AGING ASSOCIATIONS:
THE SPECIAL ISSUES THEY FACE

by

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INTRODUCTION

The community association concept was established decades ago, but began to see widespread acceptance in the 1970s with building booms, higher density construction, condominium conversions, and privately-maintained community amenities. Common interest developments constructed in that era are now "in their twenties" and have reached a maturity that brings with it both benefits and burdens. Such associations are aging -- some gracefully, some not so gracefully.

In this presentation, we acknowledge the special needs and problems facing aging associations and begin a wider colloquy on the unique concerns their Boards of Directors and members have as the end of the century nears.

Mature associations often have wonderfully comfortable personalities and a settled grace that offer a most attractive lifestyle to members. The landscaping is fully mature, neighbors are well acquainted, the management staff knows the property inside and out, and most residents know why the rules exist and how they contribute to the community's value. Such a community "feels like home."

On the other hand, aging communities present special maintenance and reconstruction concerns as buildings and other components of the common areas experience the passage of time. Money can be an issue -- either not enough of it, or concern about the proper safeguard of large reserve funds accumulated over time. Outdated governing documents can be a source of misguidance and confusion to Board members, owners and potential purchasers.

Watching out for the unique, and often unanticipated, rocks and shoals of age, however, is a task for the wary. Here are some of the concerns we believe deserve special attention and a "weather eye" ahead, especially for older associations.

MAINTENANCE AND REPAIR ISSUES

A maturing association equates to aging property. As property ages, its components predictably wear -- and eventually wear out. Beyond normal wear and tear, and sometimes in concert with it, can be unanticipated discoveries of damage due to dry rot, wet rot, tree root upheaval of sidewalks, foundations and pool decking, termites, failed retaining systems, and so forth. As structural components deteriorate and fail, difficult issues can ensue as to whether repair and replacement of major components are within the association's scope of responsibility and, if so, to what extent or how "deep" the association's repair obligation extends.

Older governing documents, especially the Declaration of Covenants, Conditions & Restrictions, may be vague and provide inadequate guidance about repairing and replacing major portions of a development. Although the Davis-Stirling Common Interest Development Act can provide some guidance, it may be

necessary to obtain a legal opinion from the association's attorney to determine the *character* of the components needing repair. Determining whether a given component is common area, exclusive use (or restricted) common area, or possibly not common area at all is critical to understanding and communicating everyone's role when major repair or reconstruction becomes necessary.

To the extent that the governing documents do not clearly and adequately allocate the responsibility between the association and the owners, the Board may have a challenging task in making a reasonable determination regarding whether, and to what extent, to undertake needed repairs with association monies and, alternatively, to what extent individual owners may be legally responsible to make repairs and pay for them personally. Of course, whatever decision the Board makes, someone is bound to be unhappy and say so.

FUNDING ISSUES

Suppose the Board discovers a major failure of a component throughout the development -- for example, all or most of the decks have serious dry rot damage and need replacement. And suppose the discovery presents an immediate threat to safety, but the association has not saved for this situation and, even more confusingly, the governing documents are not entirely clear that repair is an association responsibility.

Suppose also that there is no line item in the most recent reserve study for deck repairs. Can the association pay for the necessary deck repairs and, if so, with what monies? Can it use reserve funds allocated for other purposes? Suppose reserves have not been adequately funded over the years and there are insufficient funds in the total of the reserves to pay for the repairs?

In many well-established associations, the predictability of assessments may be a very attractive feature of living in or buying into a particular community. A suddenly announced special assessment, for an unanticipated but critical repair, affects that predictability, might be honestly beyond what some members can afford, and can be very upsetting to a community facing unpalatable choices.

As the Board contemplates solutions, it will need answers to the following legal, financial, and community-related questions: Is the Board **obligated** to impose an emergency special assessment on the members? Does it have the **authority** to do so? Is there any other way to raise the necessary capital? Is member approval required before a special assessment may be imposed by the Board? How will the Board fund an expensive repair in a prudent, businesslike fashion and still maintain the support of the community and its commitment to the common good? The association's attorneys and its financial professionals can advise the Board about these concerns.

