Study H-858 December 7, 2012

Second Supplement to Memorandum 2012-48

Common Interest Development Law: Commercial and Industrial Subdivisions (Comments on Tentative Recommendation)

In the First Supplement to Memorandum 2012-48, the staff discussed the possibility of revising the proposed definition of "nonresidential common interest development," (and "nonresidential subdivision") to achieve two aims:

(1) Simplify the structure of the definition. See First Supplement to Memorandum 2012-48, pp. 6-7.

(2) Broaden the proposed exception for "short-term residential use," so that it is not limited to use of separate interest property. *Id.*, p. 3.

Taken together, the proposed revisions were as follows:

> 4203. (a) For the purposes of this section, "~~residential~~ nonresidential common interest development" means a common interest development in which residential use is not permitted by ~~both~~ law ~~and~~ or by any declaration of covenants, conditions, and restrictions that is recorded in each county in which the common interest development is located.
>
> (b) For the purposes of subdivision (a), the following uses are not considered to be residential uses ~~and the fact that one or more of these uses is permitted within a common interest development does not make the common interest development a "residential common interest development"~~:
>
> (1) The operation of a residential rental business within a separate interest that contains three or more apartment units.
>
> (2) The provision of living space to an agent or employee of the association or a business that is located within the common interest development, as an incident of agency or employment. For the purposes of this paragraph, "agent or employee" includes, but is not limited to, a property manager, caretaker, or security guard.
>
> (3) The short-term residential occupation of ~~a boat, trailer, or motor vehicle that is located on but not permanently affixed to a separate interest~~ space within the common interest development. For the purposes of this paragraph "short-term residential

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting.

occupation" means residential occupation for no more than 60 days out of each calendar year.

~~(c) For the purposes of Section 4202, "nonresidential common interest development" means any common interest development that is not a residential common interest development.~~

The staff has since exchanged email with attorney Duncan McPherson, who made some suggestions for further refinement of that language. His comments and suggestions are discussed below. In addition, the staff has had some further thoughts on how to improve the language. They are also discussed below.

For ease of reference, the aggregate effect of the revisions recommended in this supplement are presented in a cumulative summary near the end of the supplement.

Unless otherwise indicated, references to proposed Civil Code Section 4203 should be read to also include a reference to the parallel provision of the Subdivided Lands Act, proposed Business and Professions Code Section 11002.

"Not Permitted" v. "Prohibited"

The proposed revisions to Section 4203 would define a "nonresidential" development as one in which residential use is "not permitted" by law or by any declaration of restrictions. After further reflection, the staff finds that construction of the rule to be a bit awkward and potentially confusing.

It would probably be clearer to instead define a nonresidential development as one in which residential use is *"prohibited"* by law or by a declaration of restrictions.

The only reason the staff had avoided that phrasing in drafting the proposed revision was a concern that it might be read strictly, to require an *affirmative* prohibition ("thou shalt not reside"), which would not include a restriction that *indirectly* prohibits residential use ("all separate interests shall be used for commercial purposes"). The staff now believes that concern to be hyper-technical. In the interest of making the language more readily understandable, the staff recommends using "prohibits." The chance of a problematically strict reading of that language could perhaps be avoided by adding explanatory language to the section's Comment, along these lines:

> The law or a declaration of restrictions may "prohibit" residential use by either an express prohibition or by use restrictions that effectively preclude any residential use.

Should changes along those lines be made?

Exceptions to Meaning of "Residential Use"

In general, the proposed law would provide that a development is "residential" if it permits *any* residential use. However, the recommendation would include exceptions to that general rule for certain incidental residential uses.

One of the exceptions provides that "short-term" residential use (i.e., residential use of 60 or fewer days per year) of a separate interest is not a "residential use" for the purposes of determining whether a development is residential. See proposed Civ. Code § 4203(b)(3). In other words, the fact that a development permits short-term residential occupation of separate interests would not be sufficient to make the development "residential" for the purposes of the proposed law.

In the First Supplement to Memorandum 2012-48, the staff discusses whether that exception is framed too narrowly. Specifically, the staff did not see any policy reason why the exception should be limited to short-term use of *separate interests*. With that narrow framing, any permitted short-term residential use of the *common area* would be sufficient to make a development residential.

