



HEAR SAY

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Bankruptcy Reform Brings Both Relief and Uncertainty to Homeowner Associations

The formal ceremony lasted only a few minutes, but it took credit card companies, banks, and large retailers eight years to win Congressional approval of the Bankruptcy Abuse Prevention and Consumer Protection Act President Bush signed into law April 20. Most of the changes mandated by the bankruptcy reform statute will take effect October 17, 180 days after the president signed the law. Some



provisions become effective immediately.

“This law will protect those who legitimately need help, stop those who try to commit fraud, and bring greater stability and fairness to the system,” President Bush said of the new law, which mandates the most comprehensive overhaul of the nation’s bankruptcy rules in more than 25 years. The reforms will generally make it more difficult for

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Legislative Update 2005 Session of the Virginia General Assembly

Delegates and Senators in the 2005 Session of the Virginia General Assembly introduced more than 2900 bills Virginia. More than 20 of those bills were of interest to community associations. In the end, the legislature passed fewer changes to the Property Owners’ Association Act (“POA Act”) and the Condominium Act than they have in recent years. Below is a summary of those changes, which became effective on



July 1, 2005.

Charges for resale certificates and disclosure packets. The fees charged by associations, or their managing agents, for preparing and issuing resale certificates (in condominiums) or disclosure packets (in property owners’ associations) have been the subject of significant interest in the last two

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consumers to eliminate their debts via bankruptcy by establishing a “means test,” under which most debtors earning above the median income for their

state (and able to repay at least \$6,000 over a five-year period) will be required to accept a Chapter 13 repayment plan; a Chapter 7 filing, which erases most debts, will no longer be an option for many financially-strapped consumers, as it was under the old law.

Critics argued unsuccessfully that the changes treat consumers too harshly, foreclosing the “fresh start”

that bankruptcy is supposed to provide. Supporters insisted that tighter rules were needed to prevent abuses that, they said, allowed many consumers to escape debts they could, and should be required to repay.

A Victory for Community Associations

Although community associations were not on the front lines of this prolonged and very expensive lobbying battle, they did have a horse in the race and claimed a significant victory in the outcome. The 500-page law includes language advocated by the Community Associations Institute (CAI) clarifying the treatment of delinquent fees and assessments in a bankruptcy proceeding. A bankruptcy filing “stays” or halts actions to collect outstanding debts until the bankruptcy is processed and decisions are made about how much, if any, of those debts the consumer must repay. Minor revisions in the bankruptcy rules enacted in 1994 had specified that community association fees assessed after an owner filed for bankruptcy

protection would be collectible as long as the owner continued to occupy the home or rented it to a tenant and collected rents.

But that language created a loophole exploited by some owners, who moved out of their units, left them vacant, and argued that they did not have to pay post-petition fees as a result. The wording of the 1994 revisions applied to residential condominiums and residential cooperatives, but omitted homeowner associations, time-share condominiums, and commercial condominiums. As a result, while judges in some jurisdictions applied the statutory language to all common interest ownership communities, others did not, ruling that homeowner associations, time-share condominiums, and commercial condominiums could not collect post-petition assessments even if the owners continued to occupy their units.

The bankruptcy reform law addresses both problems. It adds homeowner associations, time-share condominiums, and commercial condominiums to the list of covered entities, and it closes the collection loophole that had frustrated many associations, by linking the obligation to pay post-petition fees to ownership rather than occupancy of the unit. The new language states that the liability for payments continues “for as long as the debtor or the trustee has a legal, equitable,

or possessory ownership interest” in the unit.

The inclusion of bankruptcy trustees in the liability chain represents another significant change for at least some community associations. In some jurisdictions, the trustees charged with disposing of a debtor’s property often try to negotiate a reduction in the fees paid to the association, or refuse to pay them at all. The

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new language should shift the balance in those negotiations in favor of the associations by eliminating any question about their right to collect post-petition fees.

Relief for Landlords

Residential and commercial landlords will also benefit from three additional changes in the bankruptcy law.

