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## The Impact of Private Covenants and Equitable Servitudes on Commercial Development and Redevelopment, 52 UIC J. MARSHALL L. REV 783 (2019)

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# THE IMPACT OF PRIVATE COVENANTS AND EQUITABLE SERVITUDES ON COMMERCIAL DEVELOPMENT AND REDEVELOPMENT

JO ANNE P. STUBBLEFIELD\*

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A number of factors are driving innovation and reinvention of commercial development and redevelopment today in ways that will impact land use and property values for many years to come. Mixed-use developments and planned communities with town centers or other significant commercial components are becoming the norm in many urban and suburban areas as thought leaders and city planners promote – and the public increasingly demands – smart-growth solutions to the challenges of traffic congestion, infrastructure needs and environmental concerns.

Historic development patterns, absence of design control and lax code enforcement, particularly in unincorporated areas, have resulted in a prevalence of unattractive, cluttered commercial corridors and traffic congestion. The popularity of internet shopping and resulting closures of "brick and mortar" stores have led to a decline of suburban shopping malls and a plethora of strip shopping centers with vacant store fronts, often accompanied by an increase in crime and a decline in surrounding property values. These conditions are driving some people to move further from the urban core in search of nice neighborhoods with good schools and more affordable housing in close proximity to employment, shopping, entertainment, parks and civic facilities.<sup>1</sup> Others are moving "in town" and "downtown," seeking to improve their quality of life and reduce their carbon footprint with shorter commutes and an easy

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1. See generally WILLIAM H. HUDNUT III, *HALFWAY TO EVERYWHERE - A PORTRAIT OF AMERICA'S FIRST-TIER SUBURBS* (2003) (discussing the plight of some inner ring suburbs).

walk to shopping, dining and entertainment.<sup>2</sup>

Developers are responding to these public demands and personal preferences in a variety of ways. Some are creating new planned communities with town centers and other significant commercial components. Others are repurposing old shopping centers, dilapidated commercial properties and abandoned warehouses into new, mixed-use developments with components such as rental apartments, retail and office space, food halls with chef-driven restaurants, and craft breweries.<sup>3</sup> Often close to public transportation and an easy walk from residential neighborhoods, these underutilized properties are being transformed into dining and entertainment destinations.

There is also a strong effort underway to revitalize small town "downtowns" and main streets with new civic spaces, streetscapes, public art, and social programming such as farmers' markets, arts and music festivals, outdoor movies and similar activities that promote interaction and build a sense of community.<sup>4</sup> In many cases, new amenities, such as parks, trails, amphitheaters and other outdoor gathering places, serve as a catalyst for new commercial and residential development.<sup>5</sup>

While the current economy has driven significant new development and redevelopment, many investors, lenders, and developers who got burned in the financial crisis of the late 2000s have a lower risk tolerance than they may have had prior to the

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2. See Lena Edlund et al., *Gentrification and the Rising Returns to Skill* (Nat'l Bureau of Econ. Research, Working Paper No. 21729, 2019), [www.nber.org/papers/w21729](http://www.nber.org/papers/w21729) (discussing the factors driving gentrification and housing prices in city center areas).

3. See e.g., *Our Story*, PONCE CITY MKT., [poncecitymarket.com/our-story/](http://poncecitymarket.com/our-story/) (last visited Aug. 5, 2019) (describing Ponce City Market, an adaptive reuse of a former Sears, Roebuck & Co. building in Atlanta, Georgia that includes bars and chef-driven restaurants in a food hall atmosphere as well as retail space and rental apartments); see also COMMON GROUND, [commongroundatl.com/](http://commongroundatl.com/) (last visited Aug. 5, 2019) (describing Common Ground, an adaptive reuse of a former Western Electric Company warehouse facility, featuring shops, restaurants, a brewery with a beer garden, and office suites surrounded by new multi-family apartments); see also FORD FACTORY LOFTS, [www.fordfactorylofts.com/](http://www.fordfactorylofts.com/) (last visited Aug. 5, 2019) (presenting Ford Factory Lofts, a former automobile assembly plant converted to loft-style rental apartments).

4. See NAT'L MAIN ST. CTR., REVITALIZING MAIN STREET: A PRACTITIONER'S GUIDE TO COMPREHENSIVE COMMERCIAL DISTRICT REVITALIZATION 9 (Andrea L. Dono and Linda S. Glisson, eds., 2009) (discussing the Main Street Project launched by the National Trust for Historic Preservation to provide technical support and guidance to local communities seeking to revitalize their neighborhood commercial corridors).

5. See Tom Oder, *Gwinnett County: Gearing Up for Growth*, GEORGIA TREND (Sept. 1, 2017), [www.georgiatrend.com/2017/09/01/gwinnett-county-gearing-up-for-growth/](http://www.georgiatrend.com/2017/09/01/gwinnett-county-gearing-up-for-growth/) (discussing the impact of public investment in developing and enhancing town centers on economic development and growth in several cities in Gwinnett County, Georgia, including Duluth, Peachtree Corners, and Lawrenceville).

Great Recession. This has contributed to specialization in commercial development and lending, often resulting in different ownership entities, lenders, and developers for different components and phases of a mixed-use development.<sup>6</sup>

A "behind-the-scenes" look at these multi-owner commercial and mixed-use developments reveals a complex array of private covenants, restrictions and easements that encumber the commercial properties and sometimes adjacent properties. Unlike a conventional shopping center or office lease, which is a bilateral agreement with a fixed term that can be modified by agreement of just two parties, these covenants, restrictions, and easements are recorded in the public records and run with the title to the land, binding and benefiting the developer, the initial owners, and their successors-in-title.<sup>7</sup> They establish the rights and obligations of the developer, lenders, property owners, and one or more owners associations, to and among each other, not just for the term of a typical lease, but often in perpetuity.<sup>8</sup> How important are they to commercial and mixed-use development today and how will they impact redevelopment as the property owners seek to adapt to changing conditions and market demands over time?

