Chadwick, Washington, Moriarty, Elmore & Bunn, P.C.

The Quarterly Assessment

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Chadwick Washington Moriarty Elmore & Bunn P.C.

INSIDE THIS ISSUE:

Ten Commandments of a Director

I. Be consistent in all thy dealings

II. Be faithful in attendance at board meetings.

III. Allow the professional manager to manage.

IV. Insist that professional management be responsible to the board of directors.

V. Keep a watchful eye on the financial reports.

VI. Communicate with your fellow board members and homeowners.

VII. Deal honestly with all thy fellows.

VIII. Resist using thy position for personal gain.

IX. Remember that you are a board member of a business.

X. Encourage the association to be members of CAI.

-Terrence P. Crawford, 1981

Under-Insurance a Looming Problem For Community Associations

A fire caused by an electrical short swept through your community last night. No one was hurt, fortunately, but one building was destroyed completely and two others suffered extensive damage. Your first thought as a member of the board of directors: Buildings can be repaired or replaced. Your second thought: It is a good thing our insurance will cover the costs. But will it?

There is no question that your association's insurance policy should protect the community. The Association's governing documents often create an obligation to maintain the types and amounts of insurance. If the documents are vague, as is often the case, then boards must make a reasoned assessment of the association's risks and insure them appropriately. Failure to do so constitutes negligence and, maybe even worse, a breach of the director's fiduciary duty, subjecting the association and possibly individual board members to claims by owners and the owners' insurance companies.

Maintaining adequate insurance is the board's responsibility; it is not the responsibility of the community manager or the insurance agent, unless they have specifically assumed that obligation, and relying on them will not protect the board from claims of negligence if there is not sufficient coverage.

But despite that potential liability, and notwithstanding the common sense arguments for maintaining adequate insurance, it is probably safe to say that many boards and many owners don't have any idea what their policies cover until they drag the documents out of a drawer in order to file a claim.

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A Complete Disaster

Some 54 million people make their homes in approximately 275,000 residential community associations. In the wake of hurricane Katrina, given that a new hurricane season is upon us, many communities are thinking about disaster relief. Who pays for clean up after a hurricane, tornado, flood, or other natural disaster that affects your community's property – the common elements or common areas? Communities are generally covered under their master insurance policy for these types of things, with the exception of flood, but another logical answer to that question would seem to be the Federal Emergency Management Agency ("FEMA"). But if you said that, you would be wrong.

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"Although relatively few Virginia community associations have as yet confronted the sex offender issue, many, if not most, are likely to do so at some point, and they will find the legal terrain rocky and uncertain."

KEEP OUT!: HOME OWNER ASSOCIATIONS EYE POLICIES BARRING SEX OFFENDERS

The term "Not-In-My-Back-Yard" (NIMBY) describes a common attitude for community residents in reaction to plans for the construction of new housing, new commercial structures, or new anything in close proximity to where they live. But when a NIMBY resident learns the news that a convicted sex offender may be living nearby, the attitude escalates to a new degree.

NIMBY residents protesting low-income housing are concerned (or say they are concerned) primarily about their property values. Residents protesting the presence of a sex offender are concerned about their safety. This is an emerging issue today, visible in a few isolated communities. It promises, however, to become a much larger concern. A few examples, drawn from recent press reports, highlight the trend.

Developers of a planned subdivision under construction in Lubbock, TX have promised that the new community will be molester-free. To ensure that result, they say they're going to conduct criminal background checks on all prospective owners and reject any convicted sex offenders who apply.

Moving in a similar direction, more than 150 associations in Ohio have approved by-law amendments barring sex offenders and many more communities in Ohio and elsewhere have enacted similar measures or are considering them. There is little question that most community association residents presented with "no sex offenders allowed" initiatives will approve them. It remains to be seen whether Virginia associations will adopt these provisions and, more importantly, whether Virginia lawmakers and courts will uphold those restrictions.

Judicial Review and Public Policy

Only a few state courts have considered the question thus far. The United States Supreme Court refused to review and let stand an Iowa law preventing sex offenders whose victims were children from living within 2000 ft. of a school or a day care center. The Iowa Civil Liberties Union argued that the restriction was an unconstitutional form of continuing punishment, making it impossible for offenders to live legally in most urban neighborhoods – an argument that civil libertarians will no doubt use to challenge similar restrictions elsewhere.

