

# TASK FORCE OF THE ASSEMBLY TO STUDY HOMEOWNERS' ASSOCIATIONS

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## STAFF TO THE TASK FORCE

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# **ASSEMBLY TASK FORCE TO STUDY HOMEOWNERS' ASSOCIATIONS**

## **BACKGROUND ON THE TASK FORCE**

The **Assembly Task Force to Study Homeowners's Associations** was initially formed as a result of Assembly Resolution No. 92 of 1995 (Bateman/Kavanaugh), which passed the Assembly and was filed with the Secretary of State on June 30, 1995. The Task Force held one meeting in November of 1995, but expired prior to the completion of its mission. The Task Force was reconstituted pursuant to Assembly Resolution No. 47 of 1996 (Bateman), which passed the Assembly and was filed with the Secretary of State on March 1, 1996. The membership of the Task Force was increased at this time to 10 members. All of the Task Force members were appointed by the Speaker of the General Assembly. Three members of the Task Force are members of the General Assembly; two are republican members and one is a democratic member. Seven members are public members and represent the following interests: "one shall represent the interests of condominium management associations; one shall represent builders of planned real estate developments; one shall represent condominium associations; one shall represent associations governing units of town home construction; one shall be an attorney with knowledge of housing and condominium laws; and two shall be individuals with general knowledge of homeowner associations and their functions." The mission of the Task Force, as defined in the resolution, was "to study and make recommendations concerning the functions and powers of homeowner associations under which common elements or interests are shared, as established under the laws and regulatory scheme of this State, and any problems adhering thereto."

The Task Force, after reconstitution, held four more public hearings in different geographic regions of the State, taking testimony from members of the public. The majority of persons testifying at the hearings were unit owners who were not members of their respective association boards.

## **INTRODUCTION**

Common interest property is a term that refers to commonly-owned areas in a real estate community. Such property can consist of commonly-shared walls typical of many condominiums; playgrounds; clubhouses; or simply drainage retention areas which serve the entire community and which are commonly owned by all. Homeowners' associations, whether they manage condominiums, town homes, or single-family detached homes, are formed out of the need for management of and responsibility for these commonly-owned areas. Although the developer forms the original board, the law provides that board members be elected by the home owners as sales in the community reach a certain level. Most boards engage management companies and professional staff to assist them in managing the common interest property of the homeowners. Current law provides these boards great flexibility in their rule-making and administrative powers. As described in more detail below, these associations have traditionally been treated as corporations managing a business. Some modification of this model appears to be necessary to address the increasingly governmental nature of the duties and powers ascribed to the homeowners' association board.

Homeowners' associations are not governed by one set of statutory guidelines, and, in addition to statutory law, are subject to the common law applicable to nonprofit corporations and other common law. Decades ago, the main type of common-interest property consisted of homes existing under a "horizontal property regime," which meant that some or all of these properties were subject to clauses or covenants in master deeds to property in that area. See N.J.S.A. 46:8A-1 et seq. Over the years, laws regulating homeowners associations have evolved or emerged whenever a new form of association has been authorized, and no doubt have been influenced by other laws which sought to place stricter controls on land use development. See N.J.S.A. 46:8B-1 et seq. and N.J.S.A. 45:22A-43 et seq. In areas not specifically covered by these statutes, common law has been applied to fill in the gaps. For example, the common law applicable to fiduciaries has often been applied to association board members. In addition, since many of these associations incorporate as nonprofit corporations, the statutes and common law dealing with nonprofit corporations have been applied to them, as well as other common law. The fact that the law has evolved in this manner has made it

difficult to address in a coordinated manner issues that have arisen as these types of property ownership have gained in popularity.

Recent statutory developments have attempted to counterbalance the quasi-governmental power granted to association boards by granting homeowners the right to pursue "alternative dispute resolution" rather than requiring them to litigate against their association when a dispute arises. In addition, in response to court decisions that stated that homeowners' associations lacked the statutory authority to impose fines for violations of bylaws or late fees for payment of common expenses, the Legislature recently granted them the power to do so, with the requirement that a homeowner be notified in writing of any fine imposed and its basis, and be granted the right to alternate dispute resolution regarding any such fine imposed.

