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C-IHC WHITE PAPER
on
Homeowner Association Issues and Recommendations for Legislative Action

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Introduction

Homeowners' associations are required to be formed under New Jersey law when a community is being built as a planned real estate development or is deemed to be one by a court. Homeowners living in these communities jointly have a responsibility to maintain certain commonly-owned real estate and facilities used by all homeowners in the community.

Initially, this category of home ownership was prevalent in the form of condominiums.[1] Eventually, this type of ownership of real property expanded to include single-family attached or detached homes with commonly owned facilities. Municipalities initially welcomed such developments, because it not only relieved them of the duty to maintain drainage areas located in the community, but also of the duties to provide services, such as garbage and recycling collection, and street lighting. However, upon the passage of the Municipal Services Act,[2] these duties fell upon the municipality on the basis that such services were provided to all property taxpayers in the jurisdiction.

Due to the complex nature of this type of real estate sale, the Legislature understood the need to provide protections for purchasers. It enacted the "Planned Real Estate Development Full Disclosure Act," (hereinafter "PREDFDA") P.L.1977, c.419 (C.45:22A-21 et al.), placing enforcement in the Department of Community Affairs (DCA). The law focuses on regulating sales by developers to ensure buyers are not being defrauded. For a while, the Legislature found it necessary to codify owner protective provisions in either the Condominium Act or the PREDFDA. Today, it is accepted that the supplement to the PREDFDA (known as P.L. 1993 c.30) houses most of the owner protection laws and applies to all types of planned real estate developments – condominiums, cooperatives, and single-family homes - sold to owners living in common interest communities (CICs).

Governmental Nature of an Owner-Controlled Association Board

Initially, the developer forming the association IS the association, and appoints all members to the board which is composed of developer agents or employees. The law staggers owner membership on the board starting when 25% of owners have purchased homes. Once 75% of housing units have been sold, control of the association board shifts to the owners of the housing units but the developer retains one seat on the board as long as units remain unsold. This board-control shift is called *transition*. Until full transition, an association mainly functions as an extension of the developer's for-profit business entity. Upon transition, the owner-controlled board functions as a mini-government, as described in more detail below. Current law does not require that an owner-controlled association incorporate or register with any State authority. The law permits developers to form associations as for-profit, non-profit, unincorporated entities or as "any form permitted by law." See: N.J.S.A.45:22A-43. Moreover, the developer writes all the governing documents, which often differ from development to development, with no mandated standardization.

An owner-controlled association board functions in relation to association members exactly like a governmental body does in relation to its citizens. The board members stand for election by secret ballot, and the board enforces association governing documents. The board determines and assesses fees (analogous to taxes) for maintenance of the commonly-owned property and to fund all operations of the association. It also adopts rules for property maintenance and residents' conduct, similar to ordinances, and can take enforcement actions, including imposing fines and recording liens for unpaid assessments without court review. The

[1] See: N.J.S.A.46:8A-1 et seq. and N.J.S.A.46:8B-1 et seq.

[2] N.J.S.A 40:67-23.2 et seq.

developer-drafted documents initially set the rules for the method of change of those documents by owners, which can be cumbersome. The law now requires that a vote to amend bylaws be open to all members, and that the bylaws cannot require a greater than two-thirds majority vote.

The association is given express statutory authority to foreclose on its liens without first attempting any other means of satisfying its debt. Thus, the law treats associations as if they were mortgagees, when no loan document exists. The law requires associations to adopt and administer a "fair and efficient" dispute resolution procedure (ADR) with minimal statutory standards and no regulatory ones. These ADR procedures vary widely and are often denigrated by owners who fully understand that the board controls the offering and method of ADR.

Until a recent court decision, the law stated that in order to take binding actions, associations were required to hold meetings that are open to attendance by owners, with minutes required. The court decision reversed that requirement based on a misreading of the statute.[3] The result is that boards are now permitted to hold closed sessions in which binding votes are taken, and owners will be prevented from obtaining information concerning the vote because no minutes will be required.

Incorrect Standards Applied to Authorize Board Actions

In general, current N.J. law overlooks the governmental nature of an owner-controlled board and allows its actions to be judged under the wholly unsuitable "business judgment rule." That standard affords boards wide discretion to take any action that isn't specifically prohibited under law or its governing documents. Application of the "business judgment rule" is inconsistent with judging actions under a democracy which requires that the governing body have express authority to act. A business judgment standard allows owners to be fined for actions that were permitted when they bought the property, and which were permissible until changed by the other owners or the board. There is no "grandfathering," as in municipal law. . Although some courts have applied a nebulous "reasonableness standard" in judging boards' actions, for many reasons it rarely benefits the owners.