In what appears to be the only judicial review of a community association restriction to date, a New Jersey Appellate Court has considered and rejected a by-law barring sex offenders. While this 2001 decision in *Mulligan v. Panther Valley Property Owners Association* was narrowly focused and did not establish much precedent in New Jersey, or no binding precedent elsewhere, the court's discussion of the issue is interesting, nonetheless.

Mulligan, the plaintiff in the case, a resident of Panther Valley, challenged several bylaw amendments approved by owners, including one barring "Tier 3" sex offenders from residing in the community (New Jersey and most other states have adopted versions of "Meagan's Law," named after a child who was murdered by convicted sex offender who had been released from prison. The law classifies offenders based on the seriousness of their crimes – "Tier 3 offenders are deemed to pose the greatest risk of committing new offenses – and requires them to register with local authorities, who maintain a public data

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KEEP OUT!: HOME OWNER ASSOCIATIONS EYE POLICIES BARRING SEX OFFENDERS

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base indicating where the offenders are living.)

Mulligan complained that the restriction interfered unreasonably with her ability to sell her property, imposed an unreasonable obligation on her to identify and screen out sex offenders, and was contrary to public policy. The appeals court rejected the first two arguments out of hand, but it gave consideration to the public policy argument. The court agreed that sex offenders are not a constitutionally protected class, granting them no coverage by anti-discrimination laws or by the reasonable accommodation requirements of the Fair Housing Act. "[But] it does not necessarily follow," the court said in its opinion, "that large segments of the state could entirely close their doors to such individuals, confining them to a narrow corridor, and thus perhaps exposing those within that remaining corridor to greater risk of harm than they might otherwise have had to confront."

The court also acknowledged that many people choose to live within common interest ownership communities specifically because of the perceived security they offer. But that "understandable desire of individuals to protect themselves and their families from some of the ravages of modern society…should not become a vehicle to ensure that those problems remain the burden of those least able to afford a viable solution," the court decided.

The key public policy question, the court said, is if restrictions like the one adopted by Panther Valley became widespread, would those provisions severely and unreasonably restrict the residency options of offenders who have served their time and been released from prison. The lack of evidence submitted by the both parties relating to that point made it impossible, in the court's eyes, to determine "whether the result of such provisions is to make a large segment of the housing market unavailable to one category or individual and, indeed, to approach 'the ogre of vigilantism and harassment' the dangers of which the Supreme Court recognized, even while upholding the constitutionality of Meagan's Law."

Finding the record inadequate to decide the merits of the public policy question, the appeals court rejected the sex offender ban, reversing the lower court, which had upheld it. However, the court also made it clear that the public policy concerns it cited in this decision would weigh heavily in future challenges of similar community association measures.

Association Obligations

Although relatively few Virginia community associations have as yet confronted the sex offender issue, many, if not most, are likely to do so at some point, and they will find the legal terrain rocky and uncertain. Depending on what new legislation, if any, is proposed in the General Assembly, association boards will be challenged by competing legal obligations and conflicting liability concerns. For example, an association's governing documents may impose a duty on the Board of Directors to ensure the safety of community residents. That duty may include an obligation to anticipate and take steps to prevent dangers that are reasonably foresee-

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"At this point, communities would be wise not to adopt policies banning sex offenders."

A Complete Disaster

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Community Associations are considered private, non-profit facilities under FEMA guidelines. Based on recent refinements to FEMA's guidelines regarding assistance to private non-profit facilities, the Agency has determined that it will fund post-disaster debris removal from places such as educational facilities, medical facilities, custodial care facilities, emergency facilities, and utilities, to name but a few. Not included in the list are community associations which, taken collectively, have ownership of thousands of miles of road and thousands of acres of recreational area.

Although the guidelines are in place in theory, there are some community associations that have been able to obtain FEMA funding for debris removal and clean up after a disaster even after FEMA rejected the initial request. This inconsistent application is explained by FEMA stating that it has the right to make case-by-case determinations, noting that if there is a public health and safety hazard, it may pick up the cost of debris removal even on private property.

