2019 LEGISLATIVE CHANGES – WHAT MARYLAND BUILDERS NEED TO KNOW NOW

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The adage that "change is the only constant in life" is never more on display than when the Maryland General Assembly is in session. All residential developers and builders are familiar with the primary statutory schemes that govern the creation and sale of condominium units and single-family homes in the Maryland (that is the *Maryland Condominium Act and Maryland Homeowners Association Act*), and of the frequency with which these statutes are modified. Putting aside consideration of the underlying motivation for these legislative modifications (which often seem to be inspired by anti-development sentiment), the significance of these enactments to developers and builders is without question, and for residential and mixed-use development projects to be successful, the impact of these enactments must be addressed in the governing documents by which condominium and homeowners association projects are created, and in the disclosure materials by which the resulting dwelling units are sold to consumer purchasers. This article considers two recent examples of legislative changes that all Maryland developers and builders need to know.

SENATE BILL 305 — REAL PROPERTY - HOMEOWNERS ASSOCIATIONS - NUMBER OF DECLARANT VOTES

For decades in Maryland the assignment of Declarant votes in a homeowners association was not the subject of any specific legislative enactment, but rather was driven by the need to comply with the requirements of secondary mortgage market agencies, such as the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA). As a result, it became customary for homeowners association governing documents to assign the Declarant entity three votes for each lot planned to be included in the development, which would then be reduced by three votes for each lot sold by the Declarant (or a builder) to a consumer purchaser. This approach would result in the Declarant losing its ability to cast a majority vote at meetings of the homeowners association after 75% of the lots had been sold to consumer purchasers, with the primary effect being that the Declarant would typically thereafter no longer be able to elect a majority of the board of directors of the homeowners association. This approach was necessary to comply with limits FHA and VA placed on the Declarant's ability to control the board of a homeowners association.

It is important to note that, as with many aspects of the governing documents for both homeowners associations and condominiums, there is no universal "one size fits all" approach that works for important documents provisions, especially the designation of Declarant voting rights. In many instances, the ability of the Declarant to exercise voting control over a homeowners association, particularly in the earlier phases of a project, is vital to the Declarant's ability to successfully market and complete a project. A voting structure that works for a single-phase 30 lot development that consists only of single-family detached dwelling units is likely to be unworkable for a large-scale development (e.g., a 1,000 dwelling unit plus project) with multiple development phases and dwelling unit types, that is intended to be subdivided, built-out and sold over an extended period of time (such projects typically have a 10-year plus projected life-span). Similarly, voting structures that work for smaller projects that are planned to be developed, built and sold by a single Declarant entity, will not work for larger projects that involve multiple developer and/or builder entities.

Section 11B-117.7 of the Maryland Homeowners Association Act, which was first enacted by House Bill 669 effective July 1, 2018, seeks to impose just such an ill-advised "one size fits all" approach to Declarant voting rights by legislating that the Declarant be entitled to only one vote per lot. As originally formulated, Section 11B-117.7 appeared intended to assign the Declarant one vote for each subdivided lot actually owned by the Declarant. As compared to the historical approach outlined above, Section 11B-117.7 substantially reduces the voting power of a Declarant and also operates to deny the Declarant

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the ability to elect a majority of the board of directors after 50% of the lots have been sold to consumer purchasers, which will occur at a substantially earlier date than 75% sales. Illustrating the difficulty of attempts to legislate a "one size fits all" approach regarding Declarant voting rights, House Bill 305 (which will be effective on October 1, 2019) seeks to clarify the original wording of Section 11B-117.7 with regard to developments that are planned to be subdivided in multiple phases over an extended period of time (which is typical for any large-scale development) by providing that, beginning on the date that all lots that "may be" part of a development have been subdivided, the Declarant is entitled to one vote per lot owned by the Declarant. Prior to this date, the Declarant is entitled to exercise the number of votes specified in the governing documents for the homeowners association.

While it is true that, as amended by Senate Bill 305, Section 11B-117.7 will be somewhat easier to apply to large-scale developments, this enactment still operates to severely limit a Declarant's voting rights, particularly in projects in which the Declarant might be expected to reach 50% sales at a time substantially prior to project completion. Further, by tying Declarant voting rights to lots actually owned by the Declarant, Section 11B-117.7 fails to adequately take into account projects in which a separate Declarant entity first sells lots to unaffiliated builders, who then construct dwelling units for later sale to consumer purchasers. Such initial Declarant sales to builders could operate to deny the Declarant voting control of an association well prior to the date that consumer purchasers own 50% of the lots in a development. Similarly, the potentially negative impacts of Section 11B-117.7 will be magnified in developments that include complex "master" and "sub" homeowners association structures, which are typically utilized in large-scale projects with extended build outs.

