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Critical Assessment: The Financial Role of Community Associations

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SYMPOSIUM: PART III

CRITICAL ASSESSMENT: THE FINANCIAL ROLE OF COMMUNITY ASSOCIATIONS

James L. Winokur*

I. EMERGENCE OF COMMUNITY ASSOCIATIONS AND THEIR FINANCIAL ROLE

A. *The Rise of Community Associations*

For over a century, increasing proportions of residential life in America have been organized into housing developments containing both individually owned residential units and common areas or facilities. Such housing developments are governed by private community associations representing neighbors within each development, through regimes of privately enforceable use restrictions and financial obligations.[1]

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1. *See generally* MARK WEISS, THE RISE OF THE COMMUNITY BUILDERS: THE AMERICAN REAL ESTATE INDUSTRY AND URBAN LAND PLANNING (1987). These "servitude regimes" have been created in a few closely related forms: (1) "condominium ownership," where divided ownership of each individual unit is inseparably tied to ownership by each unit owner of an undivided ownership interest in the common areas or facilities; (2) "homeowner association" or "planned community" in which each owner of a separate residence is also a mandatory member of a homeowner association which, in turn, owns or controls common areas or facilities; and (3) the less frequent "cooperative ownership" in which all residences are owned by a cooperative corporation or other entity which leases each unit to a resident who also, in turn, owns a proportional share of the cooperative corporation entity. UNIF. COMMON INTEREST OWNERSHIP ACT § 1-103 (1994), 7 pt. 1 U.L.A. 478-79 (1997). Under § 1-103, each of these forms is a common interest community, *id.* cmt. 8, typically sharing the elements of common plus divided ownership, restrictive covenants and monetary assessments administered by a community association. *See generally* ROBERT JAY DILGER, NEIGHBORHOOD POLITICS: RESIDENTIAL COMMUNITY ASSOCIATIONS IN AMERICAN GOVERNANCE 1-2 (1992) (referring to

Early on, private restrictions in some developments were aimed at creating enclaves for the privileged by community beautification, as well as social and racial segregation.[2] The pace of growth of these privately restricted "servitude regimes" has proceeded throughout this century. However, it has been during the past thirty five years, that these servitude regimes governed by private community associations

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common interest communities as "residential community associations" or "RCAs"); James L. Winokur, *Meaner Lienor Community Associations: The "Super Priority" Lien and Related Reforms Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 353, 354-55 (1992) [hereinafter Winokur, *Meaner Lienor Associations*]. Each of these ownership forms is within the definition of "common interest community" as set forth in section 1-103 of the Uniform Common Interest Ownership Act. UNIF. COMMON INTEREST OWNERSHIP ACT § 1-103 (1994), 7 pt. 1 U.L.A. 478-79 (1997).

Although UCIOA's definition of common interest community does not expressly require *restrictive covenants*, they are virtually always present in all forms of such communities. *See, e.g.*, Norman Geis, *Beyond the Condominium: The Uniform Common-Interest Ownership Act*, 17 REAL PROP. PROB. & TR. J. 757, 773-74 (1982).

The National Conference of Commissioners on Uniform State Laws, which promulgated UCIOA, has also promulgated separate, though substantially analogous, Uniform Laws relating to each of the three types of common interest community. UCIOA is designed to apply to all three on the theory that – despite their formal distinctions—they are all largely functional equivalents and should be similarly regulated. Hereinafter, provisions cited from UCIOA should be considered parallel to analogous provisions in each of the other Uniform Laws addressing respective types of common interest communities. For more information on the Uniform Laws, see *infra* note 98.

2. *See, e.g.*, WEISS, *supra* note 1, at 45; HELEN MONCHOW, THE USE OF DEED RESTRICTIONS IN SUBDIVISION DEVELOPMENT (1928). For historical treatment of systematic racial and ethnic segregation via homeowner associations and regimes of private restrictions, see EVAN MCKENZIE, PRIVATOPIA 56-78 (1994). Enforcement of covenants restricting or prohibiting sale of homes based on race or ethnicity were held unconstitutional in *Shelley v. Kraemer*, 334 U.S. 1 (1948), and such discrimination is also prohibited by more recent legislation. *See, e.g.*, Fair Housing Act, 42 U.S.C. §§ 3601-3619 (1994). The sweep of anti-discriminatory prohibitions was substantially extended by the Fair Housing Amendments Act of 1988, Pub. L. No. 100-430, 102 Stat. 1619 (1988). *See generally* 6 PATRICK ROHAN, REAL ESTATE TRANSACTIONS: HOME OWNER ASSOCIATIONS AND PLANNED UNIT DEVELOPMENTS – LAW AND PRACTICE ch. 6B (1997). Thus, segregation of races or other minorities accomplished by common interest communities currently occurs either surreptitiously or indirectly, via the impact of prices sometimes as affected by use restrictions. *See generally* MCKENZIE, *supra*, at 74-78; Stanley Scott, *The Homes Association: Will Private Government Serve the Public Interest?*, PUBLIC AFF. REP. 8 (1967). Segregationist motives are perceived by some scholars as among the factors prompting the recent upswing in development of more recently created gated communities. *See, e.g.*, EDWARD BLAKELY & MARY GAIL SNYDER, FORTRESS AMERICA: GATED COMMUNITIES IN THE UNITED STATES 74-98, 144-60 (1997).

have proliferated.[3]

This recent reliance on common interest communities stems from a revolution in the economics of housing and related development in this country. The progressive increase in suburban land costs initiated this revolution,[4] leading to the increased development of clustered housing in suburban communities. Planners and builders undertook to redefine the concept of density in residential development.[5] Planners reasoned that housing costs could be held in check by reducing land allocated to individual residential units which, in turn, could be offset by increasing public or common spaces.[6] The common spaces sometimes contained amenities like swimming pools, which would be expensive if built for individual homes, but which were economically developed to serve entire communities.[7] Since the early 1960s, the accelerated shift toward residential development in common interest communities has been strongly encouraged by the federal government.[8]

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3. The number of American common interest communities exploded between 1970 and 1990, from approximately 10,000 to approximately 130,000, growing from just over 1% of the U.S. housing supply to well over 11% of the housing supply. COMMUNITY ASS'NS INST., COMMUNITY ASSOCIATION FACTBOOK 13 (1993) [hereinafter CAI FACTBOOK] (Note: some information contained in the 1992 edition of the *CAI Factbook* is not repeated in the newest edition. When citing such material infra, reference will be made to the information as coming from the earlier edition.). By 1992, approximately 150,000 common interest communities were governed by community associations, housing approximately 32 million people. *Id.*

4. Between 1948 and the late 1970s, suburban land costs increased from constituting a national average of 11% of each new housing unit built to 25-30%. MARTIN MAYER, THE BUILDERS: HOUSES, PEOPLE, NEIGHBORHOODS, GOVERNMENTS, MONEY 13 (1978).

5. *See generally* DAVID WOLFE, CONDOMINIUM AND HOMEOWNER ASSOCIATIONS THAT WORK 7 (1978); URBAN LAND INSTITUTE, BULLETIN NO. 40, NEW APPROACHES TO RESIDENTIAL LAND DEVELOPMENT (1961) [hereinafter URBAN LAND INST., NEW APPROACHES].

6. URBAN LAND INST., NEW APPROACHES, *supra* note 5, at 37-39; URBAN LAND INST., INNOVATIONS VS. TRADITIONS IN COMMUNITY DEVELOPMENT (1963); *see also* A. M. Schreiber, *The Lateral Housing Development: Condominium or Home Owners Association?,* 117 U. PA. L. REV. 1105, 1105-06 (1969); ROHAN, *supra* note 2, § 3.02.

7. *See generally* JON ROSENTHAL, CLUSTER SUBDIVISIONS: PLANNING ADVISORY SERVICE INFORMATION REPORT (1960).

8. *See, e.g.,* FED. HOUS. ADMIN., LAND PLANNING BULLETIN NO. 6, PLANNED-UNIT DEVELOPMENT WITH A HOMES ASSOCIATION (1964). FHA work on this project, including its decision to insure common interest communities, was part of a public-private partnership which spurred the 1960s boom in common interest communities. *See* MCKENZIE, *supra* note 2, at 91-93. The

In the decades that followed, common interest communities have evolved from an innovation in suburban residential development to its main staple.[9] In the largest United States metropolitan areas, a majority of all new housing sold is now in common interest communities.[10] These common interest communities include the residences of over 30,000,000 Americans, and in many communities virtually all new substantial residential developments are effectively required to be in common interest communities.[11] Thus, American residential markets are likely to become dominated by common interest communities in the decades ahead.

B. *Financial Responsibilities of Community Associations: Private Provision of "Public" Facilities and Services*

The sheer numbers of common interest communities continue to grow at accelerated speed, providing residences for an increasingly major segment of our population. Therefore, the society as a whole should be concerned for their viability, both financial and otherwise.[12] Moreover, governmental and public policy functions increasingly entrusted to servitude regimes constitute an important additional reason for public governments to carefully evaluate and support the continued viability and effectiveness of these private regimes.

Beginning in the 1960s, common interest communities

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most influential document to come out of that partnership was URBAN LAND INST., TECHNICAL BULLETIN NO. 50, THE HOMES ASSOCIATION HANDBOOK (rev. ed. 1964) [hereinafter HOMES ASSOCIATION HANDBOOK], masterminded by Byron Hanke (FHA chief of land planning who also worked on this project full time with the building industry's Urban Land Institute), Professor Jan Krasnowiecki and William Loring of the Public Health Service.

9. *See* James L. Winokur, *Meaner Lienor Associations, supra* note 1, at 355.

10. See James L. Winokur, *The Mixed Blessings of Promissory Servitude: Toward Optimizing Economic Utility, Individual Liberty and Personal Identity*, 1989 WISCONSIN L. REV. 1 (1989) [hereinafter Winokur, *Mixed Blessings*]; CAI FACTBOOK, *supra* note 3, at inside front cover.

11. *See, e.g.*, MONTGOMERY COUNTY, MARYLAND, 1 HOMEOWNERS' ASS'N TASK FORCE REPORT 12 (1989); Stephen E. Barton & Carol J. Silverman, *The Political Life of Mandatory Homeowners' Associations, in* RESIDENTIAL COMMUNITY ASSOCIATIONS: PRIVATE GOVERNMENTS IN THE INTERGOVERNMENTAL SYSTEM? 31, 34 (1989).

12. Analysis of the myriad of non-financial issues which threaten the well being of common interest communities and the servitude regimes by which they are governed is well beyond the scope of this article. For extensive considerations of the mixed social impacts of such servitude regimes, with emphasis on non-financial implications, *see generally* Winokur, *Mixed Blessings*, *supra* note 10, at 53-55.

have become a major vehicle for shifting responsibilities previously associated with government agencies to the private sector.[13] As fiscal pressures on local governments have increased, these governments have encouraged development of common interest communities. These communities provide substantial and costly public facilities and services which end up being financed by developers of such servitude regimes and, ultimately, by the residents who buy homes and pay assessments to support these amenities. The public facilities provided range from park-like open spaces to streets, lighting, water and sewer facilities and recreational facilities.[14] Services increasingly provided by common interest communities, but which previously have typically been provided by public governments, include general facilities maintenance, trash collection and disposal, and snow removal.[15] The financial responsibilities of community associations are funded exclusively by the community's residents, who are required to pay regular and special assessments as needed to meet association costs.[16]

There is substantial evidence to suggest that the "load-shedding" of local government fiscal responsibilities onto common interest communities has been a conscious governmental strategy for relieving strain on shrinking resources.[17]

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13. For strong characterization of provision and controlling of shared use facilities as a traditionally public governmental role, *see, e.g.,* ROHAN, *supra* note 2, § 2.02[3], at 2-12 (1997); *see also* Robert Natelson, *Condominiums Reform and the Unit Ownership Act*, 58 MONT. L. REV. 495, 543-44 (1997); Ronald B. Cox, *Purchase Money Mortgage Held Superior to Liens for Past Due Assessments*, 47 S.C. L. REV. 26, 30-31 (1995).

14. DILGER, *supra* note 1, at 86.

15. *Id.*

16. *See, e.g.,* HOMES ASSOCIATION HANDBOOK, *supra* note 8, at 314; 6 ROHAN, *supra* note 2, at 7, 49-50.