As an association ages, its bank can be an important ally in the Board's effort to maintain property conditions and values and community cohesiveness when unanticipated major repairs arise. In the past several years, banks knowledgeable about community associations have developed loan products that, for associations meeting the institutions' underwriting standards, can be a reasonable solution in such a difficult circumstance.

However, again certain legal issues arise. Does the association have the basic legal authority required to obtain a bank loan? Is member approval required for such a loan? How will the loan be paid back? What will the association's obligations be under the loan agreement? What will it have to do in exchange for receiving the bank loan?

CAPITAL IMPROVEMENTS

Sometimes when an association is contemplating a major repair and estimating its cost, a long-desired

improvement, upgrade or addition to the common area is proposed at the same time. The theory often is, if it costs $X to repair and $X plus $Y to upgrade or add to, then maybe it makes good sense to consider the latter.

This scenario, of course, raises legal issues concerning the extent to which reserve funds may be used to pay for the improvements, whether the Board is authorized to have the work done or whether obtaining prior approval of the members is required and, if so, what percentage of the members must approve the work and/or the expenditure of funds.

Statutory law may provide some guidance in answering these questions but will probably not provide the complete answer. Reference to the association's governing documents will be necessary, but it alone may not always provide a complete or definite answer. Considering all sources of association and Board authority is necessary to determine what an association can legally do to make a capital improvement to the common area.

INVESTMENT ISSUES

In an older association, the opposite side of the inadequate funding conundrum can be the issue of having a "horn of plenty." What special responsibilities does the Board have when, over time, an association has amassed large sums in its reserve funds?

When members are elected to the Board, they are entrusted with the management and safekeeping of the association's funds. If an association has existed for a long time and if reserves have been adequately funded over those years, the total amount of the funds entrusted to the Board may be very substantial. Board members have a fiduciary duty to invest those funds wisely, with a primary goal of conserving them so that they will be available when needed. It cannot be too strongly stated that this objective outweighs the goal of earning a high rate of return.

How "conserve"-ative must directors be? Are they always entitled to follow the advice of investment advisors? Can they invest association funds in other than government backed accounts such as FDIC-insured bank accounts and CDs and Treasury Bills?

These and many similar concerns can be answered by seeking the right kind of help. Many governing documents, particularly those authored in the 1970s, sought to protect association funds by expressly restricting investments to FDIC-insured accounts and institutions. Legal counsel can advise the Board concerning restrictions on reserve fund investments in the association's governing documents and under the law.

Some governing documents, rather than identifying the exact kinds of investments the Board is authorized to seek, leave the choice of investment vehicles to the discretion of the Board, which then has a fiduciary responsibility to make the wisest possible decisions in this regard. The Davis-Stirling Act requires the Board to review annually the association's reserve study and to implement adjustments as appropriate. The directors should also periodically review how and where it has invested the reserve funds to ensure the liquidity of association monies that the reserve study shows will be needed in the near future.

Creating, approving and implementing an "investment plan" that coordinates with the reserve study and its updates is a prudent policy. In concert with appropriate professional advisors including the association's attorney, the Board can then determine if its investment of association funds meets the standards of the "prudent business judgment rule" that governs all such investment decisions.

WORKING WITH OUTMODED DOCUMENTS

Difficult problems can result when an association is working with a set of governing documents that were drafted many years ago and that do not provide ready, reliable answers to questions arising in the day-to-day operations of the association. These problems are even more likely to ensue if, years after the development has been completed and the individual residences have been sold by the developer, the association is still attempting to work with developer-drafted documents. Unfortunately, these original documents rarely provide the clear guidance that a Board or homeowner needs when an issue regarding the day-to-day operation of the association arises.

An association's governing documents should provide ready answers to questions about community affairs. They should reflect the real character and needs of the community which, in older communities, have evolved significantly since the days of developer involvement. The documents should give accurate and clear guidance to directors as, in the best interests of the community, they conduct the business of the association. The documents should help owners clearly understand their rights and obligations as members of their association. And prospective purchasers have a particular need for accurate information about what their obligations will be if they become members of the association.