The staff recommended that the exception be expanded to encompass use of the common area as well. See First Supplement to Memorandum 2012-48, p. 3.

As discussed below, the staff believes that the same general principle — that incidental residential use of the common area should not make a development "residential" — applies equally to the other two proposed exceptions.

Residential Rental Business

Proposed Section 4203(b)(1) provides an exception for the commercial operation of a "residential rental business" in a separate interest. The Commission tentatively recommended this exception because a separate interest owner's operation of such a business is a *commercial* activity. See discussion in Memorandum 2012-48, attachment p. 13.

The staff believes that the same principle applies if the development's governing association is operating a residential rental business in the common area. That would still be a commercial activity, from the point of view of the development's owners. For example, if an entirely commercial development operates a hotel in its common area, that would not make the *owners'* use of the development "residential."

Employee Living Space

Proposed Section 4203(b)(2) provides an exception for living space that is provided to a business' agent or employee, as an incident of employment. For example, if a business provides living space for an onsite caretaker, that incidental residential use shouldn't change the fundamental character of the development.

Again, that principle would seem to apply with equal force if the caretaker's accommodations happen to be located in the common area (perhaps as part of a shared management arrangement between the owners of businesses within the development).

Proposed Solution

For the reasons discussed above, the staff does not believe that incidental residential use of the *common area* should affect the residential or nonresidential character of the development.

Mr. McPherson has suggested what seems to be a fairly straightforward way to implement that principle on a broader basis — revise the general definition of "nonresidential" so that only the permitted use of *separate interests* would be determinative. Thus:

> 4203. (a) For the purposes of this section, "nonresidential common interest development" means a common interest development in which residential use <u>of the separate interests</u> is not permitted by law or by any declaration of covenants, conditions, and restrictions that is recorded in each county in which the common interest development is located.
>
> …

In effect, that drafting approach is premised on the notion that all use of the common area is incidental to the fundamental residential or nonresidential character of a development. The staff believes that is a reasonable assumption.

The owners of lots or separate interests in a CID or other subdivision do not reside or operate their businesses in the common area. They do so in their separate interests. The common area serves to provide shared infrastructure to support the use of the separate interests (e.g., landscaping, lighting, parking, security walls, common structural elements, etc.). The common area may be essential to the use of the separate interests, but it is ancillary to that use.

The staff believes that the revision proposed by Mr. McPherson would provide a more straightforward way of expressing the intended rule and

recommends that it be made. If that revision is made, there will be no need to add the "common area" language to proposed Section 4203(b)(3).

Technical Revisions

Mr. McPherson has also suggested two minor technical revisions to proposed Section 4203(a), as follows (with strikeout and underscore showing changes from the language set out immediately above):

> 4203. (a) For the purposes of this section, "nonresidential common interest development" means a common interest development in which residential use of the separate interests is not permitted either by law or by any declaration~~ of covenants, conditions, and restrictions that is recorded in each county in which the common interest development is located~~.

The first proposed change is merely a matter of emphasis. The staff thinks it is not strictly necessary, but would probably make the meaning clearer. **The revision should probably be made.**

The second proposed change would rely on the definition of "declaration" that is already provided in the Davis-Stirling Act. See Civ. Code § 4135. That definition refers to a recorded document that contains information specified in two other provisions (Civ. Code §§ 4250, 4255). For example, in a CID formed after 1985, the "declaration" must include a legal description of the CID. Civ. Code § 4250(a).

That could be problematic. The staff is not certain that the "declaration" (as defined in Section 4135) is the only type of recorded document that can express use restrictions. It is at least possible that both a "declaration" and a separate recorded "declaration of covenants, conditions and restrictions" might exist and be enforceable.

Moreover, only CIDs are covered by the definition of "declaration" provided in Section 4255. Other types of subdivisions could have recorded restrictions that do not meet the same defining criteria.

In the interest of maximizing the parallelism between Sections 4203 and 11002, and avoiding any possible substantive narrowing of those provisions, **the staff recommends against making the second proposed technical revision.**

In addition to the revisions proposed by Mr. McPherson, the staff sees one other technical change that should be made if the structure of Section 4203 is revised as proposed above. The proposed revisions would delete subdivision (c), which reads:

(c) For the purposes of Section 4202, "nonresidential common interest development" means any common interest development that is not a residential common interest development.

