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HOA Brief Newsletter

Tips for the HOA Community **#27**

2014 Legislative and Case Law Update for California Community Associations

Legislative Update

One could say that 2014 was a "dry" year for legislation affecting community associations because some of the most important legislation this year affecting associations addressed an association's ability to enforce governing documents in times of government-declared drought. However, the year also brought new legislation clarifying who is responsible for repair and replacement of exclusive use common area, new rules regarding Internal Dispute Resolution (IDR), and solar energy installations by owners.

1. *AB 968 – Repair and Replacement of Exclusive Use Common Area*

What started out as a bill designed to relieve small associations from the expensive burden of dual envelope, secret ballot elections, was amended this year to instead address an ambiguity in the Davis-Stirling Act with respect to maintenance responsibility of exclusive use common area.

Common area is area within an association that is generally owned by the association. Examples of common area include a community pool, roofs in a condominium project, or a community clubhouse. This is as opposed to the separate interest owned by the members, such as the interior of an owner's unit where the members live in a condominium project. There are, however, some areas that are owned by the association, but which are designated for the exclusive use of a particular unit. These areas typically include balconies or patios. These areas may be defined in the association's governing documents as "exclusive use common area" because they are owned by the association (and, thus, common area), but are used exclusively by the residents of a particular unit.

Prior to the enactment of AB 968, the Davis-Stirling Act was unclear as to exactly which party (the association or the unit owner) was responsible for repair and replacement of exclusive use common area where the CC&Rs are not explicit. Certain components of exclusive use common area can be

expensive or difficult to maintain, repair, or replace. While Civil Code section 4775 previously stated that unit owners were responsible for the day-to-day maintenance (such as sweeping a patio or balcony), the law did not specifically address which party was responsible for what can be an expensive repair or replacement of exclusive use common areas. While industry practice has been that the association is responsible for the repair or replacement of these areas, there was some ambiguity where the governing documents were silent. As a result, boards would sometimes question whether the association had the authority to make these repairs, or if it was the owner's responsibility.

Beginning in 2017, section 4775 as amended will resolve this ambiguity. Unless the governing documents state otherwise, the unit owner will still be responsible for the maintenance of exclusive use common area, but the new language in section 4775 will make clear that, in the absence of any contrary language in the declaration (CC&Rs), it is the association's responsibility to repair and replace exclusive use common area. Accordingly, boards will now have clear direction and authority to undertake such repairs where their documents do not address the issue.

Given that AB 968 adopts current industry practice with respect to repair and replacement of exclusive use common area, it is not anticipated that AB 968 will have a serious impact on day-to-day association management. Boards should review their documents, however, and check with legal counsel to determine if their documents already address this issue differently than AB 968, or if they want to try to make a change in the maintenance responsibility, which may require an amendment to the CC&Rs.

2. AB 2188 – Solar Energy Permits and Installations

It has been the policy of the State of California to promote and encourage the use of solar energy systems and limit obstacles to their use. This bill specifies that the promotion and implementation of solar energy systems is a statewide concern. The bill amends Civil Code section 714, and requires a city, county, or city and county to adopt, on or before September 30, 2015, in consultation with specified public entities, an ordinance that creates an expedited, streamlined permitting process for small residential rooftop solar energy systems, as specified. The bill also, among other things, requires a city, county, or city and county to inspect a small residential rooftop solar energy system eligible for expedited review in a timely manner, as specified, and prohibits a city, county, or city and county from conditioning the approval of any solar energy system permit upon approval of that system by an association that manages a common interest development. Because the bill would impose new duties upon local

governments and local agencies, it would impose a state-mandated local program.

Most importantly for community associations, the bill changes the allowable restrictions an association may place on a solar energy system. Associations have been able to impose reasonable restrictions so long as the restrictions did not "significantly" increase the cost of the system or "significantly" decrease its efficiency or specified performance.

Previously, "significantly" was defined as increasing the cost of the system by $2,000, or decreasing its efficiency by more than 20%. AB 2188 changes the definition of "significantly" in this context and limits an association's ability to impose restrictions on solar energy systems to those which do not increase the cost by more than $1,000, or decrease the systems efficiency by more than 10% for photovoltaic systems, or those which increase the cost of the system by more than 10% not to exceed $1,000, or decrease the efficiency of the system by an amount exceeding 10% for systems designed to heat domestic water or swimming pools.

In addition, associations are now required to notify the applicant in writing within 45 days (previously 60 days) of receipt of the application if the application is denied. Otherwise, the application will be deemed approved, unless the delay is the result of a reasonable request for additional information.

Associations should review their current architectural applications, guidelines, and rules and regulations to make sure the new changes to the law are reflected in these documents.

3. AB 1738 – Changes to IDR

The original idea behind the Internal Dispute Resolution (IDR) process was that it would offer homeowners and a board the opportunity to meet informally, at little or no cost to either party, and discuss an issue in an attempt to reach an informal resolution. While at times attorneys would attend such meetings, their attendance was not common, and usually the meeting would be between one or two board members, a manager, and the owner. AB 1738 now expressly allows homeowners and associations to bring attorneys or other persons to assist them at these meetings.

