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Subject: Changes to HUD's Process for Approval of Condominium Planned Unit Development (PUD) Projects

September 23, 1996

MEMORANDUM FOR: Emelda P. Johnson, Deputy Assistant Secretary for Single Family Housing, HS

FROM: Nelson A. D¡az, General Counsel, C

SUBJECT: Changes to HUD's Process for Approval of Condominium and Planned Unit Development (PUD) Projects

This memorandum transmits a report on the recommendations of an interagency working group which met over a period of several years to consider needed revision of guidelines for the legal documents that establish condominium and PUD projects. For many years, these guidelines have been set forth in HUD handbooks and in comparable publications of the Department of Veterans Affairs (VA), the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Association (Freddie Mac). The guidelines have served as a basic expression of policies and standards which these governmental and secondary market agencies apply to approve condominium and PUD residential property for their respective single family mortgage insurance, loan guarantee, and mortgage-backed securities programs. Over time, the guidelines have become outdated, and there has been decreasing uniformity among the agencies.

Members of my staff participated in the working group together with members of your Development Division. The role of the Office of General Counsel in the deliberations was only advisory, and HUD's position on individual policy recommendations adopted by the working group was decided by the Housing participants.

With this working group, perhaps more than with most such collegial endeavors, the mission to coordinate policy conflicted with the obligation of individual agency representatives to protect their respective organization's authority and responsibility. All working group members were aware that the working group had before it a singular opportunity to simplify policies and procedures and minimize redundancy and confusion. Yet many times, when a remedy to a recognized problem was proposed, it did not adequately address concerns of one or more agencies or of the public as a whole. Ultimately, a great deal was accomplished, but the differences in agency perspectives explain much of the working group's delay in developing its recommendations and the lack of a single final report on behalf of the working group. The attached report, prepared at the request of (and benefitting from review by) Housing staff, still bears some evidence of the differences. We have included

separate OGC comments when we thought they could be helpful--for example, when a particular recommendation of the working group may overlook or understate a potential concern.

During the process of drafting our report, we became aware that one of the working group's basic assumptions--the need to continue detailed guidance for the legal documents of condominium and PUD projects where there is an FHA presence--should not be taken for granted. This memorandum, therefore, discusses whether to maintain the historical FHA approach both in terms of its current relevance and in light of HUD's general reconsideration about how to do business in the future, including an anticipated decline in Departmental staffing.

Whereas the report reflects the working group's assumption that HUD/FHA, VA, Fannie Mae and Freddie Mac would continue to issue detailed document guidance and focuses on how to develop common guidelines that eliminate or minimize differences between the agencies and between the treatment of condominiums and PUDs, this memorandum is intended to direct attention somewhat differently. It addresses, in contrast to the substance of the documents themselves, existing FHA procedures for condominium and PUD approval and the extent to which they can be simplified. We have identified certain options that can be considered in tandem with, or in lieu of, changes to specific document requirements.

In the expectation that HUD will continue to some extent with the approval of condominium and PUD projects in which it has a substantial interest, this memorandum also discusses different procedures for implementing the group's recommendations and otherwise updating HUD/FHA requirements.

HUD's INTERESTS

HUD's involvement to date in condominium and PUD approval has been similar to the involvement of private parties such as Fannie Mae and Freddie Mac. It also reflects public policy concerns that no longer may be as strong as they once were.

As the report indicates, in the 1960's FHA was a pioneer in fostering acceptance of both the condominium and the PUD concepts, as exemplified by the model enabling documents that FHA developed and that became the initial industry standard. This original leadership role is now ended; however, HUD also performs a continuing consumer protection role (specifically authorized by statute in the case of condominiums) by acting as proxy for the future purchasers of condominium and PUD units. Purchasers cannot directly affect the content of a project's legal documentation because it is prepared prior to construction. It generally can be said that consumer protection continues as the justification for some specific provisions of HUD's documents guidelines, but that HUD's financial interest in project soundness is usually a concern as well. In today's realities, HUD has largely ended its direct involvement in the operation of individual projects, except that approval of a project may still be rescinded if operating problems come to the attention of the

local HUD Office.

Limitations placed on the developer (such as ensuring eventual release of developer control over the governing association) function both as consumer protection measures for the homeowners and as financial protection for those institutions involved in mortgage financing for the homeowners. This is also true of some limitations placed on the associations themselves under current HUD requirements, such as the requirement for a majority exceeding 51% of the unit owners when voting on many important items.

The concern of the lender and the mortgage insurer for the protection of the condominium and the PUD homeowner stems from a unique and basic feature of these common property interest regimes -- the risk presented by an individual unit is strongly influenced by the financial viability of the entire project. For example, if adequate funds are not set aside for the maintenance, repair, and replacement of common elements or if those funds are not expended in an proper manner, the value of all units in a project will suffer. Unit values are similarly affected by the level of assessment imposed by the association on the individual property owner, much as value may be affected by real estate taxes except that assessments are levied without the constraints which operate on governmental taxing authorities. Like taxes, assessments involve a constant balancing of opposing considerations. Excessively high payments overburden homeowners and affect their ability to amortize mortgages and other housing-related debt while inadequate assessment income may lead to poor project maintenance, repair, and replacements practices or to sporadic large special assessments that the homeowner cannot anticipate or often afford.

HUD/FHA and other agencies also consider the effect a project can have on the marketability of individual condominium or PUD properties--both when the project is functioning as designed and when problems develop.

These concerns lie behind HUD's current approval procedures.

CURRENT HUD APPROVAL PROCEDURES

1. PUDS.

No statutory or regulatory provision directly requires the Department's approval of a PUD as a condition of mortgage insurance with respect to its units, but administrative issuances consistently have required such approval since the 1960s. Indirectly, the maximum statutory loan-to-value ratios imply some ability to provide guidance about how lenders should address matters affecting value. The statutory requirement for a quality of title that meets HUD's insurance claim requirements also implies authority to provide guidance on the acceptability of encumbrances. Further evidence appears in Section 204 of the National Housing Act (NHA) which expressly permits HUD to reimburse lender-paid assessments through insurance claims only if the assessment obligation arises out of a recorded covenant

approved by the Secretary before endorsement.

We are not aware that any legal challenge has been raised regarding HUD's ability to condition mortgage insurance on a PUD unit upon approval of the project, but the approval requirement does appear only in handbooks and is styled as a guide rather than a mandate. Handbook 4135.1 Rev. 2, "Procedures for Approval of Single Family Proposed Construction Applications in New Subdivision," addresses the subject in paragraph 3-13 and Appendix 9. Appendix 9 contains documents labeled "Suggested Legal Documents"; these models (Declaration of Covenants, Conditions and Restrictions, and the Articles of Incorporation and By-Laws for the homeowners association) are often collectively referred to as "Form 1400" because of the original HUD form number for the instructions that accompanied the documents. Those instructions state: "Their use is not mandatory but recommended because they will facilitate review by HUD and VA. They reflect the basic requirements of both agencies."

PUD approval is treated more comprehensively in Handbook 4150.1 Rev. 1, "Valuation Analysis for Home Mortgage Insurance," paragraphs 11-12 through 11-14. With regard to legal documentation, the starting point again is the Form 1400. Paragraph 11-12c.1)f requires that, before a PUD can be approved, HUD must be furnished the documents for the project with an attorney certification that they are in compliance with FHA "legal requirements" referring to Form 1400. Also prescribed is a "suggested format" for the legal certification which focuses on selected key features of the model documents. This attorney certification procedure was adopted in 1983 by Processing Directive #7 issued by the Deputy Assistant Secretary for Single Family Housing.