This article explores various issues presented in multi-owner commercial and mixed-use developments and "town centers" within planned communities and the role of private covenants, restrictions and easements in their development, operations, and redevelopment. It discusses the challenges such servitudes pose for the developer and its counsel, prospective buyers and tenants, and the property owners associations and property managers that administer them, highlighting the importance of anticipating and addressing such challenges in the drafting process.

## I. ROLE OF PRIVATE COVENANTS AND EQUITABLE SERVITUDES

Commercial and mixed-use developments today often include multiple parcels of real estate with separate owners and shared infrastructure, amenities, or services that are owned, maintained, operated, or provided by one or more entities for the common benefit or use of those owners.<sup>9</sup> Some are vertical developments, such as a mixed-use building or a group of connected buildings with lobbies,

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6. See Philip Langdon, *Yes, You Can Finance Mixed-Use Development*, CNU PUBLIC SQUARE (July 31, 2017), [www.cnu.org/publicsquare/2017/07/31/yes-you-can-finance-mixed-use-development](http://www.cnu.org/publicsquare/2017/07/31/yes-you-can-finance-mixed-use-development) (discussing challenges and sources for financing mixed use development).

7. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.1 (AM. LAW INST. 2000) [hereinafter RESTATEMENT (THIRD) OF PROP.].

8. *Id.* at § 4.4.

9. See DEAN SCHWANKE, *MIXED-USE DEVELOPMENT HANDBOOK* (1st ed. 1987) (providing examples of various types of mixed-use developments).

elevators, and systems shared among different uses.<sup>10</sup> Others are horizontal developments, with common roads, parking, stormwater facilities, and amenities shared among different parcels.<sup>11</sup>

Some developments have relatively simple easements and covenants, such as a retail development in which separately-owned parcels share a parking lot, signage, and stormwater pond, all of which are maintained by one owner who assesses each of the other owners for their proportionate share of the costs.<sup>12</sup> More complex developments may involve one or more condominium or other mandatory membership property owners associations with jurisdiction over different components of the development, each of which administers a separate set of servitudes applicable to the properties within its jurisdiction.<sup>13</sup> For example, a mixed-use planned community might have:

- a "master" association which owns and maintains infrastructure and amenities such as community signage, parks, trails, and open space that benefits all land uses;
- a residential owners association with jurisdiction over "for sale" residential properties;
- a commercial owners association with jurisdiction over various nonresidential properties; and
- multiple "subassociations" with jurisdiction over specific parcels within the residential and commercial components.

Likewise, an urban mixed-use development comprised of hotel, office, residential and retail components might have several condominium associations, as well as other property owners associations, interrelated by an array of reciprocal and other easements.

Whether simple or complex, the governance structure for a common interest development with commercial components will generally be established by an array of servitudes executed by the developer and recorded in the land records prior to the sale of any lot or unit within the development.<sup>14</sup> These servitudes run with the land and benefit and burden the developer, its successors-in-title, and sometimes adjacent properties.<sup>15</sup> They may include one or more instruments establishing affirmative and negative covenants and easements appurtenant to the land, as well easements in gross which benefit the developer and the property owners associations without regard to their ownership of any land.<sup>16</sup>

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10. *Id.* at 146.

11. *Id.*

12. *Id.* at 210.

13. RESTATEMENT (THIRD) OF PROP., *supra* note 7 at § 6.2.

14. *Id.* at § 6.2 cmt. e.

15. *Id.*

16. *Id.* at § 2.6; *see* Streams Sports Club, Ltd. v. Richmond, 440 N.E.2d 1264 (Ill. App. Ct. 1982), *aff'd*, 457 N.E.2d 1226 (Ill. 1983); *see also* Christiansen v.

For example, the recorded covenants will often include affirmative covenants obligating the property owners to maintain their respective parcels,<sup>17</sup> as well as negative covenants restricting the owners from making improvements or modifications to their parcels without prior approval of the developer, or a property owners association or committee thereof.<sup>18</sup> They may set forth covenants restricting certain undesirable uses, as well as covenants requiring prior approval to engage in other uses.<sup>19</sup> They may also contain affirmative covenants obligating a property owner or property owners association to operate, insure, maintain, repair and replace certain shared properties for the benefit of all or a subset of all owners.<sup>20</sup>

The servitude arrangements for commercial and mixed-use developments will often include a variety of easements appurtenant to the property within the development. Common examples include easements for ingress and egress, temporary construction, support and encroachment, utilities, reciprocal parking, signage, stormwater drainage and retention, maintenance and inspection.<sup>21</sup> They may also include easements establishing the rights of owners, their tenants, employees, customers, and other invitees, to use and enjoy shared components such as plazas, sidewalks, and parks.<sup>22</sup> The developer may also reserve various rights and easements in gross for itself and its successors, assigns, and designees to facilitate the project's expansion, development, marketing and sale, as well as the development and sale of adjacent properties.<sup>23</sup>

Some or all of these covenants and easements may be set forth in a document commonly referred to as a "declaration," which is executed by the developer and recorded in the land records.<sup>24</sup> The declaration, particularly in a phased development, may be supplemented by one or more "supplemental declarations" that are used to submit additional parcels to the original declaration and sometimes impose additional servitudes on the parcels being

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Casey, 613 S.W.2d 906 (Mo. Ct. App. 1981) (upholding the right of a property owners association and a developer, respectively, to enforce covenants even though they own no land).

17. See NAT'L ASS'N OF INDUS. & OFF. PARKS/EDUC. FOUND., PROTECTIVE COVENANTS: CREATING, UNDERSTANDING AND ENFORCING INDUSTRIAL AND OFFICE PARK PROTECTIVE COVENANTS 19, 135 (1985) [hereinafter NAT'L ASS'N OF INDUS. & OFF. PARKS/EDUC. FOUND.] (providing examples of maintenance provisions that are used in recorded covenants).

