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THE QUARTERLY ASSESSMENT

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FHA's 2011 Condominium Project Approval Rules: Problems, Problems

By Brendan P. Bunn

In 2009, the Federal Housing Administration (FHA) issued new rules and standards for condominiums to receive FHA project approval status. Why is this important for your condominium project? If a project is FHA-approved, purchasers of units in the project may seek FHA-insured mortgages from their lenders. FHA loans provide potential buyers with an additional financing option, which can help condominium market values, particularly in a difficult economy.

The 2009 FHA rules imposed some new standards on condominium projects, as well as new procedures for seeking approval. Prior to 2009, lenders had typically processed FHA approval applications. As of the 2009 rules, however, associations were permitted to file their own applications. This is called an "HRAP" (HUD Review and Approval) process. Lenders may still seek approvals (either through the HRAP or the "DELRAP" process).

On June 30, 2011, however, HUD issued an update to its 2009 FHA approval rules which could drastically alter an association's ability to apply for and receive FHA approval. Most of the update's requirements became effective on June 30, while others became effective on August 30, 2011. These new rules contain a number of additional procedural and certification requirements, many of which seem difficult – if not impossible – for a condominium association to meet as it seeks FHA approval.

Below is a review of the key criteria for condominium FHA approval, along with a summary of the potential problem issues contained in the 2011 update.

Owner Occupancy

At least 51% of the units in the condominium must be owner-occupied. This standard was unchanged under the 2011 update.

Non-Residential/Commercial Space

The 2009 rules state that no more than 25% of the property's total floor area can be used for non-residential/commercial purposes. The commercial use must be of a nature that is free of adverse conditions to residential occupants. Under the 2011 update, an association can now file an exception request to the 25% limit, which will be evaluated on a case-by-case basis. The association can seek an exception as provided that control of the association has been transferred to the unit owners and the total non-residential space does not exceed 35%. This was a positive change.

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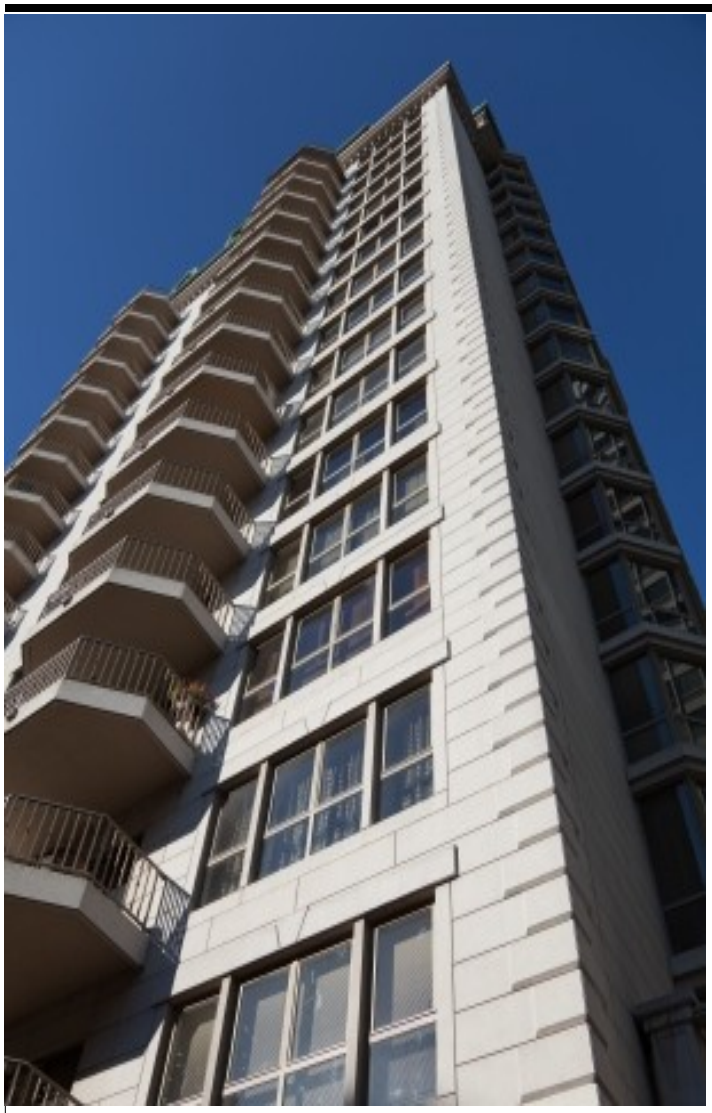

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Investor Ownership

No more than 10% of the units may be owned by one investor, which includes developer-owned units that are tenant-occupied. For projects with ten or fewer units, no single investor may own more than one unit. This was unchanged by the 2011 update.

