Real estate ownership is the greatest source of wealth for most Americans, and a home is the most valuable asset most will ever own. For many homebuyers, buying a home is a daunting and stressful process. A homebuyer considering a purchase in a new subdivision may not understand all of the significant aspects of owning a home in the subdivision and the rights and responsibilities that come with it. If the subdivision is a "common interest development," such as a condominium, the homebuyer may be even less prepared to make an informed purchase decision since these types of developments tend to be more complex than a traditional subdivision of single-family homes.

The Subdivided Lands Act is a law that was created to protect purchasers of lots, units, or interests in new subdivisions. It is designed to protect consumers from misrepresentation, deceit, and fraud, and it requires prospective purchasers to be provided with a report containing material information about the lot, unit, or interest being offered as well as the rights and responsibilities that come with the property.

The purpose of this guide is to provide a practical understanding of the subdivision process in California by explaining the Subdivided Lands Act and related laws and how they relate to residential real estate development. The focus is on the Subdivided Lands Act; however, a general comprehension of residential development and other laws is necessary to understand the Subdivided Lands Act.

In order to gain complete understanding, the various types of subdivisions – standard, condominium, planned development, community apartment, stock cooperative, and undivided interest – will be described and discussed. However, the predominant types of subdivisions reviewed by the Department of Real Estate are standard subdivisions, condominiums, and planned developments.

OVERVIEW

In most cases, the value of real estate is not in the property itself – the soil, materials, improvements, buildings on a site – but rather the *rights* associated with the ownership of the property. The value of a home is greatly diminished if the owner does not have the right to transfer the title to someone else. An apartment building is of little value to its owner if the owner does not have the right to lease out the apartments. Thus, the value of real estate is due in large part to the property rights afforded and protected by the legal system. Under our legal system, ownership of real estate is said to be ownership of a bundle of rights. These rights include the right to use, lease, encumber, transfer (by sale or will), and exclude others.

All new development of housing in California must go through a legal process of subdivision in order for the developer to market and transfer the resulting subdivided interests. A requirement of this process that contributes to a properly functioning real estate market is that real property must be described in a formal way, i.e., an adequate legal description is required in transactions transferring real property rights. Creating an adequate legal description for subdivided property is a function of one of two laws governing subdivision development in California. This law is called the Subdivision Map Act (Map Act). The Map Act governs the legal and physical requirements of subdividing real property and the process by which cities and counties may approve subdivisions in their jurisdictions.

The second law governing subdivision development in California and the subject of this study is the Subdivided Lands Act (SLA). This law governs the process by which property, once it has been subdivided, may be initially marketed and sold to members of the public.

In addition to establishing the legal framework for transferring interests in real property, California's subdivision laws have been adopted and amended over time in order to protect communities and homebuyers from potentially adverse impacts of subdivisions. New development can have a significant impact on communities, and thus, state law grants local governments the power to regulate the manner in which their communities grow. Consequently, the Map Act requires subdivision developers to obtain the approval of the local government in order to subdivide property. By placing conditions of approval on new subdivisions, local governments can ensure that new subdivisions are consistent with their own plans and regulations for growth and new development.

The primary purpose of the SLA is to protect homebuyers – purchasers and prospective purchasers of new subdivided interests – from misrepresentation, deceit, and fraud in the public sale, lease, or financing of "subdivisions." As noted above, a home purchase is likely the largest investment a consumer will make. Because of the large amounts of money and the complexity involved in real estate transactions, the possibility of fraudulent or dishonest activity is increased. Subdividers, like sellers of any product, may also be motivated to withhold information that, if known, may lead to a lower value, may influence a buyer's decision, or may ultimately negatively affect the buyer's quality of life.

Similar to the bundle of rights described above, residential real estate must be provided with a bundle of services if it is to be habitable and if it is to provide a minimum quality of life to the resident. These services are usually provided by or under the jurisdiction of the local government and funded by property taxes and/or user fees. These basic services typically include the provision of vehicular access, water, waste removal, electricity, gas, telephone, and cable television to the property as well as the maintenance of such facilities. More broadly, municipal services include law enforcement, fire protection, education, etc., that residents of the property could utilize. The quality and sufficiency of these services also contribute to the value of the property.