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Fortunately, the exercise voting control is not the only means by which a Declarant can protect its ability to successfully market and complete a project. It is typical for the governing documents for condominium and homeowners association projects to directly reserve rights for the benefit of the Declarant entity that are not dependent upon the existence of Declarant voting rights. For example, construction easements are typically directly reserved in the governing documents for the benefit of the Declarant entity, and these reservations are usually perpetual in nature or at least run until project completion. Thus, in response to enactments such as Section 11B-117.7, it is necessary not only for Declarants to carefully structure and enhance their voting rights, but to also ensure that their governing documents include direct reservations of all rights needed to ensure successful project completion.

HB 789 & HB 207 — CONDOMINIUMS AND HOMEOWNERS ASSOCIATIONS - AMENDMENT OF GOVERNING DOCUMENTS

Prior to enactment of House Bill 789, which became effective October 1, 2017, there was no statutory ceiling on the vote required to amend the governing documents of a Maryland condominium or homeowners association, and many such governing documents generally required a 90% or greater vote to amend (at least during a stated initial time-frame). As a practical matter, such high approval thresholds meant that the governing documents for a Maryland condominium or homeowners association could never be amended, with the result that it was frequently impractical to amend such governing documents to make beneficial changes, such as updates needed to comply with changes in law. To address this situation, House Bill 207 repealed and reenacted, with amendments, Section 11–104(e) of

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the Maryland Condominium Act and 11B–116 of the Maryland Homeowners Association Act to allow the Bylaws of a condominium and the governing documents of a homeowners association to be amended by the affirmative vote of owners in "good standing" (generally defined to mean owners not more than 90 days delinquent in the payment of assessments) having at least 60% of the votes in the condominium or homeowners association, or by a lower percentage if required in the applicable document. House Bill 207 (which was introduced in the 2019 session but ultimately referred to Senate Judicial Proceedings Committee) would, if ultimately adopted, make a further refinement on the required vote by allowing such document amendments to be made with the approval by 60% of the owners (rather than by owners entitled to cast 60% of the votes).

Although the foregoing enactments may have a beneficial impact to the extent that it is now easier for a condominium or homeowners association to amend to their governing documents, by establishing a statutory ceiling on the vote required for document amendments, without any limitation as to the type of amendments that may be so approved, the General Assembly has also potentially undermined document provisions intended to protect classes of owners with a minority of voting rights from detrimental (from the minority's perspective) document amendments enacted by a majority of owners. Developments that contain multiple different unit types, such as residential projects that contain a mix of single family detached, townhouse and condominium units, or mixed-use projects that contain both commercial and residential unit types, often contain voting provisions designed to protect owners with a minority of voting rights from the "tyranny of the majority", that is actions approved by a voting majority that have a detrimental impact on the owners with minority voting rights. For example, in a mixed-use high rise structure that includes ground level retail units with multiple stories of residential units above, it is typical to include provisions that require the retail owners to approve actions by the residential majority that would have a material adverse impact on the operations of the retail units. Without such protections, the residential owners in such a mixed-use structure could, in reliance on the changes made by House Bill 789, unilaterally adopt document amendments with a material adverse impact on the retail owners, such as limitations on the operating hours of the retail units or budgetary provisions making inequitable allocations of costs to the retail owners. Of course, such amendments would have a negative effect on the ability to lease retail units and their market value.

Given the potential for adverse documents amendments created by House Bill 789, the developers and builders of mixed-use structures and other similar developments that contain multiple different unit types need to pay particular attention to provisions regarding voting rights and the protection of minority voting interests. Although as practical matter it may prove difficult to draft around the provisions of House Bill 789, the need to protect owners with minority voting interests from the "tyranny of the majority" may warrant taking a more innovative approach with respect to structuring the legal documents for such mixed-use structures and developments, such as establishing separate condominiums and/or homeowners associations for each different unit type and the increased use of reciprocal easement agreements. As always, it will be important for Maryland developers and builders to keep informed of all legislation affecting the Maryland Condominium Act and the Maryland Homeowner Association Act.

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