The certification for legal documents was intended to be only part of the process for HUD approval of a newly-created PUD, which also must meet the requirements of any new subdivision, PUD or otherwise. Consequently, the developer must forward its own certification with respect to subdivision processing, together with the appraiser checksheet, to the Direct Endorsement lender at the time it submits the PUD-related attorney certification and documents to the HUD Field Office. In the case of an existing PUD, however, the only requirement is that the developer submit the attorney certification and documents to the Field Office. Handbook 4150.1 Rev-1, paragraph 11-12C, lists the documents that must be submitted when mortgage insurance is first requested for a property in an existing PUD.

2. Condominiums.

Mortgage insurance on condominium units is authorized by Section 234(c) of the NHA. That section enables the Secretary to insure units "in his discretion and under such terms and conditions as he may prescribe (including the minimum number of family units in the project which shall be offered for sale and provisions for the protection of the consumer and the public interest)." The section also disfavors investor-dominated

condominiums by requiring that owners must occupy 80% of units with insured mortgages (although there is no statutory owner-occupancy percentage for the project as a whole.) "The Secretary may also require that the rights and obligations of the mortgagor and the owners of other dwelling units in the projects shall be subject to such controls as he determines to be necessary and feasible to promote and protect individual owners, the multifamily project, and its occupants." Finally, Section 234(k) of the NHA restricts HUD's ability to provide mortgage insurance for units in projects that were converted from rental projects within the prior year. (The Section 204 provision cited in the discussion under PUDs also is applicable.) While there is no explicit mandate for a project approval step when HUD is insuring unit mortgages, clearly there is authority to do so with a strong sense that HUD has a responsibility for the overall state of the project and the terms and the conditions under which it is approved to operate.

HUD has implemented this responsibility in regulatory form through 24 CFR 234.26, "Project requirements," which requires HUD/FHA approval of a condominium project. Included are specific requirements governing, for example, presale ratios and the expiration or waiver of developer rights to modify the project other than by annexation of phases or stages that HUD has approved. Section 234.26(e)(1) further provides: "The Commissioner may require such conditions and provisions as the Commissioner determines are necessary for the protection of consumers and the public interest." In earlier times, FHA executed a regulatory agreement, first with the developer then with the condominium association as it came into independent existence, but this requirement was deleted from the rule after it had been abandoned in practice.

Two HUD handbooks address the requirement for condominium approval. Handbook 4150.1 Rev. 1, paragraphs 11-1 through 11-11 contains the most comprehensive and up-to-date discussion. Handbook 4265.1, "Home Mortgage Insurance; Condominium Units; Section 234(c)," is exclusively devoted to the Section 234(c) program, but nearly all of it is obsolete except for portions of Chapters 12 and 13 and Appendix 24.

Handbook 4150.1 Rev. 1, paragraph 11-3E requires an attorney's certification that all condominium legal documents meet HUD guidelines (Appendix 24 is referenced) as well as state and local condominium laws. Unlike PUD processing, no suggested form of certification is provided by handbook, but the usual form of certification is quite short.

To a greater extent than with PUDs, legal certification for the documents is only part of the HUD approval of a condominium. That process is described in Handbook 4150.1 at paragraphs 11-5 (for proposed construction), 11-6 (developments with building under construction or existing less than one year), 11-7 (existing construction but no operating condominium association), 11-8 (existing construction with operating condominium association), 11-9 (projects conveyed from rental housing), 11-10 (projects approved by VA), and 11-11 (projects approved by Fannie

Mae).

FHA RECIPROCITY FOR APPROVAL BY OTHER AGENCIES

1. PUDs.

Fannie Mae and Freddie Mac have limited PUD approval procedures, and HUD has no policy of accepting Fannie Mae/ Freddie Mac approval in lieu of its own. Paragraph 11-14 of Handbook 4150.1 Rev-1 provides that HUD will forgo separate legal review of documents when a VA Certificate of Reasonable Value (CRV) is being converted for FHA use, unless HUD becomes aware that the legal documents do not meet its requirements. This paragraph does not specifically address the situation in which VA has issued CRVs for some homes in the PUD but has not approved the home being considered by HUD.

In fact, the question of PUD reciprocity with VA has been overtaken by events. VA staff has reported to us that VA no longer conducts any review of existing PUDs.

2. Condominiums.

A condominium project with VA approval does not undergo separate HUD review of legal documents. HUD does a limited review to verify project compliance with statutes, regulations, and policies uniquely applicable to HUD, such as restrictions on conversion projects and pre-sale and owner-occupancy requirements. If a CRV is converted for a unit in a project less than one year old, the unit only qualifies for a 90% LTV unless there is an approved 10-year warranty plan or (in the case of proposed construction only) the CRV was issued before construction started and VA has performed construction inspections.

For proposed or newly constructed condominiums with Fannie Mae approval, HUD reviews the Fannie Mae findings and supporting documents, then determines--sometimes with an on-site review--whether to accept the project.

Although in the past HUD and Freddie Mac have observed reciprocity, they do not do so at the present time.

IMPLEMENTATION OF CHANGES

Under current HUD policy, no FHA mortgage insurance is available for any condominium or PUD unit unless the project has HUD Field Office approval, including approval of legal documents, except as noted above under "Reciprocity." When Housing considers whether to revise its guidelines for the legal documents in light of the working group's recommendations, it would be timely to consider whether HUD's current project approval requirement should be modified. A few words about what other agencies are currently doing may provide some perspective. Positions of the other agencies:

VA. VA has indicated that it is more concerned about

condominiums than about PUDs. The concern appears to be twofold: 1) Condominiums as a class are perceived as a less stable, more risky form of property interest, and 2) because the common area comprises a part of each individual property and is therefore part of the security for the homeowner's indebtedness, the interest of the lender and the mortgage insurer/loan guarantor is concrete and definite. The consequence of VA's concern is that it still conducts for condominiums the review and the approval process that it has dropped for existing PUDs and somewhat streamlined for new ones.

Fannie Mae. Fannie Mae categorizes condominium projects as Type A, B, or C, each requiring a different level of approval. Type A refers to an existing project where individual properties may be approved on a spot loan basis. Type B refers to a new or conversion project which is unremarkable and, therefore, does not require Fannie Mae acceptance. Type C covers a new or existing project which merits Fannie Mae review for a specified reason (e.g., it contains single-wide manufactured housing or is subject to annexation or phasing). Not surprisingly, Type C faces the most rigorous standard.

Fannie Mae classifies PUDs as Types E and F, Type E being an established project in which control has been turned over to the association, with Type F including any PUD still under control of the developer. For Type E, the lender must ascertain only that the project meets several general criteria assuring its stability. For Type F, the analysis is more extensive, and the requirements are much more specific.