17. *See, e.g.,* Mark Weiss & John Watts, *Community Builders and Community Associations: The Role of Real Estate Developers in Private Residential Governance, in* RESIDENTIAL COMMUNITY ASSOCIATIONS: PRIVATE GOVERNMENTS IN THE INTERGOVERNMENTAL SYSTEM? 95, 100-02 (1989), in which the authors describe a shift in the basic purpose of common interest communities beginning in the 1960s from enforcing deed restrictions to maintaining common property. For analysis at length of the privatization of public facilities and services, *see* DILGER, *supra* note 14, at 61-104. Dilger views this development less as conscious fiscal load-shedding by overburdened public governments than as a manifestation of a national movement toward privatization and decentralization of decisionmaking as advocated by conservative scholars in recent decades (including Dilger himself), and ushered in during the Reagan era. *Id.* Nevertheless, he concurs that the rise of common interest communities has imposed on those communities responsibilities previously seen as pub-

About a decade ago, noted historians of American residential communities, Mark Weiss and John Watts, concluded:

> Developers creating associations increasingly are responding to local governments' subdivision regulations rather than to the home buyers' interests. Some of the original market-driven rationale for community associations has been lost.
>
> Developers of small PUD and condominium projects have been finding that local subdivision regulations through a variety of incentives either require or encourage them to create commonly owned property managed by community associations. In some cases, localities refuse to accept public dedication of private streets, open space, or other common areas within a private development.[18]

Even where such privately created and maintained facilities are not required, these scholars assert,

> A variety of facilities – most notably streets but also utility line, construction, storm drainage, sewers and erosion control – all can be built less expensively if the developers elect to have them managed privately instead of constructing them according to public standards. The [community association] is then created by the developers chiefly to own and maintain these private facilities, which cost less to develop initially, but may cost more to repair and maintain over the long term.[19]

The common facilities and services managed by community associations may well have originally been intended for private use only by residents within each association's common interest community.[20] However, many of these facilities

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lic governmental responsibilities. *Id.* at 87-88. For a very recent analysis of such "load shedding" in the privatization of previously public services and facilities, see Wayne Hyatt, *Common Interest Communities: Evolution and Reinvention*, 31 J. MARSHALL L. REV. 303, 369-70 (1997).

18. Weiss & Watts, *supra* note 17, at 101-02. To a similar effect, see C. James Dowden, *Community Associations and Local Governments: The Need for Recognition and Reassessment, in* RESIDENTIAL COMMUNITY ASSOCIATIONS: PRIVATE GOVERNMENTS IN THE INTERGOVERNMENTAL SYSTEM? 27, 28 (1989); Robert Nelson, *The Privatization of Local Government: From Zoning to RCAs, in* RESIDENTIAL COMMUNITY ASSOCIATIONS: PRIVATE GOVERNMENTS IN THE INTERGOVERNMENTAL SYSTEM? 45, 47 (1989).

19. Weiss & Watts, *supra* note 17, at 102. Regarding the risk of substandard facilities provided for a private community association to manage than would be required for facilities dedicated to public ownership, *see also* C. JAMES DOWDEN, COMMUNITY ASSOCIATIONS: A GUIDE FOR PUBLIC OFFICIALS 9-10 (1980).

20. *See, e.g.*, MCKENZIE, *supra* note 2, at 88-89.

and services are provided instead of facilities for which the public government would be responsible, and except in gated communities, facilities like roads and open spaces would seem likely to be used by some portion of the public at large.

> [W]hat will happen if the community association, for whatever reason, is unable to perform its maintenance and government functions[?] What entity will step forward to maintain the private streets, the facilities, the open spaces, the open spaces and, indeed, the buildings? What steps should be taken at the state and local level to assure that community associations have the capability and capacity to carry out their responsibilities over the long run without becoming a burden on local governments at some future time? [21]

II. FINANCIAL VULNERABILITY OF COMMUNITY ASSOCIATIONS

Maintaining the common interest community is a crucial association board responsibility.

> Control of the finances of the home owner association, especially the preparation of the annual budget, is perhaps the single most important duty of the board of directors. Sufficient funds must be available to keep the project operating on a day-to-day basis, to pay for employee and other similar expenses, and to pay for extraordinary expenses.[22]

The financial health of common interest communities is essential to the viability and adequacy of millions of Americans' residences, and to the continued availability of many traditionally public facilities.

> Upon analysis of the association's functions, one clearly sees the association as a quasi-government entity paralleling in almost every case the powers, duties, and responsibilities of a municipal government. As a "mini-government," the association provides to its members, in almost every case, utility services, road maintenance, street and common-area lighting, and refuse removal. In many cases, it also provides security services and various

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21. Dowden, *supra* note 18, at 27, 28; *see also id.* at 29.

22. ROHAN, *supra* note 2, at 7-46. The American Institute of Certified Public Accountants ("AICPA") considers the community association's primary duties to be to maintain and preserve the common property. AM. INST. OF CPAS, AICPA AUDIT AND ACCOUNTING GUIDE: COMMON INTEREST REALTY ASSOCIATIONS § 3.01 (1991).

> forms of communication within the community. There is, moreover, a clear analogy to the municipal police and public safety functions. All of these functions are financed through assessments or taxes levied upon members of the community, with powers vested in the board of directors . . . or similar body clearly analogous to the governing body of a municipality. Terminology varies from region to region; however the duties and responsibilities remain the same. [23]

To the extent the community association as an institution is vulnerable to financial collapse, facilities essential to our society will be profoundly threatened. Yet, the financial health of community associations is, under present law, uncertain and therefore vulnerable to failure. Several problems contribute to this vulnerability.

A. *Complex Financial Management Skills Required*

First, the economic responsibilities of community associations are complex, often requiring considerable financial sophistication. Financial management of association finances involves, among other tasks: overall financial oversight, budgeting, establishment of accounting systems and financial procedures, determination of regular and special assessments, collection and disbursement processes, projection of long term financial needs and risks, definition, establishment and management of reserve funds, adequately insuring against risks to the community and to its leadership, potential negotiation of financing from sophisticated financial institutions, negotiation and contracting for substantial maintenance and repair projects, analysis of taxation impacts of association decisions, and preparation of financial statements.[24] These are daunting tasks which many would consider beyond their personal sophistication.

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23. Wayne Hyatt & James Rhoads, *Concepts of Liability in the Development and Administration of Condominium and Homeowners Associations*, 12 WAKE FOREST L. REV. 915, 918 (1976).

24. *See generally* WAYNE HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW § 6.03 (2d ed. 1988); URBAN LAND INST. & COMMUNITY ASS'NS INST., FINANCIAL MANAGEMENT OF CONDOMINIUM AND HOMEOWNERS' ASSOCIATIONS (2d ed. 1985) [hereinafter ULI/CAI FINANCIAL MANAGEMENT GUIDE].

B. *Association Politics and Decisionmaking*

Furthermore, financial management must be accomplished in the context of the complexity and explosiveness of association politics and decision-making.[25] Factors contributing to the volatility of association political life include: (1) the diversity of backgrounds, interests, stages in the life cycle, and expectations of community residents; (2) the likelihood of conflicts over complaints about rule-violations by residents' own children; (3) the omnipresent conflict between devotion of resources toward future property maintenance and maintenance of lower present assessment levels;[26] (4) possessive feelings towards each resident's home and freedoms to behave within that home and its environs as the resident chooses, which frequently confront detailed regulation of behavior within and around the home;[27] (5) widespread ignorance and confusion among homeowners regarding the obligations to which they are subject,[28] often not freely chosen by these residents when buying into the community;[29] (6) the threat of changing rules and assessment levels applicable to association members;[30] and (7) the juxtaposition of the friendship and neighborliness expected among association members with the conflicts, dissent, assessment and rule enforcement that are traditionally viewed in our society as distinctly unfriendly and non-neighborly.[31]

Moreover, ill feelings among common interest community residents likely result from a sense of dissolving personal identity for homeowners in these regimes.[32] Association residents often view the association board adversarially, seeing the board as an arms-length provider of services for which residents pay dearly, and which intrude upon resi-

25. *See generally* Barton & Silverman, *supra* note 11.

26. This conflict often divides board members, charged by the declaration and law regulating fiduciaries who serve on boards with the duty of maintaining and enhancing the common areas and overall property values within the community, and residents who often place highest priority on avoiding additional short-term costs, unburdened by the duties with which the board is charged.

27. *See* Winokur, *Mixed Blessings*, *supra* note 10, at 53-55.

28. *Id.* at 59-61.

29. *Id.* at 56-59.

30. *Id.* at 55-56.

31. Barton & Silverman, *supra* note 11; *see also* Winokur, *Mixed Blessings, supra* note 10, at 65-66.

32. *See generally* Winokur, *Mixed Blessings, supra* note 10, at 66-75.

dents' activities in their own home.[33] Meanwhile, board members often feel themselves the targets of abusive criticism by their non-board neighbors in return for working harder than these critics do on behalf of the community.[34] The tenor of some community association meetings becomes super-charged, escalating in extreme cases to threatened or actual violence among association members and board members.[35] Litigation between association boards and their members has also mushroomed in recent decades.[36]

C. *Limited Professional Competencies of Common Interest Communities*

Those making financial decisions for associations are often potentially or actually controlled by association members and leaders lacking even rudimentary financial sophistication. Association board members are common citizens all too often lacking in training to manage the associations for which they are responsible.[37]

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33. Some of the political conflict within community associations may well reflect the more general distrust of elected officials and government which has characterized our society in recent decades.

34. In a California study, for example, only 16% of the surveyed associations characterized association members as giving the board "a lot of support," while 45% report dissension. STEPHEN E. BARTON & CAROL J. SILVERMAN, COMMON INTEREST HOMEOWNERS' ASSOCIATIONS IN CALIFORNIA: REPORT TO THE CALIFORNIA DEPARTMENT OF REAL ESTATE 13 (1987). In addition, 44% of the associations reported significant harassment of individual board members within the past year. *Id.* A Florida study of condominium life found conflict among residents, and between residents and their associations, to be "common" and to generate substantial stress and strain on relations within the communities. *See generally* STEPHEN A. WILLIAMS AND RONALD J. ADAMS, DISPUTE RESOLUTION IN CONDOMINIUMS: AN EXPLORATORY STUDY OF CONDOMINIUM OWNERS IN THE STATE OF FLORIDA (1987). Even the Urban Land Institute found a "tragedy" of "great dissatisfaction" among common interest community residents in an early 1970s study of associations in California and Washington, D.C. CARL NORCROSS, TOWNHOUSES & CONDOMINIUMS: RESIDENTS LIKES AND DISLIKES 80 (1973). Norcross described residents as "unhappy, resentful, discouraged and disillusioned about their associations." *Id.* "A considerable number of families are so angry that they are selling their homes and moving away . . . to get away from what they think of as strait-jacket controls on their lives." *Id.*

35. *See* Winokur, *Mixed Blessings, supra* note 10, at 63 & n.263.

36. *Id.* at 63-64.

37. *See, e.g.,* WILLIAMS & ADAMS, *supra* note 34, at 68 (reporting almost 62% of respondents agreeing that most association leaders "lack the technical training to be effective managers"); BARTON & SILVERMAN, *supra* note 34, at 12; NORCROSS, *supra* note 34, at 80, 83-85; Uriel Reichman, *Residential Private Governments: An Introductory Survey*, 43 U. CHI. L. REV. 252, 290 (1976); *see*

From the inception of the common interest communities boom of the 1960s, it was contemplated that homeowner boards would need the expertise of professionals in managing their communities. Thus, the 1964 Homes Association Handbook clearly recommended retention of accountant services to select accounting methods, conduct audits, prepare financial statements and assist with the budget process.[38] At that time, many common interest communities of more than thirty residences employed paid personnel, with the percentage rising substantially as community size passed 500 residences.[39] But this same influential authority foresaw very active member participation in association management of small to moderate communities with common areas.[40] These projections overestimated the interest and abilities of homeowners in common interest communities to manage the complexities of community finances and operations.[41]

There was then in existence no national federation of associations, and few local federations as sources of information and guidance in association leadership.[42] This leadership

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also Armand Arabian, *Condos, Cats and CC&Rs: Invasion of the Castle Common*, 23 PEPP. L. REV. 1, 21 (1995). *But see* Hyatt, *supra* note 17, at 371-72 (arguing that current association board leadership is amply qualified to manage their associations, and that standards of conduct are more important than prerequisites of holding office to sound management, yet also recognizing the potential wisdom of separating out the community association of the future's business role). Hyatt stated:

> [A]s new and greater powers are required to meet new needs, especially as some forms of privatization take place. Examples include the provision of services of a municipal nature, social and educational activities, technological services, and wide variety of other activities . . . .
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> Issues of capacity, delegation, provision of individualized services, and use of technology will be all important. The powers and methods of operation of the board should be clarified, providing guidance as to what activities requirements for qualifying for office.

Hyatt, *supra* note 17, at 378.

Hyatt further suggests association support for serious board training in management, and notes that personnel trained and experienced in municipal management make excellent community mangers. There is a need and opportunity for academic institutions to broaden curriculum to include the large-scale common interest community. *Id.* He goes so afar as to suggest that professionalism and compensation are possible components of the future of community association board operations. *Id.* at 379.

38. *See* HOMES ASSOCIATION HANDBOOK, *supra* note 8, § 14.51, at 225-26.
39. *Id.* § 17.41, at 260.
40. *Id.* § 16.2, at 247.
41. Winokur, *Mixed Blessings*, *supra* note 10, 64-65.
42. *See* MCKENZIE, *supra* note 2, at 109-10.

role has since been filled by the Community Associations Institute ("CAI"), creation of which was spurred by the Urban Land Institute and the National Association of Homebuilders. CAI later came to embrace homeowners, public officials, association managers, attorneys, and accountants.[43]

In recent decades, the complexity of overseeing common interest community operations and finances has led to the development of an entire industry of community association managers, often trained and certified with expertise in the specialized constellation of common interest community management functions.[44] Many associations, utilize professional community association managers.[45] However, a disturbingly high number of associations operate without such specialized, professional support.[46]

Association board decisions are often upheld when challenged.[47] However, the proper standard applicable in judicial

43. MCKENZIE, *supra* note 2, at 109-20. In its rather slanted history of CAI, McKenzie is sharply critical of the evolution of CAI as an organization dominated by experts whose life's work is involved to the administration of community associations. *Id.* The present author believes this evolution—though somewhat limiting CAI's breadth of perspective—has strengthened CAI's viability, and left it as the premier organization presently able to address the urgent need association directors (and, not incidentally, public governmental entities which regulate associations) have for expert advice and education in the complex and sensitive tasks of management.

