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CONDO & HOA NEWS

COMMON SENSE

FROM SANDLER, HANSEN & ALEXANDER, LLC - COMMUNITY ASSOCIATION LAWYERS

A NEWSLETTER FROM

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This newsletter has been prepared to provide readers with information concerning the law of condominiums and community associations in Connecticut. It is not meant to be a substitute for competent professional advice. Readers are urged to consult with competent legal counsel before taking action.

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APPROVING AND CLOSING AN ASSOCIATION LOAN

This time of year, many associations are undertaking extensive capital improvement projects. Funding a project by obtaining a loan, rather than by draining reserves or levying large assessments, is an attractive option for some associations. Commercial lenders are ready and willing to make loans to associations at favorable rates. These loans are typically secured by pledge of the association's right to collect common charges.

The process of approving and closing an association loan is highly technical. Connecticut law imposes strict requirements on the method and timing for calling meetings, conducting votes, and issuing disclosure statements to the unit owners.

Additionally, lenders typically require the association's attorney to provide a formal legal opinion letter, confirming that all legal requirements and all of the lender's closing conditions have been met by the association. If, for any reason, the attorney cannot give a clean opinion, then the lender will not close the loan. It is therefore very important to have the attorney supervising the approval and closing process from start to finish.

The following is an outline of the process that an association must typically follow when obtaining a loan to fund a capital repair project.

Determine the Projected Cost of the Project and the Amount of the Loan.

A. The association usually determines the projected cost by obtaining quotes from experienced contractors. Depending on the size and complexity of the project, the association may also engage an engineer or project manager to assist in determining the scope and specifications for the work.

B. The association will review its current financial situation to determine how much of the project to fund using money held in reserve, if any, and how much it will need to borrow. Some, but not all lenders will finance the entire cost of the project.

Applying for a Loan and Obtaining a Commitment Letter.

A. Once the association knows how much it wishes to borrow, it can apply for the loan.

B. A lender may take a few days to a couple of weeks to approve the loan.

C. When approving the loan, most lenders issue a commitment letter setting out the loan terms and closing conditions.

Approval of the Loan by the Association

Once the association has an acceptable commitment letter, its attorney will prepare the following material:

Board Resolutions.

1. A resolution of the board approving the loan and the commitment letter, subject to approval of the unit owners of the assignment of the association's income as security for the loan.

2. A resolution of the board approving either an assessment or an amendment to its operating budget, to repay the loan.

These resolutions may be adopted by the vote of a majority of the board members present at either a regular or special board meeting at which a quorum is present.

Instead of conducting a meeting, these resolutions may be adopted by the written consent of two-thirds of the board members. At least two-thirds of the members of the board must confirm his or her approval of the resolutions in writing. Email is sufficient. The association should save the written confirmations for its records.

Notice of Unit Owner Meeting.

The association's attorney will prepare a notice of a special meeting of the unit owners at which they will vote to approve the loan.

- The notice of the meeting will contain disclosures concerning the material terms of the loan, as required by Subsection 47-261e(d) of the Common Interest Ownership Act ("CIOA").

- The meeting notice must be sent at least 14 days in advance of the special meeting. The governing documents of the association may require a longer notice period.

Unit Owner Resolution.

The association's attorney will prepare a resolution of the unit owners approving a pledge of the association's future income as security for the loan. The unit owners will vote to approve this resolution at the special meeting. Under Subsection 47-261e(e) of CIOA, approval of the assignment requires the affirmative vote of owners having at least a majority of the total voting power in the association, unless a greater number is required by the declaration.

It is very important to have the association's attorney supervise the approval process from start to finish. Only then can the attorney provide the lender with the required legal opinion.

The association will also ask the owners to approve the assessment or budget amendment adopted by the board to repay the loan. Under CIOA, the assessment or budget amendment is approved unless it is rejected at the meeting by unit owners having a majority of total voting power in the association.

Proxy Forms.

The meeting package should include proxies for use by unit owners. Typically, the approval of the loan depends largely on the ability of the board to collect proxies from unit owners in advance of the special meeting. Ideally, the board will have collected a sufficient number of proxies to approve the loan, in advance of the special meeting.

Closing

Once the association approves the loan, its attorney will coordinate the closing with the lender's attorney. The closing may occur within a few days or a couple of weeks after the association approves the loan.

As stated above, it is very important to have the association's attorney supervise the approval process from start to finish. Only then can the attorney provide the lender with the required legal opinion.

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COLLECTION AND FORECLOSURE PROCEDURES

The following is a summary of the procedures our office follows when collecting past due common charges for our association clients.

