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**\* \* \* LEGAL UPDATE \* \* \***

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**CHANGES IN CONDOMINIUM AND HOMEOWNER PROCEDURES REQUIRED BY VIRGINIA LEGISLATION EFFECTIVE JULY 1, 2002!**

**Brief summary.** Similar amendments were made, effective July 1, 2002, to add new language and requirements to both the Condominium Act and the Property Owners' Association Act (POAA) which will require some procedural changes by associations. Amendments were made regarding reserve study requirements as explained in this newsletter in more detail. Amendments were also made to the resale disclosure and resale certificate sections of the Property Owners' Association and Condominium Acts respectively. Gratefully, the 3-day requirement for sending notice of the rules violation hearing decision was extended to 7 days. As a new option, certain notices and voting by fax or e-mail were made permissible under the Nonstock Corporation Act as further explained below. An amendment to Section **55-79.78** of the Condominium Act eliminated the leasing reference to officers who must be unit owners so that there is no question now that officers can be nonresident owners unless the association's documents provide otherwise.

**Reserve study requirements.** Sections **55-79.41** of the Condominium Act and **Section 55-509** of the Property Owners' Association Act were both amended to add a new definition for capital components. **New Sections 55-79.83:1** of the Condominium Act and **55-514.1** of the POAA were added to establish a minimum standard requiring that the Board of every association with capital components conduct a study at least once every 5 years to determine the necessity and amount of reserves required to repair, replace and restore capital components, to review the study annually for sufficiency and to include certain items in the budget as set forth in the statute. Both resale sections were amended in **55-79.97 C 5** of the Condominium Act and **55-512 A 5** of the POAA to require the inclusion of the current reserve study or a summary thereof.

This legislation (Senate Bill 523) which becomes effective on July 1, 2002, will require that condominium associations and property owners associations deal with the issue of reserves in a more formal fashion than they may have previously. This legislation sets up minimum standards for associations under the POAA and the Condominium Act regarding reserve requirements and disclosures. This new law now requires that condominium and property owners associations ("Associations")

conduct a study at least once every 5 years to determine the need for and the amounts of any needed reserves funding for capital components within the Association. Whether or not the Association needs to reserve will be determined by and in the discretion of the Board of Directors on behalf of the Association. The threshold question for the Board will be whether there are any capital components, as defined by the statute, for which to reserve and for which the Board determines funding is necessary. "Capital components" are defined in the statutes as those items, whether or not a part of the common elements or common areas, for which the association has the obligation for repair, replacement or restoration and for which the board determines funding is necessary. If it is determined that there are capital components for which reserve funding is necessary, then the Board must conduct a study once every 5 years to determine the amount of reserves required to repair, replace and restore the capital components. Subsequently, the Board on an annual basis is responsible for reviewing the reserve study to determine the sufficiency of the current reserve funds and to make any adjustments the Board of Directors deems necessary to maintain adequate reserves.

In addition to the study, if it is determined that there is a need to budget for reserves, the budget of the Association must include:

- 1) the current estimated replacement cost, estimated remaining life and estimated useful life of each capital component;
- 2) the actual current amount of accumulated cash reserves set aside and the amount of the expected contribution to the reserve fund for that year; and

- 3) a general statement describing the procedures used for the estimation and accumulation of the cash reserves and the extent to which the association is funding its reserves consistent with the study.

Finally, this new legislative enactment requires that a copy of the reserve study conducted by the Board of Directors on behalf of the Association, or a summary thereof, must be provided to a prospective purchaser as part of the disclosure packet or resale certificate. It is likely that in many larger Associations the summary option will be chosen as a result of the length of many of the existing reserve studies performed on behalf of Associations.

It is important to point out that there is no mandate in the legislation as to who is responsible for performing the actual reserve study. The legislation does not require that a professional engineering firm or reserve specialist be used to conduct the study. Rather, the Board, in the exercise of its fiduciary duty to the Association is left with that decision as to whether to perform the reserve study itself or to hire a professional to perform the study on behalf of the Board and the Association. A reasonableness standard will likely be imposed. Please contact our office if you have questions as to how this new legislation applies to your association.