44. Substantial management designation programs have been administered by Community Associations Institute ("CAI"). As of June 1997, its affiliate, the National Board of Certification for Community Association Managers, has designated 2,900 managers nationally as *"Certified Manager of Community Associations"* ("CMCA's"). ROBERT DIAMOND, COMMUNITY ASSOCIATION INSTITUTE ANNUAL REPORT (1996-97). CAI has educated, graduated and certified well over 500 *"Professional Community Association Managers"* ("PCAMs"), and which more recently commenced as less comprehensive training and certification program for designation of *"Association Management Specialist"* ("AMS"). CAI FACTBOOK, *supra* note 3, at 26. CAI's Professional Management Development Program currently offers 101 community associations management course offerings nationally, which were attended by over 1,700 registrants during 1996-97. DIAMOND, *supra* note 44.

45. *See* CAI FACTBOOK, *supra* note 3 (suggesting that, in 1990, among Community Associations Institute member associations, about two-thirds of community associations employed on-site professional staff or community associations management companies to manage their associations, with the trend during the late 1980s being more and more toward management by specialized management companies).

46. The same study reflects, however, that over a quarter of responding associations relied solely on volunteer management. *Id.*

47. Regarding decisions involving assessments and collection, for example, see ROHAN, *supra* note 2, at 7-22, noting that most challenges to association to even special assessments are unsuccessful, especially where the association

review of a board's decision is still often uncertain as a matter of law,[48] potentially adding to board members' uncertainty regarding the scope of their power to act when they are called upon to do so.

The association's financial management task is rendered

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does not fail to follow its own articles of incorporation, bylaws, rules. For authority more generally supportive of board actions, see the discussion of the business judgment rule, see *infra* note 48.

48. Cases and commentary addressing challenges to community association board actions have disagreed the proper standard of review. For helpful and contrasting recent overviews of the current debate, see Hyatt, *supra* note 17, at 342-55, and *Reporter's Note* to RESTATEMENT OF THE LAW (THIRD): PROPERTY (SERVITUDES), TENTATIVE DRAFT NO. 7, § 6:13 (Apr. 15, 1998) [hereinafter *Reporter's Note*, RESTATEMENT OF PROPERTY]. While analysis of this controversy is beyond the scope of this article some further explanation may be helpful. Among the central points of controversy is whether and when association decisions should be presumptively protected from challenge by some version of the "business judgment rule" versus some less protective "reasonableness" rule. As Hyatt describes it, the "business judgment rule" approach sees the board as the sole arbiter of issues to which this approach is applied, provided that the procedure under which the decision was made is valid. Hyatt, *supra* note 17, at 345-46. Thus, the judicial inquiry rebuttably presumes that a board member made a challenged decision based on adequate information, and in a good faith effort to serve the interests of the community the board governs. *Id.* For an example of the application of this business judgment approach to upholding an assessment, see Dockside Association, Inc. v. Detyens, 362 S.E.2d 874 (S.C. 1987). Hyatt sees the reasonableness rule as a higher standard of review, and points up contrasting views among authorities. He asserts that a reasonableness standard of review is a "major component" of community association law, noting that it has been applied and advocated especially in cases involving the association's regulation of its own membership. Hyatt, *supra* note 17, at 348-54. By contrast, the Restatement's *Reporter's Note* takes a somewhat contrasting view. Describing the present law governing member challenges of association actions as "somewhat confusing and unsatisfactory," *Reporter's Note*, RESTATEMENT OF PROPERTY, *supra,* at 328, and noting the "business judgment" vs. "reasonableness" schism among the courts, *id.* at 329, the Restatement's *Reporter's Note* suggests that both rules are generally substantively similar in consistently limiting review to whether challenged actions were ultra vires, made in bad faith, or by interested directors, or were arbitrary, capricious, or discriminatory. *Id.*

For examples of cases taking the "business judgment" approach to challenges of board decisions, see the leading case of Levandusky v. One Fifth Ave. Apt. Corp., 553 N.E.2d 1317 (N.Y. 1990); see also, Tulluride Lodge Ass'n v. Zline, 707 P.2d 998 (Colo. App. 1987); Leppaluoto v. Warm Springs Hollow Homeowners Ass'n, 752 P.2d 605 (Idaho, 1988); Farrington v. Casa Solana Condominium Ass'n, Inc., 517 So. 2d 70 (Fla. App. 1987). For examples of decisions using the "reasonableness" approach, see Laguna Royale Owners Ass'n v. Darger, 174 Cal. Rptr. 136 (Ct. App. 1981), Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d 637 (Fla. App. 1981), Raymond v. Aquarius Condominium Owners Ass'n, Inc., 662 S.W.2d 82 (Tex. App. 1983), and Kellogg Commons Condominium Ass'n v. Carlington, No. 93 L048, 1994 WL 102244, at *1 (Ohio App. 1994).

all the more overwhelming to untrained, volunteer leadership because of the sheer size of financial sums involved in even "routine" management tasks. Thus, even modest communities are often responsible for annual association budgets of hundreds of thousands of dollars.[49]

III. ASSESSING FINANCIAL MANAGEMENT TOOLS AVAILABLE TO COMMUNITY ASSOCIATIONS

A. *Budgeting*

An association budget process is essential to financial operation of a common interest community. This process should occur at least annually,[50] and serves as both an informational tool for residents as well as a management tool for resource allocation and control.[51] The process must estimate the likely expenses for the coming year, including the expense of funding reserve accounts for future extraordinary expenditures for repair and replacement of long term assets

49. A Raleigh, North Carolina CPA who regularly served dozens of condominium and homeowner associations in the past 10 years estimates the average annual budgets of these associations as ranging from $100,000-$200,000, with some ranging as high as $500,000. Interview with Layne H. Laughlin, CPA, Denver, Colorado (Feb. 15, 1998) [hereinafter Laughlin Interview]. Of course, many larger associations, especially in larger and more sophisticated markets, would have budgets far larger than these. *Id.*; *cf.* CAI FACTBOOK, *supra* note 3, at 22 (asserting that in 1991 the average annual association budget for all associations was $122,508, and the average of all association members of CAI was $218,000).

50. ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24, at 8-9. Note that association leaders will be working with at least five different administrative types of years: calendar year, contract year(s), fiscal year(s) (which may vary for tax and financial purposes) and association board electoral year. *Id.* Setting each of these management years can involve some delicate issues, particularly regarding how they relate to each other. For example, it may be wisest to set the electoral year to commence before the fiscal year and the budget process which governs it begins. Otherwise, newly elected board members are left to administer the budget reflecting policies shaped by the prior board. Boards may wish to schedule their fiscal years to vary from tax years, so that the association's accountant will be more available for consultation than she might otherwise be during "tax season." Depending on the work involved in renewing or renegotiating contracts, it may become advisable to stagger various contract years to allow greater board focus on different respective contracts at different times of the year. Boards seeking community participation in the budget process might elect to avoid scheduling the process for summer months, when most residents are likely to be away. The summer is also likely to be a midpoint for contract years related to maintenance and recreation services. *Id.*

51. *Id.* at 3.

of the community.[52]

Aside from long term reserve issues, the process of estimating expenses can be both substantial and complex. Evaluation of current association programs, employees, and contractors requires detailed consideration of effectiveness and fairness to both recipients and providers of association funds.[53] Inspection of the community's physical components and discussion with maintenance staff will be needed to determine what repairs or replacements might be needed differently from the previous year.[54] Ideally, costs to the association should be compared with costs charged by competing providers of similar services.

The association's management might also consider surveying residents as to the quality and importance of various association facilities and activities.[55] Such surveys would alert the board to potential unknown conditions and their associated costs while educating the community about the funds needed to provide services. It can also fuel decisions to establish, maintain, restore, improve or cancel programs of the association. On the other hand, soliciting homeowner opinions and evaluation could open difficult political subjects, since residents may predictably seek improved or increased service when the questions are posed separate from the costs unit owners will be forced to bear in order to effectuate the changes.[56] Also, membership opinion often generates a de-

52. For a discussion of reserves, *see infra* Part III.C.1.

53. *See* ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24, at 28.

54. *See* ROHAN, *supra* note 2, at 7-47.

55. For an example of such a survey form, *see* ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24, at 12-16. This form could easily be supplemented to provide residents more information than it does regarding the costs of programs they are asked to evaluate and prioritize.

56. For example, consider the situation of a Denver association, where an association task force, with the support of strong community opinion, recommended replacement of an aging, though heavily utilized swimming pool which economic studies had clearly shown would be cheaper than the increasing maintenance costs the old pool would require in the coming years. Interview with Lynn Jordan, Esq., Special Counsel, Ballard Spahr Andrews & Ingersoll, LLP, Denver, Colorado (Feb. 20, 1998) [hereinafter Jordan Interview]. Because construction of the new pool required a special assessment (special assessments are discussed below, *see infra* Part III.B), the assessment was put to a community vote, and the same membership which had supported the improvement in concept rejected the assessment. Jordan Interview, *supra*. The politics were unpleasant, and the board found themselves in an awkward dilemma where neither replacement nor standing pat seemed acceptable to their constituents. *Id.*

sire by board members to respond quickly, where the better impact of such input would be to trigger a carefully considered analysis of how best to meet the expressed concern.

Among the items typically covered by the annual budget would be: utilities water, landscaping and grounds maintenance, exterior repairs, recreational expenses, payroll, management, legal and accounting fees, insurance, telephone, communication and newsletters, miscellaneous contingency fees, and contributions to reserves for extraordinary expenses.[57]

Careful analysis is required on the income side. As potential costs increase, assessment increases are required to cover these increments,[58] unless other income sources are available, such as program[59] or user fees,[60] interest, or other income. Thus, the board must assess community willingness and ability to pay higher assessments. Absent increased assessments when costs rise, services may need to be curtailed.[61]

Despite the obvious importance of sound budgeting processes, there is little law mandating any budget process in common interest communities. Considering that association boards are largely composed of unsophisticated and uncompensated residents, the absence of even minimal mandatory processes is a major financial vulnerability of this country's common interest communities.

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57. Laughlin Interview, *supra* note 49.

58. Reserve funds are sometimes used to pay these increments, but this likely defeats the essential purpose of reserve funding, and has constituted a widespread problem in community association finance. *See* discussion *infra* Part III.C.1.

59. These would include fees for special programs authorized by the association, including the rental of community facilities.

60. Typically these would include fees for use of recreational or fitness facilities by community residents or, conceivably, outsiders. These fees may be proscribed in the declaration or bylaws, and can raise interesting challenges for association managers such as determining appropriate fees, and collection and tracking the fees. Among potential programs that might generate such fees are adult education classes, child care, fitness or athletic activities, each involving value only to the participants rather than the community at large. ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24, at 74-75.

61. *Cf.* Griffith v. Rittenhouse Park Community Ass'n, 521 A.2d 1377 (N.J. Super. Ct. App. Div. 1986). The court approved a cutback in otherwise obligatory association services following the community's vote to deny an increase in assessments to provide income for operations which had become more costly. *Id.* The court considered the board's obligation to keep the association solvent even more important than its obligation to provide promised services. *Id.*

Budget processes may be mandated in association documents prepared by the developer's attorneys, especially if they are experienced with community associations. In states which have adopted the Uniform Common Interest Ownership Act ("UCIOA") (or its more limited companion statutes),[62] however, a budget is required to be adopted at least annually, once the first association assessment has been made.[63] The special priority accorded by UCIOA to a portion of association assessment liens[64] is limited to the extent it is based on such a budget.[65] Under UCIOA, the association board is expected to adopt a budget, which it then circulates to all community residents along with notice of an opportunity to meet and review the proposal.[66] The budget is considered ratified under UCIOA unless a majority of all unit owners (or any larger majority specified in the declaration) reject the budget. In the event of such a rejection, the previous association budget and assessment level already in effect continues until a new budget is ratified in this manner.[67] Unless the budget reflects egregious problems, its rejection under this procedure is unlikely because it requires extensive initiative by association members, who are typically difficult to mobilize.[68]

B. *General Assessments*

1. *Background*

Community associations fund their common interest operations through assessments.[69] While the financial strength of these communities requires the unconditional payment of assessments, enforceable as a unilateral promise, the flow of assessment dollars will naturally be subject to the personal

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62. *See supra* note 1.

63. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-115(a) (1994), 7 pt. 1 U.L.A. 598 (1997).

64. *See infra* notes 96-109 and accompanying text for a discussion of this assessment lien. For in depth analysis of the lien and related measures, see Winokur, *Meaner Lienor Associations, supra* note 1.

65. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b) (1994), 7 pt. 1 U.L.A. 600 (1997).

