

COMMUNITY ASSOCIATIONS: AN OVERVIEW

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Why Is This Important?

Clients do not intuitively understand the role that Community associations play in enhancing or restricting their enjoyment of home ownership. Pervasive as community living has become in New Jersey, and indeed in America, there is abundant misperception among homeowners and attorneys regarding the comprehensive role played by such associations. As attorneys, we are charged with the responsibility and duty to counsel clients as to what to expect when joining such a property scheme. The purpose of this article is to give the general practitioner a road map or overview that can assist her or him when giving guidance to clients.

What Are Community Associations?

Community associations are entities that exist for the development, sale, and administration of residential real estate. Community associations are creatures of statute and/or contract and were developed around the turn of the century as an attempt to control the growth and use of real estate. They are intended to create communities for the common good of all its participants. Through community associations, people get quality housing at an affordable cost with many amenities and services they would be unable to afford themselves. Individuals purchase units, or the right to occupy a unit, whether it is a house, apartment, town house or garden apartment, and share common areas with other unit owners. The association provides for a system of self-governance whereby residents elect one another to serve on a board of directors and on committees for the betterment of the community. It establishes rules and determines when to take certain actions, such as repairs, improvements, and additions. Often, potential purchasers must qualify to live in a community by receiving approval from an admissions committee before moving into a community. The term "Community Association" is used to describe any residential development in which each individual owner is contractually bound to an organization that has rules that must be followed, and assessments that must be paid, by all the individual owners for maintenance and for other general costs of managing and operating the property. Community associations are not voluntary. Membership is automatic when purchasing a unit and automatically terminated when the unit is sold.

How Are They Governed?

The typical community association consists of a corporation, or other entity (incorporated or not), with a board of directors (or trustees or governing committee) and officers, by-laws that regulate the governance of the entity, and a Declaration of Covenants and Restrictions (or the functional equivalent) that regulates the behavior of the residents. Generally, the original board of directors, usually the developers and builders of the community, will hire a property management company to run the community on a daily basis. As the developers and builders sell a substantial number of the units, the residents gradually begin to assert control over the board and then may alter the governing documents and the rules and regulations to more accurately reflect their desires instead of those of the original builders. Eventually, the board is made up

entirely of residents and the community is truly self-governed with the elected representatives answerable to all the residents. It is estimated that there are 150,000 community associations in the United States with 40 million residents. Approximately 60% of all new homes built in major metropolitan areas are within community associations.

Most community association by-laws require financial statements and an operating budget to be distributed to all the residents so that they receive an accurate picture of the financial situation of the community. Developers of common interest projects are mandated by law to disclose much information about a project, including the governing documents, which will include the rules and regulations of the community and the scheme for any normal assessments for which each unit owner is responsible. Of course, the fine print is not always read, understood, or even contemplated by potential purchasers anxious to close a deal. Assessments are made periodically in varying amounts to cover normal operating costs and for the establishment of a reserve fund for future improvements, repairs or new projects. Often, in order to mollify resident complaints about large assessments, an association will not collect enough to cover all operating expenses, future repairs, improvements and unforeseen costs. The maintenance of an adequate reserve fund is essential because if the repair, replacement, construction or unanticipated expense cannot be covered by the regular assessments, special assessments must be made from time to time or the community must borrow the money. Alternatively, the board may not want to make the unpopular decision to seek more money from the residents or take on burdensome debt, so they decide to delay the work. Failure to keep up with the financial needs of the community may result in a decrease in property value and a general inability to sell the units since potential buyers would be aware that the community is either underfunded or regularly makes special assessments to cover future expenses. By contrast, adequate assessments do a lot to maintain property values by eliminating the need for special assessments and providing a means to spread the repair or replacement costs over time. The determination of when to make an assessment and for how much is generally determined by the board of directors and must be paid by each resident, regardless of frequency or cost. There are also other fees or special charges which may be optional and cover use of certain amenities, such as the swimming pool or health spa. Procedures and vote requirements for assessments are set forth in the community association's governing documents. Unpaid assessments may become liens against the resident's property and entitle the association to legal remedies, including foreclosure on the property.

How Flexible Are They?

Often, the plan for development and sale of a community association takes place over a span of years, even decades, and a lot can happen to alter the original plan. In fact, developers often plan very little beyond the initial development stage. This may be due to market demand, potential changes in applicable property laws, or new or different ideas from the original developers. Thus, the developer's master plan should be as flexible as possible to allow for needed changes, but not so flexible that potential purchasers think the community lacks direction or is subject to radical changes upon the whim of a few people, some of whom may not even live in the community.