Freddie Mac. Freddie Mac recognizes three classes of condominiums. Class I refers to a project that is still under developer control or is subject to uncompleted add-ons or phasing; such projects are subject to the most requirements and necessitate the most extensive warranties on the part of the Seller (i.e., mortgagee). In the case of Class II, project control must have been turned over to the association for at least a year; all common areas and amenities must have been completed; and there must be no further add-ons or phasing planned. If these criteria are met, Freddie Mac's requirements are reduced significantly. For Class III, control must have resided in the association for at least two years, and the other Class II criteria apply. In that event, Freddie Mac simply requires a 90% presale, protection of a mortgagee in possession from more than six months' unpaid assessments, and if a leasehold is involved, certain lease requirements which Freddie Mac imposes anyway on many non-condominium properties.

Freddie Mac does not categorize PUDs and imposes relatively few requirements on their approval. Furthermore, if any of those requirements are not met, Freddie Mac may still accept the project on an ad hoc basis.

ALTERNATIVES TO THE CURRENT HUD/FHA APPROVAL PROCESS

There is no statutory requirement that HUD approve condominium projects as a condition to insurance if HUD

determines that adequate consumer protection and compliance with statutory restrictions can be assured in some other way. There is no statutory or regulatory requirement for approval of PUDs. Housing has legal discretion to consider policies ranging from complete abandonment of any project approval requirement whatever to a continuation of current requirements (presumably with up-to-date guidelines for legal documentation). It is not known what course, either short- or long-term, the other agencies plan to take regarding condominium and PUD approval practices. VA, Fannie Mae, and Freddie Mac may be influenced by any action that HUD/FHA adopts.

The three options discussed below assume some level of continued HUD approval on a project-by-project basis. They are presented to assist in a Housing review of its policies and should not be considered as covering all the possibilities.

Option 1. Exempt certain classes of projects from project approval requirement.

a. PUDs. This has been done to some extent by VA, Fannie Mae, and Freddie Mac. The following classes (which are not mutually exclusive) might be exempted:

- o So-called "de minimis" PUDs in which there is little or no common property owned, leased, or administered by the homeowner association. Mandatory assessments fund other operations of the associations.

- o PUDs whose associations have passed to the control of the unit owners with the developer no longer involved.

- o PUDs whose associations have existed for a specified minimum period of time but still remain under the control of the developer.

- o PUDs that meet a specified pre-sale level.

- o PUDs in States which have been identified by HUD Field Offices as providing adequate statutory or regulatory protection.

- o Any combination of the above.

b. Condominiums. As previously observed, Fannie Mae and Freddie Mac recognize different classes of condominium projects and impose different requirements accordingly.

- o The possible PUD exemptions (except de minimis projects) could also be adopted for condominiums.

- o Permit Field Offices to investigate States which may provide adequate protection by statute or regulation.

Option 2. Increase reliance on Direct Endorsement (DE) mortgagees. HUD could require a DE lender to certify compliance with HUD requirements, along the same lines as the

Servicer/Seller warranties accepted by Fannie Mae for Class A and B condominiums.

Option 3. Increased use of developer certification. HUD could rely on a developer certification regarding other matters of concern that are not covered in the attorney certification for legal documents--e.g., compliance with pre-sale requirements and the restrictions on conversions, the adequacy of budget, and management arrangements on the part of the association.

Options for Implementation Procedures:

1. Handbooks. Current handbooks will need to be revised if all or some of the changes that have been mentioned are adopted--changes in the types of projects that must receive prior HUD approval as a condition of FHA mortgage insurance on units, the basis for obtaining HUD approval, and changes in the FHA guidelines for legal documents.

If Handbook 4265.1 were retained as a separate directive for condominiums, it would need virtually complete rewriting. We suggest that it is time to retire that issuance and make any needed modifications to the more current discussion on condominium approval in Handbook 4150.1. Guidelines for condominium legal documents--equivalent in function to the current Appendix 24--could be appended to Handbook 4150.1. Such guidelines should be sufficient. We see no need to continue to reproduce as handbook appendices the outdated model condominium declarations, articles of incorporation, and by-laws that now appear as appendices to Handbook 4265.1.

In the same vein, updated guidance on PUD approval can be consolidated in Handbook 4150.1 without the need to continue the largely obsolete Handbooks 4135.1, 4140.1, 4140.2. Whether or not the specific recommendations of the working group are followed, there is a clear need to provide instruction on acceptable PUD legal documentation in a more general and flexible form than the current Form 1400 documents. Under the working group's approach, a single set of guidelines would contain HUD's requirements covering both condominiums and PUDs.

2. Federal Register Notice. Revised guidelines for legal documentation, while not rising to the level of a substantive rule that must be published in the Federal Register, still would affect the interests of many groups (attorneys, homeowners, planners, developers) who would not receive direct notice of changes through regular handbook distribution. Publication of revised guidelines in a policy notice in the Federal Register should result in a more widespread and rapid dissemination of revised FHA policy. A single one-time notice could be used, but Housing should consider the advisability of using a Federal Register notice that solicits public comment before a final policy on condominium and PUD legal documents is adopted. As in the present situation, whenever an agency is considering a course of action or policy that involves divergent interests and classes of persons or when the issues are complex, interrelated, and represent a numbers of concessions and compromises, an

administrative record can be very useful in sorting out the equities and buffering the agency's eventual decisions against legal and political challenge.

3. Regulations. As long as HUD relies upon regulations to enforce the major policies that govern its single family programs, Housing should consider selective rulemaking with respect to condominiums and PUDs.

Condominiums. There is a need to revise at least the obsolete portions of 24 CFR Part 234, and a good case could be made for using that rulemaking docket to develop a comprehensive regulatory base for the program policies that are now reflected only in the legal documents, in lieu of the very general current regulations. Arguably, HUD may have engaged in rulemaking that should have involved public comments when it has developed its condominium policies through document guidelines and review.

A basic rule on condominium project approval could set forth requirements that are: 1) currently in Part 234 (e.g., owner-occupancy ratios); 2) not included in any rule, but covered by handbook (presale obligations); and 3) not a part of either rule or handbook but significant enough to deserve attention (lender obligation to pay delinquent assessment). One regulatory section or component might address the condominium association, its rights and limitations, and this would be a nexus for those requirements that traditionally have been set out in the Appendix 24 Policy Statement and the now defunct regulatory agreements. Section 234 requires considerable explication. The statute also carries a Congressional mandate to "promote and protect" individual owners as well as the project and its occupants. Both are strong arguments for reliance on rulemaking with an opportunity for public comment.

PUDs. There is no specific regulatory base for PUDs; for regulatory purposes they are simply a variant of the Section 203(b) program.. The Department could take the occasion of document revision and regulatory reform to provide a base in the Code of Federal Regulations for this established and growing aspect of FHA activity. We strongly support Housing's effort to delete unnecessary materials from the CFR. To the extent that regulations are retained for major aspects of single family programs, however, it is anomalous to provide no mention in those regulations of the special requirements applicable to PUDs. As with a possible revised condominium rule, basic requirements such as presale ratios could be included, and there could be adequate provision setting forth the rights and the responsibilities of homeowner associations.

Whatever your decision on the substance of changes and the best means of adopting them, we are available to assist your Office in developing pertinent regulations, notices, and handbooks.

