Community Association Institute
Utah Legislative Action Committee
CAI LAC
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Utah's Advocates for Responsible Community Association Governance

POSITION STATEMENT

February 18, 2013

The CAI LAC URGES LEGISLATORS TO **VOTE AGAINST SB 64**

NO CONCENSUS

SB 64 – HOMEOWNERS ASSOCIATION RESERVE ACCOUNT AMENDMENTS

BAD IDEA

This bill has no general industry support and is an unnecessary and punitive bill. To the best of the knowledge of the members of the Utah LAC, the bill is opposed uniformly by **everyone,** except the one person behind this bill, in the community association industry who has considered it; including boards, Community Managers, individual association members, attorneys, reserve specialists, developers and others. The Utah LAC has attempted to talk to the sponsor and the person behind the bill to explain the problems with this bill and to negotiate changes, with no success.

SUMMARY OF THE PROBLEMS:

(1) It's just a bad idea – the enforcement provisions are entirely punitive.
(2) It results in LESS transparency about reserve funding .
(3) It requires reserve funding --A FUNDAMENTAL CHANGE IN THE CURRENT LAW – without explaining how much funding or offering any guidelines.
(4) It WILL RESULT IN HUNDREDS OF THOUSANDS OF DOLLARS IN ATTORNEY FEES FOR EXISTING ASSOCIATIONS BECAUSE IT introduces a NEW AND UNWORKABLE definition for "SPECIAL ASSESSMENT"
(5) It could dramatically DELAY NECESSARY REPAIRS for the unwary.
(6) It contains problems with voting processes.
*As more fully explained below, there are even further unintended consequences.

ABOUT THE LAC

The LAC, a non-profit, non-partisan Utah Legislative Action Committee, represents the interests of over 350,000 homeowners and property owners in approximately 3,000 associations throughout Utah, and the professionals who service them (management, attorneys, insurance, accounting and maintenance providers), with respect to legislative, regulatory and amicus curiae activities. Membership in the LAC is comprised of volunteer homeowners, association board members and service professionals who routinely draft and support community association legislation. The Utah CAI LAC is not a PAC, makes no financial contributions and depends solely on the donations from associations and association professionals. Visit www.utahlac.com.

DETAILED ANALYSIS

(1) **THE PURPOSE OF THIS BILL IS TO PENALIZE ASSOCIATIONS AND IT WILL RESULT IN A TRAP OF LITIGATION, LEGAL FEES, AND BOARD MEMBER LIABILITY**.

It has been suggested that this bill provides the "necessary consequence" for an association failing to comply with the current reserve statutes. In other words, punishment as opposed to rights of enforcement. It is important to recognize that the law already requires associations to obtain and disclose a reserve analysis. Failure to comply can be, and is already being, enforced through private lawsuits.

This bill takes away the right to special assess (although it is unclear under what circumstances) if an association fails to comply. The upshot, it is argued, is that it will force associations to get a reserve study before they special assess. This, however, simply does not consider the real and pressing circumstances and association faces. Associations that are not complying with the law are typically just not aware of the law or may be attempting to comply, but might be missing one or two fine points in the requirements. For these associations, the consequences are dire.

The following is a likely scenario:

A ten-unit townhome association in Draper Utah is unaware of the passage of this bill (it happens). They chose to self-manage to save money and a retired accountant is the president and keeps track of the books. They save a little money, but they talk about the amount they are saving and openly decide as a group of owners to special assess for any serious repairs. Although they try to comply with the legal requirements they know of, they don't know about the passage of SB 64. In the course of a winter, the Association suffers several roof leaks and is ultimately told that it must replace the roofs on the buildings, for a cost of $50,000. They have half of the money in savings. They spend the spring and summer carefully selecting a roofer and plan the roofing project, enter into a contract with the roofer that requires full payment when the job is done, and send out a special assessment to owners for half of the project - $2,500 per unit. By then, it is late in the year and the roof must be replaced before winter or they will suffer tens of thousands of dollars in roof repairs, leaks and untold insurance claims for damage inside the units and building.

As they are about to start, on owner who is behind on paying assessments and is irritated by the fact that collections efforts have started, delivers a letter stating that the entire special assessment is invalid under SB 64, and he is not paying it. First, he argues that under the new definition of "special assessment" under SB 64 (lines 301-303), replacing the roof is an expected and recurring common expense. Therefore it cannot be a special assessment under the CC&Rs because that is not how special assessment is defined by law and it must supersede the CC&R definition. So, he argues, they have to include it in the regular monthly assessments and collect it over time. Then, he argues, even if it is a "nonrecurring" and unexpected" expense, the only way that can special assess under SB 64 is if they have prepared a "certificate of compliance" (lines 349-352). To do that, they must have a vote of the majority of lot owners on how to fund reserves and comply with that vote within 90 days. (Lines 341-348). Naturally, they cannot comply with the "vote" required on lines 341-342, unless they have the special or annual meeting required under lines 332, comply with the requirements of lines 334-339, and pay for and obtain a reserve study to present to the Association as required under line 333. This will take months and they are now on notice that their special assessment to repair the roof is invalid as to all owners. Moreover, it appears that they will have to completely re-write their governing documents to accommodate the new definition of "special assessment" foisted on them by SB 64.

