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## Common Issues to Consider if Your Community Must Impose a Special Assessment

**By: Kimberley M. O'Halloran-Cordray  
Winta Mengisteab**

In recent years a number of our community association clients have approached us with the issue of imposing a special assessment against their membership for the purpose of funding: (a) a budget deficit carried over from a prior fiscal year; (b) the association's replacement reserves; or (c) a repair or replacement project that would significantly deplete or exhaust the association's replacement reserves.

Each of the situations outlined above gives rise to different legal frameworks that our clients should be mindful of prior to initiating any special assessments; these varying legal considerations are discussed below. Also, in our experience it is always beneficial for any board of directors that is faced with the need for a special assessment to be proactive rather than reactive in communicating to the membership about any anticipated special assessments.

### **Special Assessments to Fund Budget Deficits**

As you know, the decline in the real estate market as well as the exponential increase in foreclosures has had a devastating impact upon the budgets of some of our community association clients. Specifically, in several newer communities where homes were acquired at the peak of the market during 2005 and 2006, many of the owners paid significantly more for their homes than the property values that are

reflected in their current city or county tax assessment bills and they now have negative equity in their property. At the same time, many of these owners were enticed to buy more home than they could afford at the peak of the market by taking out adjustable rate mortgages with "teaser" interest rates that have since adjusted and proven unaffordable. For these community associations, the net result of both the decline in property values and the overextension of credit to some owners is that significant numbers of owners are delinquent in their assessment payments.

This increase in assessment delinquencies has made the art of staying on budget even more difficult because boards cannot anticipate how many owners will abandon their homes to foreclosure because of the negative equity that in turn leaves the association assessment liens unpaid when the property is ultimately foreclosed by the lender.

For these reasons, some of our association clients have faced year end deficits in the tens of thousands and more. When faced with these deficits the boards have had to grapple with the issue of imposing assessment increases for the next fiscal year in excess of thirty percent to retire the deficit or the option of imposing a one time special assessment to offset budget deficits.

In Virginia, the Condominium Act allows boards to enact special assessments to offset anticipated budget deficits without first seeking the approval of the association's membership. The Act provides that the Board may impose the special assessment without a membership vote, but the members may seek to overturn the special assessment by a vote of the membership if they can convene a meeting for that purpose in accordance with the condominium's bylaws within 60 days after the notice of assessment issued by the association. It is important to note that that this member right to revoke the assessment is limited to board imposed special assessments that are adopted to off-set budget deficits.

For our Virginia property owners' association clients as well as our Maryland and DC clients, there is no similar statutory authority allowing boards to impose special assessments for the specific purpose of funding deficits. Consequently, the question of whether or not these boards may impose a special assessment to off-set a deficit will depend upon the language in the association's governing documents.

### **Special Assessments to Fund Reserves**

Many of our established community association clients have capital components that are nearing the end of their useful life and for a myriad of reasons (extended deferral of replacements, low interest rates, as well as increased fuel and labor costs), the association's existing reserves are not sufficient to cover the costs of replacing these aging components.

In some cases our community association clients have governing documents that grant the board

of directors unilateral authority to impose special assessments without a membership vote when the board believes, for any reason, that the association's reserves are currently inadequate.

In other instances, our community association clients have governing documents that mandate that any special assessment to fund reserves or to fund a project of any sort must have the approval of the association's members. If your association's documents require member approval of a special assessment, it is imperative that the board of directors educate the other members of the community about the urgency in raising funds to supplement the association's existing reserves.

Special assessments aimed at funding reserves are often a tough sell to association members. The issue is that in our very transient DC Metropolitan region people often move every five years based upon their family needs, commutes and job commitments. In this environment the prospect of paying a large special assessment to fund capital improvements that may be decades in the future is not a priority to many owners. That said, those of our clients who have successfully obtained member approval of a special assessment to fund reserves have done so after engaging in a very thorough communications program with their members. In particular, these clients have asked their reserve advisors and management agents to highlight for the members the importance of funding reserves not only for future owners, but to protect the current property values of their homes since details on the association's reserve funding must be disclosed to potential purchasers in Virginia.

### Special Assessments to Fund Projects

Many association documents distinguish association projects based upon whether the project is an improvement or addition to the association's existing components and amenities, or whether the project is a repair and replacement of existing components.

Many association documents significantly limit the amount that the board of directors can independently expend for an addition or improvement to the community amenities. Consequently, any special assessment aimed at funding a new community amenity often requires member approval not only of the proposed special assessment, but also the approval of the proposed amenity that is to be added. As an example, the members of one of our community associations recently voted to enclose the community swimming pool, which was an improvement that required the prior approval of a majority of the members of the community and the special assessment to pay for this improvement also required the approval of a majority of the owners in the community.

For repair and replacement projects, many association documents give the board of directors broad authority to approve these projects without a vote of the membership. Yet, in the documents for some established communities we do see language that mandates member approval if the project exceeds a certain percentage of the prior year's budget.

Like special assessments imposed to fund reserves, special assessments imposed to fund projects involve the input of engineers, reserve specialists, and managing agents and in all cases

the sooner that a board can engage these experts to address the membership and respond to questions on the underlying project as well as the anticipated cost of the project, the more likely that the association will have the members' support for the assessment.

In closing, special assessments for any purpose, be it to fund a deficit, reserves, or a project, are rarely welcomed by boards of directors or association members. However, in our current economy and as more communities age special assessments are a necessary evil that more and more of our association clients are having to come to terms with and to discuss as a potential reality.

If your association anticipates the need for a special assessment for any reason, please do not hesitate to contact any of our community association attorneys to review the particular requirements that your association's governing documents may require before any assessment is proposed or approved by your board of directors.