18. *Id.* at 22.

19. *Id.* at 36, 132.

20. *Id.* at 72, 259.

21. Jo Anne P. Stubblefield, *Determining the Governance Structure for a Mixed-Use Development*, 13 PRAC. REAL EST. L. 49, 54-55 (1997).

22. *Id.* at 51-52.

23. See e.g., WAYNE S. HYATT, CONDOMINIUMS AND HOME OWNER ASSOCIATIONS: A GUIDE TO THE DEVELOPMENT PROCESS 238-241 (1985) (explaining options that can be reserved during the development process).

24. RESTATEMENT (THIRD) OF PROP., *supra* note 7, at § 6.1.

added.<sup>25</sup>

If the development or a component thereof is to be administered by a property owners association, then in addition to the matters described above, the declaration administered by that property owners association will typically establish the obligation of each owner to be a member of the association.<sup>26</sup> It will set forth responsibilities of the owners association with respect to maintenance of property within the development, administering architectural controls, and providing services such as security, janitorial services, and trash collection.<sup>27</sup> The declaration will authorize the association to levy assessments against the individually-owned parcels in the development to fund costs it incurs in carrying out its responsibilities and exercising its authority.<sup>28</sup> It will establish a method or formula for allocating a share of the association's costs to each parcel and will obligate the parcel owners to pay assessments to the association, with those assessments to be secured by lien rights against the owners' parcels in favor of the association.<sup>29</sup> Additionally, it will set forth each owner's voting rights in matters requiring a vote of the association's membership, such as election of the association's governing board and amendment of the declaration and other governing documents.<sup>30</sup> In most cases, it will include use restrictions and authorize the association to adopt rules further regulating conduct and activities within the development.<sup>31</sup> It will also establish the association's duty and authority to enforce the governing documents and impose sanctions for violations.<sup>32</sup>

In addition to the declaration and any such supplemental declarations, the documents governing a common interest development with a commercial component may include rules adopted by the association that regulate activities and conduct within the development, as well as architectural and aesthetic standards relating to the design and construction of, and modifications to, structures and other improvements such as landscaping, signage, and lighting.<sup>33</sup> These standards may also address other aesthetic issues, such as outdoor storage of inventory, type and placement of trash receptacles, parking and deliveries, and similar matters.<sup>34</sup>

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25. HYATT, *supra* note 23, at 153-54.

26. RESTATEMENT (THIRD) OF PROP., *supra* note 7, at § 6.2.

27. *Id.* at § 6.4.

28. *Id.* at § 6.5.

29. *Id.*

30. *Id.* at § 6.17.

31. *Id.* at § 6.7.

32. *Id.* at § 6.8.

33. See NAT'L ASS'N OF INDUS. & OFF. PARKS/EDUC. FOUND., *supra* note 17, at 10-11 (providing examples of protective covenants for a number of different commercial and industrial projects).

34. *Id.*

These private covenants and easements are a necessary part of, and can add value to, today's commercial and mixed-use developments and surrounding properties in a number of ways. They enable separate ownership, financing, development, and management of different land use components and phasing of larger developments while implementing a cohesive plan for development and operation of the project as if it were a single-owner development. They provide for ongoing maintenance and operation of shared infrastructure such as parking, stormwater facilities, enhanced streetscapes, shared amenities and other components. They help facilitate a compatible mix of uses and synergy among uses within the development. They establish and provide a mechanism for enforcement of high standards of design, maintenance, and conduct to make the developments attractive to purchasers, their tenants, employees, and customers. Additionally, they can provide a mechanism for delivery and funding of shared services and programming that help draw customers and employees and make the development a place that businesses want to locate.

A thoughtful and well-drafted system of private covenants and easements can benefit the developers, the parcel owners, and the community at large by enabling the development of higher density commercial and mixed-use projects that rely upon shared facilities to reduce development and maintenance costs, provide a more efficient use of resources, and create more attractive and user-friendly commercial development. For example, parking facilities used by office workers during the day can provide parking for restaurant customers at night after office workers have left. A single shared stormwater pond can meet the needs of multiple commercial parcel owners and provide an attractive amenity for the community, rather than each commercial parcel having to construct and maintain its own stormwater facilities onsite. Shared signage can eliminate the plethora of individual signs that create a cluttered, unattractive streetscape as individual businesses compete for attention of passersby. Shared entrances can eliminate multiple curb cuts that contribute to traffic congestion and increase risks of vehicular accidents.

The end result can be a commercial or mixed-use development that is an attractive and desirable place to conduct a business and an asset to the surrounding community— not just while it is fresh and new, but for the long term.

## II. CHALLENGES FOR COMMERCIAL AND MIXED-USE DEVELOPMENT

Despite the benefits that thoughtfully drafted and implemented servitude arrangements can provide, the regulatory climate, marketing considerations, and other factors pose a number of challenges in creating the governance structure for commercial

and mixed-use developments.

### A. Existing Regulation

In addition to traditional zoning and subdivision ordinances that regulate what may be developed and how it may be developed, common interest commercial and mixed-use developments may be subject to a variety of laws that dictate, limit and define the scope of the private covenants that govern them and how those covenants are disclosed, administered and enforced. All fifty states have statutes regulating the creation of condominiums and many states have adopted mandatory statutes governing the creation, operation, and management of other forms of common interest communities.<sup>35</sup> Some local jurisdictions also have ordinances that impose requirements on developments with common properties administered by property owners associations.<sup>36</sup>

Although many statutes governing common interest communities tend to be concerned primarily with residential development and often contain exemptions for developments consisting solely of commercial or nonresidential properties, one cannot assume that they are wholly inapplicable to commercial development, even if they include the word "homeowners" in their title.<sup>37</sup> Such statutes often do not define "commercial" or "nonresidential" and it is often unclear whether a multi-family rental apartment complex, an assisted living facility, or even an extended stay hotel, would be considered a "residential" use or a "commercial" use under the statute, in light of the fact that each is operated on a commercial basis but involves the provision of some

