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INSIDE THIS ISSUE

D.C. Summit Addresses Critical Association Issues

Community Associations Institute (CAI) members from around the country met in Washington, D.C., recently to address critical community association issues with officials at the Federal Housing Administration (FHA), the Federal Housing Finance Agency (FHFA), the Federal Emergency Management Agency (FEMA), and key Congressional leaders.

The intensive advocacy effort, part of a first-ever, federal Legislative Summit organized by CAI, focused on the current inability of community associations to access FEMA disaster relief directly and housing reform—specifically priority liens and uniform rules for determining the financial stability of condominiums. CAI members also shared their perspectives on community manager licensing, professional certification for managers, and flood insurance.

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FEATURE

Silent Screening: Should Associations Divulge Details of Denial?

By Donna DiMaggio Berger, Esq.

For most people, the introduction to the community association lifestyle is the dreaded interview with the board to determine whether their lease or purchase application will be approved. I remember my own interview with the president of the condominium I moved into just out of law school. My husband and I were not sure what to expect. We met only with the association president in the condominium clubhouse near the pool. The president did little to put our minds at ease and, in fact, told us he could block our purchase if he "didn't like us." Fortunately, we passed muster and our sale closed.

At the time of that interaction, I had not yet started my career in community association law. Looking back, I realize that this director was wildly out of order and our association documents did not even require an interview, nor did they empower the board to deny any transfers.

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Q&A

Making Up for Unexpected Budgetary Shortfall

Q My association's board and I have carefully planned for the future of the community I manage, but we've run into unexpected budgetary problems in the past despite that. It seems inevitable that it will happen again at some point. How can we effectively respond to unforeseen budgetary challenges in the future?

A While you may feel that budgetary shortfalls are out of your control, the way in which you respond to them could play a key part in how well they get resolved in favor of the community. Unpaid dues and foreclosures have taken a financial toll on many associations across the country. If you've been short on funds, your association may have resorted to juggling costs to prevent members from having to make up all the difference. But going forward, remember to

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Many community association boards, however, do have the authority under their governing documents to scrutinize proposed leasing and sales transactions and to approve or deny them. Of course, the manner in which they conduct that approval process varies widely depending on the community type, location, and, naturally, the personality and philosophy of the board.

Transparency Debate

Boards are often advised by legal counsel that it's safer to simply say that an application was "denied" without going into the details surrounding that denial. If the property owner wishes to know the reason for the denial and pursues it legally, then yes, the board will have to capitulate and provide that reason.

One school of thought is that providing reasons for a denial could fuel unnecessary legal fights. The other school demands transparency and the reasons that the board is exercising its authority to deny when screening renters and purchasers. There may be legitimate reasons to support a denial, and by failing to articulate them, a potential purchaser or renter can leap to an incorrect conclusion that a discriminatory motive was involved.

Regulations May Fuel Claims

Some states and counties are now getting involved in the association approval process. For example, Broward County, Fla., recently passed

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The summit was a "great success," said Ronald L. Perl, chair of CAI's federal Legislative Action Committee, a member of CAI's College of Community Association Lawyers, and a CAI past president. "We had a unique opportunity to discuss federal legislative issues at a high level. I'm confident the lines of communication … that were opened by these meetings will continue to grow and enable us to better represent the interests of our members throughout the country."

Federal regulators were equally positive about the initiative. "Your timing for this meeting was spot on," said Ivery Himes, director of the Office of Single Family Asset Management at the U.S. Department of Housing and Urban Development. Eileen Zaenger, senior policy analyst for FHFA's Office for Housing and Regulatory Policy, called the meeting "…a huge first step."

CAI representatives included homeowners, community managers, attorneys, management company executives, and state lobbyists. Organized by CAI's government and public affairs team, the summit was designed to strengthen the dialog between CAI and federal policy makers. "These relationships are essential so CAI can remain the recognized national advocate for common-interest communities," said Dawn Bauman, CAE, CAI's senior vice president of government and public affairs. ♦

a new ordinance that requires all Broward County condominium, cooperative, and homeowners associations to give a specific reason in writing for the denial of an application for purchase or rent. In addition, all Broward County associations must also give written notice to the Board of County Commissioners of the status of all pending applications to rent or purchase a dwelling.