The Task Force was charged to "review the laws and regulations as they may or may not now apply to the establishment of condominiums and town homes and the formation of condominium associations" and to "identify any problems existing in the operation of homeowner associations, with emphasis on their formation, bylaws, awarding of contracts, management companies, eligibility of board members and elections."

The members of the Task Force, being required to have a certain level of expertise in order to be appointed, utilized their knowledge in examining the issues raised by the public and also raised additional issues for consideration. The following represents a consensus of the actions which the Task Force believes will assist in addressing these issues. Any recommendations which were not endorsed unanimously by all task force members are so denoted. Although the Task Force endeavored to find solutions for many of the problems identified, time precluded in-depth coverage of every issue identified. All of the members of the task force have expressed an interest in having further discussion and debate on many of the issues raised, and hope that this will occur through the legislative process.

## **ASSEMBLY TASK FORCE FINDINGS AND RECOMMENDATIONS**

### **I. ASSOCIATION BOARD MEMBERS AND UNIT OWNERS SHOULD BE MADE AWARE OF THEIR RESPECTIVE RIGHTS AND RESPONSIBILITIES PRIOR TO THE TIME OF SALE**

- Under the current corporate model of treatment, a board has wide latitude in the creation of bylaws and the exercise of its powers.
- There are no guidelines defining the word “reasonable” in the statute which empowers condominium associations to impose “reasonable rules and regulations;” this has led in some instances to confusion, and the need for unit owners to obtain legal counsel to determine what has been deemed reasonable by the courts.
- There is currently no mechanism to ensure that elected board members are aware of what is required of them under the law regarding their fiduciary duties and responsibilities, and the limits on these powers and duties. In addition, many board members are not aware of available educational and informational resources.
- Some unit owners have indicated that they were not presented with a copy of the association bylaws applicable to them prior to or upon the purchase of their unit or house, and therefore were unaware of the particular bylaws of the association to which they are subject.

#### ***RECOMMENDATIONS:***

**1. a. The Department of Community Affairs should create a disclosure booklet to be distributed by the seller during the attorney review period upon a contract for sale of any common interest property. The booklet will contain a generic “guide to community association living” to clearly define the rights and responsibilities of owners in complying with the bylaws of a homeowner's association, and all applicable statutes and laws. The properly adopted and recorded bylaws of the association, along with a current financial statement, should also be distributed to the purchaser by the seller at this time. The booklet should also be made available by the homeowners' association to any current common interest homeowner.**

**b. The disclosure booklet should also contain information regarding the rights and responsibilities of board members and board attorneys, including conflict of interest guidelines, and should contain references to materials available to board members and common interest property owners which are published or made available through community association interest groups, such as materials and courses offered by the Community Associations Institute**

or other such associations.

c. Examples of bylaws which have been held by the courts to be unreasonable and arbitrary could be included in the booklet, as well as examples of bylaws which are typical and which the association may wish to consider (varieties of model bylaws).

## **II. THE UNIFORM COMMON INTEREST OWNERSHIP ACT (UCIOA) IS AN IMPORTANT MEASURE FOR REGULATING CERTAIN AREAS REGARDING HOMEOWNERS' ASSOCIATIONS**

- Uniformity - The UCIOA would cover all types of homeowners' associations - from co-operatives to condominiums and single family homes which are part of a master deed with common property.
- UCIOA provides for a staged transition from developer to unit owner control.
- It delineates the responsibilities of a successor developer when taking over from a developer who went bankrupt.
- The legislation deals with disclosure issues during the resale of the units.
- It ensures that investors who rent out their units must pay the common fees.
- It has default provisions to cover any gaps in offering documents.

### *Shortcomings of legislation:*

- It would operate prospectively only, so those associations which are not currently covered by the Condominium Act or the Planned Real Estate Development Laws would also not be covered by the act.
- The statutes have been amended since the UCIOA was drafted, so that some adjustments need to be made to reflect the changes.
- The UCIOA does not repeal any existing law, and in some instances where the law covers the same issue, it will be unclear which statute will be the controlling one.