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35. The Uniform Common Interest Ownership Act has been adopted in Connecticut, CONN. GEN. STAT. ANN. § 47-200 (West 1984), Delaware, DEL. CODE ANN. tit. 25 § 81-101 (West 2009), Vermont, VT. STAT. ANN. tit. 27A § 1-101 (West 1994), and Washington, WASH. REV. CODE ANN. § 64.90 (West 2019). Variations have been adopted in Alaska, Colorado, Minnesota, Nevada, and West Virginia. Arizona, California, Florida, Hawaii, Illinois, Louisiana, Maryland, North Carolina, Oregon, Pennsylvania, Utah, South Carolina, Texas and Virginia are among other states with statutes regulating the creation and operation of common interest communities. *HOA or Condominium Uniform Acts by State*, CMTY. ASS'NS INST., [www.caionline.org/Advocacy/StateAdvocacy/PriorityIssues/UniformActs/Pages/default.aspx](http://www.caionline.org/Advocacy/StateAdvocacy/PriorityIssues/UniformActs/Pages/default.aspx) (last visited Aug. 5, 2019).

36. See e.g., OCONEE CTY., GA UNIFIED DEV. CODE art. 5 §§ 506-508 (requiring the formation of an owners association and imposing minimum requirements for governing documents for developments that include common areas).

37. See FLA. STAT. § 720.302(3) (West 2014) (stating that "[t]his chapter [of the Florida Homeowners Association Act] does not apply to (a) A community that is composed of property primarily intended for commercial, industrial, or other nonresidential use; or (b) The commercial or industrial parcels in a community that contains both residential parcels and parcels intended for commercial or industrial use." This creates substantial ambiguity as to applicability to a mixed-use development).

form of housing.<sup>38</sup> In order to avoid the consequences of noncompliance if the project were ultimately determined to be subject to the statute, a developer may be forced to comply with the statute in preparing its governing documents.

Even if all of the initial planned uses are clearly commercial and would be exempt, the developer may be unwilling to restrict residential uses as may be necessary to avoid triggering applicability of the statute in the future. Restricting residential uses would limit the developer's flexibility to make changes in the development plan to accommodate changing market demands and would restrict development of buildings containing residential units over street-level retail spaces, as well as conversion of rental apartments to a condominium form of ownership.

If one assumes that the statute applies or could apply, that assumption leads to another set of challenges. Statutes governing common interest communities are typically focused on and driven by concerns that affect homeowners and homeowners associations.<sup>39</sup> These statutory requirements are often unnecessarily burdensome, if not entirely unworkable, when applied in the context of a commercial or mixed-use development. For example, they frequently require a property owners association to be created whenever owners are subject to assessment for expenses associated with property they do not own, such as maintenance of shared infrastructure, and require that the membership of the association be comprised of all parcel owners within the development.<sup>40</sup> This is

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38. *See e.g.*, OR. REV. STAT. ANN. §§ 94.550-94.783 (West 2018) (excluding from the definition of a planned community thereunder one that is "exclusively commercial or industrial" but not defining "commercial" or "industrial"). *See also* WASH. REV. CODE ANN. § 64.90.100(1) (West 2018) (showing that the Washington law excludes communities in which "all the units are restricted exclusively to nonresidential use" from applicability but does not define "nonresidential" use. § 64.90.100(4) states, "A common interest community that contains both units restricted to nonresidential purposes and units that may be used for residential purposes is not subject to this chapter unless the units that may be used for residential purposes would comprise a common interest community subject to this chapter in the absence of such nonresidential units or the declaration provides that this chapter applies as provided in subsection (2) or (3) of this section." "Residential purposes" is defined in § 64.90.010(48) as "use for dwelling or recreational purposes, or both.").

39. *See* OR. REV. STAT. ANN. § 94.560(7) (West 2018) (stating that the statute is "intended to make developers, their legal counsel and homeowners in Oregon homeowners associations the beneficiaries of experience accumulated under Oregon's condominium law and gathered from members of existing Oregon homeowners associations and associations in parts of the country where the record of experience is longer than that in Oregon.").

40. *See* NEV. REV. STAT. ANN. § 116.021 (West 2009) (defining common-interest community as "real estate described in a declaration with respect to which a person, by virtue of the person's ownership of a unit, is obligated to pay for a share of real estate taxes, insurance premiums, maintenance or improvement of, or services or other expenses related to, common elements, other units or other real estate described in that declaration."); *See also* NEV.

particularly problematic when different costs are shared among different parcels, as it may require creation of multiple levels of associations when a much simpler governance structure would otherwise suffice. It is also problematic when the costs are shared among residential and nonresidential parcels, forcing the creation of an association comprised of both, as commercial owners are often in the minority and have no interest in buying property if they will be subject to the whims of an association controlled by homeowners.<sup>41</sup>

Applicable statutes frequently do not allow the flexibility needed to adapt to the widely differing needs and concerns of commercial uses such as hotels, retail businesses, and multi-family apartment operators. In contrast to a residential development where a developer may subdivide a parcel of land into hundreds of residential lots by a single plat, the particular use of every parcel in a commercial development is rarely known at the outset and, even if the initial use is known, it could very well change over time. In horizontal developments, each commercial parcel may be separately platted and the plat may not be recorded until immediately prior to conveyance, when the buyer and use have been determined. Virtually every commercial buyer will be represented by counsel who wants to negotiate the terms of the declaration just as they do their purchase agreement. Statutory requirements for membership approval of amendments to the declaration and other governing documents pose a significant challenge in the marketing and sale of commercial parcels, making it increasingly difficult to accommodate buyers' requests as each new parcel is sold and the number of votes required to amend increases.<sup>42</sup>

Statutes imposing quorum requirements for meetings and membership approval requirements for various other actions can also be troublesome, particularly in developments where many, if not most, of the commercial units may be occupied by tenants. It is not uncommon for the owners to be located in other states with no local representative to serve on the board or committees, attend meetings, or otherwise participate in a property owners association. Although sometimes action may be taken by ballot or written consent without a meeting, it can be very difficult for an association to obtain the requisite membership approval for action if it must

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REV. STAT. ANN. § 116.3101 (requiring an association to be created for a common interest community before the first unit is conveyed).