Delinquent Dues

No more than 15% of the total units can be more than 30 days in arrears (not including late fees or other administrative expenses). Under the 2011 update, associations can seek an exception, which will be considered on a case-by-case basis, provided that no more than 20 percent of the total units are in arrears. For exception requests, the association must provide: (i) a 6-month report reflecting the history of unpaid dues, (ii) the current reserve fund balance, plus a balance sheet that is less than 90 days old and income/expense financial statements showing excess available funds in the amount of the outstanding arrearage, (iii) evidence that the association is taking action to collect the past due fees, and (iv) evidence that the association has budgeted for bad debt. This was a positive change under the 2011 update.

Special Assessments

If a special assessment has been levied, the association must submit an explanation that answers the following: the purpose of the assessment, when it is due and whether other special assessments have occurred in the past; whether the assessment affects the "marketability" of the units, as well as the effect the assessment will have on future values of the units and the "financial stability" of the project.

ISSUE: *We believe that it may be difficult for Boards or management to provide definitive opinions on the effect of a special assessment on unit marketability and "future values." We are hopeful that HUD staff will provide guidance on this issue.*

Pending Litigation

Pending litigation must be disclosed, including an explanation signed by the association's attorney describing the reason for the pending litigation, the anticipated settlement/judgment date and whether insurance is available and involved in the lawsuit. In addition, the association's attorney must provide an opinion as to whether the litigation could affect the future solvency of the association and homeowner rights (including title transfer issues).

ISSUES: *While "routine foreclosure actions by mortgagees" are exempted, no mention is made of routine collection action against debtors. In addition, it may be difficult for an association and its attorney to give a definitive opinion of the impact of the litigation on "future solvency" of the association or on homeowner rights. Again, we are hopeful that HUD staff will issue guidance on this issue.*

Insurance Requirements

The rules contain typical standards for master insurance coverage, such as hazard/casualty insurance, liability coverage and fidelity/dishonesty coverage. However, the 2011 update also requires that the association's managing agent have fidelity/dishonesty insurance covering the agent's officers and employees – with the association named as an obligee on the agent's policy.

ISSUE: *While management companies typically carry fidelity/dishonesty insurance, we understand that policies allowing associations to be named obligees are not commercially available. As such, this standard simply may not be attainable. However, the FHA has recently indicated that they will allow associations to meet this requirement by carrying policies that cover the management company, provided that the management company is listed by name.*

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FHA RULES

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New Certification Requirement

The 2011 update imposed a new certification requirement to be signed by an "association representative [or] authorized representative." An "authorized representative" could include the association's management agent, consultant or attorney. The signer must certify that:

- the project meets all state/local laws and all FHA requirements;
- the information and statements in the application are true and correct;
- the signer has "no knowledge of circumstances or conditions that might have an adverse effect on the project or cause a mortgage secured by the project to become delinquent (including but not limited to: defects in construction, substantial disputes or dissatisfaction among unit owners about the operation of the . . . association; and disputes concerning unit owner's rights, privileges and obligations)."

ISSUE: *This "adverse effect" standard appears impossible for the certificate signer to meet. For example, how is the association to know whether a construction defect issue could lead to a delinquent mortgage? Also, it is unclear what "substantial dispute" or "dissatisfaction" among owners would amount to an "adverse effect" on the project. After all, most associations have some owners who are often unhappy with the association or management for a variety of reasons, whether groundless or not. The HUD update contains little guidance on how this standard is to be measured. Whether a Board president, manager or attorney is signing, the certification requirement – at least at this juncture – does not appear reasonable, particularly when the certificate is signed pursuant to federal criminal laws regarding false certifications.*

This "adverse effect" standard also contains a requirement that the signer is under a "continuing obligation" to inform HUD if any information in the submission is no longer true.