Attachment
cc:

C Díaz 10214
CA Weidenfeller 10240
CIS Albright 9240 CIS Alexander 9240
CIS Chron 9240 CI Daly 9236
CIS Dec. File 34.0, 159.0
CIS Martin 9240
HUD CLIPS Index File No. 4.215
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ACORN Control No. 155132

Concurrences and Dates:

CIS	CIS	CIS	CI
Martin	Alexander	Albright	Daly

CA
Weidenfeller

REPORT ON RECOMMENDATIONS FROM THE INTERAGENCY WORKING GROUP ON REFORM OF CONDOMINIUM AND PLANNED UNIT DEVELOPMENT DOCUMENTS

SUMMARY

A working group of government and industry representatives (working group) has reviewed the current requirements of federal agencies and secondary market institutions (collectively referred to as agencies) for single family mortgage lending with respect to units in condominium and planned unit developments (PUDs). This review focused specifically on legal documents that prescribe the organization, responsibilities and operation of associations -- the private, non-profit, specialized organizations created by project developers for the purpose of governing a condominium or PUD regime with eventual resident control.

The working group started with three assumptions:

<<>>
Condominiums and PUDs should continue to be subject to certain requirements as a condition to single family mortgage lending. The legal documents contain most of these requirements, although the documents, standing alone, may not be a suitable means of implementing agency policy in all respects. Policy can also be expressed in regulations, handbooks, mortgagee letters, memoranda, guides, etc.

<<>>
As much as possible, the agencies should try for standardization in imposing document requirements and guidelines. Uniformity will increase a borrower's sources of financing without requiring duplication of effort and frustrating, pointless procedures on the part of lenders, developers, associations and sometimes the borrowers themselves.

<<>>
In a number of respects, the requirements are outdated.

As work progressed, the group adopted another working assumption:

<<>>
The corresponding requirements for PUDs and condominiums should differ as little as possible.

An effort to modernize and standardize the requirements for single family mortgage lending in condominiums and PUDs necessarily entails a thorough revision of the documents. This report covers working group recommendations that involve change to the more important policy matters. It highlights key points but does not try to exhaust the subject matter. The purpose of this report is to 1) explain the general background and conclusions of the working group's deliberations, and 2) serve as a vehicle for facilitating decisions by the FHA leadership concerning adoption for the FHA single family programs of the major recommendations outlined.

BACKGROUND

Whenever homeownership interests involve common areas, there are special considerations which impact on lenders and the agencies that insure, guarantee, purchase or securitize their mortgages. This is true whether the common area is owned jointly and severally by the unit owners and administered by a condominium association or owned by a PUD homeowners association comprised of all the unit owners. In either case, the owners support the association with mandatory periodic payments and control it with their voting power. In effect, these communities comprise quasi-governments that exhibit typical strengths and weaknesses of the democratic process.

The legal documents for condominiums and PUDs must reflect any applicable state or local law, and for condominiums there is invariably some law that applies since they owe their existence to enabling legislation. Still, there is always latitude for the attorneys who draft enabling documents on behalf of developers to introduce substantial differences in the rights and obligations conferred on residents, and the drafting decisions of these attorneys are influenced by standards of agencies such as FHA. FHA, in fact, was an pioneer in developing the substantive content of many condominium and PUD documents; in the mid-to-late 1960s, it set the pace by prescribing model documents for condominium developers to use whenever they anticipated use of FHA-insured financing. In that same time frame, 24 CFR part 234 was adopted to implement section 234(c) of the National Housing Act (Act), and Form 1400 was issued providing models for PUD documents paralleling those that had been developed for condominiums. By 1973, the Department of Veterans Affairs (VA) coordinated with HUD/FHA in developing standardized PUD forms and generally uniform policies for condominiums.

These pioneer standards served well for years while PUDs and

condominiums emerged as successful approaches to land subdivision and planning, but the last twenty years have seen major evolutionary changes in the concepts of common property interests. For example, in the mid-1970s, phased projects were a rarity and mixed-used projects combining condominiums, PUDs, cooperative housing, rental units and commercial property had yet to be devised. An appendix to this report includes a brief discussion of the way in which condominiums and PUDs have evolved from their original concepts, and how these sometimes subtle changes have (or should have) impacted on the agencies' treatment of both types of regimes.

The Form 1400 documents for PUDs have not been formally updated since 1973. The last joint effort by the agencies to update guidance for condominium documents began in 1975 when HUD organized a Condominium Task Force with VA, FNMA and FHLMC. This resulted in revised legal guidelines that appear as Appendix 24 of HUD Handbook 4265.1. These rules and guidelines developed for an earlier period are less and less relevant today. The agencies have differed in their response to this fact, or else have largely ignored it. As a consequence, builders, lenders, borrowers, homeowners associations and attorneys now find themselves caught up in conflicting and outdated requirements that greatly complicate the task of creating a legal structure for the projects. The result may be a legal structure that fails to provide flexibility or match current approaches to planning, development and management of projects with associations. From time to time, agency staff have acknowledged a need for document reform and agreed to cooperate more closely, but there has only been accord in principle and not on specifics. A number of issues simply had to be hammered out to return to a general uniformity of requirements while adapting to current conditions, and this was the task of the working group as it began to meet at the end of 1991.

CONCLUSIONS AND RECOMMENDATIONS

Beginning in late 1991, the working group undertook analysis of the agencies' policies for condominium and PUD documents. The objective was to update these policies and procedures, make them more effective and minimize differences among the agencies. Scrutiny of each provision led to the recommendations that follow at the end of this report.

Although there has been wide-spread recognition for some time that the various agency requirements are in need of revision, the impetus necessary to get this effort underway was missing until the CAI Research Foundation, the research arm of the Community Associations Institute (a trade organization representing homeowner and condominium associations around the country), invited agency representatives together to form the working group and offered to furnish technical support and partial staffing for the enterprise.

The group began with the premises mentioned at the start of this report, namely, that:

1) Common property interest regimes should be subject

to certain requirements as a condition to approval by the agencies;
2) Those requirements should be as uniform as possible and
3) As much as possible, the requirements for PUDs and condominiums should match one another.

This report does not purport to present a full analysis of these premises for reconsideration; however, it is important to recognize that an endorsement of many of the working group's recommendations will necessitate an implicit acceptance of the premises.

Since it was assumed that agency standards are necessary for addressing various issues that bear on underwriting risk and consumer protection, and since there was little serious question about the general benefit of minimizing differences and conflicts among the agencies' positions, the first real question for the working group was whether condominium and PUD issues should be dealt with separately or as different facets of a single inquiry. It was decided that treating them individually would not be necessary. The current approach to designing communities and subcommunities with associations lies in integrating different forms of common property interest, not in drawing distinctions that tend to separate and isolate them by configuration and use. Furthermore, many of the most pressing issues pose problems for both condominiums and PUDs: allocating financial resources and apportioning assessments; collecting delinquent assessments; resolving lien priorities; control of project expansion and phasing; guarding against discriminatory rules and practices; establishing and maintaining equitable voting rights; overcoming voter apathy; allocating use of amenities; providing liability insurance for good management and misfeasance protection against bad; and the orderly termination of regimes and disposition of assets.

Once it had been decided to treat condominium and PUDs together, the next steps fell into place. First, analyze existing agency policies as recorded in regulations, directives, memoranda and other agency documents in order to compare corresponding provisions from the different agencies and focus on the policy objective that gave rise to each provision (unearthing the reason for a number of requirements proved remarkably difficult). After that, evaluate the policies. When the working group members agreed on a policy in principle, specific language describing the policy could follow.

The working group met sporadically and the project was not a high-priority or high-visibility effort for any of the agencies, so it took several years to reach maximum feasible accord. By mid-1994, the working group felt that the next step should be pursued, which is to submit their joint conclusions and recommendations to the respective agency policymakers for approval and guidance. This report presents the results of the group's deliberations in a form keyed to FHA policy issues.