41. RESTATEMENT (THIRD) OF PROP., *supra* note 7, at § 6.1 cmt. b.

42. *See e.g.*, OR. REV. STAT. ANN. § 94.590(1)(a), (5) (West 2018) (providing, under the Oregon Planned Community Act, that “[t]he declaration may be amended only with the approval of owners representing at least 75 percent of the total votes in the planned community or any larger percentage specified in the declaration.” It goes on to say that “[d]uring any period of declarant control, voting on an amendment . . . shall be without regard to any weighted vote or special voting right reserved by the declarant, except as otherwise [specifically authorized in the statute].”).

identify a person within a large commercial organization in another state who is authorized to approve the action and then educate them on the issue and get them to execute and return a ballot or written consent in a timely manner. Statutory approval requirements for use of written consents may be even higher than would be required for approval at a meeting, and often limit the window within which the ballots or consents must be received to be counted.<sup>43</sup>

Even in states that do not have mandatory statutes governing common interest communities, the developer may have to contend with random statutes passed by the state legislature to address perceived ills arising in the context of homeowners associations or residential developments, but which were drafted so broadly that they inadvertently apply to commercial or mixed-use developments. Likewise, commercial and mixed-use developments are subject to a growing body of caselaw interpreting and applying private covenants and restrictions in the context of homeowners associations and residential developments. Those decisions may have unintended consequences when applied to commercial developments.

### *B. Affirmative Covenants Imposing Uncertain Financial Obligations*

Another challenge in establishing the governance documents for commercial and mixed-use communities lies in the fact that the commercial parcels are often marketed to buyers who are unaccustomed to the financial uncertainty imposed by the servitudes. Buyers in commercial and mixed-use developments may previously have been tenants in office buildings or shopping centers owned by others, or they may have owned standalone parcels with no property or other interests in common with owners of surrounding parcels. These buyers may be considering purchasing in a planned community or other mixed-use development because of a desire to own and control their property, the synergy created by a mix of compatible uses, the protections provided through private covenants that impose architectural controls and a high standard of maintenance, and the restrictions on undesirable uses. However, unlike a lease in which their rent is fixed or determinable for the term of the lease, or a standalone parcel over which they have total control, initial commercial buyers in a new common interest

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43. See e.g., FLA. STAT. ANN. § 617.0701(4) (West 2009) (allowing, under the Florida Not For Profit Corporation Act, actions to be taken without a meeting if the action is approved by at least the number of votes that would be necessary to authorize such action at a meeting if all members entitled to vote on such action were present and voted. Written consent to take the action is “not effective unless the consent is signed by members having the requisite number of votes necessary to authorize the action within 90 days after the date of the earliest dated consent.”).

community may find that their financial obligations are somewhat less predictable.

New commercial and mixed-use developments are often developed incrementally over a period of years, with timing dependent on obtaining governmental approvals, satisfying governmental conditions and requirements, availability of financing, and market demand. A parcel may not be platted and made subject to the declaration until the specific buyer and use is known and the parcel is ready to be conveyed. The full extent of the shared properties and the association's responsibilities and associated costs may not be known until those uses are determined.

As a result, initial buyers have no assurances as to when other parcels will be sold and begin sharing in the common expenses. They are also not likely to know the ultimate share of costs they will be responsible for, or the magnitude of those costs, until the development is completely built out. The initial buyers must have confidence in the development and marketing team, the location, and in the general real estate market, and they must be willing to assume the risk that there could be a limited number of parcels obligated under the covenants to share the common expenses for some period of time. They must also get comfortable with the potential scope and magnitude of common expenses for which they could be responsible. Unlike a lease that can be renegotiated or breached, the covenants will obligate them to pay their share of those costs, whatever they may be, as long as they own the property, and that obligation is secured by lien rights in favor of the association.

Additional financial uncertainty arises from the fact that the covenants obligate commercial owners to maintain their property to a high standard, require approval of the developer or association to make exterior changes, and may limit future use of the property. These obligations and restrictions are important to creating and maintaining the synergy that helps protect and enhance property values, draw business, and make the development appealing to consumers. As a result, owners may not be able to defer maintenance and repairs to meet financial projections. They may also be unable to make exterior changes or changes in use to enhance their property or expand their business, as they might be able to do if they owned a standalone property outside of a common interest development.

Recognizing this, commercial buyers often expect certainty and protection from future changes to the covenants that could affect their profitability. However, they must realize that those protections, whether in the covenants themselves or imposed by statute, impair the developer's ability to make adjustments to the covenants that may be necessary to attract desirable purchasers, create synergy, and help ensure the economic viability of the development – all of which are equally important to the commercial

owners. Thus, selling commercial property in a common interest development may require educating the buyers and their counsel on the balance that must be struck between these competing interests.

### *C. Allocation of Control and Costs Among Land Uses*

Urban and suburban mixed-use developments often involve not only a mix of commercial uses, but also residential uses, requiring creative approaches to allocating responsibilities and minimizing conflicts among such land uses.<sup>44</sup> However, once the developer is gone, the property owners associations that are empowered to manage such conflicts are typically administered by volunteer boards of directors elected by their respective members, each with their own interests and perspectives.

