Community Association Management Insider®

Helping You Run Your Condo or Homeowners Association Legally and Efficiently

NOVEMBER 2016

FEATURE

Here's how you can make construction defect claims as painless as possible for your association.

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PRODUCED IN CONSULTATION WITH

community ASSOCIATIONS INSTITUTE

Strategically Pursue Construction Defect Claims

Association living has many perks, and it seems that around every corner there is a new development with condos, townhouses, or freestanding homes. But after the excitement of a new planned community or condominium building dies down, and you and your property management company have been hired to manage the association, members could begin to find construction defects. Because construction defect claims can be complex, time consuming, and expensive, they are one of the most difficult issues that you'll face. Here's what you need to know in order to navigate this potentially long and winding road for your association.

Understand Nature of Problem

A construction defect is almost any condition resulting from improper construction that reduces the value of a home, condominium, or common area. Courts throughout the United States have recognized two primary categories of defects for which damages are recoverable by a homeowner or a homeowners association:

Category #1: Defects in design, workmanship, or materials. Defects in design, workmanship, and materials include dry rot, water seepage, faulty drainage, improper landscaping and irrigation, termite infestation, improper materials, structural failure or collapse, defective plumbing, faulty electrical wiring, inadequate environmental controls, defective lighting or security, insufficient insulation and poor sound protection, inadequate firewalls or equipment, and many other problems.

Category #2: Soil or settlement problems. Soil and earth settlement problems include movement in the home caused by expansive soils, underground water or streams, ancient landslides, vertical settlement, horizontal movement, land sloughing or sliding, surficial failures, improper compaction, inadequate grading, and poor drainage.

Structural failures can result from these problems, with both personal injury and substantial property damage exposure. Soil and settlement conditions may result in the collapse of roofs; cracks in slabs, walls,

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foundations, and ceilings; disturbance of public or private utilities; or a complete undermining of the structure.

Don't Forgo Legal Counsel

When faced with construction defects in the community, many association boards are tempted to take shortcuts in order to save money. Boards may act on members' behalf to resolve the construction defect without consulting an attorney or hiring an engineer or architect to evaluate construction defects rather than letting the association's legal expert engage that person or firm. But it's crucial to use an attorney to handle these types of claims.

That's because, if a board arranges for an expert evaluation, there is a greater risk that the association won't hire the most credible expert. More important, the engineer or expert's drafts and notes all fall under the "work product" exception to discovery requests when experts are hired by counsel instead of the association. That is, the association might not be required to automatically and/or immediately turn over that information to the party or parties it's suing or seeking relief from. It's in the association's interest to preserve the confidentiality of these reports until the final report is turned over to the developer.

Unfortunately, instead of hiring an attorney, an association may attempt to utilize you as its property manager to negotiate a settlement. There are profound risks to both the association and you in doing so. As fiduciaries of the members of the association, board members are at risk for being held liable if an otherwise viable claim for defective construction is impaired or lost through their neglect.

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COMMUNITY ASSOCIATION MANAGEMENT INSIDER [ISSN 1537-1093 (PRINT), 1938-3088 (ONLINE)]
is published by Vendome Group, LLC, 216 East 45th St., 6th Fl., New York, NY 10017.

Volume 16, Issue 5

SUBSCRIPTIONS/CUSTOMER SERVICE: To subscribe or for assistance with your subscription, call 1-800-519-3692 or go to our website, *www.CommunityAssociationManagementInsider.com*. Subscription rate: $370 for 12 issues. **TO CONTACT THE EDITOR:** Email: *egibney@vendomegrp.com*. Call: Elizabeth Purcell-Gibney at (212) 812-8434. Fax: (212) 228-1308. **TO PLACE AN ADVERTISEMENT:** Please contact Heather Ogilvie Stone at *hstone@vendomegrp.com* or call (212) 812-8436.

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Construction defect claims are complicated both from a legal and an engineering point of view. And being untrained in the law and often inexperienced in claims negotiation, an association manager is at a serious disadvantage when dealing with a seasoned builder or insurance adjuster that uses its own legal counsel. Furthermore, regardless of your training or experience, if you undertake negotiations for a resolution of the legal claims of the association for construction defects, you could be considered to be "engaging in the unauthorized practice of law." In that scenario, you wouldn't have any insurance protection for your acts or omissions while engaging in the unauthorized practice of law. Moreover, because the resolution of a construction defect case is outside the scope of the management agreement, there may be no insurance to protect either you or the association, which may be harmed by your error.