ISSUE: *This "continuing obligation" is a new standard that would be difficult to meet. For example, if the association's delinquency rate temporarily rises to 17%, would this cue the reporting requirement? If a special assessment occurs, must the association notify HUD? This issue is problematic for the Association, as well as its management and counsel.*

While the 2011 update to the FHA standards improved the earlier regulations (such as creating exceptions to the delinquency and commercial space limitations), the update also raises a myriad of potential problems and questions, leading to uncertainty as to whether condominium associations should utilize the HRAP process given the risks and issues involved.

As HUD begins to process applications, perhaps additional guidance will be given. For now, we believe the 2011 certification requirements and their "continuing obligation" mandate – not to mention the other ambiguous standards noted above -- are sufficiently problematic that condominium associations should be wary of pursuing the HRAP process. We will continue to monitor these issues on behalf of our condominium association clients and keep you informed.

Member Access to Association Records

By Sara J. Ross

Access to the books and records of a community association is a sensitive subject with an association's Board and/or management because the request for access is generally viewed as an owner questioning or distrusting the management or governance of an Association. It is taken as a personal affront, when in fact, it should be taken as an opportunity to put a disgruntled owner's mind at ease. Regardless of the reason for an owner's request, or an association's desire not to fulfill the request, in most cases an association is legally required to provide access.

Applicable Statutes

Both Virginia and the District of Columbia have statutes regarding associations' maintenance of books and records, and owners' right of access thereto.

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ACCESS TO RECORDS

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In Virginia, statutes relating to an association's books and records are found in Section 55-79.74:1 of the Virginia Condominium Act and Section 55-510 of the Virginia Property Owners' Association Act. Under these statutes, a member "in good standing" may make a written request to inspect or copy an association's books and records, which includes financial records, meeting minutes (including draft minutes for homeowners associations), membership lists and addresses, as well as aggregate salary information of association employees (for homeowners associations, owners may also request the actual salaries of the six highest paid employees, whose salaries are more than $75,000 per year). A member must provide five days written notice before inspecting the books and records, notifying the association of the purpose for the request and the specific books and records being requested.

The District of Columbia's relevant statutes are located in Section 42-1903.14 of the District of Columbia Condominium Act, and Section 29-301.26 of the District of Columbia Nonprofit Corporation Act. Under Section 42-1903.14, a unit owners' association's financial records are required to be maintained, in chronological order, and be made available for examination by unit owners during reasonable hours on business days. Please note, only financial records are subject to this access requirement. However, for incorporated associations within the District of Columbia, Section 29-301.26 of the Nonprofit Corporation Act provides that an association must maintain correct and complete books and records; all of which may be inspected by any member having voting rights for any proper purpose at any reasonable time.

Governing Documents

In addition to the statutory requirements, most governing documents provide some guidelines regarding access to records. As these requirements may provide more access to records than the applicable statute, it is important for the Board and management to familiarize itself with the governing documents in order to avoid a possible breach.

General Rules of Thumb

Who may request access to documents?

In Virginia, the person making the request must be "in good standing." For incorporated District of Columbia associations, only members "having voting rights" may inspect or copy records. What does "good standing" or "having voting rights" mean? Often, it is defined in the governing documents. For example, if the Bylaws state that a member in arrears by more than 30 days is not in good standing and the requesting member is in arrears by more than 30 days, then the request may be denied. Note that for unincorporated condominiums in the District of Columbia, members are not required to be in good standing to make a request for access to or for a copy of records.

How are requests to be made?

In Virginia, and for incorporated associations within the District of Columbia, requests must be in writing; however, an email request will generally suffice. The District of Columbia does not appear to require the requests to be in writing for unincorporated condominiums. Virginia and the District of Columbia both require that requests must be for a "proper purpose." By and large, most purposes are "proper." The exception is when the records are going to be used for pecuniary gain or commercial solicitation. For example, if an owner requests the membership list so he can send each member a letter asking for their support to remove the Board, that is a proper purpose. On the other hand, if the request for the membership list is so he can mail each owner a flier advertising his business, that is not a proper purpose.