Like people, the master plan needs to be able to evolve and grow with each new experience. Some states have adopted the Uniform Common Interest Ownership Act ("UCIOA"), which

seeks to provide a level of certainty regarding the developer's obligations with respect to future development, while allowing an adequate amount of developer control for a set period, usually until a certain percentage of the units have been sold. However, UCIOA has come under scrutiny for not being clear enough. For example, when UCIOA was first adopted it stated that restrictions on use must be included in the declaration. However, it was not clear what particular restrictions must be included. Was it all restrictions, including the style of window treatment, or was it just land use restrictions, such as the size, shape, and color of the houses? Obviously, there is a difference between land use restrictions and rules and regulations, but UCIOA failed to distinguish between the two. As a result, acceptance of UCIOA has been far from universal. Furthermore, even though UCIOA was amended in 1994 to address some of these problems, not all of the states that adopted UCIOA adopted the amendments. Many states have not adopted UCIOA and have no controlling law while other states already have laws in place regarding community associations. For example, New Jersey has its Condominium Act and to adopt UCIOA would require either abolition of the Condominium Act or alignment of the two statutes, a costly and time consuming process with no certainty that the product would be any more effective than the current law.

What Are The Terms Of Art?

Common Elements- While the definition varies depending on the particular legal form of the community association, it does include all of the property not owned outright by a unit owner or occupied by a owner-tenant in a cooperative development. It includes such items as common roadways, amenities, building structures, central utilities, and items of similar character.

Community Apartment- A development in which an undivided interest in land is coupled with the right of exclusive occupancy of an apartment.

Condominium- This is the form of ownership under a master deed that sets out the manner in which the property is divided into individual, separately conveyable units. An individual owns a particular unit and is a tenant in common with respect to ownership of the common elements. Generally, the individual unit owners have percentage ownership of the common elements in proportion to the relative value of their respective units, with voting rights based upon a one unit, one vote rule.

Condominium Unit- In a condominium project, this is what the individual owner actually owns and occupies. Generally, it consists of only the space contained within the exterior walls of the surrounding structure. Typical boundary surfaces would include the upper plane of the floor underlayment or the painted surface of a ceiling or outside wall. It is the part of the condominium intended for independent ownership. It also includes a proportionate interest in the condominium's common elements.

Condominium Plan- A plan consisting of a description and survey map of the project and recorded documents evidencing title to the property. Generally, the by-laws and other rules and regulations are also recorded.

Cooperative (Co-Op)- A corporation holds title to all of the units and the common areas. By lease or other form of contract, individuals receive shares in the Co-Op entitling them to exclusive rights of occupancy of a particular unit through a device of an associated long term "proprietary" lease. Technically, individual purchasers do not have ownership of a unit, only ownership of shares entitling them to exclusive possession of that unit. Each unit is allocated a percentage interest in the corporation and receives a number of shares which is often based on the size of the unit being "purchased." Smaller units have fewer shares than larger units.

Assessments are made on a per share basis, therefore the smaller units pay less than larger ones.

Declaration or Master Deed- The document which contains the required information of a community association, including the land, number of units and procedures for electing members to serve on the board of directors or any association committees. Many declarations also contain the rules and regulations of the community.

Exclusive Use (or Limited) Common Area- A portion of the common area designated for the exclusive use of fewer than all of the owners in the community, such as a front yard or a balcony.

Governing Documents- The declaration and all other documents, such as by-laws, rules and regulations, articles of incorporation or articles of association, which govern the operation of the community association.

Planned Community or Planned Development- An individual owns a unit and either the corporation or the individuals collectively have title to the common areas.

Proprietary Lease- A document granting the long term exclusive right of possession and occupancy of a designated unit to an owner-tenant of a cooperative.

What Are The Different Kinds of Associations

1. Condominiums- In a condominium, title to each unit vests in each unit owner while title to land, building, exteriors, recreational and other facilities intended for common use is held by all unit owners in common, with each owner having some defined proportionate interest. In contrast to the Homeowners Association and the Cooperative, the Condominium Association generally does not hold legal title to any property except the personal property used by the members of the association. Legal and beneficial title to the common elements is vested in the unit owners collectively. Many states, including New Jersey, prohibit separating title to the common elements from title to the individual units. Ownership of the common elements may not be partitioned either. A Master Deed divides the land into units and common elements, and sets forth rights, obligations, and restrictions of unit owners while the Certificate of Incorporation and By-Laws govern the formation and operation of the condominium association, the administrative functions, and the rights and duties of directors, officers and members. Owners are liable for amounts assessed, and an owner may not exempt himself or herself from liability for assessments.

In New Jersey, there are two different acts that regulate condominiums: the Horizontal Property Act, which only applies to condominiums created before 1970, and the Condominium Act, which

regulates condominiums created after December 31, 1969. Incorporated Community associations are governed by a Non-Profit Corporation Act or Business Corporation Act depending on whether the organization is formed as a not-for-profit or a for-profit entity.