Prior to Sending the Demand Letter

Verify the Foreclosure Policy or Resolution. Under Connecticut law, the association must have either:

- A standard foreclosure policy, adopted after giving all owners notice of and an opportunity to comment on the proposed policy; or
- A resolution of the board specifically authorizing us to foreclosure the association's lien against the unit.

Review the Ledger. We review the association's ledger for any unusual or questionable charges or assessments. These include special assessments, fines, back charges, and other similar charges that appear to be separate from regular common charges.

If we see anything that may raise a concern, we will contact the association and request additional information. For example, if the association has assessed fines against the unit, we may request copies of notices sent to the unit owner and resolutions approved by the board authorizing the fine. Once the association provides us with the requested information, we will review that material to make sure that it is complete and sufficiently addresses any concerns that we have.

If our review of the ledger does not raise any concerns, or the material provided by the association sufficiently addresses our concerns, we will the order a title search of the unit.

Review of Title Search. We typically receive the title search within one to two weeks. We review the search to identify all persons having an interest in the unit, including co-owners, mortgage holders, and other lien holders. Under Connecticut law, all co-owners and all mortgage holders must receive a copy of the demand letter. The mortgage holders must also receive a notice of the association's intention to foreclose its lien on the unit if the outstanding charges are not paid in full. We send this notice to the mortgage holders with a copy of the demand letter.

Connecticut law requires the association to give the mortgage holders 60 days to respond to the pre-foreclosure notice.

Prior to Filing a Foreclosure Complaint

Time to Respond. Connecticut law requires the association to give the mortgage holders 60 days to respond to the pre-foreclosure notice. During that time:

- The unit owner may pay off the balance due.
- The mortgage company may pay off the balance due on behalf of the unit owner.
- The unit owner may contact our office and request verification of the outstanding balance. Our office will prepare the verification based on information provided by the association.
- The unit owner requests a payment plan. We will typically agree to repayment schedules that require the unit owner to repay outstanding balance within four months. We will not agree to a repayment schedule for longer than four months without association approval.

If the unit owner fails to repay the outstanding balance, we then send the unit owner a courtesy letter and update the title search.

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Proceeding with the Foreclosure

Once we have had an opportunity to review the updated title search, we prepare a foreclosure complaint and send it to a state marshal for service.

Filing Defaults. Approximately three weeks after the foreclosure complaint is served by the marshal and filed with the court, we file default motions against any non-appearing parties, which frequently includes the unit owners. It may take the court two to three weeks to grant the motions.

Obtaining Affidavits and Supporting Materials. At the time we file the default motions, we send an affidavit of debt to the association, which we need to prove to the court the amount of the outstanding balance. We also order an appraisal of the unit to prove its fair market value.

Moving for Judgment. Once we have the signed affidavit of debt and the affidavit of the appraiser, we file a motion for judgment of strict foreclosure. It may take two to three weeks for the court to schedule a hearing. One of the attorneys from our office will appear before the court on the day of the hearing.

The court will either render a judgment of foreclosure by sale or a judgment of strict foreclosure.

- Foreclosure by Sale. If the unit owner has equity in the unit, which means that the value of the unit is more than the liens against the unit, than the court will typically order a foreclosure sale. The court has broad discretion in setting the sale date, but sales are frequently scheduled to take place three to four months after the judgment hearing.

- Strict Foreclosure. If there is little or no equity in the unit, then the court will typically order a judgment of strict foreclosure. The court will set law days, which are days by which the unit owner or anyone having a lien against the unit, other than the first and second mortgage holders, may redeem by paying off the balance due to the association. The first and second mortgage holders may redeem by paying the association's nine-month priority lien. If no one redeems, then title to the unit vests in the association on the first day following the last law day, which means the association becomes the owner of the unit, free and clear of all liens other than real estate taxes.

If a unit owner declares bankruptcy, the association and all other creditors must immediately stop pursuing any collection efforts outside of the bankruptcy court.

Things That Can Delay the Collection Process

At any point in the above process, any one of the following things may occur:

The Unit Owner Contests the Collection Action. The unit owner, either him or herself or through an attorney, may contest the association's efforts to collect the outstanding balance. If the unit owner claims not to owe the outstanding balance or raises other claims, it will become necessary for us to make additional filings and motions with the court to obtain a judgment.

The Unit Owner Declares Bankruptcy. If a unit owner declares bankruptcy, the association and all other creditors must immediately stop pursuing any collection efforts outside of the bankruptcy court. Starting or continuing with a foreclosure action requires the approval of the bankruptcy court. In some cases, the association can obtain this approval within a few weeks after the owner files the bankruptcy petition. In other cases, however, the bankruptcy court will permit the owner to repay the balance owed over the course of several years. So long as the owner is making the court-approved payments, the association cannot continue its legal action.

