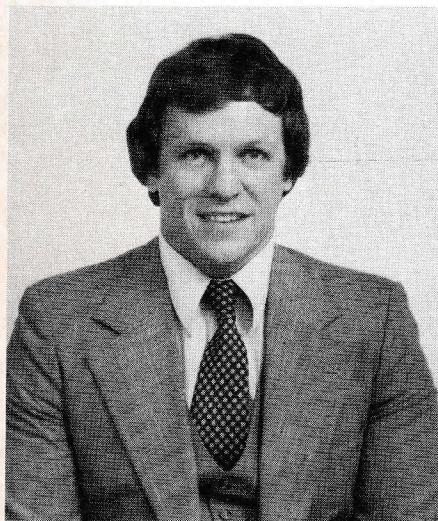


Community Associations: Problems and Prospects

This is a comprehensive discussion on community associations that should be required reading for anyone contemplating the purchase of a condominium.



by Clifford J. Treese
president
Community Association Institute

LAST YEAR, nearly 145,000 units of existing residential stock were transformed into a new and creative form of homeownership: condominium.

Condominium ownership, however, is only one of the many forms of homeownership now available to the American public. These ownership types are not entirely new, but their imaginative variety has had remarkable public acceptance in numerous legal forms: condominium, cooperative, townhouse, Planned Unit Development (PUD), and Property Owners Association (POA). These associations are private, non-profit organizations in which all property owners automatically are members and have certain rights and obligations (see accompanying table). For the sake of simplicity, all of these homeownership forms can be referred to as community associations or CAs.

Huge Expansion

In 1970 the potential home buyer could find these new ownership opportunities in only 2,000 community asso-

ciations. By 1980 this opportunity for selection had increased dramatically to almost 40,000 CAs which collected almost \$6 billion per year for the care and maintenance of commonly held property. The magnitude of this increase in home ownership organizations is even more impressive when it is realized that there are only 38,000 units of local government in the United States.

The reasons for this change are varied and complex. At one end of the spectrum, the cost of conventional detached single family housing had escalated (and continues to escalate) to the point where that type of ownership is simply not possible for many people. In fact, in older urban areas this reason coupled with congestion and deterioration of the existing housing stock had left few available avenues for revitalization other than through the rehabilitation and conversion of multifamily buildings.

At the other end of the spectrum, the use of community associations allowed planners and developers to devise innovative approaches to land planning which involved attractive combinations of housing, open spaces and amenities.

While the legal organization of community associations shifts the direct responsibility for governance and maintenance from the individual unit owner, this same legal organization, because it is so new, has created operational and educational problems not only for professionals but also for individuals who select or are interested in this life-style. In the late 1960s, as CAs became more popular, particularly in the condominium form, there

were few guideposts for either the producer or the consumer.

Independent Organization

In the fall of 1973, the Community Associations Institute* (CAI) was formed as an independent, nonprofit research and educational organization to help those individuals and professionals involved in creating and operating community associations. Located in Washington, D.C., with chapters in 24 areas across the country, including Illinois, CAI has over 3,200 active members representing every aspect of the community association process: developers, associations themselves, managers, public officials and colleagues. These five participant groups must function as a partnership for a community association to be viable. As a clearing house and research center, CAI directly assists its members through publications, workshops and technical assistance.

Certainly, anyone considering the purchase of a home in a community association should obtain copies of two very successful CAI publications: *The Homebuyer and the Community Association* and *The Homeowner and the Community Association*. These succinctly written documents enable the potential purchaser and new homeowner to understand the novel conceptual form of community association living and its attendant rights, duties and responsibilities. Checklists of particular disclosure items, as provided

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by various statutes are helpful and will be outlined later, but the prospective purchaser needs to understand, first, what the community association does, how it works, and its dual nature.

Basis of Operation

The primary responsibility of the association is to protect and enhance the assets of its members, and since the primary asset of each member is his home, the association is faced with no small task. The formal mechanism which both creates and guides the community association is its governing documents. In the case of a condominium, the declaration and by-laws are mandated by a specific enabling statute, the state's Condominium Property Act. Broadly speaking, the governing documents are just that. They set forth the covenants, conditions and rules by which the community association must operate and govern itself.

The actual implementation of the governing documents is the responsibility of the association's board of directors. A typical association is administered by a board of five to eleven community residents who are elected on an annual basis with possibly stag-

gered terms. The officers are elected by the board from its membership. In turn, the board may be assisted in its duties by various volunteer committees for finance, maintenance and other specific purposes. The board may also hire professional management to further assist it in its governance responsibilities.

Funding for the association's operations is provided through the levying and collecting of monthly assessments. Regardless of the authority delegated to a committee or professional managing agent, however, the board is always legally responsible for the proper conduct of the association's affairs. Service on the board, therefore, carries significant legal and fiduciary responsibility.