For this reason, commercial buyers are often unwilling to purchase property subject to the jurisdiction of an association controlled by residential owners. Likewise, secondary mortgage market guidelines disfavor projects with a significant commercial component under the same association as residential uses.<sup>45</sup> These factors often lead to the creation of separate associations for residential and commercial components of the development, with careful thought as to the nature and extent of the relationship between them and the servitudes needed for the efficient operation of the development, the protection of each land use, and the allocation of costs for shared components and services between them.

Fairly allocating shared costs among differing land uses is a significant issue in creating the legal structure for mixed-use developments. The nature of the shared expenses and the extent to which each land use benefits from the property or service to which that expense relates are factors that influence the fairness of a particular formula. A perceived lack of fairness may impact marketability of property in the development. However, the formula that might be perceived as most fair may not be practical from a

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44. Consider the impact on residential uses of early morning truck deliveries to a commercial establishment, late night activities at bars and restaurants with lights, music, and noise that spill out into public spaces, and odors from dumpsters behind grocery stores and restaurants. Parking may also be an issue, with conflicts over unauthorized use of resident parking spaces by retail customers and employees of office buildings usurping retail parking.

45. See *Condominium Project Approval and Processing Guide*, Fed. Hous. Auth. 1.4 (June 30, 2011), [www.hud.gov/sites/documents/11-22MLGUIDE.PDF](http://www.hud.gov/sites/documents/11-22MLGUIDE.PDF) (indicating that a condominium project is generally ineligible for FHA-insurance on residential mortgages if more than 25 percent of the total floor area within the condominium can be used for nonresidential purposes); see also *Single Family Seller/Service's Guide*, FREDDIE MAC §§ 5701.3(d), 5701.11 (Sept. 18, 2019), [sf.freddiemac.com/content/\\_assets/resources/pdf/fact-sheet/guide.pdf](http://sf.freddiemac.com/content/_assets/resources/pdf/fact-sheet/guide.pdf) (indicating that a project is ineligible if commercial or non-residential space exceeds 35 percent of the total square footage).

marketing or administrative perspective, as it may be too complicated to explain to prospective buyers or too difficult for those who are responsible for developing the budget, computing assessments, and collecting amounts due to calculate and apply.

An appropriate methodology for allocating shared expenses should take into account the impact on each parcel based on the initial mix of uses anticipated for the development, as well as the full range of possible uses that could exist over time as initial buyers sell and uses change. For example, if a parcel originally developed as multifamily rental apartments is converted to a condominium form of ownership, the share of the expenses originally allocated to the apartment parcel must be reallocated among the resulting condominium units. A formula based purely on land area will need to have special provisions for reallocation in this scenario.

Governmental owners can further complicate the allocation methodology, as they may expect or require full or partial exemptions from assessment for facilities such as schools, libraries, and public safety facilities. Thus, any formula that considers total land area allocated to each land use may need to exclude such facilities from the calculation.

Once again, the unknowns in the early development stages of commercial components of a mixed-use community may make any formula for allocating costs between commercial and residential land uses a bit of a shot in the dark, as the impact on one use or the other may not be fully appreciated until well into the development process when it is too late to make changes. The formula needs to be one that automatically adjusts the burden on each land use to reflect changes in development plans and the amount of property actually developed for each land use in order to avoid overburdening one or the other by pre-development estimates of acreage intended for each use.

#### *D. Use Restrictions and Exclusive Use Rights*

Use restrictions are an important part of the servitudes established for any commercial or mixed-use development, as they help create and maintain the synergy among uses that attracts customers and new buyers for properties in the development while keeping out incompatible and undesirable uses. This is particularly important as properties are resold and uses change over time. Use restrictions also help to minimize conflict among permitted uses by regulating activities to minimize disruption and interference between uses. However, they must be thoughtfully drafted to accomplish these goals without being unreasonable or impairing marketability and viability of the parcels comprising the development.

A developer of a planned community or mixed-use development typically will seek to attract particular types of businesses that it

believes will contribute positively to building and maintaining the synergy that the developer is attempting to create within the development. The developer will also want to establish a balance of compatible uses, such as retail with apartment or office uses, that provide both daytime and nighttime customers for those retail businesses. In order to ensure that a particular buyer doesn't change its mind and use the property for something other than what the developer intended, or sell to someone else who does, the developer may record use restrictions on each parcel at the time of conveyance, restricting that parcel from being used for any purpose other than the intended use, or a limited range of permitted uses, for some finite period of time.

These "initial use" restrictions should be limited to a stated, reasonable term, sufficient to accomplish the goal of getting the business fully operational, but not so long as to unreasonably interfere with the future marketability of the parcel.<sup>46</sup> They should also be broad enough in describing the scope of the permitted use or uses to permit any incidental, related and supporting uses that are necessary or customary to the operation of the intended use. Presumably, the broader the range of permitted uses, the longer the restriction's term might be without it being considered unreasonable. Such restrictions should also provide an opportunity to obtain approval of the developer or a third party, such as the property owners association, for an alternative use not specifically named in the restriction. This can be important if it becomes apparent that the permitted use or uses are not financially viable, the parcel owner undergoes a change in its business, or the owner (or a prospective buyer or tenant) proposes another acceptable use.

A second type of use restriction is one which prohibits incompatible uses. Although zoning ordinances may provide some level of control over incompatible uses, zoning ordinances often permit a broader range of uses than are desirable in a particular development. Some of the uses permitted by zoning may not be compatible with existing or desired uses. In addition, zoning can be unreliable, as control over the granting of special use permits and variances is likely vested in a governmental body comprised of persons who do not have the same interests and concerns as the developer and owners in the particular commercial or mixed-use development. Therefore, it may be desirable to consider what uses would be permitted by applicable zoning and impose use restrictions through private covenants that prohibit uses that might otherwise be permitted by zoning but would not be desirable for the particular development.

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46. See *e.g.*, *Net Realty Holding Trust v. Franconia Props., Inc.*, 544 F. Supp. 759 (E.D. Va. 1982) (upholding a provision of a shopping center lease requiring the tenant to operate its space as a first-class department store under its trade name for 30 years, finding that the purpose of the provision – to maintain anchor tenants – was legitimate).