### **RECOMMENDATIONS:**

**2. Legislation providing consistent and uniform guidelines for all types of homeowners' associations should be seriously discussed and considered prior to enactment. Pending bills in both the Senate and Assembly deserve full open hearings prior to action since the legislation deals with many complex and disputed issues. UCIOA should be examined as to whether it**

would be a proper vehicle for combining many or all of the recommendations within this report. The Task Force unanimously recommends that comprehensive statutory treatment of all homeowners' associations is needed.

### **III. IN CERTAIN INSTANCES, MEETINGS HAVE NOT BEEN FORUMS FOR OWNERS TO PARTICIPATE IN THE GOVERNANCE OF THEIR COMMUNITIES**

#### *Some association boards abuse their privilege of having closed meetings*

- The current statutes requiring open meetings for condominium and homeowner associations provide a loophole allowing boards to go into closed meetings as long as they don't take any action. The availability of closed meetings has reportedly been abused by certain boards.
- The law permits a board to go into a closed meeting for a "working session," in which substantive discussion can occur, outside the presence of the unit owners who should have the right to listen and contribute to such a meeting. An open meeting held subsequently to such a "working session" is sometimes just a reflection of pre-determined decisions reached in the closed meeting.
- The board is not required to take minutes at closed sessions.

#### **RECOMMENDATIONS:**

**3. Require all types of homeowners' associations to abide by a law parallel to the "Open Public Meetings Act," P.L. 1975, c. 231 (C. 10:4-6 et seq.) (also known as the "Sunshine Law"), limiting executive sessions to the narrow circumstances as set forth under that act and requiring the posting of agendas for open meetings, and require that minutes be kept and made available to the unit owners for all meetings where confidentiality is not an issue. Newspaper advertising of the agendas should not be required, however, as it is under the "Open Public Meetings Act," as long as the association can assure that all homeowners will be made aware of the meeting date, place, time and proposed agenda.**

#### *Some boards do not encourage participation*

- At open meetings, some boards refuse to allow unit owners the opportunity to speak their minds concerning issues pending consideration.
- It was reported to the task force that at some meetings where unit owners were permitted to speak, they were held up to scorn, ridicule, and derision by the board, management or other homeowners present at the meeting.

**RECOMMENDATIONS:**

4. Associations should be encouraged, but not mandated, to set aside a certain amount of time on the meeting agenda before binding votes are taken so that unit owners can have the opportunity to ask questions or comment on agenda items. Meeting agendas should also be in writing and available for the unit owners at the meeting.

**IV. MECHANISMS SHOULD BE ESTABLISHED TO ENSURE FAIR TRANSITION OF UNIT OWNER CONTROL OF THE BOARD AND FAIR ELECTION PROCEDURES**

*Guidelines for elections are needed to ensure legitimate results*

- Homeowners' associations are not required to elect their boards by anonymous ballots. This exposes unit owners to the possibility of intimidation and reciprocation for the way they cast their votes.
- There is nothing to ensure that the Board abides by the results of the elections.

**RECOMMENDATIONS:**

5. Anonymous ballots, including absentee or proxy ballots, should be a required method of balloting for all association board elections. Other methods may be permitted, but a homeowner must be afforded the opportunity to cast an anonymous ballot if he or she wishes to do so.

6. Specify in the statutes that election disputes are matters that may be reported to the Commissioner of Community Affairs if it appears that statutes or regulations have been violated. (See recommendations No. 27 and 28 hereinafter).

*Composition of the board does not necessarily reflect the will of the unit owners; transition problems*

- Sometimes developers who have not yet sold off all of the units, or investors who purchased a large number of units, find themselves with a large portion, if not a majority, of the votes in the community. Some developers have completed developments, but have failed to deliver the improvements which were promised.
- People renting from investors do not have the same level of interest in the community, most significantly its long-term development and growth, that permanent residents do.
- It can potentially be unjust when the Board appoints a large number of replacement members



upon the resignation of sitting members due to illnesses, moving, or other circumstances. In at least one instance, it has resulted in a seven member board, five members of which were appointed by the other two.