THE MORE SIGNIFICANT ISSUES ADDRESSED

Many of the proposed changes of FHA policy reflected in the

full revised "Suggested Guidelines of the working group" are minor and technical; only a small proportion merit the attention of senior policy makers. The common theme of these recommendations is the modification or termination of restrictions that impede flexibility in the design or operation of associations. Based on the working group's consensus of important matters that should be considered for change by decision makers within the respective agencies, there follows a summary of the more significant recommendations and the reasons for them. It should be emphasized that in no way are these recommendations intended as a commitment on the part of any agency. Also, if the change would position FHA differently from one or more of the other agencies, that difference is noted.

The full discussion of each recommendation as contained in the revised "Suggested Guidelines" can also be provided for more detailed review.

1. Maximum assessment.

CURRENT REQUIREMENTS

Condominiums: In practice, Field Offices, with Headquarters acquiescence, have limited annual increases to about 10% of the fee in effect.

PUDs: Annual increases should not exceed 5% according to the Form 1400; however, Field Offices have typically set a limit of 10%, again with Headquarters' consent, probably in response to inflationary periods.

AUTHORITY

Condominiums: Neither the condominium rule or handbook discusses assessment limits.

PUDs: Form 1400, Declaration, Art. IV, ⊥ 3, provides for 5% annual increases without a membership vote. In 1975, a Housing memorandum to Field Offices authorized the approval of association documents linking assessment increases to CPI levels.

ISSUES

The initial assessment charge is sometimes a problem, but probably less so than in the past. It was not uncommon in the early days of condominium and PUD expansion for developers to "low-ball" initial assessments with the intent of attracting naive buyers who would not recognize that the affordable monthly charge contained in the prospectus could not continue to meet increasing expenses or build up adequate reserves. Sometimes, too, developers would defer elements of maintenance and insurance cost or would omit expense items attributable to planned amenities. Later, when the developer was no longer a part of the picture, the assessments mushroomed to a level some homeowners could not afford. Rarely did one encounter excessively high initial charges. However, initial assessments tend today to be fairly realistic. Homebuyers are becoming more sophisticated, as association budgets are scrutinized more thoughtfully in terms of assessment income and return on investment.

In addition, the developers' representatives on the working

group urged more flexibility in setting assessment throughout the period of developer control. FHA, and we believe the other agencies as well, have observed an informal 10% limit, on the premise that controlling increases forces developers to match initial assessments with operating expenses. The 10% standard, however, is rather crude and it, too, can put a considerable burden on the homeowner. A 10% increase each year, together with the effect of compounding, can result in a doubling of the assessment in the 7-8 years that the average FHA homebuyer continues as mortgagor.

RECOMMENDATIONS

Eliminate the requirement for a limit on the assessment amount that an association board may approve without a membership vote, provided that a membership vote is required to approve any capital expenditure (other than as needed for maintenance and repair) exceeding twenty percent of the common expense budget during any twelve month period. Although this recommendation may be viewed as favoring developer interests by permitting larger increases to be imposed by the developer, the working group expects that increased buyer awareness should militate against excessive increases. Developer and CAI representatives argued that the main problem, once control passes to the association, is unwillingness on the part of the membership to approve even those assessment increases reasonably needed to meet rising operating costs. Nevertheless, some control over capital expenditures is necessary.

If, instead, an annual assessment cap is provided, reduce the vote needed for a change from 67% to a simple majority with a quorum procedure as discussed in Recommendation 12 below. During the developer's control period, the class A (developer) vote would not be counted for this purpose.

As an alternative to the somewhat arbitrary figure of 20%, some members of the working group favor tying annual increases to an appropriate cost index, or allowing associations to pass on to the membership any increases in their operating costs that they cannot control, such as taxes, plus a limited additional adjustment for inflation in other budget items, such as salaries and employee benefits.

2. Personal liability for assessments.

CURRENT REQUIREMENTS

Condominiums and PUDs: Liability for unpaid assessments does not pass to a purchaser.

AUTHORITY

Condominiums: Handbook 4265.1, Appendix 24, ¶ 7(d)(1).
PUDs: Form 1400, Declaration, Art. IV, ⊥ 1.

ISSUES

It is often difficult to collect from sellers since they may leave the jurisdiction. The seller who has defaulted should not be relieved of responsibility; however, if the seller is not available there should be recourse against the buyer, provided

the latter bought knowing of the outstanding indebtedness against the property.

RECOMMENDATIONS

Allow the association to hold successors in title personally liable for unpaid assessments, provided that it notifies the successor of the arrearage amount prior to settlement. This liability should not extend to those who take title by reason of foreclosure or an assignment by deed in lieu of foreclosure.

COMMENT OF OGC STAFF

The recommendation may be perceived as unfair to the purchaser who is likely to be unaware of unpaid assessments prior to executing the purchase contract. An alternative approach to alleviate the burden on associations would be a provision in the declaration that authorizes the association to receive payment for unpaid assessments from the seller's funds at closing whether or not a lien has been filed.

3. Developers' assessment obligations.

CURRENT REQUIREMENTS

Condominiums and PUDs: Like any other association member, the developer is responsible for assessments on any units it owns. However, HUD has approved projects where the developer may be exempted from that portion of the assessment attributable to costs that do not apply to unsold or unoccupied properties. For example, if the developer assumes responsibility for exterior maintenance otherwise performed by the association, the assessment might be reduced proportionately. A similar reduction would be appropriate if the association is obligated for a project-wide utility charge, such as water and sewer, and unsold properties have not been connected to the service.

AUTHORITY

Condominiums: Appendix 24, ¶ 8(a) requires each owner, including the developer, to pay. There is no formal statement exempting unsold units although any equitable and reasonable method is permitted for allocating common expenses among the unit owners.

PUDs: Form 1400, Declaration, Art. IV, ⊥ 1 requires each owner, including the developer, to pay. There is no formal statement exempting unsold lots or units. Art, IV, ⊥ 6 requires both annual and special assessments to be fixed at a uniform rate for all lots.

ISSUES

The working group members representing developers' interests urged that developers be relieved from the obligation to pay assessments on units, in particular undeveloped lots, that do not benefit from the common space and facilities, provided that the developer has taken steps to protect the financial integrity of the project.

RECOMMENDATION

The declarant should set forth in a five year budget a reasonable income from the initial assessment schedule. (Since

increases must be voted on and cannot be known at the regime's outset, they may not be taken into account.) Compare the discussion of imposing limits on assessments in item 1 above. Recognizing that there may be instances when the project does not include at first a sufficient number of homeowner occupied units to be financially viable, the developer would obligate itself to fund deficits, including shortfalls to reserve accounts and the association's needs for meeting insurance premiums, that occur within the five year budget term (or until such time as all units have been sold, whichever occurs first).

Apropos the separate but related issue of unimproved lots held by the developer, it is recommended that the developer be responsible in these instances for not less than 25% of the regular assessment. A proviso would be that this reduction not result in a need to compensate by imposing an unduly burdensome assessment on the homeowner occupants and that the assessments collected, giving account to the reduction, be adequate to meet the financial needs of the project and support the common elements.