2. Homeowner Associations- There is no statute regulating homeowners associations, only a privately written Declaration of Covenants, Restrictions and Easements. The defined space being purchased is exclusive to a particular owner and on a separate subdivided lot, with legal title exclusively in the purchaser of the lot. Open space, recreational, and common areas are on other lots, with title vested in the homeowners association. The homeowners association form cannot be used in mid-rise, high-rise or garden apartments because where units are stacked, there must be common legal and beneficial ownership of the land underneath, therefore individual ownership of a lot is not feasible. An owner's beneficial interest in common facilities may be apportioned among members in any formula. Funds are raised from assessments, which, if unpaid, constitute liens on the owner's lot. There are also individual assessments for real estate taxes. Since there are two separate assessments for unit owned lots and association-owned lots, there may be issues of double taxation.

3. Cooperatives- A co-op is a hybrid of personality and realty because it involves ownership of stock and rights to real estate. In New Jersey, co-ops formed after May 6, 1988 are governed by the Cooperative Recording Act, which requires recording of a Master Declaration and Master Register. Usually, legal title to the real and personal property is vested in a corporate entity that sells shares of stock, which carry the right to occupy a unit and a percentage of the common elements. When purchased, legal title to the stock is transferred to the purchaser but title to the building, land, improvements, and the unit itself, remains vested with the cooperative entity. A co-op owner gets the right to occupy an apartment or unit by means of a proprietary lease with the cooperative corporation. Approval from the Board of Trustees is often required to sell a unit. Since there is only stock, owners may incur a financial obligation for another defaulting shareholder's allotted portion of blanket mortgage payments and real estate taxes. This is in contrast to other community associations that have individually owned residences. Assessments are often calculated on a per share basis, so if smaller unit owners have fewer shares of stock, they will pay less when assessments are due. The acquisition price of a co-op apartment often seems lower than that of a comparable condominium unit, but this is deceiving. In a co-op, unlike a condominium, the owner is responsible not only for his or her own mortgage, but also for a proportionate share of the co-op's mortgage debt for the entire project. Therefore, the effective purchase price of a co-op apartment includes a share of the co-op corporation's mortgage debt.

How Does Community Ownership differ from ownership of a single family home free of restrictive covenants?

It has been said that community associations exert more control over their residents than any governmental entity. This governance limits individual control over certain aspects of the unit and common property and imposes restrictions and other rules that must be followed by all residents. Even though the objective of living in a good, clean neighborhood, with certain benefits and restrictions on the use of one's property may be shared by everyone, people have different opinions as to what this means and the best way to accomplish such an objective.

Furthermore, since every aspect of life within the community is governed by the association, from the kind of shrubs that may be planted, to whether or not pets are allowed, to the color of the walls of the community room, the particulars of an individual's living conditions are governed by majority rule and may even be governed by a vocal, active minority. Fights over the most trivial of items have been acrimonious and been known to forever pit neighbors against one another. There are numerous stories of residents driving around their community looking for infractions by other residents and of spying done by the property management company. Too many restrictions often lead to lower property values.

Since there is no overarching state or federal law governing the conduct of the board of directors or any rules that may be passed, residents must be vigilant in checking the activity of the board to insure, for example, that they respond to resident complaints and make adequate disclosure about financial affairs and contemplated property improvements. Often, a position on the board or an influential committee is used for personal vendettas or the arbitrary exertion of power with no recourse for the injured party.

The lower acquisition cost of land makes it cheaper to own a home in a community association. Many come with amenities people would be unable to afford on their own, such as tennis courts, parks, swimming pools, gyms, lakes, open space, extensive landscaping, garbage removal, and other services that greatly reduce maintenance responsibility. The cost for these amenities and services is covered by the money raised from association dues, membership fees or assessments. However, these common expenses, for which the unit owner is liable regardless of whether he uses all, some or none of the facilities and services, are in addition to individual unit costs, such as mortgage payments and real estate taxes. Sometimes certain expenses, such as belonging to the health club or swimming pool, are optional, but often they are not.

What Should I Conclude?

The market place has spoken. Community living has become a norm for America. Like it or not, affordable, quality housing is increasingly difficult to find in fee simple form, free of enveloping restrictions. Consequently, attorneys, and indeed all counselors, had better be prepared to advise and guide clients on what to expect as a member of a community association. The enormous benefits of such arrangements come with a corresponding burden -- the need to conform to community-determined standards. Purchase of a home is one of the most expensive and important transactions that most clients will experience in their entire lives. Our responsibility is to give homeowners the knowledge to make informed choices about where and how they will live. To do that, we ourselves must be knowledgeable. This overview is only a starting point on that journey. Good luck on the road ahead!

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