Bolster Legitimate Claims with Stellar Performance

So what is your role during a construction defects situation? Unfortunately, a manager is stuck in the middle between the developer and the association in these circumstances, most notably when conflicts of interest arise because the manager was originally hired by the developer and his contract was renewed after the developer turned control of the association over to the members. When faced with a conflict of interest due to an arrangement like this, be fair and objective.

Another conflict of interest happens when defects arise because a manager hasn't properly maintained the property. This is a problem because if an association brings maintenance issues to the developer, citing them as warranty claims, this reduces the credibility of any true structural defects in the community. From the developer's point of view, construction defect claims from the association will be seen as not only trying to get the developer to fix structural defects, but also handle all the deferred maintenance.

One of the primary responsibilities of the manager is to maintain the property during the warranty period. The manager should utilize the money in the budget that has been set aside for maintenance.

EXAMPLE: There's money in the budget to paint wood trim. The manager forgoes painting the wood trim and, as a result, the wood rots and the association makes a claim against the developer. The developer's response might be to ask when the manager last painted it, and to argue that if the manager properly maintained the wood trim, this would not be an issue.

Being an active manager who properly maintains the community during the warranty period makes it easier to separate maintenance issues from warranty defects. Managers who don't perform proper maintenance are essentially just giving the developer defenses against construction defect claims.

Use Experts Wisely

An association doesn't need a very sophisticated inspector to look at stick-built townhouses. However, an association for a high-rise building with multiple central systems will need a fairly sophisticated engineer to evaluate any problems.

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For example, many of these buildings have complicated electrical components for their fire control systems and air conditioning compressors that need a high level of expertise for any sort of evaluation.

When you're working with an expert, it's important to give him a clear request for a proposal or clear statement about the services you require. If an association asks an engineer in general terms what's wrong with a building, then for the sake of his own liability that engineer will report on everything that's wrong. Experts are not able to separate what is legally a structural defect from problems that aren't.

Experts should separate out maintenance from construction defect claims. If experts are not able to identify structural defects that are covered by a warranty, they need to work with an attorney. A draft report may have items on one side of a line, and the attorney will be able to say whether or not an item is a warranty defect. This process will produce a final engineer's report with input from counsel that will be taken seriously by developers.

Engineering reports should be thorough, and reasonable claims should be inferred from them. To reduce the cost of an engineering report, boards frequently want just a basic sampling. They will look at only a few units, and because they found something in a few units they will extrapolate from this information that the problem exists everywhere. This isn't necessarily the case. For example, a carpenter or the caulking subcontractor may have had a bad day, so there may be a few bad windows, but this doesn't mean that all the windows in the community are defective. Categorical statements to the developer make it more difficult to reach a settlement. The engineer has to make a representative sampling, and the association should not always generalize immediately, but rather look for evidence that a problem exists elsewhere.

Weigh Options with Association Attorney

An organized report by type of defect, location, and categories such as plumbing, electrical, or structural will most likely garner a more meaningful response from the developer and make it easier to negotiate a reasonable settlement. As a result, it should be the responsibility of the association's attorney to get a fair and thorough engineering report that highlights those defects covered under a warranty.

The attorney also has to look at and evaluate the potential avenues of recovery for the association. Before filing any lawsuit, the attorney will help the association make an early determination as to whether a lawsuit is economically feasible. The association must carefully balance the cost of litigation against the amount of the possible recovery.

Unfortunately, the builder is not always still around when the defects become apparent. An unscrupulous builder may create a new corporation for the construction project. After construction is completed but before the problems start to appear, the corporation is then dissolved, leaving the association with the difficult task of finding someone to sue. In other situations, the builder may have filed for bankruptcy, which may effectively bar subsequent suits by homeowners.

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In some cases, if the developer exists, an attorney will be able to find out if its insurer provides coverage for the types of defect your association may claim. Even if the developer is bankrupt or out of business, the insurer may still be responsible to that developer, and may have to pay claims based upon negligence, strict liability, or breach of warranty.