In 2017, the Legislature understood the applicability of governmental standards of fairness and transparency in the elections of homeowner association boards. (See P.L. 2017, c. 108.) For the first time, this law recognized and codified the fact that owners who purchase a home in a planned real estate development are automatically owners of a pro-rata portion of the common elements, and are automatically a member of the homeowner association formed to manage the community. In doing so, the Legislature accepted the significance associations have over the lives of owners; that they are "creatures of State law" and that it is "unfair and runs contrary to American democratic values for these communities to be governed by trustees who are not elected in a fair and open manner." Notably, the Legislature stated that over a million residents of the State "live under the governance of a common interest community association . . . . " The statute analogized the governance of an association to that of "State, county and municipal government" [4] It should be noted that the Legislature did not mention the business judgment rule as having any applicability. Applying the governmental standard to evaluate all board actions would finally afford owners the ample protections they have with other governmental entities. Boards would be required to follow rules concerning transparency and fiduciary duty. Examples include owners being permitted to view contracts and other documents, much like citizens can request information from a municipality. Conflict of interest guidelines similar to those applicable to governments would apply to further protect owners.

[3] See the C-IHC Winter/Spring 2024 Newsletter discussing the case at *www.c-ihc.org*

[4] Subsections a. and d. of section 1 of N.J.S.A.45:22A-45.1

Inadequate State Owner Protection

The PREDFDA only requires certain developments, but not associations, to register with the State. That law, however, provides for many exceptions to registration.[5] These exceptions are largely intended to provide some relief to small developers from the registration fees imposed under the act, and recognize certain obvious exemptions such as Federal developments or cemeteries. But by exempting single-family developments under 100 units, or those of any size with unencumbered open space, these exceptions have wreaked havoc on the enforcement of owners' rights, and may thwart the enforcement of laws concerning public safety. For example, recently the Legislature enacted P.L.2023, c.214,[6] in reaction to a high-rise building collapse in Florida. The law requires structural inspections over timed intervals in condominiums and cooperatives built with certain construction materials and is activated upon the registration required under the PREDFDA. If a development has been exempted specifically from registration under the act, or by the DCA, that activation will never occur.

Over the years the Legislature has enacted piecemeal protections for homeowners in recognition of the powers granted to homeowners' associations. However, no mechanism currently exists to provide the State enforcing agency with the basic information necessary to communicate with them, or effectively enforce the laws that have already been enacted.

Furthermore, the State has devoted very few resources to the Association Regulation Unit (ARU) in the Department of Community Affairs, the office tasked with protecting owners. For many years the DCA delegated responsibility to enforce owner protections to only one staffer, who was also given other PRED duties. It currently has two staffers. Despite Legislative enactments to provide ADR and access to financial records for owners, the DCA did not propose any regulations to effectuate the law.

In the vast majority of states, the state's Attorney General's office oversees common interest community homeowners' rights. These encompass all owners' rights, including conversions of existing buildings to condominiums. Some states also provide a fair, neutral system of alternative dispute resolution in which owners can seek redress of grievances without resorting to litigation. New Jersey law has placed responsibility for oversight of governmental-like protections for homeowners in a department which must administer a wide range of other programs. The State Commission of Investigation (SCI) has castigated the DCA for its failure to effectively administer consumer protection programs.[7] The pressure of conflicting interests of developers (from whom the DCA derives its revenue) and homeowners (from whom the DCA gets no revenue), plays a part.

[5] See N.J.S.A.45:22A-25. The law exempts five categories of developments with associations. However, the DCA has liberally used its broad powers under section 25b of the statute to exempt larger developments and even conversions of buildings to condominiums and cooperatives.

[6] C.52:27D-132.2 et seq.

[7] See the SCI report on the Home Warranty Program, as well as the SCI report on construction trade licensing, which ultimately led to the registration of Home Improvement Contractors in the Division of Consumer Affairs, rather than the Department of Community Affairs.

Inadequate Training of Board members; No Regulation of Property Managers

Partly because the State regulatory agency has been unable to locate or track associations and provide guidance, volunteer board members are forced to rely on professionals they hire to help them manage the communities. These include property managers, accountants and board attorneys. Those contracted by the board may not respect, much less prioritize, owner rights. Board members are not required to take any training or have any understanding of their fiduciary obligations. Too often they delegate almost all of their responsibilities to property managers. Unfortunately, there is no New Jersey law licensing property managers. Other states have enacted laws regulating property managers, as well as requiring board member training. While large associations often rely on certified public accountants to assist them in preparing budgets, audits or reserve studies, there is no requirement currently that associations get professional or even informed assistance in these areas.