4. Responsibility for property which neither the association nor its members own.

CURRENT REQUIREMENTS
Condominiums: This problem does not arise in condominium projects.
PUDs: Local governments sometimes require a homeowners association to bear the maintenance burden for streets, water mains and other infrastructure which is not titled in (or leased by) the association. Current policy prohibits the collection of assessments for any purpose -- maintenance, insurance, etc. -- with respect to property which it does not either lease or own, even though the property may benefit the project exclusively.

AUTHORITY
PUDs: Form 1400, Declaration, Art. IV, ⊥ 2.

ISSUE
Feeling pressed financially, local governments are sometimes requiring PUD associations to maintain property which the associations do not own or lease and which is therefore not common area. The property involved usually benefits the unit owners exclusively. Nevertheless, the associations cannot effectively control expenditures related to property in which they have no property interest; such expenditures are simply gratuitous acts.

RECOMMENDATIONS
Allow associations to collect assessments and accept responsibility as needed for property which is not a part of the common area. These recommendations, especially the transfer of responsibility for the property, may require local government approval.

5. Flexibility in plan changes that result from phasing.

CURRENT REQUIREMENTS
Condominiums and PUDs: In a phased or staged project, in order to annex land without the unit owners permission, the developer must submit to HUD or VA a plan that describes the type, size and location of all anticipated changes enlarging the initial development. Modification of a proposed enlargement must also be coordinated and cleared with HUD or VA.

AUTHORITY
PUDs: Form 1400, Instructions, instruction # 7 "Staged Developments".
Condominiums: Appendix 24, ¶¶ 4(b) and 12.

ISSUES
Developers are reluctant to construct a project larger than the anticipated market will bear, yet they may have obtained land on favorable terms which they intend to use for additional phases when the market is available. The resulting uncertainty works to the disadvantage of first-phase owners who are unsure of the final project outcome and whose rights, especially the enjoyment of amenities, may be diluted by the advent of more owners as subsequent phases are built. Phasing always involves a balancing of interests between the developer and existing homeowners. The condominium plan and the PUD general plan are reasonably explicit projections designed to alert buyers to proposed enlargement of a project. The related requirement that HUD/VA approve any modification of a plan militates against developers undermining this consumer protection by revision of what was originally offered.

RECOMMENDATIONS
Allow the developer to modify the location, type (i.e., detached, walk-up, etc.), design and price of improvements from one phase to another. Permit lot sizes to vary as well. The developer should be required, however, to notify each purchaser that the type and value of later-phased properties may be greater or less than what he or she is purchasing. It would also be necessary in the case of condominiums for the developer to specify a limit on expansion of the project so that purchasers can know the potential ultimate dimensions of their jointly-owned common area.

COMMENT OF OGC STAFF
The working group recommendation succeeds in drawing the developer's initial homebuyers into the phasing plan and blunting any objection they may raise about on-going development of the project, assuming the plan is followed. The problem remains, however, that subsequent purchasers from those initial owners will not be aware of the concern that phasing can raise, unless they happen to research the recorded developer plan, a highly unlikely event. The working group did not resolve this aspect of the problem and we frankly do not see a practical solution.

6. Flexibility in enlargement of projects.

CURRENT REQUIREMENTS
Condominiums: Unless described in the condominium plan and

disclosed in timely fashion to prospective unit owners, an annexation of land requires a heavy majority vote (67%) of the unit owners.
PUDs: Approval by 67% of the unit owners entitled to vote is necessary. There is no consistent means of effectively notifying a prospective buyer of anticipated project enlargement.

AUTHORITY
Condominiums: Appendix 24, ⊥⊥ 10(b)(7), 12.
PUDs: Form 1400, Declaration, Art, VI, ⊥ 4 and Articles of Incorporation, Art. IV, ¶ (f).

ISSUES
The problems here are analogous to those identified in topic number 5, just discussed. There we are concerned with the manner in which the developer carries out an announced plan to expand the project by adversely affecting the value of the existing properties. The classic example reflects the case where a developer decides that the market has softened in the price range of existing properties and builds out the next phase with cheaper townhouses. In this topic number 6, we are focusing on a situation where, typically, the developer holds an option on adjoining land which was not described in the project plan or shown on the plat surveys and is subsequently added as the market demand increases. Annexation of this nature burdens the infrastructure (and any amenities) serving the existing properties and clearly dilutes the rights of prior purchasers whose property values may suffer much as they would from phasing-in of the lower-market townhouses. Existing homeowners must be afforded an opportunity to vote on such a change, if they did not know at the time they acquired their properties that expansion was planned. The expansion of projects appears to have become more prevalent as they average more units with developers are more cautious about overbuilding during periods of slow economic growth. The constant concern is to protect the rights of prior owners as the development expands. This was the subject of considerable discussion within the working group.

RECOMMENDATIONS
Requirements for both condominiums and PUDs with respect to enlarging the regime and adding land and improvements should be substantially changed. More guidance is needed so as to provide, in addition to the current requirement for notice to existing condominium members of intended changes and the limitation on time for phasing completion (five to seven years), various other protections for unit owners. There must be specified a minimum and maximum number of units that will inform the individual initial purchaser about the range of his or her ultimate interest in the property. There must be assurance that the project as designed will not be overly burdened by additions, and the declaration must establish the basis for reallocating ownership interests, common expense liabilities and voting rights if the project is expanded in any way. This is particularly important in the case of condominiums, where the common area that will very likely be affected is already a joint part of each unit owner's property and therefore a part of the security for the insured mortgage, as well.

With respect to PUDs, there is a different problem. Although the enlargement of a PUD is governed by the same considerations and need for homebuyer protection, there is no requirement for a plan comparable to that which must be submitted by a condominium developer. PUD developers would have the burden of establishing that they had adequately notified all unit owners in a timely manner.

If adequate protections are in place (including recordation, as needed), it would be appropriate to reduce the necessary vote and otherwise simplify the process for permitting expansion, whether or not it has been detailed in a general plan.

7. Mixed-use communities.

CURRENT REQUIREMENTS

Condominiums and PUDs: There has been a need for clarification of the extent to which commercial and multifamily residential space may be combined with residential condominium and PUD property. HUD's position on this point has varied, although such mixes have usually been accepted by Field Offices if an overall benefit to the residential use can be shown, e.g., convenience food stores, bank branches, laundries. Mixed-use has been disallowed, when the size or value of the commercial property was out of proportion to the residential use, and it could be inferred that the intended market area was not local to the project and its immediate environs.

AUTHORITY

Condominiums and PUDs: There is no written policy, although there have been oral communications by Headquarters Housing and OGC staff with Field Offices and the public which address the matter on an ad hoc basis.

ISSUES

Rigid compartmentalization of the different types of common property interests, together with tight restrictions on commercial space have kept the agencies from fully participating in a trend towards mixed-use projects, with the FHA/VA homebuyer feeling the principal loss. Moreover, mortgage insurance guidelines are not the proper vehicle for promoting or discouraging the development of sizable, complex communities or for resolving land use questions. More flexibility is needed to accommodate modern concepts of community planning, but some adherence to traditional FHA principles is needed as well. Thus, it is essential to maintain proper allocation of costs and voting power among the different classes of persons enjoying the project, and there must be protection from security problems and nuisances caused by traffic congestion and sanitation, especially where food service is involved.