We Agree to a Repayment Plan. Any time prior to us obtaining a judgment against the unit owner, the owner may agree to a repayment schedule as described above.

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We Cannot Locate the Unit Owner. There are occasions where the unit owner cannot be found. Such occasions will require us to follow additional procedures and requirements under Connecticut law, such as publishing notice of the association's claim in local newspapers, so that we can proceed with the foreclosure.

Please contact our office if your association has any questions concerning the collection and foreclosure process.

HOW CURRENT ARE YOUR GOVERNING DOCUMENTS?

Developers have been building condominiums and other common interest communities in Connecticut for decades. Over the years, laws have been amended. Market conditions and industry standards have changed. Are your governing documents keeping up?

The Evolution of Connecticut Laws Governing Common Interest Communities

At several points during the past 60 years or more, the laws governing the creation and operation of condominiums and other communities have been amended several times.

- **The Unit Ownership Act:** This is the first Act enacted in Connecticut to govern condominiums. It applies to all condominiums created prior to 1977. It does not apply to cooperatives or planned communities.

- **The Connecticut Condominium Act of 1976:** This Act applies to all condominiums created between January 1, 1977, and December 31, 1983. Originally, the Condominium Act was designed to replace the Unit Ownership Act. However, many of the communities created under the Unit Ownership Act did not comply with the new requirements the Condominium Act. Because of this, the Condominium Act was amended shortly after it was enacted to supplement, but not supersede, the Unit Ownership Act when applied to older condominiums. Like the Unit Ownership Act, the Condominium Act does not apply to cooperatives or planned communities.

Unless your community was created within the past three or four years, your documents are likely based on an older, out of date model.

- **The Common Interest Ownership Act:** This Act, referred to as "CIOA," was enacted in 1983. It applies to all condominiums, cooperatives, and planned communities created since January 1, 1984. Additionally, several of CIOA's provisions apply to communities created prior to 1984. CIOA contains many departures from the earlier Acts. It provides associations with greater powers and flexibilities. It affords unit owners greater protections and control over their associations. The original version of CIOA accounted for the knowledge and experience gained in the nearly 25 years since the original Unit Ownership Act was enacted. In the past 30-plus years since originally enacted, CIOA has been amended several times. In 2009, CIOA underwent a major overhaul, to account for current industry trends, market conditions, new best practices, and the like. As part of this overhaul, more of CIOA's provisions now apply to communities created before 1984.

Model Documents: A Good Place to Start

Unless your community was created within the past three or four years, your documents are likely based on an older, out of date model.

The Connecticut Bar Association ("CBA") knew that it would be a challenge for real estate attorneys to draft thoughtful documents that complied with the above statutes. In 1972, the CBA published the Connecticut Condominium Manual, which included a model set of governing documents, i.e.: declaration, bylaws, and rules, for creating new condominiums.

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When CIOA was enacted in 1983, the CBA published the Common Interest Ownership Manual, with a new model set of documents, for creating communities under the new law. In 2013, the CBA published the second edition of the Common Interest Ownership Manual, incorporating the amendments to CIOA that have been enacted since 1983, as well as changing industry trends and market conditions.

Document Updates: the Good, the Bad, and the Ugly

First and foremost, it's important to know that no association is required to update its documents. The association does not have to go through the amendment process just because the law has changed. Nonetheless, the association is required to abide by the current law, even where it conflicts with the documents.

The Good: There are many reasons why the association should consider updating its documents.

- Relying on outdated documents that do not reflect the requirements of current law, increases the likelihood that the association will inadvertently violate the law.
- There will be less confusion among board members and unit owners when trying to interpret outdated documents against the current law.
- New documents will account for current industry trends and market conditions. For example, the documents will include provisions for allocating insurance deductibles against damaged units, regulating high risk components and conditions within units, the increased use of technology for communicating with unit owners and conducting meetings, and modern-day protections for mortgage holders.
- Amending the documents affords the association with an opportunity to review its practices and to make desired changes that benefit the community.
- The association can clarify or eliminate confusing or contradictory provisions contained in its current documents.

Collecting proxies in support of the documents is necessary to ensure an affirmative vote to approve them.

The Bad: Amending the documents takes time and effort.