Associations should consider updating their IDR policies to require prior notice that a party will have an attorney present for the IDR meeting, so that meetings do not get cancelled due to one party showing up with an attorney and the other deciding not to go forward without their own attorney present. Also, while it may be tempting, it is not advisable for a board member to proceed with an IDR meeting without counsel for the association being present if the homeowner brings an attorney to the meeting.

One additional change AB 1738 brings to the IDR process is that, in order for any

agreements reached during the IDR meeting to be judicially enforceable, they must be in writing, and signed by all the parties.

4. AB 2430 – Sales Disclosure Document Fees

This bill clarifies existing legislation (Civil Code Sections 4528 and 4530) relating to an association's obligation to provide owners, or any recipient authorized by an owner, with a copy of all documents described in Civil Code Section 4525. The bill makes it clear that the association may collect a reasonable fee from the seller. Also, sellers cannot charge prospective purchasers for documents already in seller's possession. Finally, the bill modifies the form to be used to itemize costs for providing documents to the seller.

5. AB 2561 – Limitations on Fruit and Vegetable Gardens

Assembly member Bradford's AB 2561 encourages home fruit and vegetable gardens, or "personal agriculture." As introduced, it would have prohibited associations from limiting personal agriculture in areas under owners' control. The bill as passed allows associations to limit fruit and vegetable gardens anywhere except in back yards.

6. SB 1243 – Manager Certification

Business and Professions Code section 11502, which allows a manager to call themselves a "certified common interest development manager" upon passing a test with a specified subject matter, was set to expire January 1, 2015. SB 1243 extended expiration date to January 1, 2019.

7. Drought bills

There were no less than five bills this legislative session which would have impacted an association's ability to enforce its governing documents in times of drought. Three of them were signed and, in various ways, will change what an association can do to enforce its governing documents in times of government declared drought.

a. AB 2100

AB 2100 amends existing Civil Code section 4735. It was signed as emergency legislation and went into effect immediately earlier in 2014. AB 2100 states that, if the governor or municipal water agencies or local governments have declared a drought, an association cannot fine an owner for dead landscaping when the owner is complying with water conservation recommendations. An exception is to this rule is if recycled water is being used to water landscaping (see SB 992).

b. SB 992

SB 992 also amended Civil Code section 4735 as emergency legislation earlier this year. It allows associations to fine owners who fail to water their landscaping so long as the association uses recycled water for landscape irrigation. SB 992 also voids any

association rules or restrictions which require pressure washing.

c. AB 2104

The last of the emergency drought legislation impacting associations this year, AB 2104, also amended Civil Code section 4735 and voids any restrictions in governing documents if they have the effect of prohibiting low water-using plants as a group, or as a replacement of existing turf, or if they have the effect of restricting compliance with water conservation measures.

What *CAN* an association do?

The most common question boards ask when told of these new laws and restrictions is "what can we do?" The first thing to do is recognize and acknowledge that California is in a long-term drought, and, even if we get significant rain, it will take some time, probably years, before water reserves are back to normal levels. That new reality must guide action now and into the future. It is likely that water rates will increase if the drought continues, so looking into the use of recycled water may be a smart thing to do now. If an association uses recycled water to irrigate landscaping, it will not only save significant amounts on the cost of water, it will also be able to fine owners who fail to water their landscape in times of drought.

Next, boards should look at their current architectural standards regarding use of low-water using or drought tolerant plants and replacement of turf. Associations are not required to allow any and all low water-using plants. AB 2104 did not go that far, however, they cannot be prevented as a group. So, boards have authority to develop an acceptable list of such plants so that owners who want to make use of drought tolerant or low water-using plants and landscaping have an acceptable palette of plant materials to choose from.

Further, while owners cannot be fined for failing to water in times of drought, that does not mean that owners cannot be required to remove dead or unsightly plant materials from their yard. The board still has the ability to enforce aesthetic standards in the community, and not only can but should require such plants to be removed. Dead, dry plants are not only unsightly, but they can be a fire hazard. That said, boards should not require the replacement of plants which have died due to lack of water if the plant died because the owner was complying with water usage recommendations in times of drought.

Also, nothing in this year's legislation requires associations to allow the installation of artificial turf. Associations remain able to restrict installations of artificial turf if they so choose. Boards should consider whether they want to allow artificial turf to be installed, and if so, what type.