Eviction stay. Under the old law, the automatic stay triggered by a bankruptcy filing halted residential eviction proceedings, allowing tenants to remain in their units for months rent-free while awaiting the processing of their petition. The new law allows landlords who have already won an eviction judgment before a tenant files for bankruptcy protection to proceed. The law also lifts the automatic stay if the landlord is seeking eviction because of a tenant's illegal drug use.

Lease assumption. Commercial tenants will now have to decide within 210 days whether to assume a non-residential lease after a bankruptcy filing. The old law gave them 60 days, but permitted indefinite extensions, which bankruptcy judges regularly granted. This enabled companies with expensive leases to continue oc-

cupying their space rent-free during bankruptcy proceedings, and then cancel their leases with little or no notice at the end of the process.

Single-asset bankruptcy. The new law changes the treatment of single-asset bankruptcies, in which a single real estate asset generates most of the debtor's income. The old law limited the automatic stay to 90 days for properties valued at \$4 million or less but allowed stays of six months or more for larger properties, to provide additional time to devise more complicated work-out plans in business bankruptcies. The

new law eliminates that distinction, applying the 90-day maximum stay to all single-asset bankruptcy filings.

Limits on Homestead Protection

Most of the changes mandated by the bankruptcy reform statute will take effect October 17, 180 days after the president signed the law. But some provisions become effective immediately. One that may affect community associations is the new cap on the "homestead exemption," allowing homeowners to protect a portion of the equity in a primary residence from the claims of creditors. Different states set different limits on the amount of protection provided, and a few states provide unlimited protection. The bankruptcy law aims to prevent debtors from shielding their assets by buying expensive homes in those no-cap states.

Under the new rules, debtors will be limited to the federal homestead cap (\$125,000) on any property purchased within 40 months of their bankruptcy filing, even if the state cap is higher. And they will not be able to claim any homestead protection at all on properties owned for less than two years, unless they previously owned a property in the same state on which a homestead existed. The law will also nullify a homestead filed within 10 years preceding the bankruptcy, if the intent was "to hinder, delay, or defraud" creditors. That means a debtor who created a homestead 10 years ago to shield assets from a negligence suit could not apply the homestead protection to a bankruptcy filed today. In the same vein, the homestead protection will be capped at the federal limit (\$125,000) if, within five years preceding the bankruptcy, the debtor was found guilty of an "intentional tort" that caused severe injury or death to another.

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What to Expect

Most analysts agree that the immediate result of the new bankruptcy law will be a surge in bankruptcy filings, as financially troubled consumers race to file before the more restrictive rules take effect. Beyond that, community associations and others in the collection line can expect to feel the ripple effects of many provisions that don't affect them directly. For example, because bankruptcy will be a less appealing and (for some) a less viable option, some debtors may try to deal with their problems sooner, before they reach a point of financial no return. This could

trigger an increase in requests for repayment plans to resolve delinquent association fees.

Association boards should be prepared to deal with these requests in an even-handed manner that balances efforts to work with troubled homeowners against the need to protect the financial interests of the community as a whole. Associations should establish detailed policies and procedures for dealing with delinquent owners, those policies should be in writing, and they should be communicated clearly to all residents.

Some analysts predict that the new law may discourage some debtors from seeking bankruptcy protection, subjecting them to the collection efforts of unsecured creditors with claims against them. Because common area fees and assessments are secured by the unit, associations will typically stand above that fray. Even so, board should move quickly to deal with delinquent owners (good advice quite apart from the new bankruptcy law), especially if there is any question about whether the owner's equity is

sufficient to cover the secured claims.

A Cumbersome Process

Supporters of the bankruptcy law expect it to reduce bankruptcy filings significantly, but that may not be the case. While the reforms may make bankruptcy more difficult, they won't eliminate the problems that force consumers to seek bankruptcy protection in the first place. However, there is no question that for those who do file, the bankruptcy process will become more cumbersome, because the new law creates a number of procedural hurdles that did not exist before.