RECOMMENDATIONS FOR LEGISLATIVE ACTION

1. Eliminate PREDFDA exemption from registration of developments on all residential projects within State jurisdiction. This avoids the confusion that an exemption also eliminates owner protections. Registration requirements and fees will be streamlined and reduced for certain statutorily-exempt residential developments, but registration would not be waived.

2. Register and Incorporate homeowner-controlled associations as a specially-designated type of non-profit residential corporation.

It is crucial that the law require each home-owner controlled association be incorporated as a new, specific type of residential non-profit entity, and require that it register with the State to provide basic information necessary for an enforcement agency to effectively act on their behalf. Although currently most homeowner associations are incorporated as non-profit entities, they are not currently prohibited from choosing other options, such as for-profit business entities, partnerships or other permissible entities. The incorporation information, if any, is not available to the DCA. In contrast, the information derived from a new corporate registration with the Treasury Department would be made available to the DCA.

a. The current reliance on Title 15A (General Non-profit corporation law) to fill in gaps in association law allows opponents of owner rights to undermine protections in PREDFDA by referencing provisions not useful for residential associations, as was done in a recent court case eliminating some election protections. There would be standard governing documents for all associations, with modifications subject to State approval. Boards would be required to prioritize common element repairs when habitability is impinged, and permit an owner to repair and deduct the cost from future maintenance fees if the association is unable or unwilling to make repairs.

b. The law requiring a new, residential non-profit incorporation would apply to cooperatives as well, notwithstanding the fact that shares of stock are issued to shareholders. The law will state that cooperatives are real estate for owners' rights purposes, regardless of the issuance of shares of stock.

c. An existing incorporated owner-controlled association would not be required to register immediately, but instead upon its normal annual business registration date. However, if an association has never been incorporated, it must register within 180 days.The initial registration fee would include a one-time fee, in addition to the normal registration fee. The fee would be proportional to the association's number of housing units, with a community cap. A percentage of the new fee would be maintained in a State fund reserved for the purposes of database creation, and tracking of and dissemination of information to homeowner associations. The remaining portion of the new fee would be set aside to supplement a dispute resolution program to be established in the Division of Consumer Affairs, as described hereinafter.

d. Associations that have opted to collect a capital contribution "buy in" fee will be required to send a portion of that fee, up to 20%, to the State for program purposes in furtherance of owner protection.[8] Developer controlled associations will be prohibited from collecting that fee.

3. Establish the right of homeowners in CICs under owner control to access the alternative dispute resolution (ADR) program in the Division of Consumer Affairs.
Although the current law requires associations to maintain a "fair and efficient" internal system of dispute resolution, the procedures vary widely and are often not administered by truly neutral parties. There have been a disturbing number of reports of associations refusing to offer ADR, and, because of the lack of the State's ability to communicate with owners; many owners are not even aware of their rights to employ that procedure. In addition, owners who can prove that their association is violating either the law or the association governing document are effectively compelled to present a case to a person or panel selected by the board. The board need not even follow the decision of the panel if it disagrees. Owners who wish to hold their board accountable must initiate a court action and bear all the costs, even if successful. The association, as a taxing entity, has unlimited resources from the assessments it collects from the owners. This situation chills enforcement of the laws by making lawsuits financially impractical for owners. Subsequent to using an association-created ADR procedure, or prior to initiating suit, an owner should have the option of applying to a State-provided neutral dispute resolver to review the matter, and issue a decision that either party can appeal. In contrast to internal association ADR, the State's determination should be admissible in any subsequent court proceeding.

4. Require that owners who sue or are sued by their association board, and prevail, be awarded counsel fees.
Association owners deserve the same right to counsel fees afforded those in civil rights or consumer fraud actions Thus, the law should be amended to provide that when owners are forced to sue the association, or defend against an association suit, they should be entitled to counsel fees if they are successful on a majority of issues litigated. This right should be codified in the Consumer Affairs statutes.

5. Create new statutory standards for reviewing board actions which shall be in line with the standards used to judge municipal governing body actions.
These governmental standards would be set forth in the enabling act for the new specific type of residential non-profit corporation entity being created for owner-controlled homeowner associations. The standards would include ethics and conflict of interest guidelines to help prevent self-dealing by board members and vendors, including property managers as well as a standard budget format. (Note: mere disclosure of conflicts will not be sufficient to permit them.) The use of other corporation law, such as Title 14 or Title 15A to fill in gaps in construing board actions, would be restricted to those provisions meeting governmental standards, such as transparency, fairness, and fiduciary responsibility to the owners. The provisions in those titles will be modified [a] to identify which laws apply to developer-controlled boards, and which laws apply to owner-controlled boards.

