



Community Association Management Insider®

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JUNE 2018

FEATURE

Here's how to ensure drama-free continuity of operations and minimize an interruption in services.

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Get Association Ready for Management Transition

Buying a home in a community association is a serious investment, so many homeowners and members live in their units for an extended period of time. Although it sometimes seems like an on-site association manager is part of the community because she's on the property continually, this is a job and, at some point, the manager or the management company will inevitably leave. The question that concerns owners and the board of directors at that point is whether the transition to a new manager and company will be smooth and productive.

Because managers and management companies are professionals, transitions largely are not as rife with issues as owners and board members sometimes fear. If the current manager and management company have acted responsibly and fulfilled their duties as part of the contract during their tenure, a transition to new management will be easier than if they are leaving on bad terms because of unprofessional or even illegal behavior. No matter what the catalyst for a change in management is, there are multiple factors that associations, boards, owners or members, and incoming or outgoing managers should take into account to ensure the drama-free continuity of operations and minimize an interruption in services.

Two Issues Take Center Stage

"The most difficult issues in a management transition are finances and lawsuits," says California association management expert Clifford J. Treese. "Many times, a new management company won't take over financial books and records unless a certified public accountant (CPA) is willing to come in to review them," he notes, "and if the current company can't do this or there is a delay for some reason, it can be a red flag." Treese points out that sometimes the refusal or delay in providing records is due to incompetency, but sometimes it's due to malfeasance or stolen funds; either way this is worrisome.

Other than financial issues such as assessment collections, which ultimately are straightforward, litigation could be in play. "Litigation

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is an issue that's more complicated," warns Treese. The incoming management company could be inheriting a serial litigant, and some companies might not bid on a management contract if there are warning signs such as frequent lawsuits. However, the good news is that most management companies talk to CPAs and reserve study specialists among other association experts to determine whether taking on an association is risky. Even an association that has some risks usually can still find a management company that will take it. Companies with experience will look at their portfolio of clients to see which are profitable and which are not. So if your association would turn a profit for them, some ongoing problems might fly under the radar.

Regardless, an incoming management company will ask the board questions about litigation and will discuss this with the outgoing company. This can be handled fairly quickly.

Remember that, typically, unless a management company has recently been formed and has no experience, it's used to taking over a new association and leaving an old one in the hands of a new company. It will be aware of the difficulties involved. In fact, management companies usually don't make a profit during the first year of a change. That begins to change in the second year, after detailed work of establishing the account is set up.

Dealing with Departure of On-Site Manager

One of two scenarios in a management transition that the board should be aware of is the departure of the on-site manager. Even during periods of time when it seems like things are going smoothly, boards should make sure at least one other

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person knows what's going on in the office. This could be the board's treasurer, secretary, or president, or a reliable office staff member. It's critical that more than one person knows the general status of operations and how to access records. You can keep track of what's going on in the office by holding a quick weekly meeting to touch base with the manager.

Under amicable circumstances, boards can give the on-site manager sufficient notice and severance pay as an incentive to train an incoming manager and prepare reports with the full information that the board and new manager will need. But what about a departure under negative circumstances? If you've been proactive enough as things have gone along, it won't be an issue, but in the real world that doesn't always happen. Try to get at least the following items before the manager leaves: (1) meeting notes; (2) correspondence; (3) reports; (4) a current list of all aspects of operations; (5) financial information; and (6) the location of the information and documents that formed the substance of the last board meeting as well the material that went into creating the annual budget.

Remember that damage control is crucial. If the manager is fired or leaves in a hurry before revealing passwords and the location of information, the board will have to reconstruct everything and could be forced to call an IT company to access the management office's computer and reclaim passwords. You could face a situation where you are required to maintain specific records (like payroll records for taxes) and they don't exist because of incompetent staff or because they were thrown away by a vindictive employee. And be aware that recovering financial information is especially important because bank accounts must be reconciled. Time is of the essence when financial records must be recovered.

Check Contract for Departure of Management Company

It's important for the board to understand its contract rights when its relationship with an outside management company ends. Otherwise, a management company could end up taking actions it's not entitled to. Ideally, at the outset of the relationship the board negotiated terms and conditions in its contract with the management company that allow the board to stay on top of things, such as a monthly reporting requirement. Don't be afraid to ask the management company to provide draft minutes so you can recreate records later if you must. Build into the management contract whatever reporting requirements the association wants and how much time it wants to spend with the outside manager.

It's important to understand that the management company works for the association, so don't be afraid to designate whatever level of disclosure or detail the board feels is useful. But don't micromanage; the board doesn't need to sit down every day with the manager. Find a reasonable balance. A weekly report or even simply a log sheet of the manager's actions might suffice. It'll at least give the board a level of comfort that tasks and goals are being accomplished. Usually, selecting one board member as the manager's liaison is an efficient way for the board and manager to communicate in between board meetings.