- Current law does not provide a sufficient remedy for the problems that occur when a developer does not finish building a development, and the control of the association board remains in his hands, leaving the homeowners with no say in the management of the common elements.
- In the case of conversion units, some landlords who have remained in control of the board have used the association common fees to subsidize the utilities and other repairs or maintenance costs of the other apartments being rented by the landlord.
- There have been instances in which a board member is no longer qualified to serve on the board because of a conviction for a crime involving fiduciary responsibility or worse, but there is no mechanism to have the board member removed.

#### ***RECOMMENDATIONS:***

**7. Create a presumption of unit voting forfeit for developers who rent out units rather than sell them. The presumption would be applied when one or more developer-owned units is rented; at that point the developer would forfeit the right to vote the rented unit's interest in board elections. This presumption would not affect the number of members that the developer is entitled to appoint to the board.**

**8. Consideration should be given to change the point of transition to unit owner control of the board. Currently, the majority of the board members are elected by unit owners after 75% of the units in a development have been sold. A majority of the task force believes that control should shift to the unit owners sooner, sometime after 51% of the units are sold. A majority of the members also believes that the index of control should change from the number of units conveyed to the number of units occupied (either sold or rented) in a development. A minority of the task force strongly believes that the transition to owner control should remain at 75% of units conveyed, and that any changes to the transition point should be made only if very serious consideration is given to the developer's investment and relative equity in the property. Since the members of the task force were not unanimous on this issue, it is clear that this issue should be debated in more depth through the legislative process.**

**9. Change the law to allow developers to build in phases, so that if the final phases of a development are not completed, the developer may sell off that land, and the control of the board can shift to the homeowners who reside in the completed phases. If the land cannot be sold, allow the Commissioner of Community Affairs to determine which developments have reached completion. In other words, if a development is only going to contain 1,000 units, but had been planned for 2,000, the commissioner will be able to make a determination that, upon**

the occupation of 750 units in the development, control of the board will shift to the unit owners. (See recommendation No. 8 - this amount will vary upon the transition percentage).

10. Amend the planned real estate development law to enumerate the remedies available to an association when a developer does not provide all promised improvements, take necessary corrective actions or transfer the assets properly. After control of an association has shifted to the unit owners, the developer and association should be required to finish the transition process within a given time period, to be determined either by the Commissioner of Community Affairs or by legislation.

11. Require that elections be held for all appointed unit owner members within one year of their appointment.

12. Mandate that a board member's seat be vacated upon a conviction within any jurisdiction of a crime involving fiduciary responsibility, fraud, or any crime of the second degree or higher. Such convictions should be reported to the Commissioner of Community Affairs, in conjunction with the recommendation that she be given the power to remove board members. The seat could be filled by appointment, with an election to occur within a year.

## **V. CONFLICTS OF INTEREST MUST BE DISCLOSED**

### *Board Attorneys*

- A conflict of interest can exist when the attorney for a homeowners' association also represents the management of the association, even in other matters.
- At times, unit owners, at their own expense, are forced to retain counsel to represent them against the board attorney, for whom they are also paying (through the common fees).

### *Management Firms*

- As reported to the Task Force by the public, there have been instances of management companies having undue influence on board members. In one reported instance, a management company required that people from the company be voted onto the board, in violation of the master deed.
- Sometimes, board members are under the impression that they should be representing the interests of the management over the unit owners instead of the converse.
- There is no statutory mechanism to hold management companies responsible for the fiduciary responsibilities that have been delegated or contracted out to them by the board.

***RECOMMENDATIONS:***

13. Conflict of interest guidelines should be developed for board members and management companies similar to those for local government officials. These guidelines should be included in the disclosure booklet (see recommendation No. 1). Also, there should be included in the disclosure booklet information regarding the fact that board attorneys are subject to the conflict of interest rules and ethics rulings of the Supreme Court regarding dual representation.