Since this new ordinance references the Human Rights Act, one can assume that the Broward County Commissioners suspect that most reasons for denial are discriminatory. But even if that isn't their suspicion, discrimination filings are likely to increase as a result of this ordinance being passed.

Critics of the ordinance have pointed out that many communities are self-managed and strapped for time as it is, so this new ordinance overlooks how impractical it may be for a volunteer board to advise the county about the status of every pending sales and leasing application. And, since there are already fair housing mechanisms in place to combat discriminatory practices in Broward County (and practically every other location in the country), the public purpose being served by the implementation of this ordinance remains to be seen.

Use Abundance of Caution

For those of you managing associations outside of Broward County, the question remains whether you should communicate the reason an application for purchase or lease was denied. Most association attorneys would agree that any communication in this area should flow only to the owner of the unit and not to the applicant. The reason for this is that the owner has what is called "privity" with the association, meaning it is the party who has standing to enforce the association's governing documents.

If you do communicate a specific reason for the denial, it is then the owner's decision whether to relate that information to his or her applicant. Of course, if your association's governing documents or your state's statutes or county ordinances outline a specific procedure for this communication, then that must be followed.

Some communities have begun requiring owners to conduct their own background checks on the people to whom they plan on renting or selling their property, in addition to the association running one. This protocol results in the owner having the pertinent information at his or her fingertips without the association having to involve itself in the process of relating the reasons for a denial. Of course, if the board is inclined to deny an application and the screening results don't support such a denial, then there's going to be a problem.

Every application presents its own unique set of facts and circumstances, so it's essential that you discuss how to handle each with your association attorney. Finally, words count, so the manner in which you frame the association's thoughts and decisions requires deliberation and some measure of finesse. ♦

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RECENT COURT RULINGS

➤ Late Fees Must Be Reasonable Under 'Totality of Circumstances'

Facts: An association sued a member for unpaid common expense assessments, among other fees and charges. The trial court ruled in the association's favor and awarded damages that were more than what the member owed. After the association informed the court that the member didn't owe as much, the court reduced the award to several thousand dollars less than the member's debt. The new award didn't include late fees the member owed. The court stated that it hadn't included them because the fees were so high they "constituted an unenforceable penalty." The association appealed.

Decision: A New Jersey appeals court reversed the trial court's order for damages.

Reasoning: On appeal, the association argued that the trial court erred by reducing the amount of the claimed assessments and charges so drastically, and by refusing to award the late fees. The appeals court

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noted that the trial court said that the late fees of 14 percent constituted an unenforceable penalty—but failed to explain how it arrived at those percentages. The appeals court stated that, moreover, the trial court also didn't properly analyze whether the late fees were even enforceable.

Typically, late fees like the ones in this case are enforced if they are determined to be reasonable under the "totality of the circumstances," said the appeals court. In assessing the reasonableness of such a fee, the court should consider: (1) the difficulty in assessing damages; (2) the intention of the parties; (3) the actual damages sustained; and (4) the bargaining power of the parties. The court may also consider what is permitted by statute and what constitutes common practice in a competitive industry.

Here, the trial court apparently determined that the late fees were unenforceable because they were too high. But the court didn't consider the totality of the circumstances, including the provision of New Jersey's Condominium Act that permits late fees to be assessed by a condominium association for delinquent payments, said the appeals court. It sent the case back to the trial court to determine whether the late fees imposed are reasonable and enforceable, in light of the totality of the circumstances.

- Whitehall Manor Condo. Assn. v. Burch, Nov. 2013

➤ Association Had No Fiduciary Duty to Member

Facts: A member noticed a window leak in her two-story penthouse unit. For several years after, the member reported that and other water leakage problems to the association's board. The association eventually waterproofed the exterior masonry, which resolved the problem. But a dispute arose over the need to replace the unit's wall of windows and over who should bear the cost of replacement.