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Prioritize What Information to Obtain

The new manager and anyone filling in between managers must be on top of accounts receivable, bank accounts, due dates and payment of bills, where money is applied, and the maintenance and pursuit of the association's delinquency list. In a negative situation there may be a time crunch and you'll have to prioritize what information to press for. If it's possible to recover only some of the information you'll need for the transition, determine what's crucial and what's secondary. Think about what the board and new manager can reconstruct on their own and focus on what can't be retrieved without the current manager. For example, you can recreate contracts with vendors by contacting them for help and you can ask the bank for statements and returned checks to get a sense of what's been happening financially.

It's easy to get another run of a report, but other items like meeting minutes are going to be a problem. Paying bills is one of the most important tasks during a transition. Make sure that utility payments have been made so that services continue.

Unfortunately, one of the most important pieces of information—material alterations of homes and violations that were grandfathered—may not be available, and it could cause problems for the new manager. If the association has an architectural control committee, you may not be able to reconstruct records as to who has permission to do what to a member's property. Whether changes were grandfathered or whether they were done without approval becomes an issue because in order for the association to enforce rules going forward it has to show that it has uniformly and consistently enforced them in the past.

Assuage Members' Fears

Some receiving companies hold a "meet and greet" session at the time of a change in management, says Treese. It's one thing to receive a letter, but because there's an open board meeting every month, an introduction in person is a nice gesture, he notes. Treese says that he has made sure to bring in the new management company or manager half an hour before then for an introduction and serves snacks and drinks.

There are some key players that you should consider bringing to the meeting. This certainly includes the manager, who incidentally has to be in attendance at the board meeting, but it can also include whoever is in charge of accounting. In addition, if there is repair work or landscaping that is currently or about to be done, bring in whoever is necessary to talk about physical asset management. Members are usually interested in visual aspects of the community and are concerned that things will change or go downhill with a management transition.

While it's helpful to keep members informed about management changes, keep in mind that you don't have to disclose to members that a negative situation has left the board struggling to keep operations running smoothly. It's a board judgment call as to what to tell members, for example, if documents have to be reconstructed because of a managerial oversight or the quick departure of a

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manager or management company that's not something that's automatically on the table for discussion. So try not to make members needlessly worry.

If there has been an incident that makes it clear that the manager's departure has been negative, a board should be judicious about what it says regarding the switch; let everyone know in a neutral way that there will be a new manager. You can acknowledge that it's unfortunate that the outgoing manager didn't work out, but play up the new manager's experience and positive attributes and encourage members to stop by and introduce themselves—especially to an onsite manager.

When it's clear that members know that there was a negative situation or much more investigation is necessary, talk to the association's attorney about whether you should say that irregularities existed, but agree on the best way—or whether to—disclose information about it.

Assemble Team to Ensure Competency

If you experienced a rushed or negative departure and had a difficult transition to new management as a result, you should be especially aware of how important it is to prepare ahead of time for the next transition even if a new manager has just started. If you haven't had the displeasure of dealing with that type of situation, it's still critical to prepare for future management changes.

Every association should routinely update its job description of what the manager or management company is expected to accomplish and do periodic performance reviews so long periods of time don't pass without knowing that problems exist. By contract, a new manager should have a 60-day (or some specified) performance period before a review and then a review every few months to pinpoint any weak spots to improve or to point out areas where the manager has been performing well.

Nobody is a perfect employee, and a great manager could have strengths in one area but weaknesses in another. For instance, your manager might get great bids on projects, be a whiz with numbers, help at budget time, and take site inspections very seriously, but lack organizational skills. Don't hesitate to hire an administrative assistant who can organize the office, make sure deadlines are met, and keep track of records. Or if an otherwise great manager has trouble with financial issues, the association could hire an outside financial firm.

You don't have to teach a manager about an area that she has trouble with if you can create a support system that together gets the job done. Transitioning to a new manager and making sure operations run smoothly during her tenure is a team effort all around.

Because it's particularly important for boards to pay attention during a management transition, a checklist of records that need to be kept is very helpful. Within each category of records, break down the specific items you need. For example, under the "financial records" category, there should be a disclosure of the location of copies of "accounts payable and receivable" and the "delinquency reports." Other important items to put on the checklist include:

- Copies of insurance policies and insurance claims;
- Amendments to documents;

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- Copies of meeting minutes;
- Rules and regulations;
- New buyer welcome packages;
- Reserve study;
- An inventory of management office equipment; and
- Architectural review committee reports.

A checklist will let you know what you're supposed to have when it comes to a turnover in management. This isn't an undertaking that will help you just with a change in management—state statutes might require the association to have some of these items as official records, anyway. The key to making this a useful strategy, however, is to make sure they are updated as needed. ♦

Insider Source

Clifford J. Treese: Association Data, Inc., Mountain House, CA.