66. *Id.* § 3-103(c), at 576.

67. *Id.*

68. *Compare* Winokur, Mixed Blessing, *supra* note 10, at 62 n.259 and accompanying text.

69. *See, e.g.*, ROHAN, supra note 2, § 7A.03[4], at 7A-29-30.

financial condition of owners, the overall economic condition of the geographic area, and the political climate of the association. When boards sense their constituents are experiencing hard times economically, understandably they would often hesitant to raise or strictly enforce assessment obligations.

When mandatory owner's associations are created to govern covenant-controlled communities, assessment parameters are typically defined and limited by the Declaration[70] creating the common interest community. Since the Declaration is drawn up by the developer before marketing of residences in the community begins, the developer can be expected often to focus primarily on the competitive position of his or her development in the market for new homes in establishing a monthly assessment. Thus, the assessed amount would often be based more upon what the market would bear than on a realistic analysis of what the promised and required community services would actually cost. As a result, the services which could be paid for by the mandated assessments, as well as the quality of these services, all too often seem based upon an earlier relatively short term developer concern for how to sell the most homes in the least amount of time.

Financial institutions counted on to finance home purchases within a given community would naturally want assurance that these assessments would not escalate excessively, overburdening their borrowers (or the lenders themselves, should they be forced to take ownership of units via foreclosure[71]). Thus, future assessment increases are often expressly limited to their original amount, or by a maximum of increases in a consumer price or other analogous index specified in the Declaration. Such provisions often confer the ability to increase assessments above that ceiling upon a vote of the owners, which are notoriously difficult to obtain.

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70. For purposes of this discussion, the recorded instrument creating the servitude regime is referred to as the "Declaration." However, in many states common interest communities are created by recorded instruments under other names (e.g., "master deed").

71. On assessment burdens of mortgagees face when obtaining common interest communities units in foreclosure, *see* GRANT NELSON & DALE WHITMAN, REAL ESTATE FINANCE LAW 965 (2d ed. 1985); Robert Zinman, *Condominium Investments and the Institutional Lender – A Review,* 48 ST. JOHN'S L. REV. 749, 754 (1974).

Such assessment-increase ceilings have been a major impediment to common interest communities' ability to implement sound fiscal policies, and the raising of necessary funds for operations which would vary over the years due to factors independent of the ceiling imposed in the declaration. For example, besides increased costs due to more general market-wide inflation, maintenance costs for which the association is responsible will often increase with the age of an asset to be maintained.[72]

While the payment of assessments may presently be more akin to the payment of taxes, the lifeblood of these communities has flowed slowly as every stakeholder has attempted to minimize payment of assessments. Lenders frequently exhibit reluctance to foreclose in order to avoid liability for assessments.[73] The practical result is that an associations' fiscal strength is limited by the developer's concern for the sales shortly after drafting the declarations, the developer's limited foresight of the long-term, the lending community's need for certainty, and for limiting their borrowers burdens, and the immediate goal of many homeowners to spend as little as possible in the operations of their communities.

The impact of assessment-limiting provisions is greatest when the community is financially weak. For example, as the economic health of an area declines, so, too, would successful assessment collection. The association must spend additional funds in collecting assessments using often more active and costly procedures (e.g., lien foreclosure and receiverships). When association assessments go uncollected, the defaulting residents' unpaid expense share falls on the neighbors in good standing, and the more reliable owners now face greater difficulty in meeting their own financial obligations to the community.[74] These owners, in turn, experi-

72. Compare the swimming pool example described *supra* note 56, where the age of the pool made it a progressively more expensive asset to maintain. As in this actual example, replacement of the asset will sometimes be the less expensive and more value-enhancing strategy for the association. But ceilings on assessment increases and prohibitions of special assessments may preclude this optimal alternative.

73. *See supra* note 71.

74. Phillip Gregory, *The California Condominium Bill*, 14 HASTINGS L.J. 189, 204 (1963); Henry Judy & Robert Wittie, *Uniform Condominium Act: Selected Key Issues*, 13 REAL PROP. PROB. & TR. J. 437, 481, (1978); John Walbran, *Condominium, Its Economic Functions*, 30 MO. L. REV. 531, 554-55

ence stronger pressure to default on the now-increased assessments, while their homes are devalued by the very same assessment increases—closing off their potential escape from the destructive cycle within the common interest community.[75] However, assessment ceilings may block associations from increasing assessments to offset losses due to defaults.

Rather than raising assessments as defaults increase, an association can instead opt to decrease maintenance below the levels they would otherwise perform. This strategy of deferred maintenance, if carried on for any significant period, is also self-defeating because it accelerates the deterioration of community facilities—eventually raising maintenance costs and inevitably lowering the values of homes in the community which depend on the common facilities.[76] As more common interest communities age, these problems will only increase in severity.[77] As the cycle repeats, the problems intensify until the community confronts financial disaster.

2. *Legal Aspects of Assessment*

The law has provided mixed responses to the risk of assessments—the lifeblood of common interest community operations—remaining uncollected. On the positive side, courts widely recognize residents' assessment obligations as covenants which run with the land.[78] Where assessment provisions are contained in Declarations,[79] this result is straightforward.[80] Courts typically find personal liability for assessments arising during an owner's ownership of a common interest community residence in cases of such real covenants or equitable servitudes.[81] Even where currently bind-

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(1965).

75. Judy & Wittie, *supra* note 74, at 482.

76. Winokur, *Meaner Lienor Associations, supra* note 1, at 359-60.

77. *Id.*

78. The classic decision was *Neponsit Property Owners' Ass'n v. Emigrant Industrial Savings Bank*, 15 N.E.2d 793 (N.Y. 1938). *See also* Stream Sports Club v. Richmond, 457 N.E.2d 1226 (Ill. 1983); Kell v. Bella Vista Village Property Owners Ass'n, 528 S.W.2d 651 (Ark. 1975); Mendrop v. Harrell, 103 So. 2d 418 (Miss. 1958); Henlopen Acres v. Potter, 127 A.2d 911 (N.J. Super. Ct. App. 1971); *and* ROHAN, *supra* note 2, § 9.02, at 9-4-7.

79. *See, e.g.*, FHA Form 1401 (VA Form 26-8201), Art. IV, § 1.

80. Stream Sports Club, Ltd. v. Richmond, 457 N.E.2d 1226 (Ill. 1983); Kell v. Bella Vista Village Property Owners Assn., 528 S.W.2d 651 (Ark. 1975); Stephens Co. v. Lisk, 82 S.E.2d 99 (N.C. 1954); *see also* Neponsit Property Owners' Ass'n, Inc. v. Emigrant Indus. Sav. Bank, 15 N.E.2d 793 (N.Y. 1938).

81. *See generally* ROBERT NATELSON, LAW OF PROPERTY OWNERS ASSO-

ing written assessment covenants are not included in the documentation, courts generally have little difficulty finding unit owner liability to contribute via assessment to the common good conferred on properties within a common interest community under quasi-contract or analogous theory.[82] Assessment obligations are also imposed by statutes in several states.[83]

Courts have usually supported association fiscal strength by holding the assessment obligation of members to be independent of the association's actual performance of services.[84] Indeed, there is statutory support for this reasonable view as well.[85] Thus, the community member's obligation is unconditional—without regard to an owner's satisfaction with services or whether an owner is pleased with the manner in which association funds are spent. A common interest community owner owes assessments simply by owning property in the community, much like the owner of land in a municipality owes real estate taxes unconditionally.

CIATIONS § 6.1.2.3 (1989); *e.g.*, Harbison Community Ass'n, Inc. v. Mueller, 459 S.E.2d 860 (S.C. App. 1995), *cert. denied*; Chateaux Condominiums v. Daniels, 754 P.2d 425 (Colo. App. 1988); *cf.* Chesapeake Ranch Club, Inc. v. C.R.C. United Members, Inc., 483 A.2d 1334 (Md. App. 1984) (finding that the assessment of liability running with the land may not include all fees imposed by the association).

82. *See* Nevel v. Shelter Island Heights Property Owners Corp., 613 N.Y.S.2d 28 (N.Y. 1994); Meadow Run & Mountain Lake Park Ass'n v. Berkel, 598 A.2d 1024 (Pa. Super. Ct. 1991), *appeal denied*, 610 A.2d 46 (Pa. 1992); Seaview Ass'n. of Fire Island, N.Y. v. Williams, 510 N.E.2d 793 (N.Y. 1987); Perry v. Bridgetown Community Ass'n, Inc., 486 So. 2d 1230 (Miss. 1986); Weatherby Lake, Improvement Co. v. Sherman, 611 S.W.2d 326 (Mo. 1980); Island Improvement Ass'n v. Ford, 383 A.2d 133 (N.J. Super. A.D. 1978); Mohegan Colony Ass'n v. Picone, 402 N.Y.S.2d 40 (N.Y. 1978).

83. *See, e.g.*, OKLA. STAT. ANN. tit. 60, § 524(a) (West 1994); *see also* UNIF. COMMON INTEREST OWNERSHIP ACT § 3-115, 7 U.L.A. 598-99 (1997); Blood v. Edgar's Inc., 632 N.E.2d 419 (Mass. App. Ct. 1994) (interpreting and applying the Massachusetts statute imposing assessment liability).

84. *See, e.g.*, Kay v. Via Verde Homeowners Ass'n, Inc., 677 So. 2d 337 (Fla. Dist. Ct. App. 1996); Panther Lake Homeowner's Ass'n v. Juergensen, 887 P.2d 465 (Wash. Ct. App. 1995); Park Place Estates Homeowners Ass'n v. Naber, 35 Cal. Rptr. 2d 51 (Ct. App. 1994); Abbey Park Homeowners Ass'n v. Bowen, 508 So. 2d 554 (Fla. Dist. Ct. App. 1987); Homsey v. University Gardens Racquet Club, 730 S.W.2d 763 (Tex. App. 1987); Pooser v. Lovett Square Townhomes Owners' Ass'n, 702 S.W.2d 226 (Tex. App. 1985); Newport West Condominium Ass'n v. Veniar, 350 N.W.2d 818 (Mich. Ct. App. 1984); Casita De Castilian, Inc. v. Kamrath, 629 P.2d 562 (Ariz. 1981). *But see* Kirktown Homes Ass'n v. Arey, 812 S.W.2d 198 (Mo. Ct. App. 1991).

85. *See, e.g.*, GA. CODE ANN. § 44-3-80(d) (1997); Forest Villas Condominium Ass'n v. Camerio, 442 S.E.2d 884 (Ga. App. 1992).

This fact does not give the association *carte blanche* in assessing unit owners. The board is limited by both the common interest community's governing documents[86] and any applicable state law.[87] Discrimination in application of assessments among residential units, except as expressly contemplated in the declaration, is typically invalid.[88]

The difficulty with assessments as a source of fiscal strength is not the non-existence of basic assessment liability on the part of common interest community residents. Rather, it is, the difficulties in collecting those assessments when residents default on their obligations, particularly in bad economic times.

Typically, common interest community declarations impose a lien on behalf of the community association to secure payment of any delinquent or unpaid assessments.[89] UCIOA[90] and many state statutes impose the lien regardless of the absence of such language in the declaration.[91] Although some common law authority gives these liens priority over all individual unit mortgages,[92] many state statutes[93]

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86. *See, e.g.*, Westbridge Condominium Ass'n v. Lawrence, 554 A.2d 1163 (D.C. 1989); Johnson v. Fairfax Village Condominium IV Unit Owners Ass'n, 548 A.2d 87 (D.C. Cir. 1988).

87. *See, e.g.*, OKLA. STAT. ANN. tit. 60, § 512 (West 1994).

88. *See, e.g.*, Thanasoulis v. Winston Towers 200 Ass'n, 542 A.2d 900 (N.J. 1988); Lion Square Phase II and III Condominium Ass'n, Inc. v. Hask, 700 P.2d 932 (Colo. Ct. App. 1985). *Compare* Theiss v. Island House Ass'n, Inc., 311 So. 2d 142 (Fla. Dist. Ct. App. 1975) *with* Casita de Castilaion, Inc. v. Kamrath, 629 P.2d 562 (Ariz. Ct. App. 1981). For a useful discussion of the general problem of association discriminatory regulation as between different residences within its community appears, see ROGER BERNHARDT & MICHAEL GOLDEN, 1997 SUPPLEMENT TO ROBERT NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS § 4.4.4. (1989).

89. *See, e.g.*, NATELSON, *supra* note 81, at 216.

90. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (1994), 7 pt. 1 U.L.A. 600-03 (1997).

91. *See, e.g.*, ARIZ. STAT. ANN. § 33-1256 (West 1990); CAL. CIV. CODE § 1367 (West 1982 & Supp. 1998); FLA. STAT. ch. 718.116 (1989); HAW. REV. STAT. § 514A-90 (1990); MICH. COMP. LAWS § 559.208 (1990); N.Y. REAL PROP. LAW § 339(z) (McKinney 1989); OHIO REV. CODE ANN. § 5311.18 (Anderson 1988); OR. REV. STAT. § 94.709 (1989); VA. CODE ANN. § 55-516 (Michie 1990); WIS. STAT. § 703.16 (West 1981).