The association contended that members owned the windows in their units and were personally responsible for replacement costs. The member claimed that her wall of windows didn't need to be replaced, but that the association should be responsible for any replacement costs because windows are a "common element." She sued the association, arguing that any need for replacement was caused by the association's alleged failure to maintain the exterior of the building as required by the governing documents—a failure that was a breach of its fiduciary duty to members.

After a jury trial, a trial court ruled in the member's favor. It determined that the windows needed to be replaced and replacement was necessary because the association hadn't exercised reasonable care in maintaining the building's exterior. It found that the association breached its duty to exercise "good faith and loyalty" in making decisions with respect to members. It awarded $54,000 to the member.

The association appealed. An appeals court reversed. The member appealed again.

Decision: The Supreme Court of Kentucky determined that the association hadn't breached its fiduciary duty, and thus upheld the appeals court's reversal.

Reasoning: The Supreme Court of Kentucky concluded that the association didn't have a fiduciary duty to individual owners. The association was a nonprofit corporation, which in Kentucky doesn't have a fiduciary duty. Rather, said the court, the officers and directors have a fiduciary duty, but that duty is to the nonprofit corporation, not the owners of individual units.

Because the association was contractually obligated to maintain the exterior of the building, the jury could have determined that its failure to do so breached its general contractual duty to act in good faith. But a jury's finding of failure to act in good faith isn't necessarily equivalent to a finding of a breach of fiduciary duty. The court noted that, in a fiduciary relationship, the fiduciary—here, the association—must make every effort to avoid having its own interests conflict with those of the principal—here, the member.

"When conflict is unavoidable, the fiduciary must place the interests of the principal above his own," the court said. "A fiduciary duty requires more than the generalized business obligation of good faith and fair dealing," it explained. Because the jury awarded $54,000 in damages as a result of a breach of fiduciary duty and not breach of contract, the court upheld the appeals court's reversal. The trial court should've dismissed the fiduciary duty claim. ♦

- Ballard v. 1400 Willow Council of Co-Owners, Inc., Nov. 2013

DOS & DON'TS

✗ Don't Invoke 'Good Standing Status' Without Checking Association Rules

If a member violates a rule, you might be tempted to deem him a "member not in good standing," and use that status to deny him certain privileges in the hopes that he'll rectify the situation. But in order to do this, the association's rules must provide for using good standing as a basis for revoking privileges.

That's what an Ohio court ruled several years ago in a long-standing decision where a member sued her association to reinstate her rights after they had been revoked because the association said she was a member not in good standing. There, she had asked for permission to use a locked entrance to exit the community, rather than driving a longer distance to reach the main gate. When she used the locked entrance despite her request being denied by the association, she was fined. Her refusal to pay prompted the association to deny her use of the clubhouse and revoke her speaking privileges at town meetings.

The court dismissed her lawsuit against the association. The court ruled that because the association's rules stated that all members are responsible for paying any fines against them, and failure to do so within the time period allotted would result in the member's being deemed "not in good standing," it was entitled to deny her those privileges [Kitchen v. Lake Lorelei Property Owners' Assn., Inc., June 2012].

✓ Use Plants to Improve Common Area IAQ

Take advantage of interior landscaping to do more than just improve the aesthetic of your community's common areas. Interior landscaping improves indoor air quality (IAQ) and can even lower your energy costs. Plants filter air by absorbing pollutants and they produce oxygen—which is especially helpful in sealed, energy-efficient buildings that have less exchange of fresh outdoor air for stale indoor air. Plants also maintain an appropriate humidity level, keeping it lower than the level at which it can cause mold and bacteria to grow. You can realize cost savings benefits, too. Plants used in interior landscaping can decrease the indoor air temperature by as much as 10 degrees, reducing the need for as much air conditioning as you might usually use.

