved in the operation of the association. The majority of problems occur after the developers' involvement in the management of the community ceases.

Administration

The problems most often expressed by residential planned community land owners can be categorized as problems in administration of their communities. Although these concerns appear to focus on the actions of the association's governing or executive body, problems cited by owners include concern for the provision of quality services; assessments; voting; and, meeting procedures. Management of residential communities by professional management organizations is not an issue considered in this report. From information available to the Board of Commerce, there is little or no concern about the effectiveness of such groups. Rather the concern is that the managing entity, whether it be the association or an independent group, has sufficient tools (clearly outlined authority) with which to work.

Lot owners testified in the two public hearings that a statutory foundation is needed to establish and maintain standards for the operation of property owners' associations. The need for this statutory foundation is more urgently supported by lot owners in communities which do not have comprehensive covenants and restrictions, or detailed association charters and by-laws. Even so, lot owners in well-managed and well-organized communities concur that voting procedures, meeting requirements and the parameters of authority granted to the governing body should be clearly established and are integral components for the efficient and effective management of residential communities. Representatives of such communities merely contend that should statutory requirements be established, such requirements should not apply to existing developments. Certain representatives of well established communities did, however, testify against the need for regulation by the Commonwealth. At the same time, these representatives recognized the need for a well conceived master document and in some instances recommended regulation of the developer.

The concerns of lot owners seem to extend beyond complaints about daily management. Rather, because of the nature of the communities and the maintenance obligations imposed upon the community association, these associations take on the characteristics of local municipalities. Like local governments, the owners' association must develop comprehensive plans to maintain road and utility systems while conducting business in a democratic manner. For this reason lot owners in some communities propose that proper legislation should be considered a reasonable and reliable means to safeguard the social and economic structure upon which these communities depend.

The first of the specific concerns expressed by persons who testified at the public hearings includes concern about the provision of quality services. Services provided by residential associations vary widely. In some

developments, the association may be a social organization whose only maintenance obligation is the sign and flower bed which mark the entrance to the subdivision. Other associations have greater responsibilities, such as providing security, water and sewer service, trash removal and road maintenance. In some communities, in which there are common recreational facilities, such facilities must be maintained.

In communities which provide elaborate services and have extensive maintenance responsibilities, the association budget may be in the hundreds of thousands of dollars. Therefore, stewardship of association funds is a second concern which falls in the category of the general administration issue. Assessment allocations and collection are a problem in some communities. As previously discussed, this issue is most prevalent in communities wherein assessments were fixed by deeds given to purchasers. Funding in such communities is hopelessly inadequate. By establishing budget and assessment requirements by statute, some lot owners argue that the financial difficulties experienced by some residential communities may be avoided.

Actions of the governing body of the association is a third administrative concern and is perhaps the concern most frequently expressed by lot owners. The powers and authority of the governing body should be clearly defined, lot owners assert. The fiduciary nature of the positions on the governing board of any residential community as well as the extent to which members of the governing board may be liable for misaction or inaction should also be set by statute.

Land owners who offered comment at the public hearings believe that the accountability of the governing body may be monitored via open meeting requirements and easy access to association books and records. In one Virginia community, lot owners have been successful in increasing their knowledge of association activities by modeling their association meeting and voting procedures after laws which provide access to information from the government. Nonetheless, these lot owners firmly believe that such standards should be set by a law directly applicable to residential communities. They believe such standards are essential to the continued success of the democratic system which they have been fortunate to adopt voluntarily. Further, it is this system which may serve as the bedrock for eradicating difficulties of communities without a well-defined structure of governance.

Regulation

The issue of regulation may be considered in three phases: prior to sale, after sale and resale. The resounding opinion of those who favor regulation of the residential planned community development is that regulation should take the form of disclosure requirements, much as the current laws which regulate other property development forms.

Those who support the concept of regulation compare the residential planned community development to the condominium, time-share and coopera-

tive forms of development. It is their position that purchasers in residential communities should be given information about the operation of the community and their obligation to participate in the operation of the community. Those who favor regulation believe that regulation may be a prophylatic measure which prevents problems such as those which have given rise to the House Joint Resolution 122 study. Support for regulation of developers' actions was expressed at the public hearings conducted by the Board of Commerce. Those who support regulation believe that a regulatory agency should guide a developer through the development of a residential community.

Opposition to regulation was also expressed both at the public hearings and in written comments provided to the Board of Commerce. Opponents distinguish the property owners' association from the condominium unit owners' association by distinguishing between the varying responsibilities of the two types of associations. Problems were cited in developing a regulatory system flexible enough to address the broad range of types of associations and the variant responsibilities of such associations.

Enforcement

Related to the issue of administration and operation is the issue of enforcing association rules and regulations. However, this issue merits separate treatment from the administration issue because of the potential harm which may result from unreasoned enforcement practices. Lot owners express concern that they are subjected to an internal judicial system or "quasi-courts system" which may not be operated in a manner which affords due process protections. These lot owners believe that a statutory framework for such systems should be provided to ensure protections generally afforded by the constitution. Their concern is with actions of internal court-like committees which levy monetary penalties without benefit of hearing, impose liens against their property without benefit of notice and an opportunity to be heard. The absence of procedures for appeal is yet another concern.