92. Mendrop v. Harrell, 103 So. 2d 418 (Miss. 1958); Prudential Ins. Co. v. Wetzel, 248 N.W.2d 791 (Wis. 1933).

93. *See* Federal Housing Administration Form #3285: Model Statute for Creation of Apartment Ownership (FHA Model Act) (reprinted with commentary in PENNEY ET AL., LAND FINANCING: CASES & MATERIALS, 580-92 (3d ed. 1984)) (providing that the association lien for assessments is subordinate to any "first mortgage of record"); *see also* UTAH CODE ANN. § 57-8-20 (1990); VA.

and declaration provisions effectively make the assessment lien subject to at least some mortgages secured by the same unit—particularly the first mortgage secured by the land. As a result, an association's assessment lien generates little or no money for the association in such foreclosure proceedings, particularly in the hard economic times when associations will most desperately need assessment revenue.[94]

Facing this bleak collection prospect in the event of foreclosure, especially in the states where foreclosure is judicially conducted, associations opt for an action on the member's personal debt obligation for delinquent assessments generated during his or her ownership of the residence. This process may be faster and less expensive, though it is usually most effective for brief delinquencies which total no more than the jurisdictional limit of the applicable small claims court.[95]

The problem of realizing on defaulted assessments and the liens which secure them is somewhat lessened in states adopting the standard lien priority[96] and related provisions[97] of UCIOA (or its sibling Uniform Laws).[98] These "super pri-

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CODE ANN. § 55-79.85 (Michie 1990); Brask v. Bank of St. Louis, 553 S.W.2d 223 (Mo. Ct. App. 1975); OKLA STAT. ANN. tit. 60 § 524 (West 1970); *see generally* GRANT NELSON & DALE WHITMAN, REAL ESTATE FINANCE LAW 965 (2d ed. 1985).

94. *See generally* Winokur, *supra* note 9, at 357-59. Unlike some other lienors, the association may be particularly hard pressed to purchase the property by "bidding it in" at a foreclosure sale. *Id.* The association's lien is typically sufficiently small as to allow very little of the bid the be, in effect, on the credit of its outstanding lien. *Id.* And the association may have inadequate resources to manage, rent or sell the residence, foregoing assessment income from that unit until a new purchaser other than the association itself succeeds to ownership. *See* Benny Kass & Donald Dyekman, *Assessment Collection, in* THE ELEVENTH ANNUAL COMMUNITY ASSOCIATION LAW SEMINAR 337, 343 (1990).

95. Kass & Dyekman, *supra* note 94, at 342.

96. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b) (1994), 7 pt. 1 U.L.A. 600 (1997).

97. *Id.* § 3-102(a)(11), at 573.

98. The Uniform Common Interest Ownership Act was adopted in 1982 (and amended in 1994) by the National Conference of Commissioners on Uniform Laws ("ULC"), as a single, comprehensive law combining the ULC's prior uniform laws in this area: the Uniform Condominium Act (ULC, 1980), the Uniform Planned Community Act (ULC, 1980), the Model Real Estate Cooperative Act (ULC, 1981). *Prefatory Note* to UNIF. COMMON INTEREST OWNERSHIP ACT (1994), 7 pt. 1 U.L.A. 472 (1997). According to the *Prefatory Note*, by 1994, UCIOA had been adopted in at least five states, while the Uniform Condominium Act, or substantially similar laws, exist twenty-one states. The Uniform Planned Community Act is the law in one state. *Id.*

ority" lien provisions[99] provide a limited first priority for up to six months of unpaid assessments over almost all other liens, including "a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent."[100] This priority may include fines and, when the statute so specifies,[101] enforcement and attorneys fees. The "super priority" accorded assessment liens under UCIOA has proved acceptable to federal governmental agencies and the secondary lending markets.[102]

In addition to giving community associations a share—albeit a limited share—of the sale proceeds when residences in common interest communities are foreclosed, the more important consequence of limited "super-priority" for a portion of association assessment defaults may be in providing the association much needed leverage in getting the property more quickly into a status where it is generating regular assessment revenues. This may be by bringing a property in default more quickly into foreclosure, leading to purchase by a solvent owner (often the senior mortgagee), or by encouraging the senior mortgagee to pay assessments it might not technically be obligated to pay in order to gain control over the timing and mode of foreclosure.[103] Another advantage to super priority accorded to portions of association assessment liens is that its permanently renewable aspect may practically induce the senior mortgagee to pay the entire delinquency on residences in assessment default.[104]

Among the paramount interests secured by common interest community residences, as with other property, are "liens for real estate taxes and other government assessments or charges against the unit."[105] Indeed, an argument can be made that common interest community assessments—*all* assessments, and not just the most recent six months in

99. For comprehensive analysis of the need for and consequences of the super priority assessment lien under the Uniform Common Interest Ownership Act, *see generally* Winokur, *Meaner Lienor Associations, supra* note 1.

100. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b) (1994), 7 pt. 1 U.L.A. 600 (1997).

101. *See, e.g.*, COLO. REV. STAT. 38-33.3-316(1) (1991); CONN. GEN. STAT. § 47-258 (1991).

102. *See* ROHAN, *supra* note 2, § 9.05[4], at 9-30.

103. *See* Winokur, *Meaner Lienor Associations, supra* note 1, at 379-80.

104. *See id.* at 379-85.

105. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116 (b) (1994), 7 pt. 1 U.L.A. 600 (1997).

default—should be appropriately prioritized as superior to even a first lien on each residence because the assessments are needed to fund facilities and services for the public in much the same sense as those financed by public government property taxes.[106]

Furthermore, the burden for such assessments, which such a rule would place on private mortgage lenders, would not be so out of line with lender burdens where an owner in a non-common interest community residence defaults on the secured loan. After foreclosure, the lender will typically own the property, at least for a time.[107] Prior to foreclosure, the lender will be forced to protect its security, often paying costs of casualty insurance, security, exterior maintenance and payment of the normally senior charges for property taxes on the security.[108] As between the lender and the association, both of which are creditors secured by the same residence, the lender has typically been in the stronger position in selecting its debtor in the first place and obtaining insurance assuring payment of its debt—unlike the association, which has less opportunity to protect debts which go to fund what are essentially public facilities.[109]

A serious problem with collecting admittedly valid common interest community assessments has been bankruptcy law governing situations where a community member declares bankruptcy.[110] As with several of the community association fiscal problems discussed above, this problem would be most acute during hard economic times, when common interest community members are least able to pay assessments, especially assessments increased by their neighbors' assessment defaults. Of course, it would during such hard times that bankruptcies among community members would be highest.

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106. *See supra* notes 13-23 and accompanying text.

107. *See, e.g.*, ROBERT LIFTON, PRACTICAL REAL ESTATE: LEGAL TAX AND BUSINESS STRATEGIES 262-63 (1979); William Prather, *A Realistic Approach to Foreclosure*, 14 BUS. LAW. 132, 135 (1958).

108. *See* Winokur, *Meaner Lienor Associations, supra* note 1, at 360-61, and authorities cited therein.

109. *See id.* at 361.

110. *See generally* Denise L. Palmieri & M. Edward Burns, *Protecting Community Association Assessments in Bankruptcy*, 8 PROB. & PROP. 26 (1994) (addressing community association strategies prior to the Bankruptcy Reform Act of 1994); *see also infra* notes 120-27 and accompanying text for discussion regarding the Bankruptcy Reform Act of 1994.

In such bankruptcies, the community association has faced the risk that its valid assessment debts will be discharged under federal bankruptcy law. Under a community member's liquidation in bankruptcy,[111] an automatic stay triggered by the filing of the bankruptcy petition prevents creditors from collecting debts.[112] Once the bankruptcy estate has been applied to the debtor's liabilities, most of the debtor's remaining debts are discharged, protecting the debtor from liability on pre-petition debts.[113]

These automatic stay and discharge provisions have been applied to bankrupt common interest community members' assessment debts, generating controversy whether post-petition assessments are swept away by the bankruptcy discharge.[114] Several bankruptcy courts had included all pre-discharge assessments—including those arising between the initial bankruptcy petition and discharge—within the debts so discharged,[115] primarily because they are based on pre-petition contracts. However, some courts have reached the conclusion that post-petition assessments were not dischargeable, viewing each assessment as a separate incident of debt, and reasoning that only such incidents preceding the bankruptcy petition were discharged.[116] Association rights have also been recognized in other decisions holding post-petition assessments recoverable from the bankruptcy trustee as administrative expenses.[117] Where the bankrupt resident seeks reorganization rather than liquidation, some

111. *See generally* ROHAN, *supra* note 2, § 9.06[1], at 9-32-33.

112. 11 U.S.C. § 362 (1994). Violation by a creditor of this automatic stay may place the association in contempt, and subject it to monetary penalties. *See, e.g., In re* O'Mara, 141 B.R. 237 (Bankr. N.D. Fla. 1992).

113. 11 U.S.C. § 524(a) (1994).

114. *See generally* ROHAN, *supra* note 2, § 9.06[3], at 9-36-39.

115. *See In re* Cohen, 122 B.R. 755 (Bankr. S.D. Cal. 1991); *In re* Rosteck, 99 B.R. 400 (Bankr. N.D. Ill. 1989), *aff'd* 899 F.2d 694 (7th Cir. 1990); *In re* Elias 98 B.R. 332 (Bankr. N.D. Ill. 1989); *In re* Turner, 101 B.R. 751 (Bankr. D. Utah 1989); *In re* Behrens, 87 B.R. 971 (Bankr. N.D. Ill. 1988); *see also In re* Montoya, 95 B.R. 511 (S.D. Ohio 1988); *cf. In re* Ryan, 100 B.R. 411 (Bankr. N.D. Ill. 1989) (reactivating liability for post-petition assessments after the debtor is in possession of the common interest community residence).

116. *See, e.g., In re* O'Mara, 141 B.R. 237 (Bankr. N.D. Fla. 1992), *In re* Raymond, 129 B.R. 354 (Bankr. S.D.N.Y. 1991); *In re* Wetherby, CIV. No. 87-B-00429 1989 WL 110796, at *1 (Bankr. D. Colo. Mar. 3, 1989); *In re* Horton, 87 B.R. 650 (Bankr. D. Colo. 1987); *In re* Strelsky, 46 B.R. 178 (Bankr. E.D. Va. 1985); *In re* Stern, 44 B.R. 15 (Bankr. D. Mass. 1984).

117. *In re* Hill, 100 B.R. 907 (Bankr. N.D. Ohio 1989); Rink v. Timers Homeowners Ass'n, Inc., 87 B.R. 653 (Bankr. D. Colo. 1987).

courts have recognized scenarios where community associations could recover post-petition assessments.[118]

Association rights to collect assessments on a common interest community residence whose owner becomes bankrupt improved after enactment of the Bankruptcy Reform Act of 1994.[119] The Bankruptcy Reform Act included the following addition to the Bankruptcy Code's catalogue of debts that are nondischargeable by a bankruptcy decree:[120]

> (16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has condominium ownership or in a share of cooperative housing corporation, but only if such fee or assessment is payable for a period during which
>
> (A) the debtor physically occupied a dwelling unit in the condominium or cooperative project; or
>
> (B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period,
>
> but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case.[121]

Although the reform strengthened the position of condominium and cooperative associations in many states, it does not protect all post-petition assessments from discharge, is inapplicable to pre-petition assessments, and inapplicable to most Chapter 13 reorganizations.[122]

Faced with enforcement difficulties in collecting assessments, some associations resort to self-help. Courts are divided on whether associations may cut off services or access

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118. *In re* Harvey, 88 B.R. 860 (Bankr. N.D. Ill. 1988); *In re* Case, 91 B.R. 102 (Bankr. D. Colo. 1988); *In re* Lenz, 90 B.R. 458 (Bankr. D. Colo. 1988).

119. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994).

120. *See generally* 11 U.S.C. § 523 (1994).

121. 11 U.S.C. § 523(a)(16). This provision applies to Chapter 7 liquidations, and to Chapter 11 reorganizations where the debtor is, as will usually be true in community associations assessment cases, an individual. 11 U.S.C. § 1141(d)(2). It applies to reorganizations under Chapter 13 only when the discharge is a "hardship" discharge. 11 U.S.C. § 1328(b).

122. *See infra* notes text accompanying notes 197-98.

to common amenities to residents who are delinquent on assessments.[123] Clearly, language in the declaration providing for extra-judicial steps can be helpful to establish association self-help powers.[124]

C. *Planning for Future Costs, Contingencies and Community Upgrades*

In the life of a community association, it is foreseeable that the association will from time to time encounter major, urgent financial demands. The exact timing and extent of these demands is difficult to project. Common facilities, like all improvements to realty, typically have limited useful lives and will periodically require major renovation or replacement. Some facilities may be mere amenities like swimming pools or clubhouses. Other facilities are necessary infrastructure, such as community roads and drainage, and may be an integral part of individual residences.[125] Casualty losses may damage the community severely, without forewarning. A community association may perceive an urgent need to expand or upgrade its amenities to keep values of homes it represents competitive with homes in the surrounding area.

Association management must perform its budgeting and set and collect its assessments with such potential future developments in mind. No one can know in advance what costs will be demanded, or when. It is inescapable that some exigencies will arise and that the association must be able to respond with urgently needed cash while keeping itself fiscally sound.