To set yourself up for these benefits, hire an interior landscaping contractor who can properly select, install, and maintain your interior landscaping. This way, you can make sure your plants will thrive, and even "pay for themselves" eventually. But don't forget to factor in your budget and communicate this to the contractor you choose. ♦

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act prudently when compensating for any budget shortfall, to minimize negative consequences to the community.

Circumstances Beyond Your Control

There are several reasons for budgetary shortfalls. Even with good contingency planning, boards may still encounter situations in which they incur a significant expense for which they had not adequately budgeted.

Market forces. Changes in the costs of goods and services can have a significant impact on an association. Over the past several years, associations have seen an increase in insurance premiums. Oil prices, which have a direct impact on an association's utility costs, have risen as well.

Weather. This could be anything from a heavier-than-anticipated snowfall to structural damage caused by windstorms or pollution. For example, in California, the fire season has become year-round due to drought, electrical storms, and other weather conditions.

Inadequate budgeting. As common elements age, boards are aware that they can require

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increasing levels of maintenance and repair. But oftentimes, the appropriate levels of repair needed in a given year are unpredictable when the budget is prepared. The unpredictability makes it difficult for boards to accurately forecast a budget for general repairs and maintenance. Another example of inadequate budgeting would be a common mistake, such as a budget that doesn't reflect a contractor's annual price increase that has already been approved in the contract with the association.

Capital "crunch." There's an ongoing possibility with all associations that common elements may have failed unexpectedly or the repair or replacement expense of something in the community is substantially greater than what was anticipated.

Five Strategies for Addressing Shortfall

Although each association's specific circumstances are unique, here are some strategies boards can evaluate and review with their professional advisors to be able to address their specific needs.

Strategy #1: Utilize prior year's accumulated surplus. If such a surplus exists, then depending on the nature, magnitude, and timing of the expense, it may be appropriate to spend some or the entire surplus to resolve an outstanding obligation.

Strategy #2: Use prior year's accumulated working capital contributions. At the time of closing on a home, many associations collect working capital contributions that are used for the association's working capital needs. It's a smart idea for associations to maintain approximately three months of operating expenses in this fund. If there's an excess of three months of expenses in the fund, the board should consider using it to address an unexpected need.

Strategy #3: Amend current year's budget. Certain expenditures, such as a sizeable increase in insurance premiums, affect both current and future members. In this situation, it may be advisable to amend the maintenance budget immediately and increase maintenance fees accordingly.

Strategy #4: Borrow funds. There are some scenarios in which obtaining financing can be an appropriate and viable approach to address the association's funding needs. Borrowing funds may be used with, or instead of, the previously listed options. Associations usually resort to obtaining a loan only for capital replacement projects, such as repairing or replacing roofs and sidewalks. But borrowing could also be appropriate when capital reserves would be depleted to the point that they could no longer sufficiently cover other anticipated capital replacement projects, a special assessment may be unaffordable, or a project would need to be extended over a time period that would create undue hardship or inconvenience to the members.

Strategy #5: Impose special assessment. You may consider imposing a special assessment—that is, an extra one-time payment members must make for a specific purpose—on your members. Although your association's governing documents almost certainly provide for the possibility of special assessments, members tend to expect their monthly payments to stay about the same. And, unlike modest annual increases in regular assessments, special assessments can strain the budgets of your members who may still be struggling or just getting back on their financial feet again after the recession.

Even members who can afford a special assessment won't be happy to pay unless it's absolutely necessary. After all, one of the great features of belonging to an association is the opportunity to share with other members the cost of amenities and services that members couldn't afford on their own if they weren't living in a planned community. For tips on how to tactfully ask members for additional money for a special assessment, see "Get Members Ready for Special Assessment," in the November 2013 issue of the *Insider.*

PRACTICAL POINTER: You can also try reducing expenses, which is always prudent. But an expense reduction by itself usually isn't enough to provide the needed funds for unforeseen circumstances. Reducing expenses along with deferring any expenses that can be—like a payment arrangement with a vendor that can be renegotiated and deferred—might add up to enough to assist with current cash flow needs, though. ♦

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