While property owners are provided these rights and services, they are expected to fulfill the obligations associated with property ownership. In addition to paying property taxes and assessments, property owners are expected to live in accordance with local ordinances and to uphold the standards of their local community. That is, residents are expected not to be a nuisance to their neighbors and not to interfere with their neighbors' enjoyment of their own property. Many residential subdivisions are subject to covenants, conditions, and restrictions (CC&Rs) as well as homeowners association rules that go beyond local ordinances and impose more accountability upon residents of these developments.

The primary purpose of the SLA is to ensure that buyers of homes within new subdivisions are provided adequate information on all matters affecting the property prior to making their purchase decision.

What is a Subdivision?

Virtually every home where the occupant has an ownership interest in the home was created by a subdivision of one form or another. Legal definitions and types of subdivisions are described later in this study, but a ***subdivision*** is simply the division or separation of ownership interests in real property. The two categories of subdivisions under the SLA are standard subdivisions and common interest developments (CIDs). A ***standard subdivision*** is one that results in entirely ***divided interests***; i.e., the owner of the subdivided interest owns the entire interest (lot or parcel) exclusively with no common ownership of anything associated with it. A ***common interest development*** is one that results in all or part of the project being an ***undivided interest***, i.e., two or more owners holding a single ownership interest.

Common Interest Developments

Due to a variety of factors, what is thought of as the "traditional home," a single-family detached home on an individual lot on a public street provided with public services, is no longer traditional. Increasingly, housing developers have been offering alternative ownership options in subdivisions where infrastructure facilities are privately owned, where services are provided or enhanced by private entities and private restrictions on residents are more prevalent. These are features of CIDs. Consider a gated neighborhood of single-family homes with a private recreational center. The streets, gates, recreational facility, and other facilities are owned "in common" by the homeowners of the gated community, and they are responsible for their maintenance.

A condominium is a type of CID. It is a multi-unit housing development that may look like an ordinary apartment building, but is actually owned by multiple owners. In a condominium project each condominium owner owns a "unit" of airspace, which he/she occupies as his/her home, and an association consisting of all the condominium owners owns the land, the building itself, and other common areas of the property. Condominiums

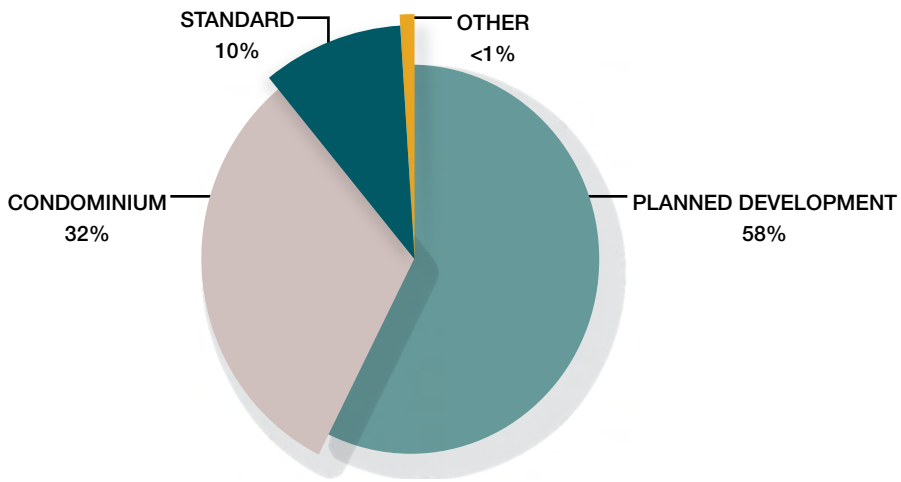
are discussed further on page 23.

The Davis-Stirling Common Interest Development Act (DSA) is the state law that governs common interest subdivisions and the SLA cannot be understood without also understanding the DSA. This law requires CIDs to be managed by a formal association, referred to as a "homeowners association" or "HOA" (HOAs are defined and discussed further in following sections of this study). While the DSA does not regulate subdivisions per se – most of the DSA concerns the ongoing operation of HOAs – developers must form the association prior to offering interests in the subdivision to the public. Thus, compliance with the DSA is necessary in the development of common interest subdivisions.

How Common are Common Interest Developments?