They cannot special assess. The roof leaks all winter, they drain their savings with leak repairs, their insurance rates go up from damage claims, they incur legal fees to unwind the contract with the roofer and the invalid special assessment and to walk them through SB 64's requirements, all of the owners are inconvenienced by a second special meeting, they agree to save the exact same amount in reserves as they had before at the meeting except that they cannot now afford the new roof.

Under this same scenario without SB 64, the disgruntled owner complains about the lack of a reserve study and the Association's noncompliance with the existing law. But, he must still pay the special assessment. The Association purchases the new roof (saving tens of thousands of dollars and untold hassle). The Association pays its attorney a couple of hundred dollars to update them on the reserve laws. They take their time selecting a reserve study provider over the winter, have a study done, and comply completely with all of the disclosure and voting requirements under the current statute at the next annual meeting.

(2) **SB 64 REDUCES TRANSPARENCY FOR OWNERS**.

Notwithstanding the assertion that this bill is intended to promote reserves, this Bill dramatically undermines the primary goal of the existing reserve statutes. The existing reserve statutes (57-8-7.5 and 57-8a-211) were carefully written to promote transparency and disclosure to the owners of future maintenance expenses and the community savings (reserves), without creating unnecessary penalties or burdens on owners or associations. SB 64 reduces that transparency by changing the annual requirement for disclosure of the most recent reserve study or update, to only those years in which the reserve study is updated or obtained, instead of every year at the annual meeting. In short, there might

only be full disclosure of the maintenance needs and savings in the community, and the opportunity to discuss this issue, every three years instead of every year. A person could move into a community and never be told about or permitted an opportunity to discuss important maintenance projects or the community's savings for up to three years! This is less transparency, not more. This is not in the best interests of owners and associations.

(3) **SB 64 REQUIRES ASSOCIATIONS TO FUND RESERVES - A SIGNIFICANT DEPARTURE FROM THE CURRENT LAW -- WITHOUT ESTABLISHING PROPER FUNDING GUIDELINES**.

(A) **LACK OF GUIDELINES.** Lines 207-209 and 336-338 of SB 64 replace carefully drafted language that permitted associations to decide "whether to fund a reserve fund" with the following undefined and potentially ambiguous language:

Current Law:

"vote on whether to fund a reserve fund and, if so, how to fund it and in what amount;"

SB 64 Language (Lines 207-209 and 336-338)

"vote, by a majority of [lot/unit] owners present at the annual meeting of [lot/unit] owners, whether to fund a reserve fund in the manner and amount suggested in the reserve analysis or in some other manner and amount."

The existing language allowing an association to decide not to fund a reserve is gone, replaced with a provision that requires some funding level. Neither current law nor this bill have any requirement that the reserve analysis include a "manner" in which to fund reserves. This will result in ambiguity and confusion which cannot be reconciled in this bill. Moreover, this bill leaves entirely unaddressed the significant differences of funding reserves methodologies. Such considerations go beyond the scope of this bill and are further evidence that it has not been properly vetted.

(B) **FAILS TO CONSIDER GOVERNING DOCUMENT LIMITS ON ASSESSMENT INCREASES**. This bill requires mandatory funding of reserves, but fails to consider limits on assessment increases customary in association governing documents. For example, if an association is severely underfunded, a decision by a simple majority of members at a meeting to increase assessments, will invariably be contrary to what is required to increase assessments under the governing documents.

Additionally, this bill removes from Boards their customary and historic function of preparing budgets. (The LAC sponsored bill actually reconciles this problem). It is customary under association governing documents to have Boards prepare budget documents, include reserve budgets, and present them to the membership for approval or veto. Such process has been codified in the Community Association Act. There is no sound reason for upsetting this customary Board function.

(4) **SB 64 INTRODUCES AN UNWORKABLE AND PROBLEMATIC DEFINTION OF "SPECIAL ASSESSMENT" RESULTING IN SIGNIFICANT AND UNNECESSARY COSTS**.

(A) **PROBLEMATIC DEFINITION.** This bill creates a new definition of "special assessment" that is not limited to the reserve context. The term "special assessment" is already defined in almost every existing declaration (CC&RS) in associations. These definitions do not match the proposed definition in this bill. Special Assessments are a critical component to the community assessment scheme and are often drafted for the specific needs of that project. This term has never been defined in either the Condominium Ownership Act or the Community Association Act because developers, builders, and Owners need the flexibility to define assessments differently according to the needs and assessment methods in each unique community. This bill would define this provision for one purpose, without any consideration to the thousands of existing and future CC&Rs it will impact by redefining a fundamental concept applicable to these communities. The cost to associations, builders and developers from the unintended consequences of this single change alone will be staggering. This proposed change to the Condominium Act and the Community Association Acts may be the legal equivalent of using a sledge hammer to get rid of a spot on a window.