FEMA will remove debris from private communities, for a limited amount of time after a disaster, when it is hauled onto public rights of way. So, as crazy as it sounds, if a private community puts its debris on a public right of way outside the community or in an area that is the legal responsibility of the government, it will be taken care of from that point on by the municipality or the federal government and those entities will be eligible for FEMA funding for the cost of the removal and clean up. It should be noted that in the aftermath of hurricane Katrina, community associations in Louisiana, Mississippi, and Alabama did become eligible for federally funded disaster clean up under FEMA. But, at present, that is still the exception and not the norm.

While FEMA has taken the position that private roads are not public responsibility, residents in community associations are still paying the same property and federal taxes as other homeowners. So while there is an argument that private road maintenance should be the responsibility of the associations, once the government, state or federal, has a natural disaster, then federal funding should kick in to help cover the costs of clean up and repair. Otherwise the financial burden to community associations asked to foot the bill is overwhelming. One association in Williamsburg, Virginia spent slightly less than $150,000 for clean up after hurricane Isabel in 2004. They are still appealing to FEMA for some sort of aid to defray that cost.

Increasing numbers of municipalities are requiring that developers establish associations, resulting in more people living within community associations. This means that in many cases, living within an association is not a luxury of the wealthy, but a reality that cuts across all economic classes. Therefore, FEMA's argument that people living within associations are more financially equipped to foot the bill for disaster clean up is, in the least, misplaced given the reality of the situation.

Working toward a solution to this catch-22, Representative Alcee Hastings, (D-FL) in March 2005 introduced H.R. 1137, Responding Equitably, Swiftly, Proportionally, and On-time to Natural Disasters Act of 2005 (The RESPOND Act.). The bill, if passed, would expand FEMA's ability to reimburse clean up costs associated with natural disasters to non-profit associations such as community associations. Unfortunately, the bill is still sitting in subcommittee and no movement forward has been recorded.

A viable tactic employed by some associations is to partner up with the local municipality and the state after a disaster and submit one master bill to FEMA for reimbursement costs.

While there are no simple and apparently immediate solutions, other than making sure that your community is adequately covered by insurance in the case of natural disasters, owners, board members, and managers alike need to be aware that federal funding for disaster clean up is most likely not available due to the private nature of the property.

UNDER-INSURANCE A LOOMING PROBLEM FOR COMMUNITY ASSOCIATIONS

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A Painful Mismatch

Needless to say, staring at the smoldering ruins of a gutted clubhouse or the rubble left by a devastating storm is not the time to discover that the association's policy will not provide the funds needed to rebuild. This is, however, precisely the crisis your community could face if the cost of replacing damaged buildings exceeds the value the insurer has "assigned" to them. Two factors directly cause this dilemma: the increase in land value of the Association's property and the rise in cost, over time, of raw materials and construction.

Partly because of the massive reconstruction efforts under way in hurricane-damaged areas of the Gulf Coast and other recent disasters, building costs have increased by more than 100 percent in the past six months alone. That means a community with a policy that would replace a building valued at $2 million would have only half of the funds needed to rebuild that structure if it is destroyed.

Associations may be able to avoid this potentially devastating shortfall by obtaining a "guaranteed replacement cost" policy, which will pay to restore a damaged property to its pre-disaster condition even if the construction costs exceed the property's assigned value. Not all insurance companies will provide this type of coverage. If your insurance company does not or you are unwilling to pay for the increased premium associated with this coverage, you should make sure your policy limits always match the estimated replacement cost of your community's buildings. To do that, you can ask your agent to confirm that there is sufficient coverage or have an insurance appraiser review your policy at least annually and update the estimated replacement value based on current construction costs in your area.

