

# **The Interplay Between Community Associations and Municipalities**

**By: Phaedra J. Howard, Esq., Hellmuth & Johnson, Edina, MN**

## **I. INTRODUCTION**

Community associations are beneficial to both municipalities and developers because they allow for a higher density of owner-occupied homes within a given area. Developers make more money when they can build and sell more homes on the same property. Cities often require developers to create associations when they are seeking to develop homes on property because having a community association govern its own property and residents takes the financial and administrative burden off the city to manage those areas. However, whereas a city has any number of paid employees who have training and experience to provide services and manage the municipal affairs, when an association is created, those same functions now fall on volunteer homeowners who are not getting paid, have other work or family obligations and may have no experience managing budgets or handling vendors. Often, the members of the association do not appreciate the difference and expect the same level of service and expertise from their volunteer board members as they would receive from the city if there were no association. Association board members as a whole do their best to serve their communities and to follow their governing documents and applicable laws, but they do not know what they do not know and cannot be expected to be experts in all things related to the governance of the association. This is why many of them rely on the outside expertise of attorneys, accountants, property managers and other professionals. But that costs money, which then increases the assessments that the owners must pay.

## **II. Oversight of development process**

Different municipalities provide differing levels of oversight of the development process when a community association is being developed and formed. Cities will typically enter into a development agreement with the developer that addresses things such as the number of homes that will be built and where, the infrastructure of roads, sewer and water lines, etc. and may require installation of parks or other green spaces, trails, or other shared amenities. Development agreements generally do not address things such as ensuring that the association governing documents comply with state law, monitoring construction for compliance with industry standards, or even in determining whether the topography and soil conditions will support the development of homes in that particular location. In that respect, there is very little or no oversight over the creation of these entities or the developers that create them to ensure compliance with existing law. Municipalities could require more of developers in this regard before signing off on the development agreement, but they do not want to get involved in ensuring compliance with anything other than zoning and city planning issues. As a result, we often run into situations where homeowners are left dealing with problems created by the developer, whether from construction defects, poorly drafted or defective governing documents, drainage issues causing damage to multiple homes or other issues affecting the use and

enjoyment of the property and that cost the association and owners money to address. In many cases, the developer is no longer in the picture or has even gone out of business by the time the association discovers the problems, so there is no source of funds for the association to draw from to address these issues. Often, the same developer has also failed to properly fund the association or to collect assessments, meaning that the association is short on funds to begin with. So now the homeowners are left trying to figure out how to govern themselves and fund their own operations often with little or no foundation to work with and added expenses to fix these various issues. Homeowners may not appreciate that these issues were caused by outside parties and often tend to blame the association and the current board members for problems that they did not create and that they inherited from others.

In some parts of the state, the city or county does not even check whether the developer has pulled building permits and there may be no required inspection of the construction to ensure compliance with basic building codes. Conversely, we see cities issuing building permits to individual homeowners within an association without regard to whether the unit owner actually owns the property in which they are proposing to do the construction, whether the proposed work is consistent with or allowed under the association documents or whether the association has approved any work that requires approval. There does not appear to be any consistency from city to city or county to county as to how these developments and building permits are handled.

### **III. Support for Associations**

After a community association is created pursuant to requirements by municipalities, there exists little to no support structure in place to ensure the ongoing success of that association. Cities are not required to monitor the activities of the association or to ensure that the properties are being maintained. They typically are not required to provide much notice to an association of proposed work being done on city property, even when that work might directly impact the association's adjacent property. Even if construction work by the municipality results in accidental damage to the association property, cities generally do not take responsibility or compensate the association for that damage. It is costly and difficult for associations to pursue claims against municipalities even if the municipality does not have immunity against such claims, so associations are often left to fend for themselves without much help or support from the city. In many cases, cities refuse to get involved even when their help is sought. We routinely see police or other city personnel refuse to even respond to calls involving conduct within associations and instead telling the residents that it is an issue for the association to handle even when there are allegations of criminal activity. The assumption appears to be that associations have police powers to address such activity when in reality the association has no ability to enforce state laws or local ordinances and generally cannot do anything to enforce its own governing documents or rules beyond fining an owner after providing proper notice and an opportunity for a hearing. Unlike rental property, most associations cannot evict an occupant for rule violations or criminal behavior, and fining is not always effective to deter violations. In many municipalities, they simply do not have enough police or other personnel to handle the volume of work, but it seems that associations often end up being a low priority and so have to find ways to handle things themselves despite not having proper authority under their governing documents to do so.