**Delivery Options and Rush Fees! Resale certificate and resale disclosure Sections 55-79.97** of the Condominium Act and Sections **55-511** and **55-512** of the POAA were amended to allow delivery of the certificate or packet by electronic means with the consent of the purchaser and seller. When a purchaser requests an update, an association may collect actual costs of mailing or delivery. As

everyone involved with resale disclosure packets and resale certificates knows, the documents are often requested shortly before settlement without allowing time for preparation within the 14 days allowed by law. Sections **55-79.97 F** and **55-512 C** were amended to allow collection of a rush fee of up to \$25 for providing the document within 3 days, plus mailing or delivery charges and any other actual costs incurred at the request and with the consent of the purchaser, in addition to the maximum charge of \$100 for providing the resale or disclosure packet within 14 days. Note that effective July 1, 2002, neither cash nor certified funds can be required, unless the owner is more than 30 days delinquent or a check has been returned for insufficient funds within the last 6 months.

**POAA Act Disclosure Packet Changes.** Section **55-511 C** of the POAA regarding resale disclosure packets was amended to clarify that the packet must be obtained by the seller. Section **55-512** of the POAA was amended to add a **new Section A 14** referring to the one-page cover sheet developed by the Real Estate Board that must be added to the Disclosure Packet.

**New Requirements for Settlement Agents.** In order to allow associations to update their records with new owner information, both Acts were amended in Sections **55-79.97 H** and **55-512 E** to add a requirement that the settlement agent provide, upon request or when transmitting funds, information on the date of sale, name and address of the purchaser, or the HUD-1, to the extent not otherwise prohibited by law.

**Hearing Decision.** Notice of the hearing decision, effective July 1, 2002, must be sent

within 7 days after the hearing, instead of within only 3 days. Sections **55-79.80:2 B of the Condominium Act** and **55-513 B** of the POAA were amended to reflect this change. This allows associations a little more time to notify owners following a rules violation hearing of the Board's or Committee's decision as to what sanctions may be imposed.

**Electronic transmission.** Section **13.1-842 A 3 and F of the Nonstock Corporation Act** now allow notice by electronic transmission for annual and special meetings if the owner consents. Section **13.1-846 B and 13.1-847 A of the Nonstock Corporation Act** allow ballots and proxies, respectively, to be submitted by fax or e-mail. Notice to Board members may also be given by electronic transmission under Section **13.1-866 C**.

The full text of amendments and the Code of Virginia, including all provisions of the Nonstock Corporation Act (Title 13.1, Chapter 10) can be found at <http://legis.state.va.us>. The Condominium Act, the Property Owners' Association Act and selected provisions of the Nonstock Corporation Act can also be found at our website at [www.chadwickwashington.com](http://www.chadwickwashington.com).

**SAFETY REMINDERS.** In mid-May it was reported in the news that apartments may be under a non-specific, general threat. The FBI Joint Terrorism Task Force issued an alert that Al Queda members had discussions about renting apartments and filling them with explosives (as was done by terrorists in Russia in recent years). The FBI stated that it had no information that the proposed plot advanced beyond the discussion stage. Terrorists may not distinguish between apartments and condominiums, therefore we are passing on

some general recommendations suggested by the FBI and the National Apartment Association. Some of these recommendations are good practices to follow for general security and safety.

1. Have on-site staff and residents be alert to things out of the ordinary, such as, materials that can be used for pipe bombs (nails, dismantled kitchen timers, pipes) or residents who are on a student visa but never go to classes. Suspicious activity may also include abandoned vehicles or packages, unusual numbers of visitors or traffic, noise, residents changing their own locks or denying access to the unit. Report suspicious activity to local law enforcement or the local FBI office. For a directory of FBI/JTTF Field offices go to [www.fbi.gov/contact/fo/info.htm](http://www.fbi.gov/contact/fo/info.htm). If the activity constitutes an emergency, the local police should be called and association management should be alerted. In taking any such steps it is important to remember that both the Federal and State Fair Housing Acts prohibit discrimination on the basis of national origin, race, or ethnicity.