It is estimated that as of 2012, 63.4 million, or 20 percent of all U.S. residents live in 323,600 CIDs nationwide. It is estimated that 14.3 million, or 38 percent of California residents live in 48,864 CIDs. According to California Department of Real Estate (DRE) data, the majority of applications for public reports processed since 1993 have been CIDs (condominium and planned development) as shown in Figures 1 and 2.

Figure 1 - Distribution of Public Reports 1993-2012



All of the project types listed are CIDs except for standard and mobile home projects,[1] and the number of CID applications has been almost 10 times the number of standard subdivisions.[2]

Figures 1 and 2 also illustrate the relative number of applications for the various types of CIDs. Few undivided interest, community apartment, stock cooperative, and limited equity housing cooperative projects have been developed in California, though the number of undivided interest applications was significant in the 2005 to 2009 period. The various subdivision types are defined and discussed in following sections of this study.

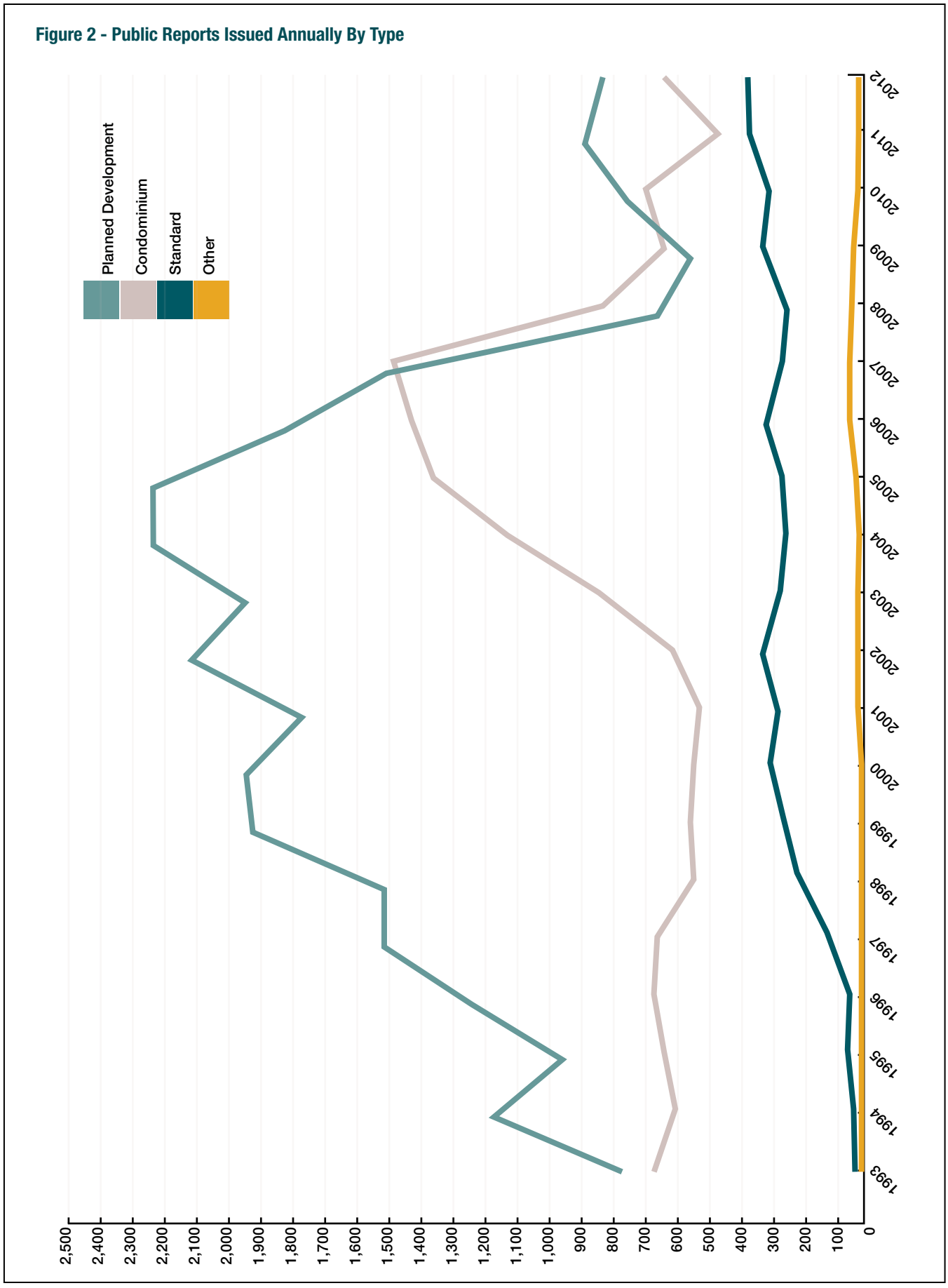
Why Common Interest Developments?