Taxation

Although taxation of the residential planned community development is cited as an area for which the General Assembly requested review and it was mentioned in the House Joint Resolution 122 public hearings, the issue of taxation appears to be a minor issue. At one time, the property of owners in residential communities in effect was taxed twice. Not only were lots assessed at heightened amounts because they were located in private developments, but common areas were assessed separately and charged to the association. This problem was cured by legislation amending the tax code in 1985.

A taxation problem which does continue to concern certain property owners is that they pay twice for certain services. A clear example of this circumstance occurs in communities which offer separate security pro-

tection. In such communities, a security force is funded by the association to patrol and enforce the laws of the Commonwealth in the development. County or city police do not, therefore, enforce the law in that community. In some instances, the private security force may be trained and authorized by the county or city police. The tax assessment of lot owners in these residential communities is not adjusted to reflect the private funding of the security force. In essence, these lot owners believe they are paying for police protection twice.

LEGISLATIVE SURVEY

In order to adequately address the concerns expressed by lot owners, management and industry representatives, the requirements of existing law should be considered. The manner in which state and federal laws regulate residential planned community developments may be helpful in determining the proper course for Virginia. Existing Virginia law is also reviewed to ascertain its adequacy or inadequacy.

Laws of Other States

Seventeen states have legislation which provides for the regulation of land sales. Only four of these seventeen states have laws which meet the substantial equivalency certification requirements of the Interstate Land Sales Full Disclosure Act. Review of these laws shows that their focus is on the regulation of sales, not the operation of the association once the developer is no longer involved. Further, the regulation of sales in these jurisdictions is limited to sales conducted in-state.

In this survey of the laws of other states, three states were found to have comprehensive regulatory and statutory schemes for the regulation of residential planned community developments: California, Connecticut, and Oregon. The laws of two of these three jurisdictions (Connecticut and Oregon) are based upon a uniform or model law. The laws of California and Connecticut are much broader in the scope of their application insofar as these laws apply to both residential planned communities and other forms of common interest developments (condominiums, for example). The laws of all three jurisdictions set forth requirements for the contents of the documents which create the property interest conveyed to purchasers. These laws also set forth extensive frameworks for the formation and operation of an owners' association.

As mentioned above, model legislation for planned communities has been developed. The Uniform Planned Community Act, which is incorporated into the Uniform Common Interest Ownership Act, drafted by the National Conference of Commissioners of Uniform State Laws is a comprehensive document which may be described as a "second generation law." Its provisions include provisions for creation and management of the planned community in addition to provisions for the protection of purchasers. This model law also recommends registration requirements to be administered by a regulatory agency.

The Virginia Subdivided Land Sales Act

The Virginia Subdivided Land Sales Act has been the subject of litigation. The Subdivided Land Sales Act has also been the subject of repeated legislative action. These two facts well document the notion that this law does not adequately address the concerns expressed by land owners in residential planned community developments. At first blush, the Subdivided Land Sales Act is simple in its construction. However, as opinions issued by the Attorney General affirm, it is complex legislation, the application of which is not clear.

In an opinion issued in 1979 to the Director of the Department of Commerce, Attorney General J. Marshall Coleman had the opportunity to address the issue of applicability. He concluded that the Act may be applied only to actions taken after the effective date of the law, July 1, 1978. To apply the law to contracts existing prior to that date would be violative of Art.I, § 11 of the Virginia Constitution and Art.I, § 10 of the United States Constitution. The Attorney General cited a number of Virginia Supreme Court cases which held that ". . .retrospective operation will not be given to a statute which interferes with antecedent rights. . .unless such be 'the unequivocal and inflexible import of the terms and the manifest intention of the legislature.'" Greene v. United States, 376 U.S. 149, 160 (1964) quoting Union Pac. R. Co. v. Laramie Stock Yards Co., 231 U.S. 190, 191 (1913); Kennedy Coal Corp. v. Buckhorn Coal Corp., 140 Va. 37, 56, 124 S.E. 482, 488 (1924). Based upon these Virginia cases, the Attorney General advised that retroactive application of certain provisions of the Subdivided Land Sales Act would effect impairment of vested rights.

In 1982, the Viriginia Attorney General again had the opportunity to address the applicability of the Subdivided Land Sales Act. In an opinion for Delegate Raymond R. Guest, Jr., Attorney General Gerald L. Baliles was asked to advise whether or not the Act applied to a particular subdivision, Shenandoah Farms. Shenandoah Farms is a subdivision created in the early 1960's in Warren and Clark Counties. The Attorney General concluded that Shenandoah Farms was not a subdivision within the meaning of the Act. This conclusion was based upon the fact that Shenandoah Farms did not include all of the elements of a subdivision as defined by the Act and its association was not formed as the law requires, prior to the sale of the first lot.