1. *Reserves*

From the outset of the common interest communities boom of the 1960s, proponents have contemplated that community associations would maintain reserves for replacement of capital assets,[126] and as working capital.[127] By 1992, funds

123. *Compare* San Antonio Villa del Sol Homeowners Ass'n v. Miller, 761 S.W.2d 460 (Tex. App. 1988), *with* Western v. Chardonnay Village Condominium Ass'n, 519 So. 2d 243 (La. Ct. App. 1988).

124. *See, e.g., Chardonnay Village*, 519 So. 2d 243; Lonon v. Board of Dir. of Fairfax Condominium IV Unit Owners Ass'n, 535 A.2d 1386 (D.C. 1988).

125. A classic example would be the roof or structural elements of a residential condominium building.

126. *See* HOMES ASSOCIATION HANDBOOK, *supra* note 8, § 14.52, at 226-27.

in common interest community reserve accounts had reached an estimated $5 billion,[128] and reserve accounts constituted the single budget category which led to the most assessment increases.[129] CAI has devoted substantial efforts to encouraging the study of reserve needs, and the maintenance of reserve funds for major, contingent future expenses.[130] Indeed, some state courts and legislatures consider the maintenance of capital reserves as among the important obligations of community associations management.[131]

In their handbook on financial management of community associations,[132] CAI and the Urban Land Institute ("ULI") have argued for programmed, long-term accumulation of reserve funds as the preferred financing method for significant capital expenses.[133] Their argument is two-pronged.

First, large amounts of money needed for repair or replacement of capital assets or for operational problems, will be difficult to raise from sources other than existing reserve funds.[134] Members will inevitably resist sharp assessment increases, some because their own incomes are fixed, some because they plan on moving out of the community before realizing the benefit of the expenditure.[135] Also, lenders may well consider the lack of reserve funds a financial weakness of associations seeking to borrow cash urgently needed for repair, replacement or operational reasons.[136]

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127. *See id.* § 14.53, at 227-28.

128. CAI FACTBOOK, *supra* note 3, at inside cover.

129. *Id.* at 23.

130. *See generally, e.g.*, COMMUNITY ASS'NS INST., RESERVE TO PRESERVE (1984).

131. *See, e.g.*, Raven's Cove Townhomes, Inc. v. Knuppe Dev. Co., 171 Cal. Rptr. 334 (Ct. App. 1981); *see also infra* notes 151-65 and accompanying text.

132. ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24.

133. *Id.* at 102-05.

134. *Id.* at 102-03.

135. *Id.*

136. *See, e.g.*, Benny Kass, *Saving for a Rainy Day*, WASH. POST, Feb. 22, 1997, at E11. Kass, a respected community association law practitioner, argues that lenders investigate a community association's reserve studies and funding in deciding whether to finance individual home purchases within a community association. *Id.*; *see also* RICHARD WYNDHAMSMITH, RESERVE STUDY GUIDELINES FOR COMMUNITY ASSOCIATIONS, PLANNED COMMUNITIES, CONDOMINIUMS 6 (1989). This practice has not yet become standard for many lenders in this situation, though analysis of reserves can be expected to become more regularly part of evaluating community associations property as security for financing in the years ahead. Lenders are currently less likely to analyze association reserves in communities "less-sophisticated" in the operation of

Second, fairness would seem to require members to pay for the association's capital assets as they "consume" them.[137] Unlike public governments, community associations should operate on a "pay as you go" basis.[138] Unlike public governments, which often assume a perpetually expanding tax base as a municipality grows, community associations are generally constituted to preclude such future growth.[139]

Reserve studies evaluating the condition of capital assets and projecting repair and replacement costs should be performed every few years for each community association.[140] A sub-industry of reserve specialists conducting such studies has developed. CAI recommends retention of a specialist to perform reserve studies, and has established a special designation for specialized reserve study providers qualified by experience, background, work, product, references and continuing experience.[141] The American Institute of Certified Public Accountants requires its members to disclose, as "unaudited supplementary information" in common interest community audits, estimates of future costs of common capital assets and the extent of actual reserves funds accumulated.[142] If such information is not provided by an association to the auditor, its absence is to be prominently reported, even

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common interest communities. Laughlin Interview, *supra* note 49.

137. The *Homes Association Handbook*, *supra* note 8, takes a similar view, except in cases where improvements being used prior to eventual replacement have, themselves, been financed by borrowing and are therefore already being paid for by those users via assessments which include debt service for the prior financing. In such cases, the *Homes Association Handbook* still recommends maintenance of reserves to account for the gap (due to inflation) between the cost of the original assets and their eventual replacement costs. HOMES ASSOCIATION HANDBOOK, § 14.52, at 226-27.

138. ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24.

139. For a summary of the debate, *see* ULI/CAI Financial Management Guide, *supra* note 50, at 103.

140. Reserve studies are typically conducted on a two to four year cycle, though more frequent studies are often recommended or required to reflect, for example, changes in the property, construction cost fluctuations and unpredictable weather. John P. Poehlman, *Updating Your Reserve Study*, COMMON GROUND, Sept.-Oct. 1996, at 28.

141. *See* RESERVE FUNDING & RESERVE INVESTMENT STRATEGIES 9 (Mitchell Frumkin & Christopher Juall eds., 3d ed. 1998); *see also* WYNDHAMSMITH, *supra* note 136, at 9.

142. AM. INST. OF CPAS, AICPA AUDIT AND ACCOUNTING GUIDE: COMMON INTEREST REALTY ASSOCIATIONS § 4.30 (1991). There is no requirement that such studies be conducted by professional engineers; the association board may instead base its estimated costs on consultations with licensed contractors. *Id.* § 4.30 n.10.

if neither state statutes nor the association's governing documents require reserve studies or funding.[143]

These studies—which include physical analysis of the association's facilities and financial analysis of maintenance and replacement costs[144]—must somehow account for the inevitable increase in replacement cost over the cost of the original asset, during its useful life. Within the field, there is debate between those who would attempt to project inflation from the start, figuring such a projected inflation adjustment into assessments allocated to reserves, and those who would factor inflation in gradually by the recurrent review and recalculation of reserve projections every few years, thus reflecting inflationary changes only after they occur.[145] There will often be the temptation to invade the reserves to lower ongoing assessments, or pay for ongoing operating costs. This, of course, would defeat the purpose of the reserves to pay for irregular, capital and unforeseeable costs, and is, therefore, ill-advised.[146]

Many common interest community members would prefer to pay the lower present assessments that would be necessary if calculated to cover only current, projected operating costs, computed without an extra allowance for reserve funding. Some would prefer to not think about the risks left unaddressed by such a smaller assessment. Of course, these same members—if they are still in the community—will face the music when the replacement, repair or other emergency materializes which would have been addressed by reserves had they been maintained. Sometimes residents feel that they will have left in the community before replacements or repairs funded by reserves are needed.[147]

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143. *Id.* § 7.40; *see also id.* § 7.41. For useful summary of the AICPA Audit Guide reporting requirements regarding community association reserves, *see generally* RESERVE FUNDING & RESERVE INVESTMENT STRATEGIES, *supra* note 141, at 19-22.

144. RESERVE FUNDING & RESERVE INVESTMENT STRATEGIES, *supra* note 141, at 9.

145. *See, e.g.,* ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24, at 104.

146. *See, e.g.,* ROHAN, *supra* note 2, §7.10[6], at 7-48-49.

147. In an astonishing comment at a reserves discussion in the Fall 1997 CAI National Conference, one Florida engineer who indicated he conducts reserve studies commented on the attitude of many very elderly community association members he deals with "don't even buy green bananas" because they don't expect to necessarily be around to eat them! Notes from this meeting, held on October 24, 1997, are on file with the author who was present at the

In some communities, members may have the financial wherewithal to address problems only as they actually materialize. These members may prefer to do so rather than have their association set aside reserves,[148] since overriding safety concerns dictate that reserve funds held by the association will often be invested at lower rates or return than its members could reap by individually investing the same funds in riskier or less liquid investments.[149] The association's rate of return on invested reserves is further limited by income taxation of whatever income is generated on its invested reserve funds.[150]

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meeting. To this author, this supposed attitude hardly seems like a basis for sound financial planning.

148. *See, e.g.*, WAYNE HYATT, CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW § 6.03(a)(5), at 248 (2d ed. 1988). In conversations with this author, Mr. Hyatt—among our most respected and experienced common interest community attorneys and scholars—he has stressed the varying needs regarding reserves of community associations of differing sizes and income levels as a reason for not legislatively mandating the maintenance of reserves by all community associations.

149. *See* NAT'L ACCOUNTANTS COMM. OF THE COMMUNITY ASS'NS INST., INVESTMENTS BY COMMON INTEREST REALTY ASSOCIATIONS (1997). The Accountants Committee characterized the safety of principal as "normally the overriding consideration followed by liquidity and return on investment" in selecting the proper investment vehicles for association reserves and other funds, with return on investment being "the last element considered" in such decisions. *Id.* On this basis, this Accountants Committee highlights as safest those "investments which are federally insured instruments or funds deposited with federally insured institutions (not to exceed the insured limitation), backed by the full faith and credit of the Federal Government," adding that "[I]nvestments in other than federally backed instruments or institutions which subject the principal to risks should only be assumed only when the board understands the level of risk and the expectations of the level of tolerance by all members of the" [community association]." *Id.*; *see also* CAROL CAGIANUT, INVESTMENT STRATEGIES BOOST ASSOCIATIONS RESERVES, BOARD BRIEFS (1995); *see generally* RESERVE FUNDING & RESERVE INVESTMENT STRATEGIES, *supra* note 141, at 23-34 (providing a general analysis of the pros and cons of the various reserve fund investment choices). This authority also cautions against investment strategies focused primarily on high rates of return. *Id.* at 34.

150. Section 528 of the Internal Revenue Code, enacted in 1976 to apply to many community associations, taxes association income on reserves at an inequitable 30% rate. I.R.C. § 528 (1994). Furthermore, a substantial number of associations may not qualify for its complex prerequisites. Associations not electing taxation under section 528 of the Internal Revenue Code would instead file as ordinary corporations subject to section 277 of the Internal Revenue Code, which would lower the rate of taxation by as much as half. I.R.C. § 277. But section 277 of the Internal Revenue Code creates its own uncertainties and risks for associations, and association accountants have urged for clarification, simplification and reform of the Code as applied to association investment income. *See, e.g.*, COMMUNITY ASS'NS INST., PROPOSAL FOR MODIFICATION OF

2. *Reserve Fund Legislation*

The importance of reserves, not only to common interest communities but to many assets which function as, or in lieu of public facilities, has led to a recent and somewhat disjointed legislative movement among about a dozen states to encourage reserve studies and maintenance.

Perhaps the most comprehensive and detailed state regulation is the Hawaii condominium statute and regulations.[151] The Hawaii statute requires associations, as part of an annual budgeting process, to conduct detailed reserve studies estimating the necessary reserves,[152] and to actually fund reserves to at least 50% of estimated needs by the year 2000.[153] This funding requirement softens a 100% funding requirement due in 1998, originally enacted a few years earlier, apparently a result of widespread complaints when initial imposition of the reserve funding requirement triggered substantially increased maintenance assessments.[154] Hawaii also prohibits each association from exceeding its adopted annual budget by more than 20%, except in emergency situations.[155] Those acting on behalf of the association are shielded from liability for incorrect estimates in the reserve analysis only when made in good faith.[156]

An intermediate approach to reserve regulation is reflected in Illinois law, where a statute interpreted to have codified a common law fiduciary obligation to maintain re-

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INTERNAL REVENUE CODE § 528 (1997). For a summary of taxes applicable to income on reserve fund investments, *see* RESERVE FUNDING & RESERVE INVESTMENT STRATEGIES, *supra* note 141, at 33-34.

151. 28 HAW. REV. STAT. § 514A-83.6 (1990); 16 HAW. CONDOMINIUM REGULATIONS subch. 6, §§ 16-107-61 to 16-107-75 (1990). The regulations state as the regulatory objective "to ensure that each owner in a condominium project pay a fair share of the short-term and long-term costs of operating the project, based on the owner's period of ownership. *Id.* § 16-107-61.

152. 28 HAW. REV. STAT. § 514A-83.6(a), (c) (1990).

153. *Id.* § 514A-83.6(b) (1990).

154. Interview by Derek Samuelson with Linda Alexander, Chaney, Brooks & Company, in Honolulu, Hawaii (Jan. 13, 1998). Ms. Alexander indicates the reserve legislation is still widely unpopular among Hawaii condominium associations, though she considers it a prudent measure to force the many associations which would not maintain adequate reserves to manage more proactively. *Id.* However, critics have opposed the Hawaii model of reserve regulation as legislative micro-management, imposing on all associations requirements which are appropriate to only some associations. *Id.*

155. 28 HAW. REV. STAT. § 514A-83.6(f) (1990).