What records must be made available?

In Virginia, all books and records are to be made available, except for those exempted by statute, such as personnel records, legal opinions, contracts still under negotiations, etc. For unincorporated condominiums in the District of Columbia, only financial records must be made available. For incorporated associations in the District of Columbia, the statute requires all books and records to be made available, and does not spell out any exemptions.

Can the Association charge for copies/access?

Effective July 1, 2012, Virginia community associations are required to adopt a cost schedule for charges related to access to association books and records. Such cost schedules must specify reasonable charges for material and labor, be applied equally to all members in good standing, and be provided to the requesting member at the time the request is made. The District of Columbia does not have a similar provision for charging for access and/or copies.

In most cases, if an owner requests access to your association's books and records, even if the owner in question is difficult and accusatory, the association will likely have to provide access and/or copies of the requested records. However, do not look at these requests with dread or fear. An inspection request from your problem owner could be your opportunity to disarm the owner through an open and welcoming response to a books and record request. Alternatively, a response that is begrudging or is borderline obstructive, will likely only serve to confirm suspicions. Therefore, an association should always respond to requests openly and cooperatively, within any limits established by statute.

Collections Corner: Issues With Using a Debt Collection Agency Rather Than a Law Firm for Collecting Delinquent Assessments

By Allen B. Warren

Has your community association's board of directors ever contemplated using a collection agency to attempt to collect the association's unpaid assessments, rather than using a law firm such as Chadwick Washington? Such an approach may sound appealing on its surface, but there are several important points to keep in mind. For example, consider the following:

- A debt collection agency is not a law firm – because it is not a law firm, it cannot engage in the practice of law. By rules and statute, the unauthorized practice of law is prohibited in Virginia. Thus, for example, a collection agency is not authorized to prepare assessment liens or file lawsuits against debtors on behalf of the association. Also, keep in mind that some companies who do not call themselves a "debt collection agency," or who offer services other than just collecting debts, are in fact debt collection agencies.

- Beware of collection agencies whose approach is just to send demand letters and threaten a nonjudicial foreclosure on every delinquent account, regardless of the amount of the debt and regardless of whether there is equity in the unit.

  - This approach does not result in the association obtaining a money judgment against the debtor and therefore does not give the association the right to garnish bank accounts, garnish wages, garnish rent, or take other judicial action to enforce a judgment.

  - Most debtors are savvy enough to know that foreclosure is not a realistic remedy for an association when there is no equity in the debtor's lot or unit, particularly in jurisdictions such as Virginia where assessment liens do not enjoy statutory priority over first deeds of trust (mortgages) that are recorded before the assessment lien.

  - This approach of threatening foreclosure regardless of circumstances could be a violation of the Federal Fair Debt Collection Practices Act (FDCPA). It is also a violation of the FDCPA for a debt collector to threaten action that the creditor (i.e., the association) does not actually intend to take or does not have the current authority to take. Also, taking this approach may give local legislators reason to amend the foreclosure statute to severely limit or eliminate the nonjudicial foreclosure remedy currently available to associations.

  - For former owners, the nonjudicial foreclosure remedy is no longer an option.

- Some collection agencies have onerous, one-sided contractual provisions in their agreements with associations. For example, the collection agency contract may require the association to indemnify the agency against third party claims, regardless of whether the claim arose from the agency's own actions or inaction. Some contracts also impose limitations on the association's ability to choose which accounts to refer to the collection agency, or impose monetary penalties if the association decides to refer an account to its own legal counsel or otherwise pull the account from the collection agency. If the collection agency and the association get into a dispute, some contracts would require the dispute to be litigated out-of-state where the collection agency's headquarters is located.

- If an account is forwarded to a collection agency and the debt remains unpaid, be aware that if the association does not file suit against a debtor before the applicable statute of limitations expires, the collection agency and our firm (or any other law firm or debt collector) would be prohibited by the Federal Fair Debt Collection Practices Act (FDCPA) from demanding payment from, or suing, the debtor for those old past due amounts.