The insurance in effect when the damage is first noticed may be a source for payment of the defect claim. Sometimes a developer's attorney may work with an association's attorney to characterize a defect to be, for example, consequential damages because consequential damages are covered under certain builders' risk policies where a structural defect may not be covered. You may be pleasantly surprised to find out that, although your community's builder doesn't have any money for recovery, it still wants to assist the association in getting the problem resolved. ♦

RECENT COURT RULINGS

➤ Property Manager Wasn't Personally Liable for Alleged FHA Violation

FACTS: A condominium owner sued the property manager of the building's association, alleging violations of the Fair Housing Act (FHA) because the manager had attempted to enforce rules regarding the owner's emotional support dog. Despite the association's rule that no unit owner may appropriate the common elements for her own use, the owner had installed an underground invisible fence within the common elements of the condominium to dispense with the need to walk or constrain her emotional support dog while it was outside her home.

The association initiated an arbitration proceeding against the owner, seeking an order requiring her removal of the invisible fence. The owner claimed that the manager violated the FHA by: (1) failing to reasonably accommodate her need for an invisible fence to constrain her emotional support dog; and (2) failing to make modifications to the condominium property to accommodate her need for an invisible fence.

The property manager asked a court for a judgment in her favor without a trial. She asserted that she couldn't be held *personally* liable for any FHA violations.

DECISION: A Florida trial court ruled in favor of the property manager.

REASONING: The court concluded that the property manager hadn't personally assisted or contributed to any FHA violations. It explained that while discrimination under the FHA includes "a refusal to permit, at the expense of the handicapped person, reasonable modifications of existing premises occupied or to be occupied by such person if such modifications may be necessary to afford such person full enjoyment of the premises," there was no evidence that the manager was personally liable. The court noted that the manager had no personal involvement with the association's refusal to accommodate the invisible fence because the association, through its board members, concluded that the owner's

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Recent Court Rulings

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invisible fence was in violation of its rules; the association directed the manager to send violation letters requesting that the owner remove the invisible fence; and the association's board voted to refer the matter to its attorney after the owner failed to comply with the two violation letters. Property managers who are acting at the behest of an association or its attorneys can't be personally liable for "ministerial" functions, such as sending correspondence, that they perform as part of their professional duties. ♦

- Sheets v. Sorrento Villas, October 2016

IN THE NEWS

HOA Advocate: Education Is Key to Board Members' Success

Community Associations Institute (CAI) recommends education and training for the 2.35 million volunteer community association board and committee members nationwide.

A new public policy to address the issue of state-mandated training for community association board members has been approved by the Community Associations Institute (CAI), an authority for community association education, governance, and management. In a press release, CAI explained that being elected to the board of directors of a condominium, co-op, or homeowners association is serious business; today, nearly every state in the U.S. has laws governing the authority of community association boards.

CAI encouraged any state or local government that's exploring new legislation and regulations regarding community association board education, including any education requirement, to encourage board members to use the industry's existing educational resources.

CAI experts say that educating volunteer board members is essential to the success of associations. CAI strongly recommends that associations voluntarily adopt the following practices for the 2.35 million board and committee members working an estimated 78 million hours to serve their communities:

- Each newly elected board member should certify in writing within 90 days following election that he/she has read the association's governing documents;
- Board members should engage in training to increase their knowledge, professionalism, competence, and effectiveness as leaders of community associations;
- Board and committee members should attest and annually reaffirm that they comply with CAI's Model Code of Ethics for Community Association Board Members; and
- Community association boards of directors should approve a resolution to adopt and comply with CAI's Community Association Governance Guidelines and CAI's Rights and Responsibilities for Better Communities, and renew that resolution annually. ♦

Q&A

Banning Outspoken Board Member from Executive Sessions

Q The president of the board of directors for the association I manage complained that the board was threatening to exclude her from sessions because she had talked about confidential information to nonboard members and had stated that she would continue to do so. She asked me whether it was permissible for the board to do that. I've never encountered this problem in my association management career so far. Could the board ban a board member from attending meetings because of what it regards as inappropriate behavior?

A No, according to the ruling in a recent Arizona homeowners association court case with similar facts. There, a homeowners association employee sent an email to a member of the board of directors (board member) and several other people, alleging that the association manager had engaged in wrongdoing. The board member brought the matter to the attention of the other board members, who consulted with the association's attorney. Concerned about a defamation lawsuit, the attorney advised the board to stop disseminating the email. The board member refused to do so and attempted to read the email in the next open meeting.

Subsequently, the remaining members of the board passed a motion excluding her (despite the fact that she was a duly-elected member of the board) from attending the board's executive sessions.