Once the applicability hurdle has been cleared, the second hurdle one confronts in considering the Subdivided Land Sales Act is its provisions concerning management of the subdivision. As repeated efforts to amend those provisions of the Act confirm, this law does not clearly provide a statutory foundation for the operation of all residential planned community developments. Representatives of established communities attest that their communities do not govern themselves according to provisions of that law. Thus, coupled with the problem of applicability, this law has been described as grievously inadequate.

Virginia Nonstock Corporation Act

Application of Virginia's Nonstock Corporation Act was an issue raised both at the public hearings conducted by the Board of Commerce and in written comments submitted to the Board. Some property owners' associations are incorporated under this law; therefore, discussion of the provisions of the Nonstock Corporation Act is relevant. It is the position of representatives from those developments with incorporated associations that no further legislation is needed to provide a statutory framework for the conduct of association business. Rather, it is their position that the Nonstock Corporation Act sufficiently provides requirements for meetings and voting procedures and limitations on authority of the governing body.

Those who favor specific legislation for residential planned community developments believe the Nonstock Corporation Act inadequate in its provisions regarding association books and records. Availability of books and records as well as disclosure of actions taken by the governing body of the association are matters which may be best addressed by separate legislation designed specifically for that purpose.

FINDINGS AND ALTERNATIVES

Based upon comment offered at the two public hearings and research and review conducted by Department of Commerce staff, the Board of Commerce makes the following findings with respect to residential planned community developments:

1. The concerns of land owners in residential planned community developments are in the administration and regulation of their developments as well as the enforcement of association rules and taxation of their property.

2. The problems associated with the residential planned community are not necessarily problems resulting from the actions of the developer. That is to say, the problems of planned community residents are not ones which arise out of the sales transaction. Rather, problems occur in the management and operation of the residential planned community development.

    a. Actions taken by the governing body of residential planned community developments may not be conducted according to established procedures for notice of meetings and voting thereby limiting the participation of land owners in the conduct of association affairs.

    b. Actions taken by the governing body of residential planned community developments may be ultra vires.

    c. Budgeting procedures including the assessment of land owners and the collection of assessments may not be adequately addressed in association documents.

d. Land owners in residential planned community developments do not have adequate opportunity to monitor the activity of their associations via access to association books and records.

3. Double taxation of real property is no longer an issue as it affects the residential planned community development. Adjustment of taxes assessments in communities which provide services similar to those provided by local municipalities is an issue which should be given further review, however.

4. The Subdivided Land Sales Act and the Nonstock Corporation Act do not adequately provide for the formation and operation of the residential planned community development association.

5. Residential planned community developments need a statutory framework tailored specifically to the needs of such developments.

6. The uniform statutes for residential communities include provisions which best address the needs of residential planned community developments and should therefore serve as a model for legislation should legislation be proposed for Virginia.

In developing conclusions which appropriately address land owner concerns as manifested in the adoption of House Joint Resolution 122, the findings of this study should be considered in terms of the regulatory hierarchy established by the General Assembly in Viriginia Code § 54-1.26. That statute is clear in its mandate that regulation be kept to a minimum: "The Board [Board of Commerce] shall regulate only within the degree, or degrees, of regulation that it finds necessary to fulfill the need of regulation and only upon approval by the General Assembly." With this statutory mandate in mince, three alternative solutions to the problems articulated by lot owners in residential planned communities are evident.

The first alternative is to take no action at all. Adopting this alternative constitutes a determination that there are in fact no problems in residential planned communities or the conclusion that the problems expressed by lot owners are unique problems for which legislation is not curative.

The second alternative is comprehensive legislation to regulate the industry and establish general provisions for the administration, operation and management of residential planned community developments. Such legislation would establish a regulatory program much like that presently in place for condominiums, time-shares and real estate cooperatives. Such a program would not only establish disclosure requirements, but also set requirements for the creation of the ownership interest and management responsibilities for common facilities. This is perhaps more comprehensive than what most owners' association seek.

The third alternative is perhaps the most viable and would likely receive minimal resistance. The third alternative would also address the problems through legislation, but not legislation which establishes a regu-

latory program. Rather, the third alternative would be to propose legislation which would provide a framework for management of the residential planned community. The Board of Commerce recommends this alternative. In considering the draft of this report at its September 22, 1986, meeting. the Board made the recommendation that legislation be drafted which would provide a framework for the management of the residential planned community development.

Developers would not oppose this alternative as they likely would oppose legislation which creates a regulatory agency charged with enforcing registration requirements. Many lot owners would welcome this alternative as responsive to their concerns. There is a faction of lot owners which would certainly oppose this alternative, however. They would categorize this alternative as intrusive and burdensome and an impairment of their contract rights. Certainly drafting would require great care to assure that the law may not be given retrospective treatment. This is a drafting issue, however, which may be resolved. Nevertheless, legislation should not be regarded as a panacea.