2. Law enforcement officers need a warrant to gain access to search a unit. To obtain copies of records or files, only a request or a subpoena is necessary. It is a good practice to ask to see a copy of any warrant or subpoena and the officer's identification.

3. It is recommended that residents get to know their neighbors. Terrorists can succeed through the anonymity that apartment-style communities may provide.

4. Residents should observe and management should enforce security procedures currently in place, such as doors with locks not being

propped open, reporting lost access cards or keys, or damaged locks. Emergency contact information should be kept updated. Security procedures should be reviewed.

5. Owners should keep their own insurance coverage for personal property, liability, loss assessments and living expenses up to date in the event that a casualty occurs.

6. The Association should review emergency evacuation plans and make sure that residents are aware of the correct procedures. Emergency systems (alarms, public address systems and sprinklers) should be tested regularly and kept in good working order.

7. Residents should be encouraged to adopt a Family Disaster Plan. The Federal Emergency Management Agency has a model plan available at [www.fema.gov/pte/displan.htm](http://www.fema.gov/pte/displan.htm). It includes such things as emergency supplies to keep on hand and picking a place for family members to meet outside of the building should a casualty occur.

**On a lighter note...** Isn't it great that we are getting some rain now and again? It's been so long, it seems, since we've had to turn on our windshield wipers that some of us may have forgotten that the Virginia legislature changed the law a couple of years ago. If you have your windshield wipers on, your headlights must be on for safety too.

**DOES YOUR ASSOCIATION HAVE ADEQUATE D&O LIABILITY INSURANCE COVERAGE? CHECK THAT POLICY!** Spurred by the recent financial losses associated with the September 11th events, it is anticipated that insurance companies will accelerate "tightening their

belts”, resulting in significant premium increases for policyholders, including community associations. As part of this process, you may also find some insurance companies offering fewer of the coverage options that are particularly important to community associations.

With this mind, we want to take this opportunity to remind our clients to carefully review the association’s current Directors & Officers (“D&O”) liability coverage.

A typical insurance contract for community associations (including D&O coverage) contains significant coverage limitations, including limitations on the duty to defend the very types of claims most often asserted against associations and their Boards of Directors.

Of particular concern is whether the insurance contract imposes on the insurance company a duty to defend the association, its Board members, and managing agent against claims for nonpecuniary damages (*i.e.*, where the claimant is not seeking money damages) and claims of discrimination. It is common for standard insurance policies to specifically exclude such coverage.

Such exclusions, however, do not address the particular needs of community associations. For instance, quite often, the disputes between associations and homeowners involve enforcement of the association’s governing documents (and rules and regulations), particularly those provisions relating to architectural and landscaping restrictions. If such disputes lead to litigation, the lawsuits that are filed typically seek injunctive (nonpecuniary) relief. The cost of defending

against such claims can be significant.

We are also seeing more discrimination claims being filed against associations, especially for housing discrimination. Discrimination claims arise from civil rights laws and ordinances enacted on the federal, state and local levels. Due to public policy concerns, an insurer will not cover money damages that are awarded due to the association’s discriminatory conduct. However, some D&O policies specifically cover the cost of defending against such claims. Unfortunately, such coverage is becoming increasingly rare.

If defense costs are covered by your policy, check to see if the duty to defend is triggered only by the filing of a lawsuit. Such a limitation can be significant, given that discrimination claims often start out in administrative hearings. If your insurance contract obligates your insurer only to defend against lawsuits, the association could find itself having to fund the cost of defending itself in federal, state or local administrative hearings.

While associations may ultimately find that fiscal constraints limit their ability to fully address the above considerations, we encourage Board members to re-examine their association’s current coverage, and if that coverage is found lacking in some respect, find out whether the insurer offers policies or riders tailored to the particular needs of associations.