RECENT COURT RULINGS

► Association Obligated to Provide Flood Insurance

FACTS: An association maintained flood insurance for five of the buildings in its multi-building property. All five buildings were in flood zones as designated by the Federal Emergency Management Agency (FEMA). The association later decided not to renew the flood insurance policy, citing concerns regarding cost and the allocation of the expense among the other members of the association who lived in the non-flood exposed buildings.

The association notified all owners in the community of its decision not to renew the flood insurance policy in a detailed letter, in accordance with the terms of the declaration, which it asserted did not require flood insurance. The association declined several homeowners' subsequent requests that the association resume purchasing and maintaining flood insurance on the five buildings.

The homeowners asked a trial court for a declaratory judgment that the association was in fact obligated to provide flood insurance. The trial court ruled in favor of the association. The homeowners appealed.

DECISION: A North Carolina appeals court reversed.

REASONING: The appeals court reviewed both the state's condominium act and the declaration. It noted that the act requires a residential condominium association to maintain insurance "against all risks of direct physical loss commonly insured against," so long as the insurance is "available." The appeals court pointed out that the declaration contains two sections that govern the association's purchase of insurance.

The first section provides generally that the association is to maintain insurance coverage in accordance with the act to the extent that such insurance is "reason-

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ably available.” The second section addresses property insurance specifically and provides that the association is to maintain property insurance against “all risks of direct physical loss.” Importantly, the declaration also explicitly provides that in the event of a conflict between the terms of the declaration and the act, “the provisions of the Condominium Act shall control.”

The association essentially argued that: (1) the phrase “all risks of direct physical loss” is limited in the declaration by the phrase “including fire and extended coverage perils”; and (2) the risk of flood is not a risk of fire or a risk commonly understood as an “extended coverage” peril. The association relied heavily on an affidavit from the attorney who drafted the declaration. In the affidavit, the attorney stated that flood is not an “extended coverage peril” and that the peril of flood is not “commonly insured against in property and casualty insurance policies.” However, the question is not whether the risk of flood is commonly insured against only in property and casualty insurance policies; rather, the question is whether the phrase “all risks of direct physical loss” is limited to only risks associated with fire and extended coverages, the appeals court said.

It concluded that the phrase “all risks of direct physical loss” is not limited by the phrase “including fire and extended coverage perils.” Had the intent been to limit the association’s obligation to maintain only those coverages contained in a standard fire and extended coverages policy, the community’s declarant could have stated as such. The word “including” indicates an intent to enlarge, not limit, a definition, it added.

The appeals court further held that “flood” is a risk of direct physical loss that is “commonly insured against” for residential buildings located in flood zones. FEMA is responsible for administering the National Flood Insurance Program (NFIP), which was created by the United States Congress “in order to make flood insurance available on reasonable terms and conditions to those in need of such protection.” The homeowners provided documentation from the NFIP showing that from 2006–2015, the program administered over five million flood insurance policies in each calendar year. At the time of the homeowners’ request for a declaratory judgment, FEMA’s flood policy statistics show that there are approximately 134,126 flood policies in force in the State of North Carolina. Approximately 1,062 of these policies are in force in the county where the community is located, said the appeals court, indicating that it is very commonly insured against.

The appeals court concluded that the trial court erred in siding with the association, and that the homeowners’ action for a declaration that the association was required to maintain flood insurance for buildings located in a flood zone was appropriate. It said that the association was obligated to provide flood insurance for those buildings inasmuch as the declaration required the association to maintain insurance coverage in accordance with the act to the extent that such insurance was “reasonably available” and to maintain property insurance against “all risks” of direct physical loss, and flood was a risk of direct physical loss that was commonly insured against for residential buildings located in a FEMA-designated flood zone. ♦

- Porter v. Beaverdam Run Condo. Assn., May 2018

RISK MANAGEMENT

Require Employees to Get Authorization Before Commenting About Accidents, Incidents

A large part of the day-to-day management of a community is providing service, in a friendly and polite manner that comports with a major point of living in an association—being part of a pleasant environment. You've probably trained your staff to make homeowners and their guests feel comfortable. So when there's an accident or other incident in your community, they might have an instinct to comfort the victim. While employees should rush to find help, there are several missteps they can take that can create major liability for the association. If an employee speculates on what caused the incident or says something to try to make the victim feel better, like "It was our fault" or "I told maintenance to repair those steps," it could help bolster the victim's argument that the accident was your fault if he or she sues the association.

Unintentional remarks can be damaging and have been used to pin liability for incidents on associations or managers. Many associations have ended up having to settle a lawsuit for a large sum because of what an employee said to the victim, witnesses, or attorneys. The wrong statement can effectively destroy any chance the association has of winning the case, forcing it to settle. The good news is that you can train employees what not to say after incident in community. Here's how to accomplish this.