14. It should be specified in the statute that conflict of interest complaints may be referred directly to the Commissioner of Community Affairs or the Real Estate Commission (see Recommendation No. 15) regarding board members and management companies. (See recommendations Nos. 27 & 28).

15. Management company personnel should be licensed, most likely by the Real Estate Commission, which would have the power to revoke such licenses for continued abuses or gross incompetence.

a. The licenses should require a certain degree of education, training and qualifications to handle money, such as being bonded and following Generally Accepted Accounting Principles (GAAP), in addition to the conflict of interest laws developed for management companies.

16. Board members should be encouraged to receive appropriate training to help them execute their duties in an independent, efficient and productive manner. This may be accomplished through the disclosure booklet. (See recommendation No. 1) (See also recommendation No. 25 regarding the creation of a Homeowners' Association Ombudsman in the Department of Community Affairs.)

***Service Providers***

- Some service providers charge exorbitant fees for providing simple services, and homeowners are prevented from completing these tasks themselves or for other people, free of charge.
- Some management companies give jobs and positions to companies they either own, or companies belonging to family without disclosing that fact.
- Management and the board are under no obligations to accept bids for the lowest price for a given service.

***RECOMMENDATIONS:***

17. Require that association boards seek out quotes for jobs costing above a certain

amount (\$500) and written proposals for jobs exceeding another set ceiling, such as \$11,000 (similar to the Public Bidding Law.)

18. Require as part of the conflict of interest rules that board members or management company personnel disclose whenever a related party's proposal is accepted and a contract is entered into with the related party. A majority of the task force believes that developer-owned companies should be disqualified from contracting. A minority of the task force believes that these companies should not be disqualified, provided that bidding safeguards are observed and disclosure is made. (See recommendations Nos. 1, 13 and 14)

## **VI. THE LAW SHOULD SPECIFY WHICH INFORMATION CONCERNING THE ASSOCIATION SHOULD BE ROUTINELY SHARED WITH UNIT OWNERS**

### *Documents*

- Some boards refuse to show unit owners certain documentation concerning payments given to outside contractors, or for insurance, etc.
- When switching management companies, there is no enforcement mechanism, short of a lawsuit, to obtain all the records, accounts, files, and contracts of the association.

### *Budget*

- In certain instances, the Board is not presenting the budget to the unit owners prior to its approval. The Board has waited until after it affirms the budget before releasing it; at this juncture, any input the unit owners may have on the budget is irrelevant.
- The association could be in serious debt or have insufficient reserves and the unit owners would not know until the situation is too difficult to resolve.
- Secrecy on financial issues creates mistrust of the board and its ability to handle the affairs of the association.

### ***RECOMMENDATIONS:***

19. Revise the law so that a homeowner shall have the right, within a few days' notice and in a location convenient to the homeowner, to review copies of the following: the proposed budget, the budget, the annual audit report, if required (see recommendation No. 22), newsletters, contract specifications, or a contract if it can be shown that a necessity to review a particular contract's terms exists. Denial of access to the above could be reported as a statutory violation to the Commissioner of Community Affairs. Some members of the task force believe that denial of access to additional information could be made subject to an

alternate dispute resolution procedure on a case-by-case basis. (See recommendation No. 23) Other members of the task force believe that appeals regarding access to the enumerated records should be solely within the purview of the Commissioner of Community Affairs. (See recommendations No. 27 & 28 regarding sanctions for refusal to show the above information.)

20. Associations should be required to present the budget to unit owners at least one month prior to the meeting in which it is to be approved.

21. Mandate that annual financial reports be made available upon request to all unit owners.

22. Require annual certified audits of associations which have annual gross receipts of over \$75,000. Require a certified three year audit for those associations which have gross receipts of over \$25,000. Also, associations, including developer-controlled ones, should be required to have sufficient reserves to cover reasonably foreseeable common expenses, including long-term capital expenditures, and funding in the budget to cover transition expenses.