Deletion of that subdivision would sever the link between the definition provided in Section 4203 and Section 4202, which uses the definition. That problem could be cured with the following additional revision:

4203. (a) For the purposes of ~~this section~~ Section 4202, "nonresidential common interest development" means …

If the Commission decides to restructure Section 4203 as discussed above, this additional revision should be made.

Scope of Exception for "Residential Rental Business"

As noted above, the proposed law would exempt the operation of a "residential rental business" from the meaning of "residential use." See proposed Section 4203(b)(1) above. Thus, if a separate interest is used for the commercial purpose of operating an apartment building, that would not be a residential use of the separate interest.

Mr. McPherson has pointed out that there can be *other* types of commercial activities that involve an overnight stay by clients, which may not clearly be a "residential rental business." For example, in a medical park, a separate interest might be used to operate a skilled nursing facility or hospice.

Mr. McPherson also notes that use of the term "business" might be confusing if the entity conducting commercial activity is a nonprofit.

The staff believes that those concerns should be addressed and recommends that the provision be revised to provide more guidance on its scope, thus:

(1) The ~~operation of a residential rental business within~~ rental of apartments in a separate interest that contains three or more apartment units or the operation of any other type of commercial facility that provides residential space for its clients, including, but not limited to, a hotel, skilled nursing facility, or assisted living facility.

Cumulative Summary of Proposed Revisions

If all of the revisions recommended in this supplement are made, proposed Sections 11002 and 4203 (and their Comments) would be revised as follows (with

strikeout and underscore showing changes from the version of the section set out in the tentative recommendation):

Bus. & Prof. Code § 11002 (added). "Nonresidential subdivision" defined

11002. (a) For the purposes of ~~this section~~ Section 11010.3, "~~residential~~ nonresidential subdivision" means a subdivision in which residential use ~~is permitted~~ of the lots, parcels, or separate interests is prohibited, either by ~~both~~ law ~~and~~ or by any declaration of covenants, conditions, and restrictions that is recorded in each county in which the subdivision is located.

(b) For the purposes of subdivision (a), the following uses are not considered to be residential uses ~~and the fact that one or more of these uses is permitted within a subdivision does not make the subdivision a "residential subdivision"~~:

(1) The ~~operation of residential rental business within~~ rental of apartments in a lot, parcel, or separate interest, that contains three or more apartment units or the operation of any other type of commercial facility that provides residential space for its clients, including, but not limited to, a hotel, skilled nursing facility, or assisted living facility.

(2) The provision of living space to an agent or employee of a governing association or a business that is located within the subdivision, as an incident of agency or employment. For the purposes of this paragraph, "agent or employee" includes, but is not limited to, a property manager, caretaker, or security guard.

(3) The short-term residential occupation of a ~~boat, trailer, or motor vehicle that is located on but not permanently affixed to a~~ lot, parcel, or separate interest. For the purposes of this paragraph "short-term residential occupation" means residential occupation for no more than 60 days out of each calendar year.

(c) ~~For the purposes of Section 11010.3, "nonresidential subdivision" means any subdivision that is not a residential subdivision.~~

~~(d)~~ For the purposes of this section, "separate interest" has the meaning provided in Section 4185 of the Civil Code.

Comment. Section 11002 is new. Subdivision (a) defines "~~residential~~ nonresidential subdivision" for the purposes of ~~the section~~ Section 11010.3. Under the definition, if ~~both~~ either the law ~~and any~~ or a recorded declaration of covenants, conditions, and restrictions ~~permit~~ prohibits any residential use ~~within a subdivision~~ of the lots, parcels, or separate interests, the subdivision is a "~~residential~~ nonresidential subdivision." The law or a declaration of restrictions may "prohibit" residential use by either an express prohibition or by use restrictions that effectively preclude any residential use.

Subdivision (b) states specific exceptions to the general rule provided in subdivision (a). The fact that one or more of the uses

listed in subdivision (b) is permitted within a subdivision ~~is not enough to make the subdivision a "residential subdivision."~~ would not affect the classification of the common interest development as "nonresidential."