The general thrust of the governing documents is to channel the board's energies into two areas which are reflective of the dual nature of all associations: community associations are a business which must function as a minigovernment or, in the words of one commentator, as a "democratic sub-society." Like any successful business, the association must operate smoothly and efficiently within its own special parameters:

- Economical and satisfactory opera-

tion and maintenance of the CA's facilities and services.

- Accurate and predictive budgeting which in turn is reflected in monthly assessments that not only operate the CA but also establish reserves for future repairs and replacements.

- Swift and judicious enforcement of the governing documents especially in the areas of delinquent assessments and flagrant violations of the CA's rules and covenants.

- Professional relationships with key participants: developer (if still present), public officials, manager, other homeowners and colleagues such as attorneys, accountants and lenders.

Similar To Government

As a minigovernment, the community association has the functional prerequisites of any government: levying assessments (taxation); enforcing rules and restrictions (police powers); governing by elected representatives according to a prescribed charter ("a democratic sub-society").

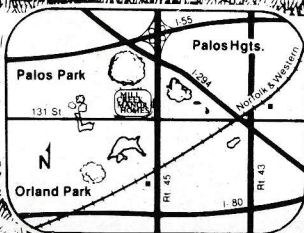
Balanced against the mandated need for asset protection, the board must conduct its business according to the principles of due process and reasonableness. The community association's

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Community Associations

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governing processes must be open to inspection, comment and revision.

Accordingly, a prospective purchaser should have the opportunity to actually see his CA in action. Given the complexity of community associations, it is not surprising that numerous problem areas arise as all the participants in the development process try to cope with their specific tasks. A homebuyer should be aware of these sensitive areas. He should also be aware, however, that all surveys to date demonstrate high satisfaction with the association life-style and a willingness by owners to buy another such unit if they moved.

In a recent CAI publication, *Community Associations: A Guide for Public Officials*, C. James Dowden has outlined in broad detail certain recurrent problems facing some associations. They can be summarized as follows.

- *Physical Constraints.* Maintenance costs of common facilities; design capacity of those facilities; construction difficulties; mismatching public/private design standards.
- *Institutional Constraints.* Unworkable legal documents with unrealistically high quorum requirements and low assessment lids; long-term or "sweetheart" contracts.
- *Sales and Resales Process.* Failure to educate the buyer; ineffective disclosure, especially for second buyers.
- *Operational Deficiencies.* Inadequate management guidelines; lack of required skills by the owners; failure to enforce rules and follow procedural details.
- *Financial Problems.* Underestimated initial assessments; unpaid developer assessments; double taxation; capital reserve deficits.

Lag in Techniques

While these problem areas appear overwhelming, the vast majority of associations function well because of the "sweat equity" which is built into the dual nature of these organizations. The actual techniques by which these problems could be prevented or alleviated, however, have developed much more slowly than the associations themselves.

Some developers either prepared themselves or sought the advice of consultants who specialized in the entire developmental process, including

consumer disclosure and institutionalized problem-solving methods. These developers realized that the creation of a successful community association begins with the governing documents and initial operating design, long before an actual homeowner occupies a unit. Most, however, followed the bare minimum as prescribed, if at all, by state or local statute.

Early legislative efforts, especially in the condominium field, however, tended toward mandating narrow bands of information for only the first purchaser in a condominium. For instance, the Illinois Act initially required only the following (in Section 322) to be provided to the first purchaser: declaration; bylaws; projected budget; and floor plan.

Failure to provide the information triggers a right of rescission by the purchaser. Such minimal disclosure, however, does little for the purchaser in a conversion condominium and nothing for a second or subsequent purchaser in an existing condominium.

Legislation Sought

It was with these shortcomings in mind that I drafted and Representative Carol Moseley Braun (D-24th) introduced, in the last session of the Illinois Legislature, two substantial changes in the Illinois Condominium Property Act. Specifically, we first desired to provide more information to the purchaser in a conversion through the following amendment to Section 322.

e. in addition, any developer of a conversion condominium shall include the following information:

1. A specific statement of the amount of any initial or special condominium fee due from the purchaser on or before settlement of the purchase contract and the basis of such fee;

2. Information, if available, on the actual expenditures made on all repairs, maintenance, operation, or upkeep of the subject building or buildings within the last 2 years, set forth tabularly with the proposed budget of the condominium and cumulatively, broken down on a per unit basis in proportion to the relative voting strengths allocated to the units by the bylaws. If such building or buildings have not been occupied for a period of 3 years then the information shall be set forth for the last 2 year period such building or buildings have been occupied;

3. A description of any provisions made in the budget for reserves for capital expenditures and an explanation of the basis for such reserves, or, if no provision is made for such reserves, a statement to that effect; and

4. For developments of more than 6 units for which the notice of intent to convert is issued after the effective date of this amendatory Act of 1979, an engineer's report furnished by the developer as to the present condition of all structural components and major utility installations in the condominium, which statement shall include the approximate dates of construction, installation, major repairs and the expected useful life of such items, together with the estimated cost (in current dollars) of replacing such items.

