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COMMON SENSE

CONDO AND HOA NEWS FROM SANDLER & HANSEN, LLC, COMMUNITY ASSOCIATION LAWYERS

A NEWSLETTER FROM

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FORM AND FUNCTION: FORGING A SOLID FOUNDATION FOR LIEN ENFORCEMENT AND FORECLOSURE

The ability of a community association to foreclose its lien for unpaid charges and assessments is a very powerful tool. The outcome is much more secure than seeking an award of money damages under a breach of contract claim. However, because foreclosure is such a powerful action, the Connecticut courts are more likely to scrutinize the facts of each individual case and the procedures followed by the association leading up to foreclosure.

In each of the following cases, the courts identified specific procedural deficiencies that impacted the ability of the association to foreclose its lien for unpaid assessments.

Notice and Hearing

Subsection 47-244(a)(11) of the Connecticut Common Interest Ownership Act ("CIOA") states that an association may levy a fine against an owner for violating the governing documents, after giving the owner notice of the violation and an opportunity to be heard ("Notice and Hearing").

In the case of *Stamford Landing Condominium Association, Inc. v. Charlene Lerman, et al.*, the association accused Ms. Lerman of a violation of its rules. The association sent a notice to Ms. Lerman, stating that it was assessing daily fines against her unit. The notice also stated that Ms. Lerman may request a hearing.

Some time later, the association sent a second notice to Ms. Lerman. The second notice stated that the association would conduct a hearing at an upcoming board meeting. Ms. Lerman did not attend that meeting.

The association proceeded with a foreclosure action to collect the unpaid fines. Ms. Lerman claimed that she was not afforded an opportunity to be heard under CIOA. The court disagreed.

More importantly, however, the court invalidated all of the fines that were assessed prior to the hearing date. The court concluded that the fines could be assessed only after the hearing took place.

Ms. Lerman appealed the case. The Connecticut Appellate Court upheld the decision of the trial court and the Connecticut Supreme Court refused any further appeals.

The Lesson Learned: Whenever the association may levy a fine or other assessment after Notice and Hearing, the board must conduct the hearing. If the fine or assessment is levied prior to or without a hearing, the court may not allow the association to foreclose its lien to collect it.

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Foreclosure Policies and Foreclosure Resolutions

Subsection 47-258(m)(2)(C) of CIOA states that an association must do either one of the following before foreclosing its lien on a unit:

1. The board of the association must specifically approve the foreclosure of the lien against the unit ("Foreclosure Resolution"); or

2. The association must adopt a standard policy that provides for the foreclosure of its lien against delinquent units ("Foreclosure Policy").

Improperly Worded Foreclosure Resolution. When collecting unpaid assessments, the association has two options:

1. The association can foreclose its lien for unpaid assessments; or

2. The association can claim a breach of contract, i.e., the governing documents of the community, and seek a personal judgment against the owner for money damages.

As stated above, the ability to foreclose the lien is a powerful enforcement mechanism. Most associations will choose foreclosure over an action for money damages. Nevertheless, the ability to proceed with action other than foreclosure exists.

In the case of *Merritt Medical Center Owners Corp., Inc. v. Charles D. Gianetti, et al.*, the association attempted to foreclose its lien against Mr. Gianetti's unit. The association did not adopt a Foreclosure Policy. Instead, the board of the association adopted a resolution to turn the account over "to collection."

Mr. Gianetti represented himself in the action. He did not bother hiring an attorney to defend him.

The trial court ruled in favor of the association and Mr. Gianetti appealed.

The Connecticut Appellate Court ruled that a resolution to turn the account over for collection is not the same as approving the foreclosure of the association's lien. The court observed that the association could engage in collection efforts other than foreclosure. Since CIOA specifically requires approval of the foreclosure of the association's lien on the unit, the board of the association had not properly approved the foreclosure action.

The Lesson Learned:

- Words matter. Minutes matter. Be specific when adopting resolutions.
- Do not assume that there is no risk because an owner is unwilling to hire an attorney to fight with the association. Self-represented parties are often given a fair amount of leeway by the courts. With the right set of facts and circumstances, and a sympathetic court, a determined unit owner can successfully challenge an association that overlooked a formality or was too cavalier with its procedures.

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Improperly Adopted Foreclosure Policy. In the case of *The Neighborhood Association, Inc v. Jill M. Limberger, et al.*, the association initiated a foreclosure action against Ms. Limberger to collect unpaid common charges. In her defense, Ms. Limberger claimed that the association failed to properly adopt its Foreclosure Policy.

The case centered around the question of whether the association's Foreclosure Policy is a rule. Section 47-261b of CIOA contains a specific procedure that an association must follow when adopting a rule. Subsection (g) of Section 47-261b states that an association's "internal business operating procedures need not be adopted as rules."

Ms. Limberger argued that the Foreclosure Policy fell within CIOA's definition of a rule. As such, the association should have followed the provisions of Section 47-261b when adopting it.