**VII. THE CURRENT MECHANISM FOR DISPUTE RESOLUTION  
SHOULD BE IMPROVED TO EFFECTIVELY AND FAIRLY  
ADDRESS COMMON INTEREST PROPERTY CONCERNS**

*There is uneven balance of power between association boards and homeowners regarding resolving disputes over any matter related to the community property.*

- Condo associations need authority to enforce bylaws to ensure compliance by the unit owners, but owners should be entitled to an unbiased party's review of the facts prior to being required to file lawsuits to defend themselves or to derivatively compel the board to follow the bylaws.
- The Legislature authorized certain homeowners' associations to issue fines and fees; however, some have raised the issue of whether this move has inadvertently enhanced the boards' capacity to abuse this enforcement method.
- The requirements for a board to provide Alternate Dispute Resolution, or ADR, is not clearly delineated in the statutes. This has led to different approaches by boards; some have hired arbitrators and charged the expense to the unit owners, some have used a covenants committee, which may not be a disinterested party.
- There is dispute among boards as to what issues are required to be submitted for alternative

dispute resolution; some board attorneys have interpreted the statute very narrowly to include very limited circumstances.

**RECOMMENDATIONS:**

23. Amend the statutes to clarify what types of matters will be subject to alternative dispute resolution. The task force recommends that a matter may be appropriate for ADR insofar as it is related in some manner to the common interest property or association bylaws and it does not involve a clearly personal dispute between two or more parties which is unrelated to the common property. Also, clarify in the statute the role of a covenants committee, (that is, that it could serve as the ADR provider if: (a) no one on the committee serves on the board, (b) no one on the committee is involved in the dispute, and (c) all parties to the dispute agree to it); otherwise it could be a pre-ADR device to resolve differences. Disputes which clearly involve a violation of statutory or regulatory law should be reported to the Commissioner of Community Affairs, to whom the Task Force recommends administrative oversight powers be granted.

24. Require the DCA to establish a database of qualified volunteers who would be available to resolve conflicts between unit owners and boards for a certain vicinage, such as the county, if an association is unable to find a disinterested party to hear a dispute. The volunteers should have expertise in all aspects of community associations as well as knowledge of dispute resolution procedures. The volunteers should be reimbursed for their travel and related expenses, which could be covered by a nominal fee (no greater than \$50) which DCA could collect from each association upon its request for a volunteer. An association and unit owner would still be free to utilize other arbitrators or dispute resolvers if they so agreed. Likewise, a dispute resolver or arbitrator would be eligible to apply to DCA as a volunteer, if they had knowledge of homeowners' association matters.

25. There should be an Ombudsman Office for Homeowners' Associations within the Department of Community Affairs which would serve to facilitate ADR, to provide a list of reference and educational materials, and, in general, to provide guidance to associations. In addition, this office could function as a liaison between associations and the Division of Codes and Standards or municipal code officials to resolve disputes regarding inspections that must be done to effect repairs, improvements or to comply with the "Hotel and Multiple Dwelling Law."

26. Specify in the law whether there will be a right to appeal an ADR decision to the court or the Commissioner of Community Affairs.

**VIII. THE STATUTES SHOULD REQUIRE THE IMPOSITION OF SANCTIONS FOR ASSOCIATION BOARDS OR REMOVAL OF BOARD MEMBERS FOR CERTAIN FLAGRANT STATUTORY VIOLATIONS.**

- Although the ADR procedure will be utilized to resolve most disputes that arise in the community association context, boards have been given the power to assess fines without the necessity of bringing litigation. The statute requires that boards provide written notification of the imposition of a fine, and that the owner have an opportunity to dispute the fine pursuant to ADR. The statutes currently give the DCA Commissioner authority to order an association to produce certain records and to put in place ADR procedures. There is absolutely no mechanism for enforcement against an association that violates these provisions.