Moreover, the new definition of special assessment requires the repair to be "unexpected". Frequently, repairs are EXPECTED and a special assessment is planned to cover such expectancy. This new definition of "special assessments" may create serious special assessment problems for all associations regardless of whether they redraft their documents or not. Even worse, the problems with the new definition may be insurmountable and could cause tremendous assessment problems until we are back up to the legislature next to fix this language.

(5) **THE FILING OF THE TYPE OF CERTIFICATE REQUIRED BY THIS BILL WILL MISLEAD THE COMMON CONSUMER**.

The certificate to be filed under this bill will invariably suggest to the common consumer that the association's reserves are fine and that special assessments will be unnecessary. This is just not the case and it is not reality. First, the bill does not require a legitimate and proper reserve analysis to have a funding plan. So, the reserve analysis could be seriously flawed. Second, since the language in SB 64 is so ambiguous about how much funding is required, the association could get a reserve analysis, have a vote and approve a funding level, and still be seriously underfunded. Yet, by demonstrating a filed certificate, owners will assume that everything is fine.

(6) **THIS BILL COULD RESULT IN TREMENDOUS CONFUSION, EXPENSE, DELAYS, AND OBSTACLES FOR NEEDED REPAIRS**.

See number (1) above. Also, imagine the complicating factors where there have been foreclosures, out-of-town owners, and dealing with a definition of special assessments that may prevent the work altogether because an owner could argue that the repair was NOT unexpected. Moreover, what if the vote was not proper, or analysis was not timely

updated, or the funding plan has not been followed, or the certificate is not filed - anyone of which may be argued as a violation of the bill.

For example:(i) the roof is old, so it is fair to say repairs are "expected", and starts leaking, (ii) a special assessment is needed, (iii) a special assessment is passed by 2/3 member vote required in the governing document, (iv) the contract is made with the roofing company, (v) a dissenting owner sues the board for failure to comply with the law, (vi) an injunction is sought to stop the work, (vii) the association AND its Board members, individually, are sued for damages, (viii) to limit, not avoid, damage claims the Board seeks a reserve study or update, (ix) months later a report is produced, (x) the Board then schedules a meeting of the members to vote on funding the reserve, usually a 30 day notice, (xii) assuming a funding plan is approved, which it may not be, a certificate is filed with the Department of Commerce, (xiii) then a new vote, with another 30 day notice, on the amount and funding plan for a special assessment is presented to the members, which may or may not pass, and (iv) ALL THE WHILE THE ROOF IS LEAKING FOR MONTHS AND DAMAGES ARE INCREASING!

(7) **SB 64 CONTAINS PROBLEMS WITH VOTING PROCESSES**.

This bill fails to recognize established quorum requirements and voting procedures already applicable to associations.

The existing reserve statute (lines 207-209, and 336-338) provide only that a “vote” shall be taken regarding reserves. It was drafted intentionally this way to default to the Association’s quorum requirements and normal voting procedures. If five issues are voted on during the annual meeting, the same voting procedures will apply. SB 64 started by inserting the term “by a majority of unit owners,” which was subsequently amended (from bad to worse) to “by a majority of lot owners present at the annual meeting”. Here are just some of the problems with this language:

(i). the new language; “at the annual meeting” does not reconcile with the fact that the vote can be taken at a “special meeting”

(ii) The new language (lines 207-209) does not clearly reconcile with the definition of “Majority” in the Condominium Ownership Act 57-8-3 (19). Lines 207-209 require “majority of unit owners” “present at the annual meeting”. “Majority of unit owners” is defined in the Condominium Ownership Act as owners holding more than 50% of the voting interests. So, do you have to have more than 50% of the voting interests present at the meeting and voting in favor? This is nonsensical and creates an interpretative conundrum that Associations will struggle with for years.

(iii) Even worse, there is no similar definition of “Majority” in the Community Association Act, so the language will be interpreted differently in a Townhome verses a Condominium, for no reason.

(iv) Without any justification, all normal quorum requirements in associations are abandoned by this section. So, if a 60% quorum is required for business at a special or regular meeting (according to the Revised Nonprofit Corporations Act and the association's articles of incorporation), does this get overridden by this provision? If so, and if the association cannot conduct any other business, can it nonetheless take the vote required by SB 64? Does it have to? Is an annual meeting without a quorum really an annual meeting for purposes of SB 64? This is another terrible interpretive conundrum that will be costly for associations who have to apply this language.