Development of common interest subdivisions in the U.S. has occurred since the mid-19th century. Historically, developers have been motivated to obtain higher values by selling private communities as exclusive, highly amenitized alternatives to the perceived negative aspects of urban housing. Homeowners within such private

[1] A public report for a mobile home project is required when the mobile home park is being converted to a park where mobile home spaces are owned separately.

[2] DRE data reflect only applications processed by the DRE. Section 11010.4 of the SLA exempts standard subdivisions meeting specific criteria from the public report process; no data is available on these projects but it is assumed to be a small number based on the specific criteria that must be met.

Figure 2 - Public Reports Issued Annually By Type



communities valued the security and local control afforded by the HOA. While these motivations continue today, CIDs have also become a response to the real or perceived failure of local governments to provide the level and quality of services demanded by homebuyers. Today, HOAs frequently assume responsibility for the maintenance of public facilities and supplement local law enforcement with private security.

In some cases, a project may be approved by the local agency with an ownership or maintenance requirement that outlives the developer's involvement in the project. For example, environmental mitigation measures and/or conditions of approval may require landscape areas or natural areas to be owned and maintained in perpetuity. In response, the developer may create a common interest in such areas to facilitate long-term maintenance.

Aside from the above factors, CIDs are necessitated by the development of higher density ownership housing. ***Residential density*** is calculated in terms of the number of dwelling units per acre of land.[3] With a standard single-family home subdivision of a given parcel as a starting point, increasing the number of units increases the project's density. In practice, such increases are also accompanied by decreases in land areas dedicated to non-residential uses such as yard or open space areas, surface parking areas, and vehicular circulation. The practical limit for a single-family detached subdivision is approximately 30 dwelling units per acre, depending on the configuration and circulation pattern of a given site. Achieving densities higher than this requires housing units to be clustered, attached and/or stacked, leading to common ownership of walls, floors, etc. Such housing types are limited in their ability to provide exclusive open space areas such as would be provided with single-family detached homes with large yards. Thus, common open space or recreational facilities are often developed in these projects as amenities. Streets and driveways within denser projects often are designed to be narrower than the standard streets of the local agency, and in many cases, the local agency requires the streets to be privately owned and maintained by the project HOA.

Some developers develop higher density ownership housing to fill this niche in the homebuying market. Some developers seek to provide higher density as a means of allocating fixed development costs over a higher number of units in order to be able to sell homes at a lower price than competitors. Increasingly, all developers must respond to public policies favoring higher density housing such as California's AB 32 and SB 375 summarized below. Higher density development is believed by policy makers to be a means of mitigating certain negative environmental impacts such as global warming as explained in the summary of SB 375. Regardless of the motivation, the higher the density of ownership housing development, the more likely the development will need to be a common interest subdivision.

AB 32 – Global Warming Solutions Act

The Global Warming Solutions Act was adopted in 2006. It requires the California Air Resources Board (CARB) to implement regulations and market mechanisms designed to reduce greenhouse gas (GHG) emissions to 1990 levels by 2020. The CARB is part of the California Environmental Protection Agency within the Executive Branch of the state government. The CARB's regulations and mechanisms for implementing AB 32 will impact all regulated industries including agriculture, energy, manufacturing, and transportation. Residential development is not directly regulated by the CARB, yet the legislation is expected to have a significant impact on residential development as described below.

In 2008 the CARB approved a Scoping Plan designed to achieve the mandated 2020 emissions reductions. The Scoping Plan presents GHG emission reduction strategies that combine regulatory approaches, voluntary measures, fees, policies, and programs. Reduction strategies are expected to evolve as technologies develop and progress toward the state's goal is monitored. Thus, the Scoping Plan sets forth the outline of California's strategy to reduce GHG emissions on a statewide basis.