***RECOMMENDATIONS:***

**27. Allow the Commissioner of Community Affairs, after an opportunity for a hearing, to impose sanctions on an association board that does not have in place ADR, or will not allow the records to be viewed (See recommendation No. 19 regarding which records must be made available.)**

**28. For very flagrant, repeated violations by an association or board member of statutory or regulatory law which have been brought to the attention of the Commissioner of Community Affairs, and for which warning letters have been sent by the commissioner to no avail, the Commissioner of Community Affairs should be empowered to impose a monetary penalty on the association or, in the most severe cases, remove a board member. Associations should be required to divulge the fact at an open meeting that the commissioner has imposed a fine on the association or has ordered a board member removed.**

**IX. MUNICIPAL RESPONSIBILITY**

***Disputes with municipalities***

- Short of an expensive and drawn-out lawsuit, some associations claim to have little leverage with municipalities to get reimbursed for services they provide for themselves (such as leaf or snow removal).

***RECOMMENDATIONS:***

**29. The Legislature should urge the Department of Community Affairs, Local Government Services Division, to follow up claims of non-compliance with the "Condominium Services Act," and create sanctions against municipalities which refuse to pay their debts to homeowners' associations within a reasonable time frame.**

**X. IRRESPONSIBLE OWNERS CAN COST UNIT OWNERS MONEY BY FAILING TO PAY THEIR MAINTENANCE FEES**

- Associations can easily lose money when a unit owner does not pay the commons fee or his mortgage, and a bank forecloses on the property. The association most often is forced to absorb the lost commons fees, resulting in additional assessments on the other unit owners. The condominium limited priority lien law recently enacted has succeeded in addressing some of these problems, but the lien priority should be broadened to include all homeowners' associations.
- Condo associations also lose money when developers, who still retain control over a certain portion of the individual units, refuse to pay the commons fees.

***RECOMMENDATIONS:***

**30. Specify that homeowners' associations be allowed, pursuant to their bylaws, to suspend privileges to use common elements from owners who are in arrears on commons fees, such as, but not limited to, the use of a parking space, or common recreational areas.**

**XI. CERTAIN BANKING AND LENDING POLICIES SHOULD BE CHANGED.**

- Some banks refuse to issue mortgages to, or require larger down payments from, potential unit-buyers who wish to purchase a condominium or cooperative in a development where more than a certain percentage of units are rented out.
- According to testimony provided to the Task Force, a prominent example is Fannie Mae; if 30% or more of the units in a development are occupied by renters, it may not underwrite the loan if it feels that this increases the chance of default on the loan.
- Many banking institutions have instituted similar policies, based on Fannie Mae's. This makes it more difficult for people to borrow the money necessary to buy homes, and makes it just as difficult for current unit owners to sell their current homes.
- Certain banks are not easily allowing homeowners associations to pledge the stream of income from the commons fees toward backing a loan which may be needed to make repairs or is otherwise needed by the condominium or community, citing a lack of statutory authority. This has led to the necessity for associations to incur legal expenses in order to obtain loans.

***RECOMMENDATIONS:***

**31. The N.J. congressional delegation should be urged by the New Jersey Legislature to call upon Fannie Mae to change its policies regarding use of rental unit percentages. A**



**change in Fannie Mae policy would inevitably encourage other banking institutions to make similar changes in their mortgage granting policies.**

**32. State laws should be amended to clarify that associations may pledge the commons fees and related revenue as collateral for association loans.**

## EXECUTIVE SUMMARY

The recommendations contained within this report attempt to deal with the problems asserted by the public that testified before the Assembly Task Force to Study Homeowners' Associations and other issues of which the task force had knowledge by virtue of its members' expertise in community property matters. The task force examined in depth whether the State's current statutory framework is adequate to guide association boards, community property management companies and homeowners in their daily interactions.

The testimony given to the Task Force by residents belonging to homeowners' associations throughout the public hearings indicates that many residents feel that the "balance of power" hangs too heavily in the direction of the association board. The testimony indicated that more should be done to safeguard homeowners' rights of due process, including guidelines for fair elections of board members, open meetings and conflicts of interest. It was suggested that there is a need for procedures to promote active participation on the part of homeowners in decision-making on issues that affect their whole community, and to increase awareness on the part of board members and homeowners as to what responsibilities and rights they have upon becoming a board member or owner, respectively.