156. *Id.* § 514A-83.6(d).

serves[157] requires condominium associations to maintain "reasonable reserves for capital expenditures and deferred maintenance for repair or replacement of the common elements."[158] "Reasonable" reserves may be determined by taking into account estimated repair and replacement costs, useful lives of common element components, rates of return on invested reserve funds, and discretionary items such as the financial impact of reserve funding on unit owners and the value of their units, and the ability of the association to obtain financing for such costs.[159] The reserve funding requirement is subject to waiver in whole or in part by two-thirds of the total votes within the association, provided that such a waiver must be declared in boldface on association financial statements and must insulate the board, its managers and the members from liability for inadequacy of reserves.[160] Some other states also follow this general pattern of a legislative mandate to budget for reserves, while allowing the association's membership by vote to override the statutory reserves mandate, and to reduce or eliminate reserve funding from the budget.[161]

California declines to require reserve funding, but extensively regulates reserve studies,[162] and their disclosure.[163] A further alternative is to require only disclosure of the status of reserves, if any.[164] Some state statutes contain simple, broad directives that associations must establish a fund for

157. Maercker Point Villas Condominium Ass'n v. Szymski, 655 N.E.2d 1192, 1194 (Ill. Ct. App. 1995) (recognizing developer's fiduciary duty to fund reserves to have arisen as of the date the condominium declaration was filed).

158. 765 ILL. COMP. STAT. § 605/9(c)(2) (West 1993 & Supp. 1998).

159. *Id.* § 605/9(c)(2)(i)-(v).

160. *Id.* § 605/9(c)(3)-(4). The implication of this section, bolstered by the language of *Maercker Point Villas Condominium Ass'n v. Szymski,* 655 N.E.2d 1192 (Ill. Ct. App. 1995), seems to be that liability could attach for inadequate funding of reserves in the absence of an express waiver under section 605/9(c)(3) of the Illinois statutes.

161. *See, e.g.,* FLA. STAT. ANN. §718.112(f) (West 1988); MASS. GEN. LAWS 183A § 10(i), (m) (1987) (requiring "adequate" reserve finding); OR. REV STAT. § 100.175 (1990) (future assessments for reserves may be reduced or terminated following the second year after transition to unit-owner control of the association; reserves may be used in some situations to meet regular operating costs).

162. CAL. CIV. CODE. § 1365.5 (West 1982 & Supp. 1998).

163. *Id.* § 1365.

164. *See, e.g.,* ALASKA STAT. § 34.08.530(a)(5) (1996) (addressing public offering statements for common interest communities).

reserves.[165]

3. *Alternatives to Reserves*

It would seem that an important alternative to funding for contingencies such as those addressed by reserve studies and funds, would be borrowing by the association at the time a cost arises, with repayment coming out of increases in future assessments. Some declarations and association documents expressly provide for authority to arrange such financing. But legislatures have largely ignored the issue of association borrowing authority[166] outside the context of UCIOA and its related uniform acts.

Under UCIOA, association borrowing is expressly contemplated and authorized, subject to significant safeguards. Under section 3-112 of UCIOA, the association is empowered to use severable portions (e.g., a separate athletic facility) of the common elements of a community as security for the association's financing if approved by 80% of the votes in the association.[167] UCIOA also contemplates association financing in which rights to future income, including assessments, is pledged as security for new financing, although such financing must be expressly authorized in the declaration.[168] It remains unclear how actively lending institutions would provide association financing, even if the association's authority was clear.[169] Furthermore, financing repairs and

165. *See, e.g.*, IND. CODE § 32-1-6-22(c) (1979 & Supp. 1997); MICH. COMP. LAWS § 559.205 (1988) (delegating rulemaking authority to establish minimum standards for reserve funds); *Id.* § 515B.3-114 (adding a brief, general reserves requirement to the surplus section of Minnesota's version of the Uniform Common Interest Ownership Act).

166. See ROHAN, *supra* note 2, § 7.10[6][c], at 7-51.

167. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-112 (1994), 7 pt. 1 U.L.A. 591 (1997). A common area or facility can be pledged *only* where the resulting encumbrance *cannot* deprive any unit of ingress, egress, or structural support. *Id.*

168. *Id.* § 3-102(1)(n), at 573; *see also* Matthew Leeds, *Executive Summary of Proposed Condominium Lending Statute, in* TITLE INSURANCE 1996: THE BASICS AND BEYOND (1996).

169. *See supra* note 136 and accompanying text. *But see* Nico F. March, *Loans Are a Many Splendored Thing*, COMMON GROUND, Mar.-Apr. 1996, at 32. March observes that institutions are "increasingly offering loans" to community associations. *Id.* For example, a few years ago the National Cooperative Bank fairly recently announced a special program to lend $250 million over a five-year period to community associations to finance major repairs and replacements such as those which have often forced associations to impose large special assessments. *Id.* Eligible associations must be at least seven years old and

replacements, when they are necessary, to be repaid by unit owners in the future, would arguably misallocate the costs of replaced or repaired assets away from those association members who actually consumed them.[170]

As an extraordinary example of association borrowing which may presage future financing strategy, in 1995 a very large community association assembled a $15 million private-placement bond offering to repay a debt to the community's developer and to finance a new recreation center and pool.[171] Highlands Ranch, a 31,000-resident planned community south of Denver, Colorado, used a 99.8% assessment collection rate and the resulting nearly $4 million annual assessment revenue to obtain a AAA rating from Standard & Poor's.[172] The Highlands Ranch association had other strengths to offer investors. For example, Colorado had adopted the portions of UCIOA which strengthened association financing powers. Also the bylaws of Highlands Ranch allowed the community association manager to impose assessments if the board lacked a quorum or failed to act, neutralizing a political risk in the event association management perceived a need for additional assessment income.[173] Attorneys involved in the bond offering recommend this strategy for well established communities with strong financial histories.[174]

4. *Special Assessments*

Perhaps the most drastic way of raising funds when a contingency materializes is a "special assessment"—a single assessment for the purpose of discharging a capital or extraordinary expense.[175] Special assessments can be payable in one or more payments and a declaration may empower the board to levy both regular and special assessments.[176] Provi-

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70% occupied. *See Special Assessment Alternative: Bank Offers Repair Loans*, *in* COMMUNITY MANAGEMENT 5 (1995).

170. ULI/CAI FINANCIAL MANAGEMENT GUIDE, *supra* note 24, at 103.

171. *See* Jerry C.M. Orten & Robert D. Hoehn, *Where No Board Has Gone Before*, COMMON GROUND, Nov.-Dec. 1995, at 20.

172. *Id.*

173. *See id.*

174. *Id.*

175. ROHAN, *supra* note 2, at 7-48.

176. The sample below was provided by Lynn Jordan, Esq.:

Common Expenses. As used in this Declaration, this term includes all charges levied by and for the benefit of the Association, pursuant to

sions relating to special assessments may provide for owner referendum for extraordinary and capital expenditures, "referred" to the membership by the board.[177]

Accordingly, special assessments have been approved for a wide range of purposes.[178] Because of the urgency of the circumstances giving rise to special assessments, courts sometimes stretch their reading of association documents to

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the Governing Documents, including, but not limited to: (i) annual costs and expenses of the Association, (ii) large, single item expenditures of the Association (including but not limited to, capital expenditures and "Special Assessments"), and (iii) amounts necessary to fund reserves pursuant to Section __ below.

Common Expense Assessment(s); Assessment(s). In addition to the definition included in the Act, these terms shall include these items levied against a particular Owner or Unit: (i) late charges, attorneys' fees, fines, and interest charged by the Association at the rate as determined by the Executive Board, (ii) charges against a particular Owner and the Unit for the purpose of reimbursing the Association for expenditures and other costs of the Association in curing any violation of the Governing Documents by the Owner or Related Users (including "default assessments"), and (iii) "Special Assessments" as described in below.

Special Assessments. In addition to the assessment authorized above, the Association may at any time, from time to time, determine, levy and assess a Special Assessment applicable to that particular assessment year for the purpose of defraying, in whole or in part, payments for (i) any operating deficit and/or unbudgeted costs, fees and expenses, or (ii) any construction, reconstruction, repair, demolition, replacement or maintenance of a capital improvement and any fixtures or personal property related thereto. Any such Special Assessment shall be due and payable as determined by the Executive Board. The term "capital improvements", as used herein, shall mean the construction, erection or installation of substantial structure(s) or other substantial improvements on the Real Estate, or the construction, reconstruction, erection, installation, maintenance, repair or replacement of Common Elements presently located on the Real Estate or which may hereafter be constructed, erected or installed on the Real Estate. Notice in writing setting forth the amount of such Special Assessment per Unit and the due date for payment thereof shall be given to the Owners not less than thirty (30) days prior to such due date.

Jordan Interview, *supra* note 56.

177. *Id.* This approach is recommended by ULI and CAI. *See* URBAN LAND INST. & COMMUNITY ASS'NS INST., CREATING A COMMUNITY ASSOCIATION: THE DEVELOPER'S ROLE IN CONDOMINIUM AND HOMEOWNER ASSOCIATIONS 36 (2d rev. ed. 1986).

178. Fogarty v. Hemlock Farms Community Ass'n, Inc., 685 A.2d 241 (Pa. Commw. Ct. 1996); Braeshire Condominium Bd. of Managers v. Brinkmeyer, 841 S.W.2d 217 (Mo. Ct. App. 1992); Cedar Cove Efficiency Condominium Ass'n v. Cedar Cove Properties, Inc., 558 So. 2d 475 (Fla. Dist. Ct. App. 1990); Washington Courte Condominium Ass'n-Four v. Cosmopolitan Nat'l Bank, 523 N.E.2d 1245 (Ill. 1988), *appeal denied* 530 N.E.2d 266 (1988).

find authority for the assessment.[179] Still, where association documents lack specific authorization for special assessments may bar the imposition of such assessments may be simply unavailable to an association.[180]

In any case, special assessments spell potential financial trauma for residents of all but the most affluent common interest communities. By definition, they have not been budgeted by the community, and they are less likely to have been budgeted by its residents. If reserves are not maintained as communities age, furthermore, the prospect of one special assessment is unrealistic. A whole range of common elements and facilities are aging, and repair or replacement will likely be needed to more than one facility within a fairly limited time span, much the way repairs start to mushroom at some point as, say, an automobile starts to age. This may well mean multiple special assessments for many associations.

IV. RECOMMENDATIONS FOR STUDY AND POTENTIAL CHANGE

The problem of funding repair or replacement of common facilities and elements is not a problem limited to any given association. Because of the relatively sudden rise of common interest communities the problem of aging association facilities needing repair or replacement for which funds are not readily available will likely reach epidemic proportions in the years directly ahead.

As we have seen, the rise of community associations has been partly spurred by the privatization of services and facilities previously provided by the public sector.[181] If associations prove unable to continuously support these services and

179. *Compare* Cottrell v. Thornton, 449 So. 2d 1291 (Fla. Dist. Ct. App. 1984). The court approved a $600 per unit special assessment for major restoration to a canal system and pool in order to prevent further damage to the common elements:

> [A] necessary repair . . . may involve a major expenditure of funds . . . The fact that a major expenditure is involved in making a substantial, necessary repair does not convert the repair into a material or substantial addition or alteration as is contemplated under the terms of the condominium documents, which would trigger a vote of the unit owners.

Id. at 1292.

180. *See, e.g.*, Lovering v. Seabrook Island Property Owners Ass'n, 352 S.E.2d 707 (S.C. 1987). *See also*, WAYNE HYATT, CONDOMINIUMS AND HOME OWNER ASSOCIATIONS: A GUIDE TO THE DEVELOPMENT PROCESS 207-208 (1985).

181. *See supra* notes 12-21 and accompanying text.

facilities, the public welfare as we traditionally have known it—which has included these services and facilities—will be injured. Those common elements which are truly private to a given community should also be of profound public concern because, in the aggregate, they affect so many of our citizens. As the need for repair or replacement of community association common elements becomes sufficiently widespread with the aging of the common interest communities they administer, the aggregate funding problem will affect our society pervasively and substantially.

The potential financial and social problem triggered raise the question of what reasonable society-wide measures can be implemented to lessen this potentially massive problem triggered if quasi-public services and facilities provided by community associations become unavailable.

A. *Empirical Research Needs*

As an initial step, research on community associations, which has increased in the past decade, must accelerate, focusing in more significant proportion on detailed empirical data we currently lack.

1. *Economic Data*

Among areas calling for further study is evaluation of the financial status of community associations throughout the U.S. Research should address the following questions. What community facilities are aging and at what rate? How soon will these assets require repair and replacement, and at what cost? On the other hand, how well prepared are our community associations with reserve funding? In which geographical and operational areas do actual reserves approach anticipated needs, and in which areas do they not? Is there any evidence that existing legislation has improved the actual funding of community association reserves?

2. *Association Management Data*

These issues, in turn, call into question a whole series of deeper, potentially difficult questions about community association governance and management. Empirical research is urgently needed. What is the present state of common inter-

est community management?[182] What financial and management competencies are currently utilized by community associations, either from members on association boards or via management companies and other professionals retained by the associations? To the extent associations have deficiencies in management and financial competencies, what options exist for addressing them?

3. *Assessing the Broader Social Role of Community Associations*

Inevitably, evaluating options for association management entails even broader, more profound choices as to the general social role of community associations in our society.

