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News and Trends in Community Association Law

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www.luederlaw.com | **Fall 2019 edition**

Published by the law firm of Lueder, Larkin & Hunter, LLC

Age of Excess: Recovery of Excess Funds

by | **Stephen A. Finamore, Esq.**

Once upon a time, in a land not so far away, many homes were encumbered by loans and secured debt far exceeding the value of the property so encumbered.

With an association's lien for assessments typically placed behind the first priority security deed and property taxes, there was little hope for an association to collect amounts owed from the sale of the property in an arm's length transaction, foreclosure, or tax levy.

As time passed, however, be it from dark magic or other enchanted forces, property values increased and many homes are now worth more than the encumbrances against them. When this occurs, there is sometimes enough value, called "equity," to pay off the first security deed, the property taxes, and the association's lien for assessments. Aside from the usual boring way of collecting all of the debt owed in a sale of the property between a willing buyer and seller, the association's lien for assessments can also be satisfied from the excess funds generated by a foreclosure sale of a first security deed holder or from a county's property tax sale.

Although a foreclosure of the first priority security deed or a tax sale will extinguish the association's lien for assessments, as a former lien holder against the property, the association may have a priority claim on any funds generated from the foreclosure that are over and above the amounts owed to the foreclosing party. When there is more than one claimant to the funds, an "interpleader" action will be filed to establish the priorities of the lien holders and to determine who should receive the excess funds.

An interpleader action is a lawsuit filed by a party that is in possession of funds to which it has no claim. That party is most commonly the first priority security deed holder that just conducted the foreclosure sale or a county that just conducted a tax sale. In order to avoid liability to a number of possible claimants who have a claim, the action is filed with the intention of depositing the funds with the court and allowing the interested parties to battle for priority. A normal reaction to receiving a lawsuit is apprehension, panic, or dread; but in this case, this is a lawsuit that the association should delight in receiving. This is because the association has a good chance of being first in line with respect to the funds over other claimants.

The Georgia Condominium Act ("COA") and the Georgia Property Owners' Association Act ("POA") each provide that the association's lien is superior to all other liens whatsoever except for property taxes, the first priority security deed, or a second security deed that was also taken to buy the property. Put another way, any other lien besides these specific kinds, will fall behind the association's lien for assessments. For an association that is not subject to the COA or POA, the declaration of covenants will establish the priorities and will typically provide for the comparable order of priority.

In many cases involving excess funds, the priorities are clearly in favor of the association. The process will often simply involve the filing of a timely answer, a motion for disbursement, and a hearing. Occasionally, the parties can agree on the appropriate order of priority and disbursement amounts. It is critical that when notification is received of excess of funds, or if an interpleader action is served upon the association, that the association's attorney be notified so that a claim can be filed. Doing so promptly may lead to success in the Age of Excess.

Another Leasing Amendment Prevails in Appellate Court

by | Cynthia C. Hodge, Esq.

The following article will discuss the outcome of a recent summer decision involving the enforceability of a leasing amendment applicable to the owners in a subdivision, even those owners who did not consent. The Georgia Court of Appeals opinion in *Pasha v. Battle Creek Homeowners Association, Inc.* was decided by the Georgia Court of Appeals on June 13, 2019.

The fundamental issue in this case revolves around the court's decision on whether an amendment to the association's Declaration, restricting the ability of the association members to lease their property, was enforceable against an owner (Mr. Pasha) who did not consent to the amendment. The relevant facts surrounding this case are as follows: The association filed an original Declaration of Covenants, Conditions and Restrictions for Battle Creek Subdivision in the Cobb County, Georgia land records in 1999 ("original Declaration"). Importantly, the association opted into the Georgia Property Owners' Association Act, O.C.G.A. 44-3-220 et seq. ("Act') in 1999. An amended Declaration (or "Declaration") was recorded in 2000. The record showed that although the Declaration included restrictive covenants, it did not restrict leasing at that time.

Mr. Pasha purchased a home in the Battle Creek Subdivision in October 2000. He was made aware of the existence of the association and the Declaration. (Georgia's established doctrine of constructive notice would apply here, as well, so that Mr. Pasha and the subject property would be subject to the 2000 Declaration and the Act.)

Several years went by, and, in 2004, Mr. Pasha moved out of the subject property. He did not convey the subject property to another, but retained it as an investment asset. He formed a real estate company (sole officer and member) and entered into a 25-year commercial lease agreement for the purpose of renting the home to several different tenants over the course of a decade.

Fast forward to the year 2016, and the association proposed an amendment to the Declaration to restrict leasing. Leasing would be temporarily permitted with a few exceptions, including (1) being eligible as a "Grandfathered Owner", (2) applying for and receiving a written Hardship Leasing Permit from the board of directors; or (3) being a Mortgagee who becomes the Owner of a Lot through foreclosure or a deed in lieu of foreclosure.

To be a "Grandfathered Owner," the amendment specified the following:

> *A Grandfathered Owner shall only have the right to lease until the earlier of: (1) the date the Grandfathered Owner conveys title to the Grandfathered Lot to any other person (other than the Owner's Spouse); or (2) the date that all current occupants of the Grandfathered Owner's Lot vacate and cease to occupy the Lot. Further, any assignment, extension, renewal, or modification of any lease agreement in existence on the Effective Date, including, but not limited to, changes in the duration of the lease or the occupants, shall be considered a termination of the lease, and commencement of a new lease, which must comply with this Section.*

The association conducted a formal vote and received the votes of more than two-thirds (2/3) of the Owners in favor. Mr. Pasha did not vote in favor of the amendment.

After the amendment was approved and adopted, the association sent notice to the Owners, including Mr. Pasha, informing them when the new restrictions would take effect and requested copies of any current leasing agreement to establish Grandfathered status. Rather than complying with these requests, Mr. Pasha filed a lawsuit with the respective trial court. After initial pleadings and expiration of discovery, the parties both filed Motions for Summary Judgment. Mr. Pasha's motion was denied, and the Association's motion was granted.

Mr. Pasha appealed the trial court's decision and lost again. Here is why.

Mr. Pasha first argued that, because he leased his property prior to the amendment, he maintained a vested right to do so regardless of the restrictive covenant. The Court of Appeals disagreed and held that, due to the submission to the Act, the Declaration could be amended at any time in the future provided that at least two-thirds (2/3) of the owners approved such an amendment. Here, that is exactly what happened in Battle Creek and, by complying with the Act, all owners subject to the Declaration were bound by the new restricted right to lease their property, even those who did not consent (like Mr. Pasha).

Next, Mr. Pasha contended that the amendment to the Declaration violated O.C.G.A. § 44-6-43, claiming that the restriction on leasing was repugnant or against public policy and made it difficult to sell the subject property. The Court of Appeals disagreed and cited to cases like *Hill v. Fontaine Condo. Association, Inc. and Godley Park Homeowners Association, Inc. v. Bowen* to establish that a leasing restriction is not an unenforceable restraint on alienation (i.e., capacity for property to be sold or transferred). This restriction, in other words, did not adversely affect the ability of Mr. Pasha to sell to transfer the subject property.

For those reasons, the Court of Appeals agreed with the Association's arguments and found in favor of the enforceability of the amendment to the Declaration restricting leasing.

If your community is interested in proposing restrictive covenants that were not originally provided for in the original Declaration, consult with your association's counsel regarding the best procedure for doing so and evaluate any challenges that may currently exist to ensure greater success on adopting future amendments.

Association Reserve Studies:
Plan the Work, Work the Plan

by | **David C. Boy, IV, Esq.**

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.

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