Closing a Gap

Accurate and updated replacement cost estimates may not provide the protection your association needs, however. Even a guaranteed replacement cost policy may leave you short of the funds required to rebuild or repair a damaged structure. That is because most policies specifically exclude losses resulting from "governmental orders." Governmental orders would include a condemnation order for a damaged structure or building code requirements that may not have been in place when the building was constructed but that will apply to any new construction or renovation undertaken today. So, while your $1 million policy might restore your damaged building to its original condition, the policy might not cover the added cost of installing sprinklers, creating parking spaces, increasing setbacks, or making other changes a modernized building code may require. To close this gap, associations need ordinance or law coverage, which is available as a fairly low-cost endorsement to a standard master policy.

Another potentially serious insurance lapse associations often encounter occurs not in their association policy, but in the coverage individual owners should have, but often do not obtain. Many owners assume incorrectly that the association policy covers everything, including their residences and all personal property therein. This is a problem not just for the owners, who may have huge uninsured losses, but also for the association itself. Uninsured or under-insured owners may not be able to pay their

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UNDER-INSURANCE A LOOMING PROBLEM FOR COMMUNITY ASSOCIATIONS

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share of the association policy deductible or they may not be able to make needed repairs for which they are responsible in their own properties. An obvious example: Untreated water damage in one unit could trigger a mold outbreak affecting adjacent units and the common areas. Because associations have a clear and compelling interest in ensuring that owners obtain adequate individual coverage, attorneys are increasingly recommending that communities amend their documents to make this a requirement.

Property values, risk profiles, and insurance requirements all can change over time, so boards should review their insurance policies periodically, to make sure they have and maintain the coverage they need. As part of this periodic review, boards should also assess, or reassess, the financial strength of their insurance carrier. Having all the insurance the association needs to recover fully from a disaster won't help much if the association's insurer doesn't survive.

Termination Clauses

Recovering from a disaster will be difficult under the best of circumstances. You want to make sure the association's governing documents do not impede the recovery effort. Many documents contain what could be a significant stumbling block, in the form of an automatic termination provision specifying that if the renovation costs exceed a stated percentage of the development's market value, the association will be terminated unless a specified percentage of the owners vote to rebuild. It is hard to imagine

many situations in which rebuilding would not be the best choice. Displaced owners will need some place to live, and while the association's insurance should cover the replacement value for rebuilding purposes, it would cover only the current market value if the association decided to dissolve. Because of this, most communities may be better served by turning the standard termination language on its head, making the rebuilding decision automatic and requiring a vote of owners to terminate instead.

Provisions governing the handling of insurance claims could also create unnecessary problems if they are not drafted properly. For example, the board should be designated as the insurance trustee, authorized to receive insurance payments. Otherwise, the disbursements could be delayed. The documents should also name the association as agent for each unit owner and for the holders of liens on all units. This will give the board the authority it needs to adjust all insurance claims under the master policy, including those covering damage inside individual units.

Before you begin planning the reconstruction/repair of your community, you should review your insurance policy to make sure you comply with all the reporting requirements and

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Under-Insurance a Looming Problem For Community Associations

meet all the filing and notice deadlines. Many policies will provide advance payments to finance emergency measures (shoring up damaged structures or removing debris, for example) and there is certainly nothing wrong with accepting those payments, as long as you don't sign any releases that might limit the damages you can recover in the future. Have the association's attorney review any insurance documents, including the final settlement offer, before you accept it. You want to make sure the compensation the insurer provides reflects the coverage to which you are entitled.

Proceed with Care

Once you know what the insurance will cover, you can begin formulating the reconstruction plans. The pressure to rebuild quickly will be intense, but caution and careful planning are essential. It is far more important to handle the construction project properly than to complete it rapidly. Approach the work as you would if it had not resulted from a disaster. Here are a few tips to consider when faced with the task of rebuilding:

- Do not hire the first contractor who arrives on the scene with a back-hoe, a construction crew, and a promise to "fix everything like new."
- Obtain competitive bids from at least three contractors.
- Verify the capabilities and the reputations of any companies you consider. Check their references and demand proof of their insurance coverage.
- Before you solicit bids from contractors, have an engineering firm assess the damage to your community, and ask that firm also to prepare the specifications for the construction bids.
- Once you select a contractor, have the association's attorney either draft the contract or review it before you sign.
- Plan to hire a construction manager to oversee the project; the association's property manager probably will not be the best choice for this task.
- Have both the construction manager and the association's consulting engineer monitor the project, reviewing the work and workmanship at every stage. You do not want to find out at the end of this process that your disaster recovery project has left the association with another disaster on its hands.