[3] Gross density is the number of units per gross acre of land, while net density refers to the number of units per net acre of land, the acreage of land after subtracting for street rights of way, easements, open space, and portions of the property that are otherwise considered undevelopable. Note that there is not a standard methodology for calculating net density, and the methodology will vary by planning jurisdiction.

The measures that will affect residential development include:

- Energy Efficiency: Building and energy codes are likely to be revised to require greater energy efficiency in new construction.
- Regional Transportation: Local agencies are likely to revise their land use and zoning plans to implement sustainable regional transportation plans designed to reduce GHG emissions from vehicles (see SB 375 discussion below).

The process of residential development will also be affected by analyses required under the California Environmental Quality Act (CEQA) which is described further on page 46. AB 32 in effect recognized GHG emissions as an environmental impact under CEQA by statute. In order to provide clarity to lead agencies when performing CEQA analysis, SB 97 was adopted in 2007. SB 97 required the Office of Planning and Research (OPR) to produce revised CEQA guidelines for the feasible mitigation of GHG emissions or the effects of GHG emissions as required by CEQA including, but not limited to, effects associated with transportation or energy consumption. The law also requires the OPR to periodically update the guidelines to incorporate new information or criteria established by the State Air Resources Board pursuant to the California Global Warming Solutions Act of 2006.

As noted above, CARB does not directly regulate residential real estate development. Real estate development projects fall under the jurisdiction of 35 local air districts. These agencies are county or regional governing authorities that have primary responsibility for controlling air pollution from stationary sources. They are governed by boards consisting primarily of elected officials and are professionally staffed. Air districts issue permits and monitor new and modified sources of air pollutants to ensure compliance with national, state, and local emission standards. They also ensure that emissions from such sources will not interfere with the attainment and maintenance of ambient air quality standards adopted by CARB and the U.S. Environmental Protection Agency.

A residential developer's interaction with air quality regulations occurs through the land use entitlement process. Pursuant to CEQA, the local agency must analyze a project's impact on the environment, including impacts on air quality, prior to approving the project. Impacts on air quality from the typical residential development project may be created in various ways including emissions from vehicles and equipment during construction, fugitive dust from earth moving and demolition, emissions of volatile organic compounds from construction materials, and emissions from equipment and vehicles once construction is completed and the housing is occupied.

If a discretionary project is approved and it is found to have a significant impact on air quality, the local agency will approve the project either: 1) conditioned upon its compliance with mitigation measures that are determined to reduce the impacts to a less than significant level, or 2) with a statement of overriding considerations in order to balance the significant environmental impact the project will have, even after the implementation of mitigation measures, with competing public objectives. The local agency will typically rely on the local air district to provide the environmental impact mitigation measures as conditions of approval. The developer then must implement the mitigation measures as part of the project. The local agency and/or the air district are then responsible for ensuring that the developer implements the mitigation measures.

In the case of ministerial entitlements, the local agency typically consults with the local air district prior to issuing permits for demolition, grading, etc. In some cases, the air district may issue a permit to the developer.

SB 375 – Sustainable Communities and Climate Protection Act

The Sustainable Communities and Climate Protection Act was adopted in 2006 as a means of reducing transportation-related emissions as contemplated by AB 32.

SB 375 directs the CARB to set regional targets for each metropolitan planning organization (MPO) in the state. An MPO is an agency responsible for planning, programming, and coordinating federal highway and transit investments in urbanized areas. Examples of these agencies are the Sacramento Area Council of Governments, Southern California Association of Governments, and the Metropolitan Transportation Commission (nine-county San Francisco Bay Area). The intent of the law is for local governments, as represented by regional agency boards, to be involved in developing effective plans to achieve regional targets.

Under SB 375, CARB, in conjunction with each MPO, develops GHG emission reduction targets for the automobile and light truck sector for the MPO. Once that target is set, each MPO must develop a "sustainable communities strategy" (SCS) as part of its regional transportation plan that will set forth a development pattern to achieve the reduction target approved by the CARB. The SCS does not supersede a local government's land use authority. SB 375 created an exemption from CEQA for local transit-oriented residential projects that are consistent with the applicable SCS as an incentive.