The task force agrees generally with these assessments, and recommends that changes be made to the statutes authorizing homeowners associations which will require more accountability on the part of board members and management companies. In addition, in recognition of the quasi-governmental functions of the homeowners' association board, the law needs to be changed to encourage more participation of homeowners in the governance of their communities and to curb conflicts of interest or self-dealing. These goals are addressed by the recommendation of a disclosure pamphlet, to be published by the Commissioner of Community Affairs and distributed prior to the time of settlement, and the requirement of having open meetings, closely paralleling the requirement of open public meetings for public bodies. Distribution of the booklet should also be made by an association to current homeowners within a development. Disclosure of adopted bylaws would also be required at this time, as well as a listing of reference materials available to aid the association board member in performing his or her duties. In addition, the pamphlet could serve as a guide to owners as to what types of bylaws have traditionally been held by courts to be unconscionable, and examples of those that have been upheld as proper. The recommendation of licensure of property management companies should serve to curb conflicts of interest and self dealing.

It is important to note that homeowners of single-family detached homes which exist in common interest property communities and cooperatives are concerned about the same types of problems as are faced by condominium owners. Current law has not been applied equally to all of these types of ownership. Therefore, it is paramount that any recommendations implemented as a result of this report should be made binding on all forms of homeowners' associations. The "Uniform Common Interest Ownership Act" legislation which is pending in both houses of the Legislature should be examined in detail to determine if it comports with the recommendations of this report, and whether it might be the appropriate document through which to consolidate many of these proposed changes to the law.

Another major area addressed by the task force is fairness of elections and control of the

association board. Two recommendations are aimed at helping associations that currently have no hope of self-governance. The first is a recommendation that there be a presumption of unit voting forfeit in the general election of unit owners to a seat on the board whenever a developer rents out a unit rather than selling it. The second is a recommendation by a majority of the task force that consideration should be given to changing the point at which transition to a unit-owner controlled association board occurs from the current point of 75% units sold. Developers that currently are bound by a requirement to complete an entire project as originally planned should be given more flexibility to build in phases and sell off portions of developments which did not come to fruition.

Perhaps one of the most important issues before the task force was oversight of board actions. From the testimony given, it appears that some boards are not adhering to the law, and therefore some governmental oversight of boards is necessary. Although the actions of boards should be given deference under the "business judgment rule," the task force is recommending that very specific guidelines be spelled out in the statutes to guide boards in the exercise of their powers, and also recommends that sanctions be imposed by the Commissioner of Community Affairs when these guidelines are not followed. In flagrant cases, the task force is recommending that the authority be given to the Commissioner of Community Affairs to impose monetary penalties or remove a board member. This should send the clear message that due process rights must be observed and that a board's powers are not to be used capriciously. Overall, it is believed that this oversight will deter improper actions by board members, and will help to lessen the need for unit owners to seek alternative dispute resolution or legal counsel.

The task force recommends that the Alternative Dispute Resolution Procedure currently required by statute be improved. It appears that boards simply do not have enough guidance in this area, and are instituting a wide variety of procedures to meet the statutory requirement, or are simply ignoring it. The first step in addressing this problem will be to specify which matters may be submitted for alternate dispute resolution, and which ones should be referred to the Commissioner of Community Affairs, in accordance with the oversight power being recommended in this report. Secondly, the task force recommends that a pool of volunteers willing to serve as mediators of ADR meetings be formed, with the list of the names and addresses of volunteers to be kept by the Commissioner of Community Affairs. The commissioner could make the names available for a nominal fee, which would be used to reimburse the volunteer for travel and related expenses. The volunteers would need to be unbiased and have expertise in community property issues. Thus, an association would not have to expend funds for an arbitrator (which many now believe they must do) and the likelihood of consistency in handling ADR would be increased without the need to resort to litigation. In addition, the law should be clarified that covenants committees would still serve an important function of resolving disputes prior to the need for ADR, and could serve as the dispute resolvers if the members were non-biased and all parties agreed to it.

The recommendations contained within this report are aimed at making homeowners' associations serve the best interests of the owners, thereby improving their lives and the quality of life in the community as a whole.