



COMMUNITY MATTERS

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News and Trends in Community Association Law

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Association Reserve Studies: Plan the Work, Work the Plan

by | David C. Boy, IV, Esq.

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Jimmy just bought his first home in a modestly-priced townhome community. It is in an excellent location, and Jimmy believes his townhome will be a great investment. Although the monthly mortgage payment is a stretch on his limited budget, after factoring in taxes, insurance, and association fees, Jimmy calculated that it is still cheaper than renting. Since the association covers most of the maintenance for the townhome, there should be minimal additional expense.

Unbeknownst to Jimmy, however, the association in his community has suffered from poor leadership since its inception. Although the board had been budgeting for replacement of townhome roofs, they mistakenly believed the roofs to be approximately 10 years old, when in fact they were original to the community's construction 20 years ago, and they have met their expected lifespan. The board also set aside some funds in reserve for replacement of the siding on the townhomes, but the amount was only based upon guesswork and estimates by board members and is woefully inadequate. It also turns out that the streets in the community, which the board previously believed to be public, are privately owned and, therefore, maintained by the association. To make matters worse, the county recently issued a citation to the association for a detention pond hidden in the woods on common area in the back of the community. Estimated cost to repair: \$150,000.

After receiving notice from the association of a proposed \$10,000.00 special assessment per townhome, Jimmy and the other owners are furious. This is more than his mortgage payment for an entire year! Jimmy reviews the association's by-laws, petitions for a special meeting, and he and the other owners vote to remove the prior directors, and elect a new board of which Jimmy becomes President. The new board engages

legal counsel to consider whether there is a viable claim for breach of fiduciary duty against the former directors. Although the Board is looking to getting a loan to help spread out the cost of the special assessment, the pending expense has made homes in the community unmarketable.

Jimmy's fictional nightmare could have been avoided with advanced planning by prior boards, including utilization of a reserve study. A reserve study is essentially a planning tool designed to help a board anticipate and prepare for a community's major repairs and replacement projects. This ensures adequate reserve funding for future maintenance, repair, and replacement of community facilities as they deteriorate over time. For example, if the community has tennis courts that have a ten-year useful life, and the estimated future price to resurface the courts will be \$10,000, then \$1,000 should be put into the reserve account each year for ten years so that \$10,000 will be in the account to resurface the courts in ten years.

Preparing a reserve study first involves an analysis of the physical condition of the common property and other items which the association is obligated to maintain. When commissioning a reserve study, the board will need to review its governing documents to confirm the association's maintenance obligations. Consultation with your association's attorney is recommended when preparing this list of maintenance items. The board should also, in conjunction with the engineering firm (or other expert) preparing the reserve study, carefully inspect the community facilities. This inspection will help create a comprehensive list of common area items maintained by the Association and identify any items which may not be specifically identified in the governing documents but still fall under the association's maintenance responsibility. (For example, the hidden detention pond in Jimmy's community).

After completion of the initial physical analysis, the expert preparing the reserve study will conduct a financial analysis and prepare a final report which will allow the board to have an educated estimate of when future expenses may occur, and it will allow the board to budget accordingly. The Board should also have the reserve study be updated every few years (e.g., 3 to 5 years) to account for changing conditions and circumstances.

What is the legal importance of obtaining a reserve study? First, an association's governing documents may require the Board to budget for and maintain an adequate reserve fund which takes into account the number and nature of replaceable assets, the expected life of such assets, and the expected repair or replacement costs of the assets. A reserve study would be an essential tool in meeting this obligation under the documents. Maintaining adequate reserves is also a factor in obtaining approval for FHA lending in condominiums, and it could be a factor considered by potential purchasers of homes in a community. Planning for and maintaining adequate reserves helps prevent special assessments and the potential need for a loan by an association.

Importantly, the board has a fiduciary duty to ensure that it is acting in the best interest of the association which arguably includes planning to minimize unexpected expenses and the resulting additional costs to the association. Obtaining a reserve study and following the recommendations of that study can help shield a board from liability in the event that owners challenge the board's management or planning for capital expenditures. In the real world, as in Jimmy's association, unexpected expenses will arise; however, planning the work and working to execute that plan, will help protect the board, and protect the association. ❖

Collecting in the Aftermath of a Bank Foreclosure: Explaining the impact of a bank's foreclosure sale on the Association's lien and collection efforts after the fact

by **Christine S. Lee, Esq.**



"Going once, going twice, sold!" That's the usual cry one will hear at a bank foreclosure sale. This means that the bank has divested a nonpaying owner of title, but where does it leave the association in its collection process? Does this mean the association is left helpless to collect the debt from the prior owner? Hardly.

A well-written assessment provision found in an association's Declaration allows an association to pursue unpaid assessments by way of a personal obligation or a lien. While Declarations will vary in their assessment provision wording, they will typically state something like, "assessments are the personal obligation of the owner against whom they are assessed and are a lien against the property." These two options may be used simultaneously to maximize collection efforts.