It is anticipated that the implementation of AB 32 and SB 375 will lead to higher density residential development in the future due to the methodologies employed by urban planners. Emissions from cars and light trucks are one of the largest sources of greenhouse gas emissions. Emissions from motor vehicles are correlated to the number of vehicle miles traveled (VMTs). VMTs are an indicator of the travel levels on the roadway system by motor vehicles and are derived from traffic volume counts and roadway lengths. Transportation planners attribute fewer VMTs to higher density residential development. Therefore, sustainable communities strategies put forth by local agencies call for higher density development as a means of achieving the reductions called for by AB 32 and SB 375.

DRE Administration of the Subdivided Lands Act

The California Department of Real Estate operates within the executive branch of the state government. The California Real Estate Commissioner is appointed by the Governor and serves as the chief executive of the DRE. The Commissioner is responsible for administering and enforcing the California Real Estate Law, the SLA, and the Vacation Ownership and Time-Share Act. The California Real Estate Law is codified in Part 1 of Division 4 of the Business and Professions Code (BPC), Sections 10000-10580, and is concerned primarily with the licensing of real estate professionals and regulating the activities they engage in. The Commissioner is also empowered to promulgate regulations (Title 10 of the California Code of Regulations), which have the force and effect of law. It is the Commissioner's responsibility to enforce these laws in a manner that achieves maximum protection for real estate consumers. In administering the laws and regulations, the Commissioner is expected to exercise judgment impartially, with fairness to both consumers and the real estate industry.

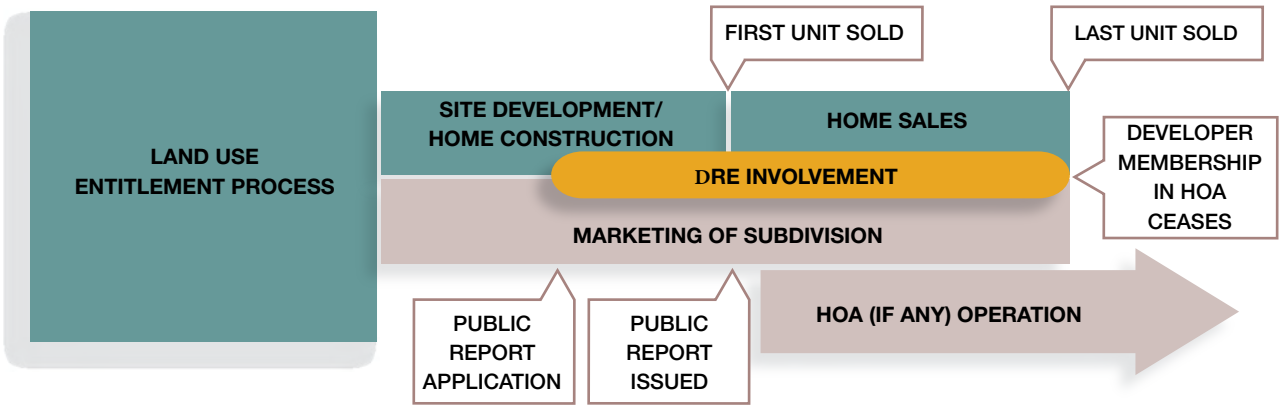
The Commissioner has the authority to issue "desist and refrain orders" or issue citations with fines up to $2,500 to stop activities that are in violation of the SLA or the real estate law. In many cases, licensed real estate professionals sell subdivision interests. In these cases the Commissioner exercises authority over both the subdivider and the licensee. For example, disciplinary action may be taken against the developer of the subdivision for violations of the SLA while a separate action may be taken against the licensed broker/sales person(s) employed by the developer for violations of the real estate law. In enforcing the provisions of the real estate law, the Commissioner has the authority, if supported by evidence, to hold formal hearings to decide issues involving a licensee or a license applicant. Such hearings may result in the suspension, revocation, or denial of a real estate license.

To enforce the SLA, the Commissioner may need to pursue action against the violator in civil court. BPC 10081 of the real estate law provides that "whenever the Commissioner believes from evidence satisfactory to him that any person has violated or is about to violate any of the provisions of the law, he or she may bring an action in the name of the people of the state of California in the superior court of the state of California against that person to enjoin him or her from continuing the violation or engaging therein or doing any act or acts in furtherance thereof." Violations of the SLA are punishable by fines of up to $10,000, by imprisonment of up to one year, or both.