For one thing, consumers must obtain (and pay for) credit counseling before filing for bankruptcy, and they must complete a financial education course before their bankruptcy is discharged. This could delay some bankruptcy filings and extend the period of time that debtors struggle with unpaid bills – including delinquent homeowner association fees – before working out a plan to deal with them. The new means test – the central feature of the new law – may add to those delays, because consumers will almost certainly contest rulings that they are ineligible for Chapter 7 debt relief, and creditors will almost certainly contest rulings that they are.

Although the law is aimed primarily at “abusive” debtors, it targets bankruptcy attorneys as well, with provisions requiring them now to certify the accuracy of the financial statements their clients file, and



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General Assembly Sessions. This year's proposed legislation was aimed at addressing the practice of charging higher or additional fees for resale disclosures than is authorized by the POA Act or Condominium Act. The final legislation contains amendments to Sections 55-512(B) and (C) of the POA Act and to Sections 55-79.97(D) and (E) of the Condominium Act that merely reinforce the understanding that the caps on fees related to resale disclosures provided in the Acts are in fact limits and that additional amounts may not be charged.

Here is a brief review of the fees and cost reimbursements which the POA Act and Condominium Act authorize associations, or their managing agents, to charge for providing resale certificates or disclosure packets:

1. For preparing and issuing such certificates and packets, associations may charge a fee representing the actual cost of preparation, not to exceed \$0.10 per page for copying costs or \$100 for all costs, unless the association and the seller agree on additional charges. Pursuant to the request of the seller for rush delivery, associations may also charge a rush fee of up to \$25 for providing the materials within 3 business days of receipt of a request, as well as the actual costs for special delivery methods requested by the seller.
2. If a purchaser requests an assurance that the certificate or packet remains materially unchanged or a statement specifying any material changes, an association may charge a fee representing the actual cost of preparing and issuing such assurances, not to exceed \$0.10 per page for copying costs or \$50 for all costs, plus the actual costs of any special delivery requested by the pur-

chaser.

Remember that the \$100 and \$50 limits are not automatic flat fees but are caps on actual costs that may be recovered. If your actual costs are less than the cap, then the actual cost is all that your association should be charging. Charging additional fees by other names in relation to resale disclosure is also a violation of the statute. Complaints about instances of overcharging have instigated legislators' efforts to change the applicable laws, and continued violations of these limitations may result in more legislative action and greater restrictions in the future. Please take care that your association is abiding by the statutory limitations on fees for resale disclosures.



Providing notice for committee and subcommittee meetings. Section 55-510.1(B) of the POA Act and Section 55-79.75(B) of the Condominium Act have been amended regarding the notice required to be sent to Members who request to be notified of meetings on a continual basis. Associations must still provide notice of meetings of the Board of Directors to requesting Members by first-class mail or e-mail, as requested by the Member. However, for notice of committee and subcommittee meetings, associations are only required to send notice to requesting Members by e-mail.



Notice to record meetings. Section 55-510.1(B) of the POA Act and Section 55-79.75(B) of the Condominium Act, which authorize Members to record open meetings, have been amended

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to allow Boards of Directors to adopt rules requiring Members to provide notice if they are recording a meeting.

Other legislation of interest. In addition to the amendments to the POA Act and the Condominium Act, here are some changes to other laws that may be of interest to your community association:

The Virginia Real Estate Cooperative Act now imposes the same requirements for reserve studies and disclosure of reserve funding for capital components as were added to the POA Act and Condominium Act in recent years.



Real estate taxes for Common Areas. Changes to tax laws now allow for Com-

mon Areas in planned residential developments that are not subject to the POA Act and do not have an automatic membership association to be taxed in the same manner as Common Area in developments that are subject to the POA Act and have mandatory membership associations. (That is, when a developer transfers ownership of Common Areas to an association, the value of that Common Area is re-assessed proportionally to all property whose owners have easement rights over that Common Area and the Common Area is then considered to have no value for real estate tax purposes and may not be taxed by the locality.)

Bow shooting. A new law will empower counties to prohibit the outdoor shooting of arrows from bows in heavily populated areas, with an exemption for the killing of deer in certain circumstances.

Study of Associations and Professional Managers.