**STRENGTHENING YOUR ASSOCIATION’S COLLECTION AUTHORITY.** It is an unfortunate reality that some owners may not pay their assessments to your association. As the

association relies upon assessments paid by owners for its funding, the failure of owners to pay timely can interfere with the association's ability to meet its contractual obligations and provide amenities and services to your community. Your association's Governing Documents should provide you with at least some basic remedies in the event that owners become delinquent. You should already have some ability to file liens against delinquent owners' lots or units and to file lawsuits against delinquent owners. You may also be able to impose late fees or interest or recover your costs and attorneys' fees incurred in pursuing delinquent owners in court. You may, however, wish to consider strengthening your association's collection authority to put more teeth in your ability to collect against delinquent owners and to increase the likelihood that a court will rule in your favor if it becomes necessary to sue delinquent owners.

**How to Begin.** The first step is to evaluate your association's collection authority. Based on the authority found in your association's Governing Documents, is your association doing all that it can to collect against delinquent owners? Is your association reaching beyond its current authority with regard to collection activities? You can only take certain actions against delinquent owners if your association's documents provide specific authority. For example, if your Declaration or Bylaws allow you to impose interest against delinquent owners, you cannot charge a late fee on the basis of the interest authority.

As a quick guide, here are the "big six" items that should be found in your association's collection authority, the ability

to: (1) impose late fees; (2) impose interest from the date of delinquency; (3) accelerate delinquent accounts if assessments are permitted to be paid in installments, so that the entire fiscal year's assessment is immediately due and owing; (4) add costs and attorneys' fees to delinquent accounts as they are incurred and to make attorneys' fees incurred the personal obligation of the delinquent owners; (5) apply payments made by delinquent owners in a particular order so that the association's attorneys' fees, and costs, which are out-of-pocket expenses to the association, are paid first and so that the oldest outstanding assessments are paid before current assessments so that the association can continue to charge monthly late fees; and (6) suspend delinquent owners' rights to use the facilities and services of the association.

**Making the Changes - Amendment or Resolution?** The next step is to determine how you will revise the association's collection authority. Revisions may be accomplished through amendments to the Declaration and/or Bylaws or through a Board of Directors' Resolution, absent a conflict in the Declaration or Bylaws. Amendments to the Declaration and/or Bylaws are legally preferable to a Board Resolution. Because Declaration and Bylaws amendments are required to be voted upon and approved by the membership, courts are sometimes more willing to enforce an association's collection authority if the provisions at issue are grounded in the Declaration and/or Bylaws as opposed to only a Board Resolution. This is particularly true with regard to late fees. If an owner challenges the association's late fee authority at trial and that authority is found only in a Board Resolution, a court may not award late fees to the association. Additionally, if the

defendant is representing himself, a judge may, upon his or her own initiative, deny the association's request for late fees.

**Passing Amendments to the Declaration And/or Bylaws.**

Almost all amendments to the association's Declaration or Bylaws require prior approval by the membership. With the appropriate "marketing" of the amendment(s), it is possible to pass amendments. The proposed amendment(s) should be distributed to all owners with an accompanying letter explaining the importance of and practical need for the amendment(s). Assessments are necessary to fund the association and provide all of the services and amenities that are available to owners. If assessments are not paid, the association and its members will suffer. Late fees and interest, in addition to generating revenue for the association, help deter individuals from becoming delinquent in the payment of assessments to the association. Additionally, if attorneys' fees in all collection cases are not made the personal obligation of the delinquent owners, all owners, including those who pay their assessments on time, will necessarily be required to pay attorneys' fees because they will become a common expense of the Association.

**Board of Directors' Resolution.** If an amendment to the Declaration and/or Bylaws does not pass or the Board does not wish to seek to amend its Governing Documents, the Board may wish to enact a Resolution adding the missing or deficient "big six" to the Association's collection authority. Prior to its effective date, the Board should distribute the Resolution to all owners under a dated cover letter. It is important that the dated cover letter accompany the Resolution to help

defend against claims made by owners that they did not have notice, or prior notice, of the Resolution. The Resolution must not be in conflict with any provision of the Declaration or Bylaws.

**In Summary.** We hope that this has assisted you in evaluating your association's collection authority and in thinking about whether you could make some changes to help your association recover against owners who become delinquent in the payment of assessments to the association. If you have any questions about your association's specific collection authority or would like us to prepare an amendment(s) to your Governing Documents or a Board Resolution, please feel free to call us.

**HAVE A SAFE AND WONDERFUL SUMMER!**