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KEEP OUT!: HOME OWNER ASSOCIATIONS EYE POLICIES BARRING SEX OFFENDERS

"A blanket policy requiring notice of any offender that comes to the board's attention is probably best."

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able. Thus, if two residents have been mugged in a dark parting lot and the board fails to install lighting, the association might be found negligent if another resident suffers a similar fate.

Under this "reasonably foreseeable" theory, associations may also have an obligation to protect residents from a sex offender in their midst. But because of the lack of judicial and statutory guidance in this area, the extent of the association's obligation and the limits of its authority, are unclear. As a result, this discussion generates far more questions than answers, among which are:

Do community associations have the legal authority to bar convicted sex offenders?

What potential liability will community associations face if they fail to bar offenders?

If community associations do adopt sex offender bans, do they also assume an obligation to ensure that no offenders move in? And would the association be liable if an offender moves in beyond the board's knowledge and harms a resident?

Is it possible an association might be sued if it does adopt a ban and sued if it does not? Unfortunately, the answer is probably yes, simply because it is "possible" for associations to be sued by almost anyone for almost anything.

Conservative Advice

So what, if anything, should associations do? Given all the uncertainties, a conservative approach is best. At this point, communities would be wise not to adopt policies banning sex offenders (although owners would no doubt approve them); they should, however, respond to reports that offenders have moved into the area and then advising their members to periodically check the websites set up for this purpose.

The Community Associations Institute, which also recommends a conservative approach, suggests that boards notify community residents only if the trustees determine, based on the nature of the offense, the length of time since it occurred, and other factors, that the offender poses a "serious" threat. But making subjective judgments of that kind may expose the association unnecessarily to liability risks. A blanket policy requiring notice of any offender that comes to the board's attention is probably best. That notice should simply state that there may be an offender is in the community or in the area, and tell residents how to obtain more detailed information from the sex offender registry. The board should also inform the onsite security force, if the community has one, of the offender's presence.

Additionally, and equally important, boards should remind residents that most state versions of Meagan's Law specifically prohibit "threats, intimidation, or harassment" of offenders, and caution that any actions of that kind could result in a law suit and a possible financial judgment against

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KEEP OUT!: HOME OWNER ASSOCIATIONS EYE POLICIES BARRING SEX OFFENDERS

community associations from barring sex offenders. But communities that adopt those policies should be prepared for a legal challenge.

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the association.

Given the legal complexities and risks on all sides of this issue, boards should consult with their attorney on the substance and form of these notices before posting them, and they should definitely obtain legal advice before adopting any policies barring or otherwise restricting the presence of sex offenders in their communities. No current Virginia law prohibits

"Given the legal complexities and risks on all sides of this issue, boards should consult with their attorney on the substance and form of these notices before posting them"

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WHO'S WORKING ON MY CASE?
WIL WASHINGTON

Wilbert Washington II is a principal in the firm's Fairfax office and joined the firm in 1990. His practice is devoted to community association law. Wil provides counsel and advice to the firm's clients regarding general community association issues, warranty, contract, fair housing and litigation matters. He recently taught courses on drafting and amending community association documents and on fair housing laws as they apply to community associations. He has recently been involved in projects concerning warranty negotiations, litigation of contract and corporate disputes, and the adoption of amendments to governing documents capping the percentage of units that may be leased.

Wil is a member of the Board of Trustees of the Community Associations Institute. He is former President of the Washington Metropolitan Chapter of CAI. Wil is also a member of the American College of Real Estate Lawyers

Wil graduated from Duke University in 1980 with a B.A. in History and obtained his J.D. from Vanderbilt University in 1983. Wil is admitted to practice in Virginia, Maryland, and the District of Columbia.

Quick Facts

Favorite Movie: *Casablanca*

Last Book Read: *Mary, Mary* by James Patterson

Last Movie Seen: *Pirates of the Caribbean 2: Dead Man's Chest*

Hobbies: Golf, Skiing, Music