Another category of use restrictions are those that restrict certain activities by permitted businesses to ensure that a particular business does not create a disproportionate burden on the common areas or unreasonably interfere with neighboring uses. For example, as many mixed-use developments are high density, parking is often shared among two or more parcels. Thus, it may be necessary to restrict any change in use of a parcel that would increase the demand for parking or that would shift the demand for parking to different hours of the day, resulting in a lack of sufficient parking for other businesses' customers. Other restrictions in this category might address noise, odors, delivery time and similar issues that can lead to conflict among uses.

Another type of use restriction that can be helpful in commercial and mixed-use developments with retail components are those that require approval of the developer during the development and sale period, and the property owners association thereafter, to engage in certain uses. The goal of this type of restriction is to provide a level of control over uses similar to that which a landlord might exercise, in order to maintain a balanced mix of uses and avoid duplication of uses within the development after parcels are sold.<sup>47</sup>

Many retail tenants are accustomed to having a landlord who is in control of all uses within the shopping center throughout the lease term and is able to grant exclusive rights to the tenant during the term of the tenant's lease to conduct the tenant's particular category of business, such as a grocery store, a coffee shop, or a sporting goods store. Other businesses, such as hospitals and medical and dental providers, may also demand certain exclusive rights within their particular field of service as a condition of purchasing property in the development. However, the developer's control over the use of parcels for permitted purposes is lost in multi-owner commercial or mixed-use developments where building sites are sold rather than leased, unless the parcels are conveyed subject to restrictions requiring prior approval of the developer or the owners association to engage in certain uses. This enables the developer to provide assurances to a particular buyer that it will be the only operator of that particular category of business, at least for some period of time, to enable it to get its building constructed and open for business and establish a customer base in the local market.<sup>48</sup>

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47. See *e.g.*, *Samuelson Nat'l. v. Kaiser-Aetna*, 160 Cal. Rptr. 395, 398-99 (Ct. App. 1979) (recognizing that maintaining a variety of uses is a legitimate purpose of restrictive covenants and upholding a restrictive covenant giving the developer of an industrial park the right to approve uses of property in the development on the basis of their impact on other uses and operations in the development).

48. See *id.* at 398 (stating, "[I]t is a legitimate business purpose for a developer (or a landlord), to elect to create and maintain a piece of property

In order to avoid unduly restricting the use of parcels within the development, the types of businesses requiring prior approval should be specified and limited to just those categories that typically expect exclusive use rights. The buyers will typically expect the approval of their intended uses to be in writing, executed by the developer, and recorded. Both the developer and property owners association will need to maintain accurate records of the parcels and businesses that have been granted rights to conduct certain business and the limitations and conditions of such approvals, in order to avoid conflicts between such approvals and exclusive use rights granted previously or thereafter.

Exclusive use rights, on the other hand, are typically granted by contract – either in the lease or the agreement of purchase and sale – and may not be intended to run with the land. There may be numerous conditions attached to them, such as a contractual obligation to commence business by a certain date, and various events which could trigger a termination of the exclusive use rights. Due to their complexity and the fact that the developer, seller, or landlord may have the discretion to terminate the rights upon the occurrence of certain events or to grant a cure period, it may be difficult for persons who are not a party to the transaction to determine whether the exclusive use right remains in effect. It is also preferable to avoid having every exclusive use right become an exception on title to other parcels, which would require recording additional documents thereafter to update the status of exclusive use rights. Thus, it may be better to record a general restriction prohibiting owners and occupants of other parcels from conducting listed activities without prior approval of the developer, rather than recording specific restrictions for the benefit of a particular grantee of exclusive use rights. However, this puts the burden on the developer to ensure that it doesn't grant approvals that infringe upon exclusive rights previously granted to others.

When exclusive use rights are granted, they should be limited in scope and time so as not to unreasonably restrict other owners' activities that might inadvertently infringe on the exclusive rights, but do not truly compete with the business granted such exclusive rights.<sup>49</sup> The area covered by the exclusive use right should also be

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devoted to a large number of various uses. Such a planned development will attract to the property a variety of prospective customers who would not be attracted by a single use, with a consequent advantage to all users. But a prospective purchaser . . . needs to be assured that the variety will be preserved and that the property as a whole does not turn into a single use area. . . . [T]he developer [may agree, in advance,] that a proposed use [is] of such a nature that the desired variety [cannot] be assured unless that use is exclusive.”)

49. See *Whitinsville Plaza, Inc. v. Kotseas*, 390 N.E.2d 243, 252 (Mass. 1979) (recognizing, as settled law in that jurisdiction, that “a covenant restraining competition will be enforced if it is reasonably limited in time and space and consonant with the public interest.”); see also *Exit 1 Props. Ltd. P’ship v. Mobil Oil Corp.*, 692 N.E.2d 115, 118 (Mass. App. Ct. 1998) (upholding a covenant

limited to only those properties subject to the prior approval requirement within a reasonable distance of the exclusive business, similar to what might be expected in a traditional shopping center, taking into account the distance to properties outside the control of the developer on which a competing business could choose to locate.

### *E. Changes in Ownership and Occupancy*

Changes in ownership provide another challenge in dealing with commercial and mixed-use development and redevelopment. The declaration for a property owners association will typically require owners to notify the association in writing of a change in title or occupancy of the property. It is also common for the declaration to require the association to give the selling owner or buyer, upon request, certain information relating to the association, such as the amount of any unpaid assessments on the parcel being transferred (since those assessments would constitute a lien on the parcel and thus may need to be paid prior to or collected at the closing). The buyer may also want assurances prior to closing that there are no known violations of the covenants and restrictions affecting the property to be transferred.