RECOMMENDATIONS

The agencies' current restrictive approach to developments that combine the different uses described should to be relaxed somewhat and there should be guidance on managing the problems introduced by large and complex projects. Mixing different uses

will usually entail a need for different classes of membership. It is essential that the association's (and sub-association's, if present) powers be drawn so as to enable it to address the more varied and complex problems common to mixed-use projects.

8. Member accountability for damage to common property.

CURRENT REQUIREMENTS
Condominiums: No provision.
PUDs: Absolute liability for damage to the common area or lots may not be imposed on the unit members, except as provided by law.

AUTHORITY
PUDs: Form 1400, Declaration, Instructions, Art. IV.

ISSUES
There has been a greater need to protect associations from the expense of repairing damage to common property caused by departing sellers and tenants who escape responsibility for their actions. The unit owner, as landlord or host, is usually in the best position to assure proper care of the premises and secure redress for any loss.

RECOMMENDATIONS
Association members may be held accountable to the association for damage to the common area caused by guests, invitees and others in the household, even when state or local law does not make them liable. This accountability would extend to expense incurred by an association when a member violates its covenants and rules. In order for such responsibility to attach, however, prospective purchasers must be advised of this liability when the disclosure packet is provided. If no disclosure is provided, as is often the case with PUDs, or if the disclosure is not timely (i.e., before the sales contract is executed), then no accountability beyond that prescribed by law can be imposed on unit owners or former unit owners.

9. Flexibility in permitting use of common areas.

CURRENT REQUIREMENT
Condominiums and PUDs: The membership must vote on significant issues, which include most important matters involving common areas (e.g., expanding, liquidating, mortgaging). Matters not reserved to the membership are the responsibility of the board of directors.

AUTHORITY
Condominiums: Handbook 4265.1, Appendix 11; Bylaws, Art. IV, ⊥ 2. See also Appendix 24, ⊥ 7 (b), 10(b)(5) and 10(b)(9); 13
PUDs: Form 1400, Bylaws, Art. VII, ⊥ 1(c).

ISSUES
As some projects become more extensive physically and the regimes more complex in organization, associations are compelled to seek membership votes on more and more matters that cannot be foreseen but are essential to daily operation and management. It

is usually very difficult to assemble a quorum and obtain membership approval for most of these management-type decisions.

RECOMMENDATIONS

The association's board and officers should have greater power in the administration of, and control over, common areas. these powers include extending rights of enjoyment (regarding amenities) to non-members when financially advisable and conveying partial or full property interest in the common areas when necessary, as in the case of boundary-line disputes, condemnation actions, etc.

10. Reducing the scope and detail of the association documents.

CURRENT REQUIREMENTS

Condominiums and PUDs: Significant rights and restrictions of the developer, the association, and the membership are set forth in three documents: the enabling declaration establishing a plan for condominium ownership (for condominiums) or the declaration of covenants, conditions and restrictions (for PUDs); the bylaws; and the articles of incorporation. Material amendment of condominium documents during the period of developer control requires approval by the first lienholders (including HUD) on a majority of units and material amendment of PUD documents requires HUD approval. During the life of the association, amendment also requires support by a substantial majority of the membership.

AUTHORITY

Condominiums: Appendix 24, ⊥ 10(b) governs the unit owners rights to decide on amendment; ⊥ 10(c) governs lienholders' rights.

PUDs: Form 1400, Art, VI, ⊥ 3 governs the voting rights of unit owners and ⊥ 5 provides for HUD/FHA approval; Articles of Incorporation, Art. X governs the voting rights of unit owner approval and Art. XI provides for HUD/FHA approval; Bylaws, Art. VIII, ⊥ 1 governs the rights of both unit owners and HUD/FHA.

ISSUES

Developers and associations find that it is difficult to change provisions of the documents whenever a membership vote is required. On the one hand, efficiency favors a flexible approach to making necessary changes in the associations' rights and restrictions, as long as the membership retains ultimate control through its selection of directors. It is difficult to assemble a quorum and when the turnout is sufficient, it is not easy to get voter agreement on key issues. On the other hand, the right to decide important issues must rest with the unit owners, notwithstanding efficiency problems this may cause management. The challenge is to decide which matters need to be brought before the voters and which can be handled administratively. It is also reasonable to reconsider whether a 75% or 67% majority is needed for all but the most vital decisions, such as termination of the regime.

RECOMMENDATIONS

In instances where a public offering statement or other

disclosure is provided to prospective purchasers, this statement could be used to specify certain powers of the developer and subsequently of the association which do not require consent by a majority of the unit owners. It would similarly be possible for HUD/VA to agree that certain matters now set forth in the documents may be covered less formally and do not require approval by mortgagees and mortgage insurers/guarantors. The working group composed an sample list of such matters (which include some that have been previously discussed): 1) assumption of personal liability for a prior owner's unpaid assessments; 2) member liability for common area damages caused by tenants, guests, etc.; 3) right of the developer to phase or annex land without committing to or describing the nature of future improvements; 4) right to use common area and grant easements across units (including those already sold) for sales purposes, such easements and use to be compensated by the developer as appropriate; 5) right of the developer to unilaterally amend documents or veto association amendments, subject to certain limitations; 6) right of the developer to appoint directors of the association; 7) right of the developer to grant easements to adjoining land owners, subject to expense sharing, and 8) exemption of the developer from architectural review restrictions.

COMMENT OF OGC STAFF
As in the case of phasing changes discussed in topic number 5, the problem arises that only the initial purchaser from the developer will likely receive the prospectus and subsequent owners will not be aware of the developer's or association's scope of authority.

11. Insurance requirements.

CURRENT REQUIREMENTS
Condominiums: The association must obtain a blanket policy that covers the common area, together with any non-common area property securing the insured/guaranteed mortgage, and protects against flood damage and the customary other hazards. Fidelity bonds are required to protect against errors and omissions of the officers, directors and staff. There is no prohibition against an association's obtaining insurance protection from liability for its officers and directors, but none is required.
PUDs: Only flood insurance is required in accordance with that necessary for a 203(b) property. The association may obtain coverage for the common area against the usual perils. The association may also elect to obtain coverage of the units on behalf of the individual owners.

AUTHORITY
Condominiums: 24 CFR 203.16a (flood insurance); Appendix 24, ¶ 14.
PUDs: 24 CFR 203.16a (flood insurance); Form 1400, Instructions, Appendix of Forms, Form #8.

ISSUE
There was no disagreement over the current need for flood insurance covering condominiums and PUDs; Congress has adequately

addressed the matter. Some members of the working group, however, favored mandatory coverage against other hazards for PUDs, and developer representatives urged mandatory liability protection for officers and directors of both condominiums and PUDs. The problem is that additional coverage requirements can be quite expensive, especially for small projects.

In the case of condominiums, an argument can be made for comprehensive hazard coverage of the common areas since they are in effect a part of the security for a mortgage on any unit. With PUDs, this reasoning does not apply; the only supporting argument in the case of a typical PUD is that its association may possibly obtain a beneficial premium rate by including all the units as well as the common areas in a single policy. Of course, whenever a homeowner association owns a significant part of the project's infrastructure as common area, e.g., streets, water systems, etc., the need for insurance against hazards, and probably for liability as well, is clear.

RECOMMENDATIONS

There should be reasonable amounts of insurance to cover repair and restoration of common elements (PUDs included); there should be $1,000,000 protection against liability. Fidelity insurance should equal generally two months' assessments, more if the agency deems appropriate. An association may require unit owners to maintain adequate hazard and/or liability coverage on individual units.