Under the first option, the personal obligation follows or "attaches to" the person who owns the subject property at the time the particular assessment was due. A personal obligation attaches to that person like a shadow regardless of whether the property has since been sold or transferred to a new owner. The only way to get out of a personal obligation is to pay the amount due or to receive a bankruptcy discharge.

Under the second option, the lien follows or "attaches to" the property at the time the particular assessment became due. A transfer in ownership does not typically extinguish a lien because, again, the lien

attaches to the property and not to the person. However, a bank's foreclosure sale has the power to extinguish any existing subordinate liens (such as, association liens). An association's lien against the property under the prior owner's possession is often considered a subordinate lien, and thus would be extinguished by the foreclosure sale.

What does this all mean for the association? This means that the association can no longer enforce its lien against the property. The association cannot foreclose its extinguished lien, or attach the extinguished debt to the property owned by the new owner. It does not mean, however, that the prior owner is off the hook for the assessments owed up to the bank's foreclosure sale date. An association may still pursue the prior owner for the pre-foreclosure debt by way of personal obligation only. The bank's foreclosure sale only extinguished the existing lien and not the prior owner's personal obligation.

Meanwhile, this also means the new owner will now be responsible for paying the current assessments owed from the bank's

foreclosure sale date moving forward. Should the new owner fail to pay the assessments in a timely manner, an association may pursue the new owner for the post-foreclosure debt by way of personal obligation, as well as collection efforts to enforce an association's lien for amounts due after the bank's foreclosure. The bank's foreclosure sale has no effect upon post-foreclosure liens against the property under the new owner's possession.

The Declaration will usually empower an association to pursue the old debt from the prior owner under that prior owner's "personal obligation," as well as the new debt from the new owner under a "personal obligation" and by enforcing the association "lien." Boards should consult their association attorney should they have any questions interpreting their association's governing documents and its tools for collections. Also, be sure to consult the attorney when interpreting other liens held by third parties that may affect an association's collection process. ❖

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TWO SESSIONS:

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REGISTER at www.luederlaw.com

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Buckhead Office
3535 Piedmont Road
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Good Record Keeping: Your Association's Sword and Shield

by | **Elina V. Brim, Esq.**

Creating and keeping records for your association is a tedious and underappreciated task. Yet it is a vital part of having a successful corporation. It not only helps in cases for unpaid assessments and enforcement of covenant violations, it can also help shield your community and its directors from liability.

There are several categories of records that your association may have. These records include, but are not limited to, covenants, articles of incorporation, bylaws, amendments to these governing documents, and design guidelines. Board meeting minutes, committee minutes, board resolutions, and actions by written consent are as essential as the governing documents for protecting your community.

Almost all community associations are non-profit corporations. The Georgia Nonprofit Corporation Code requires that a corporation must keep the following corporate documents as permanent records: minutes of all meetings of its members and board of directors, executed consents evidencing all actions taken by the members or board of directors without a meeting, a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation, and waivers of notice of all meetings of the board of directors and its committees. Compliance with this statutory requirement is one of the fiduciary responsibilities of the directors of your association.

Corporate meeting minutes are easy to create and do not have to contain an in-depth discussion of the issues that were covered at the meeting. Rather, all minutes should contain the following basic

information: the type of meeting it is (regular, special, etc.); the name of the convening body (board meeting, committee meeting, or membership meeting); the date, time, and location of the meeting; declaration of quorum; attending directors; whether the President and the Secretary are present (and if not, their designees for the meeting); approval of meeting minutes from the prior meeting; motions made and seconded; the vote of the board or the members on the issues presented by said motions; and the time the meeting was adjourned.

The minutes should be signed by the Secretary of the association. Minutes do not become an official record of the association until they are approved at the following meeting. As such, it is important for the official meeting minutes to have the approval date, and such date should be initialed by the Secretary of the association.

In addition to board meetings, business may be conducted by written action in lieu of a meeting. It is important to properly document such actions. Any action taken without a meeting must be taken by all members of the board, unless the articles or bylaws specifically permit the action to be taken by less than all, but not less than a majority of the board. As such, if the board decides to take an action without a meeting, the required number of directors must

agree to the following: (1) to take the action by written consent in lieu of a meeting and (2) to approve the action by the required number of directors. Email communications are sufficient to comply with these legal requirements.

The documents evidencing the action and consent to take said action by written consent in lieu of a meeting must be delivered to the corporation for inclusion in the minutes. The board's decision made in this manner has the same effect as if the action was taken at a board meeting. Some bylaws or articles of incorporation prohibit taking action in lieu of a meeting. Therefore, it is important to verify your community's governing documents prior to utilizing this method of decision-making.

The boring task of record keeping has time and again proved to be the winning card in litigation. Properly created and preserved records are frequently the crucial evidence needed to win a case or successfully defend against one. It protects your association and its directors.

As always, our firm's attorneys are here to assist you in navigating any legal issues relating to your community. If you need assistance in creating an effective record keeping system for your board, please contact your general attorney for advice. ❖



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t: 770.685.7000 f: 770.685.7002

www.luederlaw.com | email: newsletter@luederlaw.com

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