This notice is intended to give the property owners association information about who is occupying the parcel and contact information for the tenant and remote owner, in case of an emergency or covenant violation. It may also be helpful in determining who is authorized to use certain common areas, such as shared parking or other facilities. Such notice gives the association the opportunity to update its records so that assessment bills and other communications are sent to the proper address in a timely manner. Notice will also give the association the opportunity to provide information to a new owner or tenant about the covenants and rules of the development and the implications of owning or leasing property subject to private covenants.

Frequently, a change in ownership may occur in conjunction with a subdivision of a parcel or a combination of two or more parcels. Since voting rights and assessment obligations are frequently tied to the size of the parcel, the declaration may restrict such changes without prior approval of the developer or the association, or require prior notice to the association of such changes. The purpose of such requirements is to allow the developer or association to ensure that any such subdivision or combination is accomplished in a legal and effective manner and, in the case of subdivision, that costs previously assessed to a single parcel are reallocated among the resulting parcels. The notice requirement

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prohibiting the sale of food and beverages on a parcel adjacent to a restaurant for 50 years, finding it to be reasonable in light of the purpose, geographic extent and duration).

also allows the association to update its records and recalculate assessment liability and voting rights to reflect the change in parcel boundaries.

### *F. Management Challenges*

The use of private covenants and servitude in commercial and mixed-use developments also creates management challenges. Property owners associations are typically nonprofit corporations governed by boards of directors. For most, if not all of the development and sale period, the developer may be entitled to appoint, remove and replace the members of the board of directors.

However, once the developer no longer has an interest in the development, the board will be elected by the property owners. That may present difficulties in finding owner representatives who are willing to serve on the board in a volunteer capacity, since many if not most of the owners of commercial parcels do not occupy their parcels and do not have representatives who live or work in proximity to the development. Even those commercial owners who do occupy their parcels may lack interest in having one of their employees run for election to the association's board or have difficulty finding an employee who is willing and able to devote time to participating in association management. Departure, relocation or promotion of employees who have been elected to the association's board may require a change in an owner's designated representative, resulting in vacancies on the board and contributing to the challenge of recruiting and retaining involved and conscientious board members.

Although many commercial associations will retain professional management to assist the board, finding and training qualified management personnel on the nuances of the particular association and its governing documents is often more involved than in a homeowners association context due to the complexities of the governance structure and administration of a commercial owners association. Professional management companies with expertise in managing commercial properties for their owners are common. However, professional management companies with expertise in managing commercial owners associations are much less so.

### *G. Ability to Adapt to Changing Conditions*

Unlike a commercial lease, private covenants and equitable servitudes run with the land for decades, if not in perpetuity. Therefore, they must be drafted with the flexibility to adapt to changes in development plans, market conditions, governmental requirements, as well as changes in the law, technology, and consumer preferences. The desire to protect the developer's original vision for the development, provide certainty to buyers, and avoid

undesirable changes must be balanced against the need for flexibility to accommodate changing conditions. Such flexibility is critical to keeping the community vibrant and avoiding the negative impacts of obsolescence, changes in economic viability of particular uses, and changes in the surrounding community. When the development or the surrounding community evolves into something other than what was originally anticipated, it may be necessary to amend the covenants. However, overly restrictive amendment provisions, requirements for approval at meetings, high quorum requirements, and unrealistic supermajority approval requirements can hinder needed amendments. Changes in state laws affecting common interest communities after the covenants were recorded may purport to supersede the approval requirements set forth in the covenants themselves, further complicating the process of obtaining necessary approvals to amend.<sup>50</sup>

When proposed amendments fail to receive the necessary approval, it may be necessary to seek court assistance. The Restatement (Third) of Property: Servitudes, Section 6.12 indicates that a court may excuse compliance with various provisions in a governing document of a common interest community, including certain amendment and quorum requirements, if it finds that: (i) the provision unreasonably interferes with the ability to manage the common property, administer the servitude regime, or carry out any other function set forth in the declaration;<sup>51</sup> and (ii) compliance is not necessary to protect the legitimate interest of the members or lenders holding security interests.<sup>52</sup> The rule stated in Section 7.10(1) of the Restatement would also allow a court to modify or terminate a restrictive covenant in appropriate circumstances:

When a change has taken place since the creation of a servitude that makes it impossible as a practical matter to accomplish the purpose for which the servitude was created, a court may modify the servitude to permit the purpose to be accomplished. If modification is not practicable, or would not be effective, a court may terminate the servitude. Compensation for resulting harm to the beneficiaries may be awarded as a condition of modifying or terminating the servitude.<sup>53</sup>

However, it cannot be assumed that these tools will be available or that courts will be willing to use them in a particular case. The goal should be to draft governing documents, to the extent

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50. See S.B. 1845, 2019 Leg., 86th Sess. (Tex. 2019) (requiring a majority of the total votes allocated to property owners entitled to vote in order to amend a declaration for certain mixed-use developments unless the declaration specifies a lower approval requirement. The language of the bill does not address the situation in which a declaration requires something greater than a simple majority of the votes to amend).

51. RESTATEMENT (THIRD) OF PROP., supra note 7 at § 6.12.

52. *Id.*

53. *Id.* at § 7.10(1).

possible within statutory constraints, with an eye toward possible future changes in the development and build in the flexibility to adapt to such changes.

### III. CONCLUSION

Private covenants and equitable servitudes play an important role in development and operation of commercial properties today and can have a positive impact on communities by creating more desirable commercial development, increasing the local tax base, and maintaining and enhancing the value of surrounding properties. The private covenants provide mechanisms for maintaining and enforcing standards to ensure that the commercial or mixed-use development becomes and remains an asset to the community for the long term. However, they must be carefully thought out and implemented to ensure that they will be enforceable and to avoid unintended consequences. If private covenants are to be effective for the life of the development, they must anticipate and build in the flexibility to permit and guide future redevelopment as communities, technology, and consumer preferences evolve over time.