The association argued that the Foreclosure Policy is an internal business operating procedure. Therefore, it was not necessary to follow the provisions of Section 47-216b when adopting it.

The trial court agreed with the association. Ms. Limberger appealed.

In a rare move, the Connecticut Supreme Court chose to hear the case, effectively bypassing the Appellate Court.

The Supreme Court performed an extensive analysis of CIOA. In doing so, the court concluded that consumer protection was one of the fundamental goals of the statute. The procedures for adopting a rule under CIOA requires the association to provide unit owners with an opportunity to comment on the proposed rule. The board would then consider the comments before voting to approve the rule. The Court concluded that this process mandates a level of transparency that the association failed to honor.

The association argued that it could have adopted a Foreclosure Resolution to authorize its action against Ms. Limberger. Furthermore, CIOA permits the board to approve resolutions by written consent outside of a meeting. Thus, the issue of transparency should not be the Court's primary focus.

The Supreme Court's response to this argument, which is perhaps the most important component of its decision, is buried in a footnote. In that footnote, the Court stated that even though boards are permitted by CIOA to act by consent outside of a meeting, there may be times when doing so would be inappropriate. This is a clear indication that the Court is open to the idea of ignoring parts of CIOA if they produce a result that the Court feels is unfair.

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It's worth noting that this case started over a delinquent balance of $450.00. The attorney for the association sent Ms. Limberger a demand letter for the delinquent amount, plus attorneys' fees. Ms. Limberger submitted payment of $450.00. Rather than refusing the payment, the attorney accepted it, applied it to the attorneys' fees, and demanded that Ms. Limberger pay the difference. We can only wonder whether this inauspicious set of facts impacted the Court's judgment.

In any case, the Court concluded that a Foreclosure Policy is a rule as defined by CIOA. The association did not adopt its Foreclosure Policy following the procedures of Section 47-261b. Because of this, the court held that the association could not foreclose its lien.

Ultimately, the association was ordered to reimburse Ms. Limberger over $40,000.00 for her attorneys' fees and costs.

The Lesson Learned:

- When adopting a new policy, assume that it is a rule and follow the procedures set out in Section 47-261b of CIOA.
- Be cautious. Be reasonable. Be transparent. The Connecticut Supreme Court has expressed a willingness to ignore CIOA if the end result appears to be unfair.

NOTICE, HEARING, THEN FINE

The association should always conduct at least one hearing before levying a fine against a unit owner. Here's why.

Statutory Interpretation

When it comes to enforcing the rules, the Common Interest Ownership Act ("CIOA") requires the association to give the owner notice and an "opportunity to be heard." However, CIOA has another section completely devoted to conducting hearings before proceeding with legal action against an owner (not including the foreclosure of its lien for unpaid common charges), or at an owner's request. CIOA does not clearly distinguish between hearings for fines and hearings for other purposes.

Some have interpreted these provisions to permit the association to levy a fine without a hearing, so long as the owner is given a hearing at his or her request. The Connecticut Appellate Court, however, would disagree.

Judicial Interpretation

In 2008, the Appellate Court ruled on the case of *Stamford Landing Condominium Association, Inc. v. Charlene Lerman, et al*. In that case, the association had adopted a rule that prohibited tenants to keep dogs in the unit. Unit owners may have dogs, but not tenants.

Ms. Lerman leased her unit to a tenant with a dog. The association fined Ms. Lerman and informed her that she may request a hearing. The association eventually conducted the hearing, but by then, it had already levied daily fines.

The association brought an action to foreclose its lien for the unpaid fines. At trial, Ms. Lerman raised several arguments, including a challenge to the validity of the fines based on the lack of a hearing.

Ultimately, the Connecticut Appellate Court enforced the fines that the association assessed after the date of the hearing, but not those assessed prior to the hearing.

Due Process

In the American system of jurisprudence, anyone accused of wrongdoing is first given a chance to tell his or her side of the story before they are forced to pay a fine or endure a penalty. Even in the case of a speeding ticket, the accused has the option of pleading not guilty and is entitled to a hearing.

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Associations are often criticized for their “heavy handed” treatment of unit owners. Their enforcement of rules is portrayed as “un-American.” Assessing a fine against an owner without giving that owner a chance to tell his or her side of the story only feeds into these perceptions.

An Ounce of Prevention

To those that argue that CIOA is less than clear, that a hearing is not necessarily required before levying the fine, we ask this: Why take that chance?

Over the past couple of decades, we have seen a shift in the intensity of judicial review of association actions. What was once good enough is no longer acceptable. As illustrated by the *Stamford Landing* decision, as well as the other cases discussed in this Newsletter, the courts are now paying much more attention to the formalities. The courts are more reluctant to uphold association actions if the association failed to observe these formalities.

In light of this changing environment, it makes no sense to skip the hearing process prior to levying the fine. Doing so would only give the offending unit owner and a sympathetic court the ammunition they would need to manufacture a judgment against the association.