Reduce Risk of Liability

Although there's no way to control what people say, you can train your employees what not to say, reducing the risk that they'll say something damaging. It's key that you don't discourage your employees from assisting an injured person. Instead, tell them what not to say to a victim or to the attorneys and investigators who may later seek to interview them.

Ask your association's attorney about how you can adapt our *Model Memo: Spell Out Appropriate Employee Response When Faced with Injuries*, to train employees at your community. Like our memo, yours should tell your employees that anything they say about an incident regardless of the context could be used in court as evidence against the association or manager. It's better to err on the side of saying too little than saying something damaging or untrue. Give your employees the following guidelines on what they shouldn't say:

Don't volunteer information or opinions about the incident. A good rule of thumb to follow is: Don't offer information or opinions about the incident to anyone—especially the victim. In particular, there's no reason for an employee to offer an opinion about why an incident happened. Not only could it hurt you if the victim sues, but there's no guarantee that the employee's opinion is correct.

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**MODEL
MEMO**

Spell Out Appropriate Employee Response When Faced with Injuries

The following memo emphasizes the point that association employees should refer the victim of an accident, crime, or other incident to you and tells them what not to say to the victim in that event. Distribute the memo to your employees, and periodically remind them about it when you review community procedures with them.

STATEMENTS BY EMPLOYEES AFTER ACCIDENTS, EMERGENCIES

To: All Employees
From: *[Insert name of manager]*
Date: *[Insert date]*

Please study this memo carefully and retain it for future reference. If you have questions about it or about the community's policies, ask the manager.

If someone is the victim of a crime or accident at our community and you are at the scene, be courteous and helpful, and summon police and medical assistance, if needed. However, unless you have authorization from *[insert name of manager or designated person]*, do not comment about an incident to anyone. In particular, be careful to offer no opinions or conclusions about any aspect of the incident, either at the scene or if approached later by an attorney, investigator, or insurance representative of the victim.

Certain remarks and phrases—even if well intentioned—may open the community to liability if it is ever sued over the incident. Many courts have found communities liable for incidents based on casual statements made by community employees about the circumstances of an incident. Here are guidelines to follow when reacting to specific situations that you may encounter:

- 1. Don't volunteer information or opinions about the incident.** Don't offer information or your opinions about the incident to anyone—including the victim. Your opinion about the cause of the incident is not an appropriate subject for conversation.
- 2. Don't respond to statements about the incident from the victim.** If a victim makes a statement about the cause of the incident, do not respond. For instance, an accident victim might say, "I can't believe that railing was so shaky." Simply refrain from making any comment or response.
- 3. Don't answer victim's questions about the incident.** The victim may not know what caused the incident and ask a question like, "Did you see what I fell on?" or "How did that man get into the building?" It's not appropriate for you to engage in such conversations. Don't answer any questions, even if the victim persists and repeats a question. If you're interviewing a victim for an incident report, simply ask your questions without responding to the victim's. If the victim continues to press you for an answer, you can say, "I'm sorry, but community policy doesn't permit me to comment on that." You can also refer questions to *[insert name of manager or designated person]*.
- 4. Don't talk to attorneys, investigators, or insurance representatives.** After the incident, someone representing the victim may come to the community to find out more about it and help the victim prepare a lawsuit. These representatives may not identify themselves. Therefore, don't talk to either identified representatives of the victim or anyone else that you don't know unless you have authorization from *[insert name of manager or designated person]*. Instead, simply say, "I'm sorry, but you'll have to direct all questions on that subject to *[insert name of manager or designated person]*."

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Risk Management

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Don't respond to statements about the incident from the victim. The victim may say something like "I can't believe that railing was so weak," or "That lock hasn't worked for months." Here too, you don't want your employees to offer their opinions. Instruct them not to respond to statements from the victim about the incident. While that may make your employees seem detached or unsympathetic, it's better than leaving yourself open to a lawsuit.

Don't answer victim's questions about the incident. The victim may not know what caused the incident and may ask a question like "Did you see what I fell on?" or "How did that man get into the building?" The victim might even ask something like, "What's the community going to pay me for this?" Instruct your employees not to answer these questions. Also, tell them that if the victim persists and repeats the question, they can respond by saying, "Community policy doesn't permit me to comment on that." If pressed, they can refer the victim to you.

Don't talk to representatives. After the incident, someone representing the victim may come to the community to find more about it and help the victim prepare a lawsuit. You don't want employees giving their opinions to these representatives, who may twist or misrepresent what your employees say, or manipulate your employees into saying something favorable to the victim's case. To avoid these problems, tell your employees to refer these representatives to you. You should then refer them to the association's attorney—and to speak to these representatives only if instructed to by you or the association's attorney. ♦