The governing documents should also reflect current law and the standards that apply to community associations in California. With the ongoing enactment and amendment of laws in both Sacramento and Washington that affect community association life, and particularly with the revamping of the *Corporations Code* in the early 1980s and the creation of the Davis-Stirling Act in 1986, documents that predate these major legislative mandates can only be sources of misguidance and puzzlement.

It is very easy to see how important it is that the governing documents adequately reflect the realities of what it means to live in a particular community. These documents must serve as a clear guidebook for the Board and for both current and future homeowners. When the documents that guide the association are out-of-date and misleading, it is time for the Board to consider taking steps to revise and modernize the association's documents.

LAXITY IN ENFORCEMENT OF GOVERNING DOCUMENTS

In its 1994 opinion in *Nahrstedt* v. *Lakeside Village Condominium Association* the California Supreme Court emphatically reaffirmed that it is the fiduciary duty of a Board of Directors of an association to enforce the provisions of the governing documents for the good of the community as a whole. Sometimes, however, a Board is confronted with the reality that over the years, prior Boards of Directors have been lax or inconsistent in enforcing certain provisions or rules. This will often give rise to claims by a member who is the subject of the Board's revived enforcement efforts that the association has "waived" any right to enforce a restriction against that owner, or that the owner is being singled out for "disparate" treatment.

Before a Board attempts to stem long-overlooked violations of the governing documents, a careful evaluation of the situation, in concert with the association's attorney, is strongly recommended. Determining the association's legal position, discussing the benefits versus the risks of latter-day enforcement and the options available to the Board, and effectively communicating changes in policy are all critical elements that need thorough consideration before implementing.

DEALING WITH COMMUNITY POLITICS

Political problems face all associations at one time or another, but the longer an association has been around, the more the chances of internal controversy about community issues seem to grow. Some

associations are highly politicized, sometimes because longtime residents have become obsessively interested in the affairs of their community and are suspicious of the Board. These homeowners often have their own strongly-held views on how the association should be run, but rarely are they willing to serve on the Board.

Sometimes there is even a small, extreme and very vocal minority of homeowners who see their Board as the personification of evil. Nothing their Board does or says to try to explain the reasons for its decisions and actions can change the conviction of these homeowners that the directors are rascals leading the association down the road to disaster. Having to deal constantly with the accusations and demands of dissident homeowners can divert even the most dedicated Board's attention from important association business and can drain directors' energy.

How can a Board respond appropriately to the accusations and at the same time get on with its obligation to conduct the affairs of the association? There are no easy solutions to these problems, but one indispensable element of any attempt to "calm the waters" is **communication** -- expressed by a willingness to try to engage the entire community in a rational dialogue over the issues. If a consensus can be developed and action taken in accordance with that consensus, then homeowners who disagree with the consensus, even if vehemently, will find it harder to persuade anyone that the problem is the **Board**.

Sometimes problems are not the result of a vocal minority of the membership, but that of an individual Board member who makes it very difficult for the Board to conduct association business in an orderly manner. Sometimes a Board member can conduct himself or herself in a way that may pose a liability threat to the association. Sometimes the Board member has been elected on an "anti-Board platform" and perceives his or her role is to "kick up the dust" and to challenge the other directors on every minute detail.

These circumstances can be extremely upsetting to other Board members and can seriously interfere with their ability to attend to the work of the association. How can a Board deal effectively with the problems created by such a dysfunctional or disruptive director?

Again, there are no easy answers. Except in very unusual circumstances, the Board does not have the power to remove a recalcitrant director. Individual directors are elected by the members and can be removed only by vote of the members. Setting up a recall election is possible, but it can be costly in terms of both financial and emotional resources, and the ultimate result can rarely be ensured.

CONCLUSION

Older community associations face physical, financial, operational, social and legal issues quite different from those of newer developments. Difficult situations are born when the structural elements of an association age and wear out, when major repairs raise legal, practical and realistic concerns about solutions, when money is either hard to come by or abundant, when the documents of the association no longer guide, when people and personality problems emerge from or create difficult times.

Boards of Directors who serve in this period of their communities' history often face unique problems. It is the lucky and well-served associations whose directors, with the support of experts, deal with such problems squarely and resolutely when they arise.