DOS AND DON'TS OF MAKING RULES

Sandler & Hansen, LLC, did not originally author this list. We neither take nor will we accept credit for it. Unfortunately, the original author is unknown to us. Otherwise, we would give the author the credit he or she so richly deserves for offering such simple yet crucially important advice concerning rulemaking.

- Make rules that make sense.
- Make rules that restrict as little as possible.
- Make rules that are actually needed.
- Make rules that are acceptable to residents.
- Make rules that residents can easily follow.
- Make rules that get the needed result.
- Make rules that are enforceable and easy to administer.
- Make rules that are legal.
- Don't make rules that try to regulate the personal lives of residents.
- Don't give in to political pressure.
- Don't go to extremes.
- Don't impose harsh consequences for small infractions.
- Don't refuse to make exceptions in exceptional circumstances.
- Don't act on anonymous, unverified, or unsubstantiated complaints.
- Don't make rules that create new problems or cannot be easily enforced.

RESERVE STUDIES AND FUNDING: THE GOOD, THE BAD, AND STRIKING THE PROPER BALANCE

Associations across the nation are not adequately funding their reserves. However, stockpiling money to maintain fully funded reserves is also not ideal. So how much is enough?

You Need to Know What You Don't Know

Unless a board member happens to be either an architect or an engineer, your board probably lacks the proper knowledge and training to determine how much money the association should place in reserve for future capital repairs and replacements, such as roofing, siding, and paving projects. Engaging a qualified engineering firm to inspect your community and prepare a reserve study will provide the association with much more information to help shape its long-term financial planning.

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Unfortunately, obtaining a reserve study can be expensive. Additionally, a reserve study may not identify hidden structural deficiencies.

For example, the collapse of the high-rise condominium in Surfside, Florida, has caught the attention of many of those in the community association industry, including board members, unit owners,

and the professionals who work with associations. As discussed below, it has also caught the attention of Fannie Mae and Freddie Mac. However, a typical reserve study would not have revealed the deteriorating and failing rebar within the concrete walls of the building.

The collapse in Surfside is an example of what happens when short-term costs are prioritized over long-term needs. The community was aware of many of the issues that contributed to the collapse, but the unit owners strongly resisted any attempts to levy additional assessments to address those issues.

Associations should be looking ahead at the approaching needs of their communities and creating financial plans that properly addresses those needs.

Deciding How Much is Enough

Despite legislation appearing in varying states and in mortgage underwriting guidelines, there really is no "one size fits all" answer to reserve funding. It depends on the community itself. For instance:

- Is the association or the municipality responsible for the roadways within the community? If the association is responsible, how much asphalt would be needed to repave the roads? Can this work be done in sections, from year to year, or would it be preferable or more cost-efficient to do it all at once?
- Does the community have a pool, clubhouse, tennis courts, or other amenities that must be maintained or replaced over time?
- What other infrastructure must be replaced by the association?

When it comes to setting aside reserves, the answers to these questions provide much clearer guidance than does some randomly selected percentage of the association's annual operating budget. As stated above, a reserve study will tell the association how much money it needs to put away now in order to pay for future capital projects.

Striking the Right Balance

Are fully funded reserves the right answer? Not necessarily.

Having fully funded reserves means charging unit owners more now in order to have the money the association will need in the future. Unfortunately, most owners focus on the short-term impact of paying more money per month, rather than the long-term impact of not having the necessary funds when the project must move forward. Without sufficient reserves, the association has no choice but to levy massive special assessments and/or apply for large, long-term loans from commercial lenders. If, however, the reserves are fully funded, then the association has the money on hand to proceed with the project without the need for additional assessments or a loan, which minimizes the long-term impact on the owners.

The ideal outcome, however, is likely somewhere in the middle. Set aside money for future capital projects, while understanding that commercial loans at favorable rates are available to supplement project funding. By using a combination of reserves and a smaller, short-term loan, the association reduces both the short-term and long-term financial impacts that these projects have on the community.

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The Bureaucratic Knee-Jerk Reaction

Fannie Mae and Freddie Mac are currently revising their underwriting requirements in response to the Surfside collapse. Unfortunately, the revisions illustrate a major lack of understanding of how community associations operate and function. The revisions may also have substantial financial impacts on unit owners.

Examples of the new requirements include:

- Disclosing details of reserve studies and engineering or inspection reports.
- Disclosing how much money the association is holding in reserve and whether that amount is sufficient pursuant to the reserve study.
- Detailing any deferred maintenance or repairs.
- Disclosing whether future assessments will be needed for maintenance or repairs, and whether those assessments would have a negative impact on the community.

The Community Associations Institute ("CAI") is currently engaged in discussions with Fannie Mae and Freddie Mac. We are hoping to better educate and inform these agencies, and to convince them to modify their new requirements to better serve communities and the unit owners who live in them.

HOW TO CONTACT US

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