6. Require turnover of the board to the owners within two years of no units having been sold, regardless of marketing attempts. Control must be turned over to individual owners if the developer or its successor rents out more than 50% of the association's units, in which case the developer or successor should have only one vote on the board. C-IHC is aware of developments, including apartment conversions, in which the individual owners are paying a disproportionate share of general expenses (such as insurance and utilities). In such cases, the developer or successor remains as a landlord controlling the entire development with individual owners subsidizing his costs. It is currently permissible for developers to simply stop selling units

[8] See subsection e. of N.J.S.A.46:8B-15

and turn developments into rental properties after selling a minority of units. The disclosures provided to buyers stated they would control the association board upon the sale of 75% of the units. They are not informed of the developer's ability to stop sales and deprive them of control. In fairness, the owners should be in control of the association board, which should be managing the building and overseeing all expenses. Any conflicts of interest issues between the developer or successor and the association can be sent for resolution to the ADR unit at the Division of Consumer Affairs.

7. Empower the State enforcing agency (currently DCA) to impose penalties upon association board members directly when they intentionally violate a State order. A board should be required to divulge State enforcement actions against it in open meetings. The law should also clarify that the State enforcing agency has the power and obligation to order that elections be held when a board refuses or fails to do so. Until there is a board with a quorum, the State should appoint a manager in the nature of a receiver to maintain necessary association obligations, either on its own initiative, or upon the request of any member.

8. Require training of elected board members.

There is current legislation introduced which would require three hours of training within 180 days of taking office. The issues to be determined here is who would design the course, how would it be administered, and in what time frame should it be taken by a board member. C-IHC looks forward to discussion of this, but given that board terms can sometimes be as short as one year, we propose a more narrow timeframe for required training, such as 45 or 60 days. There are existing courses from entities such as the Community Association Institute (CAI) which could be modified to recognize and emphasize owners' rights, as well as board member fiduciary and management obligations. Because this course will be basic, C-IHC believes it can be delivered in a local setting, such as through county colleges, adult education offerings or at libraries. It should be interactive so that board members can ask questions. Thus, it cannot be offered as a taped webinar. C-IHC believes the course costs could be minimized by allowing previously-trained members to be certified to teach the course following a State-created curriculum with input from educators, related professionals, association owners, and entities such as C-IHC and CAI. Any costs will be either minimal per individual, or an association expense.

9. License property managers as a regulated profession.

C-IHC is aware of A.2450 of 2024, which addresses this issue,[9] but submits that one bill introduced many years ago by then Speaker Vincent Prieto merits reconsideration.[10] Among other desirable provisions, that bill would place property managers of homeowner associations under the regulated professions statute. A.2450 is problematic because, among other things, it would allow property managers to act as attorneys and CPAs, without a license in those areas. It would also allow DCA, which has no expertise in this area, to set the standards for the property manager license. It is crucial that regulation be under the auspices of the Attorney General's office, as are other regulated professions.

10. Require all binding votes to be taken in a meeting open to attendance by the owners. The open meeting section of the PREDFDA should be amended to specify that if a board meets in a closed session for confidentiality reasons, it must take a binding vote to effectuate that action in a meeting open to attendance by the owners. This is to counter a recent Appellate Court decision that distorts the law which required transparency, effectively now allowing boards to operate completely in secret in every major action. This legislation will restore the law to the same standard that had been in existence and had been followed by most associations, i.e., a governmental standard of transparency. C-IHC has a proposal in bill format to do that. A vote open to owners is necessary for the corporate records; it need not disclose any confidential information.

[9] See A.2450 of 2024, sponsored by Asw. Quijano and Asm. Wimberly

[10] See A.2658 of 2012

In cases involving litigation, an open vote can be delayed until filings are public, or until doing so will not undermine the association's position.

11. Require the State to prepare and publish a "Homeowner Rights" booklet. Require that each developer and registered association distribute it to all owners. At the very least this document should provide a brief explanation of the nature of CICs and the nature of the individual's ownership, along with accessible, plain-English descriptions of pertinent statutory provisions and protections offered in New Jersey. It should provide information on the rights and responsibilities of owner and board members in these communities, as well as contact information and related informational web links. Additionally, it should provide a copy of a standard model budget the association must follow.

12. Legislation is needed to place due process controls on liens and severely limit lien foreclosure against homeowners, particularly in inclusionary developments with low-and moderate-income deed-restricted units.