- The board members must commit time to reviewing the document drafts and working with the association's attorney to prepare the final documents. Of course, a knowledgeable attorney is needed to undertake this project. However, the board members, more than anyone else, understand the unique characteristics of the community, its internal politics, and the personalities of the unit owners. Their input is essential to creating a set of documents that fully meet the needs of the community.
- The amendment process can take several months to complete. Once the board is satisfied with the document drafts, it must then solicit the support of the unit owners. This may require several association meetings coupled with one-on-one discussions with the unit owners. Collecting proxies in support of the documents is necessary to ensure an affirmative vote to approve them.
- In most cases, adopting new documents requires the support of owners having at least 67% of the total voting power in the community.
- The documents of some communities also require the consent of mortgage holders to adopt amendments. Identifying and obtaining the consent of mortgage holders can increase the time and expense required to adopt the documents.

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The Ugly: It all comes down to one word: Cost.

The association must engage an attorney to review its current documents and to prepare a new set that is tailored to fit the unique needs of the community. The attorney must review a complete set of the recorded documents. This requires the attorney to review the land records and obtain copies of the recorded documents. The legal fees associated with drafting the new documents can vary from one community to the next, depending on the unique needs of each community.

In the end, however, the benefits of updating the documents typically outweigh the costs.

Please contact us if your community is interested in updating its documents.

THE OTHER F-WORD FIDUCIARY

People commonly state that the board members of their association owe a "fiduciary duty" to the community. This is not true.

The members of the board of the association do not owe the association a fiduciary duty. Black's Law Dictionary (6th Ed.) defines "fiduciary duty" as follows:

> A duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person. It is the highest standard of duty implied by law (e.g., trustee, guardian).

Under Subsection 47-245(a) of the Connecticut Common Interest Ownership Act, the directors appointed by the declarant of the community must exercise the degree of care and loyalty to the association required of a trustee. Thus, declarant-appointed directors owe a fiduciary duty.

However, directors who are elected by the unit owners must exercise the degree of care and loyalty to the association required of an officer or director of a nonstock corporation. This duty is more fully described in Subsection 33-1104(a) of the Connecticut Revised Nonstock Corporation Act, which provides as follows:

> A director shall discharge his duties as a director, including his duties as a member of a committee: (1) In good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interests of the corporation.

The board members will not be held responsible for a decision that turned out to be wrong, provided they reasonably believed it was the right decision at the time.

The directors elected by the unit owners do not owe a fiduciary duty to the association. They owe a duty of ordinary care.

This distinction is very important. A trustee must subordinate his or her own interests to that of the other person. This means that if a particular action benefits the other person, even to the detriment to the trustee, the trustee must still take that action.

That is not the case with board members who are elected by the unit owners. Their duty is to take in to account the facts and circumstances of a particular situation, and to make a decision that they believe will best serve the community. The board members may rely on professional advice or knowledgeable guidance. They are not required to subordinate their own interests. They also are not required to be ultimately proven correct. The board members will not be held responsible for a decision that turned out to be wrong, provided they reasonably believed it was the right decision at the time.

Of course, board members should not use their positions to benefit themselves at the expense of the community. If a board member has a conflicting financial interest that is different from the interests of other members of the community, that member must disclose his or her conflicting interest to the rest of the board. So long as the conflict is properly disclosed, that board member is not precluded from taking part in the decision-making process.

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OUR PEOPLE IN THE NEWS

Scott J. Sandler has received an AV Preeminent® rating from Martindale-Hubbell®. Martindale-Hubbell® Peer Review Ratings™ are the gold standard in attorney ratings, and have been for over a century. The AV Preeminent® rating is the highest peer rating standard awarded, signifying that Scott's peers rank him at the highest level of professional excellence for his legal knowledge, communication skills, and ethical standards.

In January of this year, Scott attended the CAI National Law Seminar, where he served on the "Panel of Pundits." The panelists answered questions and provided insights for managing a law practice focused on representing community associations.

In May of this year, Scott attended the CAI National Expo, where he gave a presentation on options for financing large-scale capital projects.

Christopher E. Hansen will be giving a presentation at the CAI-CT Summer Sizzler event on August 3, 2017, on the role of managers at meetings of the association.

Michael S. Alexander gave a presentation at the CAI-CT Annual Expo on March 18, 2017, on the use of technology in community associations.

Beverly LaBombard has joined our team as a paralegal/office manager. Bev has over 20 years of experience as a paralegal, working in a number of different practice areas including litigation and bankruptcy. She is an independent self-starter, having successfully operated several businesses of her own, as well as being a volunteer firefighter and EMT.

CONTACT US

If you should call our office and the automated answering system answers, you may use the following extensions to reach us if we are in the office or to leave a message in our individual voice mailboxes. You may also contact us at the following e-mail addresses:

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