The board member asked a trial court for a preliminary injunction seeking to compel the board to allow her to attend its executive sessions, but the trial court denied the request. The board member appealed and an Arizona appeals court reversed.

The appeals court concluded that the board lacked authority to exclude the board member from its executive sessions for several reasons. First, neither Arizona law nor the association's bylaws authorized the board to pass a motion excluding any board member from all executive sessions. To the contrary, by passing the motion, the board prevented the board member from performing her duties and responsibilities as a director.

And, as a member of the board, Arizona law requires the board member to participate in managing the affairs of the association, said the appeals court. It noted that the association's bylaws required the board member to participate in managing the affairs of the association. Participating in executive sessions was critical to performing her duties as a director.

The appeals court explained that a special meeting held in the absence of some of the directors and without any notice to them, is illegal "except in those cases where the articles of incorporation, bylaws, or established custom so provide, or where it is impossible or impractical to give notice." That wasn't the case here.

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Q&A

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The association contended that because the board member refused to keep executive session information confidential, excluding her from executive sessions was the "only practical option available," and therefore a reasonable exercise of its discretionary powers. The appeals court disagreed. Instead of resorting to an unlawful self-help remedy, the association could have taken other courses of action to protect confidential information. For example, the association could have sought to remove the board member from the board by filing a judicial removal action. The association also could have sought an injunction prohibiting the board member from disclosing confidential information discussed in executive session.

The appeals court stressed that a board may, in certain circumstances, request that a director recuse herself from an executive session. Additionally, there are situations where a board may be warranted in obtaining a court order excluding a director from an executive session. For example, it may be necessary to exclude a director from an executive session addressing the director's conflict of interest, alleged misconduct, or potential litigation involving the director. However, these potential circumstances weren't a part of this case, the appeals court said [McNally v. Sun Lakes Homeowners Assn. #1, Inc., October 2016]. ♦

DEALING WITH BOARDS

Don't Leave Annual Member Meeting Details for the Last Minute

Managing a condominium building or planned community is undeniably challenging; balancing the needs of members, the board of directors, your own staff, and contractors or third-party vendors can be like a juggling routine. You might feel as though each day you're interviewing for your own job. A great opportunity to both shine as a manager and execute one of the most important events of the year is the annual member meeting.

Value of Well-Planned Event

An efficient annual member meeting not only encourages future member participation, but also exhibits your and the elected directors' expertise and leadership skills. The success of this meeting goes a long way toward building trust in board members to protect and faithfully serve the community's interests. Given the importance of this yearly event, you should already have—or now create—a checklist of meeting preparation steps. If no checklist exists, create one with a list of tasks to get you to the finish line. Work with your staff to adapt our *Model Form: Annual Meeting Timeline,* for your own meeting needs to accomplish necessary tasks.

To fill in the timeline, work backwards from the meeting date to prepare for the meeting. There are four columns: date, number of days before the meeting, tasks to complete, and explanatory notes. ♦

➤ ➤ ➤ *Model Form follows* ➤ ➤ ➤

ANNUAL MEETING TIMELINE

ANNUAL MEETING DATE: _____

Fill in Date	# of Days Before Meeting	Tasks to Complete	Explanatory Notes
	120	Review governing documents.	
	110	Discuss annual meeting agenda at board meeting.	If special speakers are needed, contact them for availability.
	105	Reserve space.	Make sure attorney can attend.
	100	Send notice of annual meeting.	Include deadlines for filing candidacy and record date.
	75	Draft annual meeting materials.	
	70	Nominations/biographies due.	
	65	Board meeting—get approval of annual meeting mailing materials.	Include cover letter, ballot/proxy, meeting information, year-in-review budget summary, proposal summary, nominee information.
	53	Record date.	No adjustments to property status regarding annual meeting votes are made after this date.
	50	Send annual meeting packets.	
	40	Board approval of annual meeting agenda.	
	20	Send reminder postcard in mail or email.	Remind members that ballots/proxies will be due in two weeks.
	9	Secure volunteers and organize training sessions.	
	5	Conduct volunteer training.	Review annual meeting setup and sign-in procedures.
	4	Ballots/proxy cutoff.	Do not accept ballots/proxies after cutoff date.
	3	Verify ballots/proxies and tabulate.	Check delinquent report and pull ballot/proxy cards of delinquent members.
	1	Pack up supplies and double check all miscellaneous items.	Trash bags, equipment checks, etc.
	0	Execute the plan.	