The law currently gives associations an automatic lien on unpaid assessments and authorizes recording such liens with no right of an owner to any unbiased hearing. Additionally, there is no reasonable limitation as to what may comprise an association lien that is recorded against an owners' property. The statute states that it may include unpaid assessments and monies owed. However, if authorized in the governing documents, it may also include fines, penalties and attorney's fees. The law requires proper notice, but requires neither that the notice be in advance, nor that there must be any means for an owner to contest it. Many homeowners complain they are not given an adequate opportunity to oppose a fine imposition - particularly the low-income owners who have little resources to sue the association. Despite the law's notice requirement, it lacks any enforcement or penalty for ignoring it. The association's ability to record a lien without any due process is a significant detriment to ownership and operates as a toll of extortion to force owners to pay amounts that may be improper, or even already paid. It flies in the face of the facts to posit that a homeowners' association lien has the same status as a purchase money mortgage and should be treated identically. It is important that the legislation establishes a special ADR procedure at the Division of Consumer Affairs, to handle association lien foreclosure and lessen the occurrence of homelessness.

13. Legislation must prohibit associations from refusing to directly accept payments of monies owed to the association and require a bona fide attempt to work out payment plans before any attorney fees attach; interest, late fees and attorneys fees would be limited to the percentages permitted under usury statutes.

Owners have no notice of potential attorney fees and there is no statutory limit on them. Notably, courts that have objected to wildly disproportionate attorney fees have been instructed that the only issue is whether they are documented and reasonable for the work billed. C-IHC is aware of instances in which the amount of unpaid maintenance fees was dwarfed by the attorney fees added to it, precluding owners from having an ability to pay. (In one typical case the fees owed were around $8,000, while the attorneys fees spent to collect that amount were $38,000.) The addition of attorney fees often stops associations from working out payment plans or settling amounts. Too often association attorney fees are what put owners in an untenable position regarding payment. Currently, the law does not prohibit law firms from blocking an owner from paying the money owed directly to the association, but instead forces payment to the law firm; a situation law firms freely avail themselves of. The current situation functions largely as an attorney profitability provision and is a main reason associations do not work out payment plans or pursue other readily available means of collecting the debt. Rather, some associations, under the advice of counsel, act as if the only remedy is recording and foreclosing on a lien. Given the chance, it is doubtful association owners would approve of legal fees far in excess of the amount owed. C-IHC suggests that the percentage of a combination of interest, late fees, and

attorneys fees charged on unpaid maintenance fees be limited by the percentage amounts permitted under the usury statutes for lenders.

14. Legislation must allow owners greater participation in financial operations.
Homeowners are apprised of what the monthly fees are estimated to be in the Public Offering Statement (POS). However, if a development is exempted from registration under the PREDFDA, no one verifies that purchasers are provided with the required POS. Naturally, there can be no guarantee that the fees stated in the POS will remain static, but there is also no disclosure that the board can increase them as it sees fit. Such things as litigation, poor board decisions or commitments to pet projects causes debts requiring large special assessments which financially burden owners. Moreover, in the absence of effective safeguards in place to protect against embezzlement or unauthorized spending by board members or property managers, the costs imposed on owners often increase significantly. Unless the governing documents provide a limit on what a board can charge or spend, owners are adversely impacted. Current law does not require that owners vote on the annual budget. Even when governing documents require owners' votes on large expenditures, boards know they can ignore such provisions with impunity. Thus, typically the only way for owners to protect themselves is by electing different board members, unfortunately after the fact. C-IHC suggests changes to the laws to protect owners, including such things as; limiting fee increases to the increase in the Consumer Price Index (CPI) unless owners vote their approval, which should also be required prior to any special assessment in excess of a percentage of the annual budget, or whenever it exceeds a number of months' worth of the monthly maintenance charge.

CONCLUSION

The current situation is the result of many decades of the State's inadequate piecemeal solutions for and outright neglect of owner rights. It may have been understandable for legislators at the outset of the creation of common interest communities to assume that owners having control would need only minimal, formal protections. However, decades of documented abuses against owners have now destroyed that assumption.[11] The Legislature must be mindful that these housing developments only exist as creatures of statute and that it has an obligation to enact necessary protections. Without legislative remedies, abuses against owners will continue indefinitely and ultimately render CICs an anathema to purchasers, rather than the benefit they were intended to provide.

C-IHC looks forward to working with you. Please let us know when we can meet to discuss these issues and how we can assist in moving critical legislation forward in the current session!

[11] Despite Legislative attention to homeowner association issues, very few of the recommendations of the 1998 Task Force of the Assembly to Study Homeowner Associations have been enacted.
https://pub.njleg.state.nj.us/publications/reports/homeown.pdf