OGC STAFF COMMENT

Current policy on whether or not to require various types of insurance coverage is probably somewhat unrealistic, i.e., the mandatory requirements do not represent adequate coverage. Especially when an association owns infrastructure and provides public services, or when it operates risk-intensive amenities, there is a strong argument to be made for liability coverage. The heavy cost of most insurance, however, cannot be ignored. Perhaps more than in any other matter covered by these recommendations there is a need for flexibility, based on project size and complexity. OGC staff believes that HUD should urge associations to consider the adequacy of their insurance protection and should underscore the considerable risks attendant upon the operation of common property interest regimes. We are not persuaded, however, that HUD should mandate a broad expansion of insurance requirements for homeowner and condominium associations at the present time.

12. Quorums.

CURRENT REQUIREMENTS

Condominiums: A simple majority of 51% of owners present or voting by proxy constitutes a quorum.
PUDs: 10% of those members entitled to vote from each class of voters present or voting by proxy constitutes a quorum, except that for a vote on assessments, 60% of the franchised members present or voting by proxy is needed.

AUTHORITY

Condominiums: Handbook 4265.1, Appendix 11 (Plan of Apartment Ownership), Article II, ⊥ 3.
PUDs: Form 1400, Bylaws, Art. III, ⊥ 4; for assessment votes, Declaration, Art, IV, ⊥ 5.

ISSUES

There was considerable discussion within the working group about the difficulty of realizing quorums, especially in larger associations. Even for critical decisions, it is a major effort to turn out a sufficient number of voters, using absentee ballots, proxies and every manner of device for simplifying the voting process.

RECOMMENDATIONS

Where the members number 250 or less, a quorum should be comprised of at least 20%; over 250 members, 10% should suffice to assure that a small number of members does not gain control of the vote on a given issue. Where there are different voting classes, the quorum requirement ought not extend to each class unless the vote uniquely affects one or more classes.

13. HUD/FHA and VA approval of document changes.

CURRENT REQUIREMENTS
Condominiums: HUD, VA and lienholders are entitled to be advised of any document changes, provided they request the information in writing.
PUDs: HUD and VA have a veto power over changes to documents during the period of developer control.

AUTHORITY
Condominiums: Appendix 24, ¶ 9(a).
PUDs: Form 1400, Declaration, Art. VI, ⊥ 5.

ISSUES
Developer and association representatives urged that there was no longer a need for continued monitoring and regulation by HUD/FHA and VA, especially since neither Department is able to oversee the operations of all regimes within their respective jurisdictions.

RECOMMENDATIONS
The veto power for PUD document changes should be curtailed and the range of subject matter over which the power may be exercised should be reduced. A similar veto should be provided for condominium document changes. A list of those types of changes that would still require HUD and VA involvement is set forth in the working group's draft materials.

Appendix

APPENDIX

What are the differences between condominiums and PUDs of the 1970s compared with those of today and why is it important to reconsider the policies of HUD/FHA and the other agencies? Part of the answer lies in changes in land law, lending practices and residential lifestyles in recent decades, and changes in the

roles that condominiums and PUDs have come to play in meeting community housing needs.

Condominiums. Condominiums have become a popular form of property ownership in many parts of the country and condominium regimes are now regulated by statute in all jurisdictions, although the level and effectiveness of regulation differs widely from state to state. Condominiums also represent a growing part of FHA business that sparked when Congress lifted its original limitation of section 234(c) to units only in projects financed by an FHA-insured blanket mortgage--in 1978 for existing condominiums and in 1983 for new condominiums. The concept that a blanket mortgage with its accompanying requirements for project structure and governance is an assurance of project quality has become outdated. As condominium development has spread outward from more urbanized, higher land cost centers, highrise configurations have become less dominant. More and more, we are seeing condominium projects comprised of townhouse units, detached structures and manufactured housing units. None of these have relevance to multifamily construction standards.

The operation and management of condominium projects also seem to be undergoing a change. Residents are often cavalier about voting on association issues and many times seem indifferent to the operation of their projects. It is quite difficult to assemble quorums for annual meetings, especially in larger condominiums. Yet members seem to be increasingly strident about those few issues which provoke their interest (disputes over some associations' refusal to disclose salaries are a current example). It no longer appears appropriate for HUD to maintain the previous level of protective overview on behalf of residents who choose not to exercise the rights provided them, except to the limited extent necessary for protecting its financial interests. The Department need not abandon completely an oversight role for homeowner concerns--section 234(c) of the NHA provides for it--but as the concept of condominiums has matured, that role has become less important.

This issue over monitoring condominiums where FHA has already insured unit mortgages is related to the question of how much review HUD should undertake for an existing successful project when faced with a first-time application for insurance. There is no party such as the developer who has a financial interest in a large number of units and is therefore motivated to press for membership approval of changes in the event the association documents do not conform to FHA requirements. In this situation, Section 234 insurance is an option only if HUD waives its requirements--a less than ideal solution.

Over time there have been an increasing number of condominium projects that for one reason or another might not have been intended originally for FHA financing but which could now benefit from eligibility for such financing. The working committee considered the matter of applying agency requirements to existing operating projects and decided that the agencies must resolve it individually. For example, FNMA considers that virtually no review is needed for existing projects. HUD, on the

other hand, has not adopted a lesser degree of review, and continues to rely on the project approval process as the means to scrutinize an existing project in certain key respects such as the priority of the purchase money lien over assessment liens and the association's ability to adopt and enforce rules that are potentially discriminatory.

PUDs. Planned unit developments have also evolved and expanded in the past several decades. Typically more up-scale than condominiums, PUDs are less often a means of reducing costs and providing entry level housing than of affording amenities while relieving the homeowner of responsibility for most of the property's maintenance. They tend, also, to "stabilize" a neighborhood by controlling growth and property maintenance, the latter through architectural controls and managed upkeep.

PUDs were not always so up-scale (nor are they in all cases today, of course). Developed in the 1960s, largely under the auspices of FHA and the Urban Land Institute, as an alternative to traditional zoning and land use restrictions, PUDs were designed to reduce building costs by simplifying construction and increasing density (with the consent of local authorities). However, over time, these developments have acquired another attribute taking them in a new direction. Because the common area that often contains the project infrastructure is owned and operated by a homeowners association, these self-administering residential subcommunities have become a popular surrogate for more traditional forms of local government. Some city and county leaders, pressed by fiscal and social problems, willingly abdicate to PUD associations the responsibility for operating and controlling their projects.

A PUD, then, can be either quite minimal or quite complex -- in the latter case resembling towns more than subdivisions. Large regimes may include within their common property roads, water and sewer systems, cable television operations, fire departments, power companies, health care facilities and supplementary private law enforcement installations. Some or all of the responsibility for staffing and operating this diverse property may fall upon the association. When recreational amenities are provided, the tennis courts, swimming pools , golf courses and walking and riding trails cause added problems of liability and maintenance costs for associations. With increasing frequency, we see PUDs combined with other uses -- a single PUD may include a condominium regime, a cooperative association, rental housing and office and retail commercial use. Often there is an umbrella association to administer the various sub-associations, especially if the project is phased. All these considerations raise problems of cost allocation and the equitable distribution of voting power among different classes of owners and tenants -- matters not envisioned when HUD's Form 1400 documents were last revised.