This article has focused on the financial role of community associations, with emphasis on the maintenance of quasi-public services and facilities. But, community associations play profoundly important additional roles as well. They regulate land use within their boundaries via application and enforcement of privately imposed restrictions that intrude on resident conduct far beyond the reach of public zoning or analogous law.[183] In their rulemaking and enforcement roles, combined with their financial role of financing and maintaining quasi-public services and facilities, community associations are truly becoming powerful residential private governments. Their private status has thus far blocked application to community associations of constitutional safeguards applicable to public governments.[184] Any significant reshaping of association structures or powers to collect funds or manage community assets and services po-

182. *See supra* notes 37-46 and accompanying text.

183. Rather than broad dictates and classifications like those typical of many zoning ordinances, which decree various densities of residential or other uses, community association servitude regimes frequently regulate minute physical details of their unit appearances, including such details as the color of curtain liners or swing sets, the location and content of planter boxes, and the sizes (to the 16th of an inch) of screws used to install balcony enclosures. *See, e.g.*, Winokur, *Mixed Blessings, supra* note 10, at 74.

184. This author has agreed with shielding community associations from full applicability of public constitutions. *See id.* at 88; *see also* Stewart E. Sterk, *Minority Protection in Residential Private Governments*, 77 B.U. L. REV. 273, 275-77 (1997); Katherine Rosenberry, *The Application of Federal and State Constitutions to Condominiums, Cooperatives and Planned Developments*, 19 REAL PROP. PROB. & TR. J. 1, 28 (1984). Useful recent analysis suggesting more subtle, case-by-case inquiry appears in Hyatt, *supra* note 17, at 338-41.

tentially involves reallocation of power and alteration of roles within the larger, already explosive socio-political structure of community associations.[185] Thus, changes in associations' financial roles should be based on the most accurate and complete possible knowledge of current social, political and economic realities of current community association life. Strategies addressing financial issues facing community associations are also bound up with the role of these associations in our society's quest for a greater sense of "community."

Thus, empirical research exploring California and Florida community associations should be expanded to cover representative communities nationally,[186] probing even further into the details of how common interest communities actually function. What type of communities are taking shape in our community associations? What patterns of interactions among neighbors result from which present financial and regulatory practices? How are residents' lives, and their perceptions of their communities, enhanced, burdened or otherwise affected by present association practices?

Only with a deeper knowledge of the actual economic position, actual management abilities, and actual social realities of community associations, can sensible strategies for strengthening association finances be soundly determined. The empirical research to supply this data is necessary to sensible reform of community associations.

B. *Law Reform Possibilities to Strengthen Community Associations Financially*

However urgent they may be, proposals for legal reforms to strengthen community association finances must ultimately be weighed and evaluated against the background of the type of data called for in the research agenda just briefly summarized and in the context of decisions on the broader role common interest communities should play in our society. Accordingly, the points raised below are intended less as con-

185. *See supra* note 26-37 and accompanying text.

186. The most complete empirical research into community association life is in BARTON & SILVERMAN, supra note 34 (focusing on California associations), and WILLIAMS & ADAMS, supra note 34 (focusing on Florida associations). Both of these studies, while pathbreaking and helpful, are of limited scope, and require updating.

clusions or final recommendations than as proposals for more thorough consideration in the light of the necessary empirical research. The following points do, however, proceed on the as-yet-unproven premise that many associations are poorly prepared to meet the important financial needs which will inevitably arise during the years ahead. To strengthen associations financially, several types of legal reforms deserve further consideration.

1. *Tax Reform: Societal Sharing of Association Obligations to the Public*

We have seen that community associations finance and provide some services and facilities which have traditionally been within the realm of public governments. These range from maintenance of infrastructure such as roads, sewage facilities and parks, to provision for services such as trash collection.[187] Common interest community residents typically pay for these services twice, through private community assessments and public property taxes.[188] This double-taxation is unfair, and should be remedied.

We have also seen that income on association investment of reserves is taxed more or less as would be income to other private investors. However, community associations are not simply private, profit-seeking investors; they are, in part,[189] custodians of valuable public facilities. As such, community associations should benefit from preferential tax treatment of reserve investment income. As discussed briefly above, although section 528 of the Internal Revenue Code was enacted in 1976 to provide some such relief to community associations, this legislation has proved ineffective for associations in several respects.[190] CAI has recommended changing the tax rate applicable to association income under section 528 of the Internal Revenue Code from 30% to 21.5%, and modifica-

187. *See supra* note 15-16.

188. *See, e.g.*, Dowden *supra* note 18, at 36, 44-46.

189. Depending on the community, investment in maintaining various common elements would more properly be seen as enhancing the welfare and private property values of association residents, serving private rather than public (or even quasi-public) functions. In determining the extent of any public government subsidy via tax relief, careful analysis and classification of association services and facilities would be required to tailor the tax benefit to match the public benefits being conferred.

190. *See supra* note 148 and accompanying text.

tion or elimination of some prerequisites to applicability of section 528.[191] Congress should favorably consider these or other simplifying and clarifying changes.

2. *Strengthening Community Associations Assessment Collection Rights: Lien Priority and Bankruptcy Changes*

At least to the extent it supports maintenance of public or quasi-public services and facilities, assessment collection in common interest communities is analogous to collection of property taxes by our public governments. The impediments to assessment collection are too great, given how crucial these assessments are to societal welfare. All of our states should adopt legislation patterned on UCIOA's "super-priority" lien[192] for community association assessments.[193] Ideally, this priority would be accorded to a substantially greater share of assessments than the six months of assessments.[194] However, the prioritization of even six months of assessments substantially changes the leverage of associations in collecting defaulted assessments.[195] Wider enactment of UCIOA's provisions would be a substantial help.[196]

Earlier discussion reviewed the impediment to assessment collection posed by federal bankruptcy law.[197] Some community association assessments otherwise payable by an association member are discharged if the member obtains protection in bankruptcy. By analogy to a host of debt treated as nondischargeable for public policy reasons,[198] *no* community association assessment liabilities should be discharged in bankruptcy. By enacting the Bankruptcy Reform Act of 1994, the Congress moved in this direction by excluding from discharge many post-petition assessments.[199] At the

191. *See* COMMUNITY ASS'NS INST., PROPOSAL FOR MODIFICATION OF INTERNAL REVENUE CODE § 528 (1997).

192. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b) (1994), 7 pt. 1 U.L.A. 600 (1997).

193. *See supra* notes 91-110 and accompanying text.

194. *See supra* note 107 and accompanying text.

195. *See supra* notes 104-105 and accompanying text.

196. *See generally* Winokur, *Meaner Lienor Associations*, *supra* note 1.

197. *See supra* notes 111-23 and accompanying text.

198. 11 U.S.C. § 523 (1994).

199. *See supra* notes 120-23 and accompanying text.

very least, additional clarifications should complete the protection of post petition assessments from bankruptcy discharge. New Bankruptcy Code Section 523(a)(16) dealing with such assessments should be amended to include homeowners associations and commercial condominium associations. Its applicability should be tied to ownership, rather than occupancy, of a common interest community unit, clarifying that post petition assessments remain nondischargeable so long as the debtor or the trustee has an ownership interest in the unit. Furthermore, Section 365 should be amended to clarify that community association assessments are not executory contracts dischargeable under Chapter 13 reorganizations.

3. *Clarify Association Borrowing Power*

States should consider going at least as far as UCIOA in authorizing community associations to borrow for repair or replacement of common elements and facilities by pledging either severable portions of common elements or future assessment revenue.[200] Where funded association reserves are exceeded by urgent repair or replacement costs, such borrowing is often the principal alternative to potentially staggering special assessments, because it at least allows the spreading of repair and replacement costs over the life of the loan the association negotiates. However, the association must have clear authority to conduct such negotiation and to conclude the financing. Legislation can provide this authority for associations whose creating documents ignore the issue.

4. *Reserves Legislation*

The maintenance of fully funded reserves generally represents the soundest approach for financing extraordinary expenses such as repair and replacement of common elements.[201] On the premise that numerous associations have failed to so fund reserves,[202] legislation to increase the adequacy of reserves seems essential to operating associations

200. *See supra* notes 165-68 and accompanying text.

201. *See supra* notes 127-43 and accompanying text.

202. Research is needed to determine the accuracy of this premise, and the degree by which actual reserves fail to meet projected demands on such funds in the years ahead. *See supra* note 180 and accompanying text.

on a sound economic footing which protects the substantial public and quasi public facilities for which they are responsible and on which much of our society relies. Many professionals involved with community associations argue against legislation addressing reserves, based on the varying needs of different communities.[203] CAI recently updated its public policy to state that, while it

> believes community associations should be encouraged to fund and maintain reserves, CAI opposes laws which mandate how community associations fund and maintain reserves. CAI believes that the method and manner of funding reserves are best addressed by the members of the community associations and its elected board of directors.[204]

CAI policy further urges that it is "imperative" for associations to budget for reserve needs and agrees that associations should fully disclose elements of their budgeting process, presumably including reserves planning.[205]

If, as premised,[206] associations maintain no reserves for capital costs, while others maintain grossly inadequate reserves, it would seem clear that these matters are manifestly *not* "best addressed by the members of the community associations and its elected board of directors" in their *unfettered* discretion," as CAI's policy asserts. On the other hand, as previously noted,[207] some associations—particularly those with affluent memberships—could legitimately eschew reserve funding in favor of financing repairs and replacements as the need arises.

Of the present patterns of reserves legislation, the Illinois model[208] most effectively combines impetus to maintain reserves with flexibility for associations to explicitly elect a different financing strategy for maintaining common capital

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203. *See supra* notes 146-48 and accompanying text.

204. COMMUNITY ASS'NS INST., CAI PUBLIC POLICY MANUAL: COMMUNITY ASSOCIATION BUDGETS AND RESERVES 41 (1997).

205. *Id.*

206. Clearly, as previously urged, more accurate and detailed data are needed regarding the present adequacy of reserve funding in our community associations. However, such evidence as exists suggests that reserves currently fall far short of reasonable levels necessary to cover costs of projected maintenance costs. *See e.g.*, Winokur, *Mixed Blessings, supra* note 10, at 64 n.267, including authorities cited therein.

207. *See supra* notes 149-51 and accompanying text.

208. *See supra* notes 158-62 and accompanying text.

assets. While requiring maintenance of "reasonable" reserves, this model permits consideration of a broad range of financial impacts on unit owners in determining reserve strategy and allows a super-majority vote of association members to avoid reserve funding, provided that such election be prominently disclosed on all association financial documents. Unlike the Illinois statute, reserve legislation should apply equally to non-condominium community associations. Community association reserve legislation patterned on this model deserves careful consideration by state legislatures.

5. *Enhancing Competence of Community Association Management*

Management of community association finances is most likely to be effective if performed by competent leadership. Currently, there is serious question about the qualifications and competence of the leadership of many community associations.[209] A wide range of competency levels can be found in present community association management and a wide range of measures might be contemplated to strengthen the weaker management currently leading many associations. Thus, the community association of the future has been imagined by a prominent practitioner and scholar as one with "standards or training requirements for qualifying for office" on the association board.[210] This same noted authority has raised the idea of "professional board members," paid for their board service.[211] A different approach to upgrading community association management might be to carefully and expressly circumscribe board authority to broad policy making, and to mandate board use of credentialed professionals in executing general association management,[212] and in areas such as finance, engineering and law.

Given the importance of association management to the public welfare, and the growing complexities of management tasks, imposing legal requirements which radically reshape association management are worthy of serious consideration. However, the potential impacts of mandating professional

209. *See supra* notes 37-46 and accompanying text.
210. Hyatt, *supra* note 17, at 378.
211. *Id.* at 379.
212. *See supra* notes 38-46 and accompanying text.

association leadership are profound. While the goals of improving competence of community association management are serious and urgent, they must be considered along with equally serious concerns about threats to the intangible quality of life in our community associations. Our community associations—especially in their enforcement of use restrictions binding all association members—sometimes manifest a regimented, adversarial, even oppressive tone which angers and divides residents against each other.[213] If we hold out the hope for common interest communities to restore a constructive, healthy sense of community in our atomized, postmodern society,[214] one might wonder which way it will cut to turn more and more community governance responsibility over to professionals and corporate managers.

Improvement of association management will likely be key to placing community associations on sound financial footing. Further inquiry into financial management strategies—including the suggestions for "professionalizing" association management—should proceed parallel to thinking through the broader questions of what kinds of socio-political communities we hope to build in the servitude regimes which are coming to dominate so much of American residential life.

213. *See supra* notes 25-36 and accompanying text; *see also* Winokur, *Mixed Blessings, supra* note 10, at 53-75.

214. Increasingly in recent years, commentators have held out the achievement of meaningful "*community*" as a prominent goal of community associations. *See generally* Gregory S. Alexander, *Dilemmas of Group Autonomy: Residential Associations and Community*, 75 CORNELL L. REV. 1 (1989); Hyatt, *supra* note 17; James L. Winokur, *Reforming Servitude Regimes: Toward Associational Federalism and Community*, 1990 WIS. L. REV. 537; James L. Winokur, *Community Associations Institute Research Foundation Symposium on Community and Community Associations*, 36 ST. LOUIS U. L.J. 695 (1992). *See also Special Issue: Building Community*, COMMON GROUND, Mar.-Apr. 1998.

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