As a developer and consultant, my firm could advocate these additions because they simply restated information we had already collected in order to facilitate our own conversion project or that of a client.

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Second, we desired to protect subsequent purchasers. Previous legislative efforts were directed solely at first purchasers. Unless a buyer had a very adept attorney, he would be literally illiterate of the condominium's operations. Hence, a new Section 322.1 was added:

Sec. 322.1. In the event of any resale of a condominium unit by a unit owner other than the developer such owner shall obtain from the Board of Managers and shall make available for inspection to the prospective purchaser, upon demand, the following:

a. A copy of the Declaration and By-Laws, and any other Rules and Regulations.

b. A statement of any liens.

c. A statement of any capital expenditures anticipated by the unit owner's association within the current or succeeding two fiscal years.

d. A statement of the status and amount of any reserve for replacement fund and any portion of such fund earmarked for any specified project by the Board of Managers.

e. A copy of the statement of financial condition of the unit owner's association for the last fiscal year for which such statement is available.

f. A statement of the status of any pending suits or judgments in which the unit owner's association is a party.

g. A statement setting forth what insurance coverage is provided for all unit owners by the unit owner's association.

h. A statement that any improvements or alterations made to the unit, or the limited common elements assigned thereto, by the prior unit owner are in good faith believed to be in compliance with the condominium instruments.

i. The principal officer of the unit owner's association or such other officer as is specifically designated shall furnish the above information:

1. when requested to do so in writing
2. and within 30 days of the request.

A reasonable fee, not to exceed 10 cents per page of copy may be charged by the association or its Board of Governors to the unit seller for providing such information.

Wide Support

These legislative changes, however, were designed to do more than legally require disclosure information. Both amendments were firmly rooted in the Uniform Condominium Act (UCA). The UCA represents the most creative thinking in the community association field. It was devised by the National Conference of Commissioners on Uniform State Laws, has received the support of CAI and provides innovative techniques for the developer while protecting the consumer.

Fortunately, with the support of the Illinois Chapter of CAI and the active efforts of the Chicago Bar Association, the Illinois legislature is now considering the UCA. At this time, the pro-

Community Associations			
Type	Brief Description	Legal Basis	Governing Documents
Condominium	Fee simple ownership of air space; all else, including the land (in IL) owned as tenant in common; real property ownership.	Specific, enabling statute; recorded covenants	Declaration and by-laws
Cooperative	A corporation holds title to building and units; a proprietary lease to a unit is granted by virtue of share ownership; unless modified by state statute, personal property ownership.	Not-for-profit corporation law	Charter of incorporation Bylaws Proprietary lease FHA: also has occupancy and regulatory agreements
Townhouse	Fee simple ownership of unit and land with a party-wall agreement for common walls; real property ownership.	Conventional real estate transaction; recorded party-wall agreement	Probably none
Planned Unit Development (PUD) and Homeowner Association (HOA)	Fee simple ownership of unit and land with separate corporation holding title to amenities and common grounds; real property ownership; infinite variety possible.	Conventional real estate transaction; recorded covenants	Declaration of Covenants, Conditions & Restrictions (CC&Rs)
Property Owners Association (POA)	Similar to PUD; often vacant land which is built up later; second home and recreational community; real property ownership.	Conventional real estate transaction; recorded covenants	CC&Rs

spective home buyer is faced with numerous, overlapping and often conflicting local ordinances that do not materially improve the Illinois Condominium Act as recently amended. In their regulatory efforts to control condominium conversions, these municipalities have confused the very real need of providing more housing with intrusive and disruptive constraints on the actual operations of condominiums. By providing for pre-emption, the UCA would present the consumer with a consistent and thorough body of disclosure information and other protection.

Other Actions Advised

While the Illinois Condominium Act now provides much useful information, the potential purchaser should go further:

- He should talk with the board or the managing agent to see if the association is fulfilling its dual functions. He should certainly obtain the information which is legally owed to him.
- He should ask if the board and manager have continuously broadened their own skills through membership in CAI and other organizations.
- He should select an attorney who is familiar with CAs: their documents,

their operations and any local statutes that may affect them.

If the buyer is seeking a home in another type of community association other than a condominium, then he should definitely school himself and seek the aid of an experienced attorney. No direct legislative aids exist in Illinois for other types of CAs.

The potential purchaser must remember that the ownership of a unit in a condominium or other type of community association represents a complex challenge that can be mastered best through active participation and involvement. In many respects, the supportive dependency inherent in the community association's mandatory structure probably presages that mutual dependency which American society must also face because of increasing costs and shrinking resources. The rapid growth and acceptance of community associations represents the greatest single expansion of homeownership opportunities since the land grant ordinances which began our great republic and the FHA efforts which brought that original agrarian commitment into an urban focus. CAI welcomes these new homeowners into a "partnership in community." □