Subdivision (b)(3) establishes an exception for "short-term occupation," which is defined as 60 days out of each calendar year. For a similar short-term occupation rule, see Section 51.3(d) (60 day per year exception to age restrictions on occupants of senior housing).

~~Under subdivision (c), any subdivision in which residential use is entirely precluded, by law or by a recorded declaration of covenants, conditions, and restrictions, is a "nonresidential subdivision."~~

See also Section 11010.3 (exemption of nonresidential subdivision from provisions of this act).

Civ. Code § 4203 (added). "Nonresidential common interest development" defined

4203. (a) For the purposes of ~~this section~~ Section 4202, "~~residential~~ nonresidential common interest development" means a common interest development in which residential use ~~is permitted~~ of the separate interests is prohibited, either by ~~both~~ law ~~and~~ or by any declaration of covenants, conditions, and restrictions that is recorded in each county in which the common interest development is located.

(b) For the purposes of subdivision (a), the following uses are not considered to be residential uses ~~and the fact that one or more of these uses is permitted within a common interest development does not make the common interest development a "residential common interest development"~~:

(1) The ~~operation of a residential rental business within~~ rental of apartments in a separate interest that contains three or more apartment units or the operation of any other type of commercial facility that provides residential space for its clients, including, but not limited to, a hotel, skilled nursing facility, or assisted living facility.

(2) The provision of living space to an agent or employee of the association or a business that is located within the common interest development, as an incident of agency or employment. For the purposes of this paragraph, "agent or employee" includes, but is not limited to, a property manager, caretaker, or security guard.

(3) The short-term residential occupation of ~~a boat, trailer, or motor vehicle that is located on but not permanently affixed to~~ a separate interest. For the purposes of this paragraph "short-term residential occupation" means residential occupation for no more than 60 days out of each calendar year.

~~(c) For the purposes of Section 4202, "nonresidential common interest development" means any common interest development that is not a residential common interest development.~~

Comment. Section 4203 is new. Subdivision (a) defines "~~residential~~ nonresidential common interest development" for the purposes of ~~the section~~ Section 4202. Under the definition, if ~~both~~ either the law ~~and any~~ or a recorded declaration of covenants, conditions, and restrictions ~~permit~~ prohibits any residential use ~~within a common interest development~~ of the separate interests, the common interest development is a "~~residential~~ nonresidential common interest development." The law or a declaration of restrictions may "prohibit" residential use by either an express prohibition or by use restrictions that effectively preclude any residential use.

Subdivision (b) states specific exceptions to the general rule provided in subdivision (a). The fact that one or more of the uses listed in subdivision (b) is permitted within a common interest development ~~is not enough to make the common interest development a "residential common interest development."~~ would not affect the classification of the common interest development as "nonresidential."

Subdivision (b)(3) establishes an exception for "short-term occupation," which is defined as 60 days out of each calendar year. For a similar short-term occupation rule, see Section 51.3(d) (60 day per year exception to age restrictions on occupants of senior housing).

~~Under subdivision (c), any common interest development in which residential use is entirely precluded, by law or by a recorded declaration of covenants, conditions, and restrictions, is a "nonresidential common interest development."~~

See also Section 4202 (exemption of nonresidential common interest development from specified provisions of this act).

Timing Considerations

The technical revisions proposed in the First Supplement to Memorandum 2012-48 and this supplement are not trivial. It may be that the Commission will want to postpone approving a final recommendation until its February 2013 meeting, in order to give more time for public reaction to any revisions that it approves.

Doing so would complicate, but not preclude, the introduction of implementing legislation in 2013. The staff is working to find an author to introduce a bill to implement the companion proposal, *Commercial and Industrial Common Interest Developments* (Aug. 2012). If successful, this proposal could later be integrated into that legislation.

On the other hand, the proposed revisions would not make any significant substantive changes. Nor do they require any rethinking of the policy justification for the proposed law. They are in accord with that policy rationale. So despite all of the proposed technical tinkering, the Commission might conclude that the recommendation is ready for approval and introduction. If so, minor conforming changes would need to be made to the narrative "preliminary part" of the draft recommendation. Those changes would be nonsubstantive and could perhaps be made by the staff, subject to Chair review and approval of the final version.

How does the Commission wish to proceed?

Respectfully submitted,

Brian Hebert
Executive Director