Case Law Update

1. *Market Lofts Community Association vs. 9th Street Market Lofts LLC*

The Market Lofts case involves a condominium association on the corner of 9th and Flower streets in downtown Los Angeles, adjacent to the Staples Center. It has retail spaces on the street level, and 267 condo units on higher floors. During construction of the project, and prior to the time the association was formed, the developer of Market Lofts entered into a parking license agreement with the developer of an adjacent parking structure. The license stated that it was for the "benefit of residential homeowner's association (the 'HOA') to be formed in connection with the sale of residential condominium units in the Market Lofts Project and the owners and occupants of the residential units." The license allowed the residents of Market Lofts to use the parking Spaces in the adjacent property at "no cost," and was "irrevocable." In addition, the agreement required that upon the closing of the first unit, the developer of Market Lofts was required to assign or sub-license its rights and obligations under [the License Agreement] to the Association.

Once Market Lofts was developed and a unit was sold, the Association and the Developer entered into a "Parking Sub-License Agreement" ("Sub-License"). At that time, representatives from the developer comprised a majority of the association's board of directors. Despite the fact that the original license agreement stated that the use of the parking spaces was at "no cost" and that it was for the benefit of the association and its residents, the association, through the developer-controlled board, and the developer, agreed that the association would pay the developer a monthly fee of $75 for each of the parking spaces, to be increased annually by 5%, along with other fees and conditions not imposed by the original License Agreement.

After control of the board was given to the association's members, the association was able to investigate the facts surrounding the License Agreement and the Sub-License, and to realize that the HOA's members had been allegedly damaged in excess of $1 million in illegal parking fees paid to the developer. The association then brought suit on behalf of its members against both the developer of the association and the developer of the parking structure, asking the court to declare that the Sub-License was void and of no force and effect to the extent that it conflicts with the terms of the original License Agreement.

Both the developers then filed a demurrer to the complaint asking the court to dismiss the case on the ground that the association lacked standing to bring the lawsuit on behalf of its members. The trial court granted the request, concluding that, because the individual homeowners paid the alleged illegal parking fees and the

association only collected them, the association failed to show that it suffered an injury such that it had standing to file the suit. The association then appealed.

The Court of Appeal reversed the trial court's decision and held that the association was "an interested party because it is a directly named beneficiary of the License Agreement and is a direct contracting party to the Sub-License." The court determined that the association therefore had standing to bring an action related to the License Agreement and the Sub-License.

The court determined that an association can bring suit on behalf of the owners where: (1) An ascertainable class of owners exists and (2) There exists a well-defined community of interest in the issues.

The court also discussed the potential liability of developer-appointed directors and their obligations to the association. The Court, relying on *Raven's Cove Townhomes, Inc. v. Knuppe Dev. Co. (1981)* 114 Cal. App. 3d 783, restated the principle that the initial directors and officers of an association have a fiduciary relationship to the homeowner members analogous to that of a corporate promoter to the shareholders, and that these duties take on a greater magnitude in view of the mandatory association membership required of a homeowner. The court concluded that, because the association's original directors (comprised of the owners of the developer and the developer's employees) admittedly failed to exercise their supervisory and managerial responsibilities ... and acted with a conflict of interest, they abdicated their obligation as initial directors of the association."

The case serves as a good reminder that developer-appointed directors need to be mindful of their obligations, and be careful to avoid self-dealing or conflicts of interest as occurred here, where the developer-appointed board approved the contact between the association and the developer.

2. Huntington Continental Townhouse Association, Inc. v. The JM Trust

One of the unresolved questions related to collections for the past several years has been whether an association is required to accept partial payments from delinquent members. The appellate court has resolved this issue in the recently issued case of *Huntington Continental*.

In *Huntington*, the owner fell behind in his assessments and the association sued, asking for the court to foreclose upon the home. After the lawsuit was filed, the owner and the association agreed on a payment plan. However, the owner defaulted on the agreed upon payment plan and later sent a $3,500 check to the association, an amount that was about $2,100 short of the full balance. The association refused the check and proceeded to obtain a judgment against the owner.

In addressing the issue, the court held that the Davis-Stirling Act does not allow associations to refuse partial payments, and that, if a homeowner pays enough to reduce the balance below $1,800 or one year of assessments, the association must stop any foreclosure efforts.

The court noted that even if a homeowner stops foreclosure in this fashion, the association has options. For one thing the lien on the property still remains in force, securing the association's interest. In addition, while the association cannot continue foreclosure efforts, it can proceed with a small claims court action for the amounts due, it can pursue suit for money damages in Superior Court, or it can even wait until the principal balance due again reaches one year of unpaid assessments or $1,800 in delinquency and restart foreclosure efforts.

While the Court recognized that some owners may be able to regularly avoid foreclosure by paying just enough to keep the principal balance below the $1,800/one year threshold, the Court stated that the "Legislature engaged in a balancing process and chose to accept that risk in order to protect owners from foreclosure and the loss of equity in their homes," and felt that this superseded an association's right to collect past due assessments.

Robert M. DeNichilo

Nordberg | DeNichilo, LLP
ATTORNEYS AT LAW

4000 Barranca Parkway, Suite 250
Irvine CA 92604
Ph: (949) 654-1510

Email: robert@NDHOALaw.com
Website: NDHOALaw.com
Blog: HOABrief.com