The Role of the DRE in the Subdivision Process

The DRE is responsible for administering the SLA. Such administration generally consists of reviewing applications for public reports and issuing public reports. The DRE's activities are only a small part of the subdivision development process. Figure 3 illustrates that part of the subdivision process involving the DRE.

Figure 3 - DRE Involvement in the Development Process



Through the development process, there are many areas of interaction between the developer and the public, which may lead to conflict between the developer/project and the general public, homebuyers, and/or homeowners within the project:

- The land use entitlement process involves a public hearing process whereby the local agency approves the subdivision project.
- The environmental review process allows for public comment on the potential environmental effects of the project.
- Construction of the project, which may impact nearby residents, is permitted and monitored for compliance by the local agency.
- The developer may fail to complete project improvements or fail to complete the improvements in the manner anticipated by the various parties.
- After the project is completed and sold by the developer, conflicts commonly arise between individual HOA members and/or HOA board members.

Consequently, members of the public often contact the DRE regarding matters that arise during the development process.

All of the above matters fall outside the jurisdiction of the DRE. The DRE's role in the overall development process is best understood as that of a consumer protection agency whose authority is limited by statute. The DRE seeks to protect consumers from misrepresentation, deceit, and fraud in the initial public sale, lease or financing of subdivisions and to ensure that the initial prospective purchasers receive adequate information about the subdivision interest. Toward this end, the public report application requires a substantial amount of information to be submitted by the subdivider.

The DRE's involvement begins when an application for a public report is submitted and ends once the developer conveys the last lot or unit in the subdivision covered by the public report. The DRE has jurisdiction over a subdivider only during the time that the subdivider is marketing homes in a subdivision that is subject to the SLA. The DRE also has jurisdiction over real estate licensees performing sales activities for such subdivisions. The DRE does not have authority over other professionals involved in the development and home buying process such as title insurers, escrow companies, attorneys, or appraisers.

In addition to the review above, the DRE also seeks to ensure that adequate provisions are made for the completion of essential improvements. The DRE first assesses the project for essential habitability conditions such as water supply, sewer disposal, and location relative to natural hazards, etc. If public improvements have not been completed when the public report is issued, the DRE ensures that adequate performance security has been provided to the local agency. Ensuring that public subdivision improvements are complete is the primary responsibility of the local agency under the Map Act. For privately owned common improvements, the DRE requires the subdivider to make completion arrangements for such improvements until a notice of completion is recorded and homebuyers and HOAs have been protected from the filing of mechanics liens. The DRE may accept a completion bond for these improvements.

The DRE Does Not Exercise Land Use Authority

Pursuant to the Map Act and other state laws and local ordinances, the local agency has land use authority and is responsible for ensuring that the subdivision complies with local development standards and that adequate provisions are made for the completion of public improvements. The DRE does review the local agency's documentation of land use approval, such as conditions of project approval, as part of the DRE's subdivision public report application process. The DRE may rely upon and disclose inspection reports, findings, and statements of third parties such as the project engineer or contractor and/or various local agency officials. The DRE may question unusual development arrangements where it appears the development plan may conflict with the city-/county-approved plans, approval conditions, or ordinances and may seek local jurisdiction confirmation of changes to approved maps, plans, and conditions. Ultimately, the DRE issues a public report based upon the representations and documentation presented by the subdivider in the subdivider's application for a public report (referred to as the developer's "notice of intention").

The DRE Does Not Exercise Authority Over the Affairs of HOAs

Of primary concern in the DRE's review of CIDs is the manner in which common improvements will be owned, operated, and maintained. This review includes the assurance provided by the subdivider that improvements will be completed and the manner in which ownership of the improvements will be transferred to the HOA. As required by law, the developer forms an HOA to own, operate, and maintain the common improvements in perpetuity. The DRE reviews HOA formation documents and HOA management documents including the bylaws, operating budget, CC&Rs, and the provisions for transfer and control of the residential subdivision interest(s) and common area(s) to the purchasers (members) and the HOA. The DRE reviews proposed agreements and contracts between the subdivider (and/or third parties) and the HOA that are contemplated by the subdivider prior to issuance of a public report. The DRE is not able to intervene in contractual matters between an operating HOA and third parties such as a surety or vendor.