These are just a few of the things a board of directors should consider if contemplating whether to refer accounts to a collection agency. Each collection agency's contract and approach to collections may warrant additional considerations. We note, however, that it is within a board's authority to refer accounts to a collection agency if the board makes a good faith, informed business decision that doing so is in the best interests of the association. However, there are many pitfalls to be aware of when going that route. This is why, if your association's board of directors is contemplating using a collection agency, we would welcome the opportunity to discuss with the board the pros and cons of doing so, and to advise the board of any issues with the collection agency's standard form contract.

Dupont Implements Claim Process for Trees Affected by Imprelis

By Chris Chipman

Community associations devote large portions of their annual budgets towards landscaping in an effort to maintain the appearance of their communities and to thereby protect property values. Landscaping professionals, in turn, spend billions of dollars a year on the latest and greatest herbicides that are designed to kill stubborn weeds with minimal cost and effort.

DuPont's latest herbicide, Imprelis, may have proven effective at killing more than just unwanted weeds. DuPont recently halted Imprelis sales amid thousands of complaints from property owners and landscapers alleging that the herbicide is lethal to some commonly found species of trees.

If you are unfamiliar with Imprelis, you are not alone. Imprelis was introduced to the U.S. market in early 2011 and was marketed solely to landscaping professionals. Hailed as "the most scientifically advanced turf herbicide in the last 40 years," DuPont billed Imprelis as an environmentally safe way to tackle tough broadleaf weeds with minimal cost and effort.

True to DuPont's claims, Imprelis was extremely effective at removing unwanted broadleaf weeds; however, it also produced devastating effects on popular shallow-rooted tree species such as poplars, willows and conifers (particularly the Norway Spruce and White Pine). Shortly after Imprelis hit the market, complaints began to surface that exposed trees were dying by the thousands and that those trees that didn't immediately die were in pretty bad shape, exhibiting browning, needle loss, and curling growth.

DuPont's first formal response to the rising tide of complaints came in the form of a June 17, 2011 letter (only a few months after the initial release) that instructed landscapers to avoid applying Imprelis near Norway Spruce or White Pine trees. This warning proved to be too little too late, however, and on August 4, 2011, DuPont voluntarily suspended sales of the herbicide in response to the overwhelming number of complaints. Shortly thereafter, the Environmental Protection Agency followed suit and banned the sale of Imprelis on August 11, 2011.

In its wake, some 7,000 formal complaints have been lodged with DuPont or the EPA regarding Imprelis, and it is possible that thousands of additional claims have gone unreported. The sudden death of thousands of mature trees has left many associations scrambling to remove and replace dead trees. Given that replacing mature trees can cost tens of thousands of dollars, this is no easy task for most associations.

In response to the complaints – and to ward off potential lawsuits – DuPont implemented a claims resolution process on September 6, 2011, which promises to compensate affected property owners for Imprelis-related damages. Under DuPont's claim resolution process, DuPont is offering to pay for the removal and replacement of affected trees in addition to property owners' incidental costs. DuPont is also offering a two-year warranty on all replacement trees and any injured trees that do not recover. The deadline for filing a claim is November 30, 2011.

If a damaged tree must be removed prior to being evaluated through the claims resolution process, DuPont has requested that claimants take detailed photographs of the tree and its symptoms in order to substantiate a claim. For more information on the claims resolution process, you can visit DuPont's Imprelis website at www.imprelis-facts.com.

If associations do not care for DuPont's proposed settlement, they have few other remedies to pursue. Associations can contact the landscaping company that applied Imprelis to see if they (or their insurance) will pay for the damages. Alternatively, associations can check with their own insurance carriers to determine if the damages are covered. If all else fails, associations can file suit against their landscapers or get in line and join the pending class-action lawsuit brewing against DuPont.

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We would like to take this opportunity to say

THANK YOU

to all of our Community Association clients for their support and loyalty over the years and for letting us be of service to them! We would not be able to do what we do without you!

We would also like to thank our Colleagues and Business Partners in the Community Association Industry for being such a great group of people to work with.

Our best always!

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