#### **IV. Operations.**

In some respects, community associations operate similar to a municipality in that they often provide services related to infrastructure and have some authority to adopt and enforce rules regarding the property and the behavior of the occupants. However, while the association's authority is over a certain parcel of real estate, that does not mean that it is a division of government or that it has the same authority or obligations of a municipality. To the contrary, associations are created as (nonprofit) corporations and are governed under corporate law, not municipal law. Association members are shareholders in the corporation and hold similar rights and responsibilities as shareholders in other corporations. The Minnesota Common Interest Ownership Act (MCIOA) does create some additional obligations and rights of community associations and the members that are not found in the corporate statutes, but it is no different than any other industry that might be subject to additional regulations beyond just the corporate statutes. Associations do not have police powers to address violations and must rely on their fining powers to enforce the governing documents and rules. Community associations do not receive any public funding and rely almost entirely on assessments paid by the members to fund their operations. Additionally, most associations have tight budgets and do not plan for a surplus, so they generally do not have extra funds to cover expenses if they go over budget or fail to collect all of the anticipated income. If homeowners fail to pay assessments, the association may not be able to cover its expenses and may have to defer projects, levy a special assessment or obtain a loan to cover any shortfall. Many association documents require that the association get approval from the members prior to increasing assessments or levying a special assessment in order to address a budget deficit. If the owners do not approve the increase or the special assessment, the association is left with few options other than to cut costs, reduce services or defer maintenance. The current insurance crisis has had a significant impact on the ability of associations to fund operations and to make ends meet. If an association cannot obtain the necessary funds to pay for insurance and has to cut services or defer maintenance, this will negatively impact its ability to get insurance in the future as well as the ability of owners to sell their properties.

One issue that often arises in community associations that have a mix of public and private streets is that those owners living on the public streets have to pay their share of the costs to maintain the private streets owned by the association but then are also assessed by the city for maintenance to the public road abutting their property; whereas the owners who live on the private streets only have to pay for maintenance of the private streets and are not subject to this double assessment. In some cases, the city might agree to assess the association for the public street maintenance rather than assessing the individual owners, which then allows the association to spread that cost among all of its members and avoid the double assessment to certain members, but there currently is no statutory authority to require the cities to levy the street assessments in this manner, nor is there any provision in MCIOA authorizing the association to consider an outside obligation of individual owners to the city when allocating assessments among the owners in order to try to level the playing field.

## **V. Housing Improvement Area Loans**

Pursuant to Minnesota Statutes §428A.11 through 428A.20, municipalities can but are not required to establish Housing Improvement Areas (“HIAs”) within their jurisdictions. The HIA is established by city ordinance based on the petition of at least 50% of the property owners within the proposed district for the purpose of making repairs and improvements to the property. The improvements are funded through a low-interest loan from the municipality that is repaid through an extra assessment on the property taxes. Many associations have been able to use the HIA process to address structural issues, deferred maintenance and other major repair issues within their properties that they otherwise might not be able to afford. Because the statutes do not require cities to participate in the HIA process, not all cities participate. Unless they are able to convince the city to participate, associations located in cities that have not chosen to participate in the HIA process must look to other options when trying to fund these projects. This typically means levying a special assessment against the members that must be paid in a short amount of time or obtaining a bank loan at a higher interest rate and then repaying the loan over a 5-10 year period by levying an additional assessment against the owners. Many associations may not qualify for a traditional bank loan or are unable to borrow enough funds to pay for needed repairs. Also, whereas a special assessment by the association must be paid in full at or before closing if an owner sells their unit, since the HIA assessment is made through the annual property taxes, the full assessment generally does not have to be paid in full at closing, and the buyer can assume the assessments for future years. HIA loans can provide great benefits to community associations as well as to cities by improving properties that may appear neglected or in a run-down state due to deferred maintenance or other issues. Since many insurance carriers will not write policies for properties with old roofs, deferred maintenance, etc., having access to HIA funding can also assist associations with obtaining property insurance at more reasonable rates.

Currently, HIAs under Chapter 428A are optional and are only authorized until June 30, 2028. Per Minn.Stat. §428A.21, an HIA established after that date requires enactment of a special law authorizing the improvement area. This deadline should be extended indefinitely and the provisions under these sections should be revised to either require cities of a certain size to participate or to allow a process by which a community association could petition the city or another authority to require the city to participate if the association can otherwise meet the requirements under that chapter.

## **VI. Recommendations**

There needs to be more consistency with how municipalities and counties deal with community associations, including but not limited to, handling of permitting and inspections on the development side, emergency and police response to community associations, street assessments in associations having both public and private streets, and required participation in the HIA process. Ideally, cities would also require additional environmental and/or engineering studies to be done by developers and to require as a condition in development agreements that developers implement appropriate measures to ensure that construction of new homes in associations will not lead to issues with drainage, runoff, erosion or other problems affecting those homes or nearby properties. Additionally, cities should be required to engage in similar studies to

determine potential impact to neighboring properties from vibrations, excavation, grading or any other change to the landscape prior to commencing any major construction projects on roads or other public property. Further, I would like to see cities require documentation from homeowners in a community association reflecting that they have complied with all architectural control provisions under the association's governing documents and/or that they have permission from the association to make proposed changes to their property or the common elements prior to the city issuing building permits to the owners. Finally, in relation to the insurance crisis, I would propose a legislative work-around for associations who need member approval to increase assessments or levy special assessments to pay for insurance and other necessary expenses if the members do not approve the increase or special assessment to